

Macro scenario - Brazil



September 19, 2025

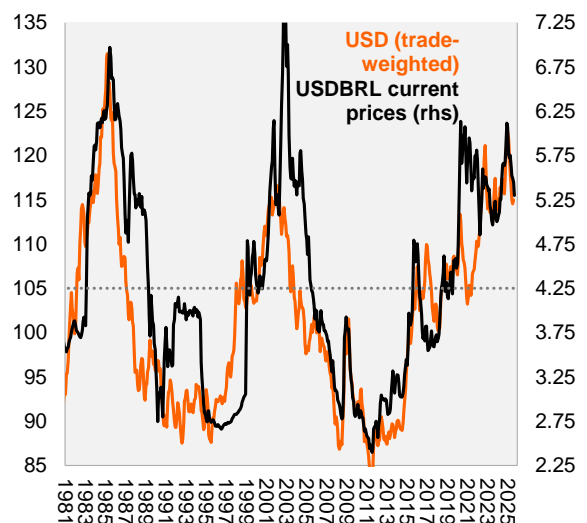
Staying the course

- ▶ We revised our exchange rate forecast to BRL 5.35/USD in 2025 (from 5.50), keeping BRL 5.50/USD for 2026. The benign external scenario, with the weak dollar trend, should allow the BRL to trade at more appreciated levels in the short term. For next year, however, the narrowing interest rate differential, risk premium, and the wide current account deficit limit a more favorable outlook.
- ▶ Economic activity is set to continue decelerating in the second half of the year, reflecting the lagged effects of contractionary monetary policy. We maintain our GDP growth forecasts at 2.2% for 2025, with a slight downside bias, and at 1.5% for 2026, with an upside bias. In the labor market, given the resilience observed in recent readings, we have lowered our estimates for the unemployment rate to 6.2% in 2025 and 6.5% in 2026.
- ▶ A stronger currency should have an impact on food prices later this year. We revised our 2025 IPCA inflation forecast from 5.1% to 5.0%. For 2026, we kept the forecast at 4.4%.
- ▶ We kept our primary balance projection at -0.6% in 2025 and revised it to -1.0% in 2026 (from -0.9%). Despite the government being close to meeting the 2025 target, we see a challenge of around 0.6% of GDP for next year, with further deterioration associated with the loss of recurring revenue due to the prospect of a more appreciated average exchange rate and lower oil prices, in addition to an increase in the spending cap under PEC 66. In the Budget sent by the government, the success of the fiscal adjustment strategy will largely depend on extraordinary revenues and the approval of measures in Congress.
- ▶ While inflation expectations have receded modestly and activity shows signs of deceleration, current inflation and expectations (at different horizons) remain substantially above target and the external scenario is uncertain, making caution and perseverance essential in the strategy of maintaining high interest rates for a prolonged period, avoiding premature cuts that could undermine the anchoring of expectations and reverse recent gains. We maintain our projection for the start of the easing cycle only in 1Q26.

Stronger BRL amid benign external scenario

We revised our forecast for the exchange rate to BRL 5.35/USD in 2025 (from 5.50 previously) and kept it at BRL 5.50/USD for 2026. The external scenario has been — and should continue to be — the main driver of the appreciation of the Real. The expectation of additional and earlier interest rate cuts by the Federal Reserve reinforces the trend of a globally weakening dollar, favoring risk assets. In this environment, the Real should continue trading at more appreciated levels in the short term. Among domestic factors, the current account deficit is wide, both in historical terms and compared to other emerging markets, offsetting part of the positive effect of the high interest rate differential. For 2026, we expect the exchange rate to become more pressured as the interest rate differential tends to narrow with the decline of the Selic rate and the scenario of weakened external accounts persists.

Weak global dollar favors the BRL



Source: BCB, Itaú

We revised our current account deficit forecast to 3.2% of GDP in 2025 (from 3.0% previously) and kept our projection at 3.1% in 2026. The worsening in the short-term forecast reflects a more pressured deficit at the margin, influenced mainly by cyclical factors, such as resilient imports, higher travel spending and lower profit and dividend receipts. On the structural side, the increase in telecommunication services spending has been offset by the disruption of outflows related to gambling platforms (after the regulation of these companies in Jan/2025).

GDP is set to continue decelerating in 2H25 due to the impact of monetary policy

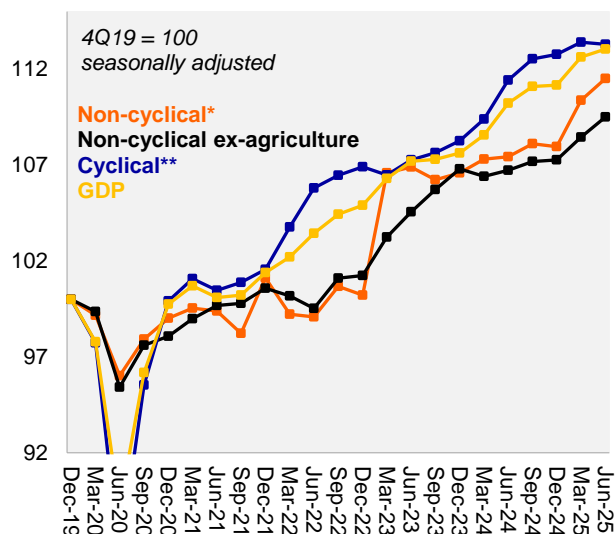
GDP in 2Q25 advanced 0.4% quarter-on-quarter, seasonally adjusted, and 2.2% year-over-year. The result came in line with expectations and reinforces the view that the economy should lose momentum over the coming quarters. Among the components, the cyclical portion¹ posted a slight decline at the margin, while non-cyclical segments² sustained the positive performance in the period.

The contractionary effects of monetary policy should continue to contribute to the slowdown in activity in the second half of the year. In July, IBGE data suggested a weaker start to 3Q25: contraction in industry and modest gains in retail and household services, insufficient to offset the sharp drop from June. In August, our daily activity indicator (IDAT-Activity) is pointing to a weak performance in the goods sector and some recovery for household services.

At the moment, our GDP tracking³ for 3Q25 indicates weaker growth than projected in our baseline scenario (+0.2% qoq vs. +0.3% qoq). Nevertheless, we expect court-ordered debt payments to stimulate consumption in August and, especially, in September, bringing the tracking closer to our projected scenario.

As a result, we maintained our GDP growth forecast at 2.2% for 2025, with a slight downside bias, due to risks associated with the credit market — especially the short-term impact of the IOF tax and private payroll-deductible loans and loans for INSS retirees.

GDP – sectors more or less sensitive to monetary policy



*Agriculture, Mining, Financial intermediation, Public administration.

**Manufacturing, construction, trade, transportation, information services, utilities, real estate activities and other services.

Source: BCB, Itaú

For 2026, we maintained our 1.5% growth forecast, with an upside bias. We continue to monitor the possibility of adopting countercyclical fiscal and quasi-fiscal policies that could mitigate a potential slowdown in activity next year.

Finally, in light of recent surprises, we revised down our unemployment rate forecast: for 2025, from 6.4% to 6.2%; and for 2026, from 6.9% to 6.5%. Short-term data suggests the rate should remain below 6.0% throughout 3Q25. In this context, a sharper rise in unemployment proved incompatible with our projection of a moderate slowdown in 4Q25.

Inflation: small downward revision for 2025

We have reduced again our forecast for the 2025 IPCA inflation, from 5.1% to 5.0%. The main contribution came from the downward revision to the food group, influenced by the stronger real — with impacts especially on food prices.

¹ Cyclical GDP: Manufacturing, Construction, Trade, Transportation, Information Services, Utilities, Real Estate Activities, Other Services

² Agriculture, Mining, Financial Intermediation, Public Administration

³ Currently with 35% of the information available

For 2025, we assess that inflation risks are slightly skewed to the downside. Food prices may face less pressure, either due to a slower reversal of the livestock cycle or perishable item prices. Additionally, a more appreciated currency also increases the chance of refinery gasoline price cuts. On the other hand, lower rainfall increases the likelihood of triggering the yellow or red tariff flag by year-end, which could raise electricity costs.

For 2026, we maintained our inflation forecast at 4.4%. The currency appreciation observed this year should be passed through with a lag to industrial goods prices, but the expectation of a more depreciated currency in 2026 tends to offset this effect, limiting more lasting relief on inflation. The balance of risks is symmetric: on one hand, the heated labor market remains the main upside driver for IPCA; on the other hand, a more appreciated currency than projected, would have a downward effect on the inflation of tradable goods.

Fiscal: high challenge for 2026 with heavy reliance on extraordinary revenues

We maintain our primary balance forecast at -0.6% of GDP in 2025 and revise to -1.0% (from -0.9%) in 2026. For 2025, we continue to see the government close to meeting the lower bound of the -0.6% of GDP target (considering abatements and the lower bound of the official 0% target). However, we see further deterioration next year, with revenue loss due to the prospect of a more appreciated average exchange rate, lower oil prices, and the expansion of the spending cap with the approval of PEC 66, which made permanent the temporary additional amount in 2025 due to the inflation differential.

The budget sent by the government relies on a high amount of extraordinary and uncertain revenues to meet the target for 2026. As expected, the government chose to repeat the strategy of recent years and included a significant amount of extraordinary revenues or those still pending Congressional approval (around BRL 92 billion). In our view, the uncertainty regarding these revenues maintains the challenge of meeting the lower limit of the target (-0.4% of GDP, considering deductions and the lower bound of the target of 0.25%) at around 0.6% of GDP. Going forward, the main risk is the implementation of initiatives that alter, circumvent, or explicitly or implicitly disfigure fiscal rules, executing higher rates of primary expenditure growth and/or

greater revenue waivers. We believe that structural measures addressing the rigidity and high growth of mandatory expenditures would bring greater credibility to the fiscal adjustment needed for public debt sustainability.

Caution and persistence in the monetary policy strategy

The Copom met on September 16 and 17 and unanimously decided to keep the Selic rate at 15.00% p.a., reaffirming the commitment to maintain the interest rate at a high level for a prolonged period in order to ensure inflation convergence to the target over the relevant horizon. The decision reflected, on one hand, the need for caution in the face of an uncertain external environment; on the other hand, the assessment that the lagged effects of monetary policy remain in progress.

It is already possible to observe some signs that the Central Bank's strategy of keeping interest rates at the current level for a prolonged period is starting to take effect. Inflation expectations, both measured by the Focus survey and implied, have declined, albeit modestly, but still remaining, substantially above the inflation target for different horizons. Current inflation itself, after some qualitative relief in mid-year, has again exceeded the seasonally adjusted tolerance range of the target. 2Q25 GDP and early 3Q25 activity indicators reinforce the view of a gradual economic slowdown, although signals remain divergent, with the labor market still resilient.

With still mixed signals, caution and perseverance in the indicated monetary policy strategy are essential, thus avoiding premature interest rate cuts, with a deleterious impact on inflation expectations (which have only recently shown a slight decline) and running the risk of higher inflation.

We maintain our expectation of the Selic rate ending the year at 15% p.a. and cuts only in 1Q26, taking the Selic rate to 12.75%. However, we acknowledge that risks have increased towards an earlier cut in 2025, which could occur if there is a more significant currency appreciation or a sharper economic slowdown. On the other hand, a significant revision by the Central Bank in the output gap towards a hotter economy could mitigate the risks of an early easing, something that seems less likely given recent data on the pace of economic activity.

Brazil | Forecasts and Data

	2020	2021	2022	2023	2024	2025F		2026F	
						Current	Previous	Current	Previous
Economic Activity									
Real GDP growth - %	-3.3	4.8	3.0	3.2	3.4	2.2	2.2	1.5	1.5
Nominal GDP - BRL bn	7,610	9,012	10,080	10,943	11,745	12,663	12,616	13,405	13,331
Nominal GDP - USD bn	1,475	1,670	1,951	2,192	2,179	2,266	2,238	2,468	2,424
Population (millions)	209.2	210.1	210.9	211.7	212.6	213.4	213.4	214.2	214.2
Per Capita GDP - USD	7,050	7,949	9,255	10,356	10,251	10,616	10,488	11,522	11,315
Nation-wide Unemployment Rate - year avg, NSA	13.5	13.5	9.5	8.0	6.9	6.1	6.2	6.4	6.8
Nation-wide Unemployment Rate - year end (*)	14.7	11.6	8.4	7.9	6.6	6.2	6.4	6.5	6.9
Inflation									
IPCA - %	4.5	10.1	5.8	4.6	4.8	5.0	5.1	4.4	4.4
IGP-M - %	23.1	17.8	5.5	-3.2	6.5	2.0	1.8	3.5	3.7
Interest Rate									
Selic - eop - %	2.00	9.25	13.75	11.75	12.25	15.00	15.00	12.75	12.75
Balance of Payments									
BRL / USD - eop	5.19	5.57	5.28	4.86	6.18	5.35	5.50	5.50	5.50
BRL / USD - average	5.16	5.40	5.17	4.99	5.39	5.59	5.62	5.43	5.50
Trade Balance - USD bn	50	61	62	99	75	65	65	58	58
Current Account - % GDP	-1.7	-2.4	-2.2	-1.3	-2.7	-3.2	-3.0	-3.1	-3.1
Direct Investment (liabilities) - % GDP	3.0	2.8	4.7	2.8	3.2	3.8	3.8	3.7	3.8
International Reserves - USD bn	356	362	325	355	330	330	330	330	330
Public Finances									
Primary Balance - % GDP	-9.2	0.7	1.2	-2.3	-0.4	-0.6	-0.6	-1.0	-0.9
Nominal Balance - % GDP	-13.3	-4.3	-4.6	-8.8	-8.5	-8.8	-8.8	-9.5	-9.5
Gross Public Debt - % GDP	86.9	77.3	71.7	73.8	76.5	79.2	79.5	84.4	84.7
Net Public Debt - % GDP	61.4	55.1	56.1	60.4	61.5	67.4	67.4	72.9	73.2
Growth of public spending (% real, pa, **)	29.2	-24.7	6.0	7.6	3.2	3.7	3.7	2.9	2.1

Source: IBGE, FGV, BCB and Itaú

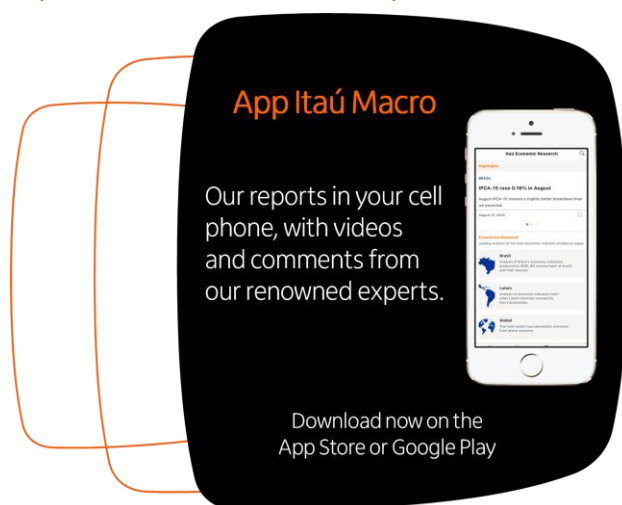
(*) Nation-wide Unemployment Rate measured by PNADC.

(**) We do not consider the 2023 payment of extraordinary court-ordered debts (precatórios). Including it, spending grew by 12.5% in 2023 and fell by 0.9% in 2024.

Macro Research – Itaú

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