Macro scenario - Brazil

July 14, 2025

Tariffs stall improvements

- In recent weeks, the external environment has undergone developments that have influenced the dynamics of Brazilian assets. The expansionary fiscal and protectionist trade policy in the United States has narrowed the growth differential between the U.S. and the rest of the world, contributing to a weaker dollar globally. This, combined with a reduction in geopolitical tensions, supported the appreciation of emerging market assets, including the BRL. This trend would likely have continued, had it not been for the announcement of 50% tariffs on Brazilian exports to the U.S. With opposing forces at play, we maintained our exchange rate forecast at BRL 5.65 for both 2025 and 2026.
- We maintained our GDP growth forecast at 2.2% for 2025 and 1.5% for 2026. For this year, we revised the balance of risks from neutral to tilted to the downside, reflecting weaker-than-expected economic activity in 2Q25 and the impact of U.S.-imposed tariffs on growth going forward. For 2026, however, we continue to see upside risks to our projection. Regarding the labor market, our unemployment rate forecasts remain at 6.4% for 2025 and 6.9% for 2026.
- We revised our 2025 IPCA inflation forecast to 5.2% from 5.3%, with the main drivers being lower food prices, influenced by the drop in corn prices, and the reduction of the IPI (industrialized products tax) on automobiles. These effects are only partially offset by specific, already announced price adjustments in electricity and lottery services. The balance of risks for the year is tilted slightly to the downside. For 2026, we maintained our forecast at 4.4%.
- We have kept our primary balance forecast at -0.6% for 2025 and updated it to -0.9% (from -0.8%) for 2026. While the revenue loss in 2025 due to the reduction of the IOF tax is expected to be offset by extraordinary pre-salt surplus auctions in the next bimonthly report (July 22), we do not anticipate an immediate offset for 2026, which still leads to a worsening of the fiscal outlook for that year.
- Given the high uncertainty and the lagged effects of monetary policy, the Brazilian Central Bank’s Monetary Policy Committee (Copom) likely ended the tightening cycle at its last meeting, keeping the rate at 15.00%. The monetary authority also signaled that interest rates will remain at this level for a rather extended period. We expect the beginning of rate cuts only in the first quarter of next year, with the Selic rate ending 2026 at 12.75% per year. Risks remain tilted toward an even later start to rate cuts, unless there are significant disinflationary shocks.

BRL: Weaker USD helps, but tariffs and domestic risks limit more favorable scenarios

The BRL had been benefiting from a favorable external environment, marked by a globally weaker dollar. Like other emerging market currencies, the Brazilian real appreciated significantly in recent months, moving from BRL 6.00/USD following the announcement of U.S. trade tariffs in April to around BRL 5.50/USD in recent weeks. Although not the main driver of currency appreciation, the high-interest rate differential has also contributed as a supporting factor.

In recent days, however, the announcement of 50% tariffs on U.S. imports from Brazil partially reversed this benign dynamic. According to our estimates, the effective tariff rate should be around 40% (already accounting for sector-specific rates). If applied to the USD 40 billion in annual exports to the U.S., this could reduce export flows by up to USD 16 billion. That said, this impact appears overstated, as it is reasonable to assume some trade reallocation of taxed goods to other destinations. Still, the dollar inflow to Brazil is likely to decline, acting as a depreciation vector for the currency.

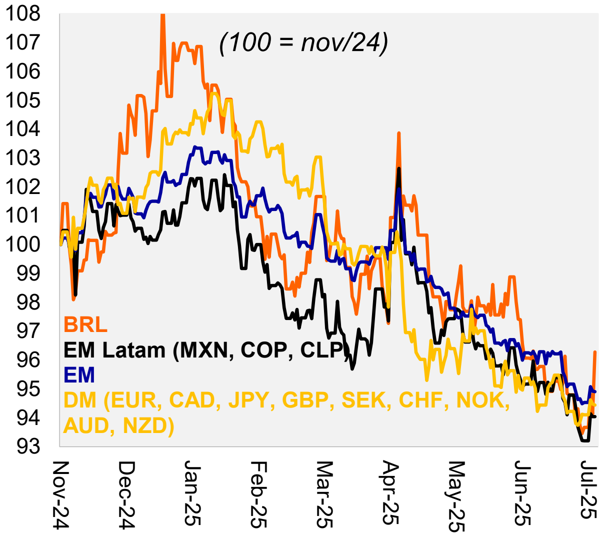
Main Brazilian exports to the U.S. and respective tariffs

	Exports BZ-US (USD bn)	% of Total	Tariffs Jul/2025	Impact (USD bn)
Sectoral Tariffs	**10.1**	**25%**		**1.1**
Oil and derivatives	7.6	19%	0%	-
Steel	1.6	4%	50%	0.8
Vehicle parts	0.3	1%	25%	0.1
Vehicles	0.2	1%	25%	0.1
Copper	0.2	1%	50%	0.1
Aluminium	0.2	0%	50%	0.1
Manufactured Goods	**15.3**	**38%**		**7.7**
Machinery/equipment/engines	4.2	10%	50%	2.1
Aircraft	2.7	7%	50%	1.3
Others	8.4	21%	50%	4.2
Metallic/Extractive "Commodities"	**9.6**	**24%**		**4.8**
Iron	5.5	14%	50%	2.7
Wood and pulp	2.4	6%	50%	1.2
Others	1.7	4%	50%	0.8
Agricultural "Commodities"	**5.3**	**13%**		**2.6**
Coffee	2.1	5%	50%	1.0
Meats	1.0	3%	50%	0.5
Juice and fruits	1.3	3%	50%	0.7
Others	0.9	2%	50%	0.4
TOTAL	**40.2**	**100%**	**40%**	**16.2**

Source: MDIC, Itaú

With opposing forces at play, we maintained our exchange rate forecast at BRL 5.65 for both 2025 and 2026. The international outlook, with a weaker global dollar, could lead to a more appreciated exchange rate. However, the tariffs imposed, combined with fiscal uncertainty (highlighted by doubts surrounding the IOF and changes to the personal income tax), limit the currency's upside.

A globally weaker dollar favored the BRL and other EM currencies. At the margin, the imposition of tariffs reversed this trend.



Source: BBG, Itaú

Even before the tariffs, the balance of payments had already been showing signs of fragility, with a structural widening of current account deficit and a decline in the quality of external financing. We forecast a trade surplus of USD 71 billion and USD 74 billion in 2025 and 2026, respectively, and current account deficits of 2.6% and 2.4% of GDP in 2025 and 2026 – above the average of the past four years (approximately 2% of GDP). It is worth noting that we have not incorporated the impact of the tariffs into our external sector projections, as they only take effect in August and may still be subject to negotiation.

Activity: More modest growth in 2Q25 and downside risks for the year

We maintained our GDP growth forecast at 2.2% for 2025. However, we revised the balance of risks from neutral to tilted to the downside, due to weaker-than-expected activity data in 2Q25 and the potential impact of the newly imposed tariffs.

Regarding 2Q25, the bias is downward relative to our forecast of +0.5% q/q and +2.4% y/y. In May, manufacturing posted its second consecutive decline, while broad retail (excluding wholesale specialized in foods) remained flat after a sharp drop in April. Additionally, our Daily Activity Indicator (IDAT-Activity) also pointed to weak performance in June, with a notable annual decline in the services sector (the first since October 2023) and a drop in income-sensitive goods.

If the announced tariffs take effect, the impact on economic activity could range from -0.2pp to -0.6pp over 12 months. These estimates carry a high degree of uncertainty, as they depend on assumptions regarding trade reallocation of taxed goods and potential retaliatory measures – hence our decision not to include them in our baseline scenario at this time.

Despite the weaker-than-expected performance in the second quarter and the risks stemming from tariffs, some factors could support economic activity in the second half of 2025. The release of court-ordered government payments, concentrated in July, and the acceleration of new private payroll loans have the potential to stimulate consumption in the latter half of the year, partially offsetting the weak performance at the start of the period.

For 2026, we maintained our growth forecast at 1.5%, with the balance of risks tilted to the upside. We continue to monitor the potential implementation of counter-cyclical fiscal and quasi-fiscal policies, which could be adopted to mitigate a possible economic slowdown next year.

Finally, we maintained our unemployment rate projections at 6.4% for 2025 and 6.9% for 2026. Short-term data reinforce our expectation that the labor market should remain resilient in the near term, mainly supported by the formal sector.

Inflation: Lower IPCA in 2025, but unchanged in 2026

We revised our 2025 IPCA inflation forecast downward, to 5.2% from 5.3%. The main contribution came from a downward revision in food items, driven by falling corn prices – which also had secondary effects on services inflation, particularly in the "food away from home" category. Additionally, we incorporated the reduction of the IPI (industrialized products tax) on automobiles. These effects were partially offset by short-term pressures, such as ENEL's electricity tariff adjustment in São Paulo, which came in above expectations, and the increase in lottery prices.

For 2025, we assess the balance of risks to inflation as slightly tilted to the downside. Among the main factors that could contribute to lower inflation are the slower reversal of the livestock cycle, which affects both food and services. On the other hand, lower rainfall increases the likelihood of activation of the yellow tariff flag later in the year, which could raise electricity costs.

For 2026, we maintained our inflation forecast at 4.4%. However, unlike in 2025, the risk balance remains skewed to the upside, with labor market pressures standing out as the main upward driver for next year's IPCA.

Fiscal: Shift in revenue sources in 2025 and deterioration in 2026

We have maintained our primary balance forecast at -0.6% of GDP for 2025 and revised it to -0.9% (from -0.8%) for 2026. For the 2025 fiscal year, the revenue loss caused by the Congress overturning the IOF tax increase is expected to be offset in the next bimonthly report (July 22) by extraordinary revenues from pre-salt surplus auctions. Thus, we continue to see the government close to meeting the lower limit of the target of -0.6% of GDP (considering abatements and the lower band of the official 0% target). For 2026, the outlook for further deterioration comes from insufficient compensation for the expected IOF revenue loss. Additionally, the main risk is the implementation of initiatives that explicitly or implicitly alter, circumvent, or undermine fiscal rules, enabling higher growth rates of primary spending and/or greater revenue exemptions.

In the second half of the year, expenditures are expected to accelerate again, while improvements in revenue will continue to depend on extraordinary sources. After a slowdown in both revenues and expenditures earlier in the year, we expect expenditures to pick up, driven by a reduction in the INSS backlog, payment of public servants' salary adjustments, payment of court-ordered payments postponed from the second to the third quarter, and less restraint on discretionary spending following the budget approval. On the other hand, an improvement in revenue performance will rely on extraordinary revenues (such as oil auctions and dividends from state-owned companies) amid an economic slowdown. Looking ahead, structural measures addressing the rigidity and rapid growth of mandatory expenditures would bring greater credibility to the fiscal adjustment needed for public debt sustainability.

Monetary policy: No change for a rather prolonged period

In its most recent decision, the Brazilian Central Bank's Monetary Policy Committee (Copom) raised the Selic rate by 25 bps to 15.00% per year – a move that, barring a significant shock, is likely to have marked the end of the monetary tightening cycle. Although inflation forecasts and expectations are still not close to the target, we believe the bar for further rate hikes is high. This is due to elevated global uncertainty, which calls for caution in interest rate decisions, and the lagged effects of monetary tightening, which are still expected to unfold over the coming quarters. The Central Bank's communication already signals that, if the scenario evolves as expected, the Selic rate should be maintained at its current level.

With the rate hike cycle now complete, the automatic question is how long the interval will be before the first interest rate cut – and the committee's answer is: quite prolonged. The signaling of keeping the Selic rate unchanged for a "rather prolonged period" was prominently featured in the post-meeting communication and, in our view, sets the expectation that the authorities will wait several meetings before even beginning to consider rate reductions. The June Monetary Policy Report (formerly the Quarterly Inflation Report) also reinforces this message, showing inflation projections above target even at the farthest horizon presented (4Q27). It is also important to note that the Central Bank reached these projections – which support a more hawkish stance – without revising its assumption for the output gap, which now appears inconsistent with the reality of an economy that has been cooling more slowly than expected. Together, the long-term projections and the unchanged output gap assumption strengthen the message that interest rates will remain on hold for quite a long time, as inflation is not projected to reach the target in any horizon, and the Central Bank may still have to revise its scenario in a more inflationary direction by updating its assumptions about the degree of economic overheating.

We maintain our expectation for the start of interest rate cuts only by the first quarter of 2026, bringing the Selic to 12.75% per year. We believe risks still lean toward an even later cut than our current forecast. However, we acknowledge that a significant appreciation of the exchange rate or a sharper economic slowdown (for example, due to a smaller-than-expected impact from the new private payroll loans program) could bring forward the beginning of rate cuts to this year.

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	**12,611**	12,650	**13,311**	13,432
Nominal GDP - USD bn	1,475	1,670	1,951	2,192	2,179	**2,219**	2,213	**2,356**	2,377
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	**10,396**	10,368	**10,998**	11,098
Nation-wide Unemployment Rate - year avg, NSA	13.5	13.5	9.5	8.0	6.9	**6.3**	6.3	**6.8**	6.8
Nation-wide Unemployment Rate - year end (*)	14.7	11.6	8.4	7.9	6.6	**6.4**	6.4	**6.9**	6.9
Inflation									
IPCA - %	4.5	10.1	5.8	4.6	4.8	**5.2**	5.3	**4.4**	4.4
IGP–M - %	23.1	17.8	5.5	-3.2	6.5	**1.3**	3.8	**3.6**	4.0
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	**5.65**	5.65	**5.65**	5.65
BRL / USD - average	5.16	5.40	5.17	4.99	5.39	**5.68**	5.70	**5.65**	5.65
Trade Balance - USD bn	50	61	62	99	75	**71**	71	**74**	74
Current Account - % GDP	-1.7	-2.4	-2.2	-1.3	-2.8	**-2.6**	-2.6	**-2.4**	-2.4
Direct Investment (liabilities) - % GDP	3.0	2.8	4.7	2.8	3.2	**3.8**	3.8	**3.9**	3.9
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	**-0.9**	-0.8
Nominal Balance - % GDP	-13.3	-4.3	-4.6	-8.8	-8.5	**-8.8**	-8.8	**-9.5**	-9.2
Gross Public Debt - % GDP	86.9	77.3	71.7	73.8	76.5	**79.7**	79.4	**85.0**	84.0
Net Public Debt - % GDP	61.4	55.1	56.1	60.4	61.5	**67.1**	66.9	**73.1**	72.2
Growth of public spending (% real, pa, **)	29.2	-24.7	6.0	7.6	3.2	**3.2**	3.1	**2.3**	2.4

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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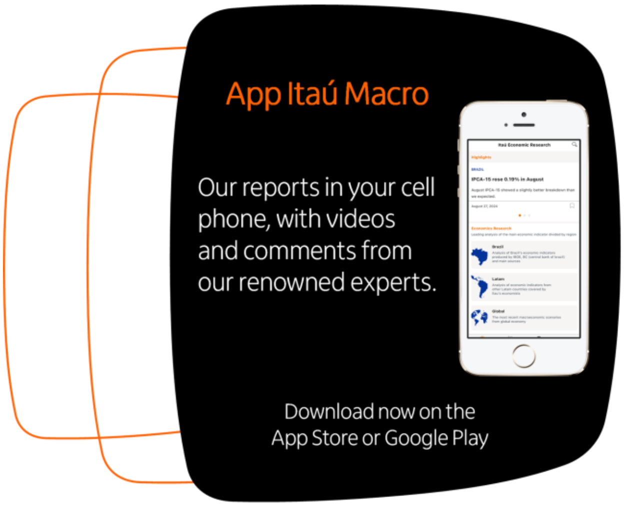

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