Macro Brazil

June 26, 2025

Monetary Policy Report: message quite clear

- The Monetary Policy Report (formerly known as Quarterly Inflation Report) presented a set of projections and assumptions that reinforce the message from the latest policy meeting: the benchmark interest rate should remain at its current level for a “quite prolonged period.” We highlight the projection of inflation above the target by the end of 2027 and an estimate of the output gap that may be revised in a more inflationary direction over the coming months. Alongside the Copom’s post-meeting communication, these details point toward later-than-expected interest-rate cuts. We expect the easing cycle to begin in the first quarter of 2026, but acknowledge the risk that it could be postponed.

Central Bank forecasts

The table below shows the inflation estimates released for the reference scenario[1].

	Central Bank inflation (IPCA) forecasts														
	2024			2025				2026				2027			
	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
IPCA	4.2	4.4	4.8	5.5	5.4	5.4	4.9	4.2	4.2	3.8	3.6	3.4	3.4	3.3	3.2
Difference to previous IR (pp)	0.0	0.0	0.0	-0.1	-0.1	-0.2	-0.2	-0.1	0.0	-0.1	-0.1	0.0	0.1	0.2	-
Market-set prices	3.5	4.1	4.9	5.6	5.6	6.0	5.2	4.5	4.3	3.8	3.4	3.3	3.2	3.2	3.1
Difference to previous IR (pp)	0.0	0.0	0.0	-0.1	-0.3	-0.1	-0.2	0.0	0.1	0.0	-0.1	0.1	0.1	0.2	-
Regulated prices	6.4	5.5	4.7	5.1	5.2	3.9	3.8	3.2	3.7	3.9	4.1	3.9	3.7	3.6	3.6
Difference to previous IR (pp)	0.0	0.0	0.0	-0.1	0.9	-0.1	-0.5	-0.2	-0.4	-0.3	-0.1	-0.1	-0.1	-0.1	-

*Painted area = forecasts.

Source: Central Bank

Compared with the estimates in the March report, the inflation projections edged down only slightly for 2025 and 2026, from 5.1 % to 4.9 % and from 3.7 % to 3.6 %, respectively – still well above the 3.0% target. Moreover, the projection for the furthest horizon shown in the previous report, Q3 2027, rose from 3.1% to 3.3%. The projection for year-end 2027, disclosed for the first time, stands at 3.2 % – that is, inflation remains slightly above target even at the most distant point in time.

The BCB reached these (hawkish) projections without revising its assumptions for the output gap over the relevant monetary-policy horizon. The estimate for end-2026 was kept at -0.8 % (implying some slack, with GDP below potential), whereas markets had expected the authorities to shift the figure closer to zero.

Taken together, the longer-term projections and the unchanged output-gap assumption reinforce the message that interest rates will stay on hold for a long time: inflation is above target at every horizon, and the BCB may still need to adjust its scenario in a more inflationary direction as it reassesses the degree of economic overheating.

Regarding economic activity, the GDP growth estimate for 2025 was revised to 2.1% from 1.9%. On the supply side, this upward revision was driven improvements in agriculture and services, and on the demand side, by investment and consumption, the latter supported by a heated labor market and expectations of an additional boost resulting

[1] With the Decree 12.709/2024, starting in January 2025, the target refers to the accumulated inflation over 12 months, calculated month by month, also known as the "continuous target". The window of the projection horizon was set at ten quarters.

from the changes in payroll-deductible loans. Despite the revision, the authorities emphasized that the outlook remains for an economic slowdown throughout the rest of the year.

The projection for credit balance growth in 2025 was also revised upward, from 7.7% to 8.5%, reflecting recent results that were stronger than previously anticipated.

Finally, on the external accounts, only slight changes compared to the previous report were made, with a slightly smaller current account deficit projected for 2025 (to USD -58 billion from USD -62 billion), due to adjustments in the forecasts for services and primary income accounts.

Gross domestic product forecasts (accumulated in the year)				
	September	December	March	June
	2025	2025	2025	2025
GDP (current prices)	2.0%	2.1%	1.9%	2.1%
Agriculture and livestock	2.0%	4.0%	6.5%	8.0%
Industry	2.4%	2.4%	2.2%	1.9%
Services	1.9%	1.9%	1.5%	1.8%
Household consumption	2.2%	2.4%	1.5%	2.1%
Government consumption	2.0%	1.6%	1.6%	1.2%
Gross fixed capital formation	2.0%	2.9%	2.0%	2.8%
Exports	2.5%	2.5%	4.0%	3.5%
Imports	2.5%	2.5%	4.0%	3.5%

Source: Central Bank.

Credit balance forecasts (12-month change)				
	September	December	March	June
	2025	2025	2025	2025
Total	10.3%	9.6%	7.7%	8.5%
Non-earmarked	10.2%	9.6%	7.9%	8.3%
Households	11.0%	10.0%	8.5%	10.0%
Corporations	9.0%	9.0%	7.0%	6.0%
Earmarked	10.5%	9.7%	7.5%	8.8%
Households	10.5%	10.0%	7.5%	8.5%
Corporations	10.5%	9.0%	7.5%	9.5%
Total households	10.8%	10.0%	8.0%	9.3%
Total corporations	9.5%	9.0%	7.2%	7.3%

Source: Central Bank.

External accounts forecasts (USD billion)				
	September	December	March	June
	2025	2025	2025	2025
Current account	-60	-58	-62	-58
Trade balance	64	65	61	60
Exports	341	338	343	340
Imports	277	274	282	280
Services	-49	-49	-52	-50
Primary income	-75	-75	-72	-70
Investment - liabilities	85	85	80	75

Source: Central Bank.

Summary of the IR studies

We present below summaries of the studies published in the IR, with links for the complete reports.

Update on Output Gap Measures in Brazil

Full study (in Portuguese) here.

- The output gap, defined as the difference between actual output and potential output, is a key variable for monetary policy, but its measurement involves significant uncertainty. An output gap above 0 indicates an overheating economy, while a gap below 0 suggests the presence of spare capacity.

- The study shows that, for the first quarter of 2025, all estimates point to a positive output gap, with an average of 1.4% and a median of 1.2%—ranging from 0.14% to 5.03%. The study does not provide estimates for 2026, when the output gap hypothesis mentioned above is at -0.8%.

Determinants of Risk Premium in Brazilian Nominal Interest Rates

Full study (in Portuguese) here.

- In this study, the Central Bank investigates the determinants of the risk premium in Brazilian nominal interest rates. In a previous analysis, the Central Bank identified that long-term nominal interest rates can be broken down into two main components: expectations of future interest rates and the risk premium. This study focuses on examining the determinants of the latter. The analysis reveals that risk premiums fluctuate over time and that a significant portion of the volatility in long-term interest rates stems from variations in these premiums, rather than solely from changes in expectations regarding the trajectory of the Selic rate. The results indicate that the risk premium is influenced by domestic factors, such as the level of interest rates, inflation expectations, and public debt, as well as external factors, including U.S. interest rates, the exchange rate, and market volatility.

- The temporal decomposition of the risk premium shows that the fiscal factor gains importance starting in 2016, while the external factor exhibits greater volatility, with peaks during financial crises and periods of global instability.

Sectoral breakdown of the IBC-Br

Full study (in Portuguese) here

- This box presents the new disclosure, launched in April 2025, of the sectoral breakdowns of the IBC-Br activity indicator, with monthly series for Agriculture, Industry, Services, Taxes, and an ex-Agriculture measure.

- The goal is to enhance the transparency and usefulness of the IBC-Br as a leading indicator of economic activity, allowing for more detailed comparisons with the Quarterly National Accounts (QNA).

- The box concludes that the IBC-Br and its new breakdown contribute to the timely monitoring of economic activity and are useful for monetary policymaking.

Brazil's Bilateral Trade with the US and China

Full study (in Portuguese) here

- This box analyzes Brazil's trade with the US and China, highlighting the sharp rise in imports from China, with falling prices, unlike other sources. Brazilian exports to China are concentrated in commodities, while those to the US are more diversified.

- China has overtaken the US as Brazil's main supplier of high and medium-high technology goods. From 2019 to 2024, prices of Chinese imports fell 11%, while those from other origins rose 24%. Brazil and the US compete in the Chinese market for soybeans, oil, beef, and cotton. In 2024, Brazil exported $59 billion of these goods to China, compared to $21 billion from the US.

- The box recalls that during the 2018 US-China trade dispute, Brazil benefited from higher soybean exports and a price premium. In the current context, although new tariffs may offer opportunities, the overlap between Chinese and Brazilian exports to the US is small, limiting potential macroeconomic gains for Brazil.

Update of the Medium-Term Projection Model for Regulated Prices

Full study (in Portuguese) here

- This box presents the new version of the BCB's model for forecasting regulated prices, which account for approximately 25% of the IPCA. The model covers 24 items using equations calibrated according to regulatory rules and is integrated into the semi-structural models used for inflation projections. The main updates include seasonal adjustments, equation simplification, and better alignment with current regulations, such as in the cases of electricity, fuel, and pharmaceuticals.

- The model accounts for shocks in exchange rate, oil prices, free prices, and the Health Care Expense Value Index (IVDA). A 10% exchange rate shock increases regulated prices by up to 1.8 percentage points; for oil, up to 1.3 p.p.; a shock in market-set-price inflation also indirectly affects regulated prices via backward-looking indexation, with a slower and more persistent response. A 1 p.p. shock in the IVDA increases health plan prices by 0.8 p.p., with a maximum impact of 0.04 p.p. on the IPCA.

Inflation decomposition through the lens of the Samba model – 2022–2024

Full study (in Portuguese) here

- This box analyzes inflation between 2022 and 2024 using the structural Samba model. Initially, supply and price markup shocks explain the inflationary or disinflationary surprises up to mid-2023. From that point on, demand shocks gain prominence and become the main inflationary driver.

- A second decomposition ("dual") highlights the growing role of inflation expectations in the persistence of inflation above the target, especially in 2024. The labor market had a disinflationary effect in 2023 but lost strength with the rebound in wages. External variables and domestic demand also gradually reduced their negative contributions over the period.

- The analysis concludes that inflation surprises between 2022 and 2023 were largely driven by exogenous and low-persistence cost shocks (markups). From the second half of 2023 onward, inflation became increasingly sustained by demand shocks and unanchored expectations, explaining its persistence above the target.

Macro Research – Itaú

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