Macro scenario - Brazil

April 16, 2025

At the whim of the global environment

- The global scenario remains marked by high uncertainty, with trade tariffs at the center of the debate. For Brazil, we identify two main channels of impact: (i) the direct channel – through trade – tends to be limited, given the low degree of trade openness in the Brazilian economy; and (ii) the indirect channel – through a global slowdown, falling commodity prices, and financial flows in a risk-averse environment – which may be more significant. Our baseline scenario assumes some degree of external relief through tariff negotiations, yet with significant risks of an escalation in the trade war, including retaliatory measures and a potential global recession. This leads us to adopt a cautious stance in our projections.
- The BRL has primarily responded to the international environment, exhibiting high volatility in reaction to shifts in global risk aversion. Given the significant uncertainty surrounding the global outlook, we maintain our exchange rate forecast at BRL 5.75 per US dollar for 2025 and 2026.
- We have maintained our GDP growth estimate for 2025 at 2.2%. While we believe the global slowdown and the decline in commodity prices will have a negative impact on activity, this should be offset by the expansion of new private payroll loans. This year's GDP forecast remains unchanged, though we note a downward bias due to the high risk of a more pronounced global economic slowdown. For 2026, we maintain our GDP growth forecast at 1.5%, with somewhat balanced risks.
- We have revised our inflation projection for 2025 from 5.7% to 5.5%, incorporating the expected reduction in gasoline prices at refineries and the impact of declining metal commodity prices on industrial goods inflation. Risks remain asymmetric, with a downward bias reflecting the potential for further declines in oil and metal commodity prices if the global slowdown intensifies. On the other hand, upside risks are concentrated in domestic agricultural commodity prices, due to increased exports resulting from the trade war between the U.S. and China, with services inflation still under pressure. For 2026, we have lowered our inflation projection to 4.4% (from 4.5%), reflecting reduced inflationary inertia.
- The fiscal challenge remains significant. We have revised our primary balance forecast to -0.8% (from -0.7%) for 2025 and 2026. Given the expectation of lower revenues due to inflation and declining oil prices, it is even more important for the government to announce measures to contain spending.
- For now, we have maintained our end-of-cycle call for monetary policy at 15.25% per year for the June meeting – a level expected to be maintained through the end of the year. We anticipate two 50-basis-point hikes at the next two meetings, although we have less conviction about the second hike, as its implementation will depend on the evolution of the international scenario and its impact on the exchange rate and commodity prices.

BRL: high volatility

The BRL has responded primarily to international factors, particularly shifts in global risk aversion. In a scenario of tariff negotiations – where the U.S. economy slows but a global recession is avoided – it is reasonable to expect a weakening of the dollar and, consequently, an appreciation of the BRL, especially given the high-interest rate differential. However, an escalation of the trade war, with retaliatory measures resulting in a global recession, there would likely be an increase in risk aversion, leading to a more depreciated exchange rate.

Given the high uncertainty, we have maintained our exchange rate forecast at BRL 5.75 per dollar for 2025 and 2026.

The decline in commodity prices, combined with higher tariffs, will likely reduce the trade balance and widen the current account deficit. We have revised our trade surplus projection to USD76 bn in 2025 and to USD77 bn in 2026 (down from USD79 bn and USD80 bn, respectively). As a result, we now forecast a slightly larger current account deficit of 2.4% of GDP in 2025 and 2.3% in 2026 (compared to 2.2% in our previous estimates for both years).

Activity: growth forecasts maintained, but with downside risk for 2025

We have maintained our GDP growth estimate for 2025 at 2.2%. Downward revisions to global GDP projections and commodity prices were offset by the positive impact of new private payroll loans[1]. Therefore, although the projection remains unchanged, we note a downward bias due to the high risk of a slowdown in global activity.

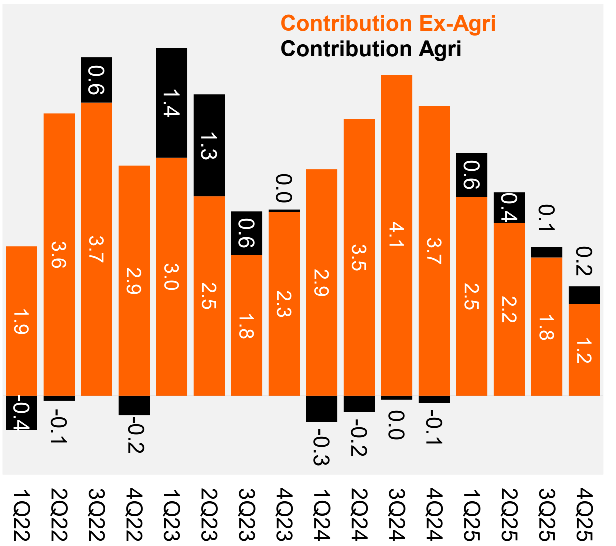
In the short term, however, the economy has continued to show resilience. We expect first-quarter 2025 GDP to grow by 3.1% year-on-year (with 1.6% growth at the margin), driven by strong performance in the agricultural GDP, though all sectors are expected to show positive growth at the margin.

The trade war and its impact on global growth support our expectation of a clearer slowdown in the second half of the year. The prospect of weaker global GDP, combined with the fiscal slowdown (via transfers) and the lagged effects of contractionary monetary policy, should exert pressure on economic activity in the second half of the year.

For 2026, we also maintained our projection at 1.5%. In our scenario, the risks are more balanced, with a more negative outlook in the external scenario offset by the additional effects of new private payroll loans and possible countercyclical fiscal and parafiscal policies.

Finally, we maintained our forecast for the unemployment rate at 6.8% for 2025 and 7.3% for 2026. Recent data continue to indicate a buoyant labor market, and the impacts of the economic slowdown are expected to be felt in the labor market with some delay.

Activity still resilient in Q1, but set to slow down throughout the year



Source: Itaú

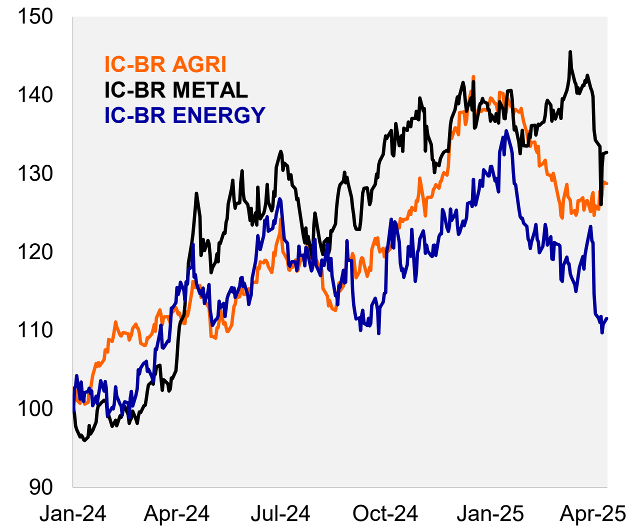
Inflation: downward revision and balance of risks asymmetric to the downside in 2025

We have revised our inflation projection for 2025 from 5.7% to 5.5%, incorporating two main downward drivers. The first is the expected reduction in gasoline prices, given the current gap between international prices and those charged by Petrobras, which leaves room for a price cut in the short term. The second is the recent drop in metal commodity prices, prompting us to a revise our inflation projection for industrial goods downward.

Overall, we assess that the downside risks to inflation continue to outweigh the upside risks in 2025. On one hand, a new round of declines in oil and metal commodity prices could contribute to a more benign inflation rate, though still far from the 3.0% target. On the other hand, the food sector presents upside risks: the increase in exports of agricultural products, driven by tensions in global trade, could generate additional pressure on domestic prices of these commodities. Notably, there was a significant premium in the domestic price of soybeans compared to the international benchmark during the first trade war.

[1] We estimate a potential impact of the new private payroll loans at approximately 0.6p.p. in 12 month, with a partial impact in 2025.

Drop in commodities explains downward revision to inflation



Source: Itaú

For 2026, we revised our inflation forecast to 4.4% (from 4.5%), incorporating the lower inertia in 2025.

Fiscal: revenues are slowing, tighter spending control remains a challenge

We have revised our primary balance projection to -0.8% of GDP (from -0.7%) for 2025 and 2026, incorporating the downward revision of inflation and lower oil prices. For 2025, for now, we do not expect the target of -0.6% of GDP (considering rebates and the lower limit of the official target of 0%) to be met. The result may be better than our current estimate if the government is more successful in its revenue agenda, especially extraordinary revenues such as oil auctions and dividends from state-owned companies. For 2026, the main risk is the implementation of initiatives that explicitly or implicitly change, circumvent, or distort fiscal rules, implementing higher growth rates in primary expenditures and/or greater revenue waivers.

With lower revenue growth, it is even more crucial for the government to announce spending control measures. A substantial budget cut – around BRL 40 billion – in the upcoming bimonthly review in May would signal greater prudence in budget execution, given the risks of disappointing extraordinary revenues and a renewed underestimation of mandatory expenses, as was the case in 2024, particularly with Social Security and the BPC, where anti-fraud initiatives have shown little evidence of success. The recent confirmation of the primary surplus target of +0.25% for 2026 reduces the risk of further deterioration in financial conditions, as seen in 2024. However, it does not eliminate the perception that the pace of fiscal adjustment under the current rules remains insufficient to stabilize public debt.

Monetary policy: caution when navigating turbulent seas

For now, we maintain our end-of-cycle projection at 15.25% per year at the June meeting, a level that should be maintained until the end of the year. The unanchored inflation expectations, the positive gap, and the Central Bank's projections still reinforce the need to continue advancing the interest rate hike cycle into contractionary territory.

We expect two final hikes of 50 bps in the next two meetings, but we recognize the risk that the final hike in June may be smaller or may not occur at all. The trade war could have a net disinflationary impact in Brazil, mainly due to the fall in commodity prices in BRL, depending on where the exchange rate stabilizes. However, we cannot rule out the possibility that the net impact will be inflationary. Evidence of a disinflationary impact could allow an early pause in the interest rate hike cycle. We believe, however, that given the uncertainty and volatility of the current scenario, the Central Bank should be cautious not to make hasty decisions that could incur more inflationary risk in the future, especially considering a scenario of quite unanchored expectations.

For 2026, we project interest rate cuts throughout the first half of the year, to 13.25% annually.

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	**12,642**	12,698	**13,441**	13,502
Nominal GDP - USD bn	1,475	1,670	1,951	2,192	2,179	**2,188**	2,197	**2,338**	2,348
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	**10,250**	10,295	**10,913**	10,962
Nation-wide Unemployment Rate - year avg, NSA	13.5	13.5	9.5	8.0	6.9	**6.6**	6.6	**7.1**	7.1
Nation-wide Unemployment Rate - year end (*)	14.7	11.6	8.4	7.9	6.6	**6.8**	6.8	**7.3**	7.3
Inflation									
IPCA - %	4.5	10.1	5.8	4.6	4.8	**5.5**	5.7	**4.4**	4.5
IGP–M - %	23.1	17.8	5.5	-3.2	6.5	**4.8**	5.9	**4.3**	4.3
Interest Rate									
Selic - eop - %	2.00	9.25	13.75	11.75	12.25	**15.25**	15.25	**13.25**	13.25
Balance of Payments									
BRL / USD - eop	5.19	5.57	5.28	4.86	6.18	**5.75**	5.75	**5.75**	5.75
BRL / USD - average	5.16	5.40	5.17	4.99	5.39	**5.78**	5.77	**5.75**	5.75
Trade Balance - USD bn	50	61	62	99	75	**76**	79	**77**	80
Current Account - % GDP	-1.7	-2.4	-2.2	-1.3	-2.8	**-2.4**	-2.2	**-2.3**	-2.2
Direct Investment (liabilities) - % GDP	3.0	2.8	4.7	2.8	3.2	**3.9**	3.9	**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	**-0.8**	-0.7	**-0.8**	-0.7
Nominal Balance - % GDP	-13.3	-4.3	-4.6	-8.8	-8.5	**-9.0**	-9.2	**-9.5**	-9.8
Gross Public Debt - % GDP	86.9	77.3	71.7	73.8	76.5	**79.8**	79.6	**84.5**	84.7
Net Public Debt - % GDP	61.4	55.1	56.1	60.4	61.5	**67.0**	66.9	**72.4**	72.7
Growth of public spending (% real, pa, **)	29.2	-24.7	6.0	7.6	3.2	**3.0**	2.9	**2.6**	2.8

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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