Macro scenario - Brazil

February 17, 2025

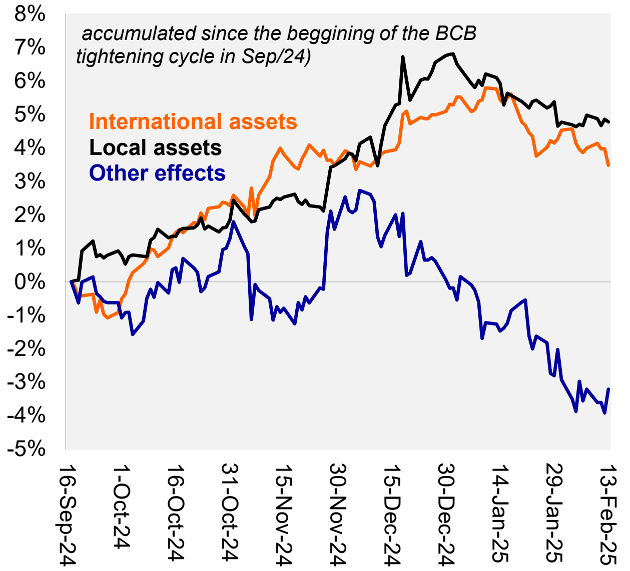
Temporary relief

- We are leaving our exchange rate forecasts unchanged at BRL 5.90 reais per dollar in both 2025 and 2026. Despite some short-term relief, the fundamentals – particularly the combination of persistently high fiscal risk with a stronger dollar globally – still point to a depreciated exchange rate. These factors will only be partially offset by the growing interest rate differential.
- We currently expect primary deficits of 0.7% of GDP in both 2025 and 2026. We believe that announcing a significant containment of discretionary expenditure – around BRL 35 billion – would serve as an important palliative measure. However, a more consistent reduction in the risk premium will only occur when there is the prospect of a more balanced public debt trajectory.
- Our GDP growth estimates for 2024, 2025 and 2026 remain unchanged at 3.6%, 2.2% and 1.5%, respectively. Despite weaker results in 4Q24, IDAT-Activity data indicate that the economy performed better in January, in line with our expectation that a more pronounced slowdown will only occur in the second half of 2025. Regarding the labor market, we forecast that the unemployment rate will end 2025 at 6.8% before rising to 7.3% in 2026.
- We are keeping our inflation forecasts at 5.8% for this year and 4.5% for 2026, with an upward asymmetry still present for both.
- The Central Bank is set to move further into contractionary territory in the coming months. We project that the Selic rate will reach 15.75% p.a. by the end of the first half of this year. However, we recognize the risk of an early interruption of the tightening cycle, depending on the dynamics of economic activity, the BRL and inflation expectations.

BRL: fundamentals still point to a depreciated exchange rate

The Brazilian currency had significant appreciation at the beginning of this year, going from the December peak of BRL 6.30 per dollar to closer to 5.70. Some of this improvement is due to the international environment, as the start of the Trump administration has been somewhat milder than expected on the trade front, with the postponement – purportedly temporary – of some announcements of tariffs. However, most of the improvement appears to reflect the widening interest rate differential.

Decomposition of BRL movements



Source: BBG, Itaú

We have left our exchange rate projections unchanged at 5.90 reais per dollar in both 2025 and 2026. Despite the short-term relief it has brought, the interest rate differential, which is likely to continue rising throughout the year, is unlikely to lead, on its own, to additional significant currency appreciation. Fundamentals still point to a more depreciated exchange rate: we expect fiscal risk to remain high and the dollar to continue to strengthen globally.

Fiscal: no signs of convergence

We expect primary deficits of 0.7% of GDP in both 2025 and 2026. For 2025 we do not currently expect the goal of -0.6% of GDP to be met (considering rebates and the lower limit around the official 0% target). That said, we recognize that the balance of risks could lead to better results than what we are currently estimating, given the government's continued efforts on the revenue agenda. For 2026, the main risk is the implementation of initiatives that explicitly or implicitly alter, circumvent, or disfigure fiscal rules, leading to higher growth rates in primary expenditure and/or greater fiscal subsidies. (See: Macrovision: The fundamental fiscal questions in 2025).

In terms of expenses, we believe that it will be important for the government to announce a significant containment in discretionary spending, of around BRL 35 billion, to reinforce its commitment to adhering to its fiscal plan. Announcing robust expenditure containment in the first bimonthly review in March would signal greater prudence in budget execution, given the risk of overestimating extraordinary revenue realization and further underestimating mandatory expenses (as occurred in 2024, particularly with respect to Social Security and BPC). Such an initiative would at least mitigate the risk of altering the framework's fiscal rules, which could significantly worsen perceived fiscal risk.

We believe that a more consistent improvement in the risk premium and domestic asset prices will only occur when the prospect of a more balanced public debt trajectory has become tangible. A complementary alternative to short-term expenditure containment is tightening the parameters of the fiscal framework, primarily by reducing the primary expenditure growth limit, which would curb the expected rise in public debt in the coming years (See Macrovision: BRAZIL – It is time to reinforce the fiscal framework).

Activity: Slowdown likely to intensify in the second half of the year

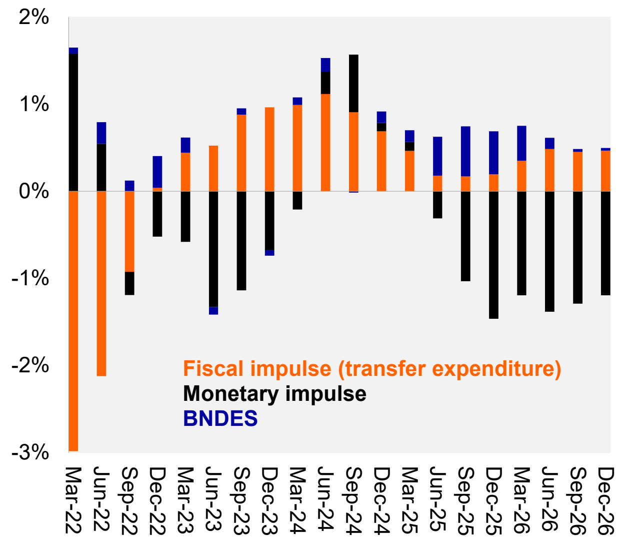
Our GDP growth estimates remain at 3.6% for 2024 and 2.2% for 2025. Monthly indicators showed weaker activity in November and December. Despite this, we expect a marginal acceleration in activity at the beginning of the year, driven mainly by agricultural GDP and the minimum wage readjustment.

Our daily activity indicator (IDAT-Activity) suggests that the economy performed better in January compared with the last two months of 2024. The highlight was the resilience of the services sector and spending on income-sensitive goods – in contrast to the consumption of more credit-sensitive goods, which showed a more pronounced slowdown at the beginning of the year.

These data support our assessment that the economic slowdown will be more pronounced in the second half of this year. With the positive impact of agricultural GDP (concentrated in 1H25) fading, along with the slowdown in fiscal impulse and the intensification of the lagging effects of contractionary monetary policy, we project that average quarterly growth will decline to 0.2% (seasonally adjusted) in the second half of 2025, compared with 0.7% in the first six months of the year.

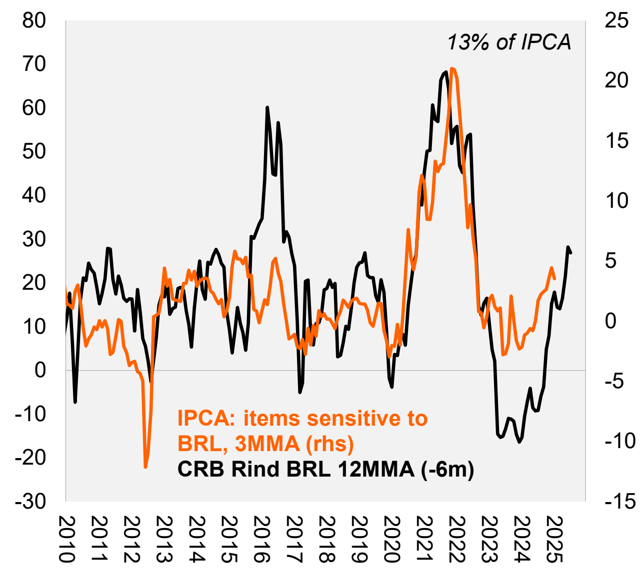
Our GDP growth estimate for 2026 is also unchanged, at 1.5%. Here the primary factor is likely to be the monetary impulse, which is set to be even more negative next year as the lagging effects of monetary policy are not offset by countercyclical fiscal and parafiscal policies.

Fiscal, monetary and BNDES impulse



Source: BCB, Itaú

We expect further acceleration in prices of goods



Source: BBG, Itaú

Our unemployment rate projections are unchanged at 6.8% for 2025 and 7.3% for 2026. Despite some weaker data at the margin, the job market continues to show overall resilience, with low and stable unemployment, a high voluntary quits rate, and robust real wage growth.

Inflation: the upward asymmetry persists

We are keeping our 2025 inflation projection at 5.8%. To date, the impact of exchange rate depreciation on prices has not yet been fully observed. Looking ahead, we expect a further acceleration in goods price increases, particularly in the first half of this year. Services inflation is also likely to remain under upward pressure, reflecting the still-resilient labor market.

The upward asymmetry in the balance of risks persists. Food inflation could rise even higher if the drop in agricultural commodity prices is less intense than expected. Furthermore, with sustained activity, the exchange rate pass-through tends to be more intense, and this could put even more pressure on the prices of goods.

For 2026 we are leaving our inflation forecast at 4.5%. The main upside risks to our scenario are a further unanchoring of long expectations and stronger inertia from 2025.

Monetary policy: moving further into contractionary terrain

In its first decision of 2025, the Copom raised the Selic rate to 13.25% per year, delivering the first of the two 100-bp increases it signaled in December following a hike of the same magnitude at that time. The committee reaffirmed the plan (+100 bps) for the next meeting, which will take place on March 18-19. However, authorities did not provide clear signaling for beyond that point.

We are leaving unchanged our end-of-cycle projection for a rate of 15.75% p.a. as of the June meeting, with this level being maintained until the end of the year. We expect an increase of 100 bps in March, followed by two final increases of 75 bps each in May and June.

We recognize, however, the risk of a shorter cycle. In line with what was highlighted by the committee in its minutes, the pace of economic activity, the dynamics of the exchange rate and exchange-rate pass-through, and inflation expectations will all be crucial in determining the length of the cycle. We believe that the rise in inflation expectations and the Central Bank's projections are consistent with our reading that the monetary tightening cycle will extend throughout the first half of the year. However, the cycle may be interrupted sooner in the event of a more pronounced slowdown in economic activity or an accommodation of the exchange rate to more appreciated levels than those observed recently.

For 2026, we are projecting interest rate cuts that bring the Selic rate to 13.75% per year.

Brazil | Forecasts and Data

	2020	2021	2022	2023	2024F		2025F		2026F	
					Current	Previous	Current	Previous	Current	Previous
Economic Activity										
Real GDP growth - %	-3.3	4.8	3.0	3.2	**3.6**	3.6	**2.2**	2.2	**1.5**	1.5
Nominal GDP - BRL bn	7,610	9,012	10,080	10,943	**11,830**	11,830	**12,800**	12,808	**13,660**	13,669
Nominal GDP - USD bn	1,475	1,670	1,951	2,192	**2,195**	2,195	**2,181**	2,125	**2,315**	2,317
Population (millions)	209.2	210.1	210.9	211.7	**212.6**	212.6	**213.4**	213.4	**214.2**	214.2
Per Capita GDP - USD	7,050	7,949	9,255	10,356	**10,326**	10,326	**10,221**	9,958	**10,808**	10,816
Nation-wide Unemployment Rate - year avg, NSA	13.8	13.2	9.3	8.0	6.8	-	**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	-	**5.8**	5.8	**4.5**	4.5
IGP–M - %	23.1	17.8	5.5	-3.2	6.5	-	**6.3**	6.6	**4.3**	4.3
Interest Rate										
Selic - eop - %	2.00	9.25	13.75	11.75	12.25	-	**15.75**	15.75	**13.75**	13.75
Balance of Payments										
BRL / USD - eop	5.19	5.57	5.28	4.86	6.18	-	**5.90**	5.90	**5.90**	5.90
BRL / USD - average	5.16	5.40	5.17	5.00	5.39	-	**5.87**	6.03	**5.90**	5.90
Trade Balance - USD bn	50	61	62	99	75	-	**76**	76	**80**	80
Current Account - % GDP	-1.7	-2.4	-2.1	-1.0	-2.5	-	**-2.1**	-2.3	**-1.9**	-2.0
Direct Investment (liabilities) - % GDP	3.0	2.8	4.7	2.8	3.2	-	**3.9**	4.0	**4.0**	4.0
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	-	**-0.7**	-0.7	**-0.7**	-0.7
Nominal Balance - % GDP	-13.3	-4.3	-4.6	-8.8	-7.9	-	**-9.2**	-9.2	**-9.9**	-9.9
Gross Public Debt - % GDP	86.9	77.3	71.7	73.8	76.2	-	**79.4**	79.4	**84.3**	84.3
Net Public Debt - % GDP	61.4	55.1	56.1	60.4	62.0	-	**67.0**	67.0	**72.7**	72.7
Growth of public spending (% real, pa, **)	29.2	-24.7	6.0	7.6	3.5	-	**2.6**	3.2	**2.8**	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.

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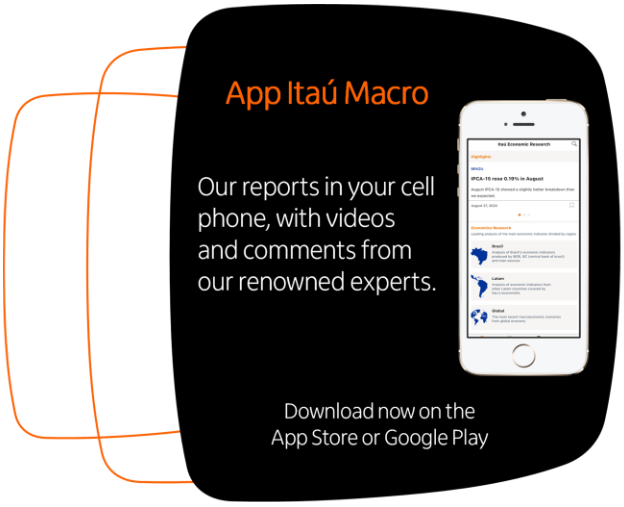

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