Macro Research

Monthly Scenario Review - Brazil
December 2024

BRAZIL: higher growth, higher interest rates

Fiscal accounts: Package with few structural changes disappoints and uncertainty prevails

- The announced spending package may be insufficient to ensure compliance with the fiscal framework until 2026

BRL: Limited room for appreciation

- We forecast the exchange rate at 5.70 reais per US dollar in 2025 and 2026. Despite the high interest rate differential, the global strong dollar scenario, the increase in domestic risk premium, and the deterioration of external accounts put pressure on the real.

Activity: Data still show a resilient economy

- We lifted our GDP growth estimates to 3.6% (from 3.2%) in 2024 and to 2.2% (from 1.8%) in 2025. Stronger activity in the short term and positive expectations for agricultural GDP next year led to the upward revisions. For 2026, we forcast 2.0% growth.
- The labor market still does not show clear signs of cooling down and represents an upward risk to GDP growth in the coming years.

Inflation: Poor coomposition and asymmetric balance of risks

- We expect inflation of 4.9% in 2024, 5.0% in 2025 and 4.3% in 2026. FX depreciation and the tight labor market persist as major upward risks, only partially offset by the possibility of milder food prices (particularly proteins).

Selic rate: Moving further into contractionary territory

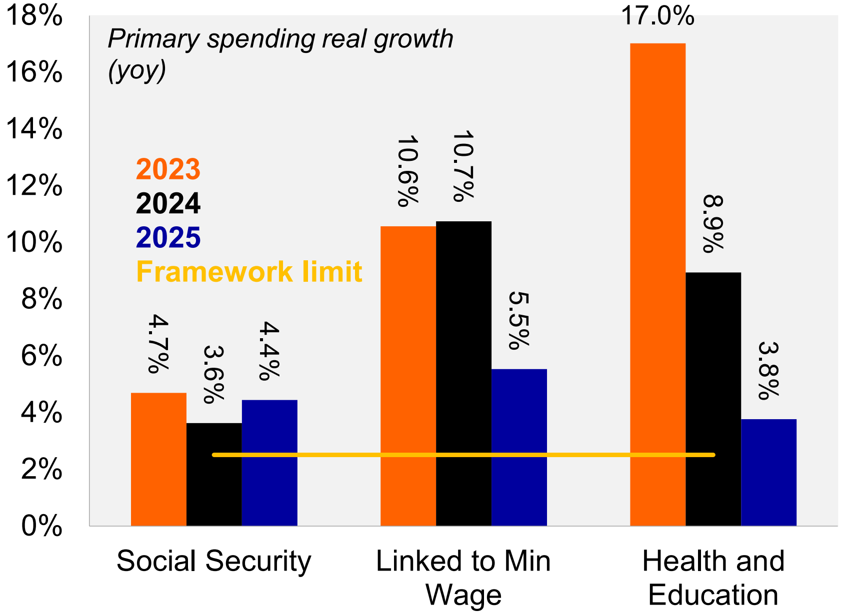
- Given the significant deterioration in inflation expectations, a weaker exchange rate and still-resilient activity, we expect the Central Bank to continue raising the benchmark rate, reaching 15%pa throughout 2025. In 2026, we expect the Selic rate to decline to 13%pa.

Fiscal: Package with few structural changes causes disappointment and uncertainty prevails

The announced spending package may be insufficient to ensure compliance with the fiscal framework until 2026

- According to our calculations, the fiscal package offers potential savings of BRL 56 billion over two years. The impact in 2026 amounts to BRL 32 billion, thus below the estimated BRL 40 billion needed in spending cuts.
- We expect primary budget deficits of -0.4% of GDP in 2024, -0.7% in 2025 and -0.7% in 2026. The fiscal situation still shows no structural improvements and carries increasing risks both in terms of revenues (as the income tax reform moves forward in legislative proceedings) and expenses (with the struggle to comply with the framework's spending cap).

High growth in Social Security, Minimum Wage, and Health/Education expenses puts pressure on other expenses within the framework



Source: Itaú, Ministry of Finance

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Fiscal: Package with few structural changes disappoints and uncertainty prevails

The announced spending package may be insufficient to ensure compliance with the fiscal framework until 2026

Expenditure control measures Potential savings, comparison to the scenario without reform (BRL bn)		2025	2026	2025-26	Govt estimates (2025-26)	Bill structure
Measures announced in November		**24**	**32**	**56**	**72**	
(1) Anti-fraud/administrative changes		**5**	**4**	**9**	**16**	
a. Anti-fraud measures (BPC & Bolsa Familia)	Biometrics, crossing databases and lowering registering renewals	4	4	8	14	PL 4614
b. Limit to super-high wages in the public sector, considering compensation for "quinquênio" (5 year working period)	Ensure that civil servant wages are within the stablished constitutional limit	0	0	0	0	PEC 45/24 + Complementary Law
c. Phasing over the coming years new civil servants entrance exams	Postponing expenses	1	0	1	2	Adm
(2) Structural measures/containing growth		**6**	**13**	**19**	**17**	
a. Limits on the minimum wage adjustment rule	Real minimum wage growth limited to 2.5% (same as fiscal framework)	5	10	15	12	PL 4614
b. Gradual reduction of wage bonus ("abono salarial")	Lowering the limit to BRL 2,640 (adjusted by inflation, becoming stable when it reaches 1.5 m.w.)	0	0	0	1	PEC 45/24 + Complementary Law
c. Military pensions (punctual adjustments)	Defining a minimum wage for military retirement and limiting pension transfers to different beneficiaries	0	2	2	2	Simple Law
d. Distrito Federal constitutional fund (FCDF)	Correction rule using the IPCA index (vs net revenue increase currently)	1	2	2	2	PL 4614
(3) Increased flexibility		**14**	**15**	**29**	**31**	
a. Parliamentary amendments linked to Health	50% of the amendments from Congressional committees will be allocated to public health, reinforcing the SUS (Public health system)	6	6	12	14	Deal w/ Congress/Simple Law
b. Conditional transfers to Culture	Conditional transfer based on the execution of resources	1	2	3	3	Simple Law
c. Fundeb for full-time enrollments	Utilization of Fundeb for the MEC's full time education program	5	6	10	10	PEC 45/24
d. Subsidies	Permission for the budget to be more aligned with execution	2	2	4	4	PEC 45/24
(4) Measures with no direct impact on spending					**7**	
a. Restriction of tax benefits	In case of a primary deficit, the creation/expansion/extension of tax benefits is prohibited	-	-	-	0	PLP 210
b. Personnel expenses limited from 2027 onwards	In case of a decrease in discretionary spending, personnel expenses can only increase by 0.6% in real terms from 2027 onwards	-	-	-	0	PLP 210
c. Extension of the DRU until 2032	-	-	-	-	7	PEC 45/24
d. Budgetary measures + blocking parliamentary amendments	Creation of expenses must respect the limits of the fiscal framework and the revocation of budget execution; Amendments blocking limited to 15%	-	-	-	0	PLP 210
e. 'Pé-de-meia' and 'vale-gás' within the budget	Use of funds and the PPSA transfer project for execution via Caixa Bank	-	-	-	0	Simple law/ Adm

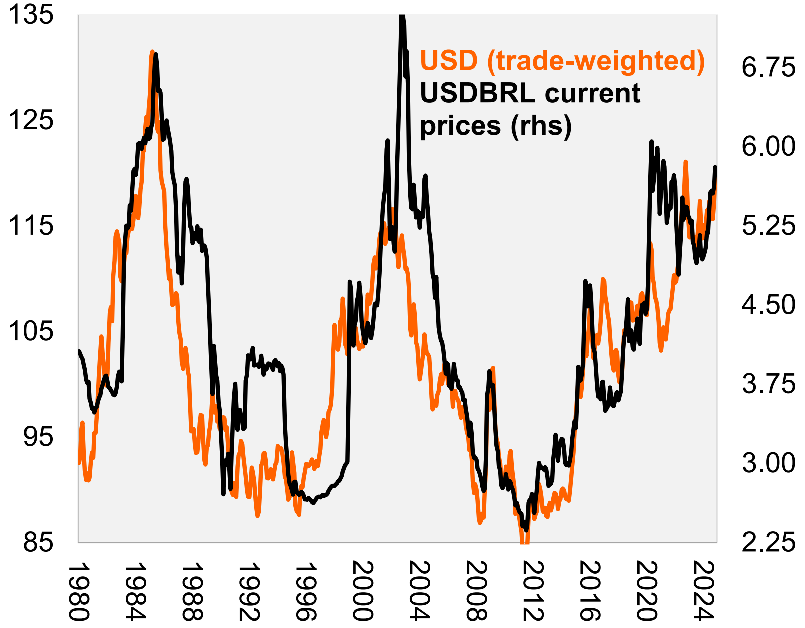
Source: Itaú, Ministry of Finance

BRL: Limited room for appreciation

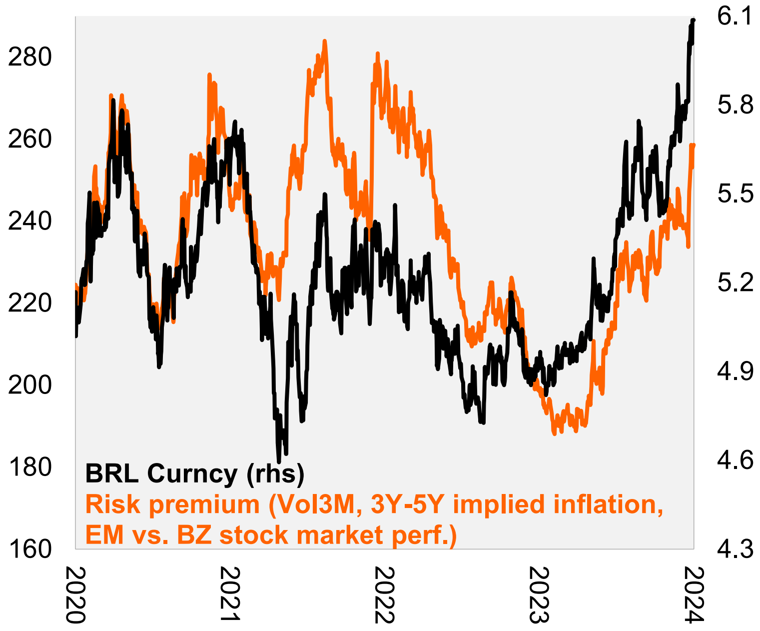
We forecast the exchange rate at BRL 5.70 per US dollar in 2025 and 2026

- Currency appreciation is limited by (i) a strong dollar globally; (ii) a higher domestic risk premium that reflects fiscal uncertainties; and (iii) deterioration in external accounts (current account deficit at -3.3% of GDP at the margin).

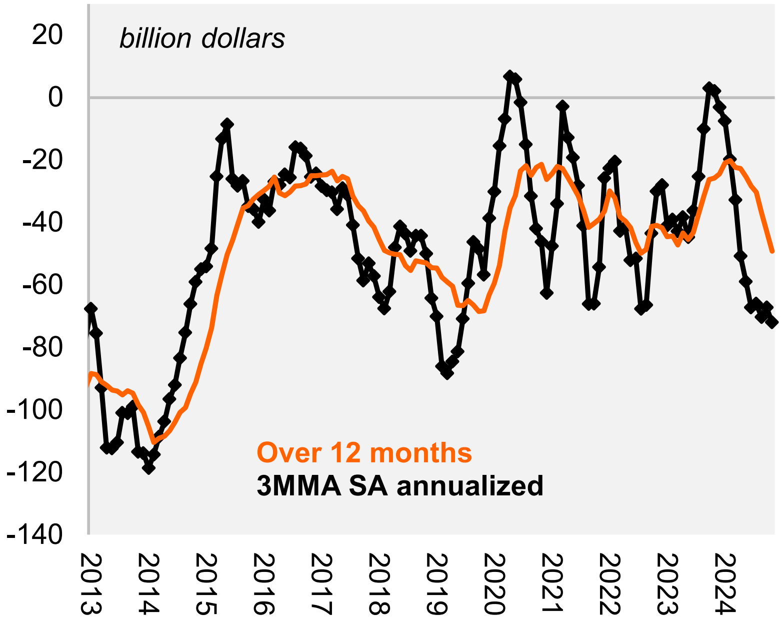
Stronger USD pressures the BRL



Risk premium at high levels



Increase in the current account deficit



Source: Itaú, BCB, BBG

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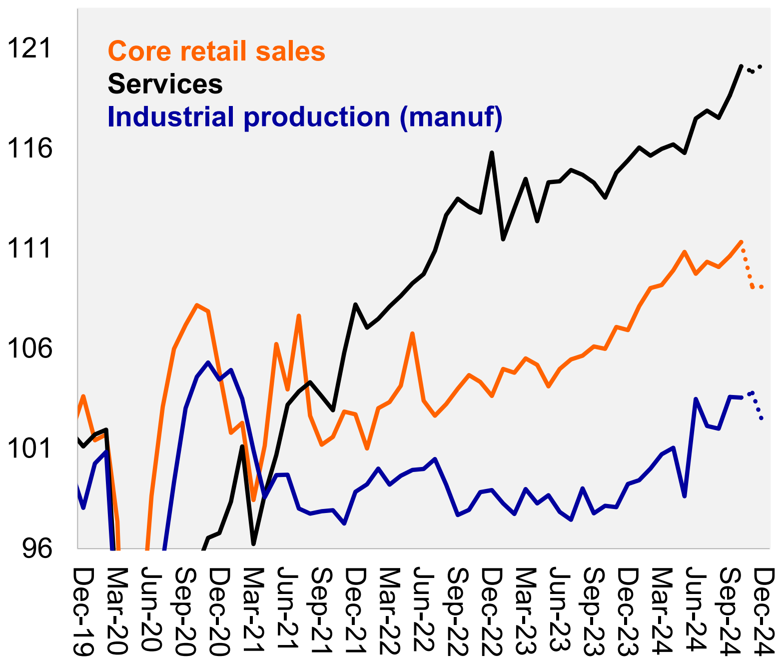
Activity: Data still show a resilient economy

Stronger activity in the short term and positive expectations for agricultural GDP in 2025 are behind upward revisions

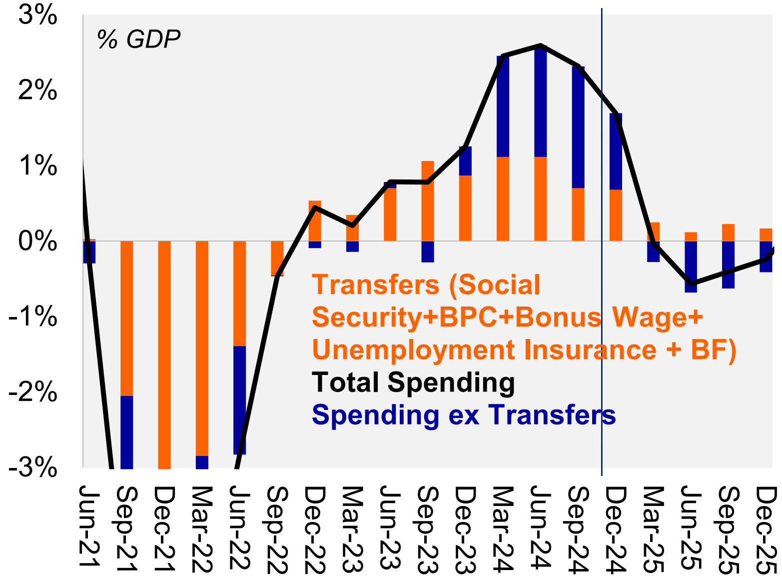
- With modest deceleration in 3Q24 and with IDAT-Activity pointing to a positive economic performance in 4Q24 (especially in the services sector), we revised our forecats for 2024 GDP to 3.6% (from 3.2%).
- Our 2025 forecast was revised to 2.2% (from 1.8%), due to a greater statistical carryover and robust agricultural GDP in 1Q25. We still anticipate some deceleration from the strong growth pace seen in 2024 due to reductions in fiscal (via social transfers) and monetary (interest rates advancing into contractionary territory) impulses.
- For 2026, we estimate 2.0% growth. Transfers and the increase in the income tax exemption limit should offset the lagged effects of higher interest rates.

Positive economic performance in 4Q24



Source: Itaú, BCB, IBGE

Smaller fiscal impulse (via social transfers) in 2025



Impulse(t) = (Spending 12m(t)-Spending 12m(t-12))/GDP 12m (t-12)

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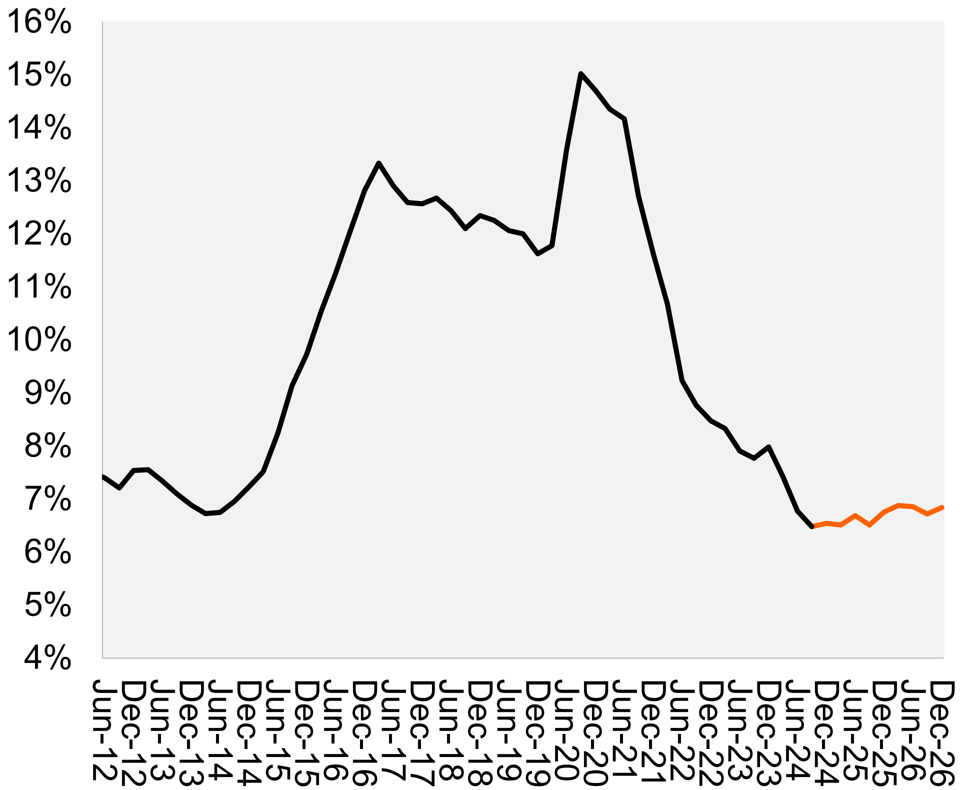
Activity: Data still show a resilient economy

The labor market still does not show clear signs of cooling down and represents upward risk to GDP

- Employment growth should decelerate. However, with the economy still expanding above potential, the unemployment rate is set to remain close to all-time lows.
- We forecast the unemployment rate at 6.5% in 2024 and at 6.8% in 2025 and 2026.

Unemployment rate



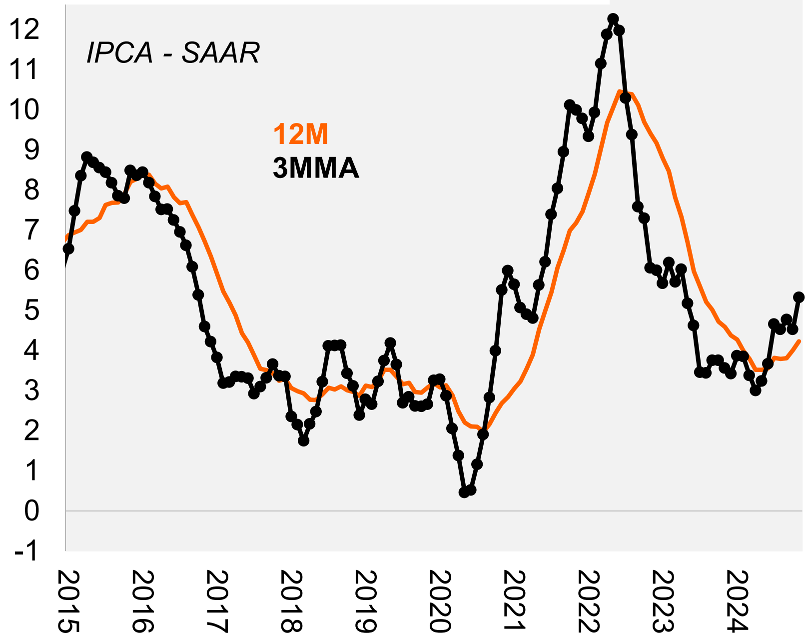
Source: Itaú, IBGE

Inflation: Poor composition and asymmetric balance of risks

We forecast inflation at 4.9% in 2024, 5.0% in 2025 and 4.3% in 2026

- Our inflation forecasts remain unchanged (we had already adjusted our call for IPCA in 2024, to 4.9% from 4.8% after the last monthly scenario update).
- The balance of risks for IPCA in 2025 is tilted to the upside: weaker BRL (↑); underlying services prices under greater pressure due to tight labor market (↑); milder costs for food consumed at home due lower pressure on protein prices (↓).
- Significant inertia, unanchored expectations and a tight labor market will exert pressure on 2026 inflation.

Core inflation indicates a qualitative worsening at the margin



Weight		2020	2021	2022	2023	2024	2025
100.0	IPCA	4.5	10.1	5.8	4.6	4.9	5.0
74.1	Market-Set prices	5.2	7.7	9.4	3.1	5.0	5.4
15.1	Food at home	18.2	8.2	13.2	-0.5	8.6	7.0
23.4	Industrial	3.2	11.9	9.5	1.1	2.6	3.8
15.8	Underlying industrial	2.3	8.7	14.0	2.3	2.1	4.0
35.5	Services	1.7	4.8	7.6	6.2	5.1	5.6
21.0	Underlying services	2.5	5.9	8.9	4.8	5.7	6.2
36.8	IPCA-EX3	2.4	7.1	11.1	3.7	4.2	5.3
25.9	Regulated prices	2.6	16.9	-3.8	9.1	4.6	4.1
4.1	Electricity	9.1	21.2	-19.0	9.5	0.2	3.5
5.0	Gasoline	-0.2	47.5	-25.8	12.1	9.2	2.7

Source: IBGE, Itaú

Source: Itaú, IBGE

Selic rate: Moving further into contractionary territory

We see the Selic rate at 15.00%pa in 2025 and 13.00%pa in 2026

- At its last monetary policy meeting, the Copom raised the Selic rate by 100 bps to 12.25% pa, indicating that, unless the scenario changes, it intends to raise the Selic by 100 bps twice more. The decision was motivated by the sharp deterioration in inflation expectations and the surprise with the activity in the third quarter of this year, resulting in a wider positive output gap.
- There was a significant increase in the inflation forecast in the relevant horizon (2Q26), from 3.6% in the November meeting to 4.0% in the December meeting, indicating the need for monetary policy to advance further into contractionary territory.
- We expect the Selic rate to reach 15.00% per year throughout 2025 (previously 13.50%) and remain at that level until the end of the year. Regarding the pace, we expect two more hikes of 100 bps – as indicated by the committee – and a final hike of 75 bps in the 3rd meeting of the year. Naturally, given the asymmetric balance of risks for inflation, odds are skewed towards an even larger cycle.
- In 2026, we expect the benchmark rate to retreat to 13.00%pa.

Inflation Forecasts - Copom (%)

	nov/24	dez/24
2024	4.6	4.9
2025	3.9	4.5
2Q2026	3.6	4.0

Source: BCB, Itaú

Brazil | Forecasts and Data

	2019	2020	2021	2022	2023	2024F		2025F		2026F
						Current	*Previous*	*Current*	*Previous*	*Current*
Economic Activity										
Real GDP growth - %	1.2	-3.3	4.8	3.0	3.2	**3.6**	3.2	**2.2**	1.8	**2.0**
Nominal GDP - BRL bn	7,389	7,610	9,012	10,080	10,943	**11,832**	11,591	**12,800**	12,415	**13,678**
Nominal GDP - USD bn	1,872	1,475	1,670	1,951	2,192	**2,202**	2,169	**2,210**	2,178	**2,400**
Population (millions)	207.9	209.2	210.1	210.9	211.7	**212.6**	212.6	**213.4**	213.4	**214.2**
Per Capita GDP - USD	9,007	7,050	7,949	9,255	10,356	**10,359**	10,202	**10,355**	10,205	**11,202**
Nation-wide Unemployment Rate - year avg, NSA	12.0	13.8	13.2	9.3	8.0	**6.8**	6.8	**6.6**	6.8	**6.6**
Nation-wide Unemployment Rate - year end (*)	11.6	14.7	11.6	8.5	8.0	**6.5**	6.5	**6.8**	7.0	**6.8**
Inflation										
IPCA - %	4.3	4.5	10.1	5.8	4.6	**4.9**	4.8	**5.0**	5.0	**4.3**
IGP–M - %	7.3	23.1	17.8	5.5	-3.2	**6.8**	5.7	**5.5**	5.3	**4.2**
Interest Rate										
Selic - eop - %	4.50	2.00	9.25	13.75	11.75	**12.25**	12.00	**15.00**	13.50	**13.00**
Balance of Payments										
BRL / USD - eop	4.03	5.19	5.57	5.28	4.86	**5.90**	5.70	**5.70**	5.70	**5.70**
BRL / USD - average	3.95	5.16	5.40	5.17	5.00	**5.37**	5.29	**5.79**	5.29	**5.70**
Trade Balance - USD bn	35	50	61	62	99	**74**	74	**67**	68	**69**
Current Account - % GDP	-3.5	-1.7	-2.4	-2.1	-1.0	**-2.5**	-2.6	**-2.6**	-2.7	**-2.2**
Direct Investment (liabilities) - % GDP	3.7	3.0	2.8	4.7	2.8	**3.2**	3.2	**3.8**	3.9	**3.8**
International Reserves - USD bn	367	356	362	325	355	**370**	370	**370**	370	**370**
Public Finances										
Primary Balance - % GDP	-0.8	-9.2	0.7	1.2	-2.3	**-0.4**	-0.4	**-0.7**	-0.7	**-0.7**
Nominal Balance - % GDP	-5.8	-13.3	-4.3	-4.6	-8.8	**-7.9**	-7.6	**-9.0**	-8.5	**-9.5**
Gross Public Debt - % GDP	74.4	86.9	77.3	71.7	73.8	**77.1**	78.2	**80.1**	81.7	**84.5**
Net Public Debt - % GDP	54.7	61.4	55.1	56.1	60.4	**61.3**	62.6	**66.1**	67.6	**71.3**
Growth of public spending (% real, pa, **)	2.3	29.2	-24.7	6.0	7.6	**3.4**	3.6	**3.2**	3.1	**2.5**

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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