

Macro scenario - Brazil



October 10, 2025

The economy slows down, uncertainties remain

- ▶ We kept our forecasts for the exchange rate at R\$/US\$ 5.35 for 2025 and R\$/US\$ 5.50 for 2026. The BRL benefits from the weak-dollar environment, but domestic factors tend to limit further gains of the currency. We revised our forecast for the current account deficit to 3.3% of GDP in 2025 (from 3.2% previously) and kept the 2026 forecast at 3.1%.
- ▶ The latest data points to a continued slowdown of the Brazilian economy in the third quarter of 2025. We maintained our GDP growth forecasts at 2.2% for 2025, with a slight downside bias, and at 1.5% for 2026, with an upside bias. Recent data shows that the labor market remains resilient, but incipient signs of cooling are emerging, in line with our expectation of a slight increase in the unemployment rate in the coming months, ending the year at 6.2% in 2025 and 6.5% in 2026 – levels below the neutral rate, which we estimate around 8.0%.
- ▶ We revised our 2025 IPCA inflation forecast from 5.0% to 4.7% incorporating the surprises from the latest releases, with the main contribution coming from the food group for the remainder of the year. For 2026, we revised it to 4.3% (from 4.4%), reflecting lower inflation inertia.
- ▶ We kept our primary balance projection at -0.6% in 2025 and revised it to -0.8% in 2026 (from -1.0%). With the approval of the income tax reform in the Lower House in similar terms to those sent by the government, we now incorporate a full (previously only partial) compensation for the income tax exemption. However, the challenge to meet the lower bound of the 2026 target remains high (around 0.4% of GDP).
- ▶ The Copom has reaffirmed its commitment to keeping interest rates high for an extended period to ensure inflation convergence to the target. Despite mixed signs of economic deceleration and falling inflation, the labor market remains resilient and expectations continue substantially above the target. We maintain our projection for the start of the easing cycle in 1Q26, taking the Selic rate to 12.75% p.a. in 2026.

BRL: supported by external factors, but local fundamentals may weigh ahead

We maintained our exchange rate forecasts at R\$/US\$ 5.35 for 2025 and R\$/US\$ 5.50 for 2026. In the short term, the Real remains supported by the Federal Reserve's interest rate cuts and the expectation of a weaker dollar level than observed in recent years. However, domestic fundamentals may limit a more benign scenario, as the interest rate differential tends to narrow when the Central Bank starts cutting the Selic rate, the risk premium tends to be more pressured, given the trajectory of public debt, and the performance of external accounts is expected to remain weak.

We revised our forecast for the current account deficit to 3.3% of GDP in 2025 (from 3.2% previously) and maintained our projection of 3.1% in 2026. The deterioration in the short-term forecast reflects the latest revision to the Income timeseries, which increased Profit and Dividend outflows in 2024 and 2025, as well as the increase in the net external liability that remunerates these flows, reflecting the appreciation of the Real observed this year.

Activity: data shows slowdown in 3Q25

The latest data indicates a continuation of the economic slowdown process in 3Q25. Despite a slight improvement in the services sector in August, our daily activity indicator (IDAT-Activity) signals another contraction in goods and services spending in September.

For 3Q25, we maintain our estimate of a 0.3% quarter-over-quarter increase (seasonally adjusted) and a 1.9% year-over-year rise. This projection takes into account the temporary boost to consumption from the payments of court-ordered debts released in late July and early August, with more evident effects in August and, especially, in September, in line with our internal data¹.

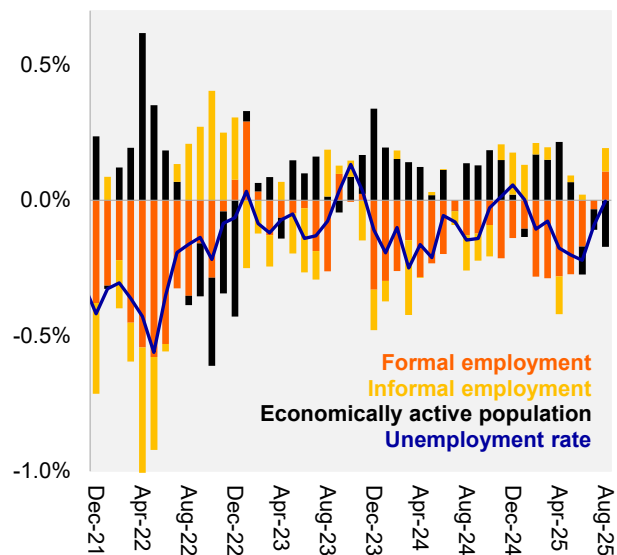
Given this picture, we maintained our GDP growth forecast at 2.2% for 2025, with a slight downside bias, reflecting uncertainties in the credit market. Payroll-deducted loan disbursements to INSS retirees have been recovering more slowly than expected following the biometric authentication requirement imposed. If the volume of disbursements does not return to previous levels, we estimate a -0.1pp impact on GDP this year. In the balance of risks, we also highlight the effects of the IOF changes, so far concentrated on short-term lines, with the possibility of spillover into medium-term maturities, which could further impact economic activity.

For 2026, we maintained the growth projection of 1.5%, with repetition of the seasonal pattern seen in recent years: higher dynamism in the first half, followed by slowdown in the second half. The balance of risks remains with an upside bias, in light of the potential adoption of countercyclical fiscal and quasi-fiscal measures capable of mitigating the potential cooling of activity over the period.

Finally, the most recent indicators suggest a still resilient labor market, but with incipient signs of cooling, in line with our expectation of a slight rise in the unemployment rate in the coming months. The Caged for August registered the creation of 48,000 jobs, decelerating from previous months (slightly above 100,000) and below the estimated neutral level of 60,000, consistent with a stable unemployment rate. The unemployment rate remains at a historically low level — 5.7% with seasonal adjustment in the August reading —, but, unlike in previous releases, this stability was sustained by a drop in the participation rate, since both formal and informal employment declined in the month. Formal employment, in fact, fell for the first time since September 2023. Our IDAT - Labor Market for September, in turn, pointed to a slight deceleration in wages and the employed population in the three-

month moving average, across all sectors. We maintained our projection for the unemployment rate at 6.2% in 2025 and 6.5% in 2026.

Breakdown of the unemployment rate variation



Source: IBGE, Itau

Inflation: downward revision

We have reduced again our forecast for the 2025 IPCA consumer inflation, from 5.0% to 4.7%. We incorporated the surprises from the latest releases, with the main contribution coming from the short-term revision of the food group.

For 2025, we assess that inflation risks are skewed to the downside. Food prices may face less pressure, either due to a slower reversal of the livestock cycle or perishable item prices. Additionally, a more appreciated currency and lower oil prices increase the chance of gasoline price cuts. On the other hand, lower rainfall increases the likelihood of triggering the yellow tariff flag by year-end, which could raise electricity costs.

For 2026, we revised our inflation forecast to 4.3% (from 4.4%), reflecting lower inflation inertia. The currency appreciation observed this year should be passed through with a lag to industrial goods prices, but the expectation of a more depreciated currency throughout 2026 tends to offset this effect, limiting more lasting relief on inflation. The balance of risks is symmetric: on one side, the heated labor market

¹ Para mais detalhes ver:

https://macroattachment.cloud.itaú.com.br/attachments/0c5fc2c5-e792-48fd-9bc9-258a09bf488d/20251002_MACRO_VISION_Precatorio.pdf

remains the main upside driver for IPCA; on the other, a more appreciated currency than projected would have a downward effect on the inflation of tradable goods.

Public accounts: primary balance improvement with prospect of full compensation for income tax exemption

We have kept our primary balance projection at -0.6% of GDP in 2025. Current data shows tax collection still at high levels, with non-recurring factors offsetting the deceleration in tax revenues, while expenditure accelerated in recent months. For the year, we continue to see the government close to meeting the lower bound of the -0.6% of GDP target (considering discounts and the lower bound of the official 0% target).

For 2026, we have revised our projection for the primary balance from -1.0% to -0.8% of GDP. With approval of the income tax reform in the Lower House in similar terms to those proposed by the government, we now incorporate a full compensation (previously only partial) for the income tax exemption. Despite the improvement, the challenge to meet the lower bound of the target (-0.4% of GDP, considering deductions and the 0.25% lower bound) remains high, heavily reliant on uncertain or extraordinary revenues. Going forward, the main risk is the implementation of initiatives that alter, circumvent, or disfigure fiscal rules, explicitly or implicitly, accommodating higher growth rates of primary expenditures and/or larger revenue waivers. We believe that structural measures addressing the rigidity and high growth of mandatory expenditures would bring greater credibility to the fiscal adjustment needed to ensure public debt sustainability.

Monetary policy: perseverance, firmness and serenity

The Copom continues to reaffirm its commitment to keeping the interest rate at a high level for a prolonged period, in order to ensure the convergence of inflation to the target over the relevant horizon. In its recent communications (the minutes of the September meeting and the 3rd Monetary Policy Report), the Central Bank presented inflation projections that remain above the target until 1Q28 and, therefore, do not support the discussion of interest rate cuts before the end of this year. The estimate for the output gap was once again revised upwards, and is likely to undergo further adjustment after the approval of the income tax reform.

It is now possible to observe some signs of the impact of monetary policy on the economy, but with data still ambiguous, caution and perseverance in the monetary policy strategy are essential. The exchange rate has appreciated, aided by the external conditions, but also supported by a high-interest rate differential. The 2Q25 GDP and 3Q25 activity indicators reinforce the view of a gradual slowdown in activity, although signals remain divergent, with the labor market still resilient. Current inflation has declined, but inflation expectations measured by the Focus survey remain substantially above the target for different time horizons.

We maintain our expectation for the start of the easing cycle in January 2026, with an initial reduction of 0.25pp, taking the Selic rate to 12.75% p.a. over the year. The Central Bank's model should show inflation closer to the target, at the relevant horizon, at the January meeting, allowing for the start of a gradual monetary easing – that is, at a slow pace and with a smaller cycle than (the 275-bp reduction) currently expected by market agents in the Focus survey. There are risks to this scenario: stronger growth, which could motivate a further revision of the output gap, or a labor market that continues to surprise with its resilience, or even a more conservative stance by the Central Bank, could delay the start of the cuts.

It is worth noting that a cycle of the size currently expected in the Focus Survey (with the Selic rate reaching 12.25% still in 2026) only seems possible if there is a more significant currency appreciation.

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	12,658	12,663	13,359	13,405
Nominal GDP - USD bn	1,475	1,670	1,951	2,192	2,179	2,269	2,266	2,460	2,468
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	10,632	10,616	11,482	11,522
Nation-wide Unemployment Rate - year avg, NSA	13.5	13.5	9.5	8.0	6.9	6.1	6.1	6.4	6.4
Nation-wide Unemployment Rate - year end (*)	14.7	11.6	8.4	7.9	6.6	6.2	6.2	6.5	6.5
Inflation									
IPCA - %	4.5	10.1	5.8	4.6	4.8	4.7	5.0	4.3	4.4
IGP-M - %	23.1	17.8	5.5	-3.2	6.5	1.1	2.0	3.4	3.5
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	5.35	5.35	5.50	5.50
BRL / USD - average	5.16	5.40	5.17	4.99	5.39	5.58	5.57	5.43	5.43
Trade Balance - USD bn	50	61	62	99	75	65	65	58	58
Current Account - % GDP	-1.6	-2.4	-2.2	-1.2	-3.0	-3.3	-3.2	-3.1	-3.1
Direct Investment (liabilities) - % GDP	3.0	2.8	4.7	2.8	3.2	3.7	3.8	3.7	3.7
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	-0.8	-1.0
Nominal Balance - % GDP	-13.3	-4.3	-4.6	-8.8	-8.5	-8.7	-8.8	-9.3	-9.5
Gross Public Debt - % GDP	86.9	77.3	71.7	73.8	76.5	79.1	79.2	84.4	84.4
Net Public Debt - % GDP	61.4	55.1	56.1	60.4	61.5	67.4	67.4	72.9	72.9
Growth of public spending (% real, pa, **)	29.2	-24.7	6.0	7.6	3.2	4.0	3.7	2.9	2.9

Source: IBGE, FGV, BCB and Itaú

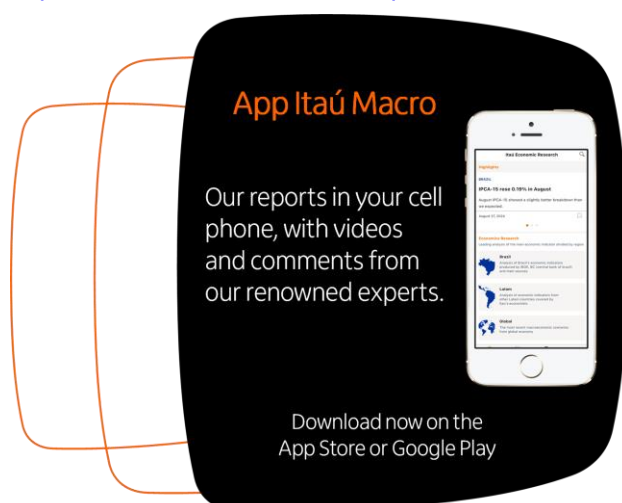
(*) Nation-wide Unemployment Rate measured by PNADC.

(**) 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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