Macro Research

Monthly Scenario Review | BRAZIL
10 themes for 2025

BRAZIL: 10 themes for 2025

Activity: moderate slowdown, but increasing risks

1. 2025 GDP growth of 2.2%, with a weaker performance in 2H. What are the fundamentals and what is the expected dynamics for each quarter?
2. Could the slowdown get sharper as the year progresses?
3. What are the risks for 2026?

BRL: above R$ 6.00 per US dollar in YE24; room for appreciation is limited

4. What are the drivers of the local currency?
5. Will a weaker BRL improve the dynamics of external accounts going forward?

Inflation: another upward revision in estimates due to weaker BRL

6. What to expect for 2025 and 2026? What are the main risks?
7. Has the BRL depreciation already impacted inflation or is the impact still coming? What is the timing?

Selic: contractionary, for a long time

8. How big is the cycle and what are the risks? What pace should the Central Bank follow?

Fiscal: persistent deficits, rising debt

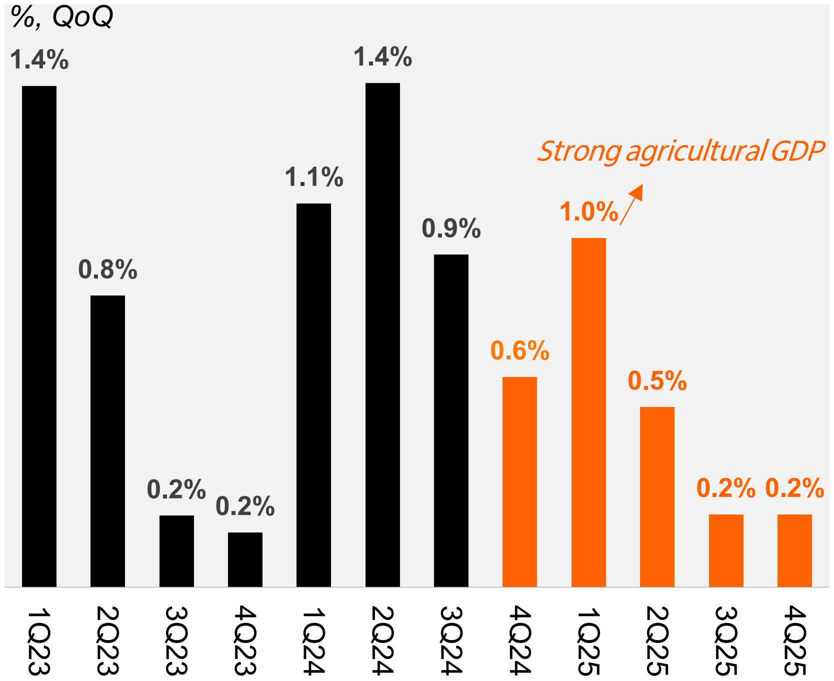
9. Will the government meet the spending limits and the primary budget target?
10. Is compliance with the framework in its current format sufficient to improve domestic risk perception?

Activity: moderate slowdown, but increasing risks

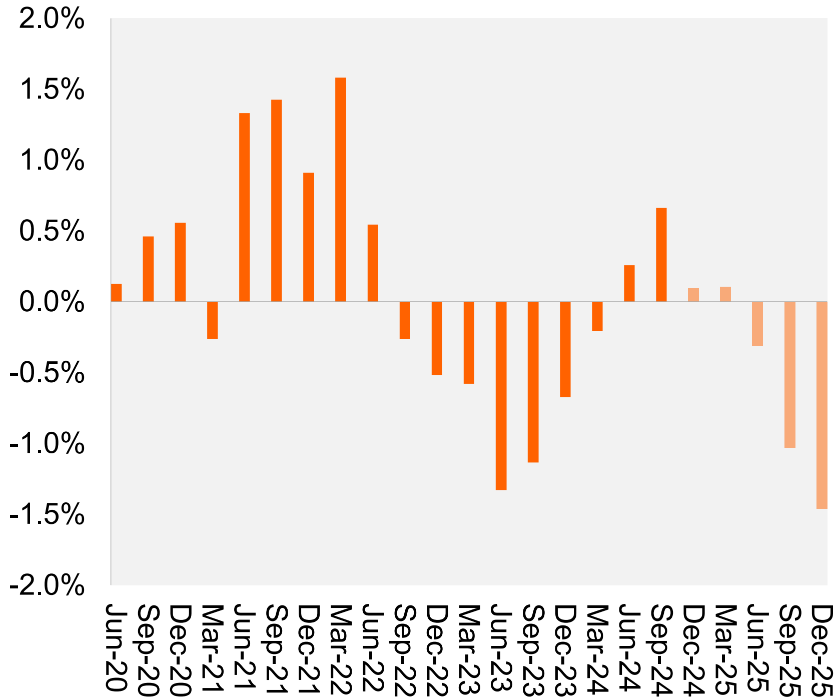
1. 2025 GDP growth of 2.2%, with a weaker performance in 2H. What are the fundamentals and what is the expected dynamics for each quarter?

- Strong agricultural GDP should support growth in 1Q25. Given the real adjustment in the minimum monthly wage and a still-tight labor market, income should also continue to support consumer spending.
- We expect some deceleration from 2Q25 onwards due to the reduction in fiscal momentum (via transfers) and in monetary momentum (as interest rates move further into contractionary territory), with the latter having a sharper impact in 2H25.

Quarterly GDP



Monetary Impulse (Credit and Rates)



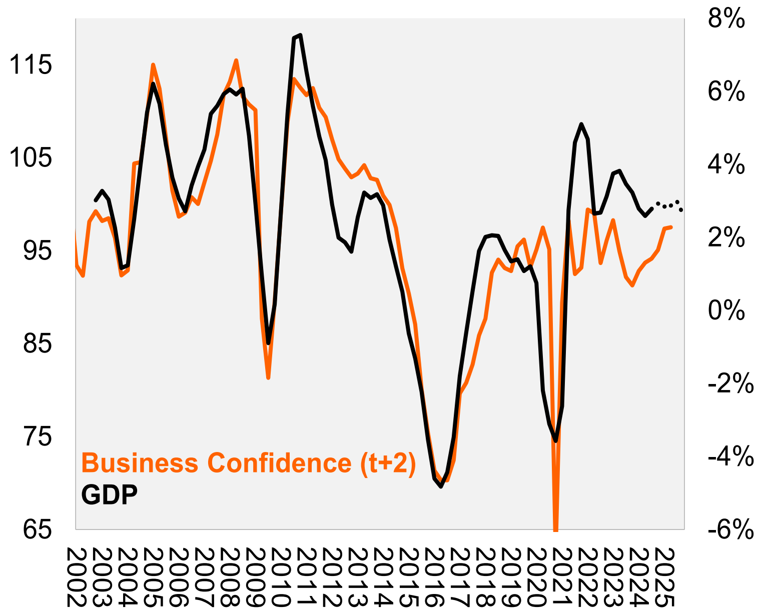
Source: IBGE, Itaú

Activity: moderate slowdown, but increasing risks

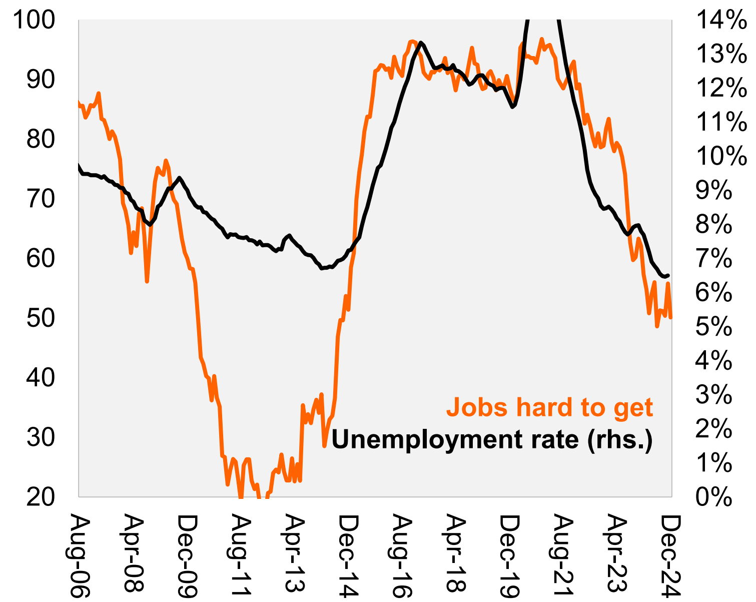
2. Could the slowdown get sharper as the year progresses?

- There are buffers that reduce the likelihood of steeper deceleration scenarios: (i) confidence still at high levels, (ii) strong agricultural GDP and potential spillovers, (iii) a resilient labor market with no signs of weakness, (iv) elevated household savings.
- However, risks are on the rise, considering the increase in the Selic benchmark interest rate and possible impacts on delinquency, new loans and issuances in the capital markets. In this case, the greatest impact would be felt from 2H25 onwards.

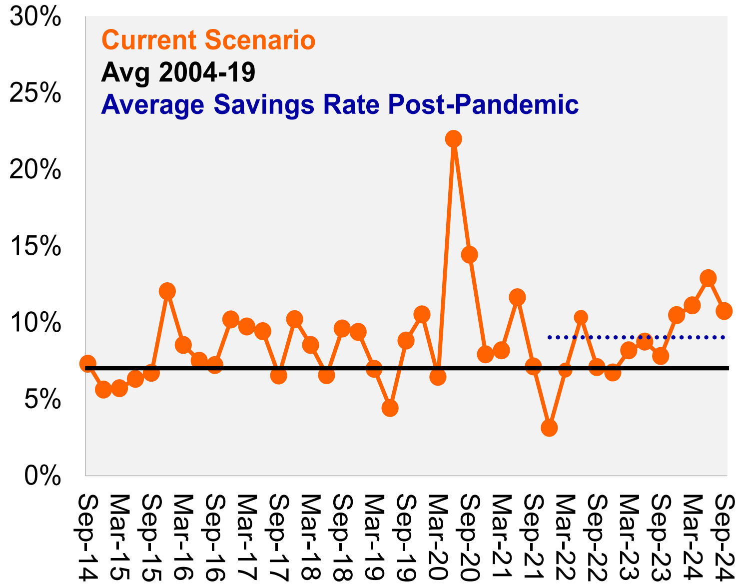
Business Confidence vs. GDP



Unemployment rate vs "Jobs Hard to Get"



Household Savings Rate

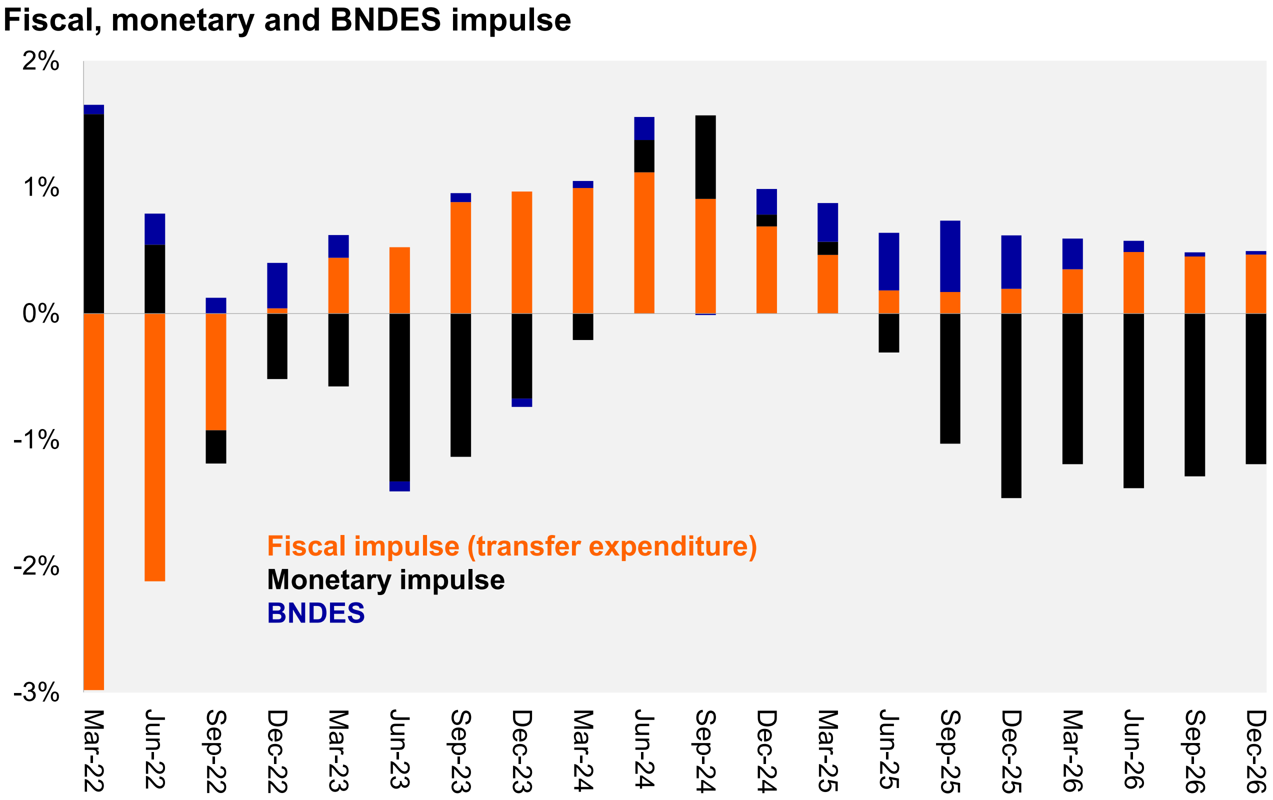


Source: IBGE, Itaú

Activity: moderate slowdown, but increasing risks

3. What are the risks for 2026?

- **We lowered our call for 2026 GDP growth to 1.5% (from 2.0%).** The lagged effects of monetary policy should be sharper in 2026.
- However, there are uncertainties surrounding the reaction of fiscal and parafiscal policies to slowing activity during an election year.



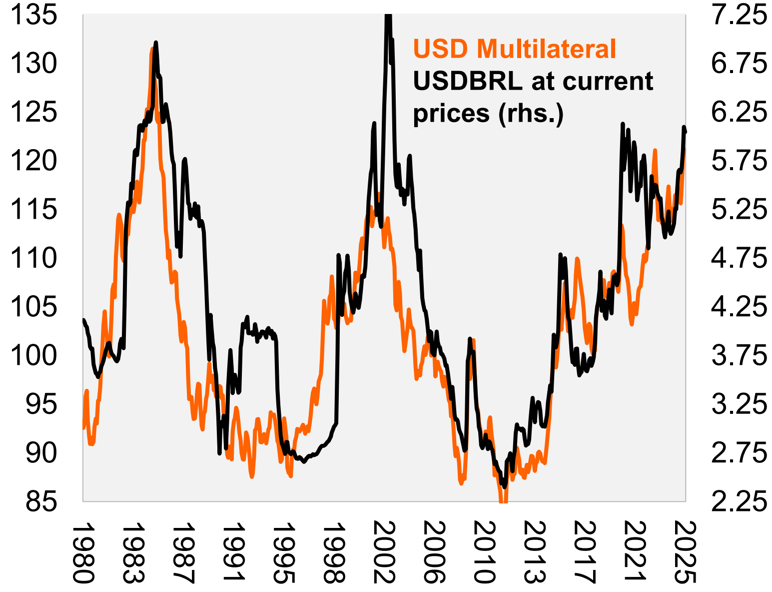
Source: IBGE, Itaú

BRL: above R$ 6.00 per US dollar in YE24; room for appreciation is limited

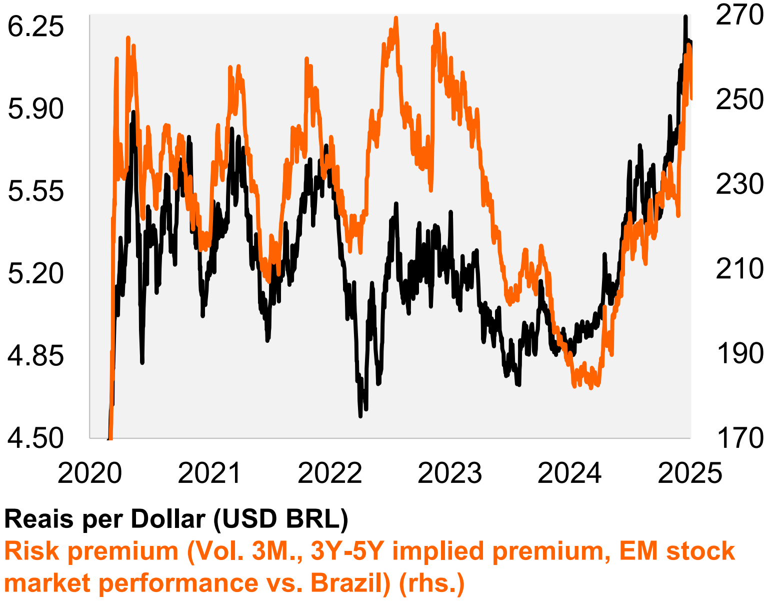
4. What are the drivers of the local currency?

- **External and domestic uncertainties should continue to exert pressure on the Brazilian currency:**
  - Dollar to remain strong globally: US growth higher than other countries'; Trump administration's tariff/inflationary policy; no additional rate cuts in the US.
  - Risk premium should remain elevated in Brazil amid fiscal uncertainties.
  - Worsening current account dynamics, reflecting heated activity.
- **Interest rate differential to provides support as the Selic rate rises further, but not enough to promote significant FX appreciation.**
- **We now forecast the BRL at R$ 5.90 per dollar in 2025 and 2026 (R$ 5.70 previously).**

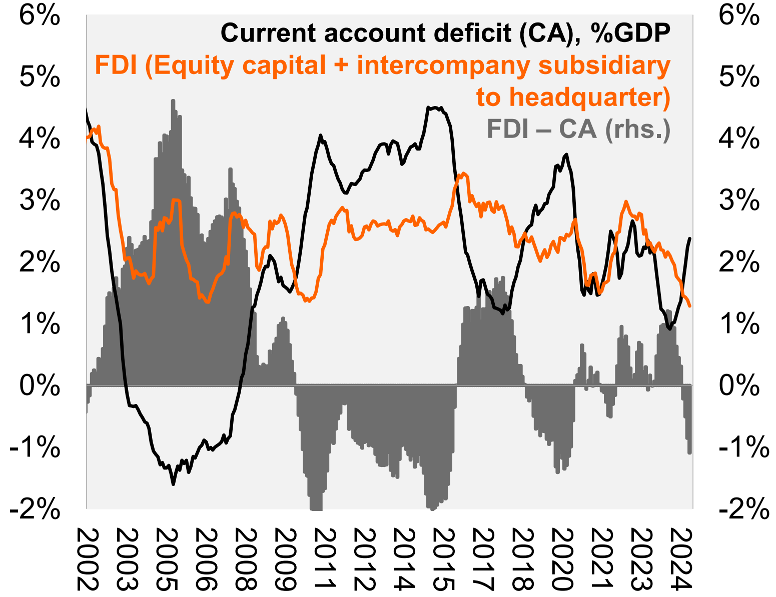
Strong USD globally



Risk premium remains high



FDI does not fully cover the CA deficit



Source: BBG, Itaú

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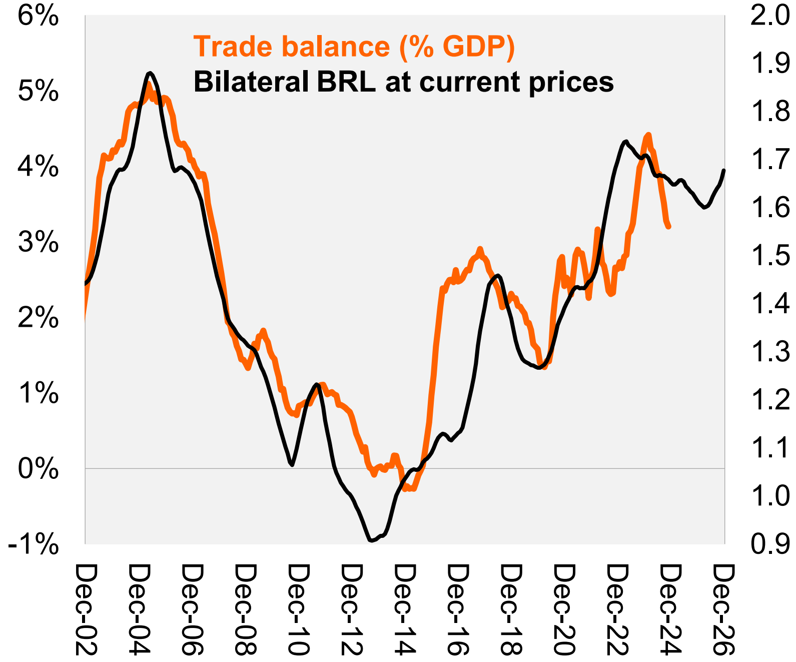
BRL: above R$ 6.00 per US dollar in YE24; room for appreciation is limited

5. Will a weaker BRL improve the dynamics of external accounts going forward?

- FX impact on external accounts has a lag of approximately 2 years, but should provide support going forward. Strong crop in 2025 and some moderation in economic activity also help. However, the deterioration in external accounts ("other services" line) is partly structural and should continue.
- **We forecast current account deficits of 2.3% of GDP in 2025 and 2.0% in 2026.**

Trade Balance vs. BRL



				Forecast		
USD Bn	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**
Current Account	**-40**	**-41**	**-25**	**-54**	**-48**	**-47**
% GDP	**-2.4%**	**-2.1%**	**-1.1%**	**-2.5%**	**-2.3%**	**-2.0%**
Trade Balance (BCB)	**44**	**44**	**81**	**68**	**69**	**73**
Trade Balance (MDIC)	61	62	99	75	76	80
Services	**-27**	**-40**	**-40**	**-50**	**-55**	**-57**
Services ex-'Other'	-23	-35	-30	-34	-35	-37
Other Services	-4	-5	-10	-16	-20	-20
Primary Income	**-59**	**-57**	**-79**	**-75**	**-65**	**-66**
Secondary Income	**3**	**4**	**3**	**3**	**3**	**3**

Source: IBGE, Itaú

Inflation: another upward revision in estimates due to weaker BRL

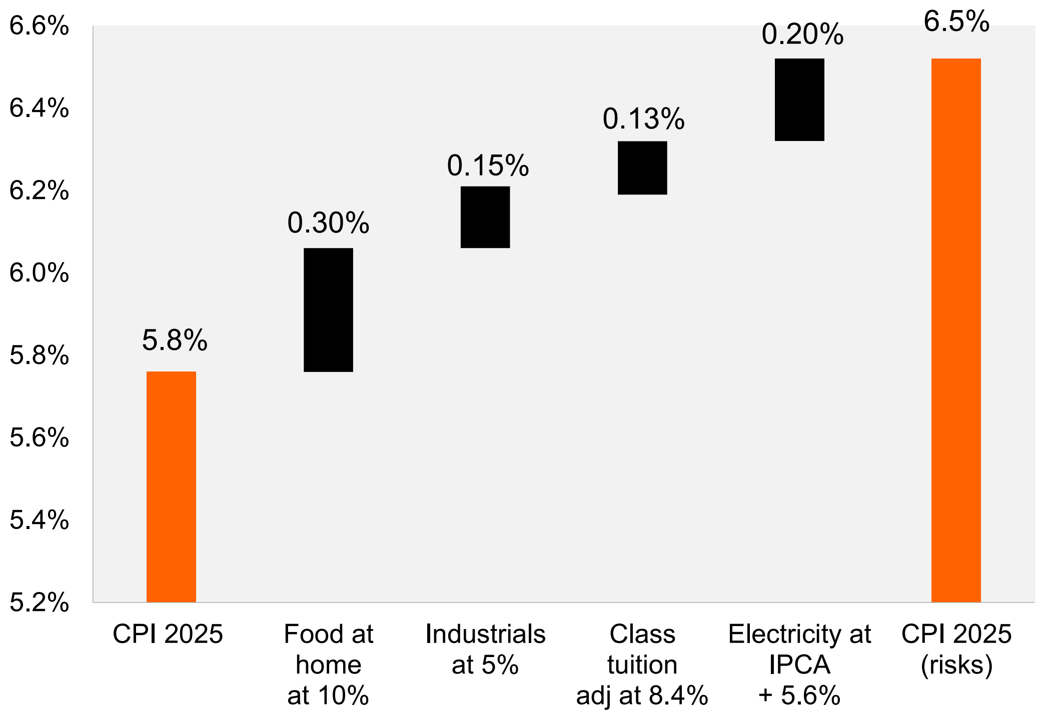
6. What to expect for 2025 and 2026? What are the main risks?

- **We forecast the consumer price index IPCA at 5.8% in 2025,** led by a weaker BRL and services prices under pressure.
- Notwithstanding the upward revision, the balance of risks remains asymmetric given that the BRL may not appreciate as we anticipate, impacting mainly food and industrial prices.
- **We see the IPCA rising 4.5% in 2026** amid greater inertia, only partially offset by higher unemployment. The main upward risks involve greater inertia from 2025 and long-term inflation expectations becoming unanchored.

Weight		2021	2022	2023	2024	2025
100.0	IPCA	10.1	5.8	4.6	4.8	5.8
74.1	Market-Set prices	7.7	9.4	3.1	4.9	6.2
15.1	Food at home	8.2	13.2	-0.5	8.2	8.0
23.4	Industrial	11.9	9.5	1.1	2.9	4.3
15.8	Underlying industrial	8.7	14.0	2.3	2.4	4.6
35.5	Services	4.8	7.6	6.2	4.8	6.6
21.0	Underlying services	5.9	8.9	4.8	5.8	7.0
36.8	IPCA-EX3	7.1	11.1	3.7	4.4	5.9
25.9	Regulated prices	16.9	-3.8	9.1	4.7	4.7
4.1	Electricity	21.2	-19.0	9.5	-0.4	5.7
5.0	Gasoline	47.5	-25.8	12.1	9.7	3.1

Source: IBGE, Itaú

2025 IPCA balance of risks



Source: IBGE, Itaú

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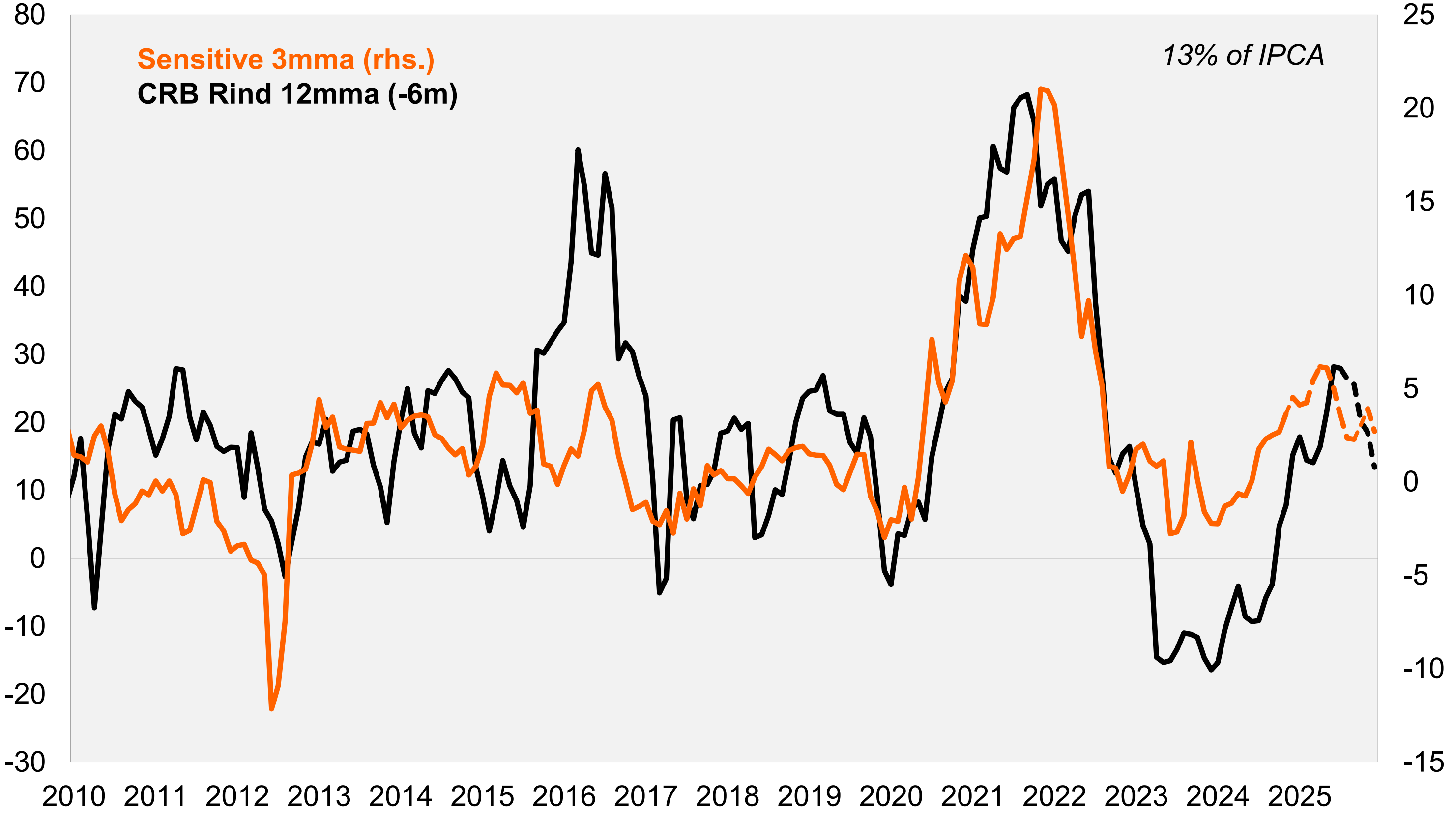
Inflation: another upward revision in estimates due to weaker BRL

7. Has BRL depreciation already impacted inflation or is the impact still coming? What is the timing?

- FX passthrough to the IPCA seems faster than usual (2 to 3 quarters). Items that are more sensitive to the exchange rate are already accelerating at the margin.
- We expect further acceleration in these prices, especially in 1Q25.

Industrial prices sensitive to CRB Rind* in BRL



Source: IBGE, Itaú

*CRB Rind: CRB Raw Industrials Commodity Index.

Selic: contractionary, for a long time

8. How big is the cycle and what are the risks? What pace should the Central Bank follow?

- A weaker BRL and unanchored expectations point to the need to move further into contractionary territory. **We expect the Selic rate to reach 15.75%pa** by the end of 1H25 (previously 15.00%) and remain at that level until the end of the year.
- **For 2026, we expect the benchmark rate to recede to 13.75%**, alleviating the restriction throughout the year.
- On the one hand, tighter monetary policy should have a deeper impact on the economy from 2Q25 onwards. On the other hand, BRL dynamics and inflation expectations will be key to determine the size of the cycle. If the BRL depreciates once again and/or expectations deteriorate further, one cannot rule out an extension of the cycle and, eventually, a postponement of rate cuts in 2026.

BRL	IPCA25	IPCA26	1Q25 BCB Forect. RH (3Q26)	2Q25 BCB Forect. RH (4Q26)	Necessary Selic to 1Q25 BCB Forect. RH (3Q26)	Necessary Selic to 2Q25 BCB Forect. RH (4Q26)
5.80	5.7	4.5	3.7	3.5	16.50	15.50
5.90	5.8	4.5	3.8	3.6	16.75	15.75
6.00	5.9	4.6	3.9	3.7	17.00	16.00
6.20	6.0	4.6	4.1	3.8	17.75	16.50
6.40	6.3	4.7	4.3	4.1	18.25	17.25

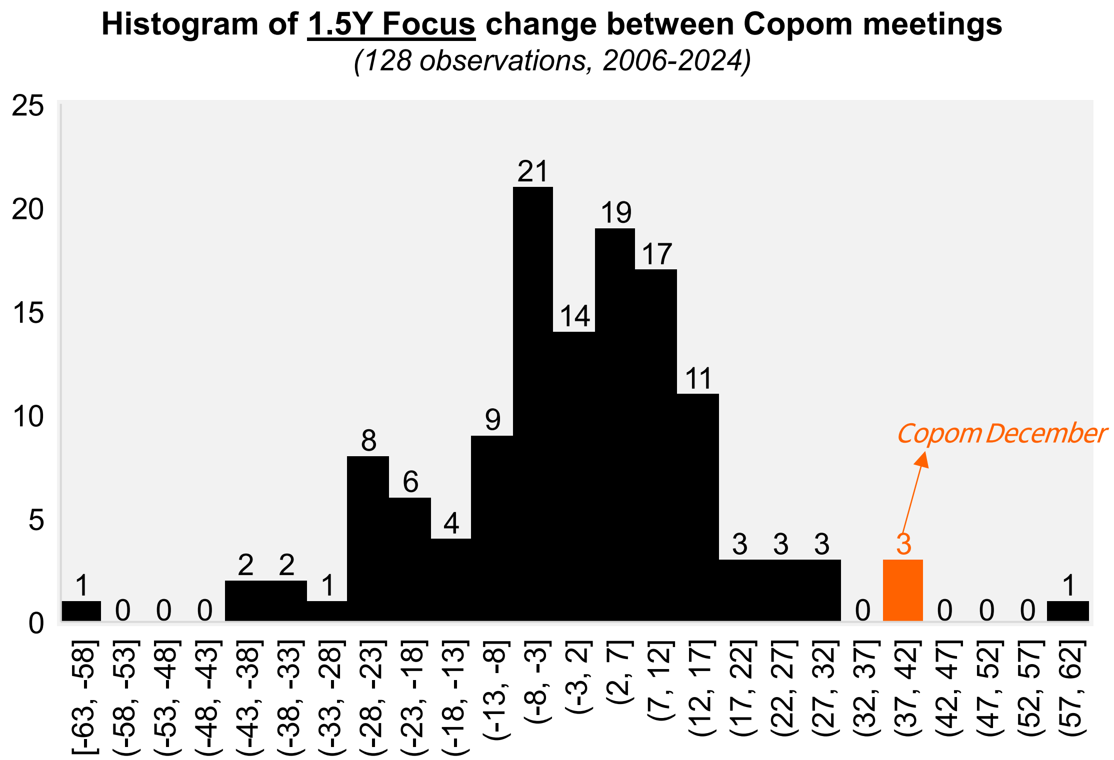
*RH: Relevant Horizon for Monetary Policy.

Source: IBGE, Itaú

Selic: contractionary, for a long time

8. How big is the cycle and what are the risks? What pace should the Central Bank follow?

- We expect two additional 100bp-increases, followed by two 75bp-hikes on the third and fourth meetings of the year.
- In the December meeting, Monetary Policy Committee members faced a significant deterioration in 18-month expectations* (+41bps between meetings), justifying a firmer stance by the Central Bank.
- Since the December meeting, expectations for the same horizon have worsened by more than 20bps. If this move continues, there is a risk that the Central Bank will not be able to reduce the pace of interest rate hikes in May.



* Relevant monetary policy horizon

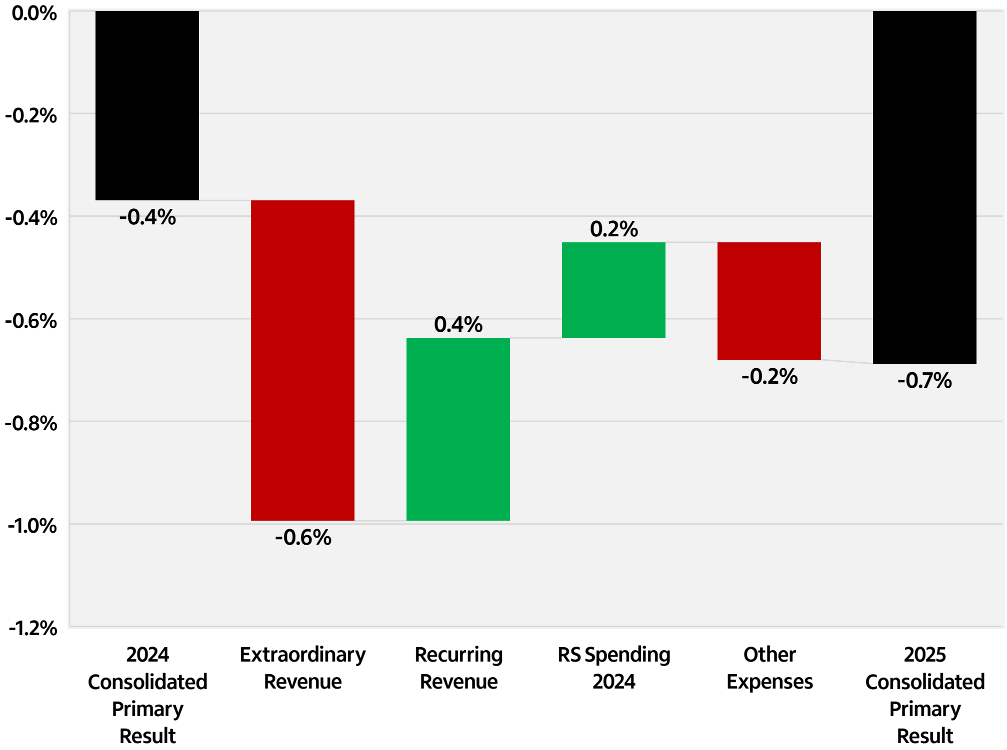
Source: IBGE, Itaú

Fiscal: persistent deficits, rising debt

9. Will the government meet the spending cap and the primary budget target?

- For now, we do not expect the primary budget target to be achieved in 2025 (we expect a deficit of 0.7% of GDP, considering 0.4% for the purposes of the target excluding court-ordered payments), although we recognize the possibility of a better result, given the resilience of economic activity and the government's continued efforts on the revenue agenda.
- We assume the spending cap will be respected, but the exact size of the challenge will depend mainly on the evolution of the number of beneficiaries of social aid programs.

Consolidated Primary Result 2025 x 2024



Source: IBGE, Itaú

Excess Spending vs Limit in 2025/26 (BRL bln)

% Beneficiaries 2025 (Social Security + BPC) \ % Beneficiaries 2026 (Social Security + BPC)	1.0%	2.0%	3.0%	3.3%	4.0%	4.9%	6.0%
1.0%	-24 / -21	-24 / -11	-24 / 0	-24 / 5	-24 / 10	-24 / 20	-24 / 31
2.0%	-13 / -8	-13 / 3	-13 / 13	-13 / 18	-13 / 24	-13 / 33	-13 / 45
3.0%	-2 / 5	-2 / 16	-2 / 26	-2 / 32	-2 / 37	-2 / 47	-2 / 58
3.3%	1 / 9	1 / 20	1 / 30	1 / 36	1 / 41	1 / 51	1 / 62
4.0%	9 / 18	9 / 29	9 / 40	9 / 45	9 / 51	9 / 61	9 / 72
4.9%	19 / 31	19 / 41	19 / 52	19 / 58	19 / 63	**19 / 73**	19 / 85
6.0%	31 / 45	31 / 56	31 / 67	31 / 72	31 / 78	31 / 88	31 / 99

Assumptions: BF = IPCA; health and education constant % GDP, other expenses real GDP/2

Scenario vs **current data**

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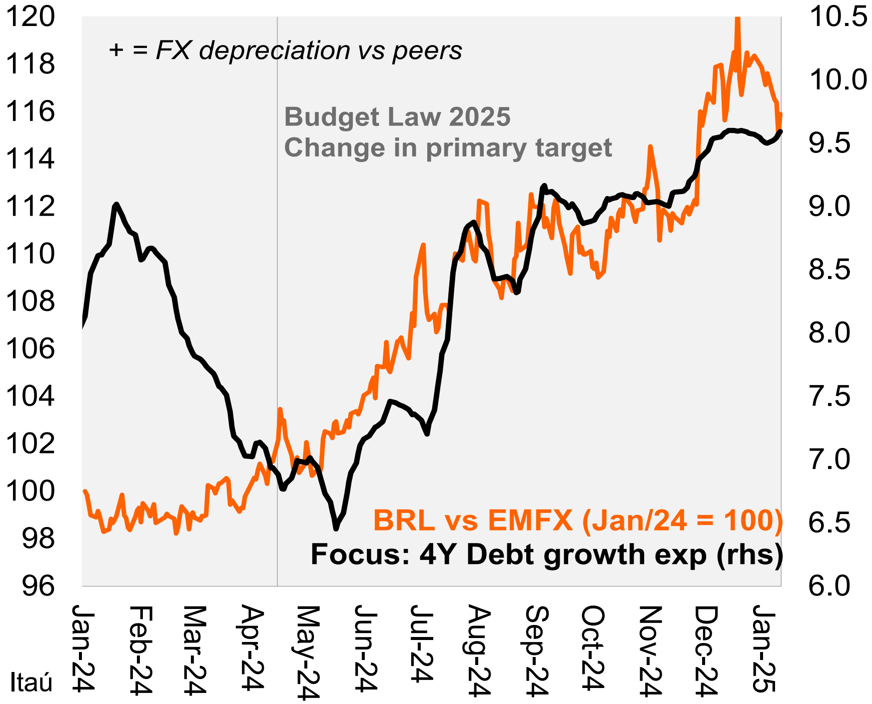
Fiscal: persistent deficits, rising debt

10. Is compliance with the framework in its current format sufficient to improve domestic risk perception?

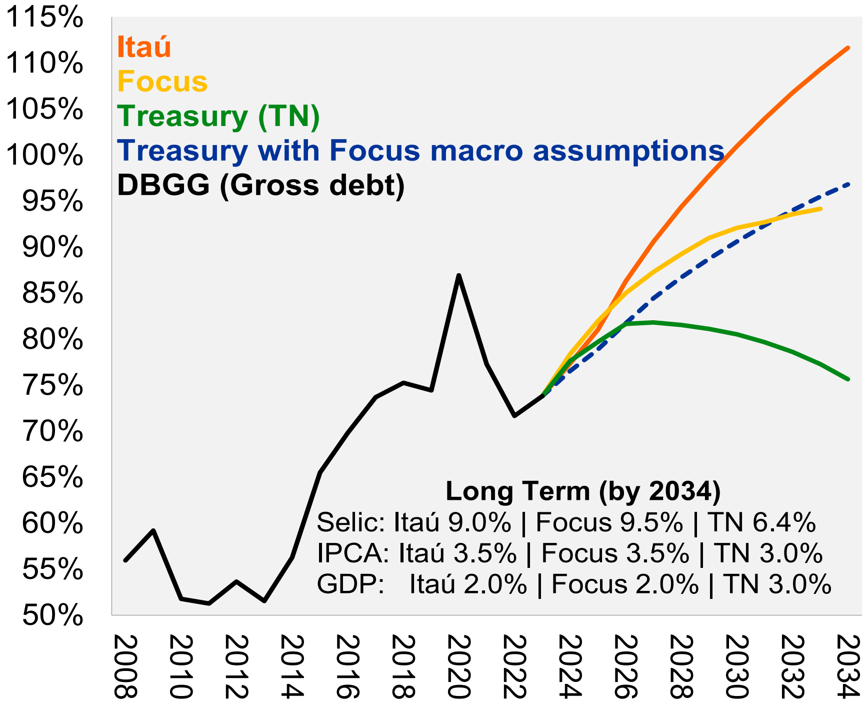
- Even if the fiscal framework strictly adhered to, its credibility in creating sustainable fiscal trajectories in the medium term has deteriorated significantly.
- The official National Treasury projections for public debt stabilization in the medium term are based on optimistic macroeconomic assumptions.
- A more consistent improvement in the risk premium and in domestic asset prices will only materialize with the outlook for a more balanced trajectory for public debt going forward.

BRL weakening more sharply than its EM peers amid worsening expectations for debt growth



Source: IBGE, Itaú

National Treasury's gross debt forecast is based on optimistic macro assumptions



BRAZIL | Forecasts

	2019	2020	2021	2022	2023	2024F		2025F		2026F	
						Current	Previous	Current	Previous	Current	Previous
Economic Activity											
Real GDP growth - %	1.2	-3.3	4.8	3.0	3.2	**3.6**	3.6	**2.2**	2.2	**1.5**	2.0
Nominal GDP - BRL bn	7,389	7,610	9,012	10,080	10,943	**11,830**	11,832	**12,808**	12,800	**13,669**	13,678
Nominal GDP - USD bn	1,872	1,475	1,670	1,951	2,192	**2,195**	2,202	**2,125**	2,210	**2,317**	2,400
Population (millions)	207.9	209.2	210.1	210.9	211.7	**212.6**	212.6	**213.4**	213.4	**214.2**	214.2
Per Capita GDP - USD	9,007	7,050	7,949	9,255	10,356	**10,326**	10,359	**9,958**	10,355	**10,816**	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**	6.6	**6.6**	6.6
Nation-wide Unemployment Rate - year end (*)	11.6	14.7	11.6	8.5	8.0	**6.5**	6.5	**6.8**	6.8	**7.3**	6.8
Inflation											
IPCA - %	4.3	4.5	10.1	5.8	4.6	4.8	-	**5.8**	5.0	**4.5**	4.3
IGP–M - %	7.3	23.1	17.8	5.5	-3.2	6.5	-	**6.6**	5.5	**4.3**	4.2
Interest Rate											
Selic - eop - %	4.50	2.00	9.25	13.75	11.75	12.25	-	**15.75**	15.00	**13.75**	13.00
Balance of Payments											
BRL / USD - eop	4.03	5.19	5.57	5.28	4.86	6.18	-	**5.90**	5.70	**5.90**	5.70
BRL / USD - average	3.95	5.16	5.40	5.17	5.00	5.39	-	**6.03**	5.79	**5.90**	5.70
Trade Balance - USD bn	35	50	61	62	99	75	-	**76**	67	**80**	69
Current Account - % GDP	-3.5	-1.7	-2.4	-2.1	-1.0	**-2.6**	-2.5	**-2.3**	-2.6	**-2.0**	-2.2
Direct Investment (liabilities) - % GDP	3.7	3.0	2.8	4.7	2.8	**3.2**	3.2	**4.0**	3.8	**4.0**	3.8
International Reserves - USD bn	367	356	362	325	355	330	-	**330**	370	**330**	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**	-0.7
Nominal Balance - % GDP	-5.8	-13.3	-4.3	-4.6	-8.8	**-7.9**	-7.9	**-9.2**	-9.0	**-9.9**	-9.5
Gross Public Debt - % GDP	74.4	86.9	77.3	71.7	73.8	**76.2**	77.1	**79.4**	80.1	**84.3**	84.5
Net Public Debt - % GDP	54.7	61.4	55.1	56.1	60.4	**62.0**	61.3	**67.0**	66.1	**72.7**	71.3
Growth of public spending (% real, pa, **)	2.3	29.2	-24.7	6.0	7.6	**3.5**	3.4	**2.6**	3.2	**2.8**	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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