Macro scenario - Brazil

April 12, 2024

Greater caution in a more challenging global environment

- We revised our GDP growth forecast to 2.3% in 2024 (from 2.0%) in light of stronger data at the beginning of the year that seems to be related to payment of court orders (*precatórios*) and real minimum wage increase. For 2025, in turn, we revised GDP growth to 1.8% (from 2.0%), reflecting the higher interest rate (see below).
- Tax revenues have been stronger at the beginning of 2024, but medium-term fiscal risks remain high, considering the difficulty in obtaining a trajectory of convergence of primary results and the possibility of changes in the parameters of the fiscal framework approved last year, too early in the game. We forecast primary deficits of 0.6% (previously 0.7%) and 0.9% of GDP in 2024 and 2025, respectively.
- We revised our exchange-rate forecasts to BRL 5.00 per U.S. dollar in 2024 (from 4.90) and to BRL 5.20 per U.S. dollar in 2025 (from 5.10). The increase in uncertainty, especially in the international scenario with the new postponement of the start of the easing cycle in the United States, pressures the currency (even though this effect is partially offset by a higher Selic rate).
- We revised our call for the IPCA consumer price index in 2024 to 3.7% (from 3.6%), with a less benign composition. We incorporated a higher forecast for underlying services inflation this year, pressured by a tighter labor market and accelerating wages. For 2025, we also revised our forecast. We expect inflation of 3.6% (3.5% previously) amid a scenario of unanchored long-term inflation expectations and still tight labor market.
- The more challenging global backdrop (slower disinflation, smaller and delayed easing cycle in developed economies) and domestic uncertainties (greater pressure on services prices, which are more sensitive to labor market conditions, and unanchored inflation expectations) will limit even more the room for monetary easing. We see, for now, the Selic benchmark rate reaching 9.75% pa by year-end (up from 9.25% in the previous report), with a slowdown in easing pace from June onwards, and remaining at the same level throughout 2025.

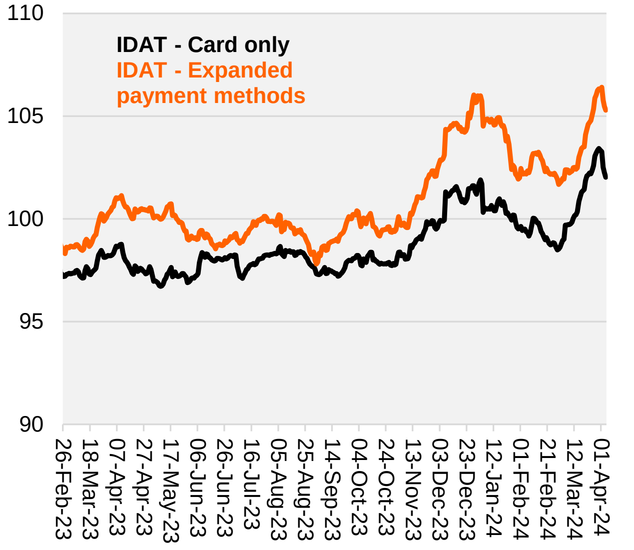
Strong activity in the first half of the year, again

We revised our GDP growth forecast to 2.3% (from 2.0%) in 2024, incorporating a more positive outlook for the first half of the year. Data from January and February, especially for the retail and services sectors, suggest the economy started the year at a strong pace. We believe that the surprise may be related to the additional payment of court orders (so-called *precatorios*) approved by the federal government in late 2023. Moreover, the anticipation of payments of regular court orders for 2024 and the real increase in the minimum wage granted at the beginning of this year should continue to boost consumption in the coming months. Our daily activity indicator (IDAT-Activity) is consistent with our expectation of positive economic performance in March (see chart).

For 2025, in turn, we revised GDP growth to 1.8% (from 2.0%). The GDP revision in 2024 reflects short-term surprises and one-off factors concentrated at the start of the year that are unlikely to occur in 2025. Furthermore, the outlook of a higher interest rate at the end of the easing cycle intensifies the negative impact of the monetary momentum on growth in 2025.

Finally, the job market remains resilient in the short term, in line with our scenario of a historically low unemployment rate of 7.8% in 2024. The latest data showed no signs of a slowdown, with expansion in formal employment and wages sustaining a robust pace in February. For 2025, we expect a slight increase in the unemployment rate (to 8.0%) with a slowdown in GDP growth.

Our daily IDAT-Activity indicator shows improvement in March



Source: Itaú

Fiscal risks remain high despite stronger tax revenues in early 2024

For 2024, we improved our deficit forecast to 0.6% of GDP (BRL 75 billion) from 0.7%. The reduction in the deficit is due to stronger revenues at the beginning of the year, which tends to be temporary and related to the increase in family income with the court orders payment. The result is still far from the zero-deficit target set by the government and even further from the surplus of at least 1.5% of GDP necessary to stabilize public debt. The balance of risks for the year is still favorable: activity may remain resilient and some additional extraordinary revenue measures with an impact restricted to 2024 may be implemented, such as greater revenues from state-owned companies (either via dividends or reduction in tax disputes), in addition to the possible recurring effect of the tax compensation limit, which we did not incorporate in our forecasts.

The main risks ahead are related to the difficulty in obtaining a persistent trajectory of convergence of primary results and the possibility of changes in the main parameters of the fiscal framework approved last year.

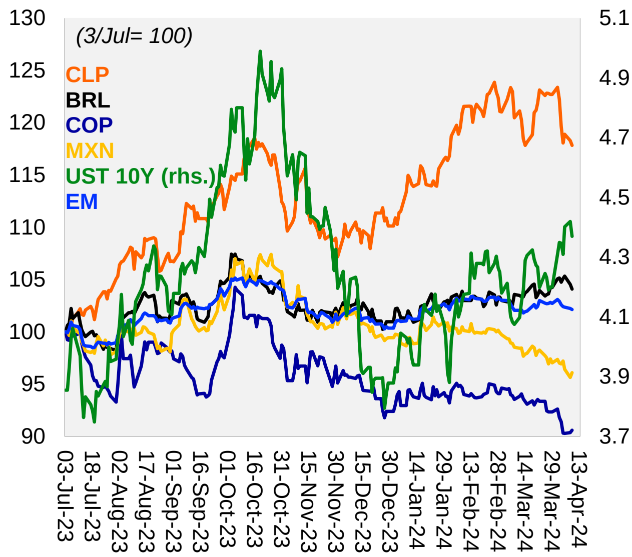
Our estimate for the deficit in 2025 remained at 0.9% of GDP (BRL 110 billion), worse than the result of 2024. We believe that there will be no changes in the key parameters of the fiscal framework, despite pressure to increase spending and too early discussions about changing the 0.5% surplus target. The deterioration in relation to 2024 reflects lower extraordinary revenues and our assumption that new revenue-boosting measures will not be approved.

We see gross debt increasing from 74% of GDP in 2023 to 77% of GDP in 2024 and 81% of GDP in 2025, respectively.

Slightly more depreciated BRL amid higher uncertainties

We revised our exchange-rate forecasts to BRL 5.00 per U.S. dollar in 2024 (from 4.90) and to BRL 5.20 per U.S. dollar in 2025 (from 5.10). The external fundamentals are becoming more challenging and lean towards greater pressure on the currency, with the strong-dollar scenario maintained and postponement of the easing cycle in the United States, even if it is partially offset by a higher Selic rate. Domestic mitigating factors still support the currency – particularly the good trade balance performance, notwithstanding the signs of a slowdown at the margin, and the fact that the domestic risk premium remains at historically low post-pandemic levels.

BRL slightly underperforming peers at the margin



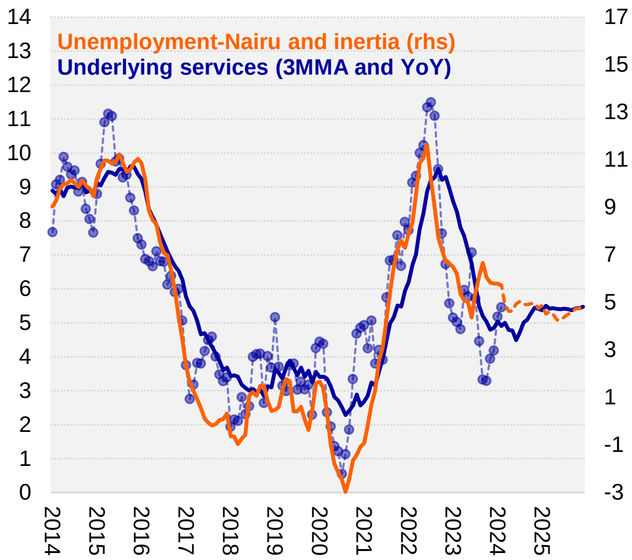
Source: BBG, Itaú

Our estimates for the trade surplus remain at USD 85 billion in 2024 and USD 70 billion in 2025. Trade balance figures remain at robust levels, running close to USD 100 billion over 12 months, but we see indications of weaker momentum at the margin, particularly rising imports led by capital and consumer goods. Starting in May, exports will be boosted by the soybean crop – smaller than last year but still historically high. For the current account, we forecast deficits of USD 14 billion in 2024 and USD 23 billion in 2025.

Upward inflation revision with worse composition

We revised our call for inflation in 2024 to 3.7% (from 3.6%), with a worse composition in the form of worse dynamics for underlying services. The fundamentals for services inflation (job market and wage hikes) suggest upward pressure on this group. Notwithstanding the outlier nature of part of the deterioration in underlying services (related to banking services), labor-intensive services should remain under pressure throughout the year. The risks for our 2024 forecast are balanced. The tight labor market could translate into underlying services inflation near 6% (vs. our nearly 5.5% forecast). On the other hand, the increase in Eletrobras' contribution to eliminate the Covid and water scarcity accounts is a downside risk to our call.

Underlying services prices pressured by labor market dynamics



Nairu 10% until dec/17 and 9% from 2018

Source: Itaú

For 2025, we continue to forecast inflation above the target, at 3.6% (3.5% previously), given the unanchored long-term inflation expectations and still tight labor market. Importantly, the balance of risks for 2025 is tilted to the upside, considering the tight labor market, persistent inflation in services prices, and the possibility of the La Niña weather pattern extending throughout 2025, affecting both food and energy prices. This also implies a certain degree of asymmetry for monetary policy options.

A more cautious Central Bank in terms of pace and terminal rate

The Brazilian Central Bank's Monetary Policy Committee (Copom) sustained the pace of rate cuts (50 bps) at the March meeting and correctly decided to shorten its forward guidance as the environment became more uncertain, signaling another 50-bp move only in the next meeting (and not in the next meetings, as was the case before). Even though risks increased, the Copom stated that its inflation and activity scenario had not changed materially and maintained its inflation projection for 2025 (the main focus in the relevant horizon) above the target, at 3.2%.

Amid escalating uncertainties domestically and a more challenging environment abroad, a more cautious stance by the Central Bank is appropriate. Abroad, the disinflation trajectory in developed economies has proven erratic and the start of interest-rate cuts has been postponed. This situation tends to impact the exchange rate. Domestically, wage increases continue to outpace inflation, services inflation (especially in items more linked to the labor market and wage dynamics) has been under more pressure at the margin, and inflation expectations have been above the target for a few quarters.

Considering such increase in risks, we now expect a higher Selic rate at the end of the cycle, at 9.75% (vs. 9.25% previously), as well as a reduction in the pace of monetary easing from June onwards. We expect the Selic rate to remain at the same level throughout 2025, trusting that the monetary authority will remain faithful to its commitment to bring inflation to the target. We recognize, however, that given the upward risks for inflation in 2025, it may be necessary for the monetary authority to end this cycle even earlier.

Brazil | Forecasts and Data

	2019	2020	2021	2022	2023	2024F		2025F	
						Current	Previous	Current	Previous
Economic Activity									
Real GDP growth - %	1.2	-3.3	4.8	3.0	2.9	**2.3**	2.0	**1.8**	2.0
Nominal GDP - BRL bn	7,389	7,610	9,012	10,080	10,856	**11,533**	11,535	**12,187**	12,225
Nominal GDP - USD bn	1,872	1,475	1,670	1,951	2,175	**2,312**	2,340	**2,386**	2,441
Population (millions)	210.1	211.8	213.3	214.8	216.3	**217.7**	217.7	**219.0**	219.0
Per Capita GDP - USD	8,910	6,964	7,830	9,084	10,055	**10,619**	10,749	**10,892**	11,145
Nation-wide Unemployment Rate - year avg (*)	12.0	13.8	13.2	9.3	8.0	**7.8**	8.0	**8.0**	8.0
Nation-wide Unemployment Rate - year end (*)	11.6	14.7	11.6	8.5	8.0	**7.8**	7.8	**8.0**	7.8
Inflation									
IPCA - %	4.3	4.5	10.1	5.8	4.6	**3.7**	3.6	**3.6**	3.5
IGP–M - %	7.3	23.1	17.8	5.5	-3.2	**1.9**	2.8	**3.0**	2.9
Interest Rate									
Selic - eop - %	4.50	2.00	9.25	13.75	11.75	**9.75**	9.25	**9.75**	9.25
Balance of Payments									
BRL / USD - eop	4.03	5.19	5.57	5.28	4.86	**5.00**	4.90	**5.20**	5.10
BRL / USD - average	3.95	5.16	5.40	5.17	5.00	**4.99**	4.90	**5.11**	5.00
Trade Balance - USD bn	35	50	61	62	99	**85**	85	**70**	70
Current Account - % GDP	-3.6	-1.9	-2.8	-2.5	-1.3	**-0.6**	-0.6	**-1.0**	-0.9
Direct Investment (liabilities) - % GDP	3.7	3.0	2.8	4.7	2.9	**3.0**	3.0	**3.6**	3.5
International Reserves - USD bn	367	356	362	325	355	**340**	340	**360**	360
Public Finances									
Primary Balance - % GDP	-0.8	-9.2	0.7	1.2	-2.3	**-0.6**	-0.7	**-0.9**	-0.9
Nominal Balance - % GDP	-5.8	-13.3	-4.3	-4.6	-8.9	**-7.0**	-7.0	**-7.2**	-7.1
Gross Public Debt - % GDP	74.4	86.9	77.3	71.7	74.4	**77.2**	77.1	**80.6**	80.2
Net Public Debt - % GDP	54.7	61.4	55.1	56.1	60.9	**64.0**	64.3	**67.3**	67.3

Source: IBGE, FGV, BCB and Itaú

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

(**) We await the release of the complete statistics of the demographic census of 2022 by IBGE. Thus, we have not yet incorporated the estimate of 203.1 million inhabitants in 2022.

Macro Research – Itaú

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