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Scenarios Brazil 2025 and 2026

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125 120 115 110 105 100 95 90 85 2019 2020 2021 2022 2023 2024 2025 2026

Figure 1: GDP Index SA and BOCOM BBM Forecasts (2019Q4 = 100)

Source: BOCOM BBM, IBGE

Industry =

-Services ----GDP

Agriculture and Livestock

On the monetary front, the second stage of the disinflation process has been far more challenging, with little progress this year. Inflation, which reached 4.6% in 2023, is set to end the year close to 5%. The Central Bank of Brazil has embarked on a cycle of rate hikes. We expect its policy rate (Selic) to reach 12.5% by December and stay unchanged until end-2025. We see room for rate cuts in 2026, as the economy slows down and labor market conditions become somewhat looser. Our projection for the year-end Selic in 2026 is 10.5% (Figure 2).

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20,0% **BOCOM BBM** 17,5% **Forecast** 15,0% 13.8% 11,8% 12,50% 10,1% 12,5% 10,5% 10,0% 7,1% 6,9% 8,2% 6,5% 7,5% 5,8% 4,6% 5,0% 4,9% 4,3% 4,0% 2,5% 0,0% -0,8% -2,5% -5,0% 2017 2018 2020 2021 2022 2023 2024 2025 2026 -CPI Selic - Real rate

Figure 2: CPI, Selic Rate and Real Ex-post Interest Rate (YoY, %)

Source: BOCOM BBM, BCB, IBGE

However, monetary tightening and the resulting economic slowdown will not be sufficient to drive inflation down to the 3% target in the coming years. Inflationary pressures at the end of this year – deriving from local currency depreciation and climate factors – will fuel inertia in 2025, in an environment in which inflation expectations are deanchored. In the absence of a more structural fiscal adjustment, such as limiting the growth of mandatory spending, the convergence of expectations and inflation to the target for the relevant horizon will become less probable. We project 4.3% inflation measured by the IPCA in 2025, and 4.0% in 2026.

Possible compliance with the fiscal framework this year does not eliminate the fiscal risks for the years ahead, especially if parafiscal policies are used to circumvent the spending cap. Considering that expenditure is rising faster than revenue, we expect deficits in the vicinity of 1% of GDP in the next two years, with gross debt rising to 86.7% of GDP in 2026, for growth of 15 percentage points in the four years of the incumbent administration (Figure 3).

The relatively comfortable balance of payments situation has mitigated exchangerate fluctuation due to the recent fiscal deterioration. After a period of low currentaccount deficits, this year's deficit is set to reach about 2.5% of GDP, and we project deficits of 2% or thereabouts in 2025 and 2026. Foreign direct investment (FDI) will remain more than sufficient to cover these deficits.

88% 86,9% **.**86,7% 86% 84% 82,1% 82% 80% 78% 77,3% 77,4% 75,3% 76% 74,4% 74,4% 74% 73,7% 72% 71,7% 70% 2018 2017 2019 2022 2025 2026 2020 2023 2024 2021

Figure 3: Gross Debt to GDP ratio

Source: BOCOM BBM, Macrobond, World Bank

The economic slowdown foreseen for 2025 is a consequence of the ongoing monetary tightening, and of a more moderate fiscal impulse than that seen in previous years, but it is likely to be gradual. The economy's fundamentals remain sound, and Brazil is still well-positioned for growth. The drivers of this growth are: the labor market, which is dynamic; agriculture, with another record grain crop forecast for next year; expansion of oil production capacity; and corporate balance sheets, which are strong after years of growing consumption and disinflation. Nevertheless, significant uncertainties persist on the domestic and foreign fronts. In the latter case, they include geopolitical conflicts, China's economic slowdown, and monetary policy and economic performance in the United States, where the results of the presidential and congressional elections will magnify market volatility.

Our projections for the main economic variables in 2025 and 2026 are shown in the table below.

ECONOMIC FORECASTS	2020	2021	2022	2023	2024F	2025F	2026F
GDP Growth (%)	-3.3%	4.8%	2.9%	2.9%	3.1%	2.0%	2.0%
Inflation (%)	4.5%	10.1%	5.8%	4.6%	4.9%	4.3%	4.0%
Unemployment Rate (eoy ,%)	14.2%	11.1%	7.9%	7.4%	6.3%	7.0%	7.5%
Policy Rate (eoy, %)	2.0%	9.3%	13.8%	11.75%	11.75%	12.50%	10.50%
External Accounts							
Trade Balance (US\$ bn)	32	36	44	92	72	77	86
Current Account Balance (US\$ bn)	-28	-46	-48	-31	-51	-49	-46
Current Account Balance (% of GDP)	-1.9%	-2.8%	-2.5%	-1.3%	-2.4%	-2.2%	-2.0%
Fiscal Policy							
Central Government Primary Balance (% of GDP)	-9.8%	-0.4%	0.5%	-2.1%	-0.5%	-0.8%	-0.8%
Government Gross Debt (% of GDP)	86.9%	77.3%	71.7%	74.4%	77.4%	82.1%	86.7%

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