

## Macro Monthly Letter

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# Materialization of Risks for the Prospective Scenario

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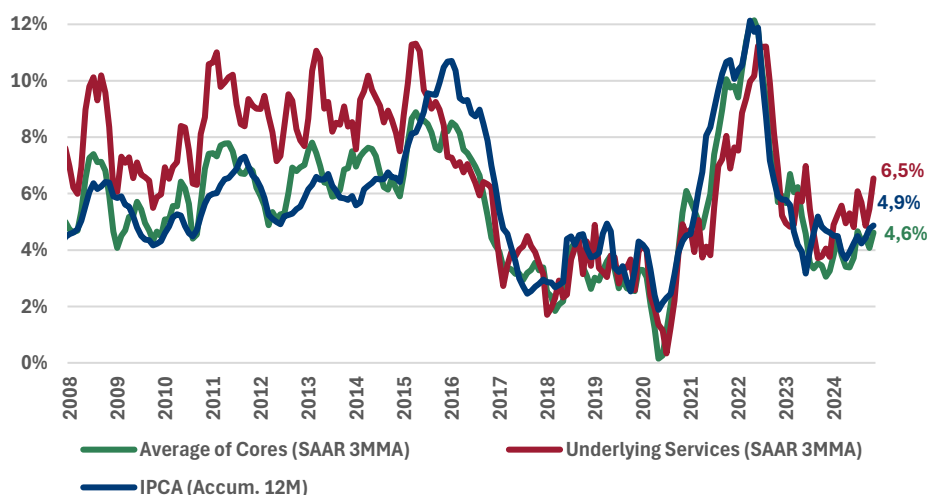
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In a little over a month, the materialization of risks has made the scenario for 2025 and 2026 more challenging. Economic agents' perception of the fiscal package – which fell short of what was needed overall – significantly affected asset prices, the exchange rate, and inflation expectations. In addition, economic activity was more dynamic than expected, as evidenced by the labor market data and third-quarter GDP growth (announced in early December).

Turning to more recent data, the headline and underlying inflation readings rose to levels close to the top of the target band (Figure 1), showing that the short-term inflation outlook has also deteriorated. We have revised up our inflation forecasts for 2025 and 2026 to 5.5% and 4.5% respectively, as the lagging effects of monetary policy on inflation will tend to become visible only during 2026. These recent developments require an even more restrictive monetary policy to drive inflation toward the target.

**Figure 1: Inflation**



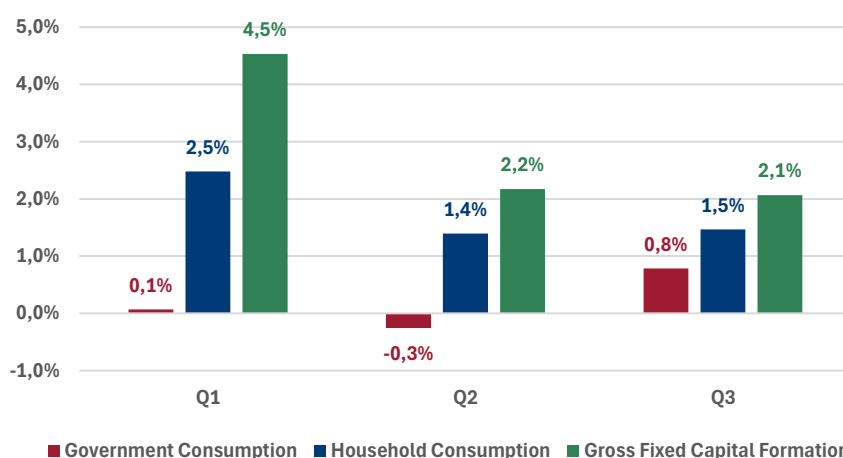
Source: BOCOM BBM, IBGE, BCB

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At its last monetary policy meeting in 2024, the Central Bank of Brazil stepped up the pace of tightening, raising its policy rate (Selic) by 100 basis points and indicating that at least two more hikes of 100 bps are likely at forthcoming meetings. This means the Selic is set to reach 14.25% p.a. in March 2025. In fact, we expect it to reach at least 15% and remain at that level until the end of the year.

With regard to economic activity, we project GDP growth of slightly more than 3.5% in 2024. This dynamism reflects the tight labor market, the fiscal impulse, and robust credit and capital markets. All these factors assure support for domestic demand despite high interest rates (Figure 2).

**Figure 2: GDP 2024 – Domestic Demand (QoQ)**

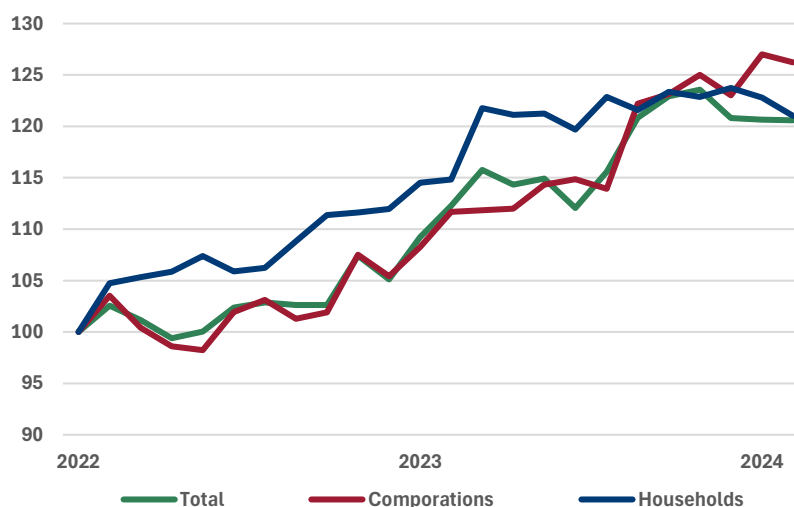


Source: BOCOM BBM, IBGE

The economy performed well in 2024 but the prospective scenario is challenging. On one hand, while monetary policy remains contractionary, local currency depreciation continues and inflation is accelerating. On the other, job creation, lending, and the capital market bull run are still strong (Figure 3), although a slowdown is expected. The significant tightening of financial conditions associated with the loss of fiscal credibility points to an adverse outlook for the credit market, aggravating the risk of a sharp economic slowdown in 2025 and 2026.

Even if the central government primary balance target (0% of GDP) is achieved in 2024, the perception of fiscal risk has increased significantly in the last few weeks. Besides the presentation of a fiscal package that was not sufficient to contain the growth of mandatory expenditure, its announcement was linked to a promise to raise the income tax threshold to BRL 5,000 per month, potentially exempting the vast majority of Brazilians from paying the tax and increasing the likelihood of continuous growth of the public debt in the years ahead.

**Figure 3: Non earmarked New Credit Operations Seasonally adjusted (Dec/22=100)**



Source: BOCOM BBM, BCB

Our prospective scenario envisages an economic slowdown, above-target inflation, high real interest rates, and an increase in the public debt. Unless the government shows signs of implementing a credible fiscal adjustment, monetary policy on its own will not be sufficient to realign expectations and support local currency appreciation.

ECONOMIC FORECASTS		2019	2020	2021	2022	2023	2024F	2025F	2026F
GDP Growth (%)		1.2%	-3.3%	4.8%	3.0%	2.9%	3.6%	2.2%	1.3%
Inflation (%)		4.3%	4.5%	10.1%	5.8%	4.6%	4.9%	5.5%	4.5%
Unemployment Rate (eoy, %)		11.1%	14.2%	11.1%	7.9%	7.4%	6.3%	7.0%	7.5%
Policy Rate (eoy, %)		4.5%	2.0%	9.3%	13.8%	11.75%	12.3%	15.0%	11.0%
External Accounts									
Trade Balance (US\$ bn)		27	32	36	44	92	67	77	86
Current Account Balance (US\$ bn)		-68	-28	-46	-48	-31	-56	-49	-46
Current Account Balance (% of GDP)		-3.6%	-1.9%	-2.8%	-2.5%	-1.3%	-2.5%	-2.2%	-2.0%
Fiscal Policy									
Central Government Primary Balance (% of GDP)		-1.3%	-9.8%	-0.4%	0.5%	-2.1%	-0.4%	-0.7%	-0.9%
Government Gross Debt (% of GDP)		74.4%	86.9%	77.3%	71.7%	74.4%	77.7%	82.9%	88.4%

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