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Opportunities for Brazil in the global context

Cecilia Machado
Chief Economist

Luana Miranda
Senior Economist

Felipe Estima
Analyst

Eduardo Affonso
Intern

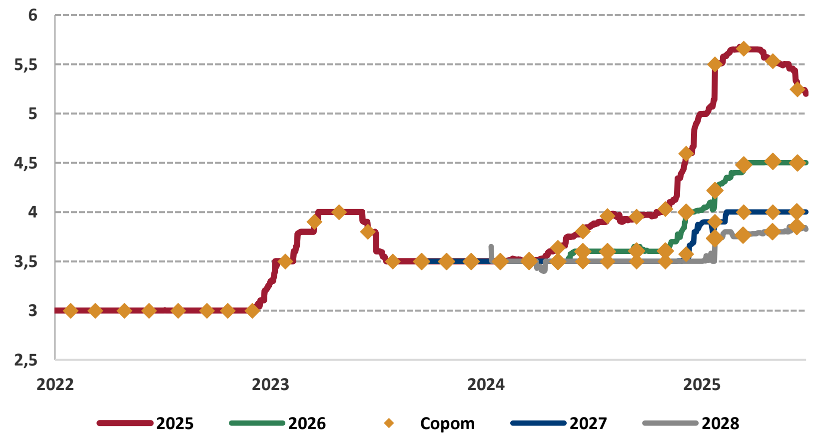
João Alonso
Intern

Maria Braun
Intern

Despite the ongoing process of monetary tightening, the Brazilian economy remains resilient, and GDP growth could exceed market expectations for the fifth year running. The strong performance of commodity-producing sectors, combined with only slow deceleration of the more cyclical sectors, should assure growth of over 2% this year.

Moreover, the inflation outlook has improved, although more inertial measures such as the core rates are still running at high levels. The latest IPCA readings were lower than expected, and this, as well as local currency appreciation, has contributed to downward revisions of our projections for this year (Figure 1).

Figure 1: Focus – Median Inflation Expectations



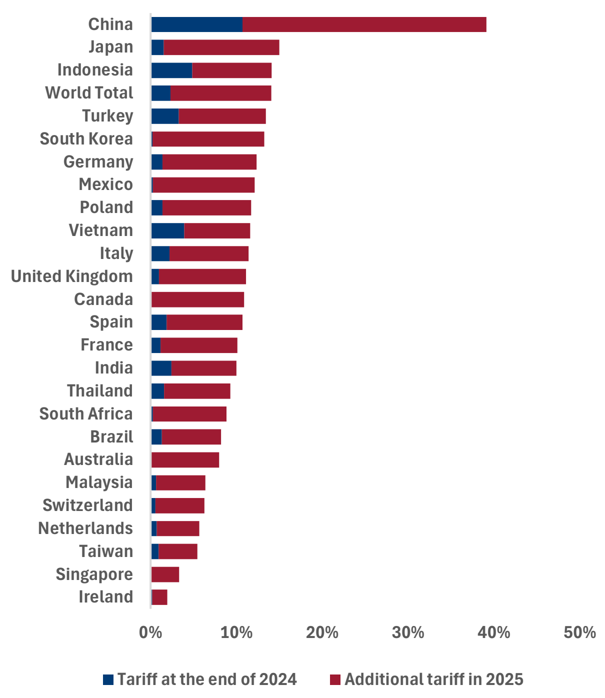
Source: BOCOM BBM, BCB

Even with the high level of uncertainty about the new direction of US economic policy, the international environment has fueled disinflation. The introduction of high tariffs means slower global growth. At the same time, Chinese manufactured goods have been redirected to other countries in response to the tariffs, helping to reduce prices of industrial goods via the advent of cheaper imports to domestic markets, as has been happening in Brazil.

Brazil also occupies a more favorable position than other countries in this new trade war, given that the effective tariffs on products exported by Brazil are among the lowest (Figure 2). This price advantage could benefit some Brazilian sectors through trade substitution, helping Brazilian exports increase their market share in the US.

Brazilian commodity producers can also supply markets lost by the US owing to retaliation by trading partners such as China.

Figure 2: US – Effective Tariff by Country



Source: BOCOM BBM, Fitch

Finally, there are many questions about the US dollar's predominance in international trade and financial transactions. The US is set to display ever higher fiscal and current-account deficits, with a growing debt trajectory and the absence of an effective plan to control growth of its national debt.

The "One Big Beautiful Bill" currently being debated in the Senate will tend to make the fiscal outlook worse and could also tax foreign capital by up to 20%. These factors will encourage diversification and a search for new investment opportunities outside the US, opening up a window of opportunity for Brazil to attract more foreign direct investment.

Turning to the domestic outlook, the high levels of nominal and real interest rates in Brazil are attractive to international investors who seek diversification, especially when Brazil is compared to other countries around the world (Figure 3). It is also important to note that Brazil is not involved in any of the wars or military conflicts in progress worldwide. On the downside, the unsustainability of Brazil's finances remains a major risk, requiring significant structural reforms that the government currently rejects. This refusal of much needed reforms will be put to the test in next year's general elections.

Figure 3: Brazil – Ex-ante Real Interest Rate

Source: BOCOM BBM, BCB, Bloomberg

ECONOMIC FORECASTS	2020	2021	2022	2023	2024	2025F	2026F
GDP Growth (%)	-3.3%	4.8%	3.0%	2.9%	3.4%	2.3%	1.5%
Inflation (%)	4.5%	10.1%	5.8%	4.6%	4.8%	5.1%	4.1%
Unemployment Rate (eoy ,%)	14.2%	11.1%	7.9%	7.4%	6.2%	6.8%	7.5%
Policy Rate (eoy, %)	2.0%	9.3%	13.8%	11.75%	12.3%	15.00%	12.0%
External Accounts							
Trade Balance (US$ bn)	36	42	52	92	66	62	73
Current Account Balance (US$ bn)	-25	-40	-42	-28	-61	-65	-55
Current Account Balance (% of GDP)	-1.7%	-2.4%	-2.2%	-1.3%	-2.8%	3.0%	-2.4%
Fiscal Policy							
Central Government Primary Balance (% of GDP)	-9.8%	-0.4%	0.5%	-2.1%	-0.4%	-0.7%	-0.6%
Government Gross Debt (% of GDP)	86.9%	77.3%	71.7%	74.4%	76.1%	80.5%	85.3%