

Macro Monthly Letter

September 2025

Challenges of economic rebalancing in Brazil

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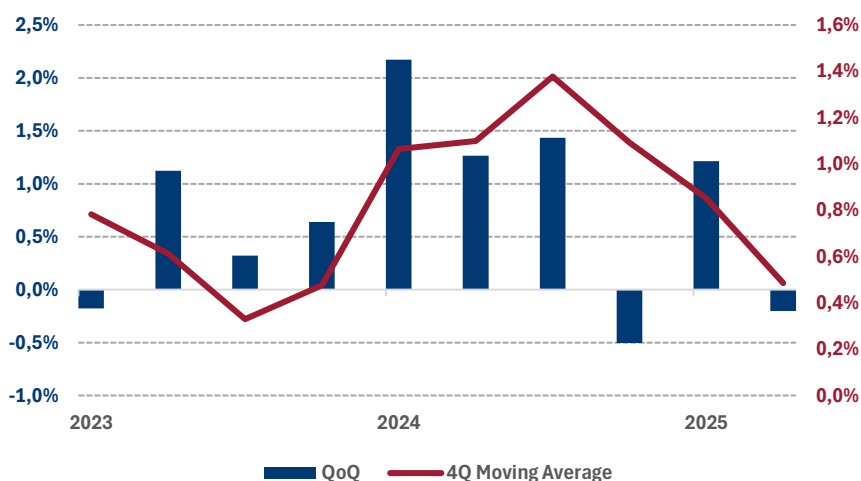
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Brazil's economic growth has significantly surpassed expectations – and probably its potential – in the last four years, while inflation has remained above the target. Monetary policy remained in restrictive territory throughout the period and should have been capable of rebalancing the economy faster. While the necessary adjustments have not materialized, there are signs that deceleration is under way.

The second-quarter GDP data just published shows a sharp fall in the growth rate to 0.4% (seasonally adjusted), down from 1.3% in the first quarter. Mining and other sectors less sensitive to the business cycle displayed the strongest growth, alongside the resilience of the service sector, while sectors more reliant on credit such as manufacturing and construction were the negative highlights. The drop of 0.2% in domestic absorption following growth of 1.2% in the first quarter (Figure 1) is the clearest indication that demand is losing dynamism.

Figure 1: Domestic Absorption

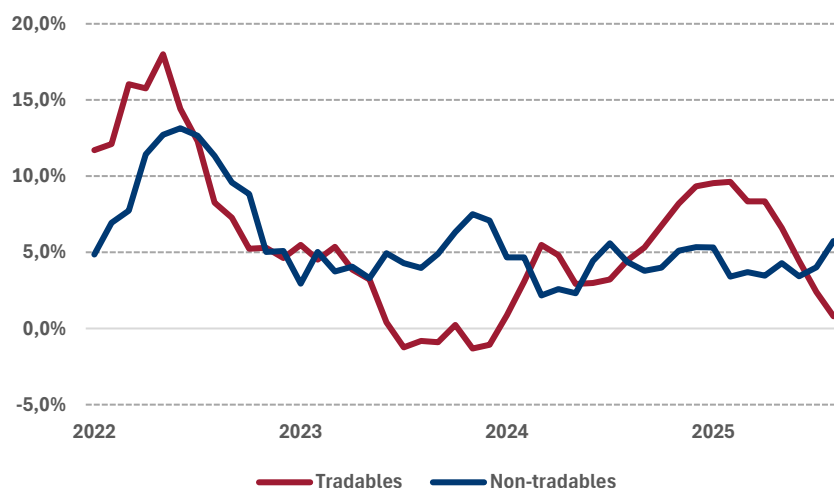


Source: BOCOM BBM, IBGE

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Current inflation also showed signs of relief, although with key differences among sectors (Figure 2). Prices of labor-intensive services and food away from home, which correlate closely with household income, remained under pressure, while prices of tradables such as food and industrial goods continued to fall steadily, thanks to local currency appreciation and weaker demand for durables in response to the high cost of credit.

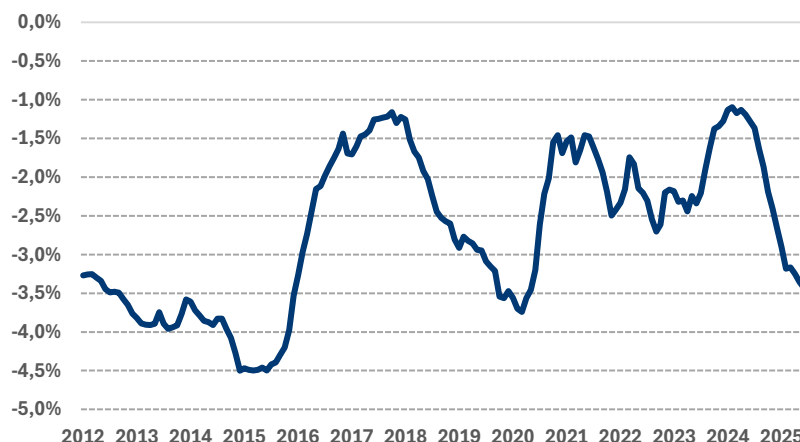
Figure 2: Inflation (SAAR 3MMA)



Source: BOCOM BBM, IBGE

The resilience of the economy came partly from the performance of the labor market, which sustained consumption of services. The number of people in paid work has risen continuously, according to the National Household Sample Survey (PNAD) conducted by IBGE, and this in turn no doubt explains real growth of 6.7% in household income in the 12 months to June. Net job creation became weaker than forecast toward the end of the first half, however, and wage growth in the formal market began to moderate, according to the Ministry of Labor's CAGED report.

The balance of payments also points to a slow rebalancing of the economy. It has worsened since July 2024, limiting appreciation of the BRL against the USD. The current-account deficit to GDP ratio rose 2 percentage points in the period (Figure 3). Foreign direct investment (FDI) held steady as a 12-month total on about USD 70 billion, but other foreign flows remained weak, while Brazilian investment abroad rose significantly in the first half of 2025. The combination of a large current-deficit and a higher outflow of domestic capital without significant FDI growth translates as a large net outflow of dollars.

Figure 3: Current Account Balance (%GDP)


Source: BOCOM BBM, BCB

Although the increase in the current-account deficit may be mitigated to some extent by the weakening of domestic demand, this improvement will be limited by structural factors in the deficit, such as growth in consumption of streaming and data processing services. In this respect, a sustained improvement in the inflow of dollars to Brazil will depend largely on expectations as to the direction of economic policy after 2026.

ECONOMIC FORECASTS	2020	2021	2022	2023	2024	2025F	2026F
GDP Growth (%)	-3.3%	4.8%	3.0%	2.9%	3.4%	2.0%	1.5%
Inflation (%)	4.5%	10.1%	5.8%	4.6%	4.8%	4.7%	4.0%
Unemployment Rate (eoy, %)	14.2%	11.1%	7.9%	7.4%	6.2%	6.5%	7.0%
Policy Rate (eoy, %)	2.0%	9.3%	13.8%	11.75%	12.3%	14.50%	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%	-0.5%	-0.7%
Government Gross Debt (% of GDP)	86.9%	77.3%	71.7%	74.4%	76.1%	80.3%	85.1%

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