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Brazil: Economic Outlook for 2026 and 2027

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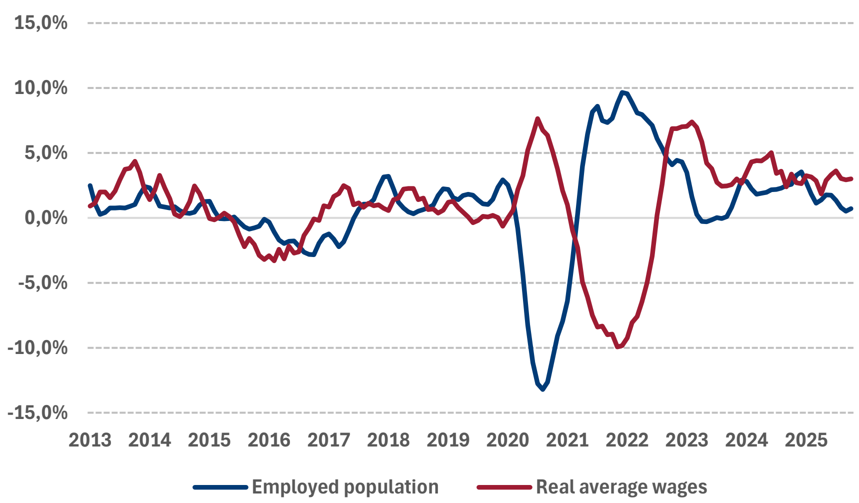
The year 2025 was marked by dualities in the economy. Inflation converged into the tolerance band of the target even though economic activity remained resilient and the labor market displayed dynamism. On one hand, (para)fiscal and credit stimulus policies sustained growth while also contributing to expansion of the current-account deficit and helping to deteriorate the nation's finances, with gross government debt (GGD) rising to about 80% of GDP. On the other, the Central Bank hiked its policy rate (Selic) to the highest level since 2006 in an effort to lower inflation.

The significant monetary tightening implemented throughout the year began recently to yield more evident effects: GDP growth slowed in the second half, the labor market cooled somewhat (Figure 1) – with the number of people in paid work falling while real wages leveled off – and inflation converged closer to the target. This dynamic is expected to continue in 2026 and should make the start of a monetary easing cycle possible in the first quarter. In our scenario, the Selic reaches 12.5% p.a. at year-end, with inflation on 4%, but the actual size and pace of the cycle will also depend partly on how the electoral dispute unfolds and its effects on fiscal dynamics and the exchange rate.

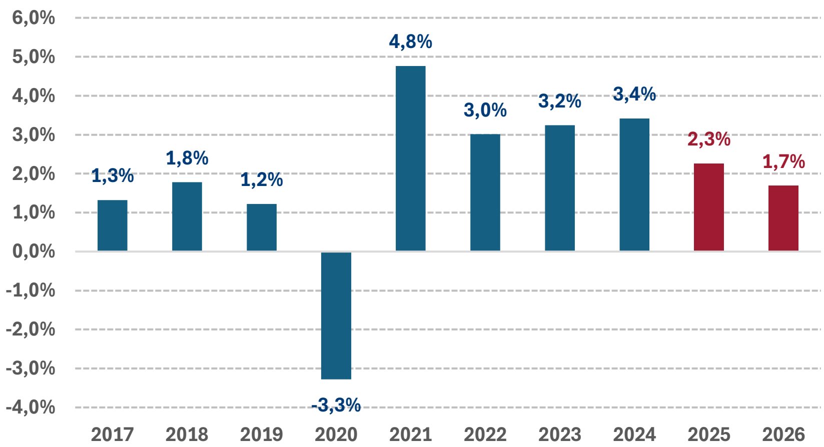
Figure 1: Employment and Real average wages (YoY)



Source: BOCOM BBM, IBGE

There is much uncertainty about the effects of the several fiscal, parafiscal and credit policies that will take effect in 2026. They include income tax exemption for a large proportion of the population, a rise in the volume of payday loans to workers in the private sector, a program called Pé-de-Meia offering low-income teenagers cash incentives to complete high school, free cooking gas and electricity for poor families, home improvement credit, and extension of the Minha Casa Minha Vida social housing program to middle-class households ("Tier 4"). The list is long and may become longer during the election campaign, limiting the economic slowdown. We project 1.7% GDP growth in 2026 (Figure 2). Less expansionary effects of these measures could limit GDP growth to 1%, while more increases in spending could lead to a higher growth rate than we are currently forecasting.

Figure 2: Annual GDP growth and Forecasts



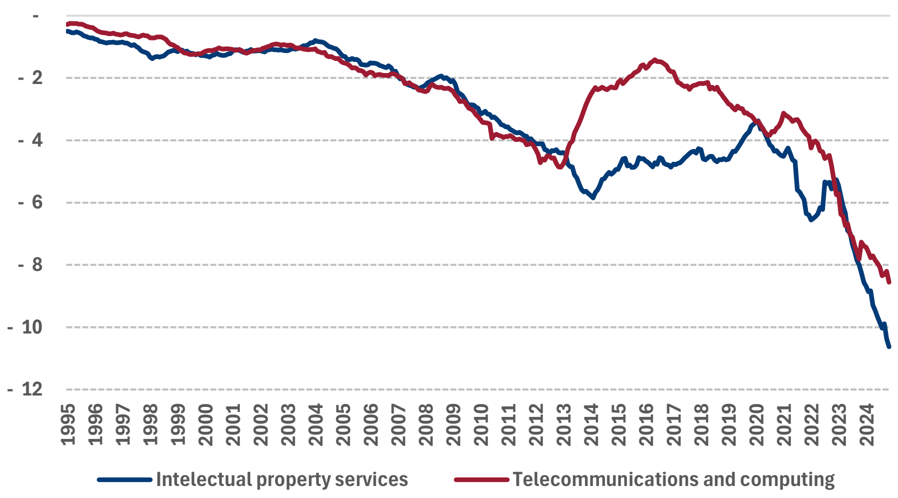
Source: BOCOM BBM, IBGE

Nevertheless, we expect the government to meet the fiscal target this year and next (with deficits of 0.5% and 0.4% of GDP respectively), since most of the stimulus policies implemented have no primary impact, even though they boost GGD, which is set to rise to 84.1% of GDP in 2026.

With regard to the balance of payments, the deterioration seen this year in the current-account deficit was mainly cyclical, with strong domestic demand driving up imports of goods and services, but digitalization of the economy has fueled demand for services supplied by other countries, especially in IT, computing and intellectual property, and this will reduce the current-account deficit more structurally from now on (Figure 3). In 2026, we expect a reduction in the current-account deficit (from -3.6% of GDP this year to -2.7% in 2026) thanks to expansion of the merchandise trade surplus and a cyclical decline in demand for services.

Looking ahead to 2027, there is more uncertainty than usual because a new federal administration will take office at the start of the year and it may or may not want to engineer the fiscal reforms needed to contain GGD growth. Our basic scenario assumes a modicum of willingness to contain the fiscal expansion seen in recent years. If a credible fiscal adjustment is undertaken, it will help lower inflation expectations and local currency appreciation, making room for a more intense cycle of rate cuts and more economic growth. On the other hand, the absence of a fiscal stabilization plan may stymie new rate cuts, de-anchor inflation expectations and depreciate the exchange rate by giving rise to fears of fiscal dominance.

Figure 3: Balance of Payments – Services related to technology (Accum. 12M, US$ bn)



Source: BOCOM BBM, BCB

The outlook therefore depends crucially on structural fiscal reforms which, if implemented, would assure a trajectory of sustained growth, controlled inflation and lower interest rates. Our macroeconomic projections are shown in the table below.

ECONOMIC FORECASTS	2020	2021	2022	2023	2024	2025F	2026F	2027F
GDP Growth (%)	-3.3%	4.8%	3.0%	2.9%	3.4%	2.3%	1.7%	1.8%
Inflation (%)	4.5%	10.1%	5.8%	4.6%	4.8%	4.4%	4.0%	3.6%
Unemployment Rate (eoy ,%)	14.2%	11.1%	7.9%	7.4%	6.2%	5.8%	6.2%	6.8%
Policy Rate (eoy, %)	2.0%	9.3%	13.8%	11.75%	12.3%	15.00%	12.5%	10.50%
External Accounts								
Trade Balance (US$ bn)	36	42	52	92	66	63	70	71
Current Account Balance (US$ bn)	-25	-40	-42	-28	-61	-79	-62	-57
Current Account Balance (% of GDP)	-1.7%	-2.4%	-2.2%	-1.3%	-2.8%	-3.6%	-2.7%	-2.5%
Fiscal Policy								
Central Government Primary Balance (% of GDP)	-9.8%	-0.4%	0.5%	-2.1%	-0.4%	-0.5%	-0.4%	-0.7%
Government Gross Debt (% of GDP)	86.9%	77.3%	71.7%	74.4%	76.1%	80.5%	84.1%	88.2%