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Uncertainties regarding the baseline scenario

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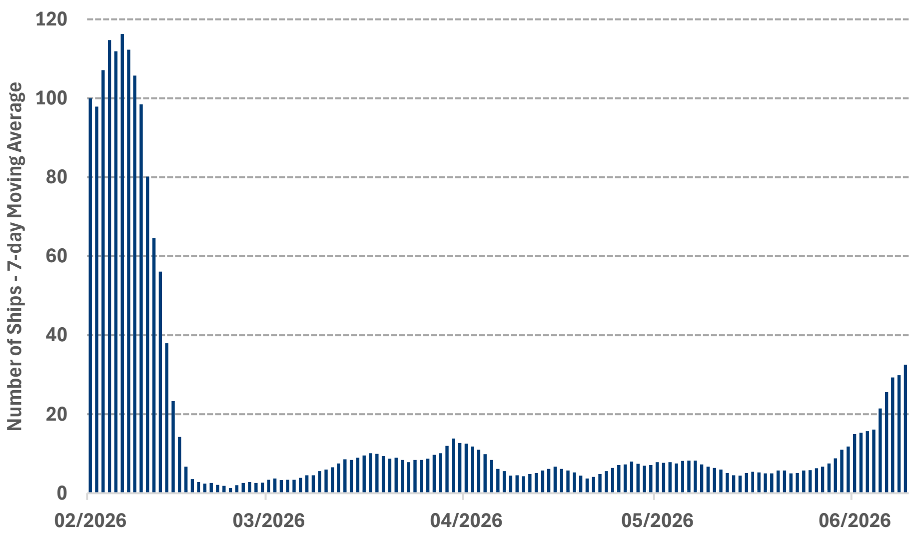
Uncertainties related the global events have made the task of projecting economic scenarios more challenging than usual. In no more than 12 months or so, the global economy has been shaken by three major supply shocks due to the sharp rise in US import tariffs, war in the Middle East, and the formation of a historically intense or "super" El Niño climate anomaly. In Brazil, these shocks are compounded by greater unpredictability regarding economic policies for the coming years, given that this is an election year marked by a fierce contest for the presidency. In this context, it is especially important to analyze the balance of risks associated with the projections in our baseline scenario.

The US-Iran agreement, which called for the reopening of the Strait of Hormuz, removed an important source of pressure on global production, shipping and distribution costs (Figure 1). However, structural rebuilding of inventories, the impact of fertilizer shortages on crop yields, and second-order effects of supply chain bottlenecks could hold up inflationary relief for a time.

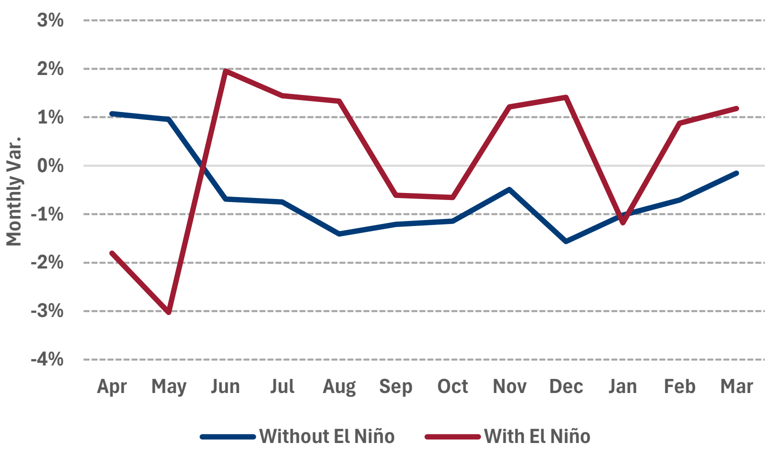
Figure 1: Strait of Hormuz - Daily Ship Transit



Source: BOCOM BBM, IMF PortWatch/Oxford University

Extreme climate events in different parts of Brazil have heightened food inflation risks. The approaching El Niño will mean more rain in the South and less rain in the North and Northeast, jeopardizing seed germination and grain development, and potentially delaying crop sowing and harvesting. Such events typically drive sharp rises in prices of fresh food (Figure 2), since the plants in question are highly sensitive to climate change, as well as reduced grain crop yields.

Figure 2: El Niño impact on Fresh Food Inflation



Source: BOCOM BBM, IBGE

Economic activity shows some signs of moderation but remains resilient thanks to a strong fiscal and parafiscal impulse, as well as the tight labor market. Expansionary measures costing some BRL 275 billion so far have been implemented since mid-2025 (Table 1). Moreover, the total wage bill continues to expand strongly, showing a real rise of 6.1% in the last 12 months. All this income has kept domestic demand high even though the economy is performing above potential.

Table 1: Fiscal measures

Program	Budegt (R$ bn)
Personal Income Tax Exemption	31
Credit to truck drivers	31.2
New mortgage credit model	37.2
Desenrola 2.0 and FGTS	23.2
Home Renovation Credito Program	40
Vehicle-financing program	30
Minha Casa Minha Vida Expansion	50
Electricity subsidy program	13
FGTS withdrawals	16.2
Subsidized cooking gas program	5.1
Total	276.9

Source: BOCOM BBM

In light of these trends, the scope for calibrating monetary policy this year has narrowed. We expect the Central Bank of Brazil's policy interest rate (Selic) to end the year on 14% p.a., with inflation running at around 5%.

As for 2027, we project GDP growth of 1.5%. The additional moderation of economic activity should make room for a continuation of interest-rate calibration during the year, but several factors, such as a post-election negative fiscal impulse, lagging effects of the restrictive monetary policy, and high levels of household debt and corporate leverage could break growth even more in 2027. If the risk of a sharper economic slowdown materializes, the monetary easing cycle might last longer than our baseline scenario assumes.

ECONOMIC FORECASTS	2020	2021	2022	2023	2024	2025	2026F	2027F
GDP Growth (%)	-3.3%	4.8%	3.0%	2.9%	3.4%	2.3%	2.0%	1.5%
Inflation (%)	4.5%	10.1%	5.8%	4.6%	4.8%	4.3%	5.4%	4.5%
Unemployment Rate (eoy ,%)	14.2%	11.1%	7.9%	7.4%	6.2%	5.1%	5.6%	6.2%
Policy Rate (eoy, %)	2.0%	9.3%	13.8%	11.75%	12.3%	15.0%	14.00%	12.00%
External Accounts								
Trade Balance (US$ bn)	36	42	52	92	66	60	81	75
Current Account Balance (US$ bn)	-25	-40	-42	-28	-66	-69	-59	-58
Current Account Balance (% of GDP)	-1.7%	-2.4%	-2.2%	-1.3%	-3.0%	-3.0%	-2.4%	-2.3%
Fiscal Policy								
Central Government Primary Balance (% of GDP)	-9.8%	-0.4%	0.5%	-2.1%	-0.4%	-0.5%	-0.4%	-0.3%
Government Gross Debt (% of GDP)	86.9%	77.3%	71.7%	74.4%	76.1%	78.7%	82.1%	85.4%