Macro scenario - Brazil

February 5, 2024

Moderate optimism

- We maintain our GDP growth forecasts at 2.9% for 2023 and 1.8% for 2024 and 2025. There is an upward bias to the balance of risks for our 2024 GDP call, with a better outlook for consumer credit and higher global growth. In the labor market, we see an 8% unemployment rate for 2024 and 2025.
- We also maintain our call for the consumer price index IPCA at 3.6% for 2024, but with a different composition. We now incorporate a higher estimate for underlying service inflation, pressured by the tight labor market and accelerating wages. For 2025, we maintain our call at 3.5%, given the persistent de-anchoring of long-term inflation expectations and the still-tight labor market.
- We revised our expectation for the trade surplus in 2024 to USD 85 billion from USD 80 billion, thanks to improving crude oil exports. For 2025, we now estimate a surplus of USD 70 billion, from USD 60 billion previously. Our exchange rate forecasts remain unchanged at BRL 4.90/USD for 2024 and BRL 5.10/USD for 2025. The still-strong dollar and low interest rate differential are set to pressure the currency, but domestic factors – such as the good trade performance and low domestic risk premium (post-pandemic period) – should act in the opposite direction.
- Fiscal risks remain high given the uncertainty surrounding the government's willingness to curb expenses and the effective impact on revenues from the measures approved last year. We forecast a primary deficit of 2.3% of GDP for 2023, 0.8% of GDP for 2024, and 1.0% of GDP for 2025. According to our estimates, a primary surplus of at least 1.5% of GDP would be required to stabilize the debt-to-GDP ratio.
- Monetary policy: With newly appointed members, the Copom cut the Selic rate by 0.5 p.p. at its first meeting of the year, as was widely expected. Communication remained practically unchanged, demonstrating that, for now, the committee is comfortable with the current pace of cuts for the next meetings. We continue to expect the Selic rate to end the year at 9.00% p.a.

Upward bias to our 2024 GDP growth estimate

We maintain our GDP growth estimate at 2.9% for 2023. After weak data in October, monthly figures for November published by census bureau IBGE and our daily IDAT- Activity indicator for December showed a recovery in spending on goods and services in the final two months of the year.

For 2024, we see GDP growth at 1.8%, with an upward bias. The latest credit data from the BCB show a better-than-expected evolution of core consumer loans[1], which could help sustain consumer spending throughout the year. Furthermore, microeconomic changes — such as the new Legal Framework for Guarantees — should support new loans throughout the year. And the upward revision of global growth estimates, driven by the U.S., is likely to provide an additional boost.

We estimate 1.8% GDP growth for 2025 as well. The impact of a less contractionary monetary policy should be offset by a smaller fiscal impulse, keeping the growth pace in line with this year's.

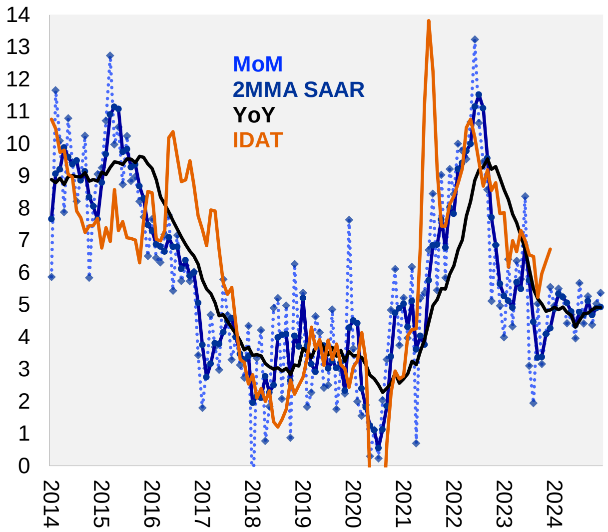
Finally, we forecast an unemployment rate of 8% for 2024 and 2025. The latest data showed a resilient labor market, but in line with our outlook for stable unemployment rate over the next few months.

[1] We consider as core consumer credit: non-earmarked loans, excluding revolving credit

Disinflation in 2024, but with a worse composition

We maintained our 2024 inflation estimate at 3.6%, though with a worse composition due to the deteriorating dynamics in underlying service prices. The mid-month consumer price index IPCA-15 for January showed more pressure on labor-intensive services (such as beauty, medical and dental services) and miscellaneous services, leading to a revision of our projections for these groups in 2024. The balance of risks to our forecast for this year is symmetric. On the one hand, increased contribution from power utility company Eletrobras could reduce the adjustments in electricity tariffs this year and represents downside risk to our estimate. On the other hand, the tight labor market could put even more pressure on wages and, consequently, on service inflation.

Underlying service prices pressured by wage and labor-market dynamics



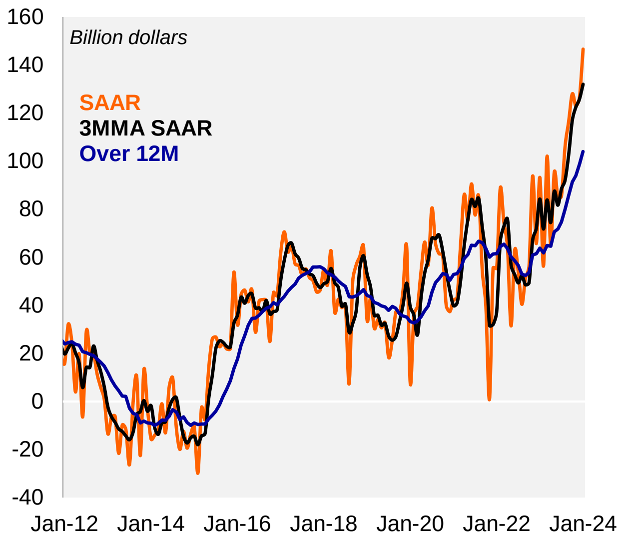
Source: Itaú

For 2025, given the persistent de-anchoring of long-term inflation expectations and the still-tight labor market, we forecast above-target inflation of 3.5%.

External pressures, but mitigating domestic factors support the BRL

We also maintained our exchange rate forecasts at BRL 4.90/USD for 2024 and BRL 5.10/USD for 2025. External fundamentals continue to generate much uncertainty and suggest greater pressure on the currency, with the continuation of a scenario that includes a strong dollar, the outperformance of the U.S. economy vs. its peers, and a narrowing interest rate differential throughout the year. However, there are mitigating domestic factors that include a good trade balance driven by crude oil and grain exports, and a low domestic risk premium (post-pandemic period).

Strong trade balance in early 2024



Source: MDIC, Itaú

We now expect a better performance from external accounts in the coming years, thanks to the positive trade flows. We estimate a trade surplus of USD 85 billion for 2024 (from USD 80 billion previously), led by higher crude oil exports. The outlook for oil shipments remains quite favorable, and our call incorporates an upward bias later in the year. We revised our projection for the trade surplus in 2025 up to USD 70 billion, from USD 60 billion previously. This led to a positive revision of our estimates for the current account deficit, to USD 14 billion (0.6% of GDP) for 2024 (from USD 19 billion, or 0.8% of GDP) and USD 23 billion (0.9 % of GDP) for 2025 (from USD 33 billion, or 1.4% of GDP).

Fiscal risks remain high: focus on expense contingency and tax collection

For 2024, we maintain our call of a deficit of 0.8% of GDP (BRL 95 billion). This marks an improvement vs. 2023, for which we estimate a deficit of 2.3% of GDP (or 1.5% excluding court-ordered *precatório* payments). However, this is still far from the zero-deficit target established by the government and further away from the surplus of at least 1.5% of GDP needed to stabilize the public debt. Risks for the year are relatively balanced: on the one hand, government measures (we estimate tax revenues gains of 0.8% of GDP) may disappoint; on the other hand, the government could announce spending limits (expense contingency) as a way to balance the revenue-related uncertainties, giving more credibility to the fiscal framework.

For 2025, we continue to expect a primary deficit of 1.0% of GDP (BRL 120 billion). We believe that the key parameters of the framework will be maintained in the budget for next year, despite the pressure to increase spending. The deterioration relative to 2024 reflects a smaller amount of extraordinary revenues and our assumption that new measures to increase tax collection will not be approved.

Gross debt is likely to increase from 72% of GDP in 2022 to 74% in 2023, 77% in 2024 and 80% in 2025.

Monetary policy: Cruise speed

At its first meeting of 2024 – also the first of the newly appointed committee members – the Copom unanimously took the widely expected decision to maintain the pace of interest rate cuts, reducing the Selic rate to 11.25%pa. The communication was virtually unchanged, repeating the forward guidance that the current easing pace is adequate for upcoming decisions. The balance of risks and main forecasts were unchanged as well.

It is worth noting that the committee marginally reduced its estimate for the component encompassing market-set prices in 2025, which is now the most important point on the relevant monetary policy horizon. With some benevolence, such change may be interpreted as a slightly more optimistic understanding of the inflation outlook in the medium term.

As the easing cycle forges ahead, the Copom is nearing the moment of having to drop the plural form in its forward guidance in order to have freedom to adapt its steps to the evolving scenario. For the time being, the authorities signaled that they are comfortable with the current pace of rate cuts for upcoming meetings, but it will be key to monitor the possibility of changes starting at its next meeting in March.

We continue to expect the Selic rate to end the year at 9.00%pa.

Brazil | Forecasts and Data

	2019	2020	2021	2022	2023F		2024F		2025F	
					Current	Previous	Current	Previous	Current	Previous
Economic Activity										
Real GDP growth - %	1.2	-3.3	4.8	3.0	**2.9**	2.9	**1.8**	1.8	**1.8**	1.8
Nominal GDP - BRL bn	7,389	7,610	9,012	10,080	**10,840**	10,840	**11,493**	11,493	**12,139**	12,139
Nominal GDP - USD bn	1,872	1,475	1,670	1,951	**2,172**	2,172	**2,345**	2,351	**2,424**	2,424
Population (millions)	210.1	211.8	213.3	214.8	**216.3**	216.3	**217.7**	217.7	**219.0**	219.0
Per Capita GDP - USD	8,910	6,964	7,830	9,084	**10,040**	10,040	**10,772**	10,802	**11,066**	11,066
Nation-wide Unemployment Rate - year avg (*)	12.0	13.8	13.2	9.3	8.0	-	**8.0**	8.0	**8.0**	8.0
Nation-wide Unemployment Rate - year end (*)	11.7	14.8	11.7	8.5	7.9	-	**8.0**	8.0	**8.0**	8.0
Inflation										
IPCA - %	4.3	4.5	10.1	5.8	4.6	-	**3.6**	3.6	**3.5**	3.5
IGP–M - %	7.3	23.1	17.8	5.5	-3.2	-	**3.0**	3.0	**3.0**	3.0
Interest Rate										
Selic - eop - %	4.50	2.00	9.25	13.75	11.75	-	**9.00**	9.00	**9.00**	9.00
Balance of Payments										
BRL / USD - eop	4.03	5.19	5.57	5.28	4.86	-	**4.90**	4.90	**5.10**	5.10
BRL / USD - average	3.95	5.16	5.40	5.17	5.00	-	**4.90**	4.90	**5.01**	5.01
Trade Balance - USD bn	35	50	61	62	99	-	**85**	80	**70**	60
Current Account - % GDP	-3.6	-1.9	-2.8	-2.5	-1.3	-	**-0.6**	-0.8	**-0.9**	-1.4
Direct Investment (liabilities) - % GDP	3.7	3.0	2.8	4.7	2.9	-	**3.0**	3.0	**3.6**	3.6
International Reserves - USD bn	367	356	362	325	355	-	**340**	340	**360**	360
Public Finances										
Primary Balance - % GDP	-0.8	-9.2	0.7	1.2	**-2.3**	-2.3	**-0.8**	-0.8	**-1.0**	-1.0
Nominal Balance - % GDP	-5.8	-13.3	-4.3	-4.6	**-8.4**	-8.4	**-7.0**	-7.0	**-7.0**	-7.0
Gross Public Debt - % GDP	74.4	86.9	77.3	71.7	**74.4**	74.4	**77.2**	77.2	**80.4**	80.4
Net Public Debt - % GDP	54.7	61.4	55.1	56.1	**61.2**	61.2	**64.7**	64.7	**67.7**	67.7

Source: IBGE, FGV, BCB and Itaú

(*) Nation-wide Unemployment Rate measured by PNADC.

(**) We await the release of the complete statistics of the demographic census of 2022 by IBGE. Thus, we have not yet incorporated the estimate of 203.1 million inhabitants in 2022.

Macro Research – Itaú

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