Brazil

A year of macroeconomic rebalancing

Brazil enters 2027 with its economy feeling the effects of a prolonged period of restrictive monetary policy, while the transition to a new political cycle should keep fiscal management and financial conditions at the centre of the outlook. Our baseline is one of slower growth, gradual disinflation and limited room for monetary easing.

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We expect gross domestic product (GDP) growth of 1.3% in 2027, after a moderate performance in 2026. The main driver will be the delayed transmission of high real interest rates to consumption, investment and other interest-sensitive sectors. The economy is therefore predicted to receive less support from domestic demand, while exports are likely to remain constrained by a less benign global environment and softer commodity prices. The key uncertainty is fiscal policy. A credible adjustment strategy could improve confidence and partially offset the drag from tight monetary conditions, while a weaker fiscal signal would keep risk premia elevated and limit investment.

The labour market should cool only gradually. Employment has stayed unusually resilient; unemployment is still low by historical standards and wage income continues to support consumption. However, the combination of weaker activity, slower credit creation and more cautious hiring should reduce labour demand during 2027. We expect some increase in unemployment over the year, but not a sharp one, as structural changes in labour supply and a lower estimated natural unemployment rate suggest that the market can hold relatively tight even with modest GDP growth. Wage gains should moderate rather than collapse, helping the disinflation process without generating a major negative shock to household income.

Inflation should continue to decline, but convergence to target is likely to remain slow. We forecast inflation to be around 4% by the end of 2027. The improvement should come from weaker demand, lower inflation inertia and more favourable behaviour from goods and food prices as the lagged effects of restrictive monetary policy start to become more evident. Services inflation, nevertheless, should continue to be the main source of persistence, reflecting the still-tight labour market and elevated wage growth. Inflation expectations will also be an important constraint, particularly because the fiscal outlook continues to influence both the exchange rate and medium-term expectations. Even with headline inflation dropping, the composition of inflation is likely to justify continued caution from the Central Bank of Brazil (BCB).

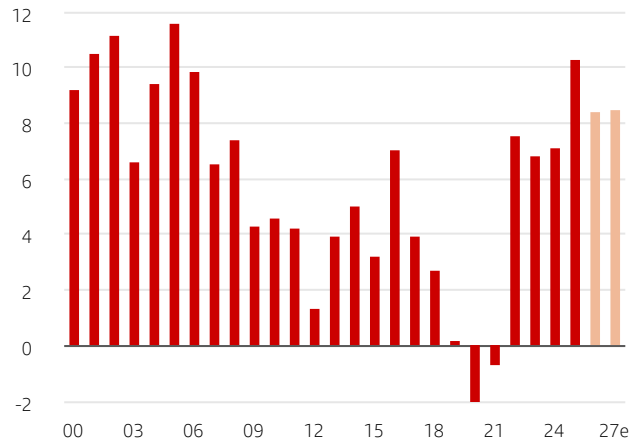
We expect monetary policy to remain restrictive throughout 2027. As the easing cycle progresses, the BCB is likely to retain a cautious approach, assessing both the cumulative impact of previous policy decisions and the fiscal direction of the new government. After the initial phase of the easing cycle, we expect the BCB to enter a

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prolonged pause, allowing time to determine where the exchange rate and inflation expectations settle and how these developments will feed through to the inflation outlook. With inflation still above target and expectations likely to remain sensitive to fiscal and policy signals, the bar for an immediate continuation of the easing cycle should remain relatively high. As the year progresses, however, the cumulative effects of restrictive monetary policy should become increasingly visible in activity and the labour market, reducing underlying inflationary pressures. This should eventually allow the BCB to resume rate cuts in the latter part of the year, bringing the Selic towards 12.5% by end-2027 while keeping monetary policy in restrictive territory.

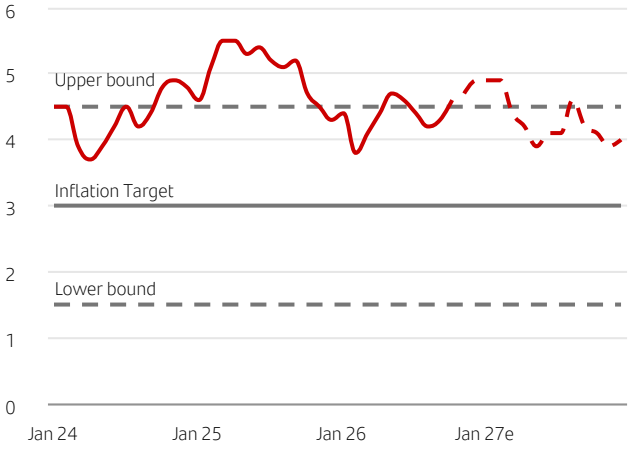
Financial conditions should stay tight even as the easing cycle progresses. Domestic interest rates are likely to stay sensitive to fiscal developments, global yields and the credibility of the incoming economic policy framework. Credit conditions should soften slowly, with banks maintaining a selective stance and highly leveraged households facing limited room for renewed borrowing. The exchange rate should also continue to act as an important transmission channel, supported by Brazil's high carry, but will remain vulnerable to shifts in global risk appetite and domestic risk. Overall, 2027 should be a year of adjustment rather than acceleration, with a prolonged monetary policy pause in the first half eventually giving way to renewed easing as weaker activity and lower inflation create room for additional rate cuts.

Brazil: Persistently high real rates
(%, y/y)



Sources: BCB, IBGE and Santander Research.

Brazil: Consumer inflation above the 3% target
(%, y/y)



Sources: IBGE and Santander Research.

Macroeconomic forecasts

	2026e	2027e	2028e
GDP growth (%)	1.8	1.3	1.5
Unemployment rate	5.5	6.0	6.5
CPI inflation	4.5	4.4	3.9

Source: Santander Research. Annual average.



Brazil In focus

The narrowing path to a soft landing in Brazil



Macroeconomic stabilisation is never free. Bringing inflation back to target requires some moderation in demand, just as supporting growth often involves tolerating temporarily higher inflation. What changes across countries and over time is not the existence of this trade-off, but its drivers. Our baseline is one of continued disinflation without a recession. However, stabilisation should rely less on monetary policy and more on fiscal convergence.

The current monetary cycle in Brazil may prove a challenging one, as the central concern revolves not only around whether inflation can return to target, but also how much economic adjustment will be required. The answer depends on the broader macroeconomic policy mix.

For much of the inflation-targeting era, Brazil operated under relatively favourable conditions. Inflation expectations remained anchored, fiscal policy broadly supported stabilisation, and financial markets interpreted gradual interest-rate adjustments as evidence of confidence. In that environment, the Central Bank could smooth business cycles while preserving credibility. Monetary policy was largely an exercise in calibration. That environment has changed.

Uncertain macroeconomic policy mix

The key issue is no longer whether Brazil will eventually stabilise public debt, but whether fiscal adjustment will come before markets demand it. In other words, will adjustment occur proactively before financial conditions force it, or only reactively? As long as this is uncertain, inflation expectations will embed part of the risk, forcing monetary policy to compensate for an adjustment yet to occur.

Since the pandemic, Brazil has combined persistent fiscal expansion, above-target inflation expectations, higher sovereign risk premia and a structurally higher neutral real interest rate. Taken together, these factors reflect some uncertainty surrounding the future macroeconomic policy mix.

None of them prevent inflation from converging to target. Collectively, however, they have raised the cost of disinflation. Brazil's stabilisation frontier has deteriorated: bringing inflation back to target now requires a stronger policy response, a larger slowdown in activity, or a combination of both.

This does not mean monetary policy has become less effective. Rather, the economy now requires tighter financial conditions to deliver the same reduction in inflation. In other words, the sacrifice ratio appears to have increased.

This also changes how monetary policy responds to shocks. Central banks should generally look through temporary supply shocks, tightening only when they threaten inflation expectations. But such an approach depends on credibility. When expectations remain above target for a prolonged period, the room to accommodate temporary shocks narrows. Markets become more sensitive to any perceived weakening of the commitment to price stability, increasing the likelihood that temporary shocks become embedded in wages and longer-term expectations.

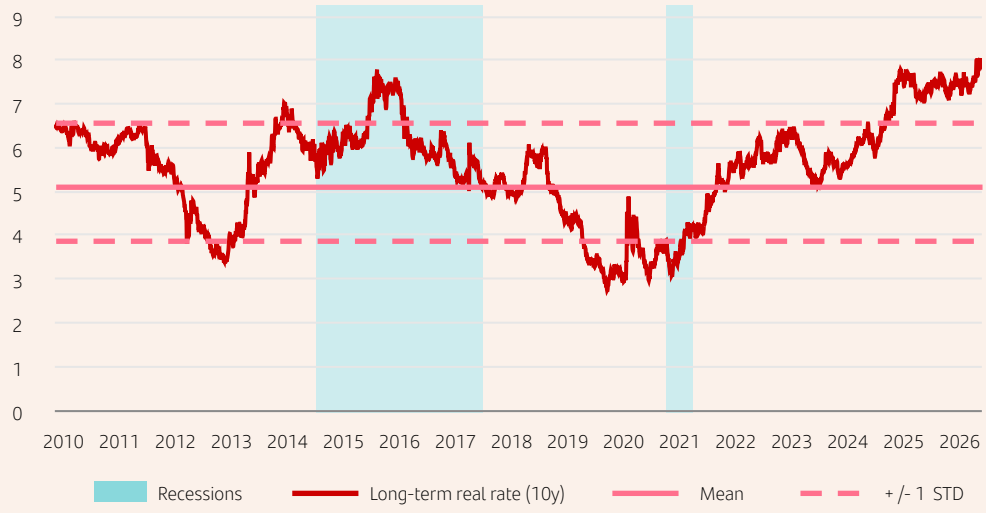
As a result, monetary policy loses flexibility. Gradualism becomes harder to distinguish from complacency, while a balanced approach becomes more difficult because credibility becomes part of the stabilisation process. Monetary policy is no longer calibrating only the business cycle; it is also preserving confidence in the broader macroeconomic regime.

The outlook for 2027 therefore deserves particular attention. As activity moderates, investors naturally expect monetary easing to accelerate. Our assessment is more cautious. Slower growth alone may not create the same room for policy normalisation if inflation expectations remain above target and the equilibrium real interest rate has shifted upwards. Monetary policy may need to keep to a restrictive approach.

Conclusion

Our baseline is one of continued disinflation without a recession. Yet risks have become increasingly asymmetric. As stabilisation relies more heavily on monetary policy, the economy becomes more vulnerable to nonlinear adjustments. Proactive fiscal consolidation would help lower risk premia, re-anchor inflation expectations and restore the Central Bank's room for policy calibration. Otherwise, monetary policy will continue to bear a larger share of the stabilisation effort.

Long-term real rates in Brazil: From mean reversion to a new high
(%)



Sources: Bloomberg and Santander Research.