BRAZIL

OUTLOOK 2026

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Executive summary

Brazil enters 2026 at a political crossroads. The high-stakes October presidential election will determine whether 80-year-old President Luiz Inácio Lula da Silva secures a fourth non-consecutive term or whether a yet-to-be-defined conservative candidate, likely São Paulo Governor Tarcísio de Freitas or a close relative of former president Jair Bolsonaro, can unite the fragmented opposition.

Lula leads in polls (46%-39% over de Freitas) yet his approval ratings remained net negative throughout 2025. Bolsonaro, a highly polarising and controversial figure, sits under house arrest appealing a 27-year prison sentence for an attempted coup, leaving the right struggling to coalesce. But the right retains an advantage, as crime and security have emerged as potent electoral issues following Rio's deadliest police operation (over 120 deaths in October), with the popular response highlighting voters' appetite for hard-line policies that may prove uncomfortable for the left.

US-Brazil relations careened from crisis to accommodation through 2025. Donald Trump's 50% August punitive tariffs, triggered by the US president's support for Bolsonaro after his detention, gave way to a productive October Lula-Trump meeting in Malaysia, with November exemptions on coffee, beef, orange juice, açaí and cassava delivering $700mn relief. Brazil's weighted average tariff rate fell from 50% to approximately 29%. The geopolitical dimension, which sees Brazil emerging as an alternative to Chinese dominance in critical minerals through vertically-integrated rare earth projects, represents perhaps the most significant long-term shift in strategic positioning.

Yet fiscal arithmetic may prove more decisive than electoral dynamics. Gross public debt reached 78.1% of GDP (Central Bank methodology) or 91.4% (IMF's broader calculation), heading toward 98% by 2030. Goldman Sachs warns that "a fourth Lula term cannot repeat his third term's fiscal management," requiring a primary surplus above 2.5% of GDP versus the government's 0.25% target, a tenfold gap necessitating 3 percentage points of GDP adjustment. Morningstar DBRS notes elections will "delay consolidation efforts," while Goldman states that fiscal balance "will become a top priority from 2027, regardless of outcome."

The implication: 2026 represents an interregnum before inevitable post-election austerity.
The economy decelerates sharply as monetary tightening bites. After 3.4% growth in 2024, consensus forecasts average 2.3% for 2025 (ranging from 2.2% to 2.4% across major institutions) before slowing to approximately 1.8% in 2026 (ranging from 1.5% to 2.2%). Third-quarter 2025 GDP grew just 0.1% quarter-on-quarter. The Central Bank's 15% benchmark interest rate (Selic)–a near-20-year high held since July–has driven this cyclical cooling. Inflation moderated from 5.5% in April to 4.5% by November, returning to the target band, though services inflation remains elevated at 6.2% reflecting record-low

5.4% unemployment.

Monetary easing is expected from January 2026, with the Selic projected to decline to 11-12% by year-end, though Goldman warns of potential delays until March if election-year spending proves excessive.
External accounts remain manageable with record FDI of $74.2bn in January-October fully offsetting the $62bn current account deficit (3.51% of GDP). The real appreciated to BRL5.40/USD driven by double-digit real interest rates creating the region's strongest carry trade, though analysts expect a gradual depreciation to 5.50-5.60 through 2026. The real economy presents contradictions: agriculture boomed (Q2 farm GDP +10.1% year-on-year) yet faces mounting competitive pressures as China suspended US tariff retaliation following talks between Trump and President Xi Jinping; manufacturing contracted sharply (September PMI 46.5) under US tariffs and Chinese auto import competition (+51.2% year-on-year to 123,482 units).

Brazil's trade is dominated by four major partners. China accounts for 28-30% of exports and 22-25% of imports, generating a $30.8bn trade surplus driven by commodity demand for soybeans, iron ore, and crude oil–a relationship reinforced by both countries' leadership roles in the BRICS bloc, whose rotating presidency was held by Brazil this year. The European Union, with whom Lula aims to finalise a free trade agreement as part of the Mercosur trading bloc, collectively ranks as Brazil's second-largest trading partner at approximately 16% of total trade ($113.67bn in two-way commerce), with the bloc serving as Brazil's largest buyer of agricultural products (38% of exports to the EU) alongside significant oil shipments (26%). The United States represents 11% of exports and 15-19% of imports, though – despite Trump's claim to the contrary – Brazil runs a deficit as it imports more machinery and technology than it exports in petroleum and manufactures.

Argentina comprises 5% of both exports and imports, concentrated in automotive trade, though purchases fell 17.6% in 2024 amid Argentina's economic crisis.
Brazil's critical minerals sector emerges as genuine strategic opportunity. Three new rare earth projects integrate domestic processing rather than simply extracting ore for Chinese refineries–learning from Serra Verde's cautionary tale. MagBras aims to manufacture super magnets entirely within Brazil by 2026, potentially loosening "China's grip," as per EIU assessment. Meanwhile, oil and gas expansion continues with national production reaching record 5.255mn boe/day (pre-salt 81.4% of output), state oil company Petrobras profits rebounding to $4.7bn, and BP's Bumerangue discovery (potentially 2-2.5bn barrels) validating exploration potential.

Social gains undergird Lula's resilience: 14.17mn lifted above the poverty line (May 2023-July 2025), life expectancy rising to 76.6 years, Gini inequality near record lows. Yet these achievements face threats from the post-election fiscal consolidation all analysts agree must occur. Goldman's 3 percentage point GDP adjustment would inevitably impact social spending, creating the political economy challenge defining Brazil's 2027-2028 trajectory. The question is whether institutions can compel adjustment before market pressure makes it involuntary, or whether Brazil's historical pattern of muddling through can persist through yet another cycle.

1.0 Politics

1.1 The October 2026 election: a fragmented landscape

Brazil's October 4, 2026 presidential election arrives at a moment of unusual uncertainty. While seasoned President Luiz Inácio Lula da Silva has declared his candidacy for a fourth non-consecutive term and leads in polls, his opponent remains unclear nine months before voters head to the ballot box. The opposition's predicament stems from the absence of its natural standard-bearer: former far-right president Jair Bolsonaro sits under house arrest, appealing a 27-year prison sentence handed down by the Supreme Court on September 11, 2025 for his role in an attempted coup d'état.

His conviction on five counts, combined with a November incident where he was taken into Federal Police custody after tampering with his ankle monitor, has effectively removed him from electoral contention.
In Bolsonaro's absence, São Paulo Governor Tarcísio de Freitas has emerged as the most competitive right-centre candidate. Described by political analysts as a "technocrat warrior," de Freitas combines technical credentials with a confrontational political style that resonates with Bolsonaro's base.

Yet polls conducted in November by MDA (2,002 respondents) reveal his vulnerability: Lula would defeat de Freitas 46%-39% in a hypothetical match-up. Against Bolsonaro himself–were he somehow to compete–Lula's margin widens to 49%-37%. Eduardo Bolsonaro, the former president's son and a federal deputy, fares even worse, trailing Lula 50%-33%. In December, Bolsonaro's eldest son Flavio announced his candidacy, though it remains uncertain whether he will ultimately enter the race.

The right's fragmentation extends beyond candidate selection. De Freitas is viewed as "too moderate by the far right," according to EIU's São Paulo-based analyst Liam Lin, creating a dilemma: "Unless Bolsonaro endorses him, Brazil's right will enter the electoral cycle divided." This internal fracture is particularly significant given polling data showing 41% of voters prefer a candidate unlinked to either Lula or Bolsonaro–a substantial constituency that neither major camp can currently claim.

The Economist Intelligence Unit assesses that "if the opposition manages to unite behind a single candidate... they would have a better chance of winning, especially if Lula continues to struggle with his popularity." That popularity has indeed proved volatile throughout 2025. According to Genial/Quaest polling of 12,150 respondents in August, Lula's approval stood at 46%–his highest level since January–while disapproval registered 51%, down from a May peak of 57%. Yet more recent data suggests this recovery has stalled, with Lula's approval ratings remaining net negative throughout the year except for a brief period following Trump's tariff announcement.

1.2 The Bolsonaro factor

The legal proceedings against Bolsonaro have unfolded with dramatic speed. The Supreme Court's September 11 verdict–27 years and 3 months imprisonment across five counts related to the January 2023 attempted coup–represented one of the most severe penalties handed down to a former Brazilian president. The conviction detailed a coordinated effort to prevent the peaceful transfer of power following Bolsonaro's October 2022 election defeat to Lula, including the storming of government buildings in Brasília by supporters who refused to accept the result.

The subsequent November incident, when Bolsonaro was taken into Federal Police custody after tampering with his electronic monitoring device, underscored his determination to resist the court's authority. This defiance triggered an immediate and severe response from the United States under President Donald Trump, who had cultivated close ties with Bolsonaro during both of his presidencies. On the day following Bolsonaro's detention, Trump announced 50% punitive tariffs on Brazilian imports and imposed personal sanctions on Supreme Court Justice Alexandre de Moraes, who oversaw the coup trial. Trump characterised the proceedings as a "witch hunt," language that resonated with Bolsonaro's supporters but complicated Brazil's diplomatic position.

The US response created an unexpected political dynamic. Rather than simply antagonising Lula's government, Trump's intervention generated a temporary rally-around-the-flag effect that briefly improved Lula's approval ratings in July and August 2025. Brazilian public opinion, traditionally sensitive to perceived foreign interference in domestic affairs, appeared to view Trump's sanctions as overreach. This nationalist sentiment cut across political lines, providing Lula with what analysts described as an involuntary boost from his ideological opposite.

1.3 US-Brazil relations: from crisis to cautious thaw

The trajectory of US-Brazil relations through 2025 offers a case study in the Trump administration's transactional approach to foreign policy. Following the initial August tariff shock–50% on most Brazilian exports–the bilateral relationship entered a phase of cautious negotiation. A crucial turning point came with a September encounter at the United Nations, where Lula and Trump discovered "some chemistry" according to diplomatic observers, followed by a substantive October 26 meeting in Kuala Lumpur where both leaders "agreed urgent negotiations" were necessary.

The results materialised quickly. By November, the United States had expanded its list of exempt products, specifically targeting Brazilian agricultural exports. Coffee, which had been subject to the full 50% tariff, received an exemption–a symbolically and economically significant gesture given Brazil's position as the world's largest coffee producer and exporter. Additional exemptions covered beef, orange juice, açaí and cassava. EIU calculates these exemptions delivered tariff relief worth $700mn to Brazilian exporters, reducing the weighted average tariff rate from an initial 29.4% (after September exemptions) to a level "expected to fall further" once November adjustments are fully reflected in trade data.

Liam Lin of EIU notes that the November exemption list was "definitely targeted toward Brazil... a lot of items that are very Brazil-specific," suggesting the Kuala Lumpur meeting had produced concrete commitments. He adds: "There's definitely room for more negotiations down the line, especially in regards to critical minerals and Brazilian rare earths"–a reference to Brazil's strategic position in supply chains that the United States is seeking to diversify away from Chinese dominance.

Yet the bilateral relationship remains fragile. Morningstar DBRS includes among Brazil's key risks for 2026 "tensions between the Trump administration and governments in Brazil and Colombia [that] could lead to higher US tariffs, sanctions, or other adverse policy actions."
The fundamental ideological distance between Lula's left-leaning government and Trump's hard-right administration creates persistent friction, even as pragmatic economic interests drive periodic accommodation.

1.4 Crime and security: the emerging electoral battleground

An unexpected issue has surged to prominence in the electoral debate: violent crime and state security responses. According to Ipsos polling conducted in October, Latin Americans express the highest level of concern about crime globally, with Brazil registering well above the global average. This concern is grounded in stark reality–Latin America has the highest homicide rate of any world region, and Brazil's major cities face endemic violence from organised criminal groups.
The issue crystallised dramatically in late October 2025 with a massive police operation targeting the Comando Vermelho (CV) organised crime group in Rio de Janeiro's favelas. The operation became the deadliest in Brazilian history, resulting in over 120 deaths during coordinated raids. What startled political observers was not the operation itself–aggressive anti-crime operations are routine in Rio–but the public response. Polling showed the operation was actually popular, with most Brazilians actually supporting it.

Lula's response proved politically awkward. Already perceived as "soft on crime" according to EIU analysts, the president's reaction was described as "very muddled," neither embracing nor clearly condemning the operation's tactics. This hedging satisfied neither camp–security hawks wanted unequivocal support, while human rights advocates expected clearer condemnation of the death toll. EIU assesses the episode "didn't help his image" and predicts "that operation will eventually reverberate... for many months to come, keeping the issue of violence and crime prominently in the public debate ahead of the election."

The political implications extend beyond Lula's immediate discomfort. EIU analyst Nicolas Saldias observes: "Crime being so pervasive... we believe favours right-wing parties. It tends to play into their strengths with voters." The trend is visible across Latin America, where "many candidates are appealing to a Bukele-styled solution to these problems"–a reference to El Salvador's President Nayib Bukele, whose flagship aggressive gang crackdown has won popular support despite significant human rights concerns.

For Brazil's left, this poses a dilemma. As Saldias frames it: "How will left-wing candidates address this concern so they can remain electorally competitive going forward?" The October operation demonstrated that traditional progressive positions on policing and criminal justice may have limited electoral appeal when voters prioritise immediate security over procedural safeguards.

1.5 The fiscal policy straitjacket

Beneath the surface dynamics of electoral competition and security debates lies a deeper structural constraint: Brazil's deteriorating fiscal position creates a policy straitjacket that will bind whoever wins in October. Goldman Sachs has articulated this constraint most starkly. In a November 12 interview with Reuters, the bank's head of Latin America macroeconomic research, Alberto Ramos, warned: "A fourth Lula term cannot repeat his third term's fiscal management," cautioning of potential "market volatility or even a financial crisis" if the pattern continues.

The current Lula administration's fiscal approach has been characterised by what Ramos describes as "rising revenues alongside increased spending." While this strategy has delivered on social policy priorities–14.17mn people lifted above the poverty line between May 2023 and July 2025, for instance–it has failed to arrest debt accumulation. Gross public debt reached 78.1% of GDP in September 2025, up from 71.7% at the end of Bolsonaro's term, with Treasury projections showing a rise to 84.2% by end-2028 before beginning to decline.

Goldman Sachs calculates that Brazil requires a primary surplus above 2.5% of GDP to reverse this trajectory–a fiscal adjustment of 3 percentage points of GDP from current levels. This stands in stark contrast to the government's official 2026 target of just 0.25% of GDP primary surplus (with a tolerance band allowing a deficit of up to 0.25% while still technically meeting the goal). The arithmetic is unforgiving: the government's stated targets fall short of stabilisation requirements by more than a factor of ten.
Morningstar DBRS places Brazil and Colombia as facing "the most challenging outlooks" in Latin America on fiscal consolidation. The rating agency points to a dual challenge: "Not only do they require large fiscal adjustments, but elections next year will likely delay consolidation efforts and generate uncertainties around the medium-term fiscal strategy." This assessment implies that 2026 will see minimal fiscal tightening–perhaps even modest loosening through "election-year fiscal measures" as Fitch expects–followed by a post-election reckoning in 2027 regardless of which party controls the presidency.

Goldman's Ramos points out this inevitability: "Brazil's fiscal balance will become a top priority from 2027 regardless of the outcome of next year's presidential election." The implication is clear: whoever wins in October will spend their political honeymoon implementing unpopular fiscal consolidation measures rather than expansionary programmes. For Lula, this would mean abandoning the fiscal approach that has defined his third term.

For a right-wing opposition candidate like de Freitas, it would mean immediate confrontation with a Congress where no party holds a comfortable majority–Morningstar notes that "regardless of who wins the presidency, party fragmentation will likely complicate efforts to pass legislation."

1.6 Market response and the role of ideology

Goldman Sachs offers an important qualifier to electoral market analysis: "Investors respond to sound policies, not ideology." This framing is particularly relevant given Brazil's recent market performance. The MSCI Brazil index delivered approximately 40% returns in dollar terms from January through November 2025, dramatically outperforming both emerging market and global indices. This occurred under Lula's left-leaning administration, suggesting markets can price in political differences when economic fundamentals appear manageable.

Ramos notes that "markets may rally if an opposition candidate gains traction" during the campaign, reflecting expectations that a right-centre government might pursue more aggressive fiscal consolidation. Yet he immediately tempers this observation with the reminder about policy over ideology. The implication is that a Lula victory would not necessarily trigger sustained market distress if accompanied by credible fiscal commitments, while an opposition victory could disappoint if consolidation proves politically difficult to implement.

This nuanced view contrasts with simpler narratives about left-right politics and market reactions. And Brazil's institutional framework, particularly the operational independence of the Central Bank, established through 2021 legislation, provides significant insulation from political interference in monetary policy. The Central Bank's credibility, maintained through its aggressive 2024-2025 tightening cycle that brought the Selic to 15% despite political pressure, offers markets confidence that inflation-fighting commitment will persist regardless of presidential preferences.

The fiscal arena, by contrast, offers no such institutional buffer. Congress must approve budgets and tax measures, and congressional fragmentation creates veto points that can obstruct consolidation regardless of executive intentions. Morningstar's assessment that fragmentation will "complicate efforts to pass legislation" applies equally to a re-elected Lula or a first-term opposition president. The structural challenge transcends individual leadership.

1.7 Scenarios and probabilities

With nine months remaining, EIU notes “it’s still too early to make hard calls.” Three scenarios emerge: Lula re-election (baseline) requiring post-election fiscal shift despite campaign messaging; opposition victory generating initial market rally but facing identical 3pp GDP adjustment arithmetic; or fragmented outcome maximising uncertainty. Across all scenarios, crime remains central, US relations oscillate between tension and pragmatism, and fiscal imperative transcends electoral outcomes–Brazil’s next president begins their term implementing unpopular consolidation regardless of campaign promises or ideology.

2.0 Macro Economy

2.1 GDP growth: the cyclical downturn

Brazil’s economic expansion is losing momentum through a well-telegraphed cyclical slowdown. After growing 3.4% in 2024, GDP growth forecasts for 2025 cluster in a narrow range: the World Bank projects 2.4%, the OECD 2.4%, the IMF 2.4%, BBVA 2.2%, and Fitch 2.3%. For 2026, the picture darkens considerably with projections ranging from BBVA’s pessimistic 1.5% to the World Bank’s relatively optimistic 2.2%, Fitch’s 1.9%, the IMF’s 1.9%, and the OECD’s 1.7%. The World Bank maintains 2027 at 2.3%, suggesting the slowdown proves temporary rather than structural.

The quarterly data tells a stark story of deceleration: first-quarter 2025 growth of 1.3% quarter-on-quarter (seasonally adjusted) slowed to just 0.4% in the second quarter, with third-quarter growth of 0.1%–a three-year low. The OECD notes that “recent data points to a slowdown,” with the activity index having fallen 1.8% since April, while retail sales and industrial production fell again in September. Business confidence has also weakened. This cyclical downturn reflects the lagged effects of aggressive monetary tightening–the Central Bank raised the Selic benchmark rate by 450 basis points between September 2024 and July 2025, bringing it to 15%, the highest level in nearly 20 years.

The 2025 outperformance relative to initial expectations stems primarily from agriculture. The OECD highlights a strong agricultural harvest projected to grow 17%, while household consumption received a boost from a tight labour market with unemployment falling to a historic low of 5.6% (OECD) or 5.4% (domestic data) and real income rising by more than 3%. Yet this strength masks growing weakness: the sectoral composition reveals where monetary policy has bitten hardest. Household consumption contributed just 1.8 percentage points to GDP growth in 2025 versus 4.8 percentage points in 2024, according to Fitch. Fixed investment surged 7.2% in 2024 but is estimated to have grown just 3.8% in 2025, with the OECD warning investment “is expected to lose momentum in 2026, pressured by high interest rates, global uncertainty and US tariffs on Brazilian exports.”

Services sector activity–representing approximately 70% of GDP–has proved particularly sensitive to tight financial conditions. The services PMI collapsed to 46.3 in both July and September 2025, marking the sharpest decline in over four years and remaining below the 50-point expansion threshold for six consecutive months. Manufacturing activity faced a double headwind from both monetary tightening and external shocks, with the September manufacturing PMI falling to 46.5–the sharpest decline in 29 months. Industrial production shows August output up 0.8% month-on-month but down 0.7% year-on-year, with current output standing 2.9% above the February 2020 pre-pandemic level but 14.4% below the May 2011 peak–a sobering reminder that Brazil's manufacturing sector never fully recovered from the 2014-2016 recession.

Agriculture provides the notable exception to this pattern of weakness. The sector delivered standout performance in second-quarter 2025 with farm GDP surging 10.1% year-on-year to BRL239.1bn ($44.7bn)–the strongest sectoral contribution to overall growth. Production gains were broad-based: soybeans +14.2%, corn +19.9%, rice +17.7%, cotton +7.1%, and coffee +0.8%. MB Associados, a São Paulo-based consultancy, estimates the agricultural boom could sustain approximately 50% of Brazil's economic expansion through 2025.

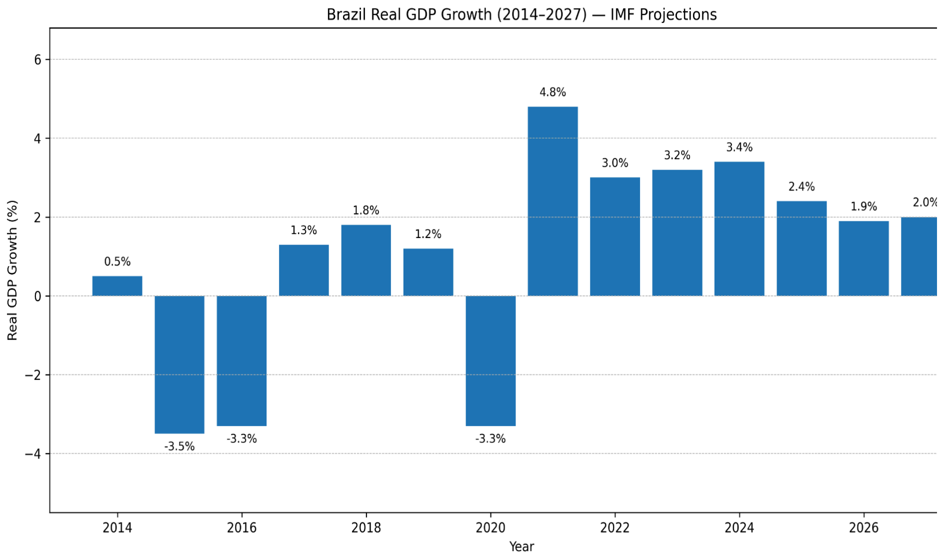
2.2 Competing forecasts

The forecast dispersion for Brazil's growth trajectory reflects differing assessments of monetary easing pace, fiscal support magnitude, and external headwinds' transmission.

2025 GDP Growth Projections: - World Bank: 2.4% - OECD: 2.4% - IMF: 2.4% - Fitch: 2.3% - BBVA: 2.2% - **Consensus average: ~2.3%**

2026 GDP Growth Projections: - World Bank: 2.2% (most optimistic) - IMF: 1.9% - Fitch: 1.9% - OECD: 1.7% - BBVA: 1.5% (most pessimistic) - **Consensus average: ~1.8%**

2027 GDP Growth Projections: - World Bank: 2.3% - Fitch: 1.8% - IMF: 2.0% - OECD: Not specified - **Suggests recovery from 2026 trough**



The 2025 outperformance stems primarily from agriculture–the OECD highlights a harvest projected to grow 17%–and household consumption supported by unemployment at historic lows (5.4-5.6%) with real income rising 3%+. Yet this strength masks growing weakness evident in the activity index falling 1.8% since April (OECD), with retail sales and industrial production declining through September.

BBVA's pessimistic 1.5% for 2026 is motivated by continued tight monetary conditions, smaller fiscal impulse, and US tariff drag. The OECD's 1.7% similarly highlights "high interest rates, global uncertainty and US tariffs" pressuring investment, though noting impact remains "limited thanks to market diversification." Fitch and the IMF's 1.9% projections incorporate election-year fiscal measures (income tax reform redistributing toward lower-income households, expanded credit programmes) offsetting restrictive monetary policy. The World Bank's higher trajectory (2.2% in 2026, 2.3% in 2027) suggests greater confidence in navigating the tightening cycle, though the institution warns that Latin America faces “low investment levels both public and private” and “persistent lack of fiscal space.”

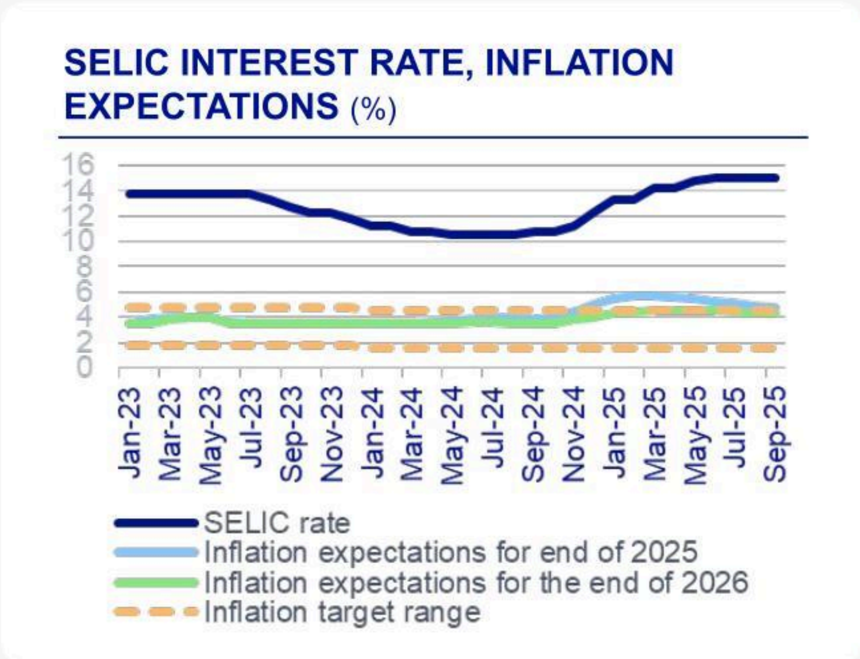
The key analytical question is whether Brazil’s neutral rate lies closer to pessimists’ assumptions requiring sustained restriction, or optimists’ view enabling earlier acceleration. The World Bank argues that overcoming slow growth requires “a growth-oriented reform agenda in infrastructure, education, regulation, competition, and tax policy”–structural improvements beyond cyclical monetary adjustments.

Inflation Projections End-2026: - BBVA: 3.7% (most optimistic, approaching target) - OECD: 4.2% - Fitch: 4.5% (most cautious) - Focus Survey: 4.18%

The OECD projects inflation reaching 5.1% in 2025, falling to 4.2% in 2026 and 3.8% in 2027, noting “electricity, food and services continue driving inflationary pressure.” BBVA cites softer domestic demand and real appreciation driving faster disinflation to 3.7%. Fitch predicts sticky services inflation (6.2% year-on-year) reflecting labour market tightness, warranting slower convergence to 4.5%.

Selic Rate End-2026: - BBVA: 11.0% (most dovish, -400bp cuts) - Fitch: 12.0% (-300bp cuts) - OECD: ~10.5% by 2027

Both note terminal rates remain “restrictive levels” with real rates of 7-7.5 percentage points–well above 2-3% neutral estimates–maintaining a contractionary stance throughout 2026.



Source: BBVA Research based on data by the BCB.

2.3 The labour market paradox

Brazil's labour market presents an unusual paradox within the broader narrative of economic slowdown: employment remains extraordinarily tight even as output growth decelerates sharply. The October 2025 unemployment rate of 5.4% represents a record low since the current data series began in 2012. Between January and August 2025, the economy created 1.5mn formal sector jobs, with average wages reaching BRL3,528 ($661) per month. This combination of near-full employment and rising nominal wages creates both a support for consumption and a constraint on disinflation.

The tightness manifests most clearly in services sector inflation, which remained elevated at 6.2% year-on-year in October 2025–well above headline inflation of 4.7% and substantially exceeding the Central Bank's 3% target. This "sticky" services inflation reflects labour market dynamics: with unemployment at historic lows, firms face limited ability to resist wage demands, and service providers can more easily pass through cost increases to customers. The phenomenon demonstrates what Fitch describes as "lower sensitivity to the stronger exchange rate"–while goods inflation responds to currency movements through cheaper imports, services inflation driven by domestic labour costs proves more resistant to external disinflationary forces.

This labour market resilience creates a policy dilemma. On one hand, tight employment supports household incomes and consumption, preventing the sharper slowdown that might otherwise result from 15% interest rates. BBVA specifically cites "tight labor markets" as a factor that will "prevent a sharper slowdown" alongside potential election-year fiscal stimulus. On the other hand, persistent labour market tightness delays the disinflationary process, potentially forcing the Central Bank to maintain restrictive policy longer than it would prefer. The Bank's cautious rhetoric throughout 2025–publicly wondering whether "a prolonged period of policy rates at 15% is enough to bring CPI back to its 3% target"–reflects this concern.

The forward-looking question is how labour market dynamics will evolve as output growth weakens further. Historical patterns suggest a 12-18 month lag between GDP deceleration and labour market softening, implying that unemployment may not rise materially until mid-to-late 2026. This timing creates an awkward sequencing: the Central Bank would ideally begin aggressive easing once labour markets cool and services inflation moderates, but this cooling may not arrive until well after the October 2026 election. The risk is that premature easing, driven by political pressure or recession fears, reignites inflation before the labour market's natural adjustment mechanism has completed its work.

2.4 External sector: resilience despite headwinds

External accounts demonstrate unexpected resilience. The $62bn January-October current account deficit (+20.5% y/y, 3.51% GDP) was more than offset by exceptional FDI of $74.2bn (+8.8% y/y), already exceeding 2024’s full-year total. October alone delivered $10.9bn FDI versus $6.3bn forecast. Brazil’s $300bn+ reserves provide an ample buffer. Trade flows reveal vulnerabilities and adaptive capacity: soybeans (85% to China) face shifting competition as China suspended US retaliatory tariffs, while EPA’s bio-diesel expansion improves US farmer conditions. Manufacturing exports faced US tariff-triggered cancellations but diversified toward Argentina, Italy, Mexico, Uruguay, UK. July’s iron ore record of 41.1mn tonnes occurred despite Chinese demand moderation. The bifurcated picture–commodity exports generating substantial inflows despite headwinds, manufacturing facing tariff obstacles–suggests FDI confidence in medium-term potential despite near-term cyclical weakness.

2.5 The 2027 outlook: potential for recovery

Looking beyond 2026’s weakness, analysts see modest acceleration potential. Fitch projects 1.8% growth as election-year fiscal supports recede but monetary easing provides offset. BBVA offers conditional optimism: “Brazil could grow above 2% from 2027 onwards” if risks are managed effectively. The structural growth rate conundrum remains contentious–potential GDP typically estimated at 2.0-2.5%. Three factors could lift potential: successful Equatorial Margin/critical minerals exploitation, infrastructure investment alleviating bottlenecks, and fiscal reforms redirecting spending toward productivity rather than consumption. The near-term priority is navigating 2026 without triggering sharper contraction, enduring the “lagged impact of cyclical slowdown” while maintaining confidence that recovery lies beyond the immediate horizon.

2.6 Inflation dynamics and monetary policy response

2.6.1 The disinflation process: progress and persistence

Brazil's inflation trajectory through 2025 tells a story of significant progress marred by stubborn persistence in key categories. After breaching the upper bound of the Central Bank's 3% ±1.5 percentage point target range to reach 5.5% year-on-year in April, headline CPI moderated steadily to 4.5% by mid-November–the first time since mid-January that inflation returned to the target band. This seven-month disinflation represents meaningful achievement, particularly given the concurrent economic expansion that kept unemployment at record lows.

The composition of inflation reveals why Central Bank officials remain cautious despite this progress. Core inflation–which strips out volatile food and energy prices to focus on underlying trends–has declined alongside headline measures, suggesting the disinflation is genuine rather than merely reflecting temporary favourable base effects. However, services inflation registered 6.2% year-on-year in October, more than double the Central Bank's target and still accelerating despite seven months of 15% policy rates. This persistence reflects what Fitch describes as "labour-market tightness and lower sensitivity to the stronger exchange rate"–a reminder that monetary policy's impact on labour-intensive, domestically-oriented sectors occurs with particularly long lags.

The OECD projects inflation reaching 5.1% in 2025 (down from its earlier 5.7% forecast), falling to 4.2% in 2026 and 3.8% in 2027, noting that “electricity, food and services continue driving inflationary pressure.” Expectations for 2026 and 2027 remain above the 3% target midpoint, the OECD observes, requiring maintenance of a “restrictive stance for longer.”

The inflation expectations data provides crucial context for policy decisions. The Central Bank's Focus survey of market analysts showed 2025 year-end inflation expectations at 4.45% as of early December (down from 4.46% the previous week), with 2026 projections at 4.18%, 2027 at 3.8%, and 2028 at 3.5%. These forecasts suggest a gradual convergence toward the 3% target over a three-year horizon–neither the rapid return that would enable aggressive easing nor the persistent above-target path that would necessitate continued tightening. The expectations pattern implies market confidence that the Central Bank will ultimately succeed in its mandate, but only through maintaining restrictive policy well into 2026.

November marked an inflection point in inflation dynamics and Central Bank rhetoric. The October quarter unemployment data showing a 5.4% record low coincided with the IPCA-15 preview index touching 4.5%–precisely at the upper end of the target band. Central Bank President Roberto Campos Neto characterised the situation as "particularly complex," noting mixed signals that were "not where mandate requires." This cautious tone, delivered just days before the Monetary Policy Committee's (COPOM) final 2025 meeting, signalled that policymakers saw insufficient evidence to declare victory despite headline inflation returning to the target range.

2.6.2 Competing inflation forecasts

Forecasts for end-2026 inflation range from BBVA's optimistic 3.7% (approaching target) to Fitch's cautious 4.5% (still 1.5pp above target). BBVA cites softer domestic demand and real appreciation driving faster disinflation. Fitch highlights sticky services inflation at 6.2% reflecting labour market tightness, warranting slower convergence. The 80bp divergence represents differing assessments of how quickly demand will cool, labour markets will soften, and the real will appreciate.

2.6.3 Monetary policy stance: the easing debate

The Central Bank's policy stance through 2025 demonstrated unwavering commitment to inflation control despite mounting criticism. After beginning its tightening cycle in September 2024, the Bank delivered a cumulative 450 basis points of increases to reach 15% by July 2025. Crucially, the Bank has held this rate steady through the remainder of 2025 rather than beginning the gradual cuts that some market participants anticipated. Board Member Nilton David's August comment that the next move "should be a cut" with "further increases not in baseline" represented the most explicit easing signal, yet the Bank refrained from action through year-end.

Finance Minister Fernando Haddad offered a more dovish perspective in September, stating "everything leads me to believe the rate-cutting cycle will start sometime in the next few months." This tension between executive branch hopes for easing and Central Bank caution about premature action reflects the institutional independence granted through 2021 legislation. The Bank's operational autonomy enabled it to resist political pressure for cuts even as the government prepared election-year fiscal support measures that could prove inflationary.

The forward rate curve pricing in the Focus survey reveals market expectations for gradual easing: end-2025 at 12% (subsequently revised down to 11.75% in later surveys), end-2026 at the "lowest projected level so far" according to mid-2025 commentary, end-2027 at 10.5%, and end-2028 at 9.75%. Capital Economics assessed in December that the "easing cycle appears just around the corner," while Pantheon Economics anticipated a 50 basis point cut in January. The question is not whether easing will occur but rather its timing and pace.

Goldman Sachs has introduced an important caveat to the January start consensus. While their baseline expects easing to begin in January, Alberto Ramos "sees a chance of a delay to March or later, citing resilient activity and election-year spending." This alternative scenario gains plausibility from the labour market data: if unemployment remains at record lows through early 2026 and services inflation stays elevated, the Central Bank may judge that conditions have not sufficiently cooled to warrant immediate action. A March or April start would still constitute early-2026 easing but would represent greater central bank caution than currently priced into forward curves.

2.6.4 The terminal rate question

Forecasts cluster tightly: BBVA projects 11.0%, Fitch 12.0%. Both explicitly note these remain “restrictive levels” implying neutral rates around 8-9%. BBVA's 400bp cuts suggest January-February start with a steady 33bp monthly pace. Fitch's 300bp cuts imply 25bp per meeting across 2026's eight COPOM meetings. Even at terminal rates, real rates would remain 7-7.5pp–well above 2-3% neutral estimates–maintaining contractionary stance throughout 2026.

2.6.5 Risks to the monetary policy path

Several factors could disrupt the baseline easing scenario. Election-year spending and persistent services inflation above 6% could delay cuts until March. Conversely, sharper-than-expected economic cooling might necessitate more aggressive easing. Exchange rate volatility linked to fiscal concerns or adverse election polls represents the primary risk, potentially forcing the Bank to slow or pause cuts despite weak growth.

2.6.6 The 2027 monetary policy outlook

The Focus survey projects the Selic declining to 10.5% by end-2027 and 9.75% by end-2028, implying continued gradual easing as inflation converges toward target. Achieving this outcome requires not just monetary policy success but also fiscal consolidation that reduces debt issuance and lowers Brazil's sovereign risk premium.

3.0 Real Economy

3.1 Retail sector: deleveraging and consolidation

Brazil’s retail sector prioritises deleveraging over expansion, with capital expenditure declining to 3.0-3.5% of revenues in 2026-2027 from 3.8% in 2024 and 6%+ pre-pandemic. Retail financing rates reached 5.5% monthly, making aggressive rollouts prohibitively expensive. Highly leveraged operators like CBD, Assaí and Nissei focus on debt reduction, while stronger players like Centauro, C&A and Vivara increase investments.

The top 300 retailers now control 51.9% of sales, with supermarkets and drugstores reaching 66% of revenues. September retail sales fell 0.3% month-on-month. Beyond interest rates, betting platforms have diverted spending–gambling tax revenues surged from BRL11mn to BRL1.09bn in October. Chains in bankruptcy (Dia, Novo Mundo, Polishop, Casas Bahia) accelerate consolidation.

3.2 Manufacturing: navigating the tariff labyrinth

Brazilian manufacturing faced double shocks through 2025: monetary tightening reducing domestic demand and US tariff uncertainty disrupting exports. The September PMI collapsed to 46.5 (sharpest decline in 29 months), recovering modestly to 48.8 in November but remaining in contractionary territory. August industrial output rose 0.8% month-on-month but fell 0.7% year-on-year, with January-August managing only 0.9% growth.

Current output stands just 2.9% above February 2020 pre-pandemic levels but 14.4% below the May 2011 peak–Brazilian manufacturing never fully recovered from the 2014-2016 recession. US tariffs delivered acute damage to export-oriented subsectors (timber, extractives, furniture), with September noting “order cancellations mounting.” International sales fell modestly but were “supported” by diversification toward Argentina, Italy, Mexico, Uruguay, UK. Cost dynamics provided relief: November input costs fell (second time in 2+ years) driven by favourable exchange rates and subdued global demand reducing imported component prices.

3.2.1 Automotive sector: the Chinese challenge

Few sectors illustrate Brazil's manufacturing challenges more vividly than automotive, where Chinese imports have surged while domestic production struggles. Chinese vehicle imports reached 123,482 units in the January-September 2025 period, representing 51.2% year-on-year growth. This compares to 150,252 units imported from Argentina (down 1.3%) and just

23,365 from Mexico (down 30.2%). Domestic production managed approximately 2mn units for the same period, up only 6%–a growth rate that pales against the Chinese import surge.
BYD's Brazilian manufacturing presence adds complexity to this narrative. The Chinese automaker inaugurated its Camaçari, Bahia factory in November 2025–a BRL5.5bn ($978mn) investment on the site of Ford's former plant. The facility produced its 10,000th unit after just five months of operation, with initial capacity of 150,000 units per year and long-term targets reaching 600,000 units. BYD manufactures the Dolphin Mini, King sedan and Song Pro crossover for the Brazilian market, supporting what the company claims will be more than 20,000 jobs.

BYD dominates Brazil's electric vehicle market with a 74.4% share, having sold more than 170,000 vehicles since entering in 2022. January-September 2025 sales reached 89,380 vehicles (54,256 plug-in hybrids, 35,124 battery electrics). This market leadership raises questions about whether local production will substitute imports or simply expand BYD's total volumes–the company could theoretically continue importing higher-end models while producing mass-market vehicles domestically. The net impact on Brazil's trade balance and domestic value-added remains unclear.

Traditional manufacturers face mounting pressure from this low-cost competition. While domestic producers maintain advantages in brand loyalty, dealer networks and after-sales service infrastructure, Chinese vehicles' price competitiveness–often 20-30% below comparable Brazilian-made models–attracts budget-conscious consumers. The government has responded with modest protective measures, but nothing approaching the comprehensive industrial policy that might shield domestic manufacturers from the Chinese onslaught.

3.2.2 Steel sector: import penetration at record levels

Brazil's steel industry confronts a similar import surge, with 2025 projected imports of 6.3mn tonnes–a 32.2% increase from 2024's 4.77mn tonnes and an all-time record. Import penetration has risen from 18% to 22% of domestic sales in 2025, with the import share reaching 30% when measured against apparent consumption of 27.4mn tonnes (up 5%, substantially exceeding an earlier 1.5% forecast). These imports enter primarily through northern ports like Manaus and southern ports such as São Francisco do Sul, exploiting logistics arbitrage and circumventing some protective measures.

The government has imposed safeguard duties up to 25% on certain steel categories, but these measures have proved insufficient to stem the tide. The fundamental challenge is straightforward: global steel overcapacity–particularly in China–creates pricing pressure that Brazilian producers struggle to match while maintaining profitability. The 5% increase in apparent consumption suggests domestic demand remains reasonably healthy; the problem is that incremental demand is being satisfied by imports rather than domestic production.

This pattern carries implications beyond the steel sector itself. Steel is a foundational input for construction, automotive, machinery and appliance manufacturing. If downstream manufacturers shift toward imported steel due to price advantages, the entire domestic metals supply chain faces pressure. The sector's 2025-2029 planned investment of $68.4bn–with iron ore accounting for $19.6bn of this total–could be scaled back if import competition makes domestic steelmaking less attractive, potentially creating a vicious cycle of underinvestment and declining competitiveness.

3.3 Critical minerals: Brazil's geopolitical opportunity

While traditional manufacturing faces headwinds, Brazil's critical minerals sector is emerging as a strategic asset with potential to reshape the country's economic and geopolitical position. The sector has attracted particular attention following the cautionary tale of Serra Verde–a rare earth mining project in Goiás that came online in 2024 after 15 years of development, financed by Western capital, yet forced to commit most production to China due to lack of processing capacity elsewhere.

As EIU's Liam Lin frames it, "the plan backfired" because rare earth mining without downstream processing simply relocates extraction without challenging China's dominance of refined products and manufactured goods.
Three new rare earth projects are explicitly learning from Serra Verde's mistake. Led by US and Australian firms, these developments include plans for domestic processing and refining facilities rather than simply extracting ore for export. The investment total for rare earths during 2025-2029 represents a 49% increase compared to the previous five-year period–a dramatic acceleration reflecting both government priority and private sector confidence. Brazil holds the world's second-largest rare earth reserves, creating natural advantages that previous policy failures had left unexploited.

The most ambitious initiative is MagBras, launched in July 2025 with the goal of manufacturing super magnets entirely within Brazil by 2026. Super magnets–permanent magnets made from rare earth elements like neodymium and dysprosium–are essential components in electric vehicles, wind turbines, advanced electronics and defence systems. Currently, China produces approximately 90% of the world's supply, creating a chokepoint that Western governments view with alarm. If MagBras succeeds in establishing vertically integrated production from mining through refining to magnet manufacturing, EIU assesses "China's grip could finally loosen" and the achievement would "improve Brazil's standing on the geopolitical stage."

This vertical integration strategy reflects painful lessons from commodity export history. Brazil has repeatedly cycled through booms where it supplies raw materials to global markets–rubber in the early 20th century, iron ore throughout the industrialisation period, soybeans more recently–without capturing value-added downstream. The rare earth opportunity offers a chance to break this pattern by building processing capacity while resource extraction is still scaling up, rather than attempting to add value-added activities after export relationships have solidified.

The geopolitical dimension adds urgency. US-China technology competition has elevated critical minerals from obscure industrial inputs to matters of national security. The United States, European Union and other Western governments are actively seeking to diversify supply chains away from Chinese dependence, creating policy and financial support for alternative sources. Brazil's combination of resource endowment, existing mining expertise, political stability relative to other potential suppliers, and reasonably developed infrastructure positions it as a natural Western alternative. The November exemptions in US tariffs that Liam Lin described as "definitely targeted toward Brazil" likely reflect this strategic calculus.

JPMorgan's designation of South America as a "critical region for global investment in 2026" rests substantially on the minerals dimension. The bank notes that the region supplies 40% of global copper production (though Brazil itself is a minor producer), with Chile holding 38% of reserves. Brazil's comparative advantage lies more in rare earths, iron ore (where it is the world's second-largest exporter), and increasingly in battery minerals. The firm's assessment that the region is a "key supplier of minerals, energy and agriculture for the AI revolution" positions Brazil's resource endowment as directly relevant to the most dynamic technology sector.

3.4 Oil and gas: the pre-salt success story continues

If critical minerals represent Brazil's future resource opportunity, oil and gas exemplify the successful exploitation of existing endowments. National production reached a record 5.255mn barrels of oil equivalent per day in October 2025, with crude output hitting 4.030mn barrels per day (up 2.9% month-on-month and 23.2% year-on-year) and natural gas production touching 194.78mn cubic metres per day (up 2.2% month-on-month and 22.5% year-on-year). The pre-salt layer accounted for 4.276mn boe/day–81.4% of national output–representing 27.8% year-on-year growth in pre-salt production alone.

Petrobras's financial performance has rebounded sharply from 2024's difficulties. Second-quarter 2025 net profit of $4.7bn contrasted with a $469mn loss in the same period of 2024, while first-quarter 2025 profit of $6bn represented 48.5% year-on-year growth. The company maintains daily production above 2mn barrels of crude oil and has approved $1.6bn in advance dividend payments for 2025. These results demonstrate that Petrobras has navigated the transition from its troubled period under previous management to more stable operations that balance production growth, financial discipline and shareholder returns.

Individual field performance illustrates the scale of Brazil's pre-salt success. The Búzios field produced 884,780 barrels per day in October, while Mero delivered 41.34mn cubic metres per day of natural gas. The FPSO Almirante Tamandaré floating production unit achieved 232,940 barrels per day oil production, with the FPSO Marechal Duque de Caxias producing 12.70mn cubic metres per day of gas. These figures represent world-class performance

from assets that began producing only in the past decade, validating Brazil's decades-long investment in ultra-deepwater technology.
BP's Bumerangue discovery in August 2025 demonstrated that major finds remain possible even in Brazil's mature basins. Described as BP's largest discovery in 25 years, the field contains a 500-metre hydrocarbon column covering potentially more than 300 square kilometres.

The Oxford Institute for Energy Studies estimates reserves at 2-2.5bn barrels of oil equivalent, with potential output of approximately 400,000 barrels per day sustainable for decades. The discovery occurs within BP's 100%-owned block, providing the company complete operational control and eliminating the partnership complexities that often slow development of new fields.
The Bumerangue find fits BP's broader strategy of raising upstream spending by 20% to $10bn by 2027, reflecting renewed industry confidence in conventional oil development despite energy transition pressures.

For Brazil, the discovery reinforces its position as Latin America's largest oil producer and demonstrates that exploration potential extends beyond the massive fields discovered in the initial pre-salt boom. The Santos and Campos basins where Bumerangue sits account for 95% of Brazil's current production, with proven reserves of 16bn barrels (potentially reaching 30bn including probable and possible reserves) that are "continuing to grow" according to EIU analysis.

The most ambitious frontier remains the Equatorial Margin, spanning Brazil's northern coast from the Amazon to the Northeast. With estimated reserves up to 30bn barrels, this region could rival or exceed the pre-salt in total resources. Petrobras obtained crucial environmental licences in November 2025 for exploratory drilling near the Amazon, though EIU notes it will take "many years before first oil" due to the extra caution required in this environmentally sensitive area.

The licensing breakthrough suggests government determination to exploit these resources despite environmental opposition, though the timeline pushes significant production beyond 2030.

4.5 Agriculture: The Double-Edged Boom

Brazilian agriculture delivered standout performance through 2025, with second-quarter farm GDP surging 10.1% year-on-year to BRL239.1bn ($44.7bn)–the strongest sectoral contribution to overall economic growth. Production gains were broad-based: soybeans up 14.2%, corn up 19.9%, rice up 17.7%, cotton up 7.1%, and coffee up 0.8%.

The 12-month farm GDP growth through June reached 5.8%. MB Associados, a São Paulo-based consultancy, estimates this agricultural boom could sustain approximately 50% of Brazil's economic expansion in 2025.
Yet consultancy analysts warn that "growing at this magnitude has consequences," pointing to inflationary pressures from rapid agricultural expansion. The mechanism is straightforward: agricultural booms drive rural income growth, which translates to increased consumption of manufactured goods and services in agricultural regions.

This demand surge occurs precisely when monetary policy is attempting to cool the overall economy, potentially offsetting some of the Central Bank's intended contractionary effect. The inflation contribution may be modest compared to services-driven price pressures, but it adds to the Central Bank's challenge of achieving convergence to the 3% target.

Export market dynamics present mounting challenges for 2026 and beyond. ING projects that Brazil will produce "yet another record soybean harvest in 2025/26," but warns that circumstances have shifted against Brazilian exporters. China's suspension of retaliatory tariffs on US agricultural products–implemented in 2024 as part of the broader trade war–has improved conditions for American soybean farmers. Additionally, the EPA's proposed expansion of bio-based diesel volumes under the Renewable Fuel Standard creates additional US domestic demand, further supporting American prices relative to Brazilian offers.

Currency movements compound these competitive pressures. ING assesses that broader "USD weakness into 2026... will eat into the competitiveness of Brazilian soybeans, relative to those from the US." When the US dollar weakens against the real, Brazilian exporters receive fewer reais per dollar of sales, compressing profit margins even as global dollar prices remain stable. The combination of record harvests (expanding supply), reduced Chinese preferential treatment (normalising demand), and real appreciation (squeezing margins) suggests Brazilian soybean cash values face downward pressure through 2026.

Coffee exports illustrated trade policy impacts dramatically. August 2025 shipments to the United States collapsed to 251,902 bags–down 55.24% year-on-year–after Trump's 50% tariffs took effect on August 6. The United States is the largest buyer of Brazilian coffee, and Brazil is the world's top producer and exporter, making this bilateral relationship critical to the sector. July shipments had reached approximately 450,000 bags, suggesting the tariff cut export volumes by more than half within a single month. The November exemption that removed tariffs on Brazilian coffee represents a significant relief, though it remains to be seen how quickly export volumes recover to pre-tariff levels.

3.5 Services: the COP30 effect

Services (70% of GDP) endured seven months of PMI contraction before November's 50.1 reading returned the sector to growth, partly driven by COP30-related demand. Employment expanded for three consecutive months through November after July job losses. Cost pressures intensified–fuel, electricity, food, insurance–but competitive pressures prevented full pass-through to clients, compressing margins. The composite PMI recovered to 49.6 in November from September's 46.0, suggesting services-led contraction is easing as intended monetary tightening cools demand.

Brazil's services sector–representing approximately 70% of GDP–endured a prolonged contraction through most of 2025 before staging a tentative recovery in November. The services PMI fell to 46.3 in both July and September (the latter marking the fastest decline in 4.5 years), remaining below the 50-point expansion threshold for six consecutive months. October brought modest improvement to 47.7, but the sector remained in contraction. November's 50.1 reading finally returned services to growth after seven months of decline, driven by what survey compilers described as "COP30-related demand and marketing initiatives."

This November improvement deserves scrutiny regarding its sustainability. COP30, the United Nations climate summit which took place in Belém in November 2025, generated temporary demand for hospitality, transport, event management and related services. Business expectations reached a six-month high in November, but respondents specifically noted "2026 election uncertainty" as a constraining factor on longer-term optimism.

Employment trends within services provide a mixed signal. The July PMI recorded private sector job losses for the first time in 2.5 years, concentrated in services rather than manufacturing or construction. Yet by November, employment had expanded for three consecutive months. This rebound may reflect COP30 hiring, raising questions about whether job growth will persist into 2026. Services inflation remaining elevated at 6.2% year-on-year despite output contraction suggests labour market tightness continues constraining supply rather than weak demand destroying jobs.

Cost pressures intensified in November at the fastest pace in three months, driven by increases in fuel, electricity, food, beverages, insurance, supplies, rent and taxes. Notably, the pace of price increases charged to clients slowed despite accelerating input costs, suggesting competitive pressures or demand weakness prevented full cost pass-through. This margin compression–absorbing input cost increases rather than passing them to customers–may prove unsustainable if costs continue rising, potentially forcing either price increases that risk demand destruction or capacity reductions that increase unemployment.

The composite PMI, which combines manufacturing and services, tracked the services-driven weakness through most of 2025: 46.6 in July (down from 48.7 in June), 46.0 in September (missing the 48.5 forecast), before recovering to 49.6 in November. The pattern suggests that Brazil's cyclical downturn has been driven as much by services sector weakness–reflecting high interest rates' impact on consumption–as by manufacturing's export and tariff challenges. This services-led contraction implies monetary policy is working as intended to cool demand, though it remains to be seen whether the cooling proves excessive.

4.0 Budget & Debt

4.1 The 2026 budget framework: optimism vs arithmetic

The government's 2026 budget projects 0.25% of GDP primary surplus "without fresh revenue measures," resting on dividend projections exceeding BRL37bn, potential oil auction revenues above BRL15bn, 10% tax benefit reduction (~BRL20bn), and BRL20.9bn from higher taxation on financial investments, betting, and bank profits. Economic parameters reveal embedded challenges: 2.44% GDP growth (down from 2.5% estimate), 3.6% inflation (up from 3.5%), average Selic 13.11% (up from 12.56%).

The minimum wage projection of BRL1,627 represents 7.2% growth, with a formula incorporating INPC inflation plus real increase based on lagged GDP growth. The structural constraint: mandatory spending consumes ~90% of the federal budget, leaving minimal room for discretionary adjustment.

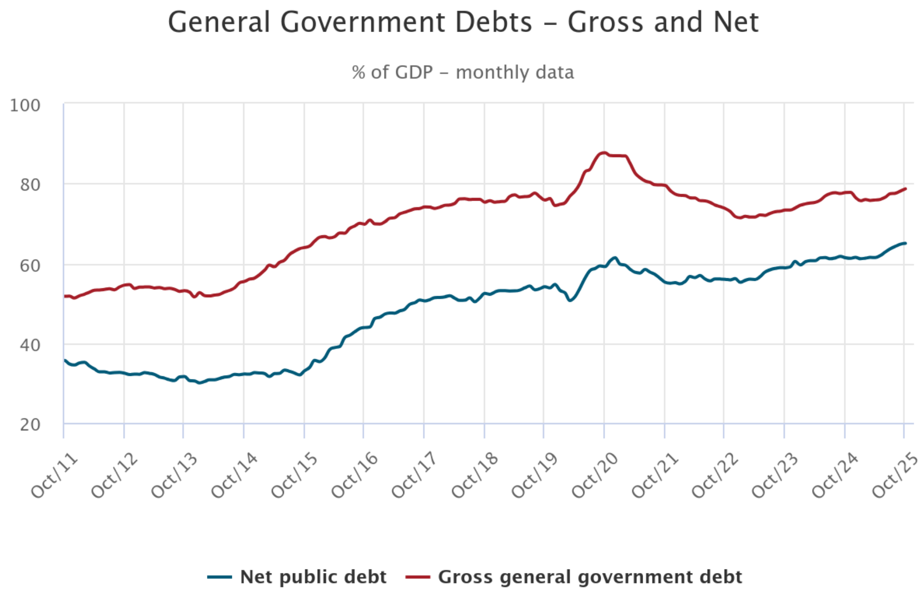
4.2 The Goldman Sachs reality check

Goldman Sachs's November assessment cuts through the budget arithmetic to expose the fundamental mismatch between government targets and stabilisation requirements. The bank calculates that Brazil requires a primary surplus above 2.5% of GDP to reverse its rising debt trajectory–more than ten times the government's 0.25% target for 2026. This gap implies a necessary fiscal adjustment of 3 percentage points of GDP, an enormous consolidation by international standards that would typically require multiple years to implement without triggering recession.

Central Bank data showing gross public debt at 78.1% of GDP in September 2025 provides the baseline for Goldman's calculations. This debt level represents the highest since November 2021 and marks substantial deterioration from the 71.7% recorded at the end of Bolsonaro's term–a 6.4 percentage point increase in less than three years. Treasury projections showing debt rising to 84.2% of GDP by end-2028 before beginning to decline suggest the government recognises the trajectory is unsustainable, yet its policy measures remain insufficient to materially alter the path.

Alberto Ramos's warning that "a fourth Lula term cannot repeat his third term's fiscal management" crystallises the political challenge. The current administration's approach has been characterised by what Ramos describes as "rising revenues alongside increased spending"–a pattern that has delivered on social policy priorities (14.17mn people lifted above the poverty line between May 2023 and July 2025) but failed to stabilise debt. The implicit message is stark: even if Lula wins re-election, his fourth term must implement austerity measures that contradict his third term's expansionary stance. For an opposition candidate, the message is equally challenging–inheriting a fiscal crisis that requires immediate unpopular action.

The consequence of insufficient adjustment is explicit in Goldman's framework: "potential market volatility or even a financial crisis." This is not mere speculation–Brazil has experienced sovereign debt crises twice in living memory (the 1980s debt crisis and the 2002 currency crisis during Lula's first election), and markets retain institutional memory of these episodes. Ramos's additional caution that "stabilising debt at high levels could leave Brazil vulnerable to future shocks" acknowledges that even achieving the Treasury's projected post-2028 decline would leave debt around 80% of GDP–elevated by emerging market standards and offering limited cushion against external shocks like commodity price collapses or sudden capital flow reversals.



4.3 Investment and infrastructure: the private sector lead

Brazil achieved record infrastructure investment of BRL280bn ($48bn) in 2025, though growth decelerated to 3% from prior years' 15-19% expansion. Private sector investment dominated at 84% (BRL234.9bn, +6%), while public investment fell 11% to BRL45.1bn, reflecting fiscal constraints forcing procyclical cuts during the slowdown. Sanitation attracted BRL44.5bn (+35.7%) as the 2020 framework law channels private capital toward water/sewerage deficits. The proposed BRL30bn defence spending exemption from fiscal targets would test Congress's willingness to create “above-the-line” expenditures that erode framework credibility.

Despite fiscal constraints, Brazil achieved record infrastructure investment of BRL280bn ($48bn) in 2025, representing 3% growth though a deceleration from 2023's 19.5% and 2024's 15.3% expansion rates. The crucial dimension is the composition: private sector investment accounted for 84% of the total at BRL234.9bn (up 6% year-on-year), while public sector investment fell 11% to BRL45.1bn. This overwhelming private sector dominance reflects both fiscal necessity–the government lacks resources for major capital programmes–and policy success in creating frameworks that channel private capital toward infrastructure gaps.

Sectoral patterns illustrate where investment is flowing. Sanitation attracted BRL44.5bn in 2025, surging 35.7% as the 2020 sanitation framework law continues driving private capital toward water and sewerage systems–Brazil's most glaring infrastructure deficit with approximately 100mn people lacking adequate sanitation. Transport and logistics investment grew 12.7% to BRL76.5bn, encompassing port modernisation, highway concessions, and railway expansion projects that aim to reduce the notorious "Brazil cost"–the logistics inefficiencies that erode export competitiveness.

The public investment decline warrants concern despite strong private sector performance. Government capital spending tends to be countercyclical–rising during downturns to support demand and falling during expansions to avoid overheating. The 11% decline occurring during a cyclical slowdown represents procyclical fiscal policy that amplifies rather than dampens the cycle. This pattern likely reflects fiscal constraints rather than deliberate policy choice: with mandatory spending consuming 90% of the budget and political resistance to cutting current spending, capital budgets become the residual absorbing fiscal pressures.

A proposed defence spending initiative would test Congress's willingness to exempt certain expenditures from fiscal targets. The government has suggested BRL5bn ($930mn) annually for six years–BRL30bn total–for defence modernisation with 35% national content requirements, to be excluded from primary balance calculations. Such exclusions are attractive politically, allowing politicians to claim fiscal responsibility while funding popular programmes, but they erode the credibility of fiscal frameworks by creating "above-the-line" spending that escapes normal constraints. If approved, this defence exception would likely trigger demands for similar treatment from other sectors, potentially rendering the fiscal target meaningless.

4.4 Rating agencies' perspective

Fitch Ratings maintains Brazil's 'BB' rating with stable outlook–unchanged since the July 2023 upgrade that moved Brazil from 'BB-' to 'BB'–suggesting the agency sees sufficient commitment to fiscal discipline to avoid a near-term crisis while acknowledging medium-term challenges. Fitch expects the government will meet its 2025 zero deficit target, a vote of confidence in Treasury's projections despite scepticism from some market participants. For 2026, Fitch anticipates the 0.25% surplus target will be achieved, though the agency acknowledges "election-year fiscal measures" may tempt easing "if growth is moderate and the election tight."

Morningstar DBRS offers a harsher assessment, placing Brazil and Colombia as facing "the most challenging outlooks" in Latin America on fiscal grounds. The rating agency's analysis points to a dual challenge: "Not only do they require large fiscal adjustments, but elections next year will likely delay consolidation efforts and generate uncertainties around the medium-term fiscal strategy." This framing suggests Morningstar sees 2026 as a lost year for fiscal repair, with meaningful consolidation only becoming possible in 2027 regardless of electoral outcome.

The Morningstar assessment extends beyond immediate fiscal arithmetic to governance challenges. The agency notes that "regardless of who wins the presidency, party fragmentation will likely complicate efforts to pass legislation." Brazil's Congress features more than 20 parties with representation, none commanding more than 20% of seats. Building coalitions to approve fiscal reforms requires complex negotiations and side payments that often dilute reform content. This fragmentation creates veto points that can block consolidation even when the executive possesses clear mandates and technical competence.

Both agencies acknowledge structural strengths that provide resilience despite fiscal fragility. Morningstar highlights "credible inflation targeting frameworks, healthy banking systems, and flexible exchange rates" that buffer external shocks. Fitch's stable outlook implies confidence these institutional strengths will prevent crises even as debt rises. Yet both also warn that these buffers are finite–Morningstar's assessment that "sovereign credit performance in 2026 will be largely driven by the political willingness of respective governments to address structural fiscal imbalances" implies that institutional strength cannot permanently substitute for policy action.

4.5 The post-election reckoning

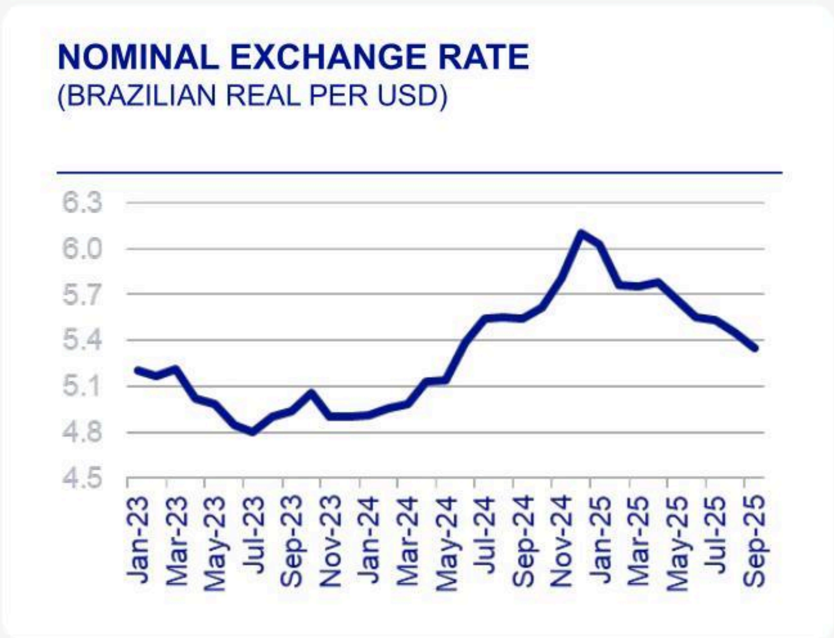
Goldman says that "Brazil's fiscal balance will become a top priority from 2027 regardless of outcome." The 3pp GDP consolidation typically requires tax increases, spending cuts, and constitutional reforms addressing social security, subnational transfers, or revenue earmarking–each facing entrenched opposition. Deputy Finance Minister Galípolo's strategy emphasises "fiscal discipline, social protection and environmental goals" as complementary, pointing to 2023-2024's adjustment as evidence of commitment. Yet Goldman's analysis suggests even this substantial consolidation proved insufficient as debt continues rising. The tension between social protection and fiscal consolidation will define post-election politics, with pressure to preserve achievements (5mn jobs created, inequality, hunger map exit) while implementing austerity that could threaten them.

5.0 Markets Outlook

5.1 Currency markets: the Real's surprising strength

The Brazilian real delivered surprising 17% appreciation from late December 2024 through mid-August 2025 to BRL5.40/USD, driven by two forces: 15% Selic creating ~10pp real rates (among highest globally), and broad dollar weakness (dollar index declining from 109.6 January peak to 98.3 by August). ING describes Brazil's real rates as "deeply restrictive," creating "the strongest carry trade in the Latin American region." Forward markets and forecasts suggest moderation through 2026: ING projects 5.50, Fitch 5.60, consensus 5.70, forwards 5.90.

ING's below-consensus view rests on "double-digit real rates" sustaining carry advantages even as Selic declines to 12-13%. Yet fiscal sustainability remains "the real's Achilles heel"–election-year concerns or adverse polls could trigger rapid depreciation despite continued high rates. Fitch flags "fiscal and policy risks ahead of October elections" as a volatility source. The real's resilience despite widening current account deficit suggests markets view external imbalance as temporary and manageable, particularly given FDI coverage exceeding 100%.



Source: BBVA Research based on data by the BCB.

5.2 Equity markets: the 2025 surge and 2026 prospects

Brazilian equities delivered exceptional returns through the first 11 months of 2025, with the MSCI Brazil index rising approximately 40% in dollar terms–dramatically outperforming both emerging market and global indices. The Economist Intelligence Unit's November analysis attributed this surge to multiple factors: rotation out of expensive US equities as valuations reached historic extremes; a global search for yield and value that benefited cheaper emerging markets; commodity price tailwinds particularly in metals and agriculture; and improved corporate earnings as Brazilian companies navigated the high-rate environment more successfully than feared.

The November correction–EIU noted that "MSCI LatAm +40% year-to-date January through November" had experienced pullback–raised questions about sustainability of 2025's gains. Yet EIU's assessment that "there are still good reasons to believe LATAM stock markets will continue to perform quite well" in 2026 (while acknowledging "not another 40%") suggests the fundamental drivers remain supportive even as valuation tailwinds moderate. The key question is whether corporate earnings growth can sustain equity returns as macro conditions deteriorate through early 2026.

Sector performance has been highly divergent. Commodity-exposed stocks benefited from strong agricultural output and resilient iron ore demand despite Chinese steel production slowdown. Petrobras's equity appreciated substantially as the company's operational turnaround and dividend policy attracted both domestic and foreign investors. Consumer-oriented stocks faced pressure from high interest rates and moderating retail sales, while financials navigated mixed conditions–strong credit growth offsetting margin compression from heightened competition.

The election introduces specific risks and opportunities. Goldman Sachs's observation that "markets may rally if an opposition candidate gains traction" reflects expectations that a right-centre government might pursue more aggressive market-friendly reforms. However, Ramos's immediate qualifier that "investors respond to sound policies, not ideology" cautions against simplistic political positioning. The 2025 rally under Lula's left-leaning administration demonstrates markets can price in political differences when economic fundamentals appear manageable.

Foreign institutional flows remain a critical determinant of equity performance. Brazil's market capitalisation of approximately $1.2tn represents only about 1.5% of global equity markets, making it highly sensitive to shifts in foreign appetite for emerging market exposure. The positive factors supporting continued flows include: attractive valuations relative to developed markets; exposure to critical minerals and energy transition themes through mining and biofuels companies; increasing corporate governance standards; and the carry trade's profitability encouraging foreign participation across asset classes.

5.3 Foreign Direct Investment: the record-setting trajectory

Brazil’s FDI performance represents the most unambiguously positive dimension of external accounts. The $74.2bn received during January-October 2025 (+8.8% yoy, already exceeding 2024’s full-year $74bn) places Brazil on track to surpass 2011’s $102.4bn record. The FDI-to-GDP ratio of 3.63% fully offsets the 3.48% current account deficit–crucial for external sustainability as FDI proves more resilient than volatile portfolio flows.

Sectoral patterns reveal what attracts investment: oil and gas (BP’s $10bn upstream commitment through 2027), critical minerals (rare earth projects with integrated processing), manufacturing (BYD’s $978mn EV plant), and infrastructure (port, airport, highway, sanitation concessions drawing Spanish, French, German capital). JPMorgan designates South America as “critical region for global investment in 2026,” positioning Brazil’s resources as “key supplier of minerals, energy and agriculture for the AI revolution.” Election uncertainty presents primary near-term risk, potentially delaying major commitment decisions until policy direction clarifies.

5.4 The current account: structural deficit or cyclical phenomenon

Brazil's current account deficit reached $62bn in the January-October 2025 period, representing a 20.5% year-on-year increase and equivalent to 3.51%

of GDP on a rolling 12-month basis. This widening from the prior year's 1.95% of GDP has reignited debates about whether Brazil faces a structural external imbalance or merely a cyclical deterioration that will self-correct as the economy cools. The October deficit of $5.12bn exceeded the $4.8bn forecast, suggesting the bleeding has not yet stopped despite GDP growth deceleration.

The deficit's drivers illuminate its character. The trade surplus has weakened "as imports grew faster than exports"–a classic pattern of domestic demand outpacing external demand. Brazil imported goods and services to satisfy consumption and investment needs while exports faced multiple headwinds: US tariffs on manufactured goods, Chinese demand moderation for iron ore, and competitive pressures in soybeans. Services and income deficits–relatively stable structural components–have not deteriorated dramatically, suggesting the current account widening stems primarily from trade dynamics rather than worsening fundamentals.

This analysis implies the current account should begin improving in 2026 as GDP growth slows to 1.5-1.9% and high interest rates continue constraining import demand. Fitch's forecast that net trade will contribute +0.2 percentage points to 2026 GDP growth (versus -0.5 percentage points in 2025) reflects this expected rebalancing. The mechanism is straightforward: when domestic demand cools, import growth slows while export volumes face less competition from domestic sales, naturally improving the trade balance.

ING's currency analysis reinforces this cyclical interpretation. The bank assesses Brazil's real appreciation as reflecting "lower risk premiums" rather than structural external imbalance. If markets perceived the current account deficit as fundamentally unsustainable, the real would be weakening rather than strengthening–currency depreciation being the classic adjustment mechanism for external imbalances. The real's resilience suggests markets view the deficit as temporary and manageable, particularly given FDI coverage exceeding 100%.

Yet the 3.51% of GDP deficit approaches levels that historically have preceded currency crises in emerging markets, typically estimated around 4-5% of GDP. While FDI coverage provides a crucial buffer, structural sustainability depends on two factors: whether the economy can generate sufficient growth to service foreign liabilities accumulated through deficits, and whether international investor appetite for Brazilian assets remains robust. The first depends on productivity growth and competitiveness–uncertain given manufacturing's struggles. The second hinges on global liquidity conditions and risk appetite that can shift rapidly.

The historical parallel that should concern policymakers is 2014-2015, when Brazil's current account deficit widened sharply just before the commodity price collapse and political crisis that triggered deep recession. That episode demonstrated how quickly external accounts can shift from manageable to crisis when multiple shocks converge. The differences today–a more flexible exchange rate, higher foreign reserves, and more credible Central Bank–provide better shock absorption capacity. But the underlying vulnerability to terms-of-trade shocks and capital flow reversals remains an endemic feature of Brazil's commodity-dependent economic structure.

5.5 Commodity markets: the terms-of-trade squeeze

ING’s 2026 forecasts present a challenging mix: $10,550/t copper (positive but less relevant given minor producer status), $95/t iron ore (cautious on slower Chinese steel), $4,150/oz gold (positive for expanding production), $11.50/bu soybeans (mixed with competitiveness under pressure). Iron ore warrants concern as Brazil ranks second-largest exporter–July 2025’s record 41.1mn tonnes saw revenues fall 8.8% y/y as prices declined ~13%. ING warns “USD weakness into 2026 will eat into competitiveness of Brazilian soybeans relative to US,” compounding challenges from record harvests and normalised Chinese demand. Coffee’s November exemption from US tariffs provides relief after August’s 55% shipment collapse. The broader terms-of-trade likely tilts unfavourably, with flat-to-declining export prices while manufactured imports reflect global inflation, squeezing external balances and real income.

5.6 Market risks and scenarios

Brazil's markets face multiple 2026 scenarios highly sensitive to electoral dynamics and fiscal credibility. The benign scenario features credible post-election fiscal commitment regardless of winner, maintaining BRL5.40-5.60, 10-15% equity returns, and $100bn FDI. Muddling-through sees contested election delaying adjustment, modest real depreciation to 5.80-6.00, flat equity returns, $80-85bn FDI. Adverse scenarios involve either fiscal crisis or commodity price collapse triggering BRL6.50-7.00, 20-30% equity declines, and slowed FDI. Brazil enters 2026 with substantial policy space–$300bn+ reserves, room for rate cuts, flexible exchange rate–meaning crisis requires multiple simultaneous shocks rather than single triggers.

Brazil's markets face multiple scenarios through 2026, with outcomes highly sensitive to electoral dynamics, fiscal policy credibility, and external conditions. The benign scenario features Lula re-election accompanied by credible commitment to post-election fiscal consolidation, or an opposition victory that markets interpret as enabling faster adjustment. Under either variant, the real maintains strength in the BRL5.40-5.60 range, equity markets build on 2025 gains with 10-15% dollar returns, FDI sustains record inflows near $100bn, and credit spreads compress modestly as sovereign risk perceptions improve.

The muddling-through scenario–arguably the baseline given Brazil's historical pattern–sees contested elections followed by political fragmentation that delays but does not prevent eventual adjustment. The real depreciates to BRL5.80-6.00 as pre-election uncertainty triggers modest capital outflows, recovering partially once results clarify. Equity markets deliver flat-to-modest returns in dollar terms as earnings growth offsets multiple compression. FDI moderates but remains healthy at $80-85bn, sufficient to cover current account deficits. This scenario implies another year of policy drift before 2027 forces the reckoning Goldman Sachs anticipates.

The adverse scenario features either fiscal crisis or trade shock triggering broader market dysfunction. A fiscal crisis could emerge if election-year spending proves excessive, markets conclude post-election adjustment will not occur, and the real depreciates sharply to BRL6.50-7.00. This depreciation feeds through to inflation, forcing the Central Bank to delay easing or even resume tightening, deepening recession. Equity markets fall 20-30% in dollar terms, FDI slows as projects are postponed, and Brazil faces brief loss of market access requiring emergency measures.

The trade shock variant sees dramatic deterioration in commodity prices–perhaps triggered by Chinese recession–collapsing export revenues while import bills remain sticky. The current account deficit widens to 5%+ of GDP, exceeding comfortable financing levels even with strong FDI. The real depreciates to BRL6.00-6.50, inflation accelerates, and recession deepens as both monetary and fiscal policy must tighten despite weak growth. This scenario closely parallels 2014-2015 dynamics, though better institutional frameworks provide more shock absorption than existed then.

External factors could override domestic dynamics entirely. A global risk-off episode–triggered by US recession, Chinese financial crisis, or geopolitical shock–would hit Brazilian markets hard regardless of domestic conditions. Conversely, a sustained commodity super-cycle driven by energy transition demand or reconstruction spending could override fiscal concerns, generating such strong export revenues that debt sustainability improves through denominator effects. Brazil's vulnerability to external shocks reflects both its commodity dependence and the reality that a $2tn economy cannot insulate itself from global trends.

The policy response capacity warrants emphasis. Brazil enters 2026 with substantial policy space compared to other emerging markets: foreign reserves exceeding $300bn provide multiple years of import cover, the Central Bank can cut rates materially if inflation cooperates, and the flexible exchange rate provides automatic adjustment mechanism. These buffers mean crisis scenarios, while possible, require multiple shocks occurring simultaneously rather than single triggers. The question is whether this policy space will be deployed proactively to address mounting fiscal challenges, or consumed reactively in crisis response.

6.0 Conclusion

The year of reckoning deferred

Brazil enters 2026 having successfully postponed difficult choices rather than resolving underlying tensions. The economy's cyclical slowdown to 1.5-1.9% growth represents monetary policy working as intended, cooling demand to enable inflation convergence. The Central Bank will likely begin gradual easing from January, providing modest relief to borrowers while maintaining sufficiently restrictive conditions to ensure disinflation continues. External accounts remain manageable despite current account widening, with record FDI providing stable financing. Markets have delivered strong returns through 2025, suggesting investor confidence in the economy's medium-term potential.

Yet beneath this surface stability, fundamental imbalances accumulate. Gross public debt rising from 71.7% to 78.1% of GDP in less than three years, heading toward 84% by 2028, represents an unsustainable trajectory that Goldman Sachs warns will trigger "market volatility or even financial crisis" without fundamental policy shifts. The government's 0.25% of GDP primary surplus target for 2026 falls more than ten-fold short of the 2.5%+ required for debt stabilisation, while the 3 percentage point GDP adjustment Goldman calculates as necessary would represent austerity unprecedented in Brazil's democratic era.

The October 2026 presidential election serves simultaneously as deadline and excuse–deadline because markets will demand post-election action regardless of victor, excuse because pre-election political constraints prevent implementing unpopular measures now. This creates a perverse dynamic where everyone understands what must occur (substantial fiscal consolidation) yet agrees it cannot happen until after voters have spoken. Lula leads polls but faces net negative approval ratings and emerging challenges from crime and security issues where his progressive positions prove electorally vulnerable. The opposition remains fragmented around São Paulo Governor Tarcísio de Freitas or possibly Bolsonaro's son Flavio, who polls suggest would lose to Lula in a run-off yet could consolidate the right if the disgraced former president provides endorsement from his prison cell.

The real economy presents a fragmented picture. Agriculture booms with record harvests yet faces competitive pressures as China's tariff suspension removes preferential treatment for Brazilian soybeans. Manufacturing contracts under pressure from high interest rates and US tariff disruptions, though some sectors like steel benefit from import protection. Services endured seven months of PMI contraction before November's tentative recovery, driven partly by temporary COP30 demand. Retail prioritises deleveraging over expansion, while Chinese competition intensifies in autos and threatens broader manufacturing competitiveness.

The critical minerals opportunity offers genuine cause for optimism, with three new rare earth projects learning from Serra Verde's mistake of extracting resources for Chinese processing. The MagBras initiative to manufacture super magnets domestically by 2026 could materially shift global supply chains if successful, positioning Brazil as a strategic Western alternative to Chinese dominance. Oil and gas expansion continues apace, with October's 5.255mn boe/day national production representing world-class performance and BP's Bumerangue discovery adding 2-2.5bn barrels to reserves. These resource sectors demonstrate Brazil's enduring comparative advantage in extractives even as manufacturing struggles.

Markets will ultimately force resolution of policy contradictions that politics defers. The real's surprising strength through 2025–appreciating 17% despite fiscal concerns–reflects carry trade attractions from 15% interest rates rather than external balance strength. This strength assists disinflation by cheapening imports but pressures exporters' competitiveness, evident in soybeans where ING warns "USD weakness will eat into competitiveness of Brazilian soybeans relative to those from the US." The currency faces medium-term depreciation pressure once the Central Bank's easing cycle gains momentum, though how rapidly depends on whether fiscal credibility prevents disorderly adjustment.

The overarching challenge facing Brazil in 2026 is whether institutions can compel policy adjustment before market pressure makes it involuntary. Goldman Sachs's assessment that fiscal balance "will become a top priority from 2027 regardless of outcome" implies the arithmetic is non-negotiable even if the political timing remains unclear. Morningstar DBRS's judgment that "sovereign credit performance will be largely driven by political willingness to address structural fiscal imbalances" emphasises agency–Brazil possesses the technical capacity and institutional strength to stabilise debt, but lacks thus far the political will to prioritise consolidation over competing objectives.

For investors and analysts, this creates a binary bet on Brazil's 2027-2028 trajectory. The optimistic case holds that the October election will clarify political direction, enabling a newly-mandated government to implement consolidation during its honeymoon period when political capital runs highest. Post-adjustment, Brazil returns to stable moderate growth underpinned by resource wealth, improving infrastructure, and the demographic dividend of a still-young population. The pessimistic case suggests political fragmentation and weak mandates prevent adequate consolidation, forcing eventual crisis adjustment under market duress that proves more costly than proactive measures would have been.

History suggests Brazil muddles through rather than embracing extremes–the country has navigated multiple near-crises since the 1994 Real Plan without descending into Argentine-style collapse, yet also without achieving Asian tiger-style transformation. The 2026 pattern likely follows this template: modest pre-election fiscal stimulus followed by post-election consolidation insufficient to stabilise debt but adequate to prevent immediate crisis, extending the adjustment timeline through 2027-2028 while hoping for favourable external conditions that ease the fiscal arithmetic.

The ultimate question is whether Brazil can achieve what might be termed sustainable mediocrity–moderate growth of 2-2.5% annually, inflation converging to 3-4%, debt stabilising around 80% of GDP–or whether the accumulation of imbalances forces either crisis adjustment downward or fundamental reform upward. The policy space remains sufficient for managing this balancing act through 2026, but each year of deferred consolidation consumes buffers that cannot be rebuilt quickly. At some point, the capacity to defer difficult choices exhausts itself, and Brazil must either embrace reform or accept stagnation.