International Commentary — May 20, 2025

Brazilian Central Bank Not Done Hiking Yet

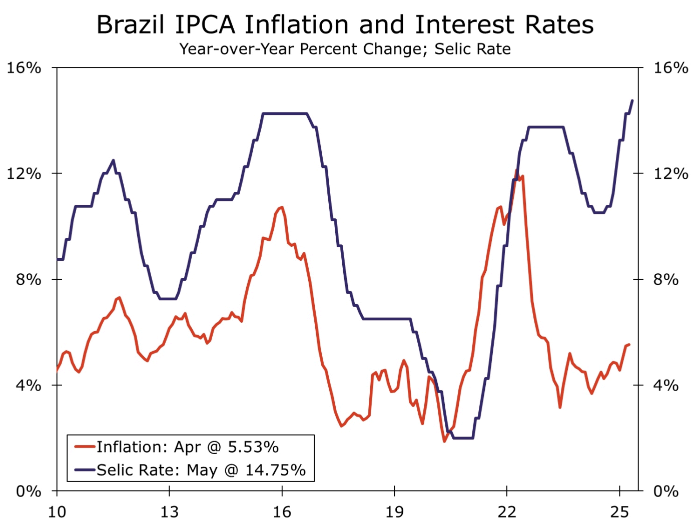
Summary

We are adjusting our outlook for the Brazilian Central Bank (BCB), and now forecast one last 25 bps rate hike to be delivered at the June Copom meeting. We view the balance of risk as between a hike or a hold, but we ultimately believe elevated inflation and fiscal concerns are enough to prompt one last BCB hike before policymakers embark on an extended pause. Attractive carry can anchor the Brazilian real in the near term; however, we remain of the view that the intersection of local politics and fiscal policy can drive the Brazilian real to all-time lows against the dollar by the middle of next year.

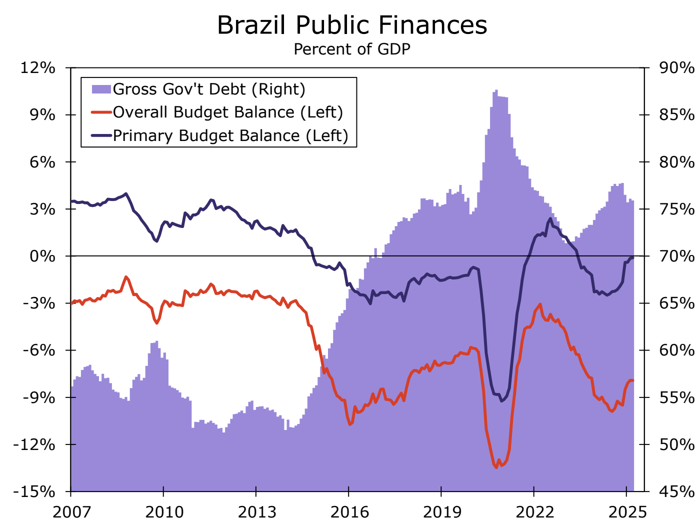
Economist(s)

Brendan McKenna
International Economist | Wells Fargo Economics
Brendan.McKenna@wellsfargo.com | 212-214-5637

Following the Brazilian Central Bank's (BCB) May monetary policy meeting and subsequent policymaker commentary we are making slight adjustments to our Selic rate forecast. To that point, we now believe the BCB Selic rate will peak at 15.00% as opposed to a prior forecast of 15.25%. In our view, a 25 bps hike at the June meeting is the most probable outcome—significantly more likely than our previous forecast calling for a 50 bps hike and slightly more likely than policymakers keeping monetary policy settings on hold. Our view for an additional 25 bps hike rather than a hold stems from local inflation that is above the upper bound of the central bank's inflation target as well as lingering fiscal concerns. The CPI has moved almost a full percentage point higher over the first few months of this year despite a stronger Brazilian real, broadly lower energy prices and fairly restrictive monetary policy settings. We believe policymakers will take the next meeting as an opportunity to continue defending against inflation that is trending in the wrong direction and attempt to anchor inflation expectations. Elevated inflation is a product of resilient economic activity, with solid economic momentum a derivative of loose fiscal policy over the course of Lula's administration. While spending cuts have materialized over the past few months, recent headlines suggest Lula may be planning more social spending. Brazil has been teetering on the brink of fiscal dominance, and in our view, policymakers will feel a need to be proactive and defend against another large BRL selloff should fiscal slippage unfold. While we have scaled back the degree of BCB tightening, we continue to believe policymakers will exhibit caution when considering a pivot to rate cuts. Our Monetary Policy Space Framework suggests BCB policymakers can lower rates by the end of this year; however, fiscal concerns lead us to continue to forecast the easing cycle to start in early 2026.



Source: Bloomberg Finance L.P. and Wells Fargo Economics



Source: Bloomberg Finance L.P. and Wells Fargo Economics

A hawkish and cautious Brazilian Central Bank can act as a near-term anchor for the Brazilian real; however, longer term, we have concerns over the path of the Brazilian currency. In our view, President Lula is likely to deliver multiple rounds of fiscal stimulus ahead of next year's presidential election as his popularity has deteriorated. Fiscal support is likely to be delivered over the course of 2026 and be directed to low-income households that Lula needs to enhance his re-election prospects. Looser fiscal policy could have markets question the viability of Brazil's fiscal framework, a dynamic that we believe will place depreciation pressure on BRL. In addition to fiscal issues, we also believe the BCB will be easing monetary policy next year. While the BCB is an independent institution, the optics of rate cuts in an election year, particularly when Lula appointees make up a majority of the board, may also weigh on BRL. Rate cuts will also make BRL less attractive from a carry perspective, which can contribute to a weaker currency. As fiscal and political risks materialize, we believe the USD/BRL exchange rate can trend toward BRL6.50 by the middle of next year. We also plan on publishing frequent updates on Brazil's election outlook and markets impact. In our view, BRL can reach all-time lows as the election comes into focus, a dynamic worthy of regular and frequent commentary.

Subscription Information

To subscribe please visit: www.wellsfargo.com/economicsemail

Via The Bloomberg Professional Services at WFRE

Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Charlie Dougherty	Senior Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Senior Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Jackie Benson	Economist	704-410-4468	Jackie.Benson@wellsfargo.com
Shannon Grein	Economist	704-410-0369	Shannon.Grein@wellsfargo.com
Nicole Cervi	Economist	704-410-3059	Nicole.Cervi@wellsfargo.com
Jeremiah Kohl	Economic Analyst	212-214-1164	Jeremiah.J.Kohl@wellsfargo.com
Aubrey Woessner	Economic Analyst	704-410-2911	Aubrey.B.Woessner@wellsfargo.com
Delaney Conner	Economic Analyst	704-374-2150	Delaney.Conner@wellsfargo.com
Anna Stein	Economic Analyst	212-214-1063	Anna.H.Stein@wellsfargo.com
Ali Hajibeigi	Economic Analyst	212-214-8253	Ali.Hajibeigi@wellsfargo.com
Azhin Abdulkarim	Economic Analyst	212-214-5154	Azhin.Abdulkarim@wellsfargo.com
Coren Miller	Administrative Assistant	704-410-6010	Coren.Miller@wellsfargo.com

Required Disclosures