# BRAZIL



## CAUGHT BETWEEN TWO CURRENTS

**The Brazilian economy is navigating between two currents: on the one hand, signs of a cyclical slowdown are mounting under the effects of monetary tightening; on the other hand, rebalancing mechanisms are emerging: disinflation is ongoing, interest rates cuts are in sight, the labour market is adjusting gradually to a more sustainable equilibrium, and economic growth is moving closer to its long-term potential. The current account deficit is resisting rebalancing, though it stays comfortably covered by steady inflows of foreign capital. The country's positioning in AI value chains reflects its comparative advantages: abundant natural and energy resources and a vibrant startup ecosystem. Unlocking AI into a productivity lever, however, faces structural obstacles including strong fiscal constraints and a large informal sector.**

### ECONOMIC SLOWDOWN CONFIRMED

After a spell of resilience, the effects of monetary tightening (initiated in the fall of 2024) are having a more noticeable impact on activity. The Brazilian economy was close to stagnating in Q3 2025; and growth is anticipated to have remained weak in Q4 perhaps even turning negative. The trend continued into early 2026 with the BCB's GDP proxy slipping 0.6% m/m in January. The breakdown of the national accounts shows a decline in domestic demand and a reversal in growth drivers with external demand making a stronger contribution to growth since Q2.

In the second half of the year, the effects of the economic slowdown on prices, the labour market and credit risks were more visible. In December, households' non-performing loans reached 6.9%, their highest level since 2012 (*vs.* 5.2% in December 2024). Job losses in the formal sector reached a peak not seen since the end of the pandemic and the decline in employment has also been pronounced in the informal sector. On a seasonally adjusted basis, this segment has been destroying jobs since May 2025. The decline in unemployment in H2 2025 (to 5.2% in November, its lowest level since 2012) should therefore be interpreted with caution – as it largely reflects a decline in labor force participation rates rather than robust job creation.

On the price front, the disinflationary momentum is ongoing: at 4.3%, inflation ended 2025 within the official target range, a first in four years. Inflation benefited from lower energy prices, especially electricity. Core inflation remained above the BCB's 3% target, as service-sector price pressures stayed elevated, underpinned by the resilience of the labour market.

In 2026, growth is expected to converge towards its potential rate (1.8%), marking a slowdown compared to recent years (2.4% anticipated in 2025 and a pace close to 3% per year between 2022 and 2024). Inflation is set to ease further, reaching its lowest level since the pandemic (3.8%). Several factors could however bolster private consumption and provide some upside risks to the growth: (a) the reallocation of unused discretionary budget funds toward social programmes, (b) gains in purchasing power stemming from slower inflation, and (c) increased disposable income, especially for the middle class, following recent income tax reforms. Additionally, structural reforms introduced in 2025 destined to expand access to payroll-backed consumer loans in the private sector and open up subsidized housing to middle-income households could improve credit availability until monetary conditions ease more broadly. We expect the SELIC rate to reach 12% at the end of 2026, reflecting a 300 bp cut from current levels.

### DESPITE FORMAL COMPLIANCE WITH FISCAL RULES, DEEP IMBALANCES PERSIST

In 2025, the central government formally managed to comply with its fiscal rule – the primary balance stood at -0.48% of GDP (the target being 0% with a tolerance of ± 0.5% of GDP). The nominal deficit remains elevated (-8.3% of GDP) driven by a heavy interest burden (BRL1000 bn, 7.8% of GDP). However, formal compliance with the fiscal rule obscures a worsening fiscal reality: according to the Independent Fiscal Institute (IFI), the government relied on the exclusion of certain expenditures from the deficit and drew on exceptional revenues to help meet its targets. For example, the significant appreciation of the real (+12% against the dollar, its strongest annual increase since 2016, helping to partly offset the 21% decline suffered in 2024) helped limit the nominal deficit through gains generated from foreign exchange

**FORECASTS**

| | 2023 | 2024 | 2025e | 2026e | 2027e |
|---|---|---|---|---|---|
| Real GDP growth, % | 3,2 | 3,6 | 2,4 | 1,8 | 1,4 |
| Inflation, CPI, year average, % | 4,6 | 4,4 | 5,0 | 3,8 | 3,8 |
| Public sector fiscal balance / GDP, % | -8,8 | -8,5 | -8,3 | -8,8 | -8,4 |
| Gross public debt / GDP, % | 74 | 77 | 79 | 83 | 87 |
| Current account balance / GDP, % | -1,2 | -3,0 | -3,0 | -2,8 | -2,7 |
| External debt / GDP, % | 33 | 33 | 35 | 36 | 33 |
| Forex reserves, USD bn | 355 | 329 | 358 | 360 | 365 |
| Forex reserves, in months of imports | 13 | 10 | 11 | 11 | 12 |

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

**FDI FLOWS: A STRUCTURAL FUNDING SOURCE FOR THE CURRENT ACCOUNT DEFICIT**

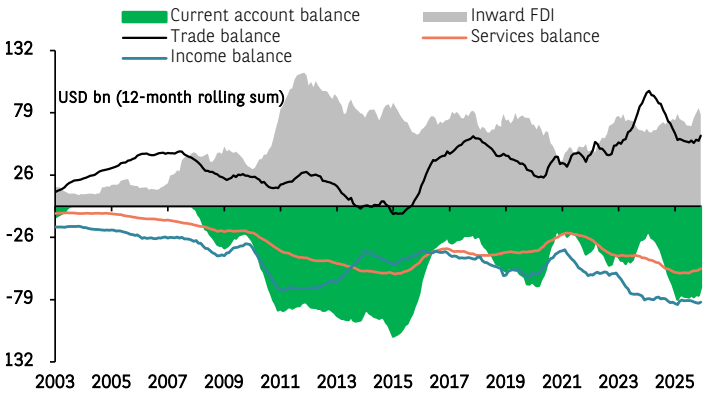


CHART 1 SOURCE: BCB, BNP PARIBAS

swaps (affecting the result of the BCB). Without this, interest payments would have reached 8.6% of GDP, and the headline deficit would have approached 9% of GDP.

To prevent its public debt ratio (79% of GDP at end-2025) from spiraling further, Brazil must generate sustained primary surpluses – a challenge given the soaring cost of its debt (the cost of refinancing public debt reached its highest level in 20 years with real rates close to 8% in 2025). Even the modest 2026 surplus target (+0.25% of GDP) faces risks, given election-year spending pressures and the government's optimistic growth assumptions (2.3%). The path set by the fiscal rule – a surplus of 1.25% of GDP by 2029 – is likely to be out of reach judging by the increase in spending in recent years.

## EXTERNAL SECTOR RESILIENCE PERSISTS AMIDST A DETERIORATING CURRENT ACCOUNT BALANCE

In 2025, the deterioration of the current account intensified (+4% increase relative to 2024) reaching a deficit of USD 68.8 bn (3% of GDP) – its highest level since 2014. This result stemmed primarily from a shrinking trade surplus. Exports – despite record sales volumes – suffered from adverse global prices. Meanwhile, imports – despite the economic slowdown – remained surprisingly robust, fueled by strong demand for low-cost Chinese goods (in particular industrial inputs and equipment) owing to supply constraints in the manufacturing sector. The US surcharge on Brazilian products ultimately had a limited impact on the trade balance owing to the rerouting of trade flows, in particular towards China. Looking ahead, the Supreme Court's partial repeal of President's Trump tariffs is set to reduce the average tariff on Brazilian exports to 15% in 2026, a decline of 11 percentage points[1]. For 2026, the current account deficit is forecast to narrow (moderation of domestic demand, increase in oil exports) but will likely remain above its historical average (USD 42.5 bn between 2016-2025).

The deterioration of the current account balance poses no immediate threat given the country's robust external buffers : foreign exchange reserves are high compared to the country's external liabilities (USD 358 bn in 2025, *i.e.* more than 11 months of imports of goods and services), its sources of financing are diversified and stable[2], and the country has a continuous access to international financial markets, with contained spreads. In 2026-27, Brazil is poised to maintain a strong appeal for foreign capital. The Mercosur-EU treaty and the Brazil-India agreement on access to rare earths should help boost foreign direct investment (FDI). In addition, portfolio investment flows will likely stay dynamic supported by high real interest rates on local debt instruments and solid prospects in the equity market on the back of : (a) attractive valuations, (b) the diversification of international portfolios towards emerging markets outside the United States, and (c) the lagged monetary cycle (Brazil has not yet started its easing cycle unlike most of its Latin American peers). By February 20th, foreign investors had already poured nearly USD 6 bn into Brazilian equities since the start of the year (compared to USD 4.6 bn recorded in all of 2025).

## AI: RICH IN RAW MATERIALS AND DATA, POOR IN TECHNOLOGY

In the global value chain of artificial intelligence and digital technology, Brazil appears mainly at three levels: (1) upstream – in the supply of critical minerals and rare earths[3], essential in manufacturing chips and other electronic components; (2) in the construction of data centers (nearly 200 sites, *i.e.* nearly 40% of data centers in Latin America but only 2% worldwide[4]); and (3) the development of AI-based products and services through its dynamic ecosystem of startups, particularly in AgroTech, FinTech, EdTech (according to the 2023 *District AI report*, amongst the ~ 500 AI startups active in Latin America, nearly 75% were in Brazil). On the other hand, the country has very little presence in the manufacturing of advanced components or software, in part a reflection of insufficient R&D investment (0.6% of GDP, compared to 2–3% in the leading countries). In 2025, exports of AI-related products represented USD 4.7 bn (ie. 0.14% of the world total).

Aware of the economic and sovereignty-related challenges associated with AI, the authorities have adopted an AI plan (2024-28) around five strategic pillars – infrastructure, training, improvement of public services, entrepreneurial innovation, regulation/governance – and four short-term priority sectors (healthcare, industry, agro-food and the environment). Amongst others, the plan aims (a) to modernize the *Santos Dumont* supercomputer (with an objective to integrate the top 5 in the world within 5 years), (b) develop a national sovereign cloud infrastructure and (c) create a large language model (LLM) in Portuguese. Due to severe fiscal constraints, however, the country has limited room to jumpstart public investment (only USD 4 bn was allocated to the plan over 4 years). To help address these constraints but also to reduce the country's technological dependence and boost R&D and local innovation, the authorities have sought to: (i) strengthen collaboration between public, private and academic actors, (ii) provide financial support to innovative startups in the sector, (iii) stimulate private investment in digital infrastructure with appropriate incentive mechanisms[5].

In a context where productivity has been broadly stagnant for close to twenty-five years, the effective diffusion of AI technologies across the economy is yet another major issue at stake for the authorities. While mainstream adoption is well under way – Brazil ranks as the second-largest user of generative AI in emerging markets behind India, according to Cisco – corporate adoption of AI solutions, particularly amongst SMEs and technology transfers to industry remain more limited. These gaps reflect structural constraints including unequal access to digital technology and infrastructure, a high prevalence of informal employment (informal structures have more limited access to finance and technology), and insufficient domestic savings to finance massive investments. According to the IMF's AI Readiness Index – which measures a country's ability to adopt and implement AI in a way that benefits its economy and society – Brazil ranks 66th out of 174, behind Chile and Uruguay. According to a study by the Federal University of Sao Paolo, under a scenario of moderate AI adoption in production processes (55% by 2030 *vs.* 70% in advanced countries), the net annual impact on GDP (*i.e.* actual annual gain after accounting for the costs related to initial investments, training, restructuring, etc.) would amount to +0.6% of GDP per year *vs.* +3.2% of GDP in advanced economies.

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**Salim Hammad**

**salim.hammad@bnpparibas.com**

1 Average tariff peaked to 35% in September, but came down to 26% in November after a new round of exemptions.
2 Over the period 2015–2025, FDI inflows (3.4% of GDP on average) ensured a comfortable financing of the current account deficit (–2.4% of GDP on average).
3 Examples: silica, copper, niobium, graphite, nickel, scandium, bauxite, neodymium, dysprosium.
4 But there isn't yet infrastructure capable of supporting the training of LLMs models.
5 For example, the Redata bill, currently under review, introduces a special tax regime for data center services. The draft legislation provides for the temporary suspension and subsequent exemption of federal taxes on the purchase of machines, servers, and technological components intended for data center infrastructure.