Global Macro Research

31 July 2025

8:14 minute read | #LatAm / #Globalisation / #Monetary Policy

How do politicised tariffs add to Brazil's policy challenges?

The US' threat of a 50% tariff on Brazil poses limited macroeconomic risks given the country's low dependence on US trade, but a prolonged standoff between the two governments could stymie investor sentiment. High interest rates should support the *real*, as the Banco Central do Brasil will keep policy tight amid inflationary and fiscal risks that could renew market pressure.

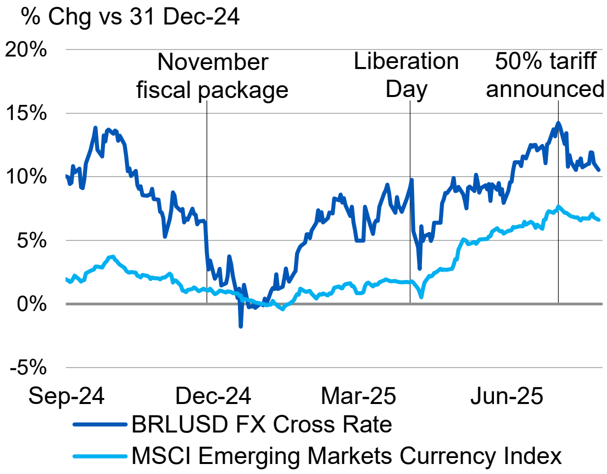
Key Takeaways

- Ahead of 1 August, the US' threat to raise Brazil's tariff rate from 10% to 50% would represent the most severe increase.
- The Brazilian *real* has so far held strong since the announcement, supported by high interest rates and Brazil's low direct exposure to US trade.
- We still see the main transmission from US trade policy to Brazilian growth being through tariffs weighing on global activity and demand, rather than tariffs on Brazil itself. Indeed, President Trump's announcement on 30 July that several products will be exempt from the blanket 50% tariff reinforces this view.
- After the Banco Central do Brasil raised its Selic rate by 450bps from September to a 15% peak in June, trade-related currency risks and still elevated inflation expectations in our view rule out a return to rate cuts until Q1 2026.
- We forecast gradual Selic cuts towards 12.5% by the end of 2026. However, the pace of easing next year risks being limited by pre-election fiscal policy, which could renew price pressures and market volatility.

Brazil enters the US' trade crosshairs

The end of US President Donald Trump's prior 90-day tariff pause saw implementation delayed until 1 August, with the US sending letters detailing revised rates for several trading partners. The threat to raise Brazil's from the prior 10% baseline to 50% has so far been the most severe.

Figure 1: Higher interest rates and low US dependence have buoyed the *real*



Source: Refinitiv, Aberdeen, July 2025

The *real* has underperformed the MSCI EM Currency Index since the announcement (-3.2% vs -1.0%). However, in year-to-date terms, the currency has still strengthened against the US dollar by 10.7%, more than recovering the ground lost due to fiscal uncertainty in late 2024 (see Figure 1).

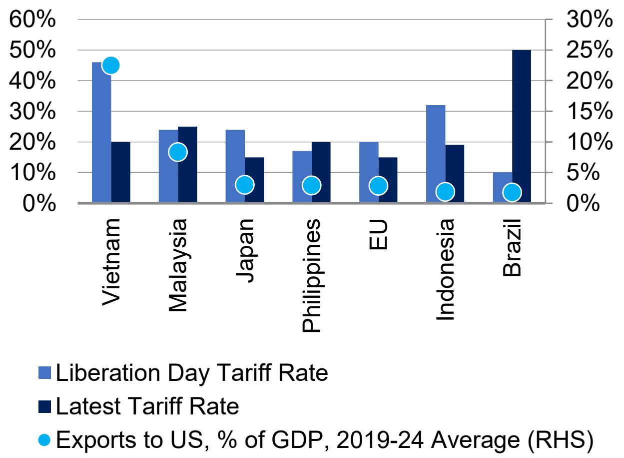
Prospects of a prolonged or escalating standoff between Trump and Brazilian President Luiz Inácio Lula da Silva risk stymieing investor sentiment.

Still, we continue to flag fiscal fragility as a more pressing risk for Brazilian assets over the coming months.

Politicisation of tariffs makes US-Brazil negotiations challenging

Brazil has shifted from one of the least to one of the most targeted countries by the US administration (see Figure 2). Prior to 'liberation day', we had flagged the country could be targeted due to factors including its complicated tax regime and political differences between the two governments. However, initially it was only hit with the 10% baseline due to the US' trade surplus with it.

Figure 2: Political motivations underpinned Washington's sharp tariff increase for Brazil



Source: White House, Haver, Aberdeen, July 2025

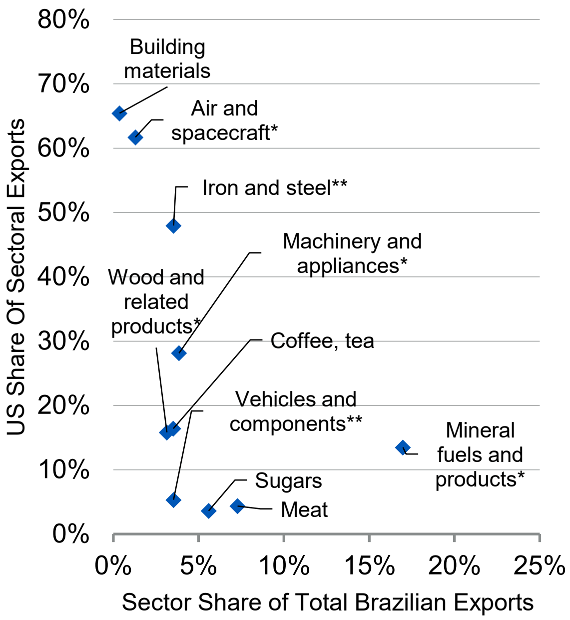
The increase to 50% therefore came as a surprise, with Trump's letter citing two motivating factors. The first was the ongoing trial of former President Jair Bolsonaro, who is charged with attempting a coup after losing the last general election to Lula. Bolsonaro is a close ally of Trump, and the US President has labelled the trial a witch hunt.

The second surrounds rulings by Brazil's Supreme Court holding social media platforms accountable for their users' posts, which Washington has labelled as censorship.

The initial plans for the coverage of the tariff would have mostly impacted the industrial sector, with building materials, such as cement, and aircraft among the exports most reliant on the US (see Figure 3). But relief came on 30 July with Trump announcing that a range of US imports from Brazil would be exempt. These include, but are not limited to, orange juice, iron ore, natural gas, and several categories of machinery.

Meanwhile, oil (19% of exports to the US) remains exempt from tariffs, while steel and autos face their own separate sectoral rates. We estimate that these exceptions lower the US weighted average tariff for Brazil to the 32% range, again with the economic drag on Brazil being mitigated by the comparatively limited trade flows between the two economies.

Figure 3: Sectoral carve-outs will help to further mitigate the impact of tariffs



*Exempt from US tariffs. **Autos and steel face separate sectoral tariffs. Source: TradeMap, Aberdeen, July 2025

However, the politics surrounding the tariffs makes it difficult for a major compromise to be reached in the coming months. Trump has labelled both cited issues as non-negotiable. But they are legal matters outside of executive control, with Brazil's Supreme Court pushing back against Trump's demands.

The launch of a Section 301 investigation into Brazil citing unfair trade practices also differentiates it from other markets, which are facing US tariffs through the international emergency economic powers act (IEEPA). Trump's ability to implement tariffs via IEEPA could potentially be blocked by US courts, but any tariffs implemented following a 301 investigation – which will take several months – would be less likely to face legal challenge.

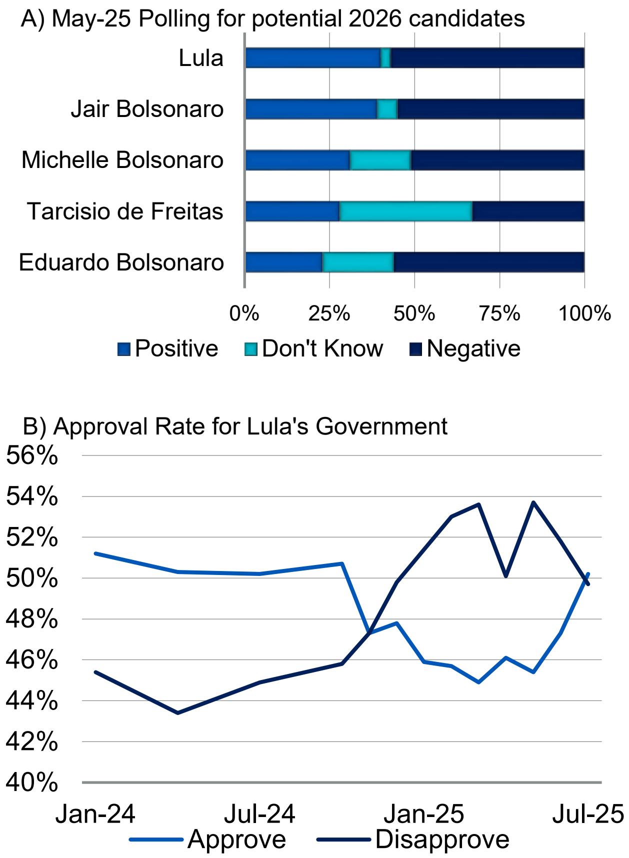
Meanwhile, the tariffs offer Lula a chance to rally Brazilians behind him and cast Bolsonaro's camp as aligning with US efforts to harm the economy.

Lula's approval rating held below 50% from January to June amid resurgent inflation, perceptions of miscommunications around fiscal policy, and corruption allegations in parts of the government.

Lula remains Brazil's most popular politician, but support has risen for Bolsonaro's family members. One of them is widely expected to run in his place in 2026, as Bolsonaro is legally barred from the presidential race. Sao Paulo Governor Tarcisio de Freitas, who is regarded as a viable frontrunner to represent the centre right, has also seen increased support.

Recent polling however suggests a marked increase in support for Lula following the tariff announcement (see Figure 4). As such, Lula will likely retain a publicly defiant stance in the coming months to capitalise on anti-Trump sentiment.

Figure 4: Lula's opposition to tariffs has offered a rebound in support



Source: Quaest, Latam Pulse survey, Aberdeen, July 2025

We do flag that a prolonged standoff against Trump could risk weighing on investor sentiment and eventually support among the electorate. We expect Lula to ultimately seek further carve-outs or tariff reductions, with the risks of a retaliatory spiral having moderated following the 30 July exemptions.

The Section 301 investigation will take several months to conclude, offering a window for potential negotiations. Assuming talks prove constructive, we eventually see the US tariff rate for Brazil moderating towards the 20-25% range by year-end.

We thereby retain our core view that the main transmission from US trade policy to Brazilian growth is through tariffs causing a global slowdown and weighing on external demand, rather than tariffs imposed directly on Brazil.

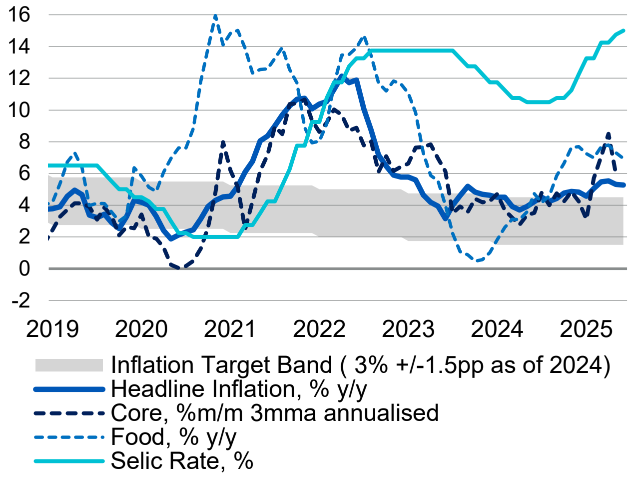
Tight monetary policy will be the primary driver of Brazil's slowdown

The lagged impacts of monetary tightening will prove the bigger drag on Brazil's growth over the coming quarters.

With high real interest rates having helped support the *real*, tariffs add to motivation for the BCB to keep policy tight over H2. Trade-related currency risks and still elevated inflation expectations in our view rule out the prospect for a return to rate cuts this year.

In June, the BCB's Monetary Policy Committee (Copom) raised its Selic rate by 25bps to 15%, bringing its cumulative hikes since September to 450bps (see Figure 5). Despite this aggressive tightening, inflation has exceeded the BCB's target range since October while activity has remained resilient. Indeed, we forecast real GDP growth of 2.4% in 2025, which remains above our estimate of trend growth.

Figure 5: The Selic rate will remain at its current peak through to Q1 2026

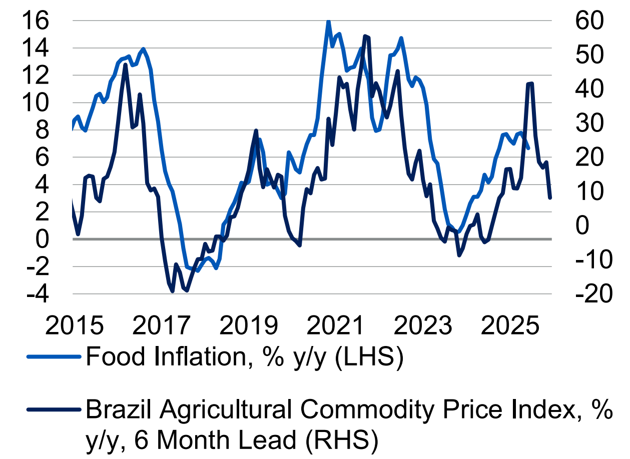


Source: Haver, Aberdeen, July 2025

Beyond the usual lags related to monetary policy, a combination of factors has blunted the impact of the BCB's tightening so far.

On the supply side, lingering impacts of adverse weather last year have kept food inflation elevated. There are however nascent signs of cooling. Base effects and the trajectory of wholesale agricultural prices signal that food inflation should moderate more significantly by Q4 (see Figure 6).

Figure 6: Food inflation is set to cool



Source: Haver, Aberdeen, July 2025

However, demand-side pressures have stayed strong, and are likely to moderate only gradually over H2. Hiring has been robust across several sectors, while nominal earnings have been strong enough for real wage growth to exceed its 10-year average (see Figure 7).

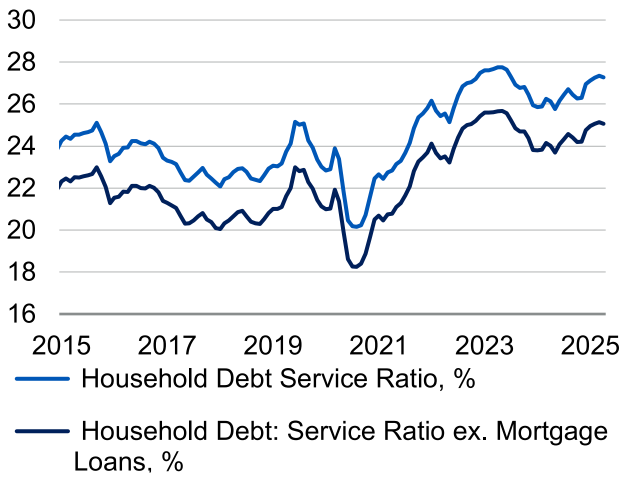
Figure 7: Strong employment and wage growth have buoyed demand and hindered core disinflation

Source: Haver, Aberdeen, July 2025

This backdrop, alongside various government transfers to households, has supported demand and will limit core disinflation over H2 of the year. Indeed, we forecast a year-end inflation rate of 5.0%, remaining above the BCB's target range.

Still, higher rates will increasingly feed through over coming months. Brazilian households are highly leveraged, with a debt service ratio of 27.3% as of April (25.1% excluding mortgages) that should rise further as Selic hikes feed through. This should eventually temper consumption growth over H2 and into early 2026.

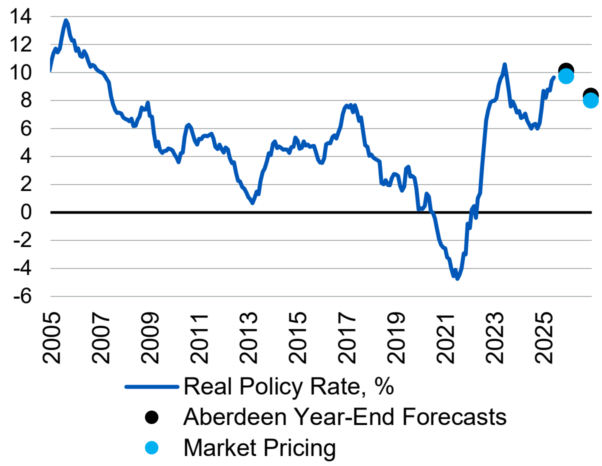
Figure 8: Higher debt servicing costs will increasingly dampen consumption over H2



Source: Haver, Refinitiv, Aberdeen, July 2025

The June hike brought Brazil's real policy rate to 9.6% – the highest since early 2023, when the BCB was at the tail end of holding the Selic rate at its previous 13.75% peak. Our projections suggest the real ex post rate will fluctuate around its current range over the coming months, ending the year around 10% (see Figure 9).

Figure 9: A prolonged period of tight monetary policy will dampen activity, even if the impacts are lagged



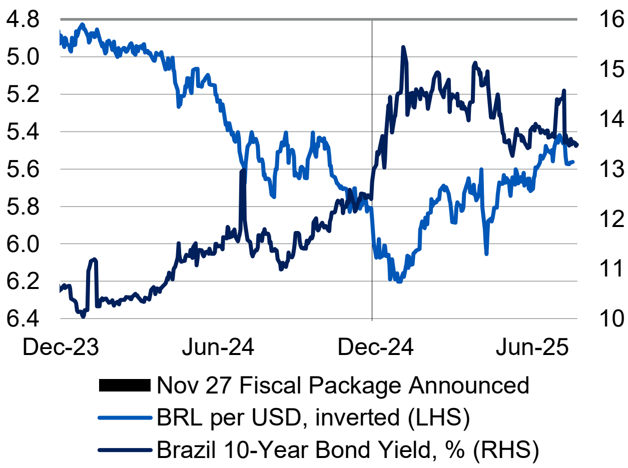
Source: Haver, Bloomberg, BCB, Aberdeen, July 2025

Moderating demand due to high real rates, alongside base effects for prices, should see growth slow and disinflation gain some more momentum from Q1 2026. As such, we forecast the Selic rate to be unchanged through to March 2026 and gradual cuts to then take the Selic to 12.5% by the end of 2026.

Fiscal issues remain in investors' sights

However, the fiscal trajectory remains the key uncertainty for the BCB and investors. Indeed, while the *real* has managed to recover, yields have remained well above pre-November levels (see Figure 10).

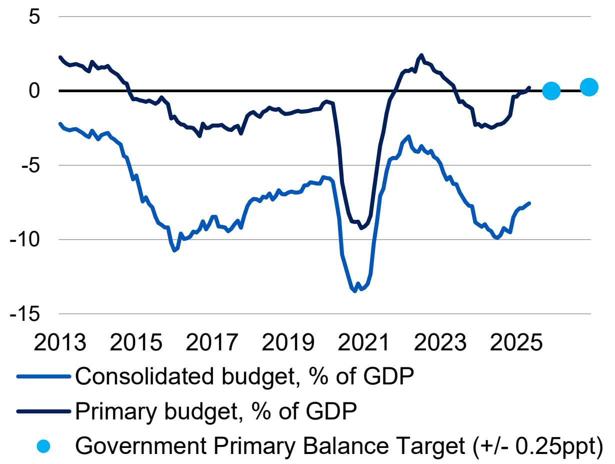
Figure 10: Investor worries surrounding fiscal policy have kept yields elevated



Source: Haver, Aberdeen, July 2025

We expect that the government will be able to muddle through towards its primary balance targets over 2025 and 2026. This should see the expansionary fiscal impulse of the past two years becoming neutral or weakly negative.

Figure 11: The government can likely reach the lower bound of its targets, but risks of slippage persist



Source: Haver, Aberdeen, July 2025

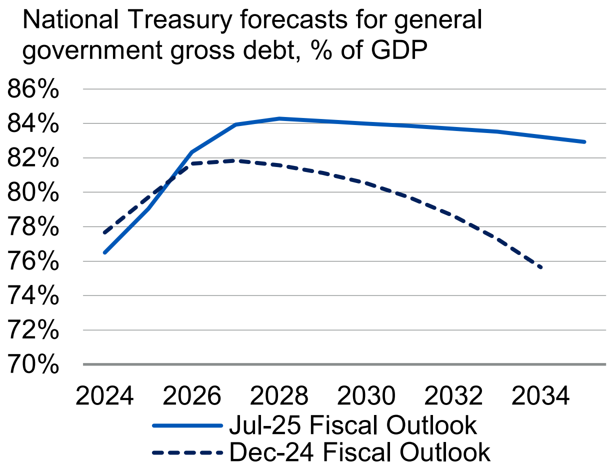
As of May, the 12-month central government primary balance returned to a surplus of 0.2% of GDP, having been in deficit since June 2023 (see Figure 11). This improvement was however partly symptomatic of delayed spending following the 2025 budget having only been finalised in late March. The government's aims for a balanced primary budget in 2025 and a 0.25% surplus in 2026, though at risk of being optimistic, do signal at least some commitment to discipline.

Fiscal reform is however widely unexpected before the elections. Constitutionally mandated primary spending (16.8% of GDP) remains a structural headwind for fiscal consolidation. Moreover, the high Selic rate and large share of debt linked to it put upside pressure on interest payments (7.8% of GDP), weighing on the overall deficit. Higher interest payments underpinned the National Treasury's increased projections for long-term debt (see Figure 12).

Author:

Tettey Addy

Figure 12: A worsening debt trajectory will underscore tough budgetary discussions



Source: National Treasury, Aberdeen, July 2025

Investors and the BCB will be awaiting greater clarity regarding the 2026 budget, its implications for inflation, and the proposals from eventual presidential candidates for post-election fiscal policy. Indeed, concerns around the trajectory of the budget balance and demand-side price pressures underpinned the uptrend for yields and the start of the BCB's tightening cycle in September.

Should Lula's support not materially improve, a politically motivated loosening of fiscal policy cannot be ruled out. As seen in November and the more recent standoff between the executive and Congress surrounding proposed tax increases, negotiations for the election year budget risk seeing renewed uncertainty and risk aversion. Perceptions of fiscal largesse could stoke renewed inflation or FX volatility, restricting the BCB's capacity to cut rates.

Important Information

For professional and Institutional Investors only – not to be further circulated. In Switzerland for qualified investors only.

Risk warning
The value of investments, and the income from them, can go down as well as up and an investor may get back less than the amount invested. Past performance is not a guide to future results.

Any data contained herein which is attributed to a third party ("Third Party Data") is the property of (a) third party supplier(s) (the "Owner") and is licensed for use by Aberdeen*. Third Party Data may not be copied or distributed. Third Party Data is provided "as is" and is not warranted to be accurate, complete or timely. To the extent permitted by applicable law, none of the Owner, Aberdeen* or any other third party (including any third party involved in providing and/or compiling Third Party Data) shall have any liability for Third Party Data or for any use made of Third Party Data. Neither the Owner nor any other third party sponsors, endorses or promotes the fund or product to which Third Party Data relates.

*Aberdeen means the relevant member of the Aberdeen Group, being Aberdeen Group plc together with its subsidiaries, subsidiary undertakings and associated companies (whether direct or indirect) from time to time.

The information contained herein is intended to be of general interest only and does not constitute legal or tax advice. Aberdeen does not warrant the accuracy, adequacy or completeness of the information and materials contained in this document and expressly disclaims liability for errors or omissions in such information and materials. Aberdeen reserves the right to make changes and corrections to its opinions expressed in this document at any time, without notice.

Some of the information in this document may contain projections or other forward-looking statements regarding future events or future financial performance of countries, markets or companies. These statements are only predictions and actual events or results may differ materially. The reader must make his/her own assessment of the relevance, accuracy and adequacy of the information contained in this document, and make such independent investigations as he/she may consider necessary or appropriate for the purpose of such assessment.

Any opinion or estimate contained in this document is made on a general basis and is not to be relied on by the reader as advice. Neither Aberdeen nor any of its agents have given any consideration to nor have they made any investigation of the investment objectives, financial situation or particular need of the reader, any specific person or group of persons. Accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the reader, any person or group of persons acting on any information, opinion or estimate contained in this document.

AA-040825-196923-49

aberdeen Investments