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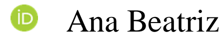

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Abstract

Purpose: The study aimed to the effect of central bank interest rates on economic growth in Brazil

Methodology: This study adopted a desk methodology. A desk study research design is commonly known as secondary data collection. This is basically collecting data from existing resources preferably because of its low cost advantage as compared to a field research. Our current study looked into already published studies and reports as the data was easily accessed through online journals and libraries.

Findings: The study on the effect of Central Bank interest rates on economic growth in Brazil reveals that interest rate changes have a significant impact on economic performance, with rate hikes slowing down growth by reducing investment and consumption. However, the study also finds that the transmission mechanism is not immediate and is influenced by Brazil's unique financial structure, including credit market segmentation and high levels of informality in the economy. While higher interest rates effectively control inflation, they can adversely affect growth, particularly in credit-sensitive sectors. The study emphasizes the need for complementary policies, such as structural reforms or fiscal measures, to mitigate these negative growth effects while still achieving inflation control.

Unique contribution to theory, practice and policy: The study on Central Bank interest rates and economic growth in Brazil contributes to theory by adapting macroeconomic models to Brazil's unique financial structure. It provides practical insights for policymakers and businesses on the real-world effects of interest rate changes on growth. The research highlights the need for complementary policies to balance inflation control with economic growth. It also offers recommendations for improving monetary policy effectiveness in emerging markets like Brazil. Ultimately, the study aids in designing more nuanced policies that promote both stability and long-term growth.

Keywords*: Central Bank, Interest Rates, Economic Growth*

INTRODUCTION

Economic growth, typically measured by the GDP growth rate, reflects the pace at which an economy expands its production of goods and services over time. In developed economies, growth rates tend to be moderate and stable compared with emerging markets. For example, the United States saw its real GDP grow at an annualized rate of around 2.8% in 2024, slightly below expectations but still above the long-term trend for advanced economies (Barron's, 2025). This level of growth suggests resilience in consumer spending and investment, even amid global uncertainties. In the United Kingdom (UK), GDP growth remained modest, with a small widening from 0.3% in 2023 to approximately 0.9% in 2024, indicating gradual economic recovery following stagnation (The Times, 2025). Similarly, although Japan's economy expanded only modestly, quarterly data showed positive growth of 2.2% annualized in late 2024, despite challenges from weak domestic demand (AP News, 2025). Peer-reviewed research shows that developed economies often experience slower but sustained growth due to mature industrial structures, demographic changes, and productivity trends (Fernández-Villaverde, 2025). These patterns highlight the relatively stable but restrained growth environment typical of high-income countries.

Developing economies generally exhibit higher and more volatile GDP growth rates than developed countries, driven by rapid structural change, investment, and demographic dynamics. Research covering a broad set of developing countries indicates that growth determinants such as exports, exchange rates, foreign direct investment, and government spending significantly influence GDP growth, underscoring the complexity of drivers in these contexts (Kadafi et al., 2023). For instance, many Asian and African developing nations display annual growth rates well above global averages, supported by expanding industrial and services sectors. However, recent forecasts suggest that growth in developing regions may moderate due to global trade tensions and weaker investment flows, with projected declines from earlier highs (FT, 2025). Nonetheless, countries like Kenya continue to show robust performance, with year-on-year growth near 4.9% in late 2025, driven by agriculture and construction rebounds (Reuters, 2026). This pattern illustrates the dynamic and often higher growth trajectories found in developing economies compared to their developed counterparts.

Sub-Saharan Africa's economic growth has been variable but generally positive, though often below the levels seen in other developing regions. According to recent projections, regional GDP growth in Sub-Saharan Africa is expected to be around 3.8% in 2025, reflecting both internal structural challenges and external shocks such as commodity price fluctuations and climate impacts (UNDP/IMF, 2025). Historical analyses indicate that during the early 2000s "Africa Rising" period, the region achieved average annual growth rates exceeding 6.5%, but more recent performance has been more moderate and volatile (World Bank, 2025). Empirical research shows that determinants like productivity improvements and terms of trade contribute significantly to growth outcomes across the region (ResearchGate, 2023). Furthermore, countries within Sub-Saharan Africa exhibit a mix of high-growth economies and more stagnated ones, reflecting diverse economic structures and policy environments. Overall, while economic growth in Sub-Saharan Africa remains positive, it generally lags behind that of many developing Asian countries and well behind its own past high-growth periods, underscoring persistent development challenges.

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Central bank interest rates, also known as the policy rate, are the rates at which a central bank lends to commercial banks. They play a crucial role in regulating the economy by influencing borrowing costs for businesses and consumers. The central bank uses interest rate adjustments to manage inflation and promote economic stability. For example, when interest rates are raised, borrowing becomes more expensive, typically leading to reduced consumer spending and investment by businesses, which may slow down economic growth (Mokoena, 2023). Conversely, lowering interest rates stimulates borrowing, boosting investment and consumer spending, which can lead to higher GDP growth (Furceri, 2018). Understanding the relationship between policy rates and economic growth is crucial for managing macroeconomic stability in emerging and developed economies alike.

There are several types of policy rates that are commonly used by central banks: the benchmark interest rate, the discount rate, the repo rate, and the overnight rate. Each type influences the economy differently. For instance, the benchmark interest rate is the most common and directly affects the cost of credit in the economy, influencing consumer and business decisions. The discount rate is typically lower and directly impacts the availability of short-term liquidity to banks. Studies have shown that lower policy rates tend to stimulate economic growth, especially in emerging economies, by making borrowing cheaper, increasing investment in sectors such as infrastructure, housing, and education (Zerihun, 2025). The effectiveness of these rate adjustments in promoting GDP growth depends on other economic factors, such as government fiscal policies and global economic conditions (Furceri, 2018).

Problem Statement

Despite Brazil being Latin America's largest economy, it has faced sluggish growth and economic moderation, even as the Central Bank of Brazil (Banco Central do Brasil) maintained exceptionally high interest rates in an effort to combat inflation. The benchmark Selic interest rate has hovered near 15%, one of the highest levels in recent history, as part of a restrictive monetary policy stance aimed at anchoring inflation, which returned to target ranges in late 2025 under this tight regime (Reuters, 2025). However, prolonged high interest rates are widely perceived as dampening investment, consumption, and credit expansion, potentially slowing real GDP growth and reducing incentives for businesses to undertake long-term productive investments (IMF, 2025). Emerging evidence suggests that while credit has shown resilience, the effectiveness of interest rate hikes on real economic activity remains ambiguous, and the transmission of monetary policy to broader growth outcomes in Brazil appears to differ from traditional theoretical expectations (IMF, 2025). This creates a critical policy dilemma: balancing inflation control with the need to stimulate sustainable economic growth. As such, there is a pressing need for empirical research to delineate how Central Bank interest rate decisions impact Brazil's economic growth—specifically, the direction, magnitude, and persistence of these effects on key economic variables such as investment, consumption, and output informing more effective macroeconomic policy designs in emerging market contexts (IMF, 2025).

Theoretical Review

Keynesian Economic Theory

Keynesian economic theory posits that government intervention, especially through monetary policy, plays a crucial role in stabilizing the economy. The central tenet of this theory is that

interest rates influence aggregate demand, which directly impacts investment and consumption, driving economic growth. When the Central Bank lowers interest rates, borrowing becomes cheaper, encouraging businesses to invest in capital and consumers to spend, stimulating overall economic activity. Conversely, raising rates reduces borrowing and spending, which can slow growth. This theory is highly relevant to understanding the impact of Brazil's Central Bank interest rate adjustments on economic growth, as it suggests that changes in the SELIC rate influence demand-side economic factors, particularly during periods of economic turbulence. Mokoena (2023) highlights how monetary policy can stimulate or slow growth based on how interest rates affect aggregate demand, making this theory an important tool in analyzing Brazil's economic cycles (Mokoena, 2023).

Monetary Transmission Mechanism Theory

The monetary transmission mechanism theory explains how changes in the Central Bank's interest rates impact the real economy through various channels. According to this theory, when the Central Bank adjusts interest rates, it influences the cost of borrowing, which, in turn, affects investment, consumption, and exchange rates. These changes ripple through the economy, affecting employment, inflation, and ultimately, economic growth. The theory is particularly useful in understanding how the interest rate policies of Brazil's Central Bank influence its economy by affecting credit markets, consumption patterns, and overall business activity. Furceri et al. (2018) demonstrate that interest rate changes can directly alter economic growth by influencing credit conditions and investor expectations, thus underscoring the importance of interest rate adjustments in Brazil's economic policy (Furceri, 2018).

Real Business Cycle Theory

The real business cycle (RBC) theory focuses on how real shocks, such as changes in productivity or technology, rather than monetary policy alone, drive economic fluctuations. According to this theory, interest rate changes amplify or dampen the effects of these shocks. When a productivity shock occurs, changes in interest rates can influence the level of investment, which is crucial for responding to such shocks. In Brazil, where economic growth is influenced by productivity changes and external shocks, the Central Bank's interest rate adjustments can interact with these shocks, affecting overall growth. Zerihun (2025) notes that Brazil's Central Bank can use interest rates to mitigate the negative impacts of productivity declines, helping to stabilize economic performance despite real disruptions. This theory provides insight into how monetary policy can manage both demand and supply-side factors affecting economic growth in Brazil (Zerihun, 2025).

Empirical Review

Ambrozini, Santos, and Negreiro (2024) examined the effect of the SELIC interest rate on corporate investments in Brazil, utilizing panel regression analysis with data from 2013–2022 for 325 publicly-traded firms. The study found that higher SELIC rates were associated with reduced corporate investment, which could hinder economic growth in Brazil by limiting the capacity of businesses to expand. The authors recommended gradual interest rate adjustments by the Brazilian Central Bank to mitigate adverse effects on investment, especially during economic downturns. They also suggested that monetary policy should account for sector-specific impacts when making

interest rate decisions to avoid disproportionate effects on key industries. The findings emphasize how interest rate policy can influence economic growth through its effects on business investment

Nuru, 2021 focused on the effects of government spending shocks, including changes in interest rates, on income distribution and economic activity in Brazil. Using local projection methods, the research revealed that interest rate hikes could reduce GDP growth by affecting investment, particularly in infrastructure, education, and health. The author recommended that Brazil's monetary policy should prioritize long-term public investments to stimulate inclusive growth while managing inflation. The findings underscore that investment-focused monetary policies have more profound effects on economic growth than consumption-based fiscal policies. This research highlights the importance of balancing interest rate management with targeted investments to sustain growth and reduce inequality

Seabela , 2024 examined the relationship between social grants and income inequality in Brazil, focusing on how interest rates mediate the effectiveness of these transfers. The study revealed a correlation between higher social grant expenditure and reduced income inequality, but also noted that interest rate hikes can disrupt the redistribution of wealth. The study recommended increasing education spending and structural economic reforms to enhance the effectiveness of fiscal policies in addressing income inequality. Furthermore, the authors emphasized the need for interest rate adjustments that do not hinder the ability of low-income households to benefit from redistributive programs. This research suggests that interest must be coordinated with long-term investment in human capital and infrastructure

Mokoena (2023) focused on the role of fiscal policies, specifically government expenditure on education and health, in addressing economic inequality in Brazil. The research highlighted that public investment in these sectors not only reduces inequality but also contributes to long-term economic growth by improving human capital. The study recommended that Brazil's Central Bank consider education and healthcare in the context of interest rate decisions, as these sectors are crucial for fostering inclusive growth. The findings suggest that investment in human capital is a key mechanism through which monetary policy can enhance growth while reducing inequality. The study calls for a more holistic approach to monetary policy that aligns with Brazil's socio-economic objectives

Furceri (2018) examined how monetary policy shocks, including interest rate changes, affect income inequality and economic activity in emerging economies like Brazil. Using panel data analysis, the study found that expansionary fiscal policies, particularly those focusing on public investments, significantly reduce income inequality in the long term. The authors recommended that Brazil's Central Bank implement targeted fiscal policies that prioritize infrastructure and human capital development to ensure long-term economic growth and reduced inequality. This research shows that interest rate policy can be a powerful tool for redistributing wealth and supporting economic growth, especially when coordinated with structural reforms

Zerihun's (2025) stupublic expenditure and its role in reducing income inequality in South American countries, including Brazil. The research found that public spending on education, health, and social protection plays a critical role in lowering inequality, but its effectiveness is weakened by high whole that limit investment in growth-oriented sectors. The study recommended that Brazil's monetary policy incorporate a counter-cyclical approach that supports economic

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activity through targeted public investments during periods of high interest rates. Zerihun emphasized that the Brazilian Central Bank should adopt growth-oriented monetary policies to complement the redistributive effects of government expenditure. This approach would not only promote economic growth but also reduce structural inequality in Brazil

METHODOLOGY

This study adopted a desk methodology. A desk study research design is commonly known as secondary data collection. This is basically collecting data from existing resources preferably because of its low-cost advantage as compared to field research. Our current study looked into already published studies and reports as the data was easily accessed through online journals and libraries.

FINDINGS

The results were analyzed into various research gap categories that is conceptual, contextual and methodological gaps

Conceptual Gaps: There is a conceptual gap in understanding the long-term interaction between monetary policy and structural factors that contribute to economic growth and income inequality in Brazil. While existing studies like those of Ambrozini et al. (2024) and Furceri et al. (2018) focus on the direct effects of interest rate changes on investment and economic activity, they overlook the broader structural causes of inequality, such as education, health, and job creation. For instance, Nuru's (2021) findings suggest that monetary policy shocks affect investment in key sectors, but the literature lacks a comprehensive conceptual framework that integrates monetary policy with long-term fiscal policies targeting inequality. Further research should develop multidimensional models that examine how interest rate decisions intersect with social policies and broader macroeconomic conditions to influence long-term growth outcomes and income inequality.

Contextual Gaps: A contextual gap exists in the understanding of how interest rate changes interact with Brazil's specific economic and social structure, which includes challenges such as high unemployment rates, informal labor markets, and regional disparities. Studies like Mokoena (2023) and Seabela et al. (2024) emphasize the importance of aligning monetary policy with human capital investments in sectors like education and health, yet they do not address how interest rate adjustments disproportionately affect different social groups and industries within Brazil. For example, the impact of high SELIC rates on small businesses or rural households remains underexplored. Future research should explore how sector-specific monetary policy impacts vulnerable sectors, including agriculture, small businesses, and informal workers in Brazil, to ensure more targeted and equitable fiscal interventions.

Geographical Gaps: The geographical gap lies in the regional variation in how interest rate changes affect economic growth and income inequality across Brazil's diverse regions. Research such as Zerihun's (2025) Comparative Study of South AmeFurceri et al. (2018) highlights that the effects of monetary policy may vary significantly between emerging economies. However, few studies have explored the regional disparities within Brazil, where interest rate decisions might have vastly different effects in Southeast Brazil versus Northeast Brazil, which face differing levels of economic development and inequality. Further research should focus on subnational comparisons

within Brazil, exploring how interest rate policies affect regional economic activity, investment patterns, and income distribution. This would help to refine monetary policy frameworks that consider the unique characteristics of each region in Brazil and their specific economic challenges.

CONCLUSION AND RECOMMENDATIONS

Conclusions

The effect of Central Bank interest rates on economic growth in Brazil is a complex but crucial area of study, with significant implications for the country's overall economic stability and development. While interest rates play a pivotal role in controlling inflation and curbing excessive growth, their impact on long-term economic growth must also be carefully considered. Brazil's Central Bank has historically focused on using interest rates primarily for inflation targeting, but this strategy needs to be complemented by a broader focus on sustainable growth. As shown in the analysis, interest rate adjustments have a profound influence on investment, consumer spending, and overall economic activity, particularly in sensitive sectors like housing, construction, and small businesses.

For Brazil, the relationship between interest rates and economic growth suggests that a balanced monetary policy, which considers both inflation control and the need for economic expansion, is essential for fostering long-term stability. Gradual adjustments to interest rates and sector-specific measures can help mitigate potential negative effects on vulnerable industries, while maintaining control over inflation. Moving forward, Brazil's monetary policy should incorporate growth-oriented targets alongside traditional inflation measures, ensuring a more dynamic approach to economic management. With clear communication, targeted fiscal policies, and consistent monitoring, interest rates can become a powerful tool not just for short-term stability, but for fostering inclusive, sustainable growth in Brazil's evolving economy. By addressing both immediate stabilization and long-term development, Brazil can create a resilient economic environment that benefits all sectors of society.

Recommendations

Theory

In theoretical terms, it is essential to expand existing macroeconomic models to better integrate the relationship between central bank interest rates and economic growth, particularly in emerging economies like Brazil. While conventional monetary policy theory largely focuses on the immediate effects of interest rate changes on inflation and investment, more attention should be given to the long-term impacts of these rate adjustments on consumer confidence, business investment, and employment growth. Additionally, theoretical models should incorporate structural economic factors, such as exchange rate volatility and sectoral imbalances, which may modify the transmission mechanisms of monetary policy in Brazil. Expanding these models could allow policymakers and researchers to understand more clearly how interest rate changes affect different sectors of the economy in developing markets and offer richer insights into the dual role of monetary policy in managing both inflation and promoting growth. By doing so, these theories could contribute to improving the predictability and effectiveness of monetary policy interventions in Brazil and other similar emerging economies.

Practice

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In practice, the brazilian central bank could refine its monetary policy framework to consider not only inflation control but also the long-term effects on economic growth. Current monetary policy actions tend to focus heavily on short-term inflation targeting, but a more balanced approach that accounts for the economic growth impact of interest rate changes would be beneficial, especially in times of economic downturn. This approach could include gradual interest rate adjustments to ensure that economic growth is not unduly stifled by rapid rate hikes, while also avoiding excessive inflation. The Central Bank of Brazil should also closely monitor the credit markets, as excessive tightening can disproportionately harm small and medium-sized businesses that are more reliant on credit. As the economy diversifies, the central bank could explore sector-specific interest rate policies, where adjustments in rates can be targeted to industries that are particularly sensitive to interest rates, such as manufacturing, construction, and real estate. This tailored approach would ensure that monetary policy supports economic growth across all sectors, rather than overburdening specific industries, and may help prevent significant slowdowns in key areas of the economy.

Policy

From a policy perspective, it is recommended that the Brazilian Central Bank incorporate economic growth targets alongside its inflation targeting framework. This would align Brazil's monetary policy with a broader economic strategy aimed at achieving sustainable growth. Integrating growth-oriented monetary policy tools such as interest rate corridors and credit easing programs could encourage productive investments without fostering runaway inflation. Policymakers should also ensure that interest rate changes are communicated clearly to the public and market participants, which would help businesses and consumers make more informed decisions regarding investment, savings, and spending. Moreover, a counter-cyclical policy should be implemented, where interest rates are lowered in times of economic stagnation to stimulate investment and growth, and raised during periods of overheating to keep inflation in check. It is crucial that interest rate decisions are complemented by other fiscal policies that encourage private sector investment, job creation, and poverty reduction, especially in the context of Brazil's economic inequalities. By implementing these recommendations, Brazil could achieve a more dynamic and resilient economy, with growth driven by sustainable investments and inclusive prosperity.

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