

WHATEVER IT TAKES

Mauricio Oreng
mauricio.oreng@santander.com.br
+5511 3553 5404

- The BCB published the minutes from its Jun 15-16 COPOM policy meeting, when the authority raised the Selic rate by 75 bps (for a third time in a row) to 4.25% p.a. Overall, the BCB struck a more hawkish tone, even compared to the policy statement.
- The Committee clarified that it considered a bolder move (i.e., a 100-bp hike) for the June meeting—signaling an inclination to step up the pace—and showed greater flexibility and willingness to do whatever it takes to curb the second-round effects of ongoing inflation shocks.
- In our view, the BCB took the opportunity to emphasize its policy flexibility (despite the transparency about pre-communicating its intended policy steps) and reinforcing its commitment to bringing inflation back to mid-target next year.
- We still project a Selic rate of 6.50% at the end of this year and 7.00% early in 1Q22. While for now we maintain our call for the terminal Selic level, we see increased probability of a more front-loaded action and earlier policy normalization. We also see greater probability that the BCB chooses to take a slightly tight policy stance at some point (meaning a Selic slightly higher than neutral).



Overview

The BCB published the minutes from its Jun 15-16 COPOM¹ policy meeting², when the authority raised the Selic rate by 75 bps (for a third time in a row) to 4.25% p.a. Overall, the BCB struck a more hawkish tone, even compared to the policy statement. The COPOM clarified that it considered a bolder move (i.e., a 100-bp hike) for the June meeting—signaling an inclination to step up the pace—and showed greater flexibility and willingness to do whatever it takes to curb the second-round effects of ongoing inflation shocks and bring inflation back to mid-target in 2022.

Key Policy Messages

In the minutes, the BCB justifies the change in the flight plan towards a full normalization (i.e., abandoning the previous guidance of “partial normalization”) by stating that its models indicate that “subsequent uninterrupted interest rate increases, up to the level considered neutral, imply projections around the inflation target in the relevant horizon” (Paragraph #14). Thus, for now the BCB models indicate that a 6.5% terminal Selic can do the trick of bringing IPCA inflation down to the 3.5% mid-target next year.

However, we believe the more important takeaway from the minutes is in the paragraphs that follow. The BCB discloses that it has “evaluated a quicker reduction of monetary stimulus already in this meeting” but found that “the best strategy would be to maintain the current pace of stimulus reduction but highlighting the possibility of a quicker adjustment in the next meeting.” A key reason for this is that it would allow the BCB to gather more information on key determinants of the inflation dynamics, particularly “the evolution of more inertial prices” (read services) and “the behavior of inflation expectations” (both median analysts’ forecasts and asset-implied estimates).

The BCB also took the opportunity to “clarify the distinction between transparency about conditional projections and invariant monetary policy intentions.” The BCB reaffirmed its unambiguous commitment to bring inflation to the target for the relevant policy horizon and claims that “future monetary policy steps are freely adjusted to this objective as new information becomes available.” According to the BCB the indications of future policy intentions (both for the next move or the terminal level) helps clarify its reaction function. The authority also stresses that the information update between meetings can modify “the assumptions present in the baseline scenario and in the balance of risks, and naturally changes the future path of interest rates.” (Paragraphs #15, #16 and #17)

An Update on the Balance of Risks

Elsewhere in the minutes, the BCB provided extra details on some key elements comprised, included or removed from the balance-of-risk analysis presented in the communiqué.

According to the COPOM, the high fiscal risks continue to imply an upward asymmetry in the balance of risks that “affects the appropriate degree of monetary stimulus, thus justifying a path for monetary policy that is less stimulative than the path used in the baseline scenario” (Paragraph #13). For now, we believe this is more an indication of speed than depth of the adjustment. But in time, we believe this sort of signal may also justify a decision to hike rates a bit beyond the neutral level (estimated by the BCB).

The COPOM also highlighted that “inflation of tradable goods in Brazil was higher than in several of its peer countries and that this process may reverse in the future, creating a new downside risk to inflation.” The COPOM also believes that the “recent rise in the weight of tradable items” in the IPCA should magnify the possible contributions from this event (Paragraph #10). This paragraph reveals a desire by BCB officials that the FX rate channel continue to work as planned, in the direction of a stronger BRL. That is possible, in our view, as long as other key variables do not interfere on the trend (e.g., fiscal risks, commodity prices).

¹ The COPOM is the monetary policy committee of the Brazilian Central Bank (BCB).

² Refer to the minutes of the 239th COPOM meeting in English (<https://www.bcb.gov.br/en/publications/copomminutes>).



The COPOM also reaffirmed an upbeat tone on real activity, as they noted that “median Focus survey growth projections were significantly revised and became more optimistic than those in its baseline scenario.” The BCB also believes that “the downside risks to inflation stemming from risks to the economic recovery have reduced significantly.” These claims justify the substitution of the downside risk element in the balance of risk assessment, with a possibly stronger BRL (reducing the cost push inflation and) replacing the eventuality of a negative surprise in the pace of economic recovery as a possible drag to IPCA (Paragraph #11).

What to Expect Ahead?

In our view, the BCB took the opportunity to change the tone on its policy flexibility (despite the transparency about pre-communicating its intended policy steps), and to show willingness to do whatever it takes to curb the spreading of inflation pressures and the rising trend in expectations, reinforcing the communication about its commitment to bringing inflation back to mid-target next year.

As the BCB suggests that the possibility of a faster normalization hinges on trends in underlying inflation (namely services) and inflation expectations, we see real chances that an adverse news flow for inflation in the next few weeks and months has the potential to trigger a bolder move (100-bp hike) by the BCB in the August 3-4 COPOM meeting.

We still project a Selic rate of 6.50% at the end of this year and 7.00% early in 1Q22, (with a hike of 50 bps in February). While for now we maintain our call for the terminal Selic level, we (and probably the whole market) see increased probability of a more front-loaded action and earlier policy normalization. We also see greater probability that the BCB may chose at some point to take a slightly tight policy stance (meaning a Selic rate slightly higher than neutral).



CONTACTS / IMPORTANT DISCLOSURES

Brazil Macro Research

Ana Paula Vescovi*	Chief Economist	anavescovi@santander.com.br	5511-3553-8567
Mauricio Oreng*	Head of Macro Research	mauricio.oreng@santander.com.br	5511-3553-5404
Jankiel Santos*	Economist – External Sector	jankiel.santos@santander.com.br	5511-3012-5726
Ítalo Franca*	Economist – Fiscal Policy	italo.franca@santander.com.br	5511-3553-5235
Daniel Karp*	Economist – Inflation	daniel.karp@santander.com.br	5511-3553-9828
Tomas Urani*	Economist – Global Economics	tomas.urani@santander.com.br	5511-3553-9520
Lucas Maynard*	Economist – Economic Activity	lucas.maynard.da.silva@santander.com.br	5511-3553-7495
Felipe Kotinda*	Economist – Credit	felipe.kotinda@santander.com.br	5511-3553-8071
Gabriel Couto*	Economist – Special Projects	gabriel.couto@santander.com.br	5511-3553-8487
Gilmar Lima*	Economist – Modeling	gilmar.lima@santander.com.br	5511-3553-6327

Global Macro Research

Maciej Reluga*	Head Macro, Rates & FX Strategy – CEE	maciej.reluga@santander.pl	48-22-534-1888
Juan Cerruti *	Senior Economist – Argentina	jcerruti@santander.com.ar	54 11 4341 1272
Ana Paula Vescovi*	Economist – Brazil	anavescovi@santander.com.br	5511-3553-8567
Juan Pablo Cabrera*	Economist – Chile	jcabrera@santander.cl	562-2320-3778
Guillermo Aboumrad*	Economist – Mexico	gjaboumrad@santander.com.mx	5255-5257-8170
Piotr Bielski*	Economist – Poland	piotr.bielski@santander.pl	48-22-534-1888
Mike Moran	Head of Macro Research, US	mike.moran@santander.us	212-350-3500

Fixed Income Research

Juan Arranz*	Chief Rates & FX Strategist – Argentina	jarranz@santanderrio.com.ar	5411-4341-1065
Mauricio Oreng*	Senior Economist/Strategist – Brazil	mauricio.oreng@santander.com.br	5511-3553-5404
Juan Pablo Cabrera*	Chief Rates & FX Strategist – Chile	jcabrera@santander.cl	562-2320-3778

Equity Research

Miguel Machado*	Head Equity Research Americas	mmachado@santander.com.mx	5255 5269 2228
Alan Alanis*	Head, Mexico	aalanis@santander.com.mx	5552-5269-2103
Andres Soto	Head, Andean	asoto@santander.us	212-407-0976
Claudia Benavente*	Head, Chile	claudia.benavente@santander.cl	562-2336-3361
Walter Chiarvesio*	Head, Argentina	wchiarvesio@santanderrio.com.ar	5411-4341-1564
Mariana Cahen Margulies*	Head, Brazil	mmargulies@santander.com.br	5511 3553 1684

Electronic

Bloomberg
Reuters

SIEQ <GO>
Pages SISEMA through SISEMZ

This report has been prepared by Santander Investment Securities Inc. ("SIS"; SIS is a subsidiary of Santander Holdings USA, Inc. which is wholly owned by Banco Santander, S.A. "Santander"), on behalf of itself and its affiliates (collectively, Grupo Santander) and is provided for information purposes only. This document must not be considered as an offer to sell or a solicitation of an offer to buy any relevant securities (i.e., securities mentioned herein or of the same issuer and/or options, warrants, or rights with respect to or interests in any such securities). Any decision by the recipient to buy or to sell should be based on publicly available information on the related security and, where appropriate, should take into account the content of the related prospectus filed with and available from the entity governing the related market and the company issuing the security. This report is issued in Spain by Santander Investment Bolsa, Sociedad de Valores, S.A. ("Santander Investment Bolsa"), and in the United Kingdom by Banco Santander, S.A., London Branch. Santander London is authorized by the Bank of Spain. This report is not being issued to private customers. SIS, Santander London and Santander Investment Bolsa are members of Grupo Santander.

ANALYST CERTIFICATION: The following analysts hereby certify that their views about the companies and their securities discussed in this report are accurately expressed, that their recommendations reflect solely and exclusively their personal opinions, and that such opinions were prepared in an independent and autonomous manner, including as regards the institution to which they are linked, and that they have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report, since their compensation and the compensation system applying to Grupo Santander and any of its affiliates is not pegged to the pricing of any of the securities issued by the companies evaluated in the report, or to the income arising from the businesses and financial transactions carried out by Grupo Santander and any of its affiliates: Mauricio Oreng*.

*Employed by a non-US affiliate of Santander Investment Securities Inc. and not registered/qualified as a research analyst under FINRA rules, and is not an associated person of the member firm, and, therefore, may not be subject to the FINRA Rule 2242 and Incorporated NYSE Rule 472 restrictions on communications with a subject company, public appearances, and trading securities held by a research analyst account.

The information contained herein has been compiled from sources believed to be reliable, but, although all reasonable care has been taken to ensure that the information contained herein is not untrue or misleading, we make no representation that it is accurate or complete and it should not be relied upon as such. All opinions and estimates included herein constitute our judgment as at the date of this report and are subject to change without notice.

Any U.S. recipient of this report (other than a registered broker-dealer or a bank acting in a broker-dealer capacity) that would like to effect any transaction in any security discussed herein should contact and place orders in the United States with SIS, which, without in any way limiting the foregoing, accepts responsibility (solely for purposes of and within the meaning of Rule 15a-6 under the U.S. Securities Exchange Act of 1934) for this report and its dissemination in the United States.

© 2021 by Santander Investment Securities Inc. All Rights Reserved.

