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MONETARY POLICY – COPOM MINUTES

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WHATEVER IT TAKES

- 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 COPOM[1] policy meeting[2], 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).

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