Santander
Macroeconomic Research

# BRAZIL MACRO

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## MONETARY POLICY – COPOM MEETING

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## RECALCULATING THE ROUTE

- As widely expected, the COPOM hiked the Selic policy rate by 100 bps, taking it to 12.75%, the highest level since 1Q17.
- The Brazil Central Bank's (BCB) inflation forecast now points to IPCA of 7.3% for 2022 (+1.0 pp from the last publication) and 3.4% for 2023 (+0.3 pp from the last publication). The simulations continue to use a slightly different-than-usual scenario, judged more likely by the BCB since the last meeting (when it was called "alternative"). This scenario assumes oil price at US$100 bbl at YE2022 and stable in real terms afterwards, as well as FX rate at USD/BRL 4.95 (and moving accordingly with the purchasing power parity subsequently). It also takes Selic rate at 13.25% for YE2022 and 9.25% for YE2023.
- According to the BCB's own scenario and calculations, an additional hike of 50bps (or a bit more) in this cycle is needed to achieve its objective (i.e., convergence to mid-target of 3.25% for 2023, the policy horizon now). No wonder that now the BCB "foresees as likely an extension of the cycle, with an adjustment of lower magnitude for the next meeting", in contrast with the previous plan to end the cycle at 12.75%.
- The authority mentions that the "uncertainty in its assumptions and projections is higher than usual". The COPOM also highlights that "the heightened uncertainty of the current scenario, the advanced stage of the current monetary policy cycle, and its impacts yet to be observed require additional caution in its actions". We interpret these words of caution as an indication that the BCB might seek to avoid what the board could possibly see as "overreacting" in terms of the terminal Selic level projected for this cycle. Yet, we also note that the BCB was not highly emphatic about ending the tightening cycle soon.
- In our view, the COPOM statement implies a little upside risk to our call for a final hike of 50 bps in June and a terminal Selic of 13.25% in the cycle. We continue to think that the cycle is near completion and do not foresee rate hikes in 2H22 for now. Yet we recognize that this will hinge on the evolution of the inflation outlook, and mainly on inflation expectations for 2023.

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**Policy Decision, Inflation Forecasts and Flight Plan**

**In its 246th monetary policy meeting, the Copom[1] hiked the Selic rate[2] by 100 bps, the same magnitude as in the previous meeting. The policy rate now has reached 12.75%, the highest level since 1Q17. The decision was widely expected both by macro analysts and the yield curve. This is the tenth consecutive hike in this cycle—which started off with Selic rate at 2.00% in 1Q21.**

**The BCB's inflation forecast now point to IPCA of 7.3% for 2022 (+1.0 pp from the last publication) and 3.4% for 2023 (+0.3 pp from the last publication).** The simulations continue to use the scenario (named Scenario A in the 1Q22 inflation report), judged more likely by the BCB. This scenario assumes the price of oil at US$100/bbl at YE2022 and stable in real terms afterward[3]. It also takes the standard parameters used in BCB simulations: (i) the FX rate departing from USD/BRL4.95 (as per the rounded average for the week before this meeting) and moving accordingly with the purchasing power parity afterwards; (ii) the Selic rate (as per the consensus among economists[4]). In this expected path, the policy rate peaks at 13.25% in June, remains stable until YE2022 and starts going down in the first COPOM meeting of 2023, before reaching 9.25% at YE2023. The scenario also assumes a "Yellow" electricity tariff flag both for December 2022 and 2023.

**Thus, according to the BCB's own scenario and calculations, an additional 50-bp hike (or a bit more) in this cycle is needed to achieve the authority's objective (i.e., convergence to mid-target of 3.25% for 2023, the only policy horizon now).** This re-estimation of the necessary policy dose to achieve next year's mid-target prompted the BCB to change its flight plan once again. In the previous meeting, the BCB's flight plan included one hike of 100 bps in May, with the cycle ending at 12.75%[5] [6]. **This time, the BCB "foresees as likely an extension of the cycle, with an adjustment of lower magnitude for the next meeting [i.e., less than 100 bps]."**

The authority mentions in the statement that the "uncertainty in its assumptions and projections is higher than usual", which is a recognition of misty macroeconomic conditions and inflation outlook. The COPOM highlights elsewhere in the communiqué that "the heightened uncertainty of the current scenario, the advanced stage of the current monetary policy cycle, and its impacts yet to be observed **require additional caution in its actions.**" We interpret this wording of caution as an indication that the BCB might seek to avoid what the board could possibly see as "overreacting" in terms of the terminal Selic level projected for this cycle. Yet, **we also note that the BCB was not highly emphatic at all about ending the tightening cycle soon**.

**Balance of Risks and Scenario Assessment**

As usual, the statement brings a discussion about the balance of risks (BoR) for inflation, which was considerably revised this time around. **Out of the changes in the BoR analysis, the most important, in our view, is dropping in the mention of an upwardly skewed balance of risks for inflation, which can be translated into a lack of bias seen in the BCB's inflation forecast.** The BCB continues to mention inflationary risks in both directions: in the upside, the BCB highlights "a greater persistence of global inflationary pressures" [new element] and "an increase in the risk premium due to the uncertainty about the country's future fiscal framework, partially incorporated in inflation expectations and asset prices" [repeated element]. In the downside, the COPOM refers to "a possible reversion (…) of the recent increase in the price of international commodities measured in local currency" [repeated element] and "a greater deceleration of economic activity than projected" [new element].

In the scenario assessment, the BCB recognizes a difficult inflation environment, but with no major changes in the wording compared to the last statement. The COPOM believes that CPI is high and has surprised to the upside "both in the more volatile components and on the items associated with core inflation." The BCB also

[1] The COPOM is the monetary policy committee of the Brazilian Central Bank (BCB).
[2] Refer to the statement of COPOM #246 in English (https://www.bcb.gov.br/en/monetarypolicy/Copomstatements).
[3] Assuming U.S. inflation of 2% for the long term.
[4] Refer to the BCB's weekly survey of professional forecasters for April 29, 2022 (https://www.bcb.gov.br/en/publications/focusmarketreadout)
[5] Santander Brazil Monetary Policy - *"COPOM Decision: A Plan Amid the Uncertainty"* – March 16, 2022 - Available on: https://bit.ly/Std-COPOM-mar22
[6] Santander Brazil Monetary Policy - *"COPOM Minutes: Reinforcing the Commitment to The Flight Plan If Conditions Allow"* – March 22, 2022 – Available on: https://bit.ly/Std-COPOM-min-mar22

noted that “various measures of underlying inflation are above the range compatible with meeting the inflation target.”

On activity, the BCB believes that “the set of indicators released since the previous COPOM meeting suggests a rate of growth in line with the Committee's expectations.”

On the global environment, the BCB naturally reveals a more worried tone, as the authority identifies further deterioration as inflationary pressures “intensified due to supply problems related to the new wave of Covid-19 in China and the war in Ukraine.” The COPOM also notes that expectations about “monetary policy in advanced countries increases uncertainty and generates additional volatility, particularly in emerging economies.”

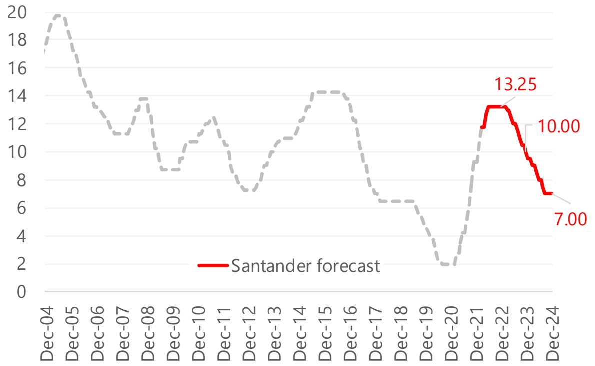
**What to Expect Ahead?**

While we did not see the BCB so emphatic about ending the tightening cycle soon, the COPOM statement imparts a little upside risk as per our call for a final hike of 50 bps in June and a terminal Selic of 13.25% in the cycle. Still, we continue to think that the cycle is near completion. At least for now, we do not foresee rate hikes in the 2H22, even though we recognize that this will hinge on the evolution of the inflation outlook, and mainly on inflation expectations for 2023.

Looking further ahead, we look for an only gradual policy easing, which reflects a slow disinflation process expected ahead and the upside risks for global (neutral) interest rate. As an upshot, we foresee monetary policy in restrictive territory until mid-2024. As for the next cycle, we see rate cuts starting in March 2023, taking the Selic down to 10.00% for YE2023 and 7.00% for YE2024. This expected convergence to the structural level of 7.00% is naturally conditional on the maintenance of (economic conditions consistent with) a long-term inflation target of 3.00%.

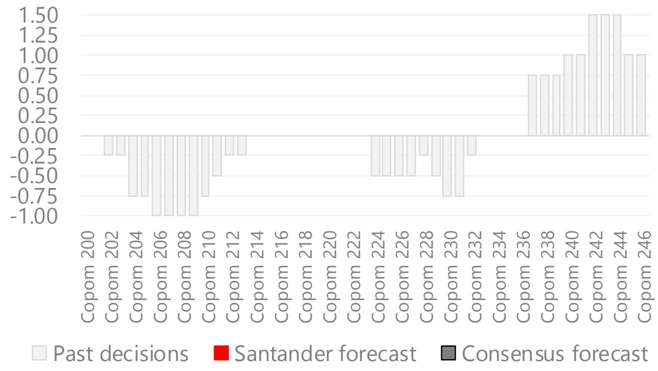
***Refer to a few graphs in the next page.***

**Figure 1. The Path for the Selic Policy Rate (monthly average, % p.a.)**



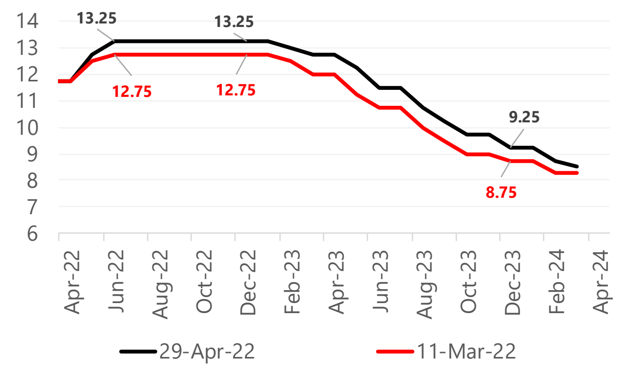

Sources: Brazilian Central Bank, Bloomberg, Santander.

**Figure 2. Selic Moves in COPOM Meetings: History, Forecast (in percentage points)**



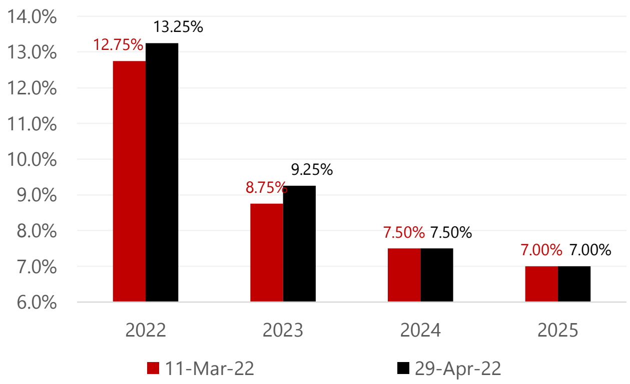

Sources: Brazilian Central Bank, Bloomberg, Santander.

**Figure 3. Median Monthly Selic Forecasts (Consensus)**



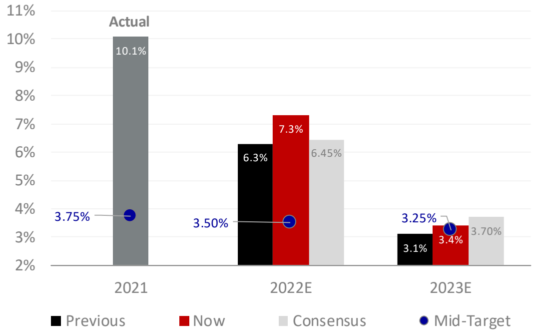

Sources: Brazilian Central Bank, Santander.
Note: Based on BCB's weekly Focus survey with professional forecasters (refer to https://www.bcb.gov.br/en/publications/focusmarketreadout).

**Figure 4. Median Annual Selic Forecasts (Consensus)**



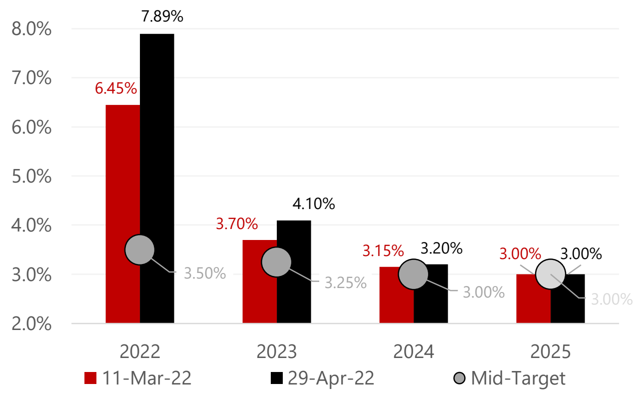

Sources: Brazilian Central Bank, Santander.
Note: Based on BCB's weekly Focus survey with professional forecasters (refer to https://www.bcb.gov.br/en/publications/focusmarketreadout).

**Figure 5. BCB's Inflation Simulation – Scenario A (% annual)**




Sources: Brazilian Central Bank, Santander.
Note: IPCA simulations assume Selic rate from the Focus survey and USD/BRL starting at 4.95 and evolving according to purchase power parity. Assumes oil price at USD 100 and (as per the week before the COPOM meeting) and a 2% change per year afterwards.

**Figure 6. Median Annual IPCA Forecasts (Consensus)**




Sources: Brazilian Central Bank, Santander.
Note: Based on BCB's weekly Focus survey with professional forecasters (refer to https://www.bcb.gov.br/en/publications/focusmarketreadout).

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