Santander
Macroeconomic Research

BRAZIL MACRO

March 22, 2023

MONETARY POLICY DECISION

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

NO BLINKING

- In its 253rd Copom meeting, the Brazilian Central Bank (BCB) again maintained the Selic policy rate at 13.75%, as widely expected by analysts and in line with the yield curve. The tone of the communiqué seems to have fallen more on the hawkish side of market expectations (and about in line with our view).
- The BCB maintained the monetary policy signal that it "remains vigilant, assessing if the strategy of maintaining the Selic rate for a long period will be enough to ensure the convergence of inflation." The authority reaffirmed its commitment with the inflation target and repeated the message that it "will not hesitate to resume the tightening cycle if the disinflationary process does not proceed as expected."
- The Copom continues to show particular concern with the deterioration of inflation expectations. No wonder: the additional (20-bp) gain in the BCB's IPCA forecasts for the relevant monetary policy horizons was likely driven by the rise in expectations of late. The inflation models seem to convey a message that, in the absence of major changes in key variables influencing them (including the medium-term inflation target), there is no room for Selic rate cuts in the short term (and perhaps not even this year).
- The most discussed topics of late – the financial system concerns abroad and the slowing credit market here – have been included in the balance of risks (on the downside, of course). The BCB also added the possibility of further de-anchoring of inflation expectations as an upside risk. The BCB continues to refrain from explicitly signaling an asymmetry in the risks.
- Judging by the communiqué, the Copom seems to keep the flight plan with stable interest rates for an extended period, as a response to fiscal uncertainties and the unmooring of inflation expectations. By focusing on the main variable (inflation expectations) influencing its main objective (inflation target), we believe the BCB is taking an approach that could favor the potential growth of the economy for the medium-to-long run.
- We continue to see any change in the BCB strategy as premature at this point and believe that the BCB might only revise it in case of important deviations from its key current hypotheses and policy parameters (such as the inflation target). For now, we continue to project (gradual) rate cuts starting in November, bringing the Selic rate down to 13% for YE2023 and 11% for YE2024.

POLICY DECISION AND FLIGHT PLAN

In the 253rd monetary policy meeting of the Brazilian Central Bank (BCB), the Copom[1] kept the Selic rate at 13.75%[2]. The decision was in line with analysts' forecasts[3] and the yield curve. Following a similar line of action as some of the main central banks of late (ECB, Fed), the Copom indicates in the statement that, despite being aware of external financial uncertainties and the signs of cooling in domestic credit, the monetary authority remains focused on its main statutory objective: to pursue the inflation target for the relevant policy horizon.

The BCB maintained the monetary policy signal that it "remains vigilant, assessing if the strategy of maintaining the Selic rate for a long period will be enough to ensure the convergence of inflation." The Copom reaffirms its indication that "will persist until the disinflationary process consolidates and inflation expectations anchor around its targets", and that the Copom "will not hesitate to resume the tightening cycle if the disinflationary process does not proceed as expected." All in all, the BCB wording heralds no changes in the flight plan for now.

The Copom continues to show particular concern with the deterioration of inflation expectations, especially for the long term, as the BCB sees an "additional deterioration". The BCB assesses that "the deanchoring of long-term inflation expectations raises the cost of the disinflation that is needed to reach the targets established by the National Monetary Council." In fact, the worsening of expectations for the relevant policy horizon (mainly 2024, for which analysts' forecasts increased by ~20 bps since the previous Copom meeting) was an important element behind the increase in the BCB's inflation projections for the monetary policy horizons. The authority's IPCA estimate rose by 0.2 pp for the relevant horizons and scenarios tested.

The BCB's inflation models seem to convey a message that, in the absence of major changes in key variables influencing them (including the medium-term inflation target), there is no room for Selic rate cuts in the short term (and perhaps not even this year). As per the inflation simulation in the reference scenario[4], assuming the Selic trajectory according to the Focus survey (with rate cuts to 12.75% for YE2023 and 10.00% for YE2024), the BCB's IPCA estimate rose to 3.8% (from 3.6%) for 3Q24 (the "adjusted" target for this horizon is 3.06%). The estimate also rose to 3.6% from 3.4% for YE2024 (mid-target: 3.00%). As per the simulation in the alternative scenario, assuming Selic rate remains stable at 13.75% over the entire horizon, the projection rose to 3.3% from 3.1% for 3Q24 ("adjusted target": 3.06%) and moved to 3.0% from 2.8% for YE2024 (mid-target: 3.00%).

The analysis of the balance of risks has seen relevant changes, incorporating new elements on both sides. Potential upside now includes the likelihood of a "larger or more persistent deanchoring of long-term inflation expectations"; the downside brings the possibility of "adverse conditions in the global financial system" dampening global growth further, in addition to " a slowdown in domestic credit concession larger than what would be compatible with the current stance of monetary policy." In this part of the communiqué, the BCB continues to refrain from explicitly signaling an asymmetry in the balance of risks.

In the scenario assessment, as one might imagine, the biggest changes in the statement were concentrated in the international scenario, where the BCB assesses that there has been a deterioration, mentioning that "episodes involving banks in the United States and Europe have increased the uncertainty and the volatility in markets" and that "the process of monetary policy tightening in major economies continued to advance". Local economic activity data is still seen corroborating "the deceleration expected by Copom" and the inflation picture still shows underlying inflation "above the range compatible with meeting the inflation target".

---

[1] The Copom is the monetary policy committee of the Brazilian Central Bank.
[2] Refer to the statement of Copom #253 in English (https://www.bcb.gov.br/en/monetarypolicy/Copomstatements) and Portuguese (https://www.bcb.gov.br/controleinflacao/comunicadoscopom).
[3] **Santander Brazil Monetary Policy: "*Copom Preview: Staying the Course, at Least for Now*"** – March 20, 2023 – Available on: https://bit.ly/Std-COPOM-p-mar23
[4] The simulations assume USD/BRL at 5.25 and then evolving with the purchasing power parity (PPP) as well as oil price following the futures curve for the next six months and then stable in real terms in USD (i.e., up 2% annually subsequently). The scenarios assume energy tariff flag "yellow" for both December 2023 and 2024.

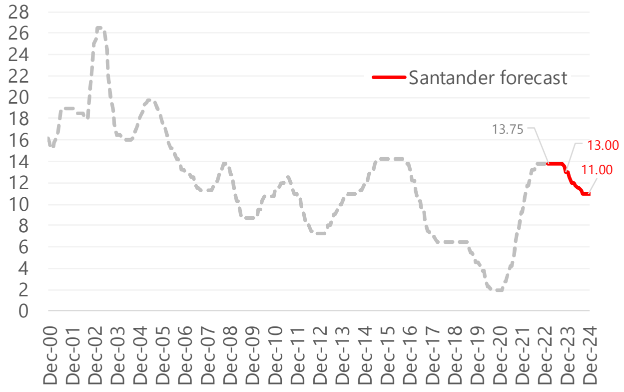
Judging by the communiqué, the Copom seems to keep the flight plan with stable interest rates for an extended period, as a response to fiscal uncertainties and the unmooring of inflation expectations. The latter remains a major concern of the Committee. We believe that the Copom communication, for the time being, remains consistent with our scenario of Selic cuts starting only at the end of the year. The Copom minutes, due next Tuesday (March 28), and the 1Q23 inflation report, due next Thursday (March 30), may shed more light on the BCB's scenario assessment, perceived risks, and policy strategy.

By focusing on the main variable (inflation expectations) influencing its main objective (inflation target), we believe the BCB is taking an approach that could favor the potential growth of the economy for the medium to long run. Additionally, we believe staying the course at this juncture makes sense considering: (i) a lack of evidence on the potential impact of the credit slowdown on broader economic activity (and hence on the inflation outlook), and (ii) the fact that the first line of defense against undesirable tightening of credit conditions involves actions on the regulatory or macro-prudential front.

While we recognize that the recent external and domestic financial developments require monitoring, as the BCB itself recognizes, we continue to see inflation risks predominantly skewed to the upside. Thus, we see any change in the BCB strategy as premature at this point and believe that the BCB might only revise its strategy in case of important deviations from its key current hypotheses and policy parameters (such as the inflation target). For now, we continue to project (gradual) rate cuts starting in November, bringing the Selic rate down to 13% for YE2023 and 11% for YE2024.

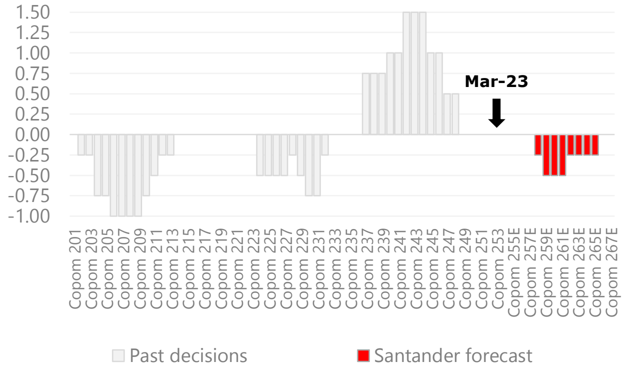
Refer to graphs on the next page.

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



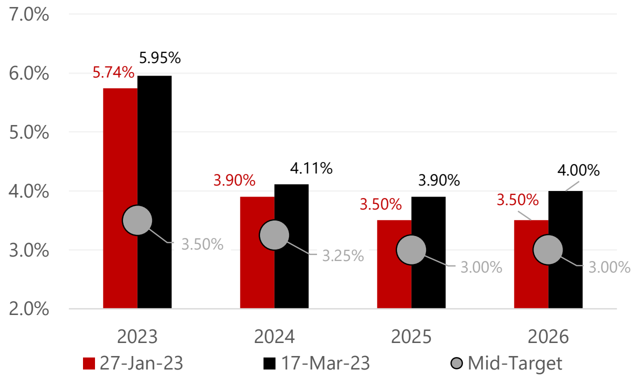
Sources: Brazilian Central Bank, Bloomberg, Santander.

Figure 2. Selic Rate Moves in Copom Meetings: History and Forecast (in percentage points)



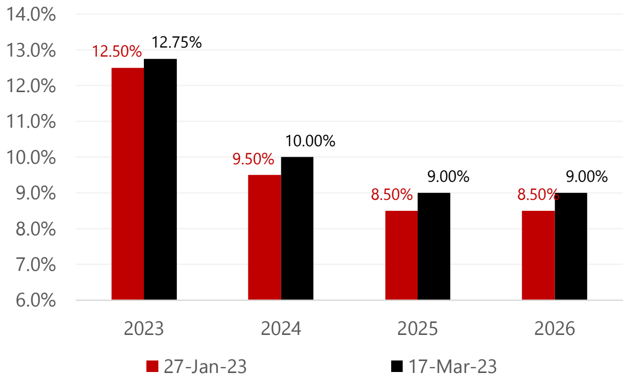
Sources: Brazilian Central Bank, Bloomberg, Santander.

Figure 3. Median Annual IPCA Forecasts (Consensus)



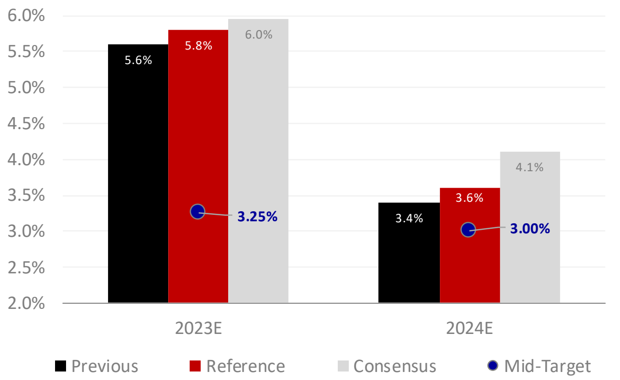
Sources: Brazilian Central Bank, Santander.
Note: Based on BCB's weekly Focus survey with professional forecasters (refer to https://www.bcb.gov.br/en/publications/focusmarketreadout).
Last report: March 17, 2023.

Figure 4. Median Annual Selic Forecasts (Consensus)



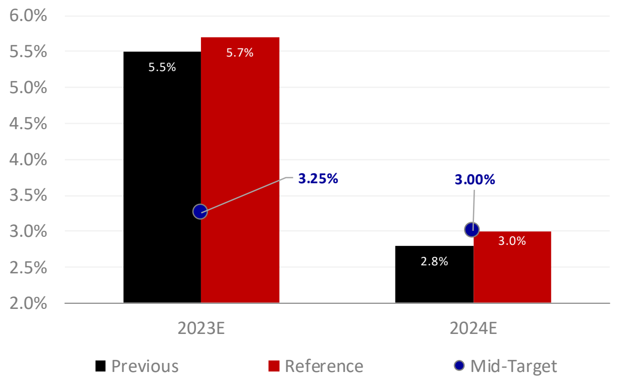
Sources: Brazilian Central Bank, Santander.
Note: Based on BCB's weekly Focus survey with professional forecasters (refer to https://www.bcb.gov.br/en/publications/focusmarketreadout).
Last report: March 17, 2023.

Figure 5. BCB's Inflation Estimates (%) – Reference Scenario



Sources: Brazilian Central Bank, Santander.
Note: Assuming FX rate departing from USD/BRL 5.25, and then moving along with the PPP (purchasing power parity). Oil price following the futures curve for six months and stable in real terms in USD. **<u>This scenario uses the consensus forecast for the future path of interest rate</u>**.

Figure 6. BCB's Inflation Estimates (%) – Alternative Scenario



Sources: Brazilian Central Bank, Santander.
Note: Assuming FX rate departing from USD/BRL 5.25, and then moving along with the PPP (purchasing power parity). Oil price following the futures curve for six months and stable in real terms in USD. **<u>This scenario uses a path of stable interest rate at 13.75% for the entire horizon</u>**.

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 Vasquez*	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 – Commodities	felipe.kotinda@santander.com.br	5511-3553-8071
Gabriel Couto*	Economist – Special Projects	gabriel.couto@santander.com.br	5511-3553-8487
Fabiana Moreira*	Economist – Credit	fabiana.de.oliveira@santander.com.br	5511-3553-6120
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
Rodrigo Park *	Economist – Argentina	rpark@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
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	SIEQ <GO>
Reuters	Pages SISEMA through SISEMZ

Santander