BRAZIL MACRO

May 3, 2023

MONETARY POLICY DECISION

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

SAME TONE, SAME STRATEGY

- In the 254th monetary policy meeting of the Brazilian Central Bank (BCB), the Copom maintained the Selic rate at 13.75%. The decision was widely in line with analysts' forecasts and the yield curve.
- 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 convergence of inflation". Referring again to a more difficult stage of the disinflation process, the BCB once again signaled that "the current scenario demands patience and serenity in the conduct of monetary policy."
- On the one hand, the BCB's inflation models convey a message that, in the absence of major changes in key variables (or BCB hypotheses) influencing them, there is no room for Selic rate cuts in the short term. The numbers also reinforced, on the other hand, that the authority does not need to raise interest rates to achieve its objectives. The authority continues to project IPCA at 3.6% for 2024 in a scenario with the rate cuts projected by economists, with convergence to mid target (3.0%) taking place in a (counter-factual) scenario of stable Selic rate all the way at 13.75%.
- The balance of risks basically maintained the same (upside and downside) elements, with some BCB emphasis on the uncertainty still present around "the final fiscal framework to be approved by the National Congress". The BCB also reaffirmed that monetary policy will focus on the "impacts on the expected paths of the public debt and of inflation expectations, and on risky assets".
- As per the Brazilian economy, local activity data is still seen corroborating "the deceleration expected by Copom", but the authority sees signs of resilience in the labor market. On inflation, the BCB avoided celebrations with the recent softening, indicating that headline and underlying inflation remain "above the range compatible with meeting the inflation target".
- The Copom minutes, due next Tuesday (May 9), may bring new elements regarding the BCB's scenario assessment, inflation risks and policy strategy. Judging by the communiqué, however, 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. That latter remains a major concern of the committee.
- We see a 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. For now, we keep our scenario of a later-than-expected start to the easing cycle: we project (gradual) interest rate cuts starting in November, bringing the Selic rate down to 13% for YE2023 and 11% for YE2024.

POLICY DECISION, STRATEGY GUIDANCE, INFLATION PROJECTIONS

In the 254th monetary policy meeting of the Brazilian Central Bank (BCB), the Copom[1] maintained the Selic rate at 13.75%[2]. The decision was widely in line with analysts' forecasts[3] and the yield curve.

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 reaffirmed its indication that it "will persist until the disinflationary process consolidates and inflation expectations anchor around its targets."

The BCB also took the opportunity to better calibrate the signaling about the conditionality of its decisions, by maintaining the indication that "it will not hesitate to resume the tightening cycle if the disinflationary process does not proceed as expected", but making it clear that this is a "less likely scenario." All in all, in our view the BCB wording heralds no changes in the flight plan (of keeping the Selic rate on hold) for now.

Still on the policy signal, on the one hand, the BCB recognizes that recent government initiatives, such as the return of the taxation on fuel prices and the proposal for a new fiscal regime "have partly reduced the uncertainty arising from fiscal policy". On the other hand, the BCB once again emphasized on the current "stage in which the disinflationary process tends to be slower in an environment of deanchored inflation expectations, requiring further attention when conducting monetary policy". **Also, the BCB once again signaled that "the current scenario demands patience and serenity in the conduct of monetary policy."**

The BCB's inflation models seem to convey a message that, in the absence of major changes in key variables (or BCB hypotheses) influencing them, there is no room for Selic rate cuts in the short term. The numbers also reinforce, once again, that the authority does not need to raise interest rates to achieve its objectives. As per the inflation simulation in the reference scenario[4], assuming the Selic trajectory according to the Focus survey (with rate cuts starting in September, reaching 12.50% for YE2023 and 10.00% for YE2024), the BCB's IPCA estimate remained unchanged (from the last Copom meeting) at 3.6% YE2024, which is now the main policy horizon (and for which the mid-point inflation target is 3.00%). As per the simulation in the alternative scenario, assuming the Selic rate remains stable at 13.75% over the entire horizon, the projection slid by a tenth (since the last meeting) to 2.9% for YE2024[5].

The BCB revised down the tariff flag hypothesis to "green" for both December 2023 and 2024, which changed the composition of the IPCA 2023 projection between free-market and administered prices. For 2024, the BCB continues to estimate free-market inflation below the consensus of economists (~3.1% vs. 4.0%).

BALANCE OF RISKS, SCENARIO ASSESSMENT

The balance of risks basically maintained the same (upside and downside) elements, with a little BCB emphasis on the uncertainty still present about "the final fiscal framework to be approved by the National Congress" The BCB also reaffirmed that monetary policy will focus on the "impacts on the expected paths of the public debt and of inflation expectations, and on risky assets". The upside elements of the balance of risks also include the possibility of "a larger or more persistent deanchoring of long-term inflation expectations."

---

[1] The Copom is the monetary policy committee of the Brazilian Central Bank.
[2] Refer to the statement in English (https://www.bcb.gov.br/en/monetarypolicy/Copomstatements) or Portuguese (https://www.bcb.gov.br/controleinflacao/comunicadoscopom).
[3] **Santander Brazil Monetary Policy: "Copom Preview: *Talking the Talk and Walking the Walk"*** – April 28, 2023 – Available on: https://bit.ly/Std-COPOM-p-may23.
[4] The simulations assume USD/BRL at 5.05 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 now assume energy tariff flag "green" (previously "yellow") for both December 2023 and 2024.
[5] Note that this is a counter-factual scenario since the strategy of keeping rate on hold at the current level until YE2023 would surprise economists in the upside and – all else equal – lead to lower inflation expectations than the path used in simulations. In any case, the signal here is that the BCB may not see inflation head to the center-target in its current horizon if it follows the consensus of economists and start cutting rate in September.

As downside elements, the BCB still mentioned the possibility of “an additional reduction in the prices of international commodities measured in local currency”, the possibility of adverse conditions in the global financial system” leading to a more intense global deceleration, as well as “a slowdown in domestic credit concession larger than what would be compatible with the current stance of monetary policy.” The BCB continued to refrain from explicitly signaling an asymmetry in the balance of risks in this part of the communiqué.

In the scenario assessment, again the most notable changes in the statement were concentrated in the international scenario, as the BCB assessed that global environment remains challenging. The BCB officials cited the uncertainty generated by the “episodes involving banks abroad” but highlighted the limited contagion to global financial conditions for now. The Copom also highlighted the contractionary stance of central banks in major economies, amid “an environment in which inflation has been resilient.”

As per the Brazilian economy, local activity data is still seen corroborating “the deceleration expected by Copom”, but the authority sees signs of resilience in the labor market. On the inflation side, the BCB avoided celebrations with the recent softening in headline CPI and some components, indicating that both headline and underlying inflation remain “above the range compatible with meeting the inflation target”.

OUR TAKE AND OUTLOOK

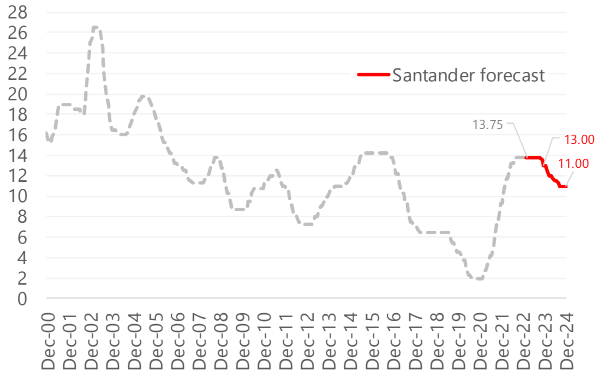
The Copom minutes, due next Tuesday (May 9), may bring new elements regarding the BCB's scenario assessment, inflation risks and policy strategy.

Judging by the communiqué, the Copom seemed 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. By focusing on the main variable (inflation expectations) influencing its main objective (the 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, despite some natural cost in terms of output in the short term.

We see a 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. For now, we stick to our scenario of a later than expected start to the easing cycle: we project (gradual) interest rate cuts starting in November, bringing the Selic rate down to 13% for YE2023 and 11% for YE2024.

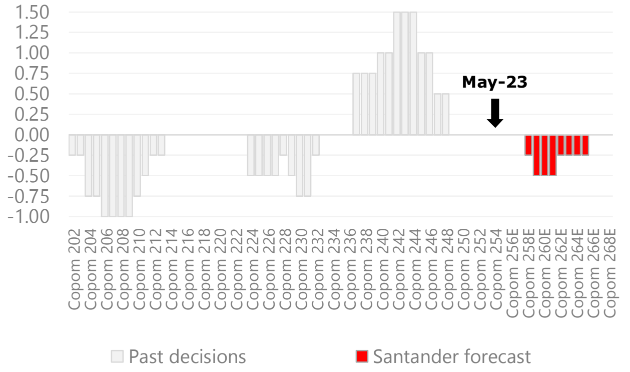
Refer to graphs on the next page.

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



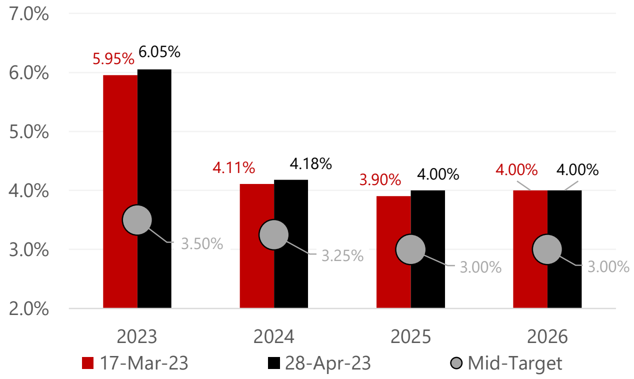
Sources: Brazilian Central Bank, Bloomberg, Santander.

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



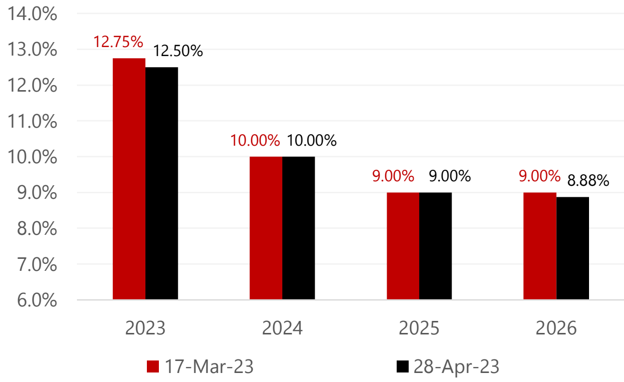
Sources: Brazilian Central Bank, Bloomberg, Santander.

Figure 3. Median Annual IPCA Forecasts (Consensus)



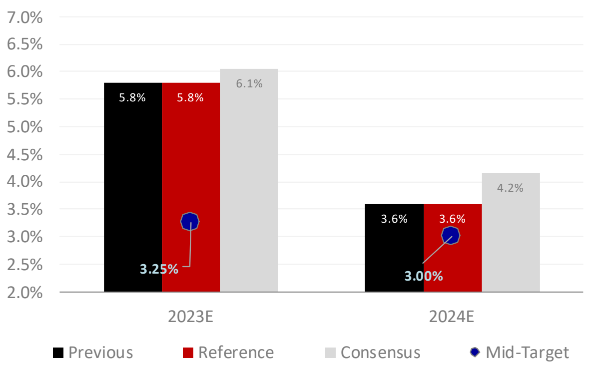
Sources: Brazilian Central Bank, Santander.
Note: Based on BCB's weekly Focus survey with professional forecasters (refer to https://www.bcb.gov.br/en/publications/focusmarketreadout).
Last report: April 28, 2023.

Figure 4. Median Annual Selic Forecasts (Consensus)



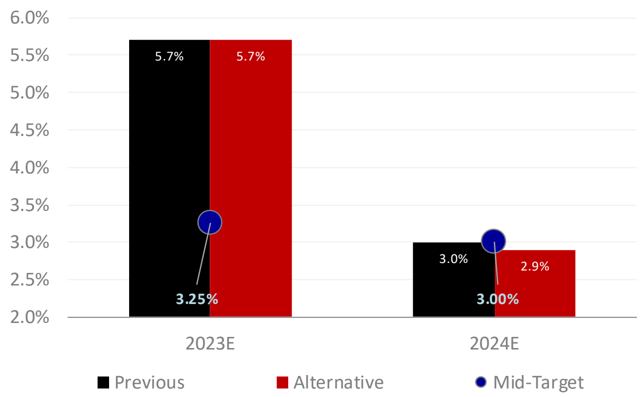
Sources: Brazilian Central Bank, Santander.
Note: Based on BCB's weekly Focus survey with professional forecasters (refer to https://www.bcb.gov.br/en/publications/focusmarketreadout).
Last report: April 28, 2023.

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



Sources: Brazilian Central Bank, Santander.
Note: Assuming FX rate departing from USD/BRL 5.05, 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. Uses the consensus forecast for the future path of interest rate.

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



Sources: Brazilian Central Bank, Santander.
Note: Assuming FX rate departing from USD/BRL 5.05, 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. Uses a path of stable interest rate at 13.75% for the entire horizon.

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
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
Aline de Souza Cardoso*	Head, Brazil	aline.souza.cardoso@santander.com.br	5511-3553-1684
Electronic			
Bloomberg		SIEQ <GO>	
Reuters		Pages SISEMA through SISEMZ	

Santander