# BRAZIL MACRO

March 22, 2022

## MONETARY POLICY – COPOM MINUTES

## REINFORCING THE COMMITMENT TO THE FLIGHT PLAN IF CONDITIONS ALLOW

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- The Brazilian Central Bank (BCB) published the minutes of its March 15-16 policy meeting, when the authority once again hiked interest rates, but this time by 100 bps, to 11.75%.

- Overall, the Copom message is not very different from the statement, except for what we perceived as a greater emphasis on the flight plan to deliver a final rate hike of 100bps in the next meeting (May 3-4), ending the cycle at 12.75%.

- The plan seems to follow the BCB's view, based on its model simulations, that IPCA inflation would converge to the mid-target in 2023 with this monetary policy dosage, even considering the upwardly skewed balance of risks (whose bias seems to have diminished, in the BCB's assessment). Such results seem to have been influenced by an even higher Selic path throughout 2023.

- Yet the BCB recognizes the high degree of uncertainties and does not close door on the possibility of further adjustment, and an even tighter policy stance if conditions worsen. Yet the BCB is clearly fine-tuning the cycle now.

- We recently updated our Selic rate forecast to reflect a hike of 100 bps in May (to 12.75%) and a last move of 50 bps (to 13.25%) in June (refer to "A Plan Amid the Uncertainty" as of March 16, 2022). Despite the clarity of the BCB's flight plan (to end the cycle at 12.75%), which we see made even more pronounced with today's Copom minutes, our expectation for this last move in June is in line with our view that inflation expectations for 2023 may continue to rise a bit in the coming weeks, before eventually stabilizing later.

- Looking further ahead, we expect a tight(er) policy stance for long(er): we forecast rate cuts to start only in March 2023, with the Selic at 10.00% for YE2023 and 7.00% (neutral level) only for YE2024.

**Overview**

The BCB published the minutes[1] of its March 15-16 Copom[2] policy meeting[3], when the authority once again hiked interest rates, but this time by 100 bps, to 11.75%. Overall, the message is not very different from the statement, except for what we perceived as a greater BCB emphasis on the flight plan to deliver a final rate hike of 100 bps in the next meeting.

The plan seems to follow the BCB's view, based on its model simulations, that IPCA inflation would converge to the mid-target in 2023 with this monetary policy dosage, even considering the upwardly skewed balance of risks. Such results seem to have been influence by an even higher Selic path throughout 2023. Yet the BCB recognizes the high degree of uncertainties and does not close door on the possibility of further adjustment. Clearly, the BCB is fine-tuning the cycle now.

**Key Policy Messages**

**The BCB sought to reaffirm the flight plan signaled in the statement, ending the cycle at 12.75%.** In the minutes, the BCB reaffirmed the message already delivered in the statement that the authority sees as most adequate "at this moment, a monetary tightening cycle similar to the one used in its scenarios" (Paragraph #18). This trajectory is based on the median consensus Selic forecasts before the meeting[4], which penciled in terminal rate at 12.75%.

**The BCB mentioned again its intention to hike rate in 100 bps for the May 3-4 Copom meeting**, which is seen as "is the most appropriate strategy to achieve sufficient monetary tightening and to ensure inflation convergence over the relevant horizon, as well as the anchoring of long-term expectations" (Paragraph #20). The BCB uses the current uncertainties, especially in the global scenario, to justify the option for a "timelier interest rate trajectory than that embedded in its scenarios", since the consensus (i.e., which determined the simulated interest-rate trajectory, as usual) projected back then two moves of 75 bps and 25 bps for May and June, respectively. The authority claims that this choice "expresses caution regarding the probabilities awarded to its scenarios and the measurement of second-round effects, as well as its commitment to the convergence of inflation and expectations to its targets over the relevant horizon." (Paragraph #19)

**The BCB justifies the flight plan based on the view that the "projected interest rate path implies a significantly restrictive monetary policy stance, which will mainly impact inflation for 2023, and is compatible with tackling second-round effects of the current supply shock."** The BCB refers to the average increase of 75 bps on the entire Selic path over the relevant policy horizon seen in consensus forecasts since the previous Copom meeting (Paragraph #18). That adjustment seems to have dealt with (or nearly neutralized) both with the elements pushing the BCB's own IPCA projections higher, as well as the upward bias for inflation projections generated by an upwardly skewed balance of risks. In other words, this means fighting the second-round effects, as "the best practice recommends", in the Copom's view (Paragraph #14). Considering all of those factors, the BCB sees "inflation projections are above the upper limit of the target tolerance band for 2022, and around the target for 2023." (Paragraphs #16 and #17) The latter [2023] is the only policy horizon in 2Q22, according with the BCB's usual rule of thumb.

**The BCB's views on inflation are also based on the greater weight associated with the alternative scenario hypothesis for oil prices, which the BCB seeks to explain in detail in the minutes** (Paragraph #15). The standard oil price assumption in the reference scenario had oil prices at USD118/barrel in March and rising to USD121/barrel at YE2023, which the BCB sees as "extrapolating for the entire relevant horizon of monetary policy the oil price resulting from a particularly unusual global situation." This made the BCB "compare this assumption with the prices of oil future contracts negotiated in international markets as well as projections from the energy sector's agencies", which basically pointed to oil prices at USD100/barrel at YE2022. The BCB decided then "to assume as more likely a scenario with an alternative assumption for the

[1] Refer to the minutes of the 245th COPOM meeting in English (https://www.bcb.gov.br/en/publications/copomminutes).
[2] The COPOM is the monetary policy committee of the Brazilian Central Bank (BCB).
[3] **Santander Brazil – Monetary Policy: *"COPOM Meeting: A Plan Amid the Uncertainty"* –** March 16, 2022- Available on: https://bit.ly/Std-COPOM-mar22
[4] Refer to the BCB's weekly survey of professional forecasters for March 11, 2022 (https://www.bcb.gov.br/en/publications/focusmarketreadout)

path of oil prices until YE2022. As of 2023, the Committee decided to stick with its more conservative assumptions."

**The BCB continues to highlight the uncertainties and leaves the door open for an eventual change of plans if the scenario worsens.** In the minutes, "the Committee recognizes the challenging scenario for the convergence of inflation to its targets and reinforces that it will be ready to adjust the size of the monetary tightening cycle, should the scenario evolve unfavorably." (Paragraph #20) Elsewhere, the BCB also notes that "should the prospective scenario prove to be closer to that observed in the reference scenario, the Committee believes that this cycle should be even more restrictive." (Paragraph #18)

**Regarding fiscal developments, the BCB continues to see the risks being incorporated into inflation expectations and asset prices (thus reducing the size of the forecast bias), and dropped the considerations that certain fiscal policies aimed at fuel prices in the short term could drive inflation even higher in the future.** Similar to the remarks made in the statement, the BCB mentioned that the "movement [of greater fiscal uncertainties driving higher the neutral level of interest rate] is already seen, to some extent, in the longer-term inflation expectations extracted from the Focus survey, as well as in the risk premia of several domestic assets." (Paragraph #13) In the February minutes, the BCB had claimed that "fiscal policies that have a downward effect on inflation in the short term can cause a deterioration in the country's risk premia, increase inflation expectations, and consequently have an upward effect on prospective inflation." The minutes no longer include this statement.

**In the scenario assessment, the BCB admits possible long-term global inflationary effects from the military conflict in Europe and sounded relatively constructive on local economic activity, though there was no change in the local inflation assessment, which is still seen as high and widespread.** The Copom refers to the possibility of a "reorganization of global production chains", with redundancies in production and higher inventory levels structurally in the wake of the conflict and its consequences. The BCB admits that these developments (which could be associated with preliminary evidence of a possible de-globalization) "might have long-term consequences and lead to more persistent inflationary pressures on global goods' production." (Paragraph #2) On activity, the BCB mentions that "GDP growth in 2021Q4 came in higher than expected", meaning a larger carry over for 2020-22 GDP growth. Based on the latest data, mostly for January, the authority refers to better than expected results for retail and services and lower industrial production. The BCB also refers to a "consistent job recovery in 2021Q4 and January 2022." (Paragraph #3)

**What to Expect Ahead?**

We recently updated our Selic rate forecast to reflect a hike of 100 bps in May (to 12.75%) and a last move of 50 bps (to 13.25%) in June. Despite the clarity of the BCB's flight plan (to end the cycle at 12.75%), which we see made even more pronounced by the BCB with today's Copom minutes, our expectation for this last move is in line with our view that inflation expectations for 2023 may continue to rise a bit for the coming weeks, before eventually stabilizing.

Looking further ahead, we expect a tight(er) policy stance for long(er): we forecast rate cuts to start only in March 2023, with Selic at 10.00% for YE2023 and 7.00% (neutral level) only for YE2024. But this expected convergence to the structural level of 7.00% is conditional on the maintenance of a long-term inflation target of 3.00%.

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