A More Hawkish Tone for the Same Message

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- In our view, the Copom minutes were more hawkish in tone than the previous statement, detailing further its views on local and international scenarios. The balance-of-risks assessment underwent no changes, remaining symmetrical, and the Copom continues to unanimously see the current “cruise-speed” of cuts as adequate. The Copom reiterated its belief of a low probability of an accelerated pace of adjustments, highlighting again the three key conditions it sees as necessary for such change: (i) a much more solid reanchoring of expectations; (ii) a sharp widening of the output gap; and (iii) a more benign than expected a services inflation dynamics.
- As we see it, the Copom’s assessment of the recent global economic developments raised two main concerns, both more on the hawkish side: (i) high long-term interest rates in advanced economies; and (ii) the implications of lower projected growth for China due to commodity prices.
- On the economic activity front, the Copom considered four possibilities for the resilience seen in the last quarters, but, in our view, gave emphasis to a potentially higher disposable income supporting consumption and to a potentially higher neutral interest rate, thus bringing a more hawkish tone to the analysis.
- Still on the hawkish tone, the Copom’s view is that the still partial reanchoring of inflation expectations continues to require a firm monetary policy, as fiscal concerns, global disinflation fears, and a possible perception of more leniency in the fight against inflation are all potential factors impeding the completion of this process. The Copom highlighted the importance of the execution of the fiscal targets in this process.
- Finally, on the dovish side, the Copom’s reading of inflation figures remains benign, as the latest figures are in line with its second stage of the disinflationary process. Although in our view, the committee somehow downplayed that benign inflation trend as being already expected, ultimately, the Copom unanimously agreed that a contractionary and cautious monetary policy is still needed to support disinflationary dynamics.
- Our forecasts remain in line with BCB communications. We continue to forecast 50-bp cuts for the next two meetings, leaving the YE2023 Selic rate at 11.75%. For 2024, we continue to project 50-bp cuts for the first four meetings of the year, before a final 25-bp cut, leaving the YE2024 Selic rate at 9.5%.
- However, we continue to see an increasing risk of an acceleration in the pace of cuts, because: (i) we expect (services) inflation to continue to decelerate (as evidenced in recently released August IPCA-15) and (ii) we expect economic activity to weaken more visibly from now on. As the BCB seems to be assigning a greater-than-usual weight to these factors (and if our outlook for inflation and activity proves accurate), we cannot rule out sharper cuts by YE2023/early 2024.
- Despite the possibility of an acceleration in the pace of easing, we are more skeptical about the probability of a much lower Selic in 2024. In our view, the interest rate differential against both EM and DM countries is already low. As a result, an increased risk of lower terminal rates is more dependent now on a change in the global rates environment toward a more dovish mood.

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In our view, the Copom minutes brought a more hawkish tone than the previous statement, detailing further its views on the risks of local and international scenarios.

According to the minutes, **the Copom continues to unanimously see the current "cruise-speed" of cuts as adequate**. The Copom reitreated its belief that there is a **low probability of an acceleration of pace of adjustments**, highlighting again the three key conditions it sees as necessary for such change: (i) a much more solid reanchoring of expectations; (ii) a sharp widening of the output gap; and (iii) a more benign than expected a services inflation dynamics .

As we see it, **the Copom's assessment of the recent global economic developments raised two main concerns, both more on the hawkish side**. (i) high long-term interest rates in advanced economies (among the potential drivers for such levels, the Copom gave emphasis to the persistent nominal deficits, and consequent fiscal prospects in these economies (particularly in the U.S.); and (ii) the implications of lower projected growth for China due to commodity prices.

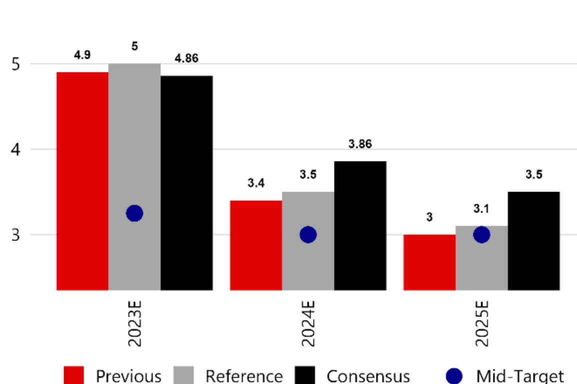
On the economic activity front, the Copom considered four possibilities for the resilience seen in the last quarters: (i) indirect impacts of the strong performance of the agribusiness on other sectors; (ii) **higher disposable income supporting consumption;** (iii) **a higher neutral interest rate**; and (iv) higher potential growth. In our view, **the Copom brought the second and third possibilities to the fore, thus bringing a more hawkish tone the analysis.**

Still on the hawkish tone, **the Copom's view is that the still partial reanchoring of inflation expectations continues to require a firm conduct of monetary policy**, as fiscal concerns, global disinflation fears, and a possible perception of more leniency in the fight against inflation are all potential factors impeding the completion of this process. The Copom highlighted the importance of the execution of the fiscal targets in this process.

On the dovish side, **the Copom's reading of inflation figures remains benign, as the latest figures are in line with its second stage of the disinflationary process**. Although in our view, the committee somehow downplayed that benign inflation trend as being already expected. At the end, the Copom unanimously agreed that a contractionary and cautious monetary policy is still needed to support disinflationary dynamics.

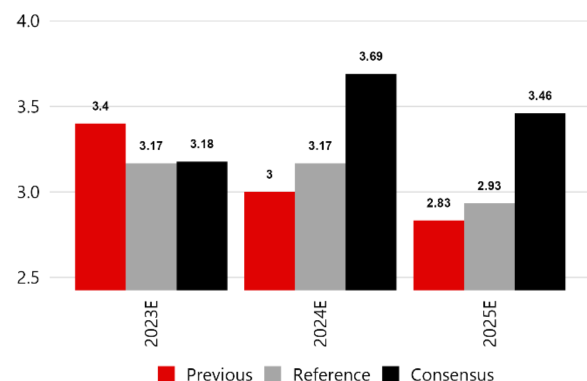
Finally, also on the dovish side**, the minutes repeated the BCB's updated inflation estimates for future years presented in last week's statement.** Again, there was a marginal deterioration across the board, since almost all the drivers used as inputs for the BCB's inflation forecasting model have worsened since the last meeting (oil prices are up, the BRL has depreciated, the output gap has become smaller, and Focus's expectation for the Selic rate has fallen). Despite the deterioration, we see this revision as a dovish message since it was smaller than expected by both us and the market (the revised numbers for 2024 and 2025 were raised by 10 bps while we had expected a 30- and 20-bp revisions, respectively). It continues to be the case that the divergence between the BCB and the economists' projections for headline IPCA 2024 (consensus: 3.9% vs BCB: 3.5%) and IPCA 2025 (consensus: 3.5% vs BCB: 3.1%) comes from free market prices.

Figure 1. BCB's Headline Inflation Estimates in August (%, Reference Scenario)



Sources: Brazilian Central Bank, Santander.
Note: Assuming FX rate departing from USD/BRL 4.90, 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. The BCB

Figure 2. BCB's Free Market Prices Inflation Estimates in August (%, Reference Scenario)



Sources: Brazilian Central Bank, Santander.
Note: Assuming FX rate departing from USD/BRL 4.90, 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. The BCB

assumes energy tariff flag "green" for both December 2023 and 2024. Consensus forecast for the future path of interest rate.

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The BCB's balance of risks analysis underwent no changes. The authority continues to identify risks in both directions and does not see either a positive or negative bias to its inflation forecasts. Among the elements that feed upward inflationary risks, the BCB highlighted global inflation worries and potentially more resistance to lower local services inflation due to a narrower output gap. On the downward inflationary risks side, the emphasis continued to be the international economy, pointing to the risk of a stronger-than-expected deceleration in global economic activity, and to the potentially large effects of globally synchronized monetary policy tightening.

Our forecasts remain in line with the BCB’s communications. We continue to forecast 50-bp cuts for the next two meetings, leaving the YE2023 Selic rate at 11.75%. For 2024, we continue to project 50-bps cuts for the first four meetings of the year, before a final 25-bp cut, leaving the YE2024 Selic rate at 9.5%.

However, **we continue to see an increasing risk of an acceleration in the pace of cuts**, because: (i) we expect (services) inflation to continue to decelerate; and (ii) we expect economic activity to weaken more visibly from now on. As the BCB seems to be assigning a greater-than-usual weight to these factors, and our outlook for inflation and activity proves accurate, we cannot rule out sharper cuts by YE2023/early 2024.

Despite the possibility of an acceleration in the pace of easing, **we are more skeptical about the probability for a much lower Selic in 2024**. In our view, the interest rate differential against both EM and DM countries is already low. As a result, an increase of the risk of lower terminal rates is more dependent now on a change in the global rates environment toward a more dovish mood.

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