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Brazil Macro Compass

Persistently Low Inflation Leaves Room for More Rate Cuts

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What's New: Lower Forecasts for Inflation and Rates

The minutes of the latest Copom meeting, released this week, show, in our view, a committee inclined toward a new rate cut in March, unless the international scenario deteriorates sharply or inflation surprises to the upside. In our view, a more challenging global background (with higher interest rates in the developed world) would have a limited impact on Copom's balance of risks, given Brazil's strong external position (high international reserves, low current account deficit), which reduces the probability of a significant BRL weakening. Moreover, recent data points toward new deflationary surprises: January monthly inflation was 24 bps lower than the BCB's forecasts presented in its December Quarterly Inflation Report, and February preliminary readings suggest another 20 bps surprise in the same direction (we forecast 0.27% m/m). Adding to persistently high levels of economic slack, we believe there is still room for an extra rate cut in March. On February 15, **we revised our year-end Selic rate forecast to 6.5% (from 6.75%), following a downward revision in our year-end inflation projection (from 3.8% in 12 months to 3.5%).** For more details, please see our report *Even Better than the Real Thing* (February 15, 2018).

Incoming Data

We expect February inflation according to IPCA-15 (a preview of the official CPI) at 0.36% m/m (2.83% in 12 months, below the target's lower bound), which would confirm our view that the Selic rate could go lower in March (we will know the official reading before the monetary policy meeting to take place on March 21).

On Monday the Brazil Central Bank will release **December IBC-Br**, its monthly GDP proxy. **We expect the indicator to continue to show signs of disseminated growth, moving up by 1.3% for the month (2.4% y/y).** This result would be compatible with 0.4% quarterly GDP growth in 4Q17 (data scheduled to be released on March 1). With that, **we are adjusting our 2017 GDP forecast to 1.1% from 1.0%.**

Political Agenda

The government expects to restart the pension reform discussions in the lower house next week, aiming for a floor vote on February 28. However, the federal intervention in Rio de Janeiro's public security, announced on Friday, may throw a monkey wrench into the works, as Brazil's Constitution forbids voting on constitutional amendments during periods of such interventions (there is ongoing debate in the press on whether the intervention can be temporarily suspended, allowing for a vote on the reform). In any case, as we have stated previously, we believe that the probability of the reform passing this year seems low, and we believe that Brazilian assets are priced accordingly.

Recent Publications (Available on Our Website)

- *Even Better than the Real Thing* (February 15, 2018)
- *Social Security Reform: Same Proposal. Different Probability?* (February 8, 2018)
- *Why Has the BRL Weakened in 2017?* (January 8, 2018)
- *The Unstoppable Force of Consumption* (January 2, 2018)

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