

**Brazil Macro Compass****Copom: Like Everyone Else, Waiting for the Elections**

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**What's New: Copom Decision**

This week's monetary policy decision in Brazil came in as expected, with Copom maintaining its base rate at 6.5% p.a. considering that current market conditions are still consistent with meeting the inflation target and that inflation expectations are expected to oscillate close to the target midpoint in the near future (although slightly above it in 2019).

The monetary authority was more emphatic in signaling through the statement (which we expect to be reinforced by the minutes, to be released next week) that it is ready to adjust monetary policy if the current outlook and balance of risks worsen from the current stance (for details see our September 17 report, *Copom: Hoping for the Best but Prepared for the Worst*, listed "In-Depth Research" section on page 2 of this report). We have previously stated that an exchange rate sustainably weaker than BRL 4.30/USD could drive the IPCA above the target midpoint at some point in the next 3-6 months and trigger a monetary policy response (see *Rely on Fundamentals and Carry On*, June 8, 2018).

However, the board of directors managed to emphasize that any monetary policy adjustment in response to a potential deterioration in the macro outlook and the balance of risks would be conducted gradually. For this reason, we consider the statement as slightly more dovish than the "do whatever it takes" signal we expected.

**Upcoming Data: External and Fiscal Accounts**

August external sector and fiscal balance data will be released next week. We expect a relatively narrow current account deficit (USD1 billion in August; USD15.6 billion in 12 months), comfortably covered by strong foreign direct investment (USD9.5 billion in August; USD68.5 billion in 12 months). We expect the full-year 2018 current account deficit to be 0.9% of GDP (USD18 billion).

On the fiscal side, we expect the central government to post a BRL20 billion deficit in August. However, the gross debt/GDP ratio should fall to 76.8% (from 77%), according to our forecast, due to the effect of USD strengthening over the stock of international reserves.

**In-Depth Research: Monetary Policy Next Steps**

In *Copom: Hoping for the Best but Prepared for the Worst* (September 17, 2018), we looked at recent inflation dynamics, following the current BRL weakening trend and its consequences for monetary policy. Although inflation in non-tradable goods remains well-contained, tradable and administered prices (such as fuel and utility tariffs) have been accelerating, to the extent that another leg of FX depreciation could take 2019 inflation expectations above the inflation target midpoint, leading the Central Bank to tight before the year ends. Therefore, the market reaction to the presidential election outcome should be crucial for the monetary policy decisions of October 31 and December 12. We still expect the Selic rate to be unchanged until 2H19, assuming a commitment of the next government to a fiscal consolidation agenda that should lead to a relief in asset prices.

**IMPORTANT DISCLOSURES/CERTIFICATIONS ARE IN THE "IMPORTANT DISCLOSURES" SECTION OF THIS REPORT.**

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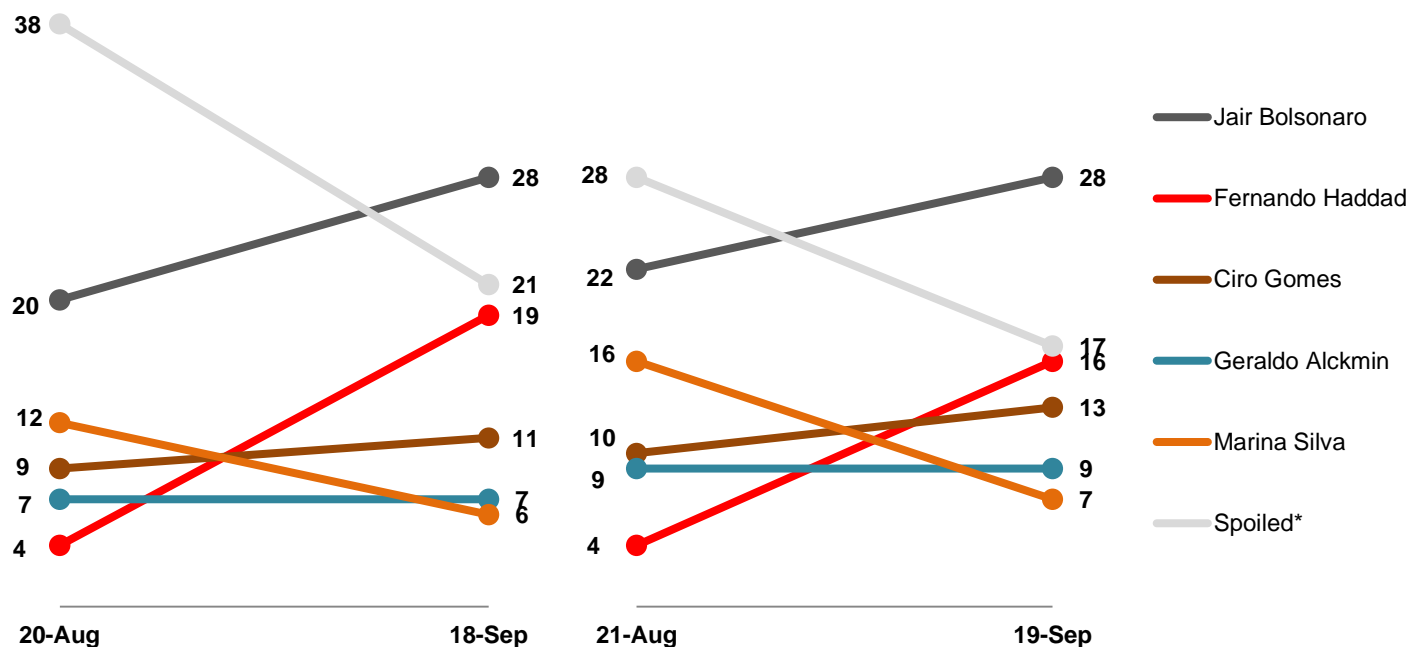
## Chart of the Week: One Month Later...

This week marked the first full month of legally authorized electoral campaigning. Our “Chart of the Week” shows how voting intentions for presidential candidates evolved in this period, according to Brazil’s two largest pollsters.

### Brazil 2018 Presidential Polls (% of Total Votes)

Ibope

Datafolha



\*Spoiled: blank, null, undecided, no answer. Sources: Ibope, Datafolha.

## Political Agenda: Two Weeks To Go

Electoral polls are likely to continue to dominate the political agenda. Ibope filed a new nationwide poll to be released on September 26. Datafolha has not filed any poll as of the publication of this report.

## Number of the Week

# 62%

Revenue from oil royalties is up 62% y/y as of the end of August (to BRL 35 billion), according to the National Oil Agency. This is a relief to Rio de Janeiro state, which receives almost three-fourths of the share of royalties allocated to such entities (about BRL9 billion so far this year).

## Quote of the Week

*“The way inflation targeting is done in Brazil is simply a ploy, a rascality of those barons.”*

— **Ciro Gomes**, PDT’s presidential candidate, defending a dual mandate for the Central Bank, in an interview with *Jornal da Globo* (September 18, 2018).



## What We've Been Reading

- “A scary election in Brazil,” by Sarah Esther Maslin (*The Economist*, September 20, 2018). This week’s cover story.
- “Are Brazil’s political and economic systems at risk?,” by Christopher Sabatini (*Global Americans*, September 19, 2018). “In the end, whatever the outcome of an open-ended, polarized and fractured election in October, the real victim of Brazil’s economic and political malaise likely will be its economic policy, which has limped along for close to five years now.”
- “Women’s votes might be the key to stopping Brazil’s far-right presidential candidate. Here’s why,” by Déborah B.L. Farias (*Monkey Cage*, September 18, 2018). Women are a majority among undecided voters and may decisively shift the presidential election results.
- “Is Brazil’s presidential front-runner Jair Bolsonaro the Latin American Donald Trump? Nope,” by Felipe Krause and André Borges (*Monkey Cage*, September 19, 2018). Comparisons between Jair Bolsonaro and Donald Trump are often a stretch, argue the authors.
- “Shifting Realities and Opportunities in Emerging Markets,” by Gene Frieda (*PIMCO Viewpoints*, September, 2018). Emerging countries have been showing resilience to more challenging global conditions, with floating currencies acting as an important buffer.
- *Candidates, Voters, and Bots: The Forces at Play in the October 2018 Brazilian Elections* (Wilson Center Brazil Institute, September 14, 2018). Summary of an interesting seminar on the coming elections.

## Recent Publications (Available on Our Website)

- *Copom: Hoping for the Best but Prepared for the Worst* (September 17, 2018)
- *Standby Mode* (September 12, 2018)
- *Worse Financial Conditions at the Margin Reinforce the Likelihood of Selic Remaining “Low for Long”* (August 30, 2018)
- *We’re Not in 2002 Anymore (Caution Advised, Though)* (August 28, 2018)
- *The Power of Trade-Off* (August 2, 2018)



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Reuters	Pages SISEMA through SISEMZ

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