ECONOMICS

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Brazil Macro Compass

Copom Sees a More Benign Inflation Outlook

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What's New: Copom's Final 2018 Decision

As widely expected, the Brazilian monetary authority kept the base interest rate (Selic) unchanged at 6.50%, on the back of substantial improvements in its inflation forecasts for the relevant time horizon, despite having factored in a weaker currency level in its simulations as well as having reckoned that the international environment has become more challenging. Using market consensus figures as input variables, BCB forecasts 2019 and 2020 year-end inflation at 3.9% (from 4.2% in the October meeting) and 3.6% (from 3.7%), respectively.

Since the October meeting, positive surprises regarding IPCA readings have led market participants to revise their forecasts downward for the coming years. At the same time, activity has failed to imply a faster expansion for now. Last but not least, according to Copom members, risks associated with the approval of institutional reforms have apparently dwindled of late. Hence, the balance of inflationary risks has become less tilted toward negative results, thus reinforcing the appropriateness of maintaining an accommodative stance toward the Selic target rate.

As usual, the post-decision communiqué brought an excerpt stating that upcoming moves are data-dependent, but – once again – the Brazilian Central Bank reiterated its view that the reversal of the accommodative stance should be carried out in a gradual fashion, which buttresses our expectation for the maintenance of the base interest rate during 2019.

The minutes of the meeting will be released next Tuesday. It will be interesting to see if the committee provides a more detailed explanation on what changes will be considered more relevant to its inflation outlook, including what led it to state that the risk of frustration regarding progress on the reform agenda has diminished. The next Copom meeting, probably the last to be chaired by Ilan Goldfajn, is scheduled for February 6, 2019.

Political Agenda: End of the Legislative Year

The 2018 legislative year ends next week, which gives little time for the Congress to do anything besides finish the approval of the 2019 budget. Bills of importance to macroeconomic management, such as the transfer of oil rights (*cessão onerosa*) and granting the Central Bank formal independence, were left until the next term, whose priorities should also include, in our view, the approval of a pension reform to be proposed by the executive.

The Congress's activities will resume on February 1, 2019, with elections for the leadership (including speakers) of both houses.

Upcoming Data: December Inflation Preview; Quarterly Inflation Report

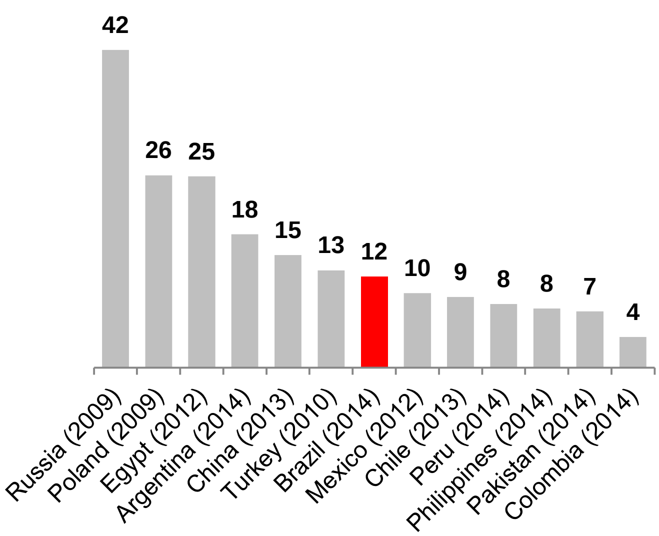
In our view, the only important indicator to be released next week is December IPCA-15. We expect slight monthly deflation (-0.12% m/m), led by falling gasoline prices (-4.5% m/m) and electricity tariffs (-3.5% m/m). With these results, we expect yearly inflation to fall to 3.9% (from 4.39% for November IPCA-15), which adds a downward bias to our year-end IPCA forecast (currently at 3.8%).

On December 20 the Central Bank releases its Quarterly Inflation Report, with in-depth analyses of the inflation forecasts presented at the Copom statement and other themes of relevance to monetary policy. A press conference with Carlos Viana de Carvalho, the deputy governor for economic policy, is scheduled for that same date.

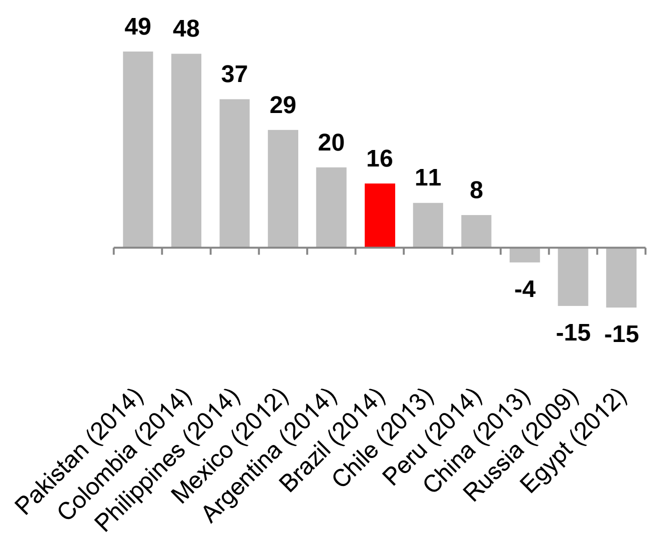
Chart of the Week: Public Sector, Size and Cost

The World Bank recently launched Worldwide Bureaucracy Indicators, a database with 87 indicators on the quality and size of the public sector in 115 bases. Data comes from harmonized labor force surveys, thus allowing for cross-country comparisons. Our "Chart of the Week" highlights two of those indicators: public sector employment as a share of total employment and the public sector wage premium (controlled for education, age, gender, and location). Brazil is close to the median of other emerging countries in both indicators, which suggests that the fiscal problems commonly associated with public payroll spending are probably more related to generous pension schemes and wages paid to certain categories of workers than to the overall size and cost of the public sector.

Public sector employment as share of total employment (%)



Public sector wage premium (compared to all private employees, %)



Sources: World Bank Worldwide Bureaucracy Indicators, Santander.

Number of the Week

10

With this week's Copom decision, the Selic rate will be stable for at least 10 months, the second longest period in the committee's history.

Quote of the Week

"The debate [about reforming social security] is very ripe."

— **Mansueto Almeida,** Treasury Secretary, in a panel at FecomercioSP (*Valor,* December 13, 2018).

What We've Been Reading

- "It's Been a Turbulent Year. Emerging Markets Are Waiting for a Better 2019," by Yumi Teso, Marton Eder, Aline Oyamada, Ben Bartenstein, and Hannah Dormido (*Bloomberg*, December 9, 2018). A retrospective of an eventful year for emerging countries.

- "Emerging Markets: Vulnerable to External Factors?" by Christopher Getter (*PIMCO Blog*, December 5, 2018). Brazil has one of the highest financing needs among emerging markets next year, although mostly concentrated in the domestic market.

- "Banks, a Food Wholesaler—Even a Condom Factory: Brazil's Government Is Big Business," by Paulo Trevisani (*The Wall Street Journal*, December 11, 2018). Brazil's federal government controls 138 companies, many of them targeted for privatization or outright shutdown by the next government.

- “What Businesses Should Know About Brazil’s New President,” by Alec Lee (*Harvard Business Review*, December 11, 2018). A good summary of what is at stake for the incoming government.

- “Judging Bolsonaro,” by Ryan C. Berg (*AEI*, December 7, 2018). Berg believes that Brazil’s strong judiciary and public prosecutors will keep centralization of powers in check.

Recent Publications (Available on Our Website)

- *Economic and Political Calendar: What to Watch in Brazil in 2019* (December 5, 2018)
- *Risks for the Selic in 2019 Expected to Become Even Less Asymmetric* (November 6, 2018)
- *20 Charts that Explain Brazil’s New Political Power Structure* (October 29, 2018)
- *Brazil Post Elections: Honeymoon and Marriage* (October 25, 2018)
- *Brazil – Risk Premium: Apples and Oranges* (October 9, 2018)

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