Santander Corporate & Investment Banking

# ECONOMICS

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## Brazil Macro Compass

# Copom: 6.5% Is a Good Place to Be

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## What's New: First Copom Meeting of 2019; January Inflation

**Brazil's monetary policy committee (Copom) followed market consensus and maintained its benchmark overnight rate at 6.5%.** The statement that followed the decision brought few changes when compared with its last edition, in December 2018: according to BCB's models, projected 2019 yearly inflation went down by 10 bps (to 3.9%), with 2020 expected inflation unchanged at 4.0%. In the "balance of risks" paragraph, the committee acknowledged that inflationary risks have decreased in the recent period (most probably because of a more benign external scenario, with lower expected Fed Fund rates), but it still attributes a greater weight to the risk factors that could lead to higher inflation in the future (namely, a frustration with the reform agenda and a deterioration in the external scenario for emerging economies). This asymmetry, in our view, is a signal that Copom is not considering a rate cut in the near future. The addition to the statement of the paragraph about "caution, serenity, and perseverance" introduced in the December minutes reinforces that call, in our view.

All in all, we think the statement is compatible with our scenario of stable rates for the remainder of 2019. Copom's next meeting (on March 20), probably to be chaired by the newly appointed governor Roberto Campos Neto, may bring changes in the communication style and in the committee's reaction function, but, in our view, a rate change seems unlikely, unless market conditions change substantially.

**January CPI inflation came in at 0.32% m/m (3.78% y/y), below our forecast (0.37% m/m)**. Seasonally high food inflation (+0.97% m/m) explains much of the index's rise in the month. On the other hand, cosmetic prices retraced part of the mid-month rise, which explains much of the divergence between the release and our projection. Services inflation accelerated slightly more than expected, but at the margin (three-month inflation seasonally adjusted and annualized), our estimated core inflation remains subdued and well below the headline, at around 2.5%. We continue to expect year-end inflation at 3.7%.

**S&P Global reaffirmed Brazil's BB- sovereign rating, with a stable outlook.** The rating agency expects reforms to advance slowly, improving the fiscal results in an environment of growth recovery. Furthermore, this institution noted that an upgrade is conditional upon, among other factors, "proposal, passage, and execution of solid policy initiatives" that could accelerate the expected turnaround in growth and debt sustainability. S&P Global expects GDP growth at 2.4% this year and the primary balance to move gradually to a surplus by 2022.

## Upcoming Data: (Still) December Activity Data

Next week is relatively slow for data releases. The only highlights are economic activity data from December: retail sales and the Central Bank's monthly GDP proxy (IBC-Br). We expect monthly core retail sales growth at 0.6% (5.3% y/y). That corresponds to a 2.5% y/y growth in the headline index (including automobiles and construction material). As for IBC-Br, we expect a 0.8% y/y contraction (flat m/m), which translates into a 1.2% average yearly growth—close to our estimate for the full-year GDP growth.

## Political Agenda: Congress Elections Aftermath

**The two houses of the Brazilian Congress had contrasting elections to their respective leaderships.** Whereas in the Lower House, the Democrats' Rodrigo Maia was reelected outright by a landslide (334 of 513 votes), the Senate saw a fierce and long dispute on the election procedures, involving candidates Davi Alcolumbre (Democrats) and Renan Calheiros (Brazilian Democratic Movement, or MDB). Eventually, Calheiros abandoned the dispute, and Alcolumbre was elected outright by a tiny margin (42 of 81 votes). The election in the Senate ended a long period of MDB's dominance (since 2001, there have been only 59 days when MDB has not held the presidency of the Senate)


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and broke with the tradition of the largest political party in the House electing its president.

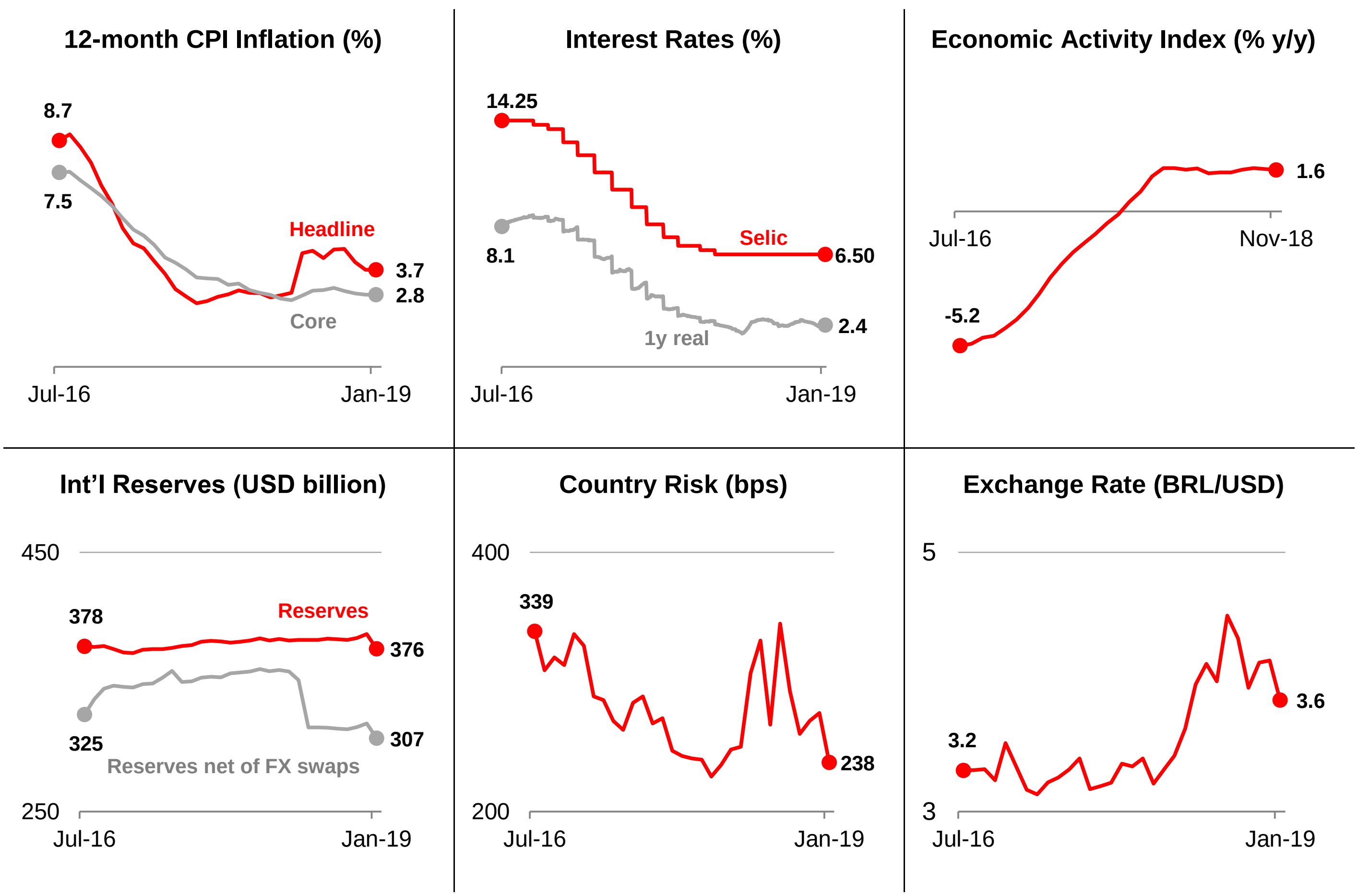
**In a press conference on February 5, Rodrigo Maia affirmed that Bolsonaro's pension reform proposal will probably have to go through two Lower House committees before being submitted to a floor vote.** This, in our view, practically eliminates the possibility of appending substantial changes to Temer's reform, a maneuver that could expedite the process in the Lower House. Although Maia affirmed that it is still possible to send the reform to a floor vote by May, we continue to believe that in the most likely scenario the Congress will enter its midyear recess in July 17 without the reform being passed through an initial floor vote. A vote in May seems to be a best-case scenario, and, in our view, the process of debating the reform and forming a coalition large enough to give the government confidence that it will not be defeated should take the better part of this year.

**The President of the Senate and party leaders are expected to meet on February 12 to define the leaders of the House's 13 permanent committees.** The definition of the Economic Affairs Committee (CAE) is of particular interest for the markets, since the CAE scrutinizes the executive's nominations for the Central Bank board (including the governor) before sending them to a floor examination and vote. Depending on negotiations between the government and the CAE's president, the process may be expedited, which will define whether the confirmation hearings can take place before the Carnival holiday (which starts on March 1).

## Chart of the Week: The Goldfajn Years

Our "Chart of the Week" is a panel showing how six macro and financial variables evolved during Ilan Goldfajn's tenure at the Brazil Central Bank. Goldfajn navigated a period of falling inflation and rates, moderate economic recovery, and some turbulence in financial markets, which led the Central Bank to intervene in the FX market and increase its short USD position on FX swaps (thereby reducing the country's net long USD exposure).

**Brazil—Selected Macro and Financial Variables—Monthly Data from July '16 to Last Available**




Core inflation: average of BCB core measures. Real rates: ex-ante rates. Economic activity index: BCB's IBC-Br. Country risk: Brazil EMBI.
Sources: IBGE, Brazil Central Bank, Bloomberg, Santander.

## Number of the Week

**42**

Davi Alcolumbre, from the Democrats party, was elected President of the Senate with 42 votes, only one more than needed for an outright win. Senator Alcolumbre will be 42 next June, which makes him the youngest person ever to lead the Brazilian Senate.

## Quote of the Week

*"We want to vote [the pension reform] as fast as possible. Our problem is not the Lower House internal rules, but to have the necessary votes."*

— **Rodrigo Maia,** Speaker of the Lower House, in a press conference (February 6, 2019).

## What We've Been Reading

- "Bullish on Brazilian Stocks? Be Cautious," by Craig Mellow (*Barron's*, February 1, 2019). The combination of high expectations on the reform agenda and somewhat stretched valuations is leading some investors to be cautious on Brazilian assets.

- "Bolsonaro's Brazil," by Perry Anderson (*London Review of Books*, February 7, 2019). An unusual left-wing/Marxist account of what has led to Bolsonaro. Low insight-to-word ratio, but interesting nonetheless.

- "Should Brazil Just Abolish the Vice Presidency?" by Brian Winter (*Americas Quarterly*, February 7, 2019). 60% of vice presidents in Brazil since 1985 ascended to the top job, which suggests that vice presidents can be inherently destabilizing, writes Winter.

- "How a Demon-Slaying Pentecostal Billionaire Is Ushering in a Post-Catholic Brazil," by Alexander Zaitchik and Christopher Lord (*The New Republic*, February 7, 2019). Meet Edir Macedo, Brazil's most influential televangelist.

- *Occupy Government: Democracy and the Dynamics of Personnel Decisions and Public Finances*, by Klenio Barbosa and Fernando V. Ferreira (*NBER Working Paper No. 25501*, January, 2019). Patronage has been a key component in public expenditure growth in Brazil, as per this study.

## Recent Publications (Available on Our Website)

- *Brazilian Asset Prices: How Much "Over" Has the Performance Been?* (January 31, 2019)
- *Substantial Challenges and Risks in the Global Outlook: How Do They Affect Brazil* (January 29, 2019)
- *Brazil Macro Scenario: 10 Macro Propositions for 2019* (January 7, 2019)
- *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)

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