

Brazil Macro Compass**We See Copom in No Rush to Change Rates**

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What's New: Rate Decision, April Inflation

Following market consensus, Brazil's Monetary Policy Committee (Copom) maintained the benchmark overnight rate at 6.5%. The statement that followed the decision was, in our view, in-line with our call that the Selic rate will stay at that level in the foreseeable future. The rise in inflation estimated by Central Bank models (+20 bps in 2018 year-end inflation, on the back of a weaker BRL) was counterbalanced by the recognition that "risks associated with economic slack have increased at the margin, and the balance of risks around BCB's baseline scenario is still qualified as symmetric".

Copom also stated that, at this point, 2020 inflation already has a greater weight in the monetary policy's "relevant horizon", which, in our view, reinforces the idea that, barring a large economic or market shock, rates will not move anytime soon. Both survey and model inflation expectations for that year remain around the target midpoint, and there is still too much uncertainty, mostly related to the fiscal adjustment process, for the Committee to change the current stance of "caution, serenity, and perseverance". Even if the pension reform process unfolds favorably in 2H19, as per our expectation, the ensuing economic activity recovery is likely to lead to a narrowing output gap that, in our view, would remove the necessity of further monetary stimulus, especially after weighing in the risks to inflation brought by the effects of the African swine fever on the protein chain supply and prices (see our report *Inflation—Year of the Pig: Good Fortune?*, April 30, 2019).

April CPI inflation came in at 0.57% m/m, below our forecast (0.66% m/m) and market consensus (0.62% m/m). In March, 12-month inflation jumped to 4.94%, from 4.71%. Most of the deceleration can be explained by food prices rising slower than we were expecting, with the rainy season's (December-April) habitual surge in reverse.

Upcoming Data: Final 1Q19 Monthly Data

March economic activity data releases will end next week, providing a better picture of how GDP evolved in 1Q19. IBGE's volume of services indicator will be out on May 14 — we expect a 1.2% y/y contraction (-0.2% m/m). On May 15, the Central Bank releases its monthly GDP proxy (IBC-Br), which, in our view, will show a 0.3% monthly contraction (-2.2% y/y). On a quarterly basis, we expect the index to have contracted 0.4% in 1Q19, a result that should be close to the GDP performance in the same period (to be released in May 30). We believe that the agricultural sector's good performance may contribute to a slightly stronger GDP performance, although, all in all, our full-year forecast (1.3% growth) should carry a negative bias.

Political Agenda: Pension Reform Discussions, Decrees to Expire

The Lower House Special Committee on the pension reform started working on May 7. Debates on the government's draft so far look favorable, in our view — most of the opposition's criticism focuses on the transition to a fully funded system that does not jeopardize the expected fiscal savings, the crucial aspect of the reform for debt sustainability. As for the timing of the committee vote, it will happen no sooner than May 29, the last date scheduled by the rapporteur for public hearings. The rapporteur, representative Samuel Moreira, promised "not to sit on the report", but even if he works fast, June is usually a quiet month in Brasília due to the midwinter parties in the Northeast that make bringing any bill to a vote more difficult. We continue to expect a floor vote only in 3Q19, between late August and early September.

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

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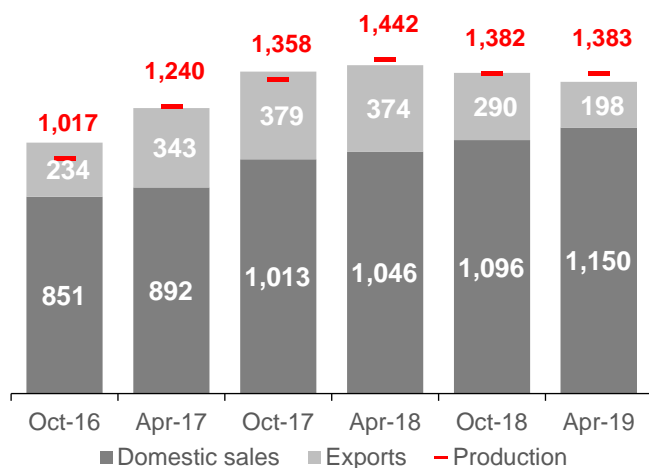


In the next few weeks, we expect the government to spend some energy on avoiding the expiration of its first presidential decrees on June 1. The decree that proposed a new cabinet structure was already severely modified by the joint congressional committee, which determined the split of one ministry (regional development into national integration and cities) and other changes. With the government still lacking a formal support coalition, the center parties should continue to have the upper hand in the negotiations, in our view.

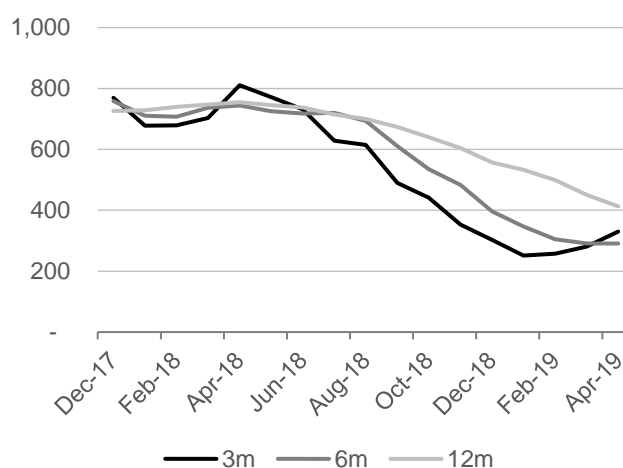
Chart of the Week: Auto Sector

Our “Chart of the Week” looks at the most recent data released by the Brazilian Association of Automakers (ANFAVEA). Domestic production has been decelerating from the recent peak in April last year, mostly driven by falling exports. Argentina, the largest external market for Brazilian autos, has been substantially reducing exports, from an average close to USD800 million/month one year ago to less than half of that most recently (share of Argentina in total auto exports collapsed to 55% from 83% in that same period). Perhaps more worrisome is that stocks have been mounting in the past six months, which will probably force automakers to reduce productions in the coming months, potentially weakening the already beleaguered domestic industry.

6-month Brazil Auto Production and Sales (thousands)



Brazil Auto Exports to Argentina (monthly average, USD million)



Includes light vehicles and light trucks. Sources: ANFAVEA, Comex Stat.

Number of the Week

**-1.6
bn**

USD1.6 billion in FX flows left Brazil in April, the biggest outflow for that month in the series (which started in 1993). The result was driven by USD5.75 billion outflows in the financial account, partially offset by USD4.12 billion trade flows.

Quote of the Week

“We have so many important issues that we need to prioritize, and we keep dispersing energy with issues that absolutely do not contribute to solving problems.”

— **General Eduardo Villas Bôas**, former army commander, on Twitter (May 8, 2019).

What We’ve Been Reading

- “Brazil’s Bolsonaro is blind to his political problems,” by Ryan C. Berg (*The National Interest*, May 5, 2019). How the open fronts in the “cultural war” and internal divisions are jeopardizing the government’s ability to delivery on the much needed reform agenda.
- “Explaining Inflation Inertia,” by Carmen M. Reinhart (Project Syndicate, May 6, 2019). To Reinhart, patterns of capital flows and real wage adjustments explain inflationary inertia in both Japan and Argentina.



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- “As Latin America Gets Poorer, Democracy Itself Is Now Questioned,” by Eric Martin and Walter Brandimarte (*Bloomberg*, May 8, 2019) and “Populism and polarization threaten Latin America” (*The Economist*, May 9, 2019). The dire consequences of poor economic performance for political stability.
 - “How Latin America Is Holding Back Its Own Growth,” by Eric Parrado (*Americas Quarterly*, May 8, 2019). IDB’s chief economist claims that smart investments in infrastructure are key to accelerate growth in the region.
 - “Modern Monetary Theory: Cautionary Tales from Latin America,” by Sebastian Edwards (*Hoover Institution Economics Working Papers*, April 25, 2019). Economic policies of Latin American populist governments look strikingly similar to what MMT proposes, argues Edwards.

Recent Publications (Available on Our Website)

- *Inflation—Year of the Pig: Good Fortune?* (April 30, 2019)
- *Economic Activity: No News Is Bad News* (April 22, 2019)
- *Will Credit Be Enough to Revive Consumption?* (April 1, 2019)
- *Monetary Policy: Low for (Much) Longer* (March 29, 2019)
- *Pension Reform—The Moment of Truth: From Intentions to Bargaining* (March 28, 2019)



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