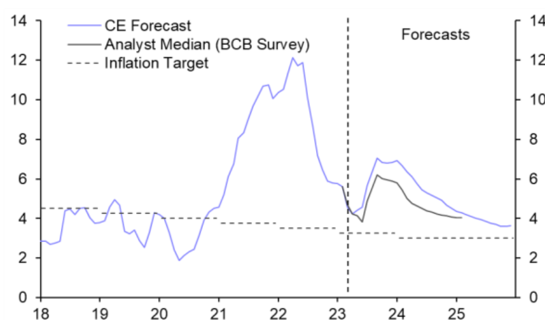
LATIN AMERICA ECONOMICS UPDATE

Brazil: Copom sticks to its guns

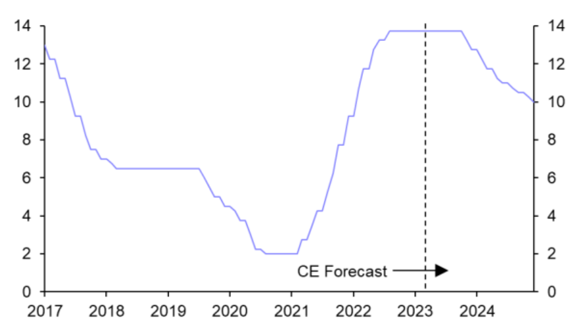
- **The statement accompanying the Brazilian central bank's decision to keep the Selic rate unchanged at 13.75% yesterday will have disappointed some (not least in the government) that thought global market turmoil and economic weakness might prompt a quicker shift to monetary easing. Policymakers remain concerned, first and foremost, about high inflation and expectations, and we doubt that Copom will turn to interest rate cuts until the final quarter of the year.**
- The interest rate decision itself was never in doubt. We and all the other analysts polled by Refinitiv correctly anticipated the outcome. Attention was always going to focus on the accompanying statement and the extent to which the recent turmoil in the global banking sector (as well as domestic economic developments) would affect Copom's thinking.
- There were some tweaks in terms of how Copom sees the balance of inflation risks. **The small fall in GDP in Q4 appears to have diminished concerns that the output gap could fuel inflation pressures**. This was removed as an upside inflation risk from the statement. For our part, given the continued strength of the labour market and wage growth (even if they are losing a little steam), we think this might be premature.
- Copom also acknowledged that credit conditions might tighten to a greater degree than it currently anticipates, which could be due both to domestic factors (including spillovers from the collapse of retailer Americanas) and the fallout from strains in global banks. That would argue in favour of looser policy.
- Finally, concerns about fiscal risks appear to have eased a bit, related to the re-instatement of fuel taxes. That too might support a case for a lower interest rates. We were a bit surprised that there was no mention of the planned new fiscal rule, which is intended to restore the long-term sustainability of the public finances but appears to have become entangled in debate between the president and the finance ministry.
- **The over-riding message from the statement, however, is that Copom remains focused on tackling above-target inflation and inflation expectations**. Copom's six quarter ahead inflation projection (which it sees as the relevant monetary policy horizon) stands at 3.8%, up from 3.6% in the previous statement from February's meeting (and well above the 3% target for next year).
- The statement also retained the line that Copom "will not hesitate to resume the tightening cycle if the disinflationary process does not proceed as expected". Prior to the meeting, there had been suggestions that policymakers might drop this phrase.
- **In our view, the strength of core inflation will keep the headline rate above the central bank's target throughout our forecast horizon**. Indeed, we think inflation will stay a little higher than most currently expect. (See Chart 1.) That doesn't preclude interest rate cuts, but we think policymakers will need to see further falls in core inflation and more progress on the fiscal front.
- **As result, we doubt that Copom will turn to monetary easing until the final quarter of the year**. We continue to anticipate 100bp of cuts in the Selic rate, to 12.75%, late this year, followed by cuts to 10.00% in 2023. (See Chart 2.) That's higher than the implied path priced into financial markets.

Chart 1: Consumer Prices (% y/y)



Sources: Refinitiv, Capital Economics

Chart 2: Selic Rate (%)



Sources: Refinitiv, Capital Economics

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