LATIN AMERICA ECONOMICS UPDATE

Brazil: Copom lines up September rate cut

22nd June 2023

- **The somewhat cautious tone of the statement accompanying yesterday's Brazilian central bank meeting (at which the Selic rate was left at 13.75%) will disappoint those hoping for an interest rate cut at the next meeting in August. But the statement does suggests that the door to an easing cycle is opening. We now think it's most likely that the first cut will come in September (our previous forecast was November).**

- The decision to leave rates unchanged itself was never in doubt. We and all the other analysts polled by Refinitiv correctly predicted the decision. But it had been clear prior to the meeting that the tide is starting to turn towards easing. In recent media comments, BCB governor Roberto Campos Neto had flagged a possible shift in monetary policy (albeit leaving the timing of this shift ambiguous).

- **The accompanying statement underscored that policymakers are trying to thread the needle between shifting to monetary easing, but not letting investors get carried away** (resulting in a premature loosening of financial conditions). Indeed, Copom seems to have gone out of its way to push back against expectations for a rate cut in August (a 25bp cut was, before yesterday's meeting, fully priced into markets).

- The statement reiterated that underlying inflation measures are above levels compatible with the inflation target and that inflation expectations are unanchored. Typically, Copom has given a clear steer if it intends to raise or lower interest rates at its next meeting. For example, it made clear at the January 2021 meeting that a tightening cycle would begin at the following meeting. There was no evidence of this yesterday.

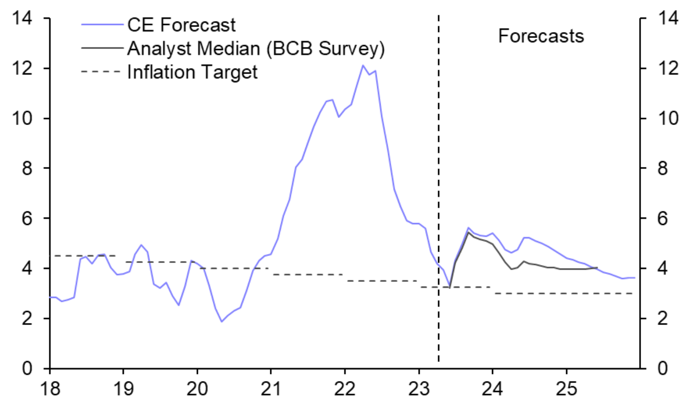
- **By the same token, however, it's clear that Copom is moving in the direction of easing**. Its inflation concerns are fading, noting that inflation expectations have fallen. Unlike at May's meeting, it didn't flag labour market risks. We had thought that rapid wage growth would continue to provide reason for caution. Concerns about the path for the public finances have eased too.

- **Copom no longer sees the need to keep the Selic rate at its current level for a significant length of time**. The statement no longer included inflation projections based on keeping the Selic rate unchanged through the forecast horizon (implying that this is no longer plausible). And the statement mentioned that the strategy of keeping the Selic rate at its current level "*has been* adequate [our emphasis]".

- This shift has been driven by a number of factors, including progress towards introducing the government's new fiscal framework, the recent rally in the real and clearer signs (particularly in the May inflation figure) that core inflation pressures are easing.

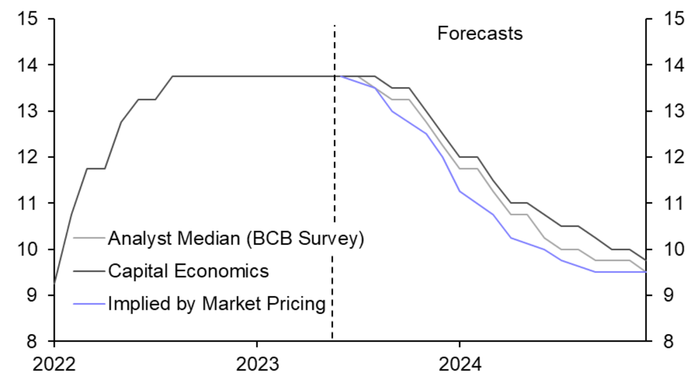
- **The upshot is that we now expect the first interest cut (probably of 25bp) in September (previously November), and we've nudged down our end-23 Selic rate forecast to 12.50% (from 12.75%)**. Looking beyond the next few meetings, though, we continue to think that the strength of wage growth will keep inflation higher than most anticipate (see Chart 1). And, as a result, we think the easing cycle will be a bit more gradual than analysts are anticipating and than is implied by market pricing. (See Chart 2.)

Chart 1: Consumer Prices (% y/y)



Sources: BCB, Refinitiv, Capital Economics

Chart 2: Selic Rate (%)



Sources: BCB, Bloomberg, Capital Economics