Copom: Navigating current uncertainties

The Brazilian Central Bank’s monetary policy committee (Copom) kept the benchmark Selic rate at 14.25%. Although the decision was in line with expectations – by both analysts and the yield curve – there was a dissent within the Committee. Two (out of eight) board members voted for an increase of 0.50 p.p. in the Selic rate to 14.75%.

The statement accompanying the decision was laconic and brings no further details beyond the split vote. The full press release is translated below:

“Assessing the macroeconomic scenario and inflation prospects, the Copom decided to maintain the Selic rate at 14.25%, without bias, on six votes for stable rates and two votes for a 0.50 p.p. rate hike. The following members of the Committee voted to maintain the Selic rate at 14.25%: Alexandre Antonio Tombini (Chairman), Aldo Luiz Mendes, Altamir Lopes, Anthero de Moraes Meirelles, Luiz Edson Feltrin and Otavio Ribeiro Damaso. The following members of the Committee voted for raising the Selic rate to 14.75%: Sidnei Corrêa Marques and Tony Volpon.”.

In recent weeks, the Copom has been signaling the adoption of necessary measures to bring inflation to the target center (4.5%) by the end of 2017.

Despite the recent exchange-rate appreciation (the BRL strengthened about 5% against the USD since the previous Copom meeting), political/fiscal uncertainties continue to pressure inflation expectations and pose risks for monetary policy. Since the last Copom meeting (October 21), the median of analyst estimates for the IPCA inflation for 2016 climbed to 6.64% from 6.12% (the 16th consecutive weekly increase). Estimates for 2017 also began to rise slightly, moving to 5.10% last week (from 5.00%). Breakeven inflation rates implicit in government bonds are also running at high levels – forward rates stand at 8-9% on the 1-2 year segment and at 7.0-7.5% on the 3-5 year segment –, yet these calculations reflect risk premia embedded in Brazilian assets. The rise in inflation expectations worsens the balance of risks for inflation, in a situation that could prompt the Copom to resume the tightening cycle. These factors are probably the reasons behind the votes in favor of an interest rate hike.

However, economic activity remains quite weak, helping contain secondary effects from the currency depreciation and adjustments in regulated prices. Furthermore, the ongoing deterioration in labor market conditions has potentially disinflationary effects on labor-intensive sectors (e.g., services). Current political/fiscal uncertainties also urge caution in the definition of monetary policy, so as to reduce market volatility. These factors help mitigate the chances of monetary tightening in the short term, and were probably decisive for the six Copom members who voted to leave the Selic rate unchanged.

With relevant factors for the inflation dynamics moving in opposite directions, and considering the substantial uncertainties in the scenario (especially on the political/fiscal front), we understand that prolonging the horizon for inflation convergence is a move that provides greater tranquility for the Copom to adjust monetary policy only if inflation comes under pressure for longer time horizons. Thus, we do not expect the Copom to change its monetary policy stance, unless there are relevant changes in the BCB’s inflation forecast for 2017.

Hence, we maintain our scenario for a stable Selic rate at 14.25% until the end of 2016.
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