

## MNI Brazil Central Bank Review – June 2021

### MNI POV: Hawkish Shift Provides Future Flexibility

At the June 16 meeting, the Copom hiked the Selic Rate by 75 basis points to 4.25%, in a unanimous decision. This was in line with the expectations of all analysts surveyed by Bloomberg.

- The post-meeting statement provided a clear hawkish shift. Persistent inflationary pressures prompted the BCB to alter their language relating to the path for normalisation. By removing the word 'partial', markets have been given a clear signal that the committee "foresees the continuation of the monetary normalization process".
- Additionally, the Copom have indicated that they predict another adjustment of the same magnitude (75 bps hike) at the August meeting. In an extra hawkish twist, however, the committee added an important caveat that a further deterioration in the expectations for inflation may prompt a "quicker reduction" of monetary policy stimulus.
- Subject to the evolution of inflation expectations, this provides the potential for the Copom with future flexibility regarding monetary policy decisions. The likelihood of the Copom surprising the market with a larger than expected hike, as they did at the March meeting, have certainly increased.
- The committee also highlighted that, despite the intensity of the second pandemic wave, indicators for the Brazilian economy "continue to evolve better than expected", reducing the risks to the economic recovery "significantly".

Key passages from the statement were as follows:

"The persistence of inflationary pressure was more intense than expected, especially in industrial goods. Additionally, the slow pace of supply normalization, the resilience of demand and implications of the energy scenario deterioration over electricity fares contribute to keeping inflation under pressure in the short run, in spite of the Real appreciation. The Committee continues to closely monitor the evolution of shocks and their possible second-round effects, as well as the behavior of service prices as the immunization effects over the economy become more relevant"

"At this moment, the Copom's baseline scenario indicates, as appropriate, a normalization of the policy rate to a level considered neutral. This adjustment is necessary to mitigate the dissemination of the temporary shocks to inflation. However, the Committee again emphasizes that there is no commitment with this plan, and that future steps of monetary policy could be adjusted to assure the achievement of the inflation target."

"For the next meeting, the Committee foresees the continuation of the monetary normalization process with another adjustment of the same magnitude. However, a deterioration of inflation expectations for the relevant horizon may require a quicker reduction of the monetary stimulus. The Copom emphasizes that its view will also depend on the evolution of economic activity, the balance of risks, and how these factors affect inflation projections."

- Link to full statement: <https://www.bcb.gov.br/en/pressdetail/2399/nota>
- The minutes will be released on Tuesday, June 22.
- **The next BCB meeting/decision will take place on Wednesday, August 4.**

## Sell-side Analyst Views

### **Goldman Sachs: The Copom came close to a 'Whatever It Takes' forward guidance moment.**

- At this juncture, Goldman Sachs are pencilling in a 75bp hike at the next meeting (with a 33% probability of a larger +100bp increase) and a steady and relatively swift climb towards broad policy neutrality, with growing risk of a 7% Selic handle in 2022.
- The Copom is paying attention to the data and the unfavourable evolution of the balance of risks for inflation: as such it became visibly more hawkish.
- In their assessment, they see limited option value in communicating the expectation of full normalization since given the current intense inflationary pressures and real business cycle dynamics we could well observe states of the world where a temporary above-neutral Selic may be required to limit second-round effects and to keep inflation expectations anchored.
- However, they believe that by hardening the language and forward signalling, including the possibility of a larger than 75bp hike at the August meeting, the Copom has a much better fighting chance of anchoring inflation expectations and of not having to go beyond neutrality.

### **Itaú: Expecting 75-bp hike in August, but closely monitoring inflation expectations**

- The Copom delivered the widely expected 75-bp rate hike, to 4.25%, and scrapped mention of partial adjustment.
- The committee indicated that its next move will probably be another 75-bp increase and added, in a hawkish twist, that in case expectations keep worsening, it may need to accelerate the pace of monetary normalization, opening the door to even faster tightening.
- For now, Itaú expect the Copom to deliver another 75-bp move in its next meeting, but they will carefully monitor inflation expectations. They expect to learn more about the committee's rationale with the release of the minutes on Tuesday, June 22.

### **JPMorgan: The COPOM highlighted that it is monitoring the potential secondary impacts that the inflationary shocks may have**

- Yesterday's hike was accompanied by a message in the statement that was slightly more hawkish than JPMorgan anticipated.
- The board excluded the wording of partial normalization and replaced it with a message that it deems appropriate to move towards neutral monetary policy to mitigate the dissemination of the temporary shocks to inflation.
- Combined with signals for the August meeting, both of those indications are supportive of their call that the COPOM will hike 75bp in the next meeting, followed by three 50bp hikes, leaving SELIC rate at 6.5% this year.
- However, on probably the most hawkish part of the communication, the board suggested that it may need to hike the policy rate faster in case inflation expectations deviate further from the target on the relevant horizon of monetary policy (i.e. 2022).
- Of note, the COPOM also changed the description of the overall state of the economy significantly, in line with recent data. The board recognized that both economic growth is evolving more favourably than expected and the persistence of inflationary pressures has been more intense.

### **SocGen: The details of the statement highlight the possibility of the BCB adopting a far more hawkish stance throughout the rest of the year**

- The BCB gave up its "partial normalization" language and signalled it could frontload the policy tightening leading the monetary policy stance towards a "neutral rate."
- The pace of tightening in August and beyond remains glued to near-term inflation development. However, the upside risks to their significantly below consensus Selic rate forecast for 2021 (5.50%) has risen considerably.
- While the inflationary pressure could remain temporary, the risks around it have unnerved the BCB.

- They view the neutral Selic rate as being about 7.5% (with medium-term real interest rate between ~3.5 and 4.0%). While we still don't see the Selic rate returning to neutral before 2023, the risk to our near-term Selic rate forecast is significantly elevated.
- They still have greater confidence in their end-2022 Selic rate forecast of 6.5%.
- If inflation surprises to upside in coming months, the BCB could well go for a 100bp (or more) hike in August.
- The BCB is trying to stay as accommodative as it can, given the persistent cyclical weaknesses. Nevertheless, it cannot and will not give up on upside inflation risks, even if the current inflation pressure might prove to be transitory.