

# Brazil Central Bank Preview: September 2021

## Details:

**Monetary policy decision and release of Copom Statement:** 2230BST / 1730ET, Wednesday 22<sup>nd</sup> September 2021.

## MNI Point of View

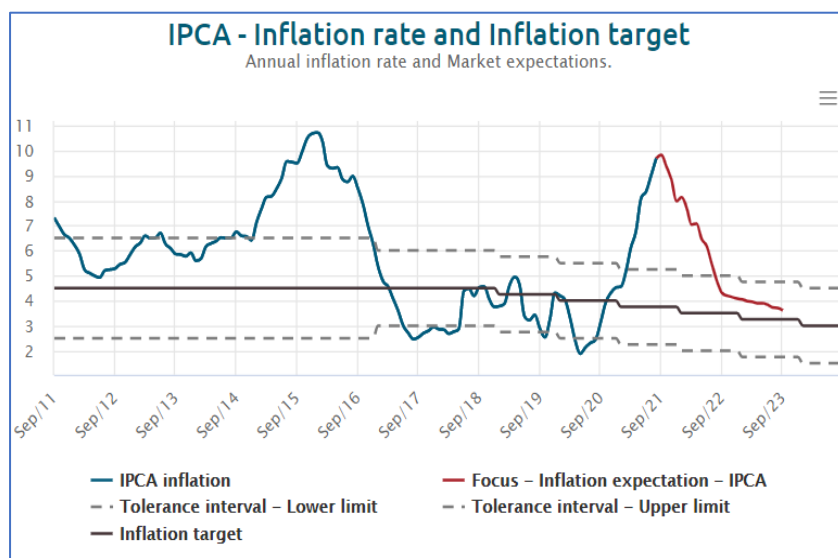
### MNI POV: Dial Up The Hawkishness

The Copom are widely expected to continue their tightening cycle with a 100 basis point hike, bringing the Selic rate to 6.25%. The persistence of inflationary pressures and the continued upward pressure on inflation expectations may even warrant more substantial tightening at the September meeting, or at least a hardening of the language/forward guidance within the monetary policy statement in order to anchor expectations.

### Relentless Inflation Acceleration

Annual IPCA headline inflation rose to 9.68% in August, above the expected 9.5%, representing the highest level since early 2016. The persistence of the upward inflation surprises has been echoed in the consistent adjustments to expectations, indicated within the most recent BCB focus surveys.

Economists now see 2021 year-end inflation at 8.35%. This is up from 8.00% previously and most notably has increased from 6.79% since the August BCB meeting. 2022 expectations have also edged higher to 4.10% from 3.81% since the last time the Copom met, evidence of a further contamination of medium-term expectations.



Combined with these adjustments to expected prices, economists also revised their Selic rate forecasts higher. They now see the key rate reaching 8.25% (up from 7% at time of prior meeting) by year-end 2021 and 8.5% by year-end 2022.

Source: Brazil Central Bank

### Governor Campos Neto's Flight Path

Following the September 9 IPCA inflation data, swap rates had a substantial move higher with Jan'23 DI's briefly printing 9.5%, rising almost 75bps in just one session as markets factored in a higher probability of sharper rate hikes. The most interesting commentary between meetings followed on September 14 from Governor Campos Neto, with his rhetoric calming market pricing for the September meeting.

The BCB Governor highlighted that Brazil has never had so many inflationary shocks in a row, with the water crisis creating additional uncertainty. While recognising the inertia surrounding inflation expectations, he stated the Copom won't always react to every high frequency data point, adding that "our plan of action is long-term".

Following the central bank head's remarks, short end swap rates fell 30 basis points in the wake of his remarks. Several analysts were justified in re-affirming their calls for a 100bp rate hike; however, we would highlight the majority of analyst previews indicate the risks are tilted to the upside and bolder action at this juncture should not be ruled out entirely.

Alongside Campos Neto's comments was a commitment to "do whatever it takes" to meet inflation targets. Since the August meeting, there have been three separate IPCA data prints that have surprised to the upside, as well as higher weekly adjustments in the Focus Survey that show few signs of near-term pressures abating.

Just as in June, an increase in the pace of hikes may be seen as the most beneficial way to avoid any further deterioration of inflation expectations.

## Markets

Market turbulence has been particularly prevalent given the ongoing political and fiscal challenges. DI swap-rates have risen roughly 100bps in the front-end of the curve and around 150bps in the belly and longer tenors since the August meeting and USDBRL has risen roughly 3%. Morgan Stanley highlight that "a hawkish BCB has been the most important anchor for the currency" and that any marginal dovish interpretation at this juncture may provide significant downside risks for BRL.

Markets may also be looking for hints on the central bank's potential view of the terminal rate. So far policy makers have only indicated they see the Selic ending the cycle above the neutral level, but have yet to elaborate on quite how far above.

# mni Central Bank Watch - Brazil

MNI Brazil Central Bank Data Watch List											
Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
CPI	% y/y	9.7	8.1	⬆️	5.2	⬆️					2.24
Core CPI	% m/m	0.7	0.6	⬆️	0.4	⬆️					1.52
Oil Price (WTI Active)	\$	70.33	65.02	⬆️	58.20	⬆️					0.66
Economic Activity		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
PMI Manufacturing	Index	53.6	53.7	⬇️	58.4	⬇️					-0.11
GDP	% y/y	12.4	-3.9	⬆️	1.6	⬆️					1.91
Industrial Man Prod	% y/y	1.2	34.8	⬇️	2.4	⬇️					-0.87
Economic Activity IGAE	% y/y	5.53	16.58	⬇️	-1.19	⬆️					-0.13
Monetary Analysis		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
M2 Money Supply	% y/y	4087.7	3941.4	⬆️	3886.1	⬆️					1.23
Non-Fin Corp Credit	% y/y	189.0	166.5	⬆️	162.6	⬆️					1.94
Household Credit	% y/y	36.9	32.7	⬆️	31.7	⬆️					1.86
Consumer / Labour Market		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
Retail Sales	% m/m	0.9	-2.7	⬆️	-5.6	⬆️					0.32
Consumer Confidence (Q)	Index	81.8	76.2	⬆️	78.0	⬆️					1.00
Unemployment Rate	%	14.1	14.7	⬇️	13.9	⬆️					-0.77
Markets		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
Ibovespa	Index	111,439	126,216	⬇️	110,035	⬆️					-0.09
Local 10-Year Swap Rate	%	10.43	9.06	⬆️	8.51	⬆️					1.81
Note: For quarterly data the 3m ago column will display the previous data point and the 6m ago column will display the data point prior to that.											
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Source: MNI, Bloomberg

## Analyst Views (Alphabetical Order):

As of writing, 22/26 analysts estimate a 100 basis point rate increase to the Selic Rate to 6.25%. Three analysts expect slightly more aggressive action with a 125bp hike and one analyst is forecasting an even greater 150bp hike.

### Barclays: Bolder Move Could Be Justified

- Barclays expect the BCB to hike the Selic rate by 125bp, to 6.50%, taking into account the latest upside, widespread surprises in inflation and the continued deterioration in inflation expectations, and considering that BCB Governor Roberto Campos Neto repeatedly warned that the bank stood ready to do "whatever it takes" to bring inflation back to its target.
- However, their confidence admittedly declined after Campos Neto's remarks on 14 September, saying that the Copom "will not change its flight plan after each high-frequency data that is released."
- Still, this is the last meeting in which 2022 has more weight than 2023 in the Copom's relevant horizon for monetary policy, which could justify a bolder move should the latest Focus survey out on 20 September confirm Barclays' expectation for additional deterioration in 2022 IPCA forecasts.

### Citi: Expect Some Acceleration In The Hiking Pace

- The inflation outlook deteriorated markedly, likely pushing Copom to upgrade again its 2021 inflation forecast to around 8.0% (from 6.5%). For 2022 year-end, Copom inflation estimate can remain roughly stable around the mid-point target (3.5%), but only under a much higher Selic rate (8% instead of 7%) and no change in the benign energy flag assumption.
- Having said that, Copom should recognize that the ongoing interest hike will be longer than the one envisaged in August's meeting, with likely repercussions for the pace of hikes, especially considering the strategy of mitigating the unfavourable effects on inflation expectations.
- Thus, despite the recent comments of BCB Chairman, Citi still expect some acceleration in the hiking pace next week (from 100bps to likely 150bps).
- If Copom opts to keep the pace of 100bps in this meeting, the risk of the ongoing hiking cycle to surpass our estimate for the terminal rate of Selic rate of 8.75% likely increases, given the likely further deterioration of inflation expectations.

### Goldman Sachs: Assess Only A Small Probability Of A Larger, Market-Surprising 125bp Hike

- Given the recent macro-financial developments and the August 4 forward guidance, Goldman Sachs expect the Copom to deliver another 100bp rate hike, driving the Selic policy rate to a moderately below neutral 6.25%.
- Given recent statements from some Copom members that the central bank should not overreact to high frequency data, they assess only a small probability of a larger, market-surprising 125bp hike.
- The Copom is expected to acknowledge the recent negative inflation surprises, growing signs of dissemination (second-round effects), deterioration of the 2021-2022 inflation expectations, and overall worsening of the outlook for inflation, including core and services. Overall, they expect the Copom to harden the language on inflation and the balance of risks around it.
- In all, GS believe the high and disseminating inflation pressures, intense cost-push pressures, deteriorating inflation expectations, lack of progress on the reforms and fiscal adjustment front, and lingering political noise should lead the central bank to continue to normalize monetary policy and reach a restrictive above-neutral stance by end-2021.

### JPMorgan: BCB To Maintain Tightening At Same Pace Until There Is Sufficient Confidence That Prospective Inflation Is Moving Toward The Target

- Continue to expect a 100bp hike at this week's COPOM meeting, a call they have held since the last meeting, in line with the consensus of economists and below the market pricing that currently seems divided between 100bp and 125bp at this moment.

- Given the remaining uncertainties in a context of re-normalization of the global economy, as well as the lags of monetary policy and higher inflation expectations, this already aggressive and vigorous 100bp pace seems appropriate.
- Expect the monetary authority to maintain the 100bp tightening pace in October and December, followed by a final 75bp increase in February 2022. This path would leave the terminal rate at 9%, the highest nominal policy rate since the end of 2017.
- In an environment of rising inflation and inflation expectations, JPM also expect the BCB will adopt a more hawkish tone. They believe that BCB will suggest it is appropriate to raise interest rates “significantly above neutral” and that it most likely will continue at its current pace of adjustment in the next meeting.
- JPM don't think the recent decline in GDP growth expectations will significantly affect the central bank's decisions either. The shift is a result of the expected monetary tightening—with the SELIC at a restrictive level to lower inflation—the recent fiscal and political turbulence, which can also generate further inflationary pressures, and the risks of a deterioration in the water crisis, a supply shock.

#### **Mizuho: Expect Another 100bp Rate Increase, BCB Will Continue To Front Load Rate Hikes**

- Mizuho expect another 100bp rate increase, as signalled by Governor Roberto Campos Neto last week, which would bring the Selic rate to 6.25%.
- Amidst high inflation, the bank will continue to front load rate hikes until the monetary policy stance becomes mildly restrictive to prevent 2nd order effects from the recent shocks on prices.

#### **Morgan Stanley: Forward Guidance On The Future Pace Of Hikes Will Likely Be In The Spotlight**

- MS economists expect the BCB to deliver a 100bp hike, broadly in line with market expectations.
- Latest comments about a less reaction-oriented approach to ongoing prints were interpreted by some market participants as a divergence from the central bank's careful communication, creating concern that the BCB might take a more lenient approach towards inflation, despite rising pressures.
- As such, while the size of the upcoming hike will of course be watched closely, the BCB's forward guidance on the future pace of hikes will likely be in the spotlight. More specifically, MS think that investors will likely look to gauge whether the governor's comments were a one-off miscommunication or whether they signalled a broadly more dovish shift compared to market pricing.
- A 100bp hike coupled with forward guidance pointing to limited prospects of increasing the pace in the coming months would pose significant upside risks to 2022 and 2023 inflation expectations and would likely trigger a further increase in inflation risk premia, which is already hovering at levels not seen since 2014.
- The implicit downward pressure on real rates should create significant downside for BRL. A hawkish BCB has been the most important anchor for the currency, amid heavy positioning and ongoing risks of fiscal slippage. A more dovish turn would open the door for USD/BRL to break out of its recent range and approach the 5.60 level, in their view. As such, MS stick to BRL shorts versus USD within their LatAm basket.

#### **SocGen: BCB President's Statement Suggests A 100bp Hike In August Is The More Likely Scenario Than 125bp**

- Directionally, SG agree with the consensus sentiment. They recently revised up their year-end inflation and rates forecasts for this year and, basically, cut their growth forecast (within a month of raising it) despite stronger-than-expected 2Q21 growth numbers. Given the persistent supply challenges, predicting the turning point on the inflation front has turned out to be a nightmare through this year.
- With the increasing prospect of inflation ending the year at more than twice the BCB target, the central bank could be concerned about inflation's impact on expectations and financial stability. Wage growth remains low but could face upward pressure in some sectors. Thus, the possibility of a 125bp hike in September is not completely off the table.
- The risk to their year-end Selic rate forecast of 7.75% is skewed to the upside. SG expect the central bank to raise the policy rate by 100bp at each of the September and October Copom meetings, followed by a final 50bp hike in December (hence a terminal rate of 7.75%). That said, the August inflation release just raised the risk of possibly a 75 or 100bp hike in December before the BCB goes on an extended pause.