MNI Brazil Central Bank Review – September 2022

Executive Summary:

- **BCB kept policy rates unchanged at 13.75%, alongside expectations**
- **Rate decision confirms the end of the tightening cycle – for now**
- **Bank again stress that risks “remain in both directions”**

Links:

Monetary Policy Statement: **https://www.bcb.gov.br/en/pressdetail/2449/nota**

Key Takeaways:

The BCB kept rates unchanged at 13.75% late Wednesday, broadly inline with expectations. Nonetheless, there were outside calls for one final 25bps hike to end the tightening cycle. The vote split showed a minority opted for a final hike, with two directors going against the headline decision – marking the first split decision among the board in six years.

Focus turns to how long the BCB will keep rates at this level, as the board tilt toward a higher-for-longer strategy and look to hold rates for a “sufficiently long period”. Nonetheless, upside risks of inflation were acknowledged, with the statement adding that they will not hesitate to resume a tightening path should the “disinflationary process not proceed as expected”.

Consensus is beginning to form around a prolonged holding phase for the bank’s policy cycle, with analysts beginning to eye a return to rate cuts from the midpoint of 2023 onwards.

The statement observed that the “global environment remains adverse and volatile”, although second quarter GDP came stronger than expected, and the set of indicators released since the previous Copom meeting suggests that the economy kept growing.

On inflation, the BCB notes that despite the recent reduction in prices of more volatile items and the impacts of tax measures, consumer inflation remains high. As such, various measures of underlying inflation are above the range compatible with meeting the inflation target.

The Committee again emphasized that risks “remain in both directions” before concluding that “future monetary policy steps can be adjusted and will not hesitate to resume the tightening cycle if the disinflationary process does not proceed as expected.”

Notable Dates:

- The Copom minutes for this meeting will be released on Tuesday, September 27.
- The next Copom meeting/decision will be held on Wednesday, October 26.

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Analyst Views

Barclays: The early central bank catches the pause

- The Copom officially interrupted its tightening cycle initiated in March 2021, keeping the Selic at 13.75%, in a split decision (7-2) — its first since 2016.
- The board vowed to “remain vigilant” as it assesses whether the strategy of maintaining the Selic rate for a sufficiently long period will be enough to ensure the convergence of inflation. In its most hawkish sentence, the BCB reinforced that future monetary policy steps can be adjusted and the board “will not hesitate to resume the tightening cycle if the disinflationary process does not proceed as expected.”
- We expected a pause in the cycle to be accompanied by a hawkish statement, in line with recent communication by board members suggesting discomfort with an early pricing of rate cuts by the market in Q1 23. However, the hawkish tone exceeded our expectations, strengthened by the uncommon split decision and the board’s reference to “no hesitation” in resuming the tightening cycle should inflation conditions not improve as anticipated.
- Mentions to the cumulative effect of earlier tightening were noticeably absent, suggesting that recent upside surprises in activity data (particularly in the labor market) could now afford the space for the additional hawkishness.
- We see more risks for our expected June 2023 cut to be postponed rather than brought forward, and new hikes cannot be ruled out in case of a fiscal “accident” during the 2023 budget discussions or early next year.
- We will look for more details on the board’s decision in the Copom minutes to be published on Tuesday, as well as the upcoming Q3 Inflation Report (including a press conference with governor Roberto Campos Neto) on 29 September.

Goldman Sachs: Expects the Copom to wait until Q2/Q3 to start to cut rates

- We underscore that central bank governor Campos Neto and both the monetary and economic policy directors voted to keep the policy rate at 13.75% (curiously the two dissenting votes came from the directors of international affairs and of licensing and resolution).
- The decision to hold at 13.75% was in line with the broader market consensus (including GS) but the policy statement and forward guidance were distinctly hawkish given that there were two dissenting votes for a 25bp rate hike and that growth surprised to the upside in Q2.
- The most likely scenario is for the Copom to be steady and patient and hold the policy rate at the currently significantly restrictive monetary stance for a while. Consistently, we expect the Copom to wait until late 2Q2023, or possibly 3Q2023, to start to cut rates.
- Furthermore, in the near-term (next 4-6 months) the risk is that the Selic may have to be driven even higher given still intense services and core inflation pressures, robust real activity and labor market dynamics (declining economic slack), drifting end-2024 inflation expectations, lingering uncertainty/risk around the fiscal stance in 2023 and subsequent years, signs of sticky global inflation, and hawkish FOMC and global monetary winds.

JP Morgan: Sees Comms as consistent with rate cuts mid-next year

- Contrary to our expectations for a final 25bp hike, the COPOM kept the policy rate stable at 13.75%, in line with the majority of the forecasts. After being the first major central bank to start tightening rates in 2021, BCB is now the first to end the tightening cycle. Despite the more dovish outcome than we expected, the tone of the statement was tentatively hawkish.
- The high-for-long message came with the conditions that would get BCB to start easing: the consolidation of disinflation and the re-anchoring of inflation expectations.
- The downside risk oddly added in this statement was the maintenance of the tax cuts in 2023, which is our base case scenario that we actually see as putting upside risks to core inflation and medium-term expectations going forward.
- BCB’s communication seems consistent with rate cuts by mid-2023 – we expect a first 25bp cut by June of next year, with additional easing leading rates to 11.50% by the end of next year. However, the monetary

outlook will depend on factors such as the fiscal plans post-elections, and the global and local GDP growth and inflation prospects.

- Depending on this outlook, all else constant we believe the decision adds upside risk to our medium-term inflation forecasts, particularly since the decision could lead to a move up in professional forecasters' survey (Focus) for 2024 and the market breakevens that are well above BCB's targets, which together suggest, at least for now, skepticism that monetary policy will decisively act to meet its goals in the foreseeable future.

SocGen: Believes tightening cycle is over

- By no stretch of the imagination was the statement dovish – or even neutral. There were several hawkish elements which leaves the question unanswered as to whether the tightening cycle is over, or it has just come to a pause.
- BCB's baseline inflation projection for 2022 has declined substantially– even below the consensus forecasts. The point is that any upside inflation surprises in the coming months – which is quite possible given the downbeat projections – should then give the BCB reasons to tighten further.
- At the very least, it could also provide enough reasons for the BCB to remain on hold for much longer than we (or consensus) expect.
- Given the uncertainties, it was apt that the BCB would keep the door open for additional rate hikes if needed. In fact, prior to this meeting we had mentioned that there was up to a 30% probability of another rate hike during this cycle (either in September or in 4Q22). After the latest decline in inflation expectations and the BCB's inflation projections, we reduce this probability closer to 20% instead.
- We maintain the probabilities about the beginning of the BCB easing cycle – a c.50% probability of an easing cycle beginning in 1Q23, 30% in 2Q23, 15% in 3Q23 and 5% in 4Q23. We also continue to expect a total of 300bp in rate cuts in 2023 and another 200bp to follow in 2024.