

Sovereign Macro- Brazil Copom minutes and commentary

December 14, 2021

Bottom line: My main takeaway was that the message of the Copom was hawkish but less so than the market interpretation. The minutes noted the upward and asymmetric risks to inflation and that their projections were higher than in the baseline as well as the path of its policy rate throughout the policy horizon. My take is that they intend to keep their terminal policy rate for a longer period of time to consolidate the convergence of inflation to the target and anchor inflation expectations. I am keeping my call of a terminal rate of 11.75% (an additional 150bp in February and 100bp in March) with some upside risks and for Bacen to remain on hold for 2022. Receivers in late 2023 or Jan 2024 are appealing.

The message from the minutes was a bit clearer than the Copom decision and reinforced its message that it wants to bring inflation to the target in the relevant horizon and anchor long tenor inflation expectations. To do so Bacen intends to take the policy stance to a “significantly restrictive level”. This statement was unclear as to what that meant. That said, with its latest rate hike to 9.25%, the real ex-ante policy rate is already at a restrictive level above the neutral of 3%, at 3.8%. If expectations were to stabilize at these levels, my call of a terminal rate of 11.75% would take the real ex-ante policy rate to 6.25%. Could it be more restrictive than that? Sure, the recent high of the real ex-ante policy rate was at 8.6% at the end of 2016 but it was in part justified by 12month inflation expectations that had been significantly above what we see today and also in relation to the inflation target during those years. With an economy likely in recession in 2022, a real ex-ante policy rate of such magnitude would be excessive in my view. Bacen sent a strong warning though: since the inflation risk is asymmetric and to the upside, their projections for inflation are above the target for both 2022 and 2023, therefore it concluded that the tightening cycle would have to be more contractionary than the one included in the baseline scenario throughout the relevant policy horizon. The baseline scenario has the Selic peaking at 11.75% and ending 2022 at 11.25% and at 8% in 2023. My takeaway on this is that they might take the policy rate above my call of 11.75% but the more important part is that they intend to keep that rate until inflation converges to the target and anchors expectations. Finally, the Copom had discussions about the pace. The staff ran a number of scenarios with different terminal rates and pace of hikes. Their conclusion was that a pace of 150 was appropriate to take the policy rate where it needs to be. The next event for Bacen will be the presentation of its latest projections on Thursday which after the minutes, I expect to see upward revisions, above those presented in last week’s decision.

Jaime Valdivia

Sovereign Macro

Founder and Chief economist

jaime.valdivia@sovereignmacro.com