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Brazil Flash

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Economic Analysis

Brazil
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COPOM warns about the lagged impact of monetary policy

The reference to the fact that the effects of monetary policy occur with lags and the downward revision of inflation forecasts, together with the changes introduced in last week's communiqué, reinforce the perception that the present monetary tightening cycle will end soon. We expect a final +25bp adjustment in January.

- **COPOM remains "especially vigilant" but counts on the impact of the monetary tightening adopted in 2013 (+275bp) to reduce inflation ahead**

  The Monetary Policy Committee (COPOM) reaffirmed the need to remain especially vigilant to minimize inflation risks in the minutes of last week's monetary policy meeting released today. However, in the same paragraph, the monetary authority highlighted that "the transmission of the effects of monetary policy actions to inflation occurs with lags". This change is in line with those introduced in the accompanying statement last week. It suggests that the COPOM considers that most of its job to drive inflation down is already done (according to its reasoning, policy actions adopted since April will continue to take some pressure off inflation next year). We also noted that the sentence "The COPOM considers that it is appropriate to maintain the current pace of adjustment of monetary conditions" was left unchanged. However, in our view, this sentence refers to the decision announced last week and not to future actions. Nonetheless, we acknowledge that alternative readings, supporting the maintenance of the +50bp rhythm in January, are possible.

- **Inflation forecasts were revised downward**

  2013 inflation forecasts were revised downward in both reference and market scenarios (the former assumes exchange and interest rates constant at pre-meeting levels, i.e. 2.30 and 9.50, respectively; the latter assumes that exchange and interest rates will behave in line with consensus forecasts). This suggests that the COPOM now sees inflation at the end of 2013 below 5.8%, which was the last figure it released for both scenarios at its 3Q13 Inflation Report. Regarding 2014 inflation, the minutes showed that the forecast in the reference scenario (which was at 5.7% in the last Inflation Report) remained stable, while the forecast in the market scenario (which was also at 5.7%) was revised downward. Therefore, according to these updated forecasts, the BCB is close to meet its informal targets, i.e. to deliver a lower inflation this year than in 2012 (5.84%) and a lower inflation in 2014 than in 2013 (our forecasts for inflation at the end of 2013 and 2014 are, respectively, 5.8% and 5.8%). This also supports the view that the end of the ongoing tightening cycle is close.

- **Weak growth and a smaller-than-expected adjustment in fuel prices also support the end of cycle view.**

Even though the recent communication shows that the BCB is not explicitly committed to any specific strategy, the changes introduced in both last week's statement and today's minutes suggest that the tightening of monetary policy has no much way to go. Weaker-than-expected growth in the second half of the year and a modest adjustment in fuel prices, which should help the BCB to meet its informal goal this year (i.e. to bring end-of-period inflation below the 5.84% YoY level observed at the end of 2012), support this view. Accordingly, we continue to expect the monetary authority to hike the SELIC by 25bp in January and then to leave it unchanged at 10.25% in the rest of 2014.

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El COPOM advierte sobre el efecto rezagado de la política monetaria

La advertencia de que los efectos de la política monetaria se producen con rezago y el ajuste a la baja de las previsiones de inflación, unidos a los cambios introducidos en el comunicado de la semana pasada, refuerzan la percepción de que el actual ciclo de ajuste monetario terminará pronto. Esperamos un ajuste final de +25pb en enero.

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