Brazil | COPOM still sees 2016 inflation above 4.5%; monetary tightening to continue ahead

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The 2Q15 Inflation Report revealed that the COPOM expects inflation to close 2015 at 9.0%, decline to 4.8% at the end of 2016 and converge to the 4.5% target only in 2Q17. As its focus is on taking inflation to the target by the end of 2016, its forecasts suggest it will continue tightening monetary policy ahead. We now expect another 50bp hike of the Selic rate in July.

2016 inflation forecasts remained broadly unchanged

In spite of both having adjusted the Selic rate up by 100bp (to 13.75%) since the release of its 1Q15 Inflation Report at the end of March and of more negative prospects for economic activity (the COPOM's 2015 GDP forecast was revised downwards to -1.1% from -0.5%), the higher-than-expected pressure from inflation of regulated prices (COPOM's current forecast for the end of 2015: 13.7%; previous one: 11.0%) and concerns about inertia issues prevented a significant reduction of 2016 inflation forecasts. More precisely, the monetary authority, in its baseline scenario, now foresees inflation at 4.8% at the end of 2016, only slightly less than three months ago (4.9%). In its alternative scenario, based on market forecasts for the main explanatory variables, inflation remains at 5.1%. This shows that the Monetary Policy Committee (COPOM) still has some work to do to fulfill its target to take inflation to 4.5% by the end of the next year. This view is backed by the explicit statement that the efforts to make inflation to converge to 4.5% by the end of the next year are "still insufficient". Today's report shows that the COPOM sees inflation converging to the target only in 2Q17. With respect to forecasts for the end of this year, they were revised upwards following extra pressure from administered prices to 9.0% from 7.9% (and from 7.9% to 9.1% in the alternative scenario).

"Vigilance", "perseverance" and "determination"

The 2Q15 Inflation Report also repeated some of the messages the COPOM has been using lately to show its commitment to taking inflation down to the 4.5% goal. Among other things, it stated that "monetary policy must remain vigilant" and that "perseverance and determination" are needed to keep second-round effects of ongoing inflationary pressures under control. All in all, the wording and the tone of today's report also support the view that the monetary tightening is not over yet. Nonetheless, even though it explicitly signaled that more SELIC hikes will be announced soon, this time the COPOM emphasized more what it considers to be some of the main achievements of the ongoing tightening policy: i) the stability -or even a small decline- of market expectations for inflation at the end of 2016 (around 5.5%) in spite of the enormous, higher-than-expected inflationary pressures in 2015; ii) the anchoring of longer-term expectations (i.e. from 2017 onwards) around the 4.5% target.

Another 50bp adjustment of the Selic rate in July

Following the continuous and somewhat surprising willingness of the COPOM to pursue its goal of taking inflation down to 4.5%, we now expect it to deliver another 50bp hike of the SELIC rate in July 29. Even though a final 25bp adjustment in September should not be ruled out, we regard that as a less likely scenario than the maintenance of the Selic at 14.25% from July onwards.