Brazil | The BCB's plan is still to keep interest rates unchanged

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The 3Q15 Inflation Report revealed that the BCB revised up its inflation forecasts for 2015 and 2016, mainly due to the exchange rate depreciation and a less supportive fiscal policy, and in spite of a more negative view on both external and domestic growth. However, the report suggested that the BCB will likely keep the Selic rate at 14.25% for some time.

The GDP forecast for 2015 was cut to -2.7%

The monetary authority employed a more dovish tone at the time of analyzing the perspectives for both external and domestic activity. Regarding the latter, it now expects GDP to drop 2.7% this year, rather than 1.1% as it forecasted three months ago, and to stand at -2.2% in 2Q16. In spite of the more negative tone on domestic growth, today's inflation report also showed that the BCB is more concerned about the fiscal situation and the ongoing exchange rate depreciation. Regarding the recent sovereign rating downgrade to high-yield by S&P, the monetary authority noted that "timely measures contributing to the rebalancing of public accounts are fundamental for macroeconomic stability and for the resumption of confidence and activity". It also affirmed that the balance of risks for inflation has deteriorated recently to some extent due to the downgrade by S&P.

Inflation forecasts: higher pressures in 2015 and 2016, but converging to 4.0% in 2017

In the BCB's baseline scenario, which takes as inputs the levels of exchange and interest rates at September 18 (3.90 and 14.25%, respectively), inflation will close 2015 at 9.5% and 2016 at 5.3%, therefore at higher levels than expected three months ago (9.0% and 4.8%, respectively). In the alternative scenario, which builds on market forecasts for some of the main variables, inflation forecasts to 2015 and 2016 were revised up to 9.5% and 5.4%, respectively, from to 9.1% and 5.1%. The upward correction in inflation forecasts is not only related to a weaker exchange rate and higher fiscal risks, but also to expectations of higher administered-prices inflation (15.4% in 2015 and 5.7% in 2016 vs. 13.5% in 2015 and 5.3% in 2016 in the 2Q15 Inflation Report). Finally, in spite of having adjusted 2015 and 2016 inflation forecasts upward, the figures for 2017 were revised downwards and the BCB now expects inflation to reach 4.0% in 3Q17, below the 4.5% target. We see this latter adjustment as a very important one as the BCB's focus in some few months -at the beginning of 2016- will move from 2016 to 2017.

We expect the Selic to remain unchanged for some time, with upside risks weighing in the next few months and downside pressures gaining momentum next year

The BCB revealed to be more confident on the impact of the previous monetary tightening to keep under control the second-round effects of the current corrections in exchange rate and in administered-prices. It repeated the message that "maintaining the benchmark interest rate at the current level for a sufficiently prolonged period, is needed to ensure that inflation converges to the target by the end of 2016". Anyway, even though today's report shows that the BCB is willing to leave the Selic rate unchanged at 14.25% for some time, there is an increasingly important risk that less supportive fiscal policy and sharp exchange rate depreciation force the monetary authority to tighten monetary policy again in the next few months. We acknowledge this risk, but continue to see the stability of the Selic rate as the most likely scenario at least until the beginning of 2016, when the BCB focus will change to 2017, which should create room for some monetary easing.