

Brazil Watch

Copom preview: another 50bp cut

Unanimous decision of 50 bps cut expected

We expect the board to decide to cut interest rates by 50bps to 12.25% unanimously on Wednesday: the external scenario deteriorated due to the war, the exchange rate depreciated, but activity retreated and core inflation continued to decelerate. The guidance should be limited to the next meeting only and the committee should highlight the uncertainty on the external side to maintain the monetary easing pace, despite the favorable internal conditions. Monetary policy remains contractionary (even with a cut to 12.25%, ex-ante real interest rates would reach 8.0%) and quite far from the 4.5% that the Central Bank sees as neutral.

Since the last meeting: lower underlying inflation

1. 12-month IPCA accelerated (from 4.61% in August to 5.25% in September). Despite the expected acceleration, the underlying measures (diffusion and core) continue to show benign behavior.
2. Inflation expectations improved: Focus 12 months ahead fell 18 bps, as well declines in longer tenures.
3. Activity data worsened: monthly indicators of services and retail sales surprised negatively in August (Services: p/ 0.9%yy of 3.6% in July; extended retail: 3.6% yoy of 6.6%). Only the trade balance continues to surprise positively.
4. Downward revision of the Central Bank's inflation projections scenario.
5. Regarding the external environment, the board should emphasize the increased uncertainty following impacts of the Middle East conflict and the surge in US treasury yields. That may sound as hawkish; however, we believe internal conditions still allow for mor monetary easing.

Downside risks for BCB 2023 inflation forecasts

With the incorporation of the September result and the disclosure of Petrobras' gasoline adjustment, the projection for 2023 should decline to 4.6%. For the rest of the horizon, currency depreciation had no relevant impact on inflation results. An IPCA above the center of the target is also a hawkish signal, supporting the view for now acceleration in the easing pace ahead. Finally, the inflation expectations relevant horizon for the interest rate decision should be expanded: in the last meeting, the board stated that 2024 was fully considered and 2025 was considered only in part. In this Copom, 2025 will be fully considered (recall that 2025 shows a benign behavior for inflation but still above the inflation target).

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