

Brazil Watch

Copom preview: 50bp cut on repeat mode

We expect another unanimous 50 bp cut

We expect the Brazilian Central Bank (BCB) to unanimously cut interest rates by 50bps to 11.75% this week. The improvement in financial conditions abroad and the evolution of domestic fiscal stance supports the continuation of the easing cycle. The stronger than expected activity and the uncertainty surrounding the achievement of fiscal targets ahead prevent any change in the pace of rate cuts, in our view. The guidance should be limited to the next couple of meetings only (we expect the BCB to keep the plural when referring to the expectation for the upcoming meetings) 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 11.75%, ex-ante real interest rates would still be near 8.0%, quite far from the 4.5% level that the Central Bank sees as neutral).

Since the last meeting: lower underlying inflation

1. 12-month IPCA decelerated (from 4.82% in October to 4.70% in November). Underlying measures (diffusion and core) continue to show benign behavior.
2. Inflation expectations were unchanged on the Focus survey, but market implied inflation dropped in all tenures.
3. Activity data worsened in line with expectations: monthly indicators of services surprised negatively in September (-1.2%yoy from +.09%yoy in Aug23). Trade Balance continue to surprise to the upside.
4. 3Q GDP numbers surprised to the upside despite deceleration: +2.0% yoy from 3.5% yoy in 2Q23. Notably, domestic demand and net exports contributed positively for the result. Inventories deployment bodes well for activity ahead.
5. Downward revision of Central Bank's inflation forecasts ahead.
6. External environment: the board should emphasize the ongoing uncertainty following impacts of the Middle East conflict and the doubts about the Fed upcoming decisions and the prospects for US Treasuries.

Downside risks for BCB 2023 inflation forecasts

With the incorporation of the October numbers and our forecasts for the remainder of the year, the BCB's forecast for 2023 should decline to 4.6% (from 4.7%). For the rest of the horizon, the BRL appreciation (to R\$4.90 from R\$5.00/US\$) and lower monitored prices expectations should bring longer term inflation down. IPCA for 2024 should be revised down to 3.5% (from 3.6%) and 2025 to 3.1% (from 3.2%). Recall that an IPCA above the center of the target is also a hawkish signal, supporting the view for no acceleration in the easing pace ahead. Finally, this will be the last Copom meeting with Fernanda Guardado and Maurício Costa de Moura, since their terms end this month.

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