

# Brazil Flash

## Single-digit SELIC ahead

After cutting the SELIC rate to 10.5% last week, the COPOM now says that the chances of a single-digit SELIC are high. The Committee sees now “more favorable” inflation signs and refrains from recognizing improvements in both external and domestic environments. We expect another 50bps cut in March and see extra cuts as very likely.

- **COPOM sees deterioration in the external environment and lower domestic risks...**

According to the minutes of the last monetary meeting, which were released today by the CB, the external scenario continued to deteriorate and the global stability risks remained elevated since the end of November. Regarding the domestic front, the COPOM sees decreasing risks related to the supply-demand gap (previously these risks were classified as both “relevant” and “decreasing”) and referred to a higher than expected deceleration of the Brazilian economy in the second half of 2012. The monetary authority refrained from highlighting the signs of recovery displayed by domestic demand since the end of 2011 and also from commenting on the recent moderation of global turbulences. Taking all this into account, the minutes were clearly more dovish than expected.

- **... and “lower neutral interest rates”.**

The COPOM also emphasized a series of structural improvements such as lower risk premium (due to “meeting inflation targets by the eight year in a row, macroeconomic stability and institutional advances”), a change in the structure of financial and capital markets, deeper credit markets, reduction of the public debt, and increasing (and cheaper) supply of external savings. According to the Committee, all these factors helped to drive neutral interest rates down in Brazil, in line with a single-digit SELIC.

- **More monetary easing ahead**

The minutes of last week’s monetary meeting reinforce the view that the SELIC will be taken down to 10.0% in March. More importantly, they strongly suggest that monetary easing will continue after March and that the SELIC will be adjusted downwards to 9.5% or even 9.0%. This additional easing should be supported by an announcement (within the next few weeks) of expenditure cuts that could put fiscal accounts on track for meeting this year’s fiscal target. The linkage between monetary and fiscal policy is, actually, a positive feature of this government’s economic policy. However, we continue seeing no room for inflation to converge to the 4.5% target this year. More precisely, we expect inflation to close the year at 5.4%.

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