Brazil | BCB is concerned with the impact of fiscal uncertainty and "non-economic events"

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The BCB sees 2016 inflation at 6.2%/6.3%, in line with its goal for the period. Moreover, it forecasts 2017 inflation to reach 4.8%/4.9%, which we see as sufficiently close to the 4.5% level it wants to make inflation to converge to. If our view is correct, and if fiscal uncertainty and "non-economic events" allow it, the Selic rate will be left unchanged in January.

The hawkish tone employed in the previous monetary policy minutes was broadly preserved in the 4Q15 Inflation Report

The wording and the tone of today's report was similar to the one used in the minutes of the last monetary policy meeting at the end of November. The concerns about the impact on inflation of fiscal deterioration were highlighted again. The recent worsening in inflation expectations were explicitly attributed to the "increase in the uncertainties related to the fiscal results". Together with the effects of the realignment of regulated prices and the exchange rate depreciation, fiscal deterioration was presented as the responsible for inflation actually being at very high levels. However, differently from the most recent monetary policy minutes, this time the BCB also underscored that uncertainties related to the development of "non-economic events [an implicit reference to the ongoing political turmoil] influence and will continue to influence, if not timely addressed, the prices of financial assets".

Monetary policy goals were made explicit, revealing more tolerance with inflation in 2016

As previously, the BCB affirmed that "monetary policy should remain especially vigilant to make sure that short-term [inflationary] pressure do not propagate into longer horizons" and that it "shall take the necessary measures to ensure the fulfillment of the inflation targets". Regarding the latter, the monetary authority explicitly stated its goals as "circumscribe inflation within the limits established by the CMN [the National Monetary Council], in 2016, and make it to converge to the 4.5% target, in 2017″. The goal of taking inflation as close as possible to 4.5%, presented in the last monetary policy minutes, was not included in the 4Q15 Inflation Report, showing some higher degree of tolerance with inflation next year.

The BCB inflation forecasts are already broadly in line its goals

Today's report showed that the BCB expects inflation to converge to 6.2%/6.3% in 2016 and to 4.8%/4.9% in 2017. Its forecasts for 2016 are already in line with its goal for the period (i.e. to take inflation within the 2.5%-6.5% target range). To some extent, the slowdown of inflation from around 10.8% in 2015 is due to the sharp expected contraction in domestic demand (the BCB expects GDP to contract by 3.6% in 2015 and by 1.9% in 2016). Regarding 2017, we see BCB forecasts as sufficiently close to its 4.5% target for the period. If our view is correct, no further monetary tightening would be needed for the BCB to meet its goals and, therefore, the Selic rate would be left unchanged at 14.25% in the next monetary policy meeting in January. However, if our view is not shared by the BCB (i.e. if it regards its 4.8%/4.9% inflation forecast for 2017 significantly higher than its 4.5% target) or if the concerns about fiscal deterioration and the political environment gain momentum, the Selic rate could then be adjusted upwards.