Brazil | No time (yet) for a monetary easing

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According to the Copom, and in line with our view, the beginning of a monetary easing cycle is not imminent. Even though the monetary authority expects a larger decrease of GDP in 2016 (-3.5%), inflation forecasts were revised up and uncertainty related to the fiscal deterioration, “non-economic” events, inflation dynamics and the global environment were highlighted.

Inflation forecasts were adjusted up to 6.6%-6.9% in 2016 and 4.9%-5.4% in 2017

In the 1Q16 Inflation Report released today, the Monetary Policy Committee (Copom) revealed that it now expects inflation to decline from 10.4% in February to 6.6% in the end of 2016, 4.9% in the end of 2017 and 4.5% (the inflation target) in 1Q18, in its baseline scenario, in which both the exchange and interest rates are assumed to be constant over the forecast horizon respectively at 3.70 and 14.25% (the values prevailing at the moment of the elaboration of the report). These figures are higher than those released three months ago (6.2% in 2016 and 4.8% in 2017), in spite of more negative prospects for economic activity (GDP forecast was cut to -3.5% from -1.9%) and a more appreciated exchange rate. This is mainly due to higher-than-expected inflation at the end of 2015 and at the very beginning of 2016. With respect to the Copom's alternative scenario, in which exchange and interest rates are assumed to behave as predicted by the market consensus, inflation forecasts were revised upwards to 6.9% in 2016 and 5.4% in 2017 (and 5.0% in 1Q18) from respectively 6.3% and 4.9% in the 4Q15 Inflation Report.

Domestic and global uncertainties were highlighted

The Copom emphasized again that series of factors are contributing to create a high uncertainty about the balance of risks for inflation. Not surprisingly, the monetary authority seems to be particularly worried with the effects of the ongoing fiscal deterioration (which "contribute to create a negative perception about the macroeconomic environment and have a negative impact on inflation expectations"). On top of that, the 1Q16 Inflation Report showed that the monetary authority is also concerned with “non-economic events” (i.e. with ongoing political tensions), the dynamics of inflation expectations, the "mechanisms that favor the persistence of inflation" and the evolution of the external environment.

We expect the Selic rate to remain at 14.25% until the end of 2016

Although the Copom's inflation forecasts show that the goals of keeping inflation within the 2.5%-6.5% target range in 2016 and of making it to converge to 4.5% in 2017 are still not ensured, a new dose of monetary tightening is unlikely given the current economic and political circumstances. However, as explicitly stated in today's report, current conditions "do not allow [the Copom] to work with the hypothesis of a monetary easing". Therefore, the most likely is that the Selic rate will be left unchanged at 14.25% for some further time. In our view, the Copom will only start to cut the Selic rate at the beginning of 2017, when inflation should finally converge within the target range (we expect inflation to close 2016 at 6.8% and then to reach 4.5% in the end of 2017).