Brazil | Still no room for a monetary easing

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The minutes of last week's monetary policy meeting, the last before the replacement of Alexandre Tombini by Ilan Goldfajn as BCB governor, signaled that the conditions for the beginning a monetary easing cycle are still not given. In spite of the changes in its board, we expect the BCB to continue to hold this view. Therefore, we see unlikely a Selic cut in the short-term.

For the BCB, inflation would converge to 4.5% in 2017 if the Selic and the exchange rate remained stable at 14.25% and 3.6 respectively

According to the BCB's baseline scenario, the one in which the Selic rate and the exchange rate remain unchanged at the values observed right before last week's monetary policy meeting (14.25% and 3.6, respectively), inflation would remain above the 4.5% target in 2016 and then converge to that level at the end of 2017. The current forecast for 2016 is higher than estimated previously, but -more importantly- the forecast for 2017 has been revised downwards. However, in the BCB's alternative scenario, in which the Selic and the exchange rate evolve in line with market expectations (i.e. the Selic is gradually cut and the exchange rate depreciates somewhat), inflation would remain above the 4.5% target not only in 2016 but also in 2017. As in the baseline scenario, the alternative forecast for 2016 has been revised upwards and the one for 2017 has been adjusted upwards. Looking at these results, we can say that maintaining the Selic rate at 14.25% for more time is an important element in the plan to make inflation to converge to the center of the target by the end of 2017. On top of the revised inflation forecasts, the main changes in today's minutes in comparison to the previous ones were: i) the highlighting of the importance of generating primary surplus that allow public debt as a share of GDP to stabilize and eventually trend downwards; and ii) the concerns about the recent (and temporary) supply shocks on food inflation. Anyway, according to the minutes "…the central scenario does not allow [the BCB] to work with the hypothesis of easing monetary conditions".

Changes in the BCB board increase uncertainty about monetary policy, but we continue to see unlikely a Selic cut in the short-term

Last week, after the announcement of the decision that the Selic rate would remain unchanged at 14.25%, the Senate approved Ilan Golfajn as the new president of the BCB. He then nominated four new members for the board of the monetary institution (PUC-Rio's Carlos Viana de Carvalho as economic policy director; Bradesco's Reinaldo Le Grazie as monetary policy director, PUC-Rio's Tiago Berriel as international relations director; and BCB's Isaac Ferreira as institutional relations director). In our view, these changes will create a more orthodox BCB board, which will likely be less tolerant with inflation. Ilan Goldfajn's recent comments, saying that the goal of monetary policy will be to make inflation to converge to the center of the inflation target (rather than to within the target range), reinforce our view. Taking that into account, we expect the Selic rate to remain stable at 14.25% for some further time. In our view, the most likely is that a monetary easing cycle will only start at the beginning of 2017. However, two events could create room for the monetary easing to start this year rather than in the next one: i) the approval by the Congress of the project to create a ceiling to fiscal expenditure (in the project presented by the new administration, federal expenses would have to grow at a rate no higher than inflation of the previous year); ii) the upward adjustment of the inflation target for 2017, from 4.5% to, for example, 5.5%.