Brazil | Copom sees 2016 inflation converging to the target, but also important risks

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The monetary policy minutes revealed that the COPOM is now seeing inflation converging to 4.5% in 2016, which explains its decision to leave the Selic unchanged at 14.25%. However, it highlighted that some upside risks (mainly fiscal policy deterioration and exchange rate depreciation) require the monetary authority to remain vigilant.

Higher inflation in 2015, but convergence to the 4.5% target in 2016

The Monetary Policy Committee (COPOM) showed in the minutes of last week's monetary policy meeting in which the Selic rate was left unchanged at 14.25% that it now expects higher inflation in 2015, probably due to higher-than-expected administered prices, a less supportive fiscal policy and a weaker exchange rate. With respect to the next year, the one on which the focus of the monetary authority currently is, the baseline forecast was revised downwards and is now around the 4.5% target. Even though 2016 inflation is still above the target in the alternative scenario, which takes market forecasts as inputs, the convergence of inflation in the baseline scenario certainly supported the COPOM decision to leave the Selic rate unchanged at 14.25% last week. The downward revision of 2016 inflation in the baseline scenario is likely to be related to a more negative view on both domestic and global activity, something that was made explicit many times in today's minutes.

Higher risks to the convergence scenario

Even though the COPOM is now expecting inflation to converge to 4.5% next year (a view we do not share), it emphasized that the balance of risks has gone through some deterioration. It also highlighted that "recent increases in risk premiums, which are reflected in the prices of assets, require monetary policy to remain vigilant". All in all, the minutes support our view that the Selic rate will be at 14.25% for a good time. However, they also show that further fiscal slippages or additional exchange rate depreciation could trigger extra doses of monetary tightening.