Brazil | COPOM: the plan is still to leave interest rates unchanged

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The minutes of last week's monetary policy meeting confirmed that the Monetary Policy Committee (COPOM) is now focused on making inflation converge to the 4.5% target in 2017 rather than in 2016. This change of focus takes some pressure out of monetary policy. However, the fiscal situation is a bigger source of concern, which requires the COPOM to remain "vigilant".

Stronger and lengthier inflationary pressure

The COPOM revised upwards its inflation forecasts for both 2015 and 2016. It now sees inflation above the 4.5% target not only in 2015 but also in 2016. The revisions were mainly driven by a "more prolonged and more intense" process of adjustment in administered prices (the COPOM now expects administered-price inflation to reach 16.9% in 2015 and 5.8% in 2016; previous forecasts were 15.2% and 5.7%, respectively) and a weaker exchange rate, which more than offset the COPOM's more negative view on economic activity.

The focus is now on 2017

Under the COPOM's previous strategy (take inflation down to 4.5% in 2016), the expectation of additional pressure on domestic prices next year would likely have determined a new increase of the Selic rate. However, today's minutes reinforced the message of last week's accompanying statement: the focus of the monetary policy is now on 2017 rather than on 2016. All the references to the convergence of inflation to the target in 2016 were replaced by references of convergence in "the relevant horizon for monetary policy" (i.e. 2017).

The Selic rate is likely to remain unchanged for some time

Taking into account the COPOM's new strategy (take inflation down to 4.5% in 2017), its most recent inflation forecasts for 2017 (around 4.0% in 3Q17, according to the 3Q15 Inflation Report; even though it could have increased lately, it is likely still around or below the target), and the overall tone of today's minutes, the most likely is that the Selic rate remains at 14.25% for some time, in our view at least until 2Q16.

Fiscal problems represent a risk to the COPOM's plan and force it to remain "vigilant"

As highlighted in many parts of the monetary policy minutes, the COPOM is now more concerned about the fiscal situation (regarding both "the pace of the recovery in fiscal results and its composition"). Further fiscal slippage is a risk for the COPOM's plan of keeping the Selic rate unchanged for some time and the main reason for it to remain "vigilant". Considering this, we expect the monetary authority to consider hiking the Selic rate again if its 2017 inflation forecasts move above the 4.5% target (due to additional signs of fiscal weakness or other reasons).