BTMU LATIN AMERICA TOPICS

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BRAZIL: COPOM GIVES NO SIGN THAT TIGHTENING CYCLE IS CONCLUDING

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As expected, COPOM increased SELIC by 50bp last week

The Central Bank's Monetary Policy Committee (COPOM) increased the policy interest rate (SELIC) by another 50bp last Wednesday to 9.50% per year. The decision was unanimous and expected, as the Central Bank (BCB) continues the monetary tightening cycle to lower inflation.

The accompanying statement was unchanged from the previous three statements: "Continuing the process of adjusting the basic interest rate, COPOM unanimously decided to increase the SELIC to 9.5% per year, without bias. The Committee views that this decision will contribute to set inflation on decline and assure that this trend persists next year."

Communications give no sign that the tightening cycle is concluding

In leaving the accompanying statement unchanged, COPOM avoided signaling that the tightening cycle is nearing its end. This stance was reinforced in the meeting minutes, which were released yesterday and maintained a tone that is unchanged from the previous minutes. While a slower tightening pace of 25bp at the November meeting is not discarded, the prospect of COPOM continuing the monetary tightening cycle at the current pace of 50bp hikes has risen.

In the minutes, COPOM states that it "understands it to be appropriate to continue the ongoing adjustment pace of monetary conditions." It did not indicate when the tightening cycle would conclude, nor did it suggest any change in the pace of tightening.

COPOM states that inflation is still showing resilience and repeats that it views the need for monetary policy to remain especially vigilant in order to guarantee that short-term inflation pressures do not extend to longer term horizons. It reiterates from the previous minutes that it is necessary to promptly revert the damages that persistent inflation would have on consumption and investment decisions. Its outlook of strengthening GDP growth this year and next year is maintained, on account of a pick-up of investment and continued growth of private consumption.

In terms of the BRL, COPOM views the recent weakening to be an expected correction amid changes in the international financial markets, and credits the Fed's postponement of QE tapering and its own interventions for reducing FX volatility. Yet it states that the BRL depreciation is a source of inflation in the short term and that its secondary effects can and should be limited by the adequate conduction of monetary policy.

Central Bank is defining its policy approach

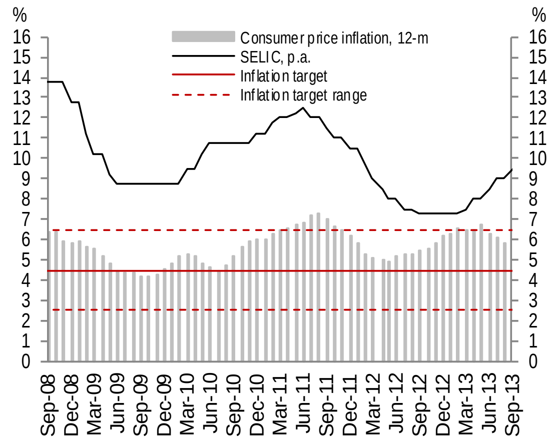
COPOM's concern over still high inflation raises the prospect of the SELIC being raised by 50bp to 10% on November 27th. We were initially expecting that the BCB, which has been lenient on inflation in exchange for higher growth, would deliver final 25bp hike in November and end the tightening cycle with the SELIC at single digits at 9.75%. But COPOM's discomfort with inflation pressures is likely to raise the SELIC back up to double digits this year. No guidance is provided on monetary policy moves beyond the next meeting in November.

The Central Bank is still balancing a high inflation, low growth dynamic. Activity indicators point to a decelerated growth pace in 3Q13 on account of a decline in industrial production. This performance sets up GDP for flat growth or a slight contraction on a quarterly basis in 3Q, slowing from growth of 1.5% qoq/sa in 2Q, though there are some signs of acceleration of economic activity in September upon stabilizing IP and positive results for retail sales.

COPOM's stricter stance on inflation should support its management of inflation expectations and serve as a needed enhancement to credibility. Yet, since COPOM still appears to be implicitly targeting an inflation rate above the official 4.5% target mid-point, its next moves pertaining to the pace and length of monetary tightening will be largely data-dependent on the trajectory of inflation expectations and the BRL.

Unless the Central Bank takes a stronger stance to re-anchor inflation expectations back to the 4.5% mid-point, the tightening cycle is unlikely to extend beyond January since the national election will be held in October 2014. Meanwhile, we continue to note that the expansionary stance of fiscal policy is placing a higher burden on the Central Bank to contain inflation.

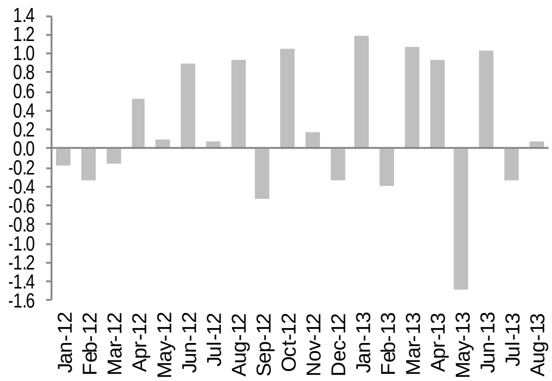
Figure 1: SELIC and consumer price inflation



Source: Central Bank; IBGE: BTMU Economic Research.

Figure 2: Economic activity index (IBC-BR)

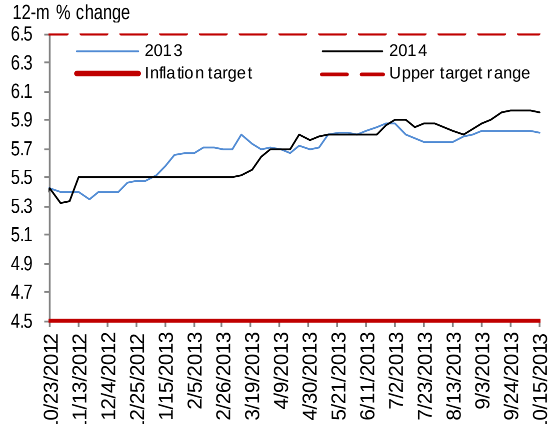
% change, month-on-month/seasonally-adjusted



Source: Central Bank; BTMU Economic Research (NY).

Figure 3: Consensus inflation expectations

12-m % change



Source: BCB Focus Survey; BTMU Economic Research.

For historical data and commentary following BTMU's Economic News Releases, see our website at: http://www.bk.mufg.jp/report/ecolatin2013/index.htm