

# Copom

18 September 2019

## Further cut ahead

### What happened

The Central Bank (CB) decided unanimously to cut Selic policy rate by 50bps to 5.50%. The decision came in line with our call and market consensus.

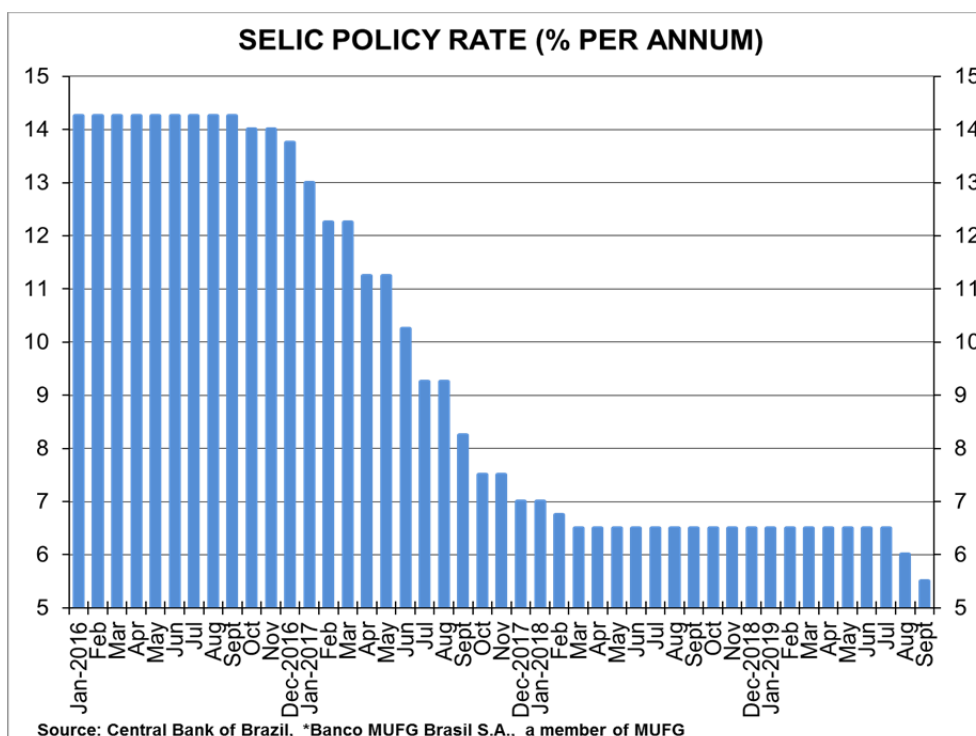
External scenario: monetary stimuli measures in large economies amid economic slowdown and inflation below targets have been able to set a relative favourable environment for emerging economies, although there are risks associated to a sharper global economic slowdown.

Economic activity: economic growth taking place at a gradual pace.

Taking as assumption market forecasts for Selic and FX rates, the CB inflation expectation is at 3.3% and 3.6%, respectively for 2019 and 2020, thus lower than the respective targets of 4.25% and 4.00%. In the reference scenario keeping Selic constant at 6.0% and FX rate at 4.05, inflation forecasts are at 3.4% and 3.6%, respectively for this and next year.

The downward bias relies on high idle capacity that might lead to lower than expected inflation. And upward bias is mainly related to the risk of hurdles to pass the reforms and to continue the economic adjustments, which might increase risk premium. And this risk is amplified in case of deterioration of the external sector affecting emerging economies.

The evolution of the baseline scenario and the balance of risks recommended this 50bps cut of Selic policy rate, and Copom assesses that the consolidation of a benign scenario for inflation might allow additional cut on Selic policy rate.



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## Our expectation

We keep our expectation that Central Bank might cut its policy rate by additional 50bps to 5.0% on the next meeting, scheduled to 30<sup>th</sup> October and then pause at 5%. CB would stop this monetary policy easing cycle at 5% because: i) the economic growth pace will be higher (our call is GDP growth at +0.4% in the 3Q19 and +0.8% in the 4Q19), ii) this 5% level is enough to contribute to foster economic growth without adding pressure on inflation ahead, iii) the market focus on domestic agenda will move to the negotiation of tax reform at the Congress, which tends to be a much more challenging one to be negotiated, iv) global risk factors of which we stress the risks of escalation of trade war between USA and China adds concerns on sharp global economic slowdown, as well as risk-off mood on emerging market assets thus contaminating BRL to more depreciated levels.

We expect that Selic policy rate might be maintained at 5% during at least the first half of 2020 due to a couple of factors: i) there is a high idle capacity (industrial capacity and high unemployment rate), so even considering sharper growth of household consumption, there is no risk of inflationary pressures. And note that it will take some quarters for the idle capacity to get closer to more normalized levels, ii) even amid sharper BRL depreciation, the FX pass-through to inflation is limited, iii) the inflation forecasts by us and the market are well-anchored to the midpoint targets set for this and next years, and core inflation also tends to keep at moderate levels, iv) although the risk-off mood to emerging assets might keep influencing on BRL depreciation, on the other hand, the concerns on global economic slowdown might add downward pressure on commodities prices, thus also offsetting the impact on producer and therefore on consumer prices.

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