

Copom Minutes

15 December 2020

Selic Rate on hold at 2% in the next meetings

What happened

External scenario: the resurgence of Covid-19 cases affects the economic activity in the short run. However, the progress on the vaccines tests might recover confidence and normalize activity in the medium run. Economic slack, along with the communication of central banks of major economies, suggests monetary stimuli will last long, resulting in a favorable environment for emerging economies.

Economic activity: recent activity indicators show an uneven recovery of the Brazilian economy aligned with expectation. There is high uncertainty on economic recovery pace, especially with the expected end of emergency transfer programs from January on

Inflation: December inflation should remain elevated, with an off-schedule collection of tuition fees and the transition to the highest level of the electricity rates flag system. CB (Central Bank) still considers the current pressure as temporary, but it will monitor inflation closely

Considering market expectation for Selic rate (2.0%, 3.0% and 4.5% respectively in the end of 2020, 2021 and 2022) and FX rates starting at 5.25 and moving by the Purchasing Power Parity (PPP), CB inflation forecasts are 4.3%, 3.4% and again 3.4%, respectively for 2020, 2021 and 2022. In the hybrid scenario, keeping Selic rate constant at 2.0% and FX rates starting at 5.25 and moving by the PPP, the inflation forecasts are 4.3%, 3.5% and 4.0%, respectively.

High idle capacity might lead to a prolonged low demand and lower-than-expected inflation. On the other hand, an extension of fiscal policy responses to the pandemic that aggravates the fiscal path or a frustration with the continuation of the reform agenda may increase the risk premium and lead to higher-than-expected inflation.

Monetary Policy: at this moment, the upward asymmetry in the balance of risks to inflation caused by fiscal risks is sufficient to compensate for the fact that inflation projections in its baseline scenario are below the target in the relevant horizon. Copom, therefore, deemed as adequate the current level of monetary stimulus, which is being provided by the maintenance of the policy rate at 2.00% p.a. and by the forward guidance. Although the forward guidance might be withdrawn soon, this would not mechanically imply an increase in interest rates.

Our expectation

Central Bank kept the main message as of the Copom communiqué released last week. So, we keep our view that Central Bank might announce the drop of forward guidance in the second quarter of next year, paving away to start increasing the policy rate in August 2021, in times of economic recovery already on track, thus there would be no need to keep policy rate at current expansionist zone. We expect Selic might end up 2021 at 3.75% and reach the nominal equilibrium level of 6.50% (which would be 2.9% in real terms) in November 2022.

CARLOS PEDROSO
Chief Economist
cpedroso@br.mufg.jp

MAURICIO NAKAHODO
Senior Economist
mnakahodo@br.mufg.jp

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Banco MUFG Brasil S.A.

Av. Paulista, 1.274
São Paulo - SP - Brazil
Ombudsman Toll-free (and DDG): 0800 770 4060
Email: ouvidoria@br.mufg.jp

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