Copom Minutes

23 June 2020

End of Easing Cycle?

What happened

External scenario: the coronavirus is provoking a significant slowdown of the global economy. The sanitary and economic effects of the pandemic are larger in emerging economies, especially in those with limited fiscal space, which reflects on risk aversion on those countries.

Economic activity: the second-quarter economic activity contraction will be even larger than the first quarter. Economic activity reached the lowest level in April, registering only a partial recovery in May/June. Uncertainty on the recovery in the 2nd half-year remains larger than usual.

Inflation: Taking as assumption stability for Selic (3.0%) and FX rates (4.95), the Central Bank inflation model results in inflation of 1.9% and 3.0%, respectively for 2020 and 2021. In the hybrid scenario, keeping FX rate constant at 4.95 and market forecast for Selic (2.25% in 2020 and 3.0% in 2021), the model results in 2.0% for 2020 and 3.2% for 2021.

High idle capacity might lead to lower than expected inflation, especially if a lengthening of the pandemic causes an increase in uncertainty and precautionary savings and, consequently, implies a larger or longer than anticipated decline in aggregate demand. Conversely, fiscal policy responses to the pandemic that permanently aggravate the fiscal trajectory or a frustration with the reform agenda may increase the risk premium and imply a higher-than-expected inflation over the relevant horizon for monetary policy. Additionally, the credit/ transfer programs implemented in response to the pandemic may cause a smaller-than-estimated decline in aggregate demand, introducing an asymmetry to the balance of risks to inflation.

Monetary Policy: regarding the potential effective lower limit for the Brazilian interest rate, we would already be close to the level from which further interest rate reductions could be accompanied by asset price instability, and potentially compromise the performance of some markets and economic sectors. So, it justifies caution in the conduct of monetary policy.

Our expectation

The Central Bank (CB) kept basically the same message as of the Copom communiqué released last week. We highlight that once again CB mentioned that the credit and transfer programs implemented in response to the pandemic may cause a smaller-than-estimated decline in aggregate demand, introducing an asymmetry to the balance of risks.

In such context, we expect the maintenance of Selic policy rate at 2.25% until July 2021. The backdrop for this expectation relies on the balance of risks between the combination of low inflation and weak economic activity that adds downward bias to inflation, and the risks coming from the fiscal balance and the lagged effects of monetary policy on activity and inflation.

As we commented last week, the weaker is the economic activity, then the sharper is the fiscal primary deficit because of lower tax collection and more government expenditures to support families, companies, as well as the extension of tax exemption. Furthermore, there are uncertainties related to the risk of temporary expenditures becoming permanent and failure to approve substantial structural reforms. And at last, there are sizeable doubts if further cut of Selic rate would have any impact on the loan rates that matters for the economic activity stimuli.

Of course, the coronavirus brings a huge uncertainty to the global and domestic economic scenario, as it is very hard to assess its effective impact and how long this crisis will last. So, we cannot discard the alternative scenario of additional cut on policy rate in case of sharper deterioration on economic growth perspectives. But, following the Copom communiqué and minutes mentioning a residual cut, we interpret it as only 25bps cut to 2%.

CARLOS PEDROSO
Chief Economist
cpedroso@br.mufg.jp

MAURICIO NAKAHODO
Senior Economist
mnakahodo@br.mufg.jp

Copom Minutes

23 June 2020

DISCLAIMER

The information herein is provided for information purposes only, and is not to be used or considered as an offer or the solicitation of an offer to sell or to buy or subscribe for securities or other financial instruments. Neither this nor any other communication prepared by Banco MUFG Brasil S.A. and/or MUFG Bank, Ltd. (herein jointly as "MUFG") is or should be construed as investment advice, a recommendation to enter into a particular transaction or pursue a particular strategy, or any statement as to the likelihood that a particular transaction or strategy will be effective in light of your business objectives or operations. Before entering into any particular transaction, you are advised to obtain such independent financial, legal, accounting and other advice as may be appropriate under the circumstances. In any event, any decision to enter into a transaction will be yours alone, not based on information prepared or provided by MUFG. MUFG hereby disclaims any responsibility to you concerning the characterization or identification of terms, conditions, and legal or accounting or other issues or risks that may arise in connection with any particular transaction or business strategy. Note that MUFG may have issued, and may in the future issue, other reports that are inconsistent with or that reach conclusions different from the information set forth herein. Such other reports, if any, reflect the different assumptions, views and/or analytical methods of the advisors who prepared them, and MUFG is under no obligation to ensure that such other reports are brought to your attention. MUFG retains copyright to this report and no part of this report may be reproduced or re distributed without the written permission of MUFG expressly prohibits the distribution or re-distribution of this report to any parties, via the Internet or otherwise and MUFG, its head office, branches, subsidiaries or affiliates accepts no liability whatsoever to any third parties resulting from such distribution or re-distribution.

Mitsubishi UFJ Financial Group, Inc. is one of the world's leading financial groups. Headquartered in Tokyo (Japan) and with over 360 years of history, MUFG has a global network with over 1,800 locations in more than 50 countries. The Group has over 150,000 employees and offers services including commercial banking, investment banking, trust banking, securities, credit cards, consumer finance, asset management, and leasing.

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

DISCLAIMER

As informações contidas neste documento servem apenas para fins de informação e não devem ser usadas como ou consideradas oferta ou solicitação de oferta para vender ou comprar ou contrair assinatura de instrumentos financeiros. Nenhuma comunicação elaborada pelo Banco MUFG Brasil S.A. e/ou MUFG Bank, Ltd. (em conjunto doravante "MUFG") é ou deve ser interpretada como conselho de investimento, recomendação para entrar em uma transação específica ou seguir uma estratégia específica, ou qualquer afirmação sobre a probabilidade de essa transação ou estratégia específica ser eficaz em vista de seus objetivos de negócios ou operações. Antes de entrar em uma transação específica, é recomendável obter assessoria independente financeira, legal, contábil ou de outra natureza, conforme adequado às suas circunstâncias. Toda e qualquer decisão de entrar em uma transação será exclusivamente sua, não baseada em informação elaborada ou fornecida pelo MUFG. O MUFG por meio desta se exonera de qualquer responsabilidade perante você envolvendo a caracterização ou identificação de termos, condições, questões legais, contábeis ou outras ou riscos que podem surgir em conexão com qualquer transação ou estratégia de negócios específica. O MUFG pode ter distribuído ou pode distribuir no futuro relatórios inconsistentes com ou que chegam a conclusões diferentes da informação aqui apresentada. Esses outros eventuais relatórios refletem diferentes hipóteses, visões e/ou métodos analíticos dos profissionais que os prepararam e o MUFG não tem obrigação de garantir que esses outros relatórios cheguem até você. O MUFG tem direito autoral sobre este relatório e nenhum trecho pode ser reproduzido ou redistribuído sem autorização por escrito. O MUFG expressamente proíbe a distribuição ou redistribuição deste relatório a terceiros via Internet ou outro meio. O MUFG, sua sede, agências, subsidiárias e afiliadas não aceitam qualquer obrigação perante terceiros resultantes de referida distribuição ou redistribuição.

O Mitsubishi UFJ Financial Group, Inc. é um dos maiores grupos financeiros do mundo. Sediado em Tóquio (Japão), e com mais de 360 anos de história, o MUFG é uma rede global com mais de 1.800 escritórios e está presente em mais de 50 países. O Grupo tem mais de 150.000 funcionários e oferece serviços de banco comercial, banco de investimento, trust, corretora, cartões de crédito, financiamento ao consumidor, gestão de ativos e leasing.

Banco MUFG Brasil S.A.
Av. Paulista, 1.274
São Paulo - SP - Brasil
Ouvidoria DDG: 0800 770 4060
Email: ouvidoria@br.mufg.jp