

Inflation Report – 1Q20

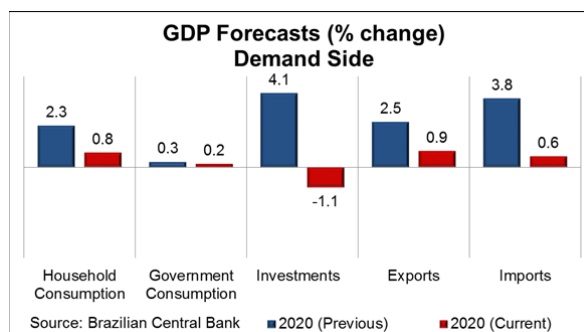
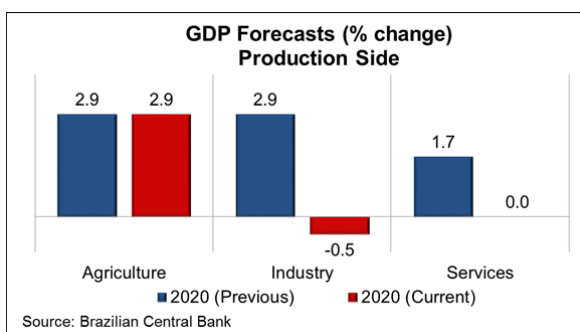
26 March 2020

Central Bank kept the tone of the minutes

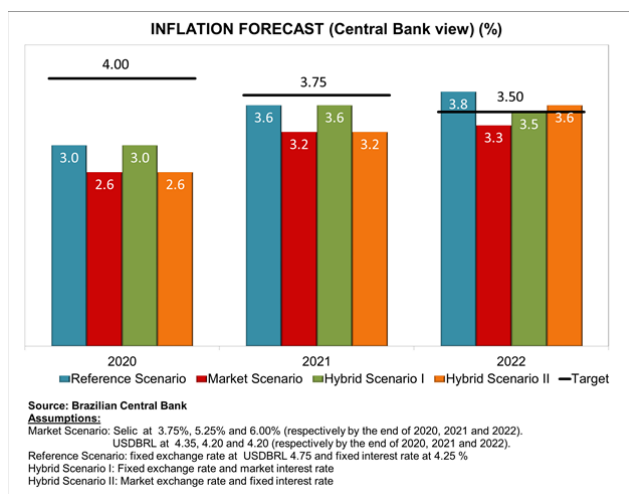
What happened

Global: the coronavirus is provoking a significant slowdown of the global economy, turning the environment challenging to emerging economies because of the risk aversion and the reallocation of assets.

Economic Activity: recent data came in line with the gradual recovery pace, but they didn't incorporate the impact of the COVID-19. The Central Bank revised down its GDP growth scenario to zero growth from +2.2% in order to incorporate the impact of the pandemic in the economic activity.



Inflation Forecasts: Broadly speaking, inflation is line with the achievement of the targets in 2020 and 2021. The Coronavirus outbreak and the drop of oil prices abroad reduced the expectation of inflation in the short run. The Central Bank four models show that inflation forecasts are well below the central target for 2020 and slightly below for 2021. For 2022, forecasts are in line or above the central target, but this is a time horizon that goes beyond the impact of current monetary policy decisions.



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Copom decided to take a cautious stance in the monetary policy, considering the current Selic policy rate level as appropriate. But, it also highlights that the balance of risks worsened and the next steps are subject to greater uncertainty and they will depend on the economic environment.

Central Bank concluded that, although the impact of monetary policy easing has been limited so far, the effects will become relevant for accelerating economic recovery when the restrictions imposed by the pandemic start to be lifted.

Our expectation

The tone of the Inflation Report was quite similar to the Copom minutes and communiqué, what was widely expected. In this sense, we keep our view that the deterioration of economic and financial conditions because of the Coronavirus pandemic will make the Central Bank cut the Selic policy rate further 50 bps to 3.25% on the 6th May meeting.

We expect Selic rate on hold at 3.25% from May onwards assuming that Central Bank will continue using additional tools to avoid a sharper deterioration on economic activity, and mainly because we expect the Coronavirus pandemic to be already controlled in the second half of this year

Of course, in case of a more prolonged than expected impact of the Coronavirus, there is a sizeable risk of further GDP slowdown, even a negative outcome for the whole 2020, as well as lower inflation than our IPCA call of 2.7% for this year. In such negative scenario, Selic policy rate might be cut further.

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