# Central Bank suggests that the benchmark Selic rate is likely to stay at 6.5% this year

## Overview

- **This week's communication by the Central Bank of Brazil reinforced expectations that the benchmark Selic rate will remain at 6.5% through the end of the year.** The minutes of the last Monetary Policy Committee (Copom) meeting and the Inflation Report highlighted the importance of anchored expectations and of the stage in the economic cycle to minimize the degree of exchange rate pass-through. The documents acknowledged a more challenging international environment, especially for emerging countries, a more gradual recovery of Brazil's economy, and that the underlying inflation measures are at "appropriate levels." As for the inflation outlook, the main highlight are the four forecasts published in the Inflation Report at or below 4.5% in 2018. However, two of those scenarios show a different picture for 2019, with inflation rising slightly above the 4.25% target. The rise in forecasts relative to those released in the June report is largely justified by higher regulated prices and BRL depreciation. In addition, the degree of exchange rate pass-through was the subject of a study, estimating that for every 1% of depreciation, pass-through is 11 to 19bps. Despite this result, the study found that factors such as the anchoring of expectations, the stage of the economic cycle and the operating margin of businesses contribute to determining the extent of pass-through. Finally, the document reiterated that the current economic outlook continues to "call for a stimulating monetary policy," but that "this stimulus will begin to be phased out if the inflation outlook over the policy horizon and/or its balance of risks worsen." Considering that expectations remain anchored, we kept our forecast for the policy rate unchanged at 6.5% through the end of 2018.
- **Wholesale prices remained under pressure, while the labor market was marked by stability in August.** After rising 0.70% in August, IGP-M inflation was up 1.52% in September. A significant part of the acceleration is due to the uptick in industrial wholesale inflation (2.22%), which were largely impacted by higher diesel and gasoline prices. Meanwhile, the Agricultural Wholesale Price Index rose 2.09% in the month, impacted by the effect of BRL depreciation on grains. The unemployment rate, meanwhile, stood at 12.1% in August. The main highlight was an increase in the number of employed persons, led by the self-employed and household employee categories.
- **In a unanimous decision, the Fed increased its policy rate by 25bps.** At a meeting this week, the Federal Open Market Committee increased the federal funds rate by 25 bps to 2.00-2.25%. The statement published after the meeting highlighted the positive outlook for U.S. growth, noting that the labor market continued to strengthen and that economic activity remained robust. The Federal Reserve also indicated that it believes interest rates are closer to their neutral level, suggesting greater uncertainty regarding future rate increases. This could ease upward pressure on the USD, which may benefit EM currencies. During last week, we had several important developments in emerging economies, including the new IMF program with Argentina and the country's new monetary regime, President Erdogan suggesting less intervention in the economy and strengthening Turkey's economic ties with Germany and France, a 50bps rate hike by the Central Bank of the Philippines and a 25bps rate increase by the Central Bank of Indonesia. In addition, India indicated it would continue to tighten monetary conditions in addition to raising import tariffs.

## Weekly outlook

- **Industrial production and consumer inflation figures are the highlights on the domestic calendar this week.** We forecast September IPCA inflation at 0.44% and expect core inflation to gradually continue to accelerate. On the other hand, we expect industrial production to cool slightly in August when compared to July.
- **Internationally, markets will keep a close eye on U.S. labor market and economic activity numbers for September.** Even though job creation could be under 200,000 due to the impact of Hurricane Florence, the U.S. labor market should continue to heat up. Final data on the industrial and service sectors in the U.S., China and the Eurozone will be announced over the week.

| Time | Country | Event | Forecast (Bloomberg) | Forecast (Depec) |
|---|---|---|---|---|
| **Monday 10/01** | | | | |
| 08:00 | Brazil | FGV: Consumer Price Index (IPC-S) (weekly) | 3.1% | |
| 08:25 | Brazil | BCB: Focus Survey | | |
| 10:00 | Brazil | Markit: PMI Manufacturing (Sep) | | |
| 15:00 | Brazil | MDIC: Trade Balance (weekly) | | |
| - | Brazil | Fenabrave: Vehicle sales (Sep) | | |
| 04:55 | Germany | Markit: Manufacturing PMI (Sep - F) | 53.7 | |
| 05:00 | Eurozone | Markit: Manufacturing PMI (Sep - F) | 53.3 | |
| 05:30 | United Kingdom | Markit: Manufacturing PMI (Sep) | 52.4 | |
| 11:00 | USA | ISM Manufacturing (Sep) | | |
| - | China | Markit: Manufacturing PMI (Sep)* | | |
| *The indicator will be released on September, 30th | | | | |
| **Tuesday 10/02** | | | | |
| 05:00 | Brazil | FIPE: Consumer Price Index - monthly (Sep) | | 0.41% (MoM) |
| 09:00 | Brazil | IBGE: Industrial Production (PIM) (Aug) | | -0.1% (MoM) |
| - | Brazil | CNI: Capacity Utilization (Aug) | | |
| **Wednesday 10/03** | | | | |
| 10:00 | Brazil | Markit: Composite PMI (Sep) | | |
| 12:30 | Brazil | BCB: Currency Flows (weekly) | | |
| 12:30 | Brazil | BCB: Commodity Price Index (Sep) | | |
| 04:55 | Germany | Markit: Composite PMI (Sep - F) | | |
| 05:00 | Eurozone | Markit: Composite PMI (Sep - F) | | |
| 05:30 | United Kingdom | Markit: Composite PMI (Sep - F) | | |
| 09:15 | USA | Employment Change (ADP) (Sep) | | |
| 11:00 | USA | ISM Services (Sep) | | |
| **Thursday 10/04** | | | | |
| 11:20 | Brazil | Anfavea: Vehicle Production (Sep) | | |
| - | Brazil | Serasa experian: Retail Activity Index (Sep) | | |
| 09:30 | USA | Initial Jobless Claims - Weekly | | |
| 15:00 | Mexico | Central bank meeting | 7.75% | |
| **Friday 10/05** | | | | |
| 09:00 | Brazil | IBGE: Consumer Price Index (IPCA) (Sep) | | 0.44% (MoM) |
| 09:30 | USA | Change in Nonfarm Payrolls (Sep) | 188k | |
| 09:30 | USA | Unemployment Rate (Sep) | 3.8% | |

| | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|
| Consumer inflation - IPCA (%) | 6.29 | 2.95 | 4.40 | 4.25 |
| GDP growth (%) | -3.6 | 1.0 | 1.1 | 2.5 |
| Industrial Production (%) | -6.4 | 2.5 | 1.5 | 2.7 |
| Retail Sales (%) | -8.7 | 4.0 | 5.0 | 4.5 |
| Unemployment Rate (% of labor force, avg) | 11.5 | 12.7 | 12.5 | 12.3 |
| Outstanding Credit Growth (%) | -3.5 | -0.5 | 4.0 | 8.3 |
| Trade Balance (USD bn) | 45.0 | 64.0 | 60.4 | 61.1 |
| Current Account (USD bn) | -23.5 | -9.8 | -9.9 | -8.5 |
| Exchange Rate (BRL/USD, eop) | 3.26 | 3.31 | 3.90 | 3.80 |
| Selic Rate (%, eop) | 13.75 | 7.00 | 6.50 | 8.00 |
| Primary Balance (BRL bn) | -155.8 | -111 | -132.7 | -94.9 |
| Gross Debt (% of GDP) | 70.0 | 74.0 | 75.7 | 76.5 |

## Technical Staff

**Department of Economic Research and Studies** Fernando Honorato Barbosa

**Economists** Andréa Bastos Damico / Constantin Jancsó / Ellen Regina Steter Hanna Farath / Estevão Augusto Oller Scripilliti / Fabiana D'Atri / Igor Velecico / Leandro Câmara Negrão / Mariana Silva de Freitas/ Myriã Tatiany Neves Bast / Priscila Pacheco Trigo / Rafael Martins Murrer / Robson Rodrigues Pereira / Thomas Henrique Schreurs Pires

**Interns** Ana Beatriz Moreira dos Santos / Camila Medeiros Tanomaru / Felipe Yamamoto Ricardo da Silva / Isabel Cristina Elias de Souza Oliveira / Lucas Maia Campos / Renan Bassoli Diniz / Thaís Rodrigues da Silva

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