Macro Brazil

January 27, 2025

Copom Cockpit: shortening the signaling horizon

- The Brazilian Central Bank's Monetary Policy Committee (Copom) will meet again on January 28th and 29th. We expect a unanimous decision to increase the Selic benchmark rate to 13.25% pa, marking the first of two additional 100-bp hikes that were signaled at the end of last year.
- When compared to forecasts presented at the December meeting, the committee's inflation projections in the reference scenario (which considers the exchange rate according to purchasing power parity and the interest rate according to the Focus survey) should rise to 5.2% from 4.5% in 2025 and to 4.2% from 4.0% at the relevant horizon (which moves to 3Q26 from 2Q26).
- Since the December meeting, the Copom has faced additional deterioration in inflation expectations in the weekly Focus survey, a more challenging composition in current inflation, and continued pressure on the exchange rate (notwithstanding the relief at the margin). When combined with prospective inflation models, these factors could justify a decision by the Copom to signal adjustments of the same magnitude in the next two meetings.
- However, the more restrictive monetary policy should have a more intense impact on the economy from 2Q25 onwards. Considering this risk and the high level of uncertainty, the authorities' most likely reaction will be not to signal the magnitude of rate moves beyond their next meeting.

1 – Inflation forecasts

The tables below summarize the estimates based on our model, which seeks to replicate the Central Bank's small-scale model, and changes in the Focus survey since the last committee meeting. The exchange rate level utilized (6.00 reais per US dollar) follows the Central Bank's procedure of averaging the rates of the last 10 business days.

When compared to forecasts presented at the November meeting, the committee's inflation projections in the reference scenario (which considers the exchange rate according to purchasing power parity and the interest rate according to the Focus survey) should rise to 5.2% for 2025 (from 4.5%) and to 4.2% at the relevant horizon (3Q26) – from 4.0% expected in December for the 2Q26 –, without signs of convergence to the 3.0% target.

Since the last Copom meeting, inflation expectations reported by the Focus survey continue to rise sharply to 5.50% in 2025 (from 4.59%) and to 4.22% in 2026 (from 4.00%). For the Selic rate, the projection rose to 15.00% (from 13.50%) for 2025, and to 12.50% (from 11.00%) for 2026.

IPCA forecasts (%) according to "Central Bank model"*			
Period	November Meeting	December Meeting	January Meeting (forecast)
2025	3.9%	4.5%	5.2%
Relevant horizon	3.6% (2Q26)	4.0% (2Q26)	4.2% (3Q26)
Exogenous variables			
Exchange Rate (R$/US$)	5.75	5.95	6.00
Selic Interest Rate (%) 2025	11.25%	13.50%	15.00%
Selic Interest Rate (%) 2026	9.50%	11.00%	12.50%
Inflation Expectations (Focus) 2025	4.00%	4.59%	5.50%
Inflation Expectations (Focus) 2026	3.60%	4.00%	4.22%

Source: Bloomberg, Central Bank of Brazil, Itaú.
* Model developed by Itaú replicating Copom's model.

Focus forecasts *(%, year-end)*						
	2025		2026		2027	
	Previous Copom	Current*	Previous Copom	Current*	Previous Copom	Current*
IPCA	4.59	5.50	4.00	4.22	3.58	3.90
GDP growth	2.00	2.06	2.00	1.72	2.00	1.96
Selic rate	13.50	15.00	11.00	12.50	10.00	10.38
Exchange rate (BRL/USD)	5.77	6.00	5.73	6.00	5.69	5.93

*considering the latest Focus report.

Source: BCB, Itaú.

2 – Asset prices

Since the last Copom meeting and until the publication of this report, the BRL/USD exchange rate reached the same level at the margin, but went through a period of high oscillation and volatility, hitting an all-time low of BRL 6.29 per US dollar. On the other hand, the perception of country risk as measured by the 5-year CDS increased to 181 bps from 165 bps. Meanwhile, 10-year US Treasury yields climbed to 4.51%. Brent crude prices went up as well, rising to $78/bbl from $74/bbl, while, on average, industrial commodity prices remained stable during this period.

Asset prices		
	Previous Copom	Current*
UST 10Y	4.27	4.51
Oil price (Brent)	74	78
Agricultural commodities**	619	649
CRB RIND Index***	547	549
CDS 5Y	165	181
Exchange rate (BRL/USD)	5.96	5.96

*considering closing prices on the eve of publication of the report.
**geometric average of soy, corn and wheat prices, in US dollars.
***Commodity Research Bureau Index of Industrial Raw Materials.

Source: CRB, BBG, Itaú.

3 – Recent data

The table below shows the dataset released since the last Copom meeting. Regarding economic activity, the unemployment rate declined further in November to 6.1%, in line with market expectations. However, formal job creation, at 106.6k, missed consensus at 120k. The Central Bank's activity indicator IBC-Br was little changed at the margin, advancing 0.1% mom (consensus: 0.0%), despite monthly decreases in industrial production, services, and retail sales.

Regarding inflation, the latest indicator released, the mid-month consumer price index IPCA-15, climbed 0.11% in January (surpassing our 0.06% projection and the median of market expectations at -0.02%). Although the report showed only a small change (with the impact of the Itaipu HPP bonus on electricity prices), the January IPCA-15 disappointed expectations in qualitative terms, particularly because of a higher-than-anticipated reading in underlying services prices. In our view, this release confirms the worsening trend of core inflation measures, which will likely remain under pressure in upcoming reports. The headline IPCA was in line with our call and the median of market expectations (0.52% mom vs. 0.53% expected).

Meanwhile, the current account had a better-than-expected deficit of $9.0 billion in December, thanks to profit and dividend remittances. However, the current account remains under pressure compared to the average of recent years, ending 2024 with a deficit of 2.5% of GDP (compared to a deficit of 1.1% in 2023). Notably, external financing is still at a less favorable level, with the difference between Direct Investment in the Country (IDP) and the current account balance widening at the margin.

Economic Indicators: Result vs. Consensus

Release Date	Indicator	Result	Consensus
12-Dec-24	Core Retail Sales (Oct/24) - MoM	0.4%	-0.2%
13-Dec-24	IBC-Br (Oct/24) - MoM	0.1%	-0.2%
27-Dec-24	IGP-M (Dec/24) - MoM	0.94%	1.09%
27-Dec-24	IPCA-15 (Dec/24) - MoM	0.34%	0.46%
27-Dec-24	Formal job creation (Nov/24) - Thousands	106.6	120.0
27-Dec-24	Unemployment rate (Nov/24)	6.1%	6.1%
30-Dec-24	Primary fiscal result (Nov/24) - BRL bn	-6.6	-7.0
8-Jan-25	Industrial production (Nov/24) - MoM	-0.6%	-0.7%
9-Jan-25	Core Retail Sales (Nov/24) - MoM	-0.4%	-0.3%
10-Jan-25	IPCA (Dec/24) - MoM	0.52%	0.53%
15-Jan-25	IBGE Services Sector Volume (Nov/24) - MoM	-0.9%	-0.5%
16-Jan-25	IBC-Br (Nov/24) - MoM	0.1%	0.0%
24-Jan-25	IPCA-15 (Jan/25) - MoM	0.11%	-0.02%

Data in red suggest more hawkish results for monetary policy (higher inflation or stronger activity than expected) and data in blue suggest more dovish results.

Source: IBGE, Brazilian Central Bank and Bloomberg

4 – Communication changes and Copom-o-Meter

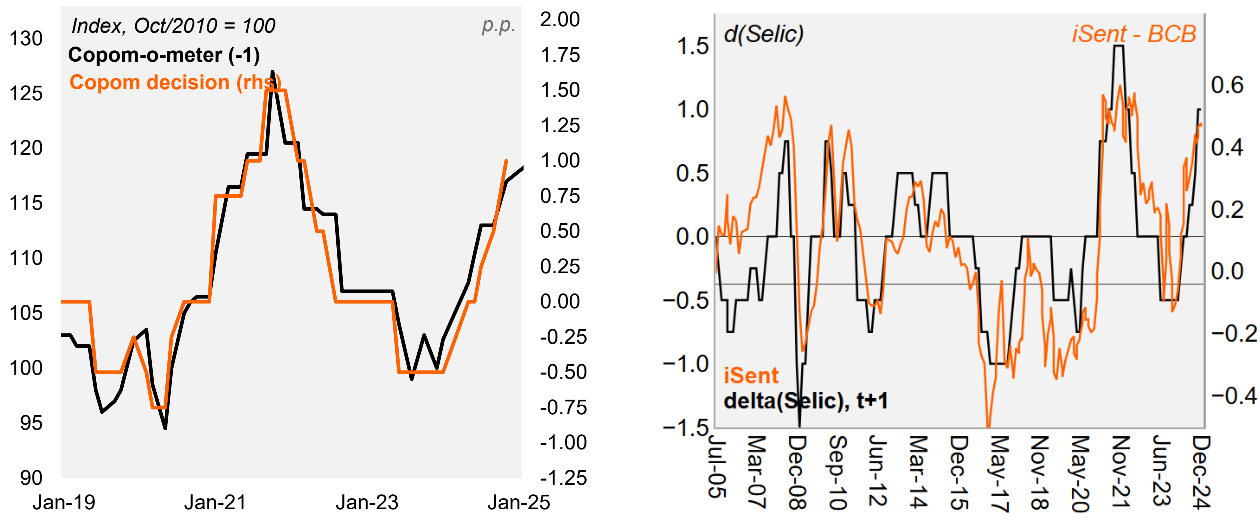
At its last monetary policy meeting, the Copom unanimously decided to further accelerate the pace of monetary tightening to 100bps (from 50bps at the previous meeting), taking the Selic rate to 12.25%pa, as widely expected.

The post-meeting statement and the minutes conveyed that this was the first of three consecutive 100bp-hikes, which would take the Selic rate to 14.25%pa, in response to a more adverse inflation scenario. According to the committee, two aspects were discussed at length to underpin this decision. First, the magnitude of the short- and medium-term deterioration in the inflation scenario required a more timely stance to maintain the firm commitment to inflation convergence to the target. Second, several risks materialized, making the scenario more adverse but less uncertain, allowing greater visibility to provide an indication of what the authorities saw for their moves in the future.

In order to try to anticipate Copom's decisions, we use the Copom-o-meter, an index that measures the degree of restriction or expansion implicit in the Central Bank's communication. Applying the methodology (based on scores attributed to relevant communication by the committee), we reckon that the messages convey more hawkish tones, and given current conditions, are compatible with expectations of maintaining the tightening pace for the Selic rate (100 bps).

In addition to the Copom-o-meter, we created iSent, Itaú's Central Bank Sentiment Classifier, based on GPT-4, developed by our data science team using phrases published in official documents released by monetary authorities and labeled by our economists. Our labeled dataset consists of approximately 1,000 sentences extracted from official documents published by the Brazilian Central Bank. Each sentence was classified as dovish, neutral, hawkish, or out of context. The index is based on the relative presence of each classification within the document. The index ranges from -1 to 1, getting higher as the tone is perceived as more hawkish. iSent-BCB shows good adherence to current and future moves in interest rates in Brazil (correlation ~0.8). A visual analysis confirms that the index is a good fit with the change in the Selic rate one meeting down the road. In fact, the index was able to capture most shifts seen during the past 18 years, particularly the hiking cycles of the late 2000s and early 2020s. For the next meeting, the index suggests that recent communication is consistent with a 100-bp increase in the benchmark rate.

Copom-o-Meter and Itaú iSent Classifier



5 – Our view

The Copom will meet again on January 28th and 29th. We expect a unanimous decision to increase the Selic benchmark rate to 13.25% pa, marking the first of two additional 100-bp hikes that were signaled at the end of last year.

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Macro Research – Itaú

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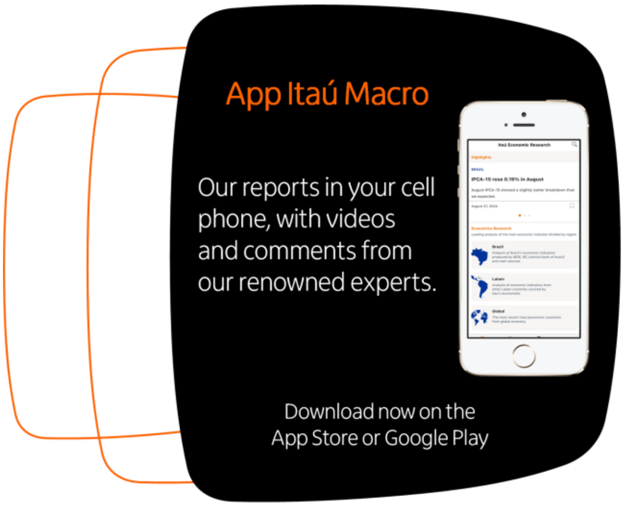

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