Macro Brazil

May 5, 2025

Copom Cockpit: slowing down the pace of tightening

- The Copom will meet again on May 6 and 7, and we expect a unanimous 50 basis points increase in the Selic rate, to 14.75% pa, following the signaling of an additional and smaller increase from the last meeting.
- Looking at the context for this meeting, we see, on the one hand, a gradual slowdown in domestic activity and increased external uncertainty, with a potentially net disinflationary impact. On the other hand, unanchored inflation expectations (though no longer worsening), the positive output gap, and the Central Bank’s projections point, at this moment, to the need to continue moving into contractionary territory.
- The balance of risks is likely to remain asymmetrically tilted to the upside, albeit less sharply than at the previous meeting, due to developments in the external scenario. Supporting this view is the emergence of a less inflationary environment for emerging economies, driven by recent shocks to international trade and global financial conditions. We additionally consider that the degree and persistence of the de-anchoring of expectations, as well as the deviation of inflation from the target itself, warrant caution in incorporating benign exogenous developments into the prospective scenario, whether in forecasts or their balance of risks.
- For the next decision, we believe that the monetary authority will seek flexibility to react to the evolving scenario, recognizing that an environment of greater global uncertainty requires greater caution in the conduct of domestic monetary policy, in line with the communication adopted by committee members in recent statements. At the same time, we assess that the committee will continue to indicate vigilance and assess whether the level of monetary policy tightening is sufficient to ensure the convergence of inflation to the target.
- The current economic environment presents some similarities to the situation faced by the Copom during two past episodes: the Global Financial Crisis, which impacted us at the end of 2008, and the European Debt Crisis, in mid-2011. We briefly discuss both in the annex below.
- In the face of a global shock that may prove contractionary and disinflationary, the monetary policymaker may adopt distinct reactions, depending on the institutional framework and the economic outlook. If inflation and expectations are close to the target, and the central bank operates under a dual mandate, it may very well respond by easing its monetary policy stance. However, if expectations and inflation are far from the target, and the mandate primarily focuses on inflation, then, in our view, the most prudent approach would be to grasp external opportunities to accelerate the convergence process – an opportunistic disinflation – while exercising great caution to avoid prematurely loosening the policy stance.
- And what if economic activity surprises negatively? The Copom has ample room to react by reducing the interest rate, as we are far from the "lower bound" for the Selic rate. From today's perspective, given the degree of de-anchoring and the outlook ahead, the risk of over-adjusting monetary policy seems smaller and easier to correct than the risk of prematurely halting the adjustment process.

1 – Inflation Forecasts

The tables below summarize the projections based on our model, which seeks to replicate the BCB's small-scale model, as well as the changes in the Focus survey since the committee's last meeting. The exchange rate used (R$5.70/US$) reflects the Central Bank’s procedure of using the average of the previous 10 business days.

Compared to what was presented at the March meeting, the committee's inflation projections in the baseline scenario— which assumes an exchange rate consistent with purchasing power parity and an interest rate aligned with the Focus survey —are likely to decline to 4.8% for 2025 (from 5.1%) and to 3.6% over the relevant horizon of 4Q26 (from 3.9% for 3Q26).

Since the last Copom meeting, inflation expectations reported in the Focus survey have declined to 5.53% for 2025 (from 5.66%), while reaching 4.51% for 2026 (from 4.48%). Projections for the Selic rate receded to 14.75% (from 15.00%), while remaining unchanged at 12.50% for 2026.

IPCA forecasts (%) according to "Central Bank model"*

Period	July Meeting	September Meeting	November Meeting	December Meeting	January Meeting	March Meeting	May Meeting (forecast)
2025	3.6%	3.7%	3.9%	4.5%	5.2%	5.1%	4.8%
2026	3.4% (1Q26)	3.5% (1Q26)	3.6% (2Q26)	4.0% (2Q26)	4.0% (3Q26)	3.9% (3Q26)	3.6% (4Q26)
Exogenous variables							
Exchange Rate (R$/US$)	5.55	5.60	5.75	6.00	6.00	5.80	5.70
Selic Interest Rate (%) 2025	9.50%	10.50%	11.25%	13.50%	15.00%	15.00%	14.75%
Selic Interest Rate (%) 2026	9.00%	9.50%	9.50%	11.00%	12.50%	12.50%	12.50%
Inflation Expectations (Focus) 2025	3.96%	3.95%	4.00%	4.59%	5.50%	5.66%	5.53%
Inflation Expectations (Focus) 2026	3.60%	3.61%	3.60%	4.00%	4.22%	4.48%	4.51%

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	5.66	5.53	4.48	4.51	4.00	4.00
GDP growth	1.99	2.00	1.60	1.70	2.00	2.00
Selic rate	15.00	14.75	12.50	12.50	10.50	10.50
Exchange rate (BRL/USD)	5.98	5.86	6.00	5.91	5.90	5.85

*considering the latest Focus report.

Source: BCB, Itaú.

2 – Asset Prices Evolution

Since the last Copom meeting and up to the publication of this report, the exchange rate remained at 5.65 reais per dollar, albeit with high volatility due to an uncertain external environment. The country risk perception, as measured by the 5-year CDS, rose by 12 basis points to 182 basis points. The 10-year U.S. Treasury yield increased to 4.31% (from 4.24%), while the price of Brent crude oil fell to 61 dollars per barrel (from 71 at the previous meeting), amid increased uncertainty about global demand and rising expectations of supply from major producers, including the U.S. and OPEC members.

Asset prices		
	Previous Copom	Current*
UST 10Y	4.24	4.31
Oil price (Brent)	71	61
Agricultural commodities**	640	635
CRB RIND Index***	571	558
CDS 5Y	170	182
Exchange rate (BRL/USD)	5.65	5.65

*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 – Data Evolution

The table below shows the set of indicators released between the last Copom meeting and the upcoming one. Regarding inflation data, the most recent release was the IGP-M for April, which rose 0.24% month-on-month, exceeding both market expectations and our projection (-0.14%). This result was mainly driven by rising agricultural product prices, reversing the index's downward trend observed in March. Another important release was the IPCA-15 for April, which increased by 0.43%, above our projection (0.40%) and slightly surpassing the market median forecast (0.42%). The data showed that the core of underlying services remains under pressure, despite some marginal relief – a trend expected to persist in the full IPCA.

On the economic activity front, the most relevant releases were related to the labor market. The unemployment rate was in line with expectations, with the seasonally adjusted figure falling to 6.4% (from 6.5%), reflecting growth in formal employment and a reduction in informal employment. Regarding formal job creation in the same month, CAGED reported 71.5 thousand new jobs, below our projection (165 thousand) and the median market expectation (187 thousand). Following a strong performance in February (431 thousand jobs created), the slowdown was more pronounced than expected. Additionally, the IBC-Br for February surprised to the upside, showing an increase of 0.44% month-on-month (compared to our forecast of +0.1%).

Economic Indicators: Result vs. Consensus			
Release Date	Indicator	Result	Consensus
27-Mar-24	IPCA-15 (Mar/24) - MoM	0.6%	0.7%
28-Mar-24	IGP-M (Mar/24) - MoM	-0.34%	-0.18%
28-Mar-24	Unemployment rate (Feb/25)	6.80%	6.80%
28-Mar-24	Formal job creation (Feb/25) - Thousands	432	227
2-Apr-24	Industrial production (Feb/25) - MoM	-0.1%	0.3%
8-Apr-24	Primary fiscal result (Feb/25) - BRL bn	-19	-248
9-Apr-24	Core Retail Sales (Feb/25) - MoM	0.50%	0.60%
10-Apr-24	IBGE Services Sector Volume (Feb/25) - MoM	0.00%	0.80%
11-Apr-24	IPCA (Mar/25) - MoM	0.56%	0.53%
11-Apr-24	IBC-Br (Feb/25) - MoM	0.44%	0.30%
25-Apr-24	IPCA-15 (Apr/25) - MoM	0.43%	0.42%
29-Apr-24	IGP-M (abr/25) - Var. mensal	0.24%	-0.07%
30-Apr-24	Primary fiscal result (Mar/25) - BRL bn	3.6	1.8
30-Apr-24	Unemployment rate (Mar/25)	6.4%	7.0%
30-Apr-24	Formal job creation (Mar/25) - Thousands	72	185
7-May-24	Industrial production (Mar/25) - MoM		

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 – Evolution of the *Copometer* Communication

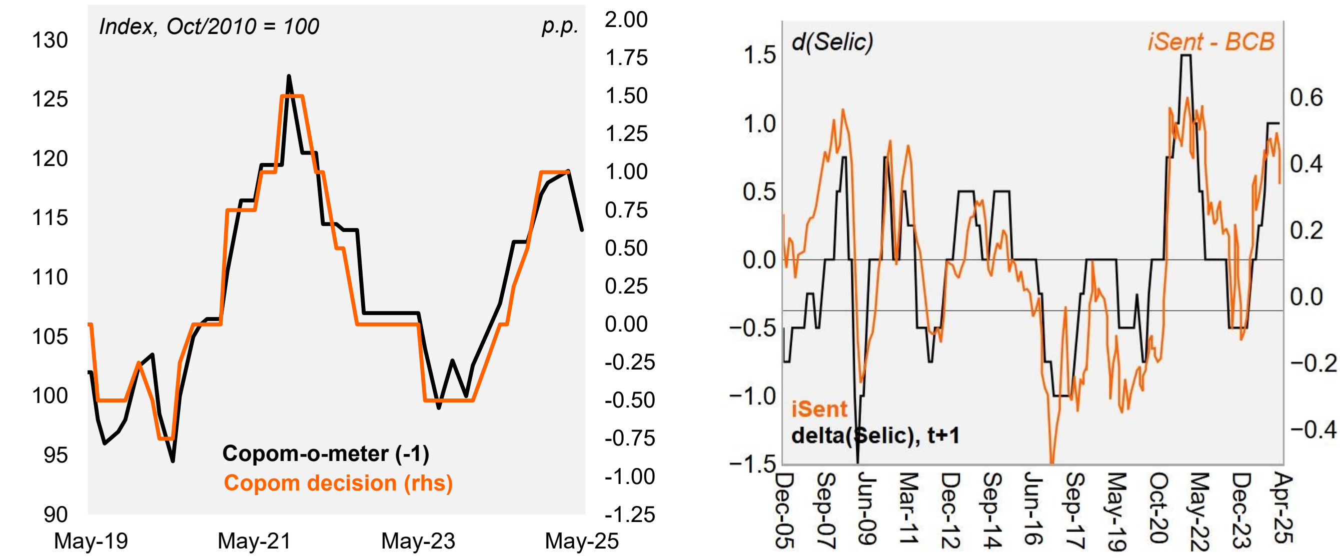
At its last monetary policy meeting, the Copom unanimously decided to maintain the pace of monetary tightening, delivering another 100-bp increase (the same magnitude as in the previous meeting), bringing the Selic rate to 14.25% pa, as widely expected by the market.

The statement and minutes indicated that this was the last of three consecutive 100-bp hikes, given a more adverse inflation outlook. The tone of the minutes was generally more hawkish, with only one aspect that could be interpreted as slightly more dovish. Although the committee noted incipient signs of an economic slowdown at the time, it emphasized the high level of uncertainty surrounding economic activity and its short-term prospects. In contrast, the text was clear and direct when addressing inflation and its undoubtedly challenging outlook. The minutes also expressed a more negative view on the potential impact of external developments – specifically, the possibility that such changes could lead to currency depreciation in emerging economies. Regarding the communication of next steps, Copom signaled that it would slow the pace of tightening, rather than pause the cycle, to account for the lagged effects of previous policy decisions.

To anticipate Copom's decisions, we use the Copometer—an index that measures the degree of monetary restriction or expansion implied in the Central Bank’s communication. Applying a methodology based on scores assigned to the committee’s key communications, we expect the Selic rate to continue rising, with a 50 basis point increase.

In addition to the Copometer, we developed iSent—Itaú's Central Bank Sentiment Classifier—based on GPT-4 and built by our data science team using sentences from official documents published by central banks, labeled by our economists. Our labeled dataset consists of about one thousand sentences from documents released by Brazil’s Central Bank. Every sentence was classified as *dovish*, *neutral*, *hawkish*, or *out of context*, and the index is constructed based on the relative frequency of each class within a document. The index ranges from -1 to 1, with higher values indicating a more hawkish tone. The iSent-BCB shows strong alignment with both current and future changes in Brazilian interest rates (with a correlation of approximately 0.8). Visual analysis also confirms that the index tracks well with Selic rate changes one meeting ahead. In fact, it has accurately captured most shifts over the past 18 years, particularly during the hiking cycles of the late 2000s and early 2020s. For the upcoming meeting, the index suggests that recent communications are consistent with a 50 basis point interest rate hike.

Copom-o-Meter and Itaú iSent Classifier



5 – Our view

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Annex

In 2008-2009, the central bank decided not to deviate from its primary objective and only eased monetary policy when its projections indicated inflation convergence toward the target. This disciplined stance proved to be the right approach: monetary policy contributed to the economic recovery, which was, in fact, already underway by the second quarter of 2009, without compromising the disinflation process. The decline in commodity prices provided support, although the reduction in international oil prices was not fully passed through to domestic consumers.

In 2011, the Copom chose to preemptively address the impact of the European crisis on economic activity and inflation, abruptly reversing its stance with a technical justification that, at the time, was widely questioned. The result was a significant de-anchoring of expectations, which led the same committee to implement a strong adjustment process starting from April 2013.

	Quarterly Inflation Report	Relevant horizon	Central bank's forecast (Focus scenario) in relevant horizon	Inflation expectations in the relevant horizon
Global financial crisis 2008-2009	**September 2008**	March 2010	4.6	4.9
	December 2008	June 2010	4.6	4.9
	March 2009	September 2010	4.3	4.4
	June 2009	December 2010	4.4	4.2
Europe crisis 2011	**June 2011**	December 2012	4.9	5.0
	September 2011	March 2013	5.1	5.4

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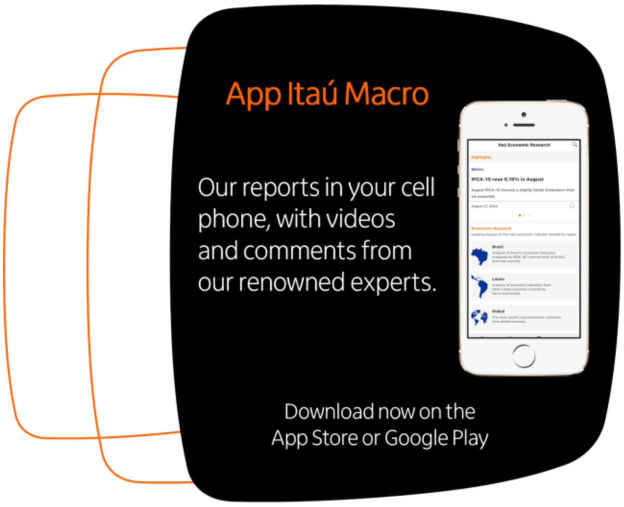

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