

## Copom Cockpit: accelerating the pace to 50 bps

- ▶ The Brazilian Central Bank's Monetary Policy Committee (Copom) will meet again on November 5 and 6 and will likely accelerate the adjustment pace to 50 bps (from 25 bps in the previous meeting), taking the Selic benchmark interest rate to 11.25% pa.
- ▶ Compared to the estimates presented at the September meeting, the committee's inflation forecasts in the baseline scenario (which includes an exchange rate following purchasing power parity and an interest rate according to the Focus survey) will likely increase to 4.6% for 2024 (compared to 4.3% at the September meeting), rise to 4.0% for 2025 (compared to 3.7%), and advance to 3.6% (from 3.5%) in the relevant horizon (2Q26).
- ▶ Faced with a still challenging scenario – with the exchange rate at a weaker level than at the previous meeting, a tight labor market, and core inflation measures and inflation expectations remaining above the target – the authorities should consider appropriate to increase the pace, moving more quickly into contractionary territory. In this context, they will likely also maintain the assessment of an upwardly asymmetric balance of risks.
- ▶ For the upcoming meetings, in a context of high volatility (especially in relation to the expected exchange rate trajectory amid interest rate repricing and elections in the US, as well as noise surrounding Brazilian fiscal policy), the authorities will likely keep their options open in terms of the pace of eventual adjustments in the future and the total magnitude of the cycle, while emphasizing the committee's firm commitment to the process of inflation convergence to the target.

### 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 (BRL 5.75 per US dollar) follows the Central Bank's procedure of averaging the rates of the last 10 business days.

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Since the last Copom meeting, inflation expectations reported by the Focus survey advanced to 4.55% from 4.35% for 2024, and to 4.00% from 3.95% for 2025. Estimates for 2026 retreated slightly to 3.60% from 3.61%. Forecasts for the Selic rate increased to 11.75% (from 11.25%) for 2024 and to 11.25% (from 10.50%) for 2025, remaining stable at 9.50% for 2026.

IPCA forecasts (%) according to "Central Bank model"			
Period	July Meeting	September Meeting	November Meeting (forecast)
2024	4.2%	4.3%	4.6%
2025	3.6%	3.7%	4.0%
Relevant horizon	3.4% (1Q26)	3.5% (1Q26)	3.6% (2Q26)
Exogenous variables			
Exchange Rate (R\$/US\$)	5.55	5.60	5.75
Selic Interest Rate (%) 2024	10.50%	11.25%	11.75%
Selic Interest Rate (%) 2025	9.50%	10.50%	11.25%
Selic Interest Rate (%) 2026	9.00%	9.50%	9.50%
Inflation Expectations (Focus) 2024	4.10%	4.35%	4.55%
Inflation Expectations (Focus) 2025	3.96%	3.95%	4.00%
Inflation Expectations (Focus) 2026	3.60%	3.61%	3.60%

Source: Bloomberg, Central Bank of Brazil, Itaú.

\* Model developed by Itaú replicating Copom's model.

Focus forecasts (% , year-end)						
	2024		2025		2026	
	Previous Copom	Current*	Previous Copom	Current*	Previous Copom	Current*
IPCA	4.35	4.55	3.95	4.00	3.61	3.60
GDP growth	2.96	3.08	1.90	1.93	2.00	2.00
Selic rate	11.25	11.75	10.50	11.25	9.50	9.50
Exchange rate (BRL/USD)	5.40	5.45	5.35	5.40	5.30	5.33

\*considering the latest Focus report.

Source: BCB, Itaú.

## 2 – Asset prices

Since the last Copom meeting and until the publication of this report, the rate on the 10-year US Treasury note has risen 58 bps. The price of Brent crude oil remained practically unchanged, despite some volatility during the period, from 74 to 73 USD per barrel, while the price of agricultural commodities fell slightly and that of industrial commodities remained stable. The exchange rate depreciated to 5.79 from 5.46. The perception of country risk measured by the 5-year CDS increased by 10 bps (to 158).

Asset prices		
	Previous Copom	Current*
UST 10Y	3.70	4.28
Oil price (Brent)	74	73
Agricultural commodities**	622	613
CRB RIND Index***	550	550
CDS 5Y	148	158
Exchange rate (BRL/USD)****	5.46	5.79

\*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.

\*\*\*\*despite the BRL at 5.46 in the day of the Copom meeting, the committee used the BRL at 5.60 in its forecast models, as per its usual rule of using the average of the last 10 working days.

Source: CRB, BBG, Itaú.

### 3 – Recent data

The table below shows the dataset released since the last Copom meeting. The latest inflation indicator (mid-month consumer price index IPCA-15 for October) printed above expectations (0.54% in the month vs. consensus at 0.50%) and its composition was not as benign, showing acceleration in core inflation measures (underlying industrial and services prices).

Regarding economic activity, the labor market continued to show signs that it is heating up, with a lower-than-expected unemployment rate in September (6.4% vs. consensus at 6.5%), a growing real wage bill, and a positive surprise in formal job creation (247k vs. consensus at 224k) in the month.

Economic Indicators: Result vs. Consensus			
Release Date	Indicator	Result	Consensus
25-Sep-24	IPCA-15 (Sep/24) - MoM	0.13%	0.28%
27-Sep-24	IGP-M (Sep/24) - MoM	0.62%	0.50%
27-Sep-24	Unemployment rate (Aug/24)	6.6%	6.7%
27-Sep-24	Formal job creation (Aug/24) - Thousands	232	237
30-Sep-24	Primary fiscal result (Aug/24) - BRL bn	-21.4	-21.2
02-Oct-24	Industrial Production (Aug/24) - MoM	0.1%	0.1%
09-Oct-24	IPCA (Sep/24) - MoM	0.44%	0.46%
10-Oct-24	Core Retail Sales (Aug/24) - MoM	-0.3%	-0.6%
11-Oct-24	IBGE Services Sector Volume (Aug/24) - MoM	-0.4%	0.2%
14-Oct-24	IBC-Br (Aug/24) - MoM	0.2%	0.1%
24-Oct-24	IPCA-15 (Oct/24) - MoM	0.54%	0.50%
30-Oct-24	Formal job creation (Sep/24) - Thousands	247	224
30-Oct-24	IGP-M (Oct/24) - MoM	1.52%	1.51%
31-Oct-24	Unemployment rate (Sep/24)	6.4%	6.5%
01-Nov-24	Industrial production (Sep/24) - MoM	1.1%	1.0%

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

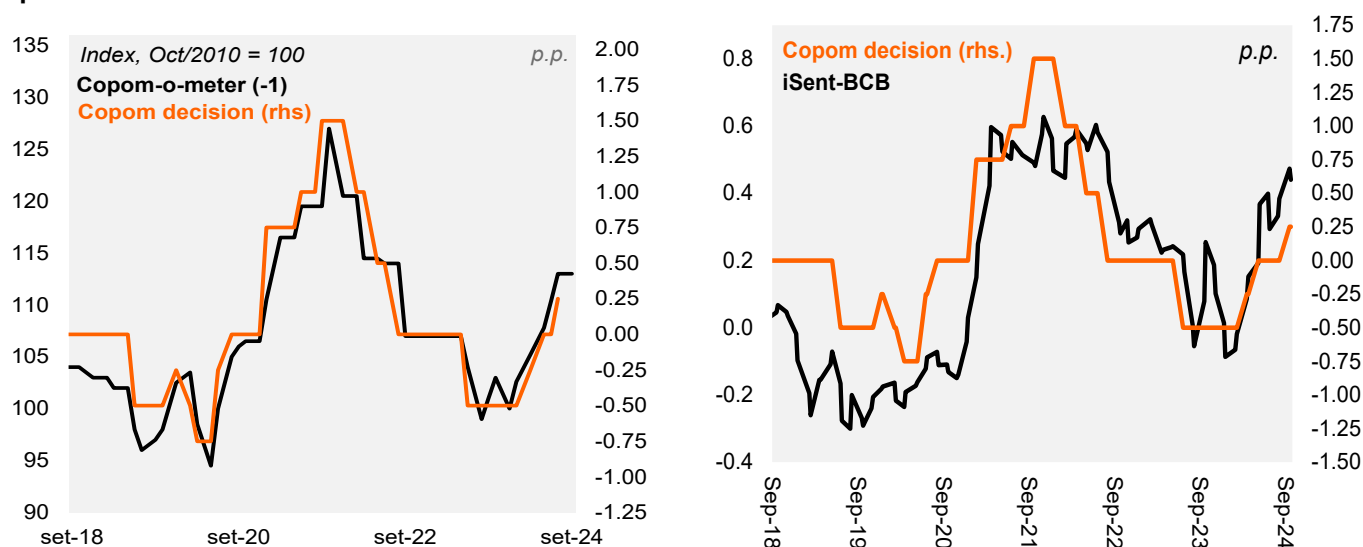
At its last monetary policy meeting, on September 17 and 18, the Copom unanimously decided to start a monetary tightening cycle with a 25-bp increase, taking the Selic rate to 10.75% pa, as widely expected.

The post-meeting statement had left the door open for the pace and magnitude of the cycle, in our view. The 3.5% projection presented for the relevant horizon would be consistent, at the time, with a 150-bp cycle. Additionally, the committee mentioned a positive output gap, and the balance of risks was described as upwardly asymmetrical. The Copom minutes clearly emphasized the cohesion among committee members regarding this gradual start of the tightening cycle and other aspects of the scenario, stressing that the 3% inflation target will be fully met, indicating no acceptance of the tolerance range around this target (this message was later reinforced by committee members in public events).

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, compatible with expectations of a faster hiking pace for the Selic rate.

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 faster increase in the benchmark rate.

### Copom-o-Meter and Itaú iSent Classifier



## 5 – Our view

We expect the Copom to accelerate the adjustment pace to 50 bps (from 25 bps in the previous meeting), taking the Selic benchmark interest rate to 11.25% pa.

Faced with a still challenging scenario – with the exchange rate at a weaker level than at the previous meeting, a tight labor market, and core inflation measures and inflation expectations remaining above the target – the authorities should consider appropriate to increase the pace, moving more quickly into contractionary territory. In this context, they will likely also maintain the assessment of an upwardly asymmetric balance of risks.

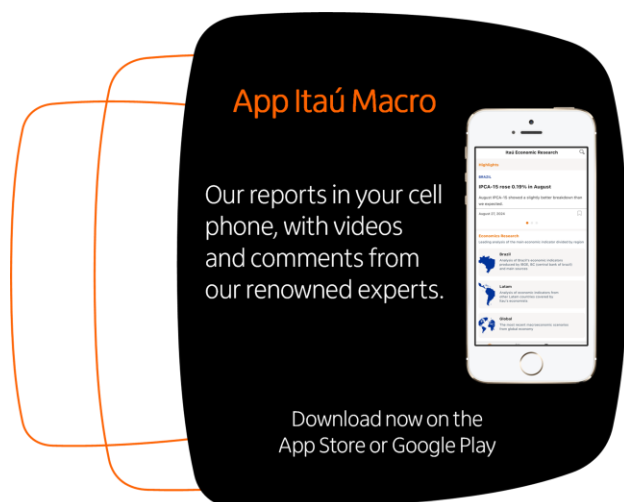
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