

Copom Cockpit: 25-bp cut, uncertain future

- ▶ The Copom will meet again next week amid a still highly uncertain global environment, with a recent deterioration in financial conditions. Since the last meeting, stronger data in the United States – particularly the May payroll, showing an acceleration in the labor market – have added to the pressure stemming from the conflict in the Middle East and contributed to a repricing of the U.S. interest rate path, with consequences for asset prices around the world, including exchange rates, where the trend of USD weakening has begun to flirt with some reversal.
- ▶ Locally, the economic activity data released were also robust, with the cyclical GDP accelerating in the 1Q26 and a still-resilient labor market. We believe that the BCB will revise its output gap estimate, recognizing that we have a stronger economy. Additionally, the prospect of further economic stimulus, which could reduce the room for interest rate cuts, also appeared to have contributed to greater concern among agents regarding the fiscal scenario. Finally, the composition of the latest inflation releases has continued to point to a relevant qualitative deterioration. These factors also resulted in a significant change in the local yield curve, with an increase in the probability assigned to maintenance of the Selic rate at the next meeting.
- ▶ Despite the recent discussion about interrupting the calibration cycle, we assess that the set of information considered by the monetary authority should still allow for a new, modest, interest rate cut at the June decision.
- ▶ The Central Bank's inflation forecast, considering the interest rate path from the Focus survey (which, so far, projects a Selic rate of 13.50% in 2026 and 11.50% in 2027) and with an exchange rate close to current levels (BRL 5.10/USD on the last 10-business-day average), should rise from 3.5% to 3.6% at the relevant horizon. This implies that the interest rate scenario in the Focus survey is inconsistent with the pursuit of the inflation target. However, it does not imply that any calibration path would be inconsistent with it. In a simulation with a constant Selic rate, we estimate that the Copom should see inflation of 3.2% at the relevant horizon (4Q27) and 2.9% in the following quarter (1Q28), which becomes the central point starting from the August meeting. Such levels, in our view, would be compatible with this modest cut.
- ▶ We assess that, in a context of heightened uncertainty, with risks on both sides, for activity and inflation, the authorities should maintain serenity and avoid actions that amplify, rather than reduce, asset price volatility.
- ▶ The release of the Focus survey next Monday could bring some change to these numbers. However, for our inflation estimate of 3.2% at the current relevant horizon (4Q27) to rise beyond 3.3%, the movement in the expectations reported by market participants would have to be significant, on the order of 30 bps for 2027 and 10 bps for 2028 – far greater than the deterioration already observed since the last Copom.
- ▶ In this context, we expect the committee to opt for a 25-bp cut to 14.25% pa, keeping its options open for the next meeting by communicating that, at this moment, the remaining room for any additional calibration is more uncertain. We do not believe the committee will describe the balance of risks for inflation as asymmetric, since such a change could lead the market to begin discussing interest rate hikes more concretely. We continue to see that the current scenario suggests a quite delicate trade-off between advancing in the easing process (particularly, amid the growing domestic uncertainties, given the high degree of leverage of companies and households), and the risk of further deterioration of the inflationary environment. On net, since the last meeting, the total size of the cycle appears to have decreased.

1 – Central Bank Inflation Forecasts

The tables below summarize the forecasts based on our estimated replica of the Central Bank's small-scale model. The exchange rate used (BRL 5.10/USD) follows the Central Bank's procedure of using the average of the last 10 business days ending on the Friday prior to the meeting.

Compared with the April meeting, the committee's inflation forecasts in the reference scenario (which assumes an exchange rate consistent with purchasing power parity and the interest rate path extracted from the Focus survey) are expected to rise to 5.1% in 2026 (from 4.6%) and to increase to 3.6% at the relevant horizon, 4Q27 (from 3.5% previously).

| IPCA forecasts (%) according to "Central Bank model" ^{1*} | | | | | | |
|--|------------------|------------------|-----------------|---------------|---------------|-------------------------|
| Period | November Meeting | December Meeting | January Meeting | March Meeting | April Meeting | June Meeting (forecast) |
| 2026 | 3.6% | 3.5% | 3.4% | 3.9% | 4.6% | 5.1% |
| Relevant Horizon | 3.3% (2Q27) | 3.2% (2Q27) | 3.2% (3Q27) | 3.3% (3Q27) | 3.5% (4Q27) | 3.6% (4Q27) |
| Exogenous variables | | | | | | |
| Exchange Rate (R\$/US\$) | 5.40 | 5.35 | 5.35 | 5.20 | 5.00 | 5.10 |
| Selic Interest Rate (%) 2026 | 12.25% | 12.25% | 12.25% | 12.13% | 13.00% | 13.50% |
| Selic Interest Rate (%) 2027 | 10.50% | 10.50% | 10.50% | 10.50% | 11.00% | 11.50% |
| Inflation Expectations (Focus) 2026 | 4.20% | 4.16% | 4.00% | 3.91% | 4.86% | 5.11% |
| Inflation Expectations (Focus) 2027 | 3.80% | 3.80% | 3.80% | 3.80% | 4.00% | 4.03% |

Source: Bloomberg, Central Bank of Brazil, Itaú.

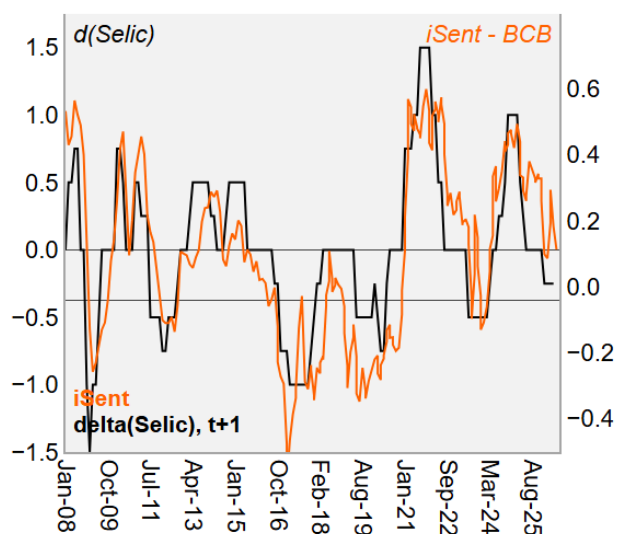
* Model developed by Itaú replicating Copom's model.

2– Pre-meeting context: recent communication and scenario evolution

In the minutes of the last meeting, the authorities reaffirmed the concern with the impacts of the conflict in the Middle East, highlighting both the rise in current inflation and the deterioration in expectations. The document brought a broader discussion of the balance of risks, without making it asymmetric to the upside. The committee combined two biases. On one hand, it expressed concern about the possible effects of the war on supply and distribution chains, a more hawkish reading. On the other, it weighed that part of the previously feared risks, especially the rise in inflation expectations, may already have materialized, without this implicitly justifying a break in the calibration cycle, which adds a more dovish bias. With the latest communications, our classifier [iSent, the BCB Communication Sentiment Index](#)¹ points to a tone closer to neutral (0.15), in line with the considerations made throughout the document.

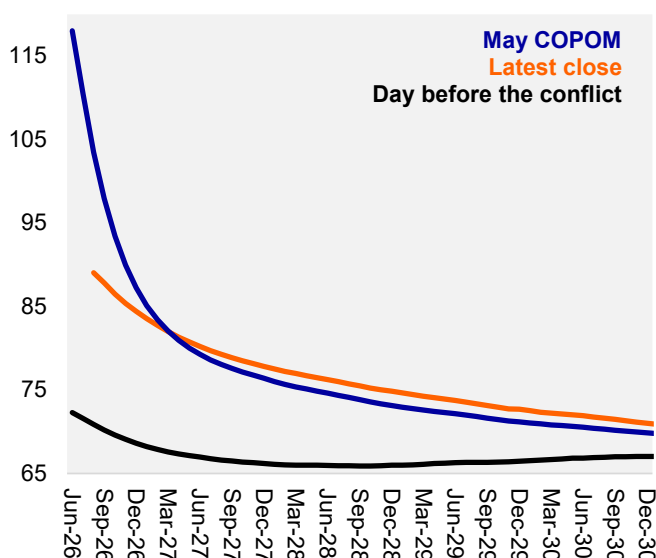
¹ *iSent, Itaú's Central Bank Sentiment Classifier, was developed, with support from GPT-4, by our data science team using sentences published in central banks' official documents, labeled by our economists. Our labeled dataset consists of around one thousand sentences from official documents of the Central Bank of Brazil. Each sentence was classified as dovish, neutral, hawkish, or out of context, and the index is constructed based on the relative presence of each class within the document. The index is a value between -1 and 1 and is higher when the perceived tone is more hawkish. iSent-BCB has a good fit with current and future changes in interest rates in Brazil (correlation of around 0.8).*

Itaú iSent Classifier



Source: BCB, Itaú

Brent oil futures curve



Source: Itaú, BBG

Regarding expectations, since the last meeting the Focus survey estimates rose across all horizons: for 2026, the median jumped to 5.11% from 4.86%; for 2027 and 2028, it advanced to 4.03% and 3.65% from 4.00% and 3.61%, respectively. The expected Selic rate path was also revised upward for 2026 and 2027.

| Focus forecasts (% , year-end) | | | | | | |
|--------------------------------|----------------|----------|----------------|----------|----------------|----------|
| | 2026 | | 2027 | | 2028 | |
| | Previous Copom | Current* | Previous Copom | Current* | Previous Copom | Current* |
| IPCA | 4.86 | 5.11 | 4.00 | 4.03 | 3.61 | 3.65 |
| GDP growth | 1.85 | 1.91 | 1.80 | 1.70 | 2.00 | 2.00 |
| Selic rate | 13.00 | 13.50 | 11.00 | 11.50 | 10.00 | 10.00 |
| Exchange rate (BRL/USD) | 5.25 | 5.15 | 5.35 | 5.20 | 5.40 | 5.30 |

*considering the latest Focus report.

Source: BCB, Itaú.

Since the last meeting, an inflection has been observed in the dynamics of domestic assets. The BRL interrupted its appreciation trend and, although it remains supported by favorable terms of trade, it has lost part of the support associated with the inflow of foreign capital. In this context, the exchange rate returned to levels close to those prevailing before the conflict, around BRL 5.10/USD on the average of the last ten business days, versus BRL 5.00/USD at the previous meeting. Meanwhile, oil stands at around USD 95/bbl, slightly below the levels seen at the April decision.

On activity, 1Q26 GDP accelerated again, rising 1.1% at the margin (versus 0.3% in 4Q25) and 1.8% year-over-year, with the acceleration of cyclical GDP standing out. Regarding inflation, the May IPCA rose 0.58%, above market consensus, with underlying industrial goods standing out (mainly personal hygiene items), which continue to reflect the indirect effect of the oil price shock on goods. On the other hand, underlying services decelerated at the margin, driven mainly by miscellaneous services. Looking at three-month seasonally adjusted moving averages, underlying services retreated to a still elevated 5.6% (from 6.0% in April), while underlying industrial goods jumped to 6.5% (from 5.0%). The average of core measures accelerated from 5.2% to 5.6%. In the labor market, PNAD data points to still-

resilient dynamics, with unemployment at 5.4% seasonally adjusted (versus our estimate of a neutral level between 7.5%-8.0%), while formal job creation (CAGED) came in well below the median of market expectations in April, with the creation of 86 thousand jobs, which shows incipient signs of moderation at the margin, but still at a pace above that consistent with neutrality (98 thousand in the three-month moving average seasonally adjusted, versus a neutral pace of around 60 thousand).

| | | | Economic indicators (actual vs. consensus) | | | | | | | | |
|--------------|---------------------------------|-----------|--|--------|--------|--------|--------|--------|--------|--------|--------|
| | | | Sep-25 | Oct-25 | Nov-25 | Dec-25 | Jan-26 | Feb-26 | Mar-26 | Apr-26 | May-26 |
| Inflation | IPCA (m/m) | Actual | 0.48 | 0.09 | 0.18 | 0.33 | 0.33 | 0.70 | 0.88 | 0.67 | 0.58 |
| | | Consensus | 0.52 | 0.15 | 0.19 | 0.32 | 0.32 | 0.64 | 0.77 | 0.68 | 0.53 |
| | IPCA-15 (m/m) | Actual | 0.48 | 0.18 | 0.20 | 0.25 | 0.20 | 0.84 | 0.44 | 0.89 | 0.62 |
| | | Consensus | 0.52 | 0.21 | 0.18 | 0.25 | 0.22 | 0.56 | 0.29 | 0.98 | 0.57 |
| | IGP-M (m/m) | Actual | 0.42 | -0.36 | 0.27 | -0.01 | 0.41 | -0.73 | 0.52 | 2.73 | 0.84 |
| | | Consensus | 0.36 | -0.23 | 0.28 | 0.15 | 0.38 | -0.61 | 0.52 | 2.55 | 0.81 |
| Labor market | Unemployment rate (PNAD, %) | Actual | 5.6 | 5.4 | 5.2 | 5.1 | 5.4 | 5.8 | 6.1 | 5.8 | - |
| | | Consensus | 5.5 | 5.5 | 5.4 | 5.1 | 5.4 | 5.7 | 6.1 | 5.9 | - |
| | Formal job creation (thousands) | Actual | 213 | 85 | 86 | -618 | 112 | 255 | 228 | 86 | - |
| | | Consensus | 170 | 110 | 77 | -473 | 95 | 258 | 148 | 216 | - |
| Activity | PIM (m/m) | Actual | 0.4 | 0.1 | 0.0 | -1.2 | 1.8 | 0.9 | 0.1 | 0.7 | - |
| | | Consensus | -0.4 | 0.5 | 0.1 | -1.1 | 0.7 | 0.8 | -0.1 | 0.5 | - |
| | PMC (m/m) | Actual | -0.3 | 0.5 | 1.0 | -0.4 | 0.4 | 0.6 | 0.5 | - | - |
| | | Consensus | 0.3 | -0.1 | 0.3 | -0.2 | -0.2 | 0.9 | 0.0 | - | - |
| | PMS (m/m) | Actual | 0.6 | 0.3 | -0.1 | -0.4 | 0.3 | 0.1 | -1.2 | - | - |
| | | Consensus | 0.4 | 0.3 | 0.1 | -0.1 | 0.1 | 0.5 | -0.1 | 0.8 | - |
| | IBC-Br (m/m) | Actual | -0.2 | -0.3 | 0.7 | -0.2 | 0.8 | 0.6 | -0.7 | - | - |
| | | Consensus | -0.2 | 0.1 | 0.4 | -0.4 | 0.9 | 0.5 | -0.4 | - | - |

Data in red/blue suggest results consistent with a tighter/looser monetary policy, relative to market consensus.

Source: IBGE, Central Bank of Brazil, Ministry of Economy and Bloomberg

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