Blue Notes | Weekly | November 1, 2019

Fed and Copom reveal their next steps. This was a positive week for the markets despite some surprises with the Fed and the Copom´s monetary policy forward guidance. The Fed indicated the end of the mini cycle, showing small chances of a rate hike following. The Copom assured another 50bps rate cuts in December and a more gradual approach after that. On the political front, noise raised in Brazil, but not as much as compared to our neighbors in Argentina, Chile and Peru. Next week, markets will focus on the pre-salt oil auction in Brazil, on the Copom minutes and (finally) on the so-expected package of reforms that follow the social security reform.

The Copom could cut rates until 4.25%, at least. This week the Copom delivered another 50bps rate cut, in line with market consensus. The central bank´s inflation forecasts that already consider a Selic rate as low as 4.5% are considerably below the target for the next three years, showing room for cuts that would take rates below 4.5%. Benign inflation dynamics leave the Copom comfortable to cut 50bps in the next meeting and then moving to a more gradual approach after that. Given Copom´s communication, we expect rates to be cut by 50bps in December and by another 25bps in February 2020, which would take the Selic rate to 4.25%.

Credit-sensitive economic activity already responds to monetary stimuli. Assuming the current Selic rate of 5% e and inflation expectations at 3.4%, we reach real rates of 1.6%, levels that were rarely visited in the recent history of Brazil (plot). As we have been highlighting in our recent publications, these monetary stimuli have already showed its effects on economic activity that are credit intensive. Industrial production report showed a 0.3%m/m seasonally adjusted increase, below expectations but showing strong growth on durable goods production and on raw material for civil construction, confirming the positive expectations for these sectors.

The Fed seems comfortable at the current rate levels. In the US, the Fed also delivered the expected 25bps rate cut taking rates to the 1.50-1.75% range. The guidance on future rate moves, that hinted the current easing cycle is coming to an end was less of a consensus in the markets. In any regard, risks of rate hikes seen low since Chairman Powell said during the press conference after the decision that, for a rate hike to happen, a significant and persistent increase in inflation would be necessary. Numbers on the activity front continue to show a heated labor market, despite all the uncertainty that surrounds the trade war and the slowdown in manufacturing activity, without high risks of an imminent recession.

Pre-salt auction and reform agenda at the spotlight. Two events that are largely expected by markets should happen next week: the pre-salt oil auction and the announcement of the government´s fiscal package.