

---

**From:** Daniel Sabba [REDACTED]  
**Sent:** 6/11/2015 5:23:36 PM  
**To:** jeffrey E. [jeevacation@gmail.com]  
**CC:** Paul Morris [REDACTED]; Stewart Oldfield [REDACTED]; Vahe Stepanian [REDACTED]; Ariane Dwyer [REDACTED]; Richard Kahn [REDACTED]  
**Subject:** FW: Faria: Brazil Daily Update [C]

Classification: Confidential

-----Original Message-----

**From:** Isin Sumengen-Ziel (DEUTSCHE BANK AG, LO) [mailto:[REDACTED]]  
**Sent:** Thursday, June 11, 2015 1:08 PM  
**Subject:** Faria: Brazil Daily Update

COPOM minutes maintain hawkish tone, signaling further tightening:

The BCB published the COPOM minutes explaining last week's decision to raise the SELIC rate by 50bps to 13.75%. There were very few changes in the document, suggesting that the tightening cycle will continue. We now expect another 50bp rate hike for the next meeting in July. We expect this to be the final increase in rates, although the risk seems tilted toward additional hikes.

There was a meaningful change on paragraph 28, toward a more hawkish tone. The BCB repeated that two main changes in relative prices (FX depreciation and increase in administered prices) are affecting inflation in the short-run and keeping it high in 2015, but added that this will require "determination and perseverance to prevent its transmission to longer periods." The choice of words could indicate not only that there is more tightening to be done, but also that once the cycle has ended, it could take a relatively long time for the BCB to cut rates again.

Regarding the official inflation forecasts, assuming an exchange rate of BRL3.15/USD, SELIC rate of 13.25%, and increase in administered prices of 12.7% in 2015 (up from 11.8%) and 5.3% for 2016 (vs. 5.2%), the passive IPCA forecasts increased and remained above the 4.5% target for 2015, and remained unchanged and above the target for 2016.

The BCB is due to publish its revised forecasts in detail in its quarterly Inflation Report at the end of June. Assuming a SELIC rate of 12.75%, exchange rate at BRL3.15/USD and GDP contraction of 0.5% this year, the Inflation Report published at the end of March forecast inflation of 4.9% for 2016. We believe the BCB's passive inflation forecast will be lower in the June report, given that the SELIC rate has climbed to 13.75%, the GDP outlook looks much worse, and the currency is roughly at the same level. However, the fact that the COPOM minutes reported no reduction in the 2016 IPCA forecast (assuming a SELIC rate of 13.25%, i.e. before the decision to raise it by another 50bps) suggests to us that the Inflation Report's forecast for 2016 will not reach 4.5% yet (even though it could show a number closer to 4.5% for 2Q17).

Thus, although we still expect the BCB to base its monetary policy decisions mainly on its own inflation forecast than on the market's forecast for 2016 (which was still at 5.5% last week, according to the Focus survey), we now believe the BCB is not done hiking rates yet. Since there was no indication of a reduction in the pace of hikes in the minutes, we believe another 50bp increase in July is more likely than a 25bp hike. We believe the extra 50bps will probably be enough to make the BCB's inflation forecast converge to 4.5% in 2016, although the authorities will likely keep the door open for additional tightening, contingent on the upcoming data.

The BCB unexpectedly reduced the rollover of FX swaps again. On Wednesday night, the BCB announced that it would offer today 6,300 contracts to roll over the USD8.7bn in FX swaps due on July 1. Until now, the BCB was offering 7,000 contracts per day, a pace that would have led to a rollover of 80% of the next maturity. By maintaining the lower pace announced on Wednesday until the end of the month, the BCB would roll over approximately 75% of the maturity. Thus, the BCB continues to signal that it is comfortable with a weaker BRL (which stimulates net exports and helps reduce the current account deficit), taking advantage of appreciating movements to reduce the supply of FX swaps (which are currently at approximately USD111bn), and using interest rates to curb inflation.

IGP-M higher than expected

The first June preview of the IGP-M inflation index came in at 0.47%, slightly down from 0.51% in the first May preview but higher than our forecast of 0.30%. Wholesale prices (60% of the index) rose 0.35%, compared to 0.56% in the first May preview, as agricultural prices fell 0.45% (vs. -1.52), led by lower prices of soybeans and corn, and industrial prices decelerated less than expected to 0.65% from 1.37%, as iron ore prices rose 4.9%. Consumer prices (30% of the index) accelerated to 0.60% from 0.47%, led by food (0.66% vs. 0.10%) and assorted expenses (5.24% vs. 0.42%), mainly reflecting the hike in lottery tickets. Construction costs (10% of the index) also advanced to 0.90% from 0.27%, led by labor costs. We expect the IGP-M to rise approximately 0.50% in June.