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International Commentary — December 12, 2024

Brazil's "Whatever It Takes" Moment

But Will "It" Be Enough?

Summary

Brazilian Central Bank (BCB) policymakers delivered a much-needed hawkish monetary policy adjustment at its December Copom meeting, all but explicitly saying they would not tolerate unanchored inflation expectations any longer. In addition to an outsized rate hike, policymakers signaled large rate hikes are to persist well into 2025. While aggressive rate hikes can offer near-term support to the currency, we maintain our view that the Brazilian real will weaken and underperform over the longer-term. Fiscal policy, not BCB monetary policy, in our view, will be the driving force of Brazilian real depreciation, especially as spending ramps up ahead of the 2026 presidential election.

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All estimates/forecasts are as of 12/12/2024 unless otherwise stated. 12/12/2024 9:13:26 EST. **This report is available on Bloomberg WFRE**

Campos-Neto Goes Full Hawk On His Way Out

Yesterday, the Brazilian Central Bank (BCB) had its “whatever it takes” moment. Maybe not as dramatic as Mario Draghi's “save the euro” speech, but with local inflation rising and inflation expectations becoming more unanchored, BCB policymakers drew their line in the sand. In an effort to ensure price stability and maintain financial market stability, policymakers delivered one of the more hawkish monetary policy decisions of the post-pandemic era at the Monetary Policy Committee's (Copom) December meeting. To that point, the BCB doubled the pace of its tightening and unanimously raised the Selic rate 100 bps to 12.25%. In addition, policymakers offered forward guidance that similar 100 bps hikes would also be delivered at both the January and March Copom meetings. While we had correctly forecast the 100 bps hike in December—and forecast a 100 bps hike in January before yesterday's meeting—policymakers' commitment to match that magnitude of tightening in March is a hawkish surprise. In addition to policy rate decisions and commitments, central bankers also called an FX auction in an attempt to stabilize the Brazilian real and halt FX pass through from contributing additional inflationary pressures. The combination of the hawkish interest rate adjustment and FX intervention have combined for Brazilian real strength this morning, despite more subdued overall moves across currency markets. Following yesterday's actions we are revising our Brazilian Central Bank Selic rate forecast higher. We now believe a terminal rate of 15.25% will be reached by the middle of 2025, and we reinforce our view that BCB rate cuts will not be delivered in 2025.

While recent BCB actions can support BRL in the near-term, we maintain our view for Brazilian real depreciation and underperformance relative to peer Latam currencies over the longer-term. We expressed this long-term outlook in multiple notes (see: Brazil's Fiscal Fiction To Foil BRL & 2025 International Economic Outlook), but to quickly summarize, we believe the fundamental path of the Brazilian real will be primarily determined by local fiscal policy, not BCB monetary policy. Under the Lula administration, fiscal discipline has been elusive. Public finance metrics have worsened, and while the fiscal framework remains intact, market participants, including us, question its viability/sustainability leading into the 2026 presidential election. While we are not calling for the fiscal framework to be abandoned, we do believe that a watering down of the stipulations or use of financial accounting to evade spending restrictions, is likely to materialize. In our view, following poor performance from Lula's Workers' Party and affiliated political parties, we believe Brazil's public finances will worsen further over time as Lula uses fiscal spending to boost his approval ratings and performance at the polls. As Brazil's deficit widens and debt burden rises, market participants are likely to lose some confidence in Brazil's fiscal credibility, resulting in capital outflows and a weaker Brazilian real. Combined with a global backdrop of broader U.S. dollar strength, we believe the USD/BRL exchange can reach BRL7.00 by Q1-2026. Should the Brazilian real reach our long-term target, the currency would hit its weakest point against the U.S. dollar on record.

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