Macro Monthly Letter

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When will the cuts come? And how far can they go?

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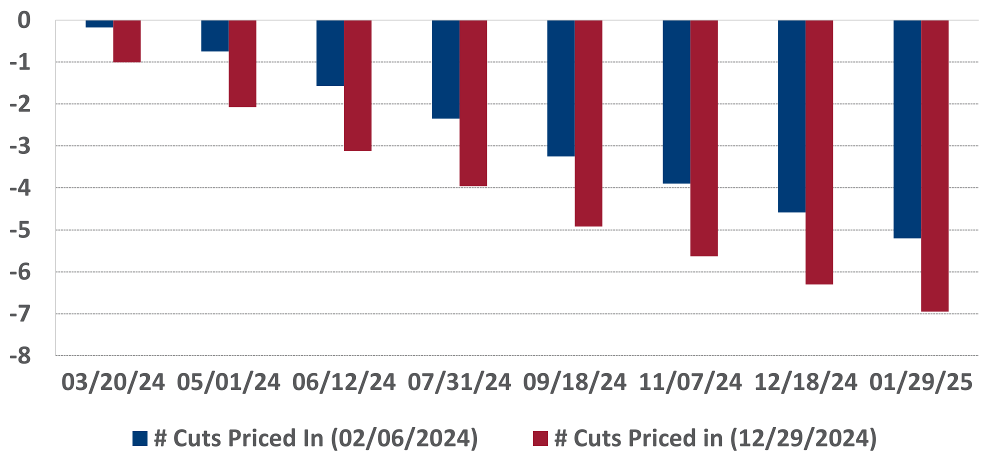
Concern about the disinflation process, which could decelerate in 2024, brought back discussions on the start of monetary loosening in the United States. While on one hand there remains little doubt that US monetary policy is in restrictive territory, on the other hand the resilience of the economy, as shown by several indicators of activity, may suggest a need to keep interest rates at a restrictive level for a longer period.

The reason is that interest rates are one of the main channels for monetary policy transmission, since they influence aggregate demand via households' spending decisions and companies' investment decisions. Disinflation processes have historically been accompanied by sharper deceleration of the economy, but this is not the case in the current cycle: economic activity remains strong even with disinflation under way.

After deciding to leave rates on hold again at its latest meeting, the FOMC recognized that the dynamics of inflation had improved but remained cautious about the timing of rate cuts. Fed Chairman Jerome Powell surprised the markets by saying monetary loosening was unlikely to start in March (Figure 1), and this guidance changed the pricing-in of rate cuts. After the previous meeting, in December, the FOMC signaled that cuts had been discussed and might start soon. So what conditions will give it sufficient confidence for monetary loosening can begin?

Figure 1: US, Number of Cuts (25 bps) Priced In

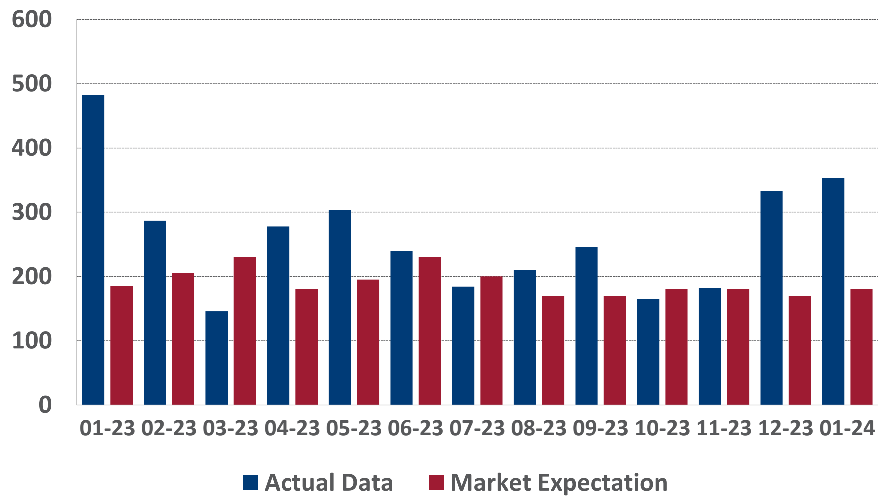


Source: BOCOM BBM, Bloomberg

In light of the uncertainty about the speed with which US inflation is moving toward the target, the FOMC has reiterated that it will go on waiting to see from current data whether the trend is continuing. It wants to make sure that inflation dynamics are compatible with convergence to the target and that the economy is not overheating. However, any deviation from the desired path results in new changes in interest-rate futures pricing.

A recent example came with the January nonfarm payrolls report showing job creation to be almost twice as high as the consensus forecast, alongside a significant upward revision of the data for the previous two months (Figure 2). Taken at face value, the numbers point to a very strong economy, although important methodological issues lie behind them, such as a high non-response rate and apparent post-pandemic breaks in seasonal patterns, making it hard to draw many conclusions from this new information.

Figure 2: US, Payroll Employment Monthly Pace (Thousands)

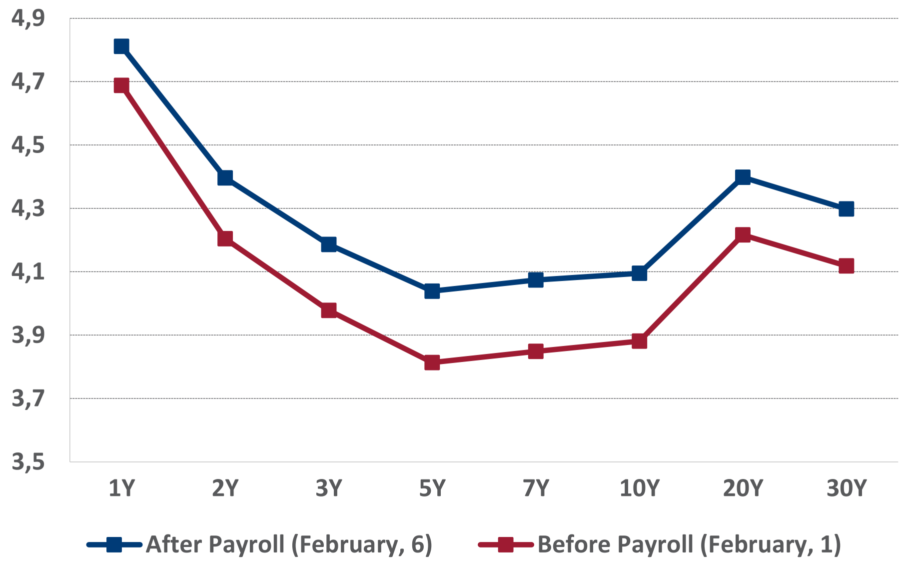


Source: BOCOM BBM, Bureau of Labor Statistics

Noisy data in conjunction with monetary policy management that provides scant guidance regarding next steps generates market volatility. After the jobs numbers were announced, the US yield curve was repriced upward, steepening at all main points (Figure 3).

In Brazil, in contrast with the US, the Central Bank stuck to its view that lowering its policy rate by 50 bps per meeting remained a suitable pace for the foreseeable future, and the Brazilian yield curve held steady, even after a battery of data showing that the economy remained sound, especially in services, industrial production and the labor market. In countries where rate cuts have begun, the discussion focuses on how far they will go, especially considering that US monetary loosening may not begin soon.

Figure 3: US, Yield Curve



Source: BOCOM BBM, Bloomberg

Our projection for the year-end Selic is now 9.5%, bearing in mind the prospect of growth in 2024, albeit at a slower pace, and the ongoing effects of climate factors on food inflation. This projection is very close to the consensus forecast, which is 9.3%. Our other projections are shown in the table below.

ECONOMIC FORECASTS	2020	2021	2022	2023F	2024F	2025F
GDP Growth (%)	-3.3%	4.8%	3.0%	3.0%	1.6%	2.0%
Inflation (%)	4.5%	10.1%	5.8%	4.6%	3.8%	4.0%
Unemployment Rate (eoy ,%)	14.2%	11.1%	7.9%	7.4%	8.4%	8.5%
Policy Rate (eoy, %)	2.0%	9.3%	13.75%	11.75%	9.50%	8.75%
External Accounts						
Trade Balance MDIC (US$ bn)	50	61	62	99	87	78
Trade Balance (US$ bn)	32	36	44	81	67	58
Current Account Balance (US$ bn)	-28	-46	-54	-29	-34	-43
Current Account Balance (% of GDP)	-1.9%	-2.8%	-2.8%	-1.3%	-1.5%	-1.8%
Fiscal Policy						
Central Government Primary Balance (% of GDP)	-9.8%	-0.4%	0.5%	-2.1%	-0.8%	-0.8%
Government Gross Debt (% of GDP)	86.9%	77.3%	71.7%	75.4%	78.7%	80.6%