

Brazil Flash

Monetary conditions are tightened to prevent inflation from running out of control

The Monetary Policy Committee (COPOM) decided to raise the SELIC rate by 25bp to 7.50%, in line with our call. By hiking the reference interest rate, the COPOM is attempting to rein-in inflation (especially medium-term expectations) at the expense of potentially higher risks on both the domestic and also the external front. We expect no more than three further 25bp hikes ahead, and thus the SELIC rate to continue at relatively low levels (for Brazilian standards) at the end of this tightening cycle.

- **“Domestic and especially external uncertainties ... require that monetary policy be managed with caution”**

The decision to hike the SELIC by 25bp was non-unanimous: two out of the eight members of the COPOM favored the stability of the SELIC rate at 7.25%. The decision was aligned with our call, but did not match the expectations of a relevant part of the market (many were expecting the SELIC to be left unchanged while others forecasted a 50bp adjustment). In the accompanying statement, the monetary authority revealed that inflation is currently the main source of concerns, even though domestic and especially external uncertainties remain high, requiring caution ahead. The statement was as follows: “The COPOM decided to raise the SELIC rate to 7.5 percent a year, without bias, by six votes in favor and two for holding the rate at 7.25 percent a year. The Committee considers that the high level of inflation and the dispersion of price increases, among other factors, contribute to the resilience of inflation and require a monetary policy response. On the other hand, the COPOM considers that domestic and principally external uncertainties surrounds the prospective inflation outlook and requires that monetary policy be managed with caution.”

- **A soft monetary tightening cycle ahead**

Considering that inflation is currently above the 6.5% target ceiling, price pressures are widespread (as signalled by diffusion indexes), and, most importantly, inflation expectations are not well-anchored (expectations for the end of 2014 are around 5.7% -well above the 4.5% target- and increasing), the decision to start a monetary tightening cycle should be seen as good news. However, this decision is not costless. On the one hand, it should have a negative (although relatively small) impact on economic growth and on credit markets. On the other hand, it could generate appreciatory pressures on the exchange rate, which could end up triggering the adoption of more measures to prevent the Brazilian Real from appreciating more sharply. Taking into account these costs, the natural dovishness of this BCB board and our perception that this cycle will be adopted to anchor medium-term inflation expectations around 5.5% (and not to drive domestic demand down in order to guarantee that inflation converges to the 4.5% target) we expect this monetary tightening cycle to be relatively soft. More precisely, we forecast three 25bp adjustments in the next three monetary meetings (in May, July and August), although the last of these three hikes could be aborted as by then we expect inflation pressures to ease somewhat.

For more on Brazil, [click here](#)

Las condiciones monetarias han sido ajustadas para prevenir que la inflación salga de control

El Comité de Política Monetaria (COPOM) decidió incrementar el SELIC en 25 puntos hasta el 7.50%, en línea con nuestras expectativas. Aumentando el tipo de interés de referencia, el COPOM pretende controlar la inflación (especialmente las expectativas de mediano-plazo), a expensas de afrontar mayores riesgos, tanto internos como externos. Esperamos no más de tres incrementos adicionales de 25bp cada uno en los próximos meses y, por tanto, que el SELIC continúe a relativamente bajos niveles al final de este ciclo de ajuste.

Para ver más acerca de Brasil, [haga clic aquí](#)

DISCLAIMER

This document and the information, opinions, estimates and recommendations expressed herein, have been prepared by Banco Bilbao Vizcaya Argentaria, S.A. (hereinafter called "BBVA") to provide its customers with general information regarding the date of issue of the report and are subject to changes without prior notice. BBVA is not liable for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, or to undertake or divest investments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. The contents of this document are based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. BBVA accepts no liability of any type for any direct or indirect losses arising from the use of the document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, options and securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such circumstances; investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying stocks. Investors should also be aware that secondary markets for the said instruments may be limited or even not exist.

BBVA or any of its affiliates, as well as their respective executives and employees, may have a position in any of the securities or instruments referred to, directly or indirectly, in this document, or in any other related thereto; they may trade for their own account or for third-party account in those securities, provide consulting or other services to the issuer of the aforementioned securities or instruments or to companies related thereto or to their shareholders, executives or employees, or may have interests or perform transactions in those securities or instruments or related investments before or after the publication of this report, to the extent permitted by the applicable law.

BBVA or any of its affiliates' salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates' proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

In the United Kingdom, this document is directed only at persons who (i) have professional experience in matters relating to investments falling within article 19(5) of the financial services and markets act 2000 (financial promotion) order 2005 (as amended, the "financial promotion order"), (ii) are persons falling within article 49(2) (a) to (d) ("high net worth companies, unincorporated associations, etc.") Of the financial promotion order, or (iii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the financial services and markets act 2000) may otherwise lawfully be communicated (all such persons together being referred to as "relevant persons"). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is available only to relevant persons and will be engaged in only with relevant persons. The remuneration system concerning the analyst/s author/s of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

BBVA is not a member of the FINRA and is not subject to the rules of disclosure affecting such members.

"BBVA is subject to the BBVA Group Code of Conduct for Security Market Operations which, among other regulations, includes rules to prevent and avoid conflicts of interests with the ratings given, including information barriers. The BBVA Group Code of Conduct for Security Market Operations is available for reference at the following web site: www.bbva.com / Corporate Governance".

BBVA is a bank supervised by the Bank of Spain and by Spain's Stock Exchange Commission (CNMV), registered with the Bank of Spain with number 0182.