

Brazil

Economic Watch

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Economic Analysis

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Reserve requirements increased by the Central Bank in Brazil

- The Central Bank announced this morning in Brazil that reserve requirements on time deposits will be increased from 15% to 20%. The additional reserve requirements on demand and saving deposits will rise from 8% to 12%. According to the Central Bank these measures will remove R\$ 61 billion from the economy.
- The monetary authority also increased capital requirements for household loans that exceed 2 years.
- These decisions follow the recent deterioration of inflation and the strong growth of credit figures, which have been supported by the dynamism of domestic demand.
- Inflation has been surprising high in the last months and is expected to close the year around 6%, much more than expected some months ago and also higher than the 4.5% inflation target for this year. Inflation perspectives for 2011 have also trended up recently (market consensus is currently at 5.2%).
- On the other hand, the Brazilian credit stock continues to grow robustly in spite of the monetary tightening cycle implemented this year. In October, total credit expanded 20.3%y/y (real estate loans grew 51.1%y/y).
- With these measures policy makers in Brazil are trying to moderate the current credit growth process and inflation pressures. In our view, they also are trying to make room for the SELIC to remain constant in coming months as markets bet on a new monetary tightening cycle increased significantly last weeks.
- The Central Bank's Monetary Policy Committee meets next week and we – as most of the market - expect the SELIC to be left unchanged, especially after today's announcements.
- Although the likelihood that the Central Bank starts a new monetary tightening cycle in January increased recently, we think that the chances of the SELIC remaining stable next year are higher than markets are currently discounting. The recent comments from government officials supporting a tighter fiscal policy as soon as in the beginning of 2011 also support this view.
- We expect the Central Bank's next moves (SELIC decision next week and minutes to be released the following week) to provide more information on SELIC's future path.

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