Brazil Flash

CB cuts the SELIC rate by 50bps to 11.0%

In the last meeting of the year, the CB's Monetary Policy Committee decided to reduce the benchmark interest rate by 50bps by the third time in a row. We expect at least two more 50bps cuts at the beginning of 2012. Additional easing should not be ruled out and would, more likely, be implemented by prolonging the cycle of 50bps adjustments and not by cutting rates at a more aggressive pace.

- **The move was widely expected.**
  The unanimous decision to cut the SELIC rate by 50bps was expected by most, including us. The bets on a sharper cut lost momentum after the CB authorities insisted on referring to "moderate adjustment" during previous weeks.
- **The communiqué kept the reference to "moderate adjustment".**
  The accompanying statement released yesterday after the close of the markets in Brazil was as follows: "Continuing the process of adjustment in monetary conditions, the Monetary Policy Committee (COPOM) decided unanimously to reduce the SELIC rate to 11.00%, without a bias. The COPOM understands that, by mitigating in a timely way the effects coming from a more restrictive global environment, a moderate adjustment in the level of the reference interest rate is consistent with the scenario of convergence of inflation to the target in 2012." This statement was identical to that released after the previous meeting in October. The inclusion of the term "moderate adjustment" was already expected and suggests that monetary easing should continue next year at the same pace.
- **Two-more 50bps cuts ahead, at least.**
  We now expect the CB to front-load extra downward adjustments meaning it should cut the SELIC rate by 50bps in each one of its next two meetings to be held on January 18 and March 7. By the end of the first quarter of 2012, therefore, the SELIC rate should be at 10.0%. Although we attach a higher probability for the CB keeping the SELIC stable at 10.0% from the end of the first quarter on, additional cuts should be implemented if global turbulences intensify and developed economies enter into recession (our risk scenario) or if the government announces a sharp reduction in public expenditures and put fiscal accounts on track for meeting the 3.1% of GDP primary surplus target (our call is for a 2.7% surplus). In addition, the re-weighting of the IPCA in line with more recent spending habits, which was announced this week, will imply the downward revision (around 30bps) of inflation forecasts for 2012 and, therefore, will add to the risks of a more prolonged monetary easing next year.

For more on Brazil, **click here**

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