Brazil Flash

CB sees, once again, more favorable balance of risks for inflation

In its Inflation Report released today, the CB reinforced both its negative view about the global economy and its focus on the recent domestic moderation (instead of on the acceleration ahead). The monetary authority sees 2012 inflation converging to the target and 2013 inflation somewhat above target. Today's report does not change our SELIC call: a last 75bps cut in April and rates constant at 9.0% for a long period (longer than markets are currently expecting).

- **Monetary authority revised 2012 inflation down and 2013 inflation up**

  CB's Inflation Report did not bring many surprises. In addition to the dovish view on global and local risks, the monetary authority reemphasized its view that inflation will converge to the target this year (in contrast with our assessment, which can be found below). CB's models show inflation around 4.4%-4.5% at the end of 2012 (in comparison to the 4.7%-4.8% forecasts announced in December's Inflation Report). For 2013, inflation is now forecasted to be around 5.3%, in comparison to 4.7% in the "reference scenario" and 5.2% in the "market scenario" presented three months ago.

- **References to lower neutral rates and to a SELIC close to historical lows were kept**

  In today's reports the CB referred once again to the structural changes that allowed a reduction of interest rates (including the neutral one) in the last years. The signalling on future rates was also kept: "the Monetary Policy Committee attaches a high probability for the scenario in which the SELIC falls to a level slightly above the historical low, and stabilizing at that level". Therefore, the CB made again practically explicit the idea to soon bring rates to 9.0% – which is slightly above the 8.75% historical low – and to adopt a pause at that level.

- **"A 3.5% GDP growth is compatible with external and domestic equilibrium".**

  The CB sees GDP growth at 3.5% in 2012 (in comparison to our 3.1% forecast). More importantly, the monetary authority sees this pace as the one compatible with external and domestic equilibrium. We, therefore, save the 3.5% rate as a reference for the future as lower (higher) SELIC rates could be delivered if GDP turns out to be lower (higher) than 3.5%.

- **We expect inflation to remain above 5.0% and SELIC to be at 9.0% till the end of 2013**

  Yearly inflation dropped from 7.5% in October of 2011 to 5.9% in February due to some moderation in economic activity and, especially, to a significant base effect. Both factors should continue playing a role for some few months. Next week March's IPCA will be released and we expect it to come up at 5.5% (0.4%m/m), with downside risks. Inflation downward trend will continue in April and May, when we expect it to reach 5.1%. From then on, both economic activity recovery and much less positive base effects will prevent inflation from going further down. More precisely, we expect inflation to fluctuate around the 5.3% mark and to close the year close to 5.4%. For 2013, inflation should average 5.6% and close the year not far from this average. Inflation above target should not intimidate this Central Bank board: a 75bps cut is expected to be announced in April and then SELIC should be stable at 9.0% for a long time (longer than the market is currently discounting).

Enestor Dos Santos
enestor.dossantos@bbva.com
+34 639 82 72 11

BBVA | RESEARCH | Pº Castellana 81, Floor 7, 28046 Madrid | Tel.: +34 91 374 60 00 | www.bbvaresearch.com

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