Brazil Flash

Industrial production surprises to the downside and reinforces signs of slower than expected recovery

Industrial production dropped 0.5%m/m in March and frustrated markets which expected a 1.2%m/m expansion. The result should reinforce the concerns about industrial sector's lack of competitiveness and could end up triggering the announcement of more measures to support the sector (including the adoption of a new scheme to remunerate saving accounts, which could create room for an even lower SELIC).

- **Industrial production weakness creates downside risks to GDP growth and, therefore, to our current SELIC call**

  Official data released today showed (once more) how fragile the industrial sector is at the current juncture: industrial production declined 0.5%m/m in March in comparison to February, 2.1%y/y in comparison to the same period last year, and 3.0% in the first quarter of the year in comparison to the fist quarter of 2011. As we have been pointing out in our reports, this weakness is related to the appreciation of the real, the labor markets tightness and to series of structural problems such as high tax burden and poor infrastructure. We should add, however, that a weaker than expected domestic demand recovery seems also to be helping to drive industrial production down at the beginning of 2012. In this environment, therefore, Q1 GDP could end up growing less than we are currently forecasting (0.6%q/q). In the same line, the batch of data released today also reinforces the non-negligible downside risks to our current SELIC call (25bps cut in May and SELIC stable at 8.75% for a long time from then on). Regarding the latter, local news report today that the government could soon announce a change in the remuneration of saving accounts which would create more space for the SELIC to move down (see the Flash note "Monetary easing to continue 'with more parsimony'" to read more about the links between saving accounts remuneration and the SELIC rate).

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