

Brazil Flash

CB sees inflation risks more balanced but leaves door open for a final SELIC cut

Domestic risks for inflation are now more equilibrated in comparison to some months ago -when the balance was considered favorable- and external risks for inflation show an upward bias in the short-term due to food prices and a downward bias in the medium-term, according to the Inflation Report released today by the CB. Even though a pause at 7.50% should not be ruled out, we continue expecting a final 25bps SELIC cut in October.

- **CB revised 2012 inflation forecasts upwards and 2013 figures downwards.**

The CB adjusted upwards its inflation forecasts for the end of 2012 from 4.7% three months ago to 5.2% due to the impact of the recent depreciation of the exchange rate and, especially, higher food prices. Inflation forecasts for 2013, which by now should be the main focus of the monetary authority, were cut to 4.8%-4.9% from 4.9%-5.0% due to lower energy prices. Regarding activity forecasts, the CB cut its 2012 GDP forecast from 2.5% to 1.6% and continued referring to a more solid domestic recovery in the second half of the year. In the report released today, the monetary authority highlighted the negative impact on inflation of higher food prices (due to climate shocks), but also the view that these prices will have a more benign performance in the medium-term. The external shock is also expected by the CB to be more supportive in the medium-term when commodity prices moderate and the impact of a low growth environment weighs on. In response to the fiscal incentives being provided by the government, the CB commented that the fiscal stance is now slightly expansionary and not neutral anymore. The fact that inflation forecasts rely on the assumption that fiscal targets will be met was also noted. All in all, the Inflation Report showed that inflation risks are now more balanced than in the recent past, when the domestic activity slowdown and external turbulences created a favorable balance of risks for inflation.

- **“If the prospective scenario allows for an additional adjustment, this move will be conducted with maximum parsimony”**

Even though the chances of the CB keeping the SELIC stable in October are now -after the release of the Inflation Report- higher, we continue expecting a final 25bps cut to be delivered in October. In any case, we expect the policy interest rate to stay constant after October -either at 7.50% or at 7.25%- for a long period as the external environment should continue turbulent, world growth relatively low and the domestic output in negative territory until the end of 2013.

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El BC ve el balance de riesgos para la inflación más equilibrado, pero deja la puerta abierta para un recorte final del SELIC

Los riesgos internos para la inflación están ahora más equilibrados -en comparación con hace algunos meses cuando el balance era considerado favorable- y los riesgos externos muestran un sesgo al alza en el corto plazo debido a los precios de los alimentos y un sesgo a la baja en el mediano-plazo, de acuerdo con el Informe de Inflación divulgado hoy. A pesar de que no se pueda descartar una pausa, continuamos esperando un recorte final de la SELIC en 25 puntos en octubre.

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