

Brazil

Economic Watch

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Economic Analysis

Enestor Dos Santos
enestor.dossantos@grupobbva.com
+34 91 537 68 87

Inflation concerns trigger new monetary tightening cycle in Brazil

- After leaving the SELIC rate unchanged during the whole second half of 2010, the Central Bank decided to adjust the reference interest rate up by 50 bps to 11.25%. The decision was aligned with BBVA and markets' expectations.
- The Central Bank's accompanying statement was as follows: "The Monetary Policy Committee decided unanimously to increase the SELIC rate to 11.25%, without a bias, starting an adjustment process in the reference interest rate, whose effects, coupled with the effects of macroprudential actions, will contribute to make inflation converge to the target." (free translation)
- The decision to tight monetary policy follows the recent deterioration of inflation (observed inflation: 5.9%/y/y in Dec/10; market forecasts: 5.4% for Dec/11) which, in turn, results from high commodity prices and also from the strong dynamism of domestic demand.
- The hike of the SELIC rate is also, in our view, an important sign of independence of the Central Bank (and of its new Governor Alexandre Tombini) from political pressures. This is especially important to ease the concerns that the monetary authority could be more tolerant with inflation under Dilma Rousseff's government.
- The move reinforces the view that monetary policy will be mainly focused on controlling inflation and that the weight of avoiding the exchange rate to appreciate will have to be carried by other policies.
- We expect the Central Bank to continue tightening the monetary policy in coming months by 50bps-100bps more. Although we initially forecasted the total size of this monetary cycle to amount to 100bps, we recognize that domestic demand and commodity prices are pressuring domestic prices by more than we had forecasted and that, therefore, the total adjustment could easily be of 150bps (and more than that if the government refrains to moderate the fiscal policy as expected).
- Next week, on January 27th, the minutes of yesterday's meeting will be released and more information about the future path of the monetary policy should be provided.

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