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Economic Watch

Brazil

Madrid, 20 July 2011
Economic Analysis

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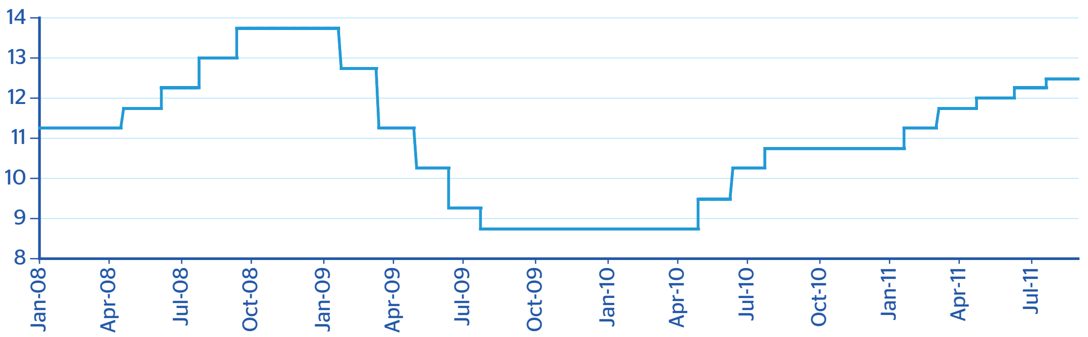
Brazil: CB adjusts the SELIC up by 25bps and signals the monetary tightening cycle is close to an end

The SELIC rate was raised to 12.50%. The monetary authority took the reference to a "prolonged" cycle out of the decision statement. We expect one final 25bps hike in August

- **The Monetary Policy Committee of the Central Bank (COPOM) decided to hike the SELIC rate by 25bps to 12.50%, as widely expected.** The adjustment of the reference interest rate accumulates now 175bps in the year.

- **The last time the SELIC was adjusted up to such high levels was in July of 2008 when the economy was booming, the inflation was at 6.4%y/y,** and markets expected the inflation to not reach the 4.5%y/y target anytime soon (expectations for the end of 2008 and 2009 were, respectively, at 6.5%y/y and 5.0%y/y). That time the Central Bank ended up increasing the SELIC up to 13.75% in September, right before international turbulences hit the country.

Chart 1
SELIC (%)



Source: Central Bank of Brazil

- **This time the environment is not very different: the domestic demand is very strong, inflation is at 6.7%y/y, and inflation expectations for the end of 2011 and 2012 are both higher than the target (6.3%y/y and 5.2%y/y respectively).** At the end of the current monetary tightening cycle, however, the SELIC will not be as high as in the end of 2008's tightening cycle.

- **The COPOM's accompanying statement released today was as follows: "Evaluating the prospective outlook** and the balance of risks for inflation, the COPOM decided, unanimously, at this moment, to raise the SELIC rate to 12.50%, with neutral bias" (free translation).

- **The mention to a "prolonged period" of adjustment of monetary conditions disappeared from the COPOM's statement** which signals the monetary authority is considering to call for an end to the monetary tightening cycle anytime soon.

- **Even tough today's communiqué leaves the door open for the Central Bank keeping the SELIC rate unchanged in the next meeting in the end of August,** we believe the most likely scenario is for a final 25bps adjustment in the next month as the current environment (very tight labor market, strong domestic demand, inflation expectations far from easing...) would make an earlier pause very costly in terms of reputation for the Central Bank.
- **In any case, we see the adoption of more macroprudential measures** to control credit expansion as very likely.
- **Next week, on July 28th, the minutes of today's monetary meeting will be released.** They should help us to envisage Central Bank's next steps.

For more on Brazil, click here

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