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Economic Watch

Brazil

Madrid, 28 June 2011
Economic Analysis

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Brazil: extending the monetary tightening cycle

The Inflation Report released by the CB reinforces the view that the monetary authority will hike the SELIC by 25pbs in July and then adopt a “wait-and-see” position. The chances, however, of the tightening cycle continuing after July are now higher than before, especially because of labor markets’ excessive dynamism

- **The Quarterly Inflation Report released today highlighted once more the risks associated with the external environment** and the still uncertain pace of moderation of domestic economic activity.
- **More than in the recent past, the Central Bank emphasized that credit markets are slowing down.** But on the other hand, the labor market’s buoyancy and the existence of important mechanisms of price indexation seem to be an increasing source of concern.
- **As in the other recent communications, the reference to the adjustment of monetary conditions for a “sufficiently prolonged period”** in order to bring inflation to the target by the end of 2012 was included in today’s report.
- **According to the Central Bank’s forecasts, inflation should be around 5.8%y/y by the end of 2011 (BBVA: 6.0%; Market Consensus: 6.1%) and around 4.8%y/y by the end of 2012 (BBVA: 4.8%; Market Consensus: 5.1%).** The convergence to the 4.5%y/y target would only occur during the second quarter of 2013.
- **The inflation outlook pictured by this Inflation Report is, therefore, worse than that presented** in the previous Inflation Report in March (inflation at 5.6%y/y and 4.5% by the end of 2011 and 2012, respectively).
- **The renewed reference to a “prolonged” monetary tightening and the tone of today’s Inflation Report consolidate the view** that the monetary authority will adjust the SELIC rate by 25bps to 12.50% at its next meeting on July 20.
- **After that the Central Bank should adopt a “wait-and-see” position to assess the outlook for inflation.** In doing so, we expect the monetary authority to focus on labor market conditions.
- **Although the most likely scenario is that the Central Bank will keep the SELIC unchanged after the July meeting, the likelihood of further hikes is now higher than before,** especially due to the labor market’s resilience to the measures taken up to this point and to the concerns that the minimum wage adjustment at the beginning of the next year will prevent inflation from trending downwards.

For more on Brazil, click here

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