BBVA Research Flash

Brazil

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Economic Analysis

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Brazil: government announces a new measure to protect domestic industry against the appreciation of the currency

The government raised the industrial products tax (IPI) by 30 percentage points for those carmakers whose vehicles do not have at least 65% of their content produced locally or regionally (Mercosur and Mexico) and that do not satisfy some R&D investment requirements

- **Even tough the Real has been depreciating in the last days as a consequence of increasing concerns with developed economies,** the government adopted yesterday a new measure to protect domestic industry against imports.
- **The industrial products tax (IPI) on all vehicles was raised by 30 percentage points to a range within 37% and 55%.** Vehicles that have at least 65% of their content produced in Brazil, in any Mercosur country, or in Mexico (with which Brazil has an agreement on car sales) and that fulfil some requirements on R&D investment will not be charged this higher IPI tax, i.e. will continue paying IPI taxes in the 7% - 25% range. The new tax will remain in place till the end of 2012.
- **From January to August the sales of imported vehicles increased 35% in comparison to the same period last year.** Imported cars represented around 29% of the sales in the first eight months of this year (22% in the same period of 2010).
- **This measure follows the announcement, around one month ago,** of the Plan "Brasil Maior" (Bigger Brazil) that provided series of incentives for domestic producers to face external competitors.
- **After being very active on adopting measures to protect the Real, the government has been showing more recently an increasing support to domestic industry by cutting taxes and implementing trade measures.** In other words, it seems that after going though a "currency war" the country is now in a "trade war" to defend local industry.
- **Given the importance of the auto industry for Brazil, the measure announced yesterday could end up supporting local jobs.** It could, however, put an extra pressure on inflation (as the prices of vehicles produced locally will have from now some room to move upwards) and, more importantly, create more inefficiencies and distortions in a country that paid a high cost in the past for protecting domestic industry.

For more on Brazil, click here

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