BTMU LATIN AMERICA TOPICS

Economic Research Group (New York)

Magalí E. Solimano
Latin America Economist
TEL: (212) 782-5708
msolimano@us.mufg.jp

BRAZIL: COPOM INTENSIFIES SELIC TIGHTENING AMID TRADE-OFF OF WEAK GROWTH AND HIGH INFLATION

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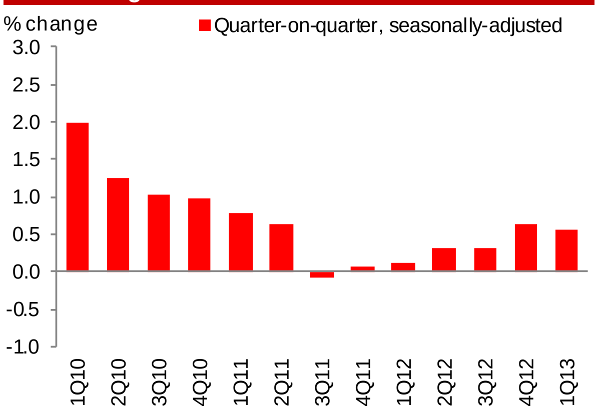
1Q13 GDP Result: It's a slow, cyclical recovery

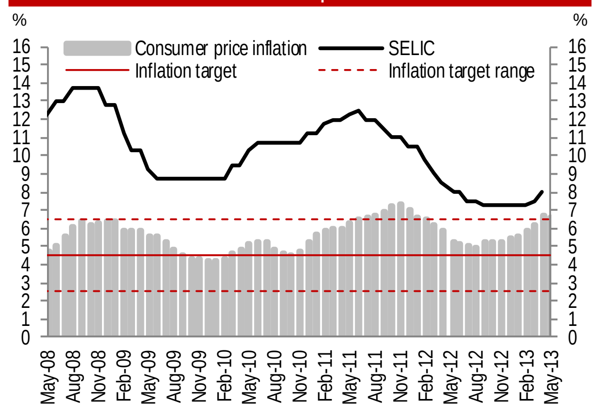
- Real GDP expanded by 0.6% quarter-on-quarter (qoq/sa) and 1.9% year-on-year (yoy) in 1Q13, according to results released on Wednesday. The pace and composition of growth were disappointing. The bright spot of the economy—private consumption—decelerated considerably, while fixed investment finally picked up. The tired growth model is constraining the strength of the recovery, which so far looks cyclical rather than structural.
- Growth of private consumption, which has been the main driver of the economy during the recovery, decelerated to just 0.1% qoq/sa and 2.1% yoy in 1Q (compared to growth of 1% qoq/sa and 3.9% yoy in 4Q12). A combination of factors—slower employment growth, high inflation, and a sluggish credit market—are weighing on the resilience of private consumption. Government consumption was flat qoq/sa and up by 1.6% yoy.
- Fixed investment growth did record much-needed improvement owed to government stimulus measures and base effects, having risen by 4.6% qoq/sa and 3% yoy in 1Q (from 1.3% qoq/sa and -4.5% yoy in 4Q12). This elevated the investment rate to 18.4% of GDP, which is higher than 18.1% at end-2012 but still lower than 18.7% in 1Q12. For the economic recovery to gain traction, fixed investment will need to continue rising at a sustained pace.
- Exports contracted by -6.4% qoq/sa and -5.7% yoy (from +6.1% qoq/sa and +2.1% yoy in 4Q12), reflecting the weak external environment and ongoing domestic supply side bottlenecks that hold back export growth. Imports grew by 6.3% qoq/sa and 7.4% yoy, in line with growth of fixed investment spending.
- On the supply side, agriculture grew by 9.7% qoq/sa and 17% yoy (from -6.1% qoq/sa and -7.5% yoy in 4Q12). The services sector expanded by 0.5% qoq/sa and 1.9% yoy (from 0.7% qoq/sa and 2.2% yoy in 4Q12). Industry disappointed with a drop of -0.3% qoq/sa and -1.4% yoy (from 0% qoq/sa and 0.1% yoy in 4Q12).

Real GDP growth



Source: IBGE; BTMU Economic Research.

SELIC and 12-month consumer price inflation rate



Source: Central Bank; IBGE: BTMU Economic Research.

COPOM decision: Unanimous rate hike of 50bp a clearer indication that containing inflation is now a higher priority

- The Central Bank's Monetary Policy Committee (COPOM) raised the intervention interest rate (SELIC) by 50bp to 8.0% per year on Wednesday, May 29th. The move was above the market consensus call for a 25bp hike, and the SELIC has now increased by a combined 75bp since the tightening cycle commenced in April.
- The decision in favor of the 50bp hike was unanimous among all eight committee members, and the statement accompanying the move was focused on containing inflation. The statement indicated that "following the process of adjusting the interest rate, COPOM decided, unanimously, to raise the SELIC rate to 8%, without bias. The Committee evaluates that this decision will contribute to bring inflation downward and assure that the trend persists next year."
- With this move to intensify the pace of tightening, the inflation-targeting Central Bank (BCB) has moved away from its cautious policy stance and adopted a firmer stance against inflation. Inflation has been increasingly pressuring monetary policy but, since mid-2011, the BCB has been lenient on inflation in exchange for higher GDP growth. Yet, because the latest rate hike follows a weak GDP growth result, COPOM is now indicating more clearly that containing inflation is a higher priority.
- As of end-April, the 12-month consumer price inflation (IPCA) stands at 6.49%, in the upper range of the BCB's target of 4.5%+/-2%. This is down from 6.59% in March; however, high inflation pressures from core inflation and food prices have lingered. Price increases are still widespread, though there has been some improvement. The diffusion index, which measures the share of items in the index with prices increases, came in at 65.8% in April versus 69.0% in March.

Balancing the deteriorating tradeoff of weak GDP growth and high inflation

- It is likely that COPOM has wanted to front-load rate hikes in order to preserve institutional credibility and contain rising inflation expectations for 2013 and 2014.
- By using the phrase "following the process of adjusting the interest rate" in its statement, COPOM suggests that the tightening cycle is still underway, though it did not explicitly offer guidance on future decisions. At least one additional 50bp hike is possible at its next meeting on July 10th, though the forthcoming minutes from the meeting, the trajectory of inflation expectations, and weakness in the BRL should provide further guidance on the BCB's position.

For historical data and commentary following BTMU's Economic News Releases, see our website at: https://reports.us.bk.mufg.jp/portal/site.