BTMU LATIN AMERICA TOPICS

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BRAZIL: COPOM HOLDS SELIC AT 7.25%

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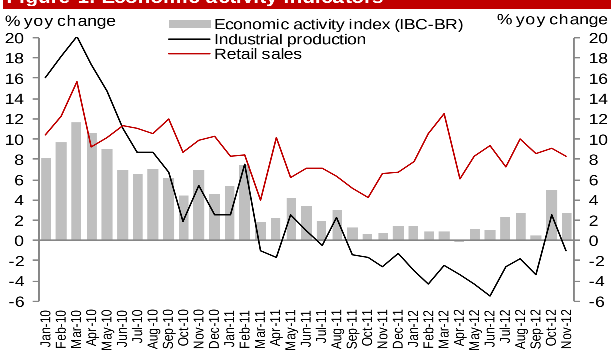
Brazil's Central Bank Monetary Policy Committee (COPOM) kept the intervention interest rate (SELIC) unchanged at 7.25% per year on Wednesday, January 16th 2013. The decision was expected, and the vote in favor was unanimous.

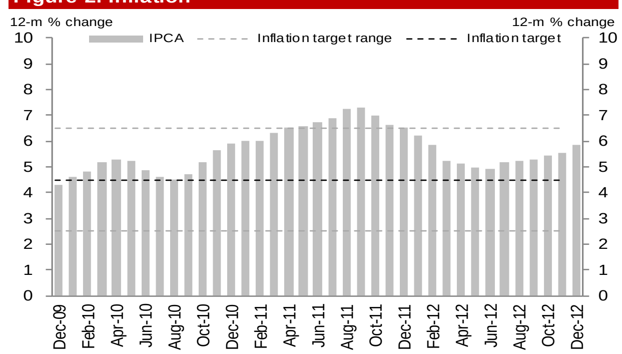
After reducing the SELIC by a total of 525bp in ten separate moves from August 2011 through October 2012, COPOM has again signaled that it is intending to keep the policy rate low for an extended period. In the statement accompanying today's decision, COPOM indicated that maintaining the "stability of monetary conditions for a sufficiently extended period is the most adequate strategy to guarantee the convergence of inflation to its target". It cited lower risks to inflation, the weaker-than-expected pace of domestic economic activity, and the complex external environment as the main considerations in its decision.

Figure 1: Economic activity indicators



Source: Central Bank; IBGE; BTMU Economic Research.

Figure 2: Inflation



Source: Central Bank; IBGE; BTMU Economic Research.

As we've noted previously, the inflation targeting Central Bank (BCB) has undertaken an implicit policy shift since mid-2011 in which it is willing to accept a higher rate of inflation in exchange for higher growth. Yet, the outlook for 2013 increasingly looks to be one of low growth and high inflation.

ECONOMIC ACTIVITY: MEDIOCRE, UNEVEN RECOVERY

The latest economic activity indicators point to the continuation of a modest and uneven recovery. The growth pace is gradually accelerating, but it still lacks sustained momentum. (Figure 1.) The Central Bank's Index of Economic Activity (IBC-BR), a proxy for GDP, grew by 0.4% mom/sa and 2.8% yoy in the month of November.

The recovery is being led by robust private consumption, which is supported by a tight labor market and government tax breaks. Thus, the services sector remains dynamic. However, the struggling industrial sector has not been able to undertake a continuous growth trend despite government stimulus efforts to support the sector through a weaker BRL.

INFLATION: ALREADY ABOVE THE TARGET MID-POINT

Meanwhile, despite the economy's prolonged underperformance, inflation persists above the target mid-point because of strong upward price pressures for services. The 12-month increase in the broad consumer price inflation index (IPCA) rose to 5.84% in December, from 5.53% in November. For the third consecutive time, inflation was in the upper range of the target at the end of the year. With inflation already above the target mid-point of 4.5%, it will become more of a challenge to manage as the pace of growth gradually accelerates.

Looking at the IPCA index alone masks the historically central challenge in managing inflation in Brazil. By segment, the prices for tradables rose by 4.10% in the 12 months through December. For non-tradables, prices rose higher—by 8.46%. (Figure 2.) The persistence of upward price pressures for non-tradables is a direct consequence of Brazil's unbalanced growth dynamics: the combination of strong private consumption and weak investment has resulted in unrelenting supply-side pressures.

HIGH INFLATION VS. LOW GROWTH

Rising inflation will concern the BCB, but will it overtake the government's concern over weak growth? For now, the policy intention is to delay rate hikes. However, inflationary pressures may contest the BCB's ability to keep rates low. The BCB may have to marginally begin raising the SELIC by the end of this year, especially if it wants to preserve its credibility as an inflation targeter.

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