BTMU LATIN AMERICA TOPICS

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BRAZIL: RAISING SELIC BACK TO DOUBLE DIGITS, COPOM CHANGES ITS STATEMENT

November 29th 2013

COPOM hikes SELIC by 50bp to 10% per year

The Central Bank's Monetary Policy Committee (COPOM) increased the policy interest rate (SELIC) by another 50bp on Wednesday, November 27th, to 10.0% per year. The decision was unanimous and expected, as the Central Bank (BCB) continues the monetary tightening cycle to lower inflation. With the move, the SELIC returned to double digits for the first time since February 2012. (Figure 1.)

The accompanying statement was shortened and simplified from the previous statements: "Continuing the process of adjusting the basic interest rate, commenced at the April 2013 meeting, COPOM unanimously decided to increase the SELIC to 10.0% per year, without bias."

The statement differed from previous ones as it included the start date of the tightening cycle. Also, this time, COPOM eliminated the entire sentence that had been used in the previous four statements: "The Committee views that this decision will contribute to set inflation on decline and assure that this trend persists next year."

The statement changes, which seem to suggest that the tightening cycle has already been long in the view of the BCB and also removes the reference to assuring a lower inflation trend in 2014, signals that COPOM is giving itself flexibility by setting up for a possible reduction to the tightening pace and the nearing conclusion of rate increases.

Since COPOM has not signaled the continuation of 50bp hikes, its next move is likely to be more data dependent. With inflation slowly falling but remaining in the upper target range, this suggests that the BCB is confident in the downward inflation trend or it is concerned over low growth. The minutes released next week should provide clarity. For now, we expect a 25bp hike in January, raising the SELIC to 10.25%, where it is likely to remain for the rest of 2014.

Inflation persists in the upper target range

Inflation is stubbornly high, despite slow growth. The 12-month consumer price inflation (IPCA) rate remains uncomfortably elevated in the upper range of the target (4.5% +/- 2%). The IPCA registered an increase of 5.84% in the 12-months through October, accelerating 0.57% month-on-month (mom) from 0.35% mom in September.

The challenge of managing high inflation is persisting owed to elevated core inflation, a weakened BRL, and deterioration of inflation expectations. Despite the BCB's tightening cycle and the government's strict control over monitored prices (such as for electricity, public transportation, and gasoline), inflation continues to hover in the upper target range. With free market price inflation at 7.4% yoy and monitored price inflation at 1.0% yoy, the gap between the two has widened sizably since the start of 2012. (Figure 2.) In our view, the suppression of monitored prices is unsustainable. Indeed, the expected fuel price adjustment—to support Petrobras' finances—is currently being negotiated and will present upward inflation risks.

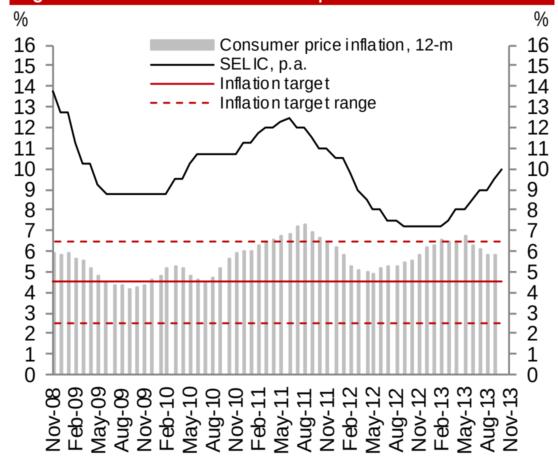
Price increases remain widespread. The diffusion index—a measure of the share of items with price rises—was 68% in October, barely an improvement from 69% in the same month last year.

Next move in January to be more dependent on forthcoming data

With COPOM having seemingly given itself some flexibility, its next moves pertaining to the pace and length of monetary tightening will be largely data-dependent. While the Central Bank's tightening cycle has supported the management of inflation expectations and enhanced institutional credibility, the BCB still appears to be implicitly targeting an inflation rate above the official 4.5% target. Unless the BCB takes a stronger stand to re-anchor expectations back to the target mid-point, the monetary tightening cycle is unlikely to extend far into 2014 given the upcoming national election in October and the government's concern over low GDP growth.

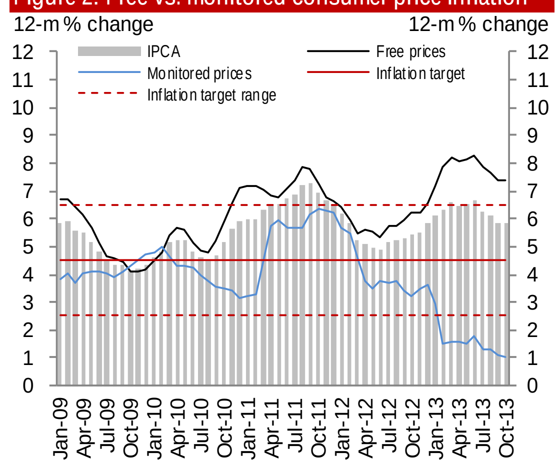
In this context, inflation will remain elevated in the upper target range next year amid the eventual readjustment of monitored prices and depreciation of the BRL. Moreover, the still-expansionary stance of fiscal policy continues to oppose the Central Bank's policy efforts. We will be looking at the release of the meeting minutes next Thursday for further assessment of the BCB's views on inflation, the BRL, and GDP growth.

Figure 1: SELIC and consumer price inflation



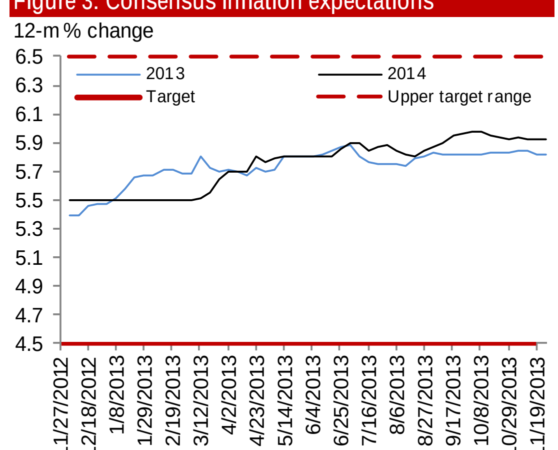
Source: Central Bank; IBGE: BTMU Economic Research.

Figure 2: Free vs. monitored consumer price inflation



Source: Central Bank; IBGE: BTMU Economic Research.

Figure 3: Consensus inflation expectations



Source: BCB Focus Survey; BTMU Economic Research.

For historical data and commentary following BTMU's Economic News Releases, see our website at: http://www.bk.mufg.jp/report/ecolatin2013/index.htm

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