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Economic Watch

Brazil

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Economic Analysis

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The Central Bank changed reserve requirements on banks' short dollar positions to take some steam off the Real. Even tough policy makers will continue focused on inflation, more FX measures are very likely

Brazil: the appreciation of the Real triggers the implementation of more FX measures

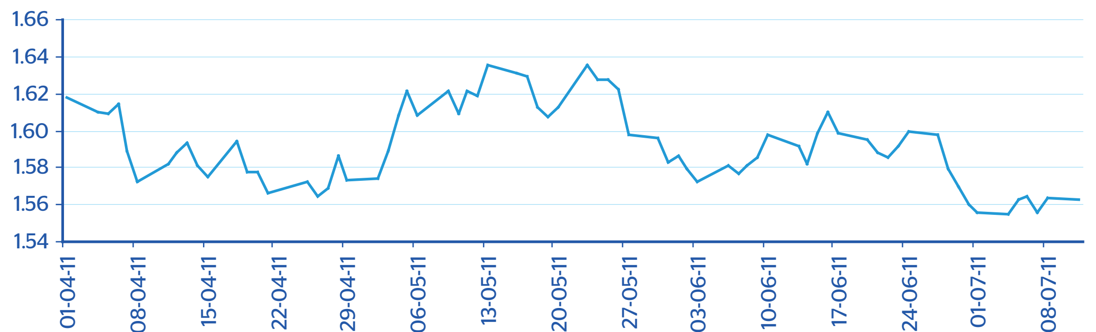
- **Brazilian banks will have to make non-remunerated deposits equal to 60% of their short dollar positions which exceed USD 1 billion from now on** Previously, according to the legislation implemented in January of 2011, a 60% reserve requirement on banks' short positions was mandatory for amounts over USD 3 billion.

- **According to the Central Bank, the goal of this measure - which was announced on Friday after financial markets closed in Brazil - is to improve the working of the spot exchange rate market and reduce total short dollar positions,** which in June of 2011 were equal to USD 14.7 billion.

- **The announcement of this measure was triggered by the recent appreciation of the Real** which reached R$ 1.55 per dollar this week, the strongest level since 1999 when the Central Bank allowed the real to float after some years under a crawling peg system.

- **This was the first FX measure implemented since the end of March** Since then until very recently, turbulences in Europe had prevented the Real from appreciating and, at the same time, the government had showed some tolerance with the appreciation of the exchange rate given the concerns with inflation.

Chart 1
Exchange rate: Real per Dollar



Source: Bloomberg

- **The chances that the economic authorities implement more measures to weaken the Real in the next few months are very high** because the Brazilian currency should continue under pressure.

- **Nonetheless, we don't expect that the concerns with the appreciation of the exchange rate will change the Central Bank's strategy to bring inflation down.** In other words, we expect the monetary authority to keep focused on inflation and to continue adjusting the SELIC rate up in the next months (more precisely, we expect the Central Bank to implement one or, more likely, two extra 25bps hikes in the next months).
- **Although the direct effect of the measure announced on Friday should be short-lived, we expect it to increase market's concerns with a renewed FX interventionism** and, therefore, to prevent the Real from appreciating more sharply.

For more on Brazil, click here

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