Brazil Flash

The last week and the months ahead

Last week we got to know that GDP decelerated sharply in Q3, inflation declined to 6.6%y/y in November from 7.0%y/y in October and the COPOM is preparing more “moderate” cuts in the months ahead. Looking ahead, we expect GDP to rebound mildly in the next quarters, inflation to trend down slowly and the CB to take the SELIC to 10.0% by the end of the first quarter of 2012.

- **GDP: from stagnation in Q3 to timid growth in the next few quarters.**
  GDP data released last week confirmed the view that economic activity decelerated sharply in Q3. GDP grew 0.0%q/q, broadly in line with expectations (consensus: 0.0%; BBVA: 0.2%). Domestic demand figures, however, surprised to the downside. Private consumption, public consumption and gross formation of fixed capital dropped 0.1%q/q, 0.7%q/q and 0.2%q/q respectively, in sharp contrast with the growth observed in previous quarter (0.5%q/q, 1.9%q/q and 1.3%q/q, respectively). External demand surprised positively and prevented GDP growth from being negative: exports expanded 1.8%q/q and imports declined 0.4%q/q. The domestic demand weakening observed in Q3 was due to the lagged impact of tightening measures taken in the first half of the year and to the impact of global turbulences on domestic agents’ confidence. High-frequency data for October shows that activity remained weak in the period (industrial production dropped 0.6%m/m and retail sales expanded 0.0%m/m). But we expect some (limited) recovery in November/December in line with the slight rebound of confidence levels and also with the tax cuts announced recently. More precisely, we expect GDP to grow around 0.3%q/q. We expect this mild rebound to continue in the first quarter of 2012 when the impact of the monetary tightening will be more significant and minimum wages will be adjusted 14% upwards. All in all, GDP should grow around 3.0% and 3.5% in 2011 and 2012, respectively. However, risks are tilted to the downside as the intensification of global turbulences should clearly not be ruled out.

- **Inflation to close 2011 at 6.4%y/y. For 2012, we keep our 5.4%y/y call but risks are now to the downside.**
  Inflation declined to 6.6%y/y in November and should reach 6.4%y/y in December. In monthly terms it moved up from 0.43%m/m in October to 0.53%m/m in November and we expect it to be equal to 0.45%m/m in December. Stripping out seasonal factors, monthly inflation will have averaged 0.42%m/m in the last quarter of the year in comparison to 0.55%m/m in the first three quarters. In 2012 the moderation of domestic demand in comparison to 2011 and limited commodity prices will allow inflation to trend down. Nonetheless, the 4.5%y/y target will not be reached given the relative strength of the labor market and the stickiness of domestic prices in Brazil. We expect inflation to be at 5.4% by the end of 2012, but this forecast is now tilted to the downside due to lower growth risks and also to the re-weighting of the IPCA to be implemented in January.

- **More monetary easing ahead.**
  The minutes of the Monetary Policy Committee’s last meeting, in which the SELIC was cut to 11.0%, showed that the focus remains on the external front. The monetary authority sees now a more benign scenario for inflation, at a good extent because of the re-weighting of the IPCA but also because of lower pressures from domestic demand. All in all, the minutes support the view that the SELIC will continue being cut at a 50bps pace. We expect two additional 50bps adjustments to take the SELIC down to 10.0% by the end of the first quarter. In addition to the reduction of the SELIC, more measures such as new tax cuts and macro-prudential measures to could be taken at the beginning of 2012 to support the activity, especially if the domestic demand refrains from showing some recovery at the end of Q4.

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