

## Brazil

# Economic Watch

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### Economic Analysis

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## Brazil: Central Bank's inflation report suggests new round of monetary tightening in the short-term

- The Central Bank's Inflation Report released today reveals a less benign outlook for inflation than before. The Central Bank now forecasts inflation at 5.9%/y/y by the end of this year and 5.0%/y/y by the end of 2012. In the previous report, released in September, the monetary authority had forecasted inflation at 5.0%/y/y and 4.6%/y/y in the end of 2010 and 2011, respectively.
- The new inflation forecasts of the Central Bank are broadly in line with BBVA and the markets' current expectations (BBVA: 5.9%/y/y in 2010 and 5.0%/y/y in 2011; Markets' Consensus: 5.9%/y/y and 5.3%/y/y).
- In the Inflation Report, the Central Bank emphasizes that the new inflation forecasts already account for the positive impact of both a fiscal tightening expected to be implemented next year and the recently announced macro-prudential measures to limit the dynamism of credit markets.
- According to the monetary authority, "it's important to highlight that, in an inflation targeting system, divergence from the target of the size implied in these projections suggest the need to implement, in the short-term, an adjustment in the reference interest rate to constrain the supply-demand gap and to control inflation expectations" (free-translation).
- Following this communication, the chances the Central Bank decides to start a new monetary tightening cycle in the first quarter of 2011 increased significantly. We, therefore, still envision the possibility that the monetary authority will adopt a "wait-and-see" position in the first quarter while some other measures are announced (extra fiscal tightening, more macro-prudential measures, etc) to create room for the Central Bank to keep interest rates unchanged throughout the year at 10.75%.
- Regarding economic activity, the Central Bank kept its GDP growth rate for 2010 at 7.3%, slightly lower than our forecast (7.5%) and also lower than consensus (7.6%). For the next year the monetary authority expect the economy to slow down and for GDP to grow 4.5% (BBVA: 4.3% and Markets' Consensus: 4.5%).

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