BBVA Research

Brazil

Economic Watch

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Economic Analysis

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Brazil: copom minutes highlight the importance of fiscal policy for future monetary policy moves

- The Monetary Policy Committee of the Central Bank recognized in the minutes of last week's meeting "that the price acceleration observed in 2010 (…) could show some persistence, in parte because services inflation remains at high levels." Also that the "period of more intense economic slowdown could be already over." The Committee showed more concerns about external drivers such as the facts that the world economic recovery is consolidating and that oil prices increased "considerably".
- In this less benign environment, the monetary authority's inflation forecasts for 2011 and 2012 increased and are now higher than the 4.5% goal.
- According to the COPOM, by raising the SELIC rate by 50bps last week, the monetary authority was "starting a process to adjust interest rates, whose effects, together with macro-prudential actions, will help inflation converge with goals".
- This clearly corroborates the view that monetary policy will continue being tightened in coming months. We particularly expect two additional hikes of 50bps in the next two meetings (on March 2 and April 20), which should then bring the SELIC rate to 12.25%.
- In addition to stressing the role of macro-prudential measures (such as those announced in December and others that could be announced in the near future), the Committee highlighted the importance of fiscal policy for future monetary policy actions.
- According to the minutes, the monetary authority "considers that the 3% primary surplus goal for 2010 will be met without adjustments. In addition, it is assumed that the primary surplus will reach 3.1% in 2012".
- For the COPOM, its also important "to note that the generation of primary results in line with [the Centrals Bank's] assumptions for inflation forecasts will contribute to slow down the gap between supply and demand growth rates, and consolidate the declining trend exhibited by the ratio public debt over GDP."

We read these words as a warning that the current monetary adjustment could be greater (than 150bps) if the government refrains from announcing measures to cut fiscal expenditures and does not reach primary surplus goals.

We do expect that the government will soon announce fiscal measures, but it is clear that if these measures fall short of expectations (or are unnecessarily delayed), then the monetary policy would have to –once more – carry the extra burden of the adjustment.

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