

Brazil

Economic Watch

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Economic Analysis

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Brazil's inflation report: benign view of inflation and gradual strategy for reaching target

- In the very dovish Inflation Report released today, the Central Bank reinforced its relatively benign view on domestic prices' recent performance. The monetary authority also proposed a very gradual strategy to bring inflation, which is currently at 6.0%/y/y, down to the 4.5%/y/y target.
- In spite of the recent deterioration of both observed and expected inflation figures, the Central Bank sees the current balance of risks as more benign than in December.
- This more benign view is explained by the positive impact both fiscal and monetary counter-cyclical policies are having on economic activity (the counter-cyclical role of macro-prudential measures was again highlighted). For the Central Bank, GDP will drop from 7.5% in 2010 to 4.0% this year (BBVA: 4.1%; markets' expectations: 4.0%).
- The monetary authority now forecasts inflation to be around 5.6%/y/y by the end of this year and 4.6%/y/y by the end of 2012 (these estimates are aligned with BBVA's forecasts and lower than the market's expectations, which are now at 6.0%/y/y and 4.9%/y/y by the end of 2011 and 2012 respectively).
- In its evaluation of inflationary pressures, the monetary authority emphasised the role of commodity prices and seasonal factors, and on the other hand, minimized the impact of domestic demand vs. supply imbalances.
- Given this view of things, the Central Bank suggested 2011 inflation should be accommodated (in the 2.5% and 6.5% range) and not strictly reigned in. Still according to the monetary authority, the costs, in terms of economic activity, to bring inflation down to the centre of the target in 2011 are too high and, then, "good practices" recommend a smoother convergence to the 4.5% target. Therefore, "the monetary policy strategy will be implemented to guarantee inflation converges to 4.5% in 2012" (and not in 2011).

- The dovishness of this inflation report reinforces the view of one last SELIC hike in April (by 50bps to 12.25%). Extra overheating pressures will be faced by the implementation of new macro-prudential measures to bring credit growth to somewhere between 10%/y and 15%/y by the end of 2011 (21%/y in February).
- In spite of consolidating the short-term path for the SELIC, today's report could increase medium and longer-term uncertainties as future monetary policy should rely more on unusual macro-prudential measures whose impact on economic activity is much more uncertain than a SELIC hike.

For more on Brazil, [click here](#).

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