Brazil surprises markets with rate hike
Jonathan Wheatley

Brazil's central bank surprised markets on Wednesday night with a 0.5 percentage point increase in interest rates, double the amount most economists expected. The rise brought to an end more than two years of rate cuts amid mounting concerns that consumer price inflation will exceed the government's target this year.

The move will provoke angry reactions from business and labour groups, who have called repeatedly on the bank to resume interest rate cuts.

The bank's monetary policy committee (Copom) had held its target overnight rate, known as the Selic, at 11.25 per cent since last September, after two years of cuts from a peak of 19.75 per cent.

The real closed at R$1.66 to the dollar on Wednesday, its strongest level in nine years, on the back of the expected rate increase.

The Copom said it had opted for a 0.5 point increase to carry out immediately a significant part of the monetary tightening that would be necessary to reduce the risk of rising inflation and reduce the size of the total increase to be implemented in the Selic rate.

Over the past two years consumer demand has taken over from the export sector as the main driver of growth in Brazil.

Falling unemployment, rising salaries and cheaper credit have driven a consumption boom, especially of credit-sensitive items such as cars and household electrical goods.

About 2.4m vehicles were sold in Brazil last year – an increase of nearly 28 per cent over 2006. Strong demand continues across the economy this year. Retail sales in February were up by 12 per cent, year on year.

This week the bank's regular survey of market economists found that consumer prices were expected to rise by 4.66 per cent this year, breaking the government's target of 4.5 per cent for the first time.

"The signs are getting stronger all the time that demand is growing strongly and that the delicate balance in place since the start of the year has been broken," said Alexandre Schwartzman, chief economist at ABN Amro in São Paulo.

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