Brazil ponders interest rate rise
Jonathan Wheatley in Sao Paulo

Brazil's central bank will decide today whether to raise interest rates as it faces its most challenging circumstances for years.

Until recently Brazil had been relatively unscathed by the global economic crisis, allowing the bank to concentrate on the threat of inflation and ignore the threat of recession.

But the outlook has worsened in the past month. Analysts adept at interpreting statements by Henrique Meirelles, central bank governor, believe fear of a sharp slowdown is now dominant.

Some economists warn that the government's financing needs will present a serious problem if global credit markets remain closed for long. Since much public debt is linked to the headline Selic interest rate, any increase would exacerbate that.

According to Rafael Guedes, managing director in Sao Paulo of Fitch Ratings, the international ratings agency, the government's total debt is equal to 64 per cent of gross domestic product, and 25 per cent of it will fall due in the next year.

Analysts are concerned about revelations of losses at companies that have bet the wrong way on the currency, adding to the potential shortfall of credit. Bradesco and Itau, Brazil's two biggest private sector banks, estimated their exposure to foreign exchange derivatives was worth R3.4bn ($1.6bn, €1.2bn, £953m) but the figure was smaller than many had feared.

Even so, analysts say bigger problems have yet to be revealed at large foreign banks operating in Brazil.

The central bank's most recent regular survey of market economists showed that most expect an increase in the Selic rate of 0.25 percentage points to 14 per cent a year, following one half-point and two three-quarter-point rises this year. But analysts with the best record of predicting interest rate changes say the bank will hold the Selic steady.

On the side of raising rates is the argument that the sharp depreciation of Brazil's currency in recent months will raise inflation.

Against that are a highly volatile exchange rate and evidence that Brazil's economy is already slowing. Consensus predictions are that it will grow by 5.2 per cent this year and by 3.1 per cent next year, although many analysts expect less than 3 per cent growth next year.

The central bank has been concerned for some time by the rapid rate of expansion of credit. While still relatively small as a percentage of GDP, the total credit has been rising by as much as 30 per cent annually this year.

"Two months ago people were still under the delusion that Brazil had delinked [from the rest of the world]," said Walter Molano of BCP Securities, a US broker. "Unfortunately [the global crisis] has broadsided them."

Fonte: Financial Times, London, October 29 2008, Primeiro Caderno, p. 8.