Price pressure threat damps Brazilian expectations

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Brazil's economy, at first glance, appears to be in an enviable position. It emerged quickly from a short and shallow recession last year and is on course to grow by about 5.5 per cent in 2010. Industrial production, retail sales, employment, business and consumer confidence are all on the way up.

South America's largest economy is, unfortunately, not ready for this level of activity. Fiscal imbalances and a shortage of productive investment mean growth cannot exceed 4.5 per cent without putting pressure on prices.

Unemployment, at 7.4 per cent in February, is below what the central bank says is the non-inflationary rate. Industry is using almost all its available capacity. The consensus among market economists is that retail price inflation will reach almost 5.2 per cent this year, too far above the government's 4.5 per cent target for comfort.

Part of the pressure on prices is probably temporary - prices of perishable foods, for example, have risen after heavy rainfall damaged some crops, and education and transport costs will have less impact now annual increases are out of the way.

But in areas such as the construction sector, household goods and personal expenditure, demand is still fuelled by rising wages.

"Inflation is stabilising but at a high rate," Bertrand Delgado of RGE, a US economics think-tank, said in a recent note. "We expect the seasonal effect on food prices to ease in upcoming months, but to be contained by demand-pull pressures."

Most economists think the central bank will be obliged to raise interest rates by between a half and three quarters of a percentage point at its next monetary policy committee meeting on April 27 and 28. Overall, they expect the bank's target overnight interest rate, known as the Selic, to rise from 8.75 per cent today to 11.25 per cent by the end of the year.

What is more, many expect the increases to come in four chunks at the committee's next four meetings between now and September. Putting the brakes on growth in this way would be politically difficult at any time. With general elections in October, it will be doubly tough this year.

Given the immediacy and size of the challenge, it seems odd to reflect that just a week ago Henrique Meirelles, Brazil's bank governor and widely regarded as one of the firmest pillars of orthodoxy in Brazil's government, should have come within a whisker of resigning to run for elected office in October.

Luiz Inácio Lula da Silva, Brazil's president, let it be known last September he would like Mr Meirelles to run for vice-president this year beside Dilma Rousseff, his chosen successor and chief minister until she stood down last week to qualify as a candidate. His presence, the reasoning went, would appeal to conservative voters and allay fears among some investors that Ms Rousseff could take Brazil farther to the left.

But the leadership of the pro-government PMDB, the biggest party in Congress, refused to give such a sought-after position to a newcomer and after intense 11th-hour negotiations Mr Meirelles stayed put.

Many economists say that, at least for monetary policy this year, the outcome is positive.

"The best way for him to leave a positive legacy will be to take decisions on a purely technical basis and resist political pressure even more than he has so far," says Alexandre Lintz, chief economist at BNP Paribas in São Paulo.

Further ahead, the outlook is less clear. Mr Meirelles has had Mr Lula da Silva's solid backing. It is hard to imagine a similar pairing in place next year.

Fonte: Financial Times, London, Apr. 14th 2010, UK, online.