Brazil set for interest rate rise

Jonathan Wheatley

Brazil's central bank is expected to raise its core interest rate by as much as a full percentage point on Wednesday evening as the unexpectedly fast pace of economic growth puts increasing pressure on prices.

Predictions for economic growth, inflation and interest rates at the end of 2010 have all risen sharply in recent weeks, adding to near-certainty among economists that the bank will raise its target overnight rate, known as the Selic, for the first time since September 10 2008 – less than a week before the collapse of Lehman Brothers and the ensuing global crisis took the pressure off an economy that was showing dangerous signs of overheating.

The bubbles that burst round the developed world are a long way from reinflating but, in Brazil, many economists fear the economy may already be behaving much as it was 18 months ago.

The central bank's most recent survey of market economists, published on Friday, put the consensus for economic growth this year at 6 per cent – well above the 4.5 per cent or so that many economists regard as the potential, or non-inflationary, rate.

That is even after factoring in an increase in the Selic rate from 8.75 per cent on Wednesday to 11.75 per cent by the end of the year – a full half point above the consensus just four weeks ago.

Consumer price inflation is seen rising to 5.41 per cent a year, almost a point above the government's target of 4.5 per cent.

Henrique Meirelles, central bank governor, in an unprecedented signal of intent, said on Monday: "In situations like this one, we need a programme of vigorous action."

His comments caused a spike in interest-rate futures contracts as many investors who had expected a half or three-quarter point increase on Wednesday evening began to see a full point rise as a real possibility.

Some economists believe the central bank should have acted more quickly as inflationary pressures emerged some months ago. In a note to clients on Friday, Nick Chamie of RBC Capital Markets said he expected the actual rate of Brazil's economic growth to overtake its potential rate during the second half of this year. "Given we are six-nine months away from the output gap closing (according to our estimates) and monetary policy tends to work with a 12 to 18-month time lag, it is fair to say the BCB is already behind the curve," he wrote, describing the task facing the central bank of bringing inflation under control as "an enormous challenge".

However, others believe there is still room for sustainable growth. On Friday, Marcelo Salomon and Guilherme Loureiro of Barclays Capital wrote that "while inflation is clearly a source of concern and domestic demand growth has jumped back to the pre-crisis levels, there is still some spare capacity to be filled before we reach the same blistering pre-crisis conditions".

Fonte: Financial Times, London, Apr. 27th 2010, Americas, online.