

## **Brazil Speeds Rate Increases, Signals More to Come**

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July 24 (Bloomberg) -- Brazil's central bank, raising interest rates more than expected for the second time in three meetings, signaled it's ready to push up lending costs faster to fight inflation. The currency rose to a nine-year high.

Policy makers led by President Henrique Meirelles raised the overnight rate by three quarters of a percentage point to 13 percent last night in a bid to bring inflation back to target in a "timely fashion." Thirty-one of 45 economists surveyed by Bloomberg predicted the bank's board would approve the same half-point increase it made at the two previous meetings.

The increase aims to slow domestic spending as food and energy costs rise. Consumer prices rose 0.63 percent in the month through mid-July, pushing annual inflation to a 32-month high, the statistics agency said today. Inflation as measured by the benchmark IPCA-15 index quickened to 6.30 percent, close to the upper end of the 2.5 percent to 6.5 percent target range.

"The tightening doesn't stop here," said Marcelo Carvalho, chief economist for Brazil at Morgan Stanley. "Markets will converge on the idea that the next move will be another 75-point hike and maybe subsequent ones as well."

Meirelles will miss his inflation goal for the first time since 2003 as consumer prices will rise 6.53 percent this year, according to a survey of about 100 economists by the central bank. For 2009, inflation forecasts are on the rise and consumer prices are expected to increase 5 percent.

By raising rates, the central bank wants to prevent the longest streak of household spending growth since 1994 from stoking inflation in Brazil's \$1.3 trillion economy, Latin America's largest.

'A Little Late'

Yesterday's increase, the biggest in more than five years, puts the key rate at the same level it was in January 2007, canceling the effect of five of the six rate cuts last year.

"The outlook will remain cloudy so long as domestic spending remains strong and there's uncertainty over the long-term prospects for the U.S. dollar," said Alvise Marino, an emerging markets analyst for IDEAGlobal in New York.

Carlos Thadeu de Freitas, chief economist for SLW Asset Management in Rio de Janeiro, raised his year-end forecast for rates to 14.75 percent from 14.25 percent because he expects the bank will maintain the current pace of increases.

"The central bank decision is the right one, perhaps a little late, because they can't run the risk of letting 2009 inflation drift above its target," Thadeu said in an e-mail.

Brazil's real gained after the central bank move, which made Brazil's interest rate the second-highest inflation- adjusted one in the world after Turkey's. The real rose 0.5 percent to 1.5755 at 9:46 a.m. New York time and earlier traded at 1.5732.

## Slower Growth

“The increase was not entirely priced in and we should see a continued strengthening of the real as the carry trade becomes more attractive,” said Carvalho.

The yield on the interest-rate futures contract due January 2009 rose to 13.71 percent from 13.53 percent yesterday.

Brazil's economy created a record 309,442 government- registered jobs in June as higher domestic demand coupled with rising commodity prices prompted companies to add staff and increase production, a July 17 Labor Ministry report showed.

The economy grew 5.8 percent in the first quarter after expanding 6.2 percent in the fourth, the fastest in 3 1/2 years. Unemployment rate fell to 7.8 percent in June, its second-lowest level in more than six years, the statistics agency said today.

Lower unemployment, combined with rising incomes and credit, is fueling retail sales that have climbed more than 10 percent in four of the first six months of this year.

## Fewer Jobs

Economic growth may slow to 3.8 percent in 2009 because of the bigger rate increases, said Fabio Silveira, an economist at RC Consultores in Sao Paulo. Before yesterday, he forecast growth of 4.2 percent.

“This decision will penalize the economy,” said Silveira, adding the tightening wouldn't produce the desired effect because inflation was coming from abroad in the form of rising energy and commodity prices.

The Sao Paulo State Federation of Industries said in a statement that higher interest rates would hurt workers by strengthening the currency and discouraging investment. It said more budget spending cuts should be used to fight inflation.

The central bank started to raise rates at the April 15-16 meeting after keeping the benchmark unchanged for six months at a record low of 11.25 percent. Policy makers have increased the rate by half a percentage point in each of the two past meetings.

Since adopting inflation targeting in 1999, policy makers missed the target three times, in 2001, 2002 and 2003.

Meirelles told senators in Brasilia on July 15 the bank will act "vigorously" to ensure next year's inflation will be in line with the 4.5 percent midpoint of the target.

Wholesale prices as measured by the IGP-DI index jumped 17.9 percent in the 12 months through June, the biggest gain in almost five years, led by agricultural products and raw materials.

"We'll be seeing some of this wholesale inflation contaminating retail prices in the second half of the year," said Sergio Vale, an economist with MB Associados in Sao Paulo.

**Source:** Andre Soliani