Economic activity has not responded to any of the government’s efforts at stimulus, including investment packages, sectoral tax exemptions, and an unprecedented reduction in the central bank policy interest rate.

and productivity observed during the current administration compared to its predecessor. “We have lived in a very different period since the onset of the global crisis. It seems difficult to achieve the much-desired growth rate of 4% or 4.5%,” said Matos.

IBRE researchers estimate that inflation was 5.4% for 2012 and will be 5.7% in 2013—less than in 2011, which hit the target ceiling (6.5%) but still far from the target mid-point of 4.5%. In 2012, the main factors contributing to inflation were the service sector, at 8.2%, and food inflation, at 9.1%; in 2013, the first of these is projected to go up slightly, to 8.5%, and the latter to drop to 6.5%. Despite the expected decline due to a positive external supply shock, Matos emphasized that food inflation will still be high enough to make it hard to bring headline inflation to the 4.5% mid-point target. Also, administered prices were not raised in 2012 because it

THE INTEREST RATE
The pursuit of sustainability

Claudio Accioli

THE ECONOMIC VARIABLE that most attracted the attention of specialists in the current year—the central bank policy interest rate—declined 525 basis points from July 2011 to December 2012, from 12.5% to 7.25%. Samuel Pessôa, associate IBRE researcher, notes that the real interest rate differential, net of inflation expectations and sovereign risk,1 has held at about 5% a year since 2003, for reasons that vary according to the period examined but usually because of movements in exchange rates.

The real interest rate differential has been high since 2006 as a result of the policies of supporting domestic industry, maintaining a more depreciated exchange rate, and lower absorption of foreign savings; the recent decline in interest rates is due mainly to the significant drop in Brazilian domestic demand, particularly the fall in investment in the last five quarters. “If investment grows back stronger, which is desirable, interest rates would increase. Is the country then condemned to have high interest rates?” Pessôa asks.

He argues that a high policy interest rate should not be viewed as by definition a nega-

1 The real interest rate differential was calculated by subtracting from the interest rate the expected inflation given by the central bank’s Focus Bulletin, the U.S. real interest rate, and the Brazil risk.
was a local elections year, and some prices, like that of gasoline, will be adjusted. Matos emphasized that “Projections for 2013 are a worrying combination of lower growth and higher inflation.”

Despite the risk of higher inflation, Matos believes that the central bank will use macroprudential measures to curb inflation, holding its policy interest rate at the current 7.25% a year. “In a way, the central bank is accepting higher inflation as long as it does not exceed the target ceiling [6.5%],” Matos observed. “If there is a stronger recovery of the world and the Brazilian economies, it will certainly be necessary to adjust the policy rate. But as this is not likely, inflation is expected to remain reasonably controlled in 2013, making it unnecessary to tighten monetary policy.”

Another important variable to contain inflation of tradable goods, according to Matos, is the exchange rate: “If the exchange rate had appreciated freely, without central bank intervention, the negative effects of external shock would have been mitigated.” IBRE researchers project an exchange rate at 2 reais per U.S. dollar by the end of 2013.

PUBLIC BUDGET

Missing the budget primary surplus target (budget balance excluding interest payments) of 3.2% of GDP was not surprising, but the result of only 2.3% was certainly disappointing. IBRE projects a primary surplus of 2.6% of GDP for 2013. The shrinking surplus is mainly due to the combination of the steep drop in tax revenue, whose real growth fell from