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BRAZIL BULLETIN INTERVIEW: Rubens Sardenberg, Chief Economist for the Brazilian Bankers Federation (Febraban) –"Government austerity measures against inflation are working, but they are working slowly." Inflation looms as Brazil's biggest macroeconomic challenge in 2011, according to Rubens Sardenberg, Chief Economist for the Brazilian Bankers Federation (Febraban). But government austerity measures, many of them aimed squarely at reducing lending volume, will begin to have a palpable effect on prices in the second half of the year. Sardenberg spoke recently with business reporters. Excerpts follow:

- On the threat of inflation: "Inflation has become the biggest macroeconomic problem for Brazil. For that reason, the latest forecast by Febraban members for 2011 inflation has risen to 6.3% from 5.8% in the previous forecast. We are also likely to see more monetary tightening. Members are now predicting a year-end base interest rate of 12.5%, higher than the previous forecast of 12.25% (The Selic base rate ended 2010 at 10.75%.)."

- On government measures against inflation: "Government austerity measures against inflation are working but they are working slowly. It takes six to nine months for interest rate hikes to do their work, although other measures such as credit restrictions may take a little less time. The government has given a solid response on the fiscal side and that has helped buoy market confidence. Fiscal austerity may help reduce pressure on prices."

- On government credit measures: "The government has taken various measures to curb the expansion of credit as part of its fight against inflation. These have included higher reserve requirements for banks and hikes in taxes on consumer loans, not to mention monetary tightening itself through higher interest rates. All of these factors will contribute to a moderation in the growth of lending this year. We now expect lending to expand by 16.7%, rather than the previously expected 17.4%. (Credit grew by a robust 20.5% in 2010.) But this is still excellent growth, especially given the fact it comes on top of an already solid base."

- On investment inflows and trade: "Investment inflows from overseas will continue strong. This is a tribute to the country's progress. It also offers a cushion against future crises. Meanwhile, there has been a clear improvement in exports, despite the strong Brazilian Real. We are now predicting direct foreign investment in 2011 of $45.7 billion. The trade surplus will reach $18.2 billion, almost as high as the $20.3 billion figure of 2010."

Top presidential aide Palocci quits, with Paraná senator taking on advisory role. Embattled presidential chief-of-staff Antonio Palocci resigned last week after being dogged for a month by allegations of influence-peddling. President Dilma Rousseff accepted the resignation "with regret," but acted swiftly to replace Palocci. As the new top presidential advisor, Rousseff appointed Workers' Party (PT) Senator Gleisi Hoffmann of the southern state of Parana. Hoffmann was elected to the Senate last year. A veteran political organizer and former official of the Itaipu hydroelectric program, Hoffmann is married to Communications Minister Paulo Bernardo. Palocci served as top presidential aide for less than six months. Press reports in May showed that Palocci had worked as a high-paid business consultant from 2006 through 2010, a period when he was also serving as a member of Congress and as Rousseff's campaign manager. Palocci never denied working as a business consultant but claimed in interviews that no conflicts of interest had ever arisen. Rousseff last week also ordered another change in her official family. Fishing Minister Ideli Salvatti switched jobs with top congressional liaison officer Luiz Sergio Oliveira.

Central Bank raises Selic rate to 12.25%, more rate hikes likely. The Brazilian Central Bank last week raised its Selic base interest rate by another 25 basis points, this time to 12.25%. The bank hinted at more rate hikes to come by stating that "a prolonged period of monetary tightening" may be necessary to curb inflation. Brazil's inflation rate is currently running at a worrisome 6.55%, well above the government target of 4.5%. Most economists are predicting another 25-point rate hike in July. Some say more hikes will follow toward the end of the year, with the Selic rate ending 2011 as high as 13.0%. Last week's action was the fourth rate hike in a row. Brazil's base rate is now the highest in the world, in either nominal or real terms, according to a study by Banco Cruzeiro do Sul. The bank put Brazil's real interest rate at 6.8%. In second place is Chile's real rate of 1.5%. Many countries, including the U.S., are currently posting negative real interest rates, the study showed.

Motor vehicle production, sales continue to soar, despite credit restrictions. Brazilian motor vehicle sales and production in May continued a strong advance against record 2010 levels, despite credit restrictions imposed earlier this year by the government. May motor vehicle sales reached 318,534, up 10% from the previous month and 27% from May of 2010, the National Motor Vehicle Manufacturers Association (Anfavea) said last week. Production hit 303,549 in May, up 8% from April and 2% from May, 2010. Sales and output continued to rise in May because of increased job opportunities and earning power among Brazilians. Credit remained plentiful, despite government restrictions. But Anfavea economists warned that market growth will likely slow at mid-year as credit becomes more expensive. Exports were also higher in May, netting $1.32 billion, up 1% from April and 12% from May of last year.

Monthly inflation declines but 12-month rate continues to exceed target range. Monthly inflation decelerated a bit in May to 0.47% from 0.77% in April as fuel prices declined but Brazil’s 12-month rate continued to climb, this time hitting 6.55% from 6.51% as of April, the Brazilian Census Bureau (IBGE) reported last week. Fuel prices fell 0.24% for the month but food prices advanced by a worrisome 0.63%, slightly more than the 0.58% seen in April. Food prices carry the heaviest weighting in the index. Economists expect further deceleration in the monthly rate in June and July, but the 12-month rate is likely to continue rising because of a high basis of comparison from 2010. The 12-month rate continued well above the government’s 2011 target of 4.5% for inflation, making more interest rate hikes almost inevitable.

Utilization of installed industrial capacity falls for second month in a row. Utilization of installed industrial capacity declined for the second month in a row in April, this time to 82.0% from 82.4% in March, the National Confederation of Industries (CNI) said last week. Utilization of industrial capacity was 83.0% in April of 2010. The figures point to a cooling of Brazil’s economy because of higher interest rates and the threat of inflation. Brazilian inflation is now running at 6.55%, with the Selic base rate at 12.25%. Motor vehicles and textiles saw sharp declines in March, the CNI said. Other segments were more stable. Industrial sales in April showed a modest 4.9% rise against April of 2010.

Transmission line concessions auctioned to state-controlled utilities. A government-organized auction of power transmission concessions last week resulted in victories for two major state-run utilities. Northeast distributor Chesf won two concessions while a partnership between Chesf and São Paulo’s CTEEP won a third concession. Bidders win concessions by offering the lowest user rates. The three concessions were located in the Northeast states of Bahia, Paraiba, Rio Grande do Norte and Ceara. The government’s National Power Authority (Aneel) auctioned a total of 430 kilometers of high-tension power line concessions. Aneel is due to hold at least two more auctions later this year.

Investment News: Brazilian **capital market activity** declined in the first five months of 2011 as the country’s economic recovery cooled, the National Association of Capital Market Institutions (Anbima) said last week. Total issuance of bonds and shares reached R$44.1 billion, down 3.8% from the first five months of 2010. High domestic interest rates discouraged investors from participating in primary or secondary share issues. Historically low international interest rates sent Brazilian companies into overseas debt markets, leaving the domestic market idle.

Company News: German car maker **Volkswagen** and auto workers unions agreed last week on a new profit-sharing plan, ending a 37-day strike at the company’s Paraná assembly line. It was the longest strike to date at the Volkswagen plant in the southern state. The company agreed to pay workers a 2011 profit-sharing package of R$11,500 per worker. The assembly line employs 3,100 workers. Lost production during the strike amounted to more than 22,000 vehicles. *** A preliminary report last week from the Brazilian government’s anti-trust office, CADE, cast a shadow over the 2009 merger of meatpackers Sadia and Perdigão. CADE board member Carlos Ragazzo said the merger would create a near monopoly in the domestic poultry market. Other board members are expected to weigh in later this month. Brazil’s government helped engineer the original merger at a time when Sadia was threatened with bankruptcy. Sadia and Perdigao merged into a new company called **BRF foods**.

Indicators: Brazilian **crude oil production** slipped in April with several offshore platforms idled by maintenance, the National Petroleum Authority (ANP) said. Domestic crude oil output was 2.052 million barrels per day, down slightly from 2.082 million in March. State-run energy giant Petrobras was once again responsible for the lion's share of production at 92.6%. *** Brazilian **retail sales** posted a 0.2% month-on-month decline in April, as higher interest rates and taxes constrained consumer credit. Nevertheless, retail sales still showed a 10% advance against April of 2010, the Brazilian Census Bureau (IBGE) said last week. Year-on-year growth in retail sales is likely to ease in the coming months, as Brazil's economy cools, economists said.

Other News: President Dilma Rousseff last week signed into law a bill providing for creation of modern **credit bureaus** in Brazil. The bureaus will be able to collect information about credit worthiness of all consumers, not just those with poor credit records. The president used her line-item veto power to eliminate sections giving banks and other institutions unlimited access to credit information. Creation of credit bureaus should lead to lower interest charges for consumers with good credit ratings.

Brazilian Calendar for Week of June 13:

- **Tuesday, June 14 -** Brazilian Transportation and Logistics Congress, Hotel Unique, São Paulo
- **Thursday, June 16 -** United National Secretary General Ban Ki-Moon visit to Brasília

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R$1.60 = $1.00