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Taxing Overseas Money Failing to Stem Inflation: Brazil Credit 2011-03-30 03:00:01.0 GMT

By Gabrielle Coppola and Matthew Bristow

March 30 (Bloomberg) -- Brazil raised a tax on foreign transactions yesterday for the fourth time in six months to slow gains in the real, stem inflation and put off further interest- rate increases. Instead the currency advanced and bond yields climbed.

"The market doesn't believe what the central bank is doing and saying," Walter Butler, chairman and partner at Butler Capital Partners, which has invested about $1 billion in emerging-market equity and debt, said in an interview yesterday at the Bloomberg Brazil Economic Summit in Sao Paulo. "It is not a good measure. It doesn't show the right signal."

Foreign currency investment totaled $35 billion this year through March 18, more than in all of 2010, according to the central bank. The government's latest curb on capital yesterday targeted Brazilian banks' overseas loans and debt sales by raising the tax on such transactions to 6 percent from 5.38 percent and extending it to borrowing with a minimum average maturity of 360 days from 90 days.

The real, which is up 41 percent against the dollar since the end of 2008, climbed to 1.6463 per U.S. dollar yesterday, the strongest level since January. The yield on the government's real-denominated bond due in 2015 jumped 10 basis points to a record 13.06 percent.

The yield on the interest-rate futures contract due in January 2017 jumped 12 basis points, or 0.12 percentage point, to 12.78 percent yesterday, the highest level since Feb. 7, according to data compiled by Bloomberg. Traders expect policy makers to raise benchmark borrowing costs to 12.75 percent by the first month of 2012 from 11.75 percent now to stem inflation running at the fastest rate since November 2008, according to Bloomberg data based on interest-rate futures contracts.

Mexico, where annual inflation slowed to 3.1 percent through mid-March, has kept its benchmark interest rate unchanged since July 17 at 4.5 percent.

Mantega's View

The increase in the tax on foreign borrowing aims to avoid further appreciation of the real and reduce borrowing in foreign currencies by banks and companies, Finance Minister Guido Mantega said yesterday.

"Three-month loans are not for investments," Mantega said yesterday. "The inflow of dollars is too strong, damaging the exchange rate, appreciating the real and harming exporters. We want to avoid that."

The move follows President Dilma Rousseff's decision this week to almost triple, to 6.38 percent, a tax Brazilians must pay on credit card purchases abroad. Policy makers in October twice increased, from 2 percent to 6 percent, the so-called IOF tax on foreign investors' fixed-income purchases in a bid to stem the currency gains that are curbing exporters' profits.

Small Impact

Yesterday’s measures may help slow the pace of lending in Brazil, which has been expanding at a 20 percent annual pace since October, said Paulo Vieira da Cunha, a central bank director until 2008 who is now a partner at Tandem Global Partners in New York. Still, the impact on inflation is likely to be minimal as domestic demand remains heated, he said.

“The net outcome is that these banks will do less lending, so the volume of credit comes down, which is good for inflation,” Vieira da Cunha said in a telephone interview from New York. Still, “the size, the quantity of the impact is likely to be small,” he said.

Total outstanding credit rose 1.3 percent in February from January to 1.74 trillion reais ($1.05 trillion), the central bank said yesterday. That’s twice the 0.6 percent increase in the previous month, even as average lending rates rose to 38.1 percent from 37.4 percent. Total credit rose 21 percent from a year ago, led by a 51 percent surge in mortgage lending.

‘Ideal’ Pace

Central bank President Alexandre Tombini told lawmakers March 22 that consumer credit growth above 15 percent needs to be monitored closely to prevent the formation of a credit bubble.

The bank “will make the adjustments that are needed to prevent imbalances from arising,” Tombini said in Senate testimony. An “ideal” pace for credit expansion in Brazil is between 12 percent and 15 percent this year, Mantega said yesterday.

Brazil’s inflation-adjusted interest rate, which at 5.7 percent is the highest in the Group of 20 nations, has made it a magnet for foreign capital as borrowing costs in the U.S. and Europe remain near zero.

‘Great Optimism’

“There’s strong capital inflows and at the same time rising demand for credit, factors that end up overshadowing the measures,” said Mauricio Molan, a Sao Paulo-based economist at Santander Brasil. ‘We’re in a moment of great optimism that makes it difficult to reduce credit or avoid real appreciation.”

The extra yield investors demand to own Brazilian government dollar bonds instead of Treasuries rose 3 basis points yesterday to 174, according to JPMorgan Chase & Co.

The cost of protecting Brazilian bonds against default for five years fell 2 basis points on March 29 to 113, according to CMA DataVision prices. Credit-default swaps pay the buyer face value in exchange for the underlying securities or the cash equivalent should a government or company fail to adhere to its debt agreements.

Brazil’s inflation, as measured by the IPCA-15 index, quickened to 6.13 percent in the year through mid-March, the fastest since November 2008. Consumer prices are expected to jump 6 percent this year, according to a March 25 central bank survey of economists. That would be the fastest year-end rate since 2004, when prices rose 7.6 percent. Brazil targets inflation between 2.5 percent and 6.5 percent.

Flows Stabilizing

Flows of capital into Latin America's biggest economy are stabilizing as growth slows, Tombini's predecessor, Henrique Meirelles, said at the Bloomberg Brazil Economic Summit.
Economists in last week's central bank survey reduced to 4 percent their forecast for growth in 2011, down from 4.5 percent five weeks ago. Brazil's economy expanded 7.5 percent last year, the fastest pace in more than two decades.

The central bank has also stepped up dollar-buying in a bid to curb the real gains. Since the start of the year, the bank has bought more than $23 billion in the spot currency market, compared with $41 billion in all of 2010.

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