WELDON FINANCIAL
GLOBAL MACRO RESEARCH & MONEY MANAGEMENT

WELDON'S MONEY MONITOR
March 30, 2011

MACRO-MACRO: Fat Tuesday, No Fasting in Brazil

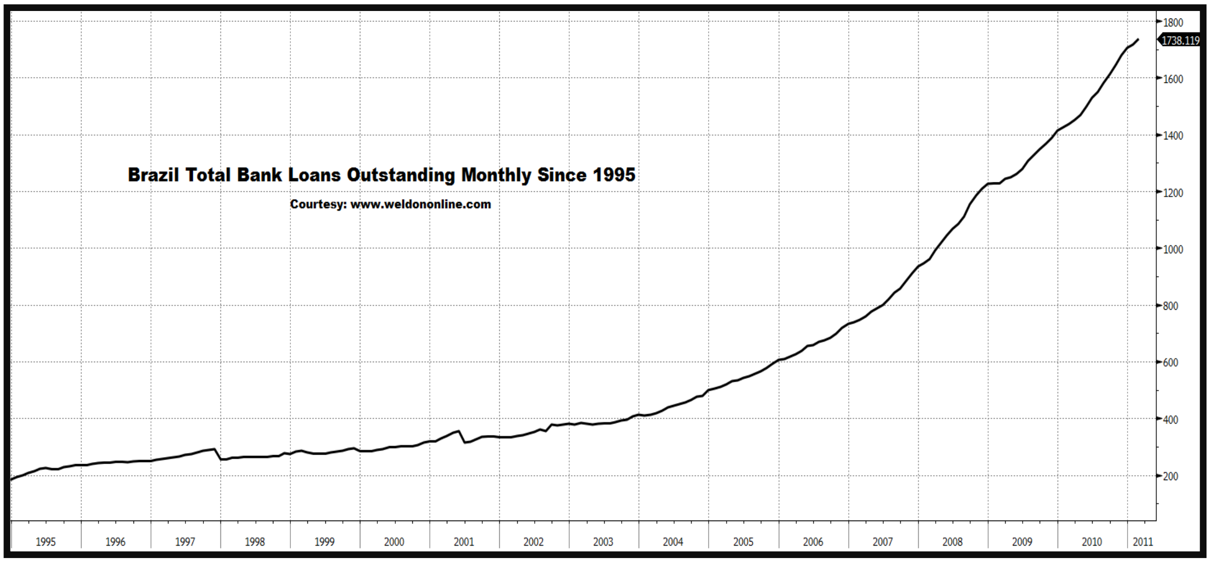
The Mardi Gras season may has passed, but one look at the most recent Brazilian data on Bank Lending suggests that Fat Tuesday might be marked by an extended celebration of credit creation in Brazil, as Bank Loans Outstanding soared to yet another NEW RECORD HIGH during the month of February. Indeed, there is NO 'fasting' when it comes to the continuing feast of fresh credit in the country that has come to define … 'Carnival'.

As reported this morning, Total Brazilian Bank Loans Outstanding reached (all figures in Brazilian Real, or BRL) 1.738 trillion as of the end of February while posting a +1.3% monthly increase … marking the fourth month in the last five during which bank credit has expanded by double-digits.

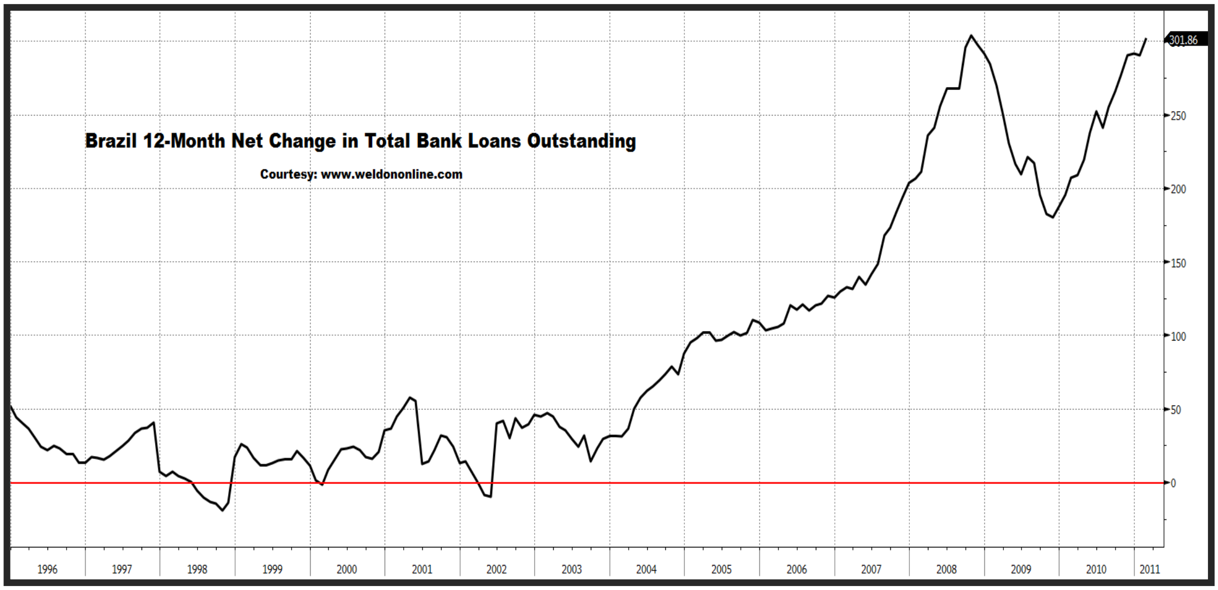
Moreover, Total Bank Loans Outstanding expanded by +301.8 billion versus February of last year, the largest EVER year-year increase for a February. Evidence the data details on display below plotting the actual Feb-Feb increases over the last five years:

Feb-2011 … up +301.857 billion
Feb-2010 … up +207.168 billion
Feb-2009 … up +269.554 billion
Feb-2008 … up +211.022 billion
Feb-2007 … up +132.557 billion

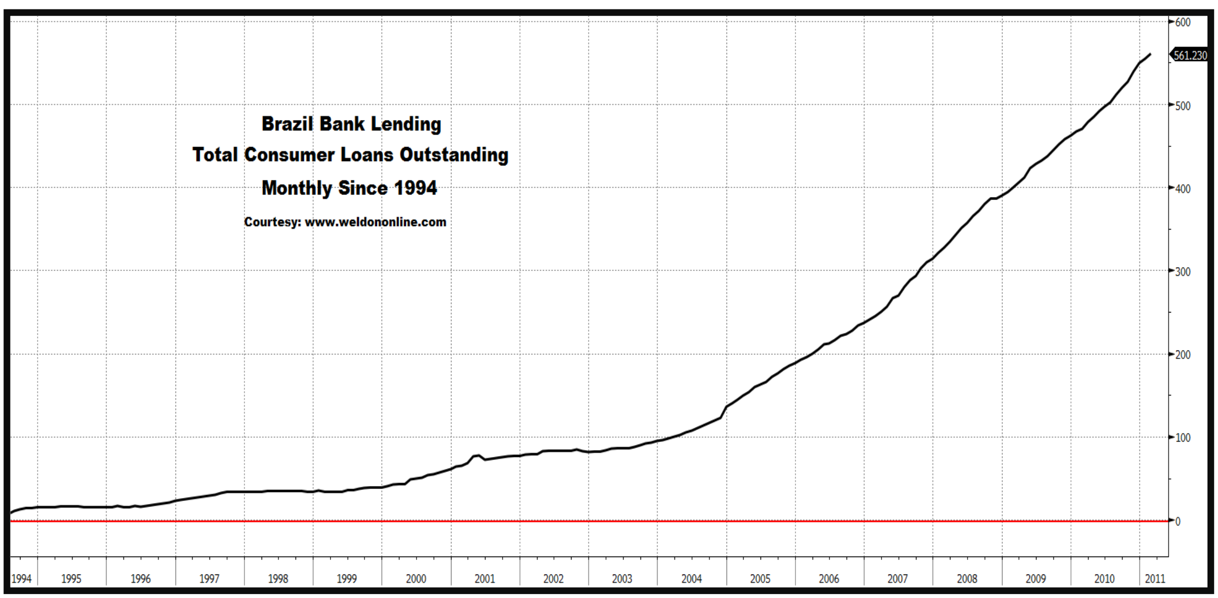
Evidence the chart below revealing the accelerated expansion to a new all-time record high in Brazilian Bank Loans Outstanding.



Additionally, as noted in the chart on display below plotting the rolling 12-Month Change in Total Brazilian Bank Loans Outstanding, February's year-over-year expansion of +301.857 billion represents the second largest EVER twelve-month increase, for ANY month, behind only the all-time record year-year increase of +303.51 billion posted in October of 2008.



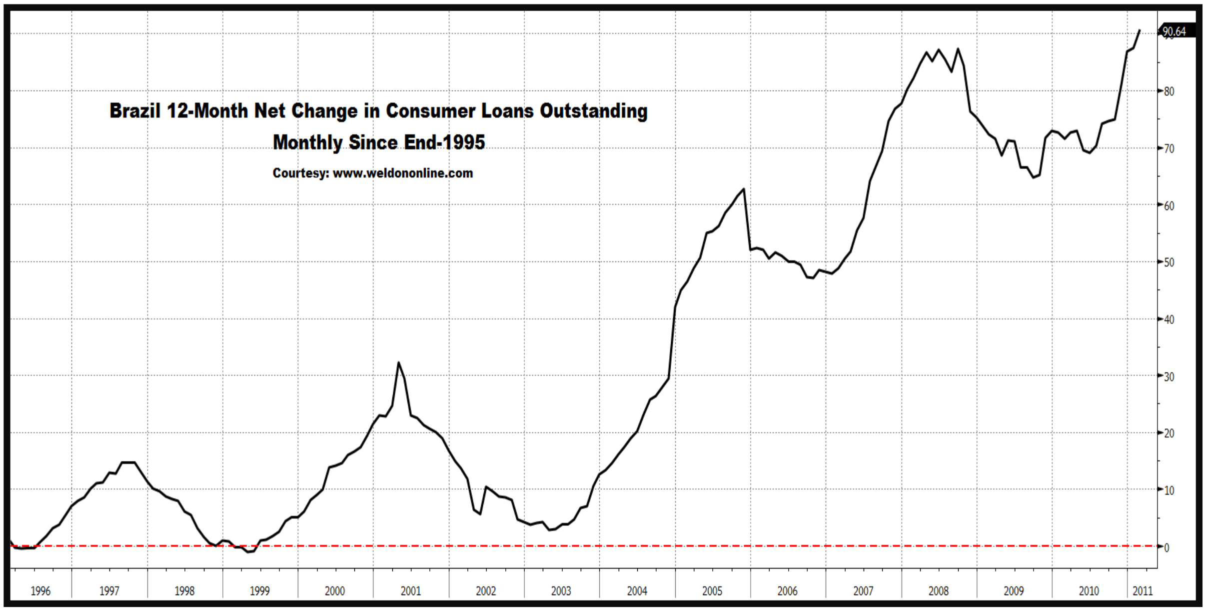
Our trusty data-scalpel in hand, we carve away to discover that the largest nominal year-year increase in Bank Loans was posted in the Consumer Loan category, which soared to its own NEW RECORD HIGH of 561.23 billion. Evidence the chart on display below revealing a parabolic path to the upside in Brazil's Consumer Loans.



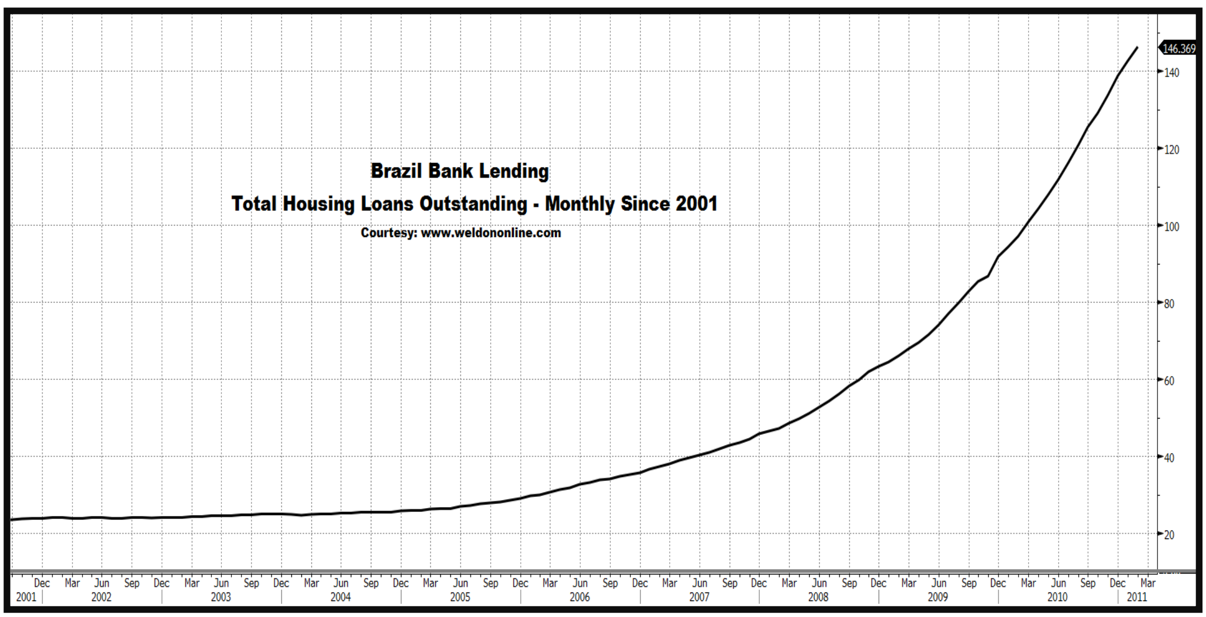
Moreover, the nominal year-year increase in Consumer Loans was also a NEW RECORD HIGH at +90.64 billion. Note the data on display below exposing the rapid acceleration in the year-year expansion, and a net nominal increase of +186.3% in the last five years, during the month of February.

Feb-2011 … up +90.64 billion
Feb-2010 … up +71.50 billion
Feb-2009 … up +72.20 billion
Feb-2008 … up +82.14 billion
Feb-2007 … up +48.72 billion

We shine the spotlight on the chart below plotting the rolling 12-Month net nominal change in Brazilian Consumer Bank Loans Outstanding, which has EXCEEDED the previous record high, set in 2008.



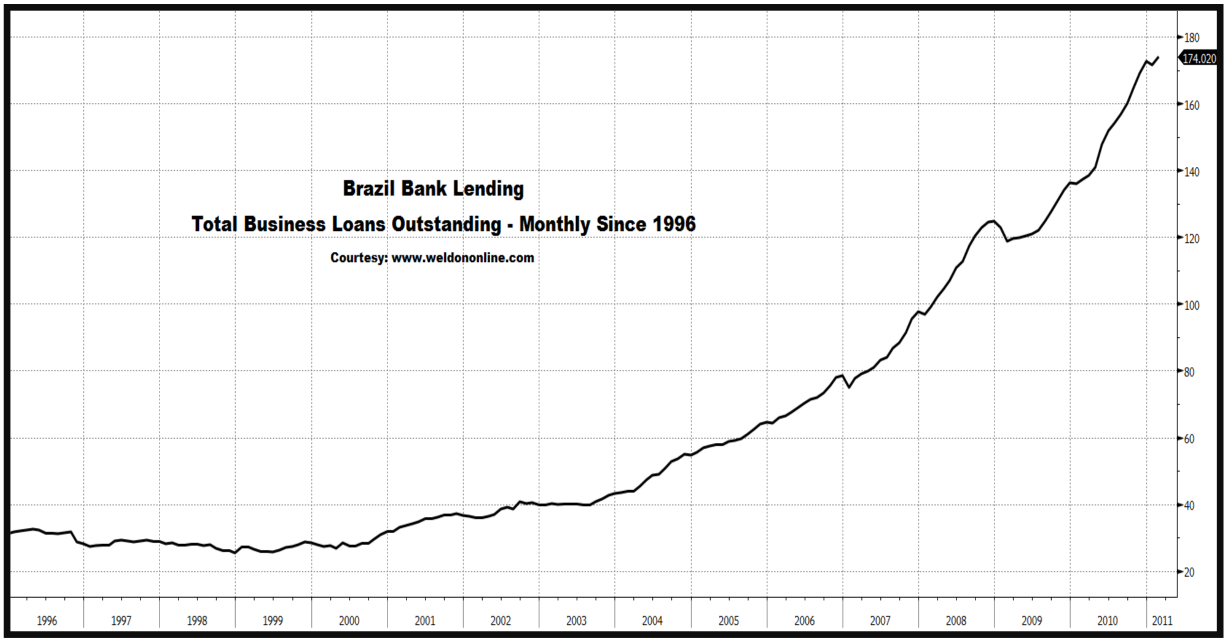
The largest year-over-year percentage gain came in Housing Loans Outstanding … which also reached its own NEW RECORD HIGH, nominally speaking, pegged at 146.369 billion, as evidenced in the chart below.



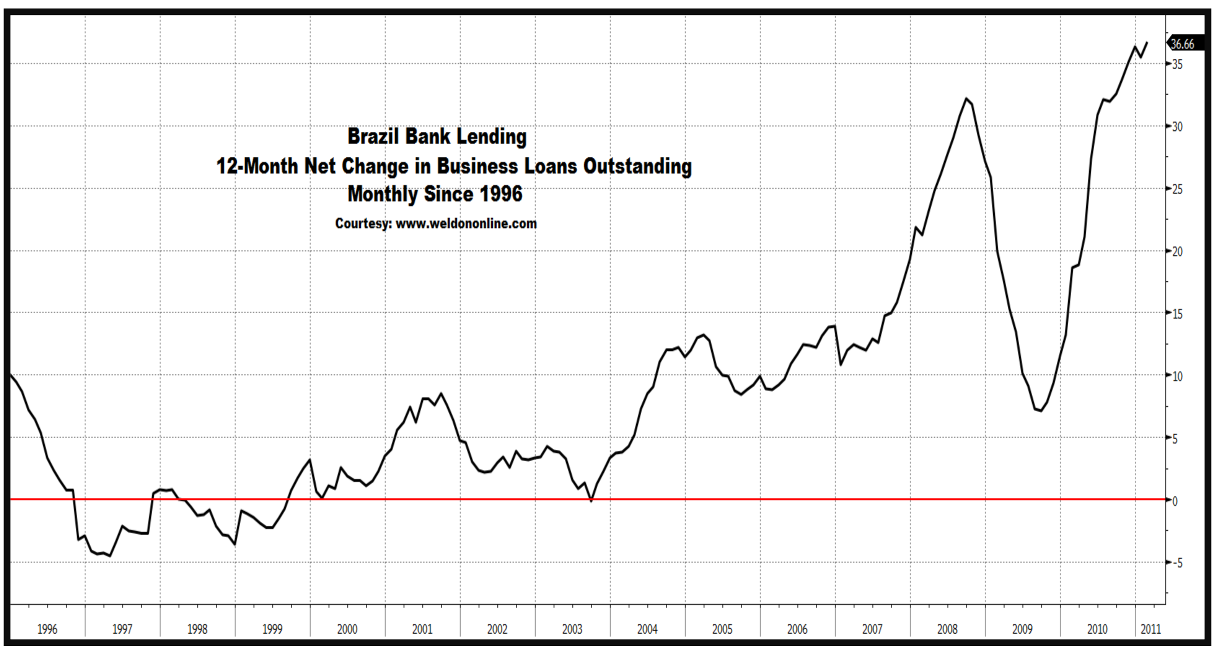
The percentage year-year gain is pegged at a FAT +50.9% rate, MORE than TWICE the rate-of-change posted in Total Loans and Consumer Loans. Moreover, the nominal net change from February of last year was pegged at +49.36 billion …for a FAT +585.7% expansion over the last five years, as detailed in the data seen below:

Feb-2011 … up +49.36 billion
Feb-2010 … up +30.93 billion
Feb-2009 … up +18.90 billion
Feb-2008 … up +10.02 billion
Feb-2007 … up +7.20 billion

We also observe the chart on display below plotting the path of Brazilian Business Loans Outstanding … revealing February's surge to a NEW ALL-TIME HIGH of 174.02 billion.



Finally, we spotlight the chart below revealing that the rolling 12-month net nominal change in Brazilian Bank Loans to Businesses also reached a new RECORD HIGH, pegged at +36.66 billion … resulting in a year-year percentage gain of +26.7%, second only to the expansion in Housing Loans Outstanding, in terms of the largest gains by 'sector'.



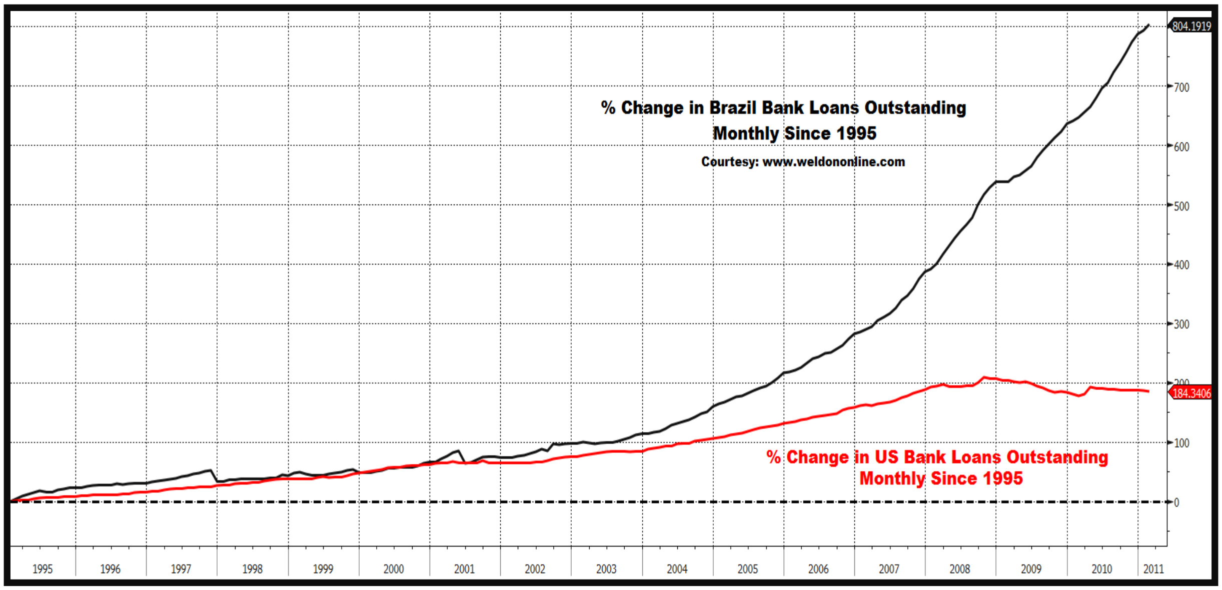
Evidence the sequential expansion in the year-year change in Business Loans over the last five years, for the month of February:

Feb-2011 … up +36.66 billion
Feb-2010 … up +18.55 billion
Feb-2009 … up +19.90 billion
Feb-2008 … up +21.18 billion
Feb-2007 … up +11.98 billion

Perhaps most important is the fact that on a nominal basis, the Total of Brazilian Bank Loans Outstanding remains relatively small. When adjusting for the difference between the population in Brazil, and that of the US, Brazil's Total Bank Loans Outstanding is pegged at US 'equivalent of $1.62 trillion (USD), or, just 24% of Total US Commercial Bank Loans Outstanding.

Despite the relatively low nominal level, the long-term overlay chart on display below is impressive nonetheless, as we compare the growth in Brazilian Bank Credit (black line) to that in the US (red line).

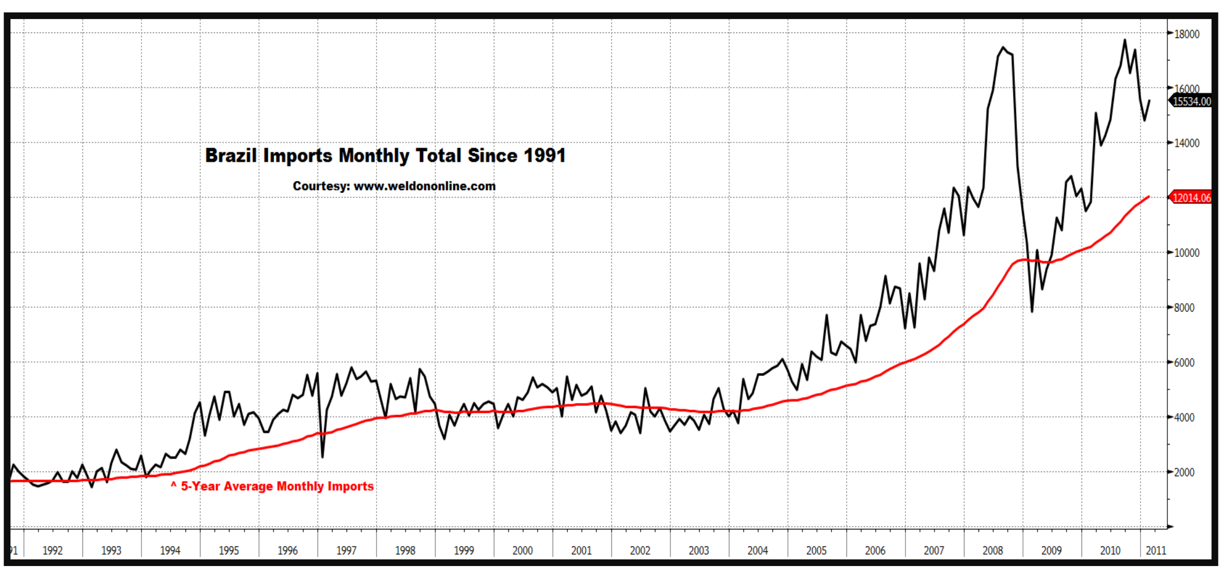
Looks like … Fat Tuesday in Brazil, and Ash Wednesday in the US !!!



The situation in Brazilian trade remains 'fat' as well, with both Imports and Exports on the rise. Data scalpel in hand, we extract the following data details from the most recent trade report covering the month of February:

> *Imports … rose by +$743 million in February, a rise of +5.0% for the month, taking the monthly total to $15.534 billion, and a year-year expansion of +$3.727 billion, or +31.6%.*

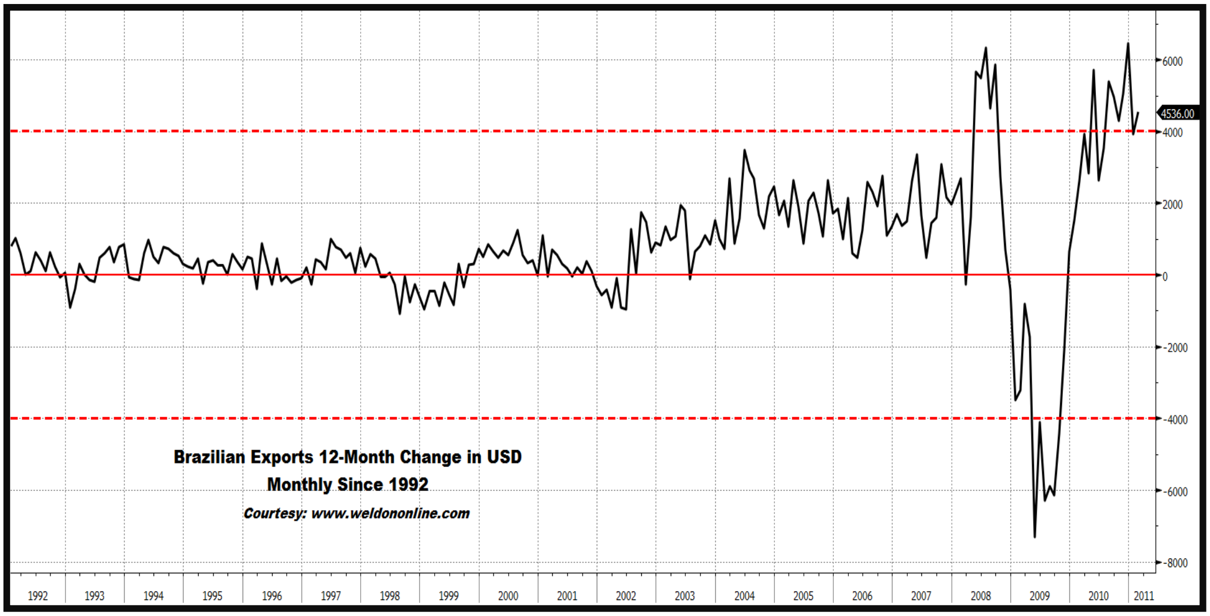
Evidence the chart below revealing that February's Imports of $15.543 billion was the eighth largest single-month total in the country's history.



As for Exports, we note the data details …

> *Exports … rose by +$1.518 billion during the month for an increase of +10.0% versus January, pegged at $16.733 billon, Exports are up by +$4.536 billion on a year-year basis, for an expansion of +37.2%.*

… and the chart on display below, revealing that the +$4.536 billion year-over-year increase in the monthly Export total represents one of the top-ten all-time expansions in the value of 'external' shipments.



'Telling' is the stellar 12-month cumulative Export total, which was pegged at $210.36 billion, which represents a sizable rise of +33.9% relative to the 12-month cumulative total of $157.129 billion posted in Feb-2010.

Even more impressive was the 12-month cumulative Import total, which was pegged at $188.703 billion, up by $55.83 billion, or +42.0%, versus the 12-month cumulative total of $132.871 billion posted in Feb-2010.

We do note the 'negative' impact linked to the intensified demand for Imported goods, as it relates to a worsening in Brazil's Current Account Balance, which posted a sizable 12-month deficit of (-) $49.21 billion, which is equal to (-) 2.31% of Brazil's GDP. The deficit of more than 2% of GDP represents a notable erosion, relative to the 12-month deficit of (-) $28.032 billion posted in February of last year, a shortfall that was equal to just (-) 1.62% of Brazil's GDP.

For now at least, an equally large inflow of Foreign Direct Investment (FDI) is enough to 'cover' the Current Account deficit.

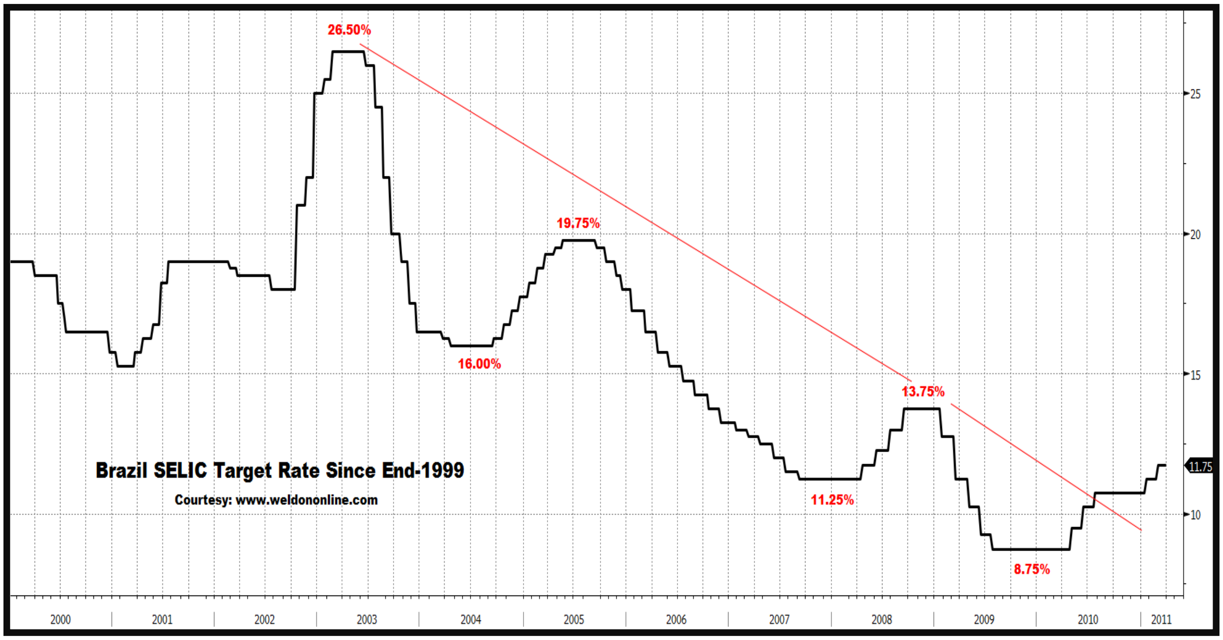
For the month of February alone, FDI totaled $7.727 billion, a MASSIVE increase of +$4.878 billion relative to the February 2010 monthly FDI total of $2.849 billion, calculating to a FAT year-over-year expansion of +171.2%.

Indeed, when measured as a percent of GDP, Brazil's 12-month cumulative FDI total of $55.695 billion calculates to 2.62% of GDP, or, more than enough to 'cover' the Current Account Deficit, and is nearly equal to the 12-month cumulative increase in Imports.

Bottom line … relative to the Feb-2010 twelve-month cumulative FDI total of $25.50 billion, the Feb-2011 figure of $55.695 billion represents a gain in excess of +100%, on a year-year basis.

It is against this FAT Tuesday like macro-backdrop, and the increase in the rate of inflation from negative territory, to more than 10% yr-yr, that on March 3rd the Brazilian Central Bank's Monetary Policy Committee, known as COPOM, decided to hike their key short-term interest rate, taking the SELIC target rate up by +50bp, to 11.75%.

The move marked the fifth rate hike enacted since April of 2010, during which time the SELIC target rate was increased from 8.75%, to the current level of 11.75%. Evidence the chart below plotting the Brazilian Central Bank's key monetary policy rate dating back to 1999.



From within the Minutes from the March COPOM meeting, released on March 10th, we note the following passage

> … *"It is the responsibility of monetary policy to remain especially vigilant to guarantee that pressures detected in shorter horizons do not spread to longer horizons."*

Perhaps it is memories of this statement that caused the markets to 'de-price' some of the additional monetary tightening that had been priced into the forward fixed-income strip … on the back of today's release of March inflation data.

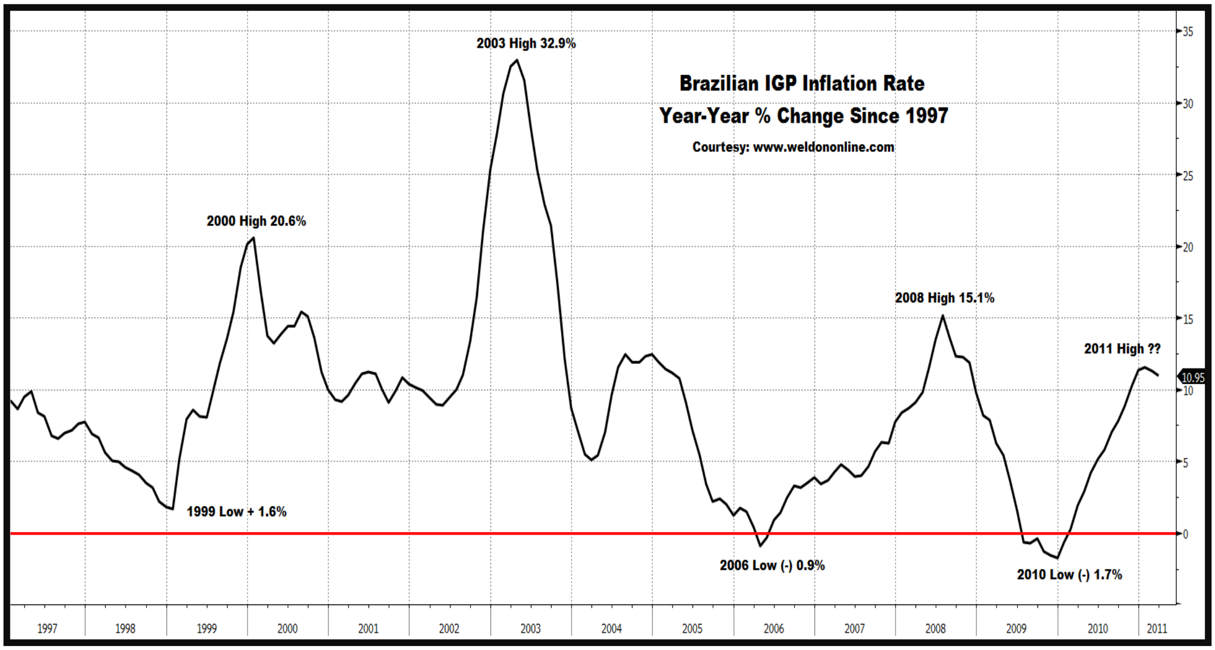
Indeed, the monthly rise of +0.62% in the IGP-M rate of inflation represents the smallest single-month increase since July of last year …

… while the slide in the year-year rate, to 10.95% from +11.30% in February, represents the second straight month of disinflation, relative to January's secular peak rate of +11.5% yr-yr.

We note the slide in Consumer Goods prices, which 'fell' to a +5.74% yr-yr of inflation, down from February's rate of +5.96%, and down from +6.18% in January … and … the slide in Food prices, which fell to a +7.11% yr-yr pace of increase, down from +8.76% in February, and +9.83% in January.

And, we also spotlight the +0.65% monthly increase in Brazil's Wholesale Price Index posted for the month of March, which represents a near HALVING in the monthly rate of WPI inflation, when compared to February's single-month spike of +1.20%. Subsequently, the year-year rate of WPI inflation fell to +13.46%, down from +13.93% in February, and down from a +14.18% yr-yr rate of Wholesale Price inflation posted in January.

‘Telling’ is the action in Brazil’s year-over-year rate of IGP-M inflation, as evidenced in the chart below, holding out hope for would-be Brazilian bulls that inflation has … gasp … peaked in the intermediate-term.

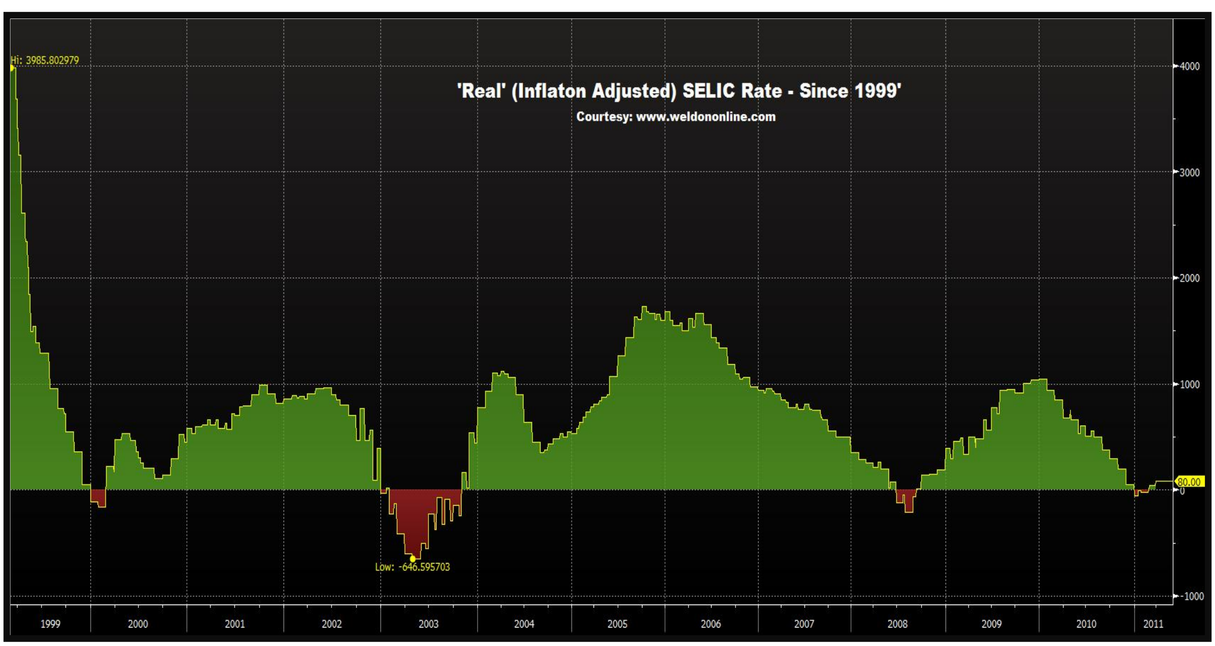


Maybe Brazil has given up an accelerating rate of inflation … for “Lent”.

If so, then the prospects for future rate hikes are lessened, amid the push back into ‘positive’ territory by the ‘real’ (or, inflation adjusted) SELIC rate, as evidenced in the chart below in which we plot the ‘differential’ between the SELIC target rate, and the year-year rate of IGP-M inflation.

Indeed, in each of the last two periods following a move from a negative ‘real’ SELIC rate, back into positive territory (meaning, the SELIC moved from a level below the year-year rate of inflation, back above the inflation rate) … the Brazilian stock market has rallied …

… in 2003-2007, and then again in 2009-2010.

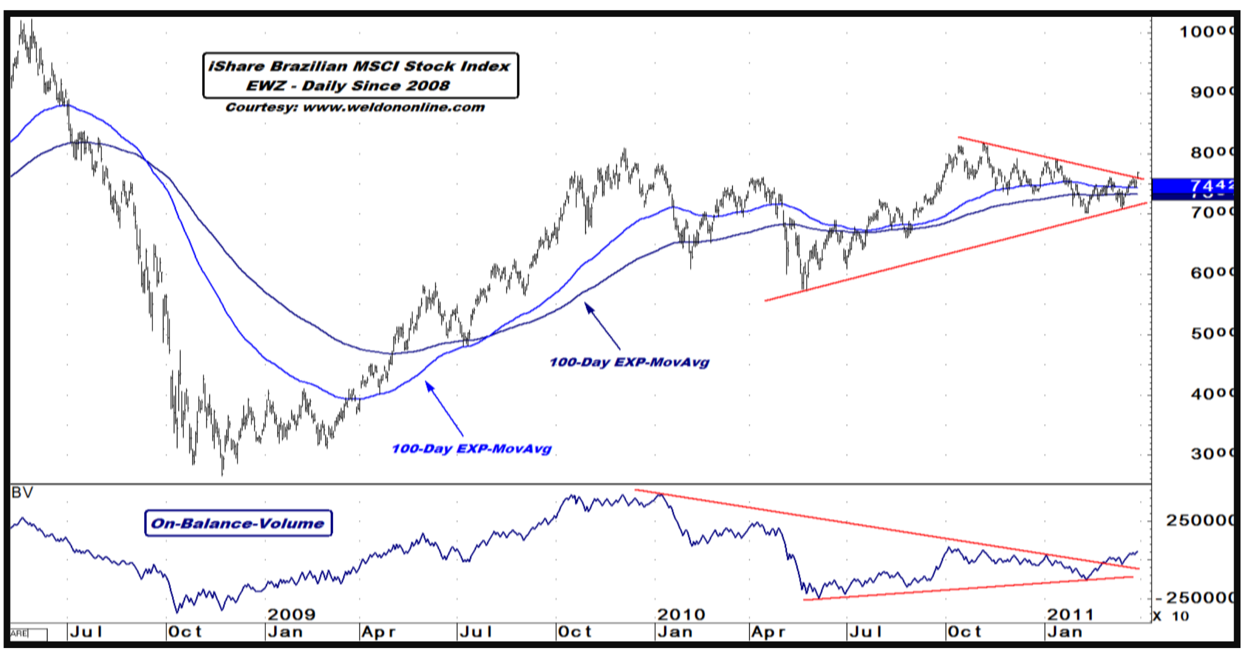


The Brazilian markets are 'celebrating' today like it is still Fat Tuesday …

… with the currency rallying to a new multi-year high (USD low), violating the previous high set in October of last year, as evidenced in the chart on display below in which we plot the US Dollar-Brazilian Real.

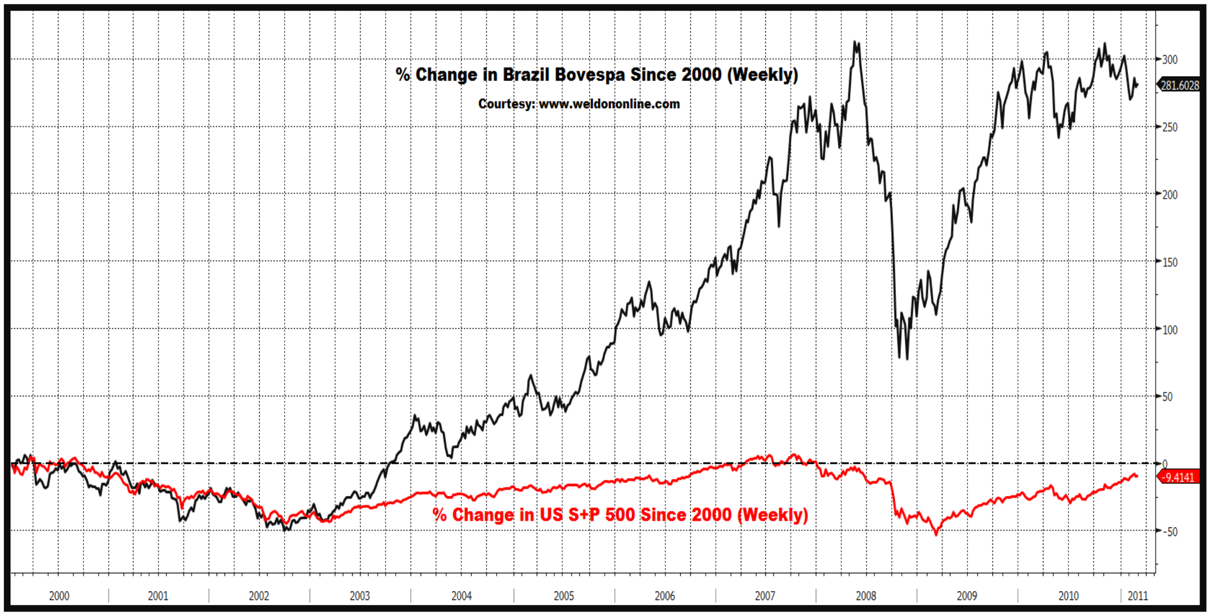
It may well be Carnival time once again in the Brazilian equity market, as evidenced within the chart below plotting the path of the iShare on the Brazilian MSCI stock index, or EWZ.

We focus on the upside breakout and subsequent bullish resolution to the multi-month pennant pattern … in synch with the upside violation of both the med-term 100-Day EXP-MA and the long-term 200-Day EXP-MA, with both averages now accelerating back to the upside, directionally. Also, we note the breakout in, and push back into overtly positive territory by, the On-Balance-Volume indicator.



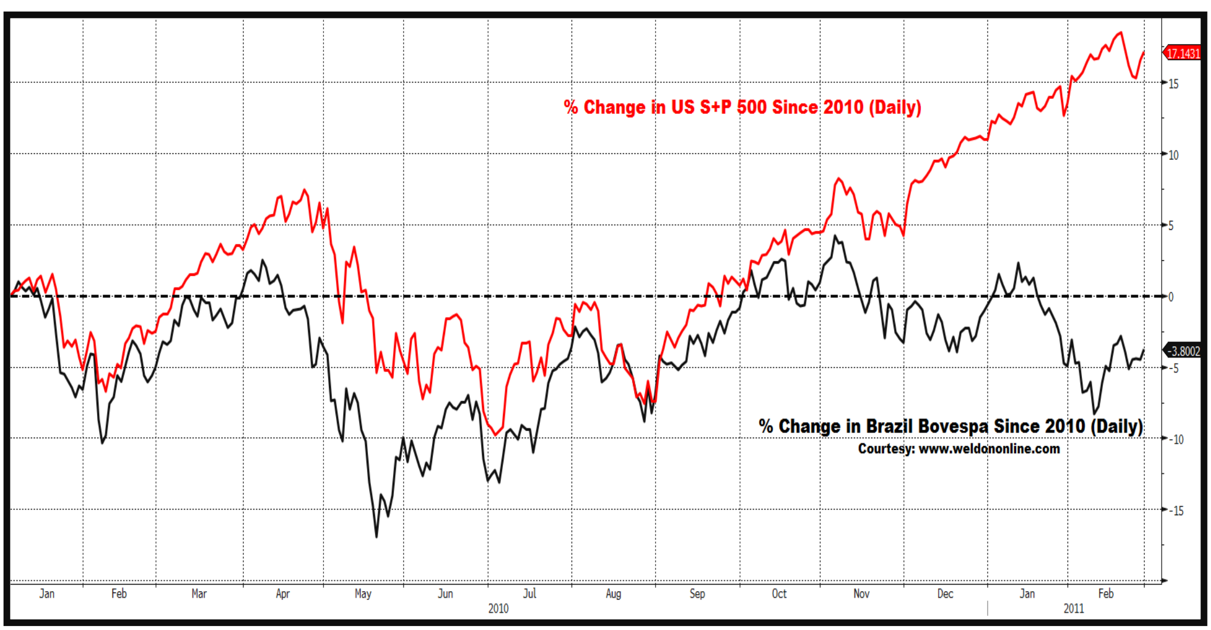
Indeed, the Brazilian stock market has been celebrating Mardi Gras for at least the last decade, with a significant degree of upside outperformance relative to the US S+P 500 stock index. Evidence the long-term weekly overlay chart on display below in which we plot the percent change since the beginning of 2000 in the Brazilian Bovespa (black line), versus the cash US S+P 500 stock index (red line).

Over the last eleven-plus years the Bovespa has appreciated by +281.6%, while the US S+P 500 has depreciated by (-) 9.4% …



… BUT … when we condense our comparison to take into account the time frame that incorporates the period during which the Brazilian Central Bank has been actively tightening monetary policy, we see a completely different dynamic, as evidenced in the daily overlay chart shown below.

Indeed, since the beginning of last year, the Brazilian Bovespa has depreciated by (-) 3.8%, while the US S+P 500 stock index has appreciated by +17.1% over that same time frame, a period during which the US Central Bank has been OVERTLY 'supportive'.



And, finally, when we observe the overlay chart on display below we might even suggest that the party is just getting started in Brazil, as we plot the path of the Brazilian Real (versus USD, futures contract, black line), against the Ratio Spread created by comparing the Brazilian iShare EWZ to the US S+P 500 stock index (red line). The chart reveals a tight positive directional correlation, implying that strength in the Brazilian currency can be linked to periods where the Brazilian stock market outperforms the US market.

As such, the divergence noted since the 4Q of last year strongly suggests that the most recent period of Brazilian stock market UNDER-performance may have come to an END, and that the Mardi Gras party in Rio is likely to more wild than the Mardi Gras party on Bourbon Street.

A suspension of monetary tightening by the Brazilian Central Bank, on the back of a potential reversal in inflationary pressure … might be akin to returning the punchbowl to the party.

Indeed, in Rio … Fat Tuesday may extend into the 2Q.

We are bullish on the Brazilian Real, and would consider a bullish stance in the Brazilian stock market.

We remain bearish on US and EU fixed-income markets.

We remain bullish on Gold, Silver, Crude Oil and Gasoline.

And we remain bearish on the British Pound.

Gregory T. Weldon ---

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Within our own money management philosophy, we consider the risk overlay as the single most important element of our portfolio based programs. Hence, while our momentum based models DO provide the basis for our OWN trading decisions, we are NOT making any specific suggestions based on this alone, particularly as applies to the application of a risk overlay.

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