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Real tumbles as Brazil imposes curbs

By Samantha Pearson in São Paulo

The Brazilian real tumbled on Wednesday after the country introduced measures to curb foreign exchange speculation in a bid to bring down the currency from a 12-year high against the dollar and protect its manufacturers.

The government imposed a 1 per cent transactions tax on currency derivatives, laid down new legislation whereby the tax could be increased to up to 25 per cent, demanded the registration of "over-the-counter" currency trades and threatened further measures such as raising minimum trading margins.

"This is a relatively severe measure because it's so comprehensive. It affects Brazilian banks, companies, residents, non-residents," said Tony Volpon, head of emerging markets research for the Americas at Nomura. "But there are still many things left answered; the market is very illiquid now, people are just sitting on their hands wondering what on earth is going on."

After gaining about 8 per cent against the dollar this year, the real is now at levels not seen since 1999. It dropped 1.7 per cent on Wednesday to R$1.5633.

The new legislation could also increase hedging costs, analysts said, given that many companies buy the Brazilian currency in the futures market to balance out their US dollar exposure.

"As a result, we could see a series of exemptions over time to dilute this measure, which would then open up new channels for arbitration," Mr Volpon said.

At a press conference on Wednesday, Guido Mantega, Brazil's finance minister, stood firm, arguing that the measure was only directed at speculators and that genuine hedgers would be unaffected.

"It's a toll that penalizes excessive long positions on the Brazilian real," said Mr Mantega. "We could also raise margins, put limits on leverage and other requirements to make this market safer and more stable."

Mr Mantega gained prominence last year after accusing the developed world of starting a global "currency war", arguing that rock-bottom interest rates across Europe and the US were damaging emerging market economies such as Brazil.

Foreign investors have traditionally borrowed cheaply and ploughed this money into Brazilian bonds, which offer some of the highest yields in the world, driving up the real

and making it more difficult for local manufacturers to export and compete with cheap imports.

However, after raising the so-called IOF transactions tax to 6 per cent on bond purchases last October, foreign investment in the Brazilian bond market dropped 35 per cent to $8.71bn in the first six months of this year from the same period in 2010.

The government has now turned its attention to the currency derivatives market, where banks' total net long Brazilian real position was last recorded in June by the central bank at close to a record high of $14.7bn.

Like many emerging market currencies, the Brazilian real cannot be freely traded, making the derivatives market a popular option for locals and the only option for many foreigners.

Wednesday's new legislation, which does not affect existing positions and only applies to new ones above $10m in notional value, would also hit non-deliverable forwards, a market favoured by big Japanese mutual funds.

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