



Inflation Outlook

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I. Introduction

II. International Environment

III. Financial Conditions

IV. Activity

V. Inflation Developments

I. Introduction

BCB's Mission

- Ensuring the stability of the purchasing power of the currency and a solid and efficient financial system

Importance of Currency Stability

- The international experience and the economic theory set low and stable inflation as precondition to sustainable growth
 - **High inflation:**
 - Increases risk premiums and interest rates; diminishes confidence and shortens the planning horizon; depresses investment and economic growth
 - Reduces employment and, therefore, income and consumption
 - Increases income concentration and diminishes society welfare as a whole

The Brazilian Experience

Period	Annual Average (%)	
	Real GDP Growth	Inflation
1980-1985	2.6	147.1
1986-1994	2.3	842.5
1995-2003	2.2	9.1
2004-2013	3.7	5.5

Retrospective - Abroad

Since the last Report release :

- The risks to global financial stability remained high (volatility and risk aversion increased):
 - In the US, the program of assets' purchase by the Fed (tapering) has ended
- Prospects remained for global activity gaining intensity throughout the relevant horizon for monetary policy
- In the international markets, there was a retreat in the prices of commodities, especially in the segment of energy
 - The price of the Brent oil barrel decreased by 36%
- In general terms, the monetary policy remained accommodative in both mature and emerging economies
 - In Japan and in the Euro Area, the central banks widened monetary policy easing

Retrospective - Brazil

Since the last Report release:

- The national accounts relative to the third quarter pointed to moderate resumption of economic activity
 - With industry and investment growth
- In the market of factors: ICU in slight decline and narrow idleness margin in the labor market
- Prices in the wholesale markets under pressure
 - Particularly in the agricultural segment
- Two important relative prices (Domestic/External and Regulated/Market) correction processes have advanced; consumer inflation increased
- The Selic rate was raised to 11.75%

Prospects – Abroad 2014-2016

- Risks for the global financial stability tend to remain high:
 - Highlights for the risks stemming from changes in the interest rate slope in important mature economies
- Prospects for more intense global activity pace throughout the relevant horizon for the monetary policy
 - Highlights for the heterogeneity of the distribution among the main blocks
- New tension and volatility rallies in the currency markets are likely to be observed
- The reduction of oil prices suggests a contained inflation in the short term, but with an upward trend in the medium term, especially in 2016

Prospects – Brazil 2014-2016

- Activity expansion pace tends to be less intense this year, compared to 2013:
 - In the second half of next year, activity enters a resumption trajectory
- In the relevant horizon for the monetary policy, changes in the composition of aggregate supply and demand are anticipated:
 - Composition of medium-term growth tends to be more favorable to the long-term growth (potential growth)
- Current accounts' deficit tends to continue to be essentially financed by FDI flows
 - Higher global growth, depreciation of BRL and higher domestic production of oil will contribute to revert trade balance deficit
- Moderate credit expansion:
 - Credit to consumption tends to grow at a pace in line with the growth of households' available income; it is highly likely that actions will be taken to reduce concession of subsidies through credit operations

Prospects – Brazil 2014-2016

- Inflation tends to increase in the short term and to remain high in 2015:
 - Realignment processes - domestic *versus* external prices and regulated *versus* market prices; fiscal stimuli; wage costs; and high inflation expectations
- In 2015, inflation gets a sustainable composition and enters a long downward period:
 - Prevailing force: effects of the Selic rate increase
 - Complementary force: more austere fiscal policy and moderation in the concession of subsidies through credit operations
 - Moreover:
 - Processes of prices realignment tend to be exhausted throughout the forecast period
 - Inflation expectations are more favorable at the end of the forecast period
 - Wage moderation

Prospects – Forecasts - 2014-2015

GDP Forecast:

- 2014 GDP growth estimate at 0.2%
- GDP growth estimate in four quarters up to September 2015 at 0.6%

Inflation Forecasts:

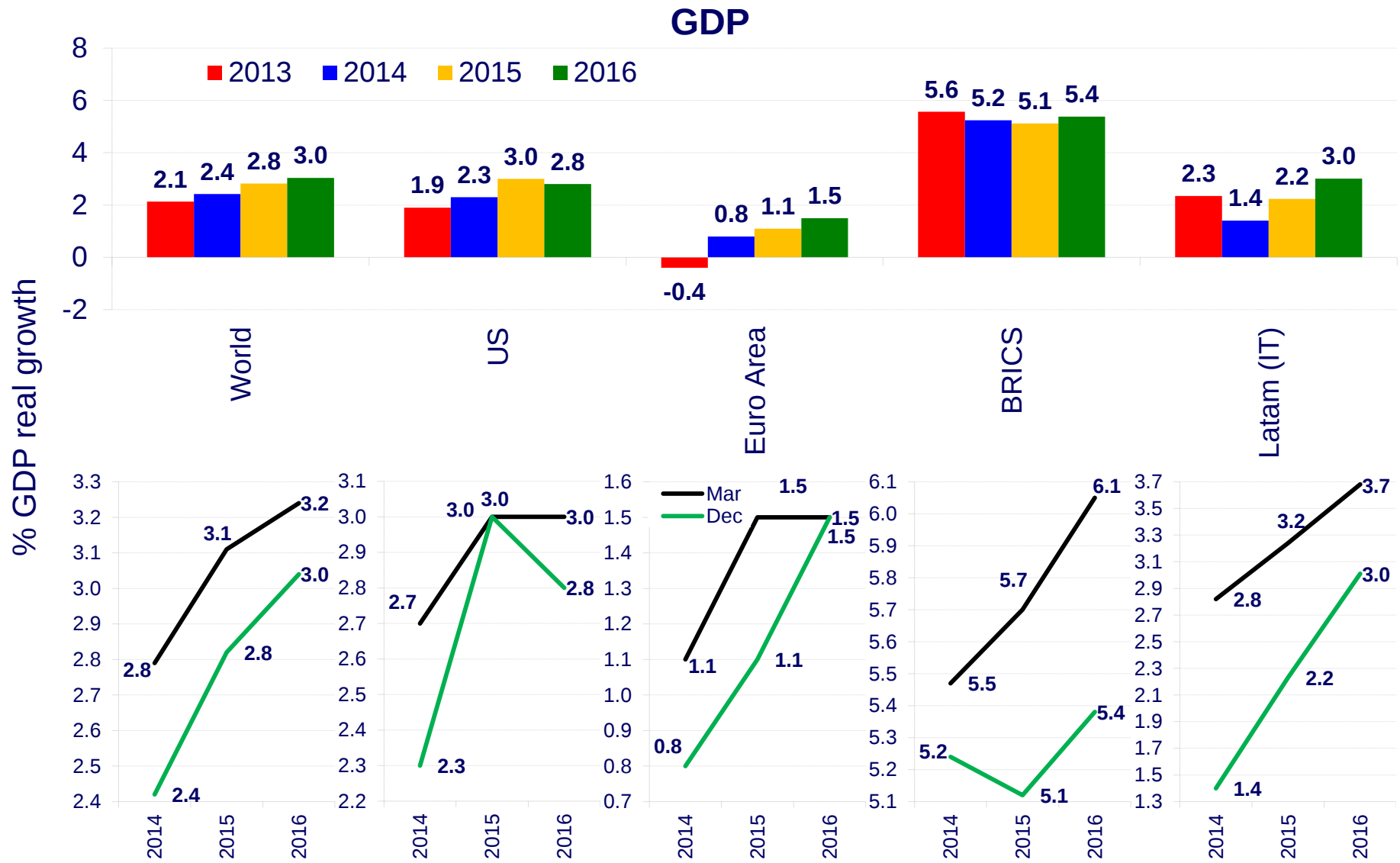
- Baseline scenario: 6.4% for 2014; 6.1% for 2015; and 5.0% for 2016
- Market scenario: 6.4% for 2014; 6.0% for 2015; and 4.9% for 2016

Prospective Scenario – Monetary Policy

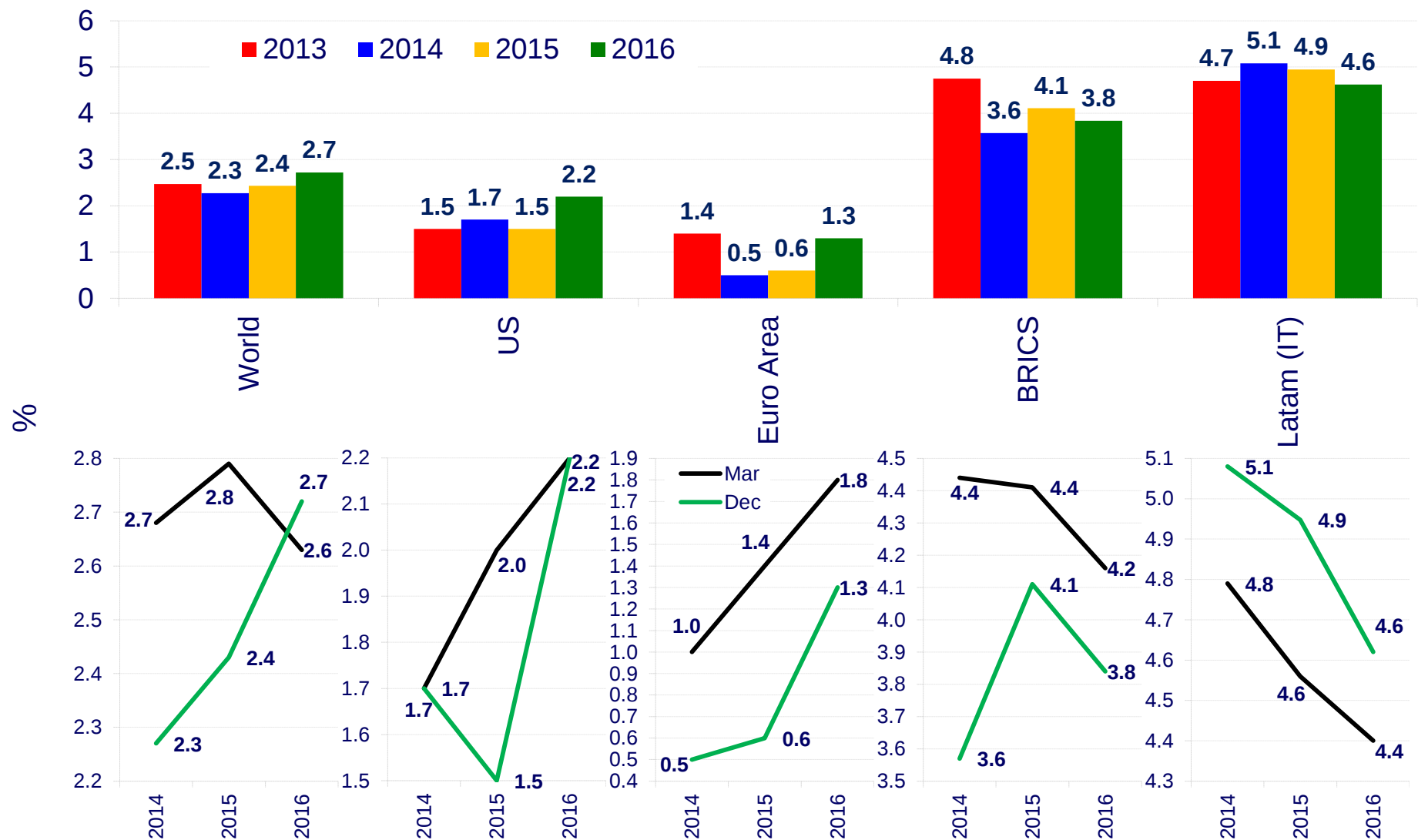
- The Copom highlights that, in moments such as the current one, the monetary policy should remain especially vigilant, in order to minimize risks that high inflation levels, such as the one observed in the last twelve months, persist in the relevant horizon for the monetary policy. Thus, the Committee will do whatever be necessary for the inflation to enter a long downward period next year, towards the 4.5% target midpoint in 2016

II. International Environment

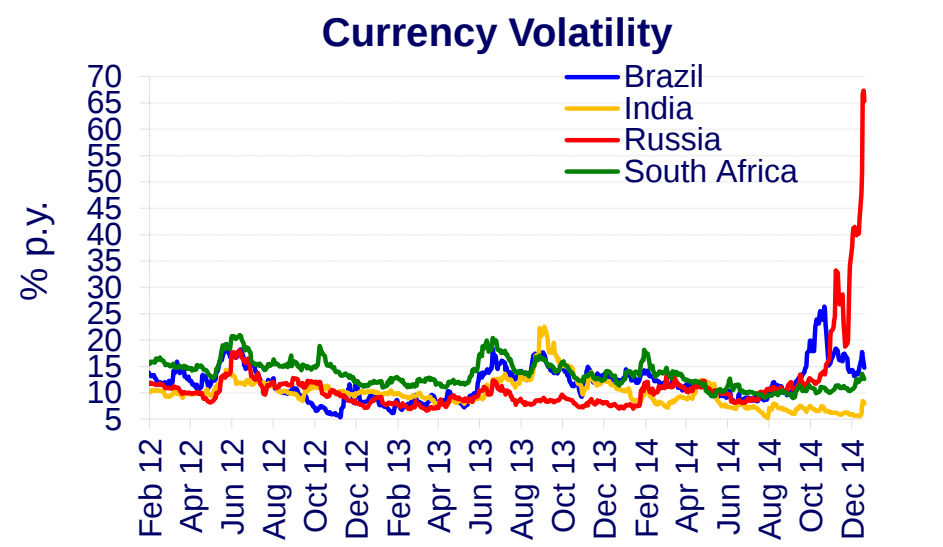
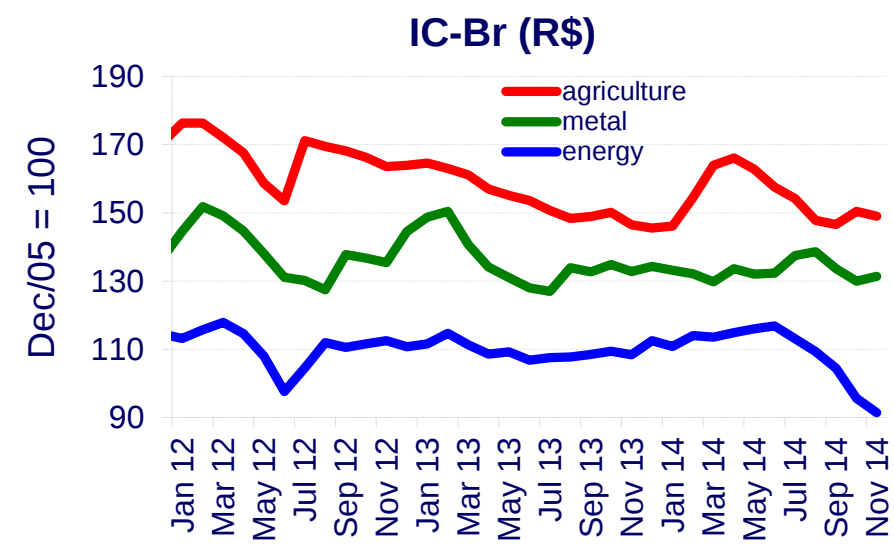
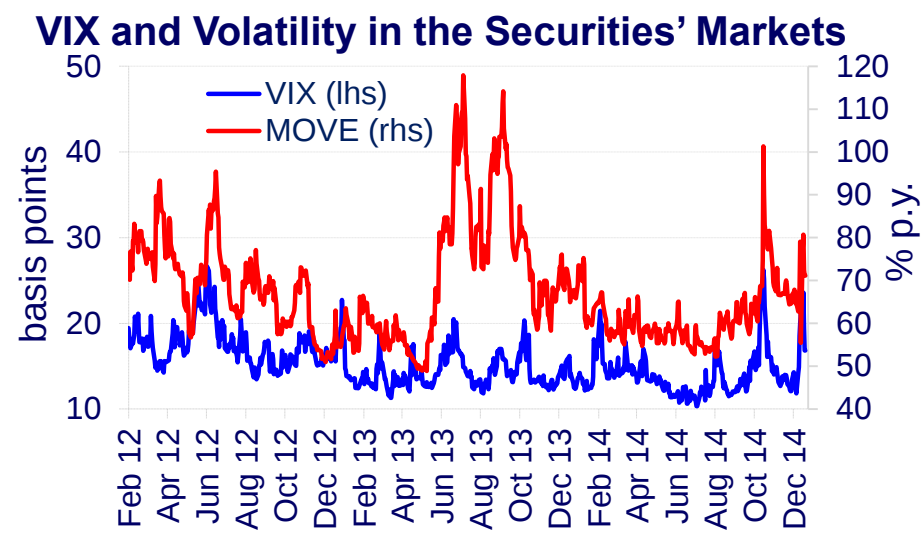
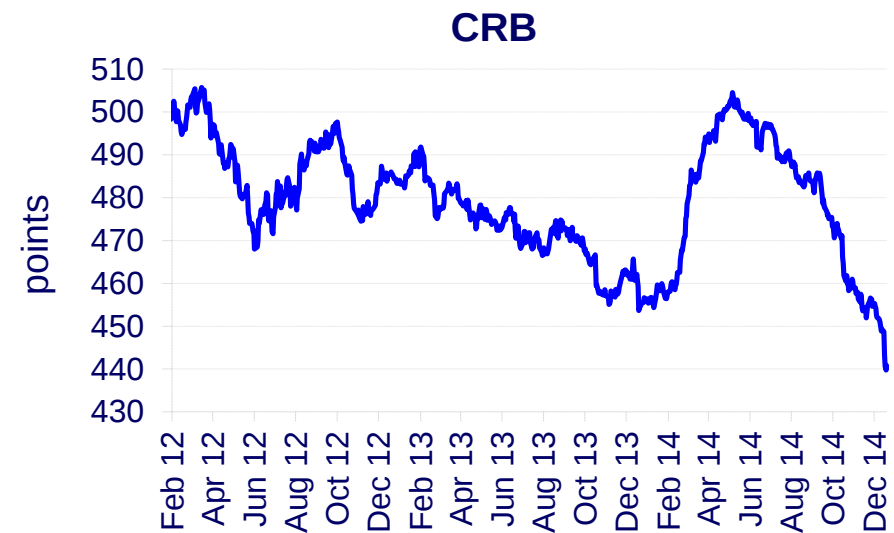
Activity – Expectations



Inflation – Expectations



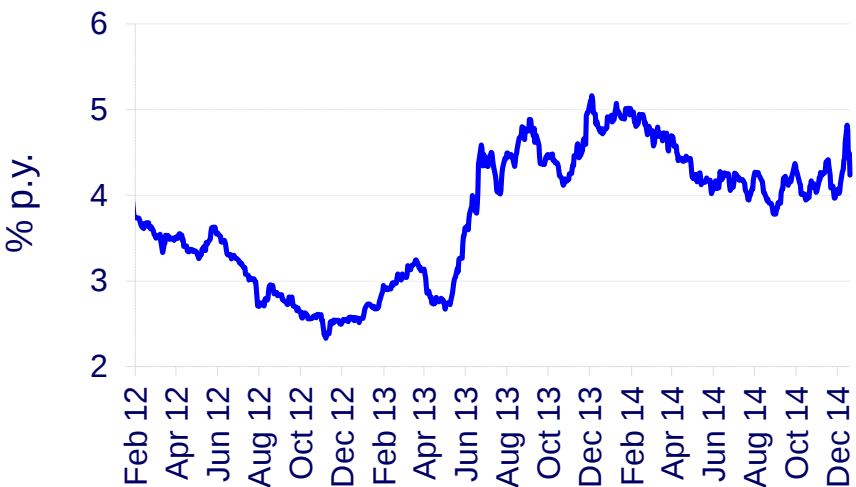
Commodities and Volatility



data up to 12/19

Interest Rate and Risk Premium

Brazil – 10-Year Interest Rate

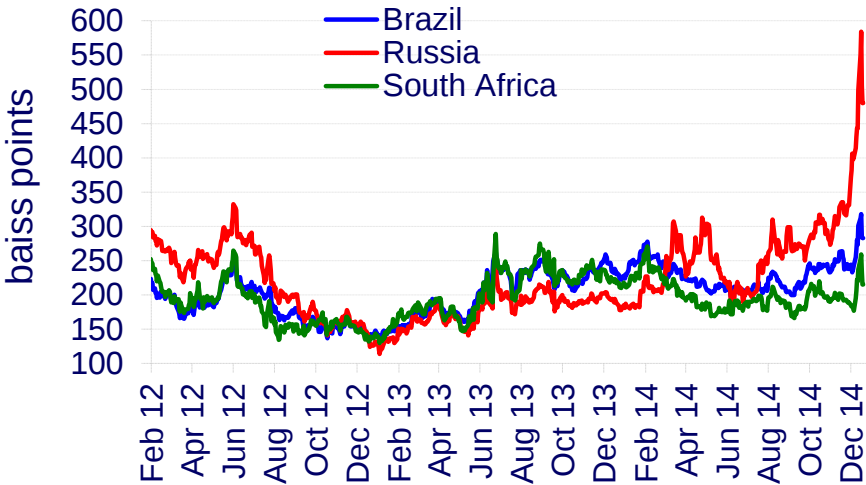


Ratings

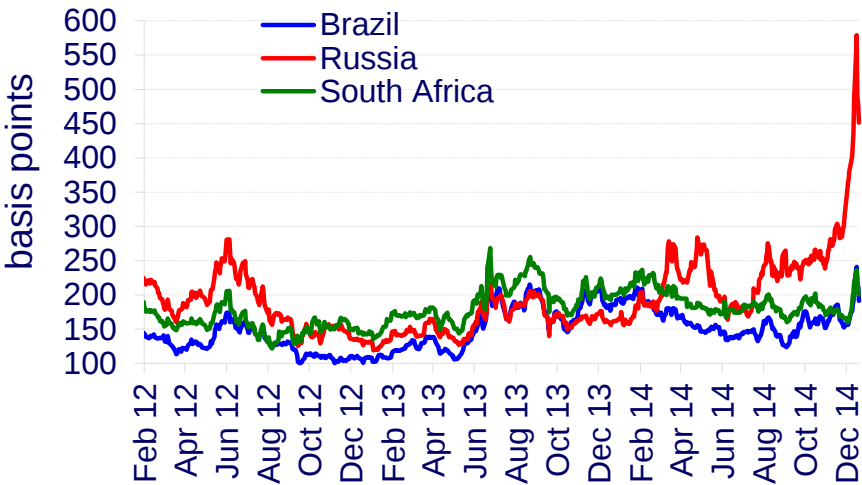
	Moody's	S&P	Fitch
Brazil	Baa2 (-)	BBB- (=)	BBB (=)
Russia	Baa2 (-)	BBB- (-)	BBB (-)
India	Baa3 (=)	BBB- (=)	BBB- (=)
South Africa	Baa2 (=)	BBB- (=)	BBB (-)

= estable; - negative; r review

EMBI+



CDS



data up to 12/19

Box: Projections for the Balance of Payments

Revised Forecasts for 2014:

- Estimate for current account deficit changed from US\$80 billion to US\$86.2 billion (3.9% of the GDP)
- For the Trade Balance, estimate of a US\$2.5 billion deficit
- Estimate of FDI inflows remains at US\$63 billion (approximately 70% of the current account deficit)

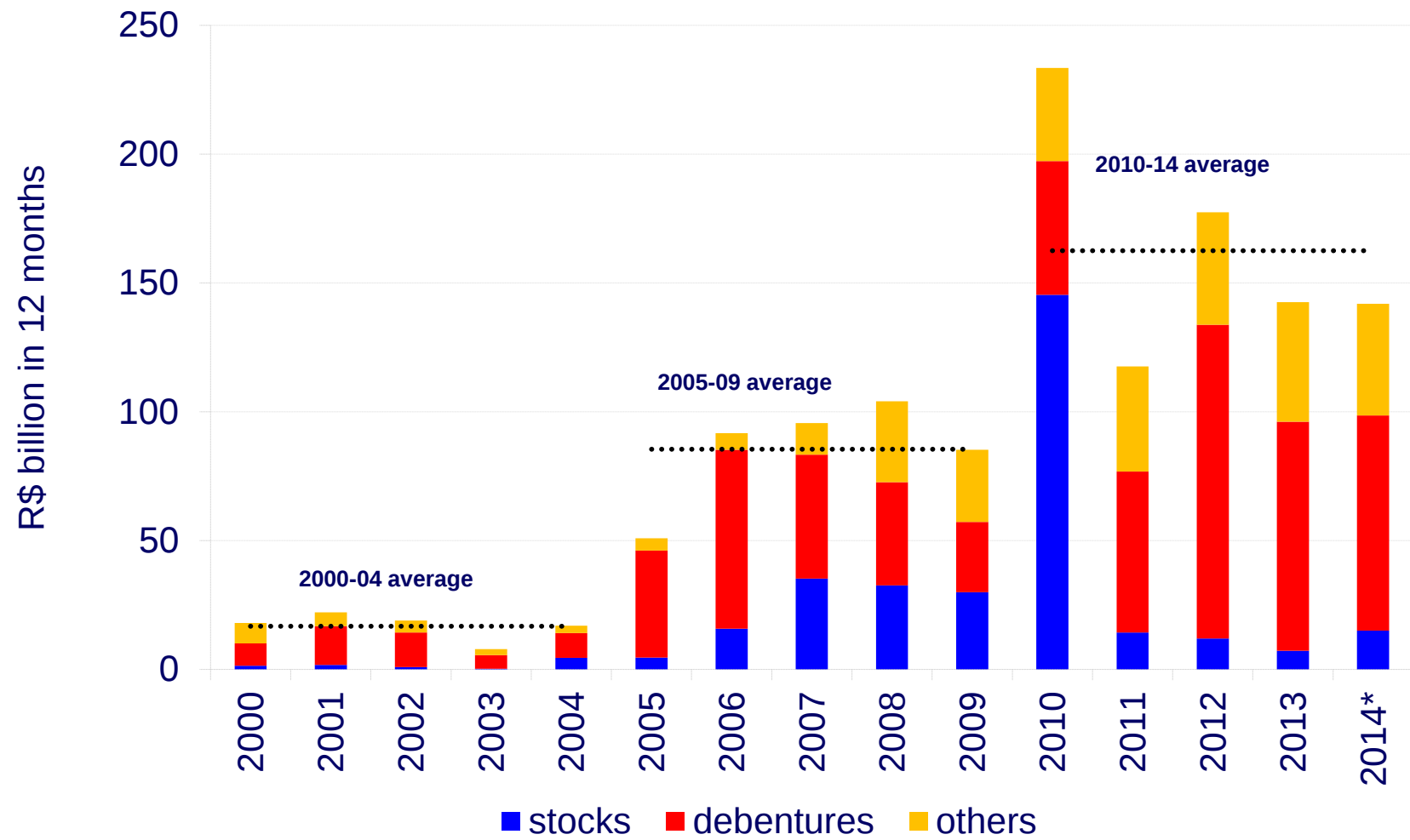
Forecasts for 2015:

- Estimate for current account deficit at US\$83.5 billion (3.8% of the GDP)
- For the Trade Balance, estimate of a US\$6 billion surplus
- Estimate of FDI inflows at US\$65 billion (approximately 80% of the current account deficit)

III. Financial Conditions

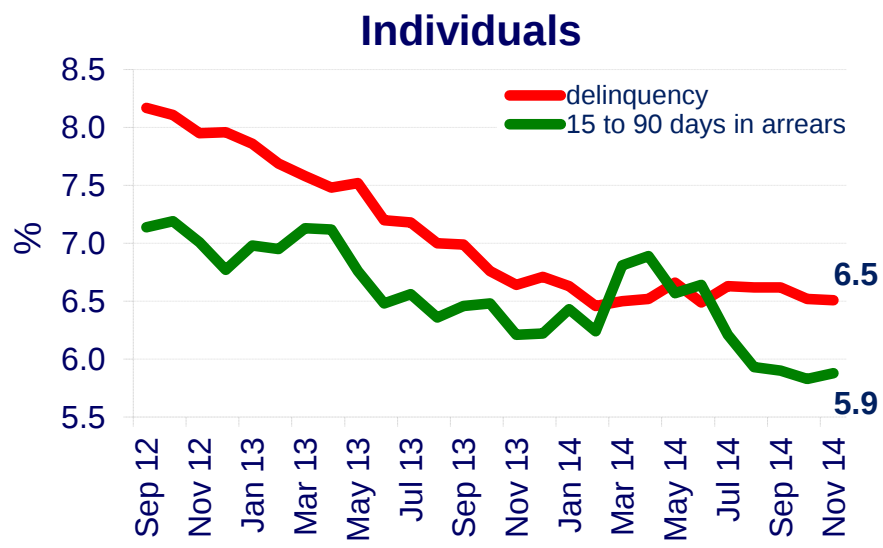
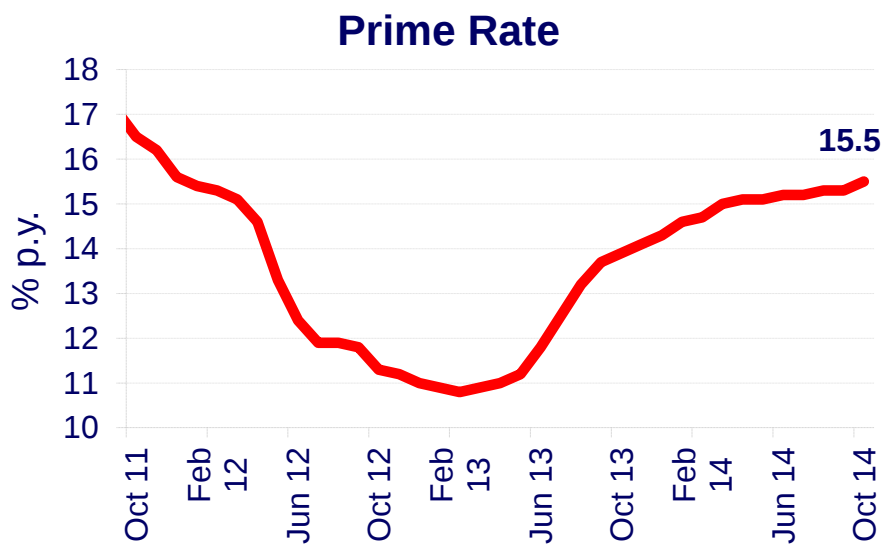
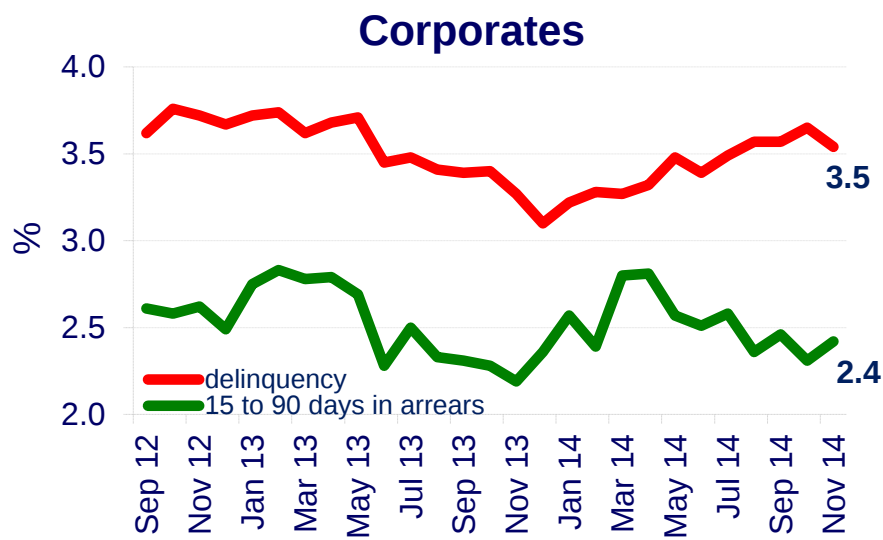
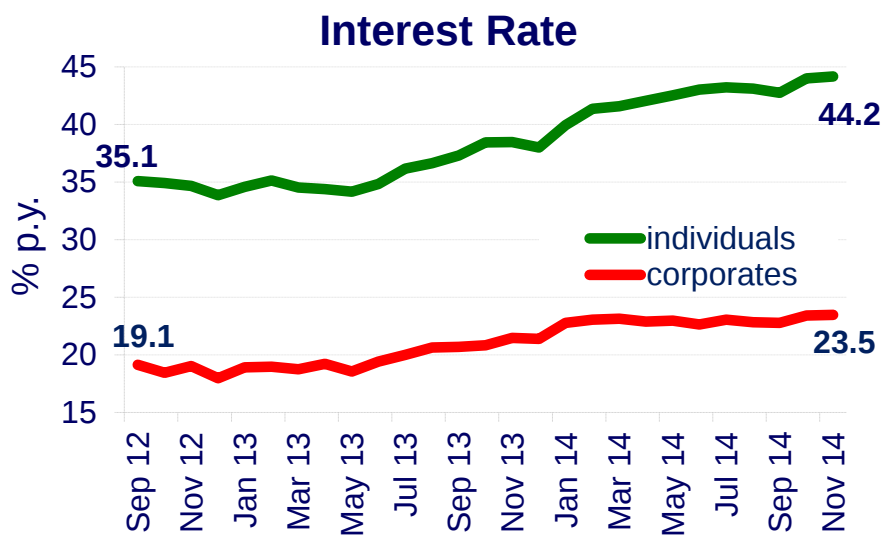
Capital Market Domestic Operations

Primary Issues

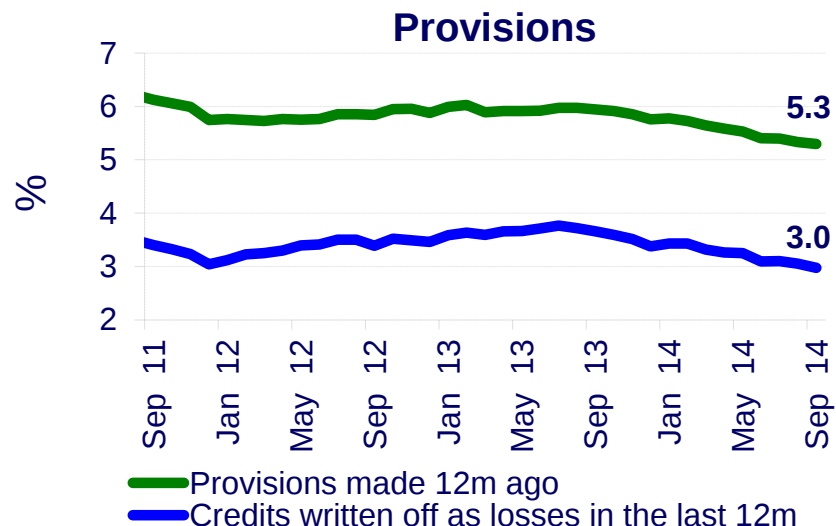
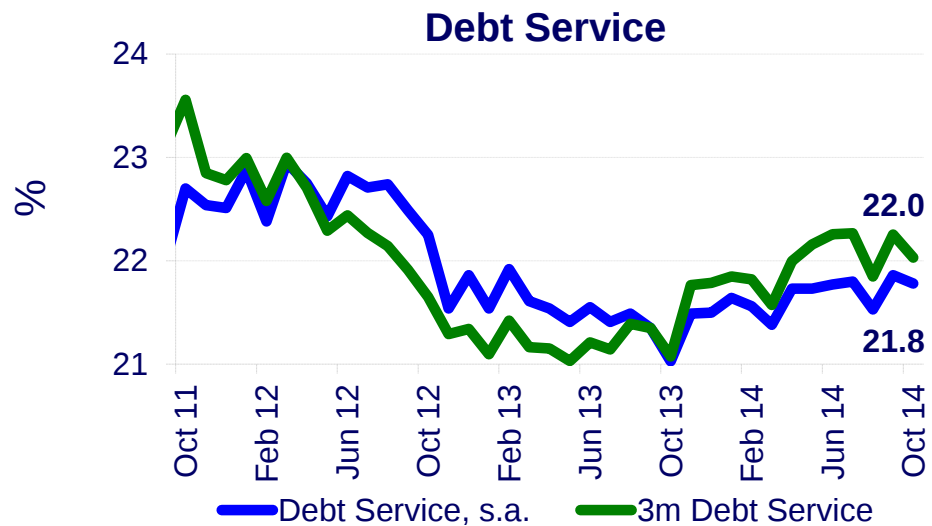
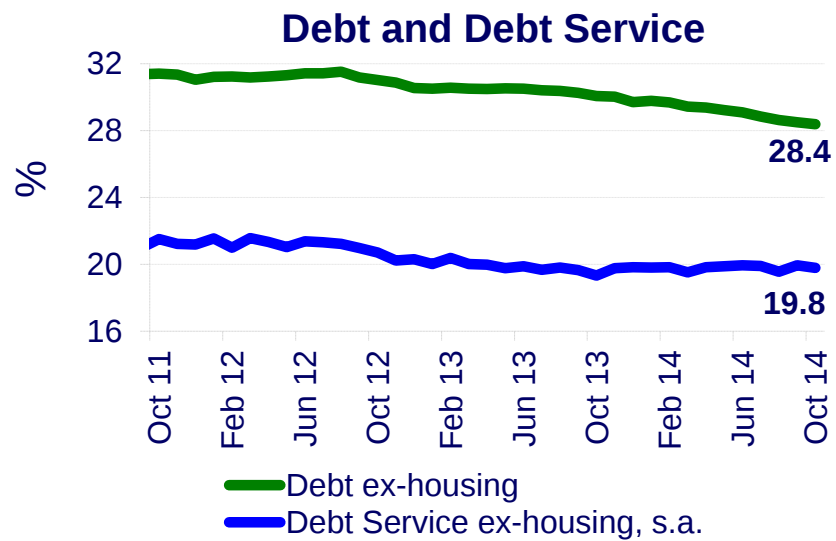
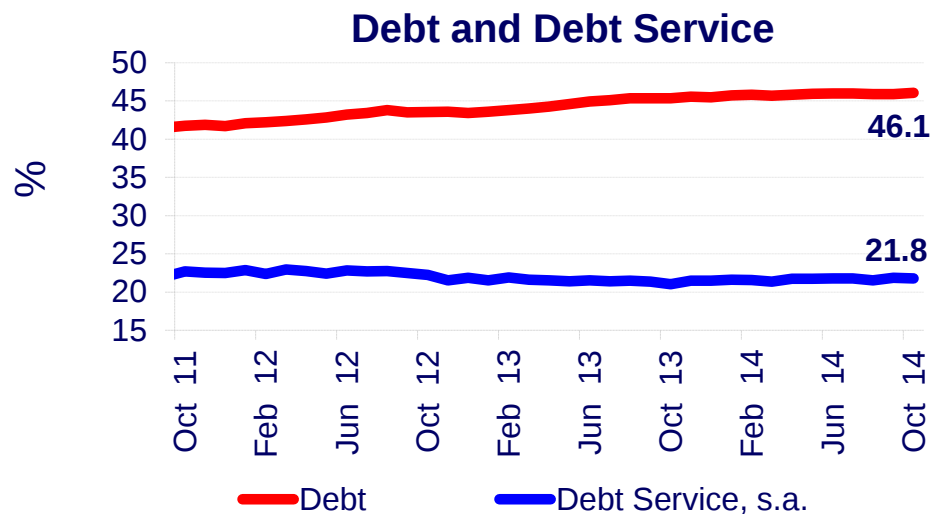


*12 months through Oct/14

Non-Earmarked Credit: Cost, Delinquency and Arrears



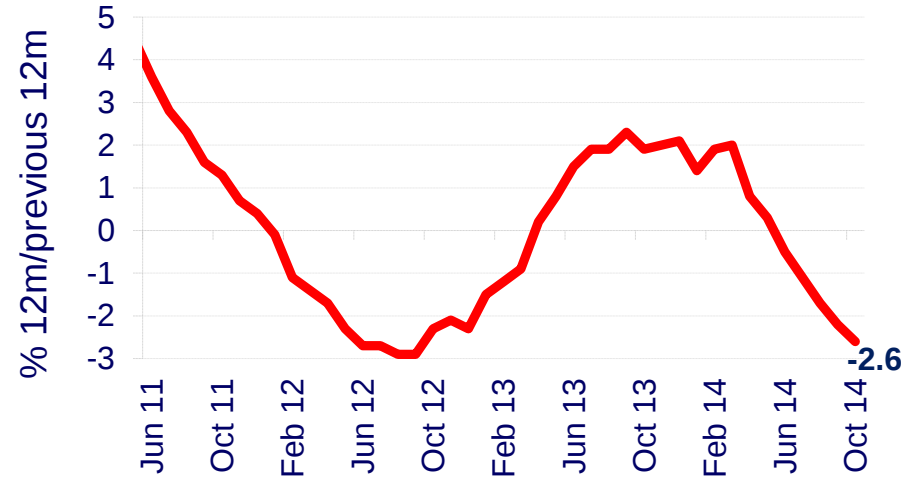
Household Debt and Provisions of the System



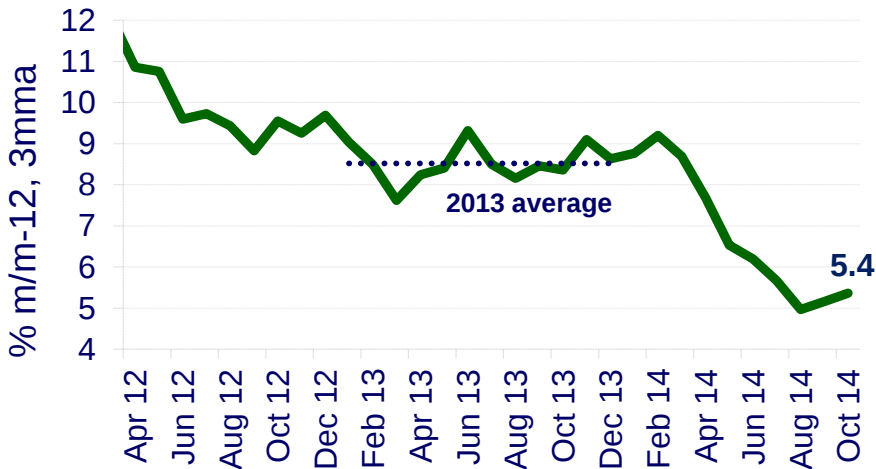
IV. Activity

Supply

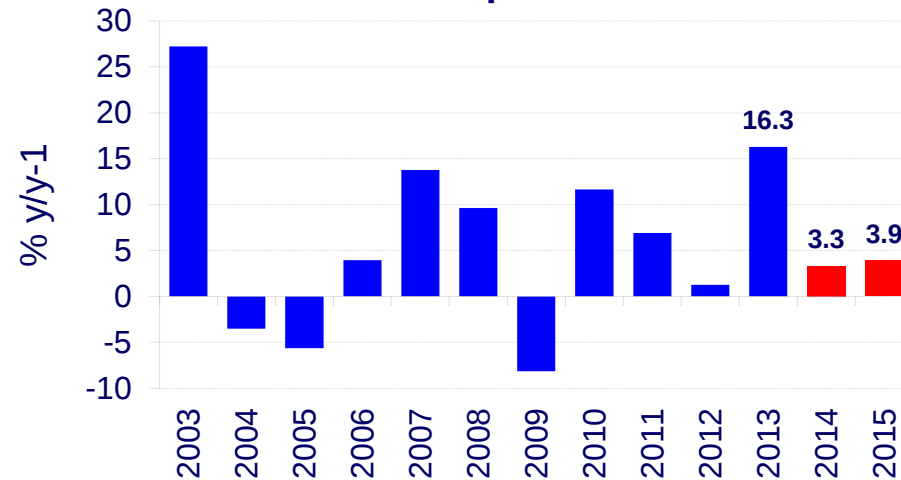
Industrial Production



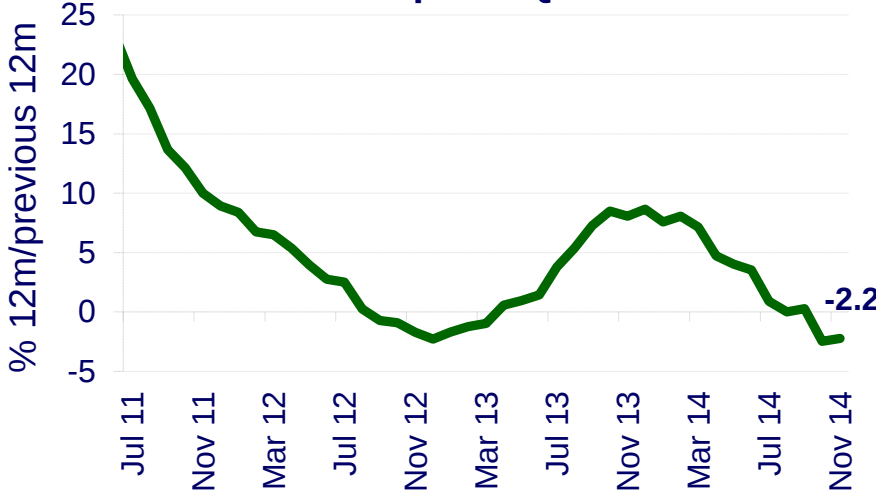
Services Nominal Income



Crop Harvest

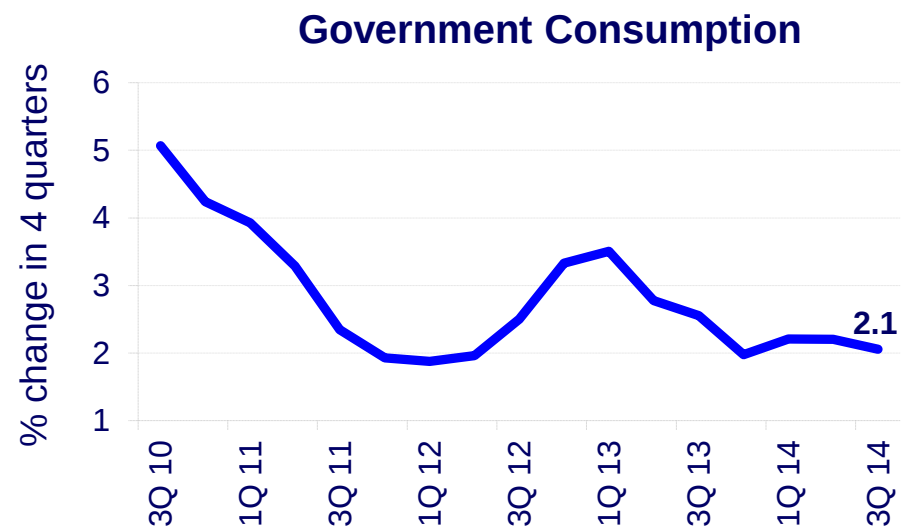
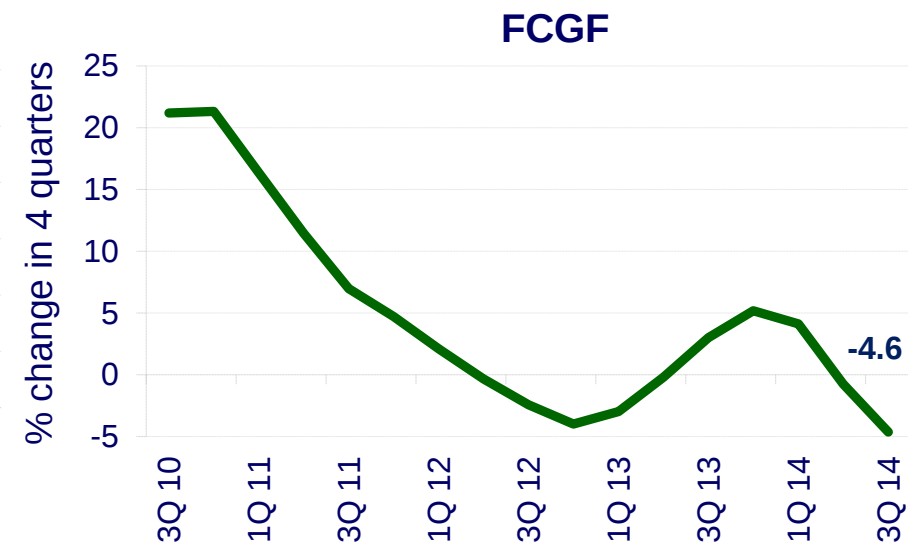
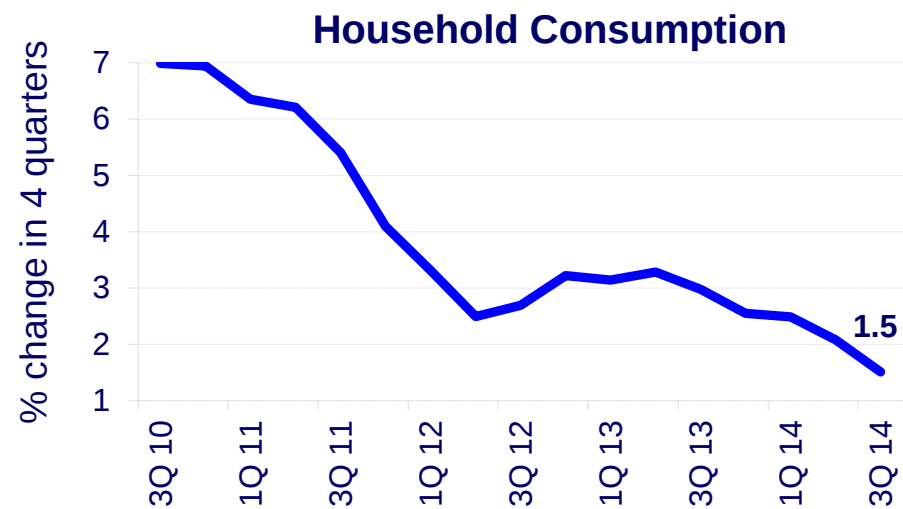


Imports Quantum

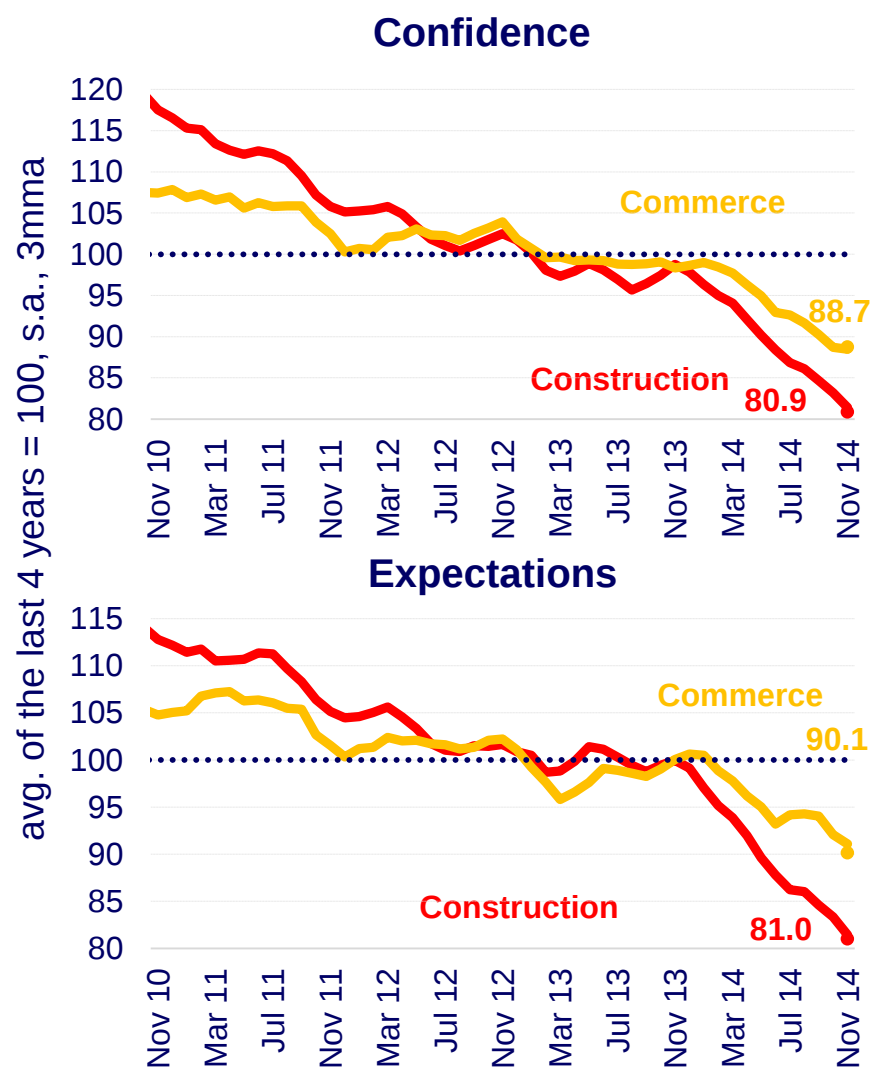
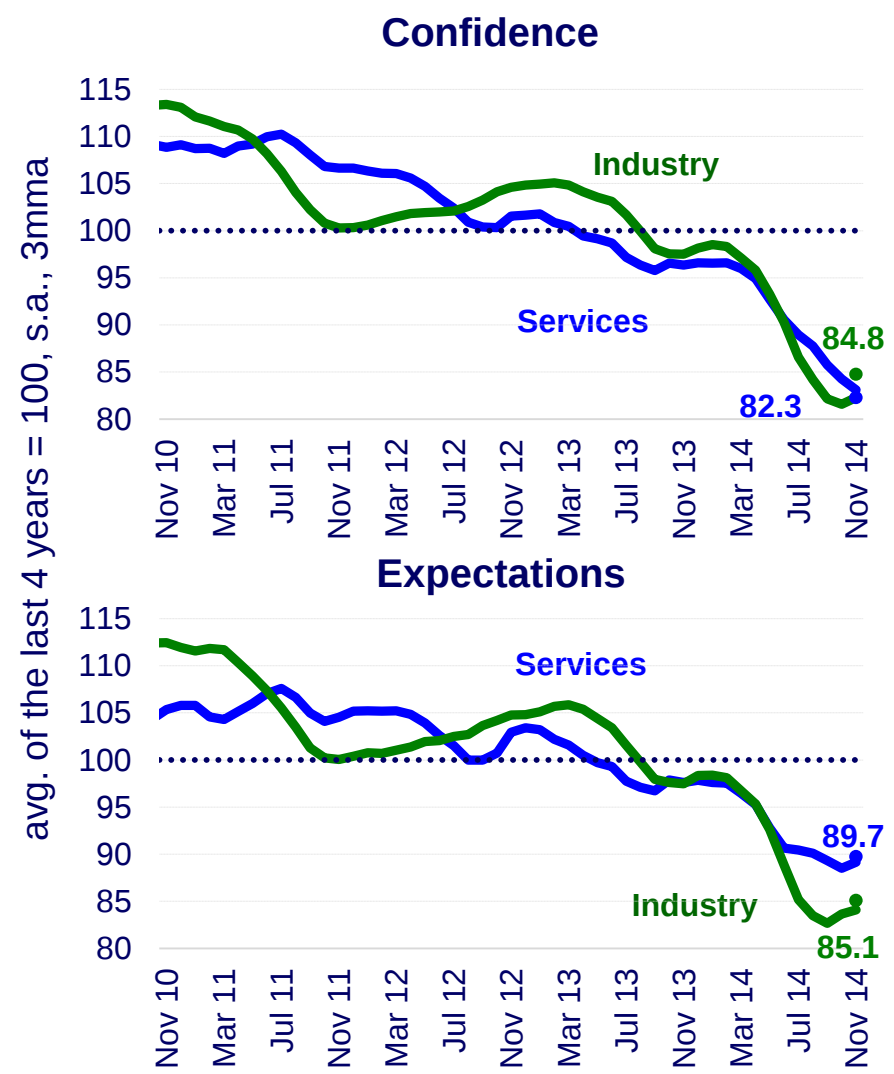


2014-15: IBGE estimates in Nov/14

Demand



Confidence



Obs.: Proportion of favorable answers – proportion of unfavorable answers + 100 (100=neutral)

PME and Other Indicators of Labor Market

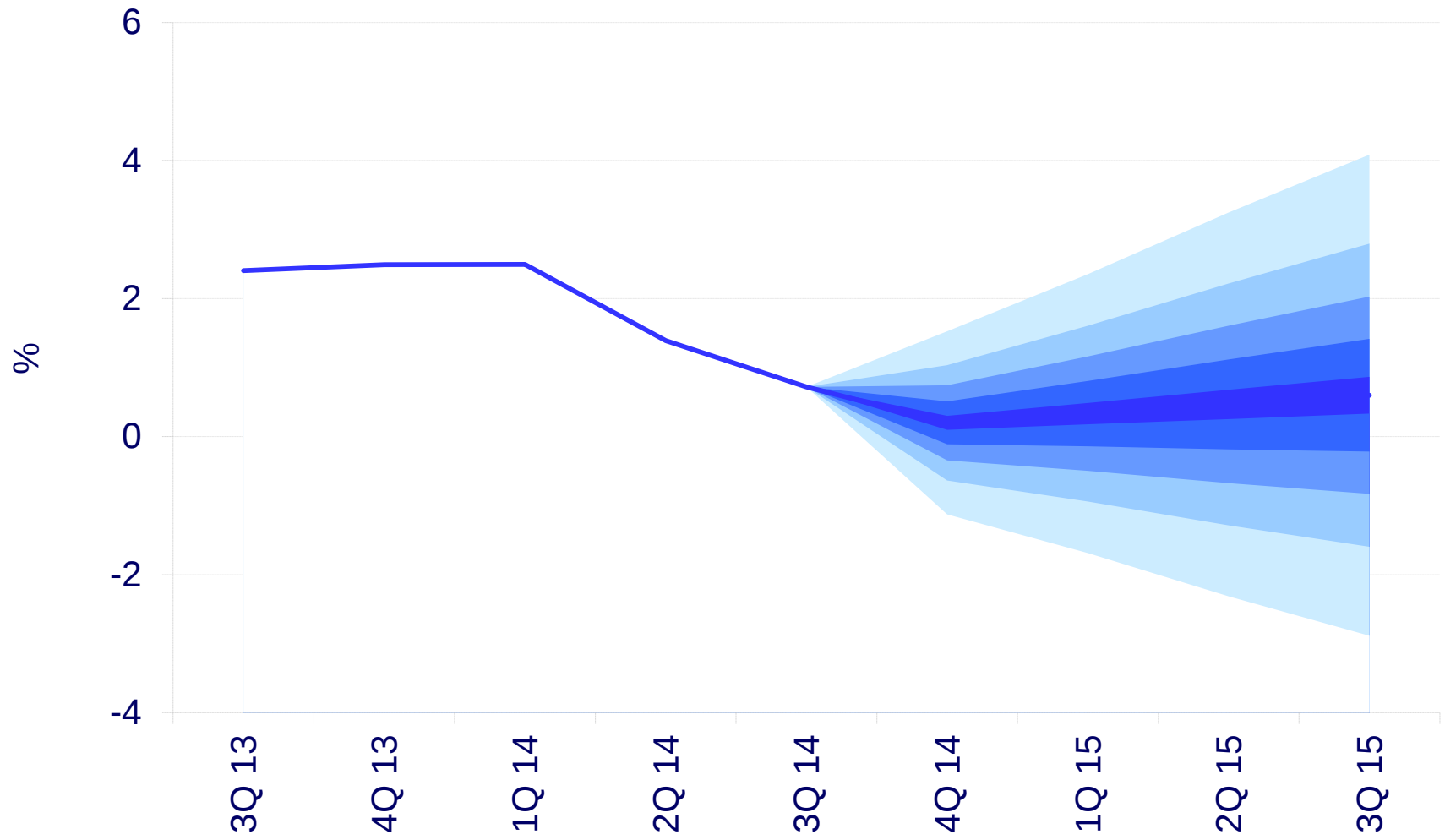
- It studies the methodological differences and reconciles indicators such as Caged, PME, PNAD and PNAD-C
- These indicators present good adherence, after adjustments
- Regarding unemployment rates, the identified trends are similar

Box: GDP Forecasts

- **Growth revision for 2014, from 0.7% to 0.2% (domestic demand, 0.0 p.p.; and net exports, 0.2 p.p.);**
- **Supply**
 - Agriculture and livestock: 1.4% (1.1% in Q3/2014)
 - Industry: -1.4% (-0.5% in Q3/2014)
 - Services: 0.7% (1.2% in Q3/2014)
- **Demand**
 - Investments: -7.1% (-4.6% in Q3/2014)
 - Household Consumption: 1.0% (1.5% in Q3/2014)
 - Government Consumption: 1.8% (2.1% in Q3/2014)
- **Growth of 0.6% in the four quarters ended in September 2015**

GDP Forecast

Baseline Scenario*



* interest rate constant at 11.75% p.y.

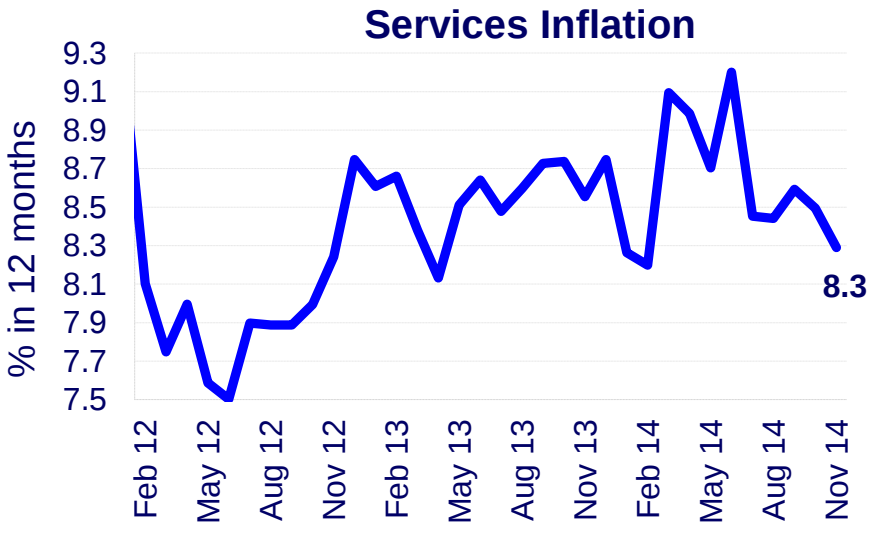
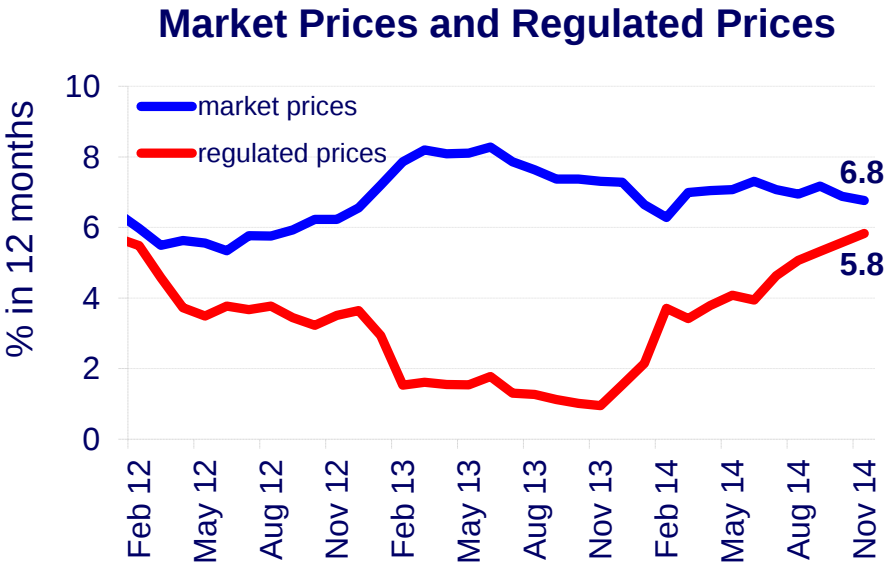
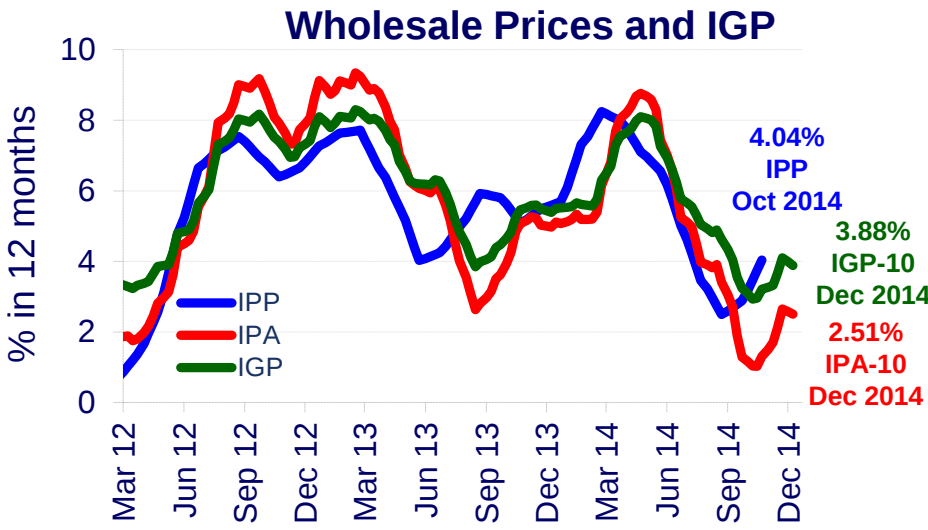
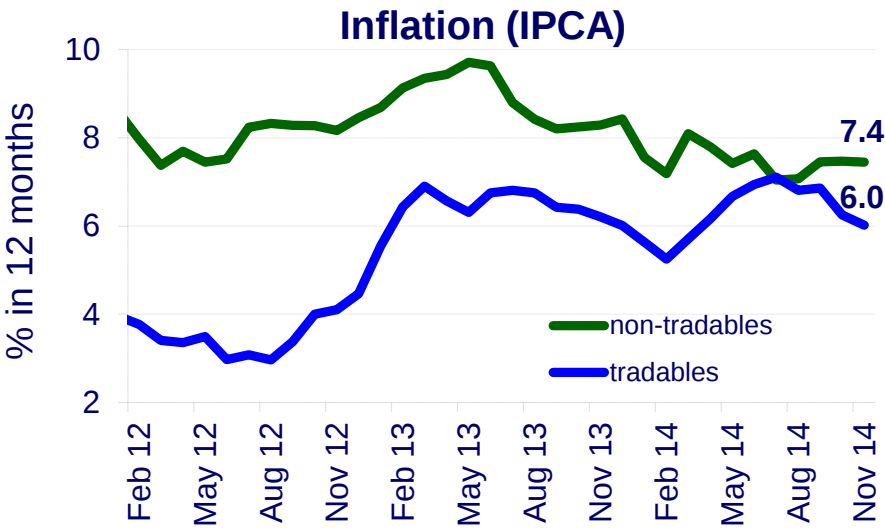
V. Inflation Developments

Inflation Developments

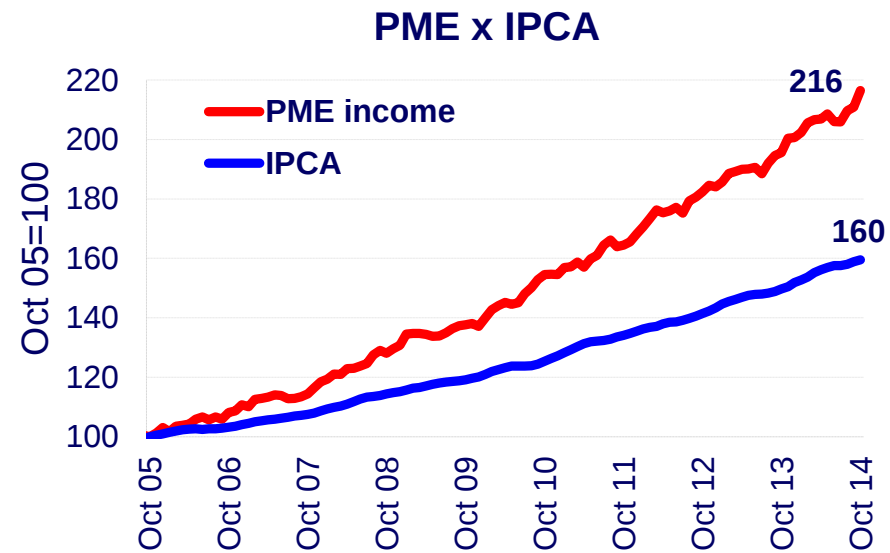
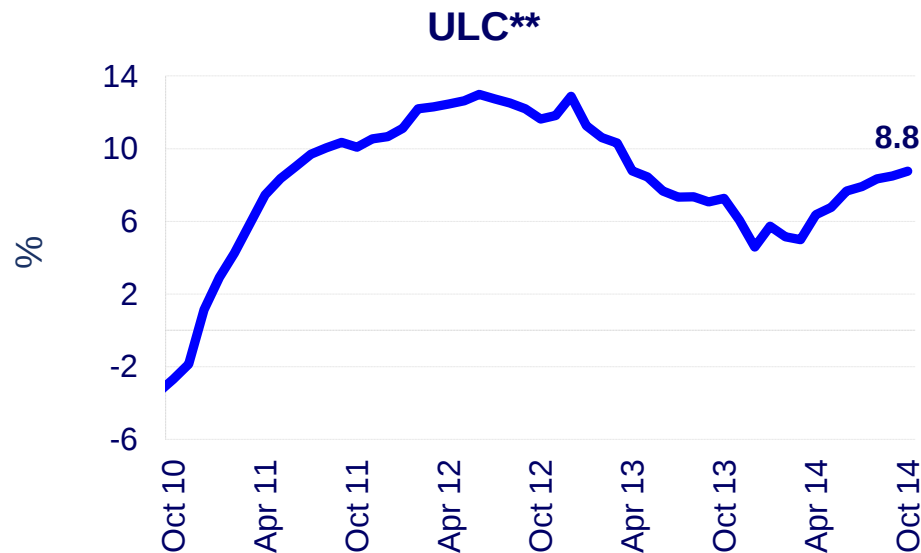
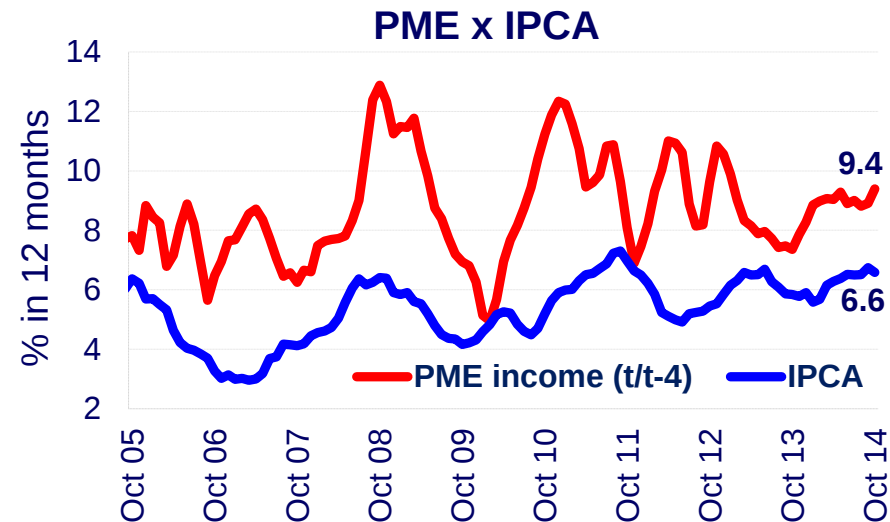
Prices Indices

	Change in 12 months (%)		
	Nov/13	Nov/14	
IPCA	5.77	6.56	▲
Market Prices	7.31	6.76	▼
Regulated	0.95	5.83	▲
Tradables	6.20	6.02	▼
Non-Tradables	8.29	7.45	▼
INPC	5.58	6.33	▲
IPC-C1	5.18	6.15	▲
IGP-DI	5.49	4.10	▼
IPA-DI	5.02	2.65	▼
Agricultural	-0.90	4.05	▲
Industrial	7.44	2.12	▼
IPC-DI	5.59	6.81	▲
INCC-DI	8.16	6.97	▼

Prices



Wages



* 12m through Nov; ** Unit Labor Cost in the Manufacturing Industry: Nominal Payroll/Physical Output

Recent Dynamics of the Wages and Inflation in the Services Sector

- It studies the relationship between admission wages and labor-intensive services inflation
- Evidences suggest that the high services inflation indices observed in recent years are partially derived from labor costs passthroughs

Decomposing “Implicit Inflation”

- It decomposes the difference between nominal and real interest rates in inflation expectations, risk premium associated to the inflation trajectory, and liquidity premium
- The exercises suggest that it is possible to extract relevant information about the future prices level, from the difference between nominal and real interest rates

BCB Inflation Forecasts

Baseline Scenario* and Market Scenario

Period		Baseline	Market
2014	4	6.4	6.4
2015	1	6.4	6.4
2015	2	6.1	6.2
2015	3	6.1	6.1
2015	4	6.1	6.0
2016	1	5.5	5.5
2016	2	5.2	5.2
2016	3	5.1	5.0
2016	4	5.0	4.9

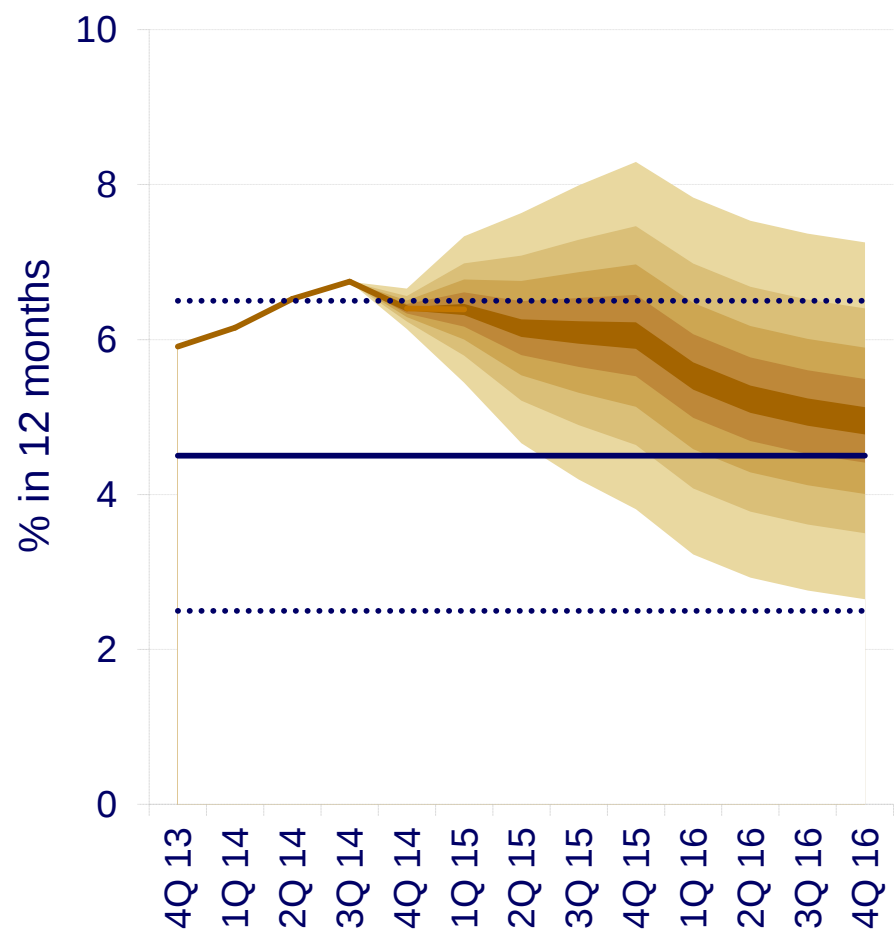
Obs.: 12-month accumulated inflation (%)

* Interest rate constant at 11.75% p.y.

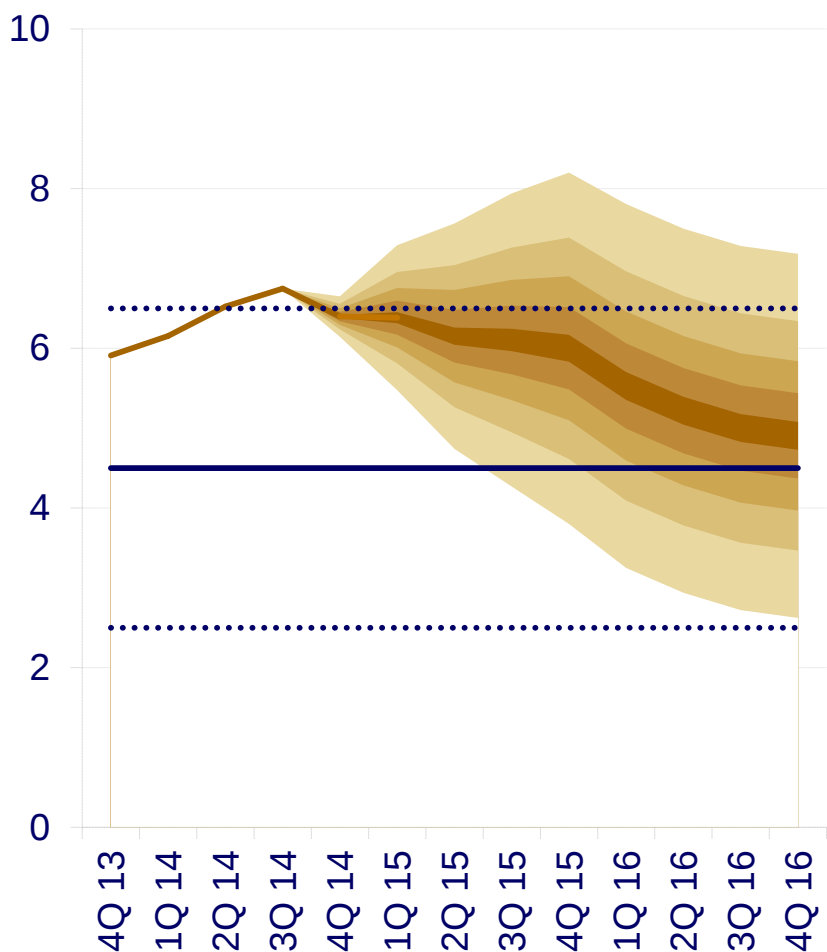
BCB Inflation Forecasts

Baseline Scenario

(interest rate constant at 11.75% p.y.)



Market Scenario



Market Expectations – Summary

	2014			2015			2016		
	9/30/14		12/19/14	9/30/14		12/19/14	9/30/14		12/19/14
IPCA	6.31	▲	6.38	6.30	▲	6.54	5.50	▲	5.70
Regulated Prices	5.20	▲	5.42	7.00	▲	7.60	5.80	▲	6.00
Market Prices	6.79	▲	6.80	5.99	▲	6.08	5.37	▲	5.57
IGP-M	3.50	▲	3.76	5.50	▲	5.72	5.50	=	5.50
IPA-DI	2.22	▲	2.41	5.00	▲	6.30	5.15	▲	5.20
Selic (end-of-period)	11.00		-	11.50	▲	12.50	11.00	▲	11.38
Exchange rate (end-of-period)	2.40	▲	2.65	2.50	▲	2.75	2.56	▲	2.75
GDP	0.26	▼	0.13	1.00	▼	0.55	2.32	▼	1.90
Industrial Production	-1.94	▼	-2.50	1.50	▼	1.02	2.68	▼	2.50
Trade Balance	2.40	▼	-1.86	8.00	▼	4.83	12.12	▲	13.50
FDI	60.00	=	60.00	57.00	▲	60.00	60.00	=	60.00
Primary Result	1.10	▼	0.10	1.80	▼	1.00	2.00	▼	1.80

Inflation Outlook

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December 2014