



Inflation Outlook

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2012/2013 – Favorable Prospects for Brazil

- Inflation converging to the target path, *i.e.*, to 4.5%, non-linearly;
- Moderate credit growth (around 16%);
- Fiscal discipline (primary surplus around 3.0% of the GDP, unadjusted);
- Current account deficit around 2.0% of the GDP, financed primarily by FDI flows;
- Unemployment rates historically low; and
- Recovery of investment and economic activity in acceleration.

Retrospective - Brazil

Since the last Report release:

- The decreasing trend of risks stemming from the mismatch between the pace of the supply and demand expansion, in specific segments, has persisted;
- In the factors market, the level of installed capacity utilization remained below the long-term level; and the idleness in the labor market remained low, despite signs of moderation in this market;
- Gradual economic growth in the second quarter;
- Improvement in the short, medium and long terms prospects for the Brazilian economy; and
- Consumer inflation accumulated in twelve months was affected by adverse domestic and foreign supply shocks.

Retrospective - Abroad

Since the last Report release:

- Volatility and risk aversion remained high, but the probability of occurrence of extreme events in international financial markets has decreased;
- Moderate global activity, including emerging economies, and recession in some mature economies;
- There were localized pricing pressures, stemming from an unfavorable supply shock in the agricultural commodities segment;
- Monetary policy in mature economies maintained the accommodative stance (there were new unconventional actions); and
- Monetary policy in emerging economies also with accommodative stance.

Prospective Scenario – Balance of Risks/Working Assumptions

Domestically:

- Activity with accelerating trend this semester and next year;
- Moderate credit expansion;
- Primary surplus targets accomplishment, without adjustment;
- Moderation of inertial pressures (minimum wage, salaries, exchange rate, electricity);
- Effects of the easing in financial conditions, especially in the monetary policy actions recently implemented, which are lagged and cumulative; and
- Evidence of movement downwards of the neutral interest rate.
 - The Copom considers that, together, domestic developments indicate a neutral balance of risks in the relevant horizon.

Prospective Scenario – Balance of Risks/Working Assumptions

Externally:

- Risks associated to the deleveraging process (of banks, government and households) in the main economic blocks;
- Prospects for low global growth, for a long period of time, with recession in several mature economies;
- Moderate growth in emerging economies (external demand weakening and, in specific cases, changes in the growth pattern);
- Challenging scenario for the Chinese (and the Indian) economy; and
- The recent rise in the price of grains tends to reverse and to be less intense and less enduring than the one that occurred in 2010/2011.
 - The Copom considers that, despite manifesting inflationary bias in the short term, the international scenario is disinflationary in the medium term.

Prospective Scenario - Forecasts

Inflation forecasts:

- The forecasts for 2012 – baseline and market scenarios – point to 5.2%; for 2013, the forecasts point to 4.9% in the baseline scenario and to 4.8% in the market scenario.

GDP forecast:

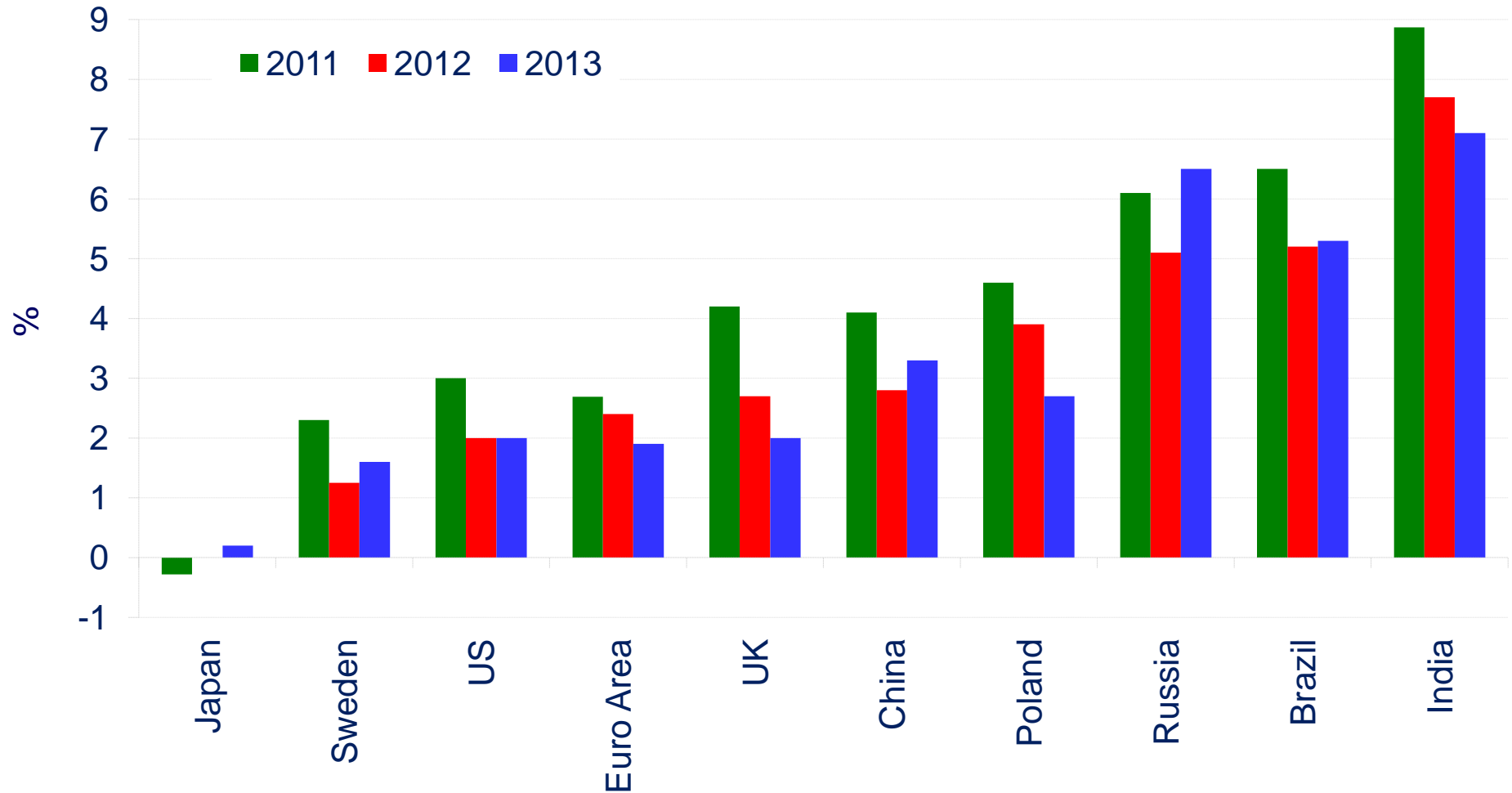
- The estimate rate for 2012 GDP growth was revised to 1.6%, compared to 2.5% in the June Report.
- The estimate rate on a four-quarter accumulated basis up to the second quarter of 2013 reaches 3.3%.

Prospective Scenario – Monetary Policy

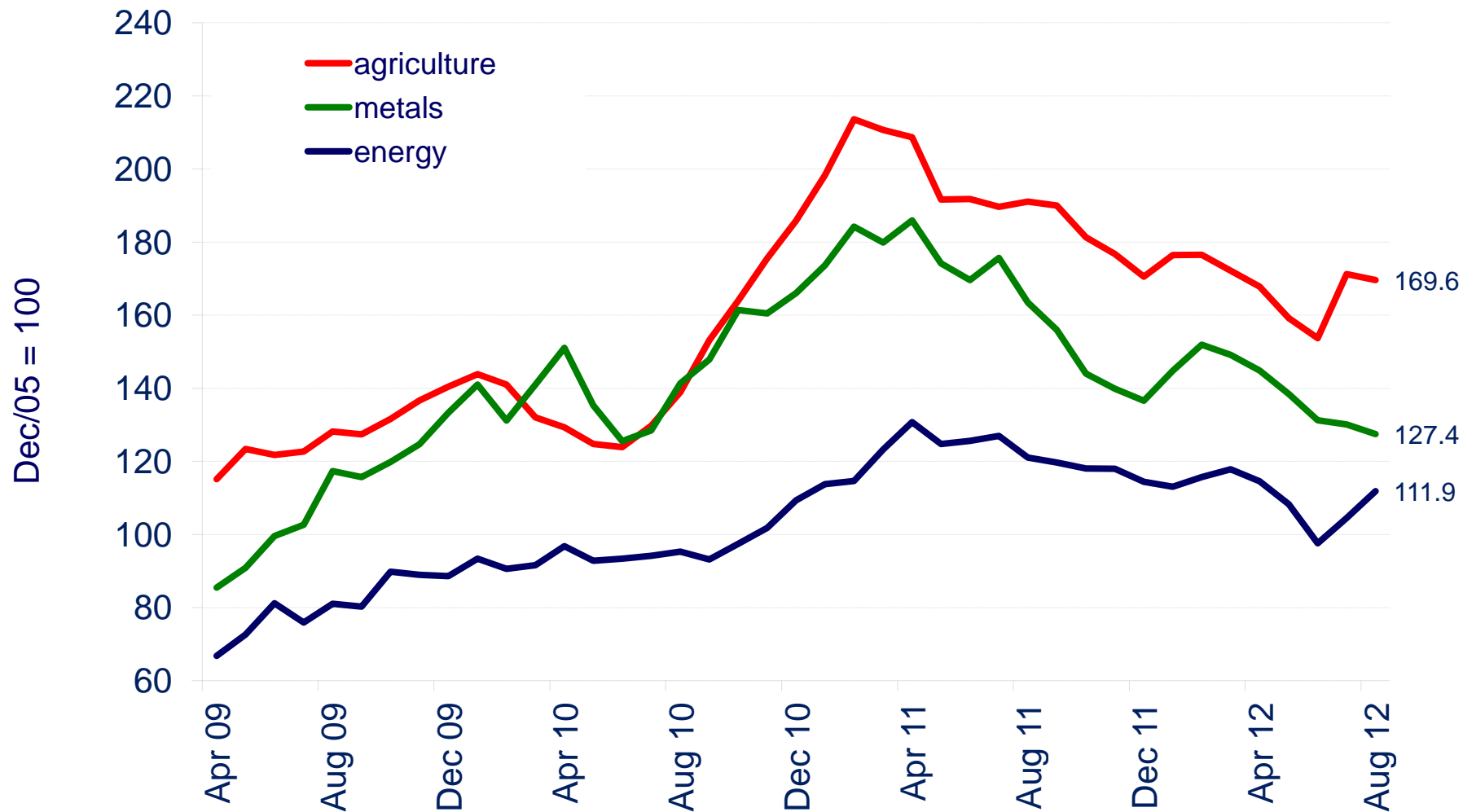
- In light of this scenario, and considering the cumulative and lagged effects of the policy actions implemented so far, which in part reflect the ongoing recovery in economic activity, the Copom understands that, if the prospective scenario justifies an additional adjustment in the monetary conditions, this movement should be conducted with extreme parsimony.

I. International Environment

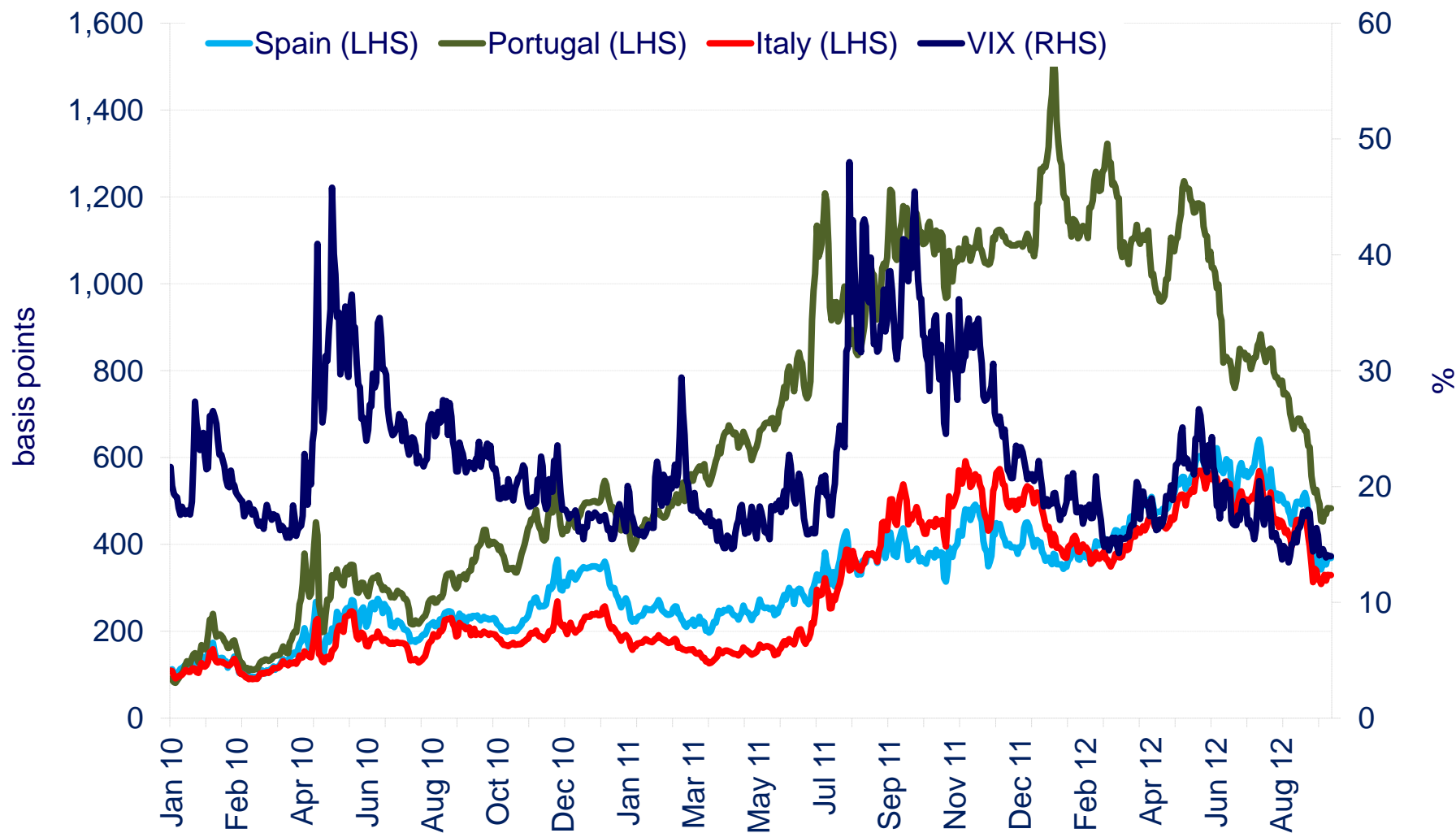
Inflation and Expectation in Selected Countries



IC-Br Commodities Index (US\$)

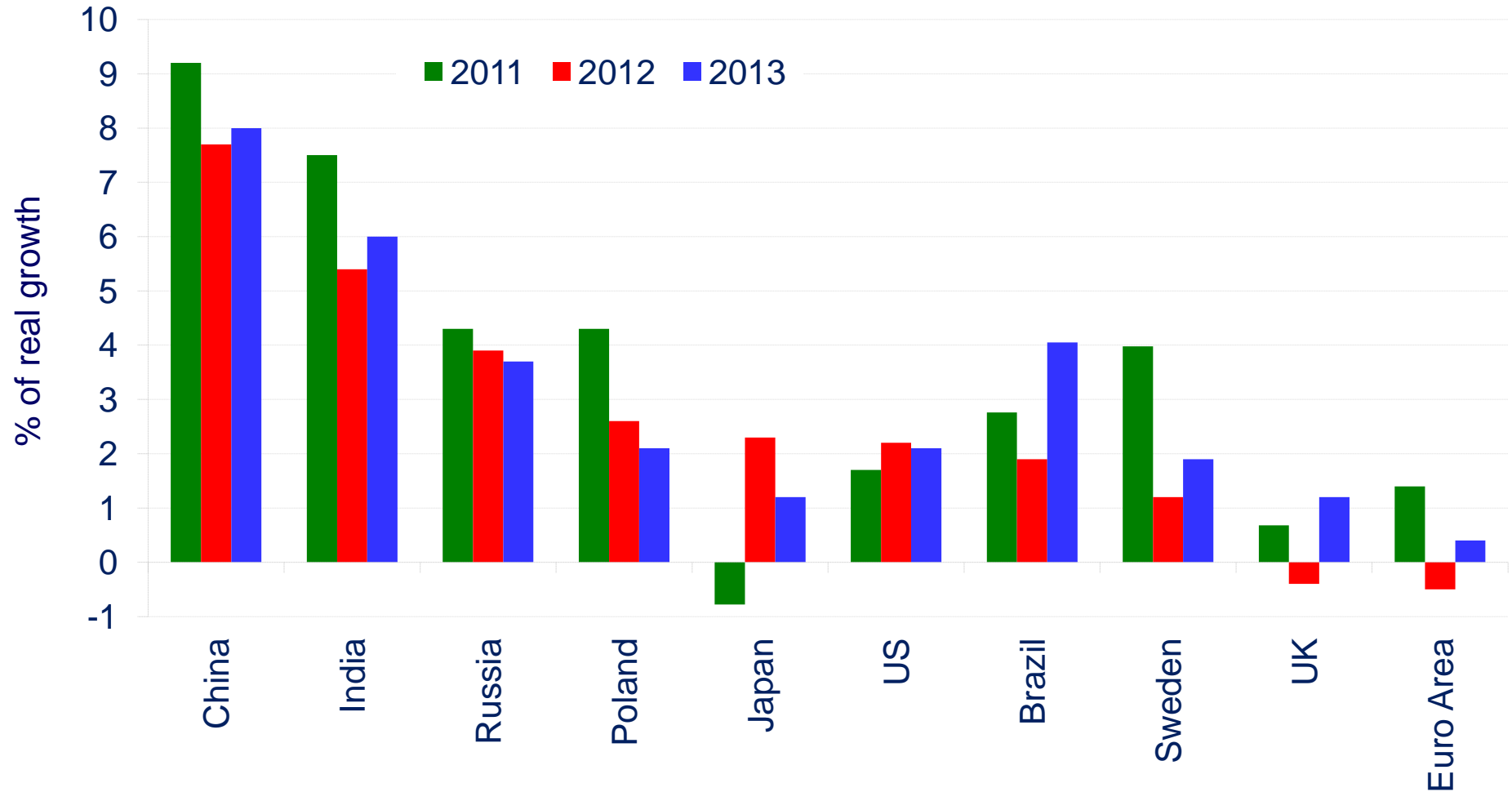


VIX and 5-Year CDS – Italy, Spain and Portugal



data up to 9/24

Activity and Expectation in Selected Countries



World Growth Forecasts in Revision

Forecasts for the 2012 GDP growth (%)

	2011	2012		
	Dec	Mar	Jun	Sep
US	2.1	2.3	2.2	2.2
Euro Area	-0.1	-0.4	-0.4	-0.5
Japan	2.0	1.9	2.5	2.4
UK	0.7	0.6	0.3	-0.3
China	8.3	8.4	8.1	7.7
India	7.5	7.2	6.6	5.9
Brazil	3.2	3.3	2.4	1.6

World Growth Forecasts in Revision

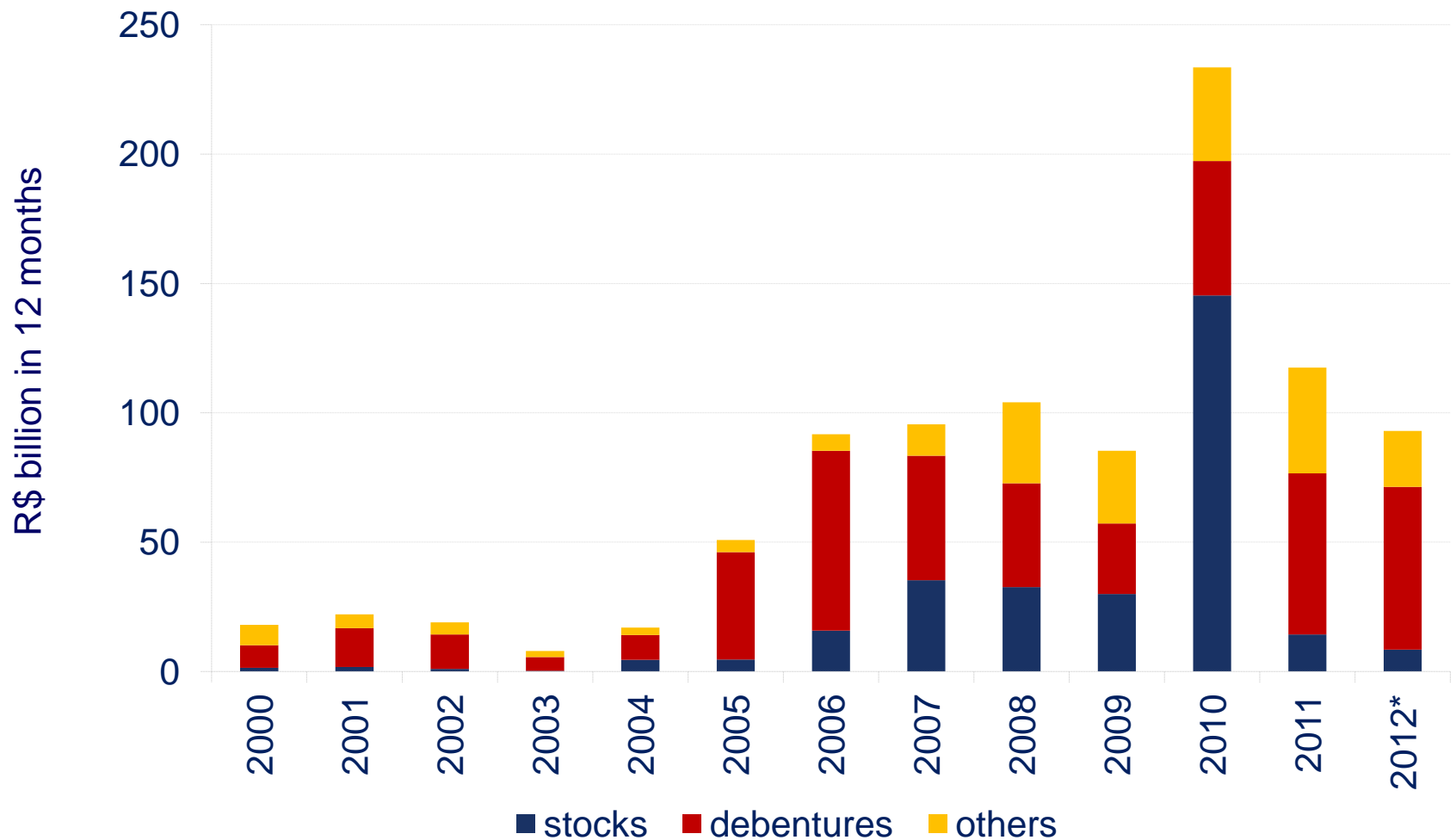
Forecasts for the 2013 GDP growth (%)

	2012			
	Jan	Mar	Jun	Sep
US	2.5	2.6	2.4	2.1
Euro Area	0.9	0.9	0.7	0.2
Japan	1.4	1.5	1.3	1.3
UK	1.8	1.8	1.8	1.3
China	8.6	8.6	8.4	8.1
India	7.3	7.2	7.3	6.9
Brazil	4.3	4.4	4.2	4.0

II. Financial Conditions

Capital Market Domestic Operations

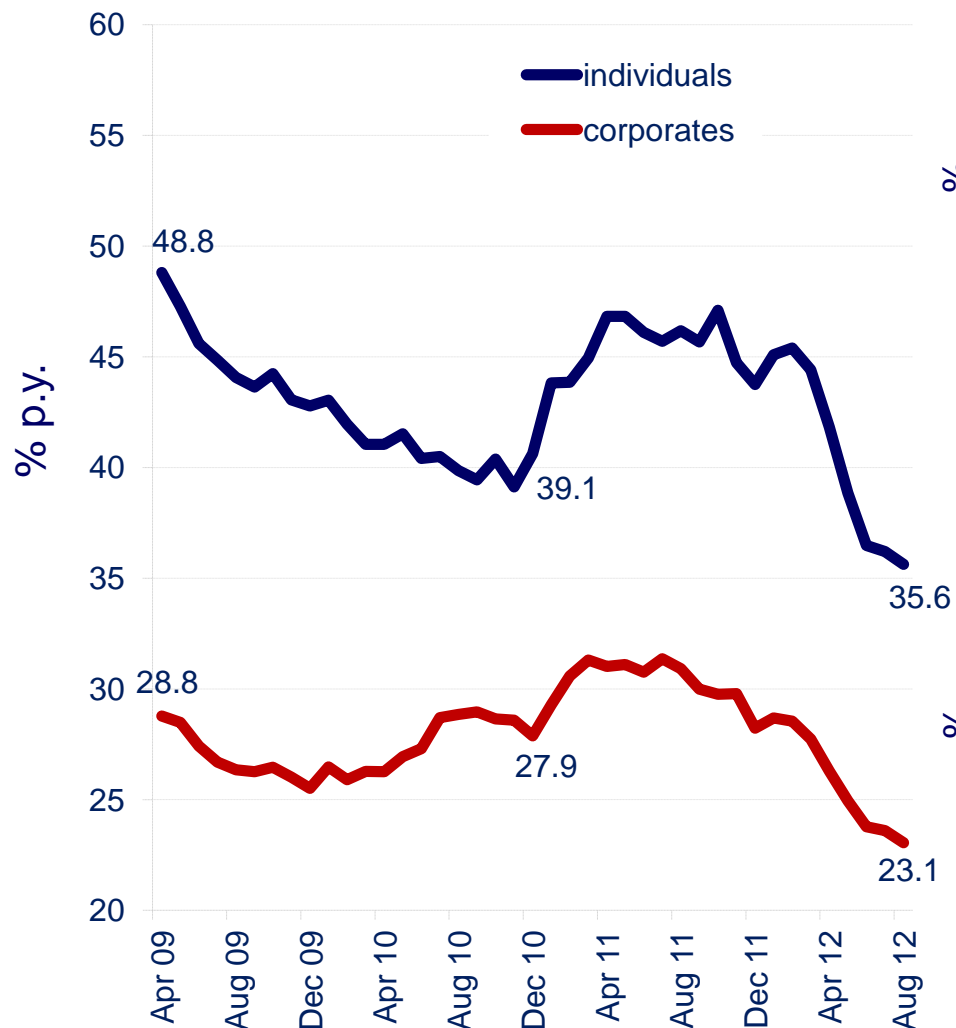
Primary Issues



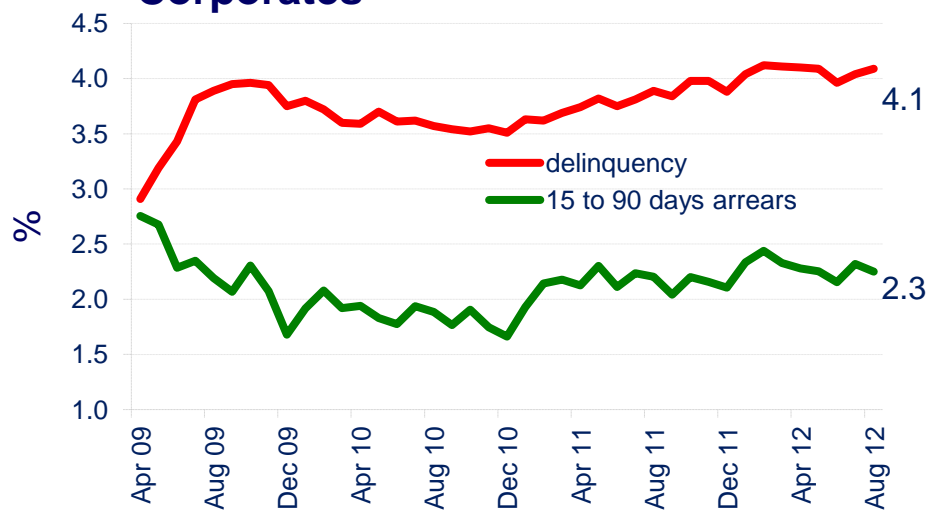
*Jul 12

Reference Credit – Interest Rate, Delinquency and Arrears

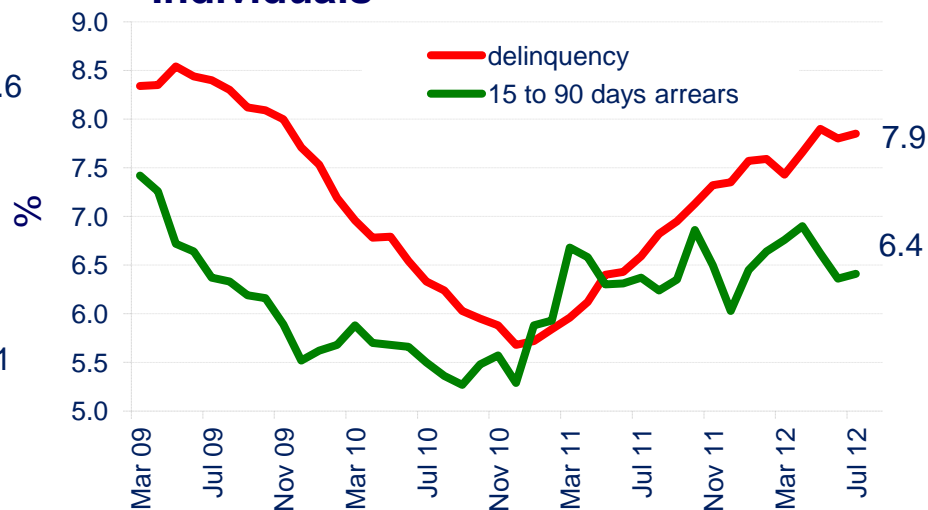
Interest Rate



Corporates

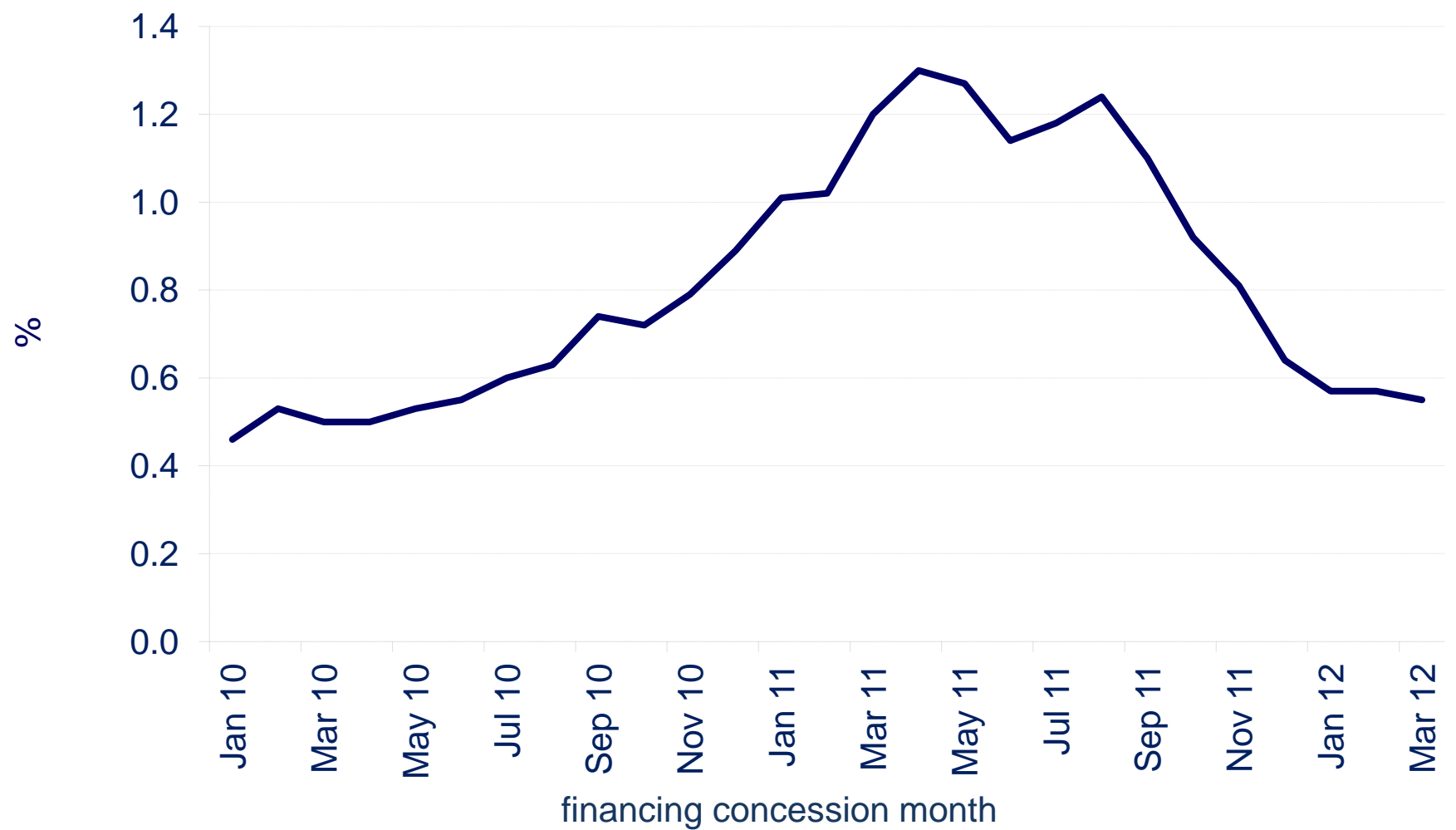


Individuals



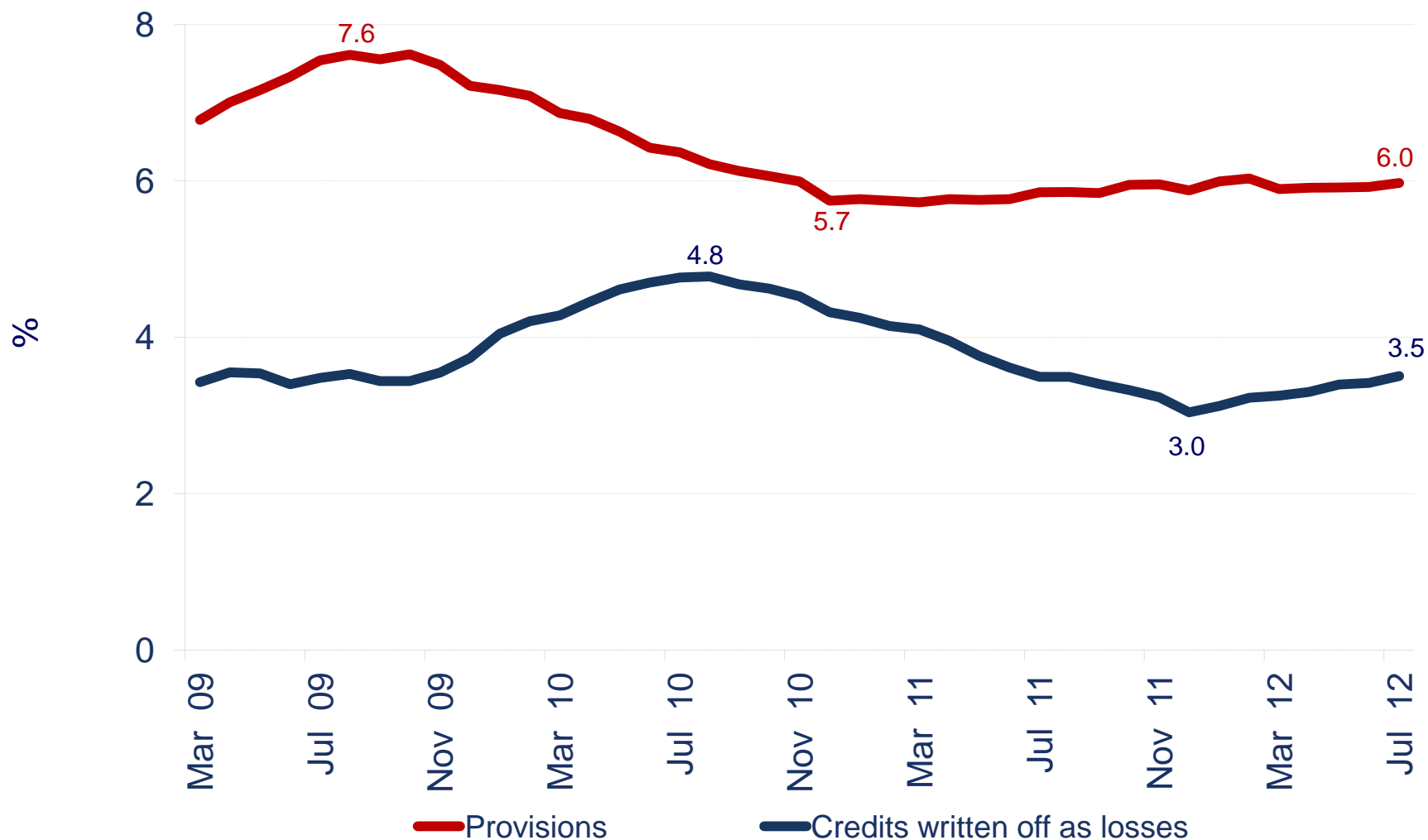
Leading Indicators Indicate Delinquency Reduction

Auto financing: delinquency 4 months after concession

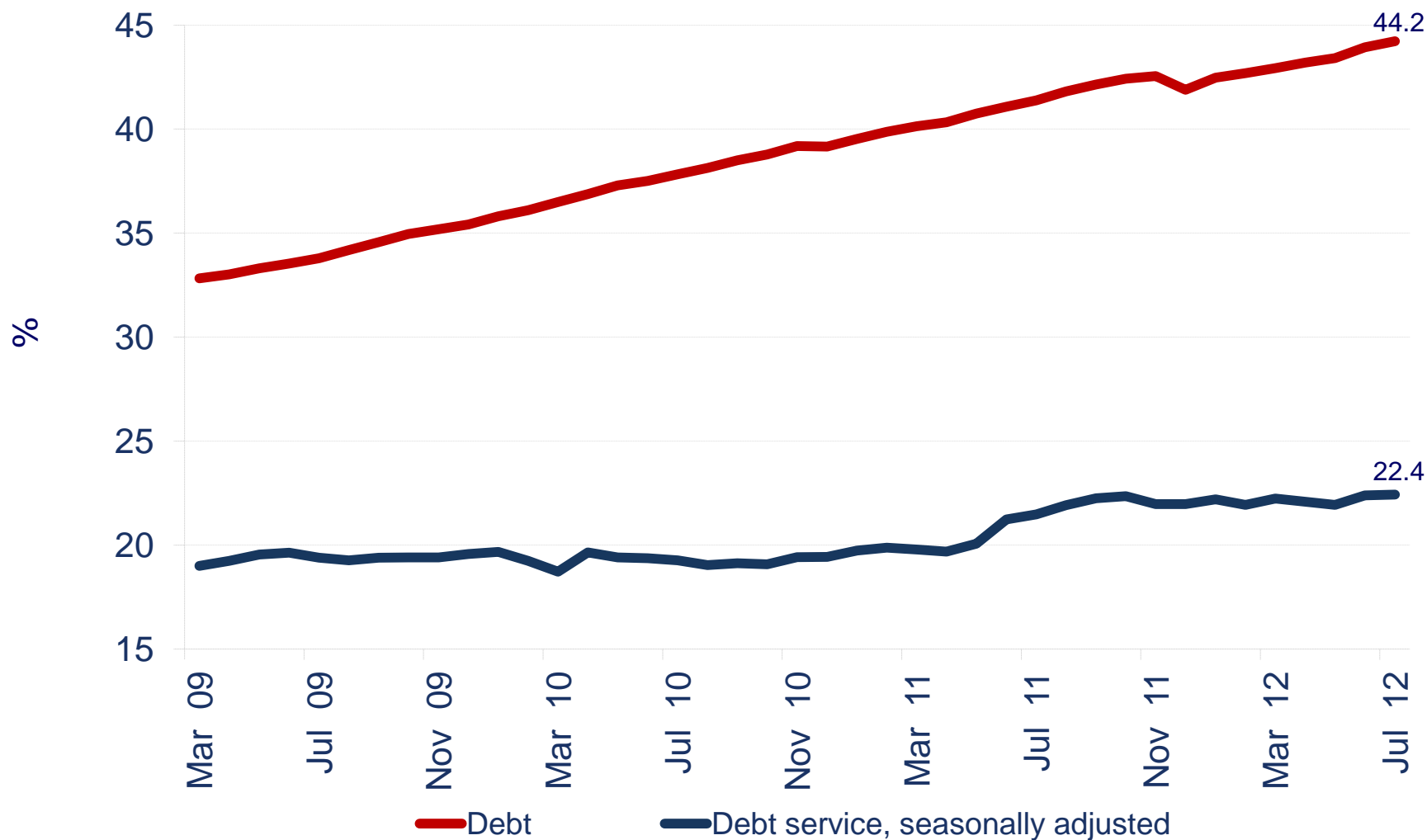


data up to Mar 12 with reflections in Jul 12

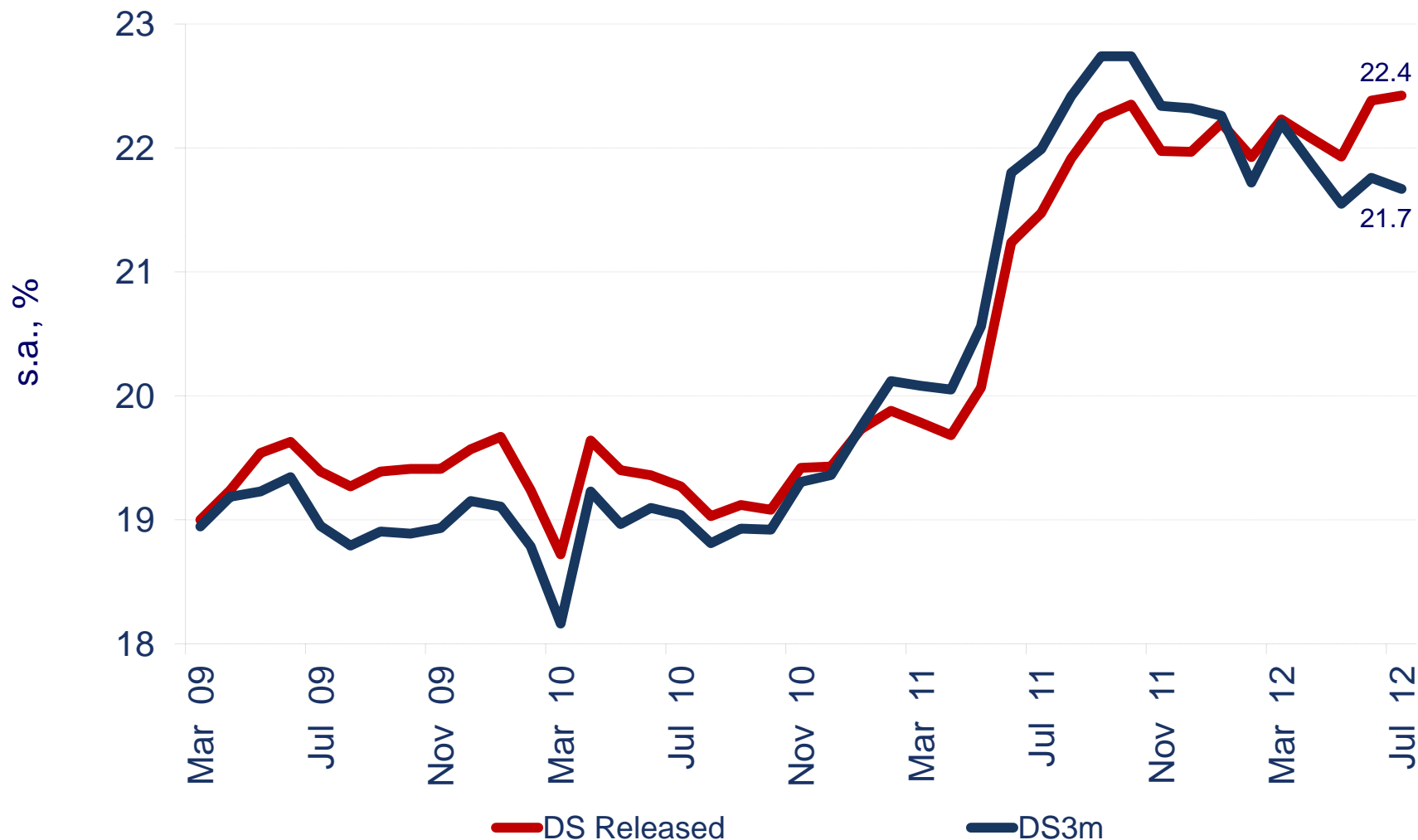
Credits Written Off as Losses and Provisions



Household Debt

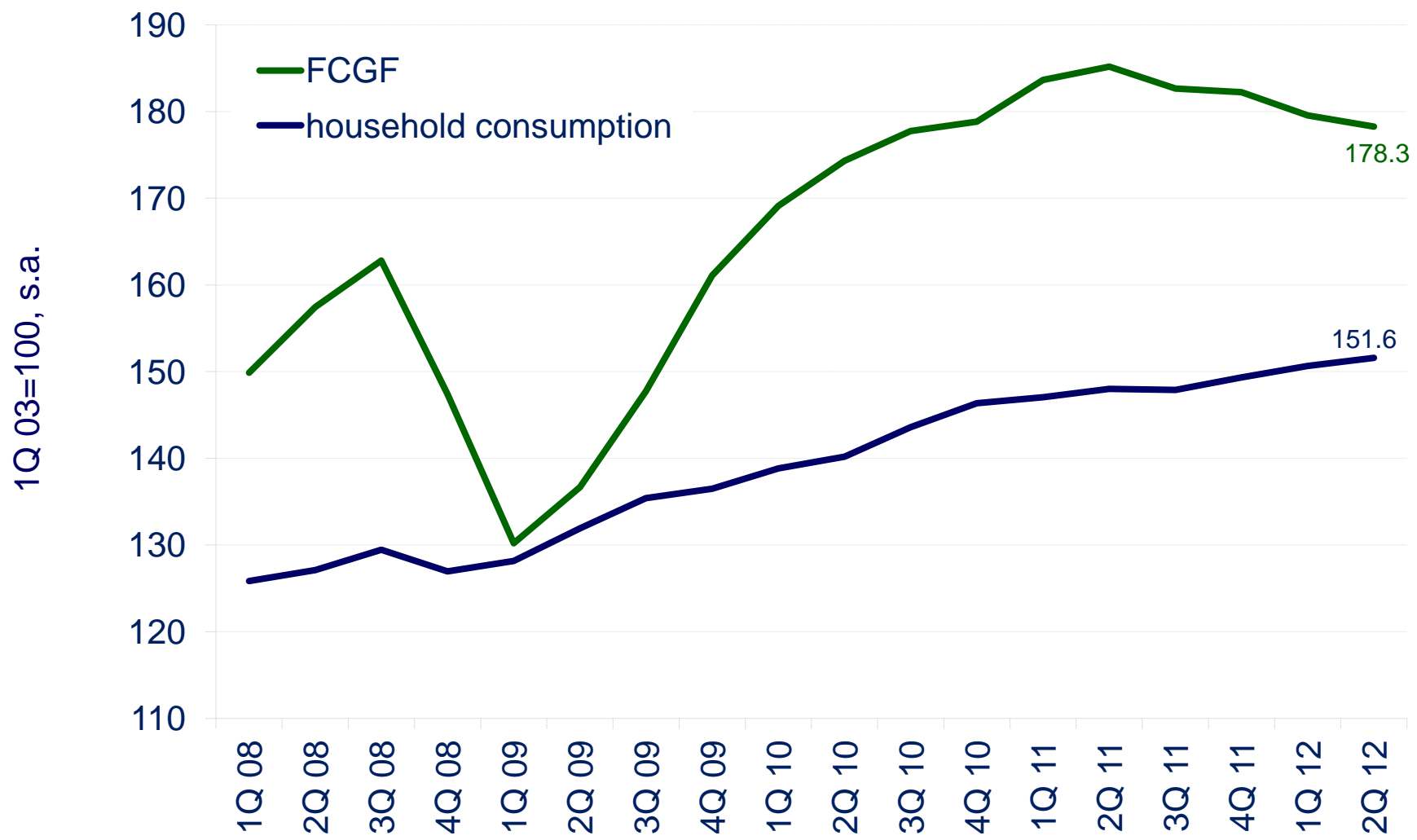


Debt Service (DS) – Impacts of the Term for the Average Rate Calculation

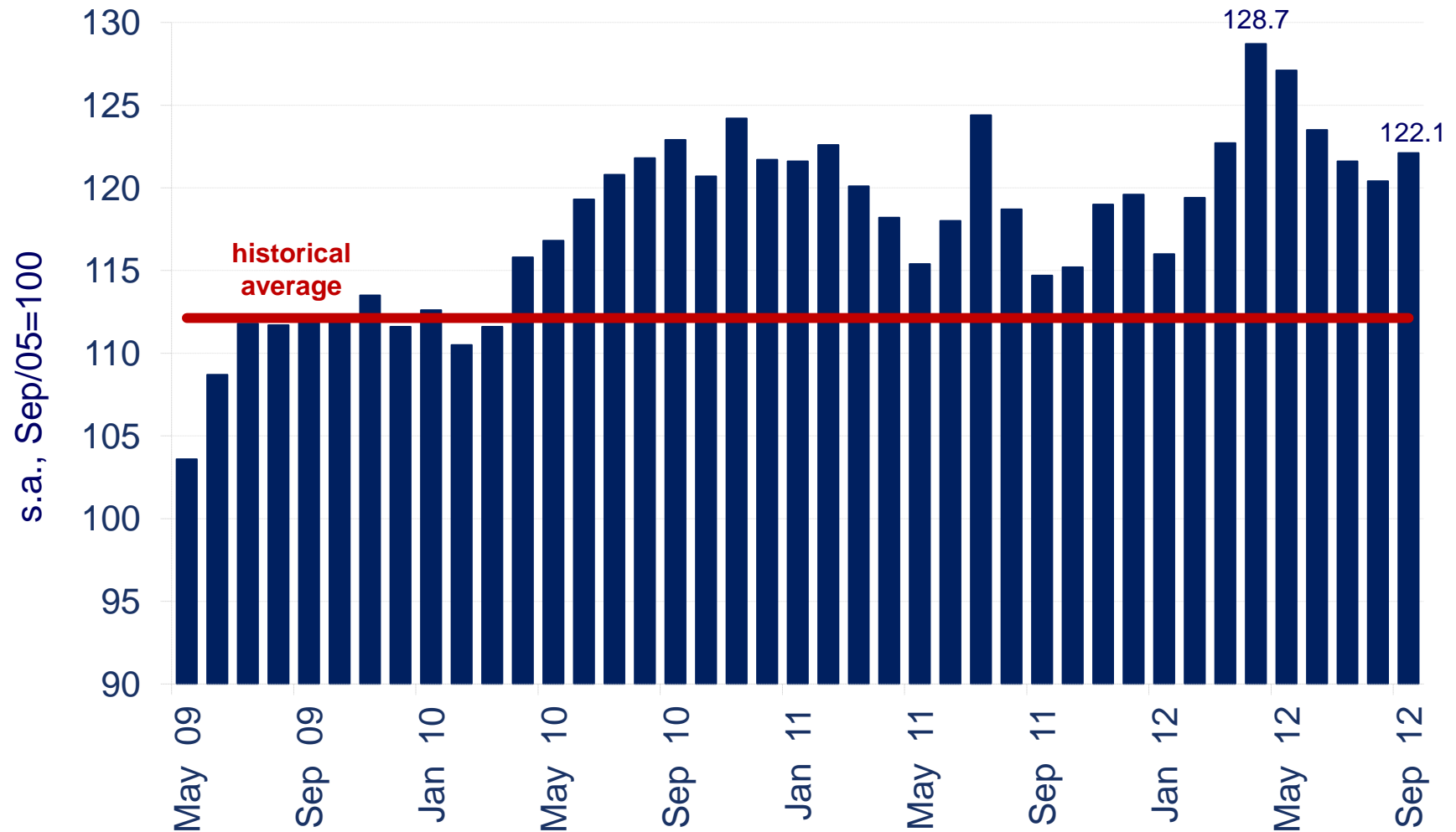


III. Demand

Household Consumption and Fixed Capital Gross Formation

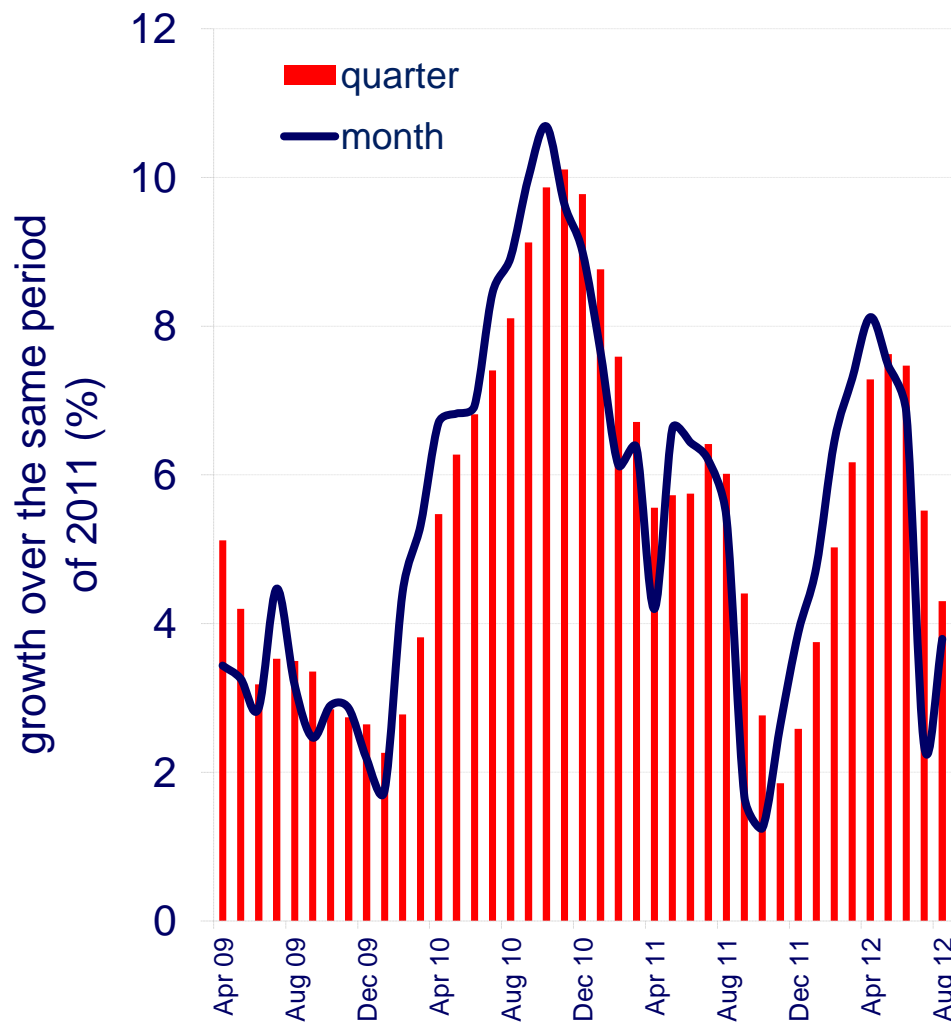


Consumer Confidence



Real Payroll and Credit for Individuals

Real Payroll

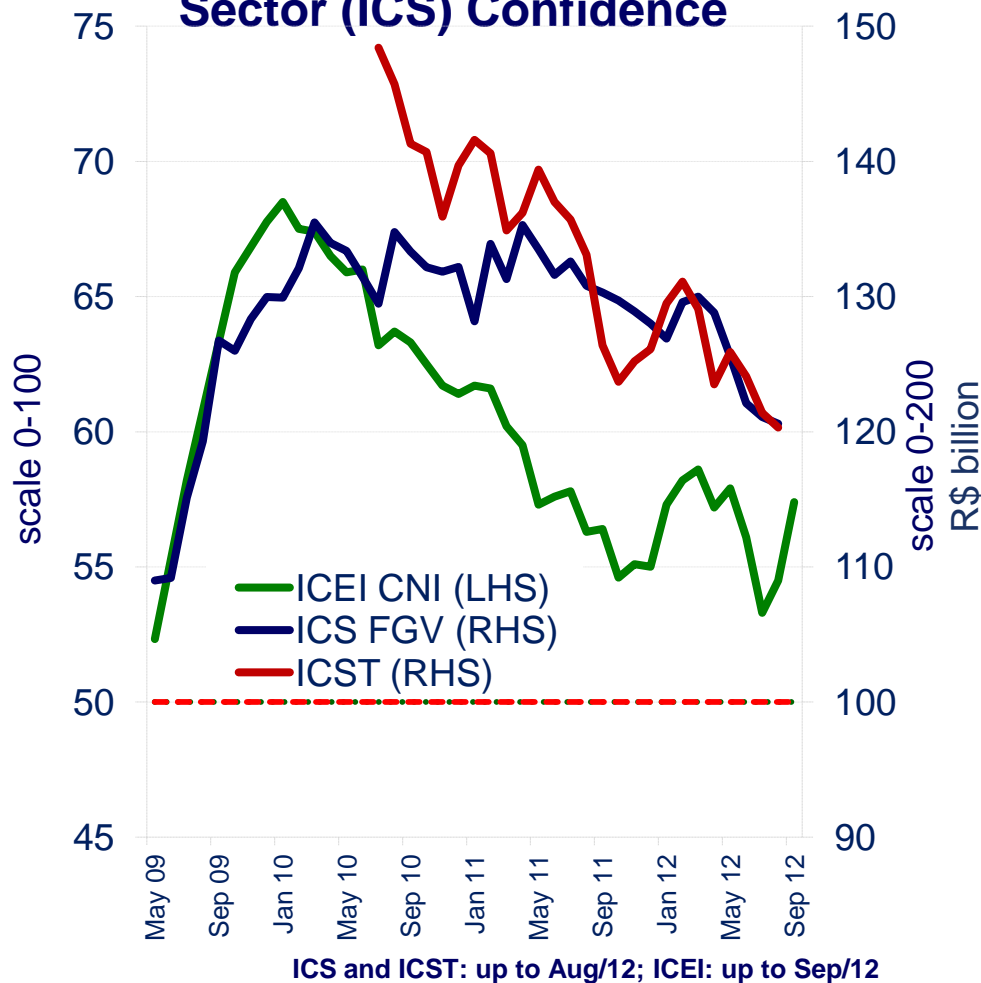


Concessions in the month

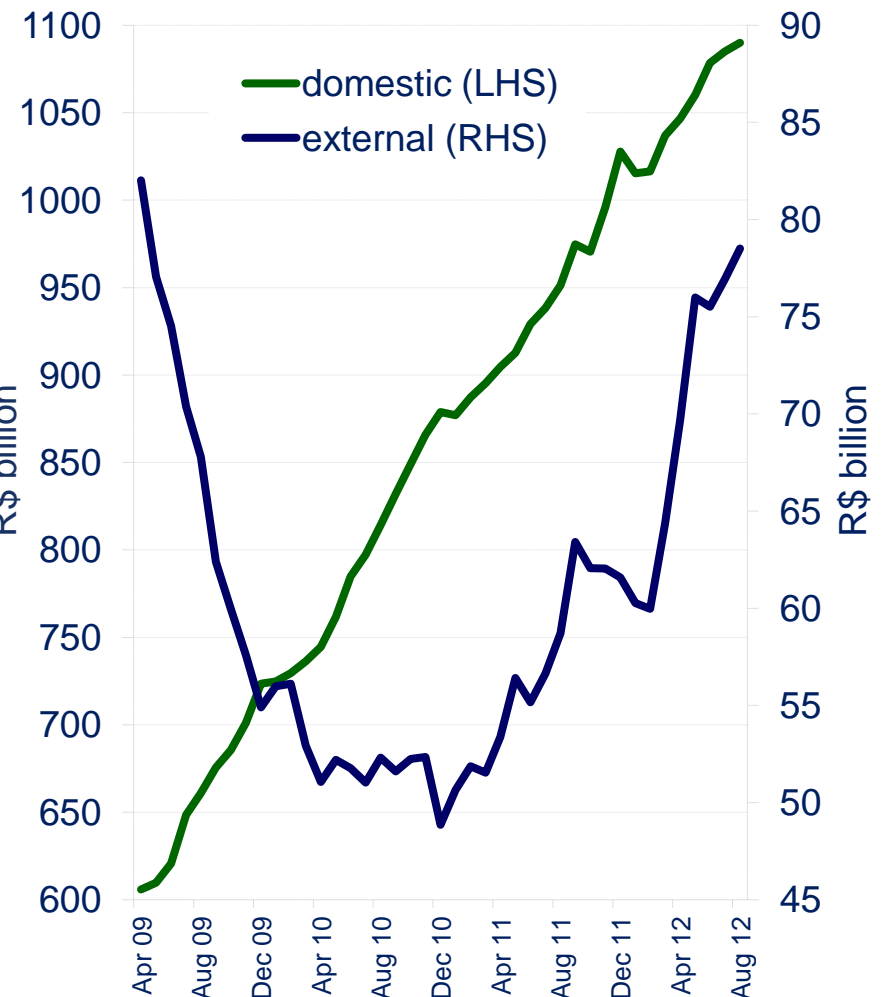


Businessmen confidence and Corporate Credit

Industrial Businessmen (ICEI), Construction (ICST) and Service Sector (ICS) Confidence



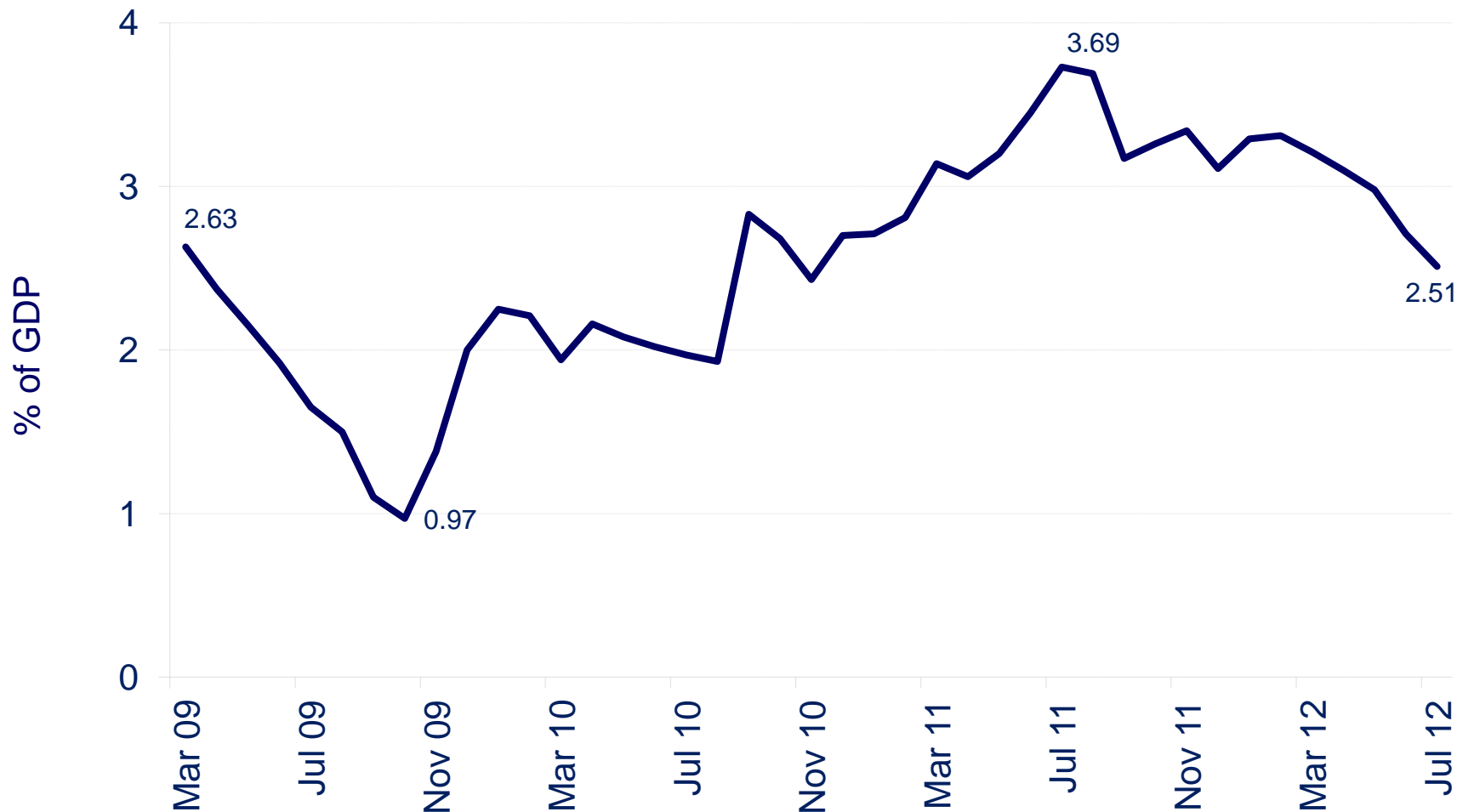
Corporate Credit



Sources: CNI (ICEI), FGV (ICS and ICST) and BCB (Credit)

Fiscal Results – Primary Surplus

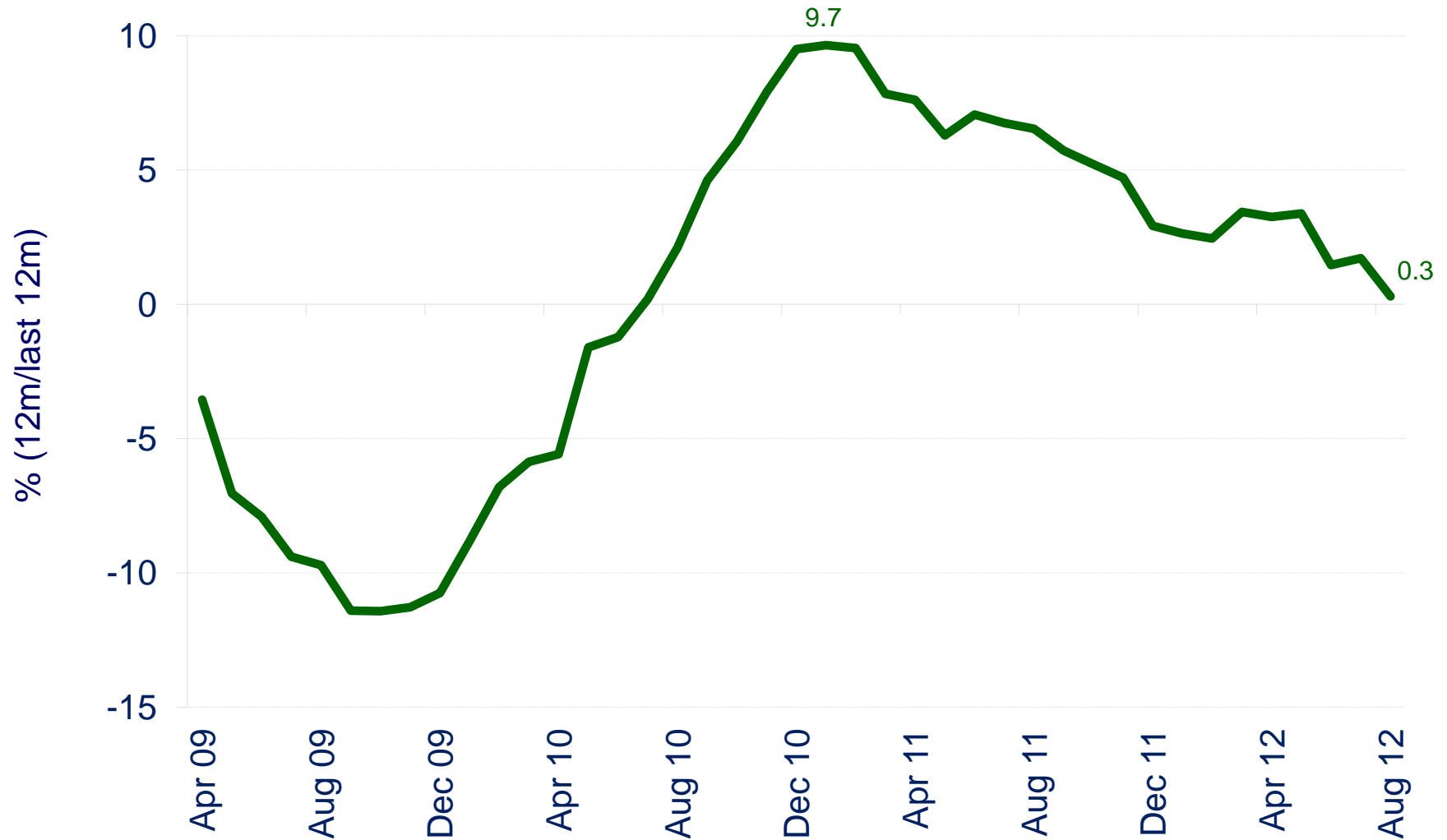
In 12 months



Target for 2012: 139.8 R\$ billion

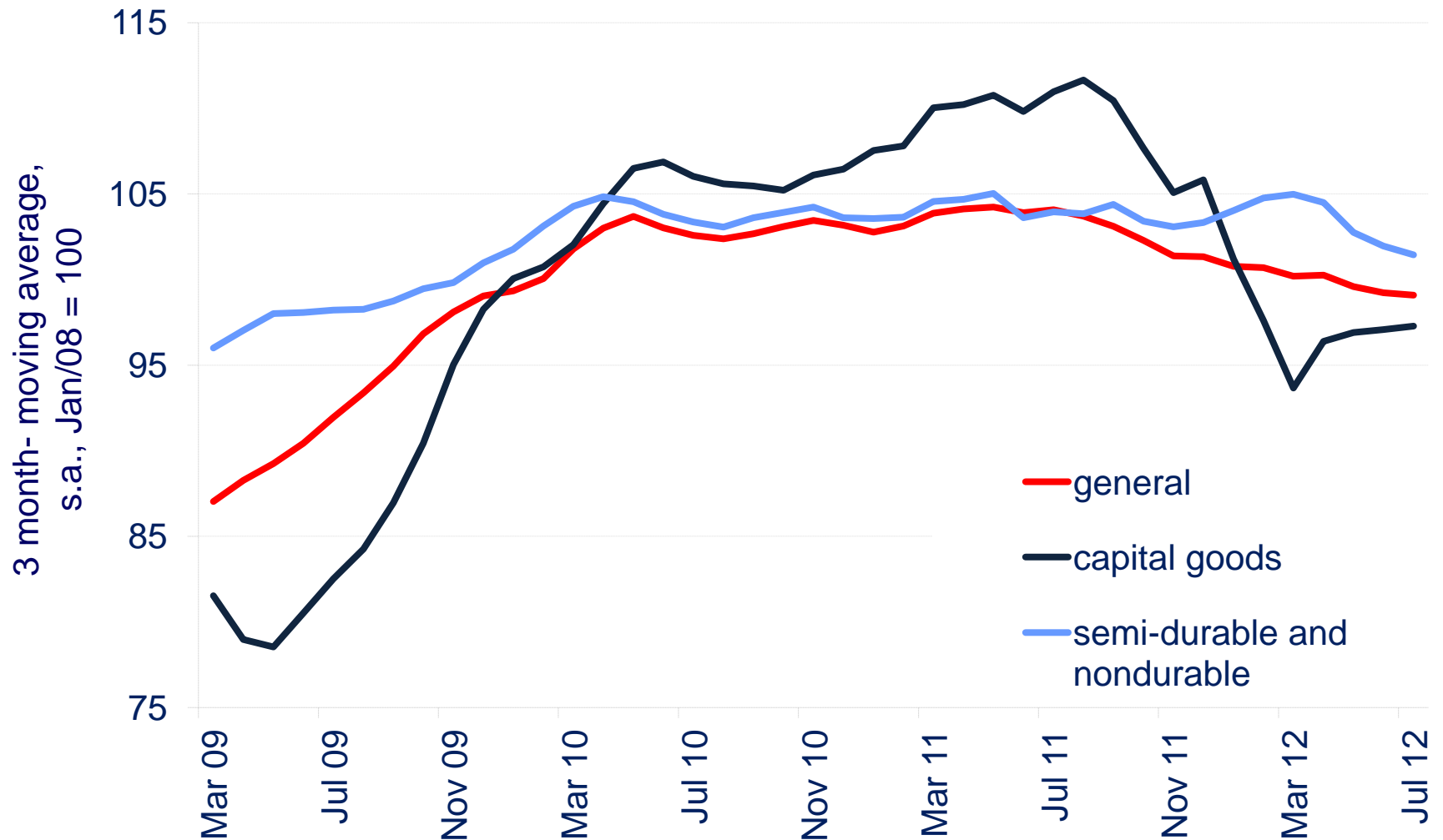
Total Exports - Quantum

Growth in 12 Months

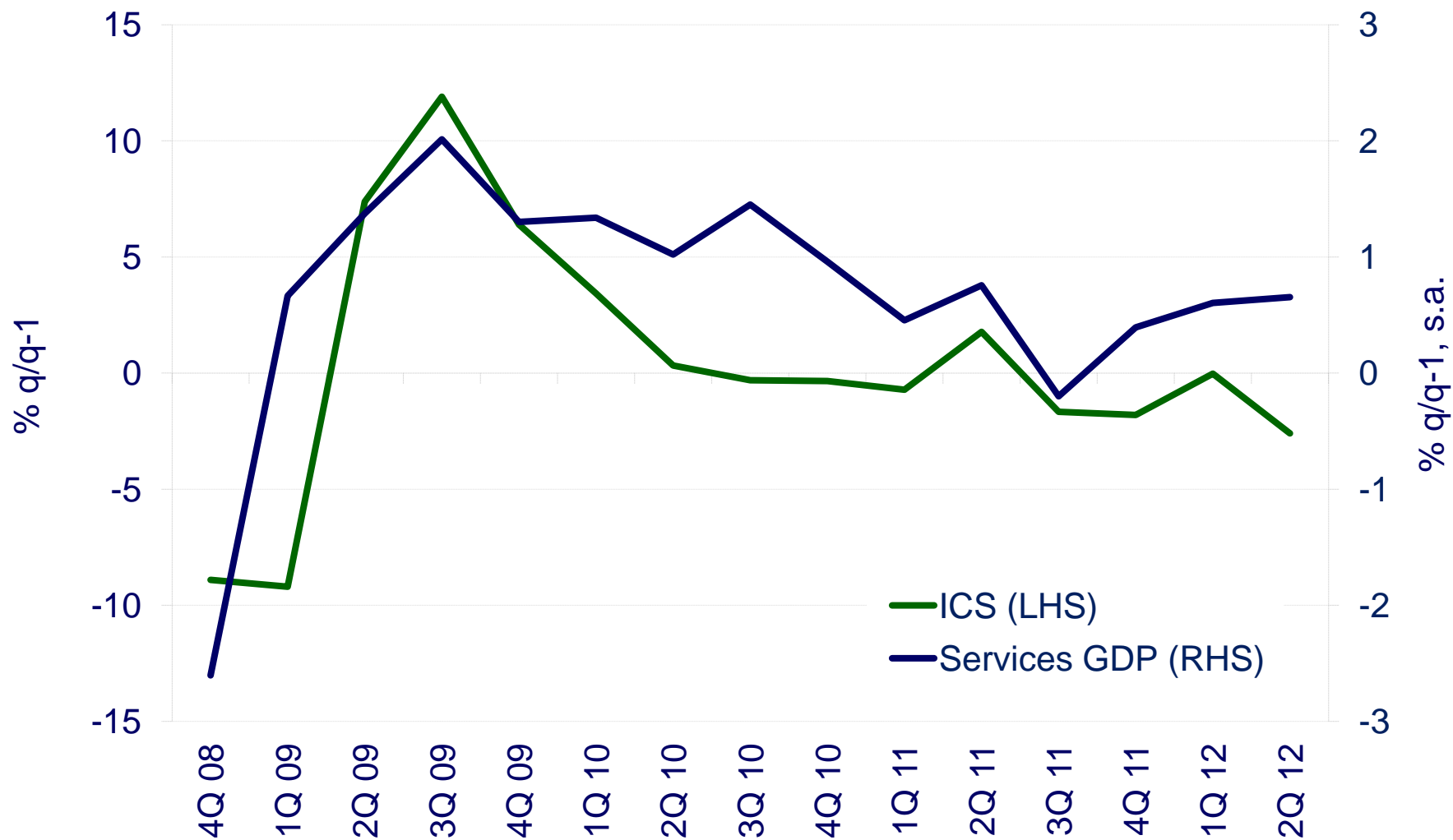


IV. Supply

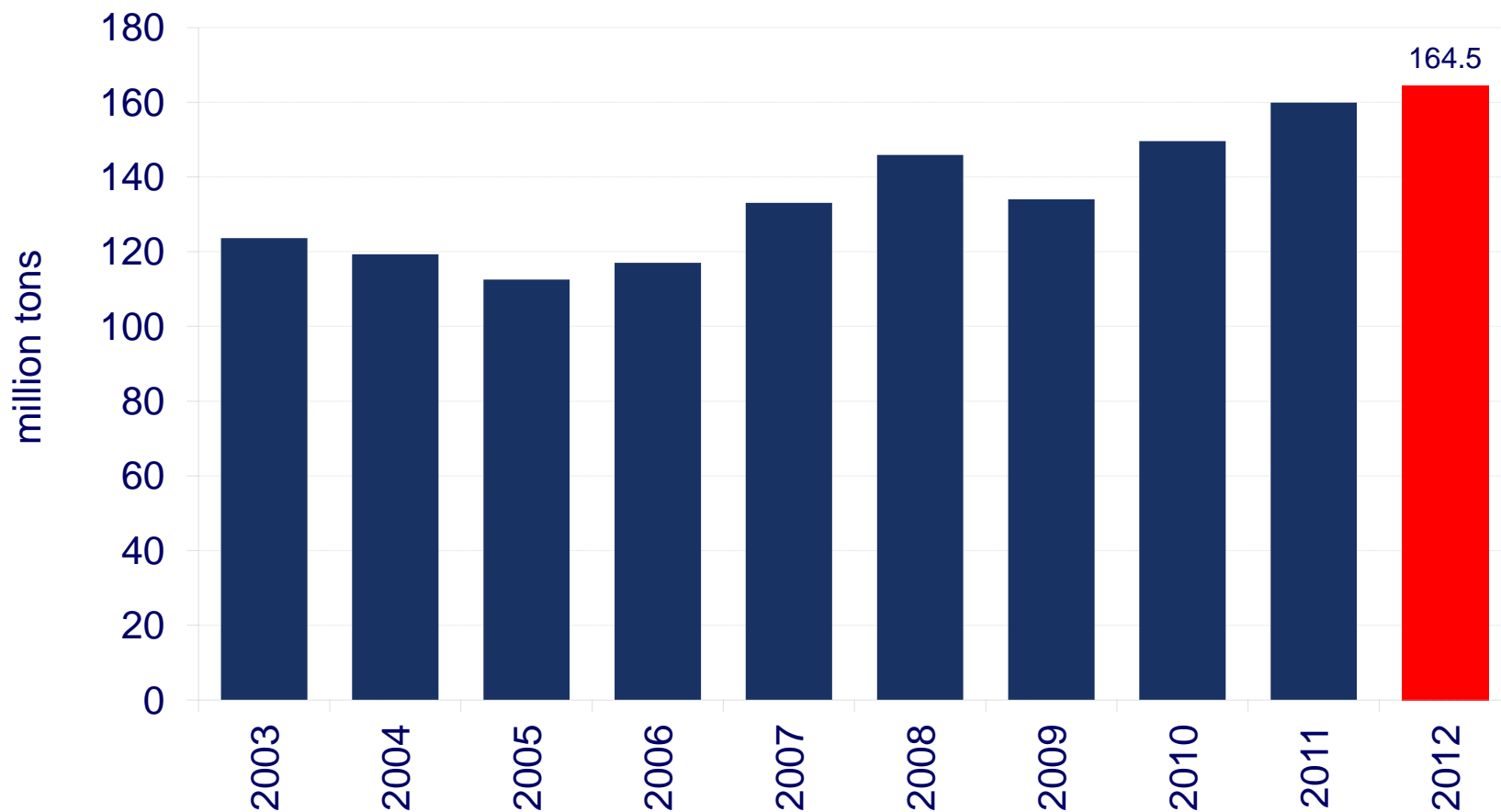
Industrial Production



Service Sector Confidence (ICS) and Services GDP

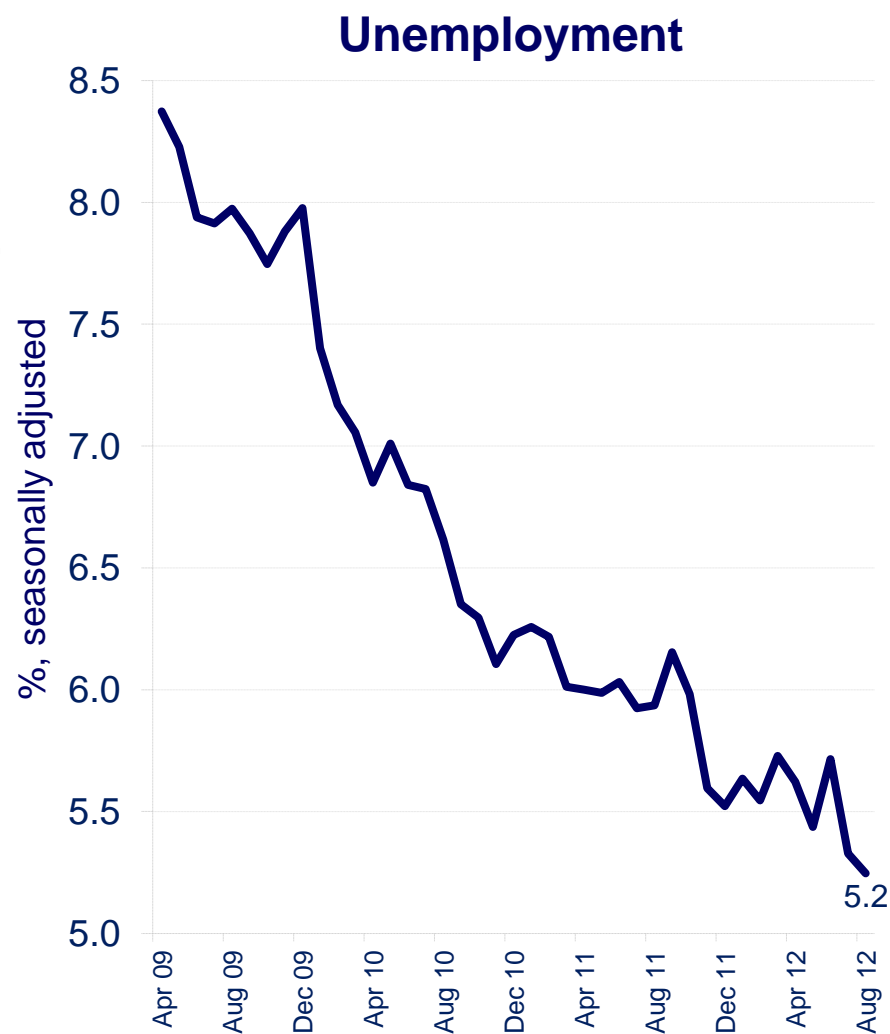
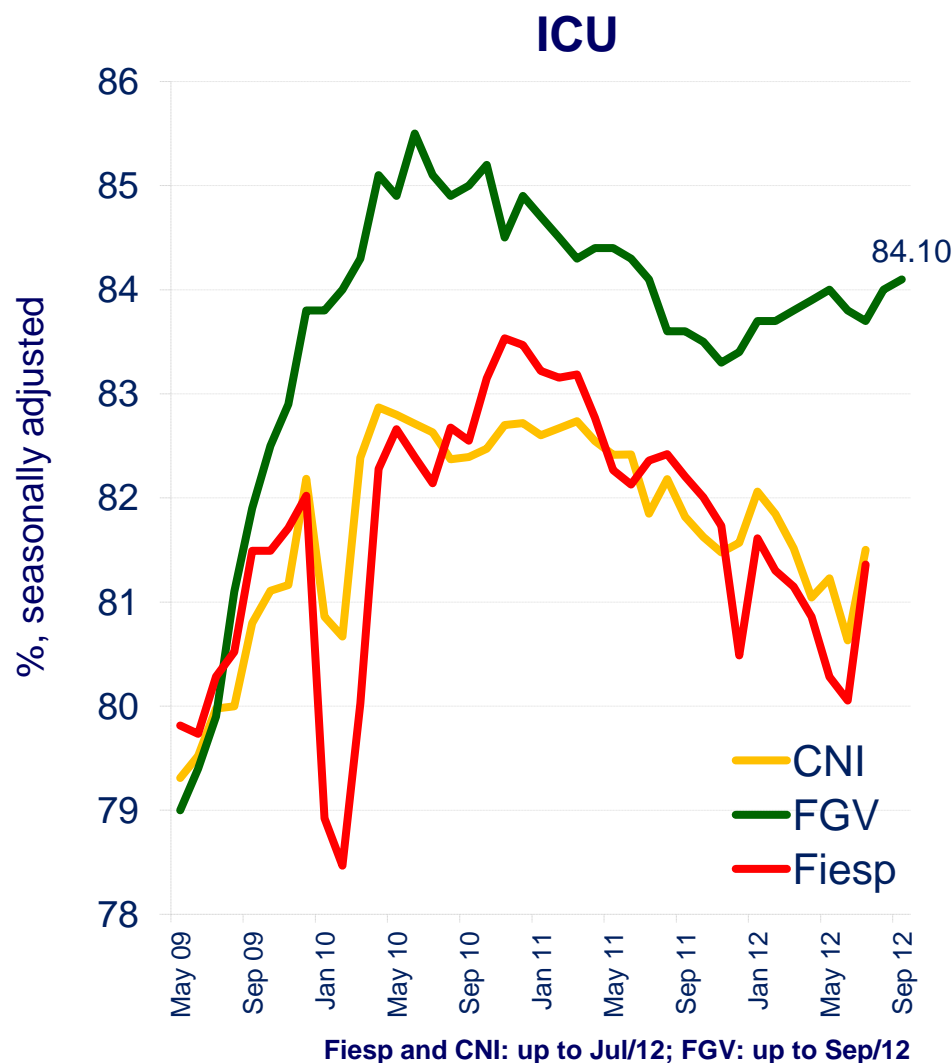


Crops Harvest



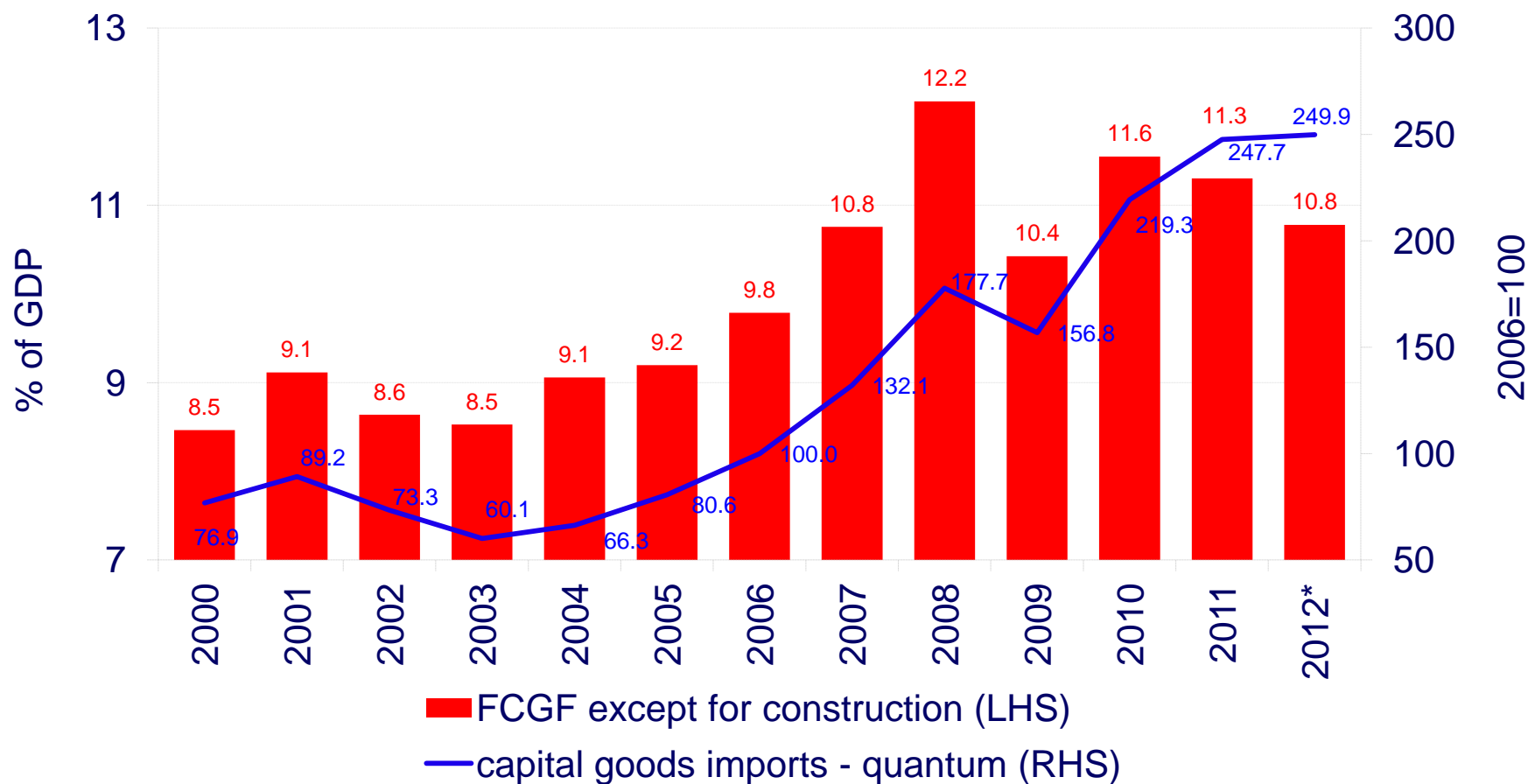
2012: IBGE estimate in Aug/12

Production Factors – ICU (Installed Capacity Utilization) and Employment



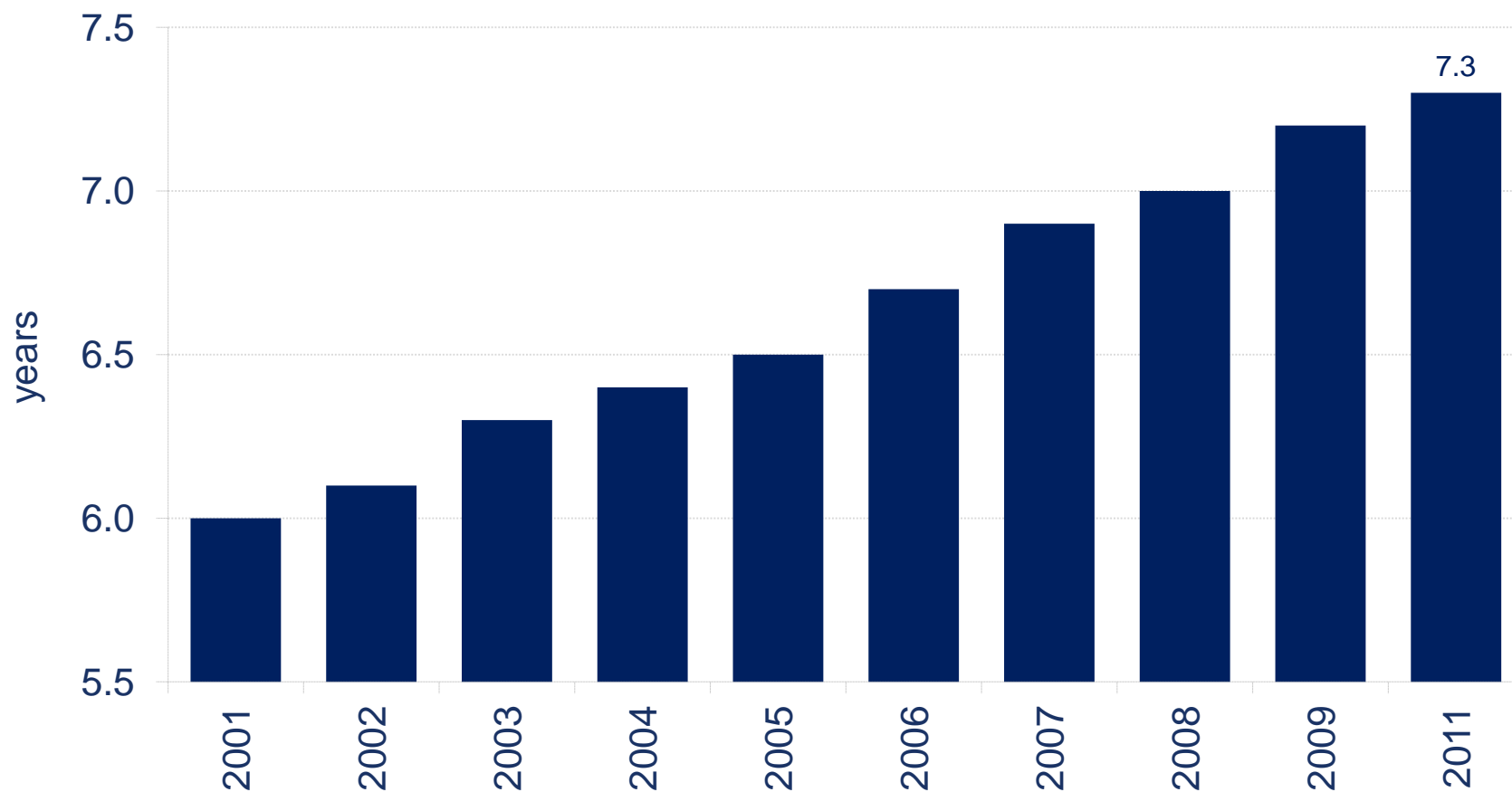
Investment

accumulated in 4 quarters



Estimate for construction VABP (value added at basic prices) until 2012.II/ data up to August for imports

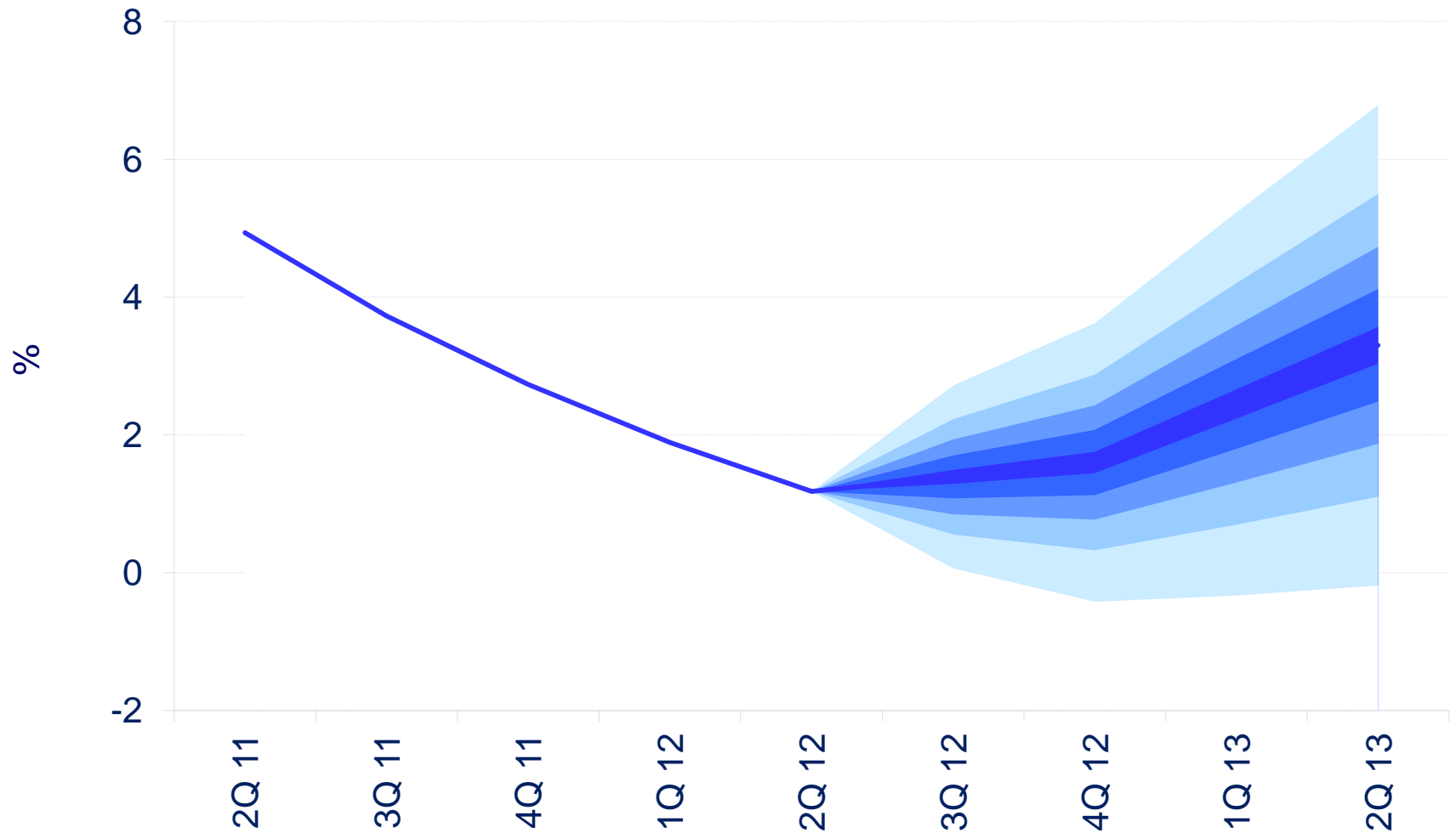
Years of Schooling*



* people older than 24 years old
2011 estimate

GDP Forecast

Baseline Scenario



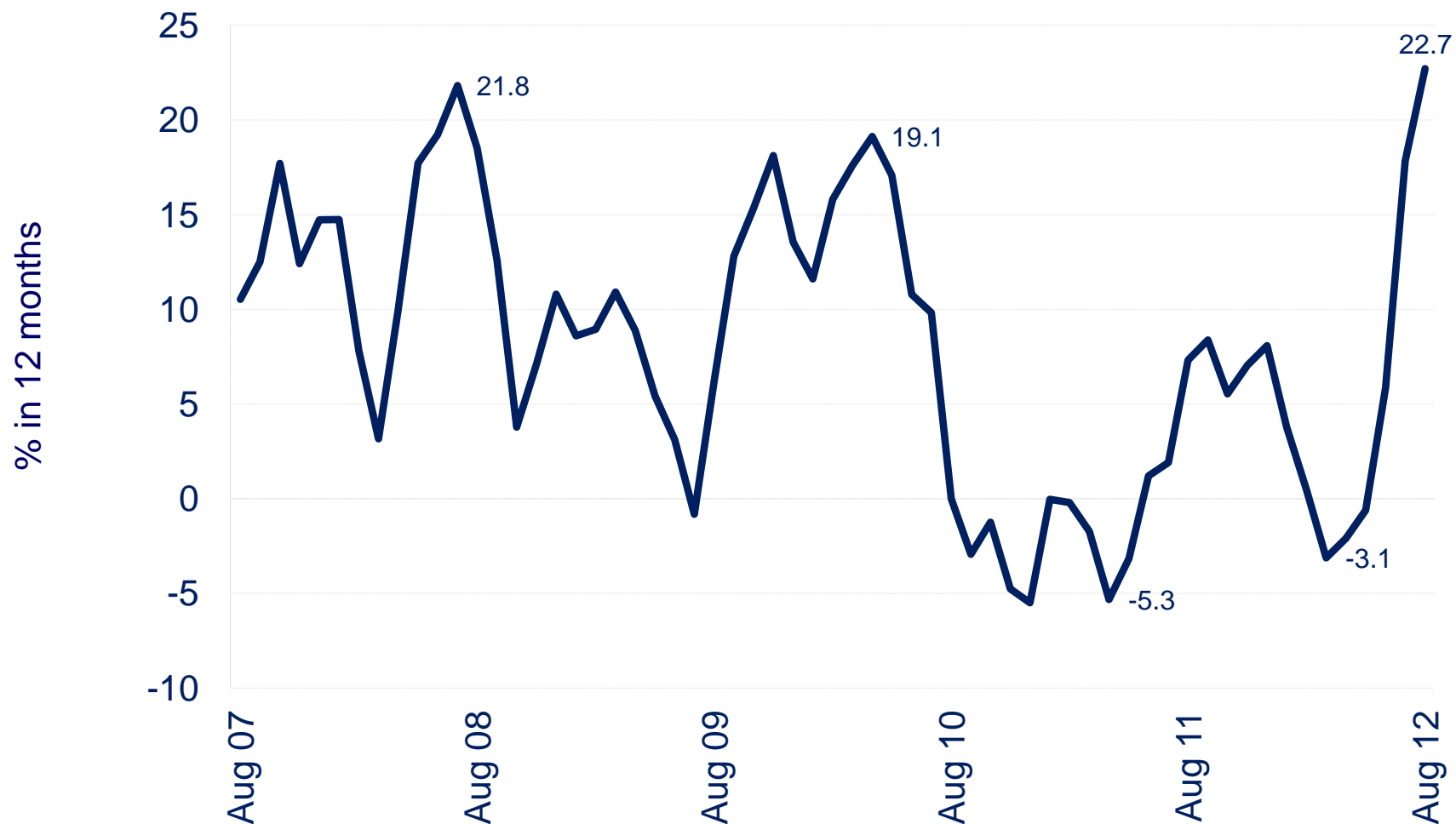
V. Inflation Developments

Inflation Developments

Prices Indexes

	change in 12 months (%)	
	Aug/11	Aug/12
IPCA	7.23	5.24
INPC	7.40	5.39
IPC-Fipe	6.83	4.11
IPC-C1	7.30	6.57
IGP-DI	7.81	8.04
IPA-DI	8.09	9.00
Agricultural	17.91	17.92
Industrial	4.97	5.83
IPC-DI	7.10	5.69
INCC-DI	7.75	7.41

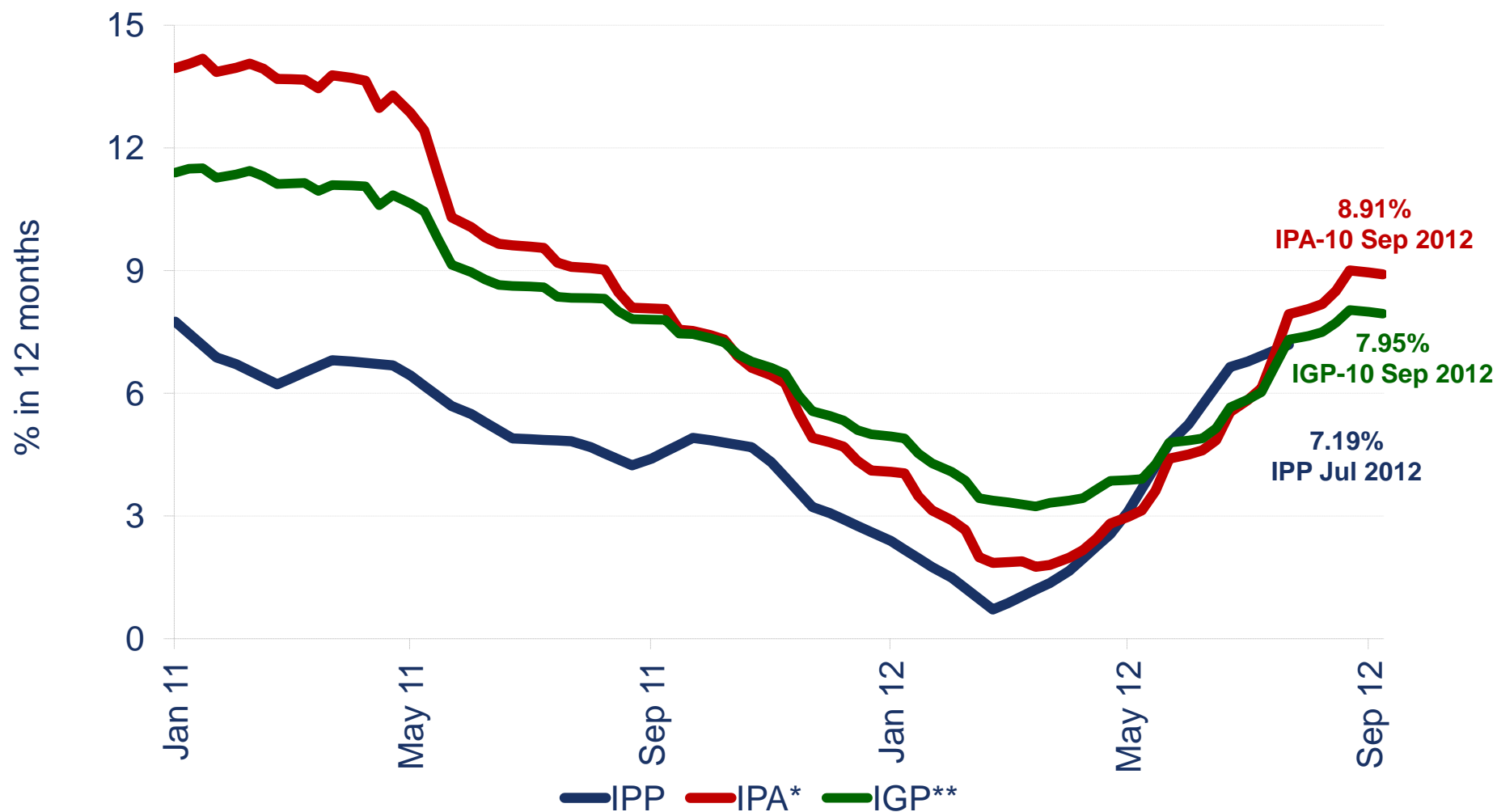
In Natura Food Prices



Agricultural IC-Br (R\$)

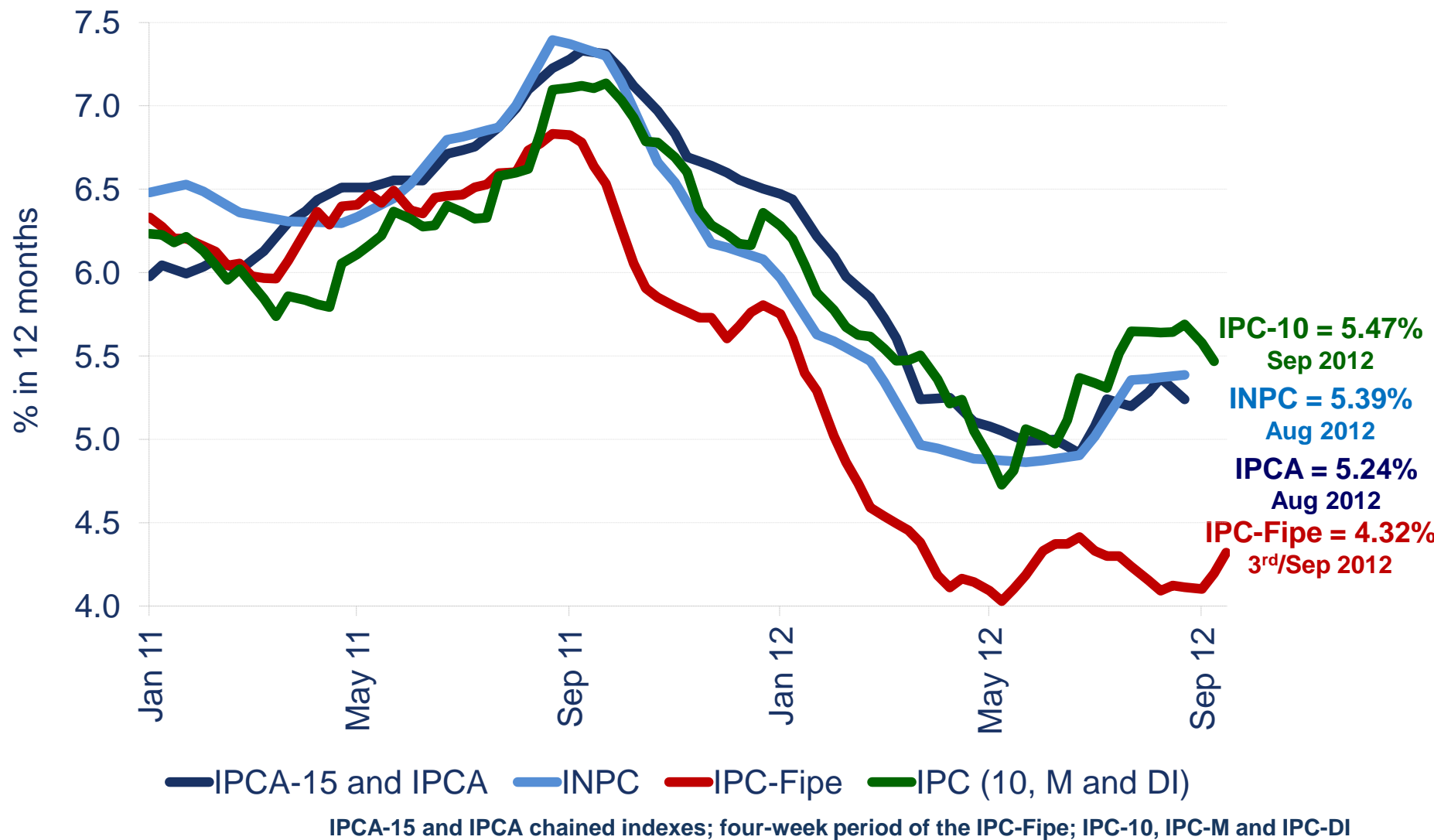


Producer Prices and General Price Index (IGP)

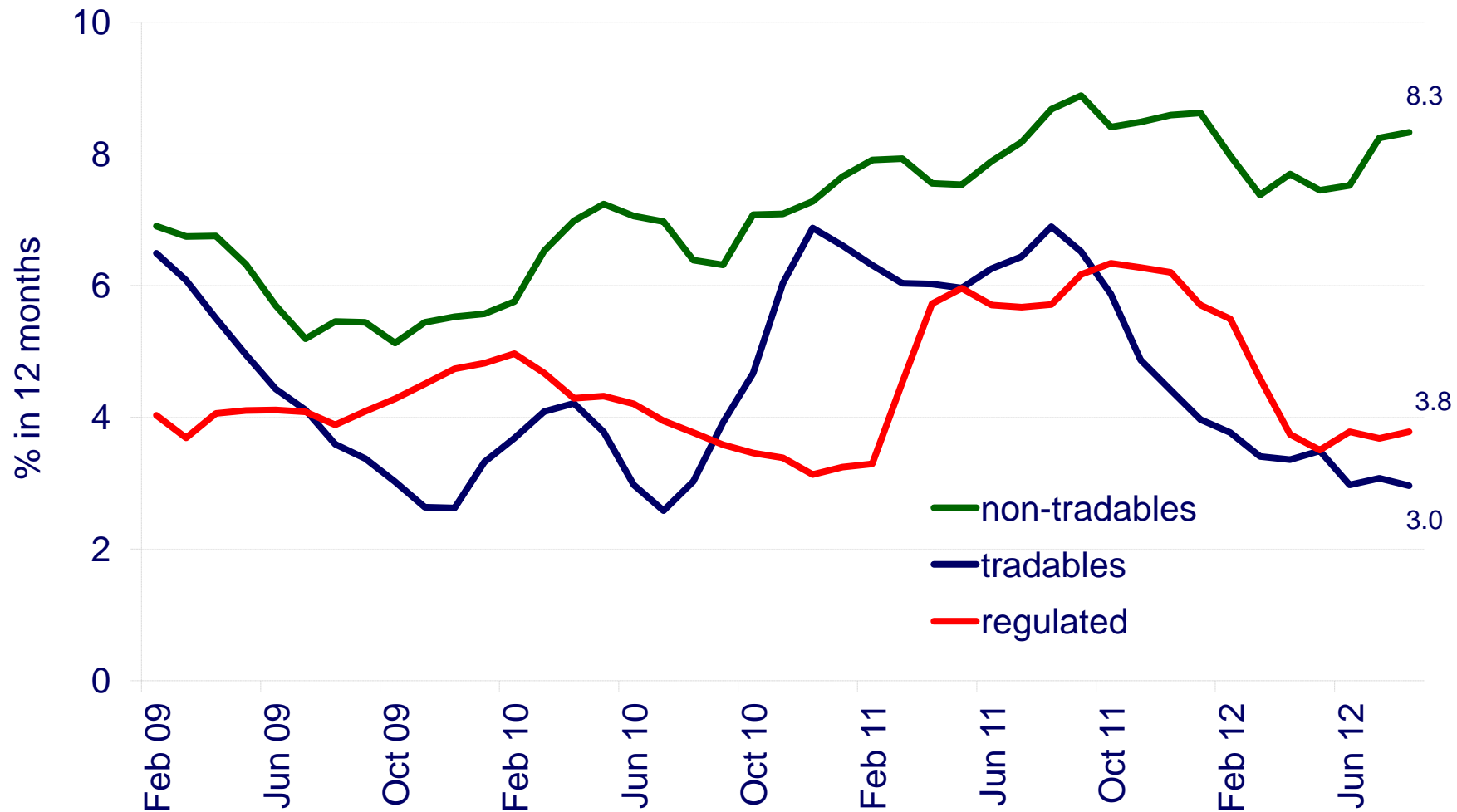


*IPA-10, IPA-M e IPA-DI chained indexes **IGP-10, IGP-M and IGP-DI chained indexes

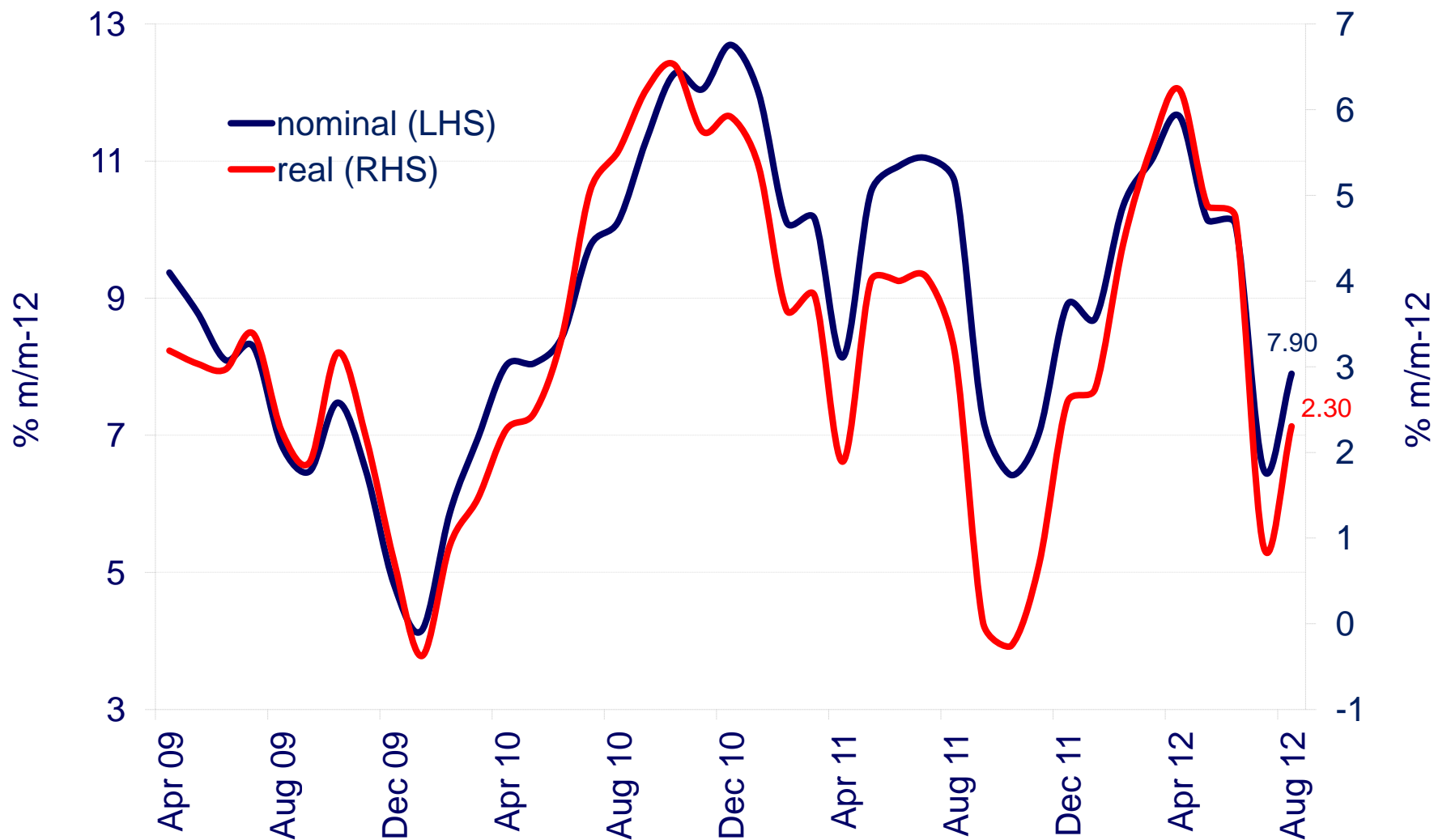
Consumer Prices



Inflation

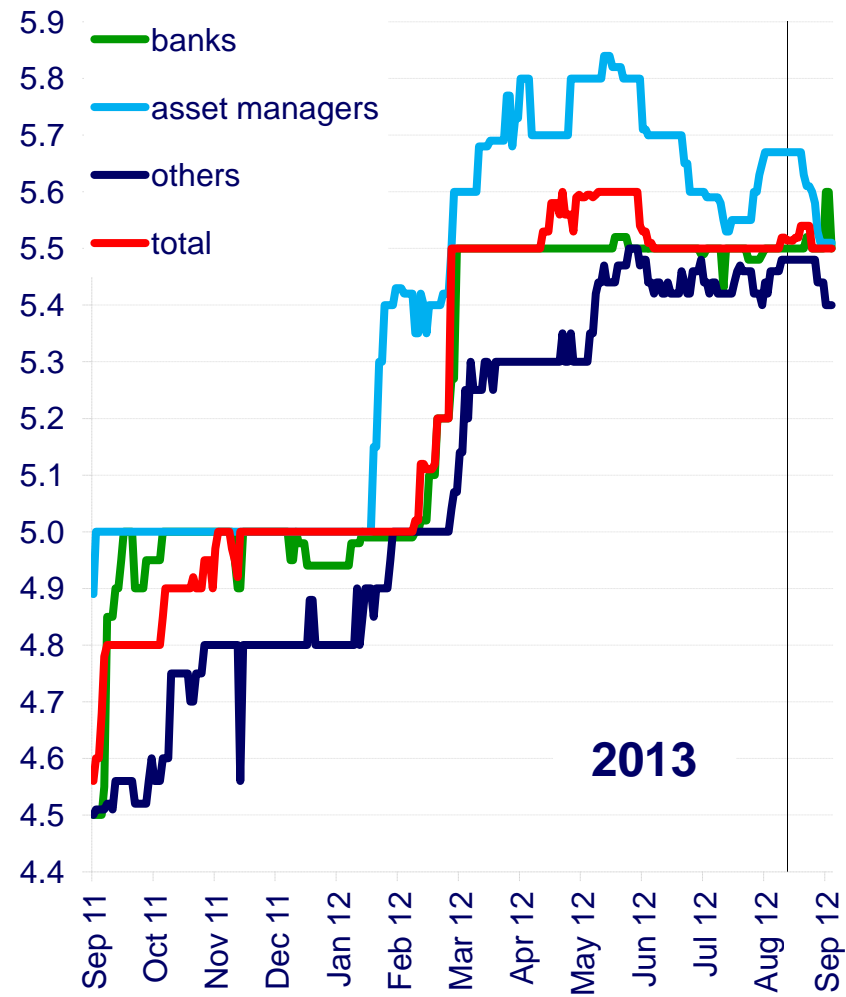
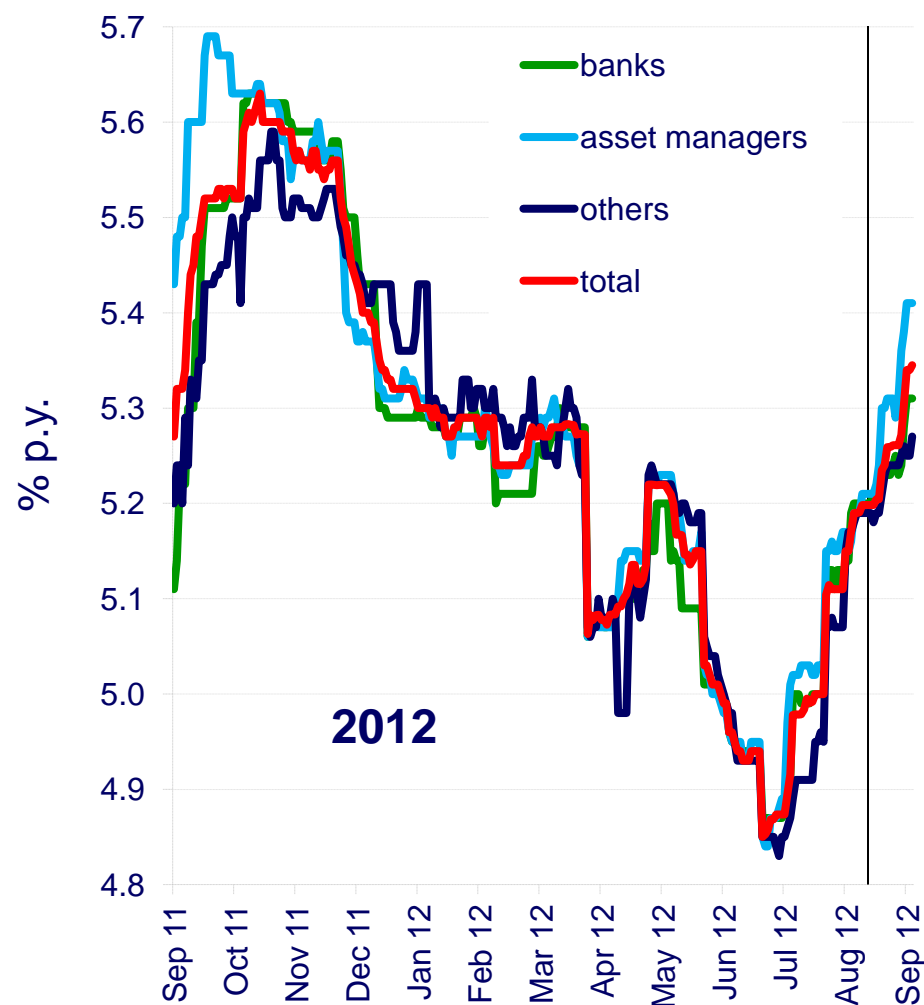


Wage Inflation



Estimates for the 2012 and 2013 IPCA

Median by Market Segment



data up to 9/21

Market Estimates for 2012

	Jun 29 th		Sep 25 th
IPCA	5.27	▲	5.36
Regulated Prices	3.95	▼	3.40
IGP-M	4.66	▲	8.49
IPA-DI	4.36	▲	10.03
Selic (End-of-Period)	9.00	▼	7.50
Exchange Rate (End-of-Period)	1.77	▲	2.00
GDP	3.20	▼	1.57
Industrial Production	2.00	▼	-1.92
Trade Balance	19.00	▼	18.04
Foreign Direct Investment	55.37	▲	57.10
Primary Result	2.90	▼	2.80

Market Estimates for 2013

	Jun 29 th		Sep 25 th
IPCA	5.50	▼	5.48
Regulated Prices	4.50	▼	4.10
IGP-M	5.00	▲	5.24
IPA-DI	5.00	▲	5.74
Selic (End-of-Period)	9.00	▼	8.13
Exchange Rate (End-of-Period)	1.90	▲	2.00
GDP	4.20	▼	4.00
Industrial Production	4.30	▼	4.15
Trade Balance	14.78	▼	14.48
Foreign Direct Investment	59.00	▲	60.00
Primary Result	2.95	▼	2.80

VI. Inflation Forecasts

Inflation Forecasts

Baseline Scenario* and Market Scenario

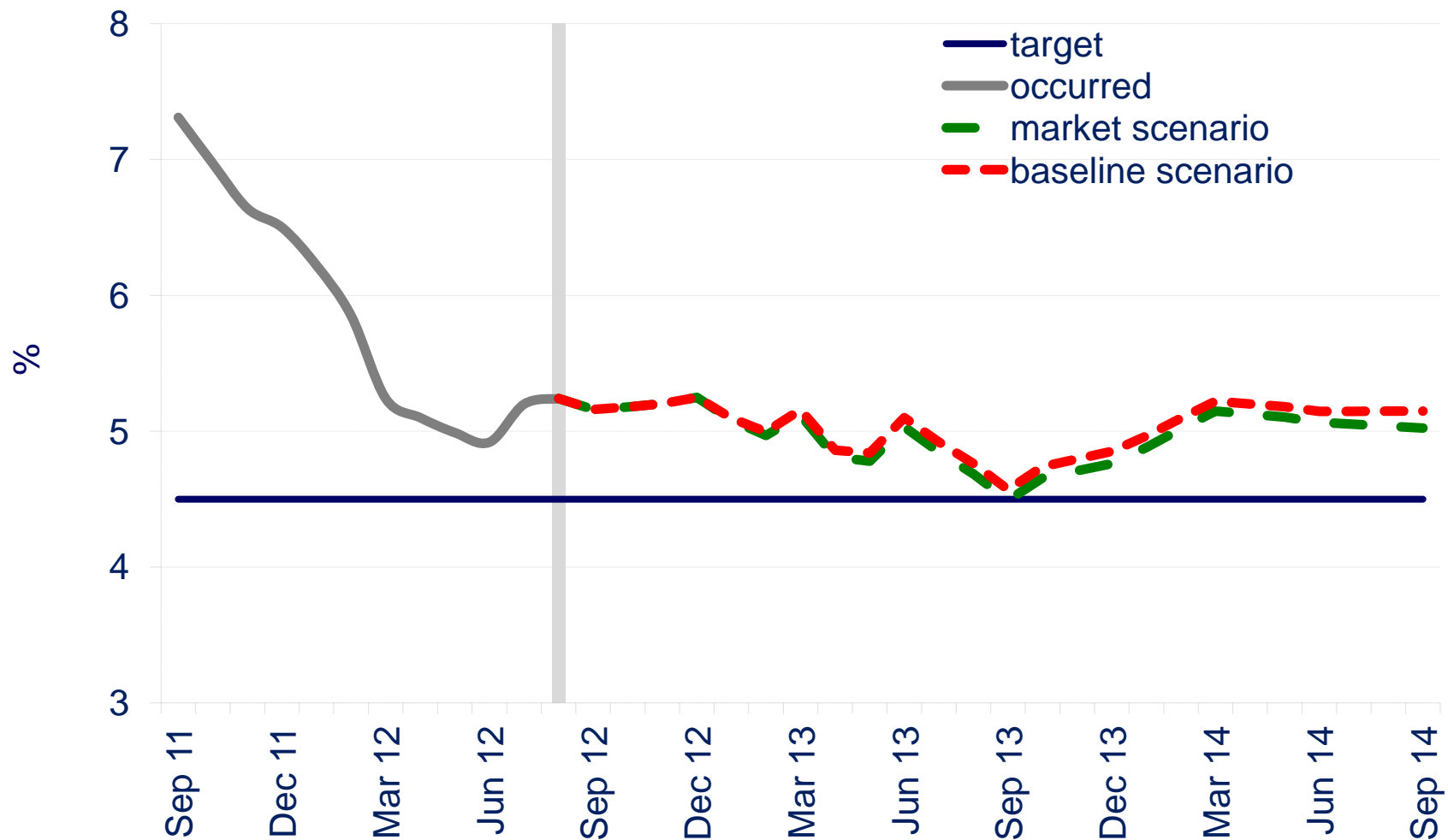
Period		Baseline	Market
2012	3	5.2	5.2
2012	4	5.2	5.2
2013	1	5.2	5.1
2013	2	5.1	5.0
2013	3	4.6	4.5
2013	4	4.9	4.8
2014	1	5.2	5.1
2014	2	5.1	5.1
2014	3	5.1	5.0

Note: 12-month cumulative inflation (%p.y.)

* interest constant at 7.5% p.y.

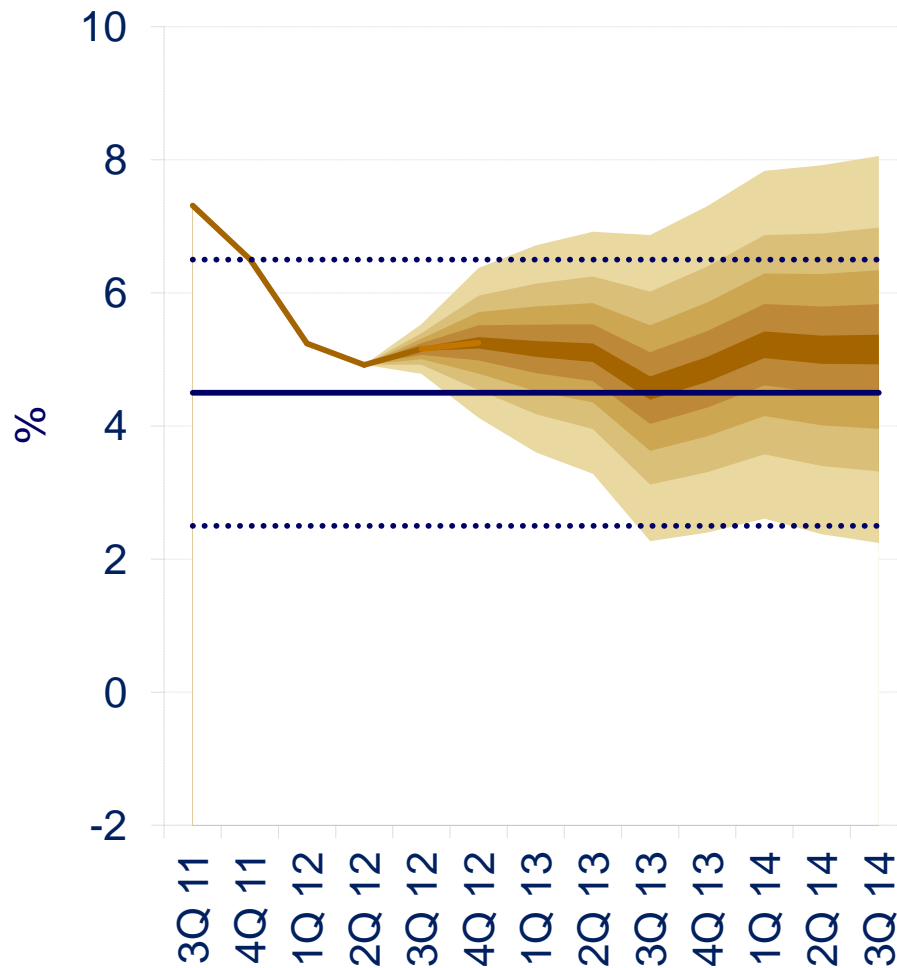
Targets and Forecasts' Path

12-month Accumulated Inflation

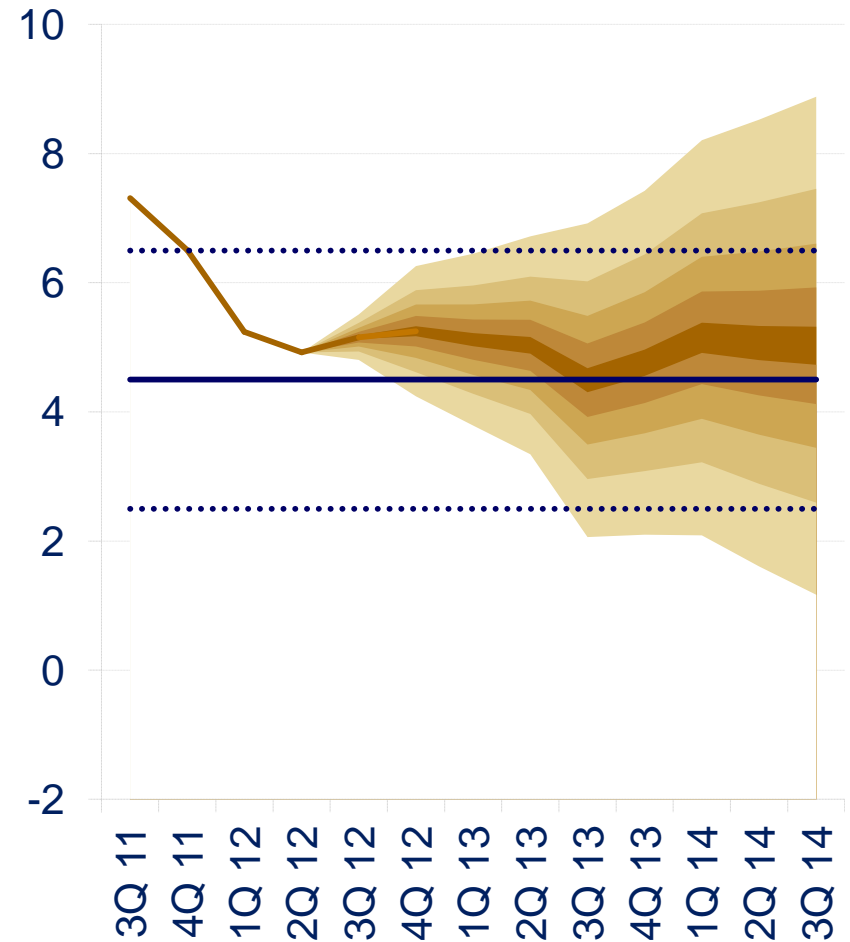


Inflation Forecast

Baseline Scenario
(interest constant at 7.5% p.y.)



Market Scenario



VII. Boxes

Box: GDP Forecasts

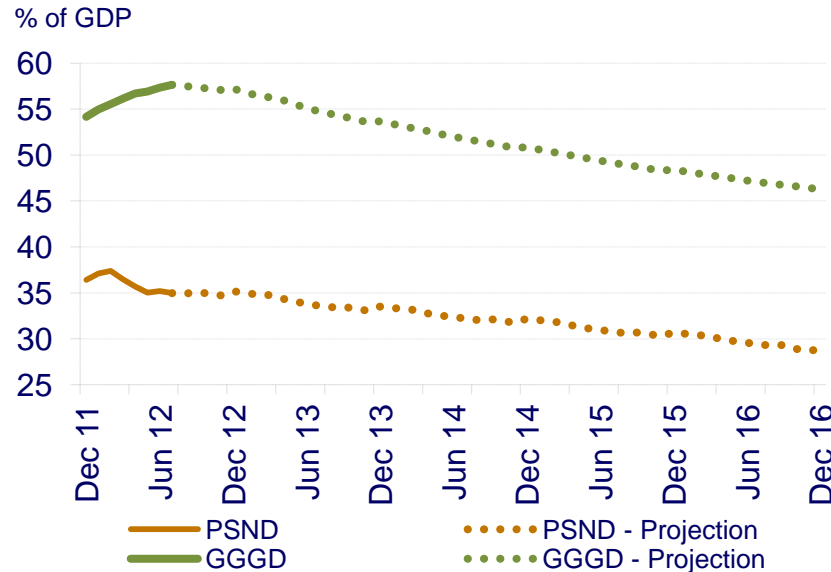
- Forecast for the 2012 GDP growth revised, from 2.5% to 1.6%;
- Forecast for the 12-month cumulative inflation through June: 3.3%
- Forecasts point to more intense activity pace in this semester and in the upcoming year.

Gross Domestic Product - % Change accumulated in 4 quarters

	2010	2011	2012 (Previous)	2012 (New)	2013 II (New)
GDP at market prices	7.5	2.7	2.5	1.6	3.3
Agricultural	6.3	3.9	-1.5	-1.4	4.8
Industry	10.4	1.6	1.9	-0.1	2.0
Services	5.5	2.7	2.8	2.2	3.3
Household Consumption	6.9	4.1	3.5	3.3	4.2
Government Consumption	4.2	1.9	3.2	3.7	3.6
FCGF	21.3	4.7	1.0	-2.2	1.4
Exports	11.5	4.5	4.1	0.9	1.5
Imports	35.8	9.7	5.6	2.7	2.7

Box: PSND (Public Sector Net Debt) and GGGD (General Government Gross Debt)

Forecasts for the PSND and GGGD

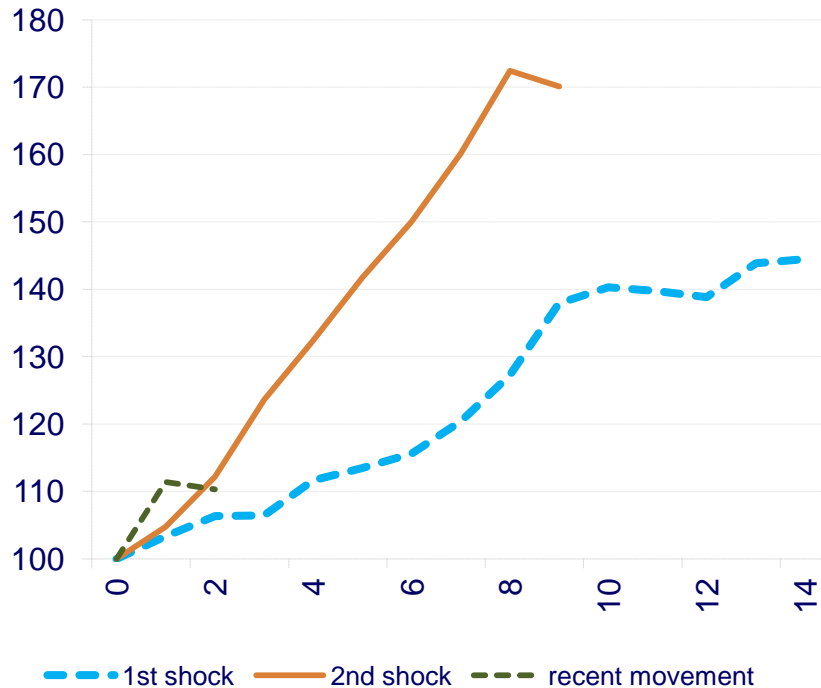


- Compared to other countries, Brazil keeps a comfortable situation;
- Forecasts based on market parameters indicate decreasing trajectory, in the medium term, both for PSND and GGGD; and
- It is expected 14.7% p.y. for the implicit interest rate on the PSND, in 2012, compared to 16.9% p.y. observed in 2011; and 10.4% for the GGGD, compared to 12.5% in 2011.

Box: Recent Evolution in the Prices of Agricultural Commodities

Evolution of the Agriculture IC-Br (in US\$) after the recent shocks

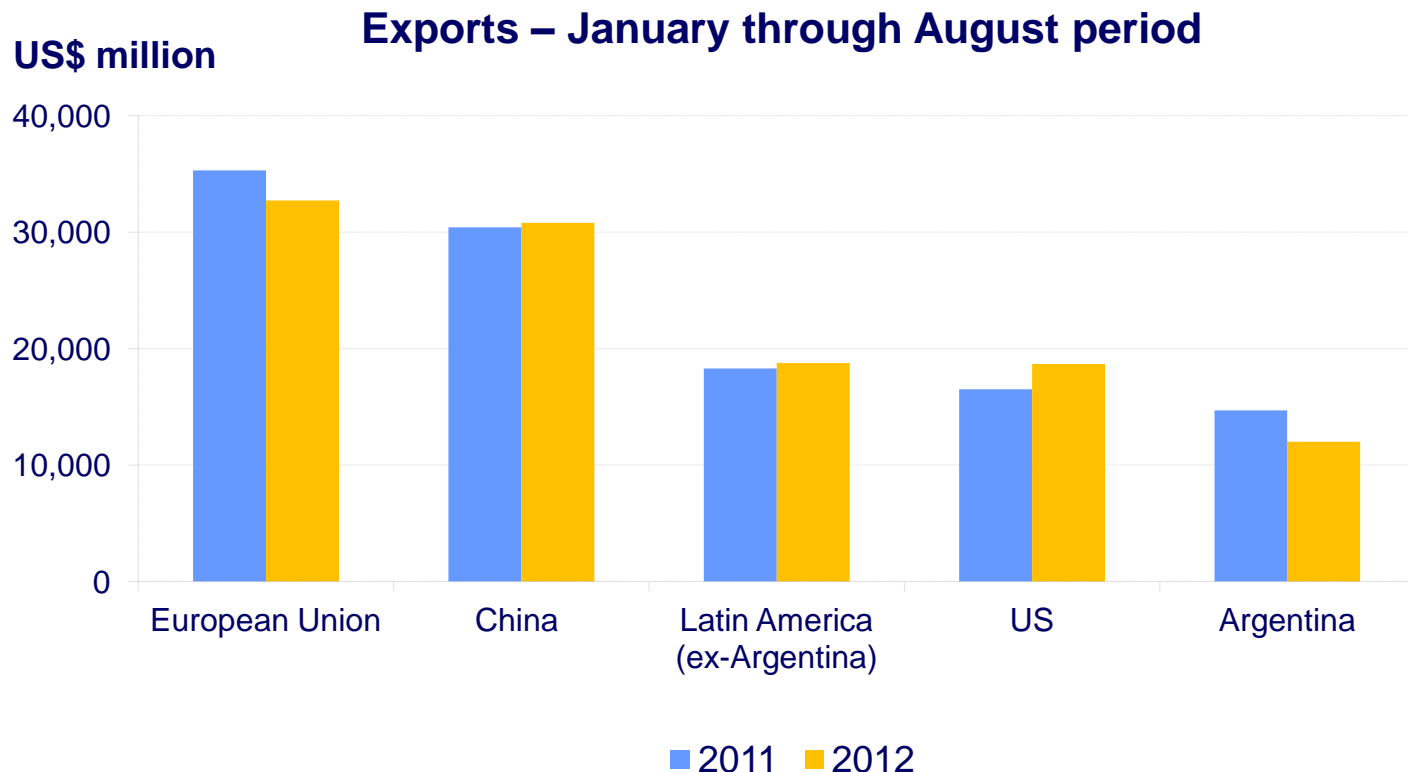
Month previous to the shock = 100



- Recent movement tends to be less intense and persistent than the previous ones;
- There is no generalized increase in prices (concentrated in grains).

Box: Brazilian Exports by Destination

- Exports destined to Argentina and European Union with important retreats (of 19.3% and 8.4%); and
- Sales for the US and Latin America (ex-Argentina) show expansion (11.7% and 1.4%); and
- Estability in exports to China.



Box: Balance of Payments Forecast

- **2012: revision of the current account deficit, to \$53 billion, and of the FDI flow, to \$60 billion**

	2012	
	IR - Jun/12	IR - Sep/12
Current account	-56.0	-53.0
Trade balance	18.0	18.0
Exports	258.0	248.0
Imports	240.0	230.0
Services	-39.0	-39.1
Income	-37.9	-34.7
Transfers	2.8	2.8
Capital and financial account	79.2	75.7
FDI	50.0	60.0
Stocks and fixed income in the country	11.0	12.0
Medium- and long-term loans and securities	0.1	9.1
Short-term loans and securities	-6.5	0.9
Foreign commercial credits and others	12.0	12.2
Brazilian assets abroad (- = increase)	12.6	-18.5
Reserve asset (- = increase)	-23.2	-22.7

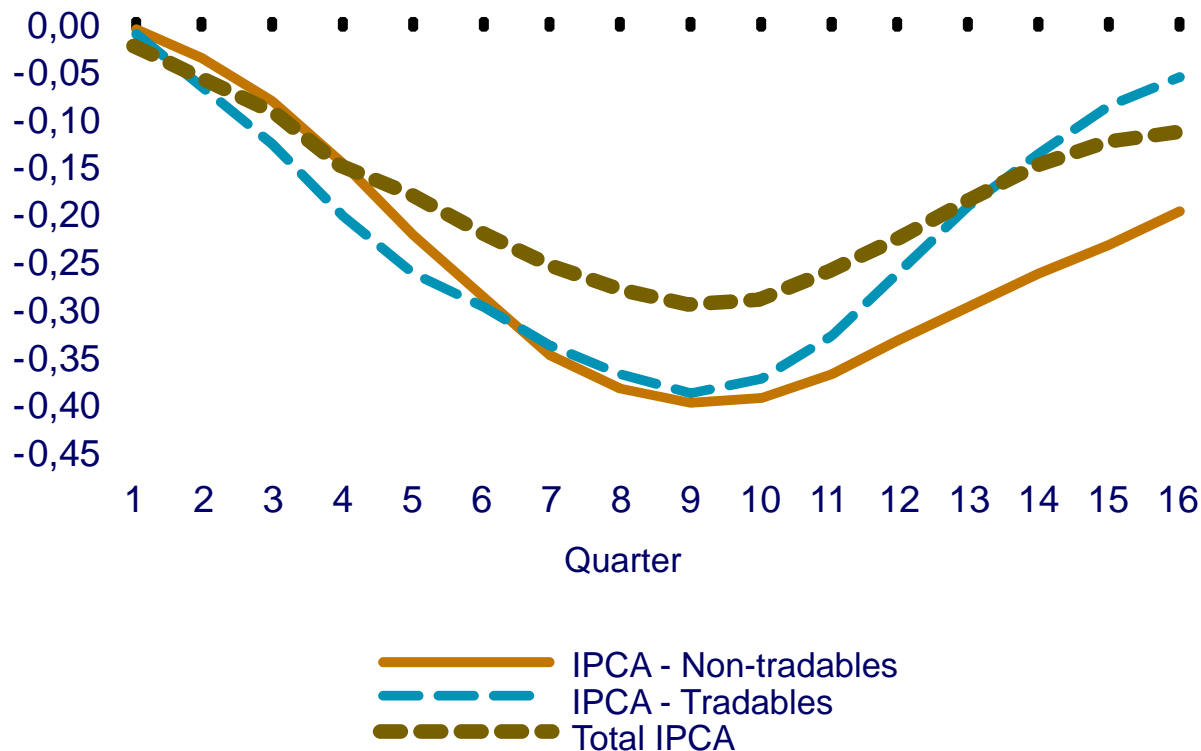
Box: Evolution of the Equilibrium Real Interest Rate in Brazil

- The equilibrium real rate is that rate consistent, in the medium term, with stable inflation and product growth equal to potential growth (Blinder, 1998)
- The Box revisits the released in the Sep/2010 Inflation Report and it shows evidences of reduction in the equilibrium rate in recent years, based on several models, which are supported by:
 - Real 360-swap suggests the reduction of 350 b.p. (1st half/2008 – 1st half/2012);
 - 5-year Inflation Linked Treasury Bonds (NTN-Bs) point to the retreat of 330 b.p. (1st half/2008 – 1st half/2012);
 - Decrease in the ten-year sovereign bonds yields in the international markets (5%/6% to 2.5%/3% (1st half/2008 – 1st half/2012); and
 - Private sector analysts estimations (survey carried out by the Investor Relations and Special Studies Dept - Gerin).
- Structural changes which certainly contributed for this reduction:
 - Retreat in the macroeconomic risk perception (inflation, growth, balance of payments and investment grade);
 - Fiscal sector consolidation (Fiscal Responsibility Law);
 - Institutional improvements (new Bankruptcy Law, chattel mortgage) and credit expansion; and
 - Acquisition of experience by institutions and consolidation of democracy (lower political risk).

Box: Inflation Forecast Using Disaggregated Semi-structural Model: Tradable and Non-Tradable Goods

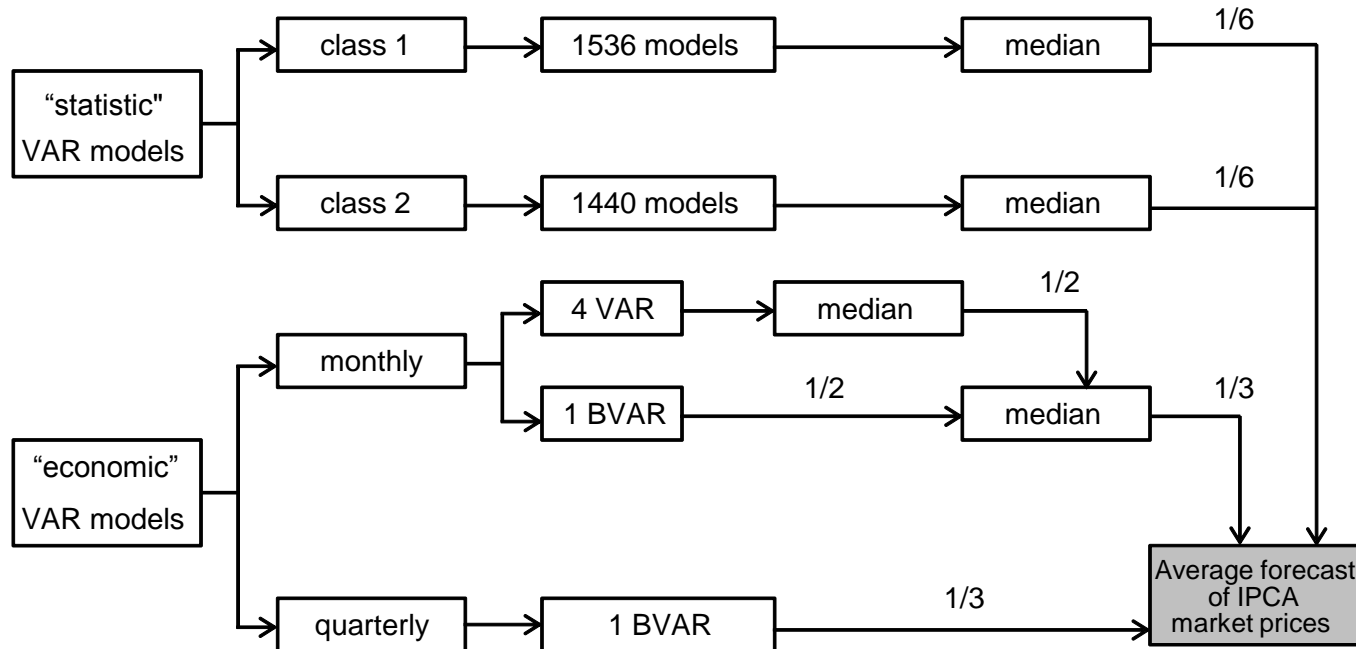
Inflation Response to monetary policy^{1/}

IPCA accumulated in 4 quarters (p.p.)



^{1/} Increase of 1 p.p. in the Selic Rate during four quarters

Box: Revision of the Economic VARs Models



Main changes:

- More transmission channels (e.g., expectations);
- More variables (e.g., GDP and credit);
- Less specifications (from 14 to 6); and
- Less variables per model (from up to 6 to up to 4).



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