

Inflation Outlook

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I. Introduction

BCB's Mission

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

Importance of this Mission

- The international experience and the economic theory set low and stable inflation (stability of the purchasing power of money) as a precondition to sustainable growth.
 - **High inflation:**
 - It increases risk premiums, diminishes confidence, shortens the planning horizon and depresses investment;
 - Reduces employment, income and consumption; and
 - Increases the income concentration, diminishes the economic growth and the society welfare.

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 and, in the US, the process of normalization of monetary conditions was started;
- The scenario of more intense global activity was confirmed, although the activity pace does not match the expectations in important emerging economies;
- Localized price pressures in the commodities markets and volatility focuses in the currency markets; and
- In general terms, accommodative monetary policy stance, in the emerging and mature economies.

Retrospective - Brazil

Since the last Report release:

- National accounts relative to the fourth quarter of 2013 confirm gradual recovery of the Brazilian economy;
- In the market of factors: relatively stable ICU and narrow idleness margin in the labor market;
- In the wholesale markets: prices pressures both in the agricultural and in the industrial segments;
- The process of correction of relative prices advanced and there were localized prices pressures in the food segment;
- High consumer inflation and still showing resistance slightly above the one previously anticipated; and
- Continuation of the monetary conditions adjustment cycle.

Prospects – Abroad 2014-2015

- Still heightened risks for the global financial stability, in particular, those deriving from changes in the slope of the interest curve in important mature economies;
- Supported by positive data recently released, the prospects indicate more intense global activity pace throughout the relevant horizon for the monetary policy;
- Prospects of moderation in the dynamics of commodities prices, albeit localized prices pressures observed at the margin;
- Tension and volatility focuses in the currency markets; and
- In the relevant horizon, prospects for the increase of global inflation.

Prospects – Brazil 2014-2015

- Relatively stable activity expansion pace this year, compared to 2013;
- In the relevant horizon for the monetary policy, changes in the composition of aggregate supply and demand are anticipated;
- Current accounts' deficit tends to be essentially financed by foreign direct investment;
- Moderate credit expansion (to consumption, especially);
- Moderation in wage gains; and
- Projections indicate high twelve-month inflation in the relevant horizon, with retreating trend in the relevant horizon.

Prospects – Forecasts – 2014-2015

GDP Forecast:

- GDP growth in 2014 estimated at 2.0%.

Inflation forecasts:

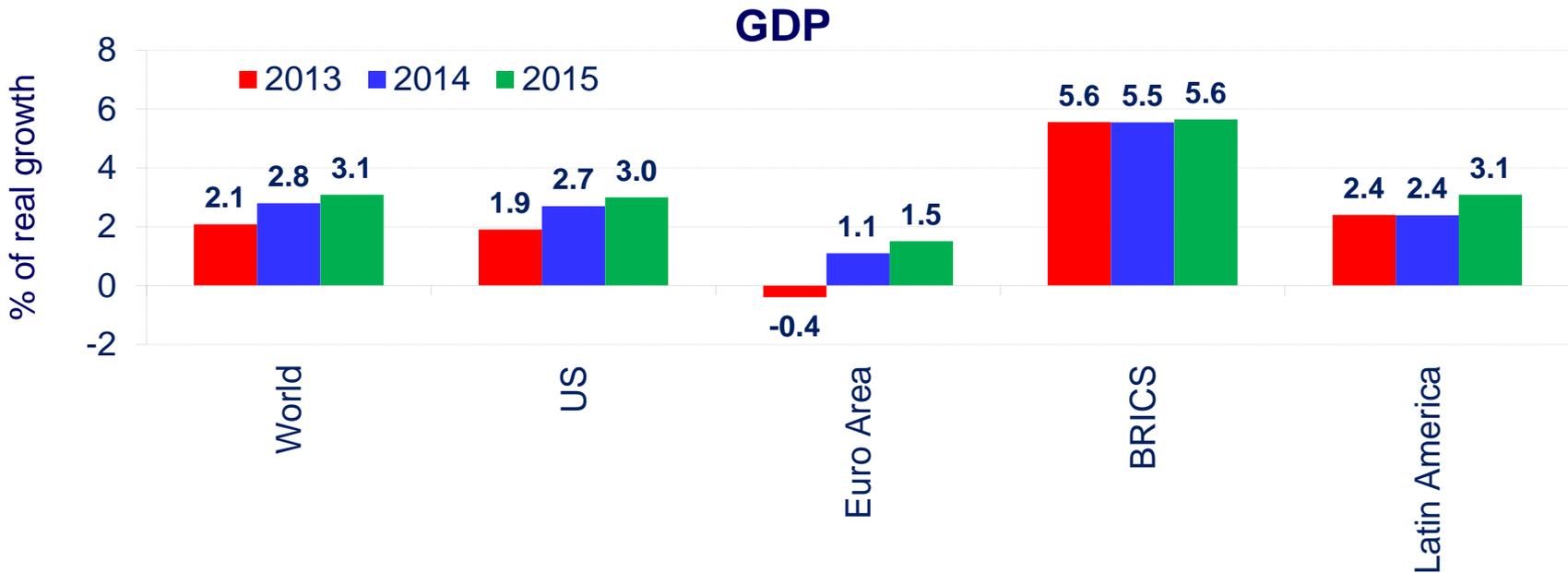
- Baseline scenario: 6.1% for 2014; 5.5% for 2015; and 5.4% in twelve months up to the first quarter of 2016; and
- Market scenario: 6.2% for 2014; 5.5% for 2015; and 5.2% in twelve months up to the first quarter of 2016.

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. At the same time, the Committee considers that the effects of monetary policy actions over inflation are cumulative and occur with lags.

II. International Environment

Activity – Expectations



2014 GDP (%)

	2013			2014
	Jun	Sep	Dec	Mar
US	2.7	2.7	2.6	2.7
Euro Area	1.0	1.0	1.0	1.1
Japan	1.5	1.6	1.6	1.4
U. Kingdom	1.6	2.0	2.4	2.7
China	7.6	7.4	7.5	7.4
India	5.8	5.2	4.8	4.8
Brazil	3.0	2.2	2.0	1.7

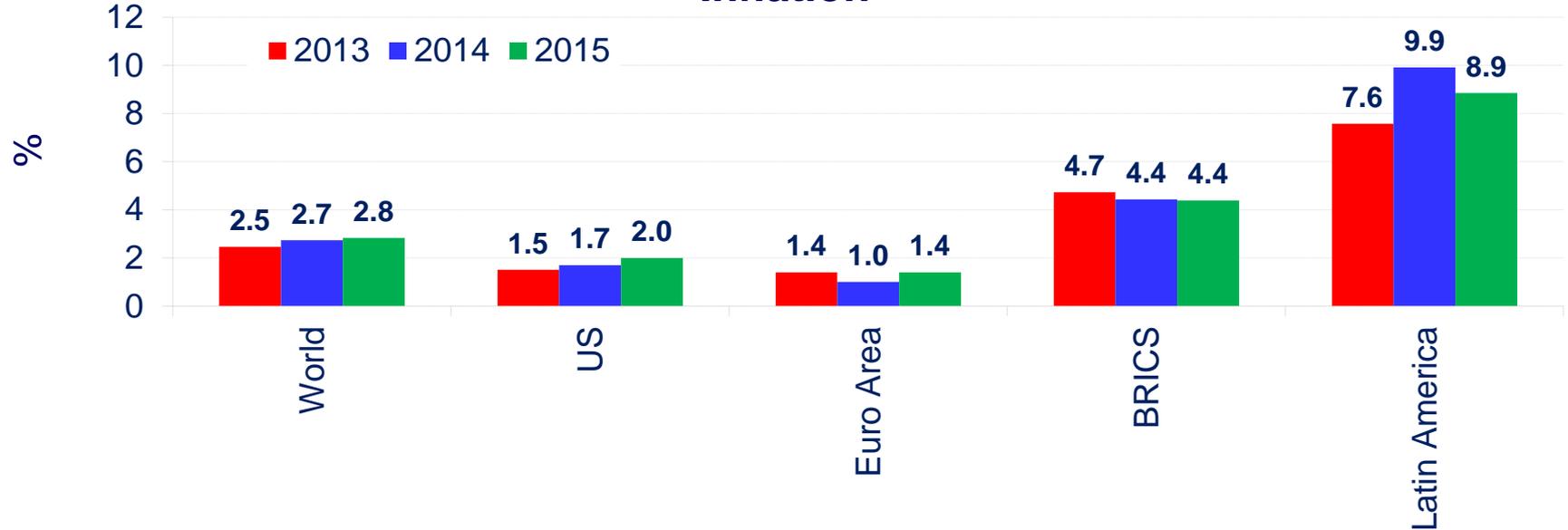
2015 GDP (%)

	2013			2014
	Jun	Sep	Dec	Mar
US	3.0	3.0	3.0	3.0
Euro Area	1.3	1.4	1.4	1.5
Japan	1.1	1.3	1.2	1.3
U. Kingdom	2.1	2.4	2.4	2.5
China	7.5	7.2	7.2	7.2
India	6.5	6.0	5.5	5.3
Brazil	3.0	2.5	2.5	2.0

Sources: Bloomberg and Focus – last available day of each month

Prices – Expectations

Inflation



2014 Inflation (%)

	2013		2014	
	Jun	Sep	Dec	Mar
US	1.9	1.9	1.7	1.7
Euro Area	1.6	1.5	1.2	1.0
Japan	2.0	2.3	2.4	2.5
U. Kingdom	2.4	2.3	2.2	2.0
China	3.2	3.1	3.1	2.8
India	8.6	8.7	9.2	9.6
Brazil	5.9	6.0	6.0	6.3

2015 Inflation (%)

	2013			
	Jun	Sep	Dec	Mar
US	2.2	2.2	2.0	2.0
Euro Area	1.7	1.5	1.5	1.4
Japan	1.6	1.6	1.8	1.8
U. Kingdom	2.2	2.1	2.2	2.0
China	3.0	3.0	3.2	3.2
India	7.9	7.5	8.0	8.2
Brazil	5.5	5.5	5.5	5.8

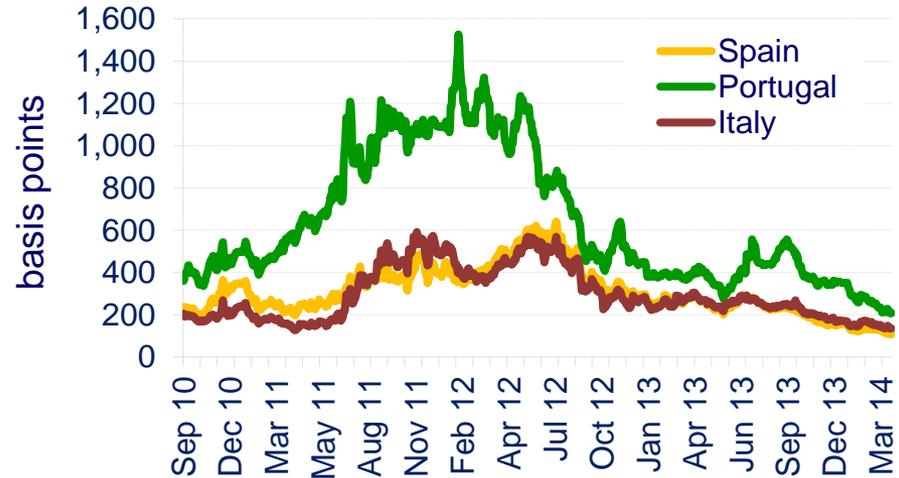
Sources: Bloomberg and Focus – last available day of each month

Commodities, Volatility and Risk Aversion

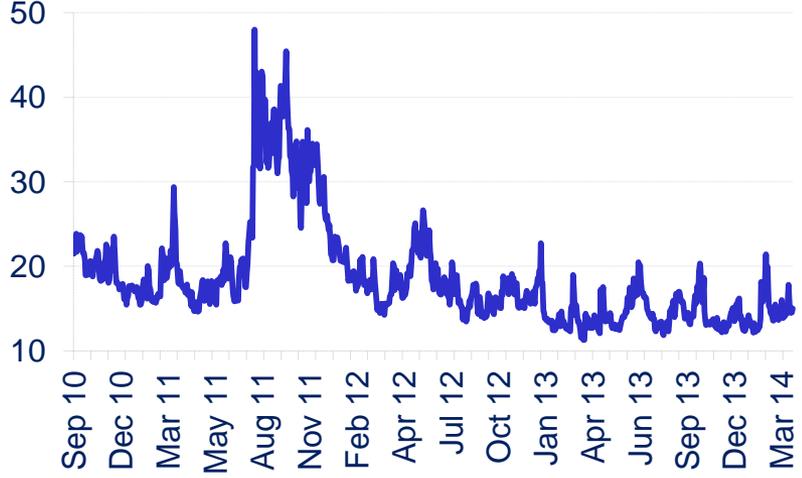
CRB



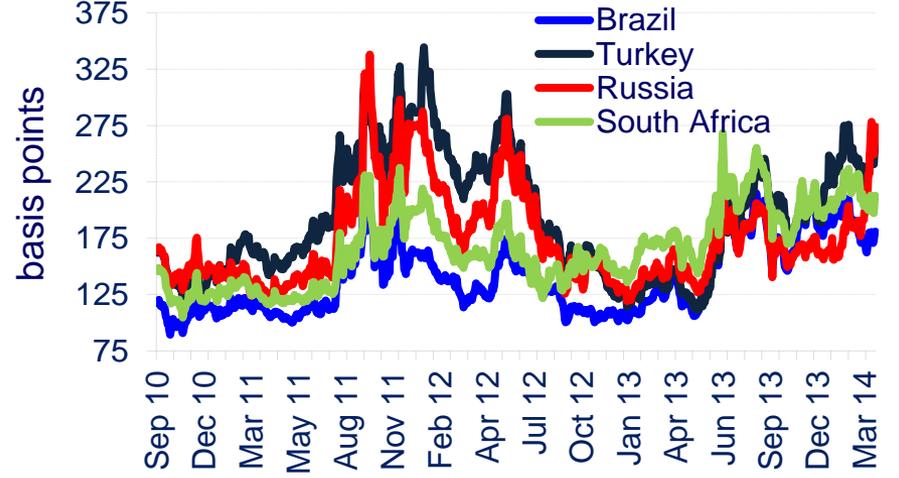
CDS



VIX



CDS

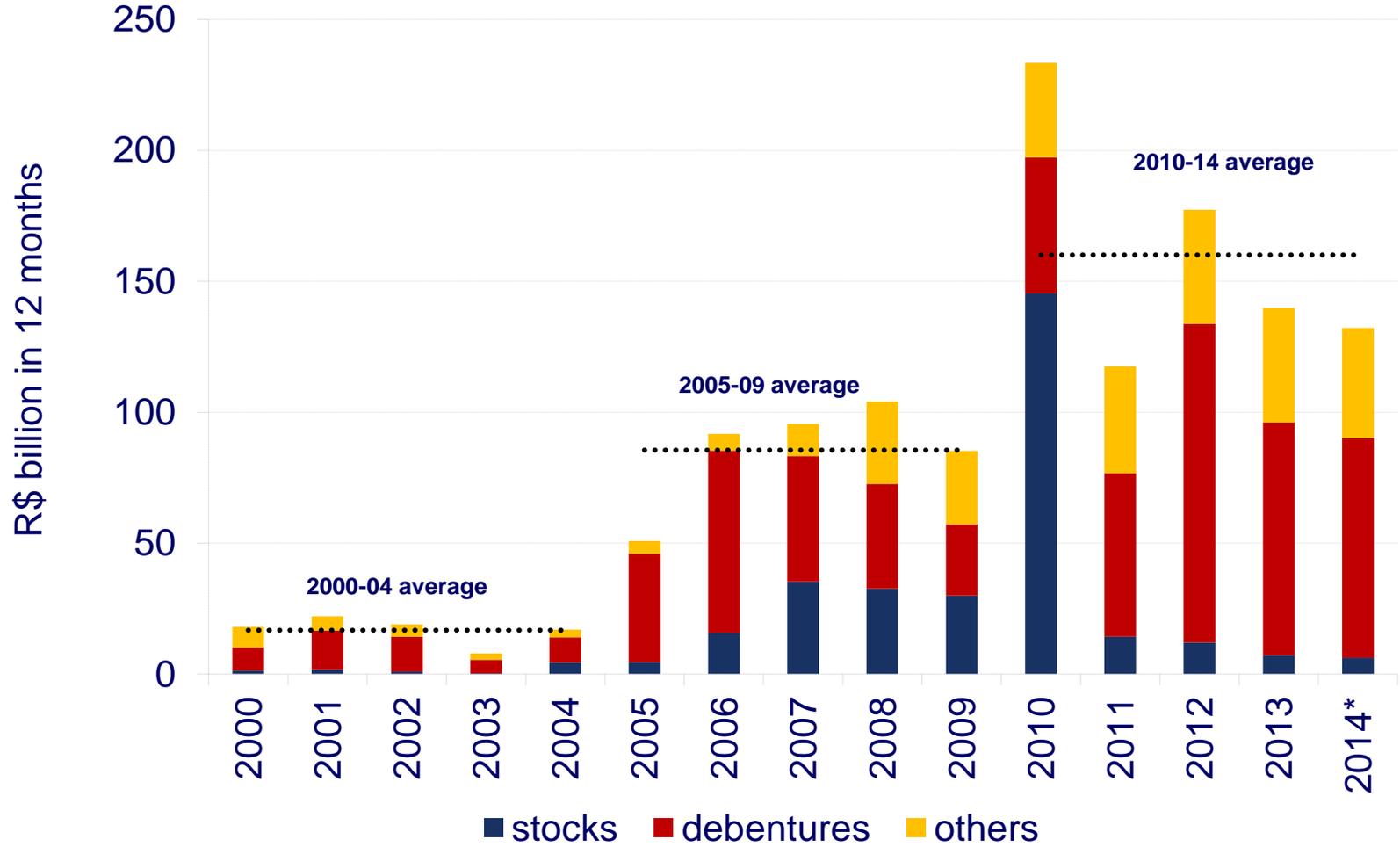


data up to 3/21

III. Financial Conditions

Capital Market Domestic Operations

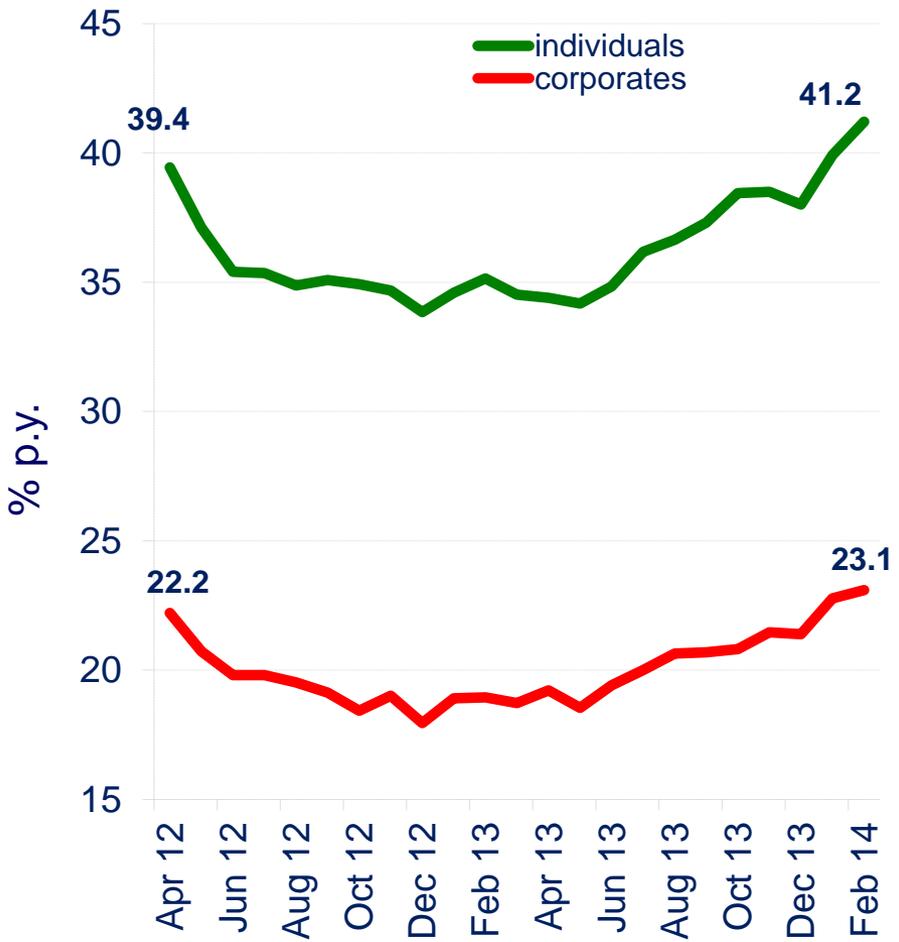
Primary Issues



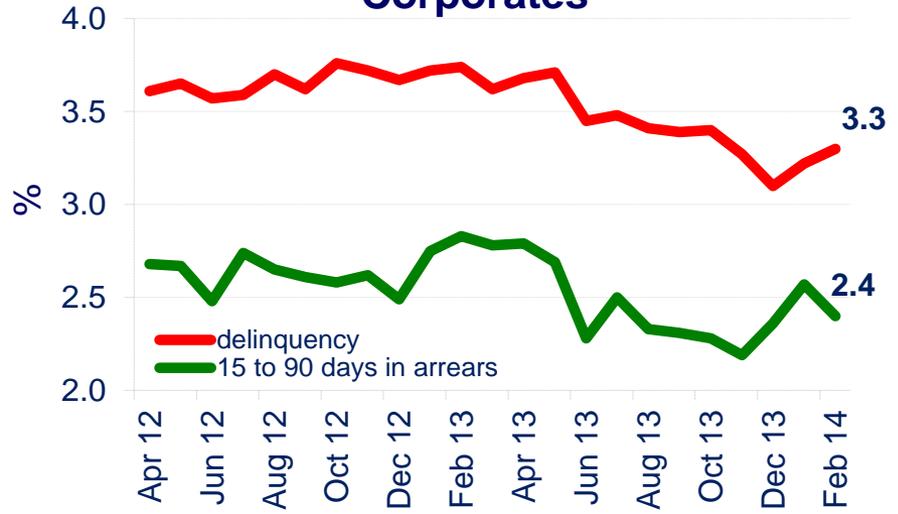
*12 months through Feb/14

Non-Earmarked Credit: Cost, Delinquency and Arrears

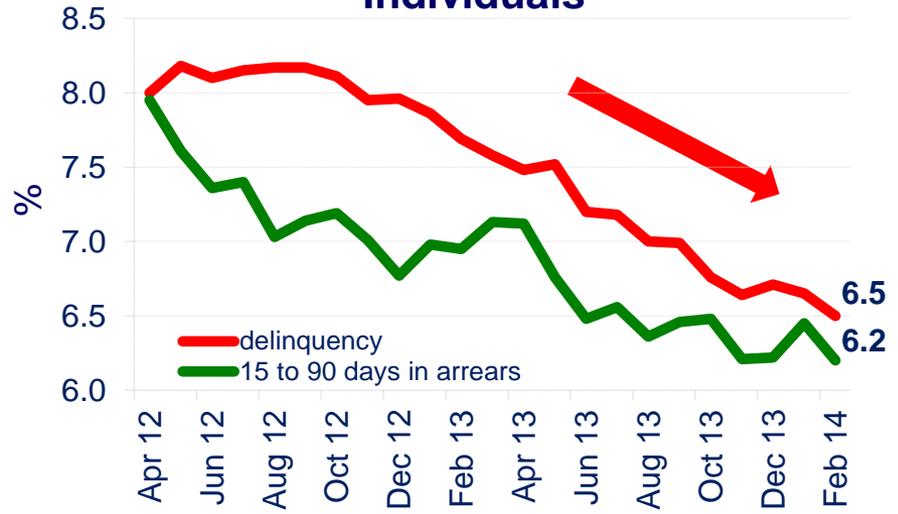
Interest Rate



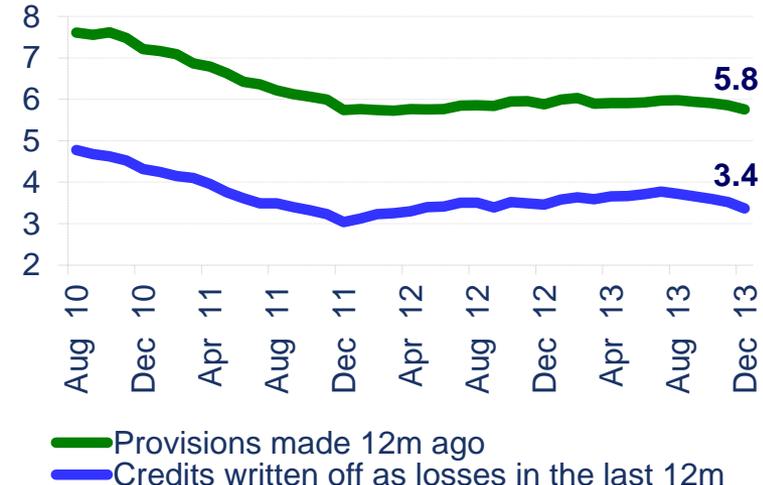
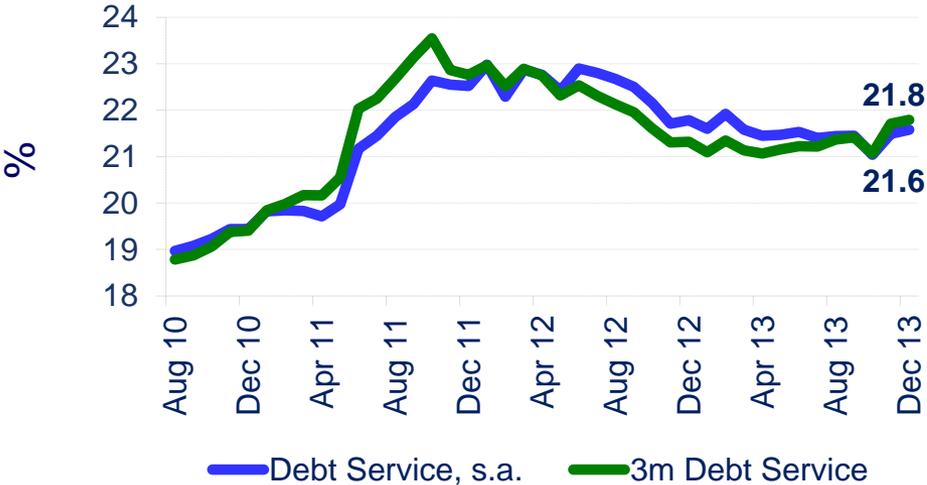
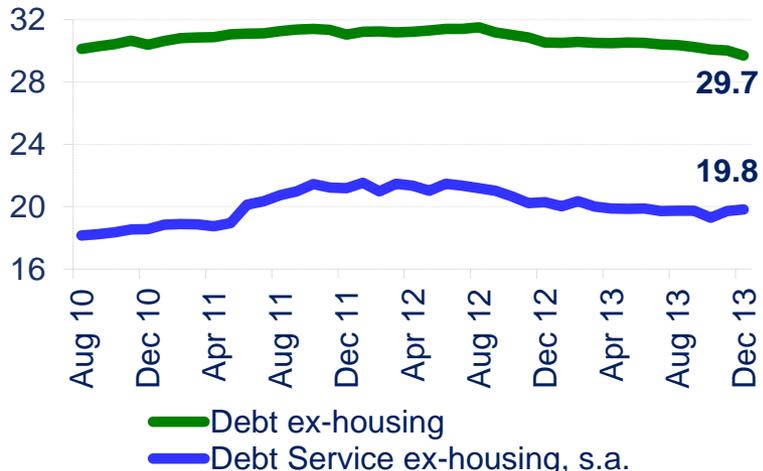
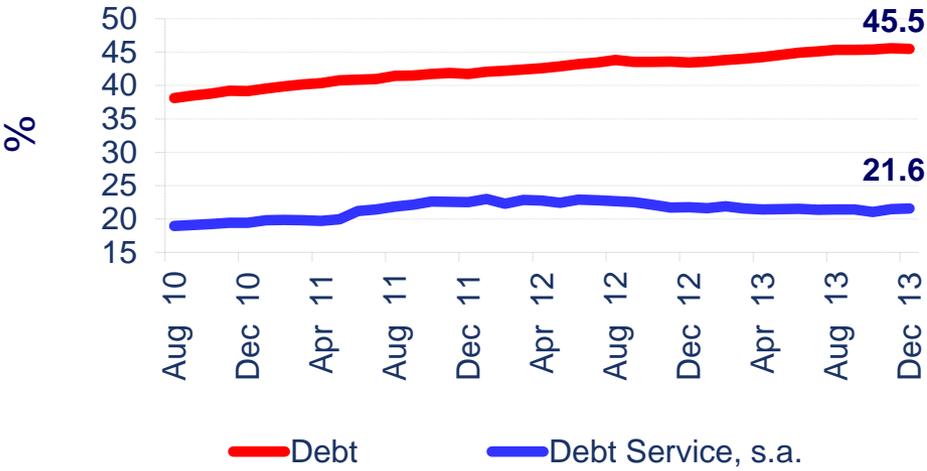
Corporates



Individuals



Household Debt and Provisions of the System



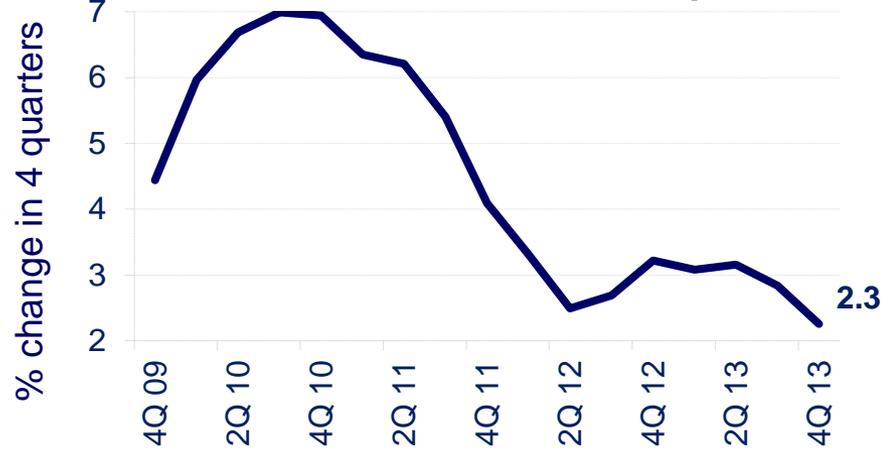
Recent Evolution of Delinquency in Credit to Individuals

- After elevation in the 2010/12 period, the delinquency of credit to individuals retreated:
 - In great part, it was due to the change in the composition of the portfolio, with greater share of housing and payroll-deducted loans, modalities that are characterized by better colaterals and, as a consequence, lower interest rates and relatively modest delinquency rates.

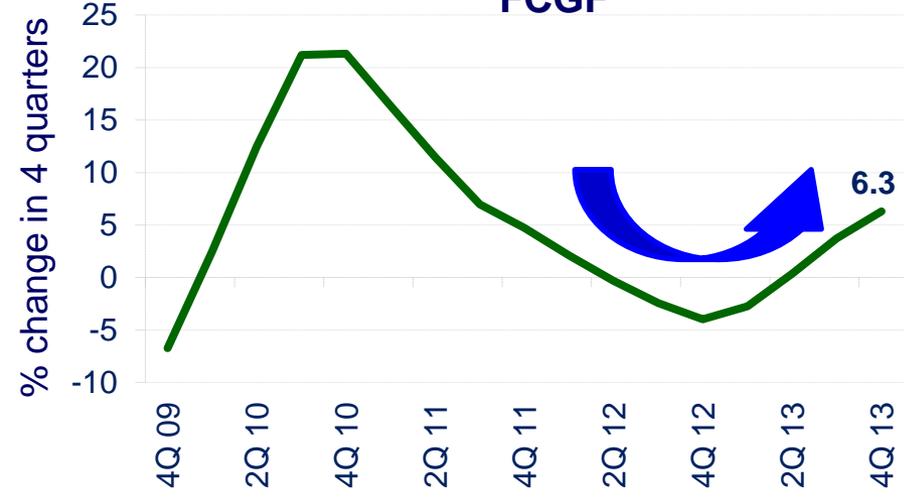
IV. Activity

Demand

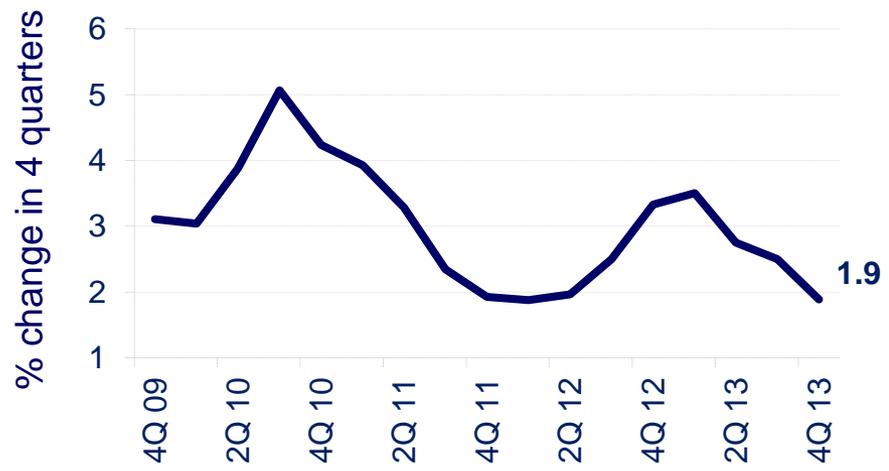
Household Consumption



FCGF



Government Consumption

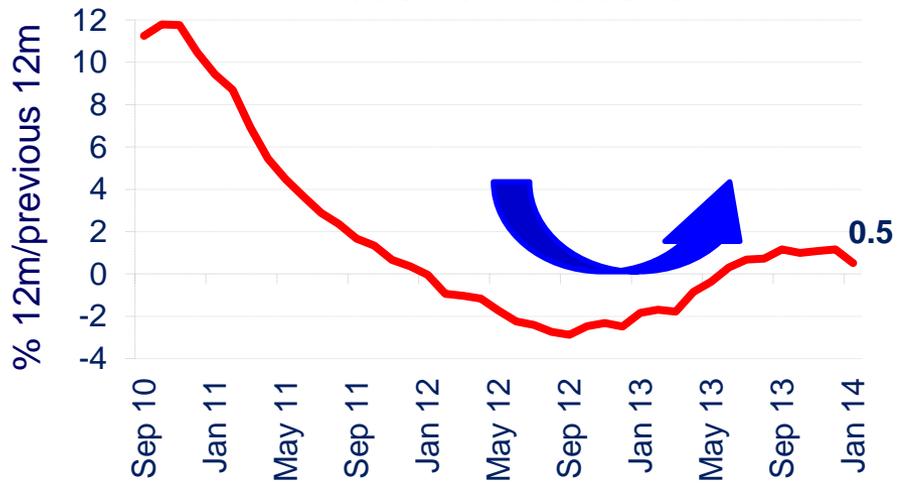


Exports Quantum



Supply

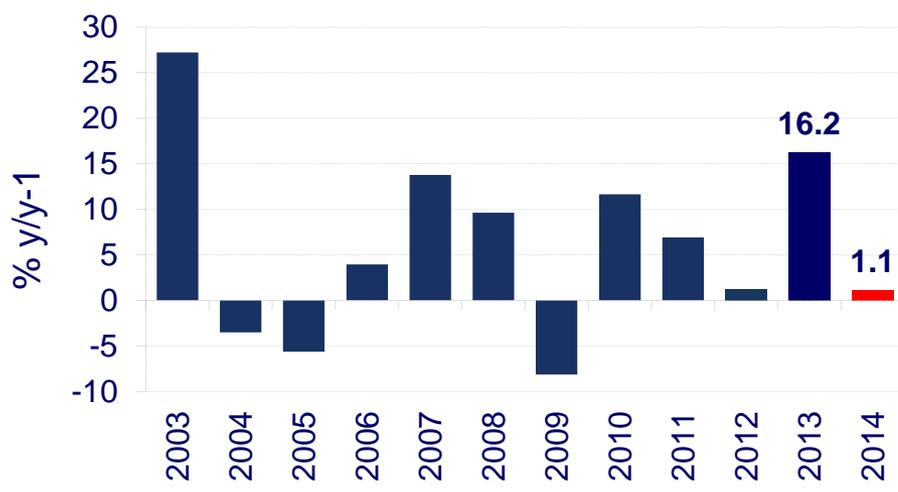
Industrial Production



Services Nominal Income

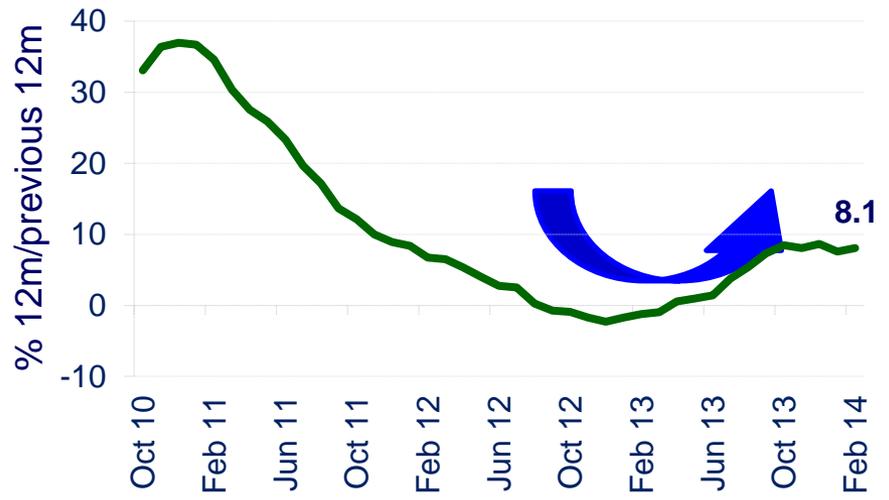


Crop Harvest

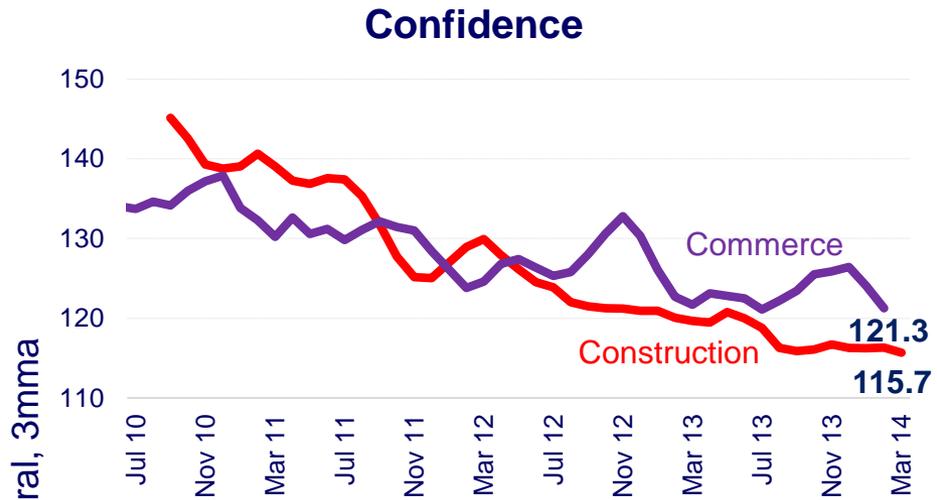
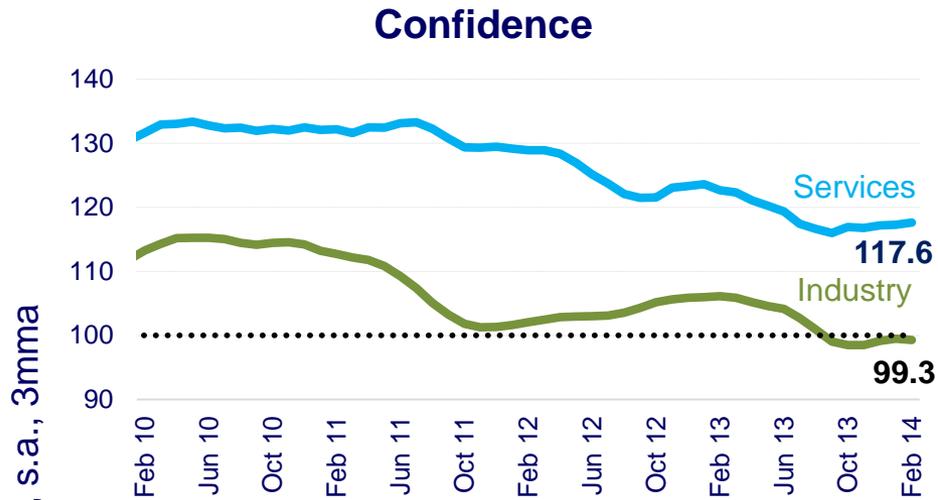


2013: IBGE estimates in Feb/14

Imports Quantum



Firms' Confidence and Expectations



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

Revised Forecast for the 2014 Balance of Payments

- Estimate for the current account deficit changed from US\$78 billion (3.5% of the GDP) to US\$80 billion (3.6% of the GDP);
 - Reduction of the trade surplus from US\$10 billion to US\$8 billion;
- Forecast indicates current account deficit essentially financed by FDI inflows (estimate of US\$63 billion).

Impacts of the Energy Account over the Trade Balance

- In 2013, the oil account responded for US\$13.9 billion out of the US\$27 billion current account deficit increase;
- Greater share of the elevation of the deficit in the trade of oil and fuels reflected the mismatch between supply and domestic demand for energy; and
- Prospects for the increase of the domestic energy supply, in this and in the upcoming year, tend to translate into reduction of the external deficit in this segment.

Box

International Capital Flows and Public Securities' Interest Rate

- Evaluates the impact of the participation of non-residents at the Federal Domestic Public Debt (DPMFi) over the nominal yield stemming from the prefixed rate public securities in Brazil, maturing in five years; and
- The simulations indicate that the nominal yield stemming from the federal public securities maturing in five years is affected, in the long run, by the participation of non-residents in the DPMFi.

Boxes

Budget Reprogramming and Accomplishment of the Fiscal Targets

- Analyses, in the 2008/2013 period, the evolution of the expenses occurred, forecast in the yearly budgetary law (LOA), and reprogrammed after restrictions;
- The expenses were, on average, 5.8% and 1.7% below the expenses initially forecast in the LOAs and the expenses reprogrammed, respectively; and
- Efficacy of the restriction mechanism as instrument of constraint of public expenses.

Continuous National Household Sample Survey (PNADC)

- The IBGE released, in January 2014, the first results of the PNADC:
 - Quarterly released, it will substitute the employment monthly survey - PME and the national household sample survey - PNAD (yearly), has national reach, and incorporates recent conceptual and methodological recommendations; and
 - For the second quarter of 2013, estimates of 7.4% unemployment rate in the country (between 4.3% in the South and 10% in the Northeast) and 61.5% activity rate in the country (between 65.2% in the Middle-West and 56.1% in the Northeast).

Recent Impacts of the Adverse Climate over the Brazilian Economy

- Accelerated the cycle of maturation of *in natura* products, and conducted to the revision (downwards) in the estimates of grains production and livestock products, with repercussions over prices; and
- Reduced the estimate of generation of the hydroelectric power plants and increased the use of thermoelectric plants which, in general, present high generation cost, with repercussions over prices.

Box: GDP Growth Forecasts

2% growth for 2014 (domestic demand: 2 p.p. and net exports with null contribution)

Supply

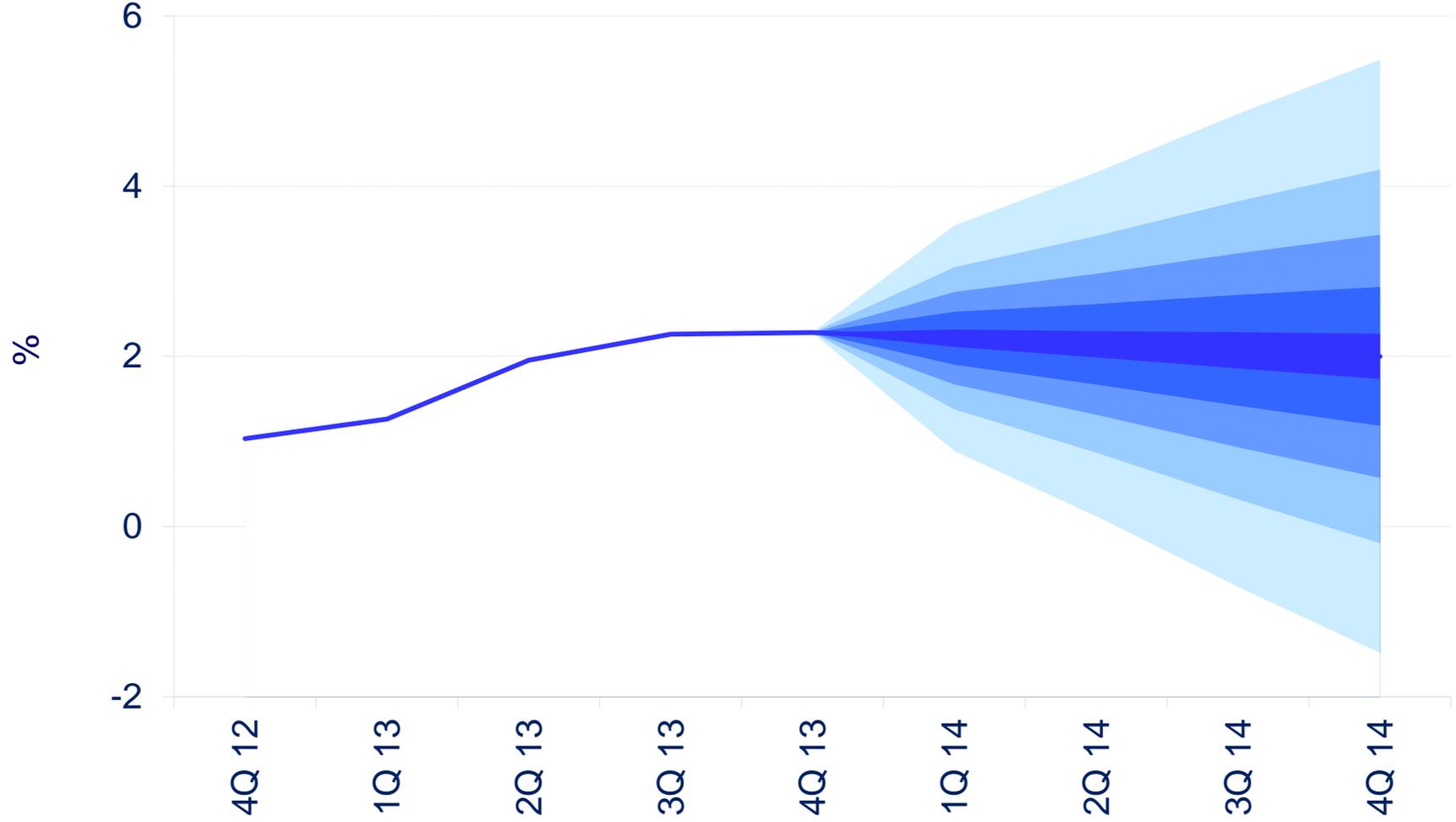
- Agriculture and livestock: 3.5% (7.0% in 2013);
- Industry: 1.5% (1.3% in 2013); and
- Services: 2.2% (2.0% in 2013).

Demand

- Investments: 1.0% (6.3% in 2013);
- Household Consumption: 2.0% (2.3% in 2013); and
- Government Consumption: 2.1% (1.9% in 2013).

GDP Forecast

Baseline Scenario*



* Interest rate constant at 10.75% p.y.

V. Inflation Developments

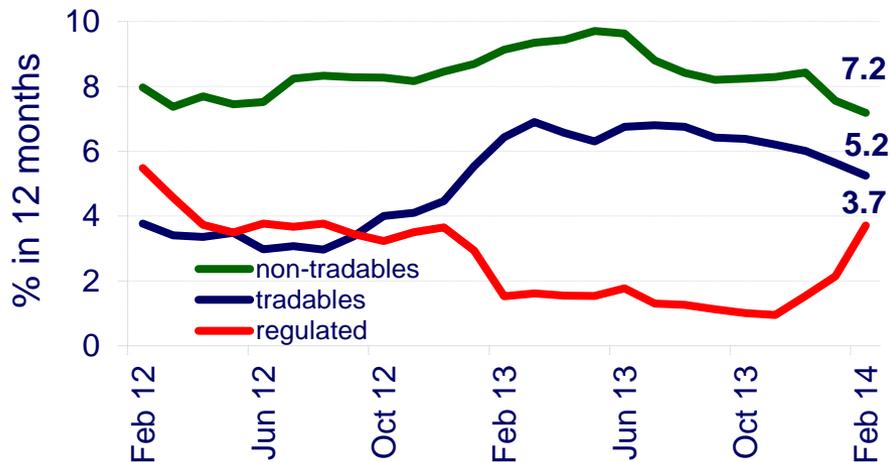
Inflation Developments

Prices Indices

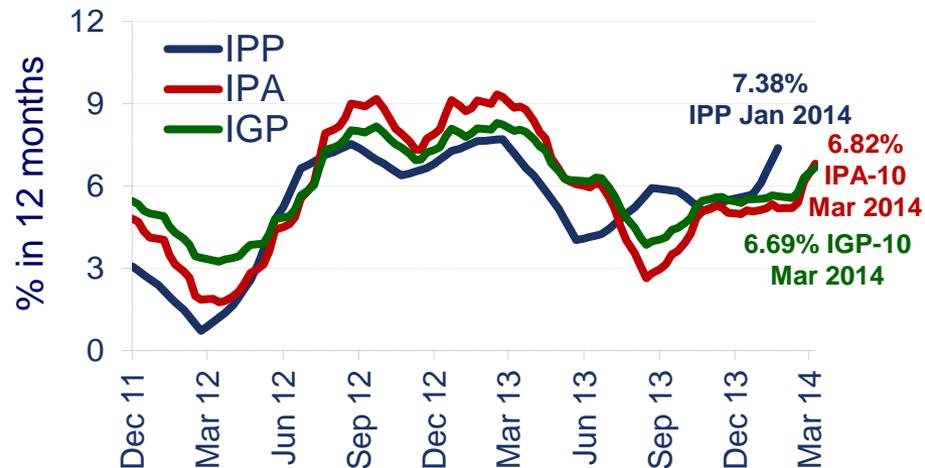
	Change in 12 months (%)		
	Feb/13	Feb/14	
IPCA	6.31	5.68	▼
INPC	6.77	5.38	▼
IPC-Fipe	5.91	3.97	▼
IPC-C1	6.94	5.00	▼
IGP-DI	8.24	6.30	▼
IPA-DI	9.24	6.15	▼
Agricultural	15.45	0.47	▼
Industrial	7.02	8.41	▲
IPC-DI	6.04	5.95	▼
INCC-DI	7.18	8.04	▲

Prices

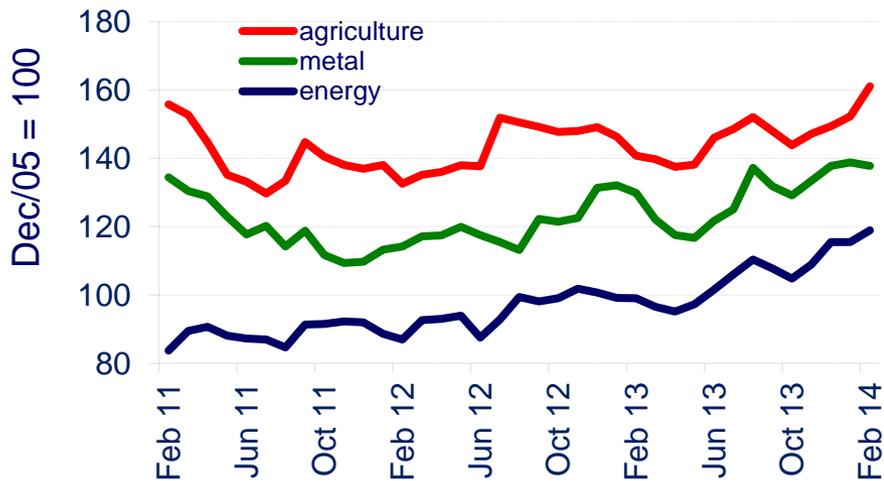
Inflation (IPCA)



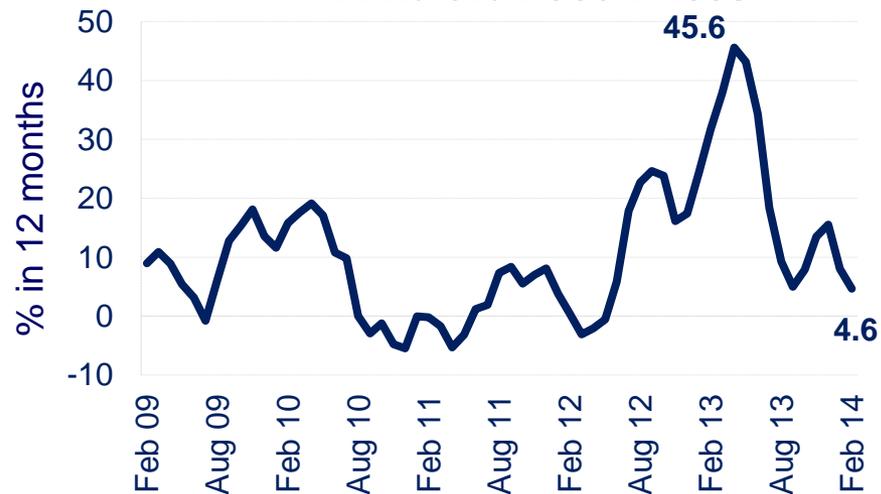
Producer Prices and IGP



IC-Br (R\$)



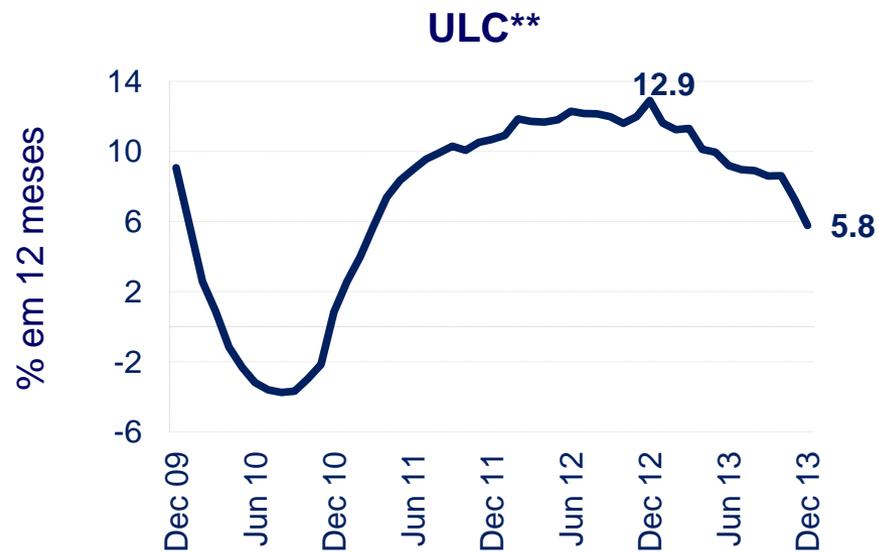
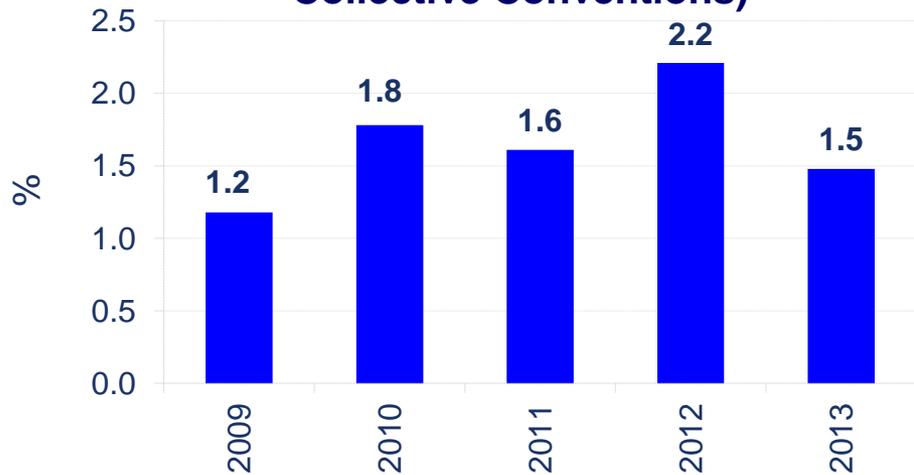
In Natura Food Prices



Wages



Real Adjustment in the CCT (Working Collective Conventions)



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

Segmentation of 2013 Inflation

- Presents estimates of the segmentation of the inflation rate measured by the Broad National Consumer Price Index (IPCA), in 2013, based on the BCB forecast models; and
- The simulations suggest that the components with the highest contribution were market prices, the inertia and the expectations.

BCB Inflation Forecasts

Baseline Scenario* and Market Scenario

Period		Baseline	Market
2014	1	6.0	6.0
2014	2	6.2	6.2
2014	3	6.4	6.4
2014	4	6.1	6.2
2015	1	6.0	6.1
2015	2	5.8	5.9
2015	3	5.8	5.8
2015	4	5.5	5.5
2016	1	5.4	5.2

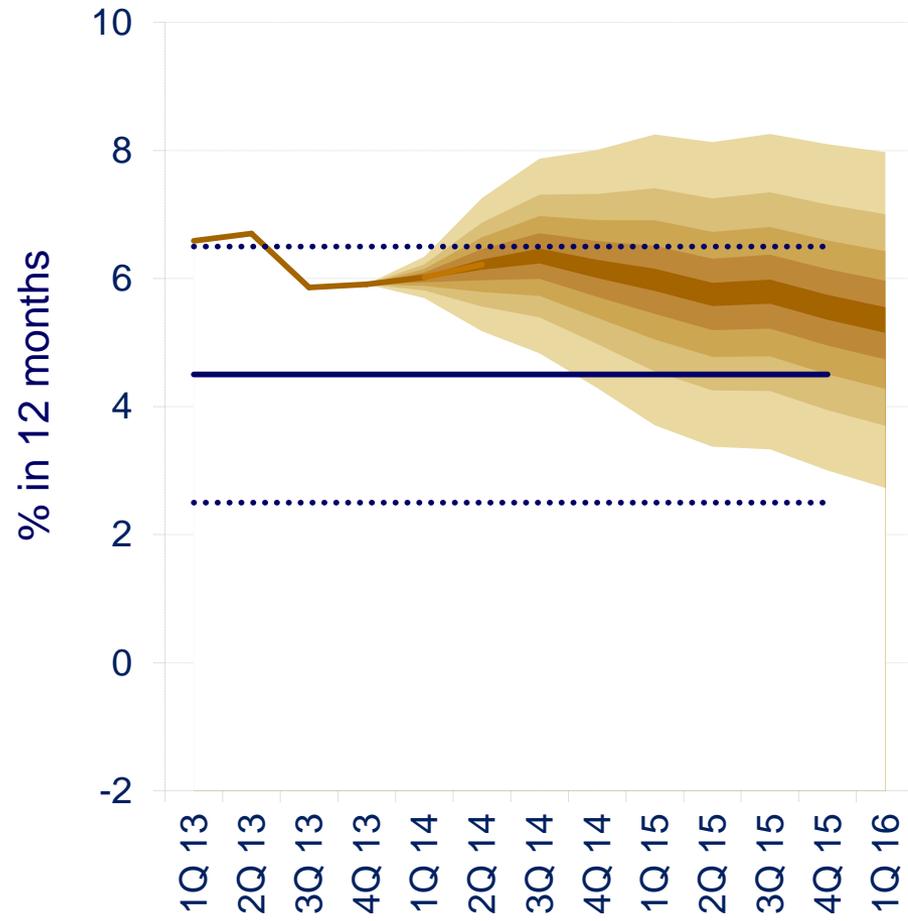
Obs.: 12-month accumulated inflation (% p.y.)

* Interest rate constant at 10.75% p.y.

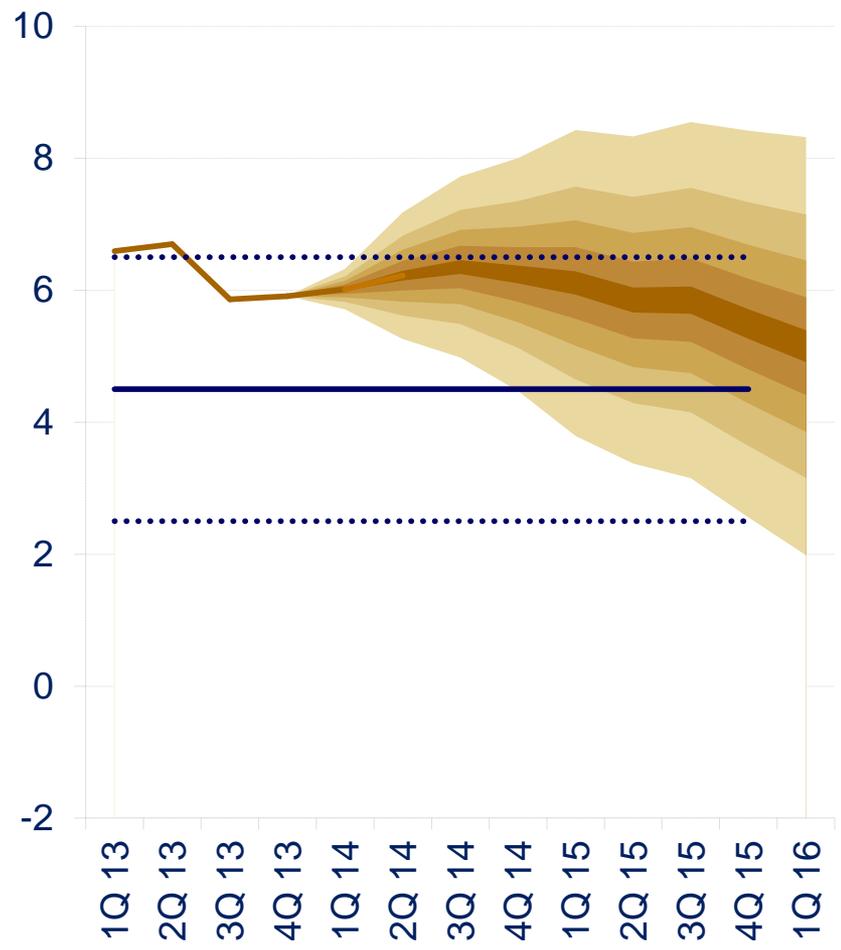
BCB Inflation Forecasts

Baseline Scenario

(interest rate constant at 10.75% p.y.)



Market Scenario



Market Expectations – Summary

	2014			2015		
	12/31/13		3/21/14	12/31/13		3/21/14
IPCA	5.97	▲	6.28	5.50	▲	5.80
Regulated Prices	4.00	▲	4.30	5.00	▲	5.50
IGP-M	6.01	▲	6.81	5.40	▲	5.50
IPA-DI	5.87	▲	6.92	5.40	▲	5.60
Selic (end-of-period)	10.50	▲	11.25	11.25	▲	12.00
Exchange rate (end-of-period)	2.45	▲	2.49	2.45	▲	2.55
GDP	2.00	▼	1.70	2.50	▼	2.00
Industrial Production	2.23	▼	1.41	2.95	▲	3.00
Trade Balance	8.00	▼	4.71	12.00	▼	10.00
FDI	60.00	▼	55.40	60.00	▼	55.00
Primary Result	1.40	▲	1.50	2.00	=	2.00



Inflation Outlook

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