



The “Three Adjustments” and Growth Outlook

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New York
June 27, 2016.

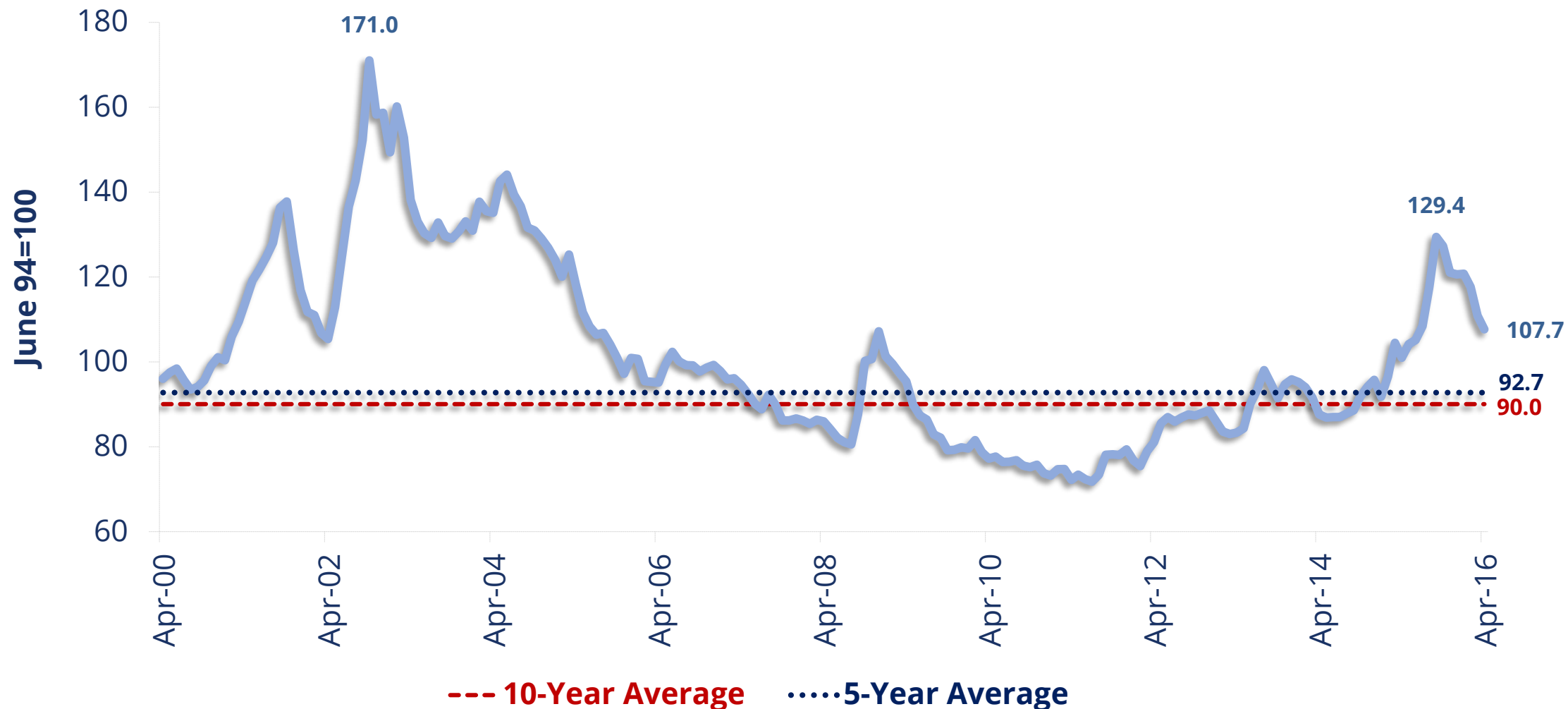
**These remarks are those of the author and do not necessarily reflect those of the Central Bank of Brazil.*



External Adjustment

External Adjustment

Real Effective Exchange Rate (REER) - IPCA

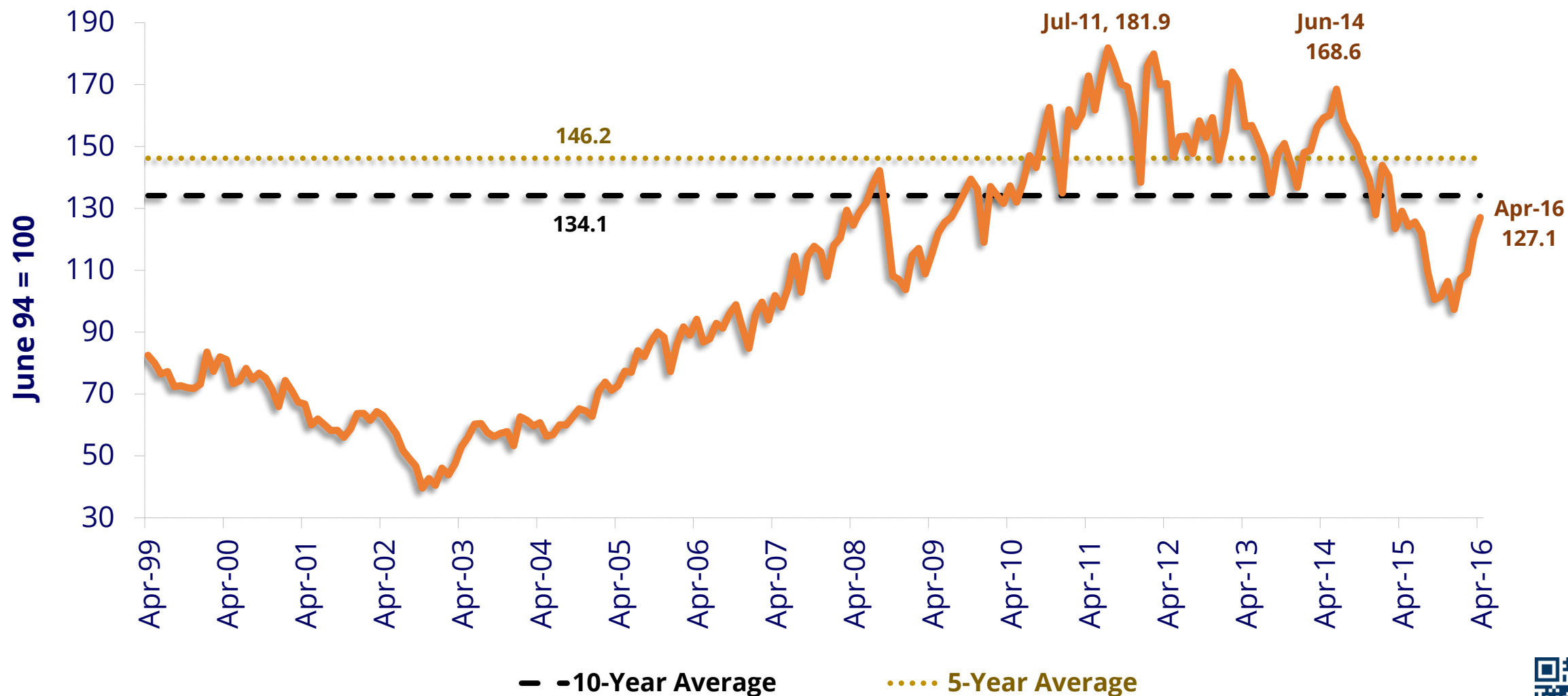


Source: BCB. Note: 15-currency basket.



External Adjustment

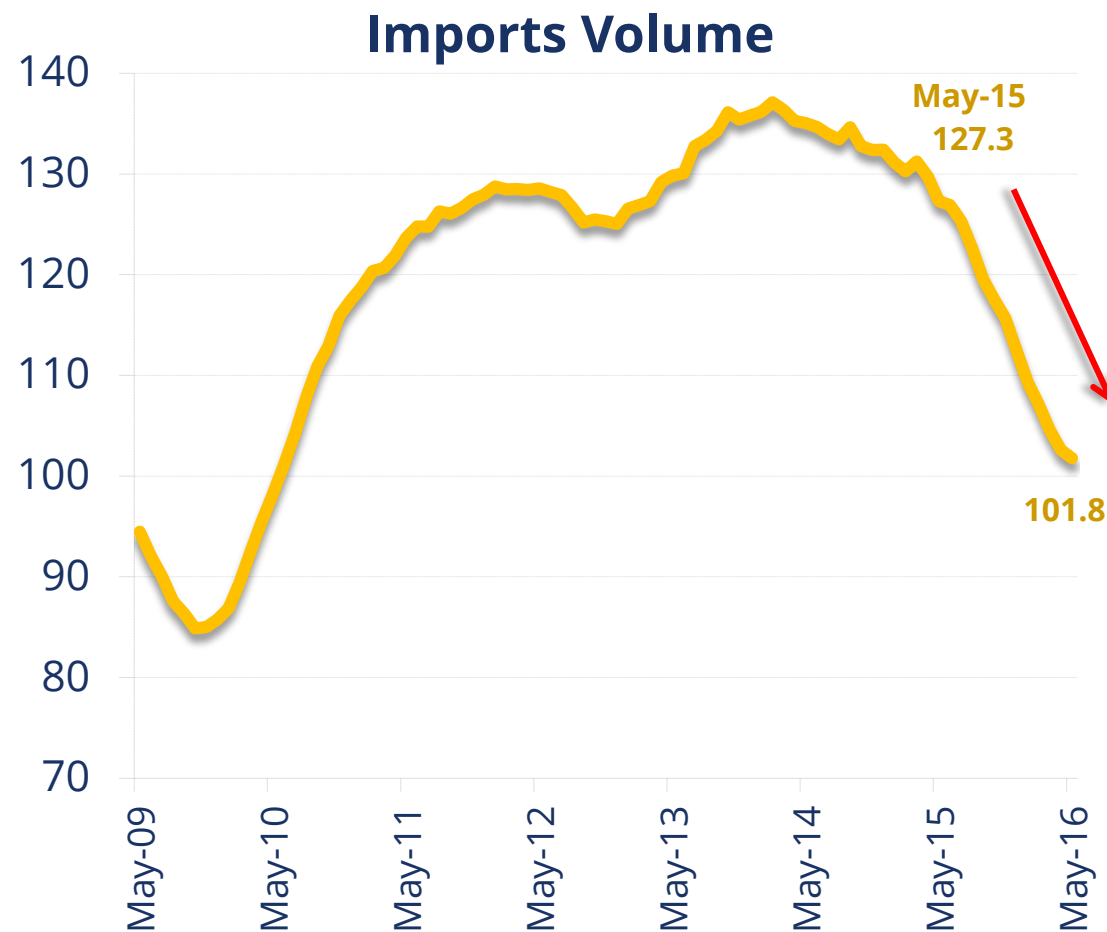
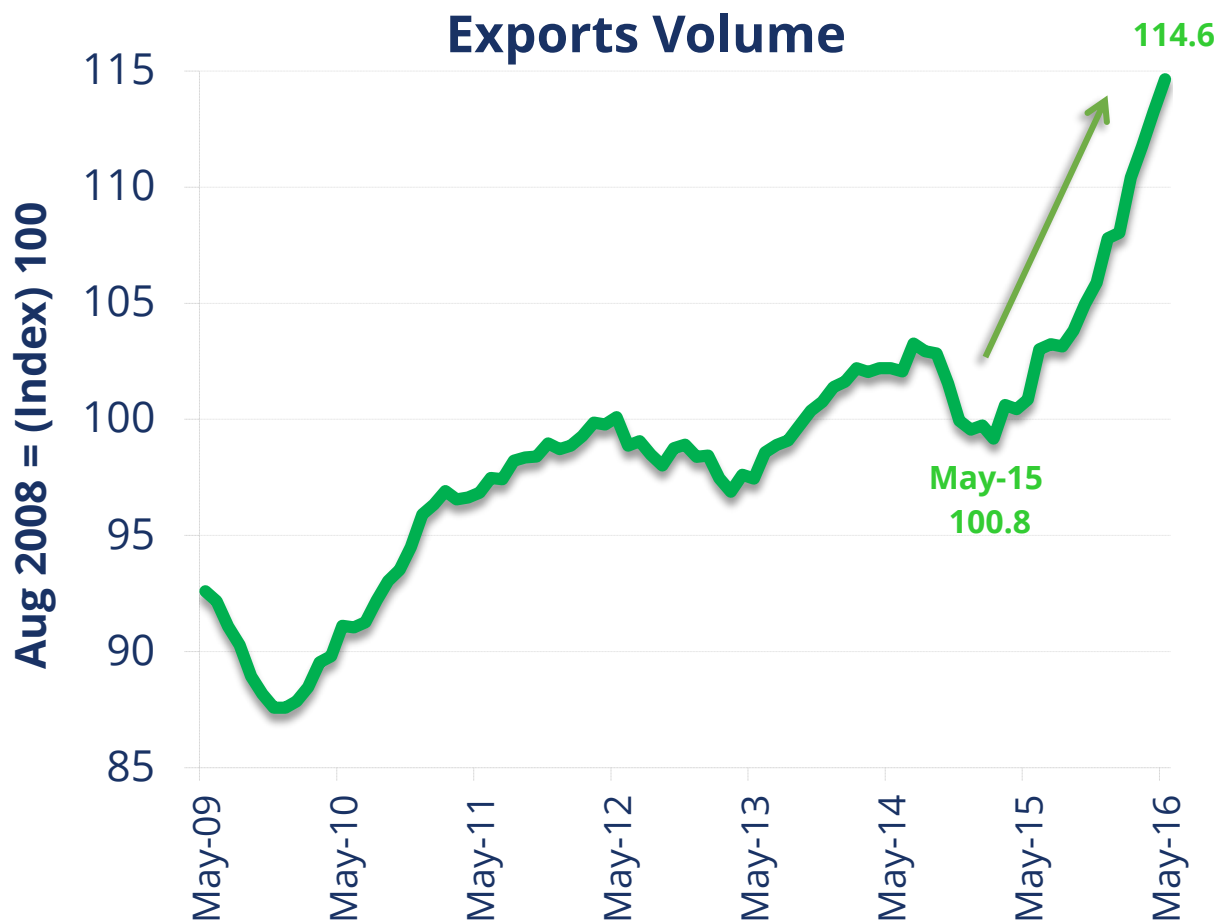
Unit Labor Cost (USD)



Source: BCB. Notes: 10-Year Average starting in April 2006 and 5-Year Average in April 2011.



External Adjustment



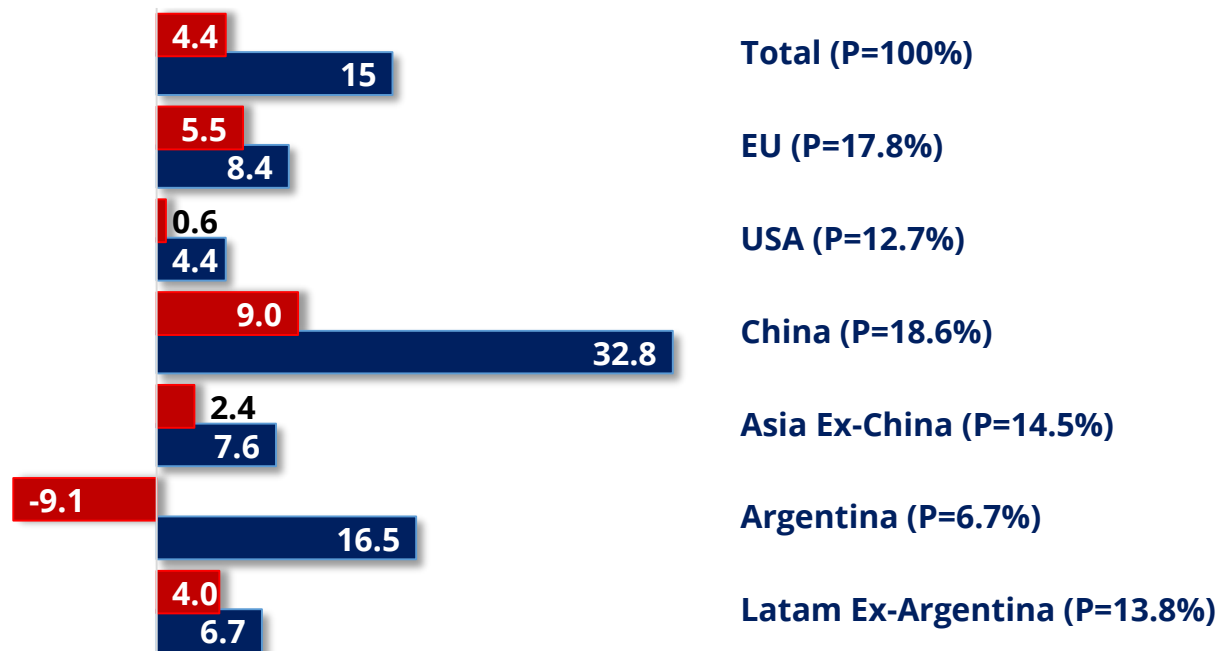
Source: Funcex. Note: 12-Month Moving Average.



External Adjustment

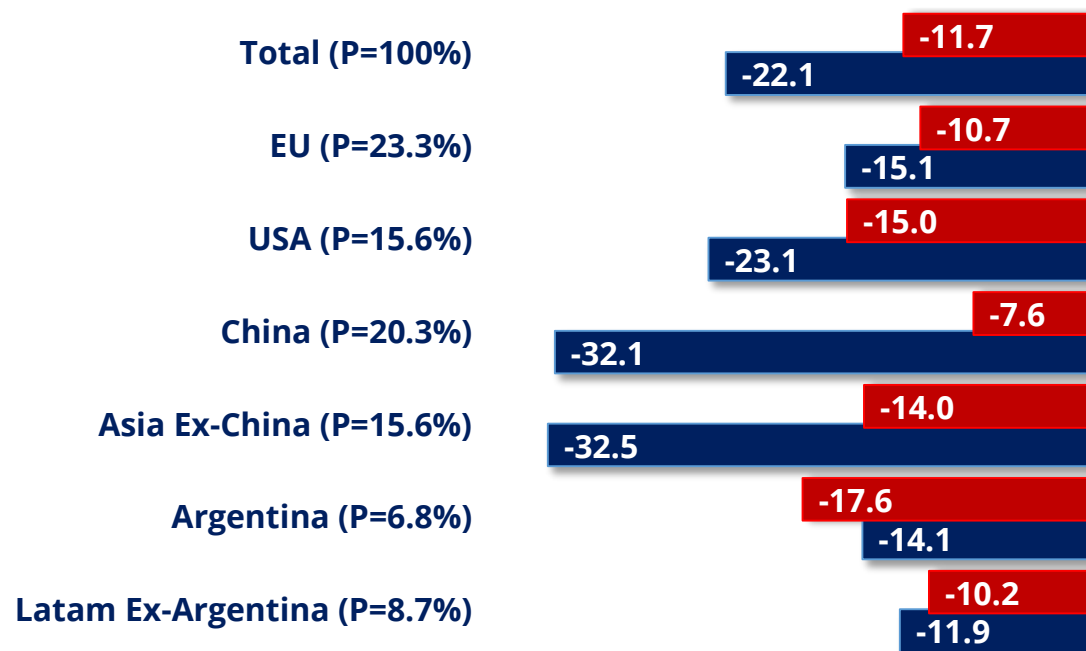
Exports and Imports by Trade Partners

Exports – Quantum Change (%)



■ Jan-May 2015/Jan-May 2014

Ex-Oil Imports - Quantum Change (%)

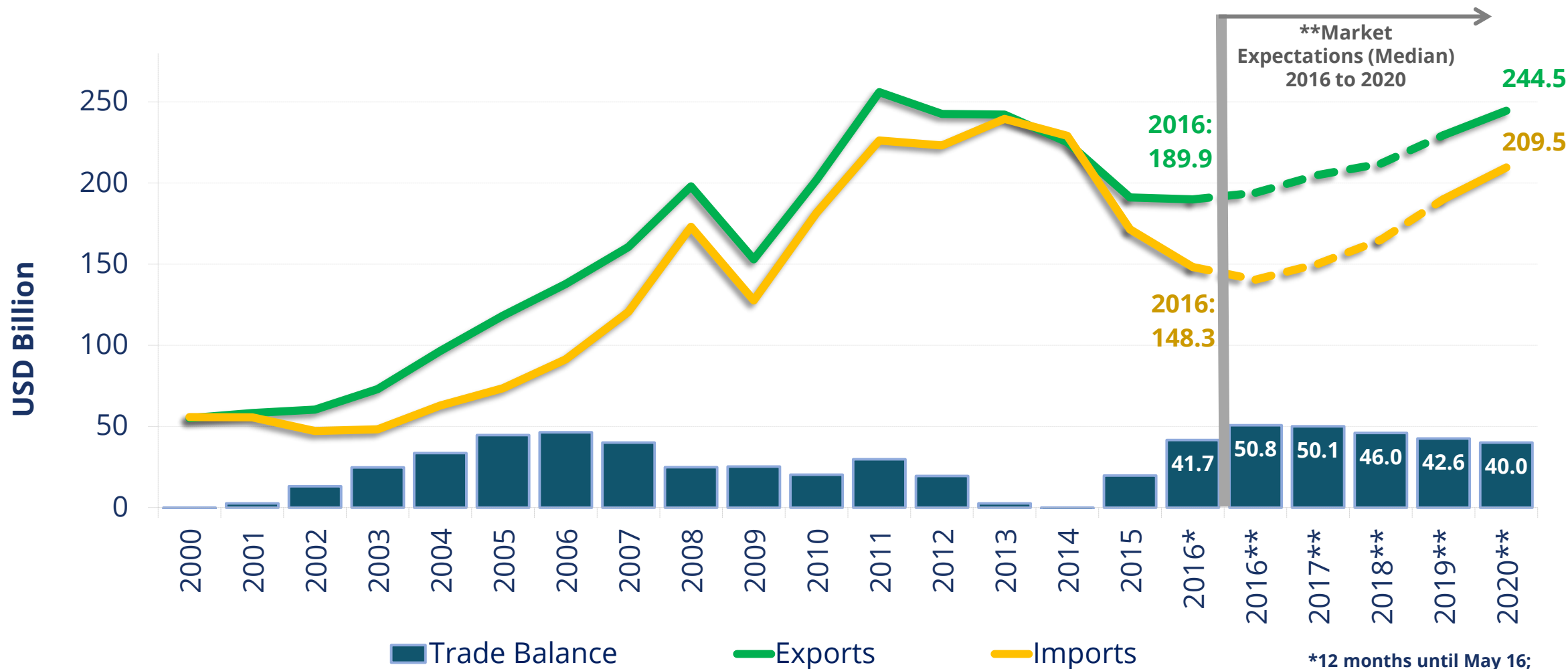


■ Jan-May 2016/Jan-May 2015

Source: MDIC/Secex. Note: P = Partner's share in 2015.



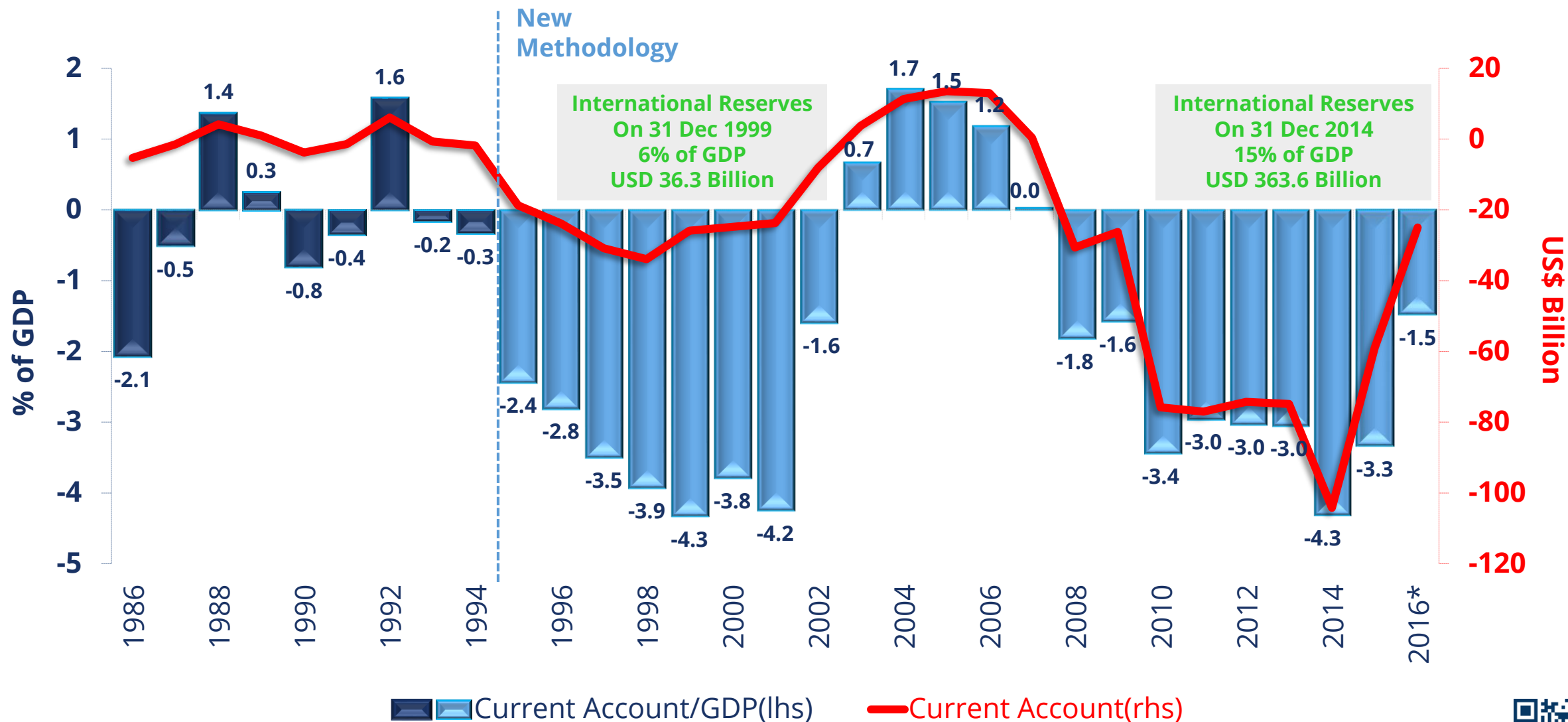
External Adjustment



*12 months until May 16;
 **as of June 17th (refers to BPM6).



External Adjustment



Source: BCB. Note: New methodology as of 1995. (*): Forecast as of 24th May, 2016 (Press Note).

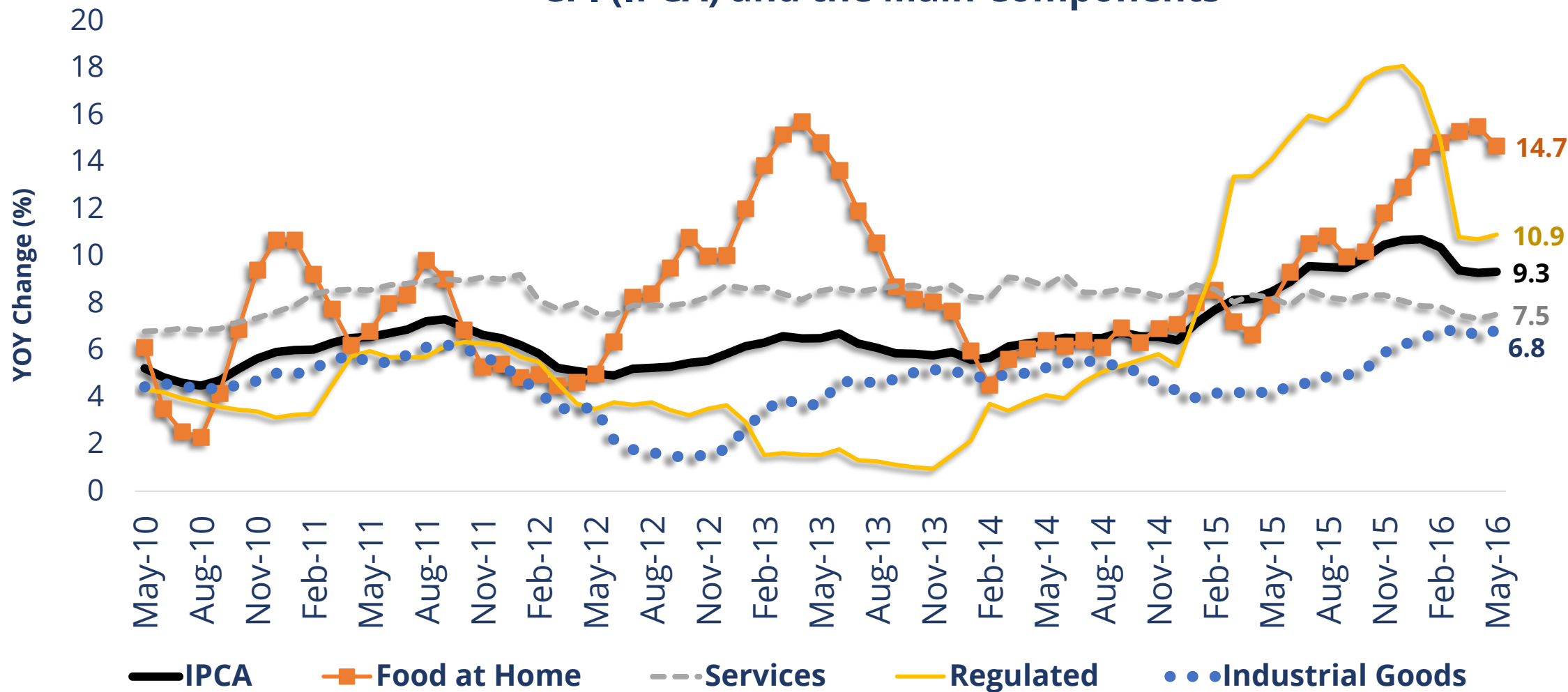




Monetary Adjustment

Monetary Adjustment

CPI (IPCA) and the Main Components

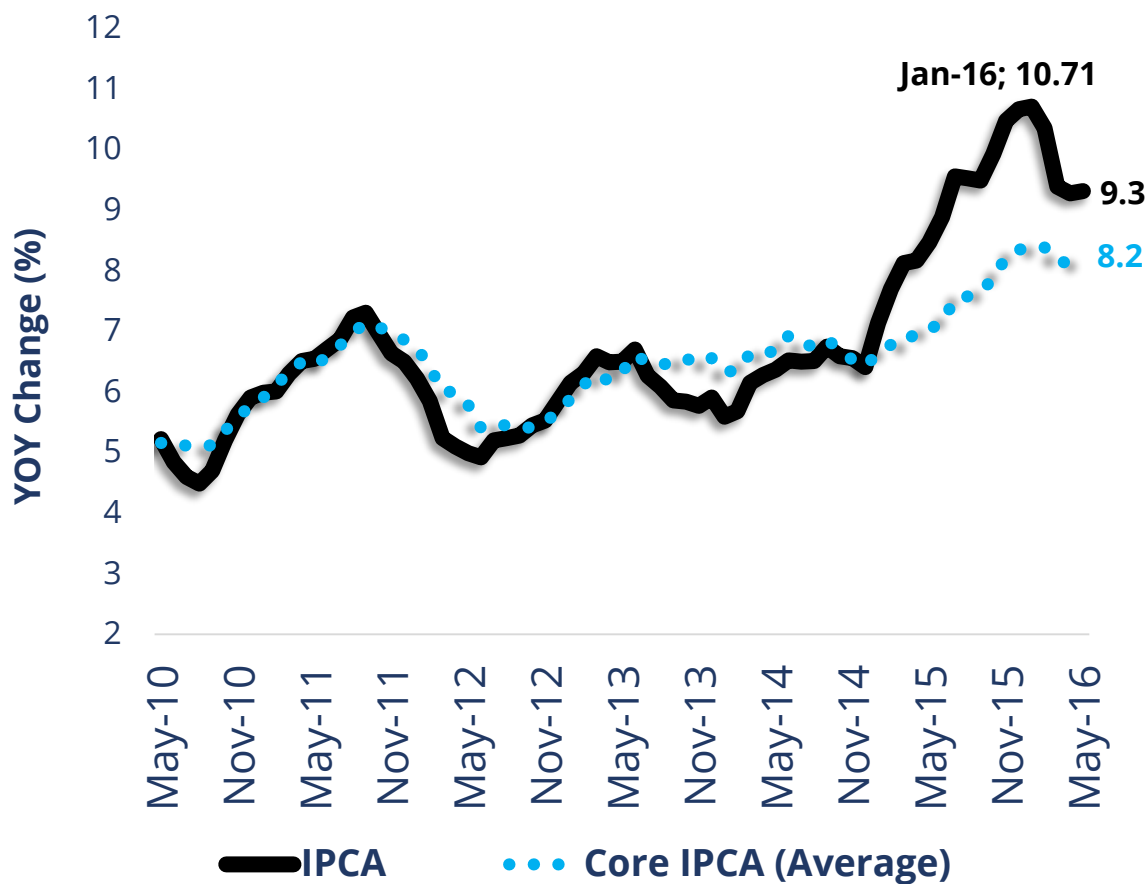


Source: BCB; IBGE.

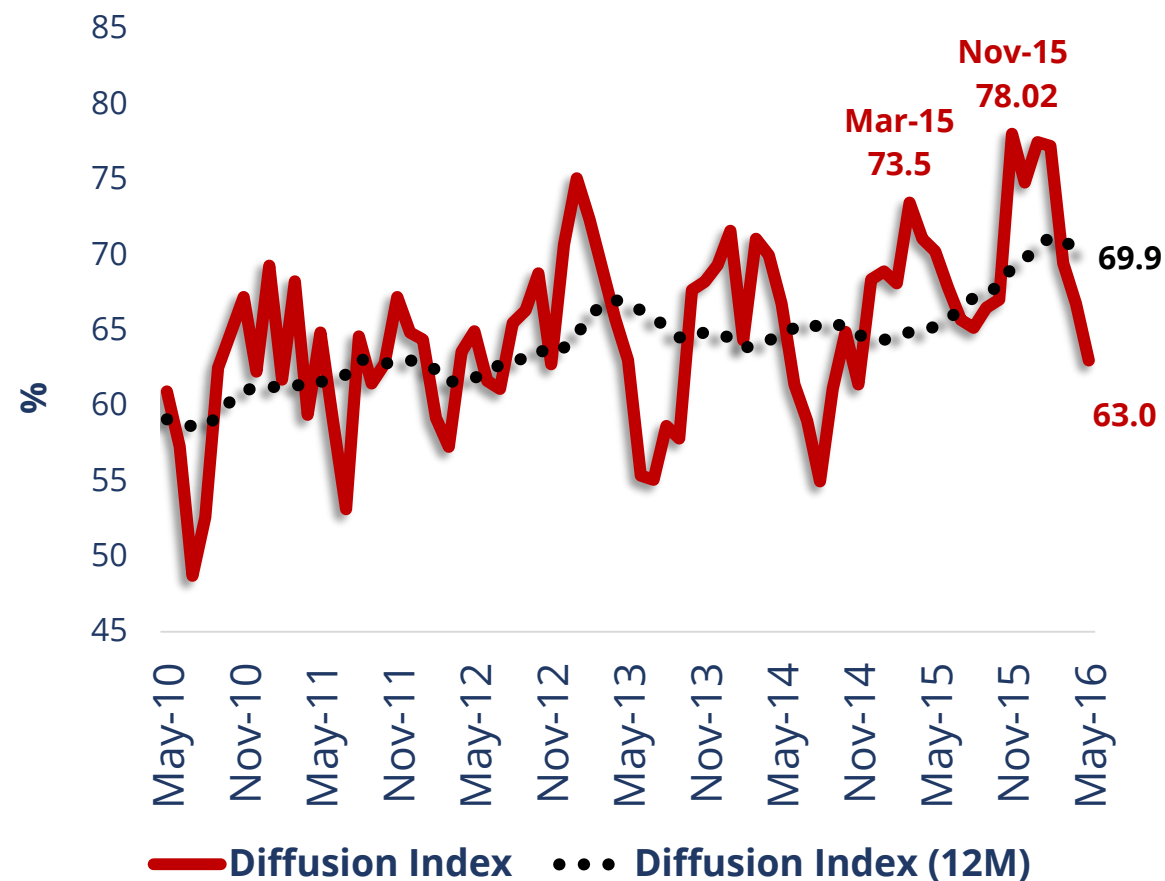


Monetary Adjustment

IPCA and Core IPCA (MS, EX2 and DP)

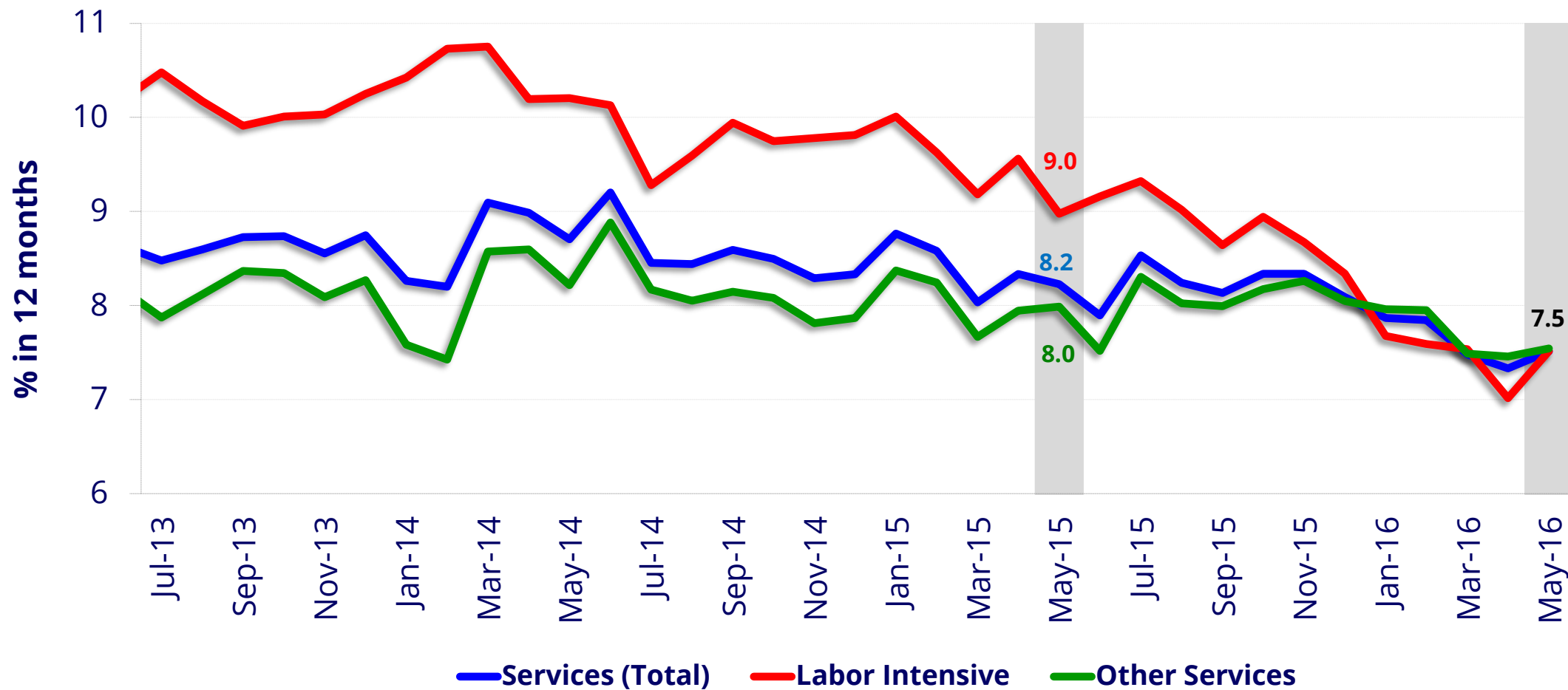


IPCA - Diffusion index



Monetary Adjustment

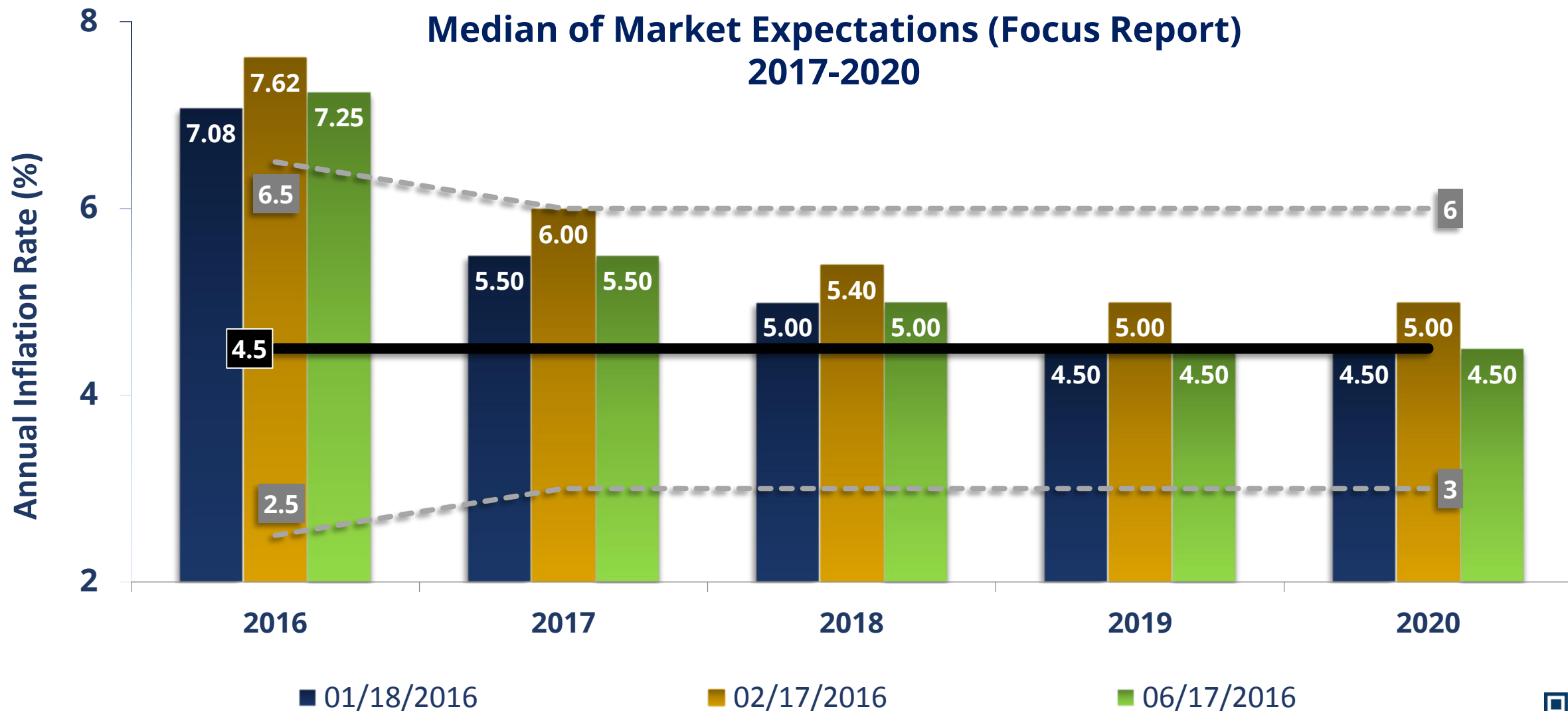
Services Inflation - IPCA*



Source: IBGE. (*): Prepared by BCB.



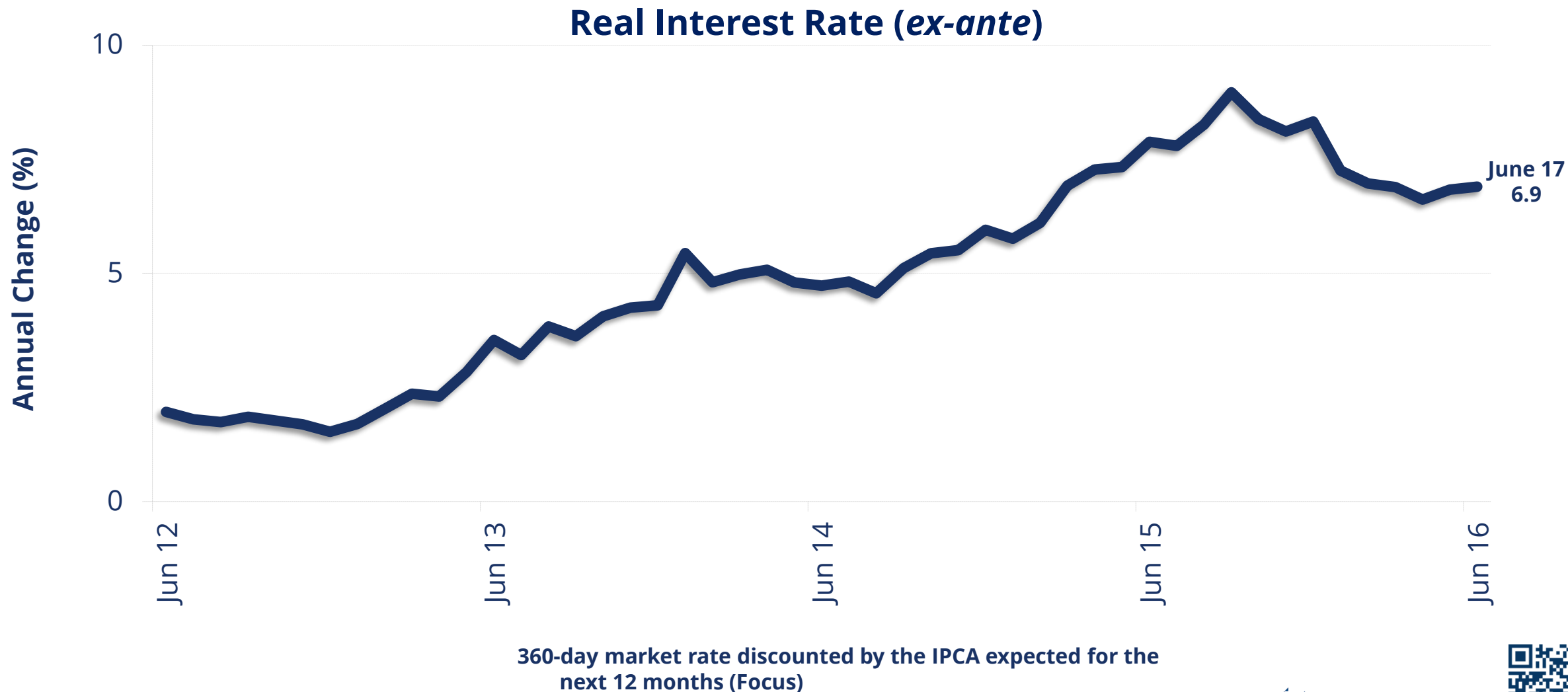
Monetary Adjustment



Source: BCB/Focus. Note: The CMN set the inflation target until 2017 at 4.5%, and narrowed the target interval to +/-1.5pp from +/-2.0pp.



Monetary Adjustment



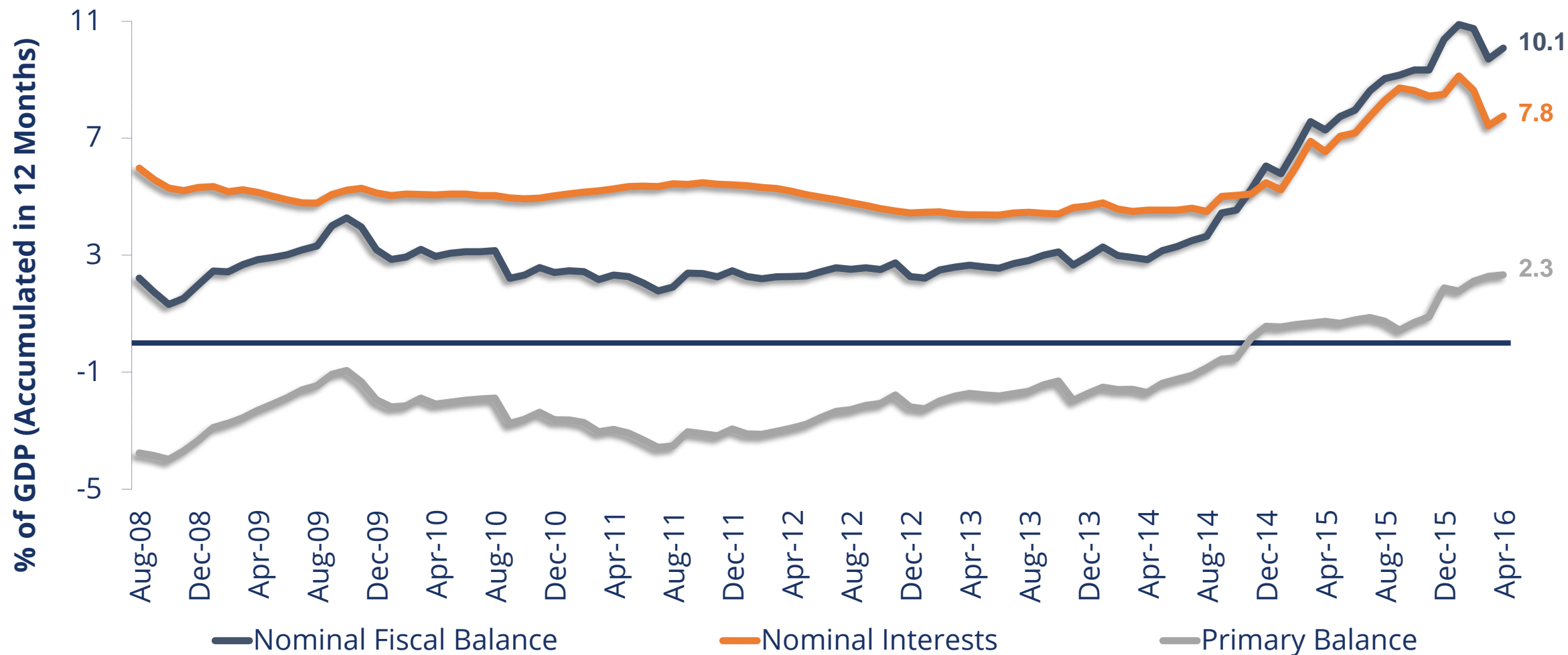
Source: BM&FBovespa; BCB.





Fiscal Adjustment

Fiscal Adjustment



(-) = Surplus; (+) = Deficit



Fiscal Adjustment

Proposal for a new fiscal regime (Constitutional Amendment) to limit public spending increases for the next 20 years and strengthen the public finances. The main measure is a ceiling for the public spending, wherein the spending of the current year would not exceed the previous one adjusted by last year inflation.

Concepts

- ✓ **Total Primary Expenses:** real growth will not be allowed from 2017 on;
- ✓ **All Government Expenses** (including Legislative and Judicial) will be **readjusted by CPI** of last year ($IPCA_{t-1}$).

Duration

- ✓ **20 years.** Possibility of reviewing the rule from the 10th year ahead.

General

- ✓ On the first year (2017), the expenses limit will be equal to the last year expenses corrected by the last year inflation;
- ✓ Minimum **health and education expenses** will be readjusted by variation of last year inflation, and no more by revenues.

*** In case of overshooting these ceiling limits, the government entity will be prohibited of readjusting the salary of public employees and/or create new jobs that increase the amount of expenses.**



Fiscal Adjustment

Two Scenarios Based on a Range of Assumptions*

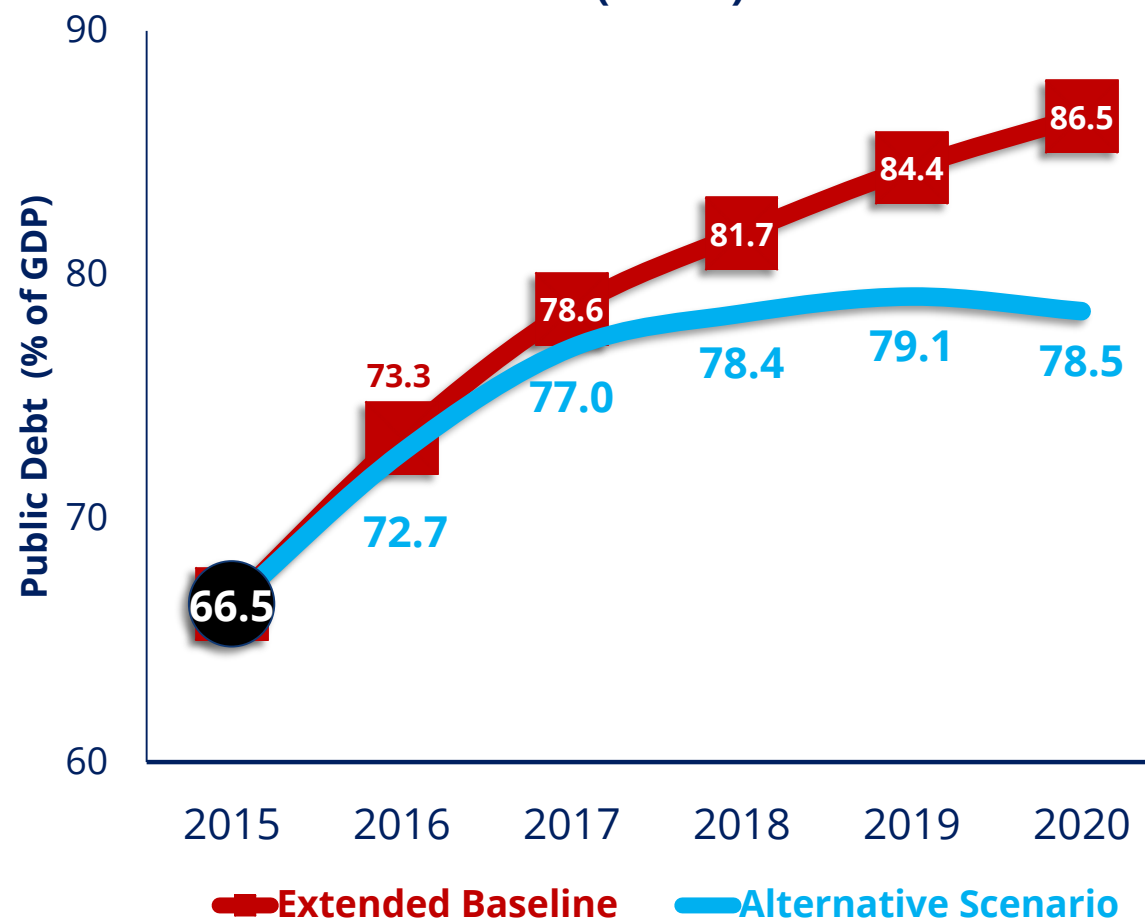
Extended Baseline Scenario

- i) Current fiscal rules;
- ii) As a reference, the baseline scenario of the Focus-Market Report.

Alternative Scenario

- i) Adjustments Rules:
 - ✓ To limit annual spending growth to the inflation rate of the prior year ($IPCA_{t-1}$);
 - ✓ Resources allocated to the area of social security limited by $IPCA + 2\%$;
 - ✓ R\$100 billion repayment from the Brazilian Development Bank (BNDES) to the National Treasury.
- ii) Assumption that these adjustments will improve national economic performance (GDP).

Paths for the General Government Gross Debt (DBGG)*



Source: BCB (historical series). (*): Projections are based on assumptions, parameters and simulations from the author and do not necessarily reflect those of the Central Bank of Brazil or those of the federal government.

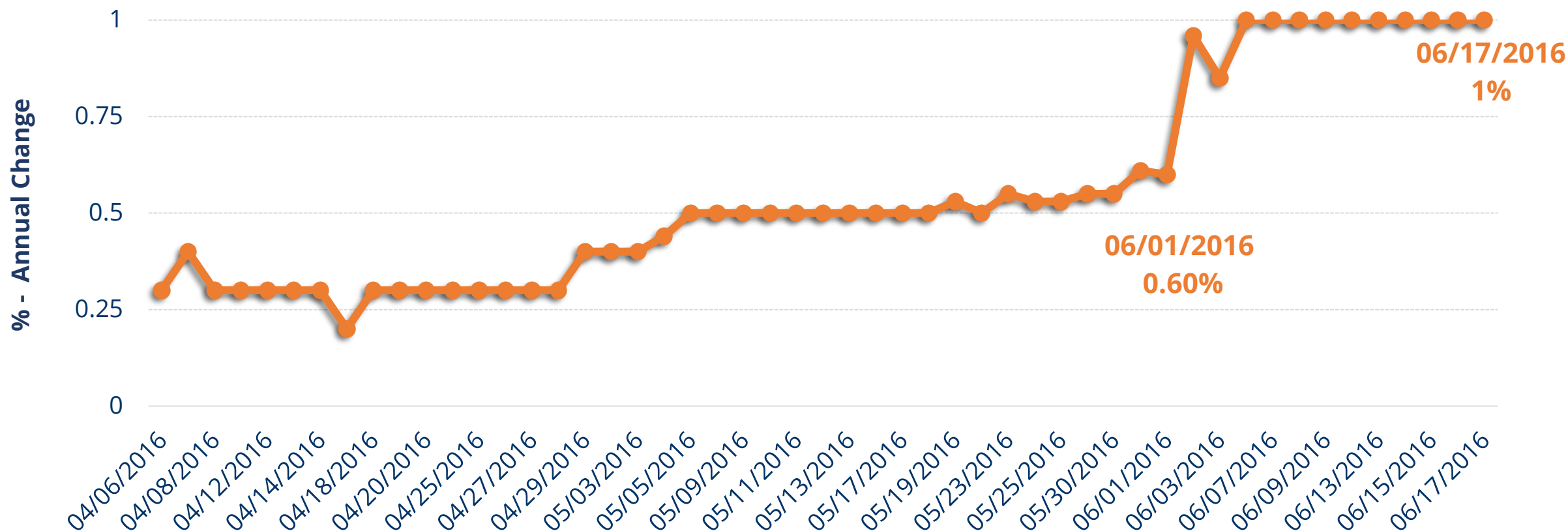




Growth Outlook

Brazil: Growth Expectations for 2017

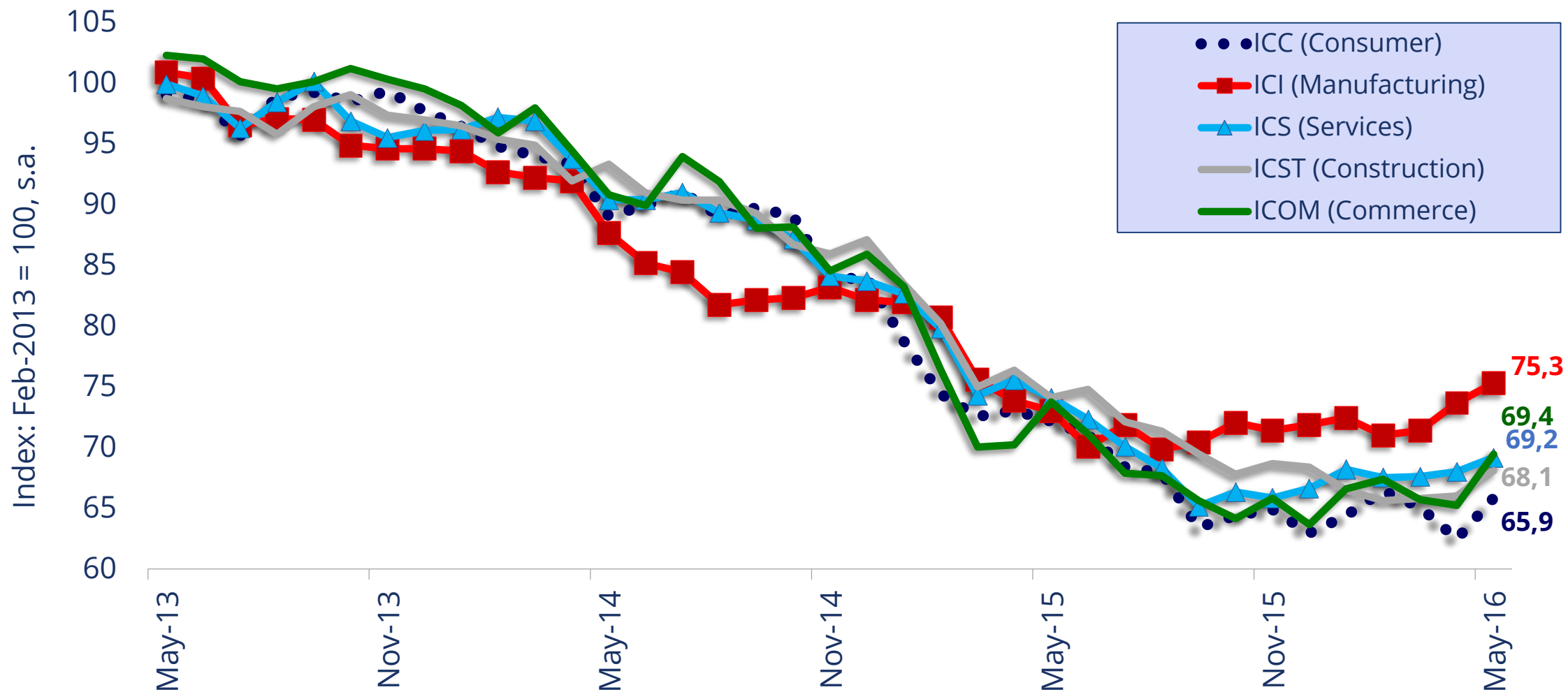
The Median Market Forecast for 2017 Real GDP



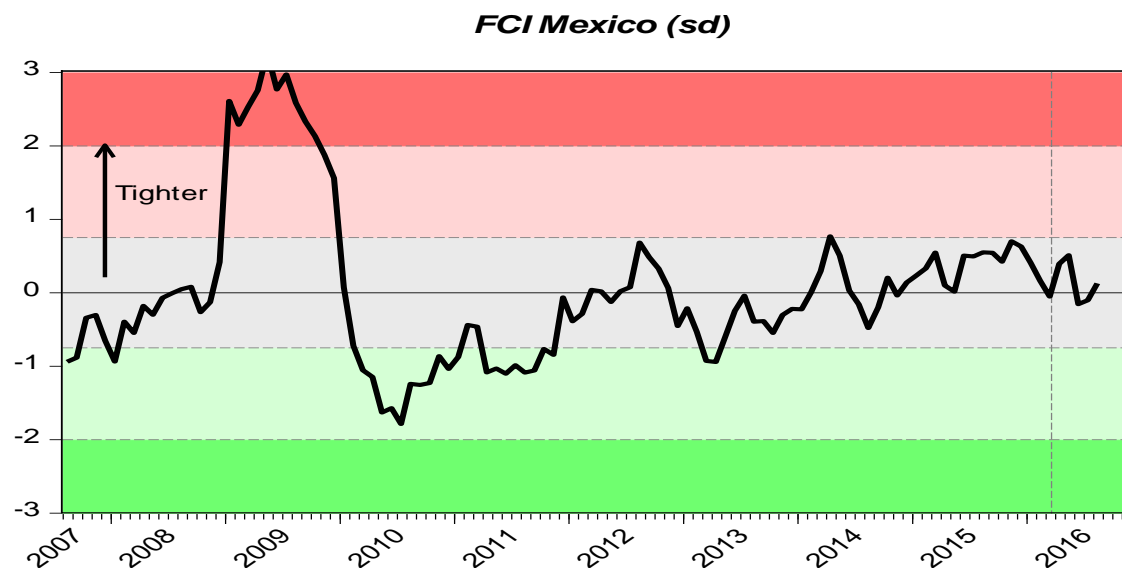
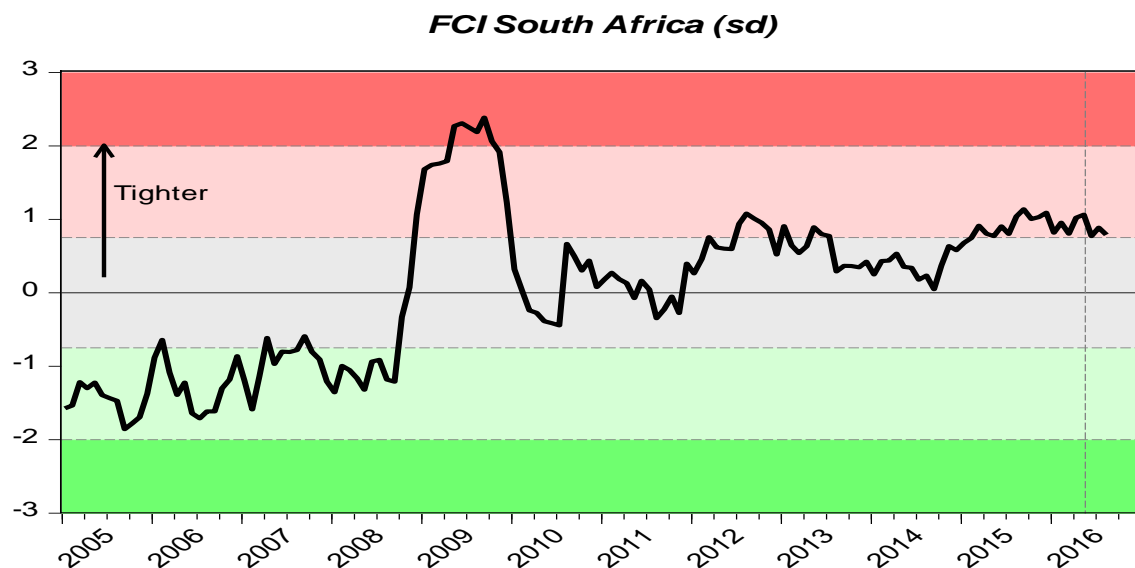
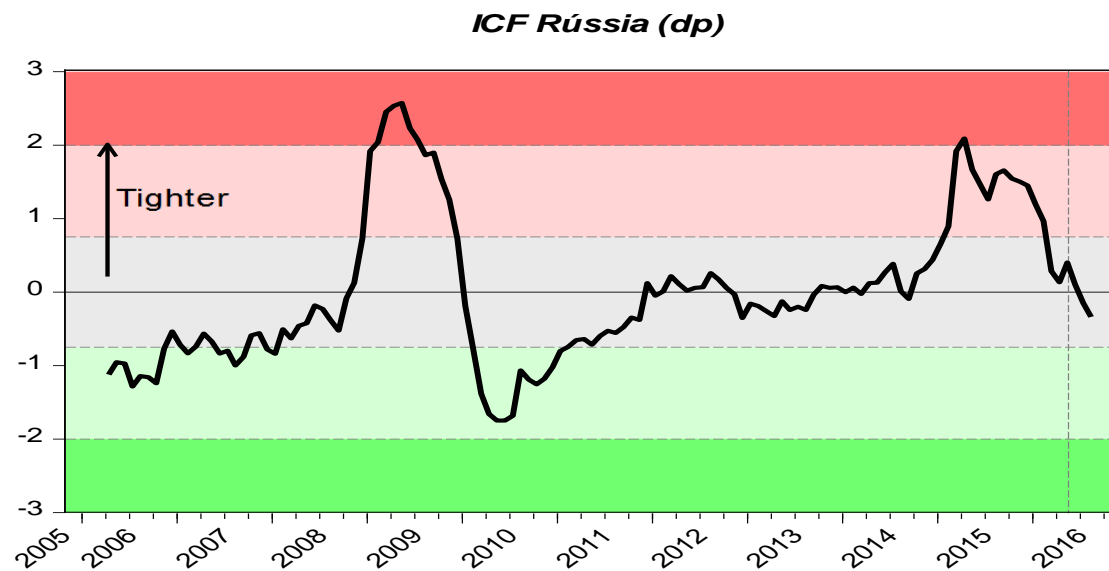
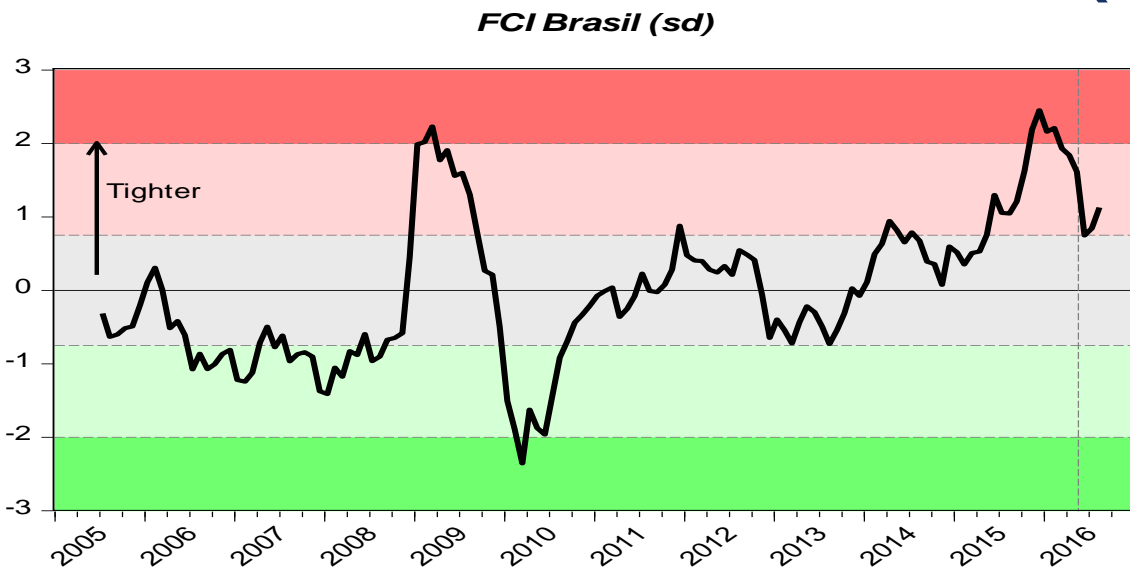
Source: BCB (Focus Report). Note: Total GDP is projected at market prices.



FGV Confidence Indices

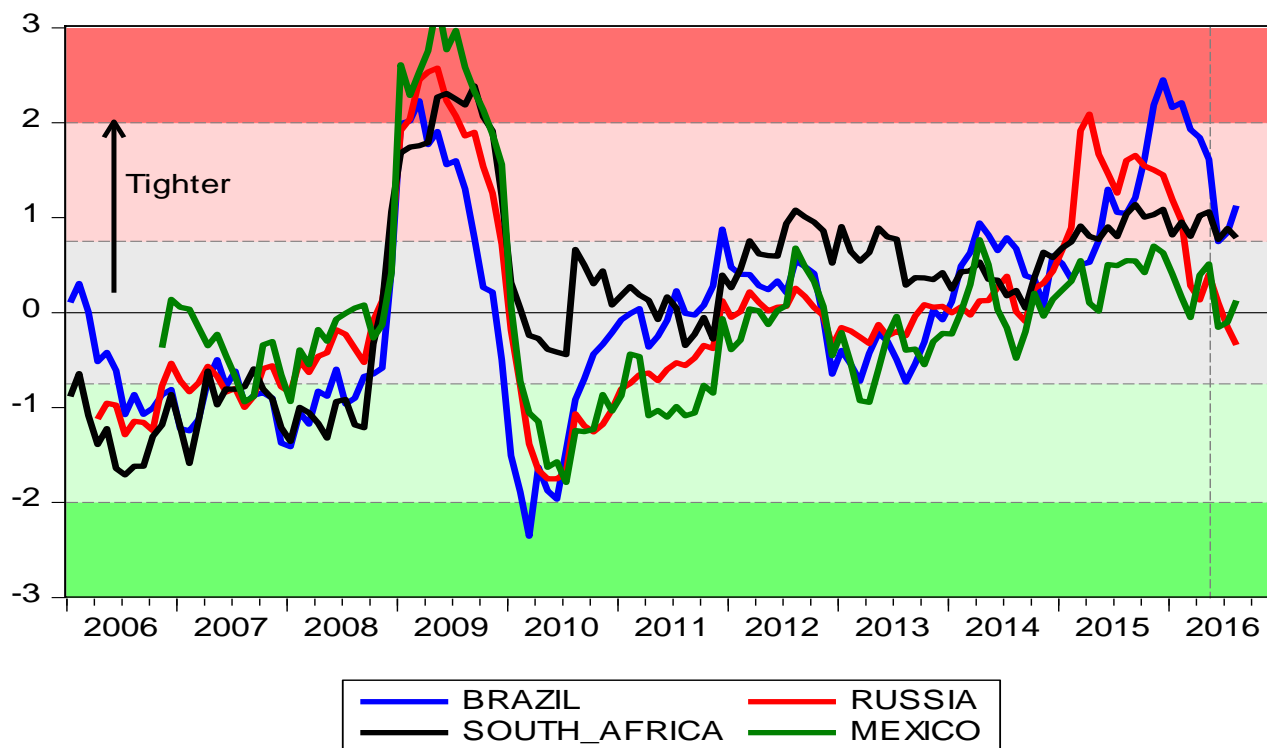


Financial Condition Index (FCI)*

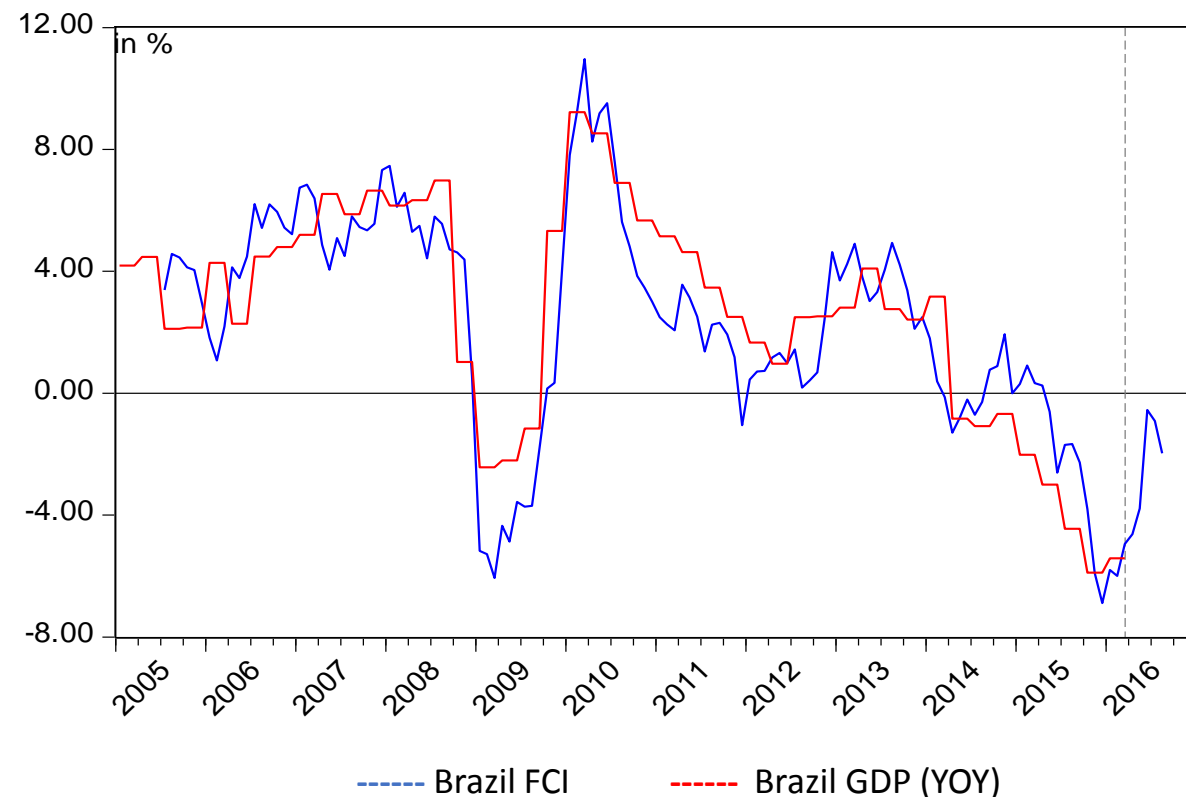


FCI* and GDP**

Financial Condition Index (sd)



Brazil (%YoY)



Source: Bloomberg and Datastream (FCI's raw data). (*): Prepared by BCB/Derin based on author's methodology; (**): PIB YoY from IBGE.





Thank you

Tony Volpon

New York

May 27, 2016.