Executive summary

Since the release of the previous Inflation Report, risks to the global financial stability remained high, particularly those associated with the deleveraging process taking place in major economic blocs and with the exposure of international banks to sovereign debts in countries with fiscal imbalances. In this context, despite the low probability of extreme events affecting the international financial markets, Copom evaluates that the external environment remains complex.

Still regarding the external environment, in general, since previous Inflation Report the prospects for moderate global activity have been unchanged. In fact, available evidence point to low and below potential growth rates in mature economies, despite the accelerating growth pace in important emerging economies. The Copom evaluates that, despite improvement at the margin, the international scenario still plays a significant role in containing the aggregate demand. It is worth mentioning that the central scenario envisages moderation in commodity prices in international markets.

In the domestic framework, the pace of activity has intensified in the fourth quarter of 2012. According to the National Accounts published by IBGE, domestic demand is still the component underlying economic expansion, and household consumption has been fueled by a moderate credit expansion, job creation and income gains. The investment component has also contributed positively to the demand growth. On the supply side, evidence indicates that the industrial segment has started to react to the economic stimulus measures. It is worth noting, still, that the central scenario envisages a more intense pace of domestic activity than the observed in 2012.

The Copom evaluates that the domestic demand tends to remain robust, especially household consumption, mostly due to the effects of stimulus factors, such as income gains and moderate credit expansion. This environment tends to prevail in this and following semesters, when domestic demand will be affected by the effects of recent policy action, which are lagged and cumulative. For the Committee, these effects, added to programs for public service concessions, the inventories at adjusted levels and gradual recovery of businessman's confidence generate prospects for investment growth.

In the credit market, there was an expansion of 16.4% in 2012, with special attention for housing finance loans. The credit market perspectives for 2013 are positive. In fact, interest rates are in historically low levels and the decline along 2012, in an environment of moderate credit expansion, contributed to diminish the household income allocation with banking debt services. Also, the delinquency rate is stable since mid-2012, even though in relatively high levels, but perspectives point to a reduction. The Copom highlights that its main scenario considers moderate expansion in the credit market, in particular, in the credit to households, in a pace more consistent with the growth of household disposable income.

The reduction in the primary surplus, in 2012, reflected, on one hand, reduction in the tax collection resulted from the slowdown in economic activity, and also from tax exemptions; on the other hand, real growth of public sector primary expenditures. Even so, net debt is in a declining trajectory. For 2013, a more intense pace in activity tends to contribute to recovery in revenues. In this context, the Copom observes that the central scenario considers the materialization of the assumed trajectories regarding fiscal variables, even though recent initiatives point to an expansionary public sector balance.

The trade balance declined in the first two months of 2013 over the same period in 2012. Net expenditures on services and income continued to follow an upward trajectory. In this scenario, the current account deficit amounted to US$17.9 billion, as compared to US$8.8 billion in the first two months of 2012. Net foreign investments, both direct and in the stock market, totaled US$7.2 billion and US$ 5.3 billion, respectively, in the first two months of the year, as against US$9.1 billion and US$5.1 billion in the same period in 2012.

The inflation measured by the 12-month IPCA reached 6.31% in February, 0.46 percentage points (p.p.) higher than the rate recorded in February 2012. Market prices increased 7.86% in the 12-month period up to February (up 1.89 p.p. against February 2012), while regulated prices rose 1.53% (down 3.95 p.p. against February 2012). The services sector inflation, which has been higher than total market prices, has reached 8.66% in the 12-month period up to February. The Copom evaluates that the greater dispersion of consumer price increases recently observed, seasonal pressures and pressures localized in the transportation segment, among other factors, contribute for inflation resistance.

Regarding inflation projections, following the usual procedures and taking into account the information set available up to the cutoff date of March 8, 2013, the baseline scenario – which assumes constant exchange rate over the forecast horizon at R$1.95/US$ and target for the Selic interest rate at 7.25% p.a. – projects inflation of 5.7% in 2013, 5.3% in 2014 and 5.4% in the first quarter of 2015.

In the market scenario – which uses data from the expectations survey undertaken by Banco Central's Investor Relations and Special Studies Department (Gerin) with a significant group of institutions – the projections indicate inflation of 5.8% in 2013, 5.1% in 2014 and 5.2% in the first quarter of 2015.

The Copom highlights that the central scenario takes into account evidence pointing to a fall in the neutral interest rate over the last years. This consideration finds support in the Banco Central's projection models and in the behavior of the returns on public and private bonds traded both in domestic and international capital markets. Additionally, the Committee evaluates that, in most cases, the variables mentioned by the literature as determinants of the decline in the neutral rate also support the above evidence.

The Copom emphasizes that the international evidence, in which it is ratified by the Brazilian experience, shows that high inflation rates generate distortions that lead to higher risks and depress investment. These distortions are manifested, for example, in shortening the planning horizons of households, businesses and governments, as well as in the deterioration of the businessman's confidence. The Committee also emphasizes that high inflation rates subtract the purchasing power of wages and transfers, with negative repercussions over households' confidence and consumption. Therefore, high inflation rates reduce the growth potential of the economy, as well as of jobs and income generation.

In light of the above, the Copom will track the evolution of the macroeconomic scenario until the next meeting, and then will define the following steps of the monetary policy strategy.

According to the baseline scenario, the 4-quarter GDP growth rate projected for 2013 is 3.1%, above the 0.9% growth rate observed in 2012.