Executive summary

Since the release of the previous Inflation Report, risks to the global financial stability remained high, like those associated with the deleveraging process taking place in major economic blocs and with the steep slope of the yield curve of relevant mature economies. The Copom appraises that the financial markets volatility tends to react to the release of new indicators and/or to the signaling made by authorities that indicate the starting (or imminent) restoration process of monetary conditions in the United States in the relevant horizon for monetary policy. In summary, despite identifying a low probability of extreme events, the Committee considers that the environment in the international financial markets remains complex.

Still regarding the external environment, in general, the prospects for moderate global activity in the short run have remained unchanged. In fact, available evidence still point to low and below potential growth rates in mature economies for this year. However, prospects indicate intensification of the pace of the global activity in the relevant horizon for monetary policy. In addition, it is worth noting that there is evidence of some accommodation of commodity prices in international markets, as well as a greater volatility and tendency of appreciation of the United States dollar.

The scenario of higher global growth, particularly of important trade partners of Brazil, combined with the depreciation of the Brazilian real, contributes to make the dynamics of external demand more favorable to the growth of the Brazilian economy.

In the domestic environment, after a strong growth in the second quarter of 2013, the economic activity dropped in the third quarter. In this context, in spite of consumption growth and a marginal decline in investment, the twelve-month accumulated variation continues to support the envisaging of an ongoing change in domestic demand composition. Accordingly, household consumption would continue to grow, however at a more moderate pace; and, in contrast, investment and net exports would gain momentum. It is worth noting, still, that the main scenario envisages a relatively stable pace of domestic activity next year, comparing to

2013, as well as considers that additional progress in terms of expected gains depends on the strengthening of firms and households' confidence.

The Copom evaluates that the domestic demand tends to remain relatively robust. On one side, household consumption tends to benefit from stimulus factors such as income gains and moderate credit expansion. On the other, favorable financial conditions, programs for public service concessions and extension of the rights for oil exploitation, among others, generate good prospects for investment.

Moderation in credit operations in the quarter ended in November followed the tendency observed since the beginning of the year, including both earmarked and non-earmarked loans. In the household segment, the modalities real estate credit and non-earmarked payroll debit loans predominated, characterized by lower interest rates and default rates. 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 less favorable than anticipated development of public accounts in the first ten months of 2013 reflected, in part, effects of tax exemptions recently granted. On the other hand, it is worth noting that, in the scenario of continuity in the pace of expansion of economic activity, tax collection tends to gain momentum.

The twelve-month accumulated current account deficit reached US$82.2 billion in October (US$52.2 billion in the same period of 2012), with reversion of the trade balance, from positive to negative, and increase in net expenditures in services, specially, in the travel and transportation accounts. In turn, net inflows of external resources as direct investment, bonds and loans abroad, share and bonds in the country totaled US$ 84.5 billion in 12 months until October (US$73.7 billion in the same period of 2012).

Balance of payments forecasts for 2014 point to stability in the current account result, with a slowdown in the services account deficit and gains in the trade balance. Forecasts also indicate that the expected current account deficit for next year tends to be essentially financed by inflows of foreign direct investment. Programs of infrastructure granting and of oil exploitation strengthen the prospects that, in the medium term, flows of foreign direct investment maintain a significant share in the current account financing.

The inflation measured by the twelve-month accumulated Broad National Consumer Price Index (IPCA) reached 5.77% in November, 0.24 percentage points (p.p.) higher than the rate recorded in November 2012. The inflation rise was due to the acceleration in the market prices, which increased 7.31% in the twelve-month period up to November (1.08 p.p. higher than the rate up to November 2012), despite some moderation at the margin. In the same period, regulated prices registered the lowest rate (0.95%) of the historical series beginning in 1994, 2.55 p.p. lower than the rate registered in November 2012. It should be highlighted some slowdown in the food and beverages group, that increased 8.63% in twelve-month period (1.45 p.p. lower than the rate up to November 2012 and 5.37 p.p. lower than the rate observed up to April 2013). In turn, the services sector inflation has reached 8.55% in the twelve-month period up to November (8.24% up to November 2012), remaining in levels above the market prices inflation.

Regarding inflation projections, following the usual procedures and taking into account the information set available up to the cutoff date of December 6, 2013, the baseline scenario – which assumes constant exchange rate over the forecast horizon at R$2.35/US$ and target for the Selic interest rate at 10.00% p.a. – projects inflation of 5.8% in 2013, 5.6% in 2014 and 5.4% in 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, 5.6% in 2014 and 5.3% in 2015.

Regarding GDP growth, the projection for 2013, according to the baseline scenario, is 2.3% (0.2 p.p. lower than the estimate considered in the previous Report) and 2.3% in the 4-quarter rate up to the third quarter of 2014.

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, firms 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. Hence, high inflation rates reduce the growth potential of the economy, as well as of jobs and income generation.

Therefore, the Committee highlights that, in moments such as the current one, the monetary policy should remain especially vigilant, in order to minimize risks that high inflation rates, such as the ones observed in the last twelve months, persist in the relevant horizon for monetary policy. At the same time, the Copom draws attention to the presence of lags in the transmission mechanism of monetary policy to inflation.