Executive summary

Since the release of the previous Inflation Report, risks to the global financial stability remained high, in particular, those derived from the changes in the 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 strengthening of the 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 more intense global activity in the relevant horizon for monetary policy have remained unchanged, despite evidences still pointing to low and below potential growth rates in some mature economies for this year. It is worth noting that prospects indicate moderate dynamics of commodity prices in international markets, despite local pressures in prices at the margin, as well as a greater volatility and tendency of appreciation of the United States dollar.

The Copom evaluates that the scenario of higher global growth, 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, the National Accounts data regarding the fourth quarter of 2013 confirmed the gradual recovery of the Brazilian economy. In this context, both marginal and the twelve-month accumulated variations support the envisaging of an ongoing change in domestic demand composition, with more moderate consumption growth and stronger contribution of net exports and investment. It is worth noting, still, that the main scenario envisages a relatively stable pace of domestic activity in 2014, comparing to 2013. The Committee highlights that the pace of occurrence of previously mentioned changes, as well as the consequent gains, depend 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 keep expanding, due to 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.

The dynamics of the credit market reflected, in the quarter ended in February, seasonal aspects of the period. In this context, the increase in credit operations for corporations was sharper in December, due to the necessity of cash flow and higher inventories typical in the end of the year. In the household segment, there was an increase in the demand for shorter-term credit and the longer-terms' credit, as agricultural and housing credit, continued to expand. Interest rates and bank spreads in the period evolved in a direction compatible with Selic target rate.

Central government revenues increased, in 2013 and in January 2014, in a slower pace than expenditures. This path was influenced, in part, by the gradual recovery of the economic activity and by the tax relieves implemented in the last years.

Trade balance deficit increased 43.7% in the first two months of 2014, compared to the same months in 2013, reflecting in part exports decrease. In the same period, net expenditures in services and income decreased 20.5% and 1.3%, respectively. Twelve-month current account deficit reached 3.68% of the GDP in February, the same level since October 2013. Regarding Balance of Payments financing, it should be noted that net foreign direct investment inflows and other relevant fundraising modalities grew in the first two months of the year.

The inflation measured by the twelve-month accumulated Broad National Consumer Price Index (IPCA) reached 5.68% in February, 0.63 percentage points (p.p.) lower than the rate recorded until February 2013. The twelve-month accumulated inflation decrease reflects the lower variation in market prices, 6.28% until February (1.58 p.p. lower than the rate up to February 2013). The regulated prices varied 3.71% (2.18 p.p. higher than the inflation accumulated up to February 2013). In turn, the services sector inflation – around 35% of the consumption basket of IPCA – has reached 8.20% (8.66% until February 2013), and remains 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 March 14, 2014, 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 10.75% p.a. – projects inflation of 6.1% in 2014, 5.5% in 2015 and 5.4% in the first quarter of 2016.

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 6.2% in 2014, 5.5% in 2015 and 5.2% in the first quarter of 2016.

Regarding GDP growth, the projection for 2014, according to the baseline scenario, is 2.0% (0.3 p.p. lower than 2013 GDP growth).

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