Executive summary

In the external environment, the Copom evaluates that the risks to the global financial stability remained high since the release of the previous Inflation Report, in particular, those derived from the changes in the slope of the yield curve of relevant mature economies. The Committee considers that, in the relevant horizon for monetary policy, risk aversion and financial markets volatility tend to react to the release of new indicators and/or to the signaling made by authorities that indicate the beginning of the restoration process of monetary conditions in great economic blocs, in particular, in the United States. Other potential sources of disturbances are geopolitical events.

In general, since the previous report, the prospects of stronger global activity remained unchanged over the relevant horizon for monetary policy. In this regard, it is important to note that evidence points to growth rates relatively more homogeneous in mature economies, although low and below potential growth, notably in the euro area. In international markets, the outlook shows moderation in the dynamics of commodity prices, as well as the occurrence of volatility outbreaks in currency markets.

Still on the external environment, it is worth mentioning that any increase in volatility and risk aversion in international markets tend to be transmitted, even in part, to domestic assets.

In the domestic environment, the Copom argues that growth rates of domestic absorption and of GDP are aligned and that the pace of expansion of domestic activity in 2015 will be lower than the potential. For the Committee, the pace of activity tends to be more intense as long as the confidence of firms and households grows stronger. Regarding the external component of aggregate demand, the scenario of recovery in some mature economies and of intensification in the pace of activity in others, combined with the depreciation of the Brazilian real, tends to favor the growth of the Brazilian economy.

Still regarding activity, in the medium-term the Copom evaluates that important changes may occur in the composition of aggregate supply and aggregate demand. Consumption tends to expand at a moderate pace and investments tend to gain momentum. In the Committee's view, these changes anticipate a growth composition in the medium term more favorable to potential growth.

The Copom highlights that the central scenario envisages moderate expansion of credit. In this regard, note that, after years of strong expansion, the credit market aimed to consumption showed moderation, leading, in the last quarters, on the one hand, to lesser exposure of banks, and, on the other hand, to household deleveraging. Taken together, therefore, it is inferred that the risks have been mitigated in the consumer credit segment. In another dimension, following recently implemented actions, the Committee considers necessary to employ initiatives aiming to moderate the concession of subsidies through credit operations.

Regarding public accounts, recent restoration of certain tax rates combined with measures aiming to reduce the expansion pace of specific expenditure groups and to balance public expenditure to revenue performance, signal commitment to the achievement of the primary surplus targets in 2015 and beyond.

Current account deficit in the first two months of 2015 was lower than in the same period of 2014. This performance reflected reductions in trade flows – consistent with the modest recovery in the global economy and the slowdown in the pace of domestic activity – and in the net outflows of services and, mainly, incomes – influenced by the decrease in net remittances of profits and dividends. Although net inflows of foreign direct investments, foreign portfolio investments and loans have decreased 2.2% in this period, current account deficit funding conditions remain comfortable.

The inflation measured by the twelve-month accumulated Broad National Consumer Price Index (IPCA) reached 7.70% in February, 2.02 p.p. higher than the rate recorded until February 2014. On the one hand, market prices accumulated variation of 7.12% in twelve months (6.28% up to February 2014); on the other hand, the regulated prices increased 9.66% (3.71% up to February 2014).

Regarding inflation projections, following the usual procedures and taking into account the information set available up to the cutoff date of March 13, 2015, the baseline scenario – which assumes constant exchange rate over the forecast horizon at R$3.15/US$ and target for the Selic interest rate at 12.75% p.a. – projects inflation of 7.9% in 2015, 4.9% in 2016 and 4.7% in the first quarter of 2017.

In the market scenario – which uses consolidated information 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 7.9% in 2015, 5.1% in 2016 and 4.9% in the first quarter of 2017.

Regarding GDP growth, the projection for 2014, according to the baseline scenario, is -0.1% (0.3 p.p. lower than the estimate considered in the previous Inflation Report) and -0.5% for 2015. These projections are based on the current National Accounts methodology of IBGE.

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.

For the Copom, the high level of the current inflation reflects, in a large part, the intensification of the two relative price adjustment processes in the economy – the domestic price adjustment relative to international prices and the regulated price adjustment relative to market prices.

In this context, according to the projections presented in this report, the Committee notes, as anticipated, that inflation rises in the short run and tends to remain high in 2015. Recognizing that relative price adjustments have direct impacts on inflation, the Committee reaffirms its view that monetary policy should and must contain the second-round effects resulting from them.

In this regard, the Committee assesses that the scenario of convergence of inflation to 4.5% in 2016 has strengthened. For the Committee, however, the progress made in combating inflation – such as benign signals from medium and long-term expectations indicators – are still not sufficient.