Executive summary

In the external environment, the Copom considers that, since the previous report, risks to global financial stability remained elevated, such as those derived from changes in the slope of the yield curve of major mature economies. In the relevant horizon for monetary policy, the Committee believes that risk aversion and volatility of international financial markets tend to react to the publication of new indicators and/or signals transmitted by authorities that point to the start of the normalization of monetary conditions in large blocks, particularly in the United States.

In general, since the previous report, prospects of a stronger global activity in the relevant horizon for monetary policy remained unchanged. In this regard, note that the evidence points to growth rates relatively more homogeneous in mature economies, though low and below potential growth, notably in the euro area. In international markets, there are prospects of moderation in the dynamics of commodity prices as well as the occurrence of volatility clusters in currencies and fixed income markets.

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

In the domestic environment, the Committee reiterates that the available indicators on the growth rates of domestic absorption and GDP lined up and that the pace of expansion of domestic activity in 2015 will be below potential. For the Committee, after a necessary period of adjustments, the pace of activity is set to increase to the extent that the confidence of firms and households strengthen. As far as the external component of aggregate demand is concerned, the higher global growth scenario, combined with the depreciation of the Real, tends to favor the growth of the Brazilian economy.

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

The Copom highlights that the central scenario envisages moderate credit expansion, which has already been noticed. In this regard, note that, after a cycle of strong expansion, the credit market directed toward consumption is undergoing a natural period of 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, one concludes that risks have been mitigated in the consumer credit segment. In another dimension, following recently implemented actions, the Committee considers appropriate to reinforce initiatives aiming to moderate the concession of subsidies through credit operations.

Regarding public accounts, the recent adjustment process, ratified with reductions to the budget and restrictions on discretionary expenditures, as well as, with restoration of certain tax rates, will contribute to improve the public account dynamics in the coming months and signal commitment to the achievement of the primary surplus targets in 2015 and beyond.

Partial results for the 2015 balance of payments confirm the view of lower current account deficit, under a scenario of depreciation of the Real and slowdown of domestic activity. Net capital inflows have been financing properly the current account deficit, with particular reference to the net inflows of direct investment in the country and portfolio investments.

The inflation measured by the twelve-month accumulated Broad National Consumer Price Index (IPCA) reached 8.47% in May, 2.10 p.p. higher than the rate recorded until May 2014. On the one hand, market prices accumulated variation of 6.82% in twelve months (7.07% up to May 2014); on the other hand, the regulated prices increased 14.09% (4.08% up to May 2014).

Regarding inflation projections, following the usual procedures and taking into account the information set available up to the cutoff date of June 12, 2015, the baseline scenario – which assumes constant exchange rate over the forecast horizon at R$3.10/US$ and target for the Selic interest rate at 13.75% p.a. – projects inflation of 9.0% in 2015, 4.8% in 2016 and 4.5% in the second 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 9.1% in 2015, 5.1% in 2016 and 4.8% in the second quarter of 2017.

Regarding GDP growth, the projection for 2015, according to the baseline scenario, is -1.1% (0.6 p.p. lower than the estimate considered in the previous Inflation Report) and -0.8% for the accumulated in four quarters up to the first quarter of 2016.

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 effects 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 these adjustments make inflation increase in the short run and tend to remain high in 2015, making determination and perseverance necessary to avoid its transmission to the long run. At the same time that the Committee understands that adjustments in relative prices have direct impact on inflation, it reaffirms its vision that monetary policy can and must contain the second order effects of these adjustments so as to circumscribe them to 2015.

The Committee observes that inflation expectations are near or at the 4.5% p.a. target in the medium and in the long run. However, the Committee stresses that, despite the reduction, inflation expectations for the end of 2016 still shows relevant differences in relation to target. This improvement, when compared with the levels observed in the Inflation Report of March, despite the significant increase in the inflation expectations for the current year, constitutes an important signal about the current strategy of monetary policy effects.

In this regard, the Copom 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 inflation expectations – are still not sufficient. In this context, the Copom reaffirms that monetary policy must remain vigilant.