Executive summary

The Copom's baseline scenario envisages economic stabilization in the short run and a possible gradual recovery in economic activity over the next quarters, in the context of a high level of economic slack. The evolution of prices indicates an ongoing disinflationary process. Although price indexes decelerated in the quarter ending in August, realized inflation exceeded expectations for the period, reflecting less intense price easing when compared to seasonal patterns. In spite of such recent behavior, prospects point to the continuity of the disinflationary process over the next quarters. This reading finds support in Copom's forecasts and in measures of inflation expectations reported in the Focus survey. Nevertheless, the speed of disinflation remains uncertain. On the external front, the scenario still considers a benign period for emerging economies. However, uncertainties regarding global economic growth and, especially, the pace of monetary policy normalization in the United States, remain.

Inflation measured by the Extended National Consumer Price Index (IPCA) in the quarter ending in August printed 0.48 p.p. above Copom's projections in the June Inflation Report. The current Report identifies the components that accounted for the largest discrepancies in this period, and presents forecasts for IPCA inflation for September, October and November, of 0.19%, 0.40% and 0.45%, respectively.

Regarding conditional inflation forecasts, under the usual procedures, the reference scenario projects inflation at 7.3% in 2016, 4.4% in 2017, and 3.8% in 2018. In the market scenario, projections point to inflation at 7.3% in 2016, 4.9% in 2017, and 4.6% in 2018. The extension of the forecast horizon up to the fourth quarter of 2018 aims to cover all calendar years for which inflation targets have already been defined by the National Monetary Council (CMN). This report also presents two additional scenarios that combine assumptions from the reference and market scenarios.

The box "Forecast for 2017 GDP growth and 2016 forecast revision" presents GDP growth forecasts. The projection for 2016 remained at -3.3%, but has undergone minor changes in its composition. For 2017, growth projection reaches 1.3%.

The Copom judges that a loosening of monetary conditions will depend on factors that allow Committee members to have greater confidence in meeting the inflation targets.

Among the elements that may increase confidence in meeting the inflation targets, the Committee emphasizes the following domestic factors: (i) that the persistence of the impacts of the food price shock on inflation be limited; (ii) that IPCA components that are most sensitive to monetary policy and economic slack show disinflation at an appropriate pace; (iii) that the uncertainty regarding the approval and implementation of the necessary economic adjustments be reduced, including the composition of fiscal measures, and their effects on inflation.

Regarding the first factor, recent evidence indicates that the fall in wholesale food prices is transmitting to the retail sector. In addition, projections for food-price subitems seem to provide increased confidence in the reversal of the price shock in this sector. In fact, part of the recent resilience of current inflation seems to be have been driven by temporary shocks to food prices. The Copom will remain alert to signs indicating that this resilience may also arise from inertial mechanisms.

With respect to the second factor, the signs about the pace of disinflation towards the target are still inconclusive, as shown in the Box "Inflation in the services sector" in this Report. The Copom will evaluate (i) the disinflationary trend of a number of measures of services inflation; and (ii) the secondary effects that disinflation in this group may have on other IPCA components.

Turning to the third factor, there are positive signs regarding the proposal and consideration of fiscal reforms. However, the procedural steps are at an initial stage and uncertainty regarding the approval and implementation of the necessary adjustments remains. These reforms are relevant for the Banco Central inasmuch as they affect the balance of risks and the inflation trajectory with respect to meeting the targets.