

Brazilian Economic Outlook

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These remarks are personal and do not necessarily reflect the opinions of the BCB.

Outline

I. International Environment

II. Financial Conditions

III. Macroeconomic Adjustment

IV. Activity

V. Inflation Developments

I. International Environment

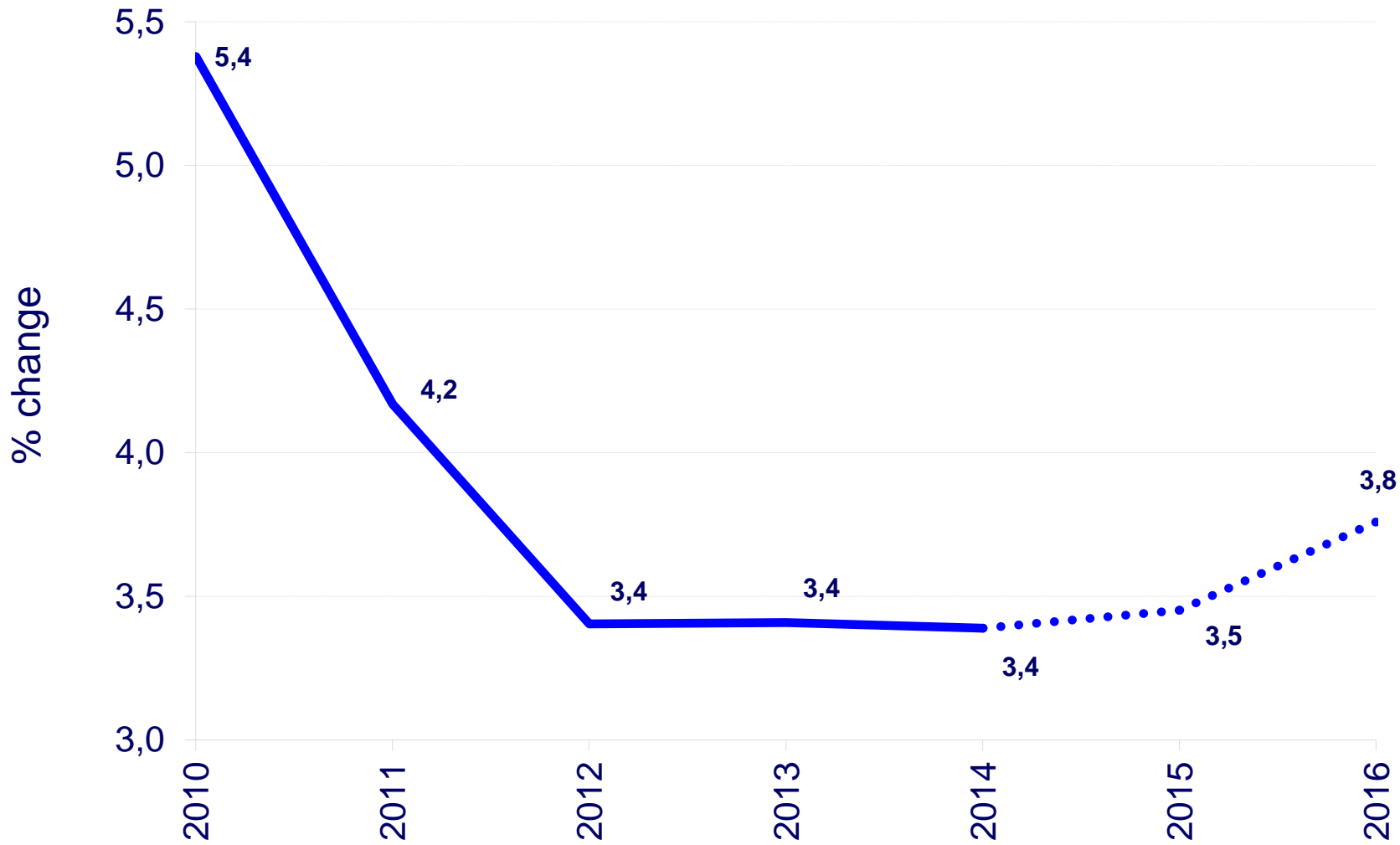
Main Points: Uneven recovery in AEs, global strengthening of the US dollar, falling commodities prices

Global Economy: Current Situation

- Uneven global economy recovery (e.g., US v-a-v Eurozone & Japan); EMEs slowed down;
- Strong USD global trend;
- Different recoveries and inflation outlook explain asynchronous MPs (e.g., US v-a-v Eurozone & Japan);
- Declining trend in the prices of commodities, especially in oil;
- Risks to global financial stability multifaceted (e.g., negative rates, corporate debt, asynchronous UMPs, etc.)

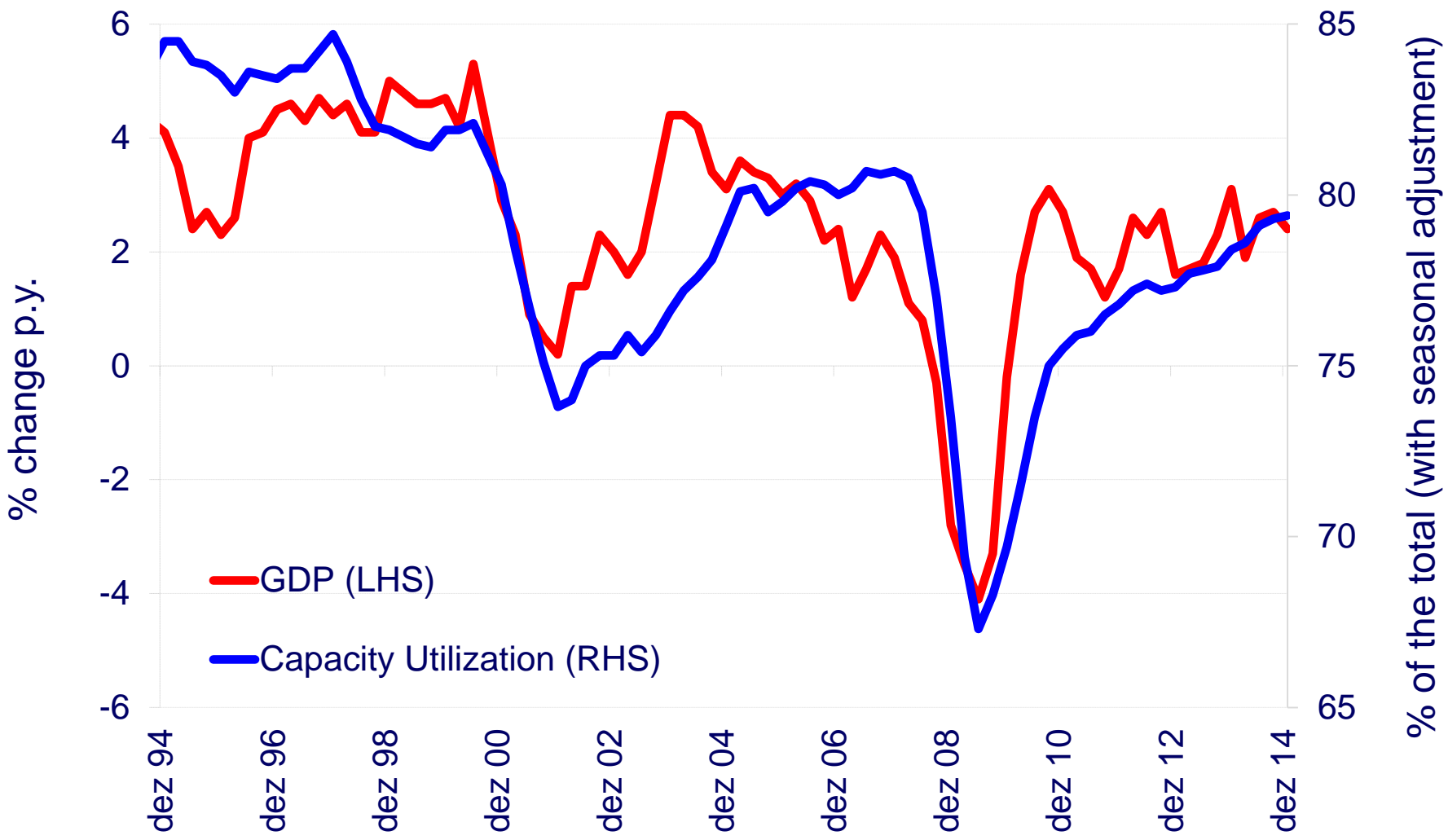
Global Economy in Gradual Recovery

Global Growth



Source: IMF (WEO, April 2015)

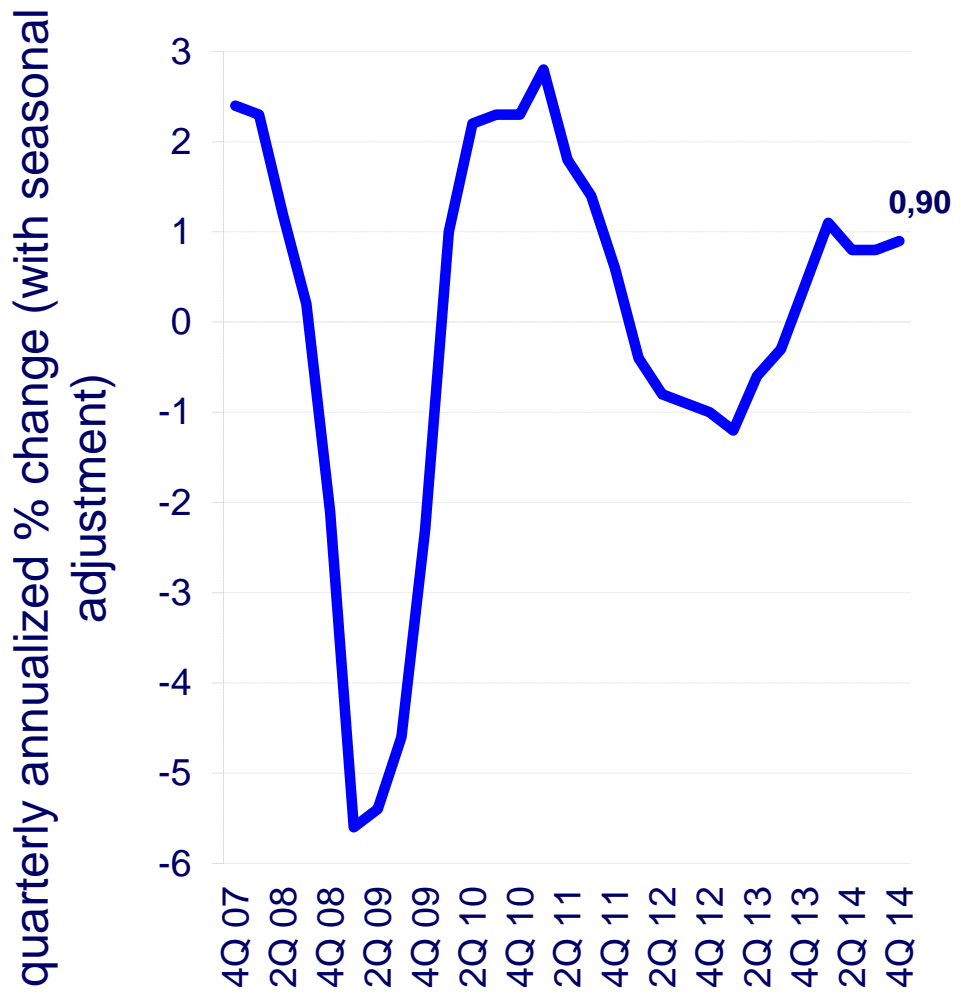
Economic Recovery in the US



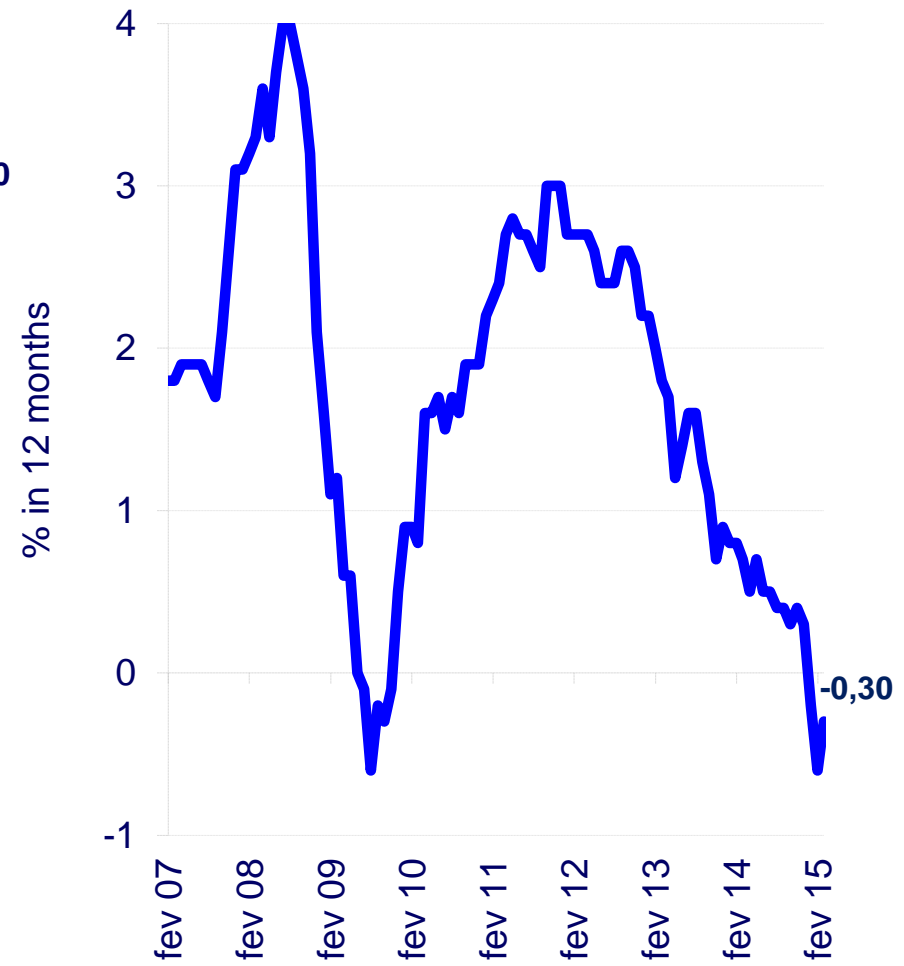
Source: U.S. Bureau of Economic Analysis / Federal Reserve

Europe – Growth and Inflation

GDP Growth – Euro Area

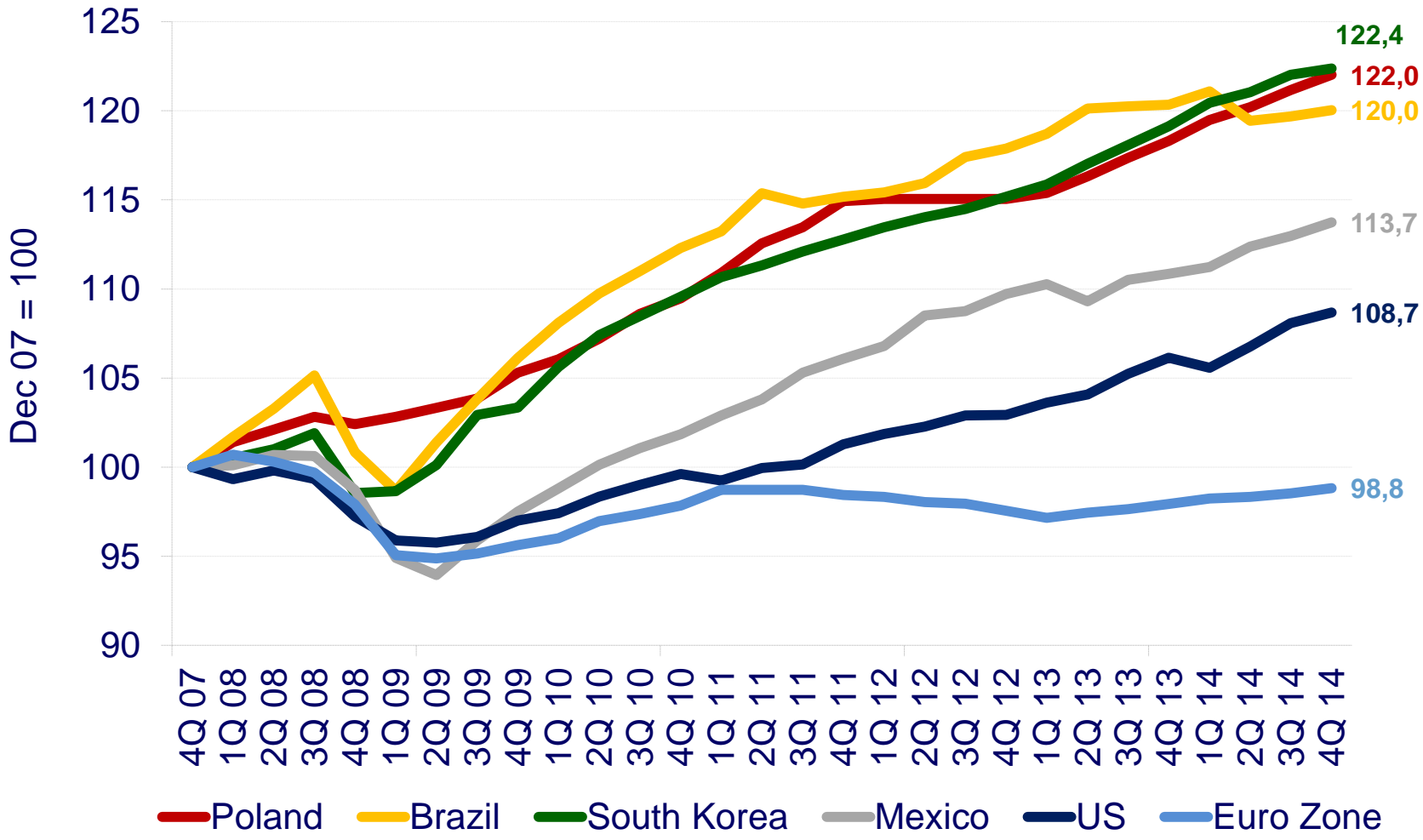


Consumer Inflation – Euro Area



Growth since the Global Financial Crisis

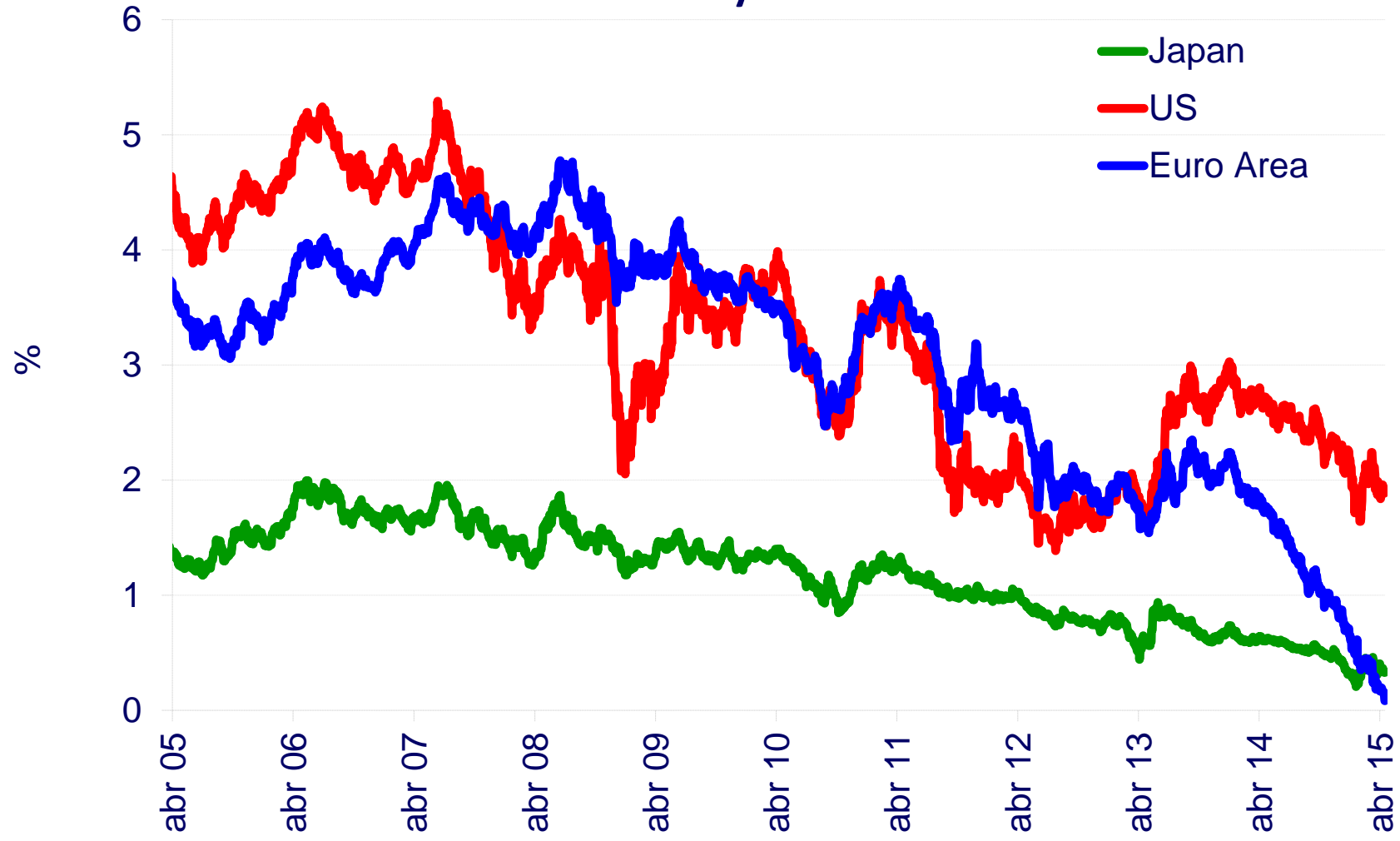
Cumulative Real GDP Growth



Source: Bloomberg

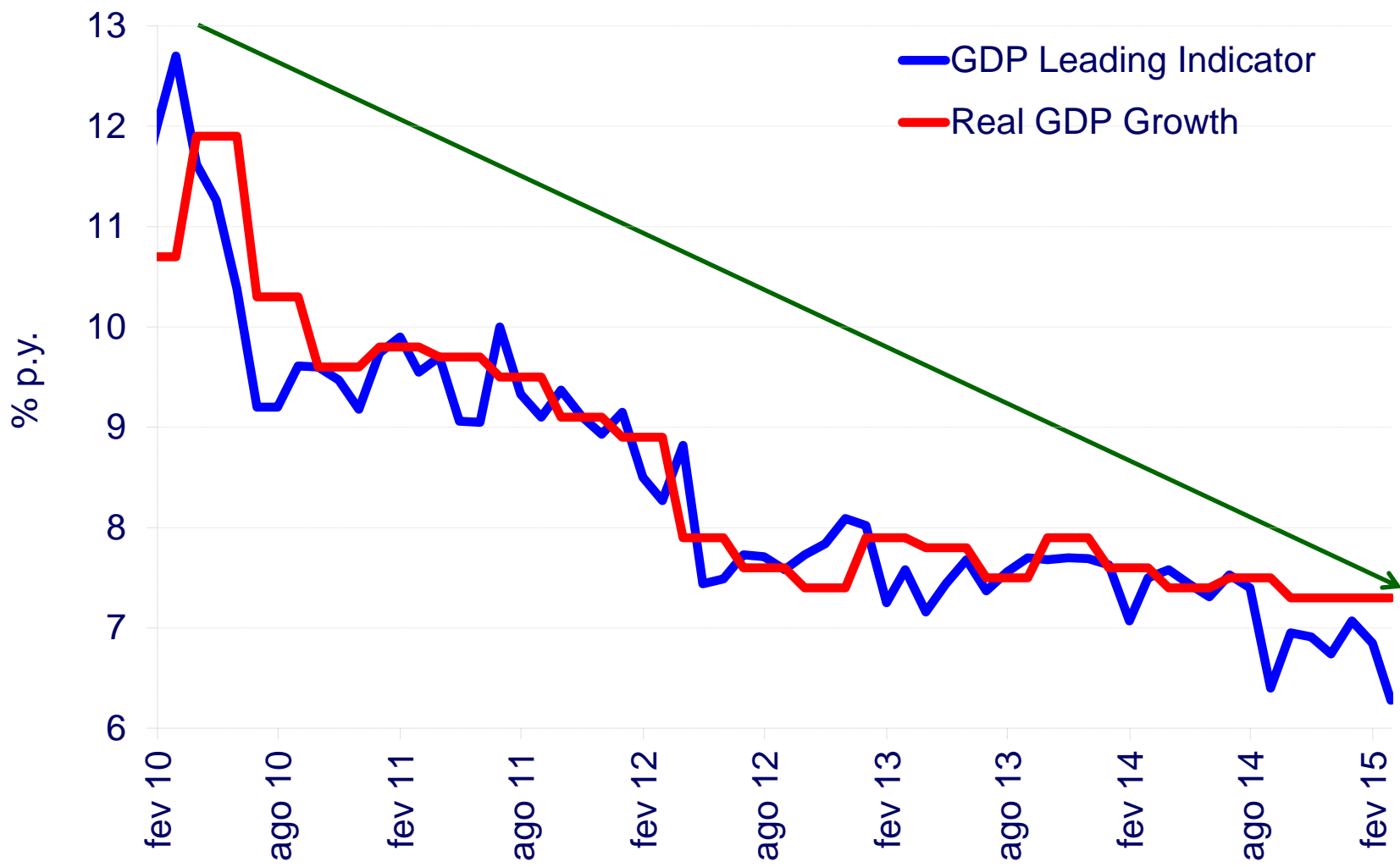
Divergence in Monetary Policy

10-year Bonds

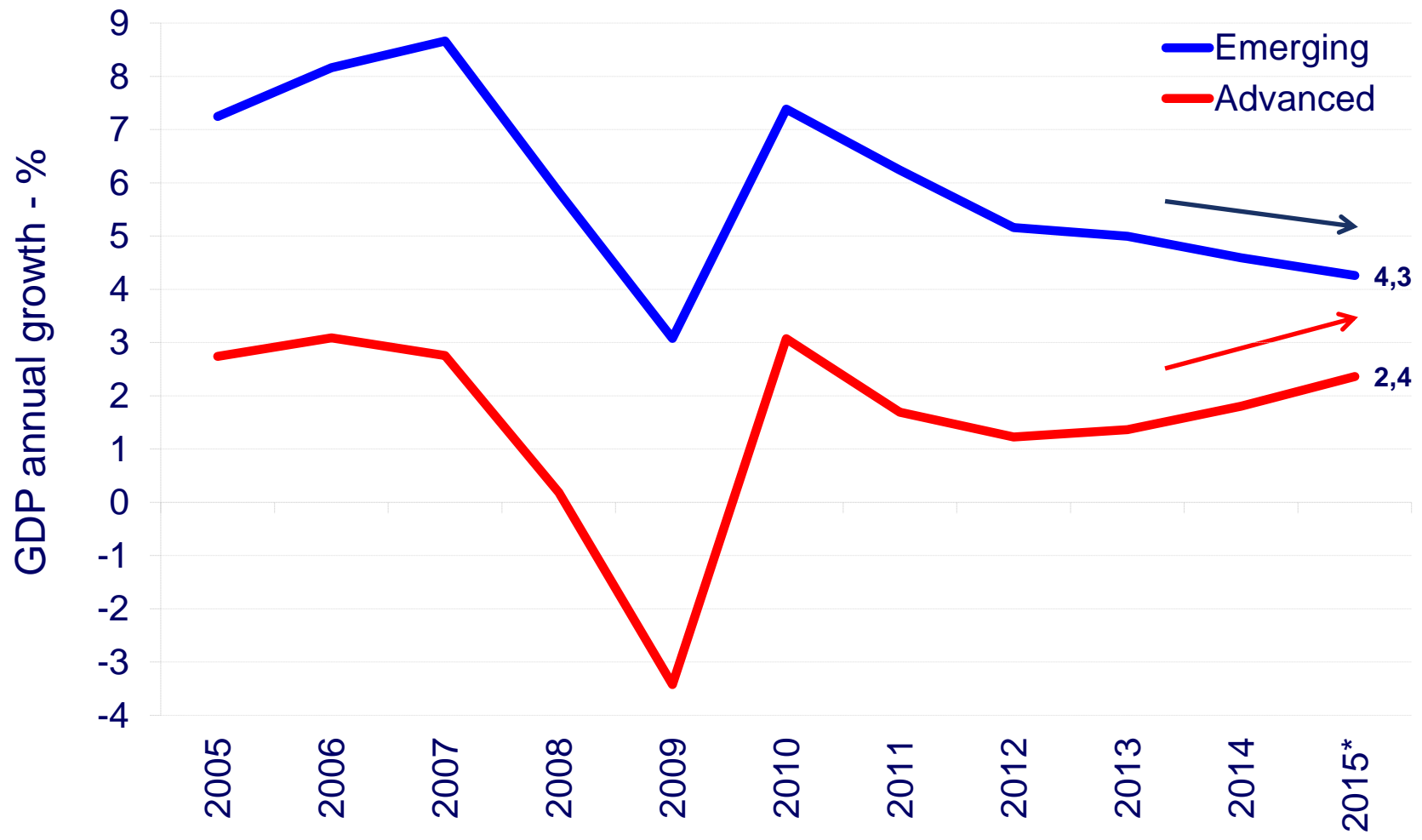


data through April 16th

China – Gradual Deceleration



Emerging Countries – Moderation in Growth

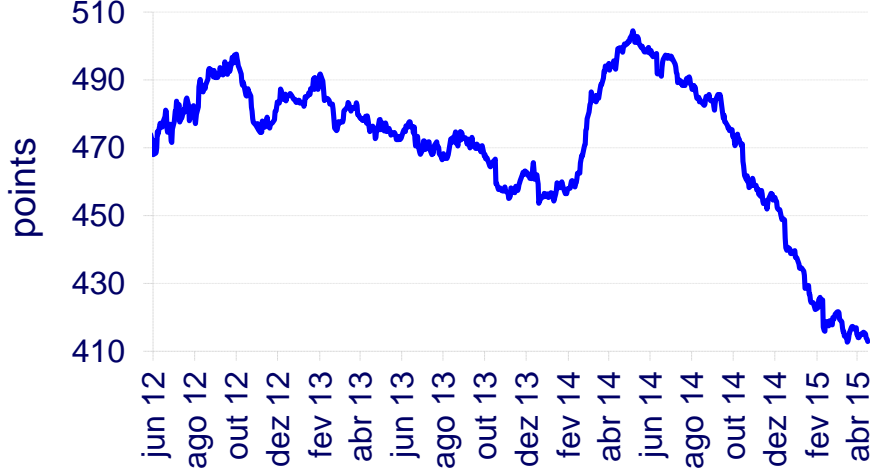


*projection for the end of 2015

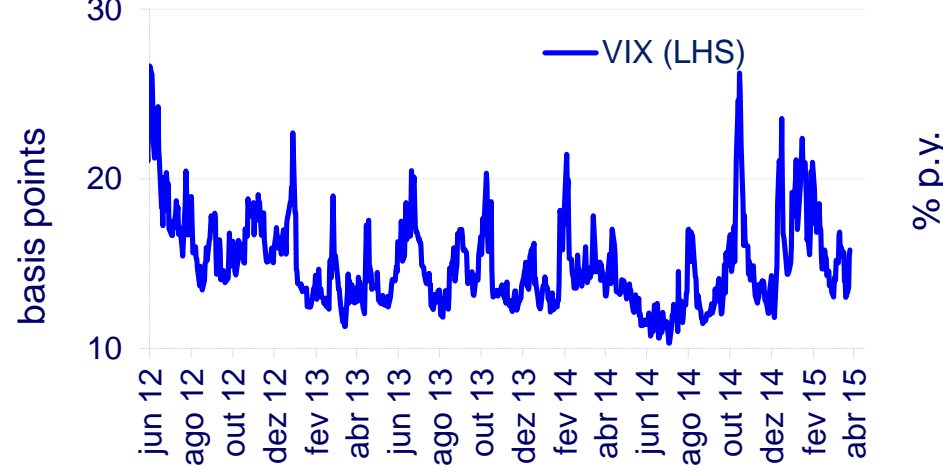
Source: FMI (WEO, April 2015)

Commodities and Volatility

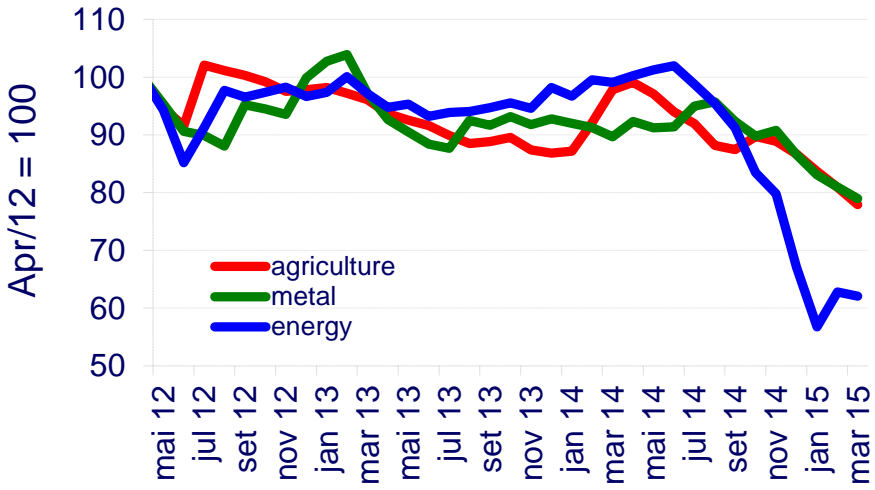
CRB



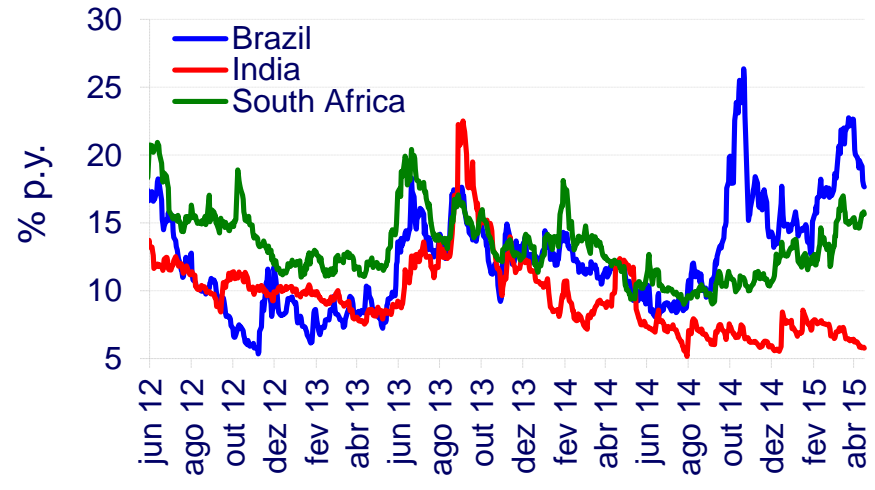
VIX and Volatility in the Bonds' Market



IC-Br (US\$)

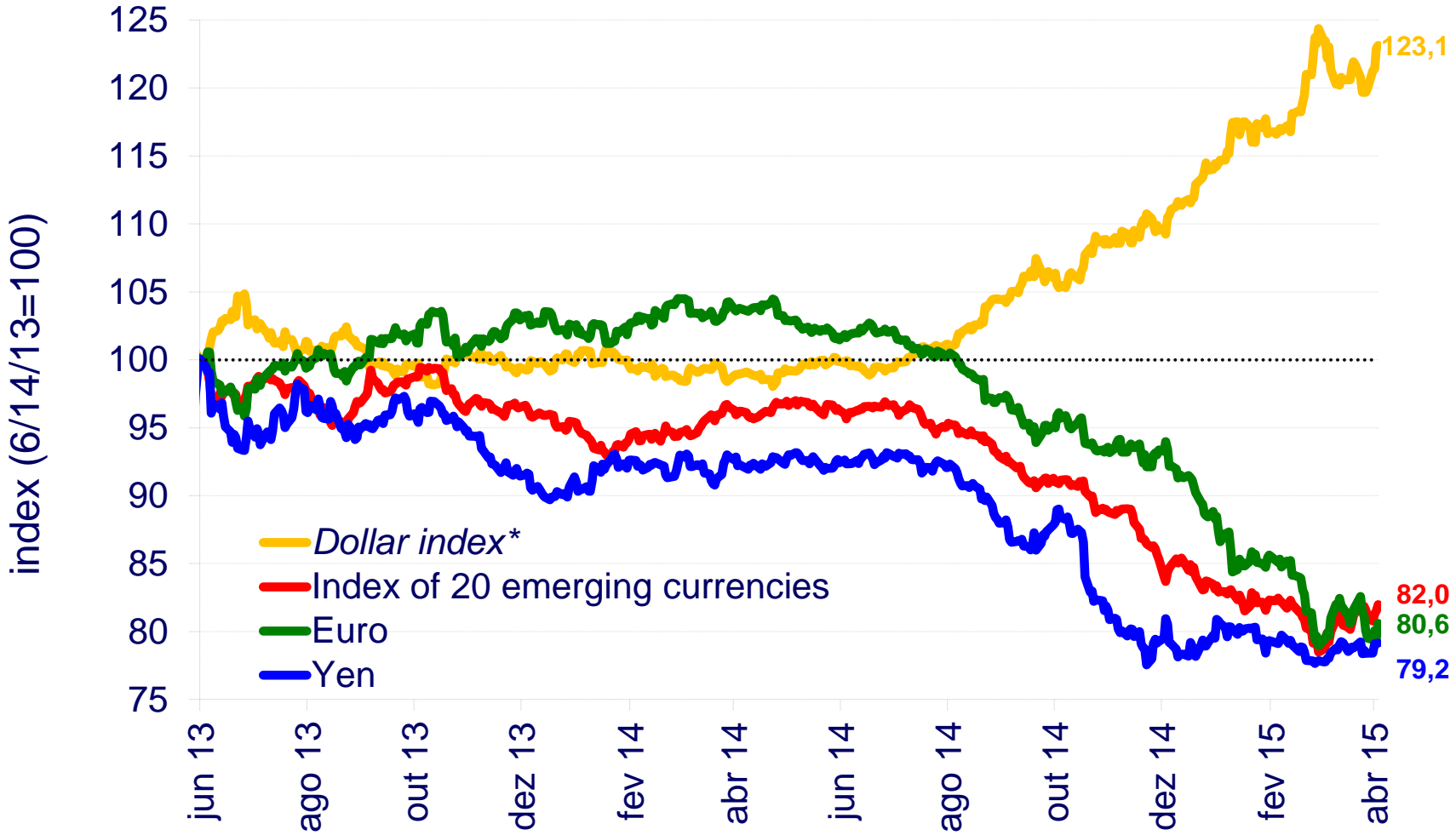


Currencies' Volatility



data through April 16th

US Dollar Appreciation is a Global Trend



data through April 16th; *dollar index: measures the international value of the dollar against basket of the six main reserve currencies in the world (swiss franc, canadian dollar, japanese yen, pound sterling, euro and swedish kron)

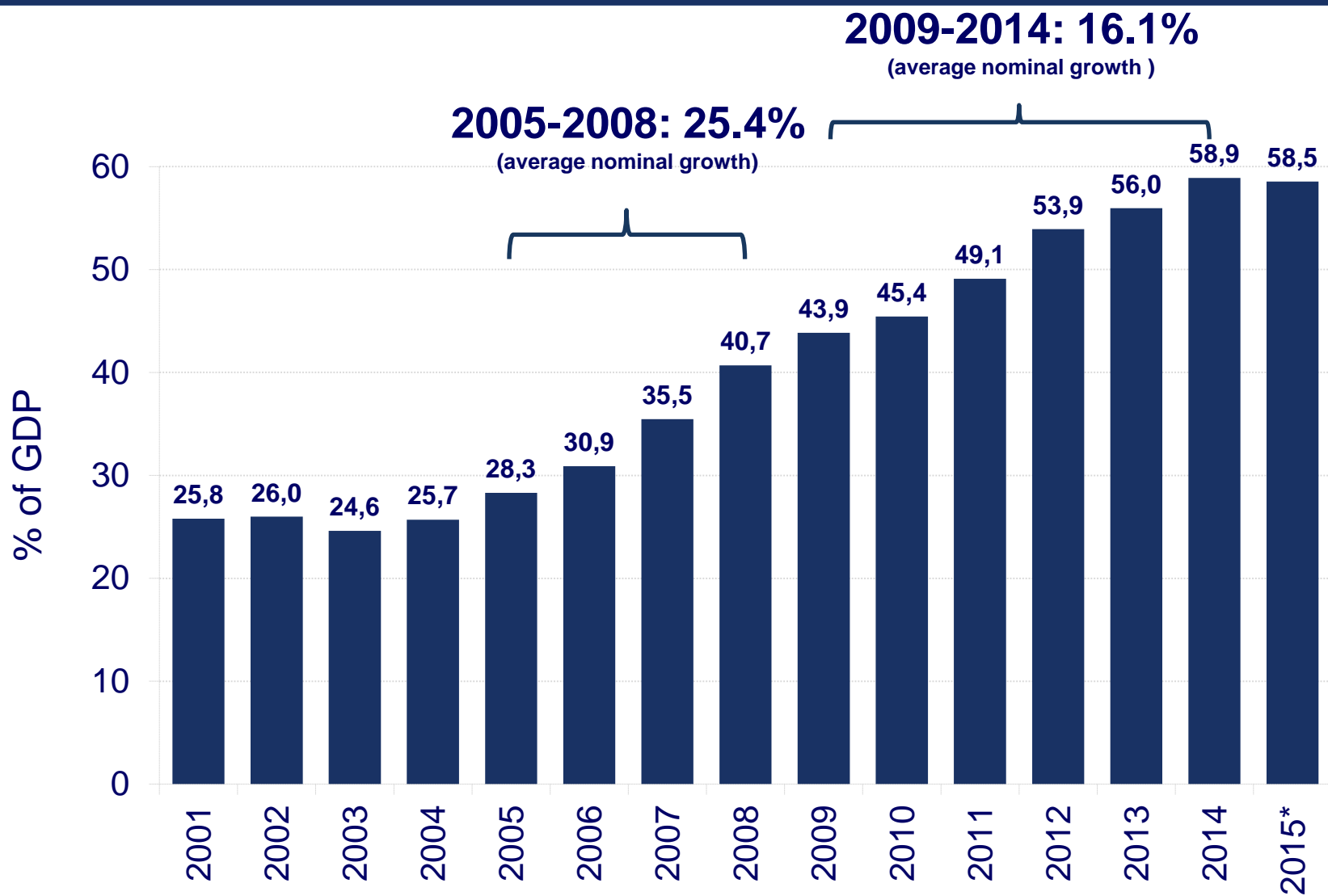
Global Economy Swings & Strong Policy Framework

- Strengthening our tested policy framework (flexible ER, responsible fiscal policy, IT framework), complemented with:
 - During upswing: moderating exuberance:
 - Allowing ER flexibility 1st line of defense;
 - Using macroprudential policies / tools (MaPs);
 - During “tapering tantrum” and preparing “lift-off”;
 - Allowing ER flexibility 1st line of defense;
 - Monitoring financial sector exposures (stress-tests);
 - Providing “hedge” to private sector;

II. Financial Conditions

Main points: After structural changes, moderation in the pace of credit expansion, robustness of the National Financial System ensures financial stability

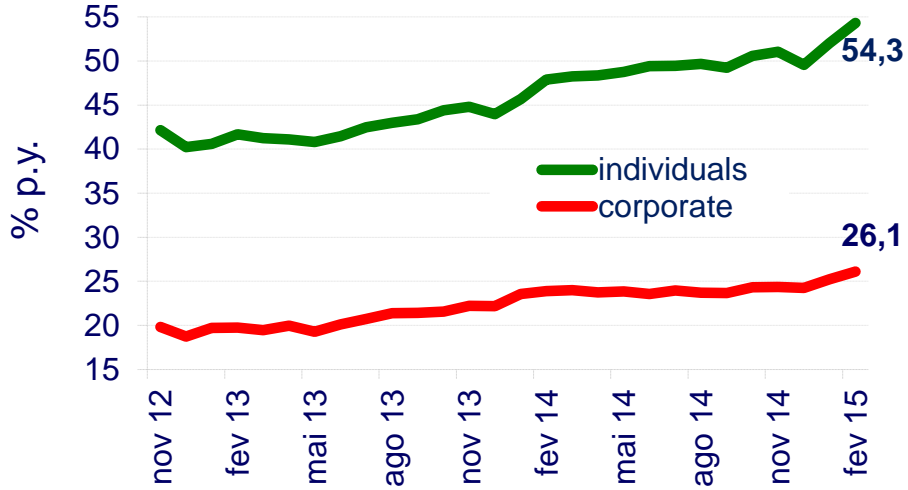
Credit-to-GDP Ratio Has Stabilized



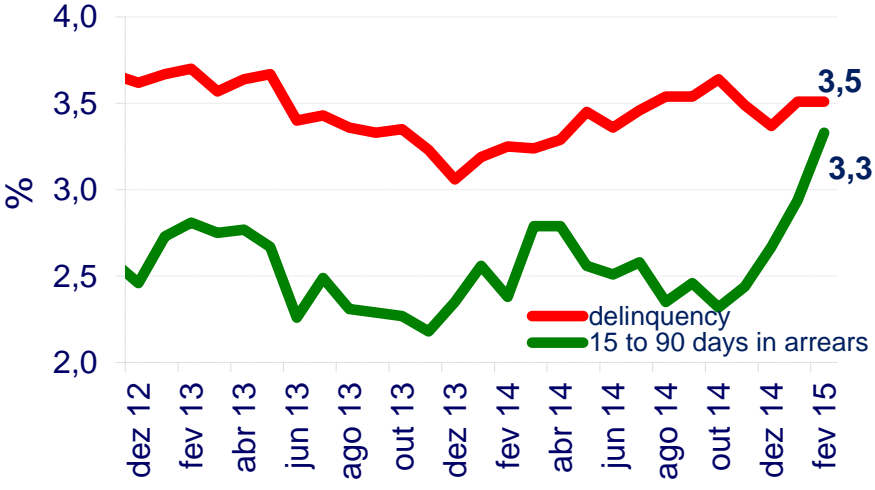
new methodology as of 2011; *Feb 15

Non-Earmarked Credit: Cost, Delinquency and Arrears

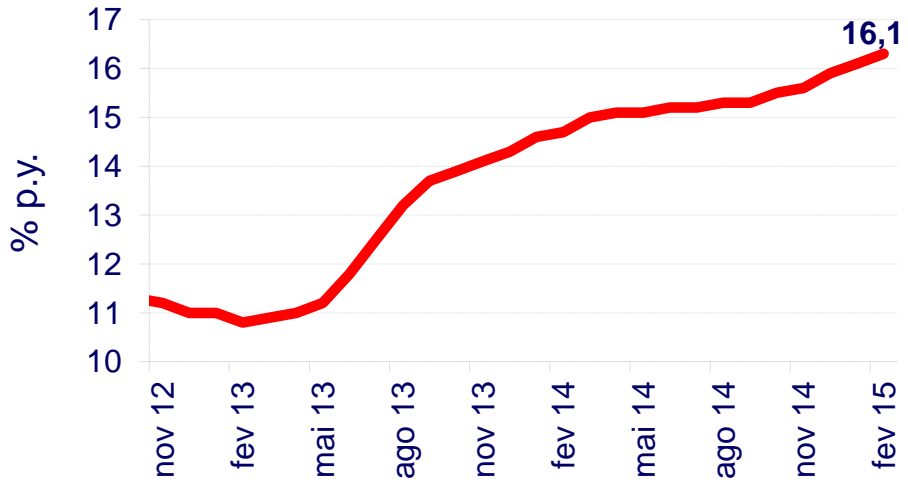
Interest Rate



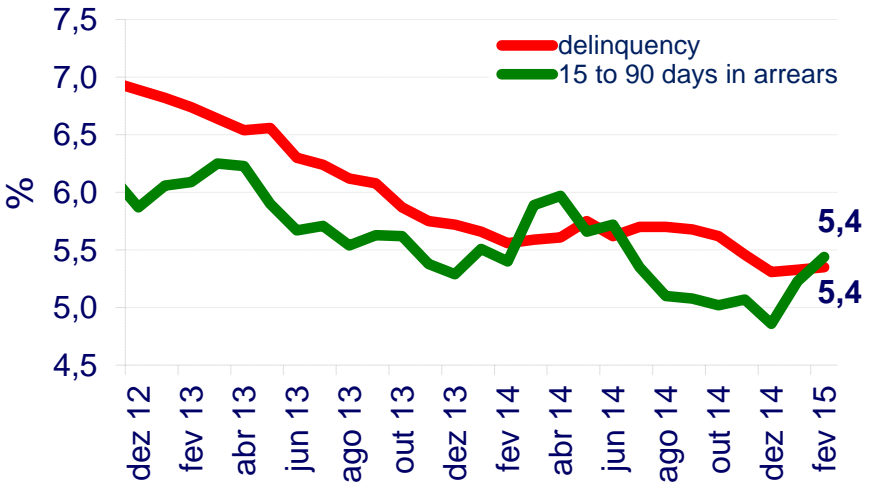
Corporates



Prime Rate

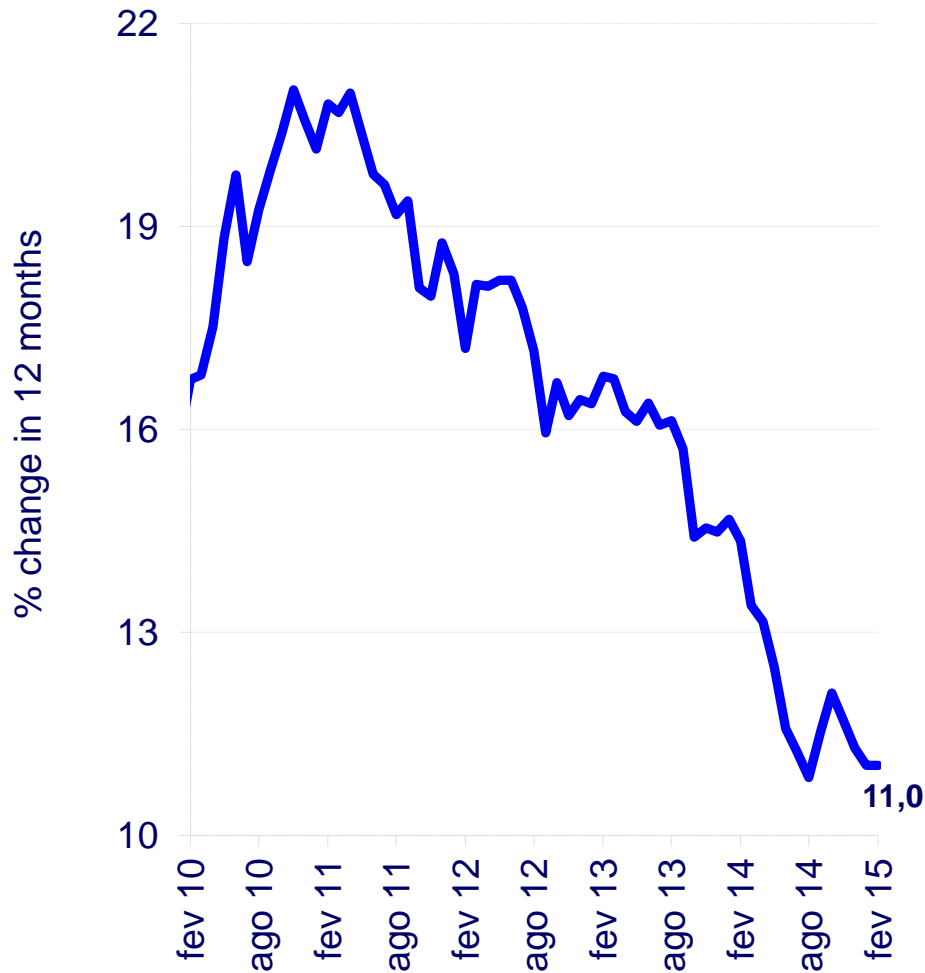


Individuals

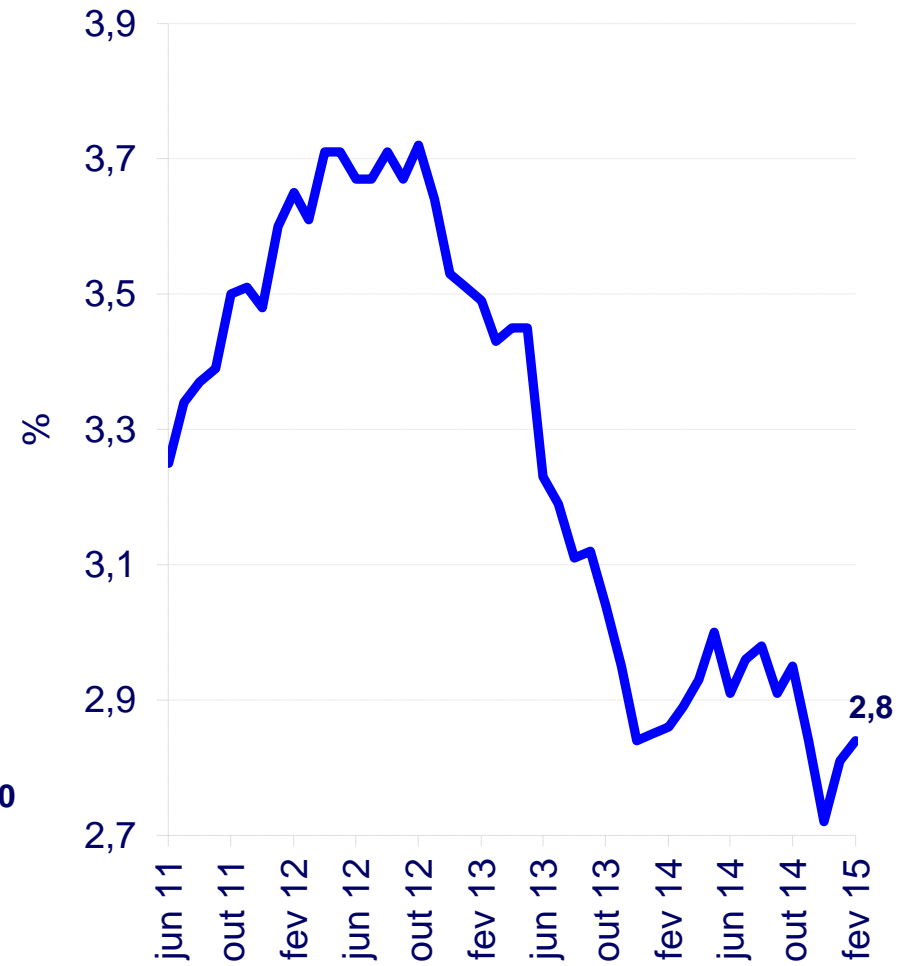


Credit Growth Has Slowed Down and Delinquency Rates Have Remained Low

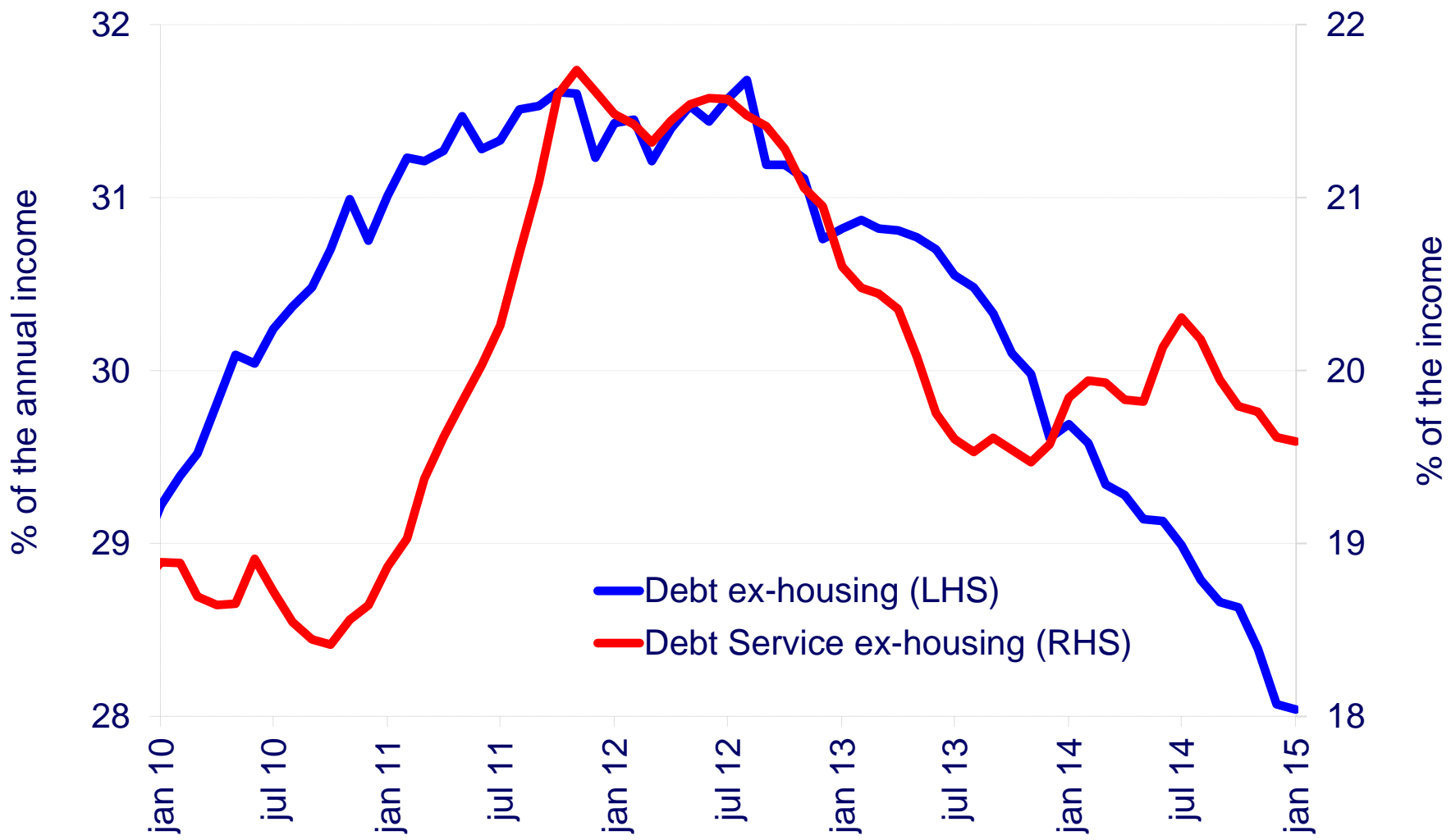
Expansion of Credit Outstanding



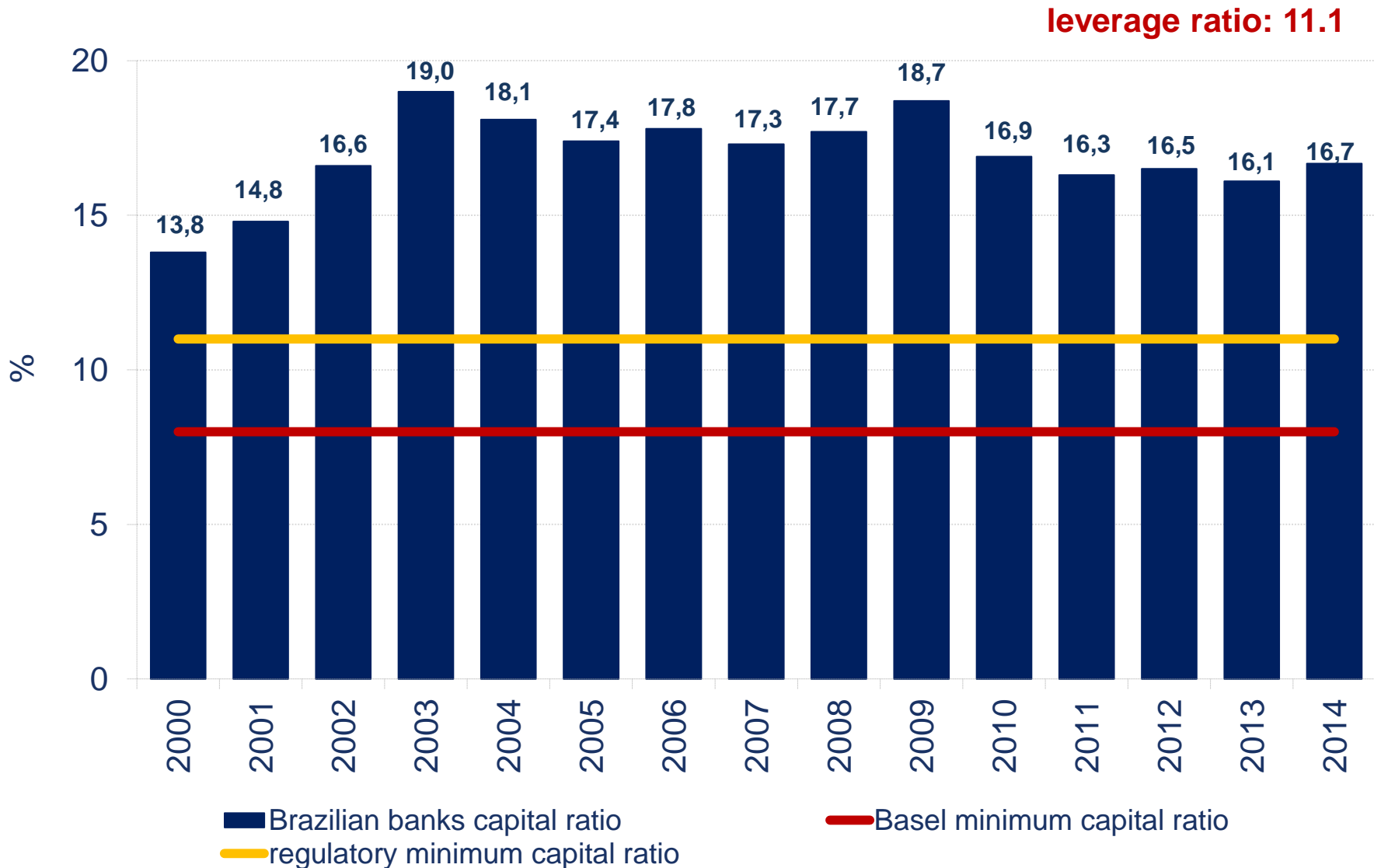
Delinquency



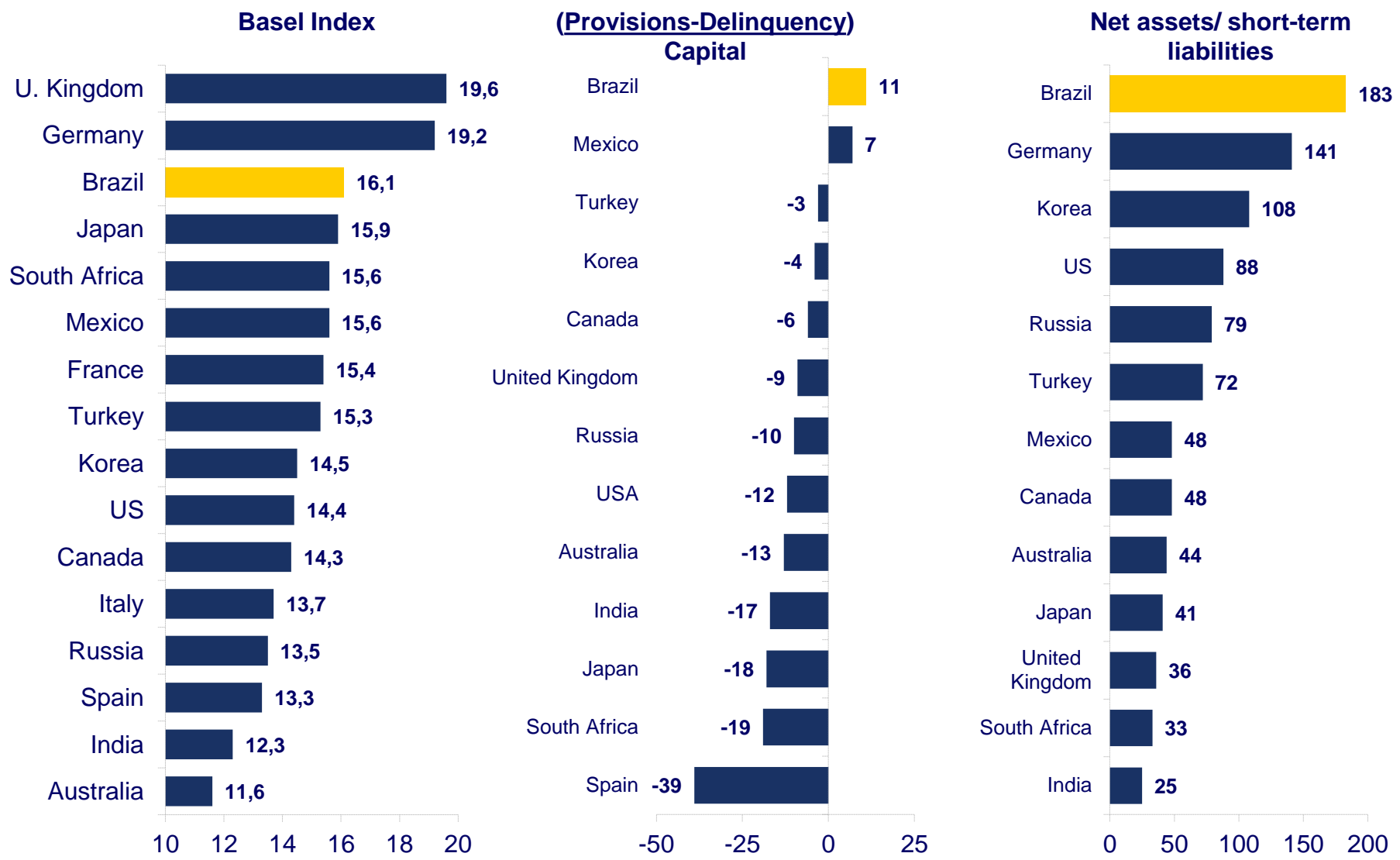
Declining Households' Debt



Banks - Capital Adequacy Ratio



Financial Soundness Indicators



Source: IMF (FSI – last available data)

Global Economy Swings & Strong Financial Sector

- Brazil's strong market infrastructure (CCPs, TRs) allows intrusive supervision to timely map systemic risk: mandatory registration of financial instruments (loans, derivatives, etc.);
- Robust Basel III compliant financial system (buffers-reserve requirements, capital, liquidity, provisions, profitability, etc.);
- Institutions for timely regulatory action: CMN, COREMEC, BACEN, CVM, new Financial Stability Committee;
- Risks to local financial stability closely monitored by regular tough stress-tests

III. Macroeconomic Adjustment in a transition year

Main Points: 2015 transition year with
adjustment of relative prices; tighter policies

Textbook Macroeconomic Adjustment in 2015

- Increasing revenue; cutting expenditure;
- Structural measures (pension, unemplt. benefits)
- Adjustment of relative prices:
 - Regulated versus market prices;
 - External versus domestic prices;
- Monetary tightening:
 - 550 basis-point increase so far;
 - Contain second-order effects of changes in relative prices

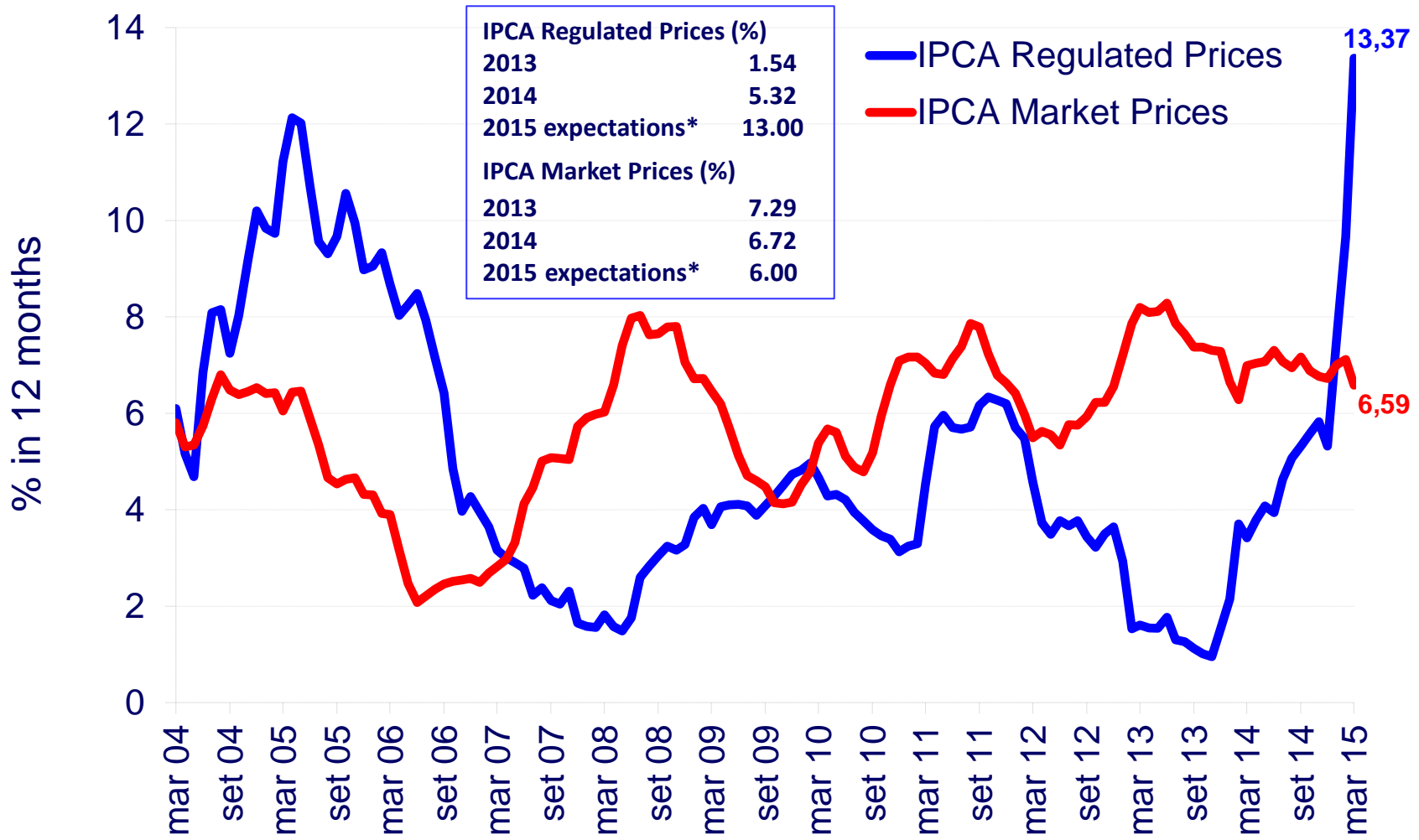
Textbook Macroeconomic Adjustment in 2015

- The adjustment is textbook and necessary; strengthens our policy framework; continues to prepare us for the next steps by the FED;
- Objective is to strengthen fundamentals and prepare for new cycle of sustainable growth
- 2015 will be a transition year

Frontloaded Fiscal Consolidation

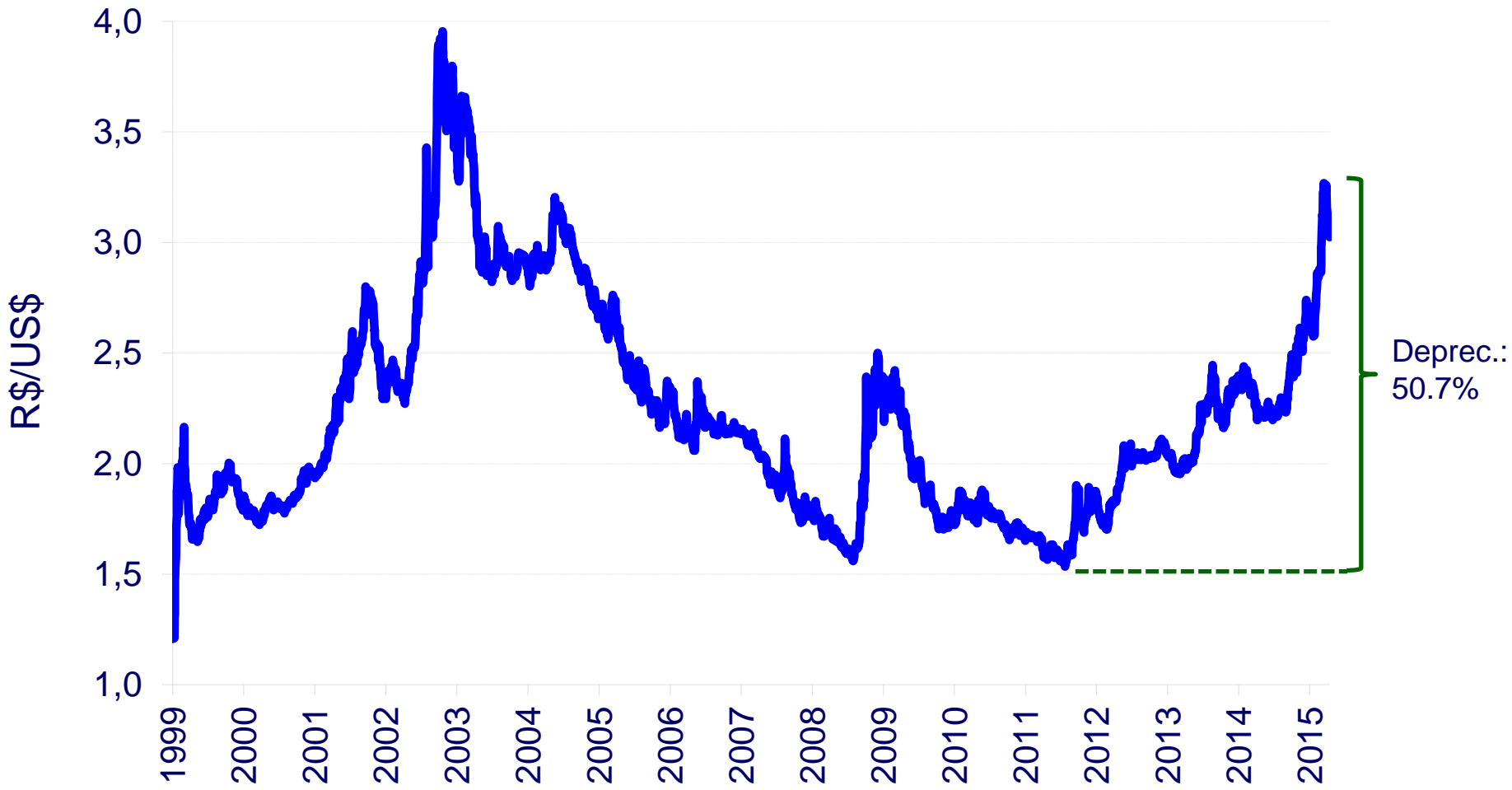
- From a -0.6% primary fiscal result in 2014, to a 1.2% target for 2015 and at least 2.0% for 2016 and 2017;
- Aims at stabilizing and then reducing public debt;
- Reduces distortions, risk spreads and uncertainties in the economy; increases national savings;
- Aligned with monetary policy

Ongoing Adjustment of Relative Prices



* data on April 10th

Depreciation of the Nominal Exchange Rate



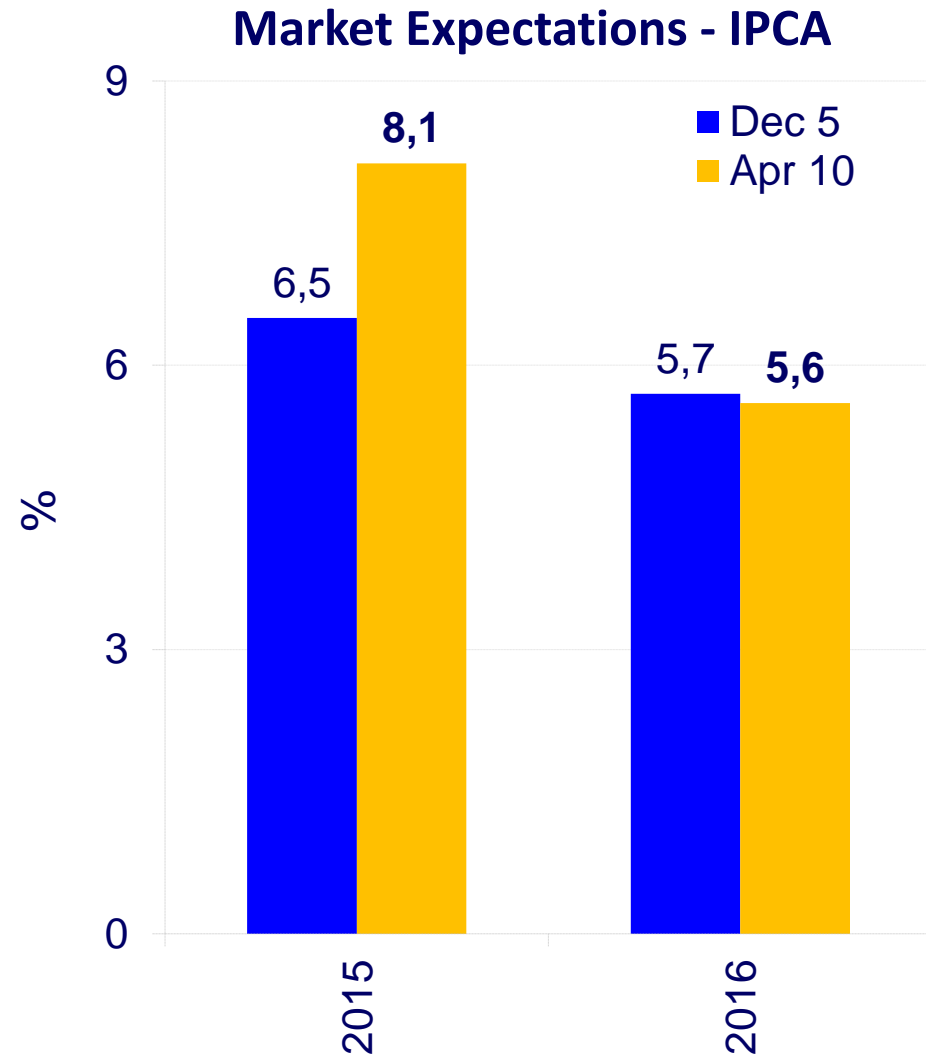
data through April 16th

Monetary Tightening

- 2015 inflation reflects in large part the relative price adjustments; BCB expects 11.0% inflation for regulated prices in 2015;
- Most of the adjustment in regulated prices is concentrated in 2015 Q1; Y-o-y inflation will be affected until Feb. 2016; consequently, inflation expectations for 2015 have increased;
- The objective is to limit this impact to 2015 and contain the second-order effects through monetary policy

... Adjustment Have Not Impacted 2016 Expectations

- Inflation expectations for 2016 have not shown significant changes;
- And they have shown stability in the last weeks



Falling Medium and Long-Term IPCA Expectations

Annual IPCA inflation expectations (Focus median)

	2015	2016	2017	2018
Jan 2	6.56	5.70	5.50	5.50
Apr 10	8.13	5.60	5.00	5.00
change	1.57 p.p. ↑	-0.10 p.p. ↓	-0.50 p.p. ↓	-0.50 p.p. ↓

Intensification of the relative prices adjustment
 Macroeconomic policy acting in the medium and long term expectations

Monetary Tightening

- Expectations, from the BCB and analysts, are that inflation in 2016 will be significantly lower than in 2015;
- BCB evaluates that the scenario of inflation convergence to 4.5% in 2016 has strengthened;
- However, progress made in combating inflation – such as more benign signals from medium and long-term expectations indicators – is still **not sufficient**

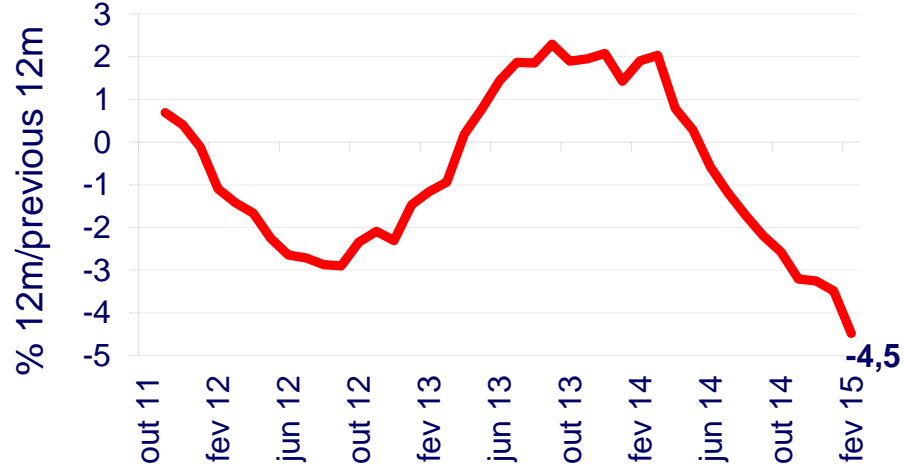
Monetary policy has been, is and will remain vigilant to ensure the convergence of inflation to the 4.5% target by December 2016

IV. Activity

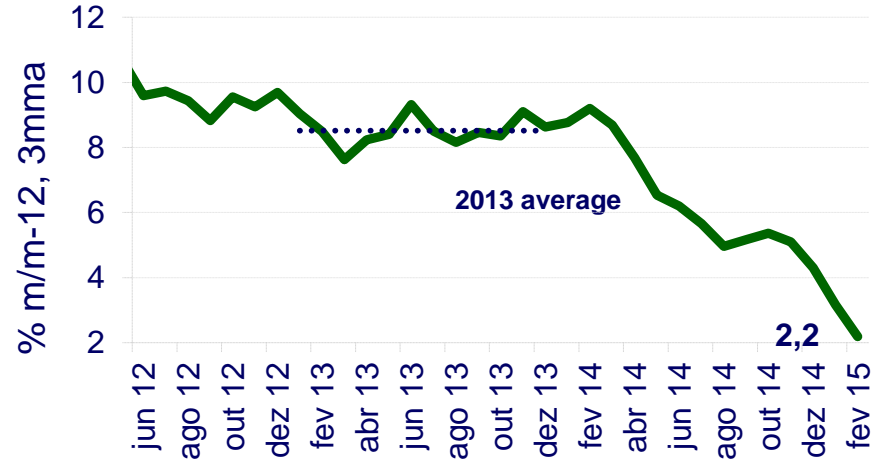
Main points: Macroeconomic adjustment takes a toll on short-term growth but improves medium-term prospects

Supply

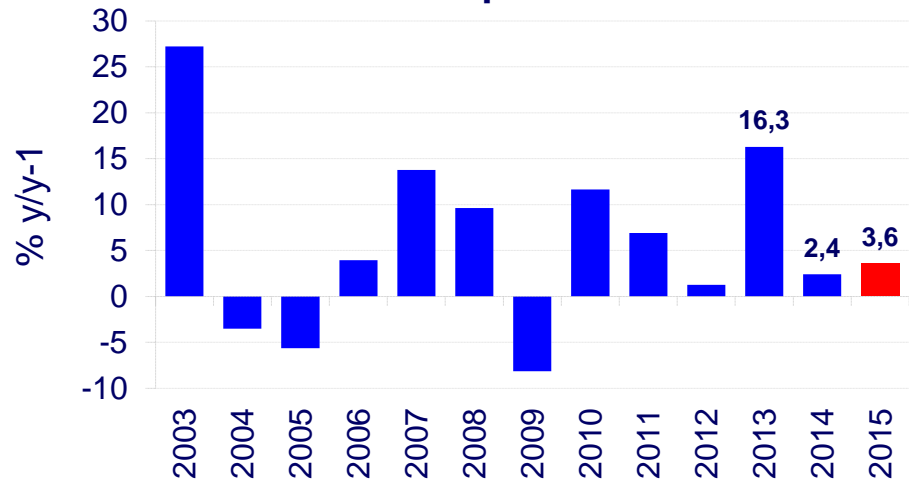
Industrial Production



Services Nominal Income

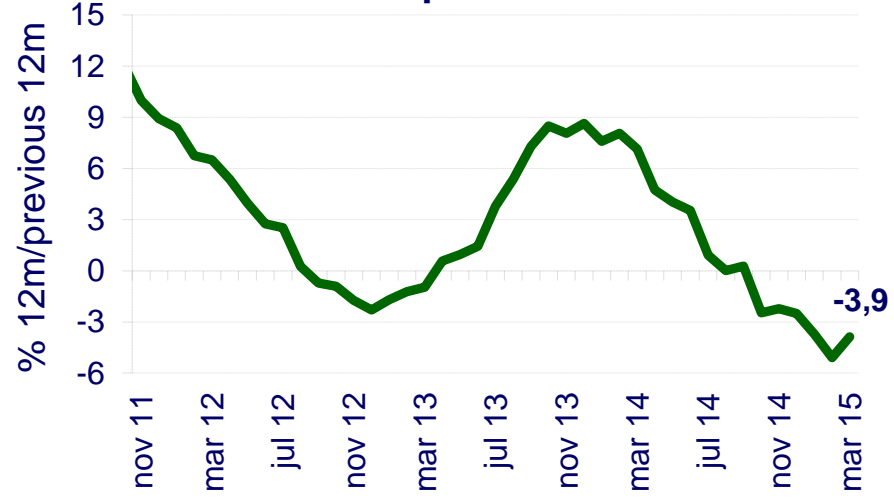


Crop Harvest



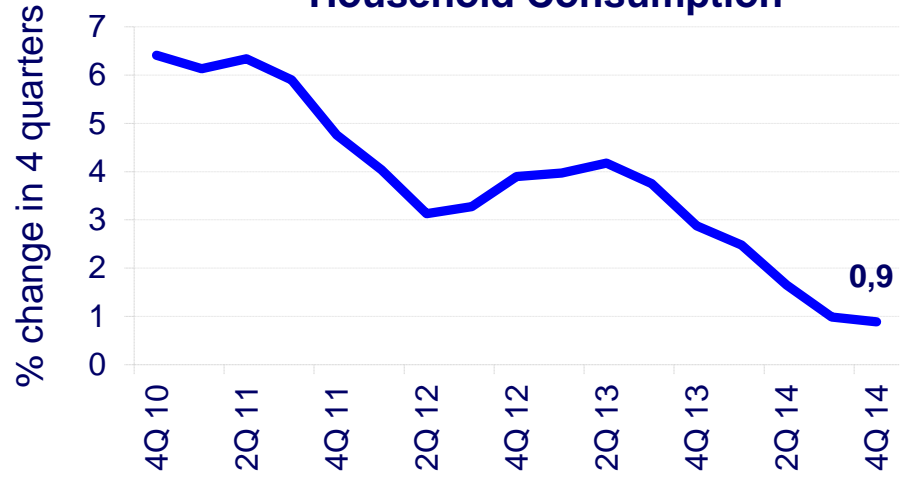
2015: IBGE estimates in Apr/15

Imports Quantum

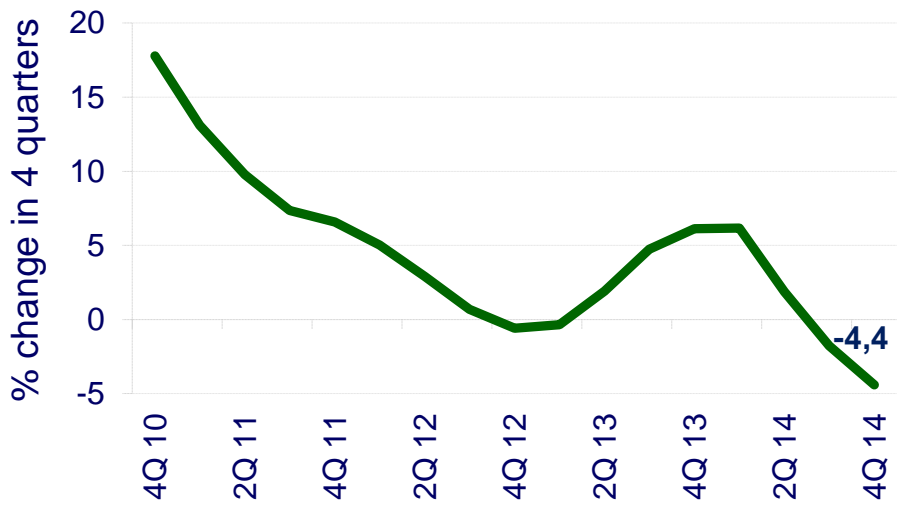


Demand

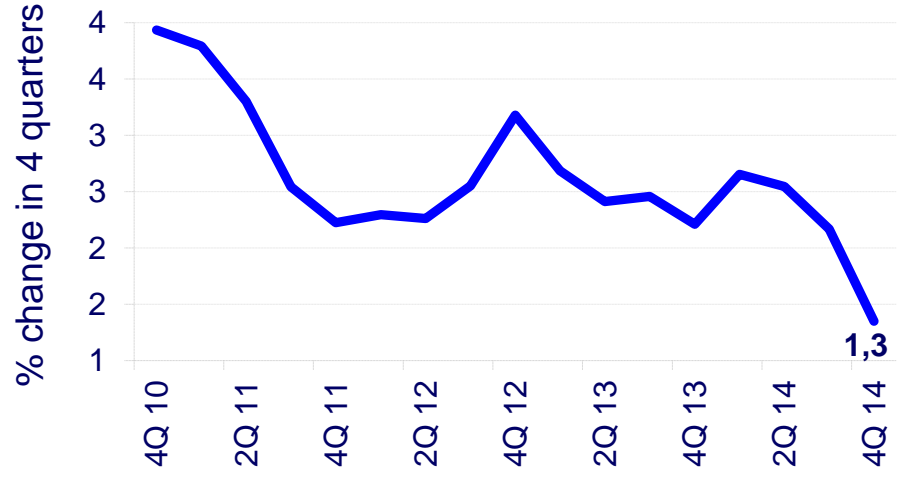
Household Consumption



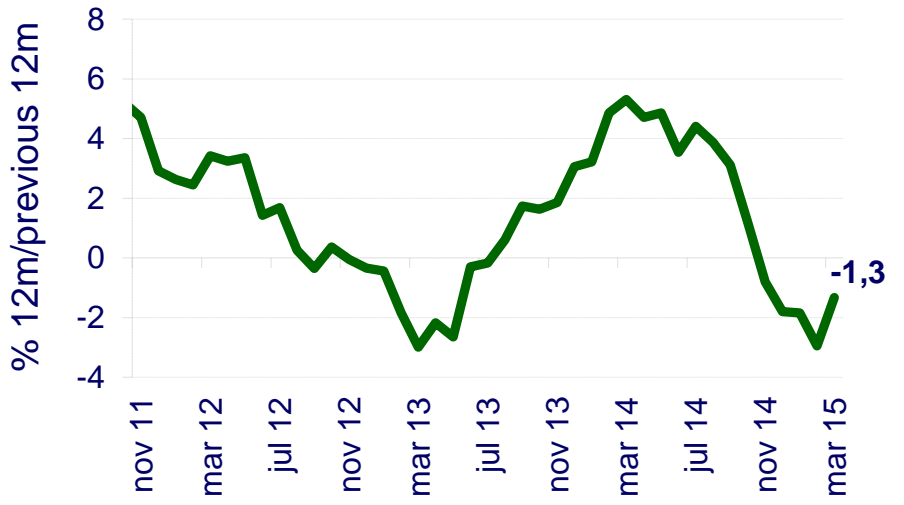
FGCF



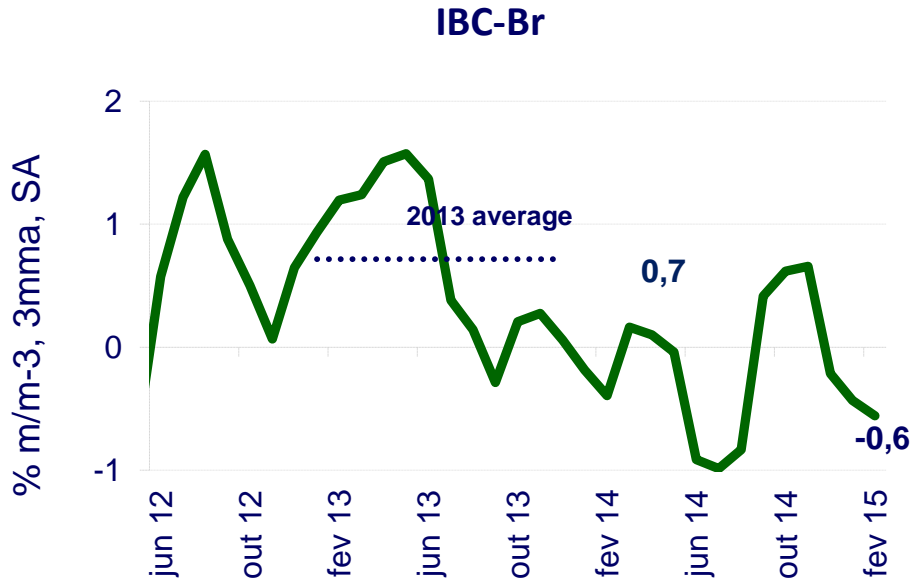
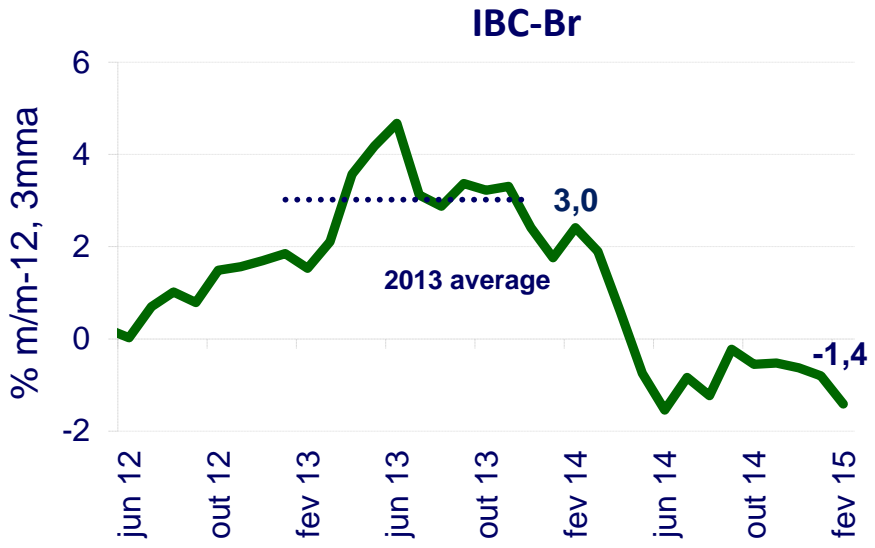
Government Consumption



Exports Quantum

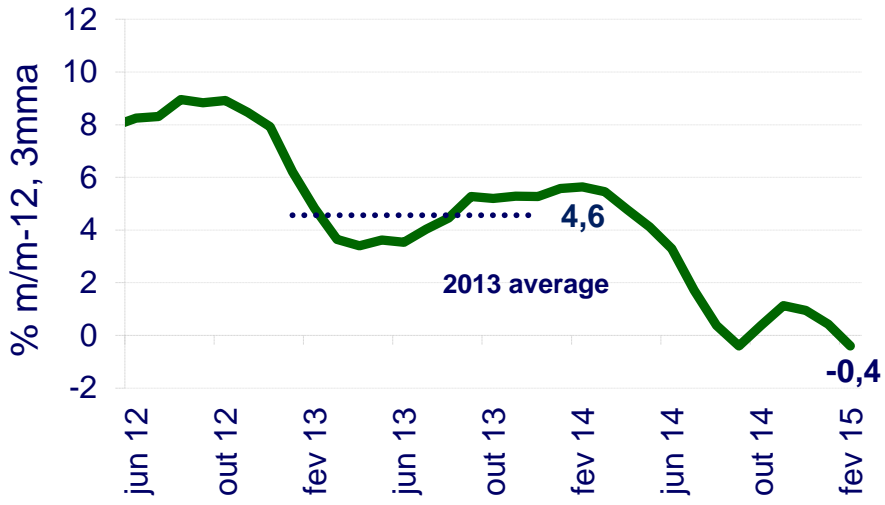


Brazilian Economic Activity Index (IBC-Br)

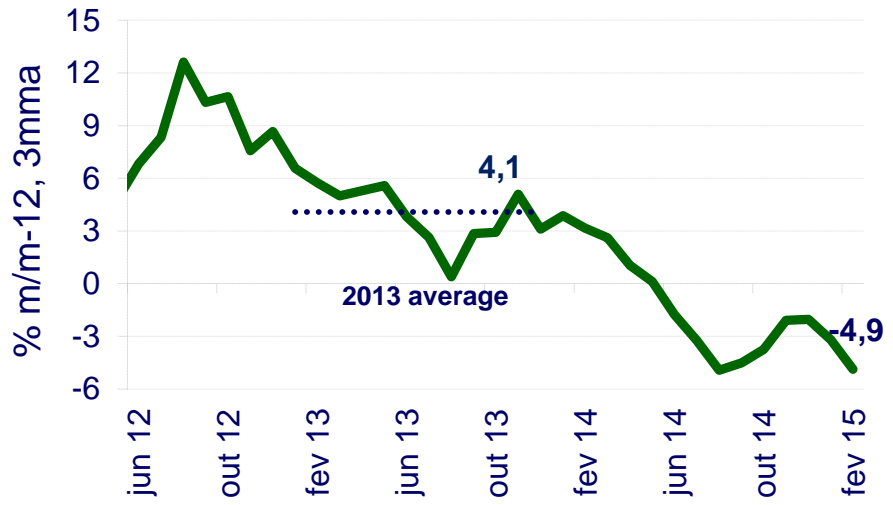


Sales Volume

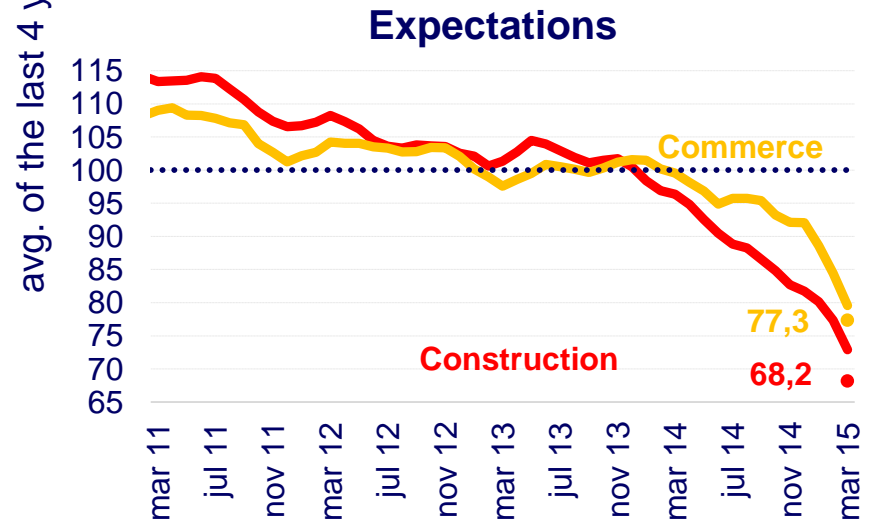
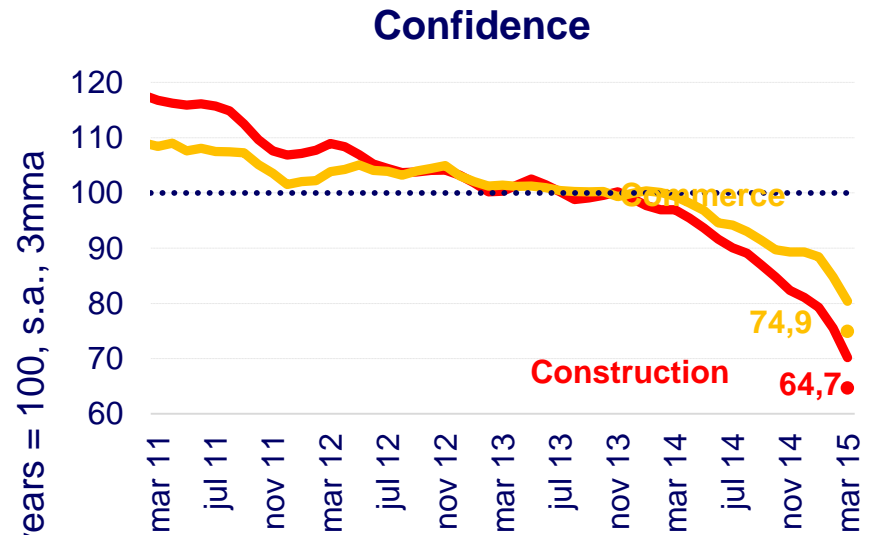
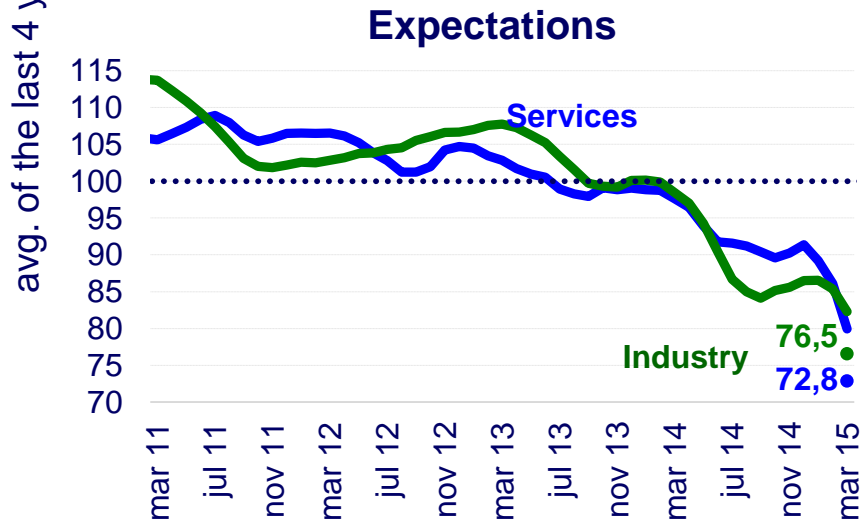
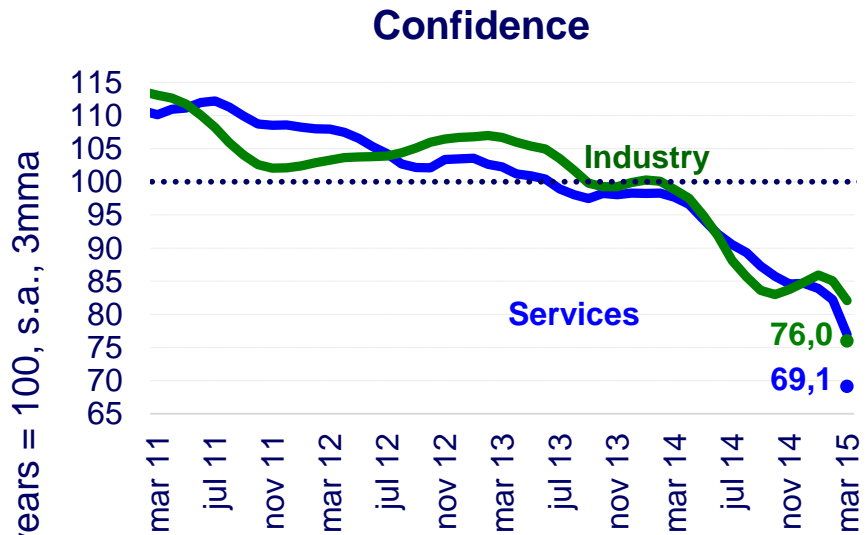
Retail sales



Broad retail sales



Confidence



Obs.: Proportion of favorable answers – proportion of unfavorable answers + 100 (100=neutral)

Labor Market

- Vigilant Monetary Policy focusses with determination to meet our objective
- But it's worth reflecting about measures of “adjustment outcomes” using several approaches for Phillips Curve
- Brings different perspectives about “feasibility” of the current adjustment process

Labor Market

- Alves and Correa (2013)*: evidence that HP filtered unemployment gaps aggregate Phillips curves estimates suggest “small” effect of unemployment on inflation;
- However, disaggregation for prices of non-tradables/tradables (of Phillips curve and inflation) seems to strengthen role of unemployment gap on inflation;
- New results show that the labor market does have significant impact on the inflation dynamics, especially through the non-traded goods sector.

(*). See, Alves S. and Correa A. “Um Conto de Três Hiatos: Desemprego, Utilização da Capacidade Instalada da Indústria e Produto, Working Paper 339, BCB, 2013.

(Output, Unemployt.) Gap Coefficient, Big or Small?

Table 1: Estimated Parameters

	M_S	M_0	M_A
<i>Phillips Curve: Non-Traded Goods</i>			
π_{t-1}^{fr}	0.367*** (0.065)	0.358*** (0.079)	0.357*** (0.066)
$E_t \pi_{t+1}^{nt}$	0.609*** (0.063)	0.618*** (0.081)	0.619*** (0.064)
π_{t-1}^*	0.024** (0.012)	0.024* (0.014)	0.024** (0.012)
\hat{u}_t^{hp} or \hat{u}_t	-0.306*** (0.067)	-0.166 (0.131)	-0.314*** (0.066)
de_t	0.380*** (0.124)	0.373*** (0.140)	0.371*** (0.127)
<i>Phillips Curve: Traded Goods</i>			
π_{t-1}^{fr}	0.445*** (0.121)	0.436*** (0.126)	0.446*** (0.121)
$E_t \pi_{t+1}^{tr}$	0.485*** (0.118)	0.493*** (0.123)	0.484*** (0.117)
π_{t-1}^*	0.070*** (0.016)	0.072*** (0.017)	0.070*** (0.016)
\hat{c}_{t-2}^{hp} or \hat{c}_{t-2}	0.145*** (0.049)	0.148* (0.087)	0.145*** (0.049)
de_t	1,154*** (0.240)	1,155*** (0.250)	1,156*** (0.242)
$shtr_{t-1}$	0.068*** (0.017)	0.069*** (0.022)	0.068*** (0.017)
$\log(\sigma_{nt}^2)$	-11.250*** (0.258)	-10.973*** (0.340)	-11.261*** (0.256)
$\log(\sigma_{tr}^2)$	-9.434*** (0.654)	-9.404*** (0.575)	-9.435*** (0.660)
$\log(\sigma_{fr}^2)$	-10.419*** (0.714)	-10.389*** (0.717)	-10.423*** (0.705)
$\log(\sigma_d^2)$	-14.977*** (0.714)	-	-14.977*** (0.714)
<i>Log-likelihood Step 1</i>	597.850	589.007	598.298
<i>Log-likelihood Step 2</i>	535.666		536.794

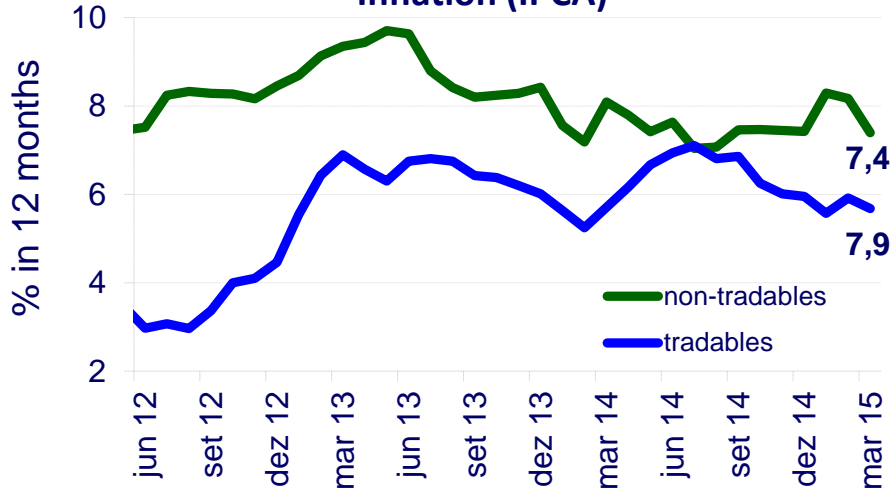
Note: Sample: 1999Q3 – 2012Q4

V. Inflation Developments

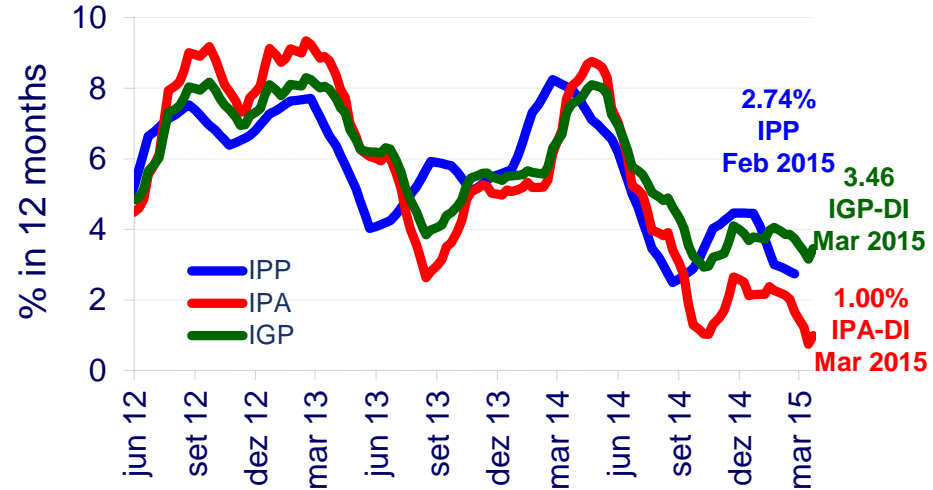
The double relative prices adjustment (regulated and external) increased Q12015 inflation and 2015 expectations; improvement of the monthly inflation will already begin to be felt in April-May 2015

Prices

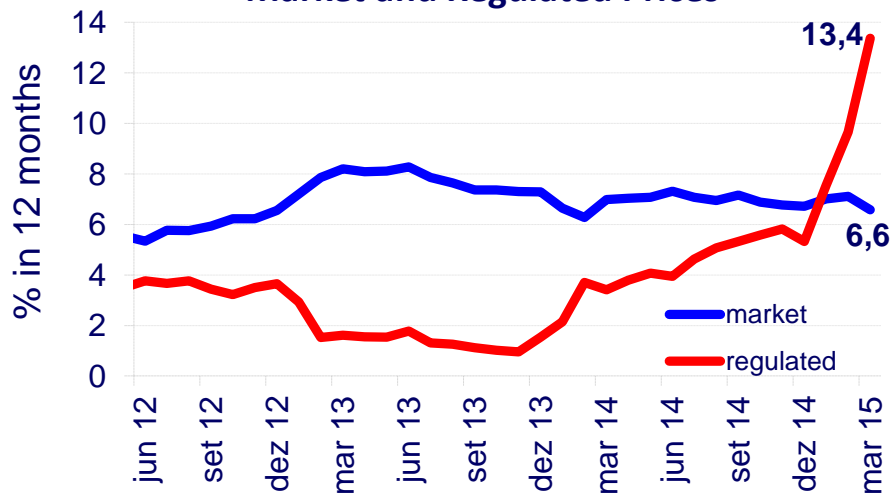
Inflation (IPCA)



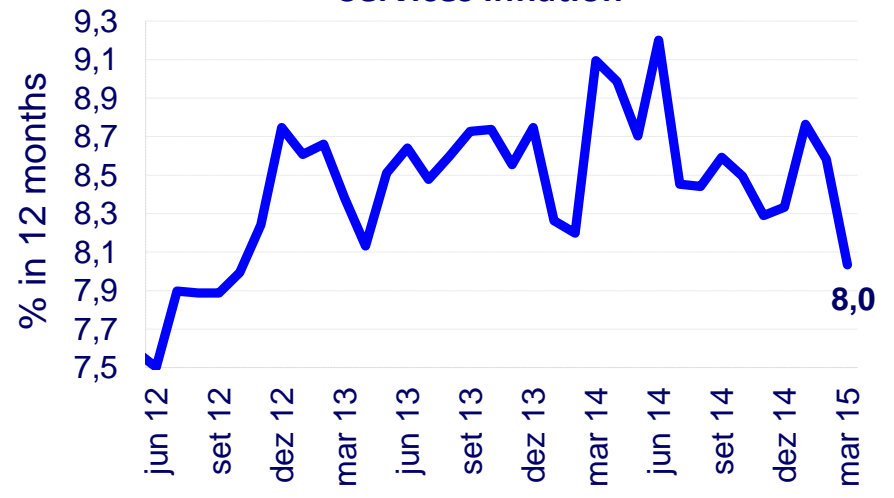
Wholesale Prices and IGP



Market and Regulated Prices



Services Inflation



	Actual*			Estimate		
	April Month	Accumulated		April		June 12 months
		Year	12 meses	Month	12 months	
IPCA-15* / IPCA	1.07	4.61	8.22	0.77	8.24	8.19
IGP-10* / IGP-DI	1.27	2.98	3.46	1.00	4.03	6.27
IPA-10* / IPA-DI	1.45	2.47	1.49	1.12	1.76	5.24

* IPCA-15 and IGP-10 of April

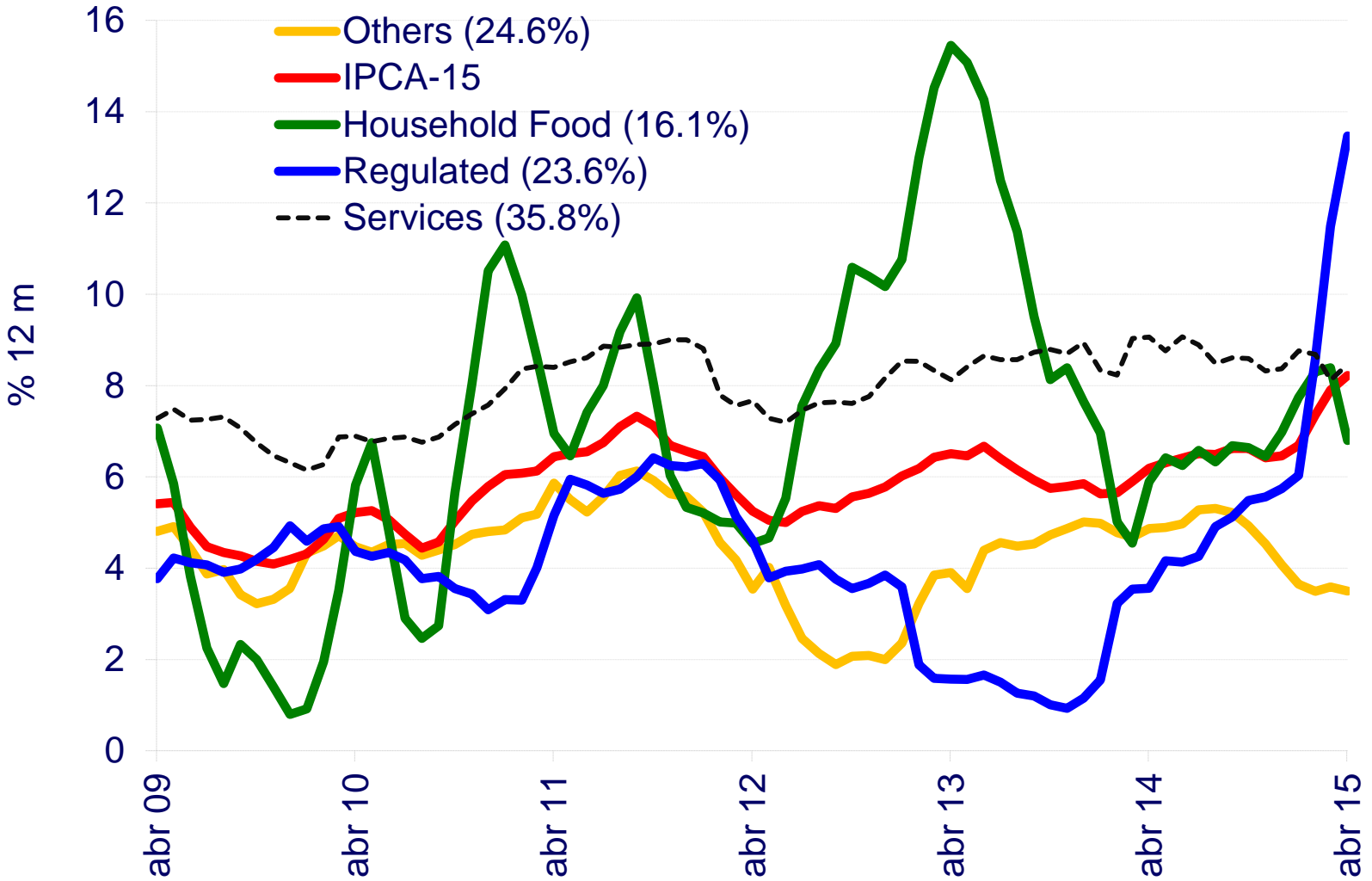
1 – Main influences observed in April (IPCA-15 and IPA-10):

- Consumer Elevation: Electric energy, Food, Milk and Milk derivatives, Maids
Fall: Fixed Telephone Tariffs, Personal Care, Alcohol
- Producer Elevation: Soybeans, Chemical products, Basic Metallurgy, Vegetable oils and products, Bovines
Fall: Oil and Alcohol by-products, Potato, Beans, Manioc, Rice

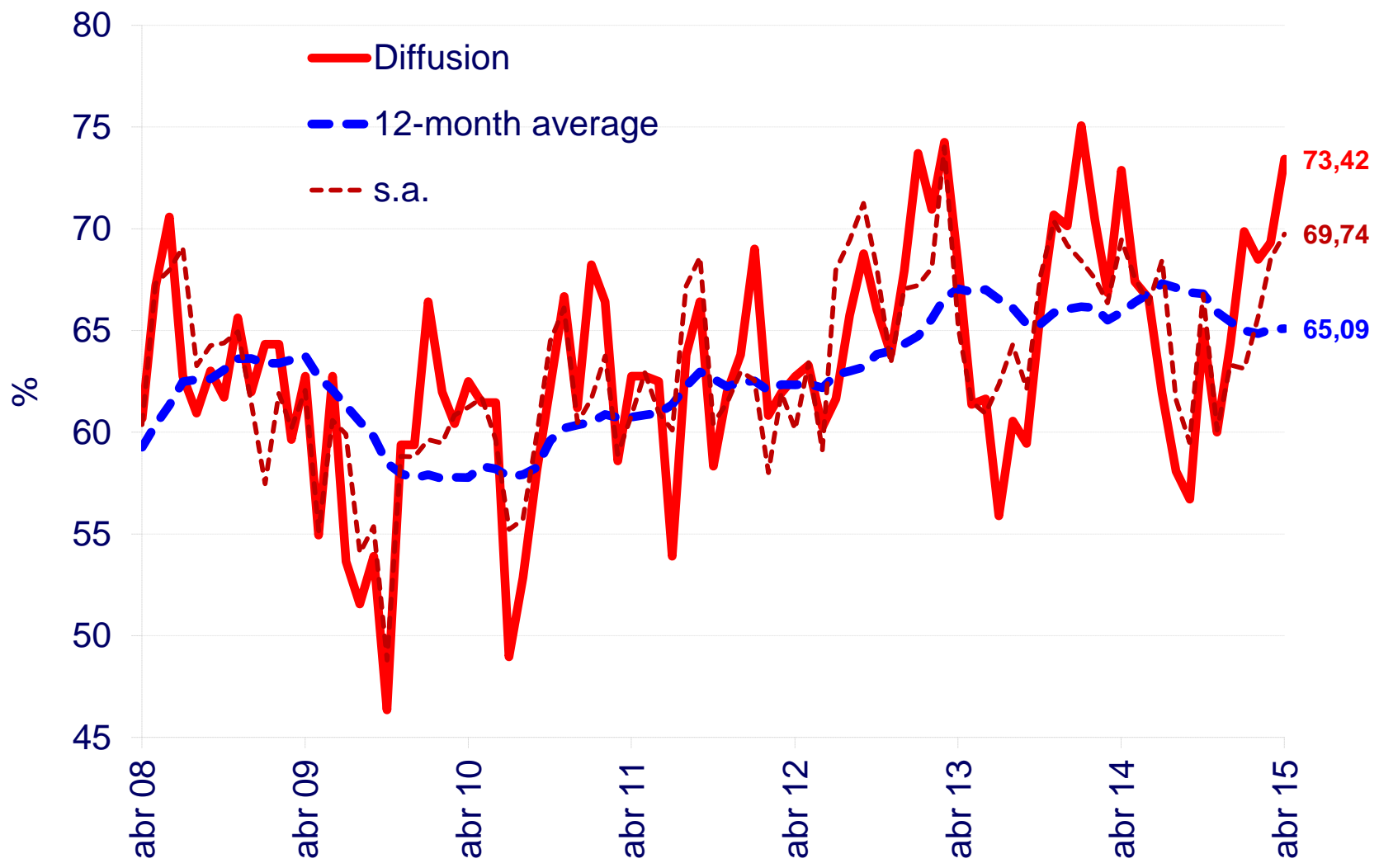
2 – Main influences expected for April (IPCA and IPA-DI):

- Consumer Elevation: Pharmaceutical products, Food out of home, Electric energy, Air fares
Fall: Gasoline, Ethanol, Personal care, Used Automobiles
- Producer Elevation: Food products, Chemical products, Soybeans, Tomato, Bovines
Fall: Oil and Alcohol by-products, Potato, Beans, Manioc, Eggs

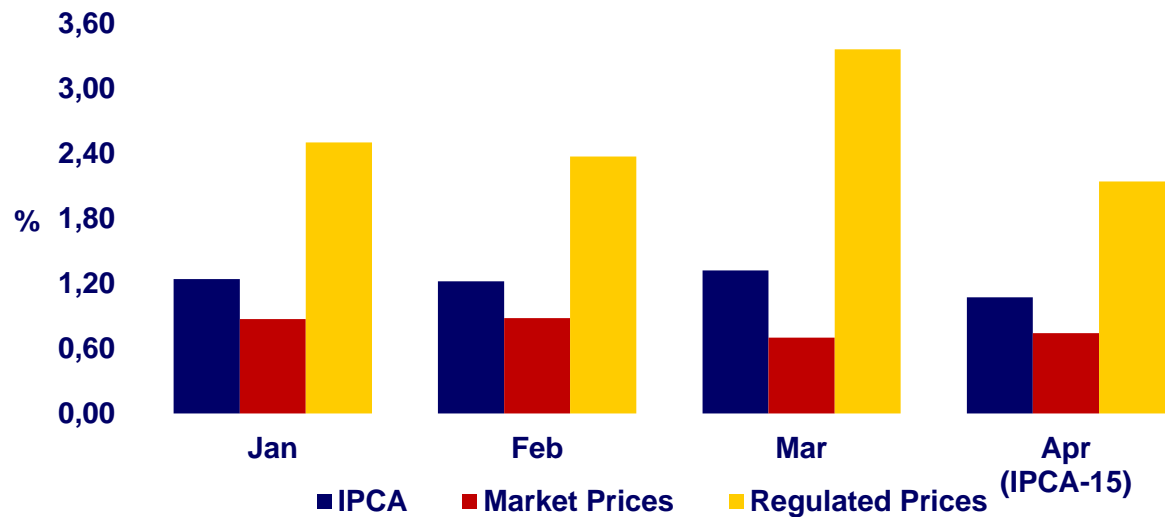
IPCA-15 Decomposition



IPCA-15 Diffusion



IPCA – Monthly Changes



Selected segments

	Weights	Dec 14	Jan 15	Feb 15	Mar 15	Apr 15
IPCA	100.0	0.78	1.24	1.22	1.32	1.07
Food	24.9	1.08	1.48	0.81	1.17	1.04
Housing	14.9	0.51	2.42	1.22	5.29	3.66
Clothing	6.2	0.85	-0.69	-0.60	0.59	0.94
Health and personal care	11.1	0.47	0.32	0.60	0.69	0.73
Personal expenses	10.8	0.70	1.68	0.86	0.36	0.57
Transportation	18.8	1.38	1.83	2.20	0.46	0.33
Education	4.8	0.07	0.31	5.88	0.75	0.14
Market	76.7	0.88	0.87	0.88	0.70	0.74
Regulated	23.3	0.43	2.50	2.37	3.36	2.14

BCB Inflation Forecasts

Baseline Scenario: Interest rate constant at 12.75% p.y. and exchange rate of R\$3.15/US\$

Period	Probability Interval						Central projection
	50%						
	30%				10%		
	80%	70%	60%	50%	40%	30%	
2015 1	8.0	8.0	8.0	8.1	8.1	8.2	8.1
2015 2	7.6	7.8	8.0	8.1	8.3	8.4	8.0
2015 3	7.6	7.8	8.1	8.3	8.5	8.8	8.2
2015 4	7.2	7.5	7.8	8.1	8.4	8.7	7.9
2016 1	4.9	5.3	5.7	6.0	6.4	6.8	5.9
2016 2	4.4	4.8	5.2	5.5	5.9	6.3	5.4
2016 3	4.0	4.4	4.8	5.2	5.5	5.9	5.0
2016 4	3.9	4.3	4.7	5.1	5.4	5.8	4.9
2017 1	3.7	4.1	4.5	4.8	5.2	5.6	4.7

Obs.: 12-month accumulated inflation (% p.y.).

*data of March 13th

BCB Inflation Forecasts

Market Scenario*: 2015 Interest rate at 13.00% p.y. and exchange rate of R\$3.06/US\$
 2016 Interest rate at 11.50% p.y. and exchange rate of R\$3.11/US\$

Period	Probability interval						Central projection
	50%						
	30%				10%		
	80%	90%	100%	90%	80%		
20151	8.0	8.0	8.0	8.1	8.1	8.2	8.1
20152	7.6	7.8	8.0	8.1	8.2	8.4	8.0
20153	7.6	7.8	8.0	8.3	8.5	8.7	8.1
20154	7.1	7.4	7.7	8.0	8.3	8.6	7.9
20161	4.9	5.3	5.6	5.9	6.3	6.7	5.8
20162	4.4	4.8	5.1	5.5	5.8	6.2	5.3
20163	4.0	4.5	4.8	5.2	5.5	5.9	5.0
20164	4.1	4.5	4.9	5.2	5.6	6.0	5.1
20171	4.0	4.4	4.8	5.1	5.5	5.9	4.9

Obs.: 12-month accumulated inflation (% p.y.).

*data of March 13th

Prospects – Projections – 2014-2015-2016

➤ **GDP Projection:**

- 2015 GDP growth projected at -0.5%

➤ **Inflation projections:**

- Baseline scenario: 7.9% (2015) and 4.9 % (2016)
- Market scenario: 7.9 % (2015) and 5.1 % (2016)

Conclusions

- A frontloaded fiscal consolidation is underway, that, jointly with an on-going dual relative price adjustment, will help correcting our current account and fiscal deficits and restore higher private sector confidence;
- Monetary policy is, has been and will remain vigilant to ensure the convergence of inflation to the 4.5% target by the end of 2016;
- The adjustment will take a toll on short-run growth, but we will reap its benefits in the medium and long term

Brazilian Economic Outlook

Thank you!