



Inflation Outlook

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I. Introduction

BCB's Mission

- Ensuring the stability of the purchasing power of the currency and a solid and efficient financial system.

Importance of this Mission

- The international experience and the economic theory set low and stable inflation (stability of the purchasing power of money) as a precondition to sustainable growth.
 - **High inflation:**
 - It increases risk premiums, diminishes confidence, shortens the planning horizon and depresses investment;
 - Reduces employment, income and consumption; and
 - Increases the income concentration, diminishes the economic growth and the society welfare.

The Brazilian Experience

Period	Annual Average (%)	
	Real GDP Growth	Inflation
1980-1985	2.6	147.1
1986-1994	2.3	842.5
1995-2003	2.2	9.1
2004-2013	3.7	5.5

Retrospective - Abroad

Since the last Report release :

- The risks to global financial stability remained high
 - In the US, the process of normalization of monetary conditions has continued;
- The scenario of more intense global activity has confirmed, although the activity pace does not match the expectations in important emerging economies;
- Localized price pressures in the commodities markets, volatility episodes in the currency markets and geopolitical tensions were observed;
- In general terms, accommodative monetary policy stance remained, in the emerging and mature economies.

Retrospective - Brazil

Since the last Report release:

- National accounts relative to the first quarter of 2014 point to growth of 0.2%;
- In the market of factors: ICU in slight decline and narrow idleness margin in the labor market;
- Reversion in prices pressures identified in the food segment in the first quarter;
- Two important relative prices correction processes have advanced; and the consumer inflation remained high and still showing resistance; and
- The Selic rate increased 0.25% at the April Copom meeting and since then, it has stood at 11%.

Prospects – Abroad 2014-2015-2016

- Risks for the global financial stability tend to remain heightened, in particular, those deriving from changes in the slope of the interest curve in important mature economies;
- Prospects for more intense global activity pace throughout the relevant horizon for the monetary policy, with growth around the trend;
- Prospects of moderation in the dynamics of commodities prices, albeit localized prices pressures observed at the margin;
- New tension and volatility focuses in the currency markets are likely to be observed; and
- In the relevant horizon for the monetary policy, prospects for gradual increase of the global inflation.

Prospects – Brazil 2014-2015-2016

- Activity expansion pace tends to be less intense this year, compared to 2013;
 - At the margin, GDP growth below potential
 - Domestic absorption expansion and GDP rates in convergence
- In the relevant horizon for the monetary policy, changes in the composition of aggregate supply and demand are anticipated;
 - Composition of short-term growth tends to be more favorable to the potential growth
- Current accounts' deficit tends to continue to be essentially financed by FDI flows;
- Moderate credit expansion; and
 - Credit to consumption tends to grow at a pace in line with the growth of income available to households
- Moderation in wage gains.

Prospects – Brazil – 2014-2015-2016

- In the next quarters, projections indicate high twelve-month inflation;
 - Pressures in wage costs and ongoing realignment of relative prices (domestic *versus* external prices and regulated *versus* market prices)
- In the final quarters of the relevant horizon, inflation tends to enter a trajectory of convergence to the target
 - Pressures mentioned above tend to cool down; shift of the output gap to the disinflationary area; inflation expectations for longer terms are more favorable.

Prospects – Forecasts – 2014-2015

GDP Forecast:

- 2014 GDP growth estimate at 1.6%; and
- GDP growth estimate in four quarters up to March 2015 at 1.8%.

Inflation Forecasts:

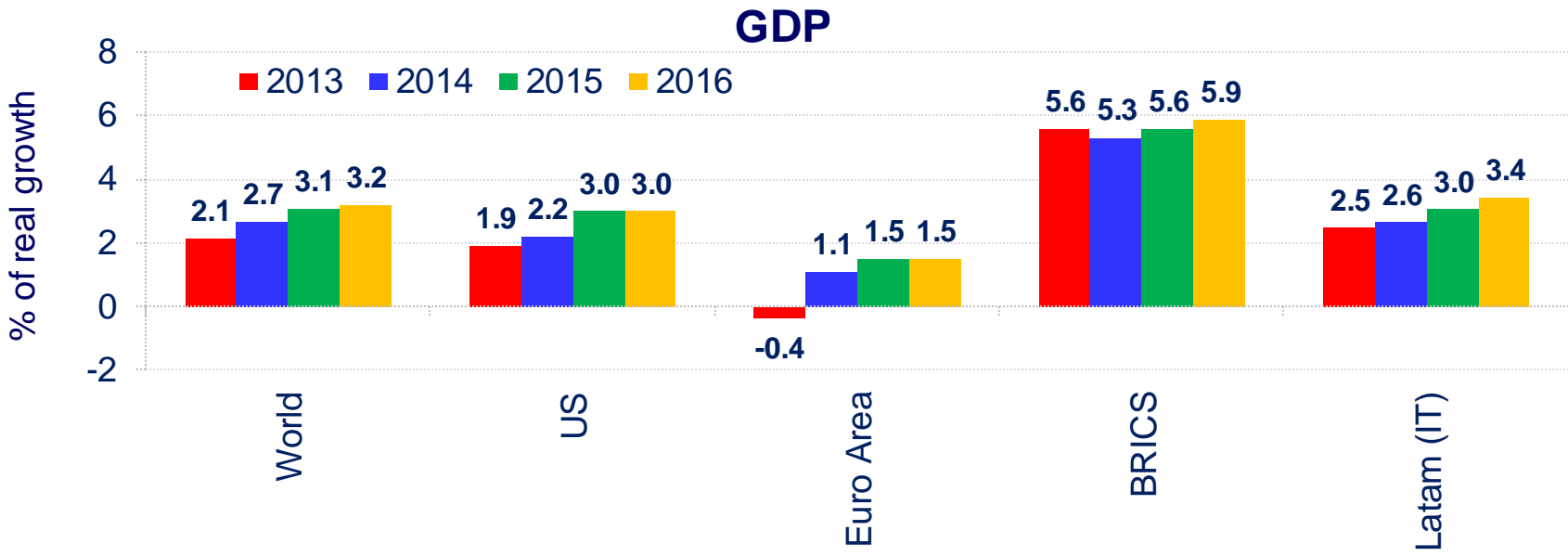
- Baseline scenario: 6.4% for 2014; 5.7% for 2015; and 5.1% in twelve months up to the second quarter of 2016; and
- Market scenario: 6.4% for 2014; 6.0% for 2015; and 5.0% in twelve months up to the second quarter of 2016.

Prospective Scenario – Monetary Policy

- The Copom highlights that, in moments such as the current one, the monetary policy should remain vigilant, in order to minimize risks that high inflation levels, such as the one observed in the last twelve months, persist in the relevant horizon for the monetary policy.

II. International Environment

Activity – Expectations

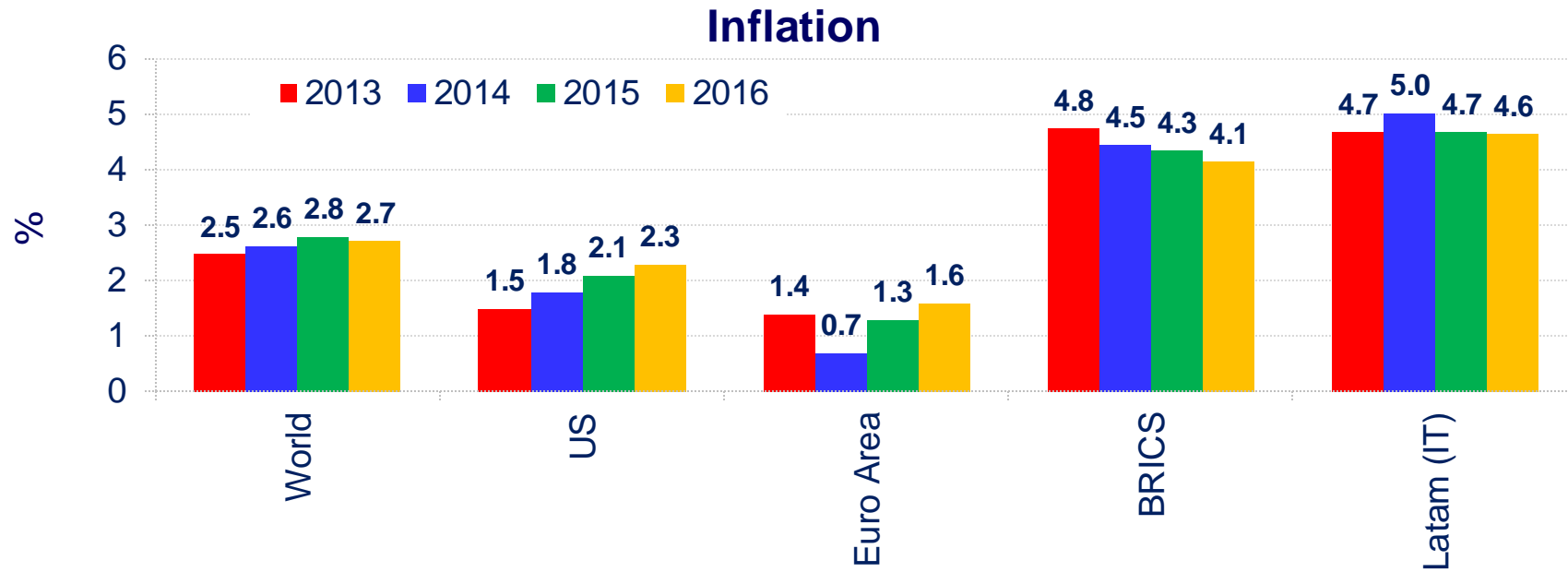


	2013		2014	
	Sep	Dec	Mar	Jun
EUA	2.7	2.6	2.7	2.2
Euro Area	1.0	1.0	1.1	1.1
Japan	1.6	1.6	1.4	1.5
UK	2.0	2.4	2.7	3.0
China	7.4	7.5	7.4	7.3
India	5.2	4.8	4.7	4.7
Brazil	2.2	2.0	1.7	1.2

	2013		2014	
	Sep	Dec	Mar	Jun
EUA	3.0	3.0	3.0	3.0
Euro Area	1.4	1.4	1.5	1.5
Japan	1.3	1.2	1.2	1.2
UK	2.4	2.4	2.5	2.5
China	7.2	7.2	7.2	7.2
India	6.0	5.5	5.4	5.4
Brazil	2.5	2.5	2.0	1.6

Sources: Bloomberg and Focus – last available day of each month

Prices – Expectations



Inflation 2014 (%)

	2013		2014	
	Sep	Dec	Mar	Jun
US	1.9	1.7	1.7	1.8
Euro Area	1.5	1.2	1.0	0.7
Japan	2.3	2.4	2.6	2.7
UK	2.3	2.2	2.0	1.8
China	3.1	3.1	2.7	2.5
India	8.7	9.2	9.5	9.5
Brazil	6.0	6.0	6.3	6.5

Inflation 2015 (%)

	2013		2014	
	Sep	Dec	Mar	Jun
US	2.2	2.0	2.0	2.1
Euro Area	1.5	1.5	1.4	1.3
Japan	1.6	1.8	1.8	1.8
UK	2.1	2.2	2.0	2.0
China	3.0	3.2	3.2	3.0
India	7.5	8.0	8.1	7.8
Brazil	5.5	5.5	5.8	6.1

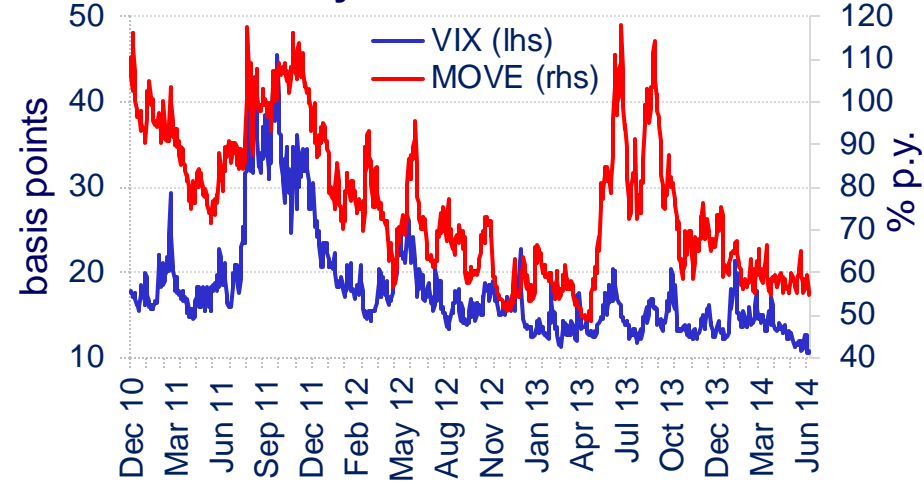
Sources: Bloomberg and Focus – last available day of each month

Commodities and Volatility

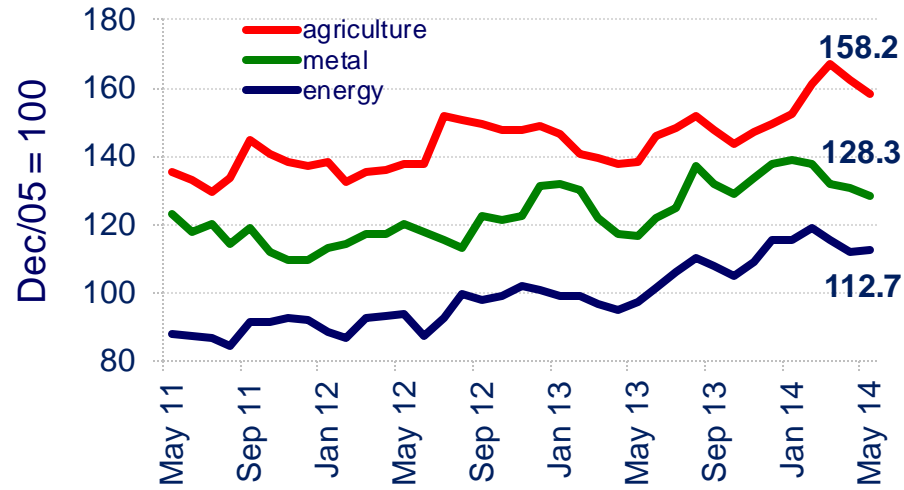
CRB



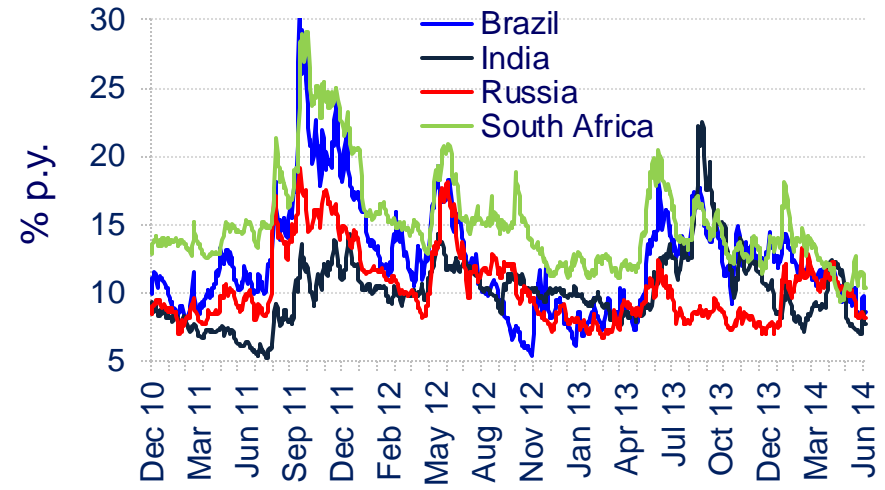
VIX and Volatility in the Securities' Markets



IC-Br (R\$)



Currency Volatility



data up to 6/20

Interest Rate and Risk Premium

Brazil – 10-Year Interest Rate

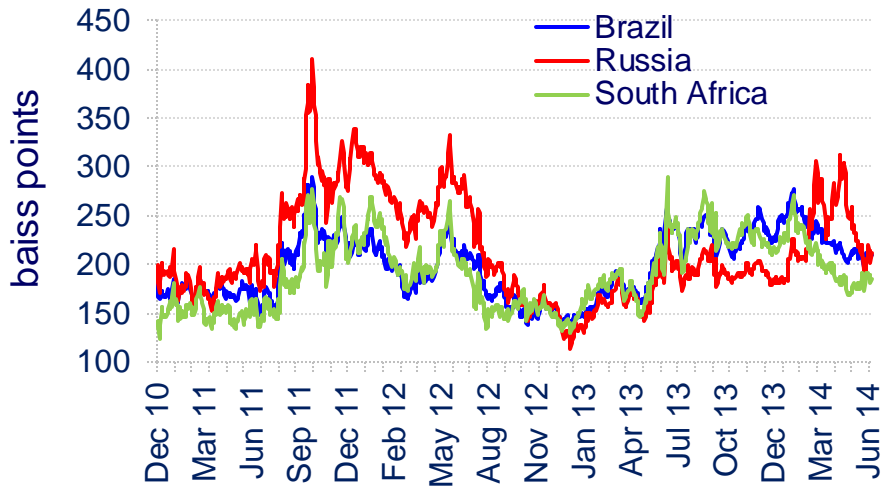


Ratings

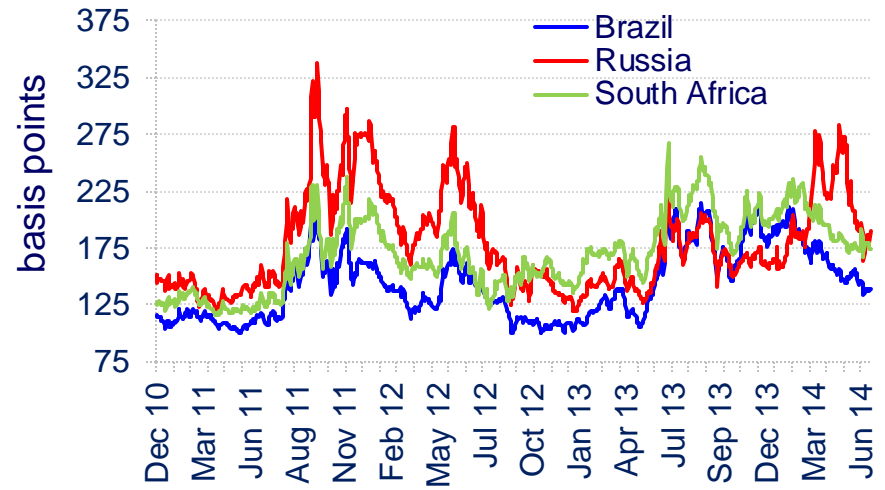
	Moody's	S&P	Fitch
Brazil	Baa2 (=)	BBB-(=)	BBB(=)
Russia	Baa1 (r)	BBB-(-)	BBB(-)
India	Baa3(=)	BBB-(-)	BBB-(=)
South Africa	Baa1 (-)	BBB-(=)	BBB(-)

= estable; - negative; r review

EMBI+



CDS

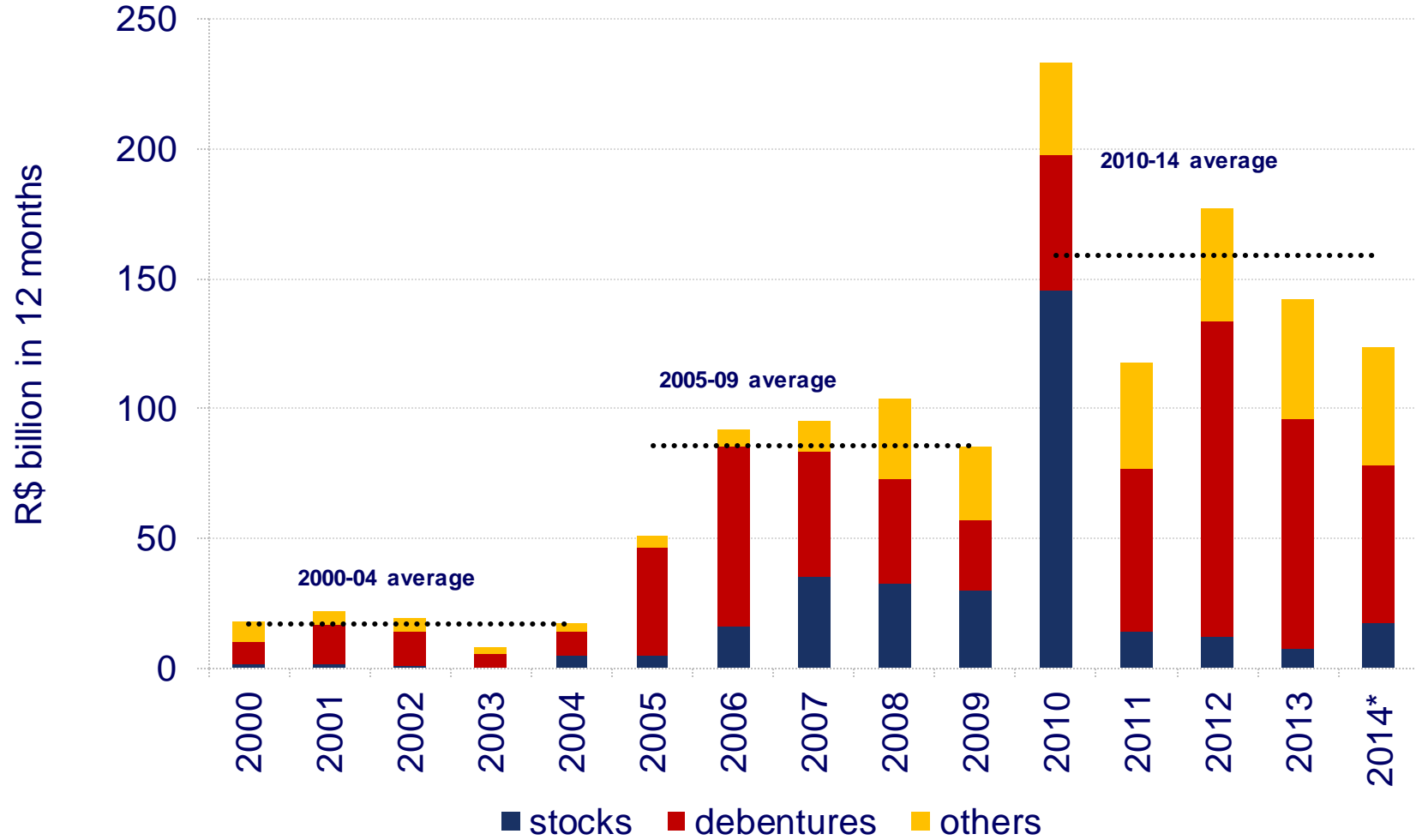


data up to 6/20

III. Financial Conditions

Capital Market Domestic Operations

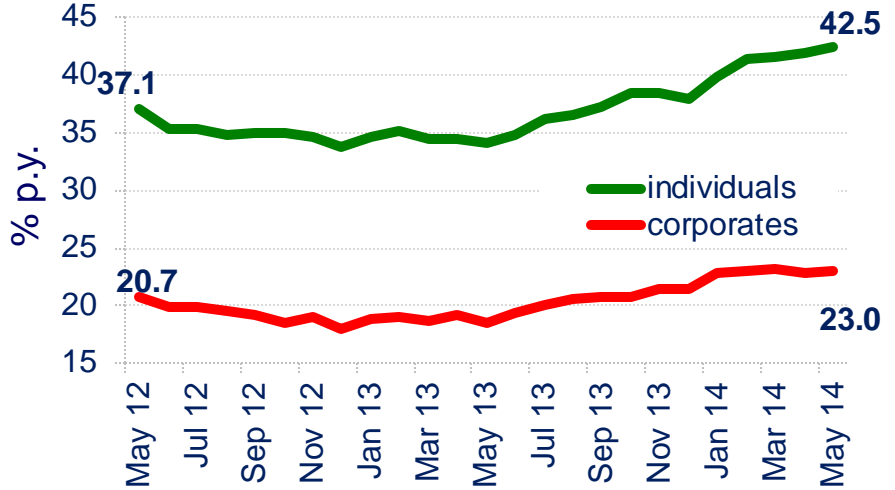
Primary Issues



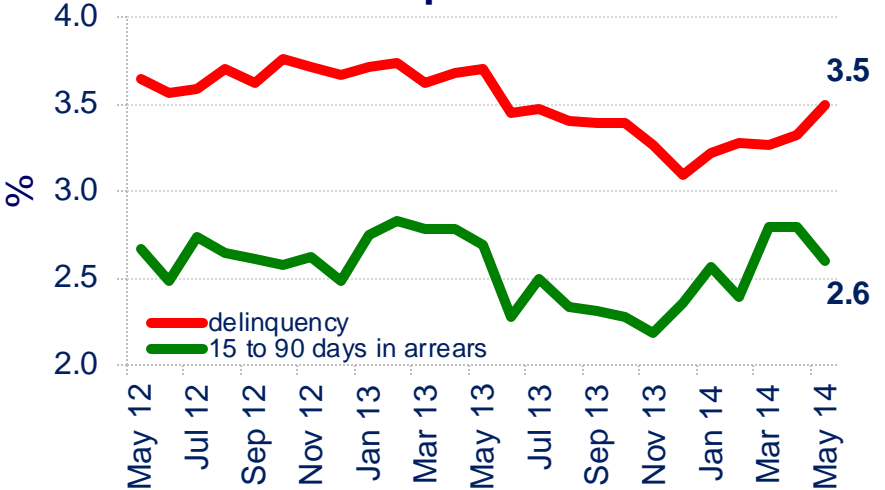
*12 months through Apr/14

Non-Earmarked Credit: Cost, Delinquency and Arrears

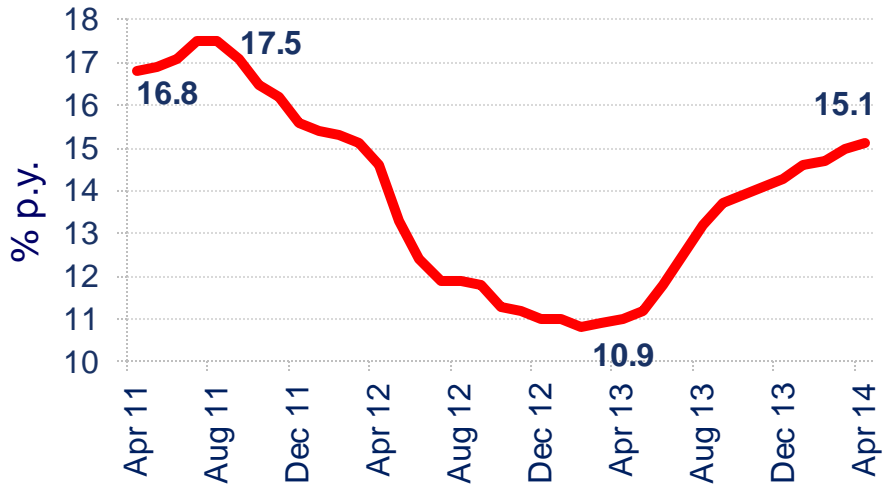
Interest Rate



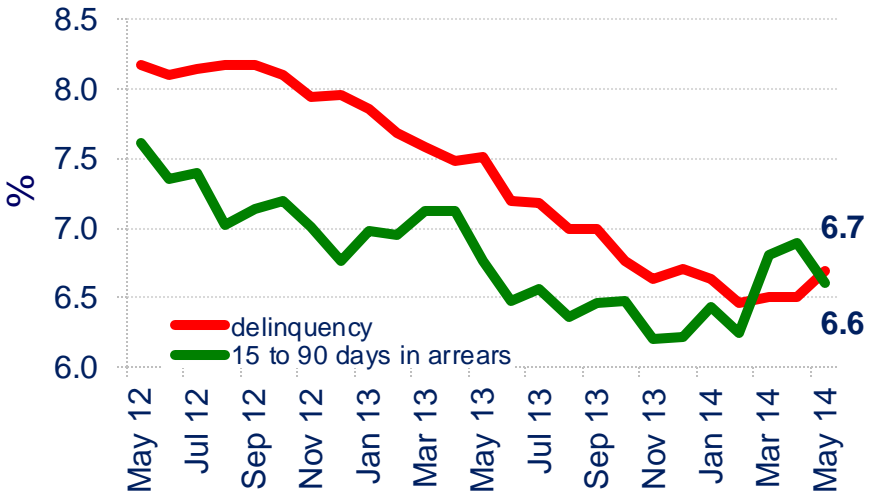
Corporates



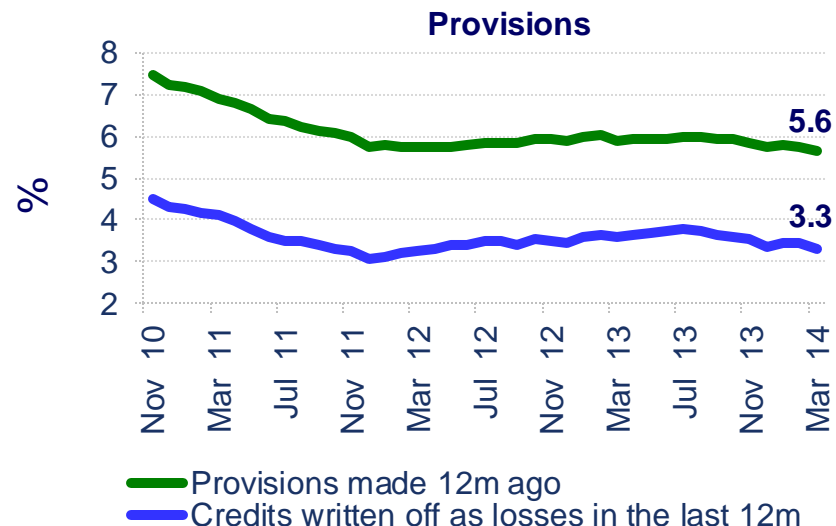
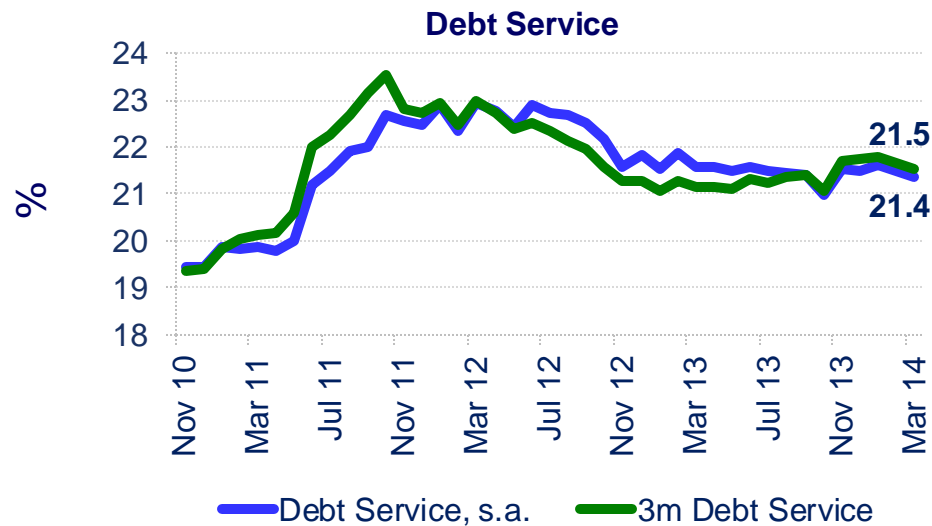
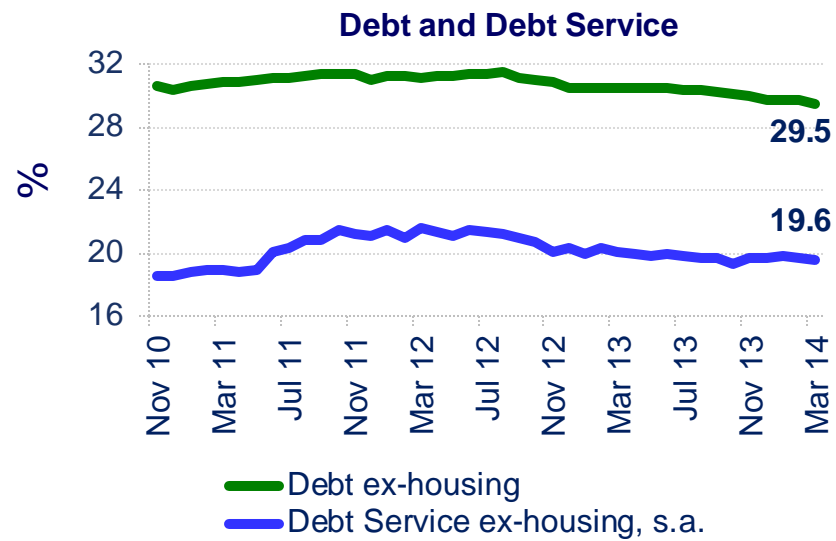
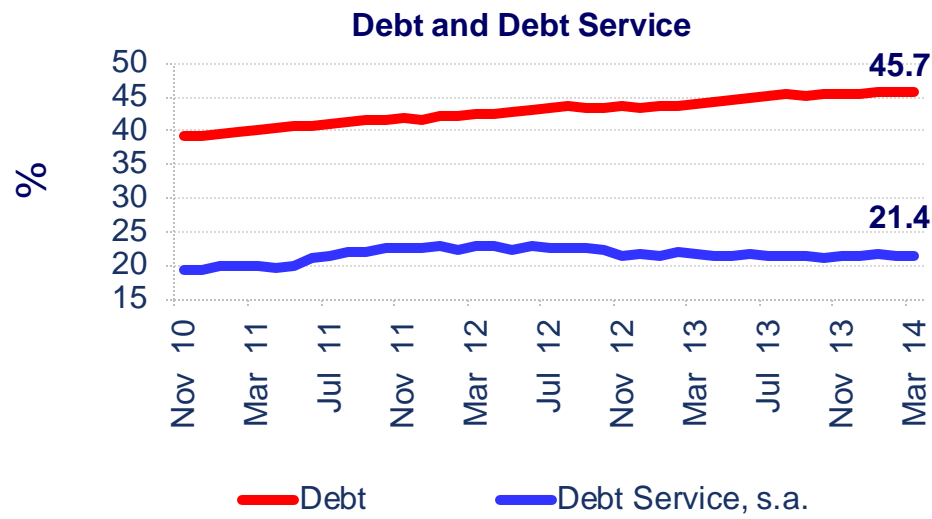
Prime Rate



Individuals



Household Debt and Provisions of the System



Source: BCB

IV. Activity

Box: GDP Forecasts

Growth revision, from 2% to 1.6%, in 2014 (domestic demand, 1.4 p.p.; and net exports, 0.2 p.p.);

Growth of 1.8% in the four quarters ended in March 2015;

- **Supply**

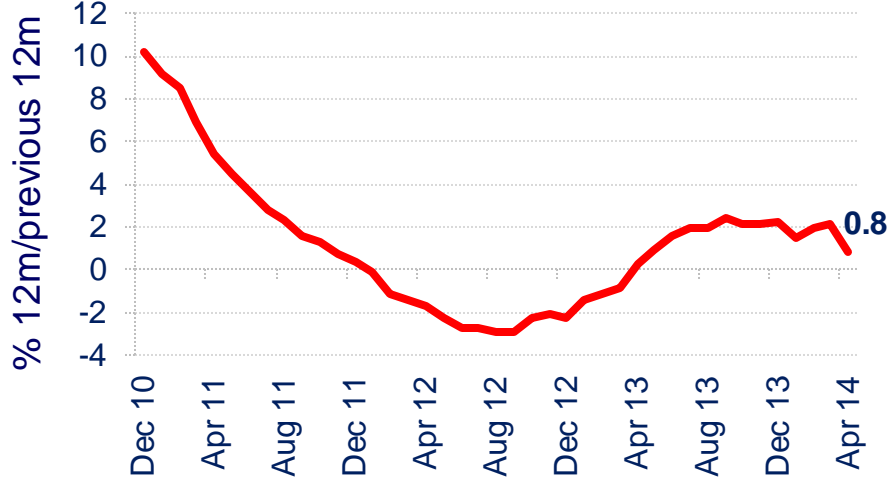
- Agriculture and livestock: 2.9% (4.8% in Q1/2014);
- Industry: 0.1% (2.1% in Q1/2014); and
- Services: 2.1% (2.2% in Q1/2014).

Demand

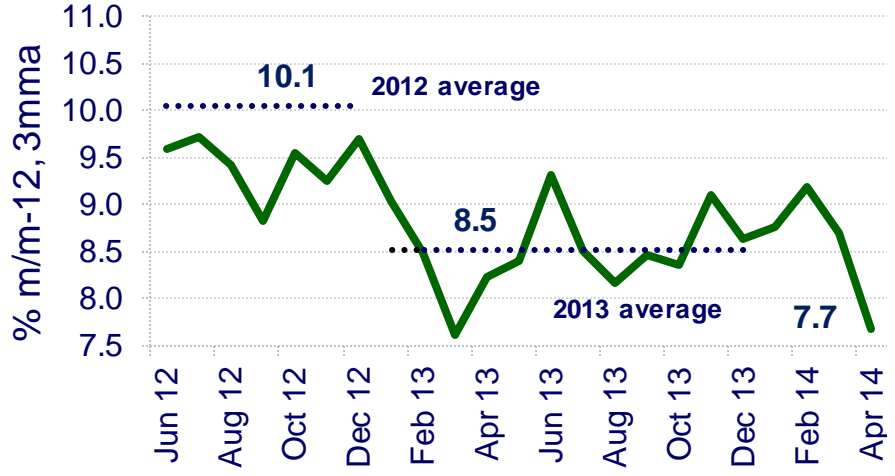
- Investments: -0.6% (4.1% in Q1/2014);
- Household Consumption: 1.9% (2.5% in Q1/2014); and
- Government Consumption: 1.8% (2.2% in Q1/2014).

Supply

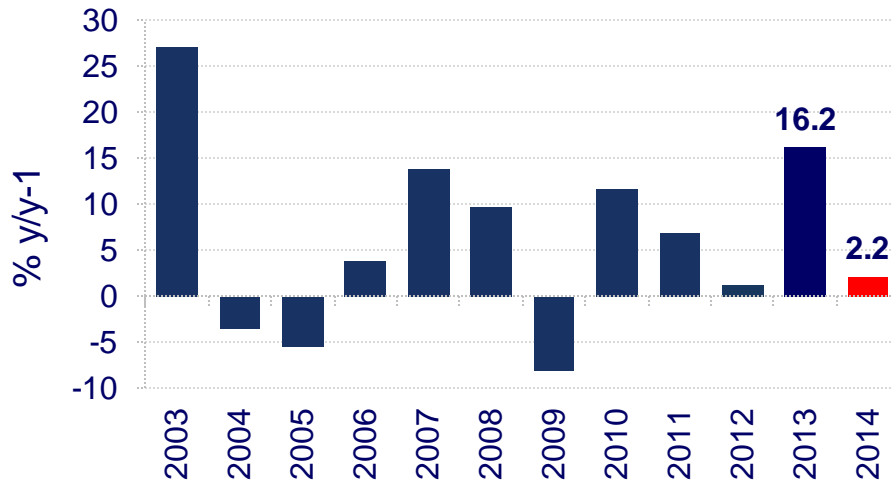
Industrial Production



Services Nominal Income

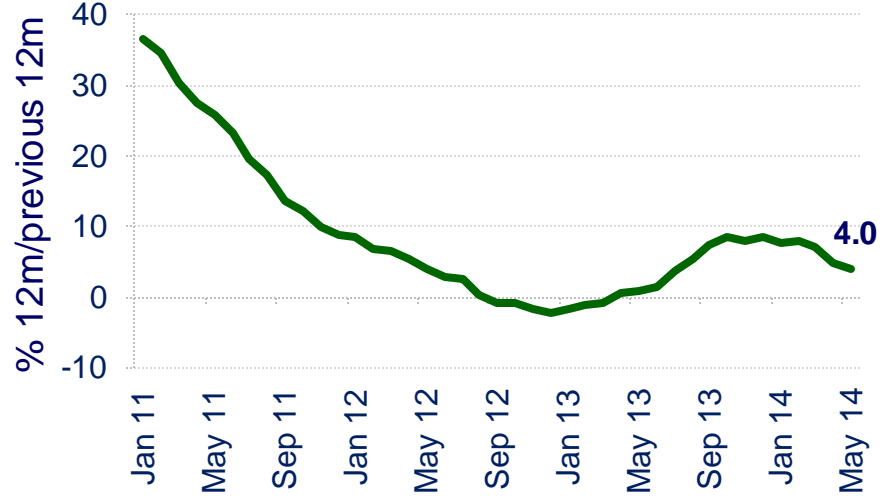


Crop Harvest



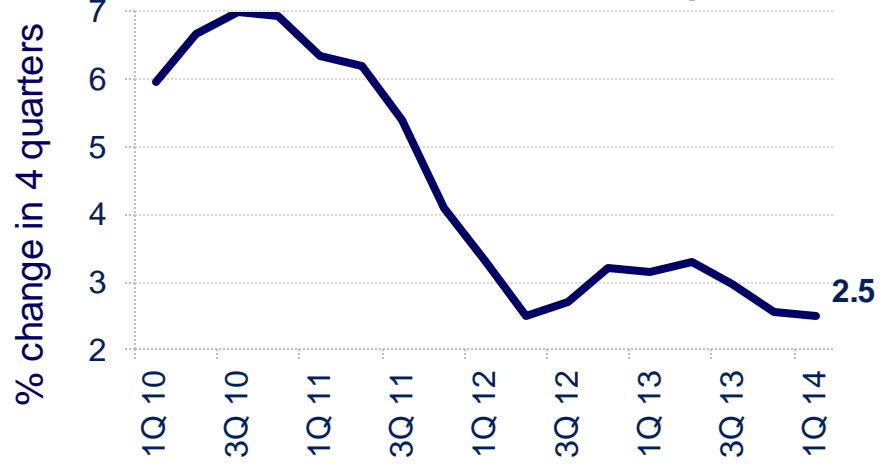
2013: IBGE estimates in May/14

Imports Quantum

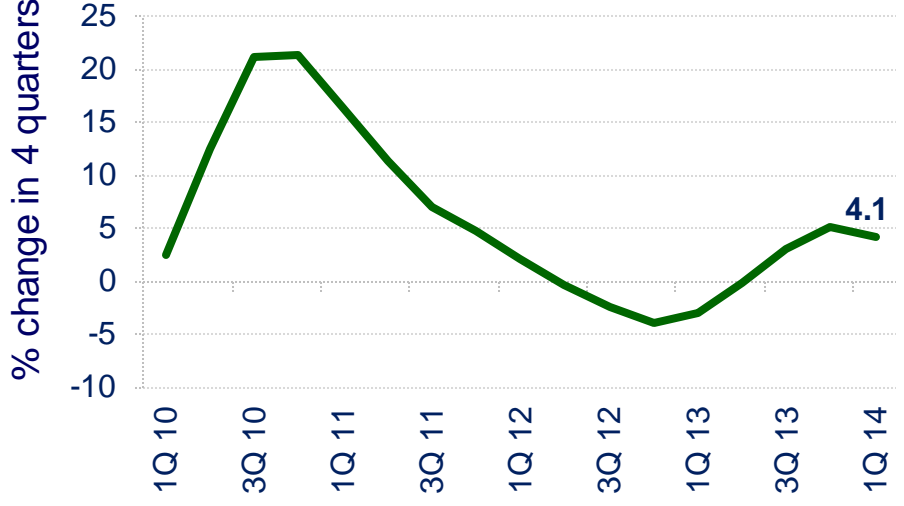


Demand

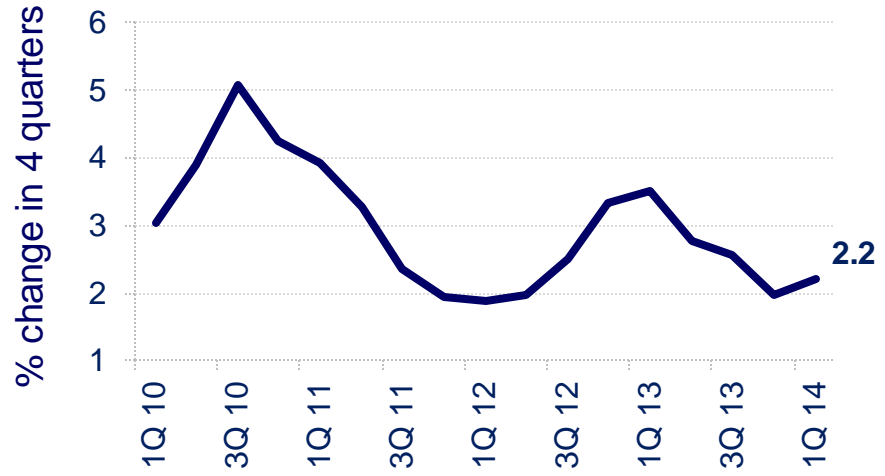
Household Consumption



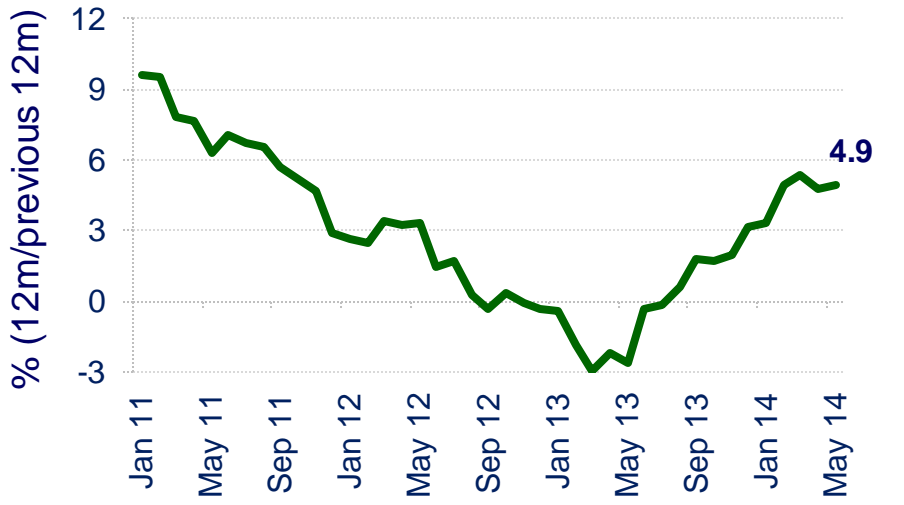
FCGF



Government Consumption

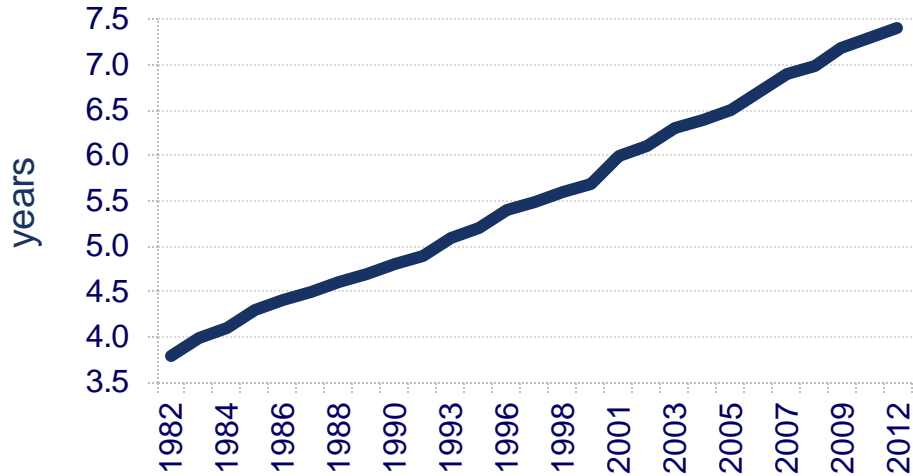


Exports Quantum

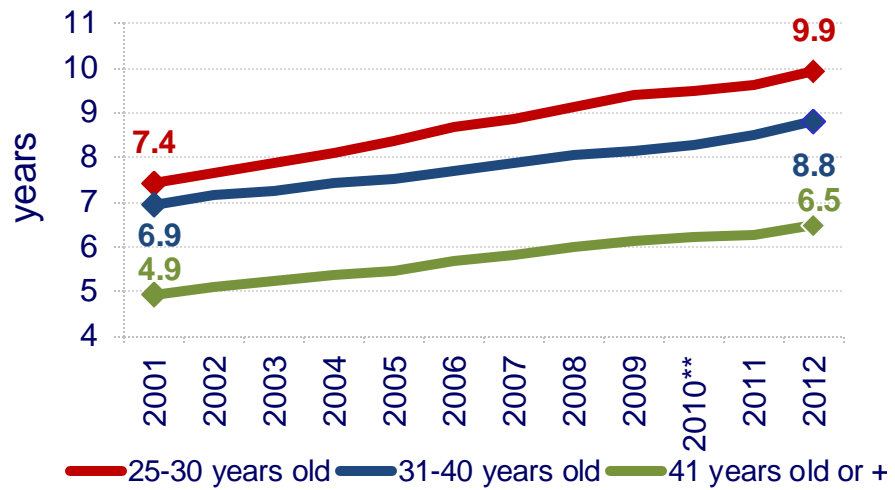


Potential Growth: Labor Force Qualification

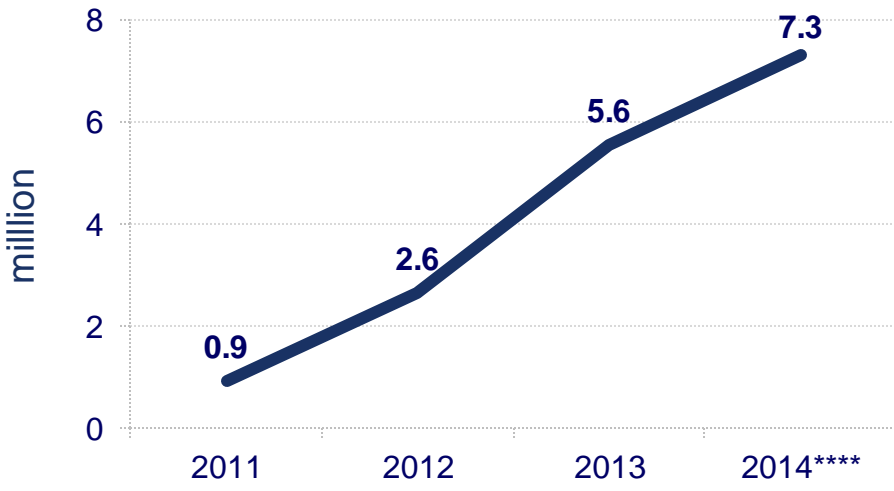
Schooling*



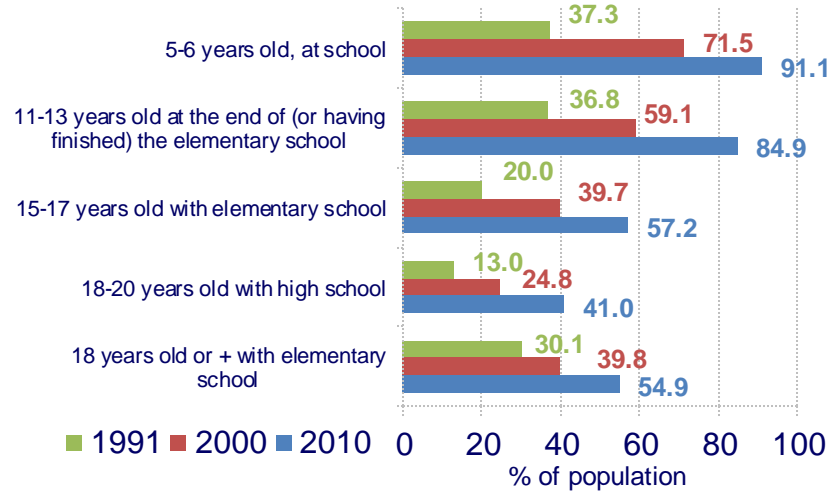
Schooling by Age Range



Enrollments in Pronatec***



Education MHDl*****



* older than 24 years old; ** PNAD not collected; *** program created by the Federal Government, in 2011, with the aim to broaden the supply of professional and technological education courses; **** data up to May – target of 8 million of enrollments in 2014; ***** Municipal Human Development Index

Potential Growth : Infrastructure Concessions

Logistics

Roads

7 thousand km

Airports

national and regional airports

Ports

leasing of public ports and regulatory framework for the exploration of private usage terminals

Railroads

11 thousand km

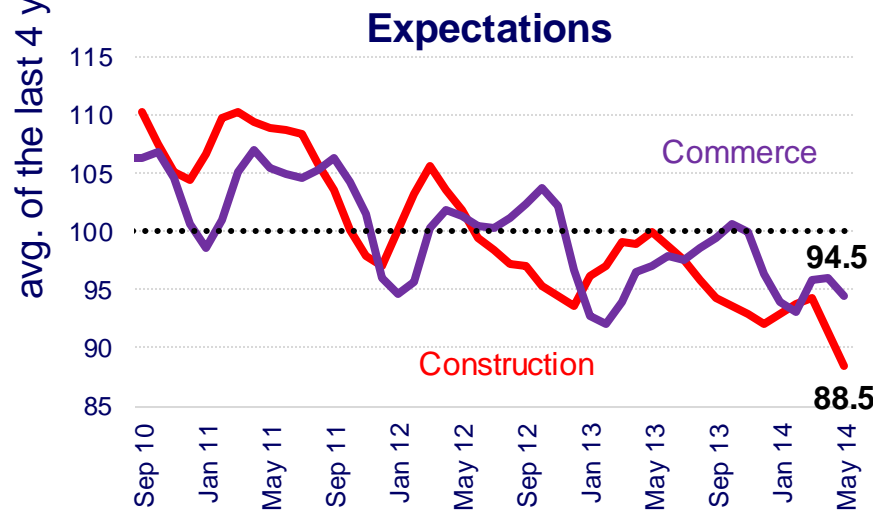
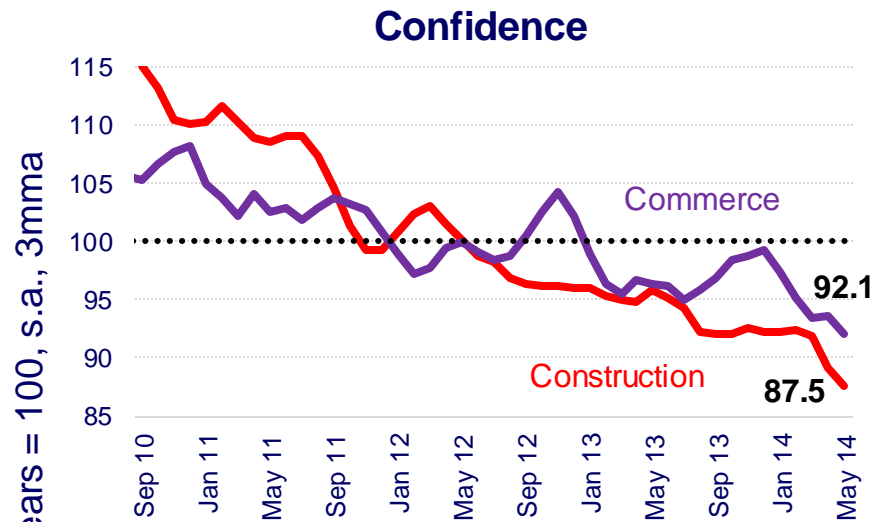
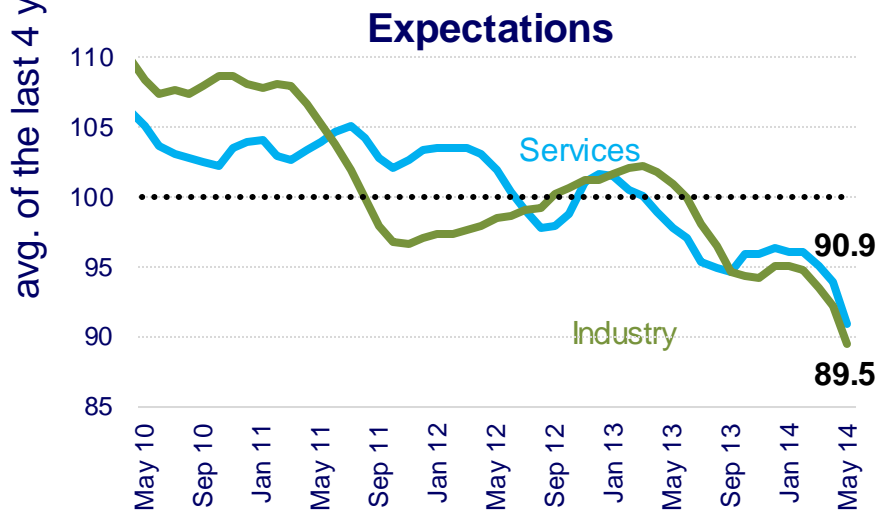
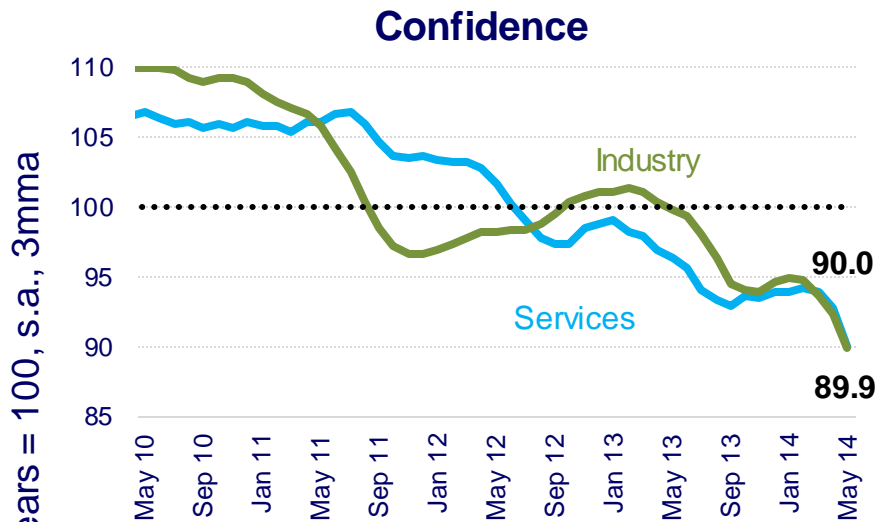
Energy

auctions for transmission and generation

Telecommunications

4G auction

Potential Growth : Confidence



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

Revised Forecast for the 2014 Balance of Payments

- Estimate for the current account deficit remains at US\$80 billion (3.5% of the GDP);
 - Estimate for the trade surplus reduced from US\$8 billion to US\$5 billion; and
 - Forecast indicates current account deficit essentially financed by FDI inflows (estimate of US\$63 billion).

Reformulation of the Monthly Industrial Survey – Physical Production

- Update of the classification of the industrial activities (CNAE 2.0); of the sample of products and respondents; and of the weighting of the indices (VTI 2000); and
- Review of the industrial production in 2013, with positive impact over the GDP.

Formalization of the Labor Market

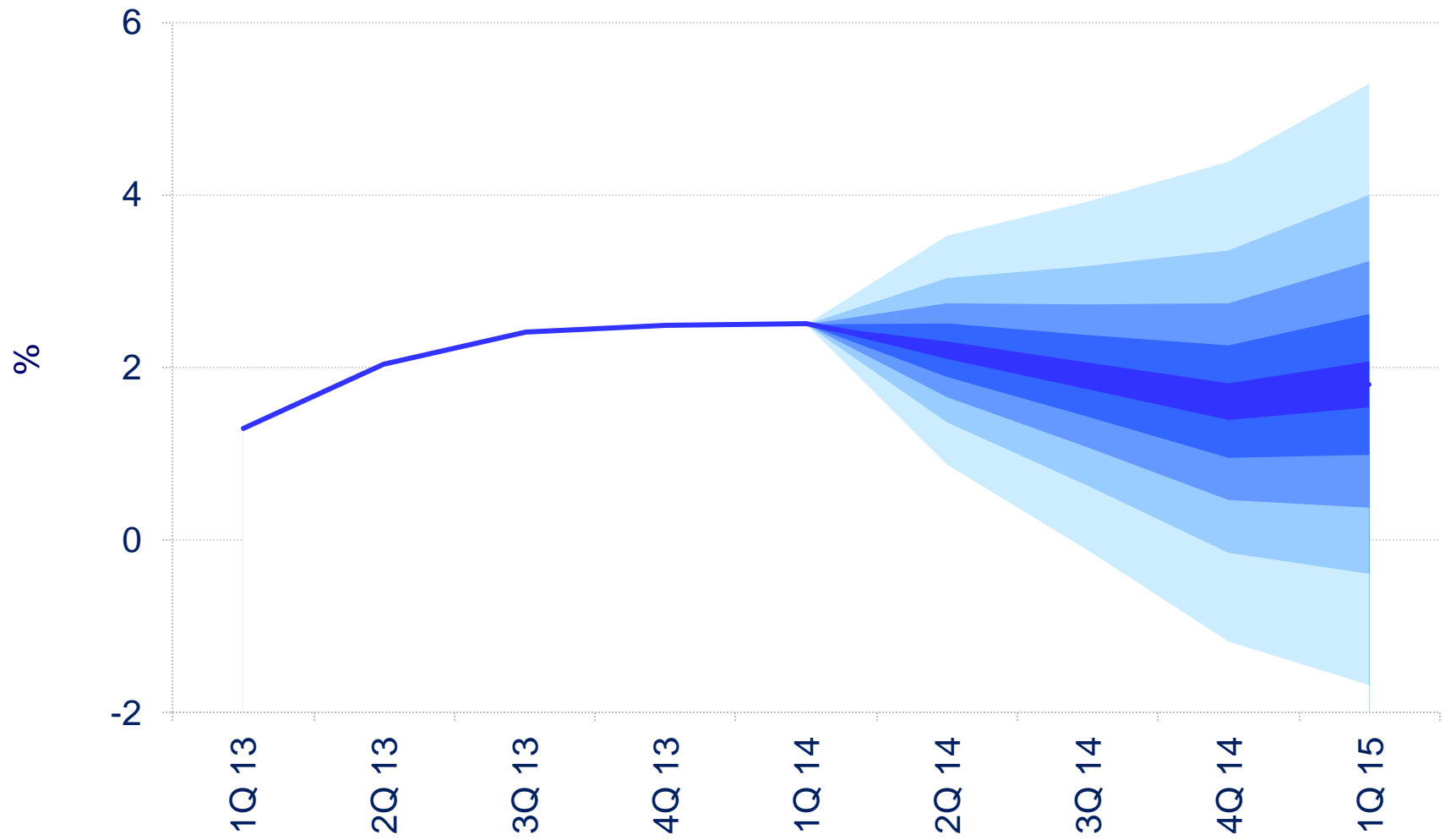
- Evaluates alternative broader indicator, for the degree of formalization of the labor market, considering contributions for the social security; and
- Evidences point to formalization around 75%, compared to 55% when considering only formal workers.

Revision of the Small-Sized Forecast Models – 2014

- Updates the information regarding the three classes of small-sized semi-structural models;
- The main innovation was the inclusion of a variable for the banking spread; therefore, it aggregates information regarding the credit market, in line with its growing importance for the Brazilian economy.

GDP Forecast

Baseline Scenario*



* Interest rate constant at 11.00% p.y.

V. Inflation Developments

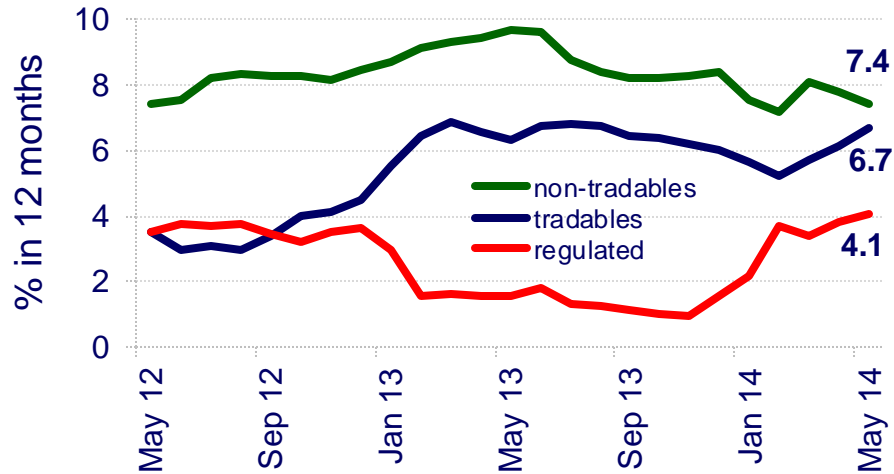
Inflation Developments

Prices Indices

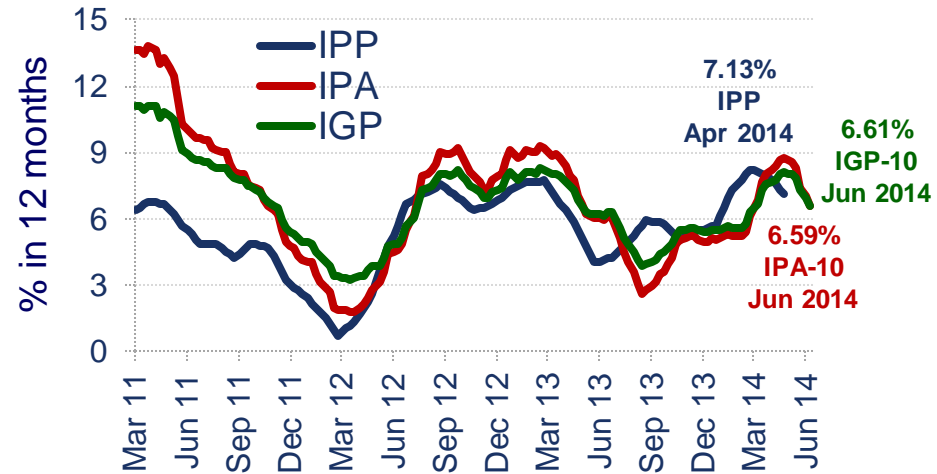
	Change in 12 months (%)		
	May/13	May/14	
IPCA	6.50	6.37	▼
Market Prices	8.11	7.07	▼
Regulated	1.54	4.08	▲
Tradables	6.31	6.67	▲
Non-Tradables	9.71	7.42	▼
INPC	6.95	6.08	▼
IPC-C1	6.52	6.00	▼
IGP-DI	6.20	7.26	▲
IPA-DI	6.07	7.43	▲
Agricultural	7.52	9.32	▲
Industrial	5.59	6.73	▲
IPC-DI	5.96	6.57	▲
INCC-DI	7.56	7.75	▲

Prices

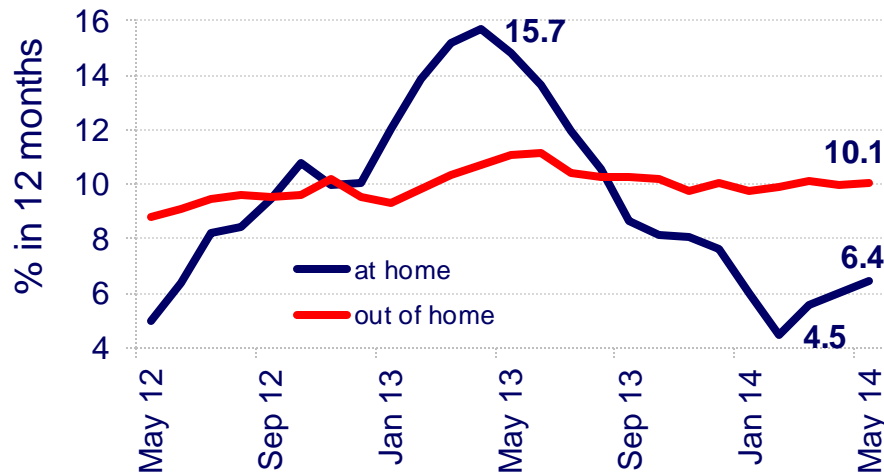
Inflation (IPCA)



Producer Prices and IGP



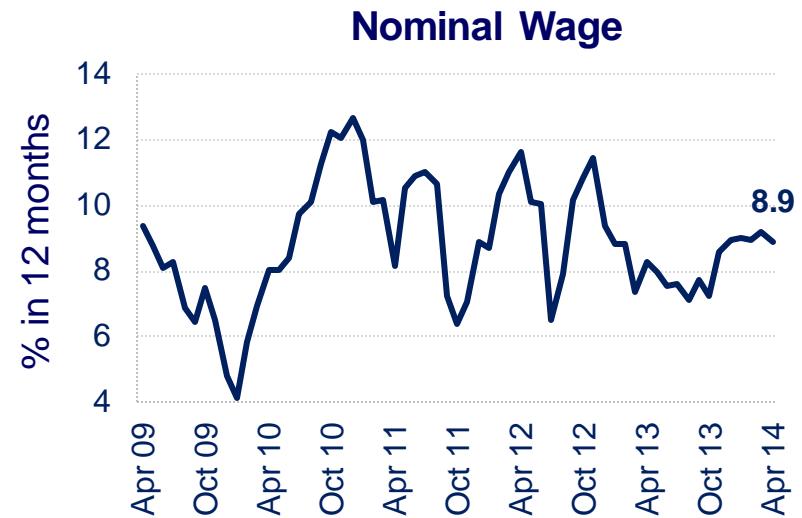
Inflation (Food)



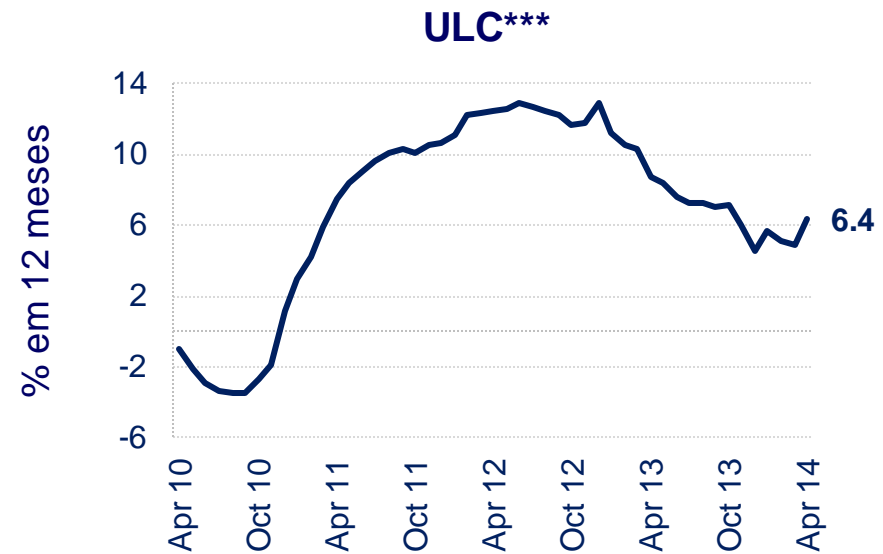
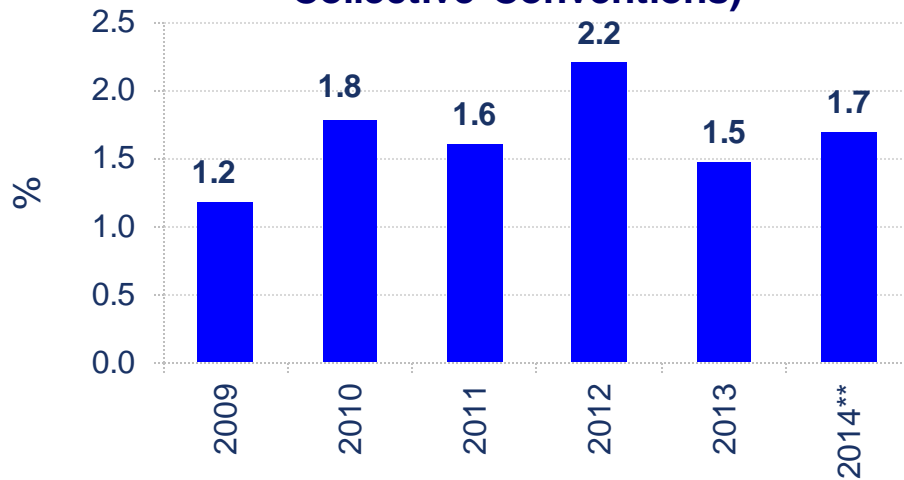
In Natura Food Prices



Wages



Real Adjustment in the CCT (Working Collective Conventions)



* 12m through Apr; ** 12m through May; *** Unit Labor Cost in the Manufacturing Industry: Nominal Payroll/Physical Output

BCB Inflation Forecasts

Baseline Scenario* and Market Scenario

Period		Baseline	Market
2014	2	6.5	6.5
2014	3	6.6	6.6
2014	4	6.4	6.4
2015	1	6.1	6.3
2015	2	5.9	6.2
2015	3	6.0	6.3
2015	4	5.7	6.0
2016	1	5.4	5.5
2016	2	5.1	5.0

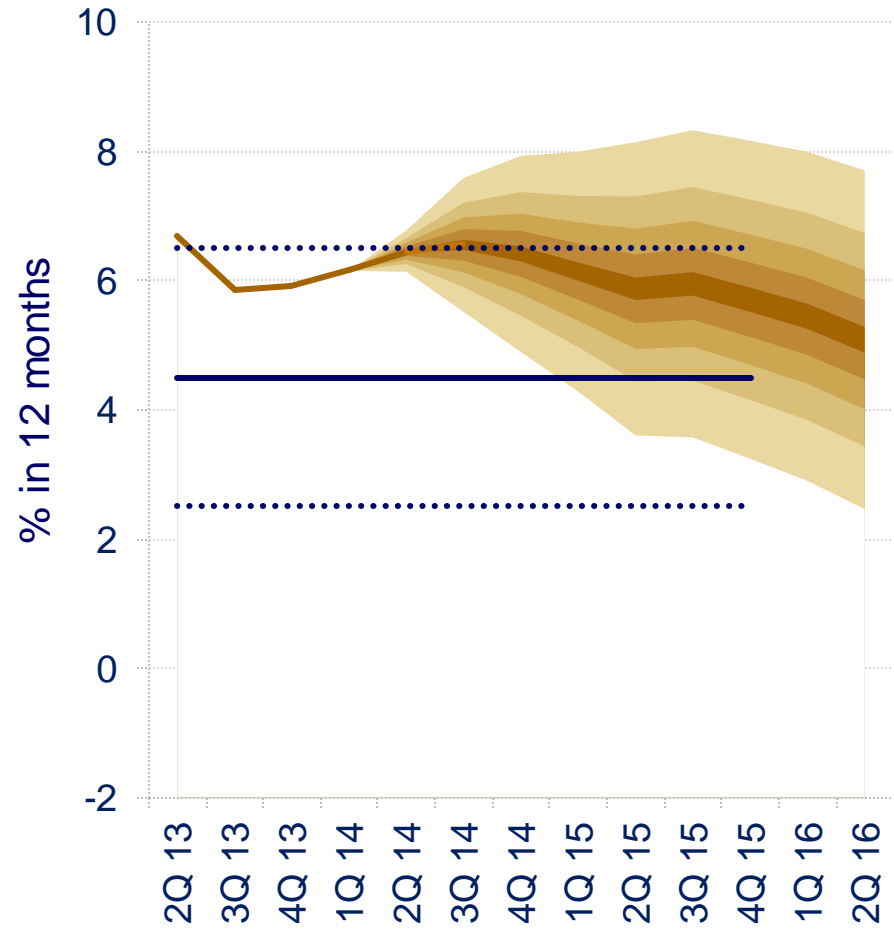
Obs.: 12-month accumulated inflation (%)

* Interest rate constant at 11.00% p.y.

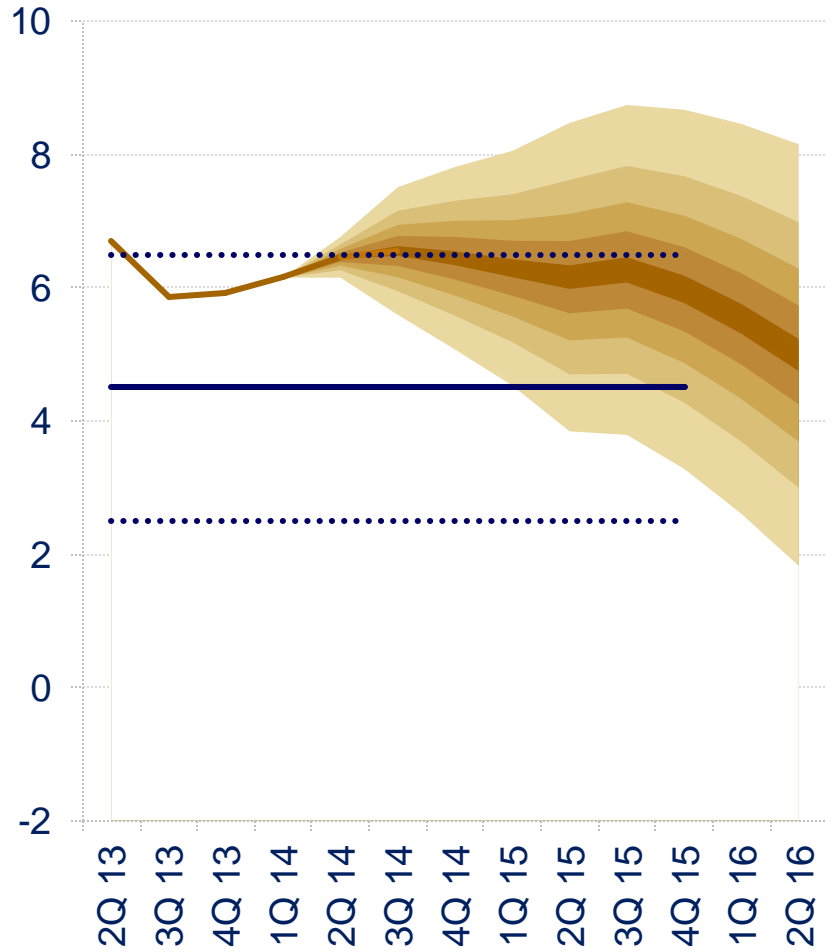
BCB Inflation Forecasts

Baseline Scenario

(interest rate constant at 11.00% p.y.)



Market Scenario



Market Expectations – Summary

	2014			2015			2016		
	3/31/14		6/20/14	3/31/14		6/20/14	3/31/14		6/20/14
IPCA	6.31	▲	6.46	5.80	▲	6.10	5.50	=	5.50
Regulated Prices	4.40	▲	5.00	5.50	▲	7.00	4.50	▲	5.50
Market Prices	7.14	▼	7.10	5.93	▼	5.71	5.94	▼	5.50
IGP-M	7.20	▼	5.94	5.50	=	5.50	5.20	▲	5.35
IPA-DI	6.61	▼	6.01	5.55	▲	6.00	5.15	▲	5.50
Selic (end-of-period)	11.25	▼	11.00	12.00	=	12.00	10.88	▲	11.00
Exchange rate (end-of-period)	2.46	▼	2.40	2.55	▼	2.50	2.56	▼	2.55
GDP	1.65	▼	1.16	2.00	▼	1.60	2.80	▼	2.50
Industrial Production	1.38	▼	-0.14	3.00	▼	2.30	3.40	▼	3.00
Trade Balance	4.25	▼	2.00	10.00	=	10.00	12.12	▼	11.00
FDI	60.00	=	60.00	55.00	▲	55.40	55.00	=	55.00
Primary Result	1.50	=	1.50	2.00	▼	1.90	2.00	=	2.00



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