

# Inflation Outlook

## Quarterly Inflation Report

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June 2017

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# I. Introduction

# *Banco Central do Brasil* - Institutional Mission

- To ensure the stability of the currency's purchasing power and a solid and efficient financial system
- The mission to ensure price stability is accomplished through the inflation targeting regime, in which the targets are defined by the National Monetary Council (CMN)

# Basic Principles

- Low, stable and predictable inflation: best contribution of monetary policy for sustainable growth
- High and volatile inflation:
  - generates distortions, increases risks, shortens planning horizons, depresses investment and economic growth
  - regressive
  - in short, reduces potential growth, affects employment and income generation, worsens income distribution

# II. Baseline Scenario

## i. Economic Activity:

- stabilization and perspective of gradual recovery
- maintenance of the high level of uncertainties in the process of reforms and adjustments may cause negative impact
- high level of idleness

## ii. External Scenario:

- has shown favorable outlook
- stronger global economic activity has mitigated the effects of possible changes of economic policy in central economies

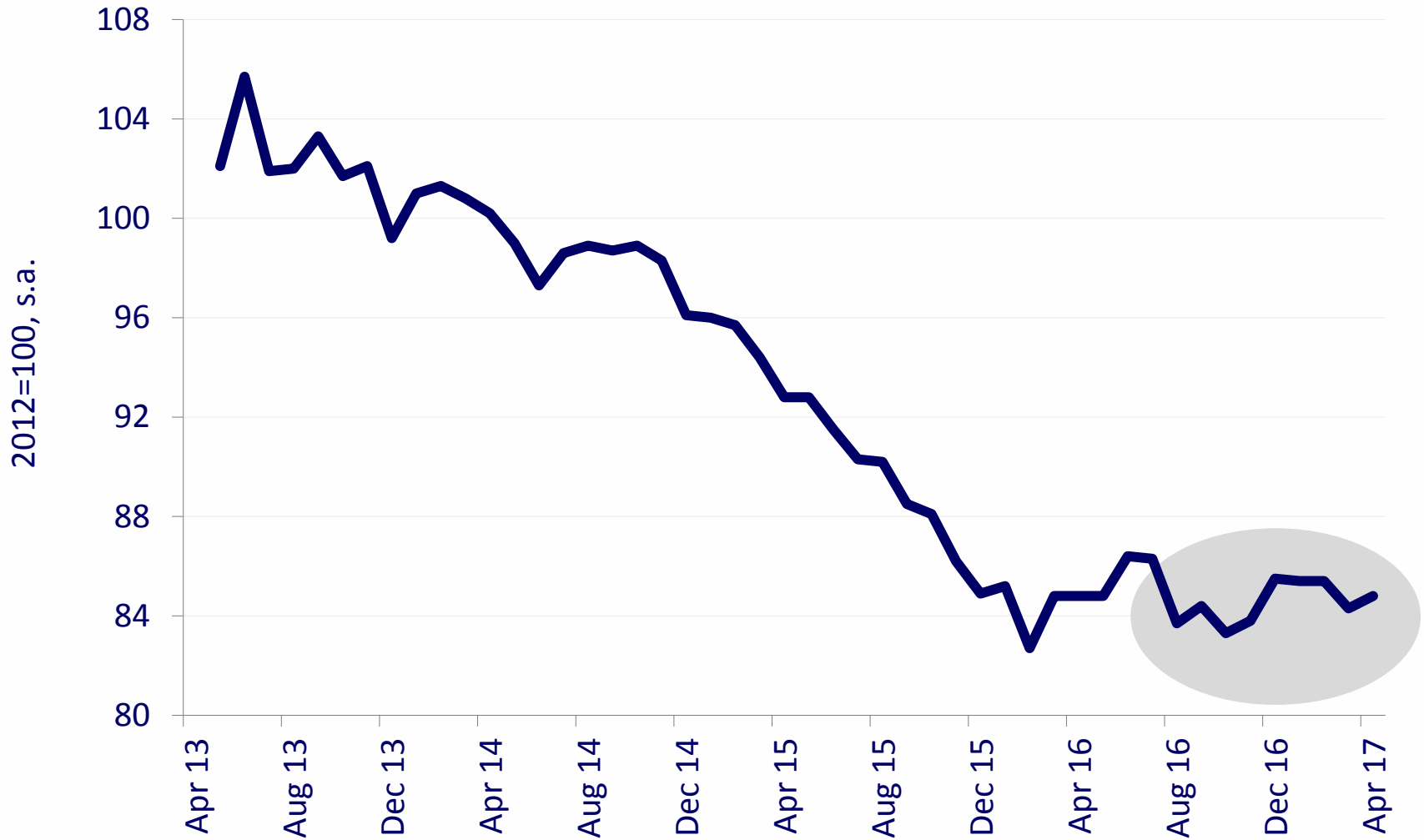
## iii. Inflation:

- favorable behavior, with widespread disinflation
- recent released data below expectations
- wide set of cores measures indicates low current inflation
- expectations for 2017, 2018 and 2019 around 3.7%, 4.4% and 4.25%, respectively

# i. Economic Activity

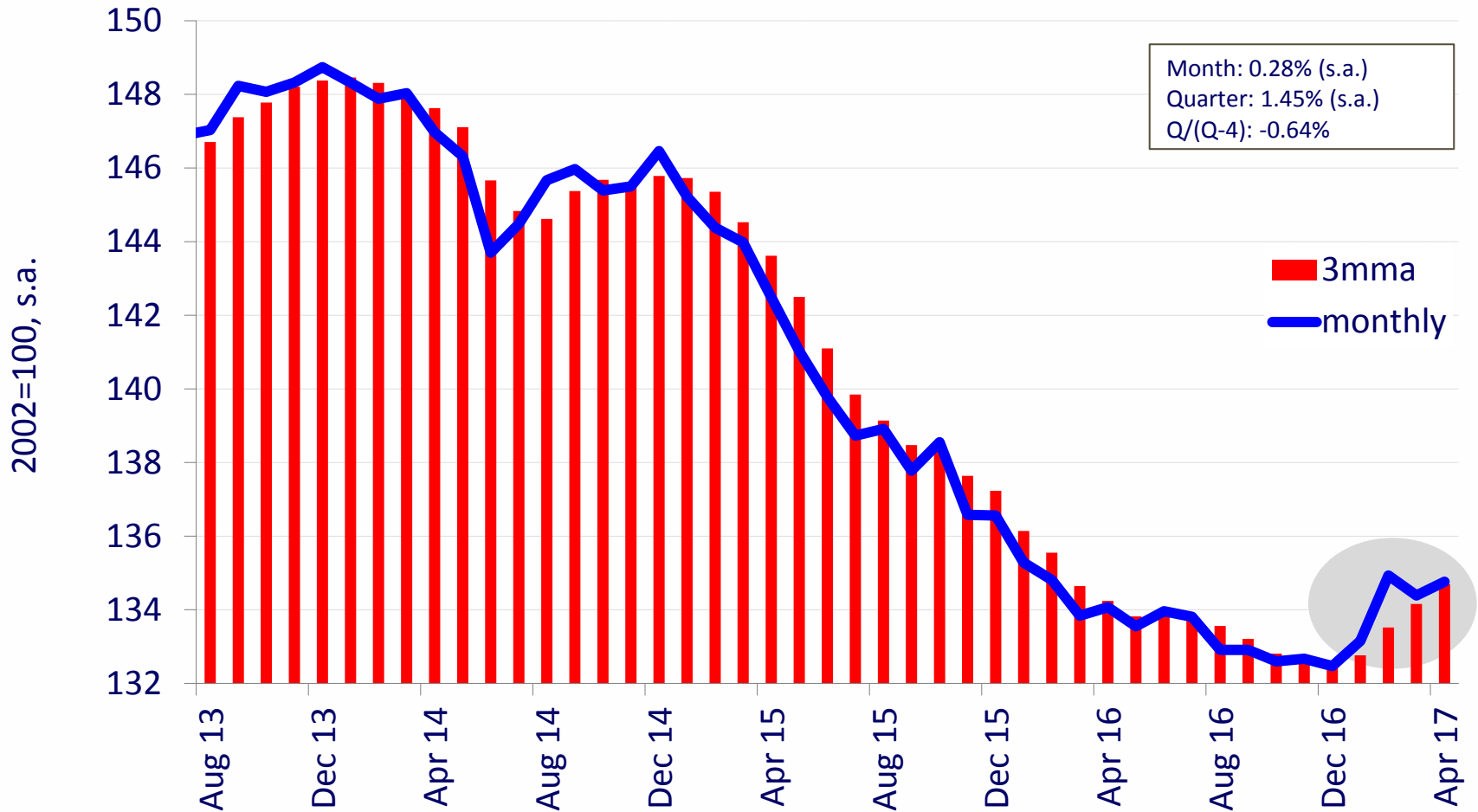


# Industrial Production



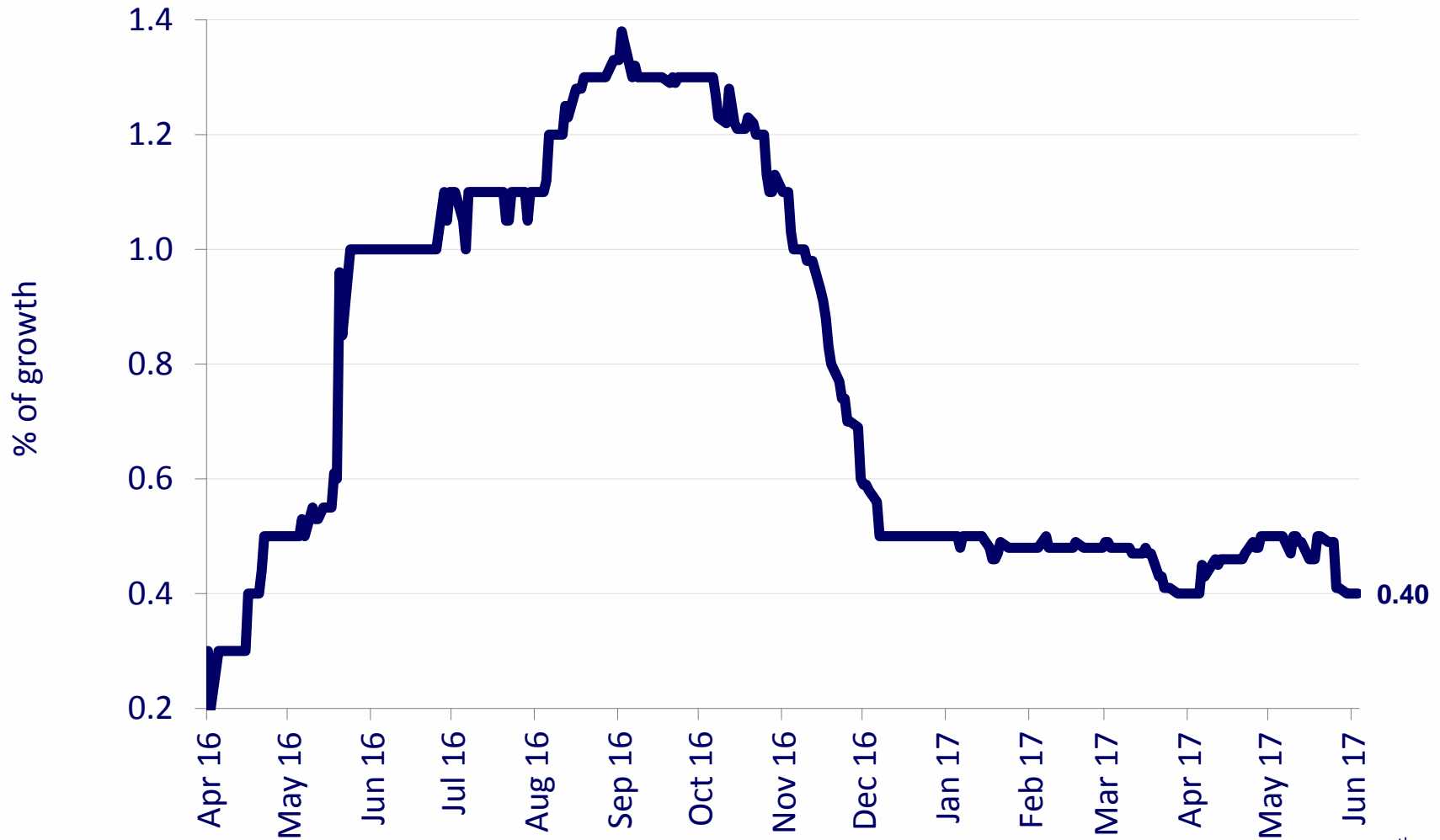
Source: IBGE

## IBC-Br



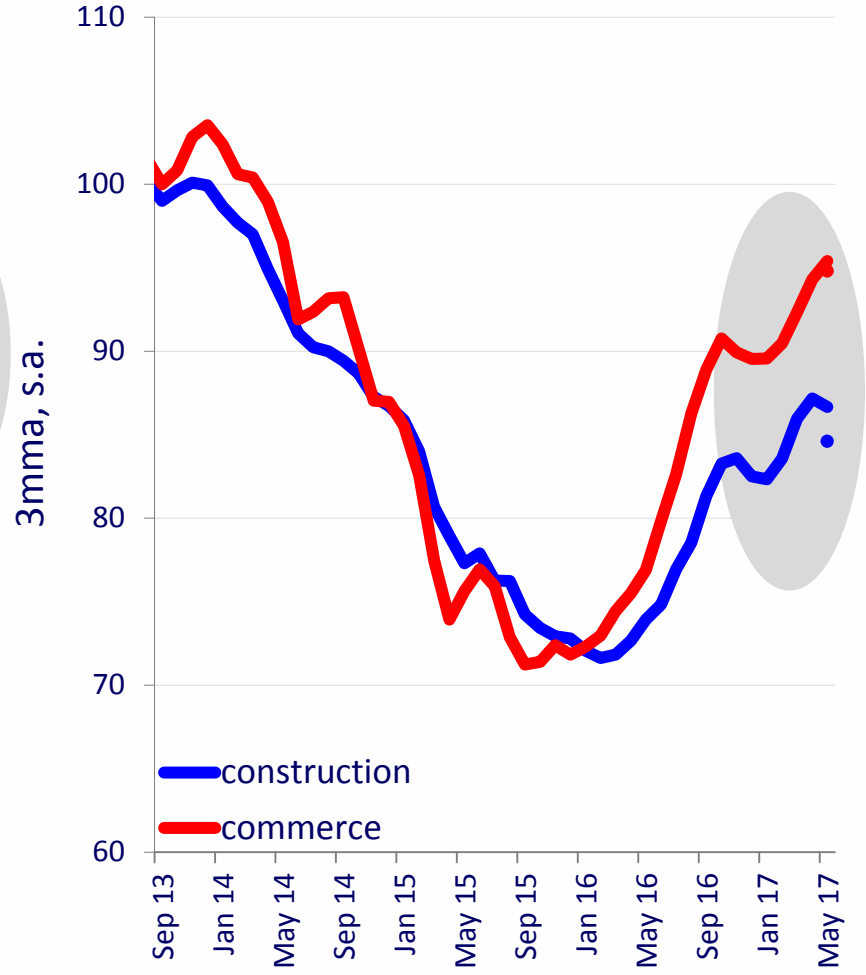
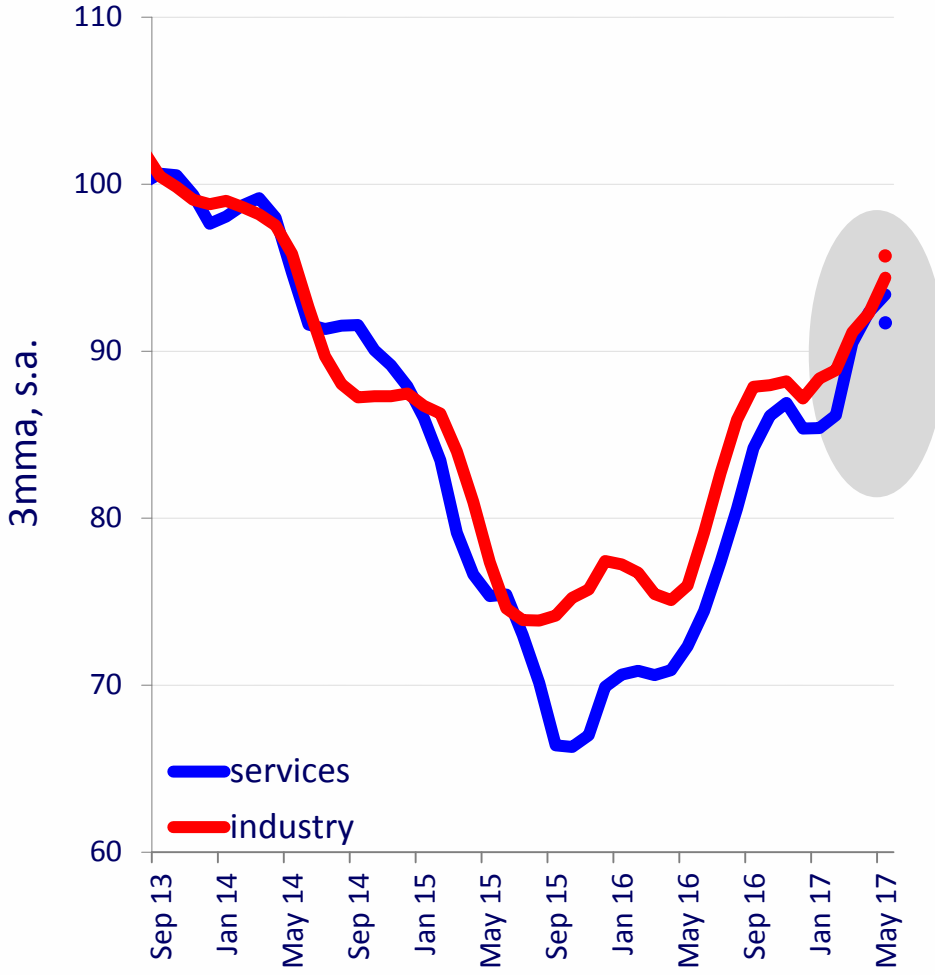
Source: BC

# Market Expectations for 2017 GDP

through June 16<sup>th</sup>

Source: BC (Focus)

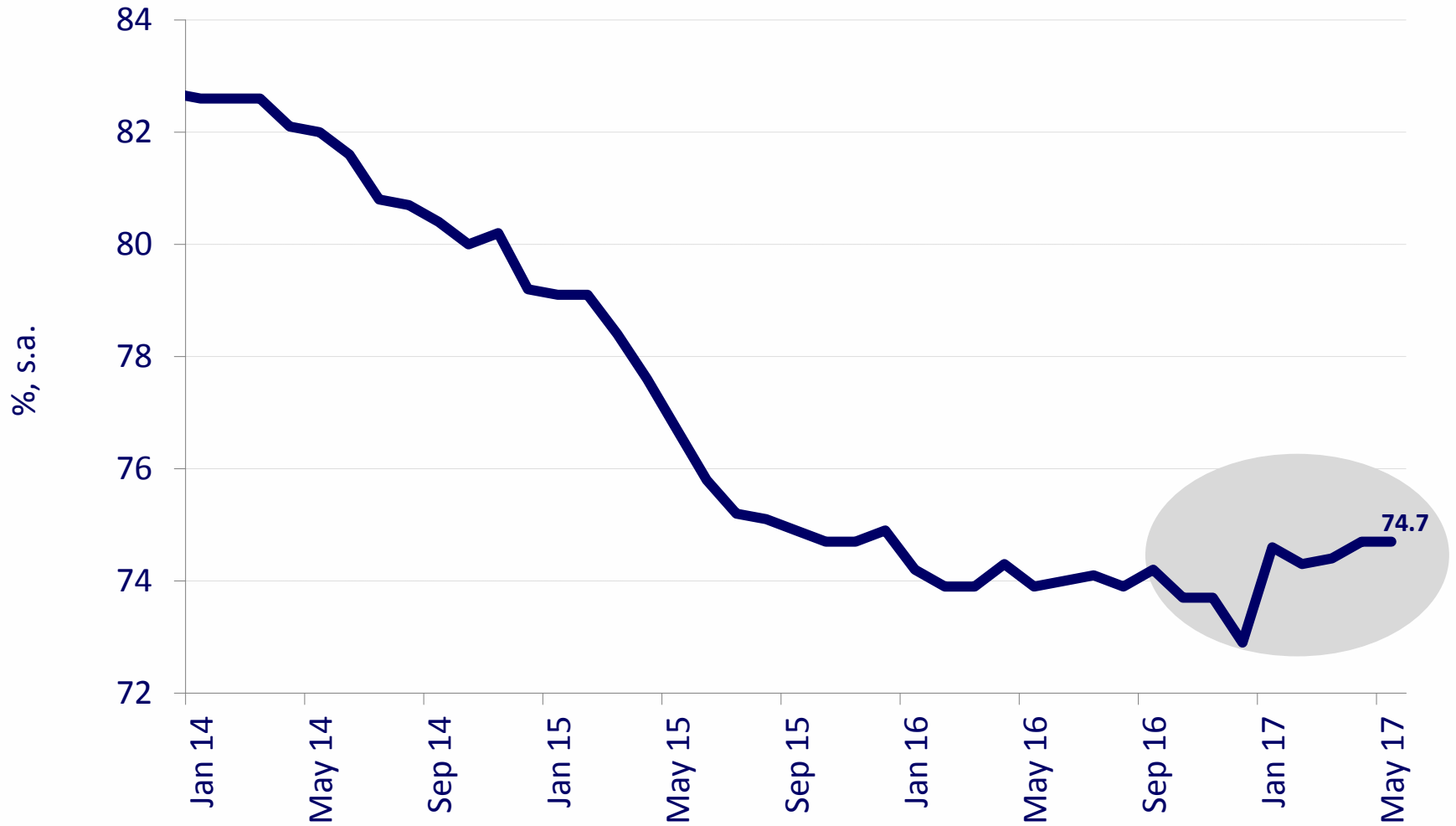
# Agents' Confidence - Businessmen



Obs.: proportion of favorable answers – proportion of unfavorable answers + 100

Source: FGV

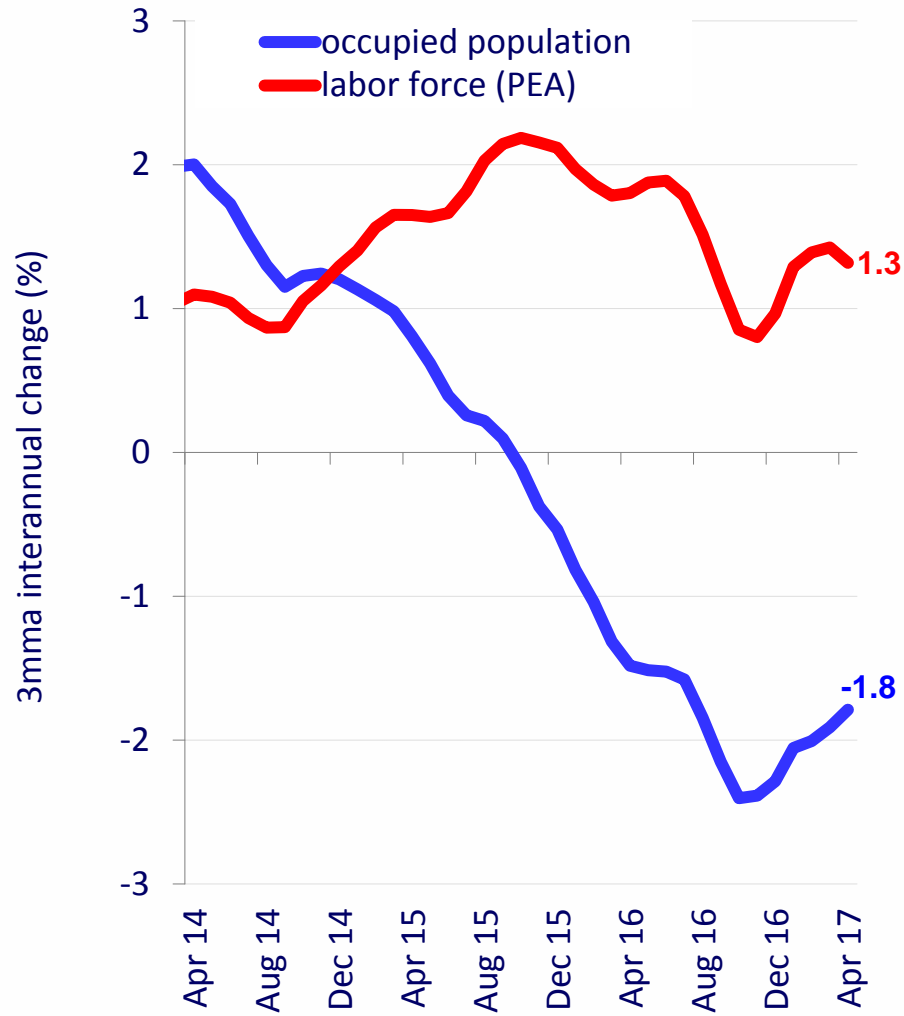
# Installed Capacity Utilization Level (NUCI)



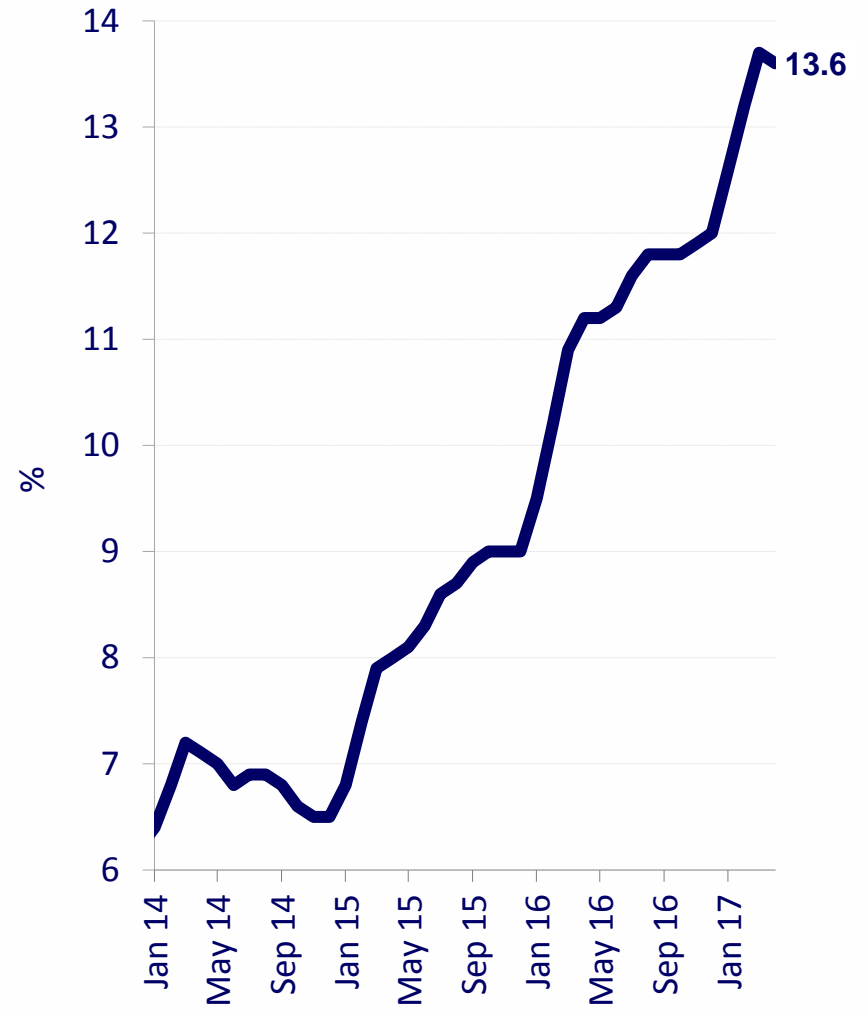
Source: FGV

# Labor Market

## Population



## Unemployment



Source: IBGE (PNADC)

# Box: 2017 GDP Projections

2017 change at 0.5%:

➤ Supply :

- Agriculture and livestock: 9.6% (-6.6% in 2016)
- Industry: 0.3% (-3.8% in 2016)
- Services: -0.1% (-2.7% in 2016)

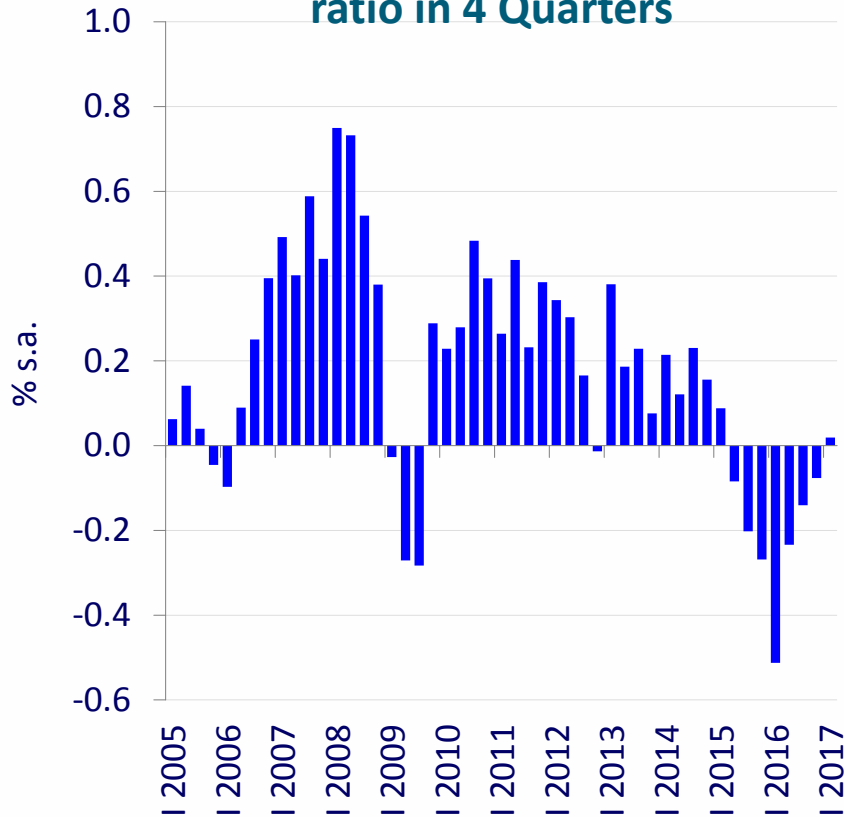
➤ Demand:

- Investment: -0.6% (-10.2% in 2016)
- Household Consumption: 0.0% (-4.2% in 2016)
- Government Consumption: -0.6% (-0.6% in 2016)
- Net Exports: 0.0 p.p. (1.7 p.p. in 2016)
- Inventory Change: 0.7 p.p. (-0.6 p.p. in 2016)

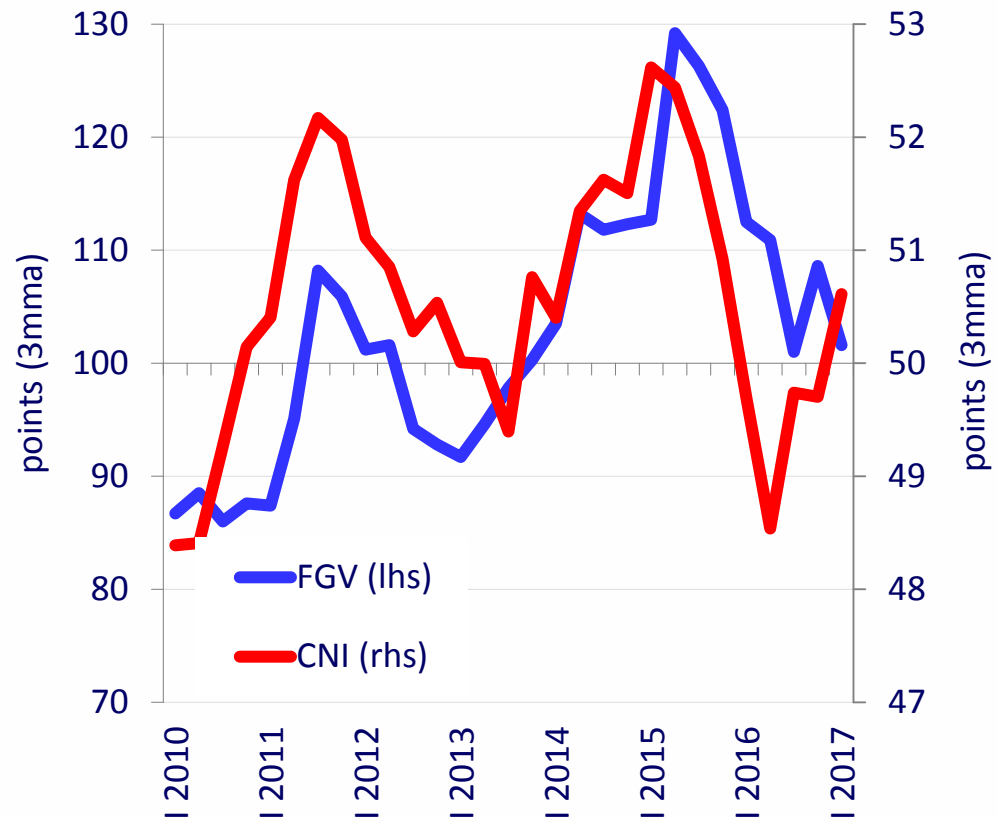
# Box: Inventories and Recent Economic Cycle

- Analyses the evolution of a set of statistics regarding the inventories of goods

## Change in Quarterly Inventories/GDP ratio in 4 Quarters



## Indicators of Inventories Adequacy

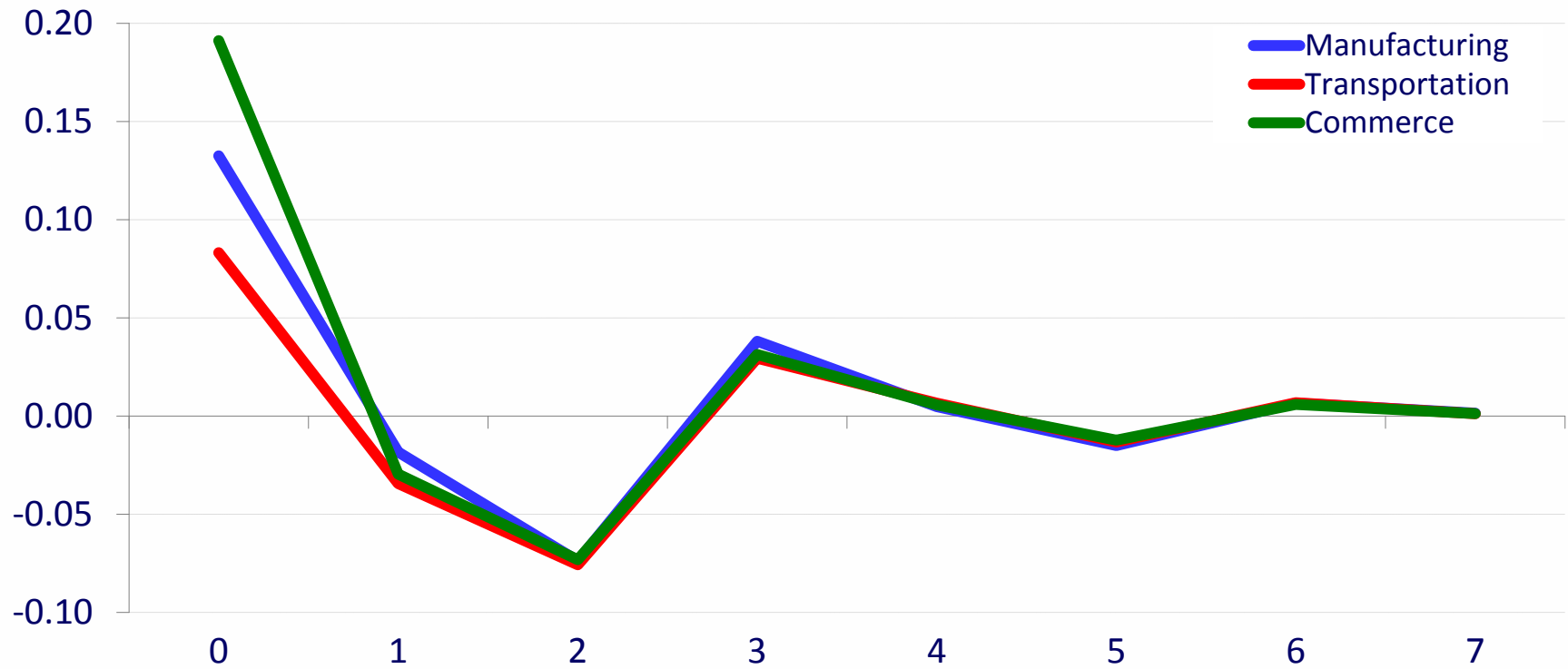




# Box: Impact of the Agricultural Harvest over Economic Activity

- Analyses the effects of the significant growth of the agricultural harvest in the first quarter over economic activity

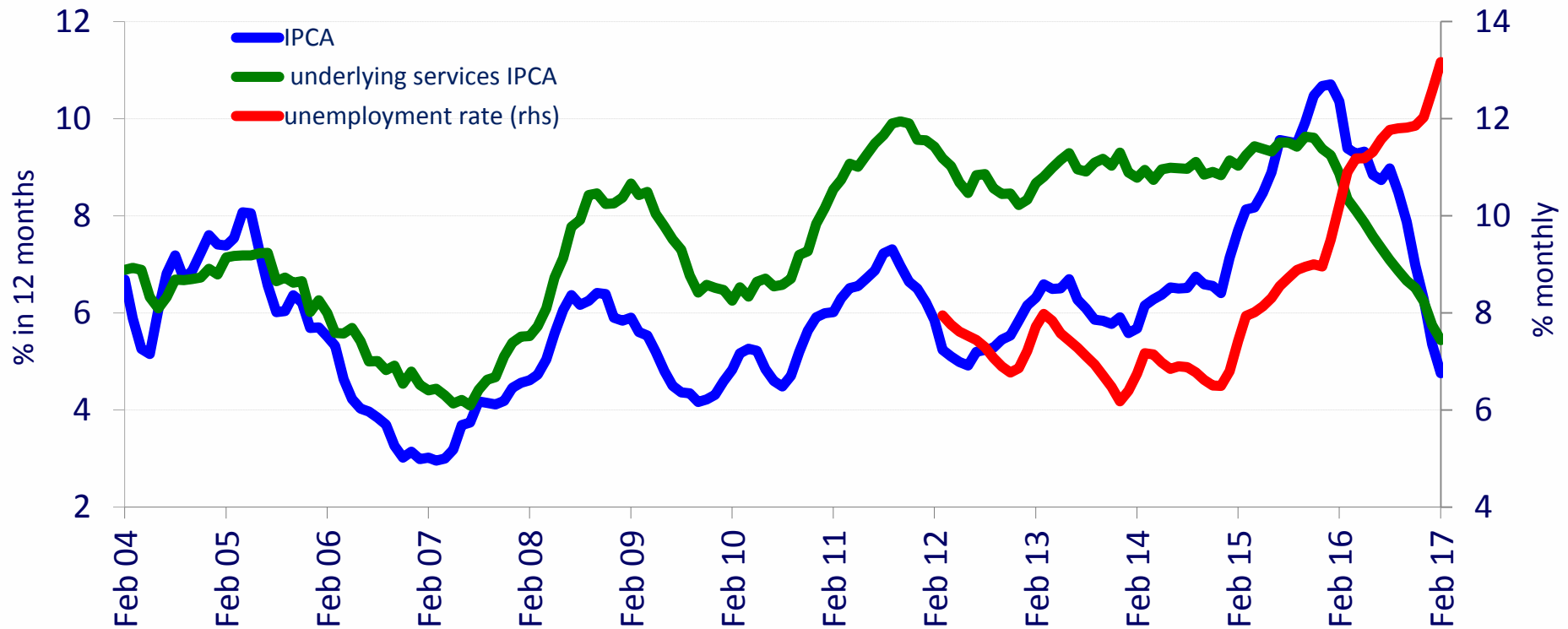
## Responses of Selected Sectors to a Shock in the Agriculture and Livestock Sector



# Box: Recent Evolution of Underlying Services Inflation

- Relates the recent trajectory of inflation in the services sector with inflationary expectations and with the economic cycle

## IPCA, Underlying Services Inflation and Unemployment

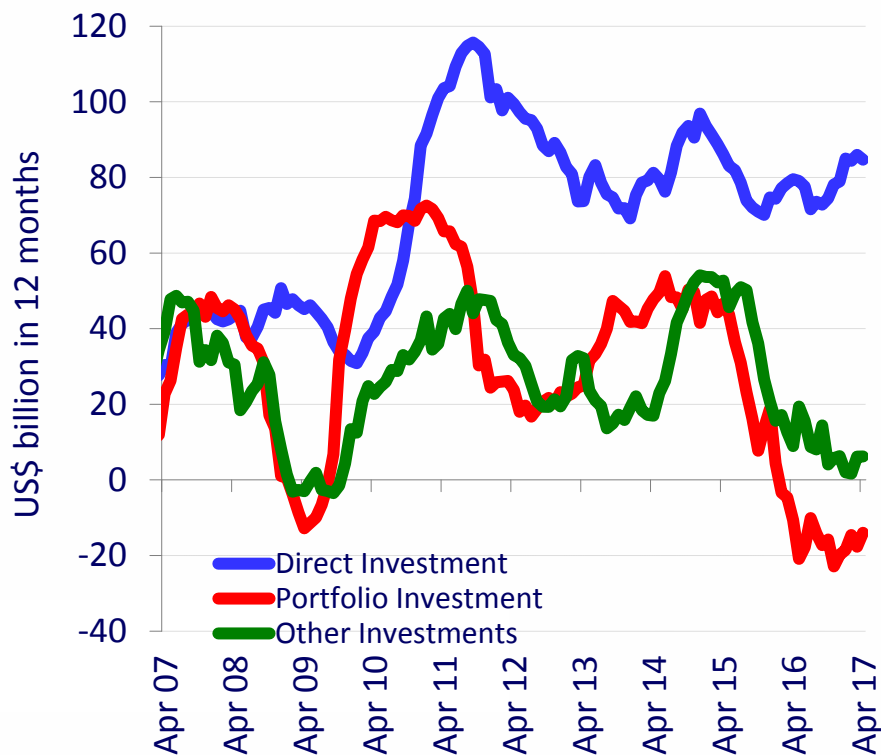


Sources: BC, IBGE and IBGE (PNADC)

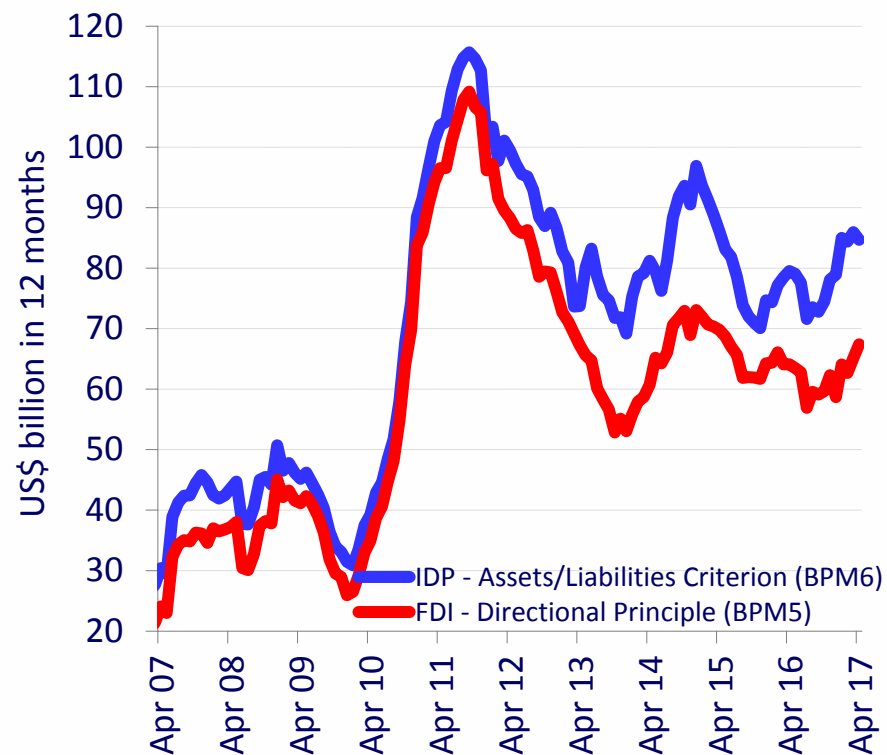
# Box: Direct Investment Liabilities(IDP)

- IDP, compiled according to the most recent international standards, behaves as a source of long-term stable funding, as expected.

## Net Flows of Foreign Capital



## Flows of Direct Investment

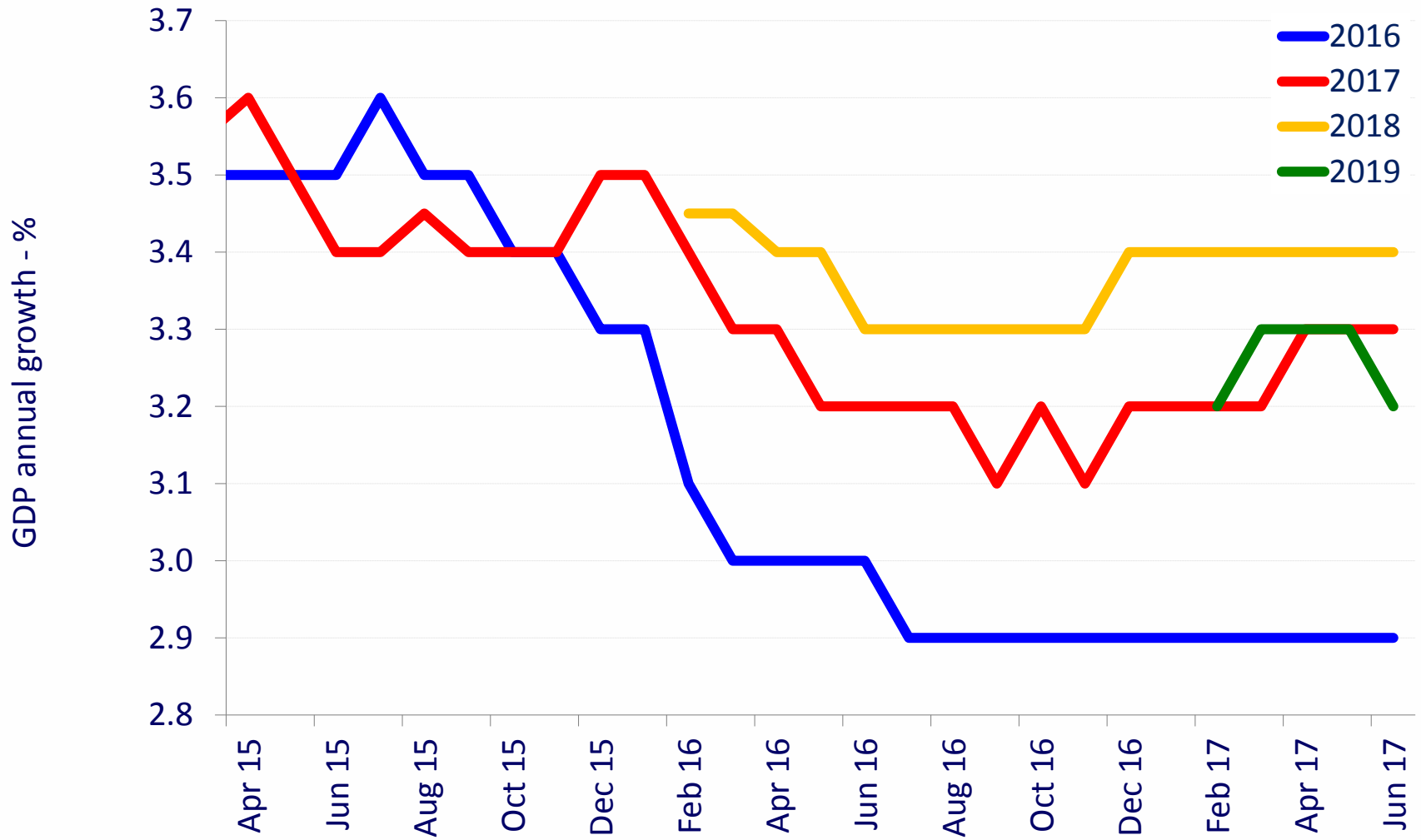


# Box: Projections for 2017 BoP

- Projection of current account *deficit* of US\$24 billion (1.19% of GDP), compared to *deficit* of US\$23.5 billion (1.31% of GDP) occurred in 2016;
  - Trade balance: projection of surplus increased from US\$51 billion to US\$54 billion (surplus of US\$45 billion in 2016)
    - Exports: US\$203 billion (+10.1% relative to 2016)
    - Imports: US\$149 billion (+6.9% relative to 2016)
- Maintenance in the projection of net inflows of Direct Investment Liabilities (DIL) at US\$75 billion, which will allow comfortable financing of the BoP
- Reduction in the inflows of stocks and investment funds (US\$10 billion to zero), but reduction in the outflows of securities in the country (-US\$7 billion to zero), with equilibrium in portfolio in the country
- Increase of the rollover rate from 80% to 90%

## ii. External Scenario

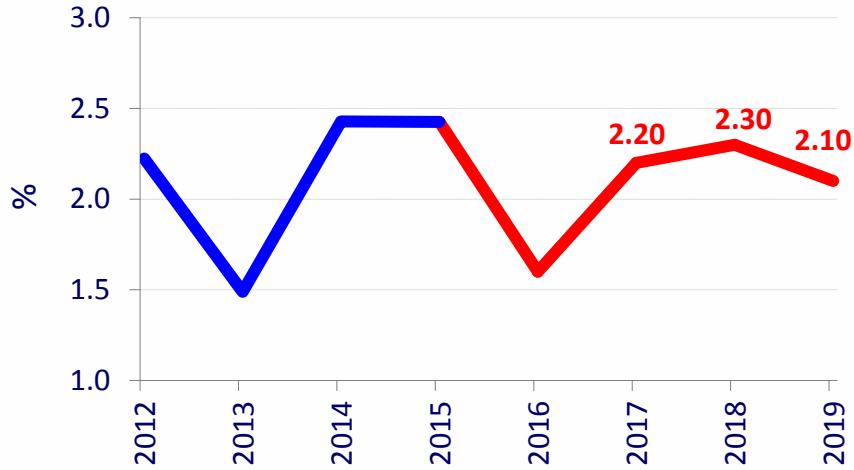
# Prospects of Moderate Global Growth



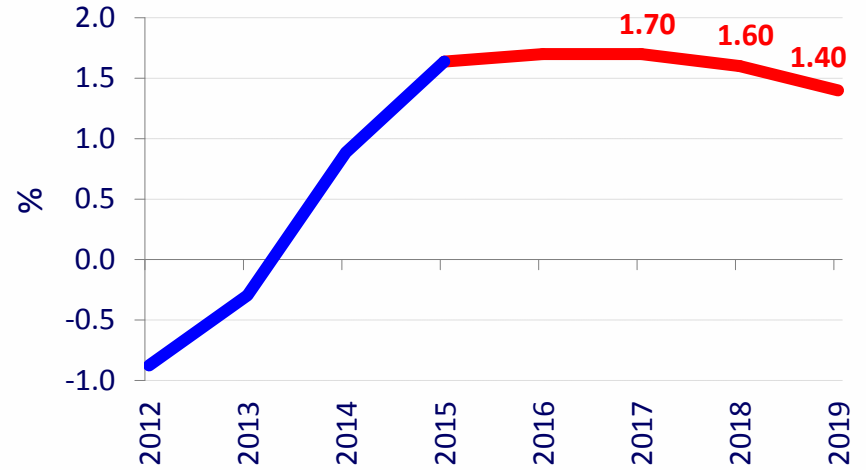
Source: Bloomberg (June: 6/16)

# Activity – GDP Annual Growth

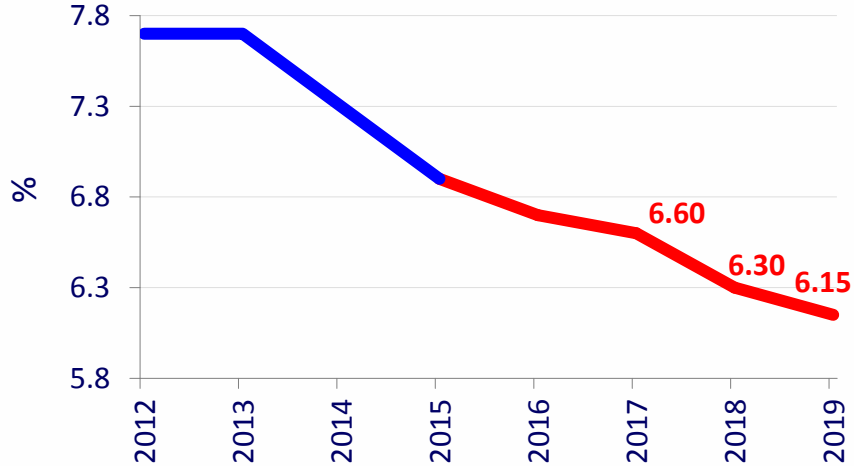
## United States



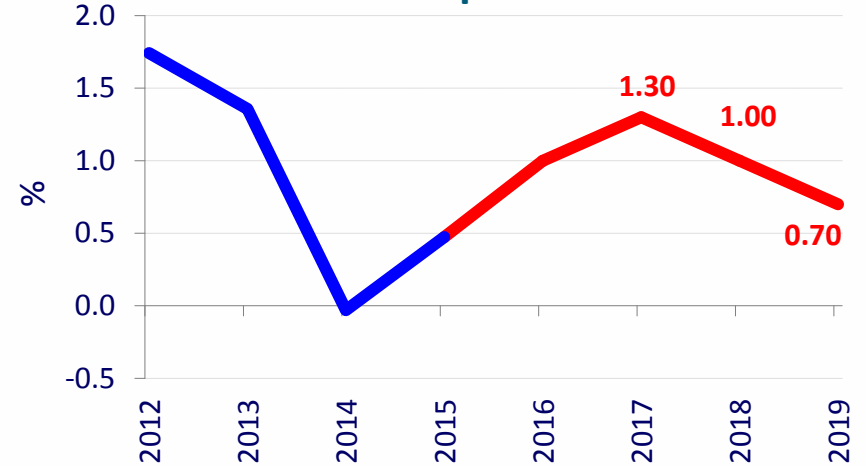
## Euro Area



## China



## Japan

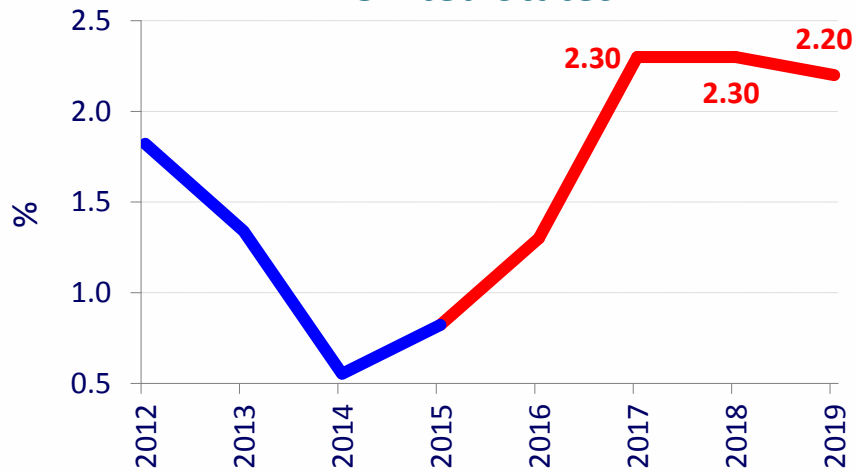


2017/18: projection

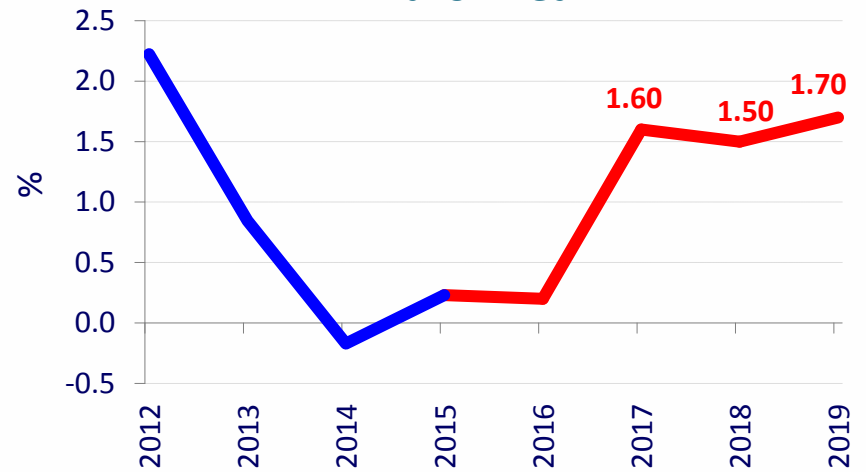
Source: Bloomberg (6/16)

# Inflation

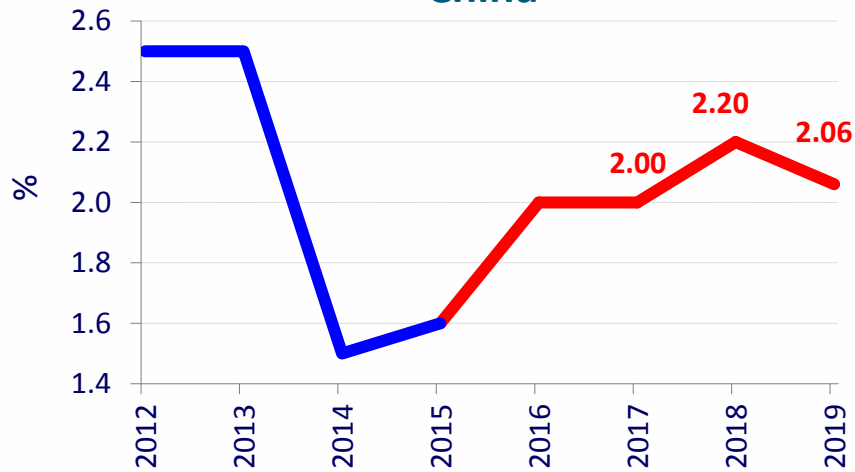
## United States



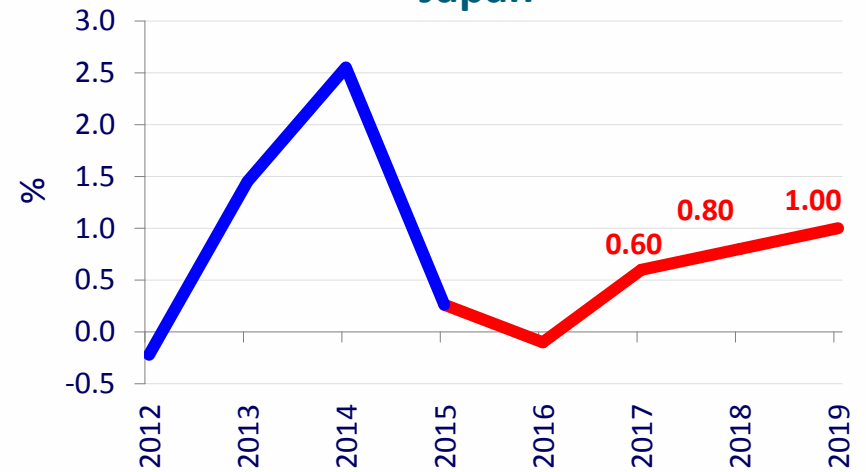
## Euro Area



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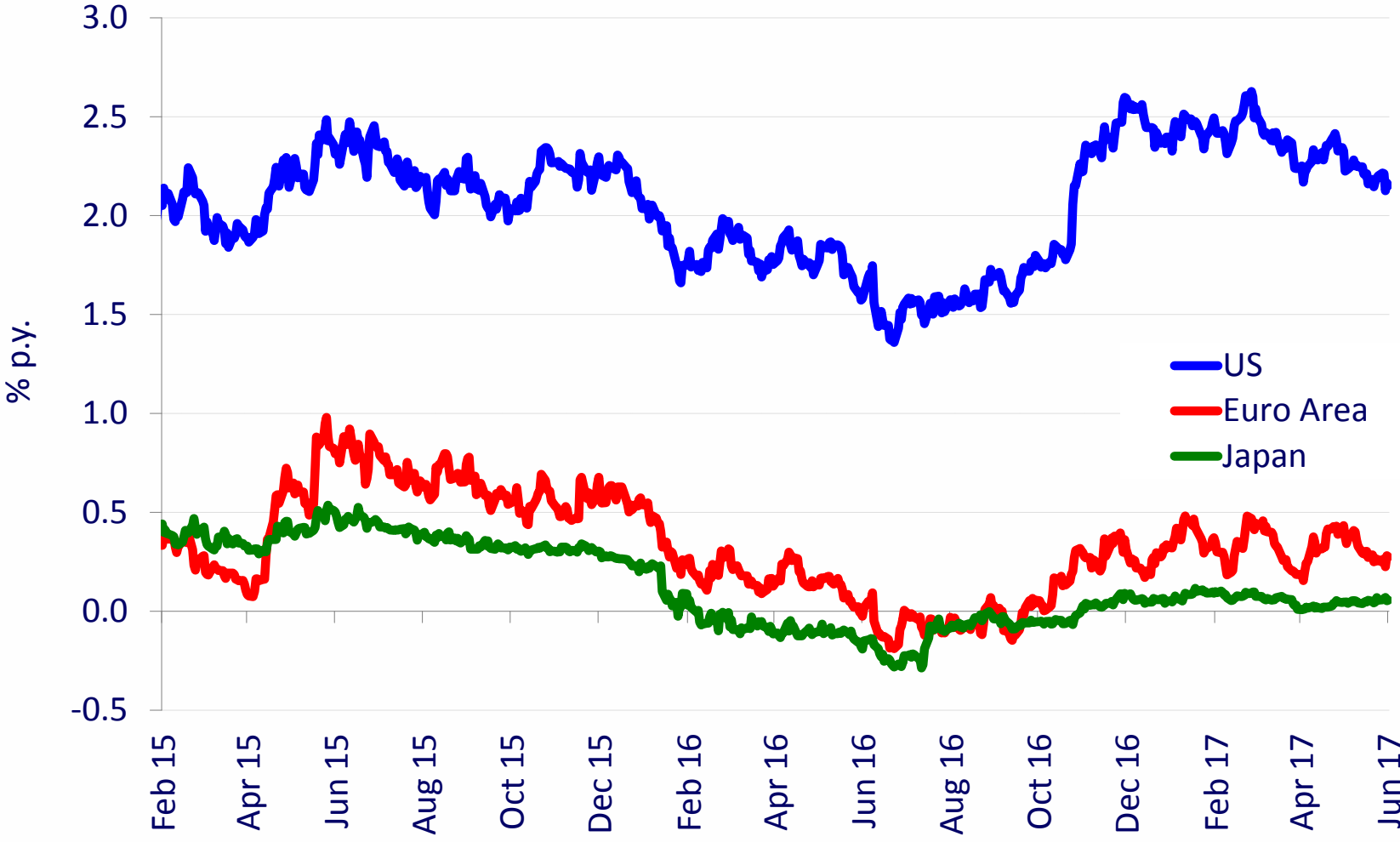
2017/18: projection

Source: Bloomberg (6/16)



# Long-Term Interest Rate

10 years

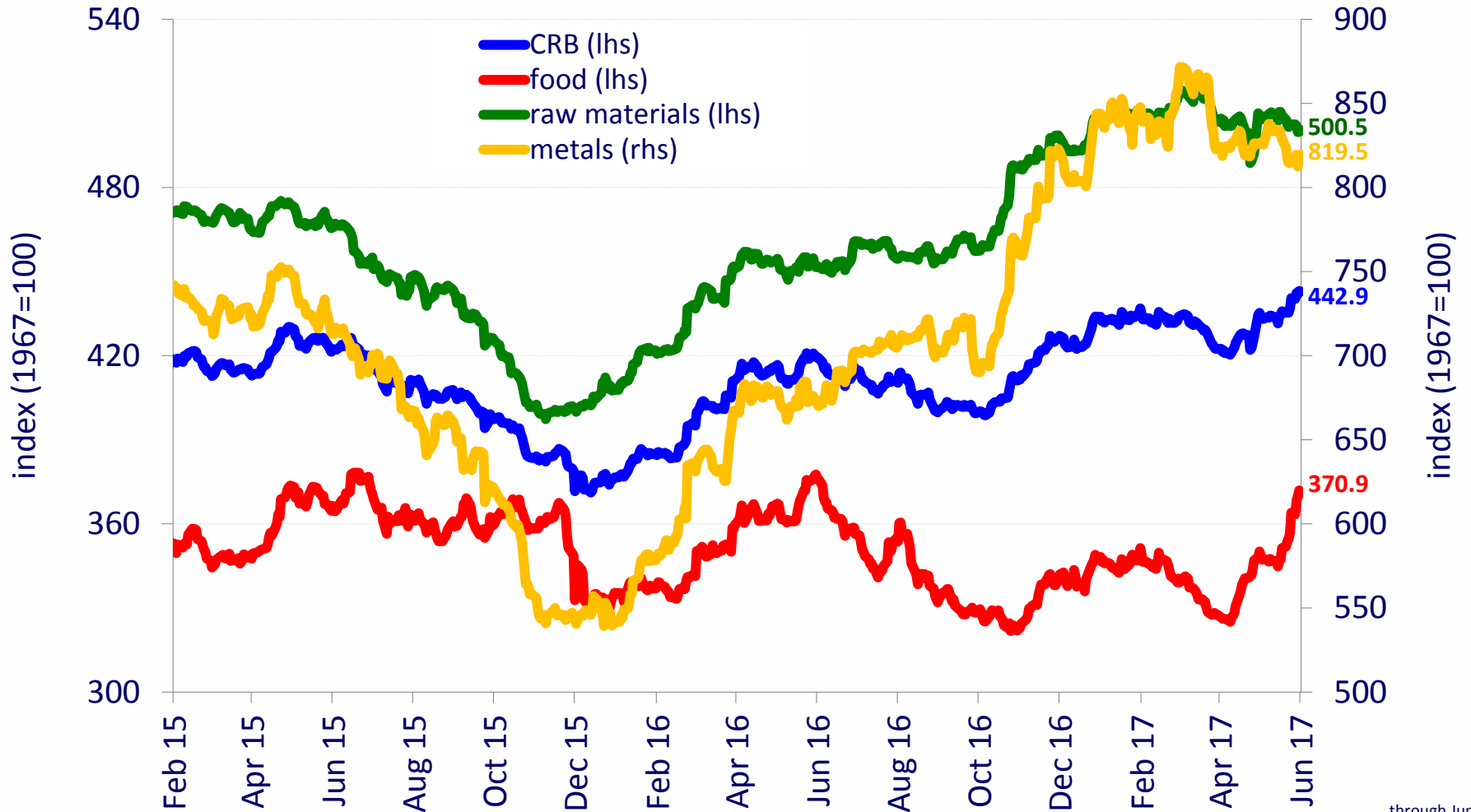


through Jun 16<sup>th</sup>

Source: Bloomberg

# Commodities Prices

## CRB Commodities Index

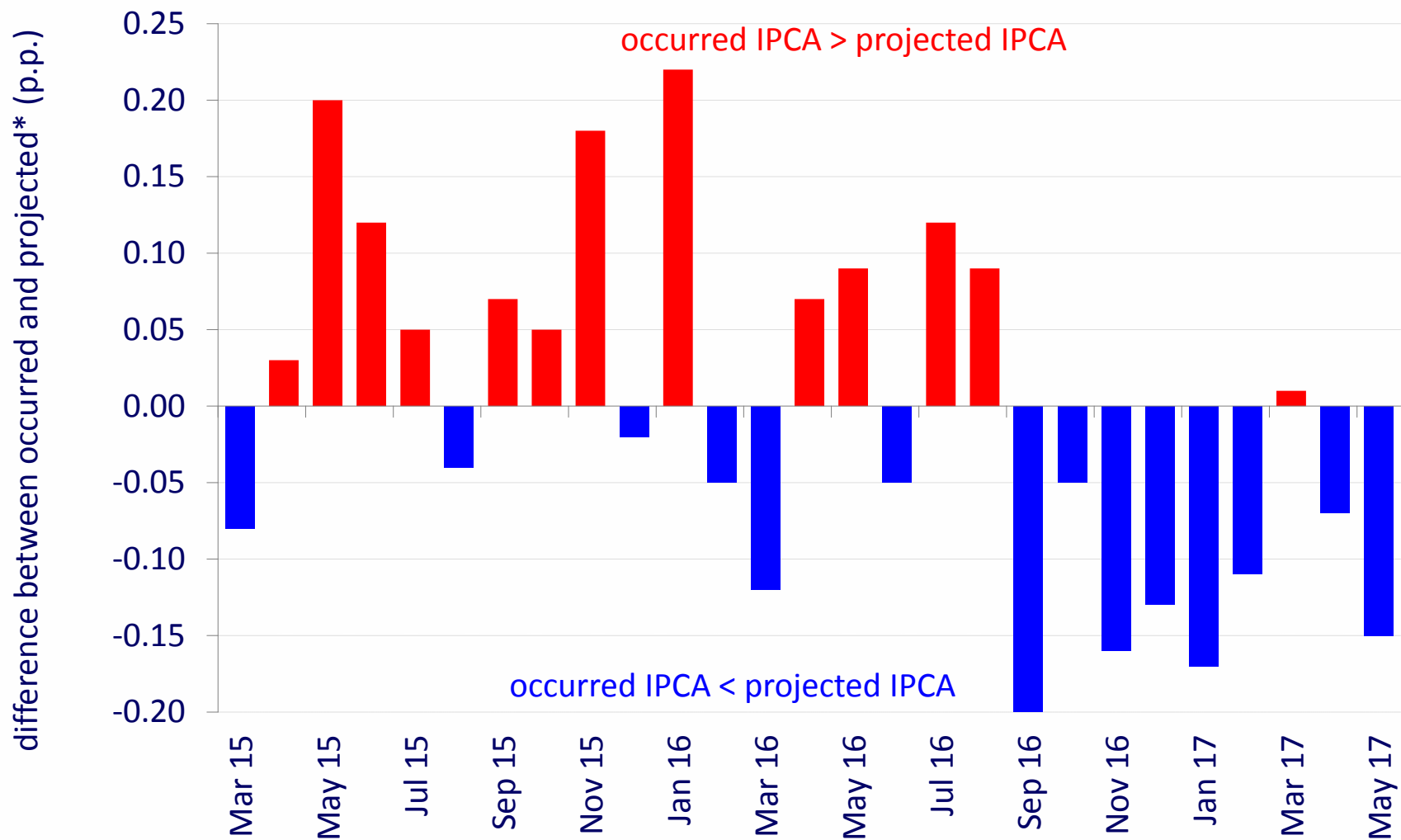


through Jun 16<sup>th</sup>

Source: Bloomberg

## iii. Inflation

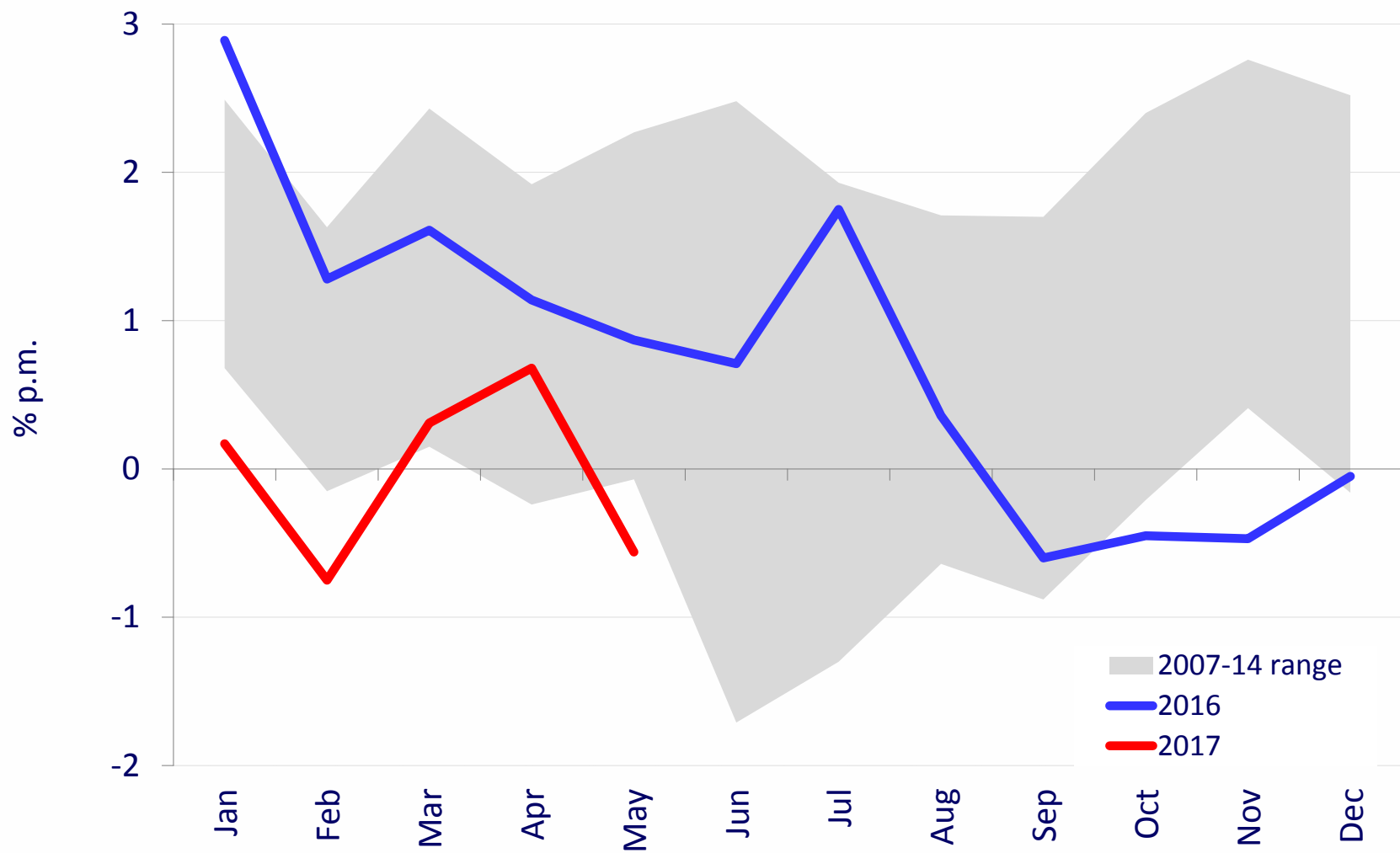
# Monthly IPCA – Expectations x Projected



\*projected on the IPCA Top 5 reference dates

Sources: IBGE and BC (Focus Survey))

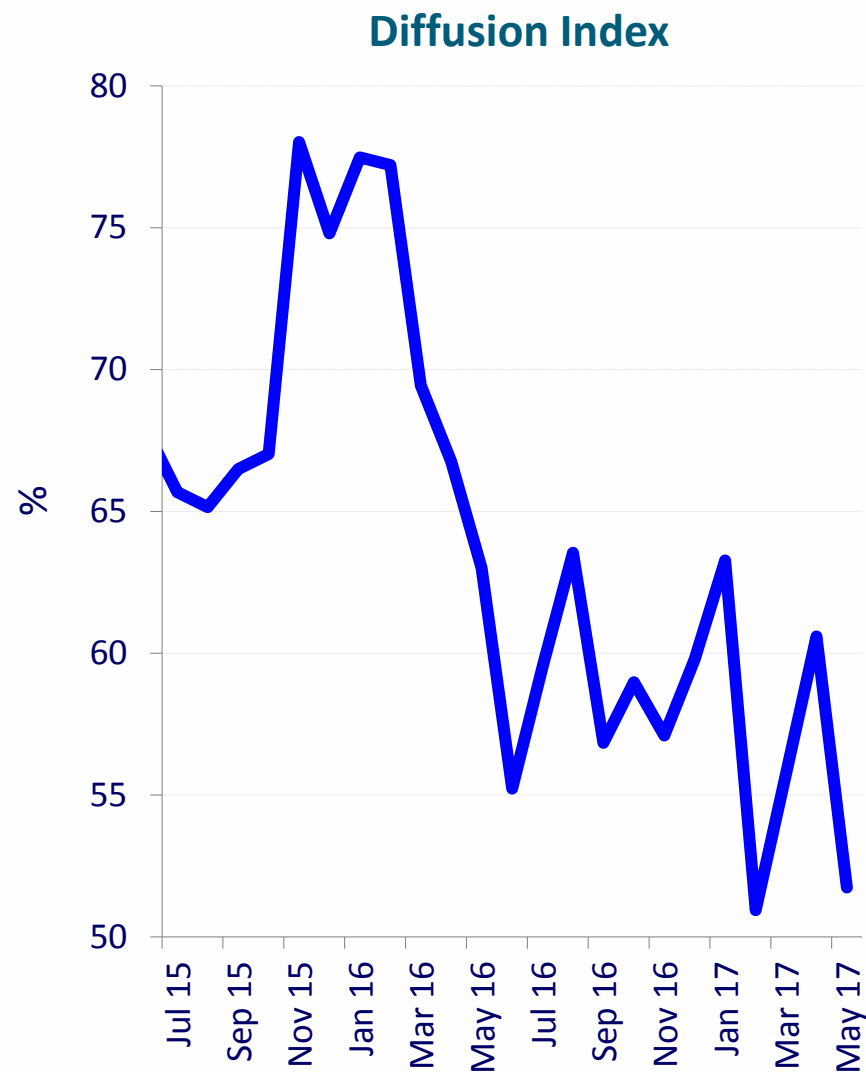
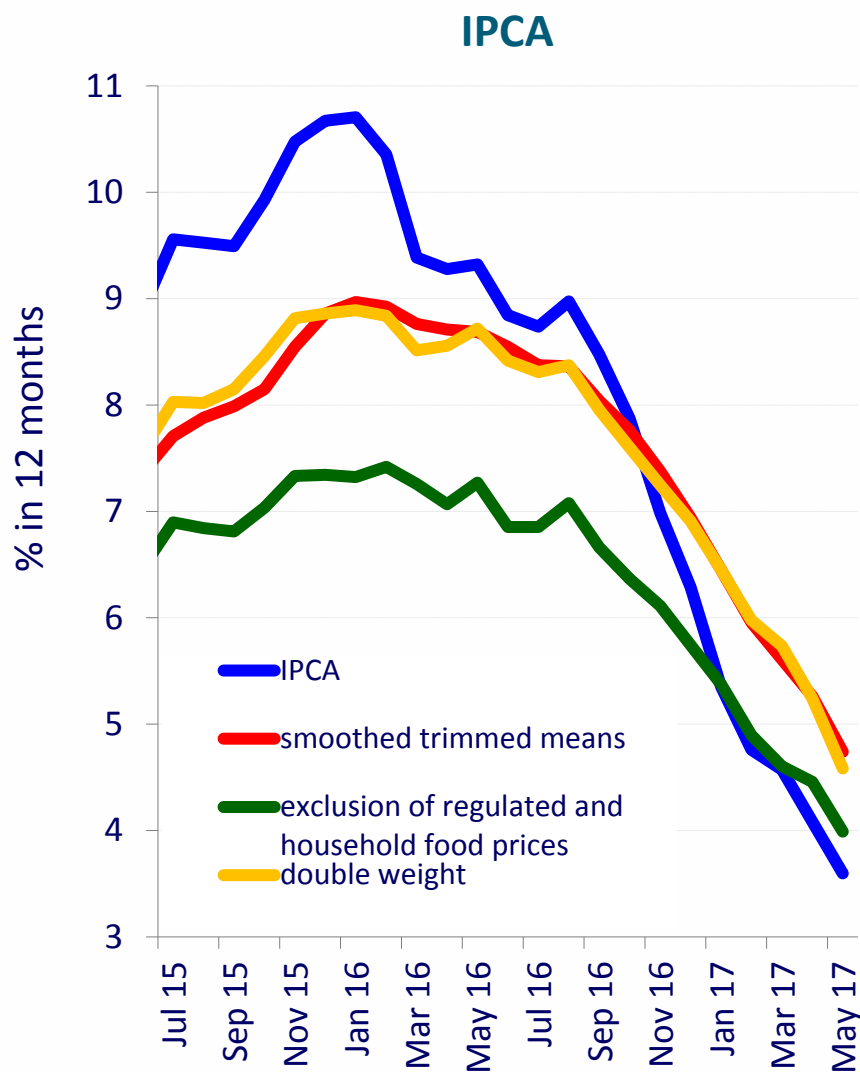
# IPCA - Food



shaded area: highs and lows for each month of 2007-2014

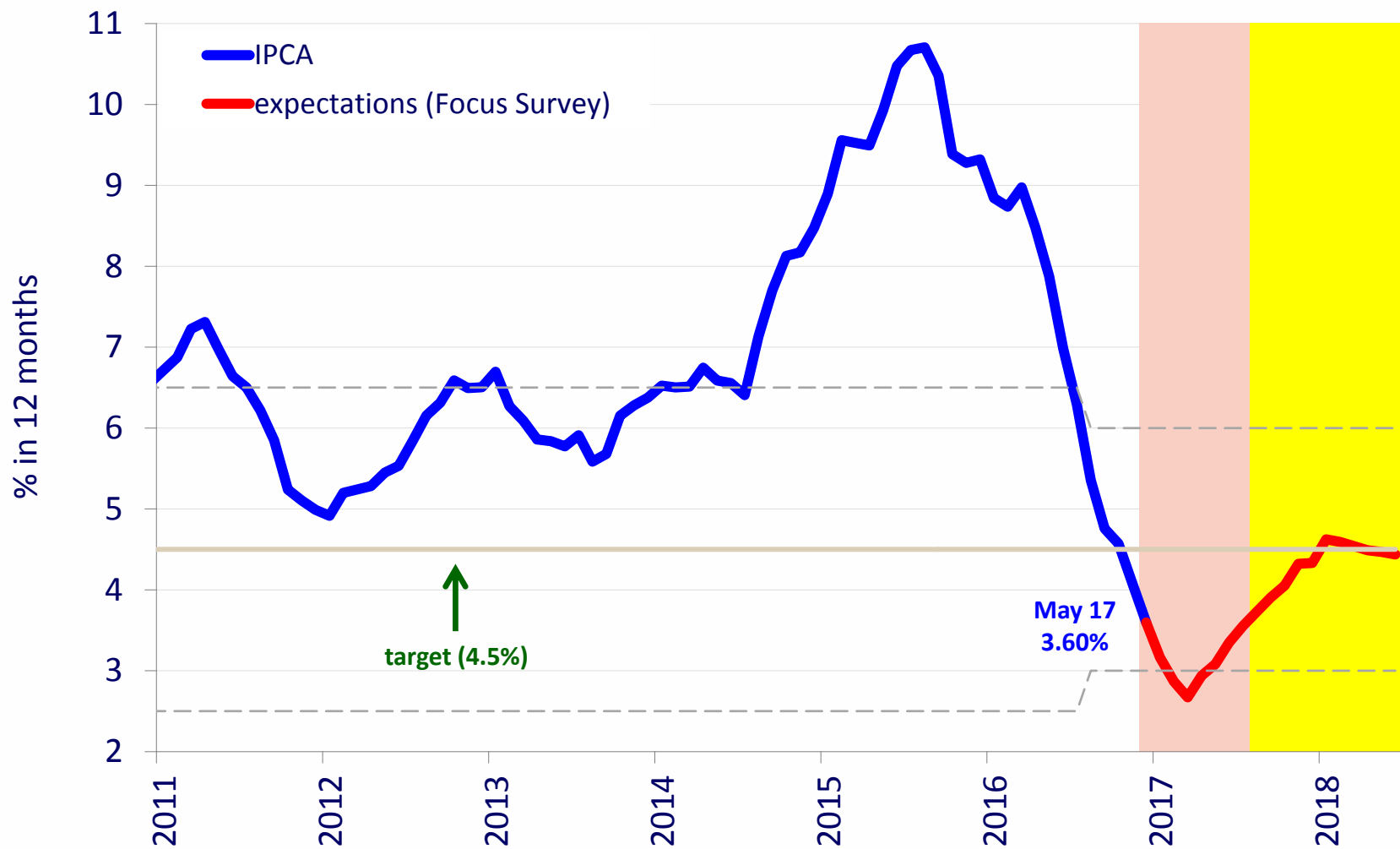
Sources: IBGE and BC

# IPCA – Headline, Cores and Diffusion Index



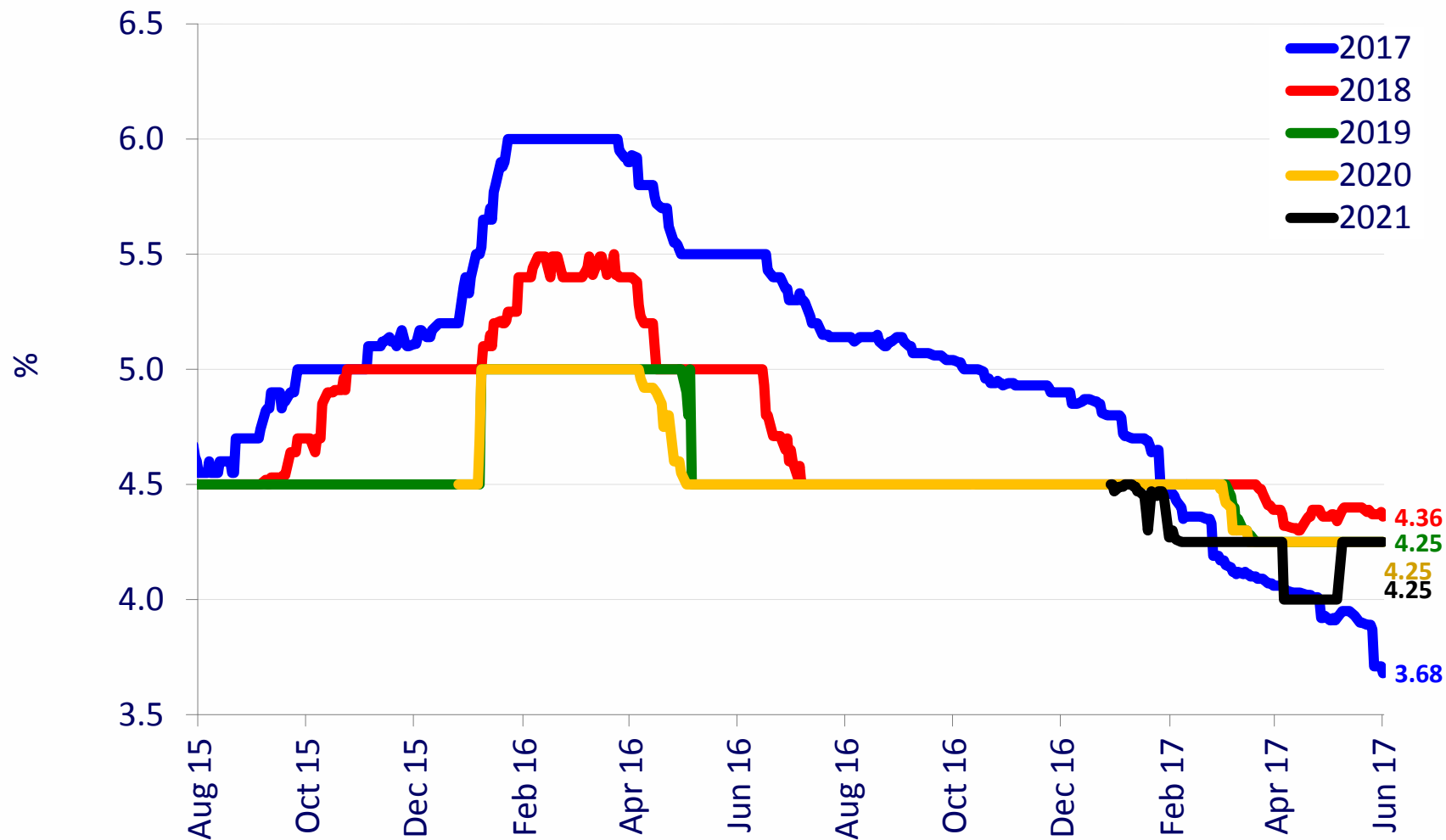
Source: IBGE

# Consumer Price Inflation (IPCA)

Focus: expectations as of Jun 14<sup>th</sup>

Source: BC (Focus Survey)

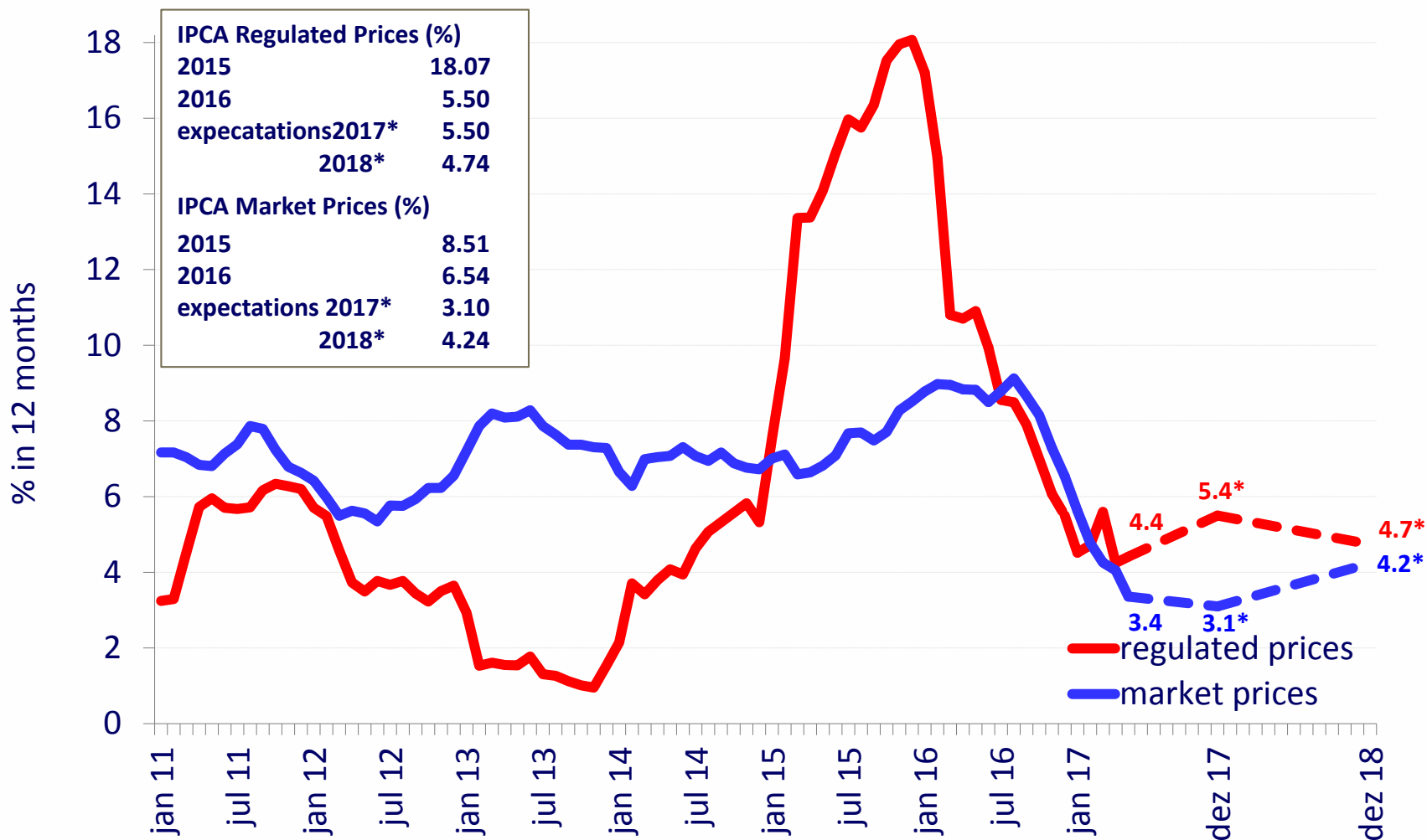
# Evolution of 2017-2021 IPCA Market Expectations

through Jun 14<sup>th</sup>

Source: BC (Focus)



# Market and Regulated Prices



\*expectations on Jun 14<sup>th</sup>

Sources: IBGE and BC (Focus)

# III. Conditional Forecasts

# Revisions and Short-Term Forecasts

## IPCA – Inflationary Surprise

	% change				
	2017				
	Mar	Apr	May	in the quarter	12 months through May
Copom Scenario <sup>1/</sup>	0.28	0.53	0.42	1.23	4.15
Observed IPCA	0.25	0.14	0.31	0.70	3.60
Surprise	-0.03	-0.39	-0.11	-0.53	-0.55

1/ At the March 2017 Inflation Report reference date

## IPCA – Short-Term Forecasts

	% change				
	2017				
	Jun	Jul	Aug	in the quarter	12 months through Aug
Copom Scenario <sup>1/</sup>	-0.10	0.30	0.27	0.47	2.73

1/ Scenario at the reference date

Sources: IBGE and BC

# Conditional Inflation Forecasts

## Cenário com Juros e Câmbio Focus

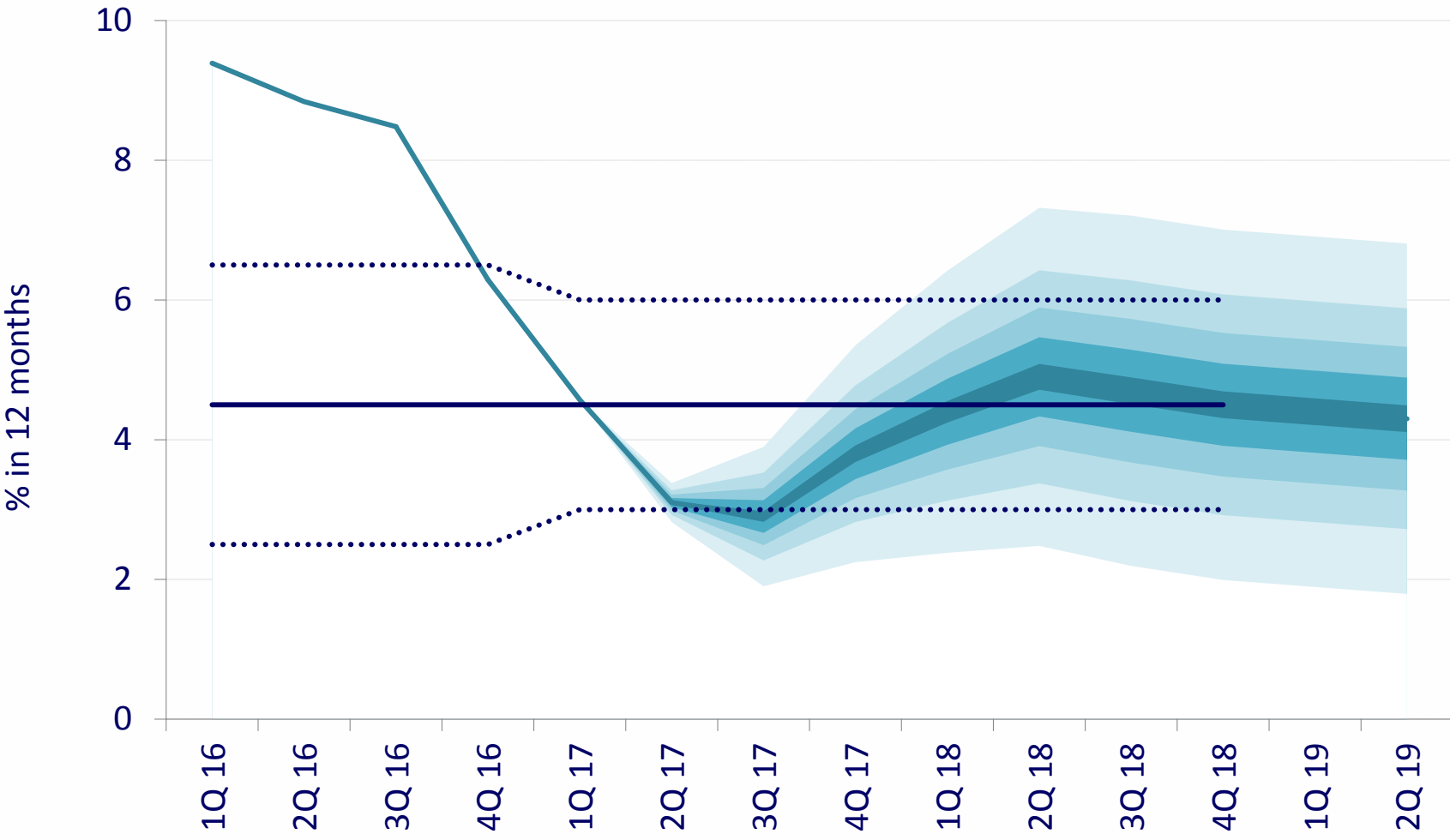
Period		March IR	June IR
2017	2	3.9	3.1
2017	3	3.4	2.9
2017	4	4.0	3.8
2018	1	4.4	4.4
2018	2	4.2	4.9
2018	3	4.2	4.7
2018	4	4.5	4.5
2019	1	4.6	4.4
2019	2	-	4.3

Obs.: 12-month accumulated inflation (%)

Source: BC

# Conditional Inflation Forecasts

Scenario with Focus Selic and Exchange Rates



Source: BC

# Conditional Inflation Forecasts

## Reported Scenarios

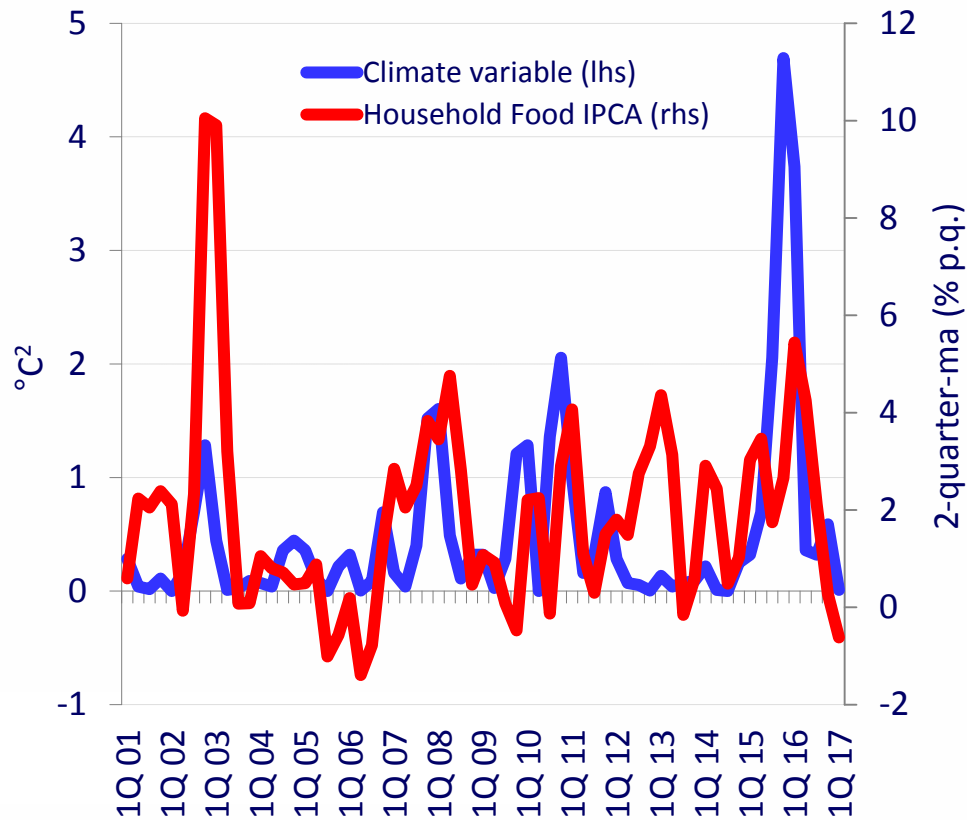
Period		Focus Selic and Exchange Rates	Focus Selic and Constant Exchange Rate	Constant Selic and Exchange Rates	Constant Selic and Focus Exchange Rate
2017	2	3.1	3.1	3.1	3.1
2017	3	2.9	2.9	2.9	2.9
2017	4	3.8	3.8	3.8	3.8
2018	1	4.4	4.4	4.3	4.3
2018	2	4.9	4.9	4.7	4.7
2018	3	4.7	4.6	4.2	4.3
2018	4	4.5	4.3	3.9	4.0
2019	1	4.4	4.3	3.8	3.9
2019	2	4.3	4.2	3.7	3.8

Obs.: 12-month accumulated inflation (%)

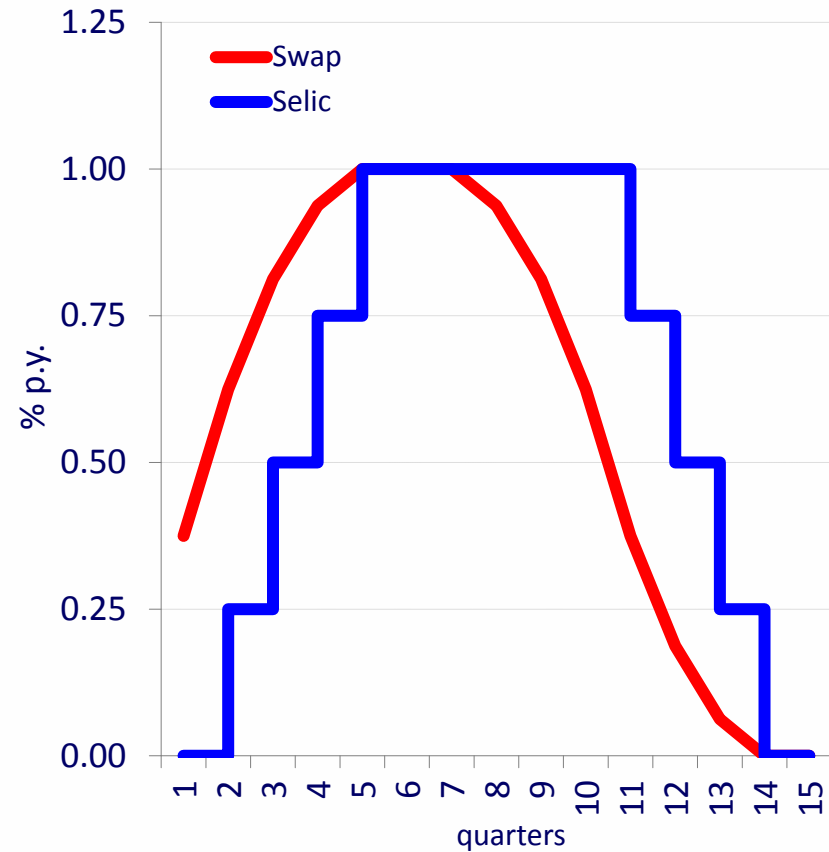
Source: BC

# Box: Aggregate Semistructural Model

## Climate and Household Food IPCA



## Response of *Swap* to a Hypothetic Cycle of Changes in the Selic Rate



# Conduct of Monetary Policy - 1

- In its meeting in May (207<sup>th</sup> meeting), the Copom unanimously decided for the reduction of the basic interest rate by one percentage point, to 10.25% p.y., without bias.
- At the occasion, the Committee communicated as main risk factor the increase of uncertainty regarding the speed in the process of reforms and adjustments in the economy. This occurs due to both the higher probability of scenarios that hamper this process and to the difficulty in the assessment of the effects of these scenarios over inflation determinants.
- Considering both the basic scenario and the balance of risks assessed in its last meeting, the Copom judged that a moderate reduction in the pace of monetary easing relative to the one adopted in that occasion should be adequate in its next meeting, in July (208<sup>th</sup> meeting).



# Conduct of Monetary Policy - 2

- The Copom evaluates that the effects of uncertainty over the prospective inflation trajectory are transmitted through two basic channels:
  - The maintenance, for a prolonged time, of heightened uncertainty levels regarding the evolution of reforms and adjustments in the economy can have detrimental effects on economic activity and, therefore, be disinflationary.
  - Impact of uncertainty over price formation and over estimates of the structural interest rate may have opposite direction.
- Possibility that the effects may compensate each other and that the inflation prospective trajectory is not impacted.
- Therefore, there is no direct and mechanical relationship between the increase in uncertainty and monetary policy.
- Flexibility of the inflation targeting regime allows the Copom to adjust monetary policy to the possible prospective scenarios

# Conduct of Monetary Policy - 3

- The Copom judges that the convergence of inflation to the 4.5% target over the relevant horizon for the conduct of monetary policy, which includes calendar-years of 2018 and, with a gradually decreasing weight, 2017, is compatible with the monetary easing process.
- The length of the monetary easing cycle will depend on the inflation projections and expectations, economic activity, the balance of risks, but also on the estimates for the structural interest rate of the Brazilian economy. The Copom judges that the recent increase in uncertainty regarding the evolution of reforms and adjustments in the economy hampers a more timely reduction of estimates of the structural interest rate, and makes them more uncertain. These estimates will continue to be reassessed by the Committee over time.

# Conduct of Monetary Policy - 4

- The Copom confirms its preference for disclosing the conditionalities regarding the evolution of monetary policy, which best communicates the economic *rationale* that guides its decisions. This contributes to increase the transparency and to improve Copom's communication.
- The pace of monetary easing will continue to depend on the evolution of economic activity, the balance of risks, possible reassessments of the extension of the cycle, and on inflation forecasts and expectations.

# Inflation Outlook

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