

Inflation Outlook

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Inflation Report
September 2016

* This presentation represents the Copom's best effort to provide an English version of the Inflation Report presentation. In case of any inconsistency, the original version in Portuguese prevails.

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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 fulfillment with the mission to ensure price stability is reached 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 the planning horizons, depresses investment and economic growth
 - regressive
 - in short, reduces potential growth, affects employment and income generation, worsens income distribution

Main Messages - 1

- **Evidences compatible with the Copom basic scenario**
 - ongoing disinflation; still uncertain pace

- **Announcement of relevant factors for a monetary policy easing**
 - to allow greater confidence in reaching the targets in the relevant horizon

Main Messages - 2

- **Relevant horizon considers calendar-years with targets defined by the CMN. Includes 2017, for which the Committee pursues the convergence to the 4.5% target**
- **Relevant horizon is not static**
 - **continuity**
 - **there is no “moment of horizon extension”**

Main Messages - 3

- **Assessment of the evolution of the three factors highlighted by the Copom**
- **Subjective assessments, but always sustained by solid evidence regarding the relevant factors**

II. Baseline Scenario

i. Economic Activity:

- **evidences of recent stabilization; high economic slack**

ii. External Scenario:

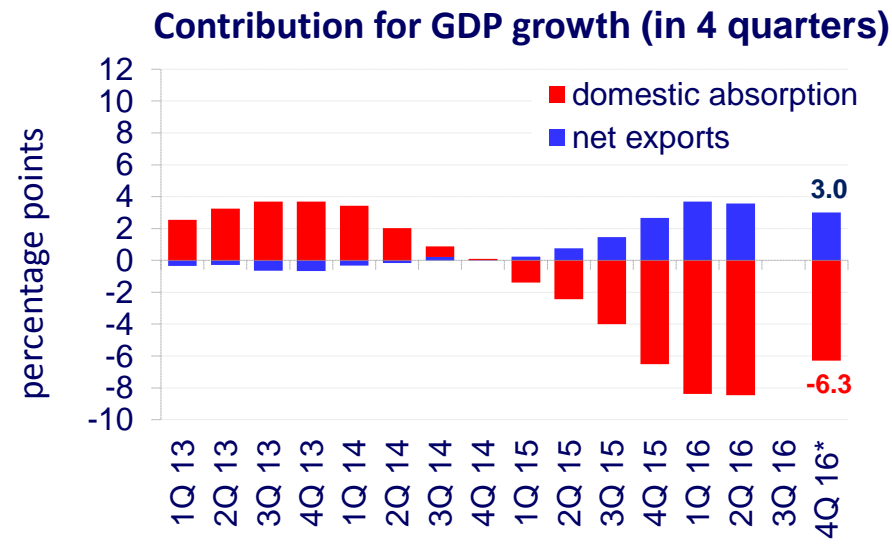
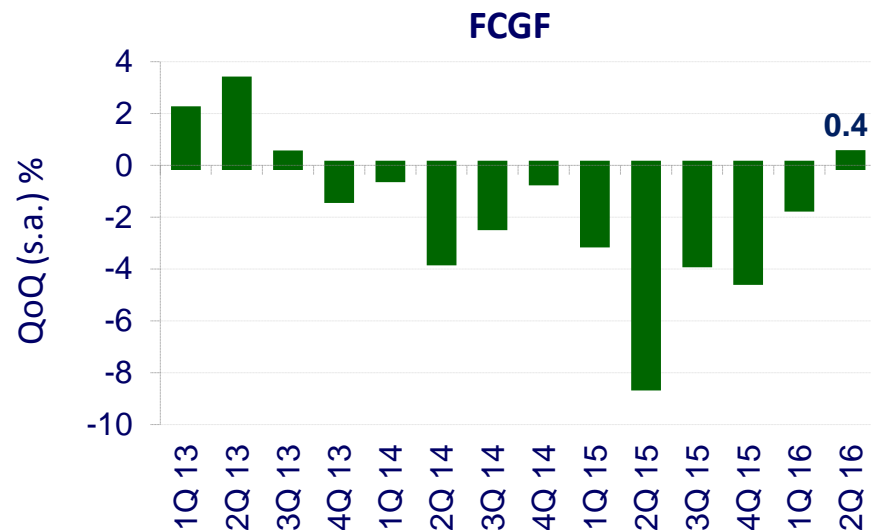
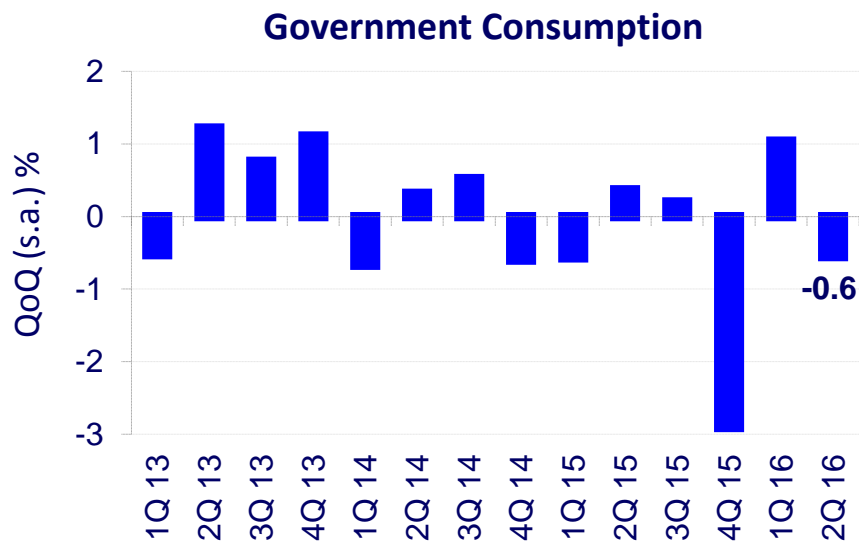
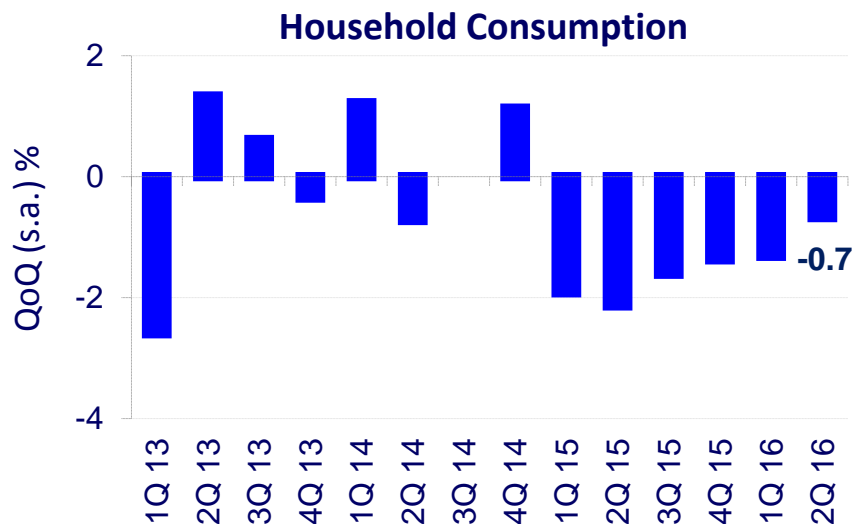
- **benign interregnum**

iii. Inflation:

- **above expectations in the short-term**
- **ongoing disinflation, still uncertain pace**

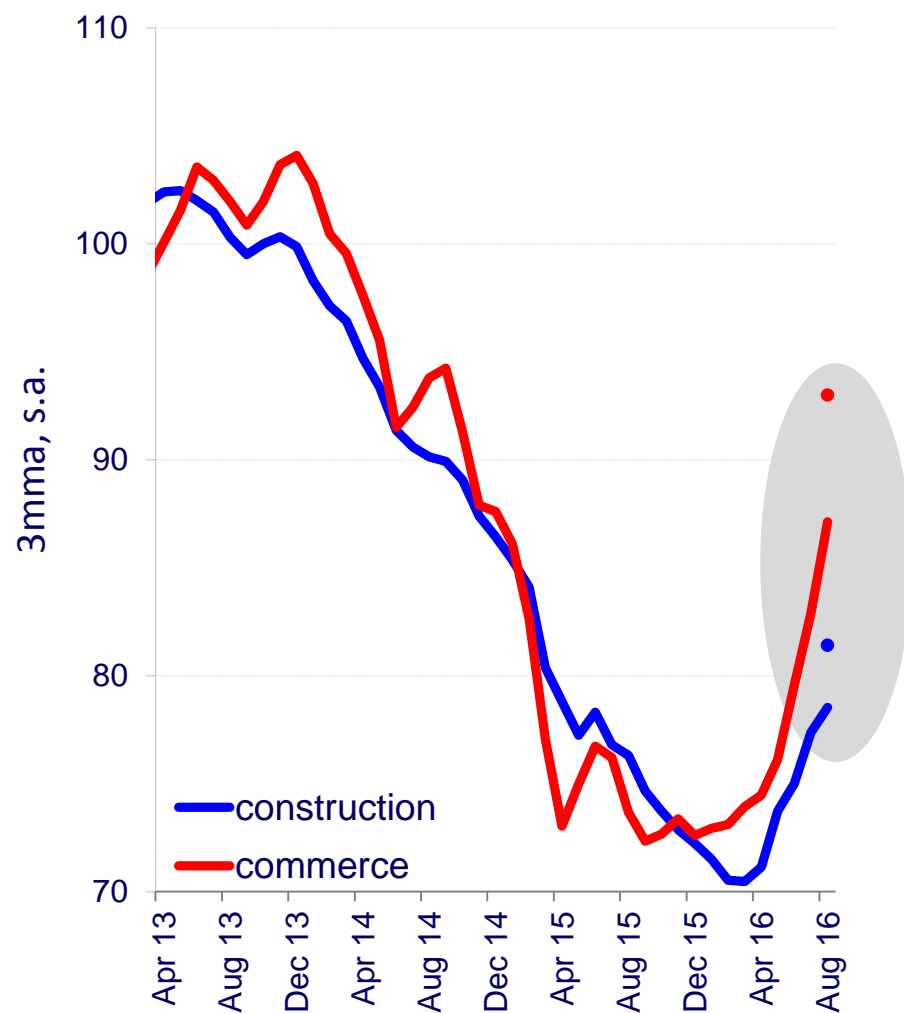
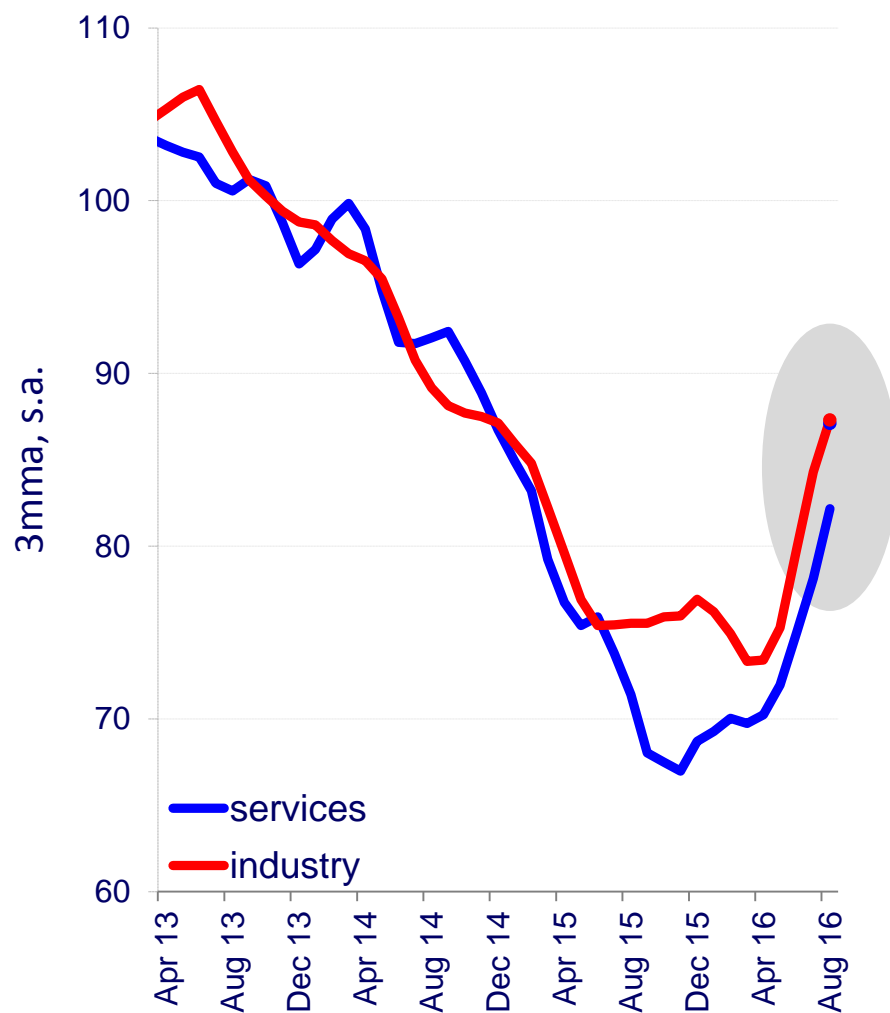
i. Economic Activity

Demand: Moderation in Line with Adjustment



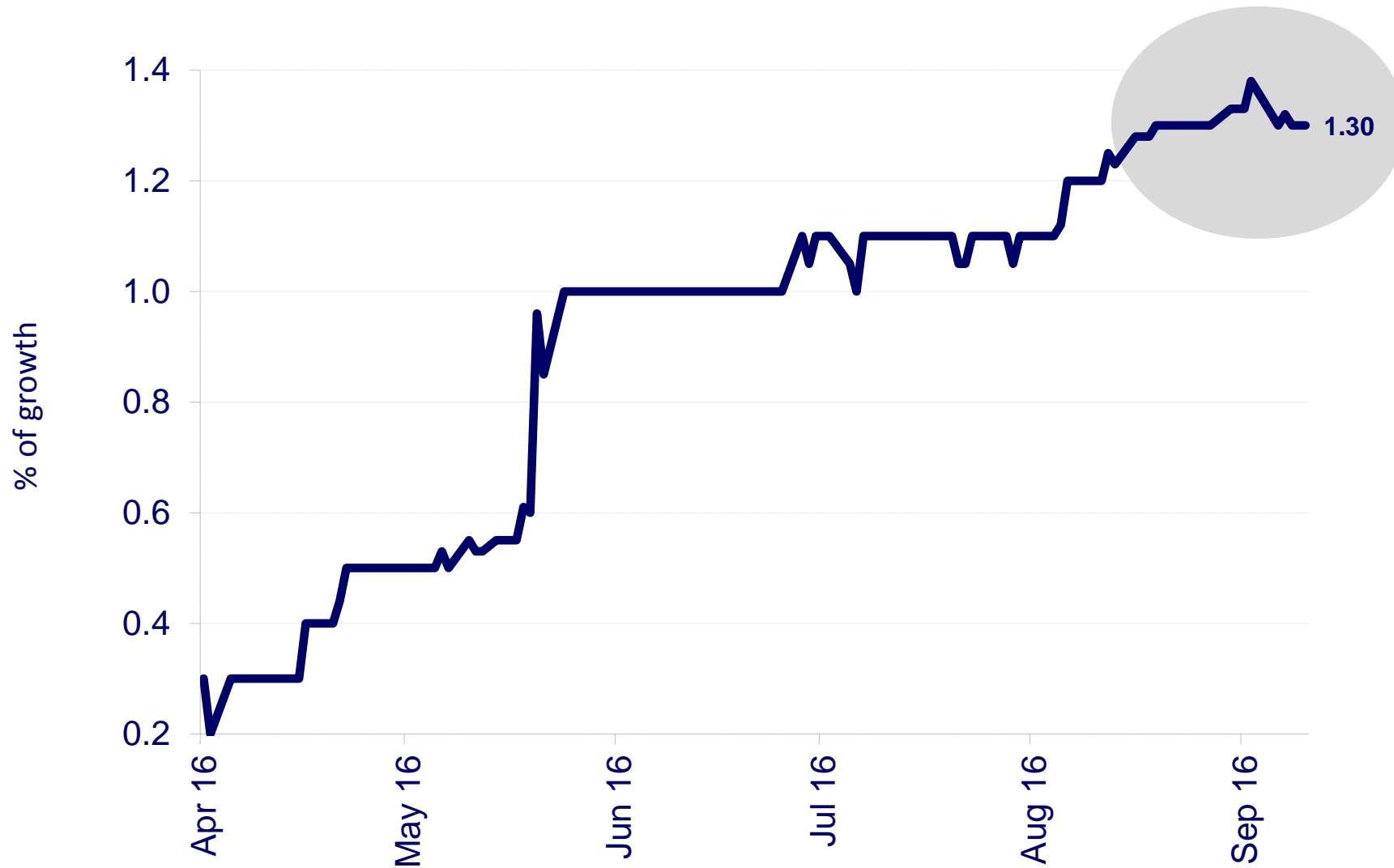
*BCB projections

Agents' Confidence - Businessmen Expectations

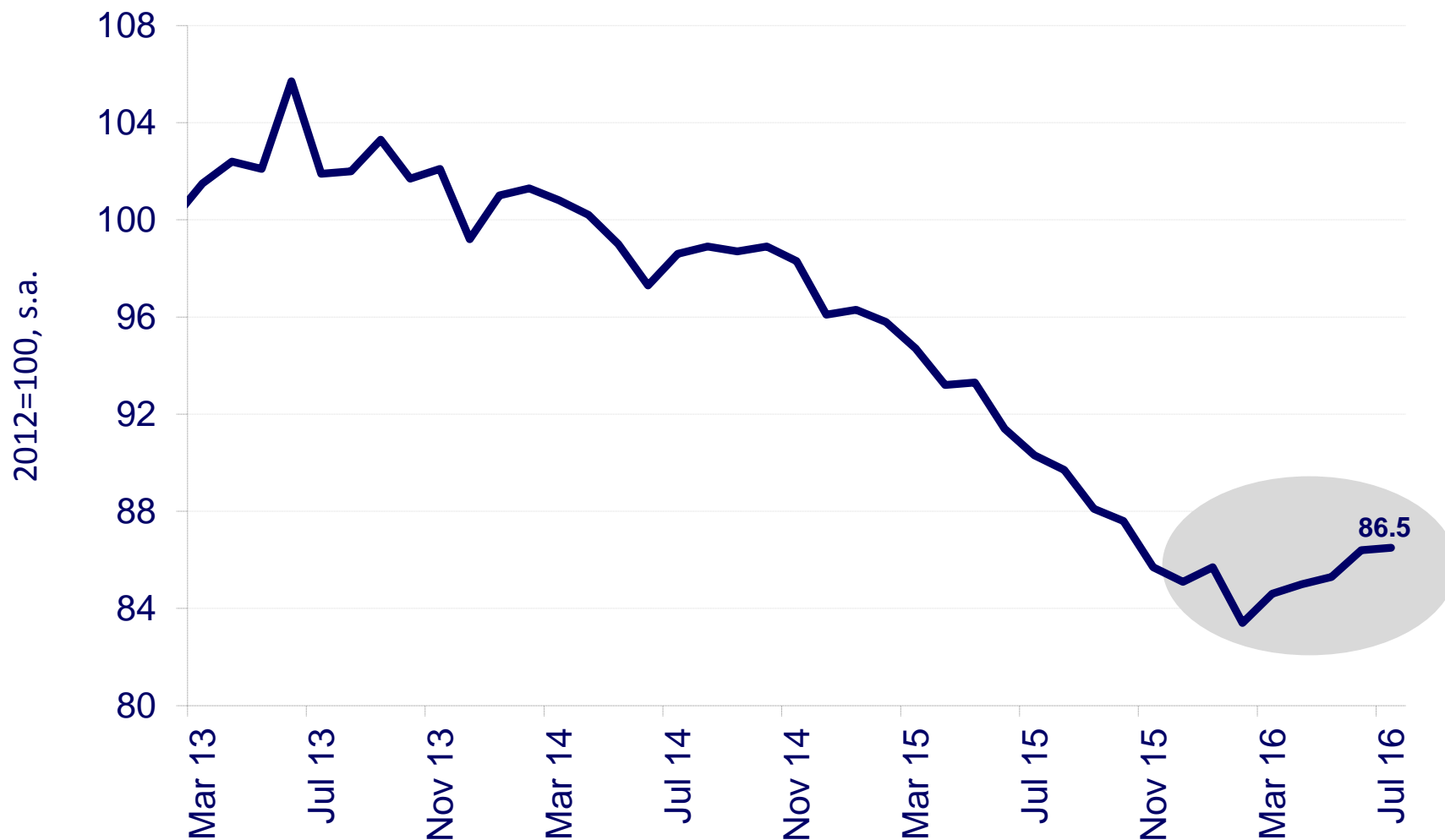


Obs.: proportion of favorable answers – proportion of unfavorable answers + 100 (100=neutral)

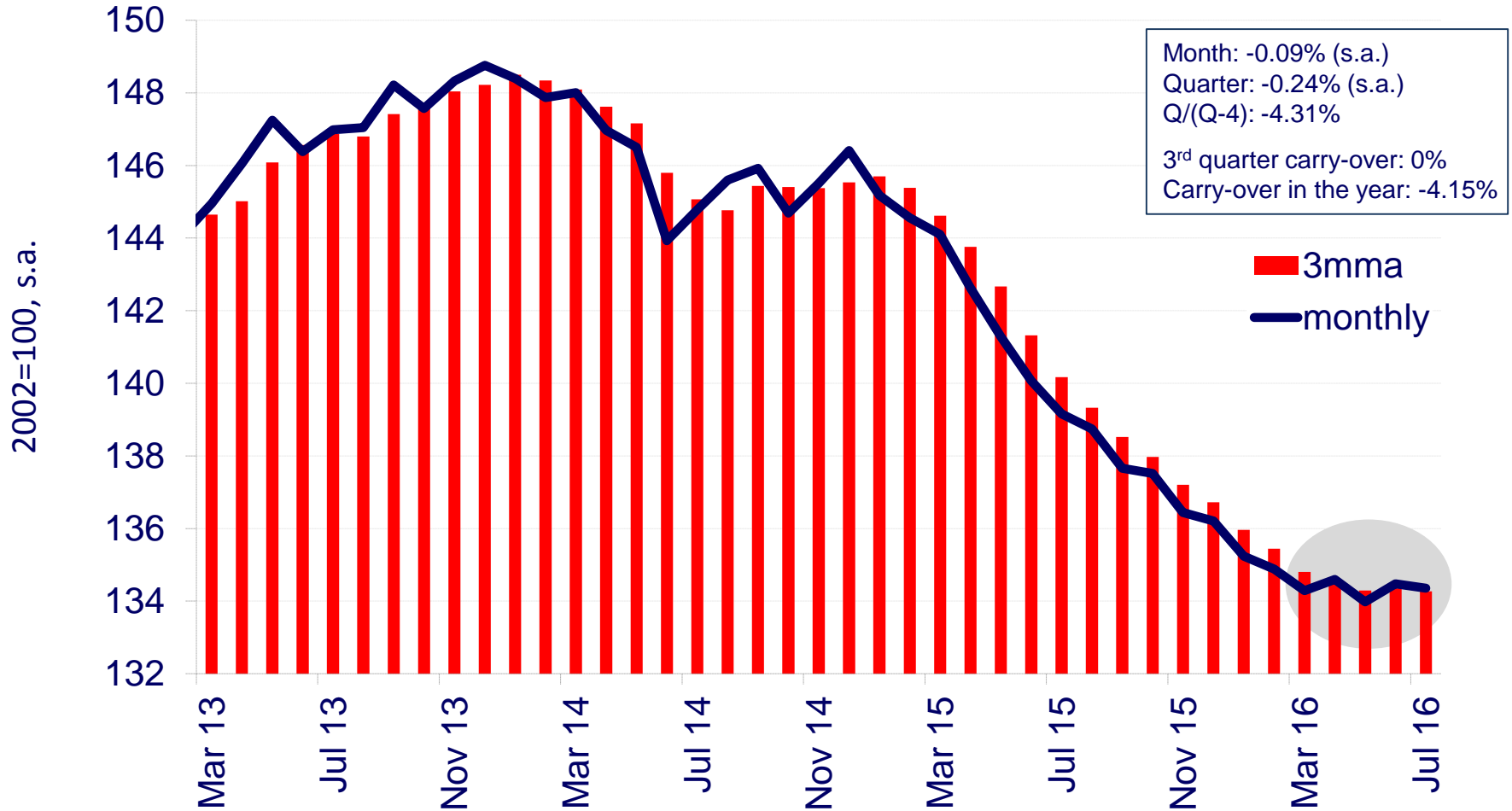
Market Expectations for 2017 GDP

through Sep 23rd

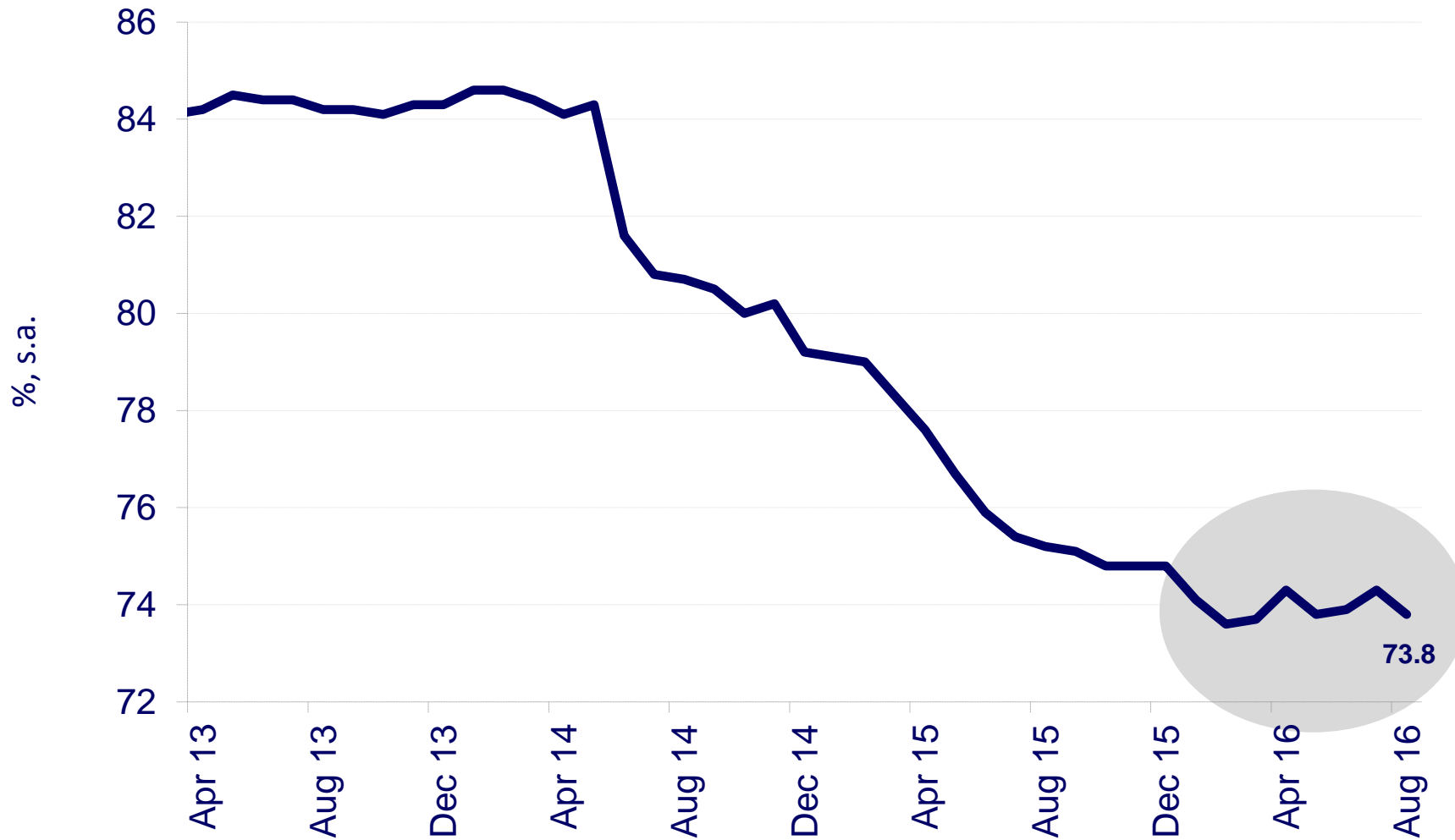
Industrial Production



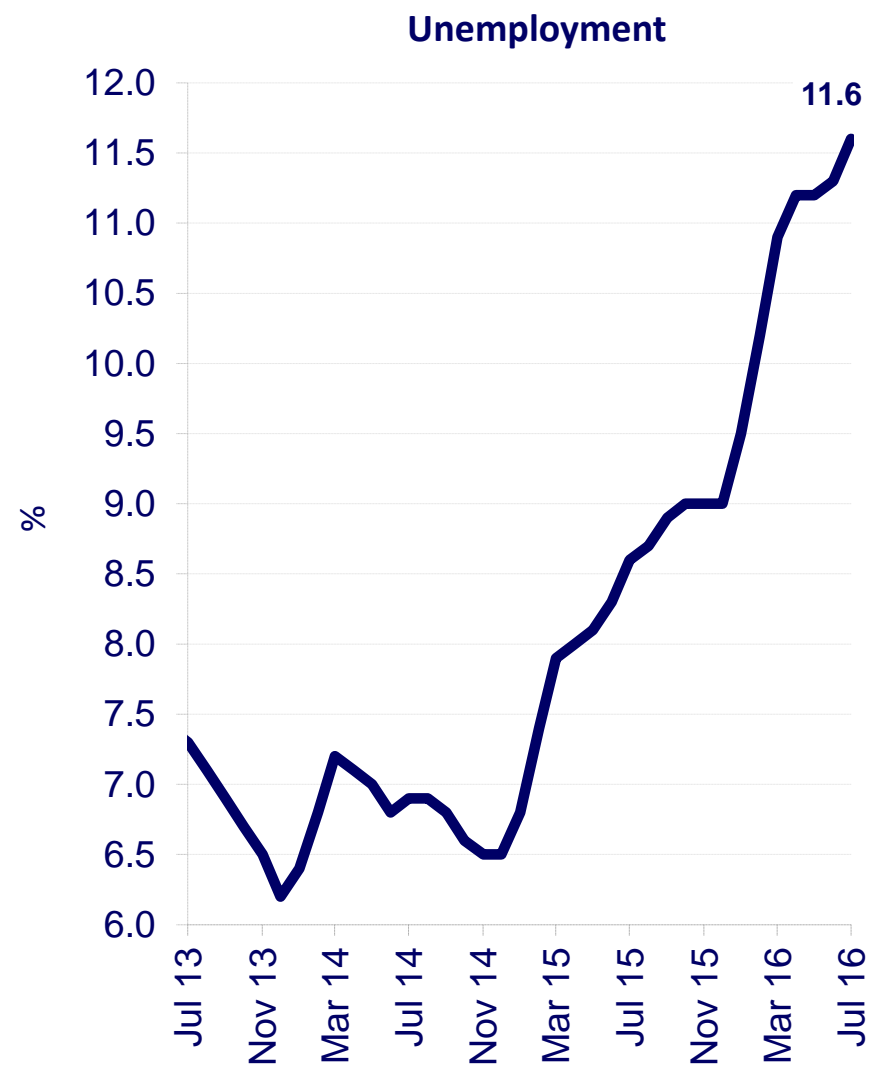
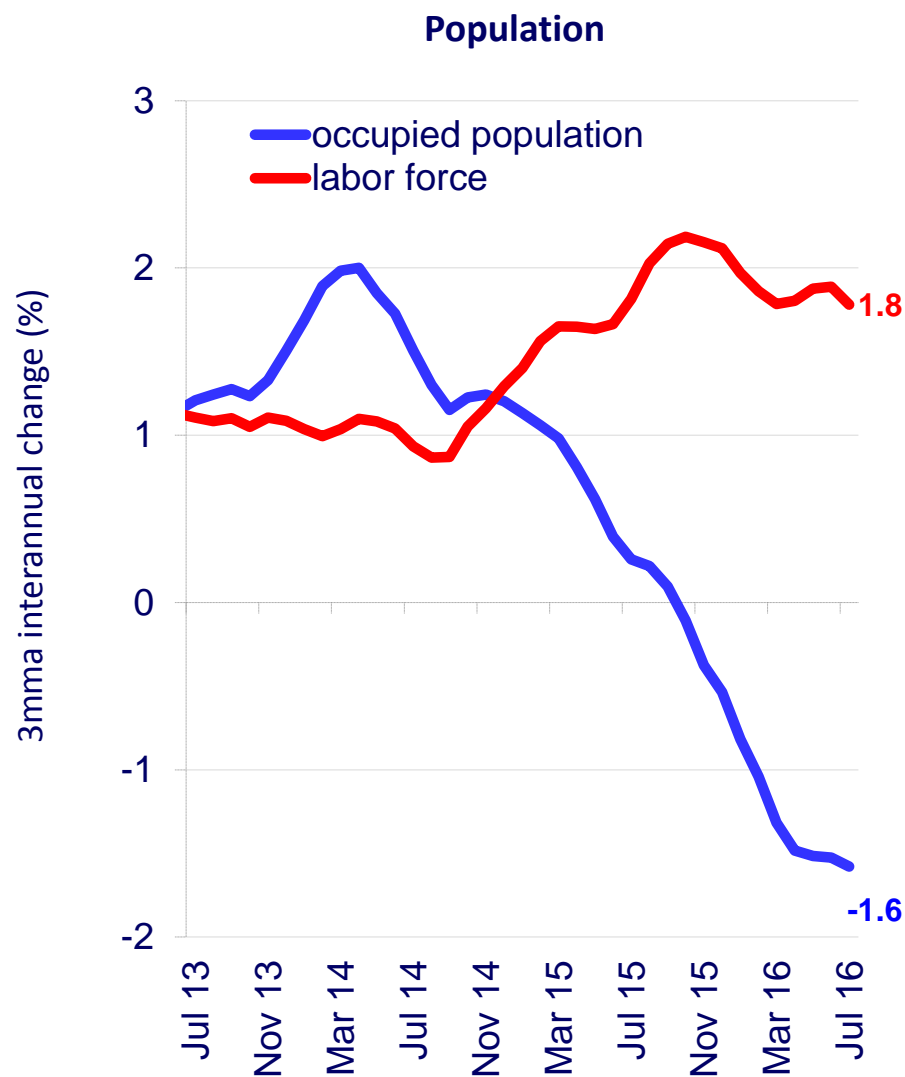
IBC-Br



Installed Capacity Utilization Level (NUCI)



Labor Market: Distension



Box: GDP Projections

- **2016 change maintained at -3.3% (domestic absorption, -6.3 p.p.; and net exports, 3.0 p.p.)**
 - **Supply**
 - Agriculture and livestock: -2.2% (1.8% in 2015)
 - Industry: -3.3% (-5.8% in 2015)
 - Services: -2.7% (-2.7% in 2015)
 - **Demand**
 - Investment: -8.7% (-14.1% in 2015)
 - Household Consumption: -4.4% (-4.0% in 2015)
 - Government Consumption: 0.9% (0.0% in 2015)

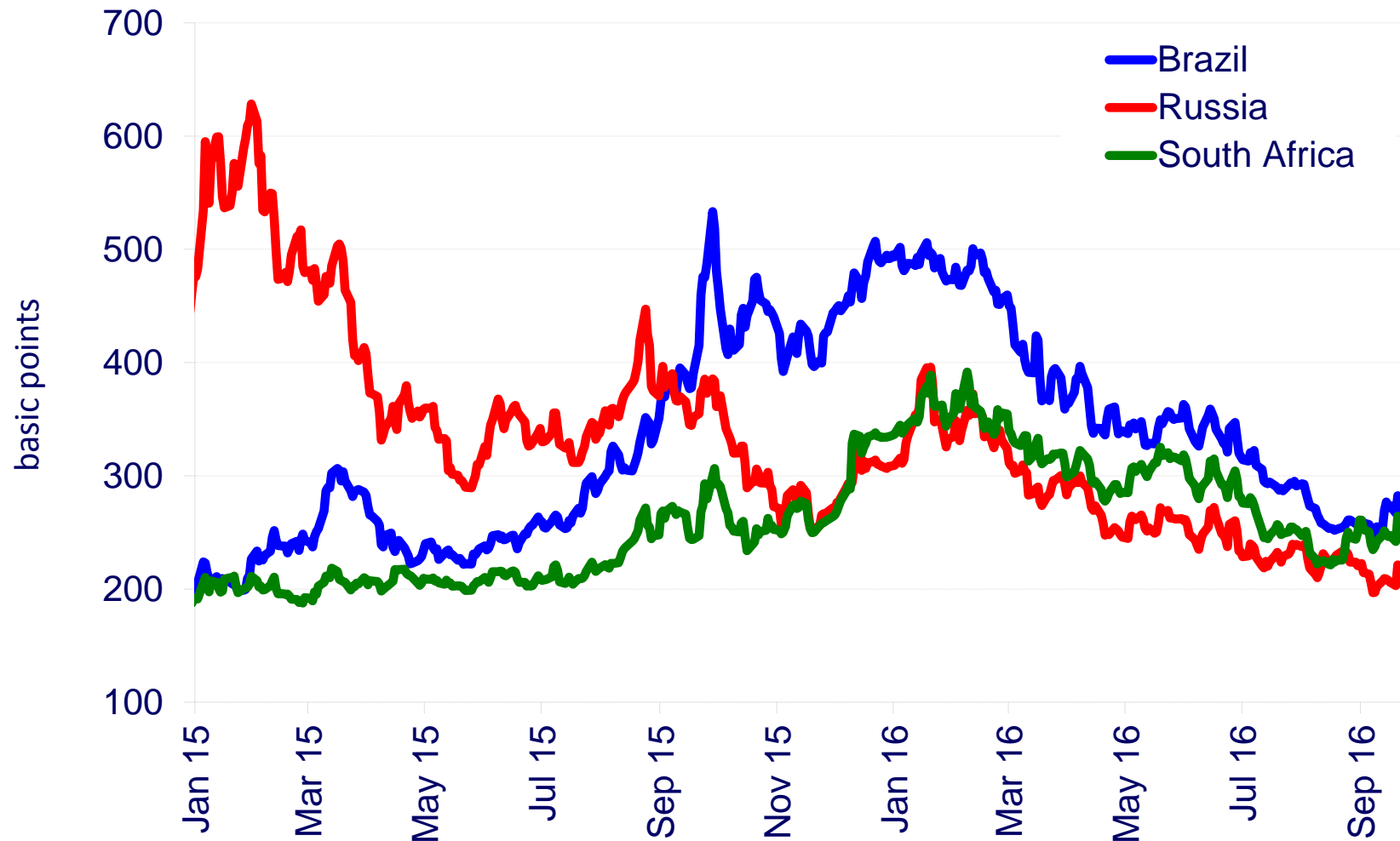
- **For 2017, expected growth of 1.3%**

Box: Occupational Mobility in the Labor Market in the Recent Period

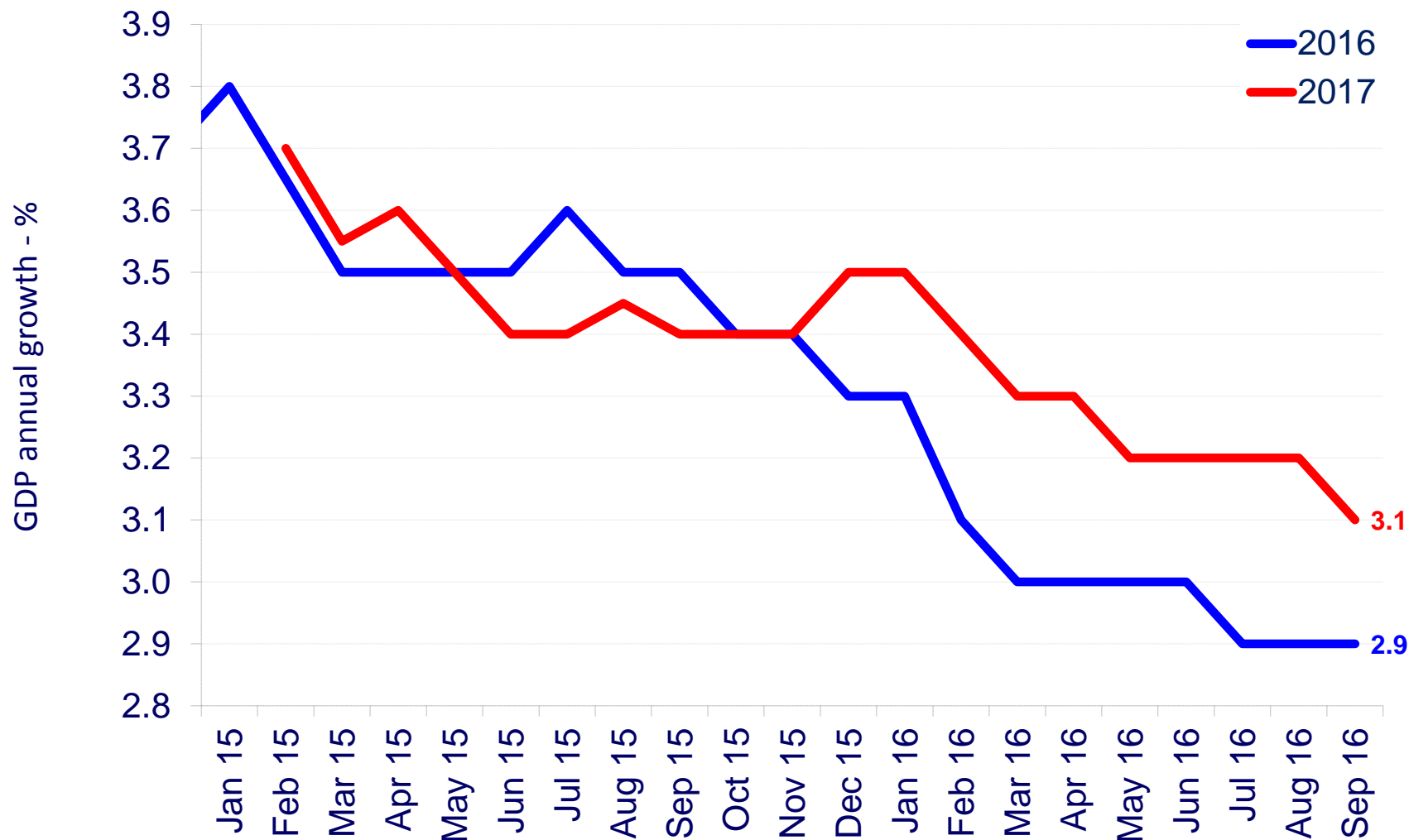
- **Analyses the mobility among occupation categories, with emphasis in the growth of self-employed workers and unemployed**
- **The analysis confirms recent change in the occupational structure of the labor market, with formal workers moving to the category of self-employed workers**
- **Increases in the net flows of formal and informal workers are still observed and, more recently, of self-employed workers, into the unemployed category. The increase in the number of unemployed has also occurred due to the increase in the net flow of people who were out of the labor force**

ii. External Scenario

5-year CDS

through Sep 23rd

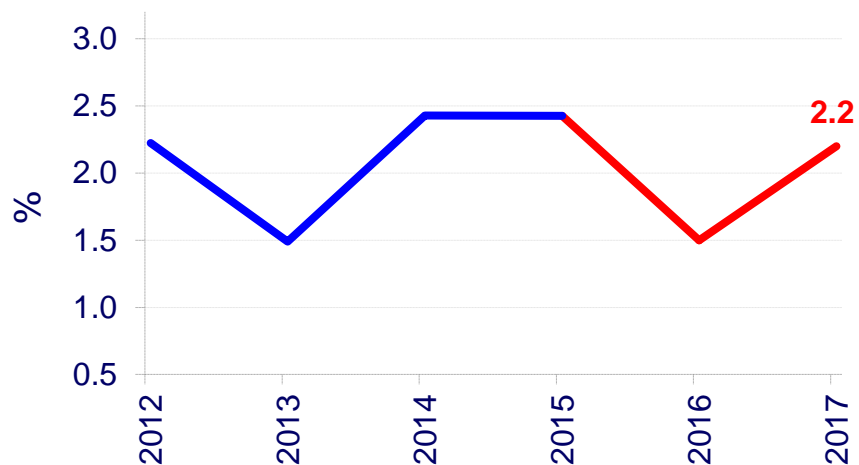
Prospect for Moderate Global Growth



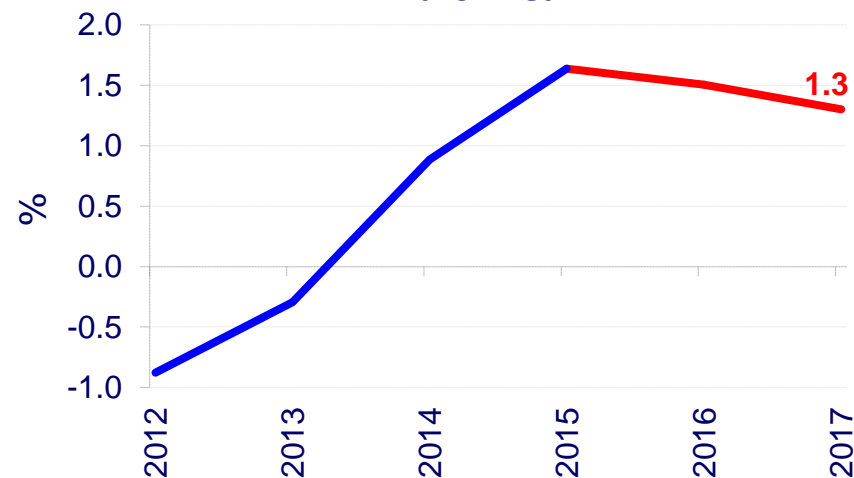
Source: Bloomberg (Sep/16: on Sep 23rd)

Activity

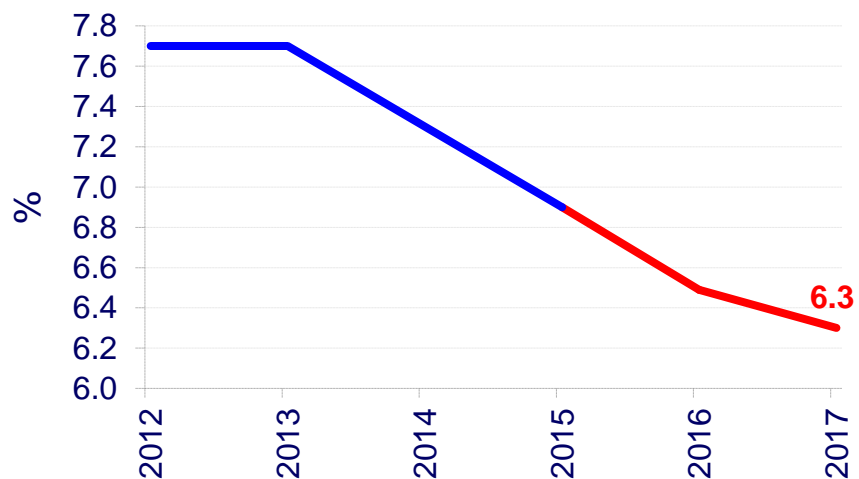
United States GDP anual growth



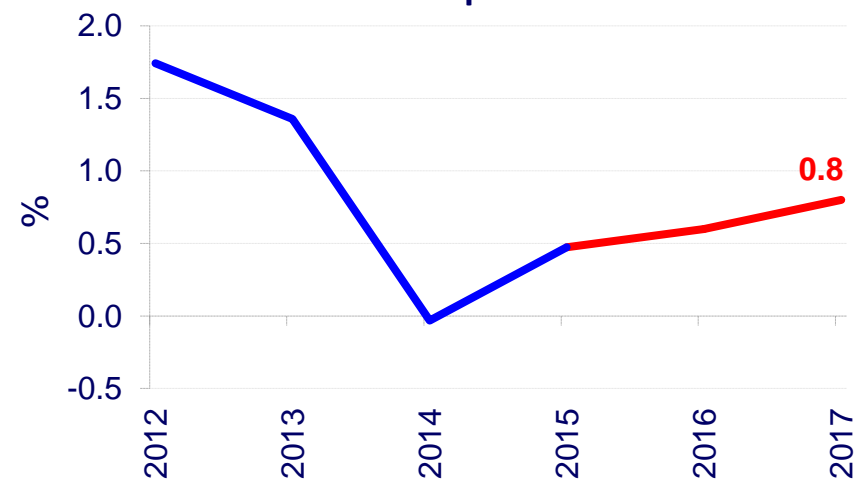
Euro Area



China



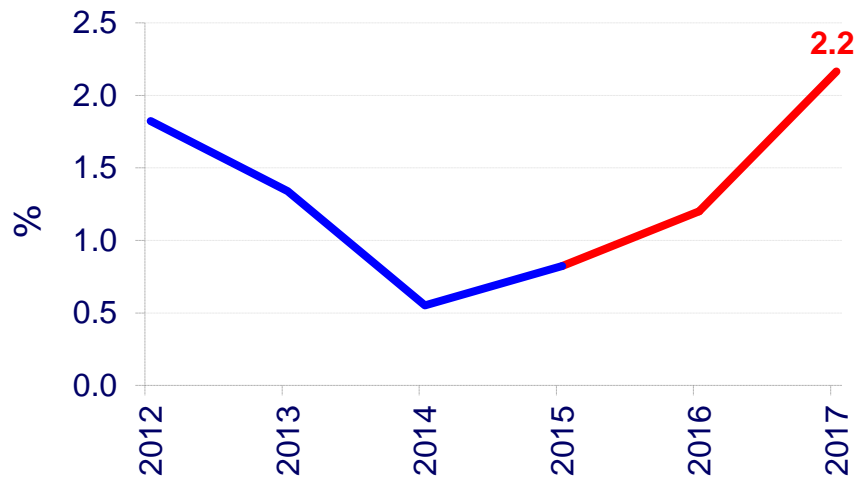
Japan



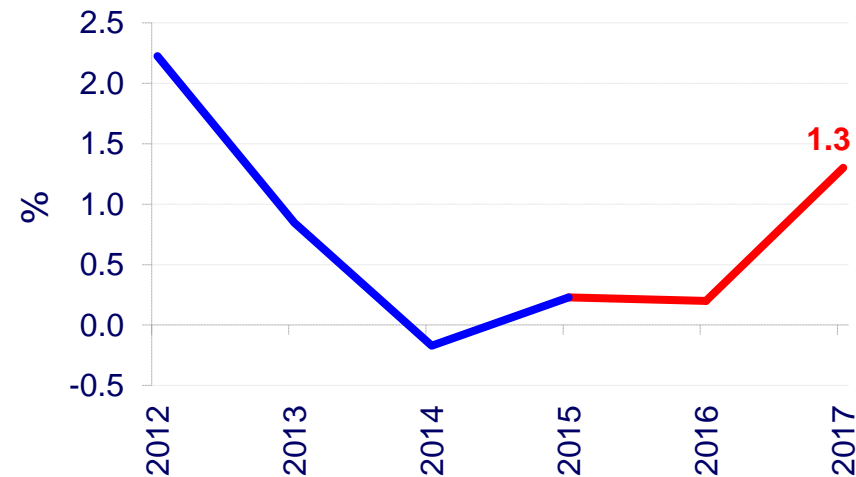
2016/17: projection

Inflation

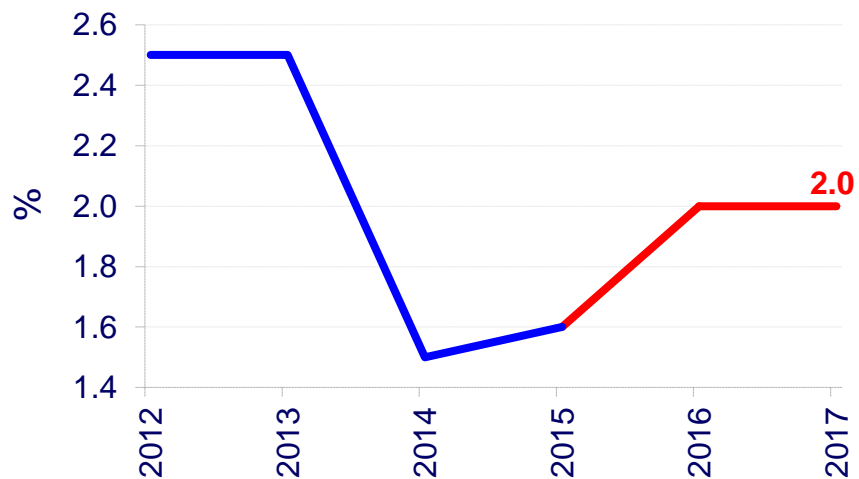
United States



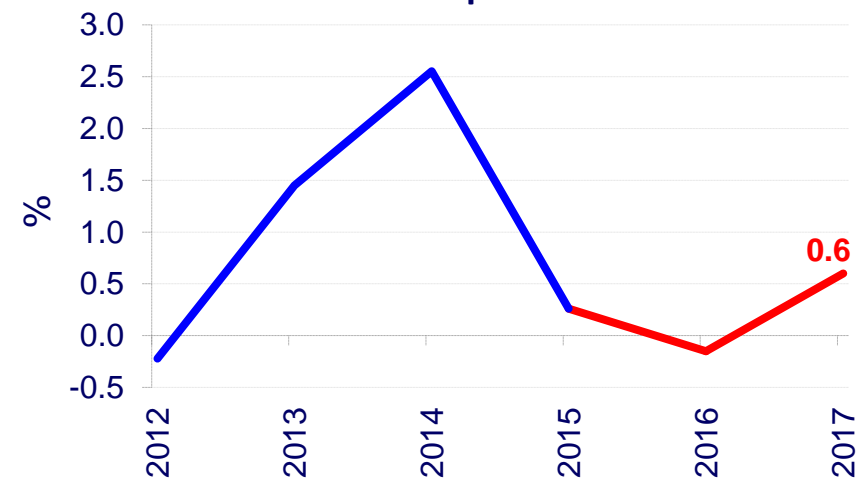
Euro Area



China



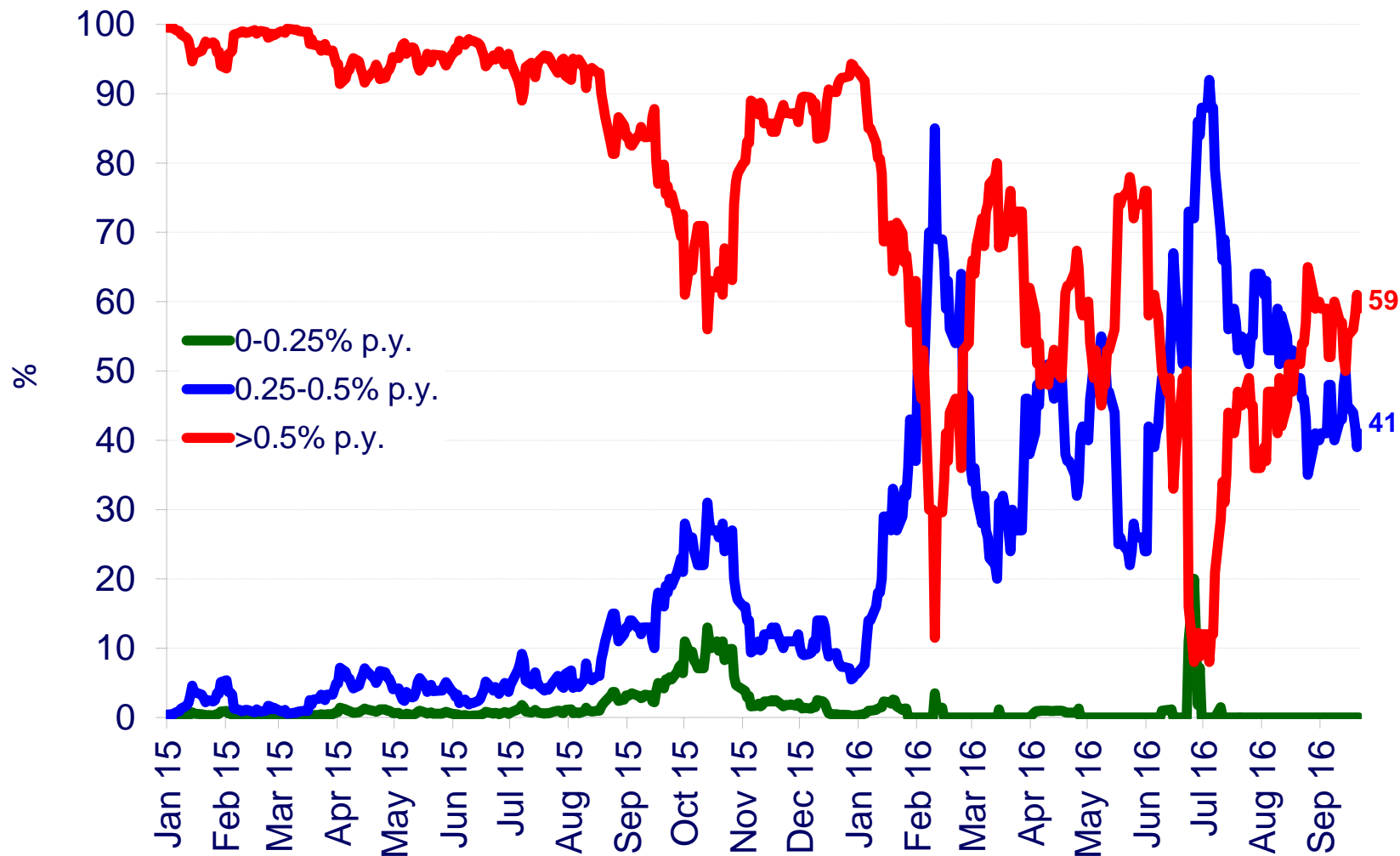
Japan



2016/17: projection

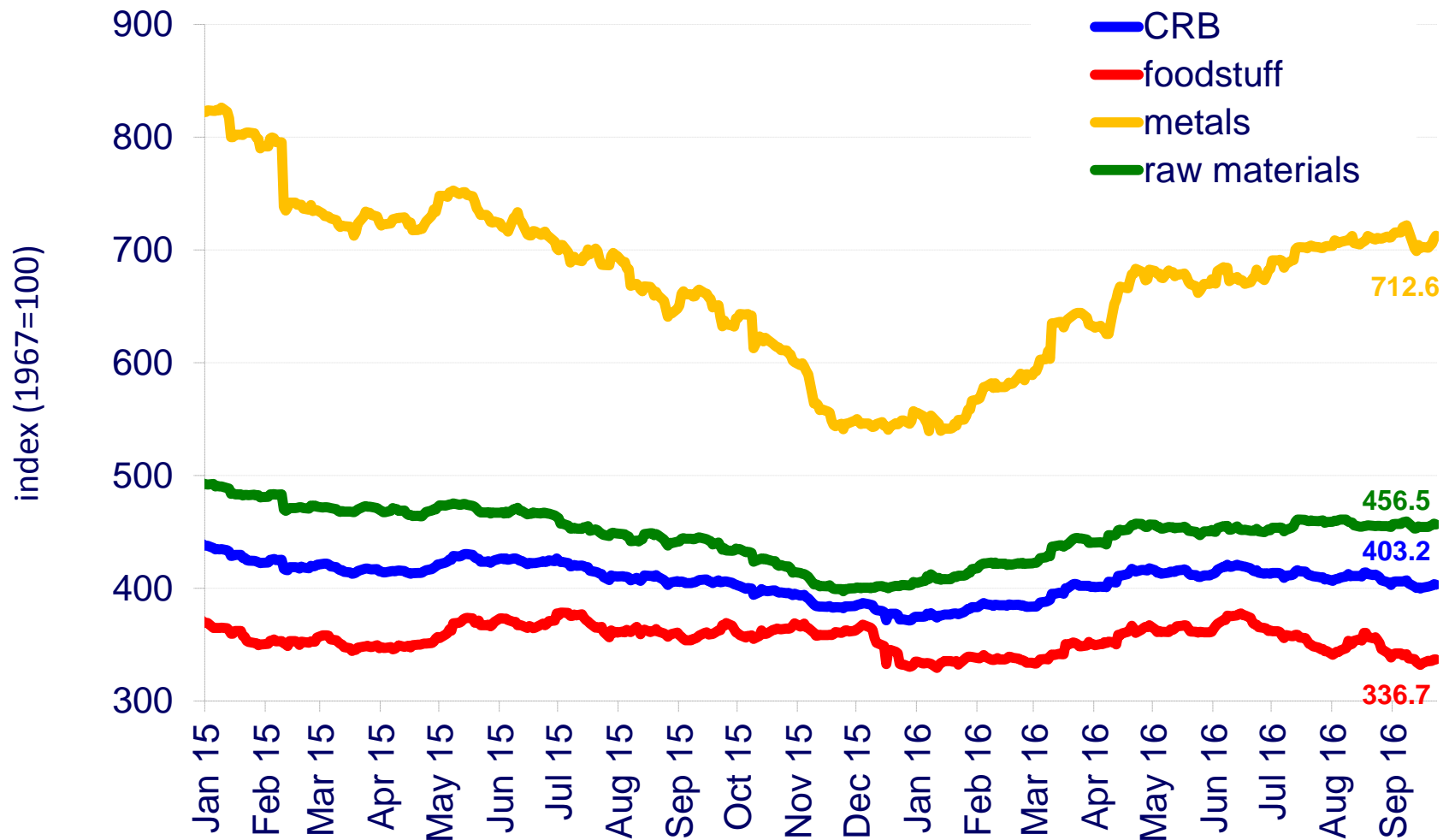
Fed Fund Rates – Implicit Probabilities

Dec 16 FOMC Meeting

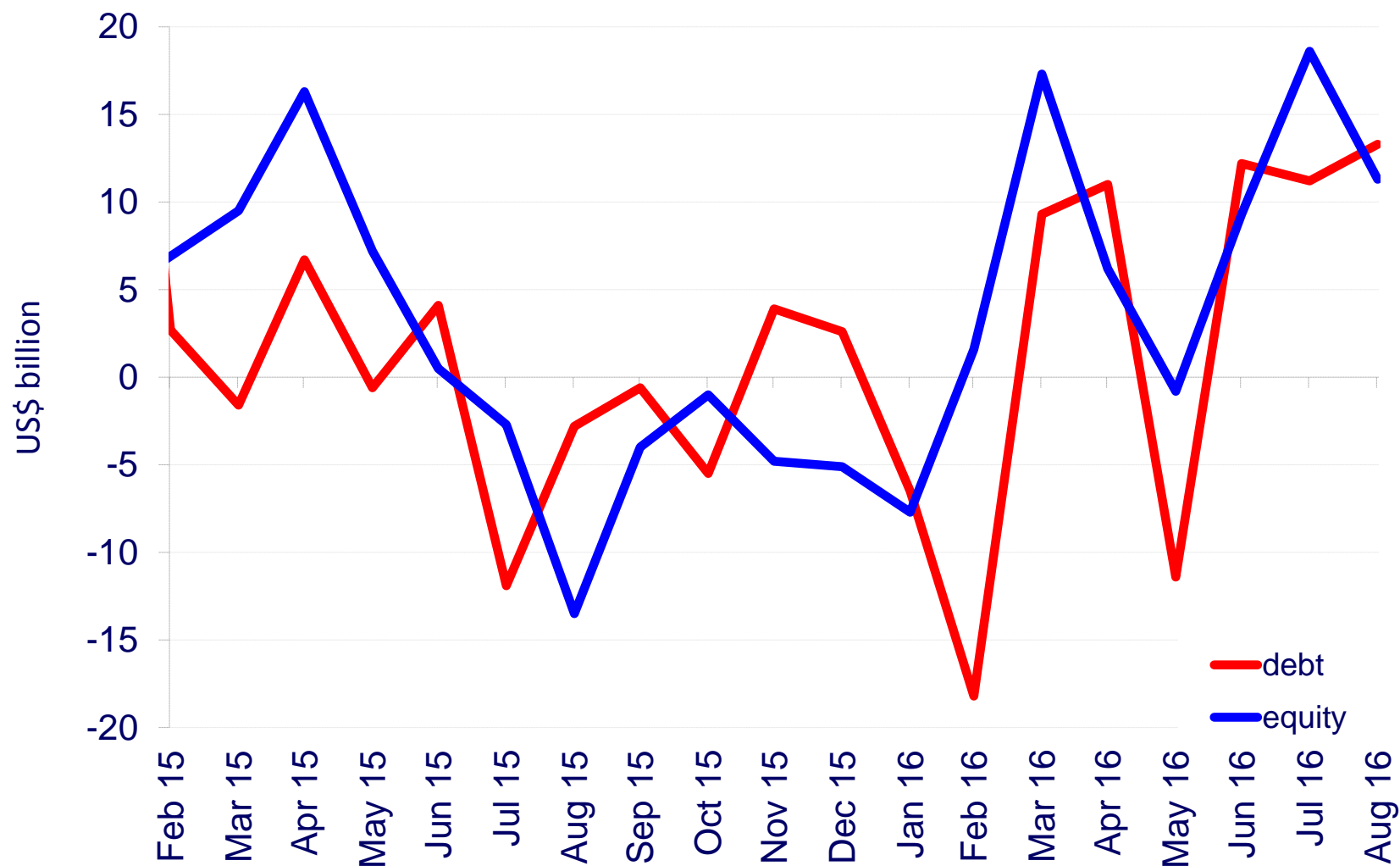
through Sep 22nd

Commodities Prices

CRB Commodities Index

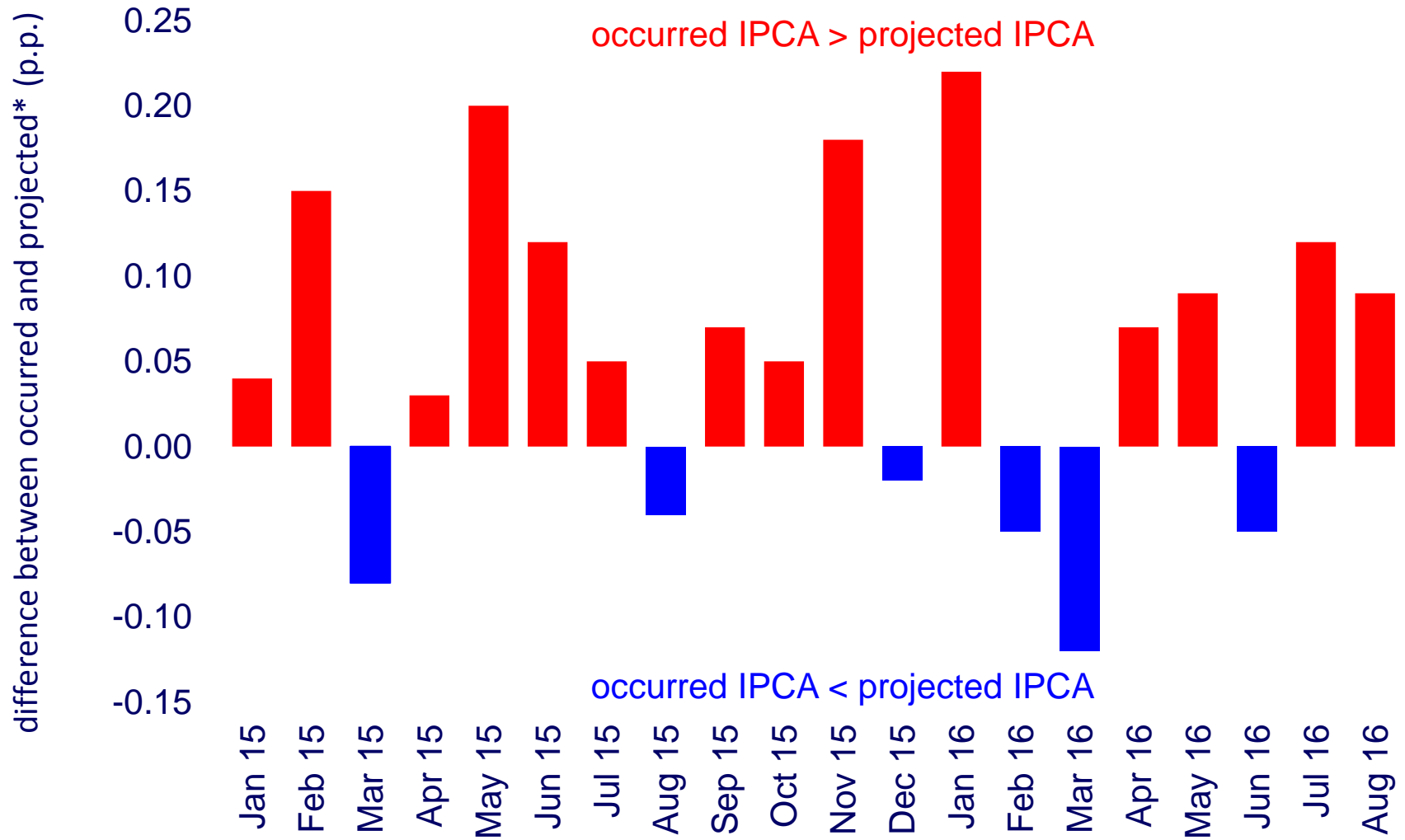
through Sep 23rd

Capital Flows for the Emerging Markets



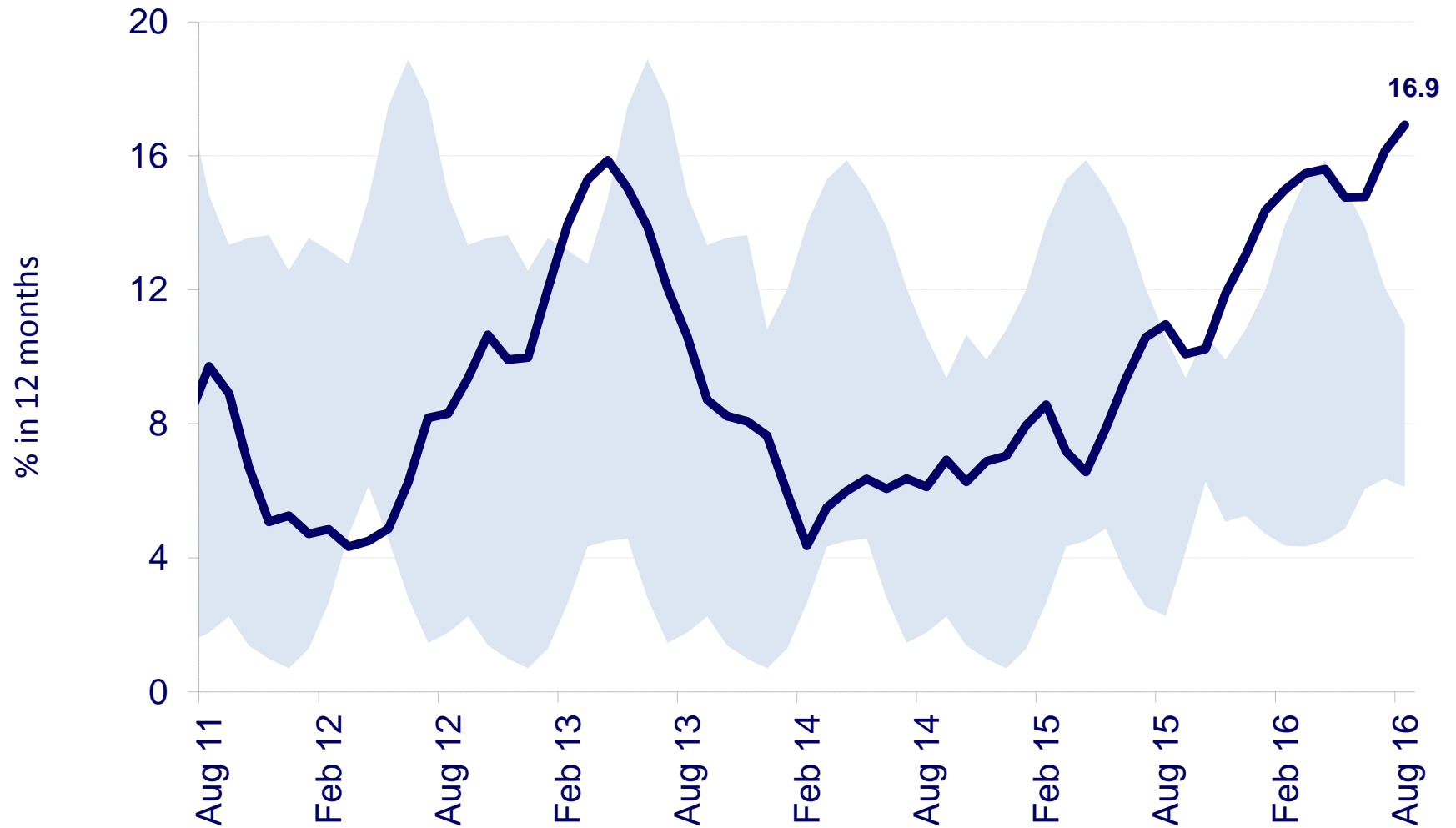
iii. Inflation

Monthly IPCA – Expectations x Projected



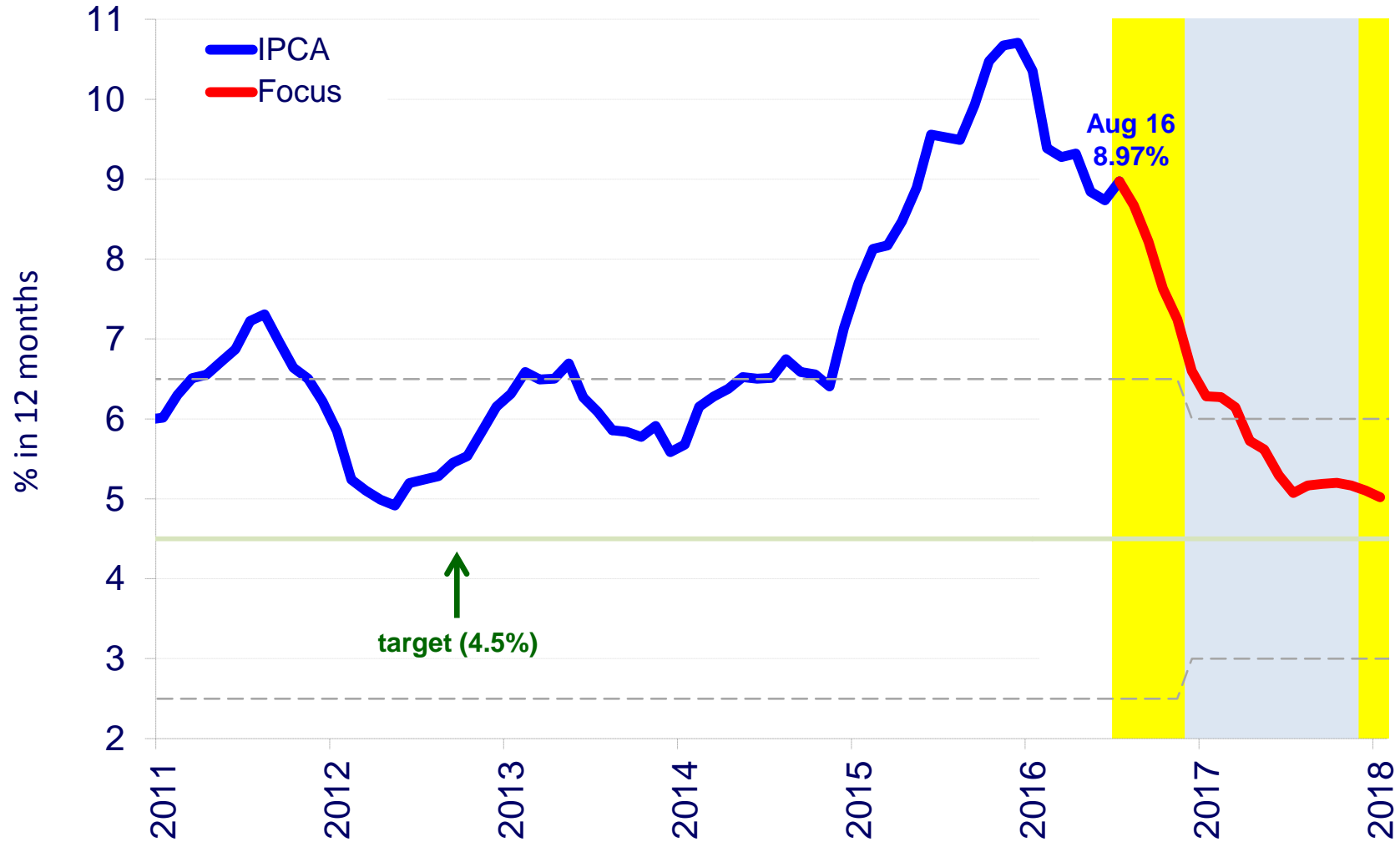
*projected on the IPCA Top 5 reference dates

IPCA - Food

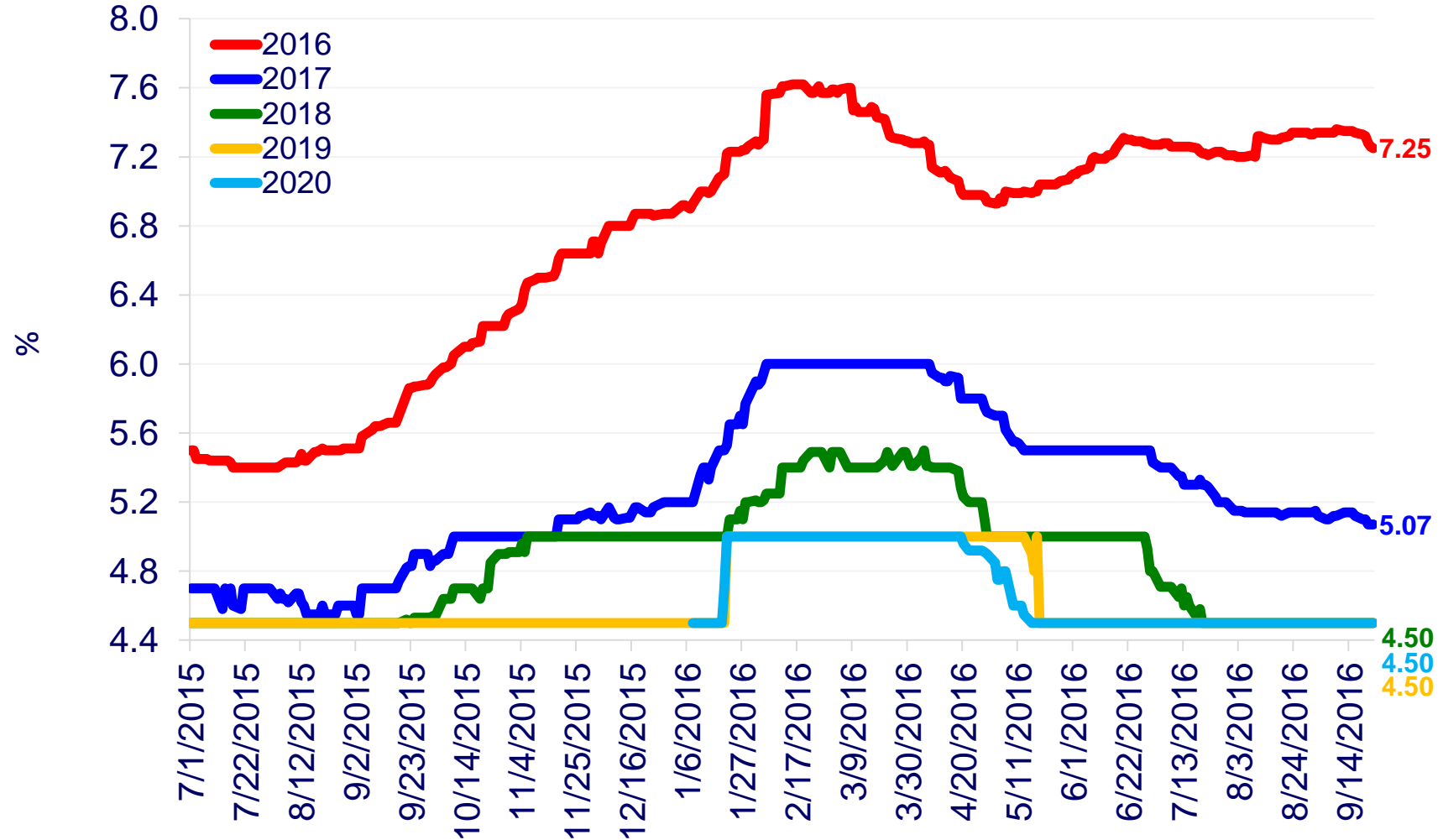


shadowed area: highs and lows for each month in the last 5 years

Consumer Price Inflation

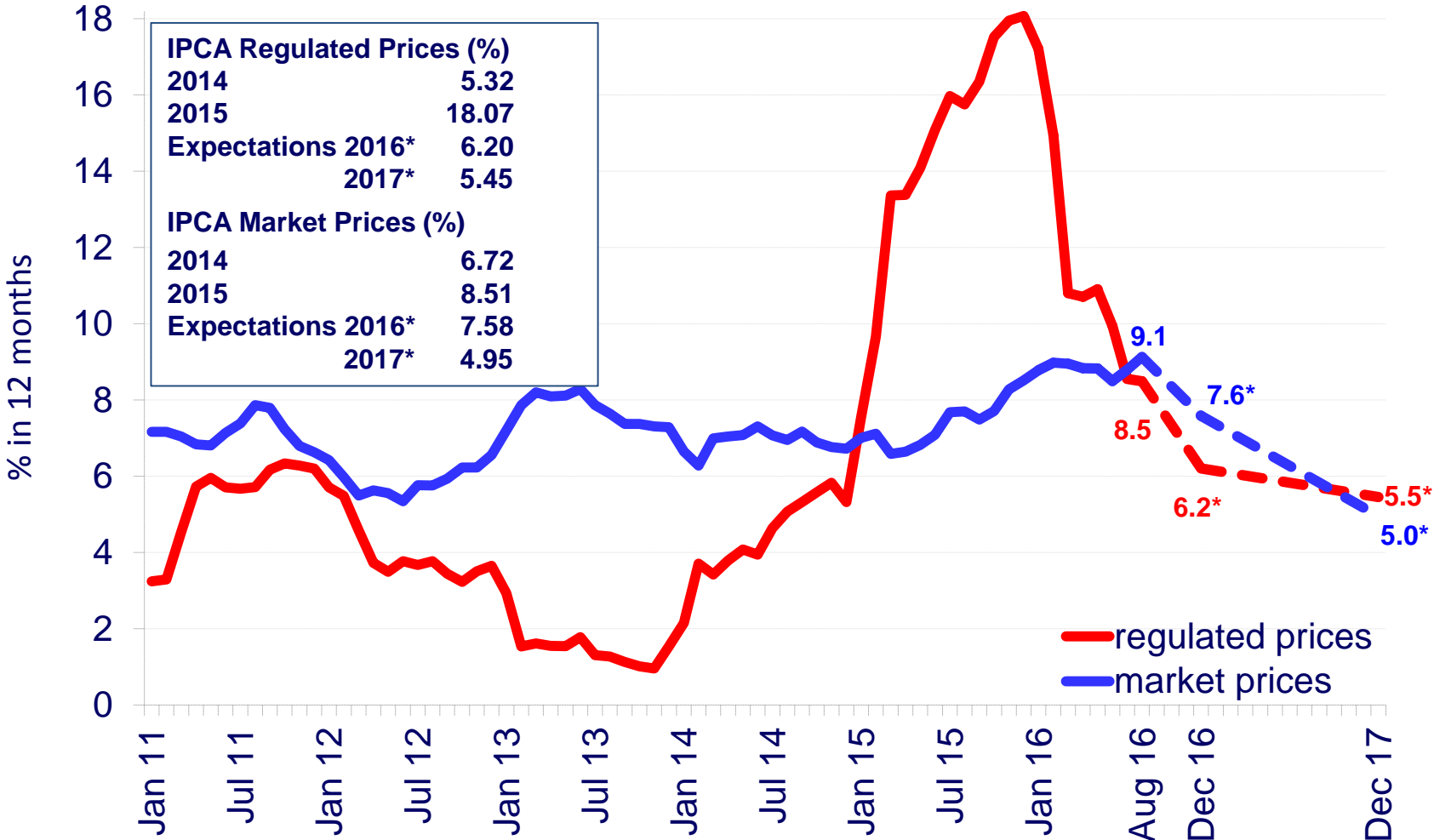
Focus: expectations as of Sep 23rd

Evolution of 2016-2020 IPCA Market Expectations



through Sep 23rd

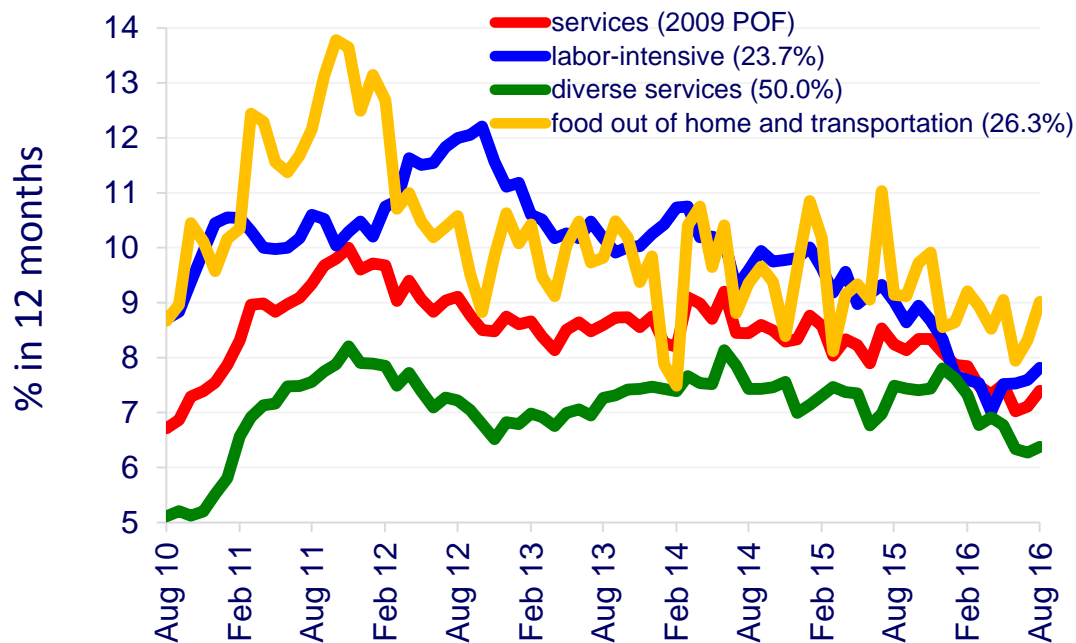
Market Prices and Regulated Prices



*expectations on Sep 23rd

Box: Services Sector Inflation

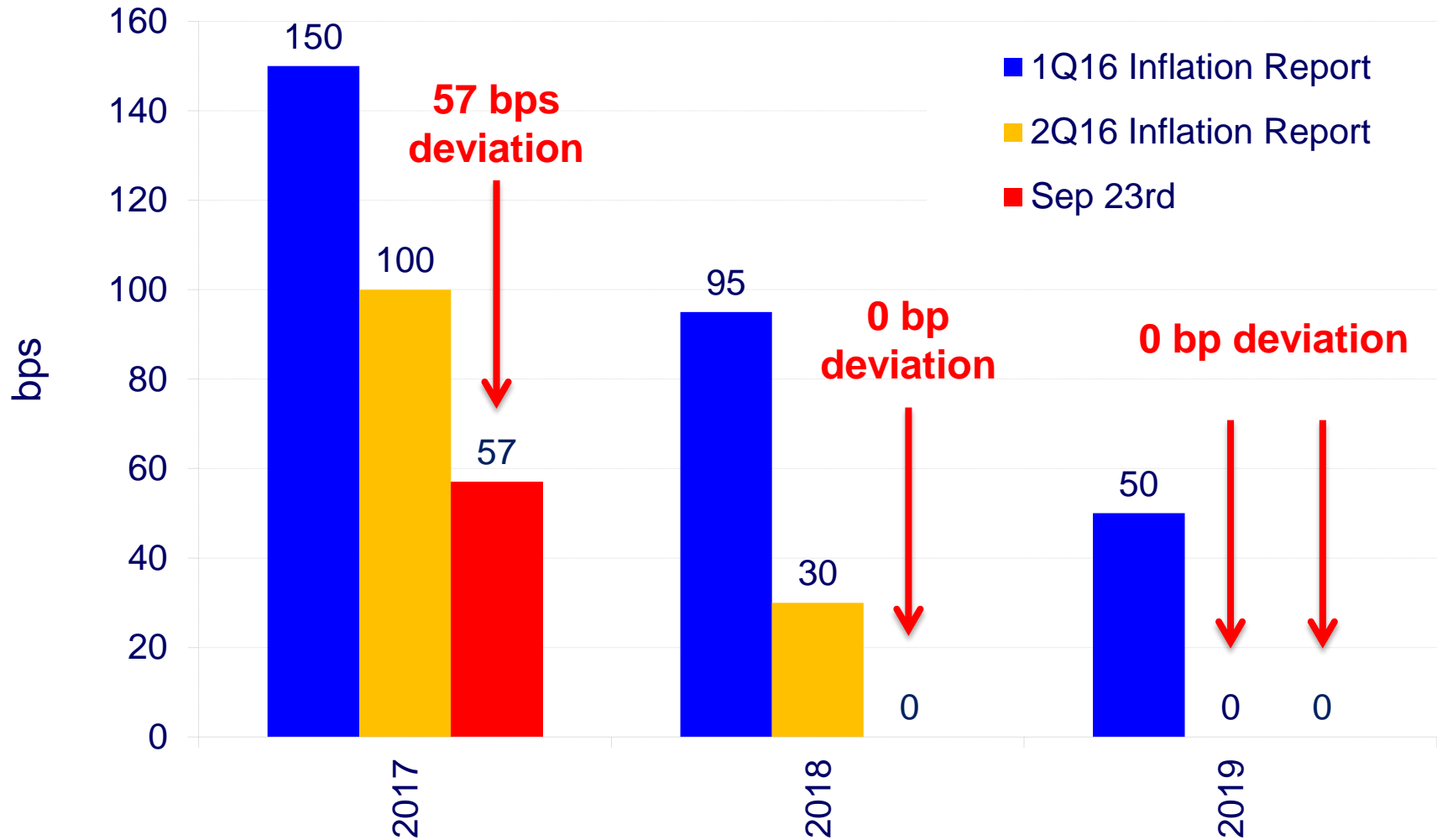
- Evaluates the disinflation process in the services sector through several available evidences
- Some measures present faster disinflation than the Services IPCA



- Uncertainties whether the recent deceleration observed in some services prices represents disinflation that should disseminate

Deviation of Market Expectations to the 4.5% Target

2018 and 2019: Anchoring



III. Conditional Forecasts

Revisions and Short-Term Forecasts

IPCA – Inflation Surprise

	in %			
	2016			
	Jun	Jul	Aug	12 months through Aug
Copom scenario ^{1/}	0.35	0.20	0.28	8.46
Observed IPCA	0.35	0.52	0.44	8.97
Forecast error	0.00	0.32	0.16	0.48

1/ On the June 2016 Inflation Report reference date

IPCA – Short-Term Forecasts

	in %			
	2016			
	Sep	Oct	Nov	12 months through Nov
Copom scenario ^{1/}	0.19	0.40	0.45	7.54

1/ on the reference date

Copom Conditional Inflation Forecasts

Reported Scenarios

Period		Reference	Market	Hybrid with constant exchange rate	Hybrid with constant interest rate
2016	3	8.6	8.6	8.6	8.6
2016	4	7.3	7.3	7.3	7.3
2017	1	6.2	6.2	6.2	6.2
2017	2	5.2	5.4	5.4	5.3
2017	3	4.5	4.9	4.8	4.6
2017	4	4.4	4.9	4.8	4.5
2018	1	4.2	4.9	4.7	4.4
2018	2	4.0	4.7	4.6	4.2
2018	3	4.0	4.7	4.5	4.1
2018	4	3.8	4.6	4.5	4.0

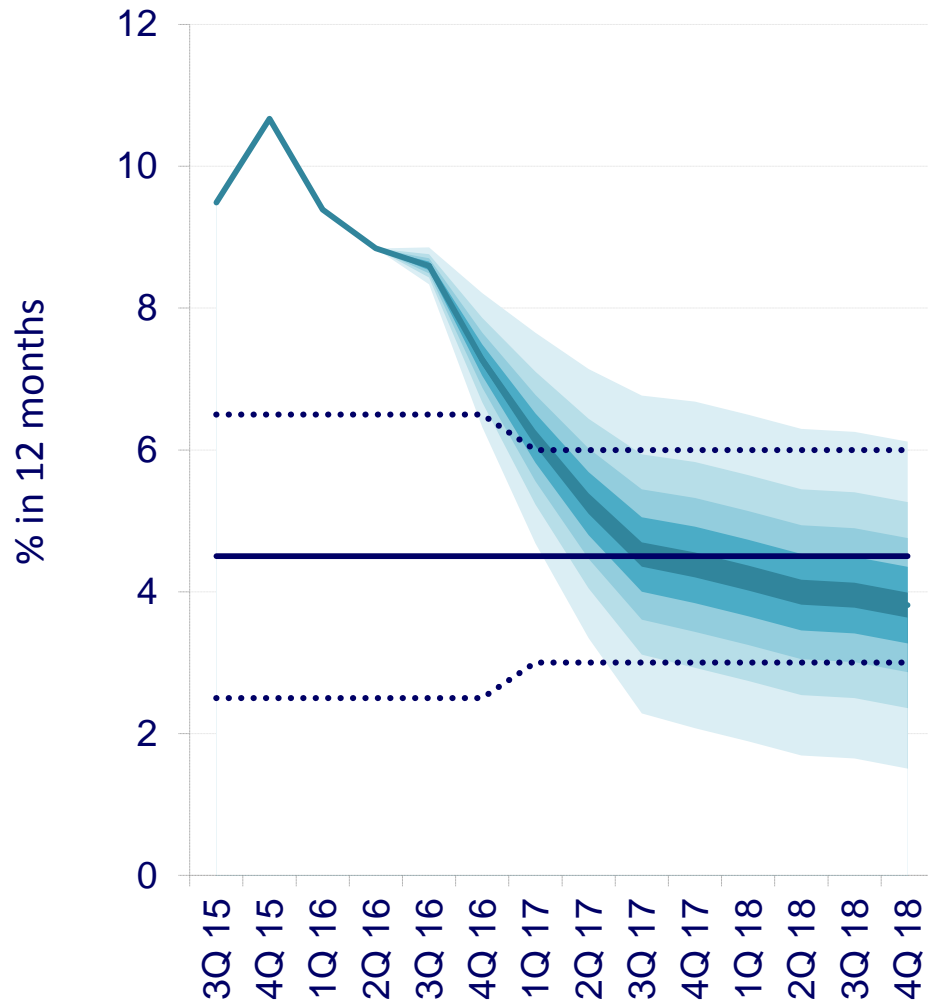
Extension of the projections' horizon encompasses the calendar-years with targets already defined by the National Monetary Council (CMN)

Obs.: 12-month accumulated inflation (%)

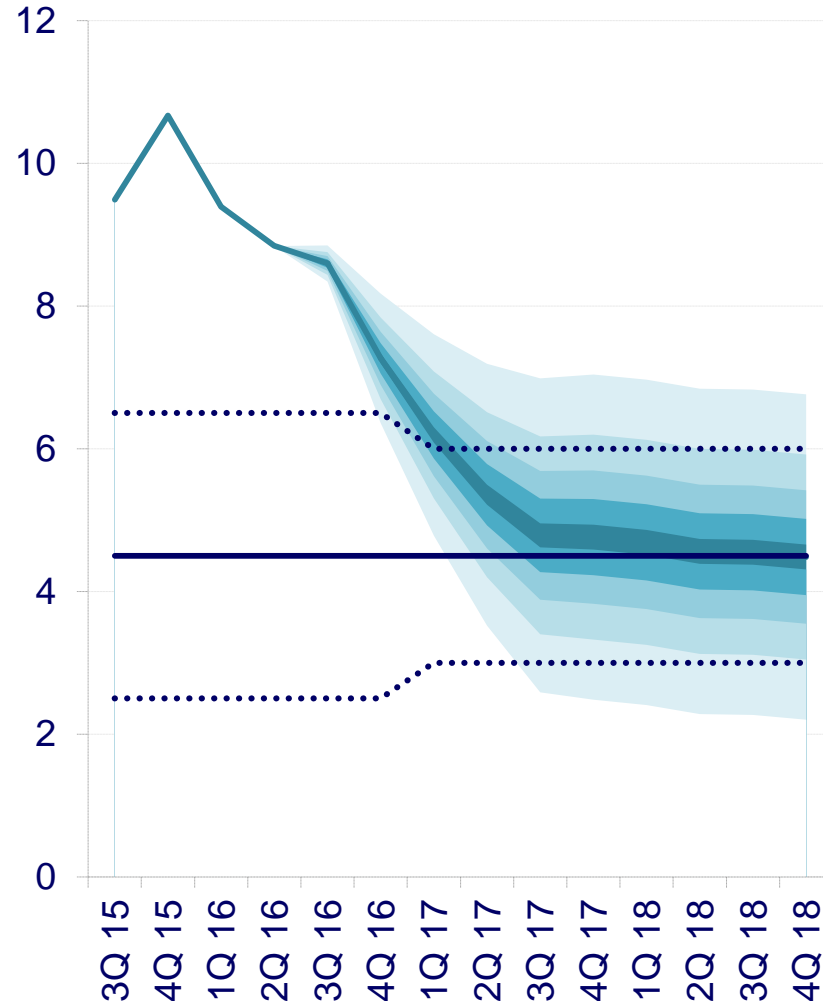
Copom Conditional Inflation Forecasts

Reference Scenario

(exchange rate constant at R\$3.30/US\$ and interest rate constant at 14.25% p.y.)



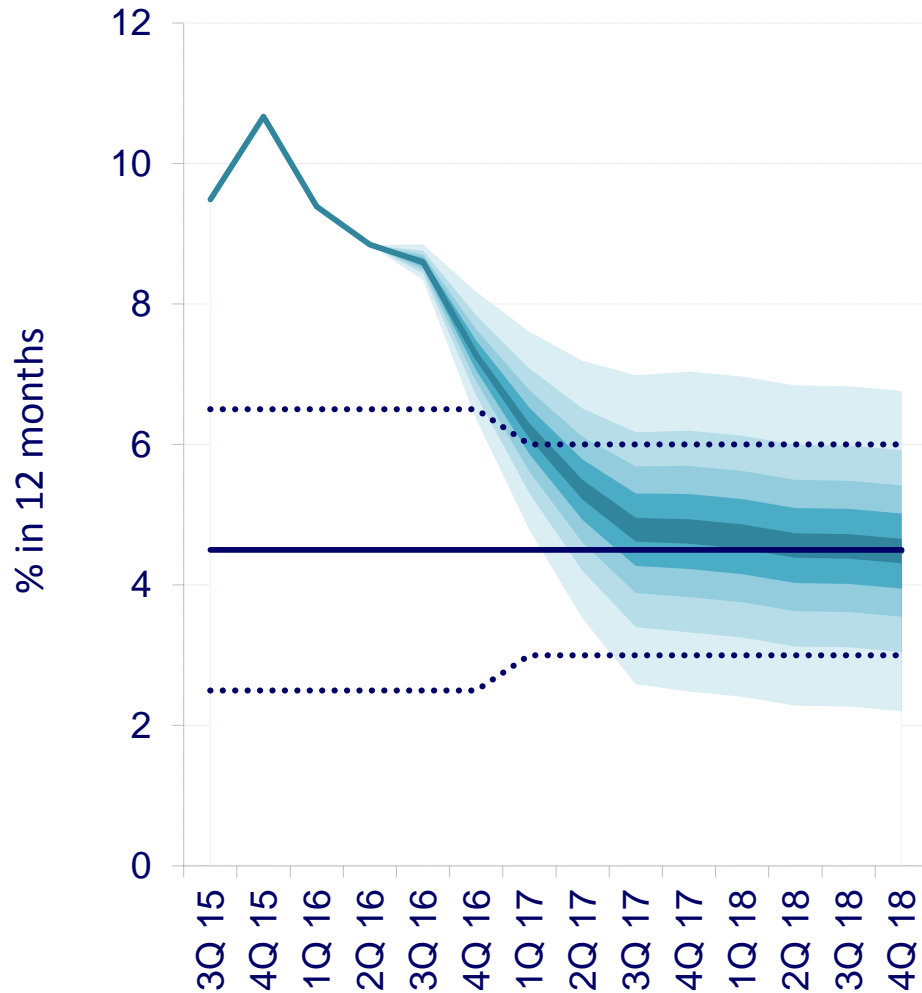
Market Scenario



Copom Conditional Inflation Forecasts

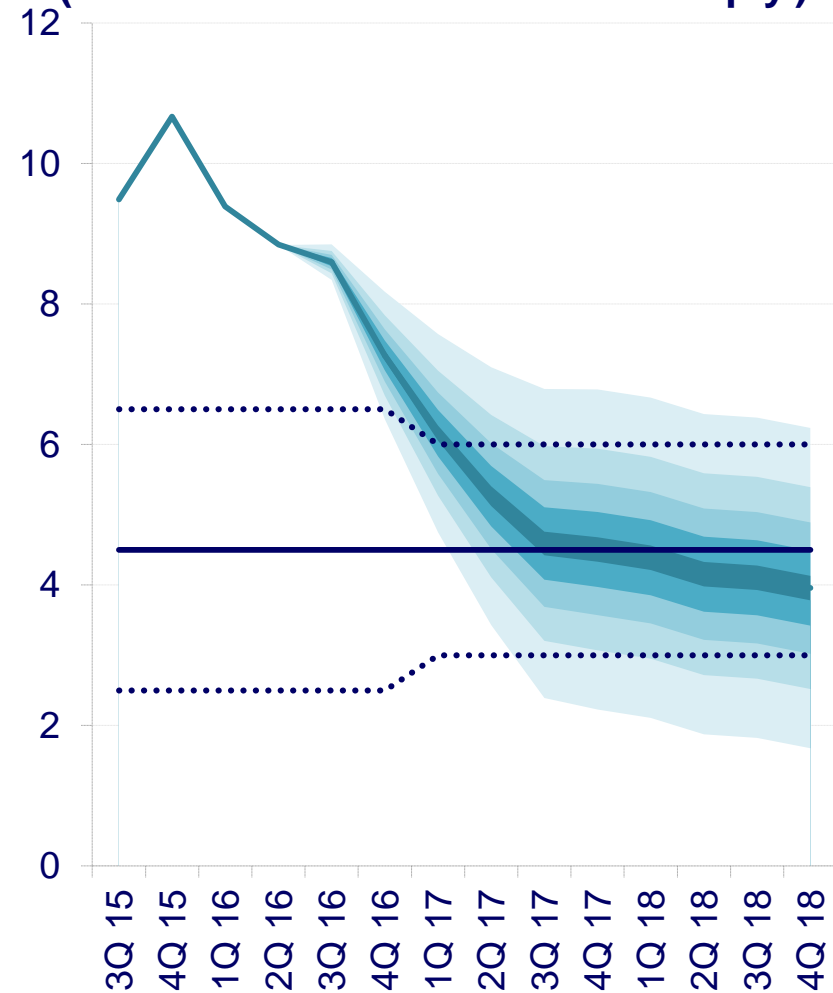
Hybrid Scenario

(exchange rate constant at R\$3.30/US\$)



Hybrid Scenario

(interest rate constant at 14.25% p.y.)



Monetary Policy Stance, Balance of Risks - 1

- **The Copom evaluates that an easing of monetary conditions will depend on factors that allow the Committee members to have greater confidence in the fulfillment of the inflation targets in the relevant horizon for the monetary policy stance. This horizon includes the calendar-years with targets already defined by the CMN, including the year of 2017, for which the Committee pursues the convergence to the 4.5% target.**

Monetary Policy Stance, Balance of Risks - 2

- **The relevant horizon of the monetary policy actions, on its turn, is not static. It moves continuously throughout time. According to this strategy, as the months go by, the monetary policy actions give more importance, gradually, for periods equally ahead.**

Monetary Policy Stance, Balance of Risks - 3

- Among the elements that can allow greater confidence in the fulfillment of the targets, the Committee highlights 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 more sensitive to monetary policy and economic activity show disinflation at an appropriate pace; and
 - 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.

First Factor

- **Recent evidences indicate that the fall in wholesale food prices has been transmitted to retail prices**
- **Projections for food subitems seem to show more confidence in the process of price shock reversion in this sector**
- **In fact, a part of the recent resistance to the fall of current inflation seems to have been caused by temporary shocks in food prices**
- **The Copom will be careful with signs that this resistance may also stem from inertial mechanisms**

Second Factor

- There are still inconclusive signs regarding the speed of disinflation towards the target (“Services Sector Inflation” Box)
- The Copom will evaluate:
 - i. the disinflation trend of several services inflation measures and
 - ii. the secondary effects that this group’s disinflation may have over other IPCA components

Third Factor

- **There are positive signs regarding the process and consent to the fiscal reforms**
- **However, the process is still at the beginning and the uncertainties regarding the approval and the implementation of the necessary adjustments remain**
- **These reforms are relevant for the BCB as they have impact over the balance of risks and the inflation trajectory in relation to the fulfillment of the targets. The fiscal dimension is important**

Final Assessment

- **The Copom will assess the evolution of the combination of these factors, because there is no element that is determinant, by itself, for the monetary policy decisions**
- **The Copom members decisions are based on assessments which are necessarily subjective, but always sustained by solid evidence regarding the relevant factors**

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