



Inflation Outlook

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**Inflation Report
December 2015**

- I. Introduction
- II. International Environment
- III. Domestic Macroeconomic
Conditions
- IV. Inflation Developments

I. Introduction

Banco Central Mission

- **Ensuring the stability of the purchase power of the currency and a solid and efficient financial system**

Importance of currency stability

- Low and stable inflation - precondition to sustainable growth

II. International Environment

Current Conditions – Abroad

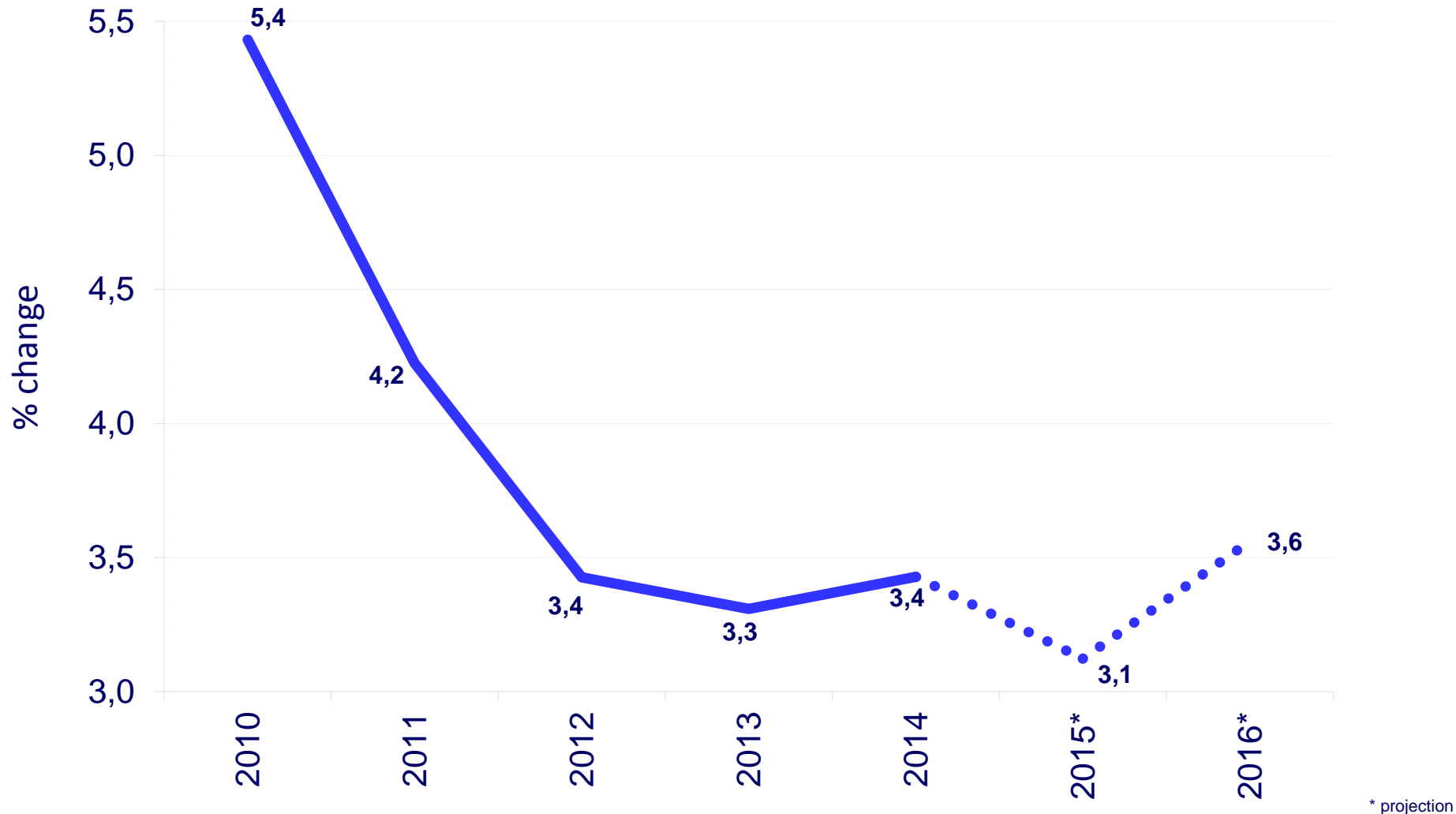
- Moderate global growth, with heterogeneous patterns
- Start of the normalization process of the monetary conditions in the US, gradually, with the strengthening of the US dollar
- Volatility affecting important emerging economies, but with low probability of occurrence of extreme events in the financial markets
- Commodities prices at a low level

Prospects

- External environment remains complex, with higher volatility affecting the main emerging economies:
 - Start of the normalization of the monetary conditions in the US
- Prospects of moderate global activity pace:
 - Highlights for the heterogeneity among the main blocks
- Important emerging economies experience period of transition, with greater moderation in the activity pace, despite the resilience of domestic demand
- Moderation in the dynamics of commodities prices

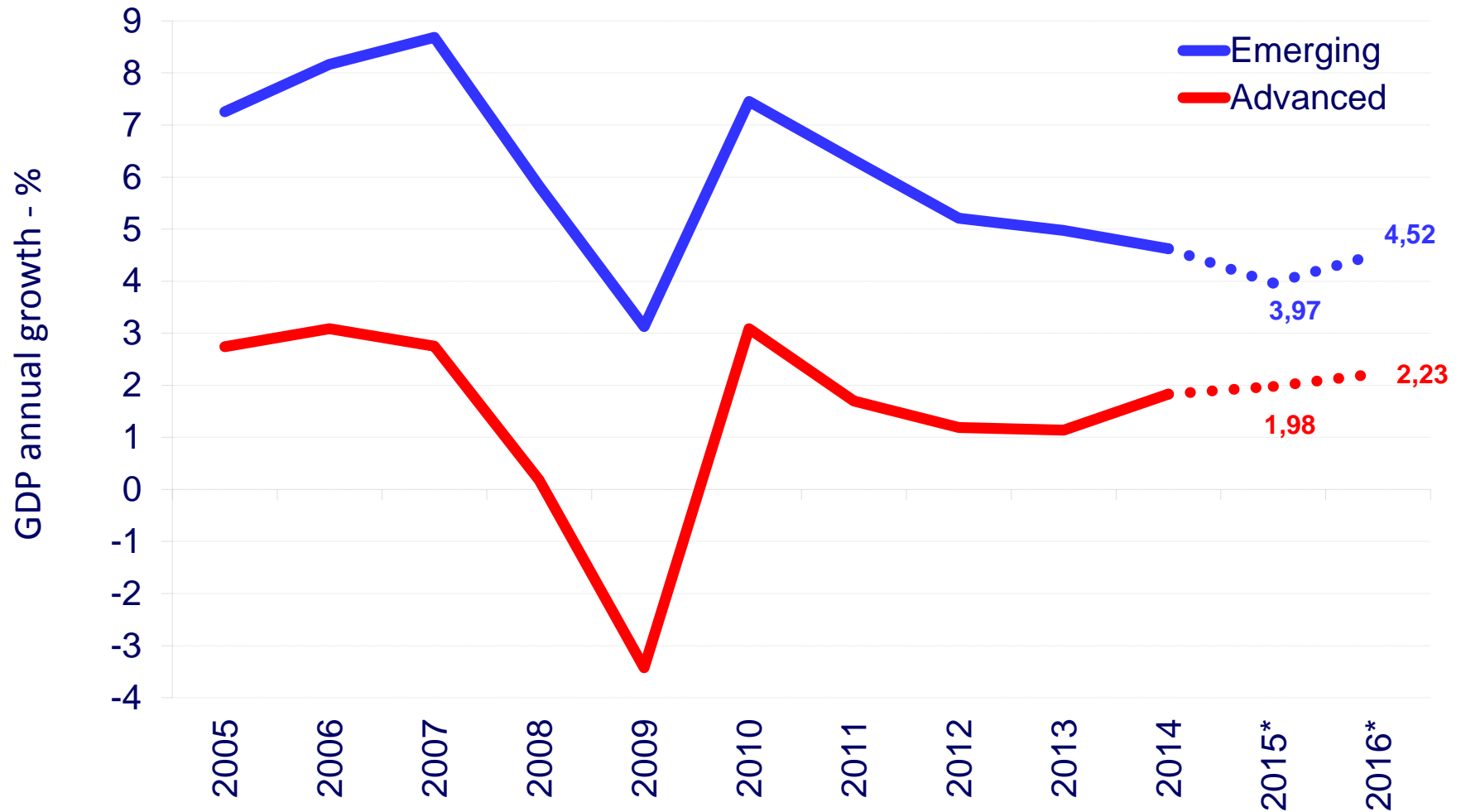
Global economy in gradual recovery

Global growth and IMF projections



Source: IMF (*World Economic Outlook*, October 2015)

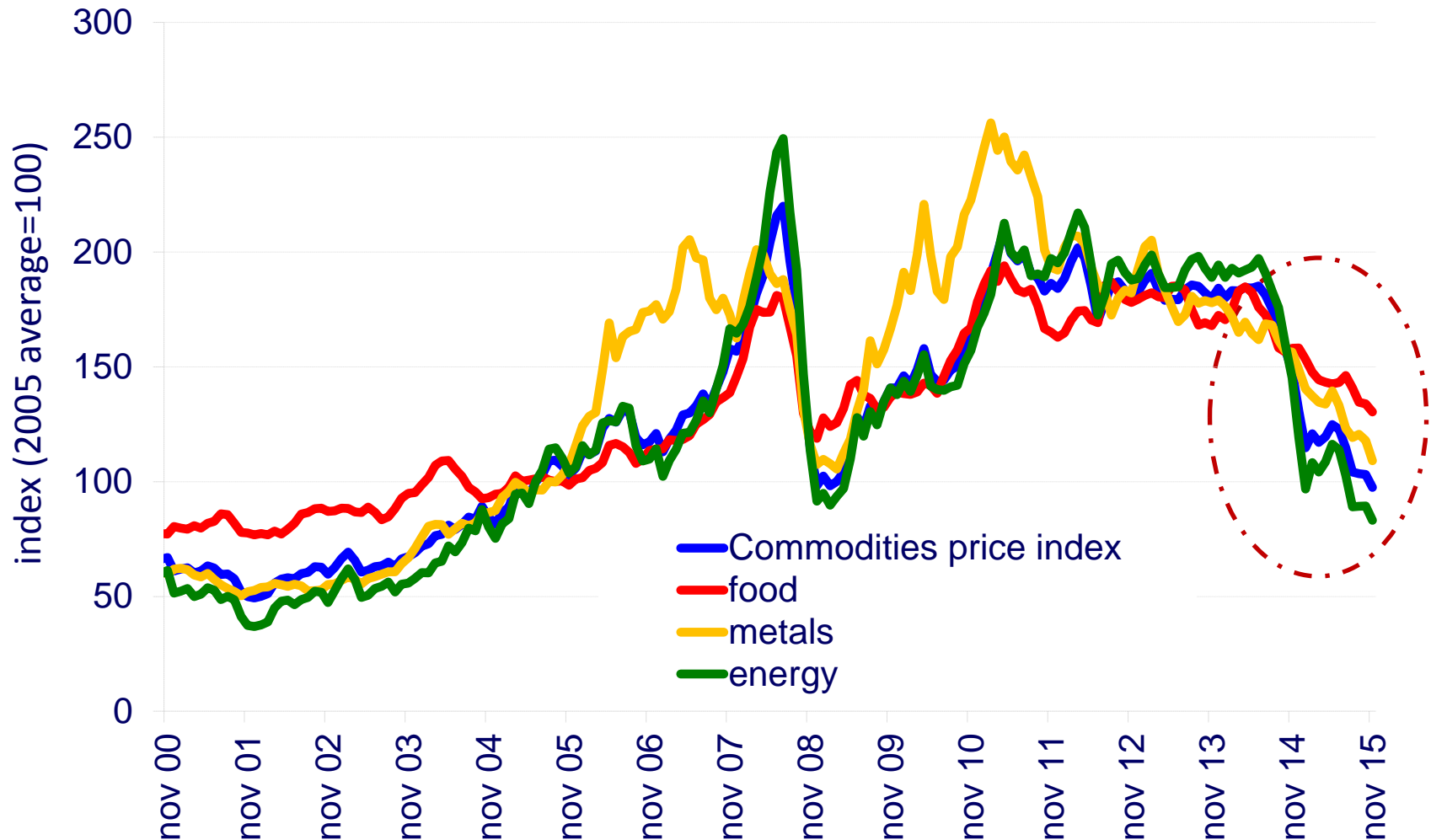
Global growth rebalance



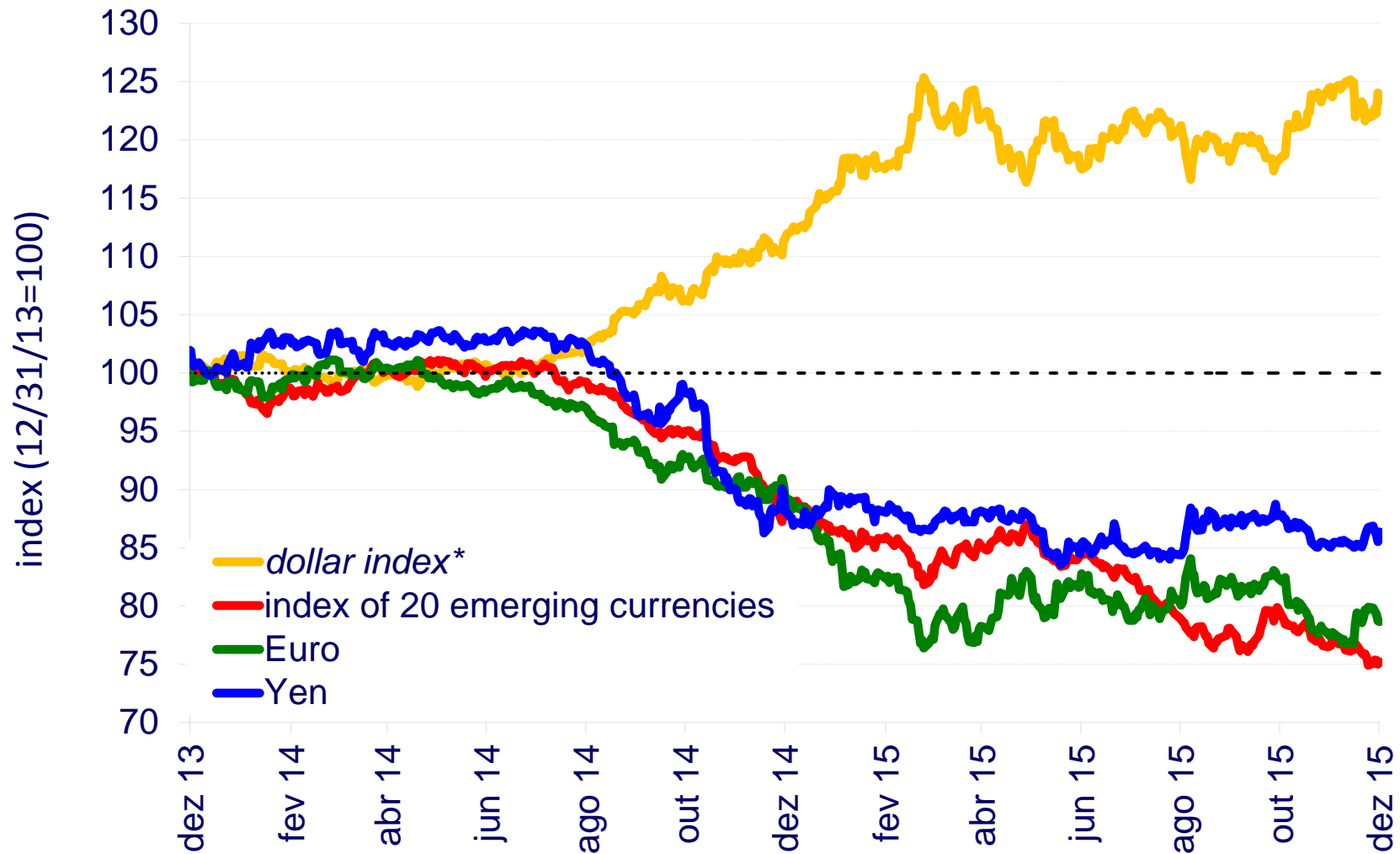
* projection

Falling commodities prices

Commodities Index and subindices calculated by the IMF

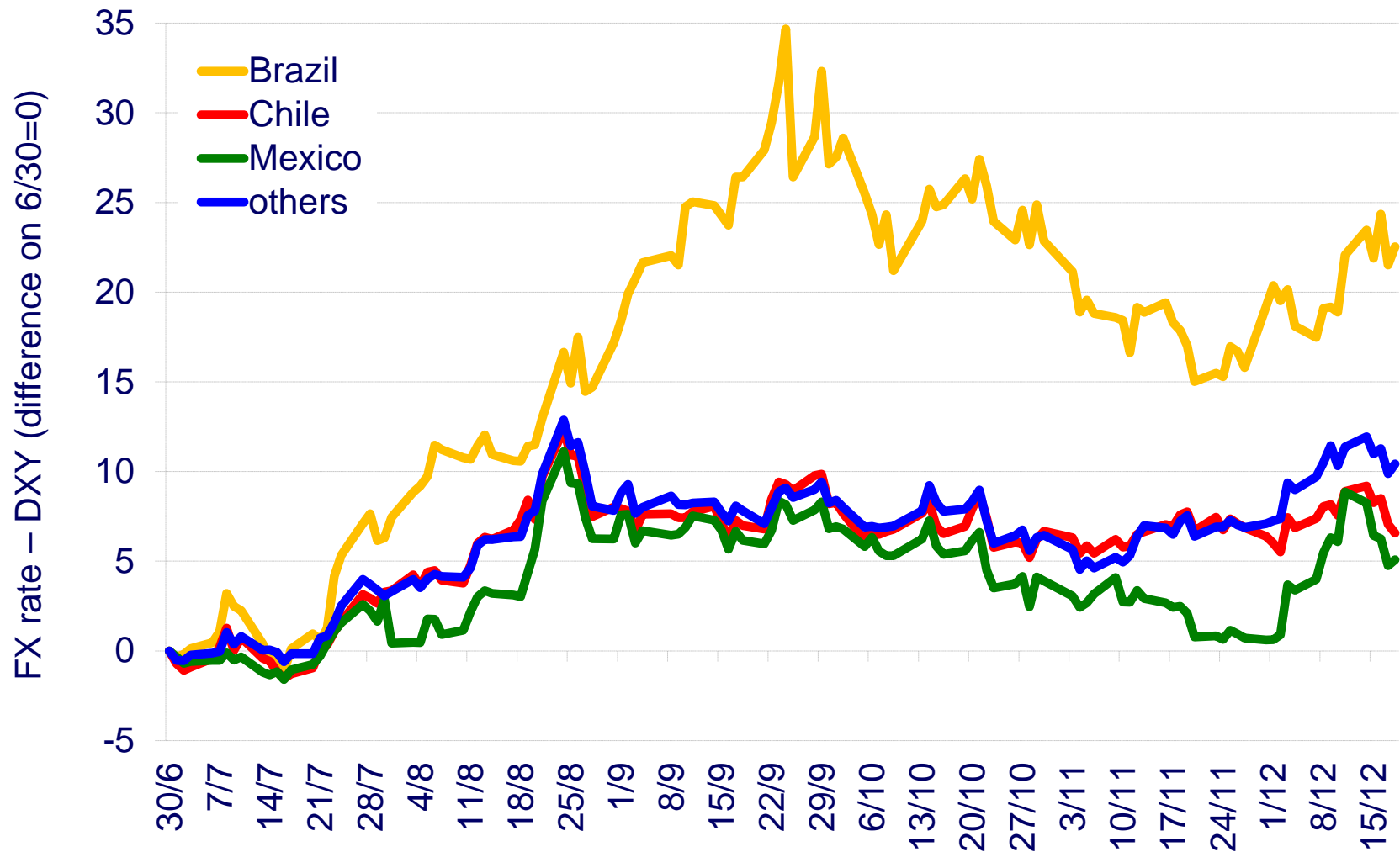


US dollar strengthening is a global trend



Data through Dec 18th; *dollar index: measures the value of the dollar against a basket of the six main reserve currencies (Swiss franc, Canadian dollar, Japanese yen, sterling pound, euro and Swedish kron)

Exchange rate (US\$) in Latin America above the Dollar Index



others = avg. (Argentina, Peru, Colombia and Uruguay), data through Dec 18th

III. Domestic Macroeconomic Conditions

Current Conditions

- Brazilian economy – important and necessary adjustments in the external, fiscal and monetary areas, with time mismatch of their effects
- The success of the adjustments depends on perseverance and determination, also to reduce their economic costs and duration
- Two important correction processes of relative prices in progress – the strengthening of the US dollar and higher regulated prices

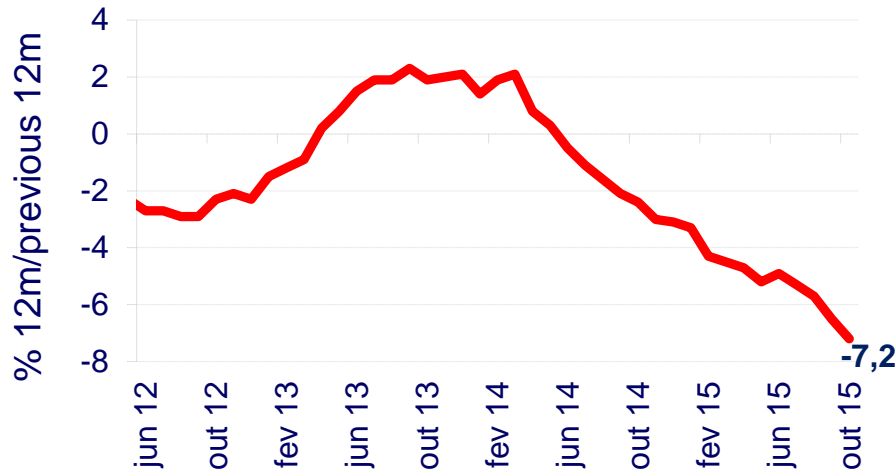
Prospects

- Adjustment in the activity expansion pace, in line with the process of macroeconomic adjustment
- External adjustment – rapid progresses with great benefits for the economy
- Process of relative prices realignment shows longer and more intense than the forecast
- Maintenance of the steadiness of the financial system

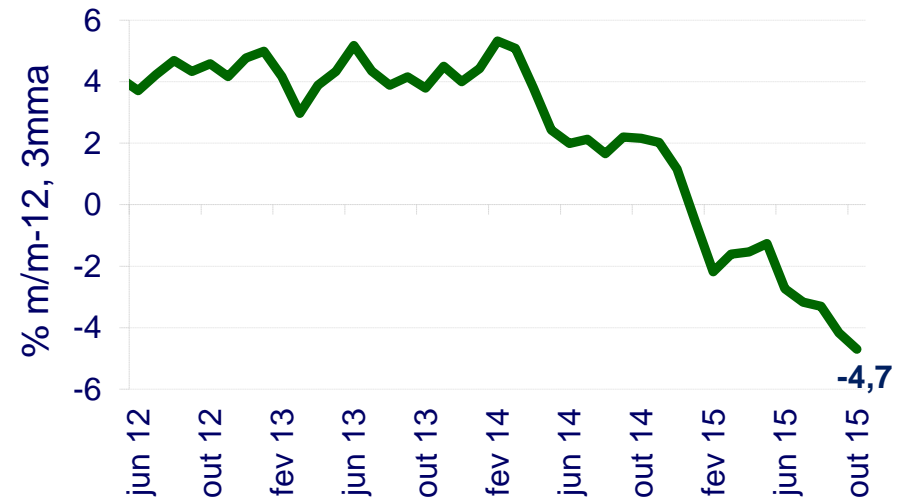
Activity

Supply: low dynamism

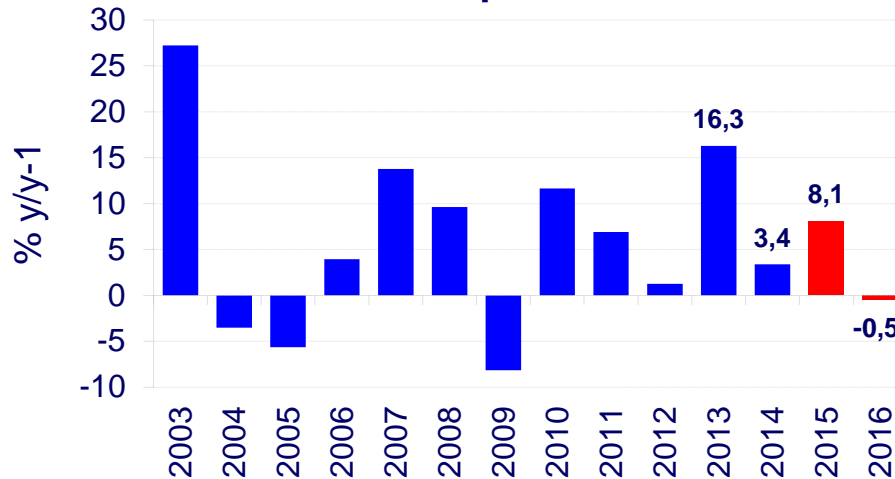
Industrial Production



Services Volume

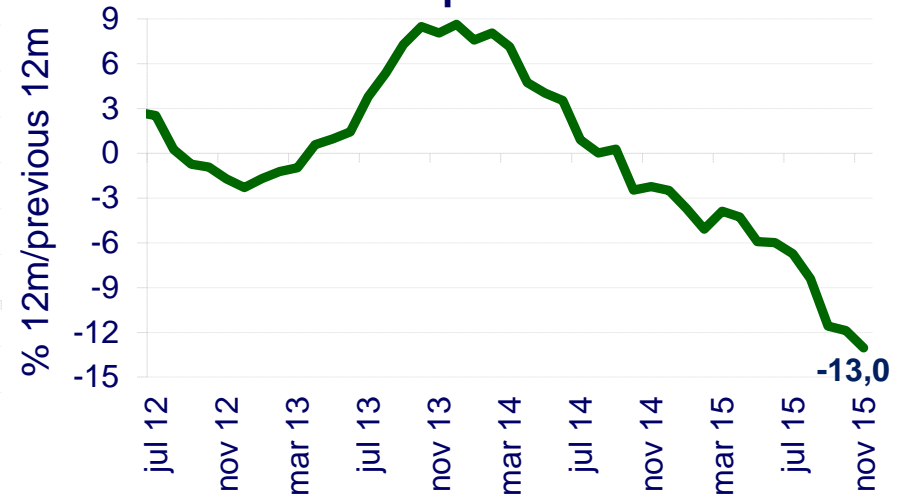


Crop Harvest

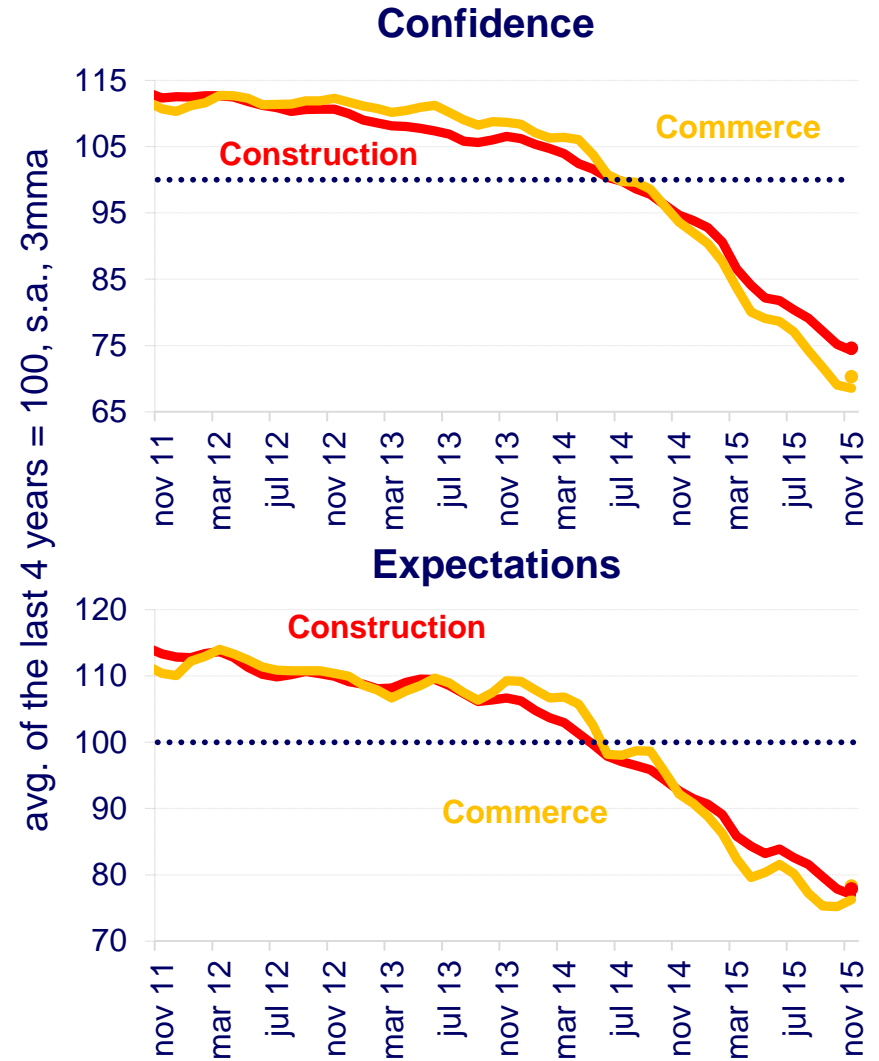
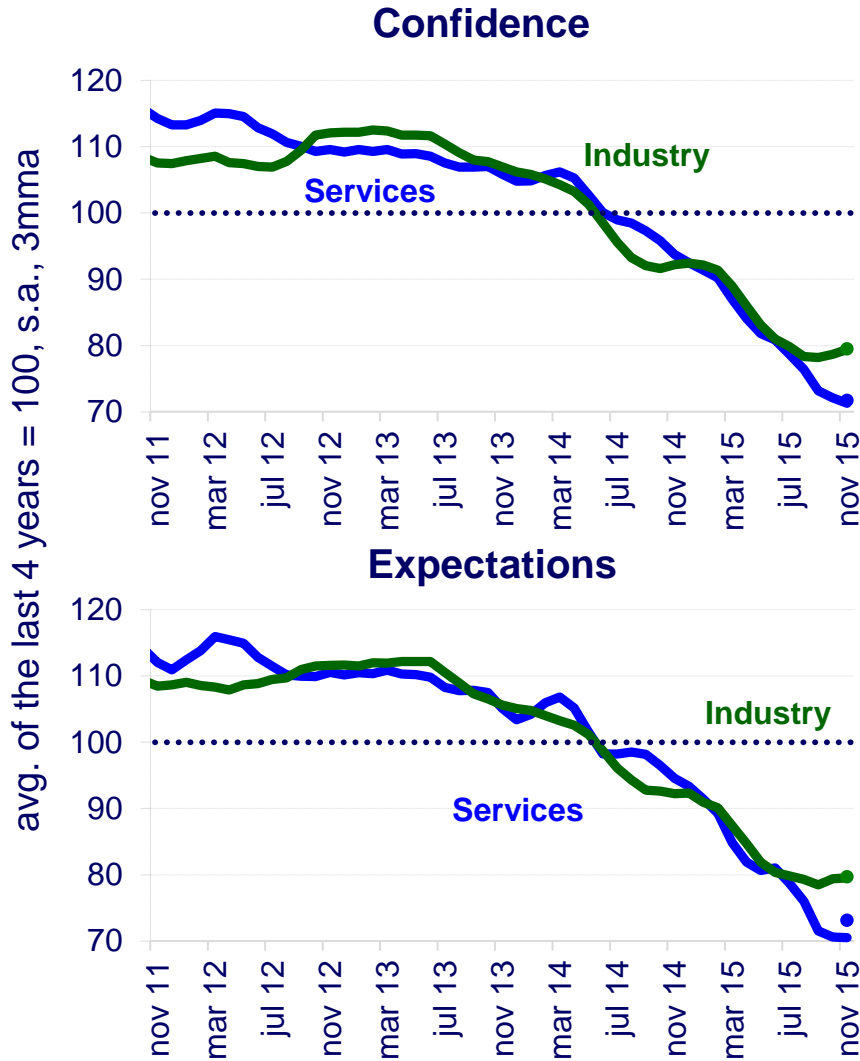


2015-16: IBGE estimates in Nov/15

Imports Volume

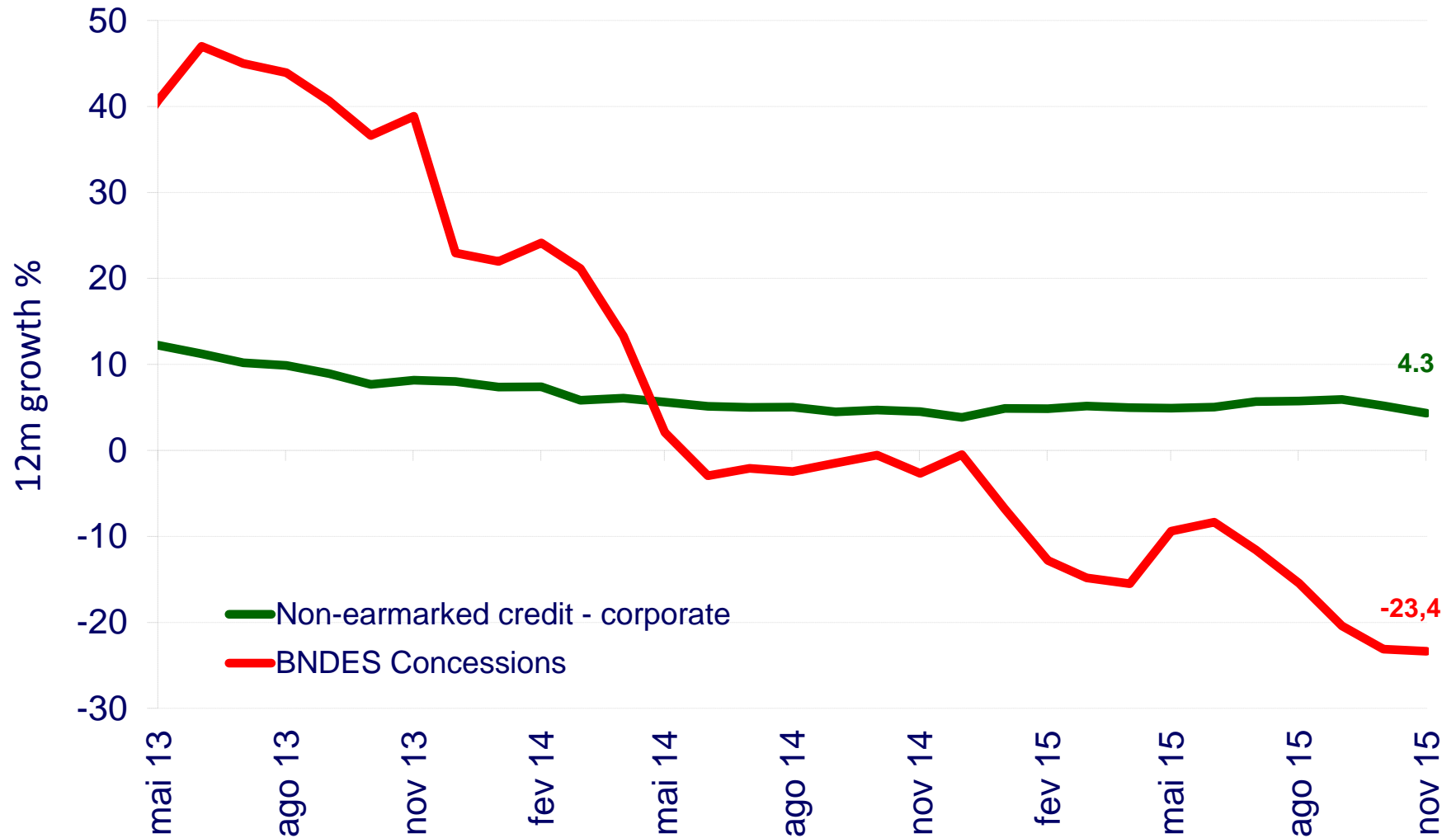


Confidence

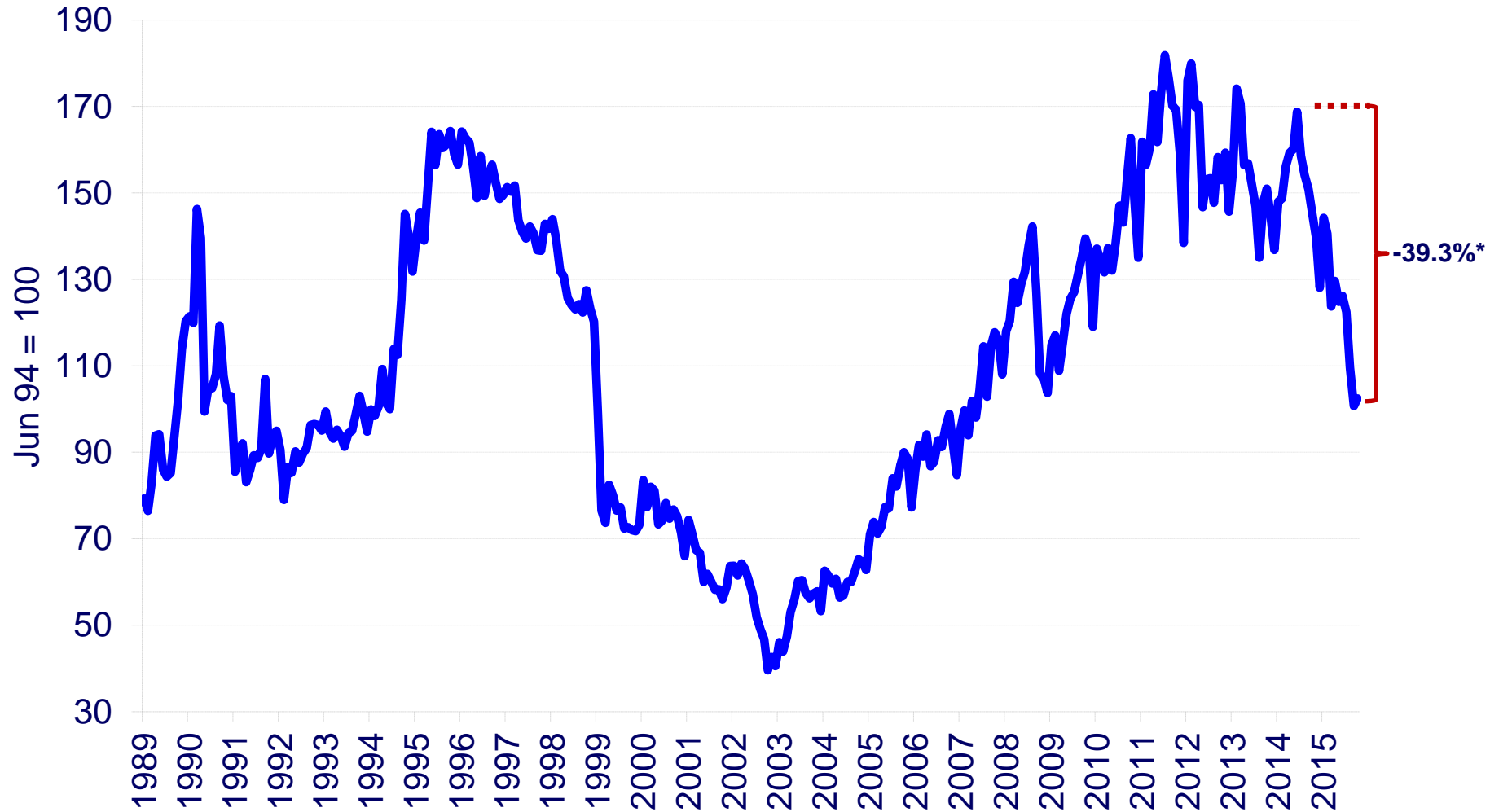


Obs.: Proportion of favorable answers – proportion of unfavorable answers + 100 (100=neutral)

Credit to corporates

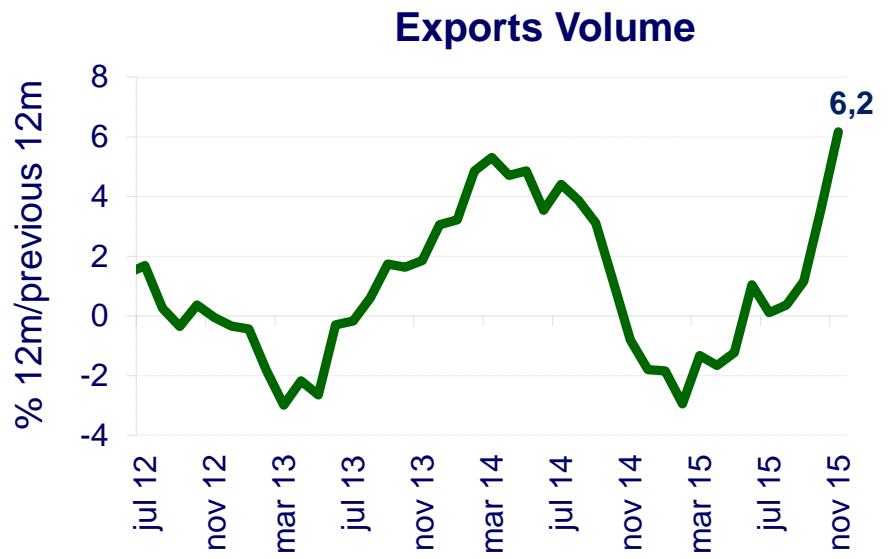
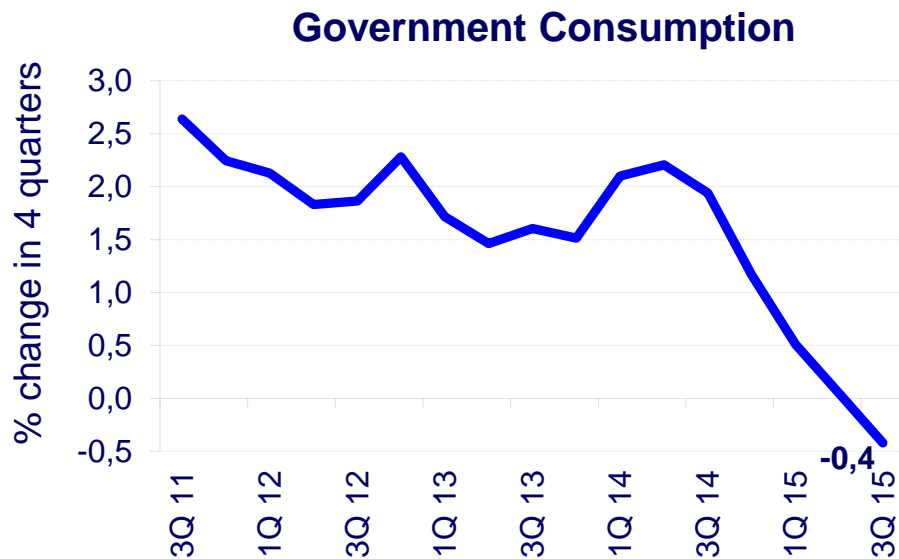
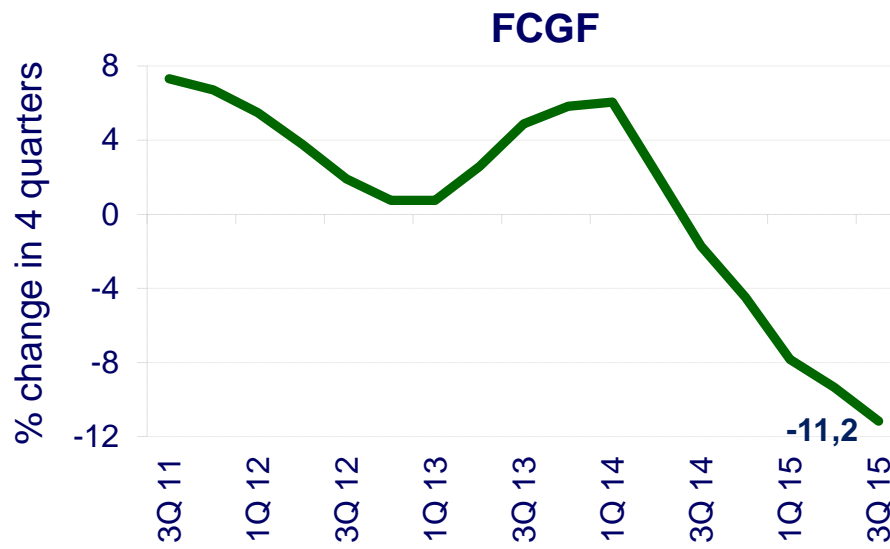
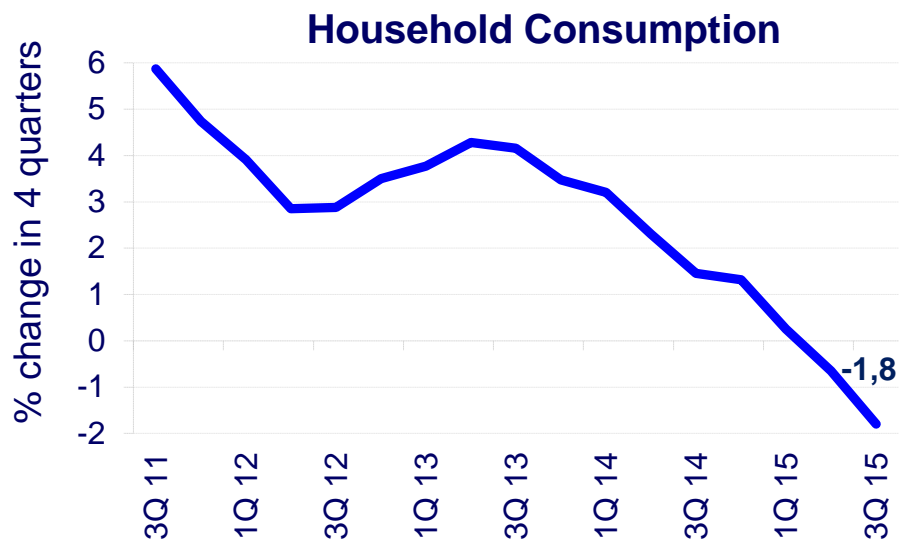


Unit Cost of Labor (in US\$)

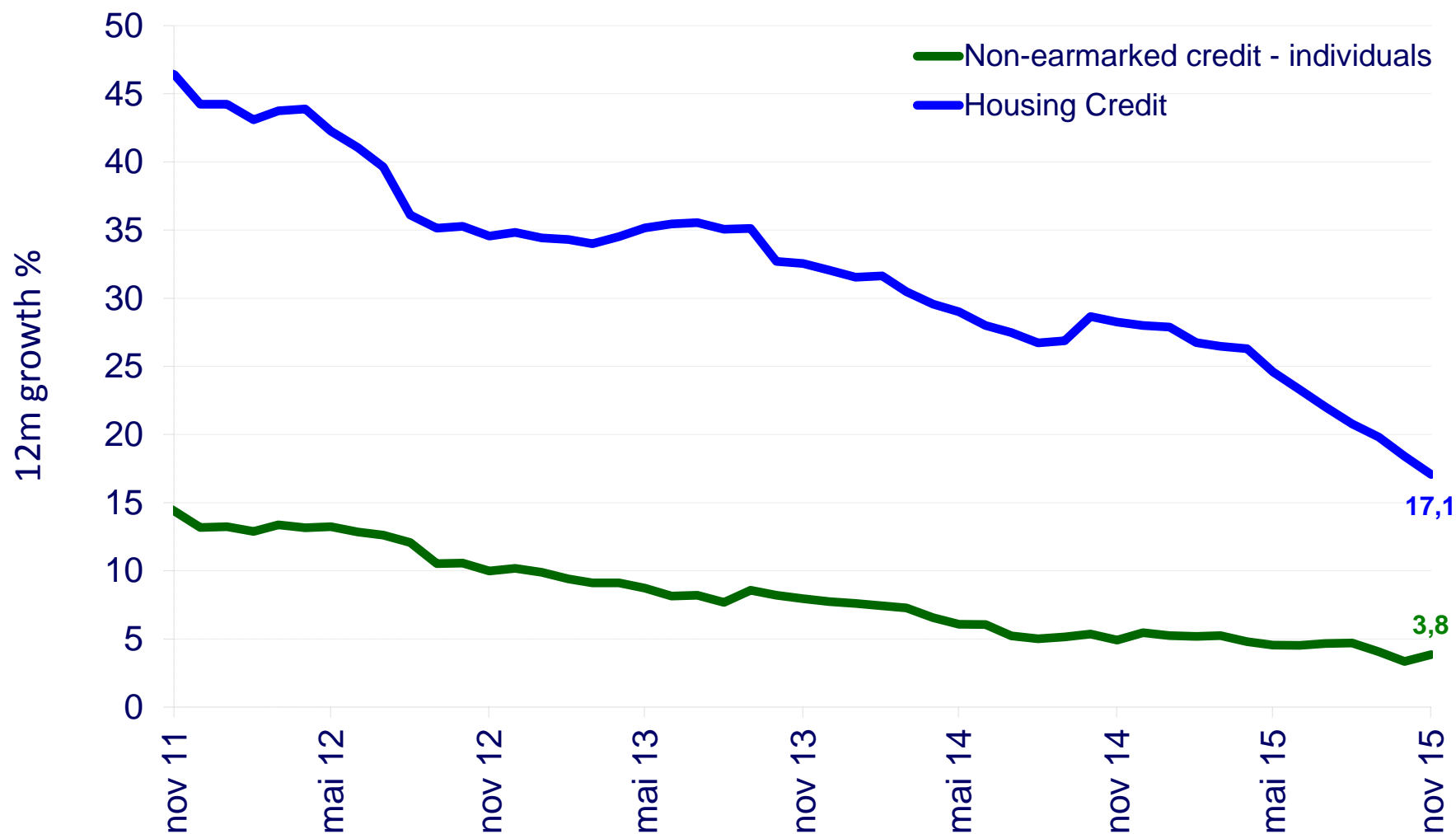


*Jun/14 to Oct/15

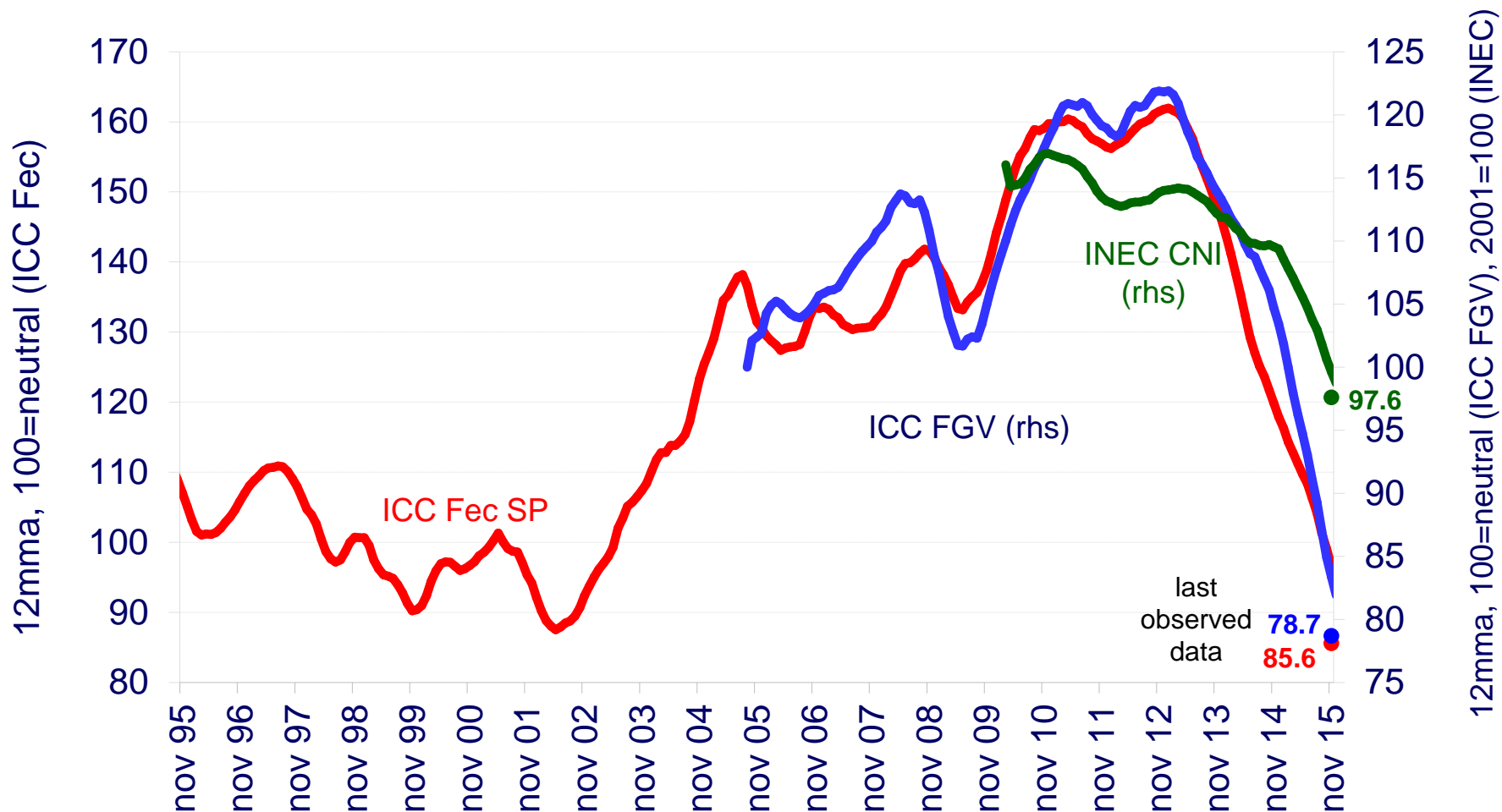
Demand: moderation in line with adjustment



Credit to households

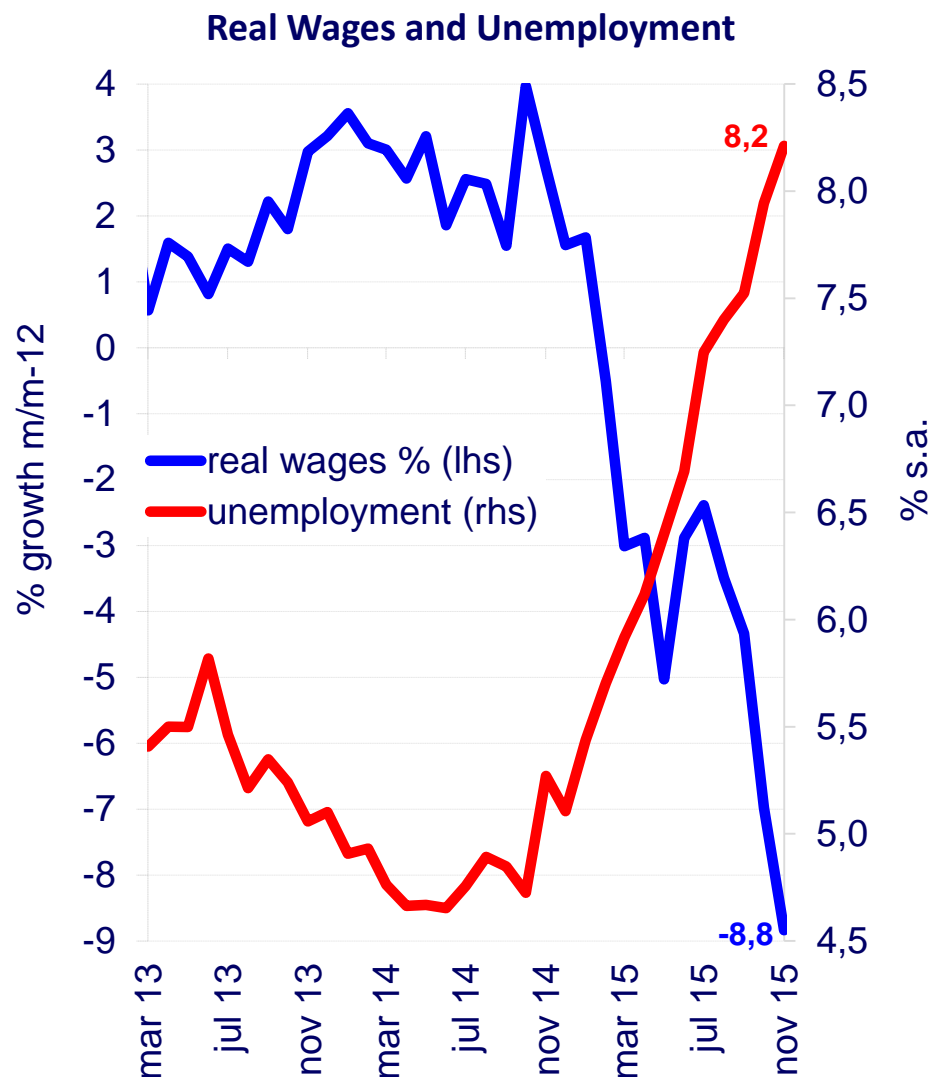
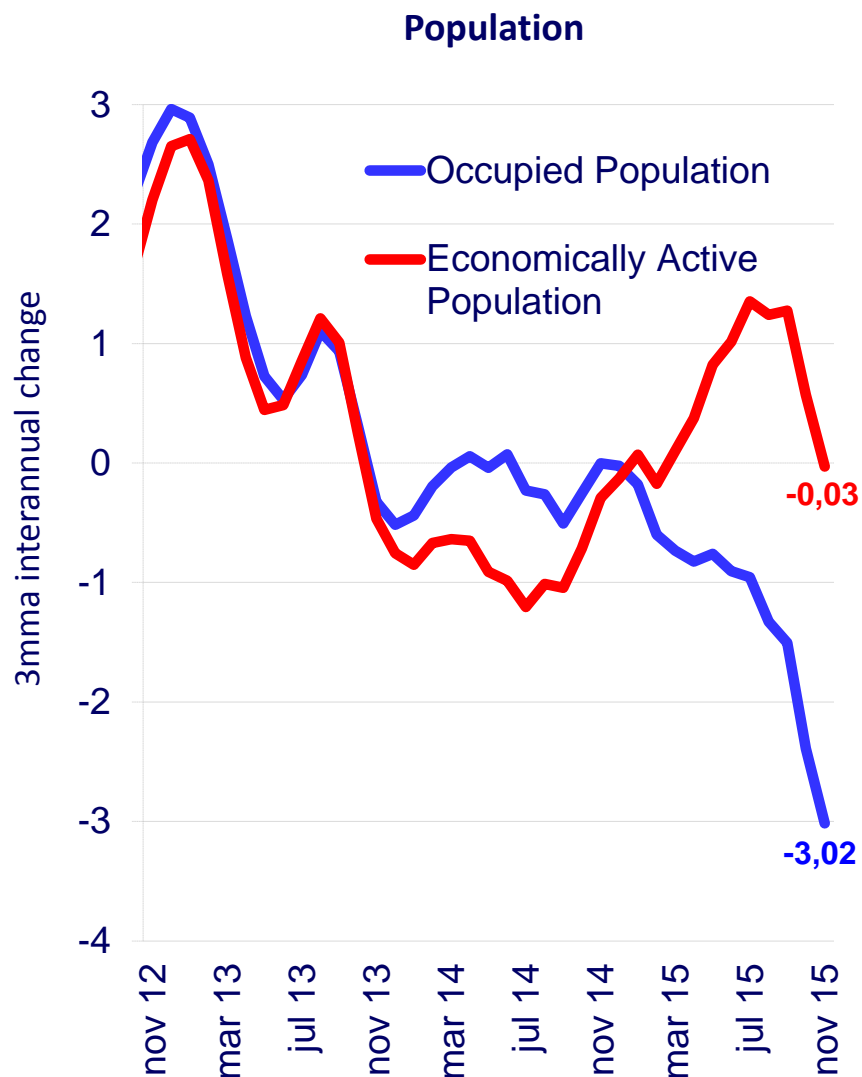


Consumer confidence



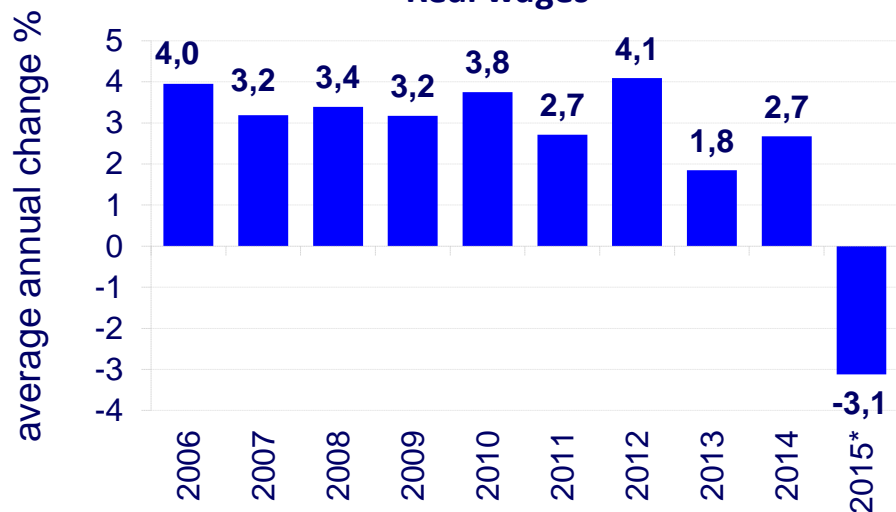
Obs.: ICCs: share of favorable responses – share of unfavorable responses + 100 (100=neutral); INEC: 2001=100

Labor market: distension

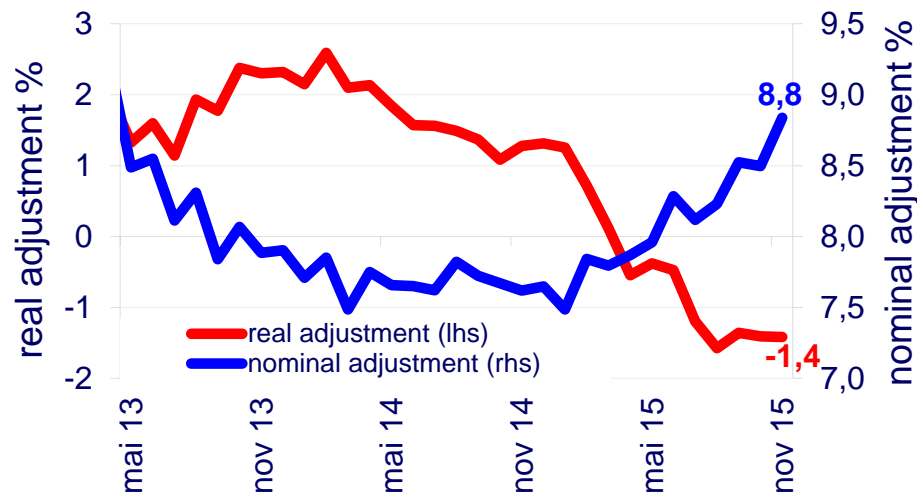


Price Adjustments: wages

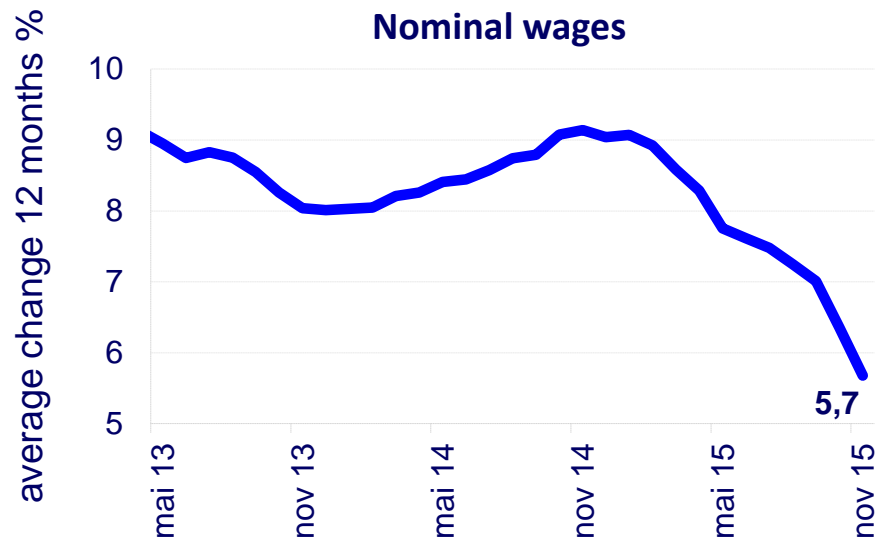
Real wages



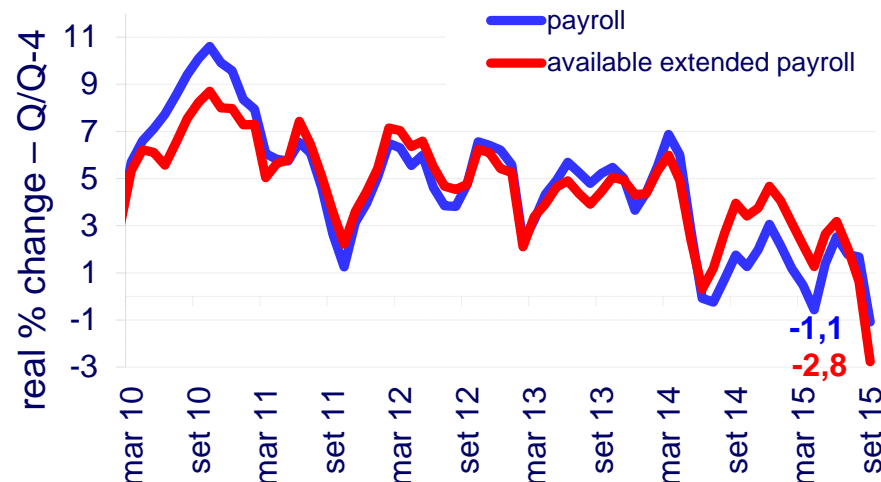
Labor Collective Conventions



Nominal wages



Payroll and Available Extended Payroll (MSAD)**



*12m through November; ** Data from the effective payroll from PNADC and Available Extended Payroll

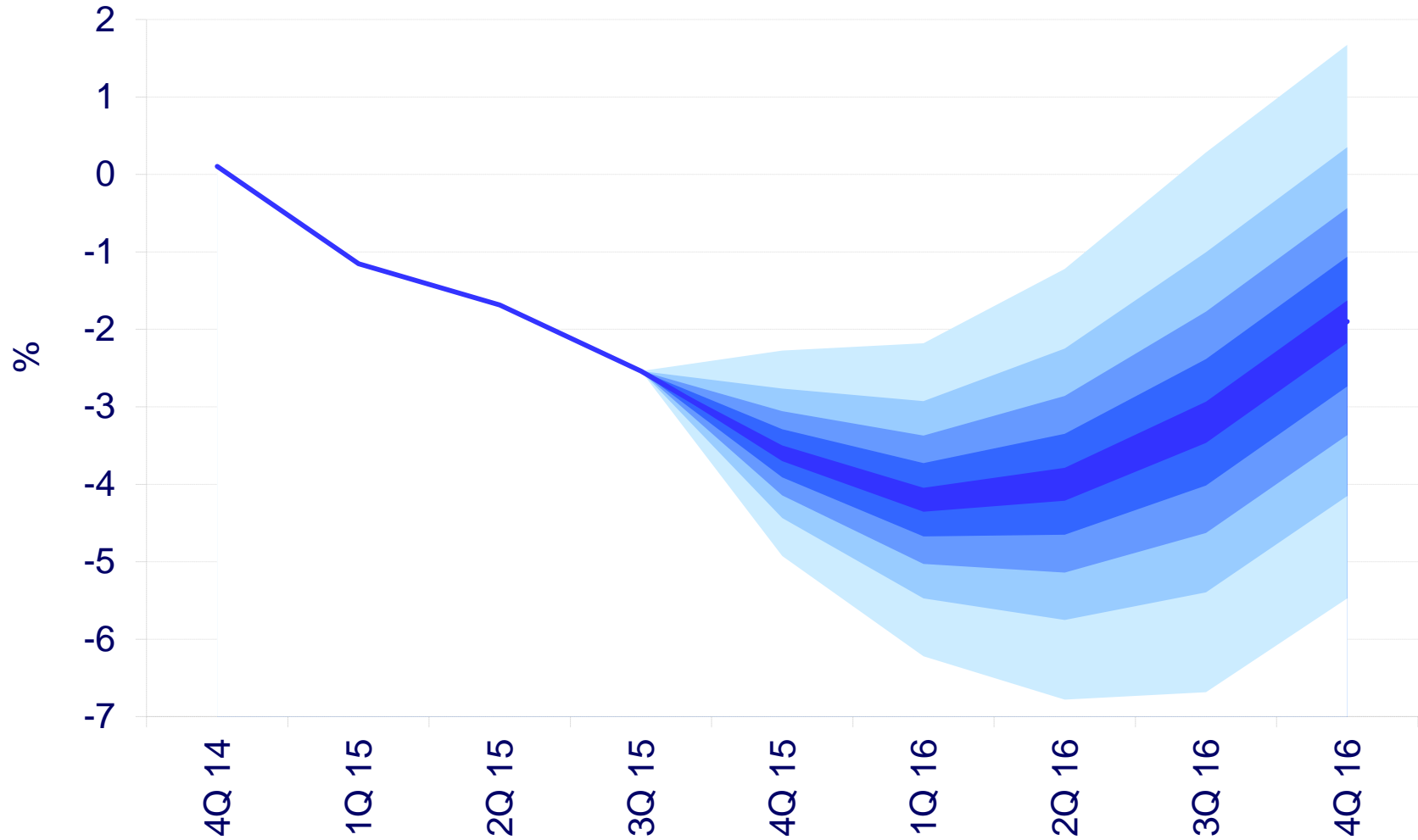
Box: GDP Projections

- **Growth revision for 2015, from -2.7% to -3.6% (domestic demand, -6.2 p.p.; and net exports, 2.6 p.p.);**
 - **Supply**
 - Agriculture and livestock: 1.7% (2.1% in Q3/2015)
 - Industry: -6.3% (-5.6% in Q3/2015)
 - Services: -2.4% (-2.1% in Q3/2015)
 - **Demand**
 - Investment: -14.5% (-12.7% in Q3/2015)
 - Household Consumption: -3.8% (-3.0% in Q3/2015)
 - Government Consumption: -0.3% (-0.4% in Q3/2015)

- **Real change for 2016 estimated in -1.9% (domestic demand, -3.7 p.p.; and net exports, 1.8 p.p.)**

GDP Projections

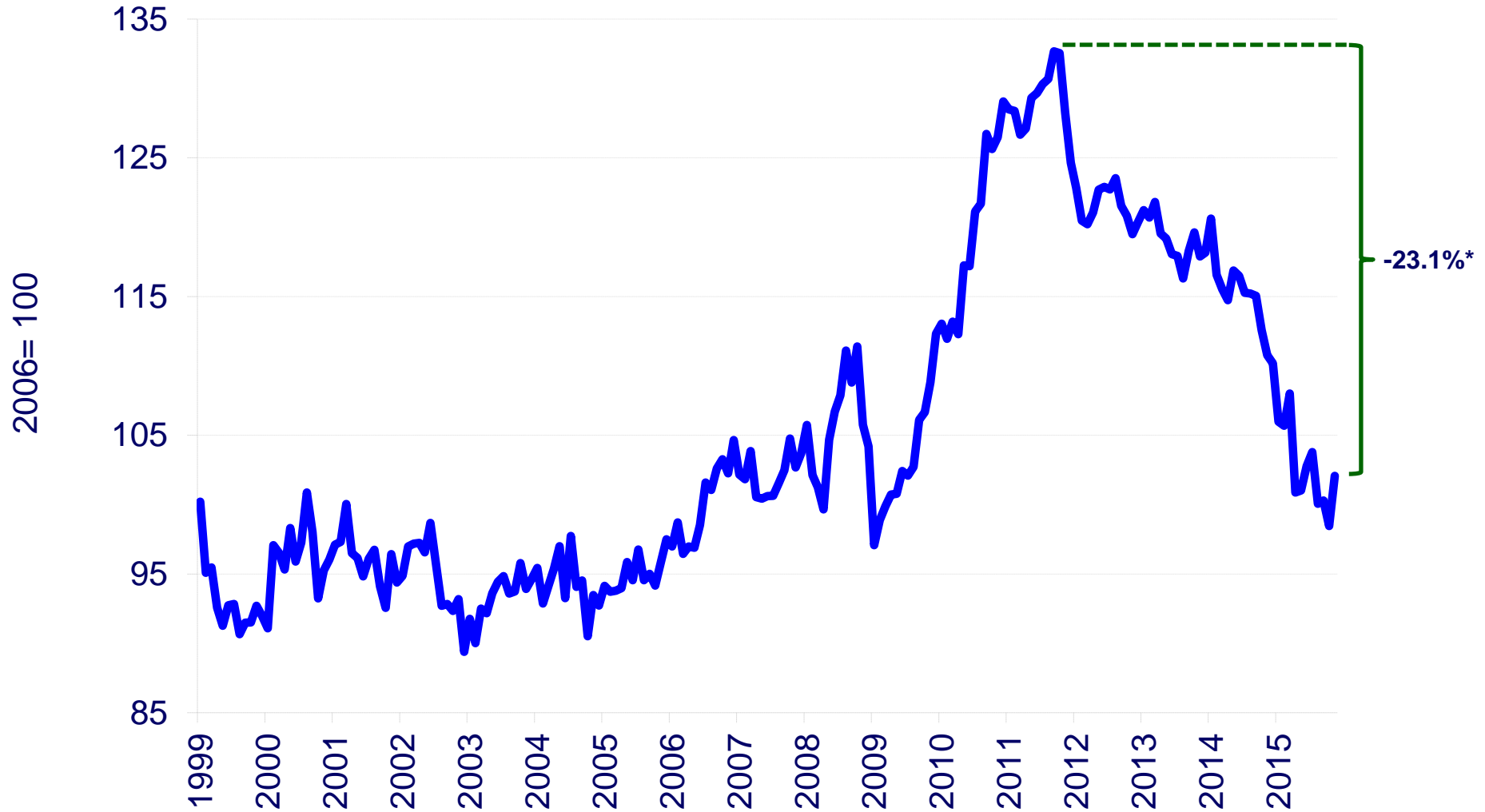
Baseline Scenario*



* interest rates constant at 14.25% p.a.

External Sector

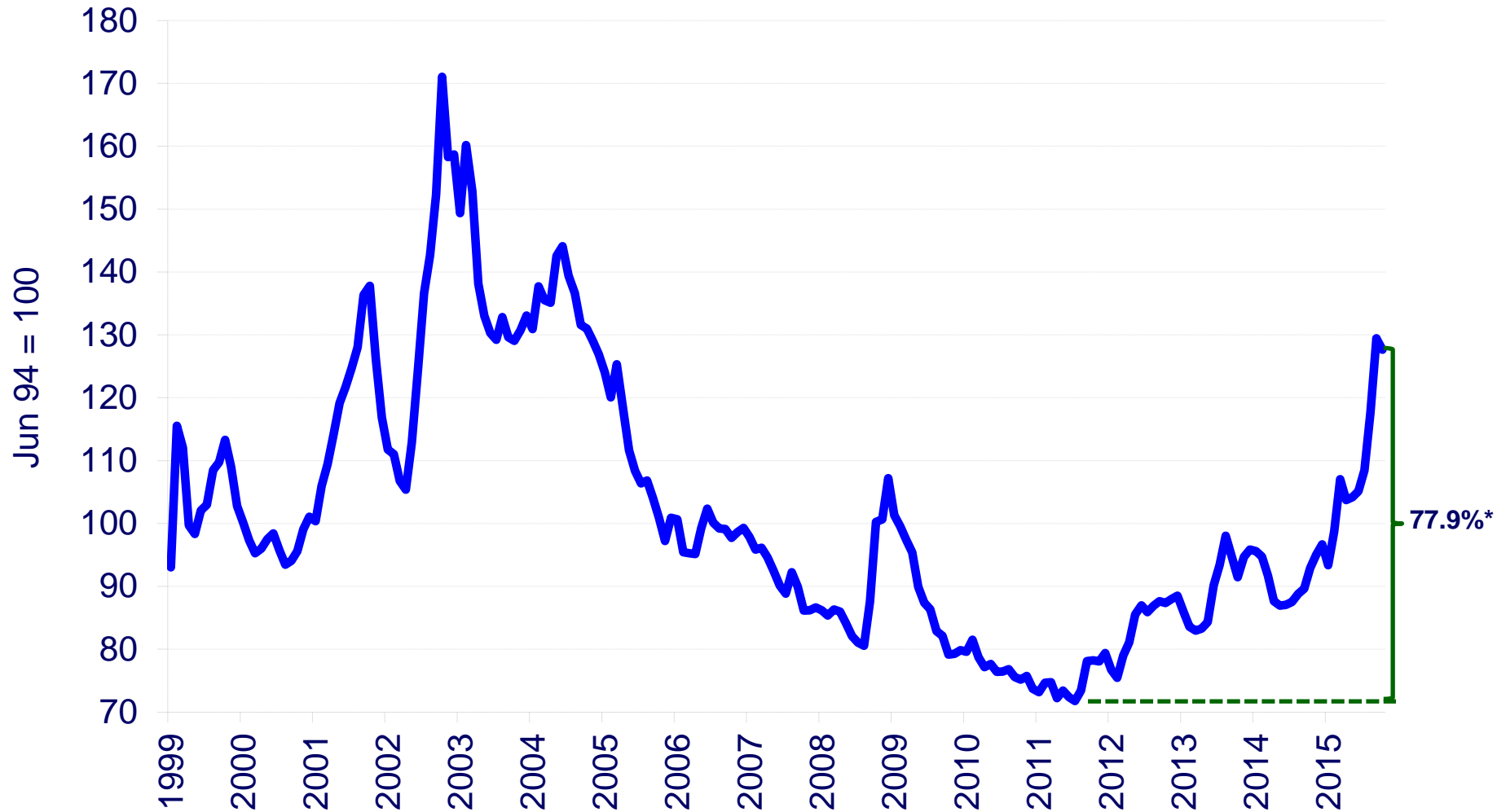
Terms of trade



*Sep/11 to Nov/15

Real exchange rate

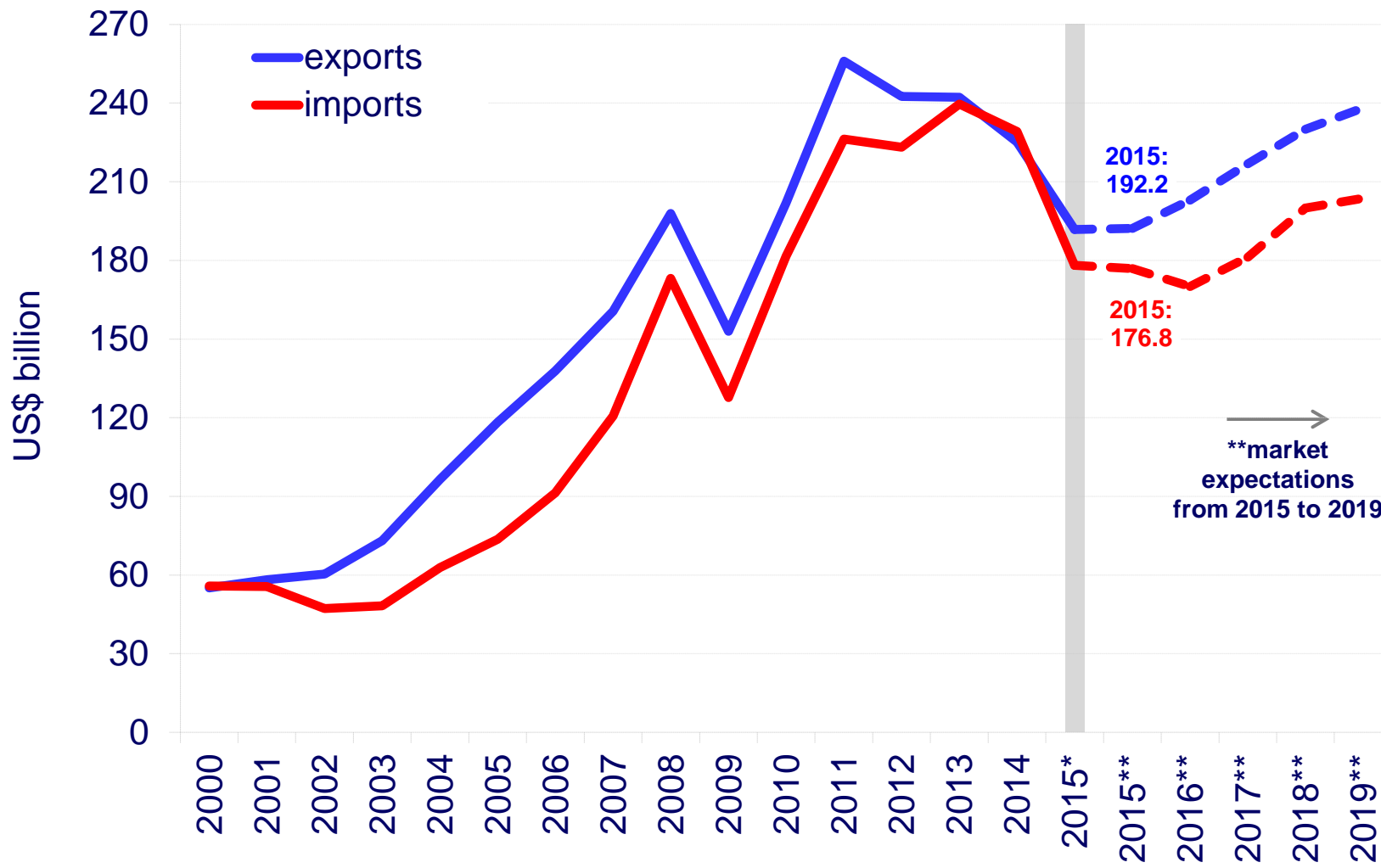
Effective real exchange rate



* Jul/11 to Oct/15

Trade balance – exports and imports

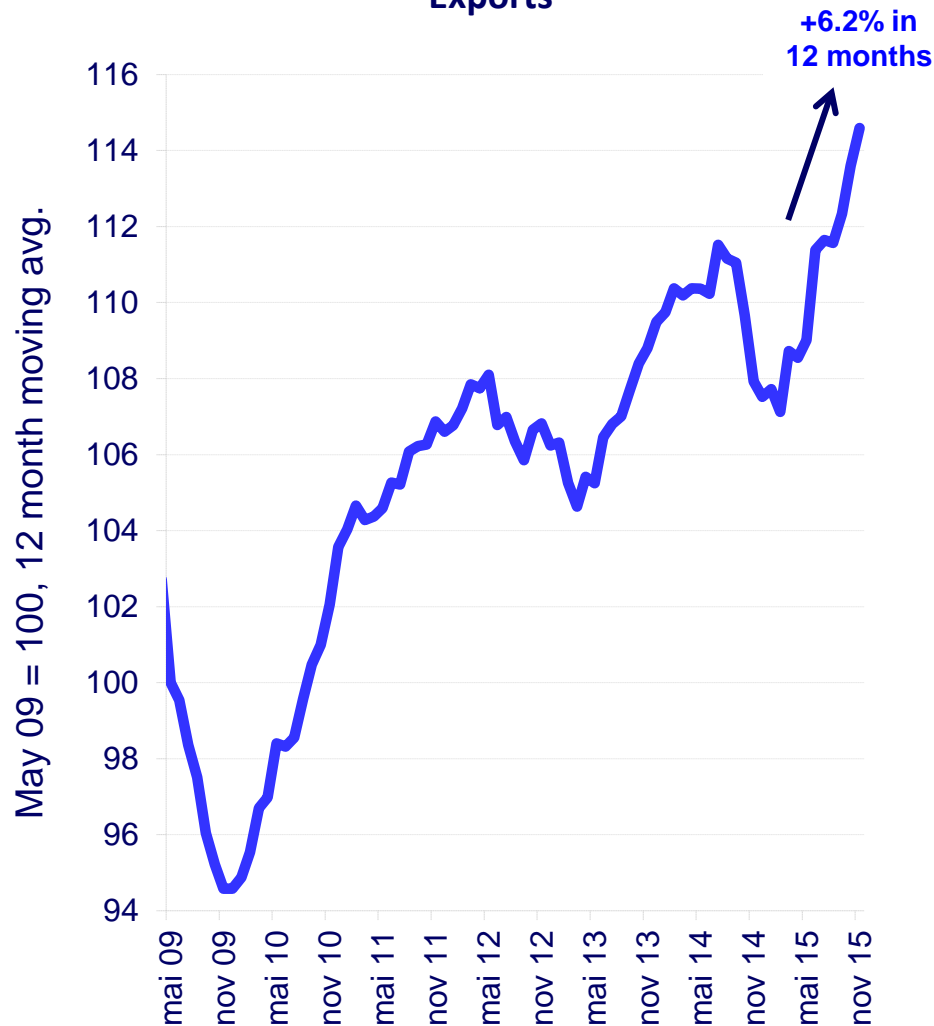
BCB projection for the 2015 trade balance 2015: US\$ 15 billion



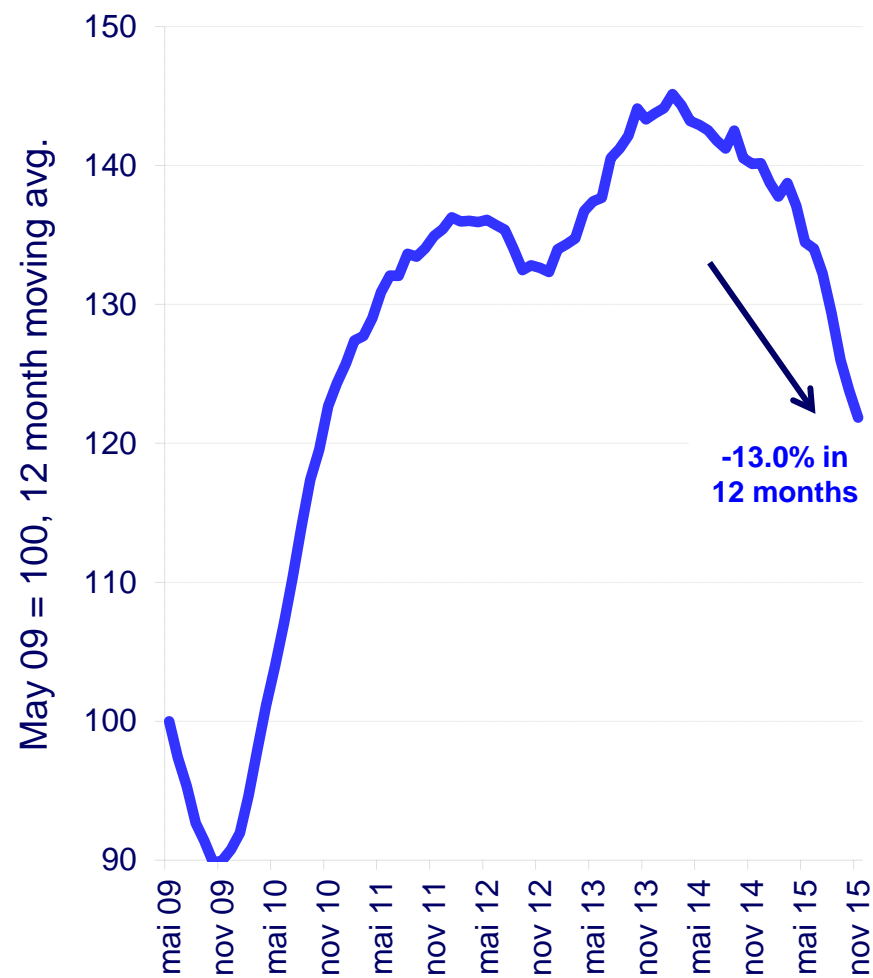
* 12 months through Nov/15; ** data as of Dec 18th

Exports and Imports Volume

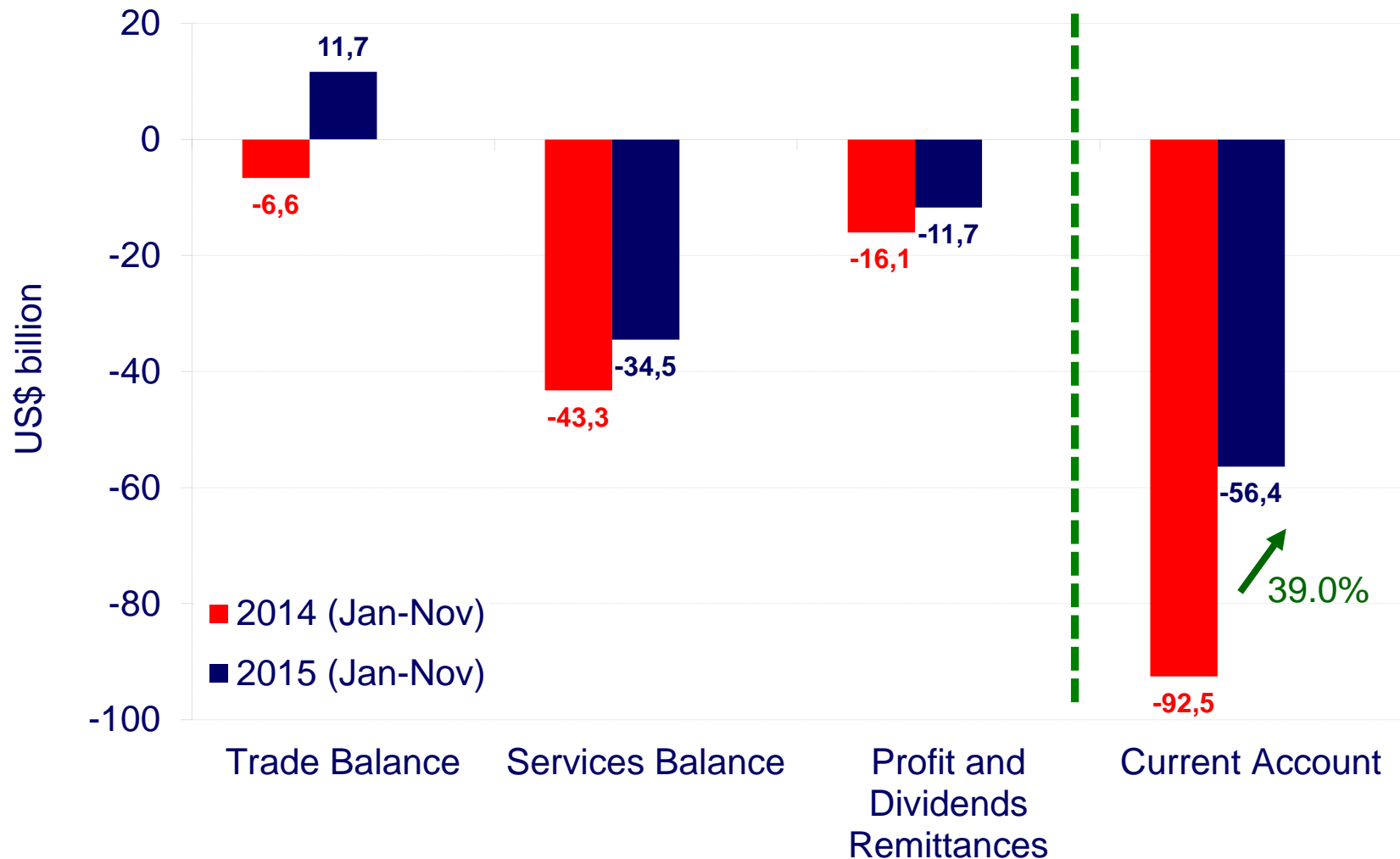
Exports



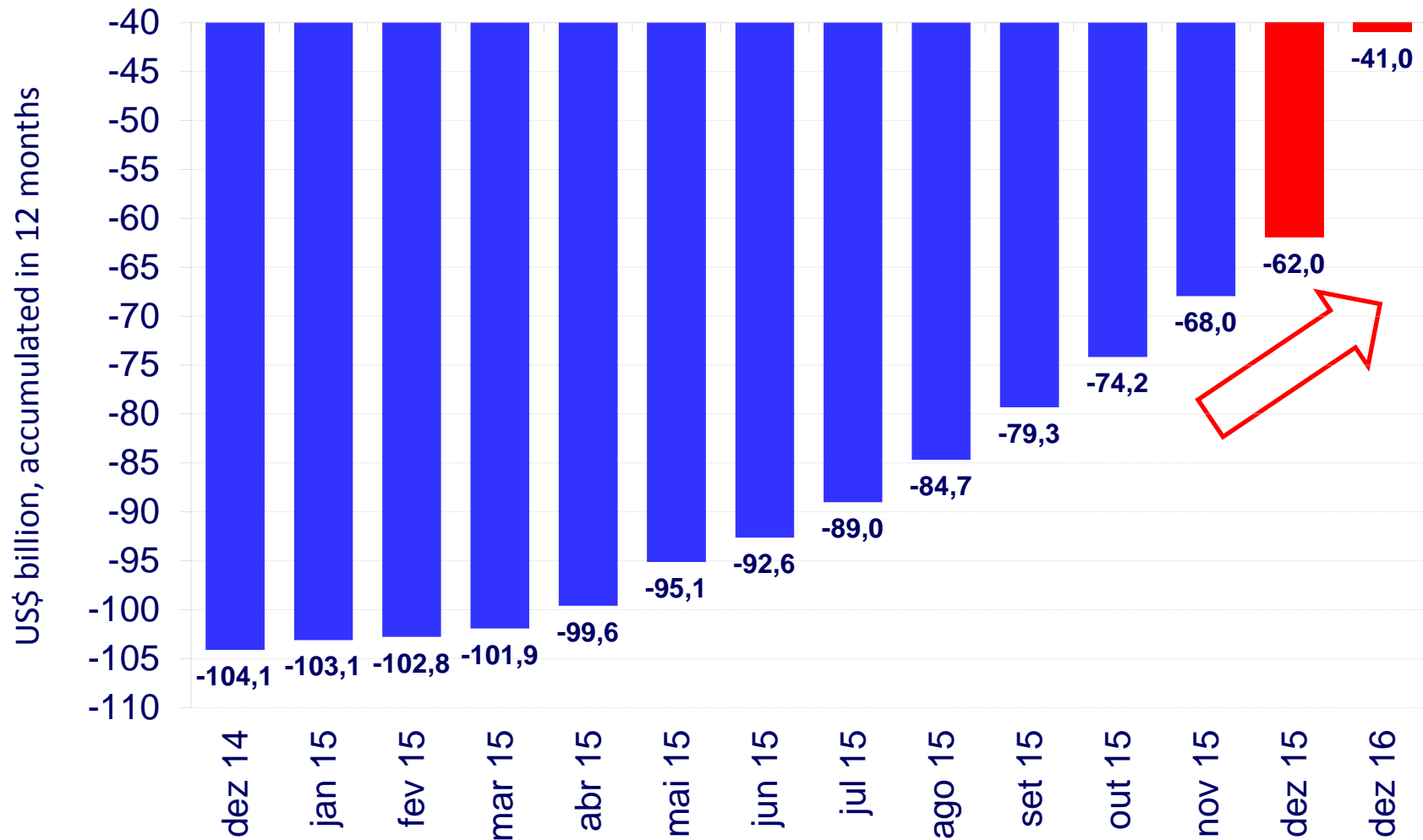
Imports



Reaction of the 2015 external accounts

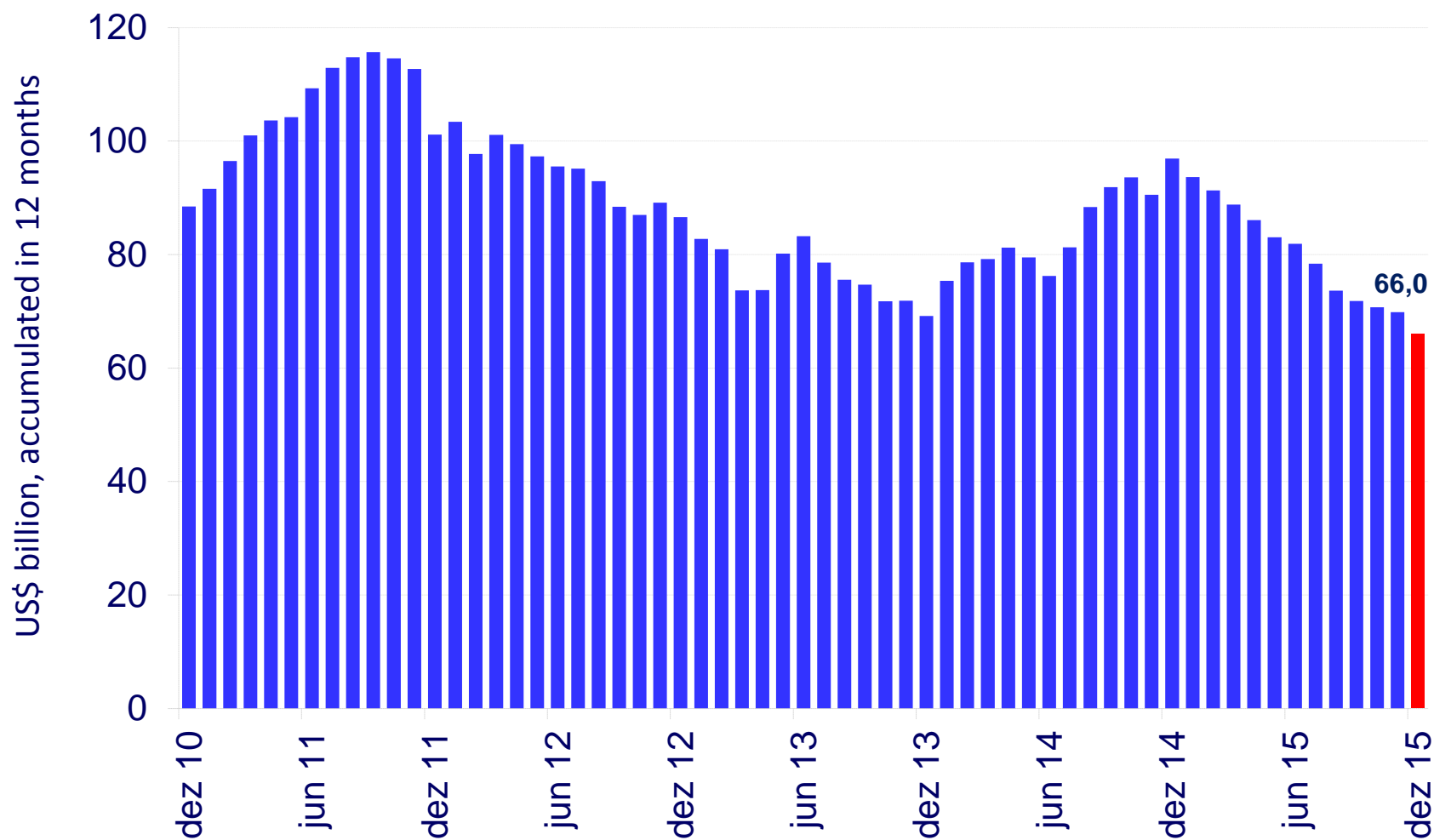


External sector in adjustment



*Dec/15 and Dec/16: projection

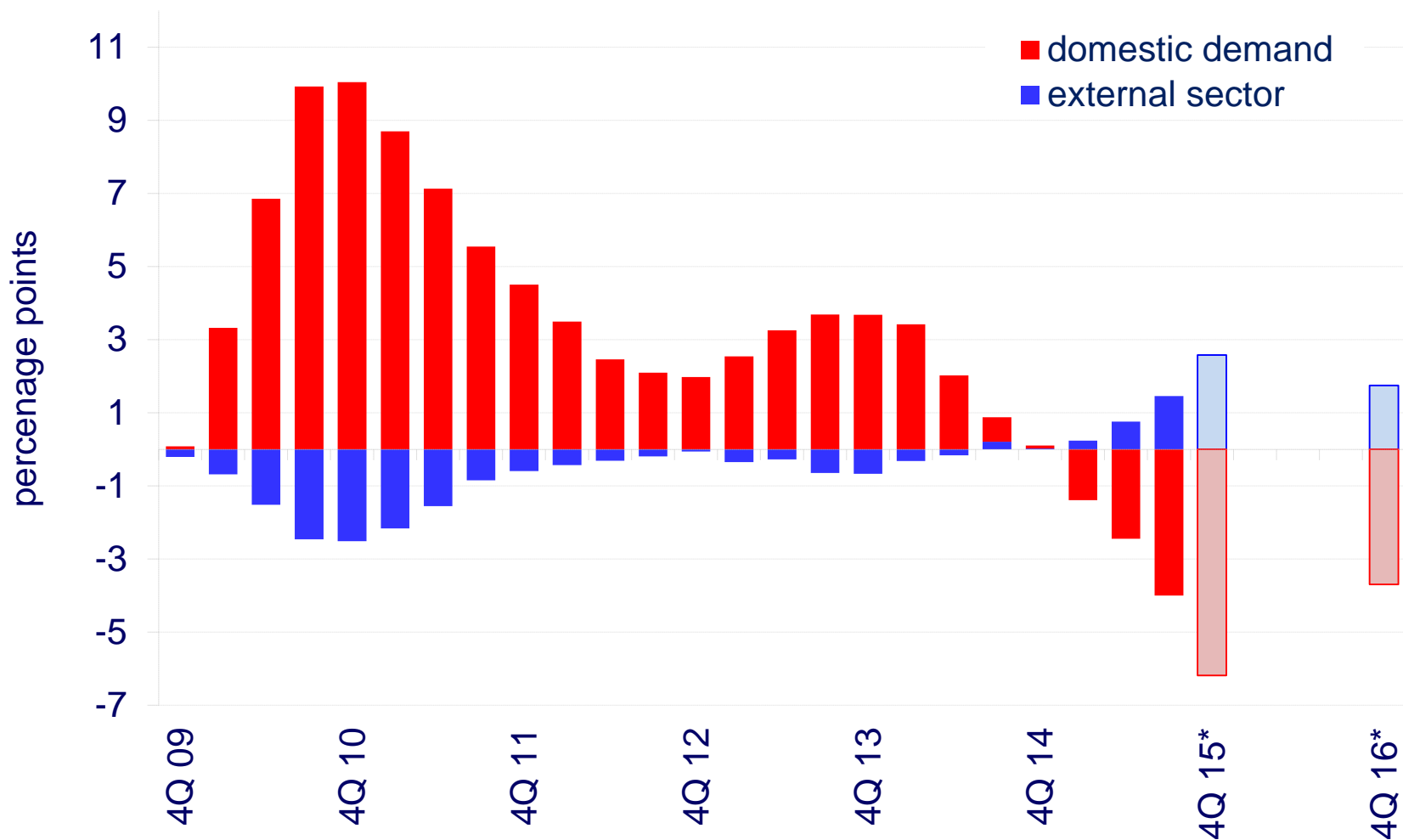
Direct Investment Liabilities



*Dec/15: projection

Contribution of the external sector for the GDP

Contribution for the GDP growth (in 4 quarters)



* BCB projections

Box: Projections for the Balance of Payments

Revised Forecasts for 2015:

- Current Account – deficit changed from US\$65 billion to US\$62 billion (3.7% to 3.5% of the GDP). US\$104 billion deficit in 2014
- Trade Balance – surplus changed from US\$12 billion to US\$15 billion
- Direct Investment Liabilities – inflows changed from US\$65 billion to US\$66 billion
- Portfolio Investment Liabilities (equities and fixed income) – changed from US\$31 billion to US\$23 billion

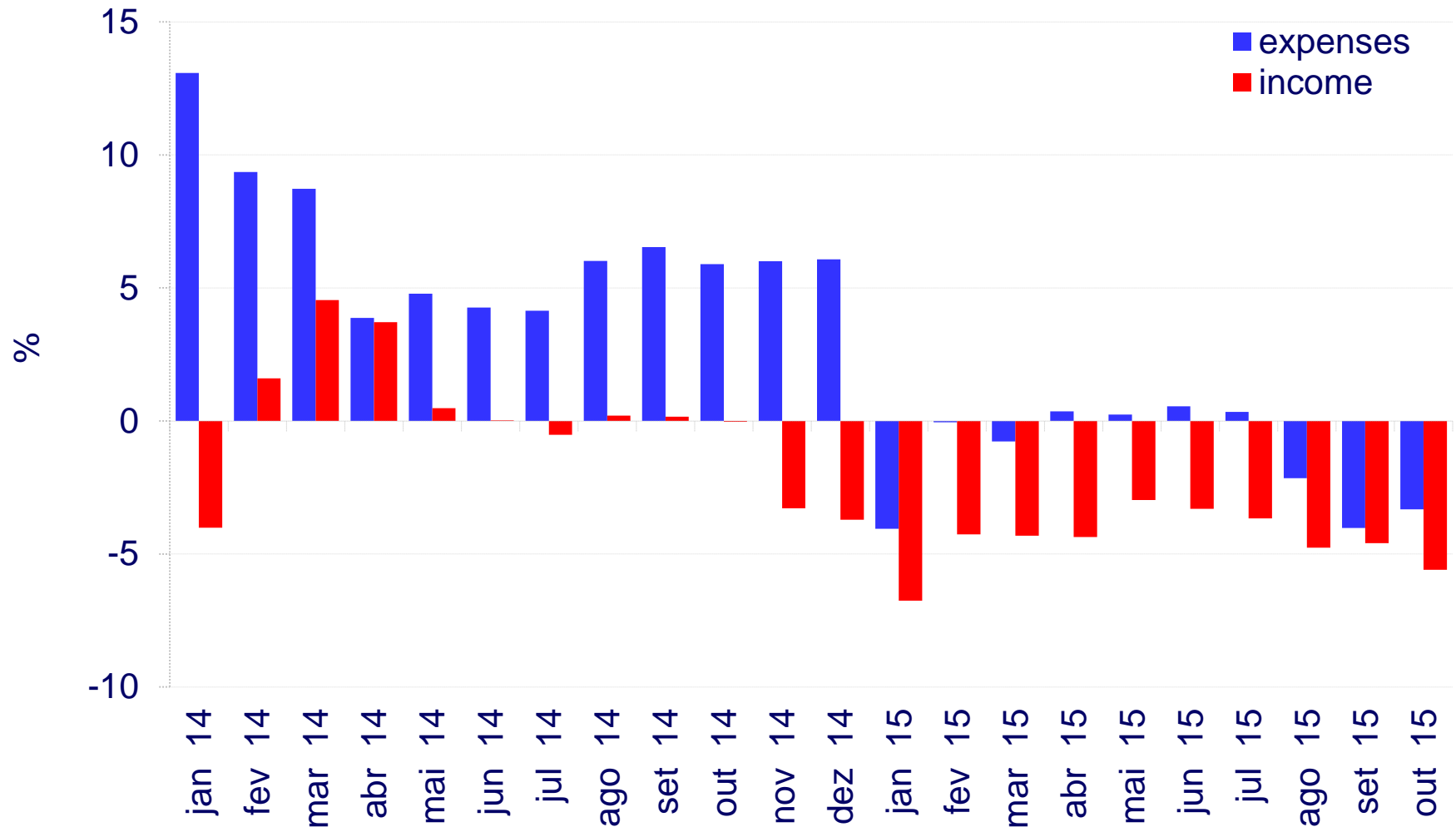
Forecasts for 2016:

- Current Account – US\$41 billion deficit (2.7% of the GDP)
- Trade Balance – US\$30 billion surplus
- Direct Investment Liabilities – US\$60 billion inflows
- Portfolio Investment Liabilities (equities and fixed income) – US\$12 billion

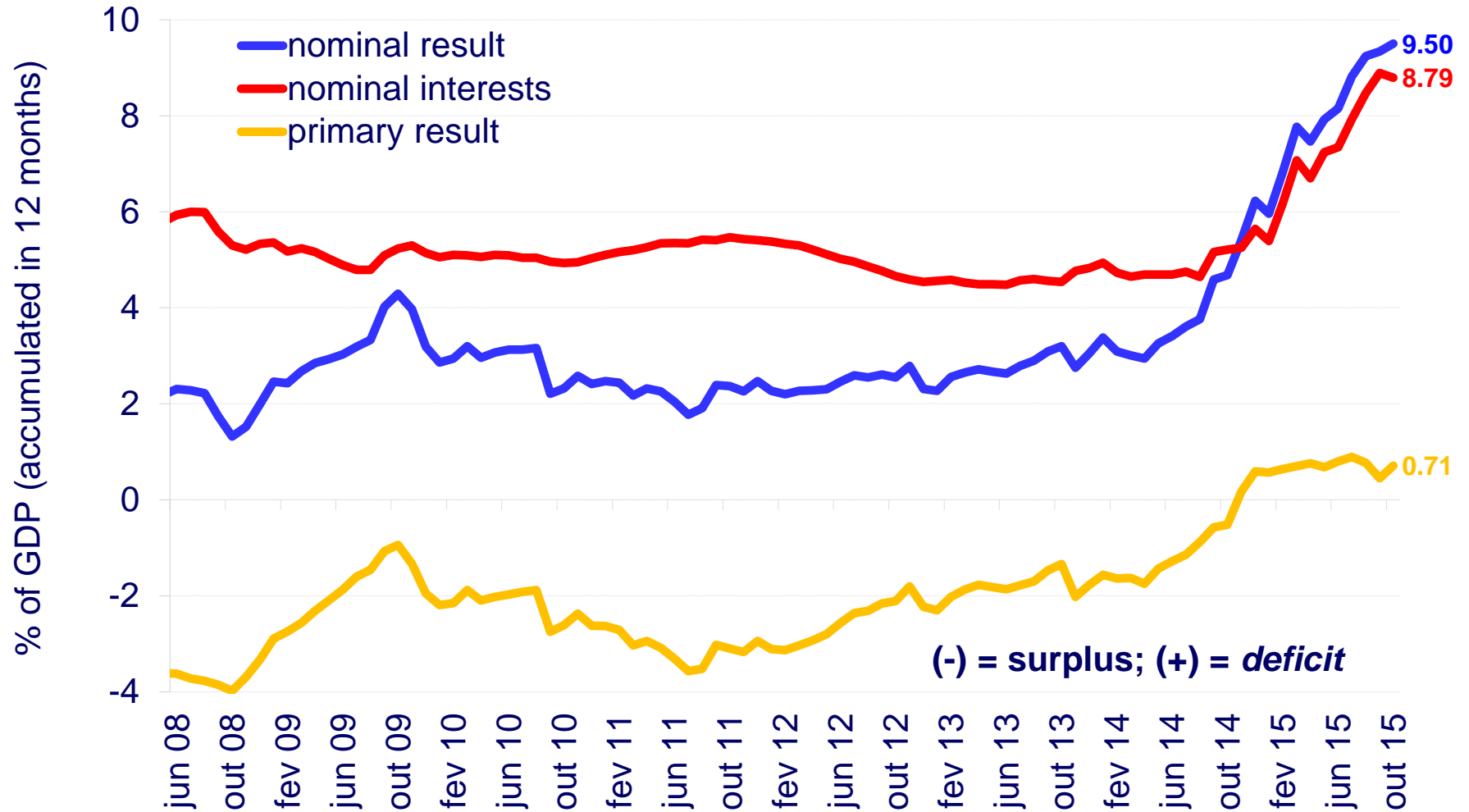
Fiscal

Real growth (IPCA) of income and expenses of the Central Government

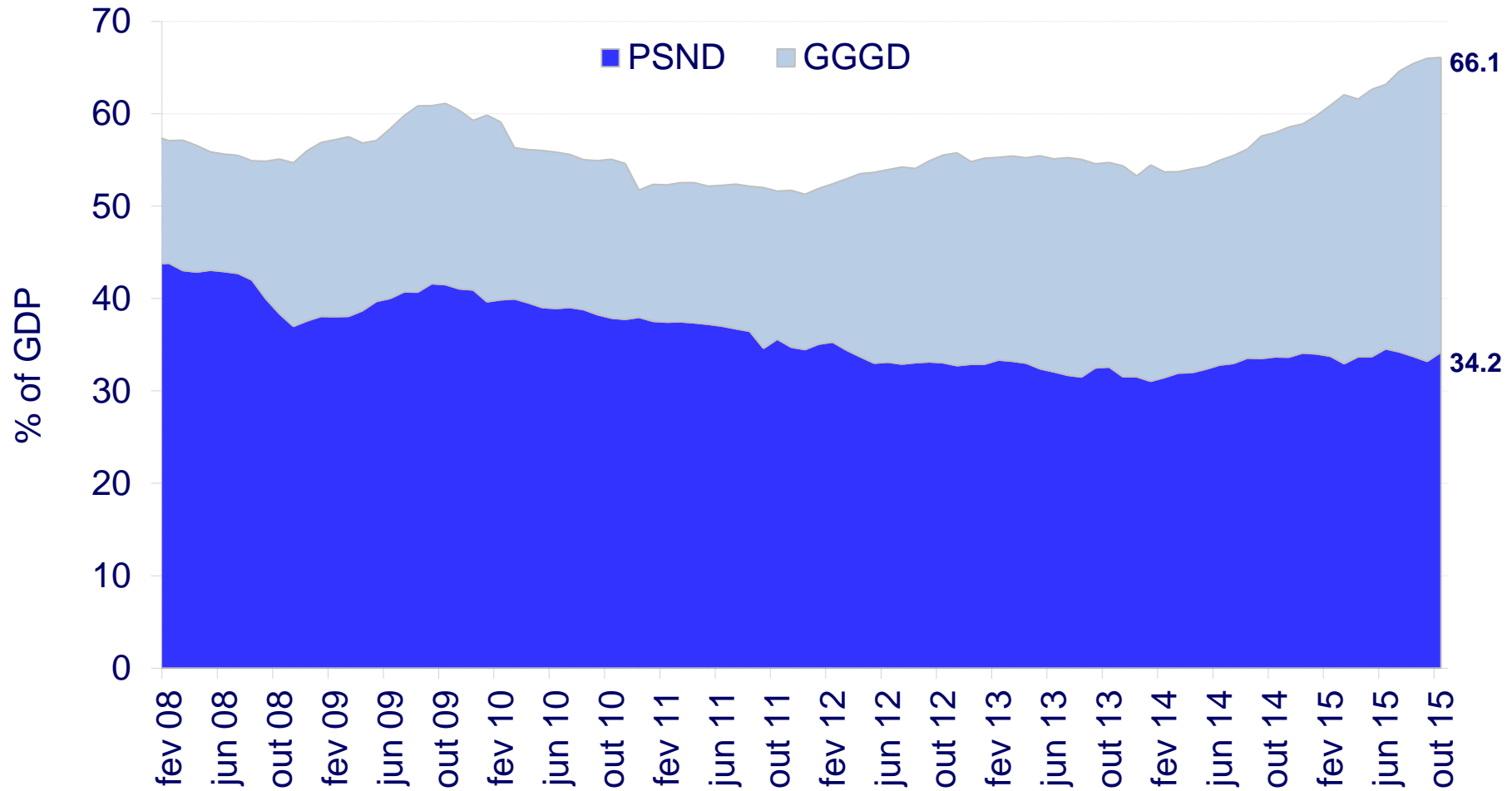
Accumulated in the year through the reference month



Fiscal data



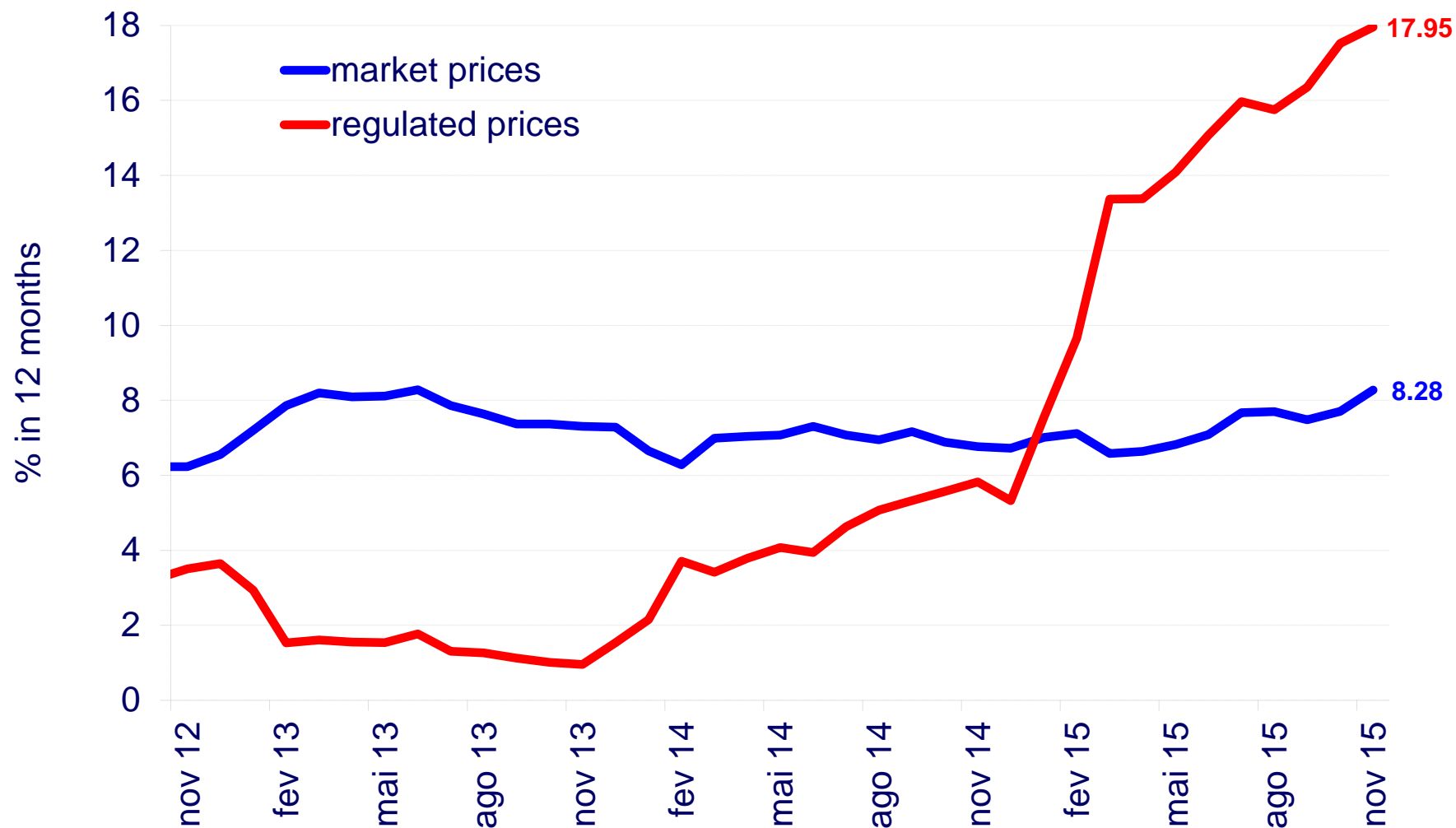
Fiscal Data



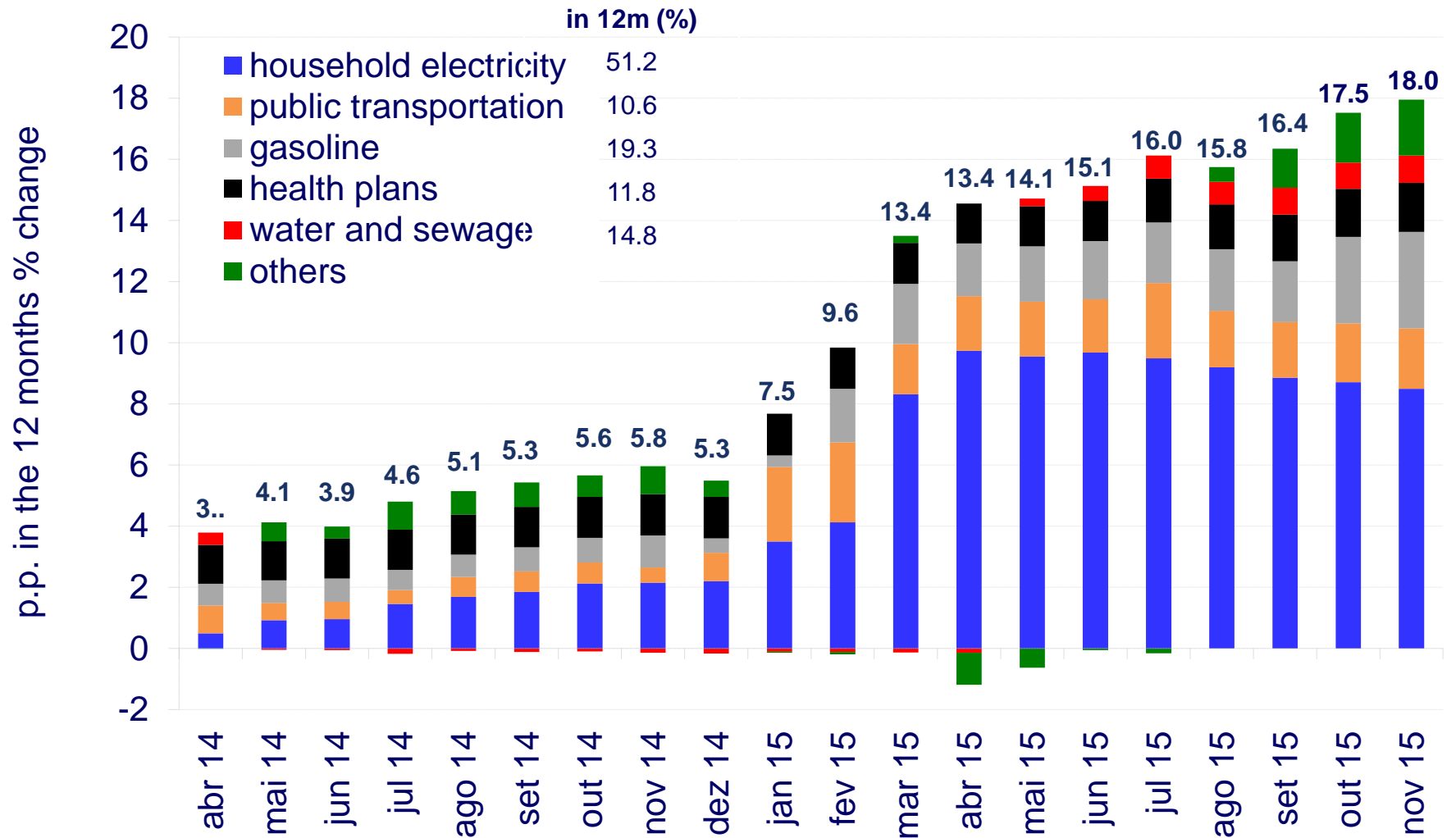
PSND: Public Sector Net Debt; GGGD: General Government Gross Debt

IV. Inflation Developments

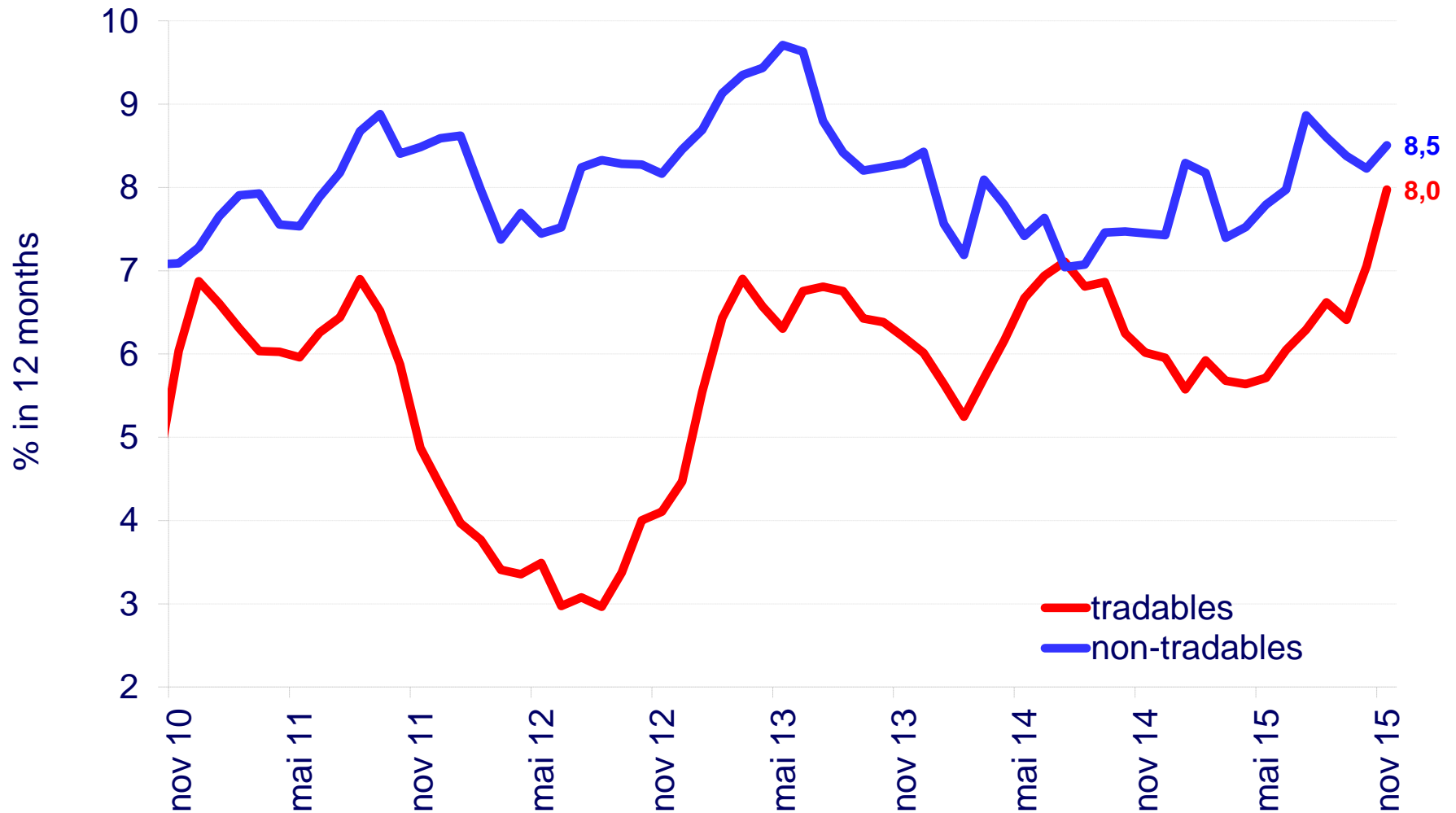
Market and regulated prices



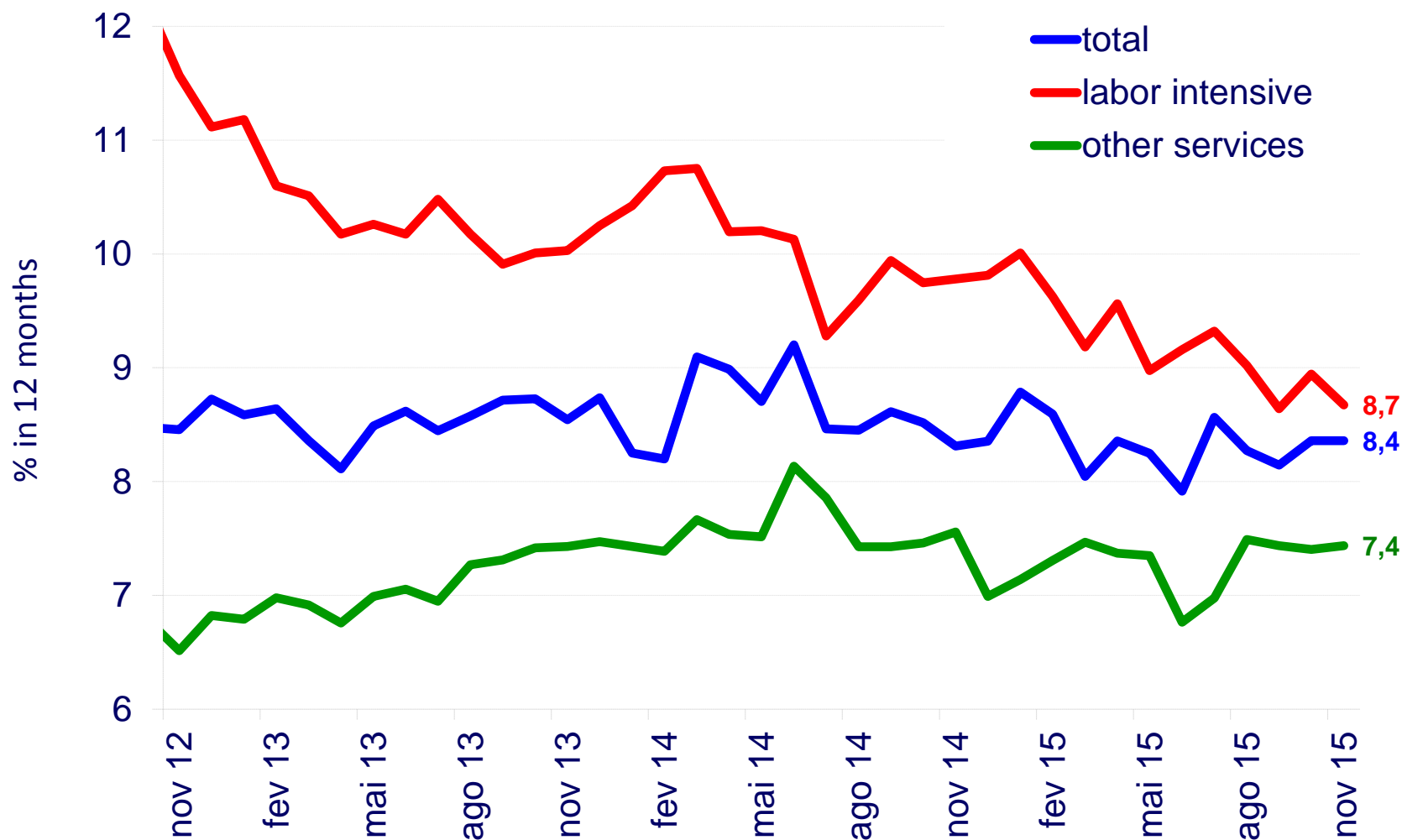
Contribution to regulated prices



Tradables and non-tradables



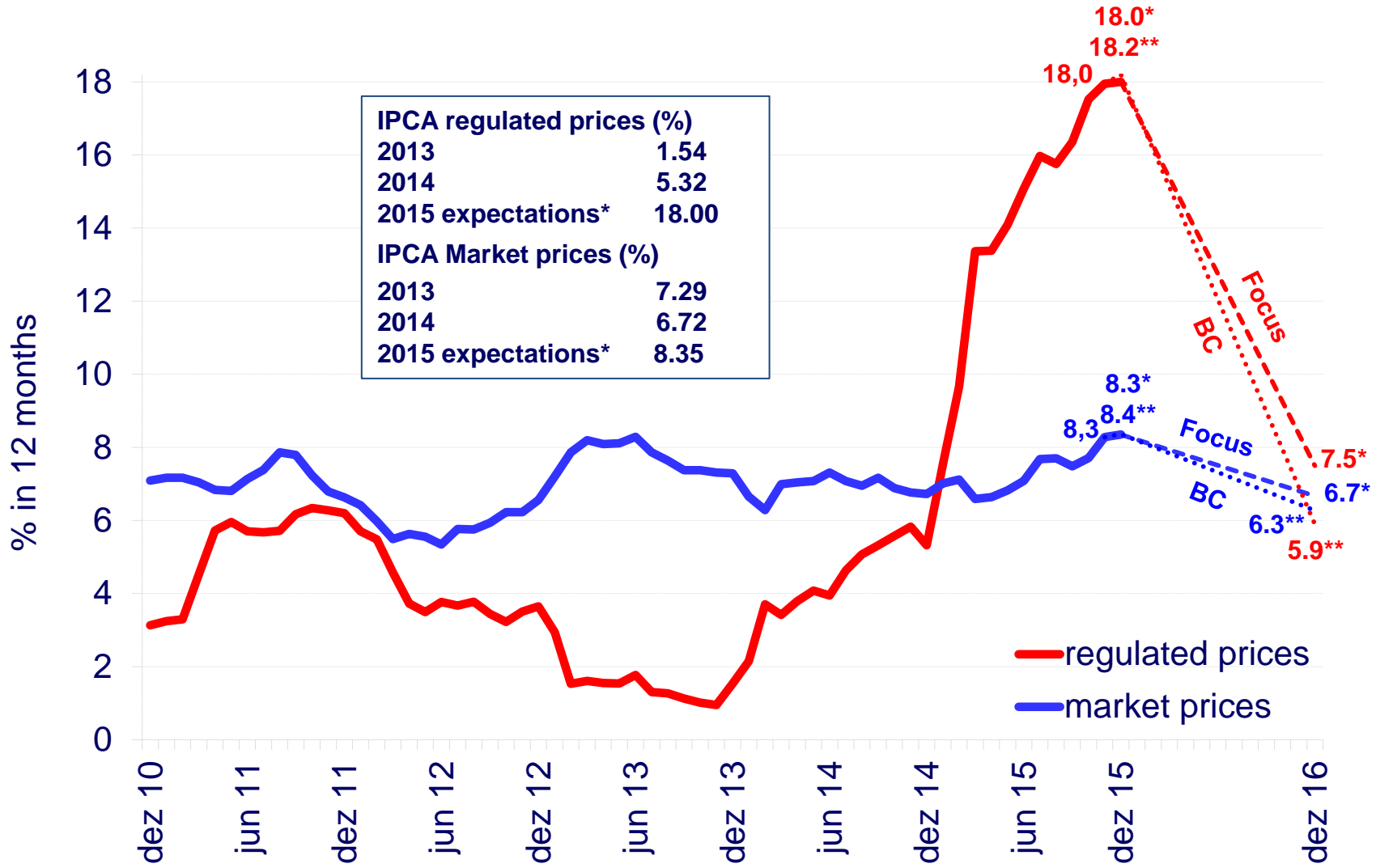
Services inflation



Recent Behavior of Services Inflation

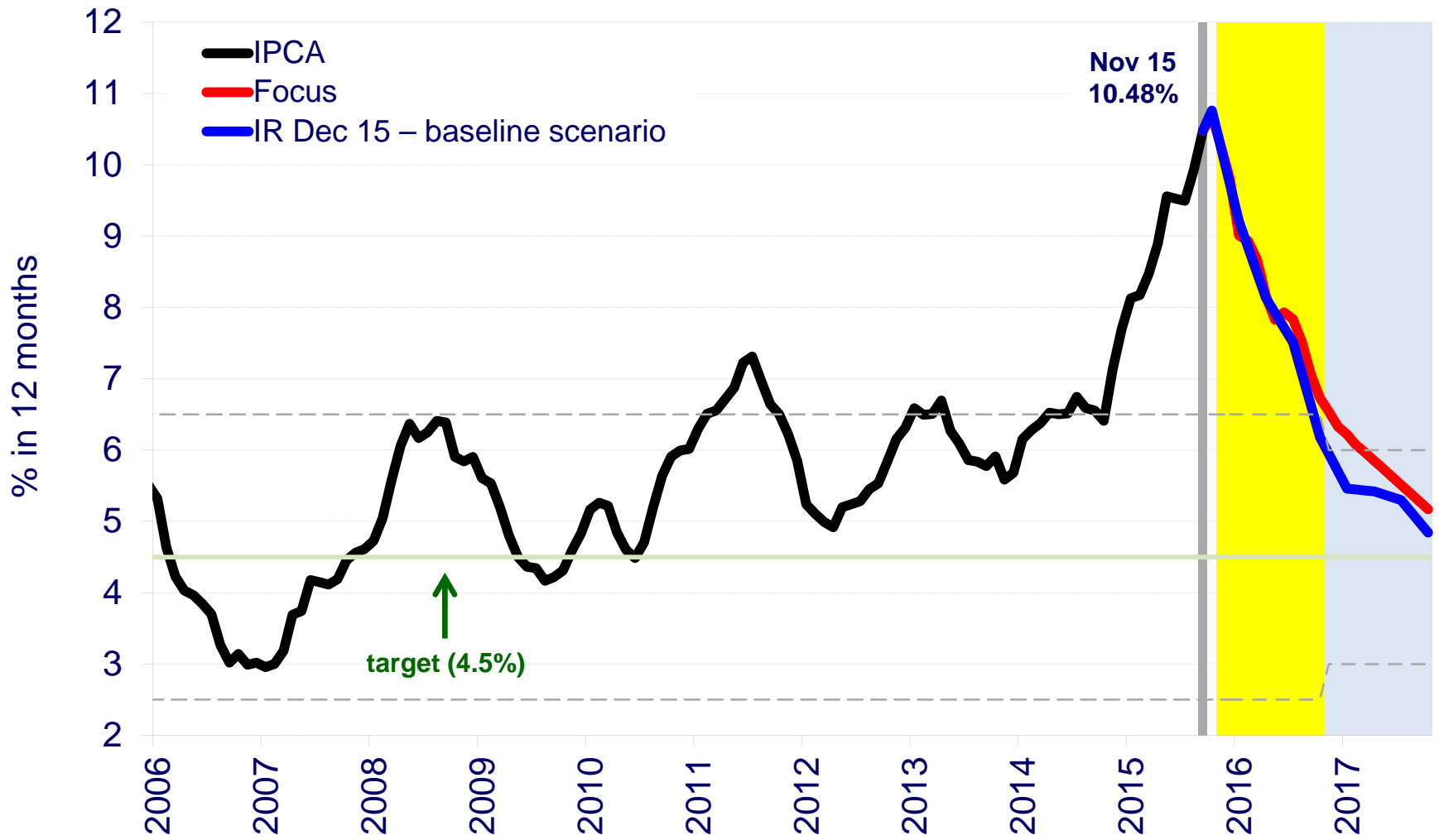
- Results of the analysis of two segments of services inflation (labor-intensive and other services) suggest that the effects of the output gap fall and real income slowdown should contribute to the reduction of services inflation since the first quarter of 2016
- The existence of lags explains part of the persistence that has been observed. Other factors, such as expectations or pass-through from other groups, are also an influence

Relative prices adjustment



*expectations as of Dec 18th ** BCB projections, baseline scenario

Consumer price inflation



Obs.: Focus: expectations as of Dec 18th

Price Formation in Brazil

- From the perspective of monetary policy, the survey indicates that:
 - pricing decisions occur in two stages: review and change implementation
 - there is important price rigidity in Brazil, although lower than in advanced economies
 - heterogeneity in rigidity among sectors
 - dominant strategy is the addition of prices markup and
 - input costs and inflation are among the most important factors in determining prices

El Niño, rainfall and major inflationary impacts

- It is expected that the climatic effects that occurred in years of moderate or strong intensive El Niño recur in the rainy season of 2015/2016, with increased rainfall in the South, Southeast and Midwest
- The pressure that the weather event may have on consumer inflation through the increase of food prices can be offset by lower energy prices resulting from increased reservoir levels

BCB Inflation Forecasts

Baseline Scenario* and Market Scenario

| Period | | Baseline | Market |
|--------|---|----------|--------|
| 2015 | 4 | 10.8 | 10.8 |
| 2016 | 1 | 9.2 | 9.2 |
| 2016 | 2 | 8.1 | 8.2 |
| 2016 | 3 | 7.5 | 7.6 |
| 2016 | 4 | 6.2 | 6.3 |
| 2017 | 1 | 5.5 | 5.6 |
| 2017 | 2 | 5.4 | 5.5 |
| 2017 | 3 | 5.3 | 5.4 |
| 2017 | 4 | 4.8 | 4.9 |

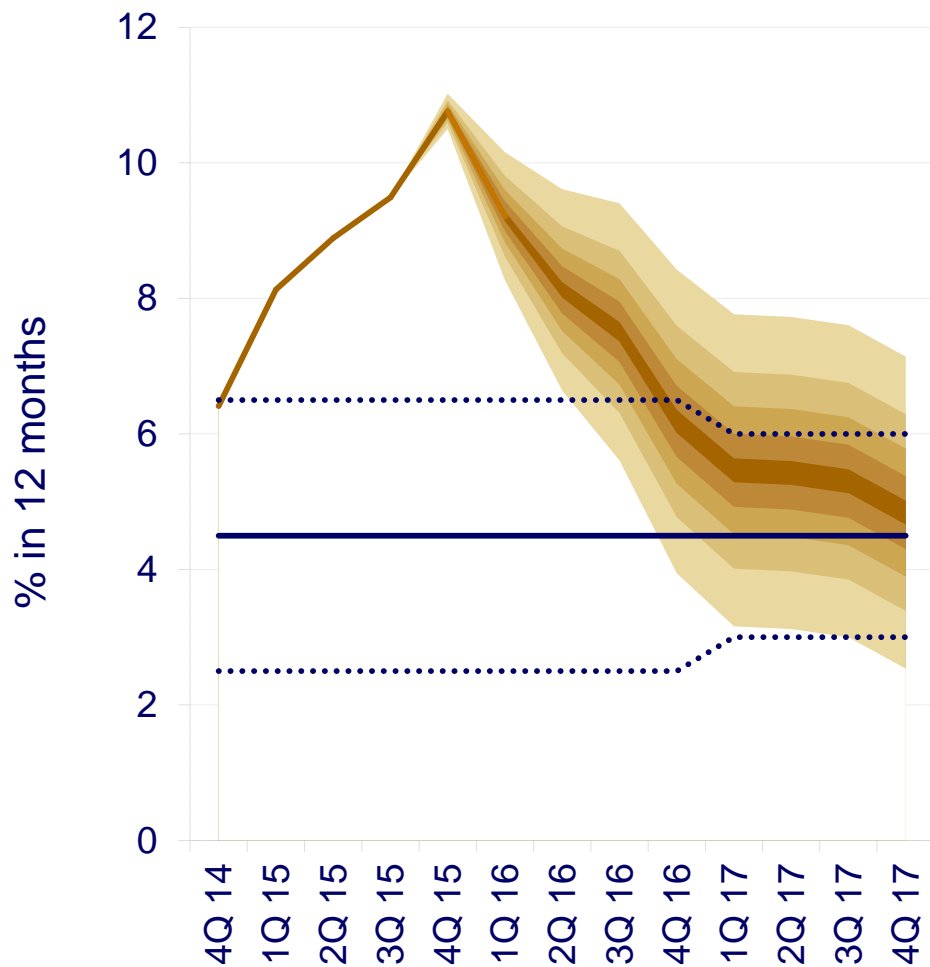
Obs.: 12-month accumulated inflation (%)

* Interest rate constant at 14.25% p.y.

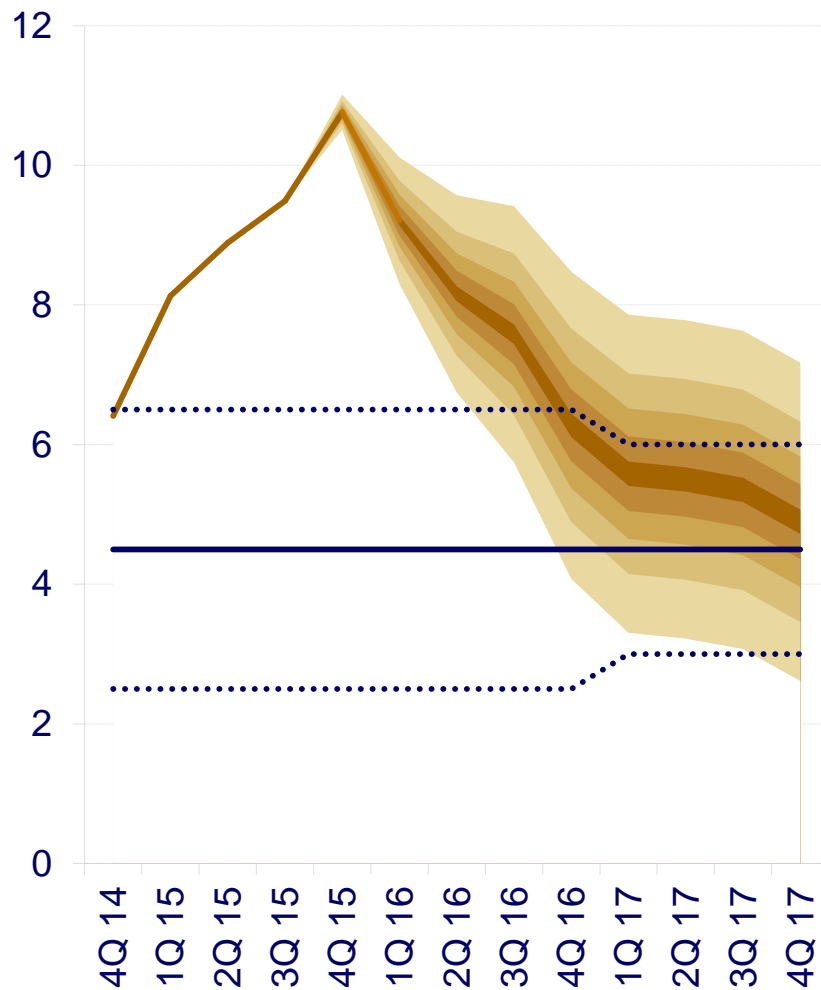
BCB Inflation Forecasts

Baseline Scenario

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



Market Scenario



Regardless other policies stances, the Banco Central will adopt the necessary measures to assure the inflation targeting regime compliance, i.e., to circumscribe 2016 inflation to the tolerance margins established by the CMN and to make inflation converge to the 4.5% target, in 2017.

Inflation Outlook

Altamir Lopes

**Inflation Report
December 2015**



Prêmio

Banco Central de Economia e Finanças

Concurso de monografias

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Patrocínio



Realização

