

Inflation Outlook

Quarterly Inflation Report

Carlos Viana de Carvalho

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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:

- signals compatible with gradual recovery of the Brazilian economy;
- high level of economic slack.

ii. External Scenario:

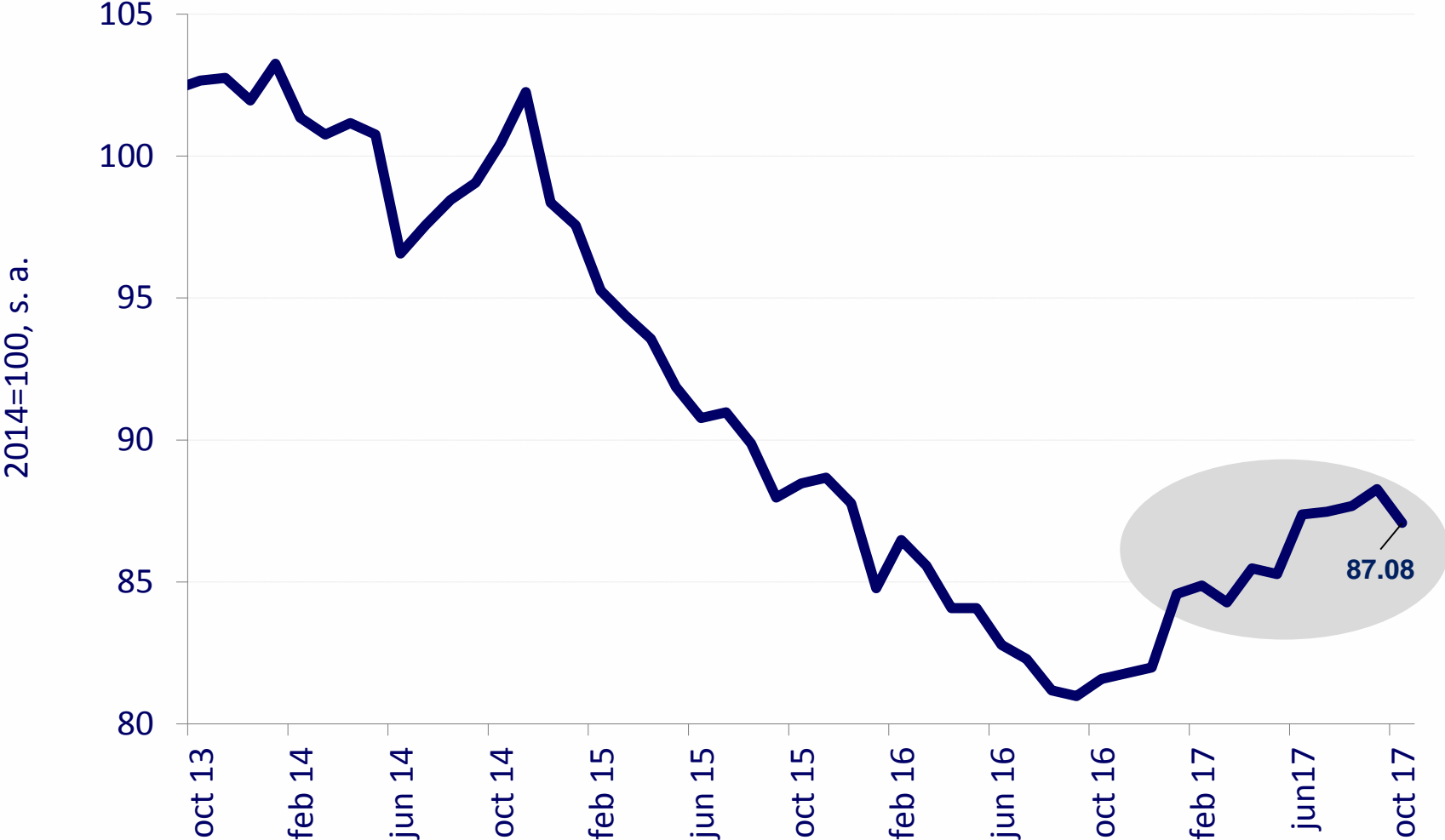
- global outlook has been favorable;
- global economic activity remains on a recovery path, without pressuring financial conditions in advanced economies;
- this supports risk appetite towards emerging economies.

iii. Inflation:

- favorable development; underlying inflation measures running at low or comfortable levels;
- expectations for 2017, 2018, 2019 and 2020 around 2.8%, 4.0%, 4.25% and 4.0%, respectively.

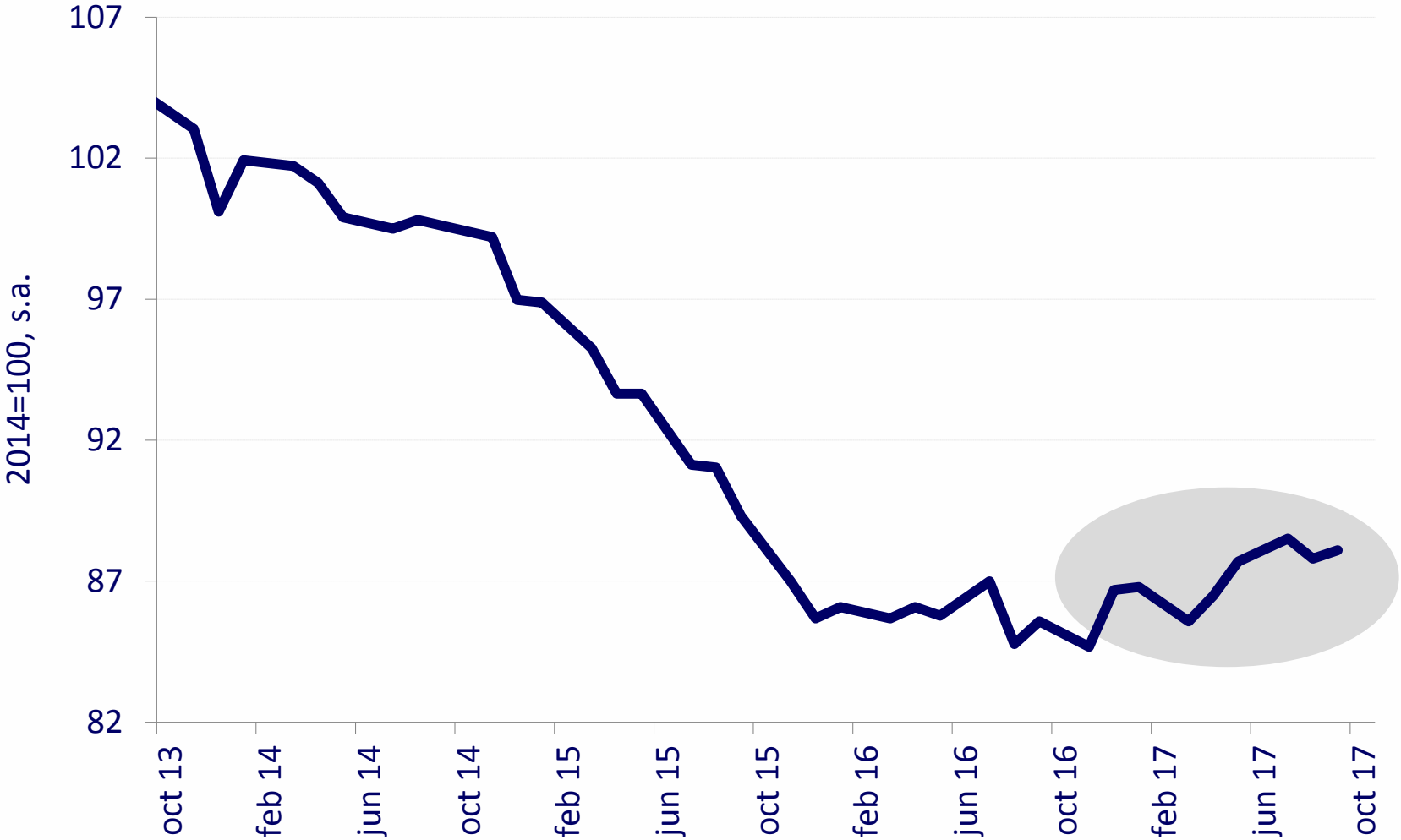
i. Economic Activity

Broad Retail Sales



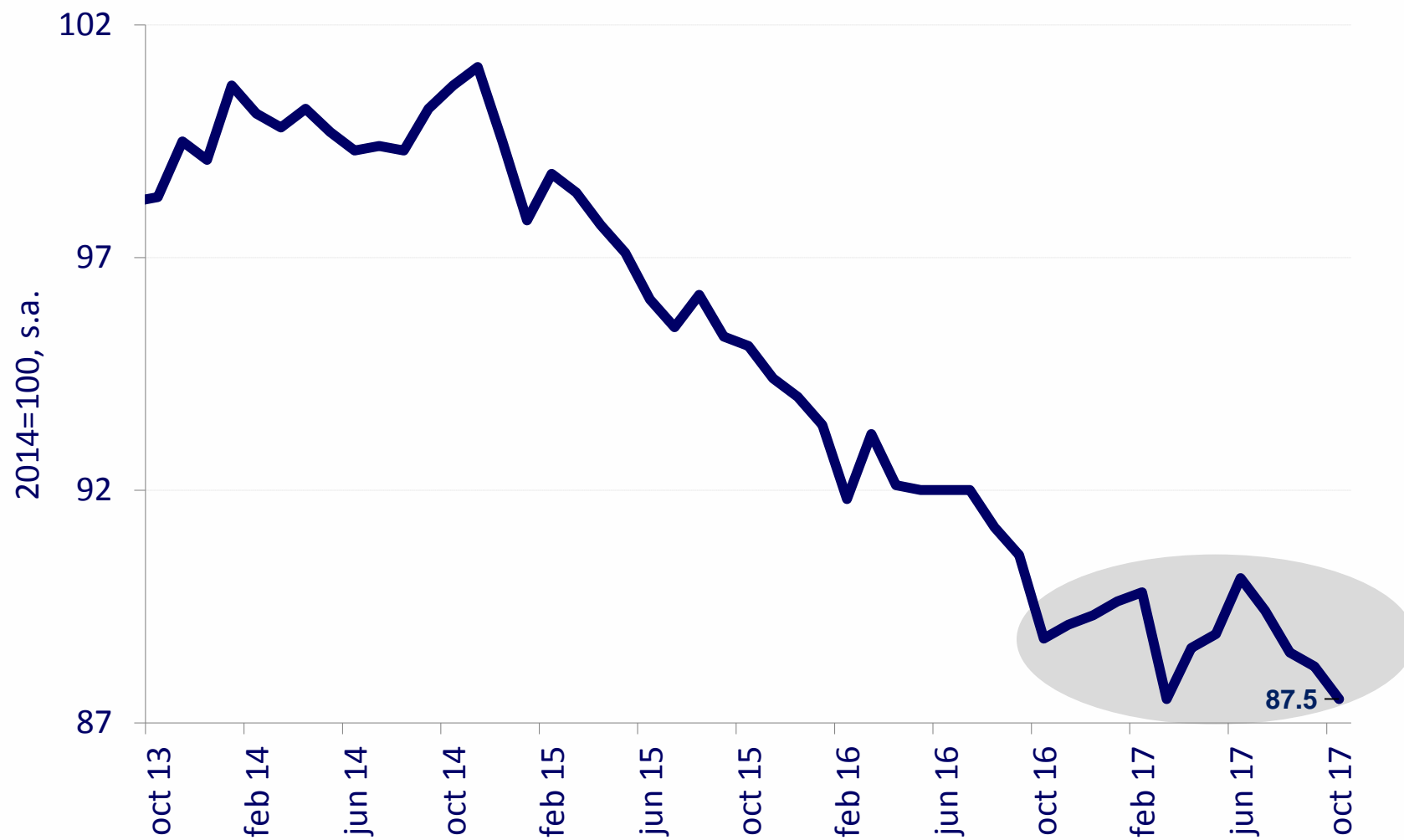
Source: IBGE

Industrial Production



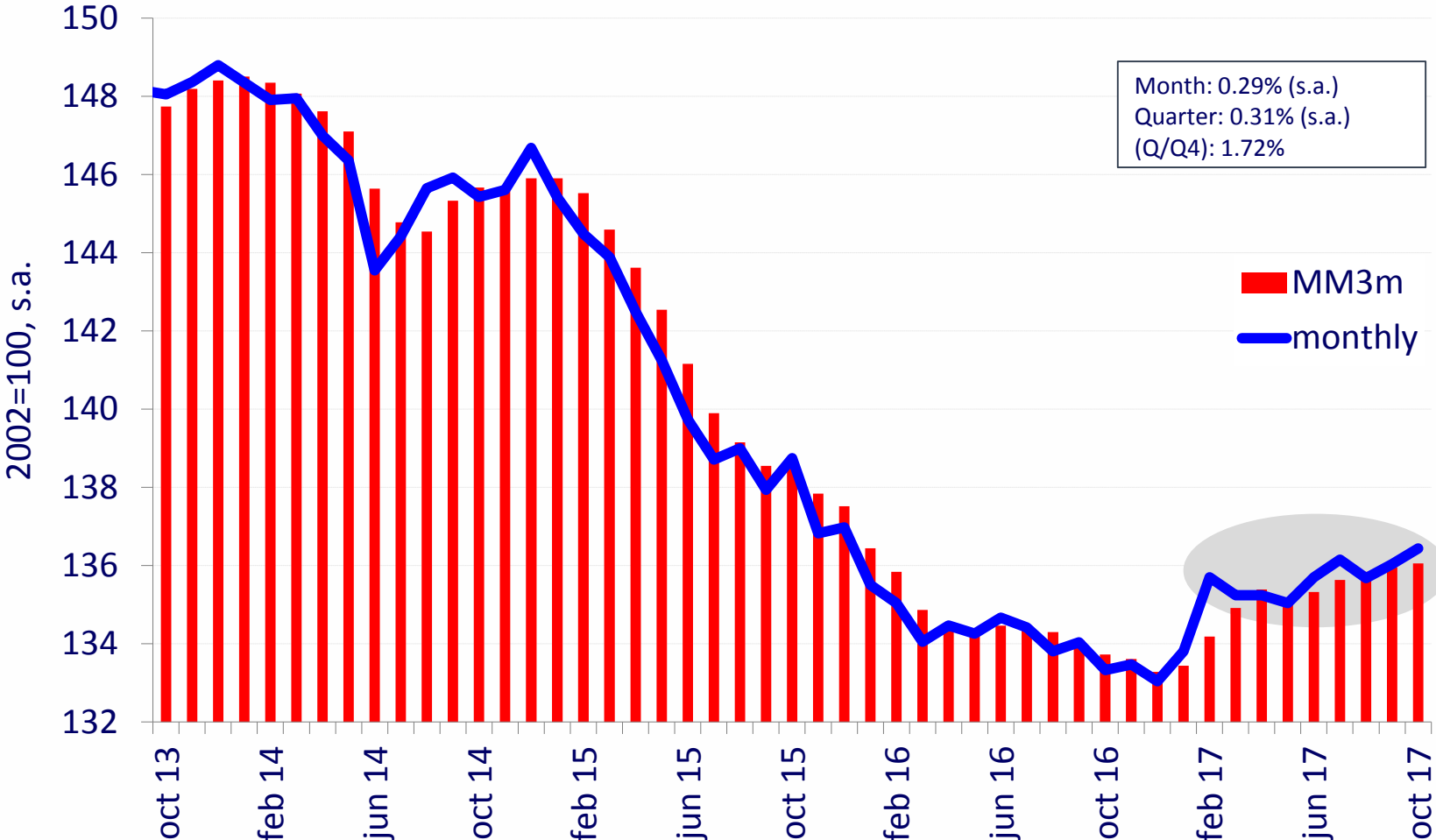
Source: IBGE

Services sector revenues



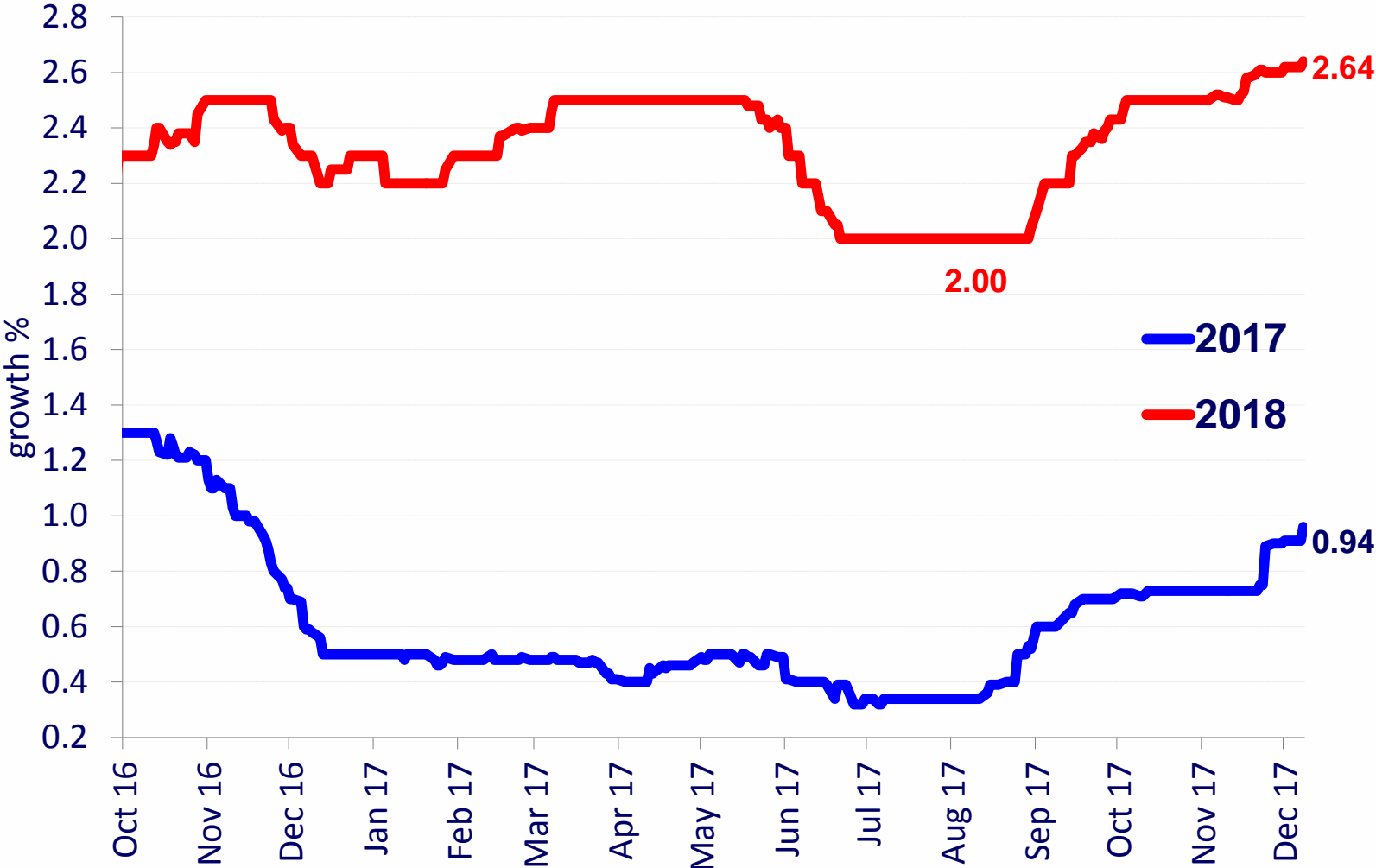
Source: IBGE

IBC-Br



Source: BCB

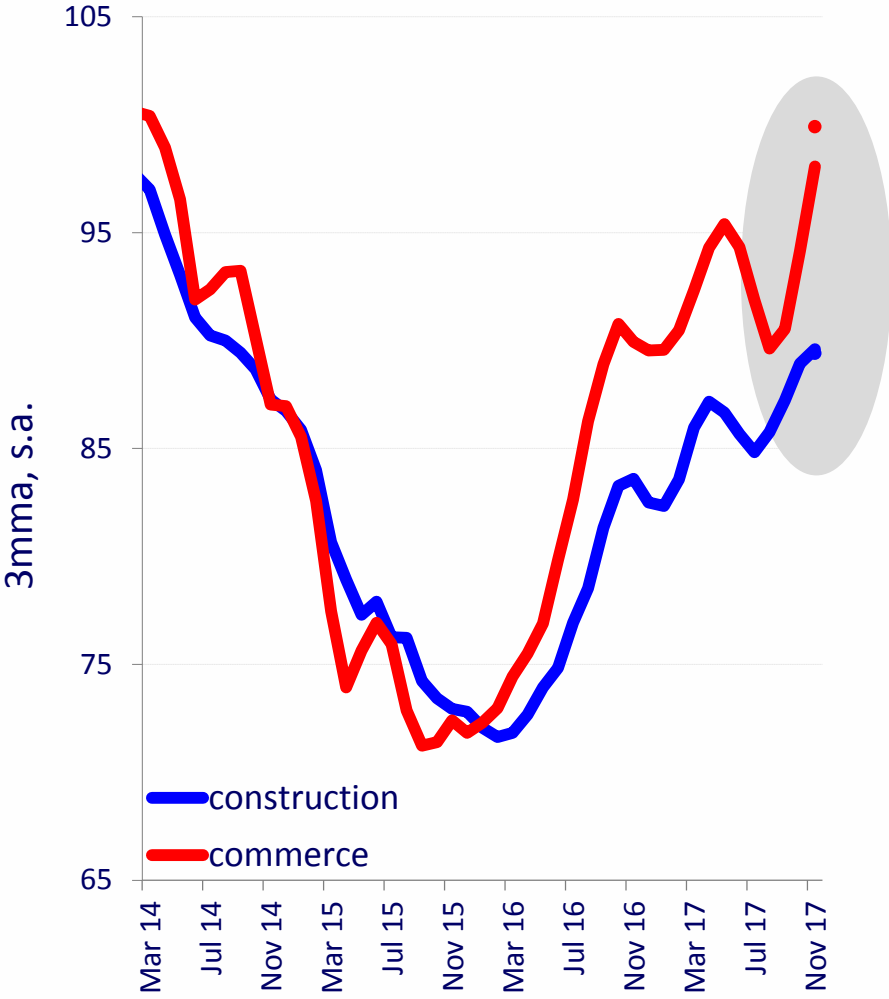
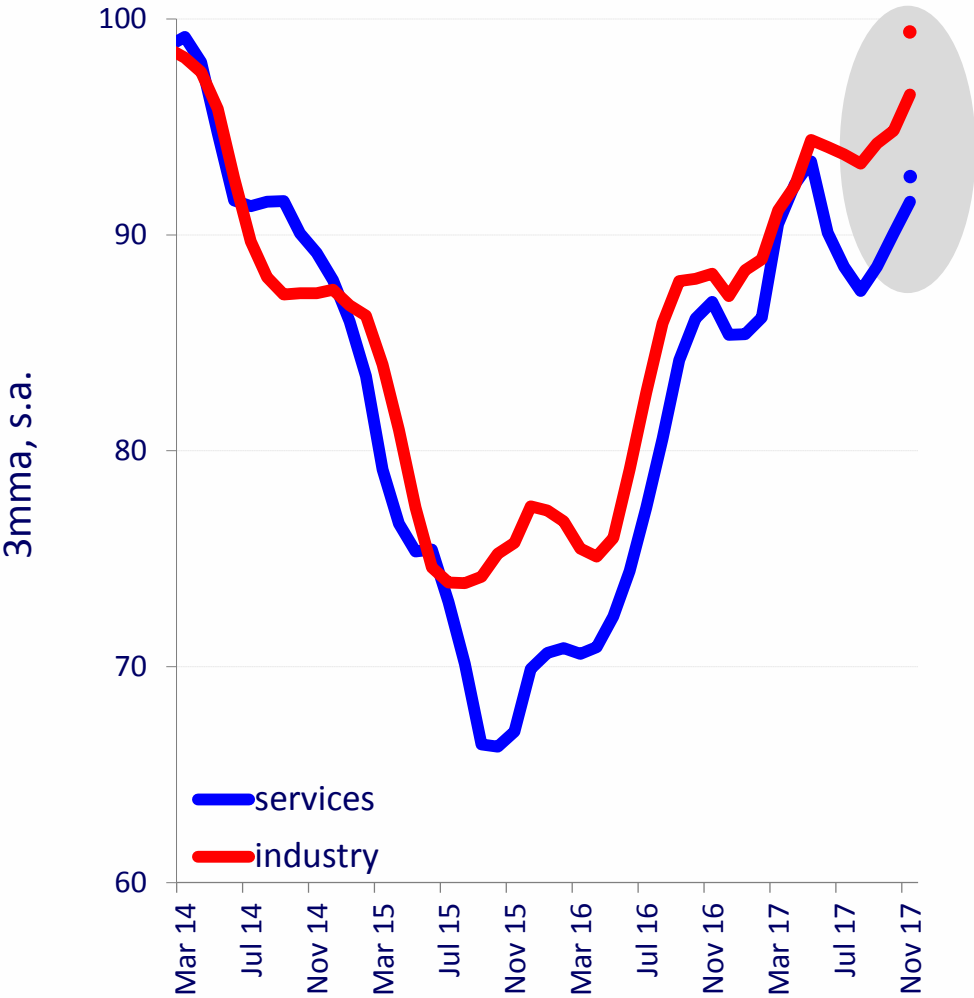
Market Expectations for GDP



Source: BCB

até 12/15

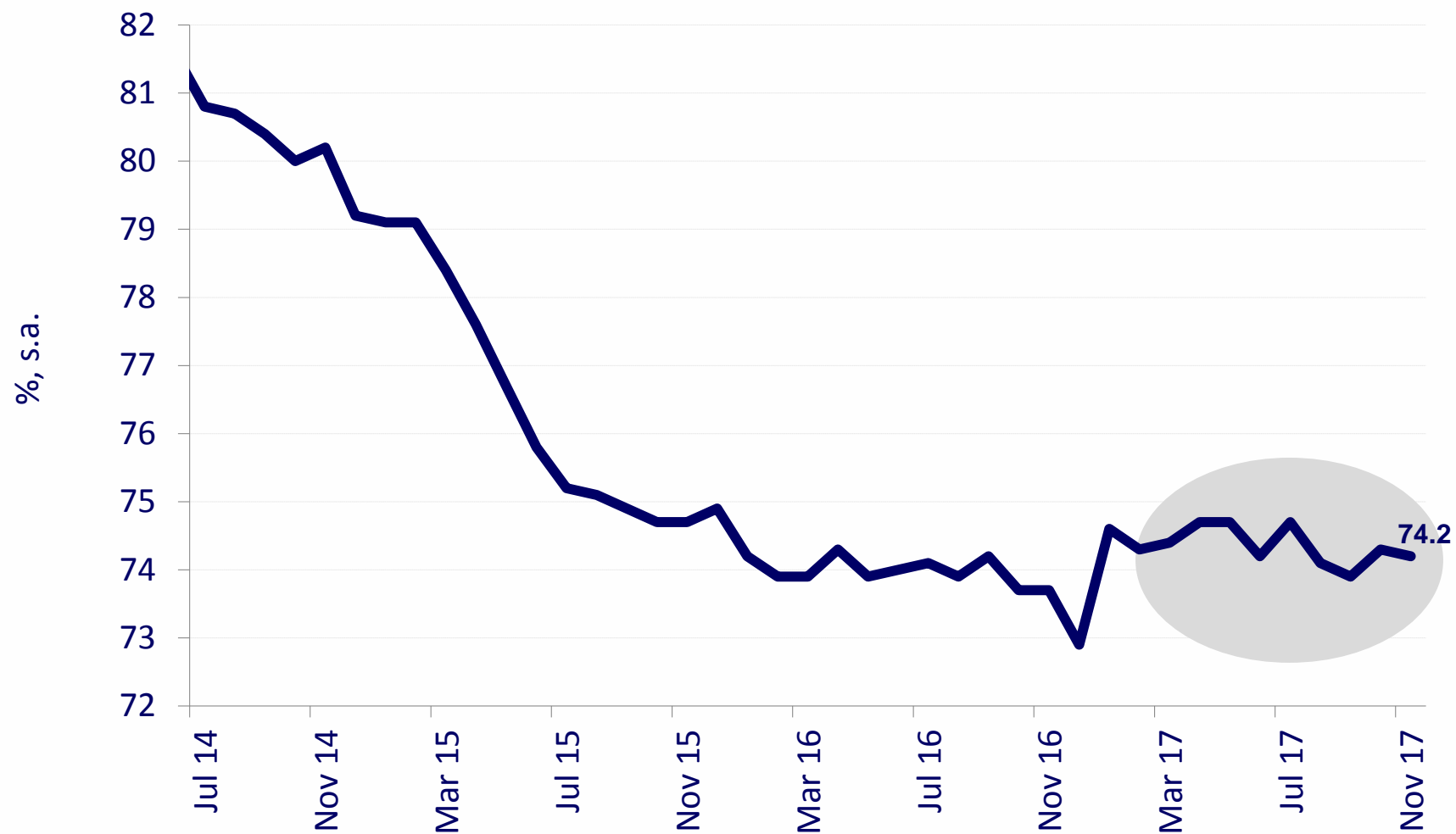
Agents' Confidence - Businessmen



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

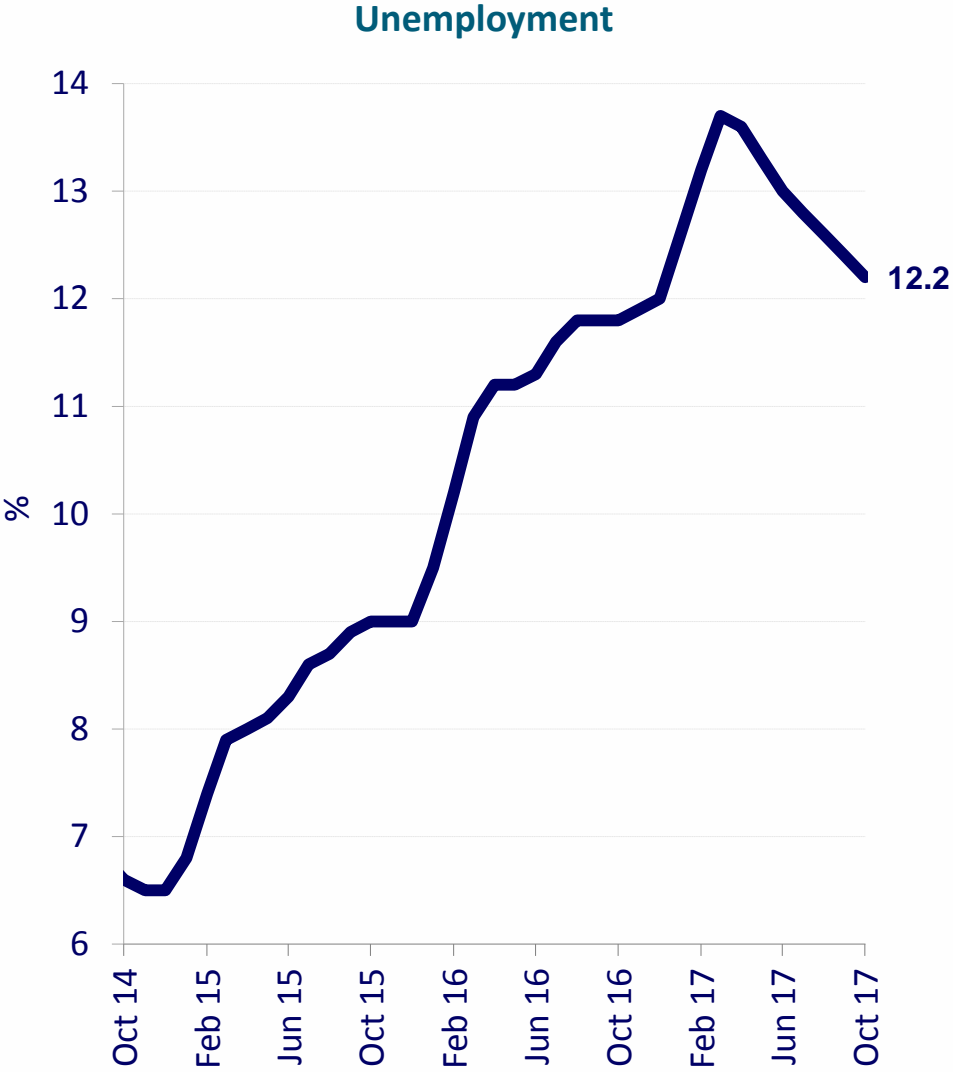
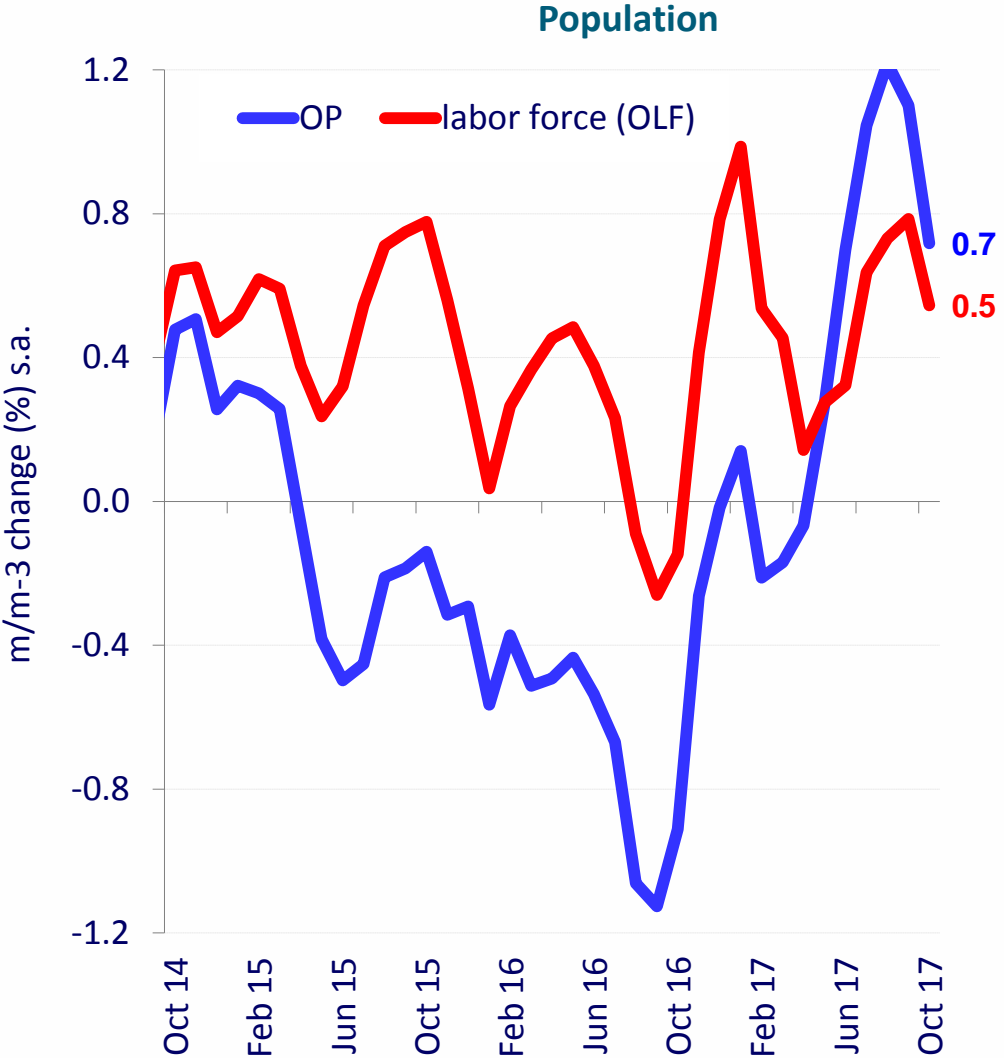
Source: FGV

Installed Capacity Utilization Level (NUCI)



Source: FGV

Labor Market



Source: IBGE (PNADC)

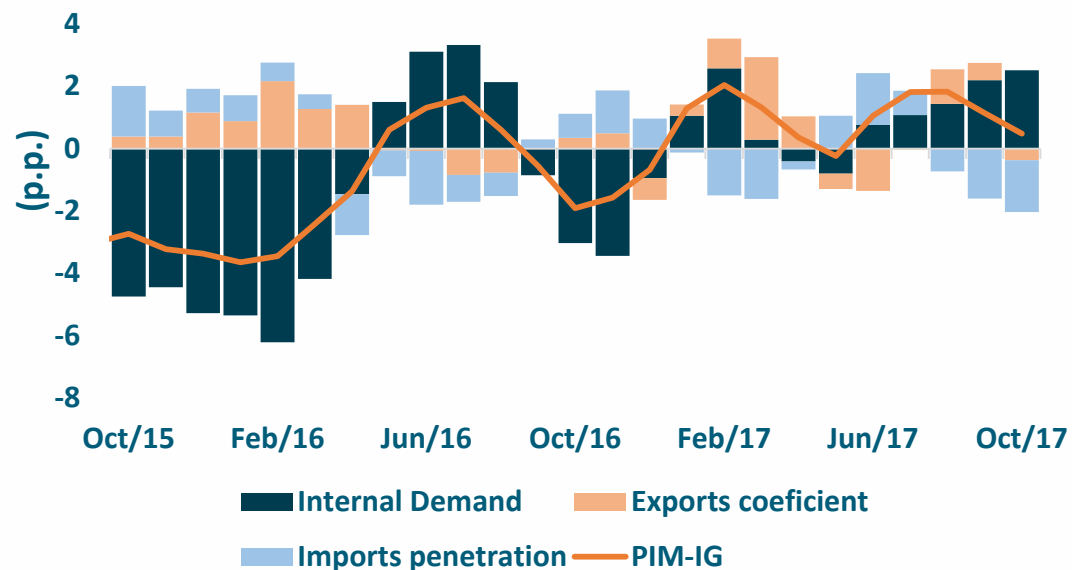
Box: 2017 and 2018 GDP Projections

- Growth of 1.0% in 2017 and 2.6% in 2018.
 - Supply:
 - agriculture and livestock: 12.8% in 2017 and -0.4% in 2018 (-4.3% in 2016);
 - industry: -0.3% in 2017 and 2.9% in 2018 (-4.0% in 2016);
 - services: 0.3% in 2017 and 2.4% in 2018 (-2.6% in 2016).
 - Demand:
 - investment: -2.5% in 2017 and 3.0% in 2018 (-10.3% in 2016);
 - household consumption: 1.2% in 2017 and 3.0% in 2018 (-4.3% in 2016);
 - government consumption : -0.8% in 2017 and 1.0% in 2018 (-0.1% in 2016);
 - net exports: 0.1 % in 2017 and -0.2% in 2018 (1.7 % in 2016).

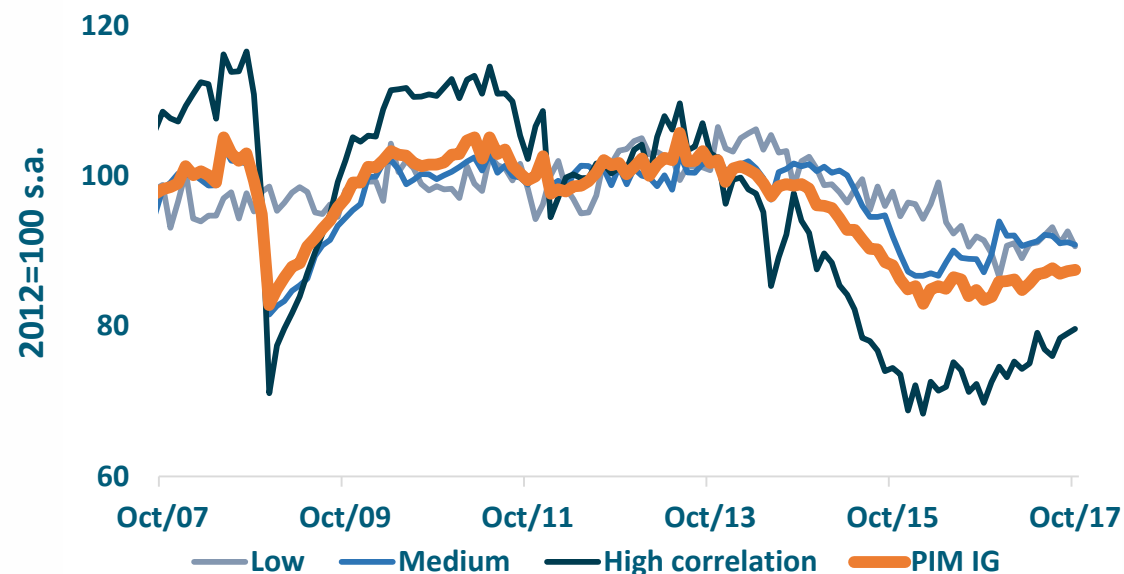
Box: Industry growth analysis – 2017

- Analysis of the characteristics of the industry recently:
 - internal demand was the main growth sector during 2017;
 - marginal better growth dispersion;
 - growth driven by more cyclical industry sectors.

3-month decomposition of the accumulated change of the PIM-IG

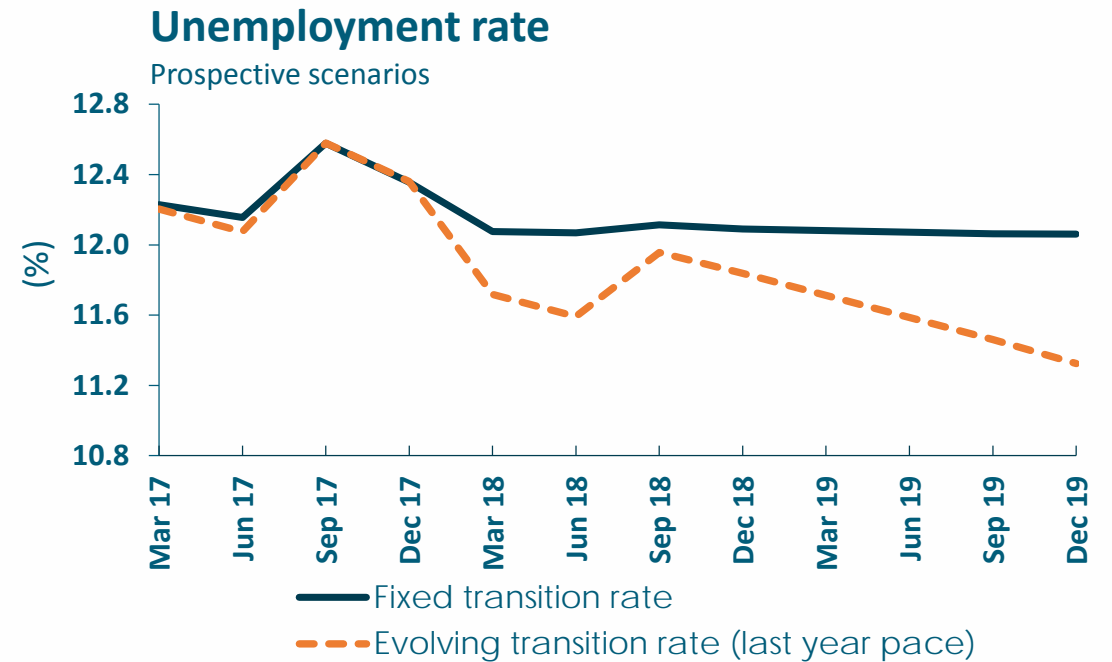
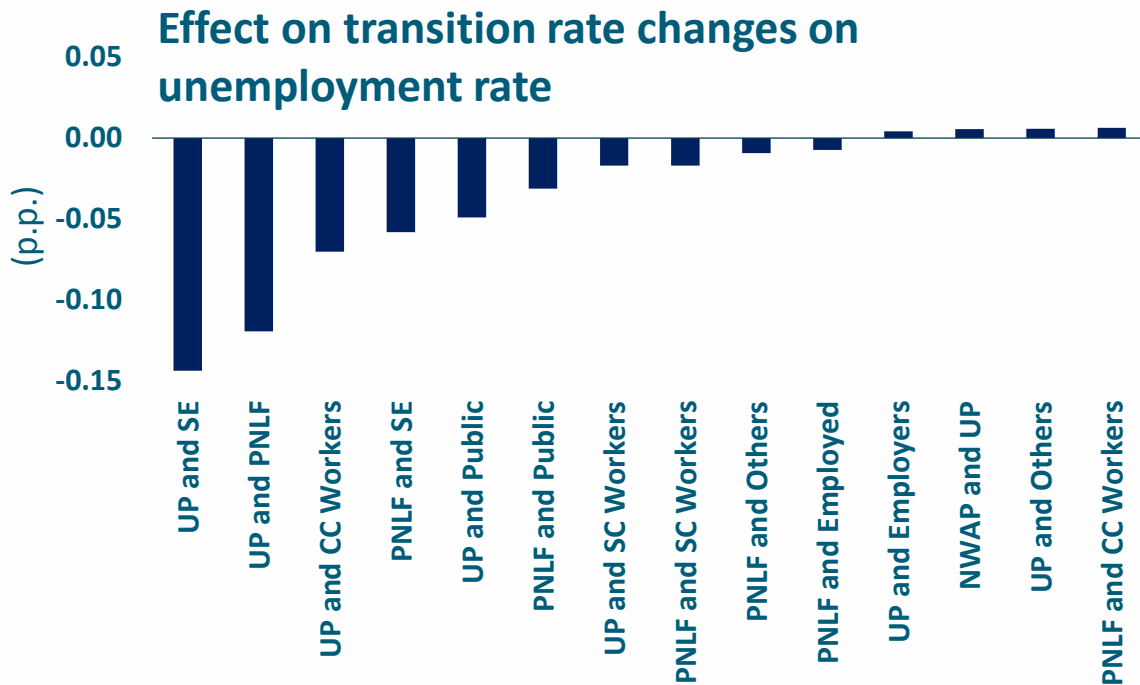


PIM-IG and group as correlated with general industry



Box: Transition rate and recent evolution in labour market

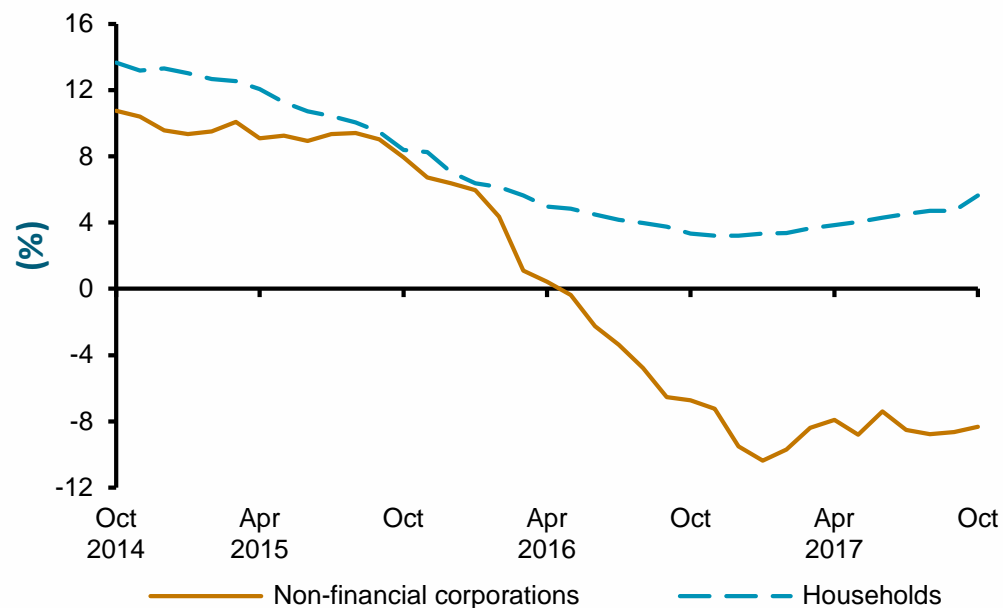
- Analyzes recent evolution of transition rates on unemployment:
 - recent decline in the unemployment rate explained mainly by the improvement in transition rates between: (1) employed and unemployed; (2) unemployed and out of the labor force; (3) unemployed and formal jobs and (4) out of the labor force and self-employed;
 - however, transition rates are still at levels worse than those observed over longer periods, requiring additional improvements to allow for sharper declines in the unemployment rate.



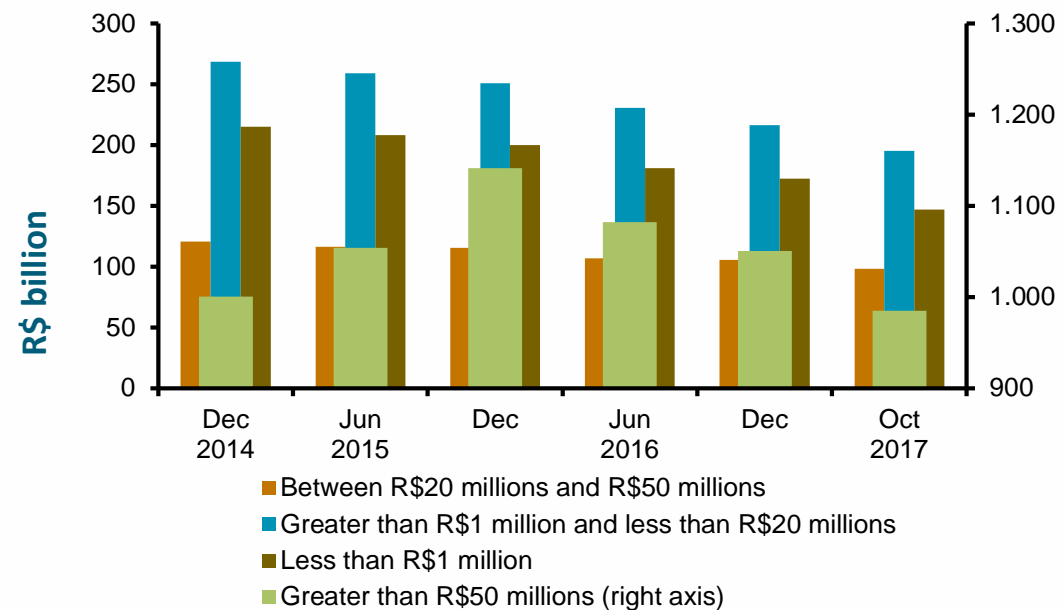
Box: Recent credit evolution in the corporate segment

- Analyzes credit performance for corporations in recent years:
 - persistent retraction in the total balance since mid-2016;
 - credit evolution in this segment is conditioned by operations for companies with large financial capacity;
 - increased concentration in a small group of companies;
 - on the credit supply side the majority of operations is from financial institutions under public control.

Credit operations total balance



Balance by debt range

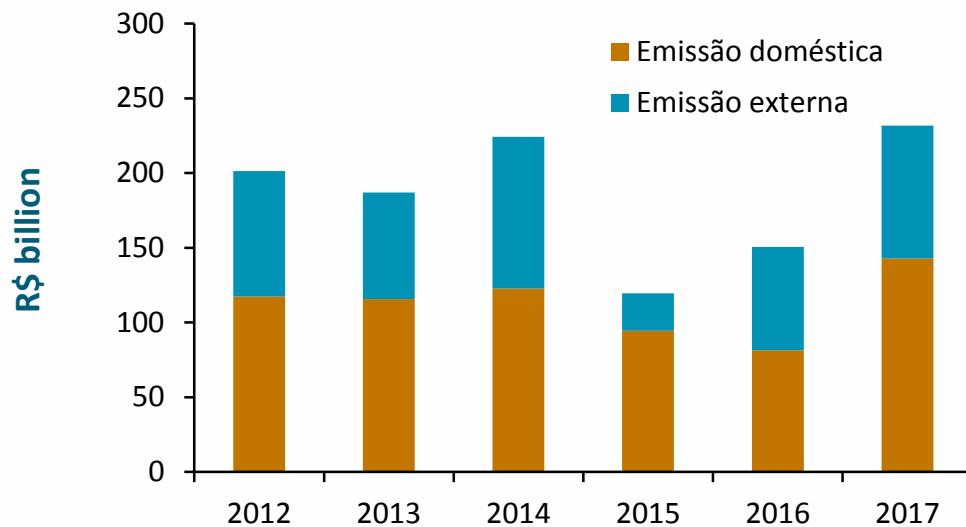


Box: Recente credit evolution at the legal entities segment

- Capital market:
 - growth of 54% in funding from the capital market accumulated until October 2017;
 - values in Brazilian reais higher than those observed in the pre-crisis period (2014);
 - in the first ten months of the year, domestic domestic issuance grew 75% while foreign issuance grew 29%;
 - the reduction of bank credit to LE is being offset by a greater capital market dynamism.

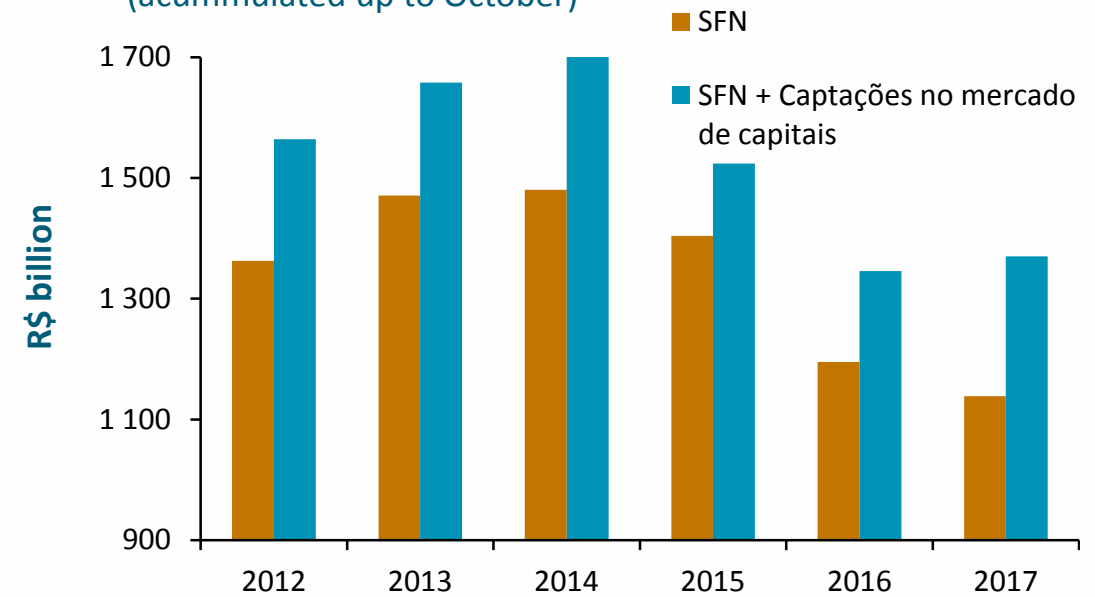
Raising at capital market

(acumulated up to October)



Raising at NFS and at capital market

(acumulated up to October)



Box: Projections for 2017 and 2018 BoP

- Current account *deficit* of US\$9.2 billion (0.45% of GDP) in 2017 and of US\$18.4 billion (0.88% of GDP) in 2018:
 - trade balance: US\$64 billion in 2017 and US\$59 billion in 2018;
 - net interest expense: US\$21.3 billion in 2017 and US\$16.9 billion in 2018;
 - profits and dividends expense: US\$21.5 billion in 2017 and US\$25.5 billion in 2018.
- FDI net inflow of US\$75 billion in 2017 and of US\$80 billion in 2018, smoothly funding the current account.
- Rollover rate at 100% in 2017 and 2018.

Box: Direct investment statistics by immediate and ultimate investing country

- Immediate and ultimate investor country concepts and the statistics of the Brazilian case are presented:
 - both concepts are presented following the international statistics standard;
 - the globalization and complexity of the organizational structures of transnational corporations increases the relevance of these statistics, which have been complementary;
 - as regards to Brazil, there is a substantial change in the stock of each country according to the concept used.

Highest increases in FDI stocks – capital share

Immediate and ultimate investing country
On 12.31.2015

Country	Immediate	Ultimate	Difference
	US\$ million		
United States	69.048	77.046	7.998
China	1.366	8.606	7.240
Italy	4.258	10.824	6.566
United Kingdom	15.549	21.894	6.345
Germany	8.323	12.472	4.149
Switzerland	11.063	14.761	3.698
France	18.437	21.309	2.872
Canada	7.574	9.791	2.217
Bermuda	2.626	4.714	2.089
Japan	17.110	18.914	1.804

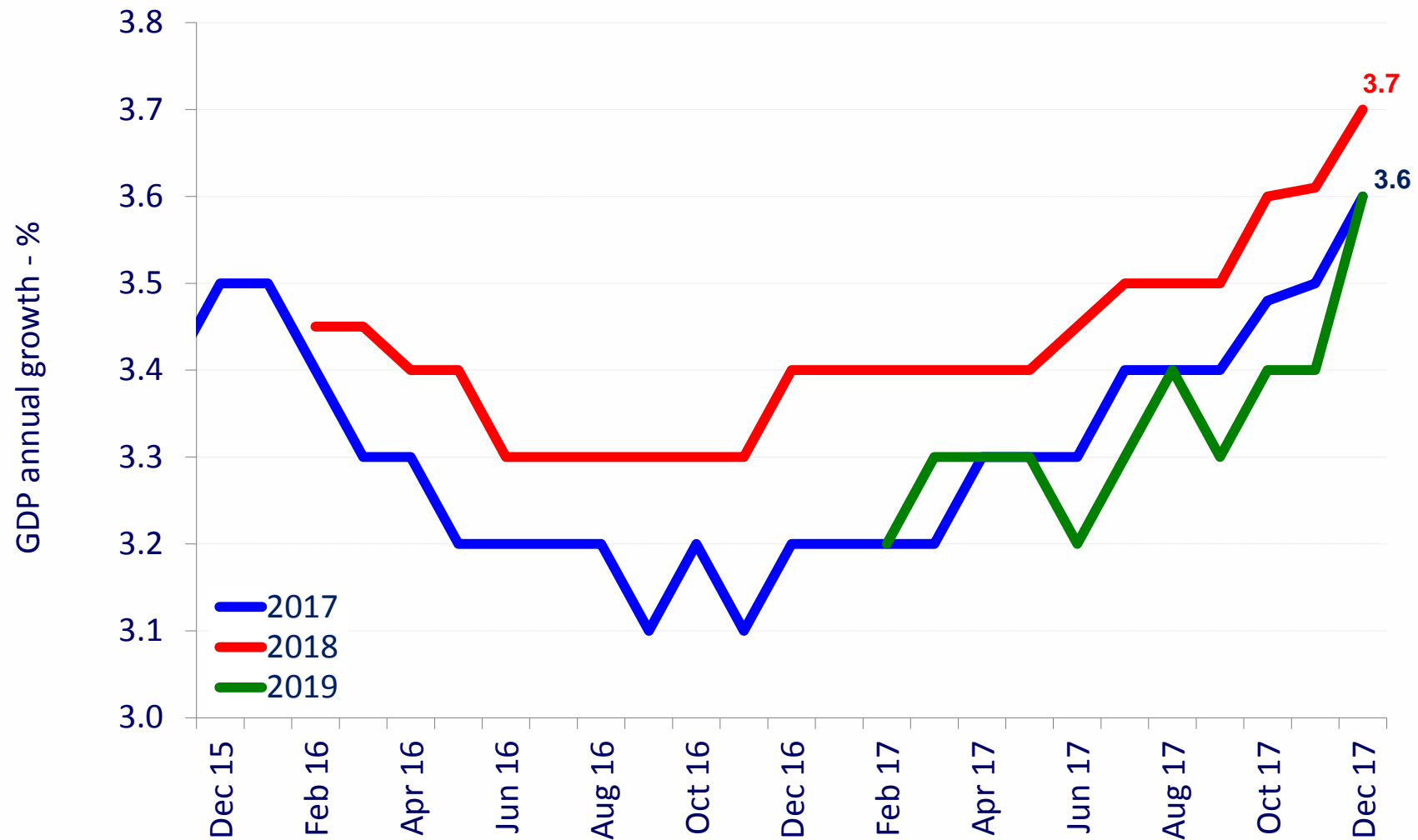
Highest decreases in FDI stocks – capital share

Immediate and ultimate investing country
On 12.31.2015

Country	Immediate	Ultimate	Difference
	US\$ million		
Netherlands	90.332	51.353	-38.979
Luxembourg	27.063	10.977	-16.086
Belgium	3.607	935	-2.672
Chile	7.200	5.363	-1.836
Spain	39.044	37.472	-1.572
Sweden	3.049	1.673	-1.375
Uruguay	2.436	1.432	-1.005
British Virgin Islands	2.304	1.501	-803
Cayman Islands	2.978	2.181	-797
Ireland	1.614	842	-772

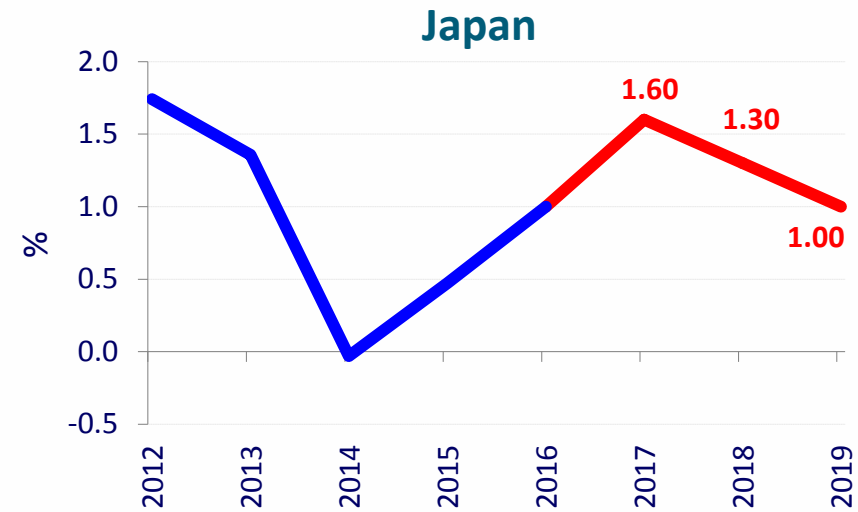
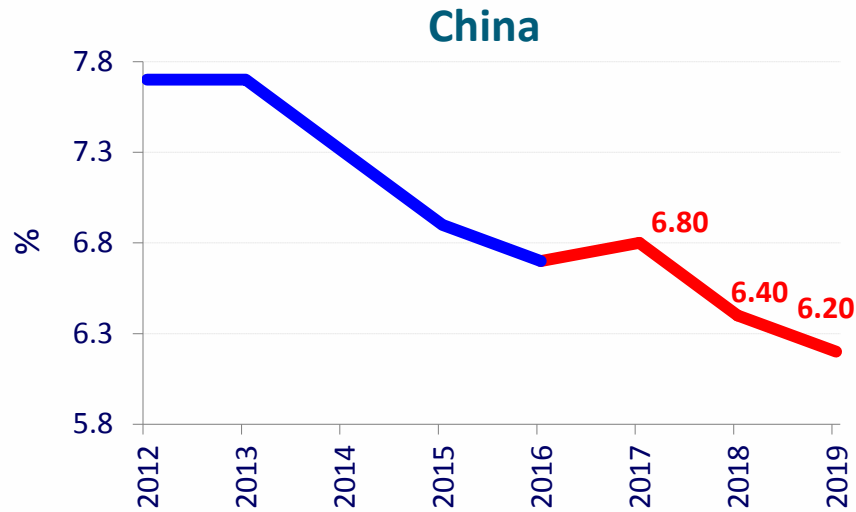
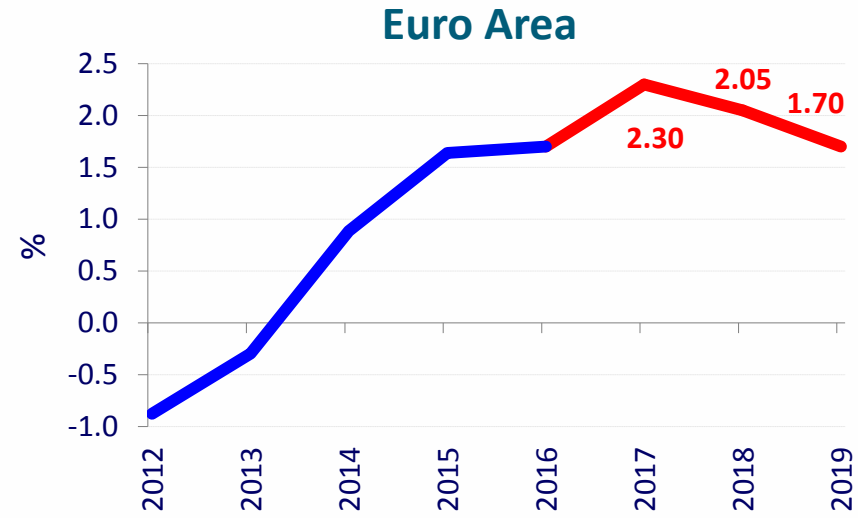
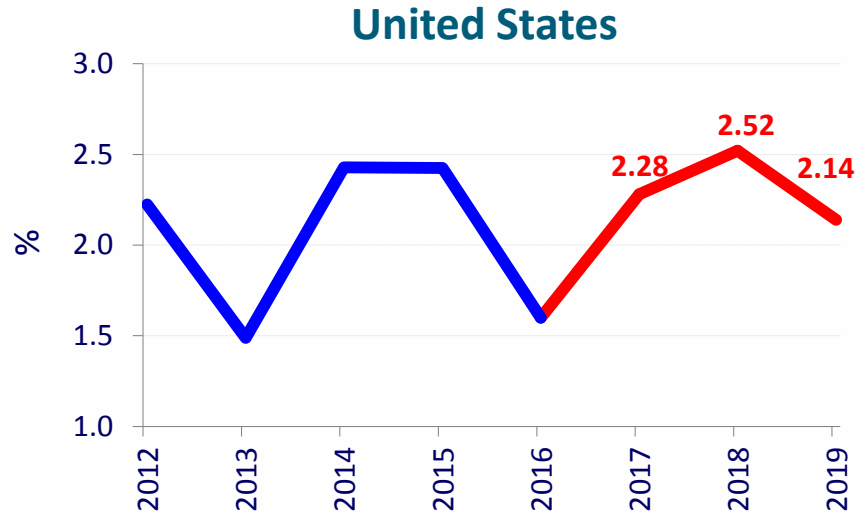
ii. External scenario

Prospects of Moderate Global Growth



Source: Bloomberg (12/15)

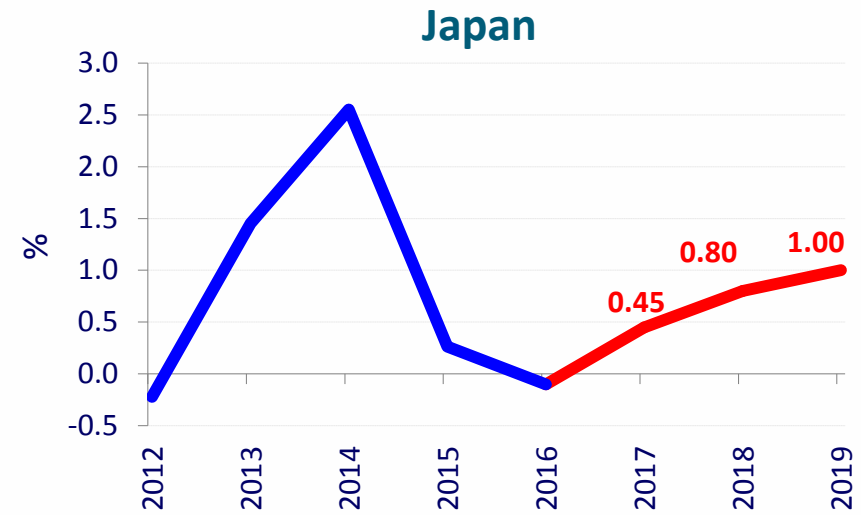
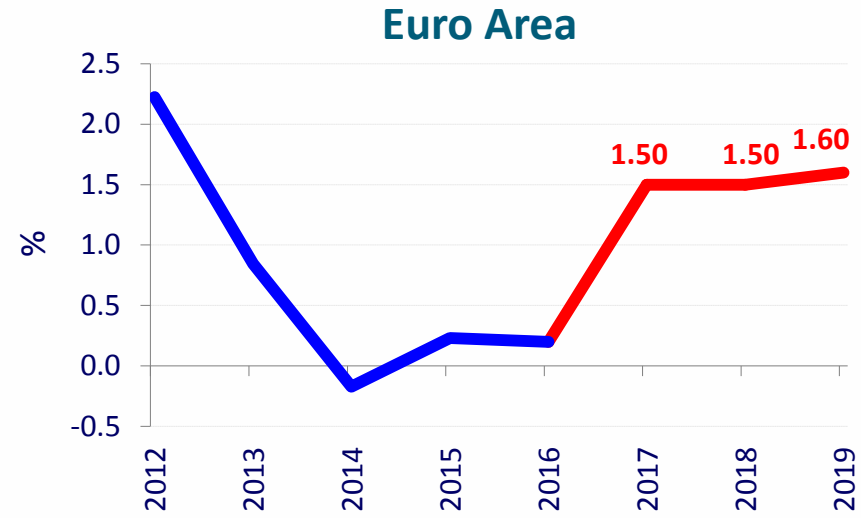
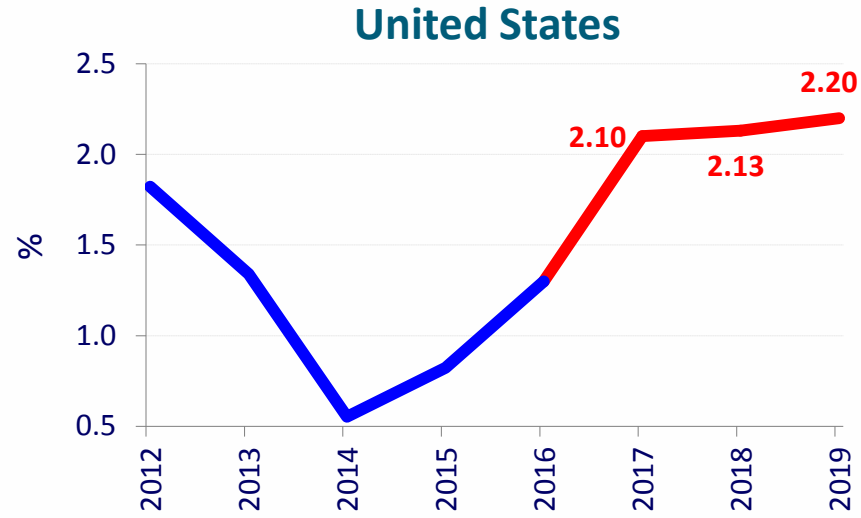
Activity – GDP Annual Growth



Source: Bloomberg (12/15)

2017/2018/2019: projection

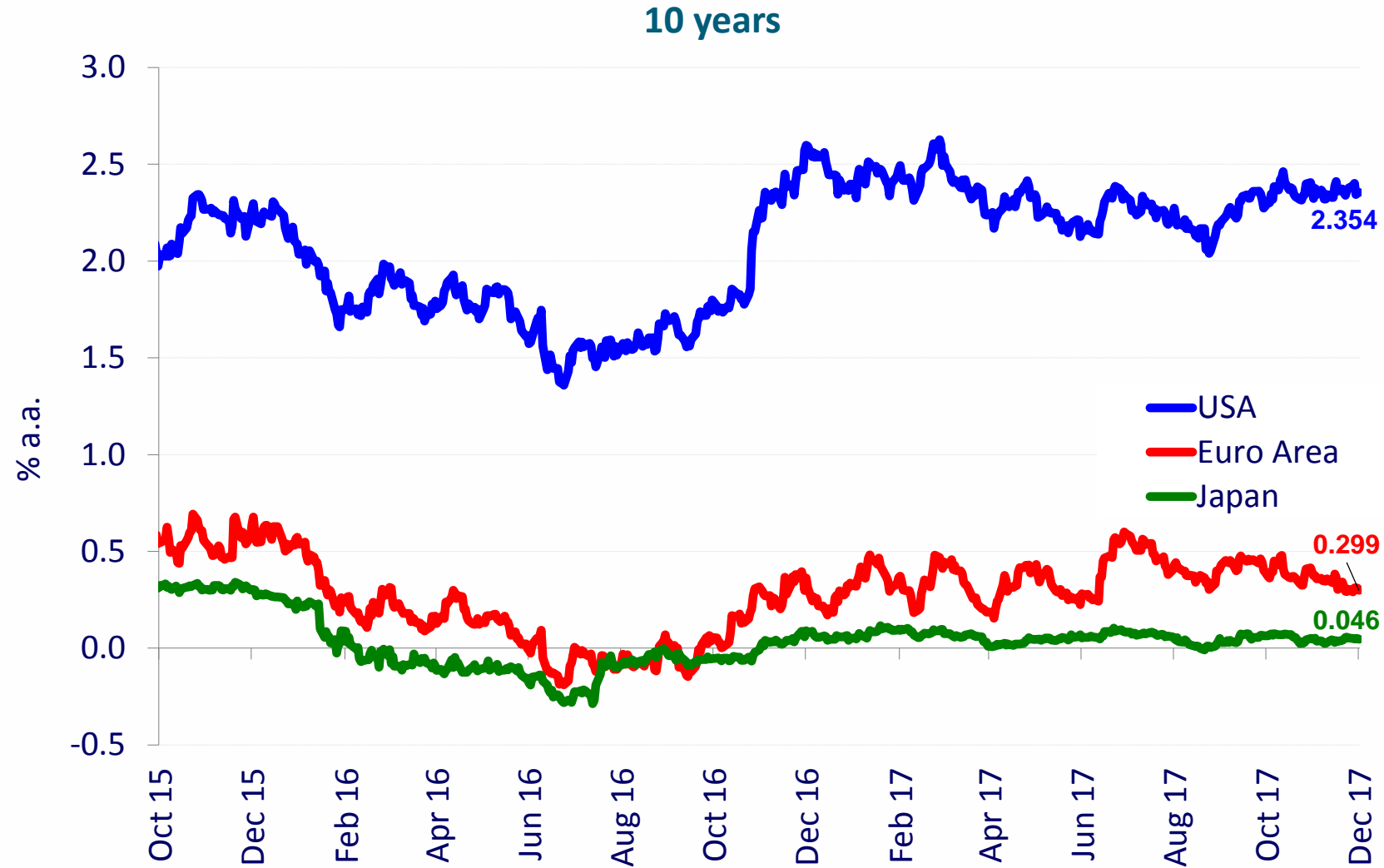
Inflation



2017/2018/2019: projection

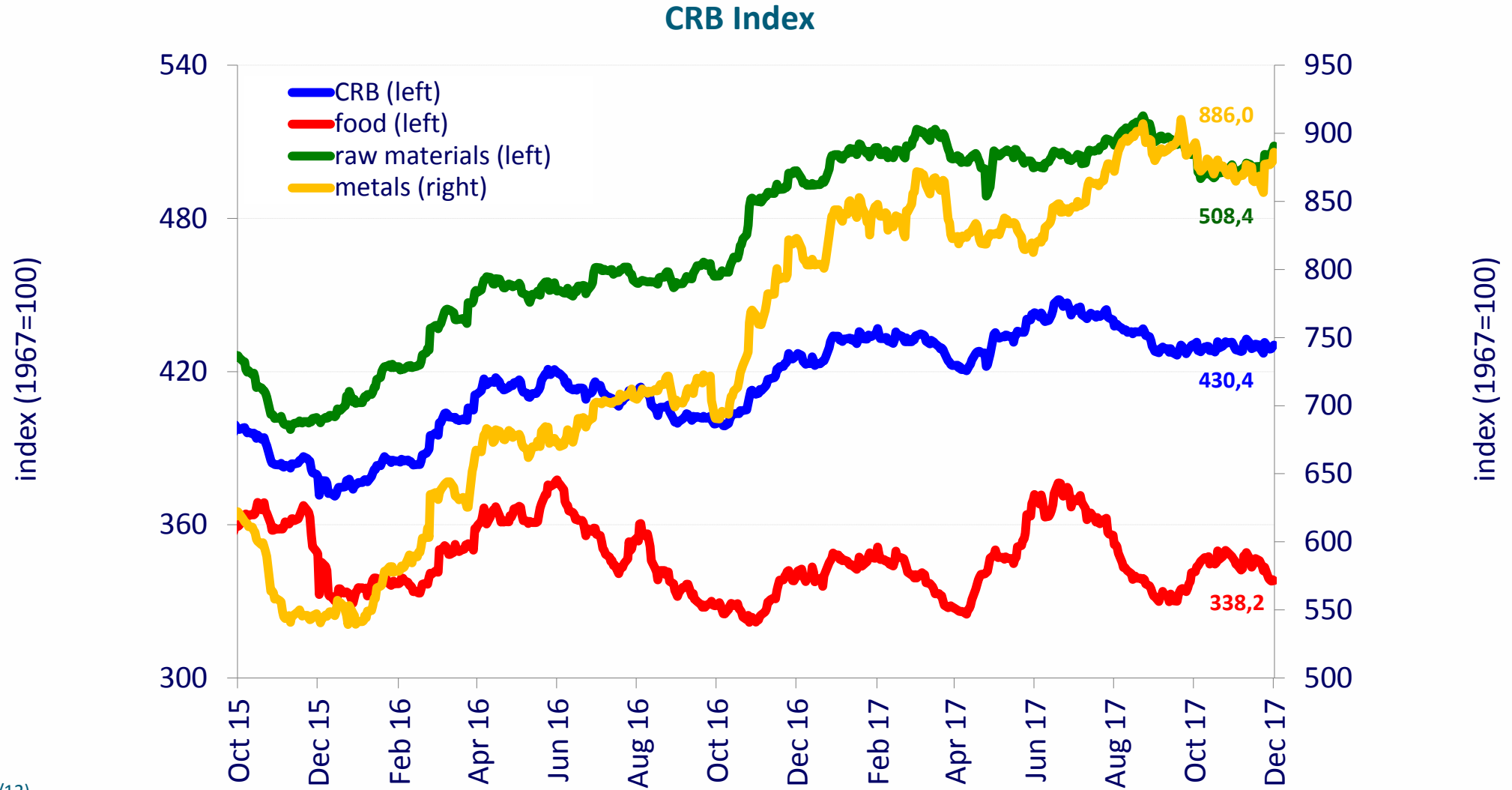
Source: Bloomberg (12/15)

Long-term interest rate



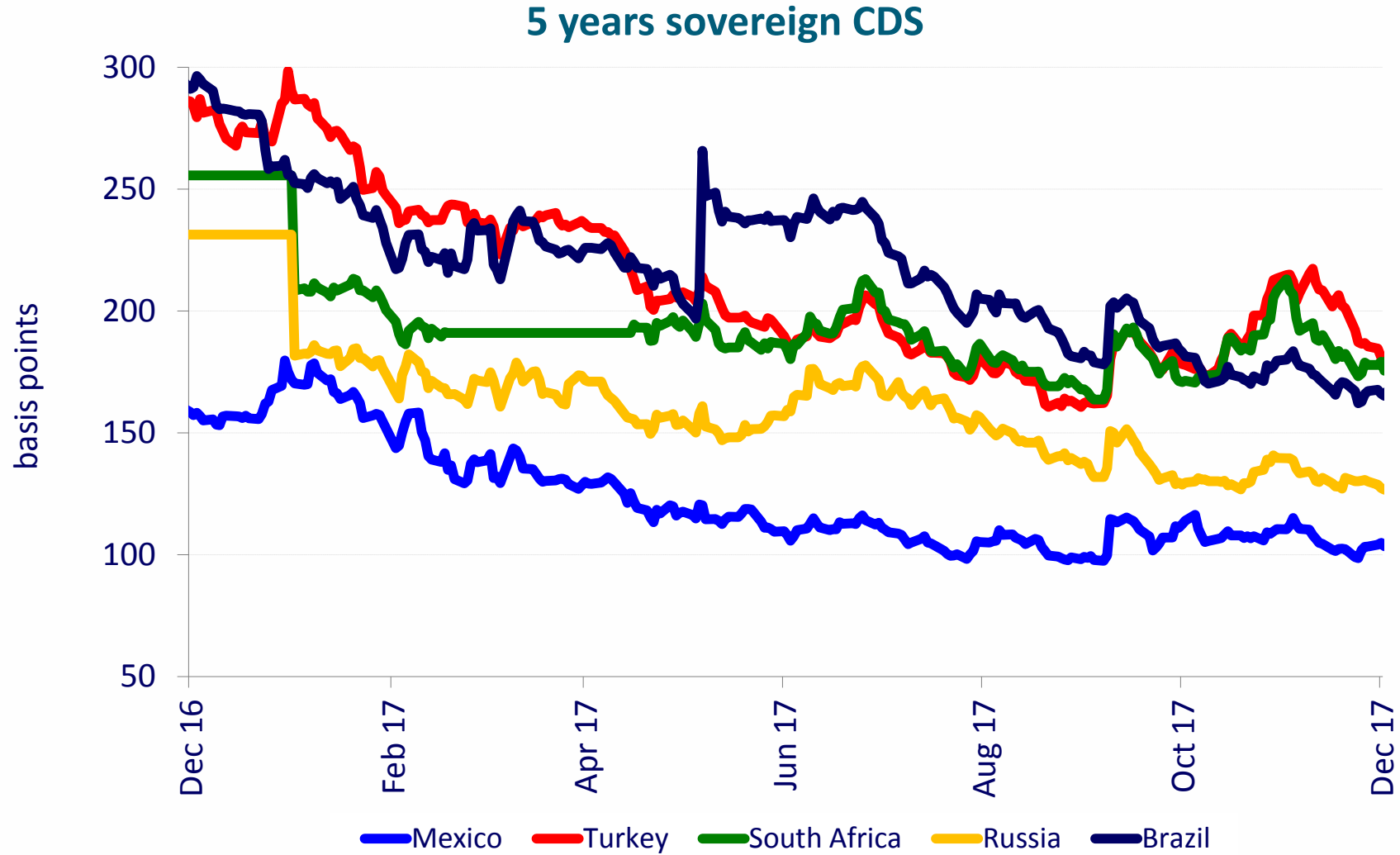
Source: Bloomberg (15/12)

Commodities prices



Source: Bloomberg (15/12)

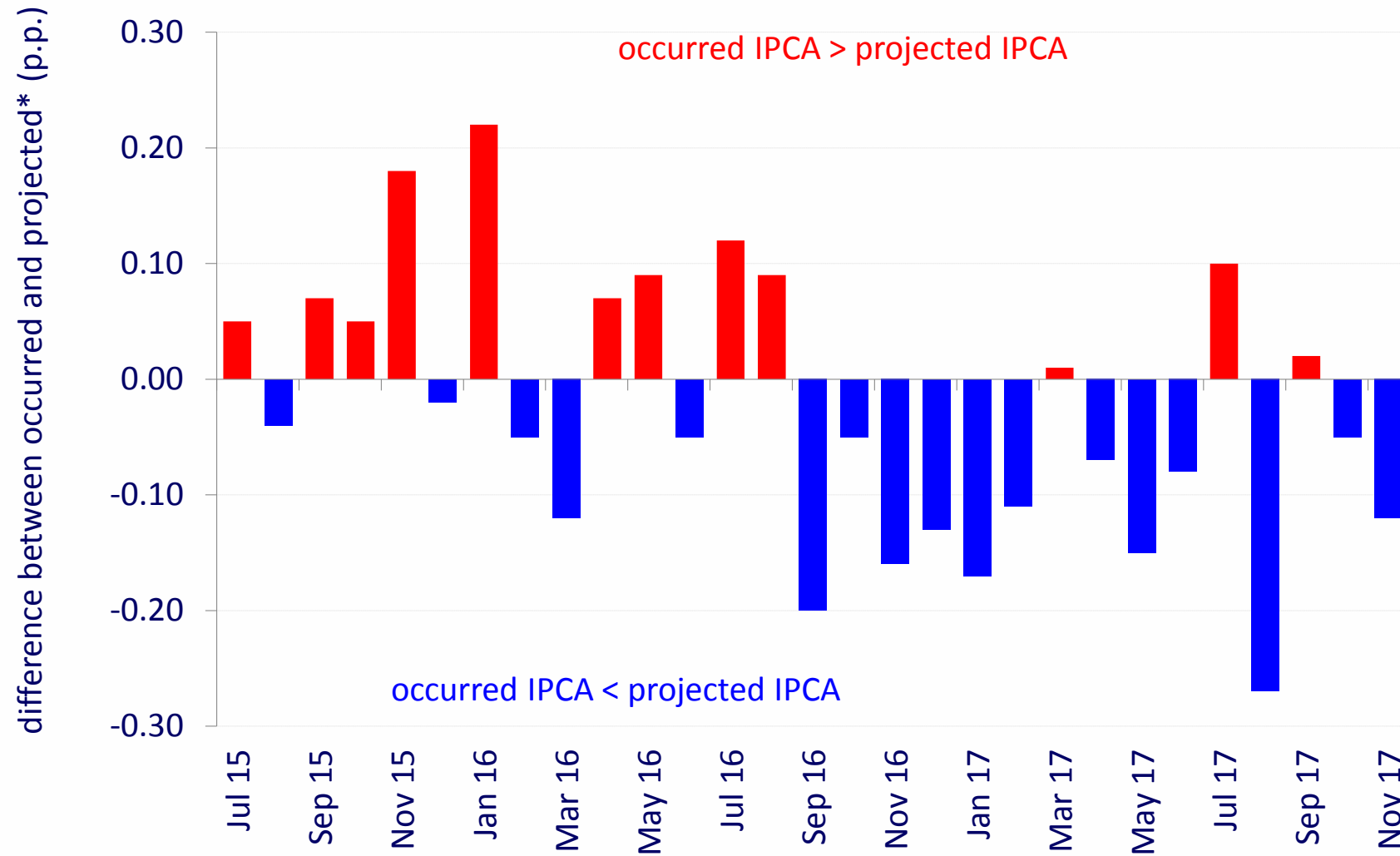
Favorable scenario to emerging countries



Source: Bloomberg (15/12)

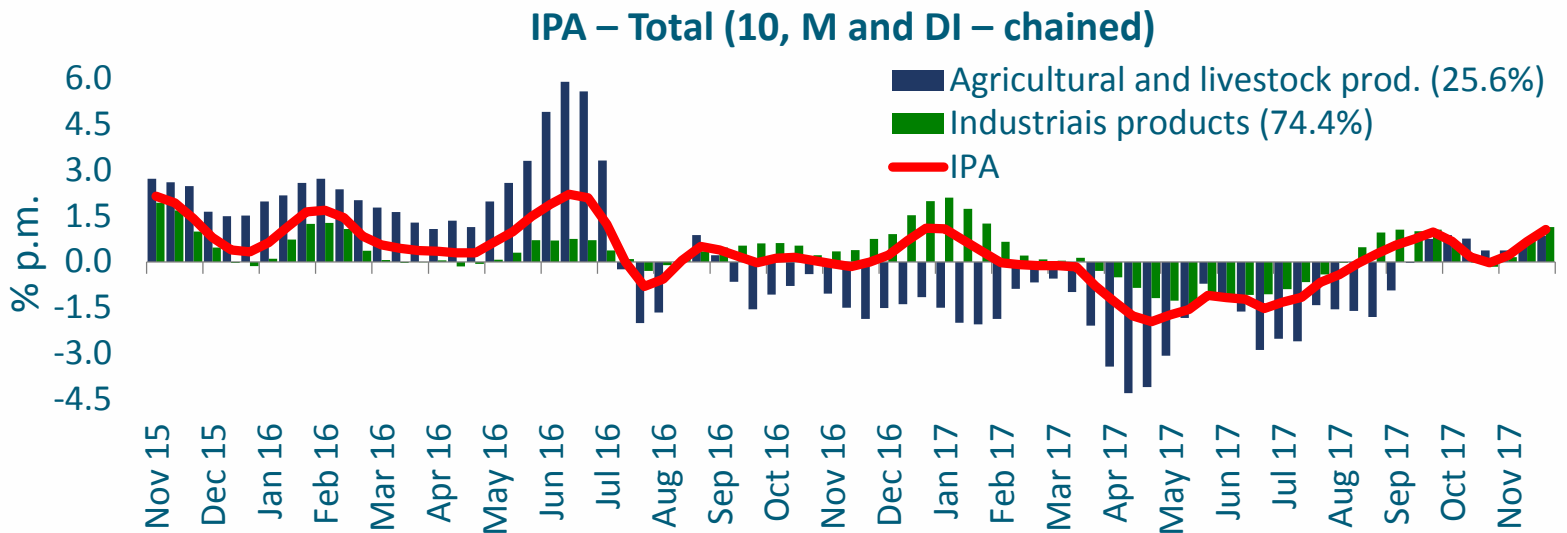
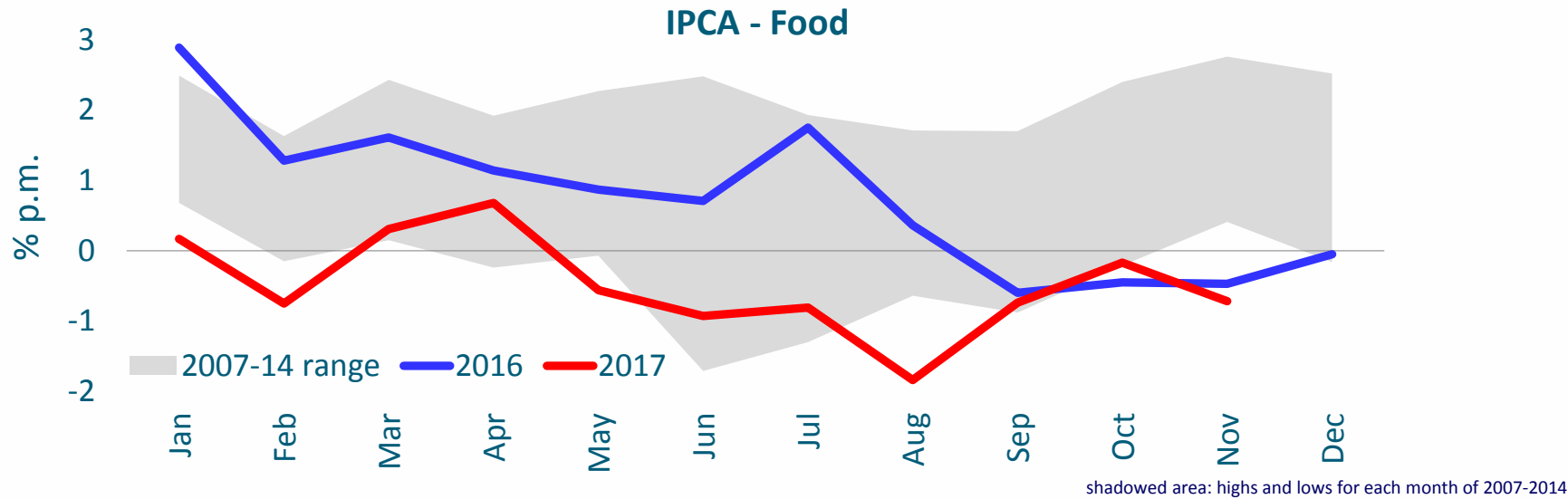
iii. Inflation

Monthly IPCA – Expectations x Projected



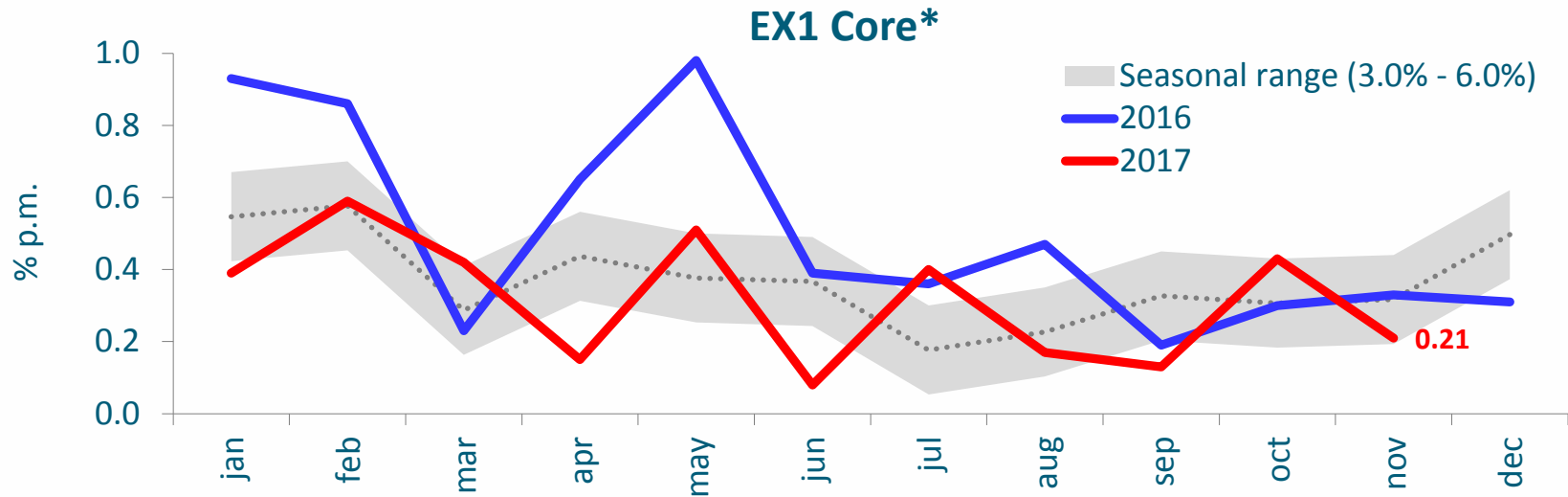
* projected on the IPCA Top 5 reference dates

Food Disinflation

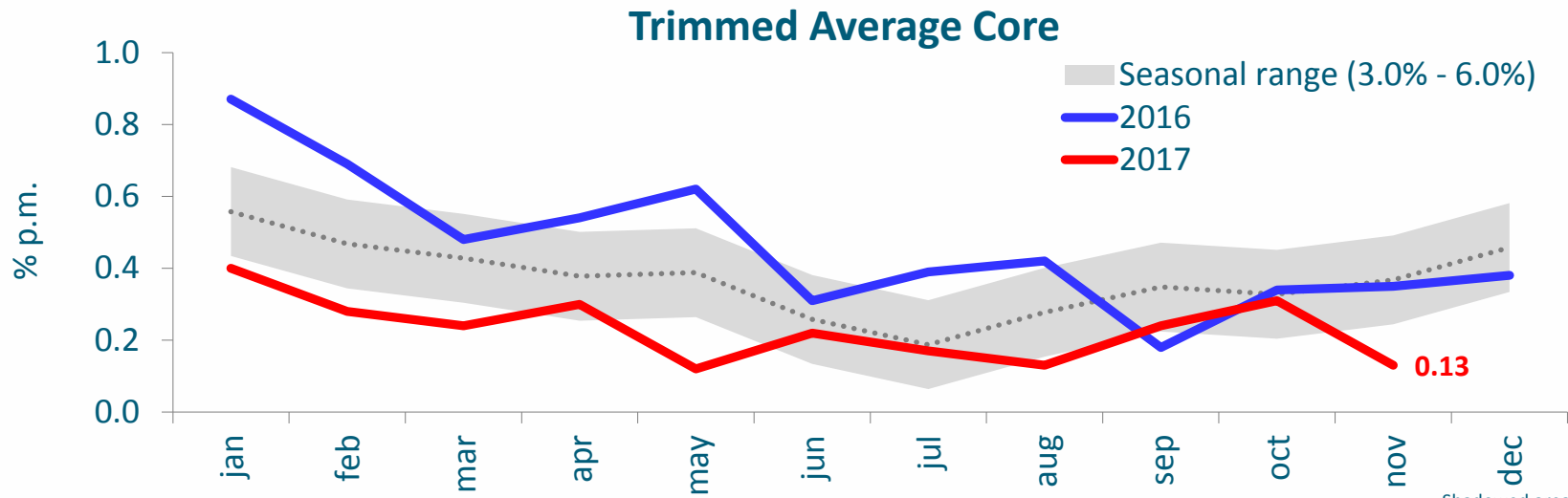


Sources: IBGE, FGV and BCB

Underlying inflation measures



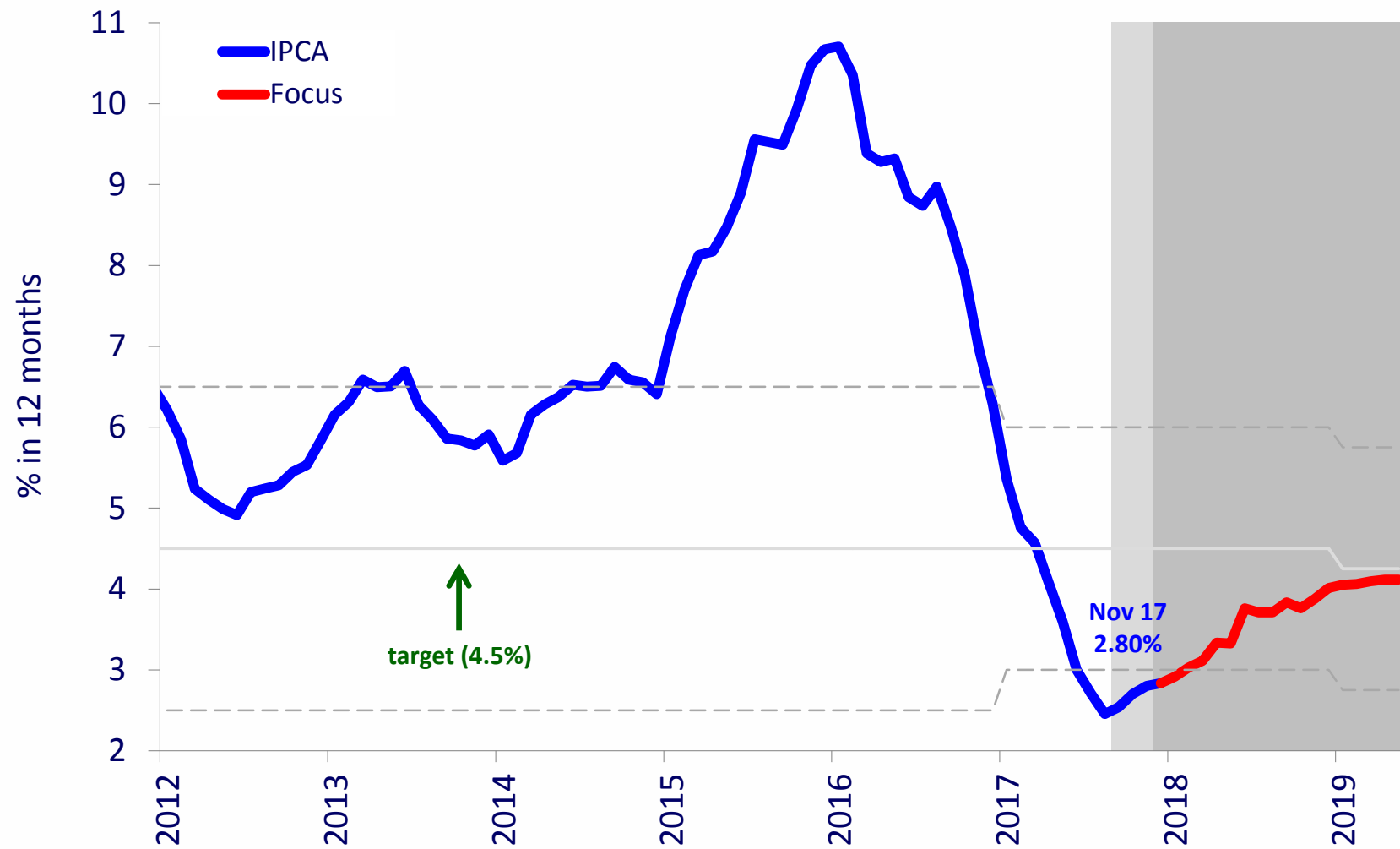
* Exclusion of 10 of the 16 items in the At-home Food group and household fuels and vehicle fuels..



Shaded area: seasonal pattern compatible with target interval

Sources: IBGE, FGV and BCB

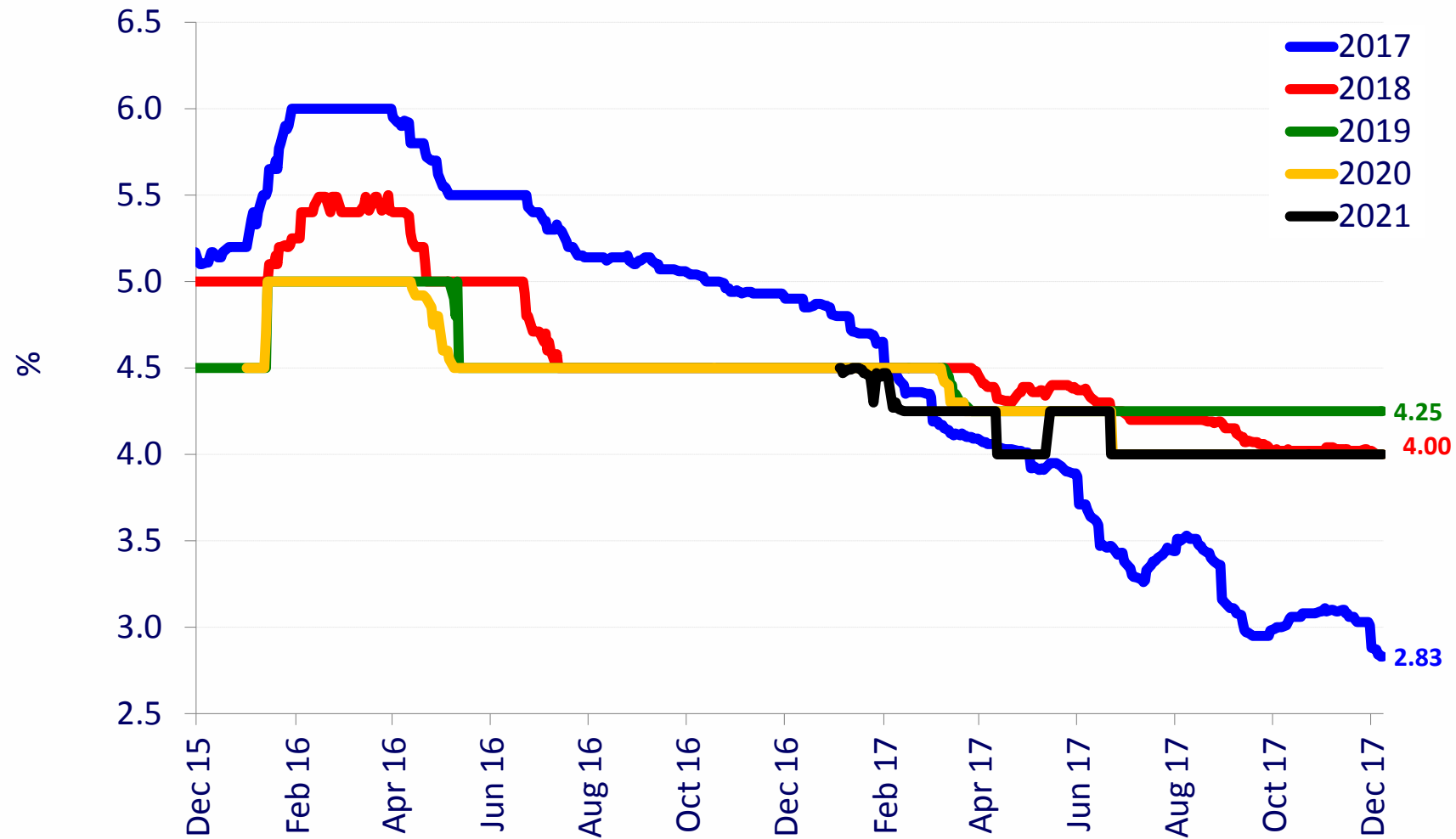
Consumers price



Focus: expectations in 12/15

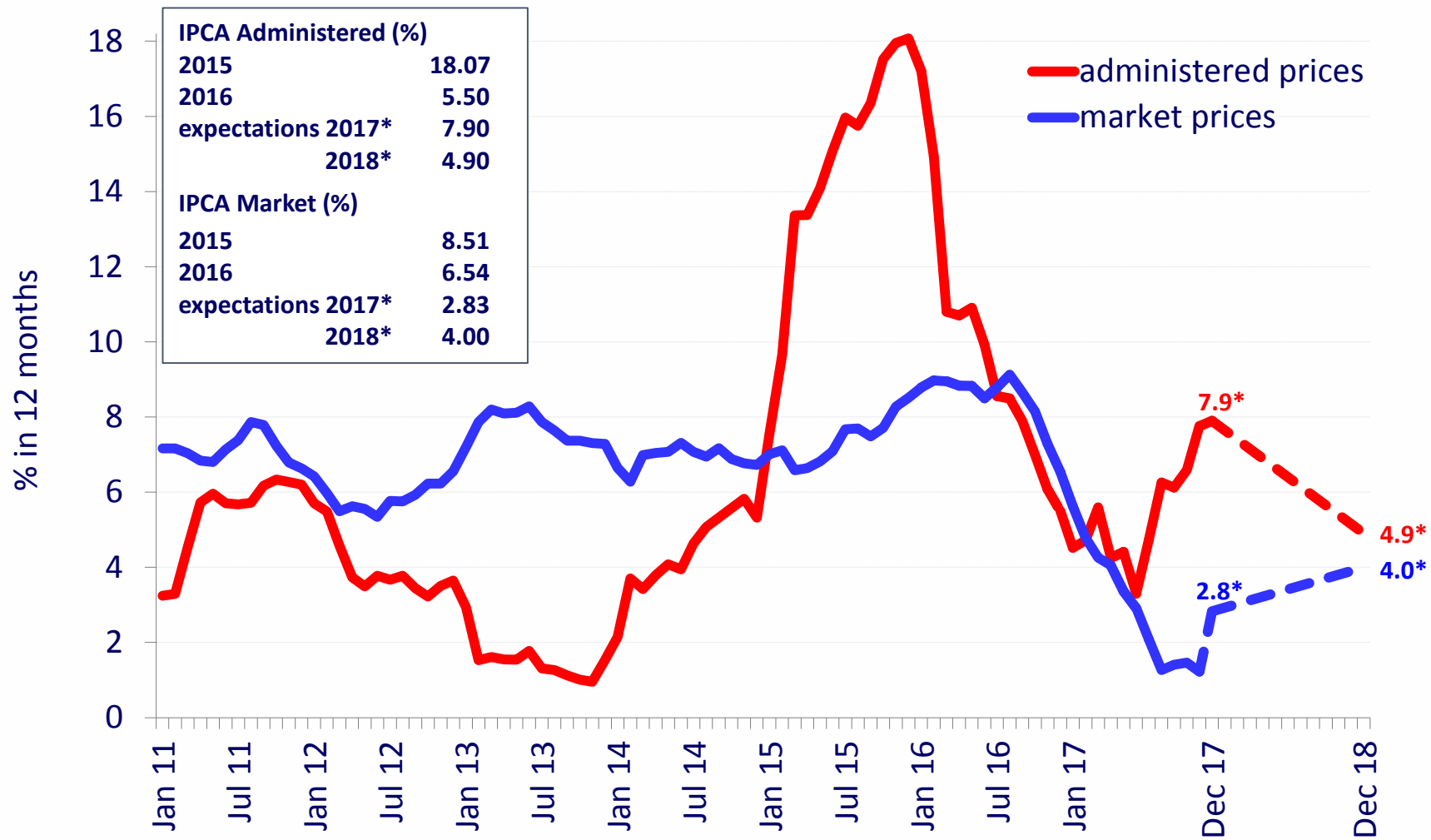
Source: BCB

Evolution of 2017-2021 IPCA Market Expectations



Source: BCB (15/12)

Market and Administered Prices

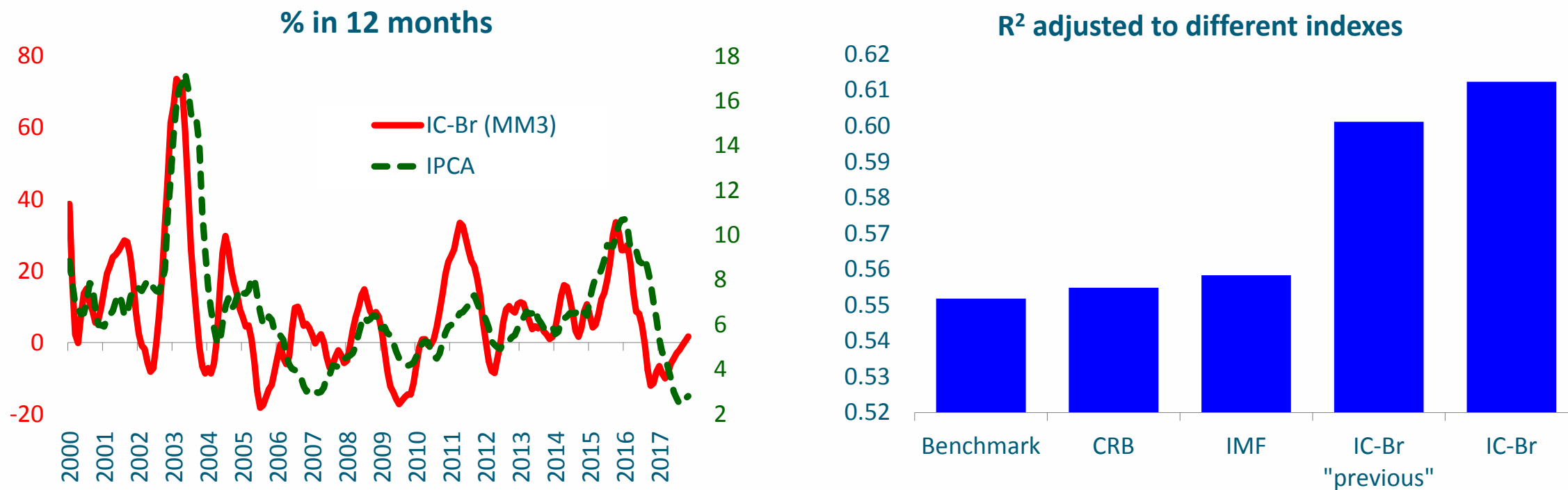


*Expectations on 12/15

Sources: IBGE and BCB

Box: Brazil Commodities Index (IC-Br) – Methodological Revision

- Considering the relevance of commodity prices for inflationary cycles in Brazil, this box updates the calculation approach of the IC-Br, aiming to adapt the index to structural changes observed in the Brazilian economy and to maximize its correlation with the IPCA.



III. Conditional Forecasts

Revisions and Short-Term Forecasts

IPCA – Inflationary Surprise

	% change				
	2017				
	Sept	Oct	Nov	in the quarter ^{2/}	12 months to Nov
Copom Scenario ^{1/}	0.17	0.46	0.40	1.04	2.98
Observed IPCA	0.16	0.42	0.28	0.86	2.80
Surprise (p.p)	-0.01	-0.04	-0.12	-0.18	-0.18

1/ Scenario at the September 2017 Inflation Report cutting date

2/ Differences between monthly and accumulated values due to rounding

IPCA – Short-Term Forecasts

	% change				
	2017	2018			
	Dec	Jan	Feb	In the quarter	12 months to Feb
Copom scenario ^{1/}	0.29	0.53	0.47	1.30	3.09

1/ Scenario at the cutting date

Sources: IBGE and BCB

Conditional Inflation Forecasts

Scenario with Focus Selic and Exchange Rates

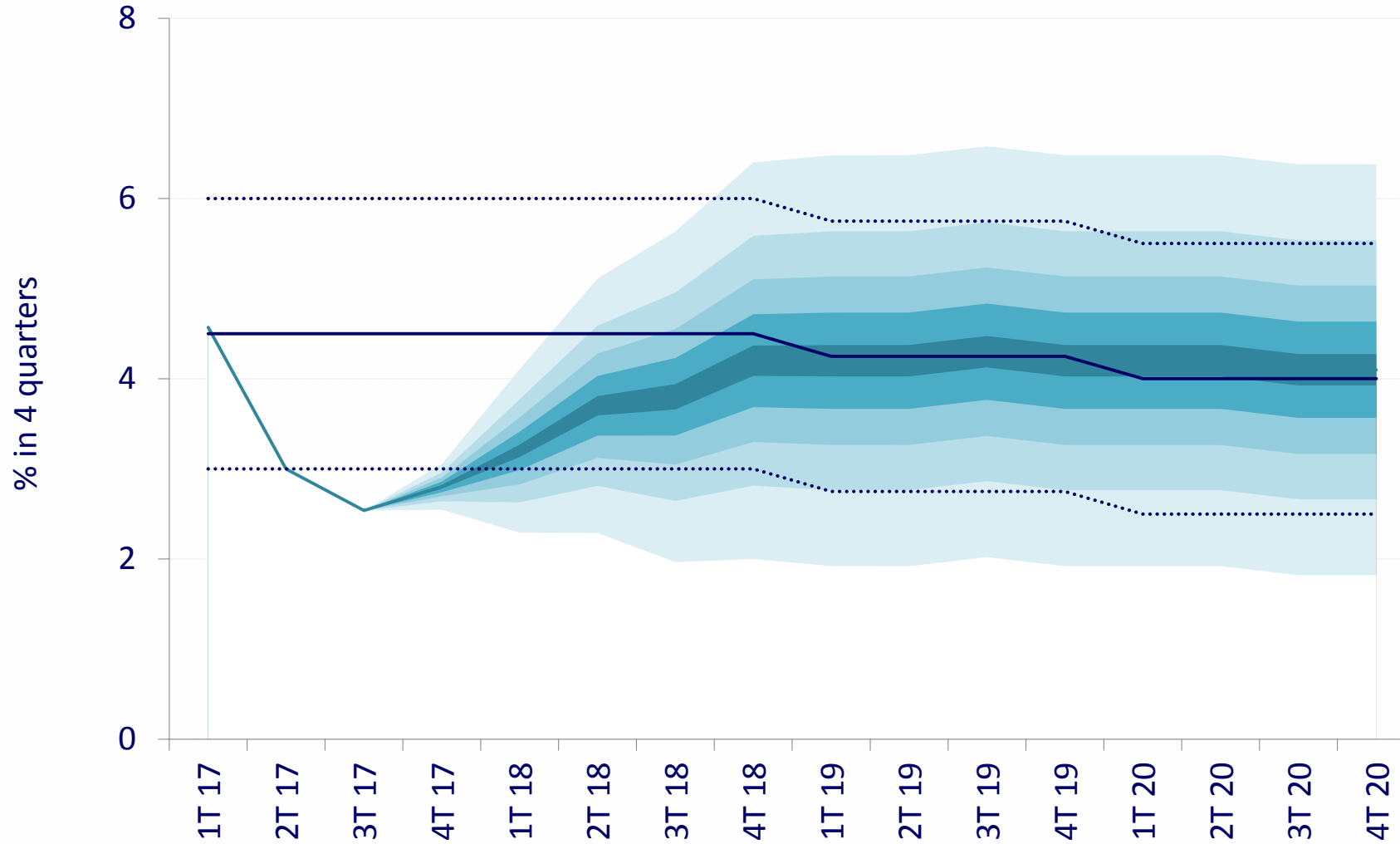
Period	September RI	December RI
2017 4	3.2	2.8
2018 1	3.6	3.2
2018 2	4.3	3.7
2018 3	4.3	3.8
2018 4	4.3	4.2
2019 1	4.3	4.2
2019 2	4.2	4.2
2019 3	4.2	4.3
2019 4	4.2	4.2
2020 1	4.1	4.2
2020 2	4.1	4.2
2020 3	4.1	4.1
2020 4	4.1	4.1

Obs.: 4 quarters accumulated inflation (%)

Source: BCB

Projeções Condicionais para a Inflação

Focus Scenario with Selic and Exchange Rates



Source: BCB

Conditional Inflation Forecasts

Reported Scenarios

Period		Focus Selic and Exchange Rates	Focus Selic and Constant Exchange Rate	Constant Selic and Exchange Rates	Focus Constant Selic and Exchange Rate
2017	4	2.8	2.8	2.8	2.8
2018	1	3.2	3.2	3.2	3.2
2018	2	3.7	3.7	3.7	3.7
2018	3	3.8	3.7	3.7	3.7
2018	4	4.2	4.1	4.0	4.1
2019	1	4.2	4.0	4.0	4.1
2019	2	4.2	4.1	4.1	4.3
2019	3	4.3	4.1	4.2	4.4
2019	4	4.2	4.0	4.1	4.4
2020	1	4.2	4.0	4.2	4.4
2020	2	4.2	3.9	4.2	4.4
2020	3	4.1	3.8	4.1	4.3
2020	4	4.1	3.9	4.2	4.4

Obs.: 4 quarters accumulated inflation (%)

Source: BCB

Conduct of Monetary Policy - 1

- In its meeting in December (211th meeting), the Copom unanimously decided for the reduction of the basic interest rate by 0.5 percentage points, to 7.0 percentage p.y., without bias.
- The Committee understands that convergence of inflation to the target over the relevant horizon for the conduct of monetary policy, which includes the calendar-years of 2018 and 2019, is consistent with the monetary easing process.
- On that occasion, the Committee reported that its baseline scenario involves risk factors in both directions:
 - On the one hand, possible second-round effects of the favorable food price shock and of low industrial goods inflation, and the possible propagation through inertial mechanisms of the low level of current inflation;
 - On the other hand, frustration of expectations regarding the reforms and a reversal of the current benign global outlook for emerging economies.

Conduct of Monetary Policy - 2

- The Copom judges that the economic conditions prescribe accommodative monetary policy, i.e., interest rates below the structural level.
- The Committee emphasizes that the process of reforms and necessary adjustments in the Brazilian economy contributes to the reduction of its structural interest rate. Estimates of this rate will be reassessed over time.

Conduct of Monetary Policy - 3

- The Copom highlights that the evolution of the baseline scenario, in line with expectations, and the stage of the monetary easing cycle made it appropriate to reduce the Selic rate by 0.5 percentage point at its December meeting. Regarding the next meeting, provided the Committee's baseline scenario evolves as expected, and taking into account the stage of the monetary easing cycle, at this time the Copom views an additional moderate reduction of the pace of easing as appropriate. The Committee views this guidance as more susceptible to changes in its baseline scenario and balance of risks than in the previous meetings. Going forward, the Committee judges that the current stage of the cycle recommends caution in conducting monetary policy. The Copom emphasizes that the monetary easing process 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 projections and expectations.

Inflation expectations

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