

# Inflation Outlook

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December 2013

**I. Introduction**

**II. International Environment**

**III. Financial Conditions**

**IV. Activity**

**V. Inflation Developments**

**VI. Prospects**

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# I. Introduction

# BCB's Mission

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

# Importance of this Mission

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- The international experience and the economic theory set low and stable inflation 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 Change	Inflation
1980-1985	2.6	147.1
1986-1994	2.3	842.5
1995-2003	2.2	9.1
2004-2012	3.9	5.5

# Retrospective - Abroad

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## Since the last Report release :

- High risks for global financial stability;
- The yield curve remained positive and strongly steepening in important mature economies;
- Moderate global activity;
- Some accommodation in the commodities prices in the international markets;
- In the currency markets, higher volatility and US dollar appreciation trend have been observed; and
- In general terms, the monetary policy stance has remained accommodative, in the emerging and mature economies.

# Retrospective - Brazil

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## Since the last Report release:

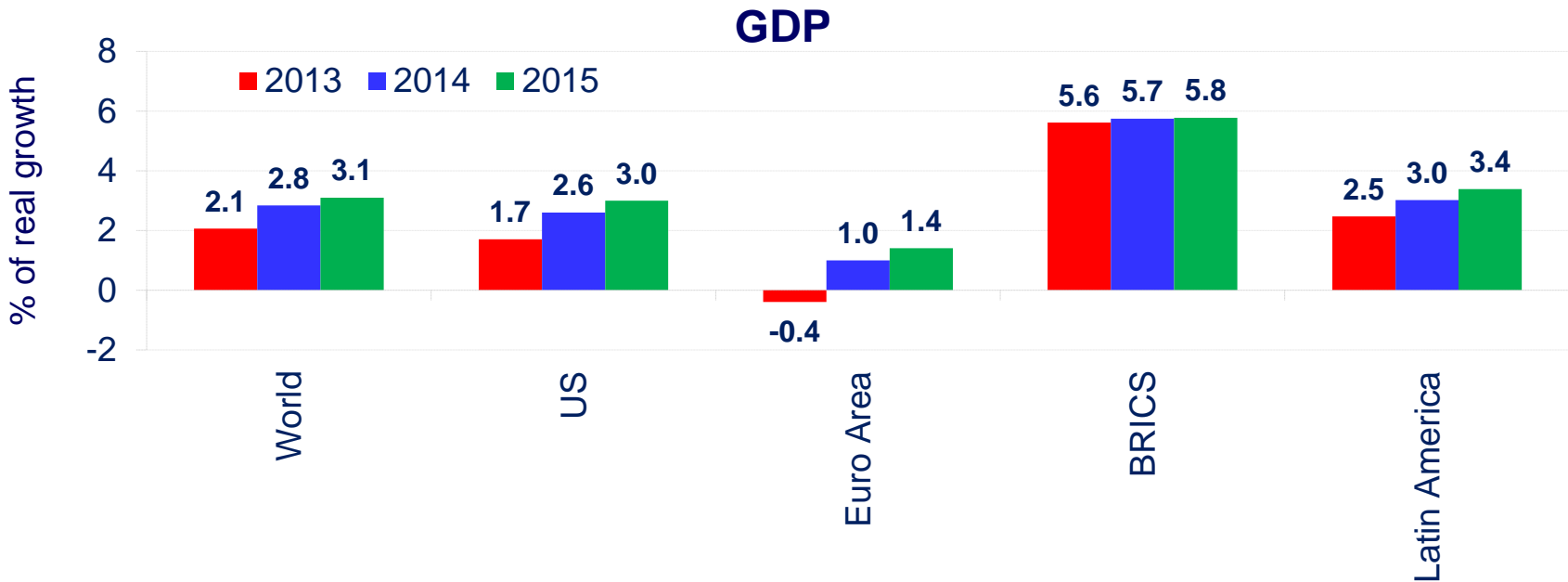
- Retreat of 0.5% in activity in the third quarter;
- In the market of factors: ICU relatively stable and narrow idleness margin in the labor market;
- In the wholesale market, prices pressures in the agricultural segment and, especially, in the industrial segment;
- Consumer inflation at high level and still showing resistance; and
- Continuation of the monetary conditions adjustment cycle started in April this year.



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# II. International Environment

# Activity – Expectations



2013 GDP (%)

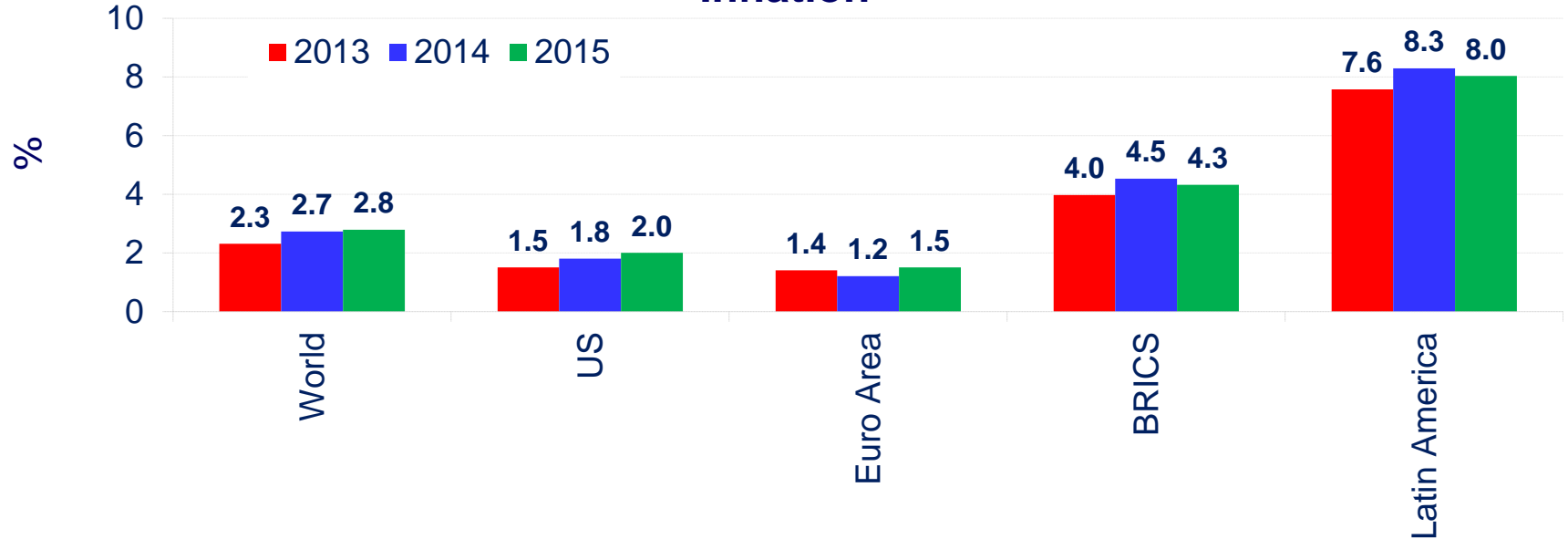
	2013			
	Mar	Jun	Sep	Dec
US	1.9	1.9	1.6	1.7
Euro Area	-0.2	-0.6	-0.4	-0.4
Japan	1.2	1.8	1.9	1.8
U. Kingdom	0.9	0.9	1.3	1.4
China	8.1	7.7	7.6	7.6
India	5.2	5.1	5.7	5.0
Brazil	3.0	2.4	2.4	2.3

2014 GDP (%)

	2013			
	Mar	Jun	Sep	Dec
US	2.7	2.7	2.7	2.6
Euro Area	1.1	1.0	1.0	1.0
Japan	1.3	1.5	1.6	1.6
U. Kingdom	1.6	1.6	2.0	2.4
China	8.0	7.7	7.4	7.5
India	6.2	6.0	5.2	4.8
Brazil	3.5	3.0	2.2	2.0

# Prices – Expectations

## Inflation



2013 Inflation (%)

	2013			
	Mar	Jun	Sep	Dec
US	1,9	1,5	1,6	1,5
Euro Area	1,7	1,5	1,5	1,4
Japan	0,1	0,1	0,2	0,3
U. Kingdom	2,6	2,7	2,7	2,6
China	3,1	2,8	2,6	2,7
India	8,6	9,3	6,1	6,1
Brazil	5,7	5,9	5,8	5,7

2014 Inflation (%)

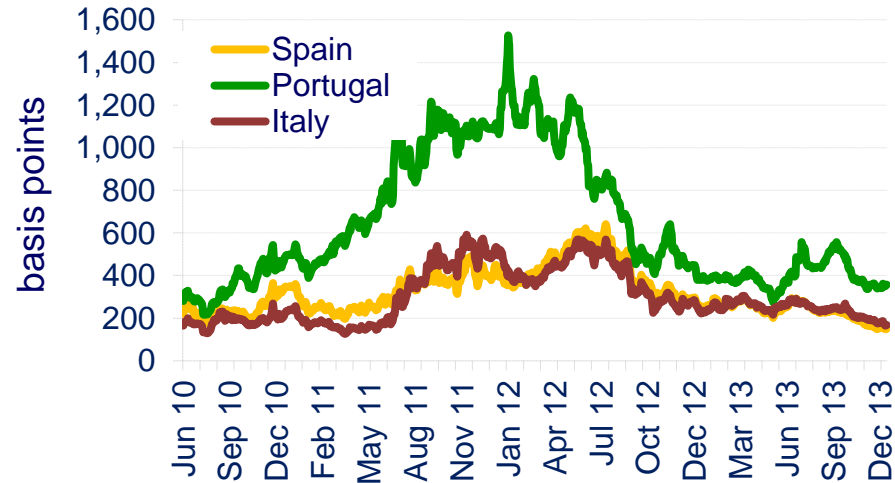
	2014			
	Mar	Jun	Sep	Dec
US	2,1	1,9	1,9	1,8
Euro Area	1,7	1,6	1,5	1,2
Japan	1,8	2,0	2,3	2,4
U. Kingdom	2,3	2,4	2,3	2,2
China	3,5	3,2	3,2	3,2
India	7,9	8,3	8,7	9,1
Brazil	5,6	5,9	6,0	6,0

# Commodities, Volatility and Risk Aversion

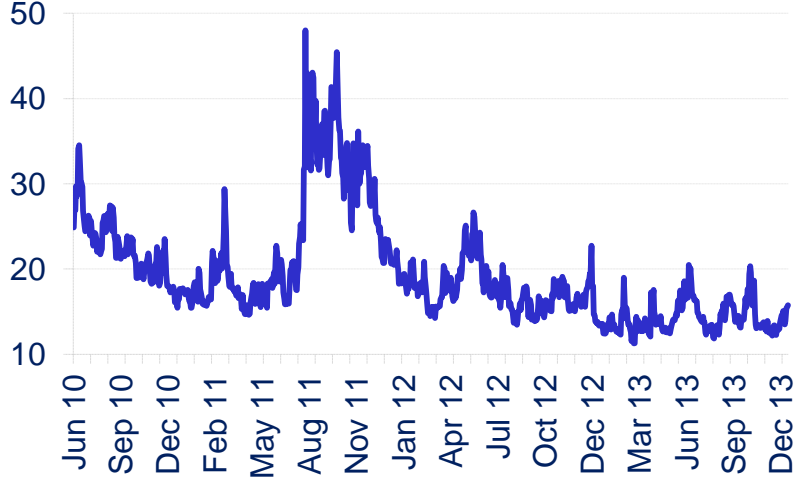
**CRB**



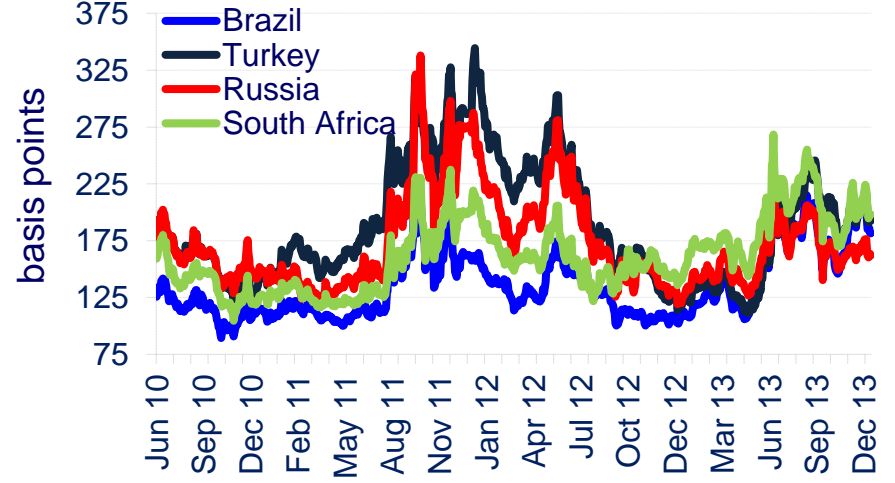
**CDS**



**VIX**



**CDS**



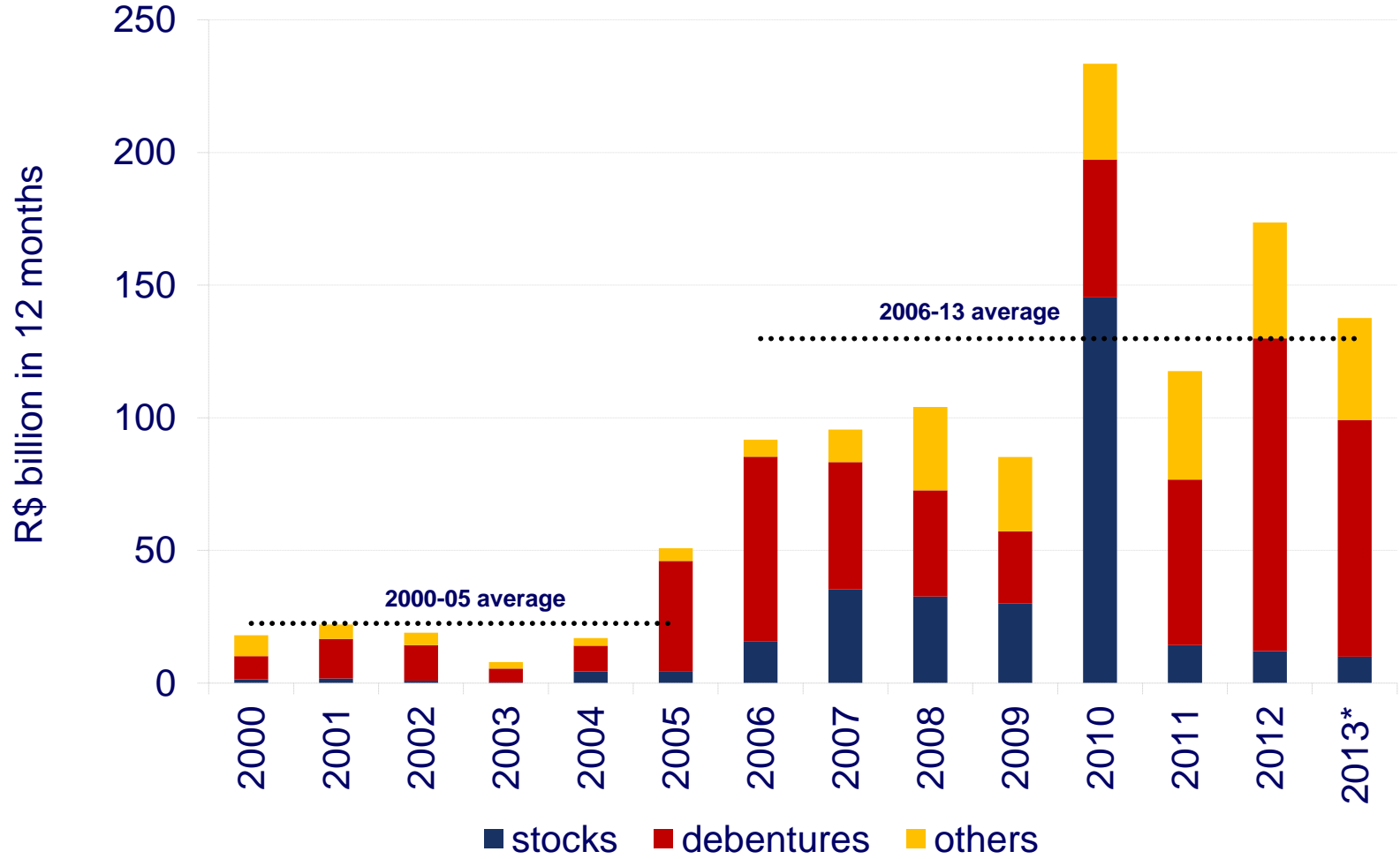
data up to 12/13

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# III. Financial Conditions

# Capital Market Domestic Operations

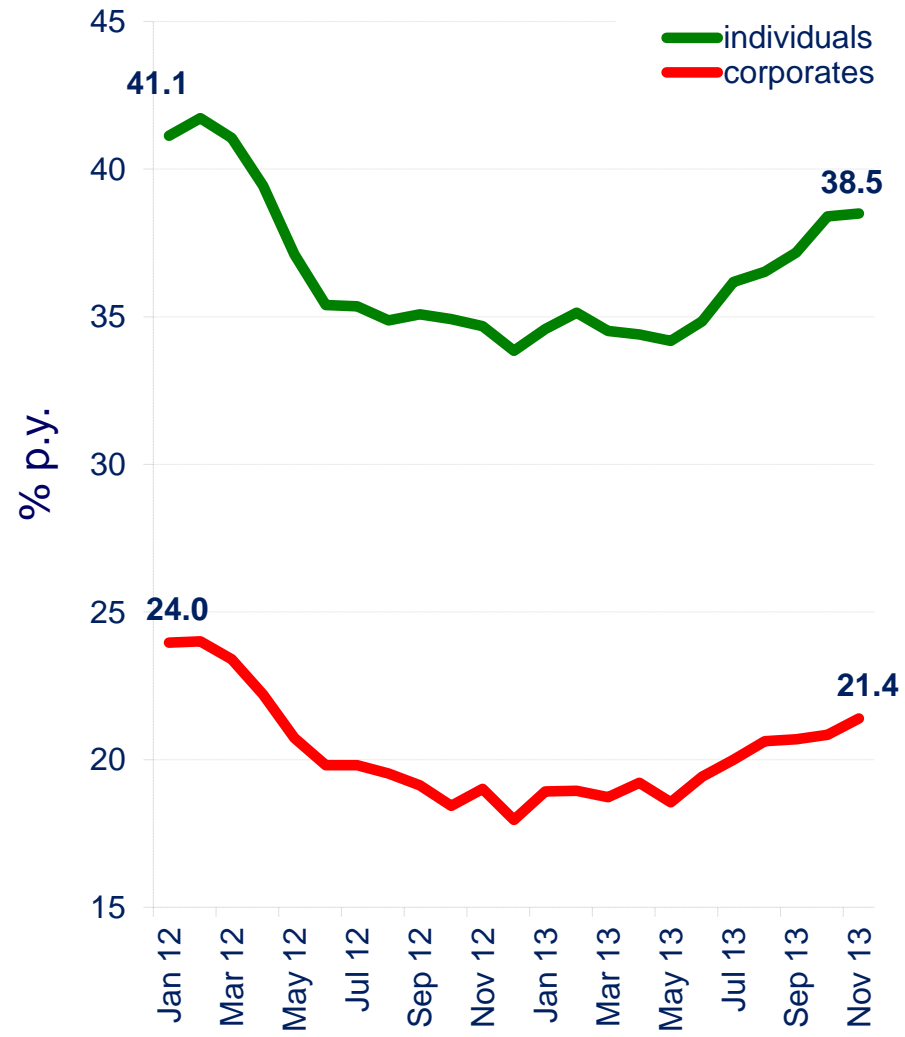
## Primary Issues



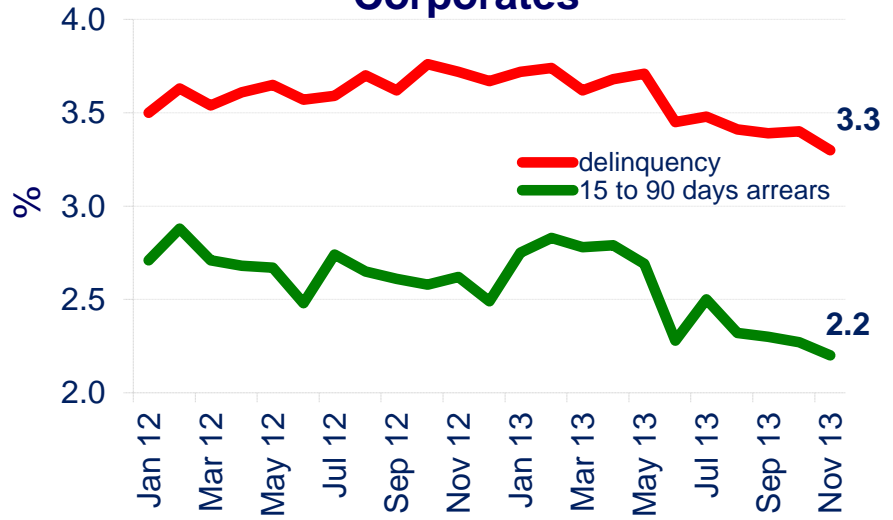
\*12 months through Nov/13

# Non-Earmarked Credit: Cost, Delinquency and Arrears

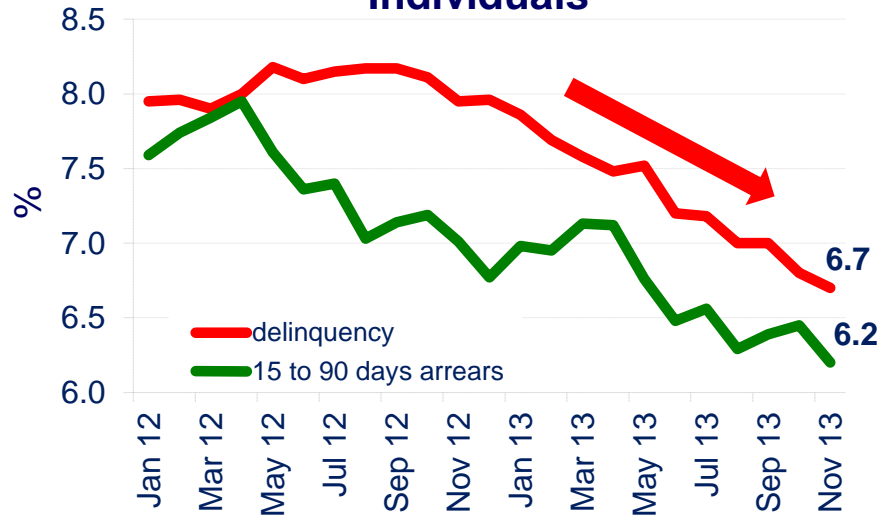
### Interest Rate



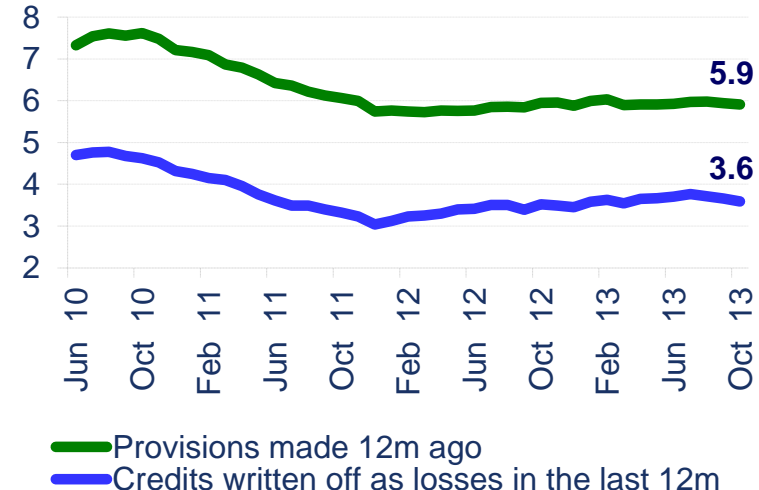
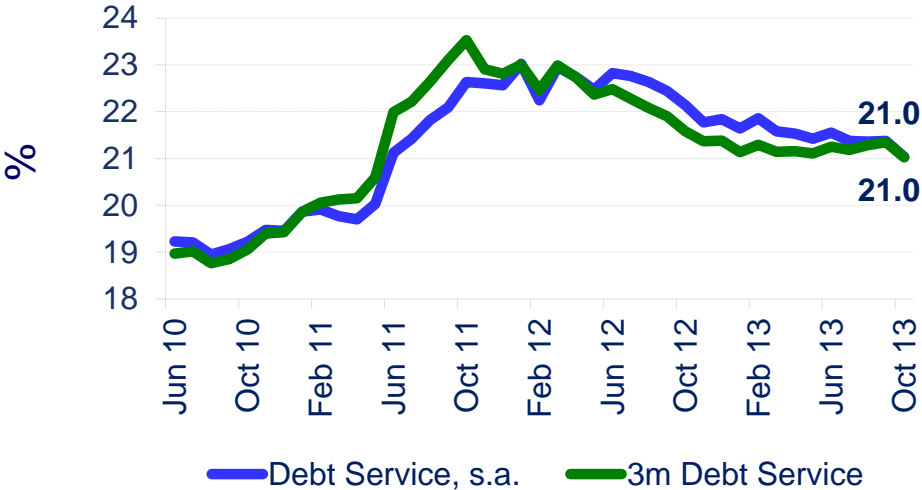
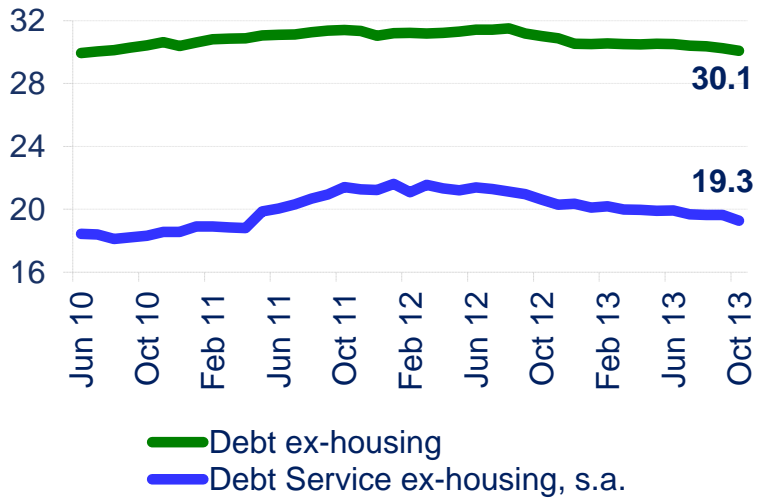
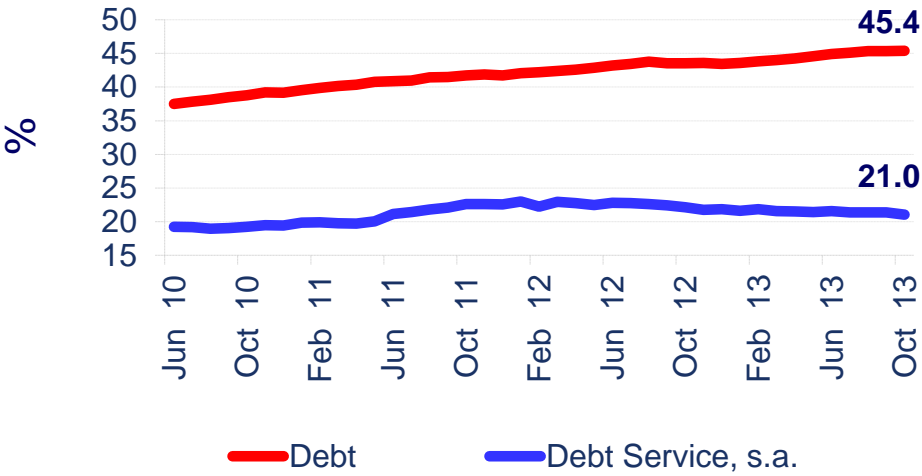
### Corporates



### Individuals



# Household Debt and Provisions of the System





# Boxes

## PSND and GGGD Projections

- In the market scenario, the GGGD/GDP ratio ends 2013 at 59.6% and at the end of 2016 it would be at 60.5%; according to the scenario based on the 2014 Budget Guidelines Law, the GGGD/GDP ratio ends 2013 at 59% and at the end of 2016 it would reach 56.8%; and
- According to the market scenario, the average primary surplus required to stabilize the GGGD/GDP ratio is estimated at 2.3% of the GDP in 2014/2016, and at 1.9% of the GDP, considering the 2014 Budget Guidelines Law.

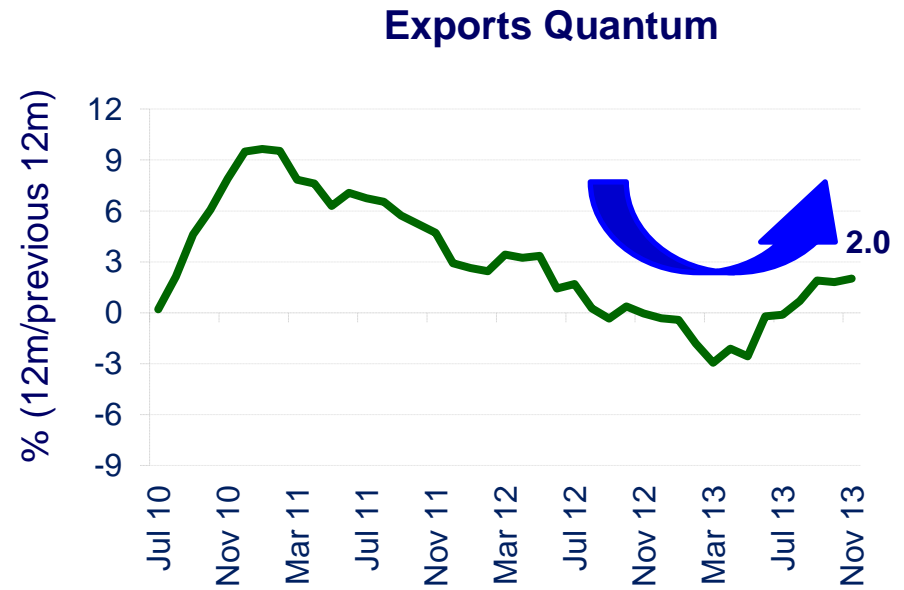
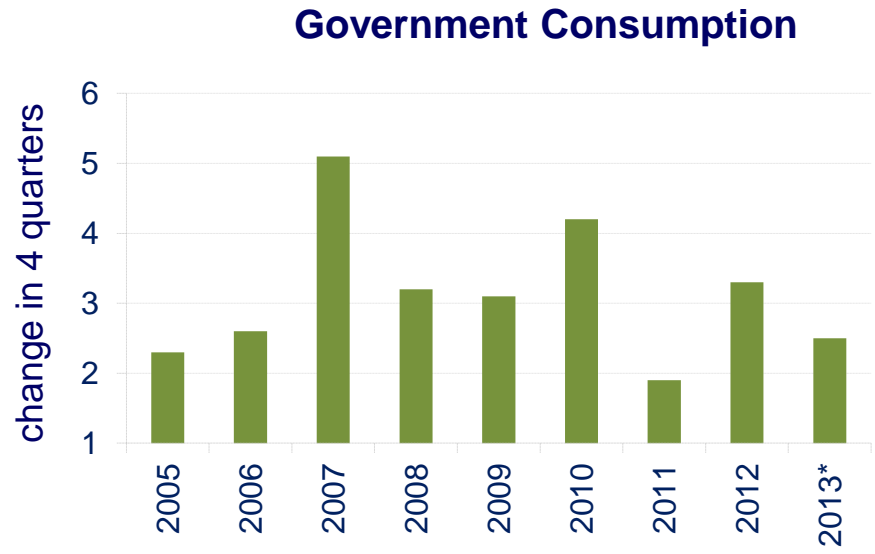
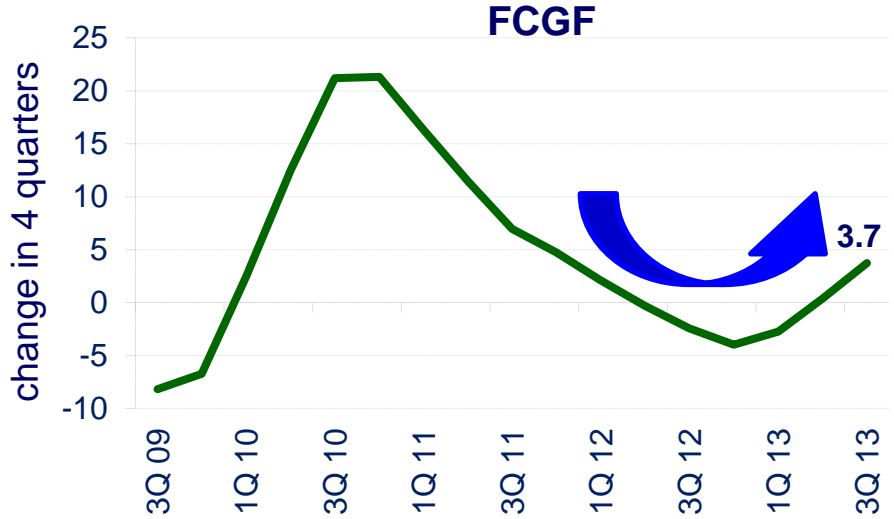
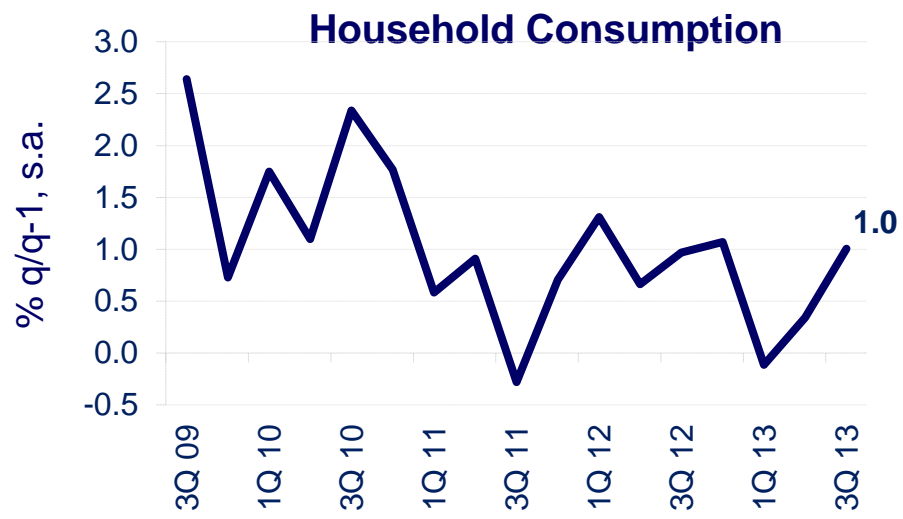
## New Funding Instruments

- With innovations introduced in the last years, the funding through LF (*Letra Financeira*), LCI (*Letra de Crédito Imobiliário*), LCA (*Letra de Crédito do Agronegócio*) and DPGE (*Depósito a Prazo com Garantia Especial*) have increased , in substitution to time deposits;
- This group represented 42% of the funding with longer tenures in October (R\$425 billion balance); and
- This evolution partially reflects the characteristics of these instruments, such as the tax exemption and the non-collection of reserve requirements.

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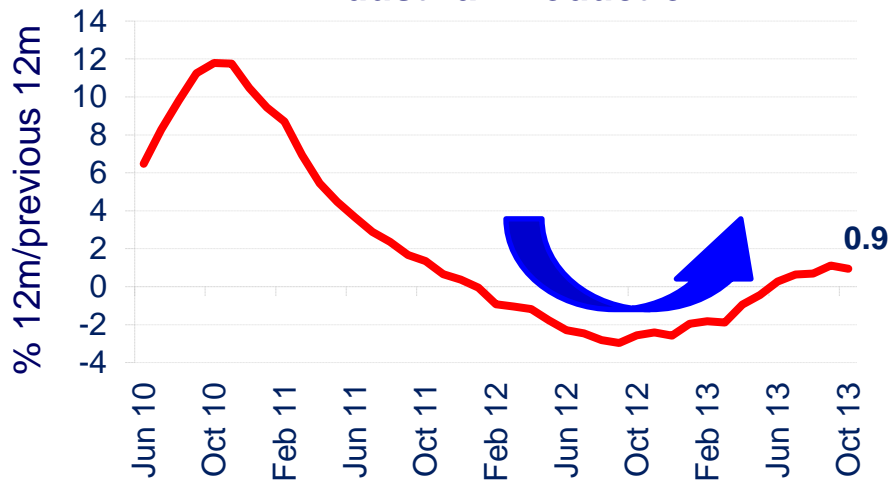
# IV. Activity

# Demand



# Supply

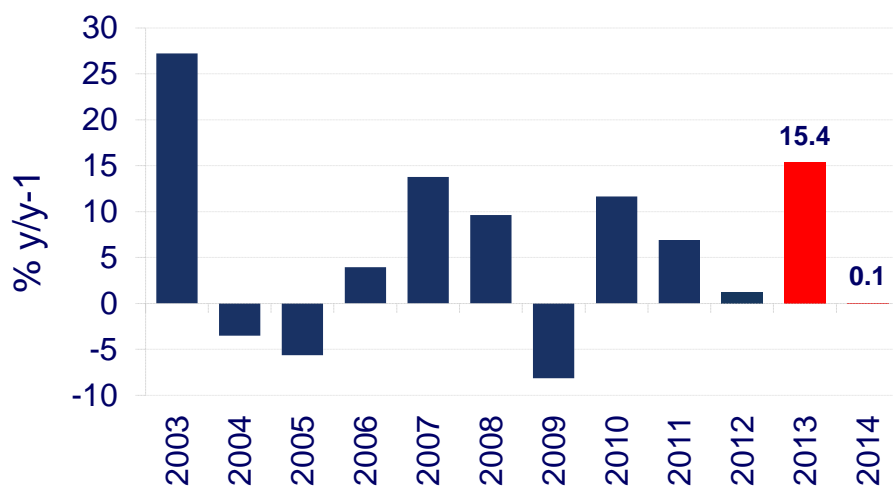
### Industrial Production



### Services Nominal Income

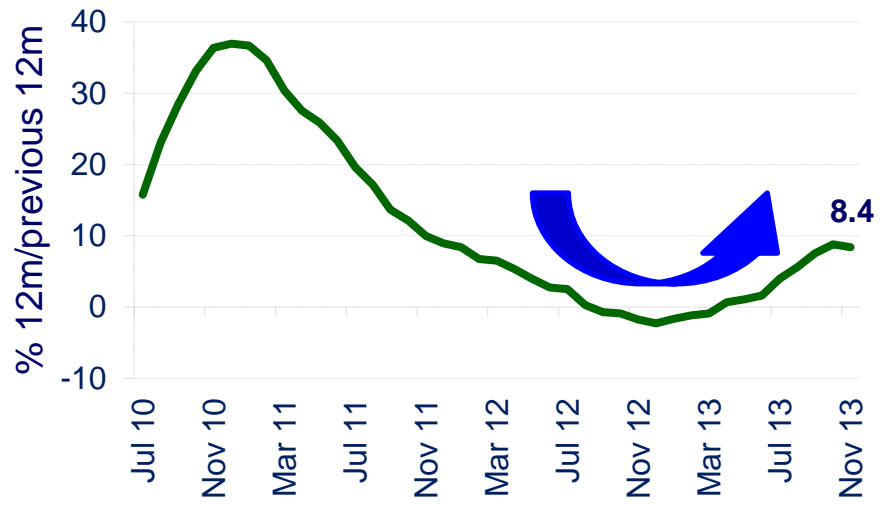


### Crop Harvest



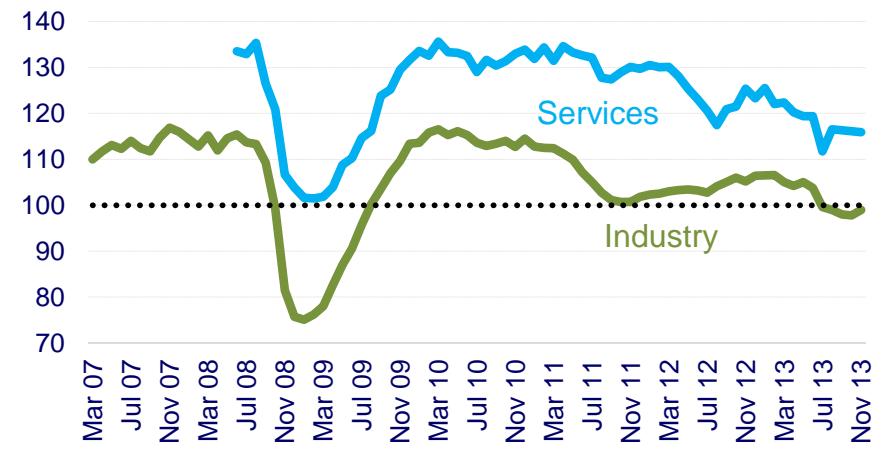
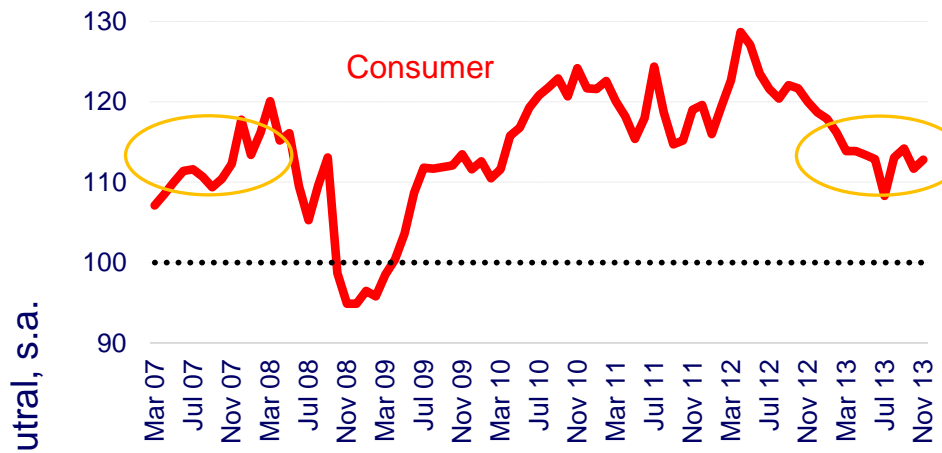
2013: IBGE estimates in Nov/13

### Imports Quantum

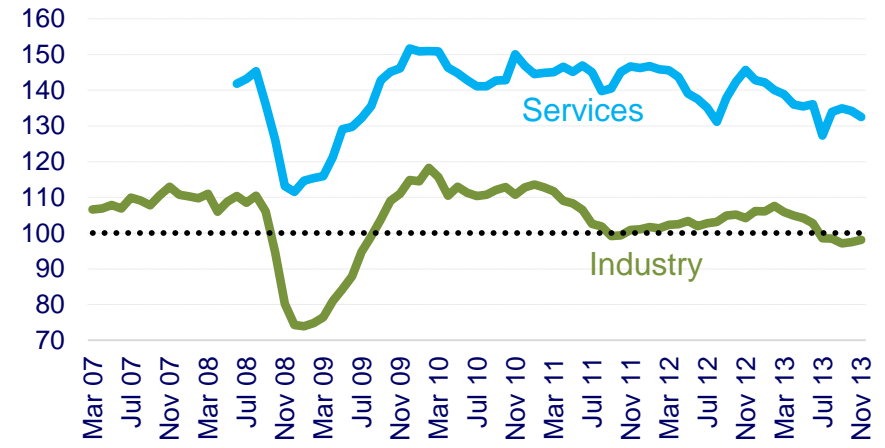
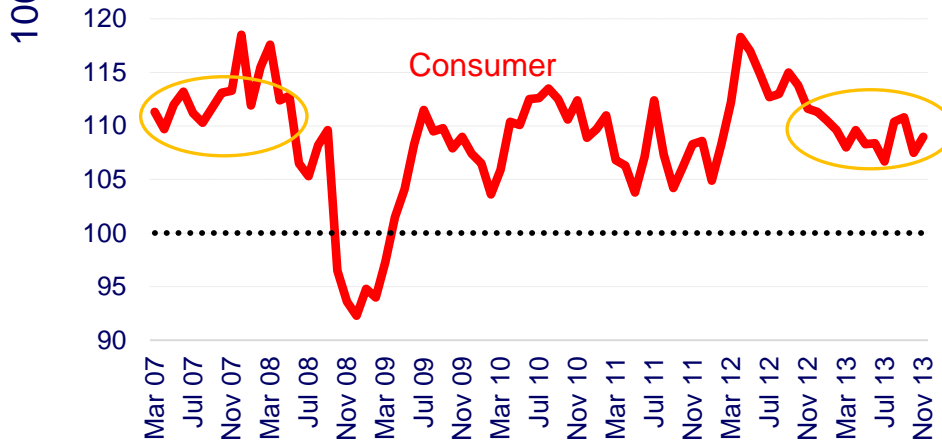


# Firms' and Households' Confidence and Expectations

## Confidence



## Expectations



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

## Forecast Power of the Confidence Indices

- It evaluates the forecast power of the main confidence indices available in Brazil; and
- The results indicate that the ICI and its components outperform, when providing information both for the present and for the next future regarding the dynamics of several variables, such as the indicators of the Monthly Industrial Survey (PIM) and the Gross Domestic Product (GDP) components.

## Unemployment Insurance in Brazil

- Apparent asymmetry between the increase of unemployment insurance beneficiaries and the decrease in the number of unemployed; and
- The evidence indicate that this can be associated to the possibility of the unemployed receiving the unemployment insurance and not looking for a job.

## 2013 Balance of Payments Projection

- Estimate of Current Account Deficit of US\$79 billion (3.6% of GDP) in 2013 and of US\$78 billion (3.5% of GDP) in 2014; and
- Estimate of FDI inflows of US\$63 billion in 2013 and in 2014.

## Direct Investment: Concentration and International Comparison

- The FDI outstanding in Brazil increased from 1.6% of the global total, in 2000, to 3.3%, in 2011; at the same time, the BDI outstanding abroad increased from 0.6% to 0.9% of the global outstanding;
- Important share of the FDI flows passes by the fiscal paradises and other international financial centers; and
- The concentration is smaller, when the country of the final investor is evaluated, than when the country of the immediate investor is evaluated.

# Box: GDP Growth Forecasts

**Increase of 2.3% for 2013 (domestic demand: 3.3 p.p. and net exports -1.0 p.p.);**

## **Supply**

- Agriculture and livestock: 7.3% (-2.1% in 2012);
- Industry: 1.3% (-0.8% in 2012); and
- Services: 2.0% (1.9% in 2012).

## **Demand**

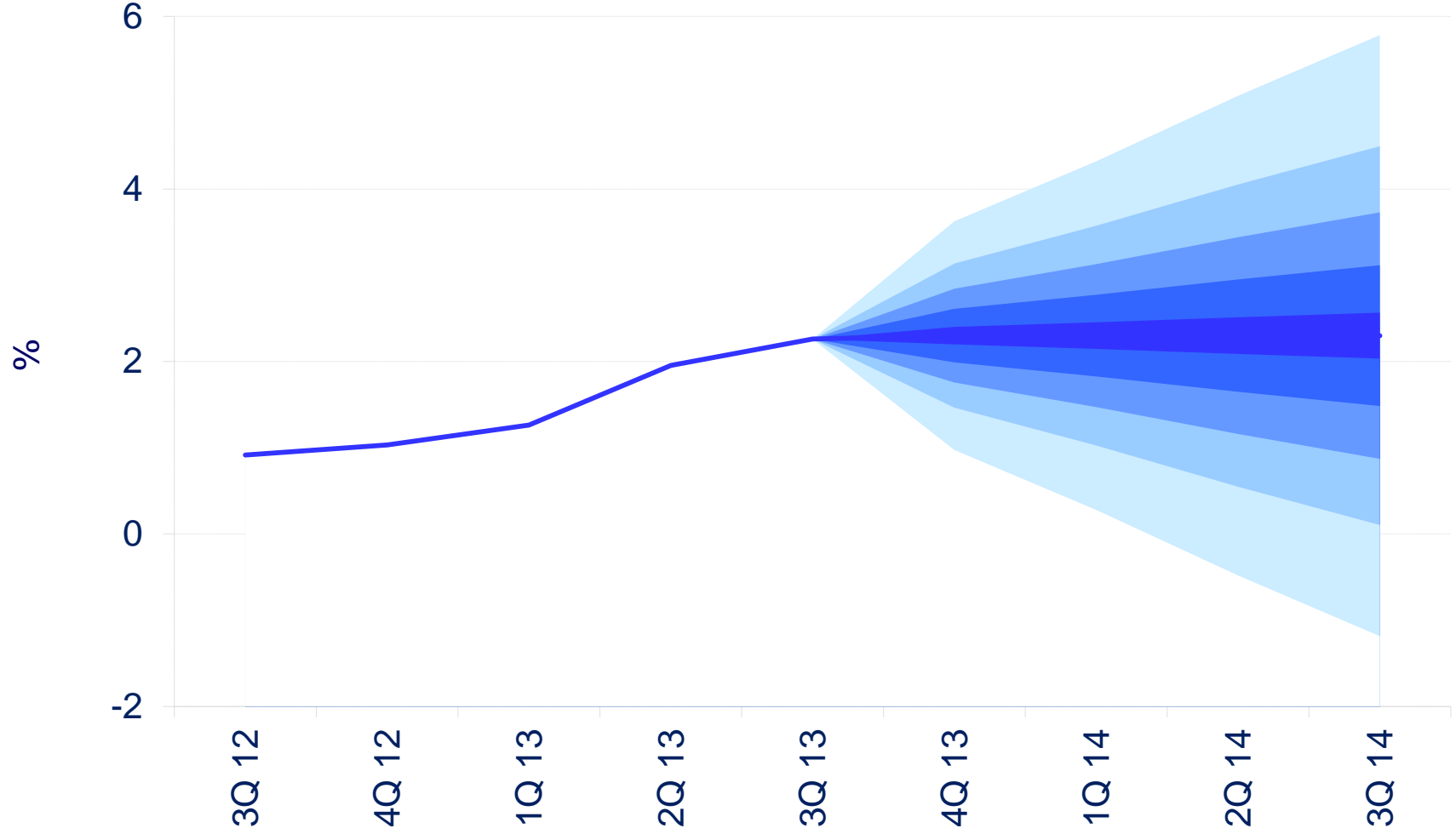
- Investments: 6.8% (-4% in 2012);
- Household Consumption: 2.3% (3.2% in 2012);
- Government Consumption: 2.1% (3.3% in 2012).

**For the accumulated in four quarters up to the 3<sup>rd</sup> quarter of 2014:  
2.3% growth.**



# GDP Forecast

## Baseline Scenario\*



\* Interest constant at 10.0% p.y.

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# V. Inflation Developments

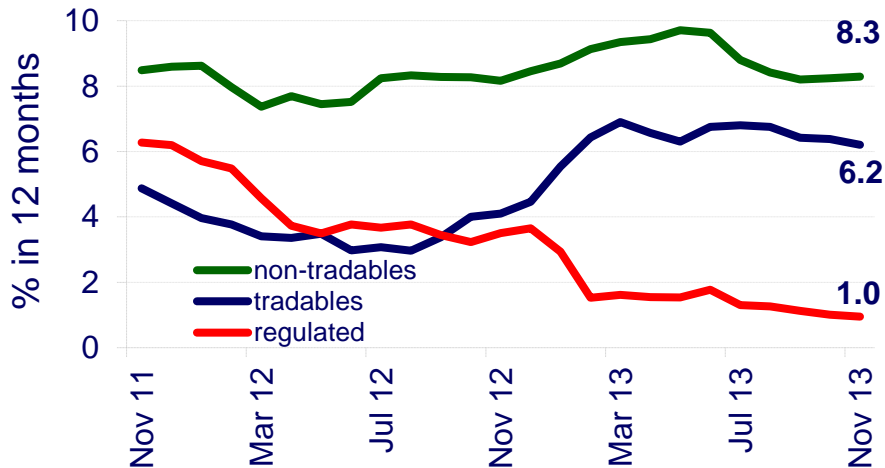
# Inflation Developments

## Prices Indices

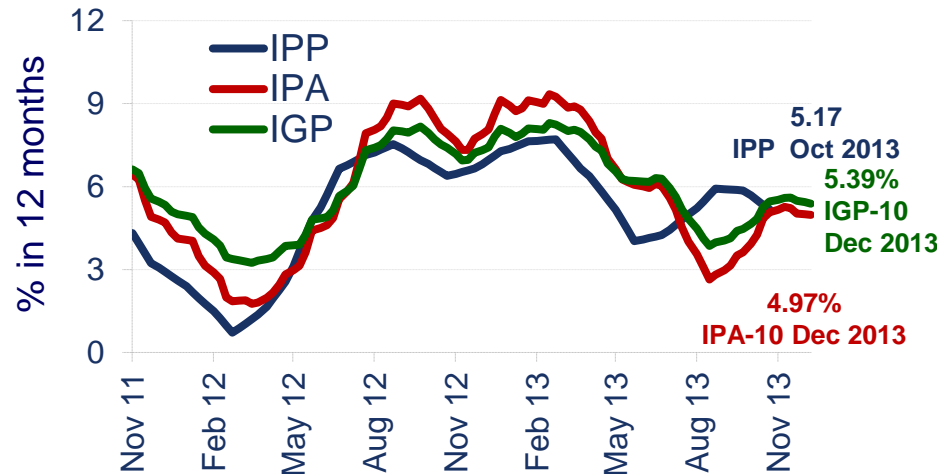
	Change in 12 months (%)		
	Nov/12	Nov/13	
IPCA	5.53	5.77	▲
INPC	5.95	5.58	▼
IPC-Fipe	4.92	4.01	▼
IPC-C1	7.16	5.18	▼
IGP-DI	7.22	5.49	▼
IPA-DI	7.73	5.02	▼
Agricultural	17.15	-0.90	▼
Industrial	4.38	7.44	▲
IPC-DI	5.89	5.59	▼
INCC-DI	7.06	8.16	▲

# Prices

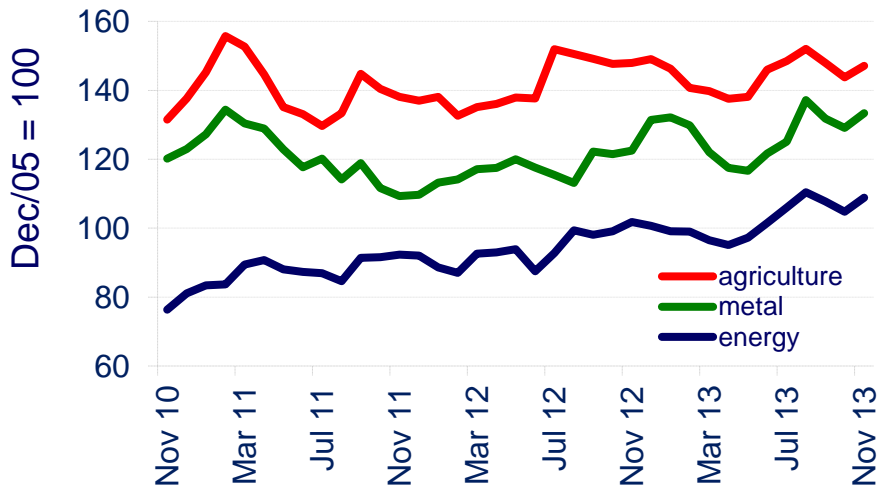
## Inflation (IPCA)



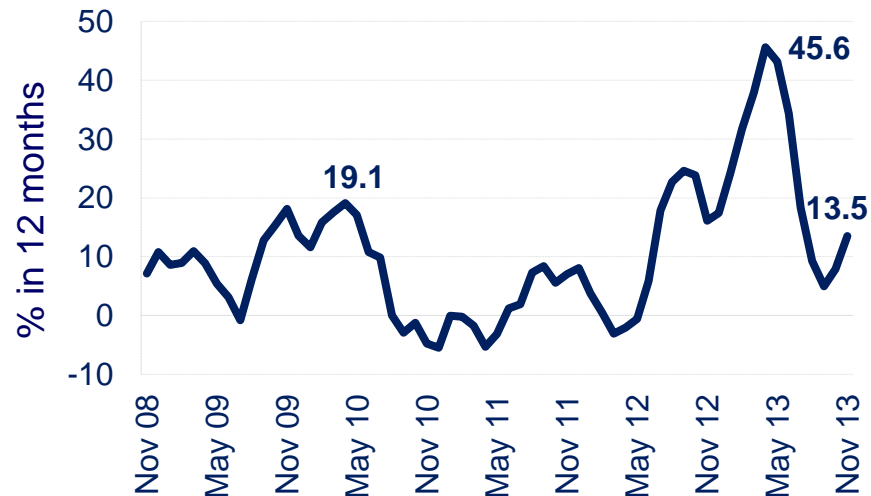
## Producer Prices and IGP



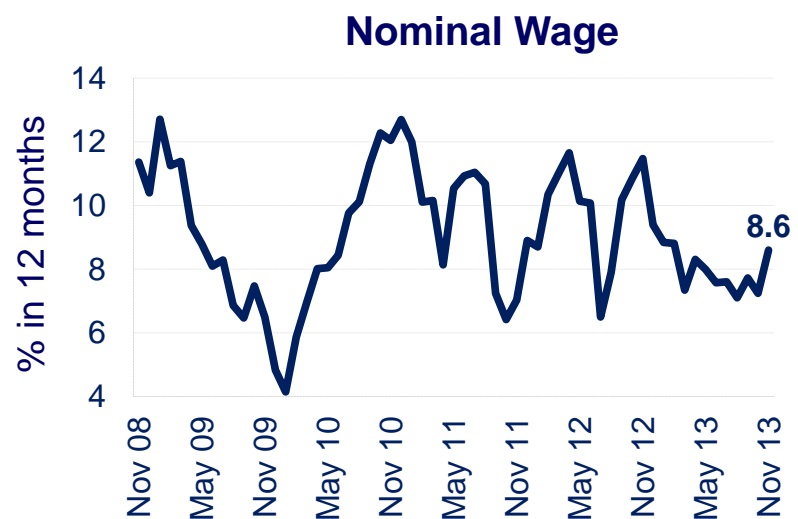
## IC-Br (R\$)



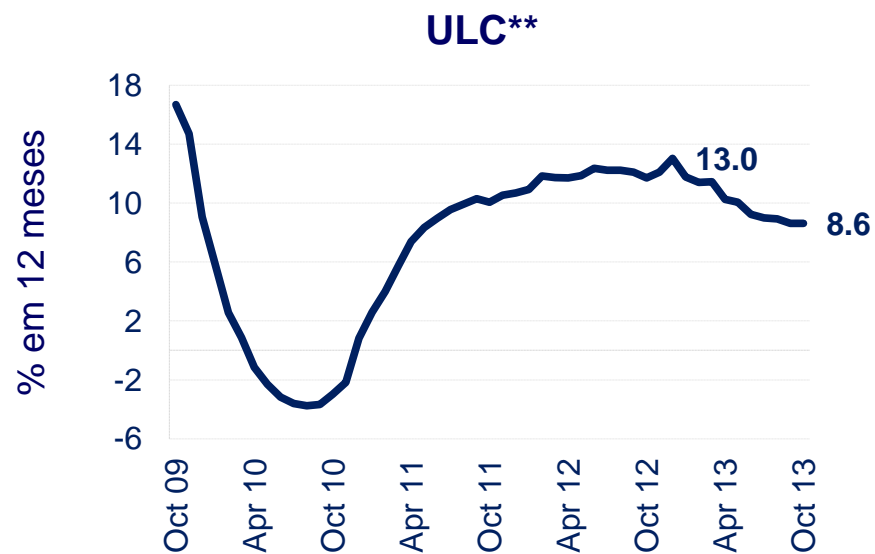
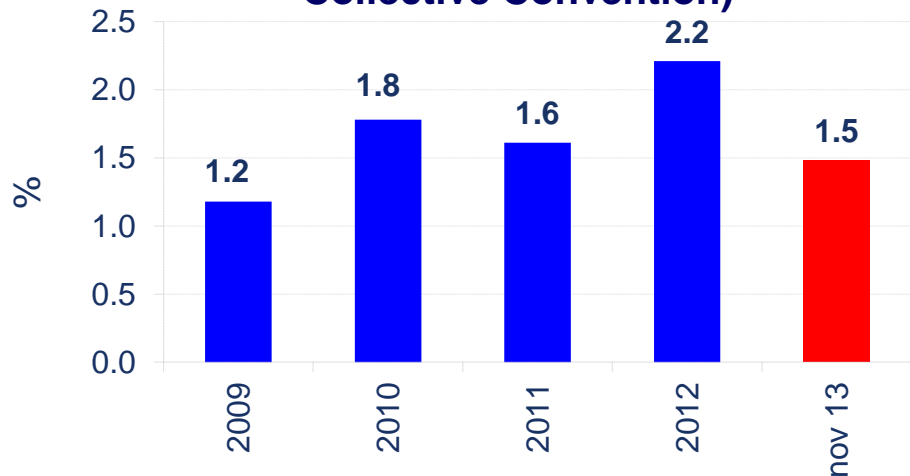
## In Natura Food Prices



# Wages



Real Adjustment in the CCT (Working Collective Convention)



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

# BCB Inflation Forecasts

## Baseline Scenario\* and Market Scenario

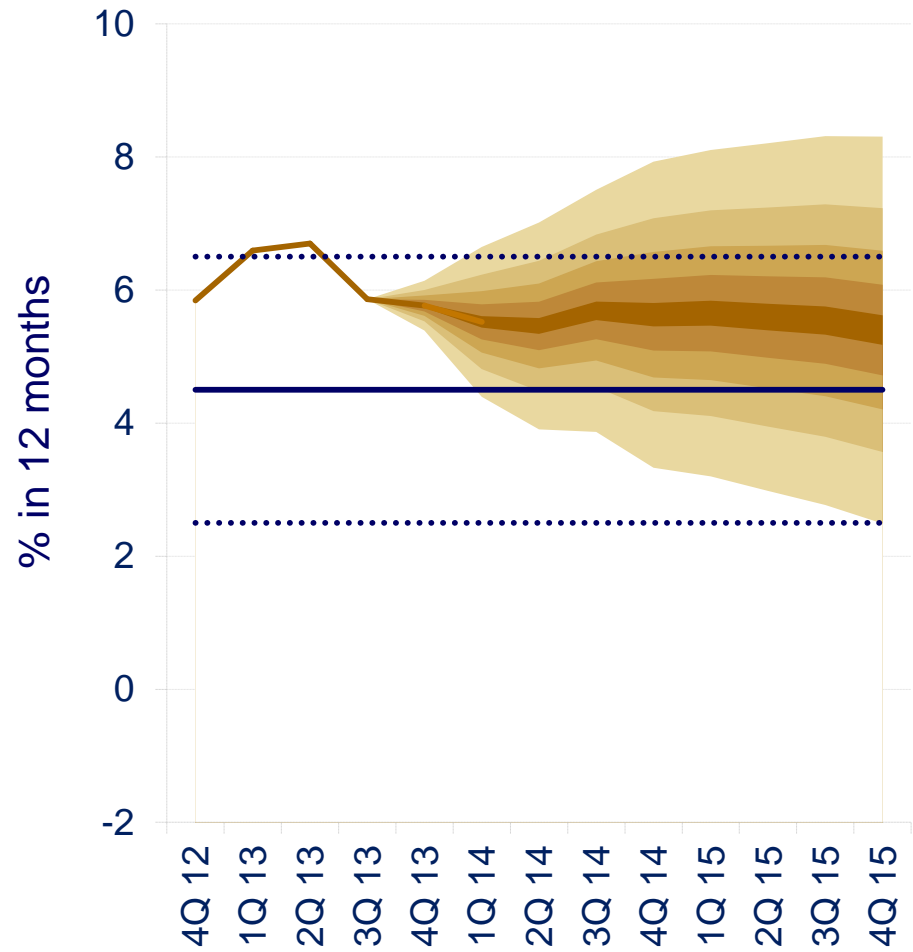
Period		Baseline	Market
2013	4	5.8	5.8
2014	1	5.5	5.5
2014	2	5.5	5.4
2014	3	5.7	5.7
2014	4	5.6	5.6
2015	1	5.7	5.7
2015	2	5.6	5.6
2015	3	5.5	5.5
2015	4	5.4	5.3

Obs.: 12-month accumulated inflation (% p.y.)

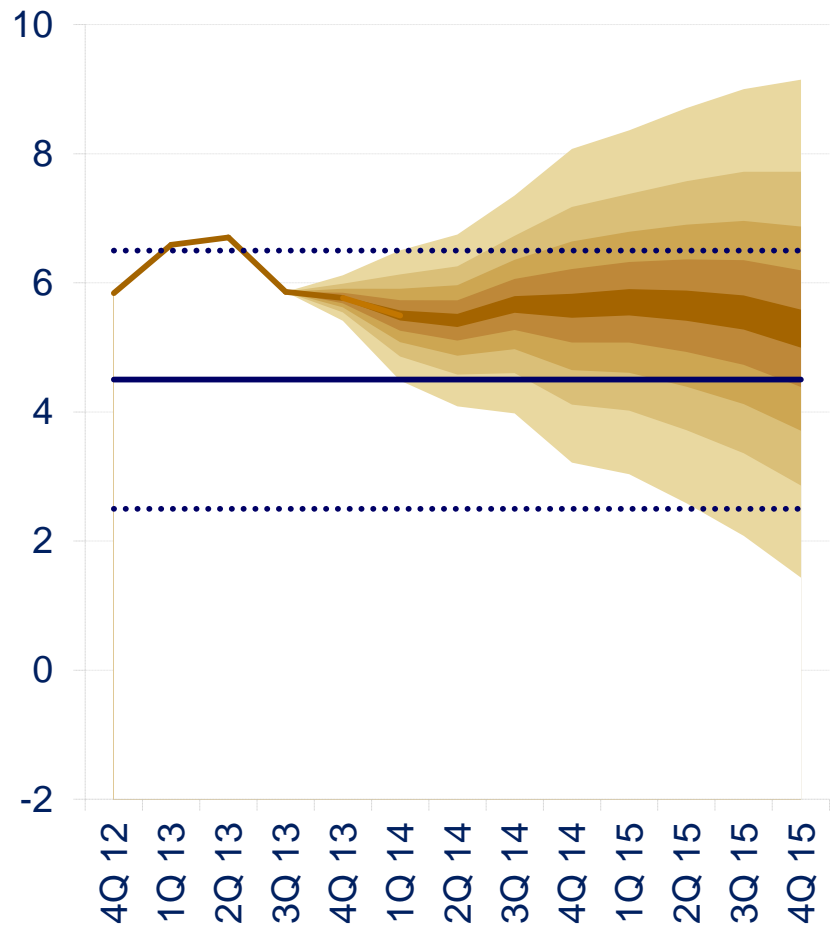
\* Interest constant at 10.0% p.y.

# BCB Inflation Forecasts

**Baseline Scenario**  
(interest constant at 10.0% p.y.)



**Market Scenario**



## Services Inflation Segmentation

- Services inflation has increased (the prices of services have increased more than the IPCA); and
- The evidences suggest that this differentiated dynamics was mainly driven by the price behaviour of two segments: Work-Intensive Services; Away-from-Home Food and e Airline Tickets.

## Sports Mega Events on Consumer Inflation

- It presents impact estimates of sports mega events over the dynamics of consumer price inflation in the host country; and
- The results suggest that shocks stemming from the accomplishment of mega events can be slightly inflationary.



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# VI. Prospects

# Prospects – Abroad - 2014-2015

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- Still heightened risks for the global financial stability, albeit low probability of occurrence of extreme events;
- In the relevant horizon for the monetary policy, the volatility of financial markets tends to react to the start of the US monetary conditions normalization process;
- Prospects of intensification of the global activity pace; and
- In the relevant horizon, prospects for the increase of global inflation.

# Prospects – Brazil - 2014-2015

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- Relatively stable activity expansion pace in the upcoming year, compared to 2013, with change in the composition of aggregate supply and demand;
- Current account deficit essentially financed with foreign direct investment;
- Moderate credit expansion (to consumption, especially);
- Moderation in wage gains;
- Relative prices adjustments; and
- Projections indicate high twelve-month inflation in the relevant horizon, but with retreating trend.

# Prospects – Fiscal Policy

- Considering estimated trajectories for the effective and potential product, the fiscal policy is admitted to move to neutrality in the relevant horizon for the monetary policy;
- The generation of primary surpluses at levels close to the average of the ones generated in recent years is necessary to maintain the public debt in a sustainable trajectory;
  - **The difference between the real rate of the public sector funding cost and the GDP growth real rate increased;**
- If this condition is matched, the cost of public debt funding would tend to retreat, with favorable consequences over the cost of capital in general, which would stimulate the private investment in the medium and long terms.

# Prospects – Projections – 2013-2014-2015

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## GDP Projection:

- The estimate rate for the GDP growth in 2013 was revised to 2.3%, down from 2.5% in the September Report; and
- The estimate rate reaches 2.3% in the four quarters through the third quarter of 2014.

## Inflation Projections:

- Baseline scenario: 5.8% for 2013; 5.6% for 2014; and 5.4% for 2015; and
- Market scenario: 5.8% for 2013; 5.6% for 2014; and 5.3% for 2015.

# Prospective Scenario – Monetary Policy

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- The Copom highlights that, in moments such as the current one, the monetary policy should remain especially 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. At the same time, the Committee states that the transmission of the effects of monetary policy actions over inflation occurs with time lags.

# Market Estimates – Summary

	2013		2014		2015				
	9/30/13	12/13/13	9/30/13	12/13/13	9/30/13	12/13/13			
IPCA	5.82	▼	5.70	5.97	▼	5.95	5.50	=	5.50
Regulated Prices	1.80	▼	1.50	4.20	▼	3.85	4.70	▲	4.75
IGP-M	5.73	▼	5.46	5.87	▲	6.01	5.00	▲	5.40
IPA-DI	4.07	▲	4.88	5.84	▲	5.87	5.00	▲	5.35
Selic (end-of-period)	9.75			9.75	▲	10.50	10.00	▲	11.25
Exchange rate (end-of-period)	2.30	▲	2.33	2.40	▲	2.43	2.40	▲	2.45
GDP	2.45	▼	2.30	2.17	▼	2.01	2.50	=	2.50
Industrial Production	2.13	▼	1.61	2.30	▲	2.31	3.50	▼	2.95
Trade Balance	2.00	▼	1.19	10.00	▼	7.85	11.00	▲	11.70
FDI	60.00	=	60.00	60.00	=	60.00	58.00	▲	59.00
Primary Result	1.70	=	1.70	1.50	▼	1.45	2.05	=	2.05



# Inflation Outlook

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Carlos Hamilton Araújo

**December 2013**