

Economic outlook

UBS Global Emerging Markets Conference

Banco Central do Brasil

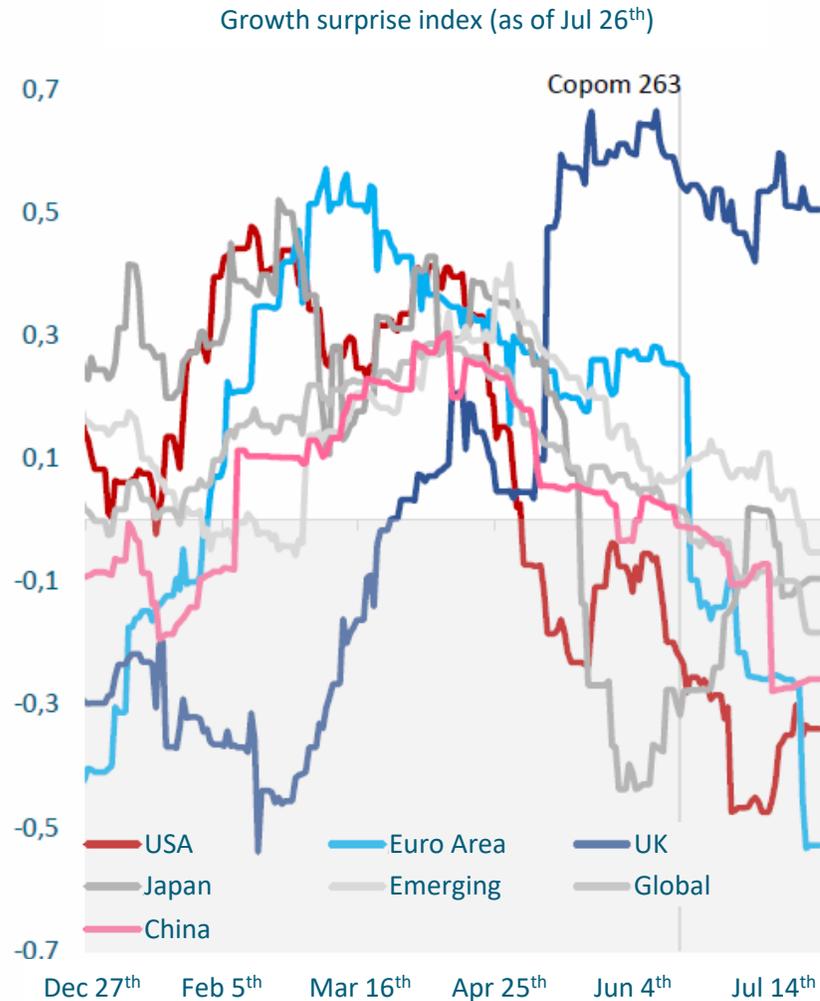
Diogo Guillen – Deputy Governor for Economic Policy

September 5th, 2024

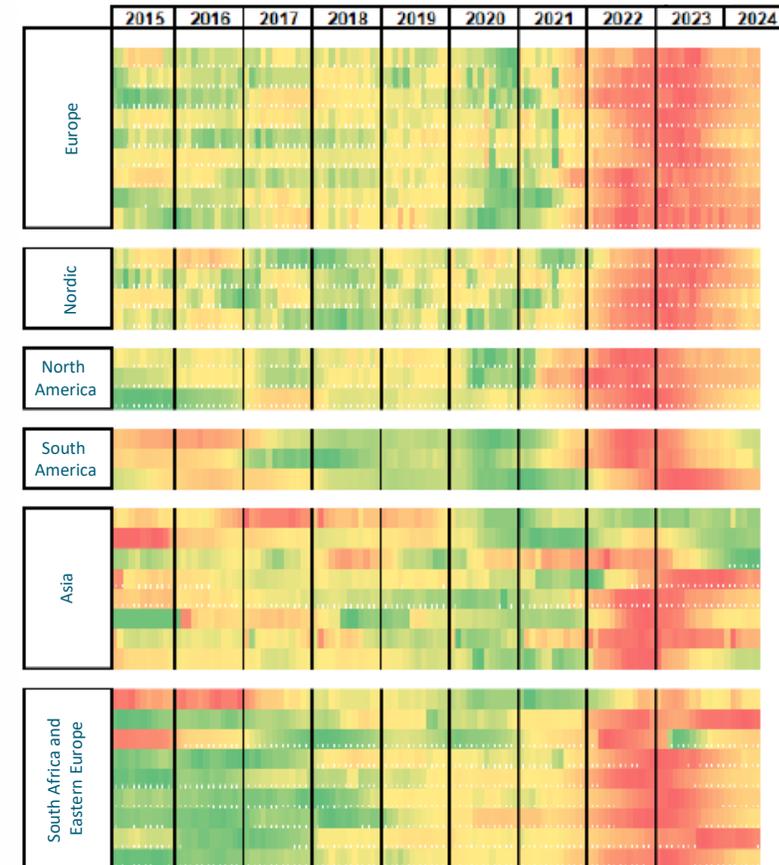
External scenario

External scenario – Economic activity and inflation

Adverse environment and uncertainties about the economic activity and inflation persist in many countries



Heatmap* core inflation YoY



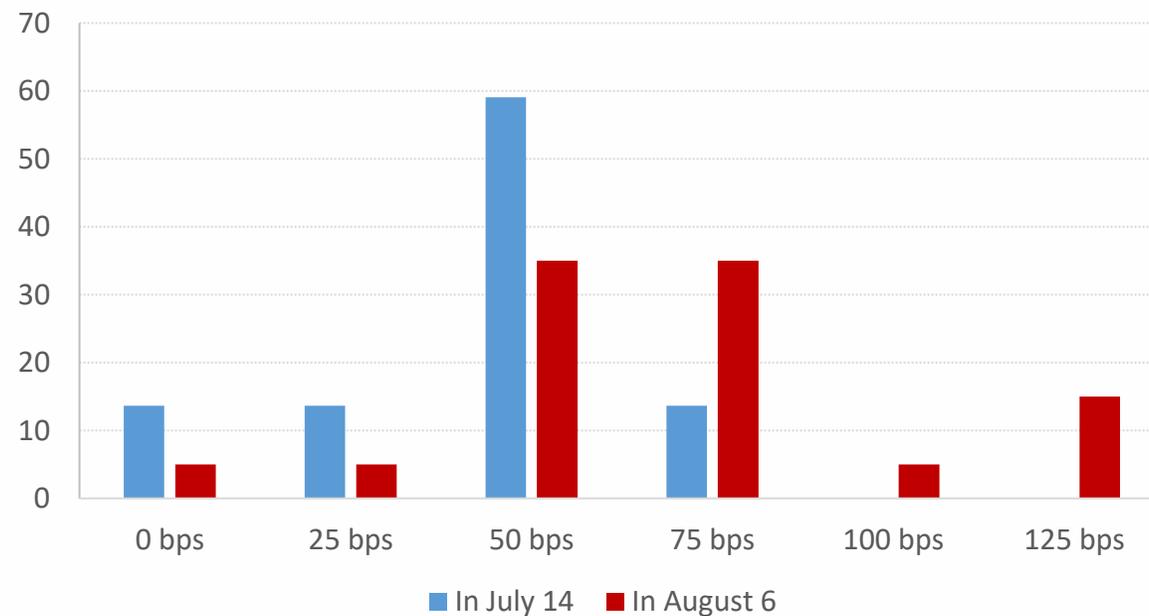
*colors based on data since 2015

External scenario – Monetary policy

The external environment remains adverse, because of the uncertainty about the effects and extension of the easing cycle in the United States.

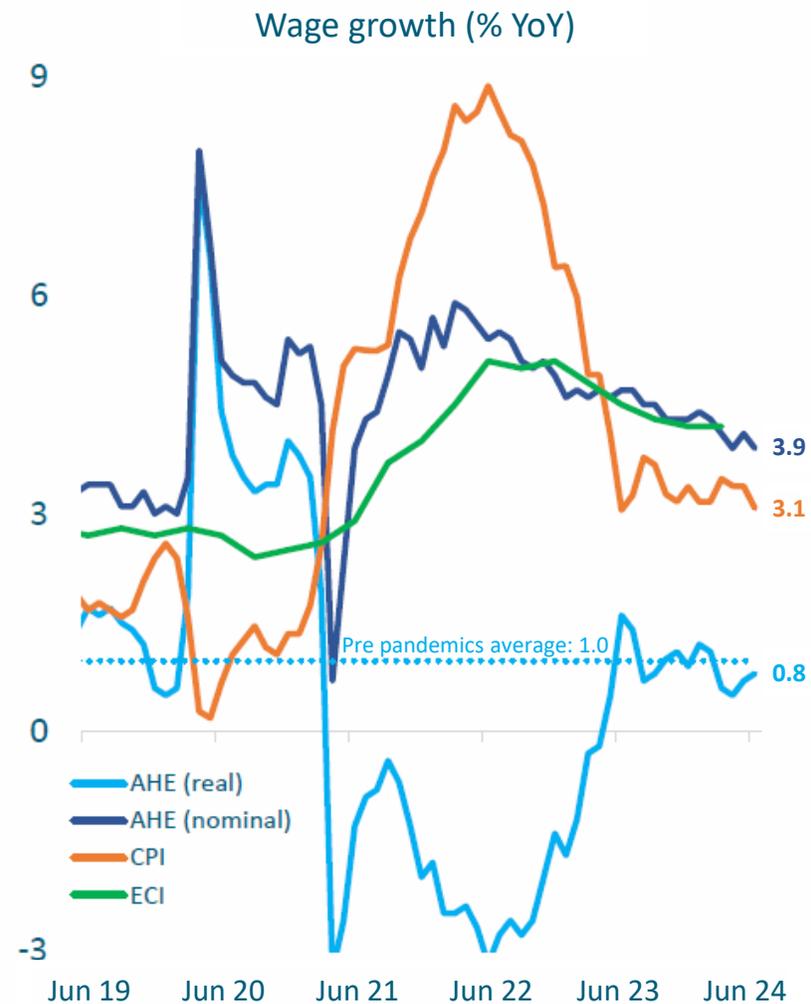
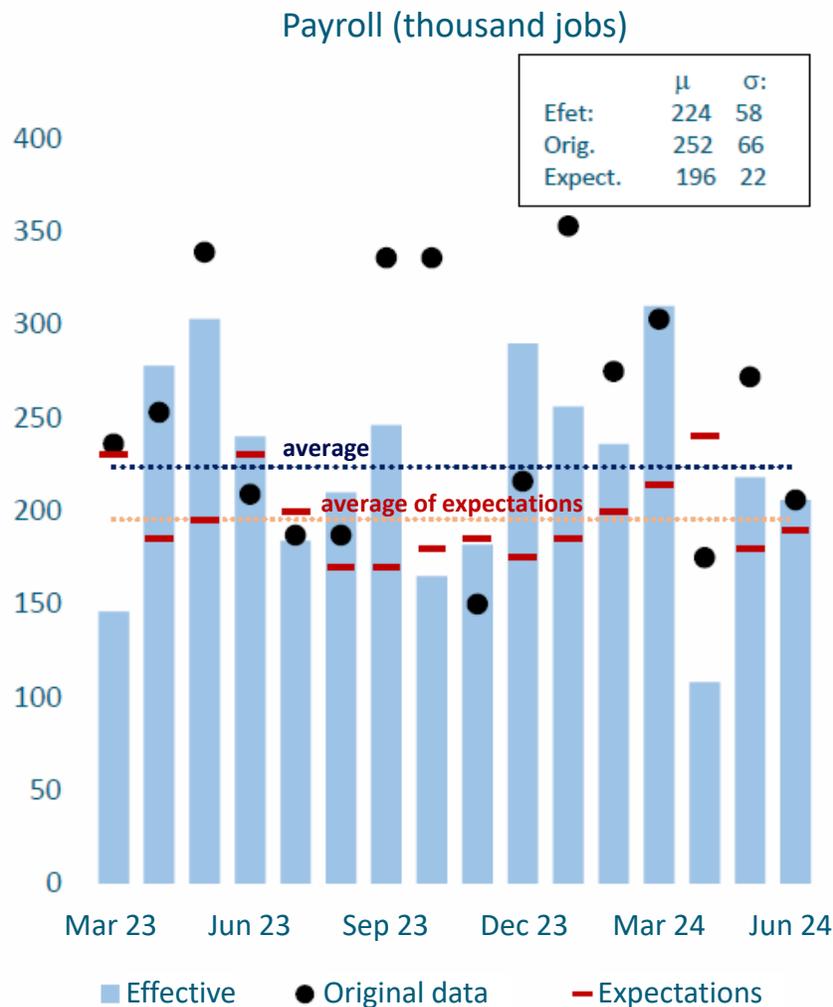


Expected cumulative cuts in 2024
(frequency %)



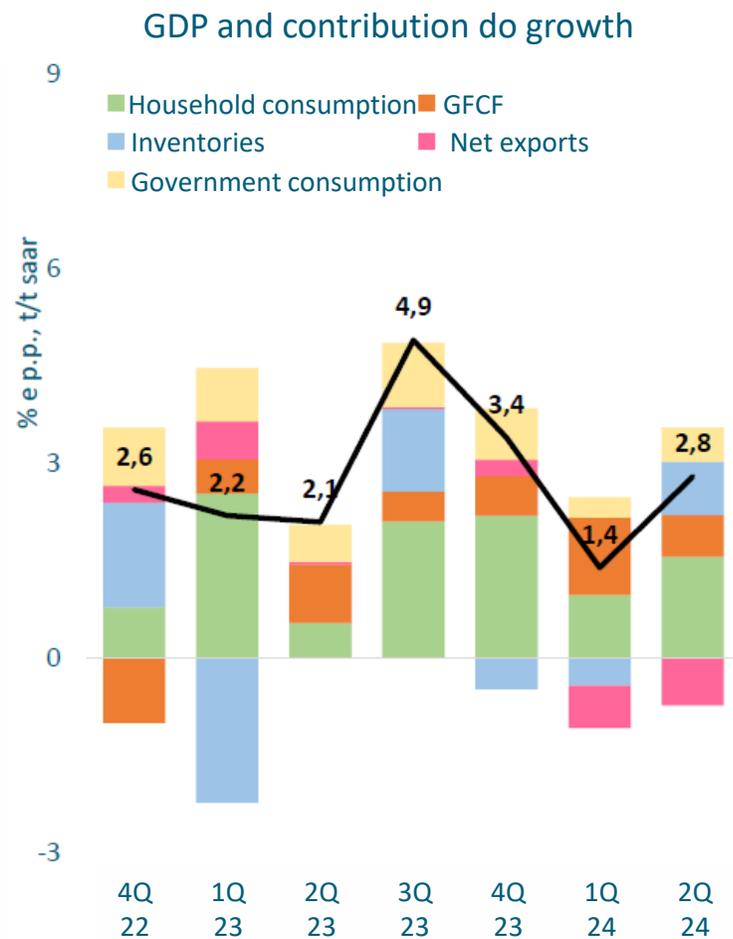
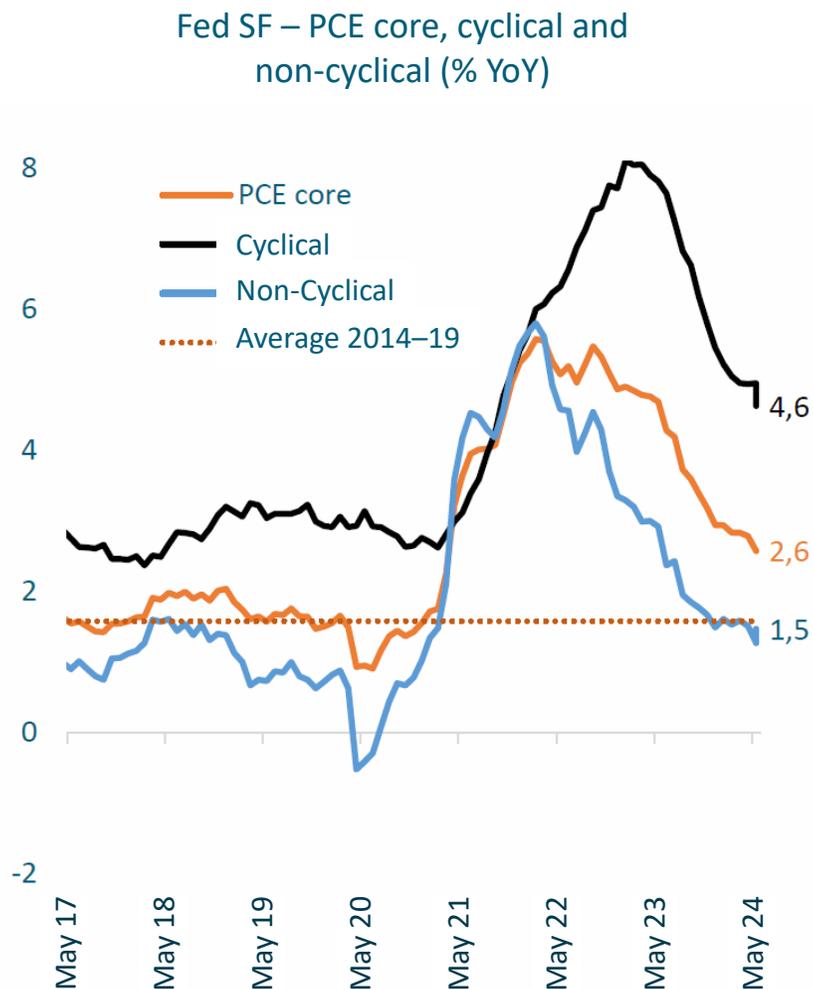
External scenario – Monetary policy

The global environment remains adverse because of the uncertainty about the effects and extension of the easing cycle in the United States: deceleration in employment data



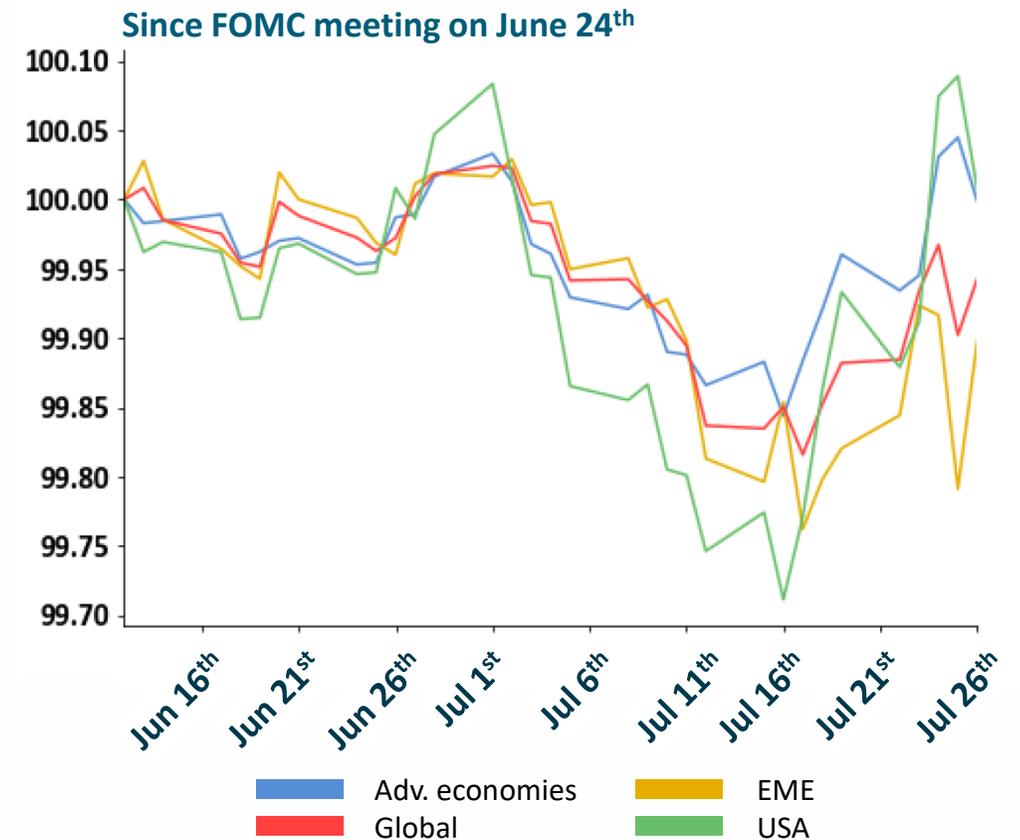
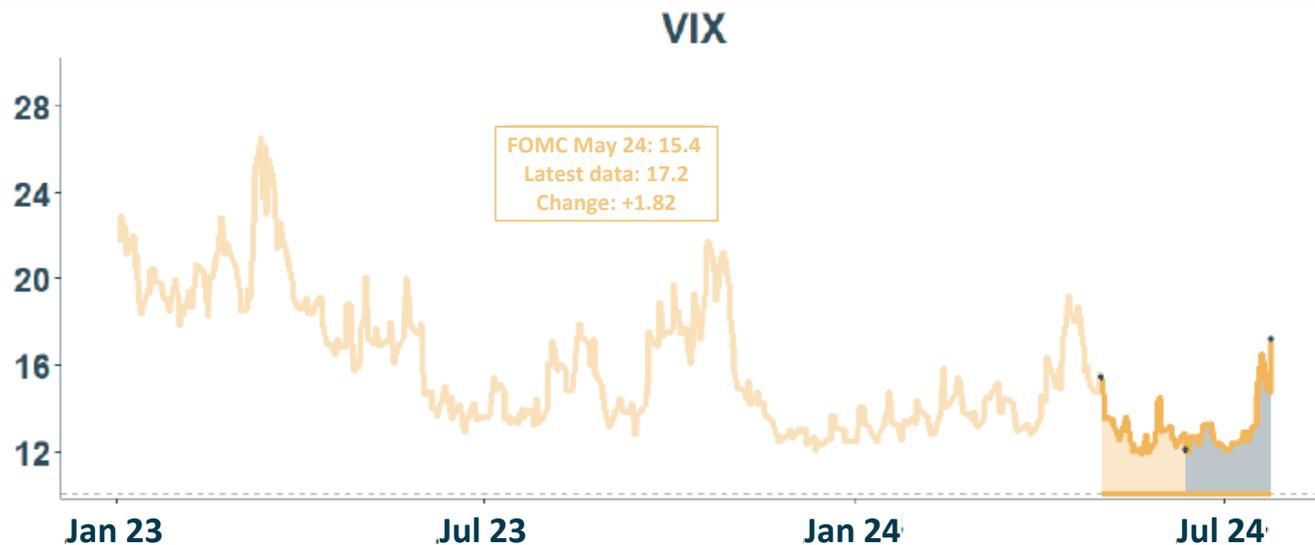
External scenario – Monetary policy

The global environment remains adverse because of the uncertainty about the effects and extension of the easing cycle in the United States: current data suggest resilience



External scenario – Monetary policy

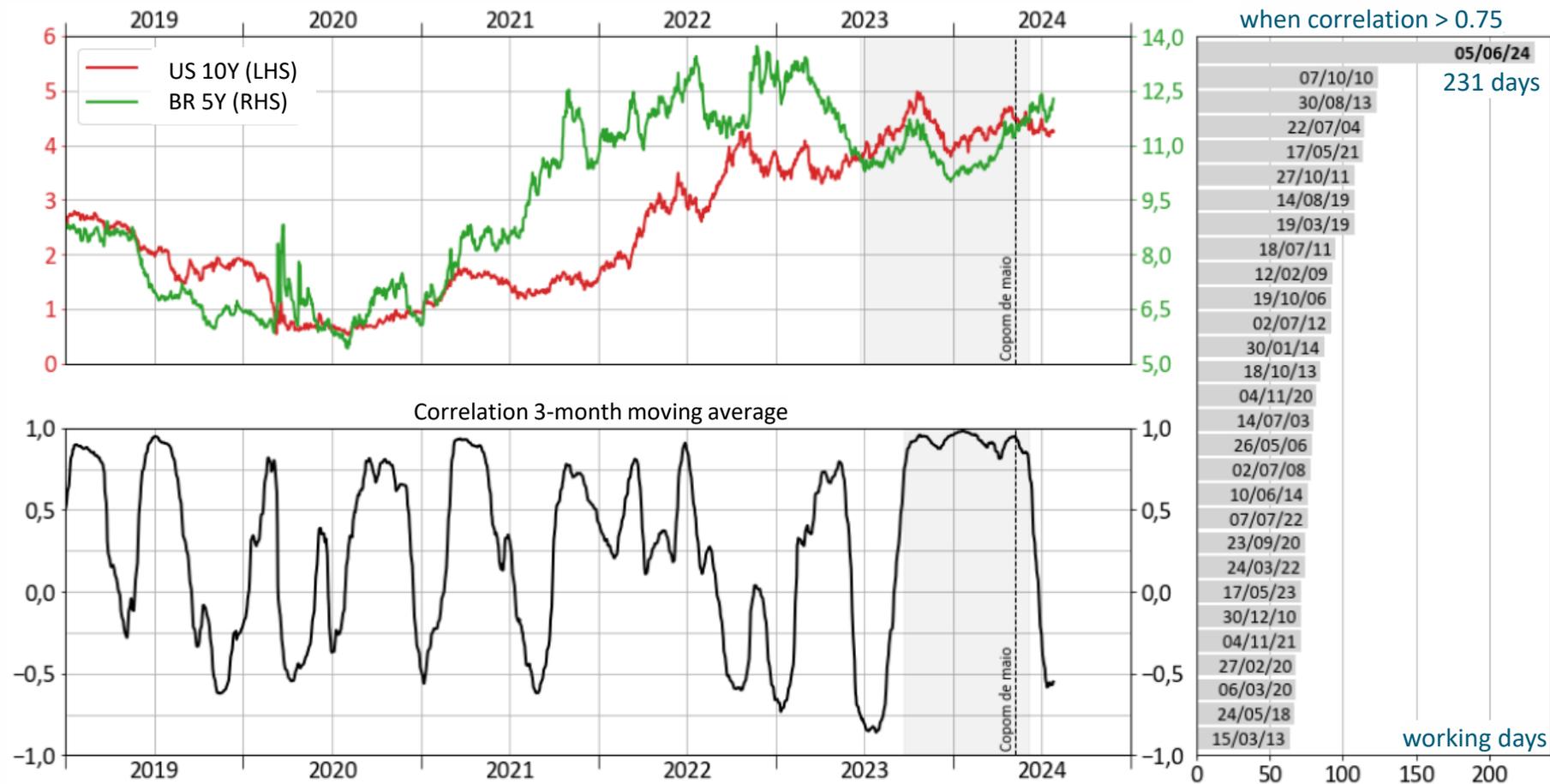
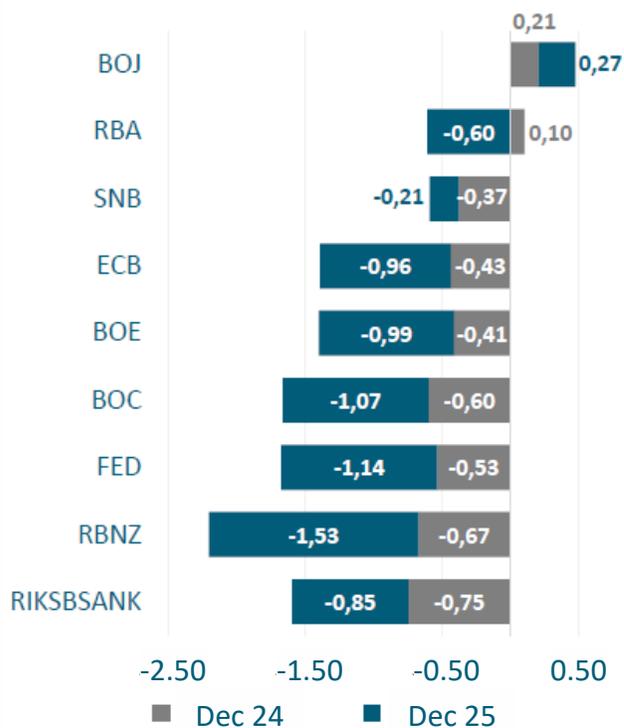
The global environment remains adverse because of the uncertainty about the effects and extension of the easing cycle in the United States: financial conditions have remained tight



External scenario – Monetary policy

Less synchrony in easing cycles contributes to volatility in markets

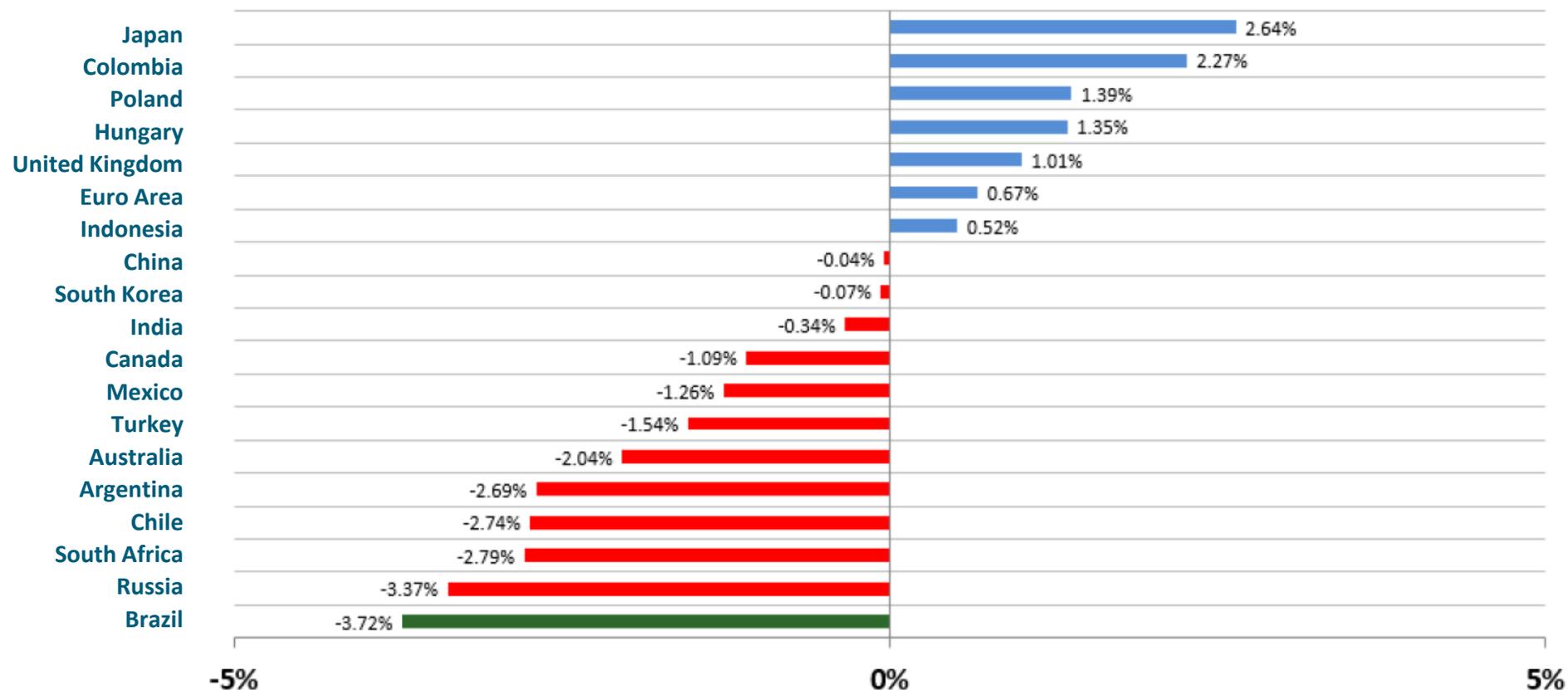
Implicit change on yield curve
(Difference relative to effective
Interest rate and current monetary policy)



External scenario – Currencies

The exchange rates of emerging market economies have depreciated recently, reflecting a more challenging scenario for these economies

FX cumulative change between Copom meetings



Additional comments

- Volatility and pricing of financial assets
- A data point is not a trend, but a trend is made up of data points
- There is no mechanical relationship with FX rate nor with the FED
- A scenario of greater global uncertainty and more abrupt exchange rate movements require greater caution in the conduct of domestic monetary policy

Economic activity and labor market

Domestic scenario – Economic activity

Economic activity and labor market data continue to exhibit more strength than expected by Copom

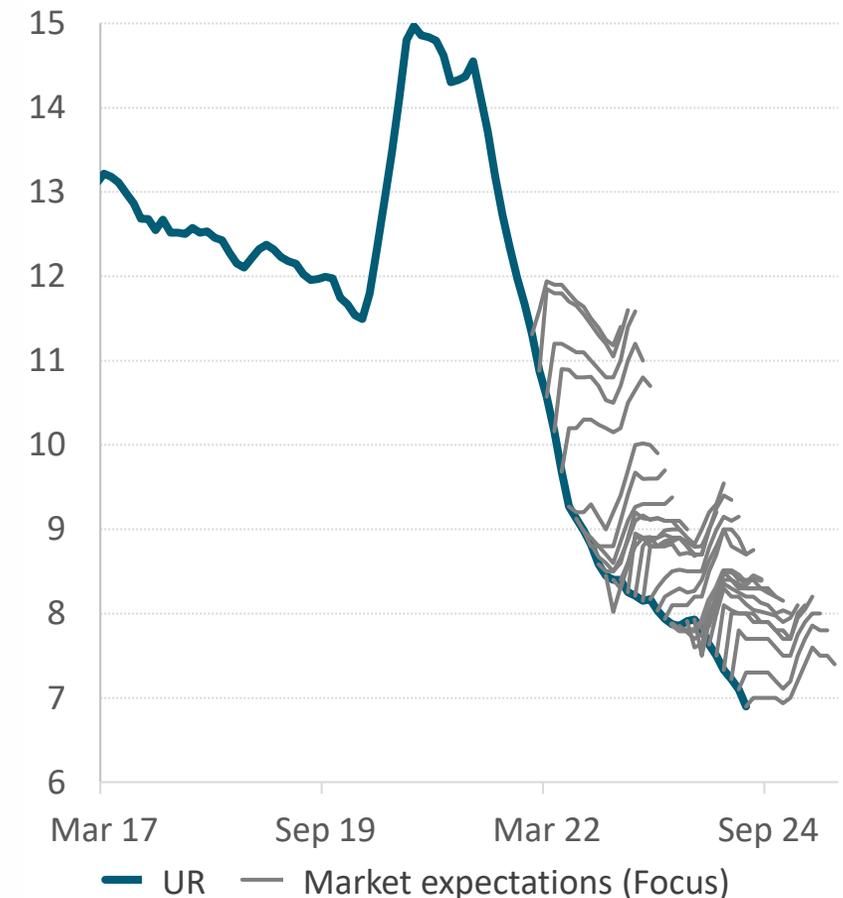
Marginal changes (%) seasonally adjusted

	1Q24	Apr24	May24	Jun24	2Q24 ^{1/}	Carry-over ^{2/}	
						3Q24	2024
Industrial output	0.5	-0.3	-1.5	4.1	0.7	2.2	3.1
Mining	-4.0	-3.6	3.4	2.5	-0.6	2.7	1.0
Manufacturing	1.3	0.4	-2.5	4.5	0.9	2.1	3.5
Restricted retail trade	2.3	0.9	1.2	...	2.3	0.4	5.0
Broad concept	2.9	-0.8	0.8	...	0.3	0.3	3.8
Broad concept ex wholesale	2.5	0.3	1.0	...	1.7	0.3	5.6
Services	0.6	0.3	0.0	...	0.5	0.0	1.2
Services to families	1.0	-2.7	3.0	...	-0.2	1.0	4.1
IBC-Br	1.4	0.3	0.2	...	0.4	0.1	1.9

1/ Quarter for industry para a PIM. For others, May carry-over

2/ Carry-over as of June to Industry and May to others

Unemployment rate (UR) and market expectations (%)

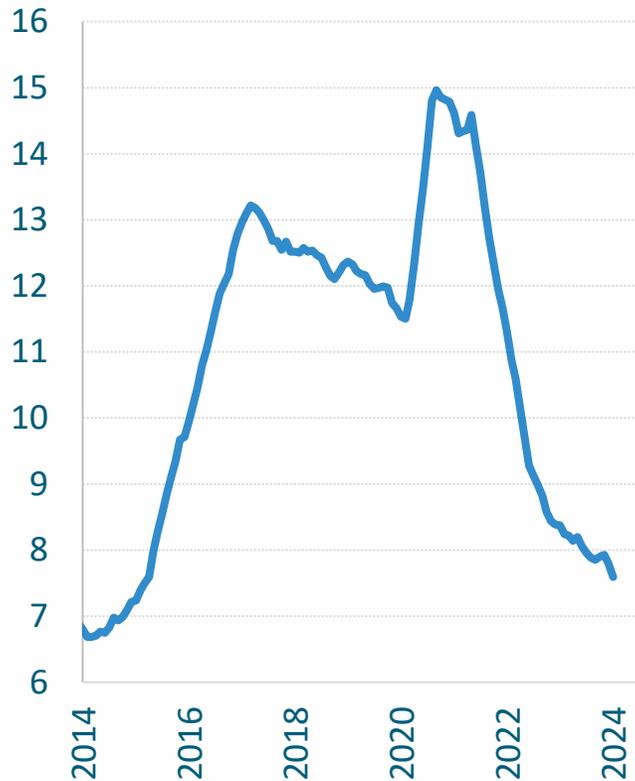


Domestic scenario – Economic activity

This movement occurs in a context of an output gap close to neutrality

Unemployment rate

%; s.a. 3MMA



Formal Jobs creation

thousand jobs, 3MMA, s.a.



Manufacturing Capacity Utilization

%; s.a.



Sources: IBGE, Ministério do Trabalho and FGV

Domestic scenario – Economic activity

This movement occurs in a context of an output gap close to neutrality

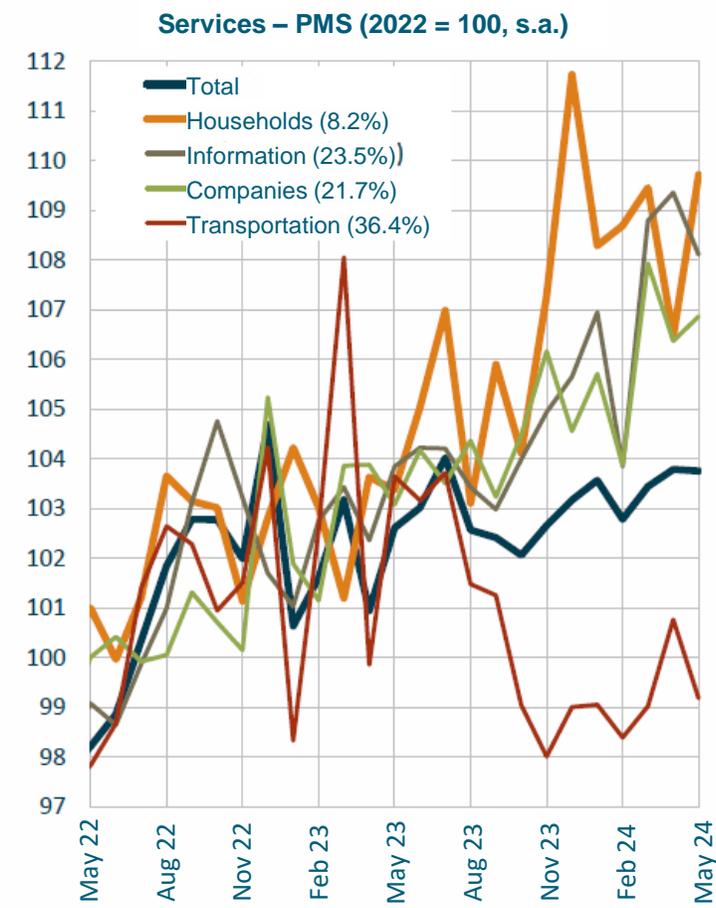
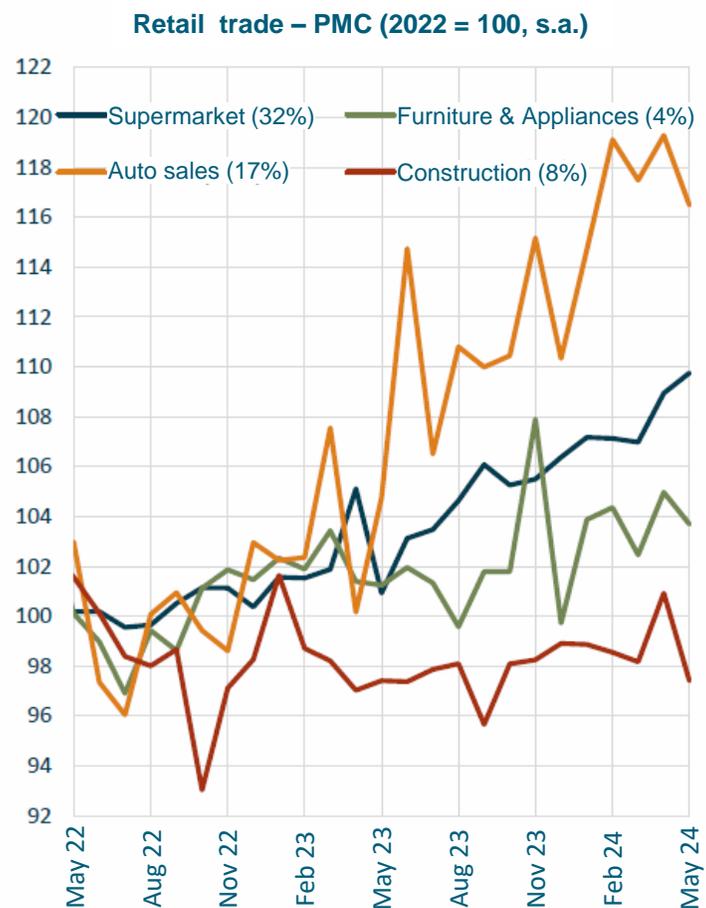
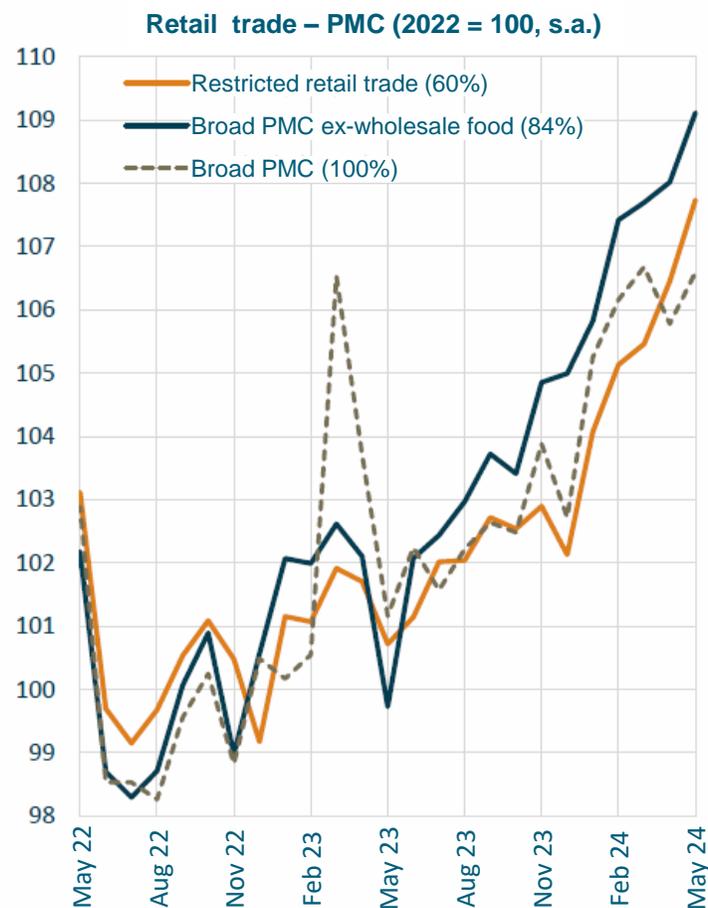
Output gap levels from 2023Q1 to 2024Q1 by type of methodology

	2023				2024	%
	Q1	Q2	Q3	Q4	Q1	
Statistical univariate gaps						
Quadratic trend	0.57	1.00	0.49	0.00	-0.21	
Non-parametric trend	0.07	0.69	0.35	0.02	-0.04	
Hodrick-Prescott	1.07	1.53	1.03	0.54	0.33	
l_1 trend	0.93	1.47	1.04	0.62	0.47	
Modified Hodrick-Prescott	0.23	0.64	0.24	-0.09	-0.17	
Band-pass	0.38	0.53	0.52	0.33	0.02	
Beveridge-Nelson	0.41	0.63	0.22	-0.18	-0.28	
Multivariate gaps						
Production Function	0.97	1.67	1.35	1.49	2.31	
Areosa	0.70	0.79	0.47	0.24	0.48	
CBO	1.07	1.65	1.96	2.33	2.37	
Jarocinski & Lenza	0.15	0.74	0.79	0.82	1.22	
Principal components	1.06	1.31	1.16	0.89	1.10	
Summary						
Mean	0.63	1.06	0.80	0.58	0.63	
Median	0.63	0.90	0.66	0.43	0.40	
25th percentile	0.34	0.68	0.44	0.01	-0.08	
75th percentile	1.00	1.49	1.07	0.84	1.13	

<https://www.bcb.gov.br/en/publications/inflationreportboxes>
 “Output gap measures in Brazil”, Inflation Report Box in June 2024

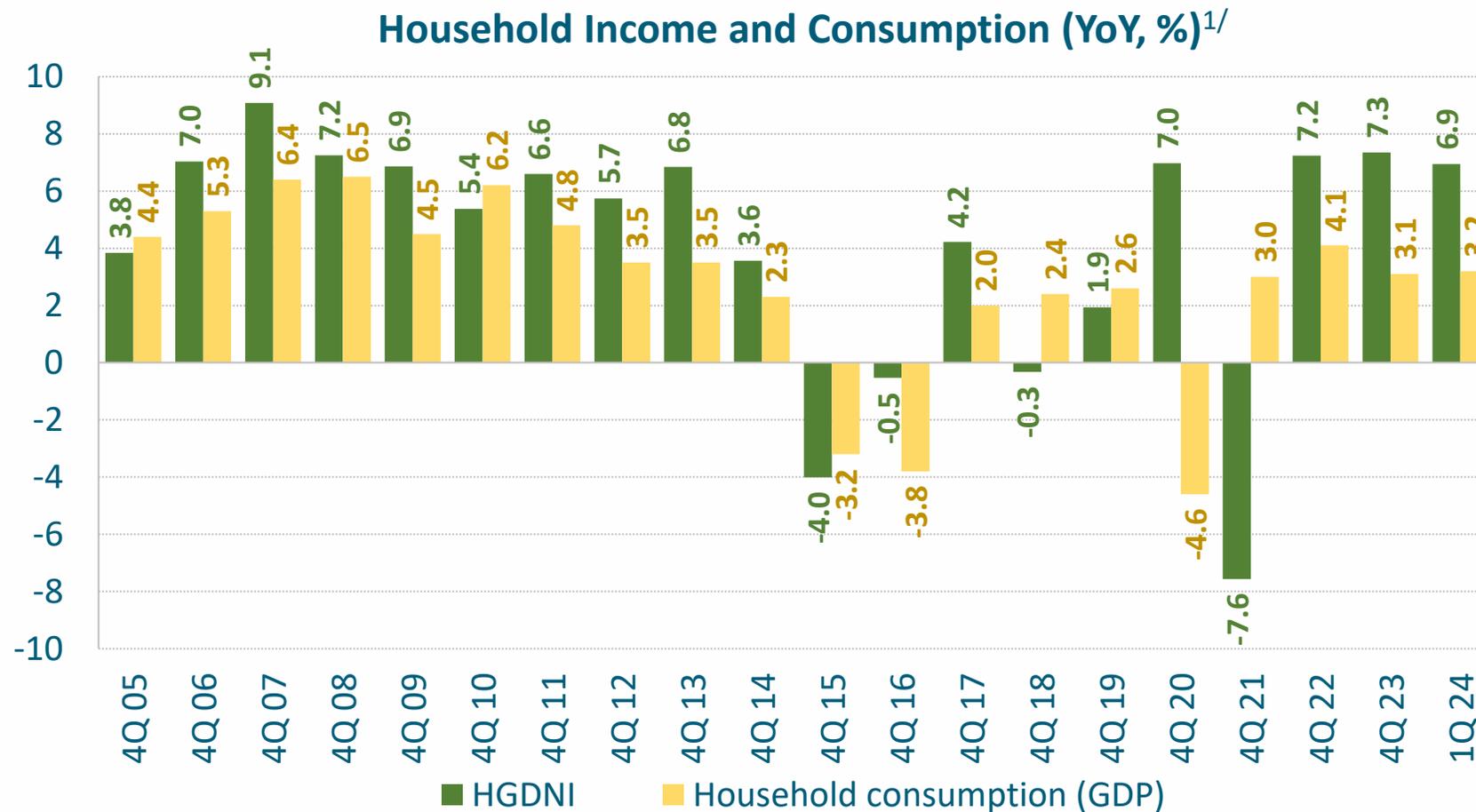
Domestic scenario – Economic activity

The dynamism of higher frequency indicators, such as of trade and services, reinforces the prospect of resilience in domestic activity



Domestic scenario – Sustained consumption

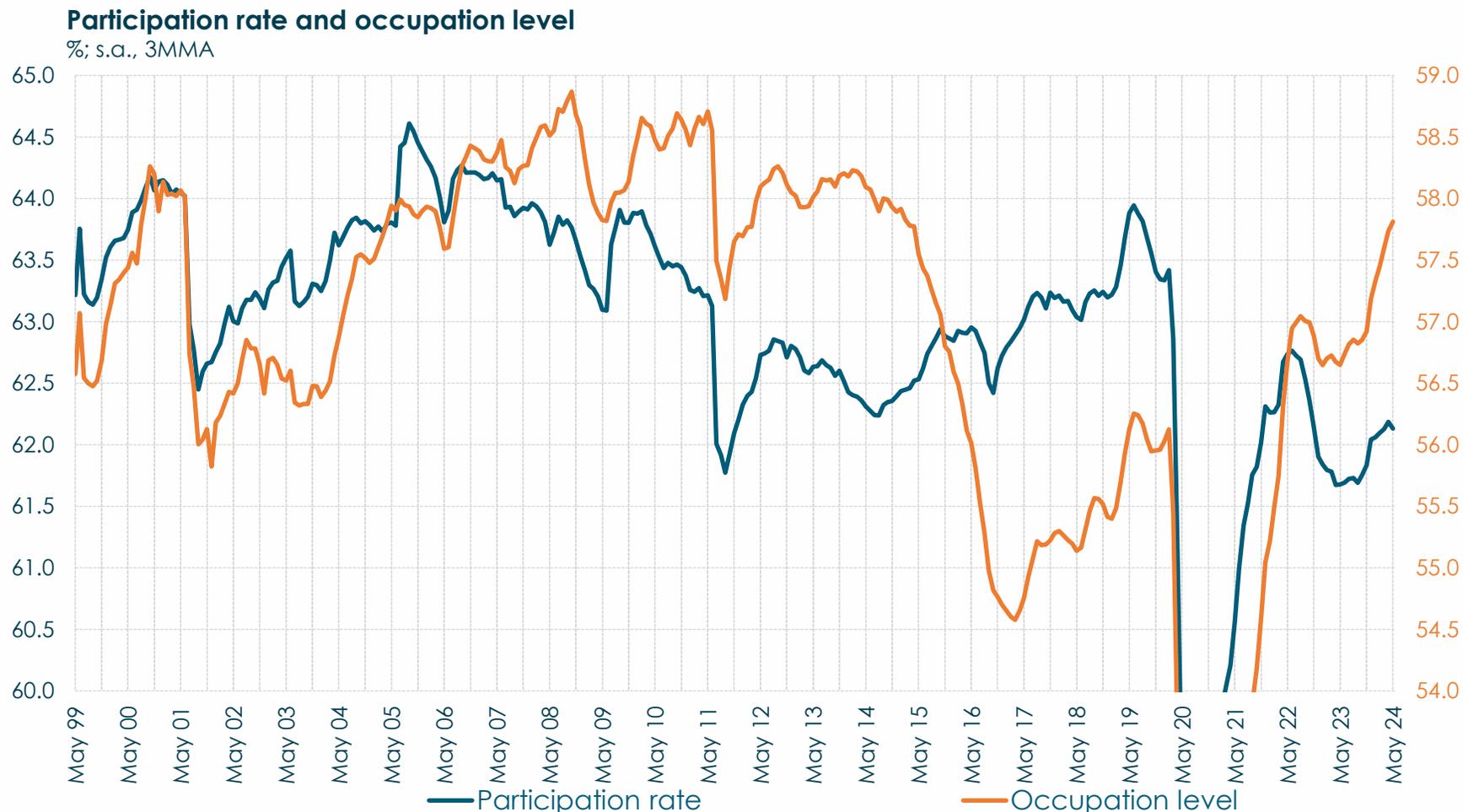
Sustained consumption over time



^{1/} HGDNO Household Gross Disposable National Income

Domestic scenario – High dynamism in the labor market

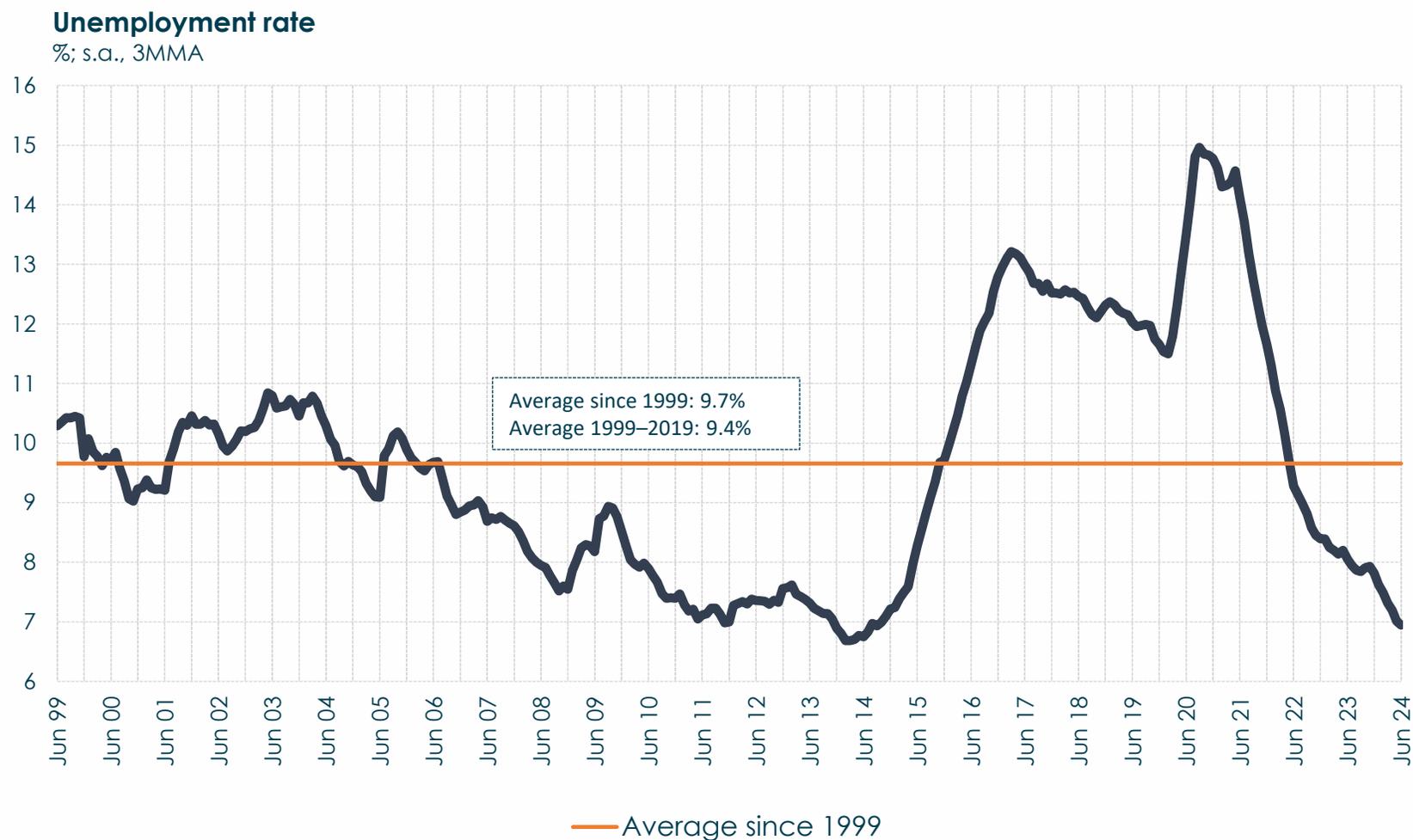
Regarding the labor market, it was pointed out that the level of employment has been systematically surprising



Alves & Fasolo (2015)

Domestic scenario – High dynamism in the labor market

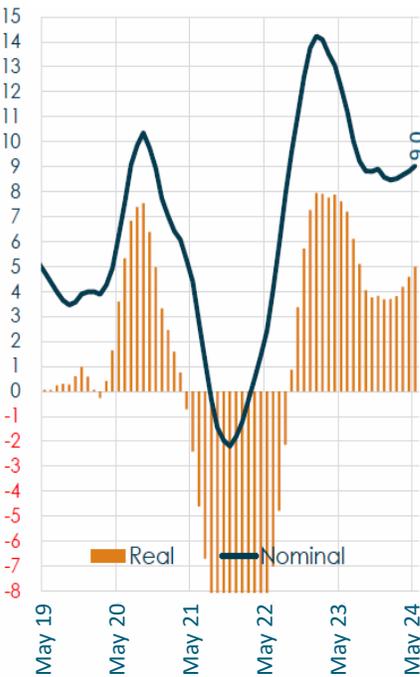
Regarding the labor market, it was pointed out that the unemployment rate has been systematically surprising



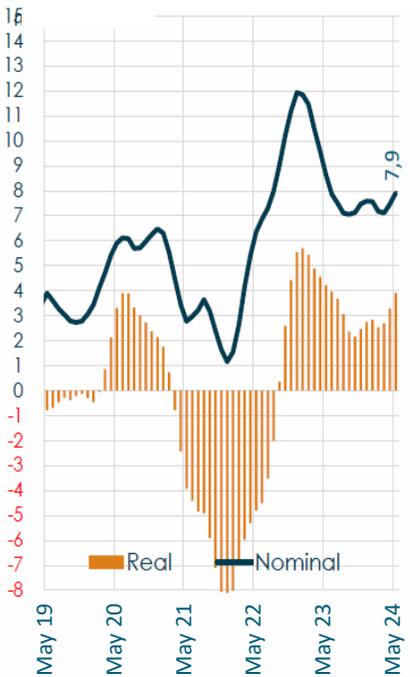
Domestic scenario – High dynamism in the labor market

Regarding the labor market, it was pointed out that income has been systematically surprising

Usually received Earnings (PNAD)
3MMA, YoY (%)



Usually received Earnings (PNAD)
People with formal jobs
3MMA, YoY (%)



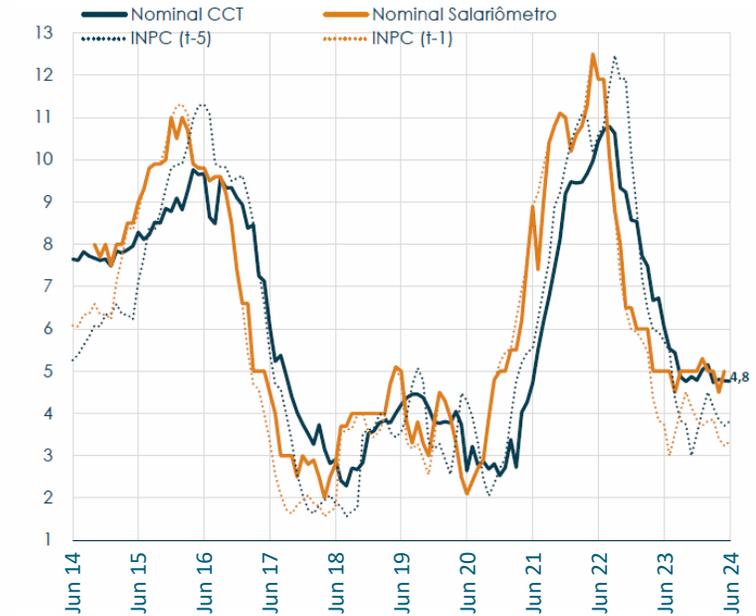
Hiring salary (CAGED)
3MMA, YoY (%)



Salary (IDAT)
3MMA, YoY (%)



Collective bargaining agreements
YoY (%)



Domestic scenario – Fiscal

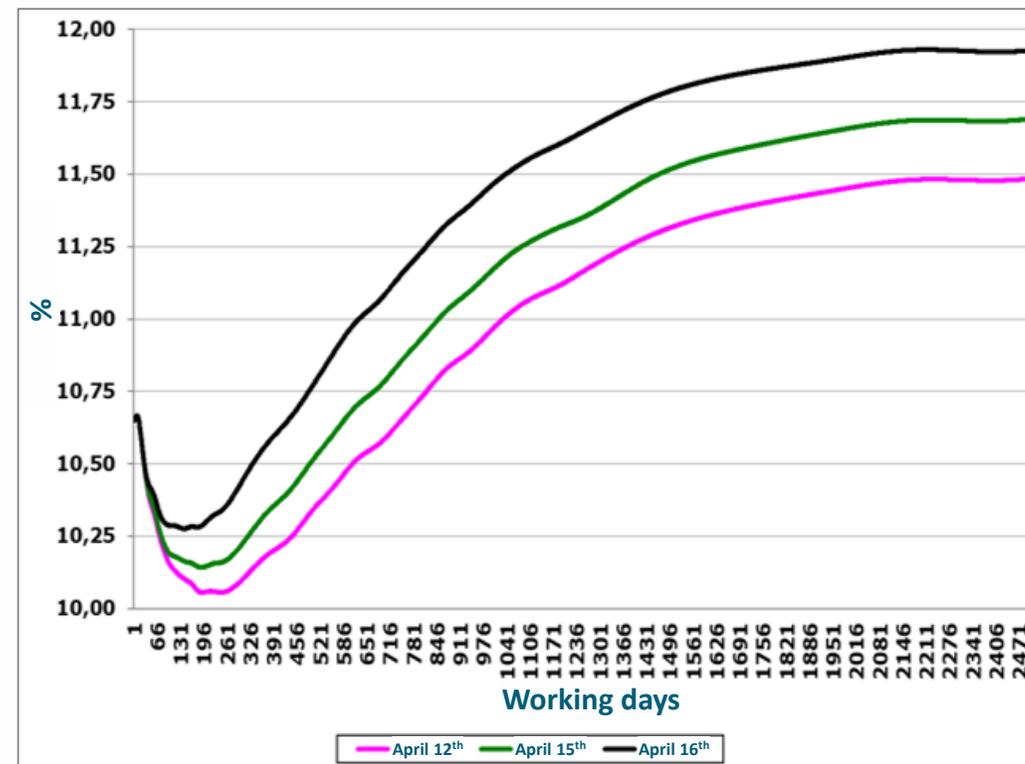
The Committee closely monitors how the recent developments on the fiscal side impact monetary policy and financial assets

Estimates of Government Spending Multipliers Using Aggregate Data, No State Dependence

(almost all are cumulative multipliers, typically over horizons between 0 to 20 quarters)

Method/Sample	Multipliers	Comments
A: Time series analysis		
Updated implementation of Blanchard and Perotti (2002) identified SVAR 1939Q1–2015Q4 1947Q1–2015Q4	0.6 to 0.8 0.6 to 0.7	The tax response is positive for the 1939Q1–2015Q4 period, but is essentially 0 for the later periods.
Military news shocks, local projections Ramey and Zubairy (2018) military news 1889Q1–2015Q4 1939Q1–2015Q4 1947Q1–2015Q4	0.6 to 0.8 0.7 to 0.8 0.5 to 0.7	Tax response is positive for 1939Q1–2015Q4 period. SE from 0.04 to 0.06 SE from 0.05 to 0.1 SE from 0.15 to 0.2
Ben Zeev and Pappa (2017) news, 1947Q1–2007Q4 ²	1.1 to 2	SE from 0.6 to 1
Hall (2019), Barro and Redlick (2011)— based on regressions using annual defense spending.	0.6 to 0.7	The Barro–Redlick analysis nets out effects of changes in tax rates.
Mountford and Uhlig (2009), SVAR with sign restrictions	0.65	Deficit-financed increase in government spending.
Iltetzki, Mendoza, and Végh (2013), Blanchard–Perotti identification in SVAR, quarterly data, 1960–2007, 44 countries high-income countries	0.3 to 0.7	

Yield curve (DI future market)
Fiscal targets revision on April 15th



Domestic scenario – Fiscal

More recent market agents' perception of public spending growth and of the sustainability of the current fiscal framework, coupled with other factors, has had a significant impact on asset prices and expectations

How do you assess the evolution of the fiscal situation since the last Copom, considering both its current scenario and the risks involved?

	Worse	No relevant changes	Better
Copom 242	80%	17%	2%
Copom 243	70%	23%	8%
Copom 244	69%	22%	10%
Copom 245	50%	28%	22%
Copom 246	24%	57%	19%
Copom 247	69%	23%	8%
Copom 248	93%	4%	3%
Copom 249	46%	44%	9%
Copom 250	21%	72%	7%
Copom 251	91%	9%	0%
Copom 252	66%	28%	6%
Copom 253	12%	69%	19%
Copom 254	26%	46%	28%
Copom 255	10%	48%	42%
Copom 256	11%	64%	25%
Copom 257	37%	56%	7%
Copom 258	27%	68%	5%
Copom 259	41%	51%	8%
Copom 260	29%	57%	14%
Copom 261	13%	48%	39%
Copom 262	79%	18%	3%
Copom 263	78%	20%	2%
Copom 264	30%	49%	21%

- The Committee stresses that a credible fiscal policy, committed to debt sustainability, contributes to the anchoring of inflation expectations and to the reduction in the risk premia of financial assets, therefore impacting monetary policy.
- Synchronous and countercyclical monetary and fiscal policies help ensure price stability and, without prejudice to its fundamental objective, smooth out fluctuations in the economic activity level and foster full employment.

Inflation

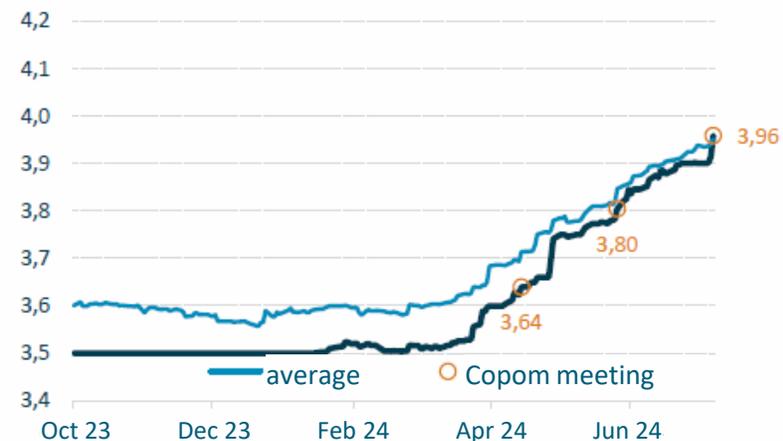
Domestic scenario – Inflation expectations

The Committee unanimously believes that the reanchoring of inflation expectations should be pursued and the committee will continue to make decisions that safeguard credibility

2024 CPI expectations (median %)



2025 CPI expectations (median %)



2026 CPI expectations (median %)

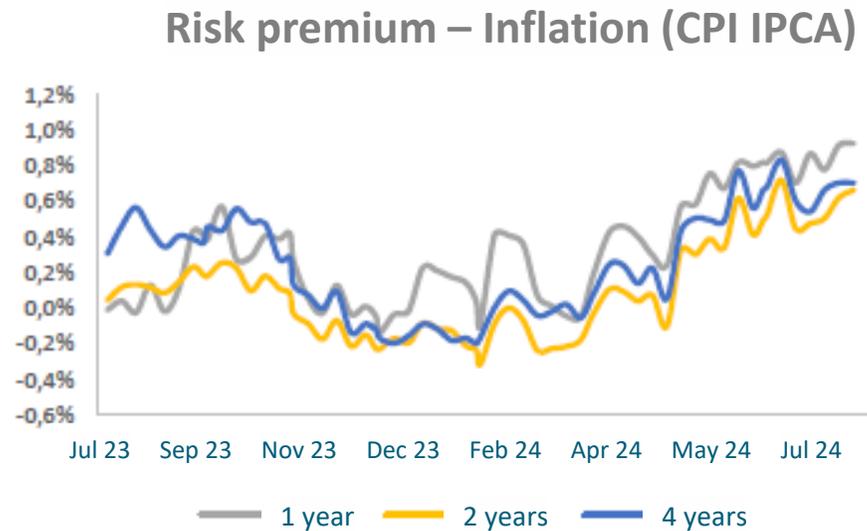
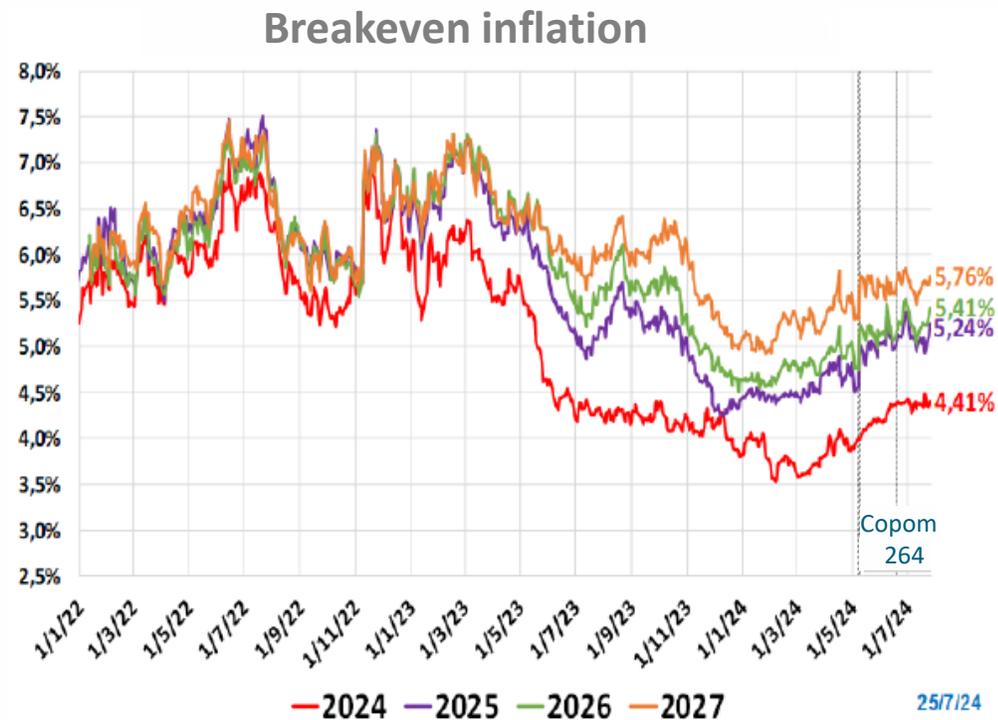


2027 CPI expectations (median %)



Domestic scenario – Inflation expectations

Breakeven inflation and inflation risk premium



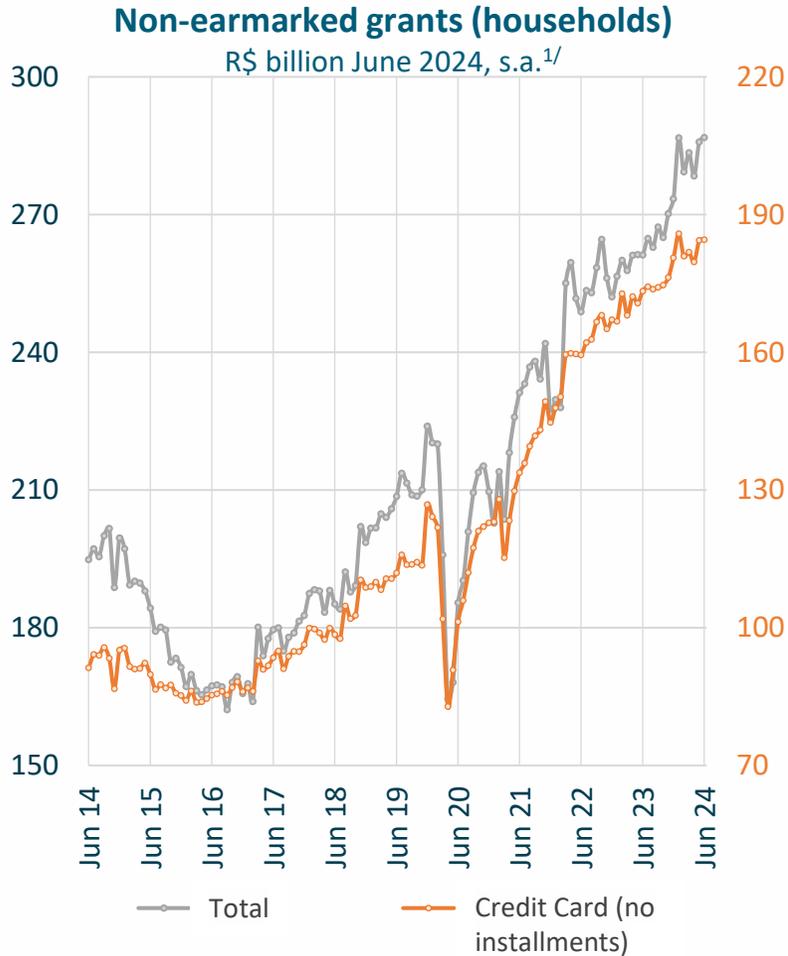
Note: risk premia calculated by Vicente & Kubudi (2018) methodology

Domestic scenario – Inflation and FX expectations

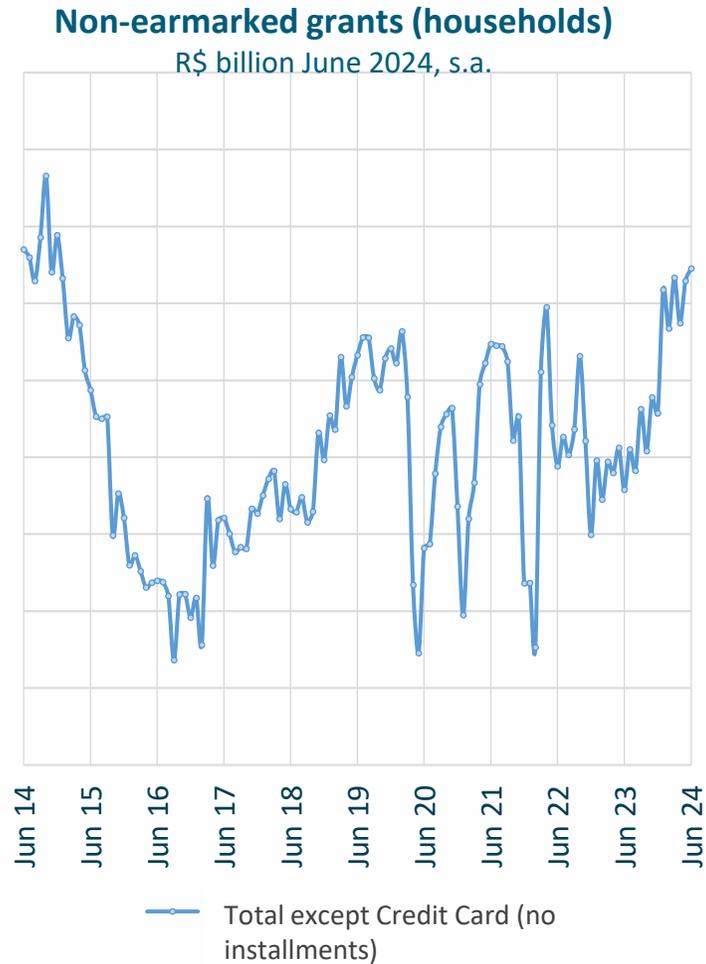
- If movements in inflation and exchange rate expectations prove to be persistent, the resulting inflationary impacts may be significant and will be duly incorporated by the Committee

Domestic scenario – Credit

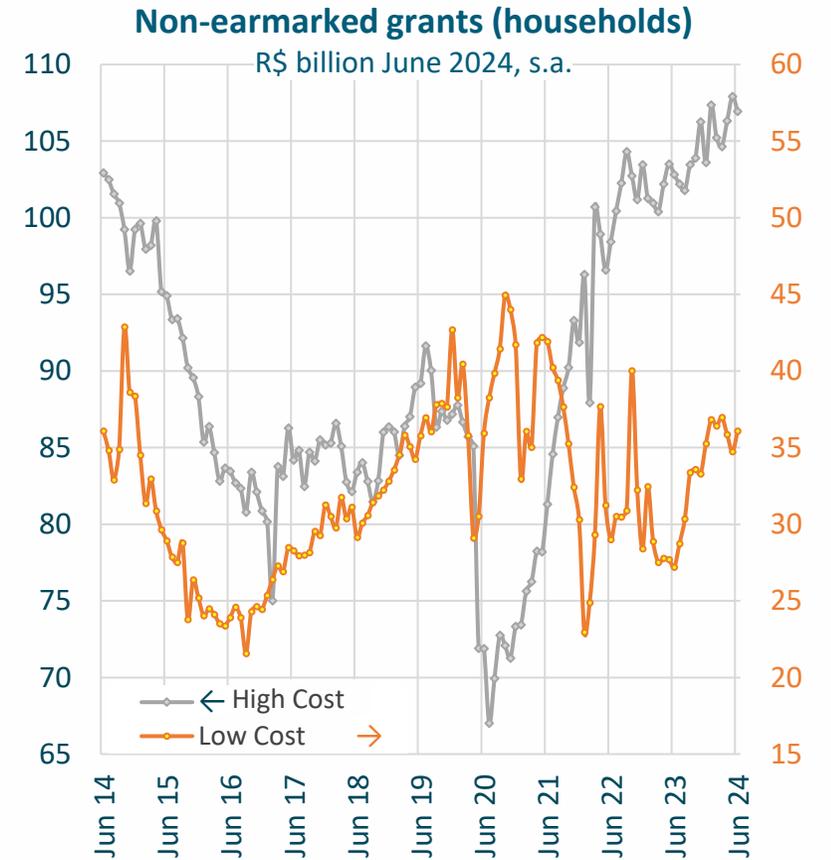
The credit cycle remains benign, with volume expansion



220
190
160
130
100
70



220
190
160
130
100
70



60
55
50
45
40
35
30
25
20
15

Not including revolving and installment cards.

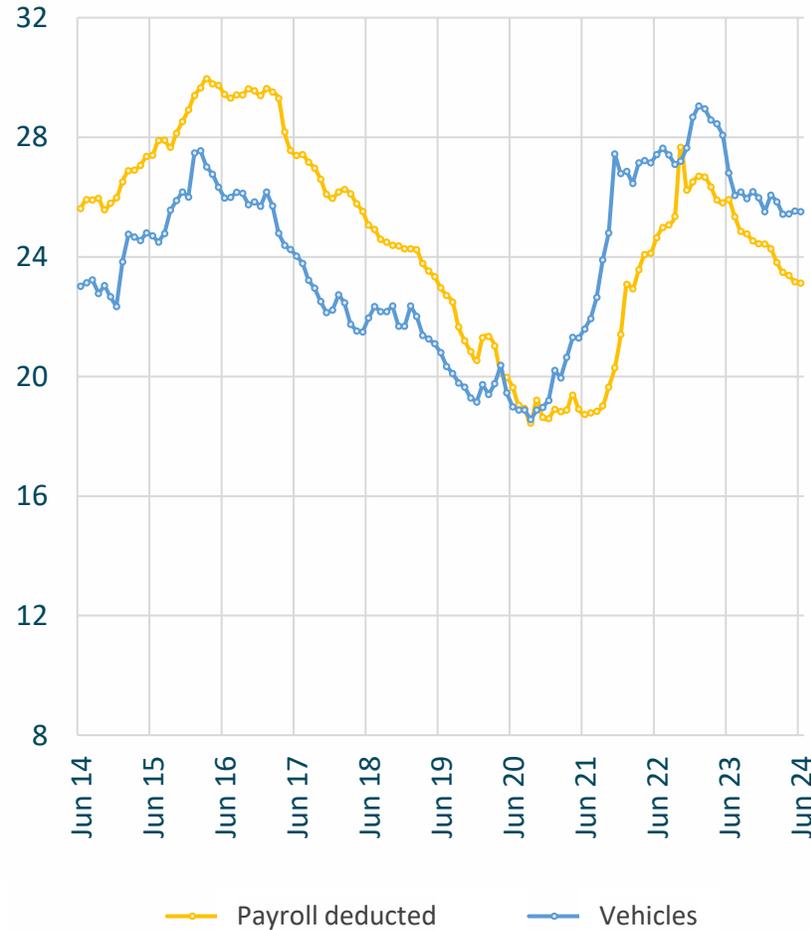
Domestic scenario – Credit

The credit cycle remains benign, with rate reductions in most credit lines

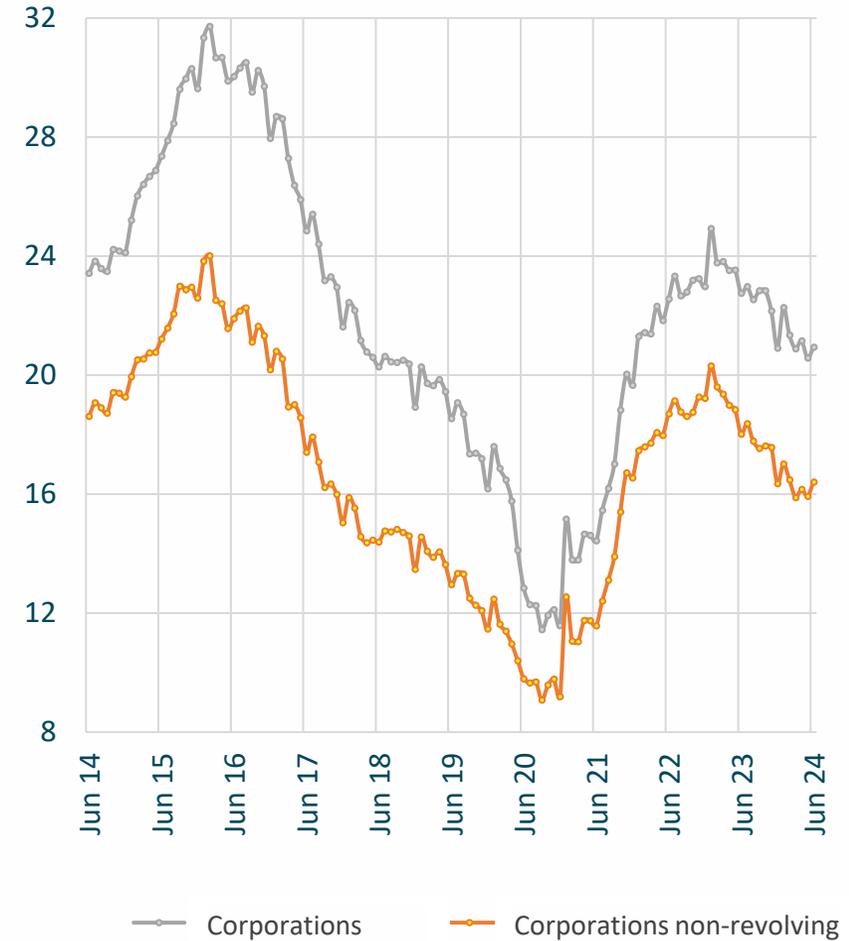
Non-earmarked credit – Interest rates %



Non-earmarked credit – Interest rates %



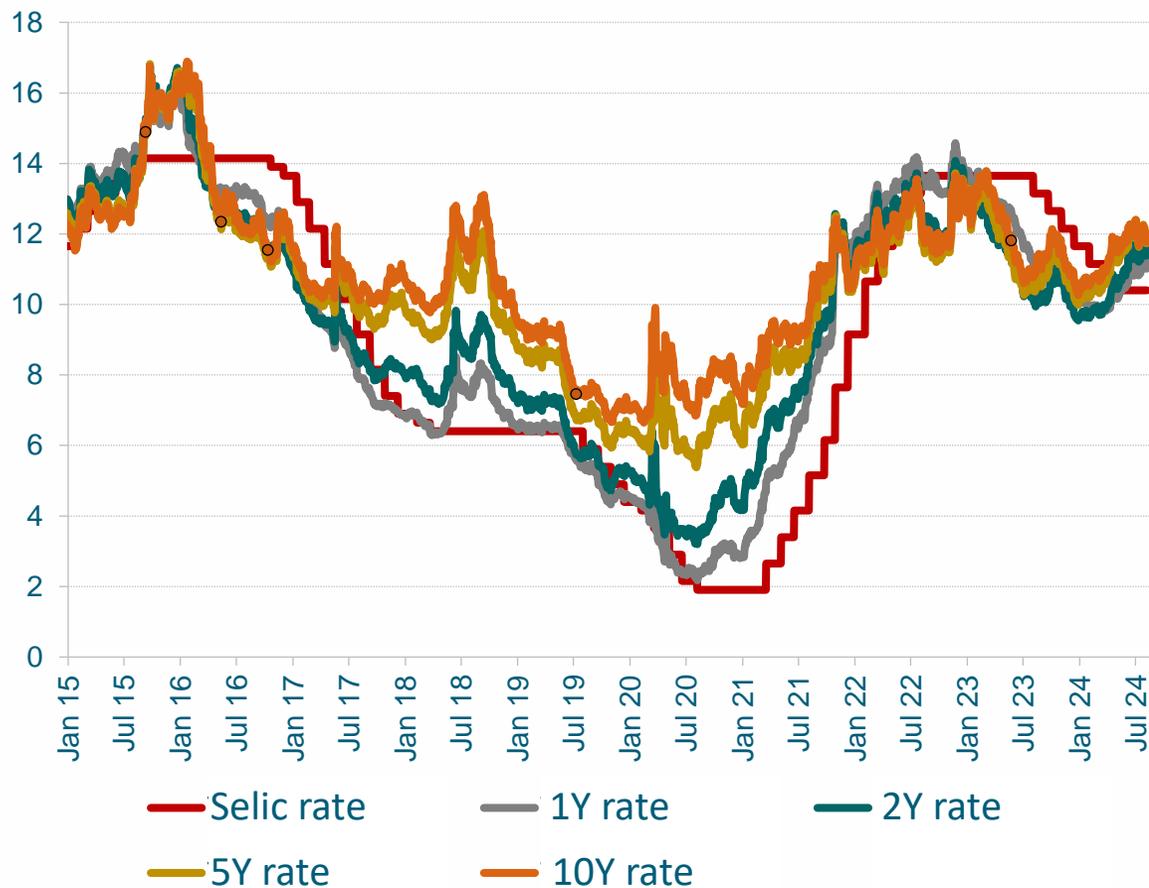
Non-earmarked credit – Interest rates %



Domestic scenario – Credit

Some members emphasized again that the recent increase of longer-term rates could result in lower credit market dynamics

Interest rates (%)

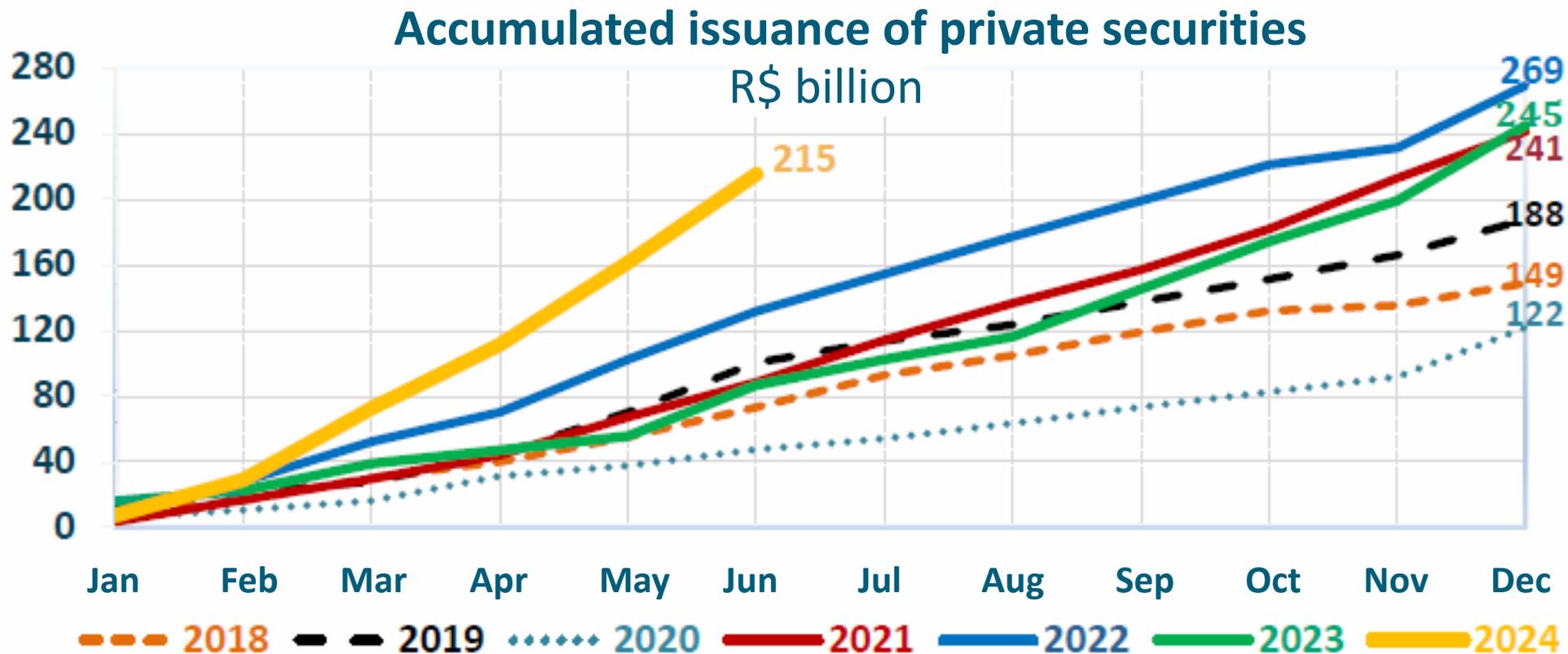


Selic rate pass-through to SFN interest rates (%)

Segment	Credit type	Selic changes lags				12-month pass-through of 1 p.p. of Selic
		3 months	6 months	9 months	12 months	
Non-earmarked household	Other goods	█	█		█	1.64
	Vehicles					0.75
	Overdraft	█	█		█	4.43
	Personal credit	█			█	1.73
Non-earmarked corporate	Other goods	█	█	█		0.86
	Guaranteed overdraft	█	█		█	2.40
	Discount of trade bills			█		1.51
	Working capital			█	█	0.91
	Compror and vendor	█		█		1.07
	ACC		█		█	0.03
	External on-lendings	█	█	█		0.56
Earmarked household	Real estate	█	█		█	0.43
	Rural		█		█	0.41
Earmarked corporate	BNDES			█	█	0.42
	Rural	█		█	█	0.55

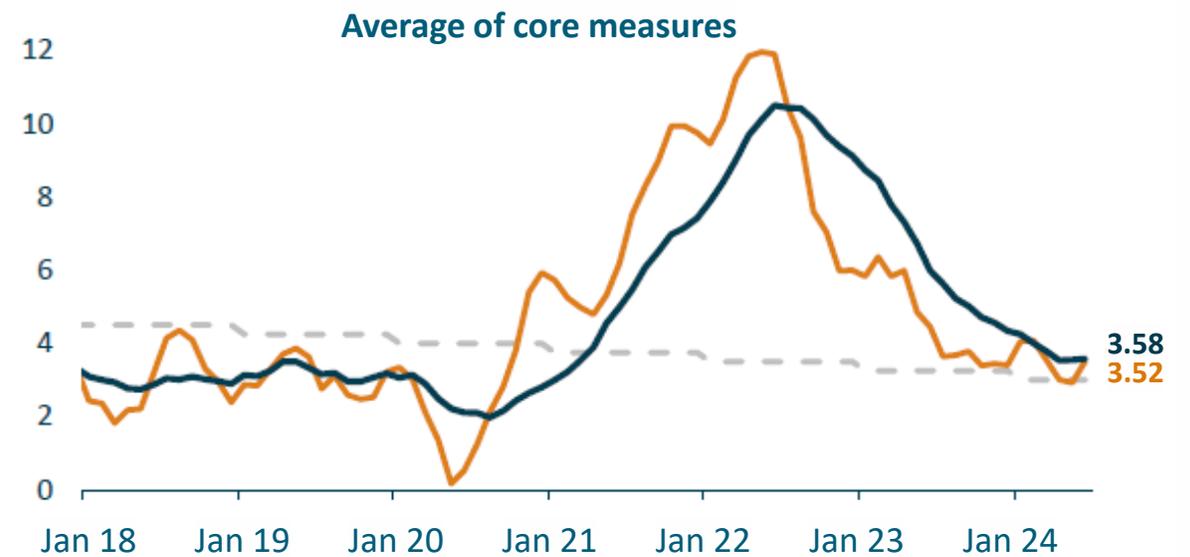
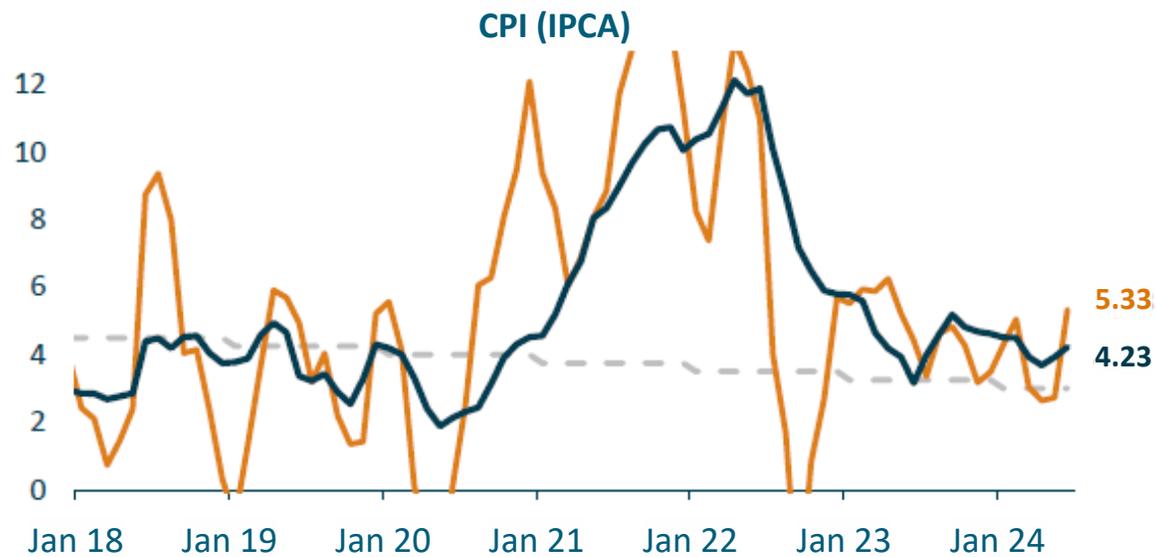
Domestic scenario – Credit

The capital market funding remains strong



Domestic scenario – Inflation

The disinflationary process has slowed down in the more recent period

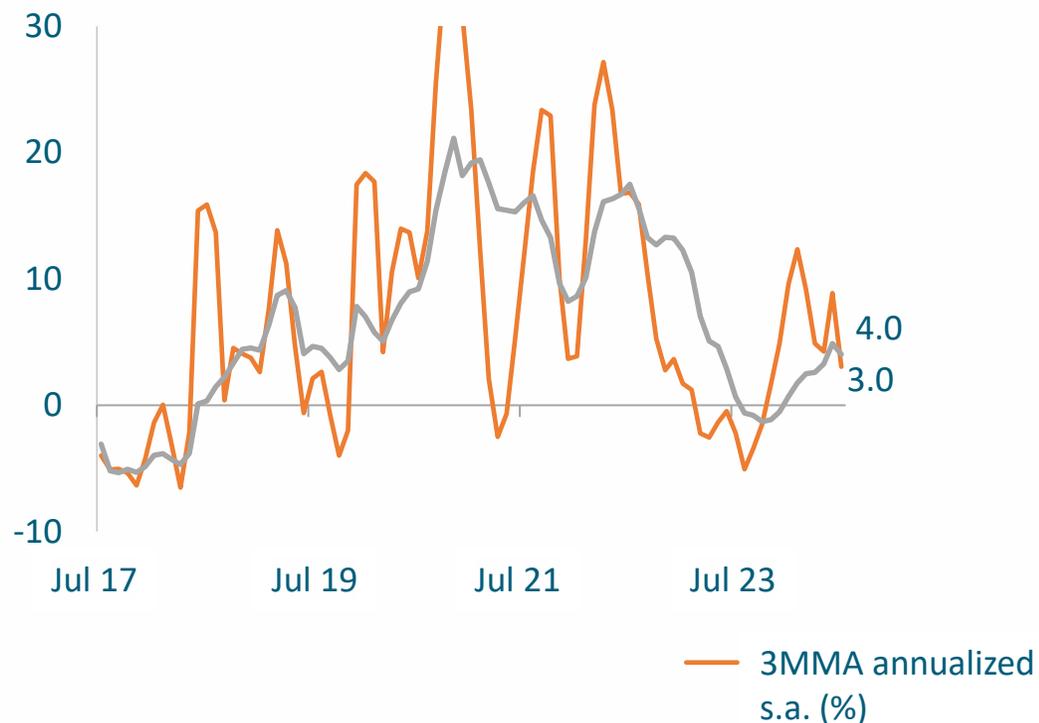


— 3-month change annualized s.a. (%)
— 12-month change

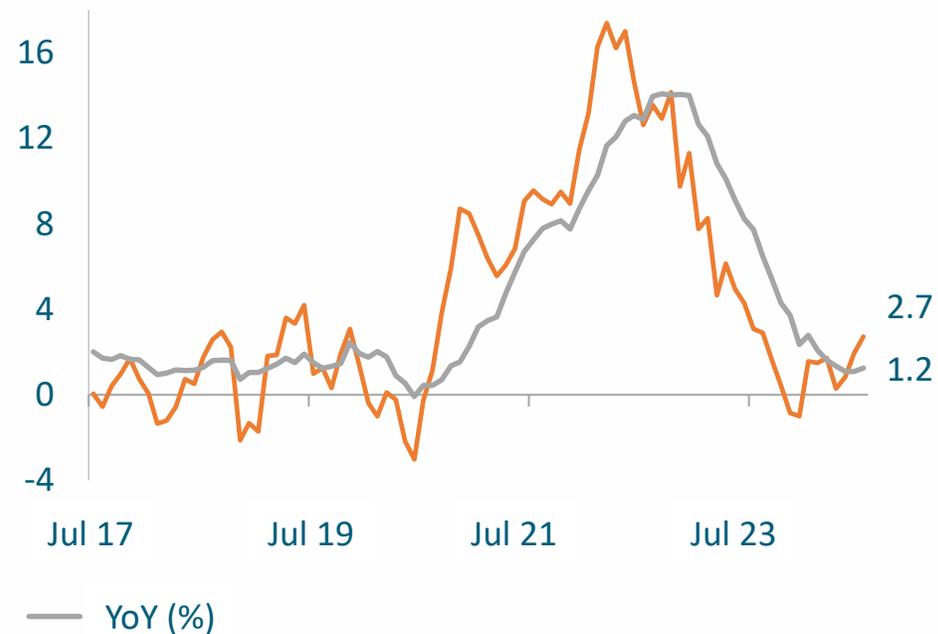
Domestic scenario – Inflation

Industrial goods and food-at-home inflation rates maintained their recent trajectories, no longer contributing to disinflation at this stage of the disinflationary process

Food (16%) (16%)

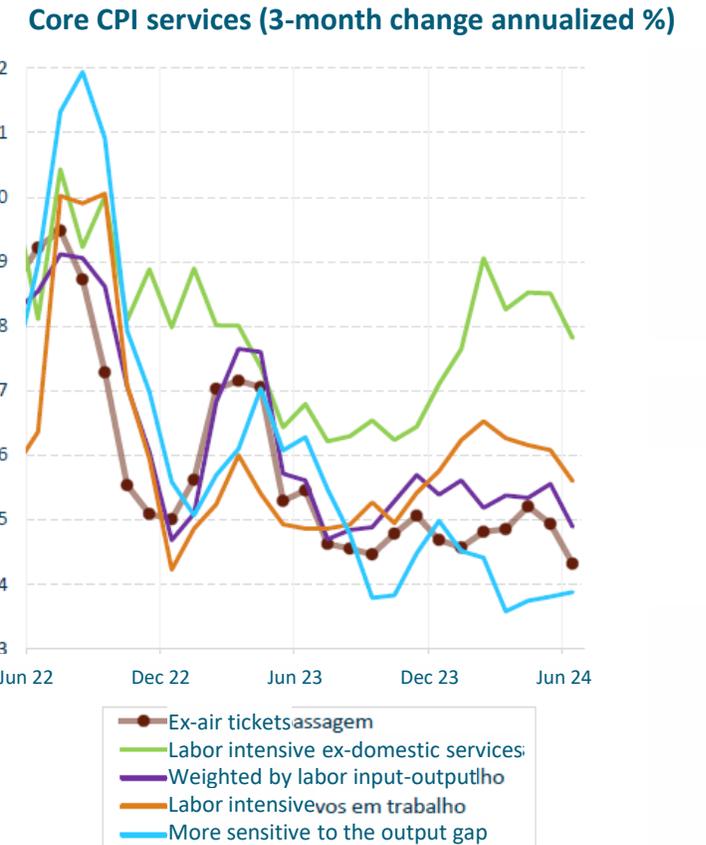
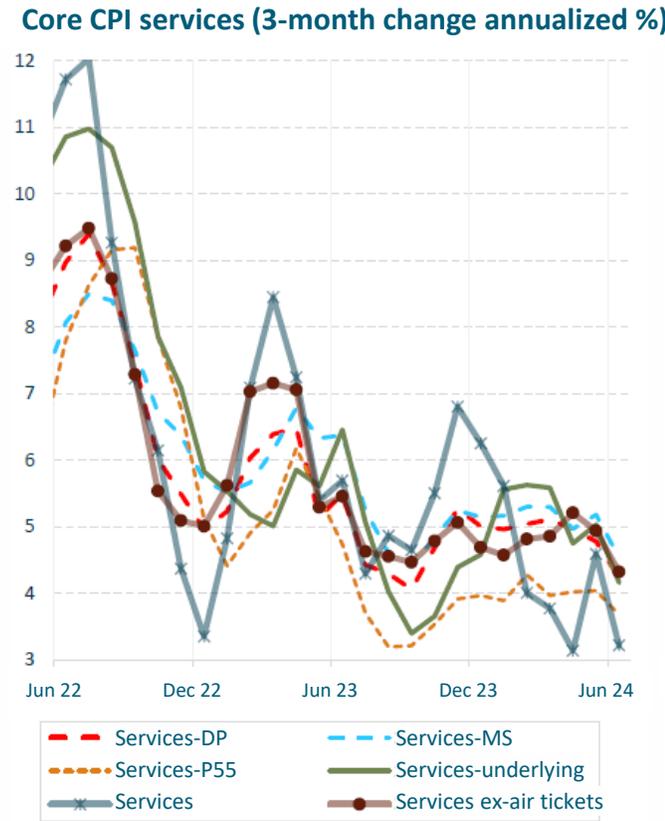
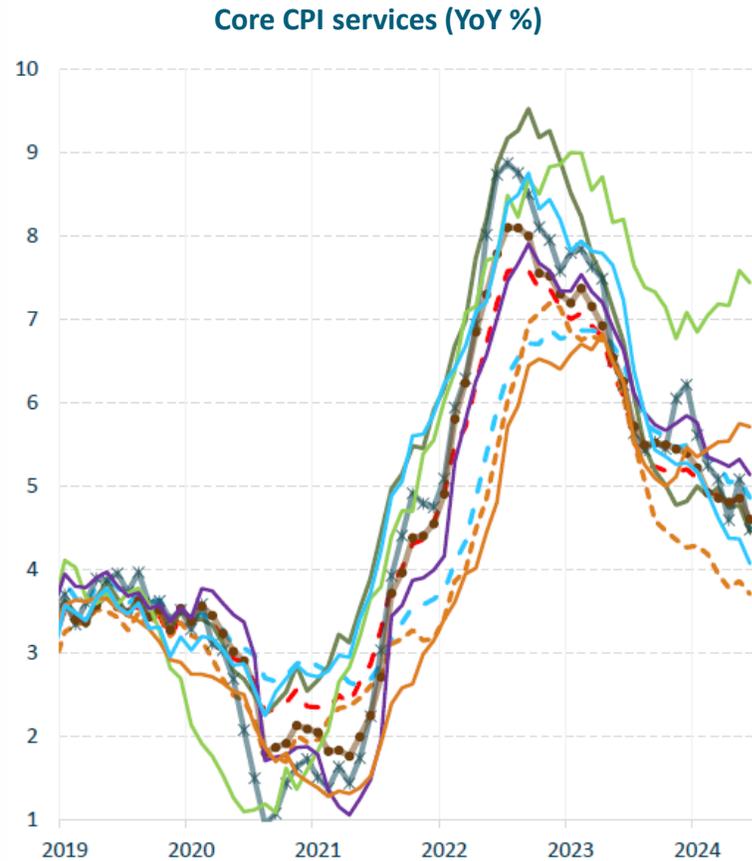


Core industrial goods (16%)



Domestic scenario – Services inflation

Services inflation, which has greater inertia, plays a major role in the disinflationary dynamics at the current stage



Domestic scenario – Inflation

In both scenarios presented – reference and alternative – there is a process of disinflation over the horizon, but the projection for the relevant horizon is above the inflation target of 3%.

Copom projections

	%		
	2024	2025	2026
	Q4	Q4	Q1
Reference scenario	4.2	3.6	3.4
Alternative scenario ^{1/}	4.2	3.4	3.2

^{1/}constant interest rate over the relevant monetary policy horizon

Domestic scenario – Inflation

Final comments

- Copom members then discussed the role of labor market dynamics and inflation expectations in determining services inflation.
- Copom concluded that the disinflationary process has slowed down and that current inflation levels above the target – in a context of dynamic economic activity – make inflation convergence to the target more challenging.
- The inflation outlook has become more challenging, with the increase of medium-term inflation projections, even conditioned on a higher interest rate path.
- There was a unanimous conclusion on the need for an even more cautious monetary policy and a diligent monitoring of the unfolding scenario.

Balance of risks

The Committee emphasizes that risks to its scenarios remain in both directions.

Among the upside risks for the inflationary scenario and inflation expectations, it should be emphasized:

- (i) a more prolonged period of deanchoring of inflation expectations;
- (ii) a stronger-than-expected resilience of services inflation due to a tighter output gap; and
- (iii) a conjunction of internal and external economic policies with an inflationary impact, for example, through a persistently more depreciated currency.

Among the downside risks, it should be noted:

- (i) a greater-than-projected deceleration of global economic activity; and
- (ii) an impact on global inflation larger than expected from monetary policy tightening.

During the discussions, all members agreed that there are more upside risks for inflation, and several members even emphasized the asymmetry of the balance of risks.

The Committee judges that the domestic and international environments require even greater caution on the conduct of monetary policy. In particular, the inflationary impacts of the movements of market variables and inflation expectations, if persistent, corroborate the need for more vigilance.

Final comments

The scenario marked by higher projections and more upside inflation risks is challenging, and the Committee believes that the unfolding of the scenario will be particularly important to define the next monetary policy steps.

Therefore, the Committee unanimously believes that the current stage is of even greater caution and of diligent monitoring of inflation conditioning factors, without committing to future strategies.

- On the one hand, whether the strategy of maintaining the interest rate for a sufficiently long time will bring inflation to the target over the relevant horizon and,
- on the other hand, Copom unanimously reinforced that it will not hesitate to raise the interest rate to ensure inflation convergence to the target if it deems it appropriate.

As usual, the strategies adopted by the Committee will reflect its commitment of reaching the inflation target, while also aiming to reanchor inflation expectations so as to minimize the cost of disinflation.

The Committee will remain vigilant and reminds that potential future changes in the interest rate will be determined by the firm commitment of reaching the inflation target.

Caution – vigilance – diligent monitoring

commitment – cohesion

Economic outlook

UBS Global Emerging Markets Conference

Banco Central do Brasil

Diogo Guillen – Deputy Governor for Economic Policy

September 5th, 2024