Executive summary

The global environment remains adverse and volatile, marked by prospects of below-potential 2023 global growth. The tightening of financial conditions in major economies, difficulties in energy supply to Europe, and a challenging scenario for growth in China, partly due to the Covid-19 policy in the country, reinforce a slowing global growth outlook in the coming quarters.

The inflationary environment remains challenging. There is a normalization in supply chains and an accommodation in the prices of major commodities in the recent period, which should lead to a moderation in global goods-related inflationary pressures. In turn, the low level of labor market slack in some economies, coupled with high current inflation and a high degree of diffusion, suggests that inflationary pressures on the services sector should last longer.

The process of normalization of monetary policy in advanced economies continues towards contractionary rates synchronized across countries, tightening financial conditions, impacting economic growth expectations, and raising the risk of abrupt repricing movements in the markets. In addition, a stronger market sensitivity of financial assets to fiscal fundamentals, including in advanced economies, and lower liquidity in several markets stand out. This environment calls for greater caution in the conduct of economic policies also by emerging economies.

Turning to the Brazilian economy, the release of the third quarter GDP figures suggested a more moderate growth rate. The recent set of indicators is in line with the scenario of deceleration expected by the Monetary Policy Committee (Copom).

The projection for GDP growth in 2022 went from 2.7%, in the previous Report, to 2.9% in this Report. This change was greatly influenced by the revision of the GDP time series, which led to an increase in the year-over-year results in the first half of the year. The growth projection of 1% for 2023 remains, reflecting the prospective scenario of a slowdown in economic activity. Domestic and external uncertainties remain high and, thus, growth projections for Brazil, especially for 2023, are more uncertain than usual.

The 12-month inflation, measured by the Extended National Consumer Price Index (IPCA), has continued to decrease since the previous Report, in the wake of the effects of tax measures and the recent decline in commodity prices. Underlying inflation remains high and at a level incompatible with meeting the inflation target, but, recently, there are incipient signs of slowdown, including in the services segment.

In the quarter ended in November, the IPCA increased 0.17 p.p. above the reference scenario presented in the previous IR. Two factors greatly influenced this surprise. Part of the expected reduction in residential electricity fares, resulting from changes in the State Value-Added Tax on Sales and Services (ICMS), did not materialize, and fresh food prices increased sharply, associated with the rains in the period.

Inflation expectations for 2022, 2023, and 2024 collected by the Focus survey remained relatively stable, around 5.9%, 5.1%, and 3.5%, respectively.

The projections presented use the information available up to the 251st Copom Meeting, held on December 6-7, 2022. As for the conditioning factors used in the projections, especially those from the Focus survey, the cut-off date is December 2, 2022, unless otherwise stated.

Regarding the conditional inflation projections, in the reference scenario, the interest rate path is extracted from the Focus survey, and the exchange rate starts at USD/BRL 5.25 and evolves according to the purchasing power parity (PPP). Oil prices follow approximately the futures market curve for the following six months and then start increasing 2% per year onwards. In this scenario, Copom's inflation projections stand at 6.0% for 2022, 5.0% for 2023, and 3.0% for 2024. The Committee decided again to emphasize the six-quarter-ahead horizon, which reflects the relevant horizon, mitigates the primary effects from the tax changes but incorporates their second-round effects. On this horizon, which refers to 2024Q2, the 12-month inflation projection stands at 3.3%. Copom judges that the uncertainty in its assumptions and projections is higher than usual.

In its most recent meeting (251st), considering the assessed scenarios, the balance of risks, and the broad array of available information, Copom decided to maintain the Selic rate at 13.75% p.a. The Committee judges that this decision reflects the uncertainty around its scenarios for prospective inflation, an even higher-than-usual variance in the balance of risks, and is consistent with the strategy for inflation convergence to a level around its target throughout the relevant horizon for monetary policy, which includes 2023 and 2024. Without compromising its fundamental objective of ensuring price stability, this decision also implies smoothing economic activity fluctuations and fostering full employment.

The Committee will remain vigilant, assessing if the strategy of maintaining the Selic rate for a sufficiently long period will be enough to ensure the convergence of inflation. The Committee emphasizes that it will persist until the disinflation process consolidates and inflation expectations anchor around its targets. The Committee reinforces that future monetary policy steps can be adjusted and will not hesitate to resume the tightening cycle if the disinflationary process does not proceed as expected.