Executive summary

In the external environment, the Copom considers that, since the previous report, risks to global financial stability remained high, such as those derived from changes in the slope of the yield curve of major mature economies. In the relevant horizon for monetary policy, the Committee assesses that risk aversion and volatility of international financial markets tend to react to signals regarding the way in which authorities will deal with new activity indicators, yielding proper signals regarding the start of the normalization of monetary conditions in large blocks, particularly in the United States, minimizing volatility and risks.

In general, since the previous report, prospects of global activity have shown increased moderation through the relevant horizon for monetary policy. In this regard, note that evidence points to growth rates relatively more homogeneous in mature economies, though low and below potential growth, notably in the euro area. In international markets, prospects point to moderation in the dynamics of commodities prices, as well as the occurrence of new volatility clusters in currencies and fixed income markets.

Still on the external environment, it is worth highlighting that eventual increases in volatility and risk aversion in international markets tend to be transmitted to domestic assets, discreetly and at the margin, but they can be amplified due to the perception of domestic macroeconomic and financial soundness.

In the internal environment, the Copom reinforces that, in accordance with the ongoing process of macroeconomic adjustment, the available indicators show that the growth rates of domestic absorption and of GDP continued to line up and confirm that the pace of expansion of domestic activity this year will be below potential. For the Committee, after a necessary period of adjustments, which may be more intense and longer than anticipated, the pace of activity tends to intensify, to the extent that the confidence of firms and households strengthen. As far as the external component of aggregate demand is concerned, the global growth scenario, though moderate, combined with the depreciation of the Real, tends to favor the rebalancing of external accounts and the sustainable growth of the Brazilian economy.

Still regarding internal activity, the Copom assesses that, in the medium-term, important changes may occur in the composition of aggregate demand and supply. Consumption tends to grow at a moderate pace and investments tend to gain momentum. In the Committee's view, these changes indicate that there is room for composition and pace of growth in the medium-term that may lead to the potential growth.

The Copom highlights that the central scenario envisages moderate credit expansion, which had already been noticed and tends to persist. In this regard, note that, after years of strong expansion, the credit market directed toward consumption underwent a period of moderation, leading in the last quarters, on the one hand, to lesser exposure of banks and, on the other hand, to household deleveraging. Taken together, therefore, one concludes that risks have been mitigated in the consumer credit segment. In another dimension, following implemented actions, the Committee considers appropriate to reinforce initiatives aiming to moderate the concession of subsidies through credit operations.

Regarding public accounts, the worsening when compared to the previous Report and the deterioration of risk perception resulted in the downgrading of the country's sovereign rating by an important rating agency to a level under the investment grade in early September. In this context, measures that contribute in a timely manner to restore the balance of public accounts are crucial for macroeconomic stability and for the recovery of confidence and economic activity.

Partial results for the 2015 balance of payments confirm the view of significant reduction of current account deficit, under a scenario of depreciation of the Real and slowdown of domestic activity. Net capital inflows have been financing properly the current account deficit, with particular reference to the net inflows of direct investment in the country and portfolio investments.

The inflation measured by the twelve-month accumulated Broad National Consumer Price Index (IPCA) reached 9.53% in August, 3.01 p.p. higher than the rate recorded until August 2014. On the one hand, market prices accumulated variation of 7.70% in twelve months (6.95% up to August 2014); on the other hand, the regulated prices increased 15.75% (5.07% up to August 2014).

Regarding inflation projections, following the usual procedures and taking into account the information set available up to the cutoff date of September 18, 2015, the baseline scenario – which assumes constant exchange rate over the forecast horizon at R$3.90/US$ and target for the Selic interest rate at 14.25% p.a. – projects inflation of 9.5% in 2015, 5.3% in 2016 and 4.0% in the third quarter of 2017.

In the market scenario – which uses consolidated information from the expectations survey undertaken by Banco Central's Investor Relations and Special Studies Department (Gerin) with a significant group of institutions – the projections indicate inflation of 9.5% in 2015, 5.4% in 2016 and 4.6% in the third quarter of 2017.

Regarding GDP growth, the projection for 2015, according to the baseline scenario, is -2.7% (1.6 p.p. lower than the estimate considered in the previous Inflation Report) and -2.2% for the accumulated in four quarters up to the second quarter of 2016.

The Copom emphasizes that the international evidence, in which it is ratified by the Brazilian experience, shows that high inflation rates generate distortions that lead to higher risks and depress investment. These distortions are manifested, for example, in shortening the planning horizons of households, firms and governments, as well as in the deterioration of the businessmen's confidence. The Committee also emphasizes that high inflation rates subtract the purchasing power of wages and transfers, with negative repercussions over households' confidence and consumption. Hence, high inflation rates reduce the growth potential of the economy, as well as of jobs and income generation.

For the Copom, the high level of the current inflation reflects, in a large part, the effects of the two important and necessary relative-price adjustment processes in the economy – the domestic price adjustment relative to international prices and the regulated price adjustment relative to market prices.

In this context, according to the projections presented in this report, the Committee notes, as anticipated, that these adjustments make inflation increase in the short run and tend to remain high in 2015, requiring determination and perseverance to avoid its transmission to longer terms. At the same time that the Committee understands that adjustments in relative prices have direct impact on inflation, it reaffirms its vision that monetary policy can, must and is containing the second-order effects of these adjustments in order to circumscribe them to 2015.

The Committee observes that inflation expectations are still near or at the 4.5% p.a. target in the medium and long runs. However, the Committee stresses the recent rise in the difference of inflation expectations in relation to the target, after some improvement in the convergence process. This rise still remains of a small magnitude when compared with the levels observed in the previous Inflation Report and it occurs despite the significant increase in inflation expectations for 2015 and the deterioration of the economic agents' perception regarding the balance of risks and the fiscal path. These facts constitute a clear and important signal about, on one hand, the progresses achieved by the current strategy of monetary policy, but on the other hand, the consequences from the deterioration of the balance of risks.

Hence, the Committee understands that maintaining the current level of the basic interest rate, for a sufficiently long period, is necessary for the convergence of inflation to the target at the end of 2016

In this regard, the Copom assesses that the scenario of convergence of inflation to 4.5% in the end of 2016 has remained, despite the deterioration in the balance of risks recently worsened by the effects of the sovereign credit downgrade. For the Committee, on one hand, the improvements achieved in the fight against inflation, such as benign signs that come from medium- and long-term indicators of expectations, show that the monetary policy strategy is on the right track. On the other hand, recent risk premium increases, which reflect in asset prices, require a monetary policy that remains vigilant in case of significant deviation of inflation forecasts relative to the target.