Executive summary

Recent data on economic activity continue to indicate gradual recovery of the Brazilian economy.

GDP grew in the third quarter, compared to the previous quarter, for the seventh consecutive period. On the supply side, industrial activity accelerated, especially in the manufacturing industry, following the impact of the halt in the transportation sector in May. In addition, the services sector continued to grow, chiefly in the trade and transportation segments. It is worth noting that the intensity of growth in the recent period reflected, in part, the weaker basis of comparison of the second quarter.

On the demand side, there was significant growth in Gross Fixed Capital Formation (GFCF), influenced by imports of equipment for the oil and gas industry, and accelerated household consumption, in line with the moderate recovery in the labor market and with the positive evolution of credit markets.

The central projection for GDP growth in 2018 was trimmed to 1.3%, slightly lower than the September Inflation Report projection (1.4%). Largely, this projection adjustment reflected the ordinary revision in the national accounts statistics, which slightly raised the level of 2017 GDP, i.e. the basis of comparison. For 2019, GDP growth is projected to reach 2.4%, naturally with a higher level of uncertainty and conditioned on the continuation of the necessary reforms and adjustments in the Brazilian economy.

The economy continues to operate with a high level of economic slack, as reflected in the low industrial capacity utilization indexes and, mainly, in the unemployment rate. However, the recovery of the economy has gradually reduced the amount of slack.

The global outlook for emerging economies remains challenging. The main risks are associated with an increase in risk aversion in global financial markets, with normalization of interest rates in some advanced economies and with uncertainty regarding global trade.
Nevertheless, the Brazilian economy is better able to withstand a setback in the international scenario, given its robust balance of payments, anchored expectations, and prospects of economic recovery.

Expectations collected by the Focus survey for the 2018, 2019 and 2020 inflation measured by the Extended National Consumer Price Index (IPCA) are around 3.7, 4.1 and 4.0%, respectively. For 2021, expectations are around 3.75%.

The Copom considers that various measures of underlying inflation are running at appropriate or comfortable levels. This includes the components that are most sensitive to the business cycle and monetary policy.

Regarding conditional inflation projections, in the scenario with a constant Selic rate at 6.50% p.a. and a constant exchange rate at R$3.85/US$, inflation projections stand around 3.7% for 2018, 4.0% for 2019 and 2020 and 4.1% for 2021. In the scenario with Selic rate and exchange rate paths extracted from the Focus survey, inflation projections stand around 3.7% for 2018, 3.9% for 2019, 3.6% for 2020 and 3.7% for 2021.

The projections presented herein use information available up to the latest meeting of the Monetary Policy Committee (Copom) held on December 11th and 12th, of 2018 (219th Meeting). As for the conditioning information used in the projections, especially those from the Focus survey, the cut-off date is December 7th 2018, unless otherwise stated.

In its most recent meeting (219th Meeting), the Copom unanimously decided to maintain the Selic rate at 6.50% p.a. The Committee judges that this decision reflects its baseline scenario for prospective inflation and the associated balance of risks and is consistent with the convergence of inflation to target over the relevant horizon for the conduct of monetary policy, which includes 2019 and, with a smaller weight, 2020.

At that meeting, the Copom communicated that its baseline scenario for inflation encompasses risks factors in both directions, but with larger weight on the last two risks. On the one hand, (i) the high level of economic slack may lead to a lower-than-expected prospective inflation trajectory. On the other hand, (ii) frustration of expectations regarding the continuation of reforms and necessary adjustments
in the Brazilian economy may affect risk premia and increase the path for inflation over the relevant horizon for the conduct of monetary policy. This risk intensifies in case (iii) the global outlook for emerging economies deteriorates. The Committee judges that risk (i) has increased, whereas risk (ii) has moderated. The Copom members judge that, when compared to the scenario of the October Copom meeting (218th meeting), the risk that the high level of economic slack may lead to a lower-than-expected prospective inflation trajectory has increased, while the risk related to the frustration of expectations regarding the continuation of reforms and necessary adjustments in the Brazilian economy has decreased. However, the members highlighted that upside risks to inflation remain significant, and with larger weight in their balance of risks. Therefore, the Committee members concluded that the balance of risks remains asymmetric, albeit to a lesser degree.

The Copom reiterates that economic conditions prescribe stimulative monetary policy, i.e., interest rates below the structural level.

The Committee stresses that the continuation of reforms and adjustments necessary to the Brazilian economy is essential to maintain low inflation in the medium and long run, for the reduction of its structural interest rate, and for the sustainable recovery of the economy. The Committee also notes that the perception of continuation of the reform agenda affects current expectations and macroeconomic projections.

The Copom pondered that caution, serenity, and perseverance in monetary policy decisions, even in the face of volatile scenarios, have been instrumental in pursuing its primary objective of keeping the inflation path towards the targets. The Committee understands that decisions governed by these principles provide good guidance for monetary policy.

In the Copom’s assessment, the evolution of the baseline scenario and the balance of risks prescribes keeping the Selic rate at its current level. The Copom emphasizes that the next steps in the conduct of monetary policy will continue to depend on the evolution of economic activity, the balance of risks, and inflation projections and expectations.