

## Executive summary

---

Fiscal and monetary stimuli are still in place in some developed countries, reinforcing the process of robust economic activity recovery. In a scenario of economic slack, central bank communication from major economies suggests that the expansionary monetary policy will last long. However, uncertainty remains high and a new round of market discussion regarding inflationary risks in these economies could result in a challenging environment for emerging countries.

Despite the intensity of the second wave of the pandemic, recent indicators of domestic activity continue to evolve better than expected, implying relevant revisions in the growth projections for the year. Additionally, the partial recovery in economic agents' confidence, the measures to preserve employment and income, the prospects of progress in the vaccination campaign, the high commodity prices, and the delayed effects of the monetary stimulus indicate a favorable outlook for the Brazilian economy. In this context, the central projection for GDP growth in 2021 rose to 4.6% from 3.6% in the March 2021 Inflation Report.

Although the risks to the economic recovery have been significantly reduced, uncertainty about the pace of growth is still high. Among the factors that may slow the growth rate are the risk of emergence or dissemination of new variants of concern of SARS-CoV-2; the difficulty in obtaining inputs and the high costs in some production chains; and the possible implications of the energy crisis. Furthermore, it is reiterated that persevering in the process of reforms and necessary adjustments in the Brazilian economy is essential for a sustainable economic recovery.

Consumer inflation surprised again in the quarter ended in May, standing 0.33 p.p. above the baseline scenario presented in the March 2021 Inflation Report. Inflationary pressure was also stronger than anticipated by market analysts and the various underlying inflation measures are at levels above the interval compatible with meeting the inflation target.

Inflation expectations for 2021, 2022, and 2023 collected by the Focus survey are around 5.8%, 3.8%, and 3.25%, respectively.

Copom's conditional projections for inflation in the baseline scenario stand around 5.8% for 2021 and 3.5% for 2022, with the interest rate path extracted from the Focus survey and the exchange rate starting from USD/BRL 5.05 and evolving according to the purchasing power parity (PPP). This scenario assumes a path for the Selic rate that ends 2021 at 6.25% p.a. and rises to 6.50% p.a. in 2022.

The projections presented use data available up to the 239<sup>th</sup> Meeting of the Monetary Policy Committee (Copom), held on June 15-16, 2021. As for the conditioning information used in the projections, especially those from the Focus survey, the cut-off date is June 11, 2021, unless otherwise stated.

In its most recent meeting (239<sup>th</sup> meeting), Copom unanimously decided to increase the Selic rate by 0.75 p.p. to 4.25% p.a. The Committee judges that this decision reflects its baseline scenario for prospective inflation, a higher-than-usual variance in the balance of risks, and it is consistent with convergence of inflation to its target over the relevant horizon for monetary policy, which includes 2022. Without compromising its fundamental objective of ensuring price stability, this decision also implies smoothing of economic fluctuations and fosters full employment.

At the time, the Committee communicated that its baseline scenario for inflation encompasses risk factors in both directions. On the one hand, a possible reversion, even if partial, of the recent increase in the price of international commodities measured in local currency would produce lower-than-projected inflation in the baseline scenario. On the other hand, further extensions of fiscal policy responses to the pandemic that pressure the aggregate demand and worsen the fiscal trajectory may increase the risk premium. Despite the improvement of debt sustainability indicators, the elevated fiscal risk creates an upward asymmetry in the balance of risks, i.e., in the direction of higher-than-expected paths for inflation over the relevant horizon for monetary policy.

At this moment, the Copom's baseline scenario indicates, as appropriate, a normalization of the policy rate to a level considered neutral. This adjustment is necessary to mitigate the dissemination of the

temporary shocks to inflation.

However, the Committee again emphasizes that there is no commitment with this plan, and that future steps of monetary policy could be adjusted to assure the achievement of the inflation target.

For the next meeting, the Committee foresees the continuation of the monetary normalization process with another adjustment of the same magnitude.

However, a deterioration of inflation expectations for the relevant horizon may require a quicker reduction of the monetary stimulus. The Copom emphasizes that its view will also depend on the evolution of economic activity, the balance of risks, and how these factors affect inflation projections.