Minutes of the 220th Meeting of the Monetary Policy Committee (Copom) * of the Central Bank of Brazil **

February 5th and 6th, 2019

BANCO CENTRAL DO BRASIL

* The Monetary Policy Committee of the Central Bank of Brazil is herein referred to as the “Copom” and the “Committee”.

** These minutes represent Copom's best effort to provide an English version of the minutes of its policy meeting. In case of any inconsistency, the original version in Portuguese prevails.

Date: February 5th and 6th, 2019

Place: BCB Headquarters' meeting rooms at the 8th floor (February 5th) and 20th floor (February 6th) – Brasília – DF – Brazil

Starting and ending time: February 5th: 10:05 am–12:34 pm; 2:30 pm–5:30 pm
February 6th: 2:30 pm–6:20 pm

In attendance:
Members of the Copom
Ilan Goldfajn – Governor
Carlos Viana de Carvalho
Carolina de Assis Barros
Maurício Costa de Moura
Otávio Ribeiro Damaso
Paulo Sérgio Neves de Souza
Sidnei Corrêa Marques
Tiago Couto Berriel

Department Heads in charge of technical presentations (present on February 5th)
Alan da Silva Andrade Mendes - Department of Foreign Reserves
André Minella - Research Department (*also present on February 6th*)
André de Oliveira Amante – Department of Open Market Operations
Flávio Túlio Vilela – Department of Banking Operations and Payments System
João Barata Ribeiro Blanco Barroso – Department of International Affairs
Tulio José Lenti Maciel – Department of Economics

Other participants (present on February 5th)
Adalberto Felinto da Cruz Junior – Executive Secretariat
Arnildo da Silva Correa – Head of the Economic Advisors' Office
Enrico Bezerra Ximenes de Vasconcelos – Secretary of the Financial Stability Committee and Senior Advisor to the Board
Eugênio Pacceli Ribeiro – Head of the Deputy Governor for Economic Policy's Office
Fabia Aparecida de Carvalho – Deputy Head of the Research Department
Fernando Alberto Sampaio Rocha – Head of the Department of Statistics
Gilneu Francisco Astolfi Vivan – Financial System Monitoring Department
Gustavo Paul Kurrle – Press Officer
Leonardo Martins Nogueira – Head of the Governor's Office
Márcio Antonio Estrela – Head of the Deputy Governor for International Affairs and Corporate Risk Management's Office
Ricardo Eyer Harris – Head of the Deputy Governor for Regulation's Office
Rogério Antônio Lucca – Head of the Deputy Governor for Monetary Policy's Office

The Copom members analyzed the recent performance and prospects for the Brazilian and international economies, under the monetary policy framework, whose objective is to comply with the inflation targets established by the National Monetary Council.

A) Update of economic outlook and Copom's baseline scenario[1]

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

2. 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.

3. The global outlook remains challenging, despite some decline in risks and a change in composition. On the one hand, short-term risks associated with the normalization of interest rates in some advanced economies have receded. On the other hand, there was an increase in risks related to a slowdown in global growth, as a result of several uncertainties, such as trade conflicts and Brexit.

4. 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.

5. Inflation expectations for 2019, 2020 and 2021 collected by the Focus survey are around 3.9%, 4.0% and 3.75%, respectively.

6. Copom's inflation projections in the scenario with Selic rate and exchange rate paths extracted from the Focus survey stand at around 3.9% for 2019 and 3.8% for 2020. This scenario assumes, among other hypotheses, a path for the Selic rate that ends 2019 at 6.50% p.a. and increases to 8.00% p.a. over the course of 2020. It also assumes a path for the exchange rate that ends 2019 at R$3.70/US$, and 2020 at R$3.75/US$. In this scenario, inflation projections for administered prices are 5.1% for 2019, and 4.7% for 2020.

7. In the scenario with a constant Selic rate at 6.50% p.a., and a constant exchange rate at R$3.70/US$[2], Copom's inflation projections stand around, 3.9% for 2019, and 4.0% for 2020. In this scenario, inflation projections for administered prices are 5.1% for 2019, and 4.5% for 2020.

B) Risks around the baseline inflation scenario

8. The Copom's baseline scenario for inflation encompasses risk factors in both directions, but with larger weight on the last two risks below, thus with asymmetry.

9. On the one hand, (i) the high level of economic slack may lead to a lower-than-expected prospective inflation trajectory.

10. 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 of inflation over the relevant horizon for the conduct of monetary policy. This risk intensifies in case (iii) the global outlook for emerging economies deteriorates.

11. The Committee judges that, since its previous meeting, notably related to the global outlook, inflationary risks have moderated.

C) Discussion about the conduct of monetary policy

12. The Committee members discussed the evolution of economic activity in light of economic indicators and available data. In particular, the members discussed evidence of some slowdown in activity in the fourth quarter of 2018, when compared to the previous quarter. Taking into account the shocks that occurred during 2018, they concluded that the evolution of the economic activity is consistent with the Copom's baseline scenario of a gradual recovery of the Brazilian economy.

13. The Copom members pointed out that an acceleration in the pace of the economic recovery will depend on the decrease in uncertainties regarding the approval and implementation of reforms—notably those of fiscal nature—and adjustments in the Brazilian economy. They also stressed the importance of other initiatives aimed at productivity increases, efficiency gains, greater flexibility of the economy, and improvements in the business environment. These efforts are fundamental for the resumption of economic activity and the development of the Brazilian economy.

14. Regarding the global outlook, the Committee members considered that it remains challenging,

[1] Unless explicitly stated otherwise, this update takes into account changes occurred since the December Copom meeting (219th meeting).

[2] This number is the rounded average R$/US$ exchange rate observed on the five business days ending on the Friday prior to the Copom meeting.

despite some decline in risks and a change in composition. The Committee discussed the contrasting scenarios for the evolution of the US economy. The first possible scenario—which seems to have affected the US yield curve and stock markets in the last months of 2018—involves risk of a significant economic slowdown. The second scenario assumes continuity of the vigorous economic growth. The two scenarios have opposite effects on the conduct of the monetary policy by the Fed. Copom members concluded that, at least until one of the scenarios becomes more likely, risks associated with the normalization of monetary policy in the US have reduced. In addition, they recognized that, given the slowdown in activity in some relevant economies, the risks associated with a weakening in the global economy have intensified. The Committee also noted that uncertainties, such as those associated with the continued expansion of international trade and Brexit, could contribute to lower overall growth. In this context, the Copom members once again highlighted the capacity of the Brazilian economy to withstand a setback in the international scenario, given its robust balance of payments and the environment of anchored inflation expectations and prospects of economic recovery.

15. The members of the Committee discussed the recent inflation projections and the levels of various measures of underlying inflation. They assessed that those measures are at appropriate or comfortable levels, and that inflation projections indicate a convergence of inflation to target over the course of 2019 and 2020. This path is consistent with inflation expectations, which remain anchored. The Copom members emphasized, however, that the consolidation of this scenario in the medium and long terms depends on the pace of necessary reforms and adjustments in the Brazilian economy.

16. The Committee members judged that inflationary risks –notably those related to the global outlook– have moderated since their last previous meeting. However, the members highlighted that upside risks to inflation remain significant, and with larger weight on their balance of risks. Therefore, the Committee concluded that the balance of risks remains asymmetric, albeit to a lesser degree.

17. The members of the Committee discussed the best way monetary policy should be conducted in the face of uncertainties regarding economic scenarios. They concluded that caution, serenity, and perseverance in monetary policy decisions, even in the face of volatile scenarios, is the best way to keep inflation on path towards the targets.

18. The Copom members assessed that economic conditions with anchored inflation expectations, underlying inflation measures at appropriate or comfortable levels, inflation projected to move toward targets for 2019 and 2020, and high level of slack in the economy prescribe accommodative monetary policy, i.e., interest rates below the structural interest rate level. Although estimates of this rate involve a high degree of uncertainty, the Committee members expressed the view that the current ex-ante real interest rates provide stimulus to the economy.

19. The Committee also discussed the conditionalities that would prescribe accommodative monetary policy. All members agreed that the appropriate level of stimulus depends on economic conditions, inflation expectations, the balance of risks and inflation projections. Importantly, the provision of monetary stimulus requires an environment with anchored inflation expectations.

20. The Copom stresses that the continuation of reforms and necessary adjustments in the Brazilian economy is essential to the reduction of its structural interest rate. The Committee will continue to reassess the estimates of this rate over time.

21. The Committee members then discussed the monetary policy decision, in light of the evolution of the baseline scenario and the balance of risks since its December meeting (219th meeting). They unanimously decided to maintain the Selic rate at 6.50% p.a.

22. The Copom then discussed the advisability of signaling the future evolution of monetary policy. All members considered that the current environment prescribes retaining greater flexibility in the conduct of monetary policy, which requires refraining from providing indications of its next steps. The members of the Copom reinforced the importance of emphasizing their commitment to conducting monetary policy in order to maintain the path for prospective inflation in line with inflation targets.

23. The Committee members reiterated their preference for communicating the conditionalities in the conduct of monetary policy, which better transmits the economic rationality guiding their decisions. This contributes to transparency and enhances Copom's communications. In this context, they reasserted 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 on inflation projections and expectations.

24. All Committee members once again emphasized that the approval and implementation of reforms—notably those of a fiscal nature—and adjustments in the Brazilian economy are crucial for the sustainability of the environment of low and stable inflation, for the full effectiveness of monetary policy, and for the reduction of the structural interest rate of the economy,

with widespread benefits for society. The Committee stresses that the perception of continuation of the reform agenda affects current expectations and macroeconomic projections.

D) Monetary Policy Decision

25. Taking into account the baseline scenario, the balance of risks, and the wide array of available information, 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 horizon relevant for the conduct of monetary policy, which includes 2019 and, with a smaller and gradually increasing weight, 2020.

26. The Committee reiterates that economic conditions prescribe accommodative monetary policy, i.e., interest rates below the structural level.

27. The Copom emphasizes that the evolution of reforms and necessary adjustments in the Brazilian economy is essential for maintaining low inflation in the medium and long runs, for the reduction of its structural interest rate, and for sustainable economic recovery. The Committee stresses that the perception of continuation of the reform agenda affects current expectations and macroeconomic projections.

28. In the Copom's assessment, the evolution of the baseline scenario and of 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 on inflation forecasts and expectations.

29. The Copom asserts 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.

30. The following members of the Committee voted for this decision: Ilan Goldfajn (Governor), Carlos Viana de Carvalho, Carolina de Assis Barros, Maurício Costa de Moura, Otávio Ribeiro Damaso, Paulo Sérgio Neves de Souza, Sidnei Corrêa Marques and Tiago Couto Berriel.