Minutes of the 222nd Meeting of the Monetary Policy Committee (Copom*) Banco Central do Brasil**

May 7-8, 2019

BANCO CENTRAL DO BRASIL

* The Monetary Policy Committee of the Banco Central do Brasil 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: May 7-8, 2019

Place BCB Headquarters' meeting rooms on the 8th floor (May 7th) and 20th floor (May 8th) – Brasilia – DF – Brazil
Starting and ending times: May 7th: 10:03 AM – 12:46 PM; 2:33 PM – 6:11 PM
May 8th: 2:00 PM – 6:00 PM

In attendance:
Copom members
Roberto Oliveira Campos Neto – Governor
Bruno Serra Fernandes
Carlos Viana de Carvalho
Carolina de Assis Barros
João Manoel Pinho de Mello
Maurício Costa de Moura
Otávio Ribeiro Damaso
Paulo Sérgio Neves de Souza
Tiago Couto Berriel

Department Heads in charge of technical presentations (present on May 7th)
Alan da Silva Andrade Mendes – Department of Foreign Reserves
André Minella – Research Department (also present on May 8th)
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 May 7th)
Angelo José Mont'Alverne Duarte – Senior Advisor at the Deputy Governor for Licensing and Resolution's Office
Enrico Bezerra Ximenes de Vasconcelos – Secretary of the Financial Stability Committee and 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
Fabio Araujo – Head of the Economic Advisors' Office
Fernando Alberto Sampaio Rocha – Head of the Department of Statistics
Gilneu Francisco Astolfi Vivan – Head of the Financial System Monitoring Department
Leonardo Martins Nogueira – Head of the Governor's Office
Márcio Antônio Estrela – Head of the Deputy Governor for International Affairs and Corporate Risk Management's Office
Mauro Zanatta – Press Officer
Rogério Antônio Lucca – Head of the Deputy Governor for Monetary Policy's Office

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 suggest that the softening observed at the end of 2018 continued in early 2019. The Copom's baseline scenario assumes that the process of gradual economic recovery will resume.

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. On the one hand, the risks associated with normalization of interest rates in some advanced economies in the short and medium runs are low. On the other hand, the risks associated with a slowdown in global growth remain.

4. Various measures of underlying inflation are running at appropriate 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 4.0%, 4.0% and 3.75%, respectively.

6. The Copom's inflation projections in the scenario with interest rate and exchange rate paths extracted from the Focus survey stand around 4.1% 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 7.50% p.a. over the course of 2020. It also assumes a path for the exchange rate that ends 2019 at R$3.75/US$, 2020 at R$3.80/US$. In this scenario, inflation projections for administered prices are 5.3% for 2019, and 5.0% for 2020.

7. In the scenario with a constant Selic rate at 6.50% p.a., and a constant exchange rate at R$3.95/US$[2], Copom's inflation projections stand around 4.3% for 2019, and 4.0% for 2020. In this scenario, inflation projections for administered prices are 5.6% for 2019, and 5.1% for 2020.

B) Risks around the baseline inflation scenario

8. The Copom's baseline scenario for inflation encompasses risk factors in both directions.

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

11. The Committee judges that, although the risk associated with economic slack has increased at the margin, the balance of risks is symmetric.

C) Discussion about the conduct of monetary policy

12. Committee members discussed the evolution of economic activity in light of available data. They concluded that the softening observed at the end of 2018 continued in early 2019. In particular, the available indicators suggest a relevant probability that the seasonally adjusted Gross Domestic Product (GDP) declined slightly in 2019Q1, when compared to the previous quarter. The first-quarter indicators led to substantive revisions to expectations for 2019 GDP growth, as collected by the Focus survey. These revisions reflect a lower-than-expected first quarter, with implications for the "statistical carry-over", but also embody some reduction in the expected growth rate for the coming quarters. Copom members judge that the process of gradual recovery of the economic activity was interrupted in the recent period, but the baseline scenario assumes its resumption ahead.

13. Committee members again remarked that the Brazilian economy experienced several shocks throughout 2018, which affected the economy and significantly tightened financial conditions. Although they tend to decay over time, their effects on economic activity persist even after their direct impacts have ceased. Committee members judge that these shocks must have significantly reduced the growth that the

[1] Unless explicitly stated otherwise, this update takes into account changes occurred since the March Copom meeting (221st meeting).

[2] Value obtained according to the usual procedure of rounding the average R$/US$ exchange rate observed during the five business days ending on the Friday prior to the Copom meeting.

Brazilian economy would have experienced otherwise, and that some of their effects still persist.

14. The Committee also discussed how its previous communication was interpreted in regard to the need to observe the Brazilian economy in order to produce an assessment of its performance in recent quarters. It is worth noting that, in addition to the shocks already discussed, uncertainties about fundamental aspects of the future economic environment — notably fiscal sustainability — have adverse effects on economic activity. In particular, uncertainty affects investment decisions that involve a high degree of irreversibility and, therefore, need greater predictability of future scenarios.

15. Copom members also discussed other factors that could hinder economic growth, given the need for deep adjustments in the Brazilian economy, notably those of fiscal nature. They concluded that the persistence of uncertainties regarding fiscal sustainability tend to be contractionary. Reforms that lead to sustainability of fiscal policy have expansionary potential, which can offset the effects of short-run fiscal adjustment on economic activity, in addition to mitigating the risks of bouts of instability with increased risk premia, as witnessed in 2018.

16. Committee members stressed that an acceleration of the pace of economic recovery to more robust levels will also depend on 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.

17. Regarding the global outlook, Committee members considered that it remains challenging. Taking into account recent information about developed economies and the communication of major central banks, Copom's baseline scenario deem the risks associated with normalization of interest rates in some advanced economies to be low in the short and medium terms. Copom members judge that risks associated with a slowing global economy remain and that uncertainties about economic policies and of geopolitical nature may contribute to even lower global growth. In this context, Copom members once again highlighted that the Brazilian economy is capable of withstanding a setback in the international scenario, given its robust balance of payments, anchored inflation expectations, and prospects of economic recovery.

18. Committee members discussed recent inflation projections and the levels of various measures of underlying inflation. They assessed that those measures are at appropriate levels, and that inflation projections indicate convergence of inflation to target over the course of 2019 and 2020. The Committee foresees that 12-month inflation should reach a peak in the short term and subsequently retreat, ending 2019 around the inflation target. Copom members emphasized, however, that the consolidation of this favorable scenario with inflation on target in the medium and long terms depends on the pace of necessary reforms and adjustments in the Brazilian economy, which are essential for the sustainability of the environment with anchored inflations expectations.

19. Committee members discussed the evolution, since their previous meeting, of the factors highlighted in their balance of risks around the baseline inflation scenario. Although the assessment that the risk associated with economic slack has increased at the margin, all members agreed that the balance of risks is symmetric.

20. Copom members assessed that caution, serenity, and perseverance in conducting monetary policy decisions, in the face of uncertainties regarding economic scenarios, is the best way of keeping inflation on a trajectory towards the targets. They then discussed the advisability of ceasing to repeat this message in their communication, since it is a matter of principle that should already be well assimilated. Hence, they agreed to exclude this message as of their next meeting, with the understanding that this should not be interpreted as a change in the conduct of monetary policy.

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

22. The Committee also discussed the conditionalities that would prescribe stimulative monetary policy. All members agreed that the appropriate level of stimulus depends on the outlook conditions, particularly inflation expectations, and the level of slack in the economy, balance of risks and inflation projections. Importantly, the provision of monetary stimulus requires an environment with anchored inflation expectations.

23. 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.

24. Committee members then discussed the monetary policy decision, in light of the evolution of the baseline scenario and the balance of risks since its March meeting (221st meeting). They unanimously decided to maintain the Selic rate at 6.50% p.a.

25. Committee members reiterated their preference for communicating the conditionalities for the conduct of monetary policy, which better transmits the economic rationality guiding their decisions. This contributes to increase transparency and enhance Copom's communications. The Copom deems important to observe how the Brazilian economy will behave over time, without the remaining effects of the various shocks that hit the economy last year and, especially, with reduction of the degree of uncertainty to which the Brazilian economy remains exposed. The Committee judges that this assessment takes time and should not be completed in the short run. 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.

26. All Committee members once again emphasized that the approval and implementation of reforms — notably those of fiscal nature — and adjustments in the Brazilian economy are crucial for the sustainability of the environment of low and stable inflation, for the full operation of monetary policy, and for the reduction of the structural interest rate of the economy, with widespread benefits for society. The Committee also stresses that the perception of continuation of the reform agenda affects current expectations and macroeconomic projections.

D) Monetary Policy Decision

27. 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 convergence of inflation to target over the relevant horizon for the conduct of monetary policy, which includes 2019 and, to a greater extent, 2020.

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

29. The Copom emphasizes that the evolution of reforms and necessary adjustments in 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 sustainable economic recovery. The Committee also stresses that the perception of continuation of the reform agenda affects current expectations and macroeconomic projections.

30. 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 Committee deems important to observe how the Brazilian economy will behave over time, without the remaining effects of the various shocks that hit the economy last year and, especially, with reduction of the degree of uncertainty to which the Brazilian economy remains exposed. The Copom judges that this assessment takes time and should not be completed in the short run. 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 projections and expectations.

31. 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.

32. The following Committee members voted for this decision: Roberto Oliveira Campos Neto (Governor), Bruno Serra Fernandes, Carlos Viana de Carvalho, Carolina de Assis Barros, João Manoel Pinho de Mello, Maurício Costa de Moura, Otávio Ribeiro Damaso, Paulo Sérgio Neves de Souza, and Tiago Couto Berriel.