

Minutes of the 224th Meeting of the Monetary Policy Committee (Copom*) of Banco Central do Brasil**

July 30-31, 2019



* 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: July 30-31, 2019

Place: BCB Headquarters' meeting rooms on the 8th floor (July 30) and 20th floor (July 31) – Brasília – DF – Brazil

Starting and ending times: July 30: 09:05 AM – 12:57 PM; 5:04 PM – 7:44 PM
July 31: 2:00 PM – 6:10 PM

In attendance:

Members of the Copom

Roberto Oliveira Campos Neto – Governor
Bruno Serra Fernandes
Carlos Viana de Carvalho
Carolina de Assis Barros
Fernanda Feitosa Nechio
João Manoel Pinho de Mello
Maurício Costa de Moura
Otávio Ribeiro Damaso
Paulo Sérgio Neves de Souza

Department Heads in charge of technical presentations (present on July 30)

Alan da Silva Andrade Mendes - Department of Foreign Reserves
André Minella - Research Department (also present on July 31)
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 July 30)

Adalberto Felinto da Cruz Júnior – Executive Secretary
Eduardo José Araújo Lima – 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
Ricardo Eyer Harris – Head of the Deputy Governor for Regulation's Office
Ricardo Franco Moura - Head of the Prudential and Foreign Exchange Regulation Department
Rogério Antônio Lucca – Head of the Deputy Governor for Monetary Policy's Office

The members of Copom 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 the Economic Outlook and Copom's Baseline Scenario¹

1. Recent data on economic activity suggest a possible resumption of the process of economic recovery. Copom's baseline scenario assumes that this recovery will occur at a gradual pace.

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 has become benign, owing to changes in monetary policy in major economies. Nevertheless, the risks associated with a slowdown in global growth remain.

4. Various measures of underlying inflation are running at comfortable levels. This includes the components that are most sensitive to the business cycle and monetary policy.

5. Inflation expectations for 2019, 2020, 2021, and 2022 collected by the Focus survey are around 3.8%, 3.9%, 3.75%, and 3.50%, respectively.

6. The Copom's inflation projections in the scenario with interest rate and exchange rate paths extracted from the Focus survey stand around 3.6% for 2019 and 3.9% for 2020. This scenario assumes, among other assumptions, a path for the Selic rate that ends 2019 at 5.50% p.a. and remains at that level until the end of 2020. It also assumes a path for the exchange rate that ends 2019 at R\$3.75/US\$ and 2020 at R\$3.80/US\$. In this scenario, inflation projections for administered prices are 4.1% for 2019, and 4.6% for 2020.

7. In the scenario with a constant Selic rate at 6.50% p.a., and a constant exchange rate at R\$3.75/US\$², conditional inflation projections for both 2019 and 2020 stand around 3.6%. In this scenario, inflation projections for administered prices are 4.1% for 2019, and 4.4% for 2020.

¹ Unless explicitly stated otherwise, this update takes into account changes occurred since the June Copom meeting (223rd meeting).

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 continue to produce lower-than-expected prospective inflation trajectory.

10. On the other hand, (ii) a possible 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 of (iii) reversal of the benign outlook for emerging economies.

11. The Committee acknowledges that the balance of risks has evolved favorably, but risk (ii) still prevails.

C) Discussion About the Conduct of Monetary Policy

12. Copom members discussed the evolution of economic activity in light of available information and indicators. They concluded that the data suggest the possibility of resumption of the process of economic recovery, which had been interrupted in recent quarters. The Committee estimates that Gross Domestic Product (GDP) should remain stable or show a small increase in the second quarter, with some acceleration expected for subsequent quarters, which will likely be reinforced by the stimuli provided by the release of FGTS and PIS-PASEP funds. Notwithstanding this expected acceleration, the Copom's baseline inflation scenario assumes that the pace of the underlying growth of the economy – that excludes the effects of temporary stimuli – will be gradual.

13. Committee members also assessed the evolution of indicators of financial conditions and concluded that there was significant easing in recent months. The Committee attributes this movement basically to the expectations of adjustment in the degree of monetary policy accommodation, to the benign evolution of financial conditions in global markets, and to the prospects for improving the fundamentals of the Brazilian economy. The latter, a result of the progress in the agenda of reforms and necessary adjustments in the economy. This easing has been reflected in both

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.

asset prices and the dynamics of credit and capital markets.

14. Copom members also discussed factors that could affect economic activity, in the context of the deep adjustments that the Brazilian economy requires, notably those of fiscal nature. They stressed that the persistence of uncertainties regarding fiscal sustainability tends to be contractionary. In particular, these uncertainties affect investment decisions that involve a high degree of irreversibility and, therefore, require greater predictability of future scenarios. In a context of limited fiscal space for public investment, they emphasized the importance of the continuation of the process of reforms and adjustments that contribute to the sustainability of fiscal policy. By reducing fundamental uncertainties about the Brazilian economy, these reforms tend to stimulate private investment. This potential expansionary effect should, to some extent, offset the impact of current fiscal adjustments on economic activity, as well as mitigate the risk of episodes of large risk premium increases, as witnessed in 2018.

15. The Copom stressed the understanding 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 development of the Brazilian economy. Initiatives in the structural agenda of the Banco Central do Brasil – BC# Agenda (formerly BC+ Agenda) – contribute to this process.

16. Regarding the global outlook, the Committee members considered that it evolved in a benign way. Central banks of several economies – some major economies included – have provided additional monetary stimuli, which contributed to easing global financial conditions. Nonetheless, the Copom judges that the risks associated with a slowing global economy remain and that economic policy and geopolitical uncertainties – notably trade disputes and geopolitical tensions – may contribute to even lower global growth. Given the risks still present in the external scenario, Copom members once again highlighted the capability of the Brazilian economy to withstand a setback in the international scenario, given its robust balance of payments, anchored inflation expectations, and prospects of continuation of structural reforms and of resumption of economic growth.

17. The Committee members discussed recent inflation projections and the levels of various measures of underlying inflation. The latter measures are deemed to be at comfortable levels. In the horizon relevant to monetary policy, which includes the

calendar year 2020, the scenario with constant interest rates at 6.50% leads to below target inflation for 2020, while the scenario with interest rate path extracted from the Focus survey, which embodies additional adjustment in the level of monetary stimuli, projects inflation around target.

18. Committee members then discussed the evolution, since their previous meeting, of the factors highlighted in their balance of risks around the baseline inflation scenario. All members agreed that the balance of risks has evolved favorably. In particular, they underlined the importance of concrete progress in the process of reforms and adjustments required by the Brazilian economy, which are fundamental for maintaining the benign environment for prospective inflation, with anchored expectations. The Committee considers that the risk of a possible frustration of expectations regarding the continuation of reforms and necessary adjustments in the Brazilian economy is still the main factor in its balance of risks.

19. Copom members assessed that economic conditions with anchored inflation expectations, underlying inflation measures at comfortable levels, 2020 inflation projected around or below target, and high level of slack in the economy prescribe stimulative monetary policy, i.e., interest rates below the structural interest rate level. The Committee members expressed the view that the current level of *ex-ante* real interest rates provides stimulus to the economy.

20. The structural interest rate is a reference for the conduct of monetary policy. When this policy yields a real (*ex-ante*) interest rate below the structural rate, it provides stimulus for economic activity and contributes to an increase in inflation. As the structural rate is not observable and economic activity and inflation depend on several other factors, estimates of this rate involve a high degree of uncertainty, and are continually reassessed by the Committee. At each meeting, the Copom assesses whether the Selic rate is at an appropriate level, considering all factors that affect the evolution of inflation projections and expectations, the balance of risks, and economic activity. Under the aforementioned circumstances, this implies evaluating whether the degree of monetary stimulus is adequate. It is worth highlighting that the provision of monetary stimulus requires an environment with anchored inflation expectations.

21. In Copom's view, the structural interest rate of the Brazilian economy embodies two components: risk-free structural rate and risk premium. Reforms and other changes to the economic environment may affect the structural rate in different ways, depending on their effects on these two components. The risk-free component depends on the structural determinants of consumption and savings, on the one hand, and investments, on the other hand. Through this

component, factors that persistently increase the willingness to invest push the economy's structural interest rate upward. However, these same factors may contribute to the reduction of the structural rate by lowering its risk premium component, if they imply an increase in the economy's growth potential and, therefore, greater fiscal policy sustainability.

22. The Pension reform, by adapting retirement rules to the country's demographic structure and dynamics, slows the pace of government spending growth, increasing public savings. In addition, it generates incentives for the population to increase its savings rate to sustain a certain pattern of consumption after retirement. Through these channels, the reform contributes to reducing the risk-free component of the structural interest rate of the Brazilian economy. Pension reform also reduces the risk premium component of the structural rate, as the reform improves the prospects for fiscal sustainability. Additionally, the reform induces an increase in labor supply and tends to stimulate private investment by reducing uncertainties about fundamental aspects of the Brazilian economy. Taking into account only the last two channels, the reform would tend to increase the structural interest rate. Notwithstanding the complexity of the channels through which the Pension reform may influence the structural interest rate of the Brazilian economy, when only its net effect is considered, the Copom understands that the reform contributes to the gradual decline of the structural interest rate of the economy.

23. The Copom reiterates its view that the continuation of reforms and necessary adjustments in the Brazilian economy is essential for the reduction of its structural interest rate, for the full efficacy of monetary policy, and for sustainable economic recovery. The Committee also stresses that the perception of continuation of the reform agenda affects current expectations and macroeconomic projections. In particular, the Committee judges that concrete progress in this agenda is fundamental for the consolidation of the benign scenario for prospective inflation.

24. 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 June meeting (223rd meeting). They unanimously decided to lower the Selic rate to 6.00% p.a.

25. The Copom also discussed the advisability of providing some perspective on possible monetary policy scenarios. The Committee decided to express its assessment that the consolidation of the benign scenario for prospective inflation should permit additional adjustment of the degree of stimulus. Given the decision to clarify conditionalities for the conduct of monetary policy, which best conveys the economic

rationality that guides its decisions, the Copom deemed it essential to emphasize that the communication of this assessment does not constrain its next decision, and to reiterate 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.

D) Monetary Policy Decision

26. Taking into account the baseline scenario, the balance of risks, and the wide array of available information, the Copom unanimously decided to lower the Selic rate to 6.00% 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 2020.

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

28. The Copom recognizes progress in the process of reforms and necessary adjustments in the Brazilian economy, but emphasizes that the continuation of this process is essential 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. In particular, the Committee judges that concrete progress in this agenda is fundamental for the consolidation of the benign scenario for prospective inflation.

29. In the Copom's assessment, the evolution of the baseline scenario and, especially, of the balance of risks prescribes adjusting the degree of monetary stimulus, lowering the Selic rate by 0.50 percentage point. The Committee deems that the consolidation of the benign scenario for prospective inflation should permit additional adjustment of the degree of stimulus. The Copom emphasizes that communicating this assessment does not constrain its next decision, and reiterates that the next steps in the conduct of monetary policy will continue to depend on the evolution of economic activity, on the balance of risks, and on inflation projections and expectations.

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