

Minutes of the 226th Meeting of the Monetary Policy Committee (Copom*) Banco Central do Brasil**

October 29-30, 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: October 29-30, 2019

Place: BCB Headquarters' meeting rooms on the 8th floor (October 29) and 20th floor (October 30) – Brasília – DF – Brazil

Starting and ending times: October 29 10:03 AM – 12:58 PM; 2:38 PM – 6:13 PM
October 30 2:00 PM – 6:06 PM

In attendance:

Members of the Copom

Roberto Oliveira Campos Neto – Governor
Bruno Serra Fernandes
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 October 29)

Alan da Silva Andrade Mendes - Department of Foreign Reserves
André Minella - Research Department (also present on October 30)
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 October 29)

Adalberto Felinto da Cruz Júnior – Executive Secretary
Carlos Eduardo de Almeida - Senior Advisor at the Deputy Governor for Licensing and Resolution's Office
Eduardo José Araújo Lima – Head of the Deputy Governor for Economic Policy's Office
Enrico Bezerra Ximenes de Vasconcelos – Secretary of the Financial Stability Committee and Advisor to the Board
Fabia Aparecida de Carvalho – Deputy Head of the Research Department
Fabio Araujo – Head of the Economic Advisors' Office
Gilneu Francisco Astolfi Vivan – Head of the Financial System Monitoring Department
Jaildo Lima de Oliveira - Head of the Prudential and Foreign Exchange Regulation Department
Leonardo Martins Nogueira – Head of the Governor's Office
Mauro Zanatta – Press Officer
Olavo Lins Romano Pereira – Head of the Deputy Governor for International Affairs and Corporate Risk Management's Office Corporate Risks
Renato Baldini Junior– Head of Statistics Department
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
Sílvia Michael de Azevedo Costa - Deputy Head of the Department of International Affairs

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 Economic Outlook and Copom's Baseline Scenario¹

1. Data on economic activity since the previous Copom meeting reinforce the continuity of the Brazilian economy recovery process. Copom's 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. Regarding the global outlook, the provision of additional monetary stimulus in major economies, in a context of economic slowdown and below-target inflation, has been able to generate a relatively favorable environment for emerging economies. The outlook remains uncertain, however, and risks of a more pronounced slowdown in global growth persist.

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

5. Inflation expectations for 2019, 2020, 2021, and 2022 collected by the Focus survey are around 3.3%, 3.6%, 3.75%, and 3.5%, respectively.

6. The Copom's inflation projections in the scenario with interest rate and exchange rate paths extracted from the Focus survey stand around 3.4% for 2019, 3.6% for 2020, and 3.5% for 2021. This scenario assumes a path for the Selic rate that ends 2019 at 4.50% p.a., remains at that level over 2020, and ends 2021 at 6.38% p.a. It also assumes a path for the exchange rate that ends 2019 at R\$4.00/US\$, remains at that level over 2020, and ends 2021 at R\$3.95/US\$. In this scenario, inflation projections for administered prices are 5.2% for 2019, 4.0% for 2020, and 3.8% for 2021.

7. In the scenario with a constant exchange rate at R\$4.05/US\$² and the interest rate path from the Focus survey, the conditional inflation projections are around 3.4% for 2019, 3.7% for 2020, and 3.6% for 2021. In this scenario, inflation projections for administered prices are 5.2% for 2019, 4.1% for 2020, and 4.0% for 2021.

¹ Unless explicitly stated otherwise, this update takes into account changes occurred since the September Copom meeting (225th 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, the combination of (i) the high level of economic slack and (ii) the potential propagation of current inflation, through inertia, may continue to produce a lower-than-expected prospective inflation trajectory.

10. On the other hand, (iii) the current degree of monetary stimulus, which affects the economy with lags, increases the uncertainty about the transmission channels and may raise the path for inflation over the relevant horizon for the conduct of monetary policy. Risk (iii) intensifies in case of (iv) a deterioration of the outlook for emerging economies or (v) a possible frustration regarding the continuation of reforms and the perseverance in the necessary adjustments in the Brazilian economy.

C) Discussion About the Conduct of Monetary Policy

11. Copom members discussed the evolution of economic activity in light of the available information and indicators. They concluded that the data released since their previous meeting reinforce the continuation of the Brazilian economic recovery process. The Committee estimates that the Gross Domestic Product (GDP) growth most likely expanded in 2019Q3. Subsequent quarters should show some acceleration, which should be reinforced by the stimuli resulting from the release of FGTS and PIS-PASEP resources – impacting mainly the last quarter of 2019. Copom's baseline inflation scenario assumes that the pace of underlying economic activity – which excludes the effects of temporary stimuli – will be gradual.

12. Copom members also evaluated the evolution of financial conditions indicators. They concluded that the conditions are favorable, despite some volatility inherent to those measures. The environment with favorable financial conditions results from the increase in the degree of monetary stimulus, the relatively favorable external environment for emerging economies and the prospects for improving the fundamentals of the Brazilian economy, as a result of the reform agenda. This easing of financial conditions has been more clearly reflected in the dynamics of non-

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.

earmarked credit and capital markets, which are growing at robust rates at this stage of the economic cycle.

13. 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. In a context of limited fiscal space, they emphasized the relevance of the approval of the Social Security Reform by the National Congress, but reinforced the importance of the continuation of the reforms and adjustments that contribute to the sustainability of fiscal policy. By reducing fundamental uncertainties about the Brazilian economy, these reforms tend to work in the same direction as the monetary policy and, therefore, to stimulate private investment. This potential expansionary effect should counterbalance the impact of current fiscal adjustments on economic activity, as well as mitigate the risks of large increases in risk premia.

14. The Copom stressed the understanding that an acceleration of the pace of economic recovery to more robust levels will also depend on other initiatives and microeconomic reforms aimed at productivity increases, efficiency gains, greater flexibility of the economy, and improvements in the business environment. These efforts are fundamental for the economic recovery and development of the Brazilian economy. Initiatives in the structural agenda of the Banco Central do Brasil (BC# Agenda) contribute to this process.

15. The Committee also discussed the characteristics of the current business cycle, with lower State participation in the economy, and their possible implications for monetary policy. Some Copom members pointed out that changes in the credit market and financial intermediation, such as the greater role played by non-earmarked credit and capital markets, may affect the monetary policy transmission channel. Copom members also conjectured about the sensitivity of macroeconomic variables to monetary policy, since we lack historical precedent in the Brazilian history for the current degree of stimulus. Given that monetary policy operates with lags in the economy, especially to price levels, the assessed factors tend to increase uncertainty about the monetary policy transmission channels.

16. Regarding the global outlook, Committee members deemed the scenario relatively favorable for emerging economies. On the one hand, central banks of several economies – some major economies included – have provided additional monetary stimuli, which contribute to easing global financial conditions. On the other hand, the Copom judges that the risks associated with a slowing global economy and geopolitical uncertainties remain. Uncertainties in the external

scenario imply risks to assets whose pricing hinge heavily on a scenario with low global interest rates and the maintenance of the recent pace of economic growth. In this context, the 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 continuing structural reforms and of economic recovery.

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. Estimates and short-term projections indicate that the 12-month inflation most likely retreated in October to levels near the lows observed during the inflation targeting regime, and should rise again over the last months of the year. This short-term trajectory reflects a lower than expected inflation in September and a downward revision of the October projection. For the last two months of this year, the projections of some administered prices have been revised, which, in turn, offset those disinflationary surprises, keeping the inflation projection stable relative to the previous meeting, in the scenario with the interest rate path from the Focus survey and a constant exchange rate.

18. In the relevant horizon for monetary policy, the scenario with the interest rate from the Focus survey and a constant exchange rate results in inflation below the 2020 target and slightly below the 2021 target. Relative to the previous Copom meeting, the conditioning factors had contrasting effects on inflation for 2020. On the one hand, additional monetary stimulus from lower interest rates contributed to increasing inflation over the relevant horizon. On the other hand, some administered price adjustments were brought forward to 2019, and, together with the decline in the Focus survey inflation expectations, were a vector in the opposite direction, which eventually prevailed. For 2021, relative to the previous Copom meeting, the main drivers behind the projected decline were the propagation of a lower-than-expected 2020 inflation and the revision of administered prices.

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

20. The Copom reiterates its view that the continuity of reforms and perseverance in the necessary adjustments in the Brazilian economy are essential for the consolidation of the reduction of the structural interest rate, for the full operation of monetary policy, and for a sustainable economic recovery. The Committee also stresses that the perception of continuation of the reform agenda affects current expectations and macroeconomic projections.

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 September meeting (225th meeting). They unanimously decided to lower the Selic rate to 5.00% p.a.

22. 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 an additional adjustment, of the same magnitude, to the degree of monetary stimulus. Then, the Committee discussed the benefits of signaling beyond the next meeting. The members of the Copom decided to stress that the current stage of the business cycle recommends caution when considering possible new changes in the degree of stimulus.

23. Given the decision to clarify the 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 decisions, 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

24. Taking into account the baseline scenario, the balance of risks, and the broad array of available information, the Copom unanimously decided to lower the Selic rate to 5.00% p.a. The Committee judges that this decision reflects its baseline scenario for prospective inflation and the associated balance of risks, and it is consistent with convergence of inflation to target over the relevant horizon for the conduct of monetary policy, which includes 2020 and, to a lesser extent, 2021.

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

26. The Copom sees progress in the process of reforms and necessary adjustments in the Brazilian economy, but emphasizes that persevering in this process is essential to allow for the consolidation of the reduction of the structural interest rate and for a sustainable economic recovery. The Committee also stresses that the perception of continuation of the reform agenda affects current expectations and macroeconomic projections.

27. In the Copom's assessment, the evolution of the baseline scenario and 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 an additional adjustment of the same magnitude. The Copom judges that the current stage of the business cycle recommends caution when considering possible new changes in the degree of stimulus. The Committee reiterates that communicating this assessment does not restrict its next decisions, and 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.

28. The following members of the Committee voted for this decision: Roberto Oliveira Campos Neto (Governor), Bruno Serra Fernandes, 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.