

Minutes of the 223rd Meeting of the Monetary Policy Committee (Copom*) Banco Central do Brasil**

June 18-19, 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: June 18-19, 2019

Place: BCB Headquarters' meeting rooms on the 8th floor (June 18) and 20th floor (June 19) – Brasília – DF – Brazil

Starting and ending times: June 18: 11:05 AM – 1:10 PM; 3:04 PM – 7:01 PM
June 19: 2:00 PM – 6:05 PM

In attendance:

Members of the Copom

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 June 18)

Alan da Silva Andrade Mendes - Department of Foreign Reserves
André Minella - Research Department (also present on June 19)
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 June 18)

Adalberto Felinto da Cruz Júnior – Executive Secretary
Angelo José Mont'Alverne Duarte – Head of Department of Competition and Financial Market Structure
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
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 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. Recent data on economic activity indicate a halt in the process of economic recovery in the past quarters. Copom's baseline scenario assumes resumption of this process ahead, in a gradual fashion.

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 less challenging, owing to changes in the prospects for 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 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 3.8%, 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 3.6% for 2019 and 3.9% for 2020. This scenario assumes, among other hypotheses, a path for the Selic rate that ends 2019 at 5.75% p.a. and increases to 6.50% p.a. over the course of 2020. It also assumes a path for the exchange rate that ends 2019 and 2020 at R\$3.80/US\$. In this scenario, inflation projections for administered prices are 3.9% 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\$3.85/US\$², Copom's inflation projections stand around 3.6% for 2019, and 3.7% for 2020. In this scenario, inflation projections for administered prices are 3.9% for 2019, and 4.6% for 2020.

B) Risks Around the Baseline Inflation Scenario

¹ Unless explicitly stated otherwise, this update takes into account changes occurred since the May Copom meeting (222nd meeting).

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 (iii) the global outlook for emerging economies deteriorates.

11. The Committee judges that the balance of risks has evolved favorably, but risk (ii) prevails at this time.

C) Discussion About the Conduct of Monetary Policy

12. The Committee members discussed the evolution of economic activity in light of available data. The members concluded that the process of economic recovery came to a halt in the past quarters. This halt is clear when adopting a slightly longer perspective, which suggests that there has been a change in the dynamics of the economy after the second quarter of 2018. From this perspective, the recovery of economic activity, which occurred at a gradual pace until then, has lost momentum. After a slight decline in the first quarter of 2019, as a result of this loss of dynamism and some occasional shocks, Gross Domestic Product (GDP) is expected to remain relatively stable in the second quarter.

13. The Copom members assessed that, to a large extent, the effects on economic activity of the main shocks suffered by the Brazilian economy throughout 2018 have dissipated. In addition, financial conditions – which had tightened significantly between the second and fourth quarters of 2018 – have already moved into more stimulative territory. In this context, the Copom's baseline scenario assumes resumption of the process of economic recovery ahead, in a gradual fashion.

14. The Copom members also discussed factors that could hinder economic growth, in the context of the deep adjustments that the Brazilian economy requires, notably those of fiscal nature. They stressed that the

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.

persistence of uncertainties regarding fiscal sustainability tend to be contractionary. In particular, these uncertainties affect investment decisions that involve a high degree of irreversibility and, therefore, need greater predictability of future scenarios. In a context of limited fiscal space for public investment, they emphasized the importance of reforms that lead to future sustainability. 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 short-term 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 recovery of the economy 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.

16. Regarding the global outlook, the Committee members deemed it less challenging. Major central banks clearly indicated a willingness to provide additional monetary stimuli in case of need, 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 may contribute to an even lower global growth. In light of evidence of economic slowdown in several countries, some Copom members considered that the global environment may be more relevant to the dynamics of economic activity than previously anticipated. 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 future structural reforms and resumption of economic recovery ahead.

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 appropriate levels. With regard to the shorter-term projections, they pointed out that the fall of food inflation and recent favorable movements in fuel and electricity prices tend to produce lower inflation than previously predicted. These revisions explain a substantial share of the decline in the conditional projections for 2019 IPCA inflation. At the horizon relevant to monetary policy, which mainly includes the calendar year 2020, the scenarios with constant interest rates produce inflation slightly below target for 2020, while the scenarios with interest rate path extracted from the Focus survey, which embody

the provision of additional monetary stimuli, produce inflation around the target.

18. The 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. Nevertheless, the Copom members stressed that the consolidation of the benign scenario reflected in inflation expectations and in the aforementioned conditional projections depends on the pace of necessary reforms and adjustments in the Brazilian economy, which are essential for the sustainability of the environment with anchored inflation expectations. A possible frustration of expectations regarding the continuity of these reforms and adjustments may affect risk premia and increase the path for inflation over the relevant horizon for the conduct of monetary policy. The Committee judges that, at this time, this factor prevails in its balance of risks.

19. The Copom members assessed that economic conditions with anchored inflation expectations, underlying inflation measures at appropriate levels, 2020 inflation projected around or slightly 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 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. Nevertheless, the Committee members expressed the view that the current *ex-ante* real interest rates provide stimulus to the economy. This assessment is not inconsistent with recent lower-than-expected economic performance, since economic activity is influenced by several other factors, as highlighted above.

20. 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, particularly on inflation expectations, the level of slack in the economy, the balance of risks, and inflation projections. Importantly, the provision of monetary stimulus requires an environment with anchored inflation expectations.

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 May meeting (222nd meeting). They unanimously decided to maintain the Selic rate at 6.50% p.a.

22. The Committee deems important to observe how the Brazilian economy will behave over time, with reduction of the degree of uncertainty to which it remains exposed.

23. The 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.

24. The Copom reiterates its view that the continuity of reforms and necessary adjustments in the Brazilian economy is essential for the reduction of its 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. In particular, the Committee judges that concrete progress in this agenda is fundamental for the consolidation of the benign scenario for prospective inflation. 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.

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 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 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, João Manoel Pinho de Mello, Maurício Costa de Moura, Otávio Ribeiro Damaso, Paulo Sérgio Neves de Souza, and Tiago Couto Berriel.

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

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

27. The Committee deems important to observe how the Brazilian economy will behave over time, with reduction of the degree of uncertainty to which it remains exposed.

28. The Copom emphasizes that the evolution of reforms and necessary adjustments in the Brazilian economy is essential for the reduction of its structural interest rate and for sustainable economic recovery. The Committee also stresses that the perception of