

Minutes of the 231st Meeting of the Monetary Policy Committee (Copom*) Banco Central do Brasil**

June 16-17 2020



* 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 16-17 2020

Place: BCB Headquarters' meeting room on the 8th floor – Brasília – DF – Brazil

Starting and ending times: June 16: 10:08 AM – 12:32 PM; 2:37 PM – 6:31 PM
June 17: 2:05 PM – 6:05 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 June 16)

André Minella - Research Department (present on June 16-17 sessions)
André de Oliveira Amante – Department of Open Market Operations
Fabia Aparecida de Carvalho – Department of International Affairs
Flávio Túlio Vilela – Department of Banking Operations and Payments System
José Aloisio Costa Filho – Department of Economics
Luís Guilherme Siciliano Pontes – Deputy Head of the Department of Foreign Reserves

Other participants (present on June 16)

Adalberto Felinto da Cruz Junior – Executive Secretary
Leonardo Martins Nogueira – Head of the Governor'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. Regarding the global outlook, the COVID-19 pandemic keeps causing a significant slowdown in global growth. Against this backdrop, despite the additional provision of fiscal and monetary stimuli in major economies and some moderation in financial assets volatility, the environment for emerging economies remains challenging.

2. Turning to economic activity, the first-quarter data release showed the largest GDP decline since 2015, reflecting the initial effects of the pandemic. Recent indicators suggest that the second-quarter economic activity contraction will be even larger. Prospectively, uncertainty about the second half-year economic recovery remains larger than usual.

3. Several measures of underlying inflation are running below the levels compatible with meeting the inflation target at the relevant horizon for monetary policy.

4. Inflation expectations for 2020, 2021, and 2022 collected by the Focus survey are around 1.6%, 3.0%, and 3.5%, respectively.

5. Short-term inflation tends to increase, mainly reflecting the impacts of the reversal of international oil prices and of price adjustments of administered items that were postponed.

6. In the hybrid scenario with interest rate path extracted from the Focus survey and constant exchange rate at R\$4.95/US\$^{2*}, the Copom projections stand around 2.0% for 2020 and 3.2% for 2021. This scenario assumes a path for the Selic rate that ends 2020 at 2.25% p.a. and rises to 3.00% p.a. in 2021. In this scenario, inflation projections for administered prices are 1.3% for 2020 and 3.8% for 2021.

7. The scenario with constant interest rate at 3.00% p.a. and constant exchange rate at R\$4.95/US\$ yields inflation projections around 1.9% for 2020, and 3.00% for 2021. In this scenario, inflation projections for administered prices are 1.3% for 2020 and 3.8% for 2021.

¹ Unless explicitly stated otherwise, this update takes into account changes occurred since the May Copom meeting (230th 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, economic slack may continue to produce a lower-than-expected prospective inflation trajectory. This risk increases if a lengthening of the pandemic causes an increase in uncertainty and precautionary savings and, consequently, implies a decline in aggregate demand that is larger and longer than estimated.

10. On the other hand, fiscal policy responses to the pandemic that permanently aggravate the fiscal path or a frustration with the continuation of the reform agenda may increase the risk premium. Additionally, the credit and transfer programs implemented in response to the pandemic may cause a smaller-than-estimated decline in aggregate demand, introducing an asymmetry to the balance of risks. This set of factors could potentially result in a higher-than-expected path for inflation over the relevant horizon for monetary policy.

C) Discussion about the conduct of monetary policy

11. Regarding the global economy, the Committee pondered that governments and central banks of major economies reacted in an unprecedentedly coordinated and strong way, thus partially mitigating the economic impacts of the crisis. However, unlike other crises, the epicenter of the current crisis moved to all countries, along with the pandemic. Better monitoring, information, as well a larger pool of resources, allows developed countries to fight against the pandemic in a more vigorous and efficient manner than emerging economies. As a result, the sanitary and economic effects of the pandemic are larger in emerging economies, especially in those with limited fiscal space, which reflects on risk aversion and capital flows toward these countries. In this context, despite some moderation in the volatility of asset prices, the international environment for the Brazilian economy remains challenging.

12. The Copom members discussed the evolution of domestic economic activity in light of the available information and indicators. They evaluated that data for the second quarter corroborate the perspective of a sharp GDP contraction and suggest that economic activity reached the lowest level in April, registering only a partial recovery in May and June. The Copom's

² Value obtained according to the usual procedure of rounding the average R\$/US\$ exchange rate observed in the five business days ended in the last day of the week prior to the Copom meeting.

baseline scenario entails a sharp decline in GDP in the first half of this year, followed by a gradual recovery from the third quarter onwards.

13. The Copom members debated on the level of economic slack. They reinforced their view that the pandemic shall exert a disinflationary impact on the Brazilian economy, together with a sharp increase in the level of economic slack. The sudden growth in economic uncertainty should result in an increase in precautionary savings and, consequently, a significant reduction of aggregate demand.

14. The Committee also considered the impact of the credit and transfer programs on aggregate demand. The Committee assessed that these programs have the potential to complement a significant portion of the aggregate demand that would be lost due to the effects of the pandemic. As a result, the economic recovery could be faster than anticipated by the baseline scenario.

15. The Committee resumed the discussion on the potential effective lower limit for the Brazilian interest rate. Most members of the Committee believe that this limit would be significantly higher among emerging economies than among developed countries, due to the existence of a risk premium. This premium is dynamic and tends to be larger in Brazil, given the country's relative fiscal fragility and the uncertainties regarding its prospective fiscal path. In this context, we would already be close to the level from which further interest rate reductions could be accompanied by asset price instability, and potentially compromise the performance of some markets and economic sectors. The Committee also reflected on the relative importance of the main components of the cost of credit and emphasized that liquidity premium seems to prevail at the moment. The Committee recognized that this set of factors, as well as prudential issues, justify caution in the conduct of monetary policy.

16. Finally, the Copom judged that the demand-driven disinflationary shock, although accompanied by greater fiscal fragility, has triggered a downward revision on inflation expectations towards levels not compatible with the target, particularly, within the relevant horizon for monetary policy. Although this movement seems to have ceased in the expectations implicit in government bonds, it continues to occur in the expectations collected by the Focus survey. Therefore, the Committee keeps a close eye on revisions to the economic scenario and inflation expectations, and reaffirmed its commitment to the inflation target set by the National Monetary Council, which has always been and still is the main objective of monetary policy.

D) Monetary Policy Decision

17. 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 by 0.75 percentage point to 2.25% p.a. The Committee judges that this decision reflects its baseline scenario for prospective inflation, a higher-than-usual variance in the balance of risks, and it is consistent with convergence of inflation to its target over the relevant horizon for monetary policy, which includes 2021.

18. The Committee believes that persevering in the process of reforms and necessary adjustments in the Brazilian economy is essential for a sustainable economic recovery. The Copom also stresses that doubts regarding the continuation of the reform agenda and permanent changes to the fiscal consolidation process could result in an increase in the structural interest rate.

19. The Copom believes that the current state of affairs continues to recommend an unusually strong monetary stimulus, but it recognizes that the remaining space for monetary policy stimulus is uncertain and should be small. The Committee believes that the fiscal trajectory over the next year, as well as the perception of its sustainability, will be crucial to determine the length of the stimulus.

20. At the present moment, the Committee judges that the magnitude of the monetary stimulus already implemented seems compatible with the economic impacts of the COVID-19 pandemic. For the next meetings, the Committee sees as appropriate to evaluate the impact of the pandemic and of the set of credit and transfer programs in place and foresees that any possible adjustment to the monetary stimulus would be residual. However, the Copom remains attentive to revisions of the economic scenario and of the inflation expectations for the relevant horizon of monetary policy. The Committee recognizes that the variance of its balance of risks has increased and that further information on the evolution of the pandemic, as well as a decline in fiscal uncertainty, will be essential to determine its next steps.

21. 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.