234th

Minutes of the Meeting of the

Monetary Policy Committee — Copom

October 27-28, 2020

BANCO CENTRAL DO BRASIL

Date: October 27-28, 2020

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

Starting and ending times: October 27: 11:08 AM – 1:32 PM; 2:39 PM – 7:09 PM
October 28: 2:05 PM – 6:11 PM

In attendance:

Members of the Copom

Roberto Oliveira Campos Neto – *Governor*
Bruno Serra Fernandes
Carolina de Assis Barros
Fabio Kanczuk
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 (October 27):

Alan da Silva Andrade Mendes – *Department of Foreign Reserves*
André Minella – *Research Department* (also present on October 28)
André de Oliveira Amante – *Department of Open Markets Operations*
Fabia Aparecida de Carvalho – *Department of International Affairs*
Flávio Túlio Vilela – *Department of Banking Operations and Payments System*
Ricardo Sabbadini – *Department of Economics*

Other participants (October 27):

Arnildo da Silva Correa – *Head of the Office of Economic Advisor*
Eugênio Pacceli Ribeiro – *Executive Secretary*
Rafael Mendonca Travassos Andrezo – *Deputy Head of the Governor's Office*
Rogério Antônio Lucca – *Head of the Deputy Governor for Monetary Policy's Office*
Sílvio 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. This document represents Copom's best effort to provide an English version of its policy meeting minutes. In case of inconsistency, the Portuguese version prevails.

A) Update of economic outlook and Copom's baseline scenario[1]

1. Regarding the global outlook, the strong recovery in some economic sectors seems to be subsiding, partly due to the pandemic resurgence in some major economies. There is significant uncertainty regarding the evolution of this scenario due to a possible decline in government stimuli and to the evolution of the COVID-19 itself. However, the moderation in financial assets volatility keeps resulting in a relatively favorable environment for emerging economies.

2. Turning to the Brazilian economy, similarly to other countries, recent indicators suggest an uneven recovery in economic activity. Sectors more directly affected by social distancing measures remain depressed despite the offsetting effects of the transfer programs. Prospectively, uncertainty about economic growth remains larger than usual, especially for the period starting at the end of this year, concurrently with the expected unwinding of the emergency transfer programs.

3. The various measures of underlying inflation are in 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 3.0%, 3.1%, and 3.5%, respectively.

5. The latest inflation readings were higher than expected, and the Committee raised its projection for the remaining months of 2020. This revision was due to continuing food and industrial price increases which, in turn, are a consequence of a persistent exchange rate depreciation, the oil price rise, and the income transfer programs. On the one hand, the partial normalization of some depressed prices should continue, in a context of a recovery in mobility indices and activity level. On the other hand, some prices, which rose extraordinarily due to a temporary reduction in supply in conjunction with an occasional increase in demand, are expected to reverse. Therefore, in spite of the stronger-than-expected inflationary pressure, the Committee maintains the diagnosis that this shock is temporary, although closely monitoring its evolution.

6. The Copom's inflation projections in its baseline scenario, with interest rate path extracted from the Focus survey and exchange rate starting at R$5.60/US$[2] and evolving according to the purchase power parity (PPP), stand around 3.1% for 2020, 3.1% for 2021 and 3.3% for 2022. This scenario assumes a path for the Selic rate that ends 2020 at 2.00% p.a., rises to 2.75% p.a. in 2021 and 4.50% p.a. in 2022. In this scenario, inflation projections for administered prices are 0.8% for 2020, 5.1% for 2021, and 3.9% for 2022.

7. The scenario with constant interest rate at 2.00% p.a. and exchange rate starting at R$5.60/US$ and evolving according to the PPP yields inflation projections around 3.1% for 2020, 3.2% for 2021 and 3.8% for 2022. In this scenario, inflation projections for administered prices are 0.8% for 2020, 5.1% for 2021, and 4.0% for 2022.

B) Risks around the baseline inflation scenario

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

[1] Unless explicitly stated otherwise, this update takes into account changes occurred since the September Copom meeting (233rd meeting).

[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.

9. On the one hand, economic slack may continue to produce a lower-than-expected prospective inflation trajectory, especially when this slack is concentrated in the service sector. This risk increases if a slower reversion of the pandemic effects lengthens the environment of high uncertainty and precautionary savings.

10. On the other hand, the extension of fiscal policy responses to the pandemic that aggravate the fiscal path or a frustration with the continuation of the reform agenda may increase the risk premium. The relative increase in the risks of these events imply an upward asymmetry to the balance of risks, ***i.e.***, in the direction of higher-than-expected paths for inflation over the relevant horizon for monetary policy.

C) Discussion about the conduct of monetary policy

11. Regarding the international economy, the recent pandemic resurgence and the consequent increase in social distancing in some of the major economies may interrupt recovery in demand. A potential non-organized and abrupt reduction of governmental stimuli also brings risks to the economic recovery. For now, however, the reduction in financial asset volatility keeps resulting in a relatively favorable environment for emerging economies. Still, the Committee judged that there is significant uncertainty about the evolution of this scenario.

12. The Copom members discussed the evolution of domestic economic activity in light of the available information and indicators. They assessed that recent data suggest an uneven recovery in economic activity. The transfer programs from the government have allowed for a relatively strong rebound in durable goods consumption and investment. However, several service sector activities, especially those more directly affected by social distancing measures, remain significantly depressed. Prospectively, the unpredictability associated with the pandemic evolution and the necessary adjustment in government spending from 2021 onwards increases the uncertainty about the maintenance of the economic activity recovery. The Committee considered that this unpredictability and the risks associated with the evolution of the pandemic may imply a domestic scenario characterized by an even more gradual economic recovery.

13. The Copom members debated on the level of economic slack. As with activity, the Committee believes that the pandemic should continue to have heterogeneous effects on the economic sectors. Given the nature of the shock, the economic slack in the service sector should remain larger than in other sectors. The Committee concluded that the nature of the crisis probably implies that disinflationary pressures from reduced demand may last longer than in previous recessions.

14. The Committee then resumed the discussion of a potential effective lower limit for the Brazilian policy interest rate and its connection with prudential and financial stability issues. Considering the long history of the Brazilian economy operating at very high levels of Selic rate, unprecedented low interest rates may compromise the performance of some markets and economic sectors, with a potential impact on financial intermediation. For the majority of the Copom members, we would already be close to the level from which further interest rate reductions could be accompanied by asset price instability.

15. Subsequently, the Copom members discussed on the maintenance of the signaling that "the remaining space for monetary policy stimulus, if it exists, should be small". The Committee assessed that this signaling is due to prudential restrictions regarding reductions of the Selic rate and, therefore, should be kept in communication.

16. Next, the Committee discussed the implementation of the monetary policy itself. Since its 232nd Meeting, the Copom has adopted forward guidance, according to which, it does not intend to reduce the monetary stimulus as long as specified conditions are

met. The Committee judged that those conditions continue to hold: inflation expectations, as well as inflation projections for its baseline scenario, are significantly below the inflation target for the relevant horizon for monetary policy; the current fiscal regime has not been changed; and long-term inflation expectations remain well anchored.

17. The Copom continued its analysis, considering not only the baseline scenario, but also the balance of risks, and restrictions of prudential nature. Regardless of prudential restrictions, the Copom considered that, at this moment, the upward asymmetry in the balance of risks caused by fiscal risks is sufficient to compensate the fact that its inflation projections in the baseline scenario are below the target at the relevant horizon. The Committee, therefore, deemed as adequate the current level of monetary stimulus, which is being provided by the maintenance of the policy rate at 2.00% p.a. and by the forward guidance, regardless of prudential nature restrictions.

18. Finally, the Committee discussed the interpretation of the fiscal clause of its forward guidance, which conditions the non-elevation of interest rates to the maintenance of the current fiscal regime. The Committee judged that changes in the fiscal policy that affect the public debt trajectory or compromise the fiscal anchor would motivate a reassessment, even if the spending ceiling in nominal terms is still maintained. This reassessment would follow the usual guidance of an inflation targeting regime, based on prospective inflation and its balance of risks.

D) Monetary policy decision

19. Taking into account the baseline scenario, the balance of risks, and the broad array of available information, the Copom unanimously decided to maintain the Selic rate at 2.00% 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 and 2022.

20. 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 uncertainty 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.

21. The Copom believes that the current economic conditions continue to recommend an unusually strong monetary stimulus but it recognizes that, due to prudential and financial stability reasons, the remaining space for monetary policy stimulus, if it exists, should be small.

22. The Committee deems as adequate the current level of monetary stimulus, which is being provided by the maintenance of the policy rate at 2.00% p.a. and by the forward guidance introduced in its 232nd meeting. The forward guidance stated that the Copom does not intend to reduce the monetary stimulus as long as specified conditions are met. The Committee judges that those conditions continue to hold: inflation expectations, as well as inflation projections for its baseline scenario, are significantly below the inflation target for the relevant horizon for monetary policy; the current fiscal regime has not been changed; and long-term inflation expectations remain well anchored.

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