

236th

Minutes of the Meeting of the
Monetary Policy Committee — Copom

January 19-20, 2021

Date: January 19-20, 2021

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

Starting and ending times: January 19: 10:06 AM – 12h42 PM; 2:41 PM – 6:20 PM
January 20: 2:39 PM – 6:34 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 (January 19):

Alan da Silva Andrade Mendes – *Department of Foreign Reserves*
André Minella – *Research Department (also present on January 20)*
André de Oliveira Amante – *Open Market Operations Department*
Fabia Aparecida de Carvalho – *Department of International Affairs*
Fábio Martins Trajano de Arruda – *Department of Banking Operations and Payments Systems*
Ricardo Sabbadini – *Department of Economics*

Other participants (January 19):

Arnildo da Silva Correa – *Head of the office of Economic Advisor*
Eugênio Paceli Ribeiro – *Executive Secretary*
Leonardo Martins Nogueira – *Head of the Governor's Office*
Pedro Henrique da Silva Castro – *Deputy Head of the Department of Economics*
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. 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 scenario¹

1. Regarding the global outlook, the increase in the number of cases and the emergence of new virus strains are reverting previous mobility gains and should affect short-term activity. However, new fiscal stimulus in some developed countries and the rollout of COVID-19 immunization programs should promote a solid economic recovery in the medium term. Economic slack and communication of central banks of major economies suggest that monetary stimuli will last long, resulting in a favorable environment for emerging economies.

2. Turning to the Brazilian economy, indicators regarding growth at the end of last year have been better than expected, but they do not capture the effects of the recent increase in the number of COVID-19 cases. Prospectively, uncertainty about economic growth remains larger than usual, especially for the first quarter of this year, concurrently with the expected unwinding of the emergency transfer programs.

3. The various measures of underlying inflation are in levels above the range compatible with meeting the inflation target.

4. Inflation expectations for 2021, 2022, and 2023 collected by the Focus survey are around 3.4%, 3.5%, and 3.25%, respectively.

5. The recent increase in commodities prices and its effects on food and fuel prices imply an increase in inflation forecasts for the next months. In spite of the stronger short-term inflationary pressure, the Committee maintains the diagnosis that the current shocks are temporary, although more persistent than expected. Hence, the Copom continues to closely monitor the evolution of inflation, in particular core inflation readings.

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\$5.35/US\$², and evolving according to the purchase power parity (PPP), stand around 3.6% for 2021 and 3.4% for 2022. This scenario assumes a path for the Selic rate that ends 2021 at 3.25% p.a. and rises to 4.75% p.a. in 2022. In this scenario, inflation projections for administered prices are 5.1% for 2021 and 3.0% for 2022.

B) Risks around the baseline inflation scenario

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

8. 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.

9. On the other hand, an extension of fiscal policy responses to the pandemic that aggravates 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 implies 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.

¹Unless explicitly stated otherwise, this update takes into account changes occurred since the December Copom meeting (235th 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.

C) Discussion about the conduct of monetary policy

10. Regarding the international environment, the Committee assessed that, on the one hand, the emergence of new variants of the virus and recent discussions about reflation in the USA are, respectively, new sources of risk for economic activity and asset prices in emerging countries. On the other hand, this risk is counterbalanced by the rollout of extensive immunization programs against the COVID-19, new fiscal stimuli in some developed countries and the communication of central banks of major economies that monetary stimuli will last long. The Committee judged that, for now, the result of this set of factors is a favorable environment for emerging economies.

11. The Copom members discussed the evolution of domestic economic activity in light of the available information and indicators. They evaluated that, despite the partial reduction in governmental transfer programs, available data for the end of last year have been positively surprising. However, these data do not capture the effects of the recent increase in the number of COVID-19 cases. Prospectively, the unpredictability associated with the pandemic developments, and the necessary adjustment in government spending from 2021 on, increases the uncertainty about the economic recovery. The Committee considers that the risks associated with both the pandemic developments and the expected unwinding of the emergency transfer programs may lead to a domestic scenario characterized by more gradualism or even a temporary reversal of the economic recovery.

12. The Copom members debated on the level of economic slack. The Committee believes that the pandemic continues to have heterogeneous effects on different economic sectors. The transfer programs from the government have reduced slack in the goods sector. Service activities, however, especially those most directly affected by social distancing, face a greater reduction in demand. Prospectively, the evolution of these sectoral gaps will depend on the pandemic developments and on the adjustment in public spending. Some members of the Committee pointed out that labor market data on the formal sector suggest that the overall economic slack has reduced more rapidly than expected. Most members, however, felt that other labor market data did not support this conclusion.

13. Next, the Committee discussed the implementation of monetary policy. According to the forward guidance introduced since its 232nd meeting the Copom would not reduce the monetary stimulus as long as three conditions were met. The Copom has evaluated that two of these conditions still hold: the fiscal regime has not changed, and long-term inflation expectations remain anchored. However, the Committee judges that the third condition no longer holds, as inflation expectations, as well as inflation projections for its baseline scenario, are sufficiently close to the inflation target over the relevant horizon for monetary policy. As a consequence, the Committee decided to drop its forward guidance. Henceforth, monetary policy will follow the usual analysis of the balance of risks for the prospective inflation.

14. The Copom continued its analysis, considering not only the baseline scenario, but also the balance of risks for inflation. According to the baseline scenario, inflation projections are around the target in the relevant horizon. The Committee also considered that fiscal risks generate an upward bias in these projections, potentially justifying an increase in policy rates earlier than that assumed in its baseline scenario.

15. The Copom members discussed the impact of this asymmetry in the balance of risks in the appropriate degree of monetary stimulus. In particular, some members questioned whether it would still be appropriate to maintain an extraordinarily high degree of stimulus, given the normalization of the economic activity observed in recent months. Since the May 2020 Copom meeting, when the desired degree of monetary stimulus was characterized as "extraordinary", there has been a reversal on the disinflationary shock that occurred in the first months of the year, a reversal of the

downward trend on inflation expectations and a decline on economic slack, bringing inflation projections on the baseline scenario closer to its target in the relevant horizon. Therefore, these members believe that the Copom should consider starting a process of partial normalization, reducing the "extraordinary" degree of monetary stimuli.

16. Lastly, the Committee concluded that despite some normalization in economic activity, uncertainty regarding the future dynamics of main economic variables remains above the usual. The next data release will be very informative about the evolution of the pandemic, economic activity, and fiscal policy. Thus, the benefits of waiting for these releases to decide on the next steps of monetary policy outweigh the costs. For this reason, at this time the Copom deemed it appropriate to maintain the extraordinarily high degree of monetary stimulus.

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 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, mainly, 2022.

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 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.

19. According to the forward guidance introduced in its 232nd meeting the Copom would not reduce the monetary stimulus as long as specified conditions were met. Based on new information, the Committee judges that those conditions no longer hold, as inflation expectations, as well as inflation projections for its baseline scenario, are sufficiently close to the inflation target over the relevant horizon for monetary policy. Therefore, the forward guidance no longer holds and, henceforth, monetary policy will follow the usual analysis of the balance of risks for the prospective inflation.

20. The Copom reiterates that the removal of the forward guidance does not mechanically imply interest rates increases, since, at this moment, uncertainties regarding the evolution of growth still prescribe an extraordinarily strong monetary stimulus.

21. 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.