

# **Minutes of the 217<sup>th</sup> Meeting of the Monetary Policy Committee (Copom) \* of the Central Bank of Brazil \*\***

September 18<sup>th</sup> and 19<sup>th</sup>, 2018



\* The Monetary Policy Committee of the Central Bank of Brazil 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:** September 18<sup>th</sup> and 19<sup>th</sup>, 2018

**Place:** BCB Headquarters' meeting rooms on the 8<sup>th</sup> floor (September 18<sup>th</sup>) and 20<sup>th</sup> floor (September 19<sup>th</sup>)  
– Brasília – DF – Brazil

**Starting and ending time:** September 18<sup>th</sup>: 10:08 am–11:59 am; 2:33 pm–5:09 pm  
September 19<sup>th</sup>: 2:00 pm–6:00 pm

**In attendance:**

**Members of the Copom**

Ilan Goldfajn – Governor  
Carlos Viana de Carvalho  
Carolina de Assis Barros  
Maurício Costa de Moura  
Otávio Ribeiro Damaso  
Paulo Sérgio Neves de Souza  
Reinaldo Le Grazie  
Sidnei Corrêa Marques  
Tiago Couto Berriel

**Department Heads in charge of technical presentations (present on September 18<sup>th</sup>)**

Alan da Silva Andrade Mendes - Department of Foreign Reserves  
André Minella - Research Department (*also present on September 19<sup>th</sup>*)  
Flávio Túlio Vilela – Department of Banking Operations and Payments System  
João Barata Ribeiro Blanco Barroso – Department of International Affairs  
João Henrique de Paula Freitas Simão – Department of Open Market Operations  
Tulio José Lenti Maciel – Department of Economics

**Other participants (present on September 18<sup>th</sup>)**

Daniela Pires Ramos de Alcântara – Head of the Deputy Governor for International Affairs and Corporate Risk Management's Office  
Enrico Bezerra Ximenes de Vasconcelos – Secretary of the Financial Stability Committee and Senior Advisor to the Board  
Eugênio Pacceli Ribeiro – Head of the Deputy Governor for Economic Policy's Office  
Fábia 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  
Gustavo Paul Kurrle – Press Officer  
Leonardo Martins Nogueira – Head of the Governor's Office  
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 scenario<sup>1</sup>

1. Recent indicators of economic activity point to the recovery of the Brazilian economy, at a more gradual pace than envisaged early this year.

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 remains challenging, with reduction of risk appetite towards emerging economies. The main risks continue to be associated with normalization of interest rates in some advanced economies and with uncertainty regarding global trade.

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 2018 and 2019 collected by the Focus survey are around 4.1%. Expectations for 2020 around 4.0% and those regarding 2021 retreated to around 3.9%.

6. The Copom's inflation projections in the scenario with interest rate and exchange rate paths extracted from the Focus survey stand around 4.1% for 2018, and 4.0% for 2019. This scenario assumes, among other hypotheses, a path for the policy interest rate that ends 2018 at 6.5% p.a., and 2019 at 8.0% p.a., and a path for the exchange rate that ends 2018 at R\$/US\$ 3.83, and 2019 at R\$/US\$ 3.75. In this scenario, projections for administered price inflation are 7.7% in 2018, and 5.4% in 2019.

7. In the scenario with a constant interest rate at 6.50% p.a., and a constant exchange rate at R\$4.15/US\$<sup>2</sup>, Copom's inflation projections stand around 4.4% for 2018, and 4.5% for 2019. In this scenario, the inflation projections for administered prices are 8.3% for 2018 and 5.7% for 2019.

<sup>1</sup> Unless explicitly stated otherwise, this update takes into account changes occurred since the August Copom meeting (216<sup>th</sup> 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, (i) the high level of economic slack may lead to a lower-than-expected prospective inflation trajectory.

10. On the other hand, (ii) 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. This risk intensifies in case (iii) the global outlook for emerging economies deteriorates. The Committee judges that the latter risks have increased.

## C) Discussion about the conduct of monetary policy

11. The Committee members discussed the evolution of economic activity in light of available data. Indicators and information available after the temporary halt in the transportation sector that occurred at the end of May 2018 point to the continuation of economy recovery of the Brazilian economy. The baseline scenario entertains the continuation of recovery of economic activity, at a more gradual pace than envisaged early this year.

12. Regarding the global outlook, the Committee judges that the scenario remains challenging for emerging economies. The baseline scenario assumes gradual normalization of monetary policy in central economies. The Committee members also mentioned the risks to the continued expansion of international trade, with possible impacts on global growth. In this context, the Copom members once again highlighted the capacity of the Brazilian economy to withstand a setback in the international scenario, given its robust balance of payments and the environment of anchored inflation expectations and prospects of economic recovery. Nevertheless, the Copom pondered the risks stemming from a possible additional deterioration in the outlook for emerging economies, in a context of frustration of expectations regarding the necessary reforms and adjustments in the Brazilian economy.

<sup>2</sup> Value obtained according to the usual procedure of rounding the average R\$/US\$ exchange rate observed on the five business days ending on the Friday prior to the Copom meeting.



13. The Copom analyzed the inflation trajectory in the short-term. All members agreed that July and August inflation along with projections for subsequent months corroborated the understanding that the effects of the halt in the transportation sector that occurred in the end of May 2018 were temporary.

14. The Committee members pointed out that several measures of underlying inflation have increased from levels considered low, reaching appropriate levels — i.e., generally consistent with the inflation target. It is possible that recent relative price changes in a context of anchored inflation expectations have contributed to raise inflation to levels compatible with the inflation targets, without posing risks to the maintenance of these levels once such relative price adjustments have taken place. However, the Committee members considered that the evolution of the prospective inflation path in the medium and long terms — along with the anchoring of inflation expectations — should be monitored in order to evaluate possible more enduring effects from shocks on inflation (i.e., their second-round effects).

15. The Committee reaffirmed the understanding that, with anchored inflation expectations, in face of occasional shocks that lead to changes in relative prices, monetary policy should only focus on their second-round effects. The Copom also highlighted that its reaction to possible changes in relative prices will be symmetric, i.e., monetary policy will follow the same principles, whether in face of inflationary shocks (as in the case of a shock leading to a depreciation of the exchange rate) or in face of disinflationary shocks (as in the case of a favorable food price shock). The Committee emphasizes that this prescription requires an environment with anchored expectations.

16. Having established how monetary policy should react to shocks that induce changes in relative prices, the Copom members discussed the extent of the exchange rate pass-through in the Brazilian economy. They assessed that, with the exception of some administered prices, the level of pass-through has been contained. The members pondered, however, that the intensity of pass-through depends on several factors, such as the level of slack in the economy and the degree of anchoring of inflation expectations. The Committee will monitor the different measures of exchange-rate pass-through to both inflation and underlying inflation.

17. The Copom members assessed that economic conditions with anchored inflation expectations, underlying inflation measures at adequate levels, inflation projections close to the target for 2019, and high level of slack in the economy still prescribe accommodative monetary policy, i.e., interest rates below the structural interest level. Although estimates of this rate involve a high degree of uncertainty, the

Committee members expressed the view that the current *ex-ante* real interest rates provide stimulus to the economy.

18. The Committee also debated the conditionalities that would prescribe accommodative monetary policy. All members agreed that the appropriate level of stimulus depends on economic conditions — in particular, on inflation expectations, the level of economic slack, the balance of risks, and inflation projections. Importantly, the provision of monetary stimulus requires an environment with anchored inflation expectations. The Committee assessed that this stimulus should be removed gradually if the prospective scenario for inflation at the relevant horizon and/or its balance of risks worsen.

19. The Copom stresses that the continuation of reforms and necessary adjustments in the Brazilian economy is essential to the reduction of its structural interest rate. The Committee will continue to reassess the estimates of this rate over time.

20. The Committee members then discussed the evolution of the baseline scenario and the balance of risks since its August meeting (216<sup>th</sup> meeting) and the appropriate monetary policy decision in light of such evolution.

21. The Committee judged that the outlook evolved in line with the baseline scenario. Regarding the balance of risks, on the one hand, the Committee judged that downward risks for the prospective inflation path due to propagation of low levels of inflation in the recent past have faded. However, the persistence of a high level of economic slack poses downward risks to inflation. On the other hand, it discussed the importance of the continuation of the process of adjustments and reforms in the Brazilian economy and the risks associated with the deterioration of the scenario for emerging economies. Based on both sides of the balance of risks, the Copom members concluded that this balance is asymmetric, as the latter risks have increased.

22. Based on all assessments, the Copom members agreed to maintain the Selic rate at 6.50% p.a.

23. The Copom then discussed the advisability of signaling the future evolution of monetary policy. All members considered that the level of uncertainty of the current environment generates a need for greater flexibility in the conduct of monetary policy, which recommends refraining from providing indications on the next steps of monetary policy. The members of the Copom have, however, considered that it is important to reinforce their commitment to conducting monetary policy in order to maintain the path for prospective inflation in line with the target. This requires flexibility to gradually adjust the conduct of monetary policy

when and if needed. This ability to respond to different circumstances contributes to the maintenance of the environment with anchored expectations, which is fundamental to ensure that the achievement of low inflation persists, even in face of adverse shocks.

24. The Copom members reiterated the importance of reaffirming the conduct of monetary policy with an exclusive focus on the evolution of inflation projections and expectations, the balance of risks, and economic activity. Relative price shocks should be tackled only in the secondary impact they may have on prospective inflation. In particular, they reiterated the importance of insisting on communicating that there is no mechanical relationship between recent shocks and the conduct of monetary policy.

25. The Committee members reiterated once again their preference for communicating the conditionalities on the evolution of monetary policy, which better transmits the economic rationality guiding their decisions. This contributes to increase transparency and enhance Copom's communications. In this context, they reasserted 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.

26. All Committee members once again emphasized that the approval and implementation of reforms — notably those of fiscal nature— and adjustments in the Brazilian economy are crucial for the sustainability of the environment of low and stable inflation, for the full operation of monetary policy, and for the reduction of the structural interest rate of the economy, with widespread benefits for society. The Committee also notes that the perception of continuity in the reform agenda affects expectations and current macroeconomic projections.

27. Finally, the Copom stressed the importance of 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 for the development of the Brazilian economy.

## D) Monetary Policy Decision

28. 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 the convergence of inflation to the targets over the relevant horizon for the conduct of monetary policy, which includes 2019.

29. The Copom emphasizes that the evolution of reforms and necessary adjustments in the Brazilian economy is essential to maintain low inflation in the medium and long run, for the reduction of its structural interest rate, and for sustainable economic recovery. The Committee stresses that the perception of continuation of the reform agenda affects current expectations and macroeconomic projections.

30. The Copom judges that it should base its decisions on the evolution of inflation projections and expectations, of the balance of risks, and of economic activity. Shocks that produce relative price changes should only lead to a monetary policy response to their possible second-round effects (i.e., to the propagation to prices in the economy that are not directly affected by the shock). It is through such second-round effects that these shocks may affect inflation projections and expectations, and change the balance of risks. These effects may be mitigated by the level of economic slack and by inflation expectations anchored around the targets. Therefore, there is no mechanical relationship between recent shocks and the conduct of monetary policy.

31. The Copom reiterates that economic conditions still prescribe stimulative monetary policy, i.e., interest rates below the structural level. This stimulus will begin to be removed gradually if the outlook for inflation at the relevant horizon for the conduct of monetary policy and/or its balance of risks worsen.

32. In the Copom's assessment, the evolution of the baseline scenario and of 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.

33. The following members of the Committee voted for this decision: Ilan Goldfajn (Governor), Carlos Viana de Carvalho, Carolina de Assis Barros, Maurício Costa de Moura, Otávio Ribeiro Damaso, Paulo Sérgio Neves de Souza, Reinaldo Le Grazie, Sidnei Corrêa Marques, and Tiago Couto Berriel