235th

Minutes of the Meeting of the

Monetary Policy Committee — Copom

December 8-9, 2020

BANCO CENTRAL DO BRASIL

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Date: December 8-9, 2020

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

Starting and ending times: December 8: 11:01AM – 1:14PM; 2:25 PM – 6:27 PM
December 9: 2:36 PM – 6:36 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 (December 8):

André Minella – *Research Department* (also present on December 9)
André de Oliveira Amante – *Open Market Operations Department*
Fabia Aparecida de Carvalho – *Department of International Affairs*
Flávio Túlio Vilela – *Department of Banking Operations and Payments System*
Luís Guilherme Siciliano Pontes – *Department of Foreign Reserves*
Ricardo Sabbadini – *Department of Economics*

Other participants (December 8):

Arnildo da Silva Correa – *Head of the office of Economic Advisor*
Eugênio Pacceli Ribeiro – *Executive Secretary*
Leonardo Martins Nogueira – *Head of the Governor's Office*
Olavo Lins Romano Pereira – *Deputy Head of the Department of International Affairs*
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*

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.

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

1. Regarding the global outlook, the pandemic resurgence in some major economies is reverting previous mobility gains and should affect short-term activity. However, promising results in COVID-19 vaccine trials tend to improve confidence and growth in the medium term. Economic slack, along with the communication of central banks of major economies, suggests monetary stimuli will last long, resulting in a favorable environment for emerging economies.

2. Turning to the Brazilian economy, recent indicators suggest the uneven recovery in economic activity continues, as expected. However, 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. 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 4.2%, 3.3%, and 3.5%, respectively.

5. The latest inflation readings were higher than expected and, despite the predicted retraction of food price pressures, December inflation should remain elevated, with an off-schedule collection of tuition fees and the transition to the highest level of the electricity rates flag system. Despite the stronger short-term inflationary pressure, the Committee maintains the diagnosis that the current shocks are temporary, but continues to monitor closely its evolution, in particular, the core inflation readings.

6. The Copom's inflation projections in its baseline scenario, with the interest rate path extracted from the Focus survey and exchange rate starting at R$5.25/US$[2] and evolving according to the purchase power parity (PPP), stand around 4.3% for 2020, and 3.4% for 2021 and 2022. This scenario assumes a path for the Selic rate that ends 2020 at 2.00% p.a., rises to 3.00% p.a. in 2021 and 4.50% p.a. in 2022. In this scenario, inflation projections for administered prices are 2.3% for 2020, 5.7% for 2021, and 3.6% for 2022.

7. The scenario with constant interest rate at 2.00% p.a. and exchange rate starting at R$5.25/US$ and evolving according to the PPP yields inflation projections around 4.3% for 2020, 3.5% for 2021, and 4.0% for 2022. In this scenario, inflation projections for administered prices are 2.3% for 2020, 5.7% for 2021, and 3.7% for 2022.

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, 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.

[1] Unless explicitly stated otherwise, this update takes into account changes that occurred since the October Copom meeting (234th meeting).

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

10. 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.

C) Discussion about the conduct of monetary policy

11. Regarding the international economy, the Committee evaluated that new information brings distinct impacts to different horizons. In the short term, the pandemic resurgence, and the resulting increase in social distancing in some of the major economies should interrupt the recovery in demand. In the medium term, however, positive vaccine test results, as well as monetary and fiscal stimuli, should imply a stronger recovery. The perception of economic slack for an extended period, along with the communication of central banks of major economies, creates an environment of liquidity and return of capital flows, favorable to emerging economies.

12. The Copom members discussed the evolution of domestic economic activity in light of the available information and indicators. They judged that the transfer programs from the government have allowed for a relatively strong rebound in durable goods consumption and investment. However, recent data continue to reflect an uneven recovery in economic activity. Prospectively, the unpredictability associated with the pandemic evolution and the necessary adjustment in government spending from 2021 on increases the uncertainty about the economic recovery. The Committee judged that the risks associated with the pandemic evolution may imply a domestic scenario characterized by an even more gradual recovery.

13. The Copom members debated on the level of economic slack. As with activity, 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 measures, face a greater reduction in demand. Prospectively, the evolution of these sectoral gaps will depend on the pandemic evolution and on the adjustment in public spending.

14. Next, the Committee discussed the implementation of monetary policy. Since its 232nd meeting, the Copom uses 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, remain 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.

15. The Copom continued its analysis, considering not only the baseline scenario but also the balance of risks. The Committee judged that, at this moment, the upward asymmetry in the balance of risks caused by fiscal risks is sufficient to compensate for the fact that inflation projections in its baseline scenario are below the target in 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.

16. The Committee again pondered over the interpretation of its forward guidance fiscal clause, which conditions the non-elevation of interest rates to the maintenance of the current fiscal regime. The Committee reaffirmed that changes in fiscal policy that affect 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 inflation target framework, which is based on the analysis of prospective inflation and its balance of risks.

17. Finally, the Committee assessed the next steps in monetary policy, in particular the evolution of the forward guidance clause on expectations and inflation projections converging to the target. In the evaluation of the Copom, this convergence can occur for two reasons: (i) an increase of expectations and projections for 2021, and (ii) the evolution of the horizon, with an increase of the relative weight of 2022, for which the expectations and projections are, at this moment, close enough to the target. Thus, the Committee decided to add to its communication that, although the forward guidance might be withdrawn soon, this would not mechanically imply an increase in interest rates.

D) Monetary policy decision

18. 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.

19. 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.

20. The Committee deems as adequate the current unusually strong 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. In spite of having increased since the last meeting, in particular for 2021, inflation expectations, as well as inflation projections for its baseline scenario, are still 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.

21. The Copom judges that, since the adoption of the forward guidance, inflation expectations reverted their declining trend relative to the target for the relevant horizon. Additionally, over the next months, the 2021 calendar-year should become less relevant than the 2022 calendar-year, for which projections and expected inflation are around the target. A scenario of inflation expectations converging to the target suggests that the conditions for maintaining the forward guidance may soon no longer apply, which does not mechanically imply interest rate increases, since economic conditions still prescribe an extraordinarily strong monetary stimulus. In case the forward guidance ceases to apply, monetary policy will follow the inflation target framework, based on the analysis of prospective inflation and its balance of risks.

22. 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.