233rd

Minutes of the Meeting of the

Monetary Policy Committee — Copom

September 15-16, 2020

BANCO CENTRAL DO BRASIL

Date: September 15-16, 2020

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

Starting and ending times: September 15: 10:17 AM – 1:17 PM; 3:16 PM – 7:11 PM
September 16: 2:01 PM – 6:08 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* (September 15):**

Alan da Silva Andrade Mendes – *Department of Foreign Reserves*
André Minella – *Research Department* (also present on September 16)
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* (September 15):**

Eugênio Pacceli Ribeiro – *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.

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 recovery in major economies, although uneven across sectors, along with a moderation in financial assets volatility, is resulting in a relatively favorable environment for emerging economies. However, 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 pandemic itself.

2. Turning to the Brazilian economy, recent indicators suggest a partial recovery in economic activity. This is similar to the pattern of other economies, where sectors more directly affected by social distancing measures remain depressed. The transfers and other government programs have allowed the Brazilian economy to recover faster than other emerging countries. 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 programs.

3. Various measures of underlying inflation remain below the level 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 1.9%, 3.0%, and 3.5%, respectively.

5. Consumer inflation should rise in the short term due to a temporary food price increase and a partial normalization of some service prices, in a context of a recovery in activity and mobility. Administered prices should change moderately reflecting a decline in health plan rates in September and an expected drop in gasoline prices by October.

6. The Copom's inflation projections in the hybrid scenario with interest rate path extracted from the Focus survey and constant exchange rate at R$5.30/US$[2] stand around 2.1% for 2020, 2.9% for 2021 and 3.3% for 2022. This scenario assumes a path for the Selic rate that ends 2020 at 2.0% p.a., rises to 2.5% p.a. in 2021 and 4.5% p.a. in 2022. In this scenario, inflation projections for administered prices are 0.0% for 2020, 4.3% for 2021, and 3.7% for 2022.

7. The scenario with constant interest rate at 2.00% p.a. and constant exchange rate at R$5.30/US$ yields inflation projections around 2.1% for 2020, 3.0% for 2021 and 3.8% for 2022. In this scenario, inflation projections for administered prices are 0.0% for 2020, 4.3% for 2021, and 3.9% 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.

10. On the other hand, fiscal policy responses to the pandemic that aggravate the fiscal path for a long time or frustrations regarding the continuation of the reform agenda may increase the risk premium. Additionally, the credit and transfer programs

[1] Unless explicitly stated otherwise, this update takes into account changes occurred since the August Copom meeting (232nd 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.

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 outlook, the recovery in major economies, although concentrated in the goods market, along with a moderation in financial assets volatility, is resulting in a relatively favorable environment for emerging economies. The Committee considered, however, that there is significant uncertainty about the evolution of this benign scenario. A possible sudden and unorganized reduction in government stimuli may delay the recovery of consumption and inventories. Meanwhile, the evolution of the Covid-19 pandemic may act as a limit to the full recovery of the service sector.

12. The Copom members discussed the evolution of domestic economic activity in light of the available information and indicators. They evaluated that recent data suggest a partial recovery of economic activity. Government transfer programs 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. Looking forward, the poor predictability associated with the evolution of the pandemic and the necessary decline in emergency aid by the end of 2020 increase uncertainty about the speed of the economic 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 recovery of the economy.

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 service sector should continue to have a larger economic slack than other sectors. The Committee concluded that the nature of the crisis probably implies that the 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. For the majority of the members of the Copom, 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.

15. The Copom also discussed the relative importance of the main components of credit and operating costs of the financial system. Considering the long history of the Brazilian economy operating with the reference interest rate at a very high level, the unprecedented low interest rates may compromise the performance of some markets and economic sectors, with potential impact on financial intermediation. Based on results from stress test scenarios, the Committee concluded that the financial system is resilient to the credit risk arising from the current pandemic. However, in analyzing the financial system in a broad way – considering its various industries, markets, products and financial services – the Committee reflected that an unprecedented low interest rate environment may increase asset prices volatility. Moreover, without the necessary time to transition to a new environment, it may affect the proper functioning and dynamics of the financial system and the capital markets. Hence, the Committee concluded that possible new interest rates reductions would demand caution and

additional gradualism. To this end, if necessary, further interest rate cuts would require greater clarity about prospective inflation and activity and could be spaced over time.

16. In order to raise the degree of monetary stimulus provided by the traditional instrument, but maintaining the necessary caution for prudential reasons, since its 232nd Meeting, the Copom has adopted forward guidance as an additional monetary policy instrument.

17. To adapt the forward guidance to the dynamic limits imposed by prudential issues, the Committee considered that it should have an asymmetric policy intention, in which, if the necessary conditions were met, the Copom would not raise the interest rate but could reduce it. To maximize its effectiveness, the Committee decided that this forward guidance should be conditional on inflation expectations, as well as on the inflation projections of its baseline scenario, for the relevant monetary policy horizon, which currently includes 2021 and, to a lesser extent, 2022. This information on inflation would be considered altogether and, when they were sufficiently close to the inflation target for the corresponding horizon, they would indicate the end of the intention.

18. Given the difficulties inherent in using forward guidance in emerging economies, in addition to expectations and projections of inflation in the relevant horizon, the Committee also deemed necessary to condition its interest rate policy intention on two other factors. First, it is conditional on the maintenance of the fiscal regime, since its rupture would imply significant changes to the structural interest rate of the economy. Second, it is conditional on the anchoring of long-term inflation expectations, given that an unanchoring would indicate that the costs derived from the monetary stimulus would be outweighing its benefits.

19. Finally, the Copom judged that the conditions for the maintenance of the forward guidance continue to be met. The Committee considers that inflation expectations, as well as inflation projections for its baseline scenario, are significantly below the inflation target for the relevant monetary policy horizon; the current fiscal regime has not been changed; and long-term inflation expectations remain well anchored.

D) Monetary policy decision

20. 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 the convergence of inflation to its target over the relevant horizon for monetary policy, which includes 2021 and, to a lesser extent, 2022.

21. 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.

22. 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. Consequently, possible future adjustments to the current degree of monetary stimulus would occur with additional gradualism and would depend on the perception of the fiscal trajectory, as well as on new information that changes the Committee's current assessment about prospective inflation.

23. To provide the monetary stimulus deemed adequate to meet the inflation target, but maintaining the necessary caution for prudential reasons, the Copom considered appropriate to continue to adopt forward guidance as an additional monetary policy tool. Therefore, despite the asymmetry on its balance of risks, the Copom does not intend to reduce the monetary stimulus unless inflation expectations, as well as its baseline scenario inflation projections, are sufficiently close to the inflation target at the relevant horizon for monetary policy, which currently includes 2021 and, to a lesser extent, 2022. This intention is conditional on the maintenance of the current fiscal regime and on the anchoring of long-term inflation expectations.

24. 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.