



# BANCO CENTRAL DO BRASIL

## Minutes of the 192<sup>nd</sup> Meeting of the Monetary Policy Committee (Copom)

**Date:** July 28<sup>th</sup> 2015, from 4:26PM to 7:31PM, and July 29<sup>th</sup>, 2015, from 5:15PM to 8:50PM

**Place:** BCB Headquarters meeting rooms – 8th floor on July 28<sup>th</sup> and 20th floor on July 29<sup>th</sup> – Brasília – DF

### **In attendance:**

#### **Members of the Committee**

Alexandre Antonio Tombini – Governor

Aldo Luiz Mendes

Altamir Lopes

Anthero de Moraes Meirelles

Luiz Awazu Pereira da Silva

Luiz Edson Feltrim

Otávio Ribeiro Damaso

Sidnei Corrêa Marques

Tony Volpon (present only on July 28<sup>th</sup>)

#### **Department Heads (present on July 28<sup>th</sup>)**

Ariosto Revoredo de Carvalho – Department of Foreign Reserves

Bruno Walter Coelho Saraiva – International Affairs Department

Eduardo José Araújo Lima – Research Department (also present on July 29<sup>th</sup>)

Flávio Túlio Vilela – Department of Banking Operations and Payments System

João Henrique de Paula Freitas Simão – Open Market Operations Department

Renato Jansson Rosek – Investor Relations and Special Studies Department

Tulio José Lenti Maciel – Economic Department

#### **Other participants (present on July 28<sup>th</sup>)**

Gustavo Paul Kurrle – Press Officer

Maurício Costa de Moura – Chief of Governor's Staff

The members of the Copom analyzed the recent performance and the prospects for the Brazilian economy and for the international economy, under the monetary policy framework, which is designed to comply with the inflation targets established by the government.

### **Recent Economic Developments**

1. Monthly inflation measured by the Extended Consumer Price Index (IPCA) reached 0.79% in June, 0.05 percentage points (p.p.) above the one recorded in the previous month. As a consequence, inflation accumulated in 12 months reached 8.89% in June (6.52% in June 2014), with market prices increasing by 7.09% (7.31% in June 2014), and regulated prices, 15.08% (3.94% in June 2014). Specifically regarding market prices, the prices of tradable goods increased 6.05% in twelve months through June (6.94% in June 2014) and the prices of non-tradable goods, 7.98% (7.63% in June 2014). It bears noticing that the prices of the food and beverages group increased 9.60% in twelve months through June (7.50% in June 2014), and the prices of services rose 7.90% (9.20% in June 2014). In short, available information suggests some persistence of inflation, which partially reflects the dynamics of prices in the services sector and, in the short run, the realignment process of regulated prices and temporary supply shocks in the food and beverages group.
2. The average of the underlying monthly inflation measures, calculated by the BCB, changed from 0.59% in May to 0.74% in June. As a consequence, on a twelve-month trailing basis, average core inflation reached 7.35% (0.59 p.p. above the one registered in June 2014). Specifically, the double weight core inflation changed from 0.66% in May to 0.77% in June; the core by exclusion, which excludes ten household food items and fuels, changed from 0.62% to 0.89%; and the core inflation by exclusion of regulated prices and



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household food, from 0.31% to 0.68%. On its turn, the non-smoothed trimmed means IPCA core inflation remained at 0.62%, and the smoothed trimmed means IPCA core inflation changed from 0.75% to 0.72%. The diffusion index stood at 67.8% in June (6.4 p.p. above the one recorded in June 2014).

3. The General Price Index (IGP-DI) increased 0.68% in June, reaching 6.22% on a twelve-month trailing basis (5.77% in June 2014). The main component of this indicator, the Wholesale Price Index (IPA), changed 5.00% in twelve months (5.24% in June 2014), with increases of 6.06% in the prices of agricultural products and 4.61% in the prices of industrial products. Inflation measured by the Consumer Price Index (IPC), the second most important component of the IGP-DI, changed 9.15% in twelve months through June (6.55% in June 2014). The Civil Construction National Index (INCC), component with the lowest weight in the IGP-DI, increased 6.97% (7.23% in June 2014), partially driven by pressures stemming from labor costs, which changed 7.98% in the period. On its turn, the Producer/Manufacturing Industry Price Index (IPP/IT), calculated by the Brazilian Institute of Geography and Statistics (IBGE), increased 0.31% in June, changing 6.56% in twelve months. The Copom considers that the effects of the behavior of wholesale prices on consumer inflation will depend on the current and prospective demand conditions and on the price setters' expectations regarding the future inflation path.
4. The Economic Activity Index of the BCB (IBC-Br) incorporates estimates for the monthly production of the three sectors of the economy, as well as for taxes on products, and constitutes important coincident indicator of the economic activity. In May 2015, the IBC-Br decreased 4.75% year-over-year and increased 0.03% month-on-month, seasonally adjusted. The composite Purchasing Managers' Index (PMI) regarding Brazil changed from 42.9 in May to 41.0 in June, indicating a pronounced contraction of the private sector output. After five consecutive decreases, the Industry Confidence Index (ICI) from the Getúlio Vargas Foundation (FGV) increased 1.5% between June and July. On their turn, the Consumer Confidence Index (ICC) and the Services Confidence Index (ICS) decreased 2.3% and 2.9%, respectively. Regarding agriculture, the Agricultural Production Systematic Assessment (LSPA), carried out by the IBGE, projected in June an increase of 6.7% in the grains production in 2015, relative to the 2014 harvest.
5. The industrial activity increased 0.6% in May, month-on-month, after decreasing 1.2% in April, according to the seasonally adjusted series released by the IBGE. Therefore, the industrial production accumulates a change of -5.3% in the last twelve months until May. According to the observed series, year-over-year, industrial production decreased 8.8% in May. The result was negative in the four use categories and in 23 out of the 26 surveyed activities. According to data released by the National Confederation of Industry (CNI), real revenue in the manufacturing industry increased 1.6% between April and May, according to the seasonally adjusted series, and it stood 10.1% lower than the one registered in May 2014. The PMI of the industrial sector, on its turn, changed from 45.9 in May to 46.5 in June.
6. Among the use categories, comparing May and April productions, according to seasonally adjusted data series, the increase of 1.2% in semi and non-durable goods production, presented the highest increase and interrupted seven consecutive months of negative results. Capital goods production, with increase of 0.2%, also presented a positive rate in May. Intermediate goods (-0.5%) and durable goods (-0.1%) presented decreases in their production. Regarding year-over-year growth, there was a decrease in the production of the four categories: capital goods (-26.3%), durable consumer goods (-17.8%), semi and non-durable consumer goods (-10.4%) and intermediate goods (-4.9%).
7. According to the Continuous National Household Sample Survey (Continuous PNAD), the unemployment rate in the moving quarter ended in May was estimated at 8.1%, an increase of 1.1 p.p. compared to the same period last year. According to the Monthly Employment Survey (PME), covering six metropolitan areas, the unemployment rate stood at 6.9% in June. The figure represents increases of 0.2 p.p. month-on-month and of 2.1 p.p. year-over-year. Data released by the Ministry of Labor and Employment (MTE) showed reduction of 111.2 thousand formal jobs in June, while 345.4 thousand formal jobs were destroyed in the first six months of the year. In short, the set of available data confirm a softening process in the labor market.



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8. According to the retail monthly survey (PMC), released by the IBGE, the retail sales volume decreased 4.5% in May, year-over-year. On its turn, broad retail sales volume, which includes vehicles and construction inputs, decreased 10.4% in May, according to the same comparison basis. The month-on-month changes were -0.9% and -1.8%, respectively, according to the seasonally adjusted series, with retraction in seven of the ten sectors surveyed. In twelve months, the retail sales growth rate fell by 0.5% and the broad retail sales decreased 5.0%. The Trade Confidence Index (ICOM), measured by the FGV, decreased 1.0% between June and July, with no signs of improvement of the activity in the coming months.
9. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by the FGV, without seasonal adjustment, reached 78.0% in July and, according to the seasonally adjusted series, 78.2%. Among the industry use categories, according to the seasonally adjusted series, the ones showing the highest Nuci are intermediate goods (82.3%) and construction material (79.5%), followed by non-durable consumer goods (75.2%), durable consumer goods (71.2%) and capital goods (69.2%). On its turn, the absorption of capital goods decreased 16.2% in the last twelve months through May.
10. According to the Ministry of Development, Industry and Foreign Trade (MDIC), the twelve-month trailing trade balance surplus reached US\$0.7 billion in June 2015. This result stemmed from US\$208.9 billion in exports and US\$208.2 billion in imports, with retreats of 12.3% and 11.5%, respectively, relative to the cumulative results through June 2014. On its turn, the current account deficit accumulated in twelve months reached US\$93.1 billion in June 2015, equivalent to 4.4% of the GDP. Foreign Direct Investment (according to the Direct Investment Liabilities concept) totaled US\$81.9 billion, according to the same comparison basis, equivalent to 3.8% of the GDP.
11. Regarding the global economy, leading indicators signal, in the horizon relevant for monetary policy, growth prospects in line with the trend in important advanced and emerging economies. Particularly about Europe, despite recent monetary policy actions, high unemployment rates, coupled with the fiscal consolidation and political uncertainties, constitute elements restraining investments and growth. Regarding the monetary policy, in general, accommodative stances prevail in advanced and emerging economies. The inflation rates remain at low levels in the advanced economies; and, in the emerging ones, they stand at relatively high levels.
12. The price of the Brent oil barrel fell to levels around US\$54 since the previous Copom meeting. It bears highlighting that the geopolitical complexity that involves the oil sector tends to heighten the volatile behavior of prices. This volatile behavior also reflects the low predictability of some global demand and supply components. Since the last Copom meeting, the international prices of agricultural and metal commodities have fallen 3.44% and 3.11%, respectively. On its turn, the Food Price Index, calculated by the Food and Agriculture Organization of the United Nations (FAO), fell 21.0% in the twelve months through June 2015.

### Assessment of Inflation Trends

13. The identified shocks, and their impacts, were reassessed according to the new set of available information.
14. For the set of regulated prices inflation, the projected adjustment is 14.8% in 2015, up from 12.7% considered at the June Copom meeting. Among other factors, this projection considers the assumption of changes of 9.2% in the price of gasoline, 4.6% in the price of bottled gas; -3.0% in fixed telephone tariffs and of 50.9% in electricity prices. The items for which there are more information available were projected individually and, for the others, the projections are based on endogenous determination models for regulated prices, which compute, among other factors, seasonal components, market prices inflation and the IGP (General Price Index) change. Based on these models, the projected regulated prices change is 5.7% for 2016, up from 5.3% considered in the June Committee meeting.
15. The estimate path for the spreads over the Selic rate, based on the 360-day swap rates, on the baseline scenario, projects -41 basis points (bps) and 18 bps for the fourth quarters of 2015 and 2016, respectively.



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16. The structural primary surplus is considered as the fiscal indicator. It derives from the primary surplus trajectories set at 0.15% of the GDP for 2015 and 0.70% of the GDP for 2016. It also bears emphasizing that, in a given period, the fiscal impulse corresponds to the variation of the structural surplus in comparison to the observed in the previous period.
17. Since the last Copom meeting, the median of the projections compiled by the Investor Relations and Special Studies Department (Gerin) for the 2015 IPCA changed from 8.39% to 9.23% and, for 2016, from 5.50% to 5.40%.
18. The baseline scenario assumes the maintenance of the exchange rate at R\$3.25/US\$1.00 and the Selic rate at 13.75% p.a. during the forecast period. Under this scenario, the projection for the 2015 inflation increased, compared to the value considered at the previous Copom meeting and remains above the 4.5% midpoint target established by the National Monetary Council (CMN). According to the market scenario, which incorporates the market expectations for the exchange and Selic rates trajectories collected by Gerin, in the period immediately prior to the Copom meeting, the 2015 IPCA inflation forecast also increased relative to the value considered at the June meeting and remains above the inflation target. For 2016, according to both the baseline and the market scenarios, the inflation forecast remained stable and above the 4.5% inflation target set by the CMN.

### Monetary Policy Decision

19. The Copom emphasizes that the international evidence, which is ratified by the Brazilian experience, indicates that high inflation rates generate distortions that lead to higher risks and depress investments. These distortions are manifested, for example, in the shortening of the planning horizons of households, companies and governments, as well as in the deterioration of the businessmen confidence. The Committee also emphasizes that high inflation rates reduce the purchasing power of wages and transfers, with negative repercussions over the households' confidence and consumption. As a consequence, high inflation rates reduce the potential of economic growth, as well as of jobs and income generation.
20. In view of this, the Copom evaluates that the monetary policy should contribute to the consolidation of a favorable longer-term macroeconomic environment. In this respect, the Copom reassures that, under the inflation targeting regime, it guides its decisions according to BCB projected inflation and based on the analysis of alternative scenarios for the evolution of the main variables that determine prices dynamics. The Committee also understands that low risks for the underlying inflation in the short run tend to reduce uncertainties regarding the future behavior of headline inflation, facilitate the assessment of scenarios by the monetary authority, as well as help the process of coordination of economic agents' expectations, particularly prices setters'. Additionally, it is noteworthy that low risks for the underlying inflation in the short run tend to intensify the effects of monetary policy actions, enabling them to affect, in a more long-lasting manner, the dynamics of headline inflation in the future. Although the Copom recognizes that other macroeconomic policy actions may influence the prices trajectory, it reaffirms its view that it is particularly under the responsibility of the monetary policy to remain especially vigilant, to guarantee that pressures detected in shorter horizons do not spread to longer horizons.
21. The Copom considers that, since its last meeting, the risks to global financial stability have remained high, such as those derived from changes in the yield curve slope of major advanced economies. Despite identifying low probability of occurrence of extreme events in the international financial markets, the Committee considers that the external environment remains complex, with possible episodes of higher volatility. However, for the Committee, a more intense global activity trend prevails throughout the monetary policy relevant horizon. In this respect, the prospects indicate activity recovery in some advanced economies and acceleration in the pace of growth in others, although, in general, the room to use monetary policy in these economies remains limited and a fiscal restraint scenario prevails. Important emerging economies experience a transition period, and therefore, of moderation in the activity pace, despite the resilience of the domestic demand.



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22. Still regarding international financial markets, the Copom highlights evidence of volatility sources in the currency and fixed income markets and moderation in the dynamics of commodities prices. Regarding oil, the Committee highlights that, regardless of the behavior of the domestic prices of gasoline, the evolution of international prices tends to be transmitted to the domestic economy both through productive chains, such as the petrochemical, and through inflation expectations.
23. The Copom reaffirms that, in accordance to the macroeconomic adjustment process underway, the available indicators show that the domestic absorption and GDP growth rates continued to adjust and confirm that the domestic activity expansion pace this year will be lower than the potential. In particular, the investment has retreated, mainly influenced by the occurrence of non-economic events, and private consumption shows moderation signals, in line with recent data regarding credit, employment and income. However, for the Committee, after a necessary period of adjustments, the activity expansion pace tends to intensify, as companies' and households' confidence strengthen. Moreover, the Committee evaluates that, in the medium term, important changes should take place in the composition of aggregate supply and demand. The consumption tends to grow at a moderate pace and the investments tend to gain momentum. These changes, together with other currently underway, anticipate a composition for aggregate demand growth in the medium term more favorable to potential growth. Regarding the external component of aggregate demand, the scenario of higher global growth, combined with the depreciation of the BRL, contributes to make this component more favorable to the Brazilian economy growth. Regarding the supply side, the Committee evaluates that, in longer horizons, more favorable prospects for the competitiveness of industry and agriculture have emerged. The services sector, on its turn, tends to grow at rates lower than those recorded over the recent years. For the Committee, it is plausible to claim that these developments – coupled with advances in terms of qualification of the labor force and with the program of public services concession - will be reflected in a more efficient allocation of the production factors of the economy and in productivity gains.
24. The Copom observes that the main inflation scenario considers the materialization of the assumed trajectories regarding fiscal variables. Relative to the structural fiscal result and depending on the economic cycle, the Committee considers that, during the relevant horizon for the monetary policy, the balance of the public sector tends to shift to the neutral zone, and does not rule out the hypothesis of migration to the fiscal restraint area, even if with lower intensity. However, the new trajectories regarding fiscal variables affected the expectations and asset prices. In this regard, the Committee notes that significant changes in the trajectory of generation of primary surpluses impact the working hypotheses considered for inflation projections and can help to create a less positive perception of the macroeconomic environment in the medium and long term. It also highlights that a primary surpluses' path that strengthens the perception of sustainability of the public sector balance contributes to reduce the public debt financing cost, with favorable impact on the cost of capital in general, stimulating private investment in the medium and long run. Specifically regarding inflation control, the Committee highlights that the literature and the best international practices recommend a consistent and sustainable fiscal policy framework, in order to allow monetary policy actions to be fully transmitted to prices.
25. The Copom highlights that the main scenario also considers moderate credit expansion, which had already been observed and tends to persist. Regarding this issue, it is important to highlight the fact that, after years of strong expansion, the consumer credit has moderated, so that, over the last quarters, it was possible to observe, on the one hand, exposure reduction by banks, and, on the other hand, deleveraging of the households. In the aggregate, therefore, it can be inferred that the risks in the consumer credit segment have been mitigated. In another dimension, as illustrated by the recently implemented actions, the Committee considers as necessary the initiatives with the aim of moderating concessions of subsidies through credit operations.
26. Regarding the factors' market, as anticipated by previous Minutes, the Copom highlights that the narrow idleness margin in the labor market has eased, with data confirming the acceleration of a process of distension in this market. However, a significant risk still prevails related, particularly, to the possibility of concession of wage increases incompatible with productivity growth, with negative impacts over inflation. In spite of the occurrence of real wage changes more consistent with the gains estimates for the labor



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productivity, the Committee evaluates that the wages dynamics remains originating inflationary cost pressures.

27. For the Copom, the fact that inflation currently stands at high levels reflects, in large part, the occurrence of two important relative prices adjustment processes underway in the economy - the realignment of domestic prices relative to international prices and the realignment of regulated prices relative to market prices. The Committee also considers that, over the first half of 2015, among other factors, these relative prices adjustments in the economy, among other factors, have made the balance of risks to inflation unfavorable this year. In this context, as anticipated in previous Minutes, these price adjustments cause inflation to rise in the short term and to tend to remain high in 2015, requiring determination and perseverance to prevent its transmission to longer horizons. While recognizing that these relative prices adjustments have direct impacts on inflation, the Committee reaffirms its view that the monetary policy can, should and is containing the second order effects stemming from them, in order to limit them to 2015.
28. Given the above, assessing the macroeconomic scenario, the inflation prospects and the current balance of risks, the Copom unanimously decided to raise the Selic rate by 0.50 pp, to 14.25% p.a., without bias. The Committee understands that maintaining this level of the basic interest rate, for a sufficiently long period, is necessary for the convergence of inflation to the target at the end of 2016.
29. The following members of the Committee voted for this decision: Alexandre Antonio Tombini (Governor), Aldo Luiz Mendes, Altamir Lopes, Anthero de Moraes Meirelles, Luiz Awazu Pereira da Silva, Luiz Edson Feltrim, Otávio Ribeiro Damaso and Sidnei Corrêa Marques.
30. The Copom reaffirms that the aggregate demand will continue to be moderate in the relevant horizon for the monetary policy. On the one hand, household consumption tends to be influenced by factors such as employment, income and credit; on the other hand, the real state financing, the concession of public services and the expansion of agricultural income, among other factors, tend to benefit investments. On its turn, exports tend to be benefited by the scenario of higher growth of major trading partners and by the depreciation of the BRL. For the Committee, the combined effects of these elements, and the developments in the quasi fiscal framework and in the assets market and, this year, the recovery dynamics of regulated prices are important factors in the context in which future monetary policy decisions will be taken, aiming to ensure the convergence of inflation to the 4.5% target established by CMN, at the end of 2016.
31. In this context, the Copom believes that the convergence scenario of inflation to 4.5% at the end of 2016 has strengthened. For the Committee, the progress made in the fight against inflation - like benign signals stemming from the medium and long term expectations indicators – show that the monetary policy strategy is the right direction. The remaining risks for the Copom's inflation forecasts to reach safely the goal of 4.5% at the end of 2016 are consistent with the lagged and cumulative effect of monetary policy action, but require that the monetary policy remains vigilant in case of significant deviations of inflation forecasts from the target.
32. At the end of the meeting, it was announced that the Committee will reconvene on September 1<sup>st</sup> 2015, for the technical presentations, and on the following day, to deliberate on monetary policy, as established in the Communiqué 26,042, of June 24<sup>th</sup>, 2014.