BANCO CENTRAL DO BRASIL

Minutes of the 197th Meeting of the Monetary Policy Committee (Copom)

Date: March 1st 2016, from 4:10PM to 7:25PM, and March 2nd 2016, from 4:46PM to 7:27PM

Place: BCB Headquarters meeting rooms – 8th floor on March 1st and 20th floor on March 2nd – Brasília – DF

In attendance:
Members of the Committee
Alexandre Antonio Tombini – Governor
Aldo Luiz Mendes
Altamir Lopes
Anthero de Moraes Meirelles
Luiz Edson Feltrim
Otávio Ribeiro Damaso
Sidnei Corrêa Marques
Tony Volpon

Department Heads (present on March 1st)
Ariosto Revoredo de Carvalho – Department of Foreign Reserves
Bruno Walter Coelho Saraiva – International Affairs Department
Eduardo José Araújo Lima – Research Department (also present on March 2nd)
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 March 1st)
Gustavo Ênio Falcão Freire - Press Officer
Maurício Barreto Campos – Division Head of the Economic Department
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 1.27% in January, 0.31 percentage points (p.p.) above the one recorded in the previous month. As a consequence, inflation accumulated in 12 months reached 10.71% in January (7.14% in January 2015), with market prices increasing by 8.78% (7.01% in January 2015), and regulated prices, 17.21% (7.55% in January 2015). Specifically regarding market prices, the prices of tradable goods increased 8.94% in twelve months through January (5.57% in January 2015) and the prices of non-tradable goods, 8.59% (8.29% in January 2015). It bears noticing that the prices of the food and beverages group increased 12.89% in twelve months through January (8.72% in January 2015), and the prices of services rose 7.87% (8.76% in January 2015). In short, available information partially reflects the more persistent dynamics of prices in the services sector, the realignment process of relative 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 0.77% in December to 0.82% in January. As a consequence, on a twelve-month trailing basis, average core inflation reached 8.47% (1.83 p.p. above the one registered in January 2015). The double weight core inflation changed from 0.72% in December to 0.86% in January; the non-smoothed trimmed means IPCA core inflation changed from 0.69% to 0.87%; the smoothed trimmed means IPCA core inflation, from 0.78% to 0.84%; and the core inflation by exclusion of ten household food items, as well as fuels, changed from 0.77% to 0.93%. On the other hand, the core inflation by exclusion of regulated prices and household food changed from 0.88% to

0.62%, in the same period. The diffusion index stood at 77.5% in January (8.6 p.p. above the one recorded in January 2015).

3. The General Price Index (IGP-DI) increased 1.53% in January, reaching 11.65% on a twelve-month trailing basis (4.06% in January 2015). The main component of this indicator, the Wholesale Price Index (IPA), changed 12.87% in twelve months (2.27% in January 2015), with increases of 17.79% in the prices of agricultural products and 10.96% in the prices of industrial products. Inflation measured by the Consumer Price Index (IPC), the second most important component of the IGP-DI, changed 10.59% in twelve months through January (7.66% in January 2015). The Civil Construction National Index (INCC), component with the lowest weight in the IGP-DI, increased 6.93% (6.99% in January 2015), partially driven by pressures stemming from labor costs, which grew 7.47% 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 0.99% in January, changing 10.49% 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 December 2015, the IBC-Br decreased 6.51% year-over-year and 0.52% month-on-month seasonally adjusted. The composite Purchasing Managers' Index (PMI) regarding Brazil, despite changing from 43.9 in December to 45.1 in January, remains in a level under 50, indicating, therefore, contraction. The Industry Confidence Index (ICI) and the Services Confidence Index (ICS), from the Getúlio Vargas Foundation (FGV), increased 3.4% and 4.1%, respectively, between December and January. The Consumer Confidence Index (ICC) increased 3.2% between January and February. Regarding agriculture, the Agricultural Production Systematic Assessment (LSPA), carried out by the IBGE, projects an increase of 0.6% in the grains production in 2016, relative to the 2015 harvest.

5. The industrial activity decreased 0.7% in December, month-on-month, according to the seasonally adjusted series released by the IBGE. Therefore, the industrial production accumulates a change of -8.3% in the last twelve months through December. According to the observed series, the industrial production decreased 11.9% in December, year-over-year, with negative results in the four use categories and in 24 out of the 26 surveyed activities. According to data released by the National Confederation of Industry (CNI), real revenue in the manufacturing industry changed 1.0% between December and January, according to the seasonally adjusted series, but it stands at a level 13.9% lower than the one registered in January 2015. The PMI of the industrial sector, on its turn, decreased from 47.4 in January to 44.5 in February, indicating deceleration, which is confirmed by the retraction observed in the investment goods market.

6. Among the use categories, comparing the December and November productions, according to the seasonally adjusted data series, capital goods production presented sharp reduction (-8.2%). On the other hand, semi and non-durable goods (0.3%) and intermediate goods (0.7%) registered small increase, while durable consumer goods (9.4%) registered more elevated expansion, interrupting four consecutive months of decline in production. Regarding year-over-year growth, there was a decrease in the production of the four categories: capital goods (-31.9%), durable consumer goods (-24.7%), intermediate goods (-11.4%) and semi and non-durable consumer goods (-4.2%).

7. According to the Continuous National Household Sample Survey (Continuous PNADC), the unemployment rate in the moving quarter ended in November was estimated at 9.0%, an increase of 2.5 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 7.6% in January, increasing 0.7 p.p. month-over-month and 2.3 p.p. year-over-year. Data released by the Ministry of Labor and Employment (MTE) showed reduction of 596.2 thousand formal jobs in December, while 1.54 million formal jobs were closed in the year. In short, the set of available data confirm intensification of the process of distension in the labor market.

8. According to the retail monthly survey (PMC), released by the IBGE, the retail sales volume decreased 7.1% in December, year-over-year. On its turn, broad retail sales volume, which includes vehicles and construction

inputs, decreased 11.0% in December, according to the same comparison basis. The month-on-month changes were -2.7% and -0.9%, respectively, according to the seasonally adjusted series, with retraction in six of the ten sectors surveyed. In twelve months, the retail sales volume fell by 4.3% and the broad retail sales volume decreased 8.6%. The Trade Confidence Index (ICOM), measured by the FGV, increased 0.7% between January and February, and reached 69.1 points.

9. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by the FGV, without seasonal adjustment, reached 72.4% in January and, according to the seasonally adjusted series, 73.9%. Among the industry use categories, according to the seasonally adjusted series, the ones showing the highest Nuci are construction material (77.7%), non-durable consumer goods (75.4%) and intermediate goods (74.3%), followed by durable consumer goods (71.4%) and capital goods (64.5%). On its turn, the absorption of capital goods decreased 27.1% in the last twelve months through January.

10. According to the Ministry of Development, Industry and Foreign Trade (MDIC), the twelve-month trailing trade balance surplus reached US$29.6 billion in February 2016. This result stemmed from US$189.9 billion in exports and US$160.3 billion in imports, with retreats of 13.2% and 28.1%, respectively, relative to the cumulative results through February 2015. On its turn, the current account deficit accumulated in twelve months reached US$51.6 billion in January 2016, equivalent to 2.9% of the GDP. Foreign Direct Investment (according to the Direct Investment Liabilities concept) totaled US$74.8 billion, according to the same comparison basis, equivalent to 4.3% of the GDP.

11. Regarding the global economy, leading indicators point to a moderation trend in the horizon relevant for monetary policy, with growth rates relatively more homogeneous in advanced economies, despite being low and below potential growth. 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. In the United States, the trend is of economic recovery; however, some cooling in the dynamics of growth is anticipated. In the emerging economies, the activity pace has been constantly revised downwards, in a scenario surrounded by uncertainties regarding the loss of strength in China and their implications for the global economy. Regarding the monetary policy, in general, accommodative stances prevail in advanced and emerging economies, reinforced by signs of a more gradual process of normalization of monetary conditions in the US. The inflation rates remain at low levels in the advanced economies and relatively high in the emerging ones.

12. The price of the Brent oil barrel increased to levels around US$37 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 components of global demand, accentuated by the effects of the slowdown of the Chinese economy, and of supply, influenced by the reduction of investments in the production process. Since the last Copom meeting, the international prices of agricultural commodities have fallen 0.47%, while metal commodities prices have increased 8.54%. On its turn, the Food Price Index, calculated by the Food and Agriculture Organization of the United Nations (FAO), fell 15.9% in the twelve months through January 2016.

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 change is 5.9% in 2016, down from 6.3% considered at the January Copom meeting. Among other factors, this projection considers average adjustment in the urban bus tariffs of 9.9% and reduction of 3.5% in electricity prices, considered the changes announced regarding the tariff flags system. For 2017, a change of 5.0% is considered, unchanged relative to the value projected at the January meeting.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.

15. The estimate path for the spreads over the Selic rate, based on the 360-day swap rates, on the baseline scenario, projects 28 basis points (bps) and 25 bps for the fourth quarters of 2016 and 2017, respectively.

16. The structural primary surplus is considered as the fiscal indicator. It derives from the trajectories of primary surplus set at 0.50% of the GDP for 2016 and of primary surplus set at 1.30% of the GDP for 2017. It also bears emphasizing that, in a given period, the fiscal impulse corresponds to the variation of the structural result 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 2016 IPCA changed from 7.00% to 7.57% and, for 2017, from 5.40% to 6.00%.

18. The baseline scenario considers the maintenance of the exchange rate at R$3.95/US$1.00 and the Selic rate at 14.25% p.a. during the forecast period. Under this scenario, the inflation projection both for 2016 and for 2017 increased, compared to the value considered at the previous Copom meeting, both remaining 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 inflation projections for 2016 and 2017 also increased relative to the value considered at the January meeting, and remain above the 4.5% inflation target.

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 the projected inflation by the BCB 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 Committee considers that the external environment remains especially complex. However, despite the occurrence of episodes of higher volatility affecting important emerging economies, the Committee also identifies low probability of occurrence of extreme events in the international financial markets. For the Committee, the trend for global activity shows more moderation throughout the monetary policy relevant horizon. The recent prospects indicate modest activity recovery in the advanced economies, while important emerging economies experience a transition period. In this context, of reduction in the activity pace, it bears highlighting the growing concern regarding the Chinese economy and its developments over the other economies.

22. Still regarding international financial markets, the Copom highlights moderation in the dynamics of commodities prices. Regarding oil, the Committee highlights that, regardless of the behavior of the domestic gasoline prices,

the evolution of international prices tends to be transmitted to the domestic economy through productive chains, such as the petrochemical. It should also be noted the increased uncertainties generated by low oil prices and their implications for sectoral companies and producing countries, as well as for the financial markets in general, with risks to global financial stability.

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 have continued to adjust, indicating domestic activity expansion pace this year lower than the previously expected. This process has been especially intensified by the uncertainties arising from the effect of non-economic events. In particular, investment has retreated, mainly influenced by the occurrence of these events, and private consumption also shows contraction signals, in line with data regarding credit, employment and income. However, for the Committee, after a necessary period of adjustments, which has been more intense and longer than anticipated, as companies' and households' confidence strengthen, the activity expansion pace tends to intensify. Moreover, the Committee evaluates that, in the medium term, important changes should take place in the composition of aggregate supply and demand. Consumption tends to grow at a moderate pace and the investments tend to gain momentum. These changes, coupled with other ones 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 depreciation of the BRL contributes to make this component more favorable to the Brazilian economic growth. Regarding the supply side, the Committee evaluates that, in longer horizons, more favorable prospects for the competitiveness of industry, agriculture and livestock have emerged. The services sector, on its turn, tends to grow at rates lower than those recorded over the recent years.

24. For the Committee, it is plausible to claim that these developments will be reflected in a more efficient allocation of the production factors of the economy and in productivity gains. However, the speed of materialization of these changes and of the gains resulting from them depends, fundamentally, on a path of primary surpluses that strengthens the perception of the public sector balance sustainability, in addition to the reduction of uncertainties surrounding the domestic and international environment. It is worth mentioning the importance of persevering in promoting structural reforms to ensure the fiscal consolidation in the longer terms.

25. 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 more slowly and with lower intensity than previously antecipated. However, the Committee observes that the lack of definitions and the significant changes in the trajectory of primary surpluses' generation, as well as in its composition, impact the hypotheses considered for inflation projections and contribute to create a negative perception regarding the macroeconomic environment, as well as have negatively impacted the inflation expectations. Concerning 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 the monetary policy actions to be fully transmitted to prices.

26. 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, consumer credit has moderated, so that, over the last quarters, there were, 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 actions that were implemented, the Committee considers as opportune to continue to reinforce the initiatives with the aim of moderating concessions of subsidies through credit operations.

27. In the factors' market, as anticipated by previous Minutes, the Copom observes that the idleness margin in the labor market is high, with data confirming the acceleration in the process of distension in this market. However, there is still the prevalence of significant risk related, particularly, to the possibility of concession of high nominal wages' increases, with negative impacts over inflation. In spite of the occurrence of real wage changes

more consistent with the estimates for the labor productivity gains, the Committee evaluates that the wages dynamics remains originating inflationary cost pressures.

28. The Copom considers that the still elevated inflation level mirrors the relative prices adjustment processes occurred in 2015, as well as the recovery process of the fiscal results observed in the federal and state levels, at the start of the year, and that cause inflation to show resistence. Although the Committee recognizes that these processes have direct impact on inflation, it reaffirms its view that the monetary policy can, should and is containing the second-order effects stemming from them.

29. Given the above, assessing the macroeconomic scenario and the inflation prospects, the Copom considers that uncertainties associated to the balance of risks remain, mainly regarding the recovery process of the fiscal results and its composition, the current inflation behavior and the inflation expectations. Additionally, the uncertainties regarding the external scenario remain, with highlights to the concern about the performance of the Chinese economy and its developments and about the evolution of oil prices. Part of its members argued that it would be appropriate to adjust, immediately, the monetary conditions, in order to reduce the risks of non-compliance of the inflation targeting regime objectives, reinforce the process of anchoring inflation expectations and contribute to contain the increase in inflation projections. However, most of the Copom members considered that the domestic and, mainly, the external uncertainties, justify to keep on monitoring the evolution of the macroeconomic scenario, to then define the next steps in its monetary policy strategy. For these members, it is necessary to continue monitoring the developments in the domestic and external environments and their impacts on the balance of risks to inflation, which, combined with the adjustments already implemented in the monetary policy, can strengthen the inflation convergence scenario for the 4.5% target in 2017.

30. The Copom, then, decided to maintain the Selic rate at 14.25% p.a., without bias, by six votes for the monetary policy action and two votes in favor of raising the Selic rate by 0.50 pp.

31. The following members of the Committee voted for maintaining the Selic rate at 14.25%: Alexandre Antonio Tombini (Governor), Aldo Luiz Mendes, Altamir Lopes, Anthero de Moraes Meirelles, Luiz Edson Feltrim and Otávio Ribeiro Damaso. The following members of the Committee voted for raising the Selic rate to 14.75%: Sidnei Corrêa Marques and Tony Volpon.

32. 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 concession of public services and the expansion of agricultural income, among other factors, tend to benefit investments. On its turn, net exports show better results, either by increasing exports, benefited by the depreciation of the BRL, or by the ongoing import substitution process. For the Committee, the combined effects of these elements, the developments in the fiscal and quasi fiscal framework and in the assets market, and, in this year, the dynamics of the regulated prices and an output gap more disinflationary than the initially anticipated 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 the CMN, in 2017.

33. The Committee emphasizes that there are uncertainties associated with the balance of risks, mainly on the recovery process of fiscal results and on its composition, and that the relative price realignment process has taken longer and has been more intense than the anticipated. Moreover, the uncertainties regarding the behavior of the global economy remain. In this context, the Committee reaffirms that it will take the necessary measures in order to ensure the compliance with the objectives of the targeting regime, which means to circumscribe inflation to the limits established by the CMN, in 2016, and to make inflation converge to the 4.5% target, in 2017.

34. At the end of the meeting, it was announced that the Committee will reconvene on April 26th 2016, for the technical presentations, and on the following day, to deliberate on monetary policy, as established in the Communiqué 28,079, of June 26th, 2015.