Minutes of the 203rd Meeting of the Monetary Policy Committee ("Copom")* of the Central Bank of Brazil

November 29th and 30th, 2016

BANCO CENTRAL DO BRASIL

* These minutes represent the 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: November 29th and 30th, 2016

Place: BCB Headquarters' meeting rooms 21st floor – Brasília – DF
Starting time: 10:48 am (November 29th), 2:30 pm (November 29th) and 2:00 pm (November 30th)
Ending time: 12:10 pm (November 29th), 5:33 pm (November 29th) and 6:20 pm (November 30th)

In attendance:
Members of the Copom
Ilan Goldfajn – Governor
Anthero de Moraes Meirelles
Carlos Viana de Carvalho
Isaac Sidney Menezes Ferreira
Luiz Edson Feltrim
Otávio Ribeiro Damaso
Reinaldo Le Grazie
Sidnei Corrêa Marques
Tiago Couto Berriel

Department Heads (present on November 29th)
André Minella – International Affairs Department
Ariosto Revoredo de Carvalho - Department of Foreign Reserves
Eduardo José Araújo Lima – Research Department (also present on November 30th)
Flávio Túlio Vilela – Department of Banking Operations and Payments System
Gilneu Francisco Astolfi Vivan – Financial System Monitoring Department
João Henrique de Paula Freitas Simão – Open Market Operations Department
Renato Jansson Rosek – Investor Relations and Special Studies Department
Tulio José Lenti Maciel – Department of Economics

Other participants (present on November 30th)
Gustavo Paul Kurrle – Press Officer
Leonardo Martins Nogueira – Chief to the Deputy Governor for Monetary Policy
Lucio Rodrigues Capelletto – Secretary to the Financial Stability Committee and Consultant to the Board
Luis Gustavo Mansur Siqueira – Senior Advisor to the Deputy Governor for Institutional Relations and Citizenship (present only in the afternoon of November 29th)
Maurício Costa de Moura - Chief of Governor's Staff
Paulo Marcelo Cavalcanti Muniz – Substitute Chief to the Deputy Governor for Regulation

The members of the Copom analyzed the recent performance and prospects for the Brazilian and the international economies, under the monetary policy framework, whose objective is to comply with the inflation targets established by the National Monetary Council. Supplementary material to these Minutes, with analysis of the recent economic developments, is available at the Central Bank of Brazil's webpage (**http://www.bcb.gov.br/?MINSUP2016203rd**).

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

1. The indicators released since the last Copom meeting suggest economic activity below expectations in the short term. Forecasts for 2016 and 2017 GDP fell, and the process of recovery of expectations components of confidence indices was interrupted. After breaking a long sequence of negative prints in the second quarter, the measure of investment in the national accounts fell again in the third quarter.

2. The economy continues to operate with a high level of economic slack, reflected in the low industrial capacity utilization indices and, mainly, in the unemployment rate.

3. After the decline in economic activity indicators for August, the absence of a reversal in the following months makes it less likely that these movements reflect natural fluctuations in economic activity around stabilization periods. There is a higher probability, therefore, that the recovery of economic activity will be slower and more gradual than previously anticipated.

4. The global outlook is particularly uncertain. The increase in asset price volatility indicates the possible end of the benign period for emerging economies. There is a high probability of resumption of the process of normalization of monetary conditions in the United States in the short term, as well as uncertainty over the future course of its economic policy.

5. Returning to the domestic economy, recent inflation figures came in more favorably than expected, partly due to the reversal of food price increases, but also with signs of more widespread disinflation. These results contributed to a decrease in expectations for 2016 IPCA[2] inflation measured by the Focus survey, which stand at around 6.7%. As for 2017, IPCA inflation expectations reported in the same survey have declined to around 4.9% and expectations for 2018 and more distant horizons remain around 4.5%.

6. The path of regulated prices, which enters the conditional forecasts in the inflation scenarios produced by the Committee, assumes increases of 5.5% in 2016, 5.9% in 2017, and 5.3% in 2018.

7. The reference scenario maintains, among other assumptions, that the interest rate and exchange rate remain unchanged throughout the forecast horizon at, respectively, 14.00% per annum (p.a.) and R$3.40/US$. The market scenario considers the paths for the policy rate and the exchange rate extracted from the Focus survey. In particular, this scenario assumes exchange rates of R$3.35/US$, R$3.40/US$ and R$3.50/US$ at the end of 2016, 2017, and 2018, respectively, and interest rates of 13.75% p.a., 10.75% p.a., and 10.00% p.a. at the end of the same periods.

8. For 2016, the Copom's projections under the reference and market scenarios retreated to around 6.6%.

9. Over the relevant horizon for the conduct of monetary policy, the Copom's conditional forecasts fluctuated around the previous levels due to factors with opposing effects. Forecasts for 2017 in the reference and market scenarios show inflation around 4.4% and 4.7%, respectively. Forecasts for 2018 inflation in the reference and market scenarios are around 3.6% and 4.6%, respectively.

B) Risks around baseline inflation scenario

10. Signs of pause, at the margin, in the process of disinflation of some IPCA components that are most sensitive to the business cycle and monetary policy persist. The inflation rate of these components has been retreating in 12-month windows, but the pause persists, at the margin, according to seasonally adjusted monthly measures of underlying inflation. This could reflect greater inflation resilience, despite the high level of economic slack.

11. On the other hand, the continuous softening of the labor market and the significant deceleration of economic activity tend to produce disinflation that can be more intense than the one reflected in inflation expectations measured by the Focus survey and in the conditional projections produced by the Copom. In fact, the more favorable inflation dynamics in the recent period show signs of more widespread disinflation. It is, therefore, reasonable to expect softer economic activity in the short run and the prospect of a further delayed and more gradual recovery to reinforce this process. Another likely outcome of this outlook would be an earlier end to the pause and resumption of disinflation, at

[1] Unless explicitly stated otherwise, this update takes into account the changes that have occurred since the previous Copom meeting.

[2] Extended Consumer Price Index.

the margin, of the aforementioned IPCA components that are most sensitive to the business cycle and monetary policy.

12. The steps toward approval of fiscal reforms have been positive so far, which suggests greater timeliness and higher probability of approval. On the other hand, the process is lengthy and carries uncertainty. The reduction of uncertainty would enhance the effects of monetary policy, and reduce the costs of the ongoing disinflationary process.

13. The possible end of the benign period for emerging economies might make disinflation more difficult. It is possible, however, that its effects be mitigated by favorable movements in commodity prices that are relevant to the country's terms of trade, which would be a stabilizing factor. Furthermore, the end of the benign period may imply tighter external financial conditions, which would contribute a disinflationary component. Therefore, there is no direct relationship between the global outlook and the conduct of monetary policy.

C) Discussion about the conduct of monetary policy

14. The Committee members discussed the evolution of economic activity in the short term, in light of the most recent releases. They all agreed that the economy continued to show signs of weakness past August. September releases and indicators available for October and November failed to show a reversal that should be expected in a scenario of natural fluctuations of economic activity around stabilization periods. This increases the likelihood that the resumption of economic activity may be further delayed, and be more gradual than previously anticipated.

15. Regarding the global outlook, the Committee members pointed out the risks associated with the possible end of the relatively benign environment for emerging economies of late. They all agreed that the process of normalization of monetary policy in the United States should be resumed in the near term, and that the course of its economic policy became a source of uncertainty. The Copom evaluated that part of this uncertainty should dissipate in the coming months. They also agreed that by the end of the year the Committee should have a more accurate assessment of the possible impacts of the resumption of the process of monetary policy normalization in the United States. The members of the Committee argued that, in face of expectations that global economic activity will strengthen, movements in the terms of trade may have mitigating effects. They also considered that, should a change in the global outlook produce relative price changes, its impact on monetary policy will be circumscribed by its second-round effects on inflation. In a context of anchored inflation expectations, these effects tend to be mitigated by the high degree of economic slack.

16. The Committee analyzed its conditional forecasts for inflation in different scenarios, the balance of risks, the wide array of available information, and the evolution of the factors emphasized by the Copom in its October Statement (202nd meeting). In this context, the Copom considered that the recent monetary policy stance contributed to the anchoring of inflation expectations, and to create more leeway for the easing of monetary policy. The discussion turned then to the pace of easing.

17. Some Committee members reasoned that the more favorable inflation developments recently, the positive steps toward the approval of the first fiscal reforms and the downgrade in the prospects for the recovery of economic activity would already support a faster pace of monetary easing at the current meeting. Other Copom members argued that the evolution of some inflation components that are more sensitive to the business cycle and to monetary policy continue to indicate a pause, at the margin. They also argued that the uncertainty over the possible end of the benign global environment for emerging economies should decrease until the January Copom meeting. The combination of such factors recommended waiting until the next meeting. These same members reasoned, nevertheless, that if economic activity fails to show clearer signs of recovering, it is reasonable to expect an intensification of the pace of monetary easing, since in this case inflation forecasts should decrease. In the end, a consensus was built on waiting until the next meeting.

18. The members of the Committee discussed the path for regulated prices and its effects on the prospective scenario for inflation. In particular, the members of the Committee mentioned: (i) the impact of the change in fuel price policy that was recently announced; (ii) possible changes in electricity prices during 2017, as a result of the fare hikes required to correct past policy distortions. In this context, the members of the Committee emphasized, once again, that the environment with anchored inflation expectations would enable the Copom to focus on preventing second-round effects of these relative price adjustments.

19. All members of the Committee recognized the progress made and efforts for approval and implementation of the necessary adjustments in the

economy, especially with respect to fiscal reforms. The members of the Committee emphasized that these efforts are crucial for the stabilization and the development of the Brazilian economy. The Committee should monitor these efforts closely, since they have important implications for the disinflation process.

20. The Committee understands that the pace of monetary easing will be calibrated, taking into account its inflation projections and its determinant factors, in order to pursue a path that allows the inflation targets for 2017 and 2018 to be met. The Committee judges that currently there is no incompatibility between these two objectives. Inflation forecasts for both years have improved, especially in the market scenario. This suggests that there may be more room for monetary easing than previously perceived.

21. The Committee discussed the factors determining the pace and magnitude of monetary easing. In particular, it was pointed out that the palpable risk that a timely recovery of economic activity fails to materialize should allow the intensification of the pace of monetary easing.

D) Monetary Policy Decision

22. Taking into account the baseline scenario, the current balance of risks, and the wide array of available information, the Copom unanimously decided to reduce the Selic rate to 13.75 percent per year, without bias.

23. The Committee judges that convergence of inflation to the 4.5% target over the relevant horizon for the conduct of monetary policy, which includes 2017 and 2018, is compatible with a gradual easing of monetary conditions.

24. The magnitude of monetary easing and the speeding up of its pace will depend on inflation forecasts and expectations, and on the evolution of the aforementioned risk factors. In that respect, the Copom emphasizes that the pace of disinflation in its forecasts might intensify if the economic recovery is delayed further, and occurs more gradually than anticipated. This intensification of the disinflation process relies on an adequate global environment. There is no mechanical relationship, however, between the global outlook and monetary policy.

25. The following members of the Committee voted for this decision: Ilan Goldfajn (Governor), Anthero de Moraes Meirelles, Carlos Viana de Carvalho, Isaac Sidney Menezes Ferreira, Luiz Edson Feltrim, Otávio Ribeiro Damaso, Reinaldo Le Grazie, Sidnei Corrêa Marques and Tiago Couto Berriel.