

# **Minutes of the 207<sup>th</sup> Meeting of the Monetary Policy Committee (“Copom”)\* of the Central Bank of Brazil**

May 30<sup>th</sup> and 31<sup>st</sup>, 2017



\* 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:** May 30<sup>th</sup> and 31<sup>st</sup>, 2017

**Place:** BCB Headquarters' meeting rooms on the 21<sup>st</sup> floor (May 30<sup>th</sup>) and 20<sup>th</sup> floor (May 31<sup>st</sup>) – Brasília – DF

**Starting and ending time:** May 30<sup>th</sup>: 10:02 am – 12:00 pm; 2:31 pm – 5:34 pm  
May 31<sup>st</sup>: 2:00 pm – 6:00 pm

**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 May 30<sup>th</sup>)**

Alan da Silva Andrade Mendes - Department of Foreign Reserves  
André Minella - Research Department (also present on May 31<sup>st</sup>)  
Flávio Túlio Vilela – Department of Banking Operations and Payments System  
Gilneu Francisco Astolfi Vivan – Financial System Monitoring Department (present only in the morning session)  
João Barata Ribeiro Blanco Barroso – International Affairs Department  
João Henrique de Paula Freitas Simão – Open Market Operations Department  
Renato Jansson Rosek – Investor Relations and Special Studies Department (present only in the afternoon session)  
Tulio José Lenti Maciel – Department of Economics

**Other participants (present on May 30<sup>th</sup>)**

Adalberto Felinto da Cruz Junior – Executive Secretary  
Edson Broxado de Franca Teixeira – Deputy Head for the Financial System Monitoring Department (present only in the afternoon session)  
Enrico Bezerra Ximenes de Vasconcelos – Secretary to the Financial Stability Committee and Consultant to the Board  
Eugênio Pacceli Ribeiro – Head of the Deputy Governor for Economic Policy's office  
Fabio Araújo – Head of the Economic Advisory to the President  
Fernando Alberto Sampaio Rocha – Deputy Head for the Department of Economics  
Gustavo Paul Kurrle – Press Officer  
Leonardo Martins Nogueira – Head of the Deputy Governor for Monetary Policy's office  
Luis Gustavo Mansur Siqueira – Head of the Deputy Governor for Institutional Relations and Citizenship's office (present only in the afternoon session)  
Maurício Costa de Moura – Head of the President's office  
Wagner Thomaz de Aquino Guerra Junior – Head of the Deputy Governor for International Affairs and Corporate Risk Management's office

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.

## A) Update of economic outlook and Copom's baseline scenario<sup>1</sup>

1. The set of indicators of economic activity released since the last Copom meeting remains consistent with stabilization of the economy in the short run and a gradual recovery of economic activity during the course of 2017. If sustained over a long period, high levels of uncertainty regarding the evolution of reforms and adjustments in the economy can have detrimental effects on economic activity.
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. Stronger global economic activity has so far mitigated the effects on the Brazilian economy of possible changes of economic policy in central economies.
4. Inflation developments remain favorable. Disinflation is widespread and includes IPCA components that are most sensitive to the business cycle and monetary policy. It is necessary to monitor possible impacts of higher uncertainty on the prospective path of inflation.
5. Inflation expectations collected by the Focus survey are around 4.0% for 2017, 4.4% for 2018 and 4.25% for 2019 and longer horizons.
6. The path of administered prices underlying the inflation scenarios produced by the Committee assumes increases of 6.1% for 2017 and 5.5% for 2018.
7. The scenario with interest rate and exchange rate paths extracted from the Focus survey considers, among other assumptions, exchange rates of R\$3.25/US\$ and R\$3.37/US\$ at the end of 2017 and 2018, respectively, and interest rates of 8.50% per annum (p.a.) at the end of the same periods.
8. Under these assumptions, the Committee's inflation projection for 2017 is around 4.0%. The projection for 2018 in this scenario is around 4.6%. The Committee emphasizes that its

conditional inflation forecasts currently involve a higher level of uncertainty.

## B) Risks around baseline inflation scenario

9. The Committee views the heightened uncertainty regarding the speed of the process of reforms and adjustments in the Brazilian economy as the main risk factor. This arises from both a higher probability of scenarios that may hinder this process, and the difficulty in assessing the effects of these scenarios on the determinants of inflation. These determinants include economic activity, inflation expectations, estimates of the structural interest rate, and prices of relevant financial assets. There are other risks around the baseline scenario:
10. The global outlook, despite currently favorable, involves a considerable level of uncertainty and might make disinflation more difficult.
11. Disinflation in food and industrial prices might produce second-round effects on inflation. Notably, it might contribute to additional reductions of inflation expectations and inflation in other sectors of the economy.
12. Economic activity points to stabilization in the short run and prospect of recovery, but the economy resumption might be more (or less) gradual and delayed than the anticipated.

## C) Discussion about the conduct of monetary policy

13. The Committee members discussed the evolution of economic activity, in light of available data. They all agreed that recent data confirm the scenario of stabilization and prospects of gradual economic recovery. However, if sustained over a long period, high levels of uncertainty regarding the evolution of reforms and adjustments in the economy can have detrimental effects on economic activity.
14. Regarding the global outlook, the Committee members pointed out the recent favorable

<sup>1</sup> Unless explicitly stated otherwise, this update takes into account the changes that have occurred since the April Copom meeting (206<sup>th</sup> meeting).



evolution of the global economy, despite the uncertainties associated with possible changes in economic policy in the United States, with the evolution of commodity prices, with risk appetite for emerging economies' assets, and with the outlook for the Chinese economy. They also highlighted that the Brazilian economy nowadays shows greater capacity to respond to occasional negative developments in the global economy, due to its more robust balance of payments and to the progress in the disinflationary process and in the anchoring of expectations.

15. All Committee members agreed that the prospects for inflation have evolved in a favorable way. The members of the Committee analyzed the inflation trajectory throughout this and subsequent years. Considering the scenario that conditions on paths of the interest rate and exchange rate extracted from the Focus survey, projections for 12-month inflation remain below the 4.5% target throughout 2017. Projections reach a trough in the third quarter of the year and increase in the last months of the year to values still below target. Part of this difference can be attributed to the primary effects of the favorable food price shock. This scenario assumes an interest trajectory that reaches 8.5% at the end of 2017 and 2018. In this scenario, the inflation trajectory reaches 4.6% in 2018.
16. Members of the Committee assessed the impacts of recent changes in regulated prices (reduction of fuel prices and the return of green flag on electricity tariffs) on short-term inflation. It is estimated that these adjustments should reduce June IPCA inflation by approximately 0.3 percentage point. All members concluded that these one-off oscillations do not have relevant implications for the conduct of monetary policy.
17. The members of the Committee discussed possible impacts of increased uncertainty on the prospective path of inflation. On the one hand, they consider that, if sustained over a long period, high levels of uncertainty regarding the evolution of reforms and adjustments in the economy can have detrimental effects on economic activity, and hence be disinflationary. On the other hand, the impact of uncertainty on price setting and on estimates of the structural interest rate can have the opposite direction. In general, the members of the Committee emphasized that, at this moment, the conditional projections of the Copom involve greater uncertainty. They concluded that there is no direct and mechanical relationship between the increase in uncertainty and monetary policy, and that the flexibility of the inflation targeting regime allows the Committee to adjust monetary policy to possible prospective scenarios.
18. The Copom members assessed the extension of the monetary easing cycle, including its implications for the level of interest rates throughout 2018. The extension will depend on the evolution of economic activity, on the other aforementioned risk factors, on the projections and expectations of IPCA inflation for 2018 and 2019, and also on the estimates for the structural interest rate of Brazilian economy. The Committee judges that the recent increase in uncertainty regarding the evolution of reforms and adjustments in the economy hampers a more timely reduction of estimates of the structural interest rate, and makes them more uncertain. These estimates naturally involve uncertainty and may be reassessed by the Committee over time.
19. The Committee members reaffirmed the understanding that, with anchored inflation expectations, with inflation forecasts at the target for 2018 and a little below target for 2017, and with the high level of economic slack, the Copom's baseline scenario prescribes continuation of the monetary easing cycle. This understanding already considers the current risks around the baseline scenario and the estimates of the extension of the cycle.
20. The Committee understands that, for a given estimate of its extension, the pace of monetary easing depends on the stage of the cycle, without necessarily reflecting changes in the baseline scenario or in the balance of risks.
21. All members of the Copom agreed that the evolution of the economy since the April Copom meeting (206<sup>th</sup> meeting) is compatible with the reduction of the Selic rate to 10.25 percent p.a.
22. Hence, the members of the Committee discussed the next steps for monetary policy. They assessed the pace of easing that would be recommended for the next meeting and whether early signaling of this possibility would be advisable. The analysis regarding the appropriate pace of easing involved considerations about inflation and activity projections, the estimates of the extension of the cycle and its current stage, and the risks surrounding the scenario and these estimates, including those associated with the prospects for reforms and adjustments in the economy. Regarding the convenience of signaling, on the one hand, it was argued that the uncertainty

regarding the evolution of the baseline scenario (more inflationary or disinflationary than the current one) and the balance of risks did not recommend conjecturing on the possible pace to be adopted in the future. On the other hand, the need, at this moment, to provide guidance and elements to reduce the uncertainty (and the scope of possibilities) regarding the future course of monetary policy was highlighted. The Copom members concluded that a moderate reduction in the pace of monetary easing should be appropriate at its next meeting. Nevertheless, they also emphasized that this pace will continue to depend on the evolution of economic activity, on the balance of risks, on possible reassessments of the extension of the cycle, and on inflation forecasts and expectations.

23. The Committee members once again emphasized that the environment with anchored inflation expectations would allow the Copom to focus on preventing second-round effects of relative price adjustments that may occur over time. This applies to the favorable food supply shock and to the positive dynamics in prices of industrial goods, but also to potential inflationary relative price adjustments. The Copom understands that it should seek to identify the primary effects of these relative price changes, to which monetary policy should not react. Monetary policy should, then, focus on possible second-round effects of those adjustments, which might contribute to changes in inflation projections and expectations.
24. All members of the Committee emphasized again that the approval and implementation of reforms, notably those of a fiscal nature, and of adjustments in the Brazilian economy, including those related to credit policy and of quasi-fiscal nature, are fundamental to the sustainability of disinflation, to the full operation of monetary policy and to the reduction of its structural interest rate, with widespread benefits for society.
25. Finally, the Committee members highlighted the importance of other reforms and investments in infrastructure aimed at increasing productivity, efficiency gains, greater flexibility of the economy, and improvement of the business environment. These efforts are fundamental for the stabilization and resumption of the economic activity and for the development of the Brazilian economy.

## D) Monetary Policy Decision

26. Taking into account the baseline scenario, the balance of risks, and the wide array of available information, the Copom unanimously decided to reduce the Selic rate by one percentage point, to 10.25 percent per year, without bias. 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, to a greater extent, 2018, is compatible with the monetary easing process.
27. The Copom emphasizes that the extension of the monetary easing cycle will depend, among other factors, on estimates of the structural interest rate of the Brazilian economy. The Committee judges that the recent increase in the uncertainty regarding the evolution of reforms and adjustments in the economy hampers a more timely reduction of estimates of the structural interest rate, and makes them more uncertain. The Committee will continue to reassess these estimates over time.
28. In light of the basic scenario and current balance of risks, the Copom judges that a moderate reduction of the pace of monetary easing relative to the pace adopted today is likely to be appropriate at its next meeting. Naturally, the pace of monetary easing will continue to depend on the evolution of economic activity, the balance of risks, possible reassessments of the extension of the cycle, and on inflation forecasts and expectations.
29. 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.