

Minutes of the 208th Meeting of the Monetary Policy Committee (“Copom”)* of the Central Bank of Brazil

July 25th and 26th, 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: July 25th and 26th, 2017

Place: BCB Headquarters' meeting rooms on the 21st floor (July 25th) and 20th floor (July 26th) – Brasília – DF

Starting and ending time: July 25th: 10:02 am – 12:01 pm; 2:30 pm – 5:08 pm
July 26th: 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 in charge of technical presentations (present on July 25th)

André Barbosa Coutinho Marques – Investor Relations and Special Studies Department (present only in the afternoon session)

André Minella - Research Department (also present on July 26th)

Ariosto Revoredo de Carvalho - Department of Foreign Reserves

Flávio Túlio Vilela – Department of Banking Operations and Payments System

João Barata Ribeiro Blanco Barroso – International Affairs Department

João Henrique de Paula Freitas Simão – Open Market Operations Department

Tulio José Lenti Maciel – Department of Economics

Other participants (present on July 25th)

Adalberto Felinto da Cruz Junior – Executive Secretary

Edson Broxado de Franca Teixeira – Deputy Head for the Financial System Monitoring Department

Eugênio Pacceli Ribeiro – Head of the Deputy Governor for Economic Policy's office

Fabio Araujo – Head of the Economic Advisory to the President

Fernando Alberto Sampaio Rocha – Deputy Head for the Department of Economics

Gustavo Paul Kurrle – Press Officer

João André Calvino Marques Pereira – Head of the Deputy Governor for Regulation's office

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 scenario¹

1. The set of indicators of economic activity released since the last Copom meeting remains consistent with stabilization of the Brazilian economy in the short run and gradual recovery. The recent increase in uncertainty regarding the evolution of reforms and adjustments in the economy had a negative impact on confidence indices. However, available information suggests that the impact of this drop in confidence on economic activity has been limited so far.
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. The global outlook has been favorable, as global economic activity remains on a gradual recovery path, without pressuring financial conditions in developed economies. This has contributed to support risk appetite towards emerging economies. In addition, changes in economic policy in some central economies have become less likely.
4. Inflation developments remain favorable. Disinflation is widespread and includes IPCA components that are most sensitive to the business cycle and monetary policy. So far, the short-run effects of higher uncertainty regarding the evolution of reforms and adjustments in the economy have been neither inflationary nor disinflationary.
5. Inflation expectations collected by the Focus survey for 2017 and 2018 fell to around 3.3% and 4.2%, respectively. Expectations for 2019 are around 4.25%, and expectations for 2020 are around 4.00%.
6. The path of administered prices underlying the inflation scenarios produced by the Committee assumes increases of 6.6% for 2017 and 5.3% 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\$3.30/US\$ and R\$3.43/US\$ at the end

of 2017 and 2018, respectively, and interest rates of 8.00% per annum (p.a.) at the end of the same periods.

8. Under these assumptions, the Committee's inflation projections for 2017 and 2018 retreated to around 3.6% and 4.3%, respectively.

B) Risks around baseline inflation scenario

9. The uncertainty regarding the evolution of reforms and adjustments in the Brazilian economy (especially those that pertain to fiscal and credit policies) remains as the main risk factor.
10. The global outlook, despite currently favorable, still carries risks associated with the monetary policy normalization process in central economies, with changes in economic policy in some central economies, and with possible impacts on risk appetite for emerging economies' assets.
11. The sharp disinflation in food and industrial prices might produce second-round effects (that is, in addition to the direct impact) on inflation. Notably, it might contribute to additional reductions of inflation expectations and inflation in other sectors of the economy.
12. The economic recovery 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 the process of stabilization of the economy seems to have consolidated. They also judged that, although a gradual recovery is most likely, the pace of recovery remains uncertain.
14. Regarding the global outlook, the Committee members pointed out the recent favorable evolution of the global economy, with gradual

¹ Unless explicitly stated otherwise, this update takes into account the changes that have occurred since the May Copom meeting (207th meeting).

recovery of activity, without pressures on financial conditions in developed economies. The Committee members also discussed the continuation of risks associated with the monetary policy normalization process in central economies and with the outlook for the Chinese economy, with possible impacts on risk appetite for emerging economies' assets. 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 reach a trough in the third quarter of the year and increase in the last months of the year to around 3.6% in December. Part of this difference in relation to the 4.5% target for 2017 can be attributed to the primary effects of the favorable food price shock. This scenario assumes an interest trajectory that reaches 8.0% at the end of 2017 and 2018. In this scenario, the inflation trajectory reaches 4.3% in 2018.
16. Members of the Committee assessed the impacts on short-term inflation of the recent increase of PIS/Confins on fuel prices. The total impact on IPCA inflation is estimated at 0.45 p.p., over the months of July and August, but with higher concentration in August. Part of this impact was already embedded in the Copom's conditional forecasts. The members of the Committee also debated the impact on July IPCA inflation of the change in the flag on electricity tariffs from green to yellow, which is estimated at around 0.15 p.p. All concluded that these one-off oscillations – in particular the ones related to fuel and electricity adjustments, which have been more volatile – do not have relevant implications for the conduct of monetary policy.
17. The members of the Committee assessed the possible impacts of increased uncertainty related to the pace of reforms and adjustments in the economy on the prospective path of inflation. They concluded that the available information suggests limited impacts so far, both through inflationary and disinflationary channels.
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 cyclical factors (evolution of economic activity, of the other aforementioned risk factors and of 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 evolution of reforms and adjustments in the economy (especially those that pertain to fiscal and credit policies) is important to the reduction of the structural interest rate. These estimates naturally involve uncertainty and will continue to be reassessed by the Committee over time.
19. The Committee members reaffirmed the understanding that, with anchored inflation expectations, with inflation forecasts a little below target for 2018 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, despite the increased uncertainty related to the pace of implementation of reforms and adjustments in the economy, the evolution of the economy since the May Copom meeting (207th meeting) is compatible with the reduction of the Selic rate to 9.25 percent p.a.
22. Hence, the members of the Committee discussed the next steps for monetary policy. In this context, they assessed the convenience of signaling the possible magnitudes of monetary easing at the next meeting. The analysis regarding the convenience of signaling and the suitable magnitude of monetary easing involved considerations about the projections for inflation and economic activity, 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.

23. The Copom members agreed on the importance of signaling, but reaffirmed their preference for communicating conditionalities for the evolution of monetary policy, which better transmits the economic rationality that guides their decisions. This contributes to increase transparency and improve Copom communication.
24. The Committee discussed the convenience of signaling an additional easing of the same magnitude as the one adopted at this meeting, versus a more moderate easing. They decided to signal, for the next Copom meeting, a possible monetary easing of the same magnitude as the one adopted at the current meeting, but which will depend on the continuation of the conditions described in the Copom's baseline scenario and on the estimates of the extension of the cycle. In general, the magnitude 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.
25. 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. 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.
26. Also in light of the recent increase in uncertainty, all members of the Committee emphasized again that the approval and implementation of reforms, notably those of fiscal and credit nature, and of adjustments in the Brazilian economy, 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.
27. Finally, the Committee members highlighted the importance of other reforms (such as the recent approval of the labor reform) 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 economic activity and for the development of the Brazilian economy.

D) Monetary Policy Decision

28. 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 9.25 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 2018, is compatible with the monetary easing process.
29. The Copom emphasizes that the extension of the monetary easing cycle will depend on cyclical factors and on estimates of the structural interest rate of the Brazilian economy. The Committee judges that the evolution of reforms and adjustments in the economy (especially those that pertain to fiscal and credit policies) is important for the reduction of estimates of the structural interest rate. The Committee will continue to reassess these estimates over time.
30. The Copom emphasizes that, despite the increase in uncertainty regarding the evolution of reforms and adjustments in the economy, the continuation of economic conditions so far has allowed the same pace of monetary easing at the current meeting. Regarding the next Copom meeting, maintenance of this pace will depend on the continuation of conditions described in the Committee's baseline scenario and on estimates of the extension of the monetary easing cycle. The pace of 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.
31. 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.