

# **Minutes of the 209<sup>th</sup> Meeting of the Monetary Policy Committee (“Copom”)\* of the Central Bank of Brazil**

September 5<sup>th</sup> and 6<sup>th</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:** September 5<sup>th</sup> and 6<sup>th</sup>, 2017

**Place:** BCB Headquarters' meeting rooms on the 8<sup>th</sup> floor (September 5<sup>th</sup> and morning session on September 6<sup>th</sup>) and 20<sup>th</sup> floor (afternoon session on September 6<sup>th</sup>) – Brasília – DF

**Starting and ending time:** September 5<sup>th</sup>: 9:03 am – 12:37 pm  
September 6<sup>th</sup>: 9:05 am – 9:56 am; 2:00 pm – 6:00 pm

**In attendance:**

**Members of the Copom**

Ilán 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 September 5<sup>th</sup> and in the morning session on September 6<sup>th</sup>)**

André Minella - Research Department (also present in the afternoon session on September 6<sup>th</sup>)  
Ariosto Revoredo de Carvalho - Department of Foreign Reserves  
Flávio Túlio Vilela – Department of Banking Operations and Payments System  
João Barata Ribeiro Blanco Barroso – Department of International Affairs  
João Henrique de Paula Freitas Simão – Department of Open Market Operations  
Tulio José Lenti Maciel – Department of Economics

**Other participants (present on September 5<sup>th</sup> and in the morning session on September 6<sup>th</sup>)**

Adalberto Felinto da Cruz Junior – Executive Secretary  
Enrico Bezerra Ximenes de Vasconcelos – Secretary of the Financial Stability Committee and Advisor to the Board  
Eugênio Pacceli Ribeiro – Head of the Deputy Governor for Economic Policy's office  
Fernando Alberto Sampaio Rocha – Head of the Department of Statistics  
Gilneu Francisco Astolfi Vivan – Head of the Financial System Monitoring Department  
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 morning session on September 6<sup>th</sup>)  
Maurício Costa de Moura – Head of the President's office  
Paulo Sérgio Neves de Souza – Head of the Banking Supervision Department  
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 a gradual recovery of the Brazilian economy.

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 advanced economies. This supports risk appetite towards emerging economies.

4. Inflation developments remain favorable, with various measures of underlying inflation running at low levels. This includes the components that are most sensitive to the business cycle and monetary policy.

5. Inflation expectations collected by the Focus survey edged up to around 3.4% for 2017 and remained around 4.2% for 2018. Expectations for 2019 are around 4.25%, and expectations for 2020 are around 4.0%.

6. The path of administered prices underlying the inflation scenarios produced by the Committee assumes increases of 7.5% for 2017 and 5.2% 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\$3.20/US\$ and R\$3.35/US\$ at the end of 2017 and 2018, respectively, and interest rates of 7.25% per annum (p.a.) at the end of 2017, 7.0% p.a. during most of 2018, ending that year at 7.50% p.a.

8. Under these assumptions, the Committee's inflation projections for 2017 and 2018 retreated to around 3.3% and increased to around 4.4%, respectively.

## B) Risks around baseline inflation scenario

9. The Committee's baseline scenario involves risk factors in both directions.

10. On the one hand, the combination of (i) possible second-round effects of the ongoing favorable food price shock and of low current levels of industrial goods inflation, and (ii) the possible propagation through inertial mechanisms of the low level of current inflation, including the components that are most sensitive to the business cycle and monetary policy, may lead to a lower-than-expected prospective inflation trajectory.

11. On the other hand, (iii) frustration of expectations regarding the continuation of reforms and necessary adjustments in the Brazilian economy may affect risk premia and increase the inflation path over the relevant horizon for the conduct of monetary policy. This risk intensifies in the case of (iv) a reversal of the current benign global outlook for emerging economies.

## C) Discussion about the conduct of monetary policy

12. The Committee members discussed the evolution of economic activity, in light of available data. They all agreed with the diagnosis that the process of stabilization of the economy has consolidated. They also agreed that economic activity should remain on a gradual recovery path, whose first signs are already visible. They assessed that, as the recovery consolidates, consumption growth should give way to a resumption in investment. They also judged that there are signs of employment recovery even in this phase of the cycle.

13. Regarding the global outlook, members of the Committee confirmed the recent favorable evolution of the global economy, with gradual recovery of activity, without pressures on financial conditions in developed economies. They discussed the 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. In this context, the Copom members reaffirmed that the Brazilian economy shows greater capacity to absorb occasional setbacks in the global economy, given its

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<sup>1</sup> Unless explicitly stated otherwise, this update takes into account the changes that have occurred since the July Copom meeting (208<sup>th</sup> meeting).



robust balance of payments, low inflation environment, anchored expectations and prospect of economic recovery. Nevertheless, the Copom members pointed out the risk for the Brazilian economy of a reversal in this benign global outlook in a context of frustration of expectations regarding the reforms and necessary adjustments in the Brazilian economy.

14. The Copom members analyzed the inflation trajectory throughout this and subsequent years and agreed that the prospects for inflation continue to evolve in a favorable way. Considering the scenario that conditions on paths of the interest rate and exchange rate extracted from the Focus survey, projections for 12-month inflation stand around 3.3% in December 2017. In the same scenario, which assumes an interest trajectory that reaches 7.25% at the end of 2017, falls to 7.0% at the start of 2018, and increases to 7.5% at the end of that year, the inflation trajectory reaches 4.4% in December 2018.

15. The Committee members discussed the dynamics of food prices, whose favorable behavior persists so far. They analyzed that, in the twelve-month period ending in August 2017, the cost of food at home measured by the IPCA fell by 5.2%, in contrast with the increase of 9.4% in 2016. This represents a contribution of more than two percentage points for the disinflation observed through August 2017. They pointed out that a retreat in food price inflation was expected for 2017, when compared to 2016. But they agreed that this sharp drop in food prices constitutes a substantial disinflationary surprise and accounts for a relevant share of the difference between the inflation projections for 2017 and the respective 4.5% target.

16. The Committee members analyzed the prospect for the future evolution of food price inflation. They confirmed the prescription that monetary policy should fight possible second-round effects stemming from this shock. They pointed out that inflation projections for 2018 (both the ones extracted from the Focus survey and those from the Copom conditional forecasts) consider some normalization of food price inflation. A slower normalization constitutes a downward risk to these projections.

17. The Copom members discussed the low levels of current inflation, including the components that are most sensitive to the business cycle and monetary policy. They observed that these low levels have allowed an increase in the population's purchasing power and contributed to the economic recovery. They also observed that the possible propagation through inertial mechanisms of the low level of current inflation may lead to a lower-than-expected prospective inflation trajectory. Notwithstanding this risk, the Copom members considered that the

recovery of the economy acts in the opposite direction, by gradually pushing inflation towards target over 2018.

18. The Copom assessed that monetary policy has the flexibility to react to risks on both sides. On the one hand, to the risk that side effects of the food price shock and the propagation of the current low level of inflation may produce lower-than-expected prospective inflation. On the other hand, to the inflationary risk stemming from a possible reversal of the global outlook, in a context of frustration of expectations regarding adjustments and reforms.

19. The Committee members expressed the understanding that economic conditions, with anchored inflation expectations, underlying inflation measures running at low levels, inflation forecasts slightly below target for 2018, and high level of economic slack – prescribe accommodative monetary policy, i.e., interest rates below the structural level. Although estimates of this rate involve a high degree of uncertainty, the Committee members expressed an understanding that current *ex-ante* real interest rates already provide stimulus to the economy.

20. The Copom understands that the evolution of reforms, such as the recently approved credit policy measures, and of adjustments in the Brazilian economy contributes to the reduction of its structural interest rate. The Committee will continue to reassess estimates of this rate over time.

21. The Committee understands that, for a given estimate of the length of the monetary easing cycle, the pace of easing depends on the stage of the cycle, without necessarily reflecting changes in the Committee's baseline scenario or in the balance of risks.

22. All Copom members agreed that the evolution of the outlook and of the balance of risks since its July meeting (208<sup>th</sup> meeting) was compatible with the reduction of the Selic rate to 8.25% percent per year.

23. The Committee members then discussed the next step in the conduct of monetary policy. In this context, they assessed the convenience of signaling the possible magnitudes of monetary easing at the next meeting. They argued for the need to maintain flexibility for monetary policy to properly react in case of changes to the baseline scenario and the balance of risks. The members also discussed the appropriate pace of easing at the current stage of the cycle. They concluded in favor of signaling, conditionally, that if the outlook evolves according to the Copom's baseline scenario, and due to the stage of the easing cycle, a moderate reduction in the

magnitude of monetary easing at the next meeting seems appropriate, from the current perspective.

24. The Committee members also assessed the convenience of signaling the possible steps after the next meeting. In particular, they assessed the costs and benefits of a gradual ending to the easing cycle. In general, the Committee members agreed that, everything else equal, there are benefits from a gradual ending of monetary cycles. A gradual process facilitates communication and allows gathering of more evidence regarding the behavior of the economy around the end of the cycle. But they also agreed that, in exceptional cases, the need for prompt frontloading of the cycle may bring greater benefits than those related to a gradual ending. In the current circumstances, the Copom judged convenient to signal that, if the baseline scenario evolves as currently expected, the Committee foresees a gradual ending to the current monetary easing cycle.

25. The Committee members 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. In this context, they once again highlighted that the monetary easing process 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.

26. All Committee members reemphasized that the approval and implementation of reforms – notably those of fiscal nature – and of adjustments in the Brazilian economy are fundamental to the sustainability of an environment with low and stable inflation, 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 initiatives (such as the recently announced privatizations and concessions) and investments in infrastructure aimed at productivity increases, efficiency gains, greater flexibility of the economy, and business environment improvement. These efforts are fundamental for the resumption of economic activity and for the development path 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 8.25% p.a., 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 Committee judges that economic conditions prescribe accommodative monetary policy, i.e., interest rates below the structural level.

30. The Copom emphasizes that the evolution of reforms, such as the recently approved credit policy measures, and necessary adjustments to the Brazilian economy contributes to the reduction of its structural interest rate. The Committee will continue to reassess estimates of this rate over time.

31. The Copom emphasizes that economic conditions have allowed the same pace of monetary easing at the current meeting. Regarding the next Copom meeting, provided that the Committee's baseline scenario evolves as expected, and due to the stage of the monetary easing cycle, the Committee views a moderate reduction of the pace of easing as appropriate at this time. In addition, under those same circumstances, the Copom foresees a gradual ending to the cycle. Notwithstanding these perspectives, the Copom emphasizes that the monetary easing process 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.

32. 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.