Minutes of the 211th Meeting of the Monetary Policy Committee (Copom) * of the Central Bank of Brazil **

December 5th and 6th, 2017

BANCO CENTRAL DO BRASIL

* The Monetary Policy Committee of the Central Bank of Brazil is herein referred to as the "Copom" and the "Committee".

** These minutes represent 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: December 5th and 6th, 2017

Place: BCB Headquarters' meeting rooms on the 8th floor (December 5th) and 20th floor (December 6th) – Brazil – Brasília – DF

Starting and ending time: December 5th: 9:04 am – 11:56 am; 2:03 pm – 4:15 pm
December 6th: 2:30 pm – 6:20 pm

In attendance:
Members of the Copom
Ilan Goldfajn – Governor
Carlos Viana de Carvalho
Isaac Sidney Menezes Ferreira
Maurício Costa de Moura
Otávio Ribeiro Damaso
Paulo Sérgio Neves de Souza
Reinaldo Le Grazie
Sidnei Corrêa Marques
Tiago Couto Berriel

Department Heads in charge of technical presentations (present on December 5th)
André Minella - Research Department (*also present on December 6th*)
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 December 5th)
Adalberto Felinto da Cruz Júnior – 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
Fábio Araújo – Economic Advisory to the President
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
Leonardo Martins Nogueira – Head of the President's office
Ricardo Eyer Harris – Head of the Deputy Governor for Regulation's office (*present only in the afternoon session*)
Rogério Antônio Lucca – Head of the Deputy Governor for Monetary Policy'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 Copom analyzed the recent performance and prospects for the Brazilian and 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[1]

1. The set of economic activity indicators released since the last Copom meeting is 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 indexes and, mainly, in the unemployment rate.

3. The global outlook has been favorable, as global economic activity remains on a gradual recovery path, without exerting excessive pressure on financial conditions in advanced economies. This supports risk appetite towards emerging economies.

4. The Committee judges that its baseline inflation scenario has evolved, to a large extent, as expected. Inflation developments remain favorable, with various measures of underlying inflation running at comfortable or 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 retreated to around 3.0 percent for 2017. Expectations for 2018, 2019 and 2020 remain around 4.0 percent, 4.25 percent and 4.0 percent, respectively.

6. The path of administered prices underlying the inflation scenarios produced by the Copom assumes increases of 8 percent for 2017, 4.9 percent for 2018, and 4.2 percent for 2019.

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$, R$3.30/US$ and R$3.37/US$ at the end of 2017, 2018, and 2019, respectively. This scenario assumes a path for the policy interest rate that ends 2017 and 2018 at 7.0 percent per year (p.y.) and increases to 8.0 p.y. during the course of 2019.

8. Under these assumptions, the Copom’s inflation projections stand around 2.9 percent for 2017, 4.2 percent for 2018, and 4.2 percent for 2019.

[1] Unless explicitly stated otherwise, this update takes into account changes occurred since the October Copom meeting (210th meeting).

B) Risks around baseline inflation scenario

9. The Committee emphasizes that its baseline scenario involves risks in both directions.

10. On the one hand, (i) possible second-round effects of the favorable food price shock and of low current levels of industrial goods inflation, and (ii) the possible propagation through inertial mechanisms of low inflation levels 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 path for inflation 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 discussed the evolution of economic activity in light of available data. All members agreed that the economy remains on a gradual recovery path, with improvements in employment even at this early stage of the process. This conjuncture has led to increases in growth projections for the current year and for 2018, consistent with a view that the recovery is more consolidated. The Committee emphasized the vision that, owing to the current levels of slack in the economy, marginal revisions in the intensity of recovery would not lead to material revisions in the expected path for inflation.

13. Regarding the global outlook, the Committee confirmed the recent favorable evolution of the global economy, which shows a gradual economic recovery, without exerting excessive pressure on financial conditions in advanced economies. The Committee acknowledged that the continuing process of normalization of monetary policy in major countries led to slightly less accommodative global financial conditions, despite the limited impact on the emerging economies so far. In this context, the Copom reaffirmed that the Brazilian economy shows greater capacity to absorb occasional setbacks in the global economy, given its robust balance of payments, low inflation environment, anchored expectations and prospects of economic recovery. Nevertheless, the Copom 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 necessary reforms and adjustments in the economy.

14. The Copom analyzed the inflation trajectory throughout this and subsequent years and all members agreed that the prospects for inflation, to a large extent, have evolved as expected.

15. The Committee assessed the current situation of the domestic electric power generation sector and incorporated the recent changes in tariffs into its baseline scenario for inflation for the next year. In the aggregate, administered prices have constituted an inflationary shock. In the opposite direction, and in a substantially greater magnitude, the dynamics of food prices constitute a relevant disinflationary shock. With the prospect of a 5 percent price reduction in the year, the food at home component measured by the IPCA explains a large share of the inflation deviation from the 4.5 percent target set for the current year.

16. Regarding monetary policy, there was consensus that, as in the case of other possible relative price adjustments resulting from supply shocks, with anchored inflation expectations, monetary policy should only address the second-round effects of these shocks. The Committee reiterates that its reaction to possible changes in relative prices, such as in food and possible adjustments of electric power tariffs, will be symmetric, that is to say, monetary policy will follow the same principles in face of both inflationary and disinflationary supply shocks.

17. The Copom discussed the levels and the path of inflation, including the components that are most sensitive to the business cycle and monetary policy. Some measures of underlying inflation were considered to be at comfortable levels while others at low levels. The Committee also discussed the extent to which their trajectories are compatible with the convergence of inflation towards the target, within the relevant horizon for monetary policy.

18. The Copom reaffirmed the view that monetary policy has the flexibility to react to risks in both directions: the risk that second-round effects of supply shocks and the propagation of the low current levels of inflation will lead to a lower-than-expected prospective inflation trajectory, as well as the risk of a setback in the global outlook in a context of frustration of expectations about the reforms and necessary adjustments.

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

20. The Copom understands that the process of reforms and necessary 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 its baseline scenario or risk balance.

22. All Copom members agreed that the evolution of the outlook and the balance of risks since its October meeting (210th meeting) took place as expected, and were, therefore, compatible with the Selic rate reduction to 7.0 percent per year.

23. The Committee then discussed the next step in conducting monetary policy. On the one hand, they evaluated that several measures of underlying inflation are at comfortable or low levels, including the components that are most sensitive to the economic cycle and monetary policy, and reflected on the path of inflation towards the target. On the other hand, they pondered on the risk that the current inflationary environment may be interrupted by a frustration of expectations on the continuity of the necessary reforms and adjustments in the Brazilian economy, particularly in a context of reversal of the current favorable external scenario for emerging economies.

24. The Committee deemed appropriate to signal that, as long as the outlook evolves according to the Copom's baseline scenario, and because of the stage of the easing cycle, an additional moderate reduction in the magnitude of easing at the next meeting seems adequate from the current perspective. However, they deemed appropriate to warn that this view is more susceptible to changes in the evolution of the scenario and associated risks than in previous meetings.

25. The Copom also assessed the extension of the cycle and the convenience of signaling steps subsequent to the next meeting. There was consensus in maintaining freedom of action and to signal that the current stage of the cycle recommends caution in conducting monetary policy.

26. The Committee reaffirmed its preference for communicating conditionalities on the evolution of monetary policy, which better transmits the economic rationality that guides its decisions. This contributes to increase transparency and improve Copom communication. In this context, it was once again highlighted that the easing process will continue to depend on the evolution of economic activity, the balance of risks, possible reassessments of the extension of the cycle length, and on inflation projections and expectations.

27. All Committee members once again emphasized that the approval and implementation of reforms – notably those of a fiscal nature – and adjustments in the Brazilian economy are fundamental for the sustainability of the environment of low and stable inflation, for the full operation of monetary policy and for the reduction of the structural interest rate of the economy, with widespread benefits for society.

28. Finally, the Copom stressed the importance of other initiatives aimed at productivity increases, efficiency gains, greater flexibility of the economy and improvements in the business environment. These efforts are fundamental for the resumption of economic activity and for the development of the Brazilian economy.

D) Monetary Policy Decision

29. 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 0.5 percentage point, to 7.0 percent per year, without bias. The Committee judges that convergence of inflation to the target over the relevant horizon for the conduct of monetary policy, which includes 2018 and 2019, is compatible with the monetary easing process.

30. The Committee judges that economic conditions prescribe accommodative monetary policy, i.e., interest rates below the structural level.

31. The Copom emphasizes that the evolution of reforms and necessary 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.

32. The evolution of the baseline scenario, in line with expectations, and the stage of the monetary easing cycle made it appropriate to reduce the Selic rate by 0.5 percentage point at this Copom meeting. Regarding the next meeting, provided the Committee's baseline scenario evolves as expected, and taking into account the stage of the monetary easing cycle, at this time the Copom views an additional moderate reduction of the pace of easing as appropriate. The Committee views this guidance as more susceptible to changes in its baseline scenario and balance of risks than in the previous meeting. Going forward, the Committee judges that the current stage of the cycle recommends caution in conducting monetary policy. 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 projections and expectations.

33. The following Committee members voted for this decision: Ilan Goldfajn (Governor), Carlos Viana de Carvalho, Isaac Sidney Menezes Ferreira, Maurício Costa de Moura, Otávio Ribeiro Damaso, Paulo Sérgio Neves de Souza, Reinaldo Le Grazie, Sidnei Corrêa Marques and Tiago Couto Berriel.