Minutes of the 210th Meeting of the Monetary Policy Committee (Copom) * of the Central Bank of Brazil **

October 24th and 25th, 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: October 24th and 25th, 2017

Place: BCB Headquarters' meeting rooms on the 8th floor (October 24th) and 20th floor (afternoon session on October 25th) – Brasília – DF
Starting and ending time: October 24th: 10:41 am – 12:25 pm; 2:37 pm – 5:34 pm
October 25th: 2:30 pm – 6:20 am

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 October 24th)
Alan da Silva Andrade Mendes - Department of Foreign Reserves
André Minella - Research Department (*also present on October 25th*)
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 October 24th)
Adalberto Felinto da Cruz Júnior – Executive Secretary
Edric Martins Ueda – Head of the Deputy Governor for Economic Policy's office
Enrico Bezerra Ximenes de Vasconcelos – Secretary of the Financial Stability Committee and Advisor to the Board
Fábio Araújo – Economic Advisory to the President (*present only in the afternoon session*)
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 President's office
Luis Gustavo Mansur Siqueira – Head of the Deputy Governor for Institutional Relations and Citizenship's office
Renato Baldini Júnior – Head of the Department of Statistics
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 as expected. Inflation developments remain favorable, with various measures of underlying inflation running at comfortable levels. This includes the components most sensitive to the business cycle and monetary policy.

5. Inflation expectations collected by the Focus survey retreated to around 3.1 percent for 2017 and 4.0 percent for 2018. Expectations for 2019 and 2020 are around 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 7.9 percent for 2017, 5.1 percent for 2018, and 4.3 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$ 3.16/US$, R$3.30/US$ and R$3.33/US$ 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 3.3 percent for 2017, 4.3 percent for 2018, and 4.2 percent for 2019.

[1] Unless explicitly stated otherwise, this update takes into account changes occurred since the September Copom meeting (209th 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 should remain on a gradual recovery path, whose signs are evident, for instance, in employment gains, even at this initial phase. As the recovery advances, consumption growth should give way to resumption in investment. Softer economic activity data pertaining to August were discussed, as well as the prospects of a stronger recovery ahead. 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. However, the impact on emerging economies has been limited so far. In this context, the Copom reaffirmed that the Brazilian economy shows a 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 Brazilian economy.

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

15. The Committee assessed the current situation of the domestic electric energy generation sector and incorporated the recent increase in tariffs into its baseline scenario for inflation.

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 energy tariffs, will be symmetric, that is, monetary policy will follow the same principles in face of both inflationary and disinflationary supply shocks.

17. The Copom discussed the levels and path of inflation, including the components that are most sensitive to the business cycle and monetary policy. These components show comfortable levels and a path compatible with convergence of inflation towards target.

18. The Copom assessed 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 slightly below the 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 meeting in September (209th meeting) took place as expected, and was, therefore, compatible with the Selic rate reduction to 7.5 percent per year.

23. The Committee then discussed the next step in conducting monetary policy and the appropriate pace of easing for the current stage of the cycle. Provided that the outlook evolves according to the Copom's baseline scenario, and because of the stage of the easing cycle, a moderate reduction in the magnitude of easing at the next meeting seems adequate from the current perspective.

24. 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 postpone any guidance on future monetary policy decisions in order to incorporate new information on the evolution of the baseline scenario and the balance of risks.

25. The Committee reaffirmed its 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, it was once again emphasized 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 forecasts and expectations.

26. 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.

27. Finally, the Copom highlighted the importance of other initiatives 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 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 0.75 percentage point, to 7.50 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.

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 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.

31. 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 0.75 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 a moderate reduction of the pace of easing as appropriate. 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 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.