

Minutes of the 228th Meeting of the Monetary Policy Committee (Copom*) Banco Central do Brasil

February 4-5, 2020



* The Monetary Policy Committee of the Banco Central do Brasil 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: February 4-5, 2020

Place: BCB Headquarters' meeting rooms on the 8th floor (February 4) and 20th floor (February 5) – Brasília – DF – Brazil

Starting and ending times: February 4: 10:07 AM – 12:30 PM; 2:35 PM – 5:40 PM
February 5: 2:30 PM – 6:20 PM

In attendance:

Members of the Copom

Roberto Oliveira Campos Neto – Governor
Bruno Serra Fernandes
Carolina de Assis Barros
Fabio Kanczuk
Fernanda Feitosa Nechio
João Manoel Pinho de Mello
Maurício Costa de Moura
Otávio Ribeiro Damaso
Paulo Sérgio Neves de Souza

Department Heads in charge of technical presentations (present on February 4)

Alan da Silva Andrade Mendes – Department of Foreign Reserves
André Minella – Research Department (also present on February 5)
André de Oliveira Amante – Department of Open Market Operations
Fabia Aparecida de Carvalho – Department of International Affairs
Flávio Túlio Vilela – Department of Banking Operations and Payments System
Tulio José Lenti Maciel – Department of Economics

Other participants (present on February 4)

Adalberto Felinto da Cruz Junior – Executive Secretary
Carlos Eduardo de Almeida – Senior Advisor at the Deputy Governor for Licensing and Resolution's Office
(present only in the morning session)
Eduardo José Araújo Lima – Head of the Deputy Governor for Economic Policy's Office
Euler Pereira Gonçalves de Mello – Deputy Head of the Research Department
Fabio Araujo – Head of the Economic Advisors' Office
Fernando Alberto Sampaio Rocha – Head of the Department of Statistics
Gilneu Francisco Astolfi Vivan – Head of the Financial System Monitoring Department
Leonardo Martins Nogueira – Head of the Governor's Office
Márcio Antônio Estrela – Head of the Deputy Governor for International Affairs and Corporate Risk Management's Office
Mauro Zanatta – Press Officer
Ricardo Eyer Harris – Head of the Deputy Governor for Regulation's Office
Ricardo Franco Moura – Head of the Prudential and Foreign Exchange Regulation Department
Ricardo Sabbadini – Deputy Head of the Department of Economics
Rogério Antônio Lucca – Head of the Deputy Governor for Monetary Policy's Office
Sílvio Michael de Azevedo Costa – Deputy Head of the Department of International Affairs

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 Scenario¹

1. Data on economic activity released since the previous meeting indicate the continuation of the process of gradual economic recovery.

2. Regarding the global outlook, despite the recent increase in uncertainty, the provision of monetary stimulus in major economies has been able to generate relatively favorable environment for emerging economies.

3. The Committee judges that various measures of underlying inflation are running at levels compatible with meeting the inflation target at the relevant horizon for monetary policy.

4. Inflation expectations for 2020, 2021 and 2022 collected by the Focus survey are around 3.4%, 3.75% and 3.5%, respectively.

5. The hybrid scenario with a constant exchange rate at R\$4.25/US\$² and the interest rate path from the Focus survey yields inflation projections around 3.5% for 2020 and 3.7% for 2021. This scenario assumes a path for the Selic rate that ends 2020 at 4.25% p.a. and rises to 6.00% p.a. in 2021. In this scenario, inflation projections for administered prices are 3.7% for 2020 and 4.1% for 2021.

6. The scenario with constant interest rate at 4.50% p.a. and constant exchange rate at R\$4.25/US\$², yields inflation projections around 3.5% for 2020, and 3.8% for 2021. In this scenario, inflation projections for administered prices are 3.7% for 2020 and 4.1% for 2021.

B) Risks Around the Baseline Inflation Scenario

7. The Copom's baseline scenario for inflation encompasses risk factors in both directions.

8. On the one hand, (i) the high level of economic slack may continue to produce a lower-than-expected prospective inflation trajectory.

9. On the other hand, (ii) the current degree of monetary stimulus, which affects the economy with

lags, may produce a higher-than-expected path for inflation over the relevant horizon for the conduct of monetary policy. Risk (ii) intensifies in case of (iii) an increase in the monetary policy power due to the changes in financial intermediation and in credit and capital markets, (iv) a deterioration of the outlook for emerging economies, or (v) a possible frustration with the continuation of reforms and the perseverance in the necessary adjustments in the Brazilian economy.

C) Discussion about the conduct of monetary policy

10. Copom members discussed the evolution of economic activity in light of available information and indicators. They assessed that the data released since their previous meeting indicate a dichotomy between labor market developments and growth in the production of goods and services. While the labor market continues to recover gradually, recent industrial production data and preliminary investment indicators have performed worse than expected.

11. In this context, Copom members also discussed the size of the economic slack. Some members assessed that the exhaustion of the centralized capital allocation model and the long duration of the recession may have produced supply constraints. In this context, the aforementioned dichotomy suggests that there may be less economic slack than that measured by traditional methods.

12. Other members stressed that the dynamics of the core inflation, despite the recent effects of the protein price shock, signals that the economic slack is still large.

13. Copom members also evaluated the evolution of financial conditions indicators. They concluded that the conditions are favorable, despite some volatility inherent to those measures. The environment with benign financial conditions results from the increase in the degree of monetary stimulus, the relatively favorable global environment for emerging economies and the prospects for the economics fundamentals in the Brazilian economy, as a result of the reform agenda and necessary adjustments.

14. The Committee also discussed the characteristics of the current business cycle, with smaller role for the government in the economy, and its possible implications for monetary policy. Some Copom members pointed out that changes in credit markets

¹ Unless explicitly stated otherwise, this update takes into account changes occurred since the December Copom meeting (227th meeting).

² Value obtained according to the usual procedure of rounding the average R\$/US\$ exchange rate observed on the five business days ending on the Friday prior to the Copom meeting.

and financial intermediation, such as the greater role played by non-earmarked credit and capital markets, must have an impact on the transmission channel of monetary policy. Copom members also conjectured on the sensitivity of macroeconomic variables to monetary policy, as we lack historical precedent in the Brazilian history for the current degree of stimulus. Copom members judge that changes in the credit and capital markets tend to bolster the power of monetary policy.

15. Regarding the global outlook, Committee members deemed the scenario relatively favorable for emerging economies. The Committee discussed the effects of the coronavirus on the global economy. A prolongation or intensification of the outbreak would imply an additional deceleration of global growth, with impacts on commodity prices and important financial assets. The Copom members concluded that the consequence of these effects to monetary policy conduct will depend on the relative magnitude of the global economic slowdown versus the reaction of financial assets.

16. In the relevant horizon for monetary policy, the scenario with the interest rate path from the Focus survey and the constant exchange rate results in inflation below the 2020 target and around the 2021 target. Short-term projections were particularly affected by the effects of the protein price shock which, after manifesting themselves more intensely than expected at the end of 2019, have already showed a partial reversal at the beginning of 2020. Regarding administered prices, the benign conditions for the occurrence of minor adjustments in electricity rates persist.

17. The Copom members assessed that the economic conditions with anchored inflation expectations, underlying inflation measures at levels compatible with meeting the inflation target, scenarios with projected inflation below or around the target for the relevant horizon of monetary policy, and elevated economic slack prescribe stimulative monetary policy, i.e., interest rates below the structural level. The Committee members expressed the view that the current level of *ex-ante* real interest rates provides stimulus to the economy.

18. However, given the multiple uncertainties regarding the current size of economic slack, the speed of economic recovery, and the increase in the power of monetary policy, which acts with lags in the economy, the Copom considers that it is important to observe the effects of the monetary stimulus cycle that started in 2019. The Committee judges that a better understanding of these effects is essential to determine the next steps in monetary policy.

19. The Committee believes that, in a context of anchored inflation expectations, the protein prices

shock anticipated inflation from 2020 to 2019. Given that there are uncertainties regarding the lag and the magnitude of the effects of the stimulus already granted, the Copom believes that it is essential to observe the evolution of economic activity and inflation projections and expectations over the next months, with increasing weight for 2021.

D) Monetary Policy Decision

20. Taking into account the baseline scenario, the balance of risks, and the broad array of available information, the Copom unanimously decided to lower the Selic rate by 0.25 percentage point to 4.25% p.a. The Committee judges that this decision reflects its baseline scenario for prospective inflation and the associated balance of risks, and it is consistent with convergence of inflation to its target over the relevant horizon for the conduct of monetary policy, which includes 2020 and, with increasing weight, 2021.

21. The Copom reiterates that economic conditions prescribe stimulative monetary policy, i.e., interest rates below the structural level.

22. The Copom sees progress in the process of reforms and necessary adjustments in the Brazilian economy but emphasizes that persevering in this process is essential to allow for the consolidation of the reduction of the structural interest rate and for a sustainable economic recovery. The Committee also stresses that the perception of continuation of the reform agenda affects current expectations and macroeconomic projections.

23. The Copom judges that the current stage of the business cycle recommends caution in the conduct of monetary policy. In light of the lagged effects of the monetary easing cycle that began in July 2019, the Committee deems appropriate to interrupt the monetary easing process. The Committee emphasizes that its next steps will continue to depend on the evolution of economic activity, the balance of risks, and inflation projections and expectations, with increasing weight for 2021.

24. The following members of the Committee voted for this decision: Roberto Oliveira Campos Neto (Governor), Bruno Serra Fernandes, Carolina de Assis Barros, Fabio Kanczuk, Fernanda Feitosa Nechio, João Manoel Pinho de Mello, Maurício Costa de Moura, Otávio Ribeiro Damaso, and Paulo Sérgio Neves de Souza.