Minutes of the 230th Meeting of the Monetary Policy Committee (Copom*) Banco Central do Brasil**

May 5-6, 2020

BANCO CENTRAL DO BRASIL

***** 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: May 5-6, 2020

Place: BCB Headquarters' meeting room on the 8th floor – Brasilia – DF – Brazil
Starting and ending times: May 5: 10:06 AM – 12:14 PM; 1:51 PM – 6:51 PM
May 6: 2:00 PM – 6:06 PM

In attendance:
Members of the Copom
Roberto Oliveira Campos Neto – Governor
Bruno Serra Fernandes
Carolina de Assis Barros
Fabio Kanczuk
Fernanda Feitosa Nechio
Maurício Costa de Moura
Otávio Ribeiro Damaso
Paulo Sérgio Neves de Souza

Department Heads in charge of technical presentations (present on May 5 during their presentations)
Alan da Silva Andrade Mendes – Department of Foreign Reserves
André Minella - Research Department (present on May 5-6 sessions)
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 May 5)
Adalberto Felinto da Cruz Junior – Executive Secretary
Leonardo Martins Nogueira – Head of the Governor'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. Regarding the global outlook, the COVID-19 pandemic is causing a significant slowdown in global growth, a fall in commodity prices, and an increase in asset prices volatility. Against this backdrop, despite the additional provision of fiscal and monetary stimuli in major economies, and some moderation in financial assets volatility, the environment for emerging economies remains challenging, with capital outflows significantly larger than in previous episodes.

2. Turning to economic activity, data through March reflect only partly the impact from the COVID-19 pandemic over the Brazilian economy. Higher frequency and more timely indicators for April show that the economic contraction will be significantly deeper than forecasted in the previous meeting.

3. Several measures of underlying inflation are running below the 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 2.0%, 3.3%, and 3.5%, respectively.

5. Short-term projections have experienced relevant revisions and incorporate the prospect of significant deflation in the coming months. There was a further decline in oil prices and a sharp drop in domestic fuel prices for producers, which will continue to impact consumer prices in the coming weeks. The most recent readings of price indices showed significant disinflationary effects on prices of services and industrial goods.

6. Inflation projections and scenarios are affected by assumptions about the future path of oil prices, which have oscillated at historically low levels due to an expansionary supply shock and, mainly, a fall in global demand. The following scenarios consider that Brent oil prices rise about 40% by the end of 2020, compared with the average prices of the week prior to the Copom meeting.

7. In the hybrid scenario with interest rate path extracted from the Focus survey and constant exchange rate at R$5.55/US$[2], the Copom projections stand around 2.4% for 2020 and 3.4% for 2021. This scenario assumes a path for the Selic rate that ends 2020 at 2.75% p.a. and rises to 3.75% p.a. in 2021. In this scenario, inflation projections for administered prices are 0.7% for 2020 and 3.9% for 2021.

8. The scenario with constant interest rate at 3.75% p.a. and constant exchange rate at R$5.55/US$ yields inflation projections around 2.3% for 2020 and 3.2% for 2021. In this scenario, inflation projections for administered prices are 0.7% for 2020 and 3.8% for 2021.

B) Risks Around the Baseline Inflation Scenario

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

10. On the one hand, economic slack may continue to produce a lower-than-expected prospective inflation trajectory. This risk increases if a worsening of the pandemic implies an increase in uncertainty and precautionary savings and, consequently, implies a decline in aggregate demand that is larger or longer than anticipated.

11. On the other hand, fiscal policy responses to the pandemic that permanently aggravate the fiscal trajectory or a frustration with the continuation of the reform agenda may increase the risk premium and imply a higher-than-expected path for inflation over the relevant horizon for monetary policy.

C) Discussion about the conduct of monetary policy

12. Regarding the global economy, the Copom judges that, as in previous international crises, the increase in risk aversion, and the consequent asset reallocation, make the environment more challenging for emerging economies. Unlike other recent crises, in which the epicenter was in the Northern Hemisphere, in the current crisis it moved to all countries, along with the pandemic. Additionally, projections point to a global recession with few historical precedents. These two factors help explain capital outflows significantly larger than in previous episodes. Among the emerging economies, those with greater fiscal vulnerability are prone to be the most harmed.

13. The Copom members discussed the evolution of domestic economic activity in light of the available information and indicators. They assessed that, despite few data available for April, there is enough evidence that the economy will contract strongly during the second quarter of the year. The Committee also discussed on the pace of economic recovery. They considered that, unless there are medical advancements in the fight against the pandemic, it is plausible to consider a scenario in which the recovery is more gradual and marked by comings and goings. The baseline scenario assumes a sharp drop in GDP in the first half of the year, followed by a gradual recovery from the third quarter on.

[1] Unless explicitly stated otherwise, this update takes into account changes occurred since the March Copom meeting (229th meeting).

[2] Value obtained according to the usual procedure of rounding the average R$/US$ exchange rate observed in the five business days ended in the last day of the week prior to the Copom meeting.

14. The Copom members debated about the level of economic slack. They reinforced their view that the pandemic shall exert a disinflationary impact on the Brazilian economy, together with a sharp increase in economic slack. The sudden growth in uncertainty among economic agents may result in an increase in precautionary savings and, consequently, a significant decline in aggregate demand.

15. The Committee then discussed the potential existence of an effective lower bound for the Brazilian policy rate. Most members pondered that this limit would be significantly higher in emerging economies than in developed countries, due to a risk premium. It was also pointed out that this premium tends to be higher in Brazil, given the country's relative fiscal fragility and the uncertainties regarding its prospective fiscal path. In this context, we would be close to a level where further reductions in the policy rate could be accompanied by instability in financial markets and asset prices. Conversely, another member argued that, in principle, there is no reason for such a minimum operational limit, since traditional channels of monetary policy remain operational, without discontinuities, although possibly with an increased effect of changes in the policy rate on financial asset prices. The Committee as a whole recognized the importance of gradualism in the conduct of monetary policy for assessing the response of financial asset prices.

16. Finally, concerning the structural rate of the economy, the Committee assessed that it also reflects economic agents' expectations about the prospective fiscal trajectory. In the Committee's view, the interaction between the deterioration of the external scenario, frustrations regarding the continuity of the reforms and possible permanent changes to the public accounts adjustment process may threaten the downward path of the structural interest rate.

17. Conversely, the Copom recognizes that, at this moment, the demand-driven disinflationary shock, although accompanied by greater fiscal fragility, has triggered a downward revision on inflation expectations towards levels not compatible with the target, particularly, within the relevant horizon for monetary policy. This decline holds for expectations measured by both the Focus survey and the break-even inflation extracted from government debt securities. The Committee reaffirms its commitment to the inflation target set by the National Monetary Council, which has always been and still is the main objective of monetary policy.

18. Two Committee members pondered that, even with the possibility of an increase in the structural rate, it could be appropriate to provide the overall monetary stimulus immediately, in combination with a guidance of keeping the interest rate constant for the next months, in order to reduce the probability of missing the inflation target for 2021.

19. However, the prevalent view was that, in light of the elevated uncertainty domestically, the remaining scope for monetary policy is unknown and may be small. Therefore, the Copom chose to provide a more moderate stimulus, for the benefit of gathering more information until its next meeting.

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 0.75 percentage points to 3.00% p.a. The Committee judges that this decision reflects its baseline scenario for prospective inflation, a higher-than-usual variance in the balance of risks, and it is consistent with convergence of inflation to its target over the relevant horizon for monetary policy, which includes 2021.

21. The Committee believes that persevering in the process of reforms and necessary adjustments in the Brazilian economy is essential for a sustainable economic recovery. The Copom also stresses that doubts regarding the continuation of the reform agenda and permanent changes to the fiscal consolidation process could result in an increase in the structural interest rate.

22. The Copom believes that the current state of affairs recommends an unusually large monetary stimulus, but it reinforces that there are potential limits to the remaining space for adjustment. The Committee believes that the fiscal trajectory over the next year, as well as the perception of its sustainability, will be crucial to determine the length of the stimulus.

23. For the next meeting, conditional on the fiscal scenario and on the economic data, the Committee considers a final monetary adjustment, not larger than this one, to complete the change to the policy rate that it deems adequate to counteract the economic consequences from the COVID-19 pandemic. However, the Committee recognizes that the variance of its balance of risks has increased and that further information on the effects of the pandemic in the economy, as well as a decline in fiscal uncertainty, will be essential to determine its next steps.

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, Maurício Costa de Moura, Otávio Ribeiro Damaso, and Paulo Sérgio Neves de Souza.