

Minutes of the 225th Meeting of the Monetary Policy Committee (Copom*) Banco Central do Brasil**

September 17-18, 2019



* 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: September 17-18, 2019

Place: BCB Headquarters' meeting rooms on the 8th floor (September 17) and 20th floor (September 18) – Brasília – DF – Brazil

Starting and ending times: September 17 10:06 AM – 12:42 PM; 2:36 PM – 6:43 PM
September 18 2:00 PM – 6:06 PM

In attendance:

Members of the Copom

Roberto Oliveira Campos Neto – Governor
Bruno Serra Fernandes
Carlos Viana de Carvalho
Carolina de Assis Barros
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 September 17)

Alan da Silva Andrade Mendes - Department of Foreign Reserves
André Minella - Research Department (also present on September 18)
André de Oliveira Amante – Department of Open Market Operations
Flávio Túlio Vilela – Department of Banking Operations and Payments System
João Barata Ribeiro Blanco Barroso – Department of International Affairs
Tulio José Lenti Maciel – Department of Economics

Other participants (present on September 17)

Adalberto Felinto da Cruz Júnior – Executive Secretary
Carlos Eduardo de Almeida - Senior Advisor at the Deputy Governor for Licensing and Resolution's Office
Eduardo José Araújo Lima – 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
Fabia Aparecida de Carvalho – 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
Paulo Marcelo Cavalcanti Muniz - Head of the Deputy Governor for Regulation's Office
Ricardo Franco Moura - Head of the Prudential and Foreign Exchange Regulation Department
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 since the previous Copom meeting suggest resumption of the process of economic recovery. Copom's baseline scenario assumes that this recovery will occur at a gradual pace.

2. The economy continues to operate with a high level of economic slack, as reflected in the low industrial capacity utilization indexes and, mainly, in the unemployment rate.

3. Regarding the global outlook, the provision of additional monetary stimulus in major economies, in a context of economic slowdown and below-target inflation, has been able to generate a relatively favorable environment for emerging economies. The outlook remains uncertain, however, and risks of a more pronounced slowdown in global growth persist.

4. Various measures of underlying inflation are running at comfortable levels. This includes the components that are most sensitive to the business cycle and monetary policy.

5. Inflation expectations for 2019, 2020, 2021, and 2022 collected by the Focus survey are around 3.5%, 3.8%, 3.75%, and 3.5%, respectively.

6. The Copom's inflation projections in the scenario with interest rate and exchange rate paths extracted from the Focus survey stand around 3.3% for 2019 and 3.6% for 2020. This scenario assumes, among other assumptions, a path for the Selic rate that ends 2019 at 5.00% p.a. and remains at that level until the end of 2020. It also assumes a path for the exchange rate that ends 2019 at R\$3.90/US\$, and remains at that level until the end of 2020. In this scenario, inflation projections for administered prices are 3.5% for 2019, and 4.5% for 2020.

7. In the scenario with a constant Selic rate at 6.00% p.a., and a constant exchange rate at R\$4.05/US\$², Copom's inflation projections stand around 3.4% for 2019, and 3.6% for 2020. In this scenario, inflation projections for administered prices are 3.6% for 2019, and 4.6% for 2020.

8. In the scenario with the interest rate path from the Focus survey and a constant exchange rate at R\$4.05/US\$, Copom's inflation projections stand around 3.4% for 2019, and 3.8% for 2020. In this scenario, inflation projections for administered prices are 3.6% for 2019, and 4.6% for 2020.

¹ Unless explicitly stated otherwise, this update takes into account changes occurred since the July Copom meeting (224th meeting).

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

11. On the other hand, (ii) a possible frustration regarding the continuation of reforms and the perseverance in the 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. Risk (ii) intensifies in case (iii) the outlook for emerging economies deteriorates.

C) Discussion About the Conduct of Monetary Policy

12. Copom members discussed the evolution of economic activity in light of available information and indicators. They concluded that the data released since their previous meeting suggest recovery of the Brazilian economic resumption process. After higher-than-expected growth in the second quarter, the Committee expects Gross Domestic Product (GDP) to grow slightly in the third quarter. Subsequent quarters should show some acceleration, which should be reinforced by the stimuli resulting from the release of FGTS and PIS-PASEP resources – impacting the last quarter of 2019, in particular. Copom's baseline inflation scenario assumes that the pace of underlying economic activity – which excludes the effects of temporary stimuli – will be gradual.

13. Copom members also evaluated the evolution of financial conditions indicators. They concluded that these conditions remained at favorable levels, despite some volatility since the previous Copom meeting, as a result of developments in international markets and of temporary impacts of the crisis in Argentina. The environment with favorable financial conditions results from the increase in the degree of monetary stimulus, the relatively favorable external environment for emerging economies and the prospects for improving the fundamentals of the Brazilian economy, as a result of the reform agenda. This easing of financial conditions has been more clearly reflected in the dynamics of credit and capital markets.

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

14. Copom members also discussed factors that could affect economic activity, in the context of the deep adjustments that the Brazilian economy requires, notably those of fiscal nature. In a context of limited fiscal space, they emphasized the importance of the continuation of the process of reforms and adjustments that contribute to the sustainability of fiscal policy. By reducing fundamental uncertainties about the Brazilian economy, these reforms tend to stimulate private investment. This potential expansionary effect should counterbalance the impact of current fiscal adjustments on economic activity, as well as mitigate the risk of episodes of large increase in risk premia.

15. The Copom stressed the understanding that an acceleration of the pace of economic recovery to more robust levels will also depend on 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 development of the Brazilian economy. Initiatives in the structural agenda of the Banco Central do Brasil (BC# Agenda) contribute to this process.

16. Regarding the global outlook, Committee members deemed the scenario relatively favorable for emerging economies. On the one hand, central banks of several economies – some major economies included – have provided additional monetary stimuli, which contribute to easing global financial conditions. On the other hand, the Copom judges that the risks associated with a slowing global economy remain and that economic policy and geopolitical uncertainties – notably trade disputes and geopolitical tensions – may contribute to even lower global growth. Uncertainties in the external scenario imply risks to assets whose pricing hinge heavily on a scenario with low global interest rates and the maintenance of the recent pace of economic growth. In this context, the Copom members once again highlighted the capability of the Brazilian economy to withstand a setback in the international scenario, given its robust balance of payments, anchored inflation expectations, and prospects of continuing structural reforms and of economic recovery.

17. The Committee members discussed recent inflation projections and the levels of various measures of underlying inflation. The latter measures are deemed to be at comfortable levels. Short-term projections indicate that 12-month inflation is expected to decline in the coming months and to revert, at the end of the year, to levels around those observed until August. This short-term trajectory reflects, among other factors, the benign behavior of some volatile inflation components and the dynamics of imported inflation, whose upward drivers have been moderated by the path of prices in foreign markets. In the relevant horizon for monetary policy, scenarios with constant interest rates at 6.00% p.a. result in inflation below the 2020 target. The same

is true for the scenario with interest rate and exchange rate paths extracted from the Focus survey. In this scenario, the conditioning factors have opposite effects on inflation for 2020. On the one hand, additional monetary stimulus from lower interest rates contributes to increasing inflation over the relevant horizon. On the other hand, the scenario considers exchange rate appreciation in the short run, which constitutes a vector in the opposite direction. The effects of the aforementioned currency appreciation become clear in the hybrid scenario with interest rate path from the Focus survey and an agnostic hypothesis of constant exchange rate, which projects inflation slightly below target in 2020. Conditional projections for 2020 inflation in the various scenarios are also affected by the propagation of lower current inflation.

18. Committee members then discussed the evolution, since their previous meeting, of the factors highlighted in their balance of risks around the baseline inflation scenario. All members emphasized the importance of continuing the reform agenda and persevering in the required adjustments in the Brazilian economy. They also assessed that while the external scenario remained relatively favorable for the conduct of monetary policy in emerging economies, the risk of adverse scenarios for risky assets appears to have intensified.

19. Copom members assessed that economic conditions with anchored inflation expectations, underlying inflation measures at comfortable levels, scenarios with 2020 inflation projected below or slightly below target, and high level of slack in the economy prescribe stimulative monetary policy, i.e., interest rates below the structural interest rate level. The Committee members expressed the view that the current level of *ex-ante* real interest rates provides stimulus to the economy.

20. The structural interest rate is a reference for the conduct of monetary policy. When this policy yields a real (*ex-ante*) interest rate below the structural rate, it provides stimulus for economic activity and contributes to an increase in inflation. As the structural rate is not observable and economic activity and inflation depend on several other factors, estimates of this rate involve a high degree of uncertainty and are continually reassessed by the Committee. At each meeting, the Copom assesses whether the Selic rate is at an appropriate level, considering all factors that affect the evolution of inflation projections and expectations, the balance of risks, and economic activity. Under the aforementioned circumstances, this implies evaluating whether the degree of monetary stimulus is adequate. It is worth highlighting that the provision of monetary stimulus requires an environment with anchored inflation expectations.

21. The Copom reiterates its view that the continuity of reforms and perseverance in the necessary adjustments in

the Brazilian economy are essential for the reduction of its structural interest rate, for the full operation of monetary policy, and for sustainable economic recovery. The Committee also stresses that the perception of continuation of the reform agenda affects current expectations and macroeconomic projections. In particular, the Committee judges that concrete progress in this agenda is fundamental for the consolidation of the benign scenario for prospective inflation.

22. The Committee members then discussed the monetary policy decision, in light of the evolution of the baseline scenario and the balance of risks since its July meeting (224th meeting). They unanimously decided to lower the Selic rate to 5.50% p.a.

23. The Copom also discussed the advisability of providing some perspective on possible monetary policy scenarios. The Committee decided to express its assessment that the consolidation of the benign scenario for prospective inflation should permit additional adjustment of the degree of stimulus. Given the decision to clarify conditionalities for the conduct of monetary policy, which best conveys the economic rationality that guides its decisions, the Copom deemed it essential to emphasize that the communication of this assessment does not constrain its next decision, and to reiterate that the next steps in the conduct of monetary policy will continue to depend on the evolution of economic activity, the balance of risks, and inflation projections and expectations.

D) Monetary Policy Decision

24. Taking into account the baseline scenario, the balance of risks, and the wide array of available information, the Copom unanimously decided to lower the Selic rate to 5.50% p.a. The Committee judges that this decision reflects its baseline scenario for prospective inflation and the associated balance of risks, and is consistent with convergence of inflation to target over the relevant horizon for the conduct of monetary policy, which includes 2020.

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

26. 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 for the reduction of its structural interest rate and for sustainable economic recovery. The Committee also stresses that the perception of continuation of the reform agenda affects current expectations and macroeconomic projections. In particular, the Committee judges that concrete progress in

this agenda is fundamental for the consolidation of the benign scenario for prospective inflation.

27. In the Copom's assessment, the evolution of the baseline scenario and of the balance of risks prescribes adjusting the degree of monetary stimulus, lowering the Selic rate by 0.50 percentage point. The Committee deems that the consolidation of the benign scenario for prospective inflation should permit additional adjustment of the degree of stimulus. The Copom reiterates that communicating this assessment does not constrain its next decision, and emphasizes that the next steps in the conduct of monetary policy will continue to depend on the evolution of economic activity, the balance of risks, and on inflation projections and expectations.

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