



BANCO CENTRAL DO BRASIL

Minutes of the 194th Meeting of the Monetary Policy Committee (Copom)

Date: October 20th 2015, from 4:12PM to 7:23PM, and October 21st, 2015, from 4:40PM to 8:19PM

Place: BCB Headquarters meeting rooms – 8th floor on October 20th and 20th floor on October 21st – Brasília – DF

In attendance:

Members of the Committee

Alexandre Antonio Tombini – Governor
Aldo Luiz Mendes
Altamir Lopes
Anthero de Moraes Meirelles
Luiz Edson Feltrim
Otávio Ribeiro Damaso
Sidnei Corrêa Marques
Tony Volpon

Department Heads (present on October 20th)

Ariosto Revoredo de Carvalho – Department of Foreign Reserves
Bruno Walter Coelho Saraiva – International Affairs Department
Eduardo José Araújo Lima – Research Department (also present on October 21st)
Flávio Túlio Vilela – Department of Banking Operations and Payments System
João Henrique de Paula Freitas Simão – Open Market Operations Department
Renato Jansson Rosek – Investor Relations and Special Studies Department
Tulio José Lenti Maciel – Economic Department

Other participants (present on October 20th)

Gustavo Paul Kurrle – Press Officer
Maurício Costa de Moura – Chief of Governor's Staff

The members of the Copom analyzed the recent performance and the prospects for the Brazilian economy and for the international economy, under the monetary policy framework, which is designed to comply with the inflation targets established by the government.

Recent Economic Developments

1. Monthly inflation measured by the Extended Consumer Price Index (IPCA) reached 0.54% in September, 0.32 percentage points (p.p.) above the one recorded in the previous month. As a consequence, inflation accumulated in 12 months reached 9.49% in September (6.75% in September 2014), with market prices increasing by 7.48% (7.17% in September 2014), and regulated prices, 16.35% (5.32% in September 2014). Specifically regarding market prices, the prices of tradable goods increased 6.41% in twelve months through September (6.86% in September 2014) and the prices of non-tradable goods, 8.38% (7.46% in September 2014). It bears noticing that the prices of the food and beverages group increased 10.04% in twelve months through September (8.21% in September 2014), and the prices of services rose 8.13% (8.59% in September 2014). In short, available information suggests some persistence of inflation, which partially reflects the dynamics of prices in the services sector and, in the short run, the realignment process of regulated prices and temporary supply shocks in the food and beverages group.
2. The average of the underlying monthly inflation measures, calculated by the BCB, changed from 0.41% in August to 0.58% in September. As a consequence, on a twelve-month trailing basis, average core inflation reached 7.82% (1.06 p.p. above the one registered in September 2014). The double weight core inflation changed from 0.43% in August to 0.69% in September; the core by exclusion, which excludes ten household food items and fuels, changed from 0.32% to 0.55%; and the core inflation by exclusion of regulated prices and household food, from 0.33% to 0.55%; the non-smoothed trimmed means IPCA core inflation changed from



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0.42% to 0.48%; and the smoothed trimmed means IPCA core inflation from 0.56% to 0.64%. The diffusion index stood at 66.5% in September (5.4 p.p. above the one recorded in September 2014).

3. The General Price Index (IGP-DI) increased 1.42% in September, reaching 9.31% on a twelve-month trailing basis (3.24% in September 2014). The main component of this indicator, the Wholesale Price Index (IPA), changed 9.52% in twelve months (1.29% in September 2014), with increases of 14.66% in the prices of agricultural products and 7.62% in the prices of industrial products. Inflation measured by the Consumer Price Index (IPC), the second most important component of the IGP-DI, changed 9.65% in twelve months through September (6.97% in September 2014). The Civil Construction National Index (INCC), component with the lowest weight in the IGP-DI, increased 7.38% (6.96% in September 2014), partially driven by pressures stemming from labor costs, which changed 8.59% in the period. On its turn, the Producer/Manufacturing Industry Price Index (IPP/IT), calculated by the Brazilian Institute of Geography and Statistics (IBGE), increased 0.97% in August, changing 7.27% in twelve months. The Copom considers that the effects of the behavior of wholesale prices on consumer inflation will depend on the current and prospective demand conditions and on the price setters' expectations regarding the future inflation path.
4. The Economic Activity Index of the BCB (IBC-Br) incorporates estimates for the monthly production of the three sectors of the economy, as well as for taxes on products, and constitutes important coincident indicator of the economic activity. In August 2015, the IBC-Br decreased 4.47% year-over-year and 0.76% month-on-month, seasonally adjusted. The composite Purchasing Managers' Index (PMI) regarding Brazil changed from 44.8 in August to 42.7 in September, indicating strong contraction. The Industry Confidence Index (ICI) and the Consumer Confidence Index (ICC), from the Getúlio Vargas Foundation (FGV), decreased 2.9% and 5.3%, respectively, between August and September. On its turn, the Services Confidence Index (ICS) decreased 8.4%, reaching a new historical minimum. Regarding agriculture, the Agricultural Production Systematic Assessment (LSPA), carried out by the IBGE, projected, in September, an increase of 8.8% in the grains production in 2015, relative to the 2014 harvest.
5. The industrial activity decreased 1.2% in August, month-on-month, according to the seasonally adjusted series released by the IBGE. Therefore, the industrial production accumulates a change of -5.7% in the last twelve months through August. According to the observed series, the industrial production decreased 9.0% in August, year-over-year, with negative results in the four use categories and in 23 out of the 26 surveyed activities. According to data released by the National Confederation of Industry (CNI), real revenue in the manufacturing industry increased 0.7% between July and August, according to the seasonally adjusted series, and it stands 7.2% lower than the one registered in August 2014. The PMI of the industrial sector, on its turn, changed from 45.8 in August to 47.0 in September.
6. Among the use categories, comparing August and July productions, according to seasonally adjusted data series, capital goods (-7.6%) and durable consumer goods (-4.0%) presented the sharpest decreases. The semi and non-durable goods production also decreased in August (-0.3%). On its turn, the intermediate goods production presented the only positive result in this month (0.2%). Regarding year-over-year growth, there was a decrease in the production of the four categories: capital goods (-33.2%), durable consumer goods (-14.6%), semi and non-durable consumer goods (-7.6%) and intermediate goods (-5.5%).
7. According to the Continuous National Household Sample Survey (Continuous PNAD), the unemployment rate in the moving quarter ended in July was estimated at 8.6%, an increase of 1.7 p.p. compared to the same period last year. According to the Monthly Employment Survey (PME), covering six metropolitan areas, the unemployment rate stood at 7.6% in August, increasing 0.1 p.p. month-over-month and 2.6 p.p. year-over-year. Data released by the Ministry of Labor and Employment (MTE) showed reduction of 86.5 thousand formal jobs in August, while 572.8 thousand formal jobs were destroyed in the year. In short, the set of available data confirm a process of distension in the labor market.
8. According to the retail monthly survey (PMC), released by the IBGE, the retail sales volume decreased 6.9% in August, year-over-year. On its turn, broad retail sales volume, which includes vehicles and construction inputs, decreased 9.6% in August, according to the same comparison basis. The month-on-month changes were -0.9% and -2.0%, respectively, according to the seasonally adjusted series, with retraction in eight of the ten



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sectors surveyed. In twelve months, the retail sales growth rate fell by 1.5% and the broad retail sales decreased 5.2%. The Trade Confidence Index (ICOM), measured by the FGV, decreased 4.1% between August and September. After the fifth consecutive drop, the index reached the lowest level for the historical series started in March 2010.

9. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by the FGV, without seasonal adjustment, reached 77.4% in September and, according to the seasonally adjusted series, 76.5%. Among the industry use categories, according to the seasonally adjusted series, the ones showing the highest Nuci are intermediate goods (81.5%) and construction material (78.1%), followed by non-durable consumer goods (74.3%), durable consumer goods (69.1%) and capital goods (64.4%). On its turn, the absorption of capital goods decreased 18.1% in the last twelve months through August.
10. According to the Ministry of Development, Industry and Foreign Trade (MDIC), the twelve-month trailing trade balance surplus reached US\$6.9 billion in September 2015. This result stemmed from US\$196.0 billion in exports and US\$189.0 billion in imports, with retreats of 17.7% and 19.5%, respectively, relative to the cumulative results through September 2014. On its turn, the current account deficit accumulated in twelve months reached US\$84.5 billion in August 2015, equivalent to 4.3% of the GDP. Foreign Direct Investment (according to the Direct Investment Liabilities concept) totaled US\$73.6 billion, according to the same comparison basis, equivalent to 3.8% of the GDP.
11. Regarding the global economy, leading indicators signal, in the horizon relevant for monetary policy, growth prospects in line with the trend in important advanced and emerging economies. For most advanced economies, the signs are of moderate growth. Particularly about Europe, despite recent monetary policy actions, high unemployment rates, coupled with the fiscal consolidation and political uncertainties, constitute elements restraining investments and growth. In the United States, the view of sustainability of the economic recovery consolidates. In the emerging economies, the activity pace has been revised downwards, with highlight for the loss of strenght in China. Regarding the monetary policy, in general, accommodative stances prevail in advanced and emerging economies, despite the ongoing advances in the debate on the normalization of monetary conditions. The inflation rates remain at low levels in the advanced economies; and, in the emerging ones, they stand at relatively high levels.
12. The price of the Brent oil barrel has remained around US\$50 since the previous Copom meeting. It bears highlighting that the geopolitical complexity that involves the oil sector tends to heighten the volatile behavior of prices. This volatile behavior also reflects the low predictability of some global demand and supply components. Since the last Copom meeting, the international prices of agricultural commodities have risen 2.14%, while metal commodities prices have fallen 6.81%. On its turn, the Food Price Index, calculated by the Food and Agriculture Organization of the United Nations (FAO), fell 18.9% in the twelve months through September 2015.

Assessment of Inflation Trends

13. The identified shocks, and their impacts, were reassessed according to the new set of available information.
14. For the set of regulated prices inflation, the projected adjustment is 16.9% in 2015, up from 15.2% considered at the September Copom meeting. Among other factors, this projection considers the hypothesis of changes of 15.0% in the price of gasoline, of 19.9% in the price of bottled gas and of 51.7% in electricity prices. The items for which there are more information available were projected individually and, for the others, the projections are based on endogenous determination models for regulated prices, which compute, among other factors, seasonal components, market prices inflation and the IGP (General Price Index) change. Based on these models, the projected regulated prices change is 5.8% for 2016, 0.1 p.p. higher than the valued considered at the September Committee meeting.
15. The estimate path for the spreads over the Selic rate, based on the 360-day swap rates, on the baseline scenario, projects -27 basis points (bps) and 12 bps for the fourth quarters of 2015 and 2016, respectively.



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16. The structural primary surplus is considered as the fiscal indicator. It derives from the primary surplus trajectories set at 0.15% of the GDP for 2015 and 0.70% of the GDP for 2016. It also bears emphasizing that, in a given period, the fiscal impulse corresponds to the variation of the structural surplus in comparison to the observed in the previous period.
17. Since the last Copom meeting, the median of the projections compiled by the Investor Relations and Special Studies Department (Gerin) for the 2015 IPCA changed from 9.28% to 9.75% and, for 2016, from 5.51% to 6.12%.
18. The baseline scenario considers the maintenance of the exchange rate at R\$3.85/US\$1.00 and the Selic rate at 14.25% p.a. during the forecast period. Under this scenario, the inflation projection increased, compared to the value considered at the previous Copom meeting, both for 2015 and for 2016, and remains above the 4.5% midpoint target established by the National Monetary Council (CMN). According to the market scenario, which incorporates the market expectations for the exchange and Selic rates trajectories collected by Gerin, in the period immediately prior to the Copom meeting, the inflation projections for 2015 and 2016 also increased relative to the value considered at the September meeting, and remain above the inflation target.

Monetary Policy Decision

19. The Copom emphasizes that the international evidence, which is ratified by the Brazilian experience, indicates that high inflation rates generate distortions that lead to higher risks and depress investments. These distortions are manifested, for example, in the shortening of the planning horizons of households, companies and governments, as well as in the deterioration of the businessmen confidence. The Committee also emphasizes that high inflation rates reduce the purchasing power of wages and transfers, with negative repercussions over the households' confidence and consumption. As a consequence, high inflation rates reduce the potential of economic growth, as well as of jobs and income generation.
20. In view of this, the Copom evaluates that the monetary policy should contribute to the consolidation of a favorable longer-term macroeconomic environment. In this respect, the Copom reassures that, under the inflation targeting regime, it guides its decisions according to BCB projected inflation and based on the analysis of alternative scenarios for the evolution of the main variables that determine prices dynamics. The Committee also understands that low risks for the underlying inflation in the short run tend to reduce uncertainties regarding the future behavior of headline inflation, facilitate the assessment of scenarios by the monetary authority, as well as help the process of coordination of economic agents' expectations, particularly prices setters'. Additionally, it is noteworthy that low risks for the underlying inflation in the short run tend to intensify the effects of monetary policy actions, enabling them to affect, in a more long-lasting manner, the dynamics of headline inflation in the future. Although the Copom recognizes that other macroeconomic policy actions may influence the prices trajectory, it reaffirms its view that it is particularly under the responsibility of the monetary policy to remain especially vigilant, to guarantee that pressures detected in shorter horizons do not spread to longer horizons.
21. The Committee considers that the external environment remains complex, with episodes of higher volatility affecting important emerging economies, despite identifying low probability of occurrence of extreme events in the international financial markets. For the Committee, the trend for global activity shows more moderation throughout the monetary policy relevant horizon. The prospects continue to indicate activity recovery in some advanced economies and acceleration in the pace of growth in others, although, in general, the room to use monetary policy in these economies remains limited and a fiscal restraint scenario prevails. Important emerging economies experience a transition period and, therefore, of more moderation in the activity pace, despite the resilience of the domestic demand.
22. Still regarding international financial markets, the Copom highlights evidence of new sources of volatility in the currency and fixed income markets, as well as moderation in the dynamics of commodities prices. Regarding oil, the Committee highlights that, regardless of the behavior of the domestic prices of gasoline, the evolution of international prices tends to be transmitted to the domestic economy both through productive chains, such as the petrochemical, and through inflation expectations.



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23. The Copom reaffirms that, in accordance to the macroeconomic adjustment process underway, the available indicators show that the domestic absorption and GDP growth rates have continued to adjust and confirm that the domestic activity expansion pace this year will be lower than the potential. This process is being intensified by the uncertainties arising from the effect of non-economic events. In particular, investment has retreated, mainly influenced by the occurrence of these events, and private consumption also shows contraction signals, in line with recent data regarding credit, employment and income. However, for the Committee, after a necessary period of adjustments, which has been more intense and may be longer than the anticipated, the activity expansion pace tends to intensify, as companies' and households' confidence strengthen. Moreover, the Committee evaluates that, in the medium term, important changes should take place in the composition of aggregate supply and demand. Consumption tends to grow at a moderate pace and investments tend to gain momentum. These changes, coupled with other ones currently underway, anticipate a composition for aggregate demand growth in the medium term more favorable to potential growth. Regarding the external component of aggregate demand, the scenario of higher global growth, combined with the depreciation of the BRL, contributes to make this component more favorable to the Brazilian economic growth. Regarding the supply side, the Committee evaluates that, in longer horizons, more favorable prospects for the competitiveness of industry, agriculture and livestock have emerged. The services sector, on its turn, tends to grow at rates lower than those recorded over the recent years. For the Committee, it is plausible to claim that these developments – coupled with advances in terms of qualification of the labor force and with the program of public services concession - will be reflected in a more efficient allocation of the production factors of the economy and in productivity gains. However, the speed of materialization of these changes and of the gains resulting from them depends fundamentally on a path of primary surpluses that strengthens the perception of the public sector balance sustainability, in addition to reducing uncertainties surrounding the domestic environment.
24. The Copom observes that the main inflation scenario considers the materialization of the assumed trajectories regarding fiscal variables. Relative to the structural fiscal result and depending on the economic cycle, the Committee considers that, during the relevant horizon for the monetary policy, the balance of the public sector tends to shift to the neutral zone, and does not rule out the hypothesis of migration to the fiscal restraint area, even if more slowly and with lower intensity than previously anticipated. However, the Committee notes that the lack of definition, the significant changes in the trajectory of primary surpluses, as well as in its composition, impact the working hypotheses considered for inflation projections and contribute to create a negative perception regarding of the macroeconomic environment. Regarding inflation control, the Committee highlights that the literature and the best international practices recommend a consistent and sustainable fiscal policy framework, in order to allow monetary policy actions to be fully transmitted to prices.
25. The Copom highlights that the main scenario also considers moderate credit expansion, which had already been observed and tends to persist. Regarding this issue, it is important to highlight the fact that, after years of strong expansion, consumer credit has moderated, so that, over the last quarters, there was, on the one hand, exposure reduction by banks, and, on the other hand, deleveraging of the households. In the aggregate, therefore, it can be inferred that the risks in the consumer credit segment have been mitigated. In another dimension, as illustrated by actions that were implemented, the Committee considers as opportune the initiatives with the aim of moderating concessions of subsidies through credit operations.
26. In the factors' market, as anticipated by previous Minutes, the Copom observes that the idleness margin in the labor market has increased at a faster pace, with data confirming the acceleration in the process of distension in this market. However, a significant risk still prevails related, particularly, to the possibility of concession of wages' increases incompatible with productivity growth, with negative impacts over inflation. In spite of the occurrence of real wage changes more consistent with the gains estimates for the labor productivity, the Committee evaluates that the wages dynamics remains originating inflationary cost pressures.
27. For the Copom, the fact that inflation stands at high levels reflects, in large part, the occurrence of two important relative prices adjustment processes underway in the economy - the realignment of domestic prices relative to international prices and the realignment of regulated prices relative to market prices. The Committee also considers that, over 2015, these relative prices adjustments in the economy, among other factors, have



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made the balance of risks to inflation unfavorable. In this context, as anticipated in previous Minutes, these price adjustments cause inflation to rise in the short term and to tend to remain high in 2015, requiring determination and perseverance to prevent its transmission to longer horizons. While recognizing that these relative prices adjustments have direct impacts over inflation, the Committee reaffirms its view that the monetary policy can, should and is containing the second order effects stemming from them.

28. Given the above, assessing the macroeconomic scenario, the inflation prospects and the current balance of risks, the Copom unanimously decided to maintain the Selic rate at 14.25% p.a., without bias. The Committee understands that the maintenance of this basic interest rate at this level, for a sufficiently long period, is necessary for the convergence of inflation to the target in the relevant horizon for the monetary policy. The Copom emphasizes that monetary policy will remain vigilant to achieve this goal.
29. The following members of the Committee voted for this decision: Alexandre Antonio Tombini (Governor), Aldo Luiz Mendes, Altamir Lopes, Anthero de Moraes Meirelles, Luiz Edson Feltrim, Otávio Ribeiro Damaso, Sidnei Corrêa Marques and Tony Volpon.
30. The Copom reaffirms that the aggregate demand will continue to be moderate in the relevant horizon for the monetary policy. On the one hand, household consumption tends to be influenced by factors such as employment, income and credit; on the other hand, the concession of public services and the expansion of agricultural income, among other factors, tend to benefit investments. On its turn, the net exports show better results, either by increasing exports, benefited by the scenario of higher growth of major trading partners and the depreciation of the BRL, or by the ongoing import substitution process. For the Committee, the combined effects of these elements, the developments in the fiscal and quasi fiscal framework and in the assets market, and, this year, the dynamics of the regulated prices adjustment, are important factors in the context in which future monetary policy decisions will be taken, aiming to ensure the convergence of inflation to the 4.5% target established by CMN, in the relevant horizon for the monetary policy.
31. The Committee emphasizes that there are uncertainties associated with the balance of risks, mainly on the speed of the recovery process of fiscal results and its composition, and that the relative price realignment process has been slower and more intense than the previously anticipated. In this context, the Committee understands that, regardless of the outline of the other policies, the monetary policy must remain vigilant, in order to ensure the compliance with the inflation targeting regime objectives and the convergence of inflation to the target of 4.5% on the relevant horizon.
32. At the end of the meeting, it was announced that the Committee will reconvene on November 24th 2015, for the technical presentations, and on the following day, to deliberate on monetary policy, as established in the Communiqué 26,042, of June 24th, 2014.