



# BANCO CENTRAL DO BRASIL

## Minutes of the 196<sup>th</sup> Meeting of the Monetary Policy Committee (Copom)

**Date:** January 19<sup>th</sup> 2016, from 4:10PM to 7:17PM, and January 20<sup>th</sup> 2016, from 4:50PM to 8:16PM

**Place:** BCB Headquarters meeting rooms – 8<sup>th</sup> floor on January 19<sup>th</sup> and 20<sup>th</sup> floor on January 20<sup>th</sup> – 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 January 19<sup>th</sup>)**

Bruno Walter Coelho Saraiva – International Affairs Department

Eduardo José Araújo Lima – Research Department (also present on January 20<sup>th</sup>)

Flávio Túlio Vilela – Department of Banking Operations and Payments System

Luiz Donizete Felício – Open Market Operations Department

Renato Jansson Rosek – Investor Relations and Special Studies Department

Tulio José Lenti Maciel – Economic Department

#### **Other participants (present on January 19<sup>th</sup>)**

Alan da Silva Andrade Mendes - Department of Foreign Reserves

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 0.96% in December, 0.05 percentage points (p.p.) below the one recorded in the previous month. As a consequence, inflation accumulated in 12 months reached 10.67% in December (6.41% in December 2014), with market prices increasing by 8.51% (6.72% in December 2014), and regulated prices, 18.07% (5.32% in December 2014). Specifically regarding market prices, the prices of tradable goods increased 8.29% in twelve months through December (5.95% in December 2014) and the prices of non-tradable goods, 8.67% (7.43% in December 2014). It bears noticing that the prices of the food and beverages group increased 12.01% in twelve months through December (8.03% in December 2014), and the prices of services rose 8.09% (8.33% in December 2014). In short, available information partially reflects the more persistent dynamics of prices in the services sector, the realignment process of relative 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 0.65% in November to 0.77% in December. As a consequence, on a twelve-month trailing basis, average core inflation reached 8.47% (2.15 p.p. above the one registered in December 2014). The double weight core inflation changed from 0.71% in November to 0.72% in December; the core inflation by exclusion of regulated prices and household food, changed from 0.59% to 0.88%; the non-smoothed trimmed means IPCA core inflation changed from 0.65% to 0.69%; the smoothed trimmed means IPCA core inflation, from 0.75% to 0.78%; and



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the core inflation by exclusion of ten household food items, as well as fuel, changed from 0.53% to 0.77%. The diffusion index stood at 74.8% in December (6.4 p.p. above the one recorded in December 2014).

3. The General Price Index (IGP-DI) increased 0.44% in December, reaching 10.70% on a twelve-month trailing basis (3.78% in December 2014). The main component of this indicator, the Wholesale Price Index (IPA), changed 11.31% in twelve months (2.17% in December 2014), with increases of 15.62% in the prices of agricultural products and 9.65% in the prices of industrial products. Inflation measured by the Consumer Price Index (IPC), the second most important component of the IGP-DI, changed 10.53% in twelve months through December (6.86% in December 2014). The Civil Construction National Index (INCC), component with the lowest weight in the IGP-DI, increased 7.48% (6.94% in December 2014), partially driven by pressures stemming from labor costs, which changed 8.11% 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 0.05% in November, changing 10.44% 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 November 2015, the IBC-Br decreased 6.14% year-over-year and 0.52% month-on-month, seasonally adjusted. The composite Purchasing Managers' Index (PMI) regarding Brazil decreased from 44.5 in November to 43.9 in December, indicating a sharp reduction rate. The Industry Confidence Index (ICI) and the Services Confidence Index (ICS), from the Getúlio Vargas Foundation (FGV), increased 1.5% and 1.0%, respectively, between November and December. On its turn, the Consumer Confidence Index (ICC) decreased 2.0% in the period. Regarding agriculture, the Agricultural Production Systematic Assessment (LSPA), carried out by the IBGE, projected, in December, an increase of 7.7% in the grains production in 2015, relative to the 2014 harvest.
5. The industrial activity decreased 2.4% in November, month-on-month, according to the seasonally adjusted series released by the IBGE. Therefore, the industrial production accumulates a change of -7.7% in the last twelve months through November. According to the observed series, the industrial production decreased 12.4% in November, year-over-year, with negative results in the four use categories and in 24 out of the 26 surveyed activities. According to data released by the National Confederation of Industry (CNI), real revenue in the manufacturing industry decreased 4.0% between September and October, according to the seasonally adjusted series, and it stands 15.3% lower than the one registered in October 2014. The PMI of the industrial sector, on its turn, increased from 43.8 in November to 45.6 in December, still indicating, however, severe deceleration in the sector, evidenced in the three monitored market groups: consumer, intermediate and investment goods.
6. Among the use categories, comparing the November and October productions, according to the seasonally adjusted data series, intermediate goods (-3.8%) and durable consumer goods (-3.2%) presented the sharpest reduction. Capital goods production (-1.6%) also retreated. On the other hand, semi and non-durable goods (0.4%) increased in November. Regarding year-over-year growth, there was a decrease in the production of the four categories: capital goods (-31.2%), durable consumer goods (-29.1%), intermediate goods (-10.8%) and semi and non-durable consumer goods (-4.8%).
7. According to the Continuous National Household Sample Survey (Continuous PNADC), the unemployment rate in the moving quarter ended in October was estimated at 9.0%, an increase of 2.4 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 7.5% in November, decreasing 0.4 p.p. month-over-month and increasing 2.7 p.p. year-over-year. Data released by the Ministry of Labor and Employment (MTE) showed reduction of 130.6 thousand formal jobs in November, while 945.4 thousand formal jobs were closed in the year. In short, the set of available data confirm intensification of the process of distension in the labor market.
8. According to the retail monthly survey (PMC), released by the IBGE, the retail sales volume decreased 7.8% in November, year-over-year. On its turn, broad retail sales volume, which includes vehicles and construction



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inputs, decreased 13.2% in November, according to the same comparison basis. The month-on-month changes were 1.5% and 0.5%, respectively, according to the seasonally adjusted series, with retraction in three of the ten sectors surveyed. In twelve months, the retail sales volume fell by 3.5% and the broad retail sales volume decreased 7.8%. The Trade Confidence Index (ICOM), measured by the FGV, decreased 6.8% between November and December, and reached 61.4 points, the second 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 76.4% in December and, according to the seasonally adjusted series, 75.1%. Among the industry use categories, according to the seasonally adjusted series, the ones showing the highest Nuci are construction material (79.1%), intermediate goods (75.7%) and non-durable consumer goods (75.7%), followed by durable consumer goods (73.5%) and capital goods (66.8%). On its turn, the absorption of capital goods decreased 24.1% in the last twelve months through December.
10. According to the Ministry of Development, Industry and Foreign Trade (MDIC), the twelve-month trailing trade balance surplus reached US\$19.7 billion in December 2015. This result stemmed from US\$191.1 billion in exports and US\$171.5 billion in imports, with retreats of 15.1% and 25.2%, respectively, relative to the cumulative results through December 2014. On its turn, the current account deficit accumulated in twelve months reached US\$68.0 billion in November 2015, equivalent to 3.7% of the GDP. Foreign Direct Investment (according to the Direct Investment Liabilities concept) totaled US\$69.9 billion, according to the same comparison basis, equivalent to 3.8% of the GDP.
11. Regarding the global economy, leading indicators point to moderation trend in the horizon relevant for monetary policy, with growth rates relatively more homogeneous in advanced economies, although low and below potential 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 trend is of economic recovery; however, some cooling in the dynamics of growth is anticipated. In the emerging economies, the activity pace has been constantly revised downwards, in a scenario of uncertainties regarding the loss of strength in China and their implications for the global economy. Regarding the monetary policy, in general, accommodative stances prevail in advanced and emerging economies, reinforced by signs of a gradual process of normalization of monetary conditions in the US. The inflation rates remain at low levels in the advanced economies and relatively high in the emerging ones.
12. The price of the Brent oil barrel fell to levels around US\$27 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 components of global demand, accentuated by the effects of the slowdown of the Chinese economy, and of supply, influenced by the reduction of investments in the production process. Since the last Copom meeting, the international prices of agricultural commodities have fallen 7.60%, while metal commodities prices remained stable. On its turn, the Food Price Index, calculated by the Food and Agriculture Organization of the United Nations (FAO), fell 17.1% in the twelve months through December 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 change is 6.3% in 2016, up from 5.9% considered at the November Copom meeting. Among other factors, this projection considers average adjustment in the urban bus tariffs of 8.9% and change of 3.7% in electricity prices, maintained the ongoing tariff flags system. 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 5.0% for 2017.



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15. The estimate path for the spreads over the Selic rate, based on the 360-day swap rates, on the baseline scenario, projects 12 basis points (bps) and 18 bps for the fourth quarters of 2016 and 2017, respectively.
16. The structural primary surplus is considered as the fiscal indicator. It derives from the trajectories of primary surplus set at 0.50% of the GDP for 2016 and of primary surplus set at 1.30% of the GDP for 2017. It also bears emphasizing that, in a given period, the fiscal impulse corresponds to the variation of the structural result 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 2016 IPCA changed from 6.64% to 7.00% and, for 2017, from 5.10% to 5.40%.
18. The baseline scenario considers the maintenance of the exchange rate at R\$4.00/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 2016 and for 2017, and remains above the 4.5% midpoint target established by the National Monetary Council (CMN) for 2016 and slightly above the midpoint target for 2017. 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 projection for 2016 also increased relative to the value considered at the November meeting, and remains above the inflation target. For 2017, the projection under the market scenario decreased relative to the considered in the last meeting, and stands slightly above the 4.5% midpoint 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 the projected inflation by the BCB 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, and that the uncertainties increased. However, despite the occurrence of episodes of higher volatility affecting important emerging economies, the Committee also identifies 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 recent prospects indicate modest activity recovery in the advanced economies, while important emerging economies experience a transition period. In this context, of reduction in the activity pace, it bears highlighting the growing concern regarding the Chinese economy and its developments over the other economies.



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22. Still regarding international financial markets, the Copom highlights moderation in the dynamics of commodities prices. Regarding oil, the Committee highlights that, regardless of the behavior of the domestic gasoline prices, the evolution of international prices tends to be transmitted to the domestic economy through productive chains, such as the petrochemical. It should also be noted the increased uncertainties generated by low oil prices and their implications for sectoral companies and producing countries, as well as for the financial markets in general, with risks to global financial stability.
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, pointing to domestic activity expansion pace this year lower than the previously expected. This process has been especially 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 data regarding credit, employment and income. However, for the Committee, after a necessary period of adjustments, which has been more intense and longer than anticipated, as companies' and households' confidence strengthen, the activity expansion pace tends to intensify. 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 the 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 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 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 the reduction on uncertainties surrounding the domestic and international 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 observes that the lack of definitions and the significant changes in the trajectory of primary surpluses' generation, as well as in its composition, impact the hypotheses considered for inflation projections and contribute to create a negative perception regarding the macroeconomic environment and have negatively impacted inflation expectations. Concerning 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 the 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 to continue to reinforce 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 stronger pace, with data confirming the acceleration in the process of distension in this market. However, there is still the prevalence of significant risk related, particularly, to the possibility of concession of high nominal wages' increases, with negative impacts over inflation. In spite of the occurrence of real wage changes more consistent with the estimates for the labor productivity gains, the Committee evaluates that the wages dynamics remains originating inflationary cost pressures.



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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 made the balance of risks to inflation unfavorable. In this context, as anticipated in previous Minutes, these price adjustments caused inflation to rise 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 and the inflation prospects, the Copom considers that uncertainties surrounding the balance of risks remain, mainly on the speed of the fiscal results' recovery process and its composition, and that the relative price realignment process has been slower and more intense than the previously anticipated. In addition, the uncertainties regarding the external scenario increased, with highlights to the growing concern with the performance of the Chinese economy and its developments and with the evolution of prices in the oil market. Part of its members argued that it would be appropriate to adjust, immediately, the monetary conditions, in order to reduce the risks of non-compliance of the inflation targeting regime objectives and reinforce the process of anchoring the inflation expectations. However, most of the Copom members considered that the elevation of the domestic and, mainly, the external uncertainties, especially more recently, justifies to keep on monitoring the evolution of the macroeconomic scenario until its next meeting, to then define the next steps in its monetary policy strategy. For these members, it is necessary to monitor the impact of the recent changes in the domestic and external environments on the balance of risks to inflation, which, combined with the adjustments already implemented in monetary policy, can strengthen the inflation convergence scenario for the 4.5% target in 2017.
29. The Copom, then, decided to maintain the Selic rate at 14.25% p.a., without bias, by six votes for the monetary policy action and two votes in favor of raising the Selic rate by 0.50 pp.
30. The following members of the Committee voted for maintaining the Selic rate at 14.25%: Alexandre Antonio Tombini (Governor), Aldo Luiz Mendes, Altamir Lopes, Anthero de Moraes Meirelles, Luiz Edson Feltrim and Otávio Ribeiro Damaso. The following members of the Committee voted for raising the Selic rate to 14.75%: Sidnei Corrêa Marques and Tony Volpon.
31. 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 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, in 2016, 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 the CMN, in 2017.
32. 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 on its composition, and that the relative price realignment process has been slower and more intense than the anticipated. Moreover, the uncertainties regarding the behavior of the global economy increased. In this context, the Committee reaffirms that will take the necessary measures in order to ensure the compliance with the objectives of the targeting regime, which means to circumscribe inflation to the limits established by the CMN, in 2016, and to make inflation converge to the 4.5% target, in 2017.
33. At the end of the meeting, it was announced that the Committee will reconvene on March 1<sup>st</sup> 2016, for the technical presentations, and on the following day, to deliberate on monetary policy, as established in the Communiqué 28,079, of June 26<sup>th</sup>, 2015.