Minutes of the 212th Meeting of the Monetary Policy Committee (Copom) * of the Central Bank of Brazil **

February 6th and 7th, 2018

BANCO CENTRAL DO BRASIL

* The Monetary Policy Committee of the Central Bank of Brazil 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 6th and 7th, 2018

Place: BCB Headquarters' meeting rooms on the 8th floor (February 6th) and 20th floor (February 7th) – Brazil – Brasília – DF

Starting and ending time: February 6th: 10:09 am – 11:42 am; 2:04 pm – 5:16 pm
February 7th: 2:30 pm – 6:20 pm

In attendance:
Members of the Copom
Ilan Goldfajn – Governor
Carlos Viana de Carvalho
Isaac Sidney Menezes Ferreira
Maurício Costa de Moura
Otávio Ribeiro Damaso
Paulo Sérgio Neves de Souza
Reinaldo Le Grazie
Sidnei Corrêa Marques
Tiago Couto Berriel

Department Heads in charge of technical presentations (present on February 6th)
André Minella - Research Department (*also present on February 7th*)
Ariosto Revoredo de Carvalho - Department of Foreign Reserves
Flávio Túlio Vilela – Department of Banking Operations and Payments System
João Barata Ribeiro Blanco Barroso – Department of International Affairs
João Henrique de Paula Freitas Simão – Department of Open Market Operations
Tulio José Lenti Maciel – Department of Economics

Other participants (present on February 6th)
Adalberto Felinto da Cruz Júnior – Executive Secretary
Daniela Pires Ramos de Alcântara – Head of the Deputy Governor for International Affairs and Corporate Risk Management's office
Enrico Bezerra Ximenes de Vasconcelos – Secretary of the Financial Stability Committee and Advisor to the Board
Eugênio Pacceli Ribeiro – Head of the Deputy Governor for Economic Policy's office
Fábio Araújo – Economic Advisory to the President
Fernando Alberto Sampaio Rocha – Head of the Department of Statistics
Gilneu Francisco Astolfi Vivan – Head of the Financial System Monitoring Department
Gustavo Paul Kurrle – Press Officer
João André Calvino Marques Pereira – Head of the Deputy Governor for Regulation's office
Luis Gustavo Mansur Siqueira – Head of the Deputy Governor for Institutional Relations and Citizenship's office

Rogério Antônio Lucca – Head of the Deputy Governor for Monetary Policy'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. The set of economic activity indicators released since the last Copom meeting shows consistent recovery of the Brazilian economy.

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

3. The global outlook has been favorable, as economies grow worldwide. This has so far contributed to support risk appetite towards emerging economies, notwithstanding recent volatility of financial conditions in advanced economies.

4. The baseline inflation scenario has evolved, to a large extent, as expected. Inflation developments remain favorable, with various measures of underlying inflation running at comfortable or low levels. This includes the components that are most sensitive to the business cycle and monetary policy.

5. Inflation expectations for 2018 collected by the Focus survey are around 3.9 percent. Expectations for 2019 and 2020 remain around 4.25 percent and 4.0 percent, respectively.

6. The path of administered prices underlying the conditional inflation scenarios produced by the Copom assumes variations of 4.8 percent for 2018, and 4.1 percent for 2019.

7. The scenario with interest rate and exchange rate paths extracted from the Focus survey considers, among other assumptions, exchange rates of R$ 3.30/US$ and R$3.40/US$ at the end of 2018 and 2019, respectively. This scenario assumes a path for the policy interest rate that ends 2018 at 6.75 percent per year (p.y.) and increases to 8.0 p.y. during the course of 2019.

8. Under these assumptions, the Copom's inflation projections for 2018 and 2019 stand around 4.2 percent.

B) Risks around baseline inflation scenario

9. The Committee's baseline inflation scenario involves risks in both directions.

10. On the one hand, the combination of (i) possible second-round effects of the favorable food price shock and of low current levels of industrial goods inflation, and (ii) the possible propagation through inertial mechanisms of present low inflation levels, may lead to a lower-than-expected prospective inflation trajectory.

11. On the other hand, (iii) frustration of expectations regarding the continuation of reforms and 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. This risk intensifies in the case of (iv) a reversal of the current benign global outlook for emerging economies.

C) Discussion about the conduct of monetary policy

12. The Committee discussed the evolution of economic activity in light of available data. All members agreed that the recovery of the economy has been more consistent. In this context, Committee members believe that as economic activity recovers, inflation tends to converge to target. They reaffirmed the view that, as a result of current levels of slack in the economy, marginal revisions in the intensity of recovery would not lead to material revisions in the expected path for inflation.

13. Regarding the global outlook, the Committee confirmed that the evolution of the global economy has been favorable, with widespread economic growth. Signs are already emerging that labor market conditions have started to lift wages in some central economies. There are also prospects that inflation rates in these economies will return to levels closer to their targets. This reinforces the scenario of continuation of the monetary policy normalization process in central economies, which should take place gradually in the baseline scenario. But the prospective trajectory of price and wage inflation may make this process more volatile and induce some tightening of global financial conditions. In this context, Committee members once again highlighted the Brazilian economy's capacity to absorb occasional setbacks in the global economy, given its robust balance of payments, low inflation environment, anchored expectations and prospects of economic recovery. Nevertheless, the Copom pondered once more the risk

[1] Unless explicitly stated otherwise, this update takes into account changes occurred since the December Copom meeting (211th meeting).

for the Brazilian economy of a reversal in this benign global outlook, in a context of frustration of expectations regarding the necessary reforms and adjustments in the economy.

14. The Copom analyzed the inflation trajectory throughout this and subsequent years and all members agreed that the prospects for inflation have, to a large extent, evolved as expected.

15. The Committee assessed the current situation of the domestic electric power generation sector and incorporated the recent changes in tariffs into its baseline scenario for inflation. It also discussed the evolution of fuel prices. Both prices have become more volatile over the past year.

16. Regarding monetary policy, there was consensus that, as in the case of other occasional relative price adjustments resulting from supply shocks, with anchored inflation expectations, monetary policy should only address the second-round effects of these shocks. The Committee reiterates that its reaction to possible changes in relative prices, such as in food and possible adjustments of electric power tariffs and fuel prices, will be symmetric, that is to say, monetary policy will follow the same principles in face of both inflationary and disinflationary supply shocks.

17. The Copom discussed the levels and the path of inflation, including the components that are most sensitive to the business cycle and monetary policy. Some measures of underlying inflation were considered to be at comfortable levels while others at low levels. The Committee also discussed the extent to which their trajectories are compatible with convergence of inflation towards the target over the relevant horizon for monetary policy. On the one hand, the persistence of underlying inflation measures at low levels poses downward risks for the prospective inflation path. On the other hand, expectation remains that the recovery of economic activity will contribute to lift underlying inflation towards target over the relevant horizon.

18. The Copom reaffirmed the view that monetary policy has the flexibility to react to risks in both directions: the risk that second-round effects of supply shocks and the propagation of the low current levels of inflation will lead to a lower-than-expected prospective inflation trajectory, as well as the risk of a setback in the global outlook in a context of frustration of expectations about the reforms and necessary adjustments.

19. The Committee expressed the view that economic conditions with anchored inflation expectations, measures of underlying inflation running at comfortable or low levels, inflation projections a little below target for 2018 and on target for 2019, and a high level of economic slack prescribe accommodative monetary policy, with interest rates below the structural level. Although estimates of this rate involve a high degree of uncertainty, Committee members expressed an understanding that current *ex-ante* real interest rates provide stimulus to the economy.

20. The Copom understands that the process of reforms and necessary adjustments in the Brazilian economy contributes to the reduction of its structural interest rate. The Committee will continue to reassess estimates of this rate over time.

21. All Copom members agreed that, since its December meeting (211th meeting), the economy and the balance of risks have evolved, to a large extent, as expected, and was, therefore, compatible with the Selic rate reduction to 6.75 percent per year.

22. The Committee then discussed the next step in conducting monetary policy. It focused on assessing under what circumstances it would be appropriate to interrupt the process of monetary easing and in what context there would be room for additional moderate monetary easing at its March meeting. On the one hand, the continuity of the environment with underlying inflation at comfortable or low levels, with an increased risk of its dissemination, would make room for such additional easing. The same would occur in the case of changes in the balance of risks that result in a lower probability of an increase in risk *premia* and consequent increase in prospective inflation. On the other hand, evolution of the economy in line with the Copom's baseline scenario, the more consistent recovery of economic activity, and a worsening of the global outlook would favor the interruption of the easing process.

23. In this context, the members of the Committee discussed the level of flexibility to be maintained in the communication on the next step for monetary policy. Some members expressed a preference for a high level of flexibility, favoring more symmetric communication about the next step, while others proposed to signal more strongly the possible interruption of the monetary easing cycle and to maintain freedom of action, but to a lesser extent. All members concluded to be appropriate to signal that, provided the conjuncture evolves according to the Committee's baseline scenario, the interruption of the monetary easing process seems appropriate from the current perspective. However, all members deemed appropriate to communicate that this view for the next meeting might change in favor of an additional moderate monetary easing, if the Committee's baseline scenario and balance of risks change.

24. The Committee reaffirmed its preference for communicating conditionalities on the evolution of monetary policy, which better transmits the economic rationality that guides its decisions. This contributes to increase transparency and improve Copom communication. In this context, the members reaffirmed that the next steps in the conduct of the monetary policy will continue to depend on the evolution of economic activity, the balance of risks, possible reassessments of the extension of the cycle length, and on inflation projections and expectations.

25. All Committee members once again emphasized that the approval and implementation of reforms – notably those of a fiscal nature – and adjustments in the Brazilian economy are fundamental for the sustainability of the environment of low and stable inflation, for the full operation of monetary policy and for the reduction of the structural interest rate of the economy, with widespread benefits for society.

26. Finally, the Copom stressed the importance of 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 for the development of the Brazilian economy.

D) Monetary Policy Decision

27. Taking into account the baseline scenario, the balance of risks, and the wide array of available information, the Copom unanimously decided to reduce the Selic rate by 0.25 percentage point, to 6.75 percent per year. The Committee judges that this decision is consistent with convergence of inflation to target over the relevant horizon for the conduct of monetary policy, which includes 2018 and, with smaller and gradually increasing weight, 2019.

28. The Committee judges that economic conditions prescribe accommodative monetary policy, i.e., interest rates below the structural level.

29. The Copom emphasizes that the evolution of reforms and necessary adjustments in the Brazilian economy contributes to the reduction of its structural interest rate. The Committee will continue to reassess estimates of this rate over time.

30. The evolution of the baseline scenario, in line with expectations, and the stage of the monetary easing cycle made it appropriate to reduce the Selic rate by 0.25 percentage point at this Copom meeting. Regarding the next meeting, provided the Committee's baseline scenario evolves as expected, at this time the Copom views the interruption of the monetary easing process as more appropriate. This view regarding the next Copom meeting might change in favor of an additional moderate monetary easing, if the Committee's baseline scenario and balance of risks change. The Copom 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, possible reassessments of the extension of the cycle, and on inflation projections and expectations.

31. The following Committee members voted for this decision: Ilan Goldfajn (Governor), Carlos Viana de Carvalho, Isaac Sidney Menezes Ferreira, Maurício Costa de Moura, Otávio Ribeiro Damaso, Paulo Sérgio Neves de Souza, Reinaldo Le Grazie, Sidnei Corrêa Marques and Tiago Couto Berriel.