Minutes of the 213th Meeting of the Monetary Policy Committee (Copom) * of the Central Bank of Brazil **

March 20th and 21st, 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: March 20th and 21st, 2018

Place: BCB Headquarters' meeting rooms on the 8th floor (March 20th, and morning session of March 21st) and 20th floor (afternoon session of March 21st) – Brazil – Brasília – DF

Starting and ending time: March 20th: 2:33 pm – 5:54 pm
March 21st: 9:24 am – 10:22 am; 2:00 pm - 6:00 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 March 20th and in the morning session of March 21st)
André Minella - Research Department (*also present in the afternoon session of March 21st*)
Ariosto Revoredo de Carvalho - Department of Foreign Reserves
Flávio Túlio Vilela – Department of Banking Operations and Payments System
Geraldo Pereira Júnior – 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 March 20th and on the morning session of March 21st)
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
Leonardo Martins Nogueira – Head of the Governor'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 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.

4. The baseline inflation scenario has evolved in a more benign fashion than expected since the turn of the year. Inflation developments remain favorable, with various measures of underlying inflation running at 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 3.6 percent. Expectations for 2019 and 2020 are around 4.2 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 3.8 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$3.39/US$ at the end of 2018 and 2019, respectively, and interest rate at 6.5 percent per year (p.y.) at the end of 2018 and 8.0 percent p.y. at the end of 2019.

8. Under these assumptions, the Copom's inflation projections declined to 3.8 percent for 2018 and to 4.1 percent for 2019.

[1] Unless explicitly stated otherwise, this update takes into account changes occurred since the February Copom meeting (212th meeting).

B) Risks around baseline inflation scenario

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

10. On the one hand (i) the possible propagation through inertial mechanisms of low inflation levels, may lead to a lower-than-expected prospective inflation trajectory.

11. On the other hand, (ii) 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 (iii) 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. One member mentioned signs of a slight slowdown, at the margin, in the process of economic recovery, but other members considered that these oscillations are natural at the present stage of the process. All members agreed that the recovery shows consistency. In this context, Committee members believe that as economic activity recovers, inflation tends to gradually return 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 reiterated 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 increase 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. There was acknowledgment of the increased risks to the

continued expansion of international trade, due to protectionist measures, with possible impacts on global growth and on the volatility of 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 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 Brazilian economy.

14. The Copom analyzed the inflation trajectory throughout the current and subsequent years. All members agreed that inflation has evolved more favorably than expected since the turn of the year.

15. The Committee reaffirmed the belief that, in the case of 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 emphasizes that its reaction to possible changes in relative prices will be symmetric, that is to say, monetary policy will follow the same principles in face of both inflationary and disinflationary supply shocks.

16. The Copom discussed the level and the path of inflation. Several measures of underlying inflation – including the components that are most sensitive to the business cycle and monetary policy – were considered to be running 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, both the expectation that the recovery of economic activity will contribute to elevate underlying inflation towards target over the relevant horizon and the risks associated of a setback in the global outlook, in a context of frustration of expectations regarding the necessary reforms and adjustments in the economy, remain.

17. The Copom understands that monetary policy has to balance these two dimensions, given the uncertainty associated with the lags in the impacts of monetary easing on the path of inflation. This includes reacting to ensure that inflation converges to target at a proper pace and, at the same time, guaranteeing that the achievement of a low inflation environment endures, even in the event of adverse shocks. The Copom reaffirms that monetary policy has the flexibility to react to risks in both directions.

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

19. 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.

20. All Copom members agreed that, since its February meeting (212th meeting), the evolution of the economy, the baseline scenario and the balance of risks was compatible with the reduction of the Selic rate to 6.50 percent per year.

21. The Committee then discussed the next steps in conducting monetary policy. There was a consensus that the evolution of the economy, the baseline scenario and the balance of risks since its February meeting (212th meeting) made clear, over time, the need for an adjustment of monetary policy in relation to the path that had been signaled at the previous meeting as most likely. Part of this adjustment could be implemented by reducing the Selic rate to 6.5 percent p.y. This had already been reflected in analysts' projections and in the term structure of interest rates. However, the members of the Copom concluded in favor of the need to make monetary policy a little more accommodative. This conclusion derived from two factors. First, the Copom judged that the dynamics of various underlying inflation measures signaled a greater risk of delayed convergence of inflation toward the targets. In this context, an additional monetary stimulus would mitigate this risk. Second, the Committee considered the fact that, even with a Selic rate path that already included a reduction to 6.50 percent p.y., the outlook for inflation – taking into account expectations, projections and assessment of a wide array of information – showed a decline over the relevant horizon, mainly for 2018. The Copom has therefore decided to signal, for the next meeting, an additional moderate monetary easing as appropriate from the current perspective. In view of the principle guiding its conduct of monetary policy, i.e., of clarifying conditionalities that it deems relevant, the Committee also decided to communicate that this vision for the next meeting might change in favor of the interruption of the monetary easing process, if risk mitigation proves unnecessary.

22. The Committee then proceeded to discuss the steps following the next meeting, bearing in mind the relevant horizon for the conduct of monetary policy at that time, which will already be focused mainly on 2019. Considering the Copom's baseline scenario, the balance of risks and the lags and uncertainties associated with the transmission of monetary policy, the Committee concluded that, by then, it should be appropriate to interrupt the process of monetary easing. Given the risks facing the economy and the uncertainty about the lags in the transmission of monetary policy, the Committee believes that it may require some time to evaluate the evolution of the economy and its reaction to the monetary stimulus already in place, given the relevant horizon at that moment. The debate then proceeded on how to communicate this vision to meetings beyond the next. Some members expressed a preference for indicating that it should be necessary to wait for a few Copom meetings, until sufficient information is gathered to assess the behavior of the economy. Other members argued that they did not see a need to commit to such signaling. In the end, the Committee decided to communicate that, for meetings other than the next, absent relevant additional changes to the baseline scenario and balance of risks, the Copom deems appropriate to interrupt the monetary easing process, with the aim of evaluating next steps, in light of the relevant horizon for monetary policy at that time.

23. 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.

24. 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.

25. 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

26. 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 6.50 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 a gradually increasing weight, 2019.

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

28. 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.

29. The evolution of the baseline scenario made it appropriate to reduce the Selic rate by 0.25 percentage point at this Copom meeting. Regarding the next meeting, at this time the Copom views an additional moderate monetary easing as appropriate. The Committee judges that this additional stimulus mitigates the risk of delayed convergence of inflation toward the targets. This view regarding the next Copom meeting might change in favor of the interruption of the monetary easing process, if risk mitigation proves unnecessary. Beyond the next meeting, absent relevant additional changes to the baseline scenario and balance of risks, the Copom deems appropriate to interrupt the monetary easing process, with the aim of evaluating next steps, in light of the relevant horizon for monetary policy at that time. 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.

30. 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.