

# Copom Minutes

11 February 2020

## Minutes reinforce 4.25% in next meetings

### What happened

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The Central Bank (CB) decided unanimously to cut Selic policy rate by 25 bps to 4.25%, renewing a new historical low level.

External scenario: despite the recent increase of uncertainty, monetary policy in large economies still produces a relative favorable environment for emerging economies. The minutes introduced uncertainty about the impact of the coronavirus on global economy and asset prices.

Economic activity: economic growth continues taking place at a gradual pace. But, while job market continue recovering at a gradual pace, the recent data on industrial production and investments came weaker than expectation.

Taking as assumption stability for Selic (4.50%) and FX rates (4.25), the CB inflation model results in inflation of 3.5% and 3.8%, respectively for 2020 and 2021. In the hybrid scenario keeping FX rate constant at 4.25 and market forecast for Selic (4.25% in 2020 and 6.00% in 2021), the model results in 3.5% for 2020 and 3.7% for 2021.

The downward bias relies on high idle capacity that might lead to lower than expected inflation. And upward bias is related to the lagged effect of monetary easing to the economy that might increase inflation path ahead, and this risk is higher in a transforming environment of banking system and capital markets that increase the power of monetary policy, due to the deterioration of the external sector affecting emerging economies, and in case of hurdles to pass the reforms and to continue the economic adjustments.

Copom assesses that the current stage of economic cycle recommends a cautious stance in next steps of monetary policy, and it sees the interruption of monetary easing as adequate. It also highlights that the next steps will depend on the evolution of balance of risks, economic activity and inflation expectation.

### Our expectation

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We don't expect further rate cuts in the next meetings based on the tone of this Copom minutes and the Communiqué released last week, and also because we assess that the 4.25% level is adequate at this moment to contribute to the ongoing economic recovery and to keep inflation expectation anchored to the target. Furthermore, the uncertainties coming from abroad (coronavirus and the pace of global economic growth) might add pressure for a weaker BRL and at the same time might impact negatively economic activity, thus reinforcing a low FX pass-through to inflation.

Copom may hold Selic policy rate at 4.25% level through at least the first half of 2020. The period of which Selic policy might be on hold at this level is still unclear. The outbreak of

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coronavirus introduces uncertainty to the whole macroeconomic scenario that might put the monetary authority in a wait-and-see mode to better assess the impact of this new variable as well as the lagged effects of the monetary policy on the economic activity. Furthermore, Copom members mentioned that the idle capacity of the economy might be smaller than those captured by traditional methods, although the dynamics of core inflation suggests that it is still excessive. In fact, there is room for inflation to increase without jeopardizing the inflation target.

Of course, we cannot discard the possibility of further cut in case of more sluggish than expected economic activity and further downward revision on market inflation expectations.

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