253rd

Minutes of the Meeting of the

# Monetary Policy Committee — Copom

March 21-22, 2023

BANCO CENTRAL DO BRASIL

**Date:** March 21-22, 2023

**Place:** BCB Headquarters' meeting rooms on the 8th floor (3/21 and 3/22 on the morning) and 20th floor (3/22 on the afternoon) – Brasilia – DF – Brazil

**Starting and ending times:** March 21: 10:05 AM – 11:34 AM; 2:10 PM – 5:24 PM
March 22: 10:05 AM – 11:05 AM; 2:33 PM – 6:30 PM

**In attendance:**

***Copom Members***

Roberto de Oliveira Campos Neto – *Governor*
Bruno Serra Fernandes
Carolina de Assis Barros
Diogo Abry Guillen
Fernanda Magalhães Rumenos Guardado
Maurício Costa de Moura
Otávio Ribeiro Damaso
Paulo Sérgio Neves de Souza
Renato Dias de Brito Gomes

***Department Heads in charge of technical presentations*** (attending on 3/21 and and on the morning of 3/22):

Alan da Silva Andrade Mendes – *Department of Foreign Reserves*
André de Oliveira Amante – *Open Market Operations Department*
Euler Pereira Gonçalves de Mello – *Research Department* (also present on the afternoon of 3/22)
Fabia Aparecida de Carvalho – *Department of International Affairs*
Ricardo Sabbadini – *Department of Economics*
Rogério Antônio Lucca – *Department of Banking Operations and Payments System*

***Other participants*** (attending on 3/21 and on the morning of 3/22):

Antônio Geraldo Filho – *Head of Division at the BCB's Internal Auditing*
Arnildo da Silva Correa – *Head of the Office of Economic Advisor*
Cristiano de Oliveira Lopes Cozer – *General Counsel*
Edson Broxado de França Teixeira – *Head of the Deputy Governor for Supervision's Office*
Eduardo José Araújo Lima – *Head of the Deputy Governor for Economic Policy's Office*
Fernando Alberto G. Sampaio de Cavalcante Rocha – *Head of the Department of Statistics*
Gilneu Francisco Astolfi Vivan – *Head of the Financial System Monitoring Department*
Isabela Ribeiro Damaso Maia – *Head of the Sustainability and International Portfolio Investors Unit*
Julio Cesar Costa Pinto – *Head of the Deputy Governor for Monetary Policy's Office*
Kathleen Krause – *Head of the Prudential and Foreign Exchange Regulation Department*
Laura Soledad Cutruffo Comparini – *Deputy Head of the Department of Economics*
Leonardo Martins Nogueira – *Executive Secretary*
Luís Guilherme Siciliano Pontes – *Deputy Head of the International Reserves Department*
Mariane Santiago de Souza – *Head of the Governor's Office*
Mauro Zanatta – *Press Office Advisor*
Olavo Lins Romano Pereira – *Deputy Head of the Department of International Affairs*
Ricardo José de Souza Oliveira – *Coordinator at the BCB's Internal Auditing*

The Copom members 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. This document represents Copom's best effort to provide an English version of its policy meeting minutes. In case of inconsistency, the Portuguese version prevails.

BANCO CENTRAL DO BRASIL

## A) Update of economic outlook and Copom's scenario[1]

1. Since the previous meeting of the Monetary Policy Committee (Copom), the global environment has deteriorated. The episodes involving banks in the United States and Europe have increased the uncertainty and the volatility in markets and require monitoring. Major economies have emphasized the principle of separation of objectives and instruments in the conduct of monetary and macroprudential policies.

2. At the same time, recent data on global activity and inflation remain resilient and the process of monetary policy tightening in major economies continues to advance. The external environment continues to be marked by the prospect of global growth below potential, but the easing of the Covid policy in China, a milder winter in Europe and the possibility of a gradual US growth slowdown soften the ongoing global economic slowdown resulting from the tightening of financial conditions in the major economies. Conversely, the impact on financial conditions and consequently on global growth of the recent episodes involving the banking system in major economies is still uncertain but has a negative bias. Recent inflation readings point to some stabilization of core inflation in several countries at levels above their targets and reinforce the inertial nature of the current inflationary process. The inflationary environment remains challenging and the low degree of labor market slack in some economies, coupled with persistently high current inflation with a high degree of diffusion, suggests that inflationary pressures, particularly in the services sector, should last longer.

3. The process of normalization of monetary policy continues towards contractionary rates synchronized across countries. In several emerging economies, tightening cycles come to a halt or suggest they are nearing an end. In any case, most monetary authorities signal a prolonged period of high interest rates is necessary to fight inflationary pressures, which calls for greater caution in the conduct of economic policies also by emerging countries.

4. Turning to the Brazilian economy, the set of indicators released since the previous meeting still corroborates the scenario of slowdown in the growth expected by the Committee. A moderation is observed in the coincident indicators of activity and the credit market has also shown deceleration at the margin. The labor market, which surprised positively throughout 2022, continues to show signs of moderation, with relative stability in the unemployment rate, stemming from declines in the employed population and in the workforce.

5. Consumer inflation remains high. The inflation of the components more sensitive to the economic cycle and the monetary policy, which present greater inflationary inertia, remain above the range compatible with meeting the inflation target. Inflation expectations for 2023 and 2024 collected by the Focus survey are around 6.0% and 4.1%, respectively.

## B) Scenarios and risk analysis

6. In the reference scenario, the interest rate path is extracted from the Focus survey, and the exchange rate starts at USD/BRL 5.25[2] and evolves according to the purchasing power parity (PPP). The Committee assumes that oil prices follow approximately the futures market curve for the following six months and then start increasing 2% per year onwards. Moreover, the energy flag is assumed to be "yellow" in December 2023 and 2024. In this scenario, Copom's inflation projections stand at 5.8% for 2023 and 3.6% for 2024. Inflation projections for administered prices are 10.2% for 2023 and 5.3% for 2024. The Committee decided again to emphasize the six-quarter horizon ahead. On

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[1] Unless explicitly stated otherwise, this update takes into account changes that occurred since the February Copom meeting (252nd meeting).

[2] Value obtained according to the usual procedure of rounding the average USD/BRL exchange rate observed on the five business days ending on the last day of the week before the Copom meeting.

this horizon, which refers to the third quarter of 2024, the 12-month inflation projection stands at 3.8%. The Committee judges that the uncertainty in its assumptions and projections is higher than usual.

7. The Committee analyzed an alternative scenario with stable interest rates over the entire relevant horizon. In this scenario, inflation projections stand at 5.7% for 2023, 3.3% for the third quarter of 2024, and 3.0% for 2024.

8. The Committee again assessed the possibility of incorporating some increase in its estimate for the neutral interest rate, towards the movement observed in expectations for longer terms extracted from the Focus survey. The real neutral interest rate is the rate in which, in the absence of impact from other factors, the inflation rate remains stable, and the output grows according to its potential, reflecting productivity gains and changes in the structural fundamentals of the economy. At this point, the Committee decided to keep the neutral interest rate at 4% but evaluated alternative scenarios and identified that the impacts of an increase in the neutral rate on its projections grow over time and become more relevant as of the second half of 2024.

9. In assessing the factors that could lead to unfold an alternative scenario characterized by a higher neutral interest rate, emphasis was placed on the possible adoption of expansionary parafiscal policies, which can increase the neutral rate and reduce the power of monetary policy, as previously remarked by the Committee.

10. The Committee continues to assess that the global disinflation process, especially regarding underlying inflation indicators, is challenging and may be slower than what is usually observed, as inflation is widespread in the services segment. In this context, the reduction of inflationary pressures continues to require the commitment and determination of central banks with the control of inflation through a more prolonged tightening of financial conditions. Such determination, with a likely impact upon asset prices in the short term, contributes to a more credible and lasting global disinflationary process.

11. Since the previous Copom meeting, some regional banks were liquidated in the US and two large Swiss banks were merged, raising concerns about the banking system in the major economies. The Committee will continue to closely monitor this situation, analyzing possible contagion channels, but assesses that the direct impact on the domestic financial system and other emerging countries is, so far, limited, with no changes in the stability or efficiency of those financial systems.

12. The scenario, therefore, looks even more challenging for the conduct of monetary policy, with increased risks both around the inflationary scenario and in relation to financial stability. On the one hand, there are the episodes involving the banking sector and the consequent need to provide liquidity. On the other hand, global growth and inflation data remain resilient, requiring commitment and determination from the monetary authorities. The Committee believes that the best contribution of monetary policy continues to be in combating inflationary pressures and smoothing out economic fluctuations. In addition, some members emphasized that they do not see a dilemma in the conduct of monetary policy between its objective of inflation control and the objective of financial stability. The Committee stressed how the two objectives have specific instruments.

13. Brazilian activity data continue to indicate a more moderate pace of growth at the margin, and employment data suggest moderation. It was pointed out that after a period of strong recovery in the last two years, a process of deceleration of growth has begun in the durable goods sector, which had been particularly buoyant in the pandemic, and which is more sensitive to interest rate policy. The deceleration spread to the non-durable goods sector and, subsequently, to the services sector, although in a milder way. Copom continues to evaluate that the economic slowdown underway is necessary to guarantee the convergence of inflation to its targets, particularly after a prolonged period of inflation above the target. Finally, it was noted that the economic

growth outlook has not changed significantly in the recent period.

14. As expected, given the greater lag in relation to the economic cycle, only recently has the labor market shown evidence of a moderate slowdown, compatible with the Committee's expectation of a moderation in the pace of economic activity. Some members have observed that there is a movement towards a partial recomposition of recent losses in real wages. This movement is expected and has been accompanied by a deceleration in nominal gains, which is expected to intensify ahead.

15. The Committee believes that the disinflation dynamics continues to be characterized by a process with two distinct stages. In the first stage, already completed, there is a greater speed of disinflation, with a greater effect on administered prices and an indirect effect on market prices through less inertia. In the second stage, which is currently observed, the speed of disinflation is slower and core inflation – which is more affected by the aggregate demand and the interest rate policy – is reduced at a slower pace, responding to the output gap and inflation expectations. It is thus observed an inflationary dynamic driven by excess demand initially in goods, and which has currently shifted to the services sector, and which therefore requires moderation of economic activity for monetary policy channels to act. Such a process demands serenity and patience in the conduct of monetary policy for the convergence of inflation to its targets.

16. The further deterioration of inflation expectations in the Focus survey, especially at longer maturities, was much debated. It has been pointed out that the behavior of expectations is a fundamental aspect of the inflationary process since it affects the setting of present and future prices and wages. As higher inflation is projected ahead, companies and workers start to incorporate such future inflation in the adjustments of prices and wages. Thus, there is a greater rise in prices in the current period, and the inflationary process is fed by these expectations. It was also highlighted that the anchoring of expectations is a key factor for price stability. Therefore, and following the best international practice, the Committee incorporates expectations in its decision-making process, analyzing and including them as one of the factors affecting its inflation projections.

17. Additional tightening of credit conditions was observed in some modalities. Some members believe that this movement is in line with what is expected, considering the interest rates rise undertaken until the middle of the second half of 2022. For these members, an increase in delinquency and a slowdown in credit granting should still be expected, but in line with what was observed in previous monetary policy tightening cycles. Other members, in contrast, assess that in the most recent period the tightening of credit granting was more intense than expected, but focused on some specific markets. The Committee believes that the BCB has the appropriate and necessary liquidity instruments linked to macroprudential policy to address localized relevant frictions in the system, should they occur. Furthermore, it reinforced that monetary policy is more appropriate to act in a counter-cyclical manner on the aggregate demand.

18. The Committee also discussed the impacts of the fiscal scenario on inflation. In this regard, the Copom emphasized again that the net effect of the fiscal policy conduct on inflation is highly dependent on the current macroeconomic and financial conditions. Copom evaluated that the Ministry of Finance's commitment to the implementation of the fiscal package, which is already identified in fiscal statistics and the reinstatement of fuel taxes, smooths the fiscal stimuli on demand, reducing the upside risk on inflation in the short-term. Furthermore, the Committee will continue monitoring the elaboration, discussion, and implementation of the fiscal framework that will be presented by the Government and voted by the National Congress. Copom emphasized that there is no mechanical relationship between the convergence of inflation and the presentation of the fiscal framework, since the former remains conditional on the reaction of inflation expectations, the public debt projections, and the asset prices. Nevertheless, the Committee stresses that the materialization of a scenario with a solid

and credible fiscal framework might result in a more benign disinflationary process through its effect on the expectations channel, by reducing inflation expectations, the economic uncertainty, and the risk premium on domestic assets.

19. The Committee emphasizes that risks to its scenarios remain in both directions. Among the upside risks for the inflationary scenario and inflation expectations, it should be emphasized (i) a greater persistence of global inflationary pressures; (ii) the uncertainty about the fiscal framework and its impacts on the expected path of the public debt; and (iii) a larger or more persistent deanchoring of long-term inflation expectations. Among the downside risks, it should be noted (i) an additional reduction in the prices of international commodities measured in local currency; (ii) a greater than projected deceleration of global economic activity, particularly due to adverse conditions in the global financial system; and (iii) a slowdown in domestic credit granting larger than what would be compatible with the current stance of monetary policy.

20. On the one hand, the recent reinstatement of fuel taxes has reduced the uncertainty of the fiscal results in the short term. On the other hand, the current scenario, marked by high volatility in financial markets and deanchored long-term inflation expectations from the targets, requires further attention when conducting monetary policy. The Committee judges that the deanchoring of long-term inflation expectations raises the cost of the disinflation that is needed to reach the targets established by the National Monetary Council. In this scenario, Copom reaffirms its commitment to set monetary policy to meet the targets.

## C) Discussion about the conduct of monetary policy

21. Copom discussed the conduct of monetary policy, considering the set of projections evaluated, as well as the balance of risks for inflation.

22. The Committee decided again to emphasize the six-quarter-ahead horizon in its projections but anticipates that for the next quarter the Committee will again use the usual calendar-year horizon, since the six-quarter horizon ahead will coincide with the 2024 calendar year, so there will be no more direct effect from the tax changes on the usual horizon.

23. Copom started the debate by evaluating whether the previously outlined strategy of stable interest rates would be enough to ensure the convergence of inflation towards to its targets. To this end, the Committee has continued its process of analyzing the main determinants of the inflation path and how they have behaved in the most recent period. No significant change occurred in the prospective scenario for the output gap, but a deeper debate took place about the effects of a possible greater-than-projected credit tightening on economic activity. As for services inflation and inflation cores, increased resilience and lower speed are observed in the recent releases, in line with the non-linear process already anticipated by Copom. In addition, inflation expectations followed a deanchoring process, partially related to the questioning about a likely change in future inflation targets. The Committee evaluates that the credibility of pursued targets is a fundamental component of the inflation targeting regime and contributes to the proper functioning of the expectations channel, making the disinflation quicker and less costly. In this regard, decisions that induce a reanchoring of expectations would reduce the disinflationary cost and uncertainties associated with this process.

24. The changes in the Copom's inflation projections have been primarily affected by changes in expectations, as in its previous meeting. Finally, in the balance of risks, most of the debate was, on the one hand, between a greater deanchoring of inflation expectations in longer terms and, on the other hand, a more abrupt reduction in the domestic or global credit granting affecting the economic activity. Copom emphasized

that the monetary policy conduct, at this moment, requires serenity and patience to incorporate the inherent delays in the inflation control through interest rates and, therefore, to reach the goals in the relevant monetary policy horizon.

25. Lastly, the Committee reinforced that the harmony between monetary and fiscal policies reduces distortions and uncertainty, facilitates the disinflationary process, and fosters full employment over time. In this regard, the Committee reinforces the importance that public and private credit granting remains at competitive interest rates sensitive to the Selic.

## D) Monetary policy decision

26. Considering the assessed scenarios, the balance of risks, and the broad array of available information, the Copom decided to maintain the Selic rate at 13.75% p.a. The Committee judges that this decision is consistent with the strategy for inflation convergence to a level around its target throughout the relevant horizon for monetary policy, which includes 2023 and, to a larger degree, 2024. Without compromising its fundamental objective of ensuring price stability, this decision also implies smoothing economic fluctuations and fostering full employment.

27. Taking into account the uncertainty of the scenarios, the Committee remains vigilant, assessing if the strategy of maintaining the Selic rate for a long period will be enough to ensure the convergence of inflation. The Committee emphasizes that it will persist until the disinflationary process consolidates and inflation expectations anchor around its targets, which have shown additional deterioration, especially at longer horizons. The Committee reinforces that future monetary policy steps can be adjusted and will not hesitate to resume the tightening cycle if the disinflationary process does not proceed as expected.

28. The following members of the Committee voted for this decision: Roberto de Oliveira Campos Neto (Governor), Bruno Serra Fernandes, Carolina de Assis Barros, Diogo Abry Guillen, Fernanda Magalhães Rumenos Guardado, Maurício Costa de Moura, Otávio Ribeiro Damaso, Paulo Sérgio Neves de Souza, and Renato Dias de Brito Gomes.