252nd

Minutes of the Meeting of the

Monetary Policy Committee — Copom

January 31 - February 1, 2023

BANCO CENTRAL
DO BRASIL

Date: January 31 - February 1

Place: BCB Headquarters' meeting rooms on the 8th floor (1/31 and 2/1 on the morning) and 20th floor (2/1 on the afternoon) – Brasilia – DF – Brazil

Starting and ending times: January 31: 10:13 AM – 11:51 AM; 2:24 PM – 5:47 PM
February 1: 10:11 AM – 11:22 AM; 2:32 PM – 6:34 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 1/31 and on the morning of 2/1):

Alan da Silva Andrade Mendes – *Department of Foreign Reserves*
André Minella – *Research Department* (also present on the afternoon of 2/1)
André de Oliveira Amante – *Open Market Operations Department*
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 1/31 and on the morning of 2/1):

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*
Euler Pereira Gonçalves de Mello – *Deputy Head of the Research Department*
Fernando Alberto G. Sampaio de Cavalcante Rocha – *Head of the Department of Statistics*
Gilneu Francisco Astolfi Vivan – *Head of the Financial System Monitoring Department*
Gustavo Andrade Barbosa de Souza – *Deputy Head of the Open Market Operations Dept.*
Julio Cesar Costa Pinto – *Head of the Deputy Governor for Monetary Policy's Office*
Laura Soledad Cutruffo Comparini – *Deputy Head of the Department of Economics*
Leonardo Martins Nogueira – *Executive Secretary*
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*

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.

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

1. The global environment continues to be marked by prospects of below-potential global growth for next year. The easing of the COVID policy in China, a milder winter in Europe, and the possibility of a gradual decline in the US growth soften the expected global economic slowdown for the coming quarters due to the tightening of financial conditions in major economies.

2. The inflationary environment remains challenging, but recent data suggest some moderation at the margin in several countries. There is a normalization in supply chains and an accommodation in the prices of major commodities in the recent period, leading to a moderation in goods-related inflationary pressures. Conversely, the low degree of labor market slack in some economies, associated with a high current inflation and a high degree of inflation diffusion, suggests that inflationary pressures on the services sector should last longer.

3. The process of normalization of monetary policy in advanced economies continues towards restrictive rates synchronized across countries, tightening financial conditions and impacting economic growth expectations. A long-lasting period of high interest rates is foreseen after the process of increasing interest rates, which calls for greater caution in the conduct of economic policies also by emerging economies

4. Regarding the Brazilian economy, the set of indicators released since the previous Copom meeting continues to be in line with the scenario of deceleration expected by the Committee. It was observed that confidence indicators dropped and industrial production, trade, and services indicators downturned. The labor market, which surprised positively throughout 2022, still shows signs of deceleration, with a decline in net hirings in New CAGED and some stability in the unemployment rate stemming from setbacks in the employed population and the workforce.

5. Notwithstanding the slowdown at the margin, 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, albeit showing some marginal moderation. Inflation expectations for 2023 and 2024 collected by the Focus survey are around 5.7% and 3.9%, 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 5.15[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 5.6% for 2023 and 3.4% for 2024. Inflation projections for administered prices are 10.6% for 2023 and 5.0% for 2024. The Committee decided again to emphasize the six-quarter-ahead horizon. On this horizon, which refers to 2024Q3, the 12-month inflation projection stands at 3.6%. 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 throughout the entire relevant horizon. In this scenario, Copom's inflation projections stand at 5.5% for 2023, 3.1% for 2024Q3, and 2.8% for 2024.

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[1] Unless explicitly stated otherwise, this update takes into account changes that occurred since the December Copom meeting (251st 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.

8. The Committee evaluated different assumptions, parameters, and scenarios in its discussion of inflation projections. On this subject, some members evaluated the possibility of incorporating some increase in the neutral interest rate, towards the movement observed in longer-term inflation expectations extracted from the Focus survey. The Committee chose, at this point, to maintain the neutral interest rate at 4%, but evaluated alternative scenarios and identified that the impacts on its projections of an increase in the neutral rate grow over time and become more relevant as of the second half of 2024.

9. Copom assesses that the scenario for prospective global growth looks a little less challenging as a result of the change in China's COVID policy and of the mild winter in Europe. Some members emphasized that economic activity and labor market data remain relatively resilient in the US. In China, the adjustments in sanitary restrictions should lead to a cyclical recovery in demand and a reduction in the risks of supply disruptions. However, the Committee assesses that the Chinese long-term growth is expected to remain lower than observed in the pre-pandemic period, reflecting both the adjustments in the real estate sector and the worsened demographics expected in the coming years. In Europe, the milder winter has also reduced the likelihood of extreme scenarios in energy supply. In the US, economic activity data have been pointing to deceleration, but still in an environment of very pressured labor market. Despite these short-term developments, the Committee continues to assess that the commitment and determination of central banks to reduce inflationary pressures and anchor expectations consolidate a global scenario of tightening of financial conditions for a longer period, with rates at the end of the tightening cycle maintained for a sufficiently long period at contractionary levels, raising the risk of a more pronounced global deceleration.

10. The Committee continues to assess that the process of global disinflation, especially regarding core inflation indicators, is challenging and will possibly happen more slowly than usually observed, since inflation is widespread in the services segment. However, some members highlighted the deceleration in the measures of core inflation in several countries.

11. Data on economic activity in Brazil continues to indicate a more moderate pace of marginal growth and employment data suggest a loss of dynamism. Some members observed a movement towards partial recomposition of recent real wages losses, but judge that this movement is expected and is coupled with a deceleration in nominal gains that is expected to intensify ahead. The Committee will continue to monitor the labor market releases, continuously assessing the role of lagged inflation and labor market pressures on wage adjustments. The set of released data, including the drop in confidence indicators and the deceleration in credit grants, together with the lagged effects of monetary policy, reinforce the Committee's expectation of a slowdown in the pace of economic activity, which should worsen over the coming quarters.

12. The Committee noted with particular concern the deterioration in longer-term inflation expectations. Such deterioration may have happened for several reasons, among them a possible perception of the Banco Central do Brasil (BCB) leniency with the targets set by the National Monetary Council (CMN), an expansionary fiscal policy that pressures the aggregate demand over the projection horizon, or the possibility of changes in the inflation targets already set.

13. In the first case, the BCB reaffirms its commitment to conduct monetary policy to achieve the established targets and assesses that, once the deanchoring is observed, it is necessary to remain even more vigilant in the conduct of monetary policy to reanchor expectations and thus reduce the future cost of the disinflation.

14. In the second case, the Committee considers that demand stimuli should be assessed in view of the stage of the economic cycle and the degree of slack in the economy, with monetary policy being the macroeconomic adjustment variable used to

mitigate any inflationary effects of the fiscal policy.

15. Finally, regarding the third case, the BCB conducts monetary policy based on the targets set by the CMN. In summary, more important than analyzing the motivations for the rise in expectations, the Committee emphasizes that it will act to ensure that inflation converges to the targets.

16. The Committee also discussed the impacts of the fiscal scenario on inflation. In this discussion, it was again emphasized that the net effect of the conduct of fiscal policy on inflation is very dependent on the prevailing macroeconomic and financial conditions. Thus, by analyzing the multiple channels, including the movement in financial conditions arising from future interest rates, and updating the assumptions for the fiscal path to incorporate the sanctioned budget for 2023, the Committee assesses that the scenario for activity has not changed significantly. Some members have noted that the median projections of the Pre-Copom Questionnaire (PCQ) and the Focus survey for the 2023 primary deficit are much lower than that estimated in the federal budget, possibly incorporating the fiscal package announced by the Ministry of Finance. Copom sustained its usual governance of incorporating the policies already sanctioned by law, but it acknowledges that the implementation of the proposed fiscal package could reduce the upside inflation risk.

17. 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 still heightened uncertainty about the country's future fiscal framework and fiscal stimuli that support aggregate demand, partially incorporated in inflation expectations and asset prices; and (iii) an output gap tighter than the one currently adopted by the Committee in its reference scenario, especially in the labor market. 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; and (iii) the continuity of tax cuts assumed to be reversed in 2023.

18. The current scenario, particularly uncertain on the fiscal side and with inflation expectations drifting away from the inflation target on longer horizons, calls for greater attention in the conduct of monetary policy. The Committee judges that this scenario raises the cost of the disinflation that is needed to reach the targets established by the CMN. In this scenario, Copom reaffirms its commitment to set monetary policy to meet the targets.

C) Discussion about the conduct of monetary policy

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

20. The Committee decided again to emphasize the six-quarter-ahead horizon for its projections but anticipates that, for the next quarter, it will resume adopting the usual horizon, according to the calendar years, since the six-quarter ahead horizon will coincide with the calendar year of 2024, and then there will be no direct effect of the tax changes in the usual horizon.

21. The Committee began its debate by evaluating whether the previously outlined strategy of stable interest rates would be sufficient for the convergence of inflation to its targets. For this purpose, Copom analyzed the main determinants of the inflation trajectory and how they behaved more recently.

22. Starting with the output gap, a deceleration in economic activity, credit, and more recently in the labor market was observed, as expected by the Committee given the monetary policy lags. In this regard, some members stressed that the deceleration

should continue, and it is necessary for the monetary policy channels to act and for inflation to converge to its targets. It was also noted that economic growth prospects have not changed significantly in the recent period.

23. Services inflation has moderated but remains at a level not compatible with the target. The Committee focuses on services inflation since it responds to inflationary inertia and economic activity more directly, and both factors are expected to put less inflationary pressures over the horizon. In any case, this dimension continues to call for attention, and the Committee continues to evaluate the speed with which the convergence process will take place.

24. In the balance of risks, global inflationary pressures have eased, but there is still high uncertainty about the deceleration of the inflation process, which tends to be non-linear. The risks are likely to persist as long as a tight labor market is observed in several advanced economies. Concerning domestic risks, two sets of risks intersect on fiscal issues. Firstly, the fiscal framework revision reduces the visibility on public accounts for the coming years, introduces premia on asset prices, and impacts inflation expectations. Secondly, concerning fiscal stimuli, Copom will continue to monitor their impact on economic activity and inflation and reinforces that, in an environment of a narrowed output gap, the impact on inflation tends to outweigh the desired impact on activity. Some members noted that the implementation of the Ministry of Finance fiscal package should mitigate the fiscal risk and consider that it will be important to monitor the challenges for its implementation. Finally, the risk of a tighter-than-evaluated output gap persists, and the Committee will continue to assess data and models for a more thorough understanding.

25. Regarding downside inflation risks, international commodity prices in local currency have reduced, but the Committee assesses that the risk of a sharper slowdown in global economic activity remains on the horizon, despite this risk is to some degree reduced by China's reopening process. In this regard, the Committee will continue to monitor, on the one hand, the process of withdrawal of fiscal and monetary stimulus in advanced economies and, on the other hand, the Chinese reopening process.

26. Regarding inflation expectations, the Committee notes with concern the recent movement at longer horizons. In addition to the direct impact of the rise in expectations on inflation projections, the rise in long-term expectations raises the cost of the disinflation by requiring greater participation of other monetary policy channels and, consequently, a wider output gap to obtain the same fall in inflation. The Committee will remain vigilant and will persist until the anchoring of expectations is consolidated.

27. Copom’s projections have risen due to the increase in both administered and market prices. Among the preponderant factors for increased projections, the rise in Focus survey inflation expectations stands out. Projections conditioned by the assumptions of the reference scenario do not show convergence to the target over the relevant monetary policy horizon, but the introduction of a more extended monetary tightening, as in its alternative scenario, generates a relevant impact on the projections toward convergence to the targets.

28. Copom chose to maintain the interest rate, reinforcing the need to evaluate, over time, the cumulative impacts to be observed of the intense and timely monetary policy cycle already undertaken. Therefore, the Committee assessed that, given the data released, the inflation projections and expectations, the balance of risks, and the lagged effects of the monetary policy already in significantly contractionary territory, it was appropriate to maintain the interest rate at the level of 13.75% p.a. The Committee reinforced that it is necessary to remain vigilant, assessing if the strategy of maintaining the Selic rate for a longer period than in the reference scenario will be enough to ensure the convergence of inflation.

29. The Committee emphasizes that it will persist until the disinflationary process consolidates and inflation expectations anchor around its targets, which have shown

deterioration at longer horizons since the previous meeting. The Committee emphasizes that it will not hesitate to resume the tightening cycle if the disinflationary process does not proceed as expected.

D) Monetary policy decision

30. Considering the assessed scenarios, the balance of risks, and the broad array of available information, Copom decided to maintain the Selic rate at 13.75% p.a. The Committee judges that this decision reflects the uncertainty around its scenarios for prospective inflation, an even higher-than-usual variance in the balance of risks and 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.

31. The Committee remains vigilant, assessing if the strategy of maintaining the Selic rate for a longer period than in the reference scenario 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 deterioration at longer horizons since the previous meeting. 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.

32. 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.