246th

Minutes of the Meeting of the

Monetary Policy Committee — Copom

May 3-4, 2022

BANCO CENTRAL DO BRASIL

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Date: May 3-4, 2022

Place: BCB Headquarters' meeting rooms on the 8th floor (5/3 and 5/4 on the morning) and 20th floor (5/4 on the afternoon) – Brasilia – DF – Brazil

Starting and ending times: May 3: 9:45 AM – 12:24 PM.; 2:19 PM – 6:04 PM
May 4: 9:37 AM – 10:48 AM; 2:34 PM – 7:12 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 May 3 and on the morning of May 4):

Alan da Silva Andrade Mendes – *Department of Foreign Reserves*
André Minella – *Research Department* (also present on the afternoon of May 4)
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 May 3 and on the morning of May 4)):

Arnildo da Silva Correa – *Head of the Office of Economic Advisor*
Cristiano de Oliveira Lopes Cozer – *General Counsel*
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*
Julio Cesar Costa Pinto – *Head of the Deputy Governor for Monetary Policy's Office*
Leonardo Martins Nogueira – *Executive Secretary*
Olavo Lins Romano Pereira – *Deputy Head of the Department of International Affairs*
Pedro Henrique da Silva Castro – *Deputy Head of the Department of Economics*
Rafael Mendonça Travassos Andrezo – *Head of the Governor's Office*
Ricardo Franco Moura – *Head of the Prudential and Foreign Exchange Regulation Department*

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 has deteriorated further. Inflationary pressures arising from the global recovery after the pandemic period have intensified due to the increase of commodity prices in 2022 and, more recently, by the new wave of Covid-19 in China, which might potentially extend even further the process of normalization in the supply of industrial inputs. The reorganization of global production chains, already fueled by the war in Ukraine, is expected to intensify, with the search for a greater regional arrangement of the supply of inputs. In Copom's view, these developments might have long-term consequences and lead to more persistent inflationary pressures on global production of goods.

2. Central banks in developed and emerging countries have adopted a more contractionary stance against increased inflation, although, in most of these economies, current interest rates are still at levels evaluated as expansionary. Because of the potential persistence of the inflationary pressure, the repricing of monetary policy in advanced countries has impacted financial conditions in emerging countries. The Committee has also discussed the growing risks involving a global deceleration in a highly pressured inflationary environment.

3. Turning to the Brazilian economy, the set of indicators released since the previous Copom meeting suggests a rate of growth in line with the Committee's expectations. The labor market is still on a recovery path, and the latest trade and industry indicators have improved.

4. Consumer inflation remains high, with increases spread among several components, and continues to be more persistent than anticipated. Whereas inflation of services and industrial goods are still high, the recent shocks have led to a strong increase in the components associated with food and fuels. Recent readings were higher than expected, and the surprise came on both the more volatile components and the items associated with core inflation. As for the more volatile components, the increase of gasoline prices is still noteworthy, with greater and faster impact than anticipated. The inflation of the components more sensitive to the economic cycle and the monetary policy continues elevated, and the various measures of core inflation are above the range compatible with meeting the inflation target. Inflation expectations for 2022 and 2023 collected by the Focus survey are around 7.9% and 4.1%, respectively.

B) Scenarios and risk analysis

5. In the reference scenario, the interest rate path is extracted from the Focus survey (the Selic rate rises to 13.25% p.a. in 2022 and decreases to 9.25% p.a. in 2023) and the exchange rate starts at USD/BRL 4.95[2] and evolves according to the purchasing power parity (PPP). The Committee decided to keep the assumption that oil prices follow approximately the futures market curve until the end of 2022, ending the year at USD 100/barrel, and then start increasing 2% per year in January 2023. The energy flag is assumed to be "yellow" in December of 2022 and 2023. In this scenario, Copom's inflation projections stand at 7.3% for 2022 and 3.4% for 2023. Inflation projections for administered prices are 6.4% for 2022 and 5.7% for 2023. The Committee judges that the uncertainty in its assumptions and projections is higher than usual.

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[1] Unless explicitly stated otherwise, this update takes into account changes that occurred since the March Copom meeting (245th 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.

6. The Committee opened its debate about the risks regarding its projections by discussing some of the likely explanations for the difference between the projection in its reference scenario and the analysts' projections. Some members emphasized that high current inflation has contaminated longer-term expectations beyond what was expected. Moreover, some additional likely explanations have been discussed through the analysis of alternative scenarios. Firstly, Copom analyzed the impact of a slower reversion in industrial goods inflation, due to successive shocks on global production chains. In addition, Copom also observed that different assumptions about the neutral interest rate have an impact on its projections, albeit modest at the relevant horizon. Finally, inflationary impacts stemming from different assumptions about the convergence between the prices of oil and its by-products have also seemed relevant.

7. In what regards the global inflationary scenario, Copom assessed that inflationary pressures have intensified and are characterized by both a persistently high demand for goods (for example, in the U.S. economy) and supply shocks associated with the war in Ukraine and the Chinese policy to fight Covid-19. These factors might potentially generate persistent inflationary pressures in several economies, particularly in those countries with more lagged normalization processes of fiscal and monetary policies.

8. Furthermore, the Committee evaluated that there is still high uncertainty about the prospective trajectory of commodity prices in local currency, because of the war in Ukraine and the economic recovery in the post-pandemic period. Copom assesses that there is a possibility of reversion, even if partial, of the increase in international commodities measured in local currency.

9. The Committee has debated the fiscal risk and how it affects the conduct of monetary policy. Uncertainties regarding the future of the current fiscal framework result in increased risk premia and raises the risk of a deanchoring of inflation expectations. This movement is already seen, to some extent, and is already partially incorporated in the longer-term inflation expectations extracted from the Focus survey, as well as in the prices of several domestic assets. The Committee emphasized that the appropriate level of monetary tightening is also dependent on the prevailing fiscal framework. Weaknesses in the structural reform effort, as well as permanent changes to the fiscal consolidation process could result in an increase in the neutral interest rate.

10. The Committee evaluated the risks around the reference scenario for economic growth in 2022 and 2023. The Committee highlighted that economic growth came in line with expectations, but the tightening of financial conditions brings a risk of greater-than-anticipated deceleration in the quarters ahead, when its impacts tend to be more evident.

11. The Committee emphasizes that risks to its inflation 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; and (ii) an increase in the risk premium due to the uncertainty about the country's future fiscal framework, partially incorporated in inflation expectations and asset prices. Among the downside risks, it should be noted (i) a possible reversion, even if partial, of the increase in the price of international commodities measured in local currency; and (ii) a greater deceleration of economic activity than projected. The Committee assesses that the uncertain and volatile current scenario requires serenity when evaluating the risks.

C) Discussion about the conduct of monetary policy

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

13. Copom opened the discussion by evaluating the adjustment cycle carried out up to this meeting. It was emphasized that the current monetary tightening cycle was quite intense and timely and that, due to monetary policy lags, much of the expected contractionary effect and its impact on current inflation are still to be seen.

14. Still, Copom noted that an additional deterioration was observed in both the short-term inflationary dynamics and the longer-term projections, even though the scenario is characterized by higher than usual uncertainty and volatility.

15. Copom then debated the monetary policy options for this meeting. The Committee concluded that a further adjustment of 1.00 percentage point was appropriate.

16. Copom members then discussed how to signal the future monetary policy. The Committee opted to signal, as likely, an extension of the cycle, with an adjustment of lower magnitude in the next meeting. This strategy was deemed more appropriate to ensure the convergence of inflation over the relevant projection horizon, as well as the anchoring of longer-term inflation expectations, while reflects the already implemented monetary tightening, reinforces the cautious monetary policy stance and emphasizes the uncertain scenario.

D) Monetary policy decision

17. Taking into account the assessed scenarios, the balance of risks, and the broad array of available information, the Copom unanimously decided to increase the Selic rate by 1.00 p.p. to 12.75% 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 convergence of inflation to its target throughout the relevant horizon for monetary policy, which includes 2023. Without compromising its fundamental objective of ensuring price stability, this decision also implies smoothing of economic fluctuations and fosters full employment.

18. The Committee considers that, given its inflation projections and the risk of a deanchoring of long-term expectations, it is appropriate to continue advancing in the process of monetary tightening significantly into an even more restrictive territory. The Committee emphasizes that it will persist in its strategy until the disinflation process and the expectation anchoring around its targets consolidate.

19. For its next meeting, the Committee foresees as likely an extension of the cycle, with an adjustment of lower magnitude. The Committee stresses that the heightened uncertainty of the current scenario, the advanced stage of the current monetary policy cycle, and its impacts yet to be observed require additional caution in its actions. The Copom emphasizes that its future policy steps could be adjusted to ensure the convergence of inflation towards its targets and will depend on the evolution of economic activity, on the balance of risks, and on inflation expectations and projections for the relevant horizon for monetary policy.

20. 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.