244th

Minutes of the Meeting of the

Monetary Policy Committee — Copom

February 1-2, 2022

BANCO CENTRAL DO BRASIL

Date: February 1-2, 2022

Place: BCB Headquarters' meeting rooms on the 8th floor – Brasilia – DF – Brazil

Starting and ending times: February 1: 10:18 AM – 1:05 PM; 2:17 PM – 6:37 PM
February 2: 2:34 PM – 6:40 PM

In attendance:

Copom Members

Roberto Oliveira Campos Neto – *Governor*
Bruno Serra Fernandes
Carolina de Assis Barros
Fernanda Magalhães Rumenos Guardado
João Manoel Pinho de Mello
Maurício Costa de Moura
Otávio Ribeiro Damaso
Paulo Sérgio Neves de Souza

Department Heads in charge of technical presentations (February 1):

Alan da Silva Andrade Mendes – *Department of Foreign Reserves*
André Minella – *Research Department* (also present on February 2)
André de Oliveira Amante – *Open Market Operations Department*
Olavo Lins Romano Pereira – *Deputy Head of the Department of International Affairs*
Ricardo Sabbadini – *Department of Economics*
Rogério Antônio Lucca – *Department of Banking Operations and Payments System*

Other participants (February 1):

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*
Jean Toledo de Freitas – *Chief of Division at the Department of International Affairs*
Julio Cesar Costa Pinto – *Head of the Deputy Governor for Monetary Policy's Office*
Leonardo Martins Nogueira – *Executive Secretary*
Pedro Henrique da Silva Castro – *Deputy Head of the Department of Economics*
Rafael Mendonça Travassos Andrezo – *Deputy Head of the Governor's Office*

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 reference scenario[1]

1. Regarding the global outlook, the environment remains less favorable. More persistent inflation raises the chances of faster monetary tightening in the US, turning financial conditions more challenging for emerging economies. In addition, the recent Covid-19 wave adds uncertainty about the pace of activity, and at the same time could delay the normalization of global supply chains. Since the previous meeting, most commodities reversed the decline observed at the end of the year and, in some cases, reached recent records, reinforcing the global environment of pressured prices.

2. Turning to the Brazilian economic activity, trade and services indicators showed a slightly better-than-expected evolution in November, while industry recovered in December. Labor market indicators showed consistent job recovery in 2021Q4.

3. For 2022, if, on the one hand, the rise in risk premia and the more intense tightening of financial conditions act stifling the economic activity, on the other hand Copom still considers that economic growth tends to benefit from the performance of agriculture and livestock and from the remaining effects of the normalization process of the economy, particularly in the services sector and in the labor market. However, confidence indexes released since the previous meeting continue to deteriorate, and weather developments have affected the projections for important agricultural crops.

4. Consumer inflation remains high, with increases spread among several components, and continues to be more persistent than anticipated. The increase of industrial prices has not slowed down and should persist in the short term, while services inflation accelerated, still reflecting the gradual normalization in the sector's activity. Recent readings were higher than expected and the surprise came in both the more volatile components and particularly on the items associated with core inflation.

5. The various measures of underlying inflation are above the range compatible with meeting the inflation target. Inflation expectations for 2022 and 2023 collected by the Focus survey are around 5.4% and 3.5%, respectively.

6. The Copom's inflation projections in its reference[2] scenario, with interest rate path extracted from the Focus survey and exchange rate starting at USD/BRL 5.45[3] and evolving according to the purchasing power parity (PPP), stand around 5.4% for 2022 and 3.2% for 2023. This scenario assumes a path for the Selic rate that rises to 12% p.a. in the first half of 2022, ends the year at 11.75% p.a., and drops to 8.00% p.a. during 2023. In this scenario, inflation projections for administered prices are 6.6% for 2022 and 5.4% for 2023. The energy flag is assumed to be "red level 1" in December of 2022 and 2023.

7. Regarding administered prices, the revision was mainly due to the strong increase in oil prices since the previous meeting of the Committee, as well as administered items whose variations will be repeated throughout the year. These pressures were only partially offset by the change in the hypothesis of the energy flag for the end of 2022, which reflected the improved rainfall scenario.

B) Risks around the reference inflation scenario

8. The Copom's reference scenario for inflation encompasses risk factors in both directions.

[1] Unless explicitly stated otherwise, this update takes into account changes that occurred since the December Copom meeting (243rd meeting).
[2] Previously called the baseline scenario, with no changes in methodology.
[3] 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.

9. On the one hand, a possible reversion, even if partial, of the increase in the price of international commodities measured in local currency would produce a lower-than-projected inflation in the reference scenario.

10. On the other hand, fiscal policies that imply additional impulses to aggregate demand or deteriorate the future fiscal path may have a negative impact on prices of important financial assets as well as pressure the country's risk premia.

11. In spite of the more favorable public accounts data, the Committee assesses that the uncertainties regarding the fiscal framework maintain elevated the risk of deanchoring inflation expectations and, therefore, the upward asymmetry in the balance of risks. This implies a higher probability of inflation paths above the one projected under the reference scenario.

C) Discussion about the conduct of monetary policy

12. Uncertainties regarding the future of the current fiscal framework result in increased risk premia and raises the risk of deanchoring inflation expectations. This implies assigning greater probability to alternative scenarios that consider higher neutral interest rates. The Committee reiterates that the process of reforms and necessary adjustments in the Brazilian economy is essential for a sustainable economic growth. Weaknesses in the structural reform effort and permanent changes to the fiscal consolidation process could result in an increase in the structural interest rate. Additionally, the Committee notes that even fiscal policies that have a downward effect on inflation in the short term can cause a deterioration in the country's risk premia, increase inflation expectations, and consequently have an upward effect on prospective inflation.

13. Next, Copom discussed the implementation of monetary policy, considering not only the reference scenario, but also the balance of risks for inflation. According to the reference scenario, which uses the interest rate path extracted from the Focus survey and the exchange rate evolving according to the purchasing power parity, the inflation projections are above the upper limit of the tolerance band of the target for 2022, and around the target for 2023.

14. As for the balance of risks, the Committee pondered that the risk of deanchoring longer-term expectations, derived from developments in the fiscal scenario, sustains an upward bias for the projections of its reference scenario. Hence, considering this bias due to asymmetric risks, Copom evaluated that its projections are above the target for both 2022 and 2023. Therefore, Copom once more concluded that the monetary tightening process should be more restrictive than that used in the reference scenario throughout the relevant horizon.

15. Next, Copom assessed the appropriate pace of interest rate hikes. For such, it analyzed its inflation projections using simulations with monetary policy paths with different terminal rates, adjustment paces, and duration of monetary tightening. It is worth noting that the scenarios considered, consistent with the convergence of inflation to its targets, assumed a higher interest rate path than that used in the reference scenario.

16. Based on these results, Copom members discussed the most appropriate strategy. The Committee concluded that another adjustment of 1.50 percentage points, followed by additional adjustments at a slower pace in the next meetings, is the most appropriate strategy to achieve sufficient monetary tightening and ensure inflation convergence over the relevant horizon, as well as the anchoring of long-term inflation expectations.

17. Finally, the particularly high uncertainty surrounding important asset and commodity prices, as well as the stage of the tightening cycle, led the Committee to judge more appropriate, at this moment, not to signal the size of its future steps.

D) Monetary policy decision

18. Taking into account the reference scenario, the balance of risks, and the broad array of available information, the Copom unanimously decided to increase the Selic rate by 1.50 p.p. to 10.75% p.a. The Committee judges that this decision reflects its reference scenario for prospective inflation, a 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 2022 and, to a larger degree, 2023. Without compromising its fundamental objective of ensuring price stability, this decision also implies smoothing of economic fluctuations and fosters full employment.

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

20. For its next steps, the Committee foresees as adequate, at this moment, a reduction in the pace of adjustment of the interest rate. This indication reflects the stage of the tightening cycle as its cumulative effects will manifest themselves over the relevant horizon. 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.

21. The following members of the Committee voted for this decision: Roberto Oliveira Campos Neto (Governor), Bruno Serra Fernandes, Carolina de Assis Barros, Fernanda Magalhães Rumenos Guardado, João Manoel Pinho de Mello, Maurício Costa de Moura, Otávio Ribeiro Damaso, and Paulo Sérgio Neves de Souza.