255th

Minutes of the Meeting of the

Monetary Policy Committee — Copom

June 20-21, 2023

BANCO CENTRAL DO BRASIL

Date: June 20-21, 2023

Place: BCB Headquarters' meeting rooms on the 8th floor (6/20 and 6/21 on the morning) and 20th floor (6/21 on the afternoon) – Brasilia – DF – Brazil

Starting and ending times: June 20: 10:15 AM – 11:40 PM; 2:30 PM – 6:15 PM
June 21: 10:20 AM – 11:38 AM; 2:40 PM – 6:36 PM

In attendance:

Copom Members

Roberto de Oliveira Campos Neto – *Governor*
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 6/20 and on the morning of 6/21):

Alan da Silva Andrade Mendes – *Department of Foreign Reserves*
André Minella – *Research Department* (also present on the afternoon of 6/21)
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 6/20 and on the morning of 6/21):

Arnildo da Silva Correa – *Head of the Office of Economic Advisory*
Cristiano de Oliveira Lopes Cozer – *General Counsel*
Eduardo José Araújo Lima – *Head of Office of the Deputy Governor for Economic Policy*
Eugênio Pacceli Ribeiro – *Executive Secretary*
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*
Julio Cesar Costa Pinto – *Head of Office of the Deputy Governor for Monetary Policy*
Laura Soledad Cutruffo Comparini – *Deputy Head of the Department of Economics*
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 Eyer Harris – *Head of Office of the Deputy Governor for Regulation*
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.

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

1. The global environment remains challenging. Despite some attenuation on the stress involving banks in the US and Europe and the limited contagion on financial conditions so far, the situation still requires monitoring. It is noticeable, however, a tightening in the US credit markets with still uncertain impacts but with a negative bias for the economic growth.

2. At the same time, the central banks of major economies remain committed to bringing inflation back to its targets, in an environment in which inflation has been resilient. Recent inflation readings from several countries point to some stabilization of core inflation at levels above their targets and reinforce the persistent nature of the current inflationary process. Furthermore, it has been recently observed the resumption of the cycle of interest rate hikes in some economies that, in their majority, signal a prolonged period of high interest rates to fight inflationary pressures, which calls for greater caution in the conduct of economic policies also by emerging countries.

3. Regarding the domestic scenario, the recent set of indicators suggests a scenario of gradual deceleration. The release of the GDP for the first quarter of 2023 surprised positively, with most of the surprise reflecting the agricultural performance, but with less dynamism in the more cyclical economic sectors. The labor market, which surprised positively throughout 2022, has shown some resilience, with a net increase in job creation and relative stability in the unemployment rate. However, a reduction in the participation rate was observed.

4. Consumer inflation has been reduced in the recent period, with emphasis on the dynamics in industrial goods and food. The inflation of the components more sensitive to the economic cycle and the monetary policy, which present greater inflationary inertia, showed an incipient improvement, but remain above the range compatible with meeting the inflation target. Inflation expectations for 2023 and 2024 collected by the Focus survey have reduced and are around 5.1% and 4.0%, respectively.

B) Scenarios and risk analysis

5. In the reference scenario, the interest rate path is extracted from the Focus survey, and the exchange rate starts at USD/BRL 4.85[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 "green" in December 2023 and 2024. In this scenario, Copom's inflation projections stand at 5.0% for 2023 and 3.4% for 2024. Inflation projections for administered prices are 9.0% for 2023 and 4.6% for 2024.

6. Following the extensive debate and based on the accumulated evidence over recent meetings, the Committee opted to increase the estimated neutral real interest rate from 4.0% p.a. to 4.5%. Copom members evaluated the different factors that justify an increase and converged on the conclusion that there was a rise in the neutral rate. Among the mentioned factors that support the increase of the neutral interest rates are the likely increase of neutral interest rates in the major economies, the resilience in the Brazilian economic activity jointly with a slow disinflationary process, as well as an analysis of supporting models that incorporate different methodologies.

7. The Committee evaluates that the international outlook is somewhat more favorable for the inflationary process in Brazil, but the low degree of slack in the labor market in

[1] Unless explicitly stated otherwise, this update takes into account changes that occurred since the May Copom meeting (254th meeting).
[2] Value obtained according to the usual procedure of rounding the average USD/BRL exchange rate observed in the five business days ending on the last day of the week before the Copom meeting.

some economies and the current inflation persistently high and widespread in the services sector suggest that inflationary pressures should take long to dissipate. However, some factors might reduce external inflationary pressures. First among these is the commitment of central banks to the control of inflation by maintaining tighter financial conditions for a longer period. Such determination, albeit with a likely impact upon domestic asset prices in the short term, coupled with a credit slowdown in major economies, contributes to a more credible and lasting global disinflationary process. Besides, the recent dynamics of the exchange rate and international commodity prices, although with greater volatility, also contribute to slowdown international pressures.

8. Brazilian activity data, in particular the release of the GDP growth for the first quarter of 2023, continues to indicate a deceleration in the sectors most sensitive to the economic cycle. At the margin, the pace of growth was moderate, except for the strong growth of the agricultural sector. In any case, it is anticipated that after this greater growth in the agricultural sector in the first quarter has passed – due to the seasonality of the harvest – the process of moderating growth in the more cyclical sectors of the economy will deepen over the following quarters.

9. The Committee debated the recent labor market data. On the one hand, formal employment data continued to reveal increase in job creation in the most recent period. On the other hand, the unemployment rate remains relatively stable, but with a lower participation rate than in the pre-pandemic period. The Committee discussed the possible reasons for the fall in the participation rate, evaluating whether this movement should be read as structural or cyclical, which would have different impacts on the participation rate in effect in the long term. Some members noted that the recent process towards a partial recomposition of losses in real wages moves forward. This movement is expected and has been accompanied by a deceleration in nominal gains, which is expected to intensify ahead.

10. The Committee believes that the disinflation dynamics is still characterized by a process with two distinct stages. In the first stage, already completed, the speed of disinflation was greater, 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 – declines at a slower pace, responding to the output gap and future inflation expectations. The Committee reaffirms that the disinflation process at its current stage demands serenity and patience in the conduct of monetary policy to ensure the convergence of inflation to its targets.

11. Still in the discussion about inflationary behavior, the recent benign behavior of wholesale prices was emphasized, both for food and industrial goods. On the food front, logistical issues, together with favorable weather and a good harvest contributed to a revision in the outlook for food prices for 2023 and, to a lesser extent, for 2024. For the latter, however, the uncertainty about the impact of the El Niño phenomenon stands out. Regarding industrial goods, wholesale prices, as well as the normalization of supply chains, have also led to a revision in the dynamics of these sectors. The Committee assesses that the consolidation of such dynamics contributes to the disinflationary process and should have some indirect impact on the other items. In terms of the trajectory of consumer inflation over 2023, it should be noted that the continuity of the drop is expected in the twelve-month inflation during this second quarter, due to the base effect of the previous year. For the second half of 2023, however, a higher twelve-month inflation is expected, as a consequence of the exclusion in this indicator of the effect of the tax measures that reduced the price level in the third quarter of 2022 and of the maintenance of the effects of this year's tax measures. Copom emphasizes that it will also continue to monitor inflationary dynamics in underlying inflation measures, which best reflect the current inflation trend as well as its prospects.

12. Inflation expectations remain deanchored from the targets set by the National Monetary Council, with a small reduction of the deanchoring at the margin. The Committee continues to assess that deanchored expectations raise the cost of bringing inflation back to the target. It was emphasized again that the behavior of expectations is a fundamental aspect of the inflationary process since it serves as a guide for present and future prices and wages setting. Thus, as expectations rise, there is a greater upward pressure on prices in the current period and the inflationary process is fueled by these expectations. It was also highlighted that the anchoring of expectations is a key factor for price stability. In this context, the Committee reinforces that decisions that induce the reanchoring of expectations and that raise confidence in inflation targets would contribute to a faster and less costly disinflation process, allowing monetary easing.

13. The domestic credit granting scenario is compatible with the current stage of the monetary policy cycle. The Committee anticipates a moderation in credit granting over the next few months, but in line with what has been observed in previous monetary policy tightening cycles. The Committee stresses that the BCB has the appropriate and necessary liquidity instruments, associated with macroprudential policy, to deal with relevant frictions in the system, should they occur.

14. The Committee also discussed the impacts of the fiscal scenario on inflation and assesses that the presentation and processing of the fiscal framework have substantially reduced the uncertainty surrounding fiscal risk. Challenges to meet the targets set for the primary result remain, although in the Committee's discussion, the commitment and the presentation of measures to achieve these results were emphasized. Copom again emphasized that there is no mechanical relationship between the convergence of inflation and the approval of the fiscal framework since the inflation path is conditional on the reaction of inflation expectations and financial conditions.

15. 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) some residual uncertainty about the final fiscal framework to be approved by the National Congress and, more relevant for monetary policy, its impacts on the expected paths of the public debt and of inflation expectations, and on risky assets; 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, even though a sizable portion of this movement has already been observed; (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 concession larger than what would be compatible with the current stance of monetary policy.

C) Discussion about the conduct of monetary policy conduct

16. Copom then discussed the conduct of monetary policy, considering the set of projections analyzed, as well as the balance of risks for prospective inflation.

17. The Committee judges that the current context, marked by unanchored expectations for longer terms and characterized by a stage of the disinflationary process that tends to be slower, requires parsimony and caution in the conduct of monetary policy.

18. The Committee unanimously believes that flexibilization of the degree of monetary tightening requires confidence in the trajectory of the disinflation process, since premature flexibilization could lead to a reacceleration of the inflationary process and, consequently, to a reversal of the monetary easing process itself. The materialization of

this type of scenario can negatively impact not only the credibility of monetary policy, but also the financial conditions.

19. In this debate, a divergence was observed in the Committee concerning the degree of signaling regarding the next steps. The prevailing assessment was that the continuation of the ongoing disinflationary process, with its consequent impact on expectations, may allow the necessary confidence to be built up to start a parsimonious process of inflection at the next meeting. Another group was more cautious, emphasizing that the disinflationary dynamics still reflects the retreat of the most volatile components and that the uncertainty about the output gap creates doubt about the impact of the monetary tightening implemented so far. For this group, it is necessary to observe further reanchoring of long-term expectations and accumulate more evidence of disinflation in the more cyclically sensitive components. However, the Committee members unanimously agreed that the future steps of monetary policy will depend on the inflationary dynamics, especially the components that are more sensitive to monetary policy and economic activity, on inflation expectations, in particular the longer-term ones, on its inflation projections, on the output gap, and on the balance of risks.

20. Following the usual analysis, the Committee discussed the different determinants that impact the conduct of the monetary policy. Listing the determinants analyzed in the meeting, there was no major change in the forward-looking output gap scenario, where the gap is projected to open slowly. Resilience of the economic activity in the first quarter was discussed, but the Committee's view remains that growth was driven by the agricultural sector and that the other sectors should show modest growth throughout 2023. As for services inflation and core inflation a slow deceleration movement is observed, in line with the non-linear process anticipated by the Committee. In addition, inflation expectations declined slightly, but remain deanchored, partially due to the questioning about a possible change in future inflation targets. The Committee believes that decisions that reanchor expectations can lead to faster disinflation. Copom's inflation projections have been reduced, especially in the relevant scenario, to a large extent due to lower inflation expectations. Finally, on the balance of risks, the Committee assesses that uncertainty about the final design of the fiscal framework is residual. Besides this, it noted that part of the downward risk coming from commodity prices has already materialized in the recent period.

D) Monetary policy decision

21. 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. and 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 the year of 2024. Without compromising its fundamental objective of ensuring price stability, this decision also implies smoothing economic fluctuations and fostering full employment.

22. The current context, characterized by a stage in which the disinflationary process tends to be slower and in an environment of deanchored inflation expectations continues to require caution and parsimony. Copom reaffirms its commitment to set monetary policy to meet the targets and judges that the strategy of maintaining the Selic rate for a long period has been adequate 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. The Committee judges that the current scenario demands patience and serenity in the conduct of monetary policy and reminds that the future steps of monetary policy will depend on the inflationary dynamics, especially the components that are more sensitive to monetary policy and economic activity, on inflation expectations, in particular the

longer-term ones, on its inflation projections, on the output gap, and on the balance of risks.

23. The following members of the Committee voted for this decision: Roberto de Oliveira Campos Neto (Governor), 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.