251st

Minutes of the Meeting of the

Monetary Policy Committee — Copom

December 6-7, 2022

BANCO CENTRAL DO BRASIL

Date: December 6-7, 2022

Place: BCB Headquarters' meeting rooms on the 8th floor (12/6 and 12/7 on the morning) and 20th floor (12/7 on the afternoon) – Brasilia – DF – Brazil

Starting and ending times: December 6: 10:06 AM – 11:46 AM; 2:10 PM – 6:27 PM
December 7: 10:14 AM – 11:18 AM; 2h35 PM – 6:10 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
Paulo Sérgio Neves de Souza
Renato Dias de Brito Gomes

Department Heads in charge of technical presentations (attending on 12/6 and and on the morning of 12/7):

Alan da Silva Andrade Mendes – *Department of Foreign Reserves*
André Minella – *Research Department* (also present on the afternoon of 12/7)
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 12/6 and on the morning of 12/7):

Arnildo da Silva Correa – *Head of the Office of Economic Advisor*
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*
Flavio José Roman – *General Counsel*
Gilneu Francisco Astolfi Vivan – *Head of the Financial System Monitoring Department*
Julio Cesar Costa Pinto – *Head of the Deputy Governor for Monetary Policy's Office*
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*
Pedro Henrique da Silva Castro – *Deputy Head of the Department of Economics*
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 remains adverse and volatile, marked by prospects of below-potential 2023 global growth. The tightening of financial conditions in major economies, difficulties in energy supply to Europe, and a challenging scenario for growth in China, partly due to the Covid-19 policy in the country, reinforce a slowing global growth outlook in the coming quarters.

2. The inflationary environment remains challenging. There is a normalization in supply chains and an accommodation in the prices of major commodities in the recent period, which should lead to a moderation in global goods-related inflationary pressures. In turn, the low level of labor market slack in some economies, coupled with high current inflation and a high degree of 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 contractionary rates synchronized across countries, tightening financial conditions, impacting economic growth expectations, and raising the risk of abrupt repricing movements in the markets. The Committee noted a stronger market sensitivity of financial assets to fiscal fundamentals, including in advanced economies, and lower liquidity in several markets. This environment calls for greater caution in the conduct of economic policies also by emerging economies.

4. Turning to the Brazilian economy, the set of indicators released since the previous meeting corroborates the scenario of slowdown in the growth expected by the Committee. The release of the third quarter GDP figures suggested a more moderate growth rate than in previous quarters, despite expansion in all components of demand. Similarly, the labor market continues to recover, but at a slower pace than in previous months.

5. Despite the recent reduction, especially on items which are more volatile and affected by tax measures, consumer inflation remains high. Items related to industrial goods, reflecting the more intense decrease in producer prices and the reduction of pressures in global value chains, also showed deceleration, albeit still slow. 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 2022, 2023, and 2024 collected by the Focus survey are around 5.9%, 5.1%, and 3.5%, 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 "green" in December 2022 and "yellow" in December 2023 and 2024. In this scenario, Copom's inflation projections stand at 6.0% for 2022, 5.0% for 2023, and 3.0% for 2024. Inflation projections for administered prices are -3.6% for 2022, 9.1% for 2023, and 4.2% for 2024. The Committee decided again to emphasize the six-quarter-ahead horizon, which reflects the relevant horizon, mitigates the primary effects from the tax changes but incorporates their second-round effects. On this horizon, which refers to the second quarter of 2024, the 12-month inflation projection stands at 3.3%. The Committee

[1] Unless explicitly stated otherwise, this update considers changes that occurred since the October Copom meeting (250th 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.

judges that the uncertainty in its assumptions and projections is higher than usual.

7. The Committee discussed the speed of the global disinflation process. On the one hand, the relaxation of pressures on global production chains, as well as the recent drop in commodity prices, indicate that the movement should continue in the short term, especially in the industrial goods, energy, and food segments. On the other hand, the Committee discussed that, given the spread of inflationary pressures to the services segment, which has a more inertial nature, in an environment of tight labor markets in several countries, the disinflation process should be non-linear and slower than that observed in recent episodes.

8. Thus, 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 longer tightening of financial conditions, with interest 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.

9. The Committee discussed two recent facts while analyzing the international markets. Firstly, it continues to assess that markets are more sensitive to developments that affect fiscal fundamentals, due to the combination of higher interest rates and sovereign debt at historically high levels. In addition, the Committee discussed the lower liquidity present in sovereign bond markets, possibly due to greater uncertainty in the interest rate dynamics, the reversal of long-term asset purchase policies and regulatory changes. These issues require monitoring and may also impact assets from emerging economies more strongly.

10. Data on economic activity in Brazil continues to indicate a more moderate pace of marginal growth. The release of the third quarter GDP figures indicates a reduction in the pace of growth, especially in some of the more cyclical components. Nevertheless, growth was observed in all demand components and, in the supply side, growth in industry and services. Moreover, labor market data also indicate a reduction in the pace of job openings, but still with positive marginal net hirings. The set of released data, including the drop in confidence indicators and the reduction in credit granting, 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.

11. The inflationary outlook was then discussed, based on the more recent information. Some members noted the benign movement of commodities in BRL, highlighting additional downside risks ahead. Other members emphasized the volatile nature of these prices in an environment of pressured inventories. Finally, all members evaluated that current inflation did not surprise significantly in relation to expectations or substantially changed the understanding about future inflation dynamics. Moreover, they emphasized that disinflation in services and core inflation – components with greater inertia – will require increased attention and perseverance in the conduct of monetary policy.

12. The Committee discussed extensively the impacts of different fiscal scenarios on inflation. In its analysis, the Committee reiterated the different channels through which fiscal policy can affect inflation not only via the primary effects of aggregated demand but also via asset prices, the degree of economic uncertainty, inflation expectations, and neutral interest rate. The Committee evaluated that changes in parafiscal policies or the reversal of structural reforms that lead to a less efficient allocation of resources might reduce the power of monetary policy. In the different exercises analyzed, it was evaluated that the final effect, either on inflation or on activity, will depend on both the combination and the magnitude of the fiscal and parafiscal policies. Furthermore, it was highlighted that the existence of economic slack and the confidence in the debt sustainability are determining factors for an expansionary fiscal policy to achieve the aimed impacts on the economic activity. In an environment of a narrow output gap, the

impact of significant fiscal stimulus on the path of inflation tends to outweigh the aimed impacts on economic activity.

13. The Committee believes that there is still a lot of uncertainty about the prospective fiscal scenario and that the moment requires caution in risk assessment. The Committee reiterates that it will continue to monitor future fiscal policy developments and their potential impacts on prospective inflation dynamics.

14. It 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 heightened uncertainty about the country's future fiscal framework and additional 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. The current scenario, particularly uncertain on the fiscal side, requires serenity when evaluating risks. The Committee will closely monitor future developments in fiscal policy and, in particular, its effects on asset prices and inflation expectations, with potential impacts on the dynamics of future inflation.

C) Discussion about the conduct of monetary policy

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

16. The 12-month inflation projection for the second quarter of 2024, in the scenario using the interest rate trajectory extracted from the Focus Survey, remains consistent with the strategy of inflation convergence to around the target over the relevant horizon. The Committee decided again to emphasize the six-quarter-ahead horizon for its projections, and stresses that this decision is conditional on the temporary nature of the taxes. Moreover, the Committee continues to consider that inflation projection for 2024 is also around the target. This assessment reflects the lower-than-normal visibility of the forward-looking scenario, which increases the uncertainty of the point projections communicated by the Committee over longer horizons.

17. Copom anticipates that, if the alternative scenario of maintaining tax exemption on fuels in 2023 materializes, it will again emphasize usual horizons that include the first quarter of 2023. However, it assesses that there will be no relevant impacts on the conduct of monetary policy since the primary effects of such measures are already being disregarded.

18. Copom began by discussing the evolution of the broad array of data monitored, the projections, inflation expectations, output gap, and the balance of risks. Copom's inflation projections showed a slight increase over the relevant horizon due to both an increase in the projection for the inflation of market prices in shorter terms and a revision of the projection for the inflation of administered prices over longer terms. Compared to the previous meeting, the median inflation expectations from the Focus Survey rose slightly for 2023 and remained stable for 2024. However, regarding 2024, the Committee noted with concern a rise in the average expectations. The uncertainty about future fiscal dynamics, and its consequences on inflation dynamics, was discussed, and the uncertain environment was deemed to require serenity in assessing these risks. Services inflation showed some moderation but remains at high levels, and the Committee believes that the disinflation process of this component will become clearer over time. Finally, regarding the output gap, the Committee observed a reduction in the degree of economic slack in the third quarter, due to data revisions and

the release of domestic variables, but believes that the gap should widen over the relevant horizon.

19. 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 members assessed that, given the data released, projections, inflation expectations, the balance of risks, and the lags of the 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 sufficiently long period will be enough to ensure the convergence of inflation.

20. The Committee emphasizes that it will persist until the disinflationary process consolidates and inflation expectations anchor around its targets. 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

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

22. The Committee will remain vigilant, assessing if the strategy of maintaining the Selic rate for a sufficiently 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. 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.

23. 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, Paulo Sérgio Neves de Souza and Renato Dias de Brito Gomes.