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Minutes of the Meeting of the

Monetary Policy Committee — Copom

September 21-22, 2021

BANCO CENTRAL DO BRASIL

Date: September 21-22, 2021

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

Starting and ending times: September 21: 10:23 AM – 1:05 PM; 2:43 PM – 6:41 PM
September 22: 2:32 PM – 6:40 PM

In attendance:

Members of the Copom

Roberto Oliveira Campos Neto – *Governor*
Bruno Serra Fernandes
Carolina de Assis Barros
Fabio Kanczuk
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 (September 21):

Alan da Silva Andrade Mendes – *Department of Foreign Reserves*
André Minella – *Research Department* (also present on September 22)
André de Oliveira Amante – *Open Markets 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 (September 22):

Alexandre de Carvalho – *Head of the Office of Economic Advisor*
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 – *Deputy Head of the Governor's Office*

The members of Copom 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 baseline scenario[1]

1. Regarding the global outlook, the long-lasting monetary stimuli and the reopening of major economies still sustain a favorable environment for emerging markets.

2. Turning to the Brazilian economy, the second quarter GDP release as well as the most recent indicators continue to show a positive evolution and do not ensue relevant revisions in growth forecasts, which display a robust economic recovery during the second half of the year.

3. The various measures of underlying inflation are above the range compatible with meeting the inflation target.

4. Inflation expectations for 2021, 2022, and 2023 collected by the Focus survey are around 8.3%, 4.1%, and 3.25%, respectively.

5. Consumer inflation remains high. Industrial goods price increases – due to higher input costs, supply restrictions, and redirecting of services demand towards goods – has not subsided and should remain a pressure in the short run. In addition, services inflation has accelerated in recent months, reflecting the gradual normalization of the sector, as expected. Finally, pressures persist in volatile components such as food and fuel prices and especially electricity fares, due to factors including the exchange rate, commodity prices, and adverse weather conditions.

6. The Copom's inflation projections in its baseline scenario, with interest rate path extracted from the Focus survey and exchange rate starting at USD/BRL 5.25[2] and evolving according to the purchase power parity (PPP), stand around 8.5% for 2021, 3.7% for 2022, and 3.2% for 2023. This scenario assumes a path for the Selic rate that rises to 8.25% in 2021 and to 8.50% during 2022 and drops to 6.75% during 2023. In this scenario, inflation projections for administered prices are 13.7% for 2021, 4.2% for 2022, and 4.8% for 2023. The energy flag is assumed to be "water scarcity" in December 2021 and "red level 2" in December of 2022 and 2023.

B) Risks around the baseline inflation scenario

7. The Copom's baseline scenario for inflation encompasses risk factors in both directions.

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

9. On the other hand, further extensions of fiscal policy responses to the pandemic that increase aggregate demand and deteriorate the fiscal path may pressure the country's risk premium. In spite of the recent improvement of debt sustainability indicators, the elevated fiscal risk creates an upward asymmetry in the balance of risks, i.e., in the direction of higher-than-expected paths for inflation over the relevant horizon for monetary policy.

[1] Unless explicitly stated otherwise, this update takes into account changes that occurred since the August Copom meeting (240th 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.

C) Discussion about the conduct of monetary policy

10. Regarding the global outlook, there are two additional risk factors to the growth of emerging economies. First, reductions in forecasts for growth in Asian economies, reflecting the evolution of the Covid-19 Delta variant. Second, a tightening of monetary conditions in various emerging economies, as a reaction to recent inflation surprises. However, the long-lasting monetary stimuli and the reopening of major economies still sustain a favorable environment for emerging markets. The Committee continues to consider that a new round of market discussion regarding inflationary risks in advanced economies could result in a challenging environment for emerging economies.

11. The Copom members discussed the evolution of domestic economic activity in light of the available information and indicators. The slightly better-than-expected second quarter GDP result was followed by more negative high frequency releases, albeit evolving favorably. These revisions stem partly from an anticipation of the expected growth for some of the sectors hardest hit by the pandemic, and partly from the lower industrial output due to continued shortage in supply chains. The Committee maintained its view of a robust recovery in activity in the second half of the year, as the effects of vaccination are felt more broadly. For 2022, Copom considers that economic growth should benefit from three tailwinds. First, the continued recovery of the labor market and the services sector, even if to a lesser extent than previously anticipated; second, the performance of sectors less dependent on the business cycle – such as agriculture and livestock and the extractive industry; and third, the remaining effects of the normalization of the economy as the health crisis recedes.

12. The Copom members then debated the level of economic slack. The reduction of unemployment - as the workforce and the occupied population - increase denotes that the labor market continues to recover. However, the levels at which the last two variables stand are considerably lower than those observed before the pandemic, suggesting a remaining gap in the labor market. In face of the difference between main employment indicators in the formal jobs segment – Continuous PNAD and Novo Caged, the latter showing a more robust recovery than the former – there are still some difficulties in assessing the real status of the labor market.

13. Next, Copom discussed the implementation of monetary policy, considering not only the baseline scenario, but also the balance of risks for inflation. According to the baseline scenario, which uses the interest rate path extracted from the Focus survey, the exchange rate at purchasing power parity, and commodity prices in USD stable in real terms, the inflation projections are slightly above the targets for 2022 and around the target for 2023. The Committee judged that the fiscal risks continue to imply an upward bias in the projections. This asymmetry in the balance of risks affects the appropriate degree of monetary stimulus thus justifying a path for monetary policy that is more restrictive than the path used in the baseline scenario.

14. In the face of this result, Copom evaluated the costs and benefits of accelerating the pace of interest rate hikes, considering the following. First, the stage of the adjustment cycle is characterized by an already effectively tightening monetary policy, which is evidenced when looking at the difference in expectations for the paths of interest rate and inflation over the relevant monetary policy horizon. Second, simulations with interest rate hikes that assume different terminal rates suggest that the current pace of adjustment is sufficient to reach a significantly restrictive level and to ensure the convergence of inflation to the target in 2022, even considering the asymmetry of the balance of risks. Finally, the weight of volatile items in the revisions of short-term inflation projections and the uniqueness of the post-pandemic economic readjustment process reinforce the benefit of accumulating more information about the state of the economy and the persistence of the existing shocks.

15. Copom concluded that, at this moment, maintaining the current pace of adjustment coupled with the extension of the magnitude of the process of monetary tightening to

a significantly restrictive level is the most appropriate strategy for assuring the convergence of inflation to the 2022 and 2023 targets.

D) Monetary policy decision

16. Taking into account the baseline scenario, the balance of risks, and the broad array of available information, Copom unanimously decided to increase the Selic rate by 1.00 p.p. to 6.25% p.a. The Committee judges that this decision reflects its baseline 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 over the relevant horizon for monetary policy, which includes 2022 and, to a lesser extent, 2023. Without compromising its fundamental objective of ensuring price stability, this decision also implies smoothing of economic fluctuations and fosters full employment.

17. The Committee considers that, at the present stage of the tightening cycle, this pace is the most appropriate to guarantee inflation convergence to the target at the relevant horizon and, simultaneously, allow the Committee to obtain more information regarding the state of the economy and the persistence of shocks. At this moment, the Copom's baseline scenario and balance of risks indicate as appropriate to advance the process of monetary tightening further into the restrictive territory.

18. For the next meeting, the Committee foresees another adjustment of the same magnitude. Copom emphasizes that its future policy steps could be adjusted to ensure the achievement of the inflation target 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.

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