245th

Minutes of the Meeting of the

Monetary Policy Committee — Copom

March 15-16, 2022

BANCO CENTRAL DO BRASIL

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Date:	March 15-16, 2022
Place:	BCB Headquarters' meeting rooms on the 8th floor – Brasilia – DF – Brazil
Starting and ending times:	March 15: 9:34 AM – 12:45 PM; 2:30 PM – 6:08 PM March 16: 2:36 PM – 7:03 PM

In attendance:

Copom Members

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

Department Heads in charge of technical presentations (March 15):

Alan da Silva Andrade Mendes – *Department of Foreign Reserves*
André Minella – *Research Department* (also present on March 16)
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 (March 15):

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. Regarding the global outlook, the environment has deteriorated significantly. The conflict between Russia and Ukraine has led to a strong tightening in financial conditions and higher uncertainty surrounding the global economic outlook. In particular, the supply shock resulting from the conflict has the potential of increasing inflationary pressures, which had already been rising both in emerging and advanced economies. Since the previous meeting, most commodities have registered strong price increases, particularly the energy ones.

2. The reorganization of global production chains, with the creation of redundancies in production and the supply of inputs, as well as changes in the management of inventories of goods (in the sense of an increased level of inventories), was further propelled by the conflict in Europe and sanctions imposed to Russia. In Copom's view, these developments might have long-term consequences and lead to more persistent inflationary pressures on global goods' production.

3. Turning to the Brazilian economy, GDP growth in 2021Q4 came in higher than expected, producing a slightly larger statistical carry-over effect for 2022. In January, retail and services indicators evolved slightly better than expected, while industrial activity fell on the month. Labor market indicators continued to show consistent job recovery in 2021Q4 and January 2022.

4. For 2022, if, on the one hand, the rise in risk premia and the more intense tightening of financial conditions act to slow economic activity, on the other hand, Copom still considers that economic growth tends to benefit from the performance of agriculture and livestock, albeit with lower volumes than projected in the previous meeting, and from the remaining effects of the normalization process of the economy, particularly in the services sector and in the labor market.

5. 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 even further. Recent readings were higher than expected and the surprise came in both the more volatile components and on items associated with core inflation.

6. 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 6.4% and 3.7%, respectively.

7. The Copom's inflation projections in its reference scenario, with interest rate path extracted from the Focus survey and exchange rate starting at USD/BRL 5.05[2] and evolving according to the purchasing power parity (PPP), stand around 7.1% for 2022 and 3.4% for 2023. This scenario assumes a path for the Selic rate that rises to 12.75% in 2022 and declines to 8.75% during 2023. In this scenario, inflation projections for administered prices are 9.5% for 2022 and 5.9% for 2023. The energy flag is assumed to be "yellow" in December of 2022 and 2023.

8. Given the recent volatility and the impact on its inflation projections due to the usual assumption for the oil price in USD[3], the Committee has also decided to adopt, at this moment, an alternative scenario. This scenario, considered of higher probability, assumes 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. In this scenario, Copom's inflation projections stand at 6.3% for 2022 and 3.1% for 2023.

[1] Unless explicitly stated otherwise, this update takes into account changes that occurred since the February Copom meeting (244th 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.
[3] Values around the oil price average in the week before the Copom meeting and, after that, a 2% change per year.

B) Risks around the scenarios

9. The Copom's scenarios for inflation encompass risk factors in both directions.

10. On the one hand, a possible reversion, even if partial, of the increase in the prices of international commodities measured in local currency would produce a lower-than-projected inflation in its scenarios.

11. 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.

12. 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 but considers that this risk is being partially incorporated in the inflation expectations and asset prices used in its models. The Committee maintains the assessment of an upward asymmetry in the balance of risks.

C) Discussion about the conduct of monetary policy

13. Uncertainties regarding the future of the current fiscal framework result in increased risk premia and raise the risk of deanchoring inflation expectations. This implies assigning greater probability to alternative scenarios that consider higher neutral interest rates. This movement is already seen, to some extent, in the longer-term inflation expectations extracted from the Focus survey, as well as in the risk premia of several domestic assets. The Committee reiterates that the process of reforms and necessary adjustments in the Brazilian economy is essential for 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.

14. The conflict in Europe adds further uncertainty and volatility to the prospective scenario and imposes a relevant supply shock in several commodities. The Committee considered that the best practice recommends that monetary policy react to the second-round effects of this type of shock, as this practice takes into account the usual lags in the effects of monetary policy.

15. Copom specifically evaluated the impact on its projections of the assumption for the path of oil prices. In its usual hypothesis, the price per barrel starts from values around USD 118 in March and rises to around USD 121 by the end of 2023, i.e., extrapolating for the entire relevant horizon of monetary policy the oil price resulting from a particularly unusual global situation. The Committee noted that the current environment of high uncertainty and volatility demands serenity for the evaluation of the long-term impacts of the current shock, and therefore, decided to compare this assumption with the prices of oil future contracts negotiated in international markets as well as projections from the energy sector's agencies. The Committee observed that both converged to a price per barrel below USD 100 by the end of 2022. Copom then concluded that it would be appropriate to keep the usual assumption in the reference scenario, but to assume as more likely a scenario with an alternative assumption for the path of oil prices until the end of 2022. As of 2023, the Committee decided to stick to its more conservative assumptions. The Committee considers that the disclosure of an alternative scenario is particularly useful and informative in a highly uncertain environment.

16. Next, Copom discussed the implementation of monetary policy, considering the relative probabilities of the scenarios evaluated, as well as the balance of risks for inflation. Considering the greater weight assigned to the scenario with an alternative assumption for oil, the inflation projections are above the upper limit of the target tolerance band for 2022, and around the target for 2023.

17. As for the balance of risks, the Committee maintains the upward bias for the projections of its scenarios. Hence, considering this bias due to asymmetric risks, Copom evaluated that its projections are above the upper limit of the target tolerance band for 2022 and still around the target for 2023. Considering these results and the Committee's evaluation regarding the probability of each scenario, Copom considered that, at this moment, a monetary tightening cycle similar to the one used in its scenarios is the most adequate.

18. The increase of at least 0.75 p.p. in the projected interest rate cycle over the entire relevant horizon, since the previous Copom meeting, weighed in the Committee's assessment. The projected interest rate path implies a significantly restrictive monetary policy stance, which will mainly impact inflation for 2023, and is compatible with tackling second-round effects of the current supply shock. However, should the prospective scenario prove to be closer to that observed in the reference scenario, the Committee believes that this cycle should be even more restrictive.

19. 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. Given the volatility and uncertainty of the current environment, particularly in the global scenario, the Committee opted for a timelier interest rate trajectory than that embedded in its scenarios. This preference expresses caution regarding the probabilities awarded to its scenarios and the measurement of second-round effects, as well as its commitment to the convergence of inflation and expectations to its targets over the relevant horizon.

20. Based on these results, Copom members discussed the most appropriate strategy. The Committee concluded that a further adjustment of 1.00 percentage point, followed by an additional adjustment at the same pace, is the most appropriate strategy to achieve sufficient monetary tightening and to ensure inflation convergence over the relevant horizon, as well as the anchoring of long-term expectations. However, the Committee recognizes the challenging scenario for the convergence of inflation to its targets and reinforces that it will be ready to adjust the size of the monetary tightening cycle, should the scenario evolve unfavorably.

D) Monetary policy decision

21. 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 11.75% 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 2022 and, mainly, 2023. Without compromising its fundamental objective of ensuring price stability, this decision also implies smoothing of economic fluctuations and fosters full employment.

22. 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.

23. The Committee's actions aim at curbing the second-round effects of the current supply shock in several commodities, which appear in inflation in a lagged manner. The current projections indicate that the interest rate cycle in its scenarios is sufficient for inflation convergence to levels around the target over the relevant horizon. The Copom judges that the moment requires serenity to assess the size and duration of the current shocks. If those shocks prove to be more persistent or larger than anticipated, the Committee will be ready to adjust the size of the monetary tightening cycle. The Committee emphasizes that it will persist in its strategy until the disinflation process and the expectation anchoring around its targets consolidate.

24. For the next meeting, the Committee foresees another adjustment of the same magnitude. 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.

25. 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, Maurício Costa de Moura, Otávio Ribeiro Damaso, and Paulo Sérgio Neves de Souza.