257th

Minutes of the Meeting of the

Monetary Policy Committee – Copom

September 19-20, 2023

BANCO CENTRAL DO BRASIL

Date: September 19-20, 2023

Place: BCB Headquarters' meeting rooms on the 8th floor (9/19 and 9/20 on the morning) and 20th floor (9/20 on the afternoon) – Brasilia – DF – Brazil

Starting and ending times: September 19: 10:16 AM – 11:51 AM; 2:14 PM – 6:36 PM
September 20: 10:09 AM – 11:18 AM; 2:33 PM – 6:38 PM

In attendance:

Copom Members

Roberto de Oliveira Campos Neto – *Governor*
Ailton de Aquino Santos
Carolina de Assis Barros
Diogo Abry Guillen
Fernanda Magalhães Rumenos Guardado
Gabriel Muricca Galípolo
Maurício Costa de Moura
Otávio Ribeiro Damaso
Renato Dias de Brito Gomes

Department Heads in charge of technical presentations (attending on 9/19 and on the morning of 9/20):

Alan da Silva Andrade Mendes – *Department of Foreign Reserves* (present on the mornings of 9/19 and 9/20)
André Minella – *Research Department* (also present on the afternoon of 9/20)
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 9/19 and on the morning of 9/20):

Arnildo da Silva Correa – *Head of the Office of Economic Advisor*
Cristiano de Oliveira Lopes Cozer – *General Counsel*
Daniela Torres de Mesquita de Souza Vale – *Head of the Governor's Office*
Edson Broxado de França Teixeira – *Head of Office of the Deputy Governor for Supervision*
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*
Isabela Ribeiro Damaso Maia – *Head of the Sustainability and International Portfolio Investors Unit*
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*
Leonardo Martins Nogueira – *Executive Secretary*
Luís Guilherme Siciliano Pontes – *Deputy Head of the International Reserves Department*
Marcelo Antonio Thomaz de Aragão – *Deputy Head of the Department of International Affairs*
Mauro Zanatta – *Press Office Advisor*
Olavo Lins Romano Pereira – *Deputy Head of the Department of International Affairs*
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 became more uncertain, with the disinflationary process continuing despite an environment of high core inflation and resilience in the labor market of many countries. At the same time, the central banks of major economies remain committed to bringing inflation back to its targets, either by continuing their monetary tightening cycles or by signaling a prolonged period of high interest rates to fight inflationary pressures or indicating a pause period still in a cycle of interest rate increase.

2. The Committee noted an increase in long-term interest rates in the United States as well as forecasts of lower growth in China, both demanding further attention from emerging market economies.

3. Regarding the domestic outlook, the recent set of indicators suggests a scenario of stronger resilience of the economic activity. Economic activity data for the second quarter, particularly the GDP release, indicate the persistence of the dynamics of non-cyclical economic sectors as well as the expansion in the demand component relative to household consumption. Generally speaking, in the sectoral indicators, there are some deceleration in the trade sector, moderate reacceleration in industry, and stability in the services sector growth, after a stronger growth pace in previous quarters. The labor market remains resilient but with some moderation at the margin.

4. Consumer inflation continues on a more benign trajectory, decelerating in both services and core inflation. Despite declining, the inflation of the components more sensitive to the economic cycle and the monetary policy, which have greater inflationary inertia, remains above target. Inflation expectations for 2023, 2024, and 2025 collected by the Focus survey are around 4.9%, 3.9%, and 3.5%, 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 4.90[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, 2024, and 2025. In this scenario, Copom's inflation projections stand at 5.0% for 2023, 3.5% for 2024, and 3.1% for 2025. Inflation projections for administered prices are 10.5% for 2023, 4.5% for 2024, and 3.6% for 2025.

6. The Committee evaluates that the international outlook is uncertain. A disinflation process is observed, reflecting the reduction of pressures on commodities after the initial impacts of the war in Ukraine, the early effects of the monetary policy tightening, and the normalization of productive sectors, but with a slow decline in core inflation. Looking ahead, uncertainties remain about the global inflation dynamics. Risks related to weather phenomena, the war in Ukraine, and international oil pricing policy suggest the possibility of renewed supply-side inflationary pressures. Furthermore, the labor market is resilient, and the output gap is tight in advanced economies, in an environment of still pressured services inflation in several economies. Conversely, central banks remain committed to controlling inflation by maintaining a tighter monetary policy for a longer period. Restrictive monetary policies in advanced economies have been fundamental in containing world inflation, facilitating the control of inflation in emerging countries. In any case, the global monetary tightening might affect domestic assets, which would lead to a slower domestic disinflationary process

[1] Unless explicitly stated otherwise, this update takes into account changes that occurred since the May Copom meeting (256th 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.

in the short term.

7. The global growth scenario has been characterized by the resilience of activity and labor market in the US, as opposed to an outlook of lower growth for the Chinese economy. In this context some members see a mild moderation in activity in major economies as more likely, particularly in the US economy, although a sharper slowdown is not ruled out. Conversely, some members continued to emphasize the risks of a synchronized deceleration. In its discussion, the Committee evaluates that part of the lower Chinese economy growth is structural, but the magnitude of the countercyclical responses that might be implemented will help determining not only the growth dynamics but also its impacts on commodity prices and on the Brazilian economy.

8. Regarding the increase of long-term interest rates in advanced economies, Copom pondered whether this movement might reflect the perception of an increased neutral interest rate in these countries, higher potential output, seasonal lack of market liquidity, or higher fiscal premium due to persistent nominal deficits. In its discussion, Copom mostly emphasized the fiscal prospects, particularly in the US, and how this would impact global financial conditions.

9. Still in the external scenario, the Committee discussed the causes for the economic activity resilience observed in several economies, concomitantly to the disinflationary process, even in face of historically strong monetary tightening cycles. Some members noted still high latent impacts of fiscal stimuli in relevant economies. However, it was emphasized that the commitment of the central banks of major economies to bring inflation back to the target and the credibility achieved, allowing a solid anchoring of inflation expectations, have contributed to disinflationary processes sacrificing less the economic activity.

10. Regarding the domestic economic activity, the Committee held a wide-ranging debate on why a more resilient growth has been seen in recent quarters. Four possibilities were mentioned.

11. The first possibility is that the strong performance of the agriculture and livestock sector might have had indirect effects on other economic sectors. Although corroborated by data, it does not justify the entire magnitude of the surprise. Another possibility is that the expansion of disposable income, as the result of the labor market dynamics, decline of food prices, or income transfer programs, has also provided some support to consumption. Copom focused on this issue, deemed of high relevance, and stressed that the assumption of a growth sustained by the increase of income is corroborated by the resilience in the consumption of services rendered to households. Consequently, the Committee also discussed the possible impact on the dynamics of the services inflation if growth is sustained by income and consumption. Another possibility, albeit with lower impact on short-term changes, would be a higher neutral interest rate. The Committee, however, decided to maintain its more recent assessment about the neutral interest rate disclosed in the June 2023 Inflation Report. Finally, Copom discussed whether the potential growth would have increased over the last quarters, in view of regulatory reforms and institutional advances. Although judging premature to reevaluate at this moment the potential growth, Copom argues that the persistence of a resilient growth over the next quarters with no inflationary impact might, in the future, lead to the reevaluation of the potential growth. Copom perceived that each of these four possibilities has different implications for the conduct of monetary policy.

12. Copom reinforced its view that the lack of commitment to structural reforms, the increase of earmarked credit granting, and the uncertainties about the stabilization of the public debt have the potential of raising the neutral interest rate of the economy, with harmful impacts on the power of monetary policy and, consequently, on the cost of disinflation in terms of activity.

13. Again, an in-depth discussion of developments in the labor market took place. Some

members still consider that there is moderation in the labor market, pointing to the slowdown in the pace of hirings in the formal market and the decline in the participation rate. Other members emphasized the drop in the unemployment rate and the still high pace of hirings in formal employment. The Committee agreed that there is no evidence of high wage pressures in labor negotiations.

14. Considering recently released data, Copom judges that the output gap is tighter than previously estimated but continues to anticipate a scenario of economic deceleration over the next quarters. Copom analyzed different output gap measures and the impacts on projections of distinct assumptions. In its discussion, Copom judged that there are elements that increase the uncertainty of estimates and add an upward bias to the revisions of the output gap estimates used by the Committee. In particular, Copom again noted that the impact of the pandemic period makes more difficult the inference about the output gap.

15. Copom still assesses that the deceleration in the credit granting is in line with the monetary policy stance. A stronger deceleration was observed in the corporate credit granting, whereas, in the household segment, the deceleration was smaller, being less intense in low-cost credit modalities. Despite the tight monetary conditions, Copom emphasized that the transmission of the monetary policy cycle expected by the market to the interest rates of new credit granting is already seen, also increasing the dynamics of the capital markets.

16. Finally, Copom assesses that part of the uncertainty observed in the markets, with increased risk premia and break-even inflation, was previously more related to the final design of the fiscal framework, and currently it is more associated with the execution of revenue and spending measures consistent with the framework and the achievement of the fiscal targets. Given the importance of the execution of the fiscal targets already established for the anchoring of inflation expectations, and hence for the conduct of monetary policy, the Committee reinforces the importance of firmly pursuing those targets.

17. Copom judged that the evolution of the current inflation scenario is benign, as already expected. The Committee believes that the disinflation dynamics is still characterized by a process with two distinct stages. The first stage showed a benign dynamics of food and industrial prices and the trajectory of wholesale prices. The second stage, begun in the recent period, continued to show a benign dynamics of food and wholesale prices, in addition to a deceleration in the prices of services and underlying services. The discussion about services inflation focused again on its determinants. Members discussed the realignment of relative prices and the role played by the labor market and the output gap for the inflation prospects. On the other hand, the components related to industrial goods and administered prices might present a less benign behavior than previously expected, due to the recent movement of the exchange rate and the prices of international commodities. Copom still assesses that the inherent volatility of food and industrial goods components suggests the possibility of abrupt reversals, recommending caution. In this debate, the risks related to the *El Niño* weather phenomenon – partially incorporated into the reference scenario – were mentioned, as well as those related to international oil price developments. In the projections, the latter followed the Committee's usual governance in its assumptions. Copom highlighted the uncertainty surrounding *El Niño* in terms of its magnitude, the period in which the phenomenon would have the greatest impact, and the particular impacts on different food products. Copom opted to incorporate a relatively small impact of the *El Niño* into its food inflation projections, but some members stressed the inflationary impacts in the event of a more extreme phenomenon. In the end, it was unanimously concluded that a contractionary and cautious monetary policy was needed to reinforce the disinflationary dynamics.

18. Inflation expectations, after partially reanchoring, are still a matter of concern. The Committee continue assessing that among the possibilities that would justify above-

target inflation expectations would be fiscal concerns, fears about global disinflation, and the possible perception by analysts that Copom could become more lenient in the fight against inflation over time. Therefore, Copom assesses that the reduction of expectations will come through a firm conduct, in line with the goal of strengthening the credibility and the reputation of both institutions and economic frameworks.

19. 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; and (ii) a stronger-than-expected resilience of services inflation due to a tighter output gap. Among the downside risks, it should be noted (i) a greater-than-projected deceleration of global economic activity; and (ii) an impact on global inflation larger than expected from synchronized monetary policy tightening.

C) Discussion on the conduct of monetary policy

20. Copom then discussed the conduct of monetary policy, considering the set of projections analyzed, and the balance of risks for prospective inflation.

21. Inflation expectations remain above target and have been relatively stable recently. Some members were particularly concerned about the possibility of deanchored targets for an extended period. Secondly, the process of disinflation continues, with services inflation decelerating at the margin. Some members emphasized in particular the recent benign composition of inflation and the decrease in services inflation, while others stressed that the underlying fundamentals for the dynamics of services inflation, particularly the resilience of economic activity and the labor market, do not yet allow for a convincing extrapolation of the recent benign behavior. Regarding the output gap, there was a tightening at the margin, due to a greater resilience of economic activity. The implications of alternative ways of measuring the output gap and its respective impacts on the projections were also assessed. Finally, it was noted that there was an increase in the projections in the reference scenario, mainly due to a tighter output gap and the change in conditioning factors, such as the rise in the oil price, foreign exchange rate depreciation, and the reduction in the Selic trajectory in the Focus survey. After the scenario evaluation, all members agreed that it was appropriate to reduce the Selic rate by 0.50 percentage point to adjust the degree of prospective monetary tightening.

22. Regarding the next steps, Copom members unanimously anticipated cuts of 0.50 percentage point in the next meetings and judged that this pace is appropriate to keep the necessary contractionary monetary policy for the disinflationary process. This pace brings together, on the one hand, the firm commitment with the reanchoring of expectations and the disinflationary dynamics and, on the other hand, the adjustment in the level of monetary tightening in real terms in face of the more benign dynamics of the anticipated inflation in the reference scenario projections. Copom also evaluated that there is no evidence of an ongoing monetary tightening beyond that necessary for the inflation convergence to the target, and the scenario still calls for caution, reinforcing the view of serenity and moderation that Copom has expressed. The Committee judges that there is low probability of an additional intensification in the pace of adjustment, since this would require substantial positive surprises that would raise even further the confidence in the prospective disinflationary dynamics. Such confidence would arise only with a significant change in the fundamentals of inflation dynamics, such as a much more solid reanchoring of expectations, a sharp widening of the output gap, or a services inflation dynamics substantially more benign than the expected.

23. Finally, the Committee debated the extension of the monetary policy adjustments cycle. It was emphasized, in this analysis, the need to maintain a still contractionary monetary policy in the relevant horizon to consolidate the inflation convergence to the target and the anchoring of expectations. Copom emphasized that the extension of the

cycle over time 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. The Committee maintains its firm commitment to the convergence of inflation to the target in the relevant horizon and reinforces that the extension of the cycle will reflect the BCB's legal mandate.

D) Monetary policy decision

24. Considering the evolution of the disinflationary process, the assessed scenarios, the balance of risks, and the broad array of available information, Copom decided to reduce the Selic rate by 0.50 percentage point, to 12.75% 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 and, to a lesser extent, 2025. Without compromising its fundamental objective of ensuring price stability, this decision also implies smoothing economic fluctuations and fostering full employment.

25. The current context, characterized by a stage in which the disinflationary process tends to be slower and with partial reanchoring of inflation expectations, requires serenity and moderation in the conduct of monetary policy. The Committee reinforces the need to persist on a contractionary monetary policy until the disinflationary process consolidates, and inflation expectations anchor around its targets.

26. If the scenario evolves as expected, the Committee members unanimously anticipate further reductions of the same magnitude in the next meetings and judge that this pace is appropriate to keep the necessary contractionary monetary policy for the disinflationary process. The Committee emphasizes that the total magnitude of the easing cycle throughout time will depend on the inflation 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.

27. The following members of the Committee voted for a reduction of 0.50 percentage point: Roberto de Oliveira Campos Neto (Governor), Ailton de Aquino Santos, Carolina de Assis Barros, Diogo Abry Guillen, Fernanda Magalhães Rumenos Guardado, Gabriel Muricca Galípollo, Maurício Costa de Moura, Otávio Ribeiro Damaso, and Renato Dias de Brito Gomes.