249th

Minutes of the Meeting of the

# Monetary Policy Committee — Copom

September 20-21, 2022

BANCO CENTRAL
DO BRASIL

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**Date:** September 20-21, 2022

**Place:** BCB Headquarters' meeting rooms on the 8th floor (9/20 and 9/21 on the morning) and 20th floor (9/21 on the afternoon) – Brasilia – DF – Brazil

**Starting and ending times:** September 20: 9:46 AM – 11:47 AM; 2:11 PM – 6:12 PM
September 21: 10:10 AM – 11:06 AM; 2:32 PM – 6:34 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
Otávio Ribeiro Damaso
Paulo Sérgio Neves de Souza
Renato Dias de Brito Gomes

***Department Heads in charge of technical presentations*** (attending on 9/20 and and on the morning of 9/21):

Alan da Silva Andrade Mendes – *Department of Foreign Reserves*
André Minella – *Research Department (also present on the afternoon of 9/21)*
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 9/20 and on the morning of 9/21):

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*

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, with continued downward revisions on prospective growth in the major economies, especially in China. The data released since the previous Copom meeting reinforce the view that the U.S. labor market, as well as in other advanced economies, remains heated. However, the reversal of countercyclical policies in major economies, the persistence of the war in Ukraine with its consequences on natural gas supplies to Europe, and the continuation of the Covid-19 policy in China reinforce a prospect of a slowdown in global growth in the coming quarters.

2. The inflationary environment remains challenging. There is an incipient 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. On the other hand, the low degree of slack in the labor market in these economies suggests that inflationary pressures in the sector of services might take long to dissipate.

3. The process of normalization of monetary policy in advanced economies continues towards contractionary rates in a synchronized way across countries, impacting economic growth expectations, and raising the risk of abrupt repricing movements in the markets. The Committee continues to monitor the risks related to the global slowdown and the increase in risk aversion in a highly pressured inflationary environment.

4. As for the domestic outlook, second quarter GDP came stronger than expected. Robust growth was observed in both consumption and investment. Moreover, the set of indicators released since the previous Copom meeting still suggests that the economy kept growing at the margin, albeit more moderately. Besides, the labor market continued to expand, although not completely reverting the real income decline observed in recent quarters.

5. Despite the recent reduction in prices of more volatile items and the impacts of tax measures, consumer inflation remains high. The recent releases have been strongly influenced by the reduction in administered prices, due to both the decrease in taxes and, to a lesser extent, the drop in international fuel prices. In addition, items related to industrial goods, reflecting the decrease in producer prices and the reduction of pressures in global value chains, also showed an incipient decline. However, 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. Inflation expectations for 2022, 2023, and 2024 collected by the Focus survey are around 6.0%, 5.0%, 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 5.20[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 5.8% for 2022, 4.6% for 2023, and 2.8% for 2024. Inflation projections for administered prices are -4.0% for 2022, 9.3% for 2023, and 3.7% for 2024. The Committee decided again to emphasize the six-quarter-ahead horizon, which reflects

[1] Unless explicitly stated otherwise, this update takes into account changes that occurred since the August Copom meeting (248th 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.

the relevant horizon, mitigates the primary effects from the tax changes but incorporates their second-round effects. On this horizon, which refers to the first quarter of 2024, the twelve-month inflation projection stands at 3.5%. The Committee judges that the uncertainty in its assumptions and projections is higher than usual.

7. Given the persistence of the inflationary process and the rise in inflation projections in several economies, the Committee assesses that the risk of a sharper deceleration in global economic activity has increased. This perception is reinforced by the monetary policy responses required to ensure the reanchoring of inflation, as well as the determination present in the communication from major central banks to reduce inflationary pressures.

8. The Committee assesses that a more tightening global monetary policy stance would have a disinflationary impact in Brazil in the medium term, as it leads to a widening of the global gap and less pressure on the prices of commodity and goods in general. However, it points out that the possible impacts of such repricing on assets in the short term add uncertainty about the effect on Brazilian inflation.

9. Measures of the degree of slack in the economy have great uncertainty. Currently, the analysis of some activity indicators, especially in the labor market, has led to the discussion if the output gap is narrower than that currently used by Copom in its reference scenario. In an alternative exercise assuming that the output gap would be at zero in the third quarter of 2022, inflation projections would be 4.9% and 3.0% for 2023 and 2024, respectively.

10. The Committee discussed the transmission channels and the effect of monetary policy on activity. Copom assessed that the pass-through of the Selic rate to the final rates of different types of credit has occurred as expected, although new corporate credit remain more robust than expected. The Committee continues to evaluate that a large part of the impact of monetary policy is still to be observed, both in economic activity and inflation, and that there was no substantial change in the transmission channels of monetary policy.

11. The Committee discussed the pace of disinflation of services and how inflation of less volatile items would behave in the coming quarters. It evaluated that there are several factors that may affect the path of services inflation, among them the drop in current inflation itself, which reduces the inertial effect on these items, and the more positive projections for economic activity, which raises the risk of more persistent pressures in this segment. In this regard, the Committee believes that continued monitoring of these factors is necessary to assess whether the maintenance of interest rate rates for a sufficiently long period will be enough to ensure inflation convergence.

12. In the domestic scenario, Copom believes that the permanent increase in spending and the uncertainty about its trajectory from next year on may increase the country's risk premia and inflation expectations as they put pressure on aggregate demand and worsen the fiscal path expectations. The Committee reiterates that there are several channels by which fiscal policy may affect inflation, including its effect on activity, asset prices, degree of uncertainty in the economy, and inflation expectations.

13. The Committee discussed the movements in inflation expectations in the Focus survey since the August Copom meeting. There has been a drop for 2023, but much of the movement observed is in items related to administered prices, possibly due to uncertainty about the tax recomposition of federal taxes. However, the median of inflation expectations for 2024 rose since the previous Copom meeting, even though the average has been more stable. Some members of the Committee emphasized that there was an increase in longer-term expectations in much of the emerging countries, reflecting the magnitude and persistence of the global shocks still underway. Finally, all members agree that it is the monetary authority's primary and fundamental role to conduct a monetary policy consistent with the anchoring of longer-term expectations, continuously strengthening its credibility, and reducing the future disinflationary cost.

14. 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) the 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 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 Committee assesses that the still uncertain and volatile current scenario requires serenity when evaluating risks.

## 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 prospective inflation.

16. The twelve-month inflation projection for the first 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. 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 prospective scenario, which increases the uncertainty of the specific projections communicated by the Committee over longer horizons.

17. 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. Copom anticipates that, if the alternative scenario of maintaining tax exemption on fuels in 2023 materialize, it will again emphasize 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 opened the discussion by evaluating the adjustment cycle carried out up to this meeting. It was emphasized that the current monetary tightening cycle has been quite intense and timely and that, due to the long and variable monetary policy lags, much of the expected contractionary effect and its impact on current inflation are still to be seen. These impacts should become clearer in the activity indicators throughout the second half of the year, but the Committee anticipates that measures to sustain aggregate demand hinder a more precise evaluation about the stage of the economic cycle and the impacts of monetary policy.

19. Copom then debated the monetary policy options for this meeting. The options to raise the base interest rates by 0.25 p.p. and to maintain it were widely debated. On the one hand, the additional interest rate increase would reinforce the vigilance stance and reflect the observation of a stronger than expected activity. On the other hand, caution and the need to evaluate, over time, the cumulative effects to be observed of the intense and timely monetary policy cycle already undertaken would be in favor of the maintenance. Therefore, most of 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. Two Committee members voted for a residual adjustment of 0.25 p.p on the Selic

rate. These members argued that the additional increase would strengthen the Committee's message of commitment to its strategy, given the rise in inflation expectations and the projection in the reference scenario for 2024, in an environment of uncertainty about the level of the output gap and the dynamics of activity. These members consider that the upside risks listed in the balance of risks may have longer-lasting impacts if they materialize, suggesting additional caution in assessing the reference scenario projections for the year 2024.

21. The Committee unanimously 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

22. 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, to a lesser extent, 2024. Without compromising its fundamental objective of ensuring price stability, this decision also implies smoothing of economic fluctuations and fosters full employment.

23. 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.

24. The following members of the Committee voted for this decision: Roberto Oliveira Campos Neto (Governor), Bruno Serra Fernandes, Carolina de Assis Barros, Diogo Abry Guillen, Maurício Costa de Moura, Otávio Ribeiro Damaso, and Paulo Sérgio Neves de Souza. The following members voted for a residual adjustment of 0.25 p.p: Fernanda Magalhães Rumenos Guardado and Renato Dias de Brito Gomes.