248th

Minutes of the Meeting of the

Monetary Policy Committee — Copom

August 2-3, 2022

BANCO CENTRAL DO BRASIL

Date: August 2-3, 2022

Place: BCB Headquarters' meeting rooms on the 8th floor (8/2 and 8/3 on the morning) and 20th floor (8/3 on the afternoon) – Brasilia – DF – Brazil

Starting and ending times: August 2: 9:48 AM – 12:04 PM; 2:18 PM – 6:32 PM 10:03 AM – 11:17 AM; 2:28 PM – 6:31 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 August 2 and on the morning of August 3):

Alan da Silva Andrade Mendes – *Department of Foreign Reserves*
André Minella – *Research Department* (also present on the afternoon of August 3)
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 August 2 and on the morning of August 3):

Arnildo da Silva Correa – *Head of the Office of Economic Advisor*
Cristiano de Oliveira Lopes Cozer – *General Counsel*
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*
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, with marked downward revisions on prospective global growth in an environment of inflationary pressures.

2. The growth of major economies has been revised down for 2022 and 2023 due to the expected reversal of the stimuli implemented during the long pandemic period, in particular, those of monetary policy. Furthermore, the war in Ukraine impacts the supply of natural gas, thus bringing additional uncertainty to the European economic scenario, whereas, in China, the deterioration of the real estate sector, coupled with the policy to fight Covid-19, negatively impact the country's growth prospects.

3. Inflation rates figures in some advanced economies released in the period suggest the persistence of strong pressures, although an incipient normalization in the supply chains and accommodation in the prices of leading commodities is already observed recently. Coupled with the adjustment of inventories of industrial goods, these developments might imply the moderation of inflationary pressures related to goods. On the other hand, the degree of slack in the labor market in these economies suggests that inflationary pressures in the sector of services might take long to dissipate.

4. Central banks in developed and emerging countries have adopted a more contractionary stance against increased inflation. The acceleration in the process of normalization of monetary policy in advanced economies, the increase in risk aversion, and the change in the growth outlook have impacted financial conditions in both advanced and emerging economies, affecting the volatility of assets and economic growth prospects. The Committee continues monitoring the risks involving a global deceleration in a highly pressured inflationary environment.

5. Turning to the Brazilian economy, the set of indicators released since the previous Copom meeting continues to suggest that the economy grew throughout the second quarter, with the labor market recovery stronger than expected by the Committee. Indicators related to both formal job openings and employment and unemployment rates suggest a rapid normalization in the labor-intensive sectors after the pandemic.

6. Consumer inflation remains high, with increases spread among several components, and continues to be more persistent than anticipated. The reduction of taxes on energy prices is already observed in high frequency indicators, although the components more sensitive to the economic cycle and monetary policy, with higher inflationary inertia, continue above the range compatible with meeting the inflation target. Inflation expectations for 2022, 2023, and 2024 collected by the Focus survey are around 7.2%, 5.3%, and 3.3%, respectively.

B) Scenarios and risk analysis

7. In the reference scenario, the interest rate path is extracted from the Focus survey, and the exchange rate starts at USD/BRL 5.30[2] and evolves according to the purchasing power parity (PPP). This scenario assumes a path for the Selic rate that ends 2022 at 13.75% p.a., falls to 11.00% in 2023 and to 8.00% in 2024. 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 "yellow" in December 2022, 2023, and 2024. In this scenario, Copom's inflation projections stand at 6.8% for 2022, 4.6% for 2023, and 2.7% for 2024. Inflation projections for administered prices are -1.3% for 2022, 8.4% for 2023, and 3.6% for

[1] Unless explicitly stated otherwise, this update takes into account changes that occurred since the June Copom meeting (247th 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.

2024. The projections based on the reference scenario incorporate the tax measures recently approved. For the six-quarter-ahead horizon, which mitigates the calendar-year impact but incorporates the second-round effects of the tax measures that occur in 2022 and the first quarter of 2023, the 12-month inflation projection stands at 3.5%. The Committee judges that the uncertainty in its assumptions and projections is higher than usual.

8. The Committee evaluates that the global inflationary scenario is still challenging. Pressures stemming from both persistently high demand for goods, as well as supply shocks linked to the war in Ukraine, China's Covid-19 policy, and policies restricting trade in agricultural products in commodity-producing countries, might have long-term consequences and lead to more persistent inflationary pressures. However, the re-evaluation of future global demand has led to price declines of leading commodities as well as the prospects of reduced imbalance in the industrial goods market. Copom, even so, reiterates that some geopolitical and particular issues in these markets still deserve attention.

9. The Committee discussed the impacts of the global synchrony in the process of stimulus withdrawal. Copom noticed a more accelerated pace in the process of monetary policy adjustment in advanced economies, as well as the commitment stated in the communication of major central banks to reduce inflationary pressures. It was observed that this movement elevated the market volatility, unevenly impacting several assets and increasing risk aversion. In addition, given the persistence of the inflationary process in advanced economies and the consequent responses by several central banks, the Committee evaluates that the probability of alternative scenarios incorporating a sharper deceleration of global economic activity increased. The uncertainty about the energy scenario in Europe, the dynamics of sectors more sensitive to interest rates in the United States, and the prospects of a more gradual growth in China contribute to this scenario.

10. In the domestic scenario, Copom evaluates that temporary policies aimed to support income could provide stimulus to aggregate demand and the extension of these policies might increase the country's risk premia and inflation expectations as they pressure aggregate demand and worsen the fiscal trajectory. The Committee reiterates that there are several channels by which fiscal policy may affect inflation, including its effect on activity, asset prices, and inflation expectations.

11. Labor market data, especially concerning the pace of job openings and the unemployment rate, surprised in the period and indicate a faster-than-anticipated narrowing of the estimate of the output gap. However, the Committee evaluates that economic slackness persists. Nevertheless, it is noteworthy that evaluations about the output gap, especially about the component related to the labor market, are always subject to uncertainty, notably in the current situation in which the economy is still normalizing after the pandemic and with remarkable heterogeneity across sectors in this process. Copom will continue monitoring and evaluating the output gap in the next releases. The Committee still considers that activity should decelerate in the coming quarters when the lagged impacts of monetary policy will be more strongly felt.

12. 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; and (ii) an increase in the risk premium due to 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. Among the downside risks, it should be noted (i) a possible reversion, even if partial, of the increase in the price of international commodities measured in local currency; and (ii) a greater deceleration of economic activity than projected. The Committee assesses that the possibility that fiscal policies that support aggregate demand become permanent heightens the upside risks of the inflationary scenario. On the other hand, the Committee notes that the rising risk of a

greater global deceleration increases the downside risks to inflation. The Committee assesses that the still uncertain and volatile current scenario requires serenity when evaluating the prospective risks.

C) Discussion about the conduct of monetary policy

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

14. Following its usual governance, the relevant horizon for monetary policy now refers to the year 2023, and, to a lesser extent, 2024. However, at this meeting, the Committee noted that inflation projections for the years of 2022 and 2023 were heavily impacted by temporary tax measures across calendar years. Therefore, the Committee decided to emphasize the projections for 12-month inflation in the first quarter of 2024, which reflects the relevant horizon, smoothens out the primary effects from tax changes, but incorporates their second-round effects on the relevant inflation projections for monetary policy decisions.

15. The 12-month inflation projection for the first quarter of 2024 – which incorporates the secondary effects of the tax changes as well as the cumulative effects of keeping interest rates at a significantly contractionary level – is consistent with the strategy of inflation convergence to around the target over the relevant horizon. The Committee noted that inflation projection for 2024 is also around the target.

16. Copom opened the discussion by evaluating the adjustment cycle carried out up to this meeting. It was emphasized that the current monetary tightening cycle was 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 for the second half of the year, but the Committee anticipates that measures to sustain aggregate demand, which will be implemented in the short term, may make it difficult a more precise evaluation about the stage of the economic cycle and the impacts of monetary policy.

17. The Committee noted that the short-term inflationary dynamics remains challenging, with increasing core inflation measures in an environment of surprises in current activity, and that its projections continued to deteriorate, even though the scenario is surrounded by uncertainty and volatility above the usual. It was emphasized that the rise in expectations and medium-term projections was concentrated in the inflation of administered prices, due to the temporary nature of some tax measures.

18. The Committee assessed, based on the projections used and on its balance of risks, that the strategy required to bring the projected inflation to around the target for the relevant horizon required that the monetary tightening cycle continued to move significantly further into contractionary territory, with an additional adjustment at this meeting and the maintenance of the interest rate in significantly contractionary territory for a sufficiently extended period.

19. Copom then debated the monetary policy options for this meeting. The Committee concluded that a further adjustment of 0.50 p.p. was appropriate in an environment of high uncertainty, despite the already significantly contractionary stage of monetary policy, which, considering its lags, should affect the economy more strongly as of the second half of 2022.

20. The Committee decided to signal that it will assess the need for a smaller residual adjustment at the next meeting, with the aim of bringing inflation to around the target in the relevant horizon. Moreover, given the persistence of recent shocks, the Committee will remain vigilant and will assess whether the prospect of maintaining the Selic rate by itself for a sufficiently long period will ensure such a convergence. This strategy was deemed more appropriate to ensure the convergence of inflation over the

relevant horizon, as well as the anchoring of longer-term inflation expectations, while reflecting the already implemented monetary tightening, reinforcing the cautious monetary policy stance, and emphasizing the uncertainty of the scenario.

D) Monetary policy decision

21. Taking into account the assessed scenarios, the balance of risks, and the broad array of available information, Copom unanimously decided to increase the Selic rate by 0.50 p.p. to 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.

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 even more restrictive territory. The Committee emphasizes that it will persist in its strategy until the disinflation process and the expectation anchoring around its targets consolidate.

23. The Committee will evaluate the need for a residual adjustment, of lower magnitude, in its next meeting. The Copom emphasizes that it will remain vigilant and that future policy steps could be adjusted to ensure the convergence of inflation towards its targets. It also stresses that the uncertainty of the current scenario, both domestic and foreign ones, coupled with the advanced stage of the current monetary policy cycle, and its cumulative impacts yet to be observed, require additional caution in its actions.

24. 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, Otávio Ribeiro Damaso, Paulo Sérgio Neves de Souza, and Renato Dias de Brito Gomes.