

242nd

Minutes of the Meeting of the
Monetary Policy Committee — Copom

October 26-27, 2021

Date: October 26-27, 2021

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

Starting and ending times: October 26: 10:20 AM – 1:15 PM; 2:40 PM – 6:14 PM
October 27: 2:40 PM – 6:35 PM

In attendance:

Members of 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 (October 26):

Alan da Silva Andrade Mendes – *Department of Foreign Reserves*
André Minella – *Research Department* (also present on October 27)
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 (October 27):

Antonio Paulo Pinto Mergulhão – *Senior Advisor at the Office of the Deputy Governor for Monetary Policy*
Arnildo da Silva Correa – *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*
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 scenario¹

1. Regarding the global outlook, the environment is becoming less favorable, reflecting the persistent inflation and the consequent central banks' reaction. Growth in 2022 should be lower, with the reversal of fiscal stimuli and advance in the process of monetary policy normalization. This combination implies a more challenging scenario for emerging markets.

2. Turning to the Brazilian economy, recently released industrial output and trade indicators show negative and below-expected results. On the other hand, the services segments hardest hit by the pandemic continue on a robust recovery trajectory. The Committee maintained the expectation of a recovery in activity in the second half of the year, although less intense and more concentrated in the services sector. This reassessment reflects the impact of supply shortages of inputs in some productive chains, which should persist until 2022.

3. For 2022, if on the one hand the rise in risk premia and the tightening of financial conditions act stifling the economic activity, on the other Copom considers that economic growth will be benefited by three tailwinds: the continued recovery of the labor market and the services sector; the performance of sectors less dependent on the business cycles – such as agriculture and livestock and the extractive industry; and the remaining effects of the normalization of the economy as the health crisis recedes.

4. Consumer inflation remains high and has been more persistent than anticipated. Price increases are more widespread and also include items more associated with core inflation. The increase of industrial prices has not slowed down and should persist in the short term, whereas services inflation accelerated due to the gradual normalization in the sector's activity, as expected. Besides these developments, since the previous Copom meeting there has been a substantial increase in international energy commodity prices, whose inflationary impact is amplified by the BRL depreciation. Combined, they are the preponderant factor for the increase in the Committee's inflation projections for both 2021 and 2022.

5. The various measures of core inflation are above the range compatible with meeting the inflation target. Inflation expectations for 2021, 2022, and 2023 collected by the Focus survey are around 9.0%, 4.4%, and 3.3%, respectively.

6. Copom's inflation projections in its baseline scenario, with interest rate path extracted from the Focus survey and exchange rate starting at USD/BRL 5.60² and evolving according to the purchase power parity (PPP), stand around 9.5% for 2021, 4.1% for 2022, and 3.1% for 2023. This scenario assumes a path for the Selic rate that rises to 8.75% p.a. in 2021 and to 9.75% p.a. in 2022, ending the year at 9.50% p.a., and drops to 7.00% p.a. during 2023. In this scenario, inflation projections for administered prices are 17.1% for 2021, 5.2% for 2022, and 5.1% 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.

¹ Unless explicitly stated otherwise, this update takes into account changes that occurred since the September Copom meeting (241st 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.

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.

10. Despite the more positive public accounts data, the Committee assesses that recent questioning regarding the fiscal framework increased the risk of deanchoring inflation expectations, raising the upward asymmetry in the balance of risks. This implies a higher probability of inflation paths above the one projected under the baseline scenario.

C) Discussion about the conduct of monetary policy

11. The public accounts have performed better than expected. Assuming the current fiscal framework is maintained, in particular the control of spending growth, Copom's projections foresee a falling trajectory for the public debt as a percentage of GDP. However, between Copom's meetings, relevant questionings arose regarding the future of the current fiscal framework, resulting in higher risk premia. These questionings have also raised the risk of deanchoring inflation expectations, increasing the upward asymmetry in the balance of risks for the conduct of monetary policy. This implies assigning greater probability to alternative scenarios that consider higher neutral interest rates.

12. The Committee reiterates that the process of reforms and necessary adjustments in the Brazilian economy is essential for a 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.

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 and the exchange rate at purchase power parity, the inflation projections are above the target for 2022 and around the target for 2023. The Committee pondered that the asymmetry in the balance of risks resulting from the developments in the fiscal scenario implies an increase in the upward risk to its baseline scenario projections and assessed that this upside bias is now larger than previously considered. Therefore, the Committee concluded that the appropriate degree of monetary tightening is significantly more contractionary than that used in the baseline scenario.

14. In view of this, Copom assessed the appropriate pace of interest rate hikes. To this end, it analyzed the convergence of inflation to targets using simulations with different monetary policy paths under different alternative scenarios. The Committee pondered that, at this moment, shocks in BRL-denominated commodity prices already impact the 2022 projections, raising their volatility. Nevertheless, Copom understands that a process of deanchoring inflation expectations may cause high economic costs in the long term and thus decided to choose a pace of interest rate hikes compatible with the convergence of inflation to the target still in 2022.

15. The Committee also considered scenarios with adjustments greater than 1.50 p.p. The prevailing view, however, was that monetary policy tightening paths with 1.50 p.p. steps, considering different ending rates, are consistent with inflation converging to the target in 2022, even considering the current asymmetry of the balance of risks.

D) Monetary policy decision

16. Taking into account the baseline scenario, the balance of risks, and the broad array of available information, the Copom unanimously decided to increase the Selic rate by 1.50 p.p. to 7.75% 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 it is consistent with convergence of inflation to the targets over the relevant horizon for monetary policy, which includes 2022 and 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, given the deterioration of the balance of risks and the increase in its inflation projections, this pace is the most appropriate to guarantee inflation convergence to the targets at the relevant horizon. At this moment, the Copom's baseline scenario and balance of risks indicate as appropriate to advance the process of monetary tightening even 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.