254th

Minutes of the Meeting of the

Monetary Policy Committee — Copom

May 2-3, 2023

BANCO CENTRAL DO BRASIL

Date: May 2-3, 2023

Place: BCB Headquarters' meeting rooms on the 8th floor (5/2 and 5/3 on the morning) and 20th floor (5/3 on the afternoon) – Brasilia – DF – Brazil

Starting and ending times: May 2: 10:13 AM – 12:21 PM; 2:28 PM – 6:38 PM
May 3: 10:06 AM – 11:15 PM; 2:34 PM – 6:46 PM

In attendance:

Copom Members

Roberto de Oliveira Campos Neto – *Governor*
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 5/2 and on the morning of 5/3):

Alan da Silva Andrade Mendes – *Department of Foreign Reserves*
André Minella – *Research Department* (also present on the afternoon of 5/3)
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 5/2 and on the morning of 5/3):

Antônio Geraldo Filho – *Head of Division at the BCB's Internal Auditing*
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*
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 the Deputy Governor for Monetary Policy's Office*
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*
Mariane Santiago de Souza – *Head of the Governor's Office*
Olavo Lins Romano Pereira – *Deputy Head of the Department of International Affairs*
Ricardo Eyer Harris – *Head of Office of the Deputy Governor for Regulation's Office*
Ricardo Franco Moura – *Head of the Prudential and Foreign Exchange Regulation Department*
Ricardo José de Souza Oliveira – *Coordinator at the BCB's Internal Auditing*

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 challenging. The episodes involving banks abroad have increased the uncertainty, but with limited contagion on financial conditions so far, requiring constant monitoring. The impact of these episodes on financial conditions and consequently on global growth is still uncertain but has a negative bias. Major economies have emphasized the principle of separation of objectives and instruments in the conduct of monetary and macroprudential policies, despite incorporating the impacts on activity in their scenarios.

2. At the same time, the central banks of major economies remain committed to bringing inflation back to its targets, in an environment in which inflation has been resilient. Recent inflation readings from several countries point to some stabilization of core inflation at levels above their targets and reinforce the persistent nature of the current inflationary process. Furthermore, most monetary authorities signal a prolonged period of high interest rates necessary to fight inflationary pressures, which calls for greater caution in the conduct of economic policies also by emerging countries.

3. Turning to the Brazilian economy, the Committee's expected scenario of gradual growth slowdown is still corroborated by the recent set of indicators. Some moderation is observed in the coincident indicators of activity, as well as a slowdown in the credit market at the margin. The labor market, which surprised positively throughout 2022, has shown resilience, with a net increase in job creation and relative stability in the unemployment rate.

4. Consumer inflation remains high. The inflation of the components more sensitive to the economic cycle and to the monetary policy, which present greater inflationary inertia, remains above the range compatible with meeting the inflation target. Inflation expectations for 2023 and 2024 collected by the Focus survey have increased marginally and are around 6.1% and 4.2%, 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 5.05[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 and 2024. In this scenario, Copom's inflation projections stand at 5.8% for 2023 and 3.6% for 2024. Inflation projections for administered prices are 10.8% for 2023 and 5.2% for 2024.

6. The Committee analyzed an alternative scenario with stable interest rates over the entire relevant horizon. In such scenario, inflation projections stand at 5.7% for 2023 and 2.9% for 2024.

7. The neutral real interest rate is the rate in which, in the absence of impact from other factors, the inflation rate remains stable, and the output grows according to its potential, reflecting productivity gains and changes in the structural fundamentals of the economy. In assessing the factors that could lead to unfold an alternative scenario characterized by a higher neutral interest rate, emphasis was placed on the possible adoption of expansionary parafiscal policies, which can increase the neutral rate and reduce the power of monetary policy, as previously remarked by the Committee. Still regarding the debate about the current neutral interest rate in the economy, some members raised an additional aspect, related to the recent economic data set. These members pointed out that a scenario marked by a possible rise in neutral interest rates

[1] Unless explicitly stated otherwise, this update takes into account changes that occurred since the March Copom meeting (253rd 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 major economies, resilience in Brazilian activity, and a slow disinflationary process could be compatible with a higher measure of neutral rate than that assumed by the Committee. Under this argument, therefore, the current monetary tightening would lead to a lower contractionary impact than that implicit in the Copom's scenarios. However, most of the committee members judged that this interpretation still seems premature and needs further corroboration by data.

8. Regarding the global outlook, the low degree of labor market slack in some economies and a persistently high current inflation and widespread in the services sector suggest that inflationary pressures should last longer. In this context, reducing inflationary pressures continues to require the commitment and determination of central banks to control inflation by maintaining the tightening of financial conditions for a longer period. Such determination, with a likely impact upon asset prices in the short term, coupled with a credit slowdown in major economies, contributes to a more credible and lasting global disinflationary process.

9. Despite the limited contagion from the recent financial instability in the US banking sector, a further tightening of credit conditions is observed in that country. Thus, despite the reduction in the likelihood of a disruption in the credit market, a scenario with a more restricted credit supply and, consequently, lower economic growth, prevails. The Committee will continue to monitor this situation, analyzing possible transmission channels, although the direct impact on the domestic financial system is deemed limited. The Committee reinforces that the best contribution of monetary policy is to fight inflationary pressures and smooth economic fluctuations, and it emphasizes, once again, the separation of instruments between the objectives of inflation control and financial stability.

10. Brazilian activity data point to a moderate pace of growth at the margin, with emphasis on the support given by consumption, on the demand side, and by the agricultural and livestock sector, on the supply side. Some members reminded that the methodological changes in monthly activity surveys may increase uncertainty in GDP projections and in the current assessment of activity. Copom anticipates a more vigorous GDP growth in the release of the first quarter of 2023, especially due to agricultural production, followed by moderation in economic activity in an environment marked by resilience in the labor market. In addition, formal employment data continued to reveal increase of job creation in the most recent period. Some members noted that there is a movement towards a partial recomposition of recent losses in real wages. This movement is expected and has been accompanied by a deceleration in nominal gains, which is expected to intensify ahead. Finally, it was noted that the economic growth outlook has not changed significantly in the recent period.

11. The Committee believes that the disinflation dynamics continues to be characterized by a process with two distinct stages. In the first stage, already completed, the speed of disinflation was greater, with a greater effect on administered prices and an indirect effect on market prices through less inertia. In the second stage, which has been currently observed, the speed of disinflation is slower, and core inflation – which is more affected by the aggregate demand and the interest rate policy – declines at a slower pace, responding to the output gap and future inflation expectations. The most recent inflationary data support the view of a slower disinflation process, in line with the view of an inflation driven by excess of demand, mostly in the services segment. The Committee reaffirms that the disinflation process at its current stage demands serenity and patience in the conduct of monetary policy to ensure the convergence of inflation to its targets.

12. Still in the discussion about inflationary behavior, the recent benign behavior of wholesale prices was emphasized, both for food and industrial goods, in line with the Committee's view. In addition, due to a comfortable water scenario for 2023, the green energy flag is assumed for December. Moreover, seeking to avoid an excessive impact of the assumption about energy tariff flags, which are inherently affected by a lot of uncertainty for longer horizons, on inflation projections and with possible impacts on

the conduct of monetary policy, it was decided to adopt the neutral flag, i.e., green flag for December 2024, also in line with the view of most analysts outlined in the pre-Copom questionnaire. In terms of the trajectory of consumer inflation over 2023, it should be noted that a relevant drop is expected in the twelve-month inflation during this second quarter, due to the base effect of the previous year. In the second half of 2023, as the twelve-month inflation no longer includes the effects of the tax measures that reduced the price level in the third quarter of 2022 and the effects of this year's tax measures will still be included, this inflation indicator will rise. Copom, therefore, emphasizes that such behavior does not reflect the underlying inflationary dynamics, nor does it change the view on future prospects.

13. Inflation expectations remain deanchored from the targets set by the National Monetary Council, having slightly deteriorated at the margin. The Committee is following this movement with concern and continues to assess that deanchored expectations raise the cost of bringing inflation back to the target. It was emphasized again that the behavior of expectations is a fundamental aspect of the inflationary process since it serves as a guide for present and future prices and wages setting. Thus, as expectations rise, there is a greater rise in prices in the current period and the inflationary process is fueled by these expectations. It was also highlighted that the anchoring of expectations is a key factor for price stability. In this context, the Committee reinforces that decisions that induce to the reanchoring of expectations and that raise confidence in the inflation targets would contribute to a faster and less costly disinflation process.

14. The domestic credit granting scenario seems compatible with the current stage of the monetary policy cycle, despite the persistence of a stronger decrease in the supply of credit in specific modalities. The Committee anticipates a moderation in credit granting over the next few months, but in line with what has been observed in previous monetary policy tightening cycles. The Committee believes that the BCB has the appropriate and necessary liquidity instruments, associated with macroprudential policy, to deal with relevant frictions in the system, should they occur.

15. The Committee also discussed the impacts of the fiscal scenario on inflation and assesses that the presentation of the fiscal framework has reduced the uncertainty associated with extreme scenarios of public debt growth. The Committee will continue to monitor the processing and implementation of the fiscal framework presented by the government and under discussion in the National Congress. Copom again emphasized that there is no mechanical relationship between the convergence of inflation and the approval of the fiscal framework since the inflation path is conditional on the reaction of inflation expectations and financial conditions. The materialization of a scenario with a solid and credible fiscal framework may lead to a more benign disinflation process through its effect on the expectations channel, by reducing inflation expectations, uncertainty in the economy, the risk premium associated with domestic assets and, consequently, the Committee's projections.

16. 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 lingering uncertainty about the final fiscal framework to be approved by the National Congress and, more relevant for monetary policy, its impacts on the expected paths of the public debt and of inflation expectations, and on risky assets; and (iii) a larger or more persistent deanchoring of long-term inflation expectations. 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, particularly due to adverse conditions in the global financial system; and (iii) a slowdown in domestic credit granting larger than what would be compatible with the current stance of monetary policy.

17. On the one hand, the reinstatement of fuel taxes and, primarily, the presentation of a proposal for the fiscal framework have partly reduced the uncertainty arising from

fiscal policy. On the other hand, the current scenario, characterized by a stage in which the disinflationary process tends to be slower in an environment of deanchored inflation expectations, requires further attention when conducting monetary policy. Copom emphasizes that there is no mechanical relationship between the convergence of inflation and the approval of the fiscal framework, and judges that the deanchoring of long-term inflation expectations raises the cost of the disinflation that is needed to reach the targets established by the National Monetary Council. In this scenario, Copom reaffirms its commitment to set monetary policy to meet the targets.

C) Discussion about the conduct of monetary policy conduct

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

19. Copom started the debate by evaluating whether the previously outlined strategy of stable interest rates would be enough to ensure the convergence of inflation towards to its targets. To this end, the Committee has continued its process of analyzing the main determinants of the inflation path and how they have behaved in the most recent period. No significant change occurred in the prospective scenario for the output gap. As for services inflation and measures of core inflation, increased resilience and lower speed are observed in the recent releases, in line with the non-linear process already anticipated by Copom. In addition, inflation expectations remain deanchored, partially related to the questioning about a possible change in future inflation targets.

20. Copom's inflation projections have remained relatively stable since the previous meeting. Finally, in the balance of risks, besides the factors already mentioned, the Committee evaluates that the probability of the most extreme scenarios for the public debt trajectory has reduced, but also noted that there was no relevant change in the inflation projections since expectations did not change significantly. This behavior reinforces the understanding that there is no mechanical relationship between monetary policy and the fiscal framework. Copom emphasized that the conduct of monetary policy, at this moment, requires serenity and patience to incorporate the inherent delays in the inflation control through interest rates and, therefore, to reach the goals in the relevant monetary policy horizon. Therefore, the Committee assessed that the scenarios that could require a resumption of the monetary policy tightening cycle have become less likely.

D) Monetary policy decision

21. Considering the assessed scenarios, the balance of risks, and the broad array of available information, Copom decided to maintain the Selic rate at 13.75% p.a. The Committee 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. Without compromising its fundamental objective of ensuring price stability, this decision also implies smoothing economic fluctuations and fostering full employment.

22. Taking into account the uncertainty of the scenarios, the Committee remains vigilant, assessing if the strategy of maintaining the Selic rate for a 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 judges that the current scenario demands patience and serenity in the conduct of monetary policy. Copom emphasizes that, although a less likely scenario, it will not hesitate to resume the tightening cycle if the disinflationary process does not proceed as expected.

23. The following members of the Committee voted for this decision: Roberto de Oliveira Campos Neto (Governor), 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.