

243rd

Minutes of the Meeting of the
Monetary Policy Committee – Copom

December 7-8

Date: December 7-8

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

Starting and ending times: December 7: 10:25 AM – 1:05 PM; 2:36 PM – 6:27 PM
December 8: 2:35 PM – 6:40 PM

In attendance:

Copom Members

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 (December 7):

Alan da Silva Andrade Mendes – *Department of Foreign Reserves*
André Minella – *Research Department* (also present on December 8)
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 (December 7):

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*
Julio Cesar Costa Pinto – *Head of the Deputy Governor for Monetary Policy's Office*
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 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 baseline scenario¹

1. Regarding the global outlook, the environment became less favorable. Some central banks in advanced economies expressed more clearly the need for caution given the increased persistence of inflation, turning the environment more challenging for emerging economies. In addition, the real estate sector situation in China, the possibility of a winter Covid-19 wave, and the emergence of the Omicron variant add uncertainty about the pace of recovery in advanced economies. These events produced falls in some important commodity prices, but it is still too early to predict the extent of this movement.

2. In relation to the Brazilian economic activity, the release of the third quarter GDP figures revealed a slightly lower-than-expected evolution, although the activities most affected by the pandemic continued on a robust recovery path. Higher frequency indicators point to reduced economic activity, widespread among various sectors, in September and possibly in October. Likewise, the already available confidence indexes for the initial months of the current quarter show deterioration. Consequently, the Committee revised downward its expectations for activity in the short term.

3. For 2022, if, on the one hand, the rise in risk premia and the more intense tightening of financial conditions act stifling the economic activity, on the other hand Copom considers that economic growth tends to benefit from the performance of agriculture and livestock and from the remaining effects of the normalization process of the economy – particularly in the services sector and in the labor market – as the health crisis recedes.

4. Consumer inflation remains high, with increases spread among several components, and has proven to be more persistent than anticipated. 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. Recent readings were higher than expected and the surprise came in both the more volatile components, and on the items associated with core inflation. Prospectively, the significant drop in international energy commodity prices, which have had substantial volatility, has limited the upward revision of short-term projections.

5. The various measures of underlying 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 10.2%, 5.0%, and 3.5%, 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 5.65² and evolving according to the purchasing power parity (PPP), stand around 10.2% for 2021, 4.7% for 2022, and 3.2% for 2023. This scenario assumes a path for the Selic rate that rises to 9.25% p.a. in 2021 and to 11.75% p.a. in 2022, ending the year at 11.25% p.a., and drops to 8.00% p.a. during 2023. In this scenario, inflation projections for administered prices are 16.7% for 2021, 3.8% for 2022, and 5.2% for 2023. The energy flag is "water scarcity" in December 2021 and is assumed to be "red level 2" in December 2022 and in December 2023.

B) Risks around the baseline inflation scenario

7. The Copom's baseline scenario for inflation encompasses risk factors in both directions.

¹ Unless explicitly stated otherwise, this update takes into account changes that occurred since the October Copom meeting (242nd 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.

8. On the one hand, a possible reversion, even if partial, of the increase in the price of international commodities measured in local currency would produce a lower-than-projected inflation in the baseline scenario.

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 doubts regarding the fiscal framework increase the risk of deanchoring inflation expectations, keeping 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. Uncertainties regarding the future of the current fiscal framework have resulted in increased risk premia and raised the risk of deanchoring inflation expectations. This implies assigning greater probability to alternative scenarios that consider higher neutral interest rates. 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.

12. 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 evolving according to the purchasing power parity, the inflation projections are above the target for 2022 and around the target for 2023.

13. As for the balance of risks, the Committee pondered that the risk of a deanchoring of longer-term expectations, derived from developments in the fiscal scenario, points to an upward bias for the projections of its baseline scenario. Hence, considering this bias due to asymmetric risks, Copom evaluated that its projections are above the target for both 2022 and 2023. Given this result, Copom concluded that the monetary tightening process should be more restrictive than that used in the baseline scenario throughout the relevant horizon.

14. Next, Copom assessed the appropriate pace of interest rate hikes. For such, it analyzed its inflation projections using simulations with monetary policy paths with different terminal rates, under several alternative scenarios. The Committee also compared scenarios with adjustments greater than 1.50 p.p. with scenarios in which the interest rate remains high for a longer period than that implied in the baseline scenario.

15. Based on these results, Copom members discussed the most appropriate strategy. The Committee concluded that adjustments of 1.50 p.p. at this moment are adequate to reach, throughout the process of monetary tightening, a level restrictive enough not only to ensure the convergence of inflation over the relevant horizon but also to consolidate the anchoring of longer-term expectations.

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 9.25% 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.

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17. The Committee considers that, given the increase in its inflation projections and in the risk of deanchoring long-term expectations, it is appropriate to advance the process of monetary tightening significantly into the restrictive territory. The Committee will persist in its strategy until the disinflation process and the expectation anchoring around its targets consolidate.

18. For the next meeting, the Committee foresees another adjustment of the same magnitude. The Copom emphasizes that its future policy steps could be adjusted to ensure the convergence of inflation towards its targets 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.