258th

Minutes of the Meeting of the

Monetary Policy Committee — Copom

October 31 – November 1, 2023

BANCO CENTRAL DO BRASIL

Date: October 31 – November 1, 2023

Place: BCB Headquarters' meeting rooms on the 8th floor (10/31 and 11/1 on the morning) and 20th floor (11/1 on the afternoon) – Brasilia – DF – Brazil

Starting and ending times: October 31: 10:08 AM – 11:55 AM; 2:33 PM – 5:40 PM
November 1: 10:35 AM – 11:48 AM; 2:38 PM – 6:30 PM

In attendance:

Copom Members

Roberto de Oliveira Campos Neto – *Governor*
Ailton de Aquino Santos
Carolina de Assis Barros
Diogo Abry Guillen
Fernanda Magalhães Rumenos Guardado
Gabriel Muricca Galípolo
Maurício Costa de Moura
Otávio Ribeiro Damaso
Renato Dias de Brito Gomes

Department Heads in charge of technical presentations (attending on 10/31 and on the morning of 11/1):

Alan da Silva Andrade Mendes – *Department of Foreign Reserves*
André Minella – *Research Department* (also present on the afternoon of 11/1)
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 10/31 and on the morning of 11/1):

André Luiz Caccavo Miguel – *Head of the Financial System Monitoring Department*
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 Office of the Deputy Governor for Supervision*
Eduardo José Araújo Lima – *Head of Office of the Deputy Governor for Economic Policy*
Euler Pereira Gonçalves de Mello – *Deputy Head of the Research Department*
Fernando Alberto G. Sampaio de Cavalcante Rocha – *Head of the Department of Statistics*
Isabela Ribeiro Damaso Maia – *Head of the Sustainability and International Portfolio Investors Unit* (present on 10/31)
Julio Cesar Costa Pinto – *Head of Office of the Deputy Governor for Monetary Policy*
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* (present on 10/31)
Marcelo Antonio Thomaz de Aragão – *Deputy Head of the Department of International Affairs*
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*
Ricardo Eyer Harris – *Head of Office of the Deputy Governor for Regulation*
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.

A) Update of economic outlook and Copom's scenario[1]

1. The global environment is adverse, due to an increase in longer-term interest rates in the United States, the persistence of high core inflation in many countries, and new geopolitical tensions.

2. The central banks of major economies remain committed to bringing inflation back to its targets in an environment characterized by labor market pressures. The Committee judges that the environment requires attention and caution from emerging market economies.

3. Regarding the domestic outlook, the recent set of economic activity indicators remains consistent with the deceleration scenario expected by the Committee. Deceleration was observed in the August data, particularly in services. Conversely, the labor market continues strong, albeit with some moderation at the margin.

4. Consumer inflation continues on the expected disinflationary trajectory, with a benign composition, decelerating in both services and core inflation. Indicators aggregating the components more sensitive to the economic cycle and the monetary policy, which have greater inflationary inertia, were lower but remained above the target. Inflation expectations for 2023, 2024, and 2025 collected by the Focus survey are around 4.6%, 3.9%, and 3.5%, 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 5.00[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, 2024, and 2025. In this scenario, Copom's inflation projections stand at 4.7% for 2023, 3.6% for 2024, and 3.2% for 2025. Inflation projections for administered prices are 9.3% for 2023, 5.0% for 2024, and 3.6% for 2025.

6. The Committee evaluates that the international outlook is adverse. After the first disinflation stage following the normalization of productive chains, the early effects of the monetary policy tightening, and the reduction of pressures on commodities, Copom is focused on the disinflation sources for the next quarters. Amid an uncertain geopolitical context, with a strong labor market and tightened output gap in advanced economies, Copom believes that the prolonged monetary policy tightening strategy has been essential to control global inflation, facilitating inflation control in emerging markets. Conversely, the global monetary tightening can put pressure on the exchange rate and impact the prices of domestic assets, contributing to a slower disinflation process in the short term.

7. Risks around the global scenario have increased. The rise of long-term interest rates in the US tightens financial conditions but it is still uncertain the lag and magnitude of this impact on the US economic activity, which remains resilient. In face of the increased long-term interest rates, the Committee discussed, at first, the possible reasons for this phenomenon. In its discussion, Copom mostly emphasized the fiscal prospects, particularly in the US, highlighting their impacts on global financial conditions. Copom also discussed how the US economy's resilience would impact the length of the required

[1] Unless explicitly stated otherwise, this update takes into account changes that occurred since the September Copom meeting (257th meeting).
[2] The value for the exchange rate was obtained according to the procedure of rounding the average USD/BRL exchange rate observed on the ten business days ending on the last day of the week before the Copom meeting, as it was announced in the Inflation Report of September 2023.
.

tightening for the inflation convergence in the US. For some members, the current outlook is highly uncertain, and the combination of a substantial tightening of financial conditions with the activity resilience can make it more difficult to achieve a soft landing.

8. Copom debated the multiple transmission channels of US interest rates to the Brazilian economy, discussing the effects via interest rate, forward premium in the interest rate curve, external demand, exchange rate, neutral interest rate, commodity prices, among others. Firstly, the Committee emphasized the impact of the need to attract resources to finance higher debt in developed countries. Other markets – such as the emerging sovereign debt and private credit markets – have been affected in this environment of higher sovereign debt interest rates in central economies. The final impact on those markets will be greater the longer the higher interest rates last, which could lead to reallocations in the debt rollover process. Another channel, with direct effect on inflation, is via exchange rate. In this discussion, Copom highlighted that, despite the severity of such events as the conflict in the Middle East and the substantial movement in the prices of international assets, the exchange rate and the oil price have had moderate changes so far. Finally, when incorporating the multiple transmission channels into a more uncertain environment, Copom evaluates as appropriate to adopt a more cautious stance in face of the risks involved.

9. Regarding the domestic economic activity, the Committee continues to anticipate an economic activity deceleration during the second half of the year, after growth surprises in the first half. In line with this understanding, data released in the more recent period suggest loss of dynamics in the services sector following a higher-than-expected expansion in the first half of the year. Copom noticed that, for the industry, the scenario remains stable, with the most credit-sensitive sectors registering stronger deceleration. In addition, inventories also increased in several sectors. Therefore, activity data released since the previous meeting corroborate the scenario outlined by Copom.

10. Copom reinforced its view that the lack of commitment to structural reforms and fiscal discipline, the increase of earmarked credit granting, and the uncertainties about the stabilization of the public debt have the potential to raise the neutral interest rate of the economy, with harmful impacts on the power of monetary policy and, consequently, on the cost of disinflation in terms of activity.

11. In its analysis of the labor market, the Committee first discussed the developments in the employment level. The unemployment rate continues to decline, although recent data also reflect a fall in the participation rate. Data relative to formal job hirings remain at high levels, consistent with a very dynamic labor market. Part of the discussion was then focused on the workers' earnings and income, which suggest some acceleration in real gains in the more recent period. The Committee considered that this development can reflect temporary issues and continues evaluating that there is no evidence of high wage pressures in labor negotiations, although judged as important to keep monitoring very carefully the several labor market variables. The recent reduction in the 12-month inflation makes it difficult to analyze real gains in an environment of wage rigidity, leading to different conclusions by different surveys and analysis about the change in real wages at the margin. Copom will continue to pay attention to the dynamics of earnings coming from several surveys to better evaluate the degree of slack in the labor market and its potential impacts on the services inflation.

12. The deceleration in credit granting is in line with the monetary policy stance. A stronger deceleration is seen in corporate credit granting, coupled with a recomposition involving relatively less credit granted via banking sector and more via capital markets. A marked heterogeneity between the productive sectors remains both in the interest rates and in the volumes of granting credit. Household credit, in turn, shows lower deceleration and a recovery favoring low-cost modalities. Despite the tight

monetary conditions, Copom emphasized that the transmission of the monetary policy cycle expected by the market to the interest rates of new credit granting is already seen.

13. The Committee had been assessing that the fiscal uncertainty was limited to the execution of targets already presented but noted that, in the more recent period, uncertainty increased about the target itself for the fiscal balance, which led to an increased risk premium. Given the importance of the execution of the fiscal targets already established for the anchoring of inflation expectations, and hence for the conduct of monetary policy, the Committee reaffirms the importance of firmly pursuing those targets.

14. Copom judged that the benign evolution of the current inflation continues as already expected. As anticipated, some sources of disinflation that contributed to the first disinflation stage are no longer present. In particular, a lower downside pressure is observed in the wholesale prices of industrial goods, which, until recently, were still normalizing with the end of the bottlenecks in productive chains. Similarly, prices of international agricultural commodities and domestic food prices, which also contributed to disinflation throughout 2023, no longer suggest downside pressures with the same intensity in the next quarters. Furthermore, the components related to industrial goods and administered prices might present a less benign behavior than previously expected, due to the recent movement of the exchange rate and the prices of international commodities. Copom still assesses that the inherent volatility of food and industrial goods components suggests the possibility of abrupt reversals, recommending caution.

15. For the prospective scenario, Copom discussed more thoroughly the determinants of services inflation. The risks related to the *El Niño* weather phenomenon – partially incorporated into the reference scenario – were also mentioned, as well as those related to international oil price developments. Copom highlighted the uncertainty surrounding *El Niño* in terms of its magnitude, the period in which the phenomenon would have the greatest impact, and the particular impacts on different food products. Copom opted to incorporate a relatively small impact of the *El Niño* into its food inflation projections, but some members stressed the inflationary impacts in the event of a more extreme phenomenon. In the end, it was unanimously concluded that a contractionary and cautious monetary policy was needed to reinforce the disinflationary dynamics.

16. Inflation expectations remain unanchored and are a cause for concern. The Committee believes that lowering expectations requires firm action by the monetary authority, as well as continued strengthening of the credibility and reputation of both the institutions and the fiscal and monetary frameworks that make up the Brazilian economic policy.

17. 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; and (ii) a stronger-than-expected resilience of services inflation due to a tighter output gap. Among the downside risks, it should be noted (i) a greater-than-projected deceleration of global economic activity; and (ii) an impact on global inflation larger than expected from synchronized monetary policy tightening. In light of the international environment, the Committee judges that the current conjuncture is more uncertain than usual and requires caution on the conduct of monetary policy.

C) Discussion about the conduct of monetary policy

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

19. The Committee believes that there has been significant disinflationary progress, in line with what the Committee had anticipated, but there is still a long way to go to anchor expectations and return inflation to the target, which requires serenity and moderation on the conduct of monetary policy.

20. The domestic scenario is moving in line with what was expected. The conclusion is that the disinflationary path of core and services inflation continues, reinforcing the recent benign dynamics of inflation. Moreover, recent data suggest a certain moderation in economic activity, as anticipated by the Committee, particularly in services and trade. Inflation expectations for longer maturities have remained unanchored since the previous Copom meeting. Finally, inflation projections for the relevant horizon have risen somewhat and are above the target. The reasons for the increase include changes in administered prices projected for 2024 and the trajectories of economic activity, economic slack, and labor market, which suggest a tighter output gap, with an impact on market prices inflation.

21. The global outlook, however, has been more volatile and adverse. There are multiple transmission mechanisms from the international to the domestic economy, both financial and economic, which must be incorporated into the decision-making process. One member believes that the external scenario introduces an asymmetric upward bias in the balance of risks for inflation. The other members believe that the international scenario primarily affects the degree of uncertainty regarding the balance of risks. The Committee is unanimous in its assessment that the increased uncertainty in the global scenario calls for caution.

22. After the scenario evaluation, all members agreed that it was appropriate to reduce the Selic rate by 0.50 percentage point to adjust the degree of prospective monetary tightening.

23. The Committee analyzed several prospective scenarios, characterized by different trajectories in the domestic and international environments. Then, it discussed the appropriate strategy and cycle length in each of these scenarios. It was decided to maintain the recent communication, which already includes the appropriate conditionality in an uncertain environment, specifying the course of action if the expected scenario is confirmed. Regarding the next steps, Copom members unanimously anticipated cuts of 0.50 percentage point in the next meetings and judged that this pace is appropriate to keep the necessary contractionary monetary policy for the disinflationary process. This pace brings together, on the one hand, the firm commitment with the reanchoring of expectations and the disinflationary dynamics and, on the other hand, the adjustment in the level of monetary tightening in real terms in face of the more benign inflation dynamics, which was anticipated in the reference scenario projections.

24. Finally, the Committee debated the extension of the monetary policy adjustments cycle in an uncertain global outlook. The Committee assesses the need to maintain a still contractionary monetary policy in the relevant horizon to consolidate the inflation convergence to the target and the anchoring of expectations. Copom emphasized again that the extension of the cycle over time will depend on the inflationary dynamics, especially the components that are more sensitive to monetary policy and economic activity, on inflation expectations, in particular the longer-term ones, on its inflation projections, on the output gap, and on the balance of risks. The Committee maintains its firm commitment to the convergence of inflation to the target in the relevant horizon and reinforces that the extension of the cycle will reflect the BCB’s legal mandate.

D) Monetary policy decision

25. Considering the evolution of the disinflationary process, the assessed scenarios, the balance of risks, and the broad array of available information, Copom decided to reduce the Selic rate by 0.50 percentage point, to 12.25% p.a., and 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 2024 and 2025. Without compromising its fundamental objective of ensuring price stability, this decision also implies smoothing economic fluctuations and fostering full employment.

26. The current context, characterized by a stage in which the disinflationary process tends to be slower, with only partial reanchoring of inflation expectations and a challenging global outlook, requires serenity and moderation in the conduct of monetary policy. The Committee reinforces the need to persist on a contractionary monetary policy until the disinflationary process consolidates and inflation expectations anchor around its targets.

27. If the scenario evolves as expected, the Committee members unanimously anticipate further reductions of the same magnitude in the next meetings, and judge that this pace is appropriate to keep the necessary contractionary monetary policy for the disinflationary process. The Committee emphasizes that the total magnitude of the easing cycle throughout time will depend on the inflation dynamics, especially the components that are more sensitive to monetary policy and economic activity, on inflation expectations, in particular the longer-term ones, on its inflation projections, on the output gap, and on the balance of risks.

28. The following members of the Committee voted for a reduction of 0.50 percentage point: Roberto de Oliveira Campos Neto (Governor), Ailton de Aquino Santos, Carolina de Assis Barros, Diogo Abry Guillen, Fernanda Magalhães Rumenos Guardado, Gabriel Muricca Galípolo, Maurício Costa de Moura, Otávio Ribeiro Damaso, and Renato Dias de Brito Gomes.