259th

Minutes of the Meeting of the

Monetary Policy Committee — Copom

December 12-13, 2023

BANCO CENTRAL DO BRASIL

Date: December 12-13, 2023

Place: BCB Headquarters' meeting rooms on the 12th floor (12/12 and 12/13 on the morning) and 20th floor (12/13 on the afternoon) – Brasilia – DF – Brazil

Starting and ending times: December 12: 10:18 am – 11:45 am; 2:25 pm – 6:10 pm
December 13: 11:08 am – 12:21 pm; 2:36 pm – 6:33 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 12/12 and on the morning of 12/13):

Alan da Silva Andrade Mendes – *Department of Foreign Reserves*
André Minella – *Research Department* (also present on the afternoon of 12/13)
André de Oliveira Amante – *Open Market Operations Department*
Marcelo Antonio Thomaz de Aragão – *Department of International Affairs*
Ricardo Sabbadini – *Department of Economics*
Rogério Antônio Lucca – *Department of Banking Operations and Payments System*

Other participants (attending on 12/12 and on the morning of 12/13):

André Mauricio Trindade da Rocha – *Head of Office of the Deputy Governor for Supervision*
Arnildo da Silva Correa – *Head of the Office of Economic Advisor*
Augusto Ornelas Filho – *Head of the Prudential and Foreign Exchange Regulation Department*
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*
Fábio Martins Trajano de Arruda – *Deputy Head of the Department of Banking Operations and Payments System* (present on the morning of 12/12)
Fernando Alberto G. Sampaio de Cavalcante Rocha – *Head of the Department of Statistics*
Gilneu Francisco Astolfi Vivan – *Head of the Financial System Monitoring Department*
Gustavo Andrade Barbosa de Souza – *Deputy Head of the Open Market Operations Department*
Isabela Ribeiro Damaso Maia – *Head of the Sustainability and International Portfolio Investors Unit*
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*
Lucas Alves Freire – *General Counsel*
Luís Guilherme Siciliano Pontes – *Deputy Head of the International Reserves Department*
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*

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.

BANCO CENTRAL DO BRASIL

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

1. The global environment remains volatile and is less adverse than in the previous meeting, with a reduction in longer-term interest rates in the United States and incipient signs of lower core inflation, despite remaining at high levels in many countries.

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 continues to require caution from emerging market economies.

3. Regarding the domestic outlook, the recent set of economic activity indicators remains consistent with the economic deceleration scenario expected by the Committee. The release of the third-quarter GDP figures confirmed the anticipated moderation in growth, but with resilience in household consumption. The labor market remains strong but with some moderation at the margin.

4. Consumer inflation follows the expected path of disinflation and its benign composition stands out. The inflation of the components more sensitive to the economic cycle and the monetary policy came closer to the inflation target in the most recent releases. Inflation expectations for 2023, 2024, and 2025 collected by the Focus survey are around 4.5%, 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 4.90[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. Moreover, the energy flag is assumed to be "green" in December 2024 and 2025. In this scenario, Copom's inflation projections stand at 4.6% for 2023, 3.5% for 2024, and 3.2% for 2025. Inflation projections for administered prices are 9.1% for 2023, 4.5% for 2024, and 3.6% for 2025.

6. The Committee believes that the international environment is less adverse than at the previous meeting. The most recent data, although still incipient, suggest moderate growth and slowdown of inflationary pressures in some countries, especially in the groups of industrial goods and energy commodities. As a result, for several Copom members, the probability of a soft landing in the United States has increased. This environment has allowed some countries to signal a shift in monetary policy, while other countries have maintained their strategy of prolonged monetary policy tightening, which has been essential to contain global inflation. The Committee again focused on the sources and uncertainties for the future disinflationary process, contrasting the improvement in the current inflationary outlook with the challenges still ahead, such as the uncertain geopolitical context, the heated labor markets, and the tight output gap in several advanced economies. Given the recent volatility and uncertainty ahead on the international outlook, Copom maintained its assessment that it is appropriate to adopt a cautious stance, especially in emerging countries. In addition, it will continue to monitor the data from the global economy and their respective transmission channels to the domestic economy.

[1] Unless explicitly stated otherwise, this update considers changes that occurred since the October/November Copom meeting (258th meeting).
[2] Corresponds to the rounded value of the average USD/BRL exchange rate observed on the ten working days ending on the last day of the week prior to the Copom meeting, according to the procedure adopted since the 258th meeting.

7. Regarding the domestic economic activity, the release of GDP for the third quarter indicated a moderation in economic growth, in line with the scenario of activity slowdown over the second half of the year anticipated by the Committee. The resilience of household consumption – which surprised positively again – may be related to an increase in gross household income, due to the expansion of the labor market, social benefits, and income gains related to disinflation in important segments of the consumer's basket. In turn, gross fixed capital formation – which is more sensitive to financial conditions and future prospects and uncertainties – continues to fall, after a sharp rise during the pandemic period. Some members judged that the persistence of a combination of greater resilience in consumption and reduction of investment could lead to demand exceeding supply in the medium term, with potential impacts on prices. In short, activity data released since the previous meeting corroborate the scenario outlined by Copom.

8. 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.

9. In the Copom's analysis of the labor market, formal job hiring remains at high levels and compatible with a very dynamic labor market. Although real income gains increased in the most recent period, the Committee maintained its assessment that this development may reflect temporary issues and that there is no evidence of high wage pressures in labor negotiations. The Committee deemed important to continue monitoring the several labor market variables very closely, in particular the dynamics of real income. 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.

10. Corporate credit granting registered a higher deceleration, coupled with a recomposition that involves relatively less credit from the banking sector and more from the capital markets. Despite the tight monetary conditions, Copom emphasized that a transmission of the monetary policy cycle expected by the market to the current rates of new credit grants is already taking place, leading, in particular, to greater dynamism in the capital market in the recent period.

11. On the fiscal front, the Committee reaffirms the importance of firmly pursuing the already established fiscal targets, given their importance for the anchoring of inflation expectations, and hence for the conduct of monetary policy.

12. The disinflationary dynamics did not diverge significantly from what the Committee expected, as the benign evolution of the current inflation scenario continues, and some sources that contributed to the first stage of disinflation have been exhausted. The underlying services component showed some downward surprises, which prompted a discussion about the reasons for this result, which include, among others, the normalization of relative prices, the inertial impact of headline inflation, the benign behavior of wages, the stronger movement of primary shocks in commodity and food, and the lagged impacts of monetary policy. The prospective evolution of the output gap and the behavior of the labor market were considered very relevant in determining the speed with which inflation will reach the target. Based on more evidence, the Committee slightly raised the inflationary impact of the *El Niño* weather phenomenon on food inflation. In the end, it was unanimously concluded that a contractionary and cautious monetary policy was needed to reinforce the disinflationary dynamics.

13. 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.

14. 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 remains uncertain and requires caution on the conduct of monetary policy.

C) Discussion about the conduct of monetary policy

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

16. The Committee believes that there has been a significant disinflationary progress, in line with what the Committee had anticipated, but there is still a long way to go to anchor expectations and bring inflation back to the target, which requires serenity and moderation in the conduct of monetary policy. In addition, uncertainty, particularly in this volatile international environment, recommends caution in the conduct of monetary policy. The Committee recalled that the incorporation of scenarios and exogenous variables, such as fiscal dynamics or the external scenario, takes place through their impact on the prospective dynamics of inflation, with no mechanical relationship with the determination of the interest rate.

17. 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 benign dynamics of recent inflation. In addition, as anticipated by the Committee, recent data suggest a moderation in economic activity. Inflation expectations for longer maturities have remained unanchored since the previous Copom meeting. Finally, inflation projections for the relevant horizon have not changed significantly, standing above the target.

18. 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.

19. The Committee analyzed various 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. On the one hand, this pace brings together 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 dynamics of the anticipated inflation in the reference scenario projections.

20. Finally, the Committee discussed the extension of the monetary policy adjustments cycle. 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

21. 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 11.75% 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.

22. 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.

23. 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.

24. 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.