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Minutes of the Meeting of the

Monetary Policy Committee — Copom

March 19-20, 2024

BANCO CENTRAL DO BRASIL

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Date: March 19-20, 2024

Place: BCB Headquarters' meeting rooms on the 8th floor (3/19 and 3/20 on the morning) and 20th floor (3/20 on the afternoon) – Brasilia – DF – Brazil

Starting and ending times: March 19: 10:37 am – 11:58 am; 2:13 pm – 5:53 pm
March 20: 10:10 am – 11:09 am; 2:32 pm – 6:31 pm

In attendance:

Copom Members

Roberto de Oliveira Campos Neto – *Governor*
Ailton de Aquino Santos
Carolina de Assis Barros
Diogo Abry Guillen
Gabriel Muricca Galípolo
Otávio Ribeiro Damaso
Paulo Picchetti
Renato Dias de Brito Gomes
Rodrigo Alves Teixeira

Department Heads in charge of technical presentations (attending on 3/19 and on the morning of 3/20):

Alan da Silva Andrade Mendes – *Department of Foreign Reserves*
André Minella – *Research Department* (also present on the afternoon of 3/20)
André de Oliveira Amante – *Open Market Operations Department*
Fábio Martins Trajano de Arruda – *Department of Banking Operations and Payments System*
Marcelo Antonio Thomaz de Aragão – *Department of International Affairs* (attending on 3/19)
Ricardo Sabbadini – *Department of Economics*

Other participants (attending on 3/19 and on the morning of 3/20):

André Maurício Trindade da Rocha – *Head of the Financial System Monitoring Department*
Arnaldo José Giongo Galvão – *Press Office Advisor*
Arnildo da Silva Correa – *Head of the Office of Economic Advisor*
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*
Gilneu Francisco Astolfi Vivan – *Head of the Financial System Regulation 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*
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*
Renata Modesto Barreto – *Deputy Head of the Department of Banking Operations and Payments System (present on the morning of 3/19)*
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 achieve the inflation targets established by the National Monetary Council.

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

1. The global environment remains volatile, with debates about the beginning of the monetary policy easing in major economies and the speed with which inflation will fall in a sustained way in many countries.

2. The central banks of major economies remain committed to bringing inflation back to its targets in a context 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. Economic growth has moderated somewhat, but with greater dynamism in some indicators at the margin, while the labor market remains strong and with acceleration of real income.

4. Consumer inflation remains on its path of disinflation. The inflation of the components more sensitive to the economic cycle and the monetary policy stood above the inflation target in the most recent releases. Inflation expectations for 2024 and 2025 collected by the Focus survey are around 3.8% and 3.5%, respectively.

B) Scenarios and risk analysis

5. In the baseline scenario, the interest rate path is extracted from the Focus survey and the exchange rate starts at USD/BRL 4.95[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 3.5% for 2024 and 3.2% for 2025. Inflation projections for administered prices are 4.4% for 2024 and 3.9% for 2025.

6. The reduction in prices volatility in emerging countries contrasts with an international environment that remains volatile. The scenario marked by a sound U.S. economy and resilient inflation permeates the debate on the sources, challenges, and uncertainties for the future disinflationary process in that country. Regarding sources, the Committee discussed the role of the normalization of productive chains and the consequent benign recomposition of relative prices between goods and services, the slowdown of commodity prices, Chinese disinflation and, to a greater extent, the role of monetary policy in the U.S. in reducing inflation in a sustained manner. It was pointed out that, as in the Brazilian case, the final stage of disinflation is more costly and requires caution in the conduct of monetary policy. Still in the subject, Copom reaffirmed that there is no mechanical relationship between the conduct of the U.S. monetary policy and the determination of the domestic policy interest rate, and that, as usual, it will focus on the transmission mechanisms from the external environment into the domestic inflationary dynamics.

7. Regarding the challenges of the external scenario, in addition to geopolitical tensions, some subjects were mentioned. Firstly, the speed of disinflation in a scenario of strong activity and a resilient labor market has once again become the subject of much debate, besides, for a longer horizon, the role of fiscal impacts on the aggregate demand and provision of liquidity and the channeling of credit resources to the economy. Finally, regarding uncertainties for the prospective disinflationary process, Copom discussed, on a global perspective, the response functions of monetary policy in

[1] Unless explicitly stated otherwise, this update considers changes since the January Copom meeting (260th meeting).
[2] Corresponds to the rounded value of the average USD/BRL exchange rate observed over 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.

major economies, the role of relative prices between goods and services, the relationship between the labor market and inflation, the interaction between monetary and fiscal policy and, lastly, the global financial cycle and risk aversion The Committee 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.

8. Regarding the domestic economic activity, Copom firstly debated the release of GDP for 2023Q4, especially emphasizing the growth composition of demand components. A reduction in the growth impetus of household consumption compared with the previous quarters and to auxiliary monthly surveys was noticed. When assessing consumption over the recent years, the prevailing view was, even so, that consumption was sustained by the labor market dynamics, both at the employment and wages level, the increased social benefits, the slow deleveraging of households and, lastly, the disinflationary process that favors the expansion of real disposable income.

9. For the prospective scenario, due to the factors mentioned above, as well as to the increase of the minimum wage, the reduction of the impact of the monetary tightening over time, fiscal transfers, and the recovering stage of the credit cycle, the assessment that consumption will continue resilient persists. Furthermore, Copom mentioned that some high frequency indicators would allow a reading that corroborates this argument, including some surprise in the more recent releases of services and trade surveys, raising the growth projection for the quarter. The Committee also discussed the reasons for the drop in investment momentum over 2023, highlighting increased uncertainty and restrictive financial conditions. The Committee noticed that the increased appetite for credit granting as well as lower interest rates and the easing of financial conditions suggest a more favorable scenario for investment over 2024, as already observed in 2023Q4. In short, released activity data reinforce the perception of a scenario characterized by economic activity resilience, although no substantial change was observed in the growth prospect.

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. The Committee discussed thoroughly the labor market and assessed that the current wage increases may be linked to some extent to pressures in the labor market. Some members recalled that, over the latest meetings, the Committee has emphasized data relative to earnings, as there remains a wide debate about the tightness of the labor market in view of methodological issues regarding employment surveys, the pandemic impacts, and the labor reform. Some members perceived that the productivity recovery in 2023 mostly occurred in agriculture and livestock, while pressures on earnings were widespread, suggesting that pressured earnings should not be mainly explained by productivity gains, but by the narrowing of the output gap. In its analysis, the Committee was therefore more concerned about the possible effects of increased real gains in the more recent period and the growth acceleration seen in overall income data on the prospective dynamics of services inflation. The Committee continued its discussion on the relationship between the labor market and prices in the economy. It highlighted the reciprocal causality between prices and the income dynamics, their respective lags, and the elasticities of impact of one on the other. Moreover, Copom stressed that it will continue incorporating labor market data into the analysis with no mechanical or definitive view about any impacts or relationships whatsoever. Copom will continue to pay attention to the dynamics of income stemming from various surveys to better evaluate the degree of slack in the labor market and its potential impacts on the services inflation.

12. Despite the restrictive monetary conditions, Copom emphasized that the cycle of

monetary easing is already being transmitted to the credit market. There are signs of increased credit granting and reduction in current interest rates on new operations, also helped by an incipient growing appetite of financial institutions to offer credit. Since the previous meeting, the capital market has also shown greater dynamics.

13. 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.

14. Copom judged that the disinflationary dynamics did not diverge significantly from what was expected but evaluates that the inflation scenario seems more uncertain. On the one hand, short-term food projections have somewhat slowed down, reverting the recent increases, while industrial prices continue on a benign trajectory. On the other hand, the recurrence of inflationary surprises on services inflation, particularly on the underlying components and labor-intensive items, raises doubts about the speed of the prospective disinflation. Copom evaluates that a relevant part of the services disinflation was due to the spillover from disinflations in food and industrial goods and the intensification of the disinflationary process, now in its second stage, will be greatly associated with the labor market and aggregate demand scenario. The prospective evolution of the output gap and the behavior of the labor market were again considered very relevant in determining the speed with which inflation will reach the target. A tighter labor market, with wage adjustments above the inflation target and without corresponding productivity gains, could potentially slow down inflation convergence, impacting notably services inflation and more labor-intensive sectors. Conversely, a favorable recovery of relative prices, a benign commodity dynamics or lower services inflation could potentially contribute to a faster disinflationary process. In its conclusion, the Committee considers that the prospective inflation scenario has not changed substantially but is more uncertain. In the end, it was unanimously concluded that a contractionary and cautious monetary policy was needed to reinforce the disinflationary dynamics.

15. Inflation expectations remain unanchored and are a cause for concern. Copom mentioned that a scenario of expectations above the target for a prolonged period requires a closer monitoring to ensure, even in this scenario, the achievement of the inflation target. 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.

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; 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. The Committee judges that the domestic and international environments are more uncertain, requiring caution on the conduct of monetary policy.

C) Discussion of the conduct of monetary policy

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

18. The baseline scenario for inflation and economic activity did not differ substantially from what was projected. Activity is resilient and labor market, dynamic. Both income and credit have behaved in such a way as to mitigate the slowdown in activity in the recent period, supporting the view that the scenario continues to be of gradual

deceleration. In the labor market, the emphasis was on the acceleration of earnings and the overall income, reinforcing the diagnosis of a dynamic labor market. Given the difficulty of reaching a firm conclusion on the time lags between the labor market and economic activity, the Committee will continue to monitor data thoroughly. Regarding inflation, as expected in the second stage of disinflation, the speed of disinflation is slowing down, requiring serenity and moderation in the conduct of monetary policy.

19. The Committee believes that there is greater uncertainty in the domestic and international contexts. Internationally, the disinflationary scenario is more uncertain, due to the context of resilient activity in the U.S. and its impact on global financial conditions. In addition, the impact of monetary policy on activity and inflation also creates uncertainty about the speed of disinflation in several countries. Regarding domestic inflationary dynamics, while on the one hand we see benign behavior in food and industrial goods, on the other hand, due to resilient activity and the latest releases, there are doubts about the speed of disinflation in services. The Committee noted that a slower disinflationary process, both domestically and globally, does not constitute the baseline scenario but has been incorporated as a source of uncertainty. This increased uncertainty 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.

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

21. The Committee then started debating the future signaling of the conduct of monetary policy. It gave a positive assessment of the use of a conditional signal for subsequent meetings over the last few meetings, reinforcing that it has fulfilled its role of coordinating expectations, increasing the power of monetary policy, and reducing volatility. It was noted that, so far, the benefits of signaling with an extended horizon have outweighed the costs in both the *ex-ante* and *ex-post* assessment.

22. The debate then turned to communication in a scenario where greater flexibility is required to conduct the appropriate monetary policy to achieve the inflation target. Copom assessed the convenience of some indication for the June decision, for which it had not yet made any announcement. The baseline scenario had not changed substantially but given its uncertainties, it was deemed appropriate to have greater monetary policy flexibility. Even though the communication already contained a built-in conditionality, Copom felt that it did not provide the required flexibility. In addition, it was argued that a late withdrawal, possibly seen as an unfulfilled promise, should be avoided because it could have an impact on the future credibility of the communication and cause excessive volatility. After all the arguments, the Committee unanimously concluded that the more uncertain scenario reduced the benefit of future signaling and increased its costs. This assessment led the Committee to communicate that it anticipated a reduction of the same magnitude at the next meeting, stressing that the change in communication was due to a change in uncertainty and not in the baseline scenario. This change only reflects a cost-benefit analysis of the use of this additional monetary policy instrument. Finally, it was emphasized that it would be a mistake to interpret the change in the future signaling as an indication of a change in the monetary policy cycle compatible with the baseline scenario.

23. The Committee believes that information provided by updating the analyzed data sets will be particularly important in defining the terminal interest rate and its respective path. Some members also argued that if prospective uncertainty remains high in the future, a slower pace of monetary easing may prove appropriate, for whatever terminal rate is desired. The Committee unanimously maintained its view that the interest rate and its respective path will be those necessary to bring inflation back

to its target in the relevant monetary policy horizon.

24. Finally, the Committee discussed the extension of the monetary policy adjustments cycle. The Committee perceives 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, particularly 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 points, to 10.75% 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, to a larger degree, 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. The committee judges that the baseline scenario has not changed substantially. Due to heightened uncertainty and the need for more flexibility in the conduct of monetary policy, the Committee members unanimously decided to communicate that, if the scenario evolves as expected, they anticipate a reduction of the same magnitude in the next meeting. The Committee judges that this monetary policy stance is appropriate to keep the necessary contractionary monetary policy for the disinflationary process.

28. 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.

29. The following members of the Committee voted for a reduction of 0.50 percentage points: Roberto de Oliveira Campos Neto (Governor), Ailton de Aquino Santos, Carolina de Assis Barros, Diogo Abry Guillen, Gabriel Muricca Galípolo, Otávio Ribeiro Damaso, Paulo Picchetti, Renato Dias de Brito Gomes, and Rodrigo Alves Teixeira.