262nd

Minutes of the Meeting of the

Monetary Policy Committee — Copom

May 7-8, 2024

BANCO CENTRAL DO BRASIL

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Date: May 7-8, 2024

Place: BCB Headquarters' meeting rooms on the 8th floor (5/7 and 5/8 on the morning) and 20th floor (5/8 on the afternoon) – Brasilia – DF – Brazil

Starting and ending times: May 7: 10:19 am – 12:03 pm; 2:08 pm – 5:49 pm
May 8: 10:08 am – 11:21 am; 2:34 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
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 5/7 and on the morning of 5/8):

André Minella – *Research Department* (also present on the afternoon of 5/8)
André de Oliveira Amante – *Open Market Operations Department*
Luís Guilherme Siciliano Pontes – *International Reserves 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 5/7 and on the morning of 5/8):

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 Office of the Economic Advisor*
Daniela Torres de Mesquita de Souza Vale – *Head of the Governor's Office*
Edson Broxado de França Teixeira – *Head of Office of the Deputy Governor for Supervision (attending on 5/7)*
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 (attending on 5/7)*
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*
Leonardo Martins Nogueira – *Executive Secretary*
Olavo Lins Romano Pereira – *Deputy Head of the Department of International Affairs*
Ricardo da Costa Martinelli – *Senior Advisor **of the International Reserves Department***)
Simone Miranda Burello – *Advisor in the Office of the Deputy Governor for Monetary Policy*
William Tales Leiria Campo – *Deputy Head of the Department of Economics*

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 has become more adverse because of the heightened and persistent uncertainty about the beginning of the easing cycle in the United States and the speed of sustained disinflation 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 scenario, the set of indicators on economic activity and labor market has exhibited more strength than expected by Copom.

4. Headline consumer inflation remains in a path of disinflation, while various measures of underlying inflation are above the inflation target in recent releases. Inflation expectations for 2024 and 2025 collected by the Focus survey are around 3.7% and 3.6%, 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 5.15[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 of years 2024 and 2025. In this scenario, Copom's inflation projections stand at 3.8% for 2024, and 3.3% for 2025. Inflation projections for administered prices are 4.8% for 2024, and 4.0% for 2025.

6. The Committee assesses that the external scenario has become more adverse and that the uncertainty regarding the U.S. interest rate cutting cycle and the disinflation process in the main economies persists. In this scenario of heightened prospective uncertainty, the need for greater caution in the conduct of domestic monetary policy is reinforced. Regarding the sources of disinflation, the Committee focused to a greater extent on the role of monetary policy in the U.S. The Committee noted that the current stage of disinflation is more challenging and requires caution in the conduct of monetary policy. It was observed that market expectations regarding the monetary easing process have shown significant fluctuations, suggesting a broader scenario regarding the next steps in the conduct of the U.S. monetary policy. Beyond the broader scenario, there has also been a repricing of the cutting cycle in the U.S., with reduction in its extension and a postponement of its beginning. Copom reinforced 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 to the domestic inflationary dynamics. Regarding the speed of disinflation, the Committee discussed the role of the U.S. fiscal policy, which tends to reduce the effects of the ongoing monetary tightening, and the impact on final prices of the wage pressures resulting from the current labor market dynamics. It was also emphasized that a scenario of increased global uncertainty suggests greater caution in the conduct of domestic monetary policy, due to the possible occurrence of more abrupt movements in the prospective scenario.

7. Over the last few quarters, economic activity data have surprised with higher growth rates in different components of demand. It was highlighted the resilience of domestic

[1] Unless explicitly stated otherwise, this update considers changes since the March Copom meeting (261st meeting).

[2] Corresponds to the rounded value of the average 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.

activity and the sustainability of consumption over time, in contrast to the scenario of gradual deceleration originally anticipated by the Committee. Regarding data at the margin, it was debated whether the upward revisions, partly explained by methodological issues related to seasonal adjustments, really reflected stronger activity. The conclusion was that, despite these mitigating factors, activity has in fact been stronger over the year.

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. The Committee has followed closely the recent developments on the fiscal side and their impacts on monetary policy. The Committee stresses that a credible fiscal policy, committed to debt sustainability, contributes to the anchoring of inflation expectations and to the reduction in the risk premia of financial assets, therefore impacting monetary policy. Although the projections for the primary balance and the debt trajectory have not changed significantly, there has been an increase in the risk premium and a perception of worsened fiscal situation over the period, according to the respondents to the Pre-Copom Questionnaire. The Committee then discussed possible reasons for the recent deanchoring of inflation expectations, listing the main factors as follows: (i) the deterioration of the external scenario; (ii) recent fiscal policy announcements; and (iii) the perception of economic agents regarding the monetary authority's commitment to achieving the target over the years. More importantly, the Committee unanimously believes that the reanchoring of inflation expectations should be pursued, regardless of the sources of the currently observed deanchoring. Reanchoring inflation expectations is seen as an essential element to ensure the inflation convergence to the target. The Committee believes that reducing expectations requires a firm action by the monetary authority, as well as continuous strengthening of the credibility and reputation of both the institutions and the fiscal and monetary frameworks that make up the Brazilian economic policy. The Committee will not shy away from its commitment of reaching the inflation target and understands the fundamental role of expectations in the inflation dynamics.

10. Copom reinforces that there are recurring surprises pointing to high dynamism in the labor market, which manifests itself in multiple dimensions. Firstly, expectations for the unemployment rate collected by the Focus Survey, both in the short and medium term, have been falling over the last few quarters. Moreover, formal jobs creation remains at strong levels and there is still a high proportion of voluntary layoffs. In addition, the participation rate, and other alternative measures – broken down by sector, demography, or region – corroborate a tight labor market scenario. The debate therefore focused on the possible transmission of the tightness in the labor market to wages and prices. The dynamics of employment and wages were highlighted, recalling the fundamental role of the labor market in determining the output gap and the prospective path of inflation. Labor-intensive services inflation, which has been persistently above the level compatible with meeting the target, was pointed out as preliminary evidence. On the other hand, it was mentioned that there is no conclusive evidence yet about the labor market impact on inflation. Finally, the combination of stronger activity and labor market has led to reassessments of the output gap level.

11. Despite restrictive monetary conditions, Copom emphasized that the cycle of monetary easing is already being transmitted to the credit market, in line with what was expected. Some members emphasized, however, that the recent increase of longer-term rates could result in lower credit market dynamics. These members highlighted the importance of longer vertices in the yield curve in the determination of credit supply and demand.

12. Copom evaluated that data relative to current inflation are benign, both in terms of

the headline index and inflation core measures. After a sequence of upward surprises, inflation core measures slowed down, although remaining above the target. Some members showed greater concern with food inflation in the short term, while others continued stressing the role of services inflation. The tragedy in Rio Grande do Sul, in addition to its humanitarian impacts, will also affect the economy. Copom will continue to monitor the situation.

13. Copom concluded by assessing that the inflation outlook has become more challenging, with the increase of medium-term inflation projections, even conditioned to a higher interest rate. Benign surprises were noted in the recent period, but also rising projections for shorter periods, involving market and administered prices. In the end, it was unanimously concluded that a more contractionary and more cautious monetary policy was needed to reinforce the disinflationary dynamics.

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. The Committee judges that the domestic and international environments should remain more uncertain, requiring greater caution on the conduct of monetary policy. Some members noted merit in the debate about an asymmetrical balance of risks tilted to the upside. These members deemed that, besides the persistent and high uncertainty of domestic and international outlooks, the weight of upside factors, at this moment, is higher than that from downside factors, therefore judging that the balance of risks is asymmetric. For those members, the resilience of activity and the strength of the labor market suggest lower elasticity of the output gap to the monetary policy, which could lead to an even slower disinflation process.

C) Discussion of 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 the prospective inflation.

16. The debate began with the analysis of the objective dimensions that guide the decisions in the inflation-targeting regime. Firstly, despite an upward interest trajectory collected by the Focus survey, used in the reference scenario, projected inflation increased for the relevant monetary policy horizon. Similarly, inflation expectations for the same horizon, which were unanchored at a stable level over the last quarters, have increased since the previous meeting. Also, the labor market and activity scenarios have shown dynamism greater than expected by Copom. Finally, the external scenario was deemed more adverse, requiring greater caution in the conduct of monetary policy.

17. After the scenario analysis, most Copom members assessed that it was appropriate to reduce the Selic rate by 0.25 percentage points. For this, they evaluated that the expected scenario has not materialized due to the additional deanchoring of expectations, increased inflation projections, the more adverse external scenario, and greater-than-expected economic activity dynamics. For those members, the forward guidance indicated in the previous meeting had always been conditional and there has been a change in the scenario compared with what was expected. They stressed that much more important than the possible reputational cost of not following some guidance, even if conditional, is the risk of loss of credibility about the commitment to fighting inflation and anchoring expectations. In view of the analysis, these members considered that a reduction of 0.25 percentage points was more appropriate to achieve the inflation target in the relevant horizon.

18. The members who voted for a reduction of 0.50 percentage points in the Selic rate also shared the perception of increased internal and external uncertainties between the meetings of March and May, which have already been discussed here. They also share the firm commitment to the fundamental goal of achieving the target and reanchoring expectations. The debate proposed by these members focused on the opportunity cost of not following the guidance vis-a-vis the change in the scenario in the period. As in the debates that occurred in other meetings, such members discussed whether the prospective scenario diverged significantly from what was expected to the point of being worth the reputational cost of not following the guidance, which could lead to a reduction in the power of the Committee's formal communications. For these members, it was deemed appropriate, as in previous meetings, to follow the guidance, but reaffirming the firm commitment to the target and the required terminal interest rate to achieve the Committee’s primary objective of inflation convergence to the target. They emphasized that extracting the underlying trend from the inflation dynamics in an uncertain environment is difficult, but it should by no means be confused with leniency towards the indicators released in the period, particularly inflation expectations. Strengthening the analysis, they noted that inflation projections were more affected by the determination of the terminal interest rate and that the reduction of 0.50 percentage points would keep monetary policy sufficiently contractionary. Finally, this group also emphasized the need for flexibility in the decisions as of June, which would allow, in view of the new set of information, to adequately calibrate the path of the monetary policy instrument.

19. All members agreed that the adoption of a tighter and more cautious monetary policy and with no indications about future movements was more appropriate in view of the uncertain global scenario and the domestic scenario marked by activity resilience and unanchored expectations. The Committee also stressed that monetary policy must remain contractionary and that the terminal interest rate will be the one that consolidates not only the disinflation process but also the anchoring of inflation expectations around the targets. Finally, all members corroborated the understanding that the extension and adequacy of future interest rate changes will be determined by the firm commitment of achieving the convergence of inflation to the target.

D) Monetary policy decision

20. 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 0.25 percentage points, to 10.50% 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 2025. Without compromising its fundamental objective of ensuring price stability, this decision also implies smoothing economic fluctuations and fostering full employment.

21. The current context, characterized by a stage in which the disinflationary process tends to be slower, deanchored inflation expectations, and a challenging global outlook, requires serenity and moderation in the conduct of monetary policy.

22. The Committee unanimously judges that the uncertain global scenario and the domestic scenario, marked by resilient economic activity and deanchored expectations, require greater caution. The Committee also stresses that monetary policy should continue being contractionary until the consolidation of both the disinflation process and the anchoring of expectations around the targets. The Committee also reinforces, with special emphasis, that the extension and adequacy of future changes in the interest rate will be determined by the firm commitment of reaching the inflation target in the relevant horizon.

23. The following members of the Committee voted for a reduction of 0.25 percentage points: Roberto de Oliveira Campos Neto (Governor), Carolina de Assis Barros, Diogo

Abry Guillen, Otávio Ribeiro Damaso, and Renato Dias de Brito Gomes. The following members voted for a reduction of 0.50 percentage points: Ailton de Aquino Santos, Gabriel Muricca Galípolo, Paulo Picchetti, and Rodrigo Alves Teixeira.