267th

Minutes of the Meeting of the

Monetary Policy Committee — Copom

December 10-11, 2024

BANCO CENTRAL
DO BRASIL

Date: December 10-11, 2024

Place: BCB Headquarters' meeting rooms on the 8th floor (12/10 and 12/11 on the morning) and 20th floor (12/11 on the afternoon) – Brasilia – DF – Brazil

Starting and ending times: December 10: 10:09 AM – 11:50 AM; 2:55 PM – 6:15 PM
December 11: 10:12 AM – 11:17 AM; 2:37 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
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 12/10 and on the morning of 12/11):

Alan da Silva Andrade Mendes – *Department of Foreign Reserves*
André Minella – *Research Department* (also attending on the afternoon of 12/11)
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 (attending on 12/10)*

Other participants (attending on 12/10 and on the morning of 12/11):

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*
Cristiano de Oliveira Lopes Cozer – *General Counsel*
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*
Gustavo Andrade Barbosa de Souza – *Deputy Head of the Open Market Operations Dep.*
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* (attending on 12/10)
Mariane Santiago de Souza Nogueira – *Head of the Governor's Office*
Olavo Lins Romano Pereira – *Deputy Head of the Department of International Affairs*
Paulo Marcelo Cavalcanti Muniz – *Head of the Prudential and Foreign Exchange Regulation Department*
Renato Kiyotaka Uema – *Deputy Head of the Financial System Regulation Department*
Ricardo Eyer Harris – *Head of Office of the Deputy Governor for Regulation*
Saulo Benchimol Bastos – *Coordinator at the Department of Banking Operations and Payments System*
Simone Miranda Burello – *Advisor in the Office of the Deputy Governor for Monetary Policy*

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 set by the National Monetary Council.

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

1. The global environment remains challenging, due mainly to the economic outlook in the United States, which poses questions about the pace of economic deceleration, disinflation and, consequently, about the Fed's monetary policy stance.

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 external environment continues to require caution from emerging market economies.

3. Regarding the domestic scenario, the set of indicators on economic activity and labor market continues to exhibit strength, as observed in the recent release of GDP, which suggests a further widening of the output gap.

4. Headline inflation and measures of underlying inflation are above the inflation target and have increased in recent releases. Inflation expectations for 2024 and 2025 collected by the Focus survey increased significantly and hover around 4.8% and 4.6%, respectively.

B) Scenarios and risk analysis

5. The inflation outlook has turned more challenging in several dimensions. The Committee initially analyzed economic activity, aggregate demand, inflation expectations, current inflation, and the international scenario. Copom then discussed inflation projections and expectations before deliberating on the current decision and future communication.

6. Looking at the current economic activity period, a scenario of resilient activity persists with greater-than-expected dynamism, as shown in the third quarter GDP release, leading to a new reassessment of a more positive gap. The labor market also continues to heat up, with an increase in the employed population, a drop in the unemployment rate, and increased jobs formalization. Nevertheless, there has been some moderation in the pace of wage growth in different surveys, despite remaining at a high level. The combination of a robust labor market, expansionary fiscal policy, and vigorous broad credit granting continue to support consumption and, consequently, aggregate demand. In particular, the pace of growth in household consumption and gross fixed capital formation indicates that domestic demand is growing at a fairly strong pace, despite the tightening monetary policy. The Committee discussed the reasons for this dichotomy. It has been noted that there are mitigating elements concurrent with the impact of monetary policy on activity, such as stronger-than-anticipated credit and fiscal stimuli. Maintaining unobstructed the monetary policy channels, with no elements mitigating their action, contributes to a more effective and efficient conduct.

7. However, regarding prospective activity, there are elements that suggest a slowdown, such as the tightened financial conditions. In any case, the Committee points out that the economy has been surprisingly resilient. The Committee will monitor this process, understanding that the reduction in the output gap forecast in its projections is inherent to the orderly functioning of the transmission mechanisms and the achievement of the inflation target. In addition to the uncertainty about the deceleration process, the question of whether the expected slowdown is due to a restriction in production factors or a drop in demand is still under debate, with highly different impacts on the inflationary process.

8. Along with activity, the credit and, mainly, capital markets have also surprised throughout the year, with volume growth above what was expected, despite high interest rates. It should be noted that, despite the resilience of activity, an environment

[1] Unless explicitly stated otherwise, this update considers changes since the November Copom meeting (266th meeting).

of high interest rates, with high levels of delinquency and income commitment, requires additional caution and diligence when granting credit.

9. Financial conditions and the exchange rate have undergone a sharp change recently. The combination of a more depreciated exchange rate with the rise in the nominal and real interest rate curves makes the environment more complex. It was recalled that the pass-through of the exchange rate to prices increases when demand is stronger, expectations are deanchored, or the exchange rate path is considered more persistent. The Committee should therefore monitor more closely how the exchange rate and financial conditions are transmitted to prices and activity.

10. Regarding the economic policy more broadly, the Committee remained firmly convinced that policies must be predictable, credible, and counter-cyclical. In particular, slowdowns are an essential part of the process of smoothing and rebalancing the economy. The Committee's debate once again highlighted the need for harmonious fiscal and monetary policies.

11. The perception of agents about the recent fiscal announcement has significantly impacted asset prices and expectations, especially the risk premium, inflation expectations, and the exchange rate. In fact, inflation expectations, measured by different instruments and obtained from different groups of agents, rose in all time horizons, indicating further deanchoring. It is notable that both the inflation premium embedded on financial instruments and inflation expectations rose in the period, making the inflation scenario more adverse and requiring a more contractionary monetary policy. Deanchoring inflation expectations is a factor of discomfort shared by all Committee members and must be tamed.

12. Short-term inflation scenario has deteriorated. Food prices have risen significantly, due to, among other factors, the drought observed throughout the year and the rise in beef prices, also affected by the cattle cycle. This increase tends to spread over the medium-term given the presence of important inertial mechanisms in the Brazilian economy. Regarding industrialized goods, the recent exchange rate movement has pressured prices and margins, suggesting a greater increase in these components in the coming months. Finally, services inflation, which has greater inertia, remains above the level required to meet the inflation target in a context of dynamic activity and has increased in the most recent readings. In fact, there has been not only an interruption in the disinflationary process, but also a greater inflationary pressure in the latest readings. Copom emphasized that the inflationary drivers have intensified since the previous meeting, such as the more positive output gap, the even more dynamic labor market, the additional exchange rate depreciation, higher current inflation, and more deanchored inflation expectations, making the convergence of inflation to the target more challenging.

13. The external environment remains challenging, with significant economic and geopolitical uncertainties. Regarding the U.S., uncertainty persists about the pace of disinflation and of the economic activity slowdown. At the same time, the possibility of changes in the conduct of economic policy also brings additional uncertainty to the scenario, particularly with possible fiscal stimuli, restrictions on labor supply, and the introduction of import tariffs. The Committee’s reference scenario continues to be for a gradual and orderly slowdown of the U.S. economy. The Committee reinforced that the central banks' commitment to achieving their targets is a fundamental ingredient in the disinflationary process, corroborated by recent indications of cautious monetary easing cycles in several countries. As usual, the Committee will focus on the transmission mechanisms from the external environment to the domestic inflation dynamics and their impact on the outlook. Copom also emphasized that a context of greater global uncertainty and more abrupt exchange rate movements requires greater caution in the conduct of domestic monetary policy.

14. The Committee discussed the estimates of the neutral interest rate that would be

used as an assumption for the projections. The neutral rate is an unobservable variable, subject to great uncertainty in its estimation. Due to the intrinsic uncertainty and the very nature of the variable, the Committee reinforced that the neutral rate is not a variable that should be updated very frequently, nor should it have abrupt movements, except in exceptional cases. In this context, the Committee raised the neutral real interest rate in its models from 4.75% to 5.00% p.a. and will continue to evaluate this assumption.

15. Copom has assessed that the shorter-term determinants, such as the exchange rate and current inflation, as well as the medium-term determinants, such as the output gap and inflation expectations have deteriorated. Copom then looked into the projections. In the reference scenario, the interest rate path is extracted from the Focus survey, and the exchange rate starts at USD/BRL 5.95[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 tariff flag is assumed to be "green" in December of years 2024 and 2025.

16. In the reference scenario, the four-quarter inflation projection for the second quarter of 2026 is 4.0% (Table 1). Inflation projections for the calendar years 2024 and 2025 are 4.9% and 4.5%, respectively.

17. Copom reinforced its view that the slowdown in structural reform efforts and fiscal discipline, the increase in earmarked credit, and uncertainties over the public debt stabilization have the potential to raise the economy's neutral interest rate, with deleterious impacts on the power of monetary policy and, consequently, on the cost of disinflation in terms of activity.

18. Due to the materialization of risks, the Committee judges that the scenario is less uncertain and more adverse than in the previous meeting. Upside inflation risks, such as the resilience of services inflation, the deanchoring of expectations, and exchange rate depreciation, have materialized. As a result, a scenario that until then had been quite uncertain has become more adverse.

19. However, the risks to its inflation scenarios remain tilted to the upside. Among the upside risks for the inflation outlook and inflation expectations, it should be emphasized (i) a more prolonged period of deanchoring of inflation expectations; (ii) a stronger-than-expected resilience of services inflation due to a more positive output gap; and (iii) a conjunction of internal and external economic policies with an inflationary impact, for example, through a persistently more depreciated currency. 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 monetary policy tightening.

C) Discussion of the conduct of monetary policy

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

21. The Committee assessed that a further deterioration in the inflation scenario has occurred, as reflected in inflation expectations and projections. It concluded that the shorter-term determinants – such as the exchange rate and current inflation – and the medium-term determinants – such as the output gap and inflation expectations – have deteriorated significantly. This worsening calls for an even more contractionary monetary policy.

[2] It 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.

22. The Committee then unanimously decided to increase the Selic rate by 1.00 p.p. and to announce that, if the expected scenario confirms, it anticipates an adjustment of the same magnitude at the next two meetings. In the discussion that led to this decision, two dimensions were discussed at length. Firstly, the magnitude of the short- and medium-term deterioration in the inflation scenario required a more timely policy action to maintain the firm commitment to converging inflation to the target. Secondly, several risks have materialized, making the scenario more adverse but less uncertain, allowing the Committee to have greater visibility and then to provide an indication of how it anticipated the next decisions.

23. The total magnitude of the tightening cycle will be determined by the firm commitment of reaching the inflation target and will depend on the inflation dynamics, especially the components that are more sensitive to economic activity and monetary policy, on the inflation projections, on the inflation expectations, on the output gap, and on the balance of risks.

D) Monetary policy decision

24. The current scenario is marked by additional deanchoring of inflation expectations, an increase of inflation projections, a stronger-than-expected economic activity, and further widening of the output gap, which requires an even more contractionary monetary policy.

25. Copom therefore decided to increase the Selic rate by 1.00 p.p. 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. Without compromising its fundamental objective of ensuring price stability, this decision also implies smoothing economic fluctuations and fostering full employment.

26. In light of a more adverse scenario for inflation convergence, the Committee anticipates further adjustments of the same magnitude in the next two meetings, if the scenario evolves as expected. The total magnitude of the tightening cycle will be determined by the firm commitment of reaching the inflation target and will depend on the inflation dynamics, especially the components that are more sensitive to economic activity and monetary policy, on the inflation projections, on the inflation expectations, on the output gap, and on the balance of risks.

27. The following members of the Committee voted for this decision: 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.

Table 1
Inflation projections in the reference scenario
Year-over-year IPCA change (%)

Price Index	2024	2025	2026Q2
IPCA	4.9	4.5	4.0
IPCA market prices	5.0	4.5	3.8
IPCA administered prices	4.6	4.5	4.6