

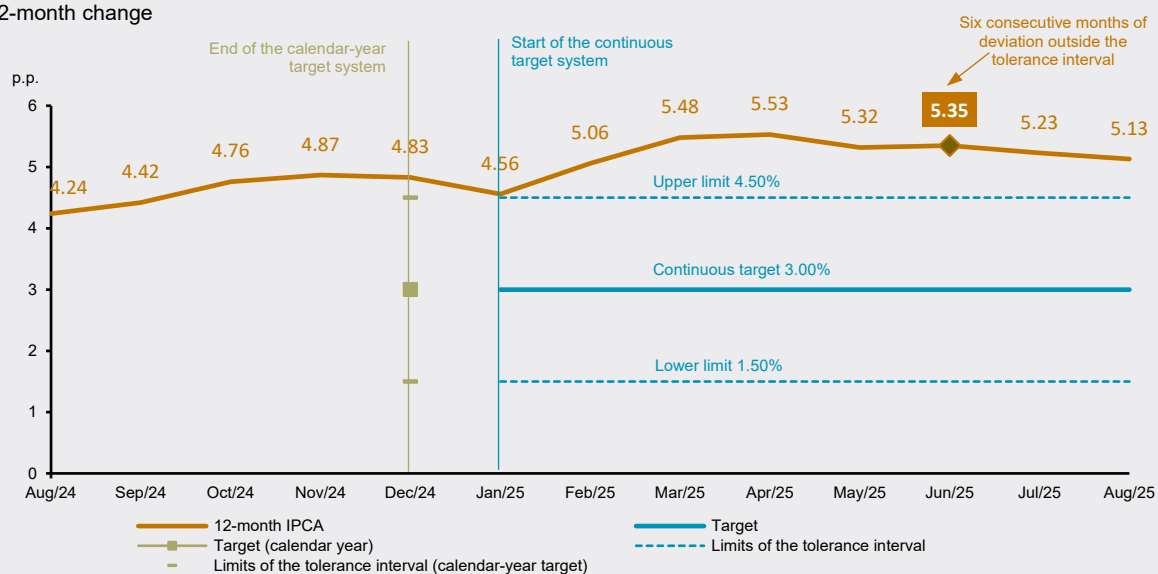
Note on the breach of the inflation target

The goal of this note is to monitor the evolution of the inflation outlook and the measures adopted by the Banco Central do Brasil (BCB) to ensure the convergence of inflation to the target. It consists of an additional instrument, pursuant to Decree 12,079 of 2024 establishing the continuous inflation-targeting framework, which increases transparency and accountability to society. The open letter and the note in the Monetary Policy Report shall be released when the inflation target is breached.

About the target breach

In June 2025, the 12-month inflation, measured by the Extended National Consumer Price Index (IPCA), reached 5.35% and exceeded the upper limit of the 4.5% tolerance interval for the inflation target. The current inflation target, set by the National Monetary Council (CMN) by means of Resolution 5,141 of June 26, 2024, is 3.00%, with a tolerance interval of plus or minus 1.50 percentage points (p.p.). The target is deemed breached when inflation remains outside its respective tolerance interval for six consecutive months.

Figure 1 – Recent dynamics of the IPCA
12-month change



Whenever the target is not met¹, the BCB shall disclose, by means of an open letter² addressed to the Minister of Finance and a note in the Monetary Policy Report, (i) a detailed description of the causes for the target breach, (ii) the measures needed to ensure the return of inflation to the established limits, and (iii) the expected time span for the measures to take effect.

1/ Article 6 of Decree 12,079 of June 26, 2024.

2/ The target breach was formalized by means of the open letter publicly disclosed on July 10, 2025. Available at <https://www.bcb.gov.br/controleinflacao/historicometas> (Portuguese only).

By the time the open letter was released, the BCB informed that it would produce a quarterly note in the Monetary Policy Report not only by the formalization of the target breach, pursuant to the decree, but throughout the period in which the breach lasts, thereby reinforcing accountability to society. The note shall detail (i) the evolution of the inflation outlook, (ii) the effects of the measures taken for bringing inflation back to the target tolerance interval; and (iii) the monitoring of the dynamics of the inflation convergence within the stipulated time span.

Dynamics of inflation convergence

Inflation measured by the IPCA remained above the upper limit of the tolerance interval for the 3% target and this behavior is expected to persist for the remainder of 2025. This evolution was indeed expected given the reference scenario projections released in Monetary Policy Reports. Economic activity surprised, with stronger-than-expected Gross Domestic Product (GDP) growth and a very heated labor market, reflecting increases in household consumption and investment. In addition, the output gap at a positive level also pressures consumer inflation. Inflation expectations deanchored, especially throughout the second half of 2024, and yet remain above the 3% inflation target, which makes the convergence scenario more challenging.

In turn, the exchange rate is a relevant factor due to the volatility observed in the period, directly impacting the prices of imported goods and inflation expectations. Moreover, the contribution of inflationary inertia is still relevant because higher past inflation implies cost pressures, stemming from more expensive inputs and informal wage indexation mechanisms.

In August, actual 12-month inflation reached 5.13%, still above the upper limit of the tolerance interval for the 3% target. In this metric, market and administered prices increased 5.45% and 4.22%, respectively, while the average of core inflation measures closed August at 5.12%. Inflationary pressures applied to several IPCA segments, reflecting the variety of inflationary factors. In particular, the following stands out:

Food-at-home: 12-month inflation of 7.01%, reflecting supply factors and exchange rate depreciation, combined with economic activity pressures and higher international prices of some agricultural commodities. In 2024, food-at-home inflation was 8.22%, particularly pressured by high meat prices;

Industrial goods: 12-month inflation reached 3.33% in August, a level considered high for this group. In 2024, inflation in this segment reached 2.89%. Recent readings show accommodation at the margin, with declines in prices of vehicles, clothing, personal hygiene, among others.

Services: after closing 2024 at 4.77%, services inflation has shown resilience at the margin, reaching a 12-month change of 6.16% in August. Adjustments in services prices continue widespread and pressured by inertial factors, tight labor market, and heated economic activity.

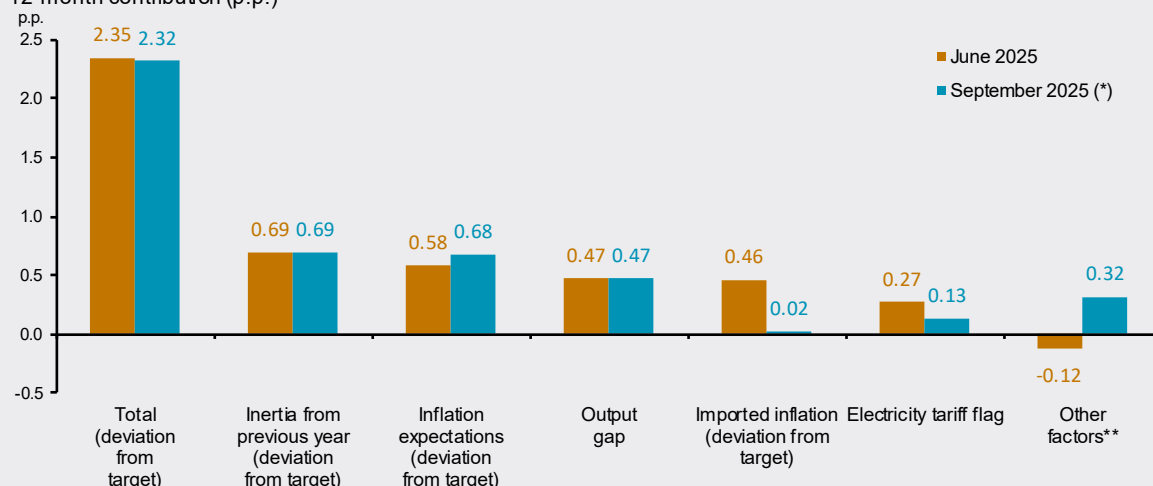
Administered prices: 12-month inflation reached 4.22% in August. In 2024, inflation in this group reached 4.66%. The recent dynamics have mainly reflected price changes in residential electricity, medicines, and gasoline.

For September, the projected inflation is 0.62% p.m., which corresponds to a projected 12-month change of 5.32% p.a. by the end of 2025Q3. Considering this projection, it is possible to update the breakdown of the IPCA deviation from the 3.0% target and compare it with the breakdown released in the July open letter. Using the breakdown of factors³ through small-scale semi-structural models, one can observe the factors that currently contribute to sustaining the projected deviation of 2.32 p.p. from the target in this quarter. Among the key factors are the inertia from the previous twelve months (contribution of 0.69 p.p.), high inflation expectations (0.68 p.p.), the positive output gap (0.47 p.p.), imported inflation (0.02 p.p.), the electricity tariff flag (0.13 p.p.), and other factors (0.32 p.p.).

3/ The breakdown is produced using the small-scale semi-structural model. For more methodological details see box [2017 inflation decomposition](#) in the March 2018 Inflation Report.

Figure 2 – Breakdown of the IPCA deviation from its target

12-month contribution (p.p.)



* Observed data until August and nowcast for September

** Contribution to the inflation as deviation from the target after excluding the following factors: inertia associated with the share of the previous year's inflation that deviated from target; expectations as a deviation from target; imported inflation as a deviation from target; and output gap.

Recent dynamics have shown readings still above the upper limit of the inflation target tolerance interval. Nonetheless, a gradual slowdown can be observed in some components but still influenced by the factors determining the breach, such as the positive output gap, deanchored inflation expectations, and inertia. Inflation projections for the next quarters indicate that the determining factors for the inflation deviation are expected to show some accommodation, in response to the transmission effects of the tight monetary policy, with a gradual slowdown in economic activity, more favorable exchange rate pass-through, and reanchoring of expectations.

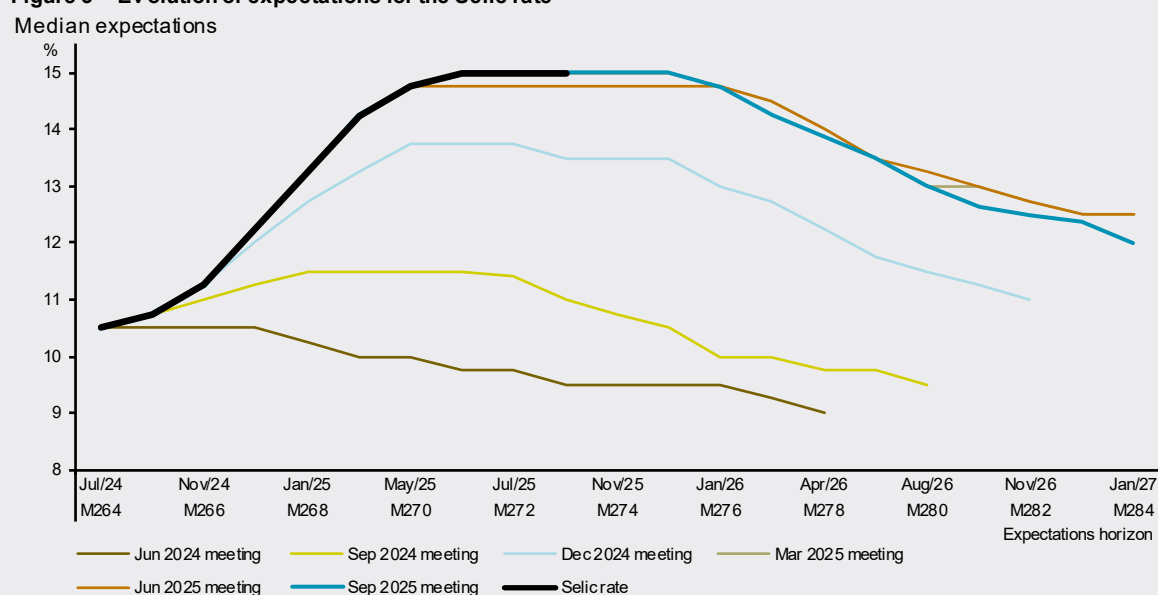
Measures taken and their effects on inflation

The BCB has implemented measures to mitigate inflationary risks and bring inflation back to the target. The Monetary Policy Committee (Copom) decisions have led the monetary policy to significantly contractionary levels, always considering the lagged effects of the interest rate on economic activity and the inflation convergence to the target in the relevant horizon.

Copom conducted a firm monetary tightening from September 2024 until the June 2025 meeting. It acknowledges a scenario with inflationary pressures, deterioration of expectations, and heated economic activity that justified a total adjustment of 4.5 p.p., rising the Selic rate to 15% p.a. In the July 2025 meeting, amid a scenario marked by heightened uncertainty requiring a cautious stance in the conduct of monetary policy, Copom interrupted the rate hiking cycle to examine its yet-to-be-seen cumulative impacts, and then evaluate whether the current interest rate level, assuming it stable for a very prolonged period, would be enough to ensure the convergence of inflation to the target.

In the September meeting, the Committee maintained the Selic rate at 15.00% p.a. and judged the decision consistent with the strategy for inflation convergence to a level around the 3.00% target throughout the relevant horizon for monetary policy. The Copom's current scenario remains marked by heightened uncertainty, with deanchored expectations, high inflation projections, resilience on economic activity, and labor market pressures. The Committee assessed that the scenario requires caution in the conduct of monetary policy and that ensuring the convergence of inflation to the target in an environment with deanchored expectations requires a significantly contractionary monetary policy for a very prolonged period.

Figure 3 – Evolution of expectations for the Selic rate



Evolution of prospective inflation scenarios

Copom evaluates several prospective scenarios that consider different trajectories for the Selic rate and market expectations for the interest rate. The prospective scenarios consider updated economic data, analysis of recent developments, and short- and medium-term projections, in addition to the Committee assessment of the current state and prospects for the economy.

In particular, Copom regularly releases the reference scenario as a monetary policy communication tool. This scenario assumes that the Selic rate will follow the median trajectory extracted from the Focus survey and that the exchange rate will follow the purchasing power parity (PPP). Updated projections for the reference scenario were presented in section 2.2 (see Table 2.2.1 in this MPR).

The BCB is committed to the continuous inflation target of 3.00% and its decisions aim to achieve this goal throughout the relevant monetary policy horizon. Bringing inflation back to the established tolerance interval is a natural step in the process of inflation convergence to the target. The open letter and the note are elements of communication pursuant to the law within the institutional framework for the conduct of monetary policy under the continuous inflation-targeting regime. The legislation defines objective criteria to formalize the breach of the inflation target and determines actions to be taken by the BCB for accountability to society in terms of bringing inflation back to the tolerance interval of the continuous target. This note complies with the law, while reinforcing that monetary policy decisions always seek the convergence of inflation to around the continuous target of 3.00%.

In its September 2025 meeting, Copom assessed that the conduct of monetary policy is appropriate and consistent with the strategy of converging inflation to the 3.00% target in the relevant horizon, which is currently 2027Q1. This assessment considers the expected inflation outlook and depends on the evolution of the components more sensitive to economic activity and to the contractionary monetary policy, inflation projections, inflation expectations, the output gap, and the balance of risks. In its decision, the Committee emphasized that it will remain vigilant, that future monetary policy steps can be adjusted, and that it will not hesitate to resume the rate hiking cycle if appropriate.