



# BANCO CENTRAL DO BRASIL

## Minutes of the 143<sup>rd</sup> Meeting of the Monetary Policy Committee (Copom)

### Summary

Recent Economic Developments  
Assessment of Inflation Trends  
Monetary Policy Decision  
Inflation  
Economic Activity  
Surveys and Expectations  
Labor Market  
Credit and Delinquency Rates  
External Environment  
Foreign Trade and International Reserves  
Money Market and Open Market Operations

**Date:** June 9<sup>th</sup>, from 4:40PM to 6:50PM, and June 10<sup>th</sup>, from 5:40PM to 7:50PM

**Place:** BCB Headquarters meeting rooms - 8<sup>th</sup> floor on June 9<sup>th</sup> and 20<sup>th</sup> floor on June 10<sup>th</sup> – Brasília – DF

### In attendance:

#### Members of the Committee

Henrique de Campos Meirelles – Governor  
Alexandre Antonio Tombini  
Alvir Alberto Hoffmann  
Anthero de Moraes Meirelles  
Antonio Gustavo Matos do Vale  
Maria Celina Berardinelli Arraes  
Mário Gomes Torós  
Mário Magalhães Carvalho Mesquita

#### Department Heads (present on June 9<sup>th</sup>)

Altamir Lopes – Economic Department  
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on June 10<sup>th</sup>)  
João Henrique de Paula Freitas Simão – Open Market Operations Department  
Jose Antonio Marciano - Department of Banking Operations and Payments System  
Márcio Barreira de Ayrosa Moreira – International Reserves Operations Department  
Renato Jansson Rosek – Investor Relations Group

#### Other participants (present on June 9<sup>th</sup>)

Alexandre Pundek Rocha – Advisor to the Board  
Eduardo José Araújo Lima – Deputy Head (to the Research Department)  
Fábio Araujo – Advisor to the Research Department  
Flávio Pinheiro de Melo – Advisor to the Board  
José de Ribamar Oliveira Júnior – Press Secretary

The members of the Monetary Policy Committee analyzed the recent performance of and the prospects for the Brazilian economy and for the international economy, under the monetary policy framework, which is designed to comply with the inflation targets established by the government.



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### Recent Economic Developments

1. IPCA inflation increased 0.47% in May, down from 0.48% in April. As a consequence, inflation accumulated in the first five months of 2009 reached 2.20%, decreasing 0.68 p.p. relative to the level registered in the same period of the previous year. In the last twelve months, inflation increased 5.20% in May, down from 5.53% in April (5.90% in December 2008 and 5.58% in May 2008). The deceleration of twelve-month consumer price trailing inflation in the first five months of the year mirrored the behavior of market prices, as regulated prices increased. Considering market prices, both prices of tradable goods and non-tradable goods cooled on a twelve-month trailing basis, reaching 4.96% and 6.31%, respectively, in May, down from 6.99% and 7.10% in December 2008 (7.09% and 7.70% in the same month of the previous year). According to the same comparison basis, the prices of services, whose dynamics tends to show more persistence than that of the prices of goods, increased from 6.39% in December to 7.23% in May (5.58 in May 2008). Preliminary data for June point to consumer inflation below that observed in May. In short, information available suggest that the inflationary cycle observed last year has been gradually overcome by a process that should continue to be led by the behavior of market prices, while regulated price inflation should show more persistence.

2. The three main underlying inflation measures calculated by the BCB increased in the last months. The core inflation by exclusion of household food items and regulated prices increased from 0.25% in March to 0.58% in April and 0.56% in May. Smoothed and non-smoothed trimmed means core inflation measures also raised, recording 0.35% and 0.21% in March, 0.35% and 0.27% in April and 0.44% and 0.39% in May, respectively. The twelve-month trailing inflation measures changed from 6.09%, 4.82% and 4.92% in December to 5.96%, 4.65% and 4.34% in May, for the core inflation by exclusion, smoothed and non-smoothed trimmed means core inflation, respectively, evidencing convergence for the midpoint of the target. Moreover, it bears emphasizing that the behavior of the IPCA diffusion index reduced from 61.7% in December to 58.9% in May (compared to 71.4% in May 2008).

3. The General Price Index (IGP-DI) inflation changed from -0.84% in March to 0.04% in April and 0.18 in May. On a twelve-month trailing basis, the IGP-DI inflation decreased from 5.86% in March to 4.74% in April and 2.99% in May, compared to 12.14% in May 2008. The slowdown of the IGP-DI has basically reflected the behavior of its main component, the Wholesale Price Index (IPA-DI), which decreased from 4.98% in March to 1.18% in May, according to the same comparison basis (15.36% in May 2008). On its turn, the Consumer Price Index-Brazil (IPC-Br) increased 5.55% up to May (5.59% in May 2008) and the Civil Construction National Index (INCC) increased 8.98% (8.06% in May 2008). Regarding the IPA-DI, the inflationary deceleration, under this comparison basis, derives basically from the behavior of both agricultural and industrial prices. The agricultural IPA reached -1.52% (33.65% in May 2008), while the elevation of wholesale industrial prices reached 2.24% (9.63% in May 2008). As mentioned in previous Copom Minutes, the Copom evaluates that the effects of wholesale prices over consumer price inflation will depend on current and prospective demand conditions and price-setters' expectations for the future inflation path.

4. The IBGE released information from Q1 2009 GDP. Data showed contraction in activity, under the criterion of cumulative change in the year (-1.8%, the same level recorded for the year-over-year comparison). From the aggregate demand side, expansion was led by public administration consumption, which increased 2.7% year-over-year. Gross fixed capital formation contracted 14.0%, and household consumption reached 1.3%, according to the same comparison basis, supported by real payroll. The contribution of domestic absorption to output growth was -1.9 p.p. in the first quarter of 2009, year-over-year, overweighing the 0.1% p.p. positive contribution of the external sector. From the aggregate supply side, still according to the year-over-year basis, the service sector performed positively, with a 1.7% growth, year-over-year, while all other sectors contracted. The GDP deflator measured by market prices, according to the same comparison basis, decreased from 7.4% in the fourth quarter of 2008 to 4.7% in the first quarter of 2009.

5. On a three-month moving average basis, according to data seasonally adjusted by the IBGE, industrial output increased 1.3% in April, after increasing by 1.6% in the previous month. Still considering the seasonally adjusted series, industrial output increased by 1.1% in April month-on-month, after expanding by 0.9% in March. On a year-over-year basis, industrial output retreated by 14.8% in April, with respective falls of 11.5% and 15.0% in mining and manufacturing industries. The analysis of the behavior of IBGE industrial output series and its components, at



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the margin, according to data available, suggests that production reached its lowest level in December-January, and was followed by gradual recovery. However, industrial activity recovery continues to be influenced by the international crisis, due to its effects both over exports and credit conditions, and over business and households' expectations.

6. Among the use categories, according to data seasonally adjusted by the IBGE, the production of capital goods increased by 2.6% in April, after decreasing 4.6% in March. Regarding the other use categories, intermediate goods production increased 1.1% in April and 0.4% in March; non-durable and semi-durable consumer goods production increased 0.3% in April and 0.8% in March, while the production of durable goods, strongly influenced by the automotive sector, increased by 2.7% in April, after increasing by 1.8% in March. The loss of dynamism in capital goods production reflects the persistence of the international financial turmoil and its consequences over business confidence. On its turn, the recovery, at the margin, in the dynamism of durable goods production reflects, predominantly, exemption tax measures and also some easing of credit conditions. The future trajectory of industrial production will depend on these factors, which counterbalance the deterioration of external demand and a remaining process of inventories adjustment.

7. Labor market has continued to record ambiguous indicators, combining positive aspects with signs of loss of strength. The unemployment rate in the six metropolitan regions covered by the Monthly Labor Survey (PME) changed from 9.0% in March to 8.9% in April (8.5% in April 2008). According to the seasonally adjusted series, the unemployment rate decreased 0.2 p.p., reaching 8.3%. Average real earnings increased by 3.2% in April, in year-over-year terms. Employment, on its turn, expanded by 0.2% in April and 0.9% in March, according to the same comparison basis. As a consequence, real payroll reached 5.9% in March and 3.4% in April, continuing to constitute a key driver for domestic demand growth. According to the National Industry Confederation (CNI) data seasonally adjusted by the BCB, manufacturing employment decreased by 3.7% in April, in year-over-year terms, and expanded by 1.7% on a twelve-month trailing basis. According to data seasonally adjusted by the IBGE, manufacturing employment increased by 0.3% in twelve months and fell 5.2% in year-over-year terms. Still regarding the labor market, data from the Ministry of Labor and Employment (MTE) indicate some recovery in the generation of formal employment, despite below the seasonal pattern. In April, 106,205 jobs were created (compared to the positive result of 34,818 in March). After five consecutive months of job losses, manufacturing industry showed stability in April. The commerce sector performed positively after four consecutive months of negative results: 5,647 jobs were created. On the other hand, the civil construction sector and the services sector continued hiring workers this month: 13,338 and 59,279 jobs, respectively.

8. According to data seasonally adjusted by the IBGE, expanded retail sales increased by 2.0% in March, after increasing 2.7% in February. On a year-over-year basis, the indicator increased by 6.5%, growing by 3.7% in the year. The three-month moving average of expanded retail sales increased 3.4% in March, according to seasonally adjusted data, after reaching 2.7% in February. On a month-on-month basis, according to seasonally adjusted data, it bears emphasizing the expansion in the sales of "vehicles, motorcycles, parts and pieces" (3.9%) and "construction inputs" (3.0%). The negative key drivers were "furniture and appliances" (-2.2%) and "hyper, supermarket and food articles" (0.0%). In the year, cumulative growth was more significant in "office material and equipment" (15.0%) and "books, newspapers, magazines and stationary" (12.3%). After consecutive falls in the last months of 2008, expanded retail sales data have evidenced recovery influenced mainly by the increase in the sales of vehicles since the beginning of the year, in response to the sector incentives granted by the government and to some improvement in the access to vehicle credit supply. For the next quarters, the retail sales trajectory will continue to be sustained by fiscal transfers, as well as by real payroll growth, whose evolution should be favored by the reduction of inflation, but it will also be affected by the recovery in the access to credit supply and by the behavior of consumer confidence.

9. The installed capacity utilization rate (Nuci) in the manufacturing industry reached 79.4% in April, above the level observed in March, according to CNI data seasonally adjusted by the BCB, and 1.22 p.p. above the minimum level recorded in January. The series seasonally adjusted by CNI showed an increase from 78.8% to 79.2% between March and April. Considering the monthly series without seasonal adjustment, in April the Nuci was 3.9 p.p. below the level registered in the same month of 2008. On its turn, the monthly Nuci without seasonal adjustment, calculated by Fundação Getúlio Vargas (FGV), increased in May to 78.7%, 6.9 p.p. below the level observed in the same month of 2008. The reduction in the Nuci according to the year-over-year comparison is also



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observed in the production of consumer goods (-3.4 p.p.), intermediate goods (-7.7 p.p.), capital goods (-14.7 p.p.) and construction inputs (-5.7 p.p.). The reduction on the Nuci calculated by CNI and FGV, according to the same comparison basis, seems to be a result of a combination between the maturity of investment projects and accommodation of economic activity, and points to significant increase in the idle capacity margin of the manufacturing industry. Regarding the absorption of capital goods, data indicate continuity of retraction year-over-year and expansion at the margin. The absorption of capital goods increased 5.1% in April, according to seasonally adjusted data, and decreased 23.3% in year-over-year terms, according to observed data. On its turn, the production of construction inputs has been showing relative stability since February, accumulating a 10.6% fall in the year. In short, evidences suggest that demand pressures over the productive capacity level of the manufacturing industry reduced, although the ones regarding the utilization rates have increased in the last months. As stressed in previous Copom Minutes, the inflation trajectory is closely linked to current and prospective developments related to the expansion of supply of goods and services to adequately meet demand conditions.

10. The twelve-month cumulative trade balance retreated at the margin. Under this comparison basis, the trade surplus reached US\$27.1 billion in April and decreased to US\$25.6 billion in May. This total resulted from US\$ 181.4 billion in exports and US\$155.7 billion in imports, equivalent to 5.1% and 10.6% growth, respectively, year-over-year. The adjustment in relative prices and the accommodation in the pace of expansion of domestic demand contribute to the recovery of the trade surplus, but the deterioration in the terms of trade acts on the opposite direction. The reduction in remittances of profits and dividends has contributed to limit the current account deficit, which reached US\$28.2 billion in December 2008, decreasing to US\$19.8 billion in April, equivalent to 1.4% of GDP. On its turn, foreign direct investment reached US\$41.1 billion in the twelve months through April, equivalent to 2.9% of GDP.

11. The period since the last Copom meeting was marked by the reduction of stress on international financial markets, which originated in the US and Europe, but whose impact over emerging economies had been significant. The unprecedented actions taken by the authorities in the US and Europe, using a wide range of instruments, in order to ensure minimum conditions of operation and liquidity in monetary markets, have moderated the perception of systemic risk. In this environment, there have been signs of reduction in risk aversion, but confidence recovery remains fragile and subject to reversals. The decrease in both the risk aversion and the scarcity of capital flows, as well as some concern about tax situation in US, continued to encourage the recovery of currencies, both from emerging and mature countries, against the US dollar.

12. Regarding the global macroeconomic scenario, contraction trends prevail over inflationary pressures. The currently predominant view points to the contraction of global economic activity in 2009, with recovery only in 2010. The consensual projections point to an intense retraction of activity in the US, Europe and Japan (G3), which wouldn't be totally offset by the economic dynamism of some emerging economies, especially in Asia. There are evidences that economic activity in G3 could be stabilizing, with some improvement in disposable income and in demand for durable goods in the US and recovery of confidence of businessmen in Europe and real exports in Japan. However, the problems in the international financial system have continued to be aggravated by a cyclical deterioration in the quality of credit, focused on the US and Europe, which tends to reinforce the contraction in the financial conditions and, as a consequence, the risk of new intensification in the deceleration. In mature economies, where inflation expectations are better anchored and economic activity has decelerated considerably and for a longer period, inflationary pressures have reduced rapidly. The disinflation process seems to have gained momentum also in the emerging economies, in spite of greater persistence of the inflationary dynamics. In this context, monetary policies stances have become highly expansionist and focused on non-traditional instruments in the mature economies, while the expansionist stance in the emerging economies has been more moderate. At the same time, the authorities in the US, Western Europe and Asia have been announcing a series of important initiatives aimed at sustaining economic activity through fiscal incentives, which could contribute to a gradual economic recovery. It's important to notice, however, that the estimates on the fiscal costs for macroeconomic stimulus and support packages to the financial sector have been increasing, which has caused pressures over the risk assessment of several sovereign credits, even in advanced economies. The increasing signs that global economy would be close to an inflexion point, as well as the deterioration of public finance, have resulted in the elevation of interest rate forward structure in advanced mature economies.



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13. Oil prices showed important elevation relative to the levels observed at the last Copom meeting. Future markets quotations also increased. Uncertainty concerning these quotations remains high, as the prospective scenario depends on the evolution of demand, especially in emerging economies, on the prospects for the evolution of global supply, subject to the rhythm of maturation of investments in the sector, in addition to the geopolitical issues that affect the price of this commodity. Nonetheless, despite the high uncertainty inherent to the projections regarding the trajectory of oil prices, the main scenario adopted by the Copom assumes unchanged gasoline prices in the rest of 2009. However, it bears highlighting that, regardless of the behavior of domestic gasoline prices, the evolution of international oil prices can eventually affect domestic prices both through productive chains, such as the petrochemical, as well as through the potential effect over inflation expectations. It bears emphasizing that the behavior of agricultural commodity prices, which have particularly important impact in the evolution of food costs, such as wheat, soybeans and corn, recorded significant increases since the last Copom meeting.

### Assessment of Inflation Trends

14. The identified shocks and their impacts were reassessed according to newly available information. The scenario considered in the simulations was based in the following assumptions:

- a) similarly to the April Copom meeting, the projected adjustments for gasoline and bottled gas prices for 2009 were kept unchanged at 0%;
- b) the projected adjustments for fixed telephone for 2009 was kept unchanged at 5.0% relative to the April Copom meeting, while the expected adjustment for electricity prices was reduced to 4.7%;
- c) the projection for regulated prices inflation for 2009, based on individual items, was reduced to 4.8%, down from 5.0% considered at the April Copom meeting. This set of prices, according to data released by the IBGE, corresponded to 29.55% of the total May IPCA;
- d) the projection for regulated prices inflation for 2010 reduced to 4.5%, against 4.8% relative to the April Copom meeting. Such projection is based on the endogenous determination model for regulated prices, which computes, among other factors, seasonal components, foreign exchange rate changes, market prices inflation and the IGP (General Price Index) variation;
- e) the projection for the spreads over the Selic rate, based on the 360-day swap rates, on the benchmark scenario, estimates a 20 bps spread in the fourth quarter of 2009 and 61 bps in the last quarter of 2010.

15. Regarding fiscal policy, projections assume the achievement of a public sector primary surplus target of 2.5% of GDP in 2009 and 3.3% in 2010, unchanged from the April Copom meeting. The additional assumptions considered in the previous meeting remained unchanged.

16. Since the last Copom meeting, according to the median IPCA inflation expectations compiled by the BCB's Investor Relations Office (Gerin), the 2009 IPCA remained relatively stable, increasing from 4.30% to 4.33%. For 2010, inflation expectations remained at 4.30%.

17. Considering the hypotheses under the benchmark scenario – which assumes the maintenance of the exchange rate at R\$/US\$1.95 and the Selic rate at 10.25% p.a. during the forecast period – the projection for the 2009 IPCA increased relative to the figure considered at the April Copom meeting, but it is still below the 4.50% target established by the National Monetary Council (CMN). According to the forecast based on the market scenario – which incorporates the consensus exchange and Selic rates trajectories collected by Gerin on the eve of the Copom meeting – IPCA inflation forecast for 2009 also increased compared to the figure considered in the previous Copom meeting, but is also below the central inflation target. Inflation projection for 2010 based on the benchmark scenario increased relative to the last Copom meeting but it is still significantly below the 4.5% inflation target. On the market scenario, the projection for 2010 remained stable, close to target.





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### Monetary Policy Decision

18. The Copom evaluates that the monetary policy should contribute to the consolidation of a favorable long-term macroeconomic environment. The pace of demand expansion has significantly cooled since the third quarter of 2008, partially as a reaction to the substantial and generalized economic activity deceleration in other developed and emerging economies. On its turn, the increase in risk aversion and the constraint observed in liquidity conditions prevailing in the international markets continue to impose adjustments in the balance of payments, but show some marginal improvements. In fact, since last Copom meeting, signs of a global risk aversion reduction continue to accumulate, despite still subject to reversion, with impacts on both Brazilian asset and commodities prices and also influencing domestic financial conditions. However, it bears emphasizing that the trajectory of price indices still evidences reduction of external inflationary pressures, especially in mature economies, but also in some emerging economies. Consequently, despite the recent increase in commodities prices, the net impact of the global deceleration over the domestic inflation path continues to be, until present, predominantly benign. The Copom emphasizes that the main challenge of monetary policy in such context is to ensure that the favorable results obtained over the last years are preserved.

19. The Copom evaluates that the probability that initially localized inflationary pressures may cause risk to the inflationary trajectory has diminished. Evidences of substantial accommodation of domestic demand and moderation of pressures over the market of factors, despite remaining subject to uncertainties, should reduce the risk of pass-through of upward pressures stemming from wholesale prices (which, apart from that, have showed deflation over the past few months) over consumer prices. The Committee evaluates that the materialization of such pass-through, as well as the generalization of pressures initially localized over consumer prices, still depends critically on economic agents' inflation expectations. Inflation expectations for 2009 and 2010 have remained below the target since the last Copom meeting and continue to be closely monitored. Additionally, it is worth noticing that, according to available data, domestic demand behavior should exert less pressure over the prices of non-tradable items, such as services, in the upcoming quarters. Anyhow, the Committee reaffirms that it will continue to conduct its actions in order to ensure that the gains obtained in inflation control in recent years become permanent.

20. The Copom emphasizes, once more, that there are important time lags between the implementation of monetary policy and its effects on economic activity and inflation. Therefore, the evaluation of alternative options for monetary policy should necessarily focus on the forward-looking inflation scenario and its risks, instead of current inflation indices. Such considerations become even more relevant in periods surrounded by heightened uncertainty. The Committee reaffirms that specific asset price movements are only relevant for monetary policy if they impact the forward-looking inflationary path.

21. Prospects for the evolution of economic activity have improved since the last Copom meeting, although industrial data still partially reflect a process of inventories retreat and the accommodation of external demand. In light of the international crisis effects over domestic financial conditions, credit contribution to sustain domestic demand severely diminished although there are some early signs of recovery, in particular regarding credit to individuals. The severity of the international crisis negatively influenced consumers and businessmen confidence, but there are also signs of recovery. Under such circumstances, the resumption of economic activity strongly depends on real payroll expansion and on the effects of government transfers that should occur in 2009, but it should also benefit from the gradual easing of financial conditions. It bears noticing, in short, that the contracting effects of the international financial crisis over the domestic economy dynamism and, consequently, over the context on which monetary policy has been acting, can become persistent but, as suggested by the recent behavior of capital markets (despite still subject to reversal), as well as by certain economic indicators, will not be permanent. These considerations become even more relevant considering the fact that the current monetary policy decisions will have concentrated impacts in the final months of 2009 and, particularly in 2010.

22. The Copom understands that the loss of domestic demand dynamism has caused an increase in the idleness margin of factors, resulting in reduction of inflationary pressures. On the other hand, the risks to the consolidation of a benign inflationary scenario derive, on the short term, from price adjustment mechanisms that contribute to lengthen inflationary pressures observed in the past, as evidenced by the behavior in the price of services and regulated items since the beginning of 2009, as well as, if it persists, from the recent trend of increased commodities prices. In the medium-term, the risk to the inflationary trajectory stems from the cumulative and lagged



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effects of the financial conditions easing over the evolution of domestic demand in a context of gradual recovery of the utilization of production factors. The balance of those influences over the inflationary prospective trajectory will be crucial to the assessment of the various alternatives available for the monetary policy stance.

23. International evidence, as well as the Brazilian experience, indicates that high inflation rates leads to increase in risk premium, both for private and public funding, to the shortening of planning horizons and, consequently, to lower potential economic growth, besides having regressive effects over income distribution. Therefore, the Copom strategy aims to ensure that inflation resumes the 4.5% midpoint target in 2009, as established by the CMN, and to keep it in a level consistent with the target path for 2010. Such strategy, which should have its results evidenced throughout time, takes into account the time lags in the transmission mechanisms and is the most adequate to deal with the uncertainty inherent to the process of monetary policy formulation and implementation.

24. The Copom evaluates that, in light of signs of economic activity slowdown, regarding, for instance, industrial production indicators, labor market and industrial capacity utilization rates, as well as businessmen and consumers confidence, and of inflation expectations for relevant horizons, the prospects for the materialization of a benign inflationary scenario, in which the IPCA would resume evolution in line with the target path, have continued to consolidate. Regarding this issue, the evolution of the forward-looking scenario is reflected on inflation projections considered by the Committee, as well as on inflation expectations set by independent analysts. Therefore, despite the residual margin for an easing process, the monetary policy should maintain a cautious stance, aiming to assure the convergence of inflation to the targets path.

25. The Committee understands that the demand slowdown, motivated by tightening of financial conditions and by the deterioration of agents' confidence, although some marginal improvement has been observed in both cases, as well as by the global economic activity contraction, has created a significant idleness margin of production factors that may not be rapidly eliminated in a scenario of gradual recovery of economic activity. Such development should contribute to restrain the inflationary pressures. On the other hand, the Copom highlights that the significant monetary policy easing process that has been implemented since January, will have cumulative effects over the economy and will be evidenced after some time lag.

26. The Committee evaluates that decisions regarding the evolution of the basic interest rate have to take into account the magnitude of the total adjustment made since January, whose impacts on several economic indicators will be evident over time. In such context, a few Copom members considered to be appropriate, under such circumstances, to immediately reduce the pace of the monetary easing process, implementing in a more smooth way the remaining portion of the adjustment process. However, the majority of the Copom members, taking into account inflation projections, which have already incorporated the magnitude of the movement already made since January, decided, at this time, to maintain the adjustment pace unchanged. It bears noticing, on the other hand, that there was consensus among the Committee members, taking into account the information available so far, relative to estimates regarding the scope for residual easing, which depends on the prospective scenario for inflation in light of the targets path and on the balance of risks for such scenario. The Copom also understands that the preservation of benign inflationary prospects will demand that the economy and financial system behavior under a different interest rate level should be closely monitored.

27. In such context, taking into account the inflation prospects relative to targets path, the Copom has decided to reduce the Selic rate to 9.25% p.a., without bias. Six votes in favor of the monetary policy action while two votes were in favor of reducing the Selic rate by 75 bps. Taking into account the fact that changes on the basic interest rate have effects over the economic activity and over the inflationary dynamics that accumulate over time, the Committee agrees that any additional monetary easing should be implemented in a more parsimonious way. The Copom will closely monitor the evolution of the forward-looking inflationary scenario up to its next meeting, in order to then define the following steps on its monetary policy strategy.

28. Under the inflation targeting regime, the Copom guides its decisions according to projected inflation, the analysis of several alternative scenarios for the evolution of the main variables that determine the forward-looking dynamics for prices, and the balance of risks associated to the projections. After a long period of expansion, domestic demand started to exert a contractionist influence over economic activity, despite the persistence of incentive factors, such as income growth. Additionally, it bears highlighting that inflation expectations for 2009 and



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2010 remain in a level consistent with the targets path. It is noteworthy that the deceleration of global economy has generated downward pressures over wholesale industrial prices. Under such environment, the monetary policy could be significantly eased since January, without jeopardizing inflation convergence to the targets path. If the risk profile deteriorates in such a manner that implies shifts to the inflation prospective basic scenario considered by the Committee at this moment, the monetary policy stance will be promptly adjusted to the circumstances.

29. At the end of the meeting it was announced that the Committee would reconvene on July 21st, 2009 for technical presentations and on the following day, to discuss the monetary policy decision, as established in Communiqué 17,327 of August 27th, 2008.

### **SUMMARY OF DATA ANALYZED BY THE COPOM**

#### **Inflation**

30. The IPCA increased 0.47% in May, down from the IPCA-15 (0.59%) and stayed virtually unchanged relative to the April IPCA (0.48%). In the last twelve months through May, the IPCA increased 5.20%, down from 5.53% in the last twelve months through April, totaling 2.20% in the year. The May result was influenced by the increase in the groups personal outlays (1.57%, down from 2.14%, with a 0.16 p.p. contribution for the index) and beverages and food (0.44%, up from 0.15%, with a 0.10 p.p. contribution).

31. Market prices accelerated, increasing 0.54% in the month, up from 0.47% in April, while regulated prices reached 0.30%, down from 0.51% in the same period. On a twelve-month trailing basis, market prices increased 5.67%, down from 6.17% in April, while regulated prices reached 4.09%, up from 4.05% in the previous month. The diffusion index reached 58.85%, up from 56.77% in April.

32. The core excluding household food items and regulated prices increased 0.56% in May, decelerating relative to the 0.58% increase observed in April, reaching 5.96% on a twelve-month trailing basis, down from 6.08% in the last month. The smoothed trimmed means core reached 0.44%, up from 0.35% in April, increasing 4.65% in the last twelve months, down from 4.71% in the previous month. The non-smoothed trimmed means core increased in May (0.39%) relative to the previous month (0.27%), reaching 4.34% in the last twelve months, down from 4.50% in the previous month.

33. The IGP-DI increased 0.18% in May, up from 0.04% in April, reaching -0.73% in the year through May and 2.99% in the last twelve months. The IPA (Wholesale Price Index) decreased 0.10% in May, reflecting the increase in crop and livestock sector prices (0.58%) and the fall in industrial prices (-0.32%). On a twelve-month basis, the IPA increased 1.18%, with a 2.24% increase in industrial products prices and a 1.52% decrease in agricultural prices. It bears highlighting IPA's significant and continuous deceleration according to a twelve-month trailing basis, since October 2008, when it totaled 14.72%. The IPC-Br decelerated, decreasing from 0.47% in April to 0.39% in May, totaling 5.55% in the last twelve months. The INCC increased 1.39% in May, up from -0.04% in April, reaching 8.98% in the last twelve months. The IPC-Br core increased 0.37% in the month, up from 0.36% in April, reaching 4.24% in the last twelve months.

#### **Economic Activity**

34. According to seasonally adjusted data from the IBGE's monthly survey (PMC), expanded retail sales, which include construction supplies and vehicles and motorcycles, parts and pieces, increased 2.0% in March, month-on-month, after increasing by 2.7% in February and 5.5% in January. As a result, expanded retail sales increased 7.4% in the first quarter, quarter-on-quarter. The expansion observed in March reflected the increase in the sales of nine out of the ten segments surveyed, with highlights to the monthly performance of vehicles and motorcycles, parts and pieces (3.9%), as a response to sectoral stimulus conceded by the government, which enabled the return to September 2008 sales levels. Sales of construction inputs grew 3.0% month-on-month, recording the second consecutive monthly increase. The only negative driver was furniture and home appliances (-2.2%).





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35. The comparison between identical periods of 2009 and 2008 revealed expansion of 6.5% in expanded retail sales in March and 3.7% in the first quarter of 2009. In March, year-over-year, it bears emphasizing the performance of office material and equipment (18%); vehicles and motorcycles, parts and pieces (17.1%); pharmaceutical and perfumery products (15.2%); and books, newspapers, magazines and stationary (10.5%). The negative drivers were fabric, clothing and shoes (-8.2%); construction inputs (-4.1%); and furniture and home appliances (-0.9%). In the year, it bears noticing the performance of office material and equipment (15%); books, newspapers, magazines and stationary (12.3%) and pharmaceutical and perfumery products (12.1%). Only construction inputs and fabric, clothing and shoes fell in Q1 sales (-9.8% and -6.6%, respectively).

36. São Paulo Trade Association (ACSP) data, related to the city of São Paulo, indicated a decrease of 4% on database consultation for credit sales (SCPC) and a 2% increase on consultations to the Usecheque system in May, on a month-on-month seasonally adjusted basis. Year-over-year, those indicators showed in May respective falls of 17.7% and 1%, while in the year through May these indicators reached 12.1% and 4.1%, respectively.

37. Automobile sales by dealers, which take into account automobiles, light commercial vehicles, trucks and buses, decreased 0.1% in May, month-on-month seasonally adjusted, according to Fenabrave (Brazilian Federation of Auto Vehicles Distribution). Year-over-year, sales increased 2%, despite the 22.9% fall in trucks sales. In the year through May, automobile vehicles sales decreased 0.2% relative to the same period of 2008, with significant fall in trucks sales (19.9%). According to the same comparison basis, automobiles sales fell 0.1%, while light commercial vehicles sales expanded by 4.9%.

38. Regarding investment indicators, capital goods production and the production of construction typical inputs increased 2.6% and 0.2% in April, month-on-month, according to seasonally adjusted data. Relative to the same period of 2008, those indicators decreased 29.3% and 11.6%, respectively, in April, and 22.6% and 10.6% in the year through April.

39. Capital goods imports retreated 3.0% in April, month-on-month, according to the Funcex quantum indices, seasonally adjusted by the BCB. The April indicator increased 10.7% year-over-year, expanding by 2.7% in the first four months of 2009, compared to the same period of last year.

40. According to IBGE's Monthly Industrial Survey (PIM), industrial production increased 1.1% in April, month-on-month seasonally adjusted, the fourth consecutive monthly growth. It bears emphasizing the durable consumer goods production, particularly automobile vehicles production. Sixteen out of the twenty-seven activities surveyed reported monthly production increase, with highlights to the performance of tobacco (13.7%), electrical machinery, devices and materials (8.3%), metal products (6.8%), rubber and plastic (6.7%) electronic material and communication equipment (5.2%) and basic metallurgy (5.1%). All the use categories increased according to this comparison basis: production of durable consumer goods (2.7%), capital goods (2.6%); intermediate goods (1.1%) and semi- and non-durable consumer goods (0.3%).

41. Industrial production decreased 14.8% in April, year-over-year, due to the decline in all use categories: capital goods (29.3%), durable consumer goods (21.6%), intermediate goods (15.5%) and semi- and non-durable consumer goods (4.2%). The twelve-month cumulative industrial production declined 3.9% in April, compared to the twelve months through March, deepening the fall relative to the twelve months through February and March, when industrial production decreased by 1% and 1.9%, respectively, according to the same comparison basis.

42. CNI indicators showed a smooth retraction in the industrial activity in April, month-on-month, with decrease of 1.3% in real revenues and stability in the hours worked in production, according to data seasonally adjusted by the BCB. The installed capacity utilization increased 0.82 p.p. in the same period, reaching 79.4%. Year-over-year these indicators decreased 10.7%, 10% and 3.9 p.p., respectively.

43. Vehicles production reached 270.2 thousand units in May, according to Anfavea, decreasing 8% year-over-year. Considering seasonally adjusted data, the production of vehicles decreased 0.2% in May, month-on-month, for a 14.7% decrease in the first five months of this year, compared to the same period of 2008. The cumulative production of vehicles decreased by 6.4% and the production of agricultural machinery increased 3%, in the last twelve months through May, compared to the last twelve months through April. Domestic sales of vehicles



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decreased 4.8% in May 2009, year-over-year, accumulating a 1.5% decrease in twelve months, while the exports of vehicles decreased 33.7% and 25%, according to the same comparison bases.

44. The LSPA survey carried out by the IBGE in February pointed to the production of 135 million tons in 2009, up from 134.7 million tons estimated in January. The new estimate represents a 7.5% decrease relative to the 2008 production. Declines of 13.8% for the production of corn and of 4.5% for soybean were also projected. The production of grains directly related to the basic food basket, such as rice and beans, should expand by 5.8% and 5.2%, respectively.

45. The IBGE released data for Q1 2009 GDP. Data showed negative growth rates in the first quarter of 2009, both for quarter-over-quarter results (-0.8%, compared to -3.6% for Q4 2008), and for year-over-year results (-1.8% as against 1.3% in the previous quarter). According to the year-over-year comparison, on the aggregate supply side, only the services sector expanded (1.7%). The agriculture sector and the manufacturing industry retreated 1.6% and 9.3%, respectively. On the aggregate demand side, household and government consumption increased, respectively, 1.3% and 2.7%, whereas gross fixed capital formation decreased 14%, resulting in negative contribution of domestic demand to GDP (-1.9 p.p.), interrupting a cycle of twenty one consecutive quarters of positive contribution. Moreover, exports and imports decreased 15.2% and 16%, respectively, resulting in positive contribution of the external sector to GDP (0.1 p.p.), the first one after twelve quarters of negative contribution.

### Surveys and Expectations

46. According to the Fecomercio-SP survey, the Consumer Confidence Index (ICC) increased 0.7% in May, month-on-month, reflecting just a 1.2% increase in the Consumer Expectations Index (IEC), considering the 0.1% decrease in the Current Economic Conditions Index (Icea). The ICC declined 14.8% year-over-year, mainly due to the retraction of 24.4% in the Icea.

47. According to the Consumer Expectations Survey carried out by the FGV, the ICC increased 1.3% in May, month-on-month seasonally adjusted, representing the third consecutive month of increase and showing a trend towards a gradual recovery of consumer confidence. The confidence increase reflected the monthly increase in consumer expectations (1.6%) and current situation (1.1%). The ICC declined 10.9% year-over-year.

48. In relation to the expectations for the manufacturing industry, the FGV Manufacturing Industry Survey showed, in May, for the fifth consecutive month, strong improvement in the businessmen confidence, although the Industry Confidence Index (ICI) stood below the level recorded in the period immediately prior to the international financial crisis. The ICI reached 89.6 points, seasonally adjusted, with increase of 5.1 p.p., month-on-month, reflecting the increases of 7.6% in the Current Situation Index (ISA) and of 4.4% in the Expectations Index (IE). According to the same survey, the installed capacity utilization (Nuci) reached 78.7% in May, 6.9 p.p. below the May 2008 level. Considering the seasonally adjusted series, the Nuci observed in May (79.2%) stood 0.9 p.p. above the level registered in April.

### Labor Market

49. According to the Ministry of Labor and Employment (MTE), 106.2 thousand formal jobs were created in April after 34.8 thousand jobs were created in March, totaling 48.5 thousand jobs in the first four months of 2009 and 651.7 thousand jobs in twelve months. Among economic activities, the services and the agriculture sectors registered the highest net hires in April (59.3 thousand and 22.7 thousand, respectively), while in the manufacturing industry and the mining sector the dismissals exceeded the hires in 582 jobs. Seasonally adjusted data showed relative stability in the employment level in April, month-on-month. The average of the first quarter showed a 3.2% increase in employment, influenced by the increases of 8.4% in the construction sector, 4.8% in the services sector and 4.7% in the retail sector, whereas in the manufacturing industry it declined 0.9%.

50. According to the IBGE employment survey (PME), carried out in the six main metropolitan areas of the country, the unemployment rate reached 8.9% in April 2009, decreasing 0.1 p.p. month-on-month and increasing 0.4 p.p. year-over-year. The monthly unemployment decrease reflected a decrease in the economically active



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population (PEA) higher than the number of employed workers, which totaled 76 thousand and 40 thousand jobs, respectively. Year-over-year, the increase in the unemployment rate was driven by the higher increase in the PEA (0.6%), than the increase in the number of employed workers (0.2%), a record low since the start of this series in March 2002, according to this comparison basis. The same survey pointed out that average real earnings of employed workers decreased 0.2% in April, month-on-month, but increased 3.2% on a year-over-year basis, accumulating a 4.7% growth in 2009.

### Credit and Delinquency Rates

51. Outstanding credit in the financial system reached R\$1,248 billion in April, increasing by 0.4% in the month and 22.6% on a twelve-month trailing basis. This volume corresponded to 42.6% of GDP, compared to December (41.3%) and April 2008 (35.8%). Non-earmarked credit operations increased 0.5% in the month and 20.8% in the last twelve months. Among the non-earmarked operations, which represent a share of 70.2% in the total of the financial system, credit operations to individuals increased 1.1% in the month and 18.7% in the last twelve months, while non-earmarked credit operations to corporate decreased 0.1% in the month and increased 22.7% in the last twelve months. Earmarked credit operations increased 0.4% in the month and 27.2% on a twelve-month trailing basis, with highlights to the 2.6% monthly increase in housing loans.

52. The leasing operations in the individuals segment continue losing momentum at the margin, with a reduction of growth on a twelve-month trailing basis from 116.3% in October 2008 to 64.8% in April. Considering the segmentation by economic activity, loans to industry decreased 0.3% in the month and expanded 26% in the last twelve months, whereas loans to the retail sector decreased 0.2% and expanded 14.1%, according to the same comparison bases.

53. The average interest rate on non-earmarked credit operations, used as reference for interest rates, totaled 38.6% in April, down from 43.3% in December. The average annual rate on credit for individuals decreased 9.1 p.p. relative to December, reaching 48.8%. The average rate on corporate credit decreased by 1.9 p.p. relative to December, reaching 28.8%.

54. The average tenure on non-earmarked credit operations, used as reference for interest rates reached 366 days in April, down from 378 days in December. The average tenure of corporate credit operations reached 273 days in April, down from 302 reached in December, while the average tenure for credit operations to individuals totaled 491 days in April, up from 488 days observed in December.

55. Delinquency rates in the financial system (non-earmarked loans used as reference for interest rates, in arrears for more than ninety days) reached 5.2% in April, a 0.8 p.p. increase compared to December. Delinquency rates for credit operations with corporate and individuals reached 2.9% and 8.2%, respectively, compared to 1.8% and 8% in December.

56. Net delinquency rate for retail credit, measured by the ACSP, reached 9.7% in May, up from 9% in the same month of 2008.

### External Environment

57. Although the stress in the international financial markets has been reduced, which can be deduced from the reduction of risk aversion indicators, the high prices of the shares, the retraction of the spreads of Credit Default Swaps (CDS) for banks and corporations and the decline in the rates of interbank loans, the conditions of operation of banking systems are still far below the normal, limiting access to the final credit borrower. Regarding economic activity, the most recent data already suggest that the pace of global economic activity contraction has decreased. The US economic activity, for instance, has shown signs of stabilization in household consumption and in the housing market. Likewise, the process of inventories adjustment, particularly in the retail sector, has advanced, making room for production recovery in the near future. On the other hand, the recent hike in oil prices and the continuing rise in the rates of households' savings and unemployment constitute risk factors for the recovery of consumption. The key issue for the medium term is whether the positive signs stemming from financial markets will find, indeed, sustainability in economic activity.



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58. Regarding inflation, despite the hike at the margin for annual prospects, the decline in the prices of commodities and the global recession still suggest the reduction of consumer price indices (CPI). In this sense, the ongoing deflationary process, for example, in the US, Japan and China, and the disinflation process, for example, in the UK and in most emerging economies, should still continue over 2009, due to the still uncertain recovery of economic activity and the fact that the prices of commodities, particularly oil, remain depressed when compared to the levels prevailing a year ago. In Japan, the deflationary process is expected to last for some quarters. In the US, where core inflation is expected to retreat to 0% this year, the CPI, in annual deflation since March, declined 0.74% in the last twelve months through April, when the price of energy decreased 25.2%. In the UK, the annual CPI increased 2.3% in April, a record low for the series recorded since early 2008.

59. Considering this scenario, in which signs of improvement in stock markets and in some segments of financial markets still coexist with credit restrictions, weak consumption and inflation decline, central banks from mature economies, and also from emerging economies, continued strengthening measures focused on monetary policy easing. The US Federal Reserve and the central banks of Japan, UK and Switzerland, which already operate with nominal interest rates close to 0%, expanded their programs to purchase public or private securities, including the expansion in the range of collateral accepted in funding operations. On the other hand, central banks in Europe (ECB), Canada (BoC) and of emerging economies, except for the People's Bank of China, where domestic absorption has restricted the expansion of product gap, the monetary policy easing has been made through the systematic reduction of basic interest rates. Thus, the basic interest rates of the ECB, BoC and the central banks of Chile, South Africa and Turkey were reduced to 1%, 0.25%, 1.25%, 7.5% and 9.25 %, respectively.

### **Foreign Trade and International Reserves**

60. The Brazilian trade surplus reached US\$2.7 billion in May, totaling US\$9.4 billion in the first five months of the year. In the month, exports reached US\$12 billion, and imports, US\$9.3 billion, decreasing by 37.9% and 38.7%, respectively, year-over-year, on a daily average basis. Total external trade recorded in May a 38.3% decrease year-over-year, on a daily average basis.

61. The decline in exports in May was amplified by the effect of a new comparison basis, due to the regularization of the exports registers recorded during the strike of the Brazilian state tax agency auditors between March and April 2008. All products categories decreased on a daily average basis: primary products (-35.8%), semi-manufactured products (-45.1%) and manufactured products (-36.8%). Regarding Brazilian imports, it bears highlighting the contraction of intermediate goods (-40.9%) and fuels and lubricants (-60.1%), which reflected the slowdown of domestic industrial output and the decrease in the prices of oil and byproducts in international markets.

62. Based on the liquidity concept, international reserves, which encompass the repurchase lines and borrowing operations in foreign currencies, reached US\$205.6 billion in May, recording a US\$4.3 billion increase in the month. Under the cash concept, international reserves totaled US\$195.3 billion, recording a US\$4.7 billion increase according to the same comparison basis.

### **Money Market and Open Market Operations**

63. In the period between the April and June Copom meetings, the future interest rates reduced significantly, especially short-term interest rates, reflecting the retreat in current inflation indices, the decline in inflation expectations and GDP growth projections. The medium- and long-term rates showed similar trend, also influenced by expectations of an extended monetary policy easing cycle and by an increasing financial inflow coming from foreign investors. After June 5, however, part of the downward movement of the curve was reversed, especially in its long segment, in reaction to the increase in the US Treasury bonds yield and the US dollar appreciation in the international market, noticeably after the disclosure of better-than-expected data on the US labor market. Between April 27 and June 8, one-, three- and six-month rates decreased by 82 bps, 74 bps and 71 bps, respectively. The one-, two- and three-year rates decreased by 64 bps, 48 bps and 30 bps, respectively. Real interest rates,



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measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month-ahead inflation expectations, decreased from 5.67% on April 27, to 5.17% on June 8.

64. In its open market operations, the BCB carried out, between April 28 and June 8, long fixed rate repo operations, borrowing R\$15.6 billion for a six-month period. The average daily balance of the five-, six- and seven-month operations reached R\$47 billion, of which R\$23.9 billion were seven-month operations. In the same period, the BCB conducted borrowing operations with tenures of 29 working days on April 30; of 15 working days on May 4; of 23 working days on May 11; of 18 working days on May 18 and of 13 working days on May 25. These operations drained from the market R\$245.7 billion, R\$10.5 billion, R\$10.6 billion, R\$12 billion and R\$12 billion, respectively. The average daily balance of these short-run borrowing operations reached R\$272.1 billion. The BCB also borrowed money through 29 overnight repo operations and conducted daily, at the end of day, one- and two-working-day-tenure liquidity management operations. Operations with tenors less than thirty days, including daily liquidity management operations, averaged R\$71 billion, on a daily basis, borrowing.

65. On April 28, the BCB carried out traditional FX swap auctions for rolling over the contracts maturing on May 4. These operations totaled US\$2 billion, around 35% of maturing contracts. On May 5, the BCB carried out reverse FX swap auctions maturing on June 1, aiming to anticipate the redemption of the traditional FX swap contracts maturing on the same date. This operation totaled US\$3.4 billion. As a result, the net short position on FX swap contracts reduced from US\$7.4 billion, on April 27, to US\$315 million, on June 8, in notional values.

66. Between April 28 and June 8, the National Treasury issuance regarding the traditional auctions raised a total of R\$41.9 billion. The issuance of fixed-rate securities reached R\$24.2 billion, being R\$17.5 billion via issuance of LTNs maturing in 2009, 2010 and 2011, and R\$6.7 billion via NTN-Fs maturing in 2013 and 2017. Issuance of LFTs totaled R\$15.1 billion, for securities maturing in 2013 and 2015. Issuance of inflation-linked NTN-Bs reached R\$2.6 billion, for securities maturing in 2011, 2014, 2020, 2024, 2035 and 2045.

67. In the same period, the Treasury conducted auctions to sell LTNs maturing in October 2009 and April 2010 combined with purchases of LTNs maturing in July 2009, totaling R\$1.9 billion; it also conducted auctions to sell LFTs maturing in March 2013 and in March 2015, combined with the purchase of LFTs maturing in June and in September 2009, totaling R\$1.3 billion. The sales of NTN-Bs settled in other National Treasury securities maturing in 2011, 2014, 2020, 2024, 2035 and 2045 totaled R\$3.6 billion. The Treasury also conducted purchase auctions of LTNs maturing in July 2009, totaling R\$2.9 billion.