BANCO CENTRAL DO BRASIL

Minutes of the 144th Meeting of the Monetary Policy Committee (Copom)

Date: July 21st, from 4:40PM to 7:05PM, and July 22nd, from 4:55PM to 6:55PM
Place: BCB Headquarters meeting rooms - 8th floor on July 21st and 20th floor on July 22nd – 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 July 21st)
Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on July 22nd)
João Henrique de Paula Freitas Simão – Open Market Operations Department
Jose Antonio Marciano - Department of Banking Operations and Payments System
Marcio Barreira de Ayrosa Moreira – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations Group

Other participants (present on July 21st)
Adriana Soares Sales – Advisor to the Board
Alexandre Pundek Rocha – Advisor to the Board
Fabio Araujo – Advisor to the Research Department
Katherine Hennings – 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.

BANCO CENTRAL DO BRASIL

Recent Economic Developments

1. IPCA inflation increased 0.36% in June, down from 0.47% in May. As a consequence, inflation accumulated in the first half of 2009 reached 2.57%, decreasing 1.08 p.p. relative to the level registered in the same period of the previous year. In the last twelve months, inflation decreased to 4.80% in June, down from 5.20% in May (5.90% in December 2008 and 6.06% in June 2008). The deceleration of twelve-month consumer price trailing inflation in the first six 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 4.45% and 5.70%, respectively, in June, down from 6.99% and 7.10% in December 2008 (7.78% and 8.16% in the same month of the previous year). However, 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 7.21% in June (5.75% in June 2008). Preliminary data for July point to consumer inflation below that observed in June. 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 decreased in June. The core inflation by exclusion of household food items and regulated prices decreased from 0.56% in May to 0.32% in June. Smoothed and non-smoothed trimmed means core inflation measures also retreated, recording 0.44% and 0.39% in May, and 0.39% and 0.28% in June, respectively. The twelve-month trailing inflation measures changed from 6.09%, 4.82% and 4.92% in December to 5.72%, 4.54% and 4.13% in June, 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 59.1% in June (compared to 67.2% in June 2008).

3. The General Price Index (IGP-DI) inflation changed from 0.18% in May to -0.32% in June. On a twelve-month trailing basis, the IGP-DI inflation decreased from 2.99% in May to 0.76% in June, compared to 13.96% in June 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 1.18% in May to -1.72% in June, according to the same comparison basis (17.90% in June 2008). On its turn, the Consumer Price Index-Brazil (IPC-Br) increased 4.87% up to June (5.96% in June 2008) and the Civil Construction National Index (INCC) increased 7.67% (9.13% in June 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 -4.87% (37.91% in June 2008), while wholesale industrial prices reached -0.43% (11.58% in June 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. On a three-month moving average basis, according to data seasonally adjusted by the IBGE, industrial output increased 1.1% in May, after increasing by 1.4% in the previous month. Still considering the seasonally adjusted series, industrial output increased by 1.3% in May month-on-month, after expanding by 1.2% in April. On a year-over-year basis, industrial output retreated by 11.3% in May, with respective falls of 14.2% and 11.1% in mining and manufacturing industries. The analysis of the behavior of IBGE industrial output series and its components, at the margin, according to data available, suggests that production reached its record low 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.

5. Among the use categories, according to data seasonally adjusted by the IBGE, it bears highlighting the 3.8% increase in the production of durable consumer goods, strongly influenced by the automotive sector. Regarding the other use categories, intermediate goods production increased 1.2% in May, non-durable and semi-durable consumer goods production increased 1.3%, while the production of capital goods increased by 0.7%.The recovery, at the margin, in the dynamism of industrial production, led by production of the durable goods, reflects, predominantly, tax exemption measures and also some easing of credit conditions. The future behavior of industrial production recovery, which should not be uniform over time, will depend on these factors, as well as on the gradual recovery of consumer and businessmen confidence, counterbalancing the deterioration of external demand.

6. 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 8.9% in April to 8.8% in May (7.9% in May 2008). According to the seasonally adjusted series, the unemployment rate reached 8.4% in May, up from 8.3% in April. Average real earnings increased by 3% in May, in year-over-year terms. Employment, on its turn, expanded by 0.2% in May, according to the same comparison basis. As a consequence, real payroll reached 3.3% in May, continuing to constitute a key driver for domestic demand growth. According to the National Industry Confederation (CNI) data, manufacturing employment decreased by 4.1% in May, in year-over-year terms, and expanded by 1.1% on a twelve-month trailing basis. According to data seasonally adjusted by the IBGE, manufacturing employment decreased by 1.1% in the last twelve months and fell by 6% in year-over-year terms. Still regarding the labor market, data from the Ministry of Labor and Employment (MTE) indicate that the generation of formal employment has continued to record some recovery, despite below the seasonal pattern. In June, 119,495 jobs were created (compared to the positive result of 131,557 in May). The manufacturing industry showed positive balance for the third consecutive month. Similarly, the commerce sector continued the recovery trajectory initiated in April, with the positive result of 17,522 jobs. On the other hand, the civil construction sector and the services sector continued hiring workers this month: 18,321 and 22,877 jobs, respectively. The agricultural sector showed the greatest dynamism, generating 57,169 jobs.

7. According to data seasonally adjusted by the IBGE, expanded retail sales increased by 3.7% in May, after decreasing by 3.3% in April. On a year-over-year basis, the indicator increased by 3.3%, growing by 2.7% in the year. The three-month moving average of expanded retail sales reached 0.6% in May, according to seasonally adjusted data, after recording 0.2% in April. 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" (8.0%) and "construction inputs" (5.7%). The negative key drivers were "office material and equipment" (-11.6%) and "hyper, supermarket and food articles" (0.1%). In the year, cumulative growth was more significant in "office material and equipment" (15.3%) and "pharmaceutical and medical articles" (11.6%). After consecutive falls in the last months of 2008, expanded retail sales data have evidenced recovery, mainly influenced by the increase in the sales of vehicles, in response to 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.

8. The installed capacity utilization rate (Nuci) in the manufacturing industry reached 79.4% in May, slightly above the level observed in April, according to CNI data seasonally adjusted by the BCB, and 1.17 p.p. above the record low reached in February. The series seasonally adjusted by CNI increased to 79.8% in May, up from 79.4% in April. Considering the monthly series without seasonal adjustment, in May the Nuci was 3.3 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 June to 79.1%, up from 78.7% in May, 7.2 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 observed in the production of consumer goods (-4.3 p.p.), intermediate goods (-7.6 p.p.), capital goods (-15.5 p.p.) and construction inputs (-4.3 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 idle capacity in 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 by 0.4% in May (after a 1.5% increase in April), according to seasonally adjusted data, and decreased 17.8% in year-over-year terms, according to observed data. On its turn, the production of construction inputs decreased by 0.3% at the margin in May, after a 0.1% increase in April, accumulating a 10.5% 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.

9. The twelve-month cumulative trade balance recovered at the margin. Under this comparison basis, the trade surplus reached US$27.0 billion in April, decreased to US$25.6 billion in May and expanded to US$27.5 billion in

June. This total resulted from US$ 177.2 billion in exports and US$149.7 billion in imports, equivalent to -0.5% and 1.6% changes, 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$20.7 billion in April, equivalent to 1.5% of GDP. On its turn, foreign direct investment reached US$42.3 billion in the twelve months through May, equivalent to 3.1% of GDP.

10. The period since the last Copom meeting was marked by the continuity of stress reduction in international financial markets, despite not in a monotonic way. 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 continued to moderate 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. Anyway, the decreasing trend of risk aversion and scarcity of capital flows, as well as some concern about the fiscal situation in the US, continued to encourage the recovery of currencies, both from emerging and mature economies, against the US dollar.

11. Regarding the global macroeconomic scenario, contraction trends prevail over inflationary pressures. The current predominant view points to the contraction of global economic activity in 2009, with recovery only in 2010. The consensual projections point to a 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. However, there are evidences that economic activity in G3 could be stabilizing, with signs of resilience in consumption in the US and recovery of manufacturing activity in Germany and Japan. On the other hand, the problems in the international financial system might continue to be aggravated by the cyclical deterioration in the quality of credit, focused on the US and Europe, which could 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 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 announced a series of important initiatives aimed at sustaining economic activity through fiscal incentives, which can 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 are high, which has caused pressures over the risk assessment of several sovereign credits, even in advanced economies. The accumulation of signs showing that global economy could 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.

12. Oil prices have shown high volatility since the last Copom meeting. However, future markets quotations decreased. 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 pace of investments maturation 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 the behavior of domestic gasoline prices, the evolution of international oil prices can affect domestic prices through productive chains, such as the petrochemical, or through the transportation costs for industry, 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

13. 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 June 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 June Copom meeting, while the expected adjustment for electricity prices increased to 5.0, up from 4.7%;
c) the projection for regulated prices inflation for 2009, based on individual items, was reduced to 4.5%, down from 4.8%, considered at the June Copom meeting. This set of prices, according to data released by the IBGE, corresponded to 29.50% of the total June IPCA;
d) the projection for regulated prices inflation for 2010 reduced to 4.3%, against 4.5% relative to the June 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 17 bps spread in the fourth quarter of 2009 and 39 bps in the last quarter of 2010.

14. Regarding fiscal policy, the projections assume the achievement of a public sector primary surplus target of 2.5% of GDP in 2009 and 3.3% in 2010, unchanged relative to the June meeting. Those figures do not take into account Petrobras contribution to the public sector primary surplus and are adjusted by the possibility of reduction by up to 0.50% in 2009 due to the implementation of the Investment Pilot Program (PPI) and 0.65% in 2010 due to the PPI implementation and the Growth Acceleration Program (PAC). The additional assumptions considered in the previous meeting remained unchanged.

15. Since the last Copom meeting, according to the median IPCA inflation expectations compiled by the BCB's Investor Relations Office (Gerin), the 2009 IPCA increased from 4.33% to 4.53%. For 2010, inflation expectations also increased between the June and the July meeting, reaching 4.41%, up from 4.30%.

16. 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 9.25% p.a. during the forecast period – the projection for 2009 inflation increased relative to the figure considered at the June Copom meeting and is close to the 4.50% target established by the National Monetary Concil (CMN). According to 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 and is also close to the inflation midpoint target. Inflation projection for 2010 based on the benchmark scenario increased relative to the figure considered in the June Copom meeting and is below the 4.50% inflation target. Under the market scenario, inflation projection for 2010 increased, but remains close to target.

Monetary Policy Decision

17. The Copom evaluates that the monetary policy should contribute to the consolidation of a favorable long-term macroeconomic environment. The risk aversion increase and the constraint of liquidity conditions prevailing in international markets continue to impose adjustments in the balance of payments, but show significant easing at the margin. In fact, since the last Copom meeting, signs of a global risk aversion reduction continue to accumulate, despite still subject to reversion, with impacts over both Brazilian asset prices, as well as over selected commodities, 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 increase in commodities prices since early 2009, 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.

18. The Copom evaluates that the probability that initially localized inflationary pressures may impose risks to the inflationary trajectory is limited. The moderation of domestic demand pressures over the market of factors, despite remaining subject to uncertainties, should contain the risk of pass-through of upward pressures stemming from wholesale prices (which, apart from that, have shown deflation over the past few months) over consumer prices. The Committee evaluates, however, 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 remain in line with the targets path, but have increased since the last Copom meeting and continue to be closely monitored. Additionally, it is worth noticing that, according to available data, the behavior of domestic demand 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 on inflation control obtained in recent years become permanent.

19. 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.

20. Prospects for the evolution of economic activity have continued to improve since the last Copom meeting, in particular relative to consumption, though data on industrial production remain reflecting the accommodation of external demand and investment. In light of the international crisis effects over domestic financial conditions, credit contribution to sustain domestic demand has diminished although signs of recovery cumulate, in particular regarding credit loans to individuals. The severity of the international crisis influenced negatively consumers and businessmen confidence, but in this case there are also more consistent signs of recovery. Under such circumstances, the rhythm of economic activity resumption strongly depends on real payroll expansion and on the effect of governmental transfers that will occur in 2009, and it should also benefit from the gradual easing of financial conditions. In short, the most recent data on domestic economic activity seem to reinforce the evaluation, mentioned in previous Copom meetings minutes, that the contractionary effects of the international financial crisis over the domestic economy dynamism and, consequently, over the context on which the monetary policy operates, could become persistent, but wouldn't be permanent. These considerations become even more relevant considering the fact that the current monetary policy decisions will have impacts concentrated in the final months of 2009 and, particularly in 2010.

21. The Copom understands that the loss of domestic demand dynamism has caused an increase in the idleness margin of factors utilization, 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 of services prices and regulated items since the beginning of 2009, as well as from a possible increase in commodities prices. In the medium-term, the risk stems from the cumulative and lagged effects, from the financial conditions easing over the evolution of domestic demand, taking into account the dynamics of consumption and investment, in a context of recovery of production factors utilization. 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.

22. International evidence, as well as the Brazilian experience, indicates that high inflation rates leads to the increase of risk premium, for both private and public funding, to the shortening of planning horizons and, consequently, to lower potential economic growth, besides having regressive effects over income distribution. As a consequence, 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 line with the target path in 2010 and 2011. 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.

23. The Copom evaluates that, in light of the increase of the idleness margin of the economy relative, in particular, to the industrial capacity utilization rates and labor market indicators, as well as to the behavior of

inflation expectations for relevant horizons, the prospects for the materialization of a benign inflation scenario, in which the IPCA would resume evolution in line with the target path, have remained favorable. Such 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. Under such circumstances, in order to preserve the improvement of the prospective inflation scenario, under a macroeconomic scenario with significant uncertainty, the Copom evaluates that monetary policy should maintain a cautious stance, aiming to assure the convergence of inflation to the targets path.

24. The Committee understands that the demand accommodation, motivated by tightening of financial conditions and by the deterioration of agents' confidence, although marginal improvements continue to be observed, as well as by the global economic activity contraction, which could also be cooling, has created significant idleness margin of production factors, which should not be rapidly eliminated in a basic scenario of gradual recovery of economic activity. The Copom also emphasizes that uncertainties around such basic scenario remain, with positive and negative biases over the pace of economic activity recovery. Anyhow, such development, contemplated under the basic scenario, should contribute to restrain inflationary pressures. On the other hand, the Committee notices that the significant monetary policy easing, implemented since January will have cumulative effects over the economy, which will be evidenced with a time lag.

25. The Committee understands 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. The Copom also evaluates that a more cautious stance will contribute to mitigate the risk of abrupt reversals of monetary policy in the future and, therefore, to the consistent recovery of the economy over the next quarters. The Copom also evaluates that the preservation of benign inflationary prospects will require that the behavior of the financial system and the economy under a new level of interest rates be closely monitored over time.

26. Although some committee members think that there would be room to keep the basic interest rate unaltered already in this meeting, there was consensus that the balance of risks to the central prospective inflation path would still justify residual monetary easing.

27. In such context, taking into account the inflation prospects relative to targets path, the Copom has unanimously decided to reduce the Selic rate to 8.75%p.a. without bias. Taking into account the fact that monetary policy easing implemented since January has lagged and cumulative effects over the economy, the committee evaluates, at the present moment, that this level of basic interest rates is consistent with a benign inflationary scenario, contributing to ensure the inflation convergence to targets path over the relevant time horizon, as well as to the non-inflationary recovery of economic activity.

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 contractionist influence over economic activity, despite the persistence of incentive factors, such as income growth. Additionally, it bears highlighting that inflation expectations for 2009, 2010 and 2011 remain in line with targets path. It is also noteworthy that global economic deceleration has generated downward pressures over wholesale industrial prices. Under such environment, monetary policy could be significantly eased since January without jeopardizing the inflation convergence to targets path. On the other hand, important monetary and fiscal stimuli were introduced in the economy over the last few months, and should contribute to the recovery of the economy, and consequently, to the reduction of the idleness margin of production factors. The stimuli effects should be closely monitored over time and are important in the context where future monetary policy decisions, which should ensure the materialization of the convergence to targets path over relevant horizons, will be taken.

29. At the end of the meeting, it was announced that the Committee will reconvene on September 1st, 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 0.36% in June, down from 0.47% in May, reaching 2.57% in the first half of 2009. In the last twelve months through June, the IPCA increased 4.80%, down from 5.20% in the last twelve months through May. The key influence over the June figure stemmed from the beverages and food prices (0.70% in June, up from 0.44% in May, with a 0.16 p.p contribution to the index), mainly pasteurized milk, whose individual contribution reached 0.13 p.p.

31. Market prices decelerated to 0.42% in June, down from 0.54% in May, while regulated prices increased 0.23%, down from 0.30%. In the last twelve months, market prices reached 5.10%, down from 5.67% in the last twelve months through May, while regulated prices increased 4.10% relative to 4.09% up to the previous month. The diffusion index reached 59.11%, up from 58.85% in May.

32. The various core inflation measures, calculated with the use of IPCA disaggregation, decelerated in June, both on month-on-month and on twelve-month trailing bases. The core excluding household food items and regulated prices increased 0.32% in June, down from 0.56% in May, reaching 5.72% in the last twelve months, relative to 5.96% in the previous month. The smoothed trimmed means core reached 0.39%, down from 0.44% in the previous month, while on a twelve-month trailing basis, it increased 4.54% in June, down from 4.65% in May. The non-smoothed trimmed means core increased 0.28% in June, down from 0.39% in May, reaching 4.13% in the last twelve months, compared to 4.34% in the previous month.

33. The IGP-DI totaled -0.32% in June, down from 0.18% in May, reaching -1.04% in 2009 and 0.76% in the last twelve months. The wholesale price index (IPA) totaled -0.64% in June, with a 0.97% decrease in industrial prices and a 0.34% increase in the prices of crop and livestock products. On a twelve-month trailing basis, the IPA decreased 1.72% in June, with decreases of 0.43% in industrial prices and 4.87% in agricultural prices. It bears highlighting the rapid reversal in the index performance, which in October 2008 accumulated 14.72% on a twelve-month trailing basis. The IPC-Br decelerated once more in June, with a 0.12% increase, down from 0.39% in May, reaching 2.66% in 2009 and 4.87% in the last twelve months. The INCC increased 0.70% in June, down from 1.39% in May, reaching 2.42% in 2009 and 7.67% in the last twelve months. The IPC-Br core increased 0.23% in the month, down from 0.37% in May, reaching 2.05% in 2009 and 4.02% in the last twelve months.

Economic Activity

34. According to data seasonally adjusted by the IBGE’s monthly survey (PMC), expanded retail sales, which include construction supplies and vehicles and motorcycles, parts and pieces, increased 3.7% in May, month-on-month, after decreasing by 3.3% in April and increasing by 1.3% in March. With those results, the average of the quarter ended in May expanded 4%, compared to the average of the quarter ended in February. Sales increased in nine out of the ten segments surveyed, with highlights for the increase in the sales of “vehicles and motorcycles, parts and pieces” (8%), “construction inputs” (5.7%) and “fuel and lubricants” (3.7%), on a month-on-month basis. The only negative driver was “office material and equipment” (-11.6%).

35. The comparison between identical periods of 2009 and 2008 revealed expansion of 3.3% in expanded retail sales in the month and of 2.7% in 2009. In May, year-over-year, it bears emphasizing the increase on sales of “other personal and domestic items” (11%) and “pharmaceutical and perfumery items” (10%). The negative drivers were “construction inputs” (-8.2%); “furniture and home appliances” (-6.3%); “fabric, clothing and shoes” (-2.3%). In the year, the following segments outperformed: “office material and equipment” (15.3%); “pharmaceutical and perfumery items” (11.6%); “books, magazines and stationary” (9.2%); and “other personal and domestic items” (9%). As negative drivers, it bears highlighting “construction inputs” (-10.7%); “fabric, clothing and shoes” (-6.1%) and “furniture and home appliances” (-2.6%), whose sales retreated, according to the same comparison basis.

36. São Paulo Trade Association data (ACSP) related to the city of São Paulo, indicated a 3.9% increase in database consultation for credit sales (SCPC) and also a 5.1% increase in consultations to the Usecheque system

in June, on a month-on-month seasonally adjusted basis. Year-over-year, those indicators decreased 14.4% and 4.6%, and on a twelve-month basis they retreated 3.4% and 0.03%, respectively.

37. Automobile sales by dealers, which take into account automobiles, light commercial vehicles, trucks and buses, increased 23.8% month-on-month seasonally adjusted in June, according to Fenabrave (Brazilian Federation of Auto Vehicles Distribution). Year-over-year, total sales increased 17.2%, despite the falls of 25.8% in the sales of buses and 20.3% in the sales of trucks. Expectations regarding the suspension of the IPI (tax on industrialized products) reduction on automobiles, expected for June, resulted in anticipation of purchases, which generated a record high on sales in a single month. In the year through June, the sales of auto vehicles increased 3.0%, year-over-year, with significant falls in the sales of trucks (20.0%) and buses (12.9%). According to the same comparison basis, the sales of automobile and light commercial vehicles expanded by 3.7% and 6.3%, respectively.

38. Regarding investment indicators, capital goods production and the production of construction typical inputs changed 0.7% and -0.3%, respectively, in May, month-on-month, according to seasonally adjusted data. Year-over-year, those indicators decreased 22.8% and 10.1%, in May, and 22.7% and 10.5%, respectively, in the year through May.

39. Capital goods imports retreated 4.9% in May, month-on-month, according to the Funcex quantum indices, seasonally adjusted by the BCB. The May indicator decreased 18.1%, year-over-year, reaching a 2.2% retreat in the year through May, compared to the same period of 2008.

40. According to IBGE's Monthly Industrial Survey (PIM), industrial production increased 1.3% in May, month-on-month seasonally adjusted, the fifth consecutive monthly growth. It bears emphasizing the durable consumer goods production (3.8%), reinforcing the recovery signs of the manufacturing activity. All use categories and twenty out of twenty seven activities surveyed recorded increases in the monthly production, with highlights to the performance of the pharmaceutical industry (9.7%); office machinery and information technology equipment (6.6%); other transportation equipment (3.3%); electrical equipment, devices and machinery (3.2%) and basic metallurgy (3.1%).

41. Industrial production decreased 11.3% in May, year-over-year, and driven by the decline in all use categories: capital goods (22.8%); intermediate goods (13.8%); durable goods (13.7%) and semi- and non-durable goods (1.8%). The twelve-month cumulative industrial production through May declined 5.1% compared to the twelve months through April, deepening the fall observed since February, a record low since the beginning of the series, in 1991, according to this comparison basis. In the year through May, industrial production fell 13.9%, year-over-year, with special highlights for the 22.7% fall in capital goods.

42. CNI indicators showed smooth recovery of industrial activity in May. Manufacturing industry real revenues increased 1.1%, after a 1.2% fall in April, growing 2.5% in the quarter ended in May, relative to the quarter ended in February, according to data seasonally adjusted by the BCB. The survey also indicated a 0.5% increase in hours worked in production and a 0.2% fall in employment, according to the same comparison basis. The installed capacity utilization remained unchanged at 79.4% relative to April, according to the seasonally adjusted series.

43. Vehicles production reached 283.9 thousand units in June, according to Anfavea, decreasing 8.2% year-over-year. Considering seasonally adjusted data, the production of vehicles increased 8.4% in June, month-on-month, totaling a 13.8% decrease in the first half of this year, year-over-year. In the last twelve months through June, the production of vehicles decreased by 9.1% and the production of agricultural machinery decreased 3.4%, compared to the last twelve months through May. Domestic sales of vehicles increased 5.9% in June 2009, year-over-year, stimulated by the expectation that the tax benefit granted by government, related to the reduction of industrialized products tax (IPI), would not be renewed. In the last twelve months through June, domestic sales of vehicles decreased by 2.3%, while exports decreased 47.0% year-over-year, and 30.3%, in twelve months through June, compared to the twelve months through May.

44. The LSPA survey carried out by the IBGE in June estimated the production of 133.3 million tons in 2009, representing a 1.2% decrease month-on-month. The new estimate represents an 8.7% decrease relative to 2008.

Concerning the three main crops, declines of 15.7% for the production of corn and of 5.1% for soybean and a 4.3% increase for the production of rice were also projected.

Surveys and Expectations

45. According to the Fecomercio-SP survey, the Consumer Confidence Index (ICC) increased 3.9% in July, month-on-month, reflecting a 3.7% increase in the Current Economic Conditions Index (Icea) and a 4.1% increase in the Consumer Expectations Index (IEC). The ICC increased 6.3%, year-over-year, mainly due to the retractions of 7.1% in the Icea and to the expansion of 16.3% in the IEC.

46. According to the Consumer Expectations Survey carried out by the FGV, the ICC increased 4% in June, month-on-month seasonally adjusted. It represents the fourth consecutive monthly increase, and the recent recovery was mainly favored by the greater optimism of consumers regarding the future of economy. In June, both the assessment of current situation and expectations for the next months outperformed those for May. The Current Situation Index (ISA) increased 5.3%, and the Expectations Index (IE) reached 4.4%, seasonally adjusted, a record high since September 2008. The ICC declined 0.7% year-over-year, recording figures much weaker than those registered last months.

47. The Consumer Expectations National Index (INEC), measured by CNI, increased 3.8% in June, compared to the index registered in the first quarter. Among the index components, the one relative to the expectations for unemployment was the most important driver of the improvement observed in the month, expanding 17%, according to the same comparison basis. The research shows that the fear related to unemployment decreased in the second quarter of 2009, with the index reaching, in June, the same level registered in September 2008, when the effects of the international economic crisis were not still so pronounced in the Brazilian economy.

48. In relation to the expectations for the manufacturing industry, the FGV Manufacturing Industry Survey showed, in June, for the sixth consecutive month, improvement in businessmen confidence. This result strengthens the consistent recovery of Industry Confidence Index (ICI) in the first half of the year, although it is still below the level recorded in the period immediately prior to the international financial crisis. The ICI reached 93.8 points, seasonally adjusted, with increase of 4.3 p.p. month-on-month, reflecting the increases of 4.4% in the Current Situation Index (ISA) and of 5.2% in the Expectations Index (IE). According to the same survey, the installed capacity utilization (Nuci) has gradually recovered, reaching 79.1% in June, against 86.3% in June 2008. Considering the seasonally adjusted series, the Nuci increased to 79.5% in June, 0.03 p.p. above the level registered in May.

Labor Market

49. According to the General Record of Employment and Unemployment (Caged) of the Ministry of Labor and Employment (MTE), 119.5 thousand formal jobs were created in June, compared to 131.5 thousand jobs created in May, totaling 299.5 thousand jobs in the first half of 2009 and 390.3 thousand new jobs in the last twelve months through June. Among economic activities, the agriculture and livestock, and the services sectors registered the highest net hires in June (57.2 thousand and 22.9 thousand, respectively). It is important to highlight that no sector of economic activity recorded net loss of jobs. Seasonally adjusted data showed a 0.1% increase in employment in June, month-on-month. The average of the first half of the year showed a 2.6% increase in employment, influenced by the increases of 7.2% in the construction sector, 4.5% in the services sector and 4.3% in the retail sector, whereas in the manufacturing industry declined by 1.8%.

50. According to the IBGE employment survey (PME), carried out in the six main metropolitan regions of the country, the unemployment rate reached 8.8% in May 2009, decreasing 0.1 p.p. month-on-month and increasing 0.9 p.p. year-over-year. The relative stability of the unemployment rate was a consequence of almost equivalent increases in the number of employed workers and of the economically active population (PEA), which totaled 71 thousand and 61 thousand jobs, respectively. Year-over-year, the increase in the unemployment rate was driven by the higher increase in the PEA (1.2%), relative to the increase in the number of employed workers (0.2%). The

same survey pointed out that average real earnings of employed workers decreased at the margin for the fourth consecutive month (-1.1%), but increased 3% year-over-year, growing by 4.3% in the year through May.

Credit and Delinquency Rates

51. Outstanding credit in the financial system reached R$1,259 billion in May, equivalent to 43% of GDP, with a 0.8% increase in the month and 20.5% on a twelve-month trailing basis. Non-earmarked credit operations increased 0.9% in the month and 18.8% in the last twelve months. Among the non-earmarked operations, which represent a share of 70.4% in the total of the financial system, credit operations to individuals increased 2.4% in the month and 20% in the last twelve months, while non-earmarked credit operations to corporate decreased 0.5% in the month and increased 17.7% in the last twelve months. Earmarked credit operations increased 0.8% in the month and 24.8% on a twelve-month trailing basis, with highlights to the 2.7% monthly increase in housing loans and 1.8% in BNDES lending.

52. Once again, the leasing operations in the individuals segment lost momentum at the margin, with a reduction of growth on a twelve-month trailing basis from 116.3% in October 2008 to 52.3% in May. Considering the segmentation by economic activity, it bears highlighting housing loans, which expanded 2.9% in the month and 40.2% in the last twelve months.

53. The average interest rate on non-earmarked credit operations, used as reference for interest rates, totaled 37.9% in May, down from 43.3% in December. The average annual rate on credit for individuals decreased 10.6 p.p. relative to December, reaching 47.3%. The average rate on corporate credit decreased by 2.2 p.p. relative to December, reaching 28.5%.

54. The average tenure on non-earmarked credit operations, used as reference for interest rates, increased in one day in May, reaching 367 days, down from 378 days in December, the first increase since October 2008. The average tenure of corporate credit operations reached 270 days in May, down from 302 days in December, while the average tenure for credit operations to individuals totaled 495 days in May, up from the record high of 492 days observed in October.

55. Delinquency rates in the financial system (non-earmarked loans used as reference for interest rates, in arrears for more than ninety days) increased for the sixth consecutive month and reached 5.5% in May, a 1.1 p.p. increase relative to December. Delinquency rates for credit operations with corporate and individuals reached 3.2% and 8.6%, respectively, compared to 1.8% and 8% in December.

56. Net delinquency rate for retail credit, measured by the ACSP, reached 7.7% in June, up from 5.7% in the same month of 2008.

External Environment

57. The contraction of industrial production in the main developed countries slowed down, with indicators for Japan and the Euro Zone returning to positive levels. The final demand for goods and services, especially household consumption, continues to present signs of stabilization, but doubts about the demand trajectory in the second semester persist. In the short run, international trade should benefit from the current phase of inventories cycle, with stabilization or a possible recovery, conditioned to the expansion of final demand. Among the emerging economies, it bears emphasizing China, which registered acceleration in economic growth for the first time since the first quarter of 2007, with Q2 GDP increasing by 7.9% year-over-year. Recent estimates of the International Monetary Fund (IMF) for global GDP point to a 1.4% contraction in 2009 and a 2.5% growth in 2010, representing, respectively, a 0.1 p.p. reduction and a 0.6 p.p. increase in relation to the April estimate.

58. The behavior of twelve-month consumer price indices in the main economies has been benefited by the low rates of installed capacity occupation, by the production price deflation and by the favorable basis effect in the prices of energy and food. In June, deflation continued to be present in consumer price indices in the US, Japan and China, and was also present in the Euro Area.

59. The behavior of international financial markets since the last meeting was more stable than the observed in the period between previous meetings. The VIX index continued a declining path, while the stock markets indicators in the main economies alternated periods of lows, in a first moment, with periods of highs, more recently observed. The three-month Libor rate, in dollar, continued to retreat, despite in lower intensity. However, the banking system still remains imposing severe restrictions to the last credit borrower.

60. Considering this scenario, the central banks from mature economies maintained the accommodative stance of their monetary policy, while the central banks of emerging economies – such as Chile, Mexico, Peru, Colombia, Russia and Turkey – continued to deepen the cuts in their basic interest rates.

Foreign Trade and International Reserves

61. The Brazilian trade surplus reached US$4.6 billion in June, a record high since December 2006, totaling US$14 billion in the first half of the year. In the month, exports reached US$14.5 billion, and imports, US$9.8 billion, decreasing by 22.2% and 38%, respectively, year-over-year, on a daily average basis. Total external trade decreased 29.4% in June, according to the same comparison basis. In the first half of the year, exports totaled US$70 billion, 22.2% lower than the one registered last year, on a daily average basis. Imports declined 28.9%, according to the same comparison basis.

62. The decline in exports in the semester reflected specially the sharp fall of manufactured goods sales, 30.6%, year-over-year, on a daily average basis, which was generalized among the main products, except for refined sugar, which increased 24.2%, according to the same comparison basis. Primary and semi-manufactured products contracted 7.4% and 26.9%, respectively. Regarding Brazilian imports, all the use categories contracted, except for non-durable consumption goods, which increased 2.9% in the year, year-over-year. The purchases of fuels and lubricants and intermediate goods showed the biggest declines, 51.4% and 32.4%, respectively, reflecting the reduction of imported volume, the impact of the international crisis over domestic industrial output and the decrease in the international prices of oil and byproducts in the period.

63. Based on the liquidity concept, international reserves, which encompass the repurchase lines and borrowing operations in foreign currencies, reached US$208.4 billion in June, recording a US$2.8 billion increase in the month. Under the cash concept, international reserves totaled US$201.5 billion, recording a US$6.2 billion increase according to the same comparison basis.

Money Market and Open Market Operations

64. After the June Copom meeting, the future short-term interest rates reduced significantly, influenced by the Copom decision and meeting minutes, by the prospective economic scenario analyses contained in the Inflation Report, and by the release of current inflation indices in line with market expectations and of employment and economic activity data indicating gradual recovery of domestic activity. On the other hand, the medium- and long-term rates behaved differently in the same period, which resulted in an upward movement in the slope of the curve, similar to the movement observed in the international market. Between June 8 and July 20, one-, three- and six-month and one-year rates decreased by 74 bps, 60 bps, 50 bps and 43 bps, respectively. The two- and three-year rates increased by 7 bps and 11 bps, respectively. Real interest rates, measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month-ahead inflation expectations, decreased from 5.17% on June 8, to 4.66% on July 20.

65. In its open market operations, the BCB carried out, between June 9 and July 20, long fixed rate repo operations, borrowing R$15.1 billion for a six-month period. The average daily balance of the five-, six- and seven-month operations reached R$54.5 billion, of which R$27 billion were six-month operations. In the same period, the BCB conducted borrowing operations with tenures of 29 and 16 working days on June 12; of 23 working days on June 22, of 18 working days on June 29; of 16 working days on July 1st and of 13 working days on July 6. These operations drained from the market R$250.7 billion, R$11.6 billion, R$7.5 billion, R$1.2 billion, R$15.1 billion and R$15.5 billion, respectively. The average daily balance of these short-run borrowing operations reached R$279.8

billion. The BCB also borrowed money through 30 overnight repo operations and conducted daily, at the end of day, two-working-day-tenure liquidity management operations. Operations with tenors less than thirty days, including daily liquidity management operations, averaged R$83.1 billion, on a daily basis, borrowing.

66. On June 18, 19 and 26, the BCB carried out traditional FX swap auctions for rolling over the contracts maturing on July 1st. These operations totaled US$1.7 billion, around 82% of maturing contracts. Through these operations, from July 1st on, the BCB ended all open positions of FX swap contracts.

67. Between April 28 and June 8, the National Treasury issuance regarding the traditional auctions raised a total of R$41.4 billion. The issuance of fixed-rate securities reached R$25.0 billion, being R$17.7 billion via issuance of LTNs maturing in 2009, 2010 and 2011, and R$7.3 billion via NTN-Fs maturing in 2013 and 2017. Issuance of LFTs totaled R$12.5 billion, for securities maturing in 2013 and 2015. Issuance of inflation-linked NTN-Bs reached R$3.9 billion, for securities maturing in 2011, 2014, 2020, 2024, 2035 and 2045.

68. In the same period, the Treasury conducted auctions to sell LTNs maturing in April and October 2010 and in January 2011, combined with purchases of LTNs maturing in July and October 2009 and in January and July 2010 and NTN-Fs maturing in July 2010, totaling R$13.2 billion. It also conducted auctions to sell LFTs maturing in September 2013, combined with the purchase of LFTs maturing in September 2009, totaling R$0.6 billion. The sales of NTN-Bs settled in other National Treasury securities maturing in 2011, 2014, 2020, 2024, 2035 and 2045 totaled R$4.5 billion. The Treasury also conducted purchase auctions of LTNs and NTN-Bs, reaching R$1.5 billion and R$0.1 billion, respectively.