BANCO CENTRAL DO BRASIL

Minutes of the 151st Meeting of the Monetary Policy Committee (Copom)

Summary

Date: June 8th, from 4:15PM to 6:00PM, and June 9th, from 4:45PM to 7:40PM

Place: BCB Headquarters meeting rooms - 8th floor on June 8th and 20th floor on June 9th – Brasília – DF

In attendance:
Members of the Committee
Henrique de Campos Meirelles – Governor
Aldo Luiz Mendes
Alexandre Antonio Tombini
Alvir Alberto Hoffmann
Anthero de Moraes Meirelles
Antonio Gustavo Matos do Vale
Carlos Hamilton Vasconcelos Araújo
Luiz Awazu Pereira da Silva

Department Heads (present on June 8th)
Adriana Soares Sales – Research Department (also present on June 9th)
Altamir Lopes – Economic Department
Ariosto Revoredo de Carvalho – International Reserves Operations Department
João Henrique de Paula Freitas Simão – Open Market Operations Department
José Antonio Marciano - Department of Banking Operations and Payments System
Renato Jansson Rosek – Investor Relations Group

Other participants (present on June 8th)
Alexandre Pundek Rocha – Advisor to the Board
Eduardo José Araújo Lima – Deputy-Head of the Research Department
Ricardo Franco Moura – Advisor to the Board

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.

Recent Economic Developments

1. IPCA inflation, after moving from 0.52% in March to 0.57% in April, reduced to 0.43% in May. As a consequence, inflation accumulated in the first five months of 2010 reached 3.09%, 0.89 p.p. above the level registered in the same period of the previous year. The rise in inflation in 2010 mirrors the behavior of market prices, which increased by 3.72% in the year through May. Focusing on market prices, both prices of tradable goods and non-tradable goods accelerated in the first five months of the year, reaching 2.52% and 4.80%, respectively, up from 1.38% and 3.12% in the same period of 2009. On its turn, regulated prices increased by

1.59% in the first five months of the year, compared to 1.99% in the same period of 2009. The change in the prices of services, whose dynamics tends to show more persistence than that of the prices of goods, reached 4.33% until May and 6.78% in twelve months. In short, information available suggests continued deterioration of inflation dynamics at the margin, although at a slower pace.

2. The three main underlying inflation measures calculated by the BCB showed convergent behavior between April and May. The smoothed trimmed means core inflation increased from 0.50% in April to 0.62% in May, as well as the double weight core inflation (from 0.42% to 0.56%) and core inflation by exclusion (from 0.42% to 0.56%), respectively. In the year through May, the core inflation by exclusion increased by 2.71%, while smoothed trimmed means and double weight core inflation measures increased 2.47% and 2.48%, respectively. These changes are, respectively, 0.20 p.p., 0.62 p.p. and 0.31 p.p. above the rates prevailing in the same period in 2009. The twelve-month trailing inflation measures changed from 4.73%, 4.36% and 4.74% in December 2009, for the core inflation by exclusion, smoothed trimmed means and double weight core inflation measures, to 4.93%, 4.99% and 5.06% in May, respectively. It is important highlighting that all core inflation measures, on a twelve-month basis, are above the midpoint of inflation target. Moreover, it bears emphasizing that, despite the IPCA diffusion index remained unchanged compared to April (60.9%), its level continues to suggest dissemination in the inflation acceleration process (58.9% in the same month of 2009).

3. The General Price Index (IGP-DI) inflation increased from 0.72% in April to 1.57% in May. In the year through May, the IGP-DI inflation reached 5.12% (-0.74% in the same period of 2009). Under this comparison basis, the acceleration of the IGP-DI reflected the behavior of its three components. The Wholesale Price Index (IPA-DI) increased 5.72% in the year through May (-2.29% in the same period of 2009). On its turn, the Consumer Price Index - Brazil (IPC-Br) increased 3.86% in the same period (2.54% in 2009). Still according to the same comparison basis, the Civil Construction National Index (INCC) increased 4.48% (1.70% in 2009). The IPA-DI inflation acceleration, under this comparison basis, derived both from the behavior of agricultural and industrial prices. While the industrial IPA increased 5.86% (-3.46% in the same period of 2009), the elevation of wholesale agricultural prices reached 5.25% (1.23% in 2009). 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, as well as on price setters' expectations for the future inflation path.

4. The IBGE (Statistics and Geography Brazilian Institute) released information about 2010Q1 GDP. The data showed expansion in activity, which increased 9.0% in the first quarter, year-over-year, and a 2.7% increase quarter-over-quarter, according to seasonally adjusted data. On the aggregate demand side, household consumption and public administration consumption increased, respectively, 9.3% and 2.0%, year-over-year. Gross fixed capital formation (FBCF) increased 26.0% and imports grew 39.5%, according to the same comparison basis, whereas exports increased 14.5%. The positive contribution of domestic absorption to the Q1 GDP growth totaled 11.8 p.p., year-over-year, overweighting the 2.9 p.p. negative contribution of the external sector. On the aggregate supply side, still according to the same comparison basis, the services sector presented a positive performance, growing by 5.9%, while industry grew by 14.6% and agriculture, 5.1%.

5. On a three-month moving average basis, according to data seasonally adjusted by the IBGE, industrial output increased 2.1% in March and 1.4% in April. Still considering the seasonally adjusted series, on a month-on-month basis, after expanding by 3.4% in March (revised from 2.8%, an increase of 0.5 pp in the observed data), industrial output decreased by 0.7% in April. On a year-over-year basis, industrial output increased by 17.4% in April, compared to 20.2% in March. On a twelve-month trailing basis, the industrial production growth expanded in April (2.3%), after consecutive declines since February 2009. Despite the decrease on a month-on-month basis, the behavior of IBGE industrial output series, and its components, shows that industrial production expands, returning to pre-crisis levels of 2008, at a pace that continues to be influenced by the international outlook, by business and households expectations, as well as by domestic financial conditions. This process is supported not only by traditional sources of credit, but also by the recovery of capital markets and the performance of public financial institutions.

6. Among the use categories, according to data seasonally adjusted by the IBGE, in April it bears highlighting the expansions of 2.4% in capital goods production, and 0.5% in durable consumer goods production.

Intermediate goods production increased 0.4%. On its turn, semi-durable consumer goods production decreased 0.8%, contributing to the 1.5% decline in the consumer goods production in the month, after rising 1.4%, 2.2% and 2.5% in January, February and March, respectively. Considering the quarterly series, all categories showed growth: capital goods, 4.9%, durable consumer goods, 4.4%, non-durable and semi-durable consumer goods, 3.5% and intermediate goods, 2.6 %. It bears highlighting that capital goods productions expanded by 28.7% in the year through April, the most remarkable expansion among the use categories, demonstrating the consistent recovery of the domestic economy. The recovery in industrial production dynamism was initially led by the production of durable goods, but it has become even more widespread than before, reflecting tax exemption measures, in advanced process of reversion, as well as the easing in financial conditions and the income expansion. The future behavior of industrial production, which should not be uniform over time, will also depend on the evolution of consumer and businessmen confidence, which should continue to be sources of dynamism, to which shall be added the gradual recovery of external demand.

7. Labor market continues to show vigor in clear process of expansion in the economic cycle. The unemployment rate in the six metropolitan regions covered by the IBGE Monthly Labor Survey (PME) decreased from 7.6% in March to 7.3% in April, 1.6 p.p. lower than that observed in the same month of last year. According to the seasonally adjusted series, the unemployment rate reached 6.8% in April, down from 7.0% in the previous month. Average real earnings were stable (0.1%) in April, month-on-month, after increasing by 0.4% in March. Employment, on its turn, increased by 3.8% in March and 4.3% in April, year-over-year. As a consequence, real payroll expanded by 6.7% in April, year-over-year, continuing to constitute a key driver for domestic demand growth. Still regarding the labor market, data from the Ministry of Labor and Employment (MTE) indicate that formal employment has continued to recover. In fact, 305 thousand jobs were created in April and 962 thousand in the year through April. In the latter case, the expansion of the period was a record high for the historical series, begun in 1985. Similarly, the manufacturing industry, trade, services and civil construction registered the largest balances accumulated since 1985. The most dynamic sector continues to be civil construction, where employment recorded a 12.9% increase in the first four months of the year, year-over-year.

8. According to data seasonally adjusted by the IBGE, expanded retail sales increased by 5.0% in March, after increasing by 2.2% in February. On a year-over-year basis, the indicator increased 22.0% in March. The three-month moving average of expanded retail sales reached 3.0% in March, according to seasonally adjusted data, after reaching 1.6% 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” (10.3%) and “office material and equipment” (8.6%). Expanded retail sales data have been evidencing growth, mainly influenced by the increase in the sales of durable goods, in response to the improvement in the access to credit, income expansion and temporary sector incentives granted by the government. The retail sector continues to register positive performance and indicates that the pace of domestic demand growth remains robust, but might, however, show some signs of cooling. For the next months, it is expected that the retail sales trajectory continues to be benefited by fiscal transfers, by real payroll growth, by the recovery in the access to credit and by the evolution of consumer confidence.

9. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by FGV, without seasonal adjustment, reached 84.6% in May, 5.9 p.p. above the level registered in the same month of 2009. According to the CNI series seasonally adjusted by the BCB, the Nuci reached 82.8 in April (up from 82.4% in March). According to the seasonally adjusted monthly series calculated by FGV, the Nuci reached 84.9% in May (85.1% in the previous month), the first decline since February 2009. Among the four use categories, the Nuci in construction material (91.6% versus 89.4% in the previous month) and in intermediate goods industry (86.5% versus 85.7% in the previous month) increased on a month-on-month basis, with the former reaching a new historical record for the series, while the latter is slightly above the historical average. On its turn, the industries of consumer goods (85.4% versus 86.3% in the previous month) and capital goods (82.8% versus 83.4% in the previous month) have shown little reduction compared to the previous month. The trend of reduction in the idle capacity is the result of economic activity expansion, not totally offset by the maturity of investment projects. Data regarding the absorption of capital goods show recovery compared to the same periods of 2009. Despite the decline of 0.3% in April compared to the previous month, the absorption of capital

goods increased 30.9%, year-over-year, and 28.2% in the year through April. On its turn, the production of construction inputs recorded virtual stability (-0.1%) at the margin in April, after a strong increase of 4.0% in March. According to observed data, it increased 18.2% in April, year-over-year, accumulating 1.7% growth in twelve months. In short, evidences suggest that the utilization rates have recorded upward trajectory in the last months, showing reduction in any remaining idle margin of the industry, despite the recovery of investments. 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, reaching a US$21.6 billion surplus in May, US$ 4.1 billion lower than the obtained in the same period last year. This total resulted from US$169.6 billion in exports and US$148.0 billion in imports, equivalent to -6.5% and -4.9% changes, respectively, year-over-year. In fact, the greater dynamism of domestic demand relative to the external demand contributes to the narrowing of the trade surplus. The increase in remittances of profits and dividends contributed to elevate the twelve-month trailing current account deficit, which reached US$36.2 billion in April, equivalent to 2.0% of GDP, up from US$31.5 billion in March. On its turn, foreign direct investment reached US$25.1 billion in the last twelve months through April, equivalent to 1.4% of GDP.

11. The period since the last Copom meeting was marked by deterioration in the process of normalization of activity in international financial markets, following the intensification of the effects of fiscal crisis in many European countries, with impact on the volatility of asset prices. Apparently, the perception of systemic risk resurfaced, fueled by the view that there would be interdependence between a possible fiscal consolidation in economies that are facing difficulties in this area and the balance sheets of financial institutions. However, until now, the possibility of realization of a stress scenario seems limited, but, anyway, there was some moderation in demand for risky assets in international financial markets.

12. The global economy continues to show recovery in 2010, whose intensity might accelerate in 2011, in a scenario in which the economies of the US, Europe and Japan (G3) recover some dynamism, but with considerable discrepancy between the regions, and with the recovery process being led by emerging economies. The U.S. economy shows signs of recovery, as can be seen, for example, at the end of the process of rebuilding of inventories, with positive impact on industrial activity and retail sales, although these indicators show some volatility. The levels of consumer confidence also advanced, although remaining at levels well below those prevailing before the crisis of 2008. Moreover, the labor market begins to show signs of recovery. On its turn, the economic activity in Japan continues to suggest a slow recovery, led by exports. In the Euro Area, fiscal concerns turn the recovery more uncertain, the household consumption shows no consistent signs of reaction, and the economic recovery tends to be slower and uneven. In short, since the last Copom meeting, the uncertainty regarding the sustainability and pace of consumption expansion in mature economies increased, mainly in Europe, in a scenario where economic policy stimuli are replaced by contractionary measures, and prospects for credit expansion are modest. On the other hand, in many emerging economies, economic activity remains in a path of expansion, showing, in some cases, evidence of heat in the markets of goods, services, production factors and assets. In fact, there is already concern about the dynamics of inflation in major emerging economies. In this context, after a period of aggressive monetary policy easing, monetary policy continues unchanged in several countries, and in those economies that were less impacted by the international crisis, which had recovered more quickly and intensely, the adoption of more restrictive monetary policy has started.

13. Since the last Copom meeting, oil prices showed some cooling, both in spot and future markets, despite the high volatility. In fact, the uncertainty concerning these quotations remains high, as the prospective scenario depends on the evolution of demand, in a context of asymmetric global economic recovery, on major uncertainties about the recovery of the European economy, on the prospects for the evolution of global supply, subject to the pace of investment maturation in the sector, in addition to the geopolitical issues that affect the price of this commodity. Nonetheless, the main scenario adopted by the Copom assumes unchanged domestic gasoline prices in 2010. However, it bears highlighting that, regardless the behavior of domestic gasoline prices, the evolution of international oil prices might affect domestic prices both through production chains, such as the petrochemical, and through the potential effect over inflation expectations. Furthermore,

measures to reduce liquidity in China may have an effect on commodity prices. It bears emphasizing that agricultural commodity prices, which have particularly important impact on the evolution of food costs, have presented some reduction since the previous Copom meeting. On the other hand, iron ore, an important input in the production chain of the industrial sector, has shown significant increase in price, although there was a reduction in May. Market players expect another price change in the contracts.

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 on the following assumptions:

    a) the projected adjustments for gasoline and bottle gas prices for 2010 were kept unchanged at 0%;
    b) the projected adjustments for fixed telephone was kept at 1.6% for 2010, while the projections for electricity prices adjustments rose to 1.5% for 2010, up from 0.7% considered in the April meeting;
    c) the projection for regulated prices inflation for 2010, based on individual items, was maintained at 3.6%, the same projection considered at the April meeting, according to the benchmark scenario. This set of prices, according to data released by IBGE, accounted for 29.27% of the total May IPCA;
    d) the projection for regulated prices inflation for 2011 was maintained at 4.4%, on the benchmark scenario. 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) change; and
    e) the projection for the spreads over the Selic rate, based on the 360-day swap rates, on the benchmark scenario, estimates 86 bps and 25 bps spreads in the fourth quarters of 2010 and 2011, respectively.

15. Regarding fiscal policy, projections assume the achievement of a public sector primary surplus target of 3.3% of GDP in 2010. This percentage can be reduced by up to 1.12 p.p., due to the implementation of the projects linked to the Growth Acceleration Program (PAC), of which 0.44 p.p. refers to amounts to be paid from 2009. Moreover, it is expected that the primary surplus in 2011 would return, without adjustments, to 3.3% of GDP. The additional assumptions considered in the previous meeting remained unchanged.

16. Since the last Copom meeting, the median of the expectations compiled by the BCB's Investor Relations Group (Gerin) for the 2010 IPCA increased from 5.41% to 5.64%. For 2011, the median of inflation expectations remained at 4.80%.

17. The benchmark scenario assumes the maintenance of the exchange rate at R$1.85/US$1.00 and the Selic rate at 9.50% p.a. during the forecast period. Under this scenario, the projection for the 2010 inflation increased relative to the figure considered at the April Copom meeting, and continues to be significantly above the 4.50% midpoint target established by the National Monetary Council (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 2010 also increased, standing significantly above the inflation midpoint target. For 2011, under the benchmark scenario, the projection decreased relative to the figure considered at the April Copom meeting, but remains significantly above the inflation midpoint target. Under the market scenario, the projection increased, and is positioned above the midpoint target.

Monetary Policy Decision

18. The Copom evaluates that the monetary policy should contribute to the consolidation of a favorable longer-term macroeconomic environment. In international markets, risk aversion has increased since the last Copom meeting, largely due to concerns about the sovereign debt of European countries. Although liquidity in international markets reduced, the prospects for external funding for the Brazilian economy remain favorable. In line with greater risk aversion and more scarce liquidity, the prices of some selected commodities and Brazilian assets decreased. On another front, the trajectory of price indices evidences inflationary pressures in relevant economies. In this context, the influence of the international scenario over the domestic inflation path is more ambiguous, although uncertainty persists about the behavior of asset prices and commodities in the context of the worsening international financial conditions. The Copom assesses that this scenario can

deteriorate, depending on the dynamics that derives from the market distrust regarding the solvency of some European economies, but, on the other hand, recognizes that this is not the baseline scenario considered. Regardless of how these aspects of the international outlook evolve, the Copom reaffirms that the main challenge of monetary policy is to ensure that the favorable results obtained over the last years are preserved.

19. The Copom believes that the indicators released since the last meeting reinforce the perception about the existence of pressures over the market of factors, increasing the probability that initially localized inflationary episodes pose risks to the inflation trajectory. In this context, the risk of pass-through of upward costs pressures to wholesale price inflation, and from these to consumer price inflation, increases as well. The Committee states that the materialization of these pass-throughs, as well as the spread of initially localized pressures over consumer prices, continues to depend critically on the economic agents' expectations for inflation and on the idleness degree of the economy, among other factors. Therefore, these and other variables are part of the information set that is taken into account in the generation of inflation forecasts by the BCB, which constitute a key element in the Committee's assessment on the prospective inflation scenario. Additionally, it should be noted that the behavior of domestic demand has exerted some pressure over the prices of non-tradable items, such as services, which, considering the prospects for the evolution of the main factors sustaining aggregate demand, may continue. In any event, the Committee reaffirms the commitment 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 considers important to emphasize, once more, that there are important time lags between the implementation of monetary policy and its effects on both economic activity and inflation. Therefore, the assessment of alternative options for monetary policy should necessarily focus on the forward-looking inflationary scenario and its risks, instead of current and past inflation figures. The prospective scenario, indeed, suffered some deterioration earlier this year, a dynamic that has continued since the last meeting, in spite of seasonal and occasional contributions to the rise in consumer prices as well as of price movements of certain domestic assets.

21. Prospects for the evolution of domestic economic activity remain favorable, as evidenced by data on trade, manufacturing capacity utilization and the labor market. This assessment is also supported by signs of continued expansion of credit supply, both for individuals and corporate; by the fact that consumers and businessmen confidence stands at historically high levels; and by income growth. The dynamism of domestic activity should also be benefited, among other factors, by fiscal impulses, the policies of official banks and, to a lesser extent, the pace of recovery in global activity. Considering the Brazilian economy's new cycle of expansion, these considerations become even more relevant when one takes into account that there are lags between the implementation of monetary policy and its effects over the activity level and inflation.

22. The Copom believes that the risks to the consolidation of a benign inflationary scenario stem mainly from the domestic side, for example, those resulting from the expansion of domestic demand in the context of virtual exhaustion of the idleness margin in the use of production factors. Incidentally, evidences of narrowing of the market factors are the acceleration of real wage gains in the recent past in some segments and higher producer price pressures. Indeed, these developments may exacerbate an outlook that already evidences the presence of mismatch between the growth of domestic absorption and capacity of supply expansion.

23. International evidence, ratified by the Brazilian experience, indicates that high inflation rates lead to the increase of risk premium, both for private and public funding, and to the shortening of planning horizons, both for households and corporate. Consequently, high inflation rates reduce investment and the economic growth potential, in addition to presenting regressive effects on income distribution. Moreover, high inflation rates do not result in any lasting results for economic growth and employment level; on the contrary, they create permanent damage to these variables in the medium and long terms. Therefore, the Copom strategy aims to ensure the convergence of inflation towards the targets path in 2010 and in the next years, which requires that possible deviations from the target path be promptly corrected. Such strategy takes into account the time lags in the transmission mechanism and is the most adequate to deal with the uncertainty inherent to the process of monetary policy formulation and implementation.

24. The Committee believes that the economy is in a new expansion cycle, and this assessment is corroborated by data released since its last meeting, although uncertainty about the pace of this process - which should be resolved over time - still persists. Signs of overheat in the economy are evidenced, for example, in core inflation trajectories, in the behavior of inflation expectations, in the evidence of workers shortage and in the rising inputs costs. In particular, during this period, the inflation projections considered by the Committee showed slight deterioration in the prospective scenario. The Copom believes that this deterioration should be contained and, therefore, the signs of persistent mismatch between the pace of aggregate demand expansion and aggregate supply, which, ultimately, tend to increase the risk for inflation dynamics, must be reversed. In such circumstances, the monetary policy stance should be adjusted, on the one hand, because it contributes to the convergence between the pace of demand expansion and supply and, on the other hand, because it prevents that originally localized price pressures determine a persistent deterioration of the inflation prospective scenario.

25. In short, despite the withdrawal of substantial share of the stimuli introduced during the recent international financial crisis, since the last meeting the risks for the achievement of a benign inflationary scenario, in which inflation would remain consistent with the inflation targets remained elevated. On the other hand, it is worth noting that in that same period, external developments have introduced a certain amount of caution in the analysis of the prospective scenario. Anyway, the prevailing opinion among the Committee members was that monetary policy should be adjusted incisively in order to avoid that the greater uncertainty detected in shorter horizons spread to longer horizons.

26. Under these considerations, continuing the adjustment process of monetary conditions to the prospective scenario of the economy, in order to ensure the convergence of inflation to the targets path, the Copom unanimously decided to increase the Selic rate to 10.25% p.a., without bias.

27. 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. Domestic demand appears robust, largely due to the effects of stimulus factors, such as income growth and credit resumption. Moreover, fiscal and credit incentives have been provided to the economy in recent quarters, and should contribute for the consolidation of activity expansion and, hence, for the reduction of any residual idleness margin of productive factors. The effects of these stimuli, however, counter the effects of the reversal of substantial share of the initiatives taken during the recent international financial crisis, and a possible deepening of the fiscal crisis that several European countries face. These elements are an important part of the context in which future monetary policy decisions will be taken, aiming to ensure a timely convergence of inflation to the targets path.

28. In addition, it bears noticing that there was consensus among the Committee members about the need to adapt the pace of adjustment of the basic interest rate to the developments in the prospective inflation scenario, as well as to the corresponding balance of risks, in order to limit the impacts caused by the behavior of current inflation over the underlying prices dynamics.

29. At the end of the meeting it was announced that the Committee will reconvene on July 20th, 2010 for technical presentations and, on the following day, to discuss the monetary policy decision, as established in Communiqué 18,927 of October 9th, 2009.

SUMMARY OF DATA ANALYZED BY THE COPOM

Inflation

30. The IPCA increased 0.43% in May, compared to 0.57% in April, recording the lowest monthly growth since December 2009. The accumulated variation of the index reached 3.09% in the first five months of the year, compared to 2.20% in the same period of 2009, while, considering periods of twelve months, the index rose 5.22% in May, compared to 5.26 % in April.

31. The deceleration recorded in the monthly IPCA reflected the larger impact of the downturn, from 0.75% to 0.47%, observed in market prices, compared to that provided by the acceleration of 0.14% to 0.33% registered in the variation of regulated prices. The segmentation of IPCA shows that its monthly change in May resulted, in large part, from the increases observed in the groups housing (0.10 pp); personal expenses (0.08 pp); and health and personal care (0.08 pp). The diffusion index reached 60.94%, recording stability compared to April and standing above 60% since November 2009.

32. The variations of the three core measures accelerated, in May, month-on-month and year-over-year. The smoothed trimmed-means core monthly values increased 0.62% from 0.50% in April, accumulating, in order, 4.99% and 4.80% for a twelve-month trailing basis ending in May and in previous month. Core by exclusion, which excludes ten items of food and fuel varied 0.56% in May, up from 0.42% in April, totaling in twelve month increases of 4.93% and 4.91% respectively. The core of double weighting grew 0.56% in May, up from 0.42% in April, totaling 5.06% and 4.98% for on a twelve-month trailing basis ending in May and in the previous month.

33. The IGP-DI increased 1.57% in May, up from 0.72% in April, accumulating 5.12% in the year and 4.38% in twelve months. The Producer Price Index Broad (IPA) changed by 2.06% in May, reflecting the increases in agricultural products prices (0.19%) and industrial prices (2.66%), whereas, considered the period of twelve months ended in May, rose 3.77%, reflecting respective increases of 4.79% and 0.71% observed in the prices of industrial goods and agricultural products. The IPC-Br showed deceleration of 0.76% in April to 0.21% in May, totaling 5.28% in twelve months. The INCC increased 1.81% in May, up from 0.84% in April, accumulating 6.07% in twelve months. The core IPC-Br, repeating the monthly evolution observed in April, rose 0.47% in May, totaling 4.16% in twelve months.

Economic Activity

34. GDP grew 2.7% in the first quarter of 2010, compared to the previous quarter, up from the 2.3% increase registered in the last quarter of 2009 on the same basis of comparison, according to seasonally adjusted data from the Quarterly National Accounts of the IBGE. The result reflected respective expansions of 2.7%, 4.2% and 1.9% observed in agriculture, industry and service sectors. From the demand viewpoint, it can be emphasized the quarterly growth of 7.4% recorded in investment, while households and government consumptions have grown, in order, 1.5% and 0.9%, confirming the importance of domestic demand for the resumption of economic activity. Exports and imports increased, respectively, 1.7% and 13.1% in the quarter. Considered accumulated changes in four quarters, GDP grew 2.4% in the period, breaking a sequence of two negative results, in this type of comparison.

35. Expanded retail sales, after registering monthly growth of 1.7% in January and 2.2% in February, rose on the same basis of comparison, 5% in March, according to seasonally adjusted data by the IBGE’s monthly survey (PMC). There were increases in sales in seven of the ten sectors surveyed, with emphasis on vehicles, motorcycles, parts and pieces - influenced by the impact of the last month's validity of the reduction of the Industrialized Product Tax (IPI) on the sector (10.3%), and office supplies and equipment (8.6%). Conversely, sales for the hypermarkets, supermarkets, food products, beverages and tobacco reported monthly decline of 0.8% in March. The average sales for the quarter ended in March rose 5.5% compared to the previous quarter.

36. Considered the observed data, March sales grew 22% year-over-year, accumulating increases of 15.5% in the year and 9.6% in the last twelve months. The year-over-year expansion was due to widespread increases in sales across all sectors addressed in the survey, with emphasis on equipment and office supplies, 35.4%; vehicles, motorcycles, parts and pieces (32.4%), and furniture and appliances (25.7%). Likewise, the accumulated growth in the quarter resulted from generalized sector increase in sales, emphasizing those registered in equipment and office supplies (29.9%); furniture and appliances (21.6%); and vehicles, motorcycles, parts and pieces (20.7%). The analysis of the evolution of retail trade in the periods of twelve months ending in March 2010 and March 2009 shows that only the sales of building materials fell (-1.5%), contrasting with the increases observed in vehicles, motorcycles, parts and parts (14.6%); equipment and

office supplies (14%); pharmaceutical and medical articles (12.1%) and hypermarkets, supermarkets and food products (10.4%).

37. The number of consultations to the Central Credit Protection Service (SCPC) and to the Usecheque System registered declines of 2.1% and 0.4% in April, month-on-month, according to seasonally adjusted data from the Commercial Association of Sao Paulo (ACSP), covering the state capital. Considered the observed data, these indicators recorded respective increases of 7.7% and 6.6% in the first four months of the year relative to the same period of last year, and respective variations of -4% and 4,5% in the period of twelve months ended in April, year-over-year.

38. Automobile sales by dealers, including cars, light commercial vehicles, trucks and buses, declined 1.5% in May, month-on-month, according to Brazilian Federation of Automotive Vehicles Distribution (Fenabrave) data, seasonally adjusted by the BCB. In the month were recorded downturns in sales of buses (19.4%), and automobiles (4.1%), while those related to trucks and light commercial vehicles recorded respective increases of 4.1% and 4%. Total sales in May reported respective increases of 1.6%, 14.6% and 17.4% year-over-year, accumulated during the year and in the last twelve months ended in May.

39. Capital goods imports decreased 2.5% in April, month-on-month, according to the Funcex quantum index, seasonally adjusted by the BCB. Considering periods of twelve months, the indicator rose 7.9% in April, registering sharp deceleration compared to the results observed in March (17%) and February (25.7%). Also in April, imports of capital goods increased 13.8% in twelve months and fell 9.9% in the year, in relation to the same periods in 2009.

40. Capital goods production increased 2.4% in April, month-on-month, according to seasonally adjusted data from Monthly Industrial Survey (PIM) by IBGE, with emphasis on the expansions observed in the segments of capital goods for serial industrial use (6.2%), transport equipment (5.2%) and equipment for the electricity sector (3.2%). The remaining segments recorded decline in the month, emphasizing the agriculture pieces (15%), and capital goods for non-serial industrial use (7.3%). The production of capital goods increased 36.3% compared to April 2009, highlighting the increases in the segments of capital goods for construction (208.5%), agricultural goods (46.5%), and goods for serial industrial use (42.9%). The production of construction inputs recorded a drop of 0.1% month-on-month and a 18.2% year-over-year growth. The production of capital goods grew 28.7% in the first four months of 2010 compared to the same period in 2009, with emphasis on the 211.3% increase in the segment of goods for the construction sector.

41. Disbursements granted by the BNDES reached R$146.5 billion in the last twelve months ended in April, with a 58% increase over the same period of last year. In the first four months of the year, disbursements mentioned expanded by 34%, compared to same period in 2009, with emphasis on the infrastructure sector, which recorded a 39% share in the total released in this four months period, industry (30%), trade and services (21%) and agriculture (10%).

42. The industrial production declined 0.7% in April, month-on-month, according to seasonally adjusted data from the PIM, by IBGE. This movement is associated, in particular, to the 0.8% decrease observed in the industry of semi- and non-durable consumer goods, affected by the 10.9% decrease experienced by the beverage industry. The other categories of use reported favorable results in the month, with highlights for the performance of the industry of capital goods, quoted above. Industrial production increased 17.4% year-over-year, reflecting in particular the performance of the categories of capital goods (36.3%), durable consumer goods (20.9%) and intermediate goods (17.8%). On twelve-month periods, the industry showed a 2.3% expansion in April year-over-year, due to the increases of 8.8%, 2.2% and 2% observed, respectively, in the durable consumer goods industry, intermediate goods and semi- and non-durable goods, offset in part by the decrease of 3.7% recorded in the production of capital goods.

43. Real earnings in the manufacturing industry decreased 0.4% in April, month-on-month, while in March it increased by 2.8%, according to data released by the CNI, seasonally adjusted by the Economic Department of BCB (Depec). Hours worked and employment showed relative stability in the same period. Year-over-year, these indicators increased by 12.7%, 5.4% and 8.3%, respectively.

44. Still according to CNI, the Nuci reached 82.4% in April, 3.6 p.p. higher than the level observed in the same month of 2009. Considering the seasonally adjusted series, the April Nuci recorded a monthly increase of 0.5 p.p., while the average quarterly NUCI recorded a growth of 1 p.p. in the quarter ended in April compared to the quarter ended in January.

45. Vehicles production reached 309.6 thousand units in May, increasing by 0.5% month-on-month, according to data released by the Anfavea, seasonally adjusted by BCB. In the year and in the last twelve months through May, the production of vehicles increased 20.7% and 13.7%, respectively. The monthly decrease of 5.3% in May vehicles sales reflected the performance of domestic market sales, with a 13.4% decrease, and the 23.5% increase in exports. In the year and in the twelve months through May, domestic sales increased 7.4% and 14.2%, respectively, while exports expanded by 78.6% and 2.5%.

46. The LSPA survey carried out by the IBGE in May estimated the production of 145.8 million tons of grains in 2010, representing an 8.8% increase relative to 2009. The increase projected for the year incorporates the estimated expansions for the production of soybeans (+19.6%), wheat (+3.8%) and corn (+3.7%), as opposed to the estimated retractions for rice (-10.8 %) and beans (- 5.5%).

Surveys and Expectations

47. According to the Fecomercio-SP survey, the Consumer Confidence Index (ICC) increased 0.5% in May, after two consecutive months of decline, reaching 152.9 points. The monthly trajectory of the ICC in May reflected the larger impact of the 4.3% increase observed in the Current Economic Conditions Index (Icea), relative to the shrinkage of 1.8% recorded in the Consumer Expectations Index (IEC). Year-over-year, the ICC increased 21.6%.

48. According to the Consumer Expectations Survey carried out by the FGV nationwide, the ICC increased 0.6% in May, month-on-month seasonally adjusted, reaching 116.1 points. In the month, the Current Situation Index (ISA) increased 2.9 points, to 128.4 points, while the Expectations Index (IE) decreased 0.4 points to 109.6 points. Year-over-year, the ICC increased 12.9%, reflecting increases of 26.4% in the ISA and 5.8% in the IE.

49. The Industry Confidence Index (ICI) from FGV reached 116.1 points in May, standing 0.7% above the level observed in April, third highest result of the series according to seasonally adjusted data and 33.5% higher than the level observed in May 2009. Considering the components, the ISA decreased 0.7%, and the IE increased 2.3%, seasonally adjusted. Year-over-year, the same indicators expanded by 34% and 33.1%, respectively. According to the same survey, the seasonally adjusted Nuci reached 84.9% in May, a level 0.2 p.p. lower than in April and 1.1 p.p. higher than in January.

Labor Market

50. According to the General Record of Employment and Unemployment (Caged) of the Ministry of Labor and Employment (MTE), 305.1 thousand formal jobs were created in April, totaling 962.3 thousand formal jobs in the first four months of 2010, the most expressive result for the period since the series began in January 1985. For the year through April, net generation of formal employment registered record highs for all segments of the economy, reaching 346.5 thousand jobs in the service sector, 287.4 thousand in the manufacturing industry, 166.1 thousand in civil construction and 74 thousand in commerce. The monthly analysis shows that the service sector recorded the creation of 96.6 thousand jobs in April, followed by the manufacturing industry, 83.1 thousand; and civil construction, 38.4 thousand. Additionally, 1,909 thousand jobs were created during the twelve months ended in April, 2.7% higher than the results reported in the same period of 2009.

51. According to the IBGE employment survey (PME), carried out in the six main metropolitan regions of the country, the unemployment rate reached 7.3% in April, declining 0.3 p.p. month-on-month and 1.6 p.p. year-over-year. The monthly decrease in unemployment reflected the 0.4% increase in the occupation and a 0.2% expansion in the Economically Active Population (PEA), while the annual decline was due to respective increases of 3.4% and 2% in the mentioned variables. In seasonally adjusted terms, the unemployment rate

fell by 0.2 p.p. in the month and reached 6.8%, representing the fourth consecutive monthly decline and the lowest percentage for the series. According to the same survey, average real earnings usually earned by workers increased 0.1% month-on-month and 2.3% in twelve months. Payroll grew 0.4% month-on-month and 6.7% in twelve months.

Credit and Delinquency Rates

52. Outstanding credit in the financial system reached R$1,468 billion in April, equivalent to 45.2% of GDP, with increases of 1.1% in the month and 17.6% in the last twelve months. Non-earmarked credit operations increased 0.9% in the month and 11.7% in the last twelve months. Among the non-earmarked operations, credit operations to individuals increased 1.2% in the month and 18.2% in twelve months, while non-earmarked credit operations to corporate increased 0.6% and 5.8%, according to the same comparison bases. Earmarked credit operations increased 1.6% in April, month-on-month, and 31.6% in twelve months, with highlights for the respective expansions of 3.2% and 50.5% recorded in housing finance.

53. The average interest rate on non-earmarked credit operations, used as reference for interest rates, increased 0.1 p.p. in April, month-on-month, reaching 34.3%. The average annual rate on credit for individuals reached 41.1% in the month, 0.1 p.p. below that recorded in March, and the average rate on corporate credit reached 26.3%, showing stability relative the level registered in the previous month.

54. The average tenure on non-earmarked credit operations, used as reference for interest rates, increased in April, reaching 404 days, up from 399 days in March. The average tenure of corporate credit operations reached 287 days, one day up from the average observed in March, while the average tenure for credit operations to individuals totaled 538 days, seven days more than in the previous month.

55. Delinquency rates in the financial system (non-earmarked loans used as reference for interest rates, in arrears for more than ninety days) reduced from 5.1% in March to 5% in April. Delinquency rates for credit operations with corporate remained stable, at 3.6%, while declined from 7% in March to 6.8% in April with individuals.

External Environment

56. Since the last Copom meeting, strains in international financial markets amounted. Apparently the adoption of a broad set of measures to restore financial stability in Europe was not sufficient to calm market participants. Risk aversion has increased, rates of stock exchanges in several countries retreated and the euro reached the lowest value against the US dollar in the last four years. In contrast, the movement of investment in assets perceived as less risky reduced the government securities yields of major mature economies.

57. Available data suggest the continuing process of global economic expansion, driven primarily by the US, Asia and Latin America, however, in an environment of high uncertainty. Among the G3 countries, the US and Japan reported annualized quarterly growth rates of, respectively, 3% and 4.9% in the 1Q 2010, while the euro area grew 0.8%. In the US, the most recent indicators for retail sales, industrial production and the net creation of jobs remained pointing to a positive performance. In the euro area, domestic consumption remains fragile, and the expansion of economic activity over the first quarter was due to the positive contribution of inventories. In China, although the Purchasing Managers Index (PMI) for Manufacturing activity in May has indicated deceleration, the main economic indicators continue to point the maintenance of high economic growth in the country.

58. Inflation remains at modest levels in the US and in the Euro Area - the consumer price index (CPI) annual changes in April reached 2.2% in the US and 1.5% in the Euro Area. In Japan, the CPI remains in deflation for fifteen months, having recorded, in April, annual change of -1.2%. In this context, the central banks of G-3 retained the accommodative monetary policies stance. The persistence of high unemployment and idle production factors in conjunction with anchored inflation expectations should help to maintain this accommodative stance for a longer period of time than had been anticipated. Among expansionary emerging economies, the price pressures have already appeared: the CPI annual changes recorded in April 2.8%, 4.3% and 10.2%, respectively, in China, Mexico and Turkey. Like China, India and Malaysia (Asia), and Brazil and

Peru (Latin America), the monetary authorities in emerging economies should change, even in 2010, the stance of their monetary policies.

Foreign Trade and International Reserves

59. The Brazilian trade surplus reached US$3.4 billion in May, a monthly record high since June 2009 accumulating US$5.6 billion in the year through May. It should be noted that this performance, 39.6% lower than that reported in the same period of last year, seems consistent with the process of recovery of strong activity observed in the Brazilian economy. In the month, exports totaled US$17.7 billion, and imports, US$14.3 billion, growing by 47.7% and 52.3%, respectively, year-over-year. In the year through May, exports and imports grew, respectively, 29.9% and 44% relative to the same period of 2009.

60. Based both on the liquidity concept and on the cash concept, international reserves reached US$249.8 billion in May, recording respectively US$10.8 billion and US$11.3 growths month-on-month. The two concepts were equal due to the full payment of borrowing operations in foreign currencies in May. In 2010 through May, the monetary authority's interventions accounted for net purchases of US$12.1 billion in the domestic market.

Money Market and Open Market Operations

61. Since the April Copom meeting, the slope of the domestic yield curve has decreased throughout its length. The short-term rates increased influenced by the disclosure of activity data suggesting consistent recovery of the Brazilian economy and expectations of inflation above the targeted path. The resume of crisis in Europe and greater pessimism about the recovery of the global economy, moreover, were key drivers in the decline of long rates. Between April 26th and June 7th, one- three- six-month and one-year rates increased by 0.82 p.p., 0.70 p.p., 0.40 p.p. and 0.05 p.p., respectively. The two- and three-year rates decreased by 0.40 p.p. and 0.66 p.p., respectively. Real interest rates, measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month-ahead inflation expectations, increased from 6.36% on April 26th to 6.46% on June 7th.

62. In its open market operations, the BCB carried out, between April 27th and June 7th, repo operations borrowing R$21.4 billion for a six-month period. As a consequence, the average daily balance of the long operations reached R$92.9 billion. In the same period, the BCB also borrowed money through repo operations with tenures between 12 and 29 working days, resulting in the average daily balance of short-term borrowing operations of US$183.6 billion. The BCB also borrowed money through 28 overnight repo operations and conducted daily one- and two-working-day tenure liquidity management operations. The very short-term operations, including the one- and two-working-day tenure liquidity management operations, averaged a daily balance of R$64.1 billion in the period, borrowing. The average daily balance of the total stock of repurchase agreement of the Central Bank decreased from US$406.7 billion, between March 16th and April 26th to US$340.6 billion between April 27th and June 7th. Considering the daily balance of operations for the most recent period, there was an increase in the repurchase agreements totaling R$26.1 billion, with a increase in total stock from R$334.1 billion on April 26th to R$360.1 billion on June 7th. The net redemption of securities by the National Treasury was the main driver of liquidity expansion in the period.

63. Between April 27th and June 7th, the National Treasury issuance regarding the traditional auctions raised a total of R$27.7 billion. The issuance of fixed-rate securities reached R$19.5 billion, with R$16.6 billion via issuance of LTNs maturing in 2010, 2011 and 2012, and R$2.9 billion via NTN-Fs maturing in 2014 and 2021. Issuance of LFTs totaled R$5 billion, for securities maturing in 2014 and 2016. Issuance of inflation-linked NTN-Bs reached R$3.2 billion, for securities maturing in 2013, 2015, 2020, 2030, 2040 and 2050.