BANCO CENTRAL DO BRASIL

Minutes of the 152nd Meeting of the Monetary Policy Committee (Copom)

Date: July 20th, from 5:50PM to 7:55PM, and July 21st, from 5:30PM to 8:15PM

Place: BCB Headquarters meeting rooms - 8th floor on July 20th and 20th floor on July 21st – 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 July 20th)
Adriana Soares Sales – Research Department (also present on July 21st)
Altamir Lopes – Economic Department
João Henrique de Paula Freitas Simão – Open Market Operations Department
José Antonio Marciano - Department of Banking Operations and Payments System
Márcio Barreira de Ayrosa Moreira – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations Group

Other participants (present on July 20th)
Alexandre Pundek Rocha – Advisor to the Board
Eduardo José Araújo Lima – Deputy-Head of the Research Department
Fabio Araujo – Advisor to the Research Department
Sonia Rabello Filgueiras Lima – 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.

Recent Economic Developments

1. IPCA inflation, after moving from 0.57% in April to 0.43% in May, reduced again to 0.0% in June. As a consequence, inflation accumulated in the first half of 2010 (2010H1) reached 3.09%, 0.52 p.p. above the level registered in the same period of the previous year. The rise in inflation in 2010H1 largely mirrors the behavior of market prices, which increased by 3.67%. Focusing on market prices, both tradable goods and non-tradable goods prices accelerated in the first half of the year, reaching 2.43% and 4.79%, respectively, up

from 2.08% and 3.29% in the same period of 2009. On its turn, regulated prices decelerated, increasing by 1.71% in the first half of the year, compared to 2.23% 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 4.75% until June and 6.82% in twelve months, notwithstanding reducing at the margin. In short, information available confirms deterioration of inflation dynamics at the start of 2010, but, on the other hand, there was marked improvement at the margin.

2. The three main underlying inflation measures calculated by the BCB showed convergent behavior between May and June. The smoothed trimmed means core inflation decreased from 0.62% in May to 0.40% in June, and so did the double weight core inflation (from 0.56% to 0.29%) and the core inflation by exclusion (from 0.56% to 0.36%), respectively. In the year through June, the core inflation by exclusion increased by 3.08%, while smoothed trimmed means and double weight core inflation measures increased 2.88% and 2.78%, respectively. These changes are, respectively, 0.30 p.p., 0.63 p.p. and 0.23 p.p. above the rates prevailing in the same period in 2009. The twelve-month trailing inflation measures, on its turn, reached in June 2010 5.03%, 5.02% and 4.97%, for the core inflation by exclusion, smoothed trimmed means and double weight core inflation measures, respectively, still standing above the midpoint of the inflation target. After six months above 60%, the June IPCA diffusion index retreated to 57.3%. Moreover, it bears highlighting the decrease at the margin of the IPCA-15 in July, for both core measures and the diffusion index.

3. The General Price Index (IGP-DI) inflation decreased from 1.57% in May to 0.34% in June. In the year through June, the IGP-DI inflation reached 5.48% (-1.06% in the same period of 2009). Under this comparison basis, the acceleration of the IGP-DI reflected the behavior of its three components. The main component, the Wholesale Price Index (IPA-DI), increased 6.18% in 2010H1 (-2.91% in the same period of 2009). On its turn, the Consumer Price Index - Brazil (IPC-Br) increased 3.64% in the same period (2.66% in 2009H1), whereas the Civil Construction National Index (INCC) increased 5.62% (2.42% in 2009H1). The IPA-DI inflation acceleration, under this comparison basis, derived both from the behavior of agricultural and industrial prices. While the industrial IPA increased 6.31% (-4.40% in the same period of 2009), the elevation of wholesale agricultural prices reached 5.75% (1.57% in 2009H1). Furthermore, it should be emphasized that the dynamics of wholesale prices improved at the margin, particularly the agricultural prices. Furthermore, the Copom evaluates that the effects of wholesale prices over consumer price inflation will depend, among other factors, on the current and prospective demand conditions, the exposure of each sector to foreign and domestic competition, as well as on the price setters' expectations for the future inflation path.

4. The Index of Economic Activity of the BCB (IBC-Br) incorporates estimates for monthly production of the three sectors of the economy, as well as products taxes and, therefore, it constitutes an important coincident indicator of activity. After registering growth for sixteen consecutive months, the IBC-Br was stable in May, compared with a 0.3% rise in the previous month, when it had slowed relative to the 1.2% growth recorded in March. The evolution of the IBC-Br, as well as other indicators of activity, suggests that the economy may have entered a path more consistent with economic growth rates evaluated as sustainable in the long term, rather than those observed in the first quarter of the year.

5. According to data seasonally adjusted by the IBGE, industrial output decreased 0.8% in April and remained unchanged in May, on a month-on-month basis. Year-over-year, the production increased 14.8% in May 2010, compared to a 17.2% increase in April. On a twelve-month trailing basis, after consecutive declines observed since February 2009, industrial production expanded for the second consecutive time (2.3% and 4.5% in April and May, respectively). On its turn, on a three-month moving average basis, according to data seasonally adjusted by the IBGE, industrial output growth rate decreased from1.3% in April to 0.8% in May. The behavior of the industrial output and its components remained stable around the levels prevailing prior to the 2008/2009 crisis. In the first months of this year, the buoyant pace in industrial activity has been influenced by the international outlook, the businesses' and households' expectations, as well as by domestic financial conditions, which have boosted domestic demand. This process was also supported by the rebuilding of inventories and the anticipation of consumption, which, on its turn, partially resulted from the prospects of fiscal stimulus withdrawal. Despite the stability on a month-on-month basis observed in May, the behavior of IBGE industrial output series and its components returned levels observed in the 2008/2009 pre-crisis period.

This process has been 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, the most important driver in May was capital goods production, which grew 1.2% at the margin. Durable consumer goods and intermediate goods production remained stable, increasing by 0.1% in both cases. On its turn, semi-durable consumer goods production decreased 0.9%, contributing to the 0.5% decline in the consumer goods production in the month, even after the 1.9% retreat recorded in April. Considering the quarterly moving average basis, all categories, except for semi-durables (-0.3%) registered growth: capital goods, 2.6%; durable consumer goods, 0.1%; and intermediate goods, 0.8 %. It bears highlighting that capital goods production expanded by 30.6% in the year through June, the most remarkable expansion among the use categories, evidencing the consistent recovery of the domestic economy. After the 2008/2009 crisis, the recovery in industrial production dynamism was initially led by the production of durable goods, but it became widespread afterwards, 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 will also depend on the evolution of consumer and businessmen confidence, which should continue to be sources of dynamism, among other factors.

7. The unemployment rate in the six metropolitan regions covered by the IBGE Monthly Labor Survey (PME) increased from 7.3% in April to 7.5%in May, 1.3 p.p. lower than that observed in the same month of last year. According to the seasonally adjusted series, the unemployment rate reached 7.1% in May, 0.3 p.p. above that observed in the previous month. After decreasing substantially after the 2008/2009 crisis, the unemployment rate has shown some stability. Average real earnings decreased 0.9% in May, month-on-month, after remaining stable in April (0.1%). Employment, on its turn, increased by 4.3% both in April and in May, year-over-year, with highlights for the civil construction sector. As a consequence, real payroll expanded by 6.8% in May, 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 continues to recover. In fact, 213 thousand jobs were created in June and 1.47 million in 2010H1, registering the second best level for June and a record high for job creation in the first half for the historical series, which begun in 1985. Similarly, the manufacturing industry, trade, services and civil construction registered the largest balances accumulated since 1985. The most dynamic sector for formal employment continues to be civil construction, where employment expanded 13.7% in the first five months of the year, year-over-year.

8. According to data seasonally adjusted by the IBGE, expanded retail sales remained stable in May (0.1%), after decreasing by 6.1% in April and increasing by 6.8% in March. On a year-over-year basis, the indicator increased 9.5% in May. The three-month moving average of expanded retail sales reached 4.4% in May, according to seasonally adjusted data. On a month-on-month basis, according to seasonally adjusted data, it bears emphasizing the expansion in the sales of construction inputs (2.4%), fuels and lubricants (2.0%) and books, newspapers, magazines and stationary (1.7%). 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 indicates that the pace of domestic demand growth remains robust and, therefore, it continues to register positive trend, although recent figures suggest some cooling. For the next months, it is expected that the retail sales trajectory continues to be benefited by governmental transfers, by real payroll growth, by credit expansion and by consumer confidence.

9. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by FGV, without seasonal adjustment, reached 85.1% in June, standing near the levels registered prior to the 2008/2009 crisis. According to the CNI series seasonally adjusted by the BCB, the Nuci reached 82.4% in May (down from 82.7% in April). According to the seasonally adjusted monthly series calculated by FGV, the Nuci reached 85.5% in June (84.9% in the previous month). Among the four use categories, the Nuci in consumer goods industry (85.6% versus 85.4% in the previous month) and in capital goods (83.2% versus 82.8% in the previous month) increased in June, month-on-month. On its turn, the Nuci for the intermediate goods industry decreased month-on-month (86.3% versus 86.5% in the previous month) and for the construction inputs industry (91.7% versus 91.6% in the previous month) remained stable and stands at historically high record levels for the series. The reduced idle capacity is the result of economic activity expansion, not totally offset by

the maturity of investment projects. Furthermore, data regarding the absorption of capital goods show recovery year-over-year. The absorption of capital goods increased 4.1% in May, month-on-month, 40.9%, year-over-year, and 30.7% in the year through May. The production of construction inputs recorded virtual stability at the margin for the second consecutive month (0.1% in May, 0% in April). According to observed data, it increased 18.3% in May, year-over-year, accumulating 4.1% growth in twelve months. In short, evidences suggest that the utilization rates have accommodated at high levels, 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 reached a US$19.3 billion surplus in June, US$ 8.3 billion lower than the obtained in the same period last year. This total resulted from US$172.2 billion in exports and US$153.0 billion in imports, equivalent to -2.8% and 2.2% changes, respectively, year-over-year. In fact, the greater dynamism of domestic demand relative to the external demand is relevant for the reduction in the trade surplus. The behavior of remittances of profits and dividends contributed to elevate the twelve-month trailing current account deficit, which reached US$36.4 billion in May, equivalent to 1.9% of GDP, up from US$36.2 billion in April. On its turn, foreign direct investment reached US$26.1 billion in the last twelve months through May, equivalent to 1.4% of GDP.

11. The global economy recovery continues to be led by emerging economies, but there are several evidences that signal that this process may be less intense than previously anticipated, in a scenario in which the dynamism in the G3 economies (US, Europe and Japan) still in 2011 becomes less likely. The US economy shows signs of recovery, but in an ambiguous way and at a slower pace than previously anticipated. In fact, consumer confidence remains at levels below those prevailing prior to the 2008/2009 crisis, and although the labor market shows some improvement, unemployment remains at a high level and should retreat slowly, which is common in after-crisis periods. Recent indicators suggest loss of strength in the US economy, which could be attributed to effects of higher than expected anticipation of consumption. On its turn, the Japanese economy cannot overcome deflation and recovers at a slow pace, led by exports. Recent data on consumption recorded negative rates for Japan and also for the Euro Area. In fact, the recovery in this region, besides being slow and uneven across the economies of the Euro, is very uncertain, partly due to the fiscal consolidation and the difficulties experienced by the credit market. In short, the uncertainty regarding the sustainability and pace of economic expansion in mature economies increased, mainly in the US and Europe, in a scenario where economic policy stimuli are replaced by contraction measures. As the economies of the G3 show high idleness for the production factors, a process exacerbated by fiscal concerns, central banks maintain the accommodative monetary policy stance. In this context, after a period of aggressive easing, monetary policy continues unchanged in several countries, but in those economies that were less impacted by the international 2008/2009 crisis, which recovered more quickly and intensely, the adoption of more restrictive monetary policy stance continues.

12. Since the last Copom meeting, oil prices showed some stability, both in spot and future markets. Despite the lower volatility in this period, the uncertainty concerning the 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. It bears emphasizing that agricultural commodity prices, which have particularly important impact on the evolution of food costs, have presented some elevation since the previous Copom meeting, with highlights for wheat. Regarding industrial commodity prices, aluminum and copper quotations increased, while the nickel quotation remained relatively stable.

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 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 and electricity prices were kept at 1.6% and 1.5% for 2010, respectively;
c) the projection for regulated prices inflation for 2010, based on individual items, was maintained at 3.6%, unchanged relative to the June meeting, according to the benchmark scenario. This set of prices, according to data released by the IBGE, accounted for 29.24% of the total June 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 114 bps and 26 bps spreads in the fourth quarters of 2010 and 2011, respectively.

14. 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 0.90 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.

15. Since the last Copom meeting, the median of the expectations compiled by the BCB's Investor Relations Group (Gerin) for the 2010 IPCA decreased from 5.64% to 5.42%. For 2011, the median of inflation expectations remained at 4.80%.

16. The benchmark scenario assumes the maintenance of the exchange rate at R$1.75/US$1.00 and the Selic rate at 10.25% p.a. during the forecast period. Under this scenario, the projection for the 2010 inflation decreased relative to the figure considered at the June Copom meeting, but 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 decreased, but stands significantly above the inflation midpoint target. For 2011, under the benchmark scenario, the projection decreased relative to the figure considered at the June Copom meeting, but remains above the inflation midpoint target. Under the market scenario, the projection also decreased, and is positioned around the midpoint target. Regarding the first half of 2012, the projection decreased in both scenarios, positioned around the midpoint target under the benchmark scenario, whilst below the midpoint target under the market scenario. The dynamics of inflation expectations matches the view expressed in the last Inflation Report, through which, in spite of an increase in the projections between March and June, there were signals of reversal of this movement at the margin.

Monetary Policy Decision

17. The Copom evaluates that the monetary policy should contribute to the consolidation of a favorable longer-term macroeconomic environment. In international markets, risk aversion and volatility have decreased since the last Copom meeting, despite remaining at high levels, and the perception of systemic risk cooled down, Perhaps because these signs are still perceived with caution, possibly as temporary movements, liquidity remains limited. Besides the persistent concerns about the sovereign debt in European countries, uncertainties about the sustainability of the US economy recovery and evidences of deceleration in China have arisen. Even so, the prices of some commodities and Brazilian assets increased and overall prospects for external funding for the Brazilian economy remain favorable. Meanwhile, the trajectory of price indices evidences the cooling of inflationary pressures in some relevant economies, whereas prospects of deflation in other economies resurfaced. In this context, the probability of some influence of external disinflation over domestic inflation increased, although uncertainty about the behavior of asset and commodities prices persists

in a context of substantial volatility in international financial markets. 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.

18. The Copom considers important to emphasize, once more, that there are time lags between the implementation of monetary policy and its effects on both economic activity and inflation. Therefore, the assessment of alternative stances 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, substantially deteriorated early this year, a dynamic that has reversed more clearly since the last meeting. In this regard, it bears highlighting that there was significant decrease in the dispersion of headline inflation expectations for both 2010 and 2011, and for market prices inflation expectations – the most sensitive component, and which more quickly responds to monetary policy actions.

19. Prospects for the evolution of domestic economic activity remain favorable, at a less intense rhythm than the observed at the start of the year, as evidenced by data on trade, inventories and industrial production, among others. This assessment is supported by signs of a more moderate expansion of credit supply, especially for individuals; by the fact that consumers and businessmen confidence stands at historically high levels, but with some accommodation at the margin; and by the recent trajectory of inventories in some industrial sectors. Anyway, the dynamism of domestic activity should continue to be benefited, among other factors, by the remaining effects of fiscal impulses, by the policies of official banks and, at a magnitude lower than previously expected, by the global activity, which presents signs of moderation.

20. In line with policy actions implemented in the first half of the year, since the last meeting, the retreat in inflation projections considered by the Copom showed improvement in the prospective scenario. The Copom considers that this process shall be intensified and, therefore, the signs of the persistent mismatch between the pace of aggregate demand and supply expansion shall be reverted, because they tend to increase the risk for the inflationary dynamics. In this sense, monetary policy stance should be adjusted, once this action contributes for the convergence between expansion paces of demand and supply.

21. 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.

22. The Committee believes that the risks for the consolidation of a benign inflationary scenario are decreasing, and are limited to the domestic environment, such as those stemming from the expansion of domestic demand, in the context of virtual exhaustion of the idleness margin in the use of production factors. Indeed, evidences of the market of factors tightening come from the real wages gains in some segments and higher pressures on production prices in the recent past. It is plausible to affirm, however, that factors that support these risks have decelerated at the margin. Moreover, it bears noticing that there are signs that the economy has moved towards a trajectory closer to long-term equilibrium, where the effects of these developments on the balance of risks for inflation tend to cool down.

23. In short, since the last meeting, the risks to the materialization of a benign inflationary scenario, in which inflation would remain consistent with the inflation targets path, have decreased, partially due to the reversion of a substantial part of stimuli introduced during the international financial crisis of 2008/09, as well as due to the change in the monetary policy stance. Another contributing factor for that, in the same period, was the higher probability of deceleration in the already slow process of recovery of G3 economies. As a consequence, the influence of the international outlook over domestic inflation behavior started to show a

disinflationary bias. Anyway, in spite of favorable conditions for inflation dynamics in both domestic and international scenarios, the prevailing opinion among the Committee members was that monetary policy should boost the effects of these changes and, in this direction, continue to act in order to avoid that uncertainties detected in shorter horizons, despite smaller than previously observed, spread to longer horizons.

24. Under these considerations, evaluating the macroeconomic mainframe and the prospects for inflation, the Copom unanimously decided to increase the Selic rate to 10.75% p.a., without bias. Considering the process of decreasing risks for the inflationary scenario unfolding since the last Copom meeting, and which is due to the recent evolution of domestic and external factors, the Committee believes that the decision will contribute to intensify this process.

25. 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 is robust, largely due to the effects of stimulus factors, such as income growth and credit expansion. 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 maintenance of the idleness margin of productive factors at historically low levels. The effects of these stimuli, however, are counterbalanced by the effects of the reversal of substantial share of the initiatives taken during the recent 2008/2009 international financial crisis, by those stemming from the monetary policy stance change and by those referring to the worsening of the global economy prospects. 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.

26. 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.

27. At the end of the meeting it was announced that the Committee will reconvene on August 31st, 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

28. The IGP-10 increased 0.05% in July, down from 1.30% in June, accumulating 5.60% in the year and 5.44% in twelve months. The Wholesale Price Index (IPA) increased by 0.02% in July, down from 1.68% in June, reflecting the larger impact of the reversal in industrial prices (from 2.23% to -0.01%) than the increase in agricultural products prices (from -0.04% to 0.15%). Considering twelve-month trailing inflation, the IPA rose 5.56% in July, reflecting respective increases of 6.85% and 1.70% observed in the prices of industrial goods and agricultural products. The IPC-Br decelerated -0.17% in July, down from -0.01% in June, totaling 4.66% in twelve months. The INCC increased 0.72% in July, down from 2.01% in June, totaling 6.54% in twelve months.

29. The IPCA-15 changed -0.09% in July, down from 0.19% in June, accumulating 3.26% in the year and 4.74% in twelve months. The reversal largely reflected the contributions observed in the groups food and beverage (-0.18 p.p.) and transportation (-0.07p.p.), which registered monthly changes of -0.80% and -0.36%, respectively. The diffusion index reached 48.96%, down from 61.46% in June.

30. The monthly change of the IPCA-15 reflected the impact of the deceleration in regulated prices, which increased 0.21%, down from 0.24%, and the reversal registered in market prices, which totaled -0.21%, down from 0.17%. Related to market prices, the reversal reflected the retreat in the prices of tradable goods (to -0.35%, down from 0.23%) and non-tradable goods (to -0.09%, down from 0.11%). Market prices rose 4.97% in

the last twelve months through July, reflecting the increases in the prices of tradable goods (2.53%) and non-tradable goods (7.14%), whilst regulated prices grew 4.18%.

31. The three IPCA-15 core inflation measures decelerated in July, month-on-month. Core inflation by exclusion increased 0.20% in July, down from 0.49% in June, totaling 5.07% in twelve months. The smoothed trimmed-means core inflation reached 0.30%, down from 0.50% in June, accumulating 5.01% in twelve months, while the double weight core inflation increased 0.19%, down from 0.43% in June, totaling 5.04% in twelve months.

32. The IPCA showed stability in June, recording 0%, a record low since June 2006, when it fell 0.21%. In the first six months of the year, the IPCA totaled 3.09%, compared to 2.57% in the same period of 2009. On a twelve-month trailing basis, the IPCA rose 4.84% in June, down from 5.22% in May and 5.26 % in April.

33. The reduction in the IPCA related to the previous month, when it grew 0.43%, reflected a downturn market prices (to -0.05% from 0.47%), and deceleration in regulated prices (to 0.12% from 0.33%). The IPCA segmentation shows that its monthly stability stemmed, in particular, from the behavior of the group food and beverages (-0.90%), which contributed -0.21 p.p. to the monthly index. The diffusion index reached 57.29%, down from 60.94% in May, standing below 60% for the first time since November 2009.

34. The three IPCA core inflation measures decelerated, in June, month-on-month. The smoothed trimmed-means core inflation measure reached 0.40% in June, down from 0.62% in May, totaling 5.02% and 4.99% in the last twelve months through June and through May, respectively. Core inflation by exclusion, which excludes ten items of household food and fuel, grew 0.36% in June, down from 0.56% in May, totaling 5.03% and 4.93% in the last twelve months through June and through May, respectively. The double weight core inflation increased 0.29% in June, down from 0.56% in May, totaling 4.97% and 5.06% in the last twelve months through June and through May, respectively.

35. The IGP-DI increased 0.34% in June, down from 1.57% in May, totaling 5.48% in the year and 5.07% in twelve months. The Wholesale Price Index (IPA) increased by 0.43% in June, down from 2.06% in May, reflecting the deceleration in industrial prices (to 0.42%, down from 2.66%) and acceleration in the prices of agricultural products (to 0.46%, up from 0.19%). In the last twelve months through June, the IPA rose 4.89%, reflecting respective increases of 6.26% and 0.83% observed in the prices of industrial goods and agricultural products. The IPC-Br totaled -0.21% in June, down from 0.21% in May, totaling 4.93% in twelve months. The INCC increased 1.09% in June, down from 1.81% in May, totaling 6.48% in twelve months. The IPC-Br core inflation rose 0.37% in June, down from 0.47% in May, totaling 4.30% in twelve months.

Economic Activity

36. Retail sales, after increasing by 6.8% in March and decreasing by 6.1% in April, rose 0.1% in May, according to seasonally adjusted data by the IBGE's monthly survey (PMC). Sales increased in six of the ten sectors surveyed, with highlights for construction inputs (2.4%) and fuels and lubricants (2%). Conversely, sales of fabric, clothing and shoes declined 3.3% in May. For the quarter ended in May, retail sales rose 4.4%, compared to the quarter ended in February.

37. Retail sales grew 9.5% in May, year-over-year, expanding by 13.6% in the year and 11.2% in the last twelve months. The year-over-year performance reflected the expansion in all sectors addressed in the survey, with highlights for the sales of equipment and office supplies (28.7%), construction inputs (19.9%), and furniture and appliances (19.5%). Likewise, the cumulative sales in the first five months of the year and in the twelve months through May resulted from generalized increases in all sectors, with emphasis, regarding the first comparison basis, the increase in the sales of equipment and office supplies (26.5%) and furniture and appliances (21.3%). Regarding the second comparison basis, it is noteworthy the sales of vehicles and motorcycles, parts and pieces (17.2%); and equipment and office supplies (15.1%).

38. The number of consultations to the Central Credit Protection Service (SCPC) and to the Usecheque System registered changes of -0.3% and 1.3% in June, month-on-month, according to seasonally adjusted data from

the Commercial Association of Sao Paulo (ACSP), covering the state capital. Considering observed data, these indicators increased 9.4% and 6.3%, respectively, in the first six months of the year, year-over-year.

39. Automobile sales by dealers, including cars, light commercial vehicles, trucks and buses, declined 1% in June, month-on-month, according to Brazilian Federation of Automotive Vehicles Distribution (Fenabrave) data, seasonally adjusted by the BCB. The sales of automobiles decreased 5.1%, while those related to buses increased 9.5%. Total sales decreased 12.4%, year-over-year, with highlights for the reduction of 20.8% in the sales of cars. In the first six months of the year and in the last twelve months through June, total sales increased by 9% and 14.3%, respectively.

40. Capital goods imports decreased 6.3% in June, month-on-month, according to the Funcex quantum index, seasonally adjusted by the BCB. On a twelve-month trailing basis, the indicator rose 58.4% in June, up from 46.7% in May and 8.3% in April.

41. Capital goods production increased 1.2% in May, month-on-month, according to seasonally adjusted data from the Monthly Industrial Survey (PIM) by IBGE, with emphasis on the expansions of capital goods for non-serial industrial use (5.5%) and for mixed use (3.8%), in contrast to the decrease of 18.9% observed in the production of capital goods for the electricity sector. The production of capital goods increased 38.5% compared to May 2009, highlighting the increases in the segments of capital goods for construction (154.7%), agricultural goods (51.2%), capital goods for mixed use (46.7%) and goods for serial industrial use (39.5%). The production of construction inputs increased 0.1% in May, month-on-month, and 18.3% in twelve months. The production of capital goods grew 30.6% in the first five months of 2010, year-over-year, with highlights for the 196.4% increase in the segment of goods for the construction sector.

42. Disbursements granted by the BNDES reached R$150.8 billion in the last twelve months through May, recording a 64% increase over the same period of last year. In the first five months of the year, disbursements expanded by 41%, year-over-year, with emphasis on the infrastructure sector, which represented 41% of the total disbursements released in the period, followed by industry (29%), trade and services (21%) and agriculture (9%).

43. Industrial production remained stable in May, month-on-month, according to seasonally adjusted data from the PIM, by IBGE, after declining 0.8% in April. In addition to the performance of capital goods industry, this movement reflects a 0.1% increase in the production of intermediate goods and durable consumer goods, and a 0.9% decline in the production of semi- and non-durable consumer goods, with highlights for the decreases in the industries of food (-1.7%) and textiles (-1.6%) and for the expansions in the industries of electronic material and communication equipment (6.1%) and office machines and computer equipment (5.7%).

44. Industrial production increased 14.8%, year-over-year, with emphasis on the expansions in the production of capital goods (38.5%), intermediate goods (15.7%) and durable consumer goods (15.4%). In the last twelve months through May, general industry grew 4.5%, year-over-year, with highlights for the increase of 11.6% in the production of durable consumer goods. The production of capital goods increased 0.8%, according to the same comparison basis.

45. Real earnings in the manufacturing industry increased 1.3% in May, month-on-month, after a 0.2% decline in April, according to data released by the CNI, seasonally adjusted by the BCB. Hours worked and employment increased 0.9% and 0.3%, respectively, in the same period. Year-over-year, these indicators increased by 13.9%, 9.9% and 6.1%, respectively.

46. Still according to CNI, the Nuci reached 82.9% in May, 3 p.p. higher than the level observed in the same month of 2009. Considering the seasonally adjusted series, the Nuci decreased 0.3 p.p. in May, while the average quarterly NUCI grew 1.6 p.p. in the quarter ended in May, compared to the quarter ended in February.

47. Vehicles production reached 306.4 thousand units in June, according to data released by the Anfavea, seasonally adjusted by BCB. It bears noticing that the 1.7% monthly decrease reflected, in particular, a 2.4%

retraction in the production of light vehicles. In the first half of the year and in the last twelve months through June, the production of vehicles increased by 19.1% and 15.8%, respectively, compared to the same periods last year.

48. The 10.7% monthly decrease of vehicles sales in June reflected the 9.7% decrease in domestic market sales and the 10.3% decrease in exports. In the year and in the twelve months through June, domestic sales increased by 6.2% and 14%, respectively, while exports expanded by 78.1% and 14.1%.

49. The LSPA survey carried out by the IBGE in June estimated the production of 145.9 million tons of grains in 2010, representing an 8.9% increase relative to 2009, 0.1 p.p. higher than the forecast made in May. The projection incorporates the estimated expansions for the production of soybeans (19.4%), wheat (5.7%) and corn (4.4%), as opposed to the estimated retractions for rice (-10.4 %) and beans (- 5.5%).

Surveys and Expectations

50. According to the Consumer Expectations Survey carried out by the FGV nationwide, the Consumer Confidence Index (ICC) increased 1.9% in June, month-on-month seasonally adjusted, reaching 118.5 points, the second best result of the historical series. In the month, the Current Situation Index (ISA) increased 1.6%, which reached a record level for the third consecutive month, while the Expectations Index (IE) increased 2.1%. Year-over-year, the ICC increased 10%, reflecting increases of 21% in the ISA and 4% in the IE.

51. The Industry Confidence Index (ICI) from FGV decreased 0.7% in June, reaching 115.3 points, considering seasonally adjusted data, reflecting 1.5% decrease in the IE and a 0.1% increase in the ISA. Year-over-year, the ICI increased 27.1%, reflecting increases of 28.6% in the ISA and 25.7% in the IE. The seasonally adjusted Nuci reached 85.5% in June, resulting in increases of 0.6 p.p. relative to May and 1.7 p.p. relative to January.

Labor Market

52. According to the General Record of Employment and Unemployment (Caged) of the Ministry of Labor and Employment (MTE), 1,473.3 thousand formal jobs were created in the first half of 2010, the most remarkable result for the period since the series began in January 1985. For the year through June, record highs in net generation of formal employment were registered for all segments of the economy, reaching 490 thousand jobs in the services sector, 394.1 thousand in the manufacturing industry, 230 thousand in civil construction, 175.1 thousand in the agricultural sector and 144.1 thousand in commerce. According to month-on-month seasonally adjusted data, employment increased 0.4% in June, with highlights for the service sector, which recorded the creation of 57.5 thousand jobs, followed by the agricultural sector, 55.4 thousand; and the manufacturing industry, 44.5 thousand. Additionally, 2,168.9 thousand jobs were created in the last twelve months through June, of which 549.5 thousand in the manufacturing industry.

53. According to the IBGE employment survey (PME), carried out in the six main metropolitan regions of the country, the unemployment rate reached 7.5% in May, increasing 0.2 p.p. month-on-month and -1.3 p.p. year-over-year. In seasonally adjusted terms, the unemployment rate increased 0.3 p.p. in the month and reached 7.1%, driven by the 0.5% expansion in the Economically Active Population (PEA) and by the 0.3% increase in occupation. According to the same survey, average real earnings usually earned by workers fell by 0.9% month-on-month and increased 1.3% in the year. Payroll recorded -0.6% and 5%, respectively.

Credit and Delinquency Rates

54. Outstanding credit in the financial system reached R$1,529 billion in June, equivalent to 45.7% of GDP, increasing by 2% in the month, 8.1% in the year and 19.7% in twelve months. Non-earmarked credit operations increased by 1.8%, 6.6% and 13.2%, according to the same comparison bases. Among the non-earmarked operations, credit operations to individuals increased 0.9% in the month and 7.6% in the year and 16.4% in twelve months, while non-earmarked credit operations to corporate increased 2.6%, 5.6% and 10.2%, according to the same comparison bases. Earmarked credit operations increased 2.4% in the month,

11.3% in the year and 35.3% in twelve months, highlighting the rises of 3.5%, 21.4% and 50.9% recorded in housing credit, according to the same comparison bases.

55. The average interest rate on non-earmarked credit operations, used as reference for interest rates, declined 0.3 p.p. in June, reaching 34.6%. The average annual rate on credit for individuals reached 40.4% in June, decreasing by 1.1 p.p. relative to May. The average rate on corporate credit totaled 27.3% in June, increasing by 0.4p.p. relative to May.

56. The average tenure on non-earmarked credit operations, used as reference for interest rates, increased in June, reaching 450 days, up from 435 days in May. This expansion mirrored the rises in the average tenure of credit for individuals and corporate (9 days and 19 days, respectively), which totaled 527days and 382 days, following the same order.

57. Delinquency rates in the financial system (non-earmarked loans used as reference for interest rates, in arrears for more than ninety days) reduced 0.1 p.p. in June, reaching 5%. Delinquency rates for credit operations with corporate decreased 0.1 p.p., reaching 3.6%, and with individuals, declined 0.2 p.p., reaching 6.6%.

58. Net delinquency rate for retail credit, measured by the ACSP, after three monthly consecutive rises, declined from 8.4% in April to 6.6% in May.

External Environment

59. The IMF revised the global economy growth projection for 2010 from 4.3% in April to 4.6% in July. This change encompasses the estimates of GDP decline from 1.3% to 1.2% for UK; the maintenance of 1% growth in the Euro Area; and favorable revisions related to the economy performance in the US, Japan and important emerging countries. However, the risk of downturn in these rates turned to increase, in an environment with uncertainties related to the fiscal crisis in Europe. In this sense, recent indicators suggest relative deceleration in the growth paces in the US and China, while the consumer annualized quarterly change recorded negative rates in Japan and in the Euro Area, and cooling in the US. Additionally, it is important to notice the deceleration in the manufacturing industry in Japan and in the Euro Area, as well as the negative change in the number of formal jobs in the US and the deceleration of retail sales and gross fixed capital formation in China. In June, this set of indicators translated into a retreat in the Purchase Management Indices (PMI) in the G3 economies and in China.

60. Despite operating with volatility, financial markets have been steadier since the last Copom meeting, especially regarding the performance of the main stock exchanges. Government securities yields of the main developed economies fell in the period.

61. The annual change of the consumer price indices (IPC) reached, in June, 1.1% in the US and 1.4% in the Euro Area. In Japan, ratifying the deflationary deceleration, the annual change in the index reached -0.9% in May, compared to -2.5% in October 2009. As the G3 economies have recorded high idleness in the production factors and that fiscal constraints have grown, the respective central banks have maintained accommodative monetary policy stances. The number of central banks which decided to adopt more restrictive monetary measures have increased in the emerging economies of America and Asia, and in commodities exporters, such as Canada and New Zealand, where domestic demand has been heated.

Foreign Trade and International Reserves

62. The Brazilian trade surplus reached US$2.3 billion in June, totaling US$7.9 billion in the first half of 2010. On a daily average basis, this surplus decreased by 43.7%, year-over-year, as a result of increases of 43.9% and 26.5% in imports and exports, respectively. External trade reached US$170.5 billion in the first half, growing by 34.2%, year-over-year.

63. Based both on the liquidity concept and on the cash concept, international reserves reached US$253.1 billion in June, growing by US$14.1 billion and US$14.6 billion, respectively, in the year. The two concepts were equal due to the full payment of borrowing operations in foreign currencies in May. In the year through June, the monetary authority's interventions accounted for net purchases of US$14.1 billion in the domestic spot market.

Money Market and Open Market Operations

64. Since the June Copom meeting, the slope of the domestic yield curve has reduced throughout its length. The drivers of this movement were, regarding the domestic outlook, a more conservative reading of the Copom Minutes, the disclosure of below-than-expected current inflation indices and economic activity data and the expectation of a shorter monetary tightening cycle. Regarding the foreign outlook, recent signals of cooling in the global economic activity were key drivers in the decline of long term rates. Between June 7th and July 19th, one- three- six-month and one- and three-year rates increased by 0.62 p.p., 0.47 p.p., 0.21 p.p., 0.03 p.p. and 0.08 p.p., respectively. The two-year rate decreased by 0.02 p.p. Real interest rates, measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month-ahead inflation expectations declined from 6.46% on June 7th to 6.30% on July 19th.

65. In its open market operations, the BCB carried out, between June 8th and July 19th, repo operations borrowing R$28.3 billion for a six-month period. As a consequence, the average daily balance of the long term operations reached R$95.0 billion. In the same period, the BCB also borrowed money through repo operations with tenures between thirteen and thirty working days, totaling a US$235.3 billion average daily balance of short-term borrowing operations. The BCB also borrowed money through 31 overnight repo operations and conducted daily two-working-day tenure liquidity management operations. The very short-term operations, including the liquidity management operations, averaged a daily balance of R$58.8 billion in the period, borrowing. The average daily balance of the total stock of repurchase agreement of the Central Bank increased from US$340.6 billion, between April 27th and June 7th, to US$389.1 billion, between June 8th and July 19th. Considering the daily balance of operations for the most recent period, there was an increase in the repurchase agreements totaling R$48.7 billion, with a increase in total stock from R$360.1 billion on June 7th to R$408.8 billion on July 19th. The net redemption of securities by the National Treasury and the federal government net expenditures were the main drivers of the liquidity expansion in the period.

66. Between June 8th and July 19th, the National Treasury issuance regarding the traditional auctions raised a total of R$45.4 billion. The issuance of fixed-rate securities reached R$29.9 billion, with R$25.0 billion via issuance of LTNs maturing in 2010, 2011 and 2012, and R$4.9 billion via NTN-Fs maturing in 2014 and 2021. Issuance of LFTs totaled R$11.5 billion, for securities maturing in 2014 and 2016. Issuance of inflation-linked NTN-Bs reached R$4.0 billion, for securities maturing in 2013, 2015, 2020, 2030, 2040 and 2050.