



# BANCO CENTRAL DO BRASIL

## Minutes of the 153<sup>rd</sup> Meeting of the Monetary Policy Committee (Copom)

### Summary

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

**Date:** August 31<sup>st</sup>, from 4:30PM to 6:35PM, and September 1<sup>st</sup>, from 5:45PM to 8:30PM

**Place:** BCB Headquarters meeting rooms - 8<sup>th</sup> floor on August 31<sup>st</sup> and 20<sup>th</sup> floor on September 1<sup>st</sup> – 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 August 31<sup>st</sup>)

Adriana Soares Sales – Research Department (also present on September 1<sup>st</sup>)  
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 August 31<sup>st</sup>)

Alexandre Pundek Rocha – Advisor to the Board  
Eduardo José Araújo Lima – Deputy-Head of the Research Department  
Emanuel Di Stefano Bezerra Freire – Advisor to the Board  
Francisco Leopoldo de Carvalho Mendonça Filho – Press Secretary  
Wagner Piazza Gaglianone – Advisor to the Research Department

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 rising in the first four months of 2010, was zero in June and near zero in July (0.01%). As a consequence, inflation accumulated in the first seven months of 2010 reached 3.10%, largely mirroring the behavior of market prices, which increased by 3.55% in the same period. Focusing on market prices, whereas tradable goods showed some stability in the year through July, year-over-year (2.22%, down from 2.26% in



## BANCO CENTRAL DO BRASIL

2009), the prices of non-tradable goods increased (4.74%, up from 3.33% in 2009). On its turn, regulated prices decelerated, increasing by 2.03% in the same period, compared to 2.81% 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, shows some increase at the margin, reaching 5.12% in the year through July and 6.90% in twelve months. In short, information available shows improvement in inflation dynamics.

2. The three main underlying inflation measures calculated by the BCB showed convergent behavior between June and July. The smoothed trimmed means core inflation decreased from 0.40% in June to 0.25% in July, and so did the double weight core inflation (from 0.29% to 0.20%) and the core inflation by exclusion (from 0.36% to 0.24%), respectively. In the year through July, the core inflation by exclusion increased by 3.32%, while smoothed trimmed means and double weight core inflation measures increased 3.14% and 2.98%, respectively. Despite the more favorable dynamics in the recent months, these changes are, respectively, 0.24 p.p., 0.58 p.p. and 0.13 p.p. above the rates prevailing in the same period in 2009. The twelve-month trailing inflation measures, on its turn, reached in July 4.98%, 4.96% and 4.87%, for the core inflation by exclusion, smoothed trimmed means and double weight core inflation measures, respectively, therefore, still standing above the midpoint of the inflation target. After six months above 60%, the June IPCA diffusion index retreated to 57.3%, retreating again in July (48.7%).
3. The General Price Index (IGP-DI) inflation decreased from 0.34% in June to 0.22% in July. In the year through July, the IGP-DI inflation reached 5.71% (-1.68% 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 6.54% in 2010 through July (-4.03% in the same period of 2009). On its turn, the Consumer Price Index - Brazil (IPC-Br) increased 3.42% in the same period (3.01% in 2009), whereas the Civil Construction National Index (INCC) increased 6.09% (2.69% in 2009). The IPA-DI inflation acceleration, under this comparison basis, derived both from the behavior of agricultural and industrial prices. The industrial IPA increased 6.82% (-5.06% in the same period of 2009), and wholesale agricultural prices rose 5.64% (-1.04% in 2009). Furthermore, it should be emphasized that the dynamics of wholesale prices improved, 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 for products taxes and, therefore, it constitutes an important coincident indicator of economic activity. After registering growth for sixteen consecutive months until April, the IBC-Br was stable in May and June. The evolution of the IBC-Br, as well as other indicators of activity, suggests accommodation of the economy in the second quarter, in contrast to the fast pace observed in the first quarter of 2010. However, the outlook for second half of 2010 signals that the economy may grow, but at a pace more consistent with rates evaluated as sustainable in the long term.
5. According to data seasonally adjusted by the IBGE, industrial output increased 0.4% in July, after having retreated in the previous three months. Year-over-year, the production increased 8.7% in July 2010, down from 11.1% in June. On a twelve-month trailing basis, after consecutive declines observed since February 2009 until March 2010, industrial production expanded 8.3% (4.5% in May and 6.5% in June), the fourth consecutive increase. On its turn, on a three-month moving average basis, according to data seasonally adjusted by the IBGE, industrial output decreased 0.3% in July, after decreasing 0.7% in June. In the first months of this year, the strength of industrial activity was 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. Due to the fall in the month-on-month comparison basis observed throughout the second quarter, the behavior of IBGE industrial output series and its components continues close to that observed in the period prior to the 2008/2009 crisis. Industrial production should resume the upward trend, being this process supported not only by traditional sources of credit, but also by the recovery of capital markets and the performance of public financial institutions, among other factors.



## BANCO CENTRAL DO BRASIL

6. Among the use categories, according to data seasonally adjusted by the IBGE, the most important drivers in July were durable consumer goods and intermediate goods production, increasing by 0.9% in both cases. Semi-durable and non-durable consumer goods production also increased (0.3%), whereas capital goods production decreased 0.2%. On a three-month moving average basis, while intermediate goods slightly increased (0.1%), the production of all other categories decreased: capital goods, -0.7%; durable consumer goods, -0.9%; and semi-durables goods, -0.5 %. It bears highlighting that capital goods production expanded by 28.3% in the year through July, 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) decreased from 7.0% in June to 6.9% in July, 1 p.p. lower than that observed in the same month of last year. According to the seasonally adjusted series, the unemployment rate remained stable in 7.0% for the third consecutive month. After decreasing substantially after the 2008/2009 crisis, the unemployment rate has shown some stability. Average real earnings increased 2.2% in July, month-on-month. Employment, on its turn, increased by 3.5% in June and 3.2% in July, year-over-year, with highlights for the industry sector. As a consequence, real payroll expanded by 8.4% in July, 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, 182 thousand jobs were created in July and 1.66 million, in the first seven months of 2010, registering the third best level for July and a record high for job creation in the first seven months of the year 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 13.9% in the first seven months of the year, year-over-year.
8. According to data seasonally adjusted by the IBGE, expanded retail sales remained stable in June, after decreasing by 0.1% in May and 6.7% in April. On a year-over-year basis, the indicator increased 3.4% in June. The three-month moving average of expanded retail sales for the quarter ended in June decreased 1.9%, as compared to the quarter ended in March, according to seasonally adjusted data. On a month-on-month basis, according to seasonally adjusted data, it bears emphasizing the expansion in the office material and equipment (5.4%), other items for personal and domestic use (5.2%), and hyper-, supermarkets and food products (1.5%). Despite the stability shown at the margin, in 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 85.4% in August, standing near the levels registered prior to the 2008/2009 crisis. According to the CNI series seasonally adjusted by the BCB, the Nuci decreased to 82.7% in June (from 82.8% in May). According to the seasonally adjusted monthly series calculated by FGV, the Nuci reached 84.9% in August (85.1% in the previous month). Among the four use categories, the Nuci in consumer goods industry (84.9% versus 85.0% in the previous month) and in construction inputs (91.0% versus 91.7% in the previous month) decreased in August, month-on-month. On its turn, the Nuci for capital goods (84.0%) increased 1.3 p.p., while the Nuci for the intermediate goods industry remained stable as compared to the previous month (86.3%). The reduced idleness capacity is the result of economic activity expansion, still 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 decreased 0.2% in July, month-on-month seasonally adjusted, and increased 27.9%, year-over-year; in the year through July, growth reached 31.0%. The production of construction inputs reduced 2.5% in July, month-on-month. According to observed data, it increased 9.5% in July, year-over-year, accumulating a 7.9% growth in twelve months. In short, evidences suggest that the utilization rates have accommodated at high levels. As stressed in previous



## **BANCO CENTRAL DO BRASIL**

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\$17.7 billion surplus in July, US\$ 9.4 billion lower than the obtained in the same period last year. This total resulted from US\$175.8 billion in exports and US\$158.0 billion in imports, equivalent to 2.8% and 9.9% 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\$43.8 billion in July, equivalent to 2.2% of GDP, up from US\$40.9 billion in June. On its turn, foreign direct investment reached US\$26.7 billion in the last twelve months through July, equivalent to 1.4% of GDP.
11. The global economy recovery continues to be led by emerging economies, but since the last Copom meeting evidences have accumulated signaling that this process may be less intense than previously anticipated, in a scenario where the observation of dynamism in the G3 economies (US, Europe and Japan) for 2011 becomes less likely. The US economy shows signs of weakening, evidencing that the current recovery should unfold at a pace slower than previously anticipated, and the possibility of a reversion may not be abandoned. In fact, consumer confidence remains at levels below those prevailing prior to the 2008/2009 crisis, and unemployment remains at a high level, with prospects of slow retreat in the next months. On its turn, the Japanese economy continues to grow at a noticeable slow pace. The recovery in the Euro Area is uncertain, besides being slow and uneven across its economies, partly due to the fiscal consolidation and the difficulties experienced by the credit market. On the other hand, German economy, the most important in the Euro Area, shows some signs of resumption. 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 G3 economies 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 2008/2009 crisis, which recovered more quickly and intensely, and that adopted more restrictive monetary policy stances, some accommodation has been verified.
12. Since the last Copom meeting, oil prices have decreased in the spot market and have increased in future markets. Volatility has increased, and the uncertainty concerning the quotations has remained high, as the prospective scenario depends on the evolution of demand, in a context of asymmetric global economic recovery, 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 the domestic economy 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 increased since the previous Copom meeting, with highlights for wheat and corn. On their turn, industrial commodity prices also increased in the same period.

### **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 adjustment for fixed telephone was kept at 1.6% for 2010 while the projected adjustment for electricity prices increased from 1.5% to 3.7% for 2010;



## BANCO CENTRAL DO BRASIL

- c) the projection for regulated prices inflation for 2010, based on individual items, was maintained at 3.6%, unchanged relative to the July meeting, according to the benchmark scenario. This set of prices, according to data released by the IBGE, accounted for 29.30% of the total July 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 142 bps and 27 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 5.42% to 5.07%. For 2011, the median of inflation expectations increased from 4.80% to 4.87%.
16. The benchmark scenario assumes the maintenance of the exchange rate at R\$1.75/US\$1.00 and the Selic rate at 10.75% p.a. during the forecast period. Under this scenario, the projection for the 2010 inflation decreased relative to the figure considered at the July Copom meeting, but continues to be 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 it still continues above the inflation midpoint target. For 2011, under the benchmark scenario, the projection decreased relative to the figure considered at the July Copom meeting, and it is now around 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 under the benchmark scenario, although the contrary movement was observed under the market scenario, but under both scenarios the projection is around the inflation midpoint target.

### Monetary Policy Decision

17. The Copom evaluates that the monetary policy should contribute to the consolidation of a favorable longer-term macroeconomic environment. In this respect, the Copom confirms that under the inflation-targeting regime, it guides its decisions according to projected inflation and based on the analysis of several alternative scenarios for the evolution of the main variables that determine the price dynamics. The Committee also understands that low risks for the underlying inflation in the short run tend to reduce uncertainties regarding the future behavior of headline inflation, facilitate the assessment of scenarios by the monetary authority, and help the process of coordination of economic agents' expectations, mainly price setters'. It is additionally noteworthy that low risks for the underlying inflation in the short run tend to reinforce the effects of monetary policy actions, enabling them to affect in a more long-lasting manner the dynamics of headline inflation in the future. Although the Copom recognizes that other actions of macroeconomic policy may influence the price trajectory, it reaffirms its view that it is the responsibility of the monetary policy to remain especially vigilant to guarantee that pressures detected in shorter horizons do not spread to longer horizons.
18. 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





## BANCO CENTRAL DO BRASIL

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.

19. As a consequence of the stabilization and correction of unbalances, which determined important structural changes, the process of maturing of the inflation targets stands at advanced stage, and it reflects favorably in the dynamics of neutral interest rate and in the power of monetary policy. Evidences under this respect can be observed, among other factors, through the accomplishment of inflation targets in the last six years, at the same time that real interest rates have reduced. Progress in the financial markets structure, the FX and inflationary risk premium reduction, among other factors, seem to have resulted in significant reduction of the neutral rate. The generation of primary surpluses consistent with the maintenance of decreasing trend for the public debt/GDP ratio also contributed for it. From another point-of-view, some of these developments, combined to others, such as the extension of contract tenures, also suggest that the power of monetary policy in Brazil has increased in the last years. Despite recognizing that a high degree of uncertainty surrounds the calculation of non-observable variables, the Copom considers that the most pessimist estimates regarding the current level of neutral interest rate tend, with significant probability, not to find support in fundamentals. The Committee also considers that there are evidences that the traction of monetary policy increased in the recent past and, compared to what was observed some years ago, currently inflationary pressures are contained with more efficiency by monetary policy actions.
20. In international markets, risk aversion and volatility have remained high since the last Copom meeting; liquidity remains limited, although the perception of systemic risk shows cooling signs. Concerns about European countries sovereign debt and the deceleration in China remain elevated, while the worries regarding the sustainability of the US economy recovery increased. 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 remain. In this context, the probability of some influence of external disinflation over domestic inflation remains high, 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.
21. 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, both for individuals and corporate; 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. The Copom considers, on the other hand, that the dynamism of domestic activity will continue to be benefited, among other factors, by the vigor of labor market, by the remaining effects of fiscal impulses and of policies of public banks and, at a magnitude lower than previously expected, by the global activity.
22. 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 substantially deteriorated early this year, a dynamic that has reversed more clearly since the last meeting, greatly mirroring less favorable prospects for global activity and the monetary policy actions implemented this year. This assessment finds support, for instance, in the significant reduction of analysts' projections for the Selic rate, without resulting in unfavorable changes in the median of inflation projections, which, in fact, have substantially reduced for 2010 and increased only marginally for 2011. Moreover, regarding the forward-looking scenario, it is fundamental to highlight that there was retreat in the values projected for inflation by the BCB.



## **BANCO CENTRAL DO BRASIL**

23. Despite recognizing the existence of risks of inflation increase in the short run, the Copom considers that the convergence of inflation to the midpoint target tends to materialize. For that, it finds support in the pertinent consideration that monetary policy acts with time lags over activity and inflation, and that the effects of the adjustment process in the basic interest rate initiated in April 2010 haven't completely materialized. On the other hand, the Committee ensures that, in case this scenario does not promptly materialize, the monetary policy stance should be adjusted in order to guarantee the convergence between the pace of demand and supply expansions. From another point-of-view, in case inflation does not promptly converge to the midpoint target established by the CMN, monetary policy should act in order to redirect price dynamics and, therefore, ensure the target to be fulfilled.
24. The intensity and frequency of shocks that both the global and Brazilian economies have undergone in recent years impose additional challenges to the analysis of the prospective scenario. The Committee recognizes an economic environment where uncertainty stands above the usual and the remaining risks for the consolidation of a benign inflationary scenario stem from the domestic outlook. For instance, it bears highlighting those deriving from domestic demand expansion, in a context of narrow idleness margin in the use of production factors. Evidences of this fact 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 the factors that support these domestic risks have decelerated. For example, there are signs that the economy has moved towards a trajectory closer to long-term equilibrium and, therefore, the effects of demand pressures and the high level of utilization of the factors on the balance of risks for inflation tend to cool down.
25. 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 substantial part of stimuli introduced during the international financial crisis of 2008/09 and, in particular, to the basic rate adjustment implemented since April. Another contributing factor for that, in the same period, was the higher probability of deceleration, and even reversion, of the already slow process of recovery of G3 economies. As a consequence, the influence of the international outlook over domestic inflation behavior shows a disinflationary bias.
26. Under these considerations, the Copom unanimously decided to maintain the Selic rate at 10.75% p.a., without bias. While the Copom does not expect the inflation level recorded in the last months to be kept in the near future, it observes the continuation of the process of risk reduction for the inflationary scenario unfolding since the June Copom meeting. In this context, the Committee judges that, at this moment, the maintenance of the basic interest rate at the level set in the July meeting provides adequate conditions to ensure the convergence of inflation to the targets path.
27. Domestic demand is robust, largely due to the effects of stimulus factors, such as income growth and credit expansion. Moreover, although they tend to cool, fiscal and credit incentives have been provided to the economy in recent quarters, and still should contribute for the consolidation of activity expansion and, hence, for the maintenance of the idleness margin of factors at 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 referring to the significant worsening of the global economy prospects and especially by those stemming from the monetary policy stance change. 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. At the end of the meeting it was announced that the Committee will reconvene on October 19th, 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**



## BANCO CENTRAL DO BRASIL

29. The IPCA-15 changed -0.05% in August, up from -0.09% in July, increasing 3.21% in the year and 4.44% in twelve months. The performance in the month reflected mainly the contribution of the group food and beverages (- 0.16 p.p.), which changed -0.68%. The diffusion index reached 52.86%, up from 48.96% in July.
30. The monthly change of the IPCA-15 reflected the impact of the deceleration in regulated prices, which increased 0.01% in August, down from 0.21% in July. Related to market prices, the prices of tradable goods showed lower retreat (-0.18%, up from -0.35%), while the prices of non-tradable goods registered a reversal in the downward trend (0.01%, up from -0.10%), in the same period. Market prices rose 4.74% in the last twelve months through August, reflecting the increases in the prices of tradable goods (2.50%) and non-tradable goods (6.69%), whilst regulated prices grew 3.77%. It can be emphasized that, according to this comparison basis, all segments decelerated, relative to July.
31. The three IPCA-15 core inflation measures cooled down in August. Core inflation by exclusion increased 0.12% in August, down from 0.20% in July, totaling 4.79% in twelve months. The smoothed trimmed-means core inflation reached 0.24%, down from 0.30% in July, accumulating 4.95% in twelve months, while the double weight core inflation increased 0.15%, down from 0.19% in July, totaling 4.81% in twelve months.
32. The IPCA changed 0.01% in July, after showing stability in June. In the first seven months of the year, the IPCA totaled 3.10%. On a twelve-month trailing basis, the IPCA rose 4.60% in July, down from 4.84% in June and 5.22 % in May.
33. The IPCA in July reflected impacts in opposite directions of the trajectories of regulated prices (0.32%, up from 0.12% in June) and market prices (-0.12%, down from -0.05% in June), which were mainly influenced by the change in the prices of tradable goods (-0.21%, down from -0.09% in June). The IPCA segmentation shows that the stability in the last two months stemmed mainly from the decreases in the prices of food and beverages, which have offset the positive contributions of the other segments. Despite the stability of the last two results, it should be noted that the decrease in the prices of food and beverages in the period cooled down, which can affect the pattern of the index in the next months. The diffusion index reached 48.70%, down from 57.29% in June.
34. The three IPCA core inflation measures decelerated, in July, month-on-month. The smoothed trimmed-means core inflation measure reached 0.25% in July, down from 0.40% in June, totaling 4.96% and 5.02% in the last twelve months through July and through June, respectively. Core inflation by exclusion, which excludes ten items of household food and fuel, grew 0.24% in July, down from 0.36% in June, totaling 4.98% and 5.02% in the last twelve months through July and through June, respectively. The double weight core inflation increased 0.20% in July, down from 0.29% in June, totaling 4.87% and 4.99% in the last twelve months through July and through June, respectively.
35. The IGP-M increased 0.77% in August, up from 0.15% in July, totaling 6.66% in the year and 6.99% in twelve months. The Wholesale Price Index (IPA) increased by 1.24% in August, up from 0.20% in July, reflecting the acceleration both in industrial prices (1.26%, up from 0.18%) and in the prices of agricultural products (1.15%, up from 0.28%). In the last twelve months through August, the IPA rose 8.13%, reflecting respective increases of 8.97% and 5.56% observed in the prices of industrial and agricultural products. The IPC-M changed -0.27% in August, down from -0.17% in July, totaling 4.04% in twelve months. The INCC increased 0.22% in August, down from 0.62% in July, totaling 6.80% in twelve months.

### Economic Activity

36. The IBC-Br showed stability in June, month-on-month, considering seasonally adjusted data. After increasing by 1.2% in March, the indicator showed relative stability in the subsequent months. For the quarter ended in June, the average increased 1.3%, down from 2.4% for the quarter ended in March, according to observed data. For the quarter ended in June, the IBC-Br expanded by 9.9%, year-over-year, totaling 10% in the year and 6% in twelve months.





## BANCO CENTRAL DO BRASIL

37. Expanded retail sales remained stable in June, after decreasing by 0.1% in May and by 6.7% in April, according to seasonally adjusted data by the IBGE's monthly survey (PMC). According to month-on-month seasonally adjusted data, sales decreased in five of the ten sectors surveyed, with highlights for the following negative drivers: construction inputs (-3.1%), books, newspapers, magazines and stationery (-2.3%) and fuels and lubricants (-1.2%). On the other hand, sales of office equipment and material grew by 5.4%, followed by other items of personal and domestic use (5.2%), and hyper-, supermarkets and food products (1.5%). For the quarter ended in June, retail sales fell by 1.9%, compared to the quarter ended in March.
38. Retail sales grew 3.4% in June, year-over-year, accumulating increases of 11.8% in the year and 10.6% in the last twelve months. Among the segments of trade, only vehicles and motorcycles, parts and pieces retracted year-over-year (9.5%). Among the segments that expanded, it bears noticing the rise in sales of office material and equipment (23.2%) and furniture and appliances (17%). In the year, sales increased for all segments, especially those regarding office material and equipment (20.6%) and furniture and appliances (25.8%). Expanded retail sales in the last twelve months through June, relative to the last twelve months through May, also shows generalized increase by activity, with highlights to the rise in office material and equipment (15.3%) and vehicles and motorcycles, parts and pieces (14.1%).
39. The number of consultations to the Central Credit Protection Service (SCPC) and to the Usecheque System recorded respective declines of 0.7% and 0.4% in July, according to seasonally adjusted data from the Commercial Association of Sao Paulo (ACSP), covering the state capital. Considering observed data, these indicators recorded respective increases of 9.1% and 6% in the first seven months of the year, year-over-year.
40. Automobile sales by dealers, including cars, light commercial vehicles, trucks and buses, rose 12.7% in July, month-on-month, according to Fenabrave (Brazilian Federation of Automotive Vehicles Distribution) data, seasonally adjusted by the BCB. It bears highlighting the sales of cars and trucks, which increased, respectively, 14.4% and 8.2%. Total sales increased 6% year-over-year, with highlights for trucks (51.7%) and light commercial vehicles (26.4%), while cars sales remained almost stable (-0.3%). In the year and in the last twelve months through July, automobile sales increased respectively 8.5% and 15%, driven by higher increases in all segments, especially trucks, buses and light commercial cars.
41. Capital goods imports increased 12% in July, month-on-month, according to the Funcex quantum index, seasonally adjusted by the BCB. Year-over-year, the indicator rose 61.8%, while in the year and on a twelve-month trailing basis, it increased 31.3% and 7.1%, respectively, compared to the same periods of the previous year.
42. Capital goods production decreased 0.2% in July, totaling expansion of 1.5% in the quarter, according to data from the Monthly Industrial Survey (PIM) by IBGE. The main declines for production in July, month-on-month, were capital goods for serial industrial use (7.8%), for mixed use (8.4%) and for construction (4.9%). On the other hand, it bears noticing the production of agriculture pieces (9.5%), capital goods for agriculture (6.6%) and capital goods for the electricity sector (2.9%). In the year through July, year-over-year, the production of capital goods increased 28.3%, with highlight for the 167.2% increase in the segment of goods for the construction sector.
43. Disbursements granted by the BNDES in the year through July reached R\$72.7 billion, recording a 3% decrease over the same period of last year. This evolution is influenced by the R\$25 billion granted for Petrobras in June 2009. The infrastructure sector absorbed 39% of the total disbursements released in the first months of 2010, followed by industry (33%), trade and services (20%) and agriculture and livestock sector (8%).
44. Industrial production grew 0.4% in July, month-on-month, after changing -1.1% in June (revised data), according to seasonally adjusted data from the PIM-PF. By use categories, monthly increases were recorded in the production of intermediate goods (0.9%), durable consumer goods (0.9%) and semi- and non-durable consumer goods (0.3%), while capital goods retreated 0.2%. Considering industry activities, the major changes were observed in medical equipment (13.8%), other transport equipment (6.8%) and furniture (6.6%).



## BANCO CENTRAL DO BRASIL

The main negative drivers were machines and equipment (-6%); publishing, printing and recording reproduction (-5.6%) and miscellaneous industries (-3.4%).

45. Industrial production increased 8.7%, year-over-year, with emphasis on the production of capital goods (21.1%), intermediate goods (11.3%) and semi- and non-durable consumer goods (3.9%). On a twelve-month trailing basis, general industry grew 8.3% in July, year-over-year, with highlights to the increases in the production of durable consumer goods (14.5%) and of capital goods (9.3%).
46. The Nuci in the manufacturing industry, calculated by FGV, reached 84.9% in August, a 0.2 p.p. fall relative to the previous month and a 3.8 p.p. increase relative to the level observed in the same month of 2009. The increase in the installed capacity utilization rate, compared to the same period of the previous year, is also observed in all use categories: durable consumer goods (1 p.p.), intermediate goods (4.3 p.p.), capital goods (7.3 p.p.) and construction material (2.9 p.p.).
47. Vehicles production reached 315.9 thousand units in July, according to data released by the Anfavea and seasonally adjusted by BCB, representing a downfall of 0.1% in relation to June. The sector production presented expansion of 11.9% in relation to July 2009, of 18.2% in the year and of 18.5% in the last twelve months ended up in July
48. Vehicles sales grew 2.3% in July, in relation to June, resulting in expansions of 3.6% in domestic market sales and of 6.1% in exports. In the year and in twelve months, domestic sales increased by 6.8% and 15.5%, respectively, while exports expanded by 78.4% and 25.5%.
49. The LSPA survey carried out by the IBGE in July designed a 9.2% annual expansion for grains in 2010, representing 146.4 million tons. The growth perspective for the year reflected the upward movements of soybeans (19.8%), wheat (7.4%), and corn (4.4%), as opposed to the estimated retractions for rice (10.3%) and beans (4.2%).

### Surveys and Expectations

50. According to the Consumer Expectations Survey carried out by the FGV nationwide, the Consumer Confidence Index (ICC) increased 0.7% in August, month-on-month seasonally adjusted, reaching 120.8 points. The result was influenced by the 0.6% increase in the Current Situation Index (ISA), which reached historical record by the fifth consecutive month, and by the 0.7% increase in the Expectation Index (IE). Year-over-year, the ICC increased 9.2%, reflecting increases of 19.1% in ISA and of 3.7% in IE.
51. The Industry Confidence Index (ICI) from FGV decreased 0.6% in August, reaching 112.9 points, considering seasonally adjusted data, reflecting the 1.4% decrease in ISA and the 0.3% increase in IE. Year-over-year, the ICI grew 12.1%, reflecting increases of 13.4% in the ISA and of 10.9% in the IE.
52. The Services Confidence Index (ICS) from FGV reduced 1.5% in July month-on-month, influenced by the 5.2% downfall in the ISA-S, while the IE-S (Expectation Index) increased 1.5%, after four consecutive months of decrease. July ICS stood at 6.6% above the historical averaged of 121.4 points and 12.5% above the July 2009 index. Nevertheless, July recorded the fourth consecutive ICS drop, resulting in a 4.4% reduction since March. The quarter ended up in July showed a 1.8% decrease in ICS, quarter-over-quarter.

### Labor Market

53. According to the General Record of Employment and Unemployment (Caged) of the Ministry of Labor and Employment (MTE), 181.8 thousand formal jobs were created in July, resulting in 1,655.1 thousand jobs in the year, a record high for the period since the series began in January 1985. From January to July 2010, the service sector registered a record in expansion of formal jobs (551.6 thousand), in manufacturing industry (435.7 thousand), in civil construction (268.4 thousand) and in commerce (172.4 thousand). In July, it bears highlighting the contractions in the service sector (61.6 thousand), in the manufacturing industry (41.5



## BANCO CENTRAL DO BRASIL

thousand) and in civil construction (38.4 thousand). From August 2009 to July 2010, 2,212.3 thousand formal jobs were created, a record high for the twelve-month period. Considering seasonally adjusted data, employment increased 0.4%.

54. According to the IBGE employment survey (PME), carried out in the six main metropolitan regions of the country, the unemployment rate reached 6.9% in July, declining 0.1 p.p. month-on-month and 1 p.p. year-over-year. In seasonally adjusted terms, the unemployment rate remained stable at 7%, for the third consecutive month, as a result of a 0.6% expansion for both the Economically Active Population (PEA) and the occupation. According to the same survey, average real earnings usually earned by workers increased 2.2% month-on-month and 2.1% in the year through July, contributing for payroll growth, 5.1% and 8.4%, according the same comparison bases.

### Credit and Delinquency Rates

55. Outstanding credit in the financial system reached R\$1,548 billion in July, equivalent to 45.9% of GDP, increasing by 1.2% in the month, 9.4% in the year and 18.4% in twelve months. Non-earmarked credit operations increased by 0.7%, 7.2% and 13.8%, according to the same comparison bases. Among the non-earmarked operations, credit operations to individuals increased 1% in the month and 8.7% in the year and 16.6% in twelve months, while those relative to corporate increased 0.4%, 5.8% and 11%, according to the same comparison bases. Earmarked credit operations increased 2.3% in the month, 14% in the year and 28.8% in twelve months, highlighting the rises of 4%, 26.3% and 51.1% recorded in housing credit and of 4.7%, 22.7% and 45.4% recorded in BNDES disbursements, according to the same comparison bases
56. The average interest rate on non-earmarked credit operations, used as reference for interest rates, expanded by 0.8 p.p. in July, reaching 35.4%, a record high since October 2009. The average annual rate on credit for individuals reached 40.5% in July, while the average rate on corporate credit totaled 28.7%, increasing by 0.1 p.p. and by 1.4p.p. relative to June, respectively.
57. The average tenure on non-earmarked credit operations, used as reference for interest rates reached 452 days, up from 448 days in June. This expansion mirrored the rises in the average tenure of credit for individuals and corporate (5 days and 3 days, respectively), which totaled 528 days and 385 days, following the same order.
58. Delinquency rates in the financial system (non-earmarked credit used as reference for interest rates, in arrears for more than ninety days) remained at 5% in July, the same level observed in June. This stability has been almost unchanged since March 2010, when the delinquency rate stood at 5.1% and recorded the same figure in the following two consecutive months. Delinquency rates for credit operations with corporate and individuals remained at 3.6% and 6.5%, respectively.

### External Environment

59. Data for the second quarter GDP in the US, Japan and China confirmed the deceleration of the global economic activity growth pace. Between the first and the second quarter, GDP annualized growth rates fell from 3.7% and 4.4% to 1.6% and 0.4% in the US and Japan, respectively. In the same period, the Chinese GDP also cooled, from 11.9% to 10.3%. High frequency recent indicators have corroborated the prospects of maintenance of this deceleration process. In Europe, although the fiscal affairs remain as an important source of concern, the economic environment has improved, driven by the favorable results of the stress tests applied in the European banks. In the Euro Area, the second quarter GDP annualized growth rate increased to 3.9%, up from 0.8%, mainly as a result of the Germany performance.
60. Since the last Copom meeting, international financial markets have oscillated between moments of higher confidence with others of higher risk aversion, mainly driven by the prospects of future evolution of the economic activity in the major economies. In the period, the dollar reached a record low against the yen in fifteen years, and the 10-year government securities yields of the main developed economies fell, with the Germany securities reaching a record low for the historical series.



## **BANCO CENTRAL DO BRASIL**

61. Inflation remains under control, while the annual change of consumer prices indices (IPC) in the US and the Euro Area reached 1.2% and 1% in July, respectively. In Japan, the July IPC recorded a 0.9% annual deflation. The G3 central banks kept the accommodative stance of their monetary policies, while the Fed is reinvesting the fund obtained from mortgages backed redemptions in long-term treasuries. In the emerging and commodities exporters economies, such as Canada e Australia, as a result of domestic demand heat and/or product gap reduction, several central banks went on with suppression of the monetary policy accommodative stance, despite at a slower-than-expected pace. In fact, this process of delay on the normalization of monetary policy has been verified in the major part of mature and emerging economies.

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

62. The Brazilian trade surplus reached US\$2.4 billion in August, totaling US\$11.7 billion in the first eight months of 2010. On a daily average basis, this surplus decreased by 41.6%, year-over-year, as a result of increases of 45.7% and 28% in imports and exports, respectively. External trade reached US\$240.5 billion in the period, growing by 35.8%, year-over-year.
63. International reserves reached US\$261.3 billion in August, growing by US\$4 billion, compared to July and US\$22.3 billion in the year. In the year through August, the monetary authority's interventions accounted for net purchases of US\$3 billion in the domestic spot market in the month, amounting US\$18.6 billion in the first eight months of 2010.

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

64. Since the last Copom meeting, the slope of the domestic yield curve has reduced throughout its length. The drivers of this movement were, regarding the domestic outlook, the disclosure of inflation figures in line with market expectations and of data signaling economic activity accommodation. Regarding the foreign outlook, signals of cooling in the US economic activity recovery and in global economy dynamism originated a global movement of interest rate drop, boosting the foreign investment flow to domestic interest rate markets, which contributed to the long-term interest rate fall. Between July 19<sup>th</sup> and August 30<sup>th</sup>, one-month rate showed stability, while, three- and six-month rates fell by 0.21 p.p. and 0.31 p.p., respectively. The one-, two-, and three-year rates decreased by 0.31 p.p., 0.38 p.p. and 0.54 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 declined from 6.30% on July 19<sup>th</sup> to 5.89% on August 30<sup>th</sup>.
65. In its open market operations, the BCB carried out, between July 20<sup>th</sup> and August 30<sup>th</sup>, repo operations borrowing R\$25.4 billion for a six-month period. As a consequence, the average daily balance of the long term operations reached R\$100.1 billion. In the same period, the BCB also borrowed money through repo operations with tenures between thirteen and thirty working days, totaling a US\$232.2 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\$55 billion in the period, borrowing. The average daily balance of the total stock of repurchase agreement of the Central Bank decreased from US\$389.1 billion, between June 8<sup>th</sup> and July 19<sup>th</sup>, to US\$387.3 billion, between July 20<sup>th</sup> and August 30<sup>th</sup>. Considering the daily balance of operations for the most recent period, there was a decrease in the repurchase agreements totaling R\$39.4 billion, with a decrease in total stock from R\$408.8 billion on July 19<sup>th</sup> to R\$369.5 billion on August 30<sup>th</sup>. The net issuance of securities by the National Treasury and the federal government net revenues were the main drivers of the liquidity contraction in the period.
66. Between July 20<sup>th</sup> and August 30<sup>th</sup>, the National Treasury issuance regarding the traditional auctions raised a total of R\$62.2 billion. The issuance of fixed-rate securities reached R\$45.5 billion, with R\$32.2 billion via issuance of LTNs maturing in 2011 and 2012, and R\$13.3 billion via NTN-Fs maturing in 2014 and 2021. Issuance of LFTs totaled R\$6.6 billion, for securities maturing in 2014 and 2016. Issuance of inflation-linked NTN-Bs reached R\$10.1 billion, for securities maturing in 2013, 2015, 2020, 2030, 2040 and 2050.