



BANCO CENTRAL DO BRASIL

Minutes of the 161th Meeting of the Monetary Policy Committee (Copom)

Summary

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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 30th, 2011, from 4:15PM to 7:55PM, and August 31st, from 4:15PM to 8:25PM

Place: BCB Headquarters meeting rooms – 8th floor on August 30th and 20th floor on August 31st – Brasília – DF

In attendance:

Members of the Committee

Alexandre Antonio Tombini – Governor
Aldo Luiz Mendes
Altamir Lopes
Anthero de Moraes Meirelles
Carlos Hamilton Vasconcelos Araújo
Luiz Awazu Pereira da Silva
Sidnei Corrêa Marques

Department Heads (present on August 30th)

Adriana Soares Sales – Research Department (also present on August 31st)
Daso Maranhão Coimbra - Department of Banking Operations and Payments System
João Henrique de Paula Freitas Simão - Open Market Operations Department
Márcio Barreira de Ayrosa Moreira – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations and Special Studies Department
Tulio José Lenti Maciel – Economic Department
Wagner Thomaz de Aquino Guerra Júnior –International Affairs Department

Other participants (present on August 30th)

Alexandre Pundek Rocha – Advisor to the Board
Eduardo José Araújo Lima – Consultant to the Research Department
Emanuel Di Stefano Bezerra Freire – Executive Secretary of the Board
Gustavo Paul Kurrle – Press Officer
Katherine Hennings – Executive Secretary of the Board
Nelson Ferreira Souza Sobrinho – Consultant 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



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1. After recording 0.15% in June, monthly inflation measured by IPCA reached 0.16% in July. As a consequence, twelve-month inflation through July 2011 reached 6.87% (6.71% in June), 2.27 p.p. above inflation registered in the twelve months through June 2010. The inflation elevation in this period reflected the behavior of both market prices, which increased 7.38% (4.88% in the same period of 2010), and regulated prices, which increased 5.67% (3.95% in the same period of 2010). Regarding market prices, it bears highlighting that tradable goods inflation reached 6.44% (2.58% in the same period of 2010), while inflation related to non-tradable goods increased 8.18% (6.97% in the same period of 2010). It should be noted, in another perspective that the twelve-month change through July of the durable goods prices stood at -0.95%, of the semi-durable goods at 7.20% and of the nondurable goods at 8.73%. Despite the moderation at the margin, services price inflation continues at high levels, with monthly growth of 0.42% in July, down from 0.60% in June. In the twelve-month period through July 2011, services inflation reached 8.82%, the highest level since September 1997. In short, the set of available information suggests persistence in the price increase observed in 2010, process led by market prices, which, in part, reflects the fact that services inflation remains at high levels.
2. The underlying inflation measures calculated by the BCB performed similarly to headline inflation: while the twelve-month inflation through July increased, the average of the monthly rates retreated between May and July. The smoothed trimmed means core inflation increased to 0.41% in July, from 0.54% in June and 0.64% in May, while the non-smoothed trimmed means core inflation increased to 0.28% in July, from 0.44% in June and 0.45% in May. Similarly, the double weight core inflation, after registering 0.59% in May, decreased to 0.42% in June and to 0.38% in July. At the same time, core inflation by exclusion, which excludes 10 items of food at home and fuel, totaled 0.33% in July, down from 0.56% in June and 0.54% in May, while core inflation by exclusion of regulated prices and of household food at home changed from 0.43% to 0.50%, and 0.40% in the same period. Therefore, the average change of these five core measures retreated to 0.36% in July, down from 0.49% in June and 0.53% in May. In the twelve-month period up to July, the five core measures registered 6.18%, 5.71%, 7.01%, 6.61% and 7.12%, respectively, compared to 6.01%, 5.59%, 6.82%, 6.51% and 6.91% in June, and 5.86%, 5.40%, 6.68%, 6.30% and 6.80% in May.
3. The General Price Index (IGP-DI) inflation registered deflation of 0.05% in July and of 0.13% in June, compared to inflation of 0.01% in May. In the twelve-month period through July, the variation of this index reached 8.34%, up from 5.98% in July 2010. Note that, however, under this criterion, the index has been slowing down since December 2010, when it recorded 11.30% change. Inflation measured by its main component, the Wholesale Price Index (IPA-DI), reached 9.09% in twelve months through July, reflecting an increase of 5.95% in the industrial IPA and of 19.14% in the agricultural IPA. The breakdown according to the production phase shows that raw material prices accumulated 19.86% change, while the prices of intermediate goods and final goods increased 5.04% and 5.46%, respectively, following the same comparison basis. Inflation measured by the Consumer Price Index (IPC-DI), another component of the IGP-DI, recorded 6.58% in the twelve months through July 2011, above the 4.36% recorded until July 2010. According to the same comparison basis, the Civil Construction National Index (INCC), component with the lowest weight in the IGP-DI, increased 7.76% (6.67% in July 2010). The Producer Price Index/Manufacturing Industry (IPP/IT), calculated by the IBGE, which measures the industry price level excluding freights and taxes, registered 0.66% deflation in June, compared to a fall of 0.46% in May and an increase of 0.28% in April. In twelve months, the variation of this index decreased to 4.89% in June, from 5.69% in May.
4. The Economic Activity Index of the BCB (IBC-Br) incorporates estimates for the monthly production of the three sectors of the economy, as well as for taxes on production, and constitutes, therefore, an important coincident indicator of economic activity. Considering seasonally adjusted data, the IBC-Br declined 0.3% in June, after registering stability in May and an increase of 0.4% in April. As consequence, the index increased 0.7% in 2011Q2, compared to the previous quarter, down from 1.1% increase in 2011Q1. For the IBC-Br accumulated in twelve months, the moderation in the growth rate trend persists, reducing to 4.9% in June, from 5.3% in May. The Services Confidence Index (ICS), from FGV, increased 0.8% in July, after two equal and consecutive falls (-1.4% in May and June). Therefore, the level of the indicator in July stood 2.4% above that measured in July 2010 and relatively stable compared to the average level of 2010.
5. Industrial activity showed expansion in July, with a 0.5% increase in the industrial output, month-on-month, according to data seasonally adjusted by the IBGE, after recording a decrease of 1.2% in June and an



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increase of 1.1% in May. The three-month moving average growth rate reached 0.1% in the period from May to July, after a decline of 0.9% in the period from April to June. Year-over-year, industrial output decreased 0.3% in July, while in the twelve-month period there was an increase of 2.9%, compared to 3.7% in June, continuing the process of growth moderation. Since December 2008, month with the lowest output level during the 2008/09 crisis, the accumulated growth until July 2011 was 25.4%.

6. Among the industry use categories, according to data seasonally adjusted by the IBGE, capital goods and durable consumer goods increased in July, respectively, 1.7% and 2.9%, month-on-month, whereas the production of non-durable and semi-durable consumer goods increased 3.8%. In the production of intermediate goods, there was a decline of 0.7%. In the twelve months through July 2011, intermediate goods output increased 2.6%, durable consumer goods output grew 1.8% and non-durable and semi-durable consumer goods output increased 1.6%. According to the same comparison basis, capital goods industry activity growth is the highest among use categories, recording an 8.3% increase.
7. The unemployment rate in the six metropolitan regions covered by the IBGE Monthly Labor Survey (PME), according to observed data, decreased to 6.0% in July, down from 6.2% in June, compared to the 6.9% level registered in July 2010. After reaching 9.0% in March 2009, the observed data not only significantly reduced until July 2011, but reached a record low for the month since the start of the series in March 2002. The seasonally adjusted rate registered 5.9% in July, a 0.2 p.p. decrease compared to June. Employment, measured by the number of employed workers in the six main metropolitan regions, year-over-year, increased 2.1% in July, after an expansion of 2.3% in June. Data from the Ministry of Labor and Employment (MTE) indicate that in July 140.6 thousand jobs were created (181.8 thousand in July 2010), with expansion of formal jobs in all the eight sectors of economic activity. Services and retail were the sectors that mostly contributed for the formal employment increase in July. According to PME, real average earnings observed in July increased 2.2% month-on-month and 4.0% year-over-year. As a consequence, real payroll, considering real average earnings in the six metropolitan regions, expanded 6.2% in July, year-over-year. The payroll expansion is an important factor in sustaining growth in domestic demand.
8. According to the retail monthly survey (PMC) from IBGE, expanded retail sales increased 9.5% in June, year-over-year, after recording 12.9% growth in May and 12% in April, according to the same comparison basis. According to the seasonally adjusted series, expanded retail sales showed month-on-month increase of 0.5% in June, after expanding 0.9% in May and 1.2% in April. The twelve-month accumulated growth rate reached 10.9% in June, up from 10.5% in May and 10.2% in April. In the last twelve months through June, all ten sectors surveyed showed growth in sales volume, with highlights in terms of growth, for equipment and office supplies, computer and communication (18.7%), furniture and appliances (17.1%), vehicles, motorcycles and parts (14.2%) and construction inputs (14%). In the next months, the retail trajectory will continue to be benefited by governmental transfers, by the pace of growth of real payroll, by the consumer confidence and by credit expansion, with the perspective of moderation.
9. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by FGV, without seasonal adjustment, kept unchanged in 84.0% in August. Thus, capacity utilization was 1.0 p.p. and 1.4 p.p., respectively, lower than the ones observed in July and August 2010. According to the seasonally adjusted monthly series calculated by FGV, the Nuci fell from 84.1% to 83.6% in August, the lowest level since November 2009. Capacity utilization is higher in the construction inputs sector (88.6%) and intermediate goods (85.8%). In the sector of capital goods, the Nuci stood at 83.8%, while in the sector of consumer goods it stood at 83.4%. According to the Confederation of National Industry (CNI) data, seasonally adjusted by the BCB, the Nuci decreased from 82.4% in May to 82.2% in June. Though they remain at high levels, rates of capacity utilization have shown a downward trend at the margin, reflecting, in part, the maturation process of investments. In fact, the absorption of capital goods grew by 14.1% in the last twelve months through July, while production of construction inputs for the civil construction grew by 5.6%.
10. The trade balance surplus in the last twelve months increased from US\$25.3 billion in June to US\$ 27.1 billion in July. This result stemmed from US\$235.6 billion in exports and US\$208.6 billion in imports, equivalent to 34.1% and 31.9% changes, respectively, in the last twelve months through July. The current account deficit accumulated in twelve months fell from US\$49 billion in June to US\$ 47.9 billion in July, equivalent to 2.1% of



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GDP. On its turn, foreign direct investment reached US\$72.2 billion in the twelve months through July, equivalent to 3.17% of GDP, exceeding the needs for external funding.

11. Global economy faces period of high uncertainty, with deterioration in the prospects for short and medium term in the advanced countries and some activity moderation in emerging countries. The risks to global financial stability increased, among others, by the possible exposure of international banks to sovereign debt, especially in the Euro Zone. The uncertainties were amplified, since the last Copom meeting, in part due to the United States' sovereign debt rating revision. It should be noted that the risk aversion levels - for example, measured by spreads and implied volatilities in equity markets, bonds and currencies - already exceed those achieved in mid-2010. From another perspective, high rates of unemployment for a long period, coupled with the need for fiscal adjustment, and limited scope for monetary policy actions, have contributed to revisions for growth projections in the advanced countries or even for its potential growth, indicating a wider and more volatile business cycle. In fact, the composite leading indicator released by the Organization for Economic Cooperation and Development (OECD), for June, showed strong signs of inflection in the main economies, with lower growth prospects in the coming months. Disaggregated indicators of the Purchasing Managers Index (PMI) for July and August related to the activity in industry and services sector are consistent with this scenario, suggesting stagnation in the United States (USA.), China, France and Germany, and contraction the rest of the Euro Zone. Regarding monetary policy, the mature economies continued to adopt accommodative monetary stances. About inflation, the core measures persist at moderate levels in the G3 (US, Euro Zone and Japan), with the Euro Zone showing an increase in core inflation in July year-over-year, and a fall compared to June 2011. In spite of still widespread inflationary pressures in emerging countries, there was discontinuity of monetary tightening cycles.
12. Oil prices as defined by the Brent Blend have shown volatility and remains above US\$115. This price level is consistent with a framework of global demand stability, coupled with high political instability in producer countries and lags in the process of resuming production. It bears highlighting that the geopolitical complexity that involves the oil sector tends to heighten price volatility, which is also a reflex of the low predictability of some global demand components and of the dependency of supply growth on long term risky investment projects. Regarding the other commodities, it is noteworthy the increase in international prices of agricultural and reduction in metallic commodities prices, after successive months with significant increases, despite the strong correction in risky assets prices. The food price index, calculated by the Food and Agriculture Organization of the United Nations (FAO), which considers 55 items, has presented some stability, but remains at high levels. In recent past, the high volatility observed in commodities prices was strongly impacted by the abundant global liquidity, in a context where financial markets adjust to new expectations of demand growth and to FX markets volatility.

Assessment of Inflation Trends

13. The identified shocks and their impacts were reassessed according to the new set of available information. The scenario considered in the simulations was based on the following assumptions:
 - a) the projected adjustments for gasoline prices accumulated in 2011 remained at 4.0%, considered in the July Copom meeting, including, therefore, partial reversal of the 6.3% increase occurred up to July; the adjustments for bottled gas prices, for the same period, were kept unchanged at 0%;
 - b) the projected adjustment for fixed telephone and electricity accumulated in 2011 were kept unchanged at 0.9% and 4.1%, respectively, the same values considered in the July meeting;
 - c) the projection for regulated prices inflation accumulated in 2011, based on individual items, according to the benchmark scenario, increased to 5%, up from 4.9% considered in the July meeting. This set of prices, according to data released by the IBGE, accounted for 29.0% of the total July IPCA;
 - d) the projection for regulated prices inflation accumulated in 2012, according to the benchmark scenario, were kept unchanged at 4.4%, value considered in the July meeting. Such projection is based on endogenous determination models for regulated prices, which compute, 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 19 bps and -39 bps spreads in the fourth quarters of 2011 and 2012, respectively.



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14. Regarding fiscal policy, projections assume the achievement of the new public sector primary surplus target, around 3.15% of GDP, without adjustments, in 2011. Moreover, a primary surplus of around 3.1% of GDP is considered for 2012 and 2013, without adjustments.
15. The set of projections incorporated the estimated effects of the reserve requirements changes announced in December 2010.
16. Since the last Copom meeting, the median of the expectations compiled by the BCB's Investor Relations and Special Studies Department (Gerin) for the 2011 IPCA were kept unchanged at 6.31%. For 2012, the median of inflation expectations were kept unchanged at 5.20%. Specifically for banks, asset managers and other institutions (real sector companies, brokers, consultancies and others), the medians for the 2011 IPCA changed from 6.28%, 6.38% and 6.31% to 6.30%, 6.32% and 6.30%, respectively. For 2012, the medians changed from 5.01%, 5.40% and 5.05% to 5.06%, 5.31% and 5.10%, in the same order.
17. The benchmark scenario assumes the maintenance of the exchange rate at R\$1.60/US\$1.00 and the Selic rate at 12.50% p.a. during the forecast period. Under this scenario, the projection for the 2011 inflation increased relatively to the figure considered at the July Copom meeting, and it stands 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 in the period immediately prior to the Copom meeting - IPCA inflation forecast for 2011 also increased and stands above the inflation midpoint target. For 2012, the projection fell in both the benchmark and the market scenarios, positioned around the midpoint of the target in both scenarios. For 2013H1 inflation, the projected inflation fell in the benchmark and remained stable in the market scenario, positioned around the midpoint of the target in both scenarios.
18. An alternative scenario built and analyzed from the perspective of a medium sized dynamic stochastic general equilibrium model, considers that the current deterioration in the international scenario will make an impact on the Brazilian economy equivalent to one quarter of the impact observed during the international crisis of 2008 / 2009. Moreover, it assumes that the current deterioration of the international scenario is more persistent than the one verified in 2008/2009, but less acute, without observance of extreme events. In this alternative scenario, the domestic economic activity slows down and, although there is depreciation of the exchange rate and reduction of the basic interest rate, among others, the inflation rate stands at a level below what would be observed if it were not considered the above mentioned effect of international crisis.

Monetary Policy Decision

19. The Copom evaluates that monetary policy should contribute to the consolidation of a favorable longer-term macroeconomic environment. In this respect, the Copom reassures that, under the inflation-targeting regime, it guides its decisions according to BCB projected inflation and based on the analysis of alternative scenarios for the evolution of the main variables that determine prices 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, as well as help the process of coordination of economic agents' expectations, particularly price setters'. Additionally, it is noteworthy that low risks for the underlying inflation in the short run tend to intensify 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 under the responsibility of the monetary policy to remain especially vigilant to guarantee that pressures detected in shorter horizons do not spread to longer horizons.
20. International evidence, ratified by the Brazilian experience, indicates that high inflation rates lead to the increase in risk premium, both for private and public funding, and to the shortening of planning horizons, both for households and companies. Consequently, high inflation rates reduce investment and economic growth potential, in addition to presenting regressive effects on income distribution. Moreover, high inflation rates do not originate any lasting results for economic and employment growth; on the contrary, they create permanent



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damage to these variables in the medium and long terms. Therefore, the strategy adopted by the Copom aims to ensure the convergence of inflation towards the targets path, which requires that 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.

21. As a consequence of the stabilization and correction of unbalances, which determined important structural changes, the inflation targeting regime maturing process stands at an 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 seven years, at the same time that real interest rates have reduced. Progress in the financial markets structure, the reduction of both FX and inflationary risk premia, among other factors, seem to have determined significant reduction in the neutral rate. The generation of primary surpluses consistent with the maintenance of the 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 been increasing in the last years, despite the substantial uncertainty that surrounds the calculation of non-observable variables. The Committee also considers that there are evidences that the monetary policy traction 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.
22. Reassessing the international scenario, the Committee considers that there has been substantial deterioration since the last meeting, reflected, for example, in generalized and significant growth projections reductions for the main economic blocks. The Committee believes that there are higher chances that the restrictions to which several mature economies are now exposed can extend over a longer than anticipated period of time. Note that in these economies, there seems to be limited scope for using monetary policy, and a scenario of fiscal restraint also prevails. Therefore, the Committee considers that the international scenario manifests disinflationary bias for the relevant horizon.
23. For the Copom, the transmission of external developments to the Brazilian economy can be realized through many channels, among others, the reduction of total trade flows, the moderation in the investment inflows, tighter credit conditions and the worsening in consumer and business confidence. The Committee understands that the complexity surrounding the international environment will help to intensify and accelerate the ongoing moderation in domestic activity, which is already manifested, for instance, in the retreat of the growth projections for the Brazilian economy. In other words, the ongoing moderation process in the economy - a result of policy actions implemented since the end of last year - tends to be boosted by the weakness of the global economy. As a result, the balance of risks for inflation becomes more favorable.
24. The Copom evaluates that, although ongoing moderation of domestic demand growth is observed, prospects for economic activity are still favorable. This assessment is supported by signs that, despite showing some cooling, point to the fact that the expansion of credit supply tends to persist, both for individuals and corporate, and by the fact that consumers and businessmen confidence stand at historically high levels, notwithstanding some accommodation at the margin. The Copom considers, additionally, that the dynamism of domestic activity will continue to be benefited by the labor market vigor, mirrored in historically low unemployment rates and substantial wages growth.
25. The Copom evaluates that since the last meeting the inflation prospective scenario shows more favorable signs. In the last quarter of 2010 and in the first quarter of 2011, inflation was strongly and negatively impacted by domestic and external supply shocks. Evidences suggest that consumer prices have already incorporated the direct effects of these shocks. Also relevant were the direct effects of the atypical concentration of regulated prices adjustments in the first quarter of the year, which, in specific cases, shows signs of reversal. The Committee considers that these effects shall still impact indirectly consumer prices dynamics, among other mechanisms, through inertia. At the same time, it evaluates, as relevant, despite on a decreasing trend, the risks derived from the persistence of the mismatch between supply and demand growth rates. Moreover, it highlights the narrow idleness margin of the production factors, especially labor force, and analyzes that, in such circumstances, a very important risk stems from the possibility of concession of nominal wages increases



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incompatible with productivity growth and from its negative impacts over inflation dynamics. On the other hand, the Copom notes that the Nuci has retreated and it is below its long-term trend, contributing, therefore, to the opening of the output gap and to contain price pressures. At the end of last year and at the start of this year, the risks associated to commodities prices trajectory in international markets were key to the prospective scenario. However, since April these prices have shown some accommodation.

26. The Copom foresees that the twelve-month inflation upward cycle ends this quarter. From the fourth quarter on, the main scenario indicates a downward trend for the twelve-month accumulated inflation rate, which will start to move toward the target.
27. The Copom reaffirms that the inflation main scenario considers the materialization of its trajectories regarding fiscal variables. It bears highlighting that the generation of primary surpluses in line with the hypotheses considered for inflation projections, in addition to contributing to reduce the mismatches between supply and demand growth rates, will strengthen the trend in the reduction of the public debt-to-GDP ratio. It bears highlighting that, since the beginning of this year, important decisions have been taken and implemented, which reinforce the view that a fiscal consolidation process is underway. Regarding this aspect, according the evaluation of the Committee, the recent revision of the fiscal policy scenario makes the balance of risks for inflation more favorable.
28. The Copom highlights that its main scenario for inflation also considers moderation in credit expansion, for which macroprudential and conventional monetary policy actions recently adopted contribute. Still about this market, the Committee considers opportune the introduction of initiatives with the aim of moderating the concession of subsidies regarding credit operations.
29. In short, the Copom recognizes an economic environment in which an increasing and above-than-usual uncertainty level prevails, and identifies decreasing risks to the materialization of a scenario where inflation timely converges to the midpoint target. In other words, the Committee evaluates that since the last meeting, the inflation prospective scenario has shown more favorable signs.
30. The Copom unanimously recognizes that the macroeconomic environment has changed substantially since its last meeting in such a way that a reassessment and possibly a reverse in the recent process of the basic interest rate hike are justified. However, two members of the Committee have assessed that the current situation does not yet offer all the necessary conditions to begin this movement immediately.
31. In this context, the Copom decided to decrease the Selic target to 12.00%, without bias, by five votes in favor of the monetary policy action, and by two votes for the maintenance of the Selic rate at 12.50%.
32. Domestic demand is still robust, largely due to the effects of stimulus factors, such as income growth and credit expansion. However, recent initiatives reinforce a scenario for restrained public sector expenditures. Also seen as important curbing factors to domestic demand are the substantial deterioration of the international scenario and the macroprudential actions implemented. These elements and the quasi fiscal developments are an important part of the context in which future monetary policy decisions will be taken, aiming to ensure the timely convergence of inflation to the targets path.
33. The Monetary Policy Committee believes that by promptly mitigating the effects from a more restrictive global environment, moderate adjustments in the level of the basic rate are consistent with the scenario of inflation convergence to the target in 2012.
34. At the end of the meeting, it was announced that the Committee will reconvene on October 18th, 2011, for technical presentations and, on the following day, to discuss the monetary policy decision, as established in Communiqué 20,223 of October 15th, 2010.

SUMMARY OF DATA ANALYZED BY THE COPOM

Inflation



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35. The IPCA rose 0.16% in July, up from 0.15% in June, according to IBGE data. In the year, the IPCA reached 4.04%, compared to 3.10% in the same period of last year. In the last twelve months through July, the index changed 6.87%, compared to 6.71% in June. The growth in market prices declined from 0.26% in June to 0.11% in July, reflecting the slowdown both in the prices of tradables, from 0.19% to -0.04%, and in the prices of non-tradables, from 0.32% to 0.23% in the same period. The segment of regulated prices changed by 0.29% in July, from reduction of 0.12% in June, emphasizing the highs of 5.80% in the prices of interstate bus, and of 0.58% in health insurance. The monthly change of IPCA reflected, in particular the contributions of the transport groups, 0.09 p.p.; personal expenses, and health and personal care, both of 0.05 p.p. The diffusion index stood at 53.13% in July, against 58.85% in June.
36. Market prices increased 7.38% in the last twelve months through July, up from 7.14% in June, while regulated prices showed deceleration to 5.67%, down from 5.70% for the same periods. Among market prices, the price change in twelve months of tradable goods accelerated from 6.26% through June to 6.44% through July, while the variation of non-tradables goods accelerated from 7.89% to 8.18%. The prices of the services segment, which present higher degree of persistence, increased 8.82% in July, up from 8.75% in June and 6.91% in July 2010.
37. The IGP-DI totaled -0.05% in July, after recording -0.13% in June, accumulating 2.89% in the year and 8.34% in twelve months up to July, compared to 8.63% in twelve months up to June, according to FGV. In the month, the IGP-DI result reflected the negative changes in the IPC and IPA, and the acceleration in the INCC.
38. The IPA totaled -0.13% in July, after recording -0.19% in June, totaling 2.09% in the year and 9.09% in twelve months. The prices of agricultural and livestock products changed -0.31% in July, after recording -1.11% in June, totaling 0.20% in the year and 19.14% in the twelve months through July. The prices of industrial products decreased 0.07% in the month, down from 0.13% in June, totaling 2.77% in the year and 5.95% in twelve months. Regarding agricultural and livestock products, the monthly retreat was more strongly influenced by the falls of 3.40% in the price of coffee, of 5.19% in the price of cotton and of 25.41% in the price of potatoes, which exerted negative contribution of 0.06 p.p., 0.06 p.p. and 0.05 p.p., respectively. The main negative contributions to the change of industrial prices came from the item chemical products, -0.11 p.p.; and metallic minerals, -0.08 p.p.
39. The IPC changed -0.04% in July, after decreasing 0.18% in June, accumulating 3.75% in the year and 6.58% in twelve months. In the month, food and education, reading and leisure groups were the ones responsible for the decrease of the index, contributing -0.20 p.p. and -0.02 p.p., respectively. The INCC changed 0.45% in the month, compared to 0.37% in June, as a consequence of the acceleration of labor force (to 0.59% in July from 0.36% in June), and decelerating of materials, equipment and services (to 0.30% from 0.38%, according to the same comparison basis). The INCC accumulated changes of 6.07% in the year and of 7.76% in twelve months up to July.
40. The five IPCA core inflation measures calculated by the BCB decelerated in the twelve months ending in July, against the twelve months through June. Month-on-month, the core inflation by exclusion, which excludes ten items of household food and fuels, increased 0.33% in July, down from 0.56% in June, accumulating 6.61% in twelve months through July, down from 6.51% in twelve months through June. The smoothed trimmed means core inflation increased 0.41% in July, down from 0.54% in June, accumulating 6.18% in twelve months through July, compared to 6.01% in twelve months through June. The double weight core inflation increased 0.38% in July, down from 0.42% in June, accumulating 7.01% increase in twelve months through July, up from 6.82% in the twelve months through June. The non-smoothed trimmed means core inflation increased 0.28% in July, down from 0.44% in June, accumulating 5.71% in twelve months through July, compared to 5.59% in twelve months through June. The core inflation by exclusion, which excludes household food and regulated prices, increased 0.40% in July, down from 0.50% in June, elevating to 7.12% in twelve months through July, compared to 6.91% in twelve months through June.
41. The release of a partial index about inflation evolution in August pointed to a still high plateau for consumer prices. The IPCA-15 increased 0.27% in August, up from 0.10% in the previous month, accumulating changes



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of 4.48% in the year and of 7.10% in twelve months up to August, up from 6.75% in twelve months up to July. This acceleration reflected higher increases in personal expenses, food and beverages and apparel.

42. The IPP/IT retreated 0.66% in June, compared to the 0.46% decrease in May, accumulating increases of 0.55% in the year and of 4.89% in the twelve-month period ended in June (5.69% in the previous month). The monthly result was influenced by the prices decreases of food products segments, metallurgy and computer equipment, electronics and optics, with respective contributions of -0.27 p.p., -0.16 p.p. and -0.13 p.p. In the year, the index change reflected specially the decrease in the segments food prices and computer products, electronics and optics, which contributed -0.85 p.p. and -0.34 p.p. for the final result.
43. The Commodities Index Brazil (IC-Br) dropped for the fourth consecutive month in July, with a variation of -3.34%, reflecting the changes of -5.92%, 0.69% and -1.28% in the sub-indices relating to agricultural and livestock, metal and energy segments, respectively. In the year up to July, the index decreased 1.96% whereas in twelve months the index increased 26.04%.

Economic Activity

44. The IBC-Br decreased 0.3% in June, accumulating 0.7% growth in the 2011Q2 compared to the 2011Q1, when it had grown 1.1% in the same quarter-on-quarter comparison basis, considering seasonally adjusted data. The IBC-Br increased 2.9% compared to June 2010, accumulating increases of 3.8% in the year and 4.9% in twelve months.
45. Expanded retail sales, which include vehicles and construction inputs, grew 0.5% in June month-on-month, according to data seasonally adjusted from IBGE's monthly survey (PMC), after increasing 0.9% in May and 1.2% in April. In the month, five out of the ten surveyed segments presented increases, with highlights for the expansion of 9.1% in office, computing and communication equipment and material and for the contraction of 0.7% in vehicles and motorcycles, parts and pieces. Expanded retail sales grew 3.1% in the 2011Q2, compared to the previous quarter. Retail sales volume increased 0.2% in June, compared to the previous month, according to seasonally adjusted data, after increasing 0.7% in May and decreasing 0.2% in April, resulting in 1.1% quarterly average increase in 2011Q2, compared to the previous quarter.
46. Considering observed data, expanded retail sales increased 9.5% in June, year-over-year, mainly influenced by the increases of: 34.3% in the sales of office, computing and communication equipment and material; 16.3% in furniture and house appliances; 13.3% in construction inputs; 13.2% in vehicles, motorcycles, parts and pieces. In twelve months up to June, expanded retail sales increased 10.9%, due to the sales increase in some segments, such as office, computing and communication equipment and material (18.7%); furniture and house appliances (17.1%); vehicles, motorcycles, parts and pieces (14.2%); and construction inputs (14%).
47. Automobile sales by dealers, including cars, light commercial vehicles, trucks and buses, retreated by 0.2% in July, according to Fenabrave (Brazilian Federation of Automobile Vehicles Distribution) data, seasonally adjusted by the BCB, decreasing 2.5% in the quarter ended in July, compared to the previous one ended in April. Automobile sales increased 8.6% in the year, influenced by increases in the sales of buses (21.8%), light commercial vehicles (17.3%), trucks (15%), and cars (5.8%).
48. Capital goods imports quantum index, released by Funcex and seasonally adjusted by the BCB, retracted 1.2% in July, compared to June. The observed data showed decrease of 1.1%, compared to July 2010, while the year through July, and in twelve months, there were increases of 26% and 39.2% respectively.
49. Capital goods production expanded 1.7% in July showing stability in the quarter, compared to the previous one ended in April, according to data seasonally adjusted from the Monthly Industrial Survey (PIM) by the IBGE. The result was influenced by the elevations in the production of: equipment for serial industrial purposes (7.9%); equipment for transport (3.7%); and equipment for construction (3.2%). On the other hand, retreats were observed in the production of capital goods for agriculture (-9.2%); mixed use (-7.9%); and equipment for non-serial industrial purposes (-6%).



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50. Construction inputs production increased 0.2% in July, compared to June, and 2.2% in the quarter ended in July, compared to the one ended in April, considering seasonally adjusted data. The segment production increased 3.9% compared to July 2010, accumulating increases of 3.9% in the year and 5.6% in the twelve months up to July.
51. Disbursements granted by the Brazilian Development Bank (BNDES) reached R\$164.7 billion in the last twelve months through June, an increase of 7.1% compared to the same period of 2010, with highlight for the expansion of 21.4% in the resources headed to manufacturing industry, neutralized in part by the decrease of 10% in those for the infrastructure sector. In 2011H1, disbursements decreased 6.2% compared to the same period of 2010, shared by infrastructure, which responded for 38% of the total, followed by industry, which accounted for 34%, commerce and services, 19%, and agriculture and livestock sector, 9%.
52. Industrial production increased 0.5% in July, compared to the previous month, according to seasonally adjusted data from IBGE, with emphasis in the expansion of 0.7% in manufacturing and contraction of 0.6% in mining. By use categories, semi-durable and non-durable goods production increased 3.8% in the month, followed by changes in the production of durable consumer goods (2.9%), capital goods (1.7%), and intermediate goods (-0.7%), highlighting that from the 26 industry activities, fourteen posted monthly increase. Industrial production decreased 0.8% in the quarter ended in July, compared to the one ended in April, when it had increased 2%, according to the same comparison basis. The quarterly evolution partially reflected the retreats in textile activities (17.4%); apparel and shoes (6.5%); leather (6.5%); and office machines and computing equipment (6.1%), partially compensated by the increases in tobacco (19.6%); publishing, printing and reproduction (13.1%), and other transport equipment (10.1%). Considering the observed data, the industrial production decreased 0.3% in the month, 1.1% in the quarter, 1.4% in the year and 2.9% in the last twelve months through July.
53. The Nuci in the manufacturing industry, calculated by FGV, dropped 0.5 p.p. in August compared to July, reaching 83.6%, considering seasonally adjusted data. The result reflected the retractions of 1.0 p.p., 0.7 p.p., 0.4 p.p. and 0.1 p.p. in construction inputs, non-durable consumer goods, intermediate goods and capital goods, respectively, and stability in durable consumer goods. Considering observed data, the Nuci decreased 1.4 p.p. compared to August 2010, influenced by the decreases in indicators related to construction material (-2.6 p.p.); consumer goods (-2.0 p.p.); intermediate goods (-0.8 p.p.); and capital goods (-0.6 p.p.).
54. Vehicles output reached 307.2 thousand units in July, according to data released by Anfavea, representing an expansion of 3.5% compared to June, considering data seasonally adjusted by the BCB. Output of the sector increased 5.7% compared to July 2010 and 4% in the year through July.
55. Still according to data released by Anfavea, national vehicles licensing increased 1.3% compared to July 2010 and 8.6% in the year up to July, while according to data seasonally adjusted by the BCB there were decreases of 0.6% month-on-month, and 2.1% in the quarter ended in July, compared to the one ended in April. Exports totaled 46.5 thousand units in July, increasing 20.1% over the same month last year. According to data seasonally adjusted by the BCB, these exports increased 38.7% in July, compared to June, and decreased 12.3% in the quarter ended in July, compared to the one ended in April.
56. The LSPA survey carried out by the IBGE, referring to July, projected 158.8 million tons for the 2011 national harvest of grains, an 6.2% increase compared to the 2010 harvest. Respective increases are projected at 18.9%, 15.4% and 9.2% for crops of rice, beans and soy; and decreases of 14.8% for crops of wheat and of 1.1% for crops of corn are expected.

Surveys and Expectations

57. The Consumer Confidence Index (ICC), considering seasonally adjusted data from the nationwide Consumer Expectations Survey (FGV), decreased 4.6% in August, reaching 118.7 points, returning to the June level. This result was driven by contractions of 2.9% in the Current Situation Index (ISA) and 4.5% in the Expectations



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Index (IE). The ICC decreased 2.6% year-over-year, influenced by the variations of -5.5% in the IE and of 2% in the ISA.

58. The Services Confidence Index (ICS), from FGV, after falling 1.4% in June, increased 0.8% in July, month-on-month, considering seasonally adjusted data, reflecting increase of 1.4% in the IE and stability in the ISA. The ICS increased 2.4% year-over-year, as a result of expansions of 2% in the ISA and 2.7% in the IE.
59. The Survey of Manufacturing Industry, from CNI, showed increased signs of slowdown in the industry for July. Industrial production remained relatively stable in July, compared to the previous month, but the industry has been operating below normal capacity utilization since December 2010. Additionally, the inventory level is still higher than planned, and the expectations of industrial entrepreneurs, although they still remain positive, are less optimistic in questions related to demand, purchases of raw materials, exports and hiring employees.

Labor Market

60. According to the General Record of Employment and Unemployment (Caged) of the Ministry of Labor and Employment (MTE), 140.6 thousand formal jobs were created in July, representing a 0.3% expansion compared to June. Out of this total, 46 thousand jobs were created in the services sector; 28.5 thousand in commerce; 25.6 thousand in civil construction; 23.6 thousand in industry; and 13.6 thousand in the agricultural. In the year up to July, the balance reached 1.4 million jobs, compared to 1.7 million in the same period of 2010.
61. According to the IBGE employment survey (PME), carried out in the six main metropolitan regions of the country, the unemployment rate reached 6% in July, a historical record low for the month, decreasing 0.2 p.p., month-on-month, and 0.9 p.p., year-over-year. The monthly result took place from 0.4% increase in occupation and 0.2% in the Economically Active Population (PEA). Considering seasonally adjusted data, the unemployment rate reached 5.9%, compared to 6.1% in the previous month. According to the same survey, average real earnings usually earned by workers grew: 2.2% month-on-month; 4% year-over-year; and 3.8% in the year through July. As a result, the expansion of payroll showed variations of: 2.6% month-on-month; 6.2% year-over-year and in the year through July.

Credit and Delinquency Rates

62. Outstanding credit in the financial system reached R\$1,854.2 billion in July, equivalent to 47.3% of GDP, increasing by 1.1% in the month, 8.7% in the year and 19.8% in twelve months. Non-earmarked credit operations increased by 0.7%, 8.2% and 17.8%, respectively, according to the same comparison basis, reflecting the respective increases of 0.9%, 8.3% and 18.7% for credit operations to individuals and 0.5%, 8.1% and 16.9% for credit operations to corporate. Earmarked credit operations increased 1.9% in the month, 9.7% in the year and 23.6% in twelve months, with highlights for the respective rises of 3.4%, 23.6% and 47.1% recorded in housing credit, according to the same comparison basis.
63. The average interest rate on reference credit operations increased 0.2 p.p. in July, reaching 39.7%. The average annual rates on credit for corporate reached 31.4%, representing an increase of 0.6 p.p. relative to June, while those for individuals decreased 0.4 p.p., reaching 45.7%.
64. The average tenure on reference credit operations increased to 486 days in July, representing an increase of four days, month-on-month. The tenure related to corporate segments increased six days, while the one related to individuals increased three days, reaching 400 days and 578 days, respectively.
65. The delinquency rate in the financial system (non-earmarked loans used as reference for interest rates, in arrears for more than ninety days) increased 0.1 p.p., reaching 5.2% in July. The delinquency rate for credit operations with corporate remained stable at 3.8%, and the one relative to individuals increased by 0.2 p.p., reaching 6.6%.

External Environment



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66. Since the last Copom meeting, the global economic outlook deteriorated, conditioned by renewed fears associated with the fiscal question in the Euro Zone, the impasse over raising the debt ceiling in the US economy and its later downgrade by a rating agency risk; and the worsening for economic slowdown expectations for these two economies and their effects on the global economy. In this scenario, the financial markets operated under extreme volatility, with a significant increase in risk perception.
67. Economic activity in major developed economies shows evident signs of slowing. In the US, despite the annualized quarterly change of GDP for 2011Q2 had increased to 1%, compared to 0.4% in 2011Q1 (revised data of GDP of 1.9%), household consumption recorded respective increases of 0.4% and 2.1% over the same periods. Latest and high frequency indicators reinforce the deteriorating prospects for US economic growth. The unemployment rate remains at a high level, 9.1% in July, while the index of consumer confidence, measured by the University of Michigan, reached 55.7 points in August, the second lowest level in 31 years, approaching 55.3 points recorded in November 2008. In industry, the purchasing managers index (PMI) of manufacturing fell to 50.9 points in July, down from 55.3 points in the previous month, signaling a strong slowdown in manufacturing activity. In the Euro Zone, the annualized quarterly change of GDP reached 0.7% in 2011Q2 from 3.4% in the previous quarter, highlighting the decline of 5.5% to 0.5% observed in the variation of this indicator to Germany. Preliminary estimates for the August consumer confidence index, calculated by the European Commission and the manufacturing PMI suggests that economic activity remains weakening in the Euro Zone. In Japan, although the 2011Q2 GDP registered a third consecutive negative quarterly change, more recent indicators indicate that economic activity is recovering, driven on by the supply side, the relaxation of restrictions caused by the earthquake and ensuing tsunami in March. Investments should gradually increase, mainly due to the reconstruction of affected areas, and private consumption, although it has not returned to pre-earthquake levels, also shows signs of recovery. In China, domestic demand remains strong, and industrial production, in a slight slowdown, keep on monthly expansion around 1%. The indicators suggest that the country's slowdown is not likely to be intense.
68. In a very uncertain environment, financial markets operated under extreme volatility, with flight to quality, to assets considered safer. This was reflected in significant losses in equity markets, notably in the financial sector; increase in the demand for US Treasury securities, and as a result, the 10-year Treasuries reached the lowest earnings for the last sixty years; in sharp appreciation of gold; and intensified appreciation of the yen and Swiss franc against the dollar. The international commodity prices were highly volatile, with devaluations in the sectors of energy and metal commodities, whose prices are more sensitive to economic cycles, whereas the prices of agricultural commodities recorded increases, influenced by the deterioration of the supply reflecting less favorable climate conditions in producing areas and partial results of the harvest of some products, indicating a lower than expected productivity.
69. The less favorable outlook for global economic activity is not yet reflected in consumer price index (IPC), which followed under pressure in the US, UK and the Euro Zone, with respective annual variations in July, of 3.6%, 4.5% and 2.5%. In the same month, the annual change of IPCs in China reached 6.5%; Turkey, 6.3%; and 4.8% in Korea. In meetings held in August, the G3 and the UK central banks have maintained their interest rates unchanged. The Bank of Japan raised its program to purchase asset from ¥ 10 trillion to ¥ 50 trillion, and the Federal Reserve (Fed) announced the likely maintenance of the Fed funds rate at exceptionally low levels until at least mid-2013 (currently between 0% and 0.25%). Since the last Copom meeting, the central banks of Switzerland and Turkey announced reductions in their basic interest rates.

Foreign Trade and International Reserves

70. The Brazilian trade surplus reached US\$3.1 billion in July. Exports reached US\$22.3 billion and imports, US\$19.1 billion. In the year, the trade surplus totaled US\$16.1 billion, 74.5% above the registered in 2010, according to the daily average criterion, reflecting expansions of 31.5% in exports and 27.5% in imports. In the year, total trade grew 29.6%, totaling US\$265 billion, compared to US\$204.5 billion in the same period of 2010.



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71. International reserves reached US\$346.1 billion in July, increasing US\$10.4 billion compared to June and US\$57.6 billion compared to December 2010. The monetary authority's interventions accounted for net purchases of US\$6.6 billion in the domestic spot market in the month.

Money Market and Open Market Operations

72. Since the last Copom meeting, in July, the domestic interest rate yield curve decreased in all its length, especially in intermediate and long extensions, which led to the complete reversal of its inclination to negative. This movement was influenced mainly by expectations of slowing global economy, due to the worsening of indicators of activity and employment in the United States; the downgrade of the US credit note; the sign given by the Fed keeping low interest rates until mid-2013; and the uncertainties related to the highly indebted countries in the Euro Zone. In the domestic scenario, the disclosure of activity indicators below expectations and the announcement of additional fiscal effort in 2011 also contributed to the fall in interest rates. Between July 18th and August 29th, one- three- and six-month interest rates decreased 0.10 p.p., 0.33 p.p. and 0.82 p.p., respectively, while one- two- and three-year rates decreased, respectively, 1.32 p.p., 1.55 p.p. and 1.49 p.p. Real interest rate, measured by the ratio between the one-year forward nominal interest rate and the smoothed twelve-month-ahead inflation expectations, retreated from 6.84%, on July 18th to 5.51% on August 29th, following the decline of nominal rates.
73. In July 27th, the Central Bank carried out reverse exchange rate swap auction directed to the rollover of the contracts due on August 1st. This operation totaled the equivalent to US\$500 million in notional value.
74. In its open market operations, the BCB carried out, between July 19th and August 29th, repo operations borrowing R\$54.5 billion for a six-month period. As a consequence, the average daily balance of the long operations increased to R\$179.3 billion. In the same period, the BCB also borrowed money through repo operations with tenures between thirteen and thirty working days, decreasing the average daily balance of short-term borrowing operations to R\$157.5 billion. The BCB also borrowed money through 31 very short-term operations. These operations had average daily balance of R\$83.6 billion in the period. The average daily balance of the total stock of repurchase agreements of the Central Bank increased from R\$392.6 billion between June 7th and July 18th, to R\$420.4 billion, between July 19th and August 29th. Considering the operations for the most recent period, there was a decrease in the daily balance of repurchase agreements of R\$47.2 billion, resulting in stock decrease from R\$443.4 billion in July 18th to R\$396.2 billion in August 29th. The main drivers of liquidity contraction in the period were the net revenues of the Central Government and the issuance of net securities by the National Treasury.
75. Between July 19th and August 29th, the National Treasury issuance regarding the traditional auctions raised a total of R\$34.0 billion. The sale of fixed-rate securities reached R\$18.7 billion, with R\$17.8 billion via issuance of LTNs maturing in 2012, 2014 and 2015, and R\$0.9 billion via NTN-Fs maturing in 2017 and 2021. Issuance of LFTs totaled R\$5.4 billion, for securities maturing in 2018. Issuance of inflation-linked NTN-Bs reached R\$9.9 billion, for securities maturing in 2016, 2020, 2030, 2040 and 2050.