BANCO CENTRAL DO BRASIL

Minutes of the 182nd Meeting of the Monetary Policy Committee (Copom)

Summary
Recent Economic Developments
Assessment of Inflation Trends
Monetary Policy Decision

Date: April 1st, 2014, from 4:12PM to 7:38PM, and April 2nd from 4:04PM to 7:46PM

Place: BCB Headquarters meeting rooms – 8th floor on April 1st and 20th floor on April 2nd – 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
Luiz Edson Feltrim
Sidnei Corrêa Marques

Department Heads (present on April 1st)
André Barbosa Coutinho Marques – Investor Relations and Special Studies Department
Ariosto Revoredo de Carvalho - Department of Foreign Reserves
Bruno Walter Coelho Saraiva - International Affairs Department
Daso Maranhão Coimbra - Department of Banking Operations and Payments System
Eduardo José Araújo Lima - Research Department (also present on April 2nd)
João Henrique de Paula Freitas Simão - Open Market Operations Department
Tulio José Lenti Maciel – Economic Department

Other participants (present on April 1st)
Gustavo Paul Kurrle – Press Officer
Otávio Ribeiro Damaso – Chief of Governor 's Staff

The members of the Copom analyzed the recent performance 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. Monthly inflation measured by the Extended Consumer Price Index (IPCA) changed 0.69% in February, 0.09 percentage points (p.p.) above the one recorded in February 2013 and 0.14 p.p. above the one recorded in January 2014. As a consequence, inflation in twelve months decreased to 5.68% in February (6.31% until February 2013). Market prices changed 6.28% in twelve months (7.86% until February 2013), and regulated prices, 3.71% (1.53% until February 2013). Among market prices, the prices of tradable goods increased 5.25% in twelve months (6.43% in February 2013), and the prices of non-tradable goods, 7.19% (9.13% in February 2013). On its turn, the prices of the food and beverages group, impacted by weather conditions, increased 6.31% in the same period (12.49% in February 2013), and the prices of services rose 8.20% (8.66% until February 2013). In short, available information suggest some persistence of inflation, which partially reflects the dynamics of prices in the services sector.

2. The average of the underlying monthly inflation measures, calculated by the BCB, changed from 0.53% in January to 0.70% in February. As a consequence, on a twelve-month trailing basis, inflation reached 6.18% (0.21 p.p. above the one registered until February 2013). Specifically, the double weight core inflation changed

from 0.55% in January to 0.69% in February. The core inflation by exclusion of regulated prices and household food, from 0.52% to 0.92%; the non-smoothed trimmed means core inflation, from 0.54% to 0.57%; and the core by exclusion, which excludes ten household food items and fuels, from 0.50% to 0.79%. On its turn, the smoothed trimmed means IPCA core inflation changed from 0.55% to 0.51%. The diffusion index stood at 63.8% in February (8.5 p.p. below the one recorded in February 2013).

3. The General Price Index (IGP-DI) increased 0.85% in February, after increasing 0.40% in January, and 6.30% on a twelve- month trailing basis (8.24% in the twelve months through February 2013). The main component of this indicator, the Wholesale Price Index (IPA), changed 6.15% in twelve months (9.24% until February 2013), with increase of 0.47% in the prices of agricultural products and of 8.41% in the prices of industrial products. Inflation measured by the Consumer Price Index (IPC), the second most important component of the IGP-DI, changed 5.95% in twelve months through February (6.04% until February 2013). The Civil Construction National Index (INCC), component with the lowest weight in the IGP-DI, changed 8.04% (7.18% until February 2013), partially driven by pressures stemming from the labor cost, which increased 9.57% in the period. On its turn, the Producer/Manufacturing Industry Price Index (IPP/IT), calculated by the Brazilian Institute of Geography and Statistics (IBGE), increased 0.51% in February and 8.24% in twelve months. The Copom considers that the effects of the behavior of wholesale prices on consumer inflation will depend on the current and prospective demand conditions and on the price setters' expectations regarding the future inflation path.

4. The Economic Activity Index of the BCB (IBC-Br) incorporates estimate for the monthly production of the three sectors of the economy, as well as for taxes on products, and constitutes important coincident indicator of the economic activity. In January 2014, the seasonally adjusted IBC-Br changed 1.3% month-on-month and 0.9% year-over-year. The composite Purchasing Managers' Index (PMI) regarding Brazil pointed to acceleration of the economic activity in February, with expansion both in the manufacturing sector and in the services sector. On its turn, the Consumer Confidence Index (ICC), from the Getúlio Vargas Foundation (FGV), stood virtually unchanged between Febuary and March 2014 and remains below the historical average of the index. On the other hand, the industrial businessmen confidence, measured by the Industry Confidence Index (ICI), decreased in March and reached the lowest level since June 2009. After the third fall in the year, the index remains below the historical average for the 13th consecutive month. The Services Confidence Index (ICS) also retreated in March. Regarding agriculture, the Agricultural Production Systematic Assessment (LSPA), carried out by the IBGE, indicates that grains production is expected to grow by 1.1% in 2014, relative to the 2013 harvest.

5. The GDP increased 0.7% in the fourth quarter of 2013, after decreasing 0.5% in the previous quarter, according to data seasonally adjusted by the IBGE. Year-over-year, it expanded by 1.9% (compared to 2.2% in the third quarter). Thus, the Brazilian economy increased 2.3% in 2013. From the aggregate demand perspective, household consumption increased 0.7% in the fourth quarter, quarter-over-quarter, according to seasonally adjusted data, and 1.9% compared to the same quarter of 2012, representing the forty-first consecutive expansion according to this comparison basis. On its turn, the government consumption increased 0.8% at the margin and 2.0% compared to the last quarter of 2012. On the other hand, the fixed capital gross formation (FBCF) increased 0.3% compared to the previous quarter and 5.5% compared to the same quarter of 2012.

6. The industrial activity increased 0.4% in February, after increasing 3.8% in January, according to the seasonally adjusted series, released by the IBGE. Year-over-year, industrial production grew 5.0% in February interrupting two months of consecutive negative rates (-2.6% in December 2013 and -2.2% in January 2014), with highlight for the production of automotive vehicles, which increased 7.0% in the month (second consecutive positive result). The industrial sector maintained the improvement in its productive pace, expressed not only by the second consecutive positive result in the comparison with the immediate previous month, but also by the widespread profile of positive rates, since 19 out of the 27 surveyed activities expanded their production in February. The PMI of the industrial sector indicates little expansion in February, with increase in the amount of new orders. According to data released by the National Confederation of Industry (CNI), real revenue in the manufacturing industry increased 6.0% between January and February 2014, according to the seasonally adjusted series (12.4% compared to February 2013).

7. Among the use categories, the production of durable consumer goods (20.9%) and capital goods (12.4%) registered increase of two digits in February, according to the monthly interannual comparison. The semi and non-durable and intermediate goods production also increased, 3.6% and 1.1%, respectively. Regarding growth accumulated in the twelve months up to February, there were expansions in the production of capital goods (12.5%) and durable consumer goods (1.3%), and retreats in the production of intermediate goods (-0.1%) and semi and non-durable consumer goods (-0.4%).

8. According to the Monthly Employment Survey (PME), covering six metropolitan areas, the unemployment rate without seasonal adjustment reached a record low for February (5.1%) since the beginning of the series, in 2002, and represents a reduction of 0.5 p.p. compared to the rate observed in February 2013. According to the BCB seasonally adjusted series, the unemployment rate reached 5.0%. Still according to the PME, the average real income increased 3.1% in February, year-over-year; while real payroll increased 4.1%, according to the same comparison basis. Data released by the Ministry of Labor and Employment (MTE) show that 260.8 thousand formal jobs were created in February. The net creation was above the one observed in February 2013 (123.4 thousand). In short, the available data indicate narrow idleness margin in the labor market, although there are some signs of moderation at the margin.

9. According to the retail monthly survey (PMC), released by the IBGE, the retail sales volume increased by 6.2% in January, compared to January 2013. On its turn, broad retail sales volume, which includes vehicles and construction inputs, increased by 3.5% in January, according to the same comparison basis. The month-on-month changes were 0.4% and 2.1%, respectively, according to the seasonally adjusted series. In twelve months, the broad retail sales growth rate was 3.3%, with expansion in eight out of the ten surveyed segments. The Trade Confidence Index (ICOM), measured by the FGV, retreated in March, mainly due to the perception of the current situation. The Copom evaluates that the retail sales trajectory will continue to be influenced by governmental transfers, by the pace of real payroll growth and by the moderate credit expansion.

10. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by the FGV, without seasonal adjustment, reached 83.6% in March (83.3% in March 2013). According to the seasonally adjusted series calculated by the FGV, the Nuci in March reached 84.4%. The utilization capacity in the capital goods sector stood at 82.9%. In the sector of consumer goods, intermediate goods and construction inputs, the utilization capacity stood at 82.0%, 85.2% and 88.4%, respectively. On its turn, the absorption of capital goods grew 10.9% in the last twelve months through January.

11. The twelve-month trailing trade balance result reached US$1.7 billion in February. This result stemmed from US$242.6 billion in exports and US$240.9 billion in imports, with advances of 1.1% and 6.5%, respectively, compared to the twelve months through February 2013. On its turn, the current account deficit accumulated in twelve months reached US$82.5 billion in February, equivalent to 3.7% of the GDP. On the other hand, foreign direct investment totaled US$65.8 billion, according to the same comparison basis, equivalent to 2.9% of the GDP.

12. Regarding the global economy, leading indicators signal growth prospects in line with advanced and emerging economies. Specifically about Europe, despite recent improvements, high unemployment rates coupled with the fiscal consolidation and political uncertainties still constitute elements constraining investments and growth. In the emerging economies, however, some deceleration in the growth pace is observed. Regarding the monetary policy, the Federal Reserve continued the process of gradual reduction of the assets purchase program; however, in general, accommodative stances prevail in the advanced economies. In the emerging economies, the monetary policy is less expansionist, and in some cases, it is contractionist. Inflation remains at moderate or low levels in the US, in the Euro Zone and in Japan.

13. The price of the Brent oil barrel remained at a level near US$110 since the previous Copom meeting. It bears highlighting that the geopolitical complexity that involves the oil sector tends to heighten the volatile behavior of prices, which also reflects the low predictability of some global demand components and the dependency of supply growth on long term risky investment projects. Since the last Copom meeting, the international prices of agricultural commodities have increased 7.7%, while those relative to metals have decreased 3.3%. On its

turn, the Food Price Index, calculated by the Food and Agriculture Organization of the United Nations (FAO), retreated 2.1% in the twelve months through February 2014.

Assessment of Inflation Trends

14. The identified shocks, and their impacts, were reassessed according to the new set of available information.

15. For the set of regulated prices inflation, the projected adjustment is 5% in 2014, compared to 4.5% considered in the February Copom meeting. This projection considers gasoline and bottled gas price changes (respectively 0.6% and 0.3%) until February, as well as assumptions of stability in fixed telephone tariffs and the increase of 9.5% in electricity prices. The items for which there are more available information were projected individually and, for the others, projections are based on endogenous determination models for regulated prices, which compute, among other factors, seasonal components, market prices inflation and the IGP (General Price Index) change. Based on these models, the projected regulated prices change is 5% for 2015, compared to 4.5% in the last Copom meeting.

16. The estimate path for the spreads over the Selic rate, based on the 360-day swap rates, on the baseline scenario, projects 21 basis point (bps) and 17 bps for the fourth quarters of 2014 and 2015, respectively.

17. The structural primary surplus that derives from the primary surplus trajectories, both for 2014 and 2015, is considered as the fiscal indicator, according to the parameters set out in the Budget Guidelines Law (LDO)/2014. Therefore, in a given period, the fiscal impulse corresponds to the variation of the structural surplus in comparison to the observed in the previous period.

18. Since the last Copom meeting, the median of the projections compiled by the Investor Relations and Special Studies Department (Gerin) for the 2014 IPCA increased to 6.30% from 6.00%. For 2015, the median of the inflation projections increased to 5.80% from 5.70%.

19. The baseline scenario assumes the maintenance of the exchange rate at R$2.30/US$1.00 and the Selic rate at 10.75% p.a. during the forecast period. Under this scenario, the projection for the 2014 inflation increased, compared to the value considered at the previous Copom meeting, and remains above the 4.5% midpoint target established by the National Monetary Council (CMN). According to the market scenario, which incorporates the market expectations for the exchange and Selic rates trajectories collected by Gerin, in the period immediately prior to the Copom meeting, the 2014 IPCA inflation forecast also increased relative to the value considered at the February meeting, and remains above the inflation target. For 2015, according to both scenarios, the inflation forecast increased relative to the value considered in February Copom meeting and it stands above the midpoint inflation target.

Monetary Policy Decision

20. The Copom emphasizes that the international evidence, which is ratified by the Brazilian experience, indicates that high inflation rates generate distortions that lead to higher risks and depress investments. These distortions are manifested, for example, in the shortening of the planning horizons of households, companies and governments, as well as in the deterioration of the businessmen confidence. The Committee also emphasizes that high inflation rates reduce the purchasing power of wages and transfers, with negative repercussions over household's confidence and consumption. Therefore, high inflation rates reduce the growth potential of the economy, as well as of jobs and income generation.

21. In view of this, the Copom evaluates that the 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 Copom 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 prices 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 macroeconomic policy actions may influence the prices trajectory, it reaffirms its view that it is particularly 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.

22. The Copom considers that, since its last meeting, the risks to global financial stability have remained high, particularly those derived from changes in the yield curve slope of major advanced economies. Despite identifying low probability of occurrence of extreme events in the international financial markets, the Committee considers that the external environment remains complex. For the Committee, based on positive data recently released, the prospects for more intense global activity throughout the relevant horizon for the monetary policy have remained. In fact, there are improvements in advanced economies, including countries from the Euro Area, although, in general, the space to use monetary policy remains limited and the fiscal restraint scenario prevails in this and in the upcoming years. In important emerging economies, however, the activity pace has not matched the expectations, despite the resilience of the domestic demand. The Committee also highlights that, despite recently observed localized pressures, the prospects indicate moderation in the dynamics of commodities' prices in the international markets, as well as that, in the currency markets, there is evidence of tension and volatility.

23. The Copom evaluates that the domestic activity expansion pace tends to remain relatively stable this year, compared to 2013, as well that recent information indicate, in the relevant horizon for the monetary policy, changes in the composition of aggregate supply an demand. The Copom notes that the domestic absorption expands at rates higher than GDP growth rates (though both are converging) and tends to be benefited, among other factors, by the effects of fiscal policy actions, the moderate expansion of credit supply (especially of credit to consumption), the program of public services concession and the one related to the permission for oil exploration. In this context, the consumption tends to continue growing, albeit at a more moderate pace than the observed over the recent years; and investments would gain momentum. Regarding the external component of aggregate demand, the scenario of greater global growth, combined with the depreciation of the real, contributes to make this component more favorable to the Brazilian economy growth. Focusing on the supply side, the Committee evaluates that more favorable prospects for the competitiveness of industry and agriculture are emerging and that, considering the relevant horizon for the monetary policy, the services sector tends to grow at rates lower than those recorded over the recent years. It is plausible to claim that these developments - coupled with advances in terms of qualification of the labor force - will be reflected in a more efficient allocation of the production factors of the economy and in productivity gains. The Committee also highlights that the speed of materialization of the aforementioned changes and of their resulting gains depends on the strengthening of companies' and households' confidence.

24. The Copom observes that the main inflation scenario considers the materialization of the assumed trajectories regarding fiscal variables and the arising of the conditions so that, in the relevant horizon for monetary policy, the balance of the public sector shifts to the neutral zone. The Committee also notes that the generation of primary surpluses in line with the working hypotheses considered in the inflation projections, on the one hand, would contribute to reduce the mismatch between supply and demand growth rates; on the other hand, it would contribute to create a positive perception regarding the macroeconomic environment in the medium and long terms. It should also be emphasized that the generation of primary surpluses at levels close to the average generated over the recent years would contribute to reduce the public debt financing cost, with favorable impact on the cost of capital in general, which would stimulate private investment in the medium and long terms.

25. The Copom highlights that its main scenario also considers moderate credit expansion. Still regarding the credit market, the Committee considers opportune initiatives with the aim of moderating concessions of subsidies through credit operations.

26. Regarding the factors market, the Copom highlights the narrow idleness margin in the labor market and it considers that, under such circumstances, a significant risk stems from the possibility of concession of wages increases incompatible with productivity growth and their negative impacts over inflation. Although the projected adjustment for the minimum wage this year is not as significant as in the previous years, and considering the occurrence over the recent quarters of real wage changes more consistent with the gains estimated for the labor productivity, the Committee evaluates that the wages dynamics remains originating inflationary cost pressures.

27. The Committee considers that the exchange rate depreciation and volatility observed in the recent semesters enable a natural and expected correction in relative prices. For the Committee, the movements in the local currency markets, to some extent, reflect prospects for the transition of the international financial markets towards normality, among other dimensions, in terms of liquidity and interest rates. It is also important to highlight that, for the Committee, the aforementioned exchange rate depreciation, despite the recently observed accomodation, constitutes a source of inflationary pressure in shorter periods. The localized pressures that manifest, especially, in the fresh food segment should be added, although, in principle, they stem from a temporary shock that tends to revert in the upcoming months.

28. The Copom evaluates that the high consumer inflation level in the last twelve months contributes for inflation to still show resistance, which, by the way, has been slightly above the level that was anticipated. In this context, the formal and informal indexation mechanisms and the economic agents' perception regarding the inflation dynamics are also included. Considering the damage that the persistence of this process would cause to the decision-making process on consumption and investment, in the Committee's view, it is necessary that, with the due promptness, it be reverted. In this context, the Copom considers that it is appropriate to adjust the monetary conditions.

29. Therefore, the Copom unanimously decided, at this moment, to increase the Selic rate by 0.25 p.p., to 11% p.a., without bias. The Committee will monitor the evolution of the macroeconomic scenario until its next meeting, so that it then defines the next steps in its monetary policy strategy.

30. The following members of the Committee voted for this decision: Alexandre Antonio Tombini (Governor), Aldo Luiz Mendes, Altamir Lopes, Anthero de Moraes Meirelles, Carlos Hamilton Vasconcelos Araújo, Luiz Awazu Pereira da Silva, Luiz Edson Feltrim and Sidnei Corrêa Marques.

31. The Copom evaluates that the aggregate demand tends to be relatively robust. On the one hand, household consumption tends to continue expanding at a moderate pace, due to the effects of stimulus factors, such as income growth and moderate credit expansion; on the other hand, relatively favorable financial conditions, concession of public services, broadening of oil exploration areas, among other factors, suggest expansion of investments. These elements and the developments in the quasi fiscal framework and in the assets market are important parts of the context in which future monetary policy decisions will be taken, aiming to ensure the timely convergence of inflation to the targets path.

32. The Copom, considering the Brazilian experience under the inflation target regime, infers that, in general, the trajectories of important economic indicators during the current adjustment cycle of the Selic rate, as well as the outlook for these trajectories in the upcoming quarters, come in line with what one would anticipate. Thus, the available information suggest that the monetary impulses introduced in the economy since April 2013 have usually propagated through the main transmission channels and that tend to continue in the upcoming quarters. In this sense, as the effects of monetary policy actions on inflation are cumulative and manifest themselves with lags, the Committee understands that a significant part of the response of prices to the current monetary tightening cycle will still materialize. Moreover, it is plausible to claim that, in the presence of relatively modest confidence levels, the effects of monetary policy actions tend to be intensified.

33. The Copom highlights that, in moments such as the current one, the monetary policy should remain vigilant, in order to minimize risks that high inflation levels, such as the one observed in the last twelve months, persist in the relevant horizon for the monetary policy.

34. At the end of the meeting, it was announced that the Committee will reconvene on May 27th, 2014, for the technical presentations, and on the following day, to discuss monetary policy, as established in the Communiqué 24,064, of June 12th, 2013.