



BANCO CENTRAL DO BRASIL

Minutes of the 184th Meeting of the Monetary Policy Committee (Copom)

Summary

Recent Economic Developments
Assessment of Inflation Trends
Monetary Policy Decision

Date: July 15th, 2014, from 4:43PM to 7:22PM, and July 16th from 5:10PM to 8:05PM

Place: BCB Headquarters meeting rooms – 8th floor on July 15th and 20th floor on July 16th – 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 July 15th)

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 July 16th)
João Henrique de Paula Freitas Simão - Open Market Operations Department
Márcio Barreira de Ayrosa Moreira - Department of Foreign Reserves
Renato Jansson Rosek – Investor Relations and Special Studies Department
Tulio José Lenti Maciel – Economic Department

Other participants (present on July 15th)

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 0.40% in June, 0.14 percentage points (p.p.) above the one recorded in June 2013 and 0.06 p.p. below the one recorded in May 2014. As a consequence, inflation in twelve months reached 6.52% in June (6.70% in June 2013). Market prices changed 7.31% in twelve months (8.28% in June 2013), and regulated prices, 3.94% (1.77% in June 2013). Among market prices, the prices of tradable goods increased 6.94% in twelve months (6.75% in June 2013) and the prices of non-tradable goods, 7.63% (9.63% in June 2013). On its turn, the prices of the food and beverages group increased 7.50% in the same period (12.80% in June 2013), and the prices of services rose 9.20% (8.64% until June 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 0.54 % in May to 0.62% in June. As a consequence, on a twelve-month trailing basis, average core inflation reached 6.76% (0.33 p.p. above the one registered in June 2013). Specifically, the double weight core inflation changed from 0.50% in May to 0.61% in June; the core inflation by exclusion of regulated prices and



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household food, from 0.42% to 0.73%; and the core by exclusion, which excludes ten household food items and fuels, from 0.54% to 0.71%. On its turn, the non-smoothed trimmed means IPCA core inflation changed from 0.58% to 0.47%; and the smoothed trimmed means IPCA core inflation, from 0.64% to 0.56%. The diffusion index stood at 61.4% in June (6.1 p.p. above the one recorded in June 2013).

3. The General Price Index (IGP-DI), after decreasing 0.45% in May, decreased 0.63% in June, reaching 5.77% on a twelve-month trailing basis (6.28% in June 2013). The main component of this indicator, the Wholesale Price Index (IPA), changed 5.24% in twelve months (6.02% in June 2013), with increases of 4.54% in the prices of agricultural products and of 5.51% in the prices of industrial products. Inflation measured by the Consumer Price Index (IPC), the second most important component of the IGP-DI, changed 6.55% in twelve months through June (6.22% in June 2013). The Civil Construction National Index (INCC), component with the lowest weight in the IGP-DI, changed 7.23% (8.00% in June 2013), partially driven by pressures stemming from the labor cost, which increased 7.89% in the period. On its turn, the Producer/Manufacturing Industry Price Index (IPP/IT), calculated by the Brazilian Institute of Geography and Statistics (IBGE), decreased 0.24% in May, changing 6.59% 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 estimates 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 April 2014, IBC-Br changed -2.29% year-over-year and, seasonally adjusted, 0.12% month-on-month. The composite Purchasing Managers' Index (PMI) regarding Brazil pointed to stability of the economic activity in June, with decline in manufacturing sector offset by expansion in the service sector. On its turn, the Consumer Confidence Index (ICC), from the Getúlio Vargas Foundation (FGV), increased 1.0% between May and June 2014, but remains in a declining trend. On the other hand, the industrial businessmen confidence, measured by the Industry Confidence Index (ICI), decreased 3.9% in June and reached the lowest level since May 2009. The Services Confidence Index (ICS) also retreated between May and June (0.7%), reaching the lowest level since April 2009. Regarding agriculture, the Agricultural Production Systematic Assessment (LSPA), carried out by the IBGE in June 2014, indicates that grains production is expected to grow by 2.3% in 2014, relative to the 2013 harvest.
5. The Gross Domestic Product (GDP) increased 0.2% in the first quarter of 2014, after increasing 0.4% in the previous quarter, according to data seasonally adjusted by the IBGE. Year-over-year, it expanded 1.9% in the first quarter (compared to 2.2% in the fourth quarter). Focusing on the aggregate demand side, household consumption decreased 0.1% in the first quarter of 2014 compared to the previous quarter, according to seasonally adjusted data, and 2.2% compared to same quarter of 2013. On its turn, the government consumption increased 0.7% at the margin and 3.4% compared to the same quarter of the previous year. On the other hand, the fixed capital gross formation (FBCF) decreased 2.1% both compared to the previous quarter and to the same quarter of 2013.
6. The industrial activity, after decreasing 0.3% in April, decreased 0.6% in May, according to the seasonally adjusted series, released by the IBGE. According to the observed series, year-over-year, industrial production decreased 3.2% in May, accumulating a decrease of 1.6% in the first five months of the year. Negative results were observed in three out of the four main economic categories and in 15 out of the 26 surveyed activities. According to data released by the National Confederation of Industry (CNI), real revenue in the manufacturing industry increased 0.3% between April and May 2014, according to the seasonally adjusted series. The PMI of the industrial sector, on its turn, indicates retraction in the Brazilian production in June.
7. Among the use categories, month-over-month and seasonally adjusted, capital goods (-2.6%), durable consumer goods (-3.6%) and intermediate goods (-0.9%) reported declines in May 2014. Only the semi- and non-durable goods sector posted a positive rate (1.0%). Regarding year-over-year growth, durable consumer goods and capital goods reported declines of 11.2% and 9.7%, respectively. The intermediate goods sector (-2.8%) also posted a negative result; however, it was less intense than the broad industrial sector figure (-3.2%). The semi- and non-durable goods was the only sector reporting a positive result, recording 0.8% year-over-year growth in May.



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8. IBGE released the Monthly Employment Survey (PME) May results covering only four, instead of the usual six metropolitan areas, due to the IBGE's employees' strike. Data referring to Salvador and Porto Alegre are yet to be released. Month-on-month, the unemployment rate in May remained stable in the four metropolitan areas whose results were released. Year-over-year, the unemployment rate declined 1.8 p.p. in Rio de Janeiro and 1.2 p.p. in São Paulo. In Recife and Belo Horizonte, figures were stable. Data released by the Ministry of Labor and Employment (MTE) show that 58.8 thousand formal jobs were created in May, the lowest net generation for the month since 1992. In short, the available data indicate narrow idleness margin in the labor market, although there are some signs of accommodation at the margin.
9. According to the retail monthly survey (PMC), released by the IBGE, the retail sales volume increased 4.8% in May, compared to May 2013. On its turn, broad retail sales volume, which includes vehicles and construction inputs, increased 0.9% in May, according to the same comparison basis. The month-on-month changes were +0.5% and -0.3%, respectively, according to the seasonally adjusted series. In twelve months, the broad retail sales growth rate stood at 2.2%, with expansion in eight out of the ten surveyed segments. The Trade Confidence Index (ICOM), measured by the FGV, fell in June, both in the subindex related to the current situation, as well as in the one related to the following months. The average index for the quarter stood at 114.7 points, the lowest for the historical series started in March 2010. 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 83.3% in June. According to the seasonally adjusted series, the Nuci in June reached 83.5%. Among the use categories of industry, the ones showing the highest Nuci, according to the seasonally adjusted series, are construction material (89.7%) and intermediate goods (85.1%), followed by durable consumer goods (83.6%), non-durable consumer goods (82.0%) and capital goods (80.0%). On its turn, the absorption of capital goods grew 2.9% in the last twelve months through May.
11. The twelve-month trailing trade balance result reached US\$3.1 billion in June. This result stemmed from US\$238.3 billion in exports and US\$235.2 billion in imports, with decline of 0.6% and increase of 2.0%, respectively, compared to the twelve months through June 2013. On its turn, the current account deficit accumulated in twelve months reached US\$81.9 billion in May, equivalent to 3.6% of the GDP. On the other hand, foreign direct investment totaled US\$66.5 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 the trend in important advanced and emerging economies, with some growth moderation in the latter ones. Specifically about Europe, despite recent improvements, high unemployment rates, coupled with the fiscal consolidation and political uncertainties constitute elements constraining investments and growth. Regarding the monetary policy, the Federal Reserve has continued the process of reduction of the assets purchase program and, in general, accommodative stances prevail in the advanced economies. In the emerging economies, less accommodative monetary policy stances prevail. Inflation remains at moderate or low levels in the advanced economies; and, in the emerging ones, it stands at higher levels.
13. The price of the Brent oil barrel has 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. This volatile behavior also reflects the low predictability of some global demand components and the fact that supply growth depends on long term risky investment projects. Since the last Copom meeting, the international prices of agricultural commodities have fallen 2.34% and those relative to metals have increased 0.58%. On its turn, the Food Price Index, calculated by the Food and Agriculture Organization of the United Nations (FAO), fell 2.8% in the twelve months through June 2014.

Assessment of Inflation Trends



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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, the same value considered in the May Copom meeting. This projection considers gasoline and bottled gas price changes (both 0.7%) until June, as well as assumptions of a 3.8% reduction in fixed telephone tariffs and the increase of 14% in electricity prices. The items for which there are more available information were projected individually. For the others, the 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 6% for 2015, comparing to the 5% considered in the May Copom Meeting. For 2016, the projected regulated price change is 4.8%.
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 6 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, according to the parameters set out in the Budget Guidelines Law (LDO)/2014 and in the Budget Guidelines Law Project (PLDO)/2015, respectively, is considered as the fiscal indicator. 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 remained stable. For 2015, the median of the inflation projections increased to 6.10% from 6.00%.
19. The baseline scenario assumes the maintenance of the exchange rate at R\$2.20/US\$1.00 and the Selic rate at 11.00% 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 May meeting, and remains above the inflation target. For 2015, according to both scenarios, the inflation forecast increased relative to the value considered in the May 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 households' 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



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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, despite recently released data have been less positive than anticipated, the prospects for more intense global activity throughout the relevant horizon for the monetary policy have remained. There are improvements in advanced economies, with recovery of activity in some countries and acceleration in the pace of growth in others, although, in general, the space to use monetary policy in these economies 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 currencies' markets, there are evidences of tension and volatility.
23. The Copom evaluates that the domestic activity expansion pace tends to be less intense this year, compared to 2013, and that, in the medium term, important changes must take place in the composition of aggregate supply and demand. The Copom notes that the expansion rates of domestic absorption have been higher than the GDP rates, but evidences suggest convergence. In this context, the consumption tends to grow at a more moderate pace than the observed over the recent years; and the investments tend to 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, in the long term, more favorable prospects for the competitiveness of industry and agriculture have emerged; and that the services sector tends to grow at rates lower than those recorded over the recent years. For the Committee, it is plausible to claim that these developments - coupled with advances in terms of qualification of the labor force and with the program of public services concession - 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 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 also bears emphasizing 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. It's important to highlight the fact that, after years of strong expansion - cooled with the introduction of macroprudential measures at the end of 2010 - the credit market oriented to consumption underwent a moderation, so that, over the recent quarters it was possible to observe, on the one hand, exposure reduction by banks, and on the other hand, deleveraging of the households. In the aggregate, therefore, it can be inferred that the risks in the consumer credit segment have been mitigated. In another dimension, 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



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projected adjustment for the minimum wage this year is not as significant as in the previous years, and considering the occurrence of real wage changes more consistent with the gains estimated for the labor productivity over the recent quarters, the Committee evaluates that the wages dynamics remains originating inflationary cost pressures.

27. The Copom evaluates that the high consumer inflation level in the last twelve months contributes for the inflation to still show resistance. This development is underpinned by two important relative prices adjustments processes now underway in the economy - the realignment of domestic prices relative to international prices and the realignment of regulated prices in relation to market prices. The Committee recognizes that these adjustments in relative prices have direct impacts on inflation and reaffirms its view that monetary policy can and should contain the second order effects arising from them. By the way, in order to fight these and other inflationary pressures, in the last twelve months, the monetary conditions were tightened, but the Committee evaluates that the effects of the Selic rates hikes on inflation have, in part, yet to materialize. Moreover, it is plausible to claim that, in the presence of relatively low levels of confidence, the effects of monetary policy actions on inflation tend to be potentialized.
28. Therefore, assessing the evolution of the macroeconomic scenario and the inflation prospects, the Copom unanimously decided, at this moment, to maintain the Selic rate at 11% p.a., without bias.
29. 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.
30. The Copom evaluates that the aggregate demand tends to be relatively robust in the in the relevant horizon for monetary policy. On the one hand, household consumption tends to record a moderate expansion 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, tend to support the 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.
31. The Copom evaluates that ongoing inflationary pressures present at the economy – as those stemming from the processes of prices realignments previously mentioned and from wage gains incompatible with productivity gains – tend to cool down or, even exhaust throughout the relevant horizon for the monetary policy. In shorter terms, the shift of the output gap to the disinflationary side should be added. However, the Committee anticipates a scenario that includes resistant inflation in the next quarters, but that, considering the maintenance of the monetary condition – that means, the strategy that does not include the reduction of the monetary policy instrument – tends to enter a trajectory of convergence to the target in the final quarters of the projection horizon.
32. In this context, 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.
33. At the end of the meeting, it was announced that the Committee will reconvene on September 2nd 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.