BANCO CENTRAL DO BRASIL

Minutes of the 193rd Meeting of the Monetary Policy Committee (Copom)

Date: September 1st 2015, from 4:21PM to 7:37PM, and September 1st, 2015, from 4:49PM to 8:17PM

Place: BCB Headquarters meeting rooms – 8th floor on September 1st and 20th floor on September 2nd – Brasília – DF

In attendance:
Members of the Committee
Alexandre Antonio Tombini – Governor
Aldo Luiz Mendes
Altamir Lopes
Anthero de Moraes Meirelles
Luiz Awazu Pereira da Silva
Luiz Edson Feltrim
Otávio Ribeiro Damaso
Sidnei Corrêa Marques
Tony Volpon

Department Heads (present on September 1st)
Ariosto Revoredo de Carvalho – Department of Foreign Reserves
Bruno Walter Coelho Saraiva – International Affairs Department
Eduardo José Araújo Lima – Research Department (also present on September 2nd)
Flávio Túlio Vilela – Department of Banking Operations and Payments System
João Henrique de Paula Freitas Simão – Open Market Operations Department
Renato Jansson Rosek – Investor Relations and Special Studies Department
Tulio José Lenti Maciel – Economic Department

Other participants (present on September 1st)
Gustavo Paul Kurrle – Press Officer
Itamar Marins da Silva – Coordinator of the Economic Department
Maurício Costa de Moura – 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) reached 0.62% in July, 0.17 percentage points (p.p.) below the one recorded in the previous month. As a consequence, inflation accumulated in 12 months reached 9.56% in July (6.50% in July 2014), with market prices increasing by 7.67% (7.07% in July 2014), and regulated prices, 15.97% (4.63% in July 2014). Specifically regarding market prices, the prices of tradable goods increased 6.29% in twelve months through July (7.11% in July 2014) and the prices of non-tradable goods, 8.86% (7.04% in July 2014). It bears noticing that the prices of the food and beverages group increased 10.48% in twelve months through July (7.70% in July 2014), and the prices of services rose 8.53% (8.45% in July 2014). In short, available information suggests some persistence of inflation, which partially reflects the dynamics of prices in the services sector and, in the short run, the realignment process of regulated prices and temporary supply shocks in the food and beverages group.

2. The average of the underlying monthly inflation measures, calculated by the BCB, changed from 0.74% in June to 0.59% in July. As a consequence, on a twelve-month trailing basis, average core inflation reached 7.79% (1.12 p.p. above the one registered in July 2014). Specifically, the double weight core inflation changed from 0.77% in June to 0.63% in July; the core by exclusion, which excludes ten household food items and fuels,

changed from 0.89% to 0.71%; and the core inflation by exclusion of regulated prices and household food, from 0.68% to 0.41%. On its turn, the non-smoothed trimmed means IPCA core inflation changed from 0.62% in June to 0.55% in July, and the smoothed trimmed means IPCA core inflation from 0.72% to 0.67%. The diffusion index stood at 65.7% in July (6.7 p.p. above the one recorded in July 2014).

3. The General Price Index (IGP-DI) increased 0.58% in July, reaching 7.43% on a twelve-month trailing basis (5.05% in July 2014). The main component of this indicator, the Wholesale Price Index (IPA), changed 6.73% in twelve months (3.97% in July 2014), with increases of 10.24% in the prices of agricultural products and 5.44% in the prices of industrial products. Inflation measured by the Consumer Price Index (IPC), the second most important component of the IGP-DI, changed 9.61% in twelve months through July (6.85% in July 2014). The Civil Construction National Index (INCC), component with the lowest weight in the IGP-DI, increased 6.76% (7.52% in July 2014), partially driven by pressures stemming from labor costs, which changed 7.65% 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 0.68% in July, changing 7.62% 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 June 2015, the IBC-Br decreased 1.20% year-over-year and 0.58% month-on-month, seasonally adjusted. The composite Purchasing Managers’ Index (PMI) regarding Brazil changed from 41.0 in June to 40.8 in July, reaching its lowest level since March 2009. The Industry Confidence Index (ICI) and the Consumer Confidence Index (ICC), from the Getúlio Vargas Foundation (FGV), decreased 1.6% and 1.7%, respectively, between July and August. On its turn, the Services Confidence Index (ICS) decreased 4.7%, reaching the historical minimum for the sixth time in 2015. Regarding agriculture, the Agricultural Production Systematic Assessment (LSPA), carried out by the IBGE, projected, in July, an increase of 8.1% in the grains production in 2015, relative to the 2014 harvest.

5. The Gross Domestic Product (GDP) at market prices fell 1.9% in the second quarter of 2015 compared to the previous quarter (after decreasing by 0.7% in the first quarter), according to data seasonally adjusted by the IBGE. Year-over-year, there was a retraction of 2.6% (a decrease of 1.6% in the first quarter according to the same comparison basis). From the aggregate demand side, household consumption decreased by 2.1% quarter-over-quarter, according to seasonally adjusted data, and 2.7% over the same quarter of 2014. On its turn, government consumption increased 0.7% at margin and decreased 1.1% over the same quarter last year. The Gross Fixed Capital Formation (GFCF) decreased by 8.1% quarter-over-quarter, and 11.9% over the second quarter 2014.

6. The industrial activity decreased 1.5% in July, month-on-month, according to the seasonally adjusted series released by the IBGE. Therefore, the industrial production accumulates a change of -5.3% in the last twelve months through July. According to the observed series, year-over-year, industrial production decreased 8.9% in July, year-over-year, with negative results in the four use categories and in 23 out of the 26 surveyed activities. According to data released by the National Confederation of Industry (CNI), real revenue in the manufacturing industry decreased 0.2% between June and July, according to the seasonally adjusted series, and it stands 6.66% lower than the one registered in July 2014. The PMI of the industrial sector, on its turn, changed from 47.2 in July to 45.8 in August.

7. Among the use categories, comparing July and June productions, according to seasonally adjusted data series, the semi and non-durable goods production presented the sharpest decrease, a decline of 3.4%. Intermediate goods (-2.1%) and capital goods (-1.9%) also presented decreases in their production. On its turn, durable goods production presented the only positive result in July, with an increase of 9.6%. Regarding year-over-year growth, there was a decrease in the production of the four categories: capital goods (-27.8%), durable consumer goods (-13.7%), semi and non-durable consumer goods (-9.2%) and intermediate goods (-5.6%).

8. According to the Continuous National Household Sample Survey (Continuous PNAD), the unemployment rate in the moving quarter ended in June was estimated at 8.3%, an increase of 1.5 p.p. compared to the same period last year. According to the Monthly Employment Survey (PME), covering six metropolitan areas, the unemployment rate stood at 7.5% in July, increasing 0.6 p.p. month-over-month and 2.6 p.p. year-over-year.Data released by the Ministry of Labor and Employment (MTE) showed reduction of 157.9 thousand formal jobs in July, while 494.4 thousand formal jobs were destroyed in the year. In short, the set of available data confirm a process of distension in the labor market.

9. According to the retail monthly survey (PMC), released by the IBGE, the retail sales volume decreased 2.7% in June, year-over-year. On its turn, broad retail sales volume, which includes vehicles and construction inputs, decreased 3.5% in June, according to the same comparison basis. The month-on-month changes were -0.4% and -0.8%, respectively, according to the seasonally adjusted series, with retraction in seven of the ten sectors surveyed. In twelve months, the retail sales growth rate fell by 0.8% and the broad retail sales decreased 4.8%. The Trade Confidence Index (ICOM), measured by the FGV, decreased 4.1% between July and August, with no signs of improvement of the activity in the coming months.

10. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by the FGV, without seasonal adjustment, reached 78.1% in August and, according to the seasonally adjusted series, 77.7%. Among the industry use categories, according to the seasonally adjusted series, the ones showing the highest Nuci are intermediate goods (82.2%) and construction material (78.7%), followed by non-durable consumer goods (74.9%), durable consumer goods (71.5%) and capital goods (66.1%). On its turn, the absorption of capital goods decreased 16.7% in the last twelve months through July.

11. According to the Ministry of Development, Industry and Foreign Trade (MDIC), the twelve-month trailing trade balance surplus reached US$3.0 billion in August 2015. This result stemmed from US$199.4 billion in exports and US$196.4 billion in imports, with retreats of 16.7% and 15.7%, respectively, relative to the cumulative results through August 2014. On its turn, the current account deficit accumulated in twelve months reached US$89.4 billion in July 2015, equivalent to 4.3% of the GDP. Foreign Direct Investment (according to the Direct Investment Liabilities concept) totaled US$78.4 billion, according to the same comparison basis, equivalent to 3.8% of the GDP.

12. Regarding the global economy, leading indicators signal, in the horizon relevant for monetary policy, growth prospects in line with the trend in important advanced and emerging economies. Particularly about Europe, despite recent monetary policy actions, high unemployment rates, coupled with the fiscal consolidation and political uncertainties, constitute elements restraining investments and growth. Regarding the monetary policy, in general, accommodative stances prevail in advanced and emerging economies, despite the current advances in the debate on the normalization of monetary conditions. The inflation rates remain at low levels in the advanced economies; and, in the emerging ones, they stand at relatively high levels.

13. The price of the Brent oil barrel fell to levels around US$43 since the previous Copom meeting, returning, however, to levels near US$50. 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 and supply components. Since the last Copom meeting, the international prices of agricultural and metal commodities have fallen 0.94% and 5.18%, respectively. On its turn, the Food Price Index, calculated by the Food and Agriculture Organization of the United Nations (FAO), fell 19.4% in the twelve months through July 2015.

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 15.2% in 2015, up from 14.8% considered at the July Copom meeting. Among other factors, this projection considers the assumption of changes of 8.9% in the price of gasoline and 15.0% in the price of bottled gas; -3.5% in fixed telephone tariffs and of 49.2% in electricity prices. The items for which there are more information available were projected individually and, 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 5.7% for 2016, unchanged relative to the July Committee meeting.

16. The estimate path for the spreads over the Selic rate, based on the 360-day swap rates, on the baseline scenario, projects -74 basis points (bps) and 10 bps for the fourth quarters of 2015 and 2016, respectively.

17. The structural primary surplus is considered as the fiscal indicator. It derives from the primary surplus trajectories set at 0.15% of the GDP for 2015 and 0.70% of the GDP for 2016. It also bears emphasizing that, 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 2015 IPCA changed from 9.23% to 9.28% and, for 2016, from 5.40% to 5.51%.

19. The baseline scenario assumes the maintenance of the exchange rate at R$3.55/US$1.00 and the Selic rate at 14.25% p.a. during the forecast period. Under this scenario, the projection for the 2015 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 2015 IPCA inflation forecast also increased relative to the value considered at the July meeting and remains above the inflation target. For 2016, according to the baseline scenario, the inflation projection reduced, and stands around the 4.5% inflation target set by the CMN. According to the market scenario, the 2016 inflation forecast remained stable and above the 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 the households' confidence and consumption. As a consequence, high inflation rates reduce the potential of economic growth, 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 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 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, such as 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, with episodes of higher volatility affecting important emerging

economies. For the Committee, the trend for global activity showed more moderation throughout the monetary policy relevant horizon. The prospects have continued indicating activity recovery in some advanced economies and acceleration in the pace of growth in others, although, in general, the room to use monetary policy in these economies remains limited and a fiscal restraint scenario prevails. Important emerging economies experience a transition period and, therefore, of moderation in the activity pace, despite the resilience of the domestic demand.

23. Still regarding international financial markets, the Copom highlights evidence of new sources of volatility in the currency and fixed income markets and moderation in the dynamics of commodities prices. Regarding oil, the Committee highlights that, regardless of the behavior of the domestic prices of gasoline, the evolution of international prices tends to be transmitted to the domestic economy both through productive chains, such as the petrochemical, and through inflation expectations.

24. The Copom reaffirms that, in accordance to the macroeconomic adjustment process underway, the available indicators show that the domestic absorption and GDP growth rates continued to adjust and confirm that the domestic activity expansion pace this year will be lower than the potential. This process is being intensified by the uncertainties arising from the effect of non-economic events. In particular, the investment has retreated, mainly influenced by the occurrence of these events, and private consumption shows contraction signals, in line with recent data regarding credit, employment and income. However, for the Committee, after a necessary period of adjustments, which may be more intense and longer than anticipated, the activity expansion pace tends to intensify, as companies’ and households’ confidence strengthen. Moreover, the Committee evaluates that, in the medium term, important changes should take place in the composition of aggregate supply and demand. Consumption tends to grow at a moderate pace and investments tend to gain momentum. These changes, coupled with other ones currently underway, anticipate a composition for aggregate demand growth in the medium term more favorable to potential growth. Regarding the external component of aggregate demand, the scenario of higher global growth, combined with the depreciation of the BRL, contributes to make this component more favorable to the Brazilian economy growth. Regarding the supply side, the Committee evaluates that, in longer horizons, more favorable prospects for the competitiveness of industry and agriculture have emerged. The services sector, on its turn, 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.

25. The Copom observes that the main inflation scenario considers the materialization of the assumed trajectories regarding fiscal variables. Relative to the structural fiscal result and depending on the economic cycle, the Committee considers that, during the relevant horizon for the monetary policy, the balance of the public sector tends to shift to the neutral zone, and does not rule out the hypothesis of migration to the fiscal restraint area, even if more slowly and with lower intensity. However, the prospects for a new change in the trajectories regarding fiscal variables, implicit in the budget proposal for 2016, affected the expectations and, signicantly, the asset prices. In this regard, the Committee notes that significant changes in the trajectory of primary surpluses generation impact the working hypotheses considered for inflation projections and contribute to create a less positive perception of the macroeconomic environment in the medium and long terms. It also highlights that a primary surpluses’ path that strengthens the perception of sustainability of the public sector balance contributes to reduce the public debt financing cost, with favorable impact on the cost of capital in general and, at last, stimulating private investment in the medium and long run. Specifically regarding inflation control, the Committee highlights that the literature and the best international practices recommend a consistent and sustainable fiscal policy framework, in order to allow monetary policy actions to be fully transmitted to prices.

26. The Copom highlights that the main scenario also considers moderate credit expansion, which had already been observed and tends to persist. Regarding this issue, it is important to highlight the fact that, after years of strong expansion, the consumer credit has moderated, so that, over the last 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, as illustrated by actions that were implemented, the Committee

considers as opportune the initiatives with the aim of moderating concessions of subsidies through credit operations.

27. Regarding the factors' market, as anticipated by previous Minutes, the Copom observes that the idleness margin in the labor market has increased at a faster pace, with data confirming the acceleration of a process of distension in this market. However, a significant risk still prevails related, particularly, to the possibility of concession of wages' increases incompatible with productivity growth, with negative impacts over inflation. In spite of the occurrence of real wage changes more consistent with the gains estimates for the labor productivity, the Committee evaluates that the wages dynamics remains originating inflationary cost pressures.

28. For the Copom, the fact that inflation currently stands at high levels reflects, in large part, the occurrence of two important relative prices adjustment processes underway in the economy - the realignment of domestic prices relative to international prices and the realignment of regulated prices relative to market prices. The Committee also considers that, over the first half of 2015, among other factors, these relative prices ajustments in the economy, among other factors, have made the balance of risks to inflation unfavorable this year. In this context, as anticipated in previous Minutes, these price adjustments cause inflation to rise in the short term and to tend to remain high in 2015, requiring determination and perseverance to prevent its transmission to longer horizons. While recognizing that these relative prices adjustments have direct impacts over inflation, the Committee reaffirms its view that the monetary policy can, should and is containing the second order effects stemming from them, in order to limit them to 2015.

29. Given the above, assessing the macroeconomic scenario, the inflation prospects and the current balance of risks, the Copom unanimously decided to maintain the Selic rate at 14.25% p.a., without bias. The Committee understands that maintaining this level of the basic interest rate, for a sufficiently long period, is necessary for the convergence of inflation to the target at the end of 2016.

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

31. The Copom reaffirms that the aggregate demand will continue to be moderate in the relevant horizon for the monetary policy. On the one hand, household consumption tends to be influenced by factors such as employment, income and credit; on the other hand, the real state financing, the concession of public services and the expansion of agricultural income, among other factors, tend to benefit investments. On its turn, exports tend to be benefited by the scenario of higher growth of major trading partners and by the depreciation of the BRL, which has started to result in better outcomes for the external sector. For the Committee, the combined effects of these elements, the developments in the quasi fiscal framework and in the assets market and, this year, the recovery dynamics of regulated prices are important factors in the context in which future monetary policy decisions will be taken, aiming to ensure the convergence of inflation to the 4.5% target established by CMN, at the end of 2016.

32. In this context, the Copom believes that the convergence scenario of inflation to 4.5% at the end of 2016 has been maintained, despite some deterioration in the balance of risks. For the Committee, on the one hand, the progress made in the fight against inflation - like benign signals stemming from the medium and long term expectations indicators – show that the monetary policy strategy is in the right direction. Under this view, some remaining risks for the Copom's inflation forecasts to reach safely the goal of 4.5% at the end of 2016 are consistent with the lagged and cumulative effect of monetary policy action. On the other hand, recent increases in the risk premmia, which reflect in the prices of assets, require that the monetary policy is vigilant in case of significant deviations of inflation forecasts from the target.

33. At the end of the meeting, it was announced that the Committee will reconvene on October 20th 2015, for the technical presentations, and on the following day, to deliberate on monetary policy, as established in the Communiqué 26,042, of June 24th, 2014.