BANCO CENTRAL DO BRASIL

Minutes of the 135th Meeting of the Monetary Policy Committee (Copom)

Date: June 3rd, from 4:50PM to 7:10PM, and June 4th, from 5:30PM to 7:00PM
Place: BCB Headquarters meeting rooms - 8th floor on June 3rd and 20th floor on June 4th – Brasília – DF

In attendance:
Members of the Committee
Henrique de Campos Meirelles – Governor
Alexandre Antonio Tombini
Alvir Alberto Hoffmann
Anthero de Moraes Meirelles
Antonio Gustavo Matos do Vale
Maria Celina Berardinelli Arraes
Mário Gomes Torós
Mário Magalhães Carvalho Mesquita

Department Heads (present on June 3rd)
Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on June 4th)
João Henrique de Paula Freitas Simão – Open Market Operations Department
José Antônio Marciano – Department of Banking Operations and Payments System
Márcio Barreira de Ayrosa Moreira – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations Group

Other participants (present on June 3rd)
Adriana Soares Sales – Deputy Head of the Research Department
Alexandre Pinheiro de Moraes Rego – Press Secretary
Alexandre Pundek Rocha – Advisor to the Board
Flávio Pinheiro de Melo – Advisor to the Board
Katherine Hennings – Advisor to the Board
Sergio Almeida de Souza Lima – Executive Secretary

The members of the Monetary Policy Committee analyzed the recent performance of and prospects for the Brazilian economy under the monetary policy framework, which is designed to comply with the inflation targets established by the government, and also the recent performance of and prospects for the international economy.

Recent Economic Developments

1. IPCA inflation accelerated in April (0.55%) relative to 0.48% in March and 0.49% in February. As a consequence, inflation reached 2.08% in the first four months of 2008, up from 1.51% in the same period of 2007.

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Twelve-month trailing inflation continued to accelerate. In fact, after reaching 4.61% in February and 4.73% in March, it totaled 5.04% in April (3.00% in April 2007). Under this comparison basis, the acceleration of consumer price inflation essentially mirrors the behavior of market prices, which increased more rapidly than regulated prices. In fact, market prices and regulated prices increased 6.59% and 1.59%, respectively, in the twelve months through April, compared to 2.97% and 2.99% in the twelve months through April 2007. Moreover, despite the BRL appreciation, the prices of tradable goods accelerated, reaching 6.15% (compared to 1.53% in April 2007), according to the same comparison basis. Regarding the prices of non-tradable goods, greatly pressured by the behavior in the prices of perishable food and services, twelve-month trailing inflation was even higher (6.99%), evidencing the influence of domestic prices over inflation. Preliminary data for May point to the continuity of inflation acceleration. The recent behavior of IPCA inflation has been remarkably less benign than that observed in previous quarters, so that since the end of 2007, inflation has signaled that it could be diverging from the targets path, reaching 3.22% in the last six months.

2. Two out of the three main underlying inflation measures calculated by the BCB followed the inflation acceleration in the headline index in April. The core inflation by exclusion of household food items and regulated prices and the smoothed trimmed means core inflation measures increased from 0.36% and 0.39% in March to 0.53% and 0.48% in April, respectively. On the other hand, the non-smoothed trimmed means core inflation measure increased 0.41% in April, unchanged relative to March. Similarly to headline inflation, the three core inflation measures remarkably accelerated in the first four months of the year, compared to the same period of 2007, with increases from 1.46%, 1.21% and 1.09% to 1.99%, 1.52% and 1.60% for the core inflation by exclusion, smoothed and non-smoothed trimmed means core inflation, respectively. On a twelve-month trailing basis, the three core inflation measures continued to accelerate substantially, following the behavior of headline inflation. Core inflation by exclusion of household food items and regulated prices continued to increase significantly, to 4.65% in April, up from 4.41% in March and 4.27% in February. Smoothed trimmed means core inflation showed similar behavior (4.36% in April, up from 4.16% in March), while the non-smoothed trimmed means core inflation increased to 4.14% in April, up from 4.01% in March, and 3.83% in February. Moreover, it bears emphasizing that the behavior of diffusion indices suggests increased dissemination of inflation acceleration, confirming the analysis present in previous Copom Minutes.

3. The General Price Index (IGP-DI) inflation increased to 1.12% in April, up from 0.70% in March and 0.38% in February. On a twelve-month trailing basis, IGP-DI inflation accelerated to 10.24% in April, up from 9.18% in March and 8.65% in February (compared to 4.61% in April 2007). In the twelve months through April, the IGP-DI increase reflected both the behavior of the Consumer Price Index-Brazil (IPC-Br), which totaled 4.95% (2.67% in April 2007), and also of the IPA-DI (Wholesale Price Index), whose variation totaled 12.82% (5.27% in April 2007). According to the same comparison basis, the Civil Construction National Index (INCC) increased 7.13% (5.35% in April 2007). Regarding agricultural IPA, inflation reached 27.90% (11.04% in the twelve months through April 2007). It bears highlighting the acceleration of industrial prices, which began in the second half of 2007 and seems to have intensified lately. In the first four months of 2008, the industrial IPA increased 4.44%, up from 1.02% in the same period of 2007. In the last twelve months, wholesale industrial price inflation increased to 7.97% in April, up from 4.42% in December 2007. As mentioned in previous Copom Minutes, the Copom evaluates that the effects of wholesale prices over consumer price inflation will depend on current and prospective demand conditions and price-setters' expectations for the future inflation path.

4. On a three-month moving average basis, according to data seasonally adjusted by the IBGE, industrial output increased 0.1% in April, after growing by 0.7% in the previous month. Still considering the seasonally adjusted series, after the 0.6% month-on-month expansion observed in March, industrial output increased 0.2% in April. It bears noticing that general industrial output grew 7.3% in the year, with respective increases of 7.4% and 5.9% in manufacturing and in mining output. In a year-over-year basis, industrial output showed remarkable volatility in March and April, with changes of 1.4% and 10.1%, respectively, mainly driven by the unusual number of working days recently observed. The data already released for the last months point, in short, to the continuity of the industrial production expansion cycle, despite at a pace dependent of possible limits to supply expansion.

5. Among the use categories, according to data seasonally adjusted by the IBGE, capital goods production increased significantly in April (1.6%), up from 1.3% in March. The other use categories showed declines at the margin, totaling –0.2% for intermediate goods, -1.9% for durable consumer goods and –1.5% for semi- and non-

durable consumer goods. Among industrial production categories, capital goods production leads the expansion, with a 20.5% increase, followed by the 15.9% elevation in durable consumer goods production. The scenario of solid expansion of capital goods production observed since 2007, mainly driven by the consolidation of positive prospects for the continuity of economic growth, underpinned by the perception of macroeconomic stability consolidation, seems to persist in this year. On its turn, the dynamism of durable consumer goods production reflects, predominantly, the remarkable improvement in credit conditions, when compared to historical patterns. It should be highlighted that the emergency of signs pointing to pressure over the availability of production factors, as suggested in some industrial surveys, indicates that accommodation in the pace of industrial activity expansion could be greatly associated to productive capacity restrictions.

6. Labor market continues to present quite favorable performance. The unemployment rate in the six metropolitan regions covered by the Monthly Labor Survey (PME) decreased to 8.5% in April, down from 8.6% in March and 8.7% in February. As a result, the average unemployment rate in the first four months of the year was 1.4 p.p. below that observed in the same period of 2007. According to data seasonally adjusted by the BCB, the unemployment rate decreased to 8.1% in April, a record low for the month since the start of the historical series in 2002, down from 8.2% in March and 8.5% in February. In March, average real earnings fell 0.6% month-on-month and increased 2.0% year-over-year. On the other hand, in April, average real earnings increased 1.0% month-on-month and 2.8% year-over-year. As a consequence, real payrolls expanded by 6.5% in April, up from 6.3% in the previous month, and 7.2% in year-over-year terms, continuing to constitute a key driver for sustained aggregate demand growth. According to the National Industry Confederation (CNI) data seasonally adjusted by the BCB, manufacturing employment reduced by 0.04% in April (+0.2% in March). In year-over-year terms, employment grew 4.0%, totaling 4.2% growth in the last twelve months. Still regarding employment, data from the Ministry of Labor and Employment (MTE) indicate the continuity of strong expansion in formal employment this year, with the creation of 294.5 thousand jobs in April (up from 206.6 thousand in March and 205.0 thousand in February). In the first four months of the year, employment reached a record high of 849 thousand hires. Formal employment grew by 0.5% in April, seasonally adjusted. Observed data point to a 5.6% expansion in formal employment in the last twelve months, an evidence of strong dynamism in the labor market. The services sector presented the highest hiring rate in April, with the creation of 97.4 thousand new jobs, followed by the manufacturing industry (82.7 thousand), and by civil construction (32.1 thousand), a record high for the period. The retail sector recorded 34.7 thousand new jobs. The agricultural sector created 38.6 thousand new jobs, due to the activities related to sugar cane plantations in the Mid-South region.

7. In line with the positive developments in the labor market and with the credit expansion, retail sales continue to record positive performance, indicating that the pace of domestic demand growth remains robust, and signs of cooling cannot be perceived. According to data seasonally adjusted by the IBGE, expanded retail sales grew by 1.4% in March, up from the 1.2% in February, growing 12.1% year-over-year. As a consequence of the March result, expanded retail sales growth averaged 3.8% in the first quarter of the year, quarter-on-quarter. Month-on-month, according to data seasonally adjusted, it should be highlighted the expansion in the sales of fabric, clothing and shoes (6.1%), - hyper- and supermarket sales, food products, beverages and tobacco (3.3%, despite the rise of food prices) and fuels and lubricants (1.7%). In 2008, accumulated growth was more significant in “office, computing and communication material and equipment” (31.3%), “other personal and domestic articles” (23.9%) and “vehicles, motorcycles, parts and pieces” (23.4%). The steady growth of retail sales has reflected the performance of both the sectors more sensitive to income and employment expansions and those more sensitive to credit conditions. For the next quarters, the continuity of the current cycle of retail sales expansion is expected, and will continue to be underpinned by employment and income growth, credit expansion and the maintenance of consumer confidence at high levels. Sector indicators, for example, relative to automobile sales in April and May, corroborate this assessment.

8. The installed capacity utilization rate (Nuci) in the manufacturing industry reached 83.4% in April, up from the 82.4% observed in March, according to CNI data seasonally adjusted by the BCB, a record high for the series. According to data seasonally adjusted by CNI, the Nuci in the manufacturing industry reached 83.2%, down from the 83.3% record high observed in November. Without the seasonal adjustment, the Nuci in April stood 1.5 p.p. above the level registered in the same month of 2007. As a consequence, the average rate of the first quarter of 2008 was 1.3 p.p. above the level observed in the same period of 2007. The quarterly Nuci calculated by Fundação Getulio Vargas (FGV) reached 85.5% in April, according to the seasonally adjusted series, above the 85.3% level

registered in January. For the consumer goods and capital goods sectors, the utilization rates in April reached 86.0% and 88.3%, respectively, in both cases a record high for the series. The maintenance of high installed capacity utilization rates, with some reduction of idle capacity at the margin, occurs in several sectors despite the significant increase in investment. Indeed, in April 2008, according to seasonally adjusted data, the absorption of capital goods firmly increased (6.2%), due to the vigorous growth of capital goods imports (10.7% in volume) and capital goods production (1.6%). Furthermore, the production of civil construction inputs decreased 3.4% in the same period, after a 2.6% increase in March. Recent data indicate that, although investment has been contributing to soften the increasing trend of capacity utilization rates, it has not been sufficient to contain this process. In this context, the timely maturation of investment projects will be crucial to limit mismatches regarding the evolution of aggregate supply and domestic demand in the relevant forecast period for monetary policy. As stressed in previous Copom Minutes, the inflation trajectory is closely linked to current and prospective developments related to the expansion of supply of goods and services, to adequately meet demand conditions.

9. The trade balance continues to present deceleration at the margin, which was already expected, and is in line with assessments present in Inflation Reports and previous Copom Minutes. In the last twelve months through May the trade surplus reached US$31.9 billion (33% below May 2007). Exports and imports totaled US$172.6 billion and US$140.7 billion, equivalent to 16.4% and 39.9% growth, respectively, in the last twelve months, in comparison to the same period ended in May 2007. As highlighted in previous Copom Minutes, imports have been growing faster than exports, both due to the strengthening of the BRL and to the robust economic activity in the country, notwithstanding the increases in the prices of several commodities included in the Brazilian export basket. The decrease in trade surplus contributed to the US$14.7 billion current account deficit registered in the twelve months through April 2008, equivalent to 1.1% of GDP. Foreign direct investment reached US$37.2 billion in the same period, equivalent to 2.8% of GDP.

10. Regarding the external scenario, the US economy seems to have entered a process of economic stagnation since the last quarter of 2007, and still suffers the impact of the crisis in the real estate sector, with spillover effects on the labor market, whose weakening, in combination with higher oil prices, affects consumer confidence, contributing importantly to depress consumption. Even if the influence of monetary and fiscal stimulus can reduce the risk of a significant contraction in activity, the dominant scenario seems to point to a more consistent recover only from 2009. Even after significant strengthening of capital basis of relevant financial institutions, uncertainties still remain about the length and amplitude of the effects of the US subprime mortgages market crisis over US and European banking system and over credit conditions for households and corporate. Therefore, uncertainties persist about the capability of monetary and fiscal policy measures implemented by the US authorities to smooth the weakening of the US economy in a timely manner, in light of the ongoing difficulties of the financial system. Despite the reduction of systemic risk perception, since mid-March, such difficulties could be worsened by a cyclic deterioration in the quality of credit, which would reinforce the already evident trend to financial contraction, increasing the risk of slowdown intensification. Prospects for economic activity in Europe and Japan, in spite of some favorable indicators in Germany, have also deteriorated, despite not provoking the same degree of concerns that surround the US economic activity. It should be highlighted that despite the prospects of continuity of slowdown for mature economies, global inflationary pressures have intensified. This has partially reflected strong economic growth in many emerging economies, which so far have been apparently little affected by the US mortgage crisis, offsetting the effects of economic deceleration in mature economies. In fact, in light of pressures over production factors availability, which have triggered inflationary pressures in many emerging economies, the trend seems to point to the continuity of monetary tightening cycles. For mature economies, prospects for monetary policy are more diverse, notwithstanding the fact that inflation acceleration, which in some cases starts to deteriorate mid-term inflation expectations, seems to limit the scope for additional monetary policy easing, even if the risks to activity stemming from the credit crisis remain. In this context, volatility and risk aversion indicators in international financial markets have remained at quite high levels since the last Copom meeting, although showing some contraction at the margin. The elevation of Brazilian sovereign risk assessment by major rating agencies tends to reduce the sensitivity that Brazilian assets prices show relative to the international scenario, contributing to mitigate, but not to eliminate, the effects of difficulties experienced by the global economy over Brazilian economic activity, essentially driven by domestic demand.

11. Oil prices, systematic source of uncertainty stemming from the international scenario, once more increased substantially since the last Copom meeting and continue highly volatile. This behavior reflects structural changes in

global energy markets, which have blocked the recovery of inventory levels traditionally observed, in addition to recurrent geopolitical tensions. Despite significant uncertainties inherent to oil prices forecasts, the main scenario considered by the Copom forecasts unchanged domestic gasoline prices in 2008, despite the probability of materialization of an alternative scenario is relevant. However, apart from the behavior of domestic gasoline prices, one should recognize that the elevation of international oil prices impacts domestic economy both through productive chains, such as the petrochemical, as well as through the deterioration of inflation expectations. The prices of other commodities, especially grains, which have also increased significantly since the last Copom meeting, despite more pessimism about the prospects for global economic growth and the turmoil on global financial markets, showed heterogeneous performance in the last weeks, but continue, with few exceptions, to record significant increases in the year.

Assessment of Inflation Trends

12. The identified shocks and their impacts were reassessed according to newly available information. The scenario considered in the simulations utilized the following assumptions:

a) Compared to the assumptions considered in the April Copom meeting, projected adjustments for gasoline and bottled gas prices didn’t change, once adjusted according to the effects stemming from specific taxes, and so were maintained at 0% for 2008;

b) Compared to the assumptions considered in the April Copom meeting, the projections for fixed telephone prices were maintained at 3.5% in 2008, while the projections for electricity price adjustments were changed to 1.1%, up from 0.1%;

c) The projection for regulated prices inflation, based on individual items, was maintained at 4.0% for 2008. This set of prices, according to data released by the IBGE, corresponded to 30.09% of the total April IPCA;

d) The projection for regulated prices inflation in 2008 was maintained at 4.5%. This projection is based on the endogenous determination model for regulated prices, which computes seasonal components, foreign exchange rate changes, market prices inflation and the IGP (General Price Index) variation;

e) The projection for the spreads over the Selic rate based on the 360-day swap rates estimates a 133bps spread in the fourth quarter of 2008 and 84bps spread in the last quarter of 2009. The identified shocks and their impacts were reassessed according to newly available information.

13. Regarding fiscal policy, the projections assume the achievement of the public sector primary surplus target of 3.8% of GDP in 2008 and 2009, increased by 0.5 p.p. The related assumptions considered in the previous meeting were maintained.

14. Since the April Copom meeting, median IPCA inflation expectations for 2008, compiled by the BCB’s Investor Relations Group (Gerin), increased significantly to 5.48%, up from 4.66%. Twelve-month ahead inflation expectations increased as well from 4.38% to 5.01%, considering the composition of median monthly inflation market expectations. For 2009, inflation expectations increased to 4.60% up from 4.40%.

15. Considering the hypotheses under the benchmark scenario – which assumes the maintenance of the Selic rate at 11.75% and the exchange rate at R$1.65/US$ during the forecast period – the projection for the 2008 IPCA increased compared to the value considered at the April Copom meeting, remaining above the 4.5% target established by the National Monetary Council (CMN) for the year. According to the forecast based on the market scenario – which incorporates the consensus exchange and Selic rates trajectories collected by Gerin on the eve of the Copom meeting – IPCA inflation forecast for 2008 also increased compared to the value considered at the last Copom meeting, and is also above the central target for the year. The projection for 2009 based on the benchmark scenario increased relative to the April Copom meeting, whilst the projection based on the market scenario remained stable – in both cases, projections are above the 4.5% target.

Monetary Policy Decision

16. The Copom evaluates that monetary policy should contribute for the consolidation of a favorable long-term macroeconomic environment. Economic activity data indicate that the intensity of domestic demand expansion continues quite robust, showing acceleration in some segments and regions in the first quarter of 2008, and is responsible, at least partially, for the inflationary pressures observed in the short-run, despite strong imports growth and the benign investment behavior. Even in the context of moderate deceleration of global growth this year and the higher volatility observed in global markets since mid-2007, the Committee believes, according to information available at the moment, that the balance of payments should not represent imminent risk to the inflationary scenario, evaluation corroborated by the recent upgrade to investment grade of Brazilian sovereign debt bonds. On the other hand, there are signs that relevant inflationary pressures are intensifying both in mature and emerging economies, evidencing the existence of inflationary risks on the global outlook. The Copom reaffirms the view, stated in previous Minutes, that an alternative scenario of more intense and generalized global deceleration represents an ambiguous risk factor for the Brazilian inflation. On the one hand, by reducing net exports it would act as a factor to restrain aggregate demand. Moreover, the potential decrease of some important commodities prices could contribute to a lower domestic inflation. On the other hand, the above-mentioned alternative scenario could unfavorably impact inflation prospects through two mechanisms. In the case of deceleration in the mature economies that comprise the global financial markets center, risk aversion could increase, resulting in decreased demand for Brazilian assets and depreciation of their prices. In addition, in the medium run, a possible reduction of net exports could similarly affect the price sustainability of certain Brazilian assets. In light of the deterioration of inflation prospects, in a more uncertain scenario, the Committee evaluates that the risk of materialization of a less benign inflationary scenario continues to be high. The Copom emphasizes that the main challenge of monetary policy in this context is to guarantee the maintenance of positive results reached in the last years. Particularly, monetary policy should act so that impacts initially focused on price indices, partially derived from relative prices adjustments that occur in global scale, do not result in persistent deterioration of inflation dynamics through the worsening in expectations. The Copom understands that the maintenance of monetary stability is a necessary condition so that the relative prices system continues to signal efficiently the adjustments requested for ongoing consumption and production patterns in the economy.

17. The Copom considers that the probability that emerging local inflationary pressures will represent risks to the domestic inflation trajectory remain high, because the heated domestic demand and market of factors, in addition to the possibility of emergency of supply restrictions in some sectors, can increase the pass-through of wholesale prices over consumer price inflation. The Committee understands that the prospects for this pass-through, as well as for the generalization of the local pressures initially focused on consumer price inflation, depend in a critical manner on inflation expectations, which increased significantly in the recent weeks, and continue to be carefully monitored. Additionally, it is worth noticing that although the external sector can restrain the inflationary pressures in the tradable sector, heated domestic demand can trigger intense inflationary pressures in the non-tradable sector, for instance, such as in the services sector. In this context, the Copom will continue to manage the monetary policy stance so that the gains obtained in inflation control in recent years become permanent. In this respect, the Copom will continue to carefully monitor the evolution of inflation and the several core inflation measures, as well as inflation expectations within the forecast period, promptly adjusting the monetary policy stance in order to avoid the consolidation of a scenario where one-off adjustments become persistent or generalized price increases.

18. The preservation of inflation rates in line with the targets path and the consequent consolidation of a long-lasting stable macroeconomic scenario will contribute to the continuous progressive reduction of macroeconomic risk perception that has occurred in the last years. The Copom evaluates that the persistence of a cautious and timely monetary policy stance has been critical to increase the probability that inflation will continue to evolve according to the targets path, even in light of global inflationary pressures. For this to materialize, however, it is important that forward-looking inflation indicators, in particular the expected dynamic of aggregate supply and demand, converge throughout relevant period for the monetary policy.

19. The Committee emphasizes, once again, that there are important time lags between the implementation of monetary policy and its effects over economic activity and inflation. Therefore, the evaluation of alternative monetary policy stances should necessarily focus on the forward-looking inflation scenario and its risks, instead of current inflation indicators.

20. During the coming months, credit growth, despite more moderate due to an increase in funding costs, and real payroll expansion should continue to bolster economic activity. The effects of governmental transfers expected for this and the next quarters should also add up to the factors that will sustain demand, but with less intensity than previously anticipated. These considerations become even more relevant considering the clear signs of heated aggregate demand, the dissemination of pressures resulting from adjustments in relative prices, and the fact that the monetary policy decisions will have concentrated effects in the second half of 2008 and in 2009.

21. The Copom recognizes the important contribution of investment to expand productive capacity. This factor, together with the external sector, has helped to mitigate inflationary pressures. However, the Copom evaluates that the pace of domestic demand expansion, which should continue to be sustained, among other factors, by income and credit growth, continues to present significant risks to inflationary dynamics. In this context, the consistent reduction of the mismatch between the rhythm of expansion of supply of goods and services and the increase of demand continue to be vital to the assessment of different possibilities of monetary policy stance.

22. Aiming at consolidating a stable and predictable environment, the Copom adopts a strategy to avoid a volatile inflationary trajectory. This strategy takes into consideration the time lags in the transmission mechanisms and has proved to be the most adequate to deal with the uncertainty inherent to the process of monetary policy formulation and implementation. That is the reason why variables such as inflation projections, the balance of risks associated to the forward-looking scenario and, especially, the preventive stance in the decision-making process of the Copom are so important. At the current moment, characterized by the deterioration in current and expected inflationary dynamics, prudence assumes an even more important role in this process. In the current circumstances, there is the risk is that economic agents start to attribute higher probability that inflation increases will become persistent, which would reduce the efficacy of the monetary policy. Therefore, the Copom's assessment, backed by international experience, is that the performance of monetary policy tends to be more effective, when the deterioration of inflationary dynamics is in its early stages, rather than when it is consolidated. The Committee believes that the present monetary policy stance, which will be kept while it is necessary, will assure the convergence of inflation towards the targets path. Evidently, if the risk profile deteriorates in a matter that implies shifts in the basic inflation prospective scenario considered at the present moment, the Committee will promptly adjust the monetary policy stance to the circumstances.

23. The Copom evaluates that, in light of signals of economy heating, as illustrated by the acceleration of some wholesale prices and the evolution of core inflation measures, and by the fast increase in inflation expectations, the risks for the concretization of a benign inflationary scenario, in which IPCA would remain in line with the targets path, are relevant. In fact, the deterioration of the forward-looking scenario is already present in the Committee's inflation projections. The Copom also considers that the persistence of significant mismatch between the paces of expansion of aggregate supply and demand tends to increase the risk for the inflationary dynamics. In these circumstances, monetary policy should act through the adjustment of the basic interest rate in order to, on the one hand, contribute to the convergence between the paces of expansion of aggregate supply and demand and, on the other hand, avoid that inflationary pressures initially focused on price indices lead to persistent deterioration of expectations and of the inflation forward-looking scenario. By acting as the balance of risks to inflation dynamics so requests, the Committee understands that it is, in fact, contributing to sustain economic growth, which requires stability, predictability and consequent extension of the planning horizon for businesses and families, as well as to protect the substantial increases in real income of workers observed in recent years. Therefore, the Copom ratifies that the decisions of monetary policy necessarily take into consideration the time lags of the transmission mechanism, and that they are part of a dynamic strategy, whose results will become evident throughout time.

24. In this context, continuing the process of adjustment of the basic interest rate initiated in the April's meeting, the Committee unanimously decided to raise the Selic target rate to 12.25% p.a., without bias.

25. Under the inflation-targeting regime, the Copom decides according to inflation prospects, the analysis of several alternative scenarios for the evolution of the main variables that determine the prospective price dynamics and the balance of risks associated to its projections. Domestic demand continues to expand vigorously, backing-up economic activity dynamism, including sectors little exposed to external competition, at a time when the effects of important incentive factors are still perceived. On its turn, the contribution of the external sector to a benign

inflationary scenario, in light of robust domestic demand growth and the increase of global inflationary pressures, seems to become less effective, at a moment when the effects of investment over productive capacity of the economy still need to consolidate. In such environment, the monetary authority should act in order to avoid that short-term uncertainties contaminate longer time horizons.

26. At the conclusion of the meeting, it was announced that the Copom would reconvene on July 22nd 2008, for technical presentations, and on the following day, to discuss the monetary policy decision, as established in Communiqué 16,051 of September 3rd, 2007.

SUMMARY OF DATA ANALYZED BY THE COPOM

Inflation

27. IPCA-15 inflation increased 0.56% in May, down from 0.59% in April. Food and beverages prices increased 1.26%, contributing 0.28 p.p. to the monthly index result, unchanged relative to April, showing the resilience of the price increases in this group. The second main driver of the IPCA-15 in May, contributing 0.09 p.p., came from the 0.93% increase in personal outlays, which accelerated relative to April (0.49%). Market prices increased 0.74% in May, up from 0.68% in the previous month, with price elevations in tradable goods (1.11%) and non-tradable goods (1.41%). Regulated prices increased 0.15%, down from 0.38% in April. The diffusion index reached 67.19% in May, the highest level since January 2007, with a 62.29% average in 2008, up from 59.22% in the same period of 2007. In the last twelve months through May, IPCA-15 increased 5.25%, against 4.94% in April, due to elevations of 6.98% in market prices and 1.41% in regulated prices.

28. The IPCA-15 core inflation measures accelerated both on month-on-month and 12-month trailing bases. The core excluding household food and regulated prices increased 0.55% in May, up from 0.44% in April, totaling 4.84% in twelve months (the highest rate since April 2006), up from 4.59% in April. The non-smoothed trimmed means core evolved from 0.39% in April to 0.40% in May, accumulating 4.06% in the last twelve months, also the highest rate since April 2006. The smoothed trimmed means core increased 0.41% in May, up from 0.39% in April, totaling 4.28% in the last twelve months (the highest rate observed since January 2007), against 4.15% in April.

29. IGP-M inflation increased 1.61% in May, up from 0.69% in April, accumulating 11.53% in the last twelve months. Among the index components, only the IPC-M decelerated month-on-month (0.68% against 0.76% in April), reaching 5.25% in twelve months. IPA-M inflation increased 2.01%, up from 0.65% in April, totaling 14.53% in twelve months. INCC inflation increased 1.10% in May, up from 0.82% in April, reaching 7.64% in the last twelve months.

30. The lower IPC-M change in May reflected inflation deceleration in five out of seven groups that compose the index, with highlights for the cooling in housing prices, which changed 0.02% in the month, down from 0.38% in April. The change in food prices in May remained the highest for the index (1.77%), although barely the same as the 1.76% rate of the previous month and according the same trend captured by IPCA-15.

31. The higher increase in the IPA-M inflation rate in May reflected the behavior of both agricultural and industrial prices. Agricultural prices increased 2.29% in May, reversing the 1.19% decrease in April, totaling 33.32% in the last twelve months. The industrial IPA increased 1.91%, up from 1.37% in April, accumulating 8.58% in twelve months. The IPA also accelerated in May considering all processing stages, mainly in the prices of gross raw materials, which increased 3.38%, after decreasing 0.13% in April. The prices of final goods increased 1.11%, up from –0.01% in April, while the prices of intermediate goods increased 1.79%, up from 1.72%, in the same period.

Economic Activity

32. According to seasonally adjusted data from the IBGE's monthly survey (PMC), retail sales increased 1.4% in March, month-on-month, considering the expanded retail sales concept, which includes construction material and vehicles and motorcycles, parts and pieces. It bears emphasizing the increases of 6.1% in the sales of fabric,

clothing and shoes, and 3.3% in hyper- and supermarkets, food products, beverages and tobacco, while the sales of office, computing and communication material and equipment decreased 5.6%.

33. Under the same concept, the volume of sales in the commerce increased 14.8% in the first quarter of 2008, recording a generalized growth in all segments, with emphasis to office, computing and communication material and equipment, 29.2%; other personal and domestic items, 26.9%; vehicles, motorcycles, parts and pieces, 21.4%; furniture and home appliances, 17.2%; and fabric, clothing and shoes, 13.3%. The results of retail sales evidenced the increase of payrolls, favorable credit conditions, impacts of income transfer programs, and higher agricultural income.

34. According to São Paulo Trade Association (ACSP) data, related to the city of São Paulo and seasonally adjusted by the BCB, database consultations for credit sales increased 0.3% in April while the consultations to the Usecheque system decreased 0.3%, month-on-month. Compared to April 2007, there were respective increases of 12.6% and 12.9%.

35. Regarding investment indicators, domestic production of capital goods increased 1.6% in April, month-on-month seasonally adjusted, while the production of construction inputs decreased 3.4%. Compared to April 2007, these indicators increased 30% and 11%, respectively. Still according to this comparison basis, the positive evolution of capital goods production reflects mainly the expansion of agricultural equipment (37.3%) and transportation equipment (42.2%).

36. Capital goods imports increased month-on-month 10.7% in April, according to Fundação Centro de Estudos do Comércio Exterior (Funcex) data, seasonally adjusted by the BCB. Confirming the expansionist trajectory of investments in Brazilian economy, capital goods imports increased 32.6% year-over-year.

37. CNI indicators, seasonally adjusted by the BCB, showed expansion of industrial activity in April, with increases of 0.6% in industrial real revenues and 0.4% in hours worked in production. Compared to April and the first four months of 2007, industrial real revenues increased 6.5% and 7.6%, respectively, and hours worked in production, 5.3% and 5.8%, in the same order. Installed capacity utilization (Nuci) reached 83.4% in April, a record high for the series and 1 p.p. above the March level, considering seasonally adjusted data, and 1.5 p.p. above the April 2007 level, according to the observed series.

38. According to IBGE's Monthly Industrial Survey (PIM), industrial production increased 0.2% in April month-on-month, while the three-month moving average remained almost stable (0.1%). Sixteen out of the twenty-seven activities surveyed recorded production increase in April and, by use categories, only the production of capital goods increased (1.6%). The production of intermediate goods showed relative stability (-0.2%), while the production of semi-durable and non-durable consumer goods declined 1.5%, after a 2.6% increase in the previous month. Durable goods production decreased 1.9%, after three consecutive increases (accumulating a 9% increase). Year-over-year, industrial activity increased 10.1%, with expansion in all use categories, highlighting the increases of 30.0% in capital goods production and 22.4% in durable consumer goods production. In the first four months of 2008, compared to the same period of 2007, these rates reached 7.3%, 20.5% and 14.5%, respectively,. In the same period, the production of intermediate goods and semi- and non-durable consumer goods expanded by 6% and 2.2%, respectively. On a twelve-month trailing basis, industrial output expanded 7.0% in April, up from 6.6% in March, showing acceleration at the margin, in contrast to month-on-month and the three-month moving average seasonally adjusted data comparisons.

39. Vehicles production reached 300.6 thousand units in April, according to Anfavea, increasing 34.4% year-over-year. Considering seasonally adjusted data, the production of vehicles increased 6.8% month-on-month, with expansions in the production of automobiles (6.9%), buses (4.1%), and trucks (1.3%). Considering seasonally adjusted data, and the same comparison basis, the production of agricultural machinery increased by 5%. In the first four months of the year, the production of vehicles and agricultural machinery increased 23.9% and 46.9%, respectively, compared to the same period of 2007. In the same period, total vehicles sales increased 21.8%, with expansion of 30.5% in domestic sales and decrease of 0.2% in exports.

40. According to the survey carried out by the IBGE in April, planted area was estimated at about 46.8 million hectares, a 3.2% increase relative to April 2007. The grains harvest should reach 142.6 million tons in 2008, increasing 7.2% year-over-year. This result encompasses increases of 8.6%, 11.4% and 2.6% in rice, corn and soybean productions, respectively, which are responsible for 90% of total grains production and occupy 82% of total planted area. The survey also estimated an 8.2% increase in sugar cane production, with an 8.0% expansion in planted area, and a 26.3% increase in coffee production, an effect of the biannual cyclic recovery in productivity.

Surveys and Expectations

41. The Fecomercio-SP survey showed a 1% month-on-month decrease in the Consumer Confidence Index (ICC) in May, reflecting the 1.4% and 0.7% retractions in Current Economic Conditions Index (Icea) and in Consumer Expectations Index (IEC), respectively. The ICC grew by 16.2% year-over-year, due to expansions of 12.9% and 18.7% in the Icea and IEC, respectively.

42. According to the FGV survey, the ICC grew 2% in May, month-on-month. This result reflected a 2.6% increase in the Current Situations Index (ISA) and a 1.6% elevation in the Expectations Index (IE), which computes 6-month ahead expectations. The survey registered increases of 5.6%, 15.5% and 0.7% in the ICC, ISA and IE, respectively, year-over-year.

43. Still according to the FGV, the Industry Confidence Index (ICI) reached 119.9 points in May, up from 120.3 in April. The indicator stayed 1.7 p.p. above the level registered in the same month of 2007, reflecting the elevations of 2.9 p.p. in the ISA and 0.5 p.p. in the IE.

44. According to the FGV Manufacturing Industry Survey, installed capacity utilization (Nuci) reached 85.6% in May, standing 0.5 p.p. above the April level and 1.2 p.p. year-over-year. The Nuci decreased 0.7 p.p. in intermediate goods segment, and increased 5.3 p.p., 3.2 p.p. and 2.7 p.p. in construction material, consumer and capital goods segments, respectively.

Labor Market

45. According to the Ministry of Labor and Employment, 294.5 thousand new formal jobs were created in April 2008, totaling 849 thousand in the first four months of the year. Employment level increased by 0.5% month-on-month in seasonally adjusted terms, expanding in all sectors, with highlights to the 1.0% expansion in the construction sector and the creation of 97 thousand new jobs in the services sector.

46. According to the IBGE employment survey (PME) in the six main metropolitan areas of the country, the unemployment rate reached 8.5% of economically active population (PEA) in April, compared to 8.6% in the previous month and 10.1% in April 2007. The stability of the unemployment rate between March and April reflected the increase of 105 thousand employed workers, compared to 102 thousand who entered the labor market. Year-over-year, occupation increased 4.3%, while the PEA increased 2.5%. Formal workers in the private sector increased 1.5% between April and March, representing 139 thousand jobs, and the number of self-employed and informal workers decreased 2.4% and 1.3%, respectively (96 thousand and 35 thousand jobs). Compared to April 2007, formal workers in the private sector leaded the occupation growth (9.9% increase), the number of self-employed workers increased 1.8% and the number of informal workers decreased 4.7%.

47. The same survey showed that average real earnings of occupied workers grew 1% in April month-on-month and 2.8% year-over-year. Real payrolls increased 1.5% in April month-on-month, 6.5% in the year, and 7.2% year-over-year.

48. According to CNI data seasonally adjusted by the BCB, employment in manufacturing industry and real payroll increased 4% and 5.3% in April, year-over-year. In the first four months of 2008, employment and real payroll in the manufacturing industry increased by 4.7% and 6.2%, respectively, compared to the same period of 2007.

Credit and Delinquency Rates

49. Credit operations in the financial system expanded by 2.5% in April, expanding by 30.9% on a twelve-month trailing basis. According to the same comparison bases, non-earmarked credit operations increased 2.8% and 35.0%, respectively, while earmarked credit operations elevated 1.7% and 21.8%, respectively. Among the non-earmarked operations, leasing operations remained strong, with expansions of 124.1% and 87.6% for credit to individuals and to corporate, respectively, in the last twelve months. Regarding earmarked credit, it bears highlighting the 24.9% and 21.5% increases in operations related to housing and the agricultural sector, respectively, according to the same comparison basis. Considering other sectors, loans to industry increased 3% month-on-month and 35.5% in twelve months.

50. The average interest rate on non-earmarked credit operations, used as reference for interest rates, reached 37.4% p.a. in April, standing 0.2 p.p. below the previous month result. The average rate on credit for individuals reached 47.7% p.a., compared to 47.8% p.a. in the previous month, while the average rate on corporate credit increased 26.3% p.a., compared to 26.5% p.a. in the previous month.

51. The average tenure on non-earmarked credit operations, used as reference for interest rates for individuals reached 370 days in April, remaining almost stable since January, when it breached, for the first time, the one-year record. The average tenure of corporate credit operations reached 298 days, while the average tenure for credit operations to individuals totaled 457 days, up from 241 days and 389 days, respectively, in April 2007.

52. Delinquency rates in the financial system for non-earmarked loans (used as reference for interest rates in arrears for more than ninety days) reached 4.2% in April, a 0.6 p.p. decrease relative to the same month of 2007. Delinquency rates for credit operations with corporate and individuals reached 1.8% and 7.0%, respectively, compared to 2.7% and 7.0% in April 2007.

53. Net delinquency rate for retail credit, measured by the ACSP, reached 8.6% in April, up from 8.1% year-over-year. According to the seasonal adjusted series, net delinquency rate stood at 6.0% in April, up from 5.7% month-on-month.

External Environment

54. There are evidences that the financial market turmoil and the worst of the liquidity crises have already finished, although still the risks to the global economic outlook stemming from the real estate markets remain. In the US, signals of deterioration in the commercial real estate mortgage market arose and tend to sharpen due to the less favorable conjuncture and the financial institution conservatism in credit analysis. Moreover, in European countries such as Spain, Ireland and the United Kingdom, there are signals of saturation of their mortgage markets, with a downward trend, mirroring the adverse effects of the crisis in credit and the weakening of economies. The prices of real estate in the UK recorded the sharpest monthly fall in May.

55. The inflationary outlook and, more important, inflation expectations continues to deteriorate. Despite the deceleration observed in great part of economies, global inflation index reached a record high for the last nine years. This fact can be perceived because the reduction of the purchase power is still not effective and also because inflation has been pressured mostly by more inelastic consumer goods. Therefore, the inflationary process remains resilient to fall, keeping the central banks under strict surveillance.

56. Oil prices have reached record highs systematically, and the cycle of commodities prices rises in the international market continues to pressure domestic inflation in several countries. Several factors explain the cycle of commodities prices rises, such as the new development standard reached by emerging economies; prices transmissions among different commodities and inventories at historically low levels.

Foreign Trade and International Reserves

57. In May 2008, Brazilian trade surplus reached US$4.1 billion, totaling surpluses of US$ 8.7 billion in the year and US$ 31.9 billion in the last twelve months. In the year trough May, exports reached US$72.1 billion, and imports, US$63.4 billion, growing by 22.2% and 49.2%, compared to the same period of 2007.

58. In May, exports totaled US$19.3 billion, reaching a US$965.3 million daily average, a 55.6% growth year-over-year. Imports totaled US$15.2 billion in May, with a US$761.5 million daily average, a 71% increase year-over-year. Imports and exports reached record highs for both series, impacted by the regularization of the exports registers, which had been harmed by the strike of the Brazilian state tax agency auditors between March 18 and May 12.

59. International reserves totaled US$195.8 billion in April, with increases of US$535 million in the month and US$15.4 billion, compared to the end of 2007.

Money Market and Open Market Operations

60. In the period between the April and the May Copom meetings, the yield curve shifted upwards in all extension, and sharpened in its intermediate tenure. This move was mainly driven by the release of above-than-expected inflation indicators and by the increase of inflation expectations. The long-tenure future interest rates recorded momentary relief twice after the grant of investment grade level to Brazilian sovereign debt by two risk agencies: on April 30 and May 29. Between April 14 and June 2, one-, three-, and six-month rates went up by 65 bps, 70 bps and 87 bps, respectively. Moreover, both one- and two-year rates increased by 103 bps, and the three-year rate, by 85 bps. Real interest rates, measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month ahead inflation expectations, increased to 8.66% on June 2, up from 8.07% on April 14.

61. On April 25 and May 28, the BCB carried out reverse FX swap auctions amounting US$1.8 billion and US$2.4 billion, respectively, with the rollover of the May and June redemptions.

62. In its open market operations, the BCB carried out, from April 15 to June 2, weekly five- and seven-month fixed rate repo operations, borrowing. The average daily balance of these operations reached R$79.4 billion, of which R$50.8 billion were seven-month operations. In the same period, the BCB conducted 38 overnight repo-borrowing operations. The BCB also conducted daily liquidity management operations with tenures up to two working days. Operations with tenors less than thirty days, including daily liquidity management operations, averaged R$29.4 billion, borrowing. In addition, on April 17 the BCB conducted borrowing operations with tenures of 32 and 10 working days, respectively, and on May 16, operations with tenures of 13 working days, amounting R$110.9 billion, R$31.1 billion, and R$19.7 billion, respectively. These operations totaled R$129.6 billion on a daily average basis.

63. Between April 15 and June 2, the National Treasury raised a total of R$30.6 billion, of which R$10.6 billion in fixed-rate securities: R$7.2 billion via issuance of LTNs maturing in 2008, 2009 and 2010, and R$3.4 billion in NTN-Fs maturing in 2012, 2014 and 2017. Issuance of LFTs totaled R$15.7 billion, for securities maturing in 2012 and 2014. Issuance of inflation-linked NTN-Bs reached R$4.3 billion, for securities maturing in 2011, 2013, 2017, 2024, 2035 and 2045.

64. In the same period, the Treasury conducted auctions to sell LTNs maturing in April and July 2009 and bought LTNs maturing in July 2008, totaling R$0.9 billion. Issuance of inflation-linked NTN-Bs for securities maturing in 2011, 2013, 2017, 2024, 2035 and 2045, settled in other National Treasury securities, totaled R$3.2 billion. The Treasury also conducted sales auctions of LFTs maturing in 2012 and 2014, which totaled R$5.9 billion, receiving LFTs maturing in 2008 as payment, and purchase auctions to buy LTNs and NTN-Bs, totaling R$0.6 billion and R$0.1 billion, respectively.