BANCO CENTRAL DO BRASIL

Minutes of the 145th Meeting of the Monetary Policy Committee (Copom)

Date: September 1st, from 4:40PM to 6:35PM, and September 2nd, from 3:40PM to 6:00PM
Place: BCB Headquarters meeting rooms - 8th floor on September 1st and 20th floor on September 2nd – 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 September 1st)
Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on September 2nd)
João Henrique de Paula Freitas Simão – Open Market Operations Department
Jose Antonio Marciano - Department of Banking Operations and Payments System
Marcio Barreira de Ayrosa Moreira – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations Group

Other participants (present on September 1st)
Adriana Soares Sales – Advisor to the Board
Alexandre Pundek Rocha – Advisor to the Board
Eduardo José Araújo Lima – Advisor to the Research Department
Fabio Araujo – Advisor to the Research Department
Katherine Hennings – Advisor to the Board
José de Ribamar Oliveira Júnior – Press Secretary

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

Recent Economic Developments

1. IPCA inflation reduced from 0.36%, in June, to 0.24% in July. As a consequence, inflation accumulated in the first seven months of 2009 reached 2.81%, decreasing 1.38 p.p. relative to the level registered in the same period of the previous year. In the last twelve months, inflation reduced from 4.80% in June to 4.50% in July (5.90% in December 2008 and 6.37% in July 2008), returning towards the target after eighteen months. The deceleration of twelve-month consumer price trailing inflation in the first seven months of the year mirrored the behavior of market prices, as regulated prices increased. Considering market prices, both prices of tradable goods and non-tradable goods cooled on a twelve-month trailing basis, reaching 4.13% and 5.19%, respectively, in July, down from 6.99% and 7.10% in December 2008 (7.41% and 8.63% in the same month of the previous year). However, according to the same comparison basis, the prices of services, whose dynamics tends to show more persistence than that of the prices of goods, increased from 6.39% in December to 7.13% in July (5.83% in July 2008). Preliminary data for August point to consumer inflation below that observed in July. In short, information available suggest that the inflationary cycle observed last year has been gradually overcome by a process that should continue to be led by the behavior of market prices, while regulated price inflation should show more persistence.

2. The three main underlying inflation measures calculated by the BCB decreased in July. The core inflation by exclusion of household food items and regulated prices decreased from 0.32% in June to 0.23% in July. Smoothed and non-smoothed trimmed means core inflation measures also retreated, recording 0.39% and 0.28% in June, and 0.30% and 0.21% in July, respectively. The twelve-month trailing inflation measures changed from 6.09%, 4.82% and 4.92% in December to 5.55%, 4.48% and 3.89% in July, for the core inflation by exclusion, smoothed and non-smoothed trimmed means core inflation, respectively. Moreover, it bears emphasizing that the behavior of the IPCA diffusion index reduced from 61.7% in December to 52.9% in July (compared to 59.4% in July 2008).

3. The General Price Index (IGP-DI) inflation changed from -0.32% in June to -0.64 in July. On a twelve-month trailing basis, the IGP-DI inflation decreased from 0.76% in June to -1.00% in July, compared to 14.81% in July 2008. The slowdown of the IGP-DI has basically reflected the behavior of its main component, the Wholesale Price Index (IPA-DI), which decreased from -1.72% in June to -4.09% in July, according to the same comparison basis (18.91% in July 2008). On its turn, the Consumer Price Index-Brazil (IPC-Br) increased 4.67% up to July (6.23% in July 2008) and the Civil Construction National Index (INCC) increased 6.40% (10.38% in July 2008). Regarding the IPA-DI, the inflationary deceleration, under this comparison basis, derives basically from the behavior of both agricultural and industrial prices. The agricultural IPA reached -8.36% (37.02% in July 2008), while wholesale industrial prices reached -2.42% (13.09% in July 2008). 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 1% in June and 1.3% in July. Still considering the seasonally adjusted series, industrial output increased by 0.4% in June and 2.2% in July month-on-month, pointing the seventh month in a roll of expansion. On a year-over-year basis, industrial output retreated by 10.9% in June and 9.9% in July, with respective falls of 9.9% and 10.1% in mining and manufacturing industries. The analysis of the behavior of IBGE industrial output series and its components, at the margin, according to data available, suggests that production reached its record low in December-January, and was followed by gradual recovery. However, industrial activity recovery continues to be influenced by the international crisis, due to its effects both over exports and credit conditions, and over business and households' expectations.

5. Among the use categories, according to data seasonally adjusted by the IBGE, it bears highlighting the 4.6% increase in the production of durable consumer goods, strongly influenced by the automotive sector. Regarding the other use categories, intermediate goods production increased 2.0%, non-durable and semi-durable consumer goods production increased 1.0%, while the production of capital goods increased by 1.4%. The recovery, at the margin, in the dynamism of industrial production, led by production of the durable goods, reflects, predominantly, tax exemption measures and also some easing of credit conditions. The future behavior of industrial production recovery, which should not be uniform over time, will depend on these factors, as well as on the gradual recovery of consumer and businessmen confidence, counterbalancing the deterioration of external demand.

6. Labor market tends to behave more favorable, in which resilient aspects prevail before signs of loss of strength. The unemployment rate in the six metropolitan regions covered by the Monthly Labor Survey (PME) changed from 8.8% in May to 8.1% in June and 8.0% in July (8.1% in July 2008). According to the seasonally adjusted series, the unemployment rate changed from 8.4% in May, down to 8.0% in June and July. Average real earnings increased by 3.4% in July, in year-over-year terms. Employment, on its turn, expanded by 1.1% in July, according to the same comparison basis. As a consequence, real payroll reached 4.5% in July, continuing to constitute a key driver for domestic demand growth. According to the National Industry Confederation (CNI) data, manufacturing employment decreased by 4.5% in June, in year-over-year terms, and expanded by 0.4% on a twelve-month trailing basis. According to data seasonally adjusted by the IBGE, manufacturing employment decreased by 4.7%, in year-over-year terms, and presented stability in the last twelve months. Still regarding the labor market, data from the Ministry of Labor and Employment (MTE) indicate that the generation of formal employment has continued to record some recovery, despite below the seasonal pattern. In July, 138,402 jobs were created (compared to the positive result of 119,495 in June). The manufacturing industry showed positive balance for the fourth-consecutive month. Similarly, the commerce sector continued the recovery trajectory initiated in April, with the positive result of 27,336 jobs. The civil construction sector, the most dynamic one, and the services sector continued hiring workers this month: 32,175 and 27,655 jobs, respectively. The agricultural and livestock sector generated 29,483 jobs.

7. According to data seasonally adjusted by the IBGE, expanded retail sales increased by 6.5% in June, after expansion of 4.9% in May. On a year-over-year basis, the indicator increased by 10.2%, growing by 3.9% in the year. The three-month moving average of expanded retail sales reached 2.7% in June, according to seasonally adjusted data, after recording 1.0% in May. On a month-on-month basis, according to seasonally adjusted data, it bears emphasizing the expansion in the sales of “office material and equipment” (15.6%)“ and “vehicles, motorcycles, parts and pieces” (11.1%). The negative key drivers were “fuels and lubricants” (-2.7%) and “construction inputs” (-1.9%). In the year, cumulative growth was more significant in “office material and equipment” (16.7%) and “pharmaceutical and medical articles” (11.8%). After consecutive falls in the last months of 2008, expanded retail sales data have evidenced recovery, mainly influenced by the increase in the sales of vehicles, in response to sector incentives granted by the government and to some improvement in the access to vehicle credit supply. For the next quarters, the retail sales trajectory will continue to be sustained by fiscal transfers, as well as by real payroll growth, whose evolution should be favored by the reduction of inflation, but it will also be affected by the recovery in the access to credit supply and by the behavior of consumer confidence.

8. The installed capacity utilization rate (Nuci) in the manufacturing industry reached 79.5% in June, slightly above the level observed in May, according to CNI data seasonally adjusted by the BCB, and 1.64 p.p. above the record low reached in January. The series seasonally adjusted by CNI changed from 79.8%, in May, to 79.3%, in June. Considering the monthly series without seasonal adjustment, in June the Nuci was 3.4 p.p. below the level registered in the same month of 2008. On its turn, the monthly Nuci without seasonal adjustment, calculated by Fundação Getúlio Vargas (FGV), increased in August to 81.6%, up from 79.8% in July, 5.0 p.p. below the level observed in the same month of 2008. The reduction in the Nuci according to the year-over-year comparison is also observed in the production of consumer goods (-2.3 p.p.), intermediate goods (-5.5 p.p.), capital goods (-10.7 p.p.) and construction inputs (-2.8 p.p.). The same indicator seasonally adjusted by FGV changed from 79.4% to 81.3%, between June and August, increasing 3.70 p.p. compared to the minimum observed in February. The reduction on the Nuci calculated by CNI and FGV, according to the same comparison basis, seems to be a result of a combination between the maturity of investment projects and accommodation of economic activity, and points to significant idle capacity in the manufacturing industry. Regarding the absorption of capital goods, data indicate continuity of retraction year-over-year and expansion at the margin. The absorption of capital goods increased by 8.1% in July (after a 3.7% decrease in June), according to seasonally adjusted data, and decreased 20.9% in year-over-year terms, according to observed data. On its turn, the production of construction inputs decreased by 2.3% at the margin in July, after a 3.9% increase in June, accumulating a 10.2% fall in the year. In short, evidences suggest that demand pressures over the productive capacity level of the manufacturing industry reduced, although the ones regarding the utilization rates have increased in the last months. 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 twelve-month cumulative trade balance reduced at the margin. Under this criterium, the trade surplus reached US$27.5 billion in June, decreasing to US$27.1 billion in July. This total resulted from US$ 170.9 billion in exports and US$143.8 billion in imports, equivalent to -7.3% and -6.4% changes, respectively, year-over-year. The adjustment in relative prices and the accommodation in the pace of expansion of domestic demand contribute to the recovery of the trade surplus, but the deterioration in the terms of trade acts in the opposite direction. The reduction in remittances of profits and dividends has contributed to limit the current account deficit, which reached US$28.2 billion in December 2008, decreasing to US$17.9 billion in July, equivalent to 1.3% of GDP. On its turn, foreign direct investment reached US$39.1 billion in the twelve months through July, equivalent to 2.9% of GDP.

10. The period since the last Copom meeting was marked by the continuity of stress reduction in international financial markets, despite not in a monotonic way. The unprecedented actions taken by the authorities in the US and Europe, using a wide range of instruments, in order to ensure minimum conditions of operation and liquidity in monetary markets, have continued to moderate the perception of systemic risk. In this environment, there have been signs of reduction in risk aversion, but confidence recovery remains fragile and subject to reversals. Anyway, the decreasing trend of risk aversion and scarcity of capital flows, as well as some concern about the fiscal situation in the US, continued to encourage the recovery of currencies, both from emerging and mature economies, against the US dollar.

11. Regarding the global macroeconomic scenario, contraction trends prevail over inflationary pressures, but recovery of economic activity seems to have begun. The current predominant view points to the contraction of global economic activity in 2009, with recovery in 2010. The consensual projections point to a retraction of activity in the US, Europe and Japan (G3), which wouldn't be totally offset by the economic dynamism of some emerging economies, especially in Asia. However, there are evidences that economic activity in G3 could be stabilizing, with signs of improvements in industrial activity and stabilization in real estate market in the US, recovery of manufacturing activity and business confidence in Germany and industrial recovery in Japan. On the other hand, the problems in the international financial system might continue to be aggravated by the cyclical deterioration in the quality of credit, focused on the US and Europe, which could reinforce the contraction in the financial conditions and, as a consequence, hinder the consolidation of economic recovery. In mature economies, where inflation expectations are better anchored and economic activity has decelerated considerably and for a longer period, inflationary pressures reduced rapidly. The disinflation process seems to have gained momentum also in the emerging economies, in spite of greater persistence of the inflationary dynamics. In this context, after a period of aggressive monetary policy easing, in a significant number of countries, monetary policy seems to have entered into a stability phase, while the increase in public sector debt imposes limits on the scope of any additional fiscal stimulus.

12. Oil prices have increased since the last Copom meeting, as well as future markets quotations. Uncertainty concerning these quotations remains high, as the prospective scenario depends on the evolution of demand, in the context of global economic recovery, on the prospects for the evolution of global supply, subject to the pace of investments maturation in the sector, in addition to the geopolitical issues that affect the price of this commodity. Nonetheless, despite the high uncertainty inherent to the projections regarding the trajectory of oil prices, the main scenario adopted by the Copom assumes unchanged gasoline prices in the rest of 2009. However, it bears highlighting that, regardless the behavior of domestic gasoline prices, the evolution of international oil prices can affect domestic prices through productive chains, such as the petrochemical, or through the transportation costs for industry, as well as through the potential effect over inflation expectations. It bears emphasizing that the behavior of agricultural commodity prices, which have particularly important impact in the evolution of food costs, such as wheat, soybeans and corn, had heterogeneous behavior since the last Copom meeting, while quotations of metallic industrial commodities, such as aluminum, copper, and nickel, showed expressive increases.

Assessment of Inflation Trends

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

a) similarly to the July Copom meeting, the projected adjustments for gasoline prices for 2009 were kept unchanged at 0%; while the projected for bottled gas prices rose to 6.9% in the same period;
b) regarding the projected adjustments for fixed telephone and electricity prices for 2009, the first one reduced to 1.1%, from 5.0%, percentage considered in the July Copom, while the second one increased to 5.4%, from 5.0%;
c) the projection for regulated prices inflation for 2009, based on individual items, was kept unchanged at 4.5%. This set of prices, according to data released by the IBGE, corresponded to 29.46% of the total July IPCA;
d) the projection for regulated prices inflation for 2010 kept unchanged at 4.3%, percentage considered at the July Copom meeting. Such projection is based on the endogenous determination model for regulated prices, which computes, among other factors, 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, on the benchmark scenario, estimates a 55 bps spread in the fourth quarter of 2009 and 49 bps in the last quarter of 2010.

14. Regarding fiscal policy, the projections assume the achievement of a public sector primary surplus target of 2.5% of GDP in 2009 and 3.3% in 2010, unchanged relative to the July meeting. Those figures do not take into account Petrobras contribution to the public sector primary surplus and are adjusted by the possibility of reduction by up to 0.50% in 2009 due to the implementation of the Investment Pilot Program (PPI) and 0.65% in 2010 due to the PPI implementation and the Growth Acceleration Program (PAC). The additional assumptions considered in the previous meeting remained unchanged.

15. Since the last Copom meeting, according to the median IPCA inflation expectations compiled by the BCB's Investor Relations Group (Gerin), the 2009 IPCA changed from 4.53% to 4.29%. For 2010, inflation expectations also decreased, changing from 4.41% to 4.30%.

16. Considering the hypotheses under the benchmark scenario – which assumes the maintenance of the exchange rate at R$/US$1.85 and the Selic rate at 8.75% p.a. during the forecast period – the projection for 2009 inflation decreased relative to the figure considered at the July Copom meeting and is below the 4.5% target established by the national Monetary Council (CMN). According to the market scenario – which incorporates the consensus exchange and Selic rates trajectories collected by Gerin on the eve of the Copom meeting – IPCA inflation forecast for 2009 also decreased compared to the figure considered in the previous Copom meeting and is also below the inflation midpoint target. For 2010, under the benchmark scenario, projection increased and is close to target, whereas decreased under the market scenario although remaining also close to target.

Monetary Policy Decision

17. The Copom evaluates that the monetary policy should contribute to the consolidation of a favorable long-term macroeconomic environment. The risk aversion increase and the constraint of liquidity condition prevailing in international markets continue to show significant easing at the margin. In fact, since the last Copom meeting, signs of a global risk aversion reduction continue to accumulate, despite still subject to reversion, with impacts over both Brazilian asset prices, as well as selected commodities, also influencing domestic financial conditions. However, it bears emphasizing that the trajectory of price indices still evidences reduction of external inflationary pressures, especially in mature economies, but also in some emerging economies. Consequently, despite the increase in commodities prices since early 2009, the net impact of the global deceleration over the domestic inflation path continues to be, until present, predominantly benign. The Copom emphasizes that the main challenge of monetary policy in such context is to ensure that the favorable results obtained over the last years are preserved.

18. The Copom evaluates that the probability that initially localized pressures may impose risk to the inflationary trajectory is limited. The moderation of domestic demand pressures over the market of factors, despite remaining subject to uncertainties, should contain the risk of pass-through of upward pressures stemming from wholesale prices. The Committee, however, evaluates that the materialization of such pass-through, as well as the generalization of pressures initially localized over the consumer prices still depends critically on economic agents' inflation expectations. Incidentally, inflation expectations for 2009 and 2010 decreased since the last Copom

meeting remain in line with the targets path and continue to be closely monitored. Additionally, it is worth noticing that the behavior of domestic demand should exert less pressure over the prices of non-tradable items, such as services, in the upcoming quarters. Anyhow, the Committee reaffirms that it will continue to conduct its actions in order to ensure that the gains on inflation control obtained in recent years become permanent.

19. The Copom emphasizes, once more, that there are important time lags between the implementation of monetary policy and its effects on economic activity and inflation. Therefore, the evaluation of alternative options for monetary policy should necessarily focus on the forward-looking inflation scenario and its risks, instead of current inflation indices. Such considerations become even more relevant in periods surrounded by heightened uncertainty. The Committee reaffirms that specific asset price movements are only relevant for monetary policy if they impact the forward-looking inflationary path.

20. Prospects for the evolution of economic activity have continued to improve since last Copom meeting, in particular relative to consumption and more recently also to industrial production although in this particular case reflecting the accommodation of external demand as well. In light of international crisis effects over domestic financial conditions, credit contribution to sustain domestic demand has diminished, although signs of recovery continue to cumulate, in particular regarding credit loans to individuals. The severity of the international crisis influenced negatively consumers and businessmen confidence but also in this case there are more consistent signs of recovery. Under such circumstances, the rhythm of economic activity resumption strongly depends on real payroll expansion and on the effects of fiscal stimulus and governmental transfers that will occur over the following months. Additionally, it should also benefit from the easing of financial conditions. In short, the most recent data on domestic economic activity seem to reinforce the evaluation mentioned in previous Copom meetings minutes, that the contraction effects of the international financial crisis over the domestic economy dynamism and, consequently, over the context on which the monetary policy operates, could become persistent, but would not be permanent. These considerations become even more relevant considering the fact that the current monetary policy decision will have impacts concentrated in 2010.

21. The Copom understands that the loss of domestic demand dynamism has caused an increase in the idleness margin of factors utilization, resulting in reduction of inflationary pressures. On the other hand, the risks to the consolidation of a benign inflationary scenario derive, on the short term, from price adjustment mechanisms that contribute to lengthen inflationary pressures observed in the past, as evidenced by the behavior of services prices and regulated items since the beginning of 2009, as well as from a possible increase in commodities prices. In the medium-term, the risk stems from the cumulative and lagged effects, from the financial conditions easing and fiscal stimulus over the evolution of domestic demand, taking into account the dynamics of consumption and investment, in a context of recovery of production factors utilization. The balance of those influences over the inflationary prospective trajectory will be crucial to the assessment of the various alternatives available for the monetary policy stance.

22. International evidence, as well as the Brazilian experience, indicates that high inflation rates lead to the increase of risk premium, for both private and public funding, to the shortening of planning horizons and, consequently, to lower potential economic growth, besides having regressive effects over the income distribution. As a consequence, the Copom strategy aims to ensure that inflation remains in a level consistent with the target path in 2009, 2010 and 2011. Such strategy, which should have its results evidenced throughout time, takes into account the time lags in the transmission mechanisms and is the most adequate to deal with the uncertainty inherent to the process of monetary policy formulation and implementation.

23. The Copom evaluates that, in light of the increase of the idleness margin of the economy relative, in particular, to the industrial capacity utilization rates and certain aspects of labor market, as well as to the behavior of inflation expectations for relevant horizons, the materialization of a benign inflation scenario, in which the IPCA would resume evolution in line with the target path, has remained favorable. Incidentally, such evolution of the forward-looking scenario continues to be reflected on inflation projections considered by the Committee, as well as on inflation expectations set by independent analysts. Under such circumstances, in order to preserve the improvement of the prospective inflation scenario under a macroeconomic scenario with significant uncertainty, the Copom evaluates that monetary policy should maintain a cautious stance, aiming to assure the convergence of inflation to the targets path.

24. The Committee understands that the demand accommodation, motivated by tightening of financial conditions and by deterioration of agents' confidence, although marginal improvements continue to be observed, as well as by the global economic activity contraction, which could also be cooling, has created significant idleness margin of production factors, which should not be rapidly eliminated in a basic scenario of gradual recovery of economic activity. The Copom emphasizes that there are uncertainties around such basic scenario, with positive and negative biases over the pace of economic activity recovery. Anyhow, such development, contemplated under the basic scenario, should contribute to restrain inflationary pressures. On the other hand, the Committee notices that the significant monetary policy easing, implemented from January to July, will have cumulative effects over the economy, which will be evidenced with a time lag.

25. The Committee understands that decisions regarding the evolution of the basic interest rate have to take into account the magnitude of the total adjustment made from January to July, whose impacts on several economic indicators will be evident over time, in a context of slow recovery of production factors utilization. The Copom also evaluates that a more cautious stance will contribute to mitigate the risk of abrupt reversals of monetary policy in the future and, therefore, to the consistent recovery of the economy over the next quarters. The Copom also evaluates that the preservation of benign inflationary prospects will require the behavior of the financial system and the economy under a new level of interest rates to be closely monitored over time.

26. Under such context, in light of the inflation perspectives regarding the targets path, the Copom has unanimously decided to maintain the Selic rate in 8.75% p.a. without bias. Taking into account, in one side, the monetary policy easing implemented since January and, on the other side, the idleness margin of production factors, among other factors, the Committee evaluates that such level of basic interest rate is consistent with a benign inflation scenario, contributing to assure the maintenance of inflation the targets path over the relevant horizon and to the non-inflationary recovery of economic activity.

27. Under the inflation targeting regime, the Copom guides its decisions according to projected inflation, the analysis of several alternative scenarios for the evolution of the main variables that determine the forward-looking dynamics for prices, and the balance of risks associated to the projections. After a long period of expansion, domestic demand started to exert contractionist influence over economic activity, despite the persistence of incentive factors, such as income growth. Additionally, it bears noticing that evidencing the credibility achieved by the Copom on the implementation of the regime, inflation expectations for 2009, 2010 and 2011 remain in line with targets path. It is also noteworthy that global economic deceleration has generated downward pressures over wholesale industrial prices. On the other hand, important monetary and fiscal stimuli were introduced into the economy over the last few months and should contribute to the activity recovery and, consequently, to the reduction of the idleness margin of production factors. Those stimuli effects must be closely monitored over time and are important in the context where future monetary policy decisions, which should ensure the materialization of the convergence to targets path over relevant horizons, will be taken.

28. At the end of the meeting it was announced that the Committee will reconvene on October 20th, 2009 for technical presentations and on the following day, to discuss the monetary policy decision, as established in Communiqué 17.327 of August 27th, 2008.

SUMMARY OF DATA ANALYZED BY THE COPOM

Inflation

29. The IPCA-15 increased 0.23% in August, down from 0.22% in July, reaching 2.95% over 2009 in comparison to 4.69% over the same period in 2008. Over the last twelve months, up to August, the IPCA-15 increased 4.34% in comparison to 4.47% in the last twelve months up to July. Housing increased 0.85% relative to 0.66% in July and was the key influence over August results (0.11p.p), especially residential electric power, whose individual impact reached 0.07 p.p.

30. Market prices reached 0.16% in August, the same as in July, with a decrease of 0.15% on tradable items and an increase of 0.43% on non-tradable items. Over the same period, regulated prices increased 0.41%, down from

0.57% in July. Over the last twelve months market prices reached a 4.53% high, the lowest rate since July 2007, while regulated prices reached 3.9%. The diffusion index reached 51.56%, down from 53.65% in July and 62.76% in June.

31. Core inflation measures calculated with the use of IPCA-15 disaggregation, accelerated in August. The core excluding household food items and regulated prices increased 0.42% in August, up from 0.13% in July; the smoothed trimmed means core reached 0.32% up from 0.29% over the previous month; the non-smoothed trimmed means core reached 0.29% up from 0.17% over the same periods. On a twelve-month trailing basis up to August there were reductions on the smoothed and non-smoothed trimmed core measures, which reached 4.71% and 3.94%, respectively, in comparison to 4.72% and 4.05% in July, while the excluding core went from 5.31% in July to 5.39% in August.

32. The IGP-M changed -0.36% in August, in comparison to -0.43% in July, with decelerations in both IPC and INCC deceleration and a milder decrease on IPA. The IGP-M has reached -2.02% in 2009 and -0.71% over the last twelve months. The IPA changed -0.61% in August, in comparison to -0.85% in July, accumulating a 4.55% fall over 2009 and also a 3.45% decrease on a twelve month trailing basis. The IPC reached 0.16%, down from 0.34% in the previous month, reaching a 3.28% high in 2009 and 4.62% over the last twelve months. The INCC increased 0.01%, in comparison to 0.37% in July, reaching a 2.62% high in 2009 and 5.39% over the last twelve months.

Economic Activity

33. According to data seasonally adjusted by the IBGE's monthly survey (PMC), expanded retail sales increased 6.5% in June, in comparison to May, after a 4.9% increase in May and a 3.3% fall in April. As a consequence, the average for the quarter ending in June reached a 3.7% increase, relative to the quarter ended in March and represented the best result of the quarter series, exceeding in 1.9% the Q3 2008 performance. Sales increased in six out of ten segments surveyed, with highlights for the increase in office material and equipment (15.6%), vehicles and motorcycles, parts and pieces (11.1%), fabric, clothing and shoes (10.1%). Among the negative drivers, highlights go for fuel and lubricants (-2.7%), construction inputs (-1.9%) and books, newspapers, magazines and stationary (-0.7%).

34. The comparison between June 2009 and June 2008 revealed expansion of 10.2% in expanded retail sales in the month. Over the first half of 2009 growth reached 3.9% while reaching 5% over twelve months. June ratio meant a new series record, 12.4% above the average for 2008 and 7.9% above the Q3 2008, prior to the crisis escalation. In June, growth drivers in comparison to June 2008 were office material and equipment (22.3%) as well as vehicles and motorcycles, parts and pieces (20.8%). As for decrease in sales, highlights for construction inputs, with a 7.8% fall. Over 2009 up to June, seven out of ten segments increased sales and it bears emphasizing office material and equipment (16.7%), pharmaceutical and perfumery items (11.8%), other personal and domestic items (9.5%), as well as books, newspapers, magazines and stationary (8.6%). As negative drivers, under the same comparison basis, construction inputs decreased the most, with a 10.2% fall.

35. São Paulo Trade Association data (ACSP) related to the city of São Paulo, indicated a 1.6% decrease in database consultation for credit sales (SCPC) and a 1.2% fall in consultations to the Usecheque system on a month-on-month, seasonally adjusted basis. Year-over-year, those indicators decreased 13.1% and 1.7%, respectively, in comparison to the same period of the previous year and decreased 5.8% and 0.1%, respectively, on a twelve-month basis.

36. Automobile sales by dealers, which take into account automobiles, light commercial vehicles, trucks and buses, declined 13.9% in July, month-on-month, seasonally adjusted, according to Fenabrave (Brazilian Federation of Auto Vehicles Distribution). Total sales decreased 0.9% in comparison to July 2008 where it bears highlighting the decrease on buses (30.9%) and trucks (21%) sales, while automobiles increased 0.8%. Over 2009 up to July, automobiles sales increased 2.3% year-over-year, with a 20.2% decline on trucks sales and a 16.7% decline on buses sales. On the same comparison basis, automobiles and light commercial vehicles increased 3.2% and 4.9%, respectively.

37. General industrial physical production increased 2.2% in July month-on-month, seasonally adjusted, according to IBGE's Monthly Industrial Survey – Physical Production (PIM-PF). Over 2009 and also on a twelve-month basis, there are still signs of retraction, of 12.8% and 8%, respectively. Among the four use items, it bears highlight the durable consumer goods industry performance, with a 4.6% increase, while the semidurable and nondurable consumer goods industry presented the mildest increase (1%). The extractive industry physical production decreased 0.3%, after a 5% increase in June, reaching a 13.2% fall over 2009 and a 7.8% fall on a twelve-month trailing basis.

38. Capital goods imports increased 8.5% in July, month-on-month, according to the Funcex quantum indices, seasonally adjusted by the BCB. July indicator decreased 23.1% in comparison to July 2008, reaching a 9% decline in the year through July, year over year. On the same comparison basis, exports decreased 19.2% month-on-month, 48% relative to July 2008 and 39.7% in the year through July. Capital goods production increased 1.4%, month-on-month but presented declines of 23.9% relative to July 2008 and 23.1% over the year, according to data released by IBGE. As a consequence, capital goods absorption increased 8.1% in July while presenting a decline of 20.9% relative to July 2008 and of 19.8% over 2009 through July. Construction inputs production decreased 2.3% in July, month-on-month, seasonally adjusted, with a 10% decline in comparison to July 2008 and 10.2% over the year up to July. Gross fixed capital formation increased 5.5% in July but still presents declines of 16.6% in comparison to July 2008 and 15.9% over 2009.

39. CNI indicators showed some moderate recovery of industrial activity for the second consecutive month. Manufacturing industry real revenues increased 0.4%, resulting on a 1.8% growth quarter-over-quarter ending in June, according to a series seasonally adjusted by the BCB. Relative to hours worked in production, and employment, the survey indicated, respectively, declines of 0.73% and 0.09%, on the same comparison basis. The installed capacity utilization increased 0.4 p.p. relative to May, reaching 79.6%, on a seasonally adjusted series.

40. Vehicles production reached 282 thousand units in July, according to Anfavea, which was 11.3% lower than in July 2008. According to seasonally adjusted data, vehicles production decreased 6.1% month-on-month. From January to July 2009 there were declines of 13.1% on vehicles production and 28.4% on agricultural machinery, while reaching 11.4% and 7.5%, respectively, over the year up to July, year-over-year. Domestic sales of vehicles decreased 3.8% in July and 2% over the 2009 up to July on the same comparison basis relative to 2008, while exports decreased 41.2% and 46.5%, respectively.

41. The LSPA survey carried out by the IBGE in July estimated the production of 134.4 million tons in 2009, representing a 7.9% decrease relative to 2008. Concerning corn and soybean crops, declines of 14.2% and 5.2% were, respectively, projected, whereas increases of 4.4%and 4.2% were estimated, respectively, for the production of black beans and rice.

Surveys and Expectations

42. According to the Fecomercio-SP survey, the Consumer Confidence Index (ICC) remained almost stable in August, decreasing 0.03% month-on-month, reflecting a 0.6% decrease in the Current Economic Conditions Index (Icea) and a 0.9% increase in the Consumer Expectations Index (IEC). The ICC increased 1.7%, year-over-year, mainly due to the retraction of 6.4% in the Icea and to the expansion of 7.3% in the IEC.

43. According to the Consumer Expectations Survey carried out by the FGV, the ICC decreased 0.4% in August, month-on-month seasonally adjusted. After five consecutive months of increase, this index retreated in August due to the retreat of future expectations, which had favored its recent recovery in the previous months. In August, the Current Situation Index (ISA) increased 2.3%, and the Expectations Index (IE) decreased 1.7%. The ICC increased 1.9% year-over-year, recording two consecutive monthly increases, reaching a level next to the registered in September 2008. Year-over-year, the ISA and the IE increased 3% and 1.2%, respectively.

44. In relation to the expectations for the manufacturing industry, the FGV Manufacturing Industry Survey showed, in August, recovery of 6.2 p.p. in the Industry Confidence Index (ICI) seasonally adjusted, although it is still below the level recorded in August 2008 (-13.5%), considering the observed series. Among components,

considering the same comparison basis, there are increases of 6.3 p.p. and 6.1 p.p.in the Current Situation Index (ISA) and retreats of 15.2 p.p. and 11.7 p.p. in the Expectations Index (IE), compared to August 2008.

Labor Market

45. According to the General Record of Employment and Unemployment (Caged) of the Ministry of Labor and Employment (MTE), 138.4 thousand formal jobs were created in July (the fourth best result of the series in this month), compared to 119.5 thousand jobs created in June, totaling 437.9 thousand jobs in the first seven months of 2009 and 325.5 thousand new jobs in the last twelve months through July. Among economic activities, all the sectors showed expansion, with highlights for the construction sector and agriculture and livestock, which registered the highest net hires in July (32.2 thousand and 29.5 thousand, respectively), followed by the services sectors and the retail sector (27.7 thousand and 27.3 thousand, respectively). It is important to highlight that the manufacturing industry registered positive performance on hiring for the fourth consecutive month, with a 17.4 thousand net hire in July. Seasonally adjusted data showed a 0.2% increase in employment in July, month-on-month, with highlight for the 0.7% increase of the construction sector. The average of the year through July showed a 2.4% increase in employment, influenced by the increases of 6.7% in the construction sector, 4.3% in the services sector and 4.1% in the retail sector, whereas in the manufacturing industry it declined by 2.1%.

46. According to the IBGE employment survey (PME), carried out in the six main metropolitan regions of the country, the unemployment rate reached 8% in July 2009, the lowest historical level for the month, showing relative stability month-on-month (-0.1 p.p) and year-over-year (-0.1 p.p). Considering the evolution of the observed data month-on-month, there were increases of 0.9% in the number of employed workers and of 0.7% in the economically active population (PEA), which totaled 185 thousand and 171 thousand jobs, respectively. The creation of new jobs was the highest in thirteen months, surpassing by 1.1% to July 2008. The same survey pointed out that average real earnings of employed workers resumed growth in margin in July (0.5%), after five consecutive months of decline, increasing 3.4% year-over-year and growing by 4% in the year through July. The real payroll increased 4.5% year-over-year and 4.8% in the year through July.

Credit and Delinquency Rates

47. Outstanding credit in the financial system reached R$1,311 billion in July, equivalent to 45% of GDP, with a 2.6% increase in the month and 20.8% on a twelve-month trailing basis. Non-earmarked credit operations increased 0.4% in the month and 16.1% in the last twelve months. Among the non-earmarked operations, which represent a share of 68.9% in the total of the financial system, credit operations to individuals increased 1.7% in the month and 19.7% in the last twelve months, while non-earmarked credit operations to corporate decreased 0.7% in the month and increased 12.8% in the last twelve months. Earmarked credit operations increased 7.8% in the month and 32.6% on a twelve-month trailing basis, with highlights to the 22% monthly increase in BNDES lending showing primarily the significant demand from the coke, oil and fuel sector.

48. The average interest rate on non-earmarked credit operations, used as reference for interest rates, totaled 36% in July, down from 43.3% in December. The average annual rate on credit for individuals decreased 13 p.p. relative to December, reaching 44.9%. The average rate on corporate credit decreased by 4 p.p. relative to December, reaching 26.7%.

49. The average tenure on non-earmarked credit operations, used as reference for interest rates, increased in July, reaching 370 days, down from 378 days in December. The average tenure of corporate credit operations reached 270 days in July, down from 302 days in December, while the average tenure for credit operations to individuals totaled 497 days in July.

50. Delinquency rates in the financial system (non-earmarked loans used as reference for interest rates, in arrears for more than ninety days) increased for the eighth consecutive month and reached 5.9% in July, a 1.5 p.p. increase relative to December. Delinquency rates for credit operations with corporate reached 3.8% and with individuals remained stable on 8.6%, compared to 1.8% and 8% respectively, in December.

51. Net delinquency rate for retail credit, measured by the ACSP, reached 7.4% in July, down from 7.7% in June and 6.3% in the same month of 2008, representing the lowest level registered in 2009.

External Environment

52. The contraction signs for the global economy are cooling, with some countries, particularly in Asia, recording economic growth in the second quarter already. Thus, in annualized terms, Q2 GDP in South Korea, Japan and Taiwan increased by 9.5%, 3.6% and 20.7% over the previous quarter, respectively, while China showed again acceleration of Q2 GDP growth, on an annual rate of 7.9%. Among European countries, both Germany and France grew 1.2% over the same period, on a quarterly basis annualized. The inventories cycle adjustment in the main developed economies is in advanced stage, especially in the retail sector.

53. Industrial production has recorded positive results for four consecutive months in Japan and for three months in China. The US economy recorded, in July, the first monthly advance in industrial production since October 2008, and production of the Euro Zone has been showing stability since last April. The US real estate market, central for the financial crisis, has showed more robust signs of stabilization, while the national index of house prices, measured by the S&P/Case-Shiller, recorded in the second quarter an increase of 1.4 % from the previous quarter, the first increase in three years.

54. The twelve-month consumer price indices through July confirmed the deflationary trend in the US, the Euro Area, Japan and China, and the deflationary behavior in the United Kingdom, Australia and, in general, in emerging economies. The low rates of installed capacity occupation, the decline in prices to producers and the favorable basis effect in the energy prices are still determining this trajectory. However, the maintenance of the current price per barrel of oil could put pressure on the behavior of these indicators from the last quarter of this year.

55. The financial market follows recovering, which has not prevented corrections in some assets. The VIX index has remained fairly stable, whereas the indices for stock markets of major economies continued to appreciate in August, with the exception of China, whose index has behaved more volatile. The three-month Libor rate, in dollar, continued to retreat, the same occurring with the spread between this rate and the overnight index swap (OIS) in the same period. Moreover, the conditions for granting credit to consumers and corporate remain restrictive.

56. Considering this scenario, the central banks from mature economies maintained the accommodative stance of their monetary policy, including in some cases, such as US and United Kingdom, extension/expansion of programs to help the financial systems. Similarly, the central banks of emerging economies - such as Mexico, Turkey, Russia and Chile - continued to deepen the cuts in their basic interest rates. For now, only the Central Bank of Israel marked the disruption of the easing stance of monetary policy, having raised the basic interest rate by 25 basis points to 0.75%.

Foreign Trade and International Reserves

57. The Brazilian trade surplus reached US$3.1 billion in August, totaling US$20 billion in the first eight months of the year, increasing by 18.7%, year-over-year, on a daily average basis. In the month, exports reached US$13.8 billion, and imports, US$10.8 billion, decreasing by 29.9% and 38.3%, respectively, year-over-year, on a daily average basis. The decrease of 24.7% of exports in the first eight months of the year reflects the slowdown in world economic activity and the effects on prices of major products exported. Total external trade reached US$24.6 billion in August, decreasing by 33.8%, year-over-year, on a daily average basis. In the year through August, total external trade reached US$175.9 billion, 27.7% lower than the one registered last year, according to the same comparison basis.

58. Based on the liquidity concept, international reserves, which encompass the repurchase lines and borrowing operations in foreign currencies, reached US$219.1 billion in August, recording a US$7.2 billion increase in the month. Under the cash concept, international reserves totaled US$215.7 billion, recording a US$8.4 billion increase according to the same comparison basis. Highlight, in the month, for receiving the special allocation of Special Drawing Rights (SDR) of the International Monetary Fund (IMF), amounting to US$3.5 billion.

Money Market and Open Market Operations

59. After the July Copom meeting, the yield curve slope increased with the future short-term interest rates remaining almost stable, while the future medium and long-term interest rates showed growth. The prospect of interrupting the cycle of monetary easing and the benign inflation scenario contributed to the maintenance of short-term rates. In the intermediate section and along the curve, the upward movement of rates was influenced by the release of unemployment data below market expectations, the improvement of some indicators of the US economy and the rising interest rates on US treasuries. Between July 20 and August 31, one- and three -month rates decreased by 11 bps and 6 bps, respectively, whereas six–month, one-, two- and three-year rates increased by 5 bps, 20 bps, 25 bps and 21 bps, respectively. Real interest rates, measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month-ahead inflation expectations, increased from 4.66% on July 20 to 4.91% on August 31.

60. The average daily balance of the stock of repo operations of BCB ranged from R$417.4 billion in the period between June 9 and July 20, to R$412.5 billion between July 21 and August 31. The main determinant of the reduction in liquidity was the net issuance of securities by the Treasury in August, reaching R$11.2 billion. In its open market operations, the BCB carried out, in the same period, long fixed rate repo operations, borrowing R$17.2 billion for a six-month period. The average daily balance of the five-, six- and seven-month operations reached R$57.3 billion, of which R$43.3 billion were six-month operations. In the same period, the BCB conducted borrowing operations with tenures of 30 and 17 working days on July 23; of 28 working days on July 27; of 23 working days on August 3; of 18 working days on August 10 and of 13 working days on August 17. These operations drained from the market R$78.9 billion, R$178.2 billion, R$1.3 billion, R$6.9 billion, R$11 billion and R$75 billion, respectively. The average daily balance of these short-run borrowing operations reached R$270.9 billion. The BCB also borrowed money through 31 overnight repo operations and conducted daily, at the end of day, two-working-day-tenure liquidity management operations. Operations with tenors less than thirty days, including daily liquidity management operations, averaged R$84.3 billion, on a daily basis, borrowing.

61. Between July 21 and August 31, the National Treasury issuance regarding the traditional auctions raised a total of R$28.5 billion. The issuance of fixed-rate securities reached R$22.8 billion, being R$13.8 billion via issuance of LTNs maturing in 2010 and 2011, and R$9 billion via NTN-Fs maturing in 2013 and 2017. Issuance of LFTs totaled R$3 billion, for securities maturing in 2013 and 2015. Issuance of inflation-linked NTN-Bs reached R$2.7 billion, for securities maturing in 2011, 2014, 2020, 2024, 2035 and 2045.