BANCO CENTRAL DO BRASIL

Minutes of the 160th Meeting of the Monetary Policy Committee (Copom)

Summary

Recent Economic Developments
Assessment of Inflation Trends
Monetary Policy Decision
Inflation
Economic Activity
Surveys and Expectations
Labor Market
Credit and Delinquency Rates
External Environment
Foreign Trade and International Reserves
Money Market and Open Market Operations

Date: July 19th, 2011, from 4:24PM to 7:33PM, and July 20th, from 4:15PM to 6:47PM

Place: BCB Headquarters meeting rooms – 8th floor on July 19th and 20th floor on July 20th – Brasília – DF

In attendance:
Members of the Committee
Alexandre Antonio Tombini – Governor
Aldo Luiz Mendes
Altamir Lopes
Anthero de Moraes Meirelles
Carlos Hamilton Vasconcelos Araújo
Luiz Awazu Pereira da Silva
Sidnei Corrêa Marques

Department Heads (present on July 19th)
Adriana Soares Sales – Research Department (also present on July 20th)
Daso Maranhão Coimbra - Department of Banking Operations and Payments System
João Henrique de Paula Freitas Simão - Open Market Operations Department
Márcio Barreira de Ayrosa Moreira – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations and Special Studies Department
Tulio José Lenti Maciel – Economic Department
Wagner Thomaz de Aquino Guerra Júnior –International Affairs Department

Other participants (present on July 19th)
Alexandre Pundek Rocha – Advisor to the Board
André Minella – Consultant to the Research Department
Emanuel Di Stefano Bezerra Freire – Executive Secretary of the Board
Gustavo Paul Kurrle – Press Officer
Nelson Ferreira Souza Sobrinho – Consultant to the Research Department

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. After recording 0.47% in May, monthly inflation measured by IPCA reached 0.15% in June. As a consequence, twelve-month trailing inflation reached 6.71% in June 2011 (6.55% in May and 6.51% in April), 1.87 p.p. above inflation registered in the twelve months through June 2010. The inflation elevation in this period reflected the behavior of both market prices, which increased 7.14% (5.11% in the same period of 2010), and regulated prices, which increased 5.70% (4.21% in the same period of 2010). Regarding market prices, it bears highlighting that tradable goods inflation reached 6.26% (2.98% in the same period of 2010), while inflation related to non-tradable goods increased 7.89% (7.06% in the same period of 2010). Services price inflation continues at high levels, reaching 0.60% in June, after 0.59% in May. In the twelve-month period through June 2011, it reached 8.75%, the highest level since September 1997. In short, the set of available information suggests persistence in the price increase observed in 2010, process led by market prices, which, in part, reflects in the fact that services inflation, which presents significant inertia, remains at high levels.

2. In the first half of 2011, IPCA increased 3.87%, 0.78p.p. above the inflation observed in the same period of 2010, with increases of 3.71% in market prices and of 4.25% in regulated prices. The main contributors were education, personal expenses and clothing, which increased 7.45%, 5.10% and 4.36%, respectively, in the first six months of 2011, compared to 5.56%, 4.17% and 3.26%, respectively, in the same period of 2010. These items were responsible for 1.35 p.p. of headline inflation in the period. On its turn, the 3.11% recorded for food and beverage inflation was 1.43p.p below the level observed for this group in 2010H1. Notwithstanding, in the twelve months ended in June, food and beverage prices play a relevant role in the dynamics of headline inflation, accumulating 8.90% in June (8.20% in May), reflecting, in part, domestic and external supply shocks, heightened by the high liquidity environment in international financial markets and by global demand increase.

3. The three main underlying inflation measures calculated by the BCB performed similarly to headline inflation: while inflation in the twelve months through June increased, the average of the monthly rates retreated between April and June. The smoothed trimmed means core inflation increased to 0.54% in June from 0.64% in May and 0.60% in April. The double weight core inflation, after registering 0.68% in April, decreased to 0.59% in May and to 0.42% in June, while the core inflation by exclusion totaled 0.56% in June, up from 0.54% in May and 0.52% in April. Therefore, the average change of the three core measures retreated to 0.51% in June, down from 0.59% in May and 0.60% in April. In the twelve-month period until June, the three core measures registered 6.01%, 6.82% and 6.51%, respectively, compared to 5.86%, 6.68% and 6.30% in May, and 5.84%, 6.66% and 6.32% in April. The IPCA diffusion index, which had reached 59.38% in April, increased to 64.84% in May, but decreased in June to 58.85%, showing, at the margin, lesser spreading of inflation.

4. The General Price Index (IGP-DI) inflation registered deflation of 0.13% in June, compared to inflation of 0.01% in May and 0.50% in April. In the twelve-month period through June it accumulated 8.63%, up from 5.07% registered in the same period through June 2010. Under this criterion, the index has been slowing since December 2010, when it recorded 11.30% change. Inflation measured by its main component, the Wholesale Price Index (IPA-DI), reached 9.61% in twelve months through June, reflecting an increase of 6.54% in the industrial IPA and 19.38% in the agricultural IPA. The breakdown according to the production phase shows that raw material prices accumulated 22.68% change, while the prices of intermediate goods and final goods increased 5.44% and 4.58%, respectively, following the same comparison basis. Inflation measured by the Consumer Price Index (IPC-DI), another component of the IGP-DI, recorded 6.40% in the twelve months through June 2011, above the 4.93% recorded until June 2010. According to the same comparison basis, the Civil Construction National Index (INCC), component with the lowest weight in the IGP-DI, increased 7.75% (6.48% in June 2010). The Producer Price Index/Manufacturing Industry (IPP/IT), calculated by the IBGE, which measures the industry price level excluding freights and taxes, registered 0.55% deflation in May, compared to inflation of 0.28% in April and 0.39% in March. In twelve months, this index decreased to 5.60% in May, from 6.68% in April. As emphasized in previous Copom Minutes, the Copom evaluates that the effects of wholesale prices over consumer price inflation will depend, among other factors, on the current and prospective demand conditions, the exposure of each sector to external and domestic competition, as well as on the price setters’ expectations for the future inflation path.

5. The Economic Activity Index of the BCB (IBC-Br) incorporates estimates for the monthly production of the three sectors of the economy, as well as for taxes on production, constituting, therefore, an important coincident indicator of economic activity. Considering seasonally adjusted data, the IBC-Br grew 0.2% in May, after increasing 0.4% for three consecutive months (from February to April). As consequence, the index increased 1.3% in the quarter ended in May, compared to the previous quarter. For the IBC-Br accumulated in twelve months, the moderation in the growth rate trend persists, reducing to 5.3% in May from 5.7% in April. The Services Confidence Index (ICS), from FGV, retreated 1.4% in June, after the same reduction in May and increase of 3.0% in April. Therefore, the level of this index in June stood 0.1% above that measured in June 2010 and 0.7% below the average index of 2010.

6. Industrial activity showed expansion in May, with a 1.3% increase in the industrial output, month-on-month, according to data seasonally adjusted by the IBGE, after recording a decrease of 1.2% in April and an increase of 0.3% in March. As a consequence, industrial output reached a new record high in May. The three-month moving average growth rate reached 0.2% in the period from March to May, standing at a level below the 0.4% growth measured in the period from February to April. Year-over-year, industrial output increased 2.7% in May and in the last twelve months, output increased 4.5% in May, down from 5.4% in April, continuing the process of growth moderation. Since December 2008, month with the lowest output level during the 2008/09 crisis, the growth accumulated until May 2011 reached 26.8%. The industry real earnings have shown similar evolution.The post-crisis recovery dynamics was partially supported by the growth of industrial activity financing by public financial institutions.

7. Among the industry use categories, according to data seasonally adjusted by the IBGE, month-on-month, capital goods, intermediate goods and durable consumer goods increased in May, respectively, 1.7%, 1.5% and 2.7%, whereas the production of non-durable and semi-durable consumer goods remained stable. In the twelve months through May 2011, intermediate goods output increased 4.7%, durable consumer goods output grew 2.4% and non-durable and semi-durable consumer goods output increased 2.3%. According to the same comparison basis, capital goods industry activity growth is the highest among use categories, recording an 11.5% increase. Such performance evidences the investment robustness, a relevant factor for economic recovery in the post-crisis period.

8. The unemployment rate in the six metropolitan regions covered by the IBGE Monthly Labor Survey (PME), according to observed data, decreased to 6.2% in June, down from 6.4% in May, compared to the 7.0% level registered in June 2010. After reaching 9.0% in March 2009, the observed data not only significantly reduced until June 2011, but reached a record low for the month since the start of the series in March 2002. The seasonally adjusted rate registered 6.1% in June, a 0.1 p.p. increase compared to May. Employment, measured by the number of employed workers in the six main metropolitan regions, year-over-year, increased 2.3% in June, after an expansion of 2.5% in May. Data from the Ministry of Labor and Employment (MTE) indicate that in June 215.4 thousand jobs were created (213.0 thousand in June 2010), with expansion of formal jobs in all the eight sectors of economic activity. Agriculture and Services were the sectors that mostly contributed for the formal employment increase in June. According to PME, real average earnings observed in June increased 0.5% month-on-month and 4.0% year-over-year. As a consequence, real payroll, considering real average earnings in the six metropolitan regions, expanded 6.2% in June, year-over-year, after recording an increase of 6.6% in May, continuing to constitute a key driver for the maintenance of domestic demand growth.

9. According to the retail monthly survey (PMC) from IBGE, expanded retail sales increased 12.8% in May, year-over-year, after recording a 12% growth in April and a 2.7% decrease in March, according to the same comparison basis. According to the seasonally adjusted series, expanded retail sales showed month-on-month increase of 1% in May, after expanding 1.2% in April and 1.9% in March. Therefore, the twelve-month accumulated growth rate reached 10.5% in May, up from 10.2% observed in the two previous months. According to the last two comparison bases, all ten sectors surveyed expanded in May, with highlights, in terms of growth, to furniture and appliances (17.2%), equipment and materials for office, computer and communication (16.7%) and construction inputs (13.9%). In the next months, the retail trajectory will continue

to be benefited by governmental transfers, by the pace of growth of real payroll, by the consumer confidence and by credit expansion.

10. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by FGV, without seasonal adjustment, kept unchanged in 84.1% between May and June. These values for May and June are, respectively, 0.5p.p. and 1.0p.p. lower than the levels observed in the same period of 2010. According to the seasonally adjusted monthly series calculated by FGV, the Nuci retreated to 84.3% in June (same level observed in March 2011), after recording 84.4% in April and May. The Nuci is higher at the construction inputs (87.2%) and intermediate goods (86.3%) sectors. At the margin, the Nuci in the construction inputs sector remained stable, in the intermediate and consumer goods sectors there were increases (0.2 p.p, and 0.3p.p., respectively), while in the capital goods sector, the Nuci decreased 0.1p.p.. According to the Confederation of National Industry (CNI) data seasonally adjusted by the BCB, the Nuci in May reached 82.4%, up from 82.1% in April. In fact, installed capacity utilization rates have shown relative stability, at high levels, reflecting the recent expansion in economic activity, whose effects have not totally been offset by the maturity of investment projects. In this sense, the absorption of capital goods grew 18.7% in the last twelve months through May, while the production of construction inputs for civil construction increased 6.7%. 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.

11. The trade balance result in the last twelve months increased from US$23.1 billion in May to US$25.3 billion in June. This result stemmed from US$231 billion in exports and US$205.8 billion in imports, equivalent to 34.1% and 34.5% changes, respectively. The current account deficit accumulated in twelve months changed from US$48.9 billion in April to US$51 billion in May, equivalent to 2.29% of GDP. On its turn, foreign direct investment reached US$64.1 billion in the twelve months through May, equivalent to 2.88% of GDP, exceeding the needs for external funding.

12. The global economy recovery follows different speeds and asymmetrical inflation pressures. The evidences show activity moderation at the margin, partially reflecting increased global uncertainty, the loss of dynamism in the US recovery process, the high oil price, as well as the effects of monetary tightening in important emerging economies. In fact, the compound leading indicator released by the Organization for Economic Co-Operation and Development (OECD), for example, signaled world recovery continuity in May, but with moderation, despite still potential, in the major economies. On the other hand, the Purchasing Managers Index (PMI) for the global economy, which shows the industry and service sector activity level, after reaching, in May, 52.7, reduced to 52.2 in June, reaching the second lowest level since the start of global recovery (August 2009). The disaggregated PMI indicators evidence lower dynamism in the US and in the Euro Area (with contraction of economic activity in Italy and Spain). The macroeconomic prospects for the Euro Area continue to exhibit strong asymmetries, because while some economies remain impacted by the insolvency risks and subject to strong fiscal adjustments, the pace of expansion remains strong in other regions, like Germany. Regarding the last Copom meeting, the market perception about the fiscal situation in the Euro Area and, in particular, its implications on the regional financial system - even after the release of stress tests - showed significant deterioration, and uncertainties related to US debt issues remain. Regarding monetary policy, mature economies continued to show accommodative monetary stances. Despite the recent inflation acceleration, inflation rate cores persist at moderate levels in the G3 group (US, Euro Area and Japan). For the emerging countries, there are widespread inflationary pressures and, since the last Copom meeting, there was continuity of monetary tightening in several economies. In particular, the People’s Bank of China raised banks’ reserve requirements once again, totaling nine increases in reserve requirements and five increases in the reference interest rates since October 2010.

13. Brent oil prices showed volatility and remains above US$115. This price level is consistent with a framework of apparent strengthening of global demand, as well as of political instability in some countries of the Middle East and North Africa, despite the decreasing intensity of conflicts. It bears highlighting that the geopolitical complexity that involves the oil sector tends to heighten price volatility, which is also a reflex of the low predictability of some global demand components and of the dependency of supply growth on long term risky investment projects. Regarding the other commodities, it is noteworthy the moderation of agricultural and metallic commodities prices, after consecutive months of relevant increases. In particular, spot prices of iron

ore traded in China fluctuated at levels similar to those valid at the beginning of the year. Over the recent months, the food price index, calculated by the Food and Agriculture Organization of the United Nations (FAO), which considers 55 items, has presented some stability, but remains at high levels. In recent past, the high volatility observed in commodities prices was strongly impacted by the abundant global liquidity, in a context where financial markets adjust to new expectations of demand growth and to FX markets volatility.

Assessment of Inflation Trends

14. The identified shocks and their impacts were reassessed according to the new set of available information. The scenario considered in the simulations was based on the following assumptions:

a) the projected adjustments for gasoline accumulated in 2011 remained at 4.0%, considered in the June Copom meeting, including, therefore, partial reversal of the 6.1% increase occurred up to June; the adjustments for bottled gas prices, for the same period, were kept unchanged at 0%;
b) the projected adjustment for fixed telephone accumulated in 2011 reduced to 0.9%, down from 2.9% considered in the June Copom meeting, whereas the one for electricity rate increased to 4.1%, up from 2.8% considered in the previous meeting;
c) the projection for regulated prices inflation accumulated in 2011, based on individual items, according to the benchmark scenario, increased to 4.9%, up from 4.6% considered in the June meeting. This set of prices, according to data released by the IBGE, accounted for 29.08% of the total June IPCA;
d) the projection for regulated prices inflation accumulated in 2012, according to the benchmark scenario, increased to 4.4%, up from 4.3% considered in the June meeting. Such projection is based on endogenous determination models for regulated prices, which compute, among other factors, seasonal components, foreign exchange rate changes, market prices inflation and the IGP (General Price Index) change; and
e) the projection for the spreads over the Selic rate, based on the 360-day swap rates, on the benchmark scenario, estimates 44 bps and -46 bps spreads in the fourth quarters of 2011 and 2012, respectively.

15. Regarding fiscal policy, projections assume the achievement of the public sector primary surplus target of R$117.9 billion (around 2.9% of GDP), without adjustments, in 2011 (according to parameters contained in the Budget Guidelines Law - 2011). Moreover, a primary surplus of R$139.8 billion (or around 3.1% of GDP) is considered for 2012, according to Budget Guidelines Law Project - 2012 parameters, including the effect of the minimum wage increase projected for 2012.

16. The set of projections incorporated the estimated effects of the reserve requirements changes announced in December 2010.

17. Since the last Copom meeting, the median of the expectations compiled by the BCB’s Investor Relations and Special Studies Department (Gerin) for the 2011 IPCA increased to 6.31% from 6.22%. For 2012, the median of inflation expectations moved from 5.10% to 5.20%. Specifically for banks, asset managers and other institutions (real sector companies, brokers, consultancies and others), the medians for the 2011 IPCA changed from 6.21%, 6.22% and 6.27% to 6.28%, 6.38% e 6.31%, respectively. For 2012, the medians changed from 5.00%, 5.40% and 5.00% to 5.01%, 5.40% and 5.05%, in the same order.

18. The benchmark scenario assumes the maintenance of the exchange rate at R$1.60/US$1.00 and the Selic rate at 12.25% p.a. during the forecast period. Under this scenario, the projection for the 2011 inflation slightly increased relatively to the figure considered at the June Copom meeting, and it stands above the 4.50% midpoint 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 in the period immediately prior to the Copom meeting - IPCA inflation forecast for 2011 also slightly increased and stands above the inflation midpoint target. For 2012, the projection remained stable in both the benchmark and the market scenarios, and therefore remained above the midpoint target in both scenarios. For 2013H1 inflation, the projection increased in the benchmark scenario and remained stable in the market scenario, remaining around the midpoint target in both scenarios. In an alternative scenario, which considers the maintenance of

the exchange rate, during the forecast period, at levels observed in the recent past and the interest rate path collected by Gerin, projected inflation is above the target for 2011 and for 2012, and around the target for 2013H1.

Monetary Policy Decision

19. The Copom evaluates that monetary policy should contribute to the consolidation of a favorable longer-term macroeconomic environment. In this respect, the Copom reassures that, under the inflation-targeting regime, it guides its decisions according to BCB projected inflation and based on the analysis of alternative scenarios for the evolution of the main variables that determine prices dynamics. The Committee also understands that low risks for the underlying inflation in the short run tend to reduce uncertainties regarding the future behavior of headline inflation, facilitate the assessment of scenarios by the monetary authority, as well as help the process of coordination of economic agents' expectations, particularly price setters'. Additionally, it is noteworthy that low risks for the underlying inflation in the short run tend to intensify the effects of monetary policy actions, enabling them to affect in a more long-lasting manner the dynamics of headline inflation in the future. Although the Copom recognizes that other actions of macroeconomic policy may influence the price trajectory, it reaffirms its view that it is the responsibility of the monetary policy to remain especially vigilant to guarantee that pressures detected in shorter horizons do not spread to longer horizons.

20. International evidence, ratified by the Brazilian experience, indicates that high inflation rates lead to the increase in risk premium, both for private and public funding, and to the shortening of planning horizons, both for households and companies. Consequently, high inflation rates reduce investment and economic growth potential, in addition to presenting regressive effects on income distribution. Moreover, high inflation rates do not originate any lasting results for economic and employment growth; on the contrary, they create permanent damage to these variables in the medium and long terms. Therefore, the strategy adopted by the Copom aims to ensure the convergence of inflation towards the targets path, which requires that deviations from the target path be promptly corrected. Such strategy takes into account the time lags in the transmission mechanism and is the most adequate to deal with the uncertainty inherent to the process of monetary policy formulation and implementation.

21. As a consequence of the stabilization and correction of unbalances, which determined important structural changes, the process of maturing of the inflation targeting regime stands at an advanced stage, and it reflects favorably in the dynamics of neutral interest rate and in the power of monetary policy. Evidences under this respect can be observed, among other factors, through the accomplishment of inflation targets in the last seven years, at the same time that real interest rates have reduced. Progress in the financial markets structure, the reduction of both FX and inflationary risk premia, among other factors, seem to have determined significant reduction in the neutral rate. The generation of primary surpluses consistent with the maintenance of the decreasing trend for the public debt/GDP ratio also contributed for it. From another point-of-view, some of these developments, combined to others, such as the extension of contract tenures, also suggest that the power of monetary policy in Brazil has been increasing in the last years, despite the substantial uncertainty that surrounds the calculation of non-observable variables. The Committee also considers that there are evidences that the traction of monetary policy increased in the recent past and, compared to what was observed some years ago, currently inflationary pressures are contained with more efficiency by monetary policy actions.

22. The Copom observes that, additional deterioration has occurred in international markets since the last meeting, with increase in volatility and risk aversion, mostly fueled by the extraordinary levels of liquidity and increasing uncertainties regarding the recovery of global activity. In this period, the concerns about European countries` sovereign and banking debts increased, including central economies, as well as those related to the possible slowdown of economic activity in China. Prices of important commodities retreated, mainly agricultural and, at the same time, some stability in the US currency was observed. In general, however, the prospects for Brazilian economy external funding remain favorable. From another point-of-view, the price indices path shows clear dissemination of inflationary pressures in the main economies.

23. The Copom evaluates that, although ongoing moderation of domestic demand growth is observed, prospects for economic activity are favorable. This assessment is supported by signs that, despite showing some cooling, point to the fact that the expansion of credit supply tends to persist, both for individuals and corporate, and by the fact that consumers and businessmen confidence stand at historically high levels, notwithstanding some accommodation at the margin, among other factors. The Copom considers, additionally, that the dynamism of domestic activity will continue to be benefited by the vigor of labor market, mirrored in historically low unemployment rates and substantial growth of wages.

24. The Copom evaluates that the inflation prospective scenario has shown more favorable signs since the last meeting. In the last quarter of 2010 and in the first quarter of 2011, inflation was strongly and negatively impacted by domestic and external supply shocks. Evidences suggest that consumer prices have already incorporated the direct effects of these shocks. Also relevant were the direct effects of the atypical concentration of regulated prices adjustments in the first quarter of the year, which, in specific cases, shows signs of reversal. The Committee considers that these effects shall still impact indirectly consumer prices dynamics, among other mechanisms, through inertia. At the same time, it evaluates, as relevant, risks derived from the persistence of the mismatch between supply and demand growth rates, despite the signs that this mismatch tends to retreat. Moreover, it highlights the narrow idleness margin of the production factors, especially labor force, and analyzes that, in such circumstances, a very important risk stems from the possibility of concession of nominal wages increases incompatible with productivity growth and its negative impacts over inflation dynamics. At the end of last year and at the start of this year, the risks associated to commodities prices trajectory in international markets were key to the prospective scenario. However, since April these prices have shown some accommodation.

25. The Copom forecasts two distinct moments for inflation trajectory, according to the 2011 main scenario. In this quarter, inflation accumulated in twelve months tends to remain at levels above those observed in the second quarter. This, in great part, is explained by the high inertia that stemmed from 2010, by the duration of the shocks that hit the economy at the end of last year, extending to the first quarter of this year, which reflect in the fact that the projections of inflation for the two-month period between July and August 2011 point to average monthly inflation rates above those registered in the same period in 2010. However, from the fourth quarter on, the main scenario indicates a downward trend for the inflation accumulated in twelve months, moving toward the target direction.

26. The Copom reaffirms that the inflation main scenario considers the materialization of its trajectories regarding fiscal variables. It bears highlighting that the generation of primary surpluses in line with the hypotheses considered for inflation projections, in addition to contributing to reduce the mismatches between supply and demand growth rates, will strengthen the reduction trend in the public debt/GDP ratio. It bears highlighting that, since the beginning of this year, important decisions have been taken and implemented, which reinforce the view that a fiscal consolidation process is in place.

27. The Copom highlights that its main scenario for inflation also considers moderation in credit expansion, for which macroprudential and conventional monetary policy actions recently adopted contribute. Still about this market, the Committee considers opportune the introduction of initiatives with the aim of moderating the concession of subsidies regarding credit operations.

28. In short, the Copom recognizes an economic environment in which an increasing and above-than-usual uncertainty level prevails, and identifies risks to the materialization of a scenario where inflation promptly converges to the midpoint target. Since the last Copom meeting, at the external outlook, evidences have shown additional moderation in the recovery process experienced by the G3 economies and, in another perspective, have still revealed ambiguous influence over the behavior of domestic inflation. Regarding the domestic outlook, macroprudential actions and, mainly, conventional monetary policy actions recently implemented will still have their effects incorporated to price dynamics, a process that tends to intensify in this half of the year. Although growing and elevated uncertainties that surround the global outlook and, at a minor magnitude, the domestic one, do not allow the clear identification of the degree of persistence of recent inflationary pressures, the Committee evaluates that the inflation prospective scenario shows more favorable signs.

29. In this context, assessing the prospective scenario and the balance of risks for inflation, the Copom unanimously decided, at the moment, to increase the Selic target to 12.50%, without bias.

30. Domestic demand is robust, largely due to the effects of stimulus factors, such as income growth and credit expansion. Moreover, although recent initiatives point to restraint in public sector expenditures in the first half, fiscal and credit incentives had been previously provided to the economy, and shall still contribute for the activity expansion and, hence, for the maintenance of the idleness level of factors at low levels. The effects of these stimuli, however, are counterbalanced by the effects of the reversal of initiatives taken during the recent 2008/09 financial crisis, by the recent macroprudential actions and, mainly, by conventional monetary policy actions taken this year. These elements and the fiscal and quasi fiscal developments are an important part of the context in which future monetary policy decisions will be taken, aiming to ensure the timely convergence of inflation to the targets path.

31. At the end of the meeting it was announced that the Committee will reconvene on August 30th, 2011, for technical presentations and, on the following day, to discuss the monetary policy decision, as established in Communiqué 20,223 of October 15th, 2010.

SUMMARY OF DATA ANALYZED BY THE COPOM

Inflation

32. The IPCA rose 0.15% in June, down from 0.47% in May, according to IBGE data. In the first half of the year, the IPCA reached 3.87%, compared to 3.09% in the same period of last year. In the last twelve months through June, the index changed 6.71%, compared to 6.55% in May. The growth in market prices declined from 0.44% in May to 0.26% in June, reflecting the slowdown both in the prices of tradables, from 0.36% to 0.19%, and in the prices of non-tradables, from 0.50% to 0.32% in the same period. The segment of regulated prices changed by 0.12% in June, down from 0.55% in May, mainly driven by the reduction of 3.94% in the price of gasoline. The groups transportation and food and beverages presented the greatest contributions to the deceleration of the index in the month, -0.12 p.p. and -0.06 p.p., respectively. The diffusion index stood at 58.85% in June, compared to 64.84% in May.

33. Market prices increased 7.4% in the last twelve months through June, down from 6.80% in May, while regulated prices showed deceleration to 5.70%, down from 5.96% for the same periods. Among market prices, the price change in twelve months of tradable goods accelerated from 5.96% through May to 6.26% through June, while the variation regarding non-tradables goods accelerated from 7.53% to 7.89%. The prices of the services segment, which present higher degree of persistence, increased 8.75% in June, up from 8.54% in May and 6.82% in June of last year.

34. The three IPCA core inflation measures calculated by the BCB accelerated in the twelve months ending in June, against the twelve months through May. Month-on-month, however, only the core inflation by exclusion, which excludes ten items of household food and fuels, increased, reaching 0.56% in June, up from 0.54% in May, accumulating 6.51% in twelve months through June, up from 6.30% in the previous month. The smoothed trimmed means core inflation increased 0.54% in June, down from 0.64% in May, accumulating 6.01% in twelve months, compared to 5.86% in May. The double weight core inflation increased 0.42% in June, down from 0.59% in May, accumulating 6.82% increase in twelve months through June, up from 6.68% in the twelve months through May.

35. The IGP-DI totaled -0.13% in June, after growing 0.01% in May, accumulating 2.95% in the year and 8.63% in twelve months, compared to 9.14% in May, according to FGV. In the month, the fall in the IGP-DI reflected the negative changes in the IPC and IPA, and the deceleration in the INCC.

36. The IPA totaled -0.19% in the month, after recording -0.63% in May, totaling 2.22% in the year and 9.61% in twelve months. The prices of agricultural and livestock products changed -1.11% in June, after recording -

3.19% in May, totaling 0.51% in the year and 19.38% in the last twelve months. The prices of industrial products increased 0.13% in the month, down from 0.32% in May, totaling 2.84% in the year and 6.54% in twelve months. Regarding agricultural and livestock products, the monthly retreat was more strongly influenced by the falls in the prices of orange, -16.20% in June, against -22.47% in May; and in the prices of pork, poultry and bovines, -12.57%, -4.93% and -2.17%, in June, respectively, against -5.49%, -5.22% and -2.33% in the previous month. Among the industrial products, the main drivers for inflation deceleration were meat, meat products and fish, -0.10 p.p., and sugar, -0.07 p.p..

37. The IPC changed -0.18% in June, after increasing 0.51% in May, accumulating 3.80% in the year and 6.40% in twelve months. In the month, food and transportation groups were the ones responsible for the decrease of the index, contributing -0.30 p.p. and -0.14 p.p., respectively. The INCC changed 0.37% in the month, compared to 2.94% in May, as a consequence of the deceleration of some prices increases, such as labor force (to 0.36% in June from 5.48% in May), and materials, equipment and services (to 0.38% from 0.51%, according to the same comparison basis). The INCC accumulated changes of 5.60% in the year and of 7.75% in twelve months.

38. The IPP/IT decreased -0.55% in May, compared to the 0.28% increase in April, accumulating increases of 1.13% in the year and of 5.60% in the twelve-month period ended in May (6.68% in the previous month). The monthly result was influenced by the prices contraction in the sectors of food and oil, coke and biofuel derivatives production, which contributed with changes of -0.36 p.p. and -0.23 p.p., respectively. In the year, the index change reflected specially the food prices decrease, which contributed -0.66 p.p. to the final result.

39. The Commodities Index Brazil (IC-Br) dropped for the third consecutive month in June, with a change of -1.56%, reflecting the decreases of 1.25%, 3.55% and 0.15% in the sub-indices relating to agricultural and livestock, metal and energy segments, respectively. In the quarter ended in June, there was a 7.51% decrease, with retractions of 10.43%, 7.08% and 0.44% in agricultural and livestock, metal and energy segments, respectively. In the year and in twelve months, the index increased 1.43% and 31.65%, respectively.

Economic Activity

40. The IBC-Br increased 0.2% in May compared to April, considering seasonally adjusted data. Considering the observed series, the IBC-Br increased 4.2% compared to May 2010, accumulating increases of 4% in the year and 5.3% in twelve months.

41. Expanded retail sales, which include vehicles and construction inputs, grew 1% in May compared to April, according to data seasonally adjusted from IBGE's monthly survey (PMC), after increasing 1.2% in April. As a consequence, the average of the quarter ended in May increased 2.7% compared to the quarter ended in February. In the month, eight out of the ten surveyed segments presented increases, with highlights for the expansion of 11.6% in office, computing and communication equipment and material. Retail sales volume increased 0.6% in May, compared to the previous month, according to seasonally adjusted data, after decreasing 0.2% in April, while the quarterly average increased 1.6%, compared to the previous period.

42. Considering observed data, expanded retail sales increased 12.8% in May, year-over-year, mainly influenced by the increases of 25.9% in the sales of vehicles, motorcycles, parts and pieces, and of 20.4% in the sales of furniture and house appliances. In twelve months, expanded retail sales increased 10.5%, due to the sales increase in some segments, such as furniture and house appliances (17.2%), office, computing and communication equipment and material (16.7%), and construction inputs (13.9%).

43. Automobile sales by dealers, including cars, light commercial vehicles, trucks and buses, expanded by 1% in June, according to Fenabrave (Brazilian Federation of Automobile Vehicles Distribution) data, seasonally adjusted by the BCB, decreasing 1.3% in the second quarter of the year, compared to the first one. Automobile sales increased 10% in the year, influenced by increases in the sales of buses (23.7%), light commercial vehicles (18.7%), trucks (17%), and cars (7.2%). In the twelve-month period ended in June, there

was a 12.3% elevation, with highlights to the sales increases for trucks (26.4%), light commercial vehicles (23.7%), and buses (22.5%).

44. Capital goods imports quantum index, released by Funcex and seasonally adjusted by the BCB, retracted 1.8% in June, compared to May. The observed data showed increases of 17.8%, compared to June 2010, 26% in the year up to June, and 39.2% in twelve months.

45. Capital goods production expanded 1.7% in May, accumulating a 4.4% increase in the quarter, compared to the previous one ended in February, according to data seasonally adjusted from the Monthly Industrial Survey (PIM) by the IBGE. The monthly result was mainly influenced the elevations of 10.1% in the production of capital goods for agriculture and of 8% for construction, while the highest falls occurred in the production of equipment for non-serial industrial purposes (-5%), and for the power supply sector (-4%). Capital goods production increased 7.1% compared to May 2010, accumulating increases of 6.4% in the year and 11.5% in the twelve-month period ended in May.

46. Construction inputs production increased 3.6% in May, compared to April, and decreased 0.2% in the quarter ended in May, compared to the one ended in February, considering seasonally adjusted data. The segment increased 3.9% compared to May 2010, accumulating increases of 3.5% in the year and 6.7% in the last twelve months.

47. Disbursements granted by the Brazilian Development Bank (BNDES) reached R$166.5 billion in the last twelve months through April, an increase of 13.8% compared to the same period of 2010, with highlights for the expansion of 26.1% in the resources headed to manufacturing industry and of 5.23% in those marked for commerce and services. In the first four-month period of the year, disbursements decreased 5.4% compared to the same period of 2010, shared by infrastructure, which responded for 40% of the total, followed by industry, which accounted for 31%, commerce and services, 20%, and agriculture and livestock sectors, 9%.

48. Industrial production increased 1.3% in May, compared to the previous month, according to seasonally adjusted data from the PIM-PF (IBGE), with emphasis in the expansion of 2.7% in the production of durable consumer goods. Compared to May 2010, industrial production expanded by 2.7%, with highlights for the increase of 7.1% in capital goods. The increases in the year and in twelve months reached 1.8% and 4.5%, respectively, compared to same previous periods, with highlights for the increases in capital goods industry, of 6.4% and 11.5%, respectively, according to the same comparison bases.

49. The Nuci in the manufacturing industry, calculated by FGV, dropped 0.1 p.p. in June compared to May, to 84.3%, considering seasonally adjusted data. The result reflected the elevation of 0.2 p.p. in intermediate goods, stability in construction inputs and retractions of 0.3 p.p., 0.2 p.p. and 0.1 p.p. in durable and non-durable consumer goods and capital goods, respectively. Considering observed data, the Nuci decreased 1 p.p. compared to June 2010, influenced by the decreases in indicators related to construction material (-3 p.p.), and consumer goods (-2 p.p.) industries, and increases of 1.4 p.p. in capital goods 0.1 p.p. in intermediate goods.

50. Vehicles output reached 295.6 thousand units in June, according to data released by Anfavea, representing an expansion of 0.6% compared to May, considering data seasonally adjusted by the BCB. Output increased 4.1% compared to June 2010 and 3.8% in the year.

51. National vehicles licensing increased 0.5% in June, compared to May, according to data seasonally adjusted by the BCB, and 8.6% compared to June 2010. Exports changed 4.2% and -10.9%, according to the same comparison bases. In the year and in twelve months, licensing grew 3.9% and 7.3%, while exports changed 2.8% and 12.1%, respectively.

52. The LSPA survey carried out by the IBGE, referring to June, projected 161.5 million tons for the 2011 national harvest of grains, an 8% increase compared to the 2010 harvest. Considering the three main cultures, elevations of 18.1%, 9.3% and 3.2% are expected in the harvests of rice, soybeans and corn, respectively.

Surveys and Expectations

53. The Consumer Confidence Index (ICC), considering seasonally adjusted data from the nationwide Consumer Expectations Survey (FGV), increased 2.3% in June, reaching 118 points and reversing the declining trend observed in the last three months. This result was driven by elevations of 1% in the Current Situation Index (ISA) and 3.2% in the Expectations Index (IE). The ICC decreased 1.1% year-over-year, influenced by the fall of 4.9% in the IE, while the ISA grew 4.9%.

54. The Industry Confidence Index (ICI), considering seasonally adjusted data from the Survey of Manufacturing Industry (SCIT-FGV), declined 2.5% in June, reaching 107.1 points. The result was driven by the decreases of 3.5% in the ISA and 1.7% in the IE. The ICI performed unfavorably for the sixth consecutive month in the year-over-year comparison, falling by 7.3%, due to the changes of -9.8% in the ISA and -4.6% in the IE.

55. The Services Confidence Index (ICS), from FGV, retracted 1.4% in June, considering seasonally adjusted data, the same performance presented in the previous month, reflecting reductions of 2.8% in the ISA and 0.3% in the IE. The ICS increased 0.1% year-over-year, as a result of the decrease of 3.3% in the ISA and the expansion of 2.9% in the IE.

Labor Market

56. According to the General Record of Employment and Unemployment (Caged) of the Ministry of Labor and Employment (MTE), 215.4 thousand formal jobs were created in June, representing a 0.4% expansion compared to May, considering seasonally adjusted data. Out of this total, 75.2 thousand jobs were created in the agricultural and livestock sector, 53.5 thousand in the services sector, 30.5 thousand in civil construction, 30 thousand in commerce and 22.6 thousand in industry. In the year, the balance reached 1.3 million jobs, compared to 1.5 million in the same period of 2010. In twelve months through June, 1.9 million jobs were created, compared to 2 million accumulated up to March.

57. According to the IBGE employment survey (PME), carried out in the six main metropolitan regions of the country, the unemployment rate decreased by 0.2 p.p. compared to May, reaching 6.2%, a historical record low for the month, with a 0.8 p.p. fall year-over-year, resulting from 0.2% decrease in occupation and 0.4% in the Economically Active Population (PEA). Considering seasonally adjusted data, the unemployment rate reached 6.1%, 0.1 p.p. above the previous month. According to the same survey, average real earnings usually earned by workers grew by 0.5% month-on-month and increased 4% compared to June 2010 and 3.8% in the year through June. As a result, the expansion of payroll, calculated by the multiplication between real earnings and occupied population, showed variations of 0.4% month-on-month, 6.4% year-over-year and 6.2% in the year through June.

Credit and Delinquency Rates

58. Outstanding credit in the financial system reached R$1,804.5 billion in May, equivalent to 46.9% of GDP, increasing by 1.6% in the month, 5.8% in the year and 20.4% in twelve months. Non-earmarked credit operations increased by 1.6%, 5.7% and 18.1%, respectively, according to the same comparison bases, reflecting the respective increases of 1.7%, 5.9% and 18.4% for credit operations to individuals and 1.4%, 5.5% and 17.8% for credit operations to corporate. Earmarked credit operations increased 1.6% in the month, 6% in the year and 25.1% in twelve months, with highlights for the respective rises of 3.5%, 15.5% and 48.2% recorded in housing credit, according to the same comparison bases.

59. The average interest rate on reference credit operations increased 0.1 p.p. in May, reaching 40%. The average annual rates on credit for corporate reached 31.1%, representing an increase of 0.1 p.p. relative to April, while those for individuals were unchanged at 46.8%.

60. The average tenure on reference credit operations remained stable at 476 days in May, month-on-month. The tenure related to corporate segments reduced three days, while the one related to individuals increased three days, always considering the comparable period, reaching 388 days and 570 days, respectively.

61. The delinquency rate in the financial system (non-earmarked loans used as reference for interest rates, in arrears for more than ninety days) increased 0.2 p.p., reaching 5.1% in May. The delinquency rate for credit operations with corporate increased 0.2 p.p. and the one relative to individuals increased by 0.3 p.p., reaching 3.9% and 6.4%, respectively.

External Environment

62. As inflation is still negatively impacting the households purchase power and the manufacture and services sectors are losing momentum worldwide, the global industrial monthly survey continued to indicate economic activity slowdown at the end of the second quarter. The orders index has also presented cooling, indicating increasing uncertainty related to the activity recovery prospects. In the US, despite the first quarter GDP revision, to 1.9% from 1.8%, labor market remains weak, with the creation of jobs below market expectations for two consecutive months. In June, only 18 thousand new jobs were created, resulting in unemployment rate increase to 9.2%. In a different way, Asian economies are again showing signs of recovery. In Japan, where the pieces supply chains have quickly returned to normality, industrial production increased for the second month, posting 5.7% in May, compared to April. The Bank of Japan's (BoJ) Tankan survey indicated positive review in investment plans in capital goods in practically all enterprises segments, while in seven out of nine country regions showed improvement in investment, production and consumption. Under this outlook, the unemployment rate retreated to 4.5% in May, as retail sales increased to 2.4% in the month. In China, the GDP annualized quarterly result in the second quarter indicated a 9.1% growth compared to 8.7% in the previous quarter.

63. Since the last Copom meeting, the financial markets have reflected the deterioration of the Greek crisis, and its impacts in Europe and the uncertainties regarding the US recovery pace. After the improvement due to the new fiscal measures in Greece, the Portugal and Ireland ratings downgrades resulted in new market volatility, causing risk aversion increase, higher sovereign spreads for European countries with fiscal problems to record levels, and dollar appreciation. In the commodities markets, international prices kept its downward trend, despite the more moderate rate, as supply increases, global economy continues to decelerate and risk aversion increases in the financial markets. In special, the agricultural and livestock commodities prices retreat reflected more favorable climate conditions in the North Hemisphere and better-than-expected harvest inventories and planted area in the US.

64. Still reflecting strong increase in commodities prices until April this year, some annual inflation indices continue under pressure, such as CPIs in the US, UK, Euro Area and China, which, in June, reached 3.6%, 4.2%, 2.7% and 6,4%, respectively. The price indices cores remained in relatively comfortable levels, including in the UK, where it decreased for the second consecutive month, to 2.7%. In the Latin America emerging economies, inflation kept the moderate upward trajectory in Chile and Colombia, but retreated in Peru and kept reduction trend in Mexico. In emerging Asia, it bears highlighting the strong reduction in Indonesia inflation.

65. Under this scenario, while monetary authorities in the US, Japan and UK kept unchanged their respective basic interest rates in July, the European Central Bank promoted new adjustment in its liquidity conditions, increasing the refinancing rate by 0.25 p.p. to 1.5% p.a. and the Chinese central bank increased for the third time in the year the borrowing rate, to 6.56%. In other emerging economies, there was continuity in the monetary policy gradual movement to normalization, with increase in the basic interest rates in Chile, Colombia, Poland, India and Thailand.

Foreign Trade and International Reserves

66. The Brazilian trade surplus reached US$4.4 billion in June. Exports reached US$23.7 billion and imports, US$19.3 billion. In 2011H1, the trade surplus totaled US$13 billion, 63.1% above the registered in 2010, according to the daily average criterion, reflecting expansions of 31.6% in exports and 28.5% in imports. In the year, total trade grew 30.1%, totaling US$223.6 billion, compared to US$170.5 billion in the same period of 2010.

67. International reserves reached US$335.8 billion in June, increasing US$2.8 billion compared to May and US$47.2 billion compared to December 2010. The monetary authority's interventions accounted for net purchases of US$2.3 billion in the domestic spot market in the month.

Money Market and Open Market Operations

68. Since the last Copom meeting, in June, the domestic interest rate yield curve increased in all its length. In the domestic scenario, this movement was influenced by the prospect of a more prolonged monetary adjustment cycle, by the release of current inflation indices close to the expectations upper limit and by the increase in inflation expectations. The international scenario, surrounded by high uncertainties, contributed to rate swings throughout the whole interest rate curve. Between June 6th and July 18th, one- three- and six-month interest rates increased 0.24 p.p., 0.19 p.p. and 0.14 p.p., respectively, while one- two- and three-year rates increased, respectively, 0.10 p.p., 0.15 p.p. and 0.19 p.p. Real interest rate, measured by the ratio between the one-year forward nominal interest rate and the smoothed twelve-month-ahead inflation expectations, retreated from 7.10%, on June 6th to 6.84% on July 18th, as a result, mainly, of the upward adjustment of the 12-month ahead inflation expectations.

69. Between June 7th and July 18th, the Central Bank carried out three reverse exchange rate swap auctions, being the one on June 28th directed to the rollover of the contracts due on July 1st. These operations totaled the equivalent to US$2.3 billion in notional value.

70. In its open market operations, the BCB carried out, between June 7th and July 18th, repo operations borrowing R$48.4 billion for a six-month period. As a consequence, the average daily balance of the long operations increased to R$166.9 billion. In the same period, the BCB also borrowed money through repo operations with tenures between thirteen and twenty-nine working days, increasing the average daily balance of short-term borrowing operations to R$160.7 billion. The BCB also borrowed money through 30 very short-term operations. These operations, including the management ones, had average daily balance of R$65.0 billion in the period. The average daily balance of the total stock of repurchase agreements of the Central Bank increased from R$361.3 billion between April 19th and June 6th, to R$392.6 billion, between June 7th and July 18th. Considering the operations for the most recent period, there was an increase in the daily balance of repurchase agreements of R$92.0 billion, resulting in stock increase from R$351.4 billion in June 6th to R$443.4 billion in July 18th. The main driver of liquidity increase in the period was the net redemption of securities by the National Treasury.

71. Between June 7th and July 18th, the National Treasury issuance regarding the traditional auctions raised a total of R$52.3 billion. The sale of fixed-rate securities reached R$33.4 billion, with R$29.6 billion via issuance of LTNs maturing in 2011, 2012, 2013, 2014 and 2015, and R$3.8 billion via NTN-Fs maturing in 2017 and 2021. Issuance of LFTs totaled R$5.5 billion, for securities maturing in 2017 and 2018. Issuance of inflation-linked NTN-Bs reached R$13.4 billion, for securities maturing in 2014, 2016, 2020, 2030, 2040 and 2050.