BANCO CENTRAL DO BRASIL

Minutes of the 162nd 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: October 18th, 2011, from 4:14PM to 7:00PM, and October 19th, from 5:04PM to 7:38PM

Place: BCB Headquarters meeting rooms – 8th floor on October 18th and 20th floor on October 19ht – 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 October 18th)
Adriana Soares Sales – Research Department (also present on October 19th)
Ariosto Revoredo de Carvalho – International Reserves Operations Department
Luiz Donizete Felício - Open Market Operations Department
Renato Jansson Rosek – Investor Relations and Special Studies Department
Rodrigo Collares Arantes - Department of Banking Operations and Payments System
Tulio José Lenti Maciel – Economic Department

Other participants (present on October 18th)
Alexandre Pundek Rocha – Advisor to the Board
Eduardo José Araújo Lima – Deputy Head 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
Wagner Thomaz de Aquino Guerra Júnior – Executive Secretary of the Board

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 0.37% in August, monthly inflation measured by the IPCA reached 0.53% in September. As a consequence, twelve-month inflation through September 2011 reached 7.31% (7.23% in August), 2.61 p.p. above inflation registered in the same period of 2010. The inflation elevation in this period reflected the behavior of both market prices, which increased 7.79% (5.17% in the twelve months through September 2010),

and regulated prices, which increased 6.17% (3.58% in the same period of 2010). Regarding market prices, it bears highlighting that tradable goods inflation reached 6.52% while inflation related to non-tradable goods increased 8.88%. Services price inflation continues at high levels, with monthly growth of 0.50% in August and 0.51% in September, increasing the twelve-month accumulated inflation to 9.03%, the highest level since September 1997. In short, the set of available information suggests some persistence in the increase of prices, process led by market prices, which, in part, reflects the fact that services inflation remains at high levels.

2. The underlying inflation measures calculated by the BCB, in general, showed similar trend to that of headline inflation, as that there was an increase in the average of monthly changes and in twelve-month accumulated inflation. The smoothed trimmed means core inflation increased from 0.41% in July to 0.55% in August and 0.58% in September, while the non-smoothed trimmed means core inflation increased from 0.28% in July to 0.33% in August and 0.55% in September. Similarly, the double weight core inflation, after registering 0.38% in July, increased to 0.39% in August and to 0.51% in September. At the same time, core inflation by exclusion, which excludes 10 items of food at home and fuel, totaled 0.45% in September, up from 0.32% in August and 0.33% in July, while core inflation by exclusion of regulated prices and of household food changed to 0.44% in September, from 0.45% in August and 0.40% in July. Therefore, the average change of these five core measures changed from 0.36% in July to 0.41% in August and 0.51% in September. In the twelve months through September, the average variation of the five core measures registered 6.87%, up from 6.73% in August and 6.53% in July.

3. The General Price Index (IGP-DI) inflation registered inflation of 0.75% in September, up from 0.61% in August. In the twelve months through September, the change reached 7.45%, 0.50 p.p. below the registered in September 2010. Under this criterion, the index has been slowing down since December 2010, when it recorded 11.30% change. Inflation measured by its main component, the Wholesale Price Index (IPA), reached 7.52% in twelve months through September, reflecting an increase of 5.30% in the industrial IPA and of 14.22% in the agricultural IPA. The breakdown according to the production phase shows that raw material prices accumulated 14.80% change, while the prices of intermediate goods and final goods increased 4.79% and 4.64%, respectively, according to the same comparison basis. Inflation measured by the Consumer Price Index (IPC), another component of the IGP-DI, recorded 7.13% in the twelve months through September 2011, above the 4.36% recorded in 2010. According to the same comparison basis, the Civil Construction National Index (INCC), component with the lowest weight in the IGP-DI, increased 7.68%. On its turn, the Producer Price Index/Manufacturing Industry (IPP/IT), calculated by the IBGE, which measures the industry price level excluding freights and taxes, registered 0.20% inflation in August, up from 0.03% in July. In twelve months, the index inflation decreased to 4.28% in August, down from 4.83% in July.

4. The IBGE (Brazilian Institute of Geography and Statistics) released information on 2011Q2 GDP, which grew by 3.1% against the same quarter of last year (yoy), and 0.8% quarter-over-quarter, according to seasonally adjusted data. The GDP growth accumulated in the last four quarters reached 4.7% over the previous four quarters. From the aggregated supply perspective, there was deceleration in all the sectors of activity, year-over-year. The services sector grew 3.4% (4.0% in Q1); for industry, the rate of expansion in the second quarter retreated to 1.7% (3.5% in Q1), while in agriculture growth was zero (3.1% in Q1). From the aggregated demand point-of-view, household consumption expanded 5.5%, government consumption, 2.5%, and gross fixed capital formation (GFKF), 5.9%, year-over-year. At the same time, imports grew 14.6% and exports, 6.0%, according to the same comparison basis. The accumulated contribution of domestic demand to GDP growth in four quarters continued to be moderate. In fact, it shifted from 10.3 p.p. in 2010Q4, to 8.8 p.p. in the 2011Q1 and 6.6 p.p. in 2011Q2, while the negative contribution of the external sector decreased from 2.8 p.p., to 2.5 p.p. and to 1.8 p.p., respectively.

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, and constitutes, therefore, an important coincident indicator of economic activity. Considering seasonally adjusted data, the IBC-Br declined 0.5% in August, after increasing 0.3% in July and decreasing 0.3% in June. Thus, the quarterly growth rate between June and August stood at -0.2%. For the period June-August 2010, there was growth of 2.5%. The rate of growth accumulated in twelve months decreased from 4.4% in July to 4.0% in August and since December 2010, it has been moderating. The Services Confidence Index (ICS), from FGV, decreased 0.4% in

September, after falling 1.3% in August. Thus, the level of the indicator was 2.3% below the September 2010 level, and 1.7% below the average level of 2010.

6. Industrial activity fell 0.2% in August, according to data seasonally adjusted by the IBGE, after slight increase of 0.3% in July and a decline of 1.2% in June. According to the quarterly moving average, there was a decline of 0.4% between June and August, after growing 0.1% between May and July. Year-over-year, industrial output increased 1.8% in August, while in the last twelve months, there was an increase of 2.3%, compared to 2.9% registered in July, continuing the process of growth moderation. Compared to December 2008, month with the lowest output level during the 2008/09 crisis, the accumulated growth until August 2011 reached 24.8%. According to data from the National Industry Confederation (CNI), earnings in the manufacturing industry recorded 6.7% real growth in the twelve months until August, while the number of worked hours worked increased 1.9%.

7. Among the industry use categories, according to data seasonally adjusted by the IBGE, there was increase of 0.9% in the production of capital goods in August, and declines of 2.9% in the durable consumer goods, 0.8% in non-durable and semi-durable consumer goods and 0.2% in intermediate goods. In the twelve months through August, intermediate goods output increased 1.9%, durable consumer goods output grew 1.5% and non-durable and semi-durable consumer goods output increased 1.3%. According to the same comparison basis, capital goods industry recorded the highest growth activity level among use categories, recording a 6.8% increase.

8. The unemployment rate in the six metropolitan regions covered by the IBGE Monthly Labor Survey (PME), according to observed data, remained unchanged in August at 6.0%, compared to the 6.7% level registered in August 2010. After reaching 9.0% in March 2009, the observed data reduced significantly and reached a record low for August, since the start of the series in March 2002. The seasonally adjusted unemployment rate remained unchanged at 5.9% in August. The employment, measured by the number of employed workers in the six main metropolitan regions, year-over-year, increased 2.2% in August, after an expansion of 2.1% in July. Data from the Ministry of Labor and Employment (MTE) indicate that in September 209.1 thousand jobs were created (246.9 thousand in September 2010), with expansion of formal jobs in seven out of the eight sectors of economic activity. Services and manufacturing industry were the sectors that mostly contributed for the formal employment increase in the month. According to PME, real average earnings increased 0.5% in August month-on-month, and accumulated 3.2% growth in twelve months. As a consequence, real payroll, considering real average earnings in the six metropolitan regions, important factor in sustaining growth in domestic demand, expanded 5.6% in August, year-over-year.

9. According to the retail monthly survey (PMC) from IBGE, expanded retail sales increased 5.3% in August, year-over-year, after recording 7.2% growth in July and 9.5% in June, according to the same comparison basis. According to the seasonally adjusted series, expanded retail sales decreased by 2.3% in August, month-on-month, after showing some stability in the previous two months. The twelve-month accumulated growth rate reached 9.8% in August, down from 10.5% in July and 10.9% in June. According to this comparison basis, all ten sectors surveyed showed expansion in the volume of sales, with highlights for equipment and supplies for office, computer and communication (18.6%), furniture and appliances (17.8%), vehicles, motorcycles, parts and pieces (12.2%) and construction inputs (12.0%). In the coming months, the retail trajectory will continue to be positively influenced by governmental transfers, by the growth pace of real payroll, by the consumer confidence level and by moderate credit expansion.

10. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by the FGV, without seasonal adjustment, registered 84.4% in September, up from 84.0% in August. Thus, capacity utilization was 1.4 p.p. and 1.5 p.p. lower than the levels observed in August and September 2010, respectively. According to the seasonally adjusted monthly series calculated by the FGV, the Nuci remained unchanged at 83.6% in September, compared to the level recorded in August, the lowest level since November 2009. Capacity utilization is higher in the construction inputs sector (90.5%) and intermediate goods (85.2%). In the sector of capital goods, the Nuci stood at 84.9%, while in the sector of consumer goods it stood at 83.4%. According to the Confederation of National Industry (CNI) data, seasonally adjusted by the BCB, the Nuci increased from 81.8% in July to 82.1% in August. The rates of capacity utilization have been retreating, reflecting, in part, the

moderation in the pace of production growth and the maturity of investments. In fact, the absorption of capital goods grew 11.6% in the last twelve months through August (14.1% until July), while the production of construction inputs increased 5.0% (5.5 % until July).

11. The trade balance surplus in the last twelve months increased from US$ 28.5 billion in August to US$ 30.5 billion in September. This result stemmed from US$247 billion in exports and US$216.5 billion in imports, equivalent to 32.7% and 27.8% changes, respectively, in the last twelve months through September. The current account deficit accumulated in twelve months increased from US$47.9 billion in July to US$ 49.7 billion in August, equivalent to 2.13% of GDP. On its turn, foreign direct investment reached US$75.4 billion in the twelve months through August, equivalent to 3.22% of GDP, exceeding largely the needs for external funding.

12. Global economy faces a period of uncertainty far above the usual, with significant deterioration in growth prospects in advanced countries and moderation of activity in emerging countries. In this environment, risks to global financial stability, of fiscal and financial nature, increased, among other factors, due to exposure of international banks to sovereign debt of countries with fiscal imbalances, especially in the Euro Area. In this region, since the last Copom meeting, there was deterioration in the sovereign and banking debt rating. It should be noted that the levels of risk aversion - for example, those measured by credit default swaps (CDS) of banks in the Euro Area - are now comparable to those observed during the 2008/2009 crisis. From another perspective, high persistent unemployment rates, coupled with the need for fiscal adjustments, as well as limited scope for monetary policy actions, have contributed for the reduction of growth projections in advanced countries or even of their potential growth, indicating a wider and more volatile business cycle. In fact, the composite leading indicator released by the Organization for Economic Cooperation and Development (OECD), for August, reinforced the signs of inflection in the main economies, with prospects of lower growth for this and the next semesters, and in some cases, of recession. Disaggregated indicators of the Purchasing Managers Index (PMI) for September, related to activity in industry and in the services sector, are, in general, consistent with this scenario. There has also been reduction in growth projections for major emerging economies. Regarding monetary policy, mature economies have continued to adopt accommodative monetary stances, in specific cases, with new non-conventional initiatives in the field of monetary policy. Regarding inflation, the core measures have persisted at moderate levels in the G3 (US, Euro Area and Japan), with a marginal deterioration in the Euro Area and in the UK. In emerging economies, in general, the bias of monetary policy is expansionary.

13. The price of Brent oil barrel has shown volatility, but remained above US$100. This price level is consistent with a framework of global demand moderation, coupled with high political instability in some producer countries and with lags in the process of resuming production. It bears highlighting that the geopolitical complexity that involves the oil sector tends to heighten the volatile behavior of prices, 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 significant drop in the international prices of the ones related to agriculture and metals. The food price index, calculated by the Food and Agriculture Organization of the United Nations (FAO), which considers 55 items, accumulated decrease of 5.5% since the peak in February 2011. 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 growth and to volatility in FX markets.

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 prices accumulated in 2011 was increased to 6.7% up from 4.0% considered in the August Copom meeting;
b) the adjustments for bottled gas prices accumulated in 2011 up to September was increased to 2.2%, compared to 0% considered in the August Copom meeting;
c) the projected adjustment for fixed telephone and electricity accumulated in 2011 were kept unchanged at 0.9% and 4.1%, respectively, the same values considered in the August meeting;

d) the projection for regulated prices inflation accumulated in 2011, based on individual items, according to the benchmark scenario, increased to 5.5%, up from 5.0% considered in the August meeting. This set of prices, according to data released by the IBGE, accounted for 28.94% of the total September IPCA;
e) the projection for regulated prices inflation accumulated in 2012, according to the benchmark scenario, was increased to 4.5% up from 4.4% considered in the August 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
f) the projection for the spreads over the Selic rate, based on the 360-day swap rates, on the benchmark scenario, estimates -55 bps and -28 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 (R$127.9 billion), around 3.15% of GDP, without adjustments, in 2011. Moreover, a primary surplus of around 3.1% of GDP is considered for 2012 and 2013, without adjustments.

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 was increased from 6.31% to 6.52%. For 2012, the median of inflation expectations were increased from 5.20% to 5.61%. Specifically for banks, asset managers and other institutions (real sector companies, brokers, consultancies and others), the medians for the 2011 IPCA changed from 6.30%, 6.32% and 6.30% to 6.51%, 6.54% and 6.50%, respectively. For 2012, the medians changed from 5.06%, 5.31% and 5.10% to 5.63%, 5.63% and 5.51%, in the same order.

18. The benchmark scenario assumes the maintenance of the exchange rate at R$1.75/US$1.00 and the Selic rate at 12% p.a. during the forecast period. Under this scenario, the projection for the 2011 inflation increased relative to the figure considered at the August 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 increased and stands above the inflation midpoint target. For 2012, the projections increased in both the benchmark and the market scenarios, and stand above the midpoint of the target in both scenarios. For 2013Q3, projected inflation stands around the midpoint of the target in the benchmark scenario and above, in the market scenario.

19. In the main scenario considered by the Copom, projected inflation stands around the midpoint of the target in 2012.

20. This scenario was developed and analyzed from the perspective of models that broadly identify the transmission mechanisms of external developments to the Brazilian economy - among others, the channels of trade, the price of imports and the external volatility. As a working hypothesis, it considers that the current deterioration in the international scenario will have an impact on the Brazilian economy equivalent to one quarter of the impact observed during the 2008/2009 international crisis. Moreover, it assumes that the current deterioration of the international scenario is more persistent than the one verified in 2008/2009, but less acute, without observance of extreme events. According to this main scenario, domestic economic activity moderates and commodities prices in international markets and the exchange rate show some stability among other effects. Even with a moderate adjustment in the basic interest rate level, the inflation rate in the relevant horizon stands around the target in 2012, at a level below the one that would be observed if the above mentioned effect of the international crisis were not considered.

Monetary Policy Decision

21. 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 under the responsibility of the monetary policy to remain especially vigilant to guarantee that pressures detected in shorter horizons do not spread to longer horizons.

22. International evidence, ratified by the Brazilian experience, indicates that high inflation rates lead to the increas in risk premium, both for private and public funding, and to the shortening of planning horizons, both for houseeholds 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.

23. As a consequence of the stabilization and correction of unbalances, which determined important structural changes, the inflation targeting regime maturing process 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 monetary policy traction 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.

24. The Copom considers that, since the last meeting, the risks to global financial stability have increased and thus contributed to the continuous process of deterioration of the international scenario which, already at that time, faced generalized and significant growth projections reductions for the main economic blocks. The Committee understands that the chances that the restrictions to which several mature economies are now exposed extend for a period longer than previously anticipated remain high. It also notes that, in these economies, there seems to be limited scope for using monetary policy, and a scenario of fiscal restraint also prevails. In addition, for the main emerging economies, despite the resilience of domestic demand, the pace of activity has moderated, in part, a consequence of policy actions and weakening external demand through the trade channel. Therefore, the Committee considers that the international scenario shows disinflationary bias for the relevant horizon.

25. For the Copom, there has been accumulated evidence supporting the view that the transmission of external developments to the Brazilian economy can be realized through many channels, among others, the reduction of total trade flows, the moderation in investment inflows, tighter credit conditions and the worsening in consumer and business confidence. The Committee understands that the complexity surrounding the international environment will contribute to intensify and accelerate the ongoing moderation in domestic activity, which is already mirrored, for instance, in the retreat of growth projections for the Brazilian economy this year and in the upcoming year. In other words, the ongoing moderation process of the economy - a result of the policy actions implemented since the end of last year - tends to be boosted by the weakness of the global economy.

26. The Copom evaluates that, although ongoing moderation of domestic demand growth is observed, prospects for economic activity are still 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' confidence stands at historically high levels, notwithstanding some accommodation at the margin. The Copom considers, additionally, that the domestic activity will continue to be benefited by the public transfers, as well as by the labor market vigor, mirrored in historically low unemployment rates and in wages growth, despite some accommodation at the margin.

27. The Copom reaffirms its view that accumulated inflation in the twelve months peaked in the last quarter, and it begins to retreat in the current quarter, therefore, moving towards the target path. The Committee evaluates that, by itself, this reversion of trend will contribute to improve the expectations of economic agents about the dynamics of inflation in the upcoming quarters, especially those of the price setters. Additionally, the Committee believes that this improved perception will be boosted by the ongoing process of reassessment of the pace of both domestic and external economic activity, in this and in the upcoming semesters.

28. The Copom reaffirms that the main inflation scenario considers the materialization of the assumed 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 trend in the reduction of the public debt-to-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 underway.

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

30. The Copom evaluates that, at the start of the year, inflation was strongly and negatively impacted by domestic and external supply shocks, as well as by the atypical concentration of regulated prices adjustments. Although in decreasing intensity, these developments should also indirectly impact the dynamics of consumer prices, through inertia, among other mechanisms. At the same time, it evaluates, as relevant, despite decreasing, the risks stemming from the persistence of the mismatch between supply and demand growth rates. Moreover, it highlights the narrow idleness margin in the labor market. Despite signs of moderation in this market, considers that in such circumstances, a very important risk stems from the possibility of concession of nominal wages increases incompatible with productivity growth and from its negative impacts over inflation dynamics. On the other hand, the Copom notes that the level of installed capacity utilization has retreated and is below the long-term trend, or is contributing to the opening of the output gap and to contain price pressures. The Committee also observes that, at the end of last year and at the start of this year, the risks associated to commodities prices trajectory were key to the prospective scenario. However, since April these prices have retreated in international markets.

31. In short, the Copom recognizes an economic environment in which a much above-than-usual uncertainty level prevails, and evaluates that since the last meeting, the inflation prospective scenario has shown favorable signs. The Copom notes that, according to the main scenario, the inflation rate stands around the target in 2012 and identifies decreasing risks to the confirmation of a scenario in which inflation timely converges to the midpoint target.

32. In this context, continuing the process of monetary conditions adjustment, the Copom unanimously decided to decrease the Selic target to 11.50%, without bias.

33. Domestic demand is still robust, especially household consumption, largely due to the effects of stimulus factors, such as income growth and credit expansion. However, recent initiatives reinforce a scenario for restrained public sector expenditures. Other important factors to curb domestic demand are the substantial deterioration of the international scenario and the macroprudential actions implemented. These elements and

the 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.

34. The Copom believes that by promptly mitigating the effects stemming from a more restrictive global environment, moderate adjustments in the level of the basic rate are consistent with the scenario of inflation convergence to the target in 2012.

35. At the end of the meeting, it was announced that the Committee will reconvene on November 29th, 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

36. The IPCA rose 0.53% in September, up from 0.37% in August, according to IBGE data. In the year, the IPCA increased 4.97%, compared to 3.60% in the same period last year. In the last twelve months through September, the index increased 7.31%, compared to 7.23% in August. The monthly result for IPCA was boosted by the acceleration in the segment of regulated prices, which changed by 0.62% in September compared to 0.03% in August, mainly reflecting an increase of 23.40% in flight ticket prices compared to a decrease of 5.95% in the previous month. Market prices increased 0.49% in September compared to 0.51% in August, reflecting a deceleration in the prices of tradable goods, from 0.55% to 0.52%, while the prices of non-tradable goods remained stable at 0.47%, unchanged relative to the August result. The monthly change of IPCA reflected, in particular, the contributions of the groups transportation, and food and beverage (both 0.15 p.p.) and housing (0.09p.p.). The diffusion index stood at 61.46% in September, compared to 64.58% in August.

37. Market prices increased 7.79% in the last twelve months through September, with a slight deceleration compared to August, when it reached 7.87%, while regulated prices showed acceleration in the period, with an accumulated change growing from 5.71% in August, to 6.17% in September, for the same period. Among market prices, tradable goods prices recorded slowdown from 6.90% to 6.52%, and acceleration in the prices of non-tradable goods from 8.68% to 8.88%.The prices of the services sector, which present a higher degree of persistence, increased 9.03% in September, up from 8.92% in August.

38. The IGP-10 totaled 0.64% in October, after recording 0.63% in September, according to FGV, reflecting the acceleration in the IPA and INCC, and the deceleration in the IPC. The index accumulated 4.68% in the year and 7.25% in the last twelve months through October, compared to 7.79% in twelve months through September and 8.31% in August.

39. The IPA-10 totaled 0.81% in October, after recording 0.73% in September, totaling 4.22% in the year and 7.31% in twelve months. The prices of agricultural and livestock products increased 0.76% in October, after recording 1.48% in September, totaling 4.08% in the year and 12.47% in twelve months. The prices of industrial products increased 0.82% in the month, up from 0.46% in September, totaling 4.27% in the year and 5.57% in twelve months. Regarding agricultural and livestock products, the monthly growth was more strongly influenced by the increase of 4.84% in the price of coffee, 13.69% in the price of cassava, 2.23% in the price of corn and 1.47% in the price of soy, with respective contributions of 0.08 p.p., 0.08 p.p., 0.06 p.p. and 0.06 p.p., respectively. The main contributions to the change of industrial prices came from the items: metallic minerals, 0.27 p.p.; chemical products, 0.18 p.p.; and oil and vegetable fat, 0.15 p.p..

40. The IPC-10 changed 0.37% in October, after increasing 0.58% in September, accumulating an increase of 5.16% in the year and 6.93% in twelve months. In the month, it bears highlighting the drivers housing, and health and personal care, contributing 0.22 p.p. and 0.05 p.p., respectively, for the increase of the index. The INCC changed 0.16% in the month, compared to 0.10% in September, due to the acceleration in the prices of materials, equipment and services (from 0.17% in September to 0.29% in October), and deceleration in the

price of labor force (from 0.04% to 0.03%, according to the same comparison basis). The INCC accumulated changes of 9.67% in the year and of 11.01% in twelve months.

41. Four out of the five IPCA core inflation measures calculated by the BCB accelerated in September, compared to August. All five measures increased in the twelve months through September, compared to the twelve months through August. Month-on-month, the core inflation by exclusion, which excludes ten items of household food and fuels, increased 0.45% in the month, up from 0.32% in August, accumulating 6.91% in twelve months through September, up from 6.82% in twelve months through August. The smoothed trimmed means core inflation increased 0.58% in September, up from 0.55% in August, accumulating 6.57% in twelve months through September, compared to 6.41% in twelve months through August. The double weight core inflation increased 0.51% in September, up from 0.39% in August, accumulating 7.36% increase in twelve months through September, up from 7.23% in the twelve months through August. The non-smoothed trimmed means core inflation increased 0.55% in September, up from 0.33% in August, accumulating 6.08% in twelve months through September, compared to 5.85% in twelve months through August. The core inflation by exclusion, which excludes household food and regulated prices, increased 0.44% in September, down from 0.45% in August, totaling 7.45% in twelve months through September, compared to 7.34% in the last twelve months through August.

42. The IPP/IT increased 0.20% in August, compared to 0.03% in July, increasing 0.79% in the year and 4.28% in the twelve-month period ended in August (4.83% in the previous month). The monthly result was mainly driven by the increase in the price of food products, which contributed 0.66 p.p.. In the year, the index change reflected, in particular, the changes in the prices of other chemical product segments (with a contribution of 0.49 p.p. to the final result); coke, oil and bio-fuel byproducts (with a contribution of 0.38 p.p.); rubber and plastic material products (which contributed 0.30 p.p.).

43. The Commodities Index Brazil (IC-Br) increased 7.83% in September, breaking the five month consecutive decreases that resulted in a devaluation of 10.75%. The IC-Br appreciation in September reflected increases of 8.80%, 5.08% and 8.43% related to the sub-indexes agriculture and livestock, metal and energy, respectively. The IC-Br increased 5.54% in the year through September and 24.77% in the twelve months through September.

Economic Activity

44. The IBC-Br decreased 0.5% in August, totaling a decrease of 0.2% in the quarter ended in August compared to the quarter ended in May, when it had grown 1%, according to the same comparison basis, considering seasonally adjusted data. The IBC-Br increased 2.9% compared to August 2010, accumulating increases of 3.4% in the year and 4% in twelve months.

45. Expanded retail sales, which include vehicles and construction inputs, declined 2.3% in August month-on-month, according to data seasonally adjusted from IBGE’s monthly survey (PMC), after decreasing 0.1% in July and increasing 0.2% in June. In the month, only two out of the ten surveyed segments presented increases, with highlights for the expansion of office, computing and communication equipment and material (7.3%) and the contraction of 4.6% in the vehicles and motorcycles, parts and pieces segment. Expanded retail sales grew 0.1% in the quarter ended in August, compared to the previous quarter, ended in May. Retail sales volume decreased 0.4% in August, after increasing 1.2% in July and 0.3% in June, resulting in 1.4% accumulated increase in the quarter ended in August, compared to the previous quarter, ended in May.

46. Considering observed data, expanded retail sales increased 5.3% in August, year-over-year, mainly influenced by increases of 25.3% in the sales of office, computing and communication equipment and material; 16.9% in furniture and household appliances; 9.3% in pharmaceutical and medical articles; and 6.6% in construction inputs. In the twelve months through August, expanded retail sales increased 9.7%, mainly driven by the sales increase in segments such as office, computing and communication equipment and material (18.6%); furniture and household appliances (17.8%); vehicles, motorcycles, parts and pieces (12.2%); and construction inputs (12%).

47. Automobile sales by dealers, including cars, light commercial vehicles, trucks and buses, increased by 0.7% in September, compared to a decrease of 4.1% in August, according to Fenabrave (Brazilian Federation of Automobile Vehicles Distribution) data, seasonally adjusted by the BCB, accumulating a decrease of 3.9% in the quarter ended in September, quarter-over-quarter. Automobile sales increased 7.2% in the year, influenced by increases in the sales of buses (20.3%), light commercial vehicles (17.7%), trucks (15.9%), and cars (3.9%).

48. Capital goods imports quantum index, released by Funcex and seasonally adjusted by the BCB, reduced 10.4% in September, compared to August. The observed data showed a decrease of 17.1%, compared to September 2010, while the year through September, and in twelve months, there were increases of 13% and 18%, respectively.

49. Capital goods production expanded 0.9% in August, accumulating an increase of 0.3% in the quarter, compared to the previous one ended in May, according to data seasonally adjusted from the Monthly Industrial Survey (PIM) by the IBGE. The result was influenced by the acceleration in the production of capital goods for agriculture (9.9%); mixed use (2.8%); construction equipment (1.9%); agricultural equipment (1.7%). On the other hand, reductions were observed in the production of capital goods for the electric energy sector (-9.5%); equipments for transport (-2.6%) and capitals goods for industrial purposes (-1.8%).

50. Construction inputs production decreased 0.4% in August, compared to July, totaling 2% in the quarter ended in August, compared to the one ended in May, considering seasonally adjusted data. The segment production increased 4.9% compared to August 2010, accumulating increases of 4% in the year and 5% in the twelve months up through August.

51. Disbursements granted by the Brazilian Development Bank (BNDES) reached R$164.9 billion in the last twelve months through July, an increase of 22.2% compared to the same period of 2010, with highlights for the expansion of 59.9% in the resources headed to manufacturing industry, while the commerce and services sector decreased by 2%. In the year through July, disbursements decreased 4.8% compared to the same period of 2010, mainly influenced by the 12.4% retraction of the manufacturing industry resources. In the period, the infrastructure sector responded for 42% of the total, followed by industry, which accounted for 32%; commerce and services, 18%; and agriculture and livestock, 8%.

52. Industrial production decreased 0.2% in August, compared to the previous month, according to seasonally adjusted data from IBGE, with emphasis in the contraction of 0.2% in manufacturing and expansion of 0.4% in mining. By use categories, durable goods production decreased 2.9% in the month, followed by changes in the production of semi-durable and non-durable consumer goods (-0.8%), intermediate goods (-0.2%) and an expansion of 0.9% in capital goods production, highlighting that fifteen out of the 26 industry activities posted monthly increase. Industrial production decreased 1.2% in the quarter ended in August, compared to the one ended in May, when it had reached 1.2%, reflecting retreat of 1% in the manufacturing industry and expansion of 1.4% in the mining industry, according to the same comparison basis. Regarding the manufacturing industry, the results reflected retreats in pharmaceutical activities (-17.2%); shoes and leather (-8%); metal products (-7.9%), while the main positive drivers stemmed from the increases in tobacco (26%); and publishing, printing and reproduction (12.4%), according to quarter-over-quarter seasonally adjusted data. Considering observed data, industrial production increased 1.8% in the month, 0.7% in the quarter, 1.4% in the year and 2.3% in the last twelve months through August, compared to the same respective periods.

53. The Nuci in the manufacturing industry, calculated by FGV, reached 83.6% in September, the same level of the previous month, considering seasonally adjusted data. The result reflected the retractions of 1.3 p.p., 0.6 p.p. and 0.4 p.p. in durable consumer goods, non-durable consumer goods and intermediate goods, respectively; the increase of 0.3 p.p. in the construction material and stability in capital goods. Considering observed data, the Nuci decreased 1.5 p.p., compared to September 2010, to 84.4%, influenced by the decreases in the indicators related to consumer goods (2.9 p.p.); intermediate goods (1.5 p.p.); construction inputs (1 p.p.) and capital goods (0.4 p.p.).

54. Vehicles output reached 261.2 thousand units in September, according to data released by Anfavea, representing a retraction of 8.6% compared to August, considering data seasonally adjusted by the BCB. It also decreased 6.2% compared to September 2010 and 3.1% in the year through September.

55. Still according to data released by Anfavea, national vehicle licensing decreased 6.8% compared to September 2010 and 1.1% in the year up to September. According to data seasonally adjusted by the BCB, there were decreases of 1.6% month-on-month, and 4.6% in the quarter ended in September, compared to that ended in June. Automobile exports totaled 44.6 thousand units in September, decreasing 1.5% compared to September 2010 and increasing 4.3% in the year through September, compared to the same period of the previous year. According to data seasonally adjusted by the BCB, these exports increased 3% in September, month-on-month, and 7.1% in the quarter ended in September, compared to the one ended in June.

56. The LSPA survey carried out by the IBGE for September, projected 159.4 million tons for the 2011 national harvest of grains, an increase of 0.3% compared to the August projection and of 6.6% compared to the 2010 result. Respective increases for crops of rice, beans, soy and corn are projected at 19%, 12.1% 9.2% and 0.3% and decrease of 15.7% for crop of wheat are expected.

Surveys and Expectations

57. The Consumer Confidence Index (ICC), considering seasonally adjusted data from the nationwide Consumer Expectations Survey (FGV), decreased 3.4% in September, to 114.7 points, reaching the lowest level since March 2010. This result was driven by contractions of 4.1% in the Current Situation Index (ISA) and 2.9% in the Expectations Index (IE). The ICC decreased 6.7% year-over-year, influenced by the variations of -5.8% in the ISA and of – 7.4 in the IE.

58. The Services Confidence Index (ICS), from FGV, retreated 0.4% in September, compared to the previous month, reaching 130.3 points, result driven by the decrease of 1.8% in the IE and the 1.4% increase in the ISA, according to the seasonally adjusted data. The ICS retreated 2.3% year-over-year, due to the 3.1% decrease in the ISA and 1.6% in the IE.

59. The Commerce Confidence Index (ICOM) measured by the Commerce Survey, from FGV, reached 134.7 points in September, increasing 0.8% year-over-year. The result reflected the 1.7% increase in the Expectations Index (IE-COM), in contrast to the 0.5% retreat in the Current Situation Index (ISA-COM). In the quarter ended in September, the ICOM decreased 1.6% year-over-year, due to the 4% retreat in the ISA-COM and the IE-COM stability.

60. The Industry Confidence Index (ICI), considering seasonally adjusted data from the Survey of Manufacturing Industry (SCIT-FGV), declined 1.6% in September, reaching 101.1 points. After nine consecutive reductions, the index reached its lowest level since August 2009, 2.9 points below the 2003 average. The result was driven by the decreases of 0.6% in the ISA and 2.6% in the IE. The ICI fell 11% year-over-year, due to the changes of -10.7% in the ISA and -11.2% in the IE.

Labor Market

61. According to the General Record of Employment and Unemployment (Caged) of the Ministry of Labor and Employment (MTE), 209.1 thousand formal jobs were created in September, representing a 0.3% expansion compared to August. Out of this total, 91.8 thousand jobs were created in the services sector; 66.3 thousand in industry; 42.4 thousand in commerce and 25 thousand in civil construction. There was also the elimination of 20.9 thousand jobs in the agricultural sector. In the year, 1.8 million jobs were created, compared to 2.2 million in the same period of 2010.

62. According to the IBGE employment survey (PME), carried out in the six main metropolitan regions of the country, the unemployment rate reached 6% in August, stable related to July and 0.7 p.p. below the same period of the previous year. The monthly result stemmed from the increases of 0.7% in occupation and 0.6% in

the Economically Active Population (PEA). Considering seasonally adjusted data, the unemployment rate remained stable relative to July, at 5.9%. According to the same survey, average real earnings usually earned by workers reached the highest level of the historical series and registered increases of 0.5% month-on-month, 3.2% year-over-year and 3.7% in the year. As a result, the expansion of payroll showed variations of 1.2%, 5.4% and 6.1%, respectively, according the same comparison bases.

Credit and Delinquency Rates

63. Outstanding credit in the financial system reached R$1,889 billion in August, equivalent to 47.8% of GDP, increasing by 1.7% in the month, 10.7% in the year and 19.4% in twelve months. Non-earmarked credit operations increased by 1.4%, 9.9% and 17.9%, respectively, according to the same comparison basis, reflecting the respective increases of 1.3%, 9.9% and 18.2% for credit operations to individuals and 1.4%, 9.9% and 17.7% for credit operations to corporate. Earmarked credit operations increased 2.4% in the month, 12.3% in the year and 22.2% in twelve months, with highlights for the respective rises of 3.6%, 28.4% and 47.1% recorded in housing credit, according to the same comparison bases.

64. The average interest rate on reference credit operations remained stable at 39.7% in August. The average annual rate on credit for corporate reached 30.9%, representing a decrease of 0.5 p.p. relative to July, while those for individuals increased 0.5 p.p, reaching 46.2%.

65. The average tenure on reference credit operations increased to 493 days in August, representing an increase of seven days, month-on-month. The tenure related to corporate segments increased eight days, while the one related to individuals increased five days, reaching 407 days and 583 days, respectively.

66. The delinquency rate in the financial system (non-earmarked loans used as reference for interest rates, in arrears for more than ninety days) increased 0.1 p.p., reaching 5.3% in August. The delinquency rate for credit operations with corporate and to individuals increased 0.1 p.p., reaching 3.9% and 6.7%, respectively. The 15 to 90 day arrears percentage retreated 0.2 p.p. for the individual credit and remained stable for the corporate, reaching 6.2% and 2.2%, respectively.

External Environment

67. Global economy scenario still presents low dynamism. Indicators released in the US are conflicting, with most recent data to retail sales, job creation and industrial production, all from September, showing some recovery, while the index of consumer confidence, measured by the University of Michigan/Thomson Reuters, of September and the preliminary October figures registered new declines and the real earnings decreased in July and August. Real estate market is still depressed. In the Euro Area, economic activity prospects are more negative, inclusive by the possibility of fiscal and banking problems outbreak. Although industrial production has monthly increased by 1.2% in August, the manufacturing PMI registered 48.5 in September, the lowest level since October 2009, signaling the sector retraction. Retail sales, in August, retreated 0.2% monthly, while the economic confidence index, calculated by the European Commission, presented an expressive decline in the same month. In Japan, exports seem to lose pace, impacted by the global economy cooling, yen appreciation and the country energy restrictions. In China, economic activity keeps a smooth growth reduction, with third quarter GDP growing by 2.3%, compared to 2.4% in the previous quarter. In the year through September, GDP grew 9.4% compared to the same period of 2010, when economic activity grew by 10.4%.

68. Considering the high global economy uncertainties, financial markets operated in high volatility environment. Risk perception kept high, reflecting the European countries fiscal deterioration, the concerns of new recessive dip in the Euro Area and in the US and the uncertainties regarding the European banking system solvency, which resulted in important losses in the main stock markets, overall in the financial segment. Nevertheless, the release of above-than-expected indicators in the US and the announcement, by European authorities, of a plan designed to recapitalize its banking system favored risk perception reduction, allowing the Chicago Board Options Exchange Volatility Index (VIX) to be traded, on October 14th, below thirty points level for the first time since the start of August. Therefore, even though European countries and some Banks credit rate downgrade

occurred since the last Copom meeting, the main stock markets partially recovery, in the first two weeks of October, the losses incurred since the start of August. European debt market development continues to be determinant for the financial market evolution.

69. Commodities international prices, mainly metallic, registered important reductions since the last Copom meeting, reacting to the deterioration in the world economy prospect, to the risk aversion increase in the financial markets and to the consequent US dollar appreciation. Following financial market observed trend, commodities prices partially recovered in the first two weeks of October.

70. However, commodities prices reduction, specially energetic and agricultural ones, has not reversed the inflationary trend observed in the last months in the main developed economies. Annual price indexes (IPC) increased in the US, in August, to 3.8%, and in the Euro Zone and UK, to 3% and 5.2%, respectively, in September. In a diverse way, annual IPC in important emerging countries presented, in September, the second consecutive retreat in China and in Mexico to 6.1% and 3.1%, respectively, and the third in Russia, to 7.3%.

71. The US, Euro Area, Japan and UK central banks (Fed, ECB, BoJ and BoE) kept their respective interest rates in their last meetings. At the same time, these monetary authorities expanded their liquidity provision measures to their banking systems. The Fed announced actions to improve banking (Twist operation) and mortgage markets liquidity conditions. The ECB, on its turn, improved a series of refinancing operations, all of them to provide unlimited liquidity, in US dollar (in cooperation with other central banks) and in Euro, at fixed rates and different tenures, to the institutions with financing difficulty. The BoE increased it assets acquisition program by £75 billion, to £275 billion, and the BoJ extended the deadline to the adhesion and the effective period of easing of eligibility conditions for the participation in the program of funds provision to the institutions located in calamitous areas. In Switzerland, concerned about the strong local currency appreciation effects in its economy, the Swiss National Bank established, at the beginning of September, the lowest level of 1.2 Swiss Franc/Euro for its exchange rate. Since the last Copom meeting, the Israel and the Indonesia central banks reduced their basic rates by 0.25 p.p. to 3% and 6.5%, respectively, while the Reserve Bank of India increased, again, its borrowing rate in 0.25 p.p., to 8.25%.

Foreign Trade and International Reserves

72. The Brazilian trade surplus reached US$3.1 billion in September. Exports reached US$23.3 billion and imports, US$20.2 billion. In the year, the trade surplus totaled US$23 billion, 80.5% above the registered in 2010, according to the daily average criterion, reflecting expansions of 30.4% in exports and 25.6% in imports. In the year, total trade grew 28.1%, totaling US$357 billion, compared to US$277.2 billion in the same period of 2010.

73. International reserves reached US$349.7 billion in September, decreasing US$3.7 billion compared to August, due to the loss of US$4.3 billion caused by the rates' changes. Compared to December 2010, there was an increase of US$61.1 billion. The monetary authority's interventions accounted for net purchases of US$327 million in the domestic spot market in the month.

Money Market and Open Market Operations

74. Since the last Copom meeting, in August, the domestic interest rate yield curve decreased in all its length, especially in short and intermediate. In the domestic scenario, this movement was influenced by the expectation of monetary easing cycle that started in August and by the release of data signaling accommodation in the activity level. Regarding the external outlook, the increase in uncertainties stemming from the developments of European countries debt crisis, the release of economic indicators weaker than expected in the main economies and the reduction in commodities prices also contributed to the fall in interest rates. Between August 29th and October 17th, one- three- and six-month interest rates decreased 0.82 p.p., 0.99 p.p. and 0.87 p.p., respectively, while one- two- and three-year rates decreased, respectively, 0.71 p.p., 0.32 p.p. and 0.06 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 5.51%, on August 29th to 4.65% on October 17th, following the decline of twelve-month-ahead nominal rates.

75. On August 30th, the Central Bank carried out reverse exchange rate swap auction directed to the rollover of the contracts due on September 1st. This operation totaled the equivalent to US$650 million in notional value. On September 22nd and October 3rd and 4th, the Central Bank carried out traditional exchange rate swaps, in which it assumed short FX and long domestic interest rate positions. These operations totaled the equivalent to US$6.1 billion in notional value.

76. In its open market operations, the BCB carried out weekly, between August 30th and October 17th, repo operations borrowing R$29.0 billion for a six-month period. As a consequence, the average daily balance of the long operations decreased to R$177.2 billion. In the same period, the BCB also borrowed money through repo operations with tenures between twelve and thirty-three working days, increasing the average daily balance of short-term borrowing operations to R$163.9 billion. The BCB also borrowed money through 34 very short-term operations and carried out two-working-day management operations, at the end of the day. These operations had average daily balance of R$51.8 billion in the period. The average daily balance of the total stock of repurchase agreements of the Central Bank decreased from R$420.4 billion between July 19th and August 29th, to R$392.9 billion, between August 30th and October 17th. Considering the operations for the most recent period, the stock of repurchase agreements changed from R$396.2 billion, on August 29th, to R$398.7, on October 17th.

77. Between August 30th and October 17th, the National Treasury issuance regarding the traditional auctions raised a total of R$31.1 billion. The sale of fixed-rate securities reached R$23.6 billion, with R$21.7 billion via issuance of LTNs maturing in 2012, 2014 and 2015, and R$1.9 billion via NTN-Fs maturing in 2017 and 2021. Issuance of LFTs totaled R$2.2 billion, for securities maturing in 2018. Issuance of inflation-linked NTN-Bs reached R$5.3 billion, for securities maturing in 2016, 2018, 2020, 2022, 2030, 2040 and 2050.