BANCO CENTRAL DO BRASIL

Minutes of the 183rd Meeting of the Monetary Policy Committee (Copom)

Summary
Recent Economic Developments
Assessment of Inflation Trends
Monetary Policy Decision

Date: May 27th, 2014, from 4:13PM to 20:27PM, and May 28th from 4:50PM to 8:55PM

Place: BCB Headquarters meeting rooms – 8th floor on May 27th and 20th floor on May 28th – 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
Luiz Edson Feltrim
Sidnei Corrêa Marques

Department Heads (present on May 27th)
Bruno Walter Coelho Saraiva - International Affairs Department
Daso Maranhão Coimbra - Department of Banking Operations and Payments System
Eduardo José Araújo Lima - Research Department (also present on May 28th)
João Henrique de Paula Freitas Simão - Open Market Operations Department
Márcio Barreira de Ayrosa Moreira - Department of Foreign Reserves
Renato Jansson Rosek – Investor Relations and Special Studies Department
Tulio José Lenti Maciel – Economic Department

Other participants (present on May 27th)
Gustavo Paul Kurrle – Press Officer
Otávio Ribeiro Damaso – Chief of Governor ‘s Staff
Vanderléia Centenaro – Coordinator of Economic Department

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

Recent Economic Developments

1. Monthly inflation measured by the Extended Consumer Price Index (IPCA) changed 0.67% in April, 0.12 percentage points (p.p.) above the one recorded in April 2013 and 0.25 p.p. below the one recorded in March 2014. As a consequence, inflation in twelve months decreased to 6.28% in April (6.49% until April 2013). Market prices changed 7.04% in twelve months (8.09% until April 2013), and regulated prices, 3.79% (1.55% until April 2013). Among market prices, the prices of tradable goods increased 6.16% in twelve months (6.57% in April 2013) and the prices of non-tradable goods, 7.79% (9.94% in April 2013). On its turn, the prices of the food and beverages group, impacted by weather conditions, increased 7.38% in the same period (14% in April 2013), and the prices of services rose 8.99% (8.13% until April 2013). In short, available information suggest some persistence of inflation, which partially reflects the dynamics of prices in the services sector.

2. The average of the underlying monthly inflation measures, calculated by the BCB, changed from 0.67 % in March to 0.51% in April. As a consequence, on a twelve-month trailing basis, average inflation core reached 6.46% (0.43 p.p. above the one registered in April 2013). Specifically, the double weight core inflation changed

from 0.59% in March to 0.56% in April; the core inflation by exclusion of regulated prices and household food, from 0.88% to 0.41%; the non-smoothed trimmed means core inflation, from 0.70% to 0.50%; and the core by exclusion, which excludes ten household food items and fuels, from 0.58% to 0.52% and the smoothed trimmed means IPCA core inflation changed from 0.59% to 0.56%. The diffusion index stood at 70.0% in April (4.2 p.p. above the one recorded in April 2013).

3. The General Price Index (IGP-DI) increased 0.45% in April, after increasing 1.48% in March, and 8.10% on a twelve-month trailing basis (6.83% in April 2013). The main component of this indicator, the Wholesale Price Index (IPA), changed 8.76% in twelve months (7.02% in April 2013), with increases of 11.23% in the prices of agricultural products and of 7.82% in the prices of industrial products. Inflation measured by the Consumer Price Index (IPC), the second most important component of the IGP-DI, changed 6.36% in twelve months through April (6.17% in April 2013). The Civil Construction National Index (INCC), component with the lowest weight in the IGP-DI, changed 7.96% (7.16% in April 2013), partially driven by pressures stemming from the labor cost, which increased 9.05% in the period. On its turn, the Producer/Manufacturing Industry Price Index (IPP/IT), calculated by the Brazilian Institute of Geography and Statistics (IBGE), changed -0.38% in April and 7.96% in twelve months. The Copom considers that the effects of the behavior of wholesale prices on consumer inflation will depend on the current and prospective demand conditions and on the price setters' expectations regarding the future inflation path.

4. The Economic Activity Index of the BCB (IBC-Br) incorporates estimate for the monthly production of the three sectors of the economy, as well as for taxes on products, and constitutes important coincident indicator of the economic activity. In March 2014, IBC-Br changed -0.09% year-over-year and, seasonally adjusted, -0.11% month-on-month.The composite Purchasing Managers' Index (PMI) regarding Brazil pointed stability of the economic activity in April, with the first decline in manufacturing in eight months and moderate expansion in the service sector. On its turn, the Consumer Confidence Index (ICC), from the Getúlio Vargas Foundation (FGV), fell 3.3% between April and May 2014 and remains below the historical average of the index. On the other hand, the industrial businessmen confidence, measured by the Industry Confidence Index (ICI), decreased in May, showing the greatest negative change at the margin since December 2008. With the sequence of falls started in January 2014, the index remains below the historical average for the 15th consecutive month. The Services Confidence Index (ICS) also retreated in May, reaching the lowest level since April 2009 and featuring the biggest monthly decline since December 2008. Regarding agriculture, the Agricultural Production Systematic Assessment (LSPA), carried out by the IBGE in March 2014, indicates that grains production is expected to grow by 0.7% in 2014, relative to the 2013 harvest.

5. The industrial activity decreased 0.5% in March, after being stable in February, according to the seasonally adjusted series, released by the IBGE. According to the observed series, year-over-year, industrial production fell 0.9% in March. Thus, the industrial sector accumulated increase of 0.4% in the first three months of the year. The decline in industrial activity from February to March was characterized by negative results, reaching two of the four major economic categories and 14 of the 24 segments surveyed. The PMI indicator for the industrial sector indicates contraction of the Brazilian production in April. According to data released by the National Confederation of Industry (CNI), the real earnings in the manufacturing industry fell 6.3% from February to March 2014, according to the seasonally adjusted series, representing the largest monthly drop since November 2008.

6. Among the use categories, year-over-year, capital goods (-8.4%) and durable consumer goods (-4.6%) reported in March 2014 more severe declines than the national average (-0.9%). The intermediate goods production also decreased 0.1% in this month and the semi and non-durable goods sector was the only one to post a positive rate (1.7%). Regarding growth accumulated in the last twelve months through March, there were expansions in the production of capital goods (8.9%) and durable consumer goods (3.9%). The production of semi and non-durable consumer goods and intermediate goods also increased 3% and 0.7%, respectively, according the same comparison basis.

7. According to the Monthly Employment Survey (PME), covering six metropolitan areas, the unemployment rate without seasonal adjustment reached 4.9% in April, representing reductions of 0.1 p.p. month-on-month and 0.9 p.p. year-over-year. According to the BCB seasonally adjusted series, the unemployment rate reached

4.6%, a record low for the series. Still according to the PME, the average real income increased 2.6% in April, year-over-year, and the real payroll increased 3.6%, according to the same comparison basis. Data released by the Ministry of Labor and Employment (MTE) show that 105.4 thousand formal jobs were created in April, representing the lowest net generation for the month since 1999. In short, the available data indicate narrow idleness margin in the labor market, although there are some signs of moderation at the margin.

8. According to the retail monthly survey (PMC), released by the IBGE, the retail sales volume decreased 1.1% in March, compared to March 2013. On its turn, broad retail sales volume, which includes vehicles and construction inputs, decreased 5.7% in March, according to the same comparison basis. The month-on-month changes were -0.5% and -1.2%, respectively, according to the seasonally adjusted series. In twelve months, the broad retail sales growth rate was 3.2%, with expansion in eight out of the ten surveyed segments. The Trade Confidence Index (ICOM), measured by the FGV, continued downward trend in May affected by the decreases both in the degree of satisfaction with the present situation as well as in the optimism for the following months. The average index for the quarter stood at 117.4 points, the lowest for the historical series started in March 2010. The Copom evaluates that the retail sales trajectory will continue to be influenced by governmental transfers, by the pace of real payroll growth and by the moderate credit expansion.

9. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by the FGV, without seasonal adjustment, reached 84.1% in May. According to the seasonally adjusted series calculated by the FGV, the Nuci in March reached 84.3%. Among the use categories of industry, the ones showing the highest Nuci, according to the seasonally adjusted series, are construction material (88.8%) and non-durable consumer goods (81.7%), followed by intermediate goods (86.2%), durable consumer goods (83.7%) and capital goods (81.7%). On its turn, the absorption of capital goods grew 7.2% in the last twelve months through March.

10. The twelve-month trailing trade balance result reached US$3.1 billion in April. This result stemmed from US$240 billion in exports and US$236.9 billion in imports, with advances of 0.3% and 3.2%, respectively, compared to the twelve months through April 2013. On its turn, the current account deficit accumulated in twelve months reached US$81.6 billion in April, equivalent to 3.7% of the GDP. On the other hand, foreign direct investment totaled US$64.5 billion, according to the same comparison basis, equivalent to 2.9% of the GDP.

11. Regarding the global economy, leading indicators signal growth prospects in line with advanced and emerging economies. Specifically about Europe, despite recent improvements, high unemployment rates coupled with the fiscal consolidation and political uncertainties still constitute elements constraining investments and growth. Regarding the monetary policy, the Federal Reserve has continued the process of gradual reduction of the assets purchase program and by and large, accommodative stances prevail in the advanced economies. In the emerging economies, in general, the monetary policy is less expansionist. Inflation remains at moderate or low levels in advanced economies and at high levels in emerging economies.

12. The price of the Brent oil barrel has remained at a level near US$110 since the previous Copom meeting. It bears highlighting that the geopolitical complexity that involves the oil sector tends to heighten the volatile behavior of prices, which also reflects the low predictability of some global demand components and the dependency of supply growth on long term risky investment projects. Since the last Copom meeting, the international prices of agricultural commodities have increased 2.3% and those relative to metals have increased 1.8%. On its turn, the Food Price Index, calculated by the Food and Agriculture Organization of the United Nations (FAO), retreated 3.5% in the twelve months through April 2014.

Assessment of Inflation Trends

13. The identified shocks, and their impacts, were reassessed according to the new set of available information.

14. For the set of regulated prices inflation, the projected adjustment is 5% in 2014, same value considered in the April Copom meeting. This projection considers gasoline and bottled gas price changes (respectively 1.8%

and 0.5%) until April, as well as assumptions of a 4.2% reduction in fixed telephone tariffs and the increase of 11.5% in electricity prices. The items for which there are more available information were projected individually and, for the others, projections are based on endogenous determination models for regulated prices, which compute, among other factors, seasonal components, market prices inflation and the IGP (General Price Index) change. Based on these models, the projected regulated prices change is 5% for 2015, same value considered in the last Copom meeting.

15. The estimate path for the spreads over the Selic rate, based on the 360-day swap rates, on the baseline scenario, projects 26 basis point (bps) and 7 bps for the fourth quarters of 2014 and 2015, respectively.

16. The structural primary surplus that derives from the primary surplus trajectories, both for 2014 and 2015, according to the parameters set out in the Budget Guidelines Law (LDO)/2014 and in the Budget Guidelines Law Project (PLDO)/2015, respectively, is considered as the fiscal indicator. Therefore, in a given period, the fiscal impulse corresponds to the variation of the structural surplus in comparison to the observed in the previous period.

17. Since the last Copom meeting, the median of the projections compiled by the Investor Relations and Special Studies Department (Gerin) for the 2014 IPCA increased to 6.47% from 6.30%. For 2015, the median of the inflation projections increased to 6.00% from 5.80%.

18. The baseline scenario assumes the maintenance of the exchange rate at R$2.20/US$1.00 and the Selic rate at 11.00% p.a. during the forecast period. Under this scenario, the projection for the 2014 inflation decreased, compared to the value considered at the previous Copom meeting, but remains above the 4.5% midpoint target established by the National Monetary Council (CMN). According to the market scenario, which incorporates the market expectations for the exchange and Selic rates trajectories collected by Gerin, in the period immediately prior to the Copom meeting, the 2014 IPCA inflation forecast also decreased relative to the value considered at the April meeting, but remains above the inflation target. For 2015, according to the baseline scenario, the inflation forecast decreased relative to the value considered in the April Copom meeting, but it stands above the midpoint inflation target. According to the market scenario, on the other hand, the inflation forecast for 2015 remains relatively stable, above the target.

Monetary Policy Decision

19. The Copom emphasizes that the international evidence, which is ratified by the Brazilian experience, indicates that high inflation rates generate distortions that lead to higher risks and depress investments. These distortions are manifested, for example, in the shortening of the planning horizons of households, companies and governments, as well as in the deterioration of the businessmen confidence. The Committee also emphasizes that high inflation rates reduce the purchasing power of wages and transfers, with negative repercussions over households' confidence and consumption. Therefore, high inflation rates reduce the growth potential of the economy, as well as of jobs and income generation.

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

21. The Copom considers that, since its last meeting, the risks to global financial stability have remained high, particularly those derived from changes in the yield curve slope of major advanced economies. Despite identifying low probability of occurrence of extreme events in the international financial markets, the Committee considers that the external environment remains complex. For the Committee, despite recently released data have been less positive than anticipated, the prospects for more intense global activity throughout the relevant horizon for the monetary policy have remained. In fact, there are improvements in advanced economies, including countries from the Euro Area, although, in general, the space to use monetary policy remains limited and the fiscal restraint scenario prevails in this and in the upcoming years. In important emerging economies, however, the activity pace has not matched the expectations, despite the resilience of the domestic demand. The Committee also highlights that, despite recently observed localized pressures, the prospects indicate moderation in the dynamics of commodities' prices in the international markets, as well as that, in the currency markets, there is evidence of tension and volatility.

22. The Copom evaluates that the domestic activity expansion pace tends to be less intense this year, compared to 2013, as well that, in the medium term, important changes must take place in the composition of aggregate supply and demand. The Copom notes that the expansion rates of domestic absorption have been higher than the GDP rates, but both tend to converge. In this context, the consumption tends to grow at a more moderate pace than the observed over the recent years; and the investments tend to gain momentum. Regarding the external component of aggregate demand, the scenario of greater global growth, combined with the depreciation of the real, contributes to make this component more favorable to the Brazilian economy growth. Focusing on the supply side, the Committee evaluates that, in the long term, more favorable prospects for the competitiveness of industry and agriculture have emerged; and that the services sector tends to grow at rates lower than those recorded over the recent years. It is plausible to claim that these developments - coupled with advances in terms of qualification of the labor force and with the program of public services concession - will be reflected in a more efficient allocation of the production factors of the economy and in productivity gains. The Committee also highlights that the speed of materialization of the aforementioned changes and their resulting gains depends on the strengthening of companies' and households' confidence.

23. The Copom observes that the main inflation scenario considers the materialization of the assumed trajectories regarding fiscal variables and the arising of the conditions so that, in the relevant horizon for monetary policy, the balance of the public sector shifts to the neutral zone. The Committee also notes that the generation of primary surpluses in line with the working hypotheses considered in the inflation projections, on the one hand, would contribute to reduce the mismatch between supply and demand growth rates; on the other hand, it would contribute to create a positive perception regarding the macroeconomic environment in the medium and long terms. It also bears emphasizing that the generation of primary surpluses at levels close to the average generated over the recent years would contribute to reduce the public debt financing cost, with favorable impact on the cost of capital in general, which would stimulate private investment in the medium and long terms.

24. The Copom highlights that its main scenario also considers moderate credit expansion. Still regarding the credit market, the Committee considers opportune initiatives with the aim of moderating concessions of subsidies through credit operations.

25. Regarding the factors market, the Copom highlights the narrow idleness margin in the labor market and it considers that, under such circumstances, a significant risk stems from the possibility of concession of wages increases incompatible with productivity growth and their negative impacts over inflation. Although the projected adjustment for the minimum wage this year is not as significant as in the previous years, and considering the occurrence of real wage changes more consistent with the gains estimated for the labor productivity over the recent quarters, the Committee evaluates that the wages dynamics remains originating inflationary cost pressures.

26. The Copom evaluates that the high consumer inflation level in the last twelve months contributes for the resilience of inflation. This development is underpinned by two important relative prices adjustments processes now underway in the economy - the realignment of domestic prices relative to international prices and the realignment of regulated prices in relation to market prices. The Committee recognizes that these

adjustments in relative prices have direct impacts on inflation and reaffirms its view that monetary policy can and should contain the second order effects arising from them. By the way, in order to fight these and other inflationary pressures, in the last twelve months, the monetary conditions were tightened, but the Committee evaluates that the effects of the Selic rates hikes on inflation are, in part, yet to materialize. Moreover, it is plausible to claim that, in the presence of relatively low levels of confidence, the effects of monetary policy actions on inflation tend to be potentialized.

27. Therefore, assessing the evolution of the macroeconomic scenario and the inflation prospects, the Copom unanimously decided, at this moment, to maintain the Selic rate at 11% p.a., without bias.

28. The following members of the Committee voted for this decision: Alexandre Antonio Tombini (Governor), Aldo Luiz Mendes, Altamir Lopes, Anthero de Moraes Meirelles, Carlos Hamilton Vasconcelos Araújo, Luiz Awazu Pereira da Silva, Luiz Edson Feltrim and Sidnei Corrêa Marques.

29. The Copom evaluates that the aggregate demand tends to be relatively robust. On the one hand, household consumption tends to record a moderate expansion pace, due to the effects of stimulus factors, such as income growth and moderate credit expansion; on the other hand, relatively favorable financial conditions, concession of public services, broadening of oil exploration areas, among other factors, tend to support the expansion of investments. These elements and the developments in the quasi fiscal framework and in the assets market are important parts of the context in which future monetary policy decisions will be taken, aiming to ensure the timely convergence of inflation to the targets path.

30. The Copom highlights that, in moments such as the current one, the monetary policy should remain vigilant, in order to minimize risks that high inflation levels, such as the one observed in the last twelve months, persist in the relevant horizon for the monetary policy.

31. At the end of the meeting, it was announced that the Committee will reconvene on July 15th, 2014, for the technical presentations, and on the following day, to discuss monetary policy, as established in the Communiqué 24,064, of June 12th, 2013.