



BANCO CENTRAL DO BRASIL

Minutes of the 185th Meeting of the Monetary Policy Committee (Copom)

Summary

Recent Economic Developments
Assessment of Inflation Trends
Monetary Policy Decision

Date: September 2nd, 2014, from 4:19PM to 7:28PM, and September 3rd from 4:43PM to 7:22PM

Place: BCB Headquarters meeting rooms – 8th floor on September 2nd and 20th floor on September 3rd – 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 September 2nd)

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 September 3th)
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 September 2nd)

Gustavo Paul Kurrle – Press Officer
Otávio Ribeiro Damaso – Chief of Governor's Staff
Rodrigo Lage de Araújo – Coordinator of the 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 0.01% in July, 0.02 percentage points (p.p.) below the one recorded in July 2013 and 0.39 p.p. below the one recorded in June 2014. As a consequence, inflation in twelve months reached 6.50% in July (6.27% in July 2013). Market prices changed 7.07% in twelve months (7.86% in July 2013), and regulated prices, 4.63% (1.31% in July 2013). Among market prices, the prices of tradable goods increased 7.11% in twelve months (6.81% in July 2013) and the prices of non-tradable goods, 7.04% (8.80% in July 2013). On its turn, the prices of the food and beverages group increased 7.70% in the same period (11.41% in July 2013), and the prices of services rose 8.45% (8.48% until July 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 0.62 % in June to 0.19% in July. As a consequence, on a twelve-month trailing basis, average core inflation reached



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6.66% (0.40 p.p. above the one registered in July 2013). Specifically, the double weight core inflation changed from 0.61% in June to 0.21% in July; the core inflation by exclusion of regulated prices and household food, from 0.73% to 0.01%; and the core by exclusion, which excludes ten household food items and fuels, from 0.71% to 0.19%. On its turn, the non-smoothed trimmed means IPCA core inflation changed from 0.47% to 0.17%; and the smoothed trimmed means IPCA core inflation, from 0.56% to 0.35%. The diffusion index stood at 59.0% in July (3.9 p.p. above the one recorded in July 2013).

3. The General Price Index (IGP-DI), after decreasing 0.63% in June, decreased 0.55% in July, reaching 5.05% on a twelve-month trailing basis (4.84% in July 2013). The main component of this indicator, the Wholesale Price Index (IPA), changed 3.97% in twelve months (4.02% in July 2013), with increases of 1.88% in the prices of agricultural products and of 4.76% in the prices of industrial products. Inflation measured by the Consumer Price Index (IPC), the second most important component of the IGP-DI, changed 6.85% in twelve months through July (5.80% in July 2013). The Civil Construction National Index (INCC), component with the lowest weight in the IGP-DI, changed 7.51% (7.80% in July 2013), partially driven by pressures stemming from the labor cost, which increased 8.48% in the period. On its turn, the Producer/Manufacturing Industry Price Index (IPP/IT), calculated by the Brazilian Institute of Geography and Statistics (IBGE), decreased 0.29% in July, changing 3.45% 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 estimates 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 June 2014, the IBC-Br changed -2.15% year-over-year and, seasonally adjusted, -1.48% month-on-month. The composite Purchasing Managers' Index (PMI) regarding Brazil reached 49.6 in August, pointing to marginal decline in the private sector production for the fifth consecutive month, with the first increase in manufacturing sector since March being partially offset by a moderate decrease in the service sector. On its turn, the Consumer Confidence Index (ICC), from the Getúlio Vargas Foundation (FGV), after increasing for two months, decreased 4.3% in August, reaching the lowest level since April 2009. The industrial businessmen confidence, measured by the Industry Confidence Index (ICI) and the Services Confidence Index (ICS), both from FGV, decreased in August for the eighth consecutive month and both also reached the lowest level since April 2009. Regarding agriculture, the Agricultural Production Systematic Assessment (LSPA), carried out by the IBGE in July 2014, indicates that grains production is expected to grow by 2.6% in 2014, relative to the 2013 harvest.
5. The Gross Domestic Product (GDP) decreased 0.6% in the second quarter of 2014, after decreasing 0.2% in the previous quarter, according to data seasonally adjusted by the IBGE. Year-over-year, it decreased 0.9% in the second quarter (compared to 1.9% in the first quarter). Focusing on the aggregate demand side, household consumption increased 0.3% in the second quarter of 2014 quarter-over-quarter, according to seasonally adjusted data, and 1.2% compared to same quarter of 2013. On its turn, the government consumption decreased 0.7% at the margin and expanded 0.9% compared to the same quarter of the previous year. The fixed capital gross formation (FBCF) decreased 5.3% quarter-over-quarter and 11.2% compared to the same quarter of 2013.
6. After decreasing for five consecutive months, the industrial activity increased 0.7% in July, according to the seasonally adjusted series, released by the IBGE. According to the observed series, year-over-year, industrial production decreased 3.6% in July, accumulating a decrease of 2.8% in the year. Compared to the same month of the previous year, negative results were observed in 3 out of the 4 main economic categories and in 16 out of the 26 surveyed branches. According to data released by the National Confederation of Industry (CNI), real revenue in the manufacturing industry decreased 5.7% between May and June 2014, according to the seasonally adjusted series. The PMI of the industrial sector, on its turn, indicates, in August, the first expansion in five months.
7. Among the use categories, according to the July month-over-month and seasonally adjusted data series, the highest increase was observed in durable consumer goods (20.3%), followed by capital goods (16.7%) and semi- and non-durable goods (0.7%). On the other hand, intermediate goods decreased (0.3%). Regarding



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year-over-year growth, only semi- and non-durable goods increased (0.6%). Yet, the durable, capital and intermediate goods sectors decreased 13.7%, 6.4% and 3.6%, respectively.

8. The IBGE data released by the Monthly Employment Survey (PME) in July 2014 covered only 4 out of the 6 metropolitan areas usually surveyed, due to the IBGE's employees' strike. In this sense, data referring to Salvador and Porto Alegre are yet to be released. Month-on-month, the unemployment rate in July remained stable in the four metropolitan areas whose results were released. Year-over-year, the unemployment rate declined 1.1 p.p. in Rio de Janeiro, 1.0 p.p. in Recife, 0.9 p.p. in São Paulo and 0.2 p.p. in Belo Horizonte. Data released by the Ministry of Labor and Employment (MTE) show that 11.8 thousand formal jobs were created in July, the lowest net generation for the month since 1999. In short, the available data indicate narrow idleness margin in the labor market, although evidences show some signs of accommodation at the margin.
9. According to the retail monthly survey (PMC), released by the IBGE, the retail sales volume increased 0.8% in June, compared to June 2013. On its turn, broad retail sales volume, which includes vehicles and construction inputs, decreased 6.1% in June, according to the same comparison basis. The month-on-month changes were -0.7% and -3.6%, respectively, according to the seasonally adjusted series. In twelve months, the broad retail sales growth rate stood at 1.9%, with expansion in eight out of the ten surveyed segments. The Trade Confidence Index (ICOM), measured by the FGV, fell in August, reflecting the deterioration of the current scenario, and reached the new historical low since 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.
10. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by the FGV, without seasonal adjustment, reached 83.6% in August and, according to the seasonally adjusted series, it reached 83.2%. Among the industry use categories, the ones showing the highest Nuci, according to the seasonally adjusted series, are construction material (88.2%) and intermediate goods (84.7%), followed by durable consumer goods (83.1%), capital goods (81.2%) and non-durable consumer goods (80.5%). On its turn, the absorption of capital goods decreased 0.4% in the last twelve months through June.
11. The twelve-month trailing trade balance result reached US\$6.4 billion in August. This result stemmed from US\$239.4 billion in exports and US\$233.0 billion in imports, with increase of 0.3% and decrease of 1.3%, respectively, compared to the twelve months through August 2013. On its turn, the current account deficit accumulated in twelve months reached US\$78.4 billion in July, equivalent to 3.5% of the GDP. On the other hand, foreign direct investment totaled US\$64.0 billion, according to the same comparison basis, equivalent to 2.8% of the GDP.
12. Regarding the global economy, leading indicators signal growth prospects in line with the trend in important advanced and emerging economies. Particularly about Europe, despite recent improvements, high unemployment rates, coupled with the fiscal consolidation and political uncertainties constitute elements constraining investments and growth. Regarding the monetary policy, the Federal Reserve has continued the process of reduction of the assets' purchase and, in general, accommodative stances prevail in the advanced economies. In the emerging economies, less accommodative monetary policy stances prevail. Inflation remains at moderate or low levels in the advanced economies; and, in the emerging ones, it stands at higher levels.
13. The price of the Brent oil barrel has remained at a level near US\$105 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. This volatile behavior also reflects the low predictability of some global demand components and the fact that supply growth depends on long term risky investment projects. Since the last Copom meeting, the international prices of agricultural and metal commodities have fallen 2.70% and 0.14%, respectively. On its turn, the Food Price Index, calculated by the Food and Agriculture Organization of the United Nations (FAO), fell 1.7% in the twelve months through July 2014.



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Assessment of Inflation Trends

14. The identified shocks, and their impacts, were reassessed according to the new set of available information.
15. For the set of regulated prices inflation, the projected adjustment is 5% in 2014, the same value considered in the July Copom meeting. This projection considers gasoline and bottled gas price changes until July (-0.1% and 0.6%, respectively), as well as assumptions of a 6.3% reduction in fixed telephone tariffs and the increase of 16.8% in electricity prices. The items for which there are more information were projected individually, and for the others, the 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 6% for 2015, the same value considered in the July Copom Meeting. For 2016, the projected regulated price change is 4.9%, against 4.8% considered in the July Copom meeting.
16. The estimate path for the spreads over the Selic rate, based on the 360-day swap rates, on the baseline scenario, projects 51 basis point (bps) and 0 bps for the fourth quarters of 2014 and 2015, respectively.
17. The structural primary surplus is considered as the fiscal indicator. It 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. 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.
18. Since the last Copom meeting, the median of the projections compiled by the Investor Relations and Special Studies Department (Gerin) for the 2014 IPCA fell from 6.48% to 6.27%. For 2015, the median of the inflation projections increased from 6.10% to 6.29%.
19. The baseline scenario assumes the maintenance of the exchange rate at R\$2.25/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 fell, 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). In 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 fell relative to the value considered at the July meeting, but remains above the inflation target. For 2015, according to both scenarios, the inflation forecast remained stable above the inflation target; and, for the early quarters of 2016, the forecasts indicate that inflation enters in a convergence path.

Monetary Policy Decision

20. 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.
21. 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



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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.

22. 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. There are improvements in advanced economies, with recovery of activity in some countries and acceleration in the pace of growth in others, although, in general, the space to use monetary policy in these economies 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 highlights the evidences of tension and volatility focuses in the currencies' markets, as well as the prospects of moderation in the dynamics of commodities' prices in the international markets, despite recently observed localized pressures.
23. The Copom considers that the expansion rates of domestic absorption and GDP rates have converged; and that the domestic activity expansion pace tends to be less intense this year, compared to 2013. In the medium term, the Committee evaluates that important changes must take place in the composition of aggregate supply and demand. 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 BRL, 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. For the Committee, 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 depend on the strengthening of companies' and households' confidence.
24. 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 the 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 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.
25. The Copom highlights that its main scenario also considers moderate credit expansion. It's important to highlight the fact that, after years of strong expansion - cooled with the introduction of macroprudential measures at the end of 2010 - the credit market oriented to consumption underwent a moderation, so that, over the recent quarters it was possible to observe, on the one hand, exposure reduction by banks, and on the other hand, deleveraging of the households. In the aggregate, therefore, it can be inferred that the risks in the consumer credit segment have been mitigated. In another dimension, the Committee considers opportune initiatives with the aim of moderating concessions of subsidies through credit operations.
26. 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



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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.

27. For the Copom, the the fact that inflation currently stands at high levels reflects, in part, the occurrence of 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 relative 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, the monetary conditions were tightened, but the Committee evaluates that the effects of the Selic rates hikes on inflation, in part, will still 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.
28. 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.
29. 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.
30. The Copom evaluates that the aggregate demand tends to be relatively robust in the relevant horizon for monetary policy. 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, the concession of public services, the 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.
31. Although inflation is still in high level, the Copom evaluates that ongoing inflationary pressures present at the economy – as those stemming from the processes of prices realignments previously mentioned and from wage gains incompatible with productivity gains – tend to cool down or, even, to exhaust throughout the relevant horizon for the monetary policy. Considering shorter periods, the shift of the output gap to the disinflationary side should be added. In this context, it is plausible to claim that, considering the maintenance of the monetary conditions – that means, the strategy that does not include the reduction of the monetary policy instrument –, the inflation tends to enter in a trajectory of convergence to the target in the final quarters of the projection horizon.
32. 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.
33. At the end of the meeting, it was announced that the Committee will reconvene on October 28th 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.