BANCO CENTRAL DO BRASIL

Minutes of the 167th Meeting of the Monetary Policy Committee (Copom)

Summary

Date: May 29th, 2012, from 4:16PM to 7:11PM, and May 30th, from 4:49PM to 7:55PM

Place: BCB Headquarters meeting rooms – 8th floor on May 29th and 20th floor on May 30th – 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 May 29th)
Adriana Soares Sales – Research Department (also present on May 30th)
Bruno Walter Coelho Saraiva – International Affairs Department
Daso Maranhão Coimbra – Department of Banking Operations and Payments System
João Henrique de Paula Freitas Simão - Open Market Operations Department
Márcio Barreira de Ayrosa Moreira - Department of Foreign Reserves
Renato Jansson Rosek – Investor Relations and Special Studies Department
Tulio José Lenti Maciel – Economic Department

Other participants (present on May 29th)
Gustavo Paul Kurrle – Press Officer
Otávio Ribeiro Damaso – Chief of Governor ‘s Staff

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. Monthly inflation measured by the Extended Consumer Price Index (IPCA) reached 0.64% in April (0.21% in March and 0.45% in February), resulting in the seventh consecutive retreat of twelve-month trailing inflation, which moved from 5.24% in March to 5.10% in April (6.51% in April 2011). Market prices inflation increased 5.63% in the twelve months through April (6.84% in April 2011), while regulated prices inflation reached 3.73% (5.73% in April 2011). Regarding market prices, it bears highlighting that tradable goods inflation increased 3.36% in the twelve months through April, while inflation related to non-tradable goods increased 7.69%, compared to 6.03% and 7.55% in the same period of 2011, respectively. Specifically on services, inflation in

this segment reached 0.77% in April, after rising 0.52% in March, totaling 8.00% in the twelve months through April (down from 8.57% registered in April 2011). In short, despite the fact that services inflation still remains at high levels, the set of available information suggests a declining trend of inflation on a twelve-month accumulated basis towards the inflation target.

2. Underlying inflation measures calculated by the BCB, in general, have performed similarly to headline inflation. The average of monthly changes moved from 0.46% in February to 0.25% in March and 0.60% in April. On its turn, on a twelve-month trailing basis, the average change of the five core inflation measures moved from 6.10% in February to 5.69% in March and 5.72% in April. The smoothed trimmed means IPCA core inflation moved from 0.41% in February to 0.28% in March and 0.51% in April, while the non-smoothed trimmed means core inflation changed from 0.28% to 0.27% and 0.50% in the same period. Similarly, the double weight core inflation, after registering 0.47% in February, retreated to 0.26% in March and increased to 0.61% in April. At the same time, core inflation by exclusion, which excludes ten household food and fuels items, decreased from 0.60% in February to 0.21% in March and increased to 0.69% in April; and the core inflation by exclusion of regulated prices and household food changed from 0.54% in February to 0.22% in March and 0.71% in April. On its turn, the average quarterly rate of the IPCA diffusion index changed from 62.69% in February to 60.16% in March and 59.98% in April.

3. The General Price Index (IGP-DI) increased 1.02% in April, after increasing 0.56% in March and 0.07% in February. Thus, on a twelve-month trailing basis, the IGP-DI reached 3.86% (6.99 percentage points (p.p.) below that registered in April 2011). The main component of this indicator, the Wholesale Price Index (IPA), changed 2.82% in the twelve months through April, reflecting an increase of 3.28% in the industrial IPA and 1.57% in the agricultural IPA. According to the breakdown by stage of production, there were increases in the prices of raw materials (1.71%), intermediate goods (3.23%) and final goods (3.33%), according to the same comparison basis. Inflation measured by the Consumer Price Index (CPI), the second most important component of the IGP-DI, stood at 5.05% in the twelve months through April (6.05% in April 2011). The Civil Construction National Index (INCC), component with the lowest weight in the IGP-DI, changed 7.77%, driven by the increase in labor cost. On its turn, the Producer/Manufacturing Industry Price Index (IPP/IT), calculated by the Brazilian Institute of Geography and Statistics (IBGE), increased 1.38% in April, after a rise of 1.04% in March. In twelve months, this index changed from 1.36% in March to 2.47% in April. The Copom considers that the effects of the behavior of wholesale prices on inflation for consumers will depend on the current and prospective conditions of the demand and on the price setters' expectations regarding the future inflation trend.

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 an important coincident indicator of economic activity. Considering seasonally adjusted data, the IBC-Br decreased by 0.4% in March, the same change observed in February, after a fall of 0.3% in January. Thus, the indicator increased 0.15% in the first quarter of 2012, quarter-over-quarter, and increased 1.1% year-over-year. In twelve months, the growth rate has been slowing since November 2010, and reached 1.8% in March. On its turn, the Consumer Confidence Index (ICC), from Getúlio Vargas Foundation (FGV), recorded slight decline in May, after reaching, in April, the highest level of the series started in September 2005. The Confidence Index Sector Services (ICS) decreased in April, after recording increases in February and March.

5. Industrial activity retreated by 0.5% in March, according to data seasonally adjusted by the IBGE, after growing by 1.3% in February and retreating by 1.6% in January. Only nine of the 27 branches of activity grew in March, especially the automotive vehicles sector, which expanded by 26.2% in February and March, offsetting part of the 31.2% drop recorded in January. On a quarterly moving average basis, industrial production decreased 0.3% from January to March. Year-over-year, production decreased 2.1% in March, while on a twelve-month accumulated basis, it decreased by 1.1%. On the other hand, compared to December 2008, month with the lowest output level during the 2008/09 crisis, the accumulated growth until March 2012 reaches 21.4%. According to seasonally adjusted data from the National Industry Confederation (CNI), revenues in the manufacturing industry recorded 3.6% real growth in March, year-over-year, with an increase of 0.7% in the number of hours worked according to the same comparison basis.

6. Among the industry use categories, according to data seasonally adjusted by the IBGE, capital goods production grew by 3.8% in March and production of durable consumer goods increased by 3.4%. The production of intermediate goods retreated by 0.9% and the production of semi-durable and nondurable consumer goods fell by 0.8%. In the twelve months through March, there were decreases in the production of capital goods (-1.5%), durable consumer goods (-6.1%), intermediate goods (-0.5%), and semi-durable and non-durable consumer goods (-0.3%).

7. The unemployment rate in the six metropolitan regions covered by the IBGE Monthly Labor Survey (PME), according to observed data, stood at 6.0% in April, after recording 6.2% in March and 5.7% in February. The index in April was 0.4 p.p. below the one recorded in the same month last year. According to data seasonally adjusted by the BCB, the unemployment rate reduced from 5.8% in March to 5.6% in April, close to the record low of the series initiated in March 2002. In twelve months, there were increases of 1.8% in the occupation level and 1.3% in the economically active population. Regarding occupied population, the share of formal employees in the private sector – which has been growing consistently in the last years – reached 48.9% in April, but data released by the Ministry of Labor and Employment (MTE) continue indicating certain moderation in this process. In fact, in April, 217.0 thousand formal jobs were created (compared to 272.2 thousand jobs created in April 2011). The slower growth of the economically active population in the recent period has contributed to the maintenance of low employment rates, despite the moderation in the pace of job creation. According to PME, real average earnings increased 6.2% in twelve months, although it had retracted 1.2% in April. As a consequence, real payroll, considering the average earnings of occupied population in the six metropolitan regions, expanded 8.1% year-over-year. In short, the set of available data indicates that, although the labor market remains robust, there are signs of moderation at the margin.

8. According to the retail monthly survey (PMC) from IBGE, expanded retail sales increased 10.2% in March, year-over-year, after growing by 3.1% in February and 8.3% in January, according to the same comparison basis. According to the seasonally adjusted series, expanded retail sales increased by 0.6% in March, month-on-month, after decreasing by 0.8 in February and increasing 1.8% in January. Thus, the accumulated rate of growth in twelve months stood at 6.7% in March. The volume of sales in all ten sectors surveyed expanded in the last twelve months, with highlights for office, computing and communication equipment and material (24.8%) and furniture and appliances (16.4%). Since October 2011, the FGV, in partnership with the BCB, has been releasing the Trade Confidence Index (ICOM). This indicator provides important additional information, as it portrays the current outlook and signals the evolution of commercial activity in a more timely manner. In April, the index evolved positively by the second consecutive month, boosted by the improvement in expectations. In the upcoming months, the retail sales trajectory will continue to be influenced by governmental transfers, by the pace of real payroll growth, by the improvement in the consumer confidence level and by moderate credit expansion.

9. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by the FGV, without seasonal adjustment, moved from 83.5% in April to 83.7% in May, 0.4 p.p. below the level observed in May 2011. According to the seasonally adjusted series calculated by the FGV, the Nuci stood at 84.0% in May (2.7 p.p. below the record high recorded in June 2008). Capacity utilization is more significant in the sector of construction inputs (87.2%), but has retreated since November 2011. In the sector of intermediate goods, the Nuci stood at 85.3%, compared to 82.5% recorded in the sector of capital goods, and 83.4% in the sector of consumer goods. According to the Confederation of National Industry (CNI) data, seasonally adjusted by the BCB, the Nuci decreased from 82.0% in February to 81.5% in March. Still according to the FGV, the difference between the share of companies that reported excess inventories and those which reported insufficient inventories showed an increase in May, according to the seasonally adjusted series, after four consecutive falls.

10. The trade balance surplus on a twelve-month accumulated basis increased from US$29.1 billion in March to US$28.1 billion in April. This result stemmed from US$259.3 billion in exports and US$231.2 billion in imports, equivalent to 18.4% and 18% changes, respectively. The current account deficit accumulated in twelve months changed from US$52.2 billion in February to US$49.8 billion in March, equivalent to 1.98% of GDP. On its turn, foreign direct investment reached US$64.1 billion in the twelve months through March, equivalent to 2.55% of GDP.

11. Global economy faces a period of above-than-usual uncertainty, with high risk aversion, and prospects of low growth. Since the last Copom meeting, the assessments regarding the activity in the United States (US) have remained relatively positive, but the risks associated to the scenario of fiscal restraint and the deepening of the European crisis have remained. Despite the substantial provision of liquidity by the European Central Bank (ECB) in the first quarter of this year, heightened risks to global financial stability remain due to, among other factors, the exposure of international banks to the sovereign debt of countries with fiscal imbalances, as well as the increased political uncertainty. These risks are evidenced, for example, in private liquidity shifts among countries in the Euro Area, as well as in high assets prices in economies with solid fundamentals. High rates of unemployment for a long period, coupled with fiscal adjustment needs, the limited scope for countercyclical policy actions and political uncertainty are translated into projections of low growth in mature economies. In fact, the composite leading indicator released by the Organization for Economic Cooperation and Development (OECD), referring to March, indicates weak activity in the Euro Area. Similarly, the disaggregated indicators of the Purchasing Managers Index (PMI) for April suggest moderation in global activity. In China, activity indicators for April, in particular industrial production and total external trade, indicate slowdown during the second quarter. Regarding monetary policy, mature economies have persisted with strongly accommodative stances. Core inflation remained at moderate levels in the US, Euro Area and Japan, considering the relatively moderate prospects for the activity level in these regions. In emerging economies, in general, the monetary policy bias is expansionist, which combines, in some cases, with additional countercyclical policies.

12. The price Brent oil barrel declined since the last Copom meeting, but remained above $ 100, reflecting, in part, political instability in important producing countries. 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. As measured by the Commodity Research Bureau (CRB), since the last Copom meeting, international prices of agricultural and metallic commodities fell 1.5% and 4.0% respectively. Thus, relative to the record highs observed in April 2011, the changes reach -18.7% and -23.2%. On its turn, the Food Price Index, calculated by the Food and Agriculture Organization of the United Nations (FAO), accumulates a fall of 10.1% until April, compared to the peak recorded in February 2011. In the recent past, the high volatility observed for the commodities prices was influenced by the abundant global liquidity, in a context where financial markets adjust to new expectations for growth and volatility in FX markets. Prospectively, it is plausible to affirm that the reduction of growth targets in China, coupled with the fragility of the global economy, should generate some impact over commodities prices.

Assessment of Inflation Trends

13. 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 adjustment for gasoline and bottled gas prices, for 2012, were maintained at 0%, the same value considered at the April meeting;

b) the projected adjustments for 2012 for fixed telephone and electricity were maintained at 1.5% and 1.3%, respectively, the same value considered at the April meeting;

c) the projection for regulated prices inflation accumulated in 2012, based on individual items, according to the benchmark scenario, was maintained at 4.0%, the same value considered at the April meeting;

d) the projection for regulated prices inflation accumulated in 2013, according to the benchmark scenario, was maintained at 4.5%, the same value considered at the April Copom meeting. Such projection is based on endogenous determination models for regulated prices, which compute, among other factors, seasonal components, foreign exchange rate changes, market prices inflation and the IGP (General Price Index) change; and

e) the projection for the spreads over the Selic rate, based on the 360-day swap rates, on the benchmark scenario, estimates 30 bps and 17 bps spreads in the fourth quarters of 2012 and 2013, respectively.

14. Regarding fiscal policy, projections assume the achievement in 2012 of the public sector primary surplus target (R$139.8 billion), around 3.10% of GDP, without adjustments, according to the parameters contained in the Budget Guidelines Law (LDO) - 2012. Furthermore, it is accepted, as a working hypothesis, a primary surplus of R$ 155.9 billion for 2013, around 3.10% of GDP, without adjustments, according to parameters set out in the Draft Budget Guidelines Law (PLDO) - 2013. For 2014, it is accepted, as a working hypothesis, a primary surplus of 3.10% of GDP, without adjustments.

15. The set of projections incorporated the estimated effects of the reduction in the neutral interest rate identified over the last years.

16. The main scenario also considers the estimated effects stemming from the current deterioration of the international scenario over the Brazilian economy, but without the observance of extreme events. It is noteworthy that part of this estimated impact is already being observed in recent economic activity and price indicators.

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 2012 IPCA increased to 5.17% from 5.08%. For 2013, the median of inflation expectations increased to 5.60% from 5.50%. Specifically for banks, asset managers and other institutions (real sector companies, brokers, consultancies and others), the median of expectations for the 2012 IPCA changed to 5.09%, 5.17% and 5.20% from 5.08%, 5.06% and 5.08%, respectively. For 2013, the median changed to 5.50%, 5.80% and 5.44% from 5.50%, 5.73% and 5.30%, in the same order.

18. The benchmark scenario assumes the maintenance of the exchange rate at R$2.05/US$1.00 and the Selic rate at 9.00% p.y. during the forecast period. Under this scenario, the projection for the 2012 inflation decreased relative to the figure considered at the April Copom meeting and it stands around 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 2012 also decreased and stands around the midpoint inflation target. For 2013, the inflation projection remained stable in the reference scenario and declined in the market scenario, but still stands above the midpoint target in both cases.

Monetary Policy Decision

19. The Copom evaluates that monetary policy should contribute to the consolidation of a favorable longer-term macroeconomic environment. In this respect, the Copom reassures that, under the inflation targeting regime, it guides its decisions according to BCB projected inflation and based on the analysis of alternative scenarios for the evolution of the main variables that determine prices dynamics. The Committee also understands that low risks for the underlying inflation in the short run tend to reduce uncertainties regarding the future behavior of headline inflation, facilitate the assessment of scenarios by the monetary authority, as well as help the process of coordination of economic agents' expectations, particularly price setters'. Additionally, it is noteworthy that low risks for the underlying inflation in the short run tend to intensify the effects of monetary policy actions, enabling them to affect in a more long-lasting manner the dynamics of headline inflation in the future. Although the Copom recognizes that other macroeconomic policy actions may influence the price 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.

20. International evidence, ratified by the Brazilian experience, indicates that high inflation rates lead to the increase in risk premia, both for private and public funding, and to the shortening of planning horizons, both for households and companies. Consequently, high inflation rates reduce investment and economic growth potential, in addition to presenting regressive effects on income distribution. In other words, 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 possible deviations from the target path be promptly corrected. Such strategy takes into account the time lags in the

transmission mechanism and is the most adequate to deal with the uncertainty inherent to the process of monetary policy formulation and implementation.

21. The Copom considers that, since the last meeting, the risks to global financial stability have remained high, particularly those deriving from the ongoing deleveraging process observed in the main economic blocks. The Committee understands that, in general, the restrictions to which several mature economies were exposed have changed little. It also notes that, in these economies, there seems to be limited leeway for monetary policy actions, and a scenario of fiscal restraint also prevails, in this and in the upcoming years. Moreover, in important emerging economies, despite the resilience of domestic demand, the pace of activity has moderated, in part, as a consequence of policy actions and the weakening of external demand, through the external trade channel. In specific cases, changes in the growth pattern are anticipated, a development that tends to be permanent. Therefore, until now, the Committee evaluates that the international scenario has shown disinflationary bias.

22. For the Copom, there are cumulative evidences supporting the view that the transmission of external developments to the Brazilian economy materializes through several channels, among others, moderation of total trade, moderation in investment flows and tighter credit conditions. Another transmission channel of great importance is the impact over businessmen confidence. The Committee understands that the effects of the complexity surrounding the international environment added up to those stemming from the moderation of domestic activity. In other words, the moderation process the Brazilian economy was already experiencing in the first half of last year was intensified by the weakness of the global economy.

23. The Copom evaluates, however, that although domestic demand expansion has also been moderate, prospects for economic activity in this and in the upcoming semesters are favorable, with some asymmetry among the several sectors. This assessment is supported by signs that point to moderate expansion of credit supply both for individuals and corporate; and by the fact that consumers' and businessmen's confidence, stands at high levels. The Copom understands, additionally, that the domestic activity will continue to be benefited by 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.

24. The Copom reaffirms its view that inflation accumulated in twelve months, which started to retreat in the last quarter of 2011, tends to continue the decline and, therefore, to move towards the targets path. The Committee evaluates that the reversion in the inflation trend will contribute to improve the economic agents' expectations, especially price setters', about the inflation dynamics of in this and in the upcoming quarters. Additionally, the Committee understands that this improvement in the sentiment tends to be boosted by the moderation observed in the last quarters in the producer prices dynamic.

25. The Copom notes 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 mismatch between supply and demand growth rates, will strengthen the reduction trend of the public debt-to-GDP ratio and the positive perception regarding the macroeconomic environment in the medium and long terms.

26. The Copom highlights that its main scenario also considers moderate expansion in the credit market. Still about the credit market, the Committee considers opportune the initiatives with the aim of moderating the concession of subsidies through credit operations.

27. The Copom evaluates as decreasing the risks stemming from the persistence of the mismatch, in specific segments, between supply and demand growth rates. However, it highlights the narrow idleness margin in the labor market, despite the signs of moderation in this market, and considers that, under such circumstances, an important risk stems from the possibility of concession of wages increases incompatible with productivity growth and their negative impacts over inflation dynamics. On the other hand, the Copom notes that the level of installed capacity utilization has stabilized and is below the long-term trend, in other words, it is contributing to the opening of the output gap and to contain prices pressures.

28. The Copom considers that the deceleration of the Brazilian economy in the second half of 2011 was deeper than expected, and that recovery has materialized in a very gradual way. Moreover, it also notes that recent events indicate the postponement of a final solution for the European financial crisis, and that the risks related to the deleveraging process – stemming from banks, households and government - under way in major economic blocks remain elevated. These and other elements, therefore, constitute an economic environment in which a much above-than-usual uncertainty level prevails. For the Committee, the prospective scenario for inflation, since the last meeting, has maintained favorable signs. The Committee also notes that, according to the main scenario adopted, the inflation rate stands around the target in 2012.

29. In short, the Copom considers that, at the present moment, the risks to the inflation trajectory remain limited. The Committee also notes that, until now, due to the global economy's fragility, the external sector contribution has been disinflationary.

30. In this context, continuing the process of monetary conditions adjustment, the Copom decided to decrease the Selic rate to 8.50% p.a., without bias. The following members of the Committee voted for this action: Alexandre Antonio Tombini, Governor, Aldo Luiz Mendes, Altamir Lopes, Anthero de Moraes Meirelles, Carlos Hamilton Vasconcelos Araújo, Luiz Awazu Pereira da Silva and Sidnei Corrêa Marques.

31. The Copom evaluates that domestic demand tends to show robustness, especially household consumption, largely due to the effects of stimulus factors, such as income growth and moderate credit expansion. This scenario tends to prevail in this and in the upcoming semesters, when domestic demand will be impacted by the effects of monetary policy actions recently implemented, which are, in short, lagged and cumulative. On the other hand, the Committee considers that recent initiatives reinforce a scenario for restrained public sector expenditures. Another important factor to curb aggregate demand is the still fragile international scenario. These elements and quasi fiscal developments are an important part of the context in which future monetary policy decisions will be taken, aiming to ensure the timely convergence of inflation to the targets path.

32. The Copom understands that the Brazilian economy has experienced significant structural changes, which determined retreat in the interest rates in general and, in particular, in the neutral rate. Among the factors that support this view, it bears highlighting the reduction of risk premia, a direct consequence of the accomplishment of the inflation target for the eighth consecutive year, of the macroeconomic stability and of institutional improvements. Moreover, the process of interest rates reduction was favored by changes in the structure of the financial and capital markets, by the credit market deepening, as well as by the generation of primary surpluses consistent with the maintenance of decreasing trend for the public debt-to-GDP ratio. For the Committee, all these changes are characterized by a high degree of persistence – although, due to the economic cycles themselves, specific and temporary reversions may occur – and contribute for the Brazilian economy's current solid indicators of solvency and liquidity.

33. The Copom also considers that the increase in the supply of external savings and the reduction of its funding cost have contributed to the reduction of the domestic interest rates, including the neutral rate, which, according to the Committee's assessment, are largely permanent developments.

34. In light of the above, even considering that the activity recovery has occurred more slowly than anticipated, the Committee believes that, given the cumulative and lagged effects of policy actions implemented so far, any additional monetary easing movement should be conducted with parsimony.

35. At the end of the meeting, it was announced that the Committee will reconvene on July 10th, 2012, for the technical presentations, and on the following day, to discuss monetary policy, as established in the Communiqué 21,213 of June 29th, 2011.

SUMMARY OF DATA ANALYZED BY THE COPOM

Inflation

36. The IPCA-15 rose 0.51% in May, up from 0.43% in April, totaling 2.39% in the year and 5.05% in the twelve months through May, compared to 5.25% in the twelve months through April, according to data released by the IBGE. The monthly result reflected acceleration in market and regulated prices. Regarding market prices, which increased 0.53% in May, compared to 0.46% in April, the movement was due to the acceleration in the prices of tradable goods, to 0.79% up from 0.23%, while the prices of non-tradable goods decelerated to 0.30%, down from 0.66%, influenced by the deceleration in the rate relative to services, which increased 0.26%, down from 0.69% in April. Regulated prices rose 0.44% in May, up from 0.35% in April. The monthly IPCA-15 change was mainly due to the increase in the prices of food and beverages, main driver of the index increase in May, which contributed 0.14 p.p., compared to 0.07 p.p. in April, personal expenses and housing, with respective contributions of 0.13 p.p. and 0.12 p.p.. The diffusion index stood at 63.29% in May, up from 62.74% in April.

37. On a twelve-month basis through May, market prices slightly increased, from 5.50% to 5.54%, while regulated prices decelerated relative to April, from 4.60% to 3.79%. The evolution of market prices reflected the greater effect of the acceleration in the prices of tradable goods, from 3.74% to 4.03%, while the prices of the non-tradable goods decelerated, from 7.08% to 6.90%. The prices of the services segment increased 7.28% in the last twelve months through May, compared to 7.67% and 7.56%, in the corresponding periods through April and March, respectively.

38. The IGP-M totaled 1.02% in May, after increasing 0.85% in April, according to FGV, reflecting the acceleration in the prices of IPA and INCC and the deceleration in consumer prices (IPC). The index accumulated an increase of 2.51% in the year, compared to 3.33% in the same period of 2011, and 4.26% in twelve months, compared to 3.65% in the twelve months through April.

39. The IPA-M changed 1.17% in the month, compared to 0.97% in April, totaling 2.24% in the year and 3.62% in twelve months. The prices of agricultural and livestock products increased 0.85% in May, down from 1.18% in the previous month, totaling 3.87% in the year and 3.75% in twelve months. The prices of industrial products increased 1.29% in May, compared to 0.89% in April, totaling 1.66% in the year and 3.57% in twelve months. The monthly performance of prices of agricultural and livestock products evidenced, in particular, the impact of the 10.05% change in the price of soybeans, which contributed 0.48 p.p. for the IPA-M result. Among the prices of industrial products, the main influence was exerted by chemicals, which increased 2.71%, with a contribution of 0.26 p.p. to the monthly index.

40. The IPC-M increased 0.49% in May, compared to 0.55% in April, totaling 2.79% in the year, compared to 4.12% in the same period of 2011, and 4.81% in twelve months. The IPC-M change in May was mainly influenced by the 0.48% increase in housing, which contributed 0.12 p.p. to the monthly index. The INCC-M changed 1.3% in the month, up from 0.83% in the previous month, as a result of the acceleration in the costs of labor force (from 1.08% to 2.22%) and the cooling in the prices of materials, equipment and services (from 0.58% to 0.35%). The INCC-M accumulated changes of 3.63% in the year and 7.16% in the twelve months through May.

41. Three out of the five IPCA-15 core measures calculated by the BCB accelerated in the month, while in the twelve months through May, the deceleration trend, recorded in the last months for all criteria, was observed in three out the five measures. Month-on-month, the core inflation by exclusion, which excludes ten items of household food and fuels, increased 0.54% in the month, up from 0.45% in April, accumulating 5.84% in the twelve months through May, up from 5.81% in the twelve months through April. The core inflation by exclusion of household food and regulated prices increased 0.47%, down from 0.49% in April, totaling 5.77% in twelve months, compared to 5.73% in the twelve months through April. The smoothed trimmed means increased 0.48% in May, up from 0.37% in April, accumulating 6.19% in the twelve months through May, compared to 6.28% in the twelve months through April. The non-smoothed trimmed means core inflation increased 0.41%, up from 0.38% in April, accumulating 4.90% and 4.97% in twelve months, respectively. The double weight

core inflation increased 0.43% in May, down from 0.48% in April, accumulating 5.87% in the twelve months through May, compared to 6.05% in the twelve months through April.

42. The IPP/IT increased 1.38% in April, after increasing 1.04% in March and 0.28% in April of the previous year. In the year, the IPP/IT increased 1.55%, compared to 1.69% in the same period of 2011 and increased 2.47% in the last twelve months through April, compared to 1.36% in the previous month. The monthly result of IPP/IT was mainly influenced by the increases of prices related to the industries of food products, other chemical products and coke, byproducts and bio-fuels, with respective contributions of 0.53 p.p., 0.30 p.p. and 0.15 p.p. for the index. The index change in the twelve months ending in April reflected, mainly elevations related to contributions stemming from the industries of food, 1.39 p.p., automotive vehicles, 0.35 p.p., and beverages, 0.28 p.p., offset by the contributions of metallurgy industry, -0.26 p.p., textiles, -0.2 p.p. and computer equipment, electronic and optical products, -0.18 p.p..

43. The Commodity Index Brazil (IC-Br) increased 0.58% in April, reflecting respective changes of 0.65%, 0.28% and 0.41% related to the segments of agriculture and livestock, metal and energy. In the last twelve months through April, the index accumulates a decrease of 5.21%, with retreats of 5.96% in the sub-index composed by agricultural products, and 8.87% in the metallic commodities sub-index, while the one related to energy increased by 2.48% in the period.

Economic Activity

44. The Commodities Index – Brazil (IBC-Br) decreased 0.35% in March, month-on-month, considering seasonally adjusted data. In the first quarter, the index increased 0.15%, quarter-over-quarter, when it had increased 0.20%, according to the same comparison basis. Considering observed data, the IBC-Br increased 0.91% in March, year-over-year, compared to the increase of 0.86% in February, according to the same comparison basis. The index increased 1.06% in the year and 1.84% in the twelve months ended in March.

45. Expanded retail sales, which include vehicles and construction inputs, increased 0.6% in March, month-on-month, according to data seasonally adjusted from IBGE’s monthly survey (PMC), after changes of -0.8% (revised) in February and 1.8% in January. With this result, expanded retail sales grew 3% in the first quarter of 2012, relative to the last quarter of 2011. By segment, four out of the ten surveyed segments presented increases, with highlights for the increases of 2.3% in pharmaceutical and medical articles, and of 1.2% in furniture and household appliances. On the other hand, the most remarkable retreats stemmed from the sales of books, newspapers, magazines and stationary (-7.1%), and office, computing and communication equipment and material (-6.9%). In the year, expanded retail sales increased 7.3%. Retail sales volume increased 0.2% in March, month-on-month, seasonally adjusted, after stability in February and increase of 3.2% in January (revised), according to the same comparison basis, accumulating growth of 4.1% quarter-over-quarter, seasonally adjusted, 10.3% in the year and 7.5% in twelve months.

46. Considering observed data, expanded retail sales increased 10.2% in March, year-over-year, with expansion in all segments, with highlights for the sales of office, computing and communication equipment and material (30.5%), furniture and household appliances (21.2%), construction inputs (16.2%), pharmaceutical and medical articles (14.1%), and hypermarkets, supermarkets and food products (12.2%). In the twelve months ended in March, expanded retail sales increased 6.7%, mainly driven by increases in the sales of office, computing and communication equipment and material (24.8%), furniture and household appliances (16.4%), pharmaceutical and medical articles (10%) and construction inputs (9.1%).

47. Automobile sales by dealers, including cars, light commercial vehicles, trucks and buses, decreased 3.7% in April, month-on-month, after falling by 5.8% in March and 3.4% in February, according to the Brazilian Federation of Automobile Vehicles Distribution (Fenabrave) data, seasonally adjusted by the BCB. Sales decreased 7.3% in the quarter ended in April, compared to the 3.5% expansion in the quarter ended in January. Automobile vehicles sales decreased 3.3% in the year, as a consequence of the fall in the sales of trucks (9.2%), automobiles (3.4%), buses (2.3%) and light commercial vehicles (1.8%).

48. Capital goods imports quantum index, released by the Foreign Trade Studies Centre (Funcex) and seasonally adjusted by the BCB, expanded 6.9% in April, month-on-month. Observed data increased by 4.8% year-over-year, 4.4% in the year and 6.4% in the twelve months through April.

49. Capital goods production increased 3.8% in March, accumulating a 9% decrease in the quarter, quarter-over-quarter, according to data seasonally adjusted from the Monthly Industrial Survey (PIM) by the IBGE. The main positive drivers in the month stemmed from the increase in the production of equipment for energy, 19.3%, and transportation, 9.2%, as opposed to the retraction of 13.9% in the production of agricultural pieces.

50. Construction inputs production increased 0.1% in March, accumulating a decrease of 0.3% in the quarter, compared to the one ended in December, considering seasonally adjusted data. The segment production increased 4.9% year-over-year, with cumulative increases of 3.3% in the year and 3.6% in twelve months.

51. Disbursements granted by the Brazilian Development Bank (BNDES) totaled R$138.5 billion in the twelve months through March, 17.5% below the one registered in the same period of 2011, as a consequence of the retraction of 48.6% in funding for the manufacturing industry. In the period, the infrastructure sector absorbed 40% of the total funds released, followed by industry, 31%, commerce and services, 22%, and agriculture and livestock, 7%.

52. Industrial production changed by -0.5% in March, according to IBGE seasonally adjusted data, after an increase of 1.3% (revised) in February, reflecting retreats of 1.8% in mining and 0.4% in manufacturing industry. By use categories, it bears highlighting the falls of 0.9% in the production of intermediate goods and of 0.8% in the production of semi and non-durable consumer goods, while capital goods and durable goods production increased by 3.8% and 3.4%, respectively. Seventeen out of the 26 manufacturing industry activities surveyed decreased in the month, with highlights for the segments of medical equipment, 10.1%, edition, printing and recording, 7.1%, and electronic material and communication equipment, 6.9%. On the other hand, the sector of automotive vehicles recorded the largest monthly expansion, 11.5%. The industrial production retreated by 0.5% in the first quarter of the year, quarter-over-quarter, when it had decreased by 1.6%, reflecting retraction of 3.3% in mining and stability in the manufacturing industry. The quarterly development was mainly influenced by the performance of automotive vehicles, which retreated by 18.8% in the period. Considering observed data, industrial production registered decreases of 2.1% in the month, year-over-year, 2.9% in the year and 1.1% in twelve months, mainly as a consequence of the unfavorable performance of the durable consumer goods industry.

53. The Nuci in the manufacturing industry reached 84% in May, a 0.1 p.p. expansion month-on-month, according to data seasonally adjusted by FGV. The monthly result stemmed from the elevation in all use categories, highlighting the respective increases of 0.7 p.p. and 0.6 p.p. in the segments of capital goods and durable consumer goods, respectively. Considering the observed series, the Nuci fell by 0.4 p.p., year-over-year, as a result of the decrease in the indicators related to capital goods (2.1 p.p.), construction inputs (1.3 p.p.), consumer goods (0.1 p.p.) and intermediate goods (0.6 p.p.).

54. Vehicles output reached 260.8 thousand units in April, representing changes of -2.3% month-on-month and -0.9% in the quarter ended in April, according to data released by the National Association of Automotive Vehicle Manufacturers (Anfavea), seasonally adjusted by the BCB. Considering observed data, there were retreats of 7.5% year-over-year, 10.1% in the year and 3.9% in twelve months.

55. Still according to data released by Anfavea, national vehicle licensing decreased 3% in April, month-on-month, and 6.4% in the quarter ended in April, quarter-over-quarter, considering data seasonally adjusted by the BCB. Regarding observed data, there were decreases of 11.4% year-over-year, 5.8% in the year and 4.4% in twelve months. Automobile exports totaled 48.7 thousand units in April, representing changes of -0.5% year-over-year, -4.9% in the year and 3.1% in twelve months. According to the series seasonally adjusted by the BCB, exports increased 7.7% in the month and retreated 6.2% in the quarter ended in April, relative to the one ended in January.

56. The LSPA survey carried out by the IBGE regarding April projected 159.3 million tons for the 2012 national harvest of grains, representing a decrease of 0.5% year-over-year and an increase of 0.5% over the March crop forecast. The new prognosis presented more favorable prospect for the second harvest of corn, with increase of 5.9% compared to the estimate of the previous month, in contrast to the predictions for the crops of beans and wheat, which reduced by 8.4% and 6.7%, respectively, according to the same comparison basis. Regarding the 2011 harvest of grains, the new projection estimates expansions in the harvests of corn (19.5%), as opposed to the declines in the harvests of wheat (-15.9%), rice (-13.8%), soybeans (-11.4%) and beans (-8.3%).

Surveys and Expectations

57. The Consumer Confidence Index (ICC), considering data seasonally adjusted from the nationwide Consumer Expectations Survey (FGV), decreased by 1.2% in May, month-on-month, to 127.1 points, driven by the reduction of 1.8% in the Current Situation Index (ISA) and 1.1% in the Expectations Index (IE). The ICC increased 9.7% year-over-year, as a result of the changes of 6% in the ISA and 12.3% in the IE.

58. The ICS, calculated by the FGV, decreased by 4.8% in April, year-over-year, reaching 128.8 points, as a result of the decreases of 8.3% in the ISA and 1.9% in the IE. Month-on-month, the ICS retreated by 0.9% in April, due to the falls of 0.6% in the ISA and 1.2% in the IE, according to observed data.

59. The Commerce Confidence Index (ICOM), measured by the Commerce Survey from FGV, reached 127 points in April, decreasing 5% year-over-year. The result reflected changes of -2.1% in the Current Situation Index (ISA-COM) and -6.9% in the Expectations Index (IE-COM). In the quarter ended in April, the ICOM decreased 4.4% year-over-year, due to the retreats of 3.7% in the ISA-COM and 4.8% in the IE-COM.

60. The Industry Confidence Index (ICI), considering seasonally adjusted data from the Survey of Manufacturing Industry (SCIT-FGV), increased 0.1% in May, month-on-month, reaching 103.4 points. The result was driven by the increase of 0.9% in the IE and the reduction of 0.5% in the ISA. The ICI fell 6% in April, year-over-year, due to decreases of 7.2% in the ISA and 4.8% in the IE.

61. The Construction Confidence Index (ICST), measured by the Construction Survey, from FGV, reached 123.5 points in April, decreasing 9.3% year-over-year. The result reflected retreats of 11% in the Current Situation Index (ISA-ICST) and 7.9% in the Expectations Index (IE-ICST). In the quarter ended in April, the ICST decreased 6.8%, year-over-year, due to the retreats of 8.6% in the ISA-ICST and 5.3% in the IE-ICST.

Labor Market

62. According to the General Record of Employment and Unemployment (Caged) of the Ministry of Labor and Employment (MTE), 217 thousand formal jobs were created in April, of which 82.9 thousand jobs in the services sector, 40.6 thousand jobs in the civil construction, 33.7 thousand jobs in commerce, 30.3 thousand jobs in manufacturing industry and 21.9 thousand jobs in agriculture and livestock. Month-on-month, formal job creation expanded by 0.2%, considering seasonally adjusted data. In the year through April, 598.2 thousand jobs were created and in twelve months, 1.4 million, compared to 797.8 thousand and 2 million, respectively, in the same periods of 2011.

63. According to the IBGE employment survey (PME), carried out in the six main metropolitan regions of the country, the unemployment rate reached 6% in April, decreasing 0.2 p.p., month-on-month, and 0.4 p.p., year-over-year. The monthly result was driven by the increases of 0.3% in occupation and 0.1% in the Economically Active Population (PEA). Considering seasonally adjusted data, the unemployment rate reached 5.6% in April, compared to 5.8% in the previous month. According to the same survey, average real earnings usually earned by the workers decreased 1.2%, month-on-month, and increased 6.2%, year-over-year, and 4.7% in the year through April. Real payroll, defined as the number of persons employed times real average earnings, changed -0.9%, month-on-month, 8.1%, year-over-year, and 6.8% in the year through April.

Credit and Delinquency Rates

64. Outstanding credit in the financial system reached R$2,100 billion in April, equivalent to 49.6% of GDP, increasing by 1.2% in the month, 3.5% in the year and 18.1% in twelve months. Non-earmarked credit operations, which represented 64.1% of the total of the financial system, changed 1.3% in the month, 3.5% in the year and 15.9% in twelve months, reflecting the respective increases of 0.8%, 3.9% and 15.4% for credit operations to individuals, and 1.7%, 3.1% and 16.4% for credit operations to corporate, in the same order. Earmarked credit operations increased 1.1% in the month, 3.4% in the year and 22.4% in twelve months. It bears highlighting the expansion of 2.1%, 10.7% and 40.9% in housing credit, according to the same comparison bases.

65. The average annual interest rate on reference credit operations reached 35.3% in April, decreasing 2 p.p. in the month and 4.5 p.p. in twelve months. The average annual rate on credit for individuals and corporate reached 42.1% and 26.3%, respectively, registering decreases of 2.3 p.p. and 1.4 p.p., month-on-month, and 4.7p.p., year-over-year, for both segments.

66. The average tenure on reference credit operations reached 500 days in April, retreating one day. The tenure related to individuals increased one day, reaching 606 days, while the one related to corporate segments decreased two days, reaching 402 days.

67. The delinquency rate in the financial system (non-earmarked loans used as reference for interest rates, in arrears for more than ninety days) reached 5.8% in April, increasing 0.1 p.p. month-on-month and 0.9 p.p., year-over–year. The indicator for the operations with individuals reached 7.6% in April, increasing 0.2 p.p. month-on-month, and 1.5 p.p. in twelve months, while the delinquency rate for credit operations to the corporate segment stood at 4.1%, remaining stable in the month and increasing 0.4 p.p. year-over-year.

External Environment

68. Since the last Monetary Policy Committee meeting, prospects for the global economy’s growth have continued low. In this context, the assessment of purchase managers, expressed by the global PMI, fell for the second consecutive month, reaching 52.2 points in April, the lowest value of the last five months. In the US, GDPQ1 growth slowed down to an annualized rate of 2.2%, despite increases in private consumption and exports. In the labor market, it bears noticing the continuity of the deceleration process in job creation in the US, which retreated to 115 thousand jobs in April, in net terms, below expectations. In the Euro Zone, which recorded zero growth in the first quarter, there was decrease in industrial production in March (-0.3%), month-on-month, and the continuity of deterioration in the composed PMI, whose preliminary evaluation relative to May pointed out a retreat to 45.9 points, the lowest level of the last 35 months. The unemployment rate reached 10.9% in March. In Japan, the GDPQ1 annualized rate exceeded expectations, recording a 4.1% growth rate, with highlights for the improvement in private consumption, exports and government investment. On the other hand, in April, it bears noticing the decrease in the composed PMI to 51.3 points, after reaching the record high of 53.2 points in the previous month; the retreat in the trade balance, which reached a ¥520 billion deficit; and the decline of 0.3% in retail sales, after retreating 1.2% in the previous month. In China, the deceleration trend for activity indicators remained, mainly for foreign trade, but also for gross fixed capital formation and industrial production.

69. In the financial markets, high risk aversion is observed, driven by the risks associated to the scenario of fiscal restraint and the deepening of the European crisis. In Europe, the debt crisis remains with the political stalement in Greece and with the fragility signs of the banking system in Spain, which increased the risk premiums in this country, hampering the access to the sovereign debt market. Under this scenario, the US dollar valued against the euro and the currencies of emerging countries, while the US and German ten-year securities’ yields reached, in May, the record lows of the respective time series.

70. Since the last Copom meeting, international commodities prices have decreased. Moreover, agricultural commodities prices were influenced by the favorable prospects for the next harvest, while the prices for energy commodities also reacted to increased oil production by the Organization of Petroleum Exporting

Countries (OPEC) and to the increase in oil inventories in the US, which, since the last Copom meeting, reached levels previously observed only in 1990.

71. Since the last Copom meeting, the process of global disinflation has continued, with decline in the annual consumer price indices (CPI), which reached 2.3%, 2.6% and 3.0% in April, in the United States, in the Euro Area and in the UK, economies where official interest rates remain at historical record lows. In Japan, where the official interest rate remains at a level virtually zero, the Bank of Japan (BoJ) opted for the reintroduction of quantitative expansion measures, having increased by ¥ 5 trillion, to ¥ 70 trillion, its assets purchase program. Among the main emerging economies, except for India, consumer price inflation also followed a downward trend. Under this context, since the last Copom meeting, the official interest rates remained largely unchanged. In China, where inflation retreated again in April, although the People's Bank of China (PBC) has not altered its basic interest rate, the reserve requirement rate was reduced by 0.5p.p. for the second time this year, retreating to 18% and 20%, respectively, for small and large banks.

Foreign Trade and International Reserves

72. The Brazilian trade surplus reached US$882 million in April, as a result of US$19.6 billion in exports and US$18.7 billion in imports. In the first four months of the year, the trade surplus totaled US$3.3 billion, down from US$5 billion in the same period of 2011, reflecting expansions of 2% in exports and 4.8% in imports. In the year through April, total external trade grew 3.4%, totaling US$146 billion, compared to US$137.8 billion registered in the same period of 2011.

73. International reserves reached US$374.3 billion in April, increasing US$9.1 billion month-on-month. Compared to December 2011, the reserves increased US$22.3 billion. The BCB bought net US$7.2 billion in the FX spot domestic market in the month.

Money Market and Open Market Operations

74. After the April Copom meeting, the domestic interest rate yield curve fell in all its extension. The fall in the rates in this period was influenced, at the local scenario, by the prospect of continuity of the monetary easing cycle and by the release of economic indicators showing low dynamism of the economy. At the external scenario, the worsening of the outlook, mainly due to the deterioration in the Euro Zone, has also contributed to this movement. Between April 16th and May 28th the one-, three- and six-month interest rates fell by 0.50 p.p., 0.57 p.p. and 0.64 p.p., respectively. The rates for maturities of one, two and three years decreased by 0.59 p.p., 0.65 p.p. and 0.65 p.p., respectively. The real interest rate, as measured by the ratio between the nominal rate of one year and expected inflation (smoothed) for the next twelve months, decreased from 3.10% on April 16th, to 2.50% on May 28th, mainly due to the reduction in the nominal rates.

75. Between April 17th and May 28th, the BCB carried out traditional FX swap auctions maturing on June 1st, July 2th and on August 1st, totaling the equivalent to US$5.4, leading the BCB to take a short FX position in the amount equivalent to US$2.3 billion in notional value.

76. In its open market operations, the BCB carried out weekly, between April 17th and May 28th, repo operations borrowing R$15.2 billion for a six-month period. The average daily balance of the long term operations decreased from R$144.2 billion, between March 6th and April 16th, to R$128.7 billion, between April 17th and May 28th. In the same period, the BCB also borrowed money through repo operations with tenures between thirteen and twenty-nine working days, increasing the average daily balance of short-term borrowing operations to R$293.8 billion. The BCB also borrowed money through 30 very short-term operations. The average daily balance of these operations totaled R$46.3 billion in the period, borrowing. The average daily balance of the total outstanding of repurchase agreements of the BCB decreased from R$479.4 billion, between March 6th and April 16th, to R$468.8 billion, between April 17th and May 28th. Considering the operations for the most recent period, the total outstanding of repurchase agreements decreased from R$488.4 billion on April 16th to R$445.2 on May 28th. The main factors that contributed to the reduction of liquidity in the period were the net revenues of the Union and the net issuance of securities by the National Treasury.

77. Between April 17th and May 28th, the National Treasury issuance regarding the traditional auctions raised a total of R$40.6 billion. The sale of fixed-rate securities reached R$31.1 billion, with R$27.3 billion via issuance of LTNs maturing in 2012, 2013, 2014 and 2016, and R$3.8 billion via NTN-Fs maturing in 2018 and 2023. The sales of LFTs totaled R$0.8 billion, with issuance of securities maturing in 2018. The sales of inflation-linked NTN-Bs reached R$8.7 billion, for securities maturing in 2016, 2018, 2022, 2030, 2040 and 2050.