BANCO CENTRAL DO BRASIL

# Minutes of the 168th Meeting of the Monetary Policy Committee (Copom)



**Date:** July 10th, 2012, from 4:20PM to 7:13PM, and July 11th, from 4:51PM to 8:28PM

**Place:** BCB Headquarters meeting rooms – 8th floor on July 10th and 20th floor on July 11th – 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 July 10th)**
Ariosto Revoredo de Carvalho - Department of Foreign Reserves
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
Nelson Ferreira Souza Sobrinho – Research Department (also present on July 11th)
Renato Jansson Rosek – Investor Relations and Special Studies Department
Tulio José Lenti Maciel – Economic Department

**Other participants (present on July 10th)**
Ângelo José Mont'Alverne Duarte – Chief of Governor 's Staff
Gustavo Paul Kurrle – Press Officer

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) retreated to 0.08% in June (0.36% in May), resulting in the ninth consecutive retreat of twelve-month trailing inflation, which moved to 4.92% in June (6.71% in June 2011). Market prices inflation increased 5.34% in the twelve months through June (7.14% in June 2011), while regulated prices inflation reached 3.77% (5.70% in June 2011). Regarding market prices, it bears highlighting that tradable goods inflation increased 2.97% in the twelve months through June (6.26% in June 2011), while inflation related to non-tradable goods increased 7.52% (7.89% in June 2011). The prices of

services increased 0.52% in June (0.21% in May), totaling 7.50% in the twelve months through June (8.75% in June 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 have performed similarly to headline inflation. The average of monthly changes moved from 0.34% in May to 0.14% in June. On its turn, on a twelve-month trailing basis, the average change of the five core inflation measures moved from 5.52% in May to 5.16% in June. The smoothed trimmed means IPCA core inflation moved from 0.45% in May to 0.39% in June, and the non-smoothed trimmed means core inflation changed from 0.31% to 0.30% in the same period. Similarly, the double weight core inflation, after registering 0.34% in May, retreated to 0.07% in June. At the same time, core inflation by exclusion, which excludes ten household food and fuels items, decreased from 0.36% in May to 0.05% in June; and the core inflation by exclusion of regulated prices and household food changed from 0.26% in May to -0.09% in June.

3. The General Price Index (IGP-DI) retreated from 0.91% in May to 0.69% in June, resulting, on a twelve-month trailing basis, in 5.66% (8.63% in June 2011). The main component of this indicator, the Wholesale Price Index (IPA), changed 5.54% in the twelve months through June, reflecting an increase of 4.72% in the industrial IPA and 7.86% in the agricultural IPA. According to the breakdown by stage of production, there were increases in the prices of raw materials (5.41%), intermediate goods (6.29%) and final goods (4.79%), 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 5.37% in the twelve months through June (6.40% in June 2011). The Civil Construction National Index (INCC), component with the lowest weight in the IGP-DI, changed 7.04%, 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 1.65% in May (1.46% in April), increasing 4.73% 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 conditions of the demand and on the price setters' expectations regarding the future inflation path.

4. The IBGE released information regarding GDP in the first quarter of 2012. Activity expanded by 0.8% in the first quarter, year-over-year, and 0.2% quarter-over-quarter, according to seasonally adjusted data. Therefore, growth accumulated in four quarters retreated to 1.9%, ratifying the view that economy has grown below its potential. On the aggregate supply side, the services sector and industry grew 1.6% and 0.1%, respectively, year-over-year. The agricultural production retreated by 8.5% according to the same comparison basis, largely due to adverse weather conditions. On the aggregate demand side, household consumption grew by 2.5%, government consumption increased by 3.4%, and Fixed Capital Gross Formation (FCGF) contracted by 2.1%, year-over-year. On its turn, the contribution of the external sector was null, after nine consecutive quarters of negative figures, with expansion of 6.6% in exports and 6.3% in imports. In short, domestic demand, boosted by moderate expansion of credit, as well as by employment and income growth, has been the main factor sustaining activity.

5. The Economic Activity Index of the BCB (IBC-Br) incorporates estimates for the monthly production of the three sectors of the economy, as well as for taxes on products, and constitutes important coincident indicator of economic activity. Considering seasonally adjusted data, the IBC-Br increased by 0.2% in April, after a fall of 0.6% in March. Thus, the indicator increased 0.2% from February to April, quarter-over-quarter, and increased 0.6% year-over-year. The twelve-month accumulated growth rate reached 1.7% in April. On its turn, the Consumer Confidence Index (ICC), from Getúlio Vargas Foundation (FGV), retreated for the second consecutive month in June, after reaching, in April, the highest level of the series started in September 2005. On its turn, the Services Sector Confidence Index (ICS) presented the third consecutive decline in June and points to moderation of the activity in the sector.

6. Industrial activity retreated by 0.9% in May, according to data seasonally adjusted by the IBGE, after retreating by 0.4% in April. The production of fourteen of the 27 branches of activity decreased in May. On a quarterly moving average basis, industrial production decreased 0.7% from March to May. Year-over-year, production retreated 4.3% in May, while on a twelve-month accumulated basis, it decreased by 1.8%. According to

seasonally adjusted data from the National Industry Confederation (CNI), revenues in the manufacturing industry recorded 5.9% real growth in May, year-over-year, while the number of hours worked decreased by 1.5%.

7. Among the industry use categories, according to data seasonally adjusted by the IBGE, capital goods production fell by 1.8% in May and the production of durable consumer goods decreased by 2.2%. The production of intermediate goods grew 0.2%, and the production of semi-durable and nondurable consumer goods fell by 2.1%. In the twelve months through May, there were decreases in the production of capital goods (-3.8%), durable consumer goods (-7.1%), intermediate goods (-1.1%), and semi-durable and non-durable consumer goods (-0.3%).

8. The unemployment rate in the six metropolitan regions covered by the IBGE Monthly Employment Survey (PME), according to observed data, reached 5.8% in May (6.0% in April), 0.6 p.p. below the rate recorded in May 2011. According to data seasonally adjusted by the BCB, the unemployment rate reduced from 5.6% in April to 5.4% in May, the lowest level of the series started in March 2002. Year-over-year, there were increases of 2.5% in the occupation level and 1.9% in the economically active population. Regarding occupied population, the share of formal employees in the private sector reached 48.9% in May. In this sense, in May, 139.7 thousand formal jobs were created (compared to 252.1 thousand jobs created in May 2011). The slower growth of the economically active population in the recent period, compared to the occupied population, has contributed to the maintenance of low unemployment rates, despite the moderation in the pace of job creation. According to PME, real average earnings increased 4.9% in May, compared to the same month of last year. As a consequence, real payroll, considering the average earnings of occupied population in the six metropolitan regions, expanded 7.5% 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.

9. According to the retail monthly survey (PMC) from IBGE, expanded retail sales increased 4.2% in May, year-over-year. According to the seasonally adjusted series, expanded retail sales decreased by 0.7% in May, month-on-month, after increasing by 0.5% in April. The accumulated growth rate in twelve months stood at 5.3% in May, with expansion in all ten sectors surveyed, with highlights for office, computing and communication equipment and material (26.4%) and furniture and appliances (14.9%). According to data released by the Automotive Vehicles Distribution National Federation (Fenabrave), the number of licensing of automobiles and light commercial vehicles strongly expanded in June, partially due to fiscal stimuli granted to this sector. 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 June, the index evolved negatively, after recording consecutive improvements in the months of March, April and May. For the upcoming months, the retail sales trajectory will continue to be influenced by governmental transfers, by the pace of real payroll growth, by the high level of consumer confidence and by moderate credit expansion.

10. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by the FGV, without seasonal adjustment, showed stability in June (83.6%), standing 0.5 p.p. below the level observed in June 2011. According to the seasonally adjusted series calculated by the FGV, the Nuci stood at 83.8% in June, also 0.5 p.p. below the level recorded in June 2011. Capacity utilization is more significant in the sector of construction inputs (85.7%), but has presented a retreat trend since December 2011. In the sectors of intermediate goods, capital goods and consumer goods, the levels stood at 85.5%, 83.4% and 83.2%, respectively. According to the Confederation of National Industry (CNI) data, seasonally adjusted by the BCB, the Nuci stood at 80.7% in May, 1.8 p.p. below the level registered in May 2011. Still according to the FGV, the difference between the share of companies that reported excess inventories and those which reported insufficient inventories resumed the downward trend in June, according to the seasonally adjusted series.

11. The trade balance surplus on a twelve-month accumulated basis decreased from US$27.5 billion in May to US$23.9 billion in June. This result stemmed from US$255.0 billion in exports and US$231.0 billion in imports, equivalent to 10.4% and 12.3% changes, respectively, relative to the previous twelve months. The current account deficit accumulated in twelve months changed from US$51.6 billion in April to US$50.9 billion in May,

equivalent to 2.11% of GDP. On its turn, foreign direct investment reached US$63.0 billion in the twelve months through May, equivalent to 2.61% of GDP.

12. Global economy faces a period of above-than-usual uncertainty, with high risk aversion, and prospects of low growth, which have intensified since the last Copom meeting. In this sense, data suggest some cooling of the activity in the United States (US), in a scenario of risks associated to the fiscal outlook and to the deepening of the European crisis. Heightened risks to global financial stability remain due to the still high level of political uncertainty and to the difficulties of implementing the recently announced measures. High rates of unemployment for a long period, coupled with the need for fiscal adjustments, the limited scope for countercyclical policy actions and the political uncertainty are translated into projections of low growth for mature economies. The composite leading indicator released by the Organization for Economic Cooperation and Development (OECD), referring to June, indicates activity below trend in the Euro Area and in the main emerging economies, besides moderation of activity in Japan and in the US. In the same sense, the disaggregated indicators of the Purchasing Managers Index (PMI) for June suggest moderation in global activity, mainly in manufacturing activity. Regarding monetary policy, advanced economies persist with strongly accommodative stances - the European Central Bank (ECB) reduced the interest rate to the lowest historical level, and the Bank of England resumed measures of quantitative easing. Core inflation measures have remained at moderate levels in the US, in the Euro Area and in Japan. In emerging economies, in general, the monetary policy bias is expansionist, which combines, in some cases, with additional countercyclical policies. In particular, China promoted, in June and July, two consecutive cuts in the reference interest rates for deposits and loans.

13. The price of Brent oil barrel has oscillated around US$100 since the last Copom meeting. 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 metallic commodities fell 6.9%, while those related to agricultural commodities increased 7.9%. Therefore, relative to the record highs observed in April 2011, the changes reach -28.5% and -12.3%, respectively. On its turn, the Food Price Index, calculated by the Food and Agriculture Organization of the United Nations (FAO), accumulated a fall of 15.4% until June, 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, tends to generate downward pressures over commodities prices.

**Assessment of Inflation Trends**

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

a) the projected adjustment for gasoline and bottled gas prices, for 2012, were maintained at 0%, the same value considered at the May Copom meeting;

b) the projected adjustment for 2012 for fixed telephone was reduced to -1.0%, compared to 1.5% considered at the May Copom meeting, and for electricity, was increased to 1.4%, up from 1.3% considered at the May meeting;

c) the projected adjustment, based on individual items, for the set of regulated prices inflation accumulated in 2012, was reduced to 3.6%, down from 4.0% considered at the May Copom meeting;

d) the projected adjustment for the set of regulated prices inflation accumulated in 2013 was maintained at 4.5%, the same value considered at the May Copom meeting. Such projection is 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; and

e) the projection for the spreads over the Selic rate, based on the 360-day swap rates, on the benchmark scenario, estimates 33 bps and 24 bps spreads in the fourth quarter of 2012 and 2013, respectively.

15. Regarding fiscal policy, projections assume the achievement in 2012 of the public sector primary surplus around 3.10% of GDP, without adjustments. 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.

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

17. The main scenario does not include the occurrence of extreme events in international financial markets, and considers the estimates of the impacts caused by changes in the external environment on the Brazilian economy.

18. 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 decreased from 5.17% to 4.85%. For 2013, the median of inflation expectations also reduced from 5.60% to 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 4.87%, 4.85.% and 4.85% from 5.09%, 5.17% and 5.20%, respectively. For 2013, the median changed to 5.50%, 5.70% and 5.46% from 5.50%, 5.80% and 5.44%, in the same order.

19. The benchmark scenario assumes the maintenance of the exchange rate at R$2.00/US$1.00 and the Selic rate at 8.50% p.y. during the forecast period. Under this scenario, the projection for the 2012 inflation decreased relative to the figure considered at the May 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 remained stable around the midpoint inflation target. For 2013, the inflation projection reduced in both scenarios, but still stands above the midpoint target in both cases.

**Monetary Policy Decision**

20. 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 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. 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 investments 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.

22. The Copom considers that, since its 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, overall, the prospects of more moderate global activity than previously anticipated have consolidated, and 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. In specific cases, changes in the growth pattern tend to be permanent. Therefore, until now, the Committee evaluates that the international scenario has shown disinflationary bias.

23. 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.

24. 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, to a lesser extent, businessmen's confidence, stands at high levels. The Committee 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.

25. 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 in this and in the upcoming quarters.

26. 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.

27. 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.

28. 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.

29. The Committee considers that the recovery in domestic economic activity has materialized quite gradually; on the other hand, it highlights that the main scenario encompasses more intense pace of activity this semester. The Committee identifies decrease in the probability of extreme events in international financial markets, but at the same time, it argues that recent developments indicate postponement of a final solution for the European financial crisis, and that risks associated to the process of deleveraging – of banks, households and government - now under way in the main economic blocs remain high. 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, maintained favorable signs. The Committee also notes that, according to the main scenario adopted, the inflation rate stands around the target in 2012.

30. In short, the Copom considers that, at the present moment, the risks for 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.

31. In this context, continuing the process of monetary conditions adjustment, the Copom unanimously decided to reduce the Selic rate to 8.00% 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, Luiz Edson Feltrim and Sidnei Corrêa Marques.

32. 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. The Committee considers that recent initiatives indicate scenario of neutrality of the public sector balance sheet. The Committee notes that the still fragile international scenario presents itself as an important factor restraining aggregate demand. 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.

33. 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.

34. 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.

35. 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.

36. At the end of the meeting, it was announced that the Committee will reconvene on August 28th, 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**

37. The IPCA rose 0.08% in June, down from 0.36% in May, totaling 2.32% in the year and 4.92% in twelve months, compared to 4.99% in the twelve months through May, according to data released by the IBGE. The monthly result reflected deceleration in market and regulated prices. Regarding market prices, which

increased 0.06% in June, compared to 0.37% in May, the movement was exclusively due to the behavior in the prices of tradable goods, from 0.49% to -0.31%, while the prices of non-tradable goods accelerated to 0.39% up from 0.27%, strongly influenced by the acceleration in the rate relative to services prices, which increased 0.52%, up from 0.21% in May. Regulated prices rose 0.15% in June, down from 0.32% in May. The transportation group was the main responsible for deceleration of the index in June, with a contribution of -0.24 p.p., compared to -0.12 p.p. in May. The diffusion index stood at 61.64% in June, down from 64.93% in May.

38. On a twelve-month basis through June, market prices decelerated in relation to May from 5.55% to 5.34%, while regulated prices accelerated in the same period, from 3.49% to 3.77%. The evolution of market prices reflected the greater effect of the deceleration in the prices of tradable goods, from 3.49% to 2.97%, while the prices of the non-tradable goods slightly accelerated, from 7.45% to 7.52%. The prices of the services segment increased 7.50% in the last twelve months through June, compared to 7.59% and 8.00%, in the corresponding periods through May and April.

39. The IGP-DI changed 0.69% in June, after increasing 0.91% in May, according to FGV, with deceleration in all its components. The index accumulates an increase of 3.59% in the year and 5.66% in twelve months.

40. The IPA-DI changed 0.89% in the month, compared to 0.91% in May, totaling 3.62% in the year and 5.54% in twelve months. The prices of agricultural and livestock products increased 0.99% in June, up from 0.67% in the previous month, totaling 5.10% in the year and 7.86% in twelve months. The prices of industrial products increased 0.86% in the month, down from 0.99% in May, totaling 3.10% in the year and 4.72% in twelve months. The monthly performance of prices of agricultural and livestock products evidenced, in particular, the impact of the 6.39% change in the price of soybeans, which contributed 0.35 p.p. for the IPA-DI result. Among the prices of industrial products, the main influence was exerted by vegetable oils and fats, and metallic minerals, with respective increases of 4.59% and 2.62%, and individual contributions of 0.14 p.p. to the monthly index.

41. The IPC-DI increased 0.11% in June, compared to 0.52% in May, totaling 2.83% in the year and 5.37% in twelve months. The IPC-DI change in June was mainly influenced by the 0.74% increase in the food group, which contributed 0.17 p.p. to the monthly index, and the decline registered in the transportation group, with change and contribution to the index of -0.73% and -0.13 pp., respectively. The INCC-DI changed 0.73% in the month, down from 1.88% in the previous month, as a result of the deceleration in the costs of labor force (from 3.38% to 1.03%) and the acceleration in the prices of materials, equipment and services (from 0.35% to 0.41%). The INCC-DI accumulated changes of 5.16% in the year and 7.04% in the twelve months through June.

42. The IPP/IT increased 1.65% in May, after increasing 1.46% in April. In the year, the IPP/IT increased 3.32%, compared to 1.22% in the same period of 2011, and increased 4.73% in the last twelve months through May, compared to 2.55% in the previous month. The monthly result of IPP/IT was mainly influenced by the increases in the prices related to the industries of food products, other chemical products, metallurgy and coke, oil derived products and bio-fuels, with respective contributions of 0.59 p.p., 0.34 p.p., 0.14 p.p. and 0.13 p.p. for the index. The index change in the twelve months through May reflected, mainly, elevations related to the contributions stemming from the industries of food, 2.33 p.p., and other chemical products, 0.57 p.p., offset by the contributions of metallurgy industry, -0.23 p.p. and textiles, -0.17 p.p..

43. The Commodity Index Brazil (IC-Br) retreated 1.40% in June, reflecting respective devaluations of 0.20%, 2.00% and 6.83% related to the segments of agriculture and livestock, metal and energy, respectively. In the first half of 2012, the index accumulated an increase of 0.83%, with increases of 0.50% in the sub-index composed by agricultural products, and of 7.14% in the metallic commodities sub-index, while the one related to energy decreased 4.91% in the period In the last twelve months through June, the index accumulated an increase of 2.59%, with increases of 3.43% in the sub-index composed by agricultural products, and 0.26% in the sub-index related to energy commodities, while the one related to metallic commodities decreased 0.13% in the period.

**Economic Activity**

44. The Commodities Index – Brazil (IBC-Br) increased 0.22% in April, month-on-month, considering seasonally adjusted data. In the quarter ended in April, the index increased 0.15%, over the quarter ended in January, when it had increased 0.89%, according to the same comparison basis. Considering observed data, the IBC-Br remained stable in April, year-over-year, compared to the increase of 0.91% in March, according to the same comparison basis. The index increased 0.78% in the year and 1.65% in the twelve months through April.

45. Expanded retail sales, which include vehicles and construction inputs, retreated in May, month-on-month, according to data seasonally adjusted from the IBGE's retail monthly survey (PMC), after changes of 0.5% in April and 0.6% in March. With this result, expanded retail sales grew 0.7% in the quarter ended in May, relative to the previous quarter ended in February. By segment, six out of the ten surveyed segments increased, with highlights for the increases of 3.5% in office, computing and communication equipment and material, and of 1.5% in vehicles, motorcycles, parts and pieces. On the other hand, the most remarkable retreats stemmed from the sales of construction inputs (-11.3%), and furniture and household appliances (-3.1%). In the year, expanded retail sales increased 5.8%. Retail sales volume decreased 0.8% in May, month-on-month, seasonally adjusted, after respective increases of 0.7% and 0.2% in April and March, according to the same comparison basis, accumulating growth of 1.3% quarter-over-quarter, seasonally adjusted, 9% in the year and 7.3% in twelve months.

46. Considering observed data, expanded retail sales increased 4.2% in May, year-over-year, with expansion in eight segments, with highlights for the sales of office, computing and communication equipment and material (17.3%), pharmaceutical, medical, orthopedic, perfumery and cosmetics articles (10.9%); furniture and household appliances (9.3%) and hypermarkets, supermarkets, food products, beverages and tobacco (9%). In the twelve months ended in May, expanded retail sales increased 5.3%, mainly driven by increases in the sales of office, computing and communication equipment and material (26.4%), furniture and household appliances (14.9%), pharmaceutical, medical, orthopedic, perfumery and cosmetics articles (9.9%) and construction inputs (8.7%).

47. Automobile sales by dealers, including cars, light commercial vehicles, trucks and buses, increased 35.8% in June, month-on-month, after increase of 2.8% in May and decrease of 3.6% in April, according to the Brazilian Federation of Automobile Vehicles Distribution (Fenabrave) data, seasonally adjusted by the BCB. The result, a record high for the month of June and the third record high for the historical series, reflected the tax cuts implemented by the federal government in the end of May. Sales increased 4.5% in the second quarter, compared to the 1% decrease in the previous quarter. Automobile vehicles sales decreased 1.1% in the first half of the year, as a consequence of the fall in the sales of trucks (-16%), buses (-10.2%) and light commercial vehicles (-1.7%), and of the increase of 0.1% for automobiles.

48. Capital goods imports quantum index, released by the Foreign Trade Studies Centre Foundation (Funcex) and seasonally adjusted by the BCB, expanded 3.2% in June, month-on-month. According to the observed data, the index decreased 5% year-over-year, but increased 3.7% in the first half of the year and 3.3% in the twelve months through June.

49. Capital goods production decreased 1.8% in May, accumulating a 0.7% decrease in the quarter ended in May, over the quarter ended in February, according to data seasonally adjusted from the Monthly Industrial Survey (PIM) by the IBGE. The main negative drivers in the month stemmed from the decrease in the production of capital goods for industrial serial use (-4.5%) and of equipment for electrical energy (-3.3%), as opposed to the expansion of 8.6% in the production of agricultural equipment.

50. Construction inputs production increased by 2.3% in May, accumulating an increase of 1% in the quarter, compared to the one ended in February, considering seasonally adjusted data. The segment production increased 3.4% year-over-year, with cumulative increases of 3.4% in the year and 4% in twelve months.

51. Disbursements granted by the Brazilian Development Bank (BNDES) totaled R$139.4 billion in the twelve months through April, 16.3% below the one registered in the same period of 2011, as a consequence of the

retraction of 48.2% 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 -0.9% in May, according to IBGE seasonally adjusted data, after a decrease of 0.4% (revised) in April, reflecting the retreat of 1.1% in manufacturing industry and the increase of 1.5% in mining. By use categories, it bears highlighting the falls of 2.2% in the durable goods production, of 2.1% in the production of semi and non-durable consumer goods and of 1.8% in capital goods, whereas the production of intermediate goods increased 0.2%. Fourteen out of the 26 manufacturing industry activities surveyed decreased in the month, with highlights for the segments of electronic material and communication equipment (-10.9%); leather and shoes (-5.3%); and automotive vehicles (-4.5%). On the other hand, the sector of metallic products recorded the largest monthly expansion, 13.2%. The industrial production retreated 1.2% in the quarter ended in May, over the quarter ended in February, when it had decreased 0.6%, reflecting retraction of 1.5% in the manufacturing industry, while mining increased 1.8%. The quarterly development was influenced by the negative performance of tobacco industry (-11.5%), medical-hospital instrumentation equipment (-10.8%) and electronic material and communication equipment (-8.9%). Considering observed data, industrial production decreased 4.3% in the month, year-over-year, 3.4% in the year and 1.8% in twelve months, mainly reflecting the unfavorable performance of the capital goods and durable consumer goods industries.

53. The Nuci in the manufacturing industry reached 83.8% in June, a 0.2 p.p. decrease month-on-month, according to data seasonally adjusted by the FGV. The monthly result stemmed from the reductions of 0.3 p.p.in durable consumer goods, 0.2 p.p. in construction inputs and capital goods, and 0.1 p.p. in intermediate goods, while non-durable consumer goods increased 0.6 p.p.. Considering the observed series, the Nuci fell 0.5 p.p., year-over-year, as a result of the decrease in the indicators related to capital goods (1.8 p.p.), construction inputs (-1.5 p.p.), intermediate goods (-0.8 p.p.) and consumer goods (-0.1 p.p.).

54. Vehicles output reached 273.6 thousand units in June, representing increases of 1.3% month-on-month and 0.8% in the second quarter, 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 7.6% year-over-year, 9.2% in the year and 5.8% in twelve months.

55. Still according to data released by Anfavea, national vehicle licensing increased 36.9% in June, month-on-month, and 5.1% in the second quarter, quarter-over-quarter, considering data seasonally adjusted by the BCB. Regarding observed data, there were changes of 19.9% year-over-year, -1.8% in the first half of 2012 and -5.3% in twelve months. Automobile exports totaled 36 thousand units in June, representing changes of -3.3% year-over-year, -11% in the year and 0.8% in twelve months. According to the series seasonally adjusted by the BCB, exports increased 53% in the month and retreated 13.9% in the second quarter.

56. The LSPA survey carried out by the IBGE regarding June projected 160.7 million tons for the 2012 national harvest of grains, representing increases of 0.4% year-over-year and 0.3% over the May crop forecast. The new prognosis presented more favorable prospect for the harvests of corn and wheat, with respective increases of 0.8% and 3.2%, compared to the estimate of the previous month, in contrast to the forecasts for the crops of beans and rice, which reduced by 8.2% and 1.5%, respectively, according to the same comparison basis. Regarding the 2011 harvest of grains, the new projection estimates expansion in the harvest of corn (22.7%), exclusively reflecting an expected increase of 59.6% for the second harvest, as opposed to the declines projected for the harvests of beans (-17.6%), rice (-14.8%), soybeans (-12.3%) and wheat (-8%). In addition, a decrease of 7.4% is projected for the harvest of sugarcane, year-over-year, 11.2% lower than the projected in the previous estimate.

**Surveys and Expectations**

57. The Consumer Confidence Index (ICC), considering data seasonally adjusted from the nationwide Consumer Expectations Survey (FGV), decreased 2.8% in June, month-on-month, to 123.5 points, driven by the

reduction of 4.4% in the Current Situation Index (ISA) and 1.8% in the Expectations Index (IE). The ICC increased 4.6% year-over-year, as a result of the changes of 0.7% in the ISA and 7.3% in the IE.

58. The ICS, calculated by the FGV, decreased 1.8% in June, month-on-month seasonally adjusted, moving from 125.4 to 123.1 points, as a result of the decreases of 2.7% in the Current Situation Index (ISA-S) and 1.1% in the Expectations Index (IE).

59. The Commerce Confidence Index (ICOM), measured by the Commerce Survey from FGV, reached 126.2 points in June, decreasing 4.1% year-over-year. The result reflected reductions of 7.4% in the Current Situation Index (ISA-COM) and 1.9% in the Expectations Index (IE-COM). In the second quarter, the ICOM decreased 3.7% year-over-year, due to the retreats of 2.7% in the ISA-COM and 4.3% in the IE-COM.

60. The Industry Confidence Index (ICI), considering seasonally adjusted data from the Survey of Manufacturing Industry (SCIT-FGV), decreased 0.2% in June, month-on-month, reaching 103.2 points. The result was driven by the increase of 0.9% in the ISA and the reduction of 1.4% in the IE. The ICI fell 3.5% in June, year-over-year, due to decreases of 3.4% in the ISA and 3.8% in the IE.

61. The Construction Confidence Index (ICST), measured by the Construction Survey, from FGV, reached 124.1 points in June, decreasing 9.4% year-over-year. The result reflected retreats of 10.5% in the Current Situation Index (ISA-ICST) and 8.4% in the Expectations Index (IE-ICST). In the second quarter of 2012, the ICST decreased 9.5%, year-over-year, due to the retreats of 10.5% in the ISA-ICST and 8.6% 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), 139.7 thousand formal jobs were created in May, of which 46.3 thousand jobs in agriculture and livestock, 44.6 thousand jobs were created in the services sector, 20.3 thousand jobs in the manufacturing industry, 14.9 thousand jobs in the civil construction and 9.7 thousand jobs in commerce. In the year through May, 737.9 thousand jobs were created and in twelve months, 1.3 million, compared to 1.0 million and 1.9 million, respectively, in the same periods of 2011. Month-on-month, formal job creation expanded by 0.2%, considering data seasonally adjusted by the BCB.

63. According to the IBGE employment survey (PME), carried out in the six main metropolitan regions of the country, the unemployment rate reached 5.8% in May, decreasing 0.2 p.p. month-on-month, and 0.6 p.p. year-over-year. The monthly result was driven by the increases of 1.2% in occupation and 0.9% in the Economically Active Population (PEA). Considering seasonally adjusted data, the unemployment rate reached 5.4% in May, compared to 5.6% in the previous month. According to the same survey, average real earnings usually earned by the workers decreased 0.1%, month-on-month, and increased 4.9%, year-over-year, and 4.8% in the year through May. Real payroll, defined as the number of persons employed times real average earnings, increased 1.1% month-on-month, 7.5% year-over-year, and 6.8% in the year through May.

**Credit and Delinquency Rates**

64. Outstanding credit in the financial system reached R$2,136 billion in May, equivalent to 50.1% of GDP, increasing by 1.7% in the month, 5.2% in the year and 18.3% in twelve months. Non-earmarked credit operations, which represented 64.1% of the total of the financial system, increased 1.6% in the month, 5.0% in the year and 16.1% in twelve months, reflecting respective increases of 1.2%, 4.8% and 15.0% for credit operations to individuals, and 1.9%, 5.1% and 17.2% for credit operations to corporate, in the same order. Earmarked credit operations increased 1.8% in the month, 5.7% in the year and 22.4% in twelve months. It bears highlighting the expansion of 2.8%, 13.8% and 39.8% in housing credit, according to the same comparison bases.

65. The average annual interest rate on reference credit operations reached 32.9% in May, decreasing 2.2 p.p. in the month and 7.1 p.p. in twelve months. The average annual rate on credit for individuals and corporate

reached 38.8% and 25.0%, respectively, registering decreases of 3.0 p.p. and 1.3 p.p., month-on-month, and 8.0 p.p. and 6.1 p.p., year-over-year, respectively.

66. The tenure related to individuals and corporate segments increased one day in May, reaching 607 and 402 days, respectively. The average tenure on reference credit operations reached 500 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 6.0% in May, increasing 0.1 p.p. month-on-month and 0.9 p.p., year-over–year. The indicator for the operations with individuals reached 8.0% in May, increasing 0.2 p.p. month-on-month, and 1.6 p.p. in twelve months, while the delinquency rate for credit operations to the corporate segment stood at 4.1%, remaining stable for the fourth consecutive month on a month-on-month basis and increasing 0.3 p.p. year-over-year.

**External Environment**

68. Since the last Copom meeting, prospects for the global economy deteriorated, due to the continuity of the European crisis, the slowdown in China and uncertainty about the sustainability of growth in the US. In this context, the assessment of purchase managers, expressed by the global PMI, fell for the fourth consecutive month, reaching 50.3 points in June, the lowest level of the last three years. In the US, the latest revision of GDPQ1 showed annualized growth of 1.9%, after rising 3.0% in the previous quarter. Among the downside risks, it bears noticing the recovery of the local labor market at a pace slower than expected, with the net creation of 80,000 jobs in June, and the decreases in industrial output and retail sales in May, 0.1% and 0.2%, both month-on-month, respectively. In the Euro Area, the risks of recession became more pronounced, as indicated by the monthly decrease in industrial production in April, -0.8% month-on-month, and the continuity of deterioration in activity, with the composed PMI recording 46.4 points in June, the ninth contraction in the last ten months. The unemployment rate reached 11.1% in May, the highest percentage since the creation of monetary union. In Japan, after a GDPQ1 annualized growth rate of 4.7%, deceleration in the pace of activity is expected, indicated by the composed PMI, which fell to 49.1 points in June, the first contraction in the year. In China, the deceleration trend for activity indicators has remained. The composed PMI showed further decline in June, mainly influenced by the performance of the manufacturing sector.

69. In the financial markets, despite the environment of high uncertainty, there was reduction in risk aversion in the period. The end of the electoral process in Greece and the measures announced by the European Union Summit at the end of June - more flexible rules allowing the use of the European Financial Stability Facility (EFSF) and, later, the European Stability Mechanism (ESM), to direct capitalization of banks and purchase of sovereign bonds in the secondary market - more than offset the signs of fragility in the Spain's banking system. The relief in the markets favored the valuation of the euro and the currencies of emerging countries against the dollar, while the US and German ten-year securities' yields increased relative to the record lows of May.

70. International commodities prices have shown some recovery in the two weeks preceding the Copom meeting, reflecting, in particular, climatic problems that affect grain producing regions in the United States. Additionally, the price of a barrel of Brent crude oil, after falling to US$89.61 on June 21$^{st}$, the lowest value since December 2010, has since then started to show recovery under the influence of supply constraints in Norway and the uncertainties regarding the consequences of the European embargo to the Iranian oil, sanction in force since July 1$^{st}$.

71. Since the last Copom meeting, the process of global disinflation has continued, especially in advanced economies, where, under the impact of the decrease in energy prices, the annual consumer price indices (CPI) declined to 1.7%, 2.4%, 2.8% and 0.2% in May, in the US, Euro Area, the UK and in Japan. Due to the deterioration in the global macroeconomic scenario, the central banks of major economies have opted for the adoption of new quantitative easing measures. On June 20$^{th}$, the Fed extended by six months the Twist Operation, which meant the additional purchase of about US$267 billion of Treasuries by the end of the year. On July 5$^{th}$, the ECB reduced the interest rates on main refinancing operations by 25 basis points, to 0.75%, effective from July 11$^{th}$. Previously, on June 22$^{nd}$, the ECB had relaxed the conditions for the eligibility of

collateral, in order to expand the access of the banking system to the operations of the Eurosystem. Still on July 5th, the Bank of England (BoE) expanded the program of purchase of assets with the issuance of £50 billion reserves to £375 billion. In China, the People's Bank of China (PBC) reduced the one-year deposit and loan rates by 25 b.p. and 31 b.p., respectively, to 3% and 6%.

**Foreign Trade and International Reserves**

72. The Brazilian trade surplus reached US$806 million in June, as a result of US$19.4 billion in exports and US$18.5 billion in imports. In the year through June, the trade surplus totaled US$7.1 billion, down from US$13 billion in the same period of 2011, reflecting retreat of 0.9% in exports and expansion of 4.6% in imports. In the year through June, total external trade grew 1.7%, totaling US$227.4 billion, compared to US$223.6 billion registered in the same period of 2011.

73. International reserves reached US$373.9 billion in June, increasing US$1.5 billion month-on-month. Compared to December 2011, the reserves increased US$21.9 billion. In the month, there were no monetary authority's interventions in the domestic spot market.

**Money Market and Open Market Operations**

74. After the May 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, by the release of weaker economic indicators, by the favorable trajectory of price indices and by the decreases in inflation and GPD expectations released by the Focus survey. At the external scenario, the worsening of the economic indicators in Europe, in the US and in China, and the uncertainties stemming from the developments of the debts crisis that hits countries in the Euro Area have also contributed to the retreat of the rates. Between May 28th and July 6th, the one-, three- and six-month interest rates fell by 0.45 p.p., 0.48 p.p. and 0.55 p.p., respectively. The rates for maturities of one, two and three years decreased by 0.67 p.p., 0.56 p.p. and 0.46 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 2.50% on May 28th, to 1.85% on July 6th, mainly due to the reduction in the nominal rates.

75. Between May 29th and July 9th, the BCB carried out traditional FX swap auctions maturing on July 2nd, August 1st, September 3rd and October 1st, totaling the equivalent to US$11.4 billion.

76. In its open market operations, the BCB carried out weekly, between May 29th and July 9th, repo operations borrowing R$45.6 billion for a six-month period. The average daily balance of the long term operations decreased from R$128.7 billion, between April 17th and May 28th, to R$127.8 billion, between May 29th and July 9th. At the same period, the BCB also borrowed money through very short term repo operations with tenures between eighteen and twenty-nine working days, increasing the average daily balance of short-term borrowing operations to R$298.6 billion. The BCB also conducted very short-term operations through 24 borrowing operations and four lending operations, and carried out leveling operations, at the end of the day, with tenures of two working days. The average daily balance of these operations totaled R$41.9 billion in the period, borrowing. The average daily balance of the total outstanding of repurchase agreements of the BCB decreased from R$468.8 billion, between April 17th and May 28th, to R$468.3 billion, between May 29th and July 9th. Considering the operations for the most recent period, the total outstanding of repurchase agreements increased from R$445.2 billion on May 28th to R$578.6 billion on July 9th. The main factor that contributed to the expansion of liquidity in the period was the net redemption of securities by the National Treasury.

77. Between May 29th and July 9th, the National Treasury issuance regarding the traditional auctions raised a total of R$30.9 billion. The sale of fixed-rate securities reached R$27.5 billion, with R$24.3 billion via issuance of LTNs maturing in 2012, 2013, 2014 and 2016, and R$3.2 billion via NTN-Fs maturing in 2018 and 2023. The sales of LFTs totaled R$0.5 billion, with issuance of securities maturing in 2018. The sales of inflation-linked NTN-Bs reached R$2.9 billion, for securities maturing in 2016, 2018, 2022, 2030, 2040 and 2050.