



BANCO CENTRAL DO BRASIL

Minutes of the 181st Meeting of the Monetary Policy Committee (Copom)

Summary

Recent Economic Developments
Assessment of Inflation Trends
Monetary Policy Decision

Date: February 25th, 2014, from 4:10PM to 7:50PM, and February 26th, from 5:10PM to 8:32PM

Place: BCB Headquarters meeting rooms – 8th floor on February 25th and 20th floor on February 26th – Brasília – DF

In attendance:

Members of the Committee

Alexandre Antonio Tombini – Governor (present only on February 26th)
Aldo Luiz Mendes
Altamir Lopes
Anthero de Moraes Meirelles
Carlos Hamilton Vasconcelos Araújo
Luiz Awazu Pereira da Silva (present only on February 26th)
Luiz Edson Feltrim
Sidnei Corrêa Marques

Department Heads (present on February 25th)

Bruno Walter Coelho Saraiva - International Affairs Department
Daso Maranhão Coimbra - Department of Banking Operations and Payments System
Eduardo José Araújo Lima - Research Department (also present on February 26th)
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 February 25th)

Enrico Bezerra Ximenes de Vasconcelos – Deputy-Head of the Governor's Economic Advisory
Gustavo Ênio Falcão Freire – Press Officer
Maurício Barreto Campos – Division Head of the Economic Department

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

Recent Economic Developments

1. Monthly inflation measured by the Extended Consumer Price Index (IPCA) changed 0.55% in January, 0.31 percentage points (p.p.) below the one recorded in January 2013 and 0.37 p.p. below the one recorded in December 2013. As a consequence, inflation in twelve months decreased to 5.59% in January (6.15% until January 2013). Market prices changed 6.65% in twelve months (7.20% until January 2013), and regulated prices, 2.15% (2.94% until January 2013). Among market prices, the prices of tradable goods increased 5.64% in twelve months (5.54% in January 2013), and the prices of non-tradable goods, 7.56% (8.69% in January 2013). On its turn, the prices of food and beverages group increased 7.25% in the same period (11.09% in January 2013), and the prices of services rose 8.26% (8.61% in January 2013). In short, available information suggests some persistence of inflation, which partially reflects the dynamics of prices in the services sector.



BANCO CENTRAL DO BRASIL

2. The average of the underlying inflation measures, calculated by the BCB, changed from 0.76% in December to 0.53% in January. As a consequence, on a twelve-month trailing basis, inflation reached 6.07% (0.25 p.p. above the one registered until January 2013). Specifically, the smoothed trimmed means IPCA core inflation changed from 0.58% in December to 0.55% in January. The double weight core inflation, from 0.79% to 0.55%; the core inflation by exclusion of regulated prices and household food, from 0.96% to 0.52%; the non-smoothed trimmed means core inflation, from 0.72% to 0.54%; and the core by exclusion, which excludes ten household food items and fuels, from 0.74% to 0.50%. The diffusion index stood at 72.1% in January (3.0 p.p. below the one recorded in January 2013).
3. The General Price Index (IGP-DI) increased 0.40% in January, after increasing 0.69% in December, and 5.62% on a twelve-month trailing basis (8.11% in the twelve months through January 2013). The main component of this indicator, the Wholesale Price Index (IPA), changed 5.19% in twelve months (9.12% until January 2013), with retreat of 1.70% in the prices of agricultural products and increase of 7.95% in the prices of industrial products. Inflation measured by the Consumer Price Index (IPC), the second most important component of the IGP-DI, changed 5.61% in twelve months through January (5.95% until January 2013). The Civil Construction National Index (INCC), component with the lowest weight in the IGP-DI, changed 8.34% (6.86% until January 2013), partially driven by pressures stemming from the labor cost, which increased 10.35% in the period. On its turn, the Producer/Manufacturing Industry Price Index (IPP/IT), calculated by the Brazilian Institute of Geography and Statistics (IBGE), increased 0.65% in December, driven by the increase in the prices of oil byproducts, and by 5.75% in 2013 (7.28% in 2012). The Copom considers that the effects of the behavior of wholesale prices on consumer inflation will depend on the current and prospective demand conditions and on the price setters' expectations regarding the future inflation path.
4. The Economic Activity Index of the BCB (IBC-Br) incorporates estimate for the monthly production of the three sectors of the economy, as well as for taxes on products, and constitutes important coincident indicator of the economic activity. In December 2013, the IBC-Br changed -1.4% month-on-month, 0.7% relative to December 2012, and increased 2.5% in 2013 (0.6% in 2012). On the other hand, the composite Purchasing Managers' Index (PMI) regarding Brazil pointed to deceleration of the economic activity in January, with expansion in the manufacturing sector and decrease in the services sector. On its turn, the Consumer Confidence Index (ICC), from the Getúlio Vargas Foundation (FGV), retreated in February and remains below its historical average. Likewise, the industrial businessmen confidence, measured by the Industry Confidence Index (ICI), decreased in February. Regarding agriculture, the Agricultural Production Systematic Assessment (LSPA), carried out by the IBGE, indicates that grains production is expected to grow by 3.0% in 2014, relative to the 2013 harvest.
5. Calculated by the BCB based on a quarterly consultation carried out with institutions representing each segment of the credit market, the Credit Conditions Indicators suggest, for the first quarter of 2014, compared to the last quarter of 2013, a small slowdown in the granting of concessions to corporations, due to both lower demand and to more restrictive supply. Regarding credit to individuals, the analysis indicates stability in the pace of credit approval destined to consumption and slight reduction to housing credit.
6. The industrial activity retreated by 3.5% in December, after decreasing 0.6% in November, according to the seasonally adjusted series, released by the IBGE. Industrial production in December stood 2.3% below the one registered in December 2012. Thus, the industrial production in 2013 was 1.2% above the 2012 one, with expansion in 17 out of the 27 surveyed activities. The PMI of the industrial sector indicates expansion in January, with increase in the amount of new orders. According to data released by the National Confederation of Industry (CNI), real revenue in the manufacturing industry increased 3.8% in 2013, the number of hours worked, 0.1%, the employment level, 0.8%, and real average earnings, 0.9%.
7. Among the use categories, the production of capital goods increased 1.8% in December 2013, compared to December 2012. At the same time, the production of intermediate goods, durable consumer goods and semidurable and non-durable consumer goods decreased 2.0%, 3.5% and 3.1%, respectively, in the same comparison basis. Regarding growth accumulated in 2013, there were expansions in the production of capital goods (13.3%) and durable consumer goods (0.6%), retreat in the production of semidurable and non-durable consumer goods (-0.5%) and stability in the production of intermediate goods.



BANCO CENTRAL DO BRASIL

8. The IBGE released the first results of the new National Household Sample Survey (Continuous PNAD). According to the survey, the unemployment rate in Brazil in the second quarter of 2013 was 7.4%, representing a decrease of 0.1 p.p. compared to the same quarter of 2012. The unemployment rate was higher in the Northeast region (10.0% of the labor force), and lower in the South region (4.3%). According to the Monthly Employment Survey (PME), covering only six metropolitan areas, the unemployment rate without seasonal adjustment was 4.8% in January, representing a reduction of 0.6 p.p. compared to the January 2013 rate. According to the BCB seasonally adjusted series, the unemployment rate reached the record low (4.9%) of the historical series started in 2002, which partially reflects the reduction in the economically active population (PEA) in the recent period. Still according to the PME, the average real income increased 3.6% in January, year-over-year; while real payroll increased 3.3%, according to the same comparison basis. Data released by the Ministry of Labor and Employment (MTE) show that 29.6 thousand formal jobs were created in January. The net creation was similar to the one observed in January 2013 (28.9 thousand), but significantly lower than the formal job creation observed in the same month in the previous three years. In short, the available data indicate narrow idleness margin in the labor market, although there are some signs of moderation at the margin.
9. According to the retail monthly survey (PMC), released by the IBGE, retail sales volume increased by 4.3% in 2013, after expanding by 8.4% in 2012. On its turn, broad retail sales volume, which includes vehicles and construction inputs, increased by 3.6% in 2013, after growing by 8.0% in the previous year. In 2013, the sales volume increased in all ten sectors surveyed, similarly to the observed in 2012. At the margin, the month-on-month retail sales changed by -0.2%, and broad retail sales, by -1.5%, in December, according to the seasonally adjusted series. After five consecutive increases, the Trade Confidence Index (ICOM), measured by the FGV, retreated in January, mainly due to the moderation in expectations. The Copom evaluates that the retail sales trajectory will continue to be influenced by governmental transfers, by the pace of real payroll growth and by the moderate credit expansion.
10. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by the FGV, without seasonal adjustment, reached 83.8% in February (83.3% in February 2013). According to the seasonally adjusted series calculated by the FGV, the Nuci in February reached 84.6%. The utilization capacity in the sector of capital goods stood at 81.2%. In the sector of consumer goods, intermediate goods and construction inputs, the utilization capacity stood at 82.9%, 85.6% and 88.8%, respectively. On its turn, the absorption of capital goods grew 12.2% in 2013 (fall of 9.7% in 2012), while the production of inputs for the civil construction increased 2.3% (1.3% in the previous year).
11. The twelve-month trailing trade balance result reached US\$2.5 billion in January. This result stemmed from US\$242.2 billion in exports and US\$239.7 billion in imports, which diminished 0.1% and increased 6.2%, respectively, compared to the previous twelve months. On its turn, the current account deficit accumulated in twelve months reached US\$81.6 billion in January, equivalent to 3.7% of the GDP. Foreign direct investment totaled US\$65.4 billion, according to the same comparison basis, equivalent to 2.9% of the GDP.
12. Regarding the global economy, the prospects point to more intense activity pace in important advanced economies. Specifically about Europe, despite recent improvements, high unemployment rates, coupled with the fiscal consolidation and political uncertainties, constitute elements constraining investments and growth. Composite leading indicators, released by the Organization for Economic Cooperation and Development (OECD), referring to December, and PMI coincident indicators, relative to January and February, signal improvements at the margin in important economies - especially in the manufacturing sector - with prospects of growth in line with the trend. Regarding the monetary policy, the Federal Reserve continued the process of gradual reduction of the assets purchase program; however, in general, accommodative stances prevail in the advanced economies. In the emerging economies, the monetary policy is less expansionist, and in some cases contractionist. Inflation remains at moderate or low levels in the US, in the Euro Zone and in Japan.
13. The price of the Brent oil barrel has increased since the previous Copom meeting. It bears highlighting that the geopolitical complexity that involves the oil sector tends to heighten the volatile behavior of prices, which also reflects the low predictability of some global demand components and the dependency of supply growth on long term risky investment projects. Since the last Copom meeting, the international prices of agricultural



BANCO CENTRAL DO BRASIL

commodities have increased 8.1%, while those relative to metals have decreased 1.3%. On its turn, the Food Price Index, calculated by the Food and Agriculture Organization of the United Nations (FAO), retreated 4.4% in the twelve months through January 2014.

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 the whole year of 2014, was maintained at 0%, the same value considered at the January Copom meeting;
 - b) the projected adjustment for the household electricity price, for the whole year of 2014, was maintained at 7.5%, the same value considered at the January Copom meeting;
 - c) the projected adjustment for the fixed telephone tariff price, for the whole year of 2014, was maintained at 0%, the same value considered at the January Copom meeting;
 - d) the projected adjustment, based on individual items, for the set of regulated prices inflation accumulated for the whole year of 2014, was maintained at 4.5%, the same value considered at the January Copom meeting; and
 - e) the projected adjustment, based on individual items, for the set of regulated prices accumulated for the whole year of 2015, was maintained at 4.5%, the same value considered at the January Copom meeting. These projections are based on endogenous determination models for regulated prices, which compute, among other factors, seasonal components, market prices inflation, and the inflation measured by the IGP (General Price Index).
15. The estimated path for the spreads over the Selic rate, based on the 360-day swap rates, on the baseline scenario, projects -1 basis point (bp) and 33 bps for the fourth quarters of 2014 and 2015, respectively.
16. The structural primary surplus that derives from the primary surplus trajectories, both for 2014 and 2015, is considered as the fiscal indicator, according to the parameters set out in the Budget Guidelines Law (LDO)/2014. Therefore, in a given period, the fiscal impulse corresponds to the variation of the structural surplus in comparison to the observed in the previous period.
17. Since the last Copom meeting, the median of the projections compiled by the Investor Relations and Special Studies Department (Gerin) for the 2014 IPCA has remained at 6.00%. For 2015, the median of the inflation projections increased to 5.70% from 5.50%.
18. The baseline scenario assumes the maintenance of the exchange rate at R\$2.40/US\$1.00 and the Selic rate at 10.5% p.a. during the forecast period. Under this scenario, the projection for the 2014 inflation remained relatively stable, compared to the value considered at the previous Copom meeting, and remains above the 4.5% midpoint target established by the National Monetary Council (CMN). According to the market scenario, which incorporates the market expectations for exchange and Selic rates trajectories collected by Gerin, in the period immediately prior to the Copom meeting, the 2014 IPCA inflation forecast increased relative to the value considered at the January meeting, and stands above the inflation target. For 2015, according to the baseline scenario, the inflation forecast decreased regarding the figure considered at the January Copom meeting, but is above the midpoint inflation target. According to the market scenario, the 2015 IPCA inflation forecast remained stable relative to the value considered at the January meeting and is above the midpoint inflation target.

Monetary Policy Decision

19. The Copom evaluates that the monetary policy should contribute to the consolidation of a favorable longer-term macroeconomic environment. In this respect, the Copom reassures that, under the inflation targeting regime, it guides its decisions according to BCB projected inflation and based on the analysis of alternative scenarios for the evolution of the main variables that determine prices dynamics. The Copom also understands that low risks for the underlying inflation in the short run tend to reduce uncertainties regarding



BANCO CENTRAL DO BRASIL

the future behavior of headline inflation, facilitate the assessment of scenarios by the monetary authority, as well as help the process of coordination of economic agents' expectations, particularly prices setters'. Additionally, it is noteworthy that low risks for the underlying inflation in the short run tend to intensify the effects of monetary policy actions, enabling them to affect in a more long-lasting manner the dynamics of headline inflation in the future. Although the Copom recognizes that other macroeconomic policy actions may influence the prices trajectory, it reaffirms its view that it is particularly under the responsibility of the monetary policy to remain especially vigilant, to guarantee that pressures detected in shorter horizons do not spread to longer horizons.

20. The Copom considers that, since its last meeting, the risks to global financial stability remained high, particularly those derived from changes in the yield curve slope of major advanced economies. Despite identifying low probability of occurrence of extreme events in the international financial markets, the Committee considers that the external environment remains complex. For the Committee, based on positive data recently released, the prospects for more intense global activity throughout the relevant horizon for the monetary policy have remained. In fact, there are improvements in advanced economies, including countries from the Euro Area, although, in general, the space to use monetary policy remains limited and the fiscal restraint scenario prevails in this and in the upcoming years. In important emerging economies, however, the activity pace has not matched the expectations, despite the resilience of the domestic demand. The Committee also highlights that, despite localized pressures, recently observed, the prospects indicate moderation in the dynamics of commodity prices in international markets, as well as that, in the currency markets, there is evidence of tension and volatility.
21. The Copom evaluates that the main scenario encompasses relatively stable domestic activity expansion pace in this year, compared to 2013, and that recent information indicate, in the relevant horizon for the monetary policy, changes in the composition of aggregate supply and demand. The domestic absorption has expanded at rates higher than GDP growth rates (both gradually converging though) and, according to the Committee, it tends to be benefited by the effects of fiscal policy actions, of the moderate expansion of credit supply (especially, of credit to consumption), of the program of public services concession and of the program of permission for oil exploration, among other factors. For the Committee, however, the outlook that has been taking shape is that consumption would tend to keep growing, but at a more moderate pace than the observed over the recent years; and investments would gain momentum. Regarding the external component of aggregate demand, the scenario of greater global growth, combined with the depreciation of the real, contributes to make this component more favorable to the Brazilian economy growth. Focusing on the supply side, the Committee evaluates that more favorable prospects for the competitiveness of industry and agriculture are emerging and that, considering the relevant horizon for the monetary policy, the services sector tends to grow at rates lower than those recorded over the recent years. It is plausible to claim that these developments - coupled with advances in terms of qualification of the labor force - will be reflected in a more efficient allocation of the production factors of the economy and in productivity gains. The Committee also highlights that the speed of materialization of the aforementioned changes and of their resulting gains depends on the strengthening of companies' and households' confidence.
22. The Copom observes that the main inflation scenario considers the materialization of the assumed trajectories regarding fiscal variables and the arising of the conditions so that, in the relevant horizon for monetary policy, the balance of the public sector shifts to the neutral zone. The Committee also notes that the generation of primary surpluses in line with the working hypotheses considered in the inflation projections, on the one hand, would contribute to reduce the mismatch between supply and demand growth rates; on the other hand, it would contribute to create a positive perception regarding the macroeconomic environment in the medium and long terms. It should also be emphasized that the generation of primary surpluses at levels close to the average generated over the recent years would contribute to reduce the public debt financing cost, with favorable impact on the cost of capital in general, which would stimulate private investment in the medium and long terms.
23. The Copom highlights that its main scenario also considers moderate credit expansion. Still regarding the credit market, the Committee considers opportune initiatives with the aim of moderating concessions of subsidies through credit operations.



BANCO CENTRAL DO BRASIL

24. Regarding the factors market, the Copom highlights the narrow idleness margin in the labor market and it considers that, under such circumstances, a significant risk stems from the possibility of concession of wages increases incompatible with productivity growth and their negative impacts over inflation. Although the projected adjustment for the minimum wage this year is not as significant as in the previous years, and considering the occurrence over the recent quarters of real wage changes more consistent with the gains estimated for the labor productivity, the Committee evaluates that the wages dynamics remains originating inflationary cost pressures.
25. The Committee considers that the exchange rate depreciation and volatility observed in the recent semesters enable a natural and expected correction in relative prices. For the Committee, the movements in the local currency markets, to some extent, reflect prospects for the transition of the international financial markets towards normality, among other dimensions, in terms of liquidity and interest rates. It is also important to highlight that, for the Committee, the aforementioned exchange rate depreciation constitutes a source of inflationary pressure in shorter periods. However, the secondary effects stemming from it, and that would tend to materialize over longer periods, can and should be limited by appropriate monetary policy handling.
26. The Copom evaluates that, despite the moderation observed at margin, the high consumer inflation level in the last twelve months contributes for inflation to still show resistance, which, by the way, has been slightly above the level that was anticipated. In this context, the formal and informal indexation mechanisms and the economic agents' perception regarding the inflation dynamics are also included. Considering the damage that the persistence of this process would cause to the decision-making process on consumption and investment, in the Committee's view, it is necessary that, with the due promptness, it be reverted. In this context, the Copom considers that it is appropriate to continue the ongoing adjustment pace of the monetary conditions.
27. Therefore, continuing the adjustment process of the basic interest rate, initiated at the April 2013 meeting, the Copom unanimously decided to increase the Selic rate by 0.25 p.p., to 10.75% p.a., without bias.
28. The following members of the Committee voted for this decision: Alexandre Antonio Tombini (Governor), Aldo Luiz Mendes, Altamir Lopes, Anthero de Moraes Meirelles, Carlos Hamilton Vasconcelos Araújo, Luiz Awazu Pereira da Silva, Luiz Edson Feltrim and Sidnei Corrêa Marques.
29. The Copom evaluates that the domestic demand tends to be relatively robust. On the one hand, household consumption tends to continue expanding, due to the effects of stimulus factors, such as income growth and moderate credit expansion; on the other hand, favorable financial conditions, concession of public services, expansion of oil exploration areas, among others, create good prospects for investments. These elements and the developments in the quasi fiscal framework and in the assets market are important parts of the context in which future monetary policy decisions will be taken, aiming to ensure the timely convergence of inflation to the targets path.
30. The Copom emphasizes that the international evidence, in which it is ratified by the Brazilian experience, indicates that high inflation rates generate distortions that lead to higher risks and depress investments. These distortions are manifested, for example, in the shortening of the planning horizons of households, companies and governments, as well as in the deterioration of the businessmen confidence. The Committee also emphasizes that high inflation rates reduce the purchasing power of wages and transfers, with negative repercussions over household's confidence and consumption. Therefore, high inflation rates reduce the growth potential of the economy, as well as of jobs and income generation.
31. The Copom highlights that, in moments such as the current one, the monetary policy should remain especially vigilant, in order to minimize risks that high inflation levels, such as the one observed in the last twelve months, persist in the relevant horizon for the monetary policy. At the same time, the Committee considers that the effects of monetary policy actions over inflation are cumulative and occur with lags.



BANCO CENTRAL DO BRASIL

32. At the end of the meeting, it was announced that the Committee will reconvene on April 1st, 2014, for the technical presentations, and on the following day, to discuss monetary policy, as established in the Communiqué 24,064, of June 12th, 2013.