BANCO CENTRAL DO BRASIL

Minutes of the 130th Meeting of the Monetary Policy Committee (Copom)

Summary

Date: October 16th, from 3:30PM to 5:42PM, and October 17th, from 4:00PM to 7:00PM
Place: BCB Headquarters meeting rooms - 8th floor on October 16th and 20th floor on October 17th – Brasília – DF

In attendance:
Members of the Committee
Henrique de Campos Meirelles – Governor
Alexandre Antonio Tombini
Antonio Gustavo Matos do Vale
Mário Gomes Torós
Mário Magalhães Carvalho Mesquita
Paulo Sérgio Cavalheiro
Paulo Vieira da Cunha

Department Heads (present on October 16th)
Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on October 17th)
Ivan Luis Gonçalves de Oliveira Lima – Open Market Operations Department
José Antonio Marciano – Department of Banking Operations and Payments System
Márcio Barreira de Ayrosa Moreira – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations Group

Other participants (present on October 16th)
Adriana Soares Sales – Deputy Head of the Research Department
Alexandre Pinheiro de Moraes Rego – Press Secretary
Flávio Pinheiro de Melo – Advisor to the Board
José Linaldo Gomes de Aguiar – Executive Secretary

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

Recent Economic Developments

1. IPCA inflation increased 0.18% in September, after reaching 0.47% in August, up from 0.24% in July, totaling 2.99% in the first nine months of 2007, compared to 2.00% in the same period of last year. Twelve-month trailing inflation reached 4.15%, exceeding that of September 2006 (3.70%). The acceleration of consumer price inflation essentially mirrors the behavior of market prices, which have increased more rapidly than regulated prices

in 2007, a reversal in the dynamics observed in the recent years. In fact, market prices and regulated prices increased 3.82% and 1.16% in the year through September, and 5.07% and 2.12% in the last twelve months. Despite the BRL appreciation in 2007, amongst market prices, the prices of tradable goods showed the sharpest acceleration. In the twelve months through September, tradable goods inflation totaled 4.92%, up from 0.78% observed in the same period of last year, whereas non-tradable goods inflation reached 5.20%, up from 4.36% in the same period of 2006. Notwithstanding the recent occurrence of inflation developments less benign than previously anticipated, price dynamics still indicates that inflation should continue to evolve according to the targets path.

2. The recent dynamics of IPCA core inflation measures has been in line with headline inflation. The core inflation by exclusion of household food items and regulated prices elevated in August (0.35%, against 0.08% in July), but decelerated in September (0.25%). Similarly, smoothed and non-smoothed trimmed means core inflation measures increased in August (0.40% and 0.43%, against 0.20% and 0.17% in July, respectively) and decelerated in September (0.34% and 0.19%, respectively). Nevertheless, core inflation by exclusion of household food items and regulated prices shows stability in the year through September (2.70%, against 2.67% in 2006), and in the last twelve months as well (3.60% against 3.65% in 2006). On its turn, smoothed trimmed means core inflation decelerated both year-to-date and on a twelve-month trailing basis (2.81% against 3.62%; and 3.82% against 5.21%, respectively). Finally, non-smoothed trimmed means core inflation increased year-to-date (2.44% against 2.18% in 2006), but retreated on a twelve-month trailing basis (3.03% against 3.53% in 2006). It is noteworthy that, in all cases, twelve-month inflation stood below the central target, but shows acceleration, which is relevant in the cases of the core inflation by exclusion and non-smoothed trimmed means core, relative to the record lows observed in previous months.

3. The General Price Index (IGP-DI) inflation accelerated in August (1.39%) and in September (1.17%) relative to the previous months. As a result, in the year through September, IGP-DI inflation increased 4.44%, up from 2.11% in the same period of last year. On a twelve-month trailing basis, inflation measured by IGP-DI totaled 6.16%, up from 3.16% in 2006. This increase reflects not only the behavior of the Consumer Price Index-Brazil (IPC-Br), which totaled 4.50% up from 2.51%, but also of the IPA-DI, whose variation totaled 6.92%, up from 3.13%. On its turn, despite at higher levels, inflation as measured by the Civil Construction National Index (INCC) showed stability in the last twelve months (5.05% against 5.09% in the same period of 2006). Regarding wholesale price inflation, it is relevant to highlight that agricultural prices strongly rallied, reaching 19.50% in the last twelve months, versus 1.98% in the same period of 2006. Conversely, industrial prices behaved positively in the period, recording 3.07%, down from 3.48% in September of last year, but significantly accelerated in the August-September period, compared to the previous two-month period, when had registered slight deflation. As highlighted in previous Copom Minutes, the effects of wholesale prices over consumer inflation will depend on current and prospective demand conditions and price-setters' expectations for the future inflation path.

4. On a three-month moving average basis, according to data seasonally adjusted by the IBGE, industrial output grew 0.7% in July and August, after increasing 0.9% in June, confirming the solid expansion of this sector. Still considering the seasonally adjusted series, after the 0.4% fall observed in July, the first decrease after nine consecutive positive figures, industrial output resumed growth, reaching 1.3% in August. This expansion suggests that the retreat in industrial output in July was punctual. Industrial output in August records a 6.5% robust growth in year-over-year terms, the thirteenth consecutive expansion under this basis. Therefore, industrial output grew 5.3% in year-to-date terms, and 4.5% on a twelve-month trailing basis, showing acceleration at the margin. Moreover, still considering the last twelve months through August, manufacturing industry production reached 4.4%, while mining industry production expanded by 6.2%. For September, the leading and coincident indicators available point to the continuity of the industrial production expansion cycle, which will be favored by the several stimulus factors that influence economic activity, including the monetary easing already implemented.

5. Among the use categories, it bears emphasizing the strong monthly expansions of capital goods production and durable consumer goods production, which increased 4.0% and 2.7%, respectively, in August, on a month-on-month basis, according to data seasonally adjusted by the IBGE. In year-to-date terms, the strong increases in capital goods production (17.6%) and durable consumer goods production (6.9%) should also be highlighted. The strength of durable consumer goods production reflects, predominantly, the remarkable improvement in credit conditions, when compared to historical patterns. The accelerated expansion of capital goods production is, to a

large extent, due to the consolidation of positive prospects for the continuity of domestic demand growth, which has reflected both the improvement of income and the expansion of credit, underpinned by the perception of higher macroeconomic stability. Furthermore, it bears emphasizing the contribution of other specific factors, such as investment resumption in the agricultural and live stock sector. Compared to August 2006, the production of the majority of industrial sectors surveyed (22 out of 27) expanded in August, with highlights to the increase in the production of machinery and equipment (18.2%) and vehicles (17.5%).

6. Labor market continues to present fairly positive developments. The unemployment rate in the six main metropolitan regions covered by the Monthly Labor Survey (PME) stood at 9.5% in August, unchanged month-on-month. However, the unemployment rate significantly decreased 1.1 p.p. in August, year-over-year, the seventh consecutive fall according to this comparison basis, so that in year-to-date terms it stood 0.5 p.p. below the observed in the same period of last year. The purchasing power of employed workers decreased month-on-month 0.5% in August, the third consecutive monthly fall. However, it increased 1.2% relative to the same month last year, and 3.8% in the first eight months of the year. As a consequence, real payrolls expanded by 6.8% in the year through August, compared to the same period of last year, a key driver for sustained aggregate demand growth. According to the National Industry Confederation (CNI) data seasonally adjusted by the BCB, manufacturing employment increased month-on-month 0.4% in August and 3.8% compared to August 2006. Regarding formal employment, data from the Ministry of Labor and Employment (MTE) confirm the continuity of strong expansion. In September, job creation grew month-on-month seasonally adjusted 0.5%, expanding by 5.0% in the year through September and 4.9% in the last twelve months, with highlights to employment expansions in the construction industry (7.2%) and in the retail sector (6.0%). These figures corroborate the creation of 1.6 million formal jobs in the year through September and 1.5 million formal jobs in the last twelve months.

7. In line with the positive developments in labor market, and with the expansion of credit, retail sales continue to record positive performance, indicating that the pace of domestic demand growth remains robust, and consistent signs of cooling cannot be perceived. In fact, retail sales increased 0.5% month-on-month in July, the seventh consecutive expansion, according to data seasonally adjusted by the IBGE. In the first seven months of 2007, relative to the same period of last year, retail sales grew by 9.7%, and in the last twelve months, by 8.7%. Compared to the same month of 2006, retail sales increased by 9.2% in July. According to the same comparison basis, it bears emphasizing the expansion in the sales of furniture and domestic appliances (18.2%), and fabric, clothing and shoes (10.4%). These developments confirm the view expressed in previous Copom Minutes that both the expansion of income and the improvement of consumer credit conditions are crucially important to the strengthening of aggregate demand growth. In fact, expanded retail sales, which include the sales of construction material and vehicles, motorcycles, parts and pieces, grew by 13.3% in July, compared to the same month of 2006. For the next quarters, it is expected the strengthening of retail sales, further boosted by the increase in real payroll and credit and by the recovery of consumer confidence, which so far has not been affected by the higher volatility in financial markets.

8. The installed capacity utilization rate in the manufacturing industry reached 83.6% in August, a record high for the series calculated by the CNI. The August result stood 1.7 p.p. above the rate observed in the same month of 2006, recording the thirteenth consecutive expansion under this basis. In the year through August, the average installed capacity utilization rate stood 1.8 p.p. above the observed in the same period of 2006 and 1.2 p.p. above the rate observed in the same period of 2005 and 2004. Such increase reflects, unmistakably, economic activity acceleration and occurs in several sectors, despite the strong expansion of investment. In fact, in the year through August, the absorption of capital goods grew 18.6%, and reflects the significant increase in capital goods imports (33.0% in volume), as well as in capital goods production (17.6%). Moreover, in the same period, the production of construction inputs increased 4.2%. The most recent data indicate that although investment has contributed to dampen the process of elevation of capacity utilization rates, it has not been sufficient to avoid its persistence at relatively high levels, which coincided, in the past, with periods of inflation acceleration. In light of the recent behavior of capacity utilization rates, the expansion of investment, as well as the timely maturity of projects, which may increase the productive capacity of economy, will be fundamental to avoid relevant mismatches regarding the evolution of aggregate supply and demand. As stressed in previous Copom Minutes, the inflation trajectory is closely linked to current and prospective developments with regard to the expansion of supply of goods and services to adequately meet demand conditions.

9. The trade balance continues to present robust performance in 2007, despite the deceleration at the margin, confirming the evaluations reported in Inflation Reports and previous Copom Minutes about important structural changes in the Brazilian foreign trade. In the year through September, the trade surplus reached US$30.9 billion, a 9.6% decrease relative to the same period of 2006. Exports rose 15.5%, to US$116.6 billion, while imports increased 28.3%, to US$85.7 billion. As stressed in previous Copom Minutes, imports have been growing more rapidly than exports, due not only to the strengthening of the BRL, but also, and mainly, to the higher level of economic activity in the country. The current account surplus reached US$5.6 billion in the year through September and US$9.0 billion in the last twelve months, or 0.75% of GDP.

10. Although the most intense effects of the crisis in the US subprime mortgages market over financial markets seem to have exhausted, uncertainties remain. On the one hand, several volatility and risk aversion indicators improved significantly since the last Copom meeting. On the other hand, neither has the situation in the interbank markets of the mature economies reached normality, nor have the developments of this crisis over real economy completely materialized. The magnitude of the crisis is not completely known – especially the effects over the US economic growth and, to a lesser extent, over the European economies. Notwithstanding the remaining difficulties in financial markets and the uncertainties regarding global economy developments, the recovery in risk appetite has been relatively fast, including that regarding Brazilian assets. In fact, the price behavior of Brazilian assets in the last episode of stress in international financial markets, similarly to the observed in February and in March this year, and in May and June 2006, evidences the consolidation of international investors confidence in the Brazilian economy. The main central banks reacted to the financial turbulence providing liquidity in the interbank market and, in the case of US, easing the monetary policy aiming at minimizing the risk that the impact of the real state sector over credit would lead to a more pronounced economic deceleration. On its turn, inflation expectations in the US (derived from financial assets) slightly increased in the last weeks, reacting to the weakening of the US dollar vis-à-vis the main currencies and to the upward trend in the prices of raw materials. In short, the long monetary tightening cycle comes to an end in the US, and the current debate seems to be centered in the duration and magnitude of additional reductions in the interest rates. In Europe and in the major Asian countries, economic activity continues to record robust expansions, despite the increase in the risk of deceleration, caused by the uncertainties regarding the US domestic macroeconomic scenario, the impact of difficulties of real state market over financial institutions and credit conditions in these regions. In this context, it bears emphasizing that the current vigor of emerging economies has importantly counterbalanced the economic deceleration in the US. The Brazilian economy, specifically, does not seem to have significantly been impacted by the recent turmoil, and should continue its growth trajectory, essentially sustained by domestic demand, in the upcoming quarters.

11. Oil prices, a systematic source of international uncertainty, which remained at historically high levels in the last months, had important additional increase since the last Copom meeting. This behavior reflects not only structural shifts in global energy markets, but also geopolitical tensions, which recently intensified. Despite the significant uncertainties surrounding the expectations about the future trend for oil prices, the main scenario considered by the Copom, which attributes no change to domestic gasoline prices in 2007, remains plausible. The prices of other commodities have also presented high volatility in the last weeks, driven by the heightened uncertainty about the prospects for global growth and by the turmoil on global markets. Nevertheless, the main raw material price indices have presented an upward trend in the last weeks. In this context, the strong acceleration of food prices in several countries should be highlighted, which has made the control of inflation by several central banks a more difficult task.

Assessment of Inflation Trends

12. The identified shocks and their impacts were reassessed according to newly available information. The scenario considered in the simulations utilized the following assumptions:

a) Compared to the values considered in the September Copom meeting, the projection for gasoline and bottled gas prices adjustments in 2007 were both maintained at 0%;

b) The projections for electricity price adjustments in 2007 remained at –4.4%, the same considered in the September Copom meeting, while the projections for fixed telephone price adjustments for the same year were modified to 2.3%, down from 2.8%;

c) The projection for regulated prices inflation in 2007 was modified to 2.9%, down from 3.2%, considered in the September Copom meeting. These items, according to the weights released by the IBGE, represent 30.66% of the total September IPCA;

d) The projection for regulated prices inflation in 2008 was also maintained, at 4.5%. This projection is based on the endogenous determination model for regulated prices. This model considers the effects of seasonal components, exchange rate changes, market prices inflation and the IGP;

e) The projection for the spreads over the Selic rate, using a Vector Autoregressive model based on the Selic and 180-day swap rates, estimates a -8 bps spread, under the benchmark scenario, in the fourth quarter of 2007, reaching 47 bps in the last quarter of 2008. The identified shocks and their impacts were reassessed according to newly available information.

13. Regarding fiscal policy, it is assumed that the consolidated public sector primary surplus target of 3.8% of GDP in 2007 and 2008 will be achieved, adjusted by the possibility of a 0.45 p.p. reduction in this percentage due to the implementation of the PPI (Investment Pilot Program). The related assumptions considered in the previous meeting were maintained.

14. Since the September Copom meeting, median IPCA inflation expectations for 2007, compiled by the BCB's Investor Relations Group (Gerin), slightly decreased to 3.91%, down from 3.92%. This reduction was mainly driven by the addition of the September inflation result, below market expectations. Twelve-month ahead inflation expectations reached 3.83%, down from 3.87%, considering the composition of monthly inflation market expectations. For 2008, inflation expectations increased to 4.1%, up from 4.0% projected on the eve of the last Copom meeting.

15. Considering the hypotheses under the benchmark scenario – which assumes the maintenance of the Selic rate at 11.25% and the exchange rate at R$1.80/US$ during the forecast period – the projection for the 2007 IPCA decreased compared to the value considered at the September Copom meeting, and remained below the 4.5% target established by the CMN for the year. According to the forecast based on the market scenario – which incorporates the consensus exchange and Selic rates trajectories collected by Gerin on the eve of the Copom meeting – IPCA inflation forecast for 2007 remained stable compared to the value considered at the September Copom meeting, and therefore, remain below the central target for the year. Both the projections for 2008 based on the benchmark scenario and on the market scenario decreased compared to the value considered at the September Copom meeting, and remain below the 4.5% target established for 2008.

Monetary Policy Decision

16. The Copom reaffirms the view expressed in previous Minutes, that in addition to containing short-term inflationary pressures, monetary policy has also contributed significantly for the consolidation of a favorable long-term macroeconomic environment. Economic activity data indicate that the pace of demand expansion remains robust, and may increase the probability of significant inflationary pressures on short-term inflation. Investment expansion and imports growth have contributed to retard this process, limiting potential inflationary effects stemming from aggregate demand sustained growth. Moreover, despite uncertainties regarding the continuity of strong growth in the international economy and the heightened volatility in global markets in the last months, the prospects for Brazilian external financing in the forecast period suggest, according to the information available until now, that the balance of payments should not present a risk to the inflation scenario. On the other hand, some recent evidences point to an intensification of the risks on the global inflation outlook, as suggested by the evolution of some raw materials prices. Therefore, although inflation prospects remain in line with the targets path, additional uncertainty surrounds this outlook. As in recent meetings, the Copom emphasizes that the main challenge of the monetary policy in this context is to guarantee the consolidation of positive developments anticipated for the future.

17. The Copom evaluates that the probability that emerging local inflationary pressures will represent risks to domestic inflation trajectory has increased, because the heated demand can increase the pass-through of wholesale prices over consumer price inflation. Additionally, although the external sector can restrain the

inflationary pressures in the tradable sector, the heated domestic demand can trigger inflationary pressures in the non-tradable sector. The Copom also observes that even though the upward movement of IPCA inflation expectations for 2008 has stabilized over the recent weeks at a level below the target established for 2008, this process must be carefully monitored. In this context, the Copom will continue to manage the monetary policy stance so that the gains obtained in inflation control in recent years become permanent. In this respect, the Copom will carefully monitor the evolution of inflation and the several core inflation measures, discriminating between one-off and persistent or generalized price increases, and promptly adjusting the monetary policy stance to the circumstances.

18. The preservation of inflation rates in line with the targets path and the consolidation of a long-lasting stable macroeconomic scenario will contribute to the progressive reduction of macroeconomic risk perception underway. The scope for a reduction in real interest rates in the future will naturally follow, as a consequence of this improved perception. The Copom evaluates that the persistence of a cautious monetary policy stance has been critical to increase the probability that inflation will continue to evolve according to the targets path. For this to materialize, however, it is important that forward-looking inflation indicators, in particular the expected dynamic of aggregate supply and demand, remain consistent with the recent benign inflation outlook observed in the last quarters.

19. The Committee emphasizes, once again, that there are important time lags in the transmission of monetary policy stance to economic activity and inflation. Since the beginning of the monetary easing cycle, in September 2005, the Selic rate has already been reduced by 850 b.p., with the bulk of the reduction concentrated in the last nine months. Consequently, neither has the activity level completely mirrored the effects of the interest rates cuts yet, nor have the effects of the economic activity on inflation completely materialized. Therefore, the evaluation of alternative monetary policy stances should necessarily focus on the prospective inflation scenario and its risks, instead of current inflation indicators.

20. During the coming months, credit growth and payroll expansion should continue to bolster economic activity. As mentioned in recent Copom Minutes, activity level should also reflect the effects of governmental transfers and other fiscal impulses expected for the next quarters of the year and for 2008. Consequently, the lagged effects of interest rates cuts on an increasingly robust aggregate demand will add up to other factors that will continue to contribute to this expansion. These issues become even more relevant considering the clear signs of heated aggregate demand, and the fact that the monetary policy decisions will have limited effects in 2007 and predominant impacts in 2008.

21. The Copom recognizes the contribution of investment, enlarging the productive capacity, and of the external sector to mitigate inflationary pressures, but evaluates that the pace of domestic demand expansion, which should continue to be sustained by factors such as the impulse derived from the monetary policy easing implemented this year, may bring non-insignificant risks to the inflationary dynamics.

22. Aiming at consolidating a stable and predictable environment, the Copom has privileged a strategy to avoid a volatile inflationary trajectory. This strategy takes into consideration the lags in the transmission mechanisms and has been the most adequate to deal with the uncertainty inherent to the process of monetary policy formulation. That is the reason why variables such as inflation projections, the balance of risks associated to the prospective scenario and the preventive stance in the decision-making process of the Copom are so important. Prudence assumes an even more important role in this process, like at the current moment, when the deterioration of the balance of inflationary risks reduces the safety margin of the monetary policy.

23. Under this context, considering the uncertainties associated with both the transmission mechanisms of the monetary policy and the prospective growth pace of aggregate supply and demand, the Copom decided to pause the monetary policy easing process. This decision aims to preserve the gains in inflation control and to ensure that the strengthening of economic activity continues to be underpinned by solid fundamentals. Therefore, the Committee unanimously decided to maintain the Selic target rate at 11.25% p.a., without bias.

24. Under the inflation-targeting regime, the Copom decides according to inflation prospects, the analysis of several alternative scenarios for the evolution of the main variables that determine price prospective dynamics and its balance of risks. Domestic demand continues to expand vigorously, backing-up economic activity strength. This

expansion encompasses some sectors little exposed to external competition, at a time when the effects of important incentive factors, such as the monetary easing already implemented, are still not fully perceived. In spite of not being an imminent threat to inflation prospects, the contribution of the external sector to the maintenance of a benign inflationary scenario may become less effective, at a moment when the effects of investment over the productive capacity of the economy still need to consolidate. In such environment, the monetary authority must remain vigilant, so that short-term uncertainties do not contaminate longer time horizons.

25. At the conclusion of the meeting, it was announced that the Copom would reconvene on December 4th 2007, for technical presentations, and on the following day to discuss the monetary policy decision, as established in Communiqué 15,011 of October 31, 2006.

SUMMARY OF DATA ANALYZED BY THE COPOM

Inflation

26. The IPCA increased 0.18% in September, down from 0.47% in August, totaling increases of 2.99% in the year through September and 4.15% in the last twelve months. The IPCA deceleration was mainly driven by the price behavior of food and beverages, which increased 0.44%, down from 1.39% in August, contributing 0.09 p.p. for the index, in comparison to 0.3 p.p. in the previous month. Conversely, housing, health and personal care and clothes registered higher rates than in the previous month. It also bears emphasizing the downturn in the prices of communication, mainly the 1.01% decline in fixed telephone tariffs, after a 1.14% increase in August.

27. Market prices inflation increased 0.28% in September, down from 0.62% in August, while regulated prices inflation totaled -0.04%, down from 0.12%, in the same period. On a twelve-month trailing basis, market prices increased 5.07%, and regulated prices, 2.12%. Among market prices, the prices of non-tradable goods increased 5.20%, while the prices of tradable goods totaled 4.92%, according to the same comparison basis.

28. The several IPCA core inflation measures declined on a month-on-month basis and showed relative stability on a twelve-month trailing basis. The smoothed trimmed means core rose 0.34% in September, down from 0.40% in August. In the last twelve months, the change totaled 3.82%, against 3.80% in August. The non-smoothed trimmed means core reached 0.19%, down from 0.43% in August, totaling 3.03% in the last twelve months through September, up from 2.94% in the last twelve months through August. Finally, the core excluding household food and regulated prices reached 0.25% in September, down from 0.35% in August, totaling 3.60% in the last twelve months through September, compared to 3.58% in August.

29. The IPCA diffusion index, which indicates the proportion of items with positive change in the month result, stood at 56.77% in September, compared to 63.28% in August and 58.13% in 2007 average terms.

30. The IGP-DI increased 1.17% in September, down from 1.39% in August, totaling 4.44% in the year through September and 6.16% in the last twelve months. Considering the index components, the IPA-DI and the IPC-Br decelerated in September, while the INCC accelerated. The IPA-DI increased 1.64%, down from 1.96% in August, reaching 4.79% in the year through September and 6.92% in twelve months. The inflation measured by the IPC-Br totaled 0.23% month-on-month in September, down from 0.42%, totaling 3.46% in the year through September and 4.50% in the last twelve months. The INCC increased 0.51%, up from 0.26% in August, reflecting the increase in the prices of materials and services, while the cost of labor was almost unchanged month-on-month. In the year through September, the INCC increased 4.62% and in the last twelve months, 5.46%.

31. The lower change of IPC-Br in September was driven by the price deceleration in many items, mainly food, which increased 0.19% in September, down from 0.99% in August. The IPC-Br core inflation measure increased 0.24%, down from 0.37% in August, totaling 2.55% in the year through September and 3.31% in the last twelve months.

32. The deceleration of IPA-DI in September reflected the lower change in industrial and agricultural prices. The agricultural IPA elevated 5.27%, down from 6.15% in August, while the industrial prices increased 0.41%,

down from 0.61%, according to the same comparison bases. The main drivers for upward agricultural price pressures in September were the prices of soy, corn, fruit and legumes, perishable milk and wheat. The deceleration in the agricultural IPA stemmed mainly from the prices of perishable milk and poultry, the downturn in the prices of bovines and the recurrent fall in the price of sugar cane, compared to the previous month. Among the prices of industrial products, it bears emphasizing the increase in the prices of mining industry products and fertilizers and the fall in the prices of non-ferrous metals.

Economic Activity

33. According to IBGE's monthly survey (PMC), retail sales increased month-on-month seasonally adjusted 0.5% in July. Among the activities included in the general indicator, only the sales of hyper- and super-markets, food products, beverages and tobacco expanded on month-on-month basis. Sales of vehicles and motorcycles, parts and pieces, which are not part of the general retail sales index, grew 0.6% in the month. Regionally, 9 out of 27 Federation units reached positive results in July.

34. Retail sales expanded by 9.2% in July, year-over-year, driven by increases in all its components segments, mainly in furniture and home appliances (18.2%) and textiles, clothing and shoes (10.4%). Expanded retail sales increased 13.3%, with highlights to the 22.8% expansion in the sales of vehicles and motorcycles, parts and pieces.

35. Retail sales performance reflects the continuity of payroll growth and better credit conditions, together with the impacts of social programs and the recovery of the agricultural sector. Retail sales increased 9.7% in the first seven months of 2007, compared to the same period of 2006, while expanded retail sales, which include vehicles, motorcycles, parts and pieces and construction material, increased by 13.6%. It bears emphasizing the increase in the sales of vehicles (22.9%) and furniture and domestic appliances (16.7%), in the same period. On a regional basis, all states but Piauí recorded growth in retail sales in 2007, with the most significant expansions in the Northeastern and Northern regions.

36. According to São Paulo Trade Association (ACSP) data, related to the city of São Paulo and seasonally adjusted by the BCB, the consultations to the Usecheque system decreased by 1.7% in September, while the database consultations for credit sales increased 0.4%, on a month-on-month basis. In the year through September, these indicators rose by 5.4% and 5.5%, respectively.

37. Regarding investment indicators, construction inputs production and capital goods production increased month-on-month seasonally adjusted 0.1% and 4% in August, respectively, while the imports of capital goods expanded by 12.2%. In the year through August, these indicators increased by 4.2%, 17.6% and 33%, in the same order. Considering the domestic production of capital goods during this period, it bears emphasizing the increases of 42.5% in the production of capital goods for agriculture; 19.7% for energy; 19.1% for serial industrials, 15.9% for construction and 15.3% for transportation.

38. Industrial production increased month-on-month 1.3% in August, according to IBGE's Monthly Industrial Survey (PIM) seasonally adjusted data, reaching a new record high in the historical series and evidencing the punctual aspect of the fall observed in July. Industrial production rose by 6.5%, compared to August 2006, and expanded by 5.3% in the year through August and 4.5% in the last twelve months.

39. Considering seasonally adjusted data, manufacturing and extractive industry production increased 1.5% and 0.1%, respectively, in the month. All use categories increased in the month: capital goods production, 4.0%; durable consumer goods production, 2.7%; intermediate goods production, 0.9%; and non-durable goods production, 0.6%. In the year through August, capital goods production leaded industrial expansion, increasing by 17.6%, followed by durable consumer goods production (6.9%), intermediate goods production (4.2%), and non-durable consumer goods production (3.2%).

40. The disaggregated analysis of industrial activity showed that, in August, seventeen out of the 26 activities with seasonally adjusted series increased, with highlights to food, vehicles, machines and equipment, and

electronic material and communication equipment. The main negative drivers stemmed from the decreases in the edition and printing sector and pharmaceutical industry.

41. Still regarding the industrial sector, according to CNI data seasonally adjusted by the BCB, real industrial sales and hours worked in production increased month-on-month 1.6% and 0.4%, respectively, in August. In the year through August, these indicators increased by 4.3% and 3.8%, respectively, compared to the same period of 2006. Installed capacity utilization reached 82.5% in August, up from 82.3% in July, after seasonal adjustment. Considering observed data, installed capacity utilization reached 83.6% in the month, 1.7 p.p. above the August 2006 level.

42. Vehicles production reached 252.8 thousand units in September, according to Anfavea. Total production increased 0.2% month-on-month, according to data seasonally adjusted by the BCB, and 23.9% compared to the same month of 2006. Considering the seasonally adjusted series, domestic sales and exports decreased 8.4% and 0.8%, in September, respectively. Compared to the data of the first nine months of 2006, vehicles production increased 10.6% in 2007, and domestic sales, 22.5%, while exports decreased 7.9%. Still according to Anfavea, the production of agricultural machines and trucks increased 34.9% and 26.2%, respectively, according to the same comparison basis, reflecting the agricultural sector recovery and investments increase.

43. According to IBGE, the September estimate for the grains harvest pointed to lower growth in 2006/2007, year-over-year, compared to the August estimate, overall due to the reduction of around 508 tons (1%) in corn estimate production, which exceeded the little increases in the forecasted production of other grains. National production of grains (cereals and legumes) may reach 133.3 million tons, 14% above the previous year harvest, due to good weather conditions and the production incentive stemming from the increase in the international prices of agricultural products. Compared to the 2005/2006 harvest, the most significant increases should occur in the production of wheat (62.1%), cottonseed (32.9%), corn (21.3%) and soy (11.3%), while the most prominent decreases should happen in the production of rice and beans (3.7% and 1.8%, respectively). Considering other agricultural products, in addition to grains, the IBGE pointed to a 15.3% decrease in coffee production and a 12.9% increase in sugar-cane production.

Surveys and Expectations

44. The Fecomercio-SP monthly survey showed a 1.2% increase in the Consumer Confidence Index (ICC) in September, month-on-month. Among the two ICC components, the Current Economic Conditions Index (Icea) increased month-on-month 3.5%, while the Consumer Expectation Index (IEC) decreased 0.4%. In September, for the ninth consecutive month, the Icea remained above the IEC. Compared to September 2006, the ICC and the Icea increased 0.5% and 13.3%, respectively, while the IEC decreased 7.3%.

45. According to the FGV survey, which encompasses two thousand homes in the seven main state capitals of the country, the ICC remained almost stable in September (109 points compared to 109.3 points in August). This result was due to the combination of less favorable assessments regarding current situation and more optimistic expectations for the next months. Compared to September 2006, the ICC increased 5.7%, with expansions of 5% in the current situation index and 6.1% in the expectations index.

46. Still according to the FGV, the Industry Confidence Index (ICI) increased to 123.1 in September 2007, up from 121.9 in August, reaching a new record high of the series begun in April 1995. The ICI increased 11.9% compared to September 2006 and expanded by 11.8% in the year through September, compared to the same period of 2006. Among the ICI issues related to the current situation, the most significant increase in the last twelve months was due to the assessment on the demand level, mainly influenced by the domestic market. Regarding the expectations for the next three months, 37% of the companies foresee increase in personnel hirings, while 6% forecast reduction. The installed capacity utilization reached 86.1% in September, compared to 84.6% in the same month of 2006.

Labor Market

47. According to the Ministry of Labor and Employment, 133.3 thousand new formal jobs were created in August, a 0.5% increase month-on-month. All the main sectors presented positive changes, except for agriculture and live stock sector, which reflected the inter-harvest period in the Middle-South period of the country. After the seasonal adjustment of the series, the employment index in August increased month-on-month 0.4%. In the year through September, 1.6 million jobs were created, a 5% elevation relative to the same period of 2006, with highlights to the higher volume of hirings in the services sector. In relative terms, it bears emphasizing the expansions of construction and manufacturing industries (4.9% and 7%, respectively).

48. According to the IBGE employment survey (PME) in the six main metropolitan areas of the country, the unemployment rate, in August, remained at 9.5%. The stability of the unemployment rate reflected the increases of 1% in employed population and 1.1% in economically active population (PEA). Considering the population employed in the private sector, there was a 1.7% increase in the month, due to the 2.5% expansion in the number of formal workers and the 0.7% reduction in the number informal workers. The number of employers increased 10.3%, while self-employed workers decreased 1.2%. In the year through August, the number of employed workers expanded 2.9%, mainly due to the increases of 4.5% in the number of formal workers and 5% in number of self-employed workers.

49. According to the same survey, real average earnings reached R$1,109.40 in August, decreasing 0.5% month-on-month. Compared to August 2006, real average earnings increased 1.2% and, in the year through August, the expansion reached 3.8%. Real payroll, the result of the average earnings times the number of occupied workers, grew 0.6% in the month, increasing by 4.1% year-over-year.

50. According to CNI data seasonally adjusted by the BCB, manufacturing employment increased 0.4% in August, month-on-month. In the year through August, this indicator expanded by 3.6%, while real manufacturing payroll raised 4.8%.

Credit and Delinquency Rates

51. Credit operations in the financial system reached R$841.5 billion in August, or 33.1% of GDP. In the month, the expansion reached 2.9%, increasing 14.9% in the year through August and 24.8% in the last twelve months. Earmarked credit operations increased 2.3% in the month and 16.6% in the last twelve months, while the non-earmarked ones expanded by 3.1% and 28.6%, in the same periods. Among non-earmarked credit operations, it bears emphasizing the twelve-month trailing leasing operations again, due to the expansions of 79.8% and 70.5% in credit to individuals and credit to corporate, respectively. Regarding earmarked credit, the most significant expansions in the last twelve months are related to housing (22.6%) and the agricultural sector (20.6%). Among agricultural sector credit operations, although it still represents a small share, it bears emphasizing the 50.6% growth in credit destined to cooperatives in this period. Considering credit operations by economic activity, loans to industries, other services and commerce increased above the overall average in August. Credit operations to individuals, equivalent to 34.2% of the total, increased by 2.7% in the month and continued to record the most significant increases in the year and on a twelve-month trailing basis (22% and 30%, respectively).

52. Non-earmarked credit, used as reference for interest rates, reached 35.7% p.a. in August, a record low for the historical series, standing 6.2 p.p. below the rate recorded in August 2006. The average rate for individuals decreased to 46.6% p.a. in August, down from 53.9% p.a. in the same month of 2006. The average rate for corporate decreased 4.8 p.p. in twelve months, reaching 23.1% p.a.

53. The average tenure of credit operations for individuals reached 414 days in August, compared to 344 in the same month of the previous year. The average tenure of personal credit operations totaled 441 days, a 90-day extension relative to August 2006, reflecting the increasing share of payroll-deducted contracts. In addition, it bears emphasizing the elevation of the twelve-month trailing average tenure of real estate financing and vehicles acquisition operations, which reached 1833 days and 571 days, up from 1403 days and 517 days, respectively.

54. Delinquency rates in the financial system (non-earmarked loans in arrears for more than ninety days) remained unchanged at 4.7% in August relative to the two previous months, and 0.3 p.p. below the August 2006 rate. Delinquency rate for corporate credit operations remained unchanged at 2.4% and decreased 0.2 p.p. in the

last twelve months. Delinquency rate for credit operations with individuals reached 7.2% in August, 0.4 p.p. below the same month of 2006.

55. Net delinquency rate for retail credit, measured by the ACSP, reached 5.2% in September, compared to 5.1% observed in the same month of 2006 and to the 5.3% average rate in 2006.

External Environment

56. International financial market business overcame the stress levels that characterized the operations in July and August, momentarily absorbing the exacerbations provoked by the crisis in the US subprime mortgage market. After the central banks interventions through open market operations, providing short term funding in order to regulate the liquidity and reduce the interest rates volatility, it bears emphasizing the actuation of the Federal Reserve Bank (Fed), in its meeting on September 18, in which the Fed funds target was reduced for the first time since June 2003. The 50-basis-point reduction, followed by the same cut in the rediscount rate, contributed to the improvement of the financial conditions in several assets markets, although there is no consensus about the intensity of this crisis effects over the US real economy and, consequently, over the global economy.

57. The recovery in the prices of commodities reinforces the uncertainties regarding inflationary pressures triggered by energy and food prices. The recent falls in consumer confidence indexes already capture the feeling of these effects over consumption intentions. Despite the current contraction of inflation in developed countries, the central banks still worry about these inflationary risks and will gradually return to prioritize inflation combat in their monetary policies stance.

Foreign Trade and International Reserves

58. Between January and September 2007, Brazilian external trade confirmed the ongoing expansion, reaching record highs in exports and imports. In the year through September, the trade surplus reached US$30.9 billion, accumulating US$43.2 billion in the last twelve months, while the external trade totaled US$202.3 billion and US$263.7 billion, respectively, in the same periods. In the first two weeks of October, the trade balance reached US$1.5 billion, with exports reaching US$6.4 billion (daily average of US$705.9 million), and imports, US$4.8 billion (daily average of US$534.4 million).

59. In September, exports reached US$14.2 billion, reaching a US$745.6 million daily average record, 18.6% above the observed in the same month of 2006. The exports of manufactured products totaled US$7.6 billion, recording a US$402.6 million daily average, 22.2% above the observed in the same month of the previous year. The exports of basic products totaled US$4.4 billion, and of semi-manufactured products, US$1.8 billion, with respective increases of 16.8% and 8.9% in daily average values, which reached record levels for the three products categories.

60. Imports totaled US$10.7 billion in September, with record daily average value of US$562.9 million, 38.8% above the observed in the same month of 2006. All products categories expanded according to the same comparison basis: fuels and lubricants (60%); capital goods (49%); consumer goods (32.2%); and raw materials and intermediate goods (30.1%). Regarding this group, it bears emphasizing the acquisitions of primary food products, mineral, chemical and pharmaceutics products, and transportation equipment accessories. Regarding the consumer goods segment, the main increases were observed in vehicles imports (72%), clothing and furniture. Amongst the imports of capital goods, it bears emphasizing the acquisition of industrial machines, machines and equipments for office and scientific service, and parts and pieces for capital goods.

61. International reserves totaled US$163 billion in September, with increases of US$1.9 billion in the month and US$77.1 billion in the year.

Money Market and Open Market Operations

62. Since the September Copom meeting, the future interest rates decreased, especially in longer terms. This movement was mainly due to the improvement in external financial markets conditions and the reduction in the risk aversion, after the Federal Open Market Committee (FOMC) decision to reduce the US economy basic interest rate by 0.50 p.p. The BRL appreciation also contributed to the interest rates decrease in the period. Between September 3 and October 15, one-, three- and six-month rates decreased, respectively, 0.14 p.p., 0.10 p.p. and 0.09 p.p. One-, two- and three-year rates decreased 0.15 p.p., 0.44 p.p. and 0.46 p.p., respectively. Real interest rates measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month ahead inflation expectations reduced to 7.06% on October 15, down from 7.31% on September 3.

63. On September 25, the BCB carried out reverse FX swap auctions amounting US$2.2 billion, with the total rollover of the October 1st redemption.

64. In its open market operations, the BCB carried out, from September 4 to October 15, weekly five- and seven-month long fixed rate repo operations. The average daily balance of these operations reached R$92.2 billion, of which R$65.9 billion were seven-month operations. In the same period, the BCB conducted 24 borrowing and one lending overnight repo operations. The BCB also conducted daily liquidity management operations with tenures up to two working days. Operations with tenors less than thirty days, including daily liquidity management operations, averaged R$13.3 billion, borrowing. In addition, on September 6 and October 1st, the BCB conducted borrowing operations with tenures of 28 and 12 working days, amounting R$75.4 billion and R$37.8 billion, respectively.

65. Between September 4 and October 15, the National Treasury raised a total of R$56.0 billion, of which R$20.9 billion in fixed-rate securities: R$16.3 billion via issuance of LTNs maturing in 2008, 2009 and 2010, and R$4.6 billion in NTN-Fs maturing in 2011, 2013 and 2017. Issuance of LFTs totaled R$19.6 billion, for securities maturing in 2010, 2011 and 2013. Issuance of inflation-linked NTN-Bs reached R$15.5 billion, for securities maturing in 2009, 2012, 2017, 2024, 2035 and 2045, of which R$5.7 billion were settled in other National Treasury securities.

66. In the same period, the Treasury conducted auctions to sell LTNs maturing in April, July and October 2008 and bought LTNs or NTN-Fs, both maturing in January 2008, totaling R$5.4 billion. The Treasury also conducted auctions to sell LFTs maturing in 2010, 2011 and 2013, totaling R$4.8 billion, receiving LFTs maturing in 2007 as payment, and to buy LTNs and NTN-Bs, totaling R$2.9 billion and R$53 million, respectively.