BANCO CENTRAL DO BRASIL

Minutes of the 131st Meeting of the Monetary Policy Committee (Copom)

Summary

Date: December 4th, from 5:20PM to 7:20PM, and December 5th, from 5:30PM to 7:20PM
Place: BCB Headquarters meeting rooms - 8th floor on December 4th and 20th floor on December 5th – 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 December 4th)
Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on December 5th)
João Henrique de Paula Freitas Simão – Open Market Operations Department
Luiz Fernando Cardoso Maciel – 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 December 4th)
Adriana Soares Sales – Deputy Head of the Research Department
Alexandre Pinheiro de Moraes Rego – Press Secretary
Alexandre Pundek Rocha – Advisor to the Board
Flávio Pinheiro de Melo – Advisor to the Board
Katherine Hennings – Advisor to the Board
Sergio Almeida de Souza Lima – 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 0.30% in October, up from 0.18% in September, totaling 3.30% in the year through October, compared to 2.33% in the same period of last year. Twelve-month trailing inflation reached 4.12% in

October, up from 3.26% in the same period of 2006. 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 4.24% and 1.20% in the year through October, and 5.05% and 2.04% 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 October, tradable goods inflation totaled 4.47%, up from 0.77% observed in the same period of last year, whereas non-tradable goods inflation reached 5.60%, up from 4.49% in the same period of 2006. Notwithstanding the recent occurrence of inflation developments less benign than previously anticipated, price dynamics still continue to be in line with the targets path.

2. Similarly to headline inflation, the three IPCA core inflation measures accelerated in October. The core inflation by exclusion of household food items and regulated prices and smoothed and non-smoothed trimmed means core inflation measures increased 0.40%, 0.43% and 0.35% in October, up from 0.25%, 0.34% and 0.19% in September. It bears emphasizing that headline inflation acceleration in the year was followed by only one of the three core inflation measures. Core inflation by exclusion of household food items and regulated prices shows slight increase in the year through October (3.11%, against 2.97% in 2006), smoothed trimmed means core inflation decelerated (3.25%, against 3.95% in 2006) and the non-smoothed trimmed means core inflation increased more significantly (2.79%, against 2.37% in 2006). On a twelve-month trailing basis, despite remaining below the central target, all inflation core measures accelerated in October, compared to September, standing at levels remarkably higher than the record lows reached in previous months.

3. The General Price Index (IGP-DI) inflation dampened in October (0.75%) after reaching high rates for two consecutive months (1.17% in September and 1.39% in August), but increased again in November (1.05%). As a result, IGP-DI inflation increased 6.32% in the year through November, up from 3.52% in the same period of last year. On a twelve-month trailing basis, inflation measured by IGP-DI totaled 6.60%, up from 3.59% in 2006. The strong IGP-DI increase reflects both the behavior of the Consumer Price Index-Brazil (IPC-Br), which totaled 4.53% in the last twelve months through November, up from 1.88% in the same period of 2006, and also of the IPA-DI, whose variation totaled 7.51%, up from 4.04% in the same periods, respectively. The Civil Construction National Index (INCC) increased 5.92% (5.05% in the same period of 2006), suggesting some persistence of inflation as measured by the INCC. Regarding agricultural IPA, prices reached 18.93% in the twelve months through November (16.72% in October). On its turn, industrial prices continue to present less unfavorable behavior, but also record significant acceleration in the last twelve months (3.76%, up from 2.71% in 2006) and higher monthly rates since August. 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 1.2% in October, the fourteenth consecutive expansion according to this comparison basis, an evidence of the solid performance of industrial sector. Still considering the seasonally adjusted series, after the 0.6% fall observed in September, industrial output recorded 2.8% robust growth month-on-month in October and 10.3% compared to October 2006. On a twelve-month trailing basis, industrial output grew 5.3%, and in the year through October, 5.9%. On its turn, manufacturing industry production reached 5.2% in the last twelve months (5.9% in 2007), while mining industry production expanded by 6.1% (5.6% in 2007). For November, statistical adjustments due to the lesser number of working days, compared to the same month of previous years, could determine the retreat of the industrial production index. However, the trend points to the continuity of the industrial production expansion cycle, which will continue to be favored by the several incentive factors that influence economic activity, such as employment and credit expansion, the monetary easing already implemented, the fiscal impulse and, in some sectors, the reduced inventory levels.

5. Among the use categories, the production of intermediate goods increased by 2.7% in October, of capital goods, 1.8%, and of consumer goods, 1.5%, according to data seasonally adjusted by the IBGE. The acceleration of intermediate goods production can be, to some extent, associated to signs of inputs shortage, as shown by the Manufacturing Industry Outlook Survey, carried out by the Getúlio Vargas Foundation (FGV). The dynamism of durable consumer goods production, which expanded 8.7% in 2007, reflects, predominantly, the remarkable improvement in credit conditions, when compared to historical patterns. Regarding capital goods production, the

18.8% steady expansion in 2007 (16.9% in the last twelve months) 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 macroeconomic stability consolidation. Finally, it bears emphasizing that 75% of the industrial activities surveyed by the IBGE expanded in October.

6. Labor market continues to present favorable developments. The unemployment rate in the six metropolitan regions covered by the Monthly Labor Survey (PME) maintained a downward trend and reached 8.7% in October, 1.1 p.p. below that observed in 2006, and a record low for the month reached after the methodological recalculation of the survey (May 2002). Therefore, in the year through October the average unemployment rate stood 0.6 p.p. below that observed in the same period last year. The unemployment rate seasonally adjusted by the BCB also reduced, reaching 8.9%, a record low for the series. After retreating for three consecutive months, the purchasing power of workers increased month-on-month 0.3% and 0.5% in September and October, respectively, and 2.5% and 1.2% compared to the same months last year. As a consequence, real payrolls expanded by 6.4% in the year through October, 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 0.5% in October and 4.6% compared to October 2006. Regarding formal employment, data from the Ministry of Labor and Employment (MTE) confirm the continuity of strong expansion. In October, job creation grew month-on-month seasonally adjusted 0.6%, expanding by 5.0% both in the year through October and in the last twelve months, with highlights to employment expansions in the construction industry (7.5%) and in the retail sector (6.0%). In absolute terms, the creation of formal jobs exceeds 1.8 million in the year through October and 1.5 million in the last twelve months.

7. In line with the positive developments in labor market, and with credit expansion, retail sales continue to record positive performance, indicating that the pace of domestic demand growth remains robust, and signs of cooling cannot be perceived. Retail sales increased month-on-month 1.1% in August and 1.4% in September, according to data seasonally adjusted by the IBGE, a record high for the series initiated in 2000. Compared to the same month of 2006, retail sales increased by 10.3% in August and 8.5% in September. In the year, retail sales grew robustly by 9.6%, and in the last twelve months, by 8.9%. The steady growth of retail sales in the year reflects the performance of both the sectors more sensitive to income and employment expansions and those more sensitive to credit conditions. In fact, in the year through September, it bears emphasizing the expansion in the sales of “furniture and domestic appliances” (16.3%), and “fabric, clothing and shoes” (10.1%). Amongst expanded retail sales, which include the sales of “vehicles, motorcycles, parts and pieces” and “construction material”, the strong growth of the first group should be highlighted (22.9% in the year). For the next quarters, the continuity of the current expanding cycle is expected, whose boosting factors will continue to be employment and income growth, credit expansion and the increase in consumer confidence.

8. The installed capacity utilization rate in the manufacturing industry reached an 83.1% record high in October (82.3% in September), according to CNI data seasonally adjusted by the BCB. Without the seasonal adjustment, the rate stood 2.2 p.p. above the level registered in the same month of 2006, while the average installed capacity utilization rate in the year through October reached 1.7 p.p. above the observed in the same period of 2006, and 0.9 p.p. and 1.5 p.p. above the average rates registered in the same periods of 2004 and 2005, respectively. The reduction of idle capacity occurs in several sectors, despite the significant increase of investment. Indeed, in the year through October, the absorption of capital goods increased firmly (20.9%), due to the significant growth of capital goods imports (35.3% in volume), as well as of capital goods production (18.8%). Furthermore, the production of construction inputs increased 5.0% in the year through October, and shows acceleration at the margin. The most recent data indicate that although investment has been contributing to soften the elevation of capacity utilization rates, it has not been sufficient to stop this process. Considering the recent behavior of capacity utilization rates, the acceleration of investment projects, and particularly their timely maturation, will be crucial 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 related 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 expected deceleration at the margin, in line with the evaluations present in Inflation Reports and previous Copom Minutes about important structural changes in the Brazilian foreign trade. In the year through November, the trade surplus reached US$36.4

billion, a 12.1% decrease relative to the same period of 2006. Exports and imports rose to US$146.4 billion and US$110.0 billion, equivalent to 16.6% and 30.8% growth, respectively, compared to the same period of 2006. As highlighted in previous Copom Minutes, imports have been growing faster than exports, both due to the strengthening of the BRL and to the robust economic activity in the country. The current account surplus reached US$5.6 billion in the year through October and US$7.4 billion in twelve months (0.6% of GDP).

10. Regarding the external scenario, high uncertainties still remain, particularly concerning the effects of the crisis in the US subprime mortgages market over global economic activity, as well as over the international financial market. Volatility and risk aversion indicators worsened again since the last Copom meeting. Despite recently issued data were, to some extent, positive, economic activity in Europe and in the US is expected to slow down. Consequently, the scenario points out to an easing monetary stance in mature economies, at different paces in each region. On the other hand, strong economic growth of main Asian emerging economies, which were apparently little affected by the US mortgage crisis, as well as the strength and steadiness of current expansion of other emerging economies, even under increasing inflationary pressures and tight monetary cycles, have been fundamental factors to offset the effects of US economic deceleration. The Brazilian economy, more specifically, does not seem to have been significantly affected by the recent turmoil, and should sustain its growth trajectory, essentially driven by domestic demand.

11. Oil prices, a systematic source of international uncertainty, not only remained at historically high levels but also continued highly volatile. This behavior reflects, in addition to structural changes in global energy markets, recurrent geopolitical tensions. Despite the significant uncertainties inherent to expectations about the future trend for oil prices, the main scenario considered by the Copom remains plausible, in which domestic gasoline prices remain unchanged in 2007. However, apart from the trajectory of domestic gasoline prices, one should recognize that the elevation of international oil prices impacts the domestic economy, both through productive chains, such as the petrochemical, as well as by the deterioration of inflation expectations. The prices of other commodities have also presented high volatility in the last months, reflecting the increased uncertainty about the prospects for global demand growth and the turmoil on global financial markets. In this context, the strong acceleration of food prices in several countries should also be highlighted, as it makes 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 October Copom meeting, the projections for gasoline and bottled gas prices adjustments in 2007 were both maintained at 0%;

b) Considering the previous meeting, the projections for electricity and fixed telephone prices adjustments in 2007 were changed to –6.0% and 0.8%, respectively;

c) The projection for regulated prices variation in 2008 remained at 4.5%, unchanged relative to the October meeting. This projection is based on the endogenous determination model for regulated prices, which computes seasonal components, exchange rate changes, market prices inflation and the IGP variation;

d) 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 -1 bps spread in the fourth quarter of 2007, under the benchmark scenario. The swap rate trajectory points to a 47bps spread in the last quarter of 2008. The identified shocks and their impacts were reassessed according to newly available information.

13. Regarding fiscal policy, the projections assume the achievement of the 3.8% target for the consolidated public sector primary surplus in 2007 and 2008, 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 October Copom meeting, median IPCA inflation expectations for 2007, compiled by the BCB's Investor Relations Group (Gerin), slightly increased to 3.96%, up from 3.91%. This elevation was due to the addition of the October inflation result and the raise of expected inflation in December. Twelve-month ahead inflation expectations changed more significantly, to 3.95%, up from 3.83%, considering the composition of monthly inflation market expectations. For 2008, inflation expectations remained at 4.10%.

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 increased compared to the value considered at the October Copom meeting, but 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 also increased compared to the value considered at the October Copom meeting, but remains below the central target for the year. The projection for 2008 based on both the benchmark and the market scenarios also increased in relation to the October meeting, but both remained below the 4.5% target.

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 intensity of demand expansion continue quite robust and can increase the probability of important pressures over inflation in the short-run. However, imports growth and the benign investment behavior, which continues to expand robustly, have contributed to slow down this process. Moreover, despite uncertainties regarding the continuity of the rapid growth recorded in the international economy in the last years and the volatility increase observed in global markets in the last months, the prospects for Brazilian external financing in the forecast period suggest, according to newly available information, that the balance of payments may not represent imminent risk to the inflation scenario. On the other hand, the relevant inflation increase both in mature and emerging economies in recent months evidences the intensification of the inflationary risks on the global outlook. Therefore, although inflation prospects remain in line with the targets trajectory, additional uncertainties surround the inflation path. The Copom emphasizes that the main challenge of monetary policy in this context is to guarantee the maintenance of positive results reached in the last years.

17. The Copom evaluates that the probability that emerging local inflationary pressures will represent risks to the domestic inflation trajectory has increased, because the heated demand and market of factors can increase the pass-through of wholesale prices over consumer price inflation. The Committee understands that the prospects for this pass-through, as well as for the generalization of the pressures initially focused on consumer price inflation, depend mostly on inflation expectations, which remain carefully monitored. 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, for instance, such as in the services sector. 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, as well as inflation expectations within the forecast period, 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. As a consequence of this improved perception, the scope for a reduction in real interest rates in the future will naturally follow. 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, evolve in a harmonic way.

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 forward-looking 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 the possibly more intense expansion of governmental transfers and other fiscal impulses expected for the next quarters. 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 effects as of 2008.

21. The Copom recognizes the important contribution of investment to expand productive capacity. This factor, together with the external sector, has helped to mitigate inflationary pressures. However, the Copom evaluates that the pace of domestic demand expansion, which should continue to be sustained, among other factors, by the impulse derived from the monetary policy easing implemented this year, may bring non-insignificant risks to the inflationary dynamics. In this context, the consistent reduction of the mismatch between the rhythm of expansion of supply of goods and services and demand is even more relevant to the assessment of possibilities of monetary policy stance.

22. Aiming at consolidating a stable and predictable environment, the Copom adopts 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 and implementation. That is the reason why variables such as inflation projections, the balance of risks associated to the forward-looking scenario and especially 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. In 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 Committee unanimously decided to maintain the Selic target rate at 11.25% p.a., without bias. 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.

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 dynamism, including 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. The contribution of the external sector to a benign inflationary scenario may become less effective, at a moment when the effects of investment over productive capacity of the economy still need to consolidate. In such environment, the monetary authority must remain vigilant to avoid that short-term uncertainties contaminate longer time horizons. If the risk profile change and imply shifts in the inflation prospective scenario, the Committee will promptly adjust the monetary policy stance to the circumstances.

25. At the conclusion of the meeting, it was announced that the Copom would reconvene on January 22nd 2008, for technical presentations, and on the following day, to discuss the monetary policy decision, as established in Communiqué 16,051 of September 3rd, 2007.

BANCO CENTRAL DO BRASIL

SUMMARY OF DATA ANALYZED BY THE COPOM

Inflation

26. The IPCA-15 increased 0.23% in November, down from 0.24% in October and 0.29% in September, totaling increases of 3.64% in the year through November and 4% in the last twelve months. Food and beverage prices increased 0.25% in November, down from 0.54% in October, mainly due to the retreat in the prices of milk and its by-products (-6.32%), contributing –0.15 p.p. for the headline IPCA-15 result. This effect offset the increases in prices of beans and bovines, 18.59% and 3.01% respectively. In the other groups, it bears emphasizing the acceleration in the prices of clothing, 0.74%, up from 0.41% in October, and the increases, higher than the headline index, in the prices of personal outlays and health and personal care, 0.48% and 0.35% respectively, in November, up from 0.45% and 0.40% in October.

27. Market prices inflation increased 0.29% in November, down from 0.32% in October, while regulated prices inflation totaled 0.09%, up from 0.06%, in the same periods. On a twelve-month trailing basis, market prices increased 4.84%, and regulated prices, 2.14%. Among market prices, the prices of non-tradable goods increased 5.44%, while the prices of tradable goods totaled 4.18%, according to the same comparison basis.

28. The several IPCA-15 core inflation measures increased in November, both on a month-on-month basis and on a twelve-month trailing basis. The smoothed trimmed means core rose 0.37% in November, up from 0.35% in October. In the last twelve months, the change totaled 3.80%, against 3.70% in October. The non-smoothed trimmed means core reached 0.29% in November, up from 0.24% in October, totaling 3.15% in the last twelve months through November. Finally, the core excluding household food and regulated prices reached 0.33% in November, up from 0.28% in October, totaling 3.65% in the last twelve months.

29. The IGP-DI increased 1.05% in November, up from 0.75% in October, totaling 6.32% in the year through November and 6.6% in the last twelve months. Considering the three index components, only the INCC decelerated in November. The IPA-DI increased 1.45%, up from 1.02% in October, reaching 7.4% in the year through November and 7.51% in twelve months. The inflation measured by the IPC-Br totaled 0.27% month-on-month in November, up from 0.13%, totaling 3.87% in the year through November and 4.53% in the last twelve months. The INCC increased 0.36%, up from 0.51% in October, accumulating 5.53% in the year through November and 5.92% in the last twelve months.

30. The higher change of IPC-Br in November was driven by the acceleration in food prices (0.25%, up from 0.19% in October), health and personal care (0.25%, up from 0.06%), and clothing (1.3%, up from 1.21%). The IPC-Br core inflation measure increased 0.25%, up from 0.24% in October, totaling 3.05% in the year through November and 3.37% in the last twelve months.

31. The acceleration of IPA-DI in November reflected the higher change in agricultural prices. The agricultural IPA elevated 4.32%, up from 2.73% in October, while industrial prices increased 0.41%, stable relative to October. The main drivers for upward agricultural price pressures in November were the prices of corn (0.42 p.p.), bovines (0.38 p.p.), soy (0.31 p.p.), and beans (0.2 p.p.). In spite of the higher IPA change, it is important to highlight the 9.55% fall in the prices of perishable milk in November. Amongst industrial prices, it bears emphasizing the increase in the prices of fuel oil (0.1 p.p.) and moisturized ethylic alcohol (0.1 p.p.), and the 0.07 p.p. fall in the prices of non-ferrous metals.

Economic Activity

32. According to IBGE’s monthly survey (PMC), retail sales increased month-on-month seasonally adjusted 1.4% in September. Among the activities included in the general indicator, sales of hyper- and super-markets, food products, beverages and tobacco expanded on month-on-month basis (3%), as well as furniture and home appliances (0.1%). Sales of vehicles and motorcycles, parts and pieces, which are not part of the general retail sales index, decreased 1.1% in the month. Regionally, 22 out of the 27 Federation units reached positive results in September.

33. Retail sales expanded by 8.5% in September, year-over-year, driven by increases in all its components segments, mainly in office material and equipment, computers and communication (30.4%), and furniture and home appliances (12.7%). Expanded retail sales, which include the activities vehicles and motorcycles, parts and pieces, and construction material, increased 11.9%, with highlights to the 19.8% expansion in the sales of automotive sector.

34. Retail sales performance reflects the continuity of payroll growth, better credit conditions, the impacts of social programs and the recovery of the agricultural sector. Retail sales increased 9.6% in the first nine months of 2007, year-over-year, while expanded retail sales increased by 13.6%. It bears emphasizing the increase in the sales of vehicles (22.9%) and furniture and domestic appliances (16.3%), in the same period. On a regional basis, retail sales grew in all states but Piauí in 2007, with the most significant expansions in the Northeastern region, mainly due to the impact of the Federal Government social programs.

35. 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 and database consultations for credit sales increased by 1.2% and 0.7% in November, respectively, on a month-on-month basis. Compared to the same month last year, these indicators rose by 7.1% and 7.3%, respectively.

36. Regarding investment indicators, the production of construction inputs and capital goods production increased month-on-month seasonally adjusted 2.6% and 1.8%, respectively, in October. Compared to October 2006, the expansions reached 10.2% for construction inputs production and 26.8% for capital goods production and accumulate increases of 5.0% and 18.8%, respectively, in the year through November, compared to the same period of the previous year.

37. Imports of capital goods decreased 5% in October, seasonally adjusted, after significant expansion of 15.3% in the previous two-month period. Actually, in August and September, imports of capital goods increased 49.4% and 48.6%, respectively, year-over-year. In October, imports of capital goods increased 38.5%, according to the same comparison basis, and in the year through October, the expansion reached 35.3%, which demonstrate the strong growth of these imports, reflecting the favorable conditions for investment expansion in Brazilian economy in 2007.

38. According to IBGE’s Monthly Industrial Survey (PIM), industrial production increased month-on-month seasonally adjusted 2.8% in October, after decreasing 0.6% in the previous month. On a seasonally adjusted three-month moving average basis, industrial production increased 1.2%, the highest growth rate since June 2005. Compared to October 2006, industrial activity increased 10.3%, accumulating 5.9% in the year through October and 5.3% in twelve months.

39. The comparison between October and September seasonally adjusted data reveals generalized growth among use categories. Intermediate goods production increased 2.7%, followed by the production of capital goods (1.8%); durable consumer goods (1.4%) and semi and non-durable consumer goods (1.3%). In the year, the production of capital goods production grew 18.8%, recording a two-digit expansion since the beginning of 2007. For the other categories, the expansions were: durable consumer goods (8.7%), intermediate goods (4.3%) and semi and non-durable consumer goods (3.0%).

40. In the industrial sector, hours worked in production increased 0.3% and real industrial sales increased 1.3% in October, compared to the previous month, according to CNI statistics seasonally adjusted by the BCB. In the year, these indicators increased, respectively, 4.0% and 4.7%, compared to the same period of 2006. Installed capacity utilization reached 83.1% in October, up from 82.3% in September, seasonally adjusted. Considering observed data, the utilization level reached 84.3% in the month, 2.2 p.p. above the October 2006 level. According to FGV data, in November, the industrial installed capacity utilization reached 87.2%, up from 84.7% in the same month of 2006.

41. Vehicles production reached 299.3 thousand units in October, a new monthly record, according to Anfavea. Total production increased 9.0% month-on-month, according to data seasonally adjusted by the BCB, and 31.6% compared to the same month of 2006. Domestic sales increased 4.7% seasonally adjusted, while exports grew

19.4%. Compared to the first ten months of 200, vehicles production increased 12.8% in 2007, and domestic sales, 25.0%, while exports decreased 6.4%. Still according to Anfavea, the production of agricultural machines increased 37.8%, in the same period, while trucks production grew 29.0%, reflecting the recovery of agricultural income in the current harvest and investments increase in the sector.

42. According to IBGE, the October estimate for the grains harvest pointed to a 13.9% increase in 2007, compared to 2006. National grains production – cereals and legumes – may reach 133.3 million tons, due to favorable weather conditions and the incentives stemming from the elevation of international agricultural prices, mainly corn and soy. Considering other agricultural products, in addition to grains, the IBGE pointed to a 16.0% decrease in coffee production, mainly driven by the biennial periodicity of the harvest, and to a 13.1% increase in sugar cane production, reflecting the 10.5% expansion of the planted area, motivated by the increasing interest in alcohol production. In October, the IBGE carried out the first prognosis of planted area and production for the 2008 harvest, including Southeast, South and Middle-West regions and the states of Rondônia, Maranhão, Piauí and Bahia. The initial estimate for 2008 grains production reached 137.1 million tons, 2.9% above the 2007 estimate.

Surveys and Expectations

43. The Fecomercio-SP monthly survey showed a 2% increase in the Consumer Confidence Index (ICC) in November, month-on-month. Both components of ICC registered positive changes in the month: the Consumer Expectation Index (IEC) increased 1.8%, and the Current Economic Conditions Index (Icea), 2.2%. Compared to November 2006, the ICC and the Icea increased 1.5% and 19.6%, respectively, while the IEC decreased 9.3%.

44. According to the FGV survey, the ICC increased month-on-month 1.3% in November, reaching a record high for the series begun in September 2005. This result reflected the 4.3% increase in the Current Situation Index (ISA), while the Expectations Index (IE), which measures the expectations for the next six months, decreased 0.2%. Compared to November 2006, the ICC grew 4.6%, with increases of 7.3% in ISA and 3.1% in IE.

45. Still according to FGV, the Industry Confidence Index (ICI) decreased to 121.3 in November down from 123.4 in October. Compared to November 2006, the ICI increased 14.1% and expanded by 12.1% in the year through November, year-over-year.

46. According to the October FGV Manufacturing Industry Survey – Special Issues, 53% of the consulted companies affirmed that they intend to raise investments in 2008, up from 38% in October 2006, regarding 2007 investments. The current survey also showed increase in labor force hiring, compared to last year (46%, up from 40%). Regarding the revenues for the next year, the 2008 forecast pointed out that 75% of the companies foresee sales real growth, up from 71% in the October 2006 survey.

Labor Market

47. According to the Ministry of Labor and Employment, 205 thousand new formal jobs were created in October. In the year through October, 1,812 thousand jobs were created, a 6.6% elevation relative to the same period of 2006. As a consequence, employment grew 5.0% in the period, year-over-year, with expansion in all the main sectors of economic activity, with highlights to the 7.5% increase in the construction sector and 6.0% in the retail sector. Employment also grew 0.6% month-on-month seasonally adjusted in October, with expansion in all sectors.

48. According to the IBGE employment survey (PME) in the six main metropolitan areas of the country, the unemployment rate, in October, reached 8.7%, down from 9.0% in the previous month. The retreat of the unemployment rate reflected the 0.2% increase in employed population and 0.1% decrease in economically active population (PEA). In the year through October, the average unemployment rate stood at 9.6%, down from 10.2% in the same period of 2006, with elevations of 2.9% in the number of occupied workers and 2.2% in PEA. The number of workers employed in the private sector increased 0.6% in the month, due to the expansions of 0.7% in the number of formal workers and 0.5% in the number of informal workers. The number of employers decreased 1.8%. In the year through October, the average number of employed workers reached 2.9%, mainly due to the increases of 4.9% in the number of formal workers and 4.7% in the number of self-employed workers.

49. According to the same survey, real average earnings reached R$1,123.60 in October, increasing 0.5% month-on-month. Compared to October 2006, real average earnings increased 1.2% and, in the year through October, the expansion reached 3.4%. Real payroll grew 0.8% month-on-month and 4.4% year-over-year, accumulating a 6.4% increase in the year through October.

50. According to CNI data seasonally adjusted by the BCB, manufacturing employment increased 0.5% in October, month-on-month. In the year through October, this indicator expanded by 3.7%, while real manufacturing payroll raised 5.2%.

Credit and Delinquency Rates

51. Credit operations in the financial system increased by 2.7% in October, expanding 20.2% in the year through October and 26.3% in the last twelve months. Earmarked credit operations increased 2.8% in the month and 30.1% in the last twelve months, while non-earmarked credit operations expanded by 2.5% and 17.9%, in the same periods. Among non-earmarked credit operations, it bears emphasizing the twelve-month trailing leasing operations again, due to the expansions of 86.2% in credit to individuals and 82.5% in credit to corporate. Regarding earmarked credit, the most significant expansions in the last twelve months were related to housing (23.5%) and to the agricultural sector (18.1%). Considering credit operations by economic activity, loans to industries increased 3.1% in October and 28.5% in the last twelve months, while loans to commerce grew 3.3% and 20.8%, according to the same comparison bases.

52. The average interest rate on credit rates reached 35.4% p.a. in October, a record low for the historical series, standing 6 p.p. below the rate recorded in October 2006. The average rate for individuals decreased to 45.8% p.a. in October, down from 53.5% p.a. in the same month of 2006. The average rate for corporate decreased 4 p.p. in twelve months, reaching 23.4% p.a.

53. The average tenure of credit operations for individuals reached 419 days in October, compared to 349 in the same month of the previous year. The average tenure of personal credit operations totaled 443 days, an 88-day extension relative to October 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 1909 days and 577 days, up from 1445 days and 524 days, respectively.

54. Delinquency rates in the financial system (non-earmarked loans in arrears for more than ninety days) reached 4.5% in October, a 0.1 p.p. decrease relative to the previous month, and 0.6 p.p. below the same month of 2006. Delinquency rate for corporate credit operations remained unchanged at 2.3%, after decreasing 0.5 p.p. in the last twelve months. Delinquency rate for credit operations with individuals remained almost stable between September (7.1%) and October (7%), but stood 0.6 p.p. below the October 2006 rate.

55. Net delinquency rate for retail credit, measured by the ACSP, reached 6.1% in October, remaining unchanged relative the same month of 2006. In the year through October, the average net delinquency rate reached 6.2%, up from 5.9% in the same period of 2006.

External Environment

56. Global economic growth continued to show robust expansion in the third quarter of 2007. The three main economic areas expanded in the third quarter, quarter-on-quarter, contradicting the expectations of greater deceleration based upon the recent finance turmoil episodes. Despite this positive evolution, recent data point to a moderation in global growth.

57. Despite the turmoil in financial markets, the US still benefit from the productivity growth, the lack of unbalances in others sectors beyond the real state sector and the still robust labor market performance, which reinforces the resilience of economic activity (Q3 GDP grew 4.9%). Emerging economies continue to present positive economic performance, with highlights for the strong growth observed in Asia. A lot of uncertainties still affect the international economy, reflecting the stress provoked by the crisis in the US subprime mortgage market.

Moreover, with the increasing oil and commodities prices, in addition to the dollar weakness, concerns about a less benign scenario for inflation increased.

58. The main central banks maintained interventions through open market operations during the turmoil financial period, providing short term funding in order to regulate the liquidity and provide an efficient, safe and flexible environment concerning the liquidity management in the banking system. However, volatility in financial markets remained high. Concerns about inflationary pressures made several central banks, such as Canada, Sweden, Norway, Switzerland, Chile, South Africa, South Korea, India and Russia, increase their basis interest rates. On the other hand, the Federal Reserve Bank (Fed) reduced again the Fed funds target in its October meeting. The central banks in the Euro Area and Japan still keep on waiting the extension of the international financial turmoil to return to their gradual tightening monetary policies stance.

Foreign Trade and International Reserves

59. Between January and November 2007, Brazilian external trade continued the ongoing expansion both in exports and mainly in imports. Due to greater dynamics of imports, the trade surplus totaled US$ 36.4 billion in the year through November, a 12.1% retreat in year-over-year terms. On a twelve-month trailing basis, the trade surplus reached US$ 44.5 billion, 13.3% below the record high registered in May. External trade totaled US$256.4 billion and US$275.9 billion, respectively, in the year through November and in the last twelve months.

60. In November, exports totaled US$14.1 billion, reaching a US$702.6 million daily average, 18.1% above the observed in the same month of 2006. Exports of manufactured products totaled US$7.5 billion, a US$376.4 million daily average, 17.1% above the observed in the same month of the previous year. Exports of primary products totaled US$4.3 billion, and of semi-manufactured products, US$1.9 billion, with respective increases of 25.2% and 7.4% in daily average values.

61. Imports totaled US$12 billion in November, with an average daily record value of US$601.3 million, 38.9% above the observed in the same month of 2006. All products categories expanded according to the same comparison basis, with highlights to the expansion of capital goods (47.1%) and raw materials and intermediate goods (39.1%). Regarding this group, it bears emphasizing the imports of transportation equipment accessories, and also of mineral products, non-food farming products and chemical and pharmaceutical products. Amongst the imports of capital goods, industrial machines, machines and equipment for office and scientific service, and parts and pieces for capital goods should be highlighted. Regarding the imports of consumer goods, whose expansion reached 36.8% year-over-year, the main increases were for vehicles, clothing, furniture, machines and equipment for domestic use. In November, imports of fuel and lubricants increased 31.9%, compared to the same month of the previous year.

62. International reserves totaled US$167.9 billion in October, with increases of US$4.9 billion in the month and US$82 billion in the year.

Money Market and Open Market Operations

63. In the period between the October and December Copom meetings, the future interest rates increased, especially in longer terms. In the external scenario, money inflows for emerging markets reduced and the country risk increased due to two main reasons: the recognition of significant losses of US financial institutions related to the crisis in the subprime mortgage market and the increase of risk aversion, due to the fear of recession in the US economy. In the domestic scenario, strong figures for economic activity and inflation gave support to a steepening of the yield curve. Between October 15th and December 3rd, one-, three-, and six-month rates went up 8 bps, 14 bps and 25 bps, respectively. Moreover, one-, two and three-year rates increased 44 bps, 89 bps and 113 bps, respectively. Real interest rates measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month ahead inflation expectations increased to 7.34% on December 3rd, up from 7.06% on October 15th.

64. On October 26th and November 27th, the BCB carried out reverse FX swap auctions amounting US$4.2 billion, with the total rollover of the November 1st and December 3rd redemptions.

65. In its open market operations, the BCB carried out, from October 16th to December 3rd, weekly five- and seven-month fixed rate repo operations, borrowing. The average daily balance of these operations reached R$88.8 billion, of which R$66.5 billion were seven-month operations. In the same period, the BCB conducted 30 borrowing and two 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$16.3 billion, borrowing. In addition, on October 18th, the BCB conducted borrowing operations with tenure of 33 working days, amounting R$80.5 billion.

66. Between October 16th and December 3rd, the National Treasury raised a total of R$36.0 billion, of which R$23.0 billion in fixed-rate securities: R$21.5 billion via issuance of LTNs maturing in 2008, 2009 and 2010, and R$1.5 billion in NTN-Fs maturing in 2011, 2013 and 2017. Issuance of LFTs totaled R$9.9 billion, for securities maturing in 2011 and 2013. Issuance of inflation-linked NTN-Bs reached R$3.1 billion, for securities maturing in 2009, 2012, 2017, 2024, 2035 and 2045.

67. In the same period, the Treasury conducted auctions to sell LTNs maturing in July and October 2008 and bought LTNs or NTN-Fs, both maturing in January 2008, totaling R$5.3 billion. The issuances of NTN-Bs, for the same tenures of the traditional auctions, settled against the reception of other fixed income instruments, totaled R$5.0 billion. The Treasury also conducted auctions to sell LFTs maturing in 2011 and 2013, totaling R$3.3 billion, receiving LFTs maturing in 2007 as payment, and to buy LTNs and NTN-Fs, totaling R$2.5 billion and R$519 million, respectively.