BANCO CENTRAL DO BRASIL

Minutes of the 132nd Meeting of the Monetary Policy Committee (Copom)

Summary

Date: January 22nd, from 4:40PM to 7:00PM, and January 23rd, from 4:40PM to 7:50PM
Place: BCB Headquarters meeting rooms - 20th floor – Brasília – DF

In attendance:
Members of the Committee
Henrique de Campos Meirelles – Governor
Alexandre Antonio Tombini
Alvir Alberto Hoffmann
Anthero de Moraes Meirelles
Antonio Gustavo Matos do Vale
Maria Celina Berardinelli Arraes
Mário Gomes Torós
Mário Magalhães Carvalho Mesquita

Department Heads (present on January 22nd)
Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on January 23rd)
João Henrique de Paula Freitas Simão – Open Market Operations Department
José Antônio Marciano – Department of Banking Operations and Payments System
Michel Rocha Amariz Gomes – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations Group

Other participants (present on January 22nd)
Alexandre Pinheiro de Moraes Rego – Press Secretary
Alexandre Pundek Rocha – Advisor to the Board
Eduardo José Araújo Lima – Advisor to the Research Department
Flávio Pinheiro de Melo – Advisor to the Board

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 0.38% in November, up from 0.30% in October, and accelerated to 0.74% in December, totaling 4.46% in the year, compared to 3.14% in 2006. The acceleration of consumer price inflation essentially mirrors the behavior of market prices, which 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 5.73%

and 1.65%, respectively, in the year, compared to 2.57% and 4.27% in 2006. Despite the BRL appreciation in 2007, the prices of tradable goods accelerated, reaching 4.75%, up from 1.31% in 2006. However, amongst market prices, pressured by the behavior in the prices of services and perishable food, non-tradable goods inflation was even higher, totaling 6.65%, the highest rate recorded since 2004. Although inflation remained, at the end of 2007, in line with the targets path, it is worth mentioning that the recent behavior of IPCA inflation has been remarkably less benign than that observed in previous quarters.

2. Similarly to headline inflation, the three IPCA core inflation measures trended upwards in December. The core inflation by exclusion of household food items and regulated prices and smoothed and non-smoothed trimmed means core inflation measures changed from 0.40%, 0.43% and 0.35% in October to 0.37%, 0.36% and 0.35% in November and 0.59%, 0.40% and 0.45% in December, respectively. It bears emphasizing that year-over-year headline inflation acceleration in 2007 was followed by two of the three core inflation measures. Core inflation by exclusion of household food items and regulated prices increased significantly (4.11% in 2007, against 3.56% in 2006). Non-smoothed trimmed means core inflation also showed sharp acceleration (3.62%, against 2.76% in 2006), while the smoothed trimmed means core inflation, which tends to present more inertial behavior, continued to retreat (4.04%, against 4.63% in 2006). On a twelve-month trailing basis, despite remaining below the central target, all inflation core measures accelerated in December, compared to November, standing at levels remarkably higher than the record lows reached in previous months.

3. The General Price Index (IGP-DI) inflation rallied in the last quarter of 2007, increasing from 0.75% in October to 1.05% in November and 1.47% in December. As a result, IGP-DI inflation increased 7.89% in 2007, up from 3.79% in 2006 and 1.22% in 2005. The IGP-DI increase reflects both the behavior of the Consumer Price Index-Brazil (IPC-Br), which totaled 4.60% in 2007 (up from 2.05% in 2006), and also of the IPA-DI (Wholesale Price Index), whose variation totaled 9.44% in 2007, up from 4.29% in 2006. According to the same comparison basis, the Civil Construction National Index (INCC) increased 6.15% (5.04% in 2006). Regarding agricultural IPA, prices reached 24.82% in 2007 (6.92% in 2006 and –6.32% in 2005). On its turn, industrial prices, which had been showing less unfavorable behavior until last quarter, also accelerated significantly in the last months, totaling 4.42% in 2007, up from 3.46% in 2006. 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 0.3% in November, the seventeenth consecutive expansion according to this comparison basis, an evidence of the solid performance of industrial sector. Still considering the seasonally adjusted series, after the 3.3% robust month-on-month increase observed in October, industrial output retreated 1.8% in November, due to reduced working days. On a twelve-month trailing basis, industrial output grew 5.5%, and in the year through November, 6.0%. On its turn, manufacturing industry production reached 5.5% in the last twelve months through November (6.0% in 2007), while mining industry production expanded by 5.6% (5.4% in 2007). For December, the effects of end-year celebrations can result in a new retreat in the month-on-month industrial production. However, the trend for the start of 2008 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 recovery of reduced inventory levels.

5. Among the use categories, the production of capital goods increased by 1.2% in November, while both the production of intermediate and consumer goods decreased by 0.7% in October, according to data seasonally adjusted by the IBGE, after increasing in October (2.6% and 1.7%, respectively). In year-over-year terms, it bears emphasizing the expansion of capital goods production (24.3%, expanding by 19.5% in the year through November), followed by the growth of durable goods production (11.1%, growing by 9.0% in the year through November). The solid expansion of capital goods production is, to a large extension, 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. On its turn, the dynamism of durable consumer goods production reflects, predominantly, the remarkable improvement in credit conditions, when compared to historical patterns. It should be highlighted that the emergency of signs pointing to consistent pressure over the availability of production factors, as suggested in some industrial surveys,

indicates that possible reductions in the pace of industrial activity expansion could be associated to productive capacity restrictions.

6. Labor market continues to present quite favorable performance. The unemployment rate in the six metropolitan regions covered by the Monthly Labor Survey (PME) maintained a downward trend and reached 8.2% in November, down from 8.7% in October and 9.5% in November 2006. The unemployment rate seasonally adjusted by the BCB also reduced: 8.5%, down from 8.8% in October. It is worth noticing that the unemployment rate in November reached a record low for the series, started in March 2002, both for the observed and for seasonally adjusted series. As a result, the average unemployment rate reached 9.5% in the year through November, down from 10.1% in the same period of 2006. The purchase power of workers recovered in November for the third consecutive month and expanded by 1.3% month-on-month and 2.4% year-over-year. As a consequence, real payrolls expanded by 6.3% in the year through November, a key driver for sustained aggregate demand growth. According to the National Industry Confederation (CNI) data seasonally adjusted by the BCB, manufacturing employment remained stable in November, month-on-month, after expanding by 0.4% in October and 4.2% compared to November 2006. On its turn, data from the Ministry of Labor and Employment (MTE) indicate the continuity of strong expansion in formal employment in 2007. Even after the 319 thousand jobs reduction in December, in line with the seasonal pattern, the expansion of 1.617 million jobs in the year represented a 5.2% growth in job creation, year-over-year, a new record high for the series started in 1992. In 2007, 587 thousand new jobs were created in the services sector (a 4.8% expansion), and 405 thousand new jobs were created in the retail sector (a 6.1% expansion), both representing record highs for the series, while 395 thousand new jobs were created in the manufacturing industry (a 5.3% expansion), the second best result for the series. To a lower extent, 177 thousand new jobs were created in the civil construction; however, this figure represented an 8.3% expansion and a record high for the series.

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. According to data seasonally adjusted by the IBGE, retail sales increased month-on-month 1.6% in November, recovering from the 0.2% contraction observed in October, the second highest growth rate for the year. Compared to the same months of 2006, retail sales increased by 9.6% in October and 9.9% in November. In the year trough November, retail sales grew robustly by 9.7% and, in the last twelve months, by 9.2%. 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 November, it bears emphasizing the expansion in the sales of “furniture and domestic appliances” (16%), and “fabric, clothing and shoes” (10.8%). 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 (23.5% in the year). For the next quarters, the continuity of the current expanding cycle is expected, and will continue to be underpinned by employment and income growth, credit expansion and the maintenance of consumer confidence at high levels.

8. The installed capacity utilization rate in the manufacturing industry reached 82.9% in November (83.1% in October), according to CNI data seasonally adjusted by the BCB, a figure close to the record high of the series. According to data seasonally adjusted by the CNI, the installed capacity utilization rate in the manufacturing industry reached 82.9%, a new record high for the series. Without the seasonal adjustment, the rate stood 1.6 p.p. above the level registered in the same month of 2006, while the average installed capacity utilization rate in the year through November stood 1.8 p.p. above the observed in the same period of 2006, and 1.0 p.p. and 1.6 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 November, the absorption of capital goods increased firmly (20.8%), due to the significant growth of capital goods imports (36.4% in volume), as well as of capital goods production (19.5%). Furthermore, the production of construction inputs increased 6.7% in the year through November, showing robust performance. The most recent data indicate that although investment has been contributing to soften the trend of increasing capacity utilization rates, it has not been sufficient to stop this process. Considering the recent behavior of capacity utilization rates, the timely maturation of investment projects will be crucial to avoid relevant mismatches regarding the evolution of aggregate supply and domestic demand in the relevant forecast period for monetary policy. 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 continued 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, the trade surplus reached US$40.0 billion, a 14.0% decrease relative to the same period of 2006. Exports and imports totaled US$160.6 billion and US$120.6 billion, equivalent to a 16.6% and 32.0% 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$3.6 billion in 2007 (0.3% of GDP).

10. Regarding the external scenario, economic deceleration becomes more effective in the US, although high uncertainties still remain, particularly concerning its magnitude and duration. Despite encouraging Q3 2007 US GDP figures, more recent data, particularly on labor market and consumption, as well as confidence indices and other leading indicators, point to significant slowdown. Although uncertainties still remain about the length and amplitude of the effects of the US subprime mortgages market crisis over US and European financial institutions and, consequently, over credit conditions for households and corporate, the dominant opinion points out to a transitory deceleration. This assessment reflects, to some extent, the expectation that the monetary policy stance implemented in the US, to which fiscal incentives can be added, will smooth the US economic weakening. Prospects for economic growth in Europe and Japan have also deteriorated, despite not provoking the same degree of concerns that surround the US economic activity. On the other hand, strong economic growth in main Asian emerging economies, which so far have been apparently little affected by the US mortgage crisis, have offset the effects of economic deceleration in mature economies. In fact, pressures over production factors availability have triggered inflationary pressures and tight monetary cycles in many emerging economies. For mature economies, prospects for monetary policy are more diverse. Economies presenting more moderate inflationary pressures concerns and more evident credit contraction tend to present additional monetary policy easing. On the other hand, in economies where inflation rates are above their respective targets, the scope for reaction to the contraction caused by the credit crisis seems more limited. In this context, volatility and risk aversion indicators worsened again since the last Copom meeting, in particular since the start of 2008, affecting the behavior of Brazilian assets prices. However, Brazilian economic activity does not seem to have been significantly impacted by the persistent deterioration on global financial markets confidence, and although not decoupled from external economic developments, should sustain its growth trajectory, essentially driven by domestic demand.

11. Oil prices, a systematic source of international uncertainty, remained at historically high levels, despite below the record high observed at the start of 2008, and also continued highly volatile. This behavior reflects, in addition to structural changes in global energy markets, recurrent geopolitical tensions. Despite significant uncertainties inherent to oil prices, the main scenario considered by the Copom forecasts unchanged domestic gasoline prices in 2008, as observed 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, especially grains, have also increased since the last Copom meeting, despite more pessimism about the prospects for global economic growth and the turmoil on global financial markets.

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) For 2008, projected adjustments for gasoline and bottled gas prices were both maintained at 0%;

b) The projections for electricity and fixed telephone prices adjustments in 2008 were set at 3.4% and 3.5%, respectively;

c) The projection for regulated prices inflation, based on individual items, totaled 4.2% in 2008, down from 4.5% in the December 2007 Inflation Report. This set of prices, according to data released by the IBGE, corresponded to 30.48% of the total December IPCA;

d) The projection for regulated prices inflation in 2009 remained at 4.2%, the same considered in the last Inflation Report. 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 (General Price Index) variation;

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 48bps spread in the fourth quarter of 2008, under the benchmark scenario. The swap rate trajectory points to a 50bps spread in the last quarter of 2009. 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 2008 and 2009, 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 December Copom meeting, median IPCA inflation expectations for 2008, compiled by the BCB's Investor Relations Group (Gerin), increased significantly to 4.37%, up from 4.10%. Twelve-month ahead inflation expectations changed more significantly, to 4.38% up from 3.95%, considering the composition of monthly inflation market expectations. For 2009, inflation expectations increased to 4.15% up from 4.00%.

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$1.75/US$ during the forecast period – the projection for the 2008 IPCA increased significantly compared to the value considered at the December Copom meeting, and is close to 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 2008 also increased compared to the value considered at the December Copom meeting, above the central target for the year. The projection for 2009 based on both scenarios are stable relative to the December Inflation Report, and remained below the 4.5% target for the benchmark scenario and above the 4.5% target for the market scenario.

Monetary Policy Decision

16. The Copom evaluates that monetary policy should contribute for the consolidation of a favorable long-term macroeconomic environment. Economic activity data indicate that the intensity of demand expansion continues quite robust, being responsible at least partially for the inflationary pressures observed in the short-run, despite the imports growth and the benign investment behavior. Even in the context of moderate deceleration of global growth this year and the higher volatility observed in global markets since mid-2007, the Committee believes that the prospects for Brazilian external financing in the forecast period suggest, according to newly available information, that the balance of payments should not represent imminent risk to the inflation scenario. On the other hand, relevant inflationary pressures continue to be present both in mature and emerging economies, evidencing the existence of inflationary risks on the global outlook. The Copom reaffirms the vision that, for the Brazilian inflation, an alternative scenario of more intense and generalized global deceleration would cause a risk factor of ambiguous signal. On the one hand, decreasing net exports would act as a factor to restrain aggregate demand. Moreover, the potential decrease of some important commodities prices could contribute to a lower domestic inflation. On the other hand, the above-mentioned alternative scenario could unfavorably impact inflation prospects through two mechanisms. In the case of deceleration in the mature economies that comprise the global financial markets center, risk aversion could increase, resulting in decreased demand for Brazilian assets and depreciation of their prices. Moreover, in the medium run, a possible reduction of net exports could similarly affect the price sustainability of certain Brazilian assets. Therefore, although inflation prospects remain in line with the targets trajectory, additional uncertainties surround the inflation path, and the risk of materialization of a less benign

inflationary scenario increased. 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, in addition to the possibility of existence of supply restrictions in some sectors, 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 local 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 that has occurred in the last years. 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, do not point to persistent imbalances.

19. The Committee emphasizes, once again, that there are important time lags in the transmission of monetary policy stance to economic activity and inflation. In the monetary easing cycle, started 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 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 real 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. Consequently, the lagged remaining effects of interest rates cuts on an increasingly robust aggregate demand will add up to other factors that will continue to contribute on a significant way 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 concentrated effects in the second half of 2008 and later.

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 remaining impulse derived from the monetary policy easing implemented until September 2007, continues to present risks to 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 different 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. At the current moment, characterized by the deterioration in the balance of inflationary risks, prudence assumes an even more important role in this process.

23. The Copom evaluates that signals of economy heating and inflation expectations increase heightened the risks for the concretization of the benign inflationary scenario, in which inflation would remain consistent with the targets path, as reflected in the projections. In this context, even considering that, at the moment, the maintenance of the basic interest rate is the most adequate decision, the Committee affirms that is ready to adopt a different stance, by adjusting the monetary policy instruments, in the case of consolidation of a divergent scenario between projected inflation and the targets path.

24. Therefore, evaluating the economic scenario and inflation prospects, the Committee unanimously decided to maintain the Selic target rate at 11.25% per year, without bias. The Committee will monitor the evolution of the macroeconomic scenario until the next meeting, when it will define the next steps in its monetary policy strategy.

25. 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 the balance of risks associated to its projections. 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, in light of robust domestic demand growth, seem to 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 deteriorates in a matter that implies shifts in the inflation basic prospective scenario, the Committee will promptly adjust monetary policy stance to the circumstances.

26. At the conclusion of the meeting, it was announced that the Copom would reconvene on March 4th 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.

SUMMARY OF DATA ANALYZED BY THE COPOM

Inflation

27. IPCA inflation increased 0.74% in December, up from 0.38% in November and 0.30% in October. Food and beverage prices increased 2.06% in December, up from 0.73% and 0.52% in the two preceding months, mainly driven by higher prices of beef (8.20%) and beans (31.70%), which contributed 0.16 p.p. and 0.13 p.p., respectively, for the IPCA headline result. Similarly, fuel prices pressured the December IPCA, due to the increase in the price of alcohol.

28. After presenting yearly decreases for four consecutive years, IPCA increased 4.46% in 2007, up from 3.14% in 2006, still below the 4.50% target established by the National Monetary Council for the year. The evolution of the IPCA was associated, predominantly, to market prices inflation behavior, influenced by the 10.77% increase in food prices, which had increased 1.23% in 2006. Regulated prices inflation totaled 1.65% in 2007, compared to 4.27% in 2006, favored by the 6.16% reduction in energy prices.

29. The several IPCA core inflation measures increased in December, both on a month-on-month and on a year-over-year basis. The smoothed trimmed means core rose 0.40% and 4.04% in December, according to the same comparison bases, up from 0.36% and 4.02% in November. The non-smoothed trimmed means core reached 0.45% in December, up from 0.35% in November, totaling 3.62% in the last twelve months through December, compared to 3.43% in November. Finally, the core excluding household food and regulated prices reached 0.59% in December, up from 0.37% in November, totaling 4.11% in the last twelve months, up from 3.86% in November.

30. The IGP-DI increased 1.47% in December and 7.89% in 2007, up from 3.79% in 2006, increasing both on a month-on-month basis and on a yearly basis for every index component. The IPA-DI increased 1.90%, up from

1.45% in November, reaching 9.44% in the year, up from 4.29% in 2006. The inflation measured by the IPC-Br totaled 0.70% month-on-month in December, up from 0.27% in November, totaling 4.60% in the year, up from 2.05% in 2006. The INCC increased 0.59% in December, up from 0.36% in November, accumulating 6.15% in the year, compared to 5.04% in 2006.

31. The behavior of IPC-Br in December was driven by the acceleration in several groups, mainly food prices (1.69% up from 0.60% in November, accumulating 10.65% in 2007, after a 0.51% decrease in 2006). The remaining groups presented yearly changes below the IPC-Br average. The IPC-Br core inflation measure increased 3.31% in the year, up from 2.82% in 2006.

32. The acceleration of IPA-DI in December reflected the higher change in industrial prices (1.01% up from 0.41% in November). The agricultural IPA elevated 4.27%, reducing 0.05 p.p. relative to November. The main drivers of upward industrial prices in December were the prices of oil and fat (0.14 p.p. increase), fuel oil and fertilizers (both increased 0.12 p.p.) and moisturized ethylic alcohol (0.08 p.p. increase). Amongst agricultural prices, it bears emphasizing the increase in the prices of beans (27.2%), corn (10.28%) and soybeans (5.90%). Industrial IPA accumulated 4.42% in 2007, compared to 3.46% in 2006, while agricultural IPA changed 24.82% in 2007, up from 6.92% in 2006.

Economic Activity

33. According to IBGE's monthly survey (PMC), retail sales increased month-on-month seasonally adjusted 1.6% in November, due to increases in all four activities included in the general indicator: fabric, clothing and shoes (1.6%), fuel and lubricants (1.5%), furniture and home appliances (1.4%), and sales of hyper- and super-markets, food products, beverages and tobacco (0.8%). Sales of vehicles and motorcycles, parts and pieces, which are not part of the general retail sales index, decreased 0.9% in the month. Regionally, retail sales retreated in 5 out of the 27 federation units in November, with the greatest expansion in Rondônia (4.9%), while the least favorable performance was in Espírito Santo (-0.9%).

34. Retail sales expanded by 9.9% in November, year-over-year, driven by increases in all its components segments, mainly in office, computer and communication material and equipment, (36.4%), other items for domestic and personal use (18.1%), furniture and home appliances (15.5%), and fabric, clothing and shoes (12.4%). Expanded retail sales, which include the activities vehicles and motorcycles, parts and pieces, and construction material, increased 13.9%, with highlights to the 21.6% expansion in the sales of automotive sector.

35. Retail sales performance reflects the continuity of payroll growth, better credit conditions, the impacts of social programs and the recovery of the agricultural sector. In the year through November, retail sales increased 9.7%, year-over-year, while expanded retail sales increased by 13.9%. It bears emphasizing the increase in the sales of vehicles (23.5%) and furniture and domestic appliances (16.0%), in the same period. On a regional basis, retail sales grew in all states, with the most significant expansions in the states of Alagoas (21.3%), Maranhão (14.1%), Mato Grosso do Sul (13.6%), São Paulo (12.3%), and Mato Grosso (12.1%).

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 and database consultations for credit sales increased month-on-month 2.8% and 1.5%, respectively, in December, expanding by 6.1% and 6.2% in 2007.

37. Regarding investment indicators, the production of construction inputs declined 0.8% in November, while domestic production of capital goods grew 1.2%, on a month-on-month seasonally adjusted basis. These indicators increased 6.7% and 24.3% year-over-year, respectively, expanding by 5.1% and 19.5% in the year through November, compared to the same period of 2006. According to the last comparison basis, evolution of domestic production of capital goods reflected the performances of agricultural equipment, 47.2%; electric energy, 25.2%; construction, 20.1%; transportation, 18.8% and serialized industrial production, 17.6%.

38. Imports of capital goods increased month-on-month seasonally adjusted 7.6% in November and 46.6% year-over-year. In the year through November, expansion reached 36.5%, reflecting investment growth in Brazilian economy in 2007.

39. BNDES funding for mid and long-term investment totaled R$56.6 billion in the year through November, exceeding in 36.6% the disbursements in the same period of 2006.

40. According to IBGE's Monthly Industrial Survey (PIM), industrial production decreased month-on-month 1.8% in November, while the three-month moving average expanded by 0.3%, reaching a record high for the seasonally adjusted series. Industrial activity increased 6.7%, compared to the same month of last year, expanding by 6.0% in the year through November and 5.5% in the last twelve months, year-over-year.

41. Monthly decrease of industrial output reflected the 1.2% expansion of capital goods production and the falls in the other use categories, which reached 0.7% for intermediate goods, 2.6% for durable consumer goods and 0.6% for semi- and non-durable consumer goods. In the year through November, capital goods production increased 19.5%, compared to the same period of 2006, sustaining a two-digit expansion since the beginning of the year; according to the same comparison basis, the production of durable consumer goods, intermediate goods and semi and non-durable consumer goods increased 9.0%, 4.7% and 3.5%, respectively.

42. According to CNI data, seasonally adjusted by the BCB, real sales increased 0.2% and hours worked in production reduced 0.3% in November, month-on-month. In the year through November, these indicators increased 5.1% and 3.8% respectively, compared to the same period of 2006. Considering seasonally adjusted data, the utilization of installed capacity stood at 82.9% in November, 0.2 p.p. below October outcome, while observed data series increased 1.6 p.p., year-over-year.

43. According to Anfavea, vehicles production reached 223.2 thousand units in December, a 17.8% expansion compared to the same month of 2006. In seasonally adjusted terms, production declined 5.7% month-on-month; domestic sales expanded 3.2%, while exports decreased 4.1%. Annual production reached the record high of 2,972.8 thousand vehicles in 2007, a 13.9% increase compared to the previous year, with a 26.2% expansion in domestic sales, while exports declined 6.6%. Still according to Anfavea, production of agricultural machines and trucks increased 41.0% and 29.0% in the year, respectively, in line with the recovery of agricultural income and investment expansion in this sector.

44. According to the survey carried out by the IBGE in December, the grains harvest reached 132.9 million tons in 2007, a 13.7% growth year-over-year and a new record high, reflecting both favorable weather conditions and the incentive caused by the elevation of agricultural prices in the international market, as well as productivity increase derived from significant investment in agricultural machines and equipment and fertilizers and agricultural defensives. The survey also pointed to a 16.7% reduction in coffee production, mainly due to the biennial periodicity of its harvest, and to a 13.2% expansion in sugar cane production, reflecting the 10.5% increase in planted area due to the growing interest in fuel alcohol production. Additionally, with the third estimate for the 2008 harvest, planted area and grains production are expected to grow by 2.7% and 2.1%, respectively.

Surveys and Expectations

45. The Fecomercio-SP survey showed a month-on-month 1.9% elevation in the Consumer Confidence Index (ICC) in January, reflecting the 0.6% fall in the Consumer Expectations Index (IEC) and the 5.4% increase in the Current Economic Conditions Index (Icea). The ICC increased 6.4% compared to January 2007, driven by expansions of 2.8% and 12.2% in the IEC and Icea, respectively.

46. According to the FGV survey, the ICC grew 5.2% in December, month-on-month, reaching a record high for the series started in September 2005. This result reflected the 9.3% elevation in the Current Situation Index (ISA) and the 3.3% increase in the Expectations Index (IE), which computes 6-month ahead expectations. Compared to December 2006 results, there were elevations of 7.7% in the ICC, 13.6% in the ISA and 4.9% in the IE; these indices increased 4.7%, 3.1% and 5.6%, respectively, in 2007.

47. Still according to the FGV, the Industry Confidence Index (ICI) decreased to 116.1 in December, down from 121.3 in the previous month, mainly due to the fall of the IE, to 103 from 111.4; the ISA also declined in the period,

to 129.3 from 131.1. The ICI expanded 9.2% compared to December 2006, showing an 11.9% increase in 2007, when the ISA and the IE grew 14.9% and 8.7%, respectively.

48. According to the FGV Manufacturing Industry Survey, installed capacity utilization reached high levels in all use categories in December, standing at 86.7%, 0.5 p.p. below the previous month and 2.3% above the December 2006 result. In December, installed capacity utilization reached 86.8% in capital goods industry, 1.3 p.p. above the registered in November, 87.2% for both in intermediate goods and consumer goods industries, and 87.1% in construction inputs industry, corresponding to 1.0 p.p., 0.5 p.p. and 0.2 p.p. falls, respectively.

Labor Market

49. According to the Ministry of Labor and Employment, employment decreased by 319.4 thousand formal jobs in December. However, 1,617.4 thousand new formal jobs were created in 2007, a 31.6% expansion compared to 2006, increasing the employment level by 5.2% p.a. All the main sectors of economic activity were benefited, with highlight to the increases in construction, 8.3%, and in commerce, 6.1%. In seasonally adjusted terms, employment index showed a 0.4% elevation in December, spread through all sectors.

50. According to the IBGE employment survey (PME) in the six main metropolitan areas of the country, the unemployment rate reached 8.2% of economically active population (PEA) in November, down from 8.7% in the previous month. The retreat of the unemployment rate reflected the 0.7% increase in employed population and the 0.2% increase in economically active population (PEA). In the year through November, the average unemployment rate stood at 9.5%, down from 10.1% in the same period of 2006, with elevations of 3.0% in the number of occupied workers and 2.2% in PEA. The number of workers employed in the private sector increased 0.9% in the month, due to the 1.5% expansion in the number of formal workers and the 0.8% reduction in the number of informal workers. The number of employers and self-employed workers increased by 2.4% and 1.3%, respectively. In the year through November, the number of self-employed workers and the number of formal workers grew by 4.5% and 5.1%, respectively, year-over-year, while the number of employers and informal workers decreased by 1.0% and 1.6% respectively.

51. The same survey points out that real average earnings reached R$1,143.60 in November, increasing 1.3% month-on-month and 2.4% year-over-year. Real payroll grew 2.1% and 6.0%, according to the same respective comparison bases. In the year through November, real average earnings and real payroll increased 3.3% and 6.3%, year-over-year.

52. In November, manufacturing employment stayed unchanged month-on-month, according to CNI data seasonally adjusted by the BCB. On the other hand, in the year through November, manufacturing employment increased 3.8%, while real manufacturing payroll raised 5.0%.

Credit and Delinquency Rates

53. Credit operations in the financial system increased 2.5% in December, month-on-month, totaling a 27.3% expansion in 2007. According to the same comparison bases, non-earmarked credit operations increased 2.8% and 32.2%, respectively, while earmarked credit operations expanded by 1.7% and 16.7%. Non-earmarked credit operations continued to be favored by the strength of leasing operations, which expanded 110.0% in credit to individuals and 69.9% in credit to corporate, in 2007. Regarding earmarked credit, the most significant expansions in the last twelve months were related to housing (23.5%) and to the agricultural sector (16.2%). Considering credit operations by economic activity, loans to industries increased 4.0% in December month-on-month and 29.8% in 2007, while loans to commerce grew 2.7% and 24.2%, according to the same respective comparison bases.

54. The average interest rate on credit operations reached 33.8% p.a. in December, a record low for the historical series, standing 6 p.p. below the rate recorded in December 2006. The average rate reached 43.9% p.a for credit to individuals, down from 52.1% p.a. year-over-year and 22.9% for credit to corporate, decreasing 3.3 p.p. in the period.

55. The average tenure of credit operations for individuals reached 440 days in December, compared to 368 in the same month of the previous year. The average tenure of personal credit operations totaled 460 days, an 88-day extension relative to December 2006, reflecting the increasing share of payroll-deducted contracts. In addition, it bears emphasizing the elevation of the twelve-month trailing average tenure of vehicles and real estate financing acquisition operations, to 593 from 540 days and to 2199 from 1562 days, respectively.

56. Delinquency rates in the financial system (non-earmarked loans in arrears for more than ninety days) stayed at 4.3% in December, decreasing 0.7 p.p. year-over-year. Delinquency rates for credit operations with corporate and individuals reached 2% and 7%, reducing by 0.7 p.p. and 0.6 p.p., respectively, in the period.

57. Net delinquency rate for retail credit, measured by the ACSP, reached –1.9% in December down from 5.5% month-on-month, reflecting the expressive seasonal increase in cancelled registrations, and –0.6% year-over-year. In the year, the average net delinquency rate reached 5.4%, up from 5.3% in 2006.

External Environment

58. Uncertainties about the evolution of international economy remain high, in an environment of continuity of disturbances in real estate markets, the elevation of commodities prices and the persistence of credit market restrictions. Risks of global economic deceleration are increasing, reinforced by the downward revisions for 2008 global growth.

59. The recent evolution of the main economic indicators in the US, especially regarding the increase in the unemployment rate, which reached 5% in December, and the fall in the confidence of managers and consumers, suggest a deterioration of the economic scenario in 2008. Worsening retail sales and slowing housing starts, high levels of delinquency in mortgage contracts, the recognition of significant losses in the financial industry and the long duration of the credit tightening reinforce this prospect.

60. Since the middle of 2007, inflationary pressures stemming from food and energy prices have increased. In developed economies, central banks, especially the European Central Bank (ECB) and the Bank of Japan (BoJ), would maintain the monetary tightening cycle, temporally interrupted, if there wasn't the necessity to provide more liquidity to credit markets and restrain the worsening expectations for economic growth. In addition, central banks of emerging economies, which remain resistant to the financial crisis spillovers, started to interrupt or revert the monetary easing policy.

61. Aiming at increasing the liquidity in the financial market and reducing pressures in interbank markets, central banks in the US, Euro Area, England, Canada and Switzerland, in coordinated operations, have intervened in the markets through forward auctions, both in domestic currency and in dollar (ECB and Bank of Switzerland).

Foreign Trade and International Reserves

62. In 2007, Brazilian external trade continued the ongoing expansion, and reached record highs both in exports and in imports. External trade increased US$52.1 billion, totaling US$281.3 billion with exports and imports amounting US$160.6 billion and US$120.6 billion, representing increases of 16.6% and 32%, respectively, year-over-year. Due to expansion of imports, the trade surplus totaled US$ 40 billion in the year, US$ 6.4 billion retreat compared to the previous year. According to Fundação Centro de Estudos do Comércio Exterior (Funcex), in the year trough November, exports recorded 9.8% growth in prices and 6.5% growth in volume, and imports increased 5.8% and 23.3%, according to the same comparison bases.

63. In December, exports totaled US$14.2 billion, reaching US$711.6 million daily average, 16% growth relative to the same month of 2006. Exports of manufactured, primary and semi-manufactured products totaled US$7.2 billion, US$4.9 billion and US$1.8 billion, respectively, recording daily averages of US$361.1 million, US$243.9 million and US$89.7 million, with respective changes of 52.7%, –5.3% and 3.6% relative to 2006 daily average values.

64. Imports totaled US$10.6 billion in December, with US$529.8 million daily average, a 46.9% increase relative to 2006 daily average. All products categories expanded according to the same comparison basis: capital goods (38.8%); raw materials and intermediate goods (37.8%); and consumer goods (28.6%).

65. International reserves totaled US$180.3 billion in December, with increases of US$3.3 billion in the month and US$94,5 billion in the year.

Money Market and Open Market Operations

66. In the period between the December and January Copom meetings, the future interest rates increased, especially in medium and longer terms. This movement was driven by the release of above-than-expected data for inflation and activity; the increase of inflation expectations; as well as the non-prorrogation of CPMF, which created uncertainties regarding the fulfillment of the fiscal targets. In the external scenario, significant losses of financial institutions, still related to the US subprime mortgage market crisis and the increasing concern of recession in the US economy, despite the release of incentive fiscal measures, provoked strong falls in the stock markets and heightened risk aversion. Between December 3rd and January 21st, one- and three-month rates remained unchanged, while the six-month rates increased 0.18 p.p. Moreover, one-, two- and three-year rates increased 0.51 p.p., 0.88 p.p. and 0.82 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, increased to 7.43% on January 21st, up from 7.34% on December 3rd.

67. On December 21st, the BCB carried out reverse FX swap auctions amounting US$1.5 billion, with the total rollover of the January 2nd redemptions.

68. In its open market operations, the BCB carried out, from December 4th to January 21st, weekly five- and seven-month fixed rate repo operations, borrowing. The average daily balance of these operations reached R$83.3 billion, of which R$65.9 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$22.9 billion, borrowing. In addition, on December 6th and on January 2nd, the BCB conducted borrowing operations with tenure of 33 and 16 working days, respectively, amounting R$82.2 billion and R$22.3 billion. These operations totaled R$92.2 billion on a daily average basis.

69. Between December 4th and January 21st, the National Treasury raised a total of R$35.8 billion, of which R$23.4 billion in fixed-rate securities: R$20.7 billion via issuance of LTNs maturing in 2008, 2009 and 2010, and R$2.7 billion in NTN-Fs maturing in 2011, 2012, 2013, 2014 and 2017. Issuance of LFTs totaled R$10.3 billion, for securities maturing in 2013 and 2014. Issuance of inflation-linked NTN-Bs reached R$2.1 billion, for securities maturing in 2011, 2012, 2013, 2017, 2024, 2035 and 2045.

70. In the same period, the Treasury conducted auctions to sell LTNs maturing in July and October 2008, and April 2009 and bought LTNs maturing in January and April 2008, totaling R$2.9 billion. Issuance of inflation-linked NTN-Bs for securities maturing in 2009, 2011, 2012, 2013, 2017, 2024, 2035 and 2045, settled in other National Treasury securities, totaled R$7.4 billion. The Treasury also conducted sales auctions of LFTs maturing in 2012 and 2014, which totaled R$1.7 billion, receiving LFTs maturing in 2008 as payment, and purchase auctions to buy LTNs, totaling R$0.5 billion.