BANCO CENTRAL DO BRASIL

Minutes of the 147th Meeting of the Monetary Policy Committee (Copom)

Summary

Date: December 8th, from 5:45PM to 7:50PM, and December 9th, from 5:00PM to 7:40PM
Place: BCB Headquarters meeting rooms - 8th floor on December 8th and 20th floor on December 9th – Brasília – DF

In attendance:
Members of the Committee
Henrique de Campos Meirelles – Governor
Aldo Luiz Mendes
Alexandre Antonio Tombini (present only on December 9th)
Alvir Alberto Hoffmann
Anthero de Moraes Meirelles
Antonio Gustavo Matos do Vale
Maria Celina Berardinelli Arraes
Mário Magalhães Carvalho Mesquita

Department Heads (present on December 8th)
Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on December 9th)
João Henrique de Paula Freitas Simão – Open Market Operations Department
Jose Antonio Marciano - Department of Banking Operations and Payments System
Marcio Barreira de Ayrosa Moreira – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations Group

Other participants (present on December 8th)
Adriana Soares Sales – Advisor to the Board
Alexandre Pundek Rocha – Advisor to the Board
André Minella – Advisor to the Board
Fabio Araujo – Advisor to the Research Department
José de Ribamar Oliveira Júnior – Press Secretary

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

Recent Economic Developments

1. IPCA inflation increased to 0.41% in November up from 0.28% in October. As a consequence, in the year through November inflation reached 3.93%, decreasing 1.68 p.p. relative to the same period of the previous year. In the last twelve months, inflation increased to 4.22% in November up from 4.17% in October (5.90% in December 2008 and 6.39% in November 2008), remaining near the target. The deceleration of twelve-month consumer price trailing inflation in the first eleven months of the year mirrored the behavior of market prices, as regulated price inflation increased. Considering market prices, both prices of tradable and non-tradable goods cooled on a twelve-month trailing basis, showed deceleration, reaching 2.64% and 5.45%, respectively, in November, down from 6.99% and 7.10% in December 2008 (7.87% and 7.74% in November 2008). However, according to the same comparison basis, the prices of services, whose dynamics tends to show more persistence than that of the prices of goods, slightly increased to 6.42% in November up from 6.39% in December 2008 (6.48% in November 2008). Preliminary data for December point to consumer inflation below the level observed in November. In short, information available suggest that the inflationary acceleration cycle observed last year has been gradually overcome by a process led by the behavior of market prices, specially goods, while regulated price and services inflation continue to show more persistence.

2. The three main underlying inflation measures calculated by the BCB increased between October and November. The core inflation by exclusion of household food items and regulated prices changed from 0.33% in October to 0.42% in November. Smoothed and non-smoothed trimmed means core inflation measures also accelerated, recording 0.37% and 0.36% in November, up from 0.31% and 0.28% in October, respectively. The twelve-month trailing inflation measures changed from 6.09%, 4.82% and 4.92% in December 2008 to 4.92%, 4.27% and 3.58% in November, for the core inflation by exclusion, smoothed and non-smoothed trimmed means core inflation, respectively. Moreover, it bears emphasizing that the behavior of the IPCA diffusion index reduced to 58.9% in November (compared to 64.6% in November 2008).

3. The General Price Index (IGP-DI) inflation changed from -0.04% in October to 0.07% in November. On a twelve-month trailing basis, the IGP-DI inflation remained at -1.76% in November (11.20%in November 2008). The slowdown of the IGP-DI has basically reflected the behavior of all its three components. Its main component, the Wholesale Price Index (IPA-DI), reached -4.64% in the last twelve months through November (12.88% in November 2008). On its turn, the Consumer Price Index-Brazil (IPC-Br) increased 4.23% through November (6.27% in November 2008) and the Civil Construction National Index (INCC) increased 3.32% (12.34% in November 2008). Regarding the IPA-DI, the inflationary deceleration, under this comparison basis, derives basically from the behavior of both agricultural and industrial prices. The agricultural IPA reached -3.26% (7.38% in November 2008), while wholesale industrial prices reached -5.14% (14.93% in November 2008). As mentioned in previous Copom Minutes, the Copom evaluates that the effects of wholesale prices over consumer price 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 increased 1.4% in August and accelerated to 1.8% in September and October. Still considering the seasonally adjusted series, industrial output increased by 1.8% in September and 2.2% in October, month-on-month, the tenth consecutive month of expansion. On a year-over-year basis, industrial output retreated by 7.2% in August, 7.6% in September and 3.2% in October. The analysis of the behavior of IBGE industrial output series, and its components, suggests that production reached its trough in December-January, and has been followed by gradual recovery. However, industrial activity recovery continues to be influenced by the international outlook, by business and households' expectations, as well as by the developments of domestic financial conditions, supported by traditional sources of credit, besides the recovery of capital markets and the performance of financial public institutions.

5. Among the use categories, according to data seasonally adjusted by the IBGE, in October, it bears highlighting the durable consumer goods production, strongly influenced by the automotive sector and by capital goods, both of them with a growth rate of 5.9%. Regarding the other use categories, intermediate goods production increased 1.2%, whilst non-durable and semi-durable consumer goods production increased 1.3%. The recovery, at the margin, in the dynamism of industrial production, led by production of durable goods, although more widespread than before, reflects, to a great extension, tax exemption measures and also some easing in credit

conditions. The future behavior of industrial production recovery, which should not be uniform over time, will depend on these factors, as well as on the evolution of consumer and businessmen confidence, counterbalancing the still emerging recovery of external demand.

6. Labor market has behaved more favorably, with resilient aspects prevailing over signs of loss of strength. The unemployment rate in the six metropolitan regions covered by the IBGE Monthly Labor Survey (PME) changed from 8.1% in August to 7.7% in September and to 7.5% in October (also 7.5% in October 2008). According to the seasonally adjusted series, the unemployment rate remained unchanged at 7.8 %, the same level reached in September. Average real earnings increased by 3.2% in October, in year-over-year terms. Employment, on its turn, retreated by 0.3% in October, according to the same comparison basis. As a consequence, real payroll reached 2.9% over October 2008, continuing to constitute a key driver for domestic demand growth. Still regarding the labor market, data from the Ministry of Labor and Employment (MTE) indicate that the generation of formal employment has continued to record significant recovery. In October, 231 thousand jobs were created (252.6 thousand in September), representing the best result in the series for the month. The manufacturing industry showed positive balance of 74.6 thousand jobs, the seventh consecutive month of expansion and the best result of the series for the month. Similarly, the commerce sector continued the recovery trajectory initiated in April, with the positive result of 68.5 thousand jobs, the best result for the month. Also, the civil construction sector, the most dynamic one with a 5.8% cumulative growth in 2009, and the services sector continued hiring workers this month: 26.2 and 69.6 thousand jobs, respectively. Also in the services sector, the creation of jobs in October was the best result for the month in the series. The agricultural and livestock sector, on its turn, lost 11.6 thousand jobs, following the seasonal pattern.

7. According to data seasonally adjusted by the IBGE, expanded retail sales increased by 4.7% in August and 3.0% in September. On a year-over-year basis, the indicator increased by 9.1% in September, growing by 4.4% in the year. The three-month moving average of expanded retail sales reached 0.4% in September, according to seasonally adjusted data, after recording 1.6% in August. On a month-on-month basis, according to seasonally adjusted data, it bears emphasizing the expansion in the sales of “vehicles, motorcycles, parts and pieces” (9.1%) and “office material and equipment” (8.8%). The negative key drivers were “building material” (1.5%) and “pharmaceutical and medical products” (-1.1%). In the year, cumulative growth was more significant in “office material and equipment” (11.9%) and “pharmaceutical and medical products” (11.9%). Since the beginning of the year, expanded retail sales data have evidenced recovery, mainly influenced by the increase in the sales of durable, in response to sector incentives granted by the government and to the improvement in the access to credit supply. For the next quarters, the retail sales trajectory will continue to be sustained by fiscal transfers, as well as by real payroll growth, whose evolution should be favored by the inflation behavior, but it will also be affected by the recovery in the access to credit supply, influenced by the lagged effects of monetary policy and by the evolution of consumer confidence.

8. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by FGV, reached 82.9% in November (82.5% in the previous month and 77.9% at the level observed in February- March), getting closer to the average observed in the last five years. The series seasonally adjusted by CNI changed from 80.6% to 80.8%, between September and October. Considering the monthly series without seasonal adjustment, the FGV calculated Nuci reached 84.5% in November, 0.7 p.p. below the level registered in the same month of 2008. This small reduction in the Nuci in November, according to the year-over-year comparison, is also observed in the production of intermediate goods (1 p.p.), while there is stability in construction inputs (0p.p.) and an increase of 1.1 p.p. in consumer goods – the expansion more intense of idleness is restricted to capital goods sector (8 p.p.). The reduction on the Nuci, according to the same comparison basis, results from a combination between the maturity of investment projects and accommodation of economic activity, but more recent data suggest that idle margin has been reducing. Data regarding the absorption of capital goods show retraction compared to the same periods of 2008 and expressive expansion at the margin. The absorption of capital goods data increased 12.6% in October (after a 6.1% increase in September), a 13.8% increase in the quarter ended in October, compared to the quarter ended in July, according to seasonally adjusted data, and a decrease of 6.5% in year-over-year terms, according to observed data. On its turn, the production of construction inputs increased by 0.5% at the margin in October (1.7% increase in the quarter), after a 1% increase in September, accumulating a 9.3% fall in the year. In short, evidences suggest that the utilization rates have been increasing the last months, showing a reduction in the idle margin of the industry, accompanied by the resume of investments. 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 twelve-month cumulative trade balance reduced at the margin, reaching a surplus of US$26.5 billion in October, and decreasing to US$25.5 billion in November. This total resulted from US$152.4 billion in exports and US$126.8 billion in imports, equivalent to -23.2% and -26.3% changes, respectively, year-over-year. The greater dynamism of domestic demand relative to the external demand contributes to the recent narrowing of trade surplus. The reduction in remittances of profits and dividends, on its turn, has contributed to limit the twelve-month trailing current account deficit, which reached US$28.2 billion in December 2008, decreasing to US$18.9 billion in October, equivalent to 1.3% of GDP. On its turn, foreign direct investment reached US$29.5 billion in the twelve months through October, equivalent to 2.1% of GDP.

10. The period since the last Copom meeting was marked by the continuity of stress reduction in international financial markets, despite not in a monotonic way. The unprecedented actions taken by the authorities in mature economies, using a wide range of instruments, have continued to moderate the perception of systemic risk, in an environment of strong liquidity expansion. Under these conditions the signs of reduction in risk aversion continue, as evidenced by the behavior of international equity markets, although this process remains subject to reversals. The trend of reduction of risk aversion and of the scarcity of capital flows, as well as some concern among investors about the fiscal situation in the US, continued to encourage the recovery of currencies, both from emerging and mature economies, against the US dollar, yet in a more modest and heterogeneous terms in relation to the movement observed in previous months.

11. Regarding the global macroeconomic scenario, contraction trends prevail over inflationary pressures in 2009, but recovery of economic activity seems to have been consolidating. The current predominant view points to the contraction of global economic activity in 2009, followed by recovery in 2010. The consensual projections point to a retraction of activity in the US, Europe and Japan (G3), which would not be totally offset by the economic dynamism of some emerging economies, especially in Asia. However, there are evidences of gradual recovery in the economic activity, but still subject to reversals, particularly due to the weakness in the labor market and economic activity in G3. On the other hand, the risks that the problems of the international financial system may be aggravated by the cyclical deterioration of the credit quality, which could contain the distension of financial conditions, and consequently, difficulty the consolidation of recovery, persist, but seem to be slowing. Therefore, the minimal points of inflation in mature economies seem to have been exceeded, despite the persistence, on a twelve-month trailing basis, of the disinflation process in several emerging economies. In this context, after a period of aggressive monetary policy easing, in a significant number of countries, monetary policy seems to have begun a phase of stability, whereas the increase in public sector debt imposes limits on the scope of any additional fiscal stimuli.

12. Oil spot prices have not shown a clear trend since the last Copom meeting. Future markets did not show a consistent trend as well. Uncertainty concerning these quotations remains high, as the prospective scenario depends on the evolution of demand, in the context of global economic recovery, on the prospects for the evolution of global supply, subject to the pace of investment maturation in the sector, in addition to the geopolitical issues that affect the price of this commodity. Nonetheless, despite the high uncertainty inherent to the projections regarding the trajectory of oil prices, the main scenario adopted by the Copom assumes unchanged domestic gasoline prices in 2010. However, it bears highlighting that, regardless the behavior of domestic gasoline prices, the evolution of international oil prices can affect domestic prices through productive chains, such as the petrochemical, as well as through the potential effect over inflation expectations. It bears emphasizing that the behavior of agricultural commodity prices, which have particularly important impact in the evolution of food costs, such as wheat, soybeans and corn, increased since the last Copom meeting, as well as metallic industrial commodities, such as aluminum and copper.

Assessment of Inflation Trends

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

a) the projected adjustments for gasoline prices for 2009, increased from 0% in the October meeting, increased to 1.9%, while the projection for bottled gas prices rose from 11.2% to 13.4% in the same period. For 2010, there are no projected changes for gasoline and bottle gas prices;
b) regarding the projected adjustment for fixed telephone and electricity prices for 2009, the former increased to 0.9% from 0.3%, percentage considered in the October meeting, while the latter moved from 4.8% to 5.2%. The projected adjustments for fixed telephone and electricity prices for 2010 are 1.6% and 3.3%, respectively;
c) the projection for regulated prices inflation for 2009, based on individual items, was kept unchanged at 4.5%. For 2010, the projection is kept at 4.0%, as considered in the October meeting. This set of prices, according to data released by the IBGE, corresponded to 29.64% of the total November IPCA;
d) the projection for regulated prices inflation for 2011 is 4.0%. Such projection is based on the endogenous determination model for regulated prices, which computes, among other factors, seasonal components, foreign exchange rate changes, market prices inflation and the IGP (General Price Index) variation; and
e) the projection for the spreads over the Selic rate, based on the 360-day swap rates, on the benchmark scenario, estimates 99bps, 37 bps and 35 bps spreads in the fourth quarters of 2009, 2010 and 2011, respectively.

14. Regarding fiscal policy, projections assume the achievement of a public sector primary surplus target of 2.5% of GDP in 2009 and 3.3% in 2010, in both cases adjusted by the possibility of reduction by up to 0.94 p.p. and 0.68 p.p., respectively, due to the implementation of the projects linked to the Growth Acceleration Program (PAC). Moreover, it is considered that the primary surplus in 2011 would return without adjusts to the level of 3.3% of GDP. The additional assumptions considered in the previous meeting remained unchanged.

15. Since the last Copom meeting, the median of the expectations compiled by the BCB’s Investor Relations Group (Gerin) for the 2009 IPCA slightly decreased, moving from 4.30% to 4.26%. For 2010, the median of inflation expectations increased to 4.48%, up from 4.41%, whereas it its 4.50% for 2011.

16. The benchmark scenario assumes the maintenance of the exchange rate at R$1.70/US$1.00 and the Selic rate at 8.75% p.a. during the forecast period. In this scenario the projection for 2009 inflation increased relative to the figure considered in the October Copom meeting, and lies around the 4.5% target established by the National Monetary Council (CMN). According to the market scenario – which incorporates the consensus exchange and Selic rates trajectories collected by Gerin on the eve of the Copom meeting - IPCA inflation forecast for 2009 increased as well, standing around the inflation midpoint target. For 2010, under the benchmark scenario, the projection increased relative to the figure considered in the October meeting, but remains close to the midpoint target, whereas the projection under the market scenario remains stable.

Monetary Policy Decision

17. The Copom evaluates that the monetary policy should contribute to the consolidation of a favorable longer-term macroeconomic environment. The risk aversion and the liquidity conditions prevailing in international markets continue to show a normalization trend at the margin. In fact, since the last Copom meeting, signs of global risk aversion reduction have continued to accumulate, despite still subject to reversion, with impacts over both Brazilian asset prices, as well as over selected commodities, which had also been influencing domestic financial conditions. However, it bears emphasizing that the trajectory of price indices still evidences external inflationary pressures contained. Consequently, the impact of the international scenario over the domestic inflation path continues to be, up to now, predominantly benign. On its turn, the possible consolidation of the world economy recovery might impact, although in a heterogeneous fashion, the global inflationary dynamics. On the top of this, it should be added the uncertainty generated by the effects of the unprecedented liquidity expansion on mature economies, over the price behavior of both assets and commodities. The Copom emphasizes that the main challenge of monetary policy in such context is to ensure that the favorable results obtained over the last years are preserved.

18. The Copom evaluates that the probability that initially localized pressures impose risks to the inflationary trajectory remains limited. The moderation of domestic demand pressures over the market of factors, at least in the short run, should contribute to contain the risk of pass-through of possible upward pressures over consumer prices stemming from wholesale prices (which, incidentally, returned to deflation in recent months). The Committee understands that the materialization of such pass-through, as well as the generalization of pressures, initially localized over the consumer prices, still depends critically on economic agents' inflation expectations. Incidentally, inflation expectations for 2010 and 2011 remain in line with the targets path and continue to be closely monitored. Additionally, it is worth noticing that the domestic demand behavior tends to exert contained pressure over non-tradable items, such as services, over the upcoming quarters. Nonetheless, the Committee reaffirms that it will conduct its actions in order to ensure that the gains on inflation control obtained in recent years become permanent.

19. The Copom emphasizes, once more, that there are important time lags between the implementation of monetary policy and its effects on both economic activity and inflation. Therefore, the assessment of alternative options for monetary policy should necessarily focus on the forward-looking inflation scenario and its risks, instead of current inflation figures. Such considerations become even more relevant in periods surrounded by heightened uncertainty. The Committee reaffirms that specific asset price movements are only relevant for monetary policy if they impact the forward-looking inflationary path.

20. Prospects for the evolution of domestic economic activity have continued to improve since the last Copom meeting, as evidenced by data on commerce activity, industry and labor market. Signs of credit recovery continue to accumulate, in particular regarding loans to individuals. Also for consumer and businessmen confidence there are consistent signs of recovery. Under such circumstances, the rhythm of economic activity resumption strongly depends on real payroll expansion, on the effects of fiscal stimulus measures and on incremental governmental transfers, which will occur in the upcoming months. It should also benefit from the easing of financial conditions, favored by the policy of official banks, among other factors. In short, the most recent data on domestic economic activity seem to reinforce the evaluation mentioned in previous Copom meetings minutes that the contractionist effects of the international financial crisis over the domestic economy dynamism and, consequently, over the context on which the monetary policy operates, could become persistent, but would not be permanent. These considerations become even more relevant considering the fact that the current monetary policy decision will have concentrated impacts in 2010.

21. The Copom understands that the risks for the consolidation of a benign inflationary scenario derive, in the short term, from price adjustment mechanisms that contribute to lengthen inflationary pressures observed in the past, as evidenced by the behavior of services prices and certain regulated items since the beginning of 2009, as well as from a possible hike in commodities prices. In the medium term, the risk stems from cumulative and lagged effects of the financial conditions easing and from the fiscal stimulus over the evolution of domestic demand, taking into account the dynamics of consumption and investment, in a context of recovery of production factors utilization. The balance of such influences over the inflationary prospective trajectory will be crucial to the assessment of the various alternatives available for the monetary policy stance.

22. International evidence, as well as the Brazilian experience, indicates that high inflation rates lead to the increase of risk premium, for both private and public funding, to the shortening of planning horizons and, consequently, to lower potential economic growth, besides having regressive effects over income distribution. Therefore, the Copom strategy aims to ensure that that the convergence of inflation towards the target path observed in 2009 continues to be registered in 2010 and 2011. Such strategy, which results have been evidenced throughout time, takes into account the time lags in the transmission mechanisms and is the most adequate to deal with the uncertainty inherent to the process of monetary policy formulation and implementation.

23. The Copom evaluates that, in light of the idleness margin of the economy, evidenced by indicators of capacity utilization in industry and of the labor market, and the behavior of inflation expectations for relevant horizons, the materialization of a benign inflation scenario, in which the IPCA would continue to evolve according to the target path, has remained favorable. By the way, such evolution of the forward-looking scenario continues to be reflected on the inflation projections considered by the Committee. Under such circumstances, in order to preserve the improvement of the prospective inflationary path, under a macroeconomic scenario with significant uncertainty, the

Copom evaluates that monetary policy should maintain a cautious stance, aiming to assure the maintenance of inflation convergence to the targets path.

24. The Committee understands that the accommodation of demand, motivated by the tightening of financial conditions and by deterioration of the agents' confidence, as well as by the global economic activity contraction, has been overcome, although significant idleness margin of production factors still persists, which should not be rapidly eliminated in a basic scenario of gradual recovery of economic activity. The Copom also highlights that there are uncertainties around such basic scenario, which should be clarified over the upcoming months, with both positive and negative biases over the pace of economic activity recovery. Anyhow, under such scenario of gradual recovery, which has been corroborated by current available data, inflationary pressures should remain restrained. On the other hand, the Committee notices that the significant monetary policy easing, implemented between January and July, will have cumulative effects over the economy, which will be evidenced with a time lag.

25. The Committee understands that decisions regarding the evolution of the basic interest rate have to take into account the magnitude of the stimuli introduced into the economy, whose impacts on several economic indicators will be evident over time, in a context of a gradual and consistent recovery of production factors utilization. The Copom also understands that a more cautious stance will contribute to mitigate the risk of abrupt reversals of monetary policy in the future and, therefore, to the consistent recovery of the economy over the upcoming quarters. The Copom also evaluates that the preservation of benign inflationary prospects will require the behavior of the financial system and the economy under a new level of interest rates to be closely monitored over time.

26. Regarding the inflation prospects compared to the targets path, the Copom has unanimously decided to maintain the Selic rate at 8.75% p.a. without bias. Taking into account, on the one hand, the monetary policy easing implemented since January and, on the other hand, the idleness margin of production factors, among other factors, the Committee evaluates that such level of basic interest rate is now consistent with a benign inflationary scenario, contributing to assure the maintenance of inflation in line with the targets path over the relevant horizon for the non-inflationary recovery of economic activity.

27. Under the inflation targeting regime, the Copom guides its decisions according to projected inflation, the analysis of several alternative scenarios for the evolution of the main variables that determine the forward-looking dynamics for prices, and the balance of risks associated to the projections. After a short period of contraction, domestic demand started to show signs of recovery, due to the stimulus factors effects, such as income growth. Additionally, it bears noticing that, evidencing the credibility achieved by the Copom on the implementation of the regime, inflation expectations for 2010 and 2011 remain in line with the targets path. It is also noteworthy that global economic deceleration has generated downward pressures over wholesale industrial prices. On its turn, important monetary, credit, and fiscal stimuli were introduced into the economy over the last quarters and should contribute to the activity recovery and, consequently, to the reduction of the idleness margin of production factors. Those stimuli effects should be closely monitored over time and are important in the context where future monetary policy decisions, which should ensure the materialization of the convergence of inflation to targets path over relevant horizons, will be taken.

28. At the end of the meeting it was announced that the Committee will reconvene on January 26th, 2010 for technical presentations and, on the following day, to discuss the monetary policy decision, as established in Communiqué 18,927 of October 9th, 2009.

SUMMARY OF DATA ANALYZED BY THE COPOM

Inflation

29. IPCA inflation reached 0.41% in November, up from 0.24% in October, but showing decrease from the variation of 0.44% for November IPCA-15. Market prices increased 0.42% in November, compared to 0.22% in October, as a result of increases of 0.22% on tradable items and 0.59% on non-tradable items, while regulated prices increased 0.40% in November, down from 0.42% in October. The diffusion index reached 58.9% in November, averaging 57.3% in 2009. On a twelve-month trailing basis, the IPCA variation was 4.22% in November, up from 4.17% in October, mirroring the 4.10% increase in market prices and the 4.5% increase in regulated prices.

30. All the core IPCA measures increased in November, both on monthly and twelve-month trailing basis. The core excluding household food items and regulated prices increased from 0.33% in October to 0.42% in November. The smoothed trimmed means core reached 0.37%, up from 0.31% over the previous month; the non-smoothed trimmed means core reached 0.36%, up from 0.28%, in the same periods. In the last twelve months through November, the smoothed and non-smoothed trimmed core measures reached 4.92% and 4.27%, respectively, in comparison to 4.86% and 4.24%, respectively, in October, while the core by exclusion recorded 3.58% and 3.5%, according to the same comparison basis.

31. Inflation measured by the IGP-DI, reported moderate variations in October (-0.04%) and November (0.07%) after growing 0.25% in September. Considering the inflation accumulated in the last twelve months through November, the IGP-DI decreased from -0.65% in September to -1.76% in October and November. Under this criterion, the deceleration of the IGP-DI is manifested in its three components, but reflecting in particular the behavior of IPA-DI, which reached -4.64% in November. The IPC-Br changed 4.23%, according to the same comparison basis, while the INCC increased 3.32%. The deceleration of the IPA-DI in twelve months stems both from the behavior of agricultural prices that reached -3.26% in November, and industrial prices, that decreased 5.14% over the same period.

Economic Activity

32. According to data seasonally adjusted by the IBGE’s monthly survey (PMC), expanded retail sales increased 3% in September, month-on-month, after a 4.7% increase in August and a 6.3% fall in July. As a consequence, the average change of the quarter ended in September reached a 3.5% increase relative to the quarter ended in June. Year-over-year, expanded retail sales increased by 9.1%, while growth reached a 4.4% increase in the three first quarters of the year and a 3.3% increase in the last twelve months through September. The month-on-month result revealed that sales increased in seven out of ten segments surveyed, with highlights for the increase in “vehicles and motorcycles, parts and pieces” (9.1%); and “office material and equipment” (8.8%). Among the negative drivers, it bears highlighting “construction inputs” (1.5%); pharmaceutical, medical, orthopedic, perfumery and cosmetic items” (1.1%) and “hyper-, supermarkets, food products, beverages and tobacco” (0.5%).

33. Year-over-year, it bears highlighting the expansions in “vehicles and motorcycles, parts and pieces” (18.9%); “hyper-, supermarkets, food products, beverages and tobacco” (9.7%); “books, newspapers, magazines and stationary” (9.7%); and “pharmaceutical, medical, orthopedic, perfumery and cosmetic items” (8.1%). Among the negative drivers, it bears noticing the 8.2% decrease for “construction inputs” and the 6.6% decrease for “textiles, clothing and footwear”. In the year through September, six out of the ten segments surveyed increased, and it bears emphasizing “office material and equipment” (11.9%); “pharmaceutical, medical, orthopedic, perfumery and cosmetic items” (11.9%); “books, newspapers, magazines and stationary” (9.3%); as well as “other personal and domestic items” (8.7%). As negative drivers, according to the same comparison basis, “construction inputs” presented the sharpest decrease, with a 9.5% fall.

34. São Paulo Trade Association (ACSP) data for November, related to the city of São Paulo, indicated a 2.6% increase in database consultations for credit sales (SCPC) and a 1.5% increase in consultations to the Usecheque system on a month-on-month, seasonally adjusted basis. In 2009 through November, those indicators showed a decrease of 10.8% and an increase of 0.6%, respectively, in comparison to the same period of the previous year. On a twelve-month basis, those indicators showed, respectively, a 9.9% decrease and a 0.9% increase.

35. Automobile sales by dealers, which take into account automobiles, light commercial vehicles, trucks and buses, decreased 4.2% in November, month-on-month, seasonally adjusted by the BCB, according to Fenabrave (Brazilian Federation of Vehicles Distribution) data. Such decrease reflected accommodation on sales, after the increase due to expectations regarding the progressive suspension of the IPI (tax on industrialized products) adopted under the context of counter cyclical measures implemented after the deepening of international crisis. Total sales increased 41.5% year-over-year, with highlights for automobiles and light commercial vehicles, which increased 45.5% and 35.4%, respectively. It is worth mentioning that the sales of trucks, which had presented successive falls throughout the year when compared to the same month last year, recorded a 17.9% increase in

November, registering the second consecutive month of growth. In the year through November, vehicles sales increased 8.5% year-over-year, as a result of the expansion on automobiles (10.3%) and light commercial vehicles (7.5%), as well as of the decline of buses sales (16.3%) and trucks sales (15.7%).

36. Capital goods imports increased 1.9% in October, month-on-month, according to the Funcex quantum index, seasonally adjusted by the BCB. The October indicator decreased 21.6% year-over-year, reaching a 15% decline in the year through October, year-over-year. Capital goods exports decreased 5.6% in October, month-on-month, and 40.6% and 40.2% year-over-year and in the year through October, respectively.

37. Capital goods production increased 5.9% in October, month-on-month seasonally adjusted, but showed decreases of 16.8% year-over-year and of 22.0% in the year through October, according to IBGE. The monthly result highlights were the increases in production of capital goods directed to construction (22.7%), to the electric energy sector (15.1%) and transport equipment (11.1%). On the other hand, the production of capital goods for industrial use registered fall of 3.7%. The production of inputs for civil construction increased 0.5%, month-on-month, and declined 9.3% in the first ten months of the year.

38. The disbursements of BNDES reached R$106.5 billion in 2009 through October, with an increase of 51.8% over the same period last year.

39. General industrial physical production increased 2.2% in October, month-on-month, seasonally adjusted, according to IBGE's Monthly Industrial Survey – Physical Production (PIM-PF). Year-over-year and on a twelve-month basis, the sector contracted by 3.2% and 10.6%, respectively. Among the four use categories, it bears highlighting the performance of capital goods and durable consumer goods production, recording the same growth rate of 5.9%. The intermediate goods production presented the mildest increase (1.2%). Mining production increased 1.2% in the period, reaching falls of 8.1% when compared to October 2008 and of 9.4% in the last twelve months.

40. CNI indicators kept on showing in October the increase of industrial activity, according to data seasonally adjusted relative to September. Manufacturing industry real revenues increased 1.5% in the month, while worked hours, employment and the Nuci increased 1%, 0.5% and 0.2 p.p. respectively. Relative to October 2008, the Nuci decreased 2 p.p., reaching fifteen among the nineteen activities in the manufacturing industry. Highlights for the decreases of basic metallurgy (17.5 p.p.), wood (9.1 p.p.) and machinery, equipments and electrical material (6.7 p.p.).

41. Vehicles production reached 292 thousand units in November, according to Anfavea, increasing by 47.9% year-over-year. According to seasonally adjusted data, vehicles production decreased 4.1% month-on-month. In the year through November the production of vehicles and agricultural machinery declined 6.8% and 24.6%, respectively, while in the last twelve months through November the same indicators declined 10.1% and 21.9%, respectively, year-over-year. Domestic sales of vehicles increased 58.3% in November and 4.7% in the first eleven months of 2009, year-over-year, while exports decreased by 0.6% and 39.1%, respectively.

Surveys and Expectations

42. According to the Fecomercio-SP survey, the Consumer Confidence Index (ICC) decreased 0.7% in November relative to October, when it reached a record level for the observed series. This result reflected contractions of 1.4% in the Current Economic Conditions Index (Icea), and 0.3% in the Consumer Expectations Index (IEC). Year-over-year, the ICC increased 15.5%.

43. According to the Consumer Expectations Survey carried out by the FGV nationwide, the ICC increased 1.5% in November, month-on-month seasonally adjusted, a record level since May 2008. In November, the Current Situation Index (ISA) increased 2%, a record high for the series started in September 2005, and the Expectations Index (IE) increased 1.2%. The ICC increased 19.2% year-over-year, reflecting the expansion of 24.9% in the ISA and of 16.2% in the IE.

44. In relation to the expectations for the manufacturing industry, the FGV Manufacturing Industry Survey recorded, in November, the tenth consecutive high, showing the consolidation of manufacturing industry recovery after recent international crisis. The Industry Confidence Index (ICI) increased 2.4%, month-on-month, seasonally adjusted. Year-over-year, the indicator increased 35.1% in the observed series, the highest percent change since July 2004 on the same comparison basis. Among components, according to the month-on-month seasonally adjusted series, there were increases of 2.9% for the Current Situation Index (ISA) and 1.8% for the IE, and increases of 29.9% and 40.9%, respectively, year-over-year.

Labor Market

45. According to the General Record of Employment and Unemployment (Caged) of the Ministry of Labor and Employment (MTE), 231 thousand formal jobs were created in October (the best result of the series for the month). In the year through October and on a twelve-month basis, respectively, 1,163.6 thousand and 467.8 thousand jobs were created. The manufacturing industry showed the seventh month positive balance, reaching the best result of the series for the month, with 74.6 thousand hires, representing a 0.6% increase in employment in October, month-on-month, seasonally adjusted data. The same data showed a 0.4% increase in employment in October, month-on-month, with highlights for the increase in the construction sector (1.1%). According to the average of the year, the level of employment increased 2%, reflecting increases of 5.8% in the construction sector and 3.9% in the services sector and in the retail sector, whereas the manufacturing industry declined by 2.5%.

46. According to the IBGE employment survey (PME), carried out in the six main metropolitan regions of the country, the unemployment rate reached 7.5% in October, showing stability year-over-year and a 0.2 p.p. decrease month-on-month. The fall in the unemployment rate is a result of decreases of 16 thousand jobs (-0.1%) and 62 thousand people (-0.3%) in the economically active population (PEA). The unemployment rate remained stable in 7.8% in October, seasonally adjusted data. The same survey pointed out for the stability of average real earnings of employed workers in the month, after three consecutive month increases, growing by 3.5% in the year through October. Real payroll decreased 0.1% month-on-month and increased 4.2% in the year through October.

Credit and Delinquency Rates

47. Outstanding credit in the financial system reached R$1,367 billion in October, equivalent to 45.9% of GDP, with increases of 1.4% in the month and of 15.3% on a twelve-month trailing basis. Non-earmarked credit operations increased 1% in the month and 9.7% in the last twelve months. Among the non-earmarked operations, which represent a share of 68.1% in the total of the financial system, credit operations to individuals increased 1.4% in the month and 17% in the last twelve months, while non-earmarked credit operations to corporate increased 0.7% and 3.6%, according to the same comparison basis. Earmarked credit operations increased 2.2% in the month and 29.4% on a twelve-month trailing basis.

48. The average interest rate on non-earmarked credit operations, used as reference for interest rates, increased in October, after ten consecutive months of decline, reaching 35.6%. The average annual rate on credit for individuals reached 44.2% (43.6% in September) and the average rate on credit to corporate reached 26.5% (26.3% in September).

49. The average tenure on non-earmarked credit operations, used as reference for interest rates, increased in October for the second consecutive month, reaching 377 days. The average tenure of corporate credit operations reached 267 days, while the average tenure for credit operations to individuals totaled 513 days.

50. Delinquency rates in the financial system (non-earmarked loans used as reference for interest rates, in arrears for more than ninety days) remained stable as compared to September (5.8%), when was registered the first fall in the rate after increasing for eight consecutive months. Delinquency rates for credit operations with corporate remained stable, at 4%, while declined 0.1 p.p. with individuals, reaching 8.1%.

51. Net delinquency rate for retail credit, measured by the ACSP, reached 4.2% in November, compared to 6.2% in October, 6.5% in September and 6.4% in the same month of 2008, representing a record low since December 2008.

External Environment

52. Evidence of recovery in the global economy strengthened with the release of positive data for Q3 GDP growth in the US and the Euro Area, after four consecutive negative results in the U.S. and five in the Euro Area. At the same time, the Japanese economy registered the second consecutive quarter of growth in the third quarter, accelerating from the expansion of the previous period. The resumption of growth in the two largest economies has supported the recovery of international trade and economic activity in other regions of the world. Among the emerging countries, China and India followed with acceleration on annual growth rates, while Mexico and South Korea registered high quarterly growth rates.

53. Due to the progressive reduction of the 2008 basis effect, the rise in commodity prices, particularly oil, which has been taking place since the beginning of the year, has changed the behavior of the consumer prices indices (CPI). In the US, the Euro Area and China, the deflationary process lost importance with the annual fluctuations in the CPI reaching -0.18%, -0.1% and -0.5%, respectively. In the United Kingdom and in some emerging economies such as South Korea, Hungary and Turkey, the disinflationary process also began to reverse. In the US and the Euro Area, the persistence of low rates of utilization of capacity, accompanied by stability in inflation expectations, should contribute to avoid inflationary pressures in the short and medium terms. In this context, except for the persistent Japanese deflation, which registered annual growth of -2.5% in October, and the economy of the United Kingdom, where high prices back to worry the authorities, the overall inflation scenario is still considered stable.

54. Despite the announcement of the debt restructuring of the Dubai World Sovereign Wealth Fund, which led, more recently, to an increased risk aversion, in general, international financial markets showed relative stability during the period.

55. In this environment, most central banks kept unchanged their basic interest rates. In some countries, however, local conditions imposed different behavior to the monetary authorities: in Australia, Israel and Norway, where the economy has given clear signs of recovery, central banks decreased the stance of their accommodative monetary policies. In the opposite direction, in the United Kingdom, Japan and Russia, central banks increased the local monetary loosening, respectively through increasing the value of direct purchases of assets, by additional injection of liquidity and through the continuous reduction of basic interest rates.

Foreign Trade and International Reserves

56. The Brazilian trade surplus reached US$615 million in November, totaling US$23.2 billion in the first eleven months of the year, increasing by 3.8%, year-over-year, on a daily average basis. In the month, exports reached US$12.7 billion, and imports, US$12 billion, decreasing by 14.2% and 8.2%, respectively, year-over-year, on a daily average basis. Total external trade reached US$24.7 billion in November, decreasing by 11.4%, year-over-year, on a daily average basis. In the year through November, total external trade reached US$253.9 billion, 25.6% below that registered in 2008, according to the same comparison basis.

57. Based on the liquidity concept, international reserves, which encompass the repurchase lines and borrowing operations in foreign currencies, reached US$238 billion in November, recording a US$5.1 billion increase in the month. Under the cash concept, international reserves totaled US$236.7 billion, recording a US$5.5 billion increase, according to the same comparison basis. It bears highlighting, in the month, purchases of US$3 billion by the monetary authority.

Money Market and Open Market Operations

58. After the October Copom meeting, the yield curve slope increased for all maturities. The release of better-than-expected data for the economic activity and labor market, and current inflation higher than expectations contributed to this movement. Between October 19 and December 7, one- three- and six-month rates increased by 0.01 bps, 0.03 bps and 0.17 bps, respectively, whereas one- two- and three-year rates increased by 0.20 bps, 0.10 bps and 0.14 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 from 5.48% on October 19 to 5.61% on December 7.

59. In its open market operations, the BCB carried out, between October 20 and December 7, long fixed rate repo operations, borrowing R$18.2 billion for a six-month period. The average daily balance of the six- and seven-month operations reached R$76.9 billion, of which R$76.1 billion were six-month operations. In the same period, the BCB conducted borrowing operations with tenures of 34 working days on October 22; of 32 working days on October 26; of 27 working days on November 3; of 23 working days on November 9; of 18 working days on November 16 and 13 working days on November 23. These operations drained from the market R$288.6 billion, R$3 billion, R$1.3 billion, R$0.2 billion, R$10.6 billion and R$0.3 billion, respectively. The average daily balance of these short-run borrowing operations reached R$299.9 billion. The BCB also borrowed money through 35 overnight repo operations and conducted two-working-day tenure liquidity management operations at the end of day. Operations with tenors less than thirty days, including daily liquidity management operations, averaged R$92.3 billion, on a daily basis, borrowing. The average daily balance of these short-run borrowing operations reached R$469.2 billion between October 20 and December 7, up from R$447.7 billion between September 1 and October 19. Considering the daily balance of operations in the most recent period, there was a reduction of the purchase commitments of R$55.3 billion. The total stock reached R$444.9 billion on December 7, down from R$500.2 billion on October 19. The main determinant factors of the liquidity decrease in the period were the net issuance of securities by the National Treasury and the net revenues of the Federal Government.

60. Between October 20 and December 7, the National Treasury issuance regarding the traditional auctions raised a total of R$42.2 billion. The issuance of fixed-rate securities reached R$31.7 billion, being R$24.9 billion via issuance of LTNs maturing in 2010 and 2011, and R$6.8 billion via NTN-Fs maturing in 2013 and 2017. Issuance of LFTs totaled R$7.6 billion, for securities maturing in 2013 and 2015. Issuance of inflation-linked NTN-Bs reached R$2.9 billion, for securities maturing in 2011, 2014, 2020, 2024, 2035 and 2045.

61. In the same period, the Treasury conducted auctions to sell LTNs maturing in April and October 2010, combined with the purchase of LTNs maturing in January 2010, totaling R$2.6 billion. It also conducted auctions to sell LFTs maturing in September 2013 and September 2015, combined with the purchase of LFTs maturing in December 2009, totaling R$0.9 billion. The sales of NTN-Bs settled in other National Treasury securities maturing in 2011, 2014, 2020, 2024, 2035 and 2045 totaled R$6.5 billion. The Treasury also conducted purchase auctions of LTNs, NTN-Bs and NTN-Fs, reaching R$1.4 billion, R$0.1 billion and R$0.5 billion, respectively.