



BANCO CENTRAL DO BRASIL

Minutes of the 148th Meeting of the Monetary Policy Committee (Copom)

Summary

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Money Market and Open Market Operations

Date: January 26th, from 4:55PM to 6:55PM, and January 27th, from 5:00PM to 6:50PM

Place: BCB Headquarters meeting rooms - 8th floor on January 26th and 20th floor on January 27th – Brasília – DF

In attendance:

Members of the Committee

Henrique de Campos Meirelles – Governor
Aldo Luiz Mendes
Alexandre Antonio Tombini
Alvir Alberto Hoffmann
Anthero de Moraes Meirelles
Antonio Gustavo Matos do Vale
Mário Magalhães Carvalho Mesquita

Department Heads (present on January 26th)

Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on January 27th)
João Henrique de Paula Freitas Simão – Open Market Operations Department
Jose Antonio Marciano - Department of Banking Operations and Payments System
Ariosto Revoredo de Carvalho – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations Group

Other participants (present on January 26th)

Adriana Soares Sales – Advisor to the Board (present only on January 27th)
Alexandre Pundek Rocha – Advisor to the Board
Fabio Araujo – Advisor to the Research Department
Isabela Ribeiro Damaso Maia – Advisor to the Board
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.



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Recent Economic Developments

1. IPCA inflation decreased slightly to 0.37% in December, down from 0.41% in November. As a consequence, in the year inflation reached 4.31%, decreasing 1.59 p.p. relative to the previous year, remaining near the target. The deceleration of twelve-month consumer price trailing inflation in the year mirrored the behavior of market prices, as regulated price inflation increased. Considering market prices, both prices of tradable and non-tradable goods decelerated, reaching 2.62% and 5.53%, respectively, in 2009, down from 6.99% and 7.10% in 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 changed to 6.37% in 2009, down from 6.39% in 2008. Preliminary data for January point to consumer inflation above the level observed in December. In short, information available suggest that the inflationary acceleration cycle observed in 2008 was overcome by a process led by the behavior of market prices, specially goods, while regulated price and services inflation continues to show more persistence.

2. The three main underlying inflation measures calculated by the BCB increased between November and December. The core inflation by exclusion changed from 0.37% in November to 0.46% in December. Smoothed trimmed means and double weight core inflation measures also accelerated, recording 0.41% and 0.47% in December, up from 0.37% and 0.40% in November, respectively. The twelve-month trailing inflation measures changed from 5.72%, 4.82% and 6.07% in 2008 to 4.73%, 4.35% and 4.74% in 2009, for the core inflation by exclusion, smoothed and double weight trimmed means core inflation, respectively. Note that all core measures grew, according to twelve-month trailing inflation, compared to local record lows observed in October and two of them are above the inflation target. Moreover, it bears emphasizing that the behavior of the IPCA diffusion index reduced to 60.2% in December 2009, compared to 61.7% in December 2008.

3. The General Price Index (IGP-DI) inflation changed from 0.07% in November to -0.11% in December. In 2009, the IGP-DI inflation reached -1.43% (9.10% in 2008). The slowdown of the IGP-DI reflected the behavior of all its three components. Its main component, the Wholesale Price Index (IPA-DI), reached -4.08% in 2009 (9.80% in 2008). On its turn, the Consumer Price Index-Brazil (IPC-Br) increased 3.95% (6.07% in 2008) and the Civil Construction National Index (INCC) increased 3.25% (11.87% in 2008). Regarding the IPA-DI, the inflationary deceleration, under this comparison basis, derives from the behavior of both agricultural and industrial prices. The agricultural IPA reached -3.16% (1.64% in 2008), while wholesale industrial prices reached -4.43% (12.96% in 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. The Brazilian Institute of Geography and Statistics (IBGE) released Q3 2009 GDP data, as well as a review of previous data, which showed a 1.2% contraction in activity, year-over-year. From the aggregate demand side, expansion was led by household consumption and public administration consumption, which increased 3.9% and 1.6%, respectively, year-over-year. Gross fixed capital formation, exports and imports contracted 12.5%, 10.1% and 15.8%, respectively, according to the same comparison basis. The contribution of domestic absorption to output growth was -2.0 p.p. in the third quarter of 2009, year-over-year, overweighing the 0.8 p.p. positive contribution of the external sector. From the aggregate supply side, still according to the year-over-year basis, the services sector performed positively, with a 2.1% growth, year-over-year, while all the other sectors contracted. The GDP deflator measured by market prices, according to the same comparison basis, changed from 7.4% in the fourth quarter of 2008 to 5.7% in the first quarter of 2009, 5.4% in the first half of 2009 and 4.7% in the first nine months of 2009.

5. On a three-month moving average basis, according to data seasonally adjusted by the IBGE, industrial output decreased from 1.8% in September and October to 1.2% in November. Still considering the seasonally adjusted series, industrial output decreased by 0.2% in November, month-on-month, after ten consecutive months of expansion. On a year-over-year basis, industrial output increased 5.1%, after retreating by 3.1% in October. The analysis of the behavior of IBGE industrial output series, and its components, suggests that production reached its trough in December 2008 and January 2009, and has been followed by gradual recovery, which continues to be influenced by the international outlook, by business and households' expectations, as well as by the developments



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of domestic financial conditions, supported by traditional sources of credit, besides the recovery of capital markets and the performance of public financial institutions.

6. Among the use categories, according to data seasonally adjusted by the IBGE, in November, it bears highlighting the production of capital and intermediate goods, with 6.1% and 2.1% growth, respectively. Durable consumer goods production, strongly influenced by the automotive sector, decreased 4.8%, while non-durable and semi-durable consumer goods production declined 0.6%. The recovery in the dynamism of industrial production, despite initially led by production of durable goods, has become more widespread than before, reflecting, to great extension, tax exemption measures, as well as also the easing in financial conditions. The future behavior of industrial production, which should not be uniform over time, will depend on these factors, as well as on the evolution of consumer and businessmen confidence, but should be a source of resilience, counterbalancing the recovery of external demand.

7. Labor market has behaved more favorably, with benign 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 7.5% in October to 7.4% in November (7.6% in November 2008). According to the seasonally adjusted series, the unemployment rate reached 7.7%, down from 7.8% in the previous month. Average real earnings remained stable for the second consecutive month. Employment, on its turn, increased 0.7% in November, after retreating by 0.3% in October, year-over-year. As a consequence, real payroll reached 2.9% over November 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 formal employment has continued to recover in the second half of 2009, despite the seasonal job cuts in December. Therefore, 995 thousand jobs were created in 2009 (1,452 thousand in 2008). The manufacturing industry showed positive balance of 10.9 thousand jobs. The most dynamic sectors were services, with the creation of 500.2 thousand jobs (a 3.9% increase compared to 2008), commerce (297.2 thousand jobs, a 3.9% increase over the previous year) and civil construction (177.2 thousand jobs, a 6.2% increase), while the agricultural and livestock sector lost 13.6 thousand jobs.

8. According to data seasonally adjusted by the IBGE, expanded retail sales increased by 0.6% in November, after decreasing by 2.6% in October. On a year-over-year basis, the indicator increased 16.4% in November, growing by 6.0% in the year. The three-month moving average of expanded retail sales reached 0.8% in November, according to seasonally adjusted data, after recording 1.7% in October. On a month-on-month basis, according to seasonally adjusted data, it bears emphasizing the expansion in the sales of "furniture and appliances" (5.9%) and "construction material" (2.7%). The negative key drivers were "other personal and domestic articles" (-1.9%) and "books, newspapers, magazines and stationary" (-1.1%). Since the beginning of 2009, expanded retail sales data have evidenced recovery, mainly influenced by the increase in the sales of durable goods, 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, but it will also be affected by the recovery in the access to credit and by the evolution of consumer confidence.

9. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by FGV, without seasonal adjustment data, reached 84.2% in December (3.6 p.p above the level registered in the same month of 2008). The CNI series seasonally adjusted by the BCB changed from 81.0% to 81.2%, between October and November. Considering the monthly series with seasonal adjustment, the Nuci calculated by FGV reached 83.8% in December (82.9% in the previous month), above the average observed in the last five years. Similarly, the Nuci in the consumer goods and building material industries in December was above the average of the last five years, recording 3.5 p.p. and 1.1 p.p growth, respectively. The Nuci in the intermediate goods and capital goods industries grew 2.0 p.p. and 1.7 p.p., respectively, compared to the same average. The reduction of the idle capacity has been led by the expansion in economic activity, not totally offset by the maturity of investment projects. On its turn, data regarding the absorption of capital goods show recovery compared to the same periods of 2008 and significant expansion at the margin in November (the third consecutive month of expansion compared to the previous month). The absorption of capital goods increased 2.3% in November, according to seasonally adjusted data, a 12.3% increase in year-over-year terms, but decreased 13.9% in the year, according to observed data. On its turn, the production of construction inputs increased by 4.2% at the margin in November, after a 1.2% increase in October and a 4.7% increase in year-over-year terms, accumulating a 8% fall in the year, also according to



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observed data. In short, evidences suggest that the utilization rates have been increasing in the last months, showing important reduction in the idle margin of the industry, followed by the recovery 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.

10. The twelve-month cumulative trade balance showed stability at the margin, reaching a US\$25.5 billion surplus in November, and decreasing to US\$25.3 billion in December. This total resulted from US\$153.0 billion in exports and US\$127.6 billion in imports, equivalent to -22.7% and -26.2% changes, respectively, year-over-year. The greater dynamism of domestic demand relative to the external demand contributes to the narrowing of trade surplus. The reduction in remittances of profits and dividends, despite the behavior observed at the margin, has contributed to limit the twelve-month trailing current account deficit, which reached US\$28.2 billion in December 2008, decreasing to US\$24.3 billion in 2009, equivalent to 1.6% of GDP. On its turn, foreign direct investment reached US\$25.9 billion in 2009, equivalent to 1.7% of GDP.

11. The period since the last Copom meeting was initially marked by the continuity of the normalization process in international financial markets, and, more recently, by some increase in the volatility of asset prices, although the perception of systemic risk continues limited. These developments can be attributed to increased regulatory uncertainty and fiscal deterioration in some mature economies, as well as the beginning of the reversal of the strong liquidity expansion occurred in 2009 in emerging economies. Under these conditions, there was moderation in demand for risky assets, as evidenced by the behavior of international financial markets. Thus, the US dollar strengthened against other currencies, especially those who had experienced more intense appreciation in previous months.

12. Regarding the global macroeconomic scenario, contraction trends prevailed over inflationary pressures in 2009, but recovery of economic activity seems to have been consolidating. The current predominant view points to the recovery in 2010 and some acceleration in 2011, in a process where the US, Europe and Japan (G3) would recover some dynamism, but which would continue to be led by emerging economies, especially from Asia. However, uncertainty regarding the sustainability of the expansion of consumption in mature economies still remains, in a scenario of withdrawal of economic policy stimuli and modest prospects for credit expansion. On the other hand, in many emerging economies, economic activity seems to have embarked on a consistent path of recovery, showing, in some cases, evidence of heat in the markets of goods, services, production factors and assets. Therefore, the inflation record lows in mature economies and major emerging economies have been exceeded. In this context, after a period of aggressive monetary policy easing, in several countries, monetary policy began a phase of stability, whereas those economies that were less impacted by the crisis and recover more quickly and intensely show a trend of adoption of more restrictive monetary policy stance.

13. Oil spot prices have retreated since the last Copom meeting. Future markets have retreated as well. Uncertainty concerning these quotations remains high, as the prospective scenario depends on the evolution of demand, in a 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 eventually affect domestic prices through productive chains, such as the petrochemical, as well as through the potential effect over inflation expectations. It bears emphasizing that agricultural commodity prices, which have particularly important impact on the evolution of food costs, such as wheat, soybeans and corn, have decreased since the last Copom meeting, while industrial commodities prices, such as aluminum, copper and nickel, have increased.

Assessment of Inflation Trends

14. 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:



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- a) the projected adjustments for gasoline and bottle gas prices for 2010 were kept unchanged at 0%;
- b) the projected adjustments for fixed telephone and electricity prices for 2010 were kept unchanged at 1.6% and 3.3%, respectively;
- c) the projection for regulated prices inflation for 2010, based on individual items, was kept unchanged at 4.0%. This set of prices, according to data released by the IBGE, corresponded to 29.64% of the total December IPCA;
- d) the projection for regulated prices inflation for 2011 increased from 4.0% to 4.1%, on the benchmark scenario. 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) change; and
- e) the projection for the spreads over the Selic rate, based on the 360-day swap rates, on the benchmark scenario, estimates 30 bps and 49 bps spreads in the fourth quarters of 2010 and 2011, respectively.

15. Regarding fiscal policy, projections assume the achievement of a public sector primary surplus target of 3.3% of GDP in 2010. This percentage can be adjusted by the possibility of reduction by up to 1.12 p.p., due to the implementation of the projects linked to the Growth Acceleration Program (PAC), of which 0.44 p.p. refer to amounts to be paid from 2009. Moreover, it is expected that the primary surplus in 2011 would return, without adjustments, to the level of 3.3% of GDP. The additional assumptions considered in the previous meeting remained unchanged.

16. Since the last Copom meeting, the median of the expectations compiled by the BCB's Investor Relations Group (Gerin) for the 2010 IPCA increased from 4.48% to 4.60%. For 2011, the median of inflation expectations was kept unchanged at 4.50%.

17. The benchmark scenario assumes the maintenance of the exchange rate at R\$1.80/US\$1.00 and the Selic rate at 8.75% p.a. during the forecast period. Under this scenario, the projection for the 2010 inflation increased relative to the figure considered in the December Copom meeting, and lies around the 4.50% 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 2010 slightly decreased, standing around the inflation midpoint target. For 2011, under the benchmark scenario, the projection remained stable relative to the figure considered in the December Copom meeting, and therefore, around the inflation midpoint target. The projection under the market scenario decreased and stands below the midpoint target.

Monetary Policy Decision

18. The Copom evaluates that the monetary policy should contribute to the consolidation of a favorable longer-term macroeconomic environment. In international markets, risk aversion has shown some increase since the last Copom meeting, despite the persistence of abundant liquidity. Under this environment, both Brazilian asset prices, which had also been favoring the easing of domestic financial conditions, as well as the prices of some selected commodities, showed decline. However, it bears emphasizing that the prospects for foreign funding of Brazilian economy remain favorable. On the other hand, the trajectory of producer price indices evidence the resumption, despite still incipient, of external inflationary pressures. Consequently, the benign impact of the international scenario over the domestic inflation path could come to an end, despite the persistence of significant uncertainty regarding the behavior of asset and commodities prices in the context of gradual normalization of international financial conditions. 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.

19. The Copom believes that, if the prospect of intensification of demand pressures over the domestic market of factors is confirmed, the probability that initially located inflationary episodes pose risks to the inflation trajectory could be rising. In this context, the risk of pass-through of possible wholesale price upward pressures to consumer prices would increase. The Committee judges that the materialization of this pass-through, as well as the spread of initially localized pressures over consumer prices, continues to depend critically on the economic agents'



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expectations for inflation. By the way, the Committee continues to carefully monitor the behavior of inflation expectations, which have risen for the intermediate section of the forecast period since the last meeting. Additionally, it should be noted that the behavior of domestic demand could exert some pressure over the prices of non-tradable items, such as services, in the upcoming quarters. In any event, the Committee reaffirms that it will continue to conduct its actions to ensure that the gains obtained in inflation control in recent years become permanent.

20. The Copom considers important to emphasize, 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 inflationary scenario and its risks, instead of current inflation figures. The Committee reaffirms that specific asset price movements are only relevant for monetary policy if they impact the forward-looking inflationary path.

21. Prospects for the evolution of domestic economic activity remain favorable, as evidenced by data on trade, manufacturing capacity utilization and the labor market, and by signs of continued expansion of credit supply, both for individuals and corporate. Consumer and business confidence also show consistent signs of recovery. Under these circumstances, the pace of activity depends significantly upon the evolution of real earnings, the effects of fiscal stimulus measures and the increments of governmental transfers that will occur in the upcoming months. The dynamism of activity should also be benefited by the easing of financial conditions, favored, among other factors, by the policies of official banks. In short, the most recent data on domestic economic activity seem to reinforce the assessment mentioned in previous Copom meeting minutes that the contraction 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 more impacts from the middle of 2010 on.

22. The Copom believes that the main risks to the consolidation of a benign inflationary scenario derive, regarding the external outlook, from a possible rise in commodity prices and, regarding the domestic scenario, from the cumulative and lagged effects of the financial condition easing and the fiscal and credit impulse over the evolution of domestic demand, taking into account the dynamics of consumption and investment, in the context of the reduction in the idleness margin in the use of production factors. The balance of these influences on the future trajectory of inflation will be crucial for the assessment of the different monetary policy stances.

23. 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 the convergence of inflation towards the targets path observed in 2009 continues to be registered in 2010 and 2011. Such strategy, whose 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.

24. The Committee considers that the accommodation of demand, driven by the tightening of financial conditions and the deterioration of the agents' confidence, as well as by the contraction of the global economy, shows persistent signs of having been overcome, despite the persistence of uncertainty, which should be resolved over time, towards positive and negative outlooks for the pace of economic recovery. Anyway, under this scenario of recovery, which is supported by the data available so far, monetary policy must ensure inflationary pressures remain contained.

25. In short, the Committee judges that, given the signs of recovery in domestic demand, resulting in the reduction in the idleness margin of the production factors, as evidenced by indicators of manufacturing capacity utilization and labor market, and by the recent behavior of inflation expectations, the risks to the achievement of a benign inflationary scenario, in which inflation would remain consistent with the inflation targets, can increase. Under this environment, monetary policy should remain especially vigilant in order to avoid that the greater uncertainty detected in shorter horizons spread to longer horizons.



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26. Under this context, regarding the macroeconomic outlook and the inflation prospects, the Copom has unanimously decided to maintain the Selic rate at 8.75% p.a., without bias. The Committee will monitor the evolution of the macroeconomic scenario until its next meeting, to define the next steps in its monetary policy strategy.

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 brief contraction, domestic demand has recovered, largely thanks to the effects of stimulus factors, such as income growth and credit resumption. On its turn, important fiscal and credit incentives have been provided to the economy in recent quarters, and should contribute to consolidating the resumption of activity and hence, to reduce the residual idleness margin of productive factors. The effects of these stimuli should be carefully monitored over time and will be an important part of the context in which future decisions on monetary policy, which must ensure the maintenance of inflation convergence to the targets path in 2010 and 2011, will be taken.

28. In the event that the risk profile deteriorates so that it implies changes to the inflation prospective scenario considered this time by the Committee, the monetary policy strategy will promptly be adapted to the circumstances.

29. At the end of the meeting it was announced that the Committee will reconvene on March 16th, 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

30. The IPCA rose 0.37% in December, down from 0.41% in November, increasing by 4.31% in 2009, compared to 5.90% in 2008. The increase in market prices decelerated from 0.42% in November to 0.31% in December, registering increases of 0.16% in the prices of tradable goods and 0.45% in the prices of non-tradable goods. Regulated prices grew 0.51%, up from 0.40% in November. The diffusion index, which stood at 60.16% in December, averaged 57.53% in 2009, up from 62.83% the previous year.

31. Market prices increased 4.14% in 2009, down from 7.05% in 2008, a slowdown associated, in particular, to the cooling in the prices of food and beverages, from 11.12% to 3.18%. Regulated prices increased 4.73%, up from 3.27% in 2008.

32. All core inflation measures accelerated in December, month-on-month, and decelerated according to the year-over-year comparison. The IPCA-EX core change, which excludes ten items of household food and fuel, rose from 0.37% in November to 0.46% in December. Last year, the indicator totaled 4.73%, down from 5.72% in 2008. Considered the smoothed trimmed-mean core measure, the monthly change reached 0.41% in December, up from 0.37% in November, totaling 4.35% in 2009, down from 4.82% the previous year. The double weight core increased by 0.47% in December, up from 0.40% the previous month, totaling an annual increase of 4.74% in 2009, down from 6.07% in 2008.

33. Inflation measured by the IGP-DI, after reaching 0.07% in November, recorded -0.11% in December. On a twelve-month trailing basis, the IGP-DI increased from -1.76% in October and November, to -1.43% in December. The IGP-DI trajectory in 2009 reflected, in particular, the behavior of the IPA-DI, which showed marked changes in the prices of intermediate goods (-7.1%); of raw materials (-6.13%); and of final goods (1.28%), falling 4.08% in the period. Considering the origin of products, the annual reduction of the IPA-DI reflected the retreat in industrial prices, 4.43%, and agricultural products, 3.16%. The IPC-Br changed 3.95% in the year and the INCC 3.25%, with the prices of labor force increasing 7.74% and the ones relative to materials, equipment and services retreating by 0.54%.

Economic Activity



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34. Expanded retail sales, after falling 2.6% in October and growing 4.7% in September, recorded monthly increase of 0.6% in November, according to seasonally adjusted data by the IBGE's monthly survey (PMC), accumulating increase of 3.1% in the quarter ended in November, in relation to the one completed in August. Additionally, expanded retail sales increased in November 16.4%, year-over-year, accumulating a 6% change in the year through November.

35. The monthly growth in sales in November led to the occurrence of positive results in seven out of the ten segments surveyed, with highlights for furniture and appliances, 5.9%. Among the segments with negative performance, it is worth mentioning the decrease of 1.9% observed in the sales of other articles of personal and household use.

36. The development of expanded retail sales in relation to November 2008 showed the occurrence of generalized increases in sales in all segments included in the survey, with highlights for vehicles and motorcycles, parts and pieces, 37.1%; equipment and office supplies, 19.2%, furniture and appliances, 13.8%, and pharmaceutical and medical articles, 12.3%.

37. Cumulative retail sales in the year through November 2009, year-over-year, registered positive results in eight out of the ten sectors surveyed, with emphasis on the ones related to pharmaceutical and medical articles, 12%; equipment and office material, 11.8 %; books, newspapers, magazines and stationery, 9.6% and vehicles and motorcycles, parts and pieces, 9.6%. Conversely, sales of building materials and textiles, clothing and footwear experienced respective decreases of 7.7% and 4.3% in the period.

38. Seasonally adjusted statistics from the São Paulo Trade Association (ACSP), covering the city of São Paulo, indicate that the number of consultations to the Central Credit Protection Service (SCPC) and to the Usecheque system recorded increases of 2.7% and 6.4% in December, respectively, on a month-on-month basis. In 2009, these indicators changed -9.3% and 1.2%.

39. Automobile sales by dealers, which take into account automobiles, light commercial vehicles, trucks and buses, increased 2.4% in December, month-on-month, seasonally adjusted by the BCB, according to Fenabrave (Brazilian Federation of Vehicles Distribution) data. This result reflected growth of 5.2% and 3.3% in the sales of trucks and buses, in contrast to the decreases of sales observed in automobiles, 0.5% and light commercial vehicles, 2.2%. Total sales increased 50.9% year-over-year, with emphasis on the growth of 63.3%, 50.2% and 48.4% observed, respectively, in the segments of light commercial vehicles, trucks and automobiles.

40. Capital goods imports decreased 7.1% in December, month-on-month, according to the Funcex quantum index, seasonally adjusted by the BCB. The December indicator decreased 4.1% year-over-year, reaching a 13% decline, year-over-year.

41. Capital goods production increased 6.1% in November, month-on-month, according to IBGE's seasonally adjusted data, with emphasis on the increases in the sectors of capital goods for industrial use (21.3%), capital goods for agricultural purposes (19%), and construction inputs (4.2%). Additionally, capital goods production fell by 2.5% year-over-year, totaling a decrease of 20.2% in the year through November 2009, year-over-year.

42. The disbursements of BNDES reached R\$117.5 billion in the year through November, increasing by 49.6% year-over-year. Industry absorbed 45.9% of the disbursements mentioned.

43. General industrial physical production decreased 0.2% in November, month-on-month, seasonally adjusted, according to IBGE's Monthly Industrial Survey – Physical Production (PIM-PF). In addition, industrial production grew 5.1% in November, year-over-year, with an emphasis on the 26.3% increase observed in the sector of durable consumer goods. In the last twelve months, industrial production contracted 9.7 %, year-over-year, emphasizing the decrease of 19.7% observed in the production of capital goods.



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44. The monthly performance of the industry reflected the marked expansion in the segments of capital goods, 6.1%, and intermediate goods, 2.1%, in contrast to the retreat observed in the production of durable consumer goods, 4.8%, and of non-durable consumer goods, 0.6%.

45. CNI indicators continued to show industrial production expansion, in the margin, in November. In this sense, considering seasonally adjusted data, real revenues in the manufacturing industry grew 1.3% month-on-month, while hours worked and employment increased respectively by 2.6% and 0.7%. In the year through November, the same indicators retracted, respectively, by 6%, 8.5% and 3.5%, year-over-year. The NUCI increased by 0.2 p.p. in the month and 0.4 p.p. year-over-year.

46. Vehicles production reached 251.5 thousand units in December, according to Anfavea, increasing by 160.4% year-over-year. According to seasonally adjusted data, vehicles production decreased 0.8% month-on-month. Additionally, the production of vehicles and agricultural machinery declined 1.2% and 22.3%, respectively, in 2009.

47. Sales of vehicles for the domestic market increased 92.7% in December and 10.4% in 2009, year-over-year, while exports registered variations of 21% and -35.3%, respectively.

Surveys and Expectations

48. According to the Fecomercio-SP survey, the Consumer Confidence Index (ICC) increased 2.2% in January, month-on-month, a record high for the series. This result reflected expansions of 2.4% in the Consumer Expectations Index (IEC) and of 1.9% in the Current Economic Conditions Index (Icea). Year-over-year, the ICC increased 27.5%.

49. According to the Consumer Expectations Survey carried out by the FGV nationwide, the ICC decreased 2.4% in December, month-on-month seasonally adjusted, reflecting the decreases of 2.7% in the Current Situation Index (ISA) and of 2.4% in the Expectations Index (IE). Year-over-year, the ICC increased 17.1%, resulting from the increases of 18.6% in the ISA and of 16.1% in the IE.

50. According to the FGV Manufacturing Industry Survey, the Industrial Business Confidence Index (IcEI) reached 113.4 points in December 2009, a record high recorded since July 2008 and 54.2% higher than the level observed in December 2008. The December IcEI increased, according to the month-on-month seasonally adjusted series, 3.5%, resulting from the increases of 3.5% both for the Current Situation Index (ISA) and for the IE, and year-over-year, 45.6% and 64.9%, respectively, according to the observed series.

Labor Market

51. According to the General Record of Employment and Unemployment (Caged) of the Ministry of Labor and Employment (MTE), there were 415.2 thousand formal job cuts in December, including 166 thousand in the manufacturing industry and 68.1 thousand in the service sector, in contrast to the net hires of 10.6 thousand jobs registered in the retail sector. In 2009, 995.1 thousand jobs were created (lowest result since 2003), of which 500.2 thousand in the service sector, 297.2 thousand in the retail sector, 177.2 thousand in civil construction and 10.9 thousand in the manufacturing industry.

52. According to the IBGE employment survey (PME), carried out in the six main metropolitan regions of the country, the unemployment rate reached 7.4% in November 2009, up from 7.3% in October and 7.2% in November 2008. The same survey pointed out that average real earnings of employed workers decreased 0.1%, month-on-month, growing by 3.4% in the year through November. Real payroll increased 0.4% month-on-month and 4.1% in the year through November.

Credit and Delinquency Rates

53. Outstanding credit in the financial system reached R\$1,410 billion in December, equivalent to 45% of GDP, with increase of 1.6% in the month and of 14.9% in 2009. Non-earmarked credit operations increased 0.8% in the



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month and 9.4% in the year. Among the non-earmarked operations, which represent a share of 67.6% in the total of the financial system, credit operations to individuals increased 1.2% in the month and 19.4% in 2009, while non-earmarked credit operations to corporate increased 0.5% and 1.2%, according to the same comparison bases. Earmarked credit operations increased 3.2% in the month and 28.4% in 2009.

54. The average interest rate on non-earmarked credit operations, used as reference for interest rates, declined again in December, reaching 34.3%, the lowest level since December 2007. The average annual rate on credit for individuals reached 42.7% in December, down from 43% in November. The average rate on corporate credit decreased to 25.5% in December, down from 26% in November.

55. The average tenure on non-earmarked credit operations, used as reference for interest rates, increased for the fourth consecutive month in December, reaching 389 days. The average tenure of corporate credit operations reached 283 days, while the average tenure for credit operations to individuals totaled 520 days.

56. Delinquency rates in the financial system (non-earmarked loans used as reference for interest rates, in arrears for more than ninety days) retreated to 5.6%, after remaining stable in 5.8% for three consecutive months. Delinquency rates for credit operations with corporate decreased 0.1 p.p., reaching 3.8%, and with individuals, declined 0.3 p.p., reaching 7.8%.

57. Net delinquency rate for retail credit, measured by the ACSP, was negative 0.4% in December, showing that the number of new records was lower than the cancellations in the month. Last year, the average rate was 6.9%, up from 6.5% in 2008.

Foreign Trade and International Reserves

58. The Brazilian trade surplus reached US\$2.2 billion in December, totaling US\$25.3 billion in 2009, increasing by 1.6% compared to 2008. In the year, exports reached US\$153 billion, and imports, US\$127.6 billion, decreasing by 22.7% and 26.2%, respectively, year-over-year.

59. Based on the liquidity concept, international reserves, which encompass the repurchase lines and borrowing operations in foreign currencies, reached US\$239.1 billion in December, recording a US\$1.1 billion increase in the month. Under the cash concept, international reserves totaled US\$238.5 billion in 2009, recording a US\$1.9 billion increase, according to the same comparison basis.

Global Economy

60. The sustained recovery of the US economic growth and the maintenance of economic vigor presented by the emerging economies, particularly in the BRIC countries and in Southeast Asia, are signs of continued global economic recovery in 2010. In contrast to this perspective, it bears highlighting the evidence of new stagnation in Germany and deepening of fiscal difficulties in Greece, Portugal, Ireland and Spain, as well as weak domestic demand in Japan.

61. Under this scenario, the recovery of international trade has been supported by the Chinese economy which, in the fourth quarter of 2009, resumed the annualized quarterly rate of 10.7% growth, a result that has favored the acceleration of activity in other Southeast Asian economies.

62. The performance of the Chinese economy has impacted commodities prices, particularly oil, which accounts for the change in the behavior of price indices (CPI). In the US, Euro Area, Japan and China, IPC annual changes reached, respectively, 2.7%, 0.9% -1.9% and 1.9% last December, compared to -2.1 %, -0.7%, -2.2% and -1.8% in July 2009. Despite the reversal in the deflationary process, expectations remain anchored in the G3 economies, where the idleness of production factors remains intense. In these economies, where inflation does not constitute relevant risk in the short- and medium-term, monetary authorities have kept interest rates unchanged. On the other hand, in China, vigilant to inflationary expectations and speculation in the real state market, the government initiated a process to reduce liquidity in the financial system through the increase of interest rates as a reference for



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the three-month and one-year securities, and increased, for the first time since mid-2008, the rate of reserve requirements, currently at 15%.

63. Similarly, as recognition of the improvement in general conditions in financial markets, the Federal Reserve (Fed) announced that it will not renew the agreements on currency swaps established with other central banks during the financial crisis, and the European Central Bank (ECB) reiterated that it will continue to shorten the maturity of the long-term refinancing operations, by scheduling one last six-month operation for next March.

Money Market and Open Market Operations

64. Since the December 2009 Copom meeting, the yield curve slope for short- and medium-term slightly increased for all maturities. The release of improved data for economic activity and the labor market, the announcement of higher-than-expected inflation rates and the increase of market projections for 2010 GDP growth contributed to this movement. Between December 7th 2009 and January 22nd 2010, one- three- and six-month rates increased by 1 bps, 4 bps and 27 bps, respectively, whereas one- two- and three-year rates increased by 25 bps, 15 bps and 3 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 5.61% on December 7th 2009 to 5.74% on January 22nd 2010.

65. In its open market operations, the BCB carried out, between December 8th 2009 and January 25th 2010, long fixed rate repo operations, borrowing R\$32.1 billion for a six-month period. The average daily balance of the long operations reached R\$80.8 billion. In the same period, the BCB conducted borrowing operations with tenures from 13 to 33 working days bringing the average daily balance of these short-run borrowing operations to R\$331.4 billion. The BCB also borrowed money through 34 overnight repo operations and conducted daily, at the end of day, two-working-day tenure liquidity management operations. Operations with tenors less than thirty days, including daily liquidity management operations, averaged R\$77.6 billion, on a daily basis, borrowing. The average daily balance of these short-run borrowing operations reached R\$489.8 billion between December 8th 2009 and January 25th 2010, up from R\$469.2 billion between October 20th and December 7th. For the most recent period, purchase agreements increased R\$ 69.3 billion, with the total stock reaching R\$514.2 billion on January 25th 2010, up from R\$ 444.9 billion on December 7th, considering the average daily balance operations. The main determinant factor of the liquidity expansion in the period was the net redemption of securities by the National Treasury.

66. Between December 8th 2009 and January 25th 2010, the National Treasury issuance regarding the traditional auctions raised a total of R\$50.3 billion. The issuance of fixed-rate securities reached R\$23.7 billion, of which R\$17.4 billion via issuance of LTNs maturing in 2010, 2011 and 2012, and R\$6.3 billion via NTN-Fs maturing in 2013, 2014 and 2017. Issuance of LFTs totaled R\$20.2 billion, for securities maturing in 2013 and 2015. Issuance of inflation-linked NTN-Bs reached R\$6.4 billion, for securities maturing in 2011, 2013, 2014, 2015, 2020, 2024, 2035 and 2045. The National Treasury also carried out purchase auctions of LTN and NTN-B, which reached R\$ 1.0 billion and \$ 0.1 billion, respectively.