BANCO CENTRAL DO BRASIL

Minutes of the 155th Meeting of the Monetary Policy Committee (Copom)

Summary

Date: December 7th, 2010, from 4:30PM to 6:50PM, and December 8th, from 4:55PM to 7:40PM

Place: BCB Headquarters meeting rooms - 8th floor on December 7th and 20th floor on December 8th – 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
Carlos Hamilton Vasconcelos Araújo
Luiz Awazu Pereira da Silva

Department Heads (present on December 7th)
Adriana Soares Sales – Research Department (also present on December 8th)
Altamir Lopes – Economic Department
Daso Maranhão Coimbra – Department of Banking Operations and Payments System
João Henrique de Paula Freitas Simão - Open Market Operations Department
Márcio Barreira de Ayrosa Moreira – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations Group

Other participants (present on December 7th)
Alexandre Pundek Rocha – Advisor to the Board
André Minella – Advisor to the Research Department
Emanuel Di Stefano Bezerra Freire – Advisor to the Board
Francisco Leopoldo Carvalho de Mendonça Filho – Press Secretary
Katherine Hennings – Advisor to the Board
Wagner Piazza Gaglianone – Advisor to the Research Department

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, after recording 0.45% and 0.75% in September and October, respectively, increased again in November, to 0.83%. As a consequence, inflation accumulated in the first eleven months of 2010 reached 5.25%, 1.32 p.p. above the one observed in the same period of 2009. Inflation increase in 2010 reflects the behavior of market prices, which increased by 6.26% in the year through November and contributed 4.4 p.p. of the 5.25% recorded in the year. In fact, regulated prices decelerated year-over-year and total 2.86% in the year through November, down from 4.21% in the same period of last year, contributing only 0.8 p.p. to cumulative inflation in the year through November. Regarding market prices, it bears emphasizing that tradable goods inflation reached 5.87% in the year through November, while the non-tradable goods inflation reached 6.61%. The change in the prices of services, whose dynamics tends to show more persistence than that of the prices of goods, shows some stability, and reached 6.99% in the year through November. The acceleration in prices in September, October and November was greatly due to the elevation in the prices of food and beverages.

2. The deviations in food prices trajectory have continued to perform relevant role in the behavior of 2010 headline inflation. In fact, in the first four-month period, the IPCA showed sharp rise, when the prices of food and beverages increased 5.19%, while in the second four-month period there was relative stability, when the prices of food and beverages retreated 1.61%. The monthly IPCA recorded consecutive price increases in the first three months of the last four-month period, with food and beverages prices increasing by 5.28%. It bears emphasizing that twelve-month trailing household food price inflation changed from 6.67%, in April 2010, to 2.29%, in August, and increased again, to 9.39%, in November; at the same time, according to the same comparison basis, IPCA inflation reached 5.26%, 4.49% and 5.64%, respectively. The recent elevation in food price inflation has partially mirrored domestic and external supply shocks, heightened by the high liquidity environment in international financial markets.

3. In line with the evolution of headline inflation, the three main underlying inflation measures calculated by the BCB increased between September and November. The smoothed trimmed means core inflation increased from 0.43% in September to 0.55% in October and 0.56% in November. In the same period, the double weight core inflation increased from 0.39% to 0.58% and 0.62%, and the core inflation by exclusion rose from 0.37% to 0.44% and 0.52%. In the year through November, the smoothed trimmed means core inflation, double weight core inflation and the core inflation by exclusion increased 5.52%, 5.32% and 5.30%, respectively. The IPCA diffusion index, which had already reached 62.5% in September, increased again to 64.8% in October and to 67.2% in November.

4. The General Price Index (IGP-DI) inflation recorded 1.03% in October, close to the change observed in September (1.10%). In the year through October, the IGP-DI inflation reached 9.16%, above the level recorded in the same period of 2009 (-1.40%). According to the same comparison basis, inflation measured by its main component, the Wholesale Price Index (IPA-DI), rose 11.40%, reflecting the increases of 9.07% and 18.78%, respectively, in industrial and agricultural prices. The 2010 IPA-DI inflation change is, therefore, above the change recorded in the same period of 2009 (-3.77%). Inflation measured by the Consumer Price Index (IPC-DI), another component of the IGP-DI, increased 4.43% in the year through October, above the 3.41% recorded in the same period of 2009. Under the same criterion, inflation measured by the Civil Construction National Index (INCC), component with the lowest weight in the IGP-DI, increased 6.66%, also above the rate recorded in the same period of 2009 (2.85%). As emphasized in previous Copom Meeting Minutes, the Copom evaluates that the effects of wholesale prices over consumer price inflation will depend, among other factors, on the current and prospective demand conditions, the exposure of each sector to external and domestic competition, as well as on the price setters' expectations for the future inflation path.

5. The Index of Economic Activity of the BCB (IBC-Br) incorporates estimates for the monthly production of the three sectors of the economy, as well as for products taxes and, therefore, it constitutes an important coincident indicator of economic activity. After registering positive growth rates in all months of 2009 until April 2010, the IBC-Br, which had been showing stability, growing by 0.2% between May and August this year, resumed growth (0.7% in September), suggesting that the period of most intense cooling activity has finished.

6. After strong retreat due to the 2008/2009 crisis, industrial activity recovered, but has shown some accommodation at levels similar to those observed in the pre-crisis period. According to data seasonally adjusted

by the IBGE, industrial output grew by 0.4% in October, and 0.1% in September, month-on-month. The three-month moving average growth rate reached 0.1%, in the period between July and October, close to that registered in the June-September period (0.2%). Year-over-year, the production increased 2.1% in October 2010 and 6.6% in September. On a twelve-month trailing basis, industrial production expanded for the seventh consecutive time, by 11.8% in October, up from 11.2% in September. Compared to December 2008, a record low for industrial production level registered during the 2008/2009 crisis period, recovery up to October totaled 24.5%. This recovery has partially been supported by the growth of industrial activity financing by public financial institutions.

7. Among the industry use categories, according to data seasonally adjusted by the IBGE, the most important driver in October, month-on-month, was durable goods production, which increased by 2.8%. Semi-durable and non-durable consumer goods production, intermediate goods production and capital goods production were negative, recording -0.1%, -0.1% and -0.2%, respectively. On a three-month moving average basis, only consumer goods production increased, reaching 0.2% (0.6% for durable goods production and 0.2% for semi- and non-durable consumer goods production). Capital goods production retreated 0.9%, while intermediate goods production reduced by 0.5%. It bears highlighting that, although capital goods production decreased at the margin, the expansion in the year through October reached 24.0%, year-over-year, the most remarkable expansion among the use categories. This evidences the robustness in capital goods investment, a relevant factor for economic recovery in the post-crisis period.

8. The unemployment rate in the six metropolitan regions covered by the IBGE Monthly Labor Survey (PME) decreased from 6.2% in September to 6.1% in October, lower than the 7.5% observed in October 2009, according to observed data. After reaching 9.0% in March 2009, the observed rate not only retreated significantly until October, but reached a historical record low for the series begun in March 2002 (6.1%). Also according to the seasonally adjusted series, the rate in October reached a new record low for the series (6.3%). Employment, measured by the number of employed workers in the metropolitan regions, increased by 3.5% in September and 3.9% in October, year-over-year. Data from the Ministry of Labor and Employment (MTE) indicate that formal employment continues to grow, although October data do not suggest acceleration. In October, 204.8 thousand jobs were created, compared to 231.0 thousand jobs registered in October 2009. In the year through October, 2.41 million jobs were created, a 107% expansion relative to the same period of 2009 and the best result for the period since the start of the series. The driver for employment in October and in 2010 was services, which contributed with 42% and 36% for job creation in the month and in the year, respectively. Real average earnings also reached a record high in October (0.3% month-on-month and 6.5% year-over-year). As a consequence, real payroll, considering the main earnings, expanded by 10.7% in October, year-over-year, continuing to constitute a key driver for the maintenance of domestic demand growth.

9. According to the retail monthly survey from the IBGE, expanded retail sales increased 5.9% in September, 14.0% in August and 12.6% in July, year-over-year. According to the seasonally adjusted series, sales retreated by 0.9% in September, after growing in the four previous months. As a consequence, the average of sales increased 3.5% in the third quarter, quarter-over-quarter. Out of the ten sectors surveyed, four sectors performed positively month-on-month in September. The most important driver was “office material and equipment”, with 5.6% growth. In the next months the retail sales trajectory should continue to be benefited by governmental transfers, by real payroll growth, by credit expansion and by consumer confidence.

10. Expanded retail sales performed positively in all months of the second four-month period of 2010, totaling 4.8%. On the other hand, in the same period, activity recorded 0.9% reduction, according to the industrial output index, and some stability, according to the IBC-Br. Therefore, industrial activity accommodation did not have a correspondence in retail sales, whose dynamism reflects both the evolution of non-durable consumer goods imports, with 8.1% increase in volume between the first and the second four-month period, according to data seasonally adjusted by the BCB, and the evolution of final products inventories, which, throughout the six first months of the year stood below companies’ forecasts, according to the industrial survey carried out by the National Industry Confederation (CNI).

11. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by FGV, without seasonal adjustment, reached 86.1% in November, down from 86.4% in October, standing close to the levels registered prior to the 2008/2009 crisis. According to the seasonally adjusted monthly series calculated by FGV, the

Nuci reached 84.5% in November, down from 85.2% in the previous month. Among the four use categories, only intermediate goods industry had a retreating Nuci (0.5 p.p.), month-on-month, reaching 86.0%. On the other hand, the Nuci in capital goods industry increased by 1.2 p.p., reaching 84.8%. No monthly change was observed for the Nuci for the construction inputs industry and for the consumer goods industry in November. According to the CNI series seasonally adjusted by the BCB, the Nuci remained stable at 82.2% in October, after reaching 82.1% in September and 82.2% in August. The installed capacity utilization rates, despite at high levels, showed slight decline. The reduced idleness margin is the result of the recent economic activity expansion, still not totally offset by the maturity of investment projects. It bears noticing that the absorption of capital goods decreased 5.8% in October month-on-month, but increased 9.6% year-over-year. In the year through October, growth reached 29.4% year-over-year, evidencing deceleration in capital goods absorption. The production of construction inputs increased 0.8% month-on-month and 5.2% year-over-year, in October. On a twelve-month trailing basis, expansion totaled 12.2%. 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.

12. The twelve-month cumulative trade balance result totaled US$ 17.1 billion in November, US$8.3 billion below the observed in the same period last year. This result stemmed from US$195.5 billion in exports and US$178.4 billion in imports, equivalent to 28.3% and 40.5% changes, respectively, year-over-year. In fact, the greater dynamism of domestic demand relative to external demand is relevant for the reduction in the trade surplus. The behavior of remittances of profits and dividends, which also reflects the growth differential between the Brazilian economy and the economy in other countries, has been contributing to elevate the current account deficit, which reached US$48 billion in October, equivalent to 2.4% of GDP, up from US$47.3 billion in September. On its turn, foreign direct investment reached US$36.1 billion in the last twelve months through October, equivalent to 1.8% of GDP, resulting in a need of foreign funding equivalent to 0.6% of GDP.

13. The global economy recovery continues to be led by a group of emerging countries, whose steady pace of economic expansion is anchored mainly by domestic demand and, in specific cases, by the export sector. Economic recovery has also continued in the US and Europe, despite at a more gradual pace than previously anticipated. The Euro Area, in particular, faces different situations, once persistent uncertainties regarding the solvency of some peripheral economies remain, while the pace of expansion continues quite strong in Germany. Business confidence reached, in November, a record high since the unification of that country. Ireland, on its turn, concluded negotiations on a joint financial assistance package from the European Community, the International Monetary Fund (IMF) and bilateral sources, totaling €85 billion. Regarding inflation rates, they have remained at very low levels in the G3 countries (US, Euro Area and Japan), despite the extremely expansionist economic policy actions, both at the fiscal and at the monetary sides. In a new effort in this direction, the US announced a $600 billion expansion of the monetary easing program and there is greater chance for an extension of fiscal incentives. Among emerging markets, it bears highlighting that the People's Bank of China has raised the reserve requirements twice since the last Copom meeting. Tightening monetary policy actions were also observed in Chile, South Korea, Hungary and India, whereas further easing was recorded in South Africa.

14. Oil prices, in spot and futures markets, remained near U$80. The low predictability of the asymmetric rebound of global economy, the dependence of supply growth on the maturity pace of risky investment projects and the geopolitical complexity of the sector add uncertainty to oil prices forecasts. The main scenario adopted by the Copom assumes unchanged domestic gasoline prices in 2011. However, it bears highlighting that, regardless of the behavior of local gasoline prices, oil prices swings might affect the domestic economy, for example, through the petrochemical sector or through the expectations channel. Regarding the prices of other commodities, it is noteworthy that the price index based on 22 commodities, published by the Commodity Research Bureau (CRB), has varied in recent weeks, around record levels. One factor that seems to contribute to the sharp elevations is the rebalancing of global demand from developed countries to emerging countries, where consumption tends to be more intensive in commodities. It also bears noticing that, in the recent past, the movement of commodity prices seems to have been strongly influenced by wide global liquidity. In recent weeks, however, there was some cooling in upward pressures, especially for agricultural commodities. The high volatility observed in commodities prices results from a context where financial markets adjust to new expectations of demand growth and to the remarkable volatility in FX markets.

Assessment of Inflation Trends

15. The identified shocks and their impacts were reassessed according to new set of available information. The scenario considered in the simulations was based on the following assumptions:

a) the projected adjustments for gasoline in 2010 increased from 0%, considered at the October Copom meeting, to 1.6%, and for bottled gas prices, increased from 0% to 1.7%, for the same period. For 2011, the projected adjustments for gasoline and bottled gas prices stand at 0%;
b) the projected adjustments for fixed telephone in 2010 reduced to 0.4%, down from 0.8%, considered at the October meeting, and for electricity prices in 2010, reduced to 2.8%, down from 3.6%. For 2011, the projected adjustments for fixed telephone and electricity rates stand at 2.9% and 2.8%, respectively;
c) the projection for regulated prices inflation in 2010, based on individual items, according to the benchmark scenario, reduced to 3.4%, down from 3.6%, considered at the October meeting. For 2011, the projection reduced to 4%, down from 4.3%. This set of prices, according to data released by the IBGE, accounted for 29.15% of the total November IPCA;
d) the projection for regulated prices inflation in 2012, according to the benchmark scenario, reached 4.4%. Such projection is based on endogenous determination models for regulated prices, which compute, 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 82 bps and 12 bps spreads in the fourth quarters of 2010 and 2011, respectively. For the third quarter of 2012, the estimate is 65 bps spread.

16. Regarding fiscal policy, projections assume the achievement of a public sector primary surplus target of 3.1% of GDP in 2010. This percentage can be reduced by up to 0.90 p.p., due to the implementation of the projects linked to the Growth Acceleration Program (PAC), of which 0.44 p.p. refers to amounts to be paid from 2009. Moreover, it is expected that the primary surplus in 2011 would return, without adjustments, to 3% of GDP (according to parameters contained in the Budget Guidelines Law) and to 3.1% in 2012.

17. The set of projections incorporated the estimated effects of the reserve requirements recently announced.

18. 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 5.20% to 5.78%. For 2011, the median of inflation expectations increased from 4.99% to 5.20% and for 2012, it stands at 4.5%.

19. The benchmark scenario assumes the maintenance of the exchange rate at R$1.70/US$1.00 and the Selic rate at 10.75% p.a. during the forecast period. Under this scenario, the projection for the 2010 inflation increased relative to the figure considered at the October Copom meeting, and it is remarkably above the 4.50% midpoint 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 at the period immediately prior to the Copom meeting - IPCA inflation forecast for 2010 also increased, and it stands considerably above the inflation midpoint target. For 2011, under the benchmark scenario, the projection increased relative to the figure considered at the October Copom meeting and stands above the inflation midpoint target, whereas according to the market scenario, the projection remained stable. Regarding the third quarter of 2012, the projections increased in both scenarios, but remained around the inflation midpoint target.

Monetary Policy Decision

20. The Copom`s assessment is that monetary policy should contribute to the consolidation of a favorable longer-term macroeconomic environment. In this respect, the Copom reassures that, under the inflation-targeting regime, it guides its decisions according to projected inflation and based on the analysis of several alternative scenarios for the evolution of the main variables that determine prices dynamics. The Committee also understands that low risks for the underlying inflation in the short run tend to reduce uncertainties regarding the future behavior of headline

inflation, facilitate the assessment of scenarios by the monetary authority, as well as help the process of coordination of economic agents' expectations, mainly price setters'. It is additionally noteworthy that low risks for the underlying inflation in the short run tend to reinforce the effects of monetary policy actions, enabling them to affect in a more long-lasting manner the dynamics of headline inflation in the future. Although the Copom recognizes that other actions of macroeconomic policy may influence the price trajectory, it reaffirms its view that it is the responsibility of the monetary policy to remain especially vigilant to guarantee that pressures detected in shorter horizons do not spread to longer horizons.

21. International evidence, ratified by the Brazilian experience, indicates that high inflation rates lead to the increase in risk premium, both for private and public funding, and to the shortening of planning horizons, both for households and corporate. Consequently, high inflation rates reduce investment and the economic growth potential, in addition to presenting regressive effects on income distribution. Moreover, high inflation rates do not result in any lasting results for economic growth and employment level; on the contrary, they create permanent damage to these variables in the medium and long terms. Therefore, the strategy adopted by the Copom aims to ensure the convergence of inflation towards the targets path in 2010 and in the next years, which requires that possible deviations from the target path be promptly corrected. Such strategy takes into account the time lags in the transmission mechanism and is the most adequate to deal with the uncertainty inherent to the process of monetary policy formulation and implementation.

22. As a consequence of the stabilization and correction of unbalances, which determined important structural changes, the process of maturing of the inflation target regime stands at an advanced stage, and it reflects favorably in the dynamics of neutral interest rate and in the power of monetary policy. Evidences under this respect can be observed, among other factors, through the accomplishment of inflation targets in the last six years, at the same time that real interest rates have reduced. Progress in the financial markets structure, the FX and inflationary risk premium reduction, among other factors, seem to have resulted in significant reduction of the neutral rate. The generation of primary surpluses consistent with the maintenance of decreasing trend for the public debt/GDP ratio also contributed for it. From another point-of-view, some of these developments, combined to others, such as the extension of contract tenures, also suggest that the power of monetary policy in Brazil has increased in the last years. Despite the substantial uncertainty that surrounds the calculation of non-observable variables, it should be emphasized that this perception is supported by estimates generated by the macroeconometric models used by the Copom. In addition, it is also noteworthy that, according to 49% of the analysts who responded to the consultation carried out by the BCB, the neutral rate in Brazil would currently be at levels equal to or lower than 6.50%. The Committee also considers that there are evidences that the traction of monetary policy increased in the recent past and, compared to what was observed some years ago, currently inflationary pressures are contained with more efficiency by monetary policy actions.

23. In international markets, volatility and risk aversion have remained high since the last Copom meeting, partially fueled by the increase of global liquidity and by the prospects that this process can eventually accentuate. Concerns about European countries` sovereign debts and the possible deceleration in China have also grown, at the same time that doubs regarding the sustainability of the US economy recovery have persisted. The prices of some commodities and Brazilian assets remained relatively stable and, overall, prospects for external funding for the Brazilian economy remain favorable. Meanwhile, the trajectory of price indices evidences the increase of inflationary pressures in some relevant economies, whereas concerns regarding the prospects of deflation in other economies cooled down. In this context, the probability of some influence of external disinflation over domestic inflation retreated, although uncertainty about the behavior of asset and commodities prices persists in a context of substantial volatility in international financial markets. Regardless of how these aspects of the international outlook evolve, the Copom reaffirms its view that the main challenge of monetary policy is to ensure that the favorable results obtained over the last years be preserved.

24. Although the accommodation observed in the last two quarters has been more intense than the expected at the start of the year, as evidenced, among others, by data on inventories and industrial production, the prospects for the evolution of domestic economic activity remain favorable. This assessment is supported, among other factors, by signs that the expansion of credit supply tends to persist, despite at a more moderate pace, both for individuals and corporate, and by the fact that consumers and businessmen confidence stands at historically high levels, notwithstanding some accommodation at the margin. The Copom considers, additionally, that the dynamism

of domestic activity will continue to be benefited by the vigor of labor market, despite the cooling in the generation of jobs in specific segments.

25. The Copom emphasizes, once more, that there are time lags between the implementation of monetary policy and its effects on both economic activity and inflation. Therefore, the assessment of alternative stances for monetary policy should necessarily focus on the forward-looking inflationary scenario and its risks, instead of current and past inflation figures. Since the August/September meeting, inflation was strong and negatively influenced by the dynamic of food prices, which in part reflected domestic and external supply shocks. These developments tend to be transmitted to the prospective scenario, among other mechanisms, through inertia, as pointed by the figures considered by the BCB in its inflation forecasts. It also bears highlighting the persistence of the mismatch between supply and demand growth rates. In this context, the Committee identifies risks to the materialization of a scenario in which inflation promptly converges to the midpoint target.

26. The Copom evaluates, on the other hand, that the effects of the adjustment process in the base interest rate, interrupted in July 2010, haven't completely materialized yet to price dynamics, and, at the same time, reaffirms that the main scenario is subject to the materialization of the trajectories regarding fiscal and parafiscal variables which the Committee considers. The main scenario also incorporates moderation in the credit pace. Regarding this last aspect, since the last meeting, the view of a substantial increase in the probability of materializing this hypothesis prevails, in light of the introduction of macroprudential initiatives.

27. The Copom emphasizes that there is some equivalence among macroprudential and conventional monetary policy actions and that the importance of this link tends to grow with the deepening of the credit market, a phenomenon already observed in Brazil in the last years. However, these two sets of instruments cannot be seen as perfect substitutes, once they diverge, among other aspects, regarding scope and transmission mechanisms. The macroprudential actions recently announced are inserted in a wider process, which includes, among other aims, the reversion of stimuli introduced to outweigh the effects of the 2008/2009 crisis over the Brazilian economy. Together with other measures, they constitute a sequence of initiatives that aim to adequate domestic financial conditions to the after-crisis scenario, characterized by intense contrast among the prospective scenarios for the main economic blocks. Regarding this point, once the Copom shares the view that the banks` attitude regarding risk taking is one of the monetary policy transmission channels, macroprudential actions may precede conventional monetary policy actions.

28. The intensity and frequency of shocks that both the global and Brazilian economies have undergone in the last years impose additional challenges to the analysis of the prospective scenario. The Committee recognizes an economic environment in which the uncertainty level prevails above the usual, where the risks for the consolidation of a benign inflationary scenario essentially stem from the domestic outlook. Among these risks, it bears mentioning those deriving from domestic demand expansion, in a context of narrow idleness margin in the use of production factors, although, in a recent past, a slight decline in the capacity utilization rate and a certain moderation in the dynamism of labor market (except for public administration) have been observed.

29. In short, since the last Copom meeting, in the foreign outlook, extraordinary liquidity eases and their impact, in a certain way, immediate and generalized over assets prices, specially commodities, point to lower probability of reversion of the still slow recovery process in which G3 economies stand. On the other hand, these liquidity eases evidence the ambiguous influence of the international scenario over domestic inflation behavior. Regarding the domestic outlook, the effects of Selic rate adjustments have not been totally incorporated into price dynamics. Additionally, recently announced macroprudential measures, a quick and powerful instrument to contain localized demand pressures, will still have their effects incorporated to price dynamics. Still, since the last Copom meeting, the materialization of short-run risks which the Copom considered at that opportunity has continued, but it revealed to be at a magnitude higher than previously anticipated. Although the uncertainties that surround the global scenario, and at a lower scale, the domestic scenario, do not allow the clear identification of the lastingness of the recent pressures, the current balance of risks is less favorable to the materialization of a benign scenario, in which inflation would consistently follow the targets trajectory.

30. In this context, after having considered the macroeconomic context and inflation prospects, the Copom unanimously decided to maintain the Selic rate at 10.75% p.a., without bias. In light of a less favorable prospective

scenario than that observed in the last meeting, but considering that, due to credit and liquidity conditions, the BCB recently introduced macroprudential measures, among the Committee members prevailed the understanding that additional time will be necessary in order to better measure the effect of these initiatives over monetary conditions. In this sense, the Committee understood it is not opportune to reevaluate monetary policy strategy at this meeting and will attentively follow the evolution of the macroeconomic scenario until its next meeting, to then define the next steps in its monetary policy strategy.

31. Domestic demand is robust, largely due to the effects of stimulus factors, such as income growth and credit expansion. Moreover, although tending to cool down, fiscal and credit incentives have been provided to the economy in the last quarters, and should still contribute for the consolidation of activity expansion and, hence, for the maintenance of the idleness margin of factors at low levels. The effects of these stimuli, however, are counterbalanced by the effects of the reversal of substantial share of the initiatives taken during the recent 2008/2009 financial crisis and by recent macroprudential initiatives. These elements are an important part of the context in which future monetary policy decisions will be taken, aiming to ensure the timely convergence of inflation to the targets path.

32. At the end of the meeting it was announced that the Committee will reconvene on January 18th, 2011 for technical presentations and, on the following day, to discuss the monetary policy decision, as established in Communiqué 20,223 of October 15th, 2010.

SUMMARY OF DATA ANALYZED BY THE COPOM

Inflation

33. The IPCA rose 0.83% in November, showing acceleration relative to the October result, 0.75%, but a reduction relative to the IPCA-15 result in November, 0.86%. The index increased by 5.25% in the year and by 5.64% in the last twelve months through November. Market prices increased by 1.04% in the month, up from 0.94% in October, as result of the increases of 1.53% in the prices of tradable goods and of 0.60% in the prices of non-tradable goods. Regulated prices increased by 0.33%, up from 0.30% in October. The diffusion index reached 67.19% in November and an average of 61.08% in 2010.

34. Monthly and twelve-month IPCA core inflation rates accelerated in November. The smoothed trimmed-means core inflation increased 0.56%, up from 0.55% in the previous month, accumulating 5.52% in twelve months, up from 5.35% in October. Core inflation by exclusion, which excludes ten items of household food and items related to vehicles fuel, grew 0.52% in November, up from 0.44% in October, totaling 5.30% and 5.15% in the last twelve months through November and through October, respectively. The double weight core inflation measure increased by 0.62% in November, up from 0.58% in October, totaling 5,32% in twelve months, up from 5.09% in the previous month.

35. The IGP-M increased 1.45% in November, totaling 10.56% in the year and 10.27% in twelve months. In November, all three components accelerated. The IPA rose 1.84%, up from 1.30% in October, mainly influenced by the high increase observed in the prices of bovines items and meat, meat and fish products, which jointly contributed 0.79 p.p. for the result. In the last twelve months through November, the IPA rose 12.62%, reflecting respective increases of 22.05% and 9.59% observed in the prices of agricultural and industrial products. The IPC increased 0.81% in November, up from 0.56% in October, with acceleration in four out of the seven surveyed groups, especially in food prices. In the year through October, and in the last twelve months, the IPC increased by 5.13% and 5.34%, respectively. The INCC increased 0.36% in November, up from 0.15% in October, reaching 6.95% in the year and 7.16% in the last twelve months.

Economic Activity

36. The IBC-Br increased 0.7% in September, after five months of relative stability, according to seasonally adjusted data. For the quarter ended in September, the IBC-Br increased by 0.3%, relative to the quarter ended in June. According to the observed series, the IBC-Br increased 8.9% in the year and 8% in the last twelve months.

37. After four consecutive months of growth at the margin, expanded retail sales decreased 0.9% in September, month-on-month, according to data seasonally adjusted by the IBGE's monthly survey (PMC). Nevertheless, retail sales continued to grow in the period, with a 0.4% increase for the fifth consecutive month. According to month-on-month seasonally adjusted data, sales increased in four of the ten sectors surveyed, with highlights for the following positive drivers: sales of office equipment and material (5.6%) and other items of personal and domestic use (2.8%). Among the negative drivers, it bears highlighting the retreats of 1.2% in pharmaceutical and medical articles and 0.8% in vehicles and motorcycles, parts and pieces. The average of expanded retail sales in the third quarter showed a 3.5% increase, quarter-over-quarter.

38. Expanded retail sales grew 5.9% in September, year-over-year, accumulating increases of 11.4% in the year and 12% in the last twelve months. The sales of vehicles, motorcycles, parts and pieces were the only ones that decreased year-over-year (-4%). Among sectors that expanded, it bears highlighting the sales of office equipment and material (28.5%), construction inputs (16.8%) and other items of personal and domestic use (15.8%). The sales of all ten sectors increased in the year, especially those relative to office equipment and material (25.3%), furniture and appliances (18.4%) and construction inputs (16.4%). The expanded sales in the last twelve months through September, year-over-year, also increased by each sector, with highlights to office equipment and material (20.4%), furniture and appliances (16.1%) and vehicles, motorcycles, parts and pieces (14.4%).

39. Automobile sales by dealers, including cars, light commercial vehicles, trucks and buses, increased 4.8% in November, month-on-month, according to Fenabrave (Brazilian Federation of Automotive Vehicles Distribution) data, seasonally adjusted by the BCB, with generalized increases in all categories. In the quarter ended in November, sales increased 8.3%, relative to the quarter ended in July, a performance mainly driven by automobile sales (10.0%). In the year and in the last twelve months through November, automobile sales increased 10% and 12.6%, respectively, reflecting increases in all categories, with emphasis on light commercial vehicles, trucks and buses.

40. Capital goods imports decreased 13.2% in October, month-on-month, according to the Funcex quantum index, seasonally adjusted by the BCB. Year-over-year, the indicator rose 32.7%, while in the year and on a twelve-month trailing basis, it increased 42.1% and 33.2%, respectively, compared to the same periods of the previous year.

41. Capital goods production decreased 0.2% in October, resulting in a 2.4% decrease in the quarter ended in October, quarter-on-quarter, according to data from the Monthly Industrial Survey (PIM) by IBGE. Among the sectors, the major production decreases recorded in October, month-on-month, stemmed from the segments of capital goods for the power sector (4.2%), capital goods for non-serial industrial purposes (3.1%) and capital goods for agricultural production (2.5%). Among the sectors that recorded increase in production, it bears highlighting transport equipment (4%) and capital goods for serial industrial purposes (3.9%). In the year, capital goods production grew 24%, with emphasis on the production for construction, which increased by 120.8%.

42. Construction inputs increased 0.8% in October, month-on-month, according to data seasonally adjusted by the Central Bank, totaling 0.2% growth in the quarter. Year-over-year, production increased 5.2%, whereas in the year through October and in the last twelve months it expanded by 12.9% and 12.2%, respectively.

43. Disbursements from granted by the BNDES reached R$ 140.9 billion in the year through October, with a 31% increase year-over-year. The industrial sector was the largest recipient of disbursements, with participation of 50% of the total released in the period, followed by the infrastructure sector (29%), trade and services (15%) and agriculture and the livestock sector (6%).

44. Industrial production increased 0.4% in October, month-on-month, after changing 0.1% in September, according to seasonally adjusted data from the PIM-PF. As a consequence, average production quarter-on-quarter was unchanged. By use categories, it bears highlighting that durable consumer goods outperformed (2.8% increase), while other categories declined. Considering the 26 industry activities, twelve showed monthly increases. In the quarter ended in October, the major changes were observed in publishing, printing and reproduction (8%), medical equipment (6.5%), and other transport equipment (3.8%). The main negative drivers were electronic

material and communication equipment (-14.5%), capital goods for the electricity sector (-6.5%), and basic metallurgy (-6.1%).

45. Industrial production increased 2.1%, year-over-year, with special emphasis on the production of capital goods (6%), followed by the production of intermediate goods (3.2%) and semi- and non-durable consumer goods (1.5%), while the production of durable consumer goods decreased (4.9%). On a twelve-month trailing basis, general industry grew 11.8% in October, year-over-year, with highlights to the increases in the production of capital goods (21.1%), durable consumer goods (15.4%), and intermediate goods (12.8%).

46. The Nuci in the manufacturing industry, calculated by FGV, reached 84.5% in November, corresponding to a 0.7 p.p. decrease month-on-month and a 1.6 p.p. increase year-over-year. According to the last comparison basis, the increase in installed capacity utilization rate mainly reflects the one relative to capital goods, which increased from 77.9% to 84.8% in November this year. The intermediate goods and construction material industries increased 2 p.p. and 1.9 p.p., respectively, while the consumer goods industry decreased by 0.7 p.p.. Month-on-month, capital goods increased 1.2 p.p., consumer goods and construction material were stable, whereas intermediate goods decreased by 0.5 p.p..

47. Vehicles production reached 321.1 thousand units in November, according to data released by the Anfavea and seasonally adjusted by BCB, representing a 0.1% increase month-on-month. The sector production expanded 10.2% year-over-year, 14.6% in the year and 19.2% in the last twelve months through November.

48. Vehicles sales increased 1.7% in November month-on-month, and 14.6% year-over-year, according to seasonally adjusted data. In the year and in the last twelve months through November, sales increased by 14.3% and 17.2%, respectively, influenced both by the domestic market expansion (4.3% and 7.8%, respectively) and by exports vehicles growth (73% and 68.4%, following the same order).

49. The LSPA survey carried out by the IBGE in October projected a 2.8% annual decrease for grains in 2011, relative to 2010, representing 144.5 million tons. It bears highlighting that, in this projection, corn and soybeans average yields, which follow last years' averages, are below 2010 levels, historical record highs for these products. The total area projected increased 1.7%, to 47.4 million ha.

Surveys and Expectations

50. According to the Consumer Expectations Survey carried out by the FGV nationwide, the Consumer Confidence Index (ICC) increased 2.7% in November, month-on-month seasonally adjusted, reaching 125.4 points, new historical record high. The result was influenced by the 4.5% increase in the Current Situation Index (ISA) and 1.5% in the Expectation Index (IE). Year-over-year, the ICC increased 9.3%, reflecting increases of 19.8% in ISA and of 3% in IE.

51. The Industry Confidence Index (ICI) from FGV decreased 1.1% in November, month-on-month, reaching 112.7 points, considering seasonally adjusted data, a record low since November 2009. The index behavior reflected, with greater intensity, lower optimism regarding the coming months. The IE decreased 1.9% and the ISA declined 0.3%. The ICI grew 2.9% year-over- year, due to the 5.8% increase in the ISA and the 0.3% decrease in the IE.

52. The Services Confidence Index (ICS) from FGV reduced 0.3% in November month-on-month, after retreating by 0.9% in the previous month, reflecting the fall of 2.5% in the Current Situation Index (ISA-S), smoothed by the 1.8% increase in the Expectation Index (IE-S). The ICS grew 2.7%, year-over-year, and 0.4% in the quarter ended in November, quarter-over-quarter.

Labor Market

53. According to the General Record of Employment and Unemployment (Caged) of the Ministry of Labor and Employment (MTE), 204.8 thousand formal jobs were created in October, representing a 0.4% increase month-on-month, considering seasonally adjusted data. In the year through October, 2,406.2 thousand jobs were created, a

record high for the ten first months of the year, since the start of the series, in January 1985. According to the same comparison basis, hiring registered a record in expansion in the services sector (860.3 thousand), in manufacturing industry (647.2 thousand), in commerce (373.9 thousand) and in civil construction (341.6 thousand). Regarding the activity sectors mentioned above, formal employment increased 5.6%, 6.1%, 6.2% and 14%, respectively. In October, it bears highlighting the hiring in the service sector (86.2 thousand); and in commerce (81.3 thousand). In the last twelve months through October, 2,237.7 thousand formal jobs were created in the country.

54. According to the IBGE employment survey (PME), carried out in the six main metropolitan regions of the country, the unemployment rate declined for the fifth consecutive month, reaching 6.1% in October, a historical record low, declining 0.1 p.p. month-on-month and 1.4 p.p. year-over-year. In seasonally adjusted terms, the unemployment rate also reached 6.3% in October, declining 0.1 p.p., month-on-month, as a result of increases of 0.3% in the Economically Active Population (PEA) and 0.4% in occupation. According to the same survey, average real earnings usually earned by workers reached a record high for the series, increasing 0.3% month-on-month and 3.4% in the year through October, contributing for the expansions of 1.4% and 7.1% in payroll growth, according to the same comparison bases.

Credit and Delinquency Rates

55. Outstanding credit in the financial system reached R$1,645 billion in October, equivalent to 47.2% of GDP, increasing by 1.9% in the month, 16.3% in the year and 20.3% in twelve months. Non-earmarked credit operations increased by 1.6%, 13% and 15.7%, respectively, according to the same comparison bases, reflecting the increases of 1.6% in the month and 14.4% in the year and 17.1% in twelve months for credit operations to individuals and 1.6%, 11.7% and 14.3%, according to the same comparison bases, for credit operations to corporate. Earmarked credit operations increased 2.5% in the month, 23.1% in the year and 30% in twelve months, with highlights for the rises of 2.9%, 40.2% and 51.1% recorded in housing credit and of 2.7%, 22.6% and 32.4% recorded in BNDES disbursements, according to the same comparison bases.

56. The average interest rate on non-earmarked credit operations increased 0.3 p.p. in October, reaching 35.4%. The average annual rate on credit for individuals reached 40.4% in October, increasing by 1 p.p. relative to September. The average rate on corporate credit totaled 28.7% in October, decreasing by 0.3 p.p. relative to September.

57. The average tenure on non-earmarked credit operations decreased in October, reaching 456 days, down from 458 days in September. This contraction mirrored the falls in the average tenure of credit for individuals and corporate (3 days and 2 days, respectively), which totaled 538 days and 383 days, following the same order.

58. Delinquency rates in the financial system (non-earmarked loans used as reference for interest rates, in arrears for more than ninety days) remained stable at 4.7% in October, reducing 1.1 p.p. in twelve months, a record low since January 2009. Delinquency rates for credit operations with corporate and to individuals remained stable at 6% and 3.5%, respectively.

External Environment

59. In the third quarter, economic activity accelerated in the US and in Japan and cooled in the Euro Area and in UK. Regarding the US and Japan, GDP acceleration was positively influenced by the expansion in household consumption, although in Japan this demand component has been benefited by governmental incentives, already extinct for the automotive sector, but still in vigor until the end of the year for some certain durable goods. In the US, the last *Beige Book* reported evidence of better performance of retail sales in several Districts, but it continues to signal a depressed housing real state market. In the same period, the interannual Chinese GDP growth rate decelerated to 9.6%, down from 10.3% in the previous quarter. Regarding manufacturing industry, the PMI index (purchase managers index) advanced in global manufacturing production in November, with highlights for the growth in the employment and new orders indices.

60. The assets prices in the financial and commodity markets shifted upwards and downwards. The upward movement, among the resumption of liquidity ease in the US, was due to the improvement in consumption

indicators in several economies and to the effects of adverse weather conditions over supply (in the specific case of agricultural commodities). The downward movement reflected the surge of fears regarding the monetary tightening in China and the fiscal sustainability of some European countries, whose uncertainties remain even after the agreement settled by Ireland, the European Union and the IMF. In this sense, the US dollar, which had been depreciating in face of other currencies, started to appreciate in response to the growth of risk perception by financial agents.

61. Less exposed to swings in food prices, due to the composition of the consumption baskets, the consumer price indices (IPC) of the mature economies maintained more stable behavior than those of the emerging economies. The annual IPC change reached, in October, 1.2% in the US, 1.9% in the Euro Zone, 3.2% in the UK and 0.2% in Japan, the first positive change since February 2009. It bears highlighting that in the US, the annual IPC core change stood at 0.6%, a record low for the series, began in 1957. Among the emerging countries, also in October, the annual IPC increased in Russia, to 7.5%, in China, to 4,4%, in Korea, to 4.1%, and in Mexico, to 4%, while it reduced in Turkey, to 8.6%.

62. In this context, the central banks in the US, Euro Area, UK and Japan maintained the accommodative stance of their policies, having the Fed announced, on November 3rd, a new quantitative easing, by deciding on the purchase, until the end of the second quarter of 2001, of more than US$600 billion in long-term Treasuries, at a pace of US$75 billion per month. It bears highlighting that, since the last Copom meeting, several central banks, among which the ones from Chile and India, have increased their basic interest rates.

Foreign Trade and International Reserves

63. The Brazilian trade surplus reached US$312 million in November, as a result of US$17.7 billion in exports and US$17.4 billion in imports. As a consequence, the trade surplus accumulated in the year reached US$14.9 billion. On a daily average basis, the trade surplus fell by 35.4% year-over-year, mirroring a 43.9% growth in imports and a 30.7% growth in exports. Total external trade grew by 36.7% in the year, increasing to US$347.1 billion in the year, up from US$254 billion in 2009.

64. International reserves reached US$285.5 billion in November, recording a US$531 million growth month-on-month and a US$46.9 billion growth in the year. The monetary authority's interventions accounted for net purchases of US$2.4 billion in the domestic market, in the month, accumulating US$39.3 billion in the first eleven months of 2010.

Money Market and Open Market Operations

65. Since the October Copom meeting, the futures interest rate yield curve shifted upwards for all tenors, mainly driven by the release of above-than-expected current inflation indices; by the increase of inflationary expectations and by the uncertainties related to the conduction of fiscal policy by the next government. On the external outlook, the increase in the US Treasuries rates also contributed to pressure the long-term domestic interest rates. However, from December 3rd, this upward movement of the interest rate was partially reverted, due to the announcement, by the BCB, of macroprudential measures involving the increase of reserve requirements and increase of capital requirements for credit operations. Therefore, between October 18th and December 6th, one-, three- and six-month rates increased by 0.08 p.p., 0.31 p.p. and 0.76 p.p., respectively. The one-, two- and three-year rates increased by 0.88 p.p., 0.76 p.p. and 0.70 p.p., respectively. Real interest rates, measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month-ahead inflation expectations, increased from 5.68% on October 18th to 6.30% on December 6th.

66. In its open market operations, the BCB carried out, between October 19th and December 6th, repo operations borrowing R$28.3 billion for a six-month period. As a consequence, the average daily balance of the long operations reached R$ 129.2 billion. In the same period, the BCB also borrowed money through repo operations with tenures between 13 and 33 working days, increasing the average daily balance of short-term borrowing operations to US$201.0 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. The very short-term operations, including the two-working-day tenure liquidity management operations, averaged a daily balance of

R$65.2 billion in the period, borrowing. The average daily balance of the total stock of repurchase agreements of the Central Bank decreased from R$402.0 billion between August 31st and October 18th to R$395.4 billion, between October 19th and December 6th. Considering the daily balance of operations for the most recent period, there was a reduction in the daily balance of repurchase agreements totaling R$49.3 billion, elevating the total stock from R$422.9 billion on October 18th to R$373.6 billion on December 6th. The main drivers of liquidity retreat in the period were the net issuance of National Treasury securities, the net revenues of the Union and the demand for currency by the public.

67. Between October 19th and December 6th, the National Treasury issuance regarding the traditional auctions raised a total of R$39.2 billion. The sale of fixed-rate securities reached R$23.5 billion, with R$21.8 billion via issuance of LTNs maturing in 2011 and 2013, and R$1.7 billion via NTN-Fs maturing in 2015, 2017 and 2021. Issuance of LFTs totaled R$11.2 billion, for securities maturing in 2015 and 2017. Issuance of inflation-linked NTN-Bs reached R$4.5 billion, for securities maturing in 2013, 2014, 2015, 2016, 2020, 2030, 2040 and 2050.