Annex

Minutes of the 138th Meeting of the Monetary Policy Committee (Copom)

Date: October 28th, from 6:10PM to 8:05PM, and October 29th, from 5:40PM to 7:50PM
Place: BCB Headquarters meeting rooms – 8th floor on October 28th and 20th floor on October 29th – Brasília – DF

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

Department Heads (present on October 28th)
Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on October 29th)
João Henrique de Paula Freitas Simão – Open Market Operations Department
José Antônio Marciano – Department of Banking Operations and Payments System
Márcio Barreira de Ayrosa Moreira – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations Group

Other participants (present on October 28th)
Alexandre Pinheiro de Moraes Rego – Press Secretary
Alexandre Pundek Rocha – Advisor to the Board
Eduardo José Araújo Lima – Advisor to the Research Department
Flávio Pinheiro de Melo – Advisor to the Board

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

Recent economic developments

1. IPCA inflation retreated in September, to 0.26%, down from 0.28% in August and 0.53% in July. As a consequence, inflation reached 4.76% in the first nine months of 2008 – the highest change in the period since 2004 – up from 2.99% in the same period of 2007. Twelve-month trailing inflation increased 6.25% in September, up from 6.17% in August (4.15% in September 2007), resuming acceleration. Under this comparison basis, the acceleration of consumer price inflation mirrors the behavior of both regulated prices and market prices. Indeed, market prices and regulated prices increased 7.66% and 3.05%, respectively, in the twelve months through September, up from 5.07% and 2.12% in the twelve months through September 2007. Moreover, despite the BRL appreciation observed until then, the prices of tradable goods accelerated, reaching 6.78% (compared to 4.92% in September 2007), according to the same comparison basis. Regarding the prices of non-tradable goods, greatly pressured by the behavior of perishable food and services prices, twelve-month trailing inflation

was even higher (8.49%), evidencing the influence of domestic factors over inflationary dynamics. For instance, the price of services increased 6.27% in September 2008, up from 5.19% in December and 4.79% in September 2007, according to the same comparison basis. Preliminary data for October point to consumer inflation index above that observed in September. In short, the reversal of the progressive divergence trend of inflation from the targets path, which had been observed since the end of 2007, hasn't consolidated yet.

2. The three main underlying inflation measures calculated by the BCB have evolved differently from the headline index. The core inflation by exclusion of household food items and regulated prices and the smoothed trimmed means core inflation measures increased from 0.50% and 0.36% in August to 0.62% and 0.43% in September, respectively, while the non-smoothed trimmed means core inflation measure increased 0.41% down from 0.42% in August. Similarly to the headline inflation, the three core inflation measures accelerated remarkably in the first nine months of the year, compared to the same period of 2007, with increases from 2.70%, 2.81% and 2.43% to 4.83%, 3.71% and 3.94% for the core inflation by exclusion, smoothed and non-smoothed trimmed means core inflation, respectively. On a twelve-month trailing basis, the core inflation by exclusion of household food items and regulated prices continues to record substantial increase, rising from 5.70% in July to 5.87% in August and 6.26% in September. The smoothed and non-smoothed trimmed means core inflation also accelerated, despite at a lower degree, under this criterion, in the last months. The smoothed trimmed means core inflation changed from 4.89% in July to 4.85% in August and 4.94% in September, whereas the non-smoothed trimmed means core inflation changed from 4.92% in July to 4.91% in August and 5.15% in September. As a consequence, all core inflation measures stand above the central value for the inflation target. Moreover, it bears emphasizing that the behavior of the IPCA diffusion index, whose average is the highest recorded since 2004, continues to suggest an inflationary process relatively disseminated, confirming the analysis present in previous Copom Minutes.

3. The General Price Index (IGP-DI) inflation changed from 1.12% in July to –0.38% in August and 0.36% in September. On a twelve-month trailing basis, IGP-DI inflation decreased to 11.90% in September, down from 12.80% in August and 14.81% in July, compared to 6.16% in September 2007. In the twelve months through September, the IGP-DI increase reflected the behavior of the three main components. The Consumer Price Index-Brazil (IPC-Br) increased 5.60% (4.50% in September 2007), while the Wholesale Price Index (IPA-DI) totaled 14.33% (6.92% in September 2007). According to the same comparison basis, the Civil Construction National Index (INCC) increased 11.88% (5.46% in September 2007). Regarding the agricultural IPA, inflation reached 15.84% (19.50% in the twelve months through September 2007). It also bears highlighting the continuity of upward pressures over wholesale industrial prices, a process that began in the second half of 2007 and does not show consistent signs of accommodation. In the first nine months of the year, wholesale industrial price inflation increased 11.72%, up from 2.54% in the same period of 2007. In addition, in the last twelve months, wholesale industrial price inflation increased 13.78% in September, up from 4.42% in December 2007. As mentioned in previous Copom Minutes, the Copom evaluates that the effects of wholesale prices over consumer price inflation will depend on current and prospective demand conditions and price-setters' expectations for the future inflation path.

4. On a three-month moving average basis, according to data seasonally adjusted by the IBGE, industrial output increased 1.0% in August, after growing by 1.1% in the previous month. Still considering the seasonally adjusted series, after the 1.4% expansion observed in July, industrial output retreated by 1.3% in August, month-on-month, partially reflecting the unusual working day distribution observed this year. It bears noticing that general industrial output grew 6.0% in the year through August, with respective increases of 6.0% and 7.1% in manufacturing and in mining output. On a year-over-year basis, industrial output expanded by 2.0% in August (with one less working day), with respective growth of 1.6% and 8.5% in manufacturing and extraction industries, respectively.

The data already released for the last months point, in short, to the continuity of the industrial production expansion cycle, despite some accommodation at the margin may occur, due to restrictions to supply expansion in some sectors, as well as to the effects of the monetary policy change in Brazil and to the international financial turmoil.

5. Among the use categories, according to data seasonally adjusted by the IBGE, durable consumer goods production increased 2.1% in August. Regarding the other use categories, intermediate goods production decreased 2.7%, semi-durable consumer goods production retreated by 0.3%, while the production of capital goods production remained stable. In the year, capital goods production leads the expansion, with an 18.1% increase, followed by the 11.8% elevation in durable consumer goods production. The strength of capital goods production until August has reflected the consolidation of favorable prospects for the continuity of macroeconomic stability. On its turn, the expansion of durable goods production reflects, predominantly, credit conditions, which remained, until recently, more favorable than historical patterns.

6. Labor market continues to present quite favorable performance. The unemployment rate in the six metropolitan regions covered by the Monthly Labor Survey (PME) retreated from 8.1% in July to 7.6% in August, the same level reached in September, down from 9% in September 2007. As a result, the average unemployment rate in the first nine months of the year was 1.6 p.p. below that observed in the same period of 2007. According to data seasonally adjusted by the BCB, the unemployment rate changed from 7.4% in August to 7.6% in September, showing stability in historically low levels in the last months. The nominal average earnings increased 13.0% in August, year-over-year, and accelerated to 13.7% in September. In August, real average earnings increased 2.1% month-on-month and 5.7% year-over-year. In September it grew 0.9% month-on-month and 6.4% year-over-year (the highest level of the series since July 2006), behavior that evidences the labor market tightening. In the first nine months of 2008, real average earnings increased 3.2%, while employment grew 3.9%. As a consequence, real payrolls expanded by 7.3% (10.0% growth in September in year-over-year terms), continuing to constitute a key driver for domestic demand growth. According to the National Industry Confederation (CNI) data seasonally adjusted by the BCB, manufacturing employment increased by 0.1% in August (compared to 0.6% in July and 0.5% in June). In year-over-year terms, employment grew 4%, totaling 4.4% growth in the last twelve months. According to data seasonally adjusted by the IBGE, manufacturing employment decreased by 0.1% in August (compared to increases of 0.7% in July and 0.6% in June). In year-over-year terms, manufacturing employment grew 2.5%, totaling 2.9% growth in the last twelve months. Still regarding employment, data from the Ministry of Labor and Employment (MTE) indicate the continuity of strong expansion in formal employment this year, with the creation of 239.1 thousand jobs in August and 282.8 thousand jobs in September, a record high for the monthly, year-to-date and twelve-month historical series. In the first nine months of the year, employment reached a record high of 2,086.6 thousand hires, 25% above the previous record high observed for the historical series in 2004, an evidence of the robust demand for work. Formal employment grew by 0.6% in September, seasonally adjusted, and observed data point to a 6.3% expansion in the last twelve months. Manufacturing industry recorded the highest hiring rate in September, with the creation of 114.0 thousand new jobs, followed by the services sector (104.7 thousand new jobs) and by the retail sector (53.3 thousand new jobs). On the other hand, the agricultural sector, due to seasonal factors related to the inter-harvest observed in the Middle-Southern part of the country, was the only sector recording employment retreat (extinction of 25.3 thousand jobs).

7. According to data seasonally adjusted by the IBGE, expanded retail sales decreased by 1.6% in August, after increasing 0.3% in July and 1.1% in June, and grew by 7.0% year-over-year in August and 13.5% in 2008 through August. Expanded retail sales three-month moving average decreased 0.1% in August, month-on-month, interrupting the sequence of 27 consecutive monthly increases in this indicator. According to seasonally adjusted data, on a month-on-month basis, it bears emphasizing the expansion in the sales of “books, newspapers, magazines and stationary” (3.2%), followed by “supermarket, food products, beverages and tobacco” (1.1%) and

"furniture and domestic appliances" (1.0%). In the year through August, cumulative growth was more significant in "books, newspapers, magazines and stationary" (31.3%), "other personal and domestic articles" (20.6%) and "vehicles, motorcycles, parts and pieces" (19.8%). The decrease in expanded retail sales was already expected, due to the decrease of 11.1% in vehicles sales in August, according to data seasonally adjusted by the National Federation of Distribution of Automotive Vehicles – Fenabrave. Expanded retail sales should resume growth in September, reflecting the positive performance of vehicles sales, which grew 8.6% month-on-month, according to data seasonally adjusted by the Fenabrave. The steady growth of retail sales had been reflecting, in short, the performance of both the sectors more sensitive to income and employment expansions and those more sensitive to credit conditions. For the next quarters, the retail sales trajectory will continue to be favored by fiscal transfers, as well as by employment and income growth, but it also will be affected, in case of persistence, by the changes in the access to credit supply, which cannot be fully associated to the monetary policy stance, and by the deterioration of consumer confidence.

8. The installed capacity utilization rate (Nuci) in the manufacturing industry reached 83.1% in August, similarly to the level observed in June, after the increase to 83.7% in July, according to CNI data seasonally adjusted by the BCB. According to data seasonally adjusted by CNI, the Nuci in the manufacturing industry showed a slight upward trend, reaching 83.5% in August, a record high for the series since 2003. Without the seasonal adjustment, the Nuci stood 0.4 p.p. above the level registered in August 2007. As a consequence, the average rate in the first eight months of 2008 was 0.9 p.p. above the level observed in the same period of 2007. The monthly Nuci calculated by Fundação Getúlio Vargas (FGV) reached 86.4% in September, standing 0.3 p.p. above the level registered in the same month of 2007. The elevation in the Nuci in September 2008, year-over-year, is also observed in the production of civil construction inputs (5.4 p.p.), of consumer goods (3.5 p.p.) and of capital goods (1.9 p.p.). For the intermediate goods sector, the Nuci stood 1.5 p.p. below the level observed in September 2007. The maintenance of installed capacity utilization rates at historically high levels occurs in several sectors (records highs for consumer goods sector and civil construction inputs sector were observed in September) despite investments made in the last twelve months. In fact, recent data about the absorption of capital goods was still inconclusive about an inflexion in the investment expansion trend. The absorption of capital goods increased 1.3% in August, according to seasonally adjusted data, accumulating a 19.7% expansion in 2008, in observed terms, compared to -1.3% and 20.9% in July, respectively, according to the same comparison bases. On the other hand, the production of civil construction inputs showed stability at the margin in August, after increasing by 2.4% in July, maintaining the 10.5% growth in 2008. In short, evidences suggest that, although investment has been importantly contributing to soften the increasing trend of capacity utilization rates, the maturation of investment projects has not been sufficient, so far, to significantly limit the existing mismatches regarding the evolution of supply and domestic demand. As stressed in previous Copom Minutes, the inflation trajectory is closely linked to current and prospective developments related to the expansion of supply of goods and services, to adequately meet demand conditions.

9. The trade balance continues to register deceleration at the margin, an already anticipated trend, and which is in line with assessments present in previous Inflation Reports and Copom Minutes. In the last twelve months through September the trade surplus reached US$28.7 billion (33.5% below September 2007). Exports and imports totaled US$194.9 billion and US$166.2 billion, equivalent to 27.0% and 50.7% growth, respectively, according to the same comparison basis. As highlighted in previous Copom Minutes, imports have been growing faster than exports, both due to the strengthening of the BRL and to the robust expansion of domestic absorption, notwithstanding the elevated price levels of several commodities included in the Brazilian export basket (this supporting factor for the exports value can moderate in case of persistence of recent trends in the prices of raw materials). The decrease in trade surplus contributed to the US$25.2 billion current account deficit registered in the twelve months through September 2008, equivalent to

1.6% of GDP. Foreign direct investment reached US$37.4 billion in the twelve months through September, equivalent to 2.4% of GDP.

10. The period since the last Copom meeting was marked by the intensification of severe intensification of stress on international financial markets, which originated in the US and Europe, but whose impact on emerging economies has become more significant. The increased risk aversion, observed since mid-September, after the bankruptcy of an important US financial institution, led the authorities in the US, Europe and Oceania to intervene in an unprecedentedly way in their financial systems, using wide range of instruments, in order to ensure minimum conditions of operation and liquidity in money markets. Although systemic risk perception is still high, such initiatives, accompanied by programs to reinforce the capital base of relevant financial institutions, seem to have managed to restore the functioning of the interbank markets. The international liquidity contraction contributed to a deleverage process by asset managers, which in turn has been pressuring down the prices of financial assets. In the environment of increased risk aversion and shortage of capital flows, pressures on emerging economies' currencies have intensified. In this context, the recent announcement of the currency swap agreements between the US Federal Reserve and the Central Bank of Brazil, as well as with the Monetary Authority of Singapore, the Bank of Korea and the Bank of Mexico, should contribute to mitigate – without, however eliminate – the impacts of international financial turmoil on emerging markets.

11. Regarding the global macroeconomic scenario, the contraction trends seem to be gradually prevailing over the inflationary pressures, which, however, are still present. The dominant view still points to the expansion, at a moderate pace, of global economic activity in 2008 and 2009, but data released in the last weeks indicate a more intense and generalized cooling of activity in mature economies. There are evidences that the deeper weakening of economic activity in Europe and parts of Asia was predominantly due to the negative shock in the terms of trade caused by the elevation of commodities prices, which could be reversing. On the other hand, the problems in the financial system have been aggravated by a cyclical deterioration in credit quality, which may reinforce the contraction in financial conditions and, as a consequence, the risk of intensification of deceleration. The US economy, specifically, started to decelerate in the last quarter of 2007 and it still continues to suffer the impacts of the housing sector crisis, with spillover effects on the labor market, whose weakening, together with the negative wealth effect associated to the fall in the prices of financial assets, has affected the consumer's confidence, significantly contributing for depressing expenditure. The prevailing interpretation is that the activity in Europe and Japan may continue to lose dynamism in the next months. In mature economies, where inflation expectations are better anchored and economic activity is decelerating considerably, inflationary pressures have reduced relatively fast. On the other hand, in emerging economies, where the secondary effects of raw materials price increases over consumer prices and the heated demand pressures over the supply expansion capacity had been more intense, the inflationary pressures have been more persistent. In this context, the monetary policy stance is mainly expansionist in mature economies, whereas in emerging economies, which have been affected by the exchange rate depreciation trend, in addition to the facts mentioned above, the situation seems to be more heterogeneous.

12. Oil prices remain highly volatile, but reduced considerably since the last Copom meeting. Future markets have followed the prices of oil in the spot market. However, uncertainty concerning oil prices is remarkably high, as the prospective scenario depends on the evolution of demand, especially in emerging countries, on the supply's reaction to stimuli derived from previous changes on relative prices, in addition to geopolitical issues that affect the price of this commodity. Nonetheless, despite the great uncertainty inherent to the projections of oil prices' trajectory, the main scenario adopted by the Copom, which assumes unchanged gasoline prices in 2008, remains plausible. However, it bears highlighting that, regardless of the behavior of domestic gasoline prices, the reduction of international oil prices can affect domestic prices both through productive chains, such as the petrochemical, as well as through the potential effect over inflation expectations. The prices of other commodities also showed important

reductions since the last Copom meeting, reacting both to the greater pessimism about the prospects for global economic growth and to the intensification of the global financial markets turmoil.

Assessment of inflation trends

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

a) the projected adjustments for gasoline and bottled gas prices were maintained at 0% for 2008;

b) the projections adjustments for electricity prices and fixed telephone prices were maintained unchanged at 1.1% and 3.5%, respectively, for 2008;

c) the projection for regulated prices inflation in 2008, based on individual items, was altered to 3.8%, down from the 4.0% considered in the September meeting. This set of prices, according to data released by the IGBE, corresponded to 29.71% of the total September IPCA;

d) the projection for regulated prices inflation in 2009 was altered to 5.5% up from 4.8%. This projection is based on the endogenous determination model for regulated prices, which computes seasonal components, foreign exchange rate changes, market prices inflation and the IGP (General Price Index) variation;

e) the projection for the spreads over the Selic rate, on the benchmark scenario, based on the 360-day swap rates estimates a 147 bps spread in the fourth quarter of 2008 and 85 bps in the last quarter of 2009. The identified shocks and their impacts were reassessed according to newly available information.

14. Regarding fiscal policy, the projections assume the achievement of the public sector primary surplus target of 3.8% of GDP in 2008 and 2009, increased by 0.5 p.p. The related assumptions considered in the previous meeting were maintained.

15. Since the September Copom meeting, according to the median IPCA inflation expectations compiled by the BCB's Investor Relations Group (Gerin), the 2008 IPCA variation remained relatively stable, increasing from 6.27% to 6.29%. Twelve-month-ahead inflation expectations also increased slightly, from 5.22% to 5.29%, considering the medians of expected monthly rates. Inflation expectations for 2009 remained at 5.00%.

16. Considering the hypotheses under the benchmark scenario – which assumes the maintenance of the exchange rate at R$2,25/US$1.00 and the Selic rate at 13.75% during the forecast period – the projection for the 2008 IPCA inflation increased relative to the figure considered at the September Copom meeting, and remained above the 4.5% target established by the National Monetary Council (CMN). According to the forecast based on the market scenario – which incorporates the consensus exchange and Selic rates trajectories collected by Gerin on the eve of the Copom meeting – IPCA inflation forecast for 2008 also increased compared to the figure considered at the previous Copom meeting, and remained, therefore, above the central target for the year. Regarding 2009, projections based on the benchmark scenario increased in relation to the figure forecast at the September meeting and the projections based on the market scenario showed a slight decrease, but, in both cases, remained above the 4.5% central target for that year.

Monetary policy decision

17. The Copom evaluates that the monetary policy should contribute for the consolidation of a favorable long-term macroeconomic environment. Economic activity data indicate that the pace of domestic demand expansion continues quite robust, and it is at least partially responsible for the inflationary acceleration trend, despite strong imports growth and the favorable investment performance. Additionally, the increase in risk aversion and the unprecedentedly constraints observed in liquidity conditions in the international markets impose some adjustment in the balance of payments which, despite the increase in Brazilian economy external resilience, can increase the inflationary pressures, especially in the short run. In general terms, the influence of the external scenario on the future trajectory of Brazilian inflation continues to be subject to contradictory effects, which can act with distinct intensity throughout

time and surrounded by significant uncertainties. On the one hand, more generalized deceleration of global economic activity in the upcoming quarters points to an accommodation of both commodities prices and external demand, therefore influencing negatively the local financial conditions. On the other hand, the trend of economic cooling has caused an increase in risk aversion, impacting the demand for Brazilian assets, and consequently, depreciating their prices. In this scenario, the additional reduction of net exports can occur, with similar effects over the behavior in the prices of certain Brazilian assets. Moreover, the recent trajectory of price indices still evidences the existence of significant inflationary risks, in several economies, despite the remarkably lower intensity compared to the middle of 2008. In light of the deterioration of inflation prospects occurred in the last months, in a more uncertain environment, the Committee evaluates that the risk of materialization of a less benign scenario is still high. The Copom emphasizes that the main challenge of monetary policy in this context is to guarantee the maintenance of favorable results achieved in the last years. Particularly, monetary policy should act so that initially limited impacts on price indices do not cause persistent deterioration of inflation dynamics due to the worsening of expectations.

18. The Copom reaffirms that is still high the probability that initially localized inflationary pressures may cause risks to domestic inflation trajectory. The heating of domestic demand and markets of factors, despite under higher uncertainty, as well as the possibility of emergence of supply restrictions in some sectors, may facilitate the pass-through of wholesale prices to consumer price inflation. The Committee evaluates that the materialization of this pass-through and the generalization of pressures initially localized on consumer price indices depend critically on inflation expectations, which remain in levels incompatible with the inflation targets path and continue to be carefully monitored. Additionally, it is worth pointing that although the external sector had been imposing some discipline on tradable goods inflation, the heating of domestic demand has pressured the prices of non-tradable items, as services. In this context, the Copom will act to ensure the gains obtained in inflation control in recent years become permanent. Doing so, the Copom will carefully monitor the evolution of inflation and the several core inflation measures, as well as of inflation expectations within the forecast period, being ready to promptly adjust the monetary policy stance in order to avoid the consolidation of a scenario in which one-off price readjustments become persistent or generalized.

19. The maintenance of inflation rates in line with the targets path and the consequent consolidation of a long-term stable macroeconomic environment will contribute for the progressive reduction of macroeconomic risk perception. The Copom thinks that the persistence of a cautious and timely monetary policy stance is essential to increase the probability that inflation in Brazil evolves once again according to the targets path in 2009. For this higher probability to continue to materialize, however, it is necessary that forward-looking inflation indicators, particularly the expected dynamic of aggregate supply and demand, converge throughout the relevant period for the monetary policy.

20. The Copom emphasizes, once again, that there are important time lags between the implementation of monetary policy and its effects on economic activity and inflation. Therefore, the evaluation of alternative options for monetary policy should necessarily focus on the forward-looking inflation scenario and its risks, instead of current inflation indices. This viewpoint is even more important in periods of higher uncertainty.

21. The prospects for the evolution of economic activity became more uncertain since the last Copom meeting. In particular, the effects of the international crisis on the domestic financial conditions indicate that the contribution of credit to support domestic demand may decline more intensively than the magnitude of what would happen exclusively by the monetary policy effects. Additionally, the intensification of international crisis seems to have caused a negative effect on consumers' and businesses' confidence. If this situation persists, the strength of economic activity would increasingly depend on real payroll expansion and the effects of governmental transfers expected for this and the next quarters. These considerations become even more relevant considering the signs of still heated

domestic demand at the end of the third quarter, the dissemination of pressures derived from relative prices adjustments, including the labor market, and the fact that the monetary policy decisions will have concentrated impacts in 2009.

22. The Copom recognizes the important contribution of investment to expand productive capacity. Moreover, it bears noticing that the accommodation of commodities prices, whose consistent signs emerged last weeks, could contribute to avoid even more intense inflationary pressures. However, the Copom evaluates that the pace of domestic demand expansion continues to present important risks to the inflationary dynamics, to which may be added, particularly in the short run, the risks derived from the trajectory of Brazilian assets prices, in a process of decreasing external funding. In this context, the prompt and consistent reduction of the mismatch between the growth of aggregate demand and supply of goods and services continues to be crucial to the assessment of different possibilities for the monetary policy stance.

23. International evidence, as well as the Brazilian experience, indicates that high inflation rates lead to higher risk premium, to shorter planning horizons and, consequently, to lower potential economic growth, besides having regressive effects on income distribution. Moreover, in the current circumstances, there is the risk that economic agents start to attribute higher probability that inflation acceleration become persistent, reducing the efficacy of monetary policy. Therefore, the Copom's strategy aims to bring inflation rates timely back to the 4.5% midpoint target established by CMN already in 2009. This strategy, which will have its results evidenced throughout time, takes into account the time lags in the transmission mechanism and is the most adequate to deal with uncertainties inherent to the process of monetary policy formulation and implementation.

24. The Copom evaluates that, in light of the economic heating signs regarding, for instance, labor market available data and the industry capacity utilization rates, and the behavior of inflation expectations, the risks for the materialization of a benign inflation scenario, in which IPCA would resume evolution in line with the targets path, continue relevant. Indeed, an unfavorable forward-looking scenario is still present in the inflation projections considered by the Committee. The Copom also thinks that the persistence of a significant mismatch between the growth paces of aggregate supply and demand continues to represent risk for the inflationary dynamics, but evaluates that the expected trajectories of domestic consumption and investment have become more uncertain. Under these circumstances, monetary policy should act according to the requirements of the balance of risks of the inflationary dynamics, through the adjustment of the basic interest rate, although not necessarily in a continuous way, aiming, on the one hand, to reduce that mismatch and, on the other hand, to avoid that inflationary pressures initially restricted to some prices indices lead to a persistent deterioration of expectations and of the inflation forward-looking scenario. Finally, the Committee thinks that the consolidation of more restrictive financial conditions could intensify the effects of monetary policy over aggregate demand and, throughout time, over inflation.

25. In such context, evaluating the prospective scenario and the balance of risks for inflation in a more uncertain environment, the Copom unanimously decided, at this moment, to keep unchanged the Selic rate at 13.75% p.a., without bias.

26. Under the inflation-targeting regime, the Copom guides its decisions according to the projected inflation, the analysis of several alternative scenarios for the evolution of the main variables that determine the forward-looking prices dynamics and the balance of risks associated to their projections. Domestic demand continues to increase vigorously, supporting the economic activity strength, including sectors less exposed to external competition, at a moment when the effects of stimuli factors, such as income growth, are still influencing the Brazilian economy. In addition, the contribution of the external sector to a favorable inflationary scenario, in light of the strong depreciation in the prices of Brazilian assets and the apparent reduction in the country's capacity to import, has become less effective, at a moment when the effects of investment on the economy's productive potential still need to consolidate. In this context, the monetary policy should act so to bring inflation back to the targets path already in 2009, in order to avoid that the higher uncertainty detected

in shorter-term horizons disseminate to longer-term periods. Evidently, if the risk profile changes in a way that implies shifts in the basic prospective scenario for inflation considered by the Committee in this meeting, the monetary policy stance will be promptly adjusted to the circumstances.

27. At the end of the meeting, it was announced that the Copom would reconvene on December 9th 2008, for technical presentations, and on the following day, to discuss the monetary policy decision, as established in Comuniqué 16,051 of September 3rd, 2007.

Summary of data analyzed by the Copom

Inflation

28. IPCA reached 0.26% in September, repeating IPCA-15, compared to 0.28% in August. For the second consecutive month, the prices of food and beverages decreased (-0.27% in September, after -0.25% in August) and contributed -0.06 p.p. to the September IPCA. Market prices increased 0.30% in September, up from 0.25% in the previous month, with price elevations of 0.22% for tradable and 0.36% for non-tradable goods. Regulated prices increased 0.17%, up from 0.35% in August. The diffusion index reached 60.94% in September, down from 63.02% in August, reaching a 63.05% average in 2008. On a twelve-month trailing basis, IPCA increased 6.25%, up from 6.17% in August, mainly due to the increases on market prices (7.66%) and regulated prices (3.05%).

29. IPCA core inflation indices increased in the last twelve months through September, while the core inflation by exclusion and the smoothed trimmed means core inflation measures accelerated over the same period. Core excluding household food items and regulated prices increased 0.62% in September, up from 0.50% in August, totaling 6.27% in the last twelve months, compared to 5.87% in the previous month. The non-smoothed trimmed means core increased from 0.42% in August to 0.41% in September, while on a twelve-month basis, it increased from 4.91% to 5.15%. The smoothed trimmed mean core inflation reached 0.43% in September, up from 0.36% in August, reaching 4.94% over the last twelve months, compared to 4.85% in the previous period.

30. IGP-DI increased 0.36% in September, after a 0.38% decrease in August, reaching 11.90% over the last twelve months. Within the index components, only IPA accelerated, with a 0.44% increase in comparison to a 0.80% decrease in August, reaching a 14.33% increase over the last twelve months. IPC-Br decreased 0.09% after increasing by 0.14% in August, reaching 5.60% over the last twelve months. INCC increased 0.95% in September (1.18% in August) and 11.88% in the last twelve months.

31. The milder variation of IPC-Br in September reflected the persistent decrease in the prices of food and beverages and deceleration in the prices of the remaining components of the index, except for clothing. IPC-Br core increased 0.22% in September, down from 0.30% in August, reaching a 3.71% increase over the last twelve months.

32. The September IPA result reflected the less sharpen fall in agricultural prices, while industrial prices showed deceleration. Agricultural-IPA decreased 0.46% in September, in comparison to a 5.09% decrease in August, reaching 15.84% over the last twelve months. Industrial-IPA grew 0.77%, down from 0.86% in the previous month, reaching 13.78% over the last twelve months. By stages of processing, IPA decelerated regarding the prices of intermediate goods prices, increasing 0.95% in September, down from 1.35% in August, while the prices of final goods decreased 0,29%, after a 0.07% slight increase in the previous month. The prices of raw material increased 0.51%, reverting the August result (-4.84%). In the last twelve months IPA by stages of processing registered 17.41%, 8.13% and 17.89% growth, respectively.

33. Partial indexes on October inflation show acceleration relative to September results for both wholesale and consumer price inflation. IPCA-15 grew 0.30%, reflecting the hike on clothing and the reversal in the fall of food and beverages prices. As for wholesale, according to IGP-M results for the second ten-day period of October, agricultural and industrial prices indicate stronger growth than on the previous month.

Economic activity

34. According to seasonally adjusted data from the IBGE's monthly survey (PMC), expanded retail sales, which include construction material and vehicles and motorcycles, parts and pieces, decreased 1.6% in August, month-on-month. Despite the retreat in the expanded index, six out of the ten segments surveyed by the IBGE increased, with highlights to the 3.2% elevation in the sales of office materials and equipment. The sales of vehicles, motorcycles, parts and pieces decreased 3.7% in the month.

35. Comparing equivalent periods of 2008 and 2007, sales grew 7% in August and 13.5% in 2008, considering the expanded retail sales. According to these two comparison basis, there was generalized growth in all segments, with highlights for office material and equipment; other personal and domestic outlays; and furniture and home appliances. Vehicles, motorcycles, parts and pieces strongly decelerated in August, growing by 2.9% year-over-year, despite the strong growth observed in the year (19.8%).

36. According to São Paulo Trade Association (ACSP) data, related to the city of São Paulo and seasonally adjusted by the BCB, database consultations for credit sales (SCPC) increased 3.7% in September, month-on-month, while consultations to the Usecheque system decreased by 0.2%, according to the same comparison basis. In the year through September, these indicators increased 8.3% and 5.6%, respectively, compared to the same period of 2007.

37. Regarding investment indicators, domestic production of capital goods and construction typical inputs remained relatively stable month-on-month in August, seasonally adjusted, while on a year-over-year basis, these indicators grew 12.1% and 9.4%, respectively. In the year through August, compared to the same period of 2007, the production of capital goods grew 18.1%, while the production of construction typical inputs grew 10.5%.

38. Capital goods imports increased 3.7% in September month-on-month. The quantum capital goods imports grew 19.7% month-on-month, according to data from Fundação Centro de Estudos do Comércio Exterior (Funcex), seasonally adjusted by the BCB. The September indicator expanded by 41.3%, year-over-year, higher than the twelve-month growth result (39%) and 2008 through September result (40%), reflecting the recent dynamism of capital goods imports and its contribution to the current cycle of investments in the Brazilian economy.

39. CNI indicators show a stable industrial activity pace in August, with a 0.6% increase in hours worked in industrial production, in contrast with a 0.7% reduction in installed capacity utilization, considering seasonally adjusted data. The strong fall (6.8%) in month-on-month seasonally adjusted real revenues in August came after increase over the two previous months, resulting in 4% growth in the quarter ended in August, quarter-on-quarter. In comparison to the same periods in 2007, real revenues grew 0.8% in August and 8.2% in the year through August, while hours worked in industrial production increased 3% and 5.7%, according to the same comparison basis. Installed capacity utilization (Nuci) reached 83.1% in August, 0.6 p.p. below the July level, considering seasonally adjusted data.

40. According to IBGE's Monthly Industrial Survey (PIM), industrial production decreased 1.3% in August month-on-month, seasonally adjusted. Fifteen out of the twenty-seven activities surveyed recorded production decrease in the month, with highlights to the negative performance in the production of chemical products (-5.5%), oil refine and ethanol production (-4.1%), influenced by the technical interruption in one of the refineries. It is also noteworthy the decline in the production of food products (-3.1%). Considering to the use categories in the seasonally adjusted series, the unfavorable industrial performance reflected mainly the retraction in intermediate goods production (2.7%), comparing to July, the sharpest fall since October 2001. Durable goods production expanded by 2.1%, while the production of semi- and non-durable consumer goods registered a slight retreat of 0.3%.

41. Comparing to August 2007, industrial production increased 2%, a percentage significantly lower than the ones observed in the previous months. Except for

the production of semi- and non-durable consumer goods, which registered a 1.1% retreat due to pressures stemming from the food and beverages sector elaborated for household consumption, all categories showed expansion, with highlights to the production of capital goods, which increased 12.1%. By segments, twelve sectors registered growth, with remarkable increases in vehicles (9.9%), pharmaceuticals (16.3%) and mining (8.6%). In the year through August, the increase in industrial production reached 6%, with highlights to the expansion in both capital goods and durable consumer goods: 18.1% and 11.8%, respectively. In the same period, the growth in the production of intermediate goods and of semi- and non-durable consumer goods reached 5% and 1.7%, respectively. The twelve-month increase in industrial activity totaled 6.8% in July and 6.5% in August, indicating a deceleration at the margin.

42. Vehicles production reached 298.4 thousand units in September, according to Anfavea, increasing 18.2% year-over-year. Considering seasonally adjusted data, the production of vehicles fell 1.5% in September month-on-month. In the year through September, the production of vehicles and agricultural machinery increased 20% and 32.6%, respectively, compared to the same period of 2007. According to the same comparison basis, domestic vehicles sales increased 26%, while vehicles exports decreased 4.6%.

43. According to the LSPA survey carried out by the IBGE in September, the planted area should grow by 4.6% in 2008, year-over-year. The grains harvest was estimated in 145.3 million tons, a 9.1% increase over 2007. This result encompasses increases of 9.2%, 13% and 3.4% in the production of rice, corn and soybean, respectively, which are responsible for 90% of total grains production. The survey also estimated a 13.7% increase in the production of sugar cane, and a 28.3% increase in the production of coffee.

Surveys and expectations

44. The Fecomercio-SP survey showed a 0.7% month-on-month decrease in the Consumer Confidence Index (ICC) in October, month-on-month, reflecting both a 1.5% retraction in the Consumer Expectations Index (IEC) and a 0.5% expansion in the Current Economic Conditions Index (Icea). The ICC grew by 3.6% year-over-year.

45. According to the FGV survey, the ICC decreased 10% in October, month-on-month, having the index reached its lowest level since June 2006. Both current situation and the expectations for 6-month ahead expectations assessments deteriorated relative to the previous month, decreasing by 12.7% in the Current Situations Index (ISA) and by 8.5% in the Expectations Index (IE). Relative to October 2007, the survey also registered decreases of 10.1%, 2.3% and 14% in the ICC, ISA, and IE, respectively.

46. Still according to the FGV, the Industry Confidence Index (ICI) stayed on high levels after reaching 120.3 points in September, compared to 123 in August. The indicator stood 2.3 p.p. below the level registered in the same month of 2007, reflecting the retractions of 3.2 p.p. in the ISA and 1.3 p.p. in the IE. Among the components related to the Current Situation, the levels of both global demand and current business situation remained high. Regarding the activity sectors, the segment of construction material was the only one that showed effective growth, 3.3% month-on-month and 8.8% year-over-year. Regarding manufacturing employment, despite being more cautious than they had been in the same period of last year, 32% of the managers projected an increase in labor force hiring in the next three months.

47. The monthly Nuci calculated by Fundação Getúlio Vargas (FGV) reached 86.4% in September, a result 0.2 p.p. lower than the August figure and 0.3 p.p. higher than the level registered in the same month of 2007. In September new records highs were registered in two categories: consumer goods, which totaled 88.1%, exceeding by 3.5 p.p. the September 2007 level; and civil construction inputs, which reached 92.1%, recording a 5.4 p.p. increase year-over-year.

Labor market

48. According to the Ministry of Labor and Employment, 282.8 thousand new formal jobs were created in September 2008, a record high for the historical series for any period, considering month-on-month, year-to-date or twelve-month periods. In

the first nine months of the year, employment reached 2,086.6 thousand new jobs. Employment level increased by 0.6% month-on-month in seasonally adjusted terms expanding in all sectors, with highlights to the 1.5% expansion in the construction sector, and the creation of 114 thousand new jobs in the manufacturing industry sector. Considering the observed series, there were increases in year-to-date terms (6.5%) and on a twelve-month basis (6.3%).

49. According to the IBGE employment survey (PME) carried out in the six main metropolitan areas of the country, the unemployment rate stayed at 7.6% of economically active population (PEA) in September recording stability relative to August. Compared to September 2007, unemployment declined 1.4 p.p. The survey also showed that the number of unemployed remained stable in the six main metropolitan regions. Year-over-year, employment grew 3.4%, while PEA increased 1.9%. Considering the number of employed by activity sectors, the total of workers in the private sector increased 0.9% in September, month-on-month, representing 112 thousand jobs, mainly reflecting the creation of 104 thousand formal jobs. The number of self-employed workers decreased 0.4%, while the number of employers increased 4.7%. Year-over-year, formal workers in the private sector led occupation growth (6% increase), the number of employers and informal workers increased 0.2% and 3.2%, respectively, while the number of self-employed workers decreased by 0.1%. Still in year-over-year terms, the number of employed workers in the public sector increased 5.1%.

50. The same survey showed that average real earnings of occupied workers increased 0.9% in September, month-on-month, and 6.4% year-over-year. Real payrolls increased 1.7% in September, month-on-month, and 10% year-over-year.

51. According to CNI data seasonally adjusted by the BCB, employment in manufacturing industry was stable in August, after increasing 0.6% in July, resulting in a 1.1% increase in the quarter ended in August, quarter-on-quarter. Year-over-year, employment in the manufacturing industry and industrial real payroll increased 4% and 3.6%, respectively, in August. In the first eight months of 2008, the same indicators increased by 4.4% and 5.1%, respectively, year-over-year.

Credit and delinquency rates

52. Outstanding credit in the financial system reached R$1,149 billion in September, setting a new volume-to-GDP ratio record high, 39.1%. Credit operations in the financial system expanded by 3.5% in September, totaling 34% expansion on a twelve-month trailing basis. According to the same comparison bases, non-earmarked credit operations increased 3.5% and 37.1%, respectively, while earmarked credit operations elevated 3.4% and 26.6%, respectively. Among the non-earmarked operations, leasing operations remained strong, with expansions of 148.5% and 61.9% for credit to individuals and to corporate, respectively, in the last twelve months. Regarding earmarked credit, it bears highlighting the 34.4% and 27.4% increases in operations related to housing and the agricultural sector, respectively, according to the same comparison basis. Considering other sectors, loans to industry increased 5.4% month-on-month in September and 40.1% in twelve months.

53. The average interest rate on non-earmarked credit operations, used as reference for interest rates, reached 40.4% p.a. in September, up from 40.1% p.a. in August and 35.5% p.a. in September 2007. The average rate on credit for individuals increased 1 p.p. in September, reaching 53.1% p.a., while the average rate on corporate credit was stable in September, at 28.3% p.a., In September 2007, the average rate on credit to individuals and credit to corporate stood at 46.3% p.a. and 23.1% p.a., respectively.

54. The average tenure on non-earmarked credit operations, used as reference for interest rates for individuals reached 378 days in September, compared to 372 days in August and 341 days in September 2007. The average tenure of corporate credit operations reached 303 days, while the average tenure for credit operations to individuals totaled 480 days, compared to 269 days and 420 days, respectively, in September 2007.

55. Delinquency rates in the financial system (non-earmarked loans, used as reference for interest

rates, in arrears for more than ninety days) stood at 4% in September, a 0.6 p.p. decrease year-over-year. Delinquency rates for credit operations with corporate and individuals reached 1.6% and 7.3%, respectively, compared to 2.3% and 7.1% in September 2007.

56. Net delinquency rate for retail credit, measured by the ACSP, reached 5.9% in September, up from 5.2% in the same month of 2007. In the year trough September, the average delinquency rate stood at 6.8%, up from 6.2% in the same month of the previous year.

External environment

57. After Lehman Brothers declared insolvent, instability increased in the international financial markets, once risk aversion and lack of liquidity affected more decisively real economy funding, mainly in the US. The financial crisis assumed more generalized aspect world wide, spreading geographically. Credit channels were obstructed by uncertainty and liquidity and solvency problems that emerged subsequently. In addition to that, the exchange rate depreciation movement, simultaneous in various economies, found international trade in contraction, or, in the best hypothesis, in a situation of important deceleration.

58. Due to the deterioration of the international financial crisis and the widening of global recession risk, governments and central banks of developed economies committed themselves to an aggressive movement in defense of the soundness of their respective financial systems. In this sense, they increased the deposits guarantees, expanding the government guarantees on interbank operations and committed to support all the banks considered systemically important, even encompassing capitalization. Moreover, central banks increased their actuation through liquidity operations (wider acceptance of collaterals, larger volume in interventions and extended tenures to pay the loans).

59. The adoption of stability and financial system soundness plans started with the approval of the US Troubled Asset Relief Program (TARP), instrument that allowed the treasury to buy up to US$700 billion of bad assets of financial institutions, in an effort to recapitalize the sector, minimize the concerns regarding the system viability and foster the recovery of its lending function.

60. In Europe, rescue plans aiming to recapitalize banks and defreeze the credit market are being approved. It is important to highlight that the resources will be provided from each respective country's budget and there isn't forecast of creation of any single fund. Regarding single measures, only uniformed intervention rules were adopted, which intend to avoid distortions in the regional banking market.

61. Recent data point to the reduction of inflationary pressures in the global economy. With the substantial fall in the prices of oil and agricultural commodities, and the increase of unemployment, the inflationary process already records turning points in the majority of mature economies. In the US, this behavior is intensified by the dollar appreciation. In UK, inflation is still pressured by the prices of food and services, and in Norway, expectations point to inflationary peek in September, as well as in Australia and New Zealand (3rd quarter). In China, despite the increase in domestic energy prices, inflation cooling is confirmed.

Foreign trade and international reserves

62. Brazilian trade surplus reached US$2.8 billion in September, totaling surpluses of US$19.6 billion in the year and US$28.7 billion in the last twelve months. In the year through September, exports reached US$150.9 billion, and imports, US$131.2 billion, growing by 29.4% and 53.2%, respectively, year-over-year. Total external trade recorded a US$282.1 billion in the first nine months of 2008, totaling US$361.1 billion in twelve months.

63. In September, exports totaled US$20 billion, reaching a US$909.9 million daily average, a 22% growth year-over-year. Imports totaled US$17.3 billion in the month, with a US$784.7 million daily average, a 39.5% increase year-over-year.

64. International reserves totaled US$207.5 billion in September, with increases of US$2.4 billion in the month and US$27.2 billion relative to the end of 2007.

Money market and open market operations

65. In the period between the September and the October Copom meetings, the future yield curve shifted sharply upwards, with increase in the slope. The period was characterized by high volatility and increased risk aversion in the international markets, as a result of the development of the financial crises in the US and in Europe and of the fear of global economy deceleration. The risk aversion boosted the generalized reduction of the leveraged positions in several markets, generating high losses in the international stock exchanges and the dollar appreciation. Under this scenario, the future interest rate in domestic markets recorded sharp increase, intensified by the BRL depreciation against the dollar. At the end of the period, the central bank operations in the FX market and the selling/ purchase auctions of fixed-income securities carried out by the Treasury contributed to smooth this movement. Between September 8 and October 27, one-, three-, and six-month rates increased by 47 bps, 38 bps and 72 bps, respectively. Moreover, one-, two- and three-year rates increased by 146 bps, 268 bps, and 359 bps, respectively. Real interest rates, measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month ahead inflation expectations, increased to 10.33% on October 27, up from 8.96% on September 8.

66. On September 29, the BCB carried out reverse FX swap auction, with the rollover of the redemption of October 1. This operation amounted US$0.5 billion, or 26% of the total redemptions. From October 6, the BCB offered traditional FX swap auctions on a daily basis, in which assumes a long position in domestic interest rate and a short position in FX. In the month through October 27, these operations totaled US$19.1 billion.

67. In its open market operations, the BCB carried out, from September 9 to October 27, weekly five- and seven-month fixed rate repo operations, borrowing. The average daily balance of these operations reached R$57.9 billion, of which R$40.3 billion were seven-month operations. In the same period, the BCB conducted 36 overnight repo operations, borrowing. The BCB also conducted daily, at the end of day, one- and two-working-day-tenure liquidity management operations. Operations with tenors less than thirty days, including daily liquidity management operations, averaged R$60.5 billion, on a daily basis, borrowing. In addition, on September 11, 15, 22 and 29, and on October 1 and 6, the BCB conducted borrowing operations with tenures from 10 to 28 working days, totaling R$20.0 billion, R$7.0 billion, R$5.7 billion, R$4.7 billion, R$2.7 billion, R$38.9 billion and R$2.2 billion, respectively. Moreover, the BCB also conducted, on September 11, a borrowing operation with tenure of 35 working days amounting R$127.3 billion. These operations averaged R$172.0 billion, on a daily basis.

68. Between September 9 and October 27, the National Treasury raised a total of R$12.2 billion, of which R$7.5 billion in fixed-rate securities: R$5.9 billion via issuance of LTNs maturing in 2009, 2010 and 2011, and R$1.6 billion in NTN-Fs maturing in 2012 and 2017. Issuance of LFTs totaled R$2.8 billion, for securities maturing in 2012 and 2014. Issuance of inflation-linked NTN-Bs reached R$1.9 billion, for securities maturing in 2011, 2013, 2017, 2024, 2035 and 2045.

69. In the same period, the Treasury conducted auctions to sell LTNs maturing in July and October 2009 and bought LTNs maturing in October 2008 and January 2009, totaling R$2.1 billion. Issuance of inflation-linked NTN-Bs for securities maturing in 2011, 2013, 2017, 2024, 2035 and 2045, settled in other National Treasury securities, totaled R$2.1 billion. The Treasury also conducted purchase auctions of LTNs and NTN-Bs totaling R$1.0 billion and R$0.1 billion, respectively.

70. On October 23, 24 and 27, the Treasury conducted simultaneous purchase/ selling auctions of NTN-F maturing in 2012, 2014 and 2017. The purchase totaled R$1.6 billion, while the selling amounted R$0.1 billion.

Minutes of the 139th Meeting of the Monetary Policy Committee (Copom)

Date: December 9th, from 4:35PM to 6:40PM, and December 10th, from 5:10PM to 9:15PM
Place: BCB Headquarters meeting rooms – 8th floor on December 9th and 20th floor on December 10th – Brasília – DF

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

Department Heads (present on December 9th)
Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on December 10th)
João Henrique de Paula Freitas Simão – Open Market Operations Department
José Antônio Marciano – Department of Banking Operations and Payments System
Márcio Barreira de Ayrosa Moreira – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations Group

Other participants (present on December 9th)
Alexandre Pinheiro de Moraes Rego – Press Secretary
Alexandre Pundek Rocha – Advisor to the Board
Eduardo José Araújo Lima – Advisor to the Research Department
Flávio Pinheiro de Melo – Advisor to the Board
Katherine Hennings – Advisor to the Board
Sergio Almeida de Souza Lima – Executive Secretary

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

Recent economic developments

1. IPCA inflation changed from 0.26% in September to 0.45% in October and 0.36% in November. As a consequence, inflation reached 5.61% in the first eleven months of 2008 – the highest change in the period since 2004 – up from 3.69% in the same period of 2007. Twelve-month trailing inflation changed from 6.25% in September to 6.41% in October and 6.39% in November (4.19% in November 2007). Under this comparison basis, the acceleration of consumer price inflation mirrors the behavior of both regulated prices and market prices. Indeed, market prices and regulated prices increased 7.80% and 3.16%, respectively, in the twelve months through November, up from 5.03% and 2.31% in the twelve months through November 2007. Moreover, both prices of tradable goods and non-tradable goods accelerated, reaching 7.87% and 7.74% in twelve months, respectively (compared to 4.13 and 5.88% in November 2007). The price of services, whose dynamics tends to show more persistence than the prices of goods, increased 6.48% in the twelve months through November 2008, up from 6.36% in October, 6.27% in September and 4.89% in November 2007, an evolution that reflects the influence of domestic factors over the inflationary dynamics. Preliminary data for December point to consumer inflation index above that observed in November. In short, the reversal of the divergence trend of inflation from the targets path, which had been observed since the end of 2007, hasn't consolidated yet, although the risk of an even higher deterioration of the inflationary dynamics has been reducing.

2. The three main underlying inflation measures calculated by the BCB have reduced in the margin, in the last months. The core inflation by exclusion of household food items and regulated prices and the smoothed and non-smoothed trimmed means core

inflation measures decreased from 0.62%, 0.45% and 0.41% in September, to 0.51%, 0.37% and 0.32% in October, and to 0.36, 0.35% and 0.28% in November, respectively. Similarly to the headline inflation, the three core inflation measures accelerated remarkably in the first eleven months of the year, compared to the same period of 2007, with increases from 3.50%, 3.62% and 3.16% to 5.74%, 4.48% and 4.57% for the core inflation by exclusion, smoothed and non-smoothed trimmed means core inflation, respectively. On a twelve-month trailing basis, the core inflation by exclusion of household food items and regulated prices rose from 6.26% in September to 6.38% in October and reduced to 6.36% in November. The smoothed and non-smoothed trimmed means core inflation slightly reduced, under this criterion, in the last months. The smoothed trimmed means core inflation changed from 4.97% in September to 4.91% in October and 4.90% in November, whereas the non-smoothed trimmed means core inflation fell from 5.15% in September to 5.11% in October and 5.04% in November. Despite the reduction observed in November, all core inflation measures remain above the central value for the inflation target. Moreover, it bears emphasizing that the behavior of the IPCA diffusion index, whose average in the year through November is the highest recorded since 2004, showed substantial increase in November, and continues to point to an inflationary process relatively disseminated, confirming the analysis present in previous Copom Minutes.

3. The General Price Index (IGP-DI) inflation changed from 1.09% in October to 0.07% in November. On a twelve-month trailing basis, IGP-DI inflation decreased to 11.20% in November, from 12.29% in October, compared to 6.60% in November 2007. In the twelve months through November, the IGP-DI increase reflected the behavior of its three main components. The Consumer Price Index-Brazil (IPC-Br) increased 6.27% (4.53% in November 2007), while the Wholesale Price Index (IPA-DI) totaled 12.88% (7.51% in November 2007). According to the same comparison basis, the Civil Construction National Index (INCC) increased 12.34% (5.92% in November 2007). Regarding IPA-DI, the inflationary acceleration, under this comparison basis, derives basically from the behavior of industrial prices. The agricultural IPA changed 7.38% (18.92% in November 2007), while the elevation of wholesale industrial prices reached 14.93% (3.76% in November 2007). In fact, despite the cooling in November, wholesale industrial prices increased 13.80% in the first eleven months of the year, up from 3.39% in the same period of 2007. 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 IBGE released data for 2008 third quarter GDP. Data still show robust growth rates, both for accumulated results in the year (6.4% up from 6.2% in the previous quarter), and for year-over-year results (6.8% as against 6.2% in the previous quarter). On the aggregate demand side, gross fixed capital formation continued to post strong figures, growing by 19.7% in the third quarter of 2008, year-over-year. Household consumption grew by 7.3%, according to the same comparison basis, influenced by the expansions of credit and real payroll. The contribution of domestic absorption to GDP growth reached 9.3 p.p., overweighing the 2.5 p.p. negative impact stemming from the external sector. On the aggregate supply side, it bears emphasizing the increase in industrial production (7.1%), followed by the agricultural sector (6.4% growth) and by the services sector (5.9%), on a year-over-year basis. Regarding industrial activity, it bears highlighting the civil construction industry (11.7% expansion), benefited by public works and by the increase in credit to housing. The GDP deflator at market prices increased from 6.1% in the second quarter of the year, year-over-year, to 6.8% in the third quarter.

5. On a three-month moving average basis, according to data seasonally adjusted by the IBGE, industrial output decreased 0.6% in October, after growing by 0.5% in the previous month. Still considering the seasonally adjusted series, after the 1.5% expansion observed in September, industrial output retreated by 1.7% in October, month-on-month, partially reflecting the programmed interruption in the petrochemical industry. Moreover, it bears noticing that general industrial output grew 5.8% in the year through October, with respective increases of 5.7% and 7.4% in manufacturing and in

mining output. On a year-over-year basis, industrial output expanded by 0.8% in October (with one more working day), with respective growths of 7.2% and 0.4% in mining and manufacturing industries, respectively. The data already released for the last months point, in short, to the interruption of the industrial production expansion cycle, mainly due to the deterioration of global economic prospects and its effects over the Brazilian economy.

6. Among the use categories, according to data seasonally adjusted by the IBGE, the production of capital goods decreased by 0.5% in October. Regarding the other use categories, intermediate goods production decreased 3.0%, semi-durable consumer goods production retreated by 2.2%, while the production of durable goods production reduced by 4.7%. In the year, capital goods production leads the expansion, with an 18.4% increase, followed by the 10.5% elevation in durable consumer goods production. The recent slowdown in capital goods production has been reflecting the intensification of the international financial turmoil and its consequences over business confidence. On its turn, the cooling in the pace of expansion of durable goods production reflects, predominantly, tighter credit conditions and the deterioration of consumer expectations.

7. Labor market continues to present favorable performance, but with signs of accommodation in the generation of formal employment. The unemployment rate in the six metropolitan regions covered by the Monthly Labor Survey (PME) retreated from 7.6% in August and September, to 7.5% in October, down from 8.7% in October 2007. The October monthly result is the second lowest rate for the series, above only December last year, which stood at 7.4%. As a result, the average unemployment rate in the first ten months of the year was 1.6 p.p. below that observed in the same period of 2007. According to data seasonally adjusted by the BCB, the unemployment rate stood at 7.6%, the same rate recorded in September, at a historically low level. Nominal average earnings increased 12.0% in October, year-over-year, decelerating from the 13.7% rate observed in September, but maintained a robust pace. In October, average real earnings fell 1.3% month-on-month (4.5% expansion relative to October 2007). In the first ten months of the year, average real earnings increased 3.3%, while the number of occupied workers grew 3.9%. As a consequence, real payroll increased 7.4% (8.6% expansion in October, in year-over-year terms), continuing to constitute a key driver for domestic demand growth. According to the National Industry Confederation (CNI) data seasonally adjusted by the BCB, manufacturing employment increased by 0.1% in October (compared to 0.7% in September and 0.1% in August). In year-over-year terms, employment grew 3.9%, totaling 4.3% growth in the last twelve months. According to data seasonally adjusted by the IBGE, manufacturing employment increased by 0.1% in September (compared to a 0.1% fall in August and a 0.7% increase in July), totaling increases of 2.9% in the last twelve months and 2.2% year-over-year. Still regarding employment, data from the Ministry of Labor and Employment (MTE) indicate loss of dynamism in the generation of formal employment in the margin, with the creation of 61.4 thousand jobs (compared to 282.8 thousand jobs in September this year and 205.3 thousand jobs in October 2007), as a result of the probable reassessment of businessmen regarding the effects of worsening of global difficulties. However, in the first ten months of the year, employment reached 2,148.0 thousand hires, 18.5% above the same period of the previous year, an evidence of the robust demand for work in the period. Formal employment grew by 0.2% in October, seasonally adjusted, and observed data point to a 6.4% expansion in the last twelve months. The retail sector recorded the highest hiring rate in October, with the creation of 54.6 thousand new jobs, followed by the services sector (36.1 thousand new jobs), by the manufacturing industry (8.7 thousand new jobs) and by civil construction (2.1 thousand new jobs). On the other hand, the agricultural sector, due to seasonal factors related to the inter-harvest observed in the Middle-Southern part of the country, was the only sector recording employment retreat (extinction of 38.4 thousand jobs).

8. According to data seasonally adjusted by the IBGE, expanded retail sales increased by 4.0% in September, after decreasing 1.3% in August, and grew by 15.9% year-over-year in September and 13.8% in 2008 through September. Expanded retail sales three-month moving average increased 1.0% in September, month-on-month seasonally adjusted,

after increasing by 0.1% in August and 0.9% in July. According to seasonally adjusted data, on a month-on-month basis, it bears emphasizing the expansion in the sales of "office material and equipment" (6.9%), followed by "vehicles and motorcycles, part and pieces" (5.5%) and "furniture and domestic appliances" (3.1%). In the year through September, cumulative growth was more significant in "office material and equipment" (33.7%), "vehicles and motorcycles, part and pieces" (20.7%) and "other personal and domestic articles" (20.3%). In October and November, expanded retail sales data should evidence the effects of credit supply restrictions and the deterioration of consumer confidence over vehicle sales, already captured by the data from the National Federation of Distribution of Automotive Vehicles – Fenabrave for these months. The steady growth of retail sales had been reflecting, in short, the performance of both the sectors more sensitive to income and employment expansions and those more sensitive to credit conditions. For the next quarters, the retail sales trajectory will continue to be favored by fiscal transfers, as well as by employment and income growth, but it will also be affected, in case of persistence, by the changes in the access to credit supply, and by the deterioration of consumer confidence.

9. The installed capacity utilization rate (Nuci) in the manufacturing industry reached 83.2% in October, slightly above the level observed in September, according to CNI data seasonally adjusted by the BCB. According to data seasonally adjusted by CNI, the Nuci in the manufacturing industry showed reduction, reaching 82.9% in October, down from 83.4% in September. Without the seasonal adjustment, the Nuci stood 0.1 p.p. above the level registered in October 2007, a record high for the series. As a consequence, the average rate in the first ten months of 2008 was 0.9 p.p. above the level observed in the same period of 2007. The monthly Nuci calculated by Fundação Getúlio Vargas (FGV) reached 85.2% in November, standing 2.0 p.p. below the level registered in the same month of 2007. The reduction in the Nuci in November 2008, year-over-year, is also observed in the production of consumer goods (-1.2 p.p.) and of intermediate goods (-2.7 p.p.). For the capital goods sector, the Nuci showed stability compared to the level observed in November 2007 while for the production of civil construction inputs the Nuci presented a 1.9 p.p. increase. The reduction on Nuci calculated by FGV seems to be a result of a combination between investment projects maturity with softening on economic activity, which should point to a start of less pressure over the idle capacity level. Recent data about the absorption of capital goods still show a strong expansion compared to the same periods of 2007. The absorption of capital goods decreased 1.0% in October, according to seasonally adjusted data, accumulating a 22.7% expansion in 2008, in observed terms, compared to 3.9% and 22.2% in September, respectively, according to the same comparison bases. On the other hand, the production of civil construction inputs showed stability at the margin in October, after decreasing by 1.5% in September, accumulating a 10.5% growth in 2008 (10.9% growth in 2008 through September). Although not widespread, evidences so far suggest to an ongoing process of reduction in the mismatches regarding the evolution of supply and domestic demand. As stressed in previous Copom Minutes, the inflation trajectory is closely linked to current and prospective developments related to the expansion of supply of goods and services, to adequately meet demand conditions.

10. The trade balance continues to register deceleration at the margin, an already anticipated trend, and which is in line with assessments present in previous Inflation Reports and Copom Minutes. In the last twelve months through November the trade surplus reached US$26.1 billion (37% below November 2007). In the same period, exports and imports totaled US$198.4 billion and US$172.3 billion, equivalent to 25.0% and 46.9% growth, respectively, year-over-year. The reversal on the strengthening trend of the BRL and the softening on the pace of expansion of domestic demand may contribute to a recover on the trade surplus, notwithstanding the reduction on price levels of exports acting on the opposite direction. The decrease in trade surplus contributed to the US$26.6 billion current account deficit registered in the twelve months through October 2008, equivalent to 1.7% of GDP. Foreign direct investment reached US$38.2 billion in the twelve months through October, equivalent to 2.5% of GDP.

11. The period since the last Copom meeting was marked by the continuity of stress on international financial markets, which originated in the US and Europe, but whose impact on emerging economies has become more significant. The increased risk aversion, observed since mid-September, after the bankruptcy of an important US financial institution, led the authorities in the US, Europe and Oceania to intervene in an unprecedentedly way in their financial systems, using wide range of instruments, in order to ensure minimum conditions of operation and liquidity in money markets. Although systemic risk perception has showed moderation, pressures on the functioning of the interbank markets came back resulting from the nearness of the end of the year and the closing of the balance sheets of financial institutions. The international liquidity contraction has been contributing to a deleverage process by asset managers, which in turn has been pressuring down the prices of financial assets. In an environment of increased risk aversion and shortage of capital flows, pressures on emerging economies' currencies have been kept.

12. Regarding the global macroeconomic scenario, at least in the short term the contraction trends prevail over the inflationary pressures. The dominant view still points to the expansion, at a modest pace, of global economic activity in 2009, but data released in the last weeks indicate a more intense and generalized cooling of activity in mature economies and also in some emerging economies. There are evidences that the deeper weakening of economic activity in Europe and parts of Asia was predominantly due to the negative shock in the terms of trade caused by the elevation of commodities prices, which could be reversing. On the other hand, the problems in the financial system have been aggravated by a cyclical deterioration in credit quality, which may reinforce the contraction in financial conditions and, as a consequence, the risk of intensification of deceleration. The US economy, in particular, entered into recession at the end of 2007 and still continues to suffer the impacts of the housing sector crisis, with spillover effects on the labor market, whose weakening, together with the negative wealth effect associated to the fall in the prices of financial assets, has affected the consumers' confidence, significantly contributing for depressing expenditure. The prevailing interpretation is that the activity in Europe and Japan may continue to lose dynamism in the next months. In mature economies, where inflation expectations are better anchored and economic activity is decelerating considerably, inflationary pressures have reduced fast. On the other hand, in emerging economies, where the secondary effects of raw materials price increases over consumer prices and the heated demand pressures over the supply expansion capacity had been more intense, the inflationary pressures have been more persistent. In this context, the monetary policy stance is mainly expansionist in mature economies, whereas in emerging economies, which have been affected by the exchange rate depreciation trend, in addition to the facts already mentioned, the reaction seems to be more heterogeneous. It is worth pointing that, particularly in mature economies, the authorities are announcing a series of initiatives aimed at sustaining the economic activity, particularly through fiscal incentives, which could contribute to a gradual economic recovery.

13. Oil prices remain highly volatile, but reduced considerably since the last Copom meeting. Future markets have followed, in general, the prices of oil in the spot market. However, uncertainty concerning oil prices is remarkably high, as the prospective scenario depends on the evolution of demand, especially in emerging countries, on the supply's reaction to stimuli derived from previous changes on relative prices, in addition to geopolitical issues that affect the price of this commodity. Nonetheless, despite the great uncertainty inherent to the projections of oil prices' trajectory, the main scenario adopted by the Copom, which assumes unchanged gasoline prices in 2008, remains plausible but with the persistence of the current framework of the oil market, it does not seem prudent to completely disregard the hypothesis that price reductions for oil can occur in 2009. However, it bears highlighting that, regardless of the behavior of domestic gasoline prices, the reduction of international oil prices can affect domestic prices both through productive chains, such as the petrochemical, as well as through the potential effect over inflation expectations. The prices of other commodities also showed important reductions since the last Copom

meeting, reacting both to the greater pessimism about the prospects for global economic growth and to the continuity of the global financial markets turmoil.

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:

a) compared to the values considered in the October Copom meeting, the projected adjustment for 2008 for gasoline prices was maintained at 0%, whereas for bottled gas price was revised to 2.6%;

b) compared to the values considered in the October Copom meeting, the projected adjustment for 2008 for fixed telephone price was revised to 3.6% from 3.5%, while for electricity prices was maintained unchanged at 1.1%;

c) the projection for regulated prices inflation in 2008, based on individual items, was altered to 3.5%, down from the 3.8% considered in the October meeting. This set of prices, according to data released by the IGBE, corresponded to 29.62% of the total November IPCA;

d) the projection for regulated prices inflation in 2009 was maintained unchanged at 5.5%. This projection is based on the endogenous determination model for regulated prices, which computes seasonal components, foreign exchange rate changes, market prices inflation and the IGP (General Price Index) variation;

e) the projection for the spreads over the Selic rate, on the benchmark scenario, based on the 360-day swap rates, estimates a 180 bps spread in the fourth quarter of 2008 and 102 bps in the last quarter of 2009. The identified shocks and their impacts were reassessed according to newly available information.

15. Regarding fiscal policy, the projections assume the achievement of the public sector primary surplus target of 3.8% of GDP in 2008 and 2009, increased by 0.5 p.p. The related assumptions considered in the previous meeting were maintained.

16. Since the last Copom meeting, according to the median IPCA inflation expectations compiled by the BCB's Investor Relations Group (Gerin), the 2008 IPCA variation showed reduction to 6.20% from 6.29%. Twelve-month ahead inflation expectations increased slightly to 5.34%, from 5.29%, considering the medians of expected monthly rates. Inflation expectations for 2009 increased to 5.20%, from 5.00%.

17. Considering the hypotheses under the benchmark scenario – which assumes the maintenance of the exchange rate at R$2,40/US$1.00 and the Selic rate at 13.75% during the forecast period – the projection for the 2008 IPCA inflation slightly decreased relative to the figure considered in the October Copom meeting, but remained above the 4.5% target established by the National Monetary Council (CMN). According to the forecast based on the market scenario – which incorporates the consensus exchange and Selic rates trajectories collected by Gerin on the eve of the Copom meeting – IPCA inflation forecast for 2008 also decreased compared to the figure considered in the previous Copom meeting, but remained, therefore, above the central target for the year. Regarding 2009, both projections based on the benchmark scenario and on the market scenario showed a decrease, in relation to the figures forecast in the previous Copom meeting, but are above the 4.5% central target for that year (benchmark scenario) and around this value (market scenario).

Monetary policy decision

18. The Copom evaluates that the monetary policy should contribute for the consolidation of a favorable long-term macroeconomic environment. Economic activity data indicate that the pace of domestic demand expansion continued quite robust until the third quarter, and it is at least partially responsible for the inflationary acceleration trend, despite strong imports growth and the favorable investment performance in line with assessments present in previous Copom Minutes. Additionally, the increase in risk aversion and the unprecedentedly constraints observed in liquidity conditions in the international markets impose adjustments in the balance of payments which, despite the increase in Brazilian economy external resilience, can increase the inflationary

pressures, especially in the short run. In general terms, the influence of the external scenario on the future trajectory of Brazilian inflation continues to be subject to contradictory effects, which can act with distinct intensity throughout time and surrounded by significant uncertainties. On the one hand, more generalized deceleration of global economic activity in the upcoming quarters points to a cooling of both commodities prices and external demand, therefore influencing negatively the local financial conditions. On the other hand, the economic cooling has caused an increase in risk aversion, impacting the demand for Brazilian assets, and consequently, depreciating their prices. Moreover, the recent trajectory of price indices evidences the reduction of inflationary external pressures, especially in mature economies, but also in emerging economies, with important implications on domestic inflationary trajectory. The Committee evaluates that the risk of materialization of a less benign scenario retreated when compared to the risk prevailing months ago, but is still relevant. The Copom emphasizes that the main challenge of monetary policy in this context is to guarantee the maintenance of favorable results achieved in the last years. Particularly, monetary policy should act to avoid that the deterioration of inflation dynamics observed in 2008 become persistent.

19. The Copom evaluates that the probability that initially localized inflationary pressures may cause risks to domestic inflation trajectory could be lowering. The evidences of cooling of domestic demand, and more incipient, of accommodation of pressures on the market of factors, despite under uncertainty, may mitigate the pass- through of wholesale prices pressures to consumer price inflation. The Committee evaluates that the materialization of this pass-through and the generalization of pressures initially localized on consumer prices depend critically on inflation expectations, which still remain in levels above the inflation targets path and continue to be carefully monitored. Additionally, it is worth pointing that, according to recent data and the indicators available so far, the heating of domestic demand was still pressuring the prices of non-tradable items, as services. In this context, the Copom will act to ensure that the gains obtained in inflation control in recent years become permanent.

20. The maintenance of inflation rates in line with the targets path and the consequent consolidation of a long-term stable macroeconomic environment will contribute for the progressive reduction of macroeconomic risk perception. The Copom evaluates that the persistence of a cautious and timely monetary policy stance is essential to increase the probability that inflation in Brazil evolve once again according to the targets path in 2009. For this higher probability to continue to materialize, however, it is necessary that forward-looking inflation indicators, particularly the expected dynamics of aggregate supply and demand, converge throughout the relevant period for the monetary policy.

21. The Copom emphasizes, once again, that there are important time lags between the implementation of monetary policy and its effects on economic activity and inflation. Therefore, the evaluation of alternative options for monetary policy should necessarily focus on the forward-looking inflation scenario and its risks, instead of current inflation indices. This viewpoint is even more important in periods of higher uncertainty.

22. The prospects for the evolution of economic activity deteriorated since the last Copom meeting. In particular, the effects of the international crisis on the domestic financial conditions indicate that the contribution of credit to support domestic demand may decline more intensively and, possibly, more persistently than the magnitude of what would happen exclusively by the monetary policy lagged effects. Additionally, the intensification of international crisis has caused a negative effect on consumers' and businesses' confidence. If this situation persists, the strength of economic activity would increasingly depend on real payroll expansion and the effects of governmental transfers expected for this and the next quarters. These considerations become even more relevant considering the fact that the monetary policy decisions will have concentrated impacts in 2009.

23. The Copom highlights the important contribution of investment to expand productive capacity. Moreover, it bears noticing that the accommodation of commodities prices could contribute to restrain inflationary pressures. However, the Copom

evaluates that, particularly in the short run, the main risk to the inflationary dynamics derives from the trajectory of Brazilian asset prices, in a process of decreasing external funding. If trends observed since the last Copom meeting prevail, the pace of domestic demand expansion could not present important risks to prices dynamics anymore, which would contribute to limit the inflationary impact of balance of payments adjustment. In this context, the pace of reduction of the mismatch between the growth of aggregate demand and supply of goods and services, relevant up to the third quarter, continues to be crucial to the assessment of different possibilities for the monetary policy stance.

24. International evidence, as well as the Brazilian experience, indicates that high inflation rates lead to higher risk premia, to shorter planning horizons and, consequently, to lower potential economic growth, besides having regressive effects on income distribution. Moreover, in the current circumstances, there is the risk that economic agents start to attribute higher probability to the fact that inflation acceleration become persistent, reducing the efficacy of monetary policy. On the other hand, the shortage of financing conditions in the economy amplifies monetary policy effects, contributing to promote inflation convergence to the targets path. Therefore, Copom's strategy aims to bring inflation rates in 2009 timely back to the 4.5% midpoint target established by CMN. This strategy, which will have its results evidenced throughout time, takes into account the time lags in the transmission mechanism and is the most adequate to deal with uncertainties inherent to the process of monetary policy formulation and implementation.

25. The Copom evaluates that, in light of signs, evidenced after the last meeting, of economic activity slowdown (relative among others to industrial production indicators, some data on the labor market and industrial capacity utilization rates, as well as confidence of consumers and businessmen), as well as inflation expectations behavior, risks against the materialization of a benign inflation scenario, in which IPCA would resume evolution in line with the targets path, are less influential but still relevant. Indeed, prospective scenario evolution has started to reflect on inflation projections considered by the Committee. The Copom also understands that the probability of persistence of mismatch between growth pace of aggregate supply and demand, that continues to represent risk for inflation dynamics, has diminished. Under these circumstances, monetary policy should be cautiously conducted, aiming to assure inflation convergence to the targets path.

26. The Copom believes that the consolidation of restrictive financial conditions for a longer period could significantly intensify monetary policy effects over demand and, throughout time, over inflation. Under these circumstances, the majority of the Committee members, taking into account the balance of risks for economic activity, and therefore for the inflation scenario in 2009, debated the possibility of a 25 bps reduction of the Selic rate. However, the understanding that inflation central prospective path would still justify the maintenance of the Selic rate unchanged has prevailed.

27. Other Copom members considered that the still remaining risks for inflationary dynamics, resulting from the possible persistence of inflation increases in 2008 and consequences of the adjusting process of balance of payments are still predominantly conditioning the various alternatives for monetary policy.

28. In such context, having the majority of Committee members discussed the possibility of reducing the Selic rate at this meeting, in a macroeconomic environment surrounded by severe uncertainty, the Copom unanimously decided, at this moment, to keep unchanged the Selic rate at 13.75% p.a., without bias. The Copom will closely monitor the prospective scenario evolution for inflation in order to timely define the next steps for its monetary policy strategy.

29. Under the inflation-targeting regime, the Copom guides its decisions according to the projected inflation, the analysis of several alternative scenarios for the evolution of the main variables that determine the forward-looking prices dynamics and the balance of risks associated to their projections. There are signs that domestic demand expansion rhythm, which remained expanding at high rates in the third quarter, would be currently contributing less intensely for the economic activity dynamics, in spite of persistence of

stimulus factors such as income growth influencing the economy. On the other hand, the contribution of the external sector to a favorable inflationary scenario, in light of the strong depreciation in the prices of Brazilian assets and the apparent reduction in the country's capacity to import, has become less effective. In such environment, the monetary policy should act so to bring inflation back to the targets path already in 2009, in order to avoid that the higher uncertainty detected in shorter-term horizons disseminate to longer-term periods, thus favoring a sustained recovery of economic activity. Evidently, if the risk profile changes in a way that implies shifts in the basic prospective scenario for inflation considered by the Committee in this meeting, the monetary policy stance will be promptly adjusted to the circumstances.

30. At the end of the meeting, it was announced that the Committee would reconvene on January 20th 2009, for technical presentations, and on the following day, to discuss the monetary policy decision, as established in Communiqué 17,327 of August 27th, 2008.

Summary of data analyzed by the Copom

Inflation

31. IPCA reached 0.36% in November, below market expectations and indicating inflation decrease taking into account IPCA-15 figures in November (0.49%) and October (0.45%). Market prices increased 0.44% in November, down from 0.54% in October, with increases of 0.60% for tradable and 0.28% for non-tradable goods. Regulated prices increased 0.18%, down from 0.24% in October. The diffusion index has remained above 60% since July, reaching 64.58% in November and a 62.93% average in 2008. On a twelve months trailing basis, IPCA increased 6.39% in November, down from 6.41% in October, reflecting the increase on market prices (7.80%) and regulated prices (3.16%).

32. In November, twelve month trailing basis and monthly IPCA core inflation have shown generalized deceleration for the first time since July 2007. Core excluding household food items and regulated prices increased 0.36% in November down from 0.51% in October, totaling 6.36% in the last twelve months, compared to 6.38% in the previous month. The smoothed trimmed means core decreased to 0.35% in November down from 0.37% in October, reaching 4.90% over the last twelve months, compared to 4.91% in the previous month. The non-smoothed trimmed means core decreased to 0.28% in November down from 0.32% in October, reaching 5.04% over the last twelve months, compared to 5.11% in the previous month.

33. IGP-DI increased 0.07% in November after a 1.09% increase in October, reaching 11.20% over the last twelve months, in comparison to 12.29% in October. Wholesale prices index (IPA) went down 0.17%, influenced by the fourth decrease in a row of agricultural prices (-0.64%) together with the decrease of industrial prices (-0.01%). Over the last twelve months, IPA increased 12.88%, down from 14.72% in October. IPC-Br accelerated, reaching 0.56% in November, in comparison to 0.47% in October, totaling 6.27% over the last twelve months. INCC increased 0.50% in November, down from 0.77% in October, reaching 12.34% over the last twelve months. IPC-Br core increased 0.45% (0.31% in October) reaching 3.98% over the last twelve months.

34. Among IPA components, the simultaneous fall of agricultural and industrial prices had not been registered since March 2006. Agricultural-IPA decreased 0.64%, in comparison to a 0.02% decrease in October, reaching 7.40% over the last twelve months. Industrial-IPA was stable in comparison to the 1.86% increase observed in the previous month, reaching 14.93% over the last twelve months. By stages of processing, IPA decreased in November in both final goods – from 0.93% in October to -0.15% in November – and intermediate goods – from 1.38% to -0.47%. Raw material prices increased 0.26% in comparison to 1.82% in the previous month. In the last twelve months, IPA by stages of processing registered 6.38%, 17.56% and 14.03% increases, respectively.

35. Weekly Consumer Price Index (IPC-S) variation accelerated from 0.56% over the last week of November to 0.73% over the first week of December.

Economic activity

36. According to seasonally adjusted data from IBGE's monthly survey (PMC), expanded retail sales, which include construction material and vehicles and motorcycles, parts and pieces, increased 4% in September, month-on-month. All ten segments surveyed by the IBGE increased, with highlights for the 6.9% growth of office material and equipment, and the 5.5% growth on sales of vehicles, motorcycles, parts and pieces, the latter partially resulting from the weak performance in the previous month.

37. Comparing equivalent periods of 2008 and 2007, expanded retail sales grew 15.9% in September and 13.8% in 2008. According to these two comparison basis, there was generalized growth in all segments, with highlights for office material and equipment; vehicles, motorcycles, parts and pieces; other personal and domestic outlays; and furniture and home appliances. Vehicles, motorcycles, parts and pieces presented significant growth on a year-over-year comparison (28.8%) after a weak performance in August (2.4% growth over August 2007).

38. According to São Paulo Trade Association (ACSP) data, related to the city of São Paulo and seasonally adjusted by the BCB, database consultations for credit sales (SCPC) decreased 0.3% in November month-on-month while consultations to Usecheque system expanded 2.7% according to the same comparison basis. In the year through November these indicators increased 7.3% and 4.2% respectively, compared to the same period of 2007.

39. Regarding investment indicators, domestic production of capital goods decreased 0.5% while production of construction typical inputs remained stable in October, month-on-month, seasonally adjusted. Within capital goods production, it bears highlighting the 4.9% increase for transport equipment, softening the fall in all remaining segments. Production of capital goods increased 15.7% in October, compared to October 2007, while production of construction typical inputs grew 7.7%. In the year, through October these indicators increased 18.4% and 10.5%, respectively, compared to the same period of 2007.

40. Capital goods imports declined 4.9% in October, month-on-month, according to the quantum indices of Fundação Centro de Estudos do Comércio Exterior (Funcex), seasonally adjusted by the BCB. The October indicator expanded by 41.2%, year-over-year, higher than the 2008 through October and the twelve-month growth results (40.1% and 39.5%, respectively), sustaining the recent dynamism of capital goods imports.

41. CNI indicators showed a relatively stable industrial activity pace in October, with a 0.1% increase in both employment and installed capacity utilization and a 0.5% reduction in worked hours, according to seasonally adjusted data by the BCB. Real revenues increased 0.7% compared to September, with a 0.2% growth in the quarter ended in October, quarter-on-quarter, seasonally adjusted. In comparison to the same periods in 2007, real revenues expanded 6.9% in October and 8% in the year through October, while worked hours in industrial production increased 4.9% and 6%, in the same comparison basis. Installed capacity utilization (Nuci) reached 83.2 in October, 0.04 above the level of September, in seasonally adjusted terms.

42. According to IBGE's Monthly Industrial Survey (PIM), industrial production decreased 1.7% in October, month-on-month, seasonally adjusted, after a 1.5% variation in the previous month. Durable consumer goods production, a category of use more responsive to credit conditions and consumers' confidence, was the most affected, with a 4.7% decline, partially reflecting the collective vacations in most automotive sector plants. Intermediate goods production decreased 3% in the same comparison basis, influenced by the falls of production of other chemical products (11.6%) and oil refine and ethanol production (9%), the latter partially caused by a technical interruption in one of the refineries.

43. Industrial production grew 0.8% in October compared to October 2007, an increase significantly lower than the ones observed in previous months. Eleven out of the twenty-six activities surveyed showed expansion in October in the same comparison basis, in the observed series, with highlights to the production of other transportation equipment, which increased 63%. It should also be noticed the

variations of 28.2%, 24.3% and 10.5% registered respectively in the production of pharmaceuticals, medical equipment and non-metallic minerals. In the same comparison basis, the segments with more significant declines were office machines and IT equipment (-18%), other chemical products (-15.9%) and wood (-13.3%).

44. Considering the use categories, production of intermediate goods and durable consumer goods declined 2.4% and 1.5% in comparison to October 2007, respectively, while production of capital goods and semi- and non-durable consumer goods expanded 15.7% and 0.6%, respectively. In the year through October, industrial production growth reached 5.8%, with highlights to the expansions of capital goods (18.4%) and durable consumer goods (10.5%). In the same period, the growth of production of intermediate and semi- and non-durable consumer goods reached 4.4% and 2.1%, respectively. The twelve-month increase in industrial activity totaled 6.8% in September and 5.9% in October, indicating a significant deceleration at the margin.

45. Vehicles production reached 194.9 thousand units in November, according to Anfavea, decreasing 28.2% year-over-year. Considering seasonally adjusted data, the production of vehicles fell 31% in November, month-on-month. In the year through November, production of vehicles and agricultural machinery increased by 13.2% and 31.5%, respectively, compared to the same period of 2007. According to the same comparison basis, domestic vehicles sales increased 16.9%, while vehicles exports decreased 6.4%.

46. According to the LSPA survey carried out by the IBGE in November, the increase in the grains harvest in 2008 was confirmed, with an estimated production of 145.7 million tons, a 9.4% increase over 2007. For 2009, the second estimate for the grains harvest points to a 3.8% fall in production, which should reach 140.2 million tons. One expects declines of 7.4% and 0.2% in the production of corn and soybean, respectively.

Surveys and expectations

47. According to the Fecomercio-SP survey, the Consumer Confidence Index (ICC) decreased 4.5% in November, month-on-month, reflecting the reductions of 4.1% in the Consumer Expectations Index (CEI) and 5.3% in the Current Economic Conditions Index (ICEA). The ICC declined 3% year-over-year.

48. According to the FGV survey, the ICC decreased 4.2% in November, month-on-month, reaching the lowest historic level in the series started in September 2005. Both current situation and 6-month ahead expectations assessments deteriorated relative to the previous month, decreasing by 5.7% in the Current Situation Index (ISA) and by 3.3% in the Expectations Index (IE). Relative to November 2007, the survey also registered decreases of 1.52% in the ICC, 11.9% in the ISA and 17% in the IE.

49. Still according to the FGV, businessmen confidence declined in November, as in October. The Industry Confidence Index (ICI) reached 84.1 points in November, seasonally adjusted, down 20.3 points month-on-month and 35.1 points in comparison to the August-October quarter. The index reached the lowest level since July 2003 and fell below 100 points, indicating expectations of declining industrial activity. Among its components, and also in seasonally adjusted terms, the Current Situation Index (ISA) leveled at 85.3 points, 24.4 points below the October outcome. The Expectations Index (IE) declined more moderately, 16.4 points, reaching 82.8 points. Considering use categories, all indicators stood below 100 points. Consumer goods, that registered the higher confidence level in the observed series, 90.1 points, had a 46 points reduction in comparison to November 2007. In the same comparison basis, construction material had the smallest fall, 33.1 points, while capital goods registered the biggest one, 51.9 points, leveling at 76.3 points.

50. In accordance with the FGV Manufacturing Industry Survey, installed capacity utilization (Nuci) reached 85.2% in November, 2 p.p. below November 2007, and 84% in the seasonally adjusted series, 1.3 p.p. below the previous month. In November 2008, only construction materials registered a year-over-year positive change (1.9 p.p.). Considering industrial segments, pharmaceuticals and textiles, should be highlighted in the same comparison bases, with 2.8 p.p. and 2.2 p.p. increases, respectively.

Labor market

51. According to the Ministry of Labor and Employment (MTE), 61.4 thousand new formal jobs were created in October 2008, the worst outcome for the month since 2002, reflecting a significant deceleration in comparison to the previous months. In the year through October, 2,148 thousand new jobs were registered, with an 18.5% increase in comparison to the same period of 2007. Employment level increased by 0.2% month-on-month in seasonally adjusted terms, expanding in all sectors but in the manufacturing industry, in which it remained stable; one should highlight the 0.6% increase in the construction sector and the 54.6 thousand new jobs in retail sector. Considering the observed series, there were increases year-to-date terms (6.5%) and on a twelve-month basis (6.4%).

52. According to the IBGE employment survey (PME), carried out in the six main metropolitan areas of the country, the unemployment rate stood at 7.5% of the economically active population (PEA) in October, remaining relatively stable in comparison to the 7.6% registered in the two previous months. Compared to October 2007, unemployment declined 1.2 pp, corresponding to the second smallest rate of all series, just below the 7.4% registered in December 2007. In seasonally adjusted terms, unemployment reached 7.6%, leveling with September's outcome. The relative stability of the unemployment rate in September and October, in the observed series, reflected the 143 thousand people growth in the PEA and 176 thousand new jobs. Compared to October 2007, occupation increased 4%, sustaining the pace of new jobs creation, which had a 3.9% increase in the ten first months of 2008. The PEA expanded 2.6% year-over-year, and 2.2% in the year through October. The number of formal workers increased 1.9% in October, month-on-month, corresponding to 186 thousand jobs; the total of informal workers reduced by 42 thousand jobs (-1.4%), while the number of self-employed workers remained stable. In the year through October, formal workers in the private sector led occupation growth (8.1% increase), followed by the 3.7% increase in public sector employees; jobs for informal workers had the worst performance in the period, with a 0.1% expansion.

53. The same survey pointed that average real earnings of occupied workers reduced by 1.3% in October, month-on-month, and increased 4.5% year-over-year, with a deceleration in relation to the two previous months, when they showed 5.7% and 6.4% expansions, respectively. Real payrolls decreased 0.5% in October, month-on-month, but still show an 8.6% increase year-over-year. In the year through October, real payrolls expanded 7.4%, with highlights for the 9.4% and 8% increases in private and public sectors, respectively.

54. In October, the PME survey shows that the aggravation of the international crisis did not affect yet the labor market in the country's main metropolitan areas. In a first moment, the adjustment should happen through the reduction of work shifts and adoption of collective vacations, impacting real earnings, while layoffs will become an option if the crisis lasts for a longer period.

55. According to the CNI data seasonally adjusted by the BCB, employment in manufacturing industry grew 0.1% in October, after a 0.7% expansion in September, resulting in a 1.1% elevation in the quarter ended in October, quarter-on-quarter. Year-over-year, employment in the manufacturing industry and industrial real payroll increased 3.9% and 3.8%, respectively, in October. In the first ten months of 2008, the same indicators increased by 4.3% and 5.2%, respectively, year-over-year.

Credit and delinquency rates

56. Outstanding credit in the financial system reached R$1,187 billion in October, an expansion of 2.9% in monthly terms, and of 34% on a twelve-month trailing basis. This volume corresponded to 40.2% of GDP, compared to the figures of September (39.2%) and October/2007 (33.6%). According to the same comparison basis, non-earmarked credit operations increased 2.6% and 37.3%, respectively. Among the non-earmarked operations, leasing operations remained dynamic, with a share of 71.7% in the total of financial system, with expansions of 116.3% and 71.9% for credit to individuals and to corporate, respectively, in the last twelve months. Credit to agricultural sector expanded 11.8% in

the month, 37.4% in the quarter, and 70.3% in the last twelve months. Regarding earmarked credit, operations increased 3.9% month-on-month 28.2% on a twelve-month trailing basis. This monthly result was basically due to the 5.4% increase in credit operations performed by the BNDES (Brazilian Development Bank). Considering the segmentation by economic activity, loans to industry increased 3.8% in October month-on-month and 41.8% in the last twelve months.

57. The average interest rate on non-earmarked credit operations, used as reference for interest rates, reached 42.9% p.a. in October, up from 40.4% p.a. in September and 35.4% p.a. in October 2007. The average rate on credit for individuals increased 1.7 p.p. in October, month-on-month, reaching 54.8% p.a., while the average rate on corporate credit showed expansion of 3.3 p.p. also on monthly terms, reaching 31.6% p.a. In October 2007, the average rate on credit to individuals and credit to corporate stood at 45.8% p.a. and 23.4% p.a., respectively.

58. The average tenure on non-earmarked credit operations, used as reference for interest rates for individuals reached 374 days in October, compared to 375 days in September and 342 days in October 2007. The average tenure of corporate credit operations reached 297 days, while the average tenure for credit operations to individuals totaled 482 days, compared to 270 days and 421 days, respectively, in October 2007.

59. Delinquency rates in the financial system (non-earmarked loans, used as reference for interest rates, in arrears for more than ninety days) stood at 4.1% in October, a 0.4 p.p. decrease year-over-year. Delinquency rates for credit operations with corporate and individuals reached 1.7% and 7.4%, respectively, compared to 2.3% and 7.0% in October 2007.

60. Net delinquency rate for retail credit, measured by the ACSP, reached 6.4% in November, up from 5.5% in the same month of 2007. In the year through November, the average delinquency rate stood at 6.8%, up from 6.1% in the same month of the previous year.

External environment

61. Global economy and particularly, advanced countries face severe deceleration, and there are clear evidences of recession in many of these countries. Overall, forecasts for 2009 show contractions of both real GDP growth and inflation indexes.

62. Global financial crisis has affected both consumer and businessmen confidences. Data from previous weeks have shown that businessmen confidence has suffered sharply deterioration in many countries. This situation reflects particularly a generalized decrease in services and manufacturing PMIs recently published. It is also evident in emerging economies, where the levels of businessmen and consumer confidence have also fallen sharply, giving additional evidences that these countries will suffer the impact of the recession that hits the developed economies.

63. In the fourth quarter of 2008, global demand retraction sharpened, installed capacity utilization lowered and unemployment increased. In the U.S., numbers of November showed the most significant job cuts since the 70s, bringing the unemployment rate to reach the highest level in fifteen years (6.7%). In the other developed economies, labor market conditions also show deterioration.

64. Price behavior confirms the trend of disinflation started in the third quarter of this year. This pattern is more evident in economies that present lower level of activity and quicker falls in commodities prices, particularly reflecting the sharp reduction in oil prices. In the United States, this pattern is reinforced by the dollar appreciation. However, in some emerging countries, exchange-rate depreciation prevents further price reductions and limits the actions of their central banks.

65. In this context, the majority of central banks started or intensified monetary easing procedures, based not only on the broadening of the risks of recession, but also on fears of deflation. In emerging economies from Southeast Asia, that are more dependent upon exports, local central banks have performed cuts in their policy rates in an attempt to mitigate the impact that the negative expectations about the worldwide economy have over their

local industrial production. In China, besides the US$ 586 billion fiscal package, the People's Bank of China implemented the most drastic rate reduction since October 2007 (the fourth since September 2008) from 6.66% to 5.58%. The deterioration in global macroeconomic conditions may increase the number of emerging countries to perform rate cuts in the near future.

Foreign trade and international reserves

66. Brazilian trade surplus reached US$1.6 billion in November, totaling surpluses of US$22.4 billion in the year and US$26.1 billion in the last twelve months. In the year through November, exports reached US$184.1 billion, and imports, US$161.7 billion, growing by 25.2% and 46.3%, respectively, year-over-year. Total external trade recorded a US$345.8 billion from January to November, totaling US$370.6 billion in twelve months.

67. In November, exports totaled US$14.8 billion, reaching a US$737.7 million daily average, a 5% growth year-over-year. Imports totaled US$13.1 billion in the month, with a US$657 million daily average, a 9.2% increase year-over-year.

68. Based on the liquidity concept, international reserves totaled US$206.4 billion in November, with increases of US$3.2 billion in the month and US$26 billion relative to the end of 2007. Under the cash concept, international reserves totaled US$194.7 billion, a US$2.6 billion decrease month-on-month and a US$14.3 billion increase year-over-year.

Money market and open market operations

69. Immediately after the last Copom decision in October, the future yield curve experienced an upward parallel shifting. The interruption of the tightening monetary cycle and the expectation of a higher inflation in the near term were decisive factors for this movement. From November on, however, the behavior of the yield curve changed and the interest rates began to show a falling trajectory, mainly influenced by the release of both inflation data below market expectations, and economic data showing a retreat in the economic activity level. In the beginning of December, the fall in interest rates became more intense especially in the long-term segment. Between October 27 and December 8, one-, three-, and six-month rates decreased by 50 bps, 78 bps and 168 bps, respectively. Moreover, one-, two- and three-year rates decreased by 299 bps, 376 bps, and 430 bps, respectively. Real interest rates, measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month ahead inflation expectation, decreased from 10.33% on October 27, to 7.38% on December 8.

70. In the period between October 28 and December 8, the BCB carried out traditional FX swap auctions, in which assumes a long position in domestic interest rate and a short position in FX. These operations totaled US$18.1 billion, US$5.1billion of them rolling contracts due on December 1.

71. In its open market operations, the BCB carried out, from October 28 to December 8, weekly five- and seven-month fixed rate repo operations, borrowing. The average daily balance of these operations reached R$45.1 billion, of which R$31.8 billion were seven-month operations. In the same period, the BCB borrowed money through 32 overnight repo operations. The BCB also 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$93.6 billion, on a daily basis, borrowing. In addition, the BCB conducted borrowing operations with tenures of 12 and 30 working days on October 30; of 10 and 29 working days on October 31; and of 23 working days on November 7. These operations draw from the market the following amounts: R$139.5 billion, R$13.1 billion, R$15 million, R$1.3 billion, and R$4.4 billion, respectively. These operations averaged R$151.9 billion, on a daily basis.

72. Between October 28 and December 8, the National Treasury raised a total of R$19.1 billion: R$6.9 billion via issuance of LTNs maturing in 2009 and 2011; R$11.5 billion LFTs maturing in 2010, 2011, and 2012; and R$0.7 billion in NTN-Bs maturing in 2013, 2017, 2035, and 2045.

73. In the same period, the Treasury conducted auctions to sell LTNs maturing in July and October

2009 and bought LTNs maturing in January 2009, totaling R$1.5 billion; and conducted auctions to sell LFTs maturing in March and December 2011 against the purchase of LFTs maturing in December 2008, totaling R$2.7 billion. The sales of NTN-Bs settled in other National Treasury securities maturing 2017, 2024, 2035 and 2045 totaled R$0.9 billion. The Treasury also conducted purchase auctions of LTNs and NTN-Bs totaling R$2.0 billion and R$0.1 billion, respectively.

74. On October 29, the Treasury conducted simultaneous purchase/selling auctions of NTN-F maturing in 2012, 2014 and 2017. The purchase totaled R$0.3 billion, while the selling amounted R$74 thousand.