

The performance of consumer and wholesale inflation rates, after leveling off in August and September in line with falling international prices of commodities, returned to record growth in October, a move associated with the growth pace of domestic demand, as indicated by increases in the prices of services, and the initial effects of recent exchange rate depreciation on prices of consumer goods and important items in the supply chain.

In November, despite the path of the exchange rate, consumer prices and especially wholesale, recorded new leveling off reflecting the sharp deterioration in analysts' expectations, reporting significant declines in international commodity prices with the demand for goods by sectors more dependent on the conditions of the credit market.

2.1 General indices

The changes in FGV general price indices slowed in the quarter ended in November in relation to August quarter end. The level of the General Price Index (IGP-DI) was 1.53%, dropping 1.11 percentage points in the period, the result of widespread reductions in some of its components.

The Wholesale Price Index – (IPA-DI) rose 1.63% in the quarter ended in November, compared to 2.78% at the end of August. This deceleration reflected, in particular, a major falloff in farm prices, showing a decline in international prices of commodities, ranging -1.13% against -0.28% in the quarter ended in August. The emphasis in reductions came from the prices of corn, wheat, soybean, fresh milk, eggs, milk and cattle.

After showing monthly variations in excess of 0.75% throughout the year, industrial prices remained stable in November, rising 2.63% in the quarter ending this month, compared to 3.94% in August, with an accumulated annual

Table 2.1 – General price indices

	Monthly % change				
	2008	Jul	Aug	Sep	Oct
IGP-DI	1.12	-0.38	0.36	1.09	0.07
IPA	1.28	-0.80	0.44	1.36	-0.17
IPC-Br	0.53	0.14	-0.09	0.47	0.56
INCC	1.46	1.18	0.95	0.77	0.50

Source: FGV

Figure 2.1 – IPA-10, IPA-M and IPA-DI – Agricultural and industrial prices

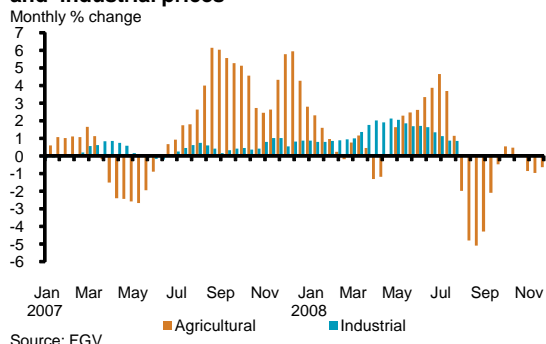


Figure 2.2 – IPCA growth

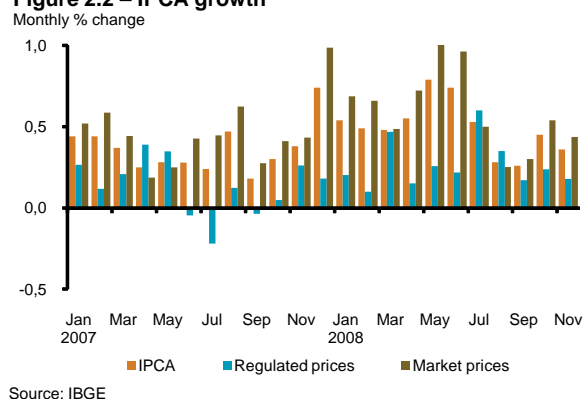


Figure 2.3 – IPCA – Food

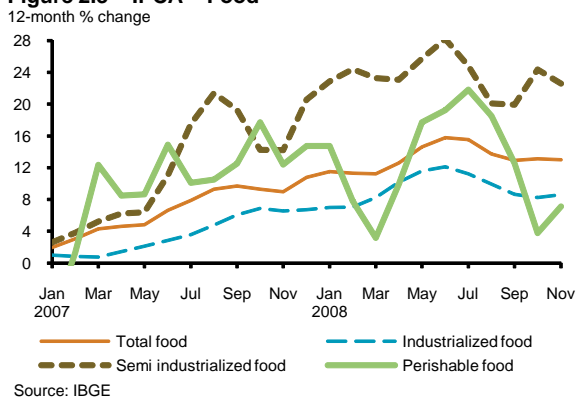
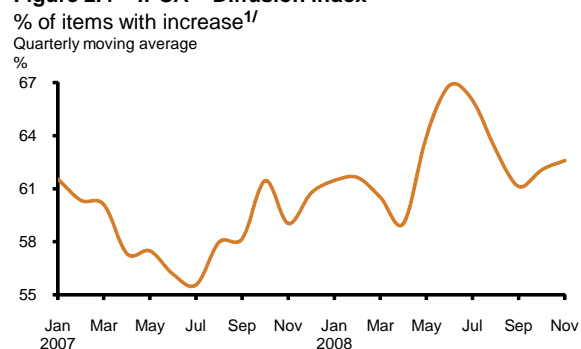


Figure 2.4 – IPCA – Diffusion index



1/ IPCA is formed by 384 subitems.

growth of 13.80% against 3.39% in the same period in 2007. The performance of the indicator for the quarter was associated, in large part, to price increases recorded in the metallic minerals, apparel, pulp, chemicals and nonmetallic minerals sectors.

The Consumer Price Index – Brazil (IPC-Br) showed an increase of 0.94% in the quarter ended in November, compared to 1.45% for August, consistent with the price trajectory in food prices. Additionally, the National Cost of Construction Index (INCC) grew 2.24% in the quarter from 4.63% in the period from June to August, showing the exhaustion of the impact of labor disputes involving civil construction workers.

2.2 Consumer Price Indices

Broad National Consumer Price Index (IPCA)

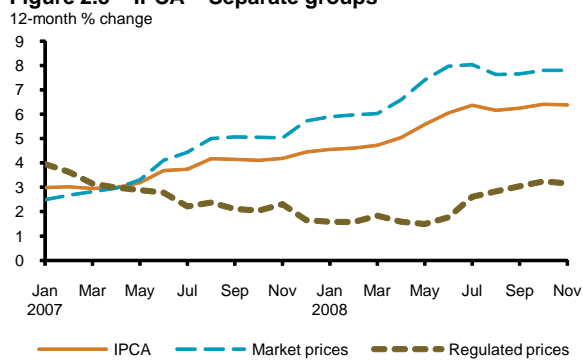
The IPCA rose 1.07% in the quarter ended in November, compared to 1.56% that ended in August, reflecting reductions in the variations from 1.72% to 1.28% in market prices and, from 1.17% to 0.59% in regulated prices. The change in the indicator in the quarter resulted from expansions of 0.26% monthly in September, the lowest of the year and of 0.45% in October and 0.36% in November.

The deceleration seen in quarterly market prices was associated with the behavior of food prices which grew 1.03%, compared to 3.00% during June to August, reflecting reductions in the price increases of semi-prepared, industrial and natural foods. On the other hand, the variation of market prices, excluding the food group, reached 1.40% in the quarter ended in November, when compared to that ended in August 1.12%, increasing the evidence of the importance of demand pressures on the behavior of prices in this segment. Also noteworthy in this period are the price variation increases in the household items group from 0.41% to 1.46%, apparel from 0.78% to 2.70% and personal expenses from 1.79% to 1.99%.

The IPCA showed an increase of 6.39% in the twelve-month period ending in November, reaching 5.61% on the year resulting from increases of 2.97% in the prices of regulated goods and services and 6.75% for market prices compared to the January November 2007 result of 4.69%.

The diffusion index, an indicator which shows the proportion of the components of the IPCA that went through positive

Figure 2.5 – IPCA – Separate groups



Sources: IBGE and Bacen

Table 2.2 – IPCA

	Weights	2008						% change
		Jul	Aug	Sep	Oct	Nov	Year	
IPCA	100.00	0.53	0.28	0.26	0.45	0.36	5.61	
Market prices	70.38	0.50	0.25	0.30	0.54	0.44	6.75	
Regulated prices	29.62	0.60	0.35	0.17	0.24	0.18	2.97	
Main items								
Electricity	3.28	0.93	1.03	-0.46	0.44	0.16	0.97	
Water and sewage	1.64	0.79	1.57	0.96	0.77	0.00	7.09	
Urban bus	3.67	0.00	0.00	0.00	0.00	0.00	2.16	
Air ticket	0.29	0.13	0.22	0.93	1.23	0.73	10.73	
Gasoline	4.22	0.59	-0.25	0.69	-0.18	0.21	-0.17	
Bottled cooking gas	1.12	0.15	-0.02	0.12	0.20	0.23	2.61	
Medicine	2.84	0.37	-0.41	0.30	0.13	0.15	4.09	
Health plans	3.37	0.49	0.48	0.48	0.48	0.48	5.66	

Source: IBGE

Table 2.3 – Consumer prices and core inflation

	Monthly % change				
	2008				
	Jul	Aug	Sep	Oct	Nov
IPCA	0.53	0.28	0.26	0.45	0.36
Exclusion	0.39	0.50	0.62	0.51	0.36
Trimmed means					
Smoothed	0.36	0.36	0.45	0.37	0.35
Non smoothed	0.43	0.42	0.41	0.32	0.28
IPC-Br	0.53	0.14	-0.09	0.47	0.56
Core IPC-Br	0.30	0.30	0.22	0.31	0.45

Source: IBGE, Bacen and FGV

growth in a determined period presented an average of 62.59% in the quarter that ended in November, compared to 63.19% in August and finished at 59.03% in the same period in 2007.

2.3 Regulated prices

Regulated Prices increased 0.59% in the quarter ending in November compared to 1.17% in the quarter ending in August, corresponding to 0.17 p.p. of the IPCA variation during the period. The slowdown in the quarter particularly reflected the smaller increases in charges for water and sewer, telephone, and electricity, which grew 1.74%, 0.36% and 0.14% respectively compared to variations of 3.12%, 2.90% and 0.93% for the quarter ending in August. This is also related to the effect of an increase of 0.72% in gasoline prices, which grew 0.26% in the quarter ending in August.

The variation in regulated market prices grew 2.97% in the first eleven months of the year and 3.16% in the twelve-month period ended in November remaining, at a level below market prices since May 2007, using the same basis of comparison

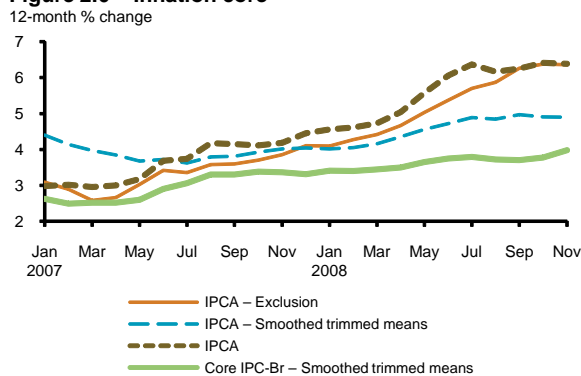
2.4 Inflation core

Considering the three measures of IPCA core inflation calculated by the Central Bank, the variation of the core by exclusion, reflecting the heated domestic demand and, more recently, the initial effects of the depreciation of the exchange rate was at a level above that registered by the IPCA for the quarter ended November, recording an increase over the quarter ended in August. For the period, variations in the core IPCA calculated by the method of smoothed and non-smoothed trimmed means recorded deceleration and change similar to the full index.

The variation of the exclusion core reached 1.50% in the quarter ended in November, compared to 1.44% in the quarter ended in August, rising in the 12 month period from 5.87% in August to 6.37% in November considering the 12-month period, during which the IPCA accumulated growth of 6.39%.

The core IPCA calculated by the method of trimmed means with and without smoothing showed variations of 1.18% and 1.02% for the quarter ended in November, compared to the same order, increases of 1.21% and 1.34% the quarter ending

Figure 2.6 – Inflation core



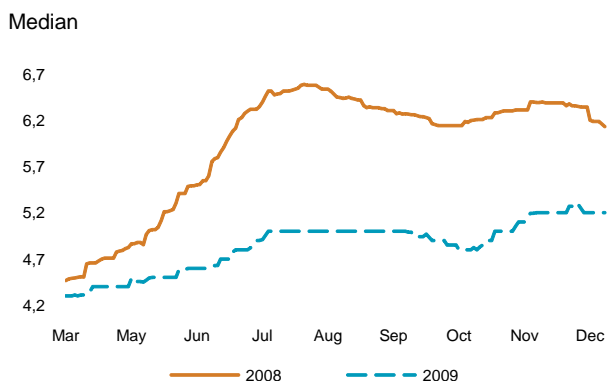
Source: IBGE, Bacen and FGV

in August. These indicators accumulated, in 12-month period ending in November, variations of 4.90% and 5.05%, compared to the respective expansions of 4.85% and 4.92% in August using the same period of comparison.

Core inflation for the IPC-Br, calculated by the FGV, using the method of smoothed trimmed means, accumulated a variation of 3.98% during the twelve months ending in November. The index rose 0.98% in the quarter ending this month, compared to a 1.04% that closed in August.

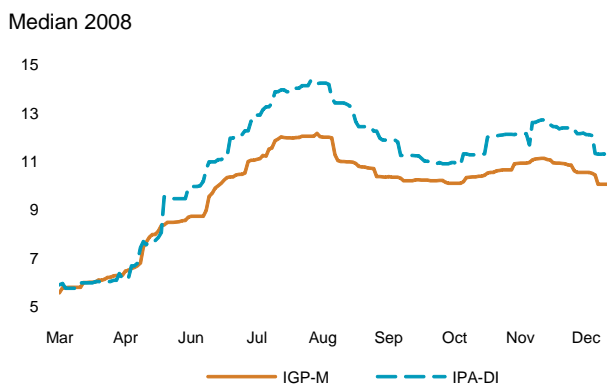
2.5 Market expectations

Figure 2.7 – IPCA



According to the bulletin – “Focus market report” of December 12, the median of expectations for the IPCA collected by the Investors Relations Group (Gerin) in 2008 rose from 6.14% in late September, to 6.13%, while that related to the 2009 increase from 4.85% to 5.20% in the period. The projections are inconsistent with the goal of 4.50% but within the tolerance margin of two percentage points above or below, established for the IPCA by the CMN. Expectations for inflation in the twelve months ahead – smoothed – reached 5.21% compared to 5.15% in late September.

Figure 2.8 – IGP-M e IPA-DI



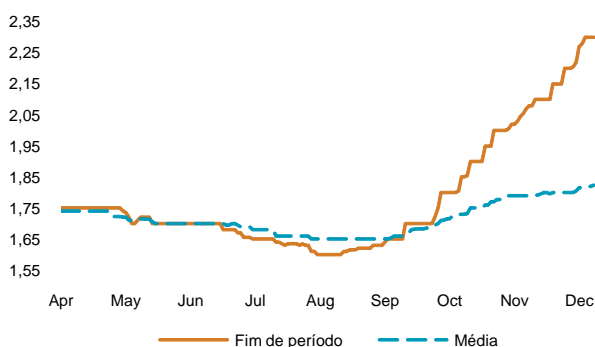
Median related to variances in the General Price Index – Market (IGP-M) and IPA-DI for 2008 reached 10.06% and 11.25% respectively on December 12, in view of, 10, 10% and 10.91% respectively at the end of September. For 2009, the median of those projections were increased by 5.37% and 5.60%, respectively, and 5.64% and 6.03%.

The median of expectations related to the evolution of regulated prices for 2008 decreased 3.7% in late September to 3.5% on December 12, while 2009’s moved from 5.1% to 5.3% for the period.

With the deepening of the current international financial crisis after the bankruptcy of Lehman Brothers investment bank on September 15, the market forecasts for the exchange rate was revised upward substantially. The median of the exchange rate average and at the end-of-period for 2008 increased from R\$1.70/US\$ and R\$1.75 per US\$, respectively at the end of September to R\$1.82/US\$ and R\$2.30/US\$, in the latest Bulletin Focus – Market Report. Similarly, projections concerning these rates for 2009 from R\$1.77/US\$ and R\$1.80 US\$, respectively, as well as R\$2.20 per US\$ in the period.

Figure 2.9 – Exchange

Median 2008

**Table 2.4 – Summary of market expectations**

	6.30.2008		9.30.2008		12.12.2008	
	2008	2009	2008	2009	2008	2009
IPCA	6.3	4.8	6.1	4.9	6.1	5.2
IGP-M	11.0	5.1	10.1	5.4	10.1	5.6
IPA-DI	12.7	5.2	10.9	5.6	11.3	6.0
Regulated Prices	3.8	4.9	3.7	5.1	3.5	5.3
Selic (end-of-period)*	14.3	13.5	14.8	13.8	13.8	13.0
Selic (average)*	12.6	13.6	12.8	14.2	12.6	13.4
Exchange rate (end-of-period)	1.65	1.76	1.75	1.80	2.30	2.20
Exchange rate (average)	1.69	1.74	1.70	1.77	1.82	2.20
GDP growth	4.8	4.0	5.2	3.5	5.6	2.5

*last available data for 2008 as of December 5

The Selic rate median at the end of 2008 declined from 14.75% per year (p.a.) at the end of September to 13.75% p.a. on December 5. For 2009, the median of expectations fell from 13.75% p.a. at the end of September, to 13% p.a. on December 12, while the median of forecasts for the GDP growth rate in 2008 increased 5.2% to 5.59%, and decreased 3.5% to 2.5% in the period relative to 2009.

The medians referring to changes in the IGP-M and the IPA-DI for 2008 reached 10.90% and 12.40% respectively in the latest bulletin “Focus- Market Report” in view of 10.20% and 10.90% for the end of September in that same order. For 2009, the medians of those projections were increased from respective 5.40% and 5.60% as well as 6.00% in the period.

The median of expectations related to growth in regulated prices stayed at 3.70% for 2008, whereas in 2009 it rose from 5.10% at the end of September to 5.30%.

The medians regarding the Selic rate at the end of 2008 and 2009 dropped from 14.75% p.a. and 13.75% p.a. at the end of September, to 13.75% p.a. and 13.31% p.a., respectively, in the latest bulletin “Focus-Market Report”, while the median of forecasts for the GDP growth rate in 2008 closed at 5.2% and the relative performance of the Brazilian economy in 2009 decreased from 3.6 % to 2.8% in that period.

2.6 Conclusion

The IPCA cumulative variation over the last 12 months, heading upward since early 2007, always remained above the annual target of 4.5% set by the CMN for 2008. The performance of inflation had been translating, particularly during the first half of the year, the vigor of the external environment on the evolution of international commodities prices, both agricultural and mineral, and the pace of domestic demand growth, as suggested by the increases recorded in several core indicators.

As of September, the prospects of a reduction in global economic growth, in line with the significant shut off experienced by credit channels, dramatically impacted the prices of major commodities, while the higher risk aversion, amid significant losses in the financial markets, set the stage for a sharp depreciation in the currencies of major emerging economies as well as the developed economies – except for Japan – against the U.S. dollar.

In this scenario, in that the reduction of the pace of growth of the world economy and domestically, the qualitative and quantitative restrictions to credit, and the shrinking of consumer confidence managed to reduce the risks of underlying demand pressures on the evolution of prices, should be considered, especially in the short-term, the increased risks inherent to the impacts of exchange rate depreciation.