Annex

Minutes of the 140th Meeting of the Monetary Policy Committee (Copom)

Date: January 20th, from 4:55PM to 6:50PM, and January 21st, from 4:20PM to 6:40PM
Place: BCB Headquarters meeting rooms – 8th floor on January 20th and 20th floor on January 21st – 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 January 20th)
Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on January 21st)
João Henrique de Paula Freitas Simão – Open Market Operations Department
José Antônio Marciano – Department of Banking Operations and Payments System
Ariosto Revoredo de Carvalho – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations Group

Other participants (present on January 20th)
Alexandre Pundek Rocha – Advisor to the Board
Flávio Pinheiro de Melo – Advisor to the Board
Katherine Hennings – Advisor to the Board
Sergio Almeida de Souza Lima – Executive Secretary
Valderez Caetano Paes de Almeida – Press 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 decelerated from 0.36% in November to 0.28% in December. It bears noticing that, in contrast to previous quarters, inflation in the last quarter of 2008 totaled 1.09%, quite lower than that registered in the same period of 2007 (1.43%). As a consequence, inflation reached 5.90% in 2008 – the highest change recorded since 2005 – up from 4.46% in 2007 and 6.39% in the last twelve months through November 2008. The acceleration of twelve-month consumer price trailing inflation mirrors the behavior of both regulated prices and market prices. Indeed, market prices and regulated prices increased 7.05% and 3.27%, respectively, up from 5.73% and 1.65% in 2007. Moreover, both prices of tradable goods and non-tradable goods accelerated on a twelve-month trailing basis, reaching 6.99% and 7.09%, respectively (compared to 4.75% and 6.65% in 2007). The price of services, whose dynamics tends to show more persistence than the prices of goods, increased 6.39% in the twelve months through December 2008, compared to 6.48% in November and 5.19% in December 2007. Preliminary data for January point to consumer inflation index above that observed in December. Considering broader intervals, twelve-month IPCA trailing inflation trended upwards since

the second quarter of 2007, reached levels close to the upper limit of the tolerance interval after June 2008 and has reduced since October (when it reached 6.41%) – market prices, under this comparison basis, which started to accelerate more intensely from the second quarter of 2007 on, started to cool down in the third quarter of 2008. In the case of regulated prices, whose behavior incorporates more intensely past inflation developments, twelve-month trailing inflation continued to trend upwards. In short, information available suggest that the inflationary cycle observed in the last quarters tends to be gradually overcome by a process that should be led by the behavior of market prices, while regulated price inflation should show more persistence.

2. The three main underlying inflation measures calculated by the BCB showed divergent behavior in the last months, but converged in December. The core inflation by exclusion of household food items and regulated prices decreased from 0.51% in October to 0.36% in November and 0.33% in December. Smoothed and non-smoothed trimmed means core inflation measures showed relative stability, recording 0.37% and 0.32% in October, 0.35% and 0.28% in November and 0.33% in December, respectively. Similarly to the headline inflation, the three core inflation measures remarkably accelerated in 2008, compared to 2007, with increases from 4.11%, 4.04% and 3.62% to 6.09%, 4.82% and 4.92%, for the core inflation by exclusion, smoothed and non-smoothed trimmed means core inflation, respectively. Also in line with headline inflation, twelve-month trailing core inflation measures seem to have reached record highs in September (smoothed and non-smoothed trimmed means core inflation measures) or in October (core inflation by exclusion of household food items and regulated prices), reducing afterwards, despite to levels above the midpoint of the target. Moreover, it bears emphasizing that the behavior of the IPCA diffusion index, which remarkably increased in November and continued to point to an inflationary process relatively disseminated, reduced in December (from 64.58 to 61.72, compared to 61.98 in December 2007).

3. The General Price Index (IGP-DI) inflation changed from 0.07% in November to -0.44% in December. On a twelve-month trailing basis, IGP-DI inflation increased 9.10% in December, down from 11.20% in November, compared to 7.89% in December 2007. The acceleration of IGP-DI in 2008 reflected the behavior of its three main components. The Consumer Price Index-Brazil (IPC-Br) increased 6.07% (4.60% in 2007), while the Wholesale Price Index (IPA-DI) totaled 9.80% (9.44% in 2007). According to the same comparison basis, the Civil Construction National Index (INCC) increased 11.87% (6.15% in 2007). Regarding IPA-DI, the inflationary acceleration, under this comparison basis, derives basically from the behavior of industrial prices. The agricultural IPA reached 1.64% (24.82% in 2007), while the elevation of wholesale industrial prices reached 12.96% (4.42% in 2007). It bears noticing that, despite the exchange rate depreciation occurred since August, both wholesale agricultural and industrial prices have showed deflation at the margin. 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 decreased 2.1% in November, after falling by 0.8% in the previous month. Still considering the seasonally adjusted series, after the 2.8% retreat observed in October, industrial output decreased by 5.2% in November, month-on-month (with less three working days than the previous month). Moreover, it bears emphasizing that the severe climatic conditions observed in the South of the country also influenced the industrial performance in November. As a consequence, industrial output grew 4.7% in the year through November, with respective increases of 4.6% and 6.2% in manufacturing and in mining output. On a year-over-year basis comparison, industrial output retreated by 6.2% in November, with respective falls of 4.6% and 6.3% in mining and manufacturing industries. Data already released for the last months point, in short, to the interruption of the industrial production expansion cycle in the last quarter of 2008. Industrial activity has been influenced by the international crisis, both due to its effects over credit conditions, and over business and households' expectations. In this context,

several industrial segments have been led to adjust inventories and reduce production, with highlights to the sectors of transportation, especially vehicles, mining, ironworks and petrochemical.

5. Among the use categories, according to data seasonally adjusted by the IBGE, the production of capital goods decreased by 4.0% in November. Regarding the other use categories, intermediate goods production decreased 3.9%, semi-durable consumer goods production retreated by 0.7%, and the production of durable goods production, strongly influenced by the automotive sector, reduced by 20.4%. In the year, capital goods production leads the expansion, with a 16.9% increase, followed by the 7.3% elevation in durable consumer goods production. The recent slowdown in capital goods production reflects the persistence 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, the tightening of credit conditions, the deterioration of consumer expectations and the process of inventories' reduction mentioned above. Such developments should continue to be evidenced by the December data.

6. Labor market started to record ambiguous indicators, combining positive aspects with significant accommodation of formal job creation at the margin. The unemployment rate in the six metropolitan regions covered by the Monthly Labor Survey (PME) increased from 7.5% in October to 7.6% in November, down from 8.3% in November 2007. As a result, the average unemployment rate in the first eleven months of the year was 1.5 p.p. below that observed in the same period of 2007. According to data seasonally adjusted by the BCB, the unemployment rate stood at 7.8% in November, above the 7.6% observed in October, remaining, however, at a historically low level. In November, average earnings increased 11.4% year-over-year (12% in October), totaling increases of 9.9% in the year and 9.6% in the last twelve months. In November, average real earnings increased 0.9% month-on-month and 4.0% year-over-year. In the year through November, average real earnings increased by 3.4%, while employment expanded by 3.8%. As a consequence, real payroll increased 7.4% (6.9% expansion in November, 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 retreated by 0.6% in November, after increasing by 0.1% in October, resulting in a 0.8% growth in the quarter ended in November, quarter-on-quarter. In year-over-year terms, employment grew 2.9%, totaling 4.2% growth in the last twelve months. According to data seasonally adjusted by the IBGE, manufacturing employment fell 0.6% in November (after falling 0.1% in October and increasing by 0.1% in September), totaling increases of 2.5% in the last twelve months and 0.4% year-over-year. Still regarding employment, data from the Ministry of Labor and Employment (MTE) indicate significant loss of dynamism in the generation of formal employment at the end of 2008. In December, 654,946 jobs were dismissed (compared to the negative result of 40,821 in November), approximately two fold the historical average for the month. On the other hand, employment reached the third best result for the yearly historical series, reaching 1,452 thousand hires for the period, only below the results for 2007 (1,617 thousand jobs) and 2004 (1,523 thousand jobs). Formal employment reduced by 0.2% in December, seasonally adjusted, and observed data point to a 6.4% expansion in the last twelve months. The manufacturing industry recorded the highest dismissal rate, with the reduction of 273,240 jobs (-1.1% seasonally adjusted change), followed by the agricultural and the services sector, which dismissed 134,487 and 117,128 workers, respectively. The civil construction sector dismissed 82,432 workers (-0.7%). The retail sector dismissed 15,092 workers (0.2%). The services sector recorded the highest hiring rate in the year (648,259 jobs, or 6% growth), a historical record high for the sector. The retail sector recorded the second most important growth (382,218 jobs; 6.7%); followed by the civil construction (197,868 jobs; 17.4%) – a record high for the series; and the manufacturing industry (178,675 jobs, or 5.6%).

7. According to data seasonally adjusted by the IBGE, expanded retail sales decreased by 3.4% in November, after decreasing 8.3% in October. On a year-over-year basis, it reduced by 4.1% and grew 11% in the year through November. The three-month

moving average of expanded retail sales decreased 3.7% in the quarter ended in November, compared to the quarter ended in August, according to seasonally adjusted data. On a month-on-month basis, according to seasonally adjusted data, it bears emphasizing the expansion in the sales of "pharmaceutical, medical, orthopedic and perfumery products" (1.6%), "books, newspapers, magazines and stationary" (1.3%) and "hyper- and supermarket and food products" (0.7%). The negative key drivers were "vehicles and motorcycles, part and pieces" (-7.0%) and "office material and equipment" (-9.8%), sectors more sensitive to the credit supply conditions. In the year through November, cumulative growth was more significant in "office material and equipment" (33.2%) and "other personal and domestic articles" (17.8%). Similar to the observed in October and November, expanded retail sales data for December should also 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 this month. However, preliminary evidence for January points to some recovery in the sales of vehicles, partially in response to sectoral incentives granted by the government. 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 sustained by fiscal transfers, as well as by real payroll growth, whose evolution may be favored by inflation reduction, but it will also be affected by the changes in the access to credit supply and by the deterioration of consumer confidence.

8. The installed capacity utilization rate (Nuci) in the manufacturing industry reached 81.3% in November, below the level observed in October, according to CNI data seasonally adjusted by the BCB. According to data seasonally adjusted by CNI, the Nuci in the manufacturing industry also showed reduction, reaching 81.6% in November, down from 82.6% in October. Without the seasonal adjustment, the Nuci stood 2.0 p.p. below the level registered in November 2007. As a consequence, the average rate in the year through November was 0.5 p.p. above the level observed in the same period of 2007. The monthly non-seasonally adjusted Nuci calculated by Fundação Getúlio Vargas (FGV) retreated strongly in December to 80.6%, standing 6.10 p.p. below the level registered in the same month of 2007. The reduction in the Nuci in December 2008, year-over-year, is also observed in the production of consumer goods (-9.5 p.p.), intermediate goods (-6.0 p.p.), capital goods (-2.6 p.p.) and civil construction inputs (-4.9 p.p.). The reduction on Nuci calculated by CNI and FGV seems to be a result of a combination between the maturity of investment projects and accommodation on economic activity, and points to significant increase of the idle capacity level of the manufacturing industry. On the other hand, recent data about the absorption of capital goods show contraction at the margin, despite continuing to show expansion, compared to the same periods of 2007. The absorption of capital goods decreased 7.7% in November, according to seasonally adjusted data, and expanded by 21.8% in 2008, according to observed data. On its turn, the production of civil construction inputs retreated 4.6% at the margin in November, after showing stability in October, accumulating a 9.7% growth in 2008. In short, evidences so far suggest an ongoing process of reduction in demand pressures on the productive capacity level of the manufacturing industry. 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 2008 the trade surplus reached US$24.7 billion (38.2% below 2007). Exports and imports totaled, respectively, US$197.9 billion and US$173.2 billion, equivalent to 23.2% and 43.6% growth, over 2007. The reversal on the appreciation trend of the BRL and the accommodation on the pace of expansion of domestic demand may contribute to the recovery of the trade surplus, while the reduction on price levels of exports acts on the opposite direction. The decrease in the trade surpluses contributed to the US$26.3 billion current account deficit registered in the twelve months through November 2008, equivalent to 1.7% of GDP. On its turn, foreign direct investment reached

US$37.8 billion in the twelve months through November, equivalent to 2.4% of GDP.

10. 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 continued being 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. Systemic risk perception, which has shown some moderation, intensified in the last weeks. 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, the volatility of emerging economies' currencies continues present, despite not showing the generalized trend of depreciation against the US dollar observed in the last months of 2008.

11. Regarding the global macroeconomic scenario, contraction trends prevail over inflationary pressures. The dominant view still points to the expansion, despite at quite 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 several emerging economies. There are evidences that the deeper weakening of economic activity in Europe and parts of Asia was in a significant manner due to the negative shock in the terms of trade caused by the elevation of commodities prices, which is being reverted. On the other hand, the problems in the financial system have been aggravated by a cyclical deterioration in the quality of credit, which tends to reinforce the contraction in financial conditions and, as a consequence, the risk of intensification of deceleration. The US economy, in particular, has been in recession since 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 consumers' confidence, significantly contributing for depressing expenditure. Moreover, the prevailing interpretation is that the activity in Europe and Japan should 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. 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, inflationary pressures have also been declining, although they show, in many cases, more persistence. 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, but expansionist bias also prevails. In mature economies, the authorities have been announcing a series of initiatives aimed at sustaining economic activity, particularly through fiscal incentives, which could contribute to a gradual economic recovery. On the other hand, estimates on the fiscal costs for packages of macroeconomic stimulus and support to the financial sector have been increasing, which has caused pressures on the assessment of risk on many sovereign credits, even in advanced economies.

12. Oil prices remain highly volatile, despite currently being close to the levels observed at the last Copom meeting. Future markets quotations have also shown high volatility, without a defined trend. Uncertainty concerning these quotations remains high, as the prospective scenario depends on the evolution of demand, especially in emerging countries, on the supply's reaction to stimuli stemming from previous changes on relative prices and on the 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 2009, remains plausible, but with the persistence of the current scenario in the oil market, it does not seem prudent to completely disregard the hypothesis of oil price reductions in 2009. However, it bears highlighting that, regardless of the behavior of domestic gasoline prices, the reduction in international oil prices observed in the second half of 2008 can eventually affect domestic

prices both through productive chains, such as the petrochemical, as well as through the potential effect over inflation expectations. Conversely, prices of agricultural commodities such as wheat, soybeans and corn, which impact particularly the evolution of food costs, have remarkably increased since the last Copom meeting, reacting both to weather problems in important production regions, as well as to the apparent exhaustion of investment repositioning by non-traditional investors that had been allocating resources to these markets.

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 adjustment for 2009 for both gasoline and bottled gas prices were maintained at 0%;

b) the projected adjustment for 2009 for fixed telephone and electricity prices were kept at 5.0% and 8.1%, respectively, unchanged relative to the values considered in the December Copom meeting;

c) the projection for regulated prices inflation in 2009, based on individual items, was maintained unchanged at 5.5%, relative to the December Copom meeting. This set of prices, according to data released by the IGBE, corresponded to 29.56% of the total December IPCA;

d) the projection of regulated prices inflation for 2010 stood at 4.8%. This projection is based on the endogenous determination model for regulated prices, which computes, among other factors, seasonal components, foreign exchange rate changes, market prices inflation and the IGP (General Price Index) variation; and;

e) the projection for the spreads over the Selic rate, on the benchmark scenario, based on the 360-day swap rates, estimates a 5 bps spread in the fourth quarter of 2009 and 22 bps in the last quarter of 2010. 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. The related assumptions considered in the previous meeting were maintained.

15. Since the last Copom meeting, according to the median IPCA inflation expectations compiled by the BCB's Investor Relations Group (Gerin), the 2009 IPCA variation noticeably reduced to 4.80% from 5.20%. For 2010, inflation expectations stand at 4.50%.

16. Considering the hypotheses under the benchmark scenario – which assumes the maintenance of the exchange rate at R$2,35/US$1.00 and the Selic rate at 13.75% during the forecast period – the projection for the 2009 IPCA inflation decreased relative to the figure considered in the December Copom meeting, and remains below 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 2009 slightly decreased compared to the figure considered in the previous Copom meeting, but remained around the central target for the year. Inflation projection for 2010, based on the benchmark scenario, reduced compared to the figure considered in the December "Inflation Report" and is considerably below the 4.5% central target for that year. On the other hand, considering the market scenario, the inflation projection slightly increased, staying around the 4.50% central target.

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, which continued quite robust until the third quarter of 2008, and was at least partially responsible for the inflationary pressures, has considerably lost momentum since then. This deceleration is partly a result of a substantial and generalized cooling of economy activity on both emerging and G-8 economies. On its turn, the increase in risk aversion and

the unprecedentedly constraints observed in liquidity conditions in the international markets continue to impose adjustments in the balance of payments. 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 uncertainty. On the one hand, the economic cooling has caused an increase in risk aversion, impacting the demand for Brazilian assets, and consequently, depreciating their prices. On the other hand, the more generalized economic deceleration in the last months, which may persist in the upcoming quarters, has caused the cooling of both commodities prices and external demand, and has also negatively impacted local financial conditions. Moreover, the trajectory of price indices evidences the reduction of inflationary external pressures, especially in mature economies, but also in some emerging economies. As a consequence, the net effect of the global deceleration over the inflation trajectory seems to be, so far, predominantly benign. 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.

18. The Copom evaluates that the probability that initially localized inflationary pressures may cause risks to domestic inflation trajectory diminished. The evidences of accommodation of domestic demand, and reduction of inflationary pressures over the market of factors, despite remaining surrounded by uncertainty, may mitigate the risk of pass-through of wholesale prices (which have been showing deflation in the last months) upward pressures to consumer price inflation. The Committee evaluates that the materialization of this pass-through, as well as the generalization of pressures initially localized on consumer prices, depend critically on economic agents' inflation expectations for 2009. The 2009 inflation expectations remain in levels above the inflation target, despite having remarkably decreased since the last Copom meeting and continue to be carefully monitored. Additionally, it is worth noticing that, according to data available, domestic demand should exert lesser pressures over the prices of non-tradable items, such as services, in the upcoming quarters. In this context, the Copom reaffirms that it will continue to conduct its actions in order to ensure that the gains obtained in inflation control in recent years become permanent.

19. 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 point of view is even more important in periods of higher uncertainty.

20. Prospects for the evolution of economic activity have continued to deteriorate since the last Copom meeting, despite the fact that industrial activity data have been partially reflecting a process of inventory retreat, which tends to exhaust. It is particularly important to notice, the effects of the international crisis over domestic financial conditions have resulted in severe decline of the credit contribution to support domestic demand. Additionally, the intensification of the international crisis has caused a negative effect on consumers and businessmen confidence. If this situation persists, the strength of economic activity will increasingly depend on payroll expansion and on the effects of governmental transfers expected for 2009. These considerations become even more relevant considering the fact that the monetary policy decisions will have concentrated impacts in the upcoming quarters.

21. The Copom evaluates that the loss of strength on domestic demand should result in reduction of inflationary pressures. On the other hand, the remaining risks for the inflationary dynamics derive from the trajectory of Brazilian assets prices, amidst a process of decreasing external sources of funding and mechanisms of price adjustments that contribute to prolong inflationary pressures observed last year. The balance of those influences over the prospective trajectory of inflation will be crucial to the assessment of the various alternatives available for the monetary policy stance.

22. International evidence, as well as the Brazilian experience, indicates that high inflation rates leads to increase in risk premiums, shortening of planning horizons and, consequently, to lower potential economic growth, besides having regressive effects

over income distribution. Therefore, the Copom's strategy aims to bring inflation back to the midpoint target of 4.5% during 2009, as already established by the CMN, and keep it in a consistent level relative to the target path during 2010. Such strategy, which should have its results evidenced throughout time, takes into account the time lags in the transmission mechanisms and is the most adequate to deal with uncertainties inherent to the process of monetary policy formulation and implementation.

23. The Copom evaluates that, in light of signs of economic activity slowdown, evidenced since the last meeting regarding, for instance, the industrial production indicators – exacerbated by an inventory cycle –, some available data on labor market and industrial capacity utilization rates, as well as on consumers and businessmen confidence, together with lower inflation expectations for relevant horizons, the risks of non-materialization of a benign inflation scenario, in which IPCA would resume evolution in line with the targets path, have been markedly reduced. Indeed, the evolution of the prospective scenario is reflected on inflation projections considered by the Committee. The Copom also understands that demand deceleration has reduced the pressure over supply conditions observed in most of 2008, which should significantly contribute to deflate the economy. Still, monetary policy should be cautiously conducted, aiming to assure the convergence of inflation to the targets path, despite some scope for an easing process.

24. The Committee believes that the consolidation of restrictive financial conditions for a longer period should exert in significant contraction effect over demand and, throughout time, a relevant deflation pressure. Under such circumstances, the majority of the Copom members, taking into account the balance of risks for economic activity and, consequently, for the prospective inflation scenario, as well as the absence of clear evidence of effects over inflation stemming from the depreciation of the exchange rate, in an environment of global reduction of inflationary pressures, has decided, at this moment, to reduce the Selic rate by 100 bps.

25. Other Copom members evaluate that, in light of the presence of inflationary feedback mechanisms in the economy, as well as the consequences of the balance of payments adjusting process, a more moderate reduction of the Selic rate would represent a more consistent signal of the prospective trend of inflation convergence to the targets path and would be more adequate to an optimal pace of the easing process.

26. In such context, taking into account inflation prospects, the Copom has decided, at this moment, to reduce the Selic rate to 12.75% p.a., without bias. Five votes were in favor of this monetary policy action while three were in favor of reducing the Selic rate by 75bps. With such action, the Committee has initiates a process of monetary policy easing, immediately accomplishing significant part of the Selic rate movement, without harming the commitment to the inflation target.

27. Under the inflation targeting regime, the Committee guides its decisions according to projected inflation, 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, after a long expansion period, domestic demand has started to have a contraction influence over economic activity, despite persistence of incentive factors, such as income growth. Additionally, it is worth noticing that inflation expectations for 2009 have substantially decreased since the last Committee meeting. On the other hand, the strong global economy deceleration has resulted in downward pressures over wholesale prices, despite the exchange rate adjustment. In such environment, monetary policy can be more flexible without putting at risk inflation convergence to the targets path. Evidently, if deterioration on the risk profile implies shifts to the inflation prospective basic scenario, considered by the Committee at this moment, the monetary policy stance will be promptly adjusted to the circumstances.

28. At the end of the meeting, it was announced that the Committee would reconvene on March 10th, 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

29. The IPCA changed 0.28% in December, showing a decrease in inflation compared to the December IPCA-15 result (0.29%) and to the November IPCA (0.36%). In 2008, the IPCA accumulated a 5.90% increase, compared to 6.39% in the twelve months through November, and 4.46% in 2007, representing the highest annual change since 2005. The 2008 result showed increases of 7.05% in market prices and of 3.27% in regulated prices, compared to 5.73% and 1.65%, respectively, in 2007. The household food group contributed 2.42 p.p. for the 2008 index, representing 41% of the annual IPCA change.

30. Market prices decelerated in December, increasing 0.28% compared to 0.44% in November, as a result of the increases of 0.17% in the prices of tradable goods and of 0.36% in the prices of non-tradable goods, compared to 0.60% and 0.29%, respectively, in November. Regulated prices changed 0.29% compared to 0.18% in the previous month. The diffusion index reached 61.72%, down from 64.58% in November, with a 62.83% average in 2008, surpassing the 2007 average, 58.79%.

31. Core excluding household food items and regulated prices increased 0.33% in December, down from 0.36% in November, accumulating a 6.09% increase in the last twelve months, compared to 6.36% in the previous month. For the third consecutive month, the smoothed trimmed means core change declined, reducing to 0.33% in December down from 0.35% in November and, in twelve months, to 4.82% down from 4.90%. The non-smoothed trimmed means core change reached 0.33% in December, compared to 0.28% in the previous month, accumulating 4.92% in the last twelve months through December, down from 5.05% through November.

32 The IGP-DI decreased 0.44% in December, compared to a 0.07% increase in November, accumulating a 9.10% increase in 2008, compared to an 11.20% twelve-month trailing change in November. The IPA decreased 0.88%, reflecting the fifth consecutive fall in the prices of agricultural products, of 1.30%, and a 0.73% decrease in the prices of industrial products. The prices of industrial products reached a record low in the series for the period after June 2003. In 2008, the IPA increased 9.80%, with increases of 12.96% in the prices of industrial products and of 1.64% in the prices of agricultural products. It is worth highlighting the IPA significant deceleration, considering the twelve-month accumulated changes ended in October and November, of 14.72% and 12.88%, respectively. The agricultural IPA behavior strongly contributed to this scenario. The IPC-Br slightly decelerated to 0.52% in December, down from 0.56% in November, increasing by 6.07% increase in 2008. The INCC changed 0.17% in December, down from 0.50% in November, and totaled 11.87% in 2008. The IPC-Br core totaled 0.34%, compared to 0.45% in the previous month, accumulating a 4.07% change in 2008.

33. By stages of processing,the IPA in December, decreased in all its components: 0.36% in the prices of final goods, 1.35% in the prices of intermediate goods, and 0.74% in the prices of gross raw materials prices. In 2008, considering the IPA by stages of processing, there were increases of 4.19%, 14.83% and 9.23%, respectively.

34. The IPC-S increased from 0.52% in the last week of December to 0.68% in the first week of January 2009 and 0.69% in the second week.

Economic activity

35. According to data seasonally adjusted from the IBGE's monthly survey (PMC), expanded retail sales, which include construction material and vehicles and motorcycles, parts and pieces, decreased 3.4% in November, month-on-month, after an 8.3% decrease in October. Among the ten segments surveyed by the IBGE, only three expanded, with highlights for the 1.6% growth in the sales of pharmaceutical, medical, orthopedic, perfumery and cosmetic products and the 1.3% growth in the sales of books, newspapers, magazines and stationery. Among the negative drivers, it is worth highlighting the 7% decline in the sales of vehicles, motorcycles, parts and pieces.

36. Considering the comparisons between identical periods of 2008 and 2007, expanded retail sales decreased 4.1% in November. From January to November 2008, sales increased 11%, compared to the same period of last year, with expansion in all commerce sectors, as well as in all Federal units, except for Amazonas.

37. According to São Paulo Trade Association (ACSP) data, seasonally adjusted by the BCB, database consultations for credit sales (SCPC) related to the city of São Paulo decreased by 3.2% in December, month-on-month, while consultations to the Usecheque system expanded by 1.4%. In 2008, these indicators increased by 6.4% and 4.3%, respectively, compared to 2007.

38. Regarding investment indicators, capital goods production declined 4% in November, while the production of construction typical inputs decreased 4.6%, month-on-month, considering the seasonally adjusted series. All sub-sectors of capital goods production decreased in the period, with highlights to the production of construction capital goods (-17.3%) and agricultural capital goods (-11.6%). Capital goods and construction typical inputs production increased 3.6% and 1.6%, respectively, year-over-year. In the year through November, these indicators increased 16.9% and 9.7%, respectively, compared to the same period of 2007.

39. Capital goods imports declined 4% in November, month-on-month, according to the quantum indices from Funcex, seasonally adjusted by the BCB. The November indicator expanded by 22.3% year-over-year, standing below the cumulative change in the year through November (37.3%), and the cumulative change in twelve months (36.9%), signaling the significant loss of dynamism.

40. CNI indicators showed deceleration in the pace of industrial activity in November, with decreases of 0.6% in employment, 2.1% in installed capacity utilization and 1% in hours worked, according to data seasonally adjusted by the BCB. Seasonally adjusted real revenues decreased by 4.8%, month-on-month. Compared to the same periods of 2007, real revenues decreased by 7% in November, with a 6.4% increase in the first eleven months of the year, while hours worked increased by 1.4% and 5.6%, respectively, according to the same comparison bases. Installed capacity utilization (Nuci) reached 81.3% in November, 1.7 p.p. below the October level, considering seasonally adjusted data, and 2.4% below the November 2007 level.

41. According to IBGE's Monthly Industrial Survey (PIM), industrial production decreased in November, for the second consecutive month, intensifying the monthly decrease to 5.2%, compared to 2.8% in October, according to the seasonally adjusted series. In November, industrial production recorded a record low for the series since May 1995. As a consequence, the production of the quarter ended in November stood 2.4% below that of the quarter ended in August. Considering seasonally adjusted data, the four use categories presented negative results, with highlights to the 20.4% decrease in durable consumer goods production, a record low for the series since December 1997. In addition to the weak performance of automotive production, the retractions in the production of audio and video equipments (17.3%), and kitchen appliances (5.1%) also contributed to the decrease. The production of semi- and non-durable consumer goods, whose consumption is more dependent on the payrolls, presented the lowest decrease among the use categories (0.7%). Capital and intermediate goods declined 4% and 3.9%, respectively, in November, month-on-month.

42. Industrial production decreased 6.2% in November, year-over-year, a record low for the series since December 2001. Only five out of the twenty six manufacturing industry activities surveyed expanded in November according to the same comparison basis, with highlights to the production of other transportation equipment, which increased 73%, backed up by the production of airplanes and the production of pharmaceuticals, with a 16.6% increase in the month. According to the same comparison basis, the most important negative drivers were office machines and IT equipment (-29.6%), electronic material and communication equipment (-20.5%), shoes and leather (-18.8%), furniture (-18.7%), and vehicles (-18.3%). Considering the use categories, the production of durable consumer goods, intermediate goods and semi- and non-durable consumer goods

declined 22.1%, 7.5% and 2.7%, respectively, year-over-year, while the production of capital goods expanded by 3.6%.

43. In the year through November, industrial production growth reached 4.7%, with highlights to the expansions of capital goods (16.9%) and durable consumer goods (7.3%). In the same period, the growth of production of intermediate and semi- and non-durable consumer goods reached 3.3% and 1.7%, respectively. Industrial production increased 4.8% in the last twelve months through November, compared to 5.9% in October and 6.8% in September, indicating significant deceleration at the margin.

44. Vehicles production reached 102.1 thousand units in December, according to Anfavea, decreasing 53.8% year-over-year. Considering data seasonally adjusted by the BCB, the production of vehicles fell 34.3% in December, month-on-month, while the last quarter averaged 32.5% less than in the previous quarter. In 2008, the production of vehicles and agricultural machinery increased by 8.2% and 30.7%, respectively, year-over-year. Domestic vehicles sales decreased 7.2% in December 2008, compared to December 2007, and increased 13.9% in the year, compared to 2007. According to the same comparison bases, vehicles exports decreased 26.1% and 7.7%, respectively.

45. The LSPA survey carried out by the IBGE in December pointed to the production of 145.8 million tons in the year, a 9.5% increase over 2007, up from the 145.7 million tons November estimate. For 2009, the third estimate for the grains harvest points to a 5.9% fall in production, which should reach 137.3 million tons. Declines of 10.5% and 1.9% in the production of corn and soybean, respectively, were also projected.

Surveys and expectations

46. According to the Fecomercio SP survey, the Consumer Confidence Index (ICC) decreased 2% in January, month-on-month, reflecting the reduction of 3.1% in the Consumer Expectations Index (IEC). The Current Economic Conditions Index (Icea) was kept virtually stable. The ICC declined 12.9% year-over-year.

47. The National Consumer Expectations Index (Inec), quarterly surveyed by CNI, declined 5% in December, quarter-on-quarter. Among its components, the indices related to the expectations of unemployment and inflation presented declines of 18.5% and 9%, respectively, registering record lows since March 2002 and November 2001, respectively.

48. According to the FGV survey, the ICC increased 0.5% in December, month-on-month, favored by the increase of 6.8% in the Current Situation Index (ISP), while the Expectations Index (IE) declined 2.8%, reaching a record low for the series started in September 2005. Relative to December 2007, the survey also registered decreases of 19% in the ICC, 13.9% in the ISP and 21.9% in the IE.

49. Still according to the FGV, businessmen confidence in the industrial sector declined in December, similarly to the observed in the previous three months. The Industry Confidence Index (ICI) reached 74.7 points in December, seasonally adjusted, falling by 9.2 points month-on-month and 40.3 points relative to September. The index reached a record low since October 1998, emphasizing the pessimistic businessmen expectations about industrial activity, already captured in the November survey. Among its components, and also in seasonally adjusted terms, the Current Situation Index (ISA) leveled at 76.1 points, 9.2 points below the November outcome. The Expectations Index (IE) declined by the same magnitude, reaching 73.3 points, a record low for the series started in April 1995.

50. In accordance with the FGV Manufacturing Industry Survey, installed capacity utilization (Nuci) reached 80.6% in December, 6.1 p.p. below December 2007, and 79.9% in the seasonally adjusted series, 4.1 p.p. below the previous month, when these changes registered 2 p.p. and 1.3 p.p. declines, respectively. The seasonally adjusted index for December was close to the 80% average of the last 20 years. In December 2008, all use categories registered year-over-year declines, with the sharpest retraction for consumer goods (-9.5%). Considering industrial segments, only pharmaceuticals and veterinary products expanded, 3.6 p.p., year-over-year. Among the negative drivers, it bears highlighting transportation material (-14.4 p.p.), metallurgy (-13.6 p.p.), and mechanics (-10.5 p.p.), according to the same comparison basis.

Labor market

51. According to the Ministry of Labor and Employment (MTE), 654.9 thousand formal jobs were eliminated in December 2008, result that ratifies the loss of dynamism in the labor market, outlined since October. Employment level decreased by 0.2% month-on-month in seasonally adjusted terms. Manufacturing industry was the sector that recorded the higher number of dismissals, 273.2 thousand, followed by agriculture and services, which eliminated 134.5 and 117.1 thousand jobs, respectively. In 2008, 1,452,204 new jobs were created, compared to the creation of 1.617.392 jobs in 2007. Moreover, the level of formal jobs grew 6.4% in 2008. By sectors, the level of employment in the construction sector registered the higher increase in the year, 17.4%, followed by the retail sector, 6.7%, services, 6%, and manufacturing industry, 5.6%.

52. According to the IBGE employment survey (PME), carried out in the six main metropolitan areas of the country, the unemployment rate stood at 7.6% of the economically active population (PEA) in November, returning to the August and September levels, after a 0.1 p.p. decline in October. Compared to November 2007, unemployment declined 0.6 p.p. Despite the slight increase, the unemployment rate recorded the lowest level for November months since the beginning of the new PME series, started in March 2002. The relative stability of the unemployment rate in November, month-on-month, reflected the dismissal of 76 thousand workers from the labor market and the elimination of 95 thousand jobs. In seasonally adjusted terms, unemployment reached 7.8%, up from 7.6% registered in October. Compared to November 2007, occupation increased 2.9%, diverging from the annual average of 3.9% recorded until October. The PEA expanded 2.1%, year-over-year, and 2.2% in the year through November. The number of formal workers slightly decreased by 0.2% in November, month-on-month, corresponding to the elimination of 22 thousand jobs, while the total number of informal workers reduced by 38 thousand jobs, corresponding to a 1.3% decline in the number of this type of workers. In the year through November, formal workers in the private sector grew by 7.9%, while informal job creation expanded by 0.2%.

53. The same survey pointed that average real earnings of occupied workers increased by 0.9% in November, month-on-month, and expanded by 4%, year-over-year, representing the second consecutive month of deceleration according to this comparison basis. Real payrolls increased by 0.4% in November, month-on-month, and by 6.9% year-over-year.

Credit and delinquency rates

54. Outstanding credit in the financial system reached R$1,209 billion in November, increasing by 2% in monthly terms and 32.8% on a twelve-month trailing basis. This volume corresponded to 40.3% of GDP, compared to the 2007 figures of October (39.6%) and November (33.6%). According to the same comparison basis, non-earmarked credit operations increased 1.7% and 34.5%, respectively. Non-earmarked operations, with a share of 71.4% in the total of financial system, registered the cooling in the dynamism of operations with individuals, both in the arrangements that includes credit used as reference to the interest rate and in the operations to rental markets, which increased 98.6% in twelve months, but only 0.1% in November. Earmarked credit operations increased 3% month-on-month and 28.6% on a twelve-month trailing basis, as result of increases of 4.2% in credit operations performed by the BNDES (Brazilian Development Bank) and 3.3% in housing loans and transfers. Considering the segmentation by economic activity, it is worth mentioning loans to industry, which increased 4.3% in November and 41.8% in the last twelve months.

55. The average interest rate on non-earmarked credit operations, used as reference for interest rates, reached 44.1% p.a. in November, up from 42.9% p.a. in October and 34.7% p.a. in November 2007. The average rate on credit for individuals increased 3.8 p.p. in November, month-on-month, reaching 58.7% p.a., while the average rate on corporate credit declined by 0.4 p.p., reaching 31.2% p.a. In November 2007, the average rate on credit to individuals and credit to corporate stood at 44.8% p.a. and 23.3% p.a., respectively.

56. The average tenure on non-earmarked credit operations, used as reference for interest rates for individuals, reached 378 days in November,

compared to 385 days in October and 343 days in November 2007. The average tenure of corporate credit operations reached 305 days, while the average tenure for credit operations to individuals totaled 482 days, up from 268 days and 429 days, respectively, in November 2007.

57. Delinquency rates in the financial system (non-earmarked loans, used as reference for interest rates, in arrears for more than ninety days) stood at 4.2% in November, a 0.3 p.p. decrease year-over-year. Delinquency rates for credit operations with corporate and individuals reached 1.7% and 7.8%, respectively, compared to 2.2% and 7.1% in November 2007.

58. Net delinquency rate for retail credit, measured by the ACSP, reached 3.6% in December, up from -1.9% in the same month of 2007. In 2008, the average delinquency rate stood at 6.5%, up from 5.4% in 2007.

External environment

59. Since September, the global macroeconomic scenario has reflected the deepening of the crisis. The current economic and financial conditions have implied a decline in consumption and deterioration of business and consumer expectations, impacting negatively production, investment and real GDP, outlining the most severe economic reversal since 1929. The recession in United States, Japan, United Kingdom, Germany, Italy and Australia, among others; the dramatic decline in the installed capacity utilization verified globally; and the retraction in international trade are responsible for the deepening in the decline in the prices of commodities, oil in particular. This picture, which progressively contaminates emerging economies, both through the fall in the imports of developed countries and through the growing difficulty of external funding, exposes the fragility of the decoupling thesis and translates into estimates of global GDP contraction of approximately 4.1% in the fourth quarter of 2008, which should be added up to the 2.6% contraction in the first quarter of 2009.

60. The domestic demand collapse and its effects over the international trade, among credit restrictions, have provoked the increase in the unemployment rate, which reached 7.2% in December in the US economy. This fact, added up to the deepening of the non-functionality in the financial systems, has evidenced the need of anti-cyclical fiscal policies. In this sense, new packages of fiscal stimulus, preferentially directed to expenditures in infrastructure and tax reduction, were released in the US, Japan, China, Germany, Spain, France and UK, among others.

61. In light of the magnitude of reversal of the inflationary process and the weakening of the economic activity, initially occurred in the developed economies, but progressively reaching emerging economies, a continuous monetary policy easing process can be observed in global terms, even in the Latin America, where the central banks of Colombia, Chile and Mexico started a process of interest rate reduction between December 2008 and January 2009. In Japan and in the US, where the interest rates are almost zero, the central banks changed the focus of monetary policy, acting under the outlook of quantitative easing and therefore widening their balance sheets (Fed balance sheets increased to US$2.3 trillion in mid- December up from US$900 billion in September). In the UK, the repo rate stood at 1.5%, the lowest level since the foundation of the bank, more than 300 years ago.

Foreign trade and international reserves

62. Brazilian trade surplus reached US$2.3 billion in December, totaling US$24.7 billion in 2008. In the year, exports reached US$197.9 billion, and imports, US$173.2 billion, growing by 21.8% and 41.9%, respectively, year-over-year, on a daily average basis. Total external trade recorded US$371.1 billion in 2008, a 30.4% increase related to 2007, on a daily average basis.

63. Despite the favorable balance in December, exports and imports reduced by 11.7% and 1.2%, respectively, on a daily average basis, compared to December 2007, signaling the cooling of 2009 total external trade.

64. Based on the liquidity concept, international reserves totaled US$206.8 billion in December, with increases of US$429 million in the month and

US$26.5 billion relative to the end of 2007. Under the cash concept, international reserves totaled US$193.8 billion, recording a US$885 million decrease month-on-month.

Money market and open market operations

65. After the last Copom meeting in December, the future yield curve shifted sharply downward in the whole extension. This behavior was mainly driven by the fall in the current and expected inflation and by the released indicators that signaled the reduction of the expansion pace of economic activity, negatively impacting in the labor market. In the external outlook, the Federal Open Market Committee (FOMC) decision to adopt, on the December 16 meeting, a reference range from zero to 0.25% to the Fed funds, also contributed to this movement. Between December 8 and January 19, one-, three-, and six-month rates decreased by 51 bps, 87 bps and 141 bps, respectively. Moreover, one-, two- and three-year rates decreased by 180 bps, 209 bps, and 211 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, decreased to 6.25% on January 19, down from 7.38% on December 8.

66. In the period between December 9 and January 19, the BCB carried out traditional FX swap auctions, in which assumed a long position in domestic interest rate and a short position in FX. These operations totaled US$12.1 billion, rolling contracts due on January 2 and February 2.

67. In its open market operations, the BCB carried out, from December 9 to January 19, weekly five- and seven-month fixed rate repo operations, borrowing. The average daily balance of these operations reached R$45.0 billion, of which R$30.0 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$114.3 billion, on a daily basis, borrowing. In addition, the BCB conducted borrowing operations with tenures of 28 and 15 working days on December 11; of 24 and 11 working days on December 17; of 14 working days on January 2; and of 11 working days on January 7. These operations draw from the market the following amounts: R$163.5 billion, R$10.4 billion, R$3.6 billion, R$2.0 billion, R$33.4 billion and R$12.4 billion, respectively. These operations averaged R$190.8 billion.

68. Between December 9 and January 19, the National Treasury raised a total of R$28.8 billion, of which R$11.6 billion in fixed-rate securities: R$10.9 billion via issuance of LTNs maturing in 2009, 2010 and 2011, and R$0.7 billion in NTN-Fs maturing in 2012, 2013, 2014 and 2017. Issuance of LFTs totaled R$15.1 billion, for securities maturing in 2011, 2012 and 2013. Issuance of inflation-linked NTN-Bs reached R$2.1 billion, for securities maturing in 2011, 2013, 2014, 2017, 2020, 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 January and April 2009, totaling R$1.3 billion; and conducted auctions to sell LFTs maturing in March and December 2011, and September 2013, against the purchase of LFTs maturing in December 2008 and January 2009, totaling R$2.0 billion. The sales of NTN-Bs settled in other National Treasury securities maturing 2011, 2013, 2014, 2020, 2024, 2035 and 2045 totaled R$2.2 billion. The Treasury also conducted purchase auctions of LTNs and NTN-Bs totaling R$1.0 billion and R$0.2 billion, respectively.

Minutes of the 141st Meeting of the Monetary Policy Committee (Copom)

Date: March 10th, from 4:00PM to 18:00PM, and March 11th, from 17:00PM to 18:50PM
Place: BCB Headquarters meeting rooms – 8th floor on March 10th and 20th floor on March 11th – 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 March 10th)
Adriana Soares Sales – Department of Banking Operations and Payments System
Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on March 11th)
João Henrique de Paula Freitas Simão – Open Market Operations Department
Márcio Barreira de Ayrosa Moreira – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations Group

Other participants (present on March 10th)
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
Valderez Caetano Paes de Almeida – Press Secretary

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

Recent economic developments

1. IPCA inflation accelerated from 0.28% in December to 0.48% in January and 0.55% in February. As a consequence, inflation accumulated in the first two months of 2009 reached 1.03%, level equivalent to the registered in the same period of the previous year. In the last twelve months, after declining from 5.90% in December to 5.84% in January, inflation increased again to 5.90% in February (4.61% in February 2008). The acceleration of twelve-month consumer price trailing inflation mirrors the behavior of regulated prices, as there was no change in market prices. Both prices of tradable goods and non-tradable goods cooled on a twelve-month trailing basis, reaching 6.51% and 6.90%, respectively, down from 6.99% and 7.10% in December 2008, despite the acceleration relative to the levels observed in the same month of the previous year. According to the same comparison basis, the prices of services, whose dynamics tends to show more persistence than that of the prices of goods, as evidenced by the intense increase in the prices of education in February 2009, increased from 6.39% in December to 6.63% in January and 7.09% in February (5.19% in February 2008). Preliminary data for March point to consumer inflation below that observed in February. In short, information available suggest that the inflationary cycle observed in the last quarters tends to be gradually overcome by a process that should be led by the behavior of market prices, while regulated price inflation should show more persistence.

2. The three main underlying inflation measures calculated by the BCB showed divergent behavior in the first months of the year. The core inflation by exclusion of household food items and regulated prices decreased from 0.33% in December to 0.27% in January and then increased to 0.88% in February, reflecting seasonal factors. Smoothed and non-smoothed trimmed means core inflation measures showed lower variation, recording 0.33% in December, 0.42% and 0.44% in January, and 0.29% and 0.27% in February, respectively. The twelve-

month trailing inflation measures changed from 6.09%, 4.82% and 4.92% in December to 6.14%, 4.89% and 4.85% in February, for the core inflation by exclusion, smoothed and non-smoothed trimmed means core inflation, respectively, remaining in levels above the midpoint of the target. Moreover, it bears emphasizing that the behavior of the IPCA diffusion index, which remarkably increased in January, on a month-on-month basis, and continued to point to an inflationary process relatively disseminated, reduced in February (from 66.2% in January to 58.1% in February, compared to 56.5% in February 2008).

3. The General Price Index (IGP-DI) inflation changed 0.01% in January and -0.13% in February up from -0.44% in December. On a twelve-month trailing basis, the IGP-DI inflation decreased from 9.10% in December to 8.05% in January and 7.50% in February, compared to 8.65% in February 2008. The slowdown of the IGP-DI has reflected the behavior of its main component, the Wholesale Price Index (IPA-DI), which decreased from 9.80% in December to 7.39% in February, on a twelve-month trailing basis (10.62% in February 2008). On its turn, the Consumer Price Index-Brazil (IPC-Br) increased 6.15% (4.55% in February 2008) and, according to the same comparison basis, the Civil Construction National Index (INCC) increased 11.67% (6.28% in February 2008). Regarding IPA-DI, the inflationary acceleration, under this comparison basis, derives basically from the behavior of agricultural prices. The agricultural IPA increased 1.94% (23.89% in February 2008), while the elevation of wholesale industrial prices reached 9.49% (6.20% in February 2008). It bears noticing that, despite the effects of the exchange rate depreciation that has occurred since the third quarter of last year, wholesale industrial prices have showed deflation at the margin. 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 (Statistics and Geography Brazilian Institute) released information about 2008 fourth quarter GDP. The data showed a slowdown in growth, both for accumulated results in the year (5.1% down from 6.4% accumulated in the first three quarters) and for year-over-year results (1.3%, down from 6.8% in the previous quarter). On the aggregate demand side, the expansion was led by public administration consumption, which increased 5.5% in the fourth quarter, year-over-year. The gross fixed capital formation (FBCF) increased 3.8% and household consumption growth grew 2.2%, according to the same comparison basis, sustained by the increase in real payroll. The contribution of domestic absorption to the GDP growth totaled 3.2 p.p. in the fourth quarter of 2008, year-over-year, overweighting the 1.9 p.p. negative impact exerted by the external sector. On the aggregate supply side, still according to the same basis, the services sector presented the best performance, growing by 2.5%, followed by agriculture (2.2%) and industry, which decreased 2.1% relative to the same period of 2007. The GDP deflator under market prices, on a year-over-year basis, changed from 6.8% in the third quarter of 2008 to 7.4% in the fourth quarter.

5. On a three-month moving average basis, according to data seasonally adjusted by the IBGE, industrial output decreased 6.2% in January, after falling by 6.9% in the previous month. Still considering the seasonally adjusted series, according to the month-to-month comparison, after the 12.7%% retreat observed in December, industrial output increased by 2.3% in January. On a year-over-year basis, industrial output retreated by 17.2% in January, with respective falls of 18.4% and 17.2% in mining and manufacturing industries. Data released for the last months point, in short, to the interruption of the industrial production expansion cycle since the last quarter of 2008. The industrial activity has been influenced by the international crisis, due to its effects both over exports and credit conditions, and over business and households' expectations. In this context, several industrial segments have been led to adjust inventories and reduce production, a process that has recently been particularly evident in the intermediate goods industry.

6. Among the use categories, according to data seasonally adjusted by the IBGE, the production of capital goods decreased by 23.3% in December, but increased 8.4% in January. Regarding the other use categories, intermediate goods production decreased 12.4% in December and increased 0.8% in January;

semi-durable consumer goods production decreased 3.9% in December and 0.6% in January; and the production of durable goods, strongly influenced by the automotive sector, reduced by 32.9% in December, and increased by 38.6% in January. The recent slowdown in capital goods production reflects the persistence 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, the tightening in credit conditions, the deterioration of consumer expectations and the process of inventories' reduction mentioned above. Such developments should continue to be evidenced by the data relative to the first months of the current year, despite with some recovery at the margin.

7. Labor market started to record ambiguous indicators, combining positive aspects with significant accommodation of formal job creation at the margin. The unemployment rate in the six metropolitan regions covered by the Monthly Labor Survey (PME) changed from 7.6% in November to 6.8% in December (record low in the historical series), but increased to 8.2% in January, up from 8.0% in January 2008. According to the seasonally adjusted series, the unemployment rate stood stable around 7.8%, between November and December, but increased to 8.6% in January. Average real earnings increased by 3.6% in December, in year-over-year terms, but increased 5.9% in January, according to the same comparison basis, resuming acceleration after three months of slowdown in the growth rate. Employment, on its turn, expanded by 3.0% in December and 1.9% in January, in year-over-year terms. As a consequence, real payroll increased 6.7% in December and 7.8% in January, 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 retreated by 1.1% in January, after decreasing by 0.5% in December and 0.7% in November. In year-over-year terms, employment declined 0.1%. According to data seasonally adjusted by the IBGE, manufacturing employment fell 1.9% in December (after falling 0.6% in November and 0.1% in October), totaling a 2.1% increase in 2008 and a 1.2% decline year-over-year. Still regarding labor market, data from the Ministry of Labor and Employment (MTE) indicate significant loss of dynamism in the generation of formal employment since the end of 2008. In January, 101,748 jobs were dismissed (compared to the negative result of 654,946 in December). The manufacturing industry recorded the highest dismissal rate, with the reduction of 55,130 jobs, followed by the commerce sector, which habitually dismisses in this period of the year, with the reduction of 50,781 positions. On the other hand, the civil construction sector and the services sector hired workers in the month: 11,324 and 2,452 jobs, respectively.

8. According to data seasonally adjusted by the IBGE, expanded retail sales decreased by 1,0% in December, after decreasing 3.1% in November. On a year-over-year basis, the indicator increased by 1.3%, resulting in 9.9% growth in the year. The three-month moving average of expanded retail sales decreased 8.7% in December, quarter-over-quarter, according to seasonally adjusted data. On a month-on-month basis, according to seasonally adjusted data, it bears emphasizing the expansion in the sales of "office material and equipment" (11.9%) and "vehicles, motorcycles, parts and pieces" (3.5%). The negative key drivers were "civil construction" (-7.3%) and "furniture and appliances" (-3.7%). In the year, cumulative growth was more significant in "office material and equipment" (33.5%) and "other personal and domestic articles" (15.6%). After falls in October, November and December, expanded retail sales data for January and February should evidence a recovery influenced mainly by the increase in the sales of vehicles, in response to the sector incentives granted by the government. This recovery was captured by the data from the National Federation of Distribution of Automotive Vehicles (Fenabrave). For the next quarters, the retail sales trajectory will continue to be sustained by fiscal transfers, as well as by real payroll growth, whose evolution should be favored by the reduction of inflation, but it will also be affected by the evolution in the access to credit supply and by the behavior of consumer confidence.

9. The installed capacity utilization rate (Nuci) in the manufacturing industry reached 78.07% in January, below the level observed in December, according to CNI data seasonally adjusted by the BCB. According to data seasonally adjusted by CNI, the Nuci in the

manufacturing industry also reduced, reaching 78.4% in January, down from 79.4% in December. Without the seasonal adjustment, in January the Nuci stood 5.1 p.p. below the level registered in the same month 2008. On its turn, the monthly non-seasonally adjusted Nuci calculated by Fundação Getulio Vargas (FGV) retreated strongly in February, to 76.9%, standing 7.8 p.p. below the level registered in the same month of 2008. The reduction in the Nuci, year-over-year, is also observed in the production of consumer goods (-4.7 p.p.), intermediate goods (-9.7 p.p.), capital goods (-15.2 p.p.) and civil construction inputs (-5.9 p.p.). The reduction on Nuci calculated by CNI and FGV seems to be a result of a combination between the maturity of investment projects and accommodation of economic activity, and points to significant increase of the idle capacity level of the manufacturing industry. On the other hand, recent data about the absorption of capital goods indicate continuity in the slowdown of investments. The absorption of capital goods decreased 1% in January, according to seasonally adjusted data, and by 19.6% in year-over-year terms, according to observed data. In its turn, the production of civil construction inputs increased 0.8% at the margin in January, after decreasing 5.8% in December, falling 9.7% year-over-year. In short, evidences so far suggest an ongoing process of reduction in demand pressures over the productive capacity level of the manufacturing industry. As stressed in previous Copom Minutes, the inflation trajectory is closely linked to current and prospective developments related to the expansion of supply of goods and services, to adequately meet demand conditions.

10. The twelve-month accumulated trade balance has been showing stability at the margin. Under this criterion, the trade surplus reached US$24.7 billion in December, decreased to US$23.3 billion in January and increased to US$24.2 billion in February. This total resulted from US$191.2 billion in exports and US$167.0 billion in imports, equivalent to 15.5% and 29.2% growth, respectively, year-over-year. The adjustment in relative prices and the accommodation in the pace of expansion of domestic demand contribute to the recovery of the trade surplus, but the deterioration in the terms of trade acts on the opposite direction. The reduction in remittances of profits and dividends has acted to limit the current account deficit, which reached US$28.3 billion in December 2008, decreasing to US$27.0 billion in January, equivalent to 1.8% of GDP. On its turn, foreign direct investment reached US$42.2 billion in the twelve months through January, equivalent to 2.7% 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 continued to be significant. Despite the unprecedented actions taken by the authorities in the US and Europe, using wide range of instruments, in order to ensure minimum conditions of operation and liquidity in money markets, systemic risk perception is still in evidence. The contraction of international liquidity has continued to contribute to a process of deleverage 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, the volatility of emerging economies' currencies remains present, despite not showing the generalized trend of depreciation against the US dollar observed in the last months of 2008.

12. Regarding the global macroeconomic scenario, contraction trends prevail over inflationary pressures. The predominant view points to the contraction of global economic activity in 2009, recovering just in 2010. The consensual projections point to an intense retraction of activity in US, Europe and Japan, which wouldn't be totally offset by the economic dynamism of some emerging economies, especially in Asia. There are evidences that the deeper weakening of economic activity in Europe and parts of Asia was in a significant manner due to the negative shock in the terms of trade caused by the elevation of commodities prices in 2008, which was reverted, allowing an increase in available income in these regions. On the other hand, the problems in the international financial system have continued to be aggravated by a cyclical deterioration in the quality of credit, focused on the US and Europe, which tends to reinforce the contraction in financial conditions and, as a consequence, the risk of intensification in the deceleration. In mature economies, where inflation expectations are better anchored and economic activity has considerably decelerated, inflationary pressures have reduced rapidly. 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, inflationary pressures have also been declining, although they show, in many cases, more persistence. In this context, while the monetary policy stance is mainly expansionist in mature economies, in emerging economies, which, in addition to the facts already mentioned, have been affected by the exchange rate depreciation trend, the expansionist stance has been more moderate. At the same time, the authorities in US, Western Europe and Asia have been announcing a series of initiatives aimed at sustaining economic activity through fiscal incentives, which could contribute to a gradual economic recovery. However, the estimates on the fiscal costs for packages of macroeconomic stimulus and support to the financial sector have been increasing, which has caused pressures on the assessment of risk on many sovereign credits, even in advanced economies.

13. Oil prices remain volatile, despite currently being close to the levels observed at the last Copom meeting. Future markets quotations have also shown volatility, without a defined trend. Uncertainty concerning these quotations remains high, as the prospective scenario depends on the evolution of demand, especially in emerging countries, on the prospects for evolution of global supply, in a scenario of uncertainties regarding the implementation and maturation of investments in the sector, in addition to the geopolitical issues that affect the price of this commodity. Nonetheless, the main scenario adopted by the Copom, which assumes unchanged gasoline prices in 2009, remains plausible. However, with the persistence of the current scenario in the oil market, it does not seem prudent to completely disregard the hypothesis of price reductions in 2009. However, it bears highlighting that, regardless of the behavior of domestic gasoline prices, the reduction in international oil prices observed since the second half of 2008 can eventually affect domestic prices both through productive chains, such as the petrochemical, as well as through the potential effect over inflation expectations. Conversely, the prices of agricultural commodities such as wheat, soybeans and corn, have reduced since the last Copom meeting, reacting both to the perspectives of reduction in demand and to the accumulation of inventorie.

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) similarly to the January Copom meeting, the projected adjustment for 2009 for both gasoline and bottled gas prices stood at 0%;

b) the projected adjustment for fixed telephone for 2009 was kept unchanged at 5.0% (the same value considered in the January Copom meeting), while the expected adjustment for electricity prices was reduced to 7.6%;

c) the projection for regulated prices inflation in 2009, based on individual items, was maintained unchanged at 5.5%, compared to the January Copom meeting. This set of prices, according to data released by IBGE, corresponded to 29.64% of the total February IPCA;

d) the projection of regulated prices inflation for 2010 remained unchanged at 4.8%, compared to the January Copom meeting. Such projection is based on the endogenous determination model for regulated prices, which computes, among other factors, seasonal components, foreign exchange rate changes, market prices inflation and the IGP (General Price Index) variation; and

e) the projection for the spreads over the Selic rate, on the benchmark scenario, based on the 360-day swap rates, estimates a 29 bps spread in the fourth quarter of 2009 and 37 bps in the last quarter of 2010. 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 2009. The additional assumptions considered in the previous meeting remained unchanged.

16. Since the last Copom meeting, according to the median IPCA inflation expectations compiled by the BCB's Investor Relations Group (Gerin), the 2009

IPCA change reduced to 4.57% down from 4.80%. For 2010, inflation expectations stood at 4.50%, the same projection observed in the January meeting.

17. Considering the hypotheses under the benchmark scenario – which assumes the maintenance of the exchange rate at R$/US$2.40 and the Selic rate at 12.75% p.a. during the forecast period – the projection for the 2009 IPCA decreased relative to the figure considered at the January Copom meeting and remains below 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 2009 also decreased compared to the figure considered in the previous Copom meeting and is below the central target. Inflation projection for 2010, based on the benchmark scenario, slightly decreased compared to the figure considered in the last Copom meeting and is significantly below the 4.5% central target, while on the market scenario, it has also decreased, staying below the 4.5% central target.

Monetary policy decision

18. The Copom evaluates that the monetary policy should contribute to the consolidation of a favorable long-term macroeconomic environment. Economic activity available data indicate that the pace of domestic demand expansion has significantly cooled since the last months of 2008, amidst a significant generalized economic activity deceleration in other economies, developed and emerging. On its turn, the increase in risk aversion and the unprecedented constraints observed in liquidity conditions in the international markets, unseen over the last few decades, continue to impose adjustments in the balance of payments. Therefore, in general terms, the influence of the external scenario over the future path of Brazilian inflation continues to be subject to apparently contradictory effects, which can act with distinct intensity throughout time, surrounded by significant uncertainty. On the one hand, the economic cooling has caused an increase in risk aversion, impacting the demand for Brazilian assets and consequently, depreciating their prices. On the other hand, the more generalized economic deceleration observed in the last months which, despite not permanent, may persist in the upcoming quarters, has caused the cooling of both commodities prices and external demand, also negatively impacting local financial conditions. Moreover, the trajectory of price indices evidences the reduction of external inflationary pressures, especially in mature economies, but also in some emerging economies. As a consequence, the net effect of the global deceleration over domestic inflation path seems to be, so far, predominantly benign. 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, when inflation targets were systematically met.

19. The Copom evaluates that the probability that initially localized inflationary pressures may cause risk to domestic inflation trajectory continues to diminish. Evidences of substantial accommodation of domestic demand and moderation of pressures over the market of factors, despite remaining subject to uncertainty, should reduce the risk of pass-through of upward pressures, observed through the end of 2008, of wholesale prices (which have been showing deflation over the last few months) to consumer prices. The Committee evaluates that the materialization of this pass-through, as well as the generalization of pressures initially localized on consumer prices, still depends critically on economic agents' inflation expectations. In particular, inflation expectations for 2009 remain in levels above the inflation target, in spite of some reduction since the last Copom meeting, and continue to be closely monitored. Additionally, it is worth noticing that, according to available data, the behavior of domestic demand should exert lesser pressures over the prices of non-tradable items, such as services, in the upcoming quarters. Anyhow, the Committee reaffirms that it will continue to conduct its actions in order to ensure that the gains obtained in inflation control in recent years become permanent.

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 point of view is even more important in periods surrounded by heightened uncertainty.

21. Prospects for the evolution of economic activity have continued to deteriorate since the last Copom meeting, although industrial activity data have been partially reflecting a process of inventory retreat, which tends to fade over time. It is particularly important to notice that the effects of the international crisis over domestic financial conditions have resulted in severe decline of the credit contribution to domestic demand support. Additionally, the intensification of the international crisis has caused negative effect on consumers and businessmen confidence. Under such circumstances, the economic activity dynamism tends to increasingly rely on payroll expansion and on the effects of the possibly enhanced governmental transfers that should occur in 2009. On the other hand, the contracting effects of the international financial crisis over the domestic economy dynamism and, consequently, over the context of monetary policy, despite not permanent, may become persistent. These considerations become even more relevant considering the fact that the current monetary policy decisions will have concentrated impacts over the upcoming quarters.

22. The Copom evaluates that the loss of domestic demand dynamism should result in the reduction of inflationary pressures. On its turn, the remaining risks for the inflationary dynamics derive from the trajectory of Brazilian asset prices, amidst a process of decreasing external sources of funding and mechanisms of price adjustments that contribute to prolong inflationary pressures observed in the past, as evidenced by the behavior of the prices of services and regulated items during the beginning of 2009. The balance of those influences over the prospective trajectory of inflation will be crucial to the assessment of the various alternatives available for the monetary policy stance.

23. International evidence, as well as the Brazilian experience, indicates that high inflation rates leads to increase in risk premiums, both for private and public funding, to the shortening of planning horizons and, consequently, to lower potential economic growth, besides having regressive effects over income distribution. Therefore, the Copom strategy aims to ensure that inflation resumes the 4.5% midpoint target path in 2009, as established by the CMN, and to keep it in level consistent with the targets path for 2010. Such strategy, which should have its results evidenced throughout time, takes into account the time lags in the transmission mechanisms 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 signs of economic activity slowdown, regarding, for instance, industrial production indicators (exacerbated by an inventory cycle), certain available data on labor market and industrial capacity utilization rates, as well as on businessmen and consumers confidence, and of lower inflation expectations for relevant horizons, the prospects for the materialization of a benign inflation scenario, in which IPCA would resume evolution in line with target path, have been increasing. Indeed, the evolution of the prospective scenario is reflected on inflation projections considered by the Committee. Nevertheless, despite there is still some scope for an easing process, monetary policy should be cautiously conducted, aiming to assure the convergence of inflation to the targets path.

25. The Committee believes that the demand slowdown, stemming from the tightening of financial conditions, the deterioration of agents' confidence and global economic activity contraction, has created significant idleness margin of production factors. Such development should contribute to restrain inflationary pressures, even in light of the consequences of the adjustment process of the balance of payments and the presence of mechanisms of inflation feedback in the economy, making room for a monetary policy easing process. On the other hand, in addition to the fact that changes on the basic interest rate have effects over activity and inflation that accumulate over time, the Copom's evaluation about the scope for some additional monetary policy easing also takes into account aspects resulting from the long periods of high inflation, still embedded within the financial system institutional framework.

26. In such context, taking into account the macroeconomic scenario, Copom has unanimously

decided, at the moment, to reduce the Selic rate to 11.25% p.a., without bias. The Committee will monitor the evolution of the inflation forward-looking scenario until its next meeting, considering the magnitude and speed of the basic interest rate adjustment already implemented and its cumulative effects, in order to define the next steps of its monetary policy strategy.

27. Under the inflation targeting regime, the Copom guides its decisions according to projected inflation, the analysis of several alternative scenarios for the evolution of the main variables that determine the forward-looking prices dynamics, and the balance of risks associated to the projections. There are signs that, after a long period of expansion, domestic demand has started to have a contractionist influence over economic activity, despite persistence of stimulus factors, such as income growth. Additionally, it is worth noticing that inflationary expectations for 2009 have decreased since the last Committee meeting. On the other hand, the deceleration of global economy has generated downturn pressures over wholesale prices, despite the exchange rate adjustment. Under such environment, monetary policy can be more flexible without putting at risk inflation convergence to the targets path. Evidently, if deterioration on the risk profile implies shifts to the inflation prospective basic scenario considered by the Committee at this moment, the monetary policy stance will be promptly adjusted to the circumstances.

28. At the end of the meeting, it was announced that the Committee would reconvene on April 28th, 2009, for technical presentations and on the following day, to discuss monetary policy decision, as established in Communiqué 17.327 of August 27th, 2008.

Summary of data analyzed by the Copom

Inflation

29. The IPCA increased 0.55% in February, decelerating relative to the February IPCA-15 (0.63%), and accelerating relative to the January IPCA (0.48%). In the last twelve months through February, the IPCA reached 5.9%, up from 5.84% observed in January, reaching 1.03% in 2009. The February result was influenced by the increase in the costs of education (4.77%), which contributed 0.33 p.p., representing 60% of IPCA change in February, as a result of the typical readjustments of this group at the start of the year.

30. Market prices accelerated, reflecting the increase in education costs, reaching 0.67% in February, up from 0.37% in January, while regulated prices reached 0.28%, down from 0.75% in the same period. On a twelve-month trailing basis, market prices increased 6.71% in February (the same change observed in January), while regulated prices reached 4.02%, up from 3.83% over the previous month. The diffusion index reached 58.07%, down from 66.15% in January, the lowest level recorded since March 2008.

31. The core excluding household food items and regulated prices increased 0.88% in February, up from 0.27% in January, reaching 6.14% over twelve months, compared to 5.95% in the previous month. The smoothed trimmed means core reached 0.29% relative to 0.42% in January, increasing by 4.89% over the last twelve months (4.88% in the previous month). The non-smoothed trimmed means core increased 0.27% in February, down from 0.44% and reached 4.85% in twelve months (4.95% in the previous month).

32. The IGP-DI decreased 0.13% in February, compared to a 0.01% increase in January, accumulating a 0.11% decrease over the year and a 7.5% increase in the last twelve months. The IPA (Wholesale Price Index) decreased 0.31% in February, reflecting lower prices on both agricultural products (-0.36%) and on industrial products (-0.29%). On a twelve-month basis, the IPA increased 7.39%, with a 9.49% increase in industrial prices and 1.94% in agricultural prices. It bears highlighting IPA’s significant deceleration in the twelve months through October, November, December and January: 14.72%, 12.88%; 9.80% and 8.27%, respectively. The IPC-Br decelerated, decelerating from 0.83% in January to 0.21% in February, reaching 6.15% in twelve months. The INCC increased 0.27% in February, down from 0.33% in January, reaching 11.67% in the last twelve months. The IPC-Br core reached 0.33% in February, down from 0.35% in January, reaching 4.25% in twelve months.

33. Analyzing the IPA by stages of processing, the prices of final goods increased 0.85% in February, while the prices of intermediate goods and gross raw material decreased 1.03% and 0.55%, respectively. In the last twelve months through February, these three segments increased 4.78%, 9.05% and 8.02%, respectively.

34. The IPC-S (Weekly Consumer Price Index) increased 0.35% over the first week of March, compared to 0.21% in February.

Economic activity

35. According to seasonally adjusted data from the IBGE's monthly survey (PMC), expanded retail sales, which include construction supplies and vehicles and motorcycles, parts and pieces, decreased 1% in December, after decreasing 3.1% in November and 8.4% in October. Four out of the ten segments surveyed by the IBGE expanded in December, with highlights to office material and equipment (11.9%) and vehicles, motorcycles, parts and pieces (3.5%), which benefitted from the IPI (Industrialized Products Tax) reduction. In October and November, automobile industry sales decreased by 18.8% and 7.1%, month-on-month, respectively. Among the segments that declined relative to December, it bears noticing the performance of construction material (-7.3%, month-on-month), deepening the contraction observed in the two previous months.

36. Considering the comparisons between identical periods of 2008 and 2007, expanded retail sales increased 1.3% in December, growing by 9.9% year-over-year in 2008. In December, it bears emphasizing a decrease in sales of fabric, clothing and shoes (6.3%); vehicles, motorcycles, parts and pieces (4.5%); and construction material (3.6%), according to the same comparison basis. Among the sectors with sales increases, office material and equipment presented the best performance, with a 35.6% increase year-over-year. In 2008 all sectors grew, with highlights, once again, for office material and equipment, which grew 33.5% compared to 2007.

37. According to São Paulo Trade Association (ACSP) data, seasonally adjusted by the BCB, database consultations for credit sales (SCPC) related to the city of São Paulo decreased by 3.3% in February, month-on-month. On the other hand, consultations to Usecheque system expanded by 2.8%. In addition, those indicators decreased 12.8% and 5.5%, respectively, year-over-year. In the first two months of 2009, those indicators decreased 9.2% and 5.3%, respectively, compared to the same period of 2008.

38. Automobile sales by dealers, which take into account light commercial vehicles, trucks and buses, declined 0.8% in February, year-over-year, according to Fenabrave. However, February data hit the second highest volume of sales in the historical series. According to seasonally adjusted data, February sales increased 4% month-on-month, after a 36.5% increase in January, according to the same comparison basis. In the quarter ended in February, sales decreased 4.6%, quarter-over-quarter.

39. Regarding investment indicators, capital goods production increased 8.4% in January, while the production of construction typical inputs increased 0.8%, month-on-month, considering the seasonally adjusted series. Relative to January 2008, those indicators decreased 13.3% and 9.7%, respectively. The positive margin increase on capital goods production reflected basically the expansion of segments of transportation equipment (9.6%) and for mixed use (7.8%).

40. According the industrial survey conducted by CNI, 89% of industrial companies plan to invest in 2009 (although in a lesser proportion than 2008), although 67% of entrepreneurs responded that their productive capacity is adequate to the expected demand for 2009. The planned investments seek to improve quality and expand production, with focus on the domestic market.

41. Capital goods imports declined 18.4% in January, month-on-month, according to the Funcex quantum indices, seasonally adjusted by the BCB. The January indicator decreased by 12.4% year-over-year, down from the twelve-month cumulative change (28.5%), signaling the significant downturn in the performance recently observed.

42. According to IBGE's Monthly Industrial Survey (PIM), industrial production increased 2.3% in January, month-on-month, after three consecutive months of decline, according to the seasonally adjusted series. Twelve of the 27 activities surveyed reported monthly decline in production, with highlights to the negative performance in the sectors of machinery, appliances and electrical materials (-9.5%), and miscellaneous (-10.7%). By use categories, still considering seasonally adjusted data, only the production of semi- and non-durable consumer goods presented negative result (-0.6%). Capital goods, intermediate goods and durable consumer goods production increased, respectively, 8.4%, 0.8% and 38.6% in January, month-on-month.

43. Industrial production decreased 17.2% in January, year-over-year, a record low for the series since its start in November 1991. All the use categories declined year-over-year: capital goods (-13.3%), intermediate goods (-20.4%), durable consumer goods (-30.9%) and semi- and non-durable consumer goods (-8.3%). The 12-month cumulative industrial production expanded by 3.1% in December and 1% in January, evidencing deceleration at the margin.

44. Vehicles production reached 201.7 thousand units in February, according to Anfavea, decreasing 20.6% year-over-year. Considering data seasonally adjusted by the BCB, the production of vehicles increased 7.2% in February, month-on-month, while the production in the last quarter stood 27.8% below than the observed in the quarter ended in November. The cumulative production of vehicles and agricultural machinery increased by 0.9% and 16.1%, respectively, in the last twelve months through February. The sales of domestic vehicles decreased 13.2% in February 2009, year-over-year, but increased 4.1% in twelve months. According to the same comparison bases, vehicles exports decreased 52.3% and 15.5%, respectively.

45. CNI indicators continued to show deceleration in the pace of industrial activity in January, with decreases of 3.5% in real revenues and 2.1 p.p. in the installed capacity utilization, according to data seasonally adjusted by the BCB. The hours worked was the only indicator that grew month-on-month. Compared to January 2008, all indicators decreased: real revenues (-13.4%), hours worked (-6.5%) and installed capacity utilization (-5.1 p.p.).

46. The LSPA survey carried out by the IBGE in February pointed to the production of 135.3 million tons in 2009, up from 134.7 million tons estimated in January. The new estimate represents a 7.3% decrease relative to the 2008 production. Declines of 12.7% and 3.9% in the production of corn and soybean, respectively, were also projected. Products directly related to the basic food basket, such as rice and beans, should have their production expanded by 3.7% and 11.1%, respectively.

47. The IBGE released information on the GDP performance of the fourth quarter of 2008. The data show a slowdown both for accumulated changes in the year (5.1%, down from 6.4% in the previous quarter), and for year-over-year results (1.3%, down from the 6.8% in the previous quarter). According to data seasonally adjusted, the GDP in the last quarter of 2008 decreased by 3.6%, quarter-on-quarter. On the supply side, according to the year-over-year comparison, only the industry activity fell (-2.1%). Agriculture and services grew, respectively, 2.2% and 2.5%. On the demand side, household and government consumption and gross fixed capital formation increased 2.2%, 5.5% and 3.8%, respectively. Additionally, exports retreated 7% and imports increased 7.6%, resulting in the twelfth consecutive quarter of growth driven exclusively by the domestic market. The domestic demand contributed 3.2 p.p. for the 1.3% increase of GDP in the last quarter of 2008 (year-over-year), while the external sector contributed -1.9 p.p..

Surveys and expectations

48. According to the Fecomercio-SP survey, the Consumer Confidence Index (ICC) decreased 3.5% in March, month-on-month, reflecting the reduction of 10.1% in the Current Economic Conditions Index (Icea) and the rise of 0.6% in the Consumer Expectations Index (IEC). The ICC declined 13.3% year-over-year, mainly due to the retraction of 24.8% in the Icea.

49. According to the FGV survey, the ICC decreased 4% in February, month-on-month, reaching a record

low for the series started in September 2005. This negative result was driven by the 5.6% decrease in the Current Situation Index (ISP) and by the 3.2% decline in the Expectations Index (IE). The survey also registered decreases of 17.5% in the ICC, resulting in falls of 15.5% in the ISP and 18.6% in the IE, year-over-year.

50. Still according to the FGV, businessmen confidence in the industrial sector was kept virtually unchanged the first two months of 2009, after falling in the last quarter of 2008, remaining at a level below 80 points. The Industry Confidence Index (ICI) reached 76.3 points in February, seasonally adjusted, increasing by 1 point month-on-month. For the second consecutive month, the seasonally adjusted index recorded growth, emphasizing the recovery of optimistic businessmen expectations about industrial activity. Among its components, and also in seasonally adjusted terms, the Current Situation Index (ISA) leveled at 77.4 points, 0.9% below the January outcome, while the Expectations Index (IE) increased 3.7%, reaching 75.2 points. By use categories, all indicators increased in the month, but stood below 100 points. Consumer goods outperformed for being the use category with greatest confidence level and greatest level of recovery in the month, increasing 12.9 points, up from 4.1 points recorded by the general industry. By industrial segments, the segment of transportation material registered the most significant recovery in ICI, 34.1 points, reaching 83 points in February. The sectors of mechanics, cellulose and paper and other products reached a record low for the historical series. Year-over-year, food products and pharmaceuticals showed the slightest fall in the confidence index, of 11.3 points and 14.3 points, respectively, while the general industry retracted 24.6 points.

51. According to the FGV Manufacturing Industry Survey, installed capacity utilization (Nuci) reached 76.9% in February, 7.8 p.p. below February 2008, and 77.5% in the seasonally adjusted series, 0.5 p.p. below the previous month, having reached, according to this criterion, a record low for the historical series. All use categories registered year-over-year declines, with highlights for the retraction in capital goods (-15.2%). Considering the industrial segments, only food products and pharmaceuticals and veterinary products expanded, respectively, 0.6 p.p. and 0.4 p.p., year-over-year. Among the negative drivers, it bears highlighting metallurgy (-25.6 p.p.), and mechanics (-20.4 p.p.), according to the same comparison basis.

Labor market

52. According to the Ministry of Labor and Employment (MTE), 101.7 thousand formal jobs were eliminated in January 2009. Employment decreased by 0.2% month-on-month, in seasonally adjusted terms. Among economic activities, manufacturing industry recorded the highest number of dismissals, 55.1 thousand, followed by the retail sector, which eliminated 50.8 thousand jobs. The services and the construction sectors increased employment level by 0.08% and 0.06%, respectively, in seasonally adjusted terms. In the last twelve months through January, employment increased 4.1%, led by the construction sector (10.8%), and followed by the retail sector (5.4%) and the services sector (5.2%).

53. According to the IBGE employment survey (PME), carried out in the six main metropolitan areas of the country, the unemployment rate reached 8.2% of the economically active population (PEA) in January, increasing 1.4 p.p. month-on-month. The unemployment rate increased 0.2 p.p. year-over-year, first increase according to this comparison basis since October 2006. In seasonally adjusted terms, the unemployment reached 8.6% in January 2009, up from 7.8% in December, reflecting decreases of 1.6% in occupation and 0.1% in the PEA.

54. Occupation expanded by 1.9% in January 2009, year-over-year, decelerating from the 3.4% average growth observed last year. The PEA expanded by 2.1%, according to the same comparison basis, slightly above the 1.8% average growth observed last year. Formal employment decreased by 1.3% in January, month-on-month, corresponding to the elimination of 129 thousand jobs, while the total number of informal workers and self-employed workers reduced by 127 thousand jobs (-4.5%) and 88 thousand jobs (-2.2%), respectively.

55. The same survey pointed out that average real earnings of occupied workers increased by 2.2%

in January, month-on-month, and expanded by 5.9%, year-over-year. Real payrolls increased by 0.5% in January, month-on-month, and by 7.8%, year-over-year.

56. According to CNI data seasonally adjusted by the BCB, employment in the manufacturing industry fell 1.1% in January, after decreasing 0.5% in December, resulting in a 1.1% decrease in the quarter ended in January, quarter-on-quarter. Year-over-year, employment in the manufacturing industry decreased by 0.1%, while industrial real payroll increased by 2.1%.

Credit and delinquency rates

57. Outstanding credit in the financial system reached R$1,230 billion in January, increasing by 0.2% in monthly terms and 30.1% on a twelve-month trailing basis. This volume corresponded to 41.2% of GDP, compared to the 2008 figures of January (34.2%) and December (41.1%). Non-earmarked credit operations decreased 0.2% month-on-month and increased 30.4% in the last twelve months. Among the non-earmarked operations, which represent a share of 70.8% in the total of the financial system, credit operations to individuals increased 1.3% month-on-month and 23.2% in the last twelve months. Non-earmarked credit operations to corporate reduced by 1.4% month-on-month, expanding by 37.2% year-over-year. Earmarked credit operations increased 1.1% month-on-month and 29.5% on a twelve-month trailing basis, with highlights to the monthly increases of 1.9% in housing loans and transfers and 1.2% in credit operations performed by the BNDES (Brazilian Development Bank).

58. The leasing operations in the individuals segment continue losing momentum at the margin. On a twelve-month trailing basis, the expansion declined to 84.1% in January, down from 116.3% in October. Considering the segmentation by economic activity, the loans to industry decreased 0.8% month-on-month and expanded 36.5% in the last twelve months.

59. The average interest rate on non-earmarked credit operations, used as reference for interest rates, reached 42.4% p.a. in January, down from 43.3% p.a. in December and 37.3% p.a. in January 2008. The average rate on credit for individuals decreased 3 p.p. in January, month-on-month, reaching 55.1% p.a.. The average rate on corporate credit increased by 0.3 p.p., month-on-month, reaching 31% p.a., but still below the levels observed in October and November, of 31.8% and 31.4%, respectively. In January 2008, the average rate on credit to individuals and credit to corporate stood at 48.8% p.a. and 24.7% p.a., respectively.

60. The average tenure on non-earmarked credit operations, used as reference for interest rates for individuals, reached 375 days in January, compared to 379 days in December and 371 days in January 2008. The average tenure of corporate credit operations reached 297 days, while the average tenure for credit operations to individuals totaled 484 days, up from 308 days and 445 days, respectively, in January 2008.

61. Delinquency rates in the financial system (non-earmarked loans, used as reference for interest rates, in arrears for more than ninety days) stood at 4.6% in January, a 0.2 p.p. increase year-over-year. Delinquency rates for credit operations with corporate and individuals reached 2% and 8.3%, respectively, compared to 2% and 7.1% in January 2008.

62. Net delinquency rate for retail credit, measured by the ACSP, reached 7.8% in February, up from 6.4% in the same month of 2008.

External environment

63. The global macroeconomic scenario continues to reflect the deepening of the international financial crisis, with impacts over the global credit and economic activity. In this context, recent economic data have pointed to the contraction in consumption and private investment, worsening the loss of dynamism in international trade, increasing unemployment rates and widening the product gap. The weakness of aggregate demand in mature economies also began to contaminate the emerging economies that still showed some resilience. The current lack of liquidity conditions and further deterioration of growth prospects are set to be the most likely scenario for the short and medium term, which contributes for the global financial system to remain under severe stress.

64. As a result of the global recession outlook, energy and commodities prices have remained low, which resulted in significant reductions in inflation rates. In the US, despite the slight rise at the margin, the decrease in energy prices continued to contribute to the decline in inflation, which recorded 0.03% in the last twelve months through January, down from 5.6% in the twelve months through July 2008. In other mature economies, the declines in are not less significant. For the same period, inflation retreated to 0%, down from 2.3% in Japan, to 1.1%, down from 4.0% in the Euro Area and to 3.0%, down from 5.2% in the UK (in this last case, between September and January).

65. Considering the deepening of credit restrictions, the crisis in financial systems and the current behavior of inflation, central banks, both in the mature economies and in the emerging economies were urged to increase the amount of resources injected into their financial systems and further the monetary policy easing in order to mitigate the risk of deflation, especially in mature economies and in China. Such easing is also noticeable in Latin America, where the central banks in Colombia, Chile, Mexico, Brazil and Peru have continued the cycle of interest rate reduction. It bears highlighting that in the United States, Japan, UK, Canada, Sweden and Switzerland, where interest rates are very close to zero, central banks have begun considering or have already started to directly purchase long-term public or private securities. Additionally, several measures of fiscal and monetary stimulus were edited or prorogated in order to reestablish the normality of private consumption, the housing market and the global financial markets. For example, the US authorities have announced or launched loans programs for banks to encourage private consumption and activity of small companies, which adds up to new plans adopted based both on fiscal stimulus and also on support to the financial system.

Foreign trade and international reserves

66. The Brazilian trade surplus reached US$1.8 billion in February, totaling US$1.2 billion in the first two months of 2009. In the month, exports reached US$9.6 billion, and imports, US$7.8 billion, decreasing by 20.9% and 30.9%, respectively, year-over-year, on a daily average basis. Total external trade recorded US$17.4 billion in February, a 25.8% decrease year-over-year, on a daily average basis.

67. The decline of 21.9% in exports and 21.6% in imports in the first two months signal the cooling of global and domestic economic activity, which exceeds initial predictions, creating concerns about the performance of total external trade for 2009.

68. Based on the liquidity concept, international reserves totaled US$199.4 billion in February, recording a US$1.4 billion decrease month-on-month. Under the cash concept, international reserves totaled US$186.9 billion, recording a US$1.2 billion decrease month-on-month.

Money market and open market operations

69. Between the January Copom meeting and the start of March, the future yield curve for tenures up to one year shifted sharply downward in the whole extension. This behavior was domestically mainly driven by the released indicators signaling strong retraction in economic activity and weakening of labor market, as well as by the improvement of current inflation rates and expectations. The long-term rates ended the period showing less intensive reduction, mainly influenced by the maintenance of uncertainty regarding the direction of global economy. Between January 19 and March 9, one-, three-, and six-month rates decreased by 143 bps, 154 bps and 148 bps, respectively. Moreover, one-, two- and three-year rates decreased by 116 bps, 88 bps, and 45 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, decreased to 5.51% on March 9, down from 6.25% on January 19.

70. In its open market operations, the BCB carried out, between January 20 and March 9, weekly five- and seven-month fixed rate repo operations, borrowing. The average daily balance of these operations reached R$41.1 billion, of which R$26.2 billion were seven-month operations. In addition, the BCB conducted borrowing operations with tenures of 33 and 16 working days on January 22; of 26 working days on February 2; of 21 working days on February 9; and of 16 working days on February

16. These operations draw from the market the following amounts: R$207.1 billion, R$23.9 billion, R$2.5 billion, R$11.4 billion and R$20.9 billion, respectively. These operations averaged R$237.9 billion. In the same period, the BCB borrowed money through 33 overnight repo operations. 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$105.3 billion, on a daily basis, borrowing.

71. In the period between January 20 and March 9, the BCB carried out traditional FX swap auctions, in which assumed a long position in domestic interest rate and a short position in FX. These operations totaled US$13.8 billion, rolling contracts due on February 2 and March 2.

72. Between January 20 and March 9, the National Treasury raised a total of R$37.4 billion, of which R$20 billion in fixed-rate securities: R$19 billion via issuance of LTNs maturing in 2009, 2010 and 2011, and R$1 billion in NTN-Fs maturing in 2013 and 2017. Issuance of LFTs totaled R$14.3 billion, for securities maturing in 2012, 2013 and 2015. Issuance of inflation-linked NTN-Bs reached R$3.1 billion, for securities maturing in 2011, 2014, 2020, 2024, 2035 and 2045.

73. In the same period, the Treasury conducted auctions to sell LTNs maturing in October 2009 and April 2010 and bought LTNs maturing in April 2009, totaling R$1.5 billion; and conducted auctions to sell LFTs maturing in September 2013, against the purchase of LFTs maturing in March and June 2009, totaling R$1.0 billion. The sales of NTN-Bs settled in other National Treasury securities maturing in 2011, 2014, 2020, 2024, 2035 and 2045 totaled R$3.4 billion. The Treasury also conducted purchase auctions of LTNs, NTN-Bs and NTN-Fs totaling R$1.0 billion, R$0.4 billion and R$83 thousand, respectively.