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Inflation Report

December 2009
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BANCO CENTRAL DO BRASIL

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Inflation Report

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The following departments are responsible for the English version of the text and the respective tables and graphs:

Department of Economics (Depec)
(E-mail: depec@bcb.gov.br);

Research Department (Depep)
(E-mail: conep.depep@bcb.gov.br); and

Investor Relations Group (Gerin)
(E-mail: gerin@bcb.gov.br).

General Control of Publications

Banco Central do Brasil
Secre/Comun/Cogiv
SBS – Quadra 3 – Bloco B – Edifício-Sede – 1º andar
Caixa Postal 8.670
70074-900 Brasília – DF – Brazil
Phones: +55 (61) 3414-3710 and 3414-3565
Fax: +55 (61) 3414-1898
E-mail: editor@bcb.gov.br

Statistical Conventions

... data not available.
- nil or non-existence of the event considered.
0 or **0.0** less than half the final digit shown on the right.
***** preliminary data.

Hiphen between years indicates the years covered, including the first and the last year.
A bar (/) between years (1970/1975) indicates the average of the years covered, including the first and the last year or even crop or agreement year, when mentioned in the text.

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Banco Central do Brasil Information Bureau

Banco Central do Brasil
Secre/Comun/Diate
SBS – Quadra 3 – Bloco B – Edifício-Sede – 2º subsolo
70074-900 Brasília – DF – Brazil
DDG: 0800 9792345
Fax: +55 (61) 3414-2553
Internet: <http://www.bcb.gov.br/?english>
E-mail: cap.secre@bcb.gov.br

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Foreword

Inflation Report is a quarterly publication of the Banco Central do Brasil with the objective of evaluating the performance of the inflation targeting system and providing a prospective scenario for inflation. The national and international economic conditions underlying decisions taken by the Monetary Policy Committee (Copom) concerning the monetary policy management are presented.

The Report is divided into six chapters: Activity level; Prices; Credit, monetary and fiscal policies; International economy; Foreign sector and Prospects for inflation. With regard to the activity level, growth in retail sales, inventories, output, labor market and investments are investigated. In the following chapter, price analysis focuses on the results obtained in the quarter as a consequence of monetary policy decisions and the real conditions of the economy outside the realm of government action. The chapter referring to the credit, monetary and fiscal policies, the analysis is centered on the behavior of credit, financial and budget operations. In the chapter dealing with the international economy, the Report presents an analysis of the world's major economies and seeks to identify those conditions capable of impacting the Brazilian balance of payments. Insofar as the foreign sector chapter is concerned, analysis is targeted at economic-financial relations with the international community, with emphasis on trade results and foreign financing conditions. Finally, prospects on inflation growth are analyzed.

Executive summary

Signs of a global economic recovery, cited in the previous edition of the quarterly *Inflation Report*, seem to have become more consistent in the last months. While the recovery in Asia seems to have gained ground, activity in the United States (US) and the Euro zone strengthened in the third quarter, thanks to the end of the cycle of inventory correction amidst expansionary fiscal and monetary policies. These developments bode well for a recovery of global trade and for a wider revival of economic activity.

International financial and commodity markets are still benefiting from an environment of high liquidity and lower risk aversion, thanks to still low yields for government bonds in key mature economies. Thus, capital flows have been increasingly directed towards emerging markets, some of which have had to adopt containment measures.

In Brazil, after a brief recession at the end of 2008 and beginning of 2009, a new expansionary cycle has begun. This upswing, as shown by Gross Domestic Product (GDP) growth in the second and third quarters, as well as by recently released high frequency indicators, has been led by domestic demand. The fast post-crisis recovery has been made possible by better macroeconomic fundamentals as well as the policy measures that were adopted at the end of 2008 and early in 2009. A key element has been the resilience of household consumption (which accounts for 60% of GDP), boosted by rising real income, thanks to lower inflation, and also, more recently, by easier credit conditions.

The new growth cycle, which tends to gather traction with stronger domestic demand and a gradually recovering global economy, will also lead to stronger investment. These developments, which are consistent with the improvement in business and consumer confidence seen in the last few months, should lead to fast growth of imports. Still, rising imports should not pose stress to the balance of payments, which exhibited strong resilience when faced with the difficulties caused by the 2008 crisis.

Actually, Brazil's external accounts performed well once again in 2009, enabling the Central Bank to accumulate reserves. This performance was due partly to the improvement in the current account. The latter was due to the fact that external liabilities now mostly take the form of investment, rather than debt, so that remittances tend to be highly correlated with the domestic business cycle. Thus, the current account deficit (12 months) narrowed by US$7 billion between December 2008 and November 2009.

In addition, external funding needs have been met through steady foreign direct investment inflows, the gradual normalization of debt rollover ratios for the private sector, as well as through substantial portfolio flows into the stock market.

With narrower current account deficits and stronger financial inflows, the foreign exchange market has been posting monthly surpluses since April, which allowed the Central Bank to resume, from May, its build up of foreign exchange reserves, which had been paused from September 2008. Against this background, the sovereign spread, that reached 688 b.p. on October 24 2008, returned to the levels seen before the Lehman Brothers collapse, reaching 212 b.p. on November 11, while the nominal exchange rate retraced the depreciation seen in the second half of 2008.

The improvement seen in global financial markets was also seen in the local market, where a gradual recovery of credit has been led, in particular, by loans to households. In fact, credit to households has been growing since the beginning of the year, thanks to rising real incomes and, more recently, lower delinquency and better consumer expectations. Corporate credit, which was more severely impacted by the global financial crisis, has been recovering at a slower pace, in a process that has been helped by better corporate sales, a revival of investment and strong growth of lending by National Bank of Economic and Social Development (BNDES), the state-owned development bank.

A consistent recovery of domestic credit is the key to a sustained economic upswing, and should benefit from the improvement in employment and income levels, as well as by the cited reduction in delinquency.

Fiscal performance continues to show the effects of slower activity in the aftermath of the global crisis, on the one hand, and tax breaks granted with a view to support certain sectors, on the other, leading to a reduction of the primary surplus compared to what was seen last year. It should be noted that, while the ongoing recovery should favor an increase in fiscal revenues, a return to the level of surpluses seen before the crisis, and the continuity of a medium and long-term downward trend in the debt-GDP ratio would hinge on expenditure control.

Against a backdrop of stronger economic activity and credit recovery, rising ratios of capacity utilization in manufacturing, and an improving labor market, consumer price inflation picked up in the three months through November. This was due to rising ethanol prices, the reversal of temporary tax breaks on car purchases, and seasonal pressures on clothing prices, in an environment of strong consumer demand.

Recent behavior of headline and core inflation measures shows some reversal of the disinflation trends seen earlier in the year. Moreover, inflation could accelerate early in 2010, thanks to seasonal pressure on foodstuff prices and school tuitions, as well as increases in urban bus fares. Nevertheless, under appropriate monetary conditions, inflation should remain consistent with the targeted path, namely 4.5% in 2010-11.

Following the usual procedure, and taking into account the information set available by December 11 2009, the baseline scenario considered by the Monetary Policy Committee (Copom) assumes that the exchange rate will remain stable throughout the forecast period at R$1.75/US$, with the basic interest rate, dubbed Selic rate, at 8.75% p.a. – compared with R$1.85/US$ and 8.75% p.a. in the September 2009 *Inflation Report*. The forecast for 2009 inflation of administered and monitored prices (those set by contracts) was set at 4.5%, the same as in the last *Report*, while forecasts of changes in administered and monitored prices for 2010 and 2011 are at 4.0%, also the same as in the September *Inflation Report*.

The market scenario includes data gathered through a broad survey of forecasters undertaken by the Central Bank's Investor Relations Group (Gerin) until December 11 2009. In the market scenario, expectations about the average exchange rate in the fourth quarter of 2009 changed from R$1.82/US$ to R$1.73/US$ and, for the last quarter of 2010, from R$1.85/US$ to R$1.75/US$. For the fourth quarter of 2011, expectations point to an average exchange rate of R$1.80/US$. Regarding expectations about the average effective Selic rate, there was a shift from 8.75% p.a. to 8.67% p.a. for the fourth quarter of 2009, and from 9.08% p.a. to 10.58% p.a. for the end of 2010. For the fourth quarter of 2011, independent forecasters expect an average Selic rate of 10.81% p.a. Such a trend for the Selic would be consistent with spreads of 360 days pre-DI swaps over the current Selic rate (8.75% pa) of 98 b.p., 219 b.p., and 242 b.p. in the fourth quarters of 2009, 2010, and 2011, respectively. Note finally that the market scenario assumes changes of 4.5%, 4.0%, and 4.1% for monitored and administered prices in 2009, 2010, and 2011, respectively.

The forecasts presented in this *Inflation Report* are based on working assumptions about fiscal policy, namely that the targets for 2009 and 2010, of primary surpluses of 2.5% and 3.3% of GDP, will be met, reduced by up to 0.94pp and 0.68pp, respectively, thanks to implementation of the government's growth acceleration program (PAC). Moreover, the working assumption is that the primary surplus will return to 3.3% of GDP, without adjustment factors, in 2011.

In this environment the Copom forecasts inflation of 4.3% in 2009, under the baseline scenario. In this scenario, twelve-month inflation rises above the 4.5% target early in 2010, partly due to increases in administered prices in January. The forecasts then hover closely around the target throughout the projection period, ending up at 4.6% both in 2010 and in 2011. Such relative stability of the forecasts hinges partly on the assumption that the primary surplus will return, without rebates, to 3.3% of GDP in 2011.

Under the market scenario, the Copom forecasts inflation of 4.3% in 2009, the same as in the baseline scenario, and higher than in the last *Report*. Twelve-month inflation hovers around the target in 2010, declines in the first half of 2011, ending that year at 4.3%. Note that forecasts follow similar paths in both scenarios, as, in 2010, the effects of expected currency depreciation are partially offset by higher interest rates. For 2011, the effects of higher expected interest rates tend to dominate.

In the inflation targeting regime, the Copom bases its decisions on inflation forecasts, under several alternative scenarios for the behavior of the key variables that determine future price dynamics, and on the balance of risks around the central forecasts. Regarding the latter, the main risk to the inflation outlook stems from the strength of the domestic economic recovery. Specifically, it will be important to assess whether economic slack might not be used up at a faster pace than that embedded in the central scenario, which is based on a gradual economic recovery. To put it differently, there is a risk that supply conditions fail to respond adequately to faster than anticipated demand growth. To the extent that actual inflation is already close to the targeted value, the scope for policy accommodation is smaller; hence the risk mentioned above becomes more significant. Regarding the external sector, the main risk refers to the speed of the global economic recovery.

According to the baseline scenario, GDP growth should reach 0.2% in 2009, below the 0.8% forecast presented in the September *Inflation Report*, accelerating to 5.8% in 2010.

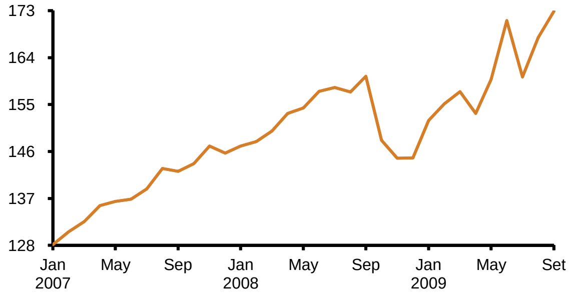
1 Economic activity

The scenario of consistent recovery in the activity level, emphasized in the September Inflation Report, was consolidated in recent months. Thus, the GDP, after reflecting, in the quarters that followed the worsening of the global crisis, the impact of the new economic environment on the internal activity, recorded significant growth in the quarter ended in September. This performance, repeating what was pointed out in the previous quarter, confirmed the importance of domestic demand to support the new expansion cycle in a scenario of import growth, consistent with the domestic recovery, and reduction in the trade balance surpluses. The sustainability vision of the current process of economic growth is reinforced by the behavior of investments, after registering an increase of 2% in the quarter ended in June, rose 6.5% in the third quarter, a trend supposed to continue over the next months, in line with the marked improvement observed in indicators related to business expectations, with the pace of production growth and the rise of the indicators of capacity utilization. The positive outlook regarding the evolution of household consumption associated with the following procedures for quantitative and qualitative improvement recorded in the labor market, the effect of increased consumer confidence on its location in relation to commitment of future income, and the impact of best credit terms on purchases of durable goods.

On the supply side, production of the industrial segment, while it follows a level lower than in the pre-crisis period, showed positive growth for the two consecutive quarters, behavior that should be kept in sequence, while the service sector showed acceleration in its growth rate. Farming, impacted by the unfavorable relationship between changes in prices of major commodities and their costs, and the slowdown in demand for livestock products, should respond favorably to the recovery scenario designed for the world economy only in 2010.

1.1 Retail sales

Figure 1.1 – Extended retail sales
Seasonally adjusted data
2003 = 100



Source: IBGE

Table 1.1 – Sales volume index

% change

	2009			
	Jun	Jul	Aug	Sep
In the month[1/]				
Retail sector	1.7	0.5	0.6	0.3
Fuel and lubricants	-3.0	-1.3	-0.3	0.5
Supermarkets	1.0	1.0	1.4	-0.5
Fabrics, apparel and footwear	10.3	-4.4	-2.1	0.9
Furniture and home appliances	3.6	2.4	0.8	1.8
Pharmac., medical items	-0.3	4.5	-0.2	-1.1
Books, newspaper, magazines,	-0.2	4.4	-0.7	1.4
Office, comp./comunic. equip.	14.6	-5.7	-5.6	8.8
Other art. of personal use	2.7	-1.2	-0.7	0.5
Broad trade sector	7.1	-6.3	4.7	3.0
Building materials	-1.4	0.0	1.3	-1.5
Automobiles and motorcycles	11.9	-9.2	2.1	9.1
3-Month Period/Previous 3-Month Period[1/]				
Retail sector	0.9	1.4	2.5	2.3
Fuel and lubricants	1.0	-1.0	-3.1	-2.8
Supermarkets	1.7	1.5	2.5	2.5
Fabrics, apparel and footwear	0.5	1.7	3.7	0.0
Furniture and home appliances	-2.1	1.8	5.3	6.2
Pharmac., medical items	1.2	2.2	2.9	4.1
Books, newspaper, magazines,	-2.7	3.0	3.4	5.0
Office, comp./comunic. equip.	9.1	2.6	3.5	-1.5
Other art. of personal use	2.3	3.2	3.1	1.3
Broad trade sector	4.2	5.4	6.1	3.5
Building materials	1.1	1.4	0.6	0.9
Automobiles and motorcycles	6.5	9.2	8.8	4.1
In the year				
Retail sector	4.4	4.7	4.7	4.7
Fuel and lubricants	2.2	1.3	0.5	-0.1
Supermarkets	6.8	7.3	7.4	7.7
Fabrics, apparel and footwear	-6.9	-6.2	-6.1	-6.2
Furniture and home appliances	-2.3	-1.9	-1.6	-1.2
Pharmac., medical items	11.8	12.1	12.4	11.9
Books, newspaper, magazines,	8.6	9.0	9.2	9.3
Office, comp./comunic. equip.	16.7	15.6	13.3	11.9
Other art. of personal use	9.5	9.3	9.0	8.7
Broad trade sector	3.9	3.4	3.7	4.4
Building materials	-9.8	-10.3	-9.7	-9.5
Automobiles and motorcycles	5.3	3.7	4.4	6.2

Source: IBGE
1/ Seasonally adjusted data.

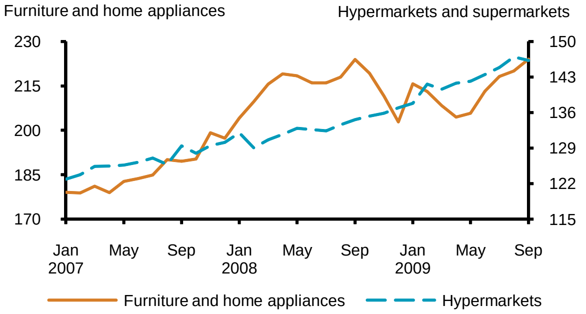
The retail sales, sustained in the months following the intensification of the crisis, the maintenance of disposable income and measures of tax relief, responded favorably in recent months, to the improvement observed in credit market conditions and growth levels consumer confidence.

In such scenario, the expanded retail sales increased 3.5% in the quarter ended in September, compared to the one completed in June, considering seasonally-adjusted data from the Monthly Retail Trade Survey (PMC), published by the Brazilian Institute of Geography and Statistics (IBGE). This result was due to expansions in the sales of eight out of eleven sectors surveyed, with emphasis on growth observed in respect of furniture and appliances, 6.2%; books, newspapers, magazines and appliances, 5%; and automobiles, motorcycles, parts and accessories and pharmaceutical, medical, orthopedic items and perfumery, both 4.1%. It is worth mentioning the positive outlook for retail sales associated with the extension of tax exemption measures for appliances with low energy consumption, by the end of January 2010, and for specific models of the automotive sector by the end of March.

Retail trade, a concept that excludes the vehicles and motorcycles segments, parts and accessories, and building materials, grew by 2.3% in the period. Geographic segmentation of these sales reveals its general expansion in the five regions of the country, highlighting the marked increase of 4% in the North, followed by the observed increases in the Southeast, 2.5%, the Center West, 1.8%; Northeast, 1.6% and the South, 1.4%. Considered by Federation units, retail sales were favorable in 25 of the 27 states, with emphasis on the dynamism observed in Rondônia, 7.7%; Acre, 6.1% and Sergipe, 5.1%, contrasting with the falloffs registered in Roraima, 5.4%; and Tocantins, 4.9%.

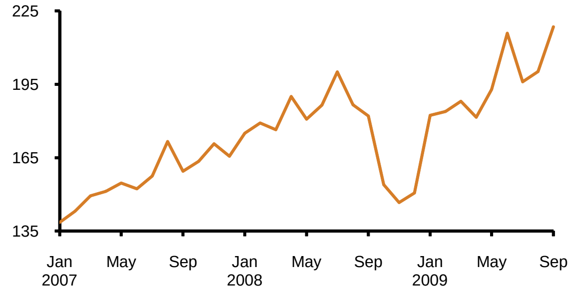
Nominal revenue of the expanded trade increased 9.6% in the first nine months of 2009 over the same period last year, resulting from increases of 4.7% in sales volume and 4.7% in prices. Of the ten sectors surveyed, five had nominal revenue growth above the average growth of 5.1% registered by the Extended National Consumer Price Index (IPCA), released by the IBGE, in the period, with emphasis on the expansion recorded in the sectors of pharmaceutical, medical and orthopedic articles and perfumery, 19.1%; other articles of personal use and household goods, 18.6% and hypermarkets, supermarkets, food products, beverages and tobacco, 13.6%.

Figure 1.2 – Retail sales
Seasonally adjusted data
2003 = 100



Source: IBGE

Figure 1.3 – Sales volume index (automobiles, motorcycles, parts and spares)
Seasonally adjusted data
2003 = 100



Source: IBGE

Table 1.2 – Retail sales
2009, September

	% accumulated growth in 2009		
	Nominal revenue	Volume	Price
Retail sector	9.6	4.7	4.7
Fuel and lubricants	1.3	0.4	0.9
Supermarkets	13.6	7.4	5.8
Fabrics, apparel and footwear	0.8	-6.2	7.5
Furniture and home appliances	-1.8	-1.6	-0.2
Pharmac., medical, orthop. and perfumery articles	19.1	12.5	5.9
Office, comp./comunic. equip.	7.4	13.3	-5.2
Books, newspaper, magazines	13.3	9.2	3.8
Other art. of personal use	18.6	9.0	8.8
Broad retail sector	5.1	3.7	1.4
Automobiles, motorcycles, parts and spares	-1.9	4.4	-6.0
Building materials	1.1	-9.8	12.1

Source: IBGE

Conversely, there were reductions in the nominal income in the segments of furniture and home appliances, 1.8% and vehicles and motorcycles, parts and accessories, 1.9%, is partly showing the impact of IPI reduction on average prices of the item new vehicles.

The favorable performance of the automotive sector, emphasized by the IBGE surveys, ratified by the trajectory of the sales of cars and light commercial vehicles, which, taking seasonally-adjusted data from the National Federation of Automotive Vehicle Distribution (Fenabrave), grew 3.6% in the quarter ended in November, compared to the one closed in August. Conversely, the National Automobile sales in the domestic market fell 2.5% on the same basis of comparison, according to the National Association of Automotive Vehicle Manufacturers (Anfavea).

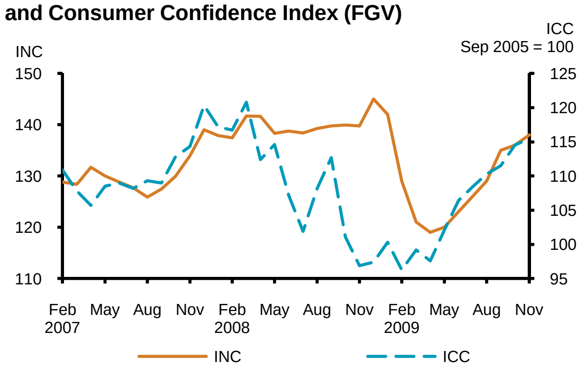
The default indicator, understood as the ratio between the number of checks returned for insufficient funds and the total number of checks cleared nationwide reached 6.4% in October, in view of 6.5% in the same month of 2008 and averages of 6.1% in the quarter ended in September and 6.8% and 7.1% respectively, in those ended in June and March. Regionally, the sharpest rate occurred in October, in the North, 13%, and the Northeast, 10.4%, followed by those observed in the Center West, 7%; South, 6.4% and Southeast, 55%.

The default rate in the state of Sao Paulo, published by the Commercial Association of Sao Paulo (ACSP), reached 4.2% in November, remaining on a downward trend that began in May, when it stood at 9.7%.

The evolution of confidence indexes continues to show the steady improvement of consumer expectations. This trend has been consistent with recent indications that the resumption of the Brazilian economy continues to take a clearer outline, and should strengthen the performance of retail sales in recent months of the year.

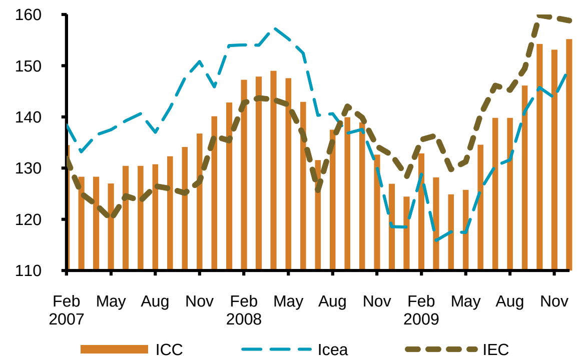
The Consumer Confidence Index (CCI) of the Getulio Vargas Foundation (FGV) registered a monthly increase of 1.5% in November, considering seasonally-adjusted data, standing at the highest level since May 2008. This development resulted in the marked growth of the Expectations Index (EI), 1.2%, and the Current Situation Index (ISA), 2%, the latter recording the seventh monthly increase in a row and reaching the highest level of the historical series, which began in September 2005.

Figure 1.4 – National Consumer Confidence (ACSP) and Consumer Confidence Index (FGV)



Sources: ACSP and FGV

Figure 1.5 – Consumer Confidence Index



Source: Fecomercio SP

The National Confidence Index (INC), prepared by Ipsos Public Affairs for the ACSP, submitted monthly growth of 1.5% in November, the seventh consecutive increase of this type of comparison, consolidating the recovery trend that followed the sharp decline registered in the indicator after the intensification of the global crisis.

The National Consumer Expectations Index (Inec) released by the National Confederation of Industry (CNI) based on a research carried out between 26 and 30 of November, increased 1.5% in the quarter finished in December, compared to the one completed in September, reaching a level 6.7% higher than in the same quarter in 2008 and reaching the highest level of the series, started in 2001. The trajectory of the indicator in the margin reflected, in particular, the impact of positive results recorded in the components of personal income expectations, 5.1%; and willingness to purchase higher-value goods, 4.5%, neutralized in part by the decrease of 2.7% registered in the indicator related to inflation expectations.

The ICC, released by the Trade Federation of the State of São Paulo (Fecomercio SP) and restricted to the metropolitan region of Sao Paulo, reached in December, the highest of the series which started in June 1994, rising 22.2 % over the same period in 2008 and 1.3% compared to November. The monthly development reflected the respective changes of 4.1% and 0.3%, marked in the Current Economic Conditions Index (Icea) and the Consumer Expectations Index (IEC).

1.2 Production

Crop/livestock output

The production of the farm sector decreased by 5.3% in the first nine months of the year over the same period in 2008, according to the Quarterly National Accounts, IBGE. There were significant decreases in production of cotton, coffee, corn, soybeans and wheat, while the livestock, showing the downturn of foreign trade, have experienced reductions in cattle and poultry slaughtering.

Crops

The grain harvest is expected to reach 134.1 million tons in 2009, according to the Systematic Farm Production Survey (LSPA) in November, from IBGE, resulting in annual decline of 8.1%.

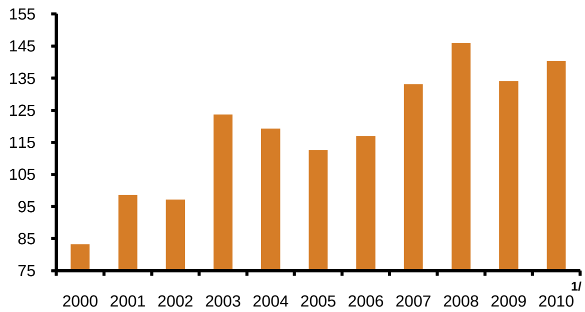
Table 1.3 – Farm production

	Production		% change
	2008	2009[1/]	2009/2008
Grain production	145 986	134 105	-8.1
Cotton (seed)	2 422	1 794	-25.9
Rice	12 101	12 604	4.2
Beans	3 460	3 513	1.5
Corn	59 012	51 031	-13.5
Soybean	59 917	57 032	-4.8
Wheat	5 886	5 098	-13.4
Other	3 188	3 032	-4.9

In 1,000 tons

Source: IBGE
1/ Estimate.

Figure 1.6 – Grain production
In million tons



Source: IBGE
1/ Estimate.

This movement, associated, in particular, to the decline of 8% recorded in the average yield, reflects the negative effects of harsh weather conditions in major producing regions, of soybean, wheat, corn, cottonseed and herbaceous cottonseed, who must register respective annual drops of 4.8%, 13.4%, 13.5% and 25.9%. The negative trend in agricultural production in 2009 also incorporated the projected reduction of 13.4% in the coffee harvest, which is in its biennial cycle of low productivity. Conversely, yields of beans, rice and cane sugar are expected to record their annual increases of 1.5%, 4.2% and 7%.

According to the second estimate for agricultural production in 2010, released by the IBGE, the grain harvest will total 140.4 million tons next year, noting that the annual growth, projected at 4.7%, reflects the prospects for increases in average productivity by 2.7% and 2% in area harvested. Positive results are estimated for soybean, bean and wheat, benefited from more favorable weather conditions, and soybean, evidencing, still, increase in planted area to the detriment of other cultures. Conversely, rice, corn and cottonseed crops are expected to register lower results than those reported in 2009, projection partly associated to the impact of the ratio between prices of these commodities and of soybeans on the migration of farmers to the cultivation of this grain.

Livestock

Table 1.4 – Livestock production
Total slaughters

% accumulated growth in the year

Itemization	2009					
	Jan	Feb	Mar	Apr	May	Jun
Cattle	-11.3	-9.9	-7.0	-9.1	-8.9	-7.4
Swine	9.2	10.4	13.6	12.0	12.0	11.8
Poultry	-9.5	-9.6	-6.3	-6.9	-6.2	-5.2

Source: IBGE

According to the Quarterly Survey of Animal Slaughter, published by IBGE, the production of beef, poultry and pork totaled, in order, 3.1 million, 4.8 million and 1.4 million tons in the first half of 2009, registering their variations of -7.4%, -5.2% and 11.8% over the corresponding period last year.

Industrial output

The recovery reported by industrial activity during 2009 is still driven by the dynamism of domestic consumption, benefited from the better conditions in credit and labor markets, and rising consumer optimism. In this scenario, the industrial employment, after presenting consecutive declines over the year, features indicative of recovery, while the recent evolution of business expectations, especially in the segments of capital goods and construction materials, reflects the consistency of the upturn in the activity level in the medium and long terms.

Table 1.5 – Industrial production

% change

	2009			
	Jul	Ago	Set	Out
Industry (total)				
In the month 1/	2.4	1.3	1.8	2.2
3-Month Period/Previous 3-Month Period 1/	4.0	4.1	4.8	5.1
Same month of the previous year	-10.0	-7.2	-7.6	-3.2
Accumulated in the year	-12.9	-12.1	-11.6	-10.7
Accumulated in 12 months	-8.1	-8.8	-10.2	-10.6
Manufacturing industry				
In the month 1/	2.2	1.3	1.8	1.2
3-Month Period/Previous 3-Month Period 1/	3.2	3.3	4.2	4.5
Same month of the previous year	-10.0	-7.0	-7.5	-2.9
Accumulated in the year	-12.8	-12.1	-11.5	-10.6
Accumulated in 12 months	-8.1	-8.8	-10.2	-10.5
Mining				
In the month 1/	-0.2	1.0	1.6	1.2
3-Month Period/Previous 3-Month Period 1/	3.9	5.1	4.1	4.0
Same month of the previous year	-10.1	-10.3	-9.4	-8.1
Accumulated in the year	-13.2	-12.8	-12.4	-11.9
Accumulated in 12 months	-7.8	-9.4	-10.9	-12.1

Source: IBGE
1/ Seasonally adjusted data.

Table 1.6 – Industrial production by category of use

% change

	2009			
	Jul	Aug	Sep	Oct
In the month 1/				
Industrial production	2.4	1.3	1.8	2.2
Capital goods	1.8	0.8	5.0	5.9
Intermediate goods	2.0	0.8	1.4	1.2
Consumer goods	3.4	1.4	0.5	1.7
Durables	5.0	3.1	-0.7	5.9
Semi and nondurables	1.3	0.8	-0.1	1.3
Quarter/previous quarter 1/				
Industrial production	4.0	4.1	4.8	5.1
Capital goods	3.7	5.8	6.2	8.4
Intermediate goods	4.0	4.1	4.3	3.9
Consumer goods	2.3	1.6	3.3	3.7
Durables	10.2	10.4	9.8	8.7
Semi and nondurables	0.3	-0.6	0.4	1.2
In the year				
Industrial production	-12.9	-12.1	-11.6	-10.7
Capital goods	-23.1	-23.0	-22.7	-22.0
Intermediate goods	-15.1	-14.2	-13.4	-12.3
Consumer goods	-6.7	-6.1	-5.9	-5.2
Durables	-17.4	-15.6	-14.5	-12.7
Semi and nondurables	-3.1	-2.8	-2.9	-2.7

Source: IBGE
1/ Seasonally adjusted data.

The overall physical output of the industrial sector increased 5.1% in the quarter ended in October, compared to the one concluded in July, according to seasonally-adjusted data from the Monthly Industrial Survey – Physical Production (PIM-PF) of the IBGE. The mining and quarrying and processing recorded respective increases of 4% and 4.5% in the period.

The analysis of industrial production by activity shows increases on the same basis of comparison, in 22 of the 26 sectors surveyed, with emphasis on those segments of electronic and communications equipment, 15.3%; machinery and equipment, 13.1%; automotive vehicles, 12% and basic metallurgy, 8.7%. Among the activities with negative performance, it should be emphasized tobacco, 5.8%, pharmaceuticals, 2.2%, and other transportation equipment, 0.9%.

The analysis of industrial production broken down by use category reveals the occurrence of positive performances for the quarter ended in October, compared to the one of July, with emphasis on the increases recorded in the industries of consumer durables, 8.7%, and capital goods, 8.4%, followed by the expansions observed in the categories of intermediate goods, 3.9% and semi-durable and nondurable goods, 1.2%. It is worth mentioning that the performance of the capital goods industry was affected by the further relaxation of credit conditions and the intensification of the resources provided by financing lines from BNDES.

The analysis of production of capital goods according to their destination shows that the dynamism of the sector reflected, in large part, to the growth of 56.8% observed in the segment of goods for the construction industry, followed by expansion in the industries of farm capital goods 16%, and agricultural parts, 11.1%. Additionally, manufacturers of capital goods of mixed use and capital goods for industrial use grew, in that order, 7.5% and 2.5% in the quarter finished in October, compared to the one concluded in July.

The production of the automotive industry reached 882,600 units in the quarter ended in November. The 6.2% growth reported in the quarter finished in August reflected, according to Anfavea seasonally-adjusted data, increases recorded in the segments of light vehicles, 5.5%; buses, 15.4% and trucks, 28, 6%. Domestic sales and exports of automotive industry reported its variations of -2.5% and 17% on the same basis of comparison. It is also worth mentioning a recovery of the farm machinery industry, which after falling 7.4% in the quarter ended in August expanded 31.1% in the period.

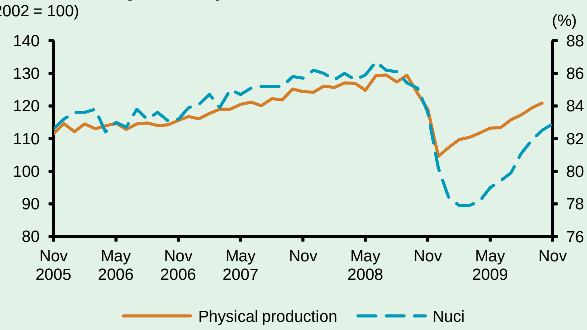
Evolution of the Installed Capacity Utilization Level during the Crisis

Industrial production completed in the third quarter of 2008 its longest growth cycle in decades. These developments showed the impact of favorable environment for consolidation of macroeconomic stability, lengthening of the planning horizon and gradual reduction of interest rates on the strengthening of domestic demand, on a scenario of continuous expansion of the external demand. It is worthy to stand out, in such period, the consequences of the confidence's increase of the industrialists on the process of investments recovering.

The worsening of the international economic crisis, starting in September 2008, has become the determining factor in the interruption of the mentioned cycle, expressed as a sharp decline in industrial production in the fourth quarter. The segmentation result of industry in the new macroeconomic environment, in which prevailed liquidity conditions markedly adverse and significant downturn in external trade flows, reveals that the most affected sectors were the producers of goods with higher added value or destined to foreign markets. In this scenario, at first the capital goods industries, consumer durables and intermediate goods were impacted more steeply, while for the production of semi non-durable consumer goods, generally of lower value and absorbed, in large part, by the portion of consumers whose available income has remained preserved, reported more favorable performance. In this context, the aim of this box is to review recent evolution of the Installed Capacity Utilization Level (Nuci[1]) of the manufacturing industry, aggregated and by categories of industries, and to anticipate the prospects for its development in the current scenario of resumption of the economic activity.

1/ The Nuci, ratio between the actual and potential production is calculated from statistics of the Manufacturing Industry Survey (SCIT) of Getulio Vargas Foundation (FGV).

Figure 1 – Physical production and Nuci in the manufactoring industry1/
(2002 = 100)



Sources: IBGE, FGV.
1/ Seasonally adjusted series.

The evolution of the manufacturing industry's Nuci followed, in the last four years, the trend of manufacturing activity, as recorded in Figure 1. Thus, while the Nuci reached 86.7% in June 2008, maximum value of the seasonally adjusted series, which began in April 1995, the physical production of goods by the manufacturing industry, considering seasonally adjusted data from the Monthly Industrial Survey – Physical Production (PIM -PF), the Brazilian Institute of Geography and Statistics (IBGE), started in January 1991, reached a record level in September 2008.

It is worth mentioning that the economic crisis worsening, in September 2008, occurred at a time of investments acceleration – typically in cycles of economic expansion – and therefore of increase of production capacity. In these circumstances, the inadequacy, in many cases, of interruptions in the process of investments in capital, intensified the effect of the sharp downturn in the physical production of the manufacturing industry's Nuci. After the brief recession cycle experienced by the Brazilian economy, the two mentioned variables began to register significant recovery during 2009, evidenced by the expansion of 4.3 percentage points (pp) reported on Nuci in October, compared to April, constituting the largest growth in this comparison, since 1995.

The trajectory of the manufacturing industry's Nuci shows, except for the capital goods industry, the occurrence of similar behavior pattern in the different use categories and fourteen kinds in the industry considered. These disaggregated statistics are presented in Table 1.

The trajectory of Nuci in the capital goods industry is distinguished by indicators such as those identified in other categories, due to inherent features in this segment. In this sense, the long expansion cycle experienced by the Brazilian economy until the intensification of the global crisis has resulted in particularly sharp increase in the Nuci of the respective category, while the subsequent interruption of the demand for capital goods has become the major determinant of the extended period of stagnation in the production category. Additionally, the gap between the drop of the Nuci in the category of capital goods and

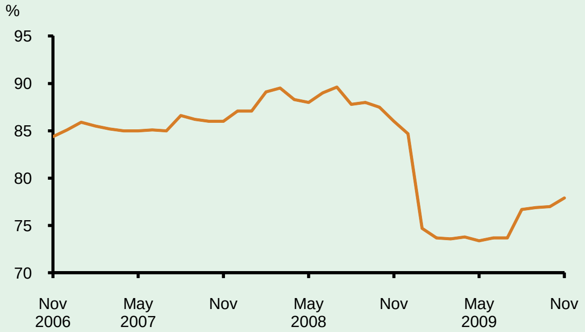
Table 1 – Capacity utilization

Seasonally adjusted series (%)

Itemization	2008				2009										
	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
Manufactoring Industry	85.4	85.1	83.6	80.2	78.4	77.9	77.9	78.2	79.0	79.4	79.9	81.1	81.9	82.5	82.9
Categorias de uso															
Consumer goods	87.1	86.6	85.4	76.8	78.4	79.1	79.6	79.4	82.1	82.2	83.0	83.9	84.1	85.8	86.5
Capital goods	88.0	87.5	86.0	84.7	74.7	73.7	73.6	73.8	73.4	73.7	73.7	76.7	76.9	77.0	77.9
Construction material	90.3	90.5	88.5	81.8	82.5	82.2	78.2	84.0	83.5	85.6	87.4	88.1	88.9	88.7	88.5
Intermediate goods	85.9	85.7	85.0	80.8	78.2	77.5	78.3	78.6	79.7	80.4	81.0	82.0	83.1	83.4	84.0
Industrial segments															
Nonmetallic minerals	89.9	89.8	88.8	77.9	83.3	82.3	79.0	79.0	77.8	78.5	80.7	80.9	81.8	83.3	85.6
Metallurgy	92.0	91.7	87.7	79.4	66.7	67.5	66.9	69.0	71.8	73.3	75.5	78.4	81.1	82.2	82.2
Mechanics	86.8	83.4	82.1	80.4	70.1	68.8	69.8	71.7	70.7	71.5	71.7	75.4	76.8	75.4	75.9
Electric and communication equipment	83.3	83.8	80.1	76.3	73.1	70.3	69.4	69.3	69.8	71.1	72.9	77.2	78.1	78.4	79.7
Transportation equipment	91.8	91.9	89.7	76.6	76.5	77.8	79.9	80.6	82.4	82.9	84.2	86.1	86.4	88.0	88.7
Furniture	80.9	78.7	75.6	75.9	74.0	72.1	75.1	74.2	73.3	72.6	76.6	77.3	72.8	72.4	76.0
Paper and cardboard	92.2	91.3	89.2	88.7	89.9	86.9	86.9	87.6	88.6	88.0	88.1	89.7	90.8	91.5	91.1
Chemicals	81.6	82.1	83.4	82.5	83.3	81.8	82.6	83.5	83.5	83.8	83.8	83.5	84.0	84.2	84.2
Pharmaceutical and veterinary products	74.1	73.0	72.1	76.2	77.4	75.1	74.3	72.9	70.8	72.6	72.9	74.1	75.8	75.3	75.1
Plastics	83.7	85.0	83.2	80.2	80.5	81.6	79.8	79.2	80.2	81.6	83.4	85.2	86.3	83.6	85.5
Textiles	86.3	86.5	86.9	84.1	81.8	84.0	83.6	85.9	85.5	84.8	85.4	86.3	85.1	86.4	86.3
Apparel	86.7	86.8	86.1	85.2	83.6	82.3	82.7	85.5	84.6	85.1	85.7	87.7	86.4	87.4	86.1
Foodstuffs	84.1	82.8	82.1	80.9	81.8	82.9	82.9	80.7	81.2	79.8	78.9	78.4	78.7	80.2	80.2
Others	80.5	80.6	79.9	79.5	78.7	77.1	77.2	75.8	77.9	78.1	77.9	79.3	79.7	80.1	83.6

Source: FGV.

Figure 2 – Nuci in the capital goods industry[1/]



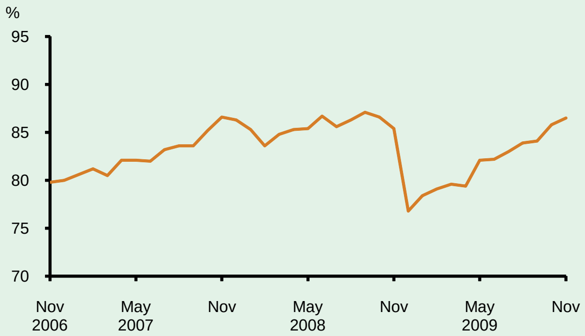
Source FGV.
1/ Seasonally adjusted series.

other segments of industry reveals, in part, the longer duration of the production cycle of this sector and its inability to interrupt an economically feasible manner. In this scenario, as shown in Figure 2, the Nuci related to the capital goods industry, after presenting a monthly reduction of 10 p.p. in January 2009, remained at this level during the first half of the year.

The Nuci of the industry of consumer goods, expressed in Figure 3, fell by 9.8 p. p. in the last two months in December 2008, noting that although Getulio Vargas Foundation (FGV) do not disclose statistics on discriminated capacity utilization between durable, non-durable and semi-durable consumer goods, the evolution of their respective industries shows that the downturn was concentrated in the first mentioned segment. Thus, while physical production of durable consumer goods, reflecting adjustments made in the automotive and electronic materials, devices and communications equipment[2], fell 45.8% in the last two months ended in December,

2/ In December 2008, the production of these industries came to in a level below the 50% indicated in October, according to seasonally adjusted data from the IBGE PIM-PF.

Figure 3 – Nuci in the consumer goods industry[1/]

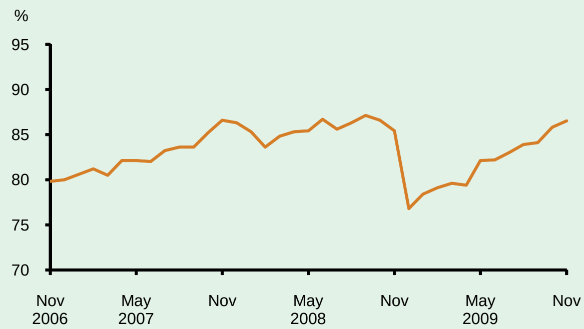


Sources: FGV.
1/ Seasonally adjusted series.

Figure 4 – Nuci in the construction materials industry[1/]

Sources: FGV.
1/ Seasonally adjusted series.

Figure 5 – Nuci in the intermediate goods industry[1/]



Sources: FGV.
1/ Seasonally adjusted series.

the one related to semi and non-durables consumer goods recorded a decrease of 4.4% in this comparison basis. The distinction between Nucis related to the durable, non-durable and semi-durable consumer goods is also suggested by the analysis of industrial segments surveyed by the FGV (Table 1). Thus, while Nuci on the product type of transportation material – associated with production of durable consumer goods – fell by 15.3 p.p. in the last two months in December 2008, relating to the category foodstuffs, characteristically non-durable and semi-durable consumer goods, decreased 1.9 p.p. Since early 2009, however, there was a significant recovery in capacity utilization in the consumer goods industry, which was in November, near the level before the crisis.

The transition to macroeconomic stability, the structural reduction of real interest rates, and the proliferation of credit instruments directed to housing and lengthening of the planning horizon experienced by the country in the last decade strongly encouraged the expansion of the construction industry. Thus, although the Nuci in the category of building materials has presented a monthly decline of 6.7 p.p. in December 2008, her recovery was relatively quick, and in April 2009,the indicator stood at a level close to the one recorded in November of the year before, as shown in Figure 4.

The drop in global demand, mostly concentrated in the developed countries has resulted in a significant stockpiling of finished products, resulting in a sharp downturn in demand for raw materials and intermediate goods. Thus, as shown in Figure 5, the Nuci on the category of intermediate goods fell by 9.4 p.p. in the last two months ended in December 2008, a move higher in all categories of the manufacturing industry, when considering the mean and variance of the respective series[3]. Also, it should be emphasized in this category, the indicator registered a strong recovery since early 2009, reaching in November, a similar level to that one observed before the external shock of 2008.

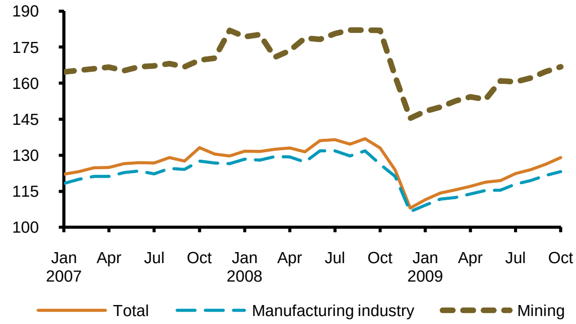
3/ The bimonthly retraction marked the in the Nuci under category of intermediate goods represents 3.3 units of standard deviation (SD) in this series, surpassing, by this criterion, the reductions noted in this period in indicators for consumer goods industries, 1,9SD.; capital goods, 2SD.; and building materials, 2.1SD. In other words, given the stability that characterizes the Nuci on the category of intermediate goods, the mentioned decrease is proportionally higher than those reported in other series of use category.

The behavior of the levels of installed capacity utilization in the fourteen industrial segments surveyed by the FGV shows, in general, the occurrence of declining trajectories in the second half of 2008 and first quarter of 2009, and their significant reversal in subsequent months. Thus, the Nuci on eight of the fourteen product types considered showed a gradual decline from July or August of 2008, while in five other series, the downward cycle began in October or November. It is worth mentioning that in the Nuci on the types metallurgy and transportation equipment showed the most pronounced occasional downturn in relation to their respective means and variances, while the chemical, plastics, pharmaceuticals and veterinary type, and other products reached in November, capacity utilization levels exceeding those recorded in the third quarter of 2008.

In general, the impact of the resumption of the economic activity consolidation on the level of installed capacity utilization in manufacturing industry can be observed as of April, driven in this period, by the performance of the construction and intermediate goods industries. This movement has started showing itself more generalized from the beginning of the third quarter of 2009, when the Nuci for the four industry's categories showed increases consistent with the performances of their respective industries.

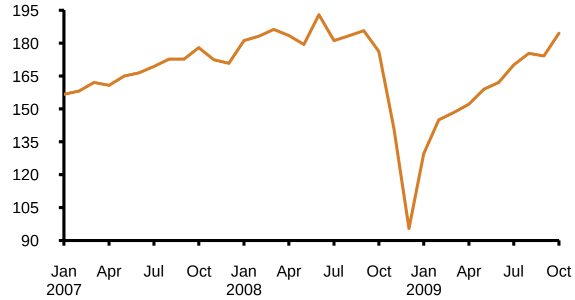
In this consolidation scenario of the beginning of a new growth cycle of the Brazilian economy, the discussion begins to involve the relationship between capacity of the industry and the pace of domestic demand growth, stressing also the additional effect on aggregate demand associated to the gradual recovery of the major mature economies. A simple exercise, considering the maintenance of quarterly expansion of 1.8 p.p. recorded in the November Nuci, suggests that the indicator would reach 86.5% in May 2010, a level only 0.2 p.p. lower than the record, reported in June 2008, of the series initiated in April 1995. In this scenario, the monetary policy management must now consider not only the prospects for effective recovery of investment in the industry's productive capacity and the maturation period of these investments, regarding the lagged effects of stimulus of economic policy adopted in recent years.

Figure 1.7 – Industrial production
Seasonally adjusted data
2000 = 100



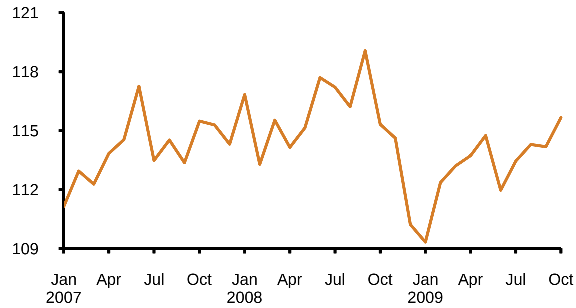
Source: IBGE

Figure 1.8 – Industrial production
Durable goods
Seasonally adjusted data
2000 = 100



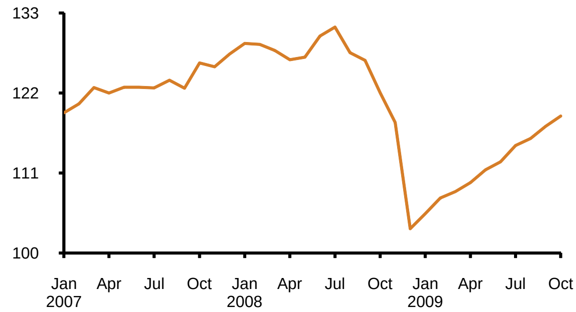
Source: IBGE

Figure 1.9 – Industrial production
Semi and nondurable goods
Seasonally adjusted data
2000 = 100



Source: IBGE

Figure 1.10 – Industrial production
Intermediate goods
Seasonally adjusted data
2000 = 100



Source: IBGE

The index of persons employed, considering seasonally-adjusted data from the Monthly Industrial Survey – Employment and Wages (Pimes) of IBGE, increased by 0.9% in the quarter ended in October, when compared to the one closed in July, compared to respective decreases in the same type of comparison, of 1.3% and 3.6% for the quarters ending July and April. The number of hours paid in production increased 1.3% in the quarter.

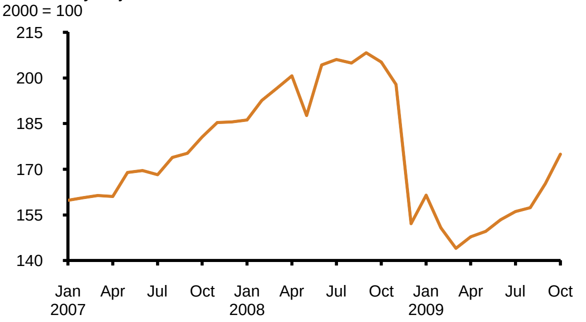
Labor productivity, estimated by the ratio between the indexes of physical production and the number of hours paid, registered an average increase of 3.8% in the quarter ending in October, in relation to the one completed in July, when it grew 5.5%, considered seasonally-adjusted data.

The level of Installed Capacity Utilization Level (Nuci) reached 82.9% in November, according to seasonally-adjusted data from the Manufacturing Industry Survey (SCIT), from the FGV, rising 1.8 percentage points over August, and reaching a level 0.7 p.p. higher than the average for the historical series, started in April 1995.

The breakdown of Nuci's use categories shows a quarterly rise of 2.6 percentage points in the indicator on the consumer goods industry, which, when reaching 86.5%, stood 6.3 percent above the historical average. The indicators for the categories of intermediate and capital goods, at a level 1.9 percentage points and 0.5 percentage points lower than their historical averages, reached, in order, 84% and 77.9%, rising 2 percentage points and 1.2 percentage points, respectively. The Nuci on the industry of building material, remaining at a high level, closed at 88.5%.

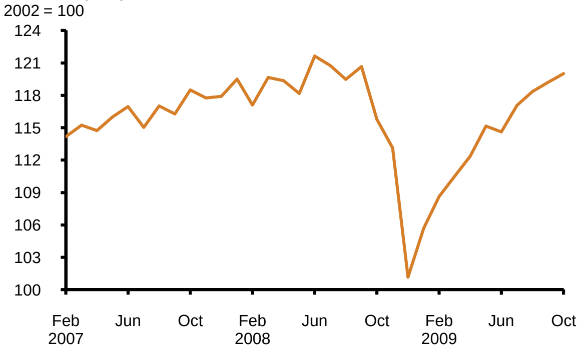
The Industrial Business Confidence Index (Icea), measured by the CNI, reached 65.9 points in October from 58.2 points in July, development arising from marked increases in the components Current Economic Conditions Index, 13.3 points, and the Expectations Index, 5.1 points. Similarly, the FGV's Industrial Confidence Index (ICI), increased by 9.4 percentage points. In the quarter ended in November, closing at 109.6 points, with emphasis on the performance of the components of forecasted physical production volume, which reached a record high of 141.8 points, and assessment of business conditions for the next six months, which increased 31 percentage points in the period. The segmentation of ICI for use categories reveals the occurrence of a general expansion of business confidence, pointing out the observed increase of 25.8 points in the capital goods industry, followed by those recorded in the categories of construction material, 20, 4 points, intermediate goods, 11 points, and consumer goods, 3.2 points.

Figure 1.11 – Industrial production
Capital goods
Seasonally adjusted data



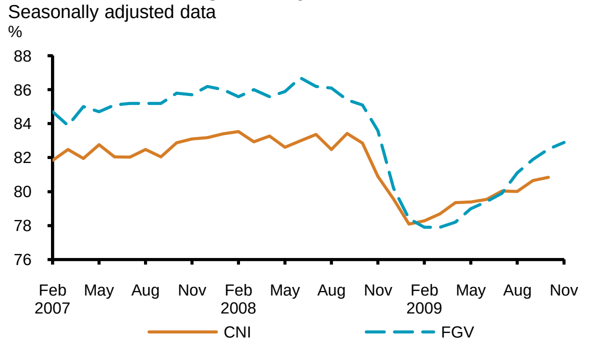
Source: IBGE

Figure 1.12 – Labor productivity
Seasonally adjusted data



Source: IBGE

Figure 1.13 – Utilization of installed capacity in the manufacturing industry
Seasonally adjusted data



Source: CNI and FGV

Table 1.7 – Industrial Confidence Index[1/]

	2009				
	Jul	Aug	Sep	Oct	Nov
Industry Confidence Index	95.7	100.2	103.6	107.0	109.6
By component:					
Current Situation Index	96.7	101.4	103.3	105.1	108.1
Global demand level	94.1	99.8	100.5	105.3	109.3
Inventory level	94.4	97.0	99.1	98.3	99.2
Business situation	97.4	103.2	106.2	107.5	111.9
Expectations Index	94.8	99.1	103.9	109.0	111.0
Business situation	112.0	124.1	136.3	144.7	155.1
Employment	106.0	107.4	109.8	115.5	112.8
Physical production	128.1	131.6	135.6	140.7	141.8

Source: FGV

1/ The average of the last ten years is equal to one hundred. Seasonally adjusted series.

1.3 Job Market

The trajectory of the labor market indicators confirms the positive impact of consistent recovery of economic activity on the employment conditions in the country. This improvement is expressed in quantitative terms, through the maintenance of the unemployment rate at a low level and in an environment of increasing number of working population, and qualitatively, as evidenced by the prevalence of maintaining formal links with occupations and the continuing process of increasing Average real incomes perceived by workers.

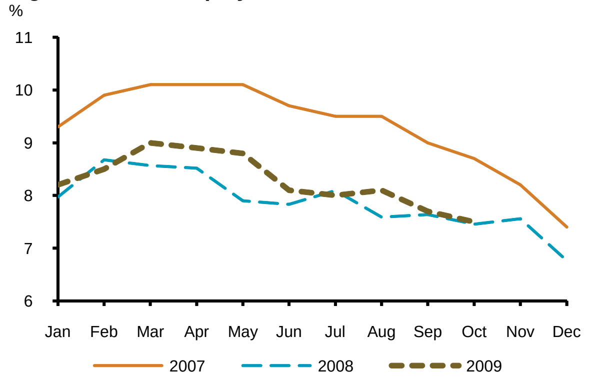
Employment

The average unemployment rate registered in the six metropolitan areas covered by the Monthly Employment Survey (PME), IBGE, reached 7.8% in the quarter ended in October, compared to 8.3% that ended in July and 7.6% in the same period of 2008. It is worth emphasizing, as noted in the previous report, the downward trend recorded for the difference between the unemployment rates seen in the same quarters of 2009 and in the previous year, developments reinforced by the continuation of the monthly rates for September and October on the same level in the corresponding months in 2008.

Analysis by job position, considered that IBGE survey shows continued recovery of formal employment, which rose 1.4% in the quarter ended in October, compared to the same period in 2008, period in which the number of unregistered employment decreased 4.2% and the number of employed people grew by 0.1%. Segmented by targeted industries, the relative stability in the number of registered employed people in the period, reflected the balance between the impacts of the decrease of 2.1% observed in the industry and the expansions observed in construction, 1.7%, and trade, 0.1%. In this scenario, the rate of formal employment, defined as the ratio between the number of registered workers and the total number of employed people reached 49% in the quarter ended in October 2009, rising 0.5 percentage points over the same period of 2008.

Statistics from the General File of Employed and Unemployed Persons (Caged), the Ministry of Labor and Employment (MTE), also show the recovery process of formal employment. In this sense, 231,000 jobs were created in October, a result 79% higher than the observed, in average, in the corresponding months from 2004 to 2008. This result

Figure 1.14 – Unemployment rate



Source: IBGE

Table 1.8 – Formal employment

In the year

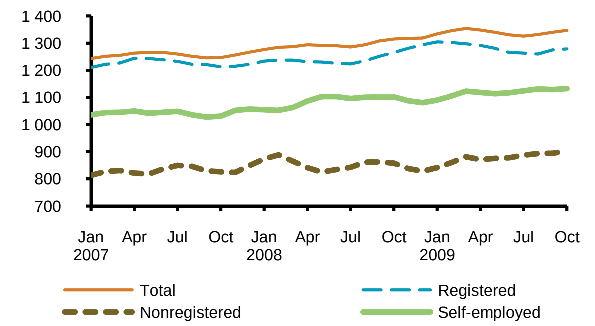
	2009				
	Jun	Jul	Aug	Sep	Oct
Total	299.5	437.9	680.0	932.7	1 163.6
Manufacturing industry	-144.5	-127.1	-60.6	62.8	137.3
Commerce	-33.0	-5.6	51.2	101.5	170.0
Services	235.4	263.1	348.7	411.4	481.0
Building	79.4	111.6	151.5	184.2	210.4
Crop and livestock	128.9	158.4	147.1	131.8	120.3
Public utilities	3.6	6.1	6.3	4.3	5.2
Other1/	29.6	31.5	35.8	36.7	39.5

Source: MTE

1/ Includes mining, public administration and others.

Figure 1.15 – Average real regular earnings1/

In R$ of October 2009, deflated by INPC



Source: IBGE

1/ Quarterly moving average.

Table 1.9 – Gross Domestic Product at market prices

% growth

	2008		2009		
	III Q	IV Q	I Q	II Q	III Q
Accumulated in the year	6.6	5.1	-2.1	-1.9	-1.7
Accumulated in 4 quarters	6.6	5.1	3.0	1.0	-1.0
Quarter/same quarter of the previous year	7.1	0.8	-2.1	-1.6	-1.2
Quarter/previous quarter1/	1.1	-2.9	-0.9	1.1	1.3
Crop and livestock	0.4	-3.1	-2.7	-0.6	-2.5
Industry	1.6	-8.1	-4.4	2.6	2.9
Services	1.5	-2.3	1.2	1.7	1.6

Source: IBGE

1/ Seasonally adjusted data.

becomes relevant if we consider that in January 101,700 jobs had been eliminated in January, compared to average generation of 110 000 formal jobs in the corresponding months of 2004 to 2008.

The level of formal employment grew by 2% in the first ten months of the year, emphasizing the marked expansion in construction, 5.8%; and in services and trade sectors, both at 3.9%, contrasting with a decrease of 2, 5% observed in manufacturing industry. It is worth mentioning that, showing his recovery, industrial activity has become the economy sector to record the more important creation of jobs in the two months ended in October.

Earnings

The real average earnings usually received by workers in the six metropolitan areas covered by SMEs increased by 2.4% in the quarter ended in October, compared to the same 2008 period. The average nominal earnings totaled R$ 1,349.70 in October, rising 7.3% over the same period in 2008. The overall real wages, product of the real average earnings usually received by the number of persons employed grew 2.8% in the quarter indicated.

1.4 Gross Domestic Product

According to seasonally-adjusted data from the IBGE's National Quarterly Accounts, GDP grew 1.3% in the quarter ended in September, compared to the one completed in June, constituting the second positive result in sequence, in this comparison base, and as a sign of exhaustion of the short-lived recession process experienced by the Brazilian economy after the deepening global crisis.

From the product's perspective, GDP quarterly performance reflected the increases registered in industry 2.9%, and services 1.6% and a 2.5% decline observed in the farm sector, while the behavior of the demand components strengthened the importance of domestic demand for the maintenance of product. From this perspective, there were expansions in Gross Fixed Capital Formation (GFCF), 6.5%, household consumption, 2%, government consumption, 0.5%, and in imports, and exports 1.8% 0.5%; respectively The GDP fell by 1.2% over the third quarter of 2008, compared with respective decreases of 2.1% and 1.6%, maintaining this type of comparison, in the quarters ended March and June. The analysis of the demand components reveals the impact of

Table 1.10 – Gross Domestic Product
Quarter/previous quarter
Seasonally adjusted

% growth

	2008		2009		
	III Q	IV Q	I Q	II Q	III Q
GDP at market prices	1.1	-2.9	-0.9	1.1	1.3
Crop and livestock	0.4	-3.1	-2.7	-0.6	-2.5
Industry	1.6	-8.1	-4.4	2.6	2.9
Services	1.5	-2.3	1.2	1.7	1.6
Households consumption	1.3	-1.2	0.4	2.4	2.0
Government consumption	2.8	-2.9	4.2	-0.1	0.5
Gross fixed capital formation	3.0	-9.9	-11.0	2.0	6.5
Exports	-1.5	-1.4	-15.4	7.1	0.5
Imports	1.6	-5.9	-16.1	4.4	1.8

Source: IBGE

Table 1.11 – Gross Domestic Product
Quarter/same quarter of the previous year

% growth

	2008		2009		
	III Q	IV Q	I Q	II Q	III Q
Crop and livestock	5.4	1.7	-2.8	-4.4	-9.0
Industry	7.3	-2.5	-10.4	-8.6	-6.9
Mining	8.4	0.7	-2.6	-1.8	-2.0
Manufacturing	5.9	-5.6	-14.0	-10.8	-7.9
Construction	11.9	2.5	-9.6	-9.3	-8.4
Public utilities	6.2	3.5	-4.2	-3.8	-3.3
Services	6.2	1.9	1.7	2.0	2.1
Commerce	10.2	-1.6	-6.0	-3.8	-2.8
Transportation	6.3	-2.3	-6.2	-5.4	-2.9
Communications	10.0	9.0	6.4	6.8	4.5
Financial institutions	13.3	6.4	6.2	5.0	6.1
Other services	5.4	3.0	5.8	6.2	4.9
Rents	1.8	0.0	1.3	1.4	1.4
Public administration	1.8	2.1	3.4	2.9	3.2
Value added at basic prices	6.5	0.6	-1.8	-1.3	-1.1
Taxes on products	10.9	2.0	-4.2	-3.5	-2.0
GDP at market prices	7.1	0.8	-2.1	-1.6	-1.2

Source: IBGE

increases in real wages, employment levels and the volume of financial system credit operations targeted to individuals for a rise of 3.9%, recorded in household consumption, in the period. In addition, government consumption and gross fixed capital formation rose 1.6%, highlighting the performance of construction and production and import of machinery and equipment fell 12.5%, contributing in such way that the impact exerted by the domestic demand on GDP performance reached -2p.p. on this basis of comparison. Imports decreased by 15.8% and exports by 10.1%, providing a contribution of 0.8 p.p. of the external demand to the GDP growth, in the period.

From the perspective of production, agriculture declined 9% in the third quarter, compared to the same period in 2008, a result consistent with the unfavorable performance recorded by crops of wheat and coffee, which hold an important role in agricultural production for the quarter.

Industry reported a decrease of 6.9% over the third quarter of 2008, with emphasis on the contractions observed in construction, 8.4%; in manufacturing, 7.9%; and the segment of production and distribution of electricity, gas and water 3.3%. The mineral extraction activity, helped by a recovery in external demand for iron ore and an increase in domestic oil production, registered a less marked reduction, 2%.

The service sector, indicating the recovery of domestic demand, grew 2.1% in the third quarter of 2009 versus the same quarter last year, highlighting the expansion segments on financial intermediation, insurance, pension and related services, 6.1%; other services 4.9%; information services, 4.5%; and administration, public health and education, 3.2%. Trade and transportation sectors, storage and postal service, highlighting the performances of primary and secondary sectors, have experienced decreases of 2.8% and 2.9% in the period.

The outlook for GDP growth in the fourth quarter and 2010 are detailed in the figure "GDP Projections for 2009 and 2010," on the page 28 of this report.

As usually occurs upon the publication of the Quarterly National Accounts for the third quarter of each year, IBGE promoted revisions of the GDP results that were previously disclosed. This procedure, which aims to incorporate statistics not available at the time of the original disclosure and eventual changes of methodological kind, resulted in a change of 5.7% to 6.1% in GDP growth in 2007, reflecting the stronger impact of changes that occurred in the industrial

GDP Projections for 2009 and 2010

Estimate for 2009 GDP

The estimate for the Gross Domestic Product (GDP) growth in 2009 was reduced from 0.8% in the last Inflation Report, to 0.2%. This change incorporates the results of the third quarter and the review conducted by the Brazilian Institute of Geography and Statistics (IBGE), regarding the performance of the aggregate in the first half-year, which moved from -1.5% in the first half of 2008, to -1.9%. This review, annually conducted is released when the results of the third quarter, incorporates the new weights and information from the Annual National Accounts of the two years earlier.

For the last quarter, the prospects are that there will be further growth acceleration, considered the comparison with the previous quarter, a movement associated with the rebalancing of stocks, which declined for four consecutive quarters, the continuity of employment growth and income and lagged effects of the easing of monetary, fiscal and credit policies.

The reduction in projection for the annual growth rate of the GDP, compared to the rate of 0.8% in the September report, reflects the larger impact of the expected falloffs in agriculture, from -1.2% to -4.3%, and for the industry, from -3.3% to -5%, compared to that provided by the increase of 0.1 p.p. to 2.8%, in the expansion of the service sector. Considering from the demand perspective, projected annual contributions are zero and 0.2 p.p., respectively, for internal and external demand – this constitutes the first positive result since 2005. The contribution of the first segment reflects estimates for household consumption, 3.8%, government consumption, 3.5%; and for the Gross Fixed Capital Formation (GFCF),

-9.9%, while the contribution of external sector shows the falloffs projected for exports, 11.1%, and regarding imports, 12.8%.

Estimate for 2010 GDP

Showing the consistent recovery of economic activity, the projection for GDP growth in 2010 reached 5.8%, a result supported solely by the performance of domestic demand.

The annual GDP growth should reflect the occurrence of positive performances in all sectors of the economy. The expansion of agricultural activities is estimated at 3.7%, consistent with the growth projection of 4.7% for the grain harvest, set the 2nd estimate for 2010, conducted by IBGE. Among the major crops, one should underscore the projections of increases in soybean and bean crops, in contrast to the falloffs projected for the crops of rice and corn. Among other cultures, it is worth mentioning the positive outlook in relation to the production of tobacco leaf, cassava and coffee.

The industrial sector should grow 7.6% in 2010, with emphasis on the expansion of 8.8% projected for the manufacturing industry, driven in part by the depressed comparison basis. The construction industry is expected to grow 6.4%, helped by the resumption of the investment environment and the continuation of works under specific government programs and the Growth Incentive Program (PAC). The estimated expansion in the mineral extraction industry, reflecting the impacts of the more dynamic world economy segments on the oil and iron ore, reaches 6.4%, while production and distribution of electricity, gas and water will increase 4.8% in the year.

The 5% estimated growth for the service sector incorporates the projected growth for the financial intermediation segments, 7.2%, helped by the continued expansion of credit, trade, 6.5%, and transportation, storage and mail, 6.4%, which have been directly affected by the performance of agricultural and industrial activities. Among the other sectors, it should be highlighted the growth projections related to information services, 7.6%, other services 6.5%, administration, public health and education, 2.2%, and real estate activities and rent, 1,8%.

Considering the demand perspective, it is projected an annual increase of 6.1% for household consumption, evolution consistent with the continued perspectives of improvements in the labor market and the maintenance of a benign inflation trajectory. Investments, showing the recovery of expectations and the realization of infrastructural works under the PAC, must show a sharp recovery, revealed as an increase of 15.8% of GFCF. The annual growth of government consumption is projected at 2.9%. In this scenario, the domestic demand contributed 6.9% to the GDP annual result in 2010.

Table 1 – Gross Domestic Product

	2008	2008				2009				2010
	Weights	I Q	II Q	III Q	IV Q	I Q	II Q	III Q	IV Q 1/	IV Q 1/
Crop and livestock	5.0	4.2	7.2	6.7	5.7	-2.8	-3.7	-5.3	-4.3	3.7
Industry	23.3	7.5	6.7	6.9	4.4	-10.4	-9.5	-8.6	-5.0	7.6
Mineral extraction	2.8	4.8	5.3	6.4	4.9	-2.6	-2.2	-2.1	-0.5	6.6
Manufacturing	13.3	8.2	6.6	6.4	3.2	-14.0	-12.3	-10.7	-6.0	8.8
Construction	4.3	8.8	9.4	10.3	8.2	-9.6	-9.5	-9.1	-6.6	6.4
Public utilities	2.9	5.5	4.8	5.2	4.8	-4.2	-4.0	-3.7	-2.0	4.8
Services	56.8	5.4	5.6	5.8	4.8	1.7	1.9	1.9	2.8	5.0
Commerce	10.6	8.2	8.2	8.9	6.1	-6.0	-4.9	-4.2	2.8	5.0
Transportation	4.3	4.7	5.1	5.5	3.4	-6.2	-5.8	-4.8	-1.3	6.5
Communications	3.1	8.2	8.2	8.8	8.9	6.4	6.6	5.9	-1.9	6.4
Financial institutions	6.4	17.2	16.6	15.4	13.0	6.2	5.6	5.8	6.2	7.2
Other services	12.1	3.6	4.2	4.6	4.2	5.8	6.0	5.6	5.9	7.6
Rents	6.9	2.8	2.3	2.1	1.6	1.3	1.4	1.4	6.2	7.2
Public administration	13.4	0.5	1.0	1.3	1.5	3.4	3.2	3.2	3.3	2.2
Value added at basic prices	85.1	6.0	6.0	6.2	4.8	-1.8	-1.5	-1.4	0.2	5.7
Taxes on products	14.9	8.4	8.6	9.4	7.4	-4.2	-3.8	-3.2	1.5	6.3
GDP at market prices	100.0	6.3	6.4	6.6	5.1	-2.1	-1.9	-1.7	3.3	5.8

Source: IBGE and Banco Central
1/ Estimated.

Exports and imports of goods and services, reflecting the gradual recovery of the world economy and consolidation of a new growth cycle of the Brazilian economy, must register their respective annual increases of 12% and 20.5% in 2010. This trajectory, although determines the negative contribution of 1.1 p.p. of the external sector to GDP in 2010, considering the strong projected performance for the domestic spending, represents an important factor to the balance between aggregate supply and demand.

Table 2 – Gross Domestic Product – Demand side

%

Period	GDP at market price	Private consumption	Government consumption	Total consumption	Gross Fixed Capital Formation	Exports	Imports
2002	2.7	1.9	4.7	2.6	-5.2	7.4	-11.8
2003	1.1	-0.8	1.2	-0.3	-4.6	10.4	-1.6
2004	5.7	3.8	4.1	3.9	9.1	15.3	13.3
2005	3.2	4.5	2.3	3.9	3.6	9.3	8.5
2006	4.0	5.2	2.6	4.5	9.8	5.0	18.4
2007	6.1	6.1	5.1	5.8	13.9	6.2	19.9
Contribution (p.p.)		3.7	1.0	4.7	2.3	0.9	-2.3
2008	5.1	7.0	1.6	5.7	13.4	-0.6	18.0
Contribution (p.p.)		4.2	0.3	4.5	2.3	-0.1	-2.1
2009 (estimated)	0.2	3.8	3.5	3.7	-9.9	-11.1	-12.8
Contribution (p.p.)		2.3	0.7	3.0	-1.8	-1.5	1.7
2010 (estimated)	5.8	6.1	2.9	5.3	15.8	12.0	20.5
Contribution (p.p.)		3.7	0.6	4.2	3.0	1.7	-2.8

Source: IBGE and Banco Central

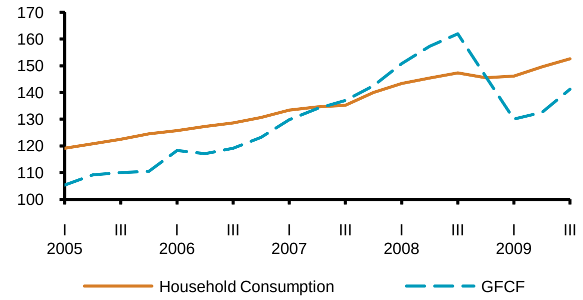
Table 1.12 – Gross Domestic Product
Quarter/same quarter of the previous year

% growth

	2008		2009		
	III Q	IV Q	I Q	II Q	III Q
GDP at market prices	7.1	0.8	-2.1	-1.6	-1.2
Households consumption	9.3	3.8	3.8	3.0	3.9
Government consumption	3.4	0.3	4.3	3.9	1.6
Gross fixed capital formation	19.0	2.7	-14.2	-16.0	-12.5
Exports	2.1	-7.2	-15.4	-11.4	-10.1
Imports	22.5	7.4	-15.8	-16.5	-15.8

Source: IBGE
1/ Estimated.

Figure 1.16 – Household Consumption and Gross Fixed Capital Formation1/
1995 = 100



Source: IBGE
1/ Seasonally adjusted data.

sector, from 4.7% to 5.3%, and the service sector, from 5.4% to 6.1%, compared to that provided by the drop, from 5.9% to 4.8% growth in the agricultural sector.

1.5 Investments

Investments, excluding changes in inventories, fell 12.5% in the third quarter of 2009 over the same period a year earlier, a more favorable development than the one indicated in the first half of the year, when there was a decrease of 15, 1% over the period for 2008, according to the IBGE's Quarterly National Accounts.

The analysis at the margin, considering seasonally adjusted data reveals that investments increased 6.5% over the June ended quarter, a trend anticipated by the performance of monthly indicators of GFCF. In this sense, the production of construction inputs and capital goods registered respective expansions of 1.6% and 6.2% in the period, while imports and exports of these goods pointed to respective reductions of 3.7% and 2.9%, resulting in a 10.5% of increase in the consumption of capital goods. Statistics for October show the continued expansion of investments, expressed in monthly increase of 6% recorded in the absorption of capital goods, resulting from their variations of 5.9%, 2.8% and -6.2% observed in the production, imports and exports of capital goods. On the same basis of comparison, production of construction inputs rose 0.5%.

Disbursements from the BNDES, the Special Industrial Financing Agency (Finame) and BNDES Participações S.A. (BNDESpar) increased by 59.7% in the first nine months of the year, over the same period in 2008, emphasizing the increases observed in resources directed to the manufacturing industry, 106.4%, to commerce and service sectors, 34.4% and agriculture 25%.

1.6 Conclusion

The growth recorded by the GDP in the third quarter and the trajectory of different sectoral indicators confirm in the months following the scenario of strong recovery of the Brazilian economy after the short recession process experienced since the end of 2008. This reversal, buttressed in particular by the performance of domestic demand was encouraged by both the strengthening observed in the main fundamentals of the Brazilian economy in recent years and the suitability of the economic policy measures implemented in late 2008 and early 2009 to cope with the impacts of global crisis. In this scenario, it is worth mentioning that the performance of household consumption, aided initially by the preservation of real income, in the context of reducing inflation and, more recently, by the improvement in credit market conditions.

The new growth cycle, which is more clearly outlined in this environment of strengthening domestic demand and a gradual recovery in the world economic activity, is also expressed in the recovery of investments. It is noteworthy that this trajectory, consistent with the increases recorded in indicators related to the expectations of consumers and businesses, even if it brings about increased imports, shall not pose any restrictions to the financing of the balance of payments.

Prices

2

The rate of consumer inflation, measured by the IBGE's IPCA, showed acceleration in the quarter ended in November, in relation to the one completed in August. This movement, linked in part to seasonal factors, showed the pressure exerted by a scenario of renewed growth in domestic demand, which, although it should be consolidated in the coming months, does not constitute, under appropriate monetary conditions, a relevant risk to the maintenance of a price stability environment.

The behavior at the margin of the diffusion index, which is the percentage of items that constitutes the IPCA with positive price variation, suggests, in addition, the interruption of the downward trend in inflation. Similarly, the accumulated changes in the last twelve months of the three measures of core inflation calculated by the Central Bank reported in November, reversing its downward trend observed during 2009.

2.1 General Price Index

Table 2.1 – General price indices

Monthly % change

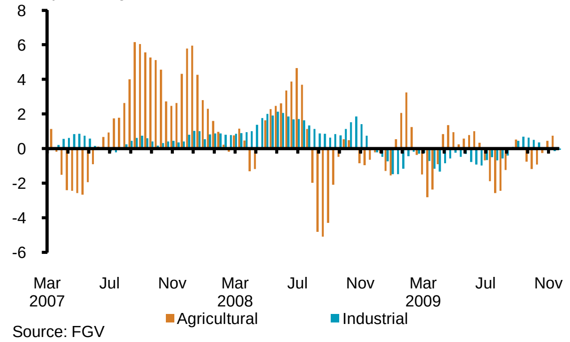
	2009				
	Jul	Aug	Sep	Oct	Nov
IGP-DI	-0.64	0.09	0.25	-0.04	0.07
IPA	-1.16	0.07	0.29	-0.08	-0.04
IPC-Br	0.34	0.20	0.18	0.01	0.26
INCC	0.26	-0.05	0.15	0.06	0.29

Source: FGV

The General Price Index – Domestic Supply (IGP-DI), published by FGV, increased 0.28% in the quarter finished in November, compared to a decline of 0.87% in the June-August period. This acceleration reflected the observed increases in the Broad Producer Price Index (PPI), 0.17% in the Consumer Price Index (IPC-Br), 0.46%, and the National Cost of Construction Index (INCC) 0.50%, compared to respective variations of -1.72%, 0.66% and 0.91% for the quarter ended in August.

The quarterly IPA growth incorporated the observed variations in the prices of industrial products, 0.54%, and farm products, -0.95%, which had recorded decreases of 1.55% and 2.23% for the June-August period. The agricultural price performance reflected, in particular, the more pronounced impact of the increases observed in items such as potatoes, corn, cassava, sugar cane, orange and pork,

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



Source: FGV

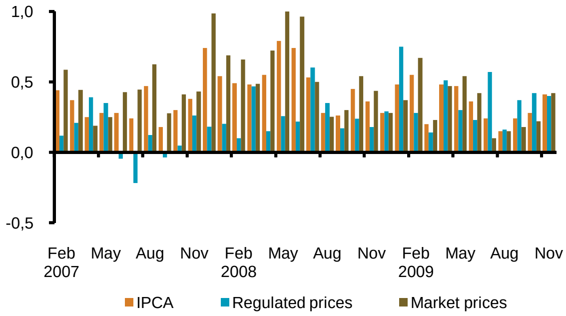
in relation to secondary decreases in the prices of items such as milk, cattle, poultry and papaya. The growth acceleration in industrial prices mostly, reflected these increases in items such as alcohol items, 23.61% sugar, 22.60% and unrefined soybean oil, 10.42%.

The slowdown experienced by the IPC-Br variation was related mainly to the reduction registered in prices of the food group and the smaller rises observed in the groups of health and personal care, and miscellaneous expenses. Similarly, the behavior of INCC reflected the impact of the respective growth rates of 0.46% and 0.54% observed in the prices of materials and services, and labor, which had varied, in order, -0.34% and 2.32% in the quarter ended in August.

2.2 Consumer price indices

Extended National Consumer Price Index

Figure 2.2 – IPCA
Monthly % change

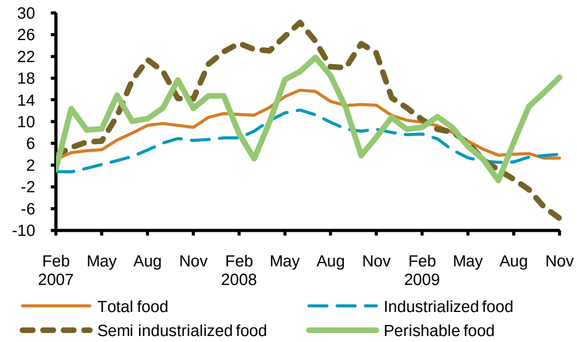


Source: IBGE

The IPCA increased 0.93% in the quarter ended in November, compared to 0.75% in that ended in August, reflecting the acceleration observed in the variations of prices, from 0.96% to 1.20%, and market prices , from 0.66% to 0.82%, is indicating the impact of changes in marked increases in prices of tradable goods, 0.54 percentage points, and the non-tradables, 0.02 percentage points, reaching, in order, 0.22% and 0.59%.

The analysis of price growth in major components of the indicator shows the accelerations observed in the groups apparel, from 0.65% to 1.81%, and transportation groups, from 0.05% to 1.40%, with an emphasis on the prices increases of items such as alcohol and new vehicles, the latter highlighting the impact of this partial exhaustion of the IPI tax exemption process on vehicles. Conversely, influenced by the continued price reduction of rice and beans and the sharp drop on milk, which had registered a significant increase in the quarter ended in August, the price variation in food and beverages rose from 0.63% to 0.35% in the quarters concerned.

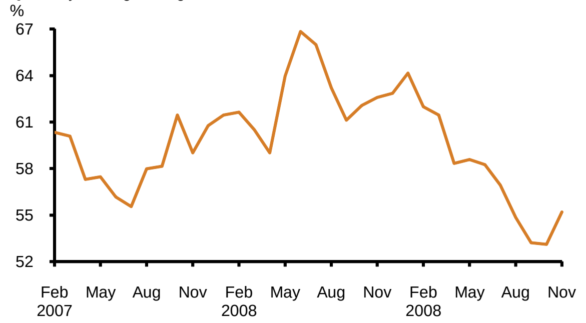
Figure 2.3 – IPCA – Food
12-month % change



Source: IBGE

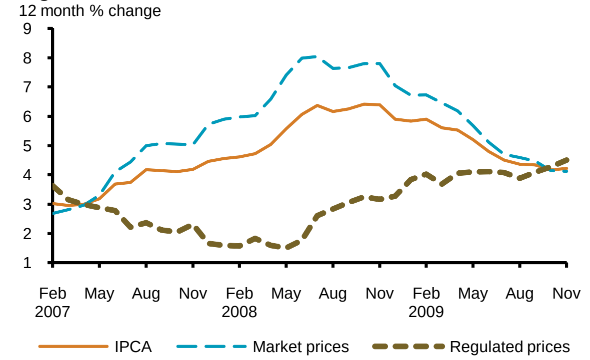
The diffusion index registered an average of 55.21% in the quarter ended in November, compared to 54.86% that ended in August. It is worth mentioning that the indicator, despite closing at a level below the average for the past ten years achieved an average higher than that indicated in the quarter ended in August, signaling the exhaustion of the process of reducing the 12-month cumulative inflation.

Figure 2.4 – IPCA
% of items with increase
Quarterly moving average



Source: IBGE

Figure 2.5 – IPCA
12 month % change



Sources: IBGE and Banco Central

Table 2.2 – IPCA

% change

	Weights 2009	Jul	Aug	Sep	Oct	Nov	Year
IPCA	100.00	0.24	0.15	0.24	0.28	0.41	3.93
Market prices	70.36	0.10	0.15	0.18	0.22	0.42	3.81
Regulated prices	29.64	0.57	0.16	0.37	0.42	0.40	4.20
Main items							
Electricity	3.30	3.25	0.39	0.00	0.51	0.49	5.14
Natural gas vehicle	0.11	-2.41	-0.58	-1.32	0.90	0.20	-8.69
Pipeline gas	0.10	1.03	0.26	0.03	0.00	-0.14	4.59
Diesel fuel	0.08	-3.19	-0.02	-0.25	0.23	-0.19	-5.32
Electricity	0.14	0.83	0.77	0.37	0.05	0.09	3.14
Tools	1.35	0.00	0.00	0.00	2.14	0.00	2.55
Water and sewage	1.65	0.23	1.00	0.82	0.53	0.05	4.76
Urban bus	3.74	0.00	0.00	0.00	0.00	0.00	5.34
Air ticket	0.22	-6.81	-10.97	3.58	-12.43	18.03	-10.23
Gasoline	4.10	0.68	0.16	-0.02	1.06	0.85	1.93
Bottled cooking gas	1.22	0.99	1.15	3.40	1.18	0.20	13.38
Medicine	2.89	0.00	-0.05	0.12	-0.25	-0.13	5.70
Health plans	3.44	0.54	0.55	0.56	0.56	0.53	5.83

Source: IBGE

The IPCA accumulated a variation of 3.93% in the first eleven months of the year, registering increases of 4.20% in the prices of goods and regulated services and 3.81% in market prices, compared to respective variations of 5.61%, 2.97% and 6.75% over the same period in 2008.

2.3 Regulated Prices

The variation in regulated prices, accounted for 0.35 percentage points of the increase recorded by the IPCA for the quarter ended in November, reflected largely the impact exerted by increases registered in the rate of cell phone, 2.14% and prices of bottled gas, 4.83%, and gasoline, 1.90%, neutralized, partially, by the continued fall in the prices of medicines.

2.4 Inflation Core

The core by exclusion[1] of the IPCA, which does not consider changes in the prices of ten[2] items in the sub-group of home meals items and domestic fuels and vehicles, increased 0.92% in the quarter ended in November, against 0.77% in relation to that one finished in August. It is worth mentioning that the variation of the indicator accumulated in the last twelve months was of 4.61% in November against 4.54% in October, marking the first rise since February, this type of comparison.

The core calculated by smoothed trimmed means accumulated respective growth rates of 1.08% and 4.27% for the three and twelve-month periods ended in November. It should be highlighted that the variation noted in the latter comparison basis constituted the lowest one since March 2008. The criterion used for the calculation of that core excludes items whose monthly variation is located in the distribution above the 80th percentile or under the 20th percentile, and smoothes over twelve months the fluctuation of items whose variations are concentrated in a few periods of the year.

Additionally, the double-adjustment core recorded variations of 1.13% in the quarter and 4.56% in twelve months, noting in this comparison basis, an increase of 0.09 percentage

1/ This core, so called IPCAEX-2, and the double-weighting core, examined below, have been discussed in the Box "Three New Measures of the. Inflation Core", of the September 2009 Inflation Report. The methodology to make these core measures is introduced in the Box "Methodology for the New Set of Measures of the Inflation Core on page 127 of this Report.

2/ The ten items are: Tubers, roots and legumes; Cereals, legumes and oilseeds; Vegetables and greens; Fruits; Meats; Fishes; Sugars and sugar-products, Milk and milk-products; Poultry and eggs; and Oils and fats.

Table 2.3 – Consumer prices and core inflation

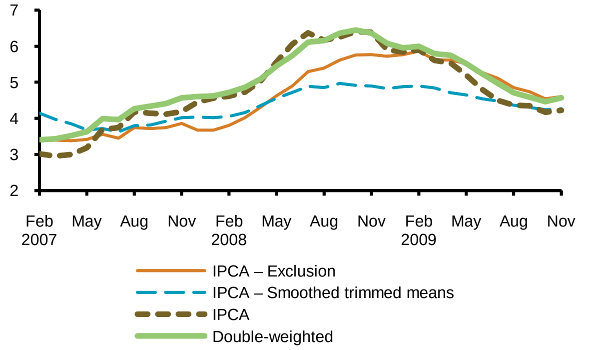
Monthly % change

	2009				
	Jul	Aug	Sep	Oct	Nov
IPCA	0.24	0.15	0.24	0.28	0.41
Exclusion	0.29	0.21	0.31	0.24	0.37
Smoothed trimmed means	0.30	0.25	0.39	0.31	0.37
Double-weighted	0.29	0.23	0.39	0.33	0.40
IPC-Br	0.34	0.20	0.18	0.01	0.26
Core IPC-Br	0.29	0.19	0.28	0.27	0.25

Sources: IBGE, Banco Central and FGV

Figure 2.6 – Core inflation

12-month % change



Sources: IBGE, Banco Central and FGV

Figure 2.7 – IPCA

Median

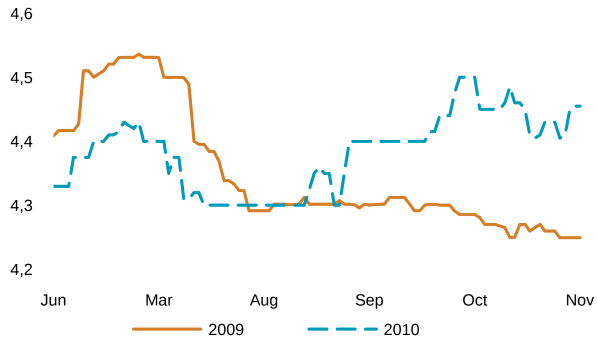
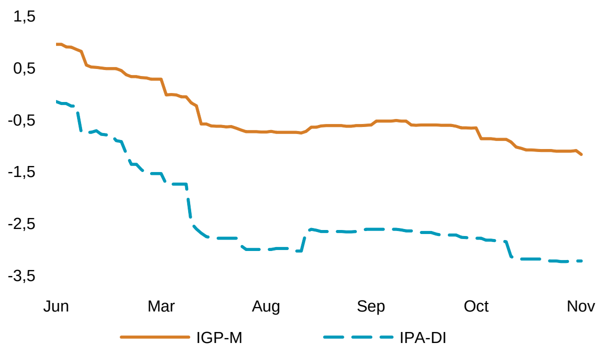


Figure 2.8 – IGP-M and IPA-DI

Median 2009



points compared to October, the first increase since February. This core is calculated through the re-adjustments of the original weights – based on the importance of each item to the IPCA basket – by their relative degrees of volatility, resulting in smaller representation for the behavior of the more volatile components.

The IPC-Br inflation core, from FGV, calculated by the method of smoothed trimmed means, registered an increase of 0.80% in the quarter ended in October, compared to 0.71% that closed in August. Although the change in the indicator shows acceleration at the margin, irs twelve-month performance in the twelve months following in decline, reaching 3.71% in November, the lowest level since September 2008.

2.5 Market expectations

According to the November 27 Focus Survey – Market Report, the median estimates of the annual variations in the IPCA for 2009 and 2010 reached, in order, 4.3% and 4.5%, compared to 4.3% and 4.4%, respectively, at the end of September. The median expectation for inflation twelve months ahead – smoothed – stood at 4.4%, compared to 4.3% at the end of September.

The median variation on the General Price Index – Market (IGP-M) for 2009 decreased from -0.5% at the end of September to -1.2% in November 27, while referring to the Producer Price Index-Domestic Supply (IPA-DI) rose from -2.6% to -3.2% in the same period. The median of forecasts for 2010, both for the IGP-M, as for the IPA-DI remained stable at 4.5% during this period.

The median value of expectations about future developments, in 2009, administered or regulated prices by contracts grew from 4.1% at the end of September to 4.2% by November 27, while referring to 2010 remained stable at 3.5%.

The projections related to the variation of the exchange rate declined in recent months, with median rates projected by the market for the end of 2009 and 2010 were revised, equally, from R$1.80/US$ at the end of September to R$1.70/US$ and R$1.75/US$, respectively, on November 27. Similarly, the median of forecasts for the average exchange rates for 2009 and 2010 decreased in the order of R$ 2.00 per US$ and R$1.80 per U.S.$ at the end of September for R$1,99 per US$ and R$1.74 per U.S.$ at the end of November.

Figure 2.9 – Exchange

Median 2009

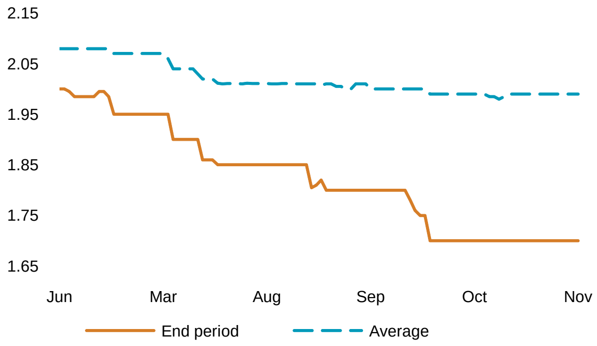


Table 2.4 – Summary of market expectations

	6.30.2009		9.30.2009		11.27.2009	
	2009	2010	2009	2010	2009	2010
IPCA	4.4	4.3	4.3	4.4	4.3	4.4
IGP-M	1.0	4.5	-0.5	4.5	-1.1	4.5
IPA-DI	-0.2	4.5	-2.6	4.5	-3.2	4.5
Regulated Prices	4.3	3.9	4.1	3.5	4.2	3.5
Selic (end-of-period)*	8.8	9.3	8.8	9.8	8.8	10.5
Selic (average)*	9.8	9.0	9.8	9.0	9.8	9.5
Exchange rate (end-of-period)	2.00	2.00	1.80	1.80	1.70	1.75
Exchange rate (average)	2.08	2.04	2.00	1.80	1.99	1.74
GDP growth	-0.5	3.5	0.0	4.5	0.2	5.0

2.6 Conclusion

The acceleration recorded by consumer prices in the quarter ending in November, besides reflecting the impacts of the increase noted in the price of alcohol fuel, raises the IPI rates on new vehicles, and the seasonal growth of prices in the apparel group, mirrored the environment of an upturn in the activity level. The recent developments of measures of core inflation and the diffusion index, although showing the reversal of their downward trend observed during the year, suggest that inflation, even down in early 2010, by seasonal increases in enrollment and tuition fees and perishable foodstuffs, and the likely increases in urban bus fares in major capitals, should, under appropriate monetary conditions, stay within the range under the regime of inflation targeting.

Credit, monetary and fiscal policies

3

3.1 Credit

Table 3.1 – Credit operations

R$ billion

Itemization	2009				% growth	
	Jul	Ago	Set	Out	3 months	12 months
Total	1 306.8	1 327.3	1 348.2	1 366.9	4.6	15.3
Nonearmarked	899.4	909.8	921.5	931.0	3.5	9.7
Earmarked	407.4	417.4	426.7	435.9	7.0	29.4
% participation:						
Total/ GDP	44.8	45.3	45.7	45.9		
Nonearmarked/GDP	30.9	31.0	31.3	31.3		
Earmarked/GDP	14.0	14.2	14.5	14.6		

Figure 3.1 – Credit by capital control of financial institutions

% of balance

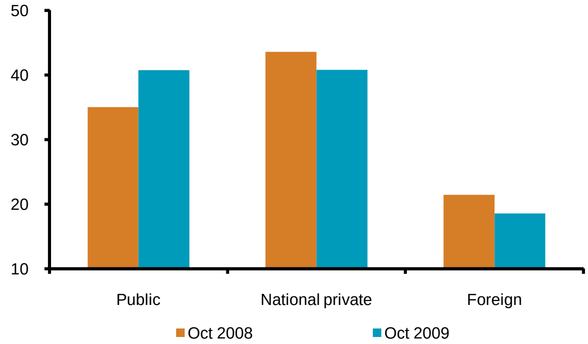
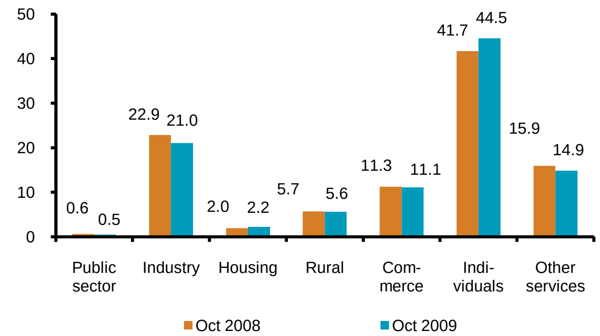


Figure 3.2 – Credit by borrower's economic activity – National private institutions

%



The balance of the financial system credit operations, including both earmarked and non-earmarked resources, reached R$1.367 billion in October, rising 4.6% in the quarter and 15.3% in twelve months. Given these basis of comparison, loans granted with earmarked credit grew, in that order, 7% and 29.4%, while those performed with free resources recorded respective increases of 3.5% and 9.7%. The total credit portfolio now represents 45.9% of GDP, compared to 44.8% in July and 39.5% in October 2008.

The credit growth in the quarter ending in October was favored by seasonal sales heating of the year end, and the positive impact on consumption and investment decisions arising from a scenario of renewed economic activity and improved indicators of income and employment. It is worth mentioning that the different trajectory between the quarterly growth of loans in the mentioned segments reflected, in particular, the impact of BNDES financing operations and housing credit operations, in accelerated expansion, on the balance of earmarked credit, while the expansion of nonearmarked credit was associated, in part with the impact of currency appreciation on the balances of the modalities backed by foreign currency.

The credit for individuals, reflecting the favorable conditions of the labor market continued to show more robust performance, with emphasis on growth in payroll-deducted loans and financing for the purchase of vehicles, while hiring in the corporate segment was conditioned, in particular, growth in working capital operations targeted to companies.

The distribution of credit, from the perspective of control of capital of financial institutions, showed the continued expansion of the participation of public banks, which reached 40.7% of the total financial system portfolio in October, compared to 40.1% in July. The portion relating to national

Figure 3.3 – Credit by borrower's economic activity – Public institutions

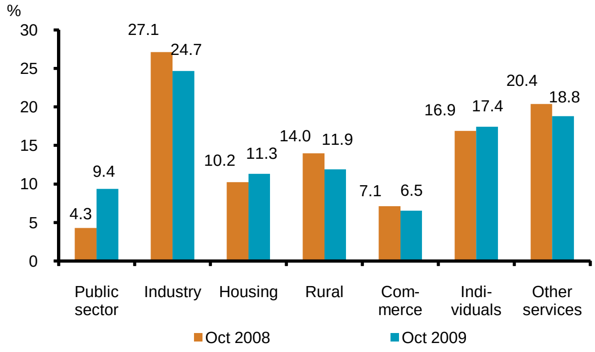


Figure 3.4 – Credit by borrower's economic activity – Foreign institutions

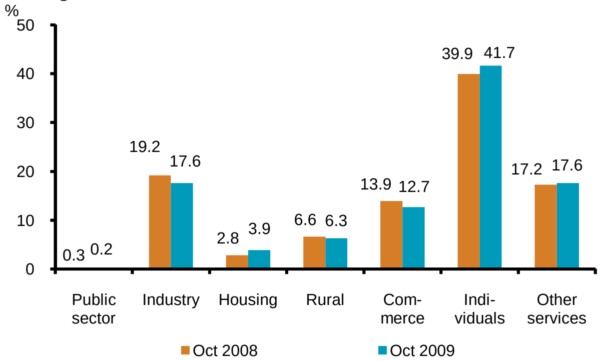


Figure 3.5 – Provisions of total financial system credit %

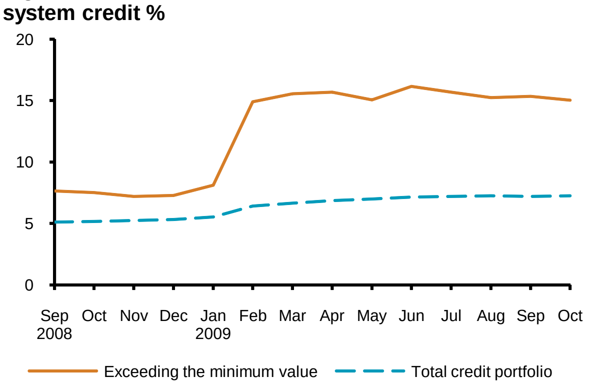


Table 3.2 – Earmarked credit operations

R$ billion

	2009				% growth	
	Jul	Aug	Sep	Oct	3 months	12 months
Total	407.4	417.4	426.7	435.9	7.0	29.4
BNDES	247.4	252.9	257.4	261.9	5.8	34.7
Direct	142.0	144.9	144.1	145.7	2.6	48.5
Onlendings	105.4	108.0	113.3	116.1	10.2	20.6
Rural	77.3	78.8	80.5	82.9	7.3	7.0
Banks and agencies	73.3	74.7	76.2	77.9	6.3	7.6
Credit unions	4.0	4.1	4.3	5.0	25.3	-1.4
Housing	73.0	75.9	78.6	81.0	11.0	43.5
Other	9.7	9.9	10.1	10.1	3.8	20.1

private institutions remained steady at 40.8%, while foreign banks decreased by 0.6 p.p. in the quarter, reaching 18.5%.

Loans to the private sector, including non-earmarked and earmarked operations, totaled R$1,311 billion in October, rising 4.7% from July and 12.7% in twelve months. In sectoral terms, it is worth mentioning that the quarterly rise of 5.9% recorded in the credits contracted with the other services segment, which, showing the dynamism of the steel, energy and road transportation branches, totaled R$232.2 billion. Loans targeted to trade, reflecting the heated year-end sales of season, particularly in the segments of automotive vehicles, food and beverage and supermarkets were up 7% in the quarter, totaling R$130.4 billion. The credit for the industrial sector, beneficiated by the demand for energy, metallurgy and steel, increased 0.9% in the quarter, totaling R$299.2 billion.

Financing targeted to the public sector totaled US$55.5 billion in October, recording increases of 2.9% in the quarter and 156.7% in twelve months. The bank debt of states and municipalities increased 12.1% to R$22.4 billion, with an emphasis on contracts related to projects of low income housing and basic sanitation resources of the Employment Compensation Fund (FGTS) and in funding for the infrastructure of transport. The quarterly decline of 2.5% reported in the balance of operations signed with the federal government, which totaled R$33.1 billion, reflecting largely the impact of currency appreciation on contracts in the energy segment.

The provisions made by financial institutions totaled US$99.2 billion in October, accounting for 7.3% of total credit portfolio, compared to 7.2% in July. The default rate on the total financial system credit, which had remained on an upward trend since September 2008, remained stable at 4.4% in the period.

Earmarked credits

The balance of credit operation referenced in earmarked resources reached R$435.9 billion in October, rising 7% in the quarter and 29.4% in twelve months, of which 60.1% is related to BNDES loans, which recorded respective increases of 5.8% and 34.7% in the comparison bases mentioned. It should be noted, though, that the expressive performance of the housing credit operations, which increased 11% in the quarter and 43.5% in twelve months.

Table 3.3 – BNDES disbursements

R$ million

Itemization	2008	2009 1/	% growth
Total	70 129	106 496	51.9
Industry	28 929	52 572	81.7
Mining	2 177	1 960	-10.0
Food products	7 308	4 316	-40.9
Vehicle, towing truch and wagon	3 696	5 678	53.6
Petroleum and alcohol refining	2 367	22 519	851.4
Cellulose and paper	741	3 228	335.6
Transportation equipments	845	2 403	794.2
Commerce/services	36 871	48 531	31.6
Overland transportation	14 632	19 006	29.9
Electricity and gas	6 765	10 672	57.8
Auxiliary transportation activities	496	1 828	268.5
Construction	3 077	4 743	54.1
Telecommunication	5 220	1 992	-61.8
Crop and livestock	4 329	5 393	24.6

1/ Refers to October.
Source: BNDES

Disbursements granted by BNDES in the first ten months of the year totaled US$106.5 billion. The marked increase of 51.9% over the same period in 2008 reflected mainly the expansion of 81.7% observed in credit to industry, aimed in particular to the sector of coke, oil and fuel. Disbursements under the segment of trade and services grew 31.6% in the period, with emphasis on agreed operations in the areas of electricity, energy and land transportation, while financing to micro, small and medium enterprises, equivalent to 17.1% of total disbursements, recorded an increase of 2.2% in the period, contributing significantly to the provision of resources to this business segment. Consultations with the BNDES, a leading indicator of investment in medium and long-term investments of the productive sector totaled US$183.5 billion in the first ten months of the year. The 20% increase registered over the same period in 2008 was determined, in particular, by the increase of 56.9% in requests from industry, which totaled R$90.1 billion, with emphasis on the potential demand from industry for coke, petroleum and fuel.

Earmarked loans for farming activities, excluding the operations undertaken by BNDES totaled R$82.9 billion in October, and now represents 73% of the total portfolio of the rural sector. The quarterly increase of 7.3% recorded in this segment was conditioned by the demand for resources to finance the 2009/2010summer harvest.

The housing credits, including transactions with individuals and housing cooperatives, totaled R$81 billion in October, growing 11% in the quarter and 43.5% in twelve months. The quarterly performance of this segment, combined with the favorable performance of savings accounts, reflected also the increase of 18.2% in FGTS grants which, representing a flow of R$2.4 billion, contributed to the outstanding performance of the housing portfolio of public financial institutions.

Table 3.4 – Nonearmarked credit operations

R$ billion

Itemization	2009				% growth	
	Jul	Aug	Sep	Oct	3 months	12 months
Total	899.4	909.8	921.5	931.0	3.5	9.7
Corporations	461.8	466.0	470.5	473.6	2.5	3.6
Reference credit 1/	379.2	383.9	386.2	389.7	2.8	2.6
Domestic funding	308.8	316.1	323.8	329.7	6.8	13.1
External funding	70.4	67.8	62.4	60.0	-14.8	-32.0
Leasing 2/	49.7	49.4	49.0	48.8	-1.6	-10.5
Rural 2/	3.5	3.7	4.0	4.0	12.4	28.0
Others 2/	29.4	29.1	31.3	31.1	5.6	57.8
Individuals	437.6	443.8	451.1	457.5	4.5	17.0
Reference credit 1/	297.4	302.3	308.0	313.7	5.5	14.2
Credit unions	18.7	19.7	19.7	19.9	6.2	20.5
Leasing	65.1	65.7	65.4	64.9	-0.4	16.4
Others	56.3	56.1	57.9	59.0	4.8	33.5

1/ Interest rate reference credit, defined according to Circular n. 2,957 dated 12.30.1999.
2/ Operations backed by domestic resources.

Nonearmarked credit

The balance of credit operations with nonearmarked resources reached R$931bilhões in October, rising 3.5% in the quarter and 9.7% in twelve months, and now represents 68.1% of the total portfolio of the financial system, compared to 71.6% in the same period in 2008. Loans targeted to individual persons, showing a faster pace of growth, reflected the favorable development of indicators of income and employment, and the consequent recovery of consumer confidence indices, the stimulus derived from IPI reduction on the purchases of vehicles and other consumer durables.

Figure 3.6 – Interest rates on nonearmarked credit
% p.y. – Average

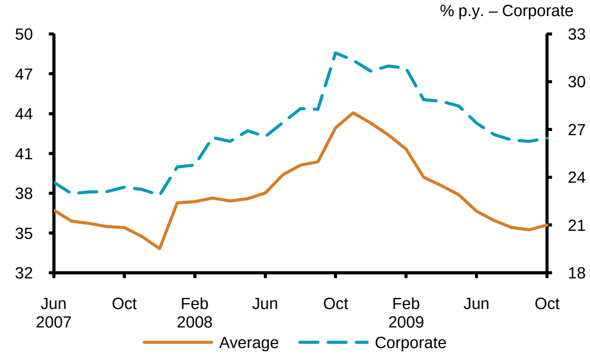


Figure 3.7 – Interest rates on fixed-rate credit – Individuals
% p.y.

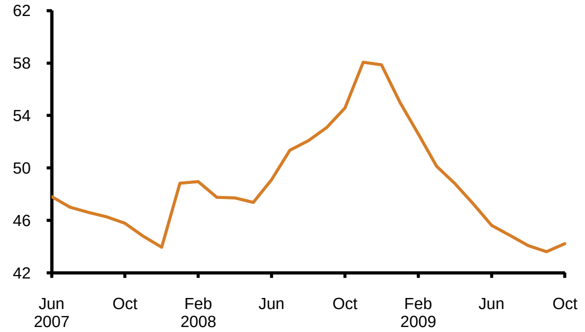


Figure 3.8 – Average spread on nonearmarked credit
p.p. – Average and corporate

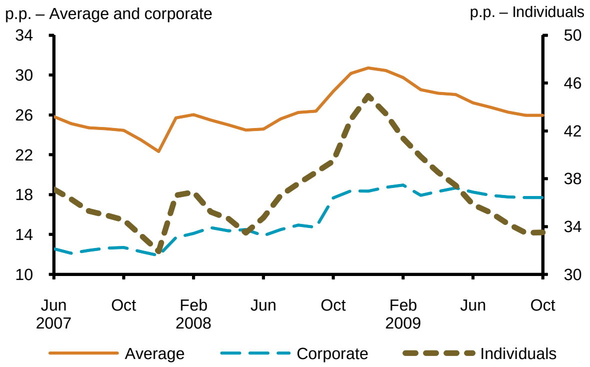
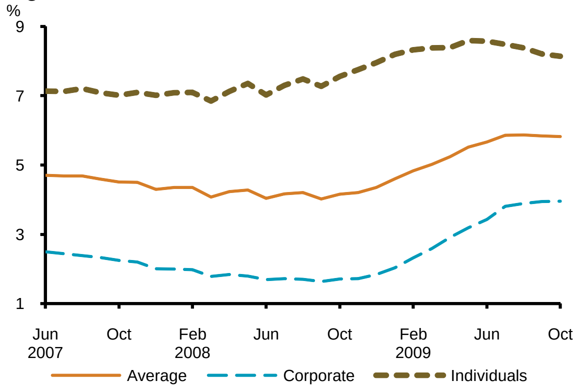


Figure 3.9 – Credit default rates1/
%



Nonearmarked corporate credit totaled R$473.6 billion in October, increasing 2.5% in the quarter and 3.6% in twelve months. The contracts with domestic resources, accounting for 87.3% of the segment, were conditioned by the performance of the.working capital modality, which balance, boosted by demand of resources for building inventory at the end of the year, rose 9.3% and 29.2% in the same basis of comparison. Conversely, the volume of loans backed by foreign funds, showing the appreciation and settlements in advance on exchange contracts (ACC) fell 14.8% in the quarter and 32% in twelve months.

The balance of loans with nonearmarked resources reached R$457.5 billion in the of segment individuals, showing increases of 4.5% in the quarter and 17% in twelve months, with emphasis on the evolution of personal credit operations that, intended in large part to the renegotiation of debt from the revolving credit arrangements, rose 6.2% and 24% in the comparison basis mentioned. Payroll-deducted loans, showing, in part, the quarterly reduction of 0.8 p.p. to 27.2% in the average interest rate for that modality, expanded by 8.3% and 32.4% in the periods considered, R$103.2 billion and spending to match the 59.1% of personal loans, compared to 57.9% in July. Additionally, credit for purchasing vehicles increased by 7.2% in the quarter and 6% in 12 months, and leasing transactions posted respective variations of -0.4% and 16.4%.

The average interest rate of the modalities that comprise the reference credit closed at 35.6% p.a. in October, dropping 0.4 percentage points in the quarter and 7.3 p.p. in twelve months. The average rate on loans for individuals reached 44.2%, decreasing in the order of 0.7 p.p. and 10.6 p.p., noting that the quarterly evolution resulted, in particular, the respective reductions of 7.3 p.p. and 1.3 p.p. observed in overdraft cheques and purchase of vehicles. The average interest rate on the corporate segment closed at 26.5% per year, recording decreases of 0.2 percentage points in the quarter and 5.3 percentage points in twelve months, with emphasis on their quarterly falloffs of 0.8 p.p. and 2.9 p.p. indicated in the fees relating to procedures and working capital guaranteed account.

The banking spread stood at 26 p.p. in October, reaching 33.5 percentage points in the segment of individuals and 17.7 p.p. in respect to corporate entities. The reduction of 0.8 percentage recorded by the spread in the quarter resulted from decreases of 1.7 p.p. and 0.2 p.p. in the segments mentioned, while the annual decline of 2.3 percentage points reflected a decline of 6.2 p.p. in the observed segment of individuals and stability in respect to corporations.

Credit Market – Post-Crisis Development

The 2008 global financial crisis affected significantly the credit market in Brazil. Supply conditions deteriorated quickly as foreign financing lines became restrict, liquidity in the domestic interbank market shrank and risk aversion in the granting of new resources by financial institutions intensified. Parallel to this, demand for credit was constrained by unfavorable expectations regarding employment, income and production, impacting both consumption and investment decisions.

The reduction in credit supply hit particularly the export-driven sectors, dependent on foreign lines and exposed to losses with exchange derivatives, and small and medium enterprises, which began to face difficulties to rollover their financial commitments, thus affecting the levels of default, interest rates and spreads. Moreover, the maturity terms of contracts were shortened and borrowers were required to contribute with higher amounts of resources when financing higher added value durable goods, like cars, for instance.

In this scenario, the upward credit trend observed up to mid 2008 started to slowdown significantly. As observed in Table 1, total loans reached R$1,367 billion in October, increasing by 15.3% in twelve months, as compared to respective increases of 26.4% and 34.4% in the corresponding periods in 2007 and 2008.

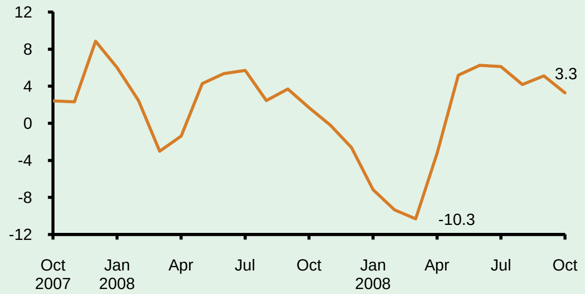
Additionally, the credit market shrinkage may be illustrated by the evolution of new credit concessions, as shown in Figure 1. Accordingly, the percentage change of credit operations accumulated in 3-month periods began to follow a downward trend as of October 2008, reaching the largest

Table 1 – Growth of credit operations

Itemization	October – 12-month % change		
	2007	2008	2009
Total	26.4	34.4	15.3
Nonearmarked	24.3	37.0	9.7
Individuals	32.6	28.2	17.0
Businesses	27.8	45.5	3.6
Domestic resources	29.5	47.9	12.1
Foreign resources	21.7	36.2	-32.0
Earmarked	18.3	28.4	29.4
BNDES	16.6	27.9	34.7
Housing	23.5	36.0	43.5

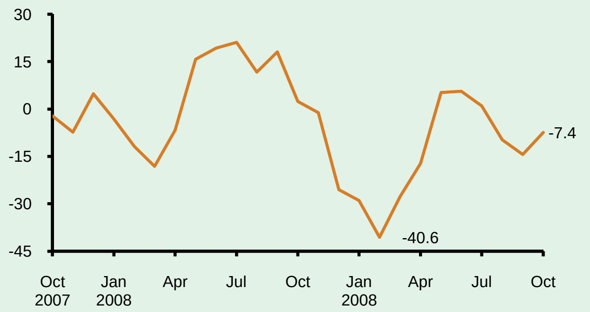
Figure 1 – Reference credit operations – % change accumulated in 3-month periods[1/]

Quarterly variation (%)



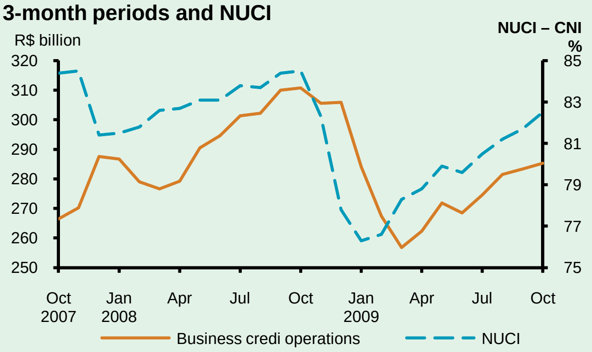
1/ The effect of exchange variation on credit granting referenced in foreign currency (ACCs, foreign onlending) is excluded.

Figure 2 – ACCs – 3-month cumulative granting[1/]
Quartely variation (%)



1/ Excluding the effects of exchange variation on the value of granting in modalities denominated in foreign currency (ACCs, external onlendings).

Figure 3 – Business credit operations[1/] accumulated in 3-month periods and NUCI



1/ The effect of exchange variation on modalities referenced in foreign exchange (ACCs, foreign onlending) is excluded.

Figure 4 – Credit operations with individuals accumulated in 3-month periods and ICC-FGV

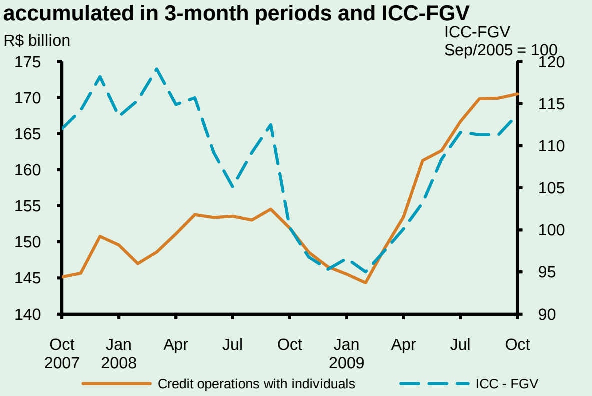
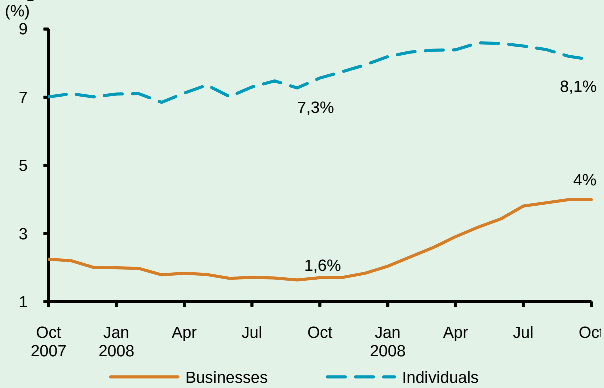


Figure 5 – Reference credit – Default rates



negative rate, 10.3%, in March 2009. As of that month, negative rates began to decline, and, as of May, turned positive, mainly as a result of the recovery in transactions with individuals, closing at 3.3% in October. It is worth mentioning that in the case of Advances on Exchange Contracts (ACC), the modality most affected by the dynamics of international trade, a similar behavior was observed up to mid 2009, and started to decline by then, as seen in Figure 2. In this case, however, it should be taken into account the price and quantity effects derived from the external crisis on the foreign trade.

Credit operations in the segments of businesses and individuals have followed different trends since the crisis intensification. Business credit operations were impacted by the restriction of both supply, which hit particularly small and medium enterprises, and demand, associated with the reduction of the Level of Installed Capacity Utilization, due to the reduction of investments. Still, the amount of credit operations remained high until the end of 2008, and this performance is explained, to a great extent, by the increased credit demand by large domestic enterprises, consequent upon restrictions for raising funds in domestic capital markets and abroad (Figure 3).

Insofar as household credit operations are concerned, a slowdown was observed as of October, following the deterioration of consumer expectations, as shown in Figure 4, which compares the 3-month credit household credit granting with the Getulio Vargas Foundation (FGV) Consumer Confidence Index. The recovery of expectations observed as of March favored the resumption of borrowings, reaching a level higher than that registered before the crisis in the period.

The default levels, essentially reflecting the restricted supply of resources to small and medium businesses, increased in the months following the worsening of the international crisis. Though keeping moderate levels, the default rate for business operations moved upward from 1.6% in September 2008 to 4% in October 2009, while that for individuals increased from 7.3% to 8,1%, as seen in Figure 5.

At first, this trend contributed to raise interest rates in both segments, from 28.3% and 53.1%, respectively,

Figure 6 – Reference credit – Interest rates

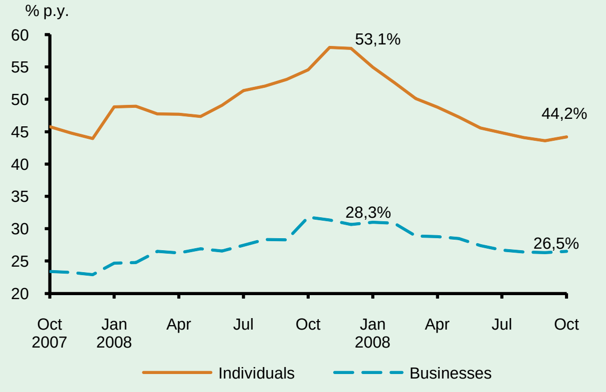
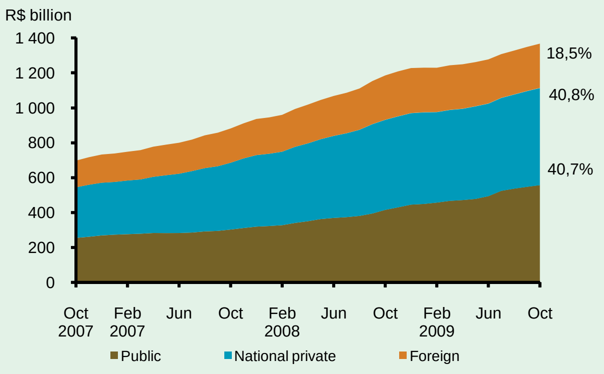


Figure 7 – Credit operations according to the source of funds



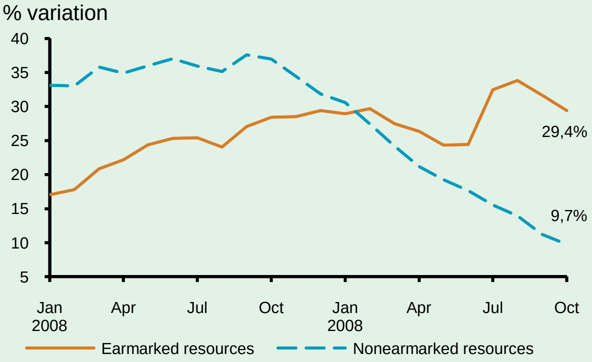
in September 2008, to 30.7% and 57.9% in December 2008 (Figure 6). Another aspect that revealed the squeezed credit conditions consisted in the shortening of average term of business credit operations, from 310 days in September to 267 days in October 2009.

In this context, the Central Bank implemented a series of measures aimed to restore liquidity in the credit markets, especially targeted to small and medium banks. Accordingly, changes in the rules of compulsory deposits, implemented in September 2008, allowed the release of funds worth R$99.8 billion. In April 2009, with the introduction of the Special Guarantee Deposits, guaranteed by the Credit Fund Guarantor (FGC) up to the limit of R$20 million per investor, R$13 billion were funded by the end of October. Another set of measures aimed to provide liquidity in foreign currency for the restoration of operations carried out with foreign resources. Between September 2008 and July 2009, by means of auctions aimed at exporters, sales of dollars in the spot market and foreign exchange swap auctions, R$72 billion were injected into the market.

In the months that followed the crisis intensification, public banks have played an important role as countercyclical agents, sustaining or expanding the supply of funds in the credit market. It should be noted that public banks that operate in the retail segment captured part of the market share of private banks deposits, thus favoring their expansion in the aftermath of the crisis. As a result, the relative participation of these institutions in the financial system increased from 34.2%, in September 2008, to 40.7% in October 2009, as shown in Figure 7, while those for private institutions and national foreign banks decreased, respectively, from 44.4% and 21.4% to 40.8% and 18.5%.

In this scenario, the balance of earmarked credit operations grew by 29.4% in October in comparison to the same month of 2008, as against the 9.7% expansion in the portfolio of nonearmarked resources. This performance, shown in Figure 8, was sustained, to a large extent, by the National Bank of Economic and Social Development (BNDES) operations and the housing loans carried out in the framework of the Housing Finance System (SFH). Such loans grew, in the period, 34,7% and 43.5%, respectively. It should

Figure 8 – Credit operations – Balance
12-month



be noted that BNDES disbursements carried out in the first ten months of the year totaled US$106.5 billion, rising 51.9% over the same period of the previous year, with emphasis on the industrial and infrastructure-related sectors.

The pace of new credit concessions and the performance of loans balances, both for individuals and businesses, demonstrate the gradual recovery observed in the credit market, restoring, in general, the scenario prevailing until September 2008. For that, it was decisive the contribution of Central Bank timely measures aimed to normalize the credit supply, coupled with tax incentives that continue to propel the sales of higher added value goods. One year after the acutest phase of the crisis, indicators reveal a downward default trend, at the same time that interest rates reached a significantly lower level and the terms of operations targeted to individuals registered the record of the series started in June 2000.

Figure 3.10 – Average term for credit operations – Calendar day

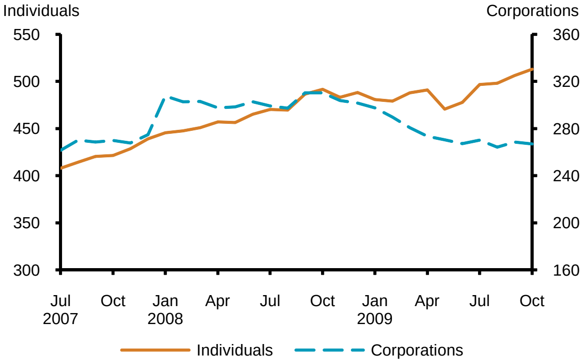


Figure 3.11 – Monetary base and M1 – Average daily balances

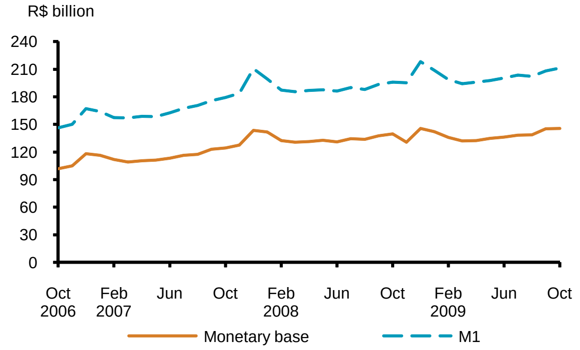
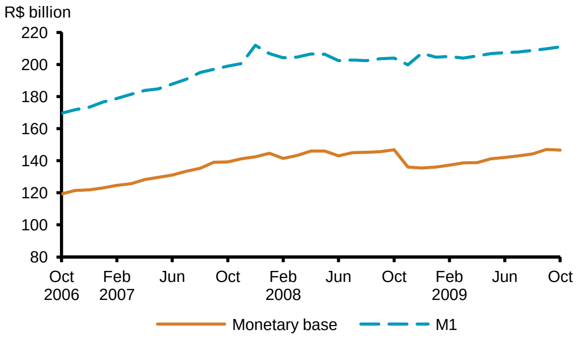
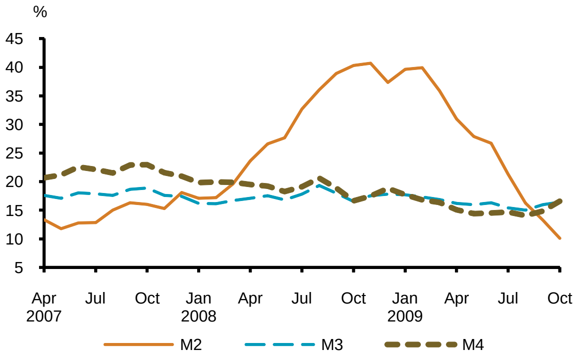


Figure 3.12 – Monetary base and M1 at October 2009 Seasonally adjusted prices[1/]



1/ Deflated by: IPCA.

Figure 3.13 – Broad money supply
12-month growth



The default rate of the reference credits, considering operations in arrears for more than ninety days, stood at 5.8% in October, recording a quarterly decline of 0.1 p.p. and an increase of 1.6 p.p. in twelve months. The default rate reached 4% in the corporate segment and 8.1% relative to individuals, registering respective variations of 0.2p.p. and 2.3p.p. and -0.4p.p. and -0.4p.p., on the above mentioned comparison bases.

The average maturity of the reference credit portfolio reached 377 days in October, an increase of seven days in the quarter and decrease of 10 days in twelve months. The quarterly change reflected a 16-day rise in operations of the segment of individuals, which reached 513 days, the highest level for the historical series since records began in June 2000, contrasting with the 3-day decrease in the average maturity of the portfolio by corporations, which closed at 267 days.

3.2 Monetary Aggregates

The restricted money supply (M1), in terms of average daily balances, totaled R$211.3 billion in October, increased 3.8% in the quarter and 7.8% in twelve months, with average balances of currency outside banks and demand deposits rising in the order of 5.1% and 2.9% from July and 11.2% and 5.5% in twelve months. Considered seasonally-adjusted data, deflated by the IPCA, M1 expanded 1.4% in the quarter and 3.4% in twelve months.

The average balance of the monetary base reached R$145.6 billion in October, registering growth of 5.2% in the quarter and 4.1% in twelve months, the result of respective increases of 6.3% and 11.9% in the balance of issued currency and changes in the same order of 1.6% and -15.2% in banking reserves, whose annual growth shows an impact of the reduction in October 2008, the rate of reserve requirements on demand deposits. Considering end-of-period data, the monetary base totaled R$147.5 billion in October. Among the factors that affected the quarterly expansion of R$11.9 billion reported by the household, pointing out the net purchases of R$23.4 billion held by the Central Bank in the interbank exchange market, in contrast to the contractionary effects derived from transfers from the National Treasury operating account, USUS$6.7 billion, and net placements of Treasury securities, USUS$4.3 billion.

The money supply in the M2 concept, which adds to M1 investment deposits, savings deposits and bonds issued by financial institutions totaled US$1.1 trillion in October, rising 1.6% in the quarter and 10.1% in twelve months. The balances of private bonds and savings deposits amounted to, in that order, US$600.5 billion and $303 billion, registering its quarterly changes of -1% and 4.1%.

The monetary aggregate M3, resulting from the sum of M2, the quotas of fixed-income funds and federal public securities that back the net financing position in repo operations between the public and the financial sector, reached R$2.1 trillion at the end of October, registering increases of 4.5% from July and 16.4% in twelve months. The concept M4, represented by the aggregation of M3 and public bonds of nonfinancial holders reached R$2.5 trillion, growing of 4.7% in the quarter and 16.6% in twelve months.

Figure 3.14 – Net financing position of the federal public securities – Daily average

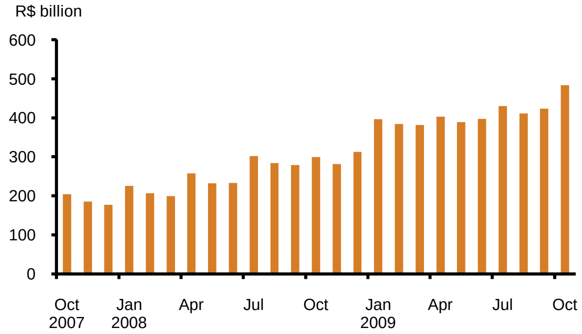


Figure 3.15 – Central Bank repo operations – Maturity – Average daily balances

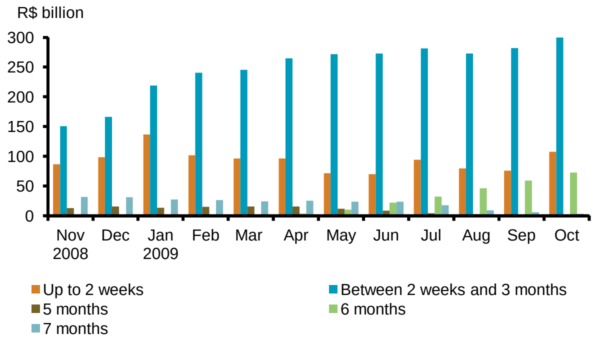
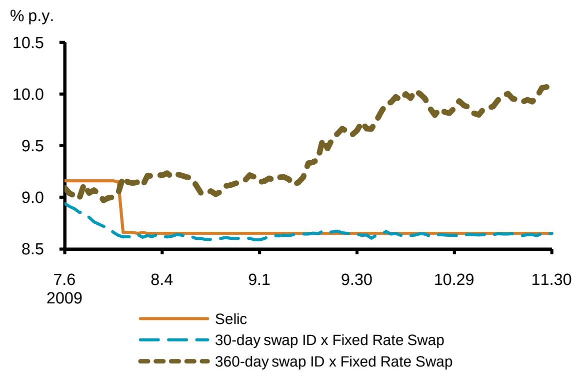


Figure 3.16 – Interest rate



Source: BM&F

Federal public securities and Central Bank open market operations

The primary operations of the National Treasury with federal public securities determined expansionary impact of R$42.3 billion in the quarter ended in October, a result of R$108.7 billion redemptions and placements of R$66.4 billion. Anticipated redemptions totaled R$2.8 billion and exchange operations, concentrated in the National Treasury Bills (LTN), R$18.1 billion.

The average daily balance of financing and go-around operations performed by the Central Bank totaled R$483.9 billion, rising 12.6% over the quarter ended in July, with increases in the very short term operations, from R$94.1 billion to R$107.9 billion; of periods between two weeks and three months, from R$281.2 billion to R$300.6 billion, and those with six-month maturity terms, from R$32.6 billion to R$72.5 billion. In contrast, the average daily balance of the operations of seven months decreased from R$17.6 billion to R$3 billion in the period.

Real interest rates and market expectations

The future interest rate curve of ID x pre swap contracts increased for all its vertices in the quarter ending in November, highlighting the movements of the vertices with maturities above one year. The rate for the swap contract DI x 360 day-pre, which recorded higher volatility, increased by 93 b.p. during the quarter to 10.12% p.y.

Figure 3.17 – Ex-ante real interest rate – Deflated by 12-month IPCA expectations
% p.y.

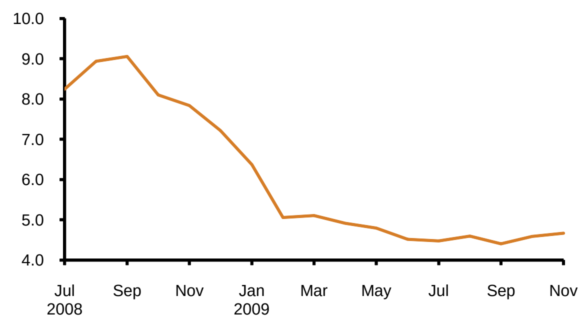
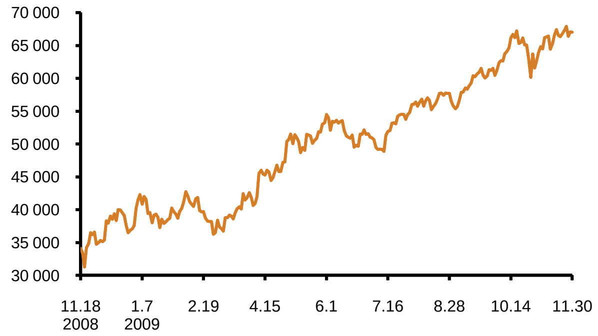


Figure 3.18 – Ibovespa
Points



Source: Bovespa

Figure 3.19 – Stock exchanges
September 2008 = 100

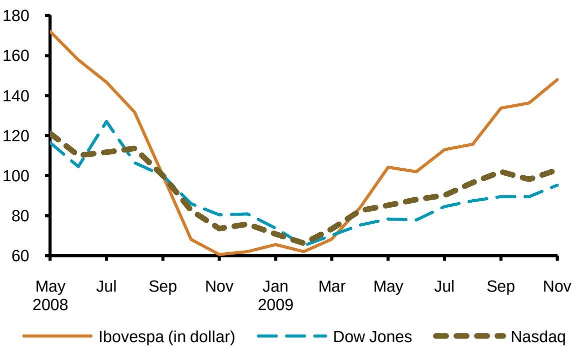
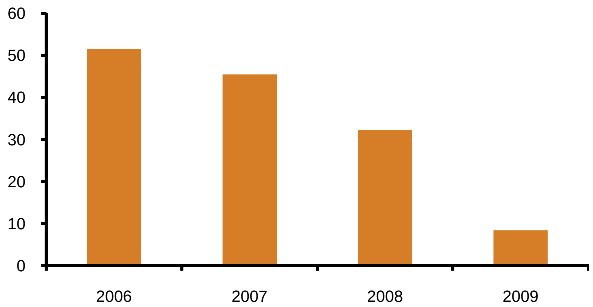


Figure 3.20 – Debenture primary issues in the capital market
R$ billion – Accumulated through November



Source: CVM

The real ex-ante Selic rate for the next twelve months, calculated based on the research Market Report of November 30, held by the Central Bank, amounted to 4.7% p.y., against 4.6% p.y. in August. The increase reflected the rising expectations for the 12-month Selic rate from 8.75% p.y. to 9.22% p.y., and CPI from 3.97% p.y. to 4.35% p.y.

Capital market

The index of the Sao Paulo Stock Exchange (Bovespa), maintained asteady appreciation, reaching 67,044 points at the end of November, posting respective gains of 18.7% and 79% in relation to the closing date of this August and December 2008. In dollarterms, the Bovespa increased 27.9% in the quarter while the Dow and the Nasdaq rose 8.9% and 6.7% respectively.

The market value of companies listed in BM&FBOVESPA S.A. – Securities, Commodities and Futures Exchange (BM&FBOVESPA) totaled R$2.3 trillion at the end of November, compared to R$1.4 trillion in the same period in 2008, while the average daily traded remained in R$6.4 billion, volume 24% above the quarter ended in August, consistent with the expanding liquidity in major developed economies.

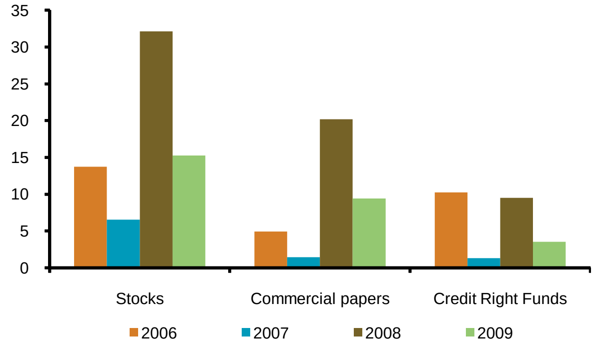
Business financing in capital markets through issuance of shares, debentures, promissory notes and placement of receivable assets, totaled R$36.6 billion in the first eleven months of the year, compared to R$99.3 billion in the same period of 2008 with emphasis on primary issues of shares, totaling R$15.3 billion, against R$31.2 billion in the same period last year. It is worth mentioning that the secondary emission of shares increased from R$1.9 billion in the first eleven months of 2008 to R$16.4 billion in the corresponding period of 2009, when it occurred, in addition, the issuance of R$14.8 billion in certificates of deposit of shares.

3.3 Fiscal Policy

Budget guidelines for the 2009 fiscal year were changed with the publication in October, of Law No. 12,053. The main change is on the increase, from R$15.6 billion to R$28.5 billion, the amount that can be deducted from the federal government primary surplus target, set at 1.4% of GDP. This deduction, which considered the projects included in Pilot Investment Project, has begun to incorporate all costs of the CAP. The Federal Government's primary surplus could be reduced to 0.46% of GDP and the consolidated

Figure 3.21 – Primary issues in the capital market

R$ billion – Accumulated through November



Source: CVM

Table 3.5 – Public sector borrowing requirements – Primary result

Segment	2007		2008		Oct 2009	
	R$ billion	% GDP	R$ billion	% GDP	R$ billion	% GDP
Central Government	-59.4	-2.3	-71.3	-2.5	-29.9	-1.2
Sub-national governments	-29.9	-1.2	-30.6	-1.1	-21.0	-0.8
State-owned companies	-0.4	-0.0	-4.5	-0.2	-0.7	-0.0
Total	-89.7	-3.5	-106.4	-3.7	-51.5	-2.1

Figure 3.22 – Public sector primary surplus

12-month cumulative

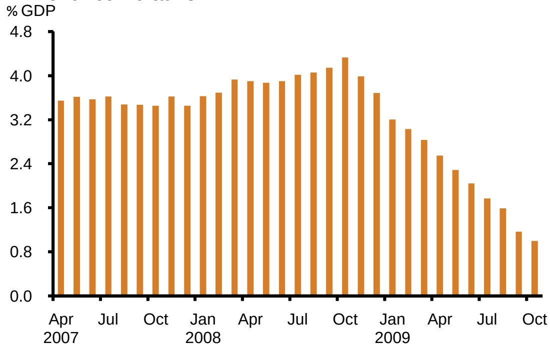
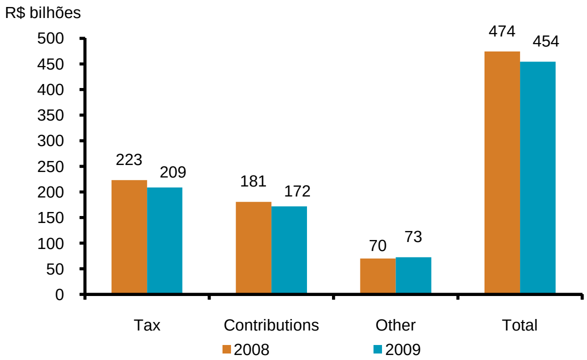


Figure 3.23 – National Treasury gross revenues

Jan-Oct



public sector surplus, whose target was set at 2.5% of GDP to 1.56% of GDP.

In line with these changes and the new revenue estimates, the Federal Government published in October, decree redefining the budget and financial program for the year and establishing a new schedule of monthly disbursements by the Executive Branch. The latest estimates indicate reductions of 10.1% and 8.8% the National Treasury and Social Security revenues, respectively, compared to forecasts released initially for the federal government budget

Public sector borrowing requirements

The public sector primary surplus totaled USUS$51.5 billion in the first ten months of the year, representing 2.06% of GDP. The reduction of 3.28 p.p. of GDP over the same period in 2008, reflected the occurrence of movements in the same direction in all spheres of the public sector, with emphasis on the decrease of 2.77 percentage points of GDP reported in the Central Government.

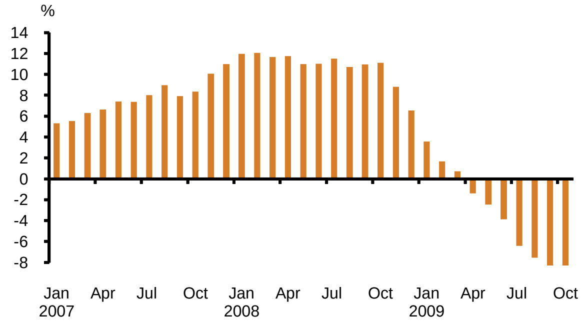
The reduction observed in the surplus from the central government reflected the downturn of 2.51 percentage points of GDP, resulting from the combination of increased costs and reduced revenues recorded in the Federal Government surplus, and an increase of 0.26 percentage points of GDP deficit observed in Social Security.

National Treasury gross revenues totaled R$453.6 billion in the first ten months of the year, 18.1% of GDP, compared to 19.7% of GDP in the same period in 2008.This reduction showed the impact of the recession experienced by the Brazilian economy after the intensification of the global crisis on the level of activity and effects on the revenues derived from the temporary fiscal stimulus measures adopted tax incentives to stimulate aggregate demand, with emphasis on the 25.6% drop recorded in the IPI collection.

The inflow from the Contribution to Social Security Financing (Cofins) and the Social Integration Program (PIS)/ Civil Service Asset Formation Program (Pasep) totaled R$119 billion, decreasing 6.2% over the same period last year, highlighting the decreases verified in the sectors of metallurgy, fuels and manufacturing of electronic equipment.

Revenues associated with the Corporate Income Tax (IRPJ) and the Social Contribution on Net Corporate Profits (CSLL) recorded decreases of 5.2% and 1.4%, due to evolution, in

Figure 3.24 – 12-month real growth rate of Treasury revenues[1/]



1/ Updated by IPCA.

Table 3.6 – National Treasury Expenditures
Jan-Oct

Itemization	2008		2009	
	R$ million	% GDP	R$ million	% GDP
Total	229 458	9.5	273 053	10.9
Personnel and payroll charges	102 513	4.3	121 383	4.8
Capital and current expenditures	126 154	5.2	150 736	6.0
Workers Support Fund	17 737	0.7	23 180	0.9
Subsidies and economic	3 737	0.7	3 418	0.9
subventions	3 737	0.2	3 418	0.1
Loas/RMV	13 266	0.6	15 670	0.6
Investment	20 032	0.8	23 940	1.0
Other capital expenditures	71 382	3.0	84 528	3.4
National Treasury transfers				
to the Central Bank	791	0.0	934	0.0

Source: Minifaz/STN

Figure 3.25 – Federal Government: investment expenditures paid
Jan-Oct

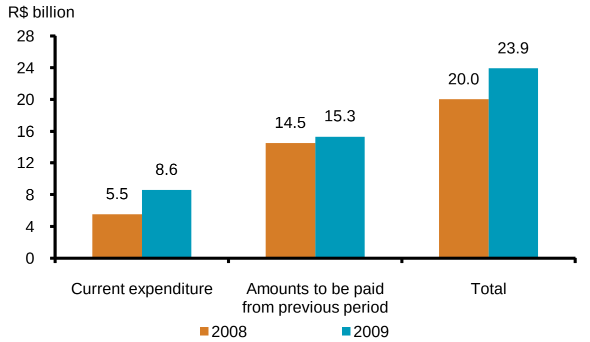
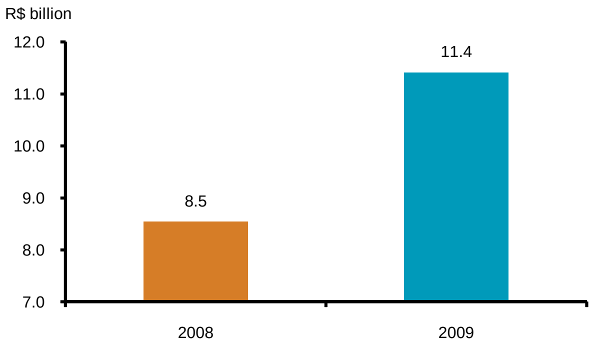


Figure 3.26 – Growth Incentive Program (PAC) expenditures
Jan-Oct



particular, the reduction in profitability of companies. The collection of the Financial Operations Tax (IOF) dropped 11.2% in the first ten months of the year, with emphasis on falloffs involving transactions related to currency inflows in exchange transactions and credit to individuals.

The inflows from the Contribution for Intervention in the Economic Domain (Cide-fuel) declined by 31.3% in the period, a development associated with the specific rate reduction on the cubic meter of fuel taken from the taxable events of May 2008 and compensation in the amount of R$1 billion incurred in the first quarter of this year.

The collection of Income Withholding Tax (IRRF), showing that the observed increases in wages and remittances abroad, the latter determined by the evolution of the average exchange rate during the first ten months of the year over the same period last year, increased by 2.6%.

In this scenario, the actual cumulative collection rate last twelve months, which had recorded a growth of 6.5% in December 2008 over the same period last year, fell 10.4% in October 2009 on the same basis comparison.

The expenses of the National Treasury totaled R$273.1 billion in the first ten months of the year, 10.9% of GDP compared to 9.5% of GDP in the same period in 2008. The growth of 19%, marked in the period, reflected the observed increases in personnel expenses, 18.4% ; in costs of current and capital expenditures, 19.5%, with an emphasis on growth of 0.19 percentage points of GDP in spending with the Worker Support Fund (FAT), with the growing number of workers assisted and the minimum wage increase, and the costs of investment, 19.5%, highlighting the expenditures under the Ministry of Transport. The CAP expenses, liable to being deducted from the primary surplus totaled USUS$11.4 billion in the first ten months of the year, increasing 34% over the same period in 2008.

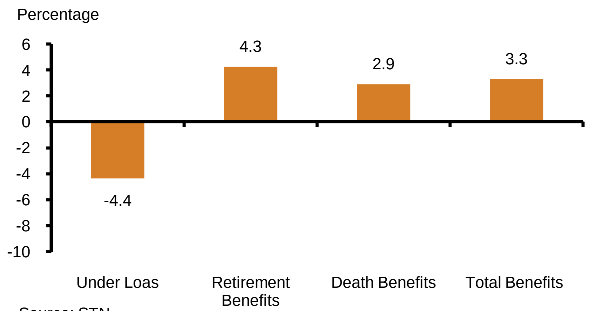
The Social Security primary deficit reached R$41.5 billion in the year through October, 0.26 percentage points of GDP higher than in the same period of 2008, reflecting the marked increases in revenue, 10.1%, and expenses with benefits, 12.8%. It is worth mentioning that the increase in expenses resulted from the minimum wage increase and benefits above the lower wage parameter, and an increase of 20.7% in judicially mandated payments paid while growth in revenues was related to overall wage growth. The number of retirements increased 4.3% in the first ten months of 2009 over the same period last year, while growth in total benefits granted closed at 3.3%.

Table 3.7 – Social security primary result
Jan-Oct

R$ billion

Itemization	2008	2008	Var. %
Gross inflow	141.3	155.6	10.1
Cash refunds	-0.4	-0.5	35.9
Transfers to third parties	-14.1	-15.5	9.9
Net inflow	126.9	139.6	10.0
Social Security benefits	160.6	181.1	12.8
Primary result	-33.7	-41.5	23.1
Net inflow/GDP	5.3%	5.6%	
Social Security benefits/GDP	6.7%	7.2%	
Primary result/GDP	-1.4%	-1.7%	

Figure 3.27 – Growth in the number of benefits issued by Social Security (Jan-Oct 2009 average/Jan-Oct 2008 average)



Source: STN

Figure 3.28 – Transfers to states and municipalities
Jan-Oct

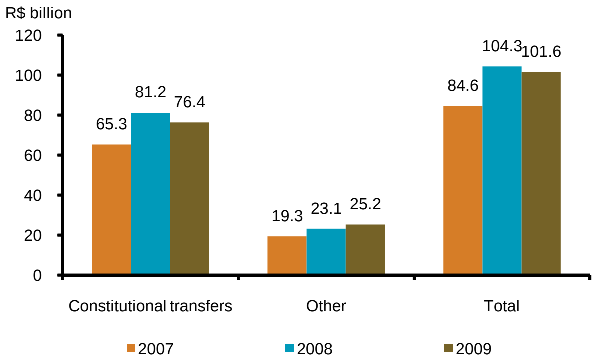
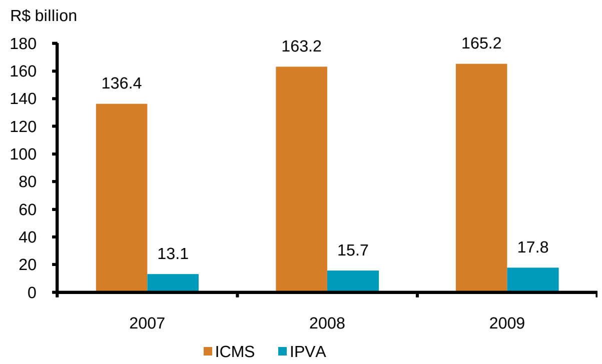


Figure 3.29 – ICMS and IPVA inflows
Jan-Sep



Transfers to regional governments totaled R$101.6 billion, decreasing 2.6% over the total recorded in the first ten months of 2008. This development reflected, in part, the decreases reported in the funds transferred to the constitutional funds, 5.9%, due to lower collection of shared revenues, and transfers of royalties and special oil participation, 24.7%, influenced by the reduction in the prices of this product. On the other hand, points out the respective increases of R$2 billion and R$1.9 billion seen in transfers from the Fund for Maintenance and Development of Basic Education and Enhancement of Education Professionals (Fundeb) and financial assistance to municipalities, provided by Provisional Measure no. 462, dated 2009.

The collections related to the Tax on the Circulation of Merchandise and Services (ICMS), a tribute more important in the sphere of regional governments, and the Tax on Automotive Vehicle Proprietorship (IPVA) recorded respective increases of 1.3% and 13.6 % in the first nine months of the year over the same period in 2008.

Regional governments recorded a primary surplus of R$21 billion in the first ten months of the year, stressing that the reduction of 0.37 percentage points of GDP observed over the same period of 2008 reflected a decrease in the occurrence of results from state governments and municipal governments. Despite this trend, the net debt of regional governments, showing deflation recorded by the IGP-DI index that corrects most of the regional liabilities, dropped in 2009.

The primary surplus of state-owned enterprises totaled 0.03% of GDP in the first ten months of 2009, against 0.16% of GDP in the same period last year. This reduction reflected the larger impact of unfavorable outcome noted in federal undertakings in relation to that provided by the observed improvement in the surplus of state and municipal enterprises.

Public sector nominal interests, appropriated on an accrual basis, totaled R$139.8 billion, 5.58% of GDP in the first ten months of the year, rising to R$4 billion over the same period last year, a development particularly associated to the effect of currency appreciation on dollar-indexed assets.

The nominal public sector deficit increased from US$7.6 billion in the first ten months of 2008 to R$88.3 billion in same period of 2009, an increase equivalent to 3.21 percentage points of GDP. The funding of this result occurred by expansion of the securities debt and other internal funding sources, including the monetary base, in contrast with the decreases observed in the net banking debt and the net external financing.

Figure 3.30 – Regional governments: Cumulative 12-month primary surplus and net debt

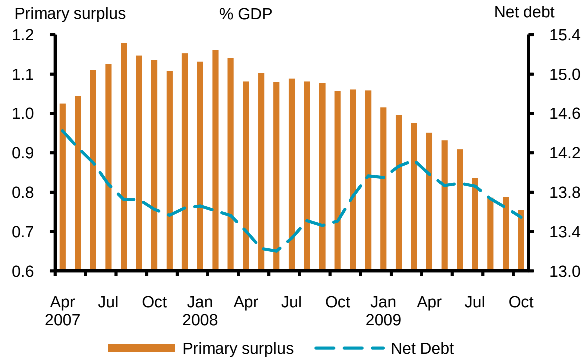
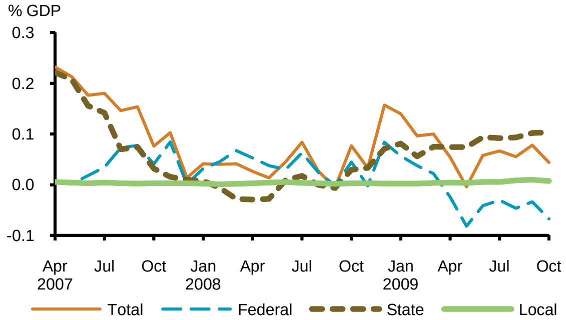
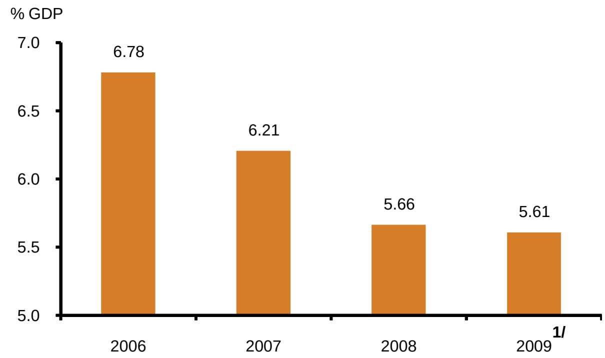


Figure 3.31 – Primary surplus of public enterprises
12-month cumulative data



(+) Surplus (-) Deficit

Figure 3.32 – Nominal interest



1/ Twelve-month accumulated up to October.

Table 3.8 – Public sector borrowing requirements

Itemization	2007		2008		Oct 2009	
	R$ billion	% GDP	R$ billion	% GDP	R$ billion	% GDP
Uses	71.5	2.8	57.2	2.0	88.3	3.5
Primary	-89.7	-3.5	-106.4	-3.7	-51.5	-2.1
Interest	161.2	6.2	163.7	5.7	139.8	5.6
Sources	71.5	2.8	57.2	2.0	88.3	3.5
Domestic financing	263.5	10.1	82.3	2.8	129.7	5.2
Securities financin(	239.4	9.2	171.1	5.9	276.2	11.0
Bank financing	-4.4	-0.2	-92.9	-3.2	-147.3	-5.9
Other	28.5	1.1	4.1	0.1	0.8	0.0
External financing	-192.0	-7.4	-25.0	-0.9	-41.5	-1.7

Federal securities debt

The federal securities debt as measured by portfolio position totaled R$1,370.8 billion, 46.1% of GDP in October, dropping 0.2 percentage points of GDP compared to July, rising 5.3 percentage points of GDP in the last twelve months. The quarterly growth reflected the impacts of net redemptions of R$12 billion held in the primary market, the financial effect of R$0.7 billion associated with exchange rate appreciation, and the incorporation of R$33.6 billion in interest ratings.

The participation of fixed-rate securities and those tied to the over/Selic rate and to the exchange rate on the total federal securities debt fell down in the quarter that ended in October, whereas that concerning bonds tied to price indices remained stable. On the other hand, the significance of funds borrowed by the Central Bank through open market operations, increased 3.2 percentage points in the period, reaching 26.5%.

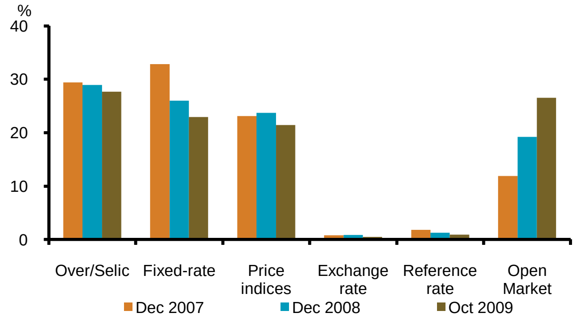
The Annual Financing Plan (PAF) of the Federal Public Debt in 2009 set minimum and maximum limits to be achieved by the end of the year for the participation of indexing factors in relation to total public debt. These limits are 24% and 31% for fixed rate bonds, 26% and 30% for those which are price-indexed, 32% and 38% for those tied to the over/Selic rate, and 7% and 11% for those related to foreign exchange. In October, these percentages reached respective levels of 22.9%, 21.4%, 27.7% and 0.5%, all, therefore, below the established parameters for the lower limit.

The repo operations carried out with the open market, representing funding of very short-term and short-term, reached R$492.7 billion in October, compared to R$435.3 billion in July, developments arising from net sales of securities of R$47.6 billion and incorporation of interest of R$9.8 billion.

The repayment schedule of securities debt in the market funding operations, in October, revealed that 2.9% of registered debt maturing in 2009, 21.6% in 2010, and 75.4%, from January 2011. It is worth mentioning that the maturity structure for bonds maturing in 12 months hit in October, 23.4%, reaching 1.6 percentage points below the limit set by the PAF in 2009. The average maturity of the debt amounted to 41.1 months, while respecting the limits established by PAF 2009.

The result of exchange swap operations, defined as the difference between the yield of DI and exchange variation

Figure 3.33 – Federal securities debt structure by indexing factor[1/]



1/ It does not include swap.

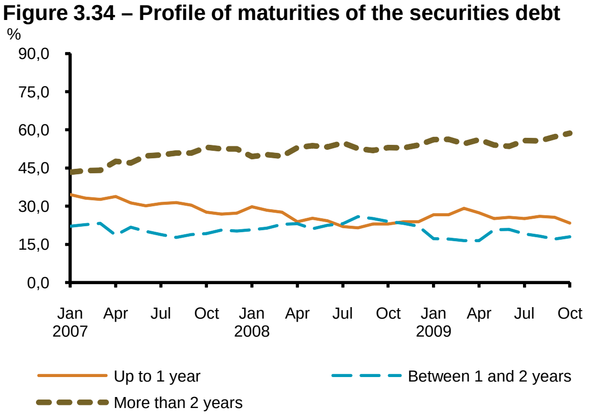
Table 3.9 – Repo operations – Open market

Balances and percentage share

R$ million

Period		Up to 1 month		More than 1 month		Total
		Balance	%	Balance	%	Balance
2003	Dec	43 742	78.5	11 975	21.5	55 717
2004	Dec	7 797	16.5	39 410	83.5	47 207
2005	Dec	-24 430	-106.9	47 286	206.9	22 856
2006	Dec	5 800	9.7	54 231	90.3	60 030
2007	Mar	41 656	39.3	64 281	60.7	105 937
	Jun	10 198	7.5	126 562	92.5	136 760
	Sep	7 561	4.3	168 525	95.7	176 086
	Dec	-1 460	-0.9	167 274	100.9	165 813
2008	Mar	37 349	18.2	167 643	81.8	204 991
	Jun	42 818	18.4	190 311	81.6	233 129
	Sep	87 261	30.9	195 107	69.1	282 368
	Dec	88 303	29.4	212 188	70.6	300 491
2009	Jan	132 202	34.7	249 018	65.3	381 220
	Feb	101 708	27.8	264 528	72.2	366 237
	Mar	124 877	33.7	246 066	66.3	370 943
	Apr	82 805	22.3	288 143	77.7	370 948
	May	75 432	19.6	309 310	80.4	384 742
	Jun	68 826	17.8	316 797	82.2	385 624
	Jul	173 895	42.5	235 662	57.5	409 557
	Aug	147 984	37.2	249 535	62.8	397 519
	Sep	60 179	14.0	369 497	86.0	429 676
	Oct	96 623	20.7	369 621	79.3	466 244

Figure 3.34 – Profile of maturities of the securities debt



plus coupon, showed a value of zero in the quarter ended in October. The cumulative result since 2002 when these operations have begun, was favorable to the Central Bank by R$7.2 billion.

Gross and net debt

The net public sector debt reached R$1,330.9 billion in October, 44.8% of GDP. The observed increase of 5.9 percentage points over the end of 2008 reflected the impact of the increase in the debt recorded on the Central Government, partly offset by decreases recorded in other spheres of government.

The contribution of nominal interest appropriation has become the main determinant of growth PSND/GDP, reaching 4.7 percentage points, followed by the effects of exchange rate appreciation in the period, 2.7 percentage points, and varying the parity between the basket of currencies comprising the net foreign debt by 0.4 percentage points. In the oppositesense, the primary surplus and privatizations exerted respective contributions of 1.7 p.p. and 0.1 p.p. to reduce PSND/GDP.

The share of net debt indexed to the Selic rate increased from 58.2% in December 2008 to 66.7% in October 2009, meanwhile, net the share of net fixed-rate debt of the creditor position referenced to the dollar and debt linked to price indices have, in that order, from 35.3% to 32.9% from 30.3% to 23.9% and from 32.6% to 30.2%. It should be noted that net issuance of debt indexed to the Selic rate reached R$152.2 billion in the period.

The General Government Gross Debt (GGGD), which includes the Federal Government, Social Welfare and the regional governments, totaled R$1,983.9 billion in October, 66.8% of GDP, rising 8.2 percentage points of GDP in years. This increase resulted in particular the incorporation of nominal interest and net issues of debt, offset partially by exchange rate adjustment levied on debts.

It should also be noted in relation to GGGD, that a significant proportion of debt issued in 2009 was due to federal government granting of credit to the BNDES, accomplished through direct placement of federal securities in the portfolio of that institution. These emissions generated credit equivalent to the Union, calculated in the net debt indicator.

Figure 3.35 – Swap and open market position

R$ billion

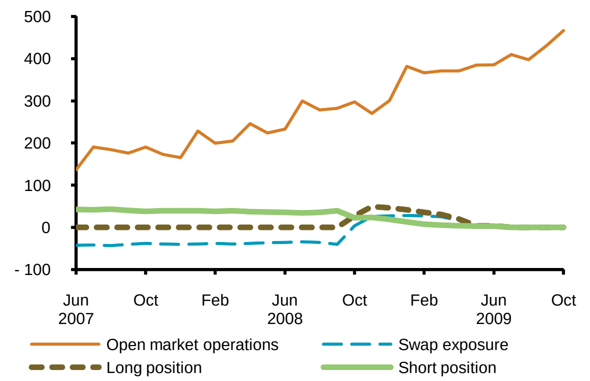


Table 3.10 – Net debt growth

Conditioning factors

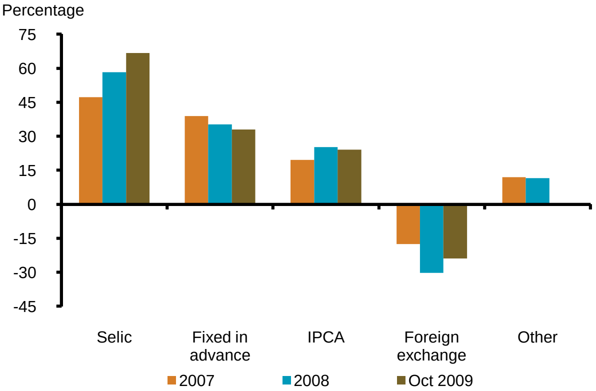
Itemization	2007		2008		Oct 2009	
	R$ million	% GDP	R$ million	% GDP	R$ million	% GDP
Total net debt – Balance	1200 799	43.9	1153 631	38.8	1330 863	44.8
Flows	**Accumulated in the year**					
Net debt – Growth	88 098	-2.0	-47 168	-5.0	177 232	5.9
Conditioning factors	88 098	3.2	-47 168	-1.6	177 232	6.0
PSBR	71 492	2.6	57 240	1.9	88 266	3.0
Primary	-89 730	-3.3	-106 420	-3.6	-51 531	-1.7
Interest	161 222	5.9	163 660	5.5	139 797	4.7
Exchange adjustment	21 016	0.8	-77 373	-2.6	79 381	2.7
Domestic securities debt[1/]	-2 432	-0.1	3 180	0.1	-3 398	-0.1
External debt	23 449	0.9	-80 553	-2.7	82 779	2.8
Others[2/]	-2 516	-0.1	-26 404	-0.9	11 969	0.4
Skeletons	- 630	0.0	135	0.0	171	0.0
Privatizations	-1265	0.0	-767	0.0	-2555	-0.1
GDP growth effect		-5.2		-3.5		0.0

1/ Domestic dollar – Indexed securities.

2/ Parity of the basket of currencies in the net external debt.

Figure 3.36 – PSND – Percentage share of indexator

Percentage



3.4 Conclusion

Credit operations has shown gradual recovery, underpinned in particular by developments in the segment of individuals who, in a marked pace since the first months of the year, reflects the scenario of maintenance of real income and, more recently, improvement in consumer expectations. The trajectory of credit in the corporate segment, most impacted by the environment that followed the intensification of the global crisis, continues at a moderate pace, but records a recovery consistent with the recovery of sales and investments, with emphasis on the contribution of BNDES disbursements.

The consolidation of the sustained recovery of the credit market, an important element for the continued recovery of growth in the Brazilian economy over the medium term, will benefit from improvements in indicators of income and employment and reduction in default rates.

The evolution of fiscal accounts follows reflecting the effects of reduced activity level and the adoption of transitional measures for tax relief on the performance of government revenues and, consequently, on the trajectory of the primary result. It should be noted that the consolidation of a new cycle of growth in the economy should provide revenue recovery and the return of budget surplus to levels recorded prior to the intensification of the crisis, signaled perspective on the goals defined in the Budget Guidelines Law (LDO) for next year.

In this scenario, although the observed reduction in primary surplus should not consist in restricting the downward movement of the medium and long term PSND/GDP, the growth in current expenditures remains a risk factor for compliance with fiscal targets.

Table 3.11 – General government gross debt
Conditioning factors

Itemization	2007		2008		Oct 2009	
	R$ million	% GDP	R$ million	% GDP	R$ million	% GDP
GGGD - Balance	1 542 852	56.4	1 740 888	58.6	1 983 868	66.8
Flows	**Accumulated in the year**					
GGGD – Growth	206 207	1.2	198 036	2.2	242 980	8.2
Conditioning factors	206 207	7.5	198 036	6.7	242 980	8.2
GGGD borrowing requirements	222 097	8.1	158 976	5.4	275 345	9.3
GGGD net issues	42 958	1.6	-41 963	-1.4	116 698	3.9
Interest	179 139	6.5	200 938	6.8	158 647	5.3
Exchange adjustment	-27 462	-1.0	38 473	1.3	-41 024	-1.4
Indexed internal securities debt[1/]	-2 432	-0.1	3 180	0.1	-3 398	-0.1
External debt	-25 029	-0.9	35 293	1.2	-37 626	-1.3
Others[2/]	7 123	0.3	-2 662	-0.1	7 134	0.2
Skeletons	4 448	0.2	3 250	0.1	1 525	0.1
Privatizations	0	0.0	0	0.0	0	0.0
GDP growth effect		-6.3		-4.4		0.0

1/ Domestic dollar – Indexed securities.
2/ Parity of the basket of currencies in the external debt.

International economy 4

Evidence of recovery in the world economic activity, highlighted in the previous report, has been strengthened in recent months. In parallel with the continued recovery observed in Asia and in several emerging economies, the products from the U.S. and the Euro area, showing the maturation process of inventory adjustment and the effects of expansionary fiscal and monetary policies, returned to expand on the quarter ended in September, exerting positive repercussions on international trade and economic activity in other regions of the world.

International financial and commodity markets continued to benefit from high liquidity and reduced risk aversion in an environment of reduced earnings from government bonds of major developed economies. In this scenario, the flows of short-term foreign capital began to be mostly channeled to the financial markets of emerging economies, leading to the adoption in some countries, of restrictive measures.

The inflationary scenario refers to evidence of exhaustion of deflation that hit the U.S., the Euro Area and China. Although the accommodative stance of monetary policies in such economies have been maintained in recent months, central banks from Australia, Norway and Israel began its cycle of hikes in basic rates, while the monetary authorities of Russia, Turkey and Hungary followed the opposite path, continuing the cycle of monetary easing.

4.1 Economic activity

After a period of significant and persistent contraction of GDP and a sharp increase in the unemployment rate, the economies of U.S. and Euro Area – the main focus of the financial crisis that has assumed global dimension and conditioned decisively the activity level in all continents – reported favorable results in the quarter ended in September. In this environment, the annualized quarterly GDP of these economies grew, in order, 2.8% and 1.5%, while Japan's

Table 4.1 – Major developed countries

GDP components and other indicators

% rate anualised

	2008				2009		
	I	II	III	IV	I	II	III
GDP							
United States	-0.7	1.5	-2.7	-5.4	-6.4	-0.7	2.8
Euro Area	3.3	-1.3	-1.7	-7.3	-9.4	-0.6	1.5
United Kingdon	2.7	-0.4	-3.0	-7.0	-9.6	-2.3	-1.2
Japan	5.6	-8.1	-4.0	-10.2	-11.9	2.7	1.3
Household consumption							
United States	-0.6	0.1	-3.5	-3.1	0.6	-0.9	2.9
Euro Area	0.8	-1.5	0.0	-2.0	-1.8	0.2	-0.9
United Kingdon	3.4	-0.5	-1.4	-4.7	-5.8	-2.4	-0.1
Japan	-6.2	-0.4	-3.6	-4.7	4.9	2.7	3.6
Non-residential investment							
United States	1.9	1.4	-6.1	-19.5	-39.2	-9.6	-4.1
Euro Area1/	3.3	-4.8	-5.6	-14.2	-18.3	-6.5	-1.4
United Kingdon1/	-9.5	15.0	-11.7	-5.3	-31.2	-34.9	-11.6
Japan	21.9	-6.2	-16.5	-24.1	-29.7	-17.0	-10.6
residential investment							
United States	-28.2	-15.8	-15.9	-23.2	-38.2	-23.3	19.5
Euro Area2/	6.6	-7.7	-5.7	-6.4	-4.4	-2.5	-3.9
United Kingdon	-5.8	-16.9	-23.2	-24.4	-34.8	-25.8	nd
Japan	16.3	0.6	16.4	10.2	-23.2	-32.8	-28.1
Exports of goods and services							
United States	-0.1	12.1	-3.6	-19.5	-29.9	-4.1	17.0
Euro Area	8.7	-2.1	-5.1	-25.7	-30.6	-5.0	12.2
United Kingdon	3.3	3.2	-3.9	-15.2	-25.5	-5.5	2.0
Japan	30.6	-15.1	-7.7	-44.9	-61.7	28.8	28.6
Imports of goods and services							
United States	-2.5	-5.0	-2.2	-16.7	-36.4	-14.7	20.8
Euro Area	7.8	-4.3	-0.3	-16.7	-26.4	-11.1	10.7
United Kingdon	-2.1	-3.5	-5.0	-20.2	-25.2	-8.4	5.2
Japan	15.0	-9.0	2.9	-6.2	-47.7	-13.0	13.9
Government spending							
United States	2.6	3.6	4.8	1.2	-2.6	6.7	3.1
Euro Area3/	2.1	2.9	2.0	2.6	2.5	2.6	2.1
United Kingdon3/	3.3	3.1	2.0	4.0	0.3	2.4	0.9
Japan	-3.9	-7.5	-0.1	4.2	4.8	5.1	-1.5
Manufacturing output							
United States	-1.2	-5.4	-9.2	-18.2	-21.9	-8.9	8.2
Euro Area	4.0	-4.3	-7.3	-27.0	-30.6	-4.9	8.2
United Kingdon	2.2	-6.0	-8.8	-19.7	-19.8	-1.0	-0.9
Japan	2.1	-7.4	-11.6	-37.3	-61.1	28.2	37.8
Unemployment rate3/							
United States	5.1	5.6	6.2	7.2	8.5	9.5	9.8
Euro Area	7.2	7.4	7.7	8.2	9.0	9.4	9.8
United Kingdon	5.2	5.4	5.9	6.4	7.1	7.8	7.8
Japan	3.8	5.4	5.9	6.4	7.1	5.4	5.3

Sources: BEA, Cabinet Office and Eurostat

1/ Includes residential and public investment expenditures.

2/ Total construction expediture.

3/ Consumption expenditures excluded.

4/ Quarter-end rate.

economy, continuing the positive rate observed in the quarter ended in June, rose 1.3%. It is worth mentioning that the UK's GDP, even when it had shrunk 1.2% in the period, has recovered somewhat compared to the results seen in previous quarters.

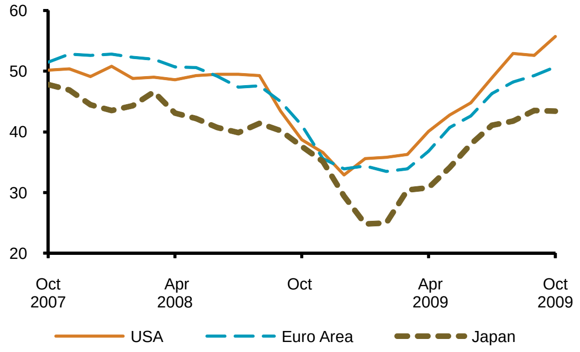
The GDP trajectory in the U.S. and Japan reflected to a great extent, the impact of the maturation process of inventory adjustments in these economies, expressed as a contribution of 0.9 p.p. and 0.3 p.p. to the variations of their products in the quarter ended in September, against, in the same order, -1.4 p.p. -2.7 p.p. in the quarter ended in June. It should be noted that this performance countered the negative effects inherent in reducing the rate of expansion of government spending, evidenced by decreases of 1.3 p.p. to 0.6 p.p. and 1.1 p.p. to -0.3 p.p. in the quarterly contributions of this component of aggregate demand to GDP growth.

Household consumption was increased 2.9% in the U.S. and 3.6% in Japan. Such development was associated mainly to the impact of their respective increases of 20.1% and 44.9% indicated in the annualized quarterly spending on durable goods, particularly those related to new vehicles, and in the case of Japan, also related to domestic appliances. It is worth mentioning that the quarterly consumption growth in the U.S., in a scenario of depletion of the impact of the stimulus program to consumer spending and a decrease of 1.5% of real disposable income in the period was helped by the reduction of 0.9 p.p. to 4.5%, the saving rate of households in the quarters indicated.

In the United Kingdom in and the Euro Area, despite spending on new vehicles have also expanded, their effect on household consumption was neutralized by reductions recorded in other segments, in these economies, relative stability in consumption for the period in question.

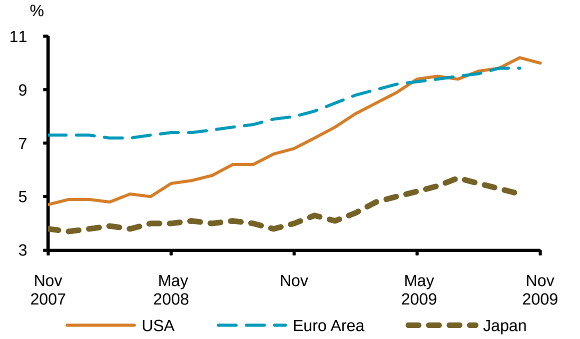
Corporate investment, maintaining the trend of reducing the rate of contraction and suggesting the relative resilience of pessimistic expectations regarding the performance of the world economy, recorded an annualized contraction of 4.1% in the U.S. and 10.6% in Japan in the third quarter in 2009. It should be noted that residential investment, although continued registering negative rates in Japan, reported a quarterly annualized increase of 19.5% in the U.S., the first positive rate after 14 quarters, confirming the prospects outlined in the previous report. Similarly, recent statistics show the expansion of mortgage lending in the Euro Area and the United Kingdom, where there were, in addition, rising housing prices.

Graph 4.1 – Manufacuring PMI
Largest developed economies



Source: Bloomberg

Graph 4.2 – Unemployment rate evolution
Largest developed economies



Source: Bloomberg

Table 4.2 – China
GDP components and other indicators

	2008				2009		
% rate [(Q)/(Q-4)]	I	II	III	IV	I	II	III
GDP	10.6	10.1	9.0	6.8	6.1	7.9	8.9
Household consumption [1/]	11.7	13.4	17.1	17.6	15.7	16.8	16.8
Gross Fixed Capital Formation	20.3	20.1	20.2	23.7	38.8	50.1	47.4
Exports of goods	17.3	17.3	18.5	4.4	-10.9	-9.1	-5.5
Imports of goods	15.7	17.1	10.6	-2.2	-3.9	18.1	28.7
Industrial production	16.3	15.9	12.9	6.4	5.6	9.0	12.4
Unemployment rate [2/]	4.0	4.0	4.0	4.2	4.3	4.3	nd

Source: Thomson
1/ Retail sales growth rate.
2/ Urban unemployment rate at the end of the quarter.

The maturation process of inventory adjustment and the stabilization of aggregate demand conditions in Japan, the U.S. and the Euro Area, besides favoring the growth of industrial production, have supported growth of imports and, in particular, the improvement process in labor market conditions, a relevant element for maintaining the economic recovery underway.

Japan’s manufacturing output registered an annualized increase of 37.8% in the quarter ended in September, against 28.2% in that ended in June. This acceleration was mostly associated to the 28.6% growth in the country’s exports in that period. The industries in the Euro Area and the U.S. grew also 8.2% contrasting with the marked decrease of 0.9% in the UK during the period. It should be emphasized that the industrial performance in this country, although negative, represented a new level of consolidation in relation to the 19.8% decrease observed in the same type of comparison, in the quarter ended in March. Exports from the U.S., Euro Area and the United Kingdom amounted, in that order, 17%, 12.2% and 2%. One should note that the resumption of external trade flows recorded in the quarter was also reflected in the annualized increases registered in U.S. imports in 20.8%, Japan 13.9%, Euro area, 10.7% and UK, 5.2%. Business sentiment indicators pointed to the continuity of positive developments in industrial production and foreign trade in those economies.

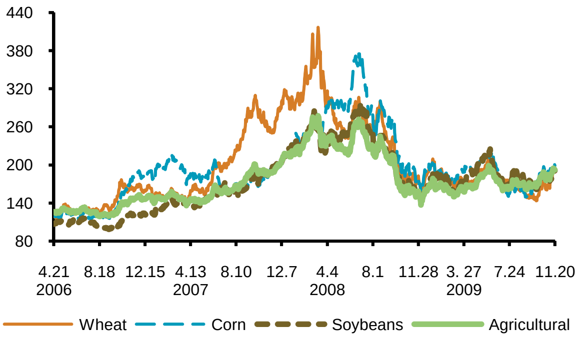
The more favorable economic conditions have contributed to the gradual stabilization of the labor market in the major developed economies. In this environment, have been eliminated 261,000 jobs in the U.S. economy in the quarter ended in November, compared to 921,000 in that ended in August, while, at the margin, there were 111,000 layoffs in October and 11,000 in November, when the monthly unemployment rate reached 10%, compared to 10.2% the previous month. This result, while keeping the rate set at a level close to the highest level since April 1983, took place in a scenario of reduction in the growth rate of the unemployment rate, which had increased from 7.2% in December 2008 to5% in March and 9.5% in June 2009.

In the context of the Euro Area, France, with the exception of the agricultural sector, recorded a reduction of 5,500 jobs in the quarter ended September, against the elimination of 85,400 jobs in the quarter ended in June. Considered the same periods, there were respective reductions of 30,000 and 60,000 jobs in Germany, and 268,000 and 288,000 jobs in Spain, the only economy among the most representative of the region to show a GDP contraction in the third quarter of the year.

China's GDP increased by 8.9% in the quarter ended September, compared to the corresponding period the last year, compared to the same type of comparison, 7.9% for the quarter ended in June. This acceleration reflected, in particular, the effect of expansion of 16.8% registered in consumption, stimulated by the maintenance of incentives to sales of durable goods, with emphasis on those relating to vehicles and household goods, neutralized, in part by a slowdown of 2,7 pp, to 47.4% in the real growth of gross fixed capital formation. In the context of external demand, real exports of goods were reduced from 9.1% to 5.5% in its pace of contraction, while real imports of goods showed further growth, 28.7%.

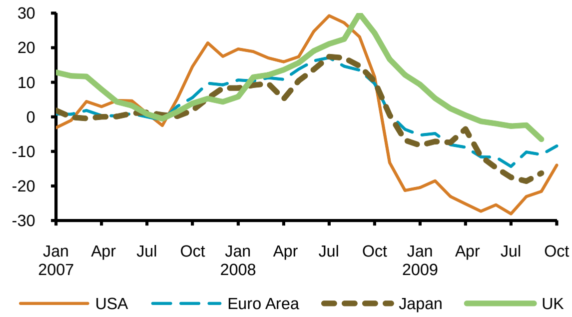
4.2 Monetary policy and inflation

Figure 4.3 – Agricultural Index
12.31.2004 = 100



Source: Thomson

Figure 4.4 – Energy inflation
Annual growth
%



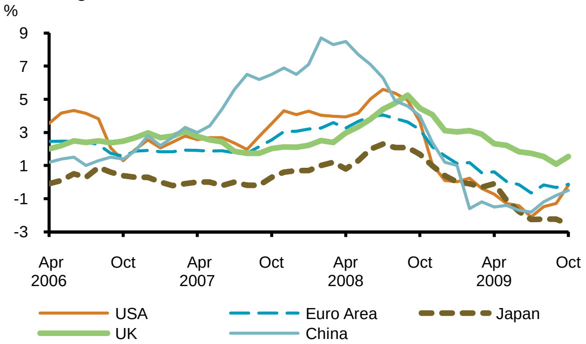
Source: Thomson

The scenario of a significant output gap, uncertainties regarding the resumption of economic growth and commodity and energy prices, despite the recent rise in the level below that of the pre-crisis period, favors the risks of inflationary pressures in major mature economies to remain low. This approach contrasts to that observed in Australia, Norway, Israel and some emerging economies, where, amid stronger recovery in domestic demand, signs of reversal of its monetary easing cycle have been registered.

In the U.S., the Consumer Price Index (IPC), reflecting in particular the 14% decline experienced by energy prices in the range of twelve months ending in October, recorded a decrease of 0.2% in the period, representing the eighth deflation, in sequence, in this comparison basis. It is worth mentioning that, although without representing- in a scenario of reduced capacity utilization high unemployment rates and continuous reduction in prices received by producers – perspectives of inflationary pressures in the short term, the GDP deflator reported quarterly change annualized of 2.9% in October, compared to a decrease of 1.5% in the quarter ended in March.

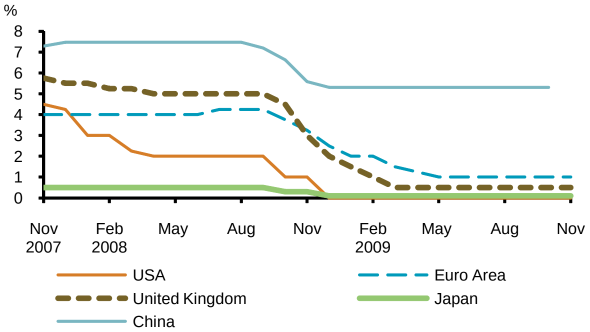
In this scenario, the Federal Reserve (Fed) kept the limits of the fluctuation band of the target for the Fed funds rate to 0% and 0.25% and made adaptations in liquidity assistance programs. In September, keeping the volume of purchases, announced the extension until the end of the first quarter of 2010, of the deadline for purchasing mortgage-backed securities of Fannie Mae and Freddie Mac Additionally, in November, the Fed reported that the upper limit of US$200

Figure 4.5 – Consumer inflation
Annual growth



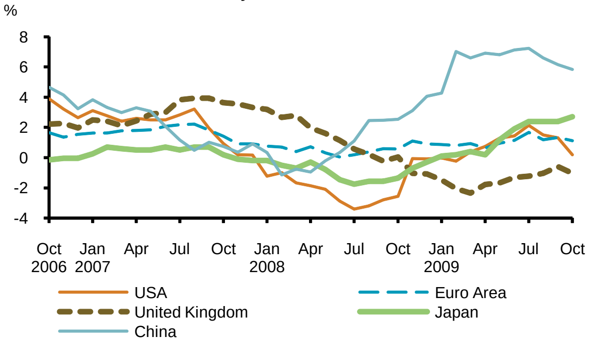
Sources: BLS, Eurostat, Bloomberg and ONS

Figure 4.6 – Official interest rates
Annual rates



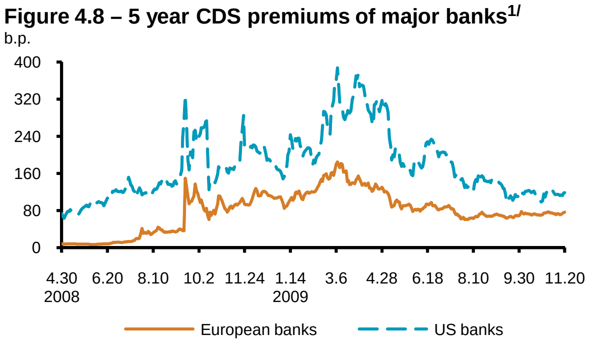
Sources: Fed, ECB, BoJ, Bank of England and The People`s Bank of China

Figure 4.7 – Real interest rates
Annual rates – deflated by CPI



Sources: Fed, BCE, BoJ, BoE, BPC, BLS, Eurostat, ONS e Bloomberg.

Figure 4.8 – 5 year CDS premiums of major banks[1/]



Source: Thomson
1/ Aritmethic average of 5-year CDS premiums for major European and US banks. Since it's not a random sample, it may not reflect the behavior of the financial system as a whole.

billion, aims to restrict the purchase of debt of those agencies to US$175 billion.

In the UK, the twelve-month variation of the IPC reached 1.5% in October, marking the first increase in this type of comparison, in eight months. Although the risks of renewing the inflation in medium term are increased in the scenario of continued depreciation of the pound, the confirmation of the upward trend of change in the Producer Price Index (PPI), which reached 1.9% in October, and the reversal, as of January 2010 of cutbacks in the Added Value Tax, the recessionary environment, the low capacity utilization and the credit crunch in the local economy have been predominant in monetary policy decisions. Therefore, in October, the Bank of England (BoE) Monetary Policy Committee kept the benchmark interest rate at 0.5% p.a. and eased the criteria for access of cooperatives to the discount window operations, while in November, once again expanded the program of quantitative easing, with the volume of purchases of corporate bonds and government securities increased by £25billons to £200 billons.

In the euro area, the change in consumer price index accumulated during the last twelve months reached -0.1% in October, with emphasis on the decreases of 8.5% and 0.4% recorded in the prices of energy and foodstuffs. The European Central Bank (ECB), even considering this deflationary outlook and the relative fragility in the recovery of the labor market, estimated that the recovery that occurred in the economic activity as of the third quarter and expectations that the deflationary process can be reversed in coming months justified the retention of key interest rates by 1% p.a., the current level since May. The ECB decided to, additionally, extend operations to supply liquidity in dollars and renewing the agreement on currency swap with the Swiss National Bank (SNB), both until January 2010.

In Japan, the CPI variation accumulated through the last twelve months reached -2.5% in October from -2.2% in July. Although the deflationary process has shown itself more intense, the progress made in the real economy, with emphasis on the favorable performance of private consumption and exports and in the domestic financial market stimulated the Bank of Japan (BoJ) to announce, at the end of October, the ending of part of the quantitative easing measures created as the global crisis intensified. Thus, the BoJ opted for maintaining the schedule for closing the end of December, from direct purchases of commercial paper and corporate bonds. Additionally, the BoJ has kept the base rate at 0.1% per year level in force since December 2008.

The deflationary process observed in China record a relative cooling off, in response to a scenario of uninterrupted liquidity injection into the economy, resulting from the expansion of international reserves of the country's international reserves. Accordingly, the annual variations of consumer and producer price indices reached, in that order, -0.5% and -5.8% in October from -1.8% and -8.2% respectively, in July. The People's Bank of China (PBC) has maintained the basic interest rates and reserve requirements at 5.31% p.a. and 14.5% p.a., respectively, levels seen since December 2008.

4.3 International financial markets

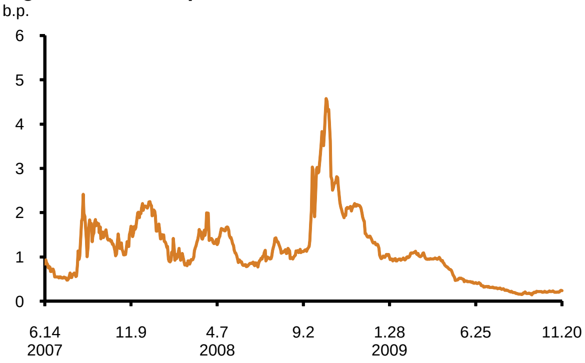
The expectation of continued expansionary policies and the most consistent indications of a resumption of activity in major economies sustained, in the quarter ended in September, the continuity of positive trends in financial markets that began in March this year.

Although a deteriorating quality of loan portfolios and worsening default indicators occurred in the quarter, the recovery in financial markets made it possible for major U.S. banks to present, in the period, more favorable results than the previously projected by the market. In this scenario, the average premiums of Credit Default Swap (CDS) of the five biggest U.S. banks, considered the criteria of market capitalization, fell 29 basis points to 119 basis points between August 31 and November 20, while average premiums of CDS of the five largest European banks, selected by the same criteria, remained relatively stable, reaching 76 b.p. on November 20.

The continuation of the expansionist policies favored the maintenance of the high degree of interbank market liquidity in the U.S., with the TED Spread – the difference between the 3-month Treasury Bill, short-term rate considered free of risk, and dollar denominated libor in the same period – standing at 0.24 basis points on November 20, a level similar to that observed before the crisis in the U.S. real estate market.

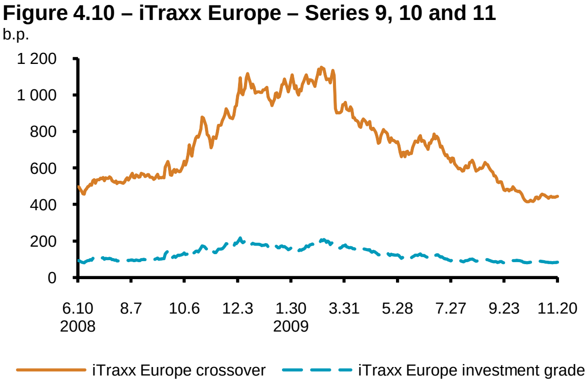
The financing conditions for enterprises, especially those considered at greatest risk, continued favorable. The iTraxx Crossover, which represents the risk premiums required to guarantee loans to European companies considered in high risk, and iTraxx IG, which represents the premium required for European companies considered as investment grade,

Figure 4.9 – TED spread



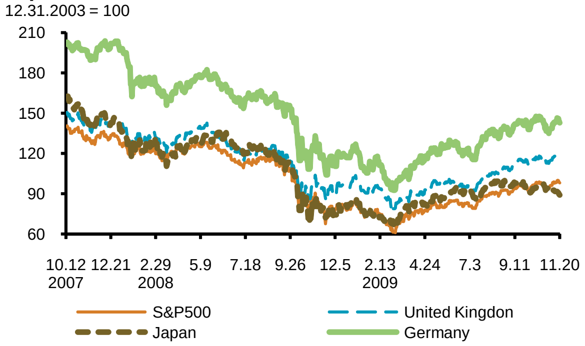
Source: Bloomberg

Figure 4.10 – iTraxx Europe – Series 9, 10 and 11



Source: Thomson

Figure 4.11 – Stock exchanges: USA, Europe and Japan



Source: Bloomberg

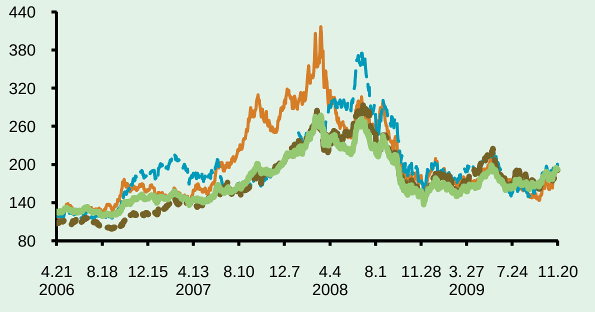
Inflation Growth in Brazil and in the World Economy during the 2008/2009 Period

The change in the consumer price index (IPC) recorded over the two-year period ended in 2009, a significant slowdown in mature economies and a large part of the emerging economies, and less pronounced volatility in Brazil. Thus, while the annual variation of the indicator in the United States of America (USA) dropped 5.6% in July 2008, the highest rate in seventeen years, to -2.1% in July 2009, lowest rate since January 1950[1], the reduction in the Brazilian indicator reached 1.9 p.p. in the same range. The aim of the figure in this scenario is to identify the main determinants of the difference between the behavior of inflation in those economies and Brazil.

The inflation trajectory in the 2008/2009 period concerns two defined periods. The first one, begun in the third quarter of 2007, runs until mid-2008 and highlights the impact of rising energy prices and the prices of major commodities, especially agricultural, in the context of excessive expansion of demand in several economies. After this period, the process of inflation deceleration moves on associated with the recessionary environment experienced by the global economy after the worsening of the financial crisis.

Figure 1 – Agricultural index

12.31.2004 = 100

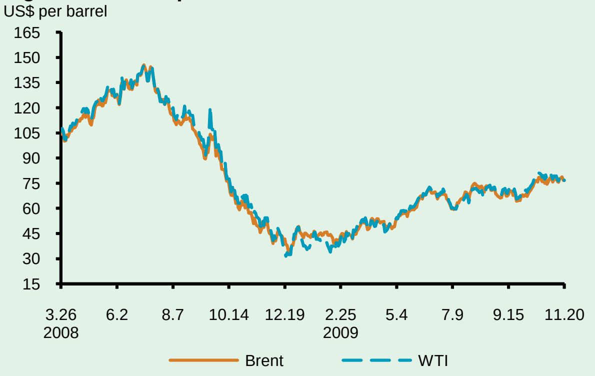


Source: Thomson

The acceleration of inflation rates occurred in a scenario of low unemployment rates, record levels of capacity utilization and increased financial speculation in commodity markets. It is worth mentioning that the evolution of agricultural prices, reported in Figure 1, reflected the pressures originating in expansions of world demand for consumption – consistent with the increase of income of emerging economies, particularly China – and for bio-fuel production, aggravated by the restrictions

1/ Considered the same periods, the drops in IPC variations for Sweden, the Euro Area and Japan reached in the order of 5.5 p.p., 4.7 p.p. and 4.6 p.p., while the indicators associated with Thailand, Chile and Turkey totaled 13.6 p.p. 9.2 p.p. and 6.7 p.p. respectively.

Figure 2 – Oil – Spot market



Source: Bloomberg

Table 1 – Food weight on CPI

Country	%
Germany	10.1
United Kingdom	10.3
United States	13.9
South Korea	14.0
France	14.9
Italy	16.1
Canada	17.0
Israel	17.1
Brazil	21.1
Mexico	22.7
Japan	22.7
Hungary	23.1
Singapore	23.4
South Africa	23.5
Taiwan	25.1
Chile	27.2
Poland	27.3
Turkey	28.5
Argentina	31.3
Malaysia	31.4
China	33.0
Saudi Arabia	36.0
Thailand	36.1
Egypt	38.9
Russia	40.2
Pakistan	40.3
Indonesia	42.3
Vietnam	42.7
Kazakhstan	44.8
Phiippines	46.6
India	60.2
Ukraine	63.8

Source: HSBC: Global Research, April 2008

expressed in reduced supply of grain stocks and crop failures of important crops[2]. The growing movement registered in variations of agricultural prices was repeated in the segment of metal commodities and the oil market, this illustrated in Figure 2.

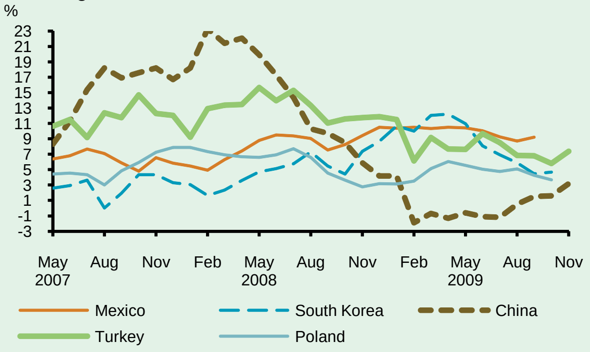
Highlighting the significance of the level of disposable income for determining the pattern of consumption, the share of food in the baskets of IPCs in emerging economies appears to be markedly higher than in the developed countries, as reported in Table 1, which shows, for example, the weight of food in the IPC in India and Ukraine is about six times higher than the one observed in Germany and the United Kingdom. Therefore, it is reasonable to conclude that inflation follows, more closely, the pattern of price variation of food prices in economies where the spending on this share of goods is higher, comparison ratified from the examination of Figures 3 and 4.

In developed economies, where energy use is more intensive, the trajectory of the IPC has been particularly linked to growth of these prices. It should be pointed out that, in the U.S., the additional effect on inflation was due to the impact of dollar depreciation on import prices. In this scenario, an increase from 2.8% to 5.6%, recorded in the annual variation in the U.S. IPC between September 2007 and July 2008, largely reflected the increase of 5.3% for 29.3% recorded in the annual change in energy prices. A similar effect could be observed in the United Kingdom, Euro Area and Japan, where there were respective variations of 19.6 p.p. 18.1 p.p. 17.2 p.p. in energy prices (Figures 5 and 6).

From mid-2008, in line with the environment of sharp reduction in liquidity, significant losses of wealth and the deterioration of expectations associated with the intensification of the global crisis, the process of increasing inflation rates that had begun in 2007 started to show signs of exhaustion. During this period, in which occurred deflationary processes in mature economies, like the U.S., Switzerland and Canada, as in emerging economies of Asia, particularly China, Malaysia and

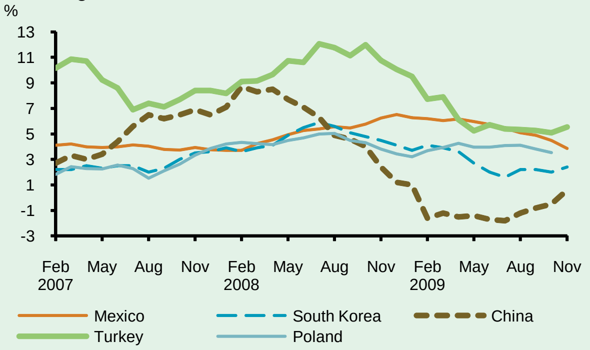
2/ Regarding stock levels, according to the World Economic Outlook of the International Monetary Fund (IMF), April 2007, the stocks of wheat and corn were at that time to the lowest levels since the early 1980. Crop failures were driven in particular by the occurrence of droughts in Australia and New Zealand, and floods in Argentina, Malaysia and India.

Figure 3 – Food inflation
Annual growth



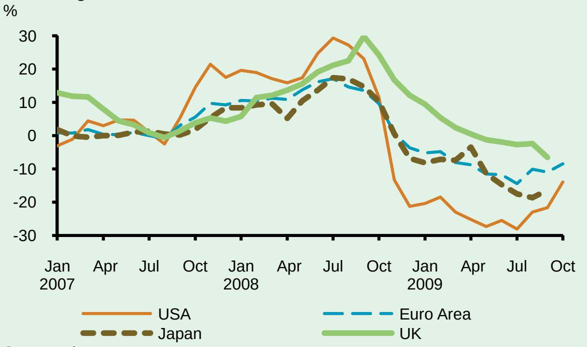
Source: Thomson

Figure 4 – Emergent market inflation
Annual growth



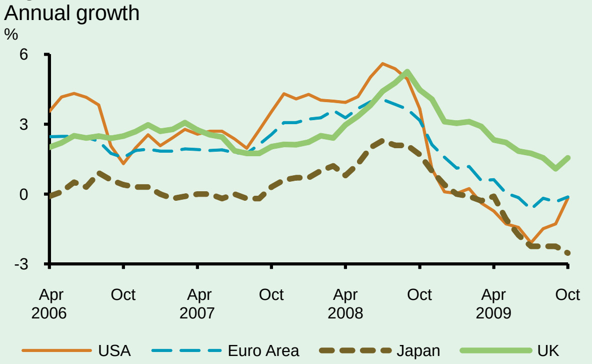
Source: Thomson

Figure 5 – Energy inflation
Annual growth



Source: Thomson

Figure 6 – Consumer inflation
Annual growth



Sources: BLS, Eurostat, Bloomberg and ONS

Thailand, inflation growth reflected, fundamentally, the price trajectory of agricultural commodities and oil[3]. The disinflationary process registered in the United Kingdom, Australia, Czech Republic, Hungary, South Korea, Mexico, Turkey, Brazil and South Africa were partly attenuated by the exchange depreciations indicated in these economies and the increased resilience of their domestic demands, in especially Brazil, Russia, India and China (BRICs).

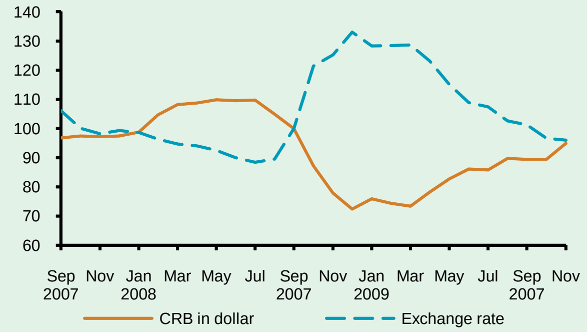
Although the changes in the Gross Domestic Product (GDP) do impress positively in the second quarter of 2009, the pace of the world economic growth has remained below potential, and commodity prices, particularly oil continued depressed. In the U.S., the twelve-month IPC reached 2.1% in July 2009, the lowest rate for six decades, a movement arising in particular from the impact of annual decline of 28.1% observed in the price of energy, but further associated to the scenario of expanding the output gap, reducing the cost of employment, deflation in the prices realized by farmers and reducing food prices and of imported goods.

In the Euro Area, the annual variation of the IPC fell by a record 4% in July 2008 to -0.7% in July 2009, the lowest rate on record, emphasizing the period, in the reversal, from 17.1% to -14.4%, marked increases in energy prices. Similarly, the IPC growth in Japan fell 2.3% – the highest rate since the mid-1990s – to -2.3%, with an emphasis on deflation of 17.5% a.a. observed in energy prices. In China, the annual change in IPC, from 8.7% in February 2008 to -1.8% in July 2009, reflected also the behavior of food prices, which dropped from 23.3% to -1.2% in the period, while energy inflation increased from 6.5% to -5.1%.

The investigation of the inflation behavior in Brazil in the two-year period ended in 2009 reveals the occurrence of similar volatility, but considerably lower in intensity to that observed in the economies considered previously. This distinction, examined below, is associated with two main factors.

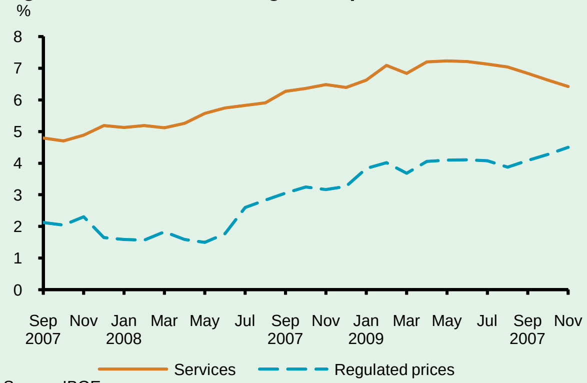
3/ Noteworthy are, additionally, the disinflationary processes registered in the United Kingdom, Australia, Czech Republic, Hungary, South Korea, Mexico, Turkey, Brazil and South Africa

Figure 7 – Exchange rate and CRB
September/2008 = 100



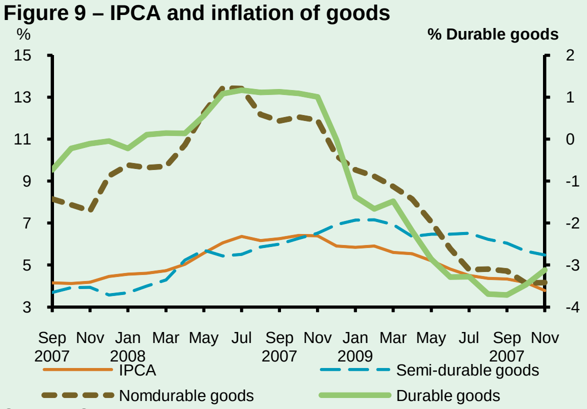
Sources: IBGE and Thompson

Figure 8 – Services and regulated price inflation



Source: IBGE

Figure 9 – IPCA and inflation of goods



Source: IBGE

Initially, it is important to identify the impact of the inverse correlation reported in the Brazilian case, between commodity prices and the exchange rate, which reached 93% in the two-year period and acted as a factor for accommodating the pressures indicated by the sharp rise in commodity prices in the period before the global crisis worsening (Figure 7). In fact, the appreciation of 16.7% underwent by the Real, between September 2007 and July 2008 helped to reduce the impact on domestic prices, the increase recorded in the U.S. dollar prices of major commodities in the period. The facts mentioned acted naturally as an element of reducing the impact on domestic inflation of the most recent drop in commodity prices.

The lower volatility registered by the change in consumer index in Brazil reflected more significantly the behavior of prices of services of monitored items, which altogether accounted for 53% of the Extended National Consumer Price Index (IPCA) in the two-year period under consideration[4]. In that sense, inflation of these components had relative stability in the period in which the evolution of commodity5 prices and energy exerted, in the order, a larger impact on prices in mature and emerging economies, and an upward trend when world inflation once again, in response to recession, registered a declining trend and, in some economies, deflation. The performance of these prices will therefore constitute an additional element in the stability provided by the negative correlation between the exchange rate and changes in commodity prices, as illustrated in Figure 8.

It is noteworthy that, according to Figure 9, the IPCA trajectory in the segments of durable and nondurable keeps in Brazil, a direct correspondence to the IPCs worldwide. Accordingly, the twelve-month cumulative variation of IPCA on these respective segments recorded amplitudes of 4.9 p.p. and 9.3 p.p. in the two-year period, with the highest rates occurring respectively in June and July 2008, and lower in October and in September 2009.

In summary, it was found that the inflation growth in the world economy in the two-year period ending in 2009 showed, at first, the impact of the acceleration of

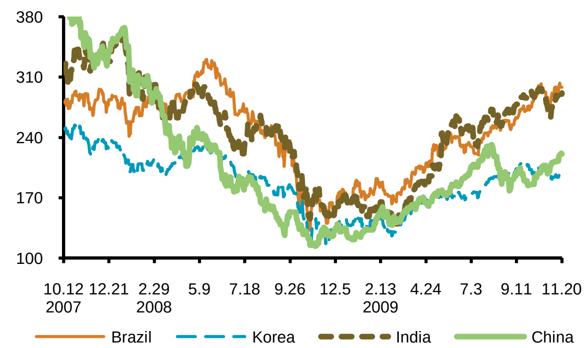
4/ Price variation of the items classified in these groups depends, in general, on the past inflation, contractual clauses, and in relation to services, the level of activity, in particular regarding the behavior of the labor market.

economic activity on commodity prices and energy, a move reversed after the aggravation of the world crisis, when, in the recession experienced in particular by mature economies, the mentioned prices registered a declining trend. In Brazil, the volatility has proved to be less intense than in most economies considered. This performance has been associated, basically, to the accommodating effects provided by both the observed inverse correlation between the evolution of exchange rates and commodity prices, and in particular, by its share of services and monitored items in the IPCA composition.

The recent price evolution and the perspectives for maintaining the process of gradual recovery in the global economic activity suggest the imminence of the exhaustion of the period of reduction in inflation rates. The new scenario can be set in another period of accelerating prices, driven, in an environment of idle production factors, by the lagged effects of the liquidity supplied by central banks over the past few quarters and the price pressures associated with commodity[5] prices. Regarding Brazil, the recent increase marked in the level of capacity utilization in manufacturing industry, in a scenario of strong dynamism of domestic demand and prospects for consolidation of the global economy recovery, strengthening the importance of a cautious stance on monetary policy management for the maintenance of price variation, according to the provisions under the inflation targeting system.

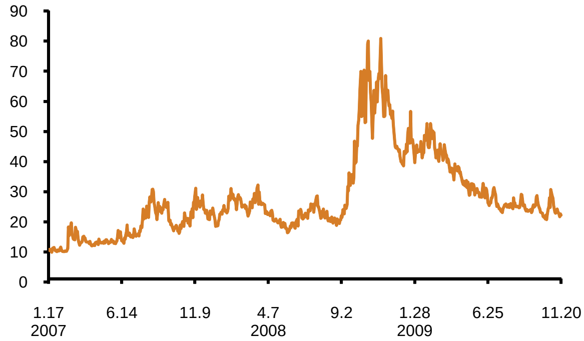
5/ With regard to emerging Asia, a survey by HSBC (What's Cooking with Rice?, of 30.11.2009) points out the resurgence of concerns regarding high food prices, especially rice, which has already achieved 25% increase in operations carried out in recent months in the U.S. The effects of this price hike, boosted by recent storms in the Philippines and droughts in India, have important impacts on the IPCs in the countries of the region, particularly Indonesia, India, Pakistan and Vietnam.

Figure 4.12 – Stock exchanges: Emerging markets
12.31.2003 = 100



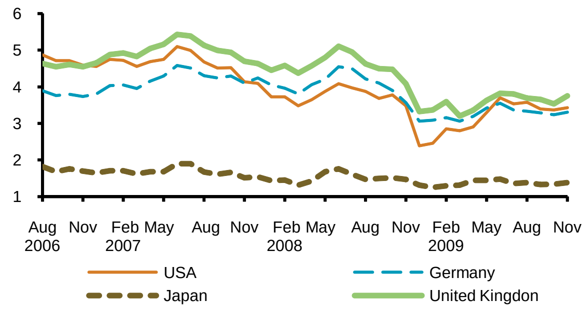
Source: Bloomberg

Figure 4.13– VIX



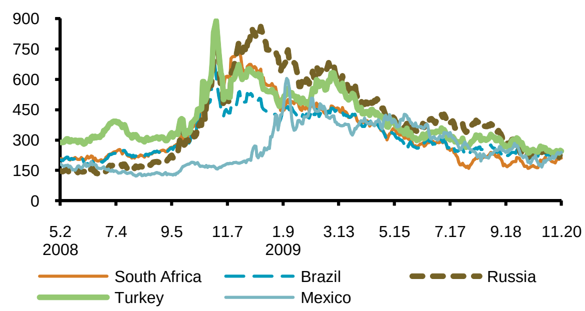
Source: Thomson

Figure 4.14 – Yield on government bonds[1/]
% per year



Source: Bloomberg
1/ Monthly average of nominal yields on 10-year bonds, up to November 20, 2009.

Figure 4.15 – Emerging Markets Bond Index Plus (EMBI+) – Countries
b.p.



Source: Bloomberg

reached, in order, 445 b.p. and 83 p.b. in September 20, recording decreases of 156 p.b. and 8 p.b. in respect of required premiums at the end of August.

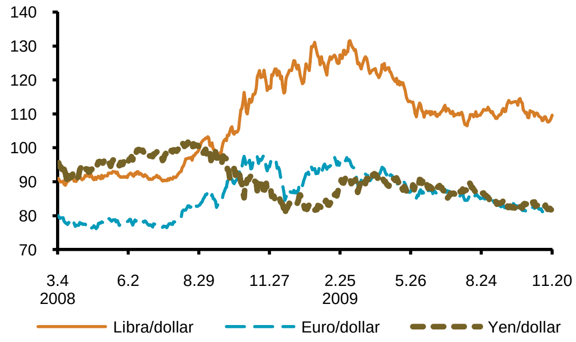
Evidence of the sustainability of the recovery of activity in key mature and emerging economies and the disclosure of corporate earnings higher than projected favored, except for the Japanese stock market, the continued trend of earnings initiated in March, on the most important stock markets. In this scenario, the indexes Financial Times Securities Exchange Index (FTSE 100), from the United Kingdom; Standard and Poor's 500 (S&P 500), from the U.S.; and Deutscher Aktienindex (DAX), Germany, recorded respective increases of 7%, 6, 9% and 3.8% between August 31 and November 20, accumulating, in order, variations of 18.4%, 20.8% and 17.7% in the year. In Japan, the Nikkei index recorded respective variations of -9.5% and 7.2% in the periods mentioned.

Reflecting a greater confidence in the U.S. stock market, the index Chicago Board Options Exchange (VIX), which measures the short-term implicit volatility of the index S&P 500, followed similar behavior reported in the September Inflation Report, dropping four points between the late August and November 20, when it reached 22 points.

The reduction in risk aversion, the abundant liquidity in mature economies and the stronger signs of recovery in emerging economies contributed to the intensification observed from the June quarter, the net flow of private capital into these economies, with positive repercussions on their respective stock markets. In this scenario, the Shanghai Composite from China; Brazil Ibovespa; India Sensex; and South Korea Kospi recorded respective increases of 24%, 17.4%, 8.7% and 1.8% between late August and November 20, accumulating annual variations of 81.7%, 76.6%, 76.4% and 44.1% respectively.

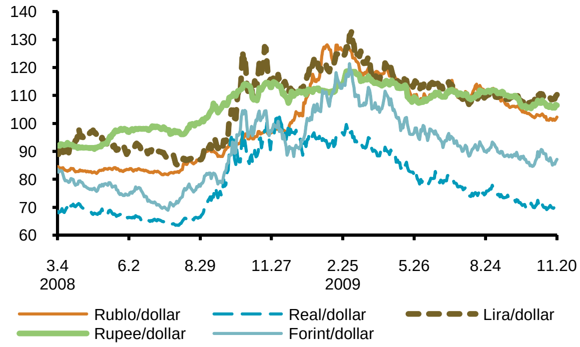
The annual yield of ten-year securities from the UK, the U.S., Germany and Japan were relatively stable over the period considered, reaching, in that order, 3.64%, 3.37%, 3.25% and 1.31 %, November 20, compared to 3.56%, 3.40%, 3.26% and 1.31% in late August. Despite this stability, the challenges persist, highlighted in the September report on the fiscal sustainability of the major developed economies, uncertainties that, parallel to the prospects for normalization – even if not immediate – the monetary policies of these economies and the investor's demands more profitable assets, can put pressure on the rates of these securities.

Figure 4.16 – Dollar exchange rates
6.1. 2005 = 100



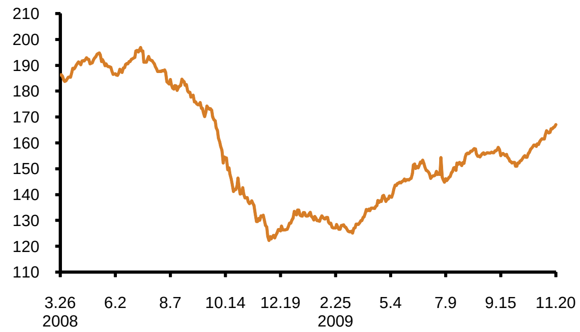
Source: Bloomberg

Figure 4.17 – Emerging markets currencies
6.1 2005 = 100



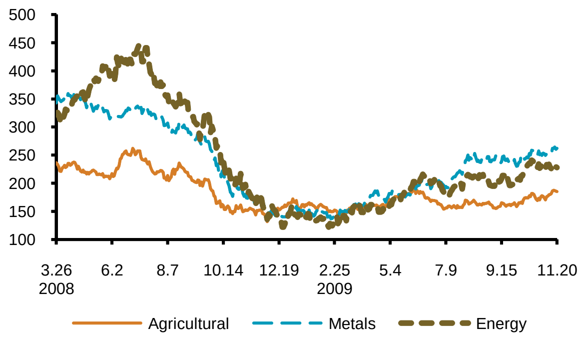
Source: Bloomberg

Figure 4.18 – CRB index
Jan/2003 = 100



Source: Commodity Research Bureau

Figure 4.19 – Commodity price index
Jan/2003 = 100



Source: S&P GSCI

The sovereign risk indicator Emerging Markets Bond Index Plus (Embi +), confirming a trend that began in December 2008, of reducing risk perception associated with emerging markets, reached 309 b.p. in November 20, compared to 381 b.p. at the end of August, with emphasis on the declines registered on indexes in Brazil, 54 b.p., Turkey, 62 b.p., Mexico, 72 b.p., 148 b.p. and Russia.

The U.S. dollar, highlighting the growing U.S. indebtedness, the low returns on U.S. assets and the possibility of diversification of global reserves, follows a depreciation trajectory, while maintenance of the policy of pegging the Chinese currency to the U.S. dollar, constitutes an additional element to the imbalance in terms of trade between nations, increasing the risk of a continued dollar depreciation. In this environment, the prospect that rising demand for currencies of emerging countries entailed their excessive overvaluation and adds unwanted volatility to the exchange market has stimulated the adoption, in some emerging markets, of measures aiming to prevent excessive inflow of volatile capital. Between late August and November 20, the dollar depreciated in major mature economies – reaching, in order, 1.3%, 3.6% and 4.6% against the pound sterling, the euro and the yen – and emerging economies, with emphasis on those observed in relation to the Indian rupee, 4.5%, the South Korean won, 7.2%, the Brazilian real, 7.9% and the Russian ruble, 8.8%.

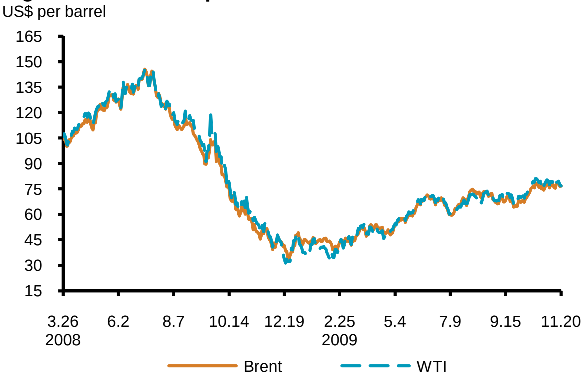
4.4 Commodities

The international commodity prices, driven by the depreciation of the dollar, the global economic recovery, especially in emerging countries and the high level of Chinese imports, have showed recovery of the losses observed in the second half of 2008.

The Commodity Research Bureau (CRB) index increased 7% between the end of August and November 20, accumulating 29% earnings in 12 months. Similarly, according to the S&P Goldman Sachs Commodity Index (GSCI), the Standard & Poor's, together with Goldman Sachs, the international commodity prices recorded an increase of 12.1% between late August and November 20, the result of respective increases of 6.1%, 11.4% and 12.9% of quotations related to segments of metallic, agricultural and energy commodities.

The recovery experienced by the prices of agricultural commodities reflected, in particular the impact of adverse climatic conditions, such as excessive rains in some U.S.

Figure 4.20 – Oil – Spot market



Source: Bloomberg

regions, which postponed the planting of wheat[3] winter crop and the corn harvest. Whereas the first delivery for future contracts negotiated on the Chicago Board of Trade (CBT), between August 31 and November 20, recorded increases in the prices of wheat, 18.8%, and corn, 19.8% and reduction of 4.9% in soybean prices, while the equivalent contracts,

The prices of metallic commodities, even in a scenario of high global oil stocks have reflected the economic recovery in emerging countries, especially China, world's largest consumer of most of these products. According to the London Metal Exchange (LME), rises were recorded between late August and November 20, in the prices of zinc, 20% lead, 10.9% aluminum, 8.6% and copper 5.5%, contrasting with the contraction of 13.3% observed in nickel prices.

Regarding the market for iron ore, it should be highlighted the expectation that failure will not occur again in negotiations between the world's big mining companies and Chinese steel mills to define the reference price of the commodity in 2010, since the Association of Iron and Steel of China has adopted a more conciliatory stance, admitting that prices could rise next year. In fact, the recovery in world steel production, especially in China, the prospects that the contracts start to incorporate the scenario of higher demand for iron ore become clearer.

4.4.1 Petroleum

The international prices of WTI- and Brent-type petroleum, showing the recovery of economic activity worldwide and the depreciation of U.S. dollar, amounted, in order, 9.7% and 11.6% between late August and November 20, at US$76.72 and US$76.75 respectively. Report of the United States Department of Energy (DOE) in November, forecasts that the average WTI oil prices are expected to remain relatively stable, reaching US$77.41 in the quarter ending December 2009 and US$78.13 in 2010.

World supply of oil, even remaining at a historically high level, began to record a reduction in recent months. Still, according to the International Energy Agency (IEA), the stocks of the Organisation for Economic Co-operation and Development (OECD) were sufficient at the end of September for 60 days consumption, a monthly level 12.4% above the average for the last five years.

3/ The price of wheat has been reflecting also their greater use for animal feed production in the U.S. in response to higher corn prices traded on the New York Intercontinental Exchange (ICE), related to coffee and sugar recorded respective variations of 11.3% and -10.2%.

According to the IEA report in November, the anticipated contraction in global demand for oil in 2009 is expected to stand at 1.7% against 1.9% in its previous report, followed by annual growth of 1.6 % in 2010, with emphasis on their estimates of respective increases in these years, 5.7% and 3.5% in Chinese consumption. Also according to the IEA report, global demand for the commodity is expected to grow 0.1% in the last quarter of 2009 over the same period last year, constituting the first positive result on this basis of comparison, in six quarters.

4.5 Conclusion

The indicators, mentioned in the September Inflation Report, that the impact of measures taken by governments and central banks of major economies in response to the world crisis intensification proved themselves to be more evident, were consolidated in the quarter ended in September. It is worth mentioning, however, that in the U.S. and Euro Area still weak banking sector and the rising unemployment remained as major risks to the ongoing process of economic recovery.

External sector

5

After fifteen months of the most critical period of the crisis in international financial markets, it becomes clear the positive developments of the proper management of the economic policy in recent years to the robustness of the external sector and, consequently, to the strength of the balance of payments. In this sense, the performance of the external accounts in the first eleven months of the year helped to fully finance the balance of payments in 2009, and has permitted significant accumulation of reserves.

As mentioned in previous Reports, the recessionary impact of the financial crisis on the pace of global economic activity led to adjustments in the country's current, reflecting the structure of foreign liabilities in which predominate debt-related investments. Considering the accumulated values over twelve months, the current account deficit for November registered a US$7 billion when compared to December 2008 results.

Additionally, the balance of payments borrowing requirements this year were favored by the maintenance of net flows of FDI, the gradual normalization of rollover rates of private external debt and significant inflows of foreign portfolio investments, especially in the stock market.

Reflecting the reduction in current account deficit and the behavior of the financial account, the Brazilian foreign exchange market has been holding monthly surpluses since April, allowing the central bank to resume the policy of strengthening international reserves as of May. Such policy was interrupted in September 2008. Likewise, the country-risk indicator, which reached 688 basis points on October 24 that year, returned to levels observed before the international crisis worsening, reaching 201 points on December 16, while the nominal exchange rate reversed the depreciation process initiated in the second half of 2008.

The projections for the balance of payments in 2010, presented in a specific box, reflect the prospects for moderate recovery in the global economy, return of foreign credit supply, reduction of country-risk indicators, and continuity of the net inflows of foreign investment in the country. So while the current account deficit is expected to rise, indicating the growth trajectory of the Brazilian economy, are expected improvements in financing conditions in the external accounts in 2010 are expected, when compared to the projection shown in the September Inflation Report.

5.1 Exchange

Table 5.1 – Foreign exchange flows

US$ billion

Itemization	2008			2009	
	Nov	Jan-nov	Ano	Nov	Jan-nov
Trade operations	3.1	48.0	47.9	1.5	11.1
Exports	13.5	176.6	188.0	13.1	131.1
Imports	10.4	128.6	140.1	11.7	120.1
Financial operations[1/]	-10.3	-42.6	-48.9	2.4	15.7
Purchases	18.7	385.9	421.2	24.9	297.1
Sales	29.0	428.5	470.1	22.4	281.4
Net flows	-7.2	5.4	-1.0	3.9	26.7

1/ Excluding interbank operations and Central Bank foreign operations.

The contracted foreign exchange market, after recording net outflows of US$3 billion in the quarter ended in March, showed a surplus of US$29.8 billion from April to November, resulting in a net inflow of US$26.7 billion in the first eleven months of the year compared to US$5.4 billion in the same period in 2008. The commercial segment surplus, reflecting respective reductions of 25.7% and 6.6% in the contracting export and import operations reached US$11.1 billion, dropping 77% in the period. The financial segment, even showing reductions of 23% on purchases and 34.3% in sales of foreign exchange, recorded net inflows of US$15.7 billion, compared with net outflows of US$42.6 billion in the first eleven months of 2008, with emphasis on monthly surplus of US$13.1 billion reported in October, the highest for the series.

IN May, the Central Bank resumed purchases of foreign exchange in the exchange spot market, with the aim of strengthening international reserves. This strategy has resulted in settlements of US$24 billion in the period from May to November, bringing about net purchases of US$20.6 billion in the first eleven months of the year. The long foreign exchange position of banks, which reflects the transactions in the primary exchange market and the Central Bank operations increased from US$1 billion at the end of December 2008 to US$4.3 billion in November.

5.2 Trade in goods

Table 5.2 – Trade balance – FOB

US$ million

Period		Exports	Imports	Balance	Total trade
Jan-Nov	2009	138 517	115 262	23 256	253 779
Jan-Nov	2008	184 125	161 590	22 535	345 715
% change		-24.8	-28.7	3.2	-26.6

Source: MDIC/Secex

The trade balance accumulated a surplus of $ US$23.3 billion in the first eleven months of 2009, 3.2% higher than the results reported in the same period in 2008 due to decreases in imports of 28.7% and 24.8% in exports totaling, in the order, US$115.3 billion and US$138.5 billion. Showing the impact on trade flows resulting from the recession recorded in major mature economies, the flow of Brazilian trade contracted by 26.6% on the same basis of comparison.

In November, the country's trade surplus reached US$615 million, decreasing 61.9% over the same month last year, reflecting decreases of 14.2% in exports and 8.4% in imports, which recorded in order, a daily average of US$632.7 million and US$601.9 million.

Exports of basic products recorded a daily average of US$251 million in the first eleven months of the year, falling 15.1% over the same period in 2008, with emphasis on observed decreases in shipments of crude oil, 32.7%; beef, 26.8%; pork, 19.4%; and chicken, 19.2%; and iron ore, 20.9%. On the same basis of comparison, there were increases in sales of tobacco leaves, 13%; soybeans, 8%; and soybean meal, 6.1%.

Table 5.3 – Exports by aggregate factor – FOB
Daily average – January-November

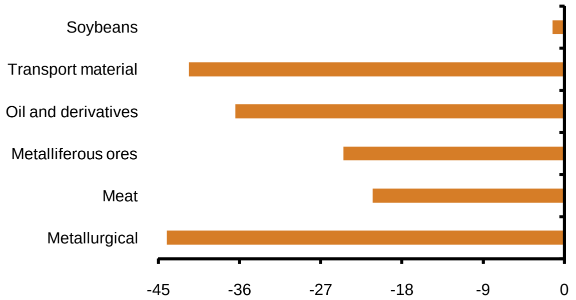
US$ million

Itemization	2008	2009	% change
Total	797.1	607.5	-23.8
Primary products	295.6	251.0	-15.1
Industrial products	480.3	343.9	-28.4
Semimanufactured goods	110.5	81.2	-26.6
Manufactured goods	369.8	262.7	-28.9
Special operations	21.2	12.7	-40.2

Source: MDIC/Secex

The reduction in exports of industrialized products was more pronounced than the indicated in the basic, registering decreases of 28.9% regarding manufactured goods and 26.6% under semi-manufactured goods, which amounted to their respective daily averages of US$262.7 million and US$81.2 million in the first eleven months of the year. The contraction in shipments of semi-manufactured products revealed, in particular, the decreases observed in respect of gross cast iron, 65.6%; manufactured iron and steel products, 58%; leather and skins, 41.7%; and unwrought aluminum, 24.9%; contrasting with the increase recorded in exports of raw sugar, 65.5%. Regarding exports of manufactured goods, highlighting reductions in ethanol, 42.2%; passenger cars, 35.8%; fueling oil, 35%; auto parts, 33.3%; and refined sugar, 30 9%.

Figure 5.1 – Main exports
January-November – 2009/2008[1/] – % growth



Source: MDIC/Secex
1/ Variation over the same period of the previous year.

The six major exporting sectors were responsible in the first eleven months of the year, by 56.4% of average daily sales, compared to 61.3% in the same period in 2008.

Decreases were recorded in shipments for the metallurgical products, 44.1%, transportation equipment, 41.6%, petroleum products, 36.5% minerals, 24.5% meat, 21.3% and the soy complex, 1.3%.

The daily average of Brazilian imports fell 27.7% in the first eleven months of the year, compared to the equivalent period in 2008. The sharpest contraction occurred in the average daily purchases of fuels and lubricants, 48.7%, due in particular to the decline in international prices of the commodity, followed by declines in purchases of raw materials and intermediate goods, 29.6 %; capital goods, 18%; and consumer durables, 12%. Conversely, purchases of nondurables-consumer products rose 0.8% in the period.

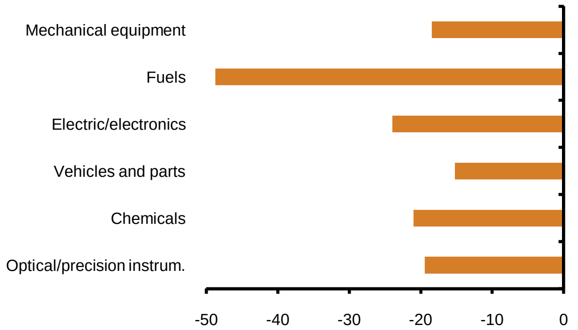
Table 5.4 – Imports by end-use category – FOB
Daily average – January-November

US$ million

Itemization	2008	2009	% change
Total	699.5	505.5	-27.7
Capital goods	143.9	118.0	-18.0
Raw materials	337.5	237.7	-29.6
Naphtha	9.6	7.0	-27.3
Consumer goods	90.2	84.4	-6.5
Durable	51.3	45.1	-12.0
Passenger vehicles	21.6	21.0	-3.1
Nondurable	38.9	39.2	0.8
Fuels	127.7	65.5	-48.7
Crude oil	67.5	35.4	-47.5

Source: MDIC/Secex

Figure 5.2 – Imports by main products
January-November – 2009/2008[1/] – % growth



Source: MDIC/Secex
1/ Variation over the same period of the previous year.

The reduction in purchases of raw materials and intermediate goods, which account for 47% of imports in the period, reflected in particular the observed decreases in purchases of mineral products, 39.4%; accessories of transportation equipment, 29.1%; parts and spares of intermediate goods, 25.8%; and chemicals and pharmaceuticals, 19.2%.

Regarding purchases of capital goods, which accounted for 23.3% of imports in the period, compared to 20.6% in the first eleven months of 2008, to highlight the reductions noticed in procurement of parts and accessories for capital goods for industry, 28.6%; machinery and office and scientific service equipment, 21%; accessories for industrial machinery, 15.1%; and industrial machinery, 10.3%.

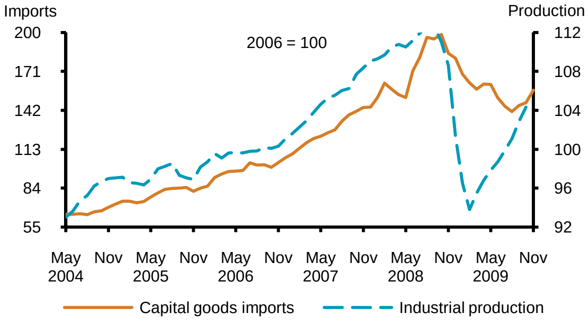
The evolution of purchases of consumer durables was associated, in large part, to a reduction of 3.1% reported in the purchase of cars, a product responsible for 46.4% of imports of this category of use in the first eleven months of 2009. Similarly, purchases of machinery and household appliances and objects of personal adornment recorded decreases of 26.8% and 6.2% in the period.

The performance of the average daily imports of non-durables consumer products reflected, in large part on the relative correspondence between the impact of decreases noticed in purchases of food products, 3.4%; and cosmetics, 1.7%; and provided by increases in purchases of beverages and tobacco, 10.9%; textiles 7.9%; and pharmaceutical products 5.5%.

The segmentation of average daily imports showed the occurrence of widespread reductions in purchases of six major importing sectors, accounting for 61.3% of purchases carried out in the first eleven months of the year, against 61.9% in the same period of 2008. Purchases of fuels and lubricants decreased 48.7% in the period, followed by the retractions on electronics, 24%; organic and inorganic chemicals, 21%; optical and precision instruments, 19.4%; mechanical equipment, 18.4%; and motor vehicles and parts, 15.2%. Among the other sectors, there were increases in imports of dairy products, 22.9%; beverages and alcohol, 6%; pharmaceuticals, and 4%; fishes and shellfishes, 3.2%.

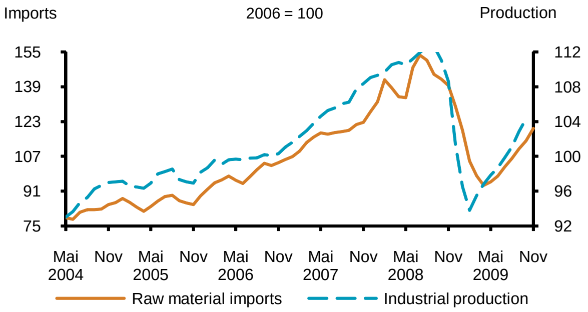
Bilateral trade with major countries and blocs registered a widespread falloff in the first eleven months of the year, compared to the corresponding period in 2008, and with emphasis on the drop of 32.9% observed in the U.S. Trade flow with other countries dropped 24.4%, comprising the retractions with the EU, 24.5%, Latin America and the Caribbean, 23.3% and Asia 12.1%.

Figure 5.3 – Capital goods imports x industrial production – 3-month moving average
Seasonally adjusted indices



Sources: Funcex and IBGE

Figure 5.4 – Raw material imports x industrial production – 3-month moving average
Seasonally adjusted indices



Sources: Funcex and IBGE

Table 5.5 – Exports and imports by area – FOB
Daily average – January-November

US$ million

Itemization	Exports			Imports			Balance	
	2008	2009	% change	2008	2009	% change	2008	2009
Total	797	608	-23.8	700	506	-27.7	98	102
L.A. and Caribe	205	137	-33.3	114	108	-5.1	91	29
Mercosur	89	59	-33.2	60	51	-14.8	28	8
Argentina	72	47	-34.4	54	44	-17.6	19	0
Other	16	12	-28.1	7	7	7.8	10	5
Other	116	78	-33.4	53	56	5.8	63	21
USA[1/]	112	63	-43.7	103	81	-21.2	9	-18
EU	187	136	-27.0	146	115	-21.1	41	21
E. Europe	23	14	-41.7	22	8	-63.3	1	5
Asia	152	158	3.8	192	144	-24.8	-39	14
China	68	83	21.6	81	63	-21.7	-13	19
Other	84	75	-10.6	111	81	-27.0	-26	-5
Other	118	100	-15.1	123	49	-59.9	-5	51

Source: MDIC/Secex
1/ Includes Puerto Rico.

Foreign trade with Asia, representing the higher flows among all countries and regions, resulted in average daily surplus of US$13.8 million, compared to a deficit of US$39.4 million in the first eleven months of 2008, reflecting variations of 3.8% in Brazilian exports and -24.8% in imports. Exports to the region accounted for 26% of Brazilian exports, of which 52.3% were directed to China, while the share of imports from Asia in the total foreign purchases of the country reached 28.5%, of which 44% came from China.

The average daily surplus recorded in trade with the EU fell from US$40.7 million in the first eleven months of 2008 to $ US$21 million, due to movement of contractions of 27% in exports and 21.1% in imports, which recorded daily average of US$136.4 million and US$115.4 million, representing, in that order, 22.4% and 22.8% of total Brazil's exports and imports.

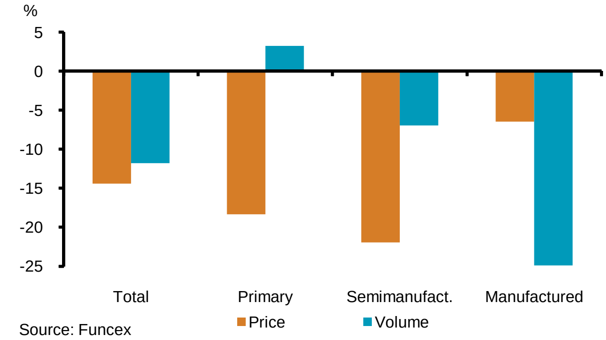
Foreign trade with Latin America and the Caribbean provided daily average surplus of US$28.9 million in the first eleven months of the year, of which 27% related to transactions with the Mercosur member countries. The observed decrease of 68.3% compared to the result reported in the corresponding period of 2008 reflected the decreases in exports, 33.3% and imports 5.1%, which represented, in that order, 22.5% and 21.3% of total sales and purchases outside the country.

The commercial operations with the U.S. determined an average daily deficit of US$18 million in the first eleven months of the year, against an average daily surplus of US$9.2 million in the corresponding range of 2008. This reversal was due to decreases in exports of 43.7% and 21.2% in imports, which, after totaling, in that order, US$63 million and US$81 million, accounted for 10.4% and 16% of total shipments and acquisitions in the country.

Exports targeted to other countries amounted to a daily average of US$100 million in the first eleven months of the year, while purchases from these countries amounted to a daily average of US$49.4 million, falling back in order, 15.1% and 59.9%. It should be noted that trends in imports reflected, in particular the marked reduction in the period, oil prices, favoring the reversal of the average daily deficit of US$5.5 million, recorded in the first eleven months of 2008 to an average daily surplus of US$50.6 million.

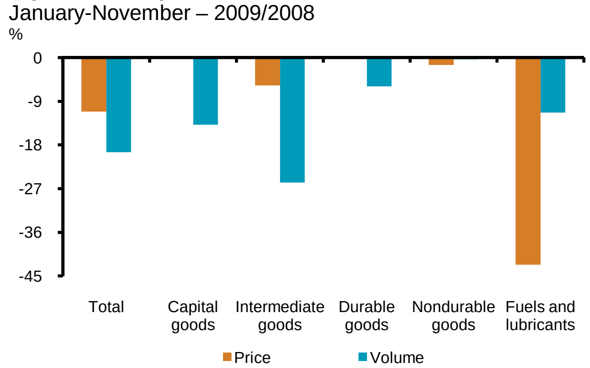
According to the Foreign Trade Studies Center Foundation (Funcex), the contraction of 24.8% recorded by exports in the first eleven months of 2009 over the same period last year, reflected the occurrence of decreases of 14.4 % in prices and 11.8% in exported volume. Growth in prices reflected the

Figure 5.5 – Exports – Price and volume index
January-November– 2009/2008



Source: Funcex

Figure 5.6 – Imports – Price and volume index
January-November – 2009/2008



Source: Funcex

Table 5.6 – Current account

US$ billion

Itemization	2008			2009			2010
	Nov	Jan-Nov	Year	Nov	Jan-Nov	Year[1/]	Year[1/]
Current account	-1.0	-25.1	-28.2	-3.3	-18.1	-22.0	-40.0
Trade balance	1.6	22.5	24.8	0.6	23.3	24.0	15.0
Exports	14.8	184.1	197.9	12.7	138.5	152.0	170.0
Imports	13.1	161.6	173.1	12.0	115.3	128.0	155.0
Services	-1.2	-14.9	-16.7	-1.8	-17.0	-18.9	-21.8
Transportation	-0.4	-4.6	-5.0	-0.4	-3.4	-3.8	-4.3
International travel	-0.1	-5.1	-5.2	-0.5	-4.9	-5.5	-7.0
Computer and inform.	-0.1	-2.4	-2.6	-0.2	-2.3	-2.7	-3.0
Operational leasing	-0.8	-6.6	-7.8	-0.7	-8.4	-9.1	-10.0
Other	0.2	3.7	3.9	0.1	2.0	2.2	2.5
Income	-1.8	-36.5	-40.6	-2.3	-27.2	-30.3	-36.7
Interest	-0.5	-6.3	-7.2	-0.4	-7.9	-8.6	-7.2
Profits and dividends	-1.4	-30.7	-33.9	-2.0	-19.9	-22.3	-30.2
Compensation of employees	0.1	0.5	0.5	0.0	0.5	0.6	0.7
Current transfers	0.4	3.8	4.2	0.2	2.9	3.2	3.5

1/ Forecast.

decreases concerning prices of semi-manufactured goods, 22%; basic products, 18.3%; and manufactured goods 6.5%, while the reduction in exported volume reflected the larger impact of the reductions observed in the volume of manufactured goods, 24.9%, semi-manufactured goods 7%, compared to the one derived from the 3.3% increase in the volume of shipments of commodities.

The decrease of 28.6% recorded in imports, on the same basis of comparison, the result of contractions of 19.5% in the imported volume and 11.2% in prices. There were decreases in the obtained volume in all use categories, with emphasis on those related to raw materials and intermediate goods, 25.8%; capital goods, 13.9%, fuels and lubricants, 11.3%, followed by those connected to consumer durables, 5.9%; and non-durable consumer goods 0.3%. Regarding price growth, it was registered the decline observed in 42.7% related to fuels and lubricants, followed by the retractions regarding raw materials and intermediate goods, 5.7%; and to non-durable consumer goods, 1.57%. The prices of capital goods remained stable and those for durable consumer goods increased by 0.3% in the period.

5.3 Services and income

The current account deficit, which had reached US$28.2 billion in 2008, recorded a significant adjustment during 2009, totaling US$18.1 billion in the first eleven months of the year, compared with US$25.1 billion in same period of 2008. Considering periods of twelve months, the current transactions deficit totaled US$21.2 billion, 1.39% of GDP in November, compared with US$25.6 billion, 1.57% of GDP in the same period of 2008, improvement consistent with increased trade surplus and the most favorable results reported in the income account.

The trade surplus reached US$23.3 billion from January to November, increasing 3.2% over the same period in 2008. Net expenses of the income account declined 25.4% to US$27.2 billion in the period, while net remittances of services account grew 14.3%, closing at US$17 billion, and net revenues from unilateral transfers decreased to 23.5%, reaching US$2.9 billion.

Revenues from international travel totaled US$4.8 billion and expenses, US$9.7 billion, respective decreases of 8.9% and 6.3% over the first eleven months of 2008. Net expenditures, although backed down from US$5.1 billion to US$4.9 billion over that period, resumed an upward trend in recent months, affected by exchange rate appreciation and income gains.

Net expenditures on equipment rental totaled account US$8.4 billion in the year, until November, rising 26.7% over the same period of 2008. Net payments abroad for royalties and licenses, including the supply of technology, copyrights, licenses and registrations for trademark use and exploitation of patents, franchises, among others, reached US$1.9 billion, dropping 5.6% in the same basis of comparison.

It is important to note the continuity, for the third consecutive year, of net remittances of profits and dividends higher than net interest expenses, a performance associated with the prevalence of FDI stock and shares in total foreign liabilities of the country. The reduction recorded in the income account deficit was associated with a decrease in net income remittances of direct investment, a development compatible with the scenario of decline in the stock of FDI, coupled with the depreciation, and reduced profitability of companies with foreign participation.

Net remittances of profits and dividends totaled US$19.9 billion in the first eleven months of the year, dropping 35.2% over the same period in 2008. Gross expenditures of profits and dividends totaled US$21 billion, showing respective reductions of 37.9% and 25.1% in expenses of FDI and portfolio investments.

Net interest expenses totaled US$7.9 billion in the year, through November, rising 25.1% over the same period in 2008, with emphasis on reduction of 33%, to US$4.4 billion, observed in the remuneration of international reserves, the main component of interest revenue, a performance consistent with the monetary easing measures taken worldwide. Expenditure on interest payments abroad totaled US$14 billion, decreasing 8.7% in the period.

Net remittances of other investments, including interests of supplier credits, loans, and deposits and other assets and liabilities, totaled US$4.8 billion, reaching a level 14.3% lower than in the first eleven months of 2008.

Companies in the industrial and service sectors were responsible, in order, for sending 58.5% and 38.5% of gross remittances of profits and dividends from FDI in the first eleven months of the year, emphasizing the participation of 35, 5% of remittances of items related to the automotive vehicles, metallurgy, and financial services segments, which totaled US$5 billion in the period.

Net unilateral transfers were US$2.9 billion in the first eleven months of 2009, decreasing 23.5% over the same period last year. Net remittances for maintenance of residents dropped 31.7% to US$1.4 billion in the period, evolution consistent with the impact of the global economic crisis on the available income in the major economies responsible for these shipments, especially in the U.S. and Japan.

5.4 Financial account

Table 5.7 – Financial account

US$ billion

Itemization	2008			2009			2010
	Nov	Jan-nov	Year	Nov	Jan-nov	Year1/	Year1/
Capital account	-9.0	35.1	28.3	7.2	58.5	63.8	45.5
Direct investments	0.5	19.6	24.6	2.4	26.7	30.0	40.0
Abroad	-1.7	-17.3	-20.5	0.8	5.8	5.0	-5.0
In Brazil	2.2	36.9	45.1	1.6	20.9	25.0	45.0
Equity capital	1.4	24.1	30.1	1.0	15.4	19.0	35.0
Intercompany loans	0.8	12.8	15.0	0.6	5.5	6.0	10.0
Portfolio investments	-4.2	5.4	1.1	4.4	43.8	47.5	25.0
Assets	0.3	0.8	1.9	1.2	0.7	0.0	0.0
Liabilities	-4.5	4.6	-0.8	3.3	43.1	47.5	25.0
Derivatives	0.0	-0.3	-0.3	0.0	0.2	0.0	0.0
Other investments	-5.4	10.4	2.9	0.4	-12.1	-13.6	-19.5
Assets	1.1	-8.3	-5.3	0.0	-29.7	-31.6	-21.1
Liabilities	-6.4	18.7	8.1	0.4	17.6	18.0	1.6

1/ Forecast.

The capital and financial accounts, in a scenario of more favorable conditions in international financial markets, had a surplus of US$59.5 billion in the first eleven months of the year, noting that the net inflows of foreign portfolio investments, of which 78.1 % directed to the stock market and 21.9% to fixed income operations, had a remarkable influence on this trend.

The flows of Brazilian direct investments abroad, after adding up US$20.5 billion in 2008, totaled net returns of US$5.8 billion in the first eleven months of 2009. The increase in participation in direct investment abroad reached US$3.4 billion, against US$10.9 billion in the equivalent period of 2008, while intercompany loans amounted to, in order, net returns of US$9.3 billion and net disbursements of US$6.6 billion in the periods considered.

Net inflows of FDI into the country reached US$20.9 billion, compared with $36.9 billion in the first eleven months of 2008, showing that despite the crisis impacts on the ability of international investments by transnational corporations, the favorable economic outlook of medium and long term for the country continued attracting significant flows of investment. Net flows of participation in capital totaled US$15.4 billion and intercompany loans, US$5.5 billion, reducing, in that order, 36.3% and 57.2% in the period. Considering twelve-month periods, FDI reached US$29 billion in November, 1.9% of GDP, proving to be a reliable source for financing the balance of payments.

Net inflows of foreign portfolio investments totaled US$43.1 billion from January to November, against US$4.6 billion in the same period of 2008. Net inflows of foreign investment in shares of Brazilian companies, in line with the rapid economic recovery following the recession of late 2008 and early 2009, with the prospects for accelerated and sustained growth over the medium term, and with the return of the initial public offerings, totaling US$33.6 billion, compared with net outflows of US$6.7 billion in the same period

Table 5.8 – BP financing sources
Selected items

US$ billion

Itemization	2008			2009			2010
	Nov	Jan-Nov	Year	Nov	Jan-Nov	Year[1/]	Year[1/]
Medium and long-term funds	0.5	12.4	13.5	1.2	13.9	15.6	15.2
Public bonds	0.0	0.5	0.5	0.0	3.6	3.6	0.0
Private debt securities	0.3	6.7	7.3	0.9	7.6	8.7	11.3
Direct loans	0.1	5.1	5.7	0.3	2.7	3.3	3.9
Short-term loans (net)[2/]	-6.7	-1.5	-8.1	-0.1	2.3	2.0	-
Short-term sec. (net)	-1.2	-0.8	-3.9	0.0	-0.6	-	-
Portfolio in the country (net)	-2.1	4.9	4.4	2.8	37.9	46.5	25.0
Roll-over rates (%)							
Total	22%	125%	109%	262%	95%	92%	125%
Debt securit.	21%	102%	83%	517%	105%	100%	125%
Direct loans	22%	175%	183%	99%	75%	75%	125%

1/ Forecast.
2/ Includes direct loans and trade credits transferred by banks.

Table 5.9 – Statement of international reserves

US$ billion

Itemization	2008		2009		2010
	Jan-nov	Ano	Jan-nov	Year	Year[1/]
Reserve position in previous period	180.3	180.3	193.8	193.8	237.1
Net Banco Central purchases	0.7	-5.4	32.2	32.4	1.2
Spot	12.4	7.6	20.6	20.6	-
Repo lines of credit	-10.2	-8.3	8.3	8.3	-
Foreign currency loans	-1.5	-4.7	3.3	3.5	1.2
Debt servicing (net)	-0.9	-0.4	-2.4	-2.1	-0.9
Interest	2.3	2.8	0.4	0.8	1.4
Credit	6.6	7.2	4.4	4.8	5.3
Debit	-4.3	-4.4	-4.0	-4.0	-3.9
Amortization	-3.2	-3.2	-2.8	-2.8	-2.2
Disbursements	1.3	1.3	1.8	1.8	-
Multilateral organizations	0.8	0.8	-	-	-
Sovereign bonds	0.5	0.5	1.8	1.8	-
Other[2/]	5.7	10.4	4.4	4.4	-
Treasury's purchases	7.5	7.6	6.8	6.9	6.2
Change in assets	14.3	13.4	42.9	43.4	6.5
Gross reserve position	194.7	193.8	236.7	237.1	243.7
Repo lines of credit position	10.2	8.3	-	-	-
Foreign currency loans position	1.5	4.7	1.3	1.2	-
Reserves position - liquidity	206.4	206.8	238.0	238.4	243.7

1/ Forecast.
2/ Includes payments/receipts in the framework of the Reciprocal Credits and Payments Agreement (CCR), fluctuations in prices of securities, exchange parities and price of gold, discounts and premiums, duty fees, release of collaterals and SDRs allocations.

of 2008. Inflows of foreign investments in fixed income securities traded in the country reached, in order, US$9.2 billion and US$14.8 billion, for the periods mentioned.

Net disbursements of sovereign bonds totaled US$469 million in the year through November. It was recorded in the period, issues of $ US$3.6 billion, of which US$1 billion related to the launch of the Global Bonds 19N in January, US$750 million to its reopening in May, US$525 million from the reopening of the Global 37 in August, and US$1.3 billion on the issuance of the Global 41 in October. Amortizations for the original schedule of maturities and early redemptions of debt totaled US$3.1 billion, of which US$2.8 billion regarding the face value of bonds and US$255 million, to the premium of those operations.

The notes and commercial papers presented net disbursements of US$369 million through November, compared with US$138 million in the corresponding period of 2008. Short-term securities recorded net amortizations of US$590 million in the period.

Other Brazilian investments presented net foreign assets of US$29.7 billion in the year through November, with emphasis on net outflows of US$24.4 billion on short-term loans. Deposits abroad amounted US$5.2 billion in the period, result of the formation of deposits of US$5.3 billion of Brazilian banks abroad and returns of US$99 million of other sectors.

Other foreign investments, which include, among other liabilities, direct loans, trade credits and constitution of deposits by foreigners in the country, reported net income of US$17.6 billion in the first eleven months of the year, compared with net disbursements of US$18,7 billion in the same period in 2008. Net disbursements of commercial loans totaled US$8.2 billion, a level 10.8% lower than that reported in the same period last year, US$9 billion for the short-term and disbursements of US$779 million related to amortization of long-term trade credits. Loans had net disbursements of US$5.7 billion, reflecting net inflows of US$3.4 billion on medium and long-term operations and US$2.3 billion related to short-term operations.

The rollover rate of the medium and long-term external debt, which reflects new disbursements of past amortizations, reached 95% up to November. The percentages relative to the rollover of securities and direct loans came to, respectively, 105% and 75%.

International reserves in the liquidity concept, which incorporates foreign currency loan operations, totaled US$238 billion in November, rising to US$31.2 billion in the year. Considering the cash basis, reserves reached US$236.7 billion, rising to $ US$42.9 billion in the period.

Central Bank purchases in the foreign exchange market amounted to US$32.2 billion in the first eleven months of the year, of which US$20.6 billion in the spot market, US$8.3 billion in transactions with repurchase commitment and US$3.3 billion for returns of lending transactions in foreign currencies.

Over this period, the reopening of the Global 37 bond, US$525 million in August, and the issue of the Global 41 bonds, US$1.3 billion, held in October contributed to the increase in reserves. Also, it should be pointed out revenues of US$4.4 billion in earnings on reserves. The other operations increased reserves by US$4.4 billion, with emphasis on inflows equivalent to US$4 billion in Special Drawing Rights (SDRs), due to SDR allocations carried out by the IMF in the context of expansion of international liquidity in response to the economic crisis impact.

The stock of foreign currency loans against warranties amounted to US$1.3 billion at the end of November, while operations with repurchase agreements, showing the improvement in the international financial scene, had already been fully repurchased since July.

At the end of 2009, it is estimated that the stock of international reserves reach US$238.4 billion in the liquidity concept, with annual growth of US$31.6 billion.

The projections for 2010 consider a stock of international reserves of US$243.7 billion, covering the full receipt of the remaining balance of US$1.2 billion of foreign currency loan transactions abroad, matching the two international reserve concepts: cash and liquidity.

5.5 External sustainability indicators

Considering the period from December 2008 to November 2009, we observe that some external sustainability indicators, reflecting the effects of international crisis disrupted the favorable trajectory presented by the end of 2008. Accordingly, it is worth mentioning the observed

Table 5.10 – Sustainability indicators[1/]

US$ billion

Itemization	2007	2008	2009			
	Dec	Dec	Mar	Jun	Sep	Nov[2/]
Exports of goods	160.6	197.9	190.4	177.2	158.9	152.3
Exports of goods and services	184.6	228.4	220.4	206.2	186.6	179.9
Debt service	52.0	37.6	37.4	38.7	41.3	41.9
Total external debt	193.2	198.3	192.7	199.0	204.9	205.5
Net external debt	-11.9	-27.7	-26.3	-28.0	-37.8	-54.3
International reserves						
Cash concept	180.3	193.8	190.4	201.5	221.6	236.7
Liquidity concept	180.3	206.8	202.5	208.4	224.2	238.0
GDP	1 367	1 636	1 521	1 439	1 458	1 521
Indicators						
Total external debt/GDP (%)	14.1	12.1	12.7	13.8	14.1	13.5
Net external debt/GDP (%)	-0.9	-1.7	-1.7	-1.9	-2.6	-3.6
Total external debt/exports	1.2	1.0	1.0	1.1	1.3	1.3
Total external debt/exports of goods and services	1.0	0.9	0.9	1.0	1.1	1.1
Net external debt/exports	-0.1	-0.1	-0.1	-0.2	-0.2	-0.4
Net external debt/exports of goods and services	-0.1	-0.1	-0.1	-0.1	-0.2	-0.3
Debt service/exports (%)	32.4	19.0	19.7	21.8	26.0	27.5
Debt service/exports of goods and services (%)	28.2	16.5	17.0	18.8	22.1	23.3
Reserves – cash concept/ total external debt (%)	93.3	97.7	98.8	101.2	108.2	115.2
Reserves – liquidity concept/ total external debt (%)	93.3	104.3	105.1	104.7	109.4	115.8

1/ Excludes stock of principal, amortizations and interests concerning intercompany loans.
2/ Estimated data.

reductions in exports and nominal GDP in U.S. dollars, which contrasted with the increases in international reserves and the asset position of total net external debt.

Over this period, the external debt service increased by 11.4% and exports fell 23%, resulting in an increase of 8.5 percentage points to 27.5% in the ratio between debt service and total exports.

The estimated position of the total external debt increased 3.6%. At the same time, the creditor position of total net external debt rose from US$27.7 billion to US$54.3 billion. Considering that the U.S. dollar-denominated GDP decreased by 7% in the period, the total debt to GDP ratio rose from 12.1% to 13.5%, while the creditor position of the of total net external debt to GDP ratio rose from -1.7% to -3.6%, the best result of the series ever, since it begun in 1970.

The total debt to exports ratio increased from 1.0 to 1.3 in the first eleven months of the year, while the total net debt/exports ratio declined from -0.1% to -0.4%, the best outcome of the historical series. Finally international reserves in the liquidity concept amounted to 15.1%, contributing to the ratio between international reserves, in the liquidity concept, and total external debt increased from 104.3% to 115.8%.

5.6 Conclusion

The strength of the country's external accounts, encouraging the adjustment of the current account deficit, the appropriate funding balance of payments and a significant accumulation of international reserves, has contributed to a less pronounced impact of the global crisis on the Brazilian economy. In this scenario, the current transactions deficit in 2009, estimated at US$22 billion, should be fully financed by net inflows of FDI.

In 2010, amid gradual recovery of the global economic activity level, the current account deficit should be expanded, a move consistent with both the impact of consolidation of the upturn in domestic activity on the level of imports and the prospect of increase in net remittances of profits and dividends. It is worth mentioning, however, that the estimated performance for the current transactions shall not pose any restriction on the financing of the balance of payments, as indicated in the projections shown in this

Inflation Report, were flows of foreign investment, both direct and in portfolio predominate, and greater ease in rolling public and private external obligations.

Projections for the Balance of Payments for 2009 and 2010

This figure shows projections for the balance of payments 2009 and 2010, revised in relation to the Inflation Report published in September. This update incorporates the positive developments associated with the scenario of continued gradual recovery from the recession of world economy and most consistent indications of renewed domestic growth on country risk indicators, external financing terms and the level of international credit supply, and on the return of both direct and portfolio foreign investments.

Table 1 – Uses and sources

US$ billion

	2008			2009			2010
	Nov	Jan-nov	Year	Nov	Jan-nov	Year[1/]	Year[1/]
Uses	-3.8	-44.2	-50.6	-5.4	-42.7	-49.9	-67.4
Current account	-1.0	-25.1	-28.2	-3.3	-18.1	-22.0	-40.0
Amortizations ML-term[2/]	-2.9	-19.1	-22.4	-2.1	-24.6	-27.9	-27.4
Securities	-1.6	-10.0	-12.4	-0.5	-10.3	-11.9	-11.3
Paid	-1.6	-10.0	-12.4	-0.5	-10.3	-11.9	-11.3
FDI conversions	0.0	0.0	0.0	0.0	0.0	0.0	-
Supplier's credits	-0.2	-1.6	-1.7	-0.3	-3.4	-3.5	-3.1
Direct loans[3/]	-1.1	-7.5	-8.3	-1.4	-10.9	-12.5	-13.1
Sources	3.8	44.2	50.6	5.4	42.7	49.9	67.4
Capital account	0.1	1.0	1.1	0.1	1.0	1.1	1.0
FDI	2.2	36.9	45.1	1.6	20.9	25.0	45.0
Domestic securities[4/]	-2.0	6.8	6.3	2.8	42.6	46.5	25.0
ML-term disbursem.[5/]	1.0	29.1	31.6	2.9	28.1	31.7	29.0
Securities	0.3	7.2	7.8	0.9	11.2	12.8	11.3
Suplier's credits	0.1	2.1	2.2	0.2	2.6	3.3	3.6
Loans[6/]	0.6	19.8	21.6	1.9	14.4	15.6	14.1
Brazilian assets abroad	-0.2	-24.6	-23.5	2.0	-22.8	-26.6	-26.1
Other[7/]	-4.1	3.5	-6.9	-0.1	15.1	15.2	-
Reserve assets	6.8	-8.5	-3.0	-3.9	-42.2	-42.9	-6.5

1/ Forecast.
2/ Registers amortization of medium and long-term supliers' credit, loans and securities placed abroad minus refinancing and discounts. Excludes amortizations referring to loans to IMF and intercompany loans.
3/ Registers amortizations loans borrowed from foreign banks, buyers, agencies and multilateral organizations.
4/ Includes foreign investment in equity and debt securities traded in the domestic market.
5/ Excludes intercompany loans disbursements.
6/ Includes multilateral and bilateral financing and buyers' credits.
7/ Registers net values of bond swaps, short-term securities, short-term trade credit, financial derivatives, nonresident deposits, other liabilites and errors & omissions.

Besides the aspects mentioned above, the revision of the projections reflect the results observed in recent months and the changes in external debt service, consistent with its stock in September. For 2009, the results that occurred up to November have been incorporated, considering interventions made by the Central Bank in the exchange domestic market and repurchases of sovereign foreign debt by the National Treasure. The current account deficit, highlighting the impact of the growth trajectory of the Brazilian economy should rise in 2010, in an environment of improving financing conditions of the external accounts.

The projected current account deficit in 2009 rose from US$18 billion in the previous Inflation Report to US$22 billion, reflecting a reduction of US$3 billion in the trade surplus and an increase of US$1.2 billion in the deficit of the services and income account. The estimated reduction for the trade balance reflects an increase of US$3 billion in the forecast for imports, which should total US$128 billion, and the maintenance in US$152 billion in the projection concerning exports.

The service account must present a deficit of US$18.9 billion in 2009. The increase of US$2.3

Table 2 – Balance of payments – Market

US$ billion

Itemization	2008 Nov	2008 Jan-Nov	2008 Year	2009 Nov	2009 Jan-Nov	2009 Year[1/]	2010 Year[1/]
Current account	-1.5	-31.7	-35.3	-3.6	-22.5	-26.8	-45.3
Capital (net)	-7.9	32.4	26.5	8.1	60.1	67.8	59.6
Foreign direct investment	2.2	36.9	45.1	1.6	20.9	25.0	45.0
Portfolio investment	-2.0	6.8	6.3	2.8	42.6	46.5	25.0
ML-term loans	-1.8	2.6	1.6	0.3	-0.6	-0.9	-0.1
Trade credits – Short, medium and long term	-5.8	13.8	2.8	0.5	13.5	14.1	1.7
Banks	-6.6	4.7	-1.6	0.4	5.3	5.3	1.2
Other	0.9	9.2	4.5	0.0	8.2	8.8	0.5
Brazilian invest. abroad	-2.1	-24.6	-27.0	3.0	-17.5	-18.0	-13.0
Other	1.6	-3.3	-2.3	0.0	1.2	1.1	1.0
Financial gap	-9.4	0.7	-8.9	4.5	37.5	41.0	14.3
Banco Central net intervent.	7.5	-0.7	5.4	-3.4	-32.2	-32.4	-1.2
Bank deposits	1.9	0.0	3.4	-1.1	-5.3	-8.6	-13.1

1/ Forecast.

billion compared to previous projection reflects, in particular, the increase of US$4.5 billion to US$5.5 billion, projected for the international travel deficit, both affected by the behavior of nominal exchange and by the increase of disposable income in a scenario of stronger resumption of domestic economic activity. The deficit in the transportation account, reflecting the impact of the acceleration of domestic activity on the level of imports, was expanded by US$800 million. Projected net spending on equipment rentals totaled US$9.1 billion, considered the existing deals, which involve the expenditure rigidities, and the results of this heading in recent months.

The projection for interest net expenses was US$8.6 billion, compared with US$9.7 billion in the previous Inflation Report, with increases from US$4.7 billion to US$4.8 billion in revenues with international reserve earnings, and US$300 million in interest revenues expected for the private sector. Gross expenditure, predicted from the position of the debt stock in September, declined from US$16.3 billion to US$15.6 billion.

The estimate for net remittances of profits and dividends was maintained at US$22.3 billion. It is important to mention that the value of the stock of foreign investment in BM&FBOVESPA S.A. – Securities, Commodities and Futures Exchange (BM&FBOVESPA) which, impacted by net outflows of capital affected by the economic crisis and currency depreciation, would reach US$70.8 billion in February of this year, amounted to US$144.2 billion by the end of August. Unilateral transfers for 2009, reflecting the outcome of this account until November were higher than US$3 billion to US$3.2 billion.

The financial account surplus, estimated at US$44.1 billion in September, is forecast at US$63.8 billion, with emphasis on the increase, consistent with the marked recovery of share prices from US$22 billion to US$46.5 billion in the projection related to net inflows of foreign investments in long-term domestic securities in the country and stocks. The projection for net inflows of Foreign Direct Investment (FDI) was maintained at US$25 billion, and expected net returns of Brazilian direct investment abroad has also remained at US$5 billion.

External debt amortizations of medium and long-term for 2009, considered the new scheme of the external debt with position in September, showed an increase of US$1.3 billion, reaching US$27.9 billion. The projection for the rollover rate of foreign indebtedness of medium and long term was raised by 17 p.p., closing at 92%.

In this scenario, the balance of payments – market should register a surplus of US$41 billion. The Central Bank, in a scenario of return of spot market purchases and repurchases of foreign currency lines and loans, will absorb US$32.4 billion of that total, while the assets of commercial banks abroad will rise by US$8.6 billion, versus a previous US$1.1 billion projection.

The projection for the 2010 deficit in current transactions was revised from US$29 billion in the last Inflation Report, to US$40 billion, equivalent to 2.1% of GDP. The trade surplus is estimated at US$15 billion, representing a decrease of US$9 billion over the forecast for 2009, due to respective increases of 11.8% and 21.1% in 'foreign sales and purchases, projected, in the order, in US$170 billion and US$155 billion. The service account should provide net remittances of US$21.8 billion, 15.3% higher than the total estimated for 2009.

Additionally, the income account deficit is expected to increase US$3.2 billion, compared to the previously projected, totaling US$36.7 billion. Net interest payments are estimated at US$7.2 billion, decreasing US$1.4 billion compared to 2009, while revenues from international reserves should total US$5.3 billion. Net spends on profits and dividends should rise from US$22.3 billion in 2009 to US$30.2 billion, an increase of 33.4% in gross outflows. Revenues from current unilateral transfers should close at US$3.5 billion next year.

The performance of the financial account in 2010 reflects the forecast for an increase to US$45 billion in net flows of FDI. Reflecting the continuing internationalization process of Brazilian companies, the Brazilian direct investments abroad should come to US$5 billion, against returns of equivalent value in 2009. Additionally, are projected net inflows of foreign portfolio investments during the year, with net inflows resulting from investments in stocks and domestic securities, significantly lower than in 2009, should close at US$25 billion.

The medium and long-term amortizations should come to US$27.4 billion in 2010, up from US$27.9 billion the previous year, while their rollover rate was increased from 100% to 125%. Repeating the pattern of previous years, it is projected that the payment of debt service on bonds of the National Treasury will be done through acquisitions in the market, estimated at US$6.2 billion.

In this scenario, the financing gap in balance of payments-market should be positive in US$14.3 billion in 2010, of which US$1.2 billion purchased by the Central Bank as a result of returns in foreign currency loans, while the banking sector should expand its assets abroad by US$13.1 billion.

Effects of the Terms of Trade on the Real Exchange Rate in Brazil

With the adoption of the floating exchange rate regime, in January 1999, the real effective exchange rate[1] recorded periods of sharp volatility until the end of 2002, when it started a trend of appreciation that was interrupted only in mid-2008, in response to the impacts of the deepened world financial crisis. After the acutest phase of the crisis, the return of the trajectory of real exchange appreciation reintroduced the debate about its effects on the country's foreign trade results, which are also sensitive to the terms of trade, i.e., the ratio between the prices of exports and imports. In this context, the aim of this Box is to analyze the interaction between the two aforementioned indicators and their impact on both full and segmented flows by major trading partners of the country's foreign trade.

Throughout the year, until October, the real effective exchange rate appreciated 15.7%, while the terms of trade rose by 10%, thus demonstrating the inverse relationship between both indicators. In fact, in the face of an increased ratio between the prices of foreign sales and purchases, with positive impacts on the trade balance, the impact of this additional inflow of foreign resources should further appreciate the exchange rate.

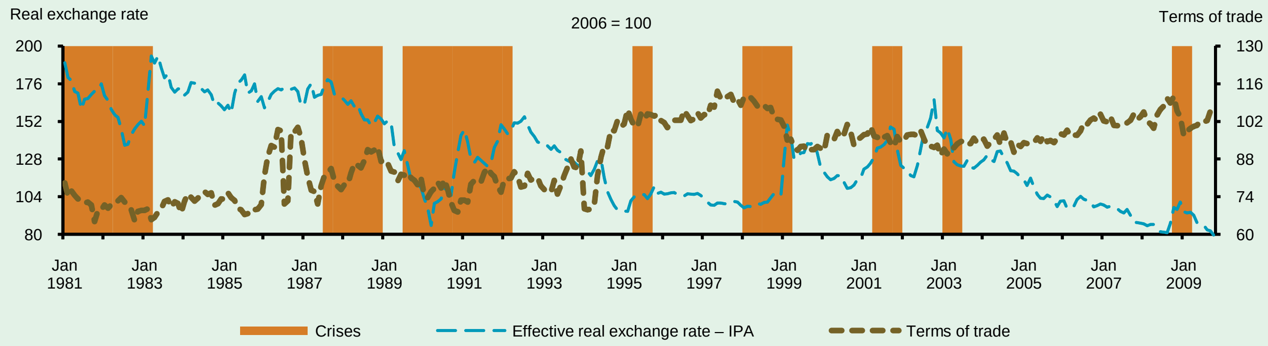
The performance of both indicators is described in Figure 1, from the perspective of the country's economic cycles observed since 1981[2]. It may be observed that, during recessions, the terms of trade follow, in general, a downward trend, with the

1/ The effective real exchange rate represents the price of one currency against a basket of foreign currencies adjusted by the differential between the variations of domestic and foreign prices, constituting, therefore, a determining factor of the country's export competitiveness.

2/ Timeline established by the Committee of the Business Cycle Dating (Codace) created by the Brazilian Institute of Economics of the Getulio Vargas Foundation. An adaptation with results presented on a quarterly basis are utilized. As for figures, data are presented on a monthly basis. For more information on Codace see: http://www14.fgv.br/dgd/asp/dsp_codace.asp.

exception of that occurred in 1987-1988 and in 2003, which are primarily associated to domestic factors, whereas the real exchange rate follows an opposite trend. The trajectories observed for both indicators corroborate studies that demonstrate the impacts of shocks in the terms of trade on the real GDP[3].

Figure 1 – Effective real exchange rate and terms of trade in Brazil during the crises[1/]



Sources: Banco Central do Brasil, Codace, Funcex and Ipeadata
1/ Up to December 1987, effective real exchange rate – IPA available at the Ipeadata, and, as of January 1988, the series calculated by the Central Bank.

To identify the inverse relationship observed between the real effective exchange rate and the performance of the terms of trade, as well as the direct relationship between the performance of this rate and the trade balance is quite intuitive. Therefore, the real exchange rate appreciation fosters the substitution of domestically produced goods, as their prices remain unchanged, for imported products, which prices become cheaper, thus reducing the trade balance. By contrast, the improvement in the terms of trade is beneficial for exports, and encourages the production of goods to be exported, increasing the trade balance[4].

However, the strong correlation between the terms of trade and the real effective exchange rate can undermine the identification of the aforementioned implications. The deterioration of the terms of trade generates a negative income effect, thus reducing the real income and lowering the demand for nontradables. Therefore, in order the equilibrium to be restored, the prices of nontradables have to fall, and, as a consequence, the real exchange rate to depreciate. On the other hand, the deterioration of the terms of trade may also generate a substitution effect on the consumption of goods, with expansion

3/ Broda, C. (2004), concludes that, in developing countries with floating exchange rate systems, shocks in the terms of trade explain, approximately, 10% of fluctuations in GDP, less than in Kose (2002), 56%, and Mendoza (1995), between 45% and 60%.

4/ See Box "Correlation between Terms of Trade and International Commodity Prices", published in the March 2009 Inflation Report of the demand for nontradables, higher prices and real exchange rate appreciation[5]. Therefore, in view of these possibilities, it is difficult to determine, a priori, what should be the impacts of a deterioration in the terms of trade on the behavior of real exchange rate. Notwithstanding, the literature suggests that the main channel by which the real exchange rate is affected is through the income effect[6].

The effects of the terms of trade and the real effective exchange rate on trade flows segmented by major countries or regions are shown in Figure 2[7].

In Figure 2 it may be observed that the growth of the terms of trade and the real effective exchange rate for Latin America, the European Union (EU), the United States (U.S.) and Asia demonstrates a distinct behavior in relation to that observed in Figure 1.

Figure 2 – Effective real exchange rate and terms of trade by major trading partners

Base 2006 = 100

5/ For more details, see Greenwood (1984).

6/ For a classical model that demonstrates the relationship between the terms of trade and the real exchange rate, see De Gregorio and Wolf (1994).

7/ The terms of trade were calculated by adding up all the countries in each region or block. To calculate the effective real exchange rates of these blocks or regions, nominal exchange rates and price indices of currency baskets of major bloc's countries or regions were utilized as proxies, according to their importance in foreign trade, weighted by participation of each country in the bilateral trade in the reference basket.

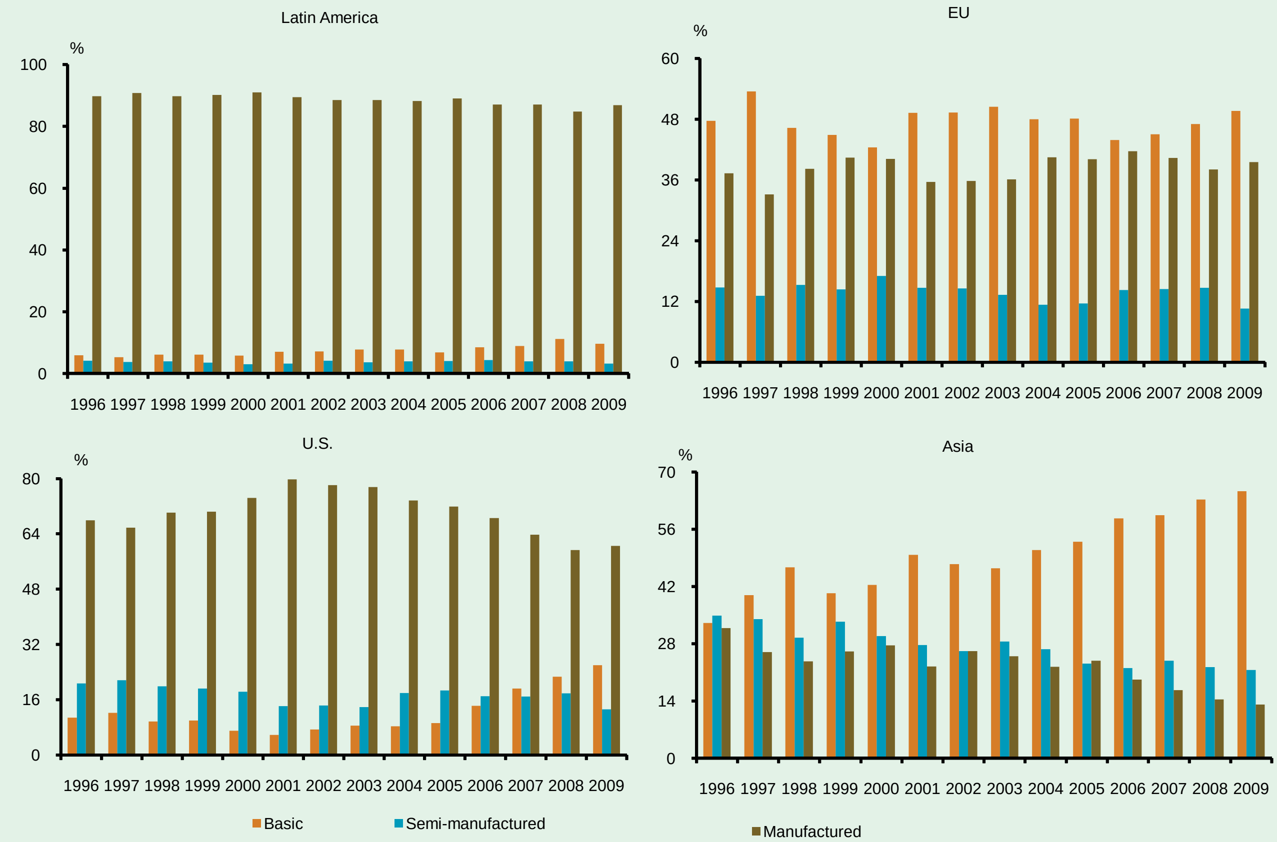
Neither the inverse relationship between indicators nor the response to economic cycles emphasized in the aggregate analysis are present. In fact, the terms of trade moved upward until mid-2005 and mid-2006, when, with the exception of Asia, they begin to fall. Meanwhile, the performance of the real effective exchange rate reveals an appreciation from mid-2001 and 2002, which occurred in a similar manner in all blocks or regions, except for the rate hike observed for the U.S. and Asia series in 2009.

This explains why the inverse relationship between the variables cannot be observed in a consistent manner in the segmented analysis. This unexpected behavior could be attributed to a delayed response of the terms of trade to shocks in the exchange rate. One factor that explains the apparent discrepancy between the results of aggregate and segmented analysis is the different composition of bilateral trade between Brazil and the countries and economic blocs taken into account in this box, which are described in Figures 3 and 4.

Figure 3 – Brazilian exports by destination

Participation by aggregate factor

January-October – 2009

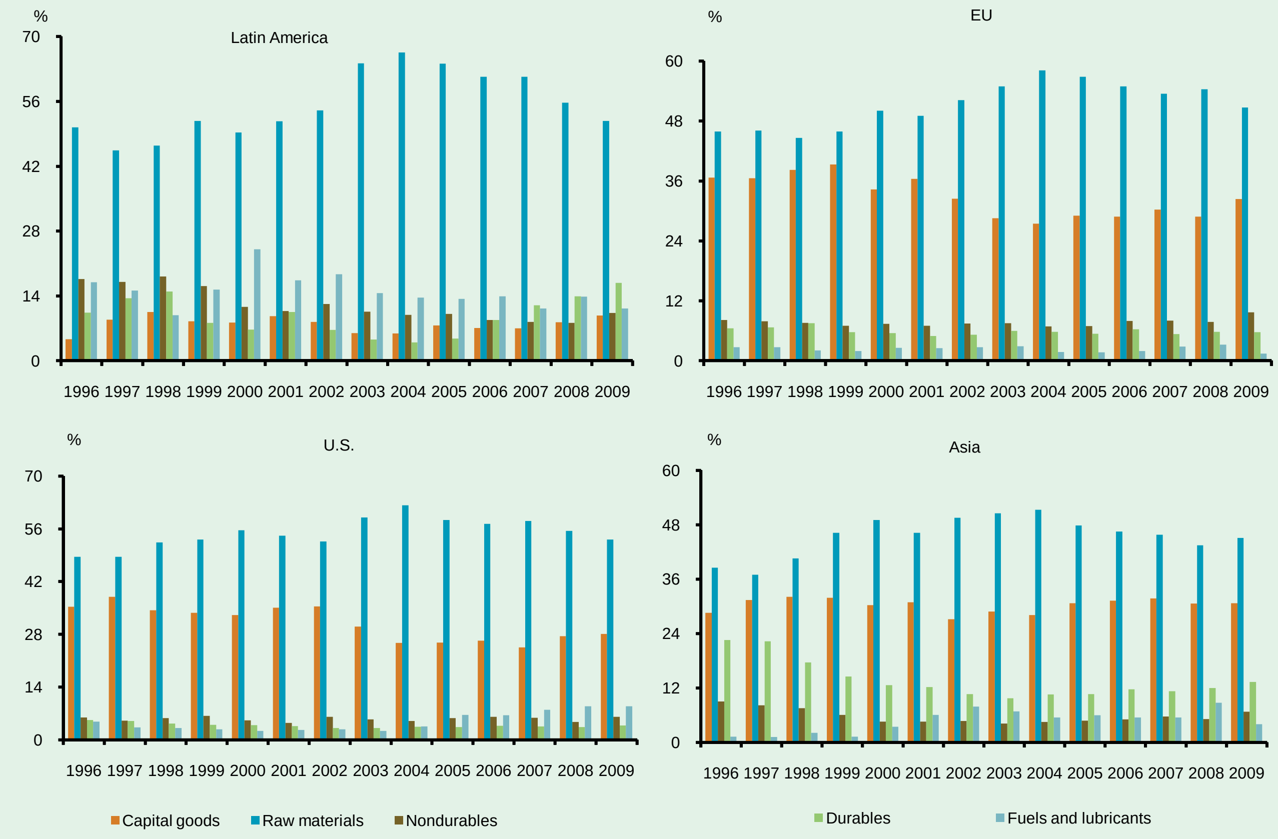


With regard to Brazilian exports, it should be highlighted the impacts of its concentration in manufactured goods for Latin America, and commodities for Asia, representing, in the order, 86.9% and 65% of shipments for those regions in the first ten months of the year. In this scenario, the recent rise observed in international prices of agricultural, energetic and metallic commodities favored a significant improvement registered in the terms of trade for Asia lately. Most of this result was due to the impact of China's entrance to the World Trade Organization (WTO), which increased the demand for commodities and the supply of low cost labor intensive industrial goods. Therefore, the terms of trade for energy, minerals and various agricultural commodities, like soybeans and raw sugar, have improved significantly. Parallel to this, in the case of industrial goods, the prices of some labor intensive goods have deteriorated, demonstrating the increase in the capital/labor ratio.

Figure 4 – Brazilian imports by origin

Participation by use category

January-October – 2009



Conversely, in Latin America and, additionally, in the U.S., it may be observed that the impact of the reduced level of global economic activity on the prices of manufactured goods, the principal component of Brazilian exports, reinforced by the effect of the significant participation of raw materials and intermediate goods acquired from these partners, has maintained the trend of deterioration in the terms of trade, started, in both cases, in mid-2005.

In summary, in view of the significant influence of the terms of trade on other economic indicators, the better understanding of its effects becomes a decisive factor for the effectiveness of exchange and trade policies. It is worth mentioning that the effects of shocks in the terms of trade on the real exchange rate do not necessarily follow the inverse relationship suggested by the economic theory. This may be explained by both the influence of the determinants of business cycles on the performance of these indicators and the impact of the predominant income or substitution effect on the behavior of economic agents. Additionally, it should be emphasized – according to the results related to the aggregate and segmented Brazilian trade by major blocs and countries – that greater economic integration to the international trade, expressed by a large number of partners and significant diversification of exports and imports, tends to highlight the inverse relationship between the terms of trade and the real exchange rate.

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Inflation outlook

6

This chapter of the *Inflation Report* presents the Monetary Policy Committee's (Copom) assessment of the behavior of the Brazilian economy and of the international scenario since the release of the previous *Report* in September 2009, as well as the analysis of the inflation prospects up to the fourth quarter of 2011 and of Gross Domestic product (GDP) growth up to the end of 2010. Inflation projections are presented in two major scenarios. The first scenario, called the baseline scenario, assumes that the Selic rate will remain unchanged at 8.75% per year over the forecasting horizon, the level defined by Copom at its most recent meeting, held on December 8 and 9, 2009, and that the exchange rate will remain at R$1.75 per US dollar. The second scenario, named the market scenario, is based on the expected paths for basic interest and exchange rates drawn from the survey carried by Brazilian Central Bank's Investors Relations Group (Gerin) among independent analysts. It is important to stress that these scenarios are used only as support for monetary policy decisions and should not be viewed as Copom forecasts of the future behavior of interest and exchange rates. The projections released here utilize the set of information available up to the cutoff date of December 11, 2009.

The projections for inflation and GDP growth released in this *Report* are not point estimates. They consist of probability intervals which embody the degree of uncertainty present at the above mentioned cutoff date. Inflation forecasts depend not only on the assumptions over the interest and exchange rates, but also on a set of assumptions on the behavior of exogenous variables. The most likely set of assumptions considered by the Copom is used to build the scenarios to which the Committee attaches the greatest weight on making its interest rate decisions. On setting out these assumptions, Copom seeks to foster transparency to the monetary policy, thereby contributing to effectiveness of policy decisions in controlling inflation, which is its primary objective.

6.1 Inflation determinants

Inflation measured by the Broad National Consumer Price Index (IPCA), which started to increase consistently since the second quarter of 2007 and reached 6.41% in October 2008, has been receding in a slow, albeit continuous pace since then. Actually, after finishing 2008 in 5.90% – 1.44 p.p. higher than that seen in 2007 (4.46%) – twelve-month inflation receded to 4.22% in November 2009, below the center of the target (4.50%). The IPCA posted inflation of 3.93% over the year, 1.30 p.p. lower than that observed in the same period of 2008. This behavior was initially influenced by the sharp fall in the commodity prices in the second half of 2008, which has largely been reverted; and later by the deceleration of the domestic economy in the fourth quarter of 2008 and in the first quarter of 2009, also by now largely reverted. It should be noted that the intensity of the fall in the headline inflation was not repeated for services prices, which still exhibit substantial persistence, while inflation of regulated and monitored prices actually accelerated.

Regulated prices rose 4.21% this year up to November whereas market prices rose by 3.81%. Within the set of market prices, it stands out that the price change in nontradables (5.03%) was much higher than that for tradables (2.46%). This behavior is largely due to the asymmetric impact of the world economic crisis on the domestic economy since the most intense effects were observed in the manufacturing sector while the service sector showed much resilience. The recent behavior of prices has led to a further narrowing of the gap between twelve-month inflation of regulated prices and market prices. The gap moved from -6.21 p.p. in June 2008 to 0.41 p.p. in November 2009. On the other hand, owing to the strength of the domestic demand, service sector inflation has remained at a much higher level than that of market prices. This year up to November, the change in service prices reached 6.01% (against 5.98% in the same period of 2008), while the twelve-month change reached 6.42% (against 6.47% in the same period of 2008).

After two consecutive falls – in the fourth quarter of 2008 (2.9%) and in the first quarter of 2009 (0.9%) – GDP at market prices increased by 1.1% and 1.3% in the second and in the third quarter of 2009 respectively on quarter-on-quarter basis according to seasonally adjusted data released by the Brazilian Institute of Geography and Statistics (IBGE). Notwithstanding its recent recovery, GDP shows a 2.9% decline compared to the same period of 2008. Although the numbers are still negative in the year-on-year comparison, economic activity has exhibited a quick recovery almost returning to the growth rates seen before the escalation of the world crisis. From the supply side viewpoint, it should be highlighted that manufacturing sector output, after having fallen by 8.1% in the fourth quarter of the last year and 4.4% in the first quarter of this year grew by 2.6% and 2.9% in the second and third quarters of 2009 respectively. The recovery of manufacturing – which was strongly affected by the reduction of the demand for durable and investment goods and in external demand in previous quarters – was due to the effects of the monetary and fiscal stimulus as well as of the measures to normalize the credit supply. It also should be noted that the inventories at the beginning of the year were substantially above planned levels and consequently underwent strong adjustment. However, inventory levels tend to be rebuilt thereby helping to sustain current dynamism of industrial production. Agricultural sector GDP receded by 2.5% in the third quarter, the fourth consecutive contraction as it has reacted to the effects of world economic crisis both on external demand and on agricultural commodity prices. On the other hand, the service sector – the sector with the largest weight in GDP and that showed resilience during the crisis – expanded 1.6% in the third quarter after expanding 1.7% in the second quarter. Overall, the strength of the domestic demand and employment greatly contributed to reduce the macroeconomic uncertainties, helping the economic recovery.

Regarding demand, after reductions of 9.9% and 11.0% in the fourth quarter of 2008 and in the first quarter of 2009 according to seasonal adjusted IBGE data, Gross Fixed Capital Formation (GFCF) expanded by 2.0% and 6.5% in the following two quarters supporting the strength of the domestic recovery. Household spending, the most important component of aggregate demand, grew by 2.0% in the last quarter after an expansion of 2.4% in the previous quarter. On the other hand, government spending increased by 0.5% in the third quarter, after a contraction of 0.1% in the second quarter according to seasonally adjusted data. In the comparison with the same period of last year, whereas GFCF dropped 12.5% in the third quarter, the latter expanded by 3.9% and 1.6% respectively. The external sector contributed positively to GDP growth in the third quarter (0.8 p.p.) with reduction in both imports (15.8%, contributing with 2.1 p.p.) and exports (10.1%, contributing with -1.4 p.p.). Considering the prospects of a faster recovery of the domestic activity, than in trading partners, the most likely scenario points out a smaller contribution of the external sector to GDP growth.

Actually, the resilience of domestic demand remains the key support factor for activity in the Brazilian economy. Retail sales figures that were considerably more buoyant than higher frequency production data over the year – partly due to the high level of industry inventories at the beginning of the year – support this assessment. Twelve-month sales growth fell from 10.3% in September 2008 when the world crisis intensified to 5.0% in September 2009, but never became negative. Actually, over the first nine months of the year, sales had an expansion of 4.7% in comparison with the same period of 2008. Despite the deceleration from the strong expansion pace seen in 2008, which reached 9.1%, sales growth remained vigorous and it has been strengthening at the margin. One should highlight the sharp sales increase of 7.7% in the first months of the year in the "supermarkets, food, beverages and tobacco" segment. The series on expanded sales, which includes "vehicles, motorcycles, parts and spares", have markedly recovered over the last few months, posting growth of 6.2% over September against the same period last year. The Copom assesses that the retail and expanded sales tend to continue displaying positive results in the coming quarters and the expansion is likely to intensify as the effects of the world crisis fade away, the unemployment rate falls and household credit maintains its dynamism.

The unemployment rate, which had been consistently falling in the last few years (annual averages of 10.0% in 2006, 9.3% in 2007, and 7.9% in 2008), increased in the first three months of 2009 but the labor market has recovered since then. Specifically, after reaching the minimum of the new time series in December 2008 (6.8%), the unemployment rate rose to 9.0% in March, moved down to 8.0% in July when it fell for the first time in the year, compared to that of the same month in 2008 (-0.1 p.p.), and moved to 7.5% in October, the same rate as in October 2008. This behavior, coupled with the reduction in inflation, limited the effects of the international crisis on labor income. According to IBGE, average real earnings which had increased by 3.2% in 2007 and 3.4% in 2008, maintained their strong upward pace in 2009 (3.5% through October). On the other hand, the average number of persons working, which increased by 2.6% in 2007 and 3.4% in 2008, shows substantial deceleration over the year (0.7% in October). Still, real wage bill growth – an important support of aggregate demand in the latest years – after reaching 5.8% in 2007 and 6.9% in 2008, reached 4.2% over the year until October. As per the National Confederation of Industry (CNI) data, the average employment level in manufacturing, which posted expansion of 3.6% in 2007 and 4.0% in 2008, fell by 3.5% in October 2009 in line with the significant fall in the industrial production at the end of 2008. As with the evolution of employment in the formal sector, Ministry of Labor and Employment (MTE) data shows that after substantial weakness at the end of 2008 and beginning of 2009 there was a consistent recovery. Actually, 1.2 million formal job positions were created until October. One should note that formal sector employment creation seems to be undergoing a marginal acceleration. In October, 231 thousand jobs were created (252.6 in September), the best record for this month. Manufacturing industry presented positive numbers for the seventh consecutive month reaching the best record in the series: 74.6 thousand positions. Commerce also maintained the recovery that began in April and presented a positive balance of 68.5 thousand positions. The construction industry, a leading sector with growth of 5.8% over the year and the service sector also opened job positions in October (26.2 thousand and 69.6 thousand positions respectively). On the other hand, the agricultural sector closed 11.6 thousand job positions, following the seasonal pattern.

In addition to increasing payrolls, credit availability to households, favored by macroeconomic stability and by institutional advances, had been an important element in the private consumption dynamics. After being negatively affected by the worsening of the world economic crisis since September 2008, financing conditions have improved in the last months. This process occurred as the effects of the world economic crisis on the domestic economy receded and as macroeconomic uncertainty abated. On the other hand, the labor market, whose brief weakening made households more reluctant to borrow, has been firmly recovering over the last months. By the way, financial system (non-directed) credit to households grew by 17% in October (24.2% in December 2008) year-on-year. In the same period, the credit to housing, whose operations are mainly based on earmarked resources, grew by 42.5% (37.5% in October 2008). Recently, corporates regained access to external and capital market resources, two funding channels that had been disrupted after September 2008. In particular, the sharp fall in the basic interest rate favored the relative attractiveness of private bonds. Credit expansion is taking place in a context of historically low interest rates combined with receding default indicators, so that market analysts and banking sector representatives have indicated that credit will continue to grow.

Investment, which had been the most dynamic component of domestic demand, was significantly affected in the two quarters after the intensification of the world economic crisis. This performance is aligned to the typical behavior of this variable in cyclical reversion episodes. The intensification of the global crisis led to the reevaluation of companies' investment plans due to deterioration of actual and expected demand prospects and funding conditions. These factors, however, showed substantial improvement since the release of the last *Report* – deterioration of funding conditions has actually been reversed. For example, the sharp exchange rate depreciation following the worsening of the world crisis was a limiting factor for financing that is already overcome, therefore reducing the costs of imported capital goods. While the scenario for investment still inspires some caution due to remaining uncertainties concerning the recovery pace in the trading partners, the strong growth of GFCF in the third quarter (6.5%) against the previous one – after increasing 2.0% in the second – indicates that from the entrepreneurs point of view the contractionary period is over and consequently, the investment plans affected by the crisis will to some extent be revived. The assessment that investment is likely to expand is also supported by the inventory changed measured by the national accounts, which was negative for the fourth consecutive period in the third quarter. In this context, Copom anticipates a scenario of growing investment for the next quarters.

The volume of credit with nonearmarked resources to corporate entities expanded 3.6% in October (38.9% in December 2008) in the comparison with same month of the previous year. The capital market, negatively influenced by the intensification of the international financial crisis, begins to return to normality more consistently. In fact, initial public offerings of shares registered in the Securities and Exchange Commission of Brazil (CVM) reached R$15.3 billion in the first eleven months of 2009, with the offerings concentrated in the second quarter. In the secondary market, issuance amounted to R$16.4 billion, especially for operations in the financial sector. The issuance of debentures (excluding operations involving leasing companies), after attaining R$6.3 billion in 2008, reached R$8.4 billion until November 2009. Loan disbursements and financing through the National Bank of Economic and Social Development (BNDES) system amounted to R$106.5 billion in the first ten months of the year, 51.9% higher than that for the same period of 2008.

Regarding the external sector, after surpluses of US$40 billion in 2007 and US$24.9 billion in 2008, the trade balance reached US$23.2 billion until November, an increase of 2.5% against the same period of 2008. This result is much higher than expected at the beginning of the year. Therefore, the trade surplus in 2009 tends to remain close to that of 2008, despite the fall of the prices of important export products. Despite the increase in the trade balance, both imports and exports displayed sharp reduction this year. After reaching a record level of US$197.9 billion in 2008 (increase of 23.2%

against 2007), exports were US$138.5 billion in the first eleven months of the year. This value is 24.8% lower than that observed for the same period of the last year. Likewise, after a record value of US$173.0 billion in 2008 (an increase of 43.4% against 2007), imports receded to US$115.3 billion until November. This represents a contraction of 28.6% against the same period of last year. Therefore, the effects of the world economic crisis on global trade – through lower world economic activity level and the fall in prices, especially for commodities – caused sharp retraction in both the exported and imported volumes in 2009.

After declining 3.5% in 2008 – the first reduction since 1996 – exports decreased 12.1% until October clearly due to the deceleration in the external demand. Furthermore, after having increased 26.3% in 2008, more than sufficient to offset the effects of the decline in volumes, average export prices declined 15.2% until October, amplifying the effects of the fall in the exported volume in 2009. One should note that 1990 was the last time when both volume and average price of exports declined. On the other hand, after expanding 17.7% in 2008, imports declined 21.3% until October as consequence of the deceleration in domestic demand. After a sharp increase (22.0%) in 2008, the average import price showed reduction of 11.4% until October. Therefore, despite the fall in exports, the trade balance remains positive and tends to reach values similar to those seen in 2008.

The signs of the global economy stabilization, which had intensified by the time of the last *Report* release, are consolidating. Actually, financial markets around the world start to return to normality, along with credit markets, partly due to the effects of several measures of economic stimulus especially in the mature economies. Furthermore, several emerging countries including Brazil begin to display stronger than anticipated economic activity. These facts have been affecting commodity prices that have shown recovery in 2009, especially oil prices which recently topped US$75. The improvement in the economic scenario and consequently the reduction in the global risk aversion also entailed the appreciation in the important emerging market currencies. On the other hand, as signs of normalization become widespread, the focus moves to the exit strategies for monetary and fiscal stimuli. One should note, however, that despite the cited progress, some structural difficulties of the international financial system remain. To summarize, the prospects for the global economy have significantly improved since the release of the last *Report*. It is plausible to assume that the benign current dynamics will remain, and could strengthen throughout the coming quarters, although uncertainty concerning the recovery pace in mature economies persists.

The reduction in profits and dividends remittances have contributed to narrow the twelve-month current transactions deficit, that reached US$28.2 billion in December 2008, moving back to US$18.9 billion (1.3% of GDP) in October. Twelve-month foreign direct investments amounted to US$29.5 billion (2.1% of GDP) in November.

Concerning aggregate supply, after displaying sharp contraction in the fourth quarter of 2008 (10.6%) and in the first quarter of 2009 (6,4%), industrial output grew in the second and third quarters (4.1% and 4.8%, respectively), against the previous ones, according to seasonally adjusted IBGE data. On the other hand, the agricultural sector presented the fourth consecutive contraction (2.5%) in the third quarter of 2009. Finally, after a reduction of 2.3% in the fourth quarter of 2008, the service sector registered the third consecutive expansion in the third quarter (1.6%), after expanding 1.7% in the last quarter. When the basis of comparison is the same period of last year, the variations are -6.9%, -9.0% and 2,1%, respectively. This demonstrates the resilience of the service sector to the world economic crisis.

Industrial production, which suffered strong contraction due to the worsening of the world economic crisis, continues to show strong signs of recovery. After an expansion of 5.8% through October 2008 compared to the period of the previous year, there was a strong contraction in the last two months of 2008 (-6.9% in November and -12.7% in December against the previous month for seasonal adjusted data). This behavior resulted in an expansion of only 3.1% in 2008. Therefore, despite having been growing since January in seasonally adjusted monthly terms and since March for the quarterly moving average, average industrial production is still lower than the values registered in the same period of the previous year. Actually, there was a decline of 10.7% against the same period of last year. The declines was equally severe for the manufacturing industry (-10.6%) as well as for the mining industry (-11.9%). It is worth noting that credit-dependent sectors such as automotive, construction and those more affected by the world economic crisis displayed clear signs of recovery in the last few months, mostly due to the effects of anti-cyclical measures taken by the government and to the normalization of the credit conditions.

From the demand viewpoint, the GDP – net of inventory adjustments – grew 1.1% in the third quarter of 2009 compared to the same quarter last year, with the external sector presenting a positive contribution (0.8 p.p). After reaching a value below 100 in June 2008 – implying that the number of companies that considers the inventories as excessive surpasses the number of those that consider inventories insufficient – the inventory level indicator dropped even more and reached 81 in December 2008 and January 2009, the lowest level since august 2003. Thereafter the indicator has risen consistently and reached 100 points in October 2009. This level was sustained in November indicating that the process of inventory adjustment has come to an end. Effectively, there are reports of lack of inventories for some industry segments, specially, for those affected by targeted tax breaks (cars and white goods). The excess of inventories after the worsening of the world global crisis was not only one of the key factors for the lack of industry dynamism in the first half of the year but also for the gap between the paces of production and sales. For the coming quarters, the Copom assesses that industrial production should continue to grow robustly, albeit not necessarily in a monotonic way, with positive effects on employment and income.

After reaching 86.7% in June last year, the seasonally adjusted Level of Utilization of Installed Capacity (Nuci) computed by the Getulio Vargas Foundation (FGV) moved down to 77.9% in February and March. This indicator has consistently risen since then and it reached 82.9% in November, the eighth consecutive monthly increase. Therefore, the fall against the same month of last year, was sharply reduced from 8.1 p.p. in March to just 0.7 p.p. in November. Regarding the expansion of capacity, the increase in the absorption of capital goods over the year moved from 21.5% in September 2008 to 16.5% in December. This downward trend intensified over the initial months of 2009. Actually, there was a contraction of 18.6% in the absorption of capital goods over the year until June that was slightly reduced to 16.4% in October. This is due to the reduction in both capital goods imports (15,0%) and domestic production of these goods (22.0%) in the period. It is also worth noting the production of inputs for the construction industry was strongly reduced until October (-9.3%). Recent industrial production indicators and retail sales figures show robust recovery in activity. Actually, after moving from 125.9 in June 2008 to 71.1 in December 2008, the seasonally adjusted FGV's Economic outlook survey indicator of global demand for the manufacturing industry surpassed the 100 points threshold in September 2009 (more precisely 100.5) and reached 109.3 in November, with more companies considering strong the demand for their products and, consequently, a decrease in the number of companies that judges demand to be weak.

With the worsening of the world crisis, the National Cost of Construction Index (INCC) began to show signs of cooling off in the last quarter of 2008 after a long period of price acceleration. Thus, after peaking in November 2008 (12.34%), the twelve-month change in INCC moved to 3.32% in November 2009. Despite the recent developments, the medium term scenario remains uncertain since the sector faces a strong recovery and the use of imported inputs is limited. Additionally, there will probably be a recovery of the prices of important raw materials used in the sector such as steel which was substantially affected by the world economic crisis.

After two years of consecutive reductions (from 10.0% in 2006 to 9.3% in 2007 and then to 7.9% in 2008), the average unemployment rate increased to 8.3% through the first ten months of this year, a level 0.2 p.p. higher than that observed in the same period of previous year. Notwithstanding, recent figures indicate consistent recovery in the labor market and this is mainly corroborated by the figures from formal sector and also industrial employment, the most affected by the crisis. The prospects for the coming quarters are for a sustained, possibly accelerating recovery.

Despite the increases in recent quarters, oil prices, a systematic source of international market uncertainty, remain on levels significantly lower than those prevailing before the escalation of the international financial crisis. After reaching almost US$150 in mid-2008, the price of a barrel fell to less than US$40, but recently this fall was partly reverted as the price approached US$80. This recovery was due, in a first moment, to reduction in macroeconomic uncertainty, as risks of more adverse scenarios for the world economic activity seemed to abate. In a second moment, the behavior was due to evidences of economic recovery, especially in emerging countries. Despite considerable uncertainty inherent to forecasts of the path of oil prices, the baseline scenario adopted by Copom, which foresees unaltered domestic prices of gasoline for 2010, remains plausible. It is also worth noting that the impact of international oil prices over domestic inflation is not transmitted exclusively through fuel prices but also, through other channels, such as the production chain of the petrochemical sector, as well as expectations of consumers and entrepreneurs. It is also appropriate to note that the price of agricultural commodities such as soybeans, wheat and corn has been showing consistent recoveries, albeit with different intensities.

After more than doubling in 2007 (7.89%, against 3.79% in 2006), and continuing to rise in 2008, when it reached

9.10%, broad inflation – measured by the General Price Index (IGP-DI) – retreated substantially. Twelve-month inflation of the IGP-DI, which reached 14.81% in July 2008, moved to negative territory in July 2009 and reached -1.76% in November, 12.96 p.p. lower than the value observed in the same month last year. The fall in IGP-DI was essentially due to the behavior of the Wholesale Price Index (IPA-DI), whose twelve-month change moved from 18.91% in July 2008 to a deflation of 4.69% in November 2009. Moreover, the drop of construction inputs prices, which are part of the INCC basket, also helped to push down the IGP-DI. On the other hand, the consumer prices deceleration, measured by the Consumer Price Index – Brazil (IPC-Br) changes, was modest with the inflation declining from 6.27% in November 2008 to 4.23% in November 2009. The sharp IPA-DI deceleration was partly due to the change in the agricultural prices behavior, for which the twelve-month change declined from 15.41% in October 2008 to 5.14% in November. As pointed out in previous *Reports*, the Copom assesses that the effects of wholesale price behavior over consumer inflation will depend on current and prospective demand conditions and on expectations of price makers in relation to the path of future inflation.

The acceleration of consumer inflation that had been taking place since mid 2007 and had intensified in 2008 was reverted throughout 2009. The sharp falls in the commodity prices and activity level that followed the worsening of the world economic crisis and were reinforced by the abrupt fall in the domestic activity in the fourth quarter of 2008 and in the first quarter of 2009 more than offset the inflationary pressure coming from the substantial exchange rate depreciation faced by the Brazilian economy in a moment characterized by the intense use of the production factors and already high inflation. Moreover, despite the commodity prices rebound, and the stronger and faster than anticipated activity recovery, twelve-month consumer inflation is still in a level consistent with the target. In addition to the two cited factors, the reversion of the exchange rate depreciation helped to reduce inflationary pressures. Nevertheless, the recovery of the world economy, and in particular, of the domestic economy could lead to potential inflationary pressures throughout next year, and should be closely monitored by the Copom. Anyhow, the Committee reaffirms that it will continue to conduct its actions in order to ensure that the gains obtained in combating inflation in recent years are made permanent.

The Copom notes that, starting from this *Report*, the set of core inflation measures released by the Brazilian Central Bank has suffered a relevant change. The exclusion core measure ceases to be released, being replaced by another measure with similar approach but with more robust statistical and economic foundations, denoted by IPCA-EX. The non-smoothed trimmed core has also been replaced by a double weighting core measure (IPCA-DP) in which no item is excluded but it is penalized by its relative volatility. Finally, the trimmed mean core measure with smoothed items (IPCA-MS) will still be published.

Figure 6.1 – Inflation target path and market expectations for twelve-month ahead inflation

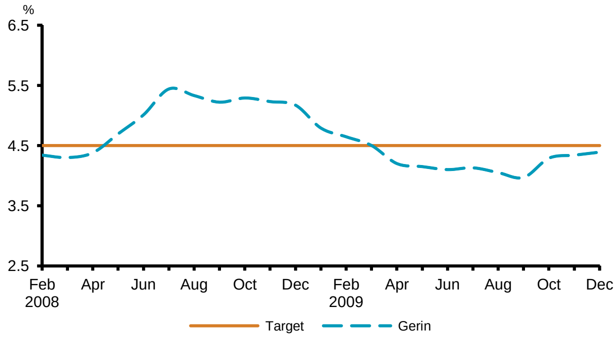
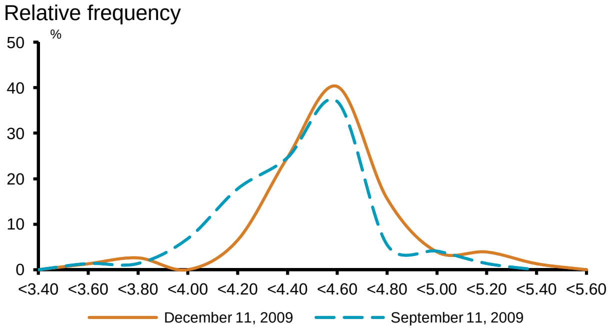


Figure 6.2 – Dispersion of inflation expectations for 2010

Relative frequency



As for headline inflation, the three core measures computed by the Central Bank show reduction in twelve-month rates. The IPCA-EX rose 4.61% in twelve months up to November from 5.77% in August last year (a reduction of 1.16 p.p. against 2.17% in the headline index). On the other hand, the change in IPCA-MS reduced from 4.90% to 4.27% (reduction of 0.63 p.p.). Finally, inflation measured by IPCA-DP fell more sharply from 6.31% to 4.48% (reduction of 1.82 p.p.), in the same basis of comparison. As expected, the core measures have been displaying more persistence than headline inflation. However, the twelve-month inflation measured by either the headline index or any core measures not only has been very close to each other but also has converged to the 4.5% target.

Inflation expectations have increased since the release of the last *Inflation Report* from 4.30%, 4.35% and 4.50% for 2009, 2010 and 2011 respectively at September 11 to 4.31%, 4.50% and 4.50% at the cutoff date of December 11. Basically there has been a reduction of the dispersion around the central tendency of inflation expectations since the release of the last *Report*. Figure 6.2 shows this development for 2009, which supports the assessment that the prospective scenario has become less uncertain since the release of the last *Report*.

6.2 Main scenario: associated risks and monetary policy implementation

The projections used by Copom are based on a set of assumptions about the behavior of key macroeconomic variables. This set of assumptions, as well as the risks associated with it, make up the main scenario based on which the Committee takes policy decisions. In general terms, the prospective scenario – whose corresponding projections are presented in the following section – envisages the recovery of the global economy in the medium term, and the continuation of the domestic expansion in a benign context for inflation. From the viewpoint of the balance of risks related to the inflation prospects, the main risk stems from the intensity of the domestic recovery, which will still be affected by important economic policy stimuli. In particular, the remaining idle capacity may be utilized at a faster pace than what is implied by the gradual economic recovery considered in the main scenario. In other words, the major risk is that the aggregate supply may not be able to meet a stronger expansion of the aggregate demand. The risk becomes more pronounced if one considers that current inflation is already around the target, limiting the room for accommodative monetary policies. On the external front, the main risk is associated with the speed of the global economic recovery.

The external scenario considers that the world economy will recover in the medium term, although at a slower pace in the short run. The current prevailing view suggests that the global economy will contract in 2009 and recover in 2010. According to consensus forecasts, the negative impact of the economic downturn in the United States, Europe and Japan (the G3) on the global economy will not be fully counterbalanced by the dynamism in emerging economies, such as those in Asia. However, there is evidence suggesting that the G3 economies are gradually recovering, albeit in a process that is still subject to reversals due to weak labor market conditions. On the other hand, there is still the risk that the cyclical deterioration in the quality of credit may deepen the existing problems in the international financial system. The materialization of such risk would interrupt the recent improvement in the financial conditions, thus making economic recovery even more difficult to sustain. However, it seems that the likelihood of such a scenario has become lower. Therefore, the trough of inflation has apparently been overcome in most mature economies, even though twelve-month inflation is still falling in several emerging economies. Against this background, monetary policy in many countries is now in pause mode after a period of aggressive easing. At the same time, the rise in the government debt prevents the implementation of further fiscal stimuli. In turn, international financial markets are gradually, though not monotonically, returning to normal.

In face of uncertainty regarding the speed and magnitude of the global economic recovery, two alternative scenarios are considered here. In the first, the world economy remains stagnated or recovers very slowly throughout 2010 so that the contractionary effects on the domestic economy would persist over the projection horizon. In the second, the economic upturn is faster than expected, accompanied by full restoration of financial conditions and confidence, together with the recovery of commodity prices, which nonetheless could imply greater risk to domestic inflation. Given the resilience of large emerging economies, mainly those in Asia, the increasing appetite for risk in the international financial markets, and the positive recent activity signs from the G3 economies, the likelihood that the second scenario materializes has increased since the previous *Inflation Report*.

After slowing down in the third quarter of 2009, the growth rate of commodity prices accelerated again in the fourth quarter. The future path of commodity prices remains uncertain because it depends, among other factors, on the pace of the recovery in mature economies and on the reaction of the major emerging economies. Overall, however, it is expected that these prices are more likely to rise than to remain stable in the medium term. It is important to remember that the analysis of the potential inflationary effects of the recent trend in commodity prices must also take into account the implications for Brazilian asset prices. In this respect, monetary policy must monitor the risk over longer horizons associated with possible inflationary pressures from abroad.

The average exchange rate appreciated slightly this quarter relative to the previous one. Even though the current level of the nominal exchange rate is higher than that prior to the crisis deepening in September 2008, most of the currency depreciation occurred in the last months of 2008 has been reverted. The US dollar also depreciated relative to most currencies, though less intensively than what was observed in previous quarters. The factors driving dollar depreciation include the overall reduction in risk aversion, the resumption of capital flows to emerging economies, the abundant liquidity, as well as some concerns among investors about the fiscal condition of the US and other mature economies.

As mentioned before, the main domestic risk stems from the intensity of the ongoing economic recovery, particularly the speed with which the remaining idle capacity will be utilized. Increasing utilization of production factors – both the capital stock and the labor force – is taking place when the twelve-month inflation is already close to the target. In such a context, isolated inflationary pressures may quickly turn into higher overall inflation. The economic downturn of the last quarter of 2008 and first quarter of 2009 led to an abrupt interruption of a cycle of strong economic growth, reining in inflationary pressures. However, the brevity of the downturn – result in large part of the government policies, both those implemented during the crisis and those put in effect much earlier – as well as the presence of mechanisms that make the Brazilian inflation downward resistant reduce the scope for accommodative stances. Additionally, the lagged effects of the monetary, fiscal and credit stimuli implemented throughout 2009 have not completely materialized yet and may reach full intensity at the time the remaining idle capacity is lower.

The behavior of the GDP in the third quarter is in line with the analysis of the previous *Inflation Report*, suggesting that the economy was picking up steam. Data for the third quarter confirmed the resilience of household consumption and the resumption of the GFFC, the component of aggregate demand most affected by the crisis. However, different from consumption, the level of aggregate investment is still lower than that of the third quarter of 2008. As a matter of fact, GFFC in the third quarter of 2009 was 12.5% lower than that of the same quarter of the previous year, whereas household consumption was 3.9% higher. The investment rate – the GFFC-to-GDP ratio – reached 17.7% in the third quarter of 2009, against 20.1% in third quarter of 2008. It is expected that the investment rate increases in the coming quarters so as to support a more sustainable growth. However, there is still the risk that the growth of the capital stock may not be enough to ensure that aggregate supply meets the expected strong growth of the aggregate demand without generating pressures on consumer prices.

Confidence on the sustainability of the economic recovery is based on three elements. First, and in contrast to previous shocks to the Brazilian economy, this time there was no balance-of-payment crisis, deterioration of public sector finances, increase in inflation or concern about policy regime change. In short, as stressed in other Copom texts, the Brazilian economy became more resilient to external shocks. Second, the monetary policy actions – without jeopardizing the full commitment to the inflation targets – and the fiscal stimuli are still positive forces that will contribute to the economic recovery. Third, and possibly more importantly, household consumption – which accounts for the largest share of the aggregate demand – has also been resilient, in part due to the low inflation rates, the resumption of credit growth, and the better-than-expected performance of the labor market. More recently, both national accounts data for the third quarter and coincident indicators have signaled that investment is also recovering. Additionally, consumers' and business' confidence is on the rise, consistent with the prospects of a sustained recovery.

Even though uncertainty regarding the growth prospects has decreased since the previous *Inflation Report*, the pace of the economic recovery is not completely clear at this point. For instance, there is uncertainty about the pace of the resumption of investment, despite the recent positive signs. Export growth depends directly on the expansion of the world economy, even though the better performance of emerging economies is affecting external sales positively. On the one hand, improving conditions in credit and labor markets are favoring consumption, but the end of sector-specific tax breaks will work in the opposite way. On the other hand, actions by private banks to regain the market shares they lost to state-owned banks – which led the resumption of credit growth – may lead to faster credit expansion, which will benefit household consumption and the overall economic activity.

The Committee judges that there are important mechanisms making Brazilian inflation rigid downwards. In particular, the presence of *de jure* and/or *de facto* indexation mechanisms has contributed to the persistence of inflationary pressures coming from the past. As an example, one may cite the behavior of services prices and of some items in the basket of the regulated price items since the beginning of this year. As a matter of fact, the price of services did not respond much to the economic downturn as they grew by 6.42% y-o-y in November 2009, very close to the figure in November 2008 (6.48%). It is well known that the existence (even informally) of price indexation mechanisms reduces the sensitivity of inflation to demand conditions. Even though inflation rates have been relatively low, by Brazilian standards, in recent years, they still encourage feedback mechanisms as they do not correspond to the usual concept of price stability. In general, the indexation mechanisms prevent the economy from disinflating during downturns, but increase the "starting point" of the inflation rate during upturns, thus raising the inflation risks for the prospective scenario.

Over the medium term, the major risk for the inflation dynamics stems from the cumulative and lagged effects of the monetary, fiscal and credit stimuli on the aggregate demand together with increasing resource utilization. After a cumulative cut of 500 basis points in the current cycle, the Selic interest rate has reached its lowest historical level (8.75% p.a.). Such a monetary easing will still have effects on the economy in the coming quarters (see box "Lags in the Transmission of Monetary Policy to Prices", June 2009 *Inflation Report*). The fiscal expansion will have important lagged effects, adding to the impact of other stimuli expected for the next quarters. The interaction of several policy stimuli tends to increase the uncertainty about the magnitude and lag structure of the corresponding transmission mechanisms.

Anyway, in the most likely scenario the effects of such stimuli will pressure consumer prices when the degree of idle capacity will be smaller than it is currently.

On the fiscal side, uncertainty about GDP growth makes future tax revenues also uncertain, which combined with some rigidity of government expenditures, ends up affecting the future path of the consolidated public sector primary surplus. Nevertheless, provided that the primary surplus rises in the coming years according to the assumptions used in the inflation projections presented in the next section, and taking into account the available information so far, the Committee assesses that a significant and consistent change in the trend of reduction in the debt-to-output ratio will not take place.

As the previous *Inflation Report* highlighted, the negative effects of the global crisis on the Brazilian economy did not provoke any disruption or change of the policy regime such as that occurred in early 1999. The basic economic policy framework founded on inflation targeting, fiscal adjustment and floating exchange rate, proved to be mature, combining resilience and flexibility. Besides, the solid external financial position – as portrayed by large international reserves, trade surpluses and external financing based mainly on foreign direct investment – was a key factor for overcoming the 2008 turbulences without disruptions.

Breaking down the IPCA into market and regulated prices reveals that the pressure from the latter increased in recent months, but those prices tend to decelerate over the medium term. As a matter of fact, the prospective scenario considers that the regulated price inflation will be lower than the market price inflation. In particular, the domestic prices of gasoline are unlikely to rise in the short and medium terms because they are currently higher than the international prices. However, public transport fares must be monitored as they are expected to increase substantially in early 2010.

The labor market is showing signs of recovery. Since mid-2009 the unemployment rate has hovered around the levels of 2008; and formal employment regained its upward trend, with signs of tightening at the margin. In spite of the negative effects of the economic downturn on the labor market, they were not as intense or widespread as those in the economic activity. Two factors contributed to the unexpected behavior of the labor market: i) the downturn was more intense on the manufacturing sector and less so in labor-intensive sectors such as services; and ii) the downturn was short-lived and the current growth prospects are favorable (employment responds with a lag to changes in economic activity).

In the domestic credit market, lending volumes are expanding fast, and lending rates charged to individuals and firms fell to below pre-crisis levels. External credit is also back to normal. Therefore, the main scenario assumes that both the domestic and the external credit will keep on expanding. Favorable credit conditions have brought the Brazilian credit-GDP indicators closer to those in economies with similar development. However, the sustainability of the intense credit expansion must be closely monitored given the potential side effects on inflation and the prudential risks.

The possibility that unexpected changes in the inflation dynamics may have long-lasting effects on agents' inflation expectations constitutes a perennial risk for monetary policy implementation and, therefore, must be monitored continuously. In principle, short-run inflationary pressures may lead to dissemination of second-round effects. This happens because large changes in relative prices that result in high inflation rates are followed by agents' desire to restore their real income, which, in turn, feeds back into the inflationary process. The international experience, as well as the own history of inflation in Brazil, recommends that the monetary authority remains cautious in order to fight potential second-round effects.

The strategy adopted by Copom aims to ensure the convergence of inflation to its target in 2010 and 2011, as happened in 2009. Such strategy, whose results will be evident over time, takes into account the lags in the transmission mechanisms and is the most appropriate way to deal with the uncertainty inherent to the process of formulating and implementing monetary policy.

The Committee judges that the conditions ensuring a benign scenario for inflation are consolidating over time. Under this scenario, the IPCA would consistently evolve according to the inflation targets, as shown by the inflation projections considered by the Copom. The Committee understands that the contraction of the domestic demand caused by the global economic crisis increased slack in the economy, thus helping to cool off inflation pressures. On the other hand, the Committee believes that the significant monetary easing implemented in 2009, accompanied by simultaneous fiscal and credit stimuli, will have delayed and cumulative effects on the real economy. Moreover, the remaining idle capacity suggests that monetary policy must remain cautions so as to ensure the convergence of inflation to its target.

The Committee understands that decisions over the policy interest rate must take into account the total easing implemented from January through July 2009 and its delayed effect on the economy, against a background of increasing utilization of production factors, as mentioned before. The Copom also considers that a more cautions monetary policy now will mitigate the risks of abrupt changes of the monetary policy stance in the future, and consequently will contribute to a consistent recovery in the coming quarters. Additionally, the Committee believes that preserving the benign inflation prospects will require careful monitoring of the financial system and of the real economy in a context of historically low interest rates.

In light of these considerations, the Committee decided to maintain the target for the Selic rate at 8.75% p.a. in its October and December meetings. Taking into account the monetary easing that has been implemented since January, as well as the remaining idle capacity in factor utilization, the Committee assesses that, at this moment, such a level for the interest rate is consistent with a benign scenario for inflation, contributing to the maintenance of the inflation in line with its target over the relevant horizon and to the non-inflationary recovery of economic activity.

6.3 Inflation forecasts

According to traditionally adopted procedures, and taking into account the available information up to the cutoff date of December 11, 2009, the baseline scenario assumes the exchange rate remains unchanged over the forecast horizon at R$1.75/US$, and the target for the Selic rate stays at 8.75% p.a. – the level set by the December Copom meeting – against R$1.85/US$ and 8.75% considered in the September *Inflation Report*. The projection for the change, in 2009, of the set of regulated and monitored prices was kept at 4.5%, the same value considered in the September *Report*. This projection is based on the hypotheses of 1.9% increase in gasoline prices; of 13.4% in bottled gas prices; of 5.2% for electricity rates; and of 0.9% in the fixed telephone rates. Regarding items for which more information is available, price changes were estimated individually, whereas for the others, the projections are based on models of endogenous determination of regulated prices, which consider seasonal components, exchange rate variations, market price inflation and General Price Index (IGP) inflation, among others. According to those models, projection of the regulated and administered prices for 2010, and for 2011, stand at 4.0%, the same values used in the September *Report*.

The market scenario, on the other hand, is based on data from the expectations survey carried out by Gerin with a representative group of institutions up to the cutoff date. In this scenario, average exchange rate depreciation expectations decreased in comparison to the values released in the September *Inflation Report*. For the last quarter of 2009, these expectations moved from R$1.82/US$ to R$1.73/US$, and for the last quarter of 2010, from R$1.85/US$ to R$1.75/US$. For the last quarter of 2011, average survey expectations project an exchange rate of R$1.80/US$. The average expectation about the Selic rate for the last quarter of 2009 moved from 8.75% to 8.67% p.a., while for the last quarter of 2010, it went from 9.08% to 10.58% p.a. For the last quarter of 2011, the projection for the average Selic rate is 10.81%. This trajectory of the Selic rate is consistent with a pre-DI swap of twelve months spread of 98 b.p., 219 b.p. and 242 b.p., considering the current target for the Selic rate (8.75% p.a.), in the last quarter of 2009, 2010 and 2011, respectively. Additionally, the market scenario assumes changes of 4.5% for the group of regulated prices in 2009, and of 4.0% and 4.1%, in 2010 and 2011, respectively.

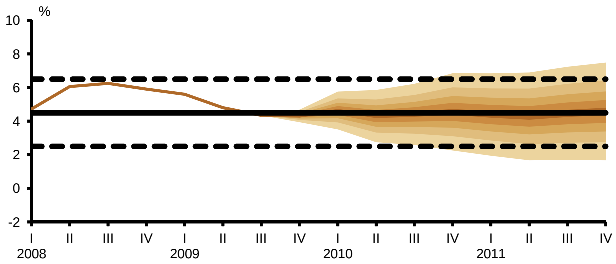
With regard to fiscal policy the projections presented in this *Report* are based on the working hypothesis of a primary surplus of 2.5% of GDP in 2009 and of 3.3% in 2010, in both cases adjusted by the possibility of reduction of 0.94 b.p. and 0.68 b.p., respectively, due to the implementation of projects belonging to the Growth Acceleration Program (PAC). Moreover, the primary surplus in 2011 is assumed to return to the level of 3.3% of GDP without any adjustment.

Based on the above assumptions and using the information set until the cutoff date (December 11, 2009), projections were constructed for four quarters of accumulated IPCA inflation, given the baseline and market scenarios interest and exchange rate paths.

The central projection associated with the baseline scenario shows inflation of 4.3% in 2009, an increase of 0.1 b.p. in comparison to the projection presented in the September *Report*, below the central value of 4.5% for the target determined by the National Monetary Council (CMN). As can be seen on Figure 6.3, in the baseline scenario, the projection for twelve months inflation stays around the target along the whole horizon. One should highlight that the twelve months inflation projection rises slightly above the target on the first quarter of 2010, due to the schedule of changes of regulated prices expected for the beginning of the year. Along the remaining horizon, the inflation projection fluctuates around the target, but closes 2010 and 2011 at

Figure 6.3 – Forecasted IPCA-inflation with interest rate constant at 8.75% p.a. (Baseline scenario)

Inflation fan chart



Note: accumulated inflation in 12 months (% p.a.).

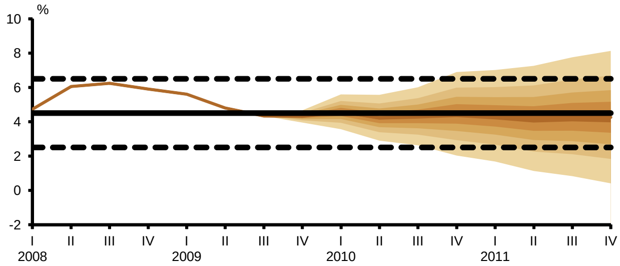
Table 6.1 – Projected IPCA-inflation with interest rate constant at 8.75% p.a. (Baseline scenario)

Year	Q	Probability Interval 50%	30%	10%				Central projection
2009	4	4.2	4.2	4.3	4.3	4.4	4.5	4.3
2010	1	4.2	4.4	4.5	4.7	4.9	5.1	4.6
2010	2	3.7	3.9	4.2	4.4	4.7	4.9	4.3
2010	3	3.7	4.0	4.3	4.5	4.8	5.1	4.4
2010	4	3.6	4.0	4.4	4.7	5.1	5.5	4.6
2011	1	3.4	3.8	4.2	4.6	5.0	5.4	4.4
2011	2	3.2	3.7	4.1	4.5	4.9	5.4	4.3
2011	3	3.3	3.8	4.3	4.7	5.1	5.6	4.5
2011	4	3.4	3.9	4.4	4.8	5.3	5.8	4.6

Note: accumulated inflation in 12 months (% p.a.).

Figure 6.4 – Forecasted IPCA-inflation with market expected interest and exchange rates

Inflation fan chart



Note: accumulated inflation in 12 months (% p.a.).

Table 6.2 – IPCA-inflation with market expected interest and exchange rates [1/]

Year	Q	Probability Interval						Central projection
		50%						
			30%					
				10%				
2009	4	4.2	4.2	4.3	4.3	4.4	4.5	4.3
2010	1	4.2	4.3	4.5	4.7	4.8	5.0	4.6
2010	2	3.7	3.9	4.1	4.3	4.5	4.8	4.2
2010	3	3.6	3.9	4.2	4.4	4.7	5.0	4.3
2010	4	3.5	3.9	4.3	4.7	5.0	5.5	4.5
2011	1	3.3	3.7	4.1	4.6	5.0	5.4	4.3
2011	2	2.9	3.5	4.0	4.4	4.9	5.4	4.2
2011	3	2.9	3.5	4.0	4.6	5.1	5.7	4.3
2011	4	2.7	3.4	4.0	4.6	5.2	5.9	4.3

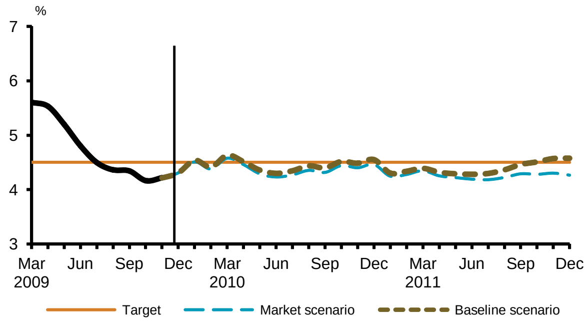
Note: accumulated inflation in 12 months (% p.a.).

1/ According to Gerin.

Table 6.3 – September 2009 *Inflation Report* forecasts

Period	Benchmark scenario	Market scenario
2009 III	4.3	4.3
2009 IV	4.2	4.2
2010 I	4.1	4.1
2010 II	3.6	3.6
2010 III	4.0	3.9
2010 IV	4.4	4.4
2011 I	4.6	4.7
2011 II	4.6	4.7
2011 III	4.5	4.6

Figure 6.5 – Forecasts and target path for twelve-month cummulative inflation



4.6%. This relative stability is partially due to the assumption that the primary surplus will return, without any rebate, to the level of 3.3% of GDP in 2011.

Data on Table 6.1 indicates that twelve months inflation moves within the 4.3% and 4.6% range in 2010 and 2011. According to the confidence interval illustrated on Table 6.1, in the baseline scenario the estimated probability that inflation will breach the upper tolerance level of the target is negligible for 2009. For 2010, this probability is close to 7%.

In the market scenario, the inflation projection for 2009 (4.3%) is the same as in the baseline scenario, an increase of 0.1 b.p. in comparison to the projection presented in the last *Report*. As can be seen on Figure 6.4 and on Table 6.2, projections fluctuate around the target along 2010, and recede along the first and second quarters of 2011, finishing the year at 4.3%, below the central value of the target. The proximity between the projected dynamics for both scenarios, along 2010, is essentially due to the fact that, in the market scenario, inflationary effects of expected exchange rate devaluation are partially offset by expected hikes in the Selic rate. Nonetheless, regarding 2011, the second effect dominates the first. In the market scenario the estimated probability that inflation will breach the upper tolerance level of the target is also negligible for 2009. For 2010, this probability is close to 9%.

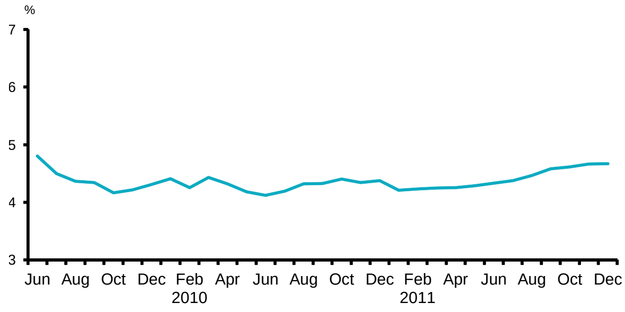
Comparing the trajectories shown in this *Report* with those released in the previous *Report*, whose projections are shown on Table 6.3, it is apparent that there was an increase of the projections along 2010 in the baseline scenario, partially due to the increase in expected inflation for that year. It should be highlighted that the same effect is observed in market scenario projections. Regarding the three first quarters of 2011, the decline in the projection is, in part, explained by a smaller inertial component, once the projection for the last quarter of 2010 is smaller than the corresponding one in the September *Report*. It is worth to note that this reduction is mainly due to a smaller projection for the variation on regulated prices.

Figure 6.5 shows the path of twelve-month accumulated inflation, according to the baseline and market scenarios, up to the last quarter of 2011, as well as the target trajectory. The figures are actual twelve-month inflation until November 2009, and, from December, projections according to the two scenarios. The projections fluctuate closely around the target along the entire projection horizon. However, it is worth noting the distance between the projection paths toward the end of the considered horizon. This departure is essentially due to the expected hike in the Selic rate in the market scenario.

The average forecast generated by the Vector Autoregression models (VAR) for the twelve-month accumulated inflation is presented in Figure 6.6. By November 2009, the values are actual twelve-month inflation and, as of December, refer to the average forecast of the VAR models. As well as in the projections generated in the baseline and market scenarios, the VAR models forecast inflation stability along the entire horizon. In the first half of the period, forecasts fluctuate around the target, nonetheless, along the second half, a slight upward trend is observed, and the forecasts return to the unconditional inflation mean.

Figure 6.7 illustrates the output growth fan chart built under baseline scenario assumptions. Considering that the model which generates GDP growth projections uses two variables that are not directly observable, potential output and the output gap, the forecast errors associated to these projections are considerably higher than the errors related to the inflation projections. According to this scenario, the GDP growth projected for 2009 is 0.2%, below the 0.8% projection presented in the September 2009 *Inflation Report*. For 2010, the projection is 5.8%.

Figure 6.6 – Inflation forecast: VAR models

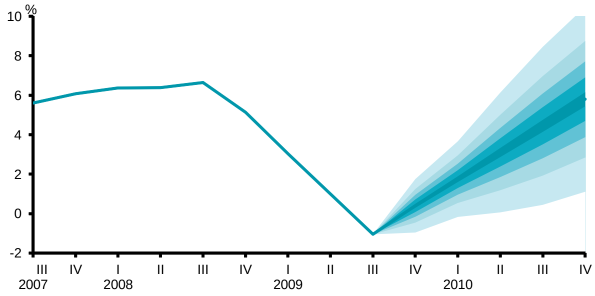


Note: accumulated inflation in 12 months (% p.a.).

Average forecast generated by the VAR models.

Figure 6.7 – GDP growth with interest rate constant at 8.75% p.a. (Baseline scenario)

Output fan chart



Methodology of the New Set of Core Inflation Measures

From this *Inflation Report* onwards, the Central Bank changes the set of periodically reported three measures of core inflation associated with the Broad National Consumer Price Index (IPCA). In this group remains the core by smoothed trimmed mean (IPCA-MS), which has been published since March 2001, to which are added two new measures, a new exclusion core measure (IPCA-EX) and the double weighted core inflation (IPCA-SD), this box describes the methodology used to construct each of these core inflation measures. Henceforth, the official documents of the Monetary Policy Committee will refer to these core measures. Note that this change only represents a statistical improvement, not implying or suggesting change in the implementation of the inflation targeting framework, which remains focused both on technical criteria and transparency, to control inflation measured by the headline IPCA.

In the construction of IPCA-MS, the method eliminates the highest and lowest monthly changes in prices – adding up 20% of the basket that makes up the IPCA[1] – and recalculates the reweighted average using only the central part of the distribution and also taking into account the original weight of each item. Note that some of the items that comprise the headline index have very infrequent changes (Household Fuel, Residential Electricity, Transportation, Motor Fuel, Tobacco Products, Courses, Other Courses and Communications). Moreover, in general the magnitude of these variations tend to be higher than that for other items, so that, in principle, when using the trimmed mean methodology those prices could be systematically eliminated from the core

1/ The cutting portion (20%) is obtained by minimizing the root of the mean square error between the 13-month centered moving average of the monthly inflation and the trimmed mean series.

computation, leading to a potential underestimation of the underlying inflation. In order to avoid this, the monthly variations for those components with infrequent price changes are divided into twelve equal parts, which are distributed in the month in which they occur and the following eleven months.

For the IPCA-EX calculation, the used methodology considers both economic and statistical criteria. Strictly speaking, this approach takes in account the basic idea of excluding items that have, in a consistent way, greater volatility throughout the analyzed sample. The procedure also considers the fact that being part of the set of Administered Prices is not a sufficient condition for the exclusion of an item, given that these prices usually show high persistence and downward rigidity[2]. Not systematically excluding these prices would contribute to avoid biasing the core measure.

Based in the statistical criterion of the Relative Volatility, sixteen items out of 52 that make up the headline IPCA were selected – as candidates for exclusion. Specifically, the items whose Relative Volatility has been more than two standard deviations during the period from January 1995 to December 2007 would be, in a first moment, subject to exclusion. Table 1 presents the relative volatilities for the entire sample and for the three sub-periods: 1/1995 to 12/1998, 1/1999 to 1/2002 and 1/2003 to 12/2007. A second statistical criterion is the volatility consistency, which means, to be excluded, the item would have to show high relative volatility in, at least, two of the three sub-periods aforementioned.

Following the procedure described in the paragraph above, IPCA-EX was obtained by excluding twelve items (in bold in Table 1) – ten items from the group “Food at Home” and at two from “Administered Prices per Contract and Monitored”. The excluded items corresponded, in average, to 15.5% of the IPCA basket, according the used sample. For comparison, the core by exclusion, as previously calculated and published by the Central Bank, excluded totally or partially 24 items which represents 44.6% of the IPCA.

2/ See, eg, da Silva Filho (2008).

Table 1 – Relative volatility for the most volatile items

Items	01/1995 12/1998	01/1999 01/2002	01/2003 12/2007	01/1995 12/2007
Potatoes and legume	**7.98**	**5.78**	**9.13**	**7.84**
Communications	11.92	1.99	1.43	6.82
Vegetables	**7.95**	**4.48**	**5.11**	**5.95**
Cereals	**5.30**	**3.79**	**3.26**	**4.12**
Household fuel	**3.78**	**4.01**	**1.05**	**3.19**
Fruits	**3.11**	**2.22**	**3.66**	**3.12**
Motor fuel	**3.10**	**3.7**	**2.32**	**3.07**
Fish	**3.96**	**2.71**	**2.24**	**3.00**
Poultry and eggs	**2.34**	**3.54**	**2.62**	**2.89**
Sugar and sweets	**1.54**	**3.78**	**2.27**	**2.75**
Electricity	5.69	1.68	1.26	2.63
Fats and oils	**2.30**	**3.47**	**1.89**	**2.63**
Dairy products	**1.90**	**2.04**	**2.50**	**2.19**
Tuition	2.72	1.86	1.81	2.18
Meat	**2.17**	**2.05**	**2.07**	**2.14**
Tobacco products	2.75	1.93	1.41	2.05

Source: da Silva Filho and Figueiredo (2009)

To obtain the third measure, the IPCA-DP, the original weights – based on the importance of each item in the IPCA basket t – are readjusted taking into consideration the respective degree of relative volatility, which means, volatility of the item adjusted by volatility of the headline IPCA. In this method, the higher the relative volatility of a component, the less its weight in the core measure computation. Differently from the cases of the IPCA-EX and IPCA-MS, the IPCA-DP does not exclude the most volatile items, only reduces their importance.

To build the IPCA-DP, first you calculate the standard deviation of each one of *n* items of the IPCA ($\sigma_{i,t}$) using a sliding window of 48 months ($j = 48$) as follows:

$$\sigma_{i,t} = \frac{1}{j-1}\sqrt{\sum_{k=1}^{j}\left(\pi_{i,t-k}^{rel} - \overline{\pi}_{i,t-k}^{rel}\right)^2}$$

where $\pi_{i,t-k}^{rel} = \pi_{i,t} - \pi_t$; $\overline{\pi}_{i,t-k}^{rel} = \frac{1}{j}\sum_{k=1}^{j}\pi_{i,t-k}^{rel}$;

and $\pi_{i,t}$ and π_t represent, respectively, the price change of item *i* and the headline inflation both for month *t*.

According, from the original IPCA weighs ($w_{i,t}$), the new weighs ($\widetilde{w}_{i,t}$) are calculated as below observing the constraint that $\sum_{i}^{n}\widetilde{w}_{i,t} = 1$.

$$\tilde{w}_{i,t} = \frac{1/\sigma_{i,t}}{\sum_{i=1}^{n} 1/\sigma_{i,t}} w_{i,t}$$

Finally, the IPCA-DP is obtained from:

$$\pi^{DP} = \sum_{i=1}^{n} \tilde{w}_{i,t} \pi_{i,t}$$

Figure 1 – IPCA and core measures
Twelve-month percentage change

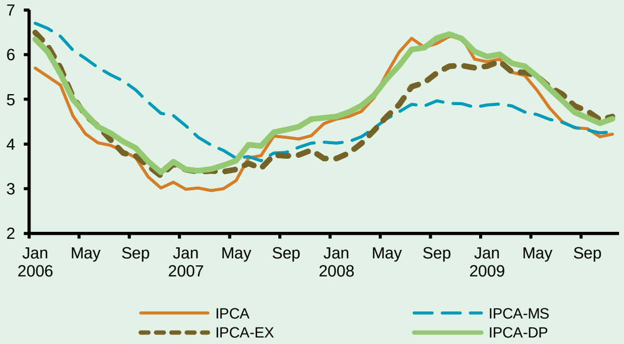


Figure 1 shows the twelve-month change for the inflation and three measures of core inflation described above. Preliminary analysis suggests that the IPCA-EX behavior is closest to that of the headline index. Despite this evidence, it is worth mentioning that international experience and the literature point out that is important to analyze a diverse set of core measures, rather than focusing on specific measures, since, in practice, it is not possible to select a core measure that is superior in every evaluation criteria. This is one of the reasons why the vast majority of countries adopting inflation targeting pursues targets measured by changes in a headline index, while the use core inflation measures as part of a broad set of information in which is based the decision making process of the monetary policy.

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GDP Revisions in Brazil

The literature on real-time data analysis has shown important differences between the values of data as they are initially calculated or released and the revised values[1]. The revisions are a natural aspect of the production data – as time goes by, the set of available information increases, seasonal factors are re-estimated and methodological revisions are implemented. Thus, usually the data become more accurate over time. Economic agents, however, must make decisions in real time, without benefit of data revisions. In particular, monetary policy decisions are also taken without that benefit.

This box based on Cusinato, Minella and Pôrto Júnior (2009), explores the theme of revisions of Gross Domestic Product (GDP) in Brazil, an important variable for assessing the inflationary scenario and, therefore, the conduct of monetary policy. Using the methodology of Orphanides and van Norden (2002), this box seeks to measure the magnitude of revisions to GDP growth rate[2], based on a set composed of fifty sets of quarterly data, containing the releases of seasonally adjusted GDP data of the period from 1996:1 to 2008:2. The measurement of revisions is obtained as the difference between the final series and the series in real time, with the first corresponding to the GDP data just as it was initially reported and the second, to the last release considered in the analysis (for the second quarter of 2008).

Table 1 presents various indicators of revisions, considering the GDP growth in a given quarter (the natural log difference multiplied by 100) in comparison with the previous quarter and with the

1/ See, for example, Croshoure and Stark (2000, 2001) and Orphanides and van Norden (2002).

2/ The study Palis, Ramos and Robitaille (2004) also discuss the revisions of Brazil's GDP, using the releases of GDP between 1994:2 and 2001:4 and focusing on the sequence of revisions. In this work, we use a larger and more recent sample and we calculate several additional indicators.

same quarter last year. The mean revision to GDP growth (quarter/previous quarter) was 0.13 p.p. Although the mean revision is a useful indicator of the revision bias, is limited as an indicator of the revisions magnitude, because positive values are offset by negatives. In this context, mean absolute revision (MAR) and the root mean square of the review (RMSR), which reached 0.67 p.p. and 0.89 p.p., respectively, emerge as alternatives to mean revision. This means that on average, the quarterly GDP growth was revised in 0.67 p.p. above or below the value initially released. Moreover, the real time and final series showed a correlation of 0.67, with the first explaining 44% of the second's variance.

Table 1 – Revision indicators – GDP growth
(Percent change in relation to the *i* th previous quarter) – 1996Q1 to 2008Q2

Accumulated GDP growth rate in	Mean revision/q	MAR/q	RMSR/q	AR	N/S	CORR	OPSIGN	FRLA
1 quarterly	0.13	0.67	0.89	-0.34	0.79	0.67	0.16	0.26
4 quarterlies	0.08	0.23	0.29	0.42	0.52	0.89	0.16	0.22

Notes: Seasonally adjusted quarterly GDP.
Mean revision/q is the mean revision divided by the number of quarterlies under analysis.
MAR/q is the mean absolute revision divided by the number of quarterlies under analysis.
RMSQ/q is the root mean square revision divided by the number of quarterlies under analysis.
AR is the first-order serial correlation of the revision series.
N/S is a proxy for the noise-to-signal ratio (obtained by the ratio of the root mean square revision to the standard deviation of the final GDP growth estimate).
CORR is the correlation of the real-time and final GDP growth estimates.
OPSIGN is the frequency with which real-time and final GDP growth estimates have opposite signs.
FRLA is the frequency with which the absolute value of the revision is larger than the absolute value of the final GDP growth.

Table 1 also presents other indicators: (1) N/S – a proxy for the signal-noise ratio, is the ratio between the RMSR and standard deviation of the final estimate of GDP. This ratio is 0.79, which indicates roughly that the revision magnitude is not so far from the series variability; (2) OPSIGN – the frequency in which GDP growth in real time has the opposite sign of final GDP growth. The OPSIGN indicates that 16 percent of the quarters the GDP level is revised so the sign of the growth rate is changed, and (3) FRLA – the frequency in which the revision of GDP growth is higher than the final GDP growth, both in absolute values. The FRLA of 0.26 implies that this occurs in 26% of cases.

Importantly, even though the indicators suggest substantial revisions of the GDP growth rate, there is a mitigating factor: the first-order serial correlation in the revision series (AR) is negative (-0.34), indicating that positive revisions of one quarter are usually followed by negative revisions in the following quarter, and vice versa. Therefore, when we aggregate the revision series, for instance, in annual periods, the revisions will tend to lose some of its importance. In fact, when considering revisions to the GDP growth rate over the same quarter last year, both the MAR and RMSR, both expressed in percentage points per quarter, decrease. For example, the mean absolute revision is 0.23 p.p. per quarter (equivalent to 0.92 p.p. in annual terms). Furthermore, there is a reduction of signal-noise ratio (N/S) and an increase in the correlation between real time and final GDP series, however, there is no considerable improvement of the indicators OPSIGN and FRLA. Table 2 shows the same indicators listed in Table 1, but for the cumulative GDP growth in four quarters. In general, the indicators show improvement, so that, although they remain relevant, the revisions of GDP becomes less important when increasing the period of aggregation.

Table 2 – Revision indicators – GDP growth
(Four-quarter accumulated GDP percent change in relation to the four previous quarters)
1996Q1 to 2008Q2

Mean revision/q	MAR/q	RMSR/q	AR	N/S	CORR	OPSIGN	FRLA
0.04	0.16	0.21	0.82	0.48	0.89	0.06	0.14

Notes: See notes toTable 1.

In summary, the analysis presented in this box implies that hurried analyses of GDP real time estimates may lead to erroneous conclusions, especially in the margin[3]. The results therefore indicate the importance of using a larger set of economic series when examining the state of the business cycle. In principle, the use of a large body of information tends to reduce the risks associated with series subject to revision. Not surprisingly, therefore, that central banks use a large and varied set of information on economic activity and its prospects. In the specific case of Brazil, this is evident both in the reading of the minutes of meetings of the Monetary Policy Committee, and the *Inflation Reports*.

3/ It should be emphasized that the existence of data revisions is a fact of reality and should not be construed as a criticism of the work of institutions that produce the data. Moreover, the fact that an economic series has most significant revisions does not necessarily mean that their measurement errors are larger.

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Observed Inflation and Inflation Targeting: the international and the brazilian experiences

This box follows the same procedure of the text published in the December 2008 *Inflation Report*. Based on an updated information set, the box compares the behavior of observed inflation with the established inflation targets, taking into account the respective tolerance intervals in a sample of inflation targeting (IT) countries. For each country, the sample period runs from the quarter in which the IT regime was adopted to the third quarter of 2009. The four-quarter accumulated inflation is compared with the target values, making interpolations whenever necessary.

Table 1 shows the frequencies associated with different ranges of the observed inflation in comparison with the prevailing targets, country by country. The sample was split into emerging market economies – historically more susceptible to external shocks – and industrial economies. Table 1 suggests that for both groups of countries the frequency with which the observed inflation remained outside the tolerance interval is high: 40% in industrial economies and 51% in emerging market economies. In periods when inflation remained outside the tolerance interval in industrial economies, there was a slightly higher frequency of cases where it was situated below the lower limit; while in the case of emerging market economies, the frequency with which inflation was above the upper limit of the tolerance interval was much higher.

Table 1 – Inflation target quarterly fulfillment in selected countries

Country	Adoption year of Inflation Targeting	π < lower bound of the target	lower bound of the target < π < central value of the target	central value < π < upper bound of the target	upper bound of the target < π	π < central value	π > central value	π = central value
Emerging		(A)	(B)	(C)	(D)	(A + B)	(C + D)	
South Africa	2000	0%	25%	23%	52%	25%	75%	0%
Chile	1991	16%	29%	35%	17%	45%	52%	3%
Hungary	2001	3%	26%	20%	49%	29%	69%	2%
Mexico	2001	0%	17%	29%	51%	17%	80%	3%
Peru	1994	35%	27%	11%	22%	62%	33%	5%
Poland	1999	42%	12%	12%	33%	54%	45%	1%
Weighted mean		18%	24%	22%	33%	42%	55%	3%
Developed								
Australia	1993	33%	12%	16%	31%	45%	47%	8%
Canada	1991	25%	27%	32%	13%	52%	45%	3%
England	1992	3%	35%	49%	8%	38%	57%	5%
Norway	2001	37%	31%	17%	11%	68%	28%	4%
New Zealand	1990	4%	25%	38%	32%	29%	70%	1%
Sweden	1995	42%	32%	19%	7%	74%	26%	0%
Weighted mean		22%	26%	30%	18%	48%	48%	4%
Brazil	1999	0%	24%	46%	24%	24%	70%	6%

*π denotes four-quarter accumulated inflation.

In only 3% and 4% of the quarters considered inflation has coincided with the central value of the target, in emerging and industrial countries, respectively. The data also reveal that inflation in industrial countries remained below the center of the target in 48% of the time (42% in the case of emerging market economies). In industrial economies, inflation was positioned between the floor and the center of the tolerance interval in 26% of the quarters (24% in the case of emerging market economies); and between the center and the ceiling of the tolerance interval in 30% of the time (22% in the case of emerging market economies). Inflation in industrial economies has exceeded the upper limit of the tolerance interval in 18% of the occasions (33% in the case of emerging market economies). In other words, when inflation exceed the center of the target in industrial countries, it typically remained within the tolerance interval, whereas in emerging market economies inflation tended to breach the upper limit of the tolerance interval.

As in other countries, the central value of the tolerance interval has been rarely achieved in

Brazil. In only 6% of the cases – corresponding to two observations, the last quarters of 2000 and 2007 – did actual inflation coincide with the center of the target. The overall frequency with which inflation remained outside the tolerance interval (24%) was lower than the average observed in both emerging market economies (51%) and in industrial economies (40%). However, different from what has happened in the majority of the countries in the sample, the Brazilian inflation has never gone below the lower limit of the tolerance interval. Thus, when the Brazilian inflation stayed outside the tolerance intervals it always breached the upper limit of that range, as also happened in Mexico and South Africa.

Regarding the distribution of inflation within the tolerance interval, the Brazilian experience differs from the pattern identified in the sample. When the Brazilian inflation remained within the tolerance interval, the frequency with which it stayed above the central value (46%) exceeded by a wide margin the frequency with which it remained below the central value (24%). This asymmetry is in sharp contrast with the average behavior of inflation in both emerging and industrial countries in the sample. Furthermore, different from what was observed in most countries, Brazil experienced low frequency of cases in which inflation was lower than the central value of the target (only 24%), versus 42% in emerging market economies and 48% in industrial countries.

Turning to more recent periods, the Brazilian inflation has remained below or at the center of target from the second quarter of 2006 to the last quarter of 2007 and above it between the first quarter of 2008 and the second quarter of 2009. In the third quarter of 2009, inflation was again below the center of the target. The fall of inflation in 2009 was not restricted to the Brazilian economy. Table 2 shows the difference between the actual inflation and the target ceiling in 2008 and in the first three quarters of 2009, country by country. No emerging country (except Brazil) and only three industrial countries (Canada, England, and Norway) experienced inflation below the target ceiling in the first quarter of 2008. On the other hand, most countries in the sample – all industrial countries and most emerging market economies – experienced inflation below the target ceiling in the third quarter of 2009. In the specific case of Brazil, after accelerating

Table 2 – Inflation deviations from the upper bound of the target

Country	2008				2009		
	I	II	III	IV	I	II	III
Emerging							
South Africa	4.1	5.6	7.0	4.3	2.5	0.9	0.1
Chile	4.5	5.5	5.2	3.1	1.0	-2.1	-5.1
Hungary	2.7	2.7	1.7	-0.5	-1.1	-0.3	0.9
Mexico	0.2	1.3	1.5	2.5	2.0	1.7	0.9
Peru	2.5	2.7	3.2	3.7	1.8	0.1	-1.8
Poland	0.6	1.1	1.0	-0.2	0.1	0.0	-0.1
Mean	2.4	3.2	3.3	2.2	1.1	0.1	-0.8
Developed							
Australia	1.2	1.5	2.0	0.7	-0.5	-1.5	-1.7
Canada	-1.6	0.1	0.4	-1.8	-1.8	-3.3	-3.9
England	-0.5	0.8	2.2	0.1	-0.1	-1.2	-1.9
Norway	-0.3	-0.1	1.8	-1.4	-1.0	-0.1	-2.3
New Zealand	0.4	1.0	2.1	0.4	0.0	-1.1	-1.3
Sweden	0.4	1.3	1.4	-2.1	-2.8	-3.8	-4.6
Mean	-0.1	0.8	1.7	-0.7	-1.0	-1.8	-2.6
Brazil	-1.8	-0.4	-0.2	-0.6	-0.9	-1.7	-2.2

*Refers to four-quarter accumulated inflation.

markedly in the second quarter of 2008, the 12-month accumulated inflation has decreased, showing more favorable dynamics in recent quarters.

In summary, the evidence presented in this box using data for IT countries suggests that one should not expect that observed inflation will systematically remain below or above the central value of the tolerance intervals. The international experience suggests that the actual inflation rate should gravitate around the center of the target, rarely reaching its central value exactly. The evidence also shows that it is not uncommon for the observed inflation eventually to breach both the upper and lower limits of the tolerance intervals. This assessment, however, does not totally apply to Brazil, Mexico and South Africa, the only countries in the sample considered in which inflation has never positioned itself below the lower limit of the tolerance interval.

Annex

Minutes of the 146th Meeting of the Monetary Policy Committee (Copom)

Date: October 20th, from 4:50PM to 6:45PM, and October 21st, from 4:45PM to 6:30PM
Place: BCB Headquarters meeting rooms – 8th floor on October 20th and 20th floor on October 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 October 20th)
Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on October 21st)
João Henrique de Paula Freitas Simão – Open Market Operations Department
José Antonio Marciano – Department of Banking Operations and Payments System
Marcio Barreira de Ayrosa Moreira – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations Group

Other participants (present on October 20th)
Adriana Soares Sales – Advisor to the Board
Alexandre Pundek Rocha – Advisor to the Board
Eduardo José Araújo Lima – Advisor to the Research Department
Fabio Araujo – Advisor to the Research Department
Katherine Hennings – Advisor to the Board
José de Ribamar Oliveira Júnior – Press Secretary

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

Recent economic developments

1. IPCA inflation increased to 0.24% in September up from 0.15% in August, returning to the level observed in July. As a consequence, in the year through September inflation reached 3.21%, decreasing 1.54 p.p. relative to the same period of the previous year. In the last twelve months, inflation reduced to 4.34% in September down from 4.36% in August (5.90% in December 2008 and 6.25% in September 2008), remaining near the target. The deceleration of twelve-month consumer price trailing inflation in the first nine months of the year mirrored the behavior of market prices, as regulated price inflation increased. Considering market prices, both prices of tradable and non-tradable goods cooled on a twelve-month trailing basis, reaching 3.38% and 5.41%, respectively, in September, down from 6.99% and 7.10% in December 2008 (6.78% and 8.49% in the same month of the previous year). However, according to the same comparison basis, the prices of services, whose dynamics tends to show more persistence than that of the prices of

goods, increased to 6.84% in September up from 6.39% in December (6.27% in September 2008). Preliminary data for October point to consumer inflation above the level observed in September. In short, information available suggest that the inflationary acceleration cycle observed last year has been gradually overcome by a process led by the behavior of market prices, specially goods, while regulated price and services inflation continue to show more persistence.

2. The three main underlying inflation measures calculated by the BCB increased between August and September. The core inflation by exclusion of household food items and regulated prices changed from 0.23% in July to 0.29% in August and 0.35% in September. Smoothed and non-smoothed trimmed means core inflation measures also accelerated, recording 0.30% and 0.21% in July, 0.25% and 0.18% in August and 0.39% and 0.31% in September, respectively. The twelve-month trailing inflation measures changed from 6.09%, 4.82% and 4.92% in December to 5.04%, 4.30% and 3.54% in September, for the core inflation by exclusion, smoothed and non-smoothed trimmed means core inflation, respectively. Moreover, it bears emphasizing that the behavior of the IPCA diffusion index reduced from 61.7% in December to 54.2% in September (compared to 60.9% in September 2008).

3. The General Price Index (IGP-DI) inflation changed from -0.64% in July to 0.09% in August and 0.25% in September. On a twelve-month trailing basis, the IGP-DI inflation changed from -1.00% in July to -0.53% in August and -0.65% in September (11.90% in September 2008). The slowdown of the IGP-DI has basically reflected the behavior of all its three components. Its main component, the Wholesale Price Index (IPA-DI), reached -3.40% in the last twelve months through September (14.33% in September 2008). On its turn, the Consumer Price Index-Brazil (IPC-Br) increased 5.02% in September (5.6% in September 2008) and the Civil Construction National Index (INCC) increased 4.27% (11.88% in September 2008). Regarding the IPA-DI, the inflationary deceleration, under this comparison basis, derives basically from the behavior of both agricultural and industrial prices. The agricultural IPA reached -3.72% (15.84% in September 2008), while wholesale industrial prices reached -3.30% (13.78% in September 2008). As mentioned in previous Copom Minutes, the Copom evaluates that the effects of wholesale prices over consumer price inflation will depend on current and prospective demand conditions and price-setters' expectations for the future inflation path.

4. The IBGE released Q2 2009 GDP data, which showed a 1.2% contraction in activity, under the criterion of the year-over-year comparison. From the aggregate demand side, expansion was led by the household consumption and public administration consumption, which increased 3.2% and 2.2%, respectively, year-over-year. Gross fixed capital formation, exports and imports contracted 17.0%, 11.4% and 16.5%, respectively, according to the same comparison basis. The contribution of domestic absorption to output growth was -1.9 p.p. in the second quarter of 2009, year-over-year, overweighing the 0.7 p.p. positive contribution of the external sector. From the aggregate supply side, still according to the year-over-year basis, the services sector performed positively, with a 2.4% growth, year-over-year, while all the other sectors contracted. The GDP deflator measured by market prices, according to the same comparison basis, changed from 7.4% in the fourth quarter of 2008, to 4.7% in the first quarter of 2009 to 4.9% in the second quarter of 2009.

5. On a three-month moving average basis, according to data seasonally adjusted by the IBGE, industrial output increased 1.3% in July and August. Still considering the seasonally adjusted series, industrial output increased by 2.2% in July and 1.2% in August, month-on-month, the eighth consecutive month of expansion. On a year-over-year basis, industrial output retreated by 10.0% in July and 7.2% in August, with respective falls of 7.0% and 10.3% in manufacturing and mining industries. The analysis of the behavior of IBGE industrial output series, and its components, suggests that production reached its record low in December-January, and has been followed by gradual recovery. However, industrial activity recovery continues to be influenced by the international outlook, by business and households' expectations, as well as by the developments of domestic financial conditions.

6. Among the use categories, according to data seasonally adjusted by the IBGE, similarly to the observed in July, it bears highlighting the 3.1% increase in August in the durable consumer goods production, strongly influenced by the automotive sector. Regarding the other use categories, intermediate goods production increased 0.7%, non-durable and semi-durable consumer goods production increased 0.6%, while the production of capital goods increased by 0.4%. The recovery, at the margin, in the dynamism of industrial production, led by production of durable goods, reflects, to a great extension, tax exemption measures and also some easing in credit conditions. The future behavior of industrial production recovery, which should not be uniform over time, will depend on these factors, as well as on the evolution of consumer and businessmen confidence, counterbalancing the still emerging recovery of external demand.

7. Labor market has behaved more favorably, with resilient aspects prevailing over signs of loss of strength. The unemployment rate in the six metropolitan regions covered by the IBGE Monthly Labor Survey (PME) changed from 8.0% in July to 8.1% in August (7.6% in August 2008). According to the seasonally adjusted series, the unemployment rate remained unchanged at 8.0%, the same level reached in June and July. Average real earnings increased by 2.2% in August, in year-over-year terms. Employment, on its turn, expanded by 0.9% in August, according to the same comparison basis. As a consequence, real payroll reached 3.2% in August, continuing to constitute a key driver for domestic demand growth. Still regarding the labor market, data from the Ministry of Labor and Employment (MTE) indicate that the generation of formal employment has continued to record significant recovery. In September, 252.6 thousand jobs were created (compared to the positive result of 242.1 thousand in August), representing the second best result for the series in the month. The manufacturing industry showed positive balance of 123.3 thousand jobs, the sixth consecutive month of expansion and the best result of the series for the month. Similarly, the commerce sector continued the recovery trajectory initiated in April, with the positive result of 50.3 thousand jobs. Also, the civil construction sector, the most dynamic one with a 5.9% cumulative growth in 2009, and the services sector continued hiring workers this month: 32.7 and 62.8 thousand jobs, respectively. The agricultural and livestock sector, on its turn, lost 17.1 thousand jobs.

8. According to data seasonally adjusted by the IBGE, expanded retail sales increased by 3.3% in August, after retraction of 5.7% in July. On a year-over-year basis, the indicator increased by 5.5%, growing by 3.7% in the year. The three-month moving average of expanded retail sales reached 1.3% in August, according to seasonally adjusted data, after recording 1.7% in July. On a month-on-month basis, according to seasonally adjusted data, it bears emphasizing the expansion in the sales of "vehicles, motorcycles, parts and pieces" (2.5%) and "hyper-, supermarket, food products, beverages and tobacco" (1.4%). The negative key drivers were "office material and equipment" (-4.9%) and "fabric, clothes and shoes" (-2.0%). In the year, cumulative growth was more significant in "office, information technology and communications material and equipment" (13.3%) and "pharmaceutical and medical products" (12.5%). After consecutive falls in the last months of 2008, expanded retail sales data have evidenced recovery, mainly influenced by the increase in the sales of vehicles, in response to sector incentives granted by the government and to the improvement in the access to vehicle credit supply. For the next quarters, the retail sales trajectory will continue to be sustained by fiscal transfers, as well as by real payroll growth, whose evolution should be favored by the reduction of inflation, but it will also be affected by the recovery in the access to credit supply, influenced by the lagged effects of monetary policy and by the evolution of consumer confidence.

9. The installed capacity utilization rate (Nuci) in the manufacturing industry reached 79.9% in August, below the level observed in July, according to CNI data seasonally adjusted by the BCB, but 1.91 p.p. above the record low reached in January. The series seasonally adjusted by CNI changed from 79.9%, in July, to 80.1%, in August. Considering the monthly series without seasonal adjustment, in August the Nuci was 2.6 p.p. below the level registered in the same month of 2008. On its turn, the monthly Nuci without seasonal adjustment, calculated by Fundação Getúlio Vargas (FGV), increased in September to

82.8%, up from 81.6% in August, 3.5 p.p. below the level observed in the same month of 2008. The reduction in the Nuci according to the year-over-year comparison is also observed in the production of consumer goods (-2.9 p.p.), intermediate goods (-2.7 p.p.), capital goods (-11.1 p.p.) and construction inputs (-1.4 p.p.). The same indicator, seasonally adjusted by FGV, changed from 81.3% in August to 81.9% in September, increasing 4.30 p.p. relative to the record low observed in February, and is close to the average of the series. The reduction on the Nuci calculated by CNI and FGV, according to the same comparison basis, results from a combination between the maturity of investment projects and accommodation of economic activity, and points to some idle capacity in the manufacturing industry. Data regarding the absorption of capital goods show retraction compared to the same periods of 2008 and expansion at the margin. The absorption of capital goods data indicate stability in August (after a 7.9% increase in July), a 3% increase in the quarter ended in August, compared to the quarter ended in May, according to seasonally adjusted data, and a decrease of 20.9% in year-over-year terms, according to observed data. On its turn, the production of construction inputs increased by 0.8% at the margin in August (2.8% increase in the quarter), after a 2.1% decrease in July, accumulating a 9.6% fall in the year. In short, evidences suggest that demand pressures over the productive capacity level of the manufacturing industry are contained, although the utilization rates have increased in the last months. As stressed in previous Copom Minutes, the inflation trajectory is closely linked to current and prospective developments related to the expansion of supply of goods and services to adequately meet demand conditions.

10. The twelve-month cumulative trade balance reduced at the margin. According to the same comparison basis, the trade surplus reached US$28.0 billion in August, decreasing to US$26.5 billion in September. This total resulted from US$ 158.9 billion in exports and US$132.3 billion in imports, equivalent to -18.5% and -20.3% changes, respectively, year-over-year. The greater resilience of domestic demand relative to the external demand contributes to the recent narrowing of trade surplus. The reduction in remittances of profits and dividends, on its turn, has contributed to limit the twelve-month trailing current account deficit, which reached US$28.2 billion in December 2008, decreasing to US$17.6 billion in August, equivalent to 1.3% of GDP. On its turn, foreign direct investment reached US$36.3 billion in the twelve months through August, equivalent to 2.8% of GDP.

11. The period since the last Copom meeting was marked by the continuity of stress reduction in international financial markets, despite not in a monotonic way. The unprecedented actions taken by the authorities in mature economies, using a wide range of instruments, in order to ensure minimum conditions of operation and liquidity in monetary markets, have continued to moderate the perception of systemic risk. In this environment, the signs of reduction in risk aversion continue, as evidenced by the behavior of international equity markets, although this process remains subject to reversals. Anyway, the improved trend of risk aversion and of the scarcity of capital flows, as well as some concern among investors about the fiscal situation in the US, continued to encourage the recovery of currencies, both from emerging and mature economies, against the US dollar.

12. Regarding the global macroeconomic scenario, contraction trends prevail over inflationary pressures, but recovery of economic activity seems to have been consolidating. The current predominant view points to the contraction of global economic activity in 2009, followed by recovery in 2010. The consensual projections point to a retraction of activity in the US, Europe and Japan (G3), which wouldn't be totally offset by the economic dynamism of some emerging economies, especially in Asia. However, there are evidences of gradual recovery in the economic activity, but still subject to reversals, particularly due to the weakness in the labor market and economic activity in G3. On the other hand, the risk that the problems in the international financial system become aggravated by the cyclical deterioration in the quality of credit – which could contain the distension in financial conditions and, as a consequence, hinder the consolidation of economic recovery – still persists, but it seems to be reducing. Therefore, the prospect of deflation in mature economies has retreated, despite the persistence, on a twelve-month trailing

basis, of the disinflation process in several emerging economies. In this context, after a period of aggressive monetary policy easing, in a significant number of countries, monetary policy seems to have begun a phase of stability and, in some cases, started a period of reversing the stimulus introduced during the sharpest international contraction period, whereas the increase in public sector debt imposes limits on the scope of any additional fiscal stimuli.

13. Oil prices, including future markets quotations, have increased significantly since the last Copom meeting. Uncertainty concerning these quotations remains high, as the prospective scenario depends on the evolution of demand, in the context of global economic recovery, on the prospects for the evolution of global supply, subject to the pace of investments maturation in the sector, in addition to the geopolitical issues that affect the price of this commodity. Nonetheless, despite the high uncertainty inherent to the projections regarding the trajectory of oil prices, the main scenario adopted by the Copom assumes unchanged gasoline prices in the rest of 2009. However, it bears highlighting that, regardless the behavior of domestic gasoline prices, the evolution of international oil prices can affect domestic prices through productive chains, such as the petrochemical, as well as through the potential effect over inflation expectations. It bears emphasizing that the behavior of agricultural commodity prices, which have particularly important impact in the evolution of food costs, such as wheat, soybeans and corn, had heterogeneous behavior since the last Copom meeting, while quotations of metallic industrial commodities, such as aluminum, copper, and nickel, showed relative stability.

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 September Copom meeting, the projected adjustments for gasoline prices for 2009 were kept unchanged at 0%, while the projection for bottled gas prices rose from 6.9% to 11.2% in the same period;

b) regarding the projected adjustment for fixed telephone and electricity prices for 2009, the first one reduced to 0.3% from 1.1%, percentage considered in the September meeting, while the second reduced from 5.4% to 4.8%;

c) the projection for regulated prices inflation for 2009, based on individual items, was kept unchanged at 4.5%. This set of prices, according to data released by the IBGE, corresponded to 29.56% of the total September IPCA;

d) the projection for regulated prices inflation for 2010 was reduced to 4.0% from 4.3% considered in the September 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;

e) the projection for the spreads over the Selic rate, based on the 360-day swap rates, on the benchmark scenario, estimates a 94bps spread in the fourth quarter of 2009 and a 47 bps spread in the last quarter of 2010.

15. Regarding fiscal policy, projections assume the achievement of a public sector primary surplus target of 2.5% of GDP in 2009 and 3.3% in 2010, unchanged relative to the September meeting. Those figures do not take into account Petrobras contribution to the public sector primary surplus and are adjusted by the possibility of reduction by up to 0.50 p.p. in 2009 due to the implementation of the Investment Pilot Program (PPI), and in up to 0.65 p.p. in 2010, due to the PPI implementation and the Growth Acceleration Program (PAC). The additional assumptions considered in the previous meeting remained unchanged.

16. Since the last Copom meeting, the median of the expectations compiled by the BCB's Investor Relations Group (Gerin) for the 2009 IPCA remained relatively stable (4.30% in comparison to 4.29% at the September meeting). For 2010, the median of inflation expectations increased to 4.41%, up from 4.30%.

17. Considering the hypotheses under the benchmark scenario – which assumes the maintenance of the exchange rate at R$/US$ 1.70 and the Selic rate at

8.75% p.a. during the forecast period – the projection for 2009 inflation slightly increased relative to the figure considered at the September Copom meeting, but remained below the 4.5% target established by the National Monetary Council (CMN). According to the market scenario – which incorporates the consensus exchange and Selic rates trajectories collected by Gerin on the eve of the Copom meeting – IPCA inflation forecast for 2009 remained stable and, therefore, below the inflation midpoint target. For 2010, under the benchmark scenario, the projection remained stable relative to the figure considered in the September meeting and, therefore, is close to the midpoint target, whereas the projection under the market scenario increased, although remaining close to 4.5%.

Monetary policy decision

18. The Copom evaluates that the monetary policy should contribute to the consolidation of a favorable long-term macroeconomic environment. The risk aversion and the liquidity conditions prevailing in international markets continue to show a normalization trend at the margin. In fact, since the last Copom meeting, signs of global risk aversion reduction have continued to accumulate, despite still subject to reversion, with impacts over both Brazilian asset prices, as well as over selected commodities, which had also been influencing domestic financial conditions. However, it bears emphasizing that the trajectory of price indices still evidences reduction of external inflationary pressures. Consequently, the impact of the international scenario over the domestic inflation path continues to be, until present, predominantly benign. On its turn, the possible consolidation of the world economy recovery, which, to a certain extent, has been reproducing the disequilibrium observed in the period prior to the 2008 crisis, might impact, although in a heterogeneous fashion, the global inflationary dynamics. On the top of this, it should be added the uncertainty generated by the effects of the unprecedented liquidity expansion on mature economies, over the price behavior of both assets and commodities. The Copom emphasizes that the main challenge of monetary policy in such context is to ensure that the favorable results obtained over the last years are preserved.

19. The Copom evaluates that the probability that initially localized pressures impose risks to the inflationary trajectory remains limited. The moderation of domestic demand pressures over the market of factors, at least in the short run, should contribute to contain the risk of pass-through of possible upward pressures over consumer prices stemming from wholesale prices. The Committee understands that the materialization of such pass-through, as well as the generalization of pressures, initially localized over the consumer prices, still depends critically on economic agents' inflation expectations. Incidentally, inflation expectations for 2010 and 2011 remain in line with the targets path and continue to be closely monitored. Additionally, it is worth noticing that the domestic demand behavior tends to exert less pressure over non-tradable items, such as services, over the upcoming quarters. Nonetheless, the Committee reaffirms that it will conduct its actions in order to ensure that the gains on inflation control obtained in recent years become permanent.

20. The Copom emphasizes, once more, that there are important time lags between the implementation of monetary policy and its effects on both economic activity and inflation. Therefore, the assessment of alternative options for monetary policy should necessarily focus on the forward-looking inflation scenario and its risks, instead of current inflation figures. Such considerations become even more relevant in periods surrounded by heightened uncertainty. The Committee reaffirms that specific asset price movements are only relevant for monetary policy if they impact the forward-looking inflationary path.

21. Prospects for the evolution of domestic economic activity have continued to improve since the last Copom meeting, although industrial data remain reflecting the relative accommodation of external demand. In light of the international crisis effects over domestic financial conditions, credit contribution for the support of domestic demand diminished, but signs of recovery continue to accumulate, in particular regarding loans to individuals. The severity of the international crisis negatively impacted consumers and businessmen confidence, but also in this case there are consistent signs of recovery. Under such circumstances, the rhythm of economic activity

resumption strongly depends on real payroll expansion, on the effects of fiscal stimulus measures and on incremental governmental transfers, which will occur in the upcoming months. It should also benefit from the easing of financial conditions. In short, the most recent data on domestic economic activity seem to reinforce the evaluation mentioned in previous Copom meetings minutes that the contractionist effects of the international financial crisis over the domestic economy dynamism and, consequently, over the context on which the monetary policy operates, could become persistent, but would not be permanent. These considerations become even more relevant considering the fact that the current monetary policy decision will have concentrated impacts in 2010.

22. The Copom understands that the loss of domestic demand dynamism that occurred at the end of 2008 caused an increase in the idleness margin of production factors utilization, resulting in reduction of inflationary pressures. On the other hand, the risks to the consolidation of a benign inflationary scenario derive, on the short term, from price adjustment mechanisms that contribute to lengthen inflationary pressures observed in the past, as evidenced by the behavior of services prices and certain regulated items since the beginning of 2009, as well as from a possible hike in commodities prices. On the medium term, the risk stems from cumulative and lagged effects of the financial conditions easing and from the fiscal stimulus over the evolution of domestic demand, taking into account the dynamics of consumption and investment, in a context of recovery of production factors utilization. The balance of such influences over the inflationary prospective trajectory 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 lead to the increase of risk premium, for both private and public funding, to the shortening of planning horizons and, consequently, to lower potential economic growth, besides having regressive effects over income distribution. Therefore, the Copom strategy aims to ensure that inflation remains in a level consistent with the target path in 2009, 2010 and 2011. 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 the uncertainty inherent to the process of monetary policy formulation and implementation.

24. The Copom evaluates that, in light of the idleness margin of the economy, and the behavior of inflation expectations for relevant horizons, the materialization of a benign inflation scenario, in which the IPCA would continue to evolve according to the target path, has remained favorable. By the way, such evolution of the forward-looking scenario continues to be reflected on the inflation projections considered by the Committee. Under such circumstances, in order to preserve the improvement of the prospective inflationary path, under a macroeconomic scenario with significant uncertainty, the Copom evaluates that monetary policy should maintain a cautious stance, aiming to assure the maintenance of inflation convergence to the targets path.

25. The Committee understands that the accommodation of demand, motivated by the tightening of financial conditions and by deterioration of the agents' confidence, as well as by the global economic activity contraction, could have been overcome, although significant idleness margin of production factors still persists, which should not be rapidly eliminated in a basic scenario of gradual recovery of economic activity. The Copom also highlights that there are uncertainties around such basic scenario, which should be clarified over the upcoming months, with both positive and negative biases over the pace of economic activity recovery. Anyhow, under such scenario of gradual recovery, which has been corroborated by current available data, inflationary pressures should remain restrained. On the other hand, the Committee notices that the significant monetary policy easing, implemented between January and July, will have cumulative effects over the economy, which will be evidenced with a time lag.

26. The Committee understands that decisions regarding the evolution of the basic interest rate have to take into account the magnitude of the total adjustment carried out between January and July, whose impacts on several economic indicators will be evident over time, in a context of gradual

recovery of production factors utilization. The Copom also understands that a more cautious stance will contribute to mitigate the risk of abrupt reversals of monetary policy in the future and, therefore, to the consistent recovery of the economy over the upcoming quarters. The Copom also evaluates that the preservation of benign inflationary prospects will require the behavior of the financial system and the economy under a new level of interest rates to be closely monitored over time.

27. Under such context, in light of the inflation prospects for the targets path, the Copom has unanimously decided to maintain the Selic rate at 8.75% p.a. without bias. Taking into account, on the one hand, the monetary policy easing implemented since January and, on the other hand, the idleness margin of production factors, among other factors, the Committee evaluates that such level of basic interest rate is consistent with a benign inflationary scenario, contributing to assure the maintenance of inflation in line with the targets path over the relevant horizon for the non-inflationary recovery of economic activity.

28. Under the inflation targeting regime, the Copom guides the decisions according to projected inflation, the analysis of several alternative scenarios for the evolution of the main variables that determine the forward-looking dynamics for prices, and the balance of risks associated to the projections. After a short period of contraction, domestic demand started to show signs of recovery, due to the stimulus factors effects, such as income growth. Additionally, it bears noticing that, evidencing the credibility achieved by the Copom on the implementation of the regime, inflation expectations for 2010 and 2011 remain in line with the targets path. It is also noteworthy that global economic deceleration has generated downward pressures over wholesale industrial prices. On its turn, important monetary and fiscal stimuli were introduced into the economy over the last quarters and should contribute to the activity recovery and, consequently, to the reduction of the idleness margin of production factors. Those stimuli effects should be closely monitored over time and are important in the context where future monetary policy decisions, which should ensure the materialization of the convergence to targets path over relevant horizons, will be taken.

29. At the end of the meeting it was announced that the Committee will reconvene on December 8th, 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

30. IPCA inflation reached 0.24% in September, up from 0.15% in August, totaling a 3.21% increase in the nine first months of 2009 and a 4.34% increase in the last twelve months. The housing group increased 0.62% in September relative to 0.47% in August, and was the key driver over the September IPCA result (0.08 p.p.).

31. Market prices increased from 0.15% in August to 0.18% in September, with increases of 0.01% on tradable items and 0.35% on non-tradable items, while regulated prices increased 0.37% in September, up from 0.16% in August. On a twelve-month trailing basis, market prices and regulated prices increased 4.45% and 4.08%, respectively, in comparison to 4.57% and 3.88% in the previous month. The diffusion index reached 54.17%, 1.57 p.p. above the August figure.

32. All the core IPCA measures increased in September, but decelerated on a twelve-month trailing basis. The core excluding household food items and regulated prices increased from 0.29% in August to 0.35% in September; the smoothed trimmed means core reached 0.39%, up from 0.25% over the previous month; the non-smoothed trimmed means core reached 0.31%, up from 0.18%, in the same periods. In the last twelve months through September, the smoothed and non-smoothed trimmed core measures reached 4.3% and 3.54%, respectively, in comparison to 4.37% and 3.65%, respectively, in August, while the core by exclusion recorded 5.04% and 5.32%, according to the same comparison basis.

33. The IGP-DI accelerated to 0.25% in September, up from 0.09% in August, reflecting primarily the IPA increase, which reached 0.29% in September, up from 0.07% in August. The IPC-Br decreased, from

0.20% in August to 0.18% in September, and the INCC increased 0.15% in September, after a 0.05% fall in the previous month. The IGP-DI decreased 1.35% in 2009 and 0.65% on a twelve-month basis. The IPA acceleration was motivated exclusively by the 0.63% increase in the prices of industrial products in September, up from 0.1% in August, while crop and livestock product prices contracted 0.76% in September, after increasing by 0.01% in the previous month. The IPA reached -3.69% and -3.4%, respectively in the year through September and on a twelve-month basis, respectively; in the same periods, the IPC-Br reached 3.41% and 5.02%, and the INCC reached 2.78% and 4.27%, respectively.

34. The IGP-10 reached 0.10% in October, down from 0.25% in September, reflecting decelerations in both IPA (0.09% in October, down from 0.46% in September) and the IPC-Br (0.11% in October, down from 0.24% in September). The INCC increased 0.20%, after a 0.11% fall in the previous month. The IGP-10 accumulated falls of 1.68% in 2009 and 0.94% on a twelve month trailing basis. The IPA deceleration reflected the 1.18% fall on crop and livestock products, down from a 0.52% increase in September, totaling -2.86% in 2009 and -3.88% in the last twelve months, while the prices of wholesale industrial products increased 0.50% in October, relative to 0.43% in the previous month, totaling declines of 4.73% in 2009 and 3.60% in the last twelve months. The IPA reached -4.20% in 2009 and -3.64% in the last twelve months; according to the same comparison basis, the IPC-Br reached 3.79% and 4.95%, and the INCC reached 2.92% and 4.03%, respectively.

Economic activity

35. According to data seasonally adjusted by the IBGE's monthly survey (PMC), expanded retail sales increased 3.3% in August, month-on-month, after a 5.7% fall in July and increases of 6.8% and 4.6% in June and May, respectively. As a consequence, the average change of the quarter ended in August reached 5.9%, relative to the quarter ended in May. Year-over-year, expanded retail sales increased by 5.5%, while growth reached a 3.7% increase in the eight first months of the year. The month-on-month result revealed that sales increased in five out of ten segments surveyed, with highlights for the increase in "vehicles and motorcycles, parts and pieces" (2.5%); and "hyper-, supermarkets, food products, beverages and tobacco" (1.4%). Among the negative drivers, it bears highlighting "office and information technology and communications material and equipment", which retreated by 4.9%.

36. Year-over-year, it bears highlighting the expansions in pharmaceutical and perfumery items (14.9%), and books, newspapers, magazines and stationary (11.1%), in August. Among the negative drivers, it bears noticing the 6.9% decrease in construction inputs. In the year through August, seven out of the ten segments surveyed increased, and it bears emphasizing office material and equipment (13.3%); pharmaceutical, medical, orthopedic, perfumery and cosmetic items (12.5%); books, newspapers, magazines and stationary (9.2%); as well as other personal and domestic items (9%). As negative drivers, according to the same comparison basis, construction inputs presented the sharpest decrease, with a 9.8% fall.

37. São Paulo Trade Association (ACSP) data, related to the city of São Paulo, indicated a 5.8% increase in database consultations for credit sales (SCPC) and a 1.9% fall in consultations to the Usecheque system on a month-on-month, seasonally adjusted basis. In 2009, those indicators decreased 12.8% and 0.6%, respectively, in comparison to the same period of the previous year, and decreased 9.2% and 0.1%, respectively, on a twelve-month basis.

38. Automobile sales by dealers, which take into account automobiles, light commercial vehicles, trucks and buses, increased 24.1% in September, month-on-month, seasonally adjusted by the BCB, according to Fenabrave (Brazilian Federation of Vehicles Distribution). Such increase reflected expectations regarding the progressive suspension of the IPI (tax on industrialized products) reduction, as of October. Total sales increased 14.9% year-over-year, with highlights for automobiles, which increased 19.8%, while buses and trucks decreased 21.2% and 16.3%, respectively. In the year through September, vehicles sales increased 4.2% year-over-year, as a result of the expansion on automobiles (5.8%) and light commercial vehicles (4%), as well as of the decline of trucks sales (20.3%) and buses sales (16.6%).

39. Capital goods imports increased 2.7% in September, month-on-month, according to the Funcex quantum indices, seasonally adjusted by the BCB. The September indicator decreased 19% year-over-year, reaching a 14.1% decline in the year through September, year-over-year. Capital goods exports increased 3.1% in September, month-on-month, and decreased 39.0% and 40.1% year-over-year and in the year through September, respectively.

40. Capital goods production increased 0.4% in August, month-on-month seasonally adjusted, but showed decreases of 22.3% year-over-year and of 23.0% in the year through August, according to IBGE. The monthly result showed greater expansion in the production of capital goods directed to the electric energy sector (11.4%), while the worst performance was registered for agricultural capital goods, which dropped 9.1%. The production of inputs for civil construction increased 0.8%, according to the same comparison basis, and declined 10% in the first eight months of the year.

41. The disbursements of BNDES increased 53.2% in the last twelve months through August, year-over-year. Industry was the most benefited sector, with expansion of 108.7%, according to the same comparison basis.

42. General industrial physical production increased 1.2% in August, month-on-month seasonally adjusted, according to IBGE's Monthly Industrial Survey – Physical Production (PIM-PF). In the year and also on a twelve-month basis, the sector contracted by 12.1% and 8.9%, respectively. Among the four use categories, it bears highlighting the performance of durable consumer goods production, with a 3.1% increase, while capital goods production presented the mildest increase (0.4%). Mining production increased 0.9% in the period, after a 0.4% decrease in July, reaching falls of 12.8% in 2009 and of 9.4% in the last twelve months.

43. CNI indicators signaled a more moderate recovery of industrial activity than that signaled by the IBGE data, having only employment, among the surveyed variables, increased in August, month-on-month (0.6%), the first increase since September 2008. Manufacturing industry real revenues remained stable in the period, while hours worked in production declined 0.5%. In August, the Nuci increased 0.2 p.p. relative to July, corresponding to 80.1%, according to the seasonally adjusted series. Among the nineteen activities in the manufacturing industry, five showed increase in Nuci in August 2009, year-over-year.

44. Vehicles production reached 275.3 thousand units in September, according to Anfavea, which was 8.4% below that recorded in September 2008. According to seasonally adjusted data, vehicles production decreased 1.5% month-on-month. In the year through September the production of vehicles and agricultural machinery declined 11.6% and 27.8%, respectively, while in the last twelve months through September the same indicators declined 14.7% and 16.4%, respectively, year-over-year. Domestic sales of vehicles increased 13.9% in September and declined 1% in the first nine months of 2009, year-over-year, while exports decreased by 30.6% and 42.8%, respectively.

Surveys and expectations

45. According to the Fecomercio-SP survey, the Consumer Confidence Index (ICC) increased 5.6% in October, month-on-month. This result reflected mainly an expansion of 7% in the Consumer Expectations Index (IEC), while the Current Economic Conditions Index (Icea) increased by 3.3%. Year-over-year, the ICC increased 11%.

46. According to the Consumer Expectations Survey carried out by the FGV nationwide, the ICC remained stable in September, month-on-month seasonally adjusted. In September, the Current Situation Index (ISA) increased 0.4%, and the Expectations Index (IE) decreased 0.3%. The ICC decreased 1.1% year-over-year, reflecting the fall of 3.2% in the ISA and the expansion of 0.2% in the IE.

47. In relation to the expectations for the manufacturing industry, the FGV Manufacturing Industry Survey showed, in September, an increase of 3.8 p.p. in the Industry Confidence Index (ICI) seasonally adjusted. Year-over-year, the indicator decreased 5.5 p.p. in the observed series. Among components, according to the month-on-month seasonally adjusted series, there were increases of 2.1 p.p. for the Current Situation Index (ISA) and 5.4% for the IE, and retreats of

9.3 p.p. and 1.8 p.p., respectively, year-over-year, according to the observed series.

Labor market

48. According to the General Record of Employment and Unemployment (Caged) of the Ministry of Labor and Employment (MTE), 252.6 thousand formal jobs were created in September (the second best result of the series for the month). In the year through September and on a twelve-month basis, respectively, 932.7 thousand and 298.3 thousand new jobs were created. The main economic activities expanded in September, with highlights for the manufacturing industry, with 123.3 thousand hires, reaching the best result of the series for the month. Seasonally adjusted data showed a 0.3% increase in employment in September, month-on-month, with highlights, once again, for the increase in the construction sector (0.7%). According to the average of the year, the level of employment increased 2%, reflecting increases of 5.9% in the construction sector, 4% in the services sector and 3.9% in the retail sector, whereas the manufacturing industry declined by 2.5%.

49. According to the IBGE employment survey (PME), carried out in the six main metropolitan regions of the country, the unemployment rate reached 8.1% in August 2009, showing relative stability month-on-month (8% in the previous month) and a 0.5 p.p. increase year-over-year. The stability in the unemployment rate is a result of increases of 112 thousand jobs (0.5%) and 148 thousand people (0.6%) in the economically active population (PEA). The same survey pointed out that average real earnings of employed workers grew for the second consecutive month (0.9%, relative to July), growing by 3.8% in the year through August. Real payroll increased 1.5% month-on-month and 4.6% in the year through August.

Credit and delinquency rates

50. Outstanding credit in the financial system reached R$1,327 billion in August, equivalent to 45.2% of GDP, with increase of 1.5% in the month and 19.5% on a twelve-month trailing basis. Non-earmarked credit operations increased 1.1% in the month and 13.9% in the last twelve months. Among the non-earmarked operations, which represent a share of 68.5% in the total of the financial system, credit operations to individuals increased 1.4% in the month and 18.4% in the last twelve months, while non-earmarked credit operations to corporate increased 0.7% and 9.8%, according to the same comparison bases. Earmarked credit operations increased 2.5% in the month and 33.9% on a twelve-month trailing basis.

51. The average interest rate on non-earmarked credit operations, used as reference for interest rates, declined for the ninth consecutive month in August, reaching 35.4%, the lowest level since December 2007. The average annual rate on credit for individuals decreased 13.8 p.p. relative to December, reaching 44.1%. The average rate on corporate credit decreased by 4.3 p.p. relative to December, reaching 26.4%.

52. The average tenure on non-earmarked credit operations, used as reference for interest rates, decreased in August, reaching 367 days. The average tenure of corporate credit operations reached 264 days, while the average tenure for credit operations to individuals totaled 498 days.

53. Delinquency rates in the financial system (non-earmarked loans used as reference for interest rates, in arrears for more than ninety days) remained stable in 5.9% after increasing for eight consecutive months. Delinquency rates for credit operations with corporate increased 0.1 p.p., reaching 3.9%, and with individuals, declined 0.1 p.p., reaching 8.4%.

54. Net delinquency rate for retail credit, measured by the ACSP, reached 6.5% in September, compared to 6.7% in August, 7.4% in July and 5.9% in the same month of 2008, representing a record low in 2009.

External environment

55. The stabilization of financial markets and the inventories adjustments, whose trajectory has been suiting final demand, were crucial factors for the recovery of global economic activity. Preliminary data suggest that economic recovery, already observed in Japan and in some emerging economies, has spread to other countries, with highlights to the USA and the Euro Area. Recent projections from the International Monetary Fund (IMF) indicate a -1.1% change in global economic activity in 2009, up from the -1.4% July

estimate. For 2010, the IMF projects global growth at 3.1 %, up from 2.5% in the previous estimate.

56. Signs of industrial production recovery in the developed countries strengthened, although they have slowed in the last months in Japan. Data through August show that the USA, the Euro Area and Japan recorded two, four and six consecutive months of positive monthly changes, respectively. Since May, China has recorded increasing growth rates on an annual basis.

57. The twelve-month consumer price indices through September recorded deflation in the USA (-1.3%) and in the Euro Area (-0.3%). With data up through August, Japan recorded a -2.2% deflation. The persistence of low rates of installed capacity occupation, added up to the stability of inflationary expectations in the medium-term, should continue to contribute inflation does not become a problem in the short- and medium-term in G3.

58. The financial market continues to recover, with key indicators pointing to increasing preference for risk. The stocks exchanges of the major mature and emerging economies kept an upward trend, and among these last ones, except for China, are close to the record highs observed in the pre-crisis period.

59. Considering this scenario, the central banks of the main mature economies, except for Australia (RBA), which resumed the increase in its basic interest rate, maintained the accommodative stance of their monetary policy, having the United Kingdom extended its programs of financial system aid. Among emerging economies, the central bank of Russia deepened the cuts in its basic interest rate, reducing it by 25 basis points in two opportunities during September, setting the rate at 10% p.a.

Foreign trade and international reserves

60. The Brazilian trade surplus reached US$1.3 billion in September, totaling US$21.3 billion in the first nine months of the year, increasing by 9.2%, year-over-year, on a daily average basis. In the month, exports reached US$13.9 billion, and imports, US$12.5 billions, decreasing by 27.4% and 23.9%, respectively, year-over-year, on a daily average basis. Total external trade reached US$26.4 billion in September, decreasing by 25.8%, year-over-year, on a daily average basis. In the year through September, total external trade reached US$202.3 billion, 27.5% below that registered last year, according to the same comparison basis.

61. Based on the liquidity concept, international reserves, which encompass the repurchase lines and borrowing operations in foreign currencies, reached US$224.2 billion in September, recording a US$5.2 billion increase in the month. Under the cash concept, international reserves totaled US$221.6 billion, recording a US$5.9 billion increase, according to the same comparison basis. It bears highlighting, in the month, a US$0.4 billion new receivable of the Special Drawing Rights (SDR), a special allocation of the International Monetary Fund (IMF), totaling US$4 billion in the August-September period.

Money market and open market operations

62. Since the September Copom meeting, the yield curve slope increased for all maturities, especially for the intermediary. Domestically, the release of improved data for the labor market, the increase of GDP growth projections, concerns with a possible reduction in the fiscal restriction and the expectation of a tax creation over foreign capital inflows contributed to this movement. In the international scenario, the improvement of some US economic indicators and the decision of the Central Bank of Australia to increase its basic interest rate, being the first monetary authority to take this decision since the beginning of the crisis, have also influenced the upward movement of the yield curve. Between August 31 and October 19, one- three- and six-month rates increased by 0.04 bps, 0.08 bps and 0.22 bps, respectively, whereas one- two- and three-year rates increased by 0.84 bps, 0.88 bps and 0.67 bps, respectively. Real interest rates, measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month-ahead inflation expectations, increased from 4.91% on August 31 to 5.48% on October 19.

63. In its open market operations, the BCB carried out, between September 1 and October 19, long fixed rate repo operations, borrowing R$23.2 billion for a six-month period. The average daily balance of the five-, six- and seven-month operations reached

R$68.7 billion, of which R$63.1 billion were six-month operations. In the same period, the BCB conducted borrowing operations with tenures of 33 working days on September 3; of 31 working days on September 8; of 27 working days on September 14; of 22 working days on September 21; of 17 working days on September 28 and 12 working days on October 5. These operations drained from the market R$251.9 billion, R$16.3 billion, R$11.2 billion, R$17.8 billion, R$1.1 billion and R$5.4 billion, respectively. The average daily balance of these short-run borrowing operations reached R$290.3 billion.The BCB also borrowed money through 34 overnight repo operations and 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$88.7 billion, on a daily basis, borrowing. The average daily balance of these short-run borrowing operations reached R$447.7 billion between September 1 and October 19, up from R$412.5 billion between July 21 and August 31. The main determinant factors of the liquidity increase in the period were the FX market interventions and the net redemption of securities by the National Treasury, during this period.

64. Between September 1 and October 19, the National Treasury issuance regarding the traditional auctions raised a total of R$25.8 billion. The issuance of fixed-rate securities reached R$22.0 billion, being R$15.2 billion via issuance of LTNs maturing in 2010 and 2011, and R$6.8 billion via NTN-Fs maturing in 2013 and 2017. Issuance of LFTs totaled R$1.7 billion, for securities maturing in 2013 and 2015. Issuance of inflation-linked NTN-Bs reached R$2.1 billion, for securities maturing in 2011, 2014, 2020, 2024, 2035 and 2045.

Minutes of the 147th Meeting of the Monetary Policy Committee (Copom)

Date: December 8th, from 5:45PM to 7:50PM, and December 9th, from 5:00PM to 7:40PM
Place: BCB Headquarters meeting rooms – 8th floor on December 8th and 20th floor on December 9th – Brasília – DF

In attendance:
Members of the Committee
Henrique de Campos Meirelles – Governor
Aldo Luiz Mendes
Alexandre Antonio Tombini (present only on December 9th)
Alvir Alberto Hoffmann
Anthero de Moraes Meirelles
Antonio Gustavo Matos do Vale
Maria Celina Berardinelli Arraes
Mário Magalhães Carvalho Mesquita

Department Heads (present on December 8th)
Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on December 9th)
João Henrique de Paula Freitas Simão – Open Market Operations Department
José Antonio Marciano – Department of Banking Operations and Payments System
Marcio Barreira de Ayrosa Moreira – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations Group

Other participants (present on December 8th)
Adriana Soares Sales – Advisor to the Board
Alexandre Pundek Rocha – Advisor to the Board
André Minella – Advisor to the Board
Fabio Araujo – Advisor to the Research Department
José de Ribamar Oliveira Júnior – Press Secretary

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

Recent economic developments

1. IPCA inflation increased to 0.41% in November up from 0.28% in October. As a consequence, in the

year through November inflation reached 3.93%, decreasing 1.68 p.p. relative to the same period of the previous year. In the last twelve months, inflation increased to 4.22% in November up from 4.17% in October (5.90% in December 2008 and 6.39% in November 2008), remaining near the target. The deceleration of twelve-month consumer price trailing inflation in the first eleven months of the year mirrored the behavior of market prices, as regulated price inflation increased. Considering market prices, both prices of tradable and non-tradable goods cooled on a twelve-month trailing basis, showed deceleration, reaching 2.64% and 5.45%, respectively, in November, down from 6.99% and 7.10% in December 2008 (7.87% and 7.74% in November 2008). However, according to the same comparison basis, the prices of services, whose dynamics tends to show more persistence than that of the prices of goods, slightly increased to 6.42% in November up from 6.39% in December 2008 (6.48% in November 2008). Preliminary data for December point to consumer inflation below the level observed in November. In short, information available suggest that the inflationary acceleration cycle observed last year has been gradually overcome by a process led by the behavior of market prices, specially goods, while regulated price and services inflation continue to show more persistence.

2. The three main underlying inflation measures calculated by the BCB increased between October and November. The core inflation by exclusion of household food items and regulated prices changed from 0.33% in October to 0.42% in November. Smoothed and non-smoothed trimmed means core inflation measures also accelerated, recording 0.37% and 0.36% in November, up from 0.31% and 0.28% in October, respectively. The twelve-month trailing inflation measures changed from 6.09%, 4.82% and 4.92% in December 2008 to 4.92%, 4.27% and 3.58% in November, for the core inflation by exclusion, smoothed and non-smoothed trimmed means core inflation, respectively. Moreover, it bears emphasizing that the behavior of the IPCA diffusion index reduced to 58.9% in November (compared to 64.6% in November 2008).

3. The General Price Index (IGP-DI) inflation changed from -0.04% in October to 0.07% in November. On a twelve-month trailing basis, the IGP-DI inflation remained at -1.76% in November (11.20%in November 2008). The slowdown of the IGP-DI has basically reflected the behavior of all its three components. Its main component, the Wholesale Price Index (IPA-DI), reached -4.64% in the last twelve months through November (12.88% in November 2008). On its turn, the Consumer Price Index-Brazil (IPC-Br) increased 4.23% through November (6.27% in November 2008) and the Civil Construction National Index (INCC) increased 3.32% (12.34% in November 2008). Regarding the IPA-DI, the inflationary deceleration, under this comparison basis, derives basically from the behavior of both agricultural and industrial prices. The agricultural IPA reached -3.26% (7.38% in November 2008), while wholesale industrial prices reached -5.14% (14.93% in November 2008). As mentioned in previous Copom Minutes, the Copom evaluates that the effects of wholesale prices over consumer price inflation will depend on current and prospective demand conditions and price-setters' expectations for the future inflation path.

4. On a three-month moving average basis, according to data seasonally adjusted by the IBGE, industrial output increased 1.4% in August and accelerated to 1.8% in September and October. Still considering the seasonally adjusted series, industrial output increased by 1.8% in September and 2.2% in October, month-on-month, the tenth consecutive month of expansion. On a year-over-year basis, industrial output retreated by 7.2% in August, 7.6% in September and 3.2% in October. The analysis of the behavior of IBGE industrial output series, and its components, suggests that production reached its trough in December-January, and has been followed by gradual recovery. However, industrial activity recovery continues to be influenced by the international outlook, by business and households' expectations, as well as by the developments of domestic financial conditions, supported by traditional sources of credit, besides the recovery of capital markets and the performance of financial public institutions.

5. Among the use categories, according to data seasonally adjusted by the IBGE, in October, it bears highlighting the durable consumer goods production, strongly influenced by the automotive sector and by

capital goods, both of them with a growth rate of 5.9%. Regarding the other use categories, intermediate goods production increased 1.2%, whilst non-durable and semi-durable consumer goods production increased 1.3%. The recovery, at the margin, in the dynamism of industrial production, led by production of durable goods, although more widespread than before, reflects, to a great extension, tax exemption measures and also some easing in credit conditions. The future behavior of industrial production recovery, which should not be uniform over time, will depend on these factors, as well as on the evolution of consumer and businessmen confidence, counterbalancing the still emerging recovery of external demand.

6. Labor market has behaved more favorably, with resilient aspects prevailing over signs of loss of strength. The unemployment rate in the six metropolitan regions covered by the IBGE Monthly Labor Survey (PME) changed from 8.1% in August to 7.7% in September and to 7.5% in October (also 7.5% in October 2008). According to the seasonally adjusted series, the unemployment rate remained unchanged at 7.8 %, the same level reached in September. Average real earnings increased by 3.2% in October, in year-over-year terms. Employment, on its turn, retreated by 0.3% in October, according to the same comparison basis. As a consequence, real payroll reached 2.9% over October 2008, continuing to constitute a key driver for domestic demand growth. Still regarding the labor market, data from the Ministry of Labor and Employment (MTE) indicate that the generation of formal employment has continued to record significant recovery. In October, 231 thousand jobs were created (252.6 thousand in September), representing the best result in the series for the month. The manufacturing industry showed positive balance of 74.6 thousand jobs, the seventh consecutive month of expansion and the best result of the series for the month. Similarly, the commerce sector continued the recovery trajectory initiated in April, with the positive result of 68.5 thousand jobs, the best result for the month. Also, the civil construction sector, the most dynamic one with a 5.8% cumulative growth in 2009, and the services sector continued hiring workers this month: 26.2 and 69.6 thousand jobs, respectively. Also in the services sector, the creation of jobs in October was the best result for the month in the series. The agricultural and livestock sector, on its turn, lost 11.6 thousand jobs, following the seasonal pattern.

7. According to data seasonally adjusted by the IBGE, expanded retail sales increased by 4.7% in August and 3.0% in September. On a year-over-year basis, the indicator increased by 9.1% in September, growing by 4.4% in the year. The three-month moving average of expanded retail sales reached 0.4% in September, according to seasonally adjusted data, after recording 1.6% in August. On a month-on-month basis, according to seasonally adjusted data, it bears emphasizing the expansion in the sales of "vehicles, motorcycles, parts and pieces" (9.1%) and "office material and equipment" (8.8%). The negative key drivers were "building material" (1.5%) and "pharmaceutical and medical products" (-1.1%). In the year, cumulative growth was more significant in "office material and equipment" (11.9%) and "pharmaceutical and medical products" (11.9%). Since the beginning of the year, expanded retail sales data have evidenced recovery, mainly influenced by the increase in the sales of durable, in response to sector incentives granted by the government and to the improvement in the access to credit supply. For the next quarters, the retail sales trajectory will continue to be sustained by fiscal transfers, as well as by real payroll growth, whose evolution should be favored by the inflation behavior, but it will also be affected by the recovery in the access to credit supply, influenced by the lagged effects of monetary policy and by the evolution of consumer confidence.

8. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by FGV, reached 82.9% in November (82.5% in the previous month and 77.9% at the level observed in February-March), getting closer to the average observed in the last five years. The series seasonally adjusted by CNI changed from 80.6% to 80.8%, between September and October. Considering the monthly series without seasonal adjustment, the FGV calculated Nuci reached 84.5% in November, 0.7 p.p. below the level registered in the same month of 2008. This small reduction in the Nuci in November, according to the year-over-year comparison, is also observed in the production of intermediate goods (1 p.p.), while there is stability in construction inputs (0 p.p.) and an increase of 1.1 p.p. in consumer goods – the expansion more intense of idleness is restricted

to capital goods sector (8 p.p.). The reduction on the Nuci, according to the same comparison basis, results from a combination between the maturity of investment projects and accommodation of economic activity, but more recent data suggest that idle margin has been reducing. Data regarding the absorption of capital goods show retraction compared to the same periods of 2008 and expressive expansion at the margin. The absorption of capital goods data increased 12.6% in October (after a 6.1% increase in September), a 13.8% increase in the quarter ended in October, compared to the quarter ended in July, according to seasonally adjusted data, and a decrease of 6.5% in year-over-year terms, according to observed data. On its turn, the production of construction inputs increased by 0.5% at the margin in October (1.7% increase in the quarter), after a 1% increase in September, accumulating a 9.3% fall in the year. In short, evidences suggest that the utilization rates have been increasing the last months, showing a reduction in the idle margin of the industry, accompanied by the resume of investments. As stressed in previous Copom Minutes, the inflation trajectory is closely linked to current and prospective developments related to the expansion of supply of goods and services to adequately meet demand conditions.

9. The twelve-month cumulative trade balance reduced at the margin, reaching a surplus of US$26.5 billion in October, and decreasing to US$25.5 billion in November. This total resulted from US$152.4 billion in exports and US$126.8 billion in imports, equivalent to -23.2% and -26.3% changes, respectively, year-over-year. The greater dynamism of domestic demand relative to the external demand contributes to the recent narrowing of trade surplus. The reduction in remittances of profits and dividends, on its turn, has contributed to limit the twelve-month trailing current account deficit, which reached US$28.2 billion in December 2008, decreasing to US$18.9 billion in October, equivalent to 1.3% of GDP. On its turn, foreign direct investment reached US$29.5 billion in the twelve months through October, equivalent to 2.1% of GDP.

10. The period since the last Copom meeting was marked by the continuity of stress reduction in international financial markets, despite not in a monotonic way. The unprecedented actions taken by the authorities in mature economies, using a wide range of instruments, have continued to moderate the perception of systemic risk, in an environment of strong liquidity expansion. Under these conditions the signs of reduction in risk aversion continue, as evidenced by the behavior of international equity markets, although this process remains subject to reversals. The trend of reduction of risk aversion and of the scarcity of capital flows, as well as some concern among investors about the fiscal situation in the US, continued to encourage the recovery of currencies, both from emerging and mature economies, against the US dollar, yet in a more modest and heterogeneous terms in relation to the movement observed in previous months.

11. Regarding the global macroeconomic scenario, contraction trends prevail over inflationary pressures in 2009, but recovery of economic activity seems to have been consolidating. The current predominant view points to the contraction of global economic activity in 2009, followed by recovery in 2010. The consensual projections point to a retraction of activity in the US, Europe and Japan (G3), which would not be totally offset by the economic dynamism of some emerging economies, especially in Asia. However, there are evidences of gradual recovery in the economic activity, but still subject to reversals, particularly due to the weakness in the labor market and economic activity in G3. On the other hand, the risks that the problems of the international financial system may be aggravated by the cyclical deterioration of the credit quality, which could contain the distension of financial conditions, and consequently, difficulty the consolidation of recovery, persist, but seem to be slowing. Therefore, the minimal points of inflation in mature economies seem to have been exceeded, despite the persistence, on a twelve-month trailing basis, of the disinflation process in several emerging economies. In this context, after a period of aggressive monetary policy easing, in a significant number of countries, monetary policy seems to have begun a phase of stability, whereas the increase in public sector debt imposes limits on the scope of any additional fiscal stimuli.

12. Oil spot prices have not shown a clear trend since the last Copom meeting. Future markets did not show a consistent trend as well. Uncertainty concerning these quotations remains high, as the prospective

scenario depends on the evolution of demand, in the context of global economic recovery, on the prospects for the evolution of global supply, subject to the pace of investment maturation in the sector, in addition to the geopolitical issues that affect the price of this commodity. Nonetheless, despite the high uncertainty inherent to the projections regarding the trajectory of oil prices, the main scenario adopted by the Copom assumes unchanged domestic gasoline prices in 2010. However, it bears highlighting that, regardless the behavior of domestic gasoline prices, the evolution of international oil prices can affect domestic prices through productive chains, such as the petrochemical, as well as through the potential effect over inflation expectations. It bears emphasizing that the behavior of agricultural commodity prices, which have particularly important impact in the evolution of food costs, such as wheat, soybeans and corn, increased since the last Copom meeting, as well as metallic industrial commodities, such as aluminum and copper.

Assessment of inflation trends

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

a) the projected adjustments for gasoline prices for 2009, increased from 0% in the October meeting, increased to 1.9%, while the projection for bottled gas prices rose from 11.2% to 13.4% in the same period. For 2010, there are no projected changes for gasoline and bottle gas prices;

b) regarding the projected adjustment for fixed telephone and electricity prices for 2009, the former increased to 0.9% from 0.3%, percentage considered in the October meeting, while the latter moved from 4.8% to 5.2%. The projected adjustments for fixed telephone and electricity prices for 2010 are 1.6% and 3.3%, respectively;

c) the projection for regulated prices inflation for 2009, based on individual items, was kept unchanged at 4.5%. For 2010, the projection is kept at 4.0%, as considered in the October meeting. This set of prices, according to data released by the IBGE, corresponded to 29.64% of the total November IPCA;

d) the projection for regulated prices inflation for 2011 is 4.0%. 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, based on the 360-day swap rates, on the benchmark scenario, estimates 99 bps, 37 bps and 35 bps spreads in the fourth quarters of 2009, 2010 and 2011, respectively.

14. Regarding fiscal policy, projections assume the achievement of a public sector primary surplus target of 2.5% of GDP in 2009 and 3.3% in 2010, in both cases adjusted by the possibility of reduction by up to 0.94 p.p. and 0.68 p.p., respectively, due to the implementation of the projects linked to the Growth Acceleration Program (PAC). Moreover, it is considered that the primary surplus in 2011 would return without adjusts to the level of 3.3% of GDP. The additional assumptions considered in the previous meeting remained unchanged.

15. Since the last Copom meeting, the median of the expectations compiled by the BCB's Investor Relations Group (Gerin) for the 2009 IPCA slightly decreased, moving from 4.30% to 4.26%. For 2010, the median of inflation expectations increased to 4.48%, up from 4.41%, whereas it its 4.50% for 2011.

16. The benchmark scenario assumes the maintenance of the exchange rate at R$1.70/US$1.00 and the Selic rate at 8.75% p.a. during the forecast period. In this scenario the projection for 2009 inflation increased relative to the figure considered in the October Copom meeting, and lies around the 4.5% target established by the National Monetary Council (CMN). According to the market scenario – which incorporates the consensus exchange and Selic rates trajectories collected by Gerin on the eve of the Copom meeting – IPCA inflation forecast for 2009 increased as well, standing around the inflation midpoint target. For 2010, under the benchmark scenario, the projection increased relative to the figure considered in the October meeting, but remains close to the midpoint target, whereas the projection under the market scenario remains stable.

Monetary policy decision

17. The Copom evaluates that the monetary policy should contribute to the consolidation of a favorable longer-term macroeconomic environment. The risk aversion and the liquidity conditions prevailing in international markets continue to show a normalization trend at the margin. In fact, since the last Copom meeting, signs of global risk aversion reduction have continued to accumulate, despite still subject to reversion, with impacts over both Brazilian asset prices, as well as over selected commodities, which had also been influencing domestic financial conditions. However, it bears emphasizing that the trajectory of price indices still evidences external inflationary pressures contained. Consequently, the impact of the international scenario over the domestic inflation path continues to be, up to now, predominantly benign. On its turn, the possible consolidation of the world economy recovery might impact, although in a heterogeneous fashion, the global inflationary dynamics. On the top of this, it should be added the uncertainty generated by the effects of the unprecedented liquidity expansion on mature economies, over the price behavior of both assets and commodities. The Copom emphasizes that the main challenge of monetary policy in such context is to ensure that the favorable results obtained over the last years are preserved.

18. The Copom evaluates that the probability that initially localized pressures impose risks to the inflationary trajectory remains limited. The moderation of domestic demand pressures over the market of factors, at least in the short run, should contribute to contain the risk of pass-through of possible upward pressures over consumer prices stemming from wholesale prices (which, incidentally, returned to deflation in recent months). The Committee understands that the materialization of such pass-through, as well as the generalization of pressures, initially localized over the consumer prices, still depends critically on economic agents' inflation expectations. Incidentally, inflation expectations for 2010 and 2011 remain in line with the targets path and continue to be closely monitored. Additionally, it is worth noticing that the domestic demand behavior tends to exert contained pressure over non-tradable items, such as services, over the upcoming quarters. Nonetheless, the Committee reaffirms that it will conduct its actions in order to ensure that the gains on inflation control obtained in recent years become permanent.

19. The Copom emphasizes, once more, that there are important time lags between the implementation of monetary policy and its effects on both economic activity and inflation. Therefore, the assessment of alternative options for monetary policy should necessarily focus on the forward-looking inflation scenario and its risks, instead of current inflation figures. Such considerations become even more relevant in periods surrounded by heightened uncertainty. The Committee reaffirms that specific asset price movements are only relevant for monetary policy if they impact the forward-looking inflationary path.

20. Prospects for the evolution of domestic economic activity have continued to improve since the last Copom meeting, as evidenced by data on commerce activity, industry and labor market. Signs of credit recovery continue to accumulate, in particular regarding loans to individuals. Also for consumer and businessmen confidence there are consistent signs of recovery. Under such circumstances, the rhythm of economic activity resumption strongly depends on real payroll expansion, on the effects of fiscal stimulus measures and on incremental governmental transfers, which will occur in the upcoming months. It should also benefit from the easing of financial conditions, favored by the policy of official banks, among other factors. In short, the most recent data on domestic economic activity seem to reinforce the evaluation mentioned in previous Copom meetings minutes that the contractionist effects of the international financial crisis over the domestic economy dynamism and, consequently, over the context on which the monetary policy operates, could become persistent, but would not be permanent. These considerations become even more relevant considering the fact that the current monetary policy decision will have concentrated impacts in 2010.

21. The Copom understands that the risks for the consolidation of a benign inflationary scenario derive, in the short term, from price adjustment mechanisms that contribute to lengthen inflationary pressures

observed in the past, as evidenced by the behavior of services prices and certain regulated items since the beginning of 2009, as well as from a possible hike in commodities prices. In the medium term, the risk stems from cumulative and lagged effects of the financial conditions easing and from the fiscal stimulus over the evolution of domestic demand, taking into account the dynamics of consumption and investment, in a context of recovery of production factors utilization. The balance of such influences over the inflationary prospective trajectory 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 lead to the increase of risk premium, for both private and public funding, to the shortening of planning horizons and, consequently, to lower potential economic growth, besides having regressive effects over income distribution. Therefore, the Copom strategy aims to ensure that that the convergence of inflation towards the target path observed in 2009 continues to be registered in 2010 and 2011. Such strategy, which results have been evidenced throughout time, takes into account the time lags in the transmission mechanisms and is the most adequate to deal with the uncertainty inherent to the process of monetary policy formulation and implementation.

23. The Copom evaluates that, in light of the idleness margin of the economy, evidenced by indicators of capacity utilization in industry and of the labor market, and the behavior of inflation expectations for relevant horizons, the materialization of a benign inflation scenario, in which the IPCA would continue to evolve according to the target path, has remained favorable. By the way, such evolution of the forward-looking scenario continues to be reflected on the inflation projections considered by the Committee. Under such circumstances, in order to preserve the improvement of the prospective inflationary path, under a macroeconomic scenario with significant uncertainty, the Copom evaluates that monetary policy should maintain a cautious stance, aiming to assure the maintenance of inflation convergence to the targets path.

24. The Committee understands that the accommodation of demand, motivated by the tightening of financial conditions and by deterioration of the agents' confidence, as well as by the global economic activity contraction, has been overcome, although significant idleness margin of production factors still persists, which should not be rapidly eliminated in a basic scenario of gradual recovery of economic activity. The Copom also highlights that there are uncertainties around such basic scenario, which should be clarified over the upcoming months, with both positive and negative biases over the pace of economic activity recovery. Anyhow, under such scenario of gradual recovery, which has been corroborated by current available data, inflationary pressures should remain restrained. On the other hand, the Committee notices that the significant monetary policy easing, implemented between January and July, will have cumulative effects over the economy, which will be evidenced with a time lag.

25. The Committee understands that decisions regarding the evolution of the basic interest rate have to take into account the magnitude of the stimuli introduced into the economy, whose impacts on several economic indicators will be evident over time, in a context of a gradual and consistent recovery of production factors utilization. The Copom also understands that a more cautious stance will contribute to mitigate the risk of abrupt reversals of monetary policy in the future and, therefore, to the consistent recovery of the economy over the upcoming quarters. The Copom also evaluates that the preservation of benign inflationary prospects will require the behavior of the financial system and the economy under a new level of interest rates to be closely monitored over time.

26. Regarding the inflation prospects compared to the targets path, the Copom has unanimously decided to maintain the Selic rate at 8.75% p.a. without bias. Taking into account, on the one hand, the monetary policy easing implemented since January and, on the other hand, the idleness margin of production factors, among other factors, the Committee evaluates that such level of basic interest rate is now consistent with a benign inflationary scenario, contributing to assure the maintenance of inflation in line with the targets path over the relevant horizon for the non-inflationary recovery of economic activity.

27. Under the inflation targeting regime, the Copom guides its decisions according to projected inflation, the analysis of several alternative scenarios for the evolution of the main variables that determine the forward-looking dynamics for prices, and the balance of risks associated to the projections. After a short period of contraction, domestic demand started to show signs of recovery, due to the stimulus factors effects, such as income growth. Additionally, it bears noticing that, evidencing the credibility achieved by the Copom on the implementation of the regime, inflation expectations for 2010 and 2011 remain in line with the targets path. It is also noteworthy that global economic deceleration has generated downward pressures over wholesale industrial prices. On its turn, important monetary, credit, and fiscal stimuli were introduced into the economy over the last quarters and should contribute to the activity recovery and, consequently, to the reduction of the idleness margin of production factors. Those stimuli effects should be closely monitored over time and are important in the context where future monetary policy decisions, which should ensure the materialization of the convergence of inflation to targets path over relevant horizons, will be taken.

28. At the end of the meeting it was announced that the Committee will reconvene on January 26th, 2010 for technical presentations and, on the following day, to discuss the monetary policy decision, as established in Communiqué 18,927 of October 9th, 2009.

Summary of data analyzed by the Copom

Inflation

29. IPCA inflation reached 0.41% in November, up from 0.24% in October, but showing decrease from the variation of 0.44% for November IPCA-15. Market prices increased 0.42% in November, compared to 0.22% in October, as a result of increases of 0.22% on tradable items and 0.59% on non-tradable items, while regulated prices increased 0.40% in November, down from 0.42% in October. The diffusion index reached 58.9% in November, averaging 57.3% in 2009. On a twelve-month trailing basis, the IPCA variation was 4.22% in November, up from 4.17% in October, mirroring the 4.10% increase in market prices and the 4.5% increase in regulated prices.

30. All the core IPCA measures increased in November, both on monthly and twelve-month trailing basis. The core excluding household food items and regulated prices increased from 0.33% in October to 0.42% in November. The smoothed trimmed means core reached 0.37%, up from 0.31% over the previous month; the non-smoothed trimmed means core reached 0.36%, up from 0.28%, in the same periods. In the last twelve months through November, the smoothed and non-smoothed trimmed core measures reached 4.92% and 4.27%, respectively, in comparison to 4.86% and 4.24%, respectively, in October, while the core by exclusion recorded 3.58% and 3.5%, according to the same comparison basis.

31. Inflation measured by the IGP-DI, reported moderate variations in October (-0.04%) and November (0.07%) after growing 0.25% in September. Considering the inflation accumulated in the last twelve months through November, the IGP-DI decreased from -0.65% in September to -1.76% in October and November. Under this criterion, the deceleration of the IGP-DI is manifested in its three components, but reflecting in particular the behavior of IPA-DI, which reached -4.64% in November. The IPC-Br changed 4.23%, according to the same comparison basis, while the INCC increased 3.32%. The deceleration of the IPA-DI in twelve months stems both from the behavior of agricultural prices that reached -3.26% in November, and industrial prices, that decreased 5.14% over the same period.

Economic activity

32. According to data seasonally adjusted by the IBGE's monthly survey (PMC), expanded retail sales increased 3% in September, month-on-month, after a 4.7% increase in August and a 6.3% fall in July. As a consequence, the average change of the quarter ended in September reached a 3.5% increase relative to the quarter ended in June. Year-over-year, expanded retail sales increased by 9.1%, while growth reached a 4.4% increase in the three first quarters of the year and a 3.3% increase in the last twelve months through September. The month-on-month result

revealed that sales increased in seven out of ten segments surveyed, with highlights for the increase in "vehicles and motorcycles, parts and pieces" (9.1%); and "office material and equipment" (8.8%). Among the negative drivers, it bears highlighting "construction inputs" (1.5%); pharmaceutical, medical, orthopedic, perfumery and cosmetic items" (1.1%) and "hyper-, supermarkets, food products, beverages and tobacco" (0.5%).

33. Year-over-year, it bears highlighting the expansions in "vehicles and motorcycles, parts and pieces" (18.9%); "hyper-, supermarkets, food products, beverages and tobacco" (9.7%); "books, newspapers, magazines and stationary" (9.7%); and "pharmaceutical, medical, orthopedic, perfumery and cosmetic items" (8.1%). Among the negative drivers, it bears noticing the 8.2% decrease for "construction inputs" and the 6.6% decrease for "textiles, clothing and footwear". In the year through September, six out of the ten segments surveyed increased, and it bears emphasizing "office material and equipment" (11.9%); "pharmaceutical, medical, orthopedic, perfumery and cosmetic items" (11.9%); "books, newspapers, magazines and stationary" (9.3%); as well as "other personal and domestic items" (8.7%). As negative drivers, according to the same comparison basis, "construction inputs" presented the sharpest decrease, with a 9.5% fall.

34. São Paulo Trade Association (ACSP) data for November, related to the city of São Paulo, indicated a 2.6% increase in database consultations for credit sales (SCPC) and a 1.5% increase in consultations to the Usecheque system on a month-on-month, seasonally adjusted basis. In 2009 through November, those indicators showed a decrease of 10.8% and an increase of 0.6%, respectively, in comparison to the same period of the previous year. On a twelve-month basis, those indicators showed, respectively, a 9.9% decrease and a 0.9% increase.

35. Automobile sales by dealers, which take into account automobiles, light commercial vehicles, trucks and buses, decreased 4.2% in November, month-on-month, seasonally adjusted by the BCB, according to Fenabrave (Brazilian Federation of Vehicles Distribution) data. Such decrease reflected accommodation on sales, after the increase due to expectations regarding the progressive suspension of the IPI (tax on industrialized products) adopted under the context of counter cyclical measures implemented after the deepening of international crisis. Total sales increased 41.5% year-over-year, with highlights for automobiles and light commercial vehicles, which increased 45.5% and 35.4%, respectively. It is worth mentioning that the sales of trucks, which had presented successive falls throughout the year when compared to the same month last year, recorded a 17.9% increase in November, registering the second consecutive month of growth. In the year through November, vehicles sales increased 8.5% year-over-year, as a result of the expansion on automobiles (10.3%) and light commercial vehicles (7.5%), as well as of the decline of buses sales (16.3%) and trucks sales (15.7%).

36. Capital goods imports increased 1.9% in October, month-on-month, according to the Funcex quantum index, seasonally adjusted by the BCB. The October indicator decreased 21.6% year-over-year, reaching a 15% decline in the year through October, year-over-year. Capital goods exports decreased 5.6% in October, month-on-month, and 40.6% and 40.2% year-over-year and in the year through October, respectively.

37. Capital goods production increased 5.9% in October, month-on-month seasonally adjusted, but showed decreases of 16.8% year-over-year and of 22.0% in the year through October, according to IBGE. The monthly result highlights were the increases in production of capital goods directed to construction (22.7%), to the electric energy sector (15.1%) and transport equipment (11.1%). On the other hand, the production of capital goods for industrial use registered fall of 3.7%. The production of inputs for civil construction increased 0.5%, month-on-month, and declined 9.3% in the first ten months of the year.

38. The disbursements of BNDES reached R$106.5 billion in 2009 through October, with an increase of 51.8% over the same period last year.

39. General industrial physical production increased 2.2% in October, month-on-month, seasonally adjusted, according to IBGE's Monthly

Industrial Survey – Physical Production (PIM-PF). Year-over-year and on a twelve-month basis, the sector contracted by 3.2% and 10.6%, respectively. Among the four use categories, it bears highlighting the performance of capital goods and durable consumer goods production, recording the same growth rate of 5.9%. The intermediate goods production presented the mildest increase (1.2%). Mining production increased 1.2% in the period, reaching falls of 8.1% when compared to October 2008 and of 9.4% in the last twelve months.

40. CNI indicators kept on showing in October the increase of industrial activity, according to data seasonally adjusted relative to September. Manufacturing industry real revenues increased 1.5% in the month, while worked hours, employment and the Nuci increased 1%, 0.5% and 0.2 p.p. respectively. Relative to October 2008, the Nuci decreased 2 p.p., reaching fifteen among the nineteen activities in the manufacturing industry. Highlights for the decreases of basic metallurgy (17.5 p.p.), wood (9.1 p.p.) and machinery, equipments and electrical material (6.7 p.p.).

41. Vehicles production reached 292 thousand units in November, according to Anfavea, increasing by 47.9% year-over-year. According to seasonally adjusted data, vehicles production decreased 4.1% month-on-month. In the year through November the production of vehicles and agricultural machinery declined 6.8% and 24.6%, respectively, while in the last twelve months through November the same indicators declined 10.1% and 21.9%, respectively, year-over-year. Domestic sales of vehicles increased 58.3% in November and 4.7% in the first eleven months of 2009, year-over-year, while exports decreased by 0.6% and 39.1%, respectively.

Surveys and expectations

42. According to the Fecomercio-SP survey, the Consumer Confidence Index (ICC) decreased 0.7% in November relative to October, when it reached a record level for the observed series. This result reflected contractions of 1.4% in the Current Economic Conditions Index (Icea), and 0.3% in the Consumer Expectations Index (IEC). Year-over-year, the ICC increased 15.5%.

43. According to the Consumer Expectations Survey carried out by the FGV nationwide, the ICC increased 1.5% in November, month-on-month seasonally adjusted, a record level since May 2008. In November, the Current Situation Index (ISA) increased 2%, a record high for the series started in September 2005, and the Expectations Index (IE) increased 1.2%. The ICC increased 19.2% year-over-year, reflecting the expansion of 24.9% in the ISA and of 16.2% in the IE.

44. In relation to the expectations for the manufacturing industry, the FGV Manufacturing Industry Survey recorded, in November, the tenth consecutive high, showing the consolidation of manufacturing industry recovery after recent international crisis. The Industry Confidence Index (ICI) increased 2.4%, month-on-month, seasonally adjusted. Year-over-year, the indicator increased 35.1% in the observed series, the highest percent change since July 2004 on the same comparison basis. Among components, according to the month-on-month seasonally adjusted series, there were increases of 2.9% for the Current Situation Index (ISA) and 1.8% for the IE, and increases of 29.9% and 40.9%, respectively, year-over-year.

Labor market

45. According to the General Record of Employment and Unemployment (Caged) of the Ministry of Labor and Employment (MTE), 231 thousand formal jobs were created in October (the best result of the series for the month). In the year through October and on a twelve-month basis, respectively, 1,163.6 thousand and 467.8 thousand jobs were created. The manufacturing industry showed the seventh month positive balance, reaching the best result of the series for the month, with 74.6 thousand hires, representing a 0.6% increase in employment in October, month-on-month, seasonally adjusted data. The same data showed a 0.4% increase in employment in October, month-on-month, with highlights for the increase in the construction sector (1.1%). According to the average of the year, the level of employment increased 2%, reflecting increases of 5.8% in the construction sector and 3.9% in the services sector and in the retail sector, whereas the manufacturing industry declined by 2.5%.

46. According to the IBGE employment survey (PME), carried out in the six main metropolitan regions of the country, the unemployment rate reached 7.5% in October, showing stability year-over-year and a 0.2 p.p. decrease month-on-month. The fall in the unemployment rate is a result of decreases of 16 thousand jobs (-0.1%) and 62 thousand people (-0.3%) in the economically active population (PEA). The unemployment rate remained stable in 7.8% in October, seasonally adjusted data. The same survey pointed out for the stability of average real earnings of employed workers in the month, after three consecutive month increases, growing by 3.5% in the year through October. Real payroll decreased 0.1% month-on-month and increased 4.2% in the year through October.

Credit and delinquency rates

47. Outstanding credit in the financial system reached R$1,367 billion in October, equivalent to 45.9% of GDP, with increases of 1.4% in the month and of 15.3% on a twelve-month trailing basis. Non-earmarked credit operations increased 1% in the month and 9.7% in the last twelve months. Among the non-earmarked operations, which represent a share of 68.1% in the total of the financial system, credit operations to individuals increased 1.4% in the month and 17% in the last twelve months, while non-earmarked credit operations to corporate increased 0.7% and 3.6%, according to the same comparison basis. Earmarked credit operations increased 2.2% in the month and 29.4% on a twelve-month trailing basis.

48. The average interest rate on non-earmarked credit operations, used as reference for interest rates, increased in October, after ten consecutive months of decline, reaching 35.6%. The average annual rate on credit for individuals reached 44.2% (43.6% in September) and the average rate on credit to corporate reached 26.5% (26.3% in September).

49. The average tenure on non-earmarked credit operations, used as reference for interest rates, increased in October for the second consecutive month, reaching 377 days. The average tenure of corporate credit operations reached 267 days, while the average tenure for credit operations to individuals totaled 513 days.

50. Delinquency rates in the financial system (non-earmarked loans used as reference for interest rates, in arrears for more than ninety days) remained stable as compared to September (5.8%), when was registered the first fall in the rate after increasing for eight consecutive months. Delinquency rates for credit operations with corporate remained stable, at 4%, while declined 0.1 p.p. with individuals, reaching 8.1%.

51. Net delinquency rate for retail credit, measured by the ACSP, reached 4.2% in November, compared to 6.2% in October, 6.5% in September and 6.4% in the same month of 2008, representing a record low since December 2008.

External environment

52. Evidence of recovery in the global economy strengthened with the release of positive data for Q3 GDP growth in the US and the Euro Area, after four consecutive negative results in the U.S. and five in the Euro Area. At the same time, the Japanese economy registered the second consecutive quarter of growth in the third quarter, accelerating from the expansion of the previous period. The resumption of growth in the two largest economies has supported the recovery of international trade and economic activity in other regions of the world. Among the emerging countries, China and India followed with acceleration on annual growth rates, while Mexico and South Korea registered high quarterly growth rates.

53. Due to the progressive reduction of the 2008 basis effect, the rise in commodity prices, particularly oil, which has been taking place since the beginning of the year, has changed the behavior of the consumer prices indices (CPI). In the US, the Euro Area and China, the deflationary process lost importance with the annual fluctuations in the CPI reaching -0.18%, -0.1% and -0.5%, respectively. In the United Kingdom and in some emerging economies such as South Korea, Hungary and Turkey, the disinflationary process also began to reverse. In the US and the Euro Area, the persistence of low rates of utilization of capacity, accompanied by stability in inflation expectations, should contribute to avoid inflationary pressures in the short and medium terms. In this context, except for the persistent Japanese deflation, which registered

annual growth of -2.5% in October, and the economy of the United Kingdom, where high prices back to worry the authorities, the overall inflation scenario is still considered stable.

54. Despite the announcement of the debt restructuring of the Dubai World Sovereign Wealth Fund, which led, more recently, to an increased risk aversion, in general, international financial markets showed relative stability during the period.

55. In this environment, most central banks kept unchanged their basic interest rates. In some countries, however, local conditions imposed different behavior to the monetary authorities: in Australia, Israel and Norway, where the economy has given clear signs of recovery, central banks decreased the stance of their accommodative monetary policies. In the opposite direction, in the United Kingdom, Japan and Russia, central banks increased the local monetary loosening, respectively through increasing the value of direct purchases of assets, by additional injection of liquidity and through the continuous reduction of basic interest rates.

Foreign trade and international reserves

56. The Brazilian trade surplus reached US$615 million in November, totaling US$23.2 billion in the first eleven months of the year, increasing by 3.8%, year-over-year, on a daily average basis. In the month, exports reached US$12.7 billion, and imports, US$12 billion, decreasing by 14.2% and 8.2%, respectively, year-over-year, on a daily average basis. Total external trade reached US$24.7 billion in November, decreasing by 11.4%, year-over-year, on a daily average basis. In the year through November, total external trade reached US$253.9 billion, 25.6% below that registered in 2008, according to the same comparison basis.

57. Based on the liquidity concept, international reserves, which encompass the repurchase lines and borrowing operations in foreign currencies, reached US$238 billion in November, recording a US$5.1 billion increase in the month. Under the cash concept, international reserves totaled US$236.7 billion, recording a US$5.5 billion increase, according to the same comparison basis. It bears highlighting, in the month, purchases of US$3 billion by the monetary authority.

Money market and open market operations

58. After the October Copom meeting, the yield curve slope increased for all maturities. The release of better-than-expected data for the economic activity and labor market, and current inflation higher than expectations contributed to this movement. Between October 19 and December 7, one- three- and six-month rates increased by 0.01 bps, 0.03 bps and 0.17 bps, respectively, whereas one- two- and three-year rates increased by 0.20 bps, 0.10 bps and 0.14 bps, respectively. Real interest rates, measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month-ahead inflation expectations, increased from 5.48% on October 19 to 5.61% on December 7.

59. In its open market operations, the BCB carried out, between October 20 and December 7, long fixed rate repo operations, borrowing R$18.2 billion for a six-month period. The average daily balance of the six- and seven-month operations reached R$76.9 billion, of which R$76.1 billion were six-month operations. In the same period, the BCB conducted borrowing operations with tenures of 34 working days on October 22; of 32 working days on October 26; of 27 working days on November 3; of 23 working days on November 9; of 18 working days on November 16 and 13 working days on November 23. These operations drained from the market R$288.6 billion, R$3 billion, R$1.3 billion, R$0.2 billion, R$10.6 billion and R$0.3 billion, respectively. The average daily balance of these short-run borrowing operations reached R$299.9 billion. The BCB also borrowed money through 35 overnight repo operations and conducted two-working-day tenure liquidity management operations at the end of day. Operations with tenors less than thirty days, including daily liquidity management operations, averaged R$92.3 billion, on a daily basis, borrowing. The average daily balance of these short-run borrowing operations reached R$469.2 billion between October 20 and December 7, up from R$447.7 billion between September 1 and October 19. Considering the daily balance of operations in the most recent period, there was a reduction of the purchase commitments of R$55.3 billion. The total stock reached R$444.9 billion on December 7, down from R$500.2 billion on October 19. The main determinant factors of the liquidity decrease in the period were the

net issuance of securities by the National Treasury and the net revenues of the Federal Government.

60. Between October 20 and December 7, the National Treasury issuance regarding the traditional auctions raised a total of R$42.2 billion. The issuance of fixed-rate securities reached R$31.7 billion, being R$24.9 billion via issuance of LTNs maturing in 2010 and 2011, and R$6.8 billion via NTN-Fs maturing in 2013 and 2017. Issuance of LFTs totaled R$7.6 billion, for securities maturing in 2013 and 2015. Issuance of inflation-linked NTN-Bs reached R$2.9 billion, for securities maturing in 2011, 2014, 2020, 2024, 2035 and 2045.

61. In the same period, the Treasury conducted auctions to sell LTNs maturing in April and October 2010, combined with the purchase of LTNs maturing in January 2010, totaling R$2.6 billion. It also conducted auctions to sell LFTs maturing in September 2013 and September 2015, combined with the purchase of LFTs maturing in December 2009, totaling R$0.9 billion. The sales of NTN-Bs settled in other National Treasury securities maturing in 2011, 2014, 2020, 2024, 2035 and 2045 totaled R$6.5 billion. The Treasury also conducted purchase auctions of LTNs, NTN-Bs and NTN-Fs, reaching R$1.4 billion, R$0.1 billion and R$0.5 billion, respectively.

Appendix

Banco Central do Brasil Management

Members of the Monetary Policy Committee (Copom)

Banco Central do Brasil Management

Board

Henrique de Campos Meirelles
Governor

Aldo Luiz Mendes
Deputy Governor

Alexandre Antonio Tombini
Deputy Governor

Alvir Alberto Hoffmann
Deputy Governor

Anthero de Moraes Meirelles
Deputy Governor

Antonio Gustavo Matos do Vale
Deputy Governor

Maria Celina Berardinelli Arraes
Deputy Governor

Mário Magalhães Carvalho Mesquita
Deputy Governor

Members of the Monetary Policy Committee (Copom)

Voting members

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Deputy Governor

Antonio Gustavo Matos do Vale
Deputy Governor

Maria Celina Berardinelli Arraes
Deputy Governor

Mário Magalhães Carvalho Mesquita
Deputy Governor

Non-voting members

Altamir Lopes
Head of the Departament of Economics (Depec)

Carlos Hamilton Vasconcelos Araújo
Head of the Research Departament (Depep)

João Henrique de Paula Freitas Simão
Head of the Departament of Open Market Operations (Demab)

José Antônio Marciano
Head of the Departament of Banking Operations and Payments System (Deban)

Márcio Barreira de Ayrosa Moreira
Head of the Departament of International Reserve Operations (Depin)

Renato Jansson Rosek
Head of the Investor Relations Group (Gerin)

Acronyms

ACC	Advance on Exchange Contracts
ACSP	São Paulo Trade Association
Anfavea	National Association of Automotive Vehicle Manufacturers
b.p.	basis points
BM&FBOVESPA	Securities, Commodities and Futures Exchange
BNDES	Brazilian Development Bank
BNDESpar	BNDES Participações S.A.
BoE	Bank of England
BoJ	Bank of Japan
BRIC	Brazil, Russia, India and China
Caged	General File of Employed and Unemployed Persons
CBT	Chicago Board of Trade
CCI	Consumer Confidence Index
CDS	Credit default swap
Cide	Contribution on Intervention in the Economic Domain
CMN	National Monetary Council
CNI	National Confederation of Industry
Codace	Economic Cycles Dating Committee
Cofins	Contribution to Social Security Financing
Copom	Monetary Policy Committee
CRB	Commodity Research Bureau
CSI	Current Situation Index
CSLL	Social Contribution on Net Corporate Profits
CVM	Securities and Exchange Commission
DAX	Deutscher Aktienindex
DOE	U.S. Department of Energy
ECB	European Central Bank
EI	Expectations Index
Embi+	Emerging Markets Bond Index Plus
FAT	Worker Support Fund
FDI	Foreign Direct Investments
Fecomercio SP	Trade Federation of the State of São Paulo
Fed	Federal Reserve
Fenabrave	National Federation of Automotive Vehicle Distribution
FGC	Credit Guaranty Fund
FGTS	Employment Compensation Fund
FGV	Getulio Vargas Foundation
Finame	Special Industrial Financing Agency
FTSE 100	Financial Times Securities Exchange Index

Funcex	Foreign Trade Studies Center Foundation
Fundeb	Fund for Maintenance and Development of Basic Education and Enhancement of Education Professionals
GDP	Gross Domestic Product
Gerin	Executive Investor Relations Group
GFCF	Gross Fixed Capital Formation
GGGD	Gross General Government Debt
GSCI	Goldman Sachs Commodity Index
IBGE	Brazilian Institute of Geography and Statistics
Ibovespa	São Paulo Stock Exchange Index/Bovespa Index
ICE	New York Intercontinental Exchange
Icea	Current Economic Conditions Index
Icei	Industrial Business Confidence Index
ICI	Industrial Confidence Index
ICMS	Tax on the Circulation of Merchandise and Services
ID	Interbank Deposit
IEA	International Energy Agency
IEC	Consumer Expectations Index
IGP-DI	General Price Index – Domestic Supply
IGP-M	General Price Index – Market
IMF	International Monetary Fund
INC	National Confidence Index
INCC	National Cost of Construction Index
INCC-DI	National Cost of Construction Index – Domestic Supply
Inec	National Consumer Expectations Index
IOF	Financial Operations Tax
IPA-DI	Producer Price Index – Domestic Supply
IPC	Consumer Price Index
IPCA	Extended National Consumer Price Index
IPC-Br	Consumer Price Index – Brazil
IPI	lndustrialized Products Tax
IPVA	Tax on Automotive Vehicle Proprietorship
IRPJ	Corporate Income Tax
IRRF	Income Withholding Tax
Kospi	Korea Composite Stock Price Index
LDO	Budget Guidelines Law
LME	London Metal Exchange
LSPA	Systematic Farm Production Survey
LTN	National Treasury Bills
MTE	Ministry of Labor and Employment
Nuci	Installed Capacity Utilization Level
OECD	Organisation for Economic Co-operation and Development
p.p.	percentage points
p.y.	per year
PAC	Growth Incentive Program
PAF	Annual Financing Plan
Pasep	Civil Service Asset Formation Program
PBC	People’s Bank of China
Pimes	Monthly Industrial Survey – Employment and Wages
PIM-PF	Monthly Industrial Survey – Physical Production

PIS	Social Integration Program
PMC	Monthly Retail Trade Survey
PME	Monthly Employment Survey
PPI	Producer Price Index
PSND	Public Sector Net Debt
S&P 500	Standard and Poor's 500
SCIT	Manufacturing Industry Survey
SDR	Special Drawing Rights
Selic	Special System of Clearance and Custody
Sensex	Bombay Stock Exchange Sensitive Index
SFH	Housing Financing System
SNB	Swiss National Bank
USA	United States of America
VaR	Value at Risk
VIX	Chicago Board Options Exchange Volatility Index