

EXECUTIVE SUMMARY

Recent regional economic data confirms the economic recovery signaled by the December 2009 Inflation Report. This recovery, led by buoyant domestic demand and, to a smaller extent, a gradual rebound in global economic activity, is taking place at an uneven pace across the regions, where it is conditioned by differences in economic structure and in openness. However, with the recovery came an increase in inflationary pressure throughout the Brazilian economy.

Northern Brazil's economic turnaround has been confirmed by stronger data on retail sales and industrial output. This turnaround has taken place amidst faster credit growth, stronger labor market activity and still contained price pressures. Accordingly, seasonally adjusted data on retail sales and the regional activity index (IBCR-N) rose by 3.8% and 2.1% in the three-months ended in November 2009, relative to those ended in August, respectively. The regional expansion should be supported in the coming months by stronger demand from the other parts of the country, particularly for durable consumer goods, as well as by consolidation of the cyclical recovery in mature economies.

In the Northeast, economic activity has been boosted by the effects of fiscal transfers on spending. These effects contributed to fast growth of regional GDP in the third quarter of 2009 and also in the fourth, as stronger activity in the services sector, especially retail trade, helped strengthen labor market conditions. Thus, the IBCR-NE seasonally adjusted activity index rose by 2% in the September-November period, compared with June-August. The outlook for the Northeastern economy in 2010 is favorable, taking into account the expected increase in the real wage bill and in fiscal transfers on household consumption, and ongoing public sector investment outlays, within the government's growth acceleration program (PAC).

Recovery has been slower in the Center-West region, which was also affected by the global crisis to a lesser extent than other regional economies – thanks to the role played by agribusiness and public sector spending in sustaining activity. It should be noted that while the 1% seasonally adjusted increase in the IBCR-CO in September-November trails growth in other regions, only the Center-West and in the Northeast – the latter benefiting from increasing fiscal transfers from the federal government and with industry focused on light

manufacturing for domestic consumption – posted positive year-on-year IBCR changes in November. Strong agribusiness and service sector activity (in Brasília) should help support economic activity in the region this year, which should see an important increase in soybeans production as well as resumption of investment in the ethanol industry.

Economic data for the Southeast points toward continuity of the ongoing economic recovery, with positive feedback of the industrial turnaround on retail sales and employment growth. Thus, the seasonally adjusted IBCR-SE rose by 2,6% in September-November, relative to June-August. The region's economy should benefit from consolidation of the manufacturing recovery that started by mid-2009, particularly in sectors, such as metallurgy, that have important weight in its productive structure and that had been lagging the overall pace of economic improvement. The outlook for the Southeast also benefits from the favorable impacts of rising employment, faster credit expansion by commercial banks and by the state-owned development bank (BNDES).

Economic recovery in Southern Brazil has been supported by manufacturing and retail trade, thanks to the expansion of the real wage bill, and of credit aggregates. In this environment, the IBCR-S index, while showing a 1,1% year-on-year decline in November, rose by 2,8% at the margin, adjusting for seasonal effects. Activity in the Southern region in 2010 should benefit from the impacts of strengthening domestic demand on retail sales and manufacturing production, and also from the effects of recovery in the global economy on manufacturing and agricultural output.

On a less benign note, in all regions, especially but not exclusively in the North and Center-West, economic recovery has been accompanied at the margin by faster inflation. This process has been led by different factors in the various regions, but seems to risk becoming widespread. In sum, faster regional inflation should be closely monitored by monetary authorities, as it could signal a nationwide deviation from the targeted path.