BANCO CENTRAL DO BRASIL

Minutes of the 123rd Meeting of the Monetary Policy Committee (Copom)

Summary

Date: November 28th, from 4:30PM to 7:40PM, and November 29th, from 4:30PM to 8:00PM
Place: BCB Headquarters meeting rooms - 8th floor on November 28th and 20th floor on November 29th – Brasília – DF

In attendance:
Members of the Committee
Henrique de Campos Meirelles – Governor
Afonso Sant'Anna Bevilaqua
Alexandre Antonio Tombini
Antonio Gustavo Matos do Vale
Mário Magalhães Carvalho Mesquita
Paulo Sérgio Cavalheiro
Paulo Vieira da Cunha
Rodrigo Telles da Rocha Azevedo

Department Heads (present on November 28th)
Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on November 29th)
Ivan Luís Gonçalves de Oliveira Lima – Open Market Operations Department
José Antonio Marciano – Department of Banking Operations and Payments System
Márcio Barreira de Ayrosa Moreira – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations Group

Other participants (present on November 28th)
Alexandre Pinheiro de Moraes Rego – Special Advisor to the Governor
Alexandre Pundek Rocha – Advisor to the Board
Flávio Pinheiro de Melo – Advisor to the Board
Jocimar Nastari – Press Secretary
Katherine Hennings – Advisor to the Board

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

Recent Economic Developments

1. IPCA inflation has increased on a month-on-month basis, recording 0.33% in October, compared to 0.21% in September and to 0.05% in August. The last monthly result is in line with the expectations registered on the eve

of the IPCA release, and is close to the expectations that prevailed at the end of September. Year-to-date IPCA inflation reached 2.33%, slightly lower than half of the 4.73% observed in the same period of 2005. Twelve-month trailing inflation reduced to 3.26% in October from 5.70% in January, the lowest level since the adoption of the inflation-targeting regime, in June 1999. IPCA inflation acceleration in October was mainly driven by the increase in market prices (0.43% up from 0.21% in September), not entirely offset by the regulated prices decrease (0.12% down from 0.22% in September). Amongst market prices, tradable prices increased to 0.42% in October up from 0.16% in September, while non-tradable prices increased to 0.44% up from 0.25%. The price of services increased to 0.43%, compared to 0.38% in September and 0.56% in October 2005. Partial November data, already captured by the IPCA-15, suggest that the IPCA change might be slightly above the expectations recorded on the days of the October Copom meeting. Despite the inflation acceleration in the last months, a benign inflation scenario continues to evolve in line with the targets path, with favorable prospects for inflation in the coming years.

2. Similarly to the headline result, IPCA core inflation measures calculated by the BCB also increased in October. Core inflation by exclusion of household food items and regulated prices increased to 0.30% in October, compared to 0.23% in September and 0.13% in August. Smoothed trimmed means core repeated the 0.32% change observed in September, and has oscillated around 0.30% since June, recording the strongest rigidity among the three core measures. After registering no change in August, the non-smoothed trimmed means core increased 0.13% in September and 0.19% in October. Despite the recent increases, the cores continue to present a downward trend on a twelve-month basis. In October, the three measures reached 3.56%, 4.93% and 3.21%, respectively, compared to 6.25%, 7.13% and 5.72% in the same period of the last year. On a twelve-month trailing basis, both the core inflation by exclusion and the non-smoothed trimmed means core stood below the midpoint of the target, also similarly to the headline result. On the other hand, the smoothed core inflation has converged more slowly to the target, reaching 4.93% in October, compared to 5.21% in the twelve months ended in September, which is an expected behavior considering its implicit inertia.

3. The General Price Index (IGP-DI) inflation hiked significantly in October, to 0.81%, compared to 0.24% in September and 0.63% in October 2005. In the year through October, the IGP-DI increased 2.93%, compared to 0.82% in the same period of last year. In twelve months through October, the IGP-DI increased 3.34%, compared to 3.16% through September. The IGP-DI inflation acceleration in October was mainly driven by the strong increase in wholesale agricultural prices. The Wholesale Price Index (IPA-DI) inflation reached 1.16% in October, compared to 0.28% in September, reflecting the 5.18% increase in agricultural prices, the highest elevation since November 2002. Wholesale agricultural prices increased 10.00% since June (7.72% in the three months ended in October). As a result of the significant increase observed in the last five months, the agricultural prices inflation reached 6.4% in twelve months, compared to a 6% deflation in July. The wholesale industrial prices presented stability in the last months, with fuel prices decrease compensating elaborated food prices increases. With the agricultural prices hike, wholesale prices may not favorably contribute to a consumer prices accommodation as previously expected, signalizing the exhaustion of one of the determinant factors of the disinflation observed in the last quarters. As highlighted in previous Copom meeting minutes, the effects of the wholesale prices behavior over consumer inflation will depend on prospective demand conditions and price-setters' expectations for the future inflation path.

4. Industrial production, according to IBGE seasonally adjusted data, decreased 1.4% in September, compared to the previous month, after two months of expansion. The contraction was expected, but it was more intense than previously anticipated by the market. The decrease in manufacturing activity in September reached 12 out of the 23 activities with seasonally adjusted data, with highlights to automotive vehicles (-9.3%), whose performance was affected by the strike in important vehicle manufacturers. On a three-month moving average basis, industrial production remained stable, close to the record high observed last August. In September, industrial production expanded 1.3%, compared to the same month of last year, after increasing 3.2% in August. In the year through August, industrial production reached 2.7%, compared to the same period of last year, while on a twelve-month trailing basis, industrial output reached 2.3%. In the third quarter, industrial production increased 0.4%, quarter-on-quarter seasonally adjusted, after reaching 0.7% in the second quarter. For October, leading and coincident indicators suggest a recovery in relation to September, on a seasonally adjusted basis, with an increase of the more stable three-month moving average basis. These results shall reflect, among other factors, the normalization of the automotive sector production, due to the end of the strikes observed during September in

some of the main manufacturers. Several incentive factors, including the monetary easing already implemented, suggest that the expanding trend in industry shall continue in the coming months.

5. Disaggregated industrial data show expansions of 2.6% in consumer goods production and 0.8% in intermediate goods production, and a 0.4% contraction in capital goods production, compared to the same month of the previous year. On a month-on-month seasonally adjusted basis, all segments decreased, with highlights to durable consumer goods production (-4.4%). On the other hand, this sector has leaded industrial activity growth in the year (6.3%), followed by capital goods production (5.0%). The growth of durable consumer goods production reflects, among other factors, the recovery of real earnings and the expansion of credit. The expansion of capital goods production is due to positive prospects for domestic demand, and also to the influence of favorable international prices for some industrial sectors.

6. Labor market results remain positive, with decreasing unemployment, expansion of jobs creation and higher purchase power of workers. The unemployment rate in the six main metropolitan areas reached 9.8% in October, compared to 10.0% in September and 9.6% in October 2005. In the Rio de Janeiro metropolitan area, unemployment stood at 7.3%, the lowest rate for October months since the beginning of the IBGE series. As a result, the average unemployment rate in the year through October was 0.2 percentage points higher than that of the same period last year, notwithstanding the 2.4% expansion in labor force. The number of employed people grew 2.2% both in the year through October and on a twelve-month trailing basis, indicating that the pace of jobs creation remains robust. In October, the purchase power of workers increased a month-on-month 1.2% and 5.4% compared to the same month last year, for a 4.1% expansion in the year through October. In addition, real payrolls increased 6.4% in the same period, an important factor for the growth of aggregate demand. According to the National Industry Confederation (CNI), manufacturing employment increased a month-on-month seasonally adjusted 0.3% in September and 1.7% in the year. Compared to the same month last year, it reached 2.7% in September. According to the Ministry of Labor and Employment (MTE), formal employment grew a month-on-month seasonally adjusted 0.5% in October, confirming the continuity of the ongoing expansion. In the last twelve months, it increased by 4.9%, the same observed in the year through September, mainly driven by the expansions of 9.6% in civil construction and 6.0% in the retail sector. With the creation of 129,795 jobs in October (1.2 million in the last twelve months), year-to-date formal job creation increased to 1,513,600.

7. After decreasing in June and July, IBGE data recorded a month-on-month seasonally adjusted 2.7% robust growth in retail sales for August and 2.1% for September. Compared to the same months of last year, retail sales grew 10.1% in September and 6.3% in August. In the year through September, retail sales expanded by 5.8%, mainly driven by furniture and domestic appliances sales (9.6%) and hyper- and supermarket sales (7.7%). The positive performance of retail sales is not restricted to income- and labor-sensitive items, but also comprises credit-sensitive items. Retail sales expansion is expected to continue in the coming months, fostered by positive labor market and income developments, credit expansion and the monetary easing cycle, as well as by the recovery in consumer confidence.

8. Installed capacity utilization in the manufacturing industry reached 82.1% in September compared to 81.9% in August, according to CNI data seasonally adjusted by the BCB. Considering non-seasonally adjusted data, the average installed capacity utilization through September was 0.4 p.p. lower than that of the same period last year, although this difference has reverted on the margin. Thus, August and September levels increased 0.6 p.p. and 0.8 p.p., respectively, compared to the same months last year. The decline in the average utilization partially reflects the improvements in the productive capacity. In fact, recent data regarding output and absorption of capital goods suggest a robust ongoing expansion of investments. In the year through September, the absorption of capital goods expanded by 8.3%, mainly driven by the increases in capital goods imports volume (26.7%) and in capital goods production (5.0%). Civil construction inputs expanded by 5.0%, according to the same comparison basis. Therefore, despite the ongoing aggregate demand expansion, relevant aggregate supply imbalances are not anticipated in the coming quarters. As stressed in previous Copom Minutes, the inflation trajectory is closely linked to current and prospective developments with regard to the expansion of supply to adequately meet demand conditions.

9. The trade balance continues to present robust results in 2006, confirming previous Copom assessments regarding important structural changes in the Brazilian external trade. In the year through October, the trade balance reached US$37.9 billion, 4.3% above the level reached in the same period last year. This result was driven by the record results of exports (US$113.4 billion) and imports (US$75.5 billion). Twelve-month trailing surplus through October reached US$46.3 billion, a new record high. As a result of domestic demand recovery, imports have outperformed on the margin, recording a new record high (US$88.8 billion), according to the same comparison basis. In spite of this increase, exports have also continued to expand, reaching a new record high (US$135.1 billion), according to the same comparison basis. As a consequence, robust external results are expected to continue in 2006 and 2007. The current account surplus stood at US$1.5 billion in October, reaching US$11.7 billion in the year, or 1.51% of GDP, for a US$14.0 billion surplus in the twelve months through October, or 1.54% of GDP.

10. Regarding the international scenario, the uncertainties regarding the monetary policy stance in the US persist. Although additional interest rate increases cannot be discarded, the consensus points to the fact that the bulk of the domestic interest rate increase may have already happened. On the other hand, concerns about the fact that the monetary tightening cycle may have been excessive continued to increase the fear of a recession in the US economy, with potential implications for the Brazilian economy. However, it bears emphasizing, so far, the limited effects of the less favorable international outlook observed in the last months, when the concerns stated above were already present, especially with regard to the increased risk aversion and the lower international liquidity. In fact, after an up-tick in May, the sovereign risk reached historically low levels in the last months, remaining stable during the electoral process. This fact corroborates recurrent analysis, expressed in previous Press Releases and Inflation Reports, that the Brazilian economy is more resilient to external shocks. In this context, the Copom reaffirms that the continued disinflation, robust and persistent trade surpluses, the buildup of international reserves, adequate public sector's primary surpluses, improved public sector's debt profile and buyback of external debt have strengthened the domestic resilience to external shocks. Therefore, the Copom continues to assign low probability to a significant deterioration in international financial market conditions that could affect Brazilian external financing.

11. Another concern regarding the international outlook, oil prices, has also dampened. Oil prices slightly decreased since the last Copom meeting, but nominal oil prices remain at historically high levels. In addition, oil prices still present high volatility, reflecting, among other factors, geopolitical tensions. It is worth mentioning that the dynamics observed in the last years reflects, to a great extent, structural imbalances in the oil market, suggesting that permanent upward moves in oil prices have occurred. The future oil prices trajectory still encompasses great uncertainty; however, the scenario considered by the Copom, which attributes no change to domestic gasoline prices in 2006, has become more likely to occur, and the risks related to its materialization have decreased significantly. Despite the stability in domestic gasoline prices, changes in international oil prices affect domestic oil prices, for instance, through productive chains, such as the petrochemical, as well as through the deterioration of market inflation expectations.

Assessment of Inflation Trends

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

a) Compared to the values considered in the Octobert Copom meeting, the projection for gasoline, bottled gas, and fixed line telephone prices adjustments in 2006 remained in 0%, 0.1%, and –0.8% respectively;

b) Considering the same comparison basis, the projections for household electricity adjustments in 2006 were changed to 0.3% from 2.5%;

c) The Copom maintained the 4.4% adjustment projection for all regulated prices in 2006. These items, according to the weights released by the IBGE, represent 31.2% of the total October IPCA;

d) The projection for regulated prices inflation in 2007 decreased to 4.8%. Some regulated prices were projected apart, considering the information available. The projection for the other regulated prices continue to be based on the endogenous determination model. This model considers the effects of seasonal components, exchange rate, market prices inflation and the IGP;

e) The projection for the spreads over the Selic rate, using a Vector Autoregressive model based on the Selic and 180-day swap rates on the eve of the meeting, stood at -53 b.p. in the fourth quarter of 2006, reaching 57 b.p. in the last quarter of 2007.

13. Regarding fiscal policy, it is assumed that the consolidated public sector primary surplus target of 4.25% of GDP in 2006 and 2007 will be achieved. The related assumptions considered in the previous meeting were maintained.

14. Since the October Copom meeting, median IPCA inflation expectations for 2006, compiled by the BCB's Investor Relations Group (Gerin), increased to 3.15% from 3.0%. This increase was mainly driven by the incorporation of the October inflation rate and an increase of inflation expectations for the remaining months of 2006. The twelve-month ahead inflation expectations increased to 4.17% from 4.06%. For 2007, inflation expectations decreased to 4.1% from 4.2%. As mentioned in previous Minutes, these developments suggest the consolidation of a more favorable long-term macroeconomic scenario.

15. The 2006 inflation forecast under the benchmark scenario – which assumes the maintenance of the Selic rate at 13.75% and the exchange rate at R$/US$2.15 during the forecast period – increased compared to the values considered at the October Copom meeting, remaining below the 4.50% target established by the CMN for the year. The forecast based on the market scenario – which incorporates the consensus exchange and Selic rates trajectories collected by Gerin on the eve of the Copom meeting – also remained above the values considered in the October Copom meeting, but below the central target for the year. On the other hand, the projections for 2007, according to both scenarios, reduced relative to the October projections, remaining below the 4.50% target in both scenarios.

Monetary Policy Decision

16. The Copom reaffirms the view that monetary policy has both contained short-term inflationary pressures and consolidated a more favorable long-term macroeconomic environment. Economic activity data still suggest low likelihood of significant pressure over inflation. Imports expansion has contributed significantly to this process, complementing domestic production and, therefore, restricting potential inflationary effects of domestic demand growth. Moreover, despite the prospects of lower liquidity in international markets, due to the interest rates increase in industrialized economies, the external outlook remains favorable, particularly regarding Brazilian external financing. Therefore, the scenario for the inflation trajectory remains benign. As in the October meeting, the Copom emphasizes that the main challenge of the monetary policy in this context is to guarantee the consolidation of anticipated favorable developments.

17. The Copom evaluates that the short-term inflation increase has been mainly driven by an expected upturn in food prices, observed in the last months. Since these effects have not depleted, it is likely that upcoming inflation indicators still capture those increases. Due to the nature of such pressures, they are expected to be temporary, with reduced intensity throughout time, without necessarily contaminating longer-time horizons. However, the Copom will continue to conduct the monetary policy stance so that the gains obtained in inflation control in recent years become permanent. For this to materialize, the Copom will carefully monitor the evolution of inflation and the several core inflation measures in the upcoming months, discriminating between one-off and persistent or generalized price increases, and promptly adapting the monetary stance to the circumstances.

18. The preservation of inflation rates in line with the targets path and the consolidation of a long-lasting stable macroeconomic scenario will contribute to the progressive reduction of macroeconomic risk perception underway. The scope for a reduction in real interest rates in the future will naturally follow as a consequence of this improved perception. The Copom evaluates that its cautionary monetary policy stance has been critical to increasing the

probability of inflation convergence to the targets path. For this to materialize, however, it is important that forward-looking inflation indicators remain consistent with the recent benign inflation outlook observed in the last quarters.

19. The Copom emphasizes, once more, that there are important lags in monetary policy transmission to economic activity and inflation. Since the beginning of the monetary easing cycle, in September 2005, the Selic rate has been reduced by 600 b.p., with the greater part of the reduction concentrated in 2006. Consequently, the activity level has not completely mirrored the effects of the interest rates cuts, as well as the effects of the economic activity resumption on inflation have not completely materialized. Therefore, the evaluation of alternative monetary policy stances should necessarily concentrate on the prospects for inflation and the risks associated to its materialization, instead of current inflation indicators.

20. During the coming months, employment and income expansions and credit growth will continue to bolster economic activity. As mentioned in the October Copom Minutes, activity level should also reflect the effects of the governmental transfers and other fiscal impulses occurred since the last quarter of 2005 and expected to continue next year. Therefore, the effects of interest rates cuts will add up to other factors that will contribute to demand expansion.

21. Given the existing incentives for expanding aggregate demand, the uncertainties surrounding the monetary policy transmission mechanisms and the lower distance between the current Selic rate and the medium-term interest rates, the Copom understood that the maintenance of important achievements in disinflation and in preserving economic growth, with job creation and rising real incomes, may demand a more cautious monetary easing stance. This argument is even more relevant in light of the fact that the monetary policy decisions in the coming months will produce concentrated impacts for 2007.

22. Given the reasons stated above, the Copom considered the convenience to reduce the Selic target by 25 basis points. The Copom members consensually concluded that several factors would justify such decision, and that such decision would contribute to increase the magnitude of the total adjustment to be implemented. However, there was no consensus that the lower pace of the monetary easing should start at the present meeting.

23. Three members of the Copom voted for a 25-basis-point reduction in the Selic target, considering that the current balance of risks justifies such decision. However, the majority of the members of the Copom emphasized that the information available at the present moment would not justify a change in the pace of the monetary easing process underway and that it would be necessary to wait the evolution of the macroeconomic outlook until the next meeting, so that to consider the convenience to reduce the Selic target by 25 basis points.

24. Therefore, the Copom decided to reduce in the Selic target by 50 basis points to 13.25% p.a., without bias. Five votes were for the Copom monetary policy action, while three votes were in favor of reducing the Selic target by 25 basis points.

25. Under an inflation-targeting regime, the monetary authority decides according to inflation prospects, analyzing alternative scenarios for the main variables that determine price dynamics. Despite the decrease in international financial markets volatility, some factors that caused heightened volatility in previous months still persist. In such an environment, the monetary authority must remain vigilant so that short-term uncertainties do not contaminate longer time horizons. In case of an exacerbation of the risk factors monitored by the Copom, the monetary policy strategy will be promptly adapted to the circumstances.

26. At the conclusion of the meeting, it was announced that the Copom would reconvene on January 23rd 2007, for technical presentations, and on the following day to discuss the monetary policy decision, as established in Communiqué 15,011 of October 31, 2006.

SUMMARY OF DATA ANALYZED BY THE COPOM

Inflation

27. The IPCA increased 0.33% in October, up from 0.21% in the previous month. Three of the nine surveyed groups presented negative change: household items (-0.41%), transportation (-0.13%) and communication (-0.01%). Amongst groups that presented positive changes, it bears emphasizing the 0.88% increase in the prices of food and beverages, mainly driven by the increase in the prices of meat and poultry, and the 0.87% increase in the prices of personal outlays, mainly driven by the prices of household workers. Food contributed 0.18 p.p. for the IPCA result in October. The IPCA rose by 2.33% in the year through October and 3.26% in the last twelve months.

28. Market prices accelerated in October, increasing by 0.43%, up from 0.21% in the previous month, for a 2.51% growth in the last twelve months. Regulated prices decelerated, posting 0.12% in October, down from 0.22% in the previous month, totaling 4.84% in the last twelve months. Amongst market prices, tradable prices increased 0.42%, while non-tradable prices rose by 0.44%. On a twelve-month trailing basis, tradable and non-tradable prices increased 0.77% and 4.49%, respectively.

29. The IGP-DI increased 0.81% in October, for cumulative changes of 2.93% in the year and 3.34% in the last twelve months. The IPA (Wholesale Prices Index, the sub-index with the largest weight in the IGP-DI) accelerated in October, increasing 1.16% up from 0.28% in September, for cumulative changes of 3.41% in the year through October and 3.51% in the last twelve months. The IPC-Br grew only 0.14% in the month down from 0.19% in the previous month, reflecting the decreases in the prices of fuel alcohol, gasoline, legumes, fruit and sugar. The INCC increased 0.21% in October, up from 0.11% in September, reflecting the higher increase in the prices of services and materials.

30. The acceleration in wholesale price inflation in October was mainly driven by the sharp increase in agricultural prices, whereas industrial prices posted -0.07%. The agricultural IPA reached 5.18% in October, up from 1.20% in September, reflecting the rises in the prices of soy, corn, bovines, poultry, rice, wheat, legumes and fruit, items whose contribution reached 1.16 p.p. for IPA inflation and 0.69 p.p. for IGP inflation. According to the processing stages of production, only intermediate goods recorded price reduction (-0.27%). The prices of final goods increased 0.39%, up from -0.35% in September. The prices of raw materials hiked, totaling 5.10% in October, up from 1.31% in August and 1.29% in September.

31. Two out of three IPCA core inflation measures increased in October on a month-on-month basis, but all of them sustained their declining trend on a twelve-month trailing basis. The non-smoothed trimmed means core reached 0.19% in October, up from 0.13% in September, totaling 3.21% in twelve months. The core under the smoothed trimmed means method stood at 0.32%, the same posted in September, totaling 4.93% in twelve months. The core excluding household food and monitored prices totaled 0.30% in October, up from 0.23% in the previous month, reaching 3.56% in the last twelve months.

32. The IPC-Br core inflation, calculated by the FGV under the symmetric trimmed means method, reached 0.17% in October, totaling 2.23% in the year through October and 2.92% in the last twelve months.

33. The IPCA diffusion index (measuring the number of items in the IPCA registering price increases) stood at 58.3% in October, up from 54.9% in September and 52.1% in August.

Economic Activity

34. According to IBGE's monthly survey, retail sales increased a month-on-month seasonally adjusted 2.1% in September. Three of the four activities with seasonally adjusted data increased: furniture and home appliances (3.9%); fabric, clothing and shoes (2.5%); and hypermarkets, supermarkets, food, beverages and tobacco (1.3%). Only fuel and lubricants decreased on a month-on-month basis (0.6%).

35. Retail sales increased 10.1% in September, compared to September 2005, mainly driven by the increases in furniture and home appliances (20.6%) and in hypermarkets and supermarkets (11.0%). Expanded retails sales, including civil construction inputs and vehicles, motorcycles, parts and pieces, grew 10.3% in the year through September. Sales in these activities increased 13.8% and 10.1%, respectively, mainly driven by the favorable credit conditions. In the year through October, retail sales expanded by 5.8%, while expanded retail sales increased 5.5%.

36. São Paulo Trade Association (ACSP) data in October, seasonally adjusted by Banco Central do Brasil, showed an increase of 6.1% in consultations to the Usecheque system, while database consultations for credit sales increased by 0.5%, on a month-on-month basis. In the year through October, these indicators expanded by 5.9% and 3.4%, respectively, compared to the same period of 2005.

37. Regarding investment indicators, capital goods production and civil construction inputs production decreased a month-on-month seasonally adjusted 2.1% and 1.2%, respectively, in September. Capital goods imports increased by 9.5%, according to the same comparison basis. In the year through September, these indicators rose by 5.0%, 5.0% and 26.7%, respectively, compared to the same period of 2005. Capital goods production for energy increased 31.8%, for construction, 11.3% and, for mixed use, 9.6%, while capital goods production for agriculture fell 20.5%, in the same period.

38. According to IBGE's monthly survey, industrial production decreased 1.4% in September on a month-on-month seasonally adjusted basis, mainly driven by the 1.4% decrease in manufacturing industry and 0.1% in mining industry. In the year through September, industrial output expanded by 2.7%, compared to the same period of 2005, with manufacturing and mining industries growing by 2.4% and 7.4%, respectively.

39. All use categories recorded output decreases on a month-on-month seasonally adjusted basis. Capital goods, intermediate and durable consumer goods production decreased by 2.1%, 2.1% and 1.0% respectively, as a result of the decrease of 4.4% in durable consumer goods production and 0.2% in semi- and non-durable consumer goods production. In the year through September, compared to the same period of 2005, production in all use categories expanded, with highlights to the increases in durable consumer goods and capital goods production, totaling 6.3% and 5.0%, respectively.

40. Seasonally adjusted data for industrial production showed a decrease in production in 12 of the 23 sectors surveyed, mainly in vehicles production, which decreased 9.3%, reflecting interruptions in the production of some important manufacturers during September. Among the activities that registered growth, electronic material and communication equipment showed a 10.8% expansion in September.

41. CNI manufacturing data decreased 0.1% in hours worked in production and increased 3.0% in real industrial sales in September, on a month-on-month seasonally adjusted basis. In the year through September, these two indicators increased by 1.1% and 0.4%, respectively, compared to the same period of 2005. Installed capacity utilization reached a month-on-month seasonally adjusted 82.1% in September, up from 81.9% in the previous month. Without seasonal adjustments, installed capacity utilization leveled at 82.3%, 0.8 p.p. above the September 2005 result.

42. Vehicles production totaled 226.4 thousand units in October, increasing 10.8% on a month-on-month seasonally adjusted basis, partially reflecting the stability in the production activity after interruptions observed in some manufacturers in September. Domestic sales grew 12.4%, and exports, 0.2%, according to the same comparison basis. In the year through October, vehicles production expanded by 4.5%; domestic sales increased by 10.9%, while exports decreased by 4.7%, compared to the same period of last year.

Surveys and Expectations

43. The Fecomercio-SP survey showed a 1.9% increase in the Consumer Confidence Index(ICC) in November. Both ICC components increased: Current Economic Conditions Index (Icea) rose 1.7%, while the Consumer Expectation Index (IEC) increased by 2.0%. The ICC expanded by 14.6%, compared to November 2005. According to the Fecomercio–RJ survey, the IEC increased a month-on-month 4.9% in October, and 10.1%, compared to the same month of last year.

44. The National Confidence Index (INC), measured by Ipsos in partnership with ACSP, increased 4.3% in October, on a month-on-month comparison, reaching 144 points in a scale from zero (maximum pessimism) to 200 (maximum optimism). The indicator that measures the individual confidence and security in relation to the financial

condition reached the highest level since its creation in April 2005, and reinforced the expectations of continuous expansion in retail sales.

45. According to the FGV survey, which encompassed 2,000 homes in the seven main capitals of the country, the ICC increased 5.0% month-on-month in October, recording a 6.0% increase in the present situation assessment and a 4.6% improvement in the 6-month ahead expectations.

46. Still according to FGV, the Industry Confidence Index (ICI), which encompasses six items of the Manufacturing Industry Survey, declined 2.2% in October, on a month-on-month basis, but expanded by 5.2% compared to October 2005. On a month-on-month basis, there was an improvement in the assessment about the present situation and deterioration in the expectations for the upcoming months.

Labor Market

47. According to the Ministry of Labor and Employment, 129,795 new jobs were created in October, spread among all major activity sectors. On a month-on-month seasonally adjusted basis, formal employment increased 0.5%. In the year through October, 1,514 thousand new jobs were created, corresponding to a 4.9% expansion compared to the same period of 2005, with highlights to the 9.6% increase in civil construction.

48. According to the IBGE survey (PME) in the six main metropolitan areas of the country, the unemployment rate decreased to 9.8% in October, down from 10.0% in September, standing 0.2 p.p. above the observed in October 2005. Average unemployment rate stood at 10.2% in the year through October, 0.2% above the level registered in the same period of 2005. The number of employed workers increased 2.2%, while the number of job seekers expanded 4.2%, according to the same comparison basis. Real average earnings reached R$1,046.50 in October, with a 1.2% month-on-month increase and a 5.4% expansion in comparison to October 2005. Real payrolls, defined as the product of real average earnings and the number of employed workers, expanded 1.0% in October, month-on-month, and 8.4% compared to October 2005. In the year through October, these indicators rose by 4.1% and 6.4%, respectively.

49. According to CNI, industrial employment increased 0.3% in September, seasonally adjusted, totaling a 1.7% growth in the year.

Credit and Delinquency Rates

50. Credit operations in the financial system increased 1.9% in October, for a 21.1% expansion in the last twelve months. Non-earmarked credit increased 2.0% month-on-month and 23.3% in twelve months, while earmarked credit operations expanded by 1.6% and 16.6% in the same comparison bases, respectively.

51. Non-earmarked credit, used as reference for interest rates, grew 1.3% in October, on a month-on-month basis, accumulating a 20.1% expansion in the last twelve months. Credit for individuals increased 1.3% in the month and 24.6% in the last twelve months. Corporate credit operations with domestic funding increased 1.4% in the month and 18.4% in twelve months, while externally funded operations increased 1.0% and 10.5%, according to the same comparison bases, respectively. Regarding non-earmarked credit, leasing operations for individuals and overall corporate credit operations should be highlighted, with 78.1% and 44.7% expansions in the last twelve months through October.

52. The average interest rate on non-earmarked credit decreased again in October, reaching 41.2% p.a., 7 p.p. below the October 2005 level. The average rate on credit for individuals declined to 53.1% p.a., compared to 61.7% p.a. in the same month of 2005, while the average rate on corporate credit decreased 6 p.p., to 27.4% p.a., in the same period.

53. Delinquency rates in the financial system (non-earmarked loans in arrears for more than ninety days) stood at 5.0% in October. Delinquency rates for corporate credit operations reached 2.7%, while for credit operations with individuals stood at 7.6%.

54. Net delinquency rates for retail credit, measured by the ACSP, rose to 6.1% in October. In the year through October, the number of new registers and cancelled registers increased 5.6% and 4.7% respectively, while the average default rate stood at 5.9%, up from 5.7% in the same period of 2005.

External Environment

55. The external outlook remains benign, despite some deceleration in global industrial production. In the US, real estate market has contracted and overall demand has grown more slowly, causing adjustments in production. In Japan, industrial production decelerated in September, with significant increase in inventories, but third quarter GDP growth was higher-than-expected and business expectations point to moderate economic growth. In the Euro Area, the pace of economic expansion declined in the third quarter, but business expectations point to the continuation of moderate expansion in the coming quarters, favored by price stabilization and the positive evolution of labor market.

56. Chinese economy continued to expand robustly in the third quarter, notwithstanding the restrictive decisions of the last months. GDP grew by a 10.4% annualized rate, compared to 11.3% in the previous quarter. Industrial production and gross capital accumulation cooled in October, compared do October 2005, but the accelerated growth trend is not expected to downturn soon. Domestic consumption and trade balance continued to expand. The excessive liquidity (M2) corroborates the expectations about a new monetary tightening in the coming months. Consumer inflation remained stable, totaling 1.4% in the year through October, compared to 1.5% in the previous month.

57. In the US, inflation has also cooled down, mainly due to declining energy costs, which have pressured down prices. However, the deceleration of productivity growth has been a concern for the markets. In the UK, inflation is above the 2% target, leading the Bank of England to raise the basic interest rate by 25 b.p. to 5% p.a.

58. Regarding commodities markets, the prices of agricultural goods are relatively stable, while the prices of metallic items continue to grow. Oil prices have shown a downward trend, despite the announcement of output cut by the Organization of Petroleum Exporting Countries (Opec). Putting aside geopolitical concerns, other aspects corroborate a benign outlook for oil prices: the deceleration of global demand and the cooling in the US economy, the adequate level of inventories, prospects of a mild weather in Northern Hemisphere's coming winter and the higher oil production of non-Opec countries.

59. Operations continue at a normal pace in financial markets. The Vix index, which measures the implicit volatility of Standard & Poor's 500 index and is considered a risk-aversion indicator, reached 9.9, approaching the 9.31 low record of December 1993. Other indicators also point to a lower risk aversion, which tends to benefit emerging countries assets. Transactions with emerging countries' debt securities totaled US$1.599 trillion in the third quarter, just 4% below the US$ 1.659 trillion record level of the previous quarter.

Foreign trade and International Reserves

60. In October, Brazilian external trade confirmed the ongoing expansion. Total external trade reached US$21.4 billion in the month, and the trade surplus totaled US$3.9 billion. In the year through October, all trade measures reached record highs: exports and imports totaled US$113.4 billion and US$75.5 billion, respectively, and trade surplus reached US$37.9 billion. In the first four weeks of November (16 working days), the trade surplus reached US$2.7 billion, as a result of US$9.7 billion exports and US$7 billion imports.

61. Exports totaled US$12.7 billion in October, averaging US$602.8 million per working day, 21.7% above October 2005. Manufactured, semi-manufactured and primary products reached daily averages of US$326.7 million, US$88.8 million and US$176.9 million, respectively, up 17.8%, 39.5% and 23.8% over the average daily levels of October last year. The two main exports drivers were iron ore (US$914 million) and raw oil (US$536 million), totaling respective increases of 24.2% and 168.9% over October 2005 daily average results.

62. Among the semi-manufactured, there were noticeable increases in raw sugar exports (US$452 million), totaling a 128.8% growth over October 2005. Among manufactured exports, vehicles exports – the main manufactured good exported - fell by 4.8% to US$368 million in the month. Manufactured exports were driven by refined sugar (US$305 million) and ethylic alcohol (US$276 million), with respective increases of 115.8% and 198.5% over October 2005. Export volumes increased for all export sectors, especially manufactured goods with low weight in total exports, and confirm the export diversification process.

63. Imports totaled US$8.7 billion in October, with a daily average of US$416.4 million, a 33.7% increase over the same month of 2005. All import categories expanded, measured in daily averages: consumer goods (44.2%), with highlights to vehicles (128.6%); raw materials and intermediate goods (34.3%); capital goods (29.9%) and fuel and lubricants (29.2%).

64. In October, Brazilian current account results recorded a US$1.5 billion surplus, a new record high for October months and accumulating a US$11.7 billion surplus in the year. In the twelve months through October, the current account surplus reached US$14 billion, or 1.54% of GDP.

65. International reserves increased US$4.8 billion in October, totaling US$78.2 billion at the end of the month. In the year through October international reserves grew by US$24.4 billion.

Money Market and Open Market Operations

66. After the October Copom meeting, the yield curve shifted downward for all tenors, driven by the Copom decision and by the indication of a careful economic policy stance. Regarding the external outlook, the perspective of smooth deceleration of the US economy and the release of US inflation core figures, in line with market expectations, drove the investment in emerging countries assets and contributed to the continuous downward move of domestic interest rates. At the end of November, the fall of the yield curve was also influenced by the cooling of inflation indicators, as well as by the perspective of Brazilian sovereign debt reclassification. From October 16 to November 27, one- three- and six-month rates fell 0.40 p.p., 0.34 p.p. and 0.32 p.p. respectively. One-, two- and three-year rates fell 0.36 p.p., 0.30 p.p. and 0.24 p.p., respectively. Real interest rates measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month ahead inflation expectations declined to 8.41% on November 27 from 8.88% on October 16.

67. On October 20 and on November 22, the BCB conducted reverse exchange rate swap auctions, in which the BCB assumed a long FX position and a short interest rate position. With these operations, which totaled US$2.1 billion, the BCB anticipated the redemption of the swaps due on November 1 and on December 1. As a result, the net redemption of FX instruments totaled US$10.1 billion in the year.

68. In its open market operations, the BCB carried out, from October 17 to November 27, weekly three-, five- and seven-month fixed rate repo operations. The average daily balance of these operations amounted R$58.0 billion, of which R$41.0 billion were 5-month operations. In the same period, the BCB also conducted 26 overnight repo operations, 20 of which aimed at draining the excess liquidity from the market. The BCB also conducted daily liquidity management operations with tenures up to two working days. Operations with tenors less than thirty days, including the daily liquidity management operations, averaged R$27.7 billion, borrowing.

69. Between October 17 and November 27, the National Treasury raised a total of R$66.6 billion, of which R$41.5 billion in fixed-rate securities: R$28.5 billion via issuance of LTNs maturing in 2007, 2008, and 2009 and R$13.0 billion in NTN-Fs maturing in 2010, 2012 and 2014. Issuance of LFTs totaled R$13.9 billion, for securities maturing in 2009, 2010, 2011 and 2012. Issuance of inflation-linked NTN-Bs reached R$9.7 billion, for securities maturing in 2009, 2011, 2015, 2024, 2035 and 2045, of which R$4.1 billion were settled in cash and R$5.6 billion were settled in other National Treasury securities. The National Treasury also raised R$1.5 billion through the issuance of inflation-linked NTN-Bs, maturing in 2021 and 2031, of which R$912 million were settled in cash and R$587 million were settled in other National Treasury securities.

70. In the same period, the Treasury conducted six auctions to sell LTNs maturing in April and October 2007 and bought LTNs maturing in January 2007 and LFTs maturing in 2006. These operations totaled R$12.5 billion.

Similarly, the Treasury conducted auctions to sell LFTs maturing in 2010 and 2012, totaling R$4.7 billion, accepting as payment LFTs maturing in 2006.

71. The Treasury also conducted auctions to buy LTNs, maturing on January 1, 2007 and NTN-Bs of several maturities, totaling R$1.2 billion and R$37 million, respectively.