BANCO CENTRAL DO BRASIL

Minutes of the 124th Meeting of the Monetary Policy Committee (Copom)

Summary

Date: January 23rd, from 4:30PM to 7:40PM, and January 24th, from 4:30PM to 8:00PM
Place: BCB Headquarters meeting rooms - 8th floor on January 23rd and 20th floor on January 24th – 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 January 23rd)
Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on January 24th)
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 January 23rd)
Alexandre Pinheiro de Moraes Rego – Special Advisor to the Governor
Alexandre Pundek Rocha – Advisor to the Board
André Minella – Deputy Head of the Research Department
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 accelerated in the last quarter of 2006, averaging 0.37% up from 0.15% in the third quarter and 0.03% in the second quarter of last year. In December, inflation reached 0.48%, above the 0.31% recorded in November and slightly above expectations registered on the eve of the IPCA release, and also above the expectations that prevailed at the end of December. Twelve-month trailing inflation also accelerated in December, compared to 3.02% in November. Favorable developments in the last months contributed to reach an inflation of 3.14% in 2006, down from 5.69% in 2005, the lowest annual inflation since the adoption of the inflation targeting regime, in 1999. Market prices increased 2.57% in 2006 (tradable prices contributed 1.31%, while non-tradable prices accounted for 3.99%), whilst regulated prices increased 4.27%. Therefore, for the third consecutive year, inflation stood within the tolerance intervals established by the National Monetary Council. Inflation acceleration in December was due to the increase in regulated prices (0.83% up from 0.00% in November), mainly driven by the urban bus fares, and not completely offset by the decrease in market prices inflation (0.32% down from 0.45% in November). Amongst market prices, tradable prices inflation decreased to 0.40% in December down from 0.54% in November, while non-tradable prices decreased to 0.24% down from 0.37%. Services inflation stood at 0.19% in December, unchanged relative to November, and slightly below the 0.22% observed in December 2005. In 2006, services inflation decreased to 5.48%, down from 6.78% in 2005. Partial January data, already captured by the IPCA-15 and underlying inflation measures, suggest that the short-term increasing IPCA trend should intensify. Despite the recent inflation acceleration in the last months, the most likely scenario is that inflation evolves according to the targets path.

2. Similarly to the headline result, IPCA core inflation measures calculated by the BCB also increased in December, on a month-on-month basis. Core inflation by exclusion of household food items and regulated prices increased to 0.34% in December, up from 0.23% in November and 0.30% in October. Smoothed trimmed means core increased to 0.38%, up from 0.27% in November and 0.32% in October, and continued to record the strongest rigidity among the three core measures. Conversely, after registering reduction in November to 0.12% down from 0.19% in October, the non-smoothed trimmed means core increased to 0.27% in December. Despite the recent increases, the cores continue to present a downward trend on a twelve-month basis, except for the core by exclusion, which slightly increased. According to the same comparison basis, the inflation cores recorded 3.56%, 4.63% and 2.76%, respectively, in December, compared to 3.52%, 4.68% and 2.83% in November. Similarly to the headline result, both the core inflation by exclusion and the non-smoothed trimmed means core stood below the central target in 2006. On the other hand, the smoothed core inflation has converged more slowly to the target, reaching 4.63% in 2006, and therefore, above the central target for the year.

3. The General Price Index (IGP-DI) inflation decelerated in the last two months of 2006, to 0.26% in December, down from 0.57% in November and 0.81% in October. This deceleration was mainly driven by wholesale price inflation. The Wholesale Price Index (IPA-DI) inflation cooled to 0.11% in December, down from 0.75% in November. On the other hand, both the INCC-DI and the IPC-DI increased in December, month-on-month. The downturn in IPA-DI was due to the deflation in agricultural prices in December (-0.66% down from 2.39% in November), after several consecutive increases, whilst industrial prices accelerated. As a consequence, the IGP-DI increased 3.79% in 2006, up from 1.22% in 2005. This acceleration was driven by wholesale price inflation, and more specifically, by the significant upturn in agricultural prices in the second half of the year. After several months of deflation (reaching -3.14% in the twelve months through April), the IPA-DI reached 4.29% in 2006. After recording –13.19% in the twelve months through March, the Agricultural IPA totaled 6.92% in the year. As highlighted in previous Copom Minutes, the effects of wholesale prices over consumer inflation will depend on prospective demand conditions and price-setters' expectations for the future inflation path.

4. Industrial production, according to IBGE month-on-month seasonally adjusted data, expanded by 1.0% in October and 0.8% in November. Compared to the same months last year, the increases totaled 4.9% and 4.2%, respectively. In the year through November, industrial production reached 3.1%, while on a twelve-month trailing basis, industrial output reached 3.0%, the third positive result according to the same comparison basis, and indicating industrial activity acceleration. On a three-month moving average basis, industrial production increased for the eightieth consecutive month in November. The expansion in manufacturing activity in November reached 14 out of the 23 activities with seasonally adjusted data, with highlights to other transportation equipment (10.1%) and beverages (4.8%). For December, leading and coincident indicators suggest accommodation of the trend, which should not surprise in light of the strong increment recorded in the preceding months. However, several incentive

factors, including the monetary easing already implemented and the fiscal impulses, suggest that the expanding trend in industry shall accelerate in 2007.

5. Disaggregated industrial data showed month-on-month seasonally adjusted expansions of 2.2% in capital goods production and 1.6% in intermediate goods production, after two months of contraction, but a 0.1% reduction in durable consumer goods production in November. Compared to the same month last year, all categories increased, with highlights to the expansions of durable consumer goods production (10.4%) and capital goods production (7.9%). In the year through November these use categories increased by 7.3% and 5.7%, respectively. The strong 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 growth, and also to the influence of favorable international prices in the purchase of capital goods destined to several industrial sectors.

6. Labor market performance remains positive, with decreasing unemployment rate, creation of formal jobs and higher purchase power of workers. The unemployment rate in the six main metropolitan areas reached 9.5% in November, compared to 9.8% in October and 9.6% in November 2005. Rio de Janeiro, Belo Horizonte and Porto Alegre metropolitan areas recorded the lowest unemployment rates for November months since the beginning of the IBGE series. The unemployment rate contracted in all the six metropolitan areas surveyed, except for Rio de Janeiro, which recorded stability. As a result, the average unemployment rate in the year through November 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% in the year through November and 3.0% in the month, compared to the same month last year, indicating that the pace of jobs creation remains robust. Still in November, the purchase power of workers increased a month-on-month 0.6% and 5.7% over the same month last year, for a 4.3% expansion in the year through November. In addition, real payrolls increased 6.6% 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 0.5% both in October and in November, consolidating a five-consecutive-month expansion. Compared to the same months last year, manufacturing employment grew 3.2% and 3.9%, respectively. In the year through November, it reached 2.1%, compared to the same period last year. Regarding formal employment, data from the Ministry of Labor and Employment (MTE) confirm the continuity of the ongoing expansion. In November, the number of jobs increased 0.4%, on a month-on-month seasonally adjusted basis. In the year through November, the number of jobs expanded by 4.9%, the same rate observed in the last twelve months, mainly driven by the expansions of 9.4% in civil construction and 6.0% in the retail sector. With the creation of 32,579 jobs in November, formal job creation reached 1,546,179 in 2006. In the twelve months through November, 1,259,460 jobs were created.

7. Retail sales continued to expand in November 2006. IBGE data recorded a month-on-month seasonally adjusted 0.6% in retail sales for November and 0.5% for October. Compared to the same months of last year, retail sales grew 7.0% in October and 9.2% in November. In the year through November, retail sales expanded by 6.2%, mainly driven by furniture and domestic appliances sales (10.9%) and hyper- and supermarket sales (7.6%). The positive performance of retail sales is not restricted to income- and labor-sensitive items, but also comprises credit-sensitive items. Expanded retail sales, which include the sales of construction material and vehicles, motorcycles, parts and pieces, increased 10.2%, compared to November 2005 results, reflecting expansions of 10.4% and 12.2%, respectively, in the sales of these segments, fostered by positive credit conditions. In the year through November, expanded retail sales expanded by 6.5%. Retail sales expansion is expected to continue in 2007, boosted by positive labor market and income developments, credit expansion and the effects of 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 November up from 82.0% in October, according to CNI data seasonally adjusted by the BCB. Considering non-seasonally adjusted data, the average installed capacity utilization through November stood 0.2 p.p. below that of the same period last year. Since July, utilization rates have been at higher levels than those observed in the same months of 2005. Disaggregated indicators compiled by the FGV show utilization rates at historically high levels for civil construction and capital goods, whose production has vigorously expanded. Despite industrial production growth, average utilization has shown relative stability, which 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 November, the absorption of capital goods expanded by 9.2%, mainly driven by the increases in capital goods imports volume (24.0%) and in capital goods production (5.7%). Civil construction inputs expanded by 4.9%, according to the same comparison basis. Therefore, despite the ongoing aggregate demand expansion, relevant aggregate supply imbalances that could jeopardy the inflation targets 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, confirming previous Copom assessments regarding important structural changes in the Brazilian external trade. In 2006, the trade balance reached US$46.1 billion, 3% above the level reached in 2005. This result was driven by the record results of exports (US$137.5 billion) and imports (US$91.4 billion). Despite significant, twelve-month trailing surplus through December was lower than the US$46.3 billion record high observed in October. As a result of domestic demand recovery, imports have outperformed on the margin, gradually compressing trade balance results. As a consequence, external results in 2007 are expected to be lower than those observed in 2005-2006, but still high for the Brazilian historical standards. The current account surplus stood at US$1.5 billion in November, reaching US$13.2 billion in the year, or 1.6% of GDP, for a US$14.0 billion surplus in the twelve months through November, or 1.5% 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 tightening cycle may have already ended. On the other hand, even though the recession scenario in the US economy seems to be less plausible, there are uncertainties about the magnitude of the US economy deceleration. The uncertainties regarding monetary policy in Europe and Japan also persist. However, it bears emphasizing, so far, the limited effects of the less clear international outlook observed in the last months, when the concerns stated above were already present, particularly with regard to the increased risk aversion, commodities prices trajectory, and lower international liquidity. In fact, after an up-tick in May, the sovereign risk reached historically low levels in the last months. 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, adequate public sector's primary surpluses, the buildup of international reserves, 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 continued to dampen. Oil prices slightly decreased since the last Copom meeting, contributing to cool down uncertainties associated with its evolution and effects on the world economy. Oil prices are below the lowest prices observed in the last 18 months, due to the exceptionally mild winter in the Northern Hemisphere and apparent difficulties that Opec faced to control supply. In spite of the recent decrease, oil prices still present high volatility, reflecting, among other factors, geopolitical tensions and weather conditions. However, the scenario considered by the Copom, which attributes no change to domestic gasoline prices in 2007, 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 December Inflation Report, the projection for gasoline and bottled gas prices adjustments in 2007 were both changed to 0%;

b) Considering the same comparison basis, the projections for household electricity and fixed telephone prices adjustments in 2007 were changed to 4.6% and 3.9%, respectively;

c) The projection for regulated prices inflation in 2007 decreased to 4.5% from 4.8% (December Inflation Report). These items, according to the weights released by the IBGE, represent 31.04% of the total December IPCA;

d) The projection for regulated prices inflation in 2008 was maintained at 5.6%, as presented in the December Inflation Report. This projection for regulated prices is based on the endogenous determination model. This model considers the effects of seasonal components, exchange rate change, 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 2007, reaching 70 b.p. in the last quarter of 2008.

13. Regarding fiscal policy, it is assumed that the consolidated public sector primary surplus target of 4.25% of GDP in 2007 and 2008 will be achieved, adjusted by the possibility of a 0.5 p.p. reduction in this percentage due to the implementation of PPI (Investment Pilot Plan). The related assumptions considered in the previous meeting were maintained.

14. Since the November Copom meeting, median IPCA inflation expectations for 2007, compiled by the BCB's Investor Relations Group (Gerin), decreased slightly to 4.07% from 4.10%. This decrease was mainly driven by lower inflation projected for the second and third quarters of the year. The twelve-month ahead inflation expectations decreased to 4.04% from 4.17%. For 2008, inflation expectations decreased to 4.0% from 4.3%. As mentioned in previous Minutes, these developments suggest the consolidation of a more favorable long-term macroeconomic scenario.

15. The 2007 inflation forecast under the benchmark scenario – which assumes the maintenance of the Selic rate at 13.25% and the exchange rate at R$/US$2.15 during the forecast period – decreased compared to the values considered at the November 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 below the values considered in the November Copom meeting, and below the central target for the year. The projections for 2008, according to both scenarios, reduced relative to the November projections, remaining below the 4.50% target in the benchmark scenario, and above the 4.50% target in the market scenario.

Monetary Policy Decision

16. The Copom reaffirms the view expressed in previous Minutes, that besides containing short-term inflationary pressures, monetary policy has also contributed significantly for the consolidation of a favorable long-term macroeconomic environment. Economic activity data still do not suggest high likelihood of important pressures over short-run inflation. Imports expansion has contributed significantly to this process, complementing domestic production and, therefore, limiting potential inflationary effects of aggregate demand sustained growth. In addition, despite the prospects of lower liquidity in international markets, due to the interest rates increase in industrialized economies, the external outlook, particularly regarding Brazilian external financing, remains favorable even in a context of moderation in international growth. The favorable external outlook strengthened as international oil prices decreased significantly in the last weeks. Therefore, the prospects for the inflation trajectory remain benign. As in the November meeting, the Copom emphasizes that the main challenge of the monetary policy in this context is to guarantee the consolidation of future positive developments.

17. The Copom evaluates that pressures stemming from food and regulated prices, mainly public transportation fares in some state capitals, have driven the short-term inflation increase. Since these effects have not exhausted yet, upcoming inflation indicators will likely reflect those increases. Due to the nature of such pressures, they are expected to be temporary, with decreasing intensity throughout time, without necessarily affecting longer-time horizons. However, the Copom will continue to manage the monetary policy stance so that the gains obtained in inflation control in recent years become permanent. In this respect, 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 adjusting the monetary policy 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 cautious 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 again, that there are important time lags in the transmission of monetary policy stance to economic activity and inflation. Since the beginning of the monetary easing cycle, in September 2005, the Selic rate has already been reduced by 650 b.p., with the greater part of the reduction concentrated in the second half of 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 focus on the prospective inflation scenario and its risks, 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 November Copom Minutes, activity level should also reflect the effects of governmental transfers and other fiscal impulses occurred in 2006 and expected for this year. Consequently, the lagged effects of interest rates cuts on an increasingly robust aggregate demand will add up to other factors that will continue to contribute to this expansion.

21. Given the reasons stated above, the Copom considered again, as in its three previous meetings, the convenience of reducing the Selic target by 25 basis points. The Copom members consensually concluded that several factors would justify such decision, and that it would contribute to increase 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. Three members of the Committee voted for a 50-basis-point reduction in the Selic target, considering that the current balance of risks justified such decision.

22. On the other hand, the majority of the members of the Copom emphasized that the information available at that moment justified a change in the pace of the ongoing monetary easing process. Given the existing incentives for expanding aggregate demand, the uncertainties surrounding the monetary policy transmission mechanisms, the lower distance between the current Selic rate and the medium-term equilibrium interest rates, and the interest rate cuts implemented since September 2005, these Copom members understood that the preservation of important achievements in disinflation and in preserving economic growth, with job creation and rising real income, demanded a more cautious monetary easing stance. This argument is even more relevant considering the signs of heated aggregate demand, the short-term inflation pressures and the fact that the monetary policy decisions should have concentrated effects in the second half of 2007 and 2008, progressively.

23. Therefore, the Copom decided to reduce in the Selic target by 25 basis points to 13.00% 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 50 basis points.

24. Under an inflation-targeting regime, the monetary authority decides according to inflation prospects, analyzing alternative scenarios for the main variables that determine price dynamics. The international scenario remains favorable, but new elements of uncertainty came up. On the other hand, a set of price pressures, apparently temporary, arises when domestic demand already expands robustly. In such an environment, the monetary authority must remain vigilant, so that short-term uncertainties do not contaminate longer time horizons. Evidently, in case of an exacerbation of the risk factors monitored by the Copom, the monetary policy strategy will be promptly adapted to the circumstances.

25. At the conclusion of the meeting, it was announced that the Copom would reconvene on March 6th 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

26. IPCA inflation increased 0.48% in December, up from 0.31% in the previous month. Such acceleration was mainly driven by an upturn in transports prices, which contributed 0.24 p.p. for the monthly result. Other groups also showed price elevations, with highlights to clothing (1%); personal outlays (0.44%); and food and beverages (0.39%), the last two with lower changes than in the previous month. IPCA inflation totaled 3.14% in 2006, the lowest variation since 1998, when it reached 1.65%. Comparing the two semesters of 2006, the index performed similarly, posting 1.54% and 1.58% in the first and second semesters, respectively. Food and beverages increased by 1.23% in 2006, far below the IPCA change.

27. Market prices variation decreased to 0.32% in December, down from 0.45% in November, for a 2.57% change in 2006. In the year, tradable and non-tradable goods prices rose by 1.31% and 3.99%, respectively. Regulated prices had a punctual contribution for the IPCA acceleration in December, which did not affect the declining trend observed during the year. Regulated prices variation stood at 4.27% in 2006, compared to 8.96% in the previous year.

28. The IGP-DI increased 0.26% in December, totaling 3.79% in 2006. The IPA (Wholesale Prices Index, the sub-index with the largest weight in the IGP-DI) decelerated to 0.11% in December from 0.75% in November, for a 4.29% increase in the year. The IPC-Br reached 0.63% in the month, up from 0.24% in November, mainly due to the elevation of urban bus fares; the index totaled 2.05% in 2006. The INCC increased 0.36% in December, up from 0.23% in November, for a 5.04% elevation in the year.

29. The deceleration in wholesale price inflation in December reflected the fall of agricultural prices and the slight acceleration in industrial prices. The Agricultural IPA reduced 0.66%, down from 2.39% in November, with highlights to the reduction in the prices of bovines, rice and sugar cane; in the year, the index rose by 6.92%. The Industrial IPA increased 0.36% in December, up from 0.22% in the previous month, for a 3.46% elevation in the year. According to the processing stages of production, only intermediate goods recorded price increase in December (0.37%). The prices of final goods declined 0.15%, after a 0.37% elevation in November. The prices of raw materials decelerated in December, falling 0.05% after the 3.03% increase in the previous month. In the year, the prices of raw materials increased by 10.07%, pressuring the IPA result; prices of intermediate and final goods rose by 3.49% and 1.22%, respectively.

30. All IPCA core inflation measures increased in December on a month-on-month basis, but sustained their declining trend on a twelve-month trailing basis, including the December results, except for the stability recorded in the core by exclusion of household food items and regulated prices. The non-smoothed trimmed means core reached 0.27% in December, up from 0.12% posted in November, increasing to 2.76% in twelve months. The core under the smoothed trimmed means method stood at 0.38% in December, up from 0.27% in November, totaling 4.63% in 2006. The core excluding household food and regulated prices reached 0.34% in December, up from 0.23% in the previous month, for a 3.56% expansion in 2006.

31. The IPC-Br core inflation, calculated by the FGV under the symmetric trimmed means method, increased to 0.31% in December, for a 2.82% expansion in the year.

Economic Activity

32. According to IBGE’s monthly survey, retail sales increased a month-on-month seasonally adjusted 0.6% in November. The four activities with seasonally adjusted data increased, with highlights to the increases observed in fabric, clothing and shoes (5.7%) and fuel and lubricants (2.0%).

33. Retail sales increased 9.2% in November, compared to November 2005, mainly driven by the increases in furniture and home appliances (14.9%) and hyper- and super-market sales (9.7%). Expanded retail sales, including civil construction inputs and vehicles, motorcycles, parts and pieces, grew 10.2%, according to the same comparison basis, evidencing increases of 10.4% and 12.2% of these segments, respectively, driven by favorable credit conditions. In the year through November, retail sales increased by 6.2%, while expanded retail sales reached 6.5%.

34. São Paulo Trade Association (ACSP) data in December, seasonally adjusted by the BCB, showed a 0.4% decline in database consultations for credit sales and a 3.5% increase in consultations to the Usecheque system, on a month-on-month basis. In 2006, these indicators expanded by 3.3% and 5.6%, respectively.

35. Regarding investment indicators, capital goods and civil construction inputs production grew a month-on-month seasonally adjusted 2.2% and 1%, respectively, in November. Capital goods imports fell 7.2%, according to the same comparison basis. In the year through November, these indicators increased by 5.7%, 4.9% and 24.0%, respectively, compared to the same period of the previous year. Also in the year through November, capital goods production for energy increased 26.7%, for construction, 9.3%, and of mixed use, 11.4%, while capital goods production for agriculture fell 18.7%.

36. According to the IBGE’s Monthly Industrial Survey (PIM), industrial production increased a month-on-month seasonally adjusted 0.8% in November, reaching a record high for the series. Industrial production expanded by 4.2%, compared to the same month of 2005, and 3.1% in the year through November, for a 3% growth on a twelve-month trailing basis, respectively.

37. According to IBGE’s monthly survey, the 0.8% growth in industrial production in November reflected monthly expansions of 2.2% and 0.8% in mining and manufacturing industry, respectively. Regarding use categories, capital goods and intermediate output increased by 2.2% and 1.6%, respectively, while consumer goods production fell 0.1%, driven by the decreases in durable goods (0.1%) and non-durable goods production (0.6%).

38. Seasonally adjusted data for industrial production showed that 14 of the 23 sectors surveyed increased in November, mainly in other transportation equipment (10.1%), beverages (4.9%) and oil and alcohol refine (4.6%). Clothing and accessories, perfume and cleansing products and vehicles recorded declines of 2.1%, 1.4% and 1%, respectively.

39. The 3.1% growth in industrial output, in the year through November, compared to the same period of 2005, was driven by the expansions of 7.3% in mining and 2.8% in manufacturing industry. All use categories grew in November, with highlights to durable consumer goods production (7.3%). Capital goods, semi- and non-durable goods and intermediate goods production increased by 5.7%, 2.9% and 2.1%, respectively, according to the same comparison basis.

40. Seasonally adjusted data for industrial production showed an increase in production in 21 of the 26 sectors surveyed, boosted by the 52.8% expansion in the production of office machines and data equipment, such as computers and monitors. It bears emphasizing the increases of 10.4% in machines production, electrical materials and devices, mainly transformers and the 7.3% growth in mining output, particularly iron ore and oil.

41. CNI manufacturing data showed decreases of 0.6% in hours worked in production and 0.8% in real industrial sales in November, on a month-on-month seasonally adjusted basis. In the year through November, these two indicators increased by 1.8% and 1.5%, respectively, compared to the same period of 2005. Installed capacity utilization reached a month-on-month seasonally adjusted 82.1% in November, up from 82.0% in the previous month. Without seasonal adjustments, installed capacity utilization leveled at 82.5%, 0.4 p.p. above the November 2005 result.

42. Vehicles production totaled 185 thousand units in December, decreasing 4.6% on a month-on-month seasonally adjusted basis. Domestic sales grew 7.8% and exports, 6.4%, according to the same comparison basis. Year-on-year vehicles production expanded by 3.1%; domestic sales increased by 11.1%, while exports declined by 5.8%.

Surveys and Expectations

43. The Fecomercio-SP survey showed a 5.1% month-on-month expansion in the Consumer Confidence Index (ICC) in January. Both ICC components increased: Current Economic Conditions Index (Icea) rose 12.7%, while the Consumer Expectation Index (IEC) increased by 0.3%. The ICC expanded by 1.6%, compared to the same month last year.

44. According to the FGV survey, which encompassed 2,000 homes in the seven main state capitals of the country, the ICC increased 2.2% month-on-month in December, recording a 3.3% increase in the present situation assessment and a 1.5% improvement in the 6-month ahead expectations.

45. Still according to FGV, the Industry Confidence Index (ICI), which encompasses six items of the Manufacturing Industry Survey, declined 0.8% month-on-month in December, but expanded by 9.5% compared to December 2005. On a month-on-month basis, there was stability in the assessment about the present situation and deterioration of 1.4% in the expectations for the upcoming months.

Labor Market

46. According to the Ministry of Labor and Employment, 32,579 new jobs were created in November, with expansion in the commerce and services sectors and contraction in the manufacturing industry, agriculture and civil construction. On a month-on-month seasonally adjusted basis, formal employment increased 0.4%. In the year through November, 1,546 thousand new jobs were created, corresponding to a 4.9% expansion compared to the same period of 2005, with highlights to the 9.4% increase in civil construction.

47. According to the IBGE survey (PME) in the six main metropolitan areas of the country, the unemployment rate reached 9.5% in November, down from 9.8% in October, standing 0.1 p.p. below the observed in November 2005. Average unemployment rate stood at 10.1% in the year through November, 0.2 p.p. above the level registered in the same period of 2005, as a result of the increases of 2.2% in the number of employed workers and 2.4% in labor force. Real average earnings reached R$1,065.38 in November, with a 0.6% month-on-month increase and a 5.7% expansion in comparison to November 2005. Real payrolls, defined as the product of real average earnings and the number of employed workers, expanded 1.0% in November, month-on-month, and 8.8% compared to November 2005. In the year through November, these indicators rose by 4.3% and 6.6%, respectively.

48. According to CNI, industrial employment increased 0.5% in November, seasonally adjusted, totaling a 2.1% growth in the year.

Credit and Delinquency Rates

49. Credit operations in the financial system increased 2.3% in December, for a 20.7% expansion in 2006. Non-earmarked credit increased 2.1% month-on-month and 23.8% in twelve months, while earmarked credit operations expanded by 2.7% and 14.6%, respectively, according to the same comparison bases.

50. Non-earmarked credit, used as reference for interest rates, decreased 0.1% month-on-month in December, for a 23.6% expansion in 2006. Credit for individuals increased 1.4% in the month and 25.2% in the last twelve months. Corporate credit operations with domestic funding increased 4.3% in the month and 20.4% in twelve months, while externally funded operations decreased 1.9% and expanded by 9.4%, according to the same

comparison bases, respectively. Still regarding non-earmarked credit, leasing operations for individuals and for overall corporate credit operations expanded by 76.1% and 42.1%, respectively, in the in the last twelve months.

51. The average interest rate on credit operations decreased again in December, reaching 39.8% p.a., 6.1 p.p. below the December 2005 level. The average rate on credit for individuals reached 52.1% p.a., compared to 59.3% p.a. in the same month of 2005, while the average rate on corporate credit decreased 5.5 p.p., to 26.2% p.a., in the same period.

52. Delinquency rates in financial system (non-earmarked loans in arrears for more than ninety days) reached 5% in December, decreasing 0.1 p.p. in the month and increasing 0.8 p.p. in the year. Delinquency rates for corporate credit operations decreased 0.1 p.p. in the month and expanded 0.7 p.p. compared to December 2005, reaching 2.7%. Delinquency rates for credit operations with individuals stood at 7.6%, decreasing 0.1 p.p. in the month and increasing 0.9 p.p. in twelve months.

53. Net delinquency rates for retail credit, measured by the ACSP, reached -0.6% in December, repeating a seasonal phenomenon caused by the reduction of new registers and the expressive increase in canceled registers in December. In the year, the number of new and canceled registers increased 5.0% and 3.3%, respectively, while the average default rate reached 5.3%, compared to 5.0% in 2005.

External Environment

54. Global growth should remain robust in 2007, despite some deceleration relative to 2006.

55. Although risks to the concretization of this scenario persist, the stability observed in the US real estate market, the support to domestic demand in Japan stemming from the heated labor market and high private investment levels and the continued expansion of consumption and investment in Europe shall not only assure output expansion close to potential levels in the main economic areas, but also support one more year of consistent expansion in international trade.

56. Although the cooling of domestic demand in the main economic areas and of international trade expansion and the economic reforms in course in China can decelerate the country's economy, the Chinese GDP growth may remain high, favoring the demand for intermediate goods and services produced in other Asian countries and also the demand for commodities produced in other regions. In the same way, the continued substitution of alternative energy sources for oil, driven by oil prices elevation in the last years, should contribute to keep the international prices of these products at high levels.

57. The main risk to this favorable scenario in 2007 is the increase of inflationary pressures driven by an eventual elevation in international oil prices, mainly related to geopolitical factors and to cost pressures stemming from US low unemployment rates.

Foreign Trade and International Reserves

58. In December, Brazilian foreign trade continued to expand, with new record highs in exports and imports for the month. Total external trade reached US$19.5 billion in the month, for a US$ 5 billion trade surplus, a record high for December and the second highest monthly level for the series. All 2006 results are historical records, indicating the improvement in Brazilian foreign trade. Exports totaled US$137.5 billion, imports reached US$91.4 billion, and total external trade totaled US$228.9 billion, for a US$46.1 billion trade surplus. In the three first week of January (fourteen working days), the trade surplus reached US$1.7 billion, a result of US$7.3 billion exports and US$5.6 billion imports.

59. World economic growth favored the increase in the demand for goods and international prices, mainly commodities prices. In the year, the elevation in prices prevailed over the expansion of shipped volumes, resulting in growth in the three exports categories. Moreover, it bears emphasizing the ongoing diversification process, with

generalized increase in shipping, particularly with regard to manufactured goods with low weight in total exports, and the expansion of exports destination.

60. Exports reached US$12.2 billion in December, with a daily average of US$611.8 million, a 23.5% increase over December 2005. In 2006, the exports of manufactured, semi-manufactured and primary products recorded record highs. Manufactured goods external sales reached US$74.7 billion, a 15.6% increase in the year, considering the daily average. Primary products exports totaled US$40.3 billion, and semi-manufactured ones, US$19.5 billion, with respective increases of 16.9% and 23.3% in 2006.

61. Imports totaled US$7.2 billion in December, a 21.0% increase considering daily averages, compared to December 2005. Fuel and lubricants imports decreased 13.7%, while other imports expanded in the period, particularly consumer goods imports (49.7%). In 2006, imports expanded by 25.2%, measured in daily averages, compared to 2005, with increases in all categories: consumer goods (42.6%), mainly automobiles (136.0%); fuels and lubricants (28.2%); capital goods (23.9%); and raw materials and intermediate goods (20.8%).

62. In December, international reserves totaled US$85.8 billion, increasing US$2.7 billion in the month and US$32.0 billion in the year.

Money Market and Open Market Operations

63. After the November Copom meeting, the yield curve shifted downward, particularly the long-tenure ones. This movement began immediately after the meeting, reflecting the Committee decision to reduce the Selic rate by 0.50 p.p., and lasted for all December, in light of good results for domestic inflation. External conditions also favored this reduction, such as prospects of cooling in the US economy and the favorable outlook for inflows to emerging countries. In the beginning of January, however, the FOMC Minutes raised concerns about the US economy developments. Employment and activity data released right after that reinforced those concerns and, in addition to the fall in the prices of commodities in international markets, caused a temporary increase in the long-term rates in local market. Since January 18, however, data regarding inflation in the US, in line with expectations, contributed to a downturn in the yield curve. Between November 27 and January 22, one-, three- and six-month rates declined 0.46 p.p., 0.55 p.p. and 0.53 p.p., respectively. One-, two- and three-year rates reduced 0.59 p.p., 0.82 p.p. and 0.96 p.p., respectively. The real interest rate measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month ahead inflation expectations decreased to 7.99% on January 22, down from 8.41% on November 27.

64. Between November 28 and January 23, the BCB conducted two reverse exchange rate swap auctions. The first one, on December 14, anticipated the redemption of the swap due January 2nd and reached US$1.6 billion. The February 1st maturity rollover was accomplished on January 23 and totaled US$742 million.

65. In its open market operations, the BCB carried out, from November 28 to January 22, weekly five- and seven-month long fixed rate repo operations. The average daily balance of these operations amounted R$55.3 billion, of which R$28.0 billion were five-month operations. In the same period, the BCB also conducted 37 overnight repo operations, 35 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$32.0 billion, borrowing.

66. Between November 28 and January 22, the National Treasury raised a total of R$59.7 billion, of which R$37.1 billion in fixed-rate securities: R$17.9 billion via issuance of LTNs maturing in 2007, 2008 and 2009 and R$19.2 billion in NTN-Fs maturing in 2010, 2012, 2014 and 2017. Issuance of LFTs totaled R$13.5 billion, for securities maturing in 2010 and 2012. Issuance of inflation-linked NTN-Bs and NTN-Cs reached, respectively, R$7.4 billion, for securities maturing in 2009, 2011, 2015, 2024, 2035 and 2045, and R$ 1.7 billion, for securities maturing in 2017, 2021 and 2031.

67. In the same period, the Treasury conducted auctions to sell LTNs maturing in July and October 2007 and, later, in October 2007 and April 2008, conjugated to the purchase of shorter-term LTN or LFT maturing in 2006, totaling R$12.2 billion. The Treasury also conducted auctions to sell LFTs maturing in 2010 and 2012, totaling

R$1.5 billion, accepting as payment LFTs maturing in 2006 or in the first half of 2007. Still, the Treasury conducted auctions to buy LTNs maturing in January and April 2007 and NTN-Bs with several maturities, totaling R$6.2 billion and R$180 million, respectively.