BANCO CENTRAL DO BRASIL

Minutes of the 156th Meeting of the Monetary Policy Committee (Copom)

Summary

Date: January 18th, 2011, from 4:15PM to 18:30PM, and January 19th, from 4:32PM to 8:08PM

Place: BCB Headquarters meeting rooms – 8th floor on January 18th and 20th floor on January 19th – Brasília – DF

In attendance:
Members of the Committee
Alexandre Antonio Tombini – Governor
Aldo Luiz Mendes
Alvir Alberto Hoffmann
Anthero de Moraes Meirelles
Antonio Gustavo Matos do Vale
Carlos Hamilton Vasconcelos Araújo
Luiz Awazu Pereira da Silva

Department Heads (present on January 18th)
Adriana Soares Sales – Research Department (also present on January 19th)
Altamir Lopes – Economic Department
Daso Maranhão Coimbra – Department of Banking Operations and Payments System
João Henrique de Paula Freitas Simão - Open Market Operations Department
Márcio Barreira de Ayrosa Moreira – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations and Special Studies Department

Other participants (present on January 18th)
Alexandre Pundek Rocha – Advisor to the Board
André Minella – Advisor to the Research Department
Emanuel Di Stefano Bezerra Freire – Advisor to the Board
Eugênio Pacceli Ribeiro – Advisor to the Economic Department
Fabio Araujo – Advisor to the Research Department
Gustavo Paul Kurrle – Press Officer

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

Recent Economic Developments

1. IPCA inflation, after recording 0.83% in November, reached 0.63% in December. As a consequence, 2010 inflation reached 5.91%, 1.60 p.p. above the one observed in 2009 and 1.41 p.p. above the midpoint target. The inflation increase in 2010 reflects the behavior of market prices, which increased 7.09% and contributed with 5.0 p.p. of the 5.91 p.p. total. In fact, regulated prices increased 3.13%, compared to 4.74% in 2009, contributing with just 0.91 p.p. for 2010 inflation. Regarding market prices, it bears emphasizing that the change in the prices of tradable goods reached 6.87%, and the one relative to the prices of non-tradable goods, 7.28% in 2010. The change in the prices of services, whose dynamics tends to show more persistence than that of the prices of goods, continues in high levels, reaching 7.62% in 2010. In short, the set of available information suggests that prices acceleration in 2010, process lead by market prices, may show some persistence, in part because services inflation continues at high levels.

2. Food prices trajectory performed relevant role for 2010 headline inflation. In fact, in the first four-month period, the IPCA showed sharp rise, when the prices of food and beverages increased 5.19%, while in the second four-month period there was relative stability, when the prices of food and beverages retreated 1.61%. In the last four-month period, monthly inflation recorded high values in all months, with food and beverages increasing by 6.67%. It bears highlighting that twelve-month household food price inflation moved from 6.67% in April 2010, to 2.29%, in August, and reached 10.69% in December. According to the same comparison basis, the IPCA reached 5.26%, 4.49% and 5.91%, respectively. The recent elevation in food price inflation has partially mirrored domestic and external supply shocks, heightened by the high liquidity environment in international financial markets and global demand increase.

3. In line with the evolution of headline inflation, each one of the three main underlying inflation measures calculated by the BCB has recorded high values. The smoothed trimmed means core inflation moved from 0.55% in October to 0.56% in November and 0.52% in December, averaging 0.46% in 2010. In the same months, the double weight core inflation increased 0.58%, 0.66% and 0.71%, also averaging 0.46% in 2010. The core inflation by exclusion rose 0.44%, 0.52% and 0.60%, in the same months, averaging 0.44% in 2010. In 2010, the smoothed trimmed means core inflation, double weight core inflation and the core inflation by exclusion increased 5.45%, 5.63% and 5.62%, respectively. The IPCA diffusion index, which had reached 64.8% in October, increased to 67.2% in November and decreased to 62.2% in December. With the diffusion index at this level, evidences support hypothesis of prices acceleration.

4. The General Price Index (IGP-DI) inflation recorded 0.38% in December, value below the one registered in November (1.58%). In 2010, inflation reached 11.30%, above the level recorded in 2009 (-1.43%). Inflation measured by its main component, the Wholesale Price Index (IPA-DI), reached 13.85% in the year (-4.08% in 2009), reflecting the increase of 10.13% in the industrial IPA and 25.61% in the agricultural IPA. Inflation measured by the Consumer Price Index (IPC-DI), another component of the IGP-DI, recorded 6.24% in 2010, above the 3.95% registered in the previous year. According to the same comparison basis, inflation measured by the Civil Construction National Index (INCC), component with the lowest weight in the IGP-DI, increased 7.77%, above the 3.25% recorded in 2009. As emphasized in previous Copom Meeting Minutes, the Copom evaluates that the effects of wholesale prices over consumer price inflation will depend, among other factors, on the current and prospective demand conditions, the exposure of each sector to external and domestic competition, as well as on the price setters’ expectations for the future inflation path.

5. The Index of Economic Activity of the BCB (IBC-Br) incorporates estimates for the monthly production of the three sectors of the economy, as well as for products taxes and, therefore, it constitutes an important coincident indicator of economic activity. Considering seasonally adjusted data, the IBC-Br, which had been showing relative stability, with 0.1% increase between April and August 2010, resumed significant growth in September (0.4%), October (0.5%) and November (0.4%), suggesting that the period of most intense cooling of economic activity may have finished.

6. Industrial activity has not still shown consistent signs of a new expansion cycle. According to data seasonally adjusted by the IBGE, industrial output retreaded by 0.1% in November 2010, after a 0.3% increase in October, month-on-month, and a 0.8% decrease between April and November. The three-month moving average growth

rate reached 0.1% in the period between August and November, unchanged relative to the rate registered in the three-month period ended in October. Year-over-year, output increased 5.3% in November and 1.8% in October. On a twelve-month trailing basis, industrial output expanded for the eighth consecutive month, recording 11.7% in November, unchanged relative to October. Compared to December 2008, a record low for industrial production level registered during the 2008/2009 crisis period, recovery up to November 2010 totaled 24.1%. This recovery has partially been supported by the growth of industrial activity financing by public financial institutions.

7. Among the industry use categories, according to data seasonally adjusted by the IBGE, the most important driver in November, month-on-month, stemmed from capital goods production, which increased by 3.2%. Consumer and intermediate goods production rates were also positive, recording 0.4% and 1.0%, respectively. Considering the three-month moving average ended in November, all categories increased. Capital goods production increased 0.2%, while consumer and intermediate goods production grew by 0.3%. It bears highlighting that increase in the capital goods industry activity is the highest among the use categories, not only according to a month-on-month comparison basis, but also according to the average until November 2010, which expanded by 22.7%, compared to the same period of 2009. Such behavior evidences the robustness in capital goods investment, a relevant factor for economic recovery in the post-crisis period.

8. The unemployment rate in the six metropolitan regions covered by the IBGE Monthly Labor Survey (PME) decreased from 6.1% in October to 5.7% in November, lower than the 7.4% observed in November 2009, according to observed data. After reaching 9.0% in March 2009, the observed rate not only retreated significantly until November, but reached a historical record low for the series begun in March 2002. According to the seasonally adjusted series, the rate in November also reached a new record low for the series (6.0%). Employment, measured by the number of employed workers in the metropolitan regions, increased by 3.9% in October and 3.7% in November, year-over-year. Data from the Ministry of Labor and Employment (MTE) indicated growth in formal employment in all months of 2010, except for December. In December, 407.5 thousand jobs were eliminated, compared to the elimination of 415.2 thousand jobs in December 2009. In November 2010, 138.2 thousand jobs were created (246.7 thousand jobs in November 2009). In the year, 2.14 million jobs were created (2.52 million according to the criterion that considers delayed data delivered by the companies), a 114.7% expansion relative to 2009, which represents the best yearly result since the start of the series. The key driver for employment retreat in December 2010 was industry, which contributed with 37.5% for the monthly reduction. In 2010, the services sector was the main driver, with 40.4% of job creation in the year. Real average earnings in November retreated by 0.8% compared to the historical record registered in October and increased 5.7% year-over-year. As a consequence, real payroll, considering real average earnings earned in the six metropolitan regions, expanded by 9.6% in November, year-over-year, continuing to constitute a key driver for the maintenance of domestic demand growth.

9. According to the retail monthly survey from the IBGE, expanded retail sales increased 17.0% in November, 11.1% in October and 6.0% in September, year-over-year. According to the seasonally adjusted series, sales increased 1.4% in November, after growing in the six previous months. The average of sales increased 3.4% in the quarter ended in November, compared to the quarter ended in August. Out of the ten sectors surveyed, eight sectors performed positively month-on-month in November. The key driver was “office material and equipment” once again, with 10.5% growth. In the upcoming months, the retail sales trajectory should continue to be benefited by governmental transfers, real payroll growth, moderate credit expansion and consumer confidence.

10. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by FGV, without seasonal adjustment, reached 85.3% in December, down from 86.1% in November, standing close to the levels registered prior to the 2008/2009 crisis. According to the seasonally adjusted monthly series calculated by FGV, the Nuci reached 84.9% in December, up from 84.5% in the previous month. The four use categories retreated. Consumer goods industry utilization rate retreated 0.8 p.p. reaching 85.0%, and, for capital goods industry, 0.3 p.p., reaching 84.5%. Both in the construction inputs and in the intermediate goods industries the reduction was lower: 0.1 p.p.. According to the CNI series seasonally adjusted by the BCB, the Nuci remained stable at 82.2% in October, after reaching 82.1% in September and 82.2% in August. Therefore, the installed capacity utilization rates have been stable at high levels. The high occupation level reflects the recent expansion in economic activity, whose effects have not been totally offset by the maturity of investment projects. In this sense, the absorption of capital goods resumed growth in November (4.4%), month-on-month, and grew by 16.4% year-over-year. The average index through November increased by 28.0%, year-over-year. The production of construction inputs

increased 1.4% month-on-month and 7.6% year-over-year, in November. As stressed in previous Copom Minutes, the inflation trajectory is closely linked to current and prospective developments related to the expansion of supply of goods and services to adequately meet demand conditions.

11. The 2010 trade balance result totaled US$20.3 billion, US$5.0 billion below the observed in 2009. This result stemmed from US$201.9 billion in exports and US$181.6 billion in imports, equivalent to 32.0% and 42.2% changes, respectively, compared to 2009. In fact, the greater dynamism of domestic demand relative to external demand explains most of the reduction of the trade surplus. The behavior of remittances of profits and dividends, which also reflects the growth differential between the Brazilian economy and other economies, has been contributing to elevate the current account deficit. The 12-month period deficit increased from US$48.0 billion in October to US$49.4 billion in November, equivalent to 2.43% of GDP. On its turn, foreign direct investment reached US$38.2 billion in the last twelve months through November, equivalent to 1.88% of GDP, resulting in a need of foreign funding equivalent to 0.55% of GDP.

12. Since the last Copom meeting, some tendency of global economy recovery has been observed, mainly in the US, whose domestic demand shows some dynamism, especially in household consumption. The leading indicator published by the Organization for Economic Co-operation and Development (OECD) – often used for inferences of future behavior of global industrial production - , for instance, registered, in November, the third consecutive monthly increase. The disaggregated indicators by country suggest acceleration on the growth pace in the US and France, and expectation of continued growth in the other G7 countries, except for Japan. The Euro Area prospects, in particular, show quite asymmetrical, as uncertainties regarding the solvency of some peripheral economies persist, at the same time that the expansion pace remains strong in Germany. Inflation rates have been very low in G3 countries (US, Euro Area and Japan), in spite of extremely expansionist economic policy actions, both in fiscal and monetary sides. In the twelve months ended in November, core inflation rates – which excludes food and energy products – reached only 0.8% in the US, 1.1% in the Euro Area and -0.8% in Japan. Since the last meeting, there was monetary tightening in several economies, as in China. The People´s Bank of China announced, in January this year, the fourth increase in reserve requirements since November last year.

13. Brent oil prices increased substantially since the last Copom meeting, reaching a level close to U$100. This acceleration is consistent with apparent strengthening in the global demand framework – given that empiric evidences suggest that international oil prices, in the last two decades, have been determined more due to the global demand conditions than by the supply side. However, it bears highlighting oil prices volatility, a result of low predictability of some global demand components, of dependency of supply growth on the maturity pace of risky investment projects and of geopolitical complexity that is typical to the sector. The main scenario adopted by the Copom assumes unchanged domestic gasoline prices in 2011. Regarding the prices of other commodities, it is noteworthy the increase in the agricultural international prices. The food price index, calculated by the Food and Agriculture Organization of the United Nations (FAO), and which considers 55 items, reached its peak in December 2010. This movement was leveraged, among other factors, by the increase in the international prices of sugar, cereals and vegetable oils. In recent past, the high volatility observed in commodities prices seems to have been strongly impacted by the abundant global liquidity, in a context where financial markets adjust to new expectations of demand growth and to the remarkable volatility in FX markets.

Assessment of Inflation Trends

14. The identified shocks and their impacts were reassessed according to the new set of available information. The scenario considered in the simulations was based on the following assumptions:

a) the projected adjustments for gasoline an bottled gas prices in 2011 were kept unchanged at 0%, the same considered at the December Copom meeting;
b) the projected adjustments for fixed telephone and electricity rates in 2011 were kept at 2.9% and 2.8%, respectively;
c) the projection for regulated prices inflation in 2011, based on individual items, according to the benchmark scenario, was kept at 4.0%, unchanged relative to the December meeting. This set of prices, according to data released by the IBGE, accounted for 29.00% of the total December IPCA;

d) the projection for regulated prices inflation in 2012, according to the benchmark scenario, was kept at 4.4%. Such projection is based on endogenous determination models for regulated prices, which compute, among other factors, seasonal components, foreign exchange rate changes, market prices inflation and the IGP (General Price Index) change; and
e) the projection for the spreads over the Selic rate, based on the 360-day swap rates, on the benchmark scenario, estimates 13 bps and 62 bps spreads in the fourth quarters of 2011 and 2012, respectively.

15. Regarding fiscal policy, projections assume the achievement of a public sector primary surplus target of 3.0% of GDP, without adjustments, in 2011 (according to parameters contained in the Budget Guidelines Law). Moreover, a primary surplus of 3.1% is considered for 2012.

16. The set of projections incorporated the estimated effects of the reserve requirements measures announced in December.

17. Since the last Copom meeting, the median of the expectations compiled by the BCB's Investor Relations Group (Gerin) for the 2011 IPCA increased from 5.20% to 5.42%. For 2012, the median of inflation expectations remained unchanged at 4.50%.

18. The benchmark scenario assumes the maintenance of the exchange rate at R$1.70/US$1.00 and the Selic rate at 10.75% p.a. during the forecast period. Under this scenario, the projection for the 2011 inflation increased relative to the figure considered at the December Copom meeting, and it stands above the 4.50% midpoint target established by the National Monetary Council (CMN). According to the market scenario – which incorporates the consensus exchange and Selic rates trajectories collected by Gerin at the period immediately prior to the Copom meeting - IPCA inflation forecast for 2011 also increased and stands above the inflation midpoint target. For 2012, the projection stands above the midpoint target in the benchmark scenario and around the target in the market scenario.

Monetary Policy Decision

19. The Copom`s assessment is that monetary policy should contribute to the consolidation of a favorable longer-term macroeconomic environment. In this respect, the Copom reassures that, under the inflation-targeting regime, it guides its decisions according to projected inflation and based on the analysis of alternative scenarios for the evolution of the main variables that determine prices dynamics. The Committee also understands that low risks for the underlying inflation in the short run tend to reduce uncertainties regarding the future behavior of headline inflation, facilitate the assessment of scenarios by the monetary authority, as well as help the process of coordination of economic agents' expectations, mainly price setters'. It is additionally noteworthy that low risks for the underlying inflation in the short run tend to reinforce the effects of monetary policy actions, enabling them to affect in a more long-lasting manner the dynamics of headline inflation in the future. Although the Copom recognizes that other actions of macroeconomic policy may influence the price trajectory, it reaffirms its view that it is the responsibility of the monetary policy to remain especially vigilant to guarantee that pressures detected in shorter horizons do not spread to longer horizons.

20. International evidence, ratified by the Brazilian experience, indicates that high inflation rates lead to the increase in risk premium, both for private and public funding, and to the shortening of planning horizons, both for households and corporate. Consequently, high inflation rates reduce investment and the economic growth potential, in addition to presenting regressive effects on income distribution. Moreover, high inflation rates do not result in any lasting results for economic growth and employment level; on the contrary, they create permanent damage to these variables in the medium and long terms. Therefore, the strategy adopted by the Copom aims to ensure the convergence of inflation towards the targets path in 2011 and in the next years, which requires that possible deviations from the target path be promptly corrected. Such strategy takes into account the time lags in the transmission mechanism and is the most adequate to deal with the uncertainty inherent to the process of monetary policy formulation and implementation.

21. As a consequence of the stabilization and correction of unbalances, which determined important structural changes, the process of maturing of the inflation target regime stands at an advanced stage, and it reflects favorably in the dynamics of neutral interest rate and in the power of monetary policy. Evidences under this respect can be observed, among other factors, through the accomplishment of inflation targets in the last seven years, at the same time that real interest rates have reduced. Progress in the financial markets structure, the FX and the inflationary risk premiums reduction, among other factors, seem to have determined in significant reduction of the neutral rate. The generation of primary surpluses consistent with the maintenance of decreasing trend for the public debt/GDP ratio also contributed for it. From another point-of-view, some of these developments, combined to others, such as the extension of contract tenures, also suggest that the power of monetary policy in Brazil has increased in the last years, despite the substantial uncertainty that surrounds the calculation of non-observable variables. The Committee also considers that there are evidences that the traction of monetary policy increased in the recent past and, compared to what was observed some years ago, currently inflationary pressures are contained with more efficiency by monetary policy actions.

22. In international markets, volatility and risk aversion have remained high since the last Copom meeting, partially fueled by the extraordinary levels of global liquidity and by the prospects that this process can eventually accentuate. Concerns about European countries` sovereign and banking debts and the possible deceleration in China have remained high, at the same time that the confidence in the sustainability of the US economy recovery increased. Prices of relevant commodities grew, without movements, in the opposite direction, of domestic assets and, in general, the prospects for external funding of Brazilian economy remain favorable. Meanwhile, the trajectory of prices indices shows the increase of inflationary pressures in some relevant economies, whereas concerns regarding the prospects of deflation in other economies tend to deplete.

23. The Copom evaluates that domestic economy activity prospects are favorable in this and in the upcoming quarters. This assessment is supported by signs that the expansion of credit supply tends to persist, despite at a moderate pace, both for individuals and corporate, and by the fact that consumers and businessmen confidence stands at historically high levels, notwithstanding some accommodation at the margin. The Copom considers, additionally, that the dynamism of domestic activity will continue to be benefited by the vigor of labor market, mirrored in the historical low unemployment rates and substantial growth of real wages, particularly in the public sector.

24. The Copom evaluates that the development of the inflation prospective scenario developed unfavorably since the last meeting. In fact, in the last quarter of 2010, inflation was strongly and negatively impacted by the dynamics of food prices, which in part reflected domestic and external supply shocks. These developments tend to be transmitted to the prospective scenario, among other mechanisms, through inertia, as pointed by the figures considered by the Committee in its inflation forecasts, as well as market analysts projections. The Committee considers relevant the risks derived from the persistence of the mismatch between supply and demand growth rates. It is also noteworthy the narrow margin in production factors idleness, especially in labor force. Under such circumstances, a relevant risk is posed by the possibility of concession of nominal wages increase incompatible with productivity growth. The prospective scenario considers the seasonal aspect of inflation in the first quarter, as well as the atypical concentration of regulated prices adjustments foreseen to be implemented in this period, although, for the year as a whole, the behavior of these items tend to be relatively benign. The benchmark scenario also considers the potential negative impact stemming from extremely adverse weather conditions observed in the beginning of this year in some regions of the country, although it attributes significant probability to the hypotheses that, at least in part, this process may be reverted during the year.

25. The Copom reaffirms that the inflation main scenario considers the materialization of its trajectories regarding fiscal variables. It bears highlighting that the generation of primary surpluses in line with the hypotheses considered for inflation projections, besides contributing to reduce the mismatches between supply and demand growth rates, will strengthen the reduction trend in the public debt/GPD ratio.

26. The Copom highlights that its main scenario for inflation also considers moderation in credit expansion, for which the macroprudential actions recently adopted contribute. The Committee considers that, in part, such regulatory changes should materialize as an element of aggregate demand constraint through the credit channel, as well as by the reduction of incentives to the adoption of strategies such as the simple broadening of contract

tenures, among others. The available information confirm this opinion, by evidencing relevant impacts both in prices and in volume of goods traded in the credit market. Additionally, it is plausible to affirm that the current regulatory framework, compared to the previous one, tends to heighten the impacts of conventional monetary policy actions.

27. In short, the Copom recognizes an economic environment in which an above-than-usual uncertainty level prevails, and identifies increasing risks to the materialization of a scenario where inflation promptly converges to the midpoint target. Since the last Copom meeting, at the external outlook, the extraordinary liquidity levels, the introduction of new fiscal stimuli in the US and respective asset price spillovers have pointed to lower probability of reversion in the recovery process experienced by the G3 economies. From another point-of-view, they reveal the still ambiguous influence of the international outlook over domestic inflation behavior. Regarding the domestic outlook, the recently announced macroprudential actions, a fast and powerful tool to contain local demand pressures, will still have their effects incorporated to price dynamics. Since the last meeting, the materialization of short term risks which the Copom considered at that opportunity has also continued. Although uncertainties that surround the global outlook and, at a minor magnitude, the domestic one, do not allow the clear identification the degree of permanence of recent pressures, the Committee evaluates that the inflation prospective scenario evolved unfavorably.

28. In this context, the Copom unanimously decided to increase the Selic rate to 11.25% p.a., without bias, starting a process of adjustment of the basic interest rate, whose effects, combined to those stemming from macroprudential actions, will contribute to inflation convergence towards the target path.

29. Domestic demand is robust, largely due to the effects of stimulus factors, such as income growth and credit expansion. Moreover, although tending to cool down, fiscal and credit incentives have been provided to the economy in the last quarters, and should still contribute for the activity expansion and, hence, for the maintenance of the idleness level of factors at low levels. The effects of these stimuli, however, are counterbalanced by the effects of the reversal of initiatives taken during the recent 2008/2009 financial crisis, by the not yet very favorable prospects for global economy and, mainly, by recent macroprudential actions. These elements and the developments in the fiscal outlook are an important part of the context in which future monetary policy decisions will be taken, aiming to ensure the timely convergence of inflation to the targets path.

30. At the end of the meeting it was announced that the Committee will reconvene on March 1st, 2011 for technical presentations and, on the following day, to discuss the monetary policy decision, as established in Communiqué 20,223 of October 15th, 2010.

SUMMARY OF DATA ANALYZED BY THE COPOM

Inflation

31. The IPCA rose 0.63% in December, down from 0.83% in November, totaling 5.91% in 2010, the highest annual rate since 2004 and 1.60 p.p. above the 2009 level. Market prices inflation retreated from 1.04% in November to 0.78% in December, with emphasis in the reduction from 1.53% to 0.95% in tradable products, favored by the deceleration of the increases in the prices of meat. Non-tradable products prices increased 0.63%, up from 0.60% in November, with highlights for the prices of services. Regulated prices increased by 0.26%, down from 0.33% in November. The diffusion index reached 62.24%, down from 67.19% in November, averaging 61.18% in 2010, up from 57.53% in the previous year.

32. Market prices increased 7.09% in 2010, up from 4.13% in 2009, while regulated prices recorded 3.13% and 4.74%, respectively. Market prices performance reflected the increased in tradable items, from 2.63% to 6.87% and non-tradable, from 5.53% to 7.28%, driven by the 10.39% increase in the prices of food and beverage, which had reached 3.17% in 2009. Services inflation increased 7.62%, up from 6.37% in the previous year.

33. The smoothed trimmed-means core IPCA inflation increased 0.52% in December, down from 0.56% in November, totaling 5.63% in the year, compared to 4.38% in 2009. The core inflation by exclusion that excludes ten items of household food and vehicles fuels rose 0.60% in December, up from 0.52% in November, totaling

5.45% in the year, up from 4.73% in 2009. The core inflation by exclusion that excludes the whole food and beverages group grew 0.42% in the month, compared to 0.41% in November, reaching 4.61% in the year, down from 4.65% in 2009, highlighting that this stability indicates the impact caused by the food group in the IPCA acceleration in 2010. The double weight core inflation rose 0.71% in December, up from 0.66% in November, reaching 5.62% in the year, up from 4.73% in 2009.

34. The IGP-DI increased 0.38% in December, down from 1.58% in November, reaching 11.30% in the year, compared to a 1.43% reduction in 2009, highlighting that the monthly rate resulted from a slowdown in the IPA and in the IPC rates and acceleration in the INCC rate. The IPA rose 0.21% in the month, down from 1.98% in November, mainly influenced by the monthly downward change from 5.56% to 0.18% in agricultural prices, driven by the reduction of 22.01% and 4.80% in the prices of beans and cattle, respectively, and by the deceleration in the price increase of soybeans, corn and cotton. The industrial products prices decreased from 0.75% to 0.22%, driven by the retreat in the prices of meat, meat products and fish. The IPA grew 13.85% in 2010, up from -4.08% in 2009, due to the increases of 25.61% in agricultural products and 10.13% in industrial products. The IPC, favored by the deceleration in the prices increase of food, mainly meat, increased 0.72% in December, down from 1.00% in November, reaching 6.24% in the year, up from 3.95% in 2009. The INCC grew 0.67% in December, up from 0.37% in November, highlighting that the 7.77% increase in the index, compared to 3.25% in 2009, was especially related to the 10.41% increase in labor force cost.

Economic Activity

35. The IBC-Br increased 0.4% in November, the sixth consecutive monthly rise, according to seasonally adjusted data. For the quarter ended in November, the IBC-Br increased by 1.1%, relative to the quarter ended in August, which had recorded 0.3% according to the same comparison basis. According to the observed series, the IBC-Br increased 6.5% in November, year-over-year, accumulating 8.1% in the year and 8.3% in the last twelve months.

36. Expanded retail sales increased 1.4% in November, month-on-month, according to data seasonally adjusted by the IBGE’s monthly survey (PMC), contributing to the 3.4% increase in the average of the quarter ended in November compared to the quarter ended in August. Retail sales grew 1.1% in the month and 2.2% in the quarter. Sales increased in eight of the ten sectors surveyed, with highlights for sales of office equipment and material (10.5%) and books, newspapers, magazines and stationery (6.6%). On the other hand, the sales of fabric, clothing and shoes reduced by 3.6%.

37. Expanded retail sales grew 17% in November, year-over-year, accumulating increases of 11.9% in the year and 12.1% in the last twelve months. Interannual evolution stemmed from sales in all segments considered in the PMC, with highlights for vehicles and motorcycles, parts and pieces (30.3%), books, newspapers, magazines and stationery (23.2%), and furniture and appliances (20.5%). The retail sales path in the first eleven months of the year was equally due to the increase in all considered activities, especially the ones related to office equipment and material (23.8%), furniture and appliances (18.3%), construction inputs (15.6%). The expanded sales in the twelve months through November showed general growth in sales by activity, highlighting office equipment and material (21.3%), furniture and appliances (17.7%), construction inputs (14.9%) and vehicles and motorcycles, parts and pieces (14%).

38. Automobile sales by dealers, including cars, light commercial vehicles, trucks and buses, increased 0.3% in December, month-on-month, according to Fenabrave (Brazilian Federation of Automotive Vehicles Distribution) data, seasonally adjusted by the BCB, totaling 5.2% in the quarter ended in December, quarter-on-quarter. Automobile sales increased 11.9% in the year, with emphasis on the sales of trucks (44.2%), light commercial vehicles (27.8%) and buses (25.3%).

39. Capital goods imports increased 5% in November, month-on-month, according to the Funcex quantum index, seasonally adjusted by the BCB. Year-over-year, the indicator rose 47.8%, while in the year through November and on a twelve-month trailing basis, it increased 42.8% and 37.9%, respectively, compared to the same periods of the previous year.

40. Capital goods production increased 3.2% in November, but decreased 1.4% in the quarter compared to the quarter ended in August, according to data seasonally adjusted from the Monthly Industrial Survey (PIM) by IBGE. The monthly increase reflected, in part, rises in the production of capital goods for serial industrial purposes (4.6%), for construction (4.2%), and for mixed use (4%), in opposition to reduction in the production of capital goods for non-serial industrial purposes production (16%) and capital goods for agricultural production (7.2%). Capital goods production increased 22.3% in the first eleven months of the year, compared to the same period of 2009, highlighting the 107.9% increase in the segment of goods for the construction sector.

41. Construction inputs production increased 1.4% in November, equal to the rate recorded for the quarter ended in the month, compared to the quarter ended in August, according to seasonally adjusted data. The industry grew 7.6% year-over-year, accumulating increases of 12.3% and 12.5% in the year through November and in the last 12 months, compared to the same periods of 2009.

42. Disbursements granted by the BNDES reached R$153.6 billion in the year through November, increasing by 30.8% year-over-year, with emphasis in the 48.2% expansion in the agriculture and livestock sector. The disbursements share to the industrial sector totaled 47% of the total, followed by infrastructure (31%), trade and services (16%) and agriculture and the livestock (6%) sectors.

43. Industrial production decreased 0.1% in November, month-on-month, according to seasonally adjusted data from the PIM-PF, while the average of the quarter ended in November increased 0.3% compared to the average recorded in the quarter ended in August, when it had decreased 1.3%, according to the same comparison basis. By use categories, capital goods production increased 3.2% in the month, followed by changes in the production of intermediate goods (1%), durable consumer goods (-0.7%), and semi-durable and non-durable goods (-0.5%), highlighting that from the 26 industry activities, fourteen posted monthly increase. Quarterly evolution partially reflected increases in publishing, printing and reproduction (9.9%), furniture (7.7%) and office machines and computing equipment (7.6%), and, in contrast, the retreats in electronic material and communication equipment (14.2%), shoes and leather (5.8%) and basic metallurgy (4.2%) production.

44. Industrial production increased 5.3%, year-over-year, with highlights to the expansion of capital goods production (9%), followed by the production of intermediate goods (5.8%), durable goods (4.6%) and semi- and non-durable consumer goods (3.1%). On a twelve-month trailing basis, general industry grew 11.7% in November, year-over-year, with highlights to the increases in the production of capital goods (22.4%), durable consumer goods (13.3%), and intermediate goods (12.9%).

45. The Nuci in the manufacturing industry, calculated by FGV, reached 85.3% in December, compared to 86.1% in November and 84.2% in the same month of 2009. The monthly reduction was driven by the retreat in all categories, highlighting the 1.00 p.p. decrease in the consumer goods industry. The Nuci in the capital goods, construction material and intermediate goods industries reduced 0.4 p.p., 0.4 p.p. and 0.3 p.p., respectively, in the period. The increase year-over-year was driven by increases in construction material (4.1 p.p.), capital goods (3.6 p.p.) and intermediate goods (1.9 p.p.) industries and reduction in the consumer goods segment (0.8 p.p.).

46. Vehicles production reached 302 thousand units in December, increasing 1.1% month-on-month, according to data released by the Anfavea and seasonally adjusted by the BCB. The sector production expanded 19.5% year-over-year, totaling a 14.9% increase in the year through November, compared to the same period of 2009.

47. Vehicles sales increased 6.4% in December month-on-month, and 31.5% year-over-year. The month-on-month change was due to the 19.8% increase in domestic sales and -22.7% in exports, while the interannual result stemmed from changes of 41.8% and -8.6%, respectively, in the same indicators. The sector sales increased 16.1% in 2010, as domestic sales increased 8.2% and exports, 61.1%.

48. The third prognosis carried out by the IBGE in December for the 2011 harvest estimated 145.8 million tons of cereals, legumes e oilseed, 2.5% below the one recorded in 2010, with emphasis in the estimated reduction in the South region. Rice and beans harvests are expected to grow by 12.6% and 10.2% and wheat, corn and soybeans are expected to reduce by 18.3%, 7.4% and 0.8%. Total harvest should increase by 1.8%, to 47.4 million ha.

Surveys and Expectations

49. The Consumer Confidence Index (ICC) from FGV decreased 2.1% in December, month-on-month, reaching 122.5 points, considering seasonally adjusted data, but still stands at a high level. There were declines in the Expectation Index (IE), by 3.4% and in the Current Situation Index (ISA), by 0.4%. The ICC increased 8.9% year-over- year, due to the increases of 21.2% in the ISA and of 1.4% in the IE.

50. The Industry Confidence Index (ICI) from FGV increased 1.6% in December, month-on-month, reaching 114.5 points, equal to the 2010 average level. The IE increased 1.9% and the ISA, 1.3%. The ICI grew 1% year-over- year, due to the 3.9% increase in the ISA and the 1.9% decrease in the IE.

51. The Services Confidence Index (ICS) from FGV increased 0.3% in December month-on-month, reflecting the increase of 5.7% in the ISA, and the fall of 4.4% in the IE. The ICS grew 1.7%, year-over-year, recording a 7.8% increase in the ISA and a 3.5% decrease in the IE.

Labor Market

52. According to the General Record of Employment and Unemployment (Caged) of the Ministry of Labor and Employment (MTE), 407.5 thousand formal jobs were eliminated in December, being 153 thousand in manufacturing industry, 92.2 thousand in agriculture, 79.6 thousand in civil construction and 75.2 thousand in the services sector, while commerce was responsible for the net creation of 14.4 thousand jobs. In 2010, 2,136.9 thousand jobs were created, a record high since the beginning of the series in 1985, with emphasis in hirings in the services sector (864.3 thousand), commerce (519.6 thousand), manufacturing industry (485 thousand) and civil construction (254.2 thousand), representing employment increase of 5.7%, 6.1%, 6.3% and 13.8%, respectively, compared to 2009.

53. According to the IBGE employment survey (PME), carried out in the six main metropolitan regions of the country, the unemployment rate reached 5.7% in November, a historical record low for the series begun in April 2002. The monthly reduction, the sixth consecutive retreat according to this comparison basis, reached 0.4 p.p., while on a twelve-month trailing basis, the decrease totaled 1.7 p.p.. In seasonally adjusted terms, the unemployment rate reached 6% in November, down from 6.3% in the previous month, as a result of the 0.1% increase in occupation and 0.2% reduction in the Economically Active Population (PEA). Average real earnings usually earned by workers reduced by 0.8% in November, interrupting the sequence of five consecutive monthly increases, but increased 3.6% in the year through November, while payroll changed -0.6% and 7.3%, according to the same comparison bases.

Credit and Delinquency Rates

54. Outstanding credit in the financial system reached R$1,678 billion in November, equivalent to 46.3% of GDP, increasing by 2% in the month, 18.6% in the year and 20.8% in twelve months. Non-earmarked credit operations increased by 2%, 15.4% and 16.5%, respectively, according to the same comparison bases, reflecting the increases of 2.1%, 16.8% and 18% for credit operations to individuals and 1.8%, 14% and 15% for credit operations to corporate, according to the same comparison bases. Earmarked credit operations increased 2% in the month, 25.3% in the year and 30.2% in twelve months, with highlights for the rises of 3.4%, 44.9% and 53.6% recorded in housing credit and of 1.9%, 39.3% and 46% recorded in BNDES disbursements, according to the same comparison bases.

55. The average interest rate on non-earmarked credit operations decreased 0.6 p.p. in November, reaching 34.8%. The average annual rates on credit for individuals reached 39.1% and for corporate, 28.6%, which represented respective reductions of 1.3 p.p. and 0.1 p.p..

56. The average tenure on non-earmarked credit operations increased from 456 days in October to 469 days in November, representing an increase of thirteen and twelve days for tenures related to individuals and corporate segments, which reached 551 days and 395 days, respectively.

57. Delinquency rates in the financial system (non-earmarked loans used as reference for interest rates, in arrears for more than ninety days) remained stable at 4.7% in November. Delinquency rates for credit operations with individuals reduced 0.1 p.p., to 5.9%, and the one relative to corporate increased by 0.1 p.p., to 3.6%.

External Environment

58. Although the prospects for developed economies to enter new short-term recessive period have strongly decreased since the last Copom meeting, the risks associated to the evolution of a benign scenario for the global economic activity remain relevant, in special those associated to the fiscal crisis in some Euro Area economies. In the US, the current prospects consider better domestic demand development, mainly consumption, in an environment of reduction of uncertainties associated to employment and income. The recent extension of tax cuts' fiscal law in the US, which included reduction in taxes levied on payroll, contributes for this favorable prospect.

59. Commodities international prices registered strong increase in the last months of 2010, in some cases exceeding the record highs reached in 2008. Heightened by investors' actions in financial markets, the occurrence of adverse weather conditions and consumption strengthening worldwide were the main drivers of that behavior. In special, the performance of agricultural commodities prices trend was highly impacted by the deterioration of supply conditions in several regions, reflecting the climate impact caused by La Niña phenomena. In the financial markets, the main stock market indices have registered gains since the last Copom meeting, influenced by economic agents' optimism, in an environment of abundant liquidity.

60. December inflation indices captured the trajectory of commodities prices increase. Annual CPI in the US, Euro Area, Chile, Mexico, Indonesia and Russia reached 1.50%, 2.20%, 3.00%, 4.40%, 7.00% and 8.80%, respectively, in December, compared to 1.10%, 1.90%, 2,50%, 4.30%, 6.30% and 8.10%, respectively, in November. This trend reflects, in emerging markets, increases in the prices of agricultural commodities, domestic demand strengthening and product gap reduction in their economies, while in the US and in the Euro Area, December hikes are mainly associated to increases in energy prices. It bears emphasizing that, in these economies, evidencing the scenario of low level installed capacity utilization and high unemployment rates, inflationary pressures continue to be contained, registering, in December, 0.80% and 1.10% CPI core annual changes, respectively, in the US and in the Euro Area.

61. In this context, the central banks in the US and Euro Area maintained the accommodative stance of their policies, choosing by keeping their respective basic interest rates unchanged, being followed by the UK and Japan central banks. It bears highlighting that, since the last Copom meeting, several central banks, among which the ones from Chile, Peru, Hungary, Sweden, China, Korea and Thailand, have increased their respective basic interest rates. On January 14th the People´s Bank of China (PBOC) announced new increase in reserve requirements, the fourth rise since November last year.

Foreign Trade and International Reserves

62. The Brazilian trade surplus reached US$5.4 billion in December, the highest monthly surplus in the year, contributing for the annual result of US$20.3 billion. Exports reached new monthly historical high of US$ 20.9 billion and imports totaled US$15.6 billion. On a daily average basis, the trade surplus fell by 20.1%, year-over-year, recording growth of 41.6% in imports and 31.4% in exports.

63. International reserves reached US$ 288.6 billion in December, increasing US$3.1 billion compared to November and US$50.1 billion in the year. The monetary authority's interventions accounted for net purchases of US$2.1 billion in the domestic market, in the month, accumulating US$41.4 billion in the year.

Money Market and Open Market Operations

64. Since the last Copom meeting, in December, the futures interest rate yield curve shifted upwards for all tenors. This movement was influenced by several factors, among which the release of high current inflation indices,

including different core measures; the upward trajectory of commodities prices in the international market; and uncertainties related to the implementation of the fiscal adjustment announced by the government. Moreover, for the short term tenures, the market agents' prospects regarding the start of a new cycle of basic interest rate increase also contributed for the upward movement in the rates. Between December 6th 2010 and January 17th 2011, one-, three- and six-month interest rates increased 0.38 p.p., 0.49 p.p. and 0.47 p.p., respectively. One-, two- and three-year interest rates increased 0.43 p.p., 0.41 p.p. and 0.45 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, increased from 6.30% on December 6th 2010 to 6.61% on January 17th 2011.

65. On January 14th, the Central Bank carried out reverse exchange rate swap auctions, in which it assumed long FX position and short interest rate position. This operation totaled the equivalent to US$987.9 million.

66. In its open market operations, the BCB carried out, between December 7th 2010 and January 17th 2011, repo operations borrowing R$ 41.5 billion for a six-month period. As a consequence, the average daily balance of the long operations reached R$138.9 billion. In the same period, the BCB also borrowed money through repo operations with tenures between thirteen and thirty working days, increasing the average daily balance of short-term borrowing operations to R$ 129.9 billion. The BCB also borrowed money through 31 overnight repo operations and conducted daily, at the end of day, two-working-day tenure liquidity management operations. The very short-term operations, including the two-working-day tenure liquidity management operations, averaged a daily balance of R$ 89.7 billion in the period, borrowing. The average daily balance of the total stock of repurchase agreements of the Central Bank decreased from R$395.4 billion between October 19th and December 6th to R$358.5 billion, between December 7th 2010 and January 17th 2011. Considering the daily balance of operations for the most recent period, there was an increase in the daily balance of repurchase agreements totaling R$23.1 billion, elevating the total stock from R$373.6 billion on December 6th 2010 to R$396.7 billion on January 17th. The main driver of liquidity expansion in the period was the net redemption of securities by the National Treasury.

67. Between December 7th 2010 and January 17th 2011, the National Treasury issuance regarding the traditional auctions raised a total of R$35.2 billion. The sale of fixed-rate securities reached R$19.8 billion, with R$18.1 billion via issuance of LTNs maturing in 2011, 2012, 2013 and 2015, and R$1.7 billion via NTN-Fs maturing in 2015, 2017 and 2021. Issuance of LFTs totaled R$11.5 billion, for securities maturing in 2015 and 2017. Issuance of inflation-linked NTN-Bs reached R$3.9 billion, for securities maturing in 2014, 2016, 2020, 2030, 2040 and 2050.