



Inflation Report

2007



December 2007
Volume 9 – Number 4



Inflation Report

2007



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Inflation Report

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Statistical Conventions:

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

Hipphen between years indicates the years covered, including the first and the last year.

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

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Foreword

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

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

Executive summary

The acceleration of economic growth observed in the third quarter was associated, fundamentally, with the performance of internal demand, in view of the reduction in trade surplus, which is relevant for the equilibrium between total demand and supply of goods and services. The consistency of the economic growth process is strengthened by the investment trajectory, be it in terms of the recent results, or in relation to the intention expressed in entrepreneurial expectations' surveys. The evolution of households' consumption continues, favored by better credit conditions, by growth of real wages and by positive confidence indicators, above all, regarding their purchasing disposition.

As regards the aggregated supply, the farm sector production, partly stimulated by favorable weather conditions and by high international prices of the main commodities, showed a marked growth in the third quarter. In this sense, the industrial and services sectors continued registering robust results.

Greater economic activity also reflected on positive developments of the job market, in qualitative and quantitative terms. In fact, while the hiring of workers in the formal market follows an intense pace in the various segments of economy, the unemployment rate follows a declining trend, and some sectors feel the lack of qualified workforce.

Credit operations registered significant growth and expectations point to the continuity of this process during next year. The favorable developments in the credit market are in line with the positive evolution of the job market, the macroeconomic stability and the institutional advances achieved in the recent past. This assessment is backed, for instance, by the reduction of interest rates on loans and by the extension of maturities, which favors the sustaining of households' consumption and of companies' investments.

Besides the growing search for banking credit, the corporate sector has been increasing its participation in capital markets, a tendency verified since 2006. In this regard, the

capitalization of the companies through the issuance of shares and debentures remain noticeable. In addition, it is highlighted the utilization of new mechanisms, such as funds for investment in stockholding and funds for investment in credit rights. This diversity of financing sources for the productive activity contributes to maintaining the strong pace of investments, essential so as to avoid worsening the imbalance between aggregated demand and supply.

The cumulative primary surplus of the first ten months of 2007 ensures accomplishing of the fiscal targets established for the year. This result reflected both on the favorable evolution of the Social Security accounts, and on the surplus growth of the regional governments, particularly of the states. The reduction in the deficit of Social Security mirrored the performance of revenues, favored by improved job market conditions, while the improvement of the states' surpluses combines growth of revenues and greater control of primary expenditures. Additionally, the reduction of the basic interest rate continues contributing so that the ratio of Public Sector Net Debt over Gross Domestic Product (PSND/GDP) maintains its downward trajectory. Even though the rejection to the proposal to maintain the Provisional Contribution on Financial Operations (CPMF) as of 2008 may have raised the degree of uncertainty associated to the prospects for fiscal policy, the declining tendency of the PSND/GDP ratio is expected to be maintained.

The country's external accounts continue robust, enabling a significant growth of the international reserves and the notable improvement of the indicators of external sustainability. Marginal results and prospects for the next periods, however, outline the beginning of a reversal process of surpluses in current transactions. In this sense, the prospects point to reduction in surplus, to US\$2.4 billion, in 2007, and a deficit of US\$3.5 billion is to be registered in 2008. These developments are in part due to the increase in net remittances of profits and dividends, as consequence of greater earnings of companies in the country and of growth in stock of direct foreign investments. In the opposite direction, one should highlight the reduction in net payments of interests, result of increased revenue related to remuneration of international reserves, which expanded, and reduction of expenditures related to cost of the external debt, which diminished. In this context, it is worth recalling that the average balance in current transactions in the last twenty years, when the economy went through rather diverse international scenarios, has posted deficits of US\$7 billion, or 1% of GDP.

The twelve-month cumulative trade surpluses, although remaining on the level of US\$40 billion, showed a moderating trajectory when compared to the results of corresponding periods of the previous year. This retraction, observed in a scenario of elevation of the trading stream and of less concentration of exports, whether in terms of number of trading partners or of products, mirrors, more intensely, the expansion of imports associated with the greater dynamics of economic activity, which has decisively contributed for the equilibrium between global demand and supply of goods. For its part, the financial account was scantily affected by the recent increase in volatility in international financial markets. Strictly speaking, there was elevation in surplus relative to the previous year, a reflex of record net inflows both in the form of direct investments and of portfolio investments.

The markedly benign scenario for consumer prices, intensively materialized last year, cooled off in 2007. These developments, at least in part, do not bring a surprise, as registered in previous *Reports*, which anticipated that twelve-month cumulative inflation would accelerate during this year. After reaching the highest level in the year in August, monthly inflation measured by the Expanded National Consumer Price Index (IPCA) dropped in September, starting to accelerate again from October onwards. Contrary to what happened in previous years, in 2007 free prices have risen more than regulated or contract-monitored prices, with the latest decisively mitigating the acceleration of IPCA. In the set of free prices, inflation associated to non-tradable goods stand way above that associated to tradable goods, which, however, have been rising despite the foreign exchange appreciation verified in 2007.

The central forecast associated to the reference scenario indicates inflation of 4,30% in 2007, a level 0.3 p.p. higher than that projected in the September *Report*, but still below the central value of 4.50% for the target established by the National Monetary Council (CMN). Twelve-month accumulated inflation reaches its minimum value in the first quarter of 2008, accelerates and reaches 4.30% in the last quarter, level 0.1 p.p. above that forecast in the last *Report*, but still below the central value of 4.50%. For 2009, twelve-month cumulative inflation forecast starts from 4.30% in the first quarter and closes the year at 4.20%, also below the central value of 4.50% for the target.

In the market scenario, inflation forecast for 2007 is equal to that of the reference scenario (4.30%), 0.4 p.p. higher than that of the last *Report*. Forecasts for 2008 also stand on the level of 4.30%, same value forecast in September. Still

according to the market scenario, twelve-month accumulated inflation forecast shows elevation during 2009, closing the year at 4.70%.

According to the reference scenario, GDP growth forecast for 2007 is 5.2%, 0.5 p.p. above that forecast in the September *Inflation Report*, given a quicker pace of growth verified in the third quarter, and, for 2008, the growth forecast is 4.5%.

The maintenance of the economic activity momentum, in an environment of price stability, corroborates the prospects of consolidation of the sustained growth scenario outlined in the latest “Inflation Reports”.

The upward trend of GDP growth observed in the third quarter was basically associated, with the performance of internal demand, in view of the reduction in the balance of trade surpluses, which play a relevant role in the balance between demand and supply of goods and services. The consistency in the process of economic growth is reinforced by the trajectory of investments, both in terms of the recent results, and intentions expressed in business expectation surveys. The evolution of household consumption continues, favored by better credit conditions, by increasing real overall wages and by positive confidence indicators, above all, as it concerns to the consumers’ readiness to go shopping.

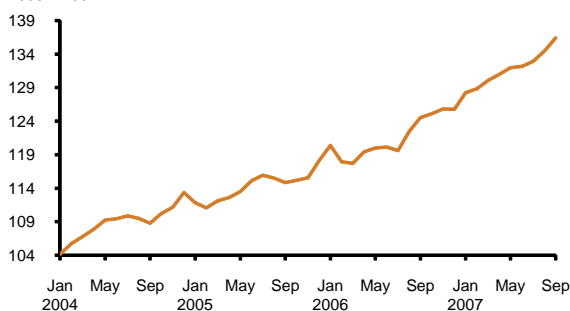
With reference to supply conditions, crop and livestock production, stimulated by favorable weather conditions and by soaring international prices of the major commodities, has shown marked growth in the third quarter. In the same direction, the segments of industry and services continue registering robust results.

Activity growth continues to positively impact the labor market, in both qualitative and quantitative terms. In this sense, while the contracting of workers in the formal job market remains at an intense and generalized pace in different segments of the economy, unemployment rate stands at a historically low level and there are signs of lack of qualified labor in various segments of the economy.

1.1 Retail sales

Retail trade sales maintained, throughout the third and beginning of the fourth quarter of 2007, the growth trend

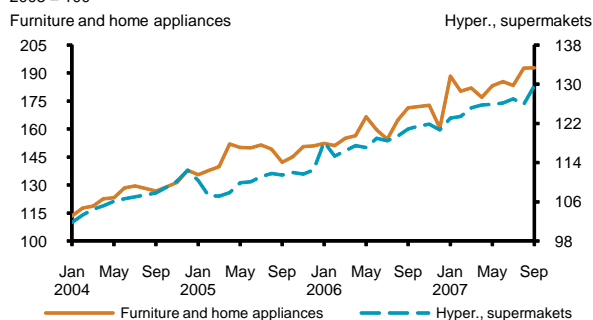
Figure 1.1 – Retail sales
Seasonally adjusted data
2003 = 100



Source: IBGE

Figure 1.2 – Retail sales

Seasonally adjusted data
2003 = 100



Source: IBGE

Table 1.1 – Retail sales

| | % change | | | |
|--|----------|------|------|------|
| | 2007 | | | |
| | Jun | Jul | Aug | Sep |
| In the month^{1/} | | | | |
| Retail sector | 0.2 | 0.6 | 1.1 | 1.4 |
| Fuel and lubricants | 0.0 | -0.7 | 1.5 | -0.4 |
| Hypermarkets | 0.2 | 0.7 | -0.9 | 3.0 |
| Fabrics, apparel and footwear | -0.4 | -3.6 | 4.2 | -2.1 |
| Furniture and home appliances | 1.2 | -1.1 | 5.0 | 0.1 |
| Automobiles, motorcycles, parts and spares | 1.3 | 1.2 | 4.6 | -1.1 |
| 3-Month Period/Previous 3-Month Period^{1/} | | | | |
| Retail sector | 2.1 | 1.9 | 1.7 | 2.2 |
| Fuel and lubricants | -1.6 | -2.0 | -1.0 | -0.1 |
| Hypermarkets | 1.7 | 1.3 | 0.6 | 1.3 |
| Fabrics, apparel and footwear | 3.5 | 5.4 | 2.6 | 0.5 |
| Furniture and home appliances | -0.9 | 2.3 | 3.5 | 4.2 |
| Automobiles, motorcycles, parts and spares | 7.2 | 4.2 | 4.8 | 5.1 |
| In the year | | | | |
| Retail sector | 9.8 | 9.7 | 9.8 | 9.6 |
| Fuel and lubricants | 5.4 | 5.3 | 5.2 | 5.0 |
| Supermarkets | 7.0 | 6.7 | 6.6 | 6.6 |
| Fabrics, apparel and footwear | 10.0 | 10.1 | 10.5 | 10.1 |
| Furniture and home appliances | 16.4 | 16.7 | 16.8 | 16.3 |
| Broad retail sector | 13.6 | 13.6 | 13.8 | 13.6 |
| Building materials | 9.7 | 9.5 | 9.6 | 9.6 |
| Automobiles, motorcycles, parts and spares | 23.0 | 22.9 | 23.4 | 22.9 |

Source: IBGE

1/ Seasonally adjusted data.

initiated in the second half of 2006, with emphasis on the dynamics of sales of durable and semi-durable goods, the performance of which is associated, more intensely, to favorable credit market conditions— expressed in the gradual reduction of interest rates, and in extension of financing terms, in a scenario of stable default.

The evolution of retail trade also reflected the expansion of available income and the maintenance of consumer confidence at a high level, a virtuous environment which should reflect, at the end of the year, into record growth rates of sales in the segment. This prospect is consistent with growth in these sales in the first nine months of the year, which, according to the Monthly Retail Trade Survey (PMC), released by the Brazilian Institute of Geography and Statistics (IBGE), reached 9.6% in relation to corresponding period of 2006.

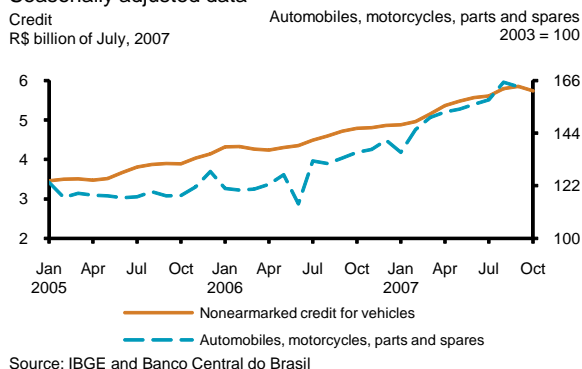
According to PMC, the balance of retail sales grew 2.2% in the quarter closed in September 2007, as compared to the April-June period, considering seasonally adjusted data, representing the twentieth-second consecutive growth, on this basis of comparison. In the period, there were increases in sales of all retail segments, except for the fall of 0.1% in fuels and lubricants, with highlight to furniture and electric house appliances, 4.2%, and hypermarkets, supermarkets, foodstuffs, beverages and tobacco, 1.3%. Sales of automotive vehicles, motorcycles, parts and spares, a segment that is not part of the general index, grew 5.1%, in the quarter.

Expanded retail trade sales, an indicator which incorporates the segments material of construction and automotive vehicles, motorcycles, parts and spares, expanded 13.5% in the quarter closed in September 2007, compared to the corresponding period of the previous year. The stronger sales performance of the expanded trade, a tendency initiated in the second half of 2006, demonstrates the importance of better credit conditions for the dynamics of the material segments of construction and automotive vehicles.

Confirming this trajectory, sales of construction materials grew 9.4% in the quarter ended in September 2007, when compared to the same quarter of the previous year. Although sales of this segment turned in decreasing growth rates for the third consecutive month, they should experience a record annual expansion, according to the Brazilian Association of the Construction Material Industry (Abramat).

When viewed by federation units, retail trade sales accumulated in the first nine months of the year posed a

Figure 1.3 – Retail sales
Seasonally adjusted data



Source: IBGE and Banco Central do Brasil

general growth, when compared to the same period of 2006, reaching 25.9% in Alagoas; 14.8% in Maranhão; 14% in Mato Grosso do Sul; 12.3% in Ceará; and 12.1% in São Paulo. On the same comparison basis, retail sales expanded 11.1% in the Northeast, 10.4% in the Southeast, 10% in the Central-West, 9.4% in the North and 7.8% in the South.

In the expanded concept, regional sales followed the pattern of restricted trade, surpassing, in all the regions, the rates recorded in that concept. More accentuated growth occurred in the North, 23.7%, followed by the regions: Central-West, 16.4%; Northeast, 14.8%; Southeast, 13.1%; and South, 12.7%.

The margin analysis, considering seasonally adjusted data related to the quarters ending in September and June, reveals sharper rises of retail sales in Rio Grande do Norte, 4.6%; Pernambuco, 3.7%; Paraíba, 3%; Goiás 2.6%; and Bahia, 2.5%, and reductions only in Rondônia, 6.5%, Roraima, 5.1% and the Federal District, 0.2%.

Table 1.2 – Retail sales
2007, September

| | % accumulated growth in 2007 | | |
|--|------------------------------|--------|-------|
| | Nominal revenue | Volume | Price |
| Retail sector | 11.2 | 9.6 | 1.5 |
| Fuel and lubricants | 1.5 | 5.0 | -3.3 |
| Hyper and Supermarkets | 12.0 | 6.6 | 5.1 |
| Fabrics, apparel and footwear | 14.4 | 10.1 | 3.9 |
| Furniture and home appliances | 12.2 | 16.3 | -3.5 |
| Broad retail sector | 14.4 | 13.6 | 0.7 |
| Automobiles, motorcycles, parts and spares | 21.1 | 22.9 | -1.5 |
| Building materials | 13.2 | 9.6 | 3.3 |

Source: IBGE

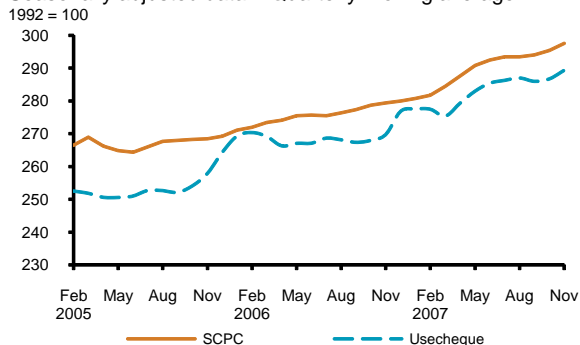
The nominal revenue from retail trade accumulated in the first nine months of 2007 rose 11.2%, compared to the same period of the previous year, posting increases of 9.6% in the balance of sales and of 1.5% in prices. With the exception of fuels and lubricants, all segments showed growth rates of nominal revenue above the 3.4% inflation registered by the IPCA, in the period, with emphasis on the dynamics in the segments of automotive vehicles, motorcycles, parts and spares, 21.1%; fabrics, apparel and foot wear, 14.4%; and construction materials, 13.2%.

The soundness of the automotive vehicle sales, registered by PMC, has been confirmed by the results of other surveys aimed at assessing the behavior of this segment. According to the National Federation of Automotive Vehicle Distribution (Fenabrave), sales of automotive vehicles by the authorized dealers grew 4.5% in the quarter ended in November, against the quarter ended in August, considering seasonally adjusted data. In the year, up to November, the segment registered sales of 2,116,788 auto vehicles (automobiles, light commercial vehicles, buses and trucks), with highs of 28.8% when compared to the same period of 2006 and of 14.8% when compared to the total of sales during the whole of 1997, a historic record of the series initiated in January 1990.

According to the National Association of Automotive Vehicle Manufacturers (Anfavea), sales of national automotive vehicles to the internal market totaled 2,034,610 units in the first eleven months of 2007, growing 24.8% when compared

Figure 1.4 – Retail sales indicators

Seasonally adjusted data – Quarterly moving average



Source: ACSP

Table 1.3 – Default rates

| | 2007 | | | | | |
|-------------------------------|------|-----|-----|-----|-----|--------------------|
| | Jul | Aug | Sep | Oct | Nov | Year ^{1/} |
| Returned checks ^{2/} | | | | | | |
| Brasil | 6.1 | 6.0 | 5.9 | 6.1 | ... | 6.3 |
| Northern region | 9.3 | 9.4 | 9.4 | 9.7 | ... | 9.6 |
| Northeast region | 9.2 | 9.2 | 8.8 | 9.3 | ... | 9.3 |
| Southeast region | 5.5 | 5.3 | 5.2 | 5.4 | ... | 5.7 |
| Center-western region | 6.9 | 6.7 | 6.7 | 7.0 | ... | 7.1 |
| Southern region | 5.6 | 5.6 | 5.6 | 5.6 | ... | 5.9 |
| SCPC (SP) ^{3/} | 4.5 | 5.8 | 5.2 | 6.1 | 5.5 | 6.1 |

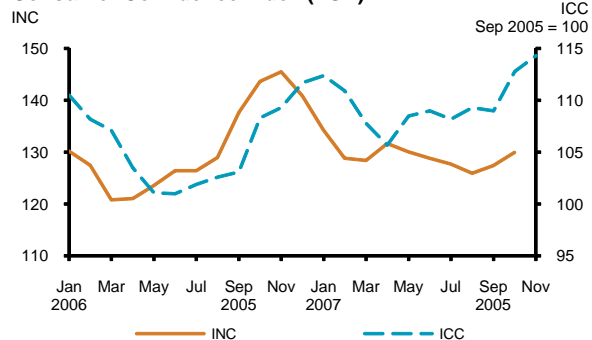
Source: Banco Central do Brasil and ACSP

1/ Annual average.

2/ Returned checks/cleared checks.

3/ [New registrations (-) registrations cancelled]/[consultations (t-3)].

Figure 1.5 – National Consumer Confidence and Consumer Confidence Index (FGV)



Source: ACSP and FGV

to the corresponding period of the previous year and 13.9% compared to sales of the whole year of 2006. It is highlighted that the Fenabrave statistics include imported vehicles, which is not the case of the surveys done by Anfavea. In the year, up to November, the participation of imported automotive vehicles in the total licensed reached 10.6%, against 6.9% in the same period of 2006.

São Paulo State trade indicators confirm the growth tendency verified in the other retail trade indicators. The number of consultations to the Credit Protection Service Center (SCPC), an indicator for long-term purchases, released by the São Paulo Trade Association (ACSP) expanded 1.4% in the quarter ended in November, compared to the period June to August, this being the twentieth consecutive increase on this basis of comparison. The consultations to Usecheque, an indicator for cash purchase, rose by 0.8% in the period, the twentieth consecutive growth in this type of analysis.

Default indicators continue at a level compatible with the acceleration experienced by the retail sales. The ratio between the number of returned checks for insufficient backing and the total of checks cleared reached 6.1% in October, against 5.9% in September and 6.2% in October of the previous year. By region, the highest rates continue to be observed in the North and the Northeast, a result consistent with the dynamics of sales in these regions.

Following the standard of national indicators, the net rate of default measured by ACSP reached 6.1% in the first eleven months of 2007, against 5.9% in the same period of 2006.

The surveys intended for the assessment of consumer expectations, of nation-wide coverage, showed, at the beginning of the fourth quarter of 2007, increases in the confidence indices. The National Confidence Index (INC), elaborated by Ipsos Public Affairs (Ipsos) for ACSP, came to 130 points in October, an increase of 2% when compared to the previous month. This evolution reflected a marked improvement of consumer expectations both for large purchases (vehicle or house), and for medium purchases (refrigerator or stove), as well as the favorable trajectory of the components capacity to invest in future and prospects for job security. INC registered increases in all regions, excepting the South region, where the cutback of 1.1% followed monthly increases of 14.7% and 23.6%, respectively, in September and August.

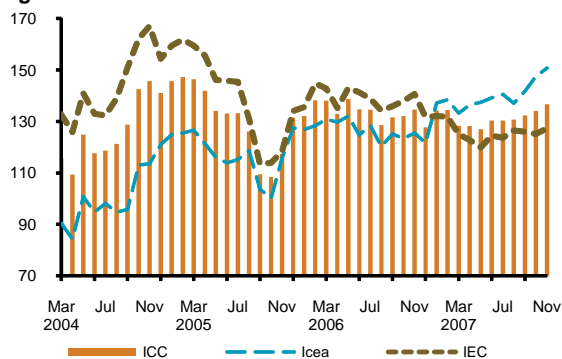
The Consumer Confidence Index (ICC), of Getulio Vargas Foundation (FGV), grew 1.3% in November 2007, compared

to the previous month, reaching the highest value of the whole historic monthly series, initiated in September 2005. The component assessment of the current situation of local economy rose 4.3%, registering increases of 9.9% in the segment current situation of local economy and of 0.4% in that which assesses the current financial situation of households. The component expectations for the coming months dropped 0.2% posting reductions in the items expectations of the situation of local economy or the coming six months, 0.7%; and expectation of the financial situation of households, 3.2%; and increase of 4.8% in the item purchases of durable goods.

The National Consumer Expectations Index (Inec), released on a quarterly basis, built up based on a survey carried out between days 13 to 18 of September 2007, by the National Confederation of Industry (CNI), dropped 1.2% in September, when compared to June, and 5.2% compared to the same month of 2006, but it remained at a level higher than the average related to the months of September. The quarterly result translated reductions in most indicator components, with emphasis to the cutback of 7.8% in the assessment of inflation expectations. This movement signifies greater pessimism when compared to the inflation of coming months, a result which must have been impacted by the hike in prices of foodstuffs in the quarter June to August, which accumulated rise of 3.8% in the IPCA group of Food and Beverages. According to the survey, 55% of the interviewees believe in rising inflation, the highest percentage since March 1995.

The ICC, released by the Trade Federation of the State of São Paulo (Fecomercio SP) and restricted to the metropolitan region of São Paulo, expanded 3% in the quarter ended in November, when compared to the quarter ended in August. Increases were registered in the two ICC components, reaching 1% in the Consumer Expectations Index (IEC), which represents 60% of the general index, and of 5.6% in the Current Economic Condition Index (Icea).

Figure 1.6 – Consumer Confidence Index



Source: Fecomercio SP

1.2 Output

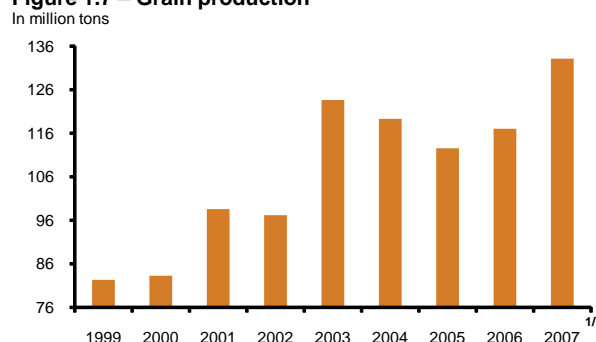
Crop/livestock

According to the National Quarterly Accounts, elaborated by IBGE, production of the farm and animal sector expanded 9.2% in the third quarter of 2007, when compared to the same period of 2006, accumulating growth of 4.3% in the year. These results reflect the favorable performance of the crops

of tree cotton, maize, soybean, sugar cane and wheat, as well as the maintenance of dynamics in livestock production.

Crops

Figure 1.7 – Grain production



Source: IBGE
1/ Estimate.

Table 1.4 – Farm production

| | In 1,000 tons | | |
|------------------|---------------|--------------------|-----------|
| | Production | | % change |
| | 2006 | 2007 ^{1/} | 2007/2006 |
| Grain production | 116 993 | 133 153 | 13.8 |
| Cotton (seed) | 1 816 | 2 428 | 33.7 |
| Rice | 11 505 | 11 080 | -3.7 |
| Beans | 3 437 | 3 330 | -3.1 |
| Corn | 42 632 | 51 590 | 21.0 |
| Soybean | 52 356 | 58 197 | 11.2 |
| Wheat | 2 482 | 3 998 | 61.1 |
| Others | 2 765 | 2 529 | -8.5 |

Source: IBGE
1/ Estimate.

According to the Systematic Farm Production Survey (LSPA), conducted by IBGE in November, grain production reached the record value of 133.2 million tons. The annual growth of 13.8% mirrored increase of 13.9% in average productivity.

Maize production totaled 51.6 million ton. The 21% growth when compared to the previous harvest derived from expansions of 9.7% in the area under cultivation and 10.3% in the average yield.

Wheat harvest totaled 4 million tons. The growth of 61.1% when compared to the previous year indicated increases of 16.7% in the cultivated area and 38% in average productivity, a performance consistent with the trajectory of international prices of the product.

Production of beans and rice came to, in the order, 3.3 million and 11.1 million t, falls of 3.1% and 3.7%, respectively, when compared to 2006. The performance of beans crop reflected falls of 2.7% in the planted area and of 0.5% in yields, while the performance of the rice crop was associated to respective reductions of 2.5% and of 1.3%.

Sugar cane production reached 514.1 million tons, with annual growth of 12.9%. The area under cultivation expanded 9.1% and the average yield, 3.5%.

The second forecast for the 2008 harvest, carried out by IBGE, in collaboration with the National Supply Company (Conab), pointed to production of 137.3 million tons. The growth of 3.1% when compared to 2007 considers increase of 2.9% in the area to be harvested, as well as more favorable performances of the crops of rice, tree cotton seeds and first harvest corn, and the delay observed in some crops, due to drought occurrence.

Livestock

In accordance with the Quarterly Survey on Animal Slaughter, released by IBGE, in September 2007, production of bovines reached 3.5 million tons in the first half of the year, with growth of 7.8% when compared to the same period

Table 1.5 – Livestock production

| Itemization | % accumulated growth in the year | | | | | | |
|-------------|----------------------------------|------|------|------|------|------|-----|
| | 2006 | 2007 | | | | | |
| | Oct | Jan | Feb | Mar | Apr | May | Jun |
| Cattle | 8.5 | 16.3 | 16.0 | 13.7 | 13.3 | 11.3 | 7.8 |
| Swine | 6.6 | 14.2 | 12.2 | 11.4 | 13.0 | 11.2 | 9.8 |
| Poultry | 3.8 | 2.3 | 0.7 | 0.4 | 4.1 | 6.8 | 7.9 |

Source: IBGE

Table 1.6 – Industrial production

| | % change | | | |
|--|----------|-----|------|------|
| | 2007 | | | |
| | Jul | Aug | Sep | Oct |
| Industry (total) | | | | |
| In the month ^{1/} | -0.2 | 1.3 | -0.6 | 2.8 |
| 3-Month Period/Previous 3-Month Period ^{1/} | 2.7 | 2.5 | 1.8 | 2.2 |
| Same month of the previous year | 7.0 | 6.6 | 5.4 | 10.3 |
| Accumulated in the year | 5.1 | 5.3 | 5.3 | 5.9 |
| Accumulated in 12 months | 4.2 | 4.5 | 4.8 | 5.3 |
| Manufacturing industry | | | | |
| In the month ^{1/} | -0.5 | 1.5 | -0.3 | 2.5 |
| 3-Month Period/Previous 3-Month Period ^{1/} | 2.7 | 2.5 | 1.8 | 2.3 |
| Same month of the previous year | 7.0 | 6.6 | 5.5 | 10.6 |
| Accumulated in the year | 5.1 | 5.3 | 5.3 | 5.9 |
| Accumulated in 12 months | 4.1 | 4.4 | 4.7 | 5.2 |
| Mining | | | | |
| In the month ^{1/} | 0.7 | 0.4 | -0.8 | 0.5 |
| 3-Month Period/Previous 3-Month Period ^{1/} | 0.7 | 1.1 | 1.0 | 0.7 |
| Same month of the previous year | 7.1 | 6.8 | 4.0 | 4.2 |
| Accumulated in the year | 5.9 | 6.0 | 5.8 | 5.6 |
| Accumulated in 12 months | 6.1 | 6.2 | 6.1 | 6.1 |

Source: IBGE

^{1/} Seasonally adjusted data.

of 2006. On the same basis of comparison, productions of poultry and of swine reached 4.3 million and 1.2 million tons, for respective increases of 7.9% and 9.8%, respectively.

Beef exports totaled 2.6 million tons in the first nine months of 2007, rising 17.3% as compared to the same period of the previous year. Exports of poultry and swine meat, in the order, expanded by 44.4% and 16.6% in the period, standing at 3 million and 808.2 thousand tons.

Industrial output

The expansion of industrial activity, reflected the strongest dynamics of production and the job market, has occurred in a generalized manner, both in sector and in regional terms. The high level of capital goods production and the evolution of the confidence level of the industrial businesses, in an environment of positive expectations when compared to the levels of employment and output, indicate a continuing industrial expansion process in the coming months.

According to IBGE's Monthly Industrial Survey – Physical Production (PIM-PF), the average index of industrial physical production showed growth of 2.2% in the quarter ended in October, when compared to the quarter ended in July, resulting from expansions of 2.3% in the manufacturing industry and of 0.7% in the mining industry, considering seasonally adjusted data. This year's cumulative physical production, up to October, rose 5.9% when compared to the same period of the previous year.

Among the 27 industrial activities surveyed by IBGE, 18 showed increase in production in the quarter, with highlight to the electronic material, communication equipment and apparatuses, 9.2%; medical/hospital instrumentation equipment, 6.4%; automotive vehicles, 6.9%; and office machines and IT equipment, 10.4%. In the opposite direction, there were sharper falls in the output of tobacco related activities, 3%; cellulose, paper and paper products, 2.2%; and pharmaceuticals, 5.8%.

The activities which presented more significant production increases in the ten first months of the year, compared to equal period of 2006, were machinery and equipment, 17.6% other transportation equipment, 17.5%; office machines and IT equipment, 16.1%; and automotive vehicles, 14.3%. Sharper reductions occurred in the segments of tobacco, 8.2%; electronic materials, apparatuses and communications equipments, 3.8%; wood, 2.2% and footwear and leather goods, 1.9%.

Figure 1.8 – Industrial production

Seasonally adjusted data

2000 = 100



Source: IBGE

Table 1.7 – Industrial production by category of use

| | % change | | | |
|--|----------|------|------|------|
| | 2007 | | | |
| | Jul | Aug | Sep | Oct |
| In the month^{1/} | | | | |
| Industrial production | -0.2 | 1.3 | -0.6 | 2.8 |
| Capital goods | -1.0 | 3.7 | 0.9 | 1.8 |
| Intermediate goods | 0.0 | 1.0 | -1.6 | 2.7 |
| Consumer goods | -0.7 | 1.2 | -0.1 | 1.5 |
| Durables | 1.1 | 2.7 | -0.2 | 1.4 |
| Semi and nondurables | -3.0 | 0.8 | -0.5 | 1.3 |
| Quarter/previous quarter^{1/} | | | | |
| Industrial production | 2.7 | 2.5 | 1.8 | 2.2 |
| Capital goods | 5.4 | 5.0 | 4.2 | 4.6 |
| Intermediate goods | 1.7 | 1.6 | 1.0 | 1.0 |
| Consumer goods | 2.8 | 2.5 | 1.5 | 1.6 |
| Durables | 3.8 | 5.1 | 5.2 | 4.7 |
| Semi and nondurables | 2.7 | 2.1 | -0.5 | -0.2 |
| In the year | | | | |
| Industrial production | 5.1 | 5.3 | 5.3 | 5.9 |
| Capital goods | 17.0 | 17.5 | 17.9 | 18.8 |
| Intermediate goods | 4.3 | 4.3 | 4.2 | 4.7 |
| Consumer goods | 3.7 | 4.1 | 4.1 | 4.6 |
| Durables | 5.9 | 6.9 | 7.6 | 8.7 |
| Semi and nondurables | 3.0 | 3.2 | 3.1 | 3.4 |

Source: IBGE

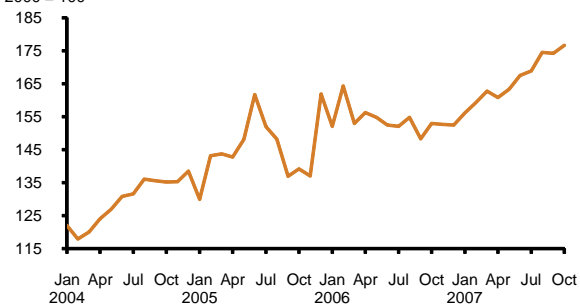
1/ Seasonally adjusted data.

Figure 1.9 – Industrial production

Consumer goods

Seasonally adjusted data

2000 = 100



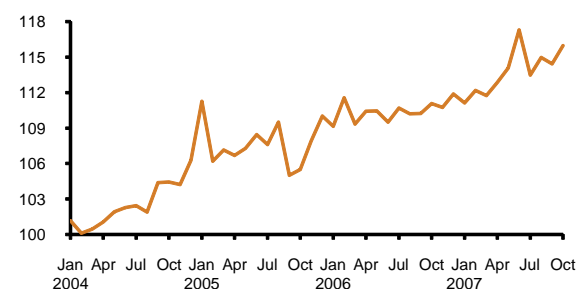
Source: IBGE

Figure 1.10 – Industrial production

Semi and nondurable goods

Seasonally adjusted data

2000 = 100



Source: IBGE

On the same basis of comparison, only the physical production of industry in Ceará showed stability. The states in which industrial activity showed greater dynamics were Minas Gerais, with expansion of 8.6%, followed by Rio Grande do Sul, 7.9%; Paraná, 7.6%; Espírito Santo, 6.1%; and São Paulo, 5.8%.

The analysis of industrial production broken down by categories of use, in the quarter ended in October, compared to the period May to July, revealed increases in the productions of durable consumer goods, 4.7%; capital goods, 4.6%; and intermediate goods, 1%; and reduction of 0.2% in that related to semi-durable and non-durable goods, considering seasonally adjusted data. Additionally, the production of capital goods increased 22.7% between the quarters ended in October 2007 and that of the previous year, while in the categories of durable consumer goods reached 14.8%, 5.5% and 4.1%, respectively. Production of typical construction inputs grew 6.7%, on that basis of comparison.

The capital goods production analysis by destination indicates relative reduction in the dynamics of segments of producers of goods directed to industry, with the production of capital goods for industrial purposes, which had increased 21.4% in the quarter ended in July, compared to corresponding period of 2006, rising 10.2% in the quarter ended in October, considering the same basis of comparison. Production of capital goods targeted to other segments showed greater dynamics, registering, in the quarter ended in October, respective annual increases of 24.9% and 29.5% in the sectors producing capital goods for the construction and transportation equipment. In this same direction, the rates of growth in the sectors of agricultural parts and capital goods for agriculture rose by 327.3% and 68.9%, respectively, a result consistent with the recovery of farm income, but strongly impacted by the reduced basis of comparison. The performance of the production of capital goods for the electric energy sector remained relatively stable in the period.

The performance of industries of low intensity in the use of electric energy was determinant for growth in industrial production of the quarter ended in October, when compared to the same period of 2006. This segment grew 9.9% in the period, while the productions of industries of medium and high intensity of electric energy spending increased, respectively, 5.4% and 4.7%.

The Index of Salaried Working Population (POA) in industry, in line with the environment of production expansion, increased 1.3% in the quarter ended in October, compared

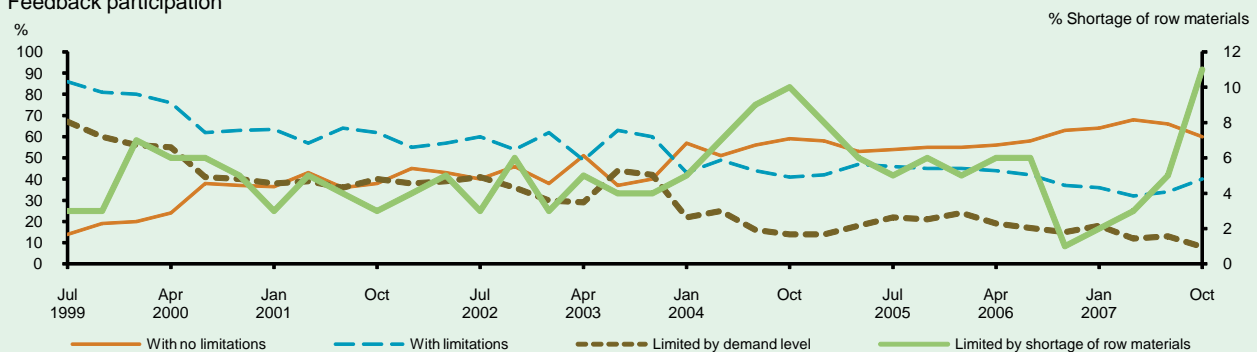
Production Growth Limiting Factors

The Brazilian economy's growth cycle, initiated in the second half of 2003, continues to be sustained by the dynamics of internal demand. In this environment, it is observed an alternation in the relevance of the factors limiting the continuity of the economy's expansionist trajectory, bearing in mind that in recent episodes the restrictions were associated, mostly, to determinants of the available income; among these were the evolution of the conditions in the labor and credit markets and the level of tax burden. Thus, the main restrictions to the progress of the current growth cycle concentrate on factors conditioning the supply, especially in relation to the available raw materials and qualified manpower and to the level of utilization of industrial installed capacity.

This modification may be investigated through the analysis of the Quarterly Indices of Production Growth Limiting Factors (IFL), of the Getúlio Vargas Foundation's Manufacturing Industry Survey (SCIT), generated on the basis of qualitative responses by industrial businesses. This survey includes one initial query about the occurrence or not of limitation to production growth and, in the affirmative case, the choice, as preponderant factor to limitation, of one of the 6 following options: Shortage of Working Capital, Shortage of Raw Materials and/or Components, Demand Level or Other Limiting Factors. It should be highlighted that the options Interest Rates and High Tax Burden were introduced in the surveys related to April 2001 and October 2003, respectively, in response to the representativeness of such options in the option Other Limiting Factors. Additionally, although the historic series of the IFL initiates in April 1978, it was interrupted between April 1995 and the beginning of 1999, a determinant reason for the period considered in this box to start in January 1999.

Analysis of Figure 1 shows that, between January 1999 and October 2007, the proportion of companies which saw limitations to growth in their respective production was subject to a sharp reduction, of 47 percentage points (p.p.). This cutback took place in 3 distinct stages: between July 1999 and July 2000, the number of companies which considered the existence of limitations to their expansion was reduced from 86% to 62%, registering additional reductions of 62% and 43%, between the months of January 2003 and January 2004, and of 44% to 32%, between April of 2006 and of 2007. This trajectory was associated with the behavior of the limiting factor Demand Level, indicated by 60% of the companies, on average, as the major factor restrictive to their performance.

Figure 1 – Production increase limiting factors
Feedback participation

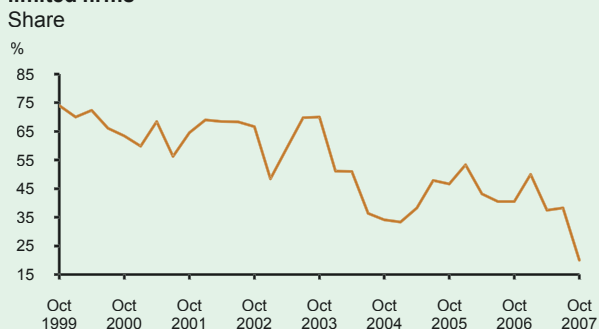


Source: FGV

It should be highlighted that, although the proportion of companies with limitations to production growth increased, on the margin, 8 p.p. between April and October 2007, to 40%, it remains 15 p.p. below the average related to the 36 quarters analyzed. The margin analysis strengthens, even, the hypothesis that the dynamics of demand, basically mirroring the increase of the internal demand, has been decisive for sustaining the cycle of economic expansion, in as much as the limiting factor Demand Level, in a trajectory opposite to that of companies with limitations to production growth, fell 4 p.p. in the two last quarters of 2007, turning to be considered as the main restriction to just 20% of the companies of this group.

The persistent reduction in the importance of the limiting factor Demand Level is registered in figure 2. This factor, after having been considered the most representative determinant of production expansion by 68.2% of the companies, in the five-year period

Figure 2 – Share of the level of the demand on the total of limited firms

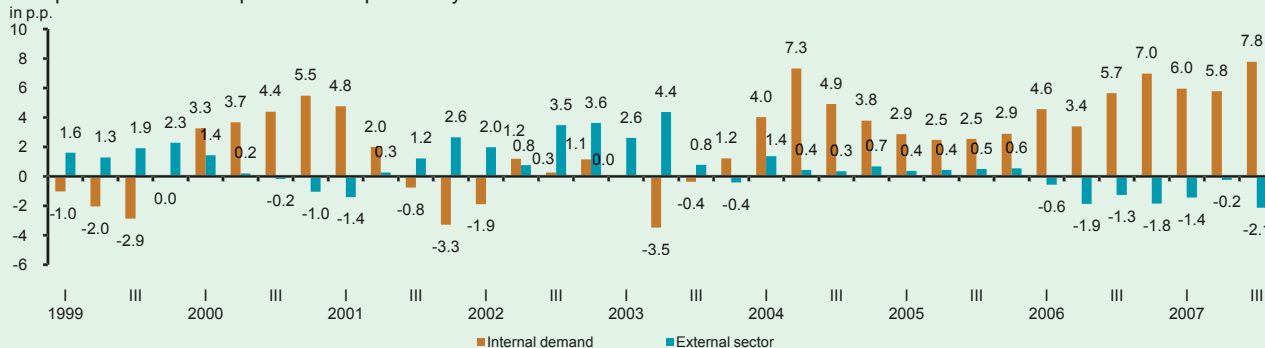


Source: FGV

1999/2003, it began to be put in a relative perspective by a substantial proportion of the companies considered in the FGV surveys, as evident in the averages related to the four-year period 2004/2007, 41.4%, and related to the year 2007, 36.4%.

It is worth highlighting that despite the SCIT refers to the total demand level, the growing importance of the internal demand for sustaining the current cycle of economic expansion leads one to consider that the reduction, by the companies, of the choice of factor Demand Level as the main limiting factor to production growth, reflects the greater dynamics of internal demand. This dynamics may be observed in figure 3, where contributions from the external sector and internal demand to GDP growth since the first quarter of 1999, can be found. It should be pointed out the internal demand in mid-2003– in the outset of the current expansion cycle of the Brazilian economy– was negative, changing its tendency after that period, until reaching 7.8 p.p. in the third quarter of 2007.

Figure 3 – Internal demand and external sector contribution to GDP growth
Compared to the same quarter of the previous year



The relative importance of the limiting factor Shortage of Raw Materials became more significant in October SCIT, when it was indicated by 11% of the companies considered as the main restriction to their expansion. This result, a series record and for the first time higher than that related to internal demand, besides standing on a level noticeably higher than the average of 4.9% related to period January 1999 to October 2007, indicates that 27.5% of these companies assess that the supply of raw materials constitute an element of restriction to their growth, something compatible with the maintenance, in the

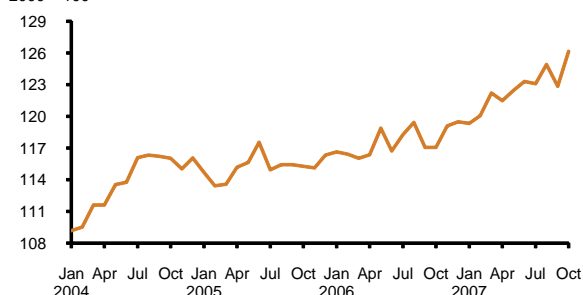
latest quarters, of the upturn observed not only in the Brazilian economy, but also in the world economy, particularly in emerging markets. The margin analysis also ratifies the rising trajectory of greater relevance of this factor, registering average indications of 2% in SCIT from December 2006 to April 2007 and of 8% in those related to June and October 2007.

The alternative Other Factors was indicated in 11% of the responses, in October SCIT, a level 4 p.p. above the average registered in the fur previous quarters. This growth is associated to concerns related to the growing level of of installed capacity utilization, which is on a record level according to estimates both of the National Confederation of Industry (CNI) and of FGV, and to the available qualified manpower, signs of a growing economic activity.

Therefore, the SCIT analysis shows both the market reduction in the percentage of companies that consider the existence of factors limiting their production growth, and the unequivocal path of decline in the importance of the demand factor, reflecting growth in internal demand as a constrainer of the dynamics of the industrial segment. Also, it reveals the growing importance attributed to limiting factors from the supply viewpoint, such as shortage of raw materials and qualified manpower, and utilization level of the installed capacity.

Figure 1.11 – Industrial production

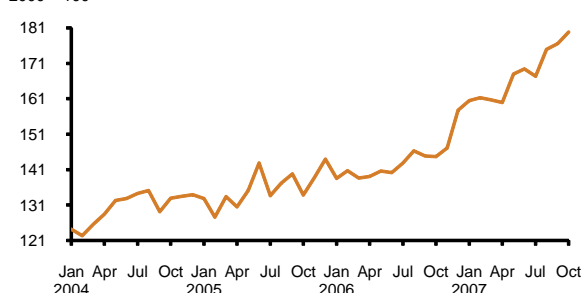
Intermediate goods
Seasonally adjusted data
2000 = 100



Source: IBGE

Figure 1.12 – Industrial production

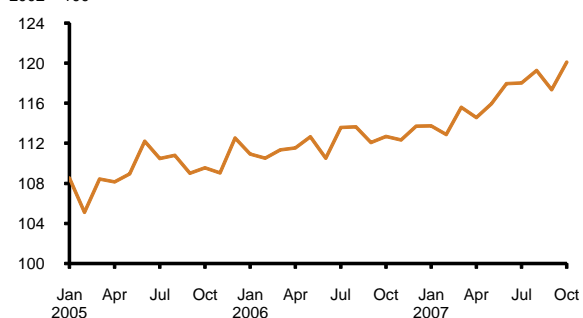
Capital goods
Seasonally adjusted data
2000 = 100



Source: IBGE

Figure 1.13 – Labor productivity^{1/}

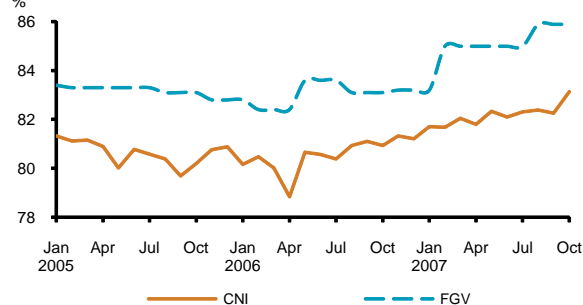
Seasonally adjusted data
2002 = 100



Source: IBGE

Figure 1.14 – Utilization of installed capacity in the manufacturing industry

Seasonally adjusted data
%



Source: CNI and FGV

to the period May to July, considering seasonally adjusted data. The annual comparisons reveal equally high increases, registering increases of 3.4% in October, and the highest since December 2004, and of 1.9% in the period January to October.

Labor productivity in general industry, estimated by the ratio between the physical production indices and the number of hours paid for, rose by 1.4% in the quarter ended in October, as compared to the quarter ended in July.

The expansion in production continues to put pressure on the industrial installed capacity. The Installed Capacity Utilization Level (Nuci) of FGV reached 87.2% in November, corresponding to a record of the historical series initiated in April 1995. Likewise, Nuci is a record when considered the seasonally adjusted series, having reached 85.9% in October. The utilization of installed capacity level finds itself at a high level in all the categories of use surveyed by the FGV.

The FGV survey revealed that the October Nuci did not represent a record of the historic series, seasonally adjusted, initiated in April 1995, in none of the fourteen surveyed industrial categories, but it indicated the dissemination of the occupation of installed capacity in the manufacturing industry. Among the categories surveyed, Nuci related to foodstuffs reached 85.8% in October, in the seasonally adjusted series, only 0.2 percentage points (p.p.) lower than the record level verified in April this year. Additionally, the Nuci associated to categories of iron and steel, plastic materials, apparel, footwear and fabric articles, transportation material, and non-metallic minerals remained on levels close to respective records, while, in the opposite direction, Nuci related to pharmaceuticals and veterinary products fell off 6.2 p.p. when compared to July.

Data related to November, only available in observed series, confirm the Nuci-generalized increase, posting records in the categories of use respectively related to consumer goods, 87.7%; construction material, 87.3%; and in furniture, 86.6%.

According to the Manufacturing Industry Survey (SCIT) of FGV, the pace of industrial production should continue robust in the coming months. The Industrial Confidence Index (ICI) reached 122 points in October, according to the highest value of the seasonally adjusted series, released on a quarterly basis and initiated in April 1995. As with the ICI components, the Current Situation Index (ISA) reached 127.1 points in October and the Expectations Index (IE), 117 points, according to highest values of the respective seasonally adjusted series.

Table 1.8 – Industry Confidence Index^{1/}

| | 2007 | | | |
|-------------------------|-------|-------|-------|-------|
| | Jan | Apr | Jul | Out |
| Manufacturing industry | 108.0 | 116.5 | 123.4 | 122.0 |
| By category of use: | | | | |
| Consumer goods | 109.3 | 119.3 | 135.0 | 139.5 |
| Capital goods | 121.2 | 130.0 | 132.9 | 138.4 |
| Building material | 116.9 | 119.5 | 133.4 | 123.5 |
| Intermediate goods | 106.0 | 120.6 | 122.3 | 116.5 |
| By component: | | | | |
| Current Situation Index | 108.6 | 123.3 | 129.7 | 127.1 |
| Global Demand Level | 100.6 | 119.5 | 124.3 | 120.3 |
| Inventory level | 92.0 | 97.7 | 103.8 | 103.4 |
| Business Situation | 110.0 | 126.9 | 133.8 | 130.7 |
| Expectations Index | 107.3 | 109.7 | 117.0 | 117.0 |
| Business Situation | 143.1 | 155.9 | 161.4 | 155.6 |
| Employment | 108.6 | 112.7 | 122.4 | 124.2 |
| Physical production | 131.2 | 123.2 | 133.3 | 136.3 |

Source: FGV

1/ The average of the last ten years is equal to one hundred. Values above one hundred indicate industrial activity expansion.

Still according to SCIT, among the items which form the Expectations Index, the balance of production index forecasted for the next three months reached 136.3 points in October, seasonally adjusted data, the third highest level ever reached. Additionally, the indices related to productions forecasted of the category consumer goods and of the industrial category transportation materials reached 159.7 and 179.3 points, respectively, both historical records. The employment index forecasted for the next three months reached 124.2 points, highest value of the historical series, reflecting the record results registered in the categories consumer goods, 130.8 points, and capital goods, 163.4 points.

The ICI evolution in November, considering observed data, strengthens the robust trajectory of the indicator. In this sense, ICI registered 121.3 points, in the month, with the ISA component reaching the record of 130.7 points and IE falling to 112 points.

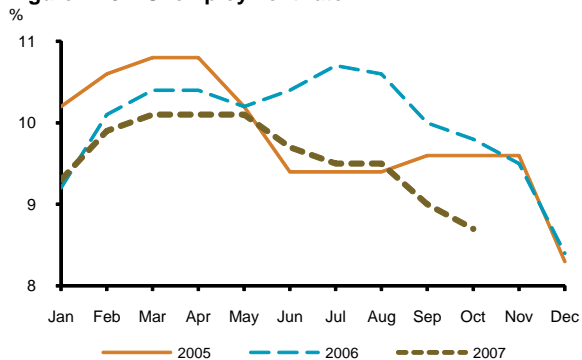
1.3 Labor market

Employment

The evolution of the job market remains consistent with the dynamics of economic activity. According to IBGE's Monthly Employment Survey (PME), which covers six metropolitan regions, the rate of open unemployment reached, on average, 9.1%, in the quarter closed in October, the lowest percentage ever registered in this period, showing respective falls of 1.1 p.p. and 0.7 p.p. when compared to the corresponding quarter of 2006 and to the quarter ended in July. The reduction registered in comparison with the same quarter of 2006 reflected increases of 2.9% in the rate of occupation growth and of 1.7% in the Overall Labor Force (PEA).

Formal employment growth rate remained high in the quarter ended in October, closing at 4.2% when compared to the period May to July, while in the segment of informal workers the rate of expansion stood at 0.3%. The distance between these rates, which demonstrate the qualitative improvement in job market conditions, becomes more visible, if one takes into account its evolution in the period from January to October 2007 and of the previous year, when formal employment expansion reached 5.1%, compared to the retraction of 1.4% in informal employment. The number of self-employed workers, though it has increased 4.7% in the year, it turned in a marginal growth of 0.5% in the quarter ended in November.

Figure 1.15 – Unemployment rate



Source: IBGE

Table 1.9 – Formal employment

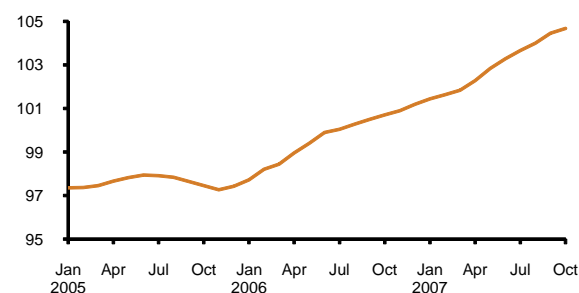
| | New job openings – Accumulated in the period (1,000 employees) | | | |
|------------------------|--|-------|-------|---------|
| | 2007 | | | |
| | I H | III Q | Oct | Year |
| Total | 1 095.5 | 511.5 | 205.3 | 1 812.3 |
| Manufacturing industry | 299.5 | 180.5 | 60.0 | 540.1 |
| Commerce | 97.1 | 114.5 | 63.8 | 275.3 |
| Services | 327.6 | 170.2 | 67.8 | 565.5 |
| Building | 97.6 | 75.6 | 21.7 | 194.8 |
| Crop and livestock | 238.4 | -41.2 | -11.4 | 185.8 |
| Public utilities | 5.5 | 1.6 | 0.2 | 7.3 |
| Others ^{1/} | 29.9 | 10.4 | 3.2 | 43.5 |

Source: MTE

1/ Includes mining, public administration and others.

Figure 1.16 – Employment in the manufacturing industry – Quarterly moving average

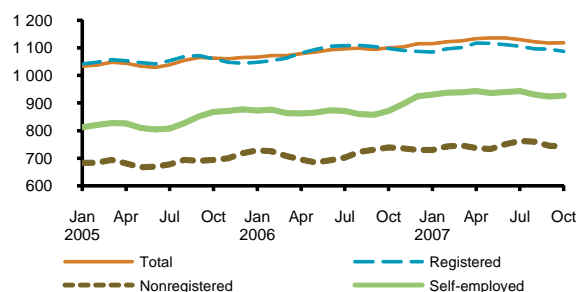
Seasonally adjusted data
2003 = 100



Source: CNI

Figure 1.17 – Average real regular earnings^{1/}

In R\$ of August 2007, deflated by INPC



Source: IBGE

1/ Quarterly moving average

Table 1.10 – Gross Domestic Product at market

| | % growth | | | | | | | |
|---|----------|------|-------|------|------|------|-------|--|
| | 2006 | | | | 2007 | | | |
| | I Q | II Q | III Q | IV Q | I Q | II Q | III Q | |
| Accumulated in the year | 4.0 | 2.7 | 3.3 | 3.8 | 5.0 | 5.3 | 5.3 | |
| Accumulated in 4 quarters | 3.3 | 3.0 | 3.3 | 3.8 | 3.9 | 4.9 | 5.2 | |
| Quarter/same quarter of the previous year | 4.0 | 1.5 | 4.4 | 5.1 | 4.5 | 5.6 | 5.7 | |
| Quarter/previous quarter ^{1/} | 1.6 | 0.2 | 1.8 | 1.4 | 1.1 | 1.3 | 1.7 | |
| Crop and livestock | 3.5 | 2.5 | 3.3 | 1.2 | -1.9 | 0.3 | 7.2 | |
| Industry | 1.4 | -2.5 | 3.6 | 2.2 | -0.2 | 1.3 | 1.8 | |
| Services | 1.4 | 0.5 | 1.2 | 1.2 | 1.6 | 0.7 | 1.2 | |

Source: IBGE

1/ Seasonally adjusted data.

According to the General File of Employed and Unemployed Persons (Caged), of the Ministry of Labor and Employment (MTE), 1,812,252 positions were created in the year, up to October, the best result for the period since the series has begun, in January 1985. The number of formal jobs rose 5%, with emphasis on the dynamics of the segments of trade, 6%; manufacturing industry, 5.1%; and services, 4.8%. Construction industry employment, which continues showing high rates of expansion since 2005, registered growth of 7.5% in the period.

CNI data, related to 12 states of the federation, also disclose an increase in the rates of expansion of industrial employment. From January to October this year, personnel occupied in the industry grew 3.7%, against 2.1% in the same period of 2006. The margin analysis, expressed by the increase of 1.3% of industrial occupations in the quarter ended in October, when compared to the quarter ended in July, indicates the continuity of this movement.

Income

The average real income usually received by those occupied in the six metropolitan regions covered by PME, under deceleration since May this year, expanded 3.4% in the year, up to October, compared to the corresponding period of 2006. The overall real wages, product of the average real income usually received by the number of the occupied personnel, grew 6.4%, on the same basis of comparison, while the value of average income reached R\$1,123.60 in October, with nominal increase of 5.8% when compared to the same month of 2006.

The evolution of earnings by job position in the first ten months of the year, when compared to the same period of 2006, reveals more accentuated gains in the segment self-employed workers, 8%; and informal workers of the private sector, 4.6%. Earnings from registered workers expanded 0.9% in the year.

1.4 Gross Domestic Product

According to IBGE's National Quarterly Accounts, GDP expanded 5.3% in the first nine months of 2007, when compared to the corresponding period of 2006, boosted by the contribution of 6.6 p.p. of internal demand, the highest, since 1995, in this type of comparison. It should be highlighted that it was registered, on the same basis of comparison,

GDP Estimates: 2007 and 2008

The estimates for Gross Domestic Product (GDP) for 2007 were revised to 5.2%, against 4.7%, since the “Inflation Report” of June 2007. The reassessment reflects both the favorable result observed in the third quarter, and the performance of precedent indicators related to October and November. The estimates for GDP growth in the fourth quarter of 2007 reaches 4.9%, compared to the same quarter of 2006, and, according to seasonally adjusted data, 0.7% against the previous quarter.

From the production perspective, increases were observed in the estimates of performance of the three sectors of economy. The annual growth forecast to the farming sector, moved from 4.5% to 5.5%, incorporating both the revision, from 1.4% to 2.3%, done by the Brazilian Institute of Geography and Statistics (IBGE) in relation to the sector growth in the first half-year, and the results related to the two last quarters of the year. It should be highlighted that the growth projection of 10.3% of the farming sector in the fourth quarter of 2007, against the corresponding period of the previous year, shows, especially, the increase of 61.1% of the annual wheat crop, disclosed by the November Systematic Farm Production Survey (LSPA), important for the result of this quarter. On the margin, considering seasonally adjusted data related to the fourth and third quarters of the year, the production in the sector should be maintained stable.

The growth forecast for industrial production, from 4.6% to 4.8%, reflects the revision from 4.4% to 5.2% in the manufacturing industry, with weight of 61.8% in the sector, motivated by both the sector dynamics evident in October and by favorable prospects for the remainder of the year. The forecast of expansion of the mining industry, impacted by the substantial

Table 1 – Gross Domestic Product

| | 2006 | 2006 | 2007 | | | | 2008 ^{1/} |
|--------------------------------------|---------|------|------|------|-------|--------------------|--------------------|
| | Weights | IV Q | I Q | II Q | III Q | IV Q ^{1/} | |
| Crop and livestock | 4.9 | 4.2 | 3.7 | 2.3 | 4.3 | 5.5 | 4.4 |
| Industry | 25.1 | 2.9 | 3.2 | 5.1 | 5.1 | 4.8 | 4.8 |
| Mineral extraction | 2.1 | 5.7 | 4.0 | 5.0 | 4.0 | 2.8 | 8.1 |
| Manufacturing | 15.5 | 2.0 | 3.1 | 5.3 | 5.5 | 5.2 | 4.2 |
| Construction | 4.2 | 4.6 | 2.3 | 4.3 | 4.6 | 4.6 | 5.6 |
| Public utilities | 3.3 | 3.3 | 3.8 | 4.9 | 4.5 | 4.7 | 4.9 |
| Services | 55.8 | 3.8 | 4.7 | 4.7 | 4.7 | 4.6 | 4.2 |
| Commerce | 9.6 | 5.1 | 6.2 | 7.2 | 7.3 | 7.2 | 7.3 |
| Transportation | 4.3 | 3.2 | 3.9 | 4.9 | 4.8 | 4.9 | 6.3 |
| Communications | 3.4 | 2.5 | 7.3 | 7.2 | 7.7 | 6.6 | 5.4 |
| Financial institutions ^{2/} | 6.1 | 6.2 | 9.3 | 9.4 | 10.7 | 9.8 | 5.3 |
| Other services | 11.8 | 3.1 | 3.7 | 3.2 | 2.8 | 2.8 | 2.9 |
| Rents | 7.7 | 2.3 | 4.5 | 4.2 | 3.9 | 3.9 | 4.5 |
| Public administration | 12.9 | 3.7 | 2.2 | 1.8 | 1.7 | 1.7 | 1.3 |
| Value added at basic prices | 85.8 | 3.5 | 4.1 | 4.5 | 4.8 | 4.7 | 4.4 |
| Taxes on products | 14.2 | 5.0 | 6.9 | 8.1 | 8.3 | 8.0 | 5.5 |
| GDP at market prices | 100.0 | 3.8 | 4.5 | 5.0 | 5.3 | 5.2 | 4.5 |

Source: IBGE and Banco Central

1/ Estimated.

2/ Includes insurance, private pension and related services.

decelerated growth in the production of petroleum throughout the second half-year, was revised from 6.2%, in the previous Report, to 2.8%. Forecast of industrial production growth in the fourth quarter of 2007, in relation to the same period of the previous year, reaches 4.2%. On the margin, considering seasonally adjusted data related to the fourth and third quarters of the year, the production in the sector should expand by 1%.

Growth in the service sector, reflecting the alterations in the forecasts related to other sectors, moved from 4.3% to 4.6%, with an emphasis on the increases forecast for the subsectors of trading, from 6.3% to 7.2%, and financial intermediation, from 7.3% to 9.8%, trajectories determined, in the order, by accentuated increases in total supply and financial balance throughout the year. The growth forecast of the sector in the fourth quarter of 2007, compared to the corresponding period in the previous year, reaches 4.2%. On the margin, considering seasonally adjusted data related to the fourth and third quarters of the year, the production in the sector should climb 0.7%, representing the 18th consecutive increase on the basis of comparison.

From the demand perspective, it is highlighted the change in the forecasted growth of the Fixed Gross Capital Formation, from 9.6% in the last Inflation Report to 12.2%, a revision consistent with the growing dynamics observed in investment expenditures. The estimates related to household consumption and by the government were changed on the margin, while those related to exports and imports of goods and services were elevated by 2 percentage points (p.p.) and 2.4 p.p., respectively.

Table 2 – Gross Domestic Product – Demand side

| Period | GDP at market price | Private consumption | Government consumption | Total consumption | Gross Fixed Capital Formation | Exports | Imports | % |
|-------------------------|---------------------|---------------------|------------------------|-------------------|-------------------------------|---------|---------|-------|
| 2002 | | 2.7 | 1.9 | 4.7 | 2.6 | -5.2 | 7.4 | -11.8 |
| 2003 | | 1.1 | -0.8 | 1.2 | -0.3 | -4.6 | 10.4 | -1.6 |
| 2004 | | 5.7 | 3.8 | 4.1 | 3.9 | 9.1 | 15.3 | 13.3 |
| 2005 | | 3.2 | 4.5 | 2.3 | 3.9 | 3.6 | 9.3 | 8.5 |
| 2006 | | 3.8 | 4.6 | 2.8 | 4.2 | 10.0 | 4.7 | 18.3 |
| Contribution (p.p.) | | | 2.8 | 0.6 | 3.4 | 1.6 | 0.7 | -2.1 |
| 2007 (estimated) | | 5.2 | 5.9 | 3.8 | 5.4 | 12.2 | 7.3 | 20.8 |
| Contribution (p.p.) | | | 3.6 | 0.8 | 4.3 | 2.0 | 1.1 | -2.4 |
| 2008 (estimated) | | 4.5 | 5.9 | 3.7 | 5.4 | 10.4 | 6.6 | 22.4 |
| Contribution (p.p.) | | | 3.6 | 0.7 | 4.3 | 1.8 | 1.0 | -2.8 |

Source: IBGE and Banco Central

First 2008 GDP Estimates

GDP growth should reach 4.5% in 2008, sustained, exclusively, for the third consecutive year, by the performance of internal demand. Additionally, it is forecasted, as observed in 2007, an overall expansion in all sectors of the economy.

Expansion of 4.4% in the crop and livestock production is expected. This growth is consistent with the favorable prospects in relation to the grain harvest – which shall grow 3.1% in the year, according to forecast carried out by IBGE, in collaboration with the National Supply Company (Conab); to growth in other crops, especially sugar cane; and to the increasing production of livestock, benefited by both the end of phytosanitary embargos in important external consumer markets, and by the maintenance of the world demand on a high level.

The forecast of expansion of the industrial sector reaches 4.8%, same level of 2007, and incorporates favorable expectations in relation to the performances of the mining industries, stimulated by the dynamics

of the segments of petroleum and iron ore; and of civil construction, in line with the expansion of real estate credit and investments. Manufacturing industries and the production and distribution of electricity, gas and water should present, equally, robust performance in 2008.

Regarding the service sector, it is anticipated growth of 4.2% in 2008. Reduction in relation to 2007 reflects, mainly, the cutbacks on rates associated with the segments Financial Intermediation and Public Administration, reflecting, in the order, a high basis of comparison and adjustment of the public sector. The trade segment should continue justifying the scenario of growth in the economic global supply.

From the demand perspective, forecast of expansion in investments of 10.4%, following the increases in household consumption, 5.9%, and in government consumption, 3.7%. The evolution of internal demand, in an environment of price stability, should continue to reflect the favorable evolution of the credit and job markets, besides the more significant growth of infrastructural works within the schedule foreseen by the Growth Incentive Program (PAC). The internal demand contribution to GDP growth is estimated at 6.4 p.p. in 2008, corresponding to the third consecutive year, in which the growth of economy derives, exclusively, from expanded internal demand.

The increases of imports and exports of goods and services should reach 22.4% and 6.6%, respectively, in 2008. This trajectory, although implying negative contribution from the external sector of 1.9 p.p. for GDP growth, in the year, it will be relevant for the equilibrium between aggregated supply and demand.

positive performances in all of GDP components, be it from the demand or the production perspective.

Internal demand expansion has been driven mainly by favorable credit market conditions and by the high levels of confidence on the part of businesses and consumers, with favorable developments over the household consumption and over investment decisions. In this sense, the Gross Fixed Capital Formation (GFCF) grew 12.4% in the first nine months of the year, against the same period of the previous year. This was the component of internal demand that showed the largest expansion in the period. Consumption by households expanded by 5.9%, making the highest contribution to the accumulated GDP growth in the first nine months of the year, 3.5 p.p., while the government consumption grew 3.9%.

On the same basis of comparison, exports grew 6.7% and imports, demonstrating, in part, the very dynamics of internal demand, 19.6%, generating negative contribution of 1.3 p.p. of the external sector for the GDP result, the most modest performance since 1995.

From a production perspective, it should be highlighted growth of 5.1% in the output of the industrial sector, followed by the sector of services, 4.7%; and the farming sector, 4.3%.

The industrial sector performance confirmed the occurrence of generalized increases in all subsectors. Manufacturing industry's output, representing approximately 60% of the sector, grew 5.5% in the first nine months of 2007, when compared to the same period of 2006, the best performance registered in the last three years, on this basis of comparison. Mining production expanded 4% and construction industry, 4.6%, in the same period.

Evolution of the service sector has also been associated to the generalized expansion in all subsectors, with emphasis on the financial intermediation segment, with a 10.7% growth, followed by information services, 7.7%; commerce, 7.3%; transportation, storage and postal services, 4.8%; and real estate and renting activities, 3.9%.

Farm outputs reflected, to a large extent, the favorable performance of the crops of tree cotton, corn, soybeans, sugar cane and wheat, as well as the maintenance of the dynamics of the livestock subsector. Despite the behavior of the domestic market, the farming sector, contrary to the other sectors of the economy, has shown better results for the

Table 1.11 – Gross Domestic Product
Accumulated in the year

| | % growth | | | | |
|----------------------|----------|------|------|------|-------|
| | 2006 | | 2007 | | |
| | III Q | IV Q | I Q | II Q | III Q |
| GDP at market prices | 3.3 | 3.8 | 4.5 | 5.0 | 5.3 |
| Households | | | | | |
| consumption | 4.5 | 4.6 | 5.7 | 5.8 | 5.9 |
| Government | | | | | |
| consumption | 3.3 | 2.8 | 4.2 | 4.1 | 3.9 |
| Gross fixed | | | | | |
| capital formation | 9.5 | 10.0 | 8.8 | 11.4 | 12.4 |
| Exports | 4.4 | 4.7 | 6.0 | 9.7 | 6.7 |
| Imports | 16.7 | 18.3 | 19.8 | 19.2 | 19.6 |

Source: IBGE

Table 1.12 – Gross Domestic Product
Accumulated in the year

| | % growth | | | | |
|-----------------------------|----------|------|------|------|-------|
| | 2006 | | 2007 | | |
| | III Q | IV Q | I Q | II Q | III Q |
| Crop and livestock | 2.2 | 4.2 | 3.7 | 2.3 | 4.3 |
| Industry | 2.3 | 2.9 | 3.2 | 5.1 | 5.1 |
| Mining | 5.9 | 5.7 | 4.0 | 5.0 | 4.0 |
| Manufacturing | 0.9 | 2.0 | 3.1 | 5.3 | 5.5 |
| Construction | 5.2 | 4.6 | 2.3 | 4.3 | 4.6 |
| Public utilities | 3.1 | 3.3 | 3.8 | 4.9 | 4.5 |
| Services | 3.7 | 3.8 | 4.7 | 4.7 | 4.7 |
| Commerce | 4.5 | 5.1 | 6.2 | 7.2 | 7.3 |
| Transportation | 2.9 | 3.2 | 3.9 | 4.9 | 4.8 |
| Communications | 2.2 | 2.5 | 7.3 | 7.2 | 7.7 |
| Financial institutions | 7.8 | 6.2 | 9.3 | 9.4 | 10.7 |
| Other services | 2.5 | 3.1 | 3.7 | 3.2 | 2.8 |
| Rents | 2.4 | 2.3 | 4.5 | 4.2 | 3.9 |
| Public administration | 3.5 | 3.7 | 2.2 | 1.8 | 1.7 |
| Value added at basic prices | 3.1 | 3.5 | 4.1 | 4.5 | 4.8 |
| Taxes on products | 4.6 | 5.0 | 6.9 | 8.1 | 8.3 |
| GDP at market prices | 3.3 | 3.8 | 4.5 | 5.0 | 5.3 |

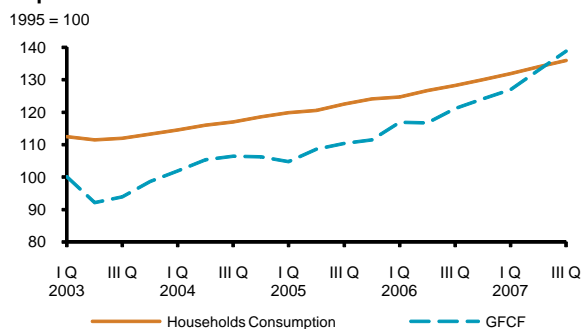
Source: IBGE

Table 1.13 – Gross Domestic Product
Quarter/previous quarter
 Seasonally adjusted

| | % growth | | | | | | |
|-------------------------------|----------|------|-------|------|------|------|-------|
| | 2006 | | | | 2007 | | |
| | I Q | II Q | III Q | IV Q | I Q | II Q | III Q |
| GDP at market prices | 1.6 | 0.2 | 1.8 | 1.4 | 1.1 | 1.3 | 1.7 |
| Crop and livestock | 3.5 | 2.5 | 3.3 | 1.2 | -1.9 | 0.3 | 7.2 |
| Industry | 1.4 | -2.5 | 3.6 | 2.2 | -0.2 | 1.3 | 1.8 |
| Services | 1.4 | 0.5 | 1.2 | 1.2 | 1.6 | 0.7 | 1.2 |
| Households consumption | 0.5 | 1.5 | 1.2 | 1.5 | 1.4 | 1.6 | 1.5 |
| Government consumption | 1.7 | -0.1 | 0.5 | -0.1 | 3.3 | 0.1 | 0.3 |
| Gross fixed capital formation | 4.8 | -0.1 | 3.8 | 2.5 | 2.3 | 4.6 | 4.5 |
| Exports | 0.4 | -5.9 | 13.0 | -1.2 | 0.6 | 1.0 | 1.4 |
| Imports | 7.5 | 3.0 | 7.0 | 3.8 | 4.1 | 2.6 | 9.1 |

Source: IBGE

Figure 1.18 – Households Consumption and Gross Fixed Capital Formation^{1/}



Source: IBGE
 1/ Seasonally adjusted data.

export products, favored by record prices in the international market for the principal commodities.

On the margin, considering seasonally adjusted data, GDP grew 1.7% in the third quarter of the year, when compared to the previous quarter, representing the eighth positive consecutive result on this basis of comparison. Farming grew 7.2%, the highest rate in the latest 37 quarters, while in the industrial and service sectors there were respective increases of 1.8% and 1.2%, representing, in the order, the fifth and tenth increases in this type of comparison.

The margin analysis under the prism of demand, considering seasonally adjusted data, shows a vigorous trajectory of investments, reflected by the expansion of 4.5% of GFCF in the third quarter of the year, as compared to the immediately previous period. Household consumption expanded 1.5%, and government consumption, 0.3%, while the exports and imports grew, respectively, 1.4% and 9.1%, stressing that the external purchases increased for the seventeenth consecutive quarter.

1.5 Investments

The cycle of investment expansion continued on its robust trajectory in the third quarter of 2007. This performance has been marked by leading indicators; mirroring reductions of the risk-Brazil, measured by the Emerging Markets Bond Index Plus (Embi+), and in interest rates, as well as by the consistent increase in the level of utilization of industry's installed capacity.

According to IBGE, investments, excluding the stock variations, grew 14.4% in the third quarter of 2007, when compared to the same quarter of 2006, fifteenth positive result on this basis of comparison. The cumulative growth in four quarters closed at 12.1%, the highest rate registered in the last forty-eight quarters, on this comparison basis.

GFCF monthly indicators anticipated the trajectory of investments in the third quarter. In this sense, the absorption of capital goods, main component of FBCF, and construction industry grew 20.3% and 4.9%, respectively, in this quarter, when compared to the same period of 2006.

Capital goods production grew 18%, up to the third quarter. This result derived from generalized increases in its components, with emphasis to electric energy, 20.9%; construction, 17.9%; transportation equipment, 17.2%; and

typically industrialized capital goods, 16.9%. Productions of the segments related to farming activities experienced growth rates remarkably stronger an evolution which, although demonstrating recovery of the farming income, explains the depressed basis of comparison.

The indicators for the month of October continue pointing to the expansion of GFCF. The absorption of capital goods and construction expanded, respectively, 32.9% and 8.9%, against the same month of the previous year. Growth in the absorption of capital goods reflects an expansion of 26.8% in production, 38.5% under imports and 10.4% in exports of capital goods, on the same basis of comparison.

According to the National Bank of Economic and Social Development (BNDES), the disbursements from the BNDES system totaled R\$48.8 billion in the first ten months of 2007, rising 39.7% when compared to the same period of 2006. By activity sector, financing granted to the manufacturing industry expanded 12.7%, followed by those directed to the mining industry, 65.3%; commerce and services, 78.3%; and farming, 52.8%.

According to the CNI survey, investments should continue its expanding trajectory in the next quarters, taking into account that 45% of the companies consulted intend investing, in 2008, the same as in 2007, while 42% seeks to expand the level of investments. The favorable prospect when compared to the investment trajectory becomes clearer when one considers that, at the end of 2006, only 32% of the companies surveyed by CNI intended to invest more in 2007 than they did in 2006, and the investments foreseen for 2007, 85% have already been totally or partially carried out. Investment performance is fundamental to ensure that the dynamics of domestic demand does not turn into a source of inflationary pressure.

1.6 Conclusion

The expansion of the Brazilian economy in the third quarter of 2007, across-the-board in both sectorial and geographical terms, demonstrated by the performance of domestic demand, reacted to increases both in internal production and in imports. The dynamics of consumption reflects favorable conditions for both the job market, expressed in its broader formalization, and for credit, where lower interest rates and longer terms tend to stimulate purchases of more valuable product types.

The current growth cycle has been taking place in a sustained manner, posting marked increases in investments, which should reach 12.2% in the year, the most representative expansion since 1994. The prospects when compared to maintenance, in 2008, of the growth trajectory of productive capacity, shown by the results of surveys with the industrial businesses, continue favorable and showing consistency with the dynamics of domestic demand.

Inflation measured by the general price indices started again to register acceleration in the quarter ended in November. This movement, in continuity to that registered in the quarter ended in August, was fundamentally associated to growth in wholesale prices, conditioned by increases in both industrial and farming prices.

Consumer price indices variation experienced relative slackening between the quarters ended in November and in August. This performance, consistent with the reduction of inflation observed in prices of the Foodstuffs group, should be considered carefully, taking into account the recent acceleration observed in the inflation cores.

2.1 General indices

Variation of the FGV general price indices, of the FGV, showed acceleration in the quarter ended in November, in relation to the period June to August. The General Price Index – Domestic Supply (IGP-DI) grew 2.99%, against 2.04% in the quarter ended in August, a result associated, mainly, with the evolution of wholesale prices.

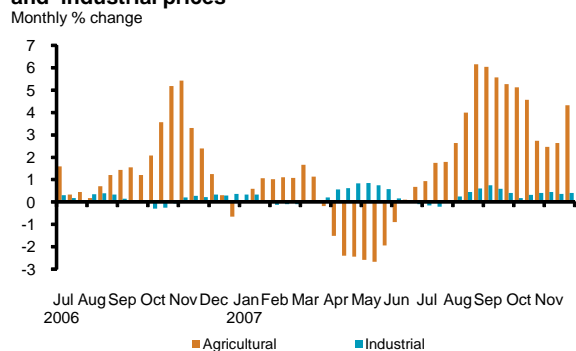
Industrial prices, after dropping in June and July, climbed by 0.61% in August and 1.24% in the quarter closed in November. This trajectory reflected, in part, the increases in prices of plastic materials, fertilizers, animal feed, refined soybean oil and non-metallic minerals. The acceleration of wholesale farming prices, of which the quarterly variation reached 12.82%, 4.04 p.p. more than in the quarter ended in August, reflects a higher internal demand and the expansion in international prices of commodities. On the one side, this performance mirrored more representative increases registered in the prices of perishable goods, cereal and grain, while, reversely, showed a smaller variation in the prices of products of animal origin, which came to 1.22%, against 19.47% in the quarter ended in August.

Table 2.1 – General price indices

| | Monthly % change | | | | | |
|--------|------------------|------|------|------|------|------|
| | 2007 | | | | | |
| | Jun | Jul | Aug | Sep | Oct | Nov |
| IGP-DI | 0.26 | 0.37 | 1.39 | 1.17 | 0.75 | 1.05 |
| IPA | 0.09 | 0.42 | 1.96 | 1.64 | 1.02 | 1.45 |
| IPC-Br | 0.42 | 0.28 | 0.42 | 0.23 | 0.13 | 0.27 |
| INCC | 0.92 | 0.31 | 0.26 | 0.51 | 0.51 | 0.36 |

Source: FGV

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



Source: FGV

The variation of retail trade prices showed a downturn in the quarter ended in November, with the Consumer Price Index – Brazil (IPC-Br) rising 0.62%, against 1.12% in the quarter June to August. This cutback, just as observed in the other consumer price indices, was mainly associated with minor expansions in prices of the foodstuff group.

2.2 Consumer price indices

Extended National Consumer Price Index

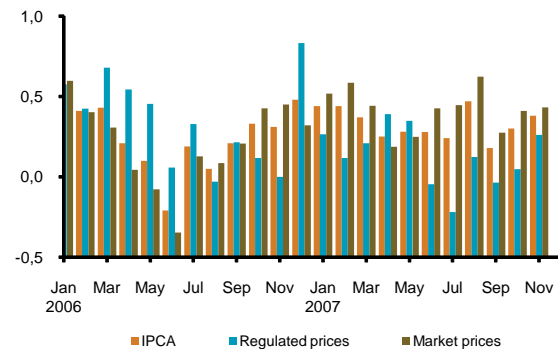
Twelve-month cumulative IPCA variation reached 4.19% in November, a consequence of 2.31% increases in the government regulated prices of goods and services and 5.03% in market prices, remaining on a stable level since August, when it reached 4.18%.

IPCA accumulated a high of 0.86% in the quarter ended in November, against 0.99% in the quarter from June to August, result of increases of 1.5% in market prices and of 0.27% in government regulated prices, against respective variations of 1.5% and -0.14% in the quarter ended in August. IPCA showed monthly variations of 0.18% in September, the lowest rate of the year; 0.30% in October; and 0.38% in November.

The reduction in the variation of market prices in the quarter ended in November reflected the performance of the foodstuffs group. In that group, prices grew 1.70%, against 3.80% in the quarter ended in August. This performance demonstrated the slowdown in price increases of semi-processed foodstuffs, in line with the cutback in the prices of milk and industrialized foodstuffs, notwithstanding the variation of prices of perishable foodstuffs closed at 5.99%, against -3.97% in the quarter ended in August. The variation of market prices, excluding the foodstuffs group, reached 0.87% in the quarter, against 0.52% in the quarter June to August, showing both the of seasonal effects, in particular in the segment of apparel, and pressures associated to the dynamics of internal demand.

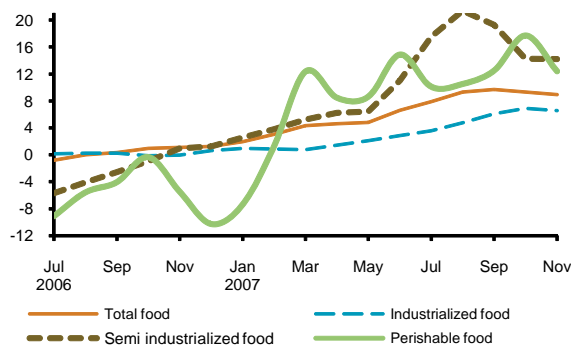
The evolution of the IPCA diffusion index – an indicator which reveals the proportion of the index components to show a positive variation in a given period – indicated more generalized increases of prices in the quarter ended in November, when it reached 59%, against 58% and 57.5%, respectively, in the quarters ended in August and May.

Figure 2.2 – IPCA
Monthly % change



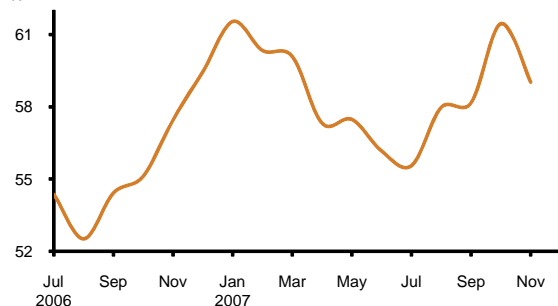
Source: IBGE

Figure 2.3 – IPCA – Food
12-month % change



Source: IBGE

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



Source: IBGE

Accumulated IPCA variation of 3.69% in the first eleven months of the year, against 2.65% from January to November 2006, a result of increases of 1.47% in government-regulated prices of goods and services and 4.70% in market prices.

2.3 Regulated prices

Regulated prices varied 0.27% in the quarter ended in November, corresponding to 0.08 p.p. of the quarterly increase of IPCA, against -0.14% in the period June to August. This performance was mainly associated with cutbacks in prices of electric energy and fixed telephone fares, thus offsetting the impact of increases in items such as health plans, medicines, water and sewage fares and gasoline.

The item household electric energy posted a negative growth of 1.58% in the quarter ended in November, registering reductions of 5.89% in Goiânia, 5.51% in São Paulo, 3.85% in Belém, 0.46% in Salvador and 0.32% in Rio de Janeiro. In the opposite sense, prices of gasoline and medicines expanded 0.2% and 1.11% in the quarter, against respective reductions of 2.15% and 0.67% in the quarter ended in August. The water and sewage fares presented variation of 1.96%, in the period, registering increases of 5.09% in Recife, 4.33% in Rio de Janeiro and 4.23% in São Paulo.

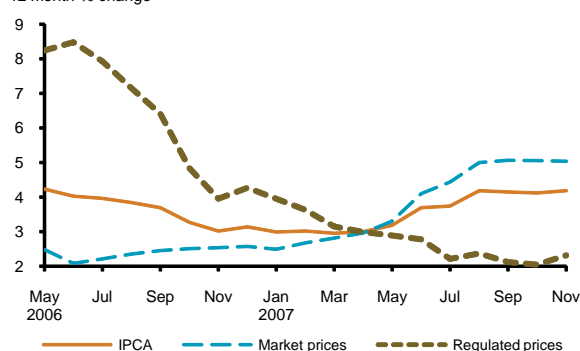
Inflation of regulated prices reached 2.31% in twelve months ended in October, standing on a level lower than those of market prices since May, on this basis of comparison. It should be highlighted that the annual variation of these prices, for the first time since the implementation of the Real Plan, should close at a level lower than that of the market prices.

2.4 Inflation core

The variation of the three measures of the core inflation calculated by the Central Bank reached, in the quarter ended in November, a level higher than that of the IPCA. Additionally, the variation of the cores revealed itself more intense, in relation to the quarter ended in August, in its three forms of calculation.

The core by exclusion¹ expanded 1.02% in the quarter ended in November, against 0.64% in the period June to August. The IPCA core, calculated by the method of

Figure 2.5 – IPCA
12 month % change



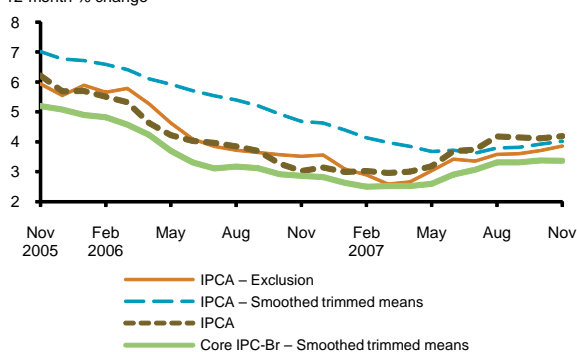
Source: IBGE

Table 2.2 – IPCA

| | Weight: 2007 | % change | | | | | |
|---------------------|--------------|----------|-------|-------|-------|-------|-------|
| | | Jul | Aug | Sep | Oct | Nov | Year |
| IPCA | 100.0 | 0.24 | 0.47 | 0.18 | 0.30 | 0.38 | 3.69 |
| Market prices | 69.23 | 0.45 | 0.62 | 0.28 | 0.41 | 0.43 | 4.70 |
| Regulated prices | 30.77 | -0.22 | 0.12 | -0.04 | 0.05 | 0.26 | 1.47 |
| Main items | | | | | | | |
| Electricity | 3.58 | -3.01 | -0.49 | -0.15 | -1.65 | 0.22 | -5.80 |
| Water and sewage | 1.61 | 0.23 | 0.02 | 1.23 | 0.71 | 0.01 | 4.82 |
| Urban bus | 3.82 | 0.00 | 0.43 | 0.21 | 0.00 | 0.00 | 4.32 |
| Air ticket | 0.28 | 0.21 | 2.19 | 0.22 | 0.32 | 0.26 | 2.90 |
| Gasoline | 4.53 | -0.51 | -0.89 | -0.79 | 0.36 | 0.64 | -1.69 |
| Bottled cooking gas | 1.17 | -0.18 | 0.05 | 0.68 | 0.08 | -0.07 | 0.30 |
| Medicine | 2.94 | -0.32 | 0.04 | 0.22 | 0.36 | 0.53 | 1.67 |
| Health plans | 3.35 | 0.69 | 0.56 | 0.53 | 0.53 | 0.53 | 7.57 |

Source: IBGE

Figure 2.6 – Core inflation
12-month % change



Source: IBGE, Bacen and FGV

^{1/} Core by exclusion of household food prices and regulated prices.

Table 2.3 – Consumer prices and core inflation

| | Monthly % change | | | | |
|---------------|------------------|------|------|------|------|
| | 2007 | | | | |
| | Jul | Aug | Sep | Oct | Nov |
| IPCA | 0.24 | 0.47 | 0.18 | 0.30 | 0.38 |
| Exclusion | 0.08 | 0.35 | 0.25 | 0.40 | 0.37 |
| Trimmed means | | | | | |
| Smoothed | 0.20 | 0.40 | 0.34 | 0.43 | 0.36 |
| Non smoothed | 0.17 | 0.43 | 0.19 | 0.35 | 0.35 |
| IPC-Br | 0.28 | 0.42 | 0.23 | 0.13 | 0.27 |
| Core IPC-Br | 0.26 | 0.37 | 0.24 | 0.24 | 0.25 |

Source: IBGE, Bacen and FGV

Figure 2.7 – IPCA

Median

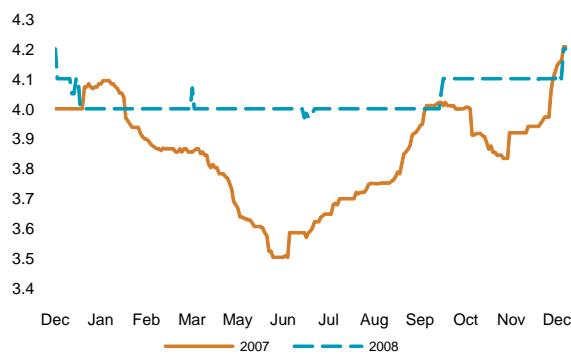


Figure 2.8 – IGP-M and IPA-DI

Median 2007

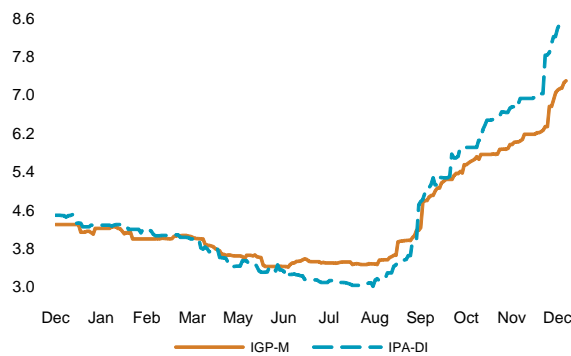
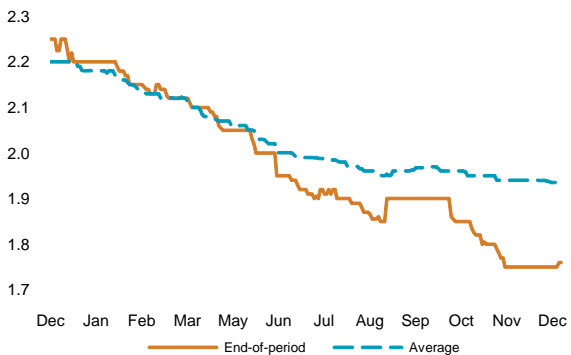


Figure 2.9 – Exchange rate

Median 2007



2/ Utilizes the method of smoothed trimmed means.

smoothed trimmed means varied 1.13% and 0.93% in the corresponding periods, while, without this smoothing procedure, variations reached, in the same order, 0.89% and 0.83%. In the last twelve months, the three methods of calculation of inflation core grew 3.86%, 4.02% and 3.43%, compared to variation of 4.19% shown by IPCA.

The inflation core for the IPC-Br, calculated by the FGV,² grew 0.73% in the quarter ended in November, against 0.97% in the period from June to August, for a cumulative expansion of 3.37% in twelve months.

2.5 Market expectations

The median of expectations for IPCA in 2007, collected by the Investor Relations Group (Gerin) moved from 4%, at the end of the third quarter of this year, to 4.2% in the second week of December, rising from 4.1% to 4.2%, for 2008. These forecasts are consistent with the inflation target established by the CMN, with a core in 4.5%, and margins of two percentage points.

The expectations for IPCA evolution twelve months ahead moved from 3.8%, at the end of September, to 4.2%, in the second week of December. The prospects for both less inflationary inertia and accomplishment of inflation targets for the fifth consecutive year has contributed to maintaining the expectations of future inflation on a level lower than the target.

The estimates concerning the general price indices variations in 2007 have increased, with medians relative to the IGP-M and to IPA-DI reaching 7.3% and 8.5%, respectively, in the second week of December, against 5.3% and 5.8%, at the end of September. For 2008, the medians of market forecasts for IGP-M and for IPA-DI expanded to 4.3%.

The prospects for lower increases in regulated prices continue contributing to the consolidation of a scenario with less inflationary inertia, facilitating the anchorage of expectations onto the trajectory of targets. The median of expectations related to the correction of regulated prices in 2007 reached 2% in the second week of December, against 2.5% at the end of September. For 2008, the forecast of the median fell back from 3.8%, at the end of September, to 3.7%, in the second week of December.

The market forecasts for the exchange rate continue reflecting the perception of a steady and positive scenario for

Table 2.4 – Summary of market expectations

| | 6.29.2007 | | 9.28.2007 | | 12.14.2007 | |
|-------------------------------|-----------|------|-----------|------|------------|------|
| | 2007 | 2008 | 2007 | 2008 | 2007 | 2008 |
| IPCA | 3.6 | 4.0 | 4.0 | 4.1 | 4.2 | 4.2 |
| IGP-M | 3.5 | 4.0 | 5.3 | 4.1 | 7.3 | 4.3 |
| IPA-DI | 3.1 | 4.0 | 5.8 | 4.3 | 8.5 | 4.3 |
| Regulated Prices | 3.1 | 3.8 | 2.5 | 3.8 | 2.0 | 3.7 |
| Selic (end-of-period) | 10.8 | 9.8 | 11.0 | 10.3 | | 10.5 |
| Selic (average) | 11.8 | 10.1 | 11.9 | 10.6 | | 10.9 |
| Exchange rate (end-of-period) | 1.90 | 2.00 | 1.86 | 1.90 | 1.76 | 1.80 |
| Exchange rate (average) | 1.99 | 2.00 | 1.96 | 1.90 | 1.93 | 1.78 |
| GDP growth | 4.3 | 4.1 | 4.7 | 4.4 | 5.1 | 4.4 |

the external accounts. The median for the average exchange rate in 2007 slightly, moving from R\$1.96/US\$1.00, at the end of September, to R\$1.93/US\$1.00, in the second week of December. The end-of-period rate of exchange for 2007 varied from R\$1.86/US\$1.00 to R\$1.76/US\$1.00, in the period. On the same basis of comparison, the medians of expectations for the average exchange rate and for the end-of-period exchange rate fell back from R\$1.90/US\$1.00 to R\$1.78/US\$1.00 and R\$1.80/US\$1.00, respectively.

Forecasts for the Selic rate followed the tendency of greater uncertainty in the global markets. The Selic rate for the end of 2007 was revised from 11% per year, at the end of September, to 11.25% per year, at the end of November, while the forecast for the average Selic rate closed at 11.9% per year. Additionally, in the second half of December, the median of projections for the Selic rate for the end of 2008 moved from 10.3% per year to 10.5% per year, while the median of the average rate for the next year rose to 10.9% per year.

Considering the same basis of comparison, the median related to the forecast of GDP growth in 2007 rose to 5.1%, while that related to 2008 remained stable at 4.4%.

2.6 Conclusion

Although the performance of inflation in the latest months point to a progressive depletion of the effects of the upturn in prices of foodstuffs on other prices of the economy, the scenario of a greater acceleration risk remains. In this environment, associated to both the rising dynamics of the internal market and the relative instability of the external scenario, a favorable prospect persists in relation to achievement of the inflation targeting, expressed in a recurrent way by the market estimates. This posture, consistent with the favorable prospects about the level of global supply resulting from the maturity of investments made in important links of the productive chain, demonstrates the confidence of the economic agents in relation to the continuity of the correct management of the monetary policy.

3.1 Credit

Credit growth has been consolidating as an important factor for sustaining internal demand. Demand growth for banking credit by companies demonstrates the warming up of the industrial and commercial activities also associated to the year-end sales. Growth in loans targeted to individual persons, in line with the increase of available income and occupation, continues to be driven by the modalities of personal credit, especially by the payroll-deducted operations and by financing for the acquisition of durable goods. One should also highlight the significant performance of leasing operations.

The financial system credit operations maintained an expansionary trajectory in the quarter ended in October, reflecting positive performances of the operations contracted both with nonearmarked and earmarked resources. The total balance of credit reached R\$880.8 billion in October, with increases of 7.7% in the quarter and 26.3% in twelve months, turning to represent 34% of GDP, against 32.6% in July and 29.8% in October of 2006.

As regards credit distribution, based on the capital holdings of the financial institutions, loans granted by the national private banks summed up R\$383 billion in October, with growth of 8.7% in relation to July. This volume corresponded to 43.5% of the total portfolio of the financial system, with emphasis on the evolution of loans channeled to individual persons, industry and other services. Operations contracted with the foreign banks expanded 8.8% in the quarter, representing 22.3% of the total credit, with emphasis on credit to the segments of individual persons and industry. Loans granted by the public financial institutions, which, upon summing up R\$301.7 billion, totaled 34.2% of loans, were absorbed, especially by the industrial and service segments.

The balance of credit channeled to the private sector, including nonearmarked and earmarked resources, totaled

Table 3.1 – Credit operations

| | R\$ billion | | | | | |
|-------------------------|-------------|-------|-------|-------|----------|-----------|
| | 2007 | | | | % growth | |
| | Jul | Aug | Sep | Oct | 3 months | 12 months |
| Total | 817.9 | 842.3 | 857.3 | 880.8 | 7.7 | 26.3 |
| Nonearmarked | 572.7 | 590.8 | 602.3 | 619.4 | 8.2 | 30.1 |
| Earmarked | 245.2 | 251.5 | 255.0 | 261.4 | 6.6 | 17.9 |
| % participation: | | | | | | |
| Total/ GDP | 32.6 | 33.0 | 33.3 | 34.0 | | |
| Nonearmarked/GDP | 22.8 | 23.2 | 23.4 | 23.9 | | |
| Earmarked/GDP | 9.8 | 9.9 | 9.9 | 10.1 | | |

Figure 3.1 – Credit by capital control of financial institutions

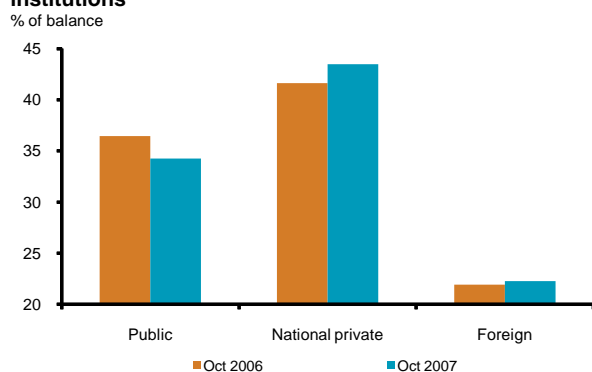


Figure 3.2 – Credit by borrower's economic activity – National private institutions

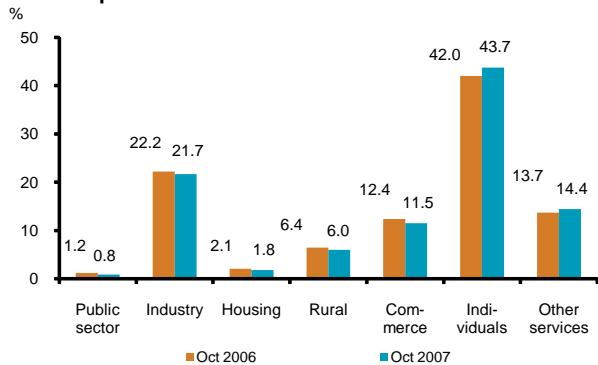


Figure 3.3 – Credit by borrower's economic activity – Public institutions

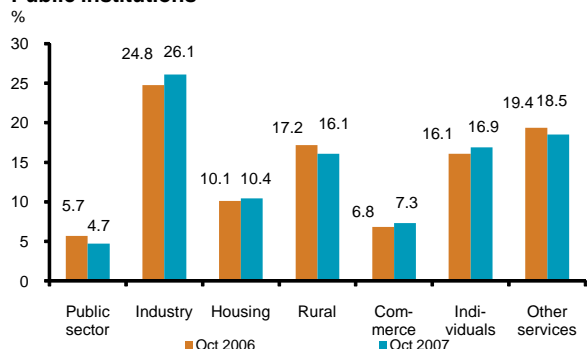


Figure 3.4 – Credit by borrower's economic activity – Foreign institutions

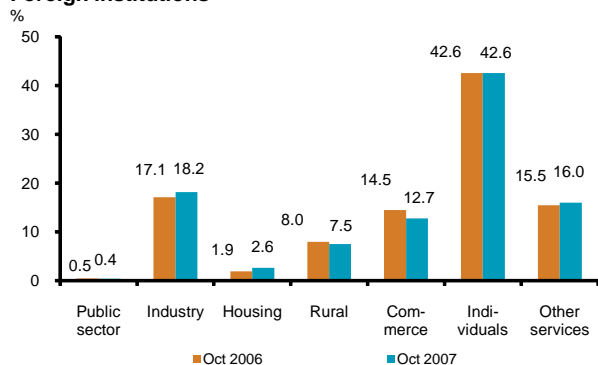
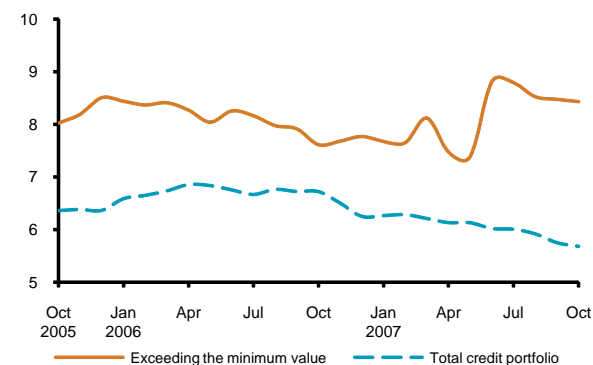


Figure 3.5 – Provisions of total financial system credit %



R\$862.6 billion in October, rising 7.9% in relation to July. Operations contracted with individual persons grew 7.9%, with emphasis on the modalities of personal credit and of financing for vehicle acquisition, while the total channeled to the industrial sector increased 8.8%, boosted by the credits to the segments of energy, agribusiness and chemical industries. Loans targeted to commerce grew 8.7% in the quarter, with emphasis on the retail sector, represented, mainly, by the segments of supermarkets and automobiles, while operations with the segment of other services increased 7.7%, with highlights to disbursements to the fields of telecommunications, energy and transportation.

Credit channeled to the public sector totaled R\$18.2 billion in October, with a downturn of 0.2% in relation to July. This result demonstrated a 2.3% decline in the federal government stock of credit for an amount of R\$3.7 billion, reflecting amortization and exchange appreciation in contracts with gas, petroleum and electricity generation companies. The banking debt of state and municipal governments expanded 0.4%, concentrating on operations with the electricity sector companies.

The balance of provisions set aside by the financial institutions represented 5.7% of the total credit portfolio in October. The reduction of 0.3 p.p. in relation to July was impacted by the cutback of 0.2 p.p. to 3.3%, in the default rate of the total credit portfolio.

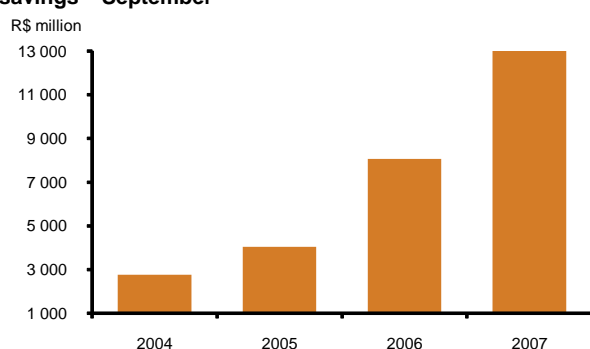
Earmarked credit

The credit operations carried out with earmarked resources totaled R\$261.4 billion in October, for increases of 6.6% in relation to July and of 17.9% in twelve months. The quarterly performance was mostly determined by the expansion of 6.7% in the financing granted by BNDES. In that case, the balance totaled R\$152 billion, reflecting respective increases of 8.3% and of 5.3% in operations granted directly or by mean of onlendings from the financial institutions. In the quarter, loans channeled to the rural sector grew 7.5%, and operations contracted with the housing segment expanded 5.7%.

The rural financing with earmarked resources, excepting those carried out by the BNDES, mostly reflecting the releases for covering the 2007/2008 harvest current expenditures, summed up R\$60.9 billion in October, rising 7.5% in the quarter and becoming 70.6% of the total rural credit portfolio. Considering the modalities of rural credit involving free and earmarked resources, the current

Table 3.2 – Earmarked credit operations

| | R\$ billion | | | | | |
|--------------------|-------------|-------|-------|-------|----------|-----------|
| | 2007 | | | | % growth | |
| | Jul | Aug | sep | Oct | 3 months | 12 months |
| Total | 245.2 | 251.5 | 255.0 | 261.4 | 6.6 | 17.9 |
| BNDES | 142.4 | 146.9 | 148.0 | 152.0 | 6.7 | 16.6 |
| Direct | 67.4 | 70.5 | 70.9 | 73.0 | 8.3 | 8.8 |
| Onlendings | 75.0 | 76.4 | 77.1 | 79.0 | 5.3 | 24.9 |
| Rural | 56.7 | 57.6 | 59.3 | 60.9 | 7.5 | 18.1 |
| Banks and agencies | 54.1 | 54.8 | 56.3 | 57.7 | 6.7 | 17.2 |
| Credit unions | 2.6 | 2.8 | 3.0 | 3.2 | 23.9 | 38.4 |
| Housing | 39.3 | 40.1 | 40.8 | 41.5 | 5.7 | 23.5 |
| Others | 6.9 | 6.9 | 7.0 | 7.0 | 2.6 | 14.1 |

Figure 3.6 – Credit to housing with resources from savings – September^{1/}

1/ Disbursements accumulated in 12 months

Table 3.3 – BNDES disbursements

| | R\$ million | | | % growth |
|--|-------------|--------|-------|----------|
| | Jan-Oct | | | |
| | 2006 | 2007 | | |
| Total | 34 957 | 49 825 | 42.5 | |
| Industry | 18 423 | 21 007 | 14.0 | |
| Other transportation equipment ^{1/} | 4 115 | 1 341 | -67.4 | |
| Motor vehicles | 2 609 | 2 065 | -20.9 | |
| Basic metallurgy | 1 122 | 2 659 | 137.0 | |
| Food and beverage | 2 913 | 4 279 | 46.9 | |
| Chemical | 711 | 1 714 | 141.1 | |
| Petroleum, coke and alcohol refining | 957 | 1 297 | 35.5 | |
| Commerce/Services | 13 925 | 24 833 | 78.3 | |
| Overland transportation | 5 800 | 8 833 | 52.3 | |
| Electricity, gas and hot water | 3 232 | 4 785 | 48.1 | |
| Construction | 1 145 | 2 214 | 93.4 | |
| Vehicle dealer ship and repairation | 959 | 2 197 | 129.1 | |
| Post and telecommunication | 517 | 3 032 | 486.5 | |
| Crop and livestock | 2 609 | 3 985 | 52.7 | |

Source: BNDES

1/ Includes aircraft industry.

expenditure operations expanded 6.5% in the quarter, while the installments related to investments and rural trading grew 3.6% and 13.6%, representing, in the same order, 37.7%, 48.9% and 13.4% of the total rural credit.

Financing channeled to the housing sector, encompassing individual persons and housing cooperatives, totaled R\$41.5 billion in October, with an increase of 5.7% when compared to July. Disbursements with resources from the savings accounts accumulated R\$11.6 billion in the period from January to September, with an expansion of 75.6% in relation to the same period of 2006. In the same period, funding from the Employment Compensation Fund (FGTS) aimed at financing houses to the low-income population layers, although dropping 22.9%, totaled R\$4.3 billion, continued on a high level, in relation to the previous years.

Disbursements granted by BNDES reached R\$49.8 billion in the period of January to October, rising 42.5% in relation to the same period of the previous year (see box Contribution of BNDES Financing to the Recent Evolution of Investments). In sectorial terms, the most visible operations were channeled to the segment of trade and services, R\$24.8 billion, with relevance to the sectors of land transportation, telecommunications and energy. Loans to the industrial sector totaled R\$21 billion, indicating a growing demand in the fields related to basic metallurgy and foodstuffs and beverages, while operations targeted to the crop and livestock sector totaled R\$4 billion. It should be highlighted that, from total disbursements, R\$9.9 billion corresponded to contracting of micro, small and medium-sized companies, with expansion of 51.8%, in the period.

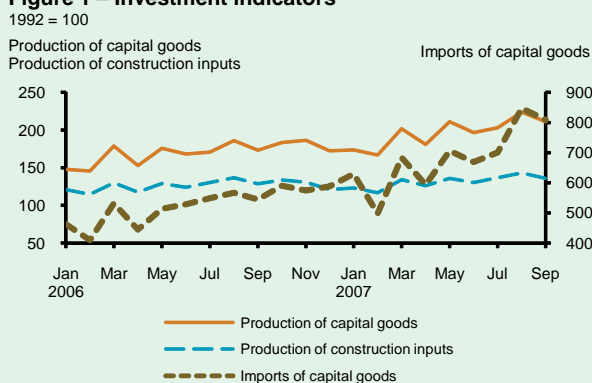
Consultations to BNDES totaled R\$103.3 billion in the first ten months of the year. The expansion of 35.8% in relation to the corresponding period of 2006 reflected, basically, the expansion of 88.6% in the requests by the commerce and service segment, mirroring greater demand in the areas of construction and energy and electricity. The requests from the crop and livestock sector expanded 17.5%, while, by contrast, consultations from the industrial sector, showing retraction of demand from the segment of other transportation equipment, including the aviation industry, fell off by 2.6%.

Nonearmarked credit

The credit operations with nonearmarked resources came to R\$619.4 billion in October, registering increases of 8.2%

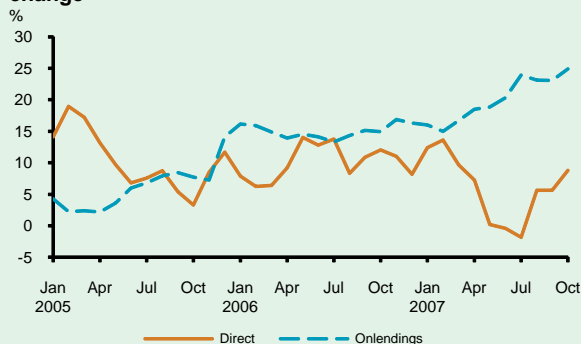
Contribution of BNDES Financing towards the Recent Evolution of Investments

Figure 1 – Investment indicators



Source: BNDES

Figure 2 – Evolution of BNDES financing – 12-month change



Source: BNDES

Investments have been registering an important cycle of expansion, reflected, mainly, in the growing absorption of capital goods, supplied both by the domestic market and by the imports. This movement reflects, from the demand perspective, the impetus of decisions by the economic agents favored by an environment of price stability, while, regarding the conditions for credit supply, there is a consistent improvement – explicit in reductions of rates and extension of maturities – registered in this market, including the credit expansion with non earmarked resources, the development of the capital market and the action exerted by the National Bank of Economic and Social Development (BNDES) as an important resource supplier for medium and long-term investments.

It should be highlighted that the current cycle, contrary to the pattern verified in recent periods, has been led by the sector of capital goods, of which the cumulative twelve month production rose 16.9% in October, against 5.5% in the corresponding period of 2006, while in the category of durable consumer goods have seen respective increases of 17.4% and 6.8%. Imports of capital goods expanded 33.3% and 22%, respectively, on the same basis of comparison. It is worth pointing out that even with growth in investments, the rates of utilization of installed capacity continued to rise in the latest months.

In this environment, the BNDES stock of credit reached R\$152 billion in October 2007, rising 16.6% in relation to the same month of the previous year, against respective elevations of 13.4% and 5.4% in the corresponding periods of 2006 and 2005. The growth of BNDES loans was fundamentally associated to the expansion of 24.9% observed in operations carried

out by means of transfers to the authorized financial institutions, which totaled R\$79 billion in October, stimulated by the evaluation of 19% occurred in credit lines in the context of the Special Industrial Financing Agency (Finame), channeled to finance the production and commercialization of new machinery and equipment.

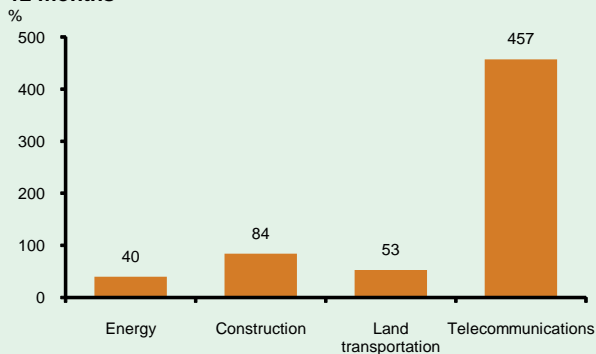
The relevance of Finame-backed operations for the dynamics of BNDES operations becomes evident when one analyzes the trajectory of disbursements, which represent the effective release of resources of contracted loans.

In this sense, while the BNDES disbursements accumulated in twelve months totaled R\$66.6 billion in October 2007, with expansion of 37% in relation to the previous twelve months, those related to Finame operations summed up R\$19.5 billion, rising 62.8% on the same basis of comparison.

The analysis of disbursements by economic segment reveals the predominance of concessions channeled to the industry and infrastructure segments, the balances of which totaled R\$29.8 billion and R\$25.9 billion, respectively, in the twelve months closed in October, registering, in the order, increases of 15% and of 60%, in the period. The performance of the industrial sector was favored by the concessions to the areas of iron and steel, chemicals and petrochemicals, while the dynamics of the sector of infrastructure turned in, in line with the incentives favored by the Growth Incentive Program (PAC), increase in lines of financing which should contribute, in the next years, for sustaining private investments.

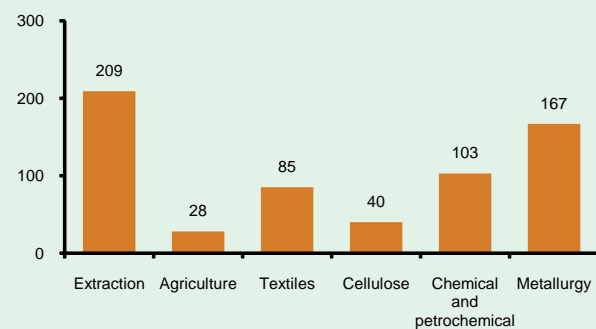
It should still be highlighted that the increased demand for investment resources have been impacted by the high rates of capacity utilization observed in various sectors, and by the level, lower since 1994, reached by the Long-Term Interest Rate (TJLP) – main indexing factor of the loans contracted through the BNDES system, correcting 76% of the portfolio of direct operations and 83% of the contracts related to Interfinancial transfers, which dropped from 9% p.y., in the first quarter of 2006, to 6.25% p.y. in the last quarter of 2007.

Figure 3 – Growth in infrastructure disbursements – 12 months



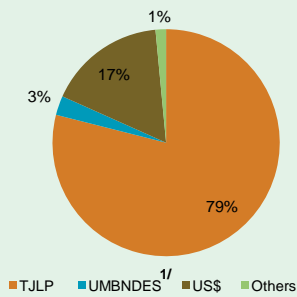
Source: BNDES

Figure 4 – Growth in disbursements for the industrial sector – 12 months%



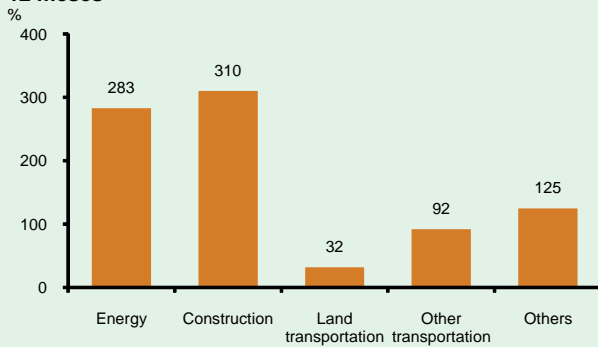
Source: BNDES

Figure 5 – Distribution of BNDES portfolio by financial charges– October 2007



1/ BNDES monetary unit, composed by a basket of foreign currencies.

Figure 6 – Growth in infrastructure consultations – 12 meses



Source: BNDES

The prospects of maintenance of the rising trajectory of BNDES loans may be anticipated by the analysis of consultations to that entity, which represent a leading indicator of potential disbursements. These requests, which reached R\$133.4 billion in the twelve months closed in October, rose 41% in relation to the same period of 2006, concentrating on the segment of infrastructure, accounting for 50.2% of the total.

The dynamics of investments in infrastructure should be more intensive in the sectors of construction and electric energy, in which the consultations grew, respectively, 310% and 283%. This performance reflects, in part, the prioritization of these sectors within PAC, benefited with specific reductions in the financing costs and should contribute toward reducing the energy shortage risk in the medium term.

Recent surveys related to intentions to invest on the part of the companies corroborate the favorable prospects as to the ongoing expansion of investments in the next quarters; a trajectory essential to ensure that the imbalance between the paces of the expansion rate vs. demand will not jeopardize the inflation dynamics.

Table 3.4 – Nonemarked credit operations

| | 2007 | | | | R\$ billion | |
|--------------------------------|-------|-------|-------|-------|-------------|-----------|
| | Jul | Aug | Sep | Oct | % growth | |
| | | | | | 3 months | 12 months |
| Total | 572.7 | 590.8 | 602.3 | 619.4 | 8.2 | 30.1 |
| Corporations | 290.1 | 300.4 | 306.6 | 314.5 | 8.4 | 27.9 |
| Domestic funding | 229.8 | 234.6 | 242.1 | 249.6 | 8.6 | 29.6 |
| Reference credit ^{1/} | 180.0 | 182.0 | 188.9 | 193.6 | 7.6 | 26.0 |
| Leasing | 26.7 | 28.6 | 31.4 | 32.8 | 22.7 | 82.5 |
| Rural | 1.9 | 1.8 | 1.8 | 1.8 | -2.4 | 3.8 |
| Others | 21.2 | 22.2 | 20.0 | 21.4 | 1.0 | 11.4 |
| External funding | 60.3 | 65.7 | 64.5 | 64.8 | 7.5 | 21.8 |
| Individuals | 282.6 | 290.4 | 295.7 | 304.9 | 7.9 | 32.5 |
| Reference credit ^{1/} | 221.9 | 226.0 | 229.5 | 234.8 | 5.8 | 24.2 |
| Credit unions | 11.2 | 11.5 | 11.7 | 11.9 | 5.7 | 25.1 |
| Leasing | 20.3 | 21.8 | 22.1 | 24.6 | 21.5 | 86.2 |
| Others | 29.2 | 31.2 | 32.4 | 33.6 | 15.1 | 83.0 |

1/ Interest rate reference credit, defined according to Circular 2,957, dated 12.30.1999.

Figure 3.7 – Interest rates on nonemarked credit

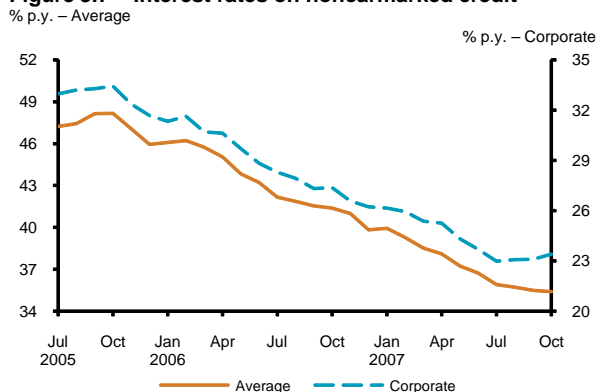
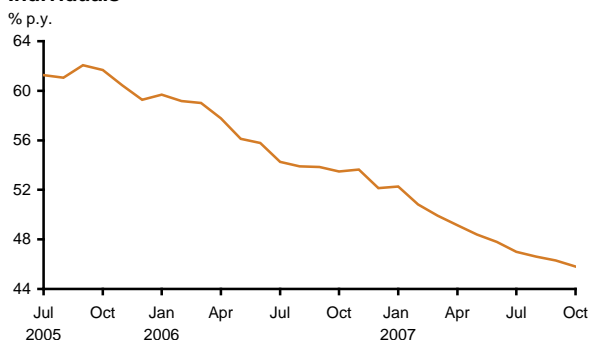


Figure 3.8 – Interest rates on fixed rate credit – Individuals



in relation to July and of 30.1%, in twelve months. The participation of these loans in the total credit stock of the financial system reached 70%, against 68% in October of the previous year.

Loans to corporate entities summed up R\$314.5 billion in October, registering more significant expansion, of 8.4%, in relation to July. The modalities contracted with domestic resources reached R\$249.6 billion, rising 8.6% in the quarter.

The interest rate reference credit operations expanded 7.6% in the period, in line with a more intense demand for resources in the last few months of the year, a result of an upturn in business activities and expenditures with employees. In addition to that, the stock of leasing operations reached R\$32.8 billion, with increases of 22.7% in the quarter and 82.5% in twelve months, reflecting the dynamics in leasing of vehicles aimed at renewal and expansion of the companies' fleets.

The total credit contracted in the segment of individual persons summed up R\$304.9 billion in October, with increases of 7.9% in relation to July and 32.5% in twelve months. The quarterly result was impacted by the dynamics of the automotive segment, as demonstrated by increases of 21.5% in leasing operations, concentrated on automotive vehicles, and 5.8% in those related to interest rate reference credit, with emphasis on the modalities channeled to consumption, particularly personal credit and financing for the acquisition of durable goods, particularly, vehicles.

The average interest rate of nonemarked credit operations fell off 0.5 p.p. in the quarter ended in October, in relation to the May- July period, closing at 35.4% p.y., the lowest value of the historical series initiated in June 2000. The cost of operations in the segment of individual persons fell by 1.2 p.p. in the quarter, down to 45.8%, the lowest level of the series, mirroring, mainly, the retraction of 1.7 p.p. in the personal credit rate, which closed at 48.9%, also the lowest percentage of the series. The average interest rate concerning loans to corporations increased 0.4p.p., when compared to July, closing at 23.4% per year, impacted by the 1p.p. increase in the inflation-indexed rates, in connection to the exchange rate appreciation during the period.

The banking spread reached 24.4 p.p. in October, with decrease of 0.7 p.p. in relation to July. This behavior resulted in a drop of 1.8 p.p. in the segment of individual persons and expansion of 0.6 p.p. in that segment related to corporate entities, standing, in order, at 34.5 p.p., smaller than the series value, 12.7p.p.

Figure 3.9 – Average spread on nonemarked credit

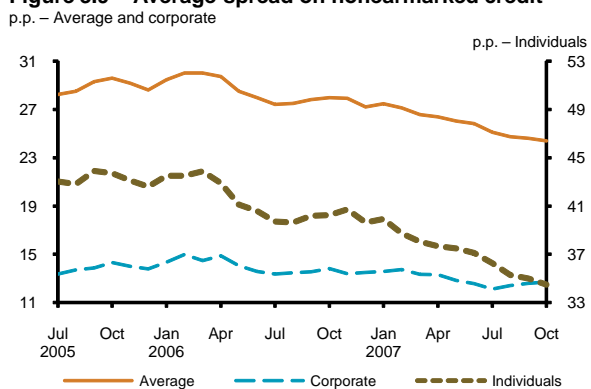
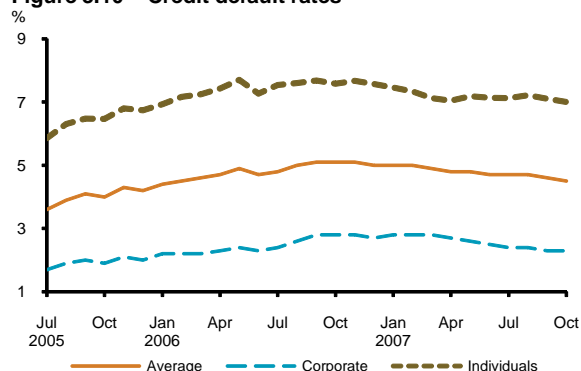


Figure 3.10 – Credit default rates^{1/}



1/ Nonemarked credit in arrears of more than 90 days.

Figure 3.11 – Monetary base and M1 – Average daily balances

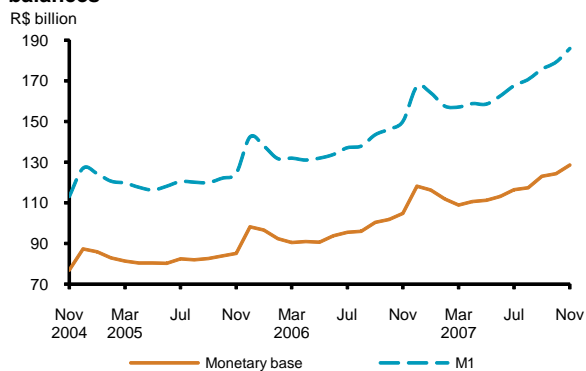
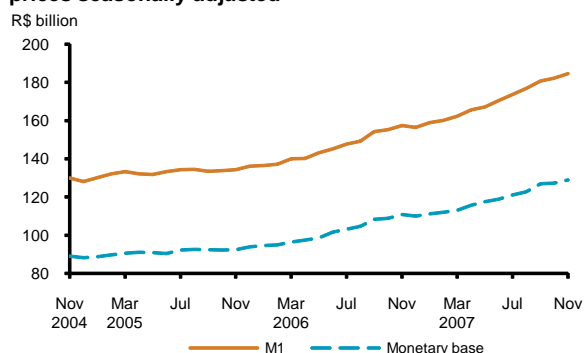


Figure 3.12 – M1 and monetary base at November 2007 prices seasonally adjusted^{1/}



1/ Deflated by: IPCA.

Default of the reference credit portfolio, considering delays higher than ninety days, reached 4.5% in October. The drop of 0.2 p.p. in relation to July derived from reductions of 0.1 p.p. in both segments. In that case, rates closed at 7% and 2.3%, respectively.

3.2 Monetary aggregates

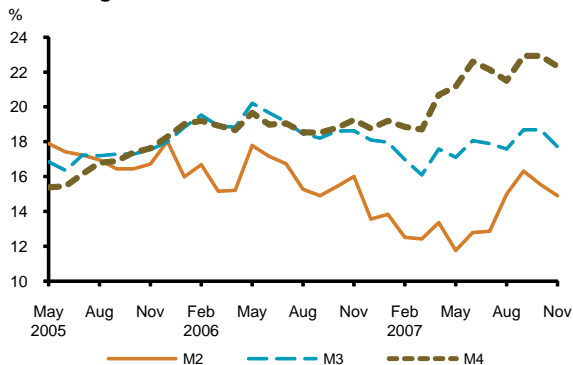
Money supply in the restricted concept (M1), considering the average daily balances, came to R\$183.8 billion in November. The increase of 22.4% in the last twelve month derived from growth of 18.2% in the average balance of currency outside banks and of 25.1% in terms of demand deposits.

When considering the seasonally adjusted data deflated by IPCA, the M1 aggregate registered 4.4% growth in the quarter ended in November, in relation to the quarter ended in August, maintaining the upward trend observed during 2007. This behavior proved to be consistent, in particular, with the pace of expansion of credit operations and with the anticipation of the thirteenth salary installment for the beneficiaries of the National Social Security Institute (INSS), in September. In November, in line with the evolution of M1, the average daily balances of the monetary base reached R\$127.4 billion, rising 21.5% in twelve months, as a result of increases of 18% in the average balance of currency issued and of 29.3% in that related to banking reserves.

The external sector operations, reflecting net purchases of foreign currency by the Central Bank on the interbank exchange market, exerted an expansionist impact of R\$16.4 billion on the monetary base, in the quarter ended in November. Additionally, the adjustments in the operations with derivatives caused an expansion of R\$4.3 billion, while, reversely, the National Treasury operations had a contractionist impact of R\$21 billion, the additional requirement over deposits, of R\$1.9 billion, and the reserve requirements on deposits from the Brazilian System of Savings and Loans (SBPE), of R\$1.8 billion. The combination of these factors together with net redemptions of federal public securities of R\$20.4 billion determined the increase of R\$16.4 billion of the monetary base in the quarter.

Money supply in the M2 concept, which aggregates M1, deposits for investments, savings deposits and bonds issued by financial institutions, grew 5% in November, in relation to August, and 14.9% compared to the same month of 2006. The balances of the savings accounts and of private bonds grew 4.7% and 1.8%, respectively, in the quarter.

Figure 3.13 – Broad money supply 12-month growth

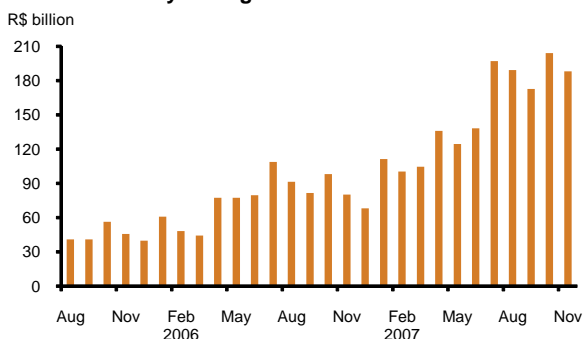


The balance of M3, a concept which adds to M2 the quotas from fixed income funds and the federal public securities which back the net financing position in repo operations between the public and the financial sector, grew 4.7% in relation to August, reaching R\$1.6 trillion. M4, which comprises M3 plus the public securities from nonfinancial holders, turned in a balance of R\$1.9 trillion in November, with growth of 6% in the quarter.

Federal Public Securities and Bacen open market operations

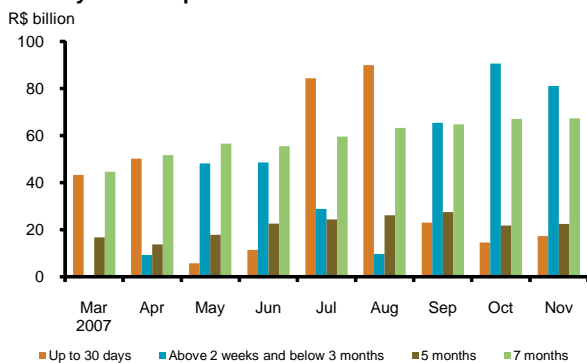
The National Treasury's (TN) primary operations with federal public securities resulted in net redemption of R\$4.3 billion in the quarter ended in November, registering maturities of R\$82.5 billion, anticipated redemptions of R\$8.2 billion and placements of R\$86.3 billion from the Internal Federal Public Securities Debt (DPMFi). The swaps summed up R\$27 billion, of which 39.7% in National Treasury Notes – Series B (NTN-B). The expansionist result of the primary operations reflected, basically, the reduced pace of placements of National Treasury bonds, in response to the increased volatility of the financial market.

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



At the end of October, the fixed-rate bonds accounted for 35.2% of DPMFi, followed by those remunerated by the Selic-rate, 35.5%, and those earmarked to price indices, 26.1%. Consistent with the strategic directives of the National Treasury's Annual Financing Plan (PAF), the average term of DPMFi reached 36.7 months, evincing placements of NTN-B, typically of medium and long term.

Figure 3.15 – Central Bank repo operations – Maturity – End of period



The average daily balance of financing and go-around operations carried out by the Central Bank, which envisage the adjustment of the system's liquidity conditions, dropped from R\$90 billion, at the beginning of September, to R\$15.6 billion at the end of November. In this same direction, the daily balance of the repo operations with a five-month term moved from R\$26.2 billion to R\$21.9 billion. Reversely, the average daily balance of operations with terms of two weeks to three months and those operations with seven-month terms expanded, in the same order, from R\$9.7 billion to R\$81.2 billion and from R\$63.3 billion to R\$66.7 billion. The net financing position of the Central Bank in the open market, after reaching R\$204.2 billion in October, closed at R\$185.4 billion at the end of November, against R\$189.1 billion at the end of August. It is worth noting that, in these circumstances, the market liquidity situation in reais remains

comfortable, in contrast with what has been observed in some developed economies.

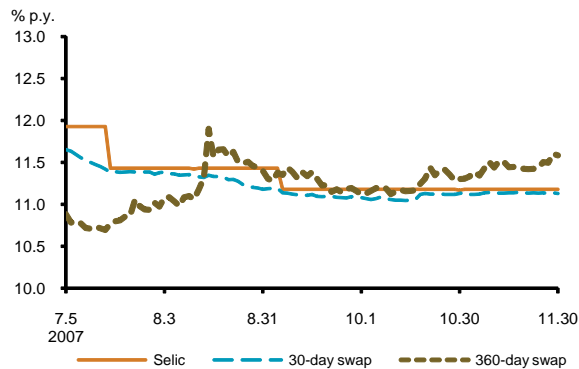
The foreign exchange long position was maintained in the quarter ended in November, registering placements of US\$4.7 billion and redemption of US\$5.4 billion in reverse exchange swaps. The DPMFi installment exposed to exchange variation moved from -2.5%, at the beginning of September, to -2.2%, at the end of October. The adjustments in reverse swap operations, carried out in national currency in accordance to the variation of the interest rate of the Interfinance Deposit Certificate (CDI) and of exchange rate, resulted in financial inflow of R\$4.3 billion in favor of the public.

Real interest rates and market expectations

The interest curve inclination derived from ID swap x fixed-rate contracts for November remained stable in relation to the quarter ended in August. The rate for swap DI x pre 360 day contract reached 11.6% per.year in November. During October, this contract dropped 28 base points against the previous quarter, evincing reduction of the yield curve for all the vertices. This movement was reverted, however, in view of the worsening of uncertainties in the international financial markets, reflected in the trajectory of the country risk, which registered an average of 191 points in the quarter, against 171 point in the three previous months.

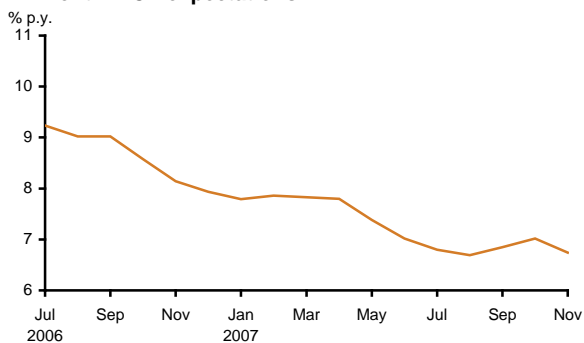
The real ex-ante interest rate of the Special System of Clearance and Custody (Selic) for the next twelve months, calculated based on the survey Market Report of 30 November, of the Central Bank, remained stable in relation to the end of August, when it reached 6.7% per.year, registering increases, on the margin, in the expectations both of inflation measured by IPCA and the Selic rate for 12 months.

Figure 3.16 – Selic x swap DI x Pre



Source: BM&F

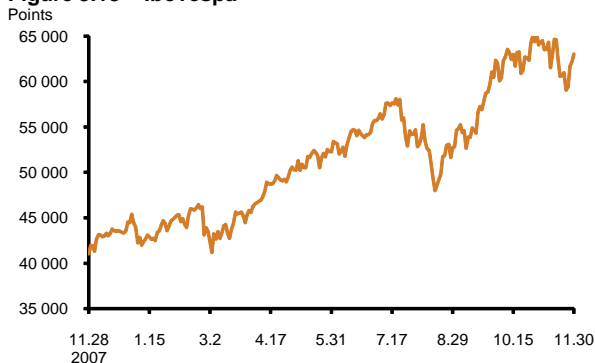
Figure 3.17 – Ex-ante real interest rate – Deflated by 12-month IPCA expectations



Capital market

The São Paulo Stock Exchange Index (Ibovespa), after accumulating losses in the July-August period, resumed its rising tendency as observed in the first half-year reaching, at the end of September, the level prevailing before the beginning of the instability of the international financial market. Beginning in October, Ibovespa observed successive records, reaching the maximum of 65,317 points at the end of that month and accumulating a high of 15.3% in the quarter ended in November. The average daily balance of

Figure 3.18 – Ibovespa



Source: Bovespa

Figure 3.19 – Stock exchanges

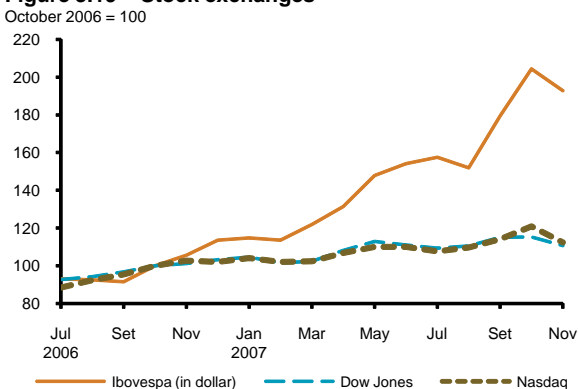
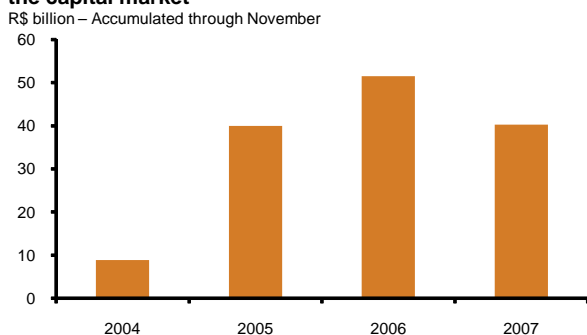
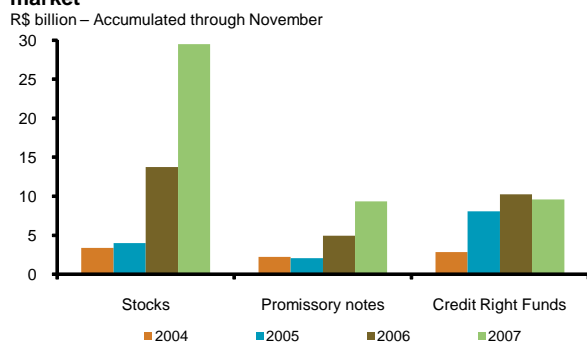


Figure 3.20 – Debenture primary issues in the capital market



Source: CVM

Figure 3.21 – Primary issues in the capital market



Source: CVM

transactions in the quarter totaled R\$6.1 billion, registering expansion of 18.7% in relation to the balance of transactions in the quarter ended in August and registering daily records of R\$15.8 billion, on October 17, and a monthly record of R\$6.7 billion, in November. In dollar terms, Ibovespa registered an increase of 26.8% in the period, favored by the exchange rate evolution, while the Dow Jones and Nasdaq indices varied 0.1% and 2.5%, respectively.

The financing of companies in the capital markets, by means of issuance of stocks, debentures, promissory notes and placements of credit right receivables, reached R\$93.9 billion in the year, up to November. Debenture issues summed up R\$45.4 billion, against R\$51.5 billion in the equivalent period of 2006, of which 73% carried out by leasing companies and, therefore, characterized by showing long maturity and high balances (see box on Capital Markets, Credit and Economic Growth).

Stock primary issues summed up R\$29.5 billion in the first eleven months of 2007, rising 114.7% in relation to equal period of the previous year. The real estate sector was the principal issuer, accounting for some 44% of total issuance in the period. The issues of credit right funds reached R\$9.3 billion, against R\$10.2 billion in the same period of the previous year. It is highlighted that the inflow of R\$19.1 billion by Stock Investment Fund (FIP), regulated in 2003 and channeled to investment in projects by open or closed capital companies (FIP), in which participation in decision making is open to shareholders.

Financial Investments

Investment funds, term deposits and savings account deposits totaled R\$1,5 trillion in November, registering growth of 3,8% in relation to August and of 15.6% in twelve months.

The net worth from investment funds, considering the exchange-indexed funds, short-term and fixed-income funds, the multimarket and the referenced funds, expanded 3.6% in the quarter ended in November, totaling R\$921.7 billion.

The consolidated portfolio of investment funds concentrated, at the end of October, 57.2% of the investments in public securities, 20% in the form of repo operations and 10.7% in banking securities, as compared to 63.1%, 15.6% and 11.7%, respectively, in the same period of 2006.

Capital Market, Credit and Economic Growth Evolution of Investments

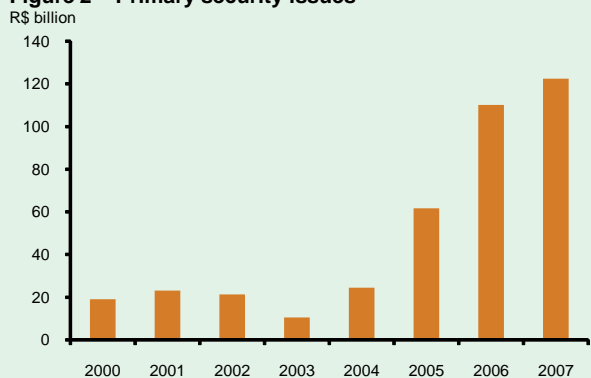
The international experience suggests the existence of a positive correlation between the degree of development of the financial markets and the economic growth rates. This ratio is established in view that, in developed markets, the financial intermediaries allocate resources more efficiently and benefit from an increase of asset liquidity so as to offer new services. This context favors the availability of information on the companies, the reduction of transaction costs, the carrying out of long-term projects and the improvement in resource allocation, from viewpoint of risk diversification.

Figure 1 – Market capitalization/GDP^{1/} and number of Bovespa monthly trades



Source: Bovespa
1/ 12-month cumulative GDP.

Figure 2 – Primary security issues



Source: CVM

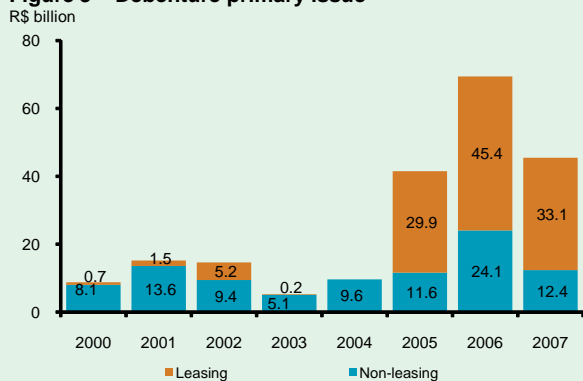
In Brazil, the macroeconomic stabilization which followed the implementation of *Plano Real* favored the opening of the economy to international liquidity, while the more recent adjustments to the financial system – associated, for instance, to the creation of the Credit Guarantee Fund and the Credit Risk Centralizer, to the regulation of tax levying on the capital market, to the implementation of the Brazilian Payment System and of the Law on Bankruptcies – consolidated the bases for the strengthening and expansion of the capital market as an alternative source of funding by the companies. In this sense, the primary issuance of private bonds registered at the Securities and Exchange Commission (CVM) reached R\$122 billion in 2007, through November, with 454 records of public securities offers, compared to R\$19 billion and 258 records, in 2000.

Among the modalities of funding, the issuance of debentures summed R\$69.5 billion in 2006 and R\$45.5 billion in 2007, through November, compared to R\$14.9 billion in the 2003-2004 biennium. The participation of leasing companies has been determinant for the dynamics of that market, since

2005 accounting for some 70% of issues, and providing for the maintenance of the accentuated growth of the mercantile leasing operations, channeled mainly to the financing of vehicles, machines and equipment.

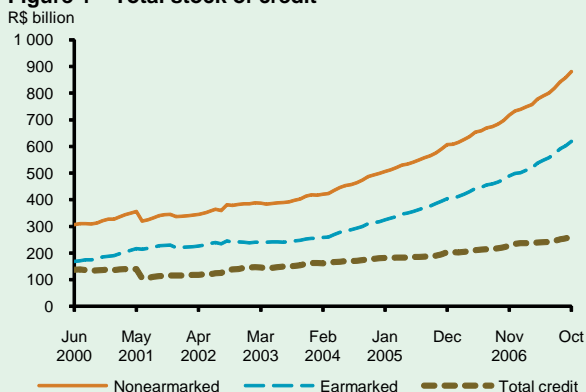
The stock market has presented a similar dynamics, reflected on the marked growth, from 30% in 2003, to 100.1% in October 2007, of the ratio between the capitalization of companies listed in São Paulo Stock Exchange (Bovespa) and the 12-month cumulative GDP. The issues of stocks reached R\$29.5 billion in the first ten months of 2007, surpassing the total of issues carried out from 2000 to 2006, with emphasis on the performance of the real estate companies, accounting for 44.4% of placements done in 2007.

Figure 3 – Debenture primary issue



Source: CVM

Figure 4 – Total stock of credit

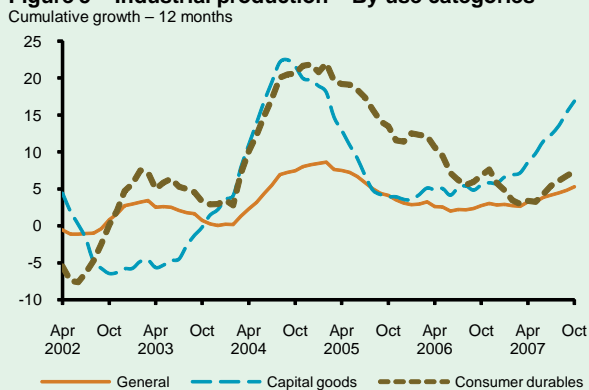


It should also be noted the rising trajectory of issues backed by new funding instruments, such as the Receivables-Backed Investment Funds (FIDC) and the Stock Investment Funds (FIP), which together registered a balance of R\$28.7 billion in primary issues in the first twelve months of 2007. FIP, created in 2003, aimed at funding sectoral investments, constituted the modality of greatest relative growth, with its issues moving from R\$2.1 billion, in 2005, to R\$19.1 billion, in the first eleven months of 2007.

Simultaneously, the expansion of the credit market, which evolved from 26% to 34% of the Gross Domestic Product (GDP), between June 2000 and October 2007, has decisively contributed to the strengthening of economic activity, stimulating, in particular, the consumption of durable goods and vehicle acquisitions. The best credit market conditions reflect, in part, the very evolution of the capital market, whereas the sources of the institutions' capitalization potentially expand. In this sense, it should be highlighted that, in 2007, eleven banks, the majority of which specialized in payment-deducted loans or in operations channeled to medium-size companies, went public with issuance in the order of R\$6.1 billion.

The positive relation between the capital and credit markets and the economic activity is suggested also by the behavior of industrial production indicators. From the supply perspective, the categories which

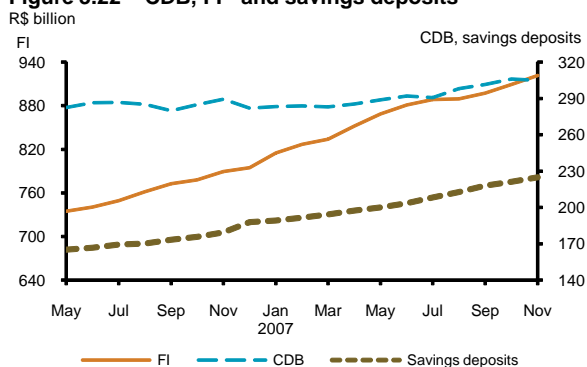
Figure 5 – Industrial production – By use categories



presented higher growth were that of durable consumer goods and capital goods, which are related, respectively, with the credit behavior with non earmarked resources and the development of the capital market.

It is observed, therefore, that the recent evolution of the capital market in Brazil follows closely the performance of the economy, favoring expansion of the activity level by expanding the available resources channeled to investment and consumption. These resources reach their destination both through the credit market, which benefit from the liquidity to increase their financial intermediation capacity, and by the issuance of bonds by companies, which favors the carrying out of the investment projects financed at lower costs and for longer periods. At the same time, the growing activity level and the macroeconomic stability favor the development of the capital market, when they expand their attractiveness to negotiated papers. Thus, the initial process gains momentum, which tends to become more robust in an environment of consistent inflows of external resources.

Figure 3.22 – CDB, FI^{1/} and savings deposits



1/ Excludes investment funds in stocks and in external debt.

Figure 3.23 – Public securities in investment funds – Portfolio by indexer

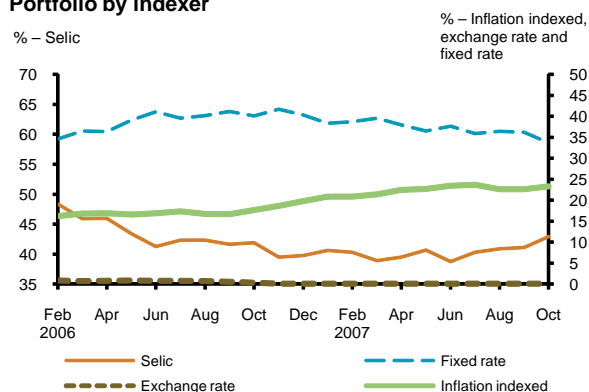
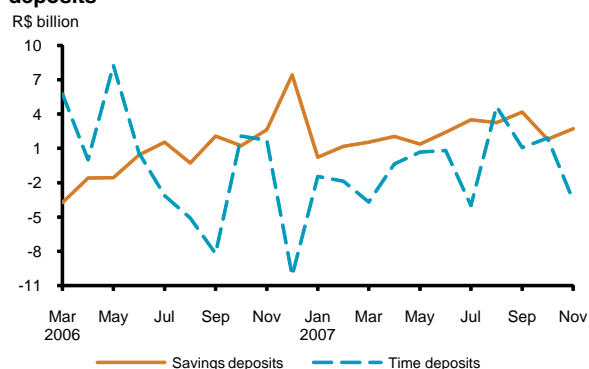


Figure 3.24 – Net inflow – Savings deposits and time deposits



The net worth from extramarket investment funds, which manage resources pertaining to the indirect federal administration entities, totaled R\$26.9 billion in November, registering expansion of 8.1% in relation to August.

The resources invested on variable-income funds came to R\$145.6, in November, rising 18.3% in the quarter and 77.8% in twelve months, while the net worth from Mutual Privatization Funds (FMP-FGTS) and from the Mutual Privatization Funds – Free Portfolio (FMP – FGTS – CL) summed up, together, R\$17.7 billion, rising 32.3% in the quarter.

The balances of savings account deposits, in which net inflows totaled R\$24.2 billion in the first eleven months of the year, and long-term deposits reached, in that order, R\$225 billion and R\$305.1 billion, in November, showing increases of 25.4% and 5.4%, respectively, in relation to the corresponding month of the previous year.

3.3 Fiscal policy

Constitutional Amendment 55, enacted in September, upgraded from 22.5% to 23.5% the percentage of collection of taxes on income and on industrialized products transferred by the Federal Government to the Municipal Revenue Sharing Funds (FPM). This alteration, considering the Union’s estimate in the budget proposal for 2008, should increase the transfers to the municipalities in approximately R\$2 billion, next year.

It is important to highlight that the Union’s budget proposal incorporate forecast of R\$40.1 billion in tax collection related to the CPMF. Considering the significance of this tax and the rejection of proposal for its postponement by the Senate, one must consider the risks of its interruption for the maintenance of the expected pace of reduction of the Public Sector Net Debt in the coming years.

Public sector borrowing requirements

The public sector’s nonfinancial primary surplus totaled R\$106.6 billion from January to October 2007, corresponding to 5.1% of GDP. Distribution of this result by spheres of the public sector evinces increases in surpluses from the regional governments and from the Central Government and reduction in that related to the state-owned companies.

Table 3.5 – Public sector borrowing requirements – Primary result – January-October

| | 2004 | | 2005 | | 2007 | |
|--------------------|---------|------|---------|------|---------|------|
| | R\$ | % | R\$ | % | R\$ | % |
| | billion | GDP | billion | GDP | billion | GDP |
| Central government | -59.8 | -3.4 | -57.2 | -3.0 | -63.7 | -3.1 |
| Sub-national gov. | -20.8 | -1.2 | -19.2 | -1.0 | -28.6 | -1.4 |
| State companies | -14.5 | -0.8 | -14.6 | -0.8 | -14.6 | -0.7 |
| Total | -95.1 | -5.4 | -91.0 | -4.8 | -106.9 | -5.1 |

Figure 3.25 – National Treasury gross revenue January-October
% of GDP

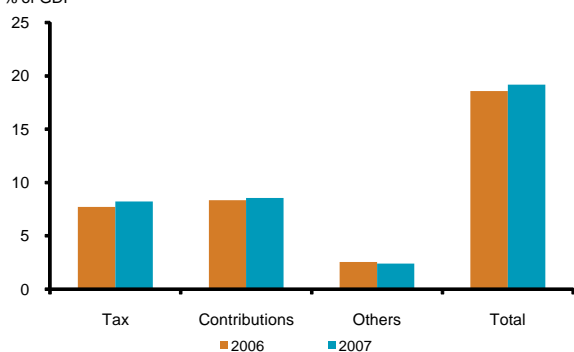


Table 3.6 – National Treasury expenditures January-October

| Itemization | 2006 | | 2007 | |
|---|-------------|-------|-------------|-------|
| | R\$ million | % GDP | R\$ million | % GDP |
| Total | 179 754 | 10.20 | 204 146 | 10.72 |
| Personnel and social charges | 83 208 | 4.72 | 93 107 | 4.89 |
| Capital and current expenditures | 96 035 | 5.45 | 110 713 | 5.81 |
| Workers Support Fund | 12 466 | 0.71 | 15 084 | 0.79 |
| Subsidies and economic subventions | 5 275 | 0.30 | 5 815 | 0.31 |
| Loas/RMV | 9 566 | 0.54 | 11 183 | 0.59 |
| Other capital expenditures | 57 556 | 3.27 | 64 386 | 3.38 |
| National Treasury transfers to the Central Bank | 511 | 0.03 | 326 | 0.02 |

Source: STN

The Central Government surplus performance mirrored growth of 12.7% of the revenues, in relation to the same period of 2006, in which case participation in GDP moved from 23.3% to 24%, in the period. The progress of revenues, consistent with the dynamics of economic activity, was also favored by the programs of installment payment of debits in arrears with the Federal Revenue Secretariat, with the General Attorney of the National Treasury and with the INSS.

The National Treasury's gross revenue grew 12.8%, on the same basis of comparison, while the other revenues, evincing cutbacks in collections related to the participation quota of financial compensation and dividends – the latter arising from a reduction in the balance of resources distributed by the federal financial companies, registered an increase of 2.9%.

The joint collection of the Income Tax – Corporate Entities and of the Social Contribution on Net Corporate Profits expanded 18% in the first ten months of the year, in relation to the corresponding period of 2006, boosted by the increase in the activity level and by the increased number of companies going public and stock offerings, resulting in growth in the global number of transactions carried out in the stock market. This latter factor, coupled with the intensification in the control of operations and real estate activities, also contributed to the Income Tax collection – Individual Persons to expand 46.4%, in the period.

The revenues associated with the Industrialized Products Tax (IPI) and the Contribution to Social Security Financing (Cofins) grew 19% and 11.4%, respectively, favored by the dynamics of the sectors of metallurgy and vehicle manufacturing. The performance of IPI collection was, additionally, associated with expansions of 29.9% in the dollar value of levied imports and 11.5% in the average rate of the tax.

Treasury expenditures, which grew 12.4% in relation to the first ten months of 2006, accounted for 9.81% of GDP. Expenses with personnel and social charges, reflecting the process of restructuring of specific careers of public and military personnel, expanded 13.1% in the period.

Outlays associated with current and capital expenditures expanded 15.3% registering a 21% growth in expenditures with the Worker Support Fund (FAT) and 16.9% with social benefits (Lifetime Monthly Income – RMV – provided for in the Social Assistance Law – Loas). The evolution of these expenses reflected both growth in the number of beneficiaries and the readjustment of minimum wage, which affect the values of the benefits paid.

Figure 3.26 – Basic Investment Project (PPI) expenditures

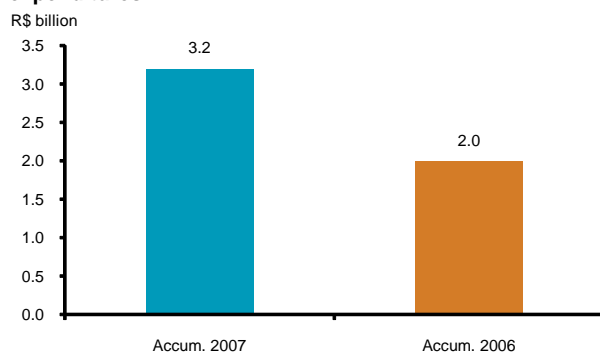


Figure 3.27 – Federal Government: investment expenditures paid up to September

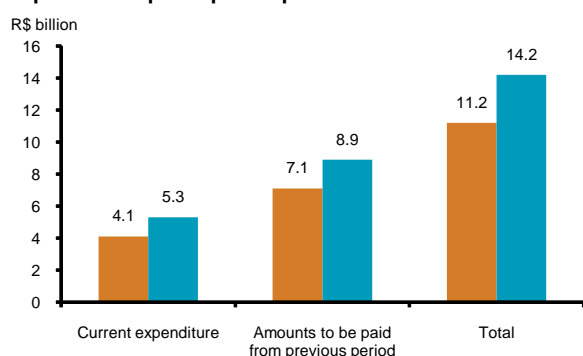
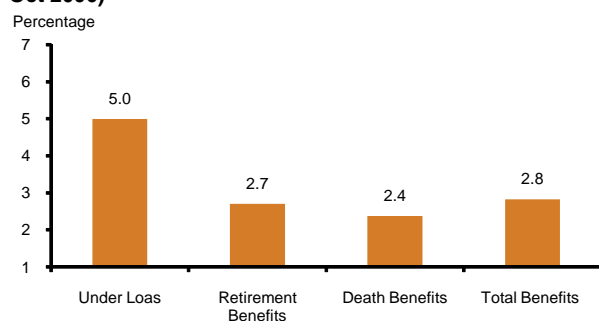


Table 3.7 – Social security primary result

| Itemization | 2006 | R\$ billion | |
|----------------------------|--------|-----------------|-----------------|
| | | 2006 Jan-Oct | 2007 Jan-Oct |
| Gross inflow | 133.7 | 104.2 | 120.5 |
| Cash refunds | -0.5 | -0.4 | -0.4 |
| Transfers to third parties | -9.7 | -8.1 | -11.2 |
| Net inflow | 123.5 | 95.7 | 108.8 |
| Social Security benefits | 165.6 | 132.8 | 147.3 |
| Primary Result | -42.1 | -37.1 | -38.4 |
| Primary Result/GDP | -1.81% | -1.95% | -1.85% |

Figure 3.28 – Growth in the average number of benefits issued by Social Security (Jan-Oct 2007/Jan-Oct 2006)



Source: STN

Outlays with federal government investments, reflecting the impact of the directives adopted for resuming the federal government's investment capacity, expanded 27.5%, coming to R\$14.2 billion in the first ten months of the year. Of this total, R\$3.2 billion are in the context of the Pilot Investment Project (PPI), liable to be deducted from the primary surplus, against R\$2 billion in the same period of 2006.

The Social Security deficit, showing a more visible growth of the revenues compared to expenditures, reduced from 1.95% of GDP, in the first ten months of 2006, to 1.85% of GDP, in the same period of 2007. Expansion in collection of contributions, consistent with the increase in formalization of the job market, reached 13.7%, while growth in expenses with benefits, resulting from minimum wage increases and growth in the average amount of benefits paid, reached 10.8%.

The constitutional transfers to states and municipalities expanded 14.1% in the year, following the performance of tax collection shared with these two government levels. This expansion accounted for 0.2 p.p. of GDP.

Revenues from the Tax on the Circulation of Merchandise and Services (ICMS), favoring growth in the surplus of the regional governments, grew 10.2% from January to September 2007, in relation to the corresponding period of the previous year.

The appropriated nominal interests totaled R\$135.2 billion in the first ten months of the year, of which R\$104.6 billion in the context of the Central Government and R\$32.5 billion in the regional level, while the state-owned companies registered net interest revenue of R\$1.9 billion in the period. The decrease in the Selic rate, which moved from 12.8% in the cumulative period from January to October 2006 to 10% in the same period of 2007, contributed to the appropriated interest to post a reduction of 0.6% p.p. of GDP.

The public sector's borrowing requirements, which comprise the primary result and the appropriate nominal interests, totaled R\$28.7 billion in the first ten months of 2007, against R\$43.9 billion in the same period of the previous year, corresponding, in that order, to 1.4% and 2.3% of GDP. The Central Government and the regional governments showed respective reductions in their borrowing requirements equivalent to 0.8 p.p. and 0.2 p.p. of GDP, while the surplus of state-owned companies was curtailed by 0.1 p.p.

With regard to sources of financing of the cumulative nominal deficit in the year, the resources of internal origin expanded

Figure 3.29 – Transfers to states and municipalities
Accumulated up to October

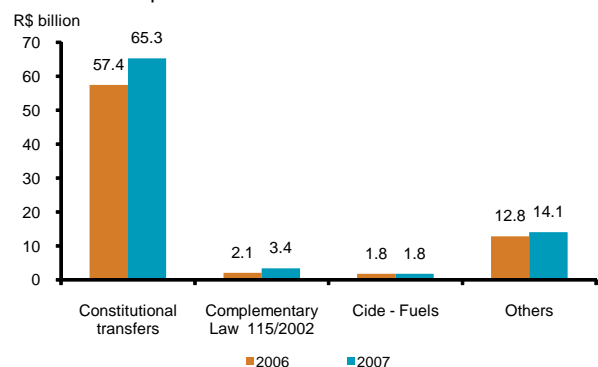


Figure 3.30 – ICMS inflow

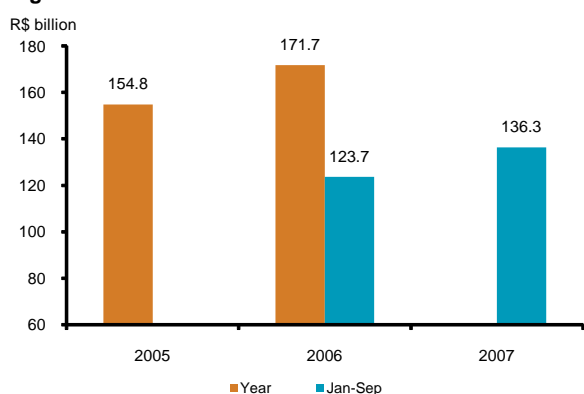
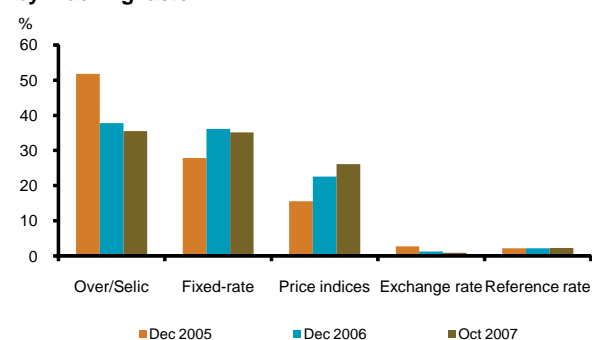


Table 3.8 – Public sector borrowing requirements - January-October

| Itemization | 2006 | | 2007 | |
|--------------------|-------------|-------|-------------|-------|
| | R\$ billion | % GDP | R\$ billion | % GDP |
| Uses | | | | |
| Primary | 43.9 | 2.3 | 28.1 | 1.4 |
| Interest | -91.0 | -4.8 | -106.9 | -5.1 |
| | 134.9 | 7.1 | 135.0 | 6.5 |
| Sources | | | | |
| Domestic financing | 43.9 | 2.3 | 28.1 | 1.4 |
| Securities debt | 140.2 | 7.4 | 220.9 | 10.6 |
| Bank debt | 151.1 | 7.9 | 238.7 | 11.5 |
| Others | -10.9 | -0.6 | -22.6 | -1.1 |
| External financing | 0.0 | 0.0 | 4.8 | 0.2 |
| | -96.3 | -5.1 | -192.7 | -9.3 |

Figure 3.31 – Federal securities debt structure by indexing factor^{1/}



^{1/} It does not include swap.

by R\$221.4 billion, as a result of increases of R\$238.7 billion in the securities debt and of R\$4.8 billion in the other sources of internal financing, which include the monetary base, and of retraction of R\$22 billion in the banking debt. The net external financing dropped by R\$192.7 billion, mainly in view of elevation of the international reserves.

Federal Securities Debt

In October 2007, the stock of the federal securities debt, assessed by the portfolio position, reached R\$1.199 billion 46.3% of GDP, for growth of R\$27.9 billion in relation to July. This variation evinced net redemptions of R\$8.5 billion on the primary market, reduction of R\$0.9 billion related to exchange appreciation of 7.1% registered in the quarter, and incorporation of interests of R\$37.3 billion.

The participation of Selic-indexed bonds and inflation-indexed bonds in the total of the federal securities debt grew 0.2 p.p. and 1.1 p.p., respectively, in the quarter, reaching, in the order, 30.6% and 22.5%, while that related to fixed-rate bonds dropped 0.9 p.p., to 30.4%. The borrowing taken by the Central Bank through open market operations reached, in October, R\$190.8 billion, a level similar to that of July 2007.

The October position demonstrates, once again, the continued improvement in the maturity profile of the federal securities debt. The schedule of amortization of the debt on market, except for financing operations, indicates that 2.7% of the maturities will take place in 2007; 27.3%, in 2008; and 70%, as of January 2009. The average term moved from 35.6 months, in July, to 36.7 months, in October.

The foreign exchange swap operations reached R\$37.9 billion, in October. The result of these operations, defined as the difference between the profitability of the Interbank Deposit (DI) and the exchange variation plus coupon, calculated by the cash criterion, was negative to the Central Bank by R\$3 billion in the quarter ended in October. The result of operations, since its inception, in 2002, is adverse to the Central Bank by R\$0.9 billion.

Public Sector Net Debt

The PSND reached R\$1.132 billion in October, 43.7% of GDP, against R\$1,067.4 billion, 44.9% of GDP, in December 2006. This trajectory was a result of, in contractionary terms, primary surplus contributions, 4.1 p.p. of GDP, and

Figure 3.32 – Swap and open market position

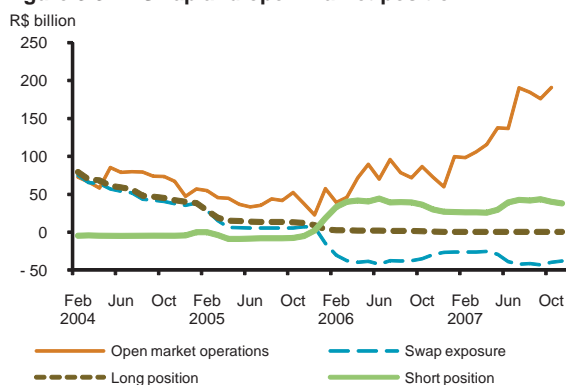


Table 3.9 – Repo operations – Open market

Balances and percentage share

| | R\$ million | | | | | |
|----------|---------------|--------|-------------------|-------|---------|-----|
| | Up to 1 month | | More than 1 month | | Total | |
| | Balance | % | Balance | % | Balance | % |
| 2003 Dec | 43 742 | 78.5 | 11 975 | 21.5 | 55 717 | 100 |
| 2004 Dec | 7 797 | 16.5 | 39 410 | 83.5 | 47 207 | 100 |
| 2005 Mar | 5 239 | 11.5 | 40 506 | 88.5 | 45 744 | 100 |
| Jun | 4 099 | 12.3 | 29 165 | 87.7 | 33 264 | 100 |
| Sep | -6 857 | -16.4 | 48 591 | 116.4 | 41 734 | 100 |
| Dec | -24 430 | -106.9 | 47 286 | 206.9 | 22 856 | 100 |
| 2006 Mar | -8 399 | -18.3 | 54 395 | 118.3 | 45 996 | 100 |
| Jun | 7 241 | 10.3 | 62 821 | 89.7 | 70 062 | 100 |
| Sep | 19 120 | 26.6 | 52 779 | 73.4 | 71 899 | 100 |
| Dec | 5 800 | 9.7 | 54 231 | 90.3 | 60 030 | 100 |
| 2007 Jan | 46 943 | 47.0 | 52 882 | 53.0 | 99 825 | 100 |
| Feb | 41 464 | 42.2 | 56 883 | 57.8 | 98 347 | 100 |
| Mar | 41 656 | 39.3 | 64 281 | 60.7 | 105 937 | 100 |
| Apr | -5 028 | -4.3 | 120 726 | 104.3 | 115 698 | 100 |
| May | 12 947 | 9.4 | 124 885 | 90.6 | 137 832 | 100 |
| Jun | 10 198 | 7.5 | 126 562 | 92.5 | 136 760 | 100 |
| Jul | 99 117 | 52.1 | 91 202 | 47.9 | 190 320 | 100 |
| Aug | 85 662 | 46.4 | 98 887 | 53.6 | 184 548 | 100 |
| Sep | 7 561 | 4.3 | 168 525 | 95.7 | 176 086 | 100 |
| Oct | 20 723 | 10.9 | 170 112 | 89.1 | 190 835 | 100 |

in growth of valued GDP, 3.7 p.p. In the opposite sense, the appropriated nominal interests and the adjustment arising from the cumulative exchange appreciation of 18.4% in the year exerted expansionist impact of 5.2 p.p. and 1.3 p.p., respectively.

PSND composition reveals that, in line with the increase of international reserves, the participation of dollar-tied net assets in the overall total expanded 13.3 p.p., during 2007. The Selic-indexed PSND installment, including the open market operations carried out by the Central Bank, grew 10 p.p. in the period.

The Gross General Government Debt (GGGD), which includes the federal government financial liabilities, INSS and regional governments, reached R\$1,678.4 billion in October, 64.7% of GDP, against R\$1,556.5 billion, 65.5% of GDP, in December 2006.

3.4 Conclusion

The credit operations continued to register significant growth, compatible with the job market evolution –reflected in greater formalization, increase of overall wages and positive expectations of the workers concerning job maintenance, with effects on decisions related to income commitment – and with the process of improvement of credit conditions, expressed in the continuous reduction of interest rates and lengthening of terms. This outlook promotes the sustained consumption of durable goods, stimulating the powered credit demand by the companies, both to provide working capital and to make new investments feasible.

Besides the growing demand for banking credit, the business sector has increased its participation in the capital markets, evincing the tendency prevailing since 2006. In this sense, the capitalization of companies based on issues of shares and debentures remains strong. At the same time, the utilization of new mechanisms is strengthened, in the form of investment in shareholding and credit right investment funds. Such diversity of funding instruments for the productive activity tends to provide sustainability to the evolution of the aggregate investment and, as consequence, of the general level of economic activity.

The cumulative primary surplus in the first ten months of 2007 assures the achievement of the fiscal targets established for the year. This result reflected both the positive evolution of the Social Security accounts, and the expansion of the

Table 3.10 – Net debt growth

Conditioning factors

| Itemization | 2005 | | 2006 | | 2007- Oct | |
|--|--------------------------------|------|----------|------|-----------|------|
| | R\$ | % | R\$ | % | R\$ | % |
| | million | GDP | million | GDP | million | GDP |
| Total net debt – | | | | | | |
| Balance | 1002 485 | 46.5 | 1067 363 | 44.9 | 1131 481 | 43.6 |
| Flows | | | | | | |
| | Accumulated in the year | | | | | |
| Net debt – Growth | 45 488 | -0.5 | 64 879 | -1.5 | 64 118 | -1.3 |
| Conditioning factors | | | | | | |
| | 45 488 | 2.1 | 64 879 | 2.7 | 64 118 | 2.5 |
| PSBR | | | | | | |
| Primary | -93 505 | -4.3 | -90 144 | -3.8 | -106 890 | -4.1 |
| Interest | 157 146 | 7.3 | 160 027 | 6.7 | 135 013 | 5.2 |
| Exchange adjustment | | | | | | |
| | -18 202 | -0.8 | -4 881 | -0.2 | 32 462 | 1.3 |
| Domestic securities debt^{1/} | | | | | | |
| | -4 554 | -0.2 | -2 222 | -0.1 | -2 610 | -0.1 |
| External debt | | | | | | |
| | -13 648 | -0.6 | -2 659 | -0.1 | 35 072 | 1.4 |
| Others^{2/} | | | | | | |
| | -2 258 | -0.1 | 2 302 | 0.1 | 3 582 | 0.1 |
| Skeletons | | | | | | |
| | 3 262 | 0.2 | - 375 | 0.0 | 1 215 | 0.0 |
| Privatizations | | | | | | |
| | -954 | 0.0 | -2049 | -0.1 | -1265 | 0.0 |
| GDP growth effect | | | | | | |
| | | -2.6 | | -4.3 | | -3.7 |

1/ Domestic dollar-indexed securities.

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

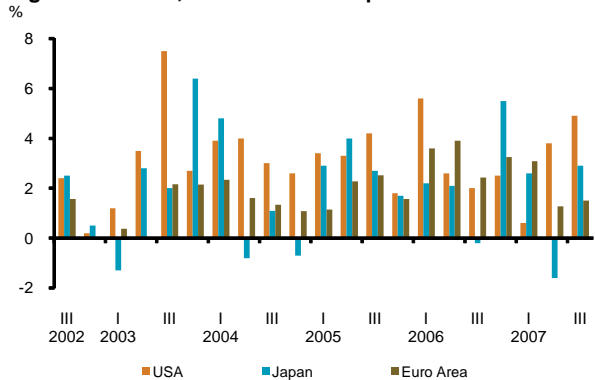
regional government surpluses, particularly in the states. The reduction of the Social Security deficit reflected the performance of the revenues, helped by the improved conditions of the job market, while the improvement in the states' surpluses combines growth in revenues and higher control of primary expenditures. Also, the reduction of the basic interest rate contributes to a declining trajectory of the PSND/GDP ratio. However, the rejection of the proposal to postpone the CPMF as of 2008 raises the degree of uncertainty associated with the prospects of fiscal policy.

The growth of international economy, contradicting deceleration expectations formed after the market crisis of second-line mortgage loans in the United States of America (USA) – subprime, continued at an accelerated pace in the third quarter of 2007, registering favorable performances both in the three principal economic areas and in most emerging economies. The general balance of risks to global growth, however, continued to deteriorate vis-à-vis the developments of the crisis on the subprime market in relation to financial institutions and credit supply in mature economies and as consequence of the rising price per barrel of petroleum, the quotations of which, in real terms, came close to their historic record.

The crisis in the subprime market affected the joint performance of the principal central banks. On one side, many central banks had, and continue having to act with a view to maintaining the liquidity of the international financial system. On the other, the central banks adopted measures to mitigate the macroeconomic impact of the difficulties in the financial sector. In this environment, the Federal Reserve (Fed) reduced, cumulatively, the basic interest rate by 0.75 p.p., while the European Central Bank and the Bank of Japan adopted a more careful posture in the process of raising their basic rates.

Though these actions may have decisively contributed to the softening of the restrictions on liquidity, depicting the apex of the financial instability in the developed financial markets in August, some markets did not entirely resume normalcy. Liquidity restrictions persist in forward interbank markets, especially as it comes to operations which cover the turn of the year period. The financial difficulties suggest that the credit market conditions should limit economic growth in the next quarters, mainly in the United States and in Europe, which may give rise to a negative revision of the prospects for the world's economic growth in 2008.

Figure 4.1 – USA, Euro Area and Japan – GDP^{1/}



Sources: Bureau of Economic Analysis, Economic and Social Research Institute
^{1/} Quarterly growth. Seasonally adjusted annualized rates.

Figure 4.2 – Consumer Confidence Index – USA and Euro Area

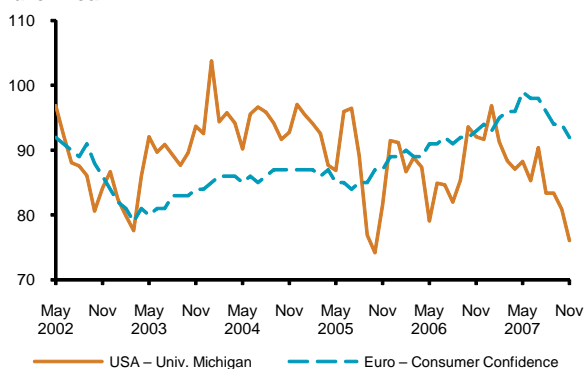
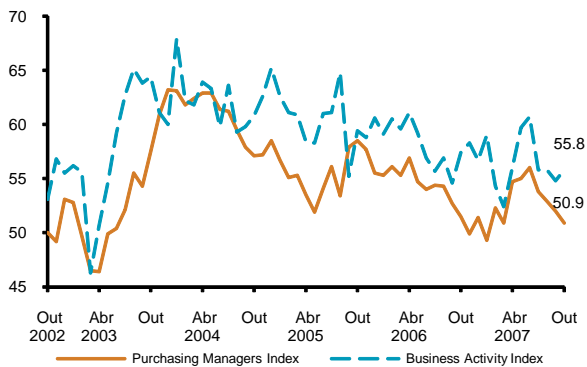
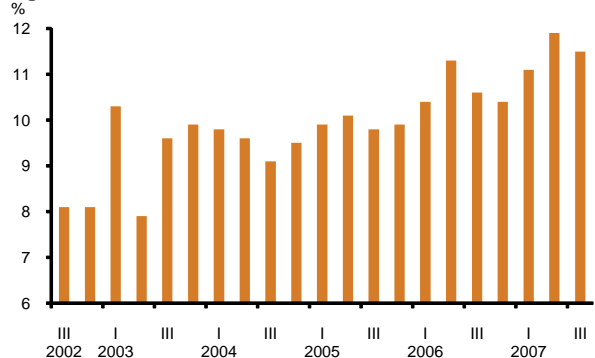


Figure 4.3 – EUA – Business expectations



Source: Bloomberg

Figure 4.4 – China – GDP^{1/}



Source: Bloomberg
^{1/} Growth rate over the same period of preceding year.

4.1 Economic activity

According to preliminary data, the US, the Euro Area and Japan's economies expanded, in annualized terms, 4.9%, 2.9% and 1.5%, respectively, in the quarter ended in September, in relation to the period May to June. For the three areas, growth rates observed in the third quarter seem to be surpassed the consensual estimates of the potential pace of GDP expansion.

In the USA, despite the continuity of correction of the real estate housing market, which exerted negative contribution of 1 p.p. on total growth of the economy, the other components of domestic demand seemed sound. Expenses with consumption, sustained by the continuity of gains with employment and income, showed annualized expansion of 2.7%, while the companies' investments rose by 9.4%.

For the fifth time, in the last seven quarters, foreign trade contributed positively to the US economic growth. This performance, opposite to that during the ascending stage of the economic cycle in the US, evinces an increased demand for North-American products and services, boosted both by growth in other economies and by the dollar depreciation (some 12% against the Canadian dollar, 11% against the Euro, and 4% against the Yen, between the end of November 2006 and last November), and the developments of gradual deceleration of the US economy over their imports.

In the Euro Area and in Japan, where economies are more impacted by external demand, GDP growth reflected, also, the expansion of domestic demand. In Japan, company investments expanded, in annualized terms, 4.5% in the third quarter, as compared to the previous quarter, after having registered negative variation in the second quarter of the year.

It should be highlighted that, although the consumer expectation indicators in the US and in the Euro Area may have demonstrated the crisis developments in the subprime market, they continue on satisfactory levels suggesting the continued expansion of household expenses. The indicators related to the employers' expectations, even showing retraction in the US, they persist pointing at the expansion of industrial and services activities.

The activity level in emerging countries continues experiencing vigorous expansion. China's GDP, suggesting efficacy of the contractionist measures adopted by the central bank, registered, in the charter ended in September, the

third consecutive growth above 11%, when compared with equal period of the previous year. The annualized growth of industrial production in India and in Russia reached 11.6% and 6.1%, respectively, in the third quarter, in relation to the quarter ended in June.

4.2 Monetary policy and inflation

World economy experienced, in the third quarter, the aggravation of inflationary pressures. This movement was associated with increases in the prices of petroleum and agricultural commodities, in an environment of expanding worldwide demand for food, supply shocks, and progressive use of grains for the production of bioenergy. In general terms, there are signs that economic growth, in diverse regions, could be coming close to the limits of productive capacity.

With the exception of the G3 countries (United States, Japan and Euro Area), the central banks of mature economies like Canada, Sweden, Norway, Switzerland and Australia assume a more restrictive monetary posture. In this same direction, central banks of emerging countries, notably Chile, Poland, South Africa, Korea, India and Malaysia, followed the increase movement of basic interests, a performance with a more marked potential impact on the respective economies, considering the greater weight of consumer goods and foodstuffs in their consumer baskets. China and Russia, besides monetary restriction, announced the price freezing of staple food.

In the US, annual inflation, measured by the core of personal consumer expenses, has remained below 2%, while the job market shows signs of dampening. In this environment, the Fed assessed that the risks were more intensive for the deceleration of growth than for the increase of inflation and curtailed the target for the Fed funds by 0.75%, in the third quarter, keeping it at 4.5% p.y. According to the Fed, after the cut in the Fed funds, done on October 31, despite the uncertainties related to the economic scenario still remained high, the prospects are that the balance between the risks of growth setback and those related to inflation hike has been achieved.

In Japan, despite the increase in the prices of commodities and the relative economic expansion, the consumer price index does not signal an increase. In this environment, the monetary authority opted for keeping interest rates unaltered.

Figure 4.5 – Consumer inflation
Annual growth

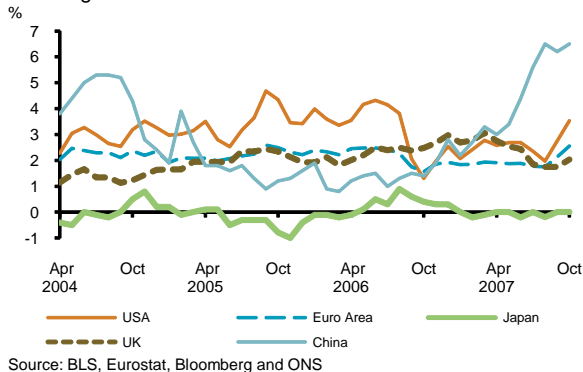


Figure 4.6 – USA – Energy Inflation

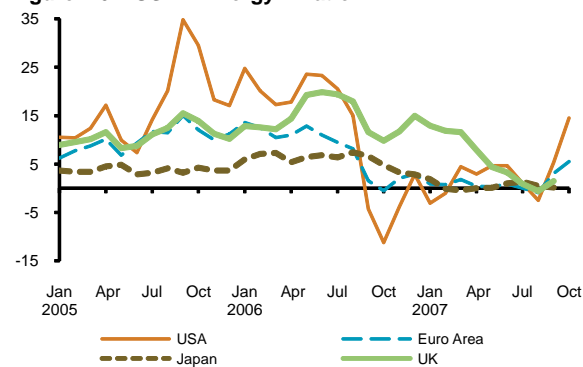


Figure 4.7 – Agricultural Index

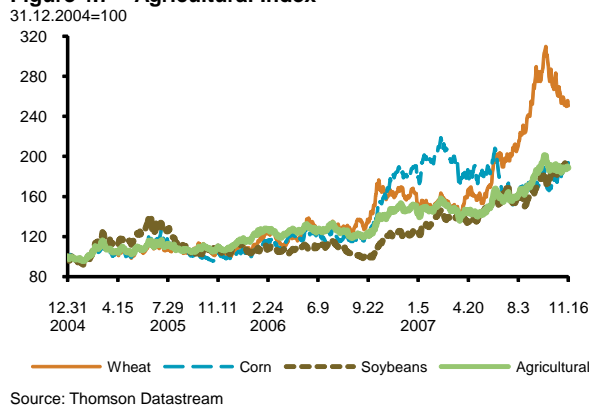
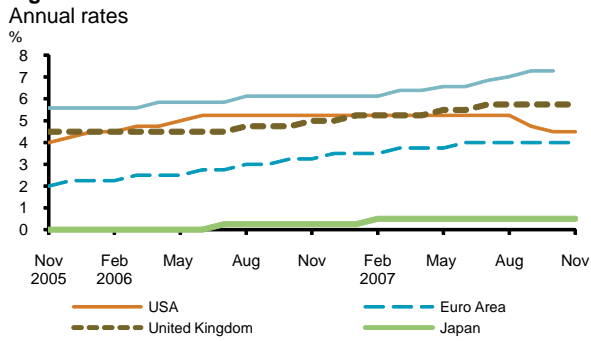
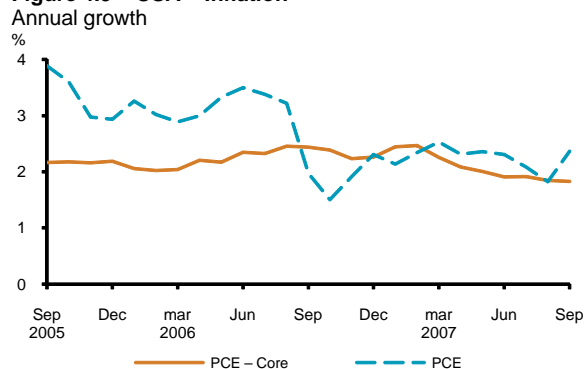


Figure 4.8 – Official interest rates



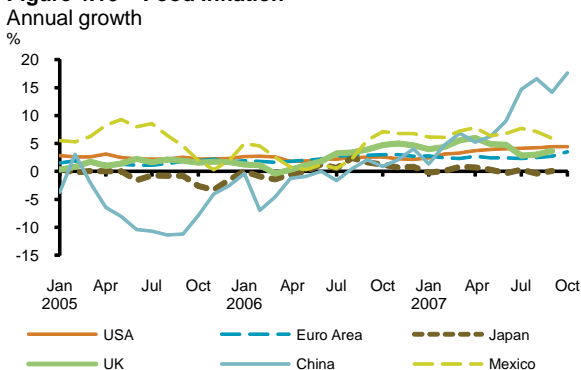
Source: Fed, ECB, BoJ, Bank of England and The People's Bank of China

Figure 4.9 – USA – Inflation



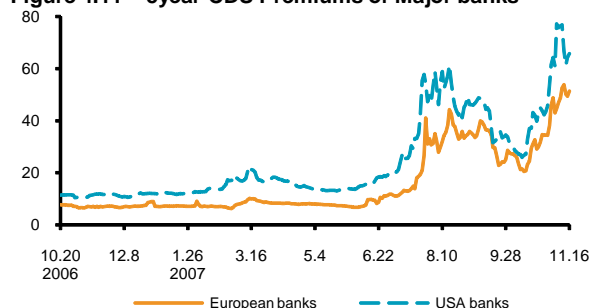
Source: Bureau of Labor Statistics

Figure 4.10 – Food inflation



Source: Thomson Datastream and National Bureau of Statistics of China

Figure 4.11 – 5year CDS Premiums of Major banks^{1/}



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

In the Euro Area, the European Central Bank (ECB) keeps the *refi rate* at 4% p.y. since June, despite the reduced rate of unemployment and the growing rate of inflation, which, evincing the pressures derived from increases of prices of agricultural commodities and of petroleum, reached 2.6% in the twelve months ended in October. The tension between prudential (watch for the stability of the banking system) and macroeconomic (inflation target below, but not distant from, 2% per year) responsibilities, may be more evident in the case of BCE than in other economies.

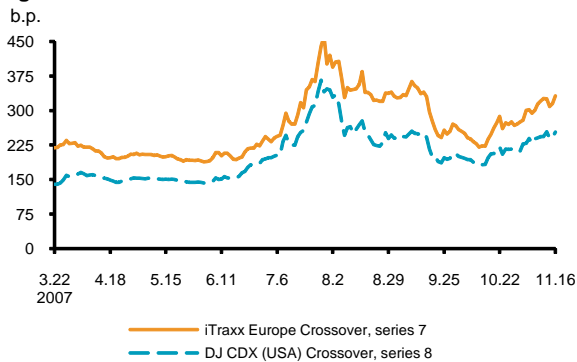
In China, twelve-month cumulative inflation reached 6.5% in October, equaling the highest rate registered in the decade. This behavior reflected, mainly, the evolution of the prices of foodstuffs and energy, which rose 17.6% and 4.5%, respectively, in the period. In this scenario, the People's Bank of China (PBC), aiming at reducing liquidity and speculation in the real estate and securities markets, as well as to anchor the inflationary expectations, intensified the use of restrictive measures, raising the rate on compulsory deposits to 13.5% and that of basic interests, to 7.29% p.y. Still with the objective to contain the inflationary process, it authorized the utilization of governmental stocks of meat and the reduction in the taxes on import of grains, as well as the imposition of new restrictions to the real estate market and the increased issuance of BPC bonds.

4.3 International Financial Markets

The financial turbulence experienced by the financial markets in the months of July and August continues impacted by the performance of these markets. Since the last inflation report, diverse banks headquartered, mainly, in the USA and in Europe, reported high losses resulting from accounting write-offs associated with the adverse effects of the subprime market crisis. This process impacted on the financing conditions, which became more restrictive, evincing ever higher costs of financing for these institutions.

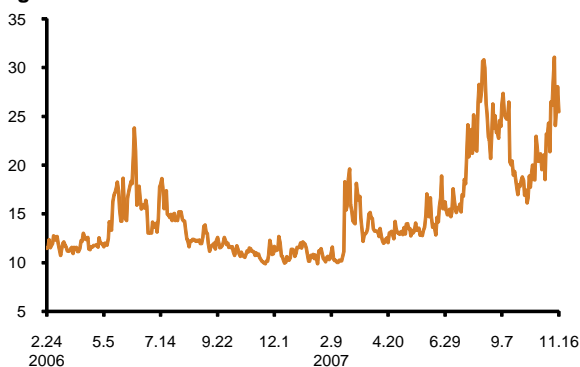
The evolution of average premiums from the credit default swap (CDS) of five important banks of the United States and of five important European banks reached 77.2 b.p. and 53.8 b.p., respectively, in mid-November, after recoiling to 25.9 b.p. and 20.5 b.p., in the same order, mid-October. In August, these premiums had achieved record values of 61.4 b.p. and 44.3 b.p. The evolution of premiums required for guaranty of loans from North-American and European

Figure 4.12 – iTraxx & DJ CDX



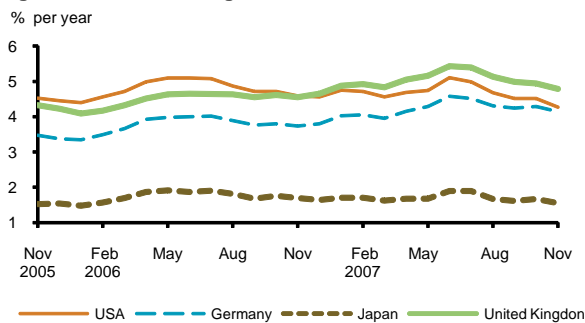
Source: Thomson Datastream

Figure 4.13 – VIX



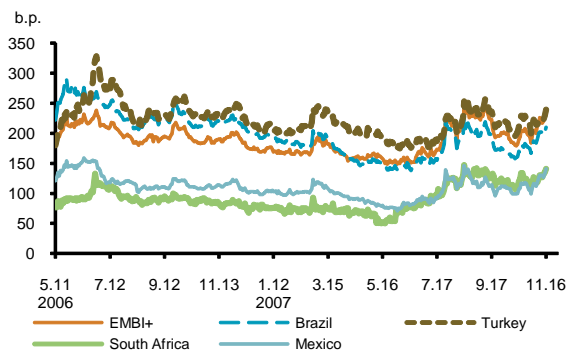
Source: Thomson Datastream

Figure 4.14 – Yield on government bonds^{1/}



Source: Bloomberg
 1/ Monthly average of nominal yields on 10-year bonds, up to November 16 2007.

Figure 4.15 – Emerging Markets Bond Index Plus (Embi+)



Source: Bloomberg

companies, in an environment of deteriorating credit conditions for the corporate sector, followed a trajectory similar to that of the CDS, with the iTraxx Crossover and Dow Jones CDX US Crossover indices, which measure the average annual cost for the protection of loans of European and American companies, respectively, with classification below investment grade, turning to rises of the second half of October.

The developments of the financial turbulence were also perceived in the capital markets. The Chicago Board Options Exchange Volatility Index (VIX), which measures the short-term implicit volatility of the Standard and Poor's (S&P 500) and is regarded as one indicator of investors' risk aversion, registered significant high in the first fortnight of November, after the downturn initiated in the second fortnight of August, showing average of 25.60 points and maximum of 31.09 points, against 30.83 points verified on August 16.

Since the end of August, annual incomes from ten-year government bonds from Germany and from Japan recoiled by 14 b.p., while the returns on papers of equal term from the United Kingdom and the United States registered respective reductions of 40 b.p. and 36 b.p., a trajectory consistent with the insecurity in relation to future returns on greater risk assets, responsible for this movement of flight to quality. On November 16, the annual returns on 10-year bonds from Germany and from Japan closed at 4.10% and 1.48%, while those related to same term papers from the United States and from the United Kingdom reached 4.17% and 4.64%, respectively.

The Embi+, indicator of risk premium associated to emerging markets, presented a trajectory similar to that of the VIX index, rising sharply in November, after signaling significant reduction in the September-October two-month period. Although the Embi+ rose only 5 p.b. between August 31 and November 16, it rose only by 48 b.p., to 232 points, in the first sixteen days of November. The Embi+ indicators associated to Brazil, Turkey, South Africa, Mexico and Russia reached, in this sequence, 210, 239, 141, 141, and 156 base points, on November 16, rising 72 b.p., 64 b.p., 91 b.p., 70 b., and 72 b.p. in relation to the minimum punctuations registered throughout 2007. Considering the period from August 31 to November 16, the Embi+ of Brazil, Turkey, South Africa, Mexico and Russia rose by 15 b.p., 8 b.p., 11 b.p., 31 b.p. and 22 b.p., respectively.

The main stock exchanges, after outlining, up to the end of October, a movement of recovery in relation to the losses

Figure 4.16 – Stock exchanges – USA, Europe and Japan
12.31.2003=100

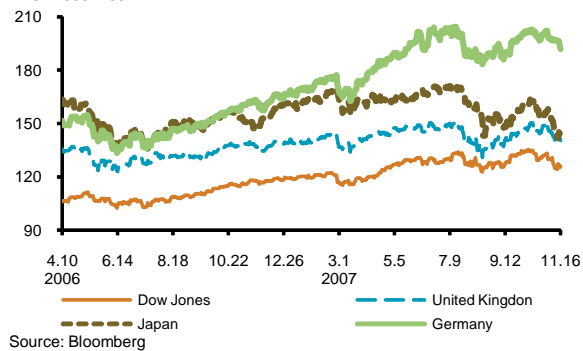


Figure 4.17 – Stock exchanges – Emerging markets
12.31.2003=100

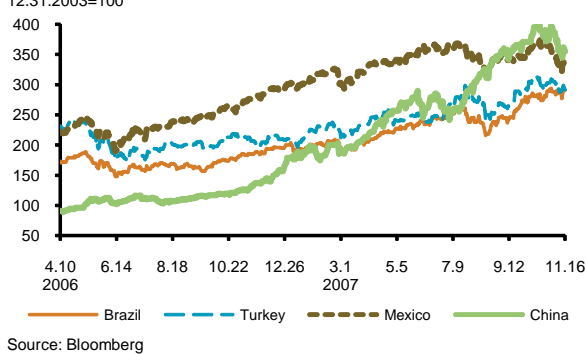


Figure 4.18 – Dollar exchange rates
6.1.2005=100

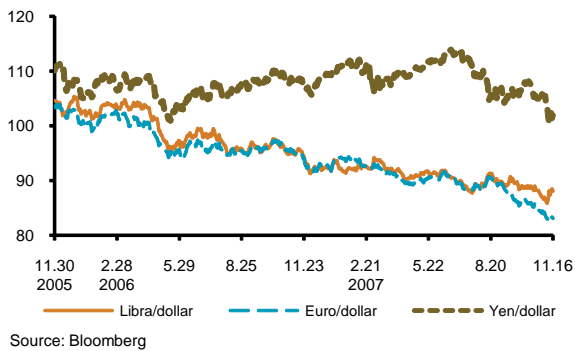
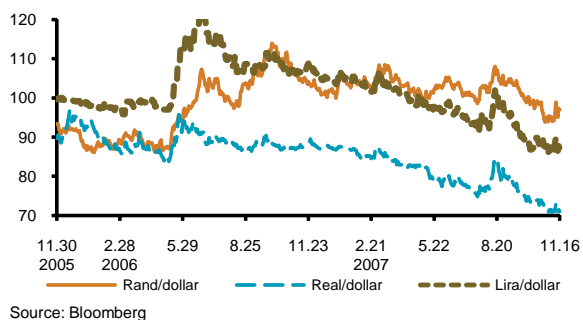


Figure 4.19 – Emerging markets currencies
South Africa, Brazil, Turkey
6.1.2005=100



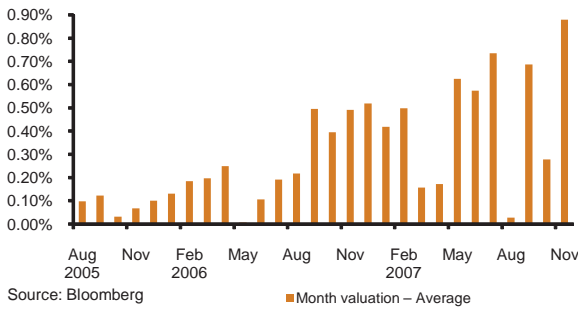
registered in July and August, turned to register a negative performance. In this sense, in line with the aggravation of turbulences in the credit markets, the indices, USA's Dow Jones, UK's Financial Times Securities Exchange Index (FTSE 100), Germany's Deutscher Aktienindex (DAX), and Japan's Nikkei, recoiled, in the order, by 5.4%, 6.4%, 5.1%, and 9.5%, in the first sixteen days of November, accumulating losses of 1.4%, 0.2% 0.3% and 8.5%, in relation to August 31. In the year, up to November 16, while the DAX index accumulated high of 15.4%, the Nikkei registered drop of 12%.

The stock exchanges of the main emerging economies, showed a similar trajectory. From day 1 up to November 16, the indices, Indice de Precios y Cotizaciones (IPC) of Mexico, Istanbul Stock Exchange National 100 Index (XU100), of Turkey and Ibovespa registered respective losses of 5.8%, 5.7% and 1.1%. China's Shanghai Compound Index, which, during the year has shown a behavior decoupled from the other markets, registered a more significant drop, 10.7%, impacted by determinants of domestic origin. Considering the period August 31 to November 16, while the IPC fell back 2.4%, the stock exchanges of Turkey and Brazil recorded, respectively, valuations of 8.2% and 18.3%.

Since the last inflation report was disclosed, dollar quotation continued suffering important depreciation against the major currencies. This movement demonstrates both expectations related to possible developments of the Fed's monetary policy vis-à-vis other important central banks, in a scenario of growing deceleration of the North-American economy, and the narrowing of the income differential along the yield curves. Between August 31 and November 16, the US dollar depreciated 7% against the Euro and 4.1% and 1.8%, against the Yen and the Pound Sterling, respectively. In the year, up to November 16, the dollar has lost 10% value against the Euro. The harshening of the financial turbulence with the consequent rising of the risk aversion encouraged investors to liquidate operation considered of high risk, enabling the dismantling of carry trade operations, and supporting the appreciation of the Yen vis-à-vis the other currencies. In the first 16 days of November, the Japanese currency appreciated 4.1%, 4.8%, and 2.3% against the dollar, the pound sterling and euro, respectively.

The dollar depreciation against the currencies of emerging countries having good macroeconomic fundamentals, the prospect of a consistent economic growth and higher interest rates have proved to be even more accentuated. Between August 31 and November 16, the South African rand, the Brazilian real, and the Turkish lira appreciated 6%, 11% and

**Figure 4.20 – Renminbi/dollar exchange rate
Month valuation – Average^{1/}**



Source: Bloomberg
1/ Up to November 16, 2007.

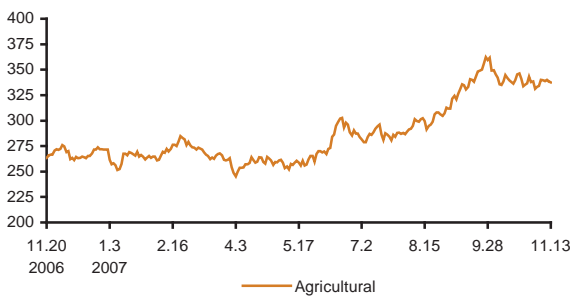
9%, respectively, in relation to the North-American currency. One should highlight that in November, the environment of risk perception in the financial market favored the recovery of the North-American currency, reflecting respective appreciations of 3.3%, 1.8% and 0.6%, in relation to the South African, Turkish and Brazilian currencies.

In China, the combination of reduction in Fed funds rates and an increase of the Chinese basic interest rate, which this year has accounted for five increases, pushes the pace of appreciation of the Chinese currency which, in the year, up to November 16, appreciated 4.9% against the dollar. The excess of foreign currency as a result of robust trade has been neutralized by the sale of BPC bonds.

4.4 World trade

4.4.1 Commodities

Figure 4.21 – S&P GSCI agricultural commodity price index



Source: S&P GSCI Thomson

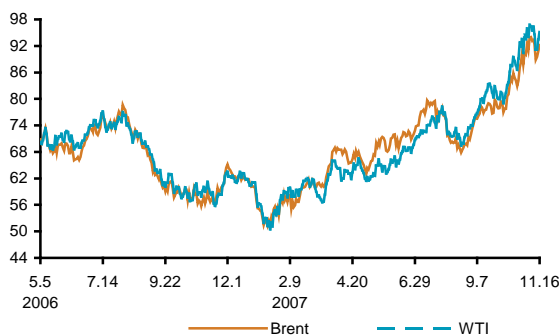
Although the outlook of the crisis of the subprime market has exerted, in August, temporary contractionist pressure on the prices of the main commodities, the dynamics of world economy, restrictions to expansion in supply of some products and the weakening of the US dollar against the principal currencies continue determining the upturn of these quotations.

The prices of agricultural commodities expanded 9% between August 31 and November 16, showing relative stability as of the beginning of October, when higher quotations were registered. Soybean and maize quotations rose more than 15%, favored, in the order, by the performance of prices of soy bean oil and by intense demand for the production of ethanol, mainly in the USA. Coffee quotations continue to indicate low world stocks and the relatively limited supply against the consumption prospects, reflecting, in part, the long period of drought in Brazil. The prospects for evolution of price of agricultural commodities in the coming months is of moderate high, in line with both supply limitations by the occurrence of climatic adversities and by the low world stocks, and by ongoing demand pressures.

The dynamics of world economy continues pressuring the prices of metallic commodities, which even falling 1.1% from August 31 to November 16, keep on a level historically high. In the period, there were reductions in the prices of zinc, 19.1%, and of copper, 6.2%, reflecting, in part, the contraction in the North-American real estate segment, and accretions in those related to gold, 16.4%; nickel, 4.9%; and lead, 5.8%.

Figure 4.22 – Oil – Spot market

US\$ per barrel



Source: Bloomberg

4.4.2 Petroleum

After a brief retraction period in August international prices of petroleum sharply increased between August 31 and November 16, reflected in respective increases of 28% and 28.4% of the Brent type barrel and West Texas Intermediate (WTI), level close to its record quotations, in real terms. This behavior reflects both the ongoing dynamics of world demand, with emphasis on the increase of the Chinese demand, in a scenario of only moderate growth of the oil supply, and the prospect that the demand for the commodity will continue high in the last quarter of the year and in 2008. Additionally, the weakening of the dollar against the principal currencies and the persistence of geopolitical conflicts put pressure on the price of petroleum.

4.5 Conclusion

The world economy continues to post high rates of growth in 2007, a situation which, even in the presence of deceleration, should persist in the coming year. In the USA, slower pace of growth is expected for 2008, in line with the repercussions, more intensive and prolonged than previously foreseen, of the real estate sector crisis, which may negatively affect the companies' investment capacity and the level of household consumption. The significant dollar depreciation against the currencies of the Euro Area and Japan should negatively impact the expansion of respective export sectors, with developments over the dynamics of these countries' economies, observing that, in the Euro Area, the negative effects of the banking sector's exposure to the financial crisis make up an additional concern.

On the other hand, the leading emerging economies do not seem to have been significantly affected by the turbulence in the financial markets, and continue registering robust expansion of the domestic demand, representing a source of absorption of goods and services in the international market. For 2008, emerging economies are expected to continue sustaining global growth.

However, it is worth highlighting that the moderately favorable prospective scenario for the global economic activity in 2008, included in the last forecasts disclosed by the International Monetary Fund (IMF) seems to tangibly depend on three questions on which considerable uncertainty persists: how strong will be the effects of the real estate crisis over the US economy, how strong will be the impact of the American deceleration over other

mature economies and how resistant will be the emerging economies to a scenario of potentially marked deceleration in the USA, Europe and Japan.

On the other hand, inflationary pressures intensified in the latest months, mainly in view of the increases in the prices of petroleum and agricultural commodities, while in the USA, the significant devaluation of the dollar against the other currencies adds up to the risks of rising inflation. The central banks remain with a controversial tasks of avoiding the worsening of the credit supply crisis, accommodating the setback of the economic growth, and anchoring the inflationary expectations. The Fed's current dilemma consists in counterbalancing growth and inflation, while in the Euro Area, despite inflation is above the desired level, the strong dollar depreciation against the Euro, the easing of the monetary policy adopted by the Fed and the uncertainties derived from the international financial turbulence have led the BCE to delay the resumption of the cycle of high interest rates. In Japan, Yen appreciation and the relevance of the export sector for the dynamics of economy have retarded the BoJ's decision regarding alterations in the conduction of the monetary policy.

The developments in the credit sector associated to the subprime market crisis are still going to persist for some time. The recent turbulence in the financial markets, although favoring greater discipline in the medium-term credit markets, acts as a restrictive element, in the short term, to the world's economic growth, and should contribute, for a period of time, to increased volatility.

The evolution of the country's external accounts continues to show solidity, just as emphasized in the previous editions of this Inflation Report, enabling the entire financing of the balance of payments in the year, the significant growth of international reserves and strong improvement of the external sustainability indicators. Margin results and the prospects for the next periods, however, outline the beginning of the reversal in the balances of current transactions, with foreseen reduction in surplus, to US\$2.4 billion, in 2007, and a deficit of US\$3.5 billion, in 2008. In this context, one should recall that the average balance of current transactions in the last twenty years, when the economy went through quite diverse international situations, registered a deficit of US\$7 billion, or 1% of GDP.

Accumulated surpluses in the balance of trade, although remaining on the level of US\$40 billion, show a moderation trajectory when compared with results of corresponding periods of the previous year. This retraction, observed in a scenario of growing trade flow and greater export de-concentration stream, either in terms of the number of trading partners or products, reflects, more intensively, the expansion of imports associated to the greater dynamics of economic activity, a factor which favors the equilibrium between global demand and supply of goods. The trajectory of the results in current transactions is conditioned, also, to the expansion of net remittances of profits and dividends, stimulated by the greater profitability of companies in the country. Reversely, the reduction in net payments of interests has contributed to the increase of revenues associated to the remuneration of international reserves.

The Brazilian external accounts were slightly affected by the volatility observed in the international financial markets since the outbreak of the crisis with the US subprime mortgage segment. The surplus of the financial account registered increase in relation to the previous year, a consequence of net record inflows both in terms of direct foreign direct investments (IED) and of portfolio investments, while the

roll over rate of the medium and long-term external private debt remained slightly above 100%.

5.1 Exchange operations

The foreign exchange market generated net inflows of US\$82.1 billion in the first eleven months of 2007, against US\$40.7 billion in the corresponding period of the previous year. The balance of the trade segment reached US\$73.5 billion, rising 47.5% in the period, resulting from contracting of exports of US\$170.7 billion and of imports of US\$97.3 billion, expanding 32.5% and 23.1%, respectively, in relation to the same period of 2006.

The net inflows in the financial segment totaled US\$8.6 billion, against net outflows of US\$9.1 billion from January to November of the previous year, registering increases of 71.1% in purchases and 58.3% in sales of the foreign currency.

The foreign exchange surplus in the first eleven months of the year allowed purchases of foreign currency by the Central Bank to reach US\$76.3 billion in the period, against US\$34.3 billion during the whole of 2006. The difference between the balance of the foreign exchange market and the net acquisitions by the Central Bank was determined by the expansion of the long position of banks, which reached US\$3.8 billion at the end of November, compared to the short position of US\$2 billion, observed at the end of 2006.

Table 5.1 – Foreign exchange flows

| | US\$ billion | | | | |
|------------------------------------|--------------|-------------|-------|------|-------------|
| | 2006 | | | 2007 | |
| | Nov | Jan- Nov | Year | Nov | Jan- Nov |
| Trade operations | 5.1 | 49.8 | 57.6 | 7.3 | 73.5 |
| Exports | 12.8 | 128.8 | 144.4 | 17.2 | 170.7 |
| Imports | 7.7 | 79.0 | 86.8 | 9.9 | 97.3 |
| Financial operations ^{1/} | 0.4 | -9.1 | -20.3 | -2.0 | 8.6 |
| Purchases | 17.3 | 179.3 | 195.4 | 32.3 | 306.7 |
| Sales | 16.9 | 188.4 | 215.7 | 34.3 | 298.1 |
| Net flows | 5.5 | 40.7 | 37.3 | 5.3 | 82.1 |

^{1/} Excluding interbank operations and Central Bank foreign operations.

Table 5.2 – Trade balance – FOB

| Period | Exports | Imports | Balance | US\$ million |
|--------------|---------|---------|---------|--------------|
| | | | | Total trade |
| Jan-Nov 2007 | 146 418 | 110 016 | 36 402 | 256 435 |
| Jan-Nov 2006 | 125 543 | 84 138 | 41 405 | 209 680 |
| % change | 16.6 | 30.8 | -12.1 | 22.3 |

Source: MDIC/Secex

5.2 Trade in goods

Exports totaled US\$14.1 billion and imports, US\$12 billion, in November, resulting in surplus of US\$2 billion, smallest monthly value registered in 2007. In the year, the balance of trade, which reached US\$36.4 billion, dropped 12.1% in relation to the same period of 2006, evincing increases of 30.8% in imports and of 16.6% in exports. The trade flows summed up US\$256 billion, surpassing that related to 2006.

The daily average of external sales, in November, although dropping for the second consecutive time, remained above US\$700 million, while that related to external purchases posted a record monthly value. Generalized increases, as compared to the same period of 2006, were registered in exports of all categories of aggregate factor, reaching 25.3%

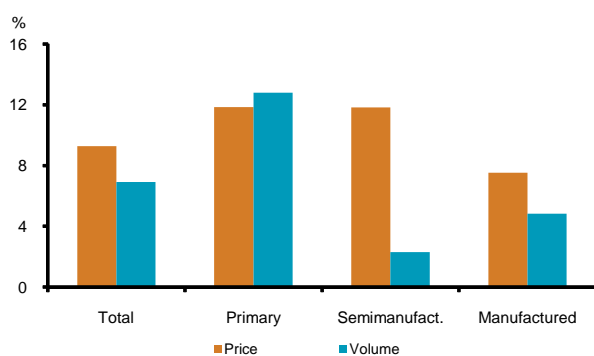
Table 5.3 – Exports by aggregate factor – FOB

Daily average – January-November

| | US\$ million | | |
|------------------------|--------------|-------|----------|
| | 2006 | 2007 | % change |
| Total | 548.2 | 636.6 | 16.1 |
| Primary products | 162.0 | 203.1 | 25.4 |
| Industrial products | 374.2 | 420.6 | 12.4 |
| Semimanufactured goods | 77.0 | 87.0 | 13.0 |
| Manufactured goods | 297.2 | 333.6 | 12.3 |
| Special operations | 12.1 | 12.9 | 6.8 |

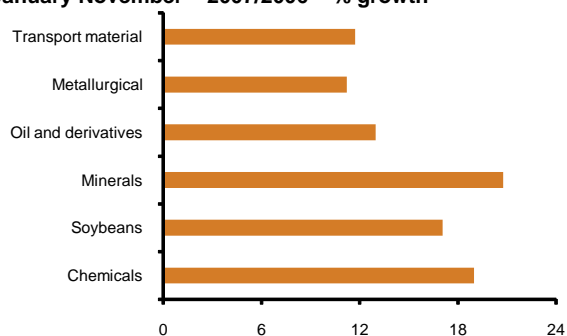
Source: MDIC/Secex

in basic products, 7.4% in semi-manufactured, and 17.1% in manufactured goods. The dynamics of exports of basic products evinced evolution of international quotations of the major metallic and agricultural commodities, reflected in increases in the sales of maize, 356%; petroleum, 47.9%; soy bean, 22.9%; chicken, 33.7%; and tobacco leaves, 79.5%. The performance of the segment of semi-manufactured products reflected increases in exports of soybean oil, 27.3%; cellulose, 12.7%; cast iron, 25%; and iron alloys, 105.7%; while, inversely, sales of raw sugar and semimanufactured iron and steel goods dropped 20.7% and 6%, respectively. In relation to manufactured goods, one should highlight the increases in exports of gasoline, 507%; fuel oils, 438.5%; aircrafts, 139.1%; tractors, 46.1%; and automobiles, 24.2%; and reductions in those related to transmitter or receiver apparatuses, 31.3%, and refined sugar, 45.4%.

Figure 5.1 – Exports – Price and volume index

Source: Funcex

The daily average of exports climbed 16.1% in the first eleven months of the year, in relation to the same period of 2006, result of increases in all of the categories of products. Sales of basic products grew 25.4% in the period, followed by those related to semi-manufactured, 13%, and manufactured goods, 12.3%, while the ten main products sent abroad, in this period, represented 33% of total exports, with highlight to iron ores, petroleum, soybean, automobiles, chicken and aircrafts.

Figure 5.2 – Main exports January-November – 2007/2006 – % growth

Source: MDIC/Secex

Considering the principal export sectors, on the same basis of comparison, expansion in sales of ores, 20.8%; chemical products, 19%; soybean, 17.1%; iron and steel products, 11.2%; transportation materials, 11.7%; and oil and oil derivatives, 13%, took the lead. The value exported by these sectors totaled US\$80 billion, equivalent to 60.4% of the total of Brazilian sales in the period.

According to the Foreign Trade Studies Center Foundation (Funcex), the performance of exports in the first ten months of the year, as compared to the same period of 2006, reflected increases of 9.3% in the export price index and 6.9% in the volume index. Analysis of exports by aggregated factor category reveals the predominance of the price effect on sales of semi-manufactured and manufactured goods, registering increases of 11.8% and 7.5%, respectively, against growth of 2.3% and 4.8% in the respective amounts exported. The performance of sales of basic products, favored by the renewed growth of the world's economy, resulted in rise of 12.8% in the volume exported and 11.8% in prices.

In November, the daily average of imports posted a generalized growth in all of the final use categories,

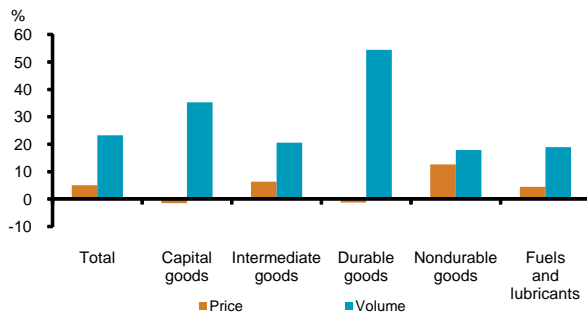
Table 5.4 – Imports by end-use category – FOB

Daily average – January-November

| Itemization | US\$ million | | |
|--------------------|--------------|-------|----------|
| | 2006 | 2007 | % change |
| Total | 367.4 | 478.3 | 30.2 |
| Capital goods | 75.6 | 99.4 | 31.6 |
| Raw materials | 181.8 | 236.3 | 30.0 |
| Naphtha | 7.1 | 7.7 | 8.5 |
| Consumer goods | 47.5 | 63.9 | 34.4 |
| Durable | 24.2 | 32.6 | 35.1 |
| Passenger vehicles | 7.4 | 12.0 | 63.8 |
| Nondurable | 23.4 | 31.2 | 33.6 |
| Fuels | 62.5 | 78.8 | 26.0 |
| Crude oil | 38.2 | 46.9 | 22.7 |

Source: MDIC/Secex

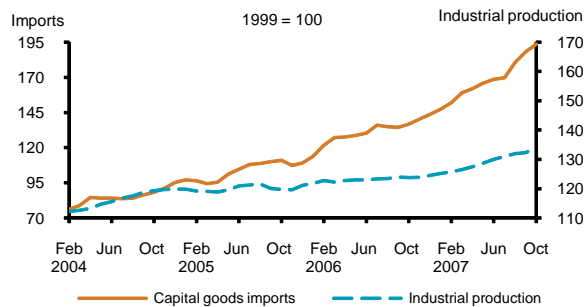
Figure 5.3 – Imports – Price and volume index January-October – 2007/2006



Source: Funcex

Figure 5.4 – Capital goods imports x industrial production – 3-month moving average

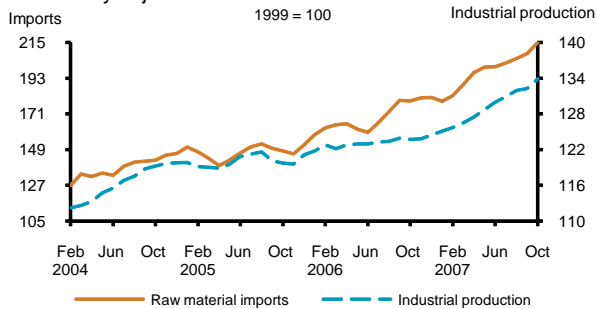
Seasonally adjusted indices



Source: Funcex and IBGE

Figure 5.5 – Raw material imports x industrial production – 3-month moving average

Seasonally adjusted indices



Source: Funcex and IBGE

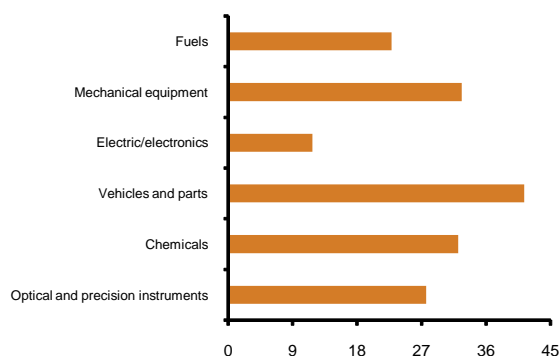
compared to the corresponding month of 2006. External purchases of capital goods expanded 46.8% in the period, reflecting increases in the acquisitions of industrial machinery, 69.2%; office and scientific service machines and apparatuses, 31.7%; and parts and spares for industrial capital goods, 129.7%. The expansion of durable consumer goods imports reached 41.4%, with emphasis to passenger automobiles, 71.5%; articles of personal adornment and use, 31.8%; and household machines and apparatuses, 52%. The purchases of nondurable consumer goods evinced increases in the segments of foodstuffs, 28.1%; pharmaceuticals, 22.9%; and clothing and textiles, 34.7; while those related to the category of raw materials and intermediate products, equivalent to 46.8% of the total imported in the month, were boosted by the dynamics of the accessory sectors of transportation equipment, 58.5%; mineral products, 41.3%; chemical and pharmaceutical products, 27.4%. Imports of fuels and lubricants grew 31.7%, on the same basis of comparison.

Considering the first eleven months of the year, in relation to the corresponding period of 2006, the daily average imports related to all the categories of use registered, likewise, marked and generalized increases. This result, which reflects the dynamics of the process of economic activity resumption, occurred with greater intensity under imports of durable consumer goods. In that case the expansion of 35.1% was boosted by the increase – consistent with the improvements on the job and credit markets – of 63.8% in the acquisitions of passenger automobiles. Imports of nondurable consumer goods registered expansion of 33.6%; followed by those related to capital goods, 31.6%; and raw materials and intermediate products, 30%; and fuels and lubricants, 26.0%.

A breakdown analysis of imports, just as verified in relation to the exports, indicates a generalized growth of external purchases classified in the six main import sectors, which accounted for 63.4% of the value imported in the first eleven months of 2007. The imports of automotive vehicles and parts expanded 41.4%, as compared to the same period of 2006, followed by those related to mechanical equipments, 32.6%; organic and inorganic chemical products, 32.1%; optical, precision and medical instruments, 27.7%; fuels and lubricants, 22.8%; and electric and electronic equipment, 11.8%.

According to Funcex, the upturn of 29.8% in the value of imports during the period from January to October 2007, against the same period of the previous year, reflected a rise

Figure 5.6 – Imports by main products



Source: MDIC/Secex

of 5.1% in the prices and of 23.3% in the volume. Growth in imported volume was determinant for growth in imports of all use categories, with emphasis on durable consumer goods, 54.4%, and in capital goods, 35.3%. The imported volume of raw material and intermediate product, fuels and lubricants and nondurable consumer goods expanded, 20.6%, 19% and 17.9%, respectively, in the period. The evolution of the prices did not exert uniform pressure on the imports of diverse final use categories, registering increases in the prices of nondurable consumer goods, 12.7%, raw materials and intermediate products, 6.4%; and fuels and lubricants, 4.5%, in parallel to reductions related to capital goods, 1.4% and to durable consumer goods, 1.2%.

It should be highlighted that, despite the significant growth in the balance of imported durable consumer goods, external purchases classified in this category of use continue representing a reduced part of the total imported value, reaching 6.8% in the first eleven months of 2007.

The breakdown, in terms of main partners, of the trade results registered in the first eleven months of the year reveals the maintenance, excepting Asia, of surpluses with the main blocs or regions. The 12.5% reduction in trade surplus, compared to the same period of 2006, reflected the lesser dynamics of exports targeting the USA and the rising trajectory of imports originating in Asia, particularly from China.

Table 5.5 – Exports and imports by area – FOB

Daily average – January-November

| Itemization | US\$ million | | | | | | | |
|-------------------|--------------|------|----------|---------|------|----------|---------|------|
| | Exports | | | Imports | | | Balance | |
| | 2006 | 2007 | % change | 2006 | 2007 | % change | 2006 | 2007 |
| Total | 548 | 637 | 16.1 | 367 | 478 | 30.2 | 181 | 158 |
| Latin America | 125 | 144 | 14.9 | 65 | 81 | 24.9 | 61 | 63 |
| Mercosur | 56 | 69 | 23.4 | 35 | 45 | 29.1 | 21 | 23 |
| Argentina | 47 | 57 | 21.6 | 32 | 41 | 28.5 | 15 | 16 |
| Other | 9 | 12 | 32.9 | 4 | 5 | 34.5 | 5 | 7 |
| Mexico | 18 | 17 | -4.7 | 5 | 8 | 51.4 | 13 | 9 |
| Other | 51 | 58 | 12.5 | 24 | 27 | 13.0 | 27 | 31 |
| USA ^{1/} | 100 | 100 | 0.8 | 59 | 76 | 27.9 | 40 | 25 |
| EU | 123 | 160 | 29.3 | 81 | 107 | 31.7 | 42 | 53 |
| E. Europe | 15 | 17 | 13.3 | 6 | 11 | 92.2 | 9 | 6 |
| Asia | 83 | 100 | 20.6 | 92 | 122 | 32.1 | -9 | -21 |
| Japan | 15 | 17 | 12.0 | 16 | 19 | 19.4 | 0 | -1 |
| South Korea | 8 | 8 | 2.4 | 13 | 14 | 7.2 | -5 | -6 |
| China | 34 | 44 | 28.2 | 32 | 50 | 57.1 | 2 | -6 |
| Other | 26 | 31 | 21.1 | 32 | 39 | 23.2 | -6 | -8 |
| Others | 102 | 116 | 13.4 | 65 | 83 | 27.6 | 37 | 33 |

Source: MDIC/Secex

1/ Includes Puerto Rico.

The main destination markets for Brazilian exports, in the period, were the European Union, 25.1% of the total, and the Latin American Integration Association (Aladi), 22.6%, while the main purchasing country, despite a reduction of 2.4 p.p. in relation to its participation in Brazilian sales in the January November 2006 period, continued to be the United States. On the same basis of comparison and considering the daily averages, exports to the European Union and to China grew 29.3% and 28.2%, respectively, and those directed to Aladi, evincing reduction of 4.7% in sales to Mexico, 14.9%.

The participations related to the main regions and blocs in Brazilian imports maintained relatively stable, in the period, with purchases originating from Asia, European Union and Aladi representing, in the order, 25.4%, 22.3% and 16.9% of the total imported by Brazil. The USA remained as the principal individual supplier, despite the growing participation of purchases originating in China, which expanded 57.1% in the period.

5.3 Services and income

Table 5.6 – Current account

| | US\$ billion | | | | | | |
|-------------------------------|--------------|-------------|-------|------|-------------|--------------------|--------------------|
| | 2006 | | | 2007 | | | 2008 |
| | Nov | Jan- Nov | Year | Nov | Jan- Nov | Year ^{1/} | Year ^{1/} |
| Current account | 1.4 | 13.2 | 13.6 | -1.3 | 4.3 | 2.4 | -3.5 |
| Trade balance | 3.2 | 41.4 | 46.5 | 2.0 | 36.4 | 39.0 | 30.0 |
| Exports | 11.9 | 125.5 | 137.8 | 14.1 | 146.4 | 160.0 | 172.0 |
| Imports | 8.7 | 84.1 | 91.3 | 12.0 | 110.0 | 121.0 | 142.0 |
| Services | -0.7 | -8.8 | -9.7 | -1.2 | -11.3 | -12.6 | -13.5 |
| Transportation | -0.3 | -3.0 | -3.1 | -0.3 | -3.5 | -4.0 | -3.9 |
| International travel | -0.1 | -1.3 | -1.4 | -0.4 | -2.9 | -3.4 | -3.5 |
| Computer and informat. | -0.1 | -1.7 | -1.9 | -0.1 | -1.9 | -2.1 | -2.2 |
| Operational leasing | -0.5 | -4.4 | -4.9 | -0.6 | -4.9 | -5.4 | -5.2 |
| Other | 0.2 | 1.6 | 1.7 | 0.2 | 2.0 | 2.2 | 1.2 |
| Income | -1.5 | -23.4 | -27.5 | -2.4 | -24.5 | -27.9 | -24.2 |
| Interest | -0.8 | -10.3 | -11.3 | -0.3 | -6.8 | -7.5 | -4.5 |
| Profits and dividends | -0.8 | -13.3 | -16.4 | -2.1 | -18.1 | -20.9 | -20.0 |
| Compensation of employment | 0.0 | 0.2 | 0.2 | 0.0 | 0.4 | 0.5 | 0.4 |
| Current transfers | 0.4 | 3.9 | 4.3 | 0.3 | 3.6 | 4.0 | 4.2 |

1/ Forecast.

The surplus in current transactions reached US\$4.7 billion in the twelve months ended in November 2007, corresponding to 0.37% of GDP, against US\$13.7 billion in the corresponding period of the previous year, 1.3% of GDP. The drop in the balance of trade was responsible for 47% of this reduction, impacted the increases of net remittances related to services and of the deficit in revenues. The downward trajectory of the surplus in current account is consistent with the acceleration of the dynamics of internal economic activity.

In the first eleven months of the year, the net remittances of services totaled US\$11.3 billion and those of incomes, US\$24.5 billion, registering, in the order, expansions of 28.1% and 4.8% compared to the same period of 2006. Simultaneously with the deficit, one should emphasize the persisting rising tendency of values of transactions under the services heading, both in revenues and in expenditures.

Revenues with international travel reached US\$4.5 billion and the expenditures, US\$7.4 billion, record values for the period, with increases of 14.5% and of 41.5%, respectively, as compared to the same period of 2006. The net expenditures totaled US\$2.9 billion, against US\$1.3 billion in the previous year.

The net expenditures with interests accumulated US\$6.8 billion from January to November, against US\$10.3 billion in the corresponding period of 2006. This result reflected the increase of revenue with interests derived from the expansion of Brazilian assets abroad, with emphasis to the rise of 126.1% in the remuneration of international reserves, totaling US\$5.7 billion.

The net remittances of profits and dividends summed up US\$18.1 billion, of which US\$14.1 billion related to direct investments and US\$4 billion to portfolio investments, against US\$13.3 billion from January to November 2006. Growth in remittances reflected growth in profitability of companies operating in the country, the appreciation of the foreign exchange nominal rate and growing stock of IED. The remittances related to the segments of automotive vehicles, financial services, iron and steel, electricity and gas, and beverages represented, altogether, 53.2% of the total sent in the period, rising 72.3% in relation to the same period of 2006.

The unilateral transfers summed up US\$3.6 billion in the first eleven months of the year. Reduction of 8.2% in

relation to the corresponding period of 2006 demonstrated, both the cutback of 2.2% in gross inflows for maintenance of residents, which represent, approximately 60% of total net revenues of the heading, and the increase of 64.5% in gross expenditures.

5.4 Financial account

The financial account of the balance of payments presented a surplus of US\$7.8 billion in November, accumulating balance of US\$84.7 billion in the year. The Brazilian Direct Investments Abroad (BDIA) showed net amount of assets abroad totaling US\$3.3 billion in the year, up to November. While the intercompany loans showed net amortizations of US\$6.1 billion in the period, investments of Brazilian companies abroad or capitalization of branches and subsidiaries registered net outflows of US\$9.4 billion, corroborating the ongoing process of internationalization of domestic companies.

The net inflows of FDI totaled US\$33.7 billion in the first eleven months of the year, Record for the period, against US\$16.3 billion from January to November 2006. The net inflows of capital sharing reached US\$24.9 billion and the intercompany loans, US\$8.9 billion. Considering the amounts accumulated in twelve months, the net FDI inflows totaled US\$36.2 billion in November.

Foreign portfolio investments registered a US\$1 billion deficit in November, totaling net inflows of US\$40.8 billion in the year. The portfolio investments negotiated in the country –stocks and fixed-income securities – showed net outflows of US\$496 million, in the month, and net inflows of US\$35.9 billion in the year. Inflows related to stocks which continue favoring the performance of Ibovespa, reached US\$17.1 billion in the first eleven months of the year, accounting for approximately three-quarters of the acquisitions of stocks in initial offerings throughout the year, including US\$3 billion related to stock placements by Bovespa. Foreign investments in fixed-income bonds in the country came to US\$18.7 billion in the first eleven months of the year and the stock of these investments reached US\$44.4 billion, in October.

In relation to the foreign portfolio investments, stocks of Brazilian companies negotiated abroad showed net inflows, both in November and in cumulative terms for the year. Among the fixed-income bonds, sovereign bonds, impacted by the external debt bond repurchase program carried out

Table 5.7 – Financial account

| Itemization | US\$ billion | | | | | | |
|-----------------------|--------------|-------------|-------|------|-------------|--------------------|--------------------|
| | 2006 | | | 2007 | | | 2008 |
| | Nov | Jan- Nov | Year | Nov | Jan- Nov | Year ^{1/} | Year ^{1/} |
| Capital account | 2.6 | 13.2 | 15.1 | 7.8 | 84.7 | 86.9 | 10.3 |
| Direct investments | 0.5 | -8.6 | -9.4 | 0.1 | 30.5 | 28.7 | 18.0 |
| Abroad | -2.1 | -24.9 | -28.2 | -2.4 | -3.3 | -6.3 | -10.0 |
| In Brazil | 2.7 | 16.3 | 18.8 | 2.5 | 33.7 | 35.0 | 28.0 |
| Equity capital | 2.6 | 12.6 | 15.4 | 2.3 | 24.9 | 25.9 | 24.8 |
| Intercompany loans | 0.0 | 3.7 | 3.4 | 0.2 | 8.9 | 9.1 | 3.2 |
| Portfolio investments | 2.5 | 7.8 | 9.6 | -1.2 | 39.6 | 46.4 | 20.8 |
| Assets | -0.1 | 0.7 | 0.5 | -0.2 | -1.2 | -1.0 | -1.1 |
| Liabilities | 2.6 | 7.1 | 9.1 | -1.0 | 40.8 | 47.4 | 21.9 |
| Derivatives | 0.0 | 0.4 | 0.4 | -0.1 | 0.2 | 0.0 | 0.0 |
| Other investments | -0.5 | 13.7 | 14.6 | 9.0 | 14.4 | 11.8 | -28.5 |
| Assets | -3.2 | -10.4 | -8.9 | 5.1 | -15.7 | -17.4 | -30.2 |
| Liabilities | 2.7 | 24.1 | 23.5 | 4.0 | 30.2 | 29.1 | 1.6 |

1/ Forecast.

Table 5.8 – BP financing sources

Selected items

| | US\$ billion | | | | | | |
|-----------------------------------|--------------|-------------|------|------|-------------|--------------------|--------------------|
| | 2006 | | | 2007 | | | 2008 |
| | Nov | Jan- Nov | Year | Nov | Jan- Nov | Year ^{1/} | Year ^{1/} |
| Medium and long-term funds | 3.9 | 32.3 | 33.5 | 1.0 | 22.4 | 23.7 | 15.5 |
| Public bonds | 1.5 | 4.4 | 4.8 | 0.0 | 2.9 | 2.9 | 0.0 |
| Private debt securities | 1.1 | 9.8 | 10.3 | 0.7 | 14.0 | 15.0 | 9.7 |
| Direct loans | 1.3 | 18.1 | 18.4 | 0.4 | 5.5 | 5.8 | 5.8 |
| Short-term loans (net) | -0.8 | -3.1 | -0.5 | -0.2 | 14.5 | 15.3 | 0.0 |
| Short-term securities (net) | 0.0 | 0.6 | 0.1 | 0.0 | 4.6 | 3.5 | 0.0 |
| Portfolio (net) | 1.6 | 14.9 | 16.9 | -0.5 | 35.9 | 46.0 | 26.0 |
| Roll-over rates ^{3/} (%) | | | | | | | |
| Private sector: | 531% | 450% | 206% | 211% | 116% | 100% | 100% |
| Debt securities | 255% | 212% | 206% | 187% | 231% | 162% | 100% |
| Direct loans | 2594% | 1129% | 205% | 275% | 51% | 50% | 100% |

1/ Forecast.

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

3/ Represents the medium- and long-term disbursement/amortization ratio, excluding amortizations related to conversions of debt to FDI.

Table 5.9 – Statement of international reserves

| | US\$ billion | | | | |
|-------------------------------------|--------------|-------|---------|--------------------|--------------------|
| | 2006 | | 2007 | | 2008 |
| | Jan-Nov | Year | Jan-Nov | Year ^{1/} | Year ^{1/} |
| Reserve position in previous period | 53.8 | 53.8 | 85.8 | 85.8 | 177.7 |
| Net Banco Central purchases | 31.9 | 34.3 | 76.3 | 76.3 | - |
| Debt servicing (net) | -22.9 | -22.8 | -8.4 | -7.8 | 1.4 |
| Interest | -3.0 | -2.8 | 0.9 | 1.5 | 3.5 |
| Credit | 2.5 | 2.8 | 5.7 | 6.4 | 7.8 |
| Debit | -5.5 | -5.6 | -4.8 | -4.9 | -4.3 |
| Amortization | -19.9 | -20.0 | -9.2 | -9.3 | -2.1 |
| Disbursements | 6.3 | 6.6 | 2.9 | 2.9 | - |
| Multilateral organizations | 1.2 | 1.2 | - | - | - |
| Sovereign bonds | 5.1 | 5.5 | 2.9 | 2.9 | - |
| Others ^{2/} | 1.8 | 1.5 | 6.6 | 6.6 | - |
| Treasury's purchases | 12.3 | 12.3 | 13.9 | 14.0 | 6.4 |
| Change in assets | 29.3 | 32.0 | 91.2 | 91.9 | 7.8 |
| Gross reserve position | 83.1 | 85.8 | 177.1 | 177.7 | 185.5 |

1/ Forecast.

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

by the National Treasury, presented net amortizations throughout the year. In November, the medium and long-term bonds posted net outflows of US\$590 million, resulting from amortizations of US\$462 million and of premiums of US\$128 million. In the year, the net outflows of Republic bonds totaled US\$7.7 billion, as a result of disbursements of US\$2.9 billion and of amortizations of US\$10.6 billion, of which US\$9.1 billion in face value and US\$1.5 billion related to premium in the context of the repurchase program.

With reference to medium and long-term private bonds, net amortizations reached US\$307 millions in November, accumulating net inflows of US\$7.2 billion in the first eleven months of the year, resulting in roll over rate of 231%. In the last period, net disbursements of the short-term bonds summed up US\$4.6 billion.

The heading other Brazilian investments registered reduction of assets abroad of US\$5.1 billion in November, totaling an increase of US\$15.7 billion in the first eleven months of the year, of which US\$5.6 billion related to the constitution of deposits by Brazilian banks.

The net inflows related to other foreign investments summed up US\$4 billion in November. Suppliers' commercial credit registered net inflows of US\$1.7 billion basically associated to net amortizations of short-term credits, US\$1.6 billion. The loans summed up net inflows of US\$2 billion, result of net payments of US\$241 million in short-term loans and net disbursements of US\$2.2 billion related to long-term loans. In the first eleven months of the year, the other foreign investments accumulated net inflows of US\$30.2 billion. Short-term commercial credit registered net disbursements of US\$15.8 billion; while loans posted a distinct performance, according to the term of operations; those with medium and long-terms resulted in net outflows of US\$610 million and those with short-term, net inflows of US\$14.5 billion.

The international reserves expanded US\$91.2 billion in the year, up to November, totaling US\$177.1 billion. In this period, the Central Bank's purchases on the foreign exchange spot market totaled US\$2.9 billion in Republic bonds and amortizations related to the Multi-Year Deposit Facility Agreement (MYDFA), of US\$138 million. Unheard net revenues from interests, US\$880 million, resulting from inflows of US\$5.7 billion related to the reserves earnings and expenditures of US\$4.8 billion with interests on bonds, were observed. The other operations generated expansion

of US\$6.6 billion on reserves. The change in the financial position of the federal government in foreign currency contributes to expand the prospects for external financing to the private sector.

The stock of international reserves was estimated at US\$177.7 billion, at the end of 2007, with growth of US\$91.9 billion in the year. Including the operations carried out in the first eleven months, payments of US\$86 million related to external debt service, for which the National Treasury is liable, are expected to occur, plus placements, already observed, of US\$2.9 billion in sovereign bonds. It is also estimated liquidations of purchases of US\$76.3 billion of the Central Bank on the foreign exchange domestic market, fully carried out from January to November.

5.5 External sustainability indicators

External sustainability indicators maintained, in the first eleven months of 2007, the favorable trajectory observed in the two previous years, especially in view of the expansion of exports, GDP calculated in US dollars and the international reserves.

The external debt service, even incorporating the effects of the external debt sovereign bond repurchase program, initiated in January 2006, was reduced by US\$659 million in comparison to December 2006. The reduction of the debt service reaches US\$9.9 billion, in comparison with the level of the start of the program. The participation of the debt service in exports fell from 41.3%, in December 2006, to 35.4%, in November 2007.

In the same period, the total debt grew by US\$23.6 billion, to US\$196.2 billion, result of the expansions of US\$20.6 billion of the short-term debt and of US\$3 billion of the medium and long-term debt; the total net debt fell by US\$71.1 billion; and GDP in dollars grew US\$194.5 billion, to US\$1,266 billion. Thus, the total debt /GDP ratio dropped 0.6 p.p., to 15.5%, and the proportion between the net total debt and GDP decreased 6.7 p.p., to 0.3%, the lowest value of the series, initiated in 1970.

The total debt over exports and net total debt over exports coefficients closed at 1.2 and zero, respectively, in November 2007.

Table 5.10 – Sustainability indicators^{1/}

| | US\$ billion | | | | | |
|---|--------------|-------|-------|-------|-------|-------------------|
| | 2005 | 2006 | 2007 | | | |
| | Dec | Dec | Mar | Jun | Sep | Nov ^{2/} |
| Exports of goods | 118.3 | 137.8 | 142.4 | 150.0 | 153.5 | 158.7 |
| Exports of goods and services | 134.4 | 157.3 | 162.8 | 171.3 | 175.9 | 182.0 |
| Debt service | 66.0 | 56.9 | 59.4 | 53.2 | 55.0 | 56.2 |
| Total external debt | 169.5 | 172.6 | 182.1 | 191.4 | 195.3 | 196.2 |
| Net external debt | 101.1 | 74.8 | 60.0 | 28.9 | 17.0 | 3.7 |
| International reserves | 53.8 | 85.8 | 109.5 | 147.1 | 163.0 | 177.1 |
| GDP | 882 | 1 072 | 1 120 | 1 175 | 1 231 | 1 266 |
| Indicators | | | | | | |
| Total external debt/GDP (%) | 19.2 | 16.1 | 16.3 | 16.3 | 15.9 | 15.5 |
| Net external debt/GDP (%) | 11.5 | 7.0 | 5.4 | 2.5 | 1.4 | 0.3 |
| Total external debt/exports | 1.4 | 1.3 | 1.3 | 1.3 | 1.3 | 1.2 |
| Total external debt/exports of goods and services | 1.3 | 1.1 | 1.1 | 1.1 | 1.1 | 1.1 |
| Net external debt/exports | 0.9 | 0.5 | 0.4 | 0.2 | 0.1 | 0.0 |
| Net external debt/exports of goods and services | 0.8 | 0.5 | 0.4 | 0.2 | 0.1 | 0.0 |
| Debt service/exports (%) | 55.8 | 41.3 | 41.8 | 35.4 | 35.8 | 35.4 |
| Debt service/exports of goods and services (%) | 49.2 | 36.2 | 36.5 | 31.0 | 31.3 | 30.9 |
| Reserves/total external debt (%) | 31.7 | 49.7 | 60.2 | 76.9 | 83.4 | 90.2 |

^{1/} Excludes stock of principal, amortizations and interests concerning intercompany loans.

^{2/} Estimated data.

The ratio between the international reserves, which rose by US\$91.2 billion, and the total external debt moved from 49.7%, in December, to 90.2%, in November, the highest value since the start of the calculation, in 1970. Aside from this, reserves represented, in November, 282.5% of the short-term debt, by the criterion of residual term.

5.6 Conclusion

The balance of payments net inflows in the first eleven months of the year already enable the full financing of external accounts in 2007, besides permitting the significant accumulation of reserves during the period. In an environment of reduction of the trade surpluses and current transactions, record financial inflows, both in FDI and portfolio investments, have been contributing, more intensely, to the result of the balance of payments.

The prospect of reversal of the balances of current transactions, after the prolonged period of significant surpluses, does not create any restriction to the robustness of the external accounts. It is worth highlighting that the successive positive results, observed as of 2003, have contributed to the consolidation of important adjustments in stocks. This has been evinced by both the reduction of the public sector external debt, and by the expansion of international reserves, which have made the public sector a net creditor of foreign exchange, strengthening the Brazilian economy's international position. In addition, the prospect of deficits in current transactions lower than the historic average does not affect the perception of solidity of the country's external accounts, taking into account the comfortable financing position provided by investment inflows.

Balance of Payment Forecasts

Table 1 – Uses and sources

| | US\$ billion | | | | | | |
|-------------------------------------|--------------|-------------|-------|------|-------------|--------------------|--------------------|
| | 2006 | | | 2007 | | | 2008 |
| | Nov | Jan- Nov | Year | Nov | Jan- Nov | Year ^{1/} | Year ^{1/} |
| Uses | -0.6 | -22.6 | -30.5 | -3.3 | -30.2 | -34.6 | -33.0 |
| Current account | 1.4 | 13.2 | 13.6 | -1.3 | 4.3 | 2.4 | -3.5 |
| Amortizations ML-term ^{2/} | -2.0 | -35.8 | -44.1 | -2.0 | -34.4 | -37.0 | -29.5 |
| Securities | -1.5 | -25.1 | -25.6 | -1.1 | -18.1 | -20.0 | -13.8 |
| Paid | -1.5 | -23.7 | -24.2 | -1.1 | -17.6 | -19.5 | -13.8 |
| Refinancing | 0.0 | -0.7 | -0.7 | 0.0 | 0.0 | 0.0 | 0.0 |
| FDI conversions | 0.0 | -0.7 | -0.7 | 0.0 | -0.5 | -0.5 | 0.0 |
| Suppliers' credits | -0.1 | -1.3 | -1.7 | -0.2 | -1.2 | -1.4 | -2.8 |
| Direct loans ^{3/} | -0.4 | -9.4 | -16.9 | -0.7 | -15.1 | -15.6 | -12.9 |
| Sources | 0.6 | 22.6 | 30.5 | 3.3 | 30.2 | 34.6 | 33.0 |
| Capital account | 0.1 | 0.8 | 0.9 | 0.1 | 0.6 | 0.8 | 1.0 |
| FDI | 2.7 | 16.3 | 18.8 | 2.5 | 33.7 | 35.0 | 28.0 |
| Domestic securities ^{4/} | 1.1 | 13.2 | 14.7 | -0.5 | 31.0 | 38.5 | 26.0 |
| ML-term disbursements ^{5/} | 4.6 | 41.9 | 43.7 | 3.8 | 32.8 | 35.0 | 27.1 |
| Securities | 2.6 | 14.9 | 15.8 | 0.7 | 16.9 | 17.9 | 9.7 |
| Suppliers' credits | 0.0 | 0.7 | 0.8 | 0.2 | 1.4 | 1.7 | 3.3 |
| Loans ^{6/} | 2.0 | 26.3 | 27.1 | 2.9 | 14.5 | 15.4 | 14.1 |
| Brazilian assets abroad | -5.4 | -34.2 | -36.1 | 2.4 | -20.0 | -24.6 | -41.3 |
| Other ^{7/} | 1.8 | 11.9 | 19.1 | 1.4 | 36.4 | 35.0 | 0.0 |
| Reserve assets | -4.3 | -27.4 | -30.6 | -6.4 | -84.4 | -85.1 | -7.8 |

1/ Forecast.

2/ Registers amortization of medium and long-term suppliers' credit, loans and securities placed abroad minus refinancing and discounts. Excludes amortizations referring to loans to IMF and intercompany loans.

3/ Registers amortizations loans borrowed from foreign banks, buyers, agencies and multilateral organizations.

4/ Includes foreign investment in equity and debt securities traded in the domestic market.

5/ Excludes intercompany loans disbursements.

6/ Includes multilateral and bilateral financing and buyers' credits.

7/ Registers net values of bond swaps, short-term securities, short-term trade credit, financial derivatives, nonresident deposits, other liabilities and errors & omissions.

The forecasts for the 2008 balance of payments were updated when compared to those shown in the September "Inflation Report". Besides the carrying effects as function of the results obtained in the latest months, alterations were introduced into the external debt service which was compatible with its September stock. Aside from this, net Central Bank purchases on the exchange market and sovereign external debt repurchases by the National Treasury both carried out through November were also considered.

Current transactions surplus for 2007 was revised from US\$7.8 billion contained in the previous "Inflation Report", to US\$2.4 billion, fundamentally as a result of the revised projection of net remittances of profits and dividends, from US\$16.5 billion to US\$20.9 billion. Also revised were the forecasts of trade surplus, net expenditures with services and interests, and net revenues from unilateral transfers.

The trajectory outlined by the results observed in current transactions, in an environment of ongoing acceleration of internal demand and increasing international integration of the Brazilian economy, should imply reversal of the sequence of positive balances initiated in 2003 toward a deficit of US\$3.5 billion, in 2008.

Exports should turn in an annual increase of 7.5% in 2008, while the expansion of imports, while consistent with the maintenance of the dynamics of the internal demand, is projected at 17.4%. In this scenario, the balance of trade will drop by US\$39 billion, in 2007, to US\$30 billion, a forecast US\$4 billion below that registered in the previous report.

The service account should turn in a deficit of US\$13.5 billion, in 2008, for an increase of US\$0.9 billion when compared to the previous year. The principal determinant of this change consists in a US\$3.5 billion deficit forecasted under the heading international travel, an estimate consistent with the acceleration registered in recent months of net outflows, a trajectory that will continue in the next year, in line both with the process of income gains and the exchange rate level.

The forecast for net expenditures with interests for next year was reduced from US\$6.9 billion to US\$4.5 billions. Revenues with interests on Brazilian assets abroad, showing marked growth of these assets, were raised to US\$11.8 billion, of which US\$7.8 billion refer to the remuneration on international reserves in the country, while the expenditures, reflecting the September debt stock position, expanded from US\$15.9 billion to US\$16.3 billion.

The forecast of the result in current transactions for 2008 comprises, also, the revision of the estimates for net remittances of profits and dividends, from US\$16.8 billion to US\$20 billion. The reduction from US\$0.9 billion against the 2007 forecast is based on the hypotheses of more reinvestment of the earnings obtained by foreign companies in the country and an increase in revenues with Brazilian assets abroad. The unilateral transfers in 2008 dropped US\$4.5 billion, closing September down to US\$4.2 billion.

The US\$10.3 billion surplus estimated for the financial account for the coming year is in accordance with the conservative scenario that considers the annual reduction of net inflows of foreign investments in direct modality, portfolio and others. It is significant for this scenario, the hypothesis of integral rollover of the short-term flows. Thus, in 2008, the balance of payments will be entirely financed and, in addition, the financial sector will expand the constitution of assets abroad, as a result of the surplus in market external transactions.

The process of internationalization of the Brazilian companies continues to expand. In this context, the net remittances of direct Brazilian investments abroad, after registering the record level of US\$28.2

billion, in 2006, should close at US\$6.3 billion in 2007, impacted by amortizations of intercompany loans, and at US\$10 billions, in 2008, same level as in the previous forecast. Direct foreign investments should total US\$35 billion in 2007, a volume lower than in cumulative twelve-month figures through November, but a record value in annual terms. For 2008, the forecast continued at US\$28 billion.

The amortizations of medium and long-term external debt in 2007 were raised from US\$36.1 billion to US\$37 billion, in view of incorporation of results of the repurchase program. For 2008, the forecast, comprising both the stock of external indebtedness related to September and the increase in the forecast for the exercise of put/call options was expanded from US\$27.5 billion to US\$29.5 billion. Additionally, the hypothesis of 100% rolling rate was maintained for the private external indebtedness.

The forecasts for 2007, related to foreign investments in domestic stocks and papers were raised, from US\$24 billion, in the September “Inflation Report”, to US\$38.5 billion, an alteration consistent with the positive evolution of the macroeconomic scenario and the results registered in the initial stock offers, both in quantity and value, with emphasis on those associated to Bovespa and BM&F. For 2008, in accordance with the prospects of lasting preference for Brazilian assets and of maintenance of the other macroeconomic conditioning factors, these net flows were revised from US\$10 billion to US\$26 billion.

The banking sector assets abroad are expected to grow US\$12.4 billion in 2007, against US\$8 billion forecasted in the previous “Inflation Report”, with outflows foreseen for 2008, of US\$25.2 billion, against US\$16.4 billion in the September projection. This growth demonstrates the sharper effect of inflows related to foreign direct and portfolio investments when compared to the reduction of the balance foreseen for current transactions. At last, a surplus of US\$85.1 billion is forecasted for the balance of payments, in 2007, higher than the estimate disclosed in the previous “Inflation Report”, given the incorporation of the Central Bank net purchases on the market. In 2008, this surplus should reach US\$7.8 billion, equivalent to projected revenues from reserve earnings, taking into account

Table 2 – Balance of payments – Market

| Itemization | US\$ billion | | | | | | |
|-----------------------------|--------------|-------------|-------|------|-------------|--------------------|--------------------|
| | 2006 | | | 2007 | | | 2008 |
| | Nov | Jan- Nov | Year | Nov | Jan- Nov | Year ^{1/} | Year ^{1/} |
| Current account | 1.1 | 10.4 | 10.3 | -2.0 | -1.4 | -3.9 | -11.3 |
| Capital (net) | 4.3 | 26.3 | 25.7 | 4.4 | 83.2 | 92.5 | 36.5 |
| Foreign direct investment | 2.7 | 16.3 | 18.8 | 2.5 | 33.7 | 35.0 | 28.0 |
| Portfolio investment | 1.1 | 13.2 | 14.7 | -0.5 | 31.0 | 38.5 | 26.0 |
| Medium and long term | | | | | | | |
| loans | 1.3 | 13.5 | 6.9 | 0.3 | -9.2 | -10.1 | -3.9 |
| Trade credits – Short, | | | | | | | |
| medium and long term | 1.4 | 5.8 | 11.9 | 2.8 | 35.1 | 33.8 | 1.5 |
| Banks | -0.8 | -3.3 | -0.7 | 1.1 | 19.2 | 20.2 | 1.0 |
| Other | 2.2 | 9.1 | 12.6 | 1.7 | 16.0 | 13.6 | 0.4 |
| Brazilian investment | | | | | | | |
| abroad | -2.6 | -29.4 | -34.5 | -0.9 | -14.5 | -12.3 | -16.1 |
| Other | 0.5 | 6.8 | 7.9 | 0.1 | 7.0 | 7.5 | 1.0 |
| Financial gap | 5.4 | 36.7 | 36.1 | 2.5 | 81.8 | 88.6 | 25.2 |
| Banco Central net intervent | -2.6 | -31.9 | -34.3 | -5.7 | -76.3 | -76.3 | 0.0 |
| Bank deposits | -2.7 | -4.8 | -1.7 | 3.2 | -5.6 | -12.4 | -25.2 |

1/ Forecast.

the hypothesis that the National Treasury entirely pays its debt service with resources acquired on the market and that the Central Bank does not carry out any purchases.

This chapter of the *Inflation Report* shows the assessment made by the Copom on the performance of the Brazilian economy and of the international scenario since release of the last *Report*, in September 2007, as well as an analysis of prospects for inflation up to end-2009 and for GDP growth up to the end of 2008. Inflation forecasts are presented in two main scenarios. The first, denominated reference scenario, presupposes that the Selic rate will be maintained unaltered during the forecast horizon, at 11.25% per year, value decided by Copom in its last meeting, on December 4 and 5, and that the foreign exchange rate will remain at a value close to that prevailing on the days that preceded the meeting (R\$1.80 per US dollar). The second scenario, known as the market scenario, utilizes the basic interest rate and exchange rate trajectories indicated by Gerin survey carried out among private sector analysts in the period leading up to the Copom Meeting. It is important to highlight that these scenarios only serve to provide a more solid footing to monetary policy decisions, and their hypotheses should not be taken as Copom forecasts of the future behavior of interest and exchange rates.

The inflation and GDP growth forecasts released in this *Report* are not highly centered ones. They clarify probability gaps which highlight the degree of uncertainty present at the moment in which the decision on basic interest rate is taken. Inflation forecasts depend not only on the hypotheses about interest and exchange rates, but also on a set of hypotheses about the behavior of exogenous variables. The set of hypotheses considered most probable by Copom forms the scenarios to which the Committee attributes the greatest weight on making interest-rate decisions. On exposing them, Copom seeks to give more transparency to monetary policy decisions, contributing to their efficacy in inflation control, which is its primary objective.

6.1 Inflation determinants

Inflation, measured by the IPCA, after closing 2006 at 3.14%, caught up in 2007, especially after the third quarter and, if agents' expectations are confirmed, it should close the year above 4.00%. Contrary to what occurred in 2006, when the benign inflation behavior was, to a great extent, benefited by the exceptionally favorable trajectory of prices of foodstuffs, 2007 inflation has been adversely affected by the unfavorable negative shock which, on a global scale, reached the prices of foodstuffs. On the other hand, contrary to what was verified in many years, in 2007 the behavior of regulated prices has been fairly benign, increasing 1.47% up to November, against 3.41% in the same period of 2006. Despite the inflation acceleration in 2007, the Committee assesses that the behavior of the core measures, along with the fact that expectations remain anchored, signals that the inflation dynamics tends to continue consistent with the inflation target path.

GDP expanded 1.7% in the third quarter of 2007, compared to the second, and 5.7% in relation to the same period of 2006. From the supply perspective, growth in the third quarter was led by the services sector (expansion of 1.2%) and by the industrial sector (expansion of 1.8%), in view of the respective weights over the index. However, it should be called to attention the performance of the farming sector, which grew 7.2%. As to the demand perspective, the most important component was the GFCF (expansion of 4.5%) and household consumption (expansion of 1.5%). The Committee considers that, even with weaker prospects for the global economy, as compared to the situation prevailing at the time of publishing the previous *Report*, the favorable dynamics of aggregated demand should continue during the next quarters, which should be favored by the several stimulus factors affecting economic activity, such as employment and credit expansion, the monetary easing and fiscal impulses. Taking into account, also, the factor market tightening observed in 2007, Copom assesses that demand expansion tends to gain more and more importance in the balance of risks to the inflationary dynamics.

In the third quarter, household consumption, the main component of aggregated demand, grew 1.5%, against the previous quarter, according to IBGE-seasonally adjusted data, and 6.0%, compared to the same quarter of the previous year. As a result, the twelve-month accumulated rate reached 5.6%. At a moment in which the confidence as to the pace of expansion of global economy lessens, the dynamics of household consumption contributes importantly to the

sustainment of domestic demand, and thereby to maintain the positive prospects for the economic activity in Brazil. The robust performance of the national accounts related to consumption has been anticipated by the monthly data on retail trade. In this sense, it is worth mentioning that the retail trade sales registered elevation of 9.6% in the year up to October, against the same period of 2006. More importantly, the increase in the sales of furniture and electric and electronic equipment (16.0%), favored by the continued growth in real payroll and by improved credit conditions, as well as in sales of fabrics, clothing and footwear (10.5%). For their part, the sales of vehicles, motorcycles, parts and spares, included only in the expanded sales index, rose a significant 23.8% during the first ten months of 2007.

The acceleration in the pace of economic activity during the last quarters produced positive effects on the job market. After three months in decline, the average real income rose in September and October, with the accumulated rate in the year reaching 3.4%. This fact, associated to the expansion of 2.9% in employment, led to an increase of 6.4% in real payroll in the first ten months of the year, as compared to the same period of 2006. Employment level in the manufacturing industry, for its part, showed growth of 3.7% in the first ten months of the year, according to CNI data. As with formal employment, data released by MTE indicates that the expansion in 2006 intensified in 2007, with the creation of 1.9 million jobs up to November, meaning an expansion of 5.1% of the employment level, led by civil construction (7.9%) and trade (6.1%). The favorable developments on the job market strengthen the perception, expressed by Copom in previous *Reports*, that the real payroll will remain as one of the pillars of sustainment of aggregated demand. Additionally, the positive performance of the job market has contributed to maintaining the consumer confidence indices on high levels, signaling a will to increase spending.

The household credit availability, favored by macroeconomic stability, institutional advances and reduction in loan interest rates, has been another important element in boosting consumption. Between October 2006 and October 2007 financial system credit (from free resources) to individuals grew 32.5%, with emphasis to the expansion of leasing operations (86.2%). In the monthly comparison, the stock of credit has been followed by lengthening of the average terms and stability of default in October. Regarding the prospective scenario, market analysts' and banking sector's representatives' expectations are that individual credit growth rates, even if with some moderation against the pace of 2007, should remain robust in 2008, with potential

acceleration in some segments, such as real estate financing. This assessment is, for instance, backed up by the growing formalization in job market, by the “bankarization” of the population, by an improved institutional environment and by the consolidation of macroeconomic stability, which should continue sustaining the elevation of personal credit in 2008.

In a way, contradicting less optimistic expectations regarding the performance of the Brazilian economy, the investment has shown to be one of the most dynamic components of domestic demand. Compared with the same quarter of the previous year, the GFCF expansion moved from 8.8% in the first quarter of 2007 to 14.4% in the third quarter. According to the seasonally adjusted series, the GFCF expansion in the third quarter was 4.5%, even after the robust 4.6% registered in the second quarter. The dynamics of investment reflects the warming up of economic activity and the increase in companies’ profitability (confirmed by the exuberant performance of the Brazilian stock market), which has led to increased confidence by the entrepreneurship. By the way, the juncture survey of the manufacturing industry, carried out by FGV in October, for instance, indicates that 53% of the interviewees (39% in October 2006) intended raising investment in 2008, against 8% which envisage reducing it (13% in October 2006). Similarly, the CNI’s survey shows that 42% of the companies intend to increase their purchases of machinery and equipment (against expectation of 32% for 2007 and of 29% for 2006).

There is evidence that credit expansion would help sustaining the expansion of investments. In fact, credit from free resources to corporate entities grew 27.9% in October, against the same month of 2006, and accumulates expansion of 20.8% in the year. Now, the loans with BNDES resources grew 16.6%, against the amount observed in October 2006, and 9.3% in the year. Besides, the capital market, both by means of public stock offerings (R\$19.5 billion in the year up to October) and of placements of fixed income bonds (R\$22.6 billion, excluding issuances carried out by leasing companies) have contributed to financing investment in practically all the sectors. For their part, the strengthening of the real has also favored investment growth, since it reduces the costs of imported capital goods. Also, the deepening of implementation of the PAC should expand public investments in infrastructure. In summary, despite the uncertainty about the behavior of global economy, and the recent volatility of the international financial markets, the combination of high profitability and confidence, associated to favorable financing conditions, should contribute to the continuity of the benign performance of investment.

According to IBGE, government consumption grew 3.5% in the third quarter, compared to the same period of 2006. This development was followed by strong increment of public revenues – Central Government revenues grew 12.7% and ICMS collection, the main state-level tax, grew 9.7%, in the year up to October. In view of the framework of budgetary relationship prevailing in the country, and of the directives from public policies, it is to be expected that the pace of government consumption growth will remain as it is for the next quarters. On the other hand, the interruption of CPMF collection, beginning 2008, added up this uncertainty to the prospects for development of the federal revenues.

As with the external sector, exports have shown expansion of 1.8% in the third quarter, as compared to the same period of 2006, according to national account compiled by IBGE. Imports, on the other hand, expanded 20.4%, on the same basis of comparison. Therefore, the contribution of net exports for total aggregated demand growth was negative by 1.3 p.p. in the first three quarters of 2007 (-1.3 p.p. also in the same period of 2006). However, as occurred in the past, a scenario comes up where the contribution of external demand for the dynamics of economic activity in 2007 will be higher than what, in a general way, the agents had anticipated at the beginning of the year. The evolution of net exports reflects the quicker pace of internal economic activity vis-à-vis the situation of our trade partners, as well as the strengthening of the prices of Brazilian assets, including the exchange rate. Despite their relevance to mitigate inflationary pressures, evidence indicates that net exports would become less effective as an ancillary instrument in the maintenance of price stability.

Still on foreign trade, despite the fact that in the latest quarters the imported volume has grown more rapidly than exported volume, to a great extent the increase of external purchases (22.1%, in the twelve-month accumulated up to October), is due to the significant increase of capital goods acquisition (33.4%, on the same basis of comparison). One should also note that the growth in exported value (16.3%, in accumulated twelve-months up to November) reflects the growth of the exported volume, and not only that of prices, especially with reference to the main commodities of the Brazilian exports basket. Strictly speaking, in twelve-months up to October, the volume exported rose 5.8%, while the prices advanced 9.5% in the same period. In this context, even though, for 2008, lower trade balances surplus is anticipated, than those observed in the last biennium, Copom does not foresee an abrupt reversal in the balance of trade. On the other hand, the Committee recognizes that,

as it comes to current transactions – with a US\$4.7 billion surplus in twelve-months up to November, equivalent to 0.4% of GDP – the more plausible scenario is that which considers the possibility of a small deficit taking place in the not so distant future.

The prospective path of external accounts and net external demand depend not only on developments of the domestic economy, but also, importantly, on the global economic context. In view of this, one should highlight that relevant changes were observed since the publishing of the last *Report*, as it comes to the external scenario. It is a fact that the September *Inflation Report* indicated that problems in the international financial markets, specifically regarding loan-backed bonds and obligations, were suffering comprehensive impacts and, thus, added up one piece of caution to the external scenario which, up to mid-2007, in general terms, pointed to a robust global economic growth, despite the expected deceleration of the American economy. However, since that time, worries with the financial stability in mature economies intensified and brought along a new round of squeezing liquidity conditions.

Under these circumstances, a consensus took shape that the global economy will grow less in 2008 than in previous years. In this context, persistent uncertainties as to the extent and allocation of losses originated in the US subprime credit market, which led to disturbances in the interbank liquidity term market and to the contraction of credit supply to companies and families, signaled that the deceleration may be more intense than anticipated. A pronounced deceleration in the USA, with potential developments for the economies of Europe and Japan, would put to test the thesis that the robust growth of the principal emerging economies, especially in Asia, would have acquired a dynamics of its own, i.e., the advancement of these economies would be less dependent on the demand derived from mature economies and, in turn, more dependent on demand generated internally or in other emerging economies. In summary, since the last *Inflation Report*, the central prospective scenario for global economic activity has deteriorated, and which is now surrounded by more uncertainty with a basic negative bias.

These developments have led to changes in the conduction of the monetary policy in mature economies, generally in the sense of limiting, due to the increased risk of more pronounced economic deceleration and of potential systemic stability problems, the scope for contractionist measures. In particular, the need for mitigating the potential impact of the financial turbulence over economic

activity led the Fed to reduce the interest rate by 100 b.p. in the meetings of September, October and December. Such actions suggest that, in the Fed's viewpoint, despite the robust growth observed in the third quarter, there is a stronger possibility that the crisis effects due to the real estate sector may lead to a sharper deceleration of economy, and the possibility of a recession cannot be discarded completely. Besides dealing with the potential macroeconomic impact of financial system difficulties, central banks, like the Fed, the European Central Bank and the Bank of England, have had to act vigorously to assure the functioning of interbank markets. Banks' liquidity needs as consequence of the real estate crisis have been potentialized by the nearing of the year end and, as some agents put it, they constitute an additional pressure on the short-term interest rates in these economies. One should recognize that, despite the timely response of these central banks to the increased financial volatility, the external scenario continues well uncertain, and changes in market sentiment and increasing risk perception in the financial sector should be monitored closely.

In this context, the prospects for the behavior of international prices of raw materials, an outstanding component of the Brazilian exports basket, are subject to the still more intense than usual, uncertainty. However, in the particular case of iron ore, there are signs that its price would again be raised at the beginning of 2008. As regards the prices of agricultural commodities, the assessment that their prices could come down has not been corroborated by the facts. Indeed, the most recent data on all-round inflation in economies like the United States, China, Euro Area, signal a sharpening of inflationary pressures on a global scale. There is, also, the reading that the expansionist inflection of the monetary policy on the part of the largest central banks of the major economies might have an inflationary impact and that such impact would be as strong as the economic activity's resistance, in Asian emerging economies, to the deceleration of the mature economies.

Regarding the aggregated supply, the three sectors presented positive performance in the third quarter of this year. The industrial sector signaled strong acceleration, with a growth rate (1.8%) markedly higher than that verified in the second quarter (1.3%), thereby frustrating analyses that foresaw a backward movement of its dynamics. In fact, the 5.1% expansion of the industrial output in the year, against the same period of last year, was the highest since the third quarter of 2004. The services sector also presented positive performance, by posting the seventeenth consecutive rise

against the previous quarter (1.2%). In its turn, the more vigorous performance was shown by the farming sector which, in the third quarter, grew 7.2% in relation to the second and 9.2% compared with the third quarter of 2006. This strong performance finds itself aligned with other indicators of the farming sector, such as the IBGE estimates for farming crops, which signals a 13.8% growth for the production of grains in 2007, as compared to 2006. The quarterly moving average of general industrial production, purged from seasonal factors by IBGE, grew 1.2% in October, the twelfth consecutive expansion on this basis of comparison, showing the solid performance of the textile sector, disseminated by various sectors. Still considering the seasonally adjusted series, after the reduction of 0.6% in September, there was, in October, a significant increment of 2.8%, in comparison with the previous month, and of 10.3% in relation to October 2006. In the twelve-month cumulative up to October, growth reached 5.3%, with the manufacturing industrial production advancing 5.2% (5.9% in 2007) and that of mining 6.1% (5.6% in 2007). For November, statistical adjustments due to the smaller number of business days, compared to the same month of previous years, might eventually cause a downturn of the industrial production index. The tendency, however, is of continuity of the cycle of expansion of the industrial production, which will continue to be favored by the diverse incentive factors which affect the economic activity, such as credit and employment expansion, the monetary easing already carried out, fiscal impulses and, in some segments, reduced stock levels.

Information from national accounts suggests a decrease in stock levels during 2007. GDP, viewed from the supply perspective grew 5.3% in the first nine months of this year, against a growth of demand components, excluding stock, of 5.1%. From the restricted perspective of the industrial sector, data from the FGV's Situational Survey show that the difference between the number of companies assessing that the respective stocks are insufficient and those which assess that these are excessive is greater since April 1995. For CNI, the stocks of final-use goods, at the end of the third quarter, were stable compared to the second quarter and within the companies' planning. From the standpoint of economic activity, this situation is better than that observed in the third quarter of 2006, when the effective stocks surpassed the planned levels and indicated frustration of the entrepreneurs' expectations as to demand progress.

The manufacturing industry's Nuci reached the historic record of 83.1% in October (82.2% in September), according to CNI data purged from seasonal factors by the Central Bank.

Considering the series without seasonal adjustment, the Nuci in October stood at 2.2 p.p. above the level observed in the same month of 2006, with the average rate of the first ten months of the year, standing at 1.7 p.p. above that observed in the equivalent period of 2006, 0.9 p.p. and 1.5 p.p. above the average rates observed in the same periods of 2004 and 2005, respectively. Similarly, the capacity utilization series, measured by FGV, came to 87.2% in November, a series record since April 1995, and 2.5 p.p. higher than that of the same month of the previous year. With special regard to the São Paulo industry, data compiled by the São Paulo Federation of Industries (Fiesp) indicate that the Nuci reached 84.1% in October, the highest level since August 2004.

Generally speaking, the reduction in idle capacity reflects the acceleration of economic activity; it is present in diverse sectors and occurs in spite of the substantial increase in investment expenditures. In fact, in the year, up to October, the absorption of capital goods presented solid growth (19.7%), substantiated in the vigorous increment of imports (35.3% in volume, up to October), as well as the production of capital goods (18.8%, up to October). Note, also, that the production of civil construction inputs grew 5.0% up to October and shows acceleration in the margin. Taking into account the recent behavior of the capacity utilization rates, the acceleration in investment is fundamental to avoid a widening of the gap between the evolution of aggregated supply and that of demand during the latest quarters, which may raise the risk of inflationary pressures.

Despite the production of civil construction inputs has been increasing in the latest quarters, rising costs of production are observed in this sector, according to the evolution shown by the National Construction Cost Index – Internal Availability (INCC-DI), with accumulated variation of 5.92% in twelve-months up to November. The twelve-month accumulated INCC-DI change, worth mentioning, has been standing at above 5% since August 2006, and has accelerated much in the last three months. These developments have engendered concerns about forthcoming possible supply restrictions in this sector, which, given its production structure, would hardly be mitigated through imports of inputs. In part, these concerns are enlarged by the prospects of demand expansion in an environment of favorable financing conditions.

With the gradual overcoming of the impetus effect, typical of initial stages of expansion cycles, the growth of the economically active population (EAP) has been decelerating, while the expansion of employment proceeds at a strong pace. In fact, the average monthly growth rate of EAP was of

0.46% in the quarter August-October, while the occupation grew at an average of 0.74%. In the twelve-months ended in October, EAP and occupation expanded, respectively, 2.3% and 2.9%. Consequently, after remaining constant by 10.1% in the March-May quarter, the unemployment rate moved to 9.7% in June, 9.5% in July and August, 9% in September and 8.7% in October. As a result, the average unemployment between January and October stood at 0.6 .p. below that verified in the same period of last year, a difference which has been increasing since July, as unemployment has been, on average, during the July-October period, of 1.1 p.p. lower than that verified in the same period of 2006. Besides the typical fluctuations of the months around the year end, it is reasonable to expect that, if maintained the tendencies for EAP and employment, the rates of unemployment should keep a declining trajectory, which could mean the emergency of pressures for more significant wage increments.

The price of oil, a systematic source of uncertainty originating from the international scenario, remains high and continues showing sharp volatility, reflecting not only structural changes in the world's energy market, but also recurring episodes of geopolitical uncertainty. Despite the considerable uncertainty inherent in forecasts about the trajectory of oil prices, the baseline scenario adopted by Copom seems plausible, which foresees the stability of domestic prices of gasoline in 2007. It is worth highlighting, however, that the impact of the international oil prices on domestic inflation is not transmitted exclusively by means of fuel prices, but also, for instance, by the productive chain of the petrochemical sector and by the very expectations of the agents. One may not disregard, even, that the volatility of prices of other important commodities also continues relatively high, a reflex of the increased uncertainty over the prospects for the growth of world's demand, as well as of turbulence in the global financial markets.

Inflation measured by IGP-DI cooled off in October (0.75%), after two months on quite high rates (1.17% in September and 1.39% in August), but it started to rise again in November (1.05%). In this way, the IGP-DI accumulates changes of 6.32% in 2007 (3.52% in the equivalent period of the previous year), and of 6.61% in twelve-months up to November (3.59% in 2006). The strong increment of IGP-DI reflects both the behavior of IPC-Br, with variation of 4.53% in twelve-months up to November (1.88% in 2006), and the IPA-DI, which registered inflation of 7.51% (4.04% in 2006). On the same basis of comparison, the National Cost of Construction Index (INCC) increased 5.92% (5.05% in 2006), suggesting persistence of

inflation measured by INCC. As regards specifically the agricultural IPA, prices accumulated increases of 18.93% in twelve-months up to November (16.72% in October). For its part, the industrial prices continue showing a less unfavorable behavior, but they also show important acceleration in the last twelve-months (3.76% against 2.71% in 2006), and higher monthly rates since August. The acceleration of farming prices on the wholesale market has had significant effects on the prices of foodstuffs, which form IPCA itself, and it is associated to upward tendencies in the international markets of commodities such as soy bean. Now the dynamics of industrial prices on the wholesale seems to reflect the opposing impacts of appreciation of the foreign exchange rate and the elevations in the prices of inputs.

The markedly benign scenario for the consumer prices, which materialized with intensity last year, cooled off in 2007. These developments, at least in part, are not perceived as a surprise, as mentioned in previous *Reports*, which anticipated that the twelve-month accumulated inflation would accelerate during this year. After reaching the highest level in the year in August, monthly inflation measured by IPCA cooled off in September, starting to accelerate again in October and November. Twelve-month cumulative inflation moved from 2.96% in March to 4.19% in November, 1.17 p.p. above the rate observed in November 2006. Contrary to what happened in previous years, in 2007 free prices have risen more than the regulated and contract-monitored prices, with the latter decisively mitigating IPCA acceleration. In fact, while free prices increased 4.70% this year up to November, regulated prices advanced only 1.47%. Taken free prices together, inflation associated to non-tradable goods stand at 5.62% in 2007, therefore, way above the 3.71% registered by tradable goods, which, however, have been accelerating despite the foreign exchange appreciation verified in 2007. Still on non-tradables, in the segment of services, inflation registered in the year up to November reached 4.69% and in twelve-months, 4.89%.

Two of the three main core measures calculated by the Central Bank showed increases in the first eleven months of this year, against the corresponding period in 2006. The core by exclusion of monitored prices and of foodstuffs in the household stood at 3.50% (3.20% in 2006) and the trimmed mean core without smoothing of preestablished items fell back to 3.62% (4.23% last year). It is worth highlighting that, similarly to all-round inflation) these three measurements of underlying inflation have been accelerating at the margin, but also positioning below the central target of 4.50% for the next years.

Inflation expectations, which had risen from the second to the third quarter, in a way remained stable in the fourth quarter, but started to rise again in the latest weeks. In effect, the median of inflation expectations for 2007 reached 3.60% at the time of publishing of the June *Report* slightly surpassed 4.00% at the time of publishing the September *Report* and currently stands at 4.20%. For 2008, the median stood at 4.00% for a significant time, but moved to 4.10% in September, and to 4.20% recently. For 2009, which in this *Report* starts being included in the forecast horizon, the median of expectations has been positioned at 4.00%, but the average, which in general anticipates future median developments, have been positioned above this level. In general terms, although manifesting enough sensitivity to the occurrence of inflationary surprises, inflation expectations are still anchored onto the trajectory of targets.

6.2 Main scenario: associated risks and monetary policy implementation

The forecasts with which Copom works are based on a set of hypotheses about the behavior of the main macroeconomic variables. This set of assumptions, as well as the risks associated to them, make up the main scenario which the Committee takes decisions based upon. In general terms, this scenario, substantiated in forecasts that will be presented in the following section, considers a moderate downturn in the pace of global economic expansion, on the external side, followed by acceleration of prices and maintenance of the cycle of expansion of the Brazilian economy, on the domestic side, with rising inflationary risks.

From the standpoint of risks derived from external factors, the principal is associated with the possibility that the deceleration of the world's economy is more intensive than that considered in the main scenario. As registered in the foregoing section, since the publishing of the last *Report*, the prospective scenario for the growth of global economy became not only less favorable, but also more uncertain. In spite of the robust performance of the U.S. economy in the third quarter, there is mounting evidence that the endogenous squeeze of credit conditions may be more accentuated and prolonged, therefore, with potential impact on the economic activity stronger than anticipated. Besides the impact that, by itself, would be caused by more intensive economic deceleration in the USA on the global economy, there are also potential negative effects on mature economies of Europe

and Asia and on emerging economies. On the other hand, since publication of the last *Report*, rising concerns with the progress of inflation came up, in diverse regions, even when the direct effects of the increase in the prices of energy and foodstuffs are disregarded.

It is worth highlighting, however, that, for Brazilian inflation, an alternative scenario of a more intensive and generalized worldwide deceleration would mean a risk factor of an ambiguous signal. On the one hand, upon reducing the net exports, it would work as a contention factor for aggregate demand. Besides, the potential downturn of the prices of a few important commodities could contribute to a smaller domestic inflation. On the other hand, the above-mentioned alternative scenario could work unfavorably to the prospects of inflation by means of two mechanisms. In the case of deceleration of mature economies which form the center of the global financial market, the risk aversion could rise, thereby reducing the demand for Brazilian assets and leading to a depreciation of their prices. In addition, in the medium term, a possible reduction of net exports could have a similar effect on the sustainability of the prices of some Brazilian assets. In this context, in spite of the fact that the Brazilian economy has been giving repeated signs of having developed greater resistance to changes in the sentiment of the international financial markets, the capacity of the external sector to contribute to mitigating inflationary risks could be jeopardized.

Another risk coming from the external context, which at the moment takes on a neatly negative nature regarding the inflation trajectory, is the performance of the international prices of petroleum. A rise in the price of the barrel of petroleum is a risk factor which, on the one hand, is associated with the domestic prices of fuels and, on the other, with the potential impact on the domestic prices of other by-products, especially regarding those used along the productive chain of the petrochemical sector. One cannot disregard, also, that the excessive volatility of the price of petroleum generates even more uncertainties, which may contribute negatively to the evolution of economic agents' expectations in general, and in particular of those involved in price formation.

The process of expansion of our economy, which, beyond that, continues relatively little exposed to the foreign trade, and, therefore, with an economic cycle low synchronized to those of the mature economies, is led by a vigorous expansion of domestic demand. Even so, the external sector has been, in the latest years, performing an important role in the maintenance

of inflation in a trajectory consistent with CMN preestablished targets. This occurs, especially, by means of the discipline exerted on the prices of tradable goods and by the expansion of investments, in an environment of buoyant demand. However, the gradual and consistent increase in inflation in the recent past, as well as in inflation expectations, suggests that the behavior of domestic factors, especially demand growth, would be offsetting the contribution of the external sector, making it less effective.

By the way, despite the recent developments of the world's economy, there are risks as much or more important to the main scenario which stem from internal factors. In fact, the robustness of the domestic demand has exerted pressure on the capacity of supply of all sectors of economy, especially those not exposed to external competition. This assessment is clearer when one analyzes data related to the economic activity, such as the high level of capacity utilization and retail sales. Besides, one should recognize that the fiscal impulses expected for 2008 constitute an additional factor of incentive to domestic demand. It is still too early to assess possible consequences of the non-postponement of CPMF for the aggregate demand, as these depend on future developments of the fiscal policy. In this context, in line with the assessment made by Copom in previous documents, uncertainties related to the future dynamics of inflation are increasing, associated with the intensity and lags with which the mechanism of monetary policy transmission operates, especially if one considers that the effects of the process of monetary relaxation initiated in 2005 are cumulative. GDP figures for the third quarter of 2007 corroborate this assessment.

Copom recognizes the important contribution of investment to expand the productive capacity. This factor, coupled with the external sector aid, has been working towards mitigating the inflationary pressures. However, the Committee assesses that the pace of expansion of domestic demand, which should continue sustained, among other factors, by the impulse derived by the relaxation of the monetary policy implemented this year, remains a factor capable of placing important risks to the inflation dynamics.

It is also important to consider the risks derived from the movements of wholesale prices and their possible repercussion on the consumer price index. In the two last quarters, it was observed a sharp pressure of the agricultural prices on the wholesale market. There is a controversy over the origins of this movement, with strong evidence supporting the view that demand factors, domestic or international, have played an important role. It is plausible

to assume that the pressures on agricultural prices verified in 2007 will be reduced in 2008. However, this assumption should be examined in the light of the prospects of the expansion of global demand for foodstuffs and relative scarcity, especially in mature economies, of resources for their production. Wholesale industrial prices, for their part, also started showing elevation in the second half of 2007, possibly in view of external inflationary pressures. Copom assesses that the impact of variations of the wholesale prices on consumer prices will depend essentially on prospective supply and demand conditions and, in a critical manner, on expectations of price formation in relation to future inflation trajectory. In any case, in relation to the prevailing scenario in September, there is a rising probability that the emergence of inflationary pressures initially localized may present risks to the domestic inflation trajectory, since the warm-up of demand may result in increased transmission of pressures on wholesale prices to consumer prices.

Upon breaking down the IPCA among free prices and monitored prices, it is observed that negative risks outlined in relation to the dynamics of free prices contrast with a benign situation depicted for the evolution of administered prices, despite the recent increase in the general price indices. In fact, just as verified in 2007, the latter may continue contributing toward mitigating the pressures of the headline index. Specifically regarding energy, the specialists' assessment is that probably new tariff reductions take place in 2008. In this way, there is no assessment indicating substantial negative risks deriving from administered prices. The exception, though, refers specifically to the price of gasoline, as previously highlighted.

The recent inflationary acceleration may have contributed to the contention of real wages, whose growth, in the inter-annual comparison, has been moderate in the latest months. Employment expansion, however, anchored at the lagging effects of the monetary relaxation, among other factors, has been sustaining the growth of the real payroll at a healthy pace, and tends to continue. In fact, the deceleration of PEA growth, associated with the continuity of employment expansion, will lead to a reduction of unemployment, which could bring about the acceleration of salary-related gains, with potential impact both on domestic demand and on the costs of diverse sectors. In these circumstances, the wage behavior vis-à-vis the growth of labor productivity should be carefully monitored.

Credit expansion has been an important factor of sustainment of the expansion of aggregate demand. Apparently, the

recent hike of the interest rates practiced in the interbank market has not been transferred to the rates on financing of consumption. In this sense, the increase of the yield curve would not be containing the process of credit expansion. It is to be recognized that the elevation of the market interest rates, in as much as it reflects predominantly the deterioration of investors' inflation expectations, by itself tends to have incipient effects over the pace of expansion of the aggregate demand. On the other hand, one may not disregard that the introduction of institutional changes aimed at stimulating the credit market competition may keep concessions at a strong pace or even determine their acceleration, which could boost even further the domestic demand.

The possibility that the inflation movements, which in a preliminary assessment seem to be transitory, may impact on agents' expectations as to the inflationary trajectory in the medium term constitute a perennial risk for the implementation of the monetary policy. This risk tends to intensify in moments such as the current one, when the demand is high, the factor market is under pressure and there is greater uncertainty about aspects of public policies. It is known, also, that episodes of inflationary acceleration are not uniformly distributed among the different components of the price indices. Incidentally, the behavior of IPCA cores and diffusion indices, of prices of services and industrial wholesale prices in the latest months suggests that inflationary pressures initially localized could disseminate. It is up to the monetary policy, therefore, to maintain a vigilant attitude, in such a way as to prevent this possibility from coming true. This posture is justified, among other reasons, because the international experience suggests that elevations in prices of items with high visibility, such as energy and foodstuffs, tend to have greater effects over the formation of inflationary expectations than the respective price index weights.

In summary, the Committee assesses that, since the publishing of the last *Report*, the balance of risks for the expected inflation trajectory became less favorable, both from the viewpoint of the external and internal factors. In the external context, the developments of the latest months suggest that the contribution of imports to the maintenance of a benign inflationary scenario may have become less effective. In the domestic arena, the pace of expansion of demand gains more and more relevance as a source of risks to the inflationary dynamics, in view of signs that, despite the robust behavior of investment, restrictions to the expansion of supply could be emerging. In this context, Copom assesses that the consistent reduction of the gap between the pace of expansion in the supply of goods and services and that

of demand makes it even more relevant in the assessment of different possibilities which present themselves to the monetary policy.

Copom understands that the posture of monetary policy adopted during the latest years has been contributing, in an important manner, to the consolidation of a favorable macroeconomic environment, extensive to the long-term horizons, by means of the construction of a benign scenario for inflation evolution. In view of this new reality, the main challenge of the monetary policy consists in assuring the maintenance of the favorable developments observed in the latest years. Inflation rates consistent with the trajectory of the targets and the consequent materialization of a scenario of lasting macroeconomic stability will decisively contribute to the consolidation of the process of progressive reduction of the macroeconomic risk perception which has been occurring in the latest years. As this improved perception is materialized, the room for smaller real interests in the future will continue to consolidate. For this tendency to manifest in terms of concrete results, however, it is necessary that the prospective indicators of inflation, in particular the trajectories of aggregate demand and supply, to evolve in a harmonious way.

The Committee also considers it is fundamental to highlight, once more, that there are important lags between the implementation of the monetary policy and its effects over the activity level and over inflation. In this way, considering that, since the beginning of the cycle of monetary policy relaxation in September 2005, the base interest rate was reduced by 850 b.p. (475 b.p. in 2006), the tendency is that, over time, the lagging effects of the reduction of interest rate occurred in 2006 will be overlapped by the effects of reductions occurred in 2007 (b.p.). Thus, although the economy has been showing signs of robust expansion since the third quarter of last year, a significant part of the effects of these cutbacks in the interest rates have not yet reflected on the activity level, and, likewise, the effects of activity over inflation have not had time to fully materialize either.

The Committee also understands that the assessment of alternative monetary policy decisions should concentrate necessarily on the analysis of the prospective scenario for inflation and on the risks associated with it, instead of favoring the current values for this variable. Incidentally, during the next quarters, the expansion of the payroll and of the credit will continue to drive the aggregate demand. One should add up to these factors the effects, possibly expanded, of the expansion of the current expenses and transfers of

the government, as well as of other fiscal impulses. To this scenario are added the effects on the aggregate demand from the above-referred interest cutbacks, the signs of buoyant demand and the fact the recent monetary policy decisions will have impacts as of the beginning of 2008.

In the light of these considerations, Copom decided to maintain the Selic rate stable at 11.25% p.a. in its meetings of October and December. With a view to consolidating an environment of stability and predictability, Copom opts for a strategy that seeks to avoid a volatile inflationary trajectory. Such a strategy takes into account the lags of the mechanism of transmission and has shown to be the most appropriate for dealing with the uncertainty inherent in the process of formulation and implementation of the monetary policy. Thence, the importance attributed to inflation forecasts and, in a fundamental way, to the preventive action in the Committee's decision-making process. Prudence becomes even a more important ingredient, in this process, in moments such as the current one, in which the deterioration of the balance of inflationary risks tangibly reduces the safety margin of the monetary policy. In this environment, it is up to the monetary policy to keep itself especially vigilant to prevent the greater uncertainty detected in shorter horizons from disseminating to longer horizons. In the event of modification in the profile of risks which imply alteration in the prospective scenario outlined for inflation, at this moment, by the Committee, the monetary policy strategy will be promptly adjusted to the circumstances.

6.3 Assumptions and inflation forecasts

Based on traditionally adopted procedures, the benchmark scenario assumes the exchange rate constant over the forecasting horizon, at R\$1.80/US\$, a value close to that in effect on the eve of the Copom meeting in December, and the target for the Selic rate at 11.25%, set on that meeting. The projections for regulated and administered prices in 2007 was upgraded to 2.5%, against 3.2% considered in the *Inflation Report* of September 2007. This projection is based on the hypotheses of nil variation in gasoline and bottled gas prices, for the accumulated of 2007, a drop of 6.0% in the average prices of electricity, and an increase of 0.8% in the fixed telephony prices. Projection for regulated and administered prices is maintained at 4.5% for 2008, and stands at 4.2% for 2009. The projections were made individually for those items for which there are more information, whereas, for

the others, the forecasts continue based on the model of endogenous determination of administered prices, which considers seasonal components, exchange variations, market prices inflation and General Price Index (IGP) inflation.

The market scenario is based on data from the survey carried out by Gerin with a representative group of institutions. In this scenario, the evolution of exchange rate expectations fell back in comparison with the values released by the September *Inflation Report*. For the last quarter of 2007, these expectations moved from R\$1.90 to R\$1.78, and for the last quarter of 2008, from R\$1.95 to R\$1.80. For 2009, the survey expectations project an average exchange rate of R\$1.89 for the last quarter of the year. The average expectations around the evolution of the Selic rate rose when compared to the values contained in the last *Report*. For the last quarter of 2007, they moved from 11.05% to 11.20%, whereas, for the last quarter of 2008, they moved from 10.17% to 10.50%. For 2009, the projection for average Selic rate is 10.05%. This trajectory is consistent with spreads for the pre-DI swap of six months of 3 b.p., 18 b.p. and -42 b.p., in relation to the current Selic rate, in the last quarter of 2007, of 2008, and of 2009, respectively. Additionally, reflecting mainly the effect of different exchange rate of those used in the benchmark scenario, the market scenario presupposes variations of 2.4%, 4.6%, and of 4.5% for regulated and administered prices in 2007, 2008, and in 2009, respectively.

With regard to fiscal policy, the forecasts presented in this *Report* assumes the fulfillment of primary surplus target of 3.8% of GDP in 2007, 2008, and 2009, adjusted by the possible reduction of 0.45 p.p., as result of implementation of the Pilot Investment Program.

Based on above assumptions, and using the available set of information, forecasts were made for four quarters accumulated IPCA inflation, given the benchmark and market scenarios interests and exchange rates trajectories.

The central forecast associated with the benchmark scenario indicates inflation of 4.3% in 2007, an increase of 0.3 p.p. regarding the forecast presented in the September *Report*, but still below the central value of 4.50% for the CMN-established target. As can be seen in Figure 6.2, the convergence tendency of four quarter accumulated inflation toward the central value of inflation target continues present throughout the forecast horizon, which reflects, basically, the effects associated to reductions in the Selic rate implemented. Twelve-month accumulated inflation reaches the minimum value of 4.0% in the first quarter of 2008, accelerates and

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

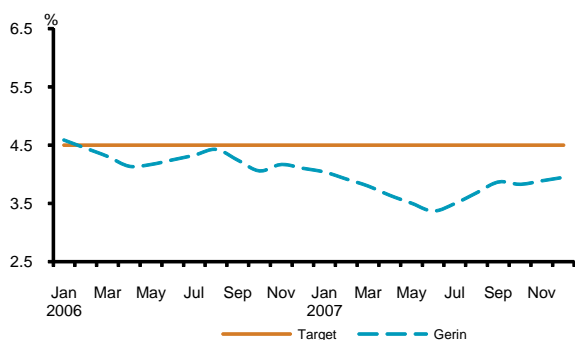
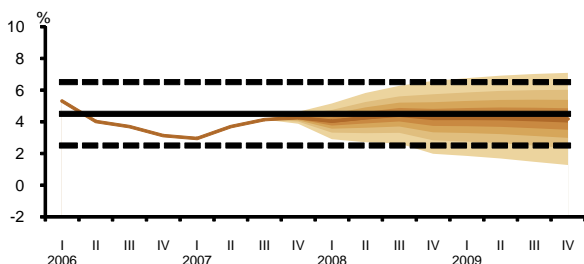


Figure 6.2 – Forecasted IPCA-inflation with interest rate constant at 11.25% p.a. (Benchmark scenario)

Inflation fan chart



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

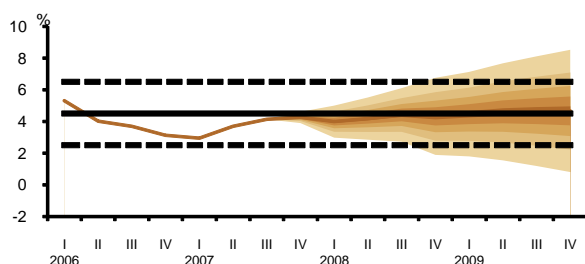
Table 6.1 – IPCA-inflation with interest rate constant at 11.25% p.a.
(Benchmark scenario)

| Year | Q | Confidence interval | | | | | Central projection | |
|------|---|---------------------|-----|-----|-----|-----|--------------------|-----|
| | | 50% | 30% | 10% | 50% | 30% | | |
| 2007 | 4 | 4.1 | 4.2 | 4.2 | 4.3 | 4.3 | 4.4 | 4.3 |
| 2008 | 1 | 3.6 | 3.8 | 3.9 | 4.1 | 4.3 | 4.5 | 4.0 |
| 2008 | 2 | 3.6 | 3.9 | 4.2 | 4.4 | 4.6 | 4.9 | 4.3 |
| 2008 | 3 | 3.7 | 4.0 | 4.3 | 4.6 | 4.9 | 5.2 | 4.5 |
| 2008 | 4 | 3.3 | 3.7 | 4.1 | 4.5 | 4.8 | 5.2 | 4.3 |
| 2009 | 1 | 3.3 | 3.7 | 4.1 | 4.5 | 4.9 | 5.3 | 4.3 |
| 2009 | 2 | 3.2 | 3.7 | 4.1 | 4.5 | 4.9 | 5.4 | 4.3 |
| 2009 | 3 | 3.1 | 3.6 | 4.0 | 4.5 | 4.9 | 5.4 | 4.3 |
| 2009 | 4 | 3.0 | 3.5 | 4.0 | 4.4 | 4.9 | 5.4 | 4.2 |

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

Figure 6.3 – Forecasted IPCA-inflation with market expected interest and exchange rates

Inflation fan chart



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

Table 6.2 – IPCA-inflation with market expected interest and exchange rates ^{1/}

| Year | Q | Confidence interval | | | | | Central projection | |
|------|---|---------------------|-----|-----|-----|-----|--------------------|-----|
| | | 50% | 30% | 10% | 50% | 30% | | |
| 2007 | 4 | 4.1 | 4.2 | 4.2 | 4.3 | 4.3 | 4.4 | 4.3 |
| 2008 | 1 | 3.6 | 3.8 | 3.9 | 4.1 | 4.2 | 4.4 | 4.0 |
| 2008 | 2 | 3.6 | 3.9 | 4.1 | 4.3 | 4.5 | 4.7 | 4.2 |
| 2008 | 3 | 3.7 | 4.0 | 4.3 | 4.5 | 4.8 | 5.1 | 4.4 |
| 2008 | 4 | 3.3 | 3.8 | 4.1 | 4.5 | 4.9 | 5.3 | 4.3 |
| 2009 | 1 | 3.4 | 3.8 | 4.3 | 4.7 | 5.1 | 5.6 | 4.5 |
| 2009 | 2 | 3.4 | 3.9 | 4.4 | 4.8 | 5.3 | 5.9 | 4.6 |
| 2009 | 3 | 3.2 | 3.8 | 4.4 | 4.9 | 5.5 | 6.1 | 4.7 |
| 2009 | 4 | 3.1 | 3.8 | 4.4 | 5.0 | 5.6 | 6.3 | 4.7 |

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

^{1/} According to Gerin.

reaches 4.3% in the last quarter, a level 0.1 p.p. above that forecasted in the last *Report*, but still below the central value of 4.50%. For 2009, the forecast of twelve-month accumulated inflation starts from 4.30% in the first quarter and ends the year at 4.20%, also below the central value of 4.50% for the target.

Table 6.1 data indicates reduction of 0.3 p.p. in accumulated inflation in twelve-months ended in the first quarter of 2008, in relation to the last quarter of 2007; and of 0.2 p.p. in the fourth quarter 2008, when compared to the third quarter. In the first case, the movement reflects a smaller forecast of market prices inflation, for the first quarter of 2008, than observed inflation for equivalent period of 2007. In the second, the cutback reflects smaller forecasts for inflation of both administered and market prices in the last quarter of 2008, when compared to the forecasts for the last quarter of 2007. On the other hand, Table 6.1 indicates an increase in twelve-month inflation in the second and third quarters of 2008. In the first case, the movement results of higher forecasts for market and administered prices than those observed in the second quarter of 2007. In the second, the elevation of the headline inflation forecast is essentially due to the fact that forecast for inflation of administered prices surpass the value observed in equivalent period of 2007, given that, in relation to the market prices, the contrary occurs. According to confident interval presented on Table 6.1, the estimated probability for inflation to exceed the upper limit of 2008 inflation targeting stands at around 6%, within the benchmark scenario.

In the market scenario, the forecast for 2007 inflation is equal to that of the benchmark scenario (4.3%) and 0.4 p.p. higher than that contained in the last *Report*. The forecasts for 2008, presented on Figure 6.3 and on Table 6.2, indicate a fall of the twelve-month accumulated inflation in the first quarter, with elevation in the following quarters, ending the year at 4.3%, same value forecasted in September, below the central target value. In comparison with benchmark scenario, the values are slightly below for the second and third quarters, explained basically by exchange rate appreciation expectations during these quarters. Probability of exceeding upper limit tolerance interval of the 2008 target stands at 7%. Additionally, according with market scenario, twelve-month accumulated inflation forecast shows elevation throughout 2009, and ends the year at 4.7%, therefore above the central value for the CMN established target.

Comparing the trajectories presented in this *Report*, with those presented in the previous *Report*, reproduced on Table 6.3,

Table 6.3 – September 2007 Inflation Report forecasts

| Period | Benchmark scenario | Market scenario |
|----------|--------------------|-----------------|
| 2007 III | 4.2 | 4.2 |
| 2007 IV | 4.0 | 3.9 |
| 2008 I | 3.7 | 3.6 |
| 2008 II | 4.0 | 3.8 |
| 2008 III | 4.1 | 4.0 |
| 2008 IV | 4.2 | 4.3 |

one can see that there was elevation of the forecasts for 2007 in both scenarios. The benchmark and market scenarios point to 4.3% of inflation, respectively 0.3 p.p. and 0.4 p.p. above the forecasts presented in September, reflecting, to a large extent, the incorporation of inflation rates for recent months above the expectations prevailing on occasion of release of the last *Report*. For 2008, it is observed an elevation in the benchmark scenario forecast (0.1 p.p.) and stability of the market scenario forecast when compared with the forecasts of the previous *Report*.

Figure 6.4 – Forecasts and target path for twelve-month cumulative inflation

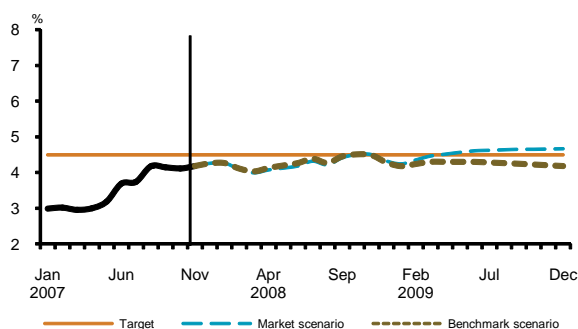


Figure 6.4 shows the evolution of the twelve-month accumulated inflation, in accordance with the benchmark and market scenarios, together with the trajectory of the target for the 2007-2009 interval. Up to November 2007, the values refer to observed inflation in twelve-months, and beginning in December the trajectories consider forecasts of the respective scenarios for the construction of accumulated values. The forecasts for the benchmark scenario remain below the center of the target practically in the entire forecast horizon. The market scenario shows a similar evolution up to the last quarter of 2008, when, roughly, the forecast become equal to the target. After a slight reduction in the first quarter of 2009, the forecasts turn to elevate and reach values above the target center of 4.50%, as of the second quarter of the year.

Figure 6.5 – GDP growth with interest rate constant at 11.25% p.a. (Benchmark scenario)

Output fan chart

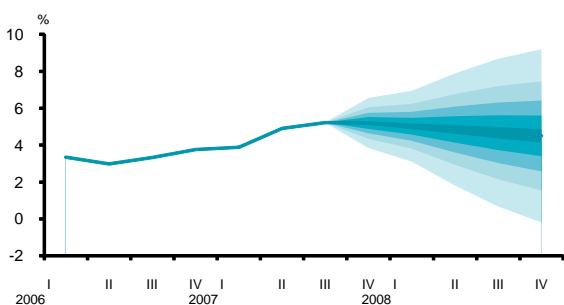


Figure 6.5 shows the output growth fan chart based on the benchmark scenario assumptions. It should be stressed that the forecasting errors associated to the forecast of GDP growth are considerably greater than in the case of inflation forecasts, taking into account that the model which generates GDP forecasts utilizes two components that are not directly observable – potential output and output gap. According to this scenario, the GDP growth foreseen for 2007 is 5.2%, 0.5 p.p. above that forecasted in the September *Inflation Report*, given the third quarter higher growth than expected, and, for 2008, the forecast of growth is 4.5%.

Measuring Output Gap – Non-Observed Components Model

The potential output is usually defined as the maximum level of product that an economy could achieve without generating inflationary pressures. Therefore, it is a variable of essential importance for the analytical framework that underlies the formulation, analysis and evaluation of the monetary policy. In general, however, potential output is indirectly introduced in this structure, that is, through estimates of the output gap. In turn, the output gap is defined as the difference between the effective output and the potential output. In this sense, it functions as an indicator of economic fluctuations, the output gap provides policy-makers the opportunity to anticipate potential demand pressures over prices. This analytical framework has been used by the main central banks, and the Central Bank of Brazil is no exception.

The main difficulty in resorting to measures of potential output and output gap lies in the fact that these are not variables which can be directly observed. Thus, in practice there remains the use of statistical and/or economic models to obtain estimates for such variables, which, in general may differ enough from one another, depending on the model. The simplest models are usually the univariate and simply use some statistical filter to extract the potential output and, by residue, the output gap. This approach has the main advantage of the simplicity involved in the estimation process. In turn, the more complex models are multivariate and, besides the statistical filters, comprise some economic foundation and may generate estimates for the potential output and/or for the output gap. The great advantage of this approach lies in the imposition of relations or characteristics of economy.

Faced with the uncertainty surrounding the estimation of variables of such importance for the conduction of the monetary policy, the Central Bank, similar to what occurs in most major economies, uses diverse methods to measure potential output the output gap, as shown in previous reports. However, this Box is intended to present one more methodology, namely, the unobserved component model of, and presents updated estimates for the output gap, calculated according to other methodologies.

Among the univariate methods that measure the output gap, Harvey (1985) and Clark (1987) proposed the model of unobserved components, according to which the output is decomposed into two unobserved variables: potential output (y_t^*) and the output gap (gap_t) [Equation (01)]. In addition, a dynamics is specified for the potential output [Equations (02) e (03)], as well as for the output gap [Equation (04)].¹

$$(01) \quad y_t = y_t^* + gap_t$$

$$(02) \quad y_t^* = y_{t-1}^* + nvly_{t-1}^* + \eta_t$$

$$(03) \quad nvly_t^* = nvly_{t-1}^* + v_t$$

$$(04) \quad gap_t = \varphi_1 gap_{t-1} + \varphi_2 gap_{t-2} + \omega_t$$

The above structure, of which the only observable variable is the output (y_t), can be enriched by including variables that are assumed to contain important information about the output gap and the potential output. This strategy has the advantage of using more information, but, by contrast, it increases the possibility of making mistakes in the specification of the relations between the variables. According to Bjørnland et al. (2006), there is one expanded structure which involves another three observed variables [Equations (05) to (07)]. According to Equation (05), the output growth rate (Dy_t) is equal to the sum of the growth rate in the potential output (Δy_t^*) with the change in the output gap ($gap_t - gap_{t-1}$). Equation (06) links inflation (p_t) and output gap, and can be viewed as a variant of the Phillips Curve. Equation (07) explores the relation between unemployment (u_t) and output gap [Okun Law (1962)] and uses the non-accelerationist rate of unemployment ($unairu_t$) as a latent variable.

1/ The methodology is based on the hypothesis that any observed variable could be written as the sum of two or more non-observed components. Intuitively, such hypothesis would justify itself because the non-observed variables could affect the behavior of observed variables.

$$(05) \Delta y_t = \Delta y_t^* + gap_t - gap_{t-1}$$

$$(06) \pi_t = \phi_{11} \pi_{t-1} + \phi_{12} \pi_{t-2} + \delta_{11} gap_{t-1} + \varepsilon_{2,t}$$

$$(07) u_t - unairu_t = \phi_{21} (u_{t-1} - unairu_{t-1}) + \delta_{21} gap_{t-1} + \varepsilon_{3,t}$$

The temporal evolution of the state variables is described by the set of equations from (08) to (12).²

$$(08) gap_t = \theta_{11} gap_{t-1} + \theta_{12} gap_{t-2} + \xi_{1,t}$$

$$(09) \Delta y_t^* = \theta_{21} \Delta y_{t-1}^* + nvl\Delta y_{t-1}^* + \xi_{2,t}$$

$$(10) nvl\Delta y_t^* = nvl\Delta y_{t-1}^* + \xi_{3,t}$$

$$(11) unairu_t = unairu_{t-1} + nvlunairu_{t-1} + \xi_{4,t}$$

$$(12) nvlunairu_t = nvlunairu_{t-1} + \xi_{5,t}$$

Moreover, in case of observable variables, the set of equations from (05) to (07) can be described in a compacted way using a matrix notation, as seen below (13).

$$(13) \begin{bmatrix} \Delta y_t \\ \pi_t \\ u_t \end{bmatrix} = \begin{bmatrix} 0 & 0 & 0 \\ \phi_{11} & \phi_{12} & 0 \\ 0 & 0 & \phi_{21} \end{bmatrix} \begin{bmatrix} \pi_{t-1} \\ \pi_{t-2} \\ u_{t-1} \end{bmatrix} + \begin{bmatrix} 1 & -1 & 1 & 0 & 0 & 0 & 0 \\ 0 & \delta_{11} & 0 & 0 & 0 & 0 & 0 \\ 0 & \delta_{21} & 0 & 0 & 1 & -\phi_{21} & 0 \end{bmatrix} \begin{bmatrix} gap_t \\ gap_{t-1} \\ \Delta y_t^* \\ nvl\Delta y_t^* \\ unairu_t \\ unairu_{t-1} \\ nvlunairu_t \end{bmatrix} + \begin{bmatrix} 0 \\ \varepsilon_{2,t} \\ \varepsilon_{3,t} \end{bmatrix}$$

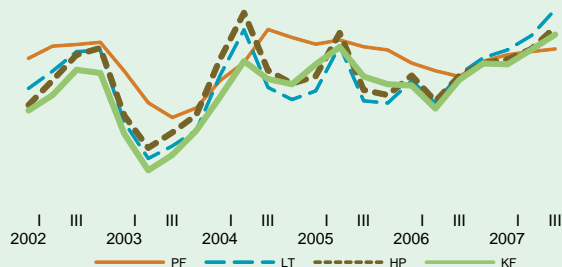
Finally, also in a matrix form, system (14) groups the state equations or transition of the system of equations from (08) to (12).

$$(14) \begin{bmatrix} gap_t \\ gap_{t-1} \\ \Delta y_t^* \\ nvl\Delta y_t^* \\ unairu_t \\ unairu_{t-1} \\ nvlunairu_t \end{bmatrix} = \begin{bmatrix} \theta_{11} & \theta_{12} & 0 & 0 & 0 & 0 & 0 \\ 1 & 0 & 0 & 0 & 0 & 0 & 0 \\ 0 & 0 & \theta_{21} & 1 & 0 & 0 & 0 \\ 0 & 0 & 0 & 1 & 0 & 0 & 0 \\ 0 & 0 & 0 & 0 & 1 & 0 & 1 \\ 0 & 0 & 0 & 0 & 1 & 0 & 0 \\ 0 & 0 & 0 & 0 & 0 & 0 & 1 \end{bmatrix} \begin{bmatrix} gap_{t-1} \\ gap_{t-2} \\ \Delta y_{t-1}^* \\ nvl\Delta y_{t-1}^* \\ unairu_{t-1} \\ unairu_{t-2} \\ nvlunairu_{t-1} \end{bmatrix} + \begin{bmatrix} \xi_{1,t} \\ 0 \\ \xi_{2,t} \\ \xi_{3,t} \\ \xi_{4,t} \\ 0 \\ \xi_{5,t} \end{bmatrix}$$

The model composed by subsystems (13) and (14) is estimated by maximum likelihood using the Kalman Filter admitting that errors ($\varepsilon_{2,t}, \varepsilon_{3,t}, \xi_{1,t}, \xi_{2,t}, \xi_{3,t}, \xi_{4,t}, \xi_{5,t}$) are independent and identically distributed. The sample is made up of quarterly data from the third quarter of 1994 to the second quarter of 2007. The output and

2/ Equation (08) imposes a second order autoregressive process, with mean equals to zero, to the output gap. Equation (09) specifies the growth rate of the potential output as a first order autoregressive process with stochastic drift specified by equation (10). Equation (11) specifies the non-accelerationist rate of unemployment as a random walk with stochastic drift specified by equation (12).

Figure 1 – Output Gap Evolution: 2002-I to 2007-III
 Production Function, Linear Trend, HP Filter and Kalman Filter
 (% per quarter)



unemployment were seasonally adjusted using univariate unobserved component-methods, with seasonal component, as suggested by Harvey (1991).

Figure 1 shows the evolution of the estimate for the output gap. In general terms, the path of the output gap does not significantly diverge from others techniques which have long been used by the Central Bank of Brazil, like for instance, the Hodrick-Prescott filter, the production function and the linear trend function. However, it is to be recognized that, besides supporting the validity of the estimates which had been considered by the Central Bank, the inclusion of other relevant economic variables in the process of measuring the output gap, within the multivariate structure, constitute an important methodological advance. Finally, from another perspective, one should point out that it is noted a straightening of the output gap in the recent past, regardless of the methodology used, a result that is supported by indicators of use of factors of production, such as unemployment rate and capacity utilization.

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Credibility of the Inflation Targeting System in Brazil

Svensson (1993) points to two definitions of credibility that may be associated with the system of inflation targeting: the absolute one and that of expectations. Absolute credibility occurs when the agents believe, with probability 1, that future inflation will stay within the target's tolerance gap. For its part, expectations credibility is verified when the agents believe with probability lower than 1. Roughly speaking, these measures of credibility may be understood as indicators of the confidence that the agents deposit on the monetary policy and, therefore, of the costs associated with the reduction of inflation and/or of its maintenance on levels compatible with the concept of price stability. The issue is so relevant, that in this Box we seek to verify the degree of credibility, absolute or of expectations, of the inflation targeting system in Brazil.

The exercise comprises the carrying of some simple tests suggested by Svensson (1993) to assess the credibility of an inflation targeting system.¹ The sample period goes from January 2003 to October 2007. In order to test the absolute credibility, as well as the expectations credibility, Svensson (1993) builds up higher and lower limits of ex-ante real interest rates that would be compatible with the pre-established tolerance gap. The limits of this gap are obtained as follows: for the higher, one subtracts from the nominal interest rate of fixed-rate bonds, the lower limit of the tolerance gap for the inflation gap; for the lower limit, one subtracts from the nominal interest rates of fixed-rate bonds, the higher limit of the tolerance gap for the inflation target. Following the nomenclature adopted by Svensson (1993), the

^{1/} These are tests in the broad sense of the word, i.e., they are not statistical tests.

gap defined by these limits is denominated ex-ante consistent real interest rates.²

As with the expectations credibility, verification is done via comparison between the ex-post real interest rates linked to fixed-rate bonds and the consistent targets of ex-ante real interest rates. If there is evidence that the ex-post real interest rates are positioned within these targets, then credibility of expectations cannot be rejected. One similar test could be done, for instance, replacing the rates associated to fixed-rate bonds by the rates implicit in futures contracts of interest rates (if available) with maturities similar to those of the pre-established inflation targets.

Figure 1 – Credibility of Expectations: LTN

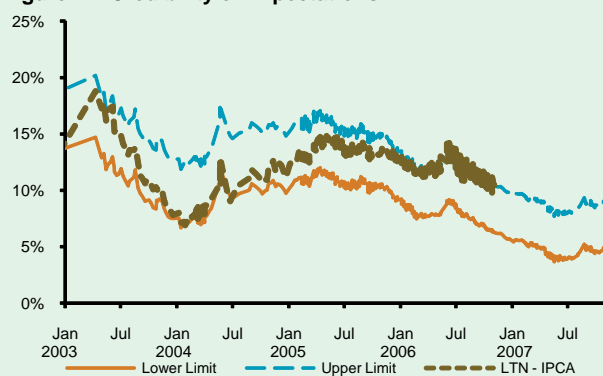


Figure 2 – Credibility of Expectations: Future DI

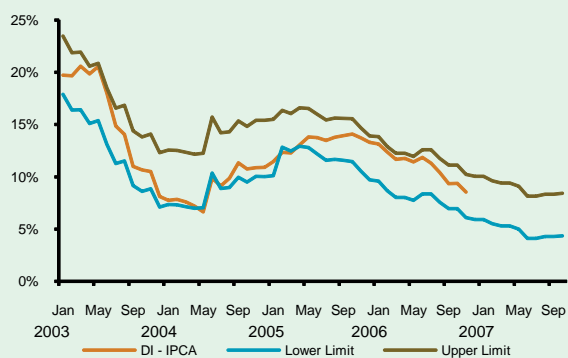


Figure 1 shows the evolution of the consistent targets of ex-ante real interest rate, calculated based on average rates of the primary auctions of National Treasury Bills (LTN).³ Besides, it shows the evolution of the series of ex-post real interest rates associated with these bonds. The average of this series in 2003 was 11.18% p.a. (standard deviation of 2.85% p.a.); from 2003 to 2004, 10.67% p.a. (standard deviation of 2.37% p.a.); from 2003 to 2005, 12.26% p.a. (standard deviation of 2.8% p.a.); and, finally, from 2003 to November 2006, was 12.26% p.a. (standard deviation of 1.88% p.a.). Comparing these rates with the consistent targets of ex-ante real interest rates, one can infer that the credibility of expectations cannot be rejected in the period 2003-2007.

In Figure 2, fixed interest rates associated to LTN are replaced by rates implicit in financial derivatives. In the case of futures contracts of Interfinancial Deposits (DI), with maturity of one year,⁴ one more time the non-rejection of the expectations credibility for period 2003-2007 prevails. In order to verify the robustness of this result, pre and post-fixed interest rates implicit in interest rate swap contracts are calculated according to the flat-forward method

2/ Maturities of fixed-rate bonds must be similar to the maturities of inflation targets.

3/ Initially, annual average rates are obtained from all LTN public auctions with maturity above one year. Later, the higher or lower limits of tolerance gap for inflation target for all the years and corresponding values for each month are found. For the time to maturity elapse of each bond, accumulated higher and lower limits are calculated. Later, these limits are subtracted from the rates of the LTN public auctions.

4/ We built up the series of rates for future DI using the model of Diebold & Li (2006). We defined the yield curve as a sum of three basic movements (level, inclination and, curvature). Each movement is represented by an exponential function. The variables that model the curve variation over time are the coefficients which multiply the exponential movements.

Figure 3 – Credibility of Expectations: Pre-DI Swap

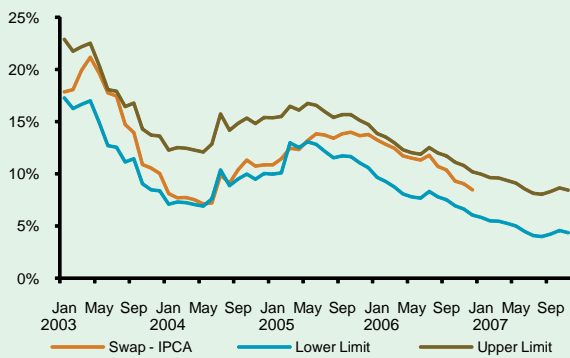


Figure 4 – Absolute Credibility: Median Inflation Expectations

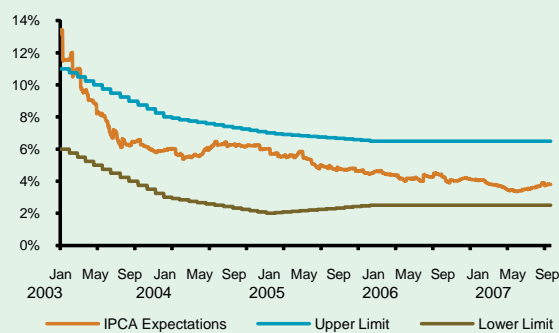
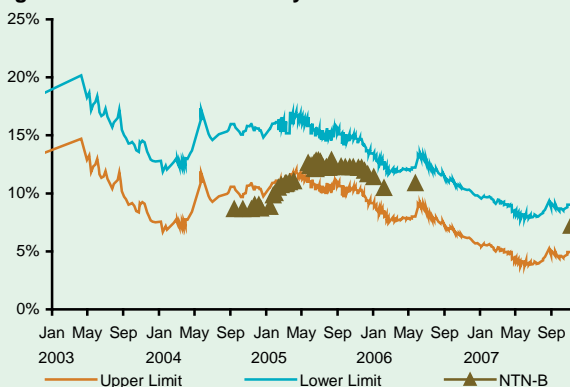


Figure 5 – Absolute Credibility: NTN-B



(constant term rate).⁵ As Figure 3 indicates one cannot reject the expectations credibility.

Based on Figure 4, we can assess the absolute credibility of the system of inflation targeting in Brazil, related to inflation expectations.⁶ Considering that the median of the expectations positioned itself within the tolerance gaps, except in January and February 2003, one cannot reject the absolute credibility in the period 2003-2007. Now on Figure 5, the absolute credibility is assessed by means of the average of real rates of the primary auctions of National Treasury Bills – Series B (NTN-B), beginning September 2004.⁷ In view that, since 2005, the real rates of the NTN-B find themselves within the interval of consistent targets of ex-ante real interest rates, we cannot reject the absolute credibility in the recent past.

In summary, this box presents some exercises that verify the credibility of the inflation targeting system in Brazil, according to the methodology proposed in Svensson (1993). In general, there is strong evidence that the inflation targeting system in Brazil enjoys credibility. At least in part, this credibility results from the fact the monetary policy has been successful in achieving the target for inflation in the last three years. It is also noted that, upon confirming the expectations of market stakeholders, this should happen again in 2007.

References

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5/ The Pre and Post Swap Rates are disclosed by BM&F for maturities of 6, 12 and 24 months. With two of these information, we calculate the pre fixed rate for the period of 252 working days, by the flat-forward methodology (constant term rate). Maturities measured in days of swaps of 6, 12, and 24 months vary. The 12-month swap varies from 243 to 253 working days, for instance. When the one year maturity considered (252 working days) is situated between the swap terms of 6 and 12 months, these are the instruments utilized to find the one year rate. When the one year maturity term (252 working days) is situated between the swaps of 12 and 24 months, these are the instruments considered to find the one year rate.

6/ We obtained the higher and lower limits of annual inflation targets and calculated their monthly values. For each month, we calculated the monthly value for the following twelve months.

7/ We have the average transaction rates of primary NTN-B auctions since September 13, 2004. We select only NTN-B which had a yield to maturity in the primary auction between 1 and 3 years.

Industrial Labor Unit Cost

The job market is a source of key indicators used in the management of the monetary policy, such as the unemployment rate, wage and employment levels and the number of hours worked. Upon analyzing them, central banks face two difficulties. First, they may show conflicting evidence, be it because not all point to the same direction, or because they may evolve with different intensities. Second, even if the indicators point to a common scenario, it is fundamental to assess whether there is in fact some immediate or latent imbalance in the job market, and at which degree. One indicator that has precisely this objective is the employment gap, in which definition is found the concept of the natural rate of unemployment. When the gap is negative (i.e. the unemployment rate is lower than the natural rate of unemployment) inflation tends to rise, and vice-versa.

Despite less known, there is another indicator which also seeks to assess the existence of inflationary pressures derived from the job market: the Unit Labor Cost (CUT). The most used definition of CUT is that given by the ratio between overall nominal labor costs and the real output level, as shown by equation (1).

$$CUT = \frac{C}{y} \quad (1)$$

Where y stands for real output and C stands for total or overall nominal labor costs, which include not only wage costs, but all the costs effectively incurred by the employer in benefit of the employee. That is, besides wages, social security contributions paid by the employer, eventual profit shares, extra worked hours, costs of training and health plans, payroll taxes and any other outlays directly or indirectly linked to the employee. Therefore, CUT shows how much it costs, in terms of labor input, to produce one unit of output.

CUT can be expressed in another – more revealing – way when one divides both the numerator and denominator by the quantity of labor input used in production. For instance, we may divide both by the number of hours worked

$$CUT = \frac{C/H}{y/H} = \frac{h}{A} \quad (2)$$

where h is average total labor cost (per hour worked) and A is labor productivity. Another option would be to divide by the number of workers.

Equation (2) is particularly useful in demonstrating that CUT will rise only if average total labor cost exceeds the per-hour productivity. One implication of this reading is that one cannot infer the consequences of wage increases on inflation just by its magnitude. That is, wage changes *per se* may be a misleading indicator of the emergency of inflationary pressures, as they must be confronted with productivity gains. For example, if wages are rising at a pace apparently incompatible with price stability (increase in h), but whose magnitude is equal or lower than productivity gains (increase equal or higher than A), then there is no inflationary threat stemming from the behavior of labor incomes, since CUT is not rising. This particular definition of CUT stresses wage dynamics (and other labor associated costs), and is quite utilized, for instance, to assess cost competitiveness among countries.

In addition, upon comparing changes in CUT with the inflation rate, one may have an idea if there is any demand pressure derived from the labor market, which may push inflation. For example, if CUT is rising but it is below the inflation rate (i.e. real CUT is falling), inflationary pressures tend to be subdued. On the other hand, if CUT rises above the inflation rate (i.e. real CUT is rising), pressures over inflation deriving from the labor market are expected to emerge. That is, in principle, CUT may be a relevant indicator of inflationary pressures.

The above analysis refers us to a second definition of CUT, shown by equation (3): real CUT (CUTR)

$$CUTR = \frac{c/H}{y/H} = \frac{l}{A} \quad (3)$$

where $c=C/P$ is total real labor costs (i.e. deflated by inflation) and l is the real average total labor cost. Thus, when CUTR is rising it means that the real average total labor cost is rising more quickly than productivity and, therefore, inflationary pressures may be looming ahead.

Note that CUT is a synthetic indicator, as it puts on the same perspective several variables such as labor costs, output level, productivity and inflation, and may be understood as one indicator that aims at summarizing the quality of the economic cycle. If the economy is in an expansionist cycle, but CUT signals possible costs pressures stemming from the labor market, this expansion will probably lead to inflationary pressures and, therefore, will not live long.

It is important to note some limitations of this indicator. For instance, the costs of labor inputs are only one of the costs incurred by the firm during the productive process. For example, another essential cost is that with machinery, equipment and facilities (i.e. fixed capital). In this way, even if CUT is rising, it is possible that the total production costs remain unaltered or even falls. On the other hand, increases in these other costs may engender inflationary pressures even if there is moderation in labor costs.

Figure 1 – Manufacturing Industry: CUT and its Components (YoY)

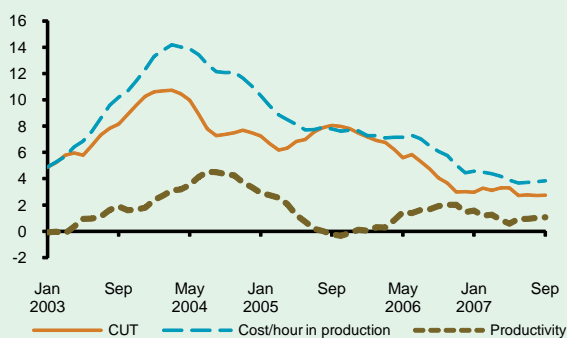


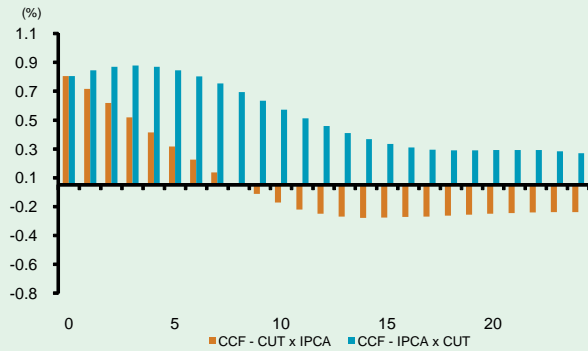
Figure 1 shows the evolution of the CUT changes in twelve months for the manufacturing industry in Brazil since the end of 2002 up to July 2007, as well as its decomposition according to (2). In this case, CUT is defined as the ratio between the manufacturing industry payroll and the seasonally adjusted industrial production, both released by IBGE. Its decomposition is done by dividing both variables by the number of hours worked, released by CNI.¹

Note that, after accelerating at the beginning of the sample, CUT reached growth rates higher than 10% in the first half of 2004, mirroring salary increases above productivity gains, as a consequence of inflation increases that followed the strong exchange

1/ The sample is small, as the current series of the payroll started to be released in December 2000. Note, still, that the monthly figures for December are much higher than those for other months, due to the payment of the so-called 13^o wage. Hence, the value for that month was lessened by calculating the average of the two adjacent months.

rate depreciation in the years 2001 and 2002. After the peak reached in mid-2004, industrial CUT had been falling, but in the last eight months, it stabilized at a level close to that of current inflation in the period. However, despite the recent acceleration of GDP, evidence summarized in this graph suggest that inflationary pressures derived from the labor (industrial) market have not yet emerged.

Figure 2 – Cross Correlogram of CUT and Inflation



In its turn, Figure 2 shows monthly correlations between CUT changes (i.e. percentage difference between the averages of the indices of the last twelve months against the immediately preceding twelve months) and IPCA inflation. Note that the correlations are significant in both directions. However, while the correlation between CUT and inflation lags fall rapidly and ceases to be significant in the fifth lag, the correlation between inflation and CUT lags increases up to the third/fourth lag and begins to decrease afterwards, remaining significant up to the sixteenth lag. That is, there seems to be a temporal precedence between CUT increases and inflation, suggesting that CUT is one leading indicator of inflationary pressures. Note, however, that the higher correlations refer to inflation and changes in CUT two and three months earlier.

One must stress that the above calculated CUT does not reflect developments in the whole economy, but only in the industrial sector. Secondly, inflation is affected by various factors, especially in the short term, like, for instance, supply shocks. Finally, as mentioned, CUT represents only part of the total costs faced by the firm. It is important to highlight, also, that industrial CUT may, eventually, underestimate the aggregated CUT in moments of buoyant domestic demand (like currently experienced by the Brazilian economy), in view that in this sector, in contrast with the services sector, prices and costs tend to be constrained by international competition.

Minutes of the 130th Meeting of the Monetary Policy Committee (Copom)

Date: October 16th, from 3:30PM to 5:42PM, and October 17th, from 4:00PM to 7:00PM

Place: BCB Headquarters meeting rooms – 8th floor on October 16th and 20th floor on October 17th – Brasília – DF

In attendance:

Members of the Committee

Henrique de Campos Meirelles – Governor

Alexandre Antonio Tombini

Antonio Gustavo Matos do Vale

Mário Gomes Torós

Mário Magalhães Carvalho Mesquita

Paulo Sérgio Cavalheiro

Paulo Vieira da Cunha

Department Heads (present on October 16th)

Altamir Lopes – Economic Department

Carlos Hamilton Vasconcelos Araújo – Research Department (also present on October 17th)

Ivan Luis 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 October 16th)

Adriana Soares Sales – Deputy Head of the Research Department

Alexandre Pinheiro de Moraes Rego – Press Secretary

Flávio Pinheiro de Melo – Advisor to the Board

José Linaldo Gomes de Aguiar – Executive Secretary

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 increased 0.18% in September, after reaching 0.47% in August, up from 0.24% in July, totaling 2.99% in the first nine months of 2007, compared to 2.00% in the same period of last year. Twelve-month trailing inflation reached 4.15%, exceeding that of September 2006 (3.70%). The acceleration of consumer price inflation essentially mirrors the behavior of market prices, which have increased more rapidly than regulated prices in 2007, a reversal in the dynamics observed in the recent years. In fact, market prices and regulated prices increased 3.82% and 1.16% in the year through September, and 5.07% and 2.12% in the last twelve months. Despite the BRL appreciation in 2007, amongst market prices, the prices of tradable goods showed the sharpest acceleration. In the twelve months through September, tradable goods inflation totaled 4.92%, up from 0.78% observed in the same period of last year, whereas non-tradable goods inflation reached 5.20%, up from 4.36% in the same period of 2006. Notwithstanding the recent occurrence of inflation developments less benign than previously anticipated, price dynamics still indicates that inflation should continue to evolve according to the targets path.

2. The recent dynamics of IPCA core inflation measures has been in line with headline inflation. The core inflation by exclusion of household food items and regulated prices elevated in August (0.35%, against 0.08% in July), but decelerated in September (0.25%). Similarly, smoothed and non-smoothed trimmed means core inflation measures increased in August (0.40% and 0.43%, against 0.20% and 0.17% in July, respectively) and decelerated in September (0.34% and 0.19%, respectively). Nevertheless, core inflation by exclusion of household food items and regulated prices shows stability in the year through September (2.70%, against 2.67% in 2006), and in the last twelve months as well (3.60% against 3.65% in 2006). On its turn, smoothed trimmed means core inflation decelerated both year-to-date and on a twelve-month trailing basis (2.81% against 3.62%; and 3.82% against 5.21%, respectively). Finally, non-smoothed trimmed means core inflation increased year-to-date (2.44% against 2.18% in 2006), but retreated on a twelve-month trailing basis (3.03% against 3.53% in 2006). It is noteworthy that, in all cases, twelve-month inflation stood below the central target, but shows acceleration, which is relevant in the cases of the core inflation by exclusion and non-smoothed trimmed means core, relative to the record lows observed in previous months.

3. The General Price Index (IGP-DI) inflation accelerated in August (1.39%) and in September (1.17%) relative to the previous months. As a result, in the year through September, IGP-DI inflation increased 4.44%, up from 2.11% in the same period of last year. On a twelve-month trailing basis, inflation measured by IGP-DI totaled 6.16%, up from 3.16% in 2006. This increase reflects not only the behavior of the Consumer Price Index-Brazil (IPC-Br), which totaled 4.50% up from 2.51%, but also of the IPA-DI, whose variation totaled 6.92%, up from 3.13%. On its turn, despite at higher levels, inflation as measured by the Civil Construction National Index (INCC) showed stability in the last twelve months (5.05% against 5.09% in the same period of 2006). Regarding wholesale price inflation, it is relevant to highlight that agricultural prices strongly rallied, reaching 19.50% in the last twelve months, versus 1.98% in the same period of 2006. Conversely, industrial prices behaved positively in the period, recording 3.07%, down from 3.48% in September of last year,

but significantly accelerated in the August-September period, compared to the previous two-month period, when had registered slight deflation. As highlighted in previous Copom Minutes, the effects of wholesale prices over consumer inflation will depend on current and prospective demand conditions and price-setters' expectations for the future inflation path.

4. On a three-month moving average basis, according to data seasonally adjusted by the IBGE, industrial output grew 0.7% in July and August, after increasing 0.9% in June, confirming the solid expansion of this sector. Still considering the seasonally adjusted series, after the 0.4% fall observed in July, the first decrease after nine consecutive positive figures, industrial output resumed growth, reaching 1.3% in August. This expansion suggests that the retreat in industrial output in July was punctual. Industrial output in August records a 6.5% robust growth in year-over-year terms, the thirteenth consecutive expansion under this basis. Therefore, industrial output grew 5.3% in year-to-date terms, and 4.5% on a twelve-month trailing basis, showing acceleration at the margin. Moreover, still considering the last twelve months through August, manufacturing industry production reached 4.4%, while mining industry production expanded by 6.2%. For September, the leading and coincident indicators available point to the continuity of the industrial production expansion cycle, which will be favored by the several stimulus factors that influence economic activity, including the monetary easing already implemented.

5. Among the use categories, it bears emphasizing the strong monthly expansions of capital goods production and durable consumer goods production, which increased 4.0% and 2.7%, respectively, in August, on a month-on-month basis, according to data seasonally adjusted by the IBGE. In year-to-date terms, the strong increases in capital goods production (17.6%) and durable consumer goods production (6.9%) should also be highlighted. The strength of durable consumer goods production reflects, predominantly, the remarkable improvement in credit conditions, when compared to historical patterns. The accelerated expansion of capital goods production is, to a large extent, due to the consolidation of positive prospects for the continuity of domestic demand

growth, which has reflected both the improvement of income and the expansion of credit, underpinned by the perception of higher macroeconomic stability. Furthermore, it bears emphasizing the contribution of other specific factors, such as investment resumption in the agricultural and live stock sector. Compared to August 2006, the production of the majority of industrial sectors surveyed (22 out of 27) expanded in August, with highlights to the increase in the production of machinery and equipment (18.2%) and vehicles (17.5%).

6. Labor market continues to present fairly positive developments. The unemployment rate in the six main metropolitan regions covered by the Monthly Labor Survey (PME) stood at 9.5% in August, unchanged month-on-month. However, the unemployment rate significantly decreased 1.1 p.p. in August, year-over-year, the seventh consecutive fall according to this comparison basis, so that in year-to-date terms it stood 0.5 p.p. below the observed in the same period of last year. The purchasing power of employed workers decreased month-on-month 0.5% in August, the third consecutive monthly fall. However, it increased 1.2% relative to the same month last year, and 3.8% in the first eight months of the year. As a consequence, real payrolls expanded by 6.8% in the year through August, compared to the same period of last year, a key driver for sustained aggregate demand growth. According to the National Industry Confederation (CNI) data seasonally adjusted by the BCB, manufacturing employment increased month-on-month 0.4% in August and 3.8% compared to August 2006. Regarding formal employment, data from the Ministry of Labor and Employment (MTE) confirm the continuity of strong expansion. In September, job creation grew month-on-month seasonally adjusted 0.5%, expanding by 5.0% in the year through September and 4.9% in the last twelve months, with highlights to employment expansions in the construction industry (7.2%) and in the retail sector (6.0%). These figures corroborate the creation of 1.6 million formal jobs in the year through September and 1.5 million formal jobs in the last twelve months.

7. In line with the positive developments in labor market, and with the expansion of credit, retail sales continue to record positive performance, indicating

that the pace of domestic demand growth remains robust, and consistent signs of cooling cannot be perceived. In fact, retail sales increased 0.5% month-on-month in July, the seventh consecutive expansion, according to data seasonally adjusted by the IBGE. In the first seven months of 2007, relative to the same period of last year, retail sales grew by 9.7%, and in the last twelve months, by 8.7%. Compared to the same month of 2006, retail sales increased by 9.2% in July. According to the same comparison basis, it bears emphasizing the expansion in the sales of furniture and domestic appliances (18.2%), and fabric, clothing and shoes (10.4%). These developments confirm the view expressed in previous Copom Minutes that both the expansion of income and the improvement of consumer credit conditions are crucially important to the strengthening of aggregate demand growth. In fact, expanded retail sales, which include the sales of construction material and vehicles, motorcycles, parts and pieces, grew by 13.3% in July, compared to the same month of 2006. For the next quarters, it is expected the strengthening of retail sales, further boosted by the increase in real payroll and credit and by the recovery of consumer confidence, which so far has not been affected by the higher volatility in financial markets.

8. The installed capacity utilization rate in the manufacturing industry reached 83.6% in August, a record high for the series calculated by the CNI. The August result stood 1.7 p.p. above the rate observed in the same month of 2006, recording the thirteenth consecutive expansion under this basis. In the year through August, the average installed capacity utilization rate stood 1.8 p.p. above the observed in the same period of 2006 and 1.2 p.p. above the rate observed in the same period of 2005 and 2004. Such increase reflects, unmistakably, economic activity acceleration and occurs in several sectors, despite the strong expansion of investment. In fact, in the year through August, the absorption of capital goods grew 18.6%, and reflects the significant increase in capital goods imports (33.0% in volume), as well as in capital goods production (17.6%). Moreover, in the same period, the production of construction inputs increased 4.2%. The most recent data indicate that although investment has contributed to dampen the process of elevation of capacity utilization rates, it has not been

sufficient to avoid its persistence at relatively high levels, which coincided, in the past, with periods of inflation acceleration. In light of the recent behavior of capacity utilization rates, the expansion of investment, as well as the timely maturity of projects, which may increase the productive capacity of economy, will be fundamental to avoid relevant mismatches regarding the evolution of aggregate supply and demand. As stressed in previous Copom Minutes, the inflation trajectory is closely linked to current and prospective developments with regard to the expansion of supply of goods and services to adequately meet demand conditions.

9. The trade balance continues to present robust performance in 2007, despite the deceleration at the margin, confirming the evaluations reported in Inflation Reports and previous Copom Minutes about important structural changes in the Brazilian foreign trade. In the year through September, the trade surplus reached US\$30.9 billion, a 9.6% decrease relative to the same period of 2006. Exports rose 15.5%, to US\$116.6 billion, while imports increased 28.3%, to US\$85.7 billion. As stressed in previous Copom Minutes, imports have been growing more rapidly than exports, due not only to the strengthening of the BRL, but also, and mainly, to the higher level of economic activity in the country. The current account surplus reached US\$5.6 billion in the year through September and US\$9.0 billion in the last twelve months, or 0.75% of GDP.

10. Although the most intense effects of the crisis in the US subprime mortgages market over financial markets seem to have exhausted, uncertainties remain. On the one hand, several volatility and risk aversion indicators improved significantly since the last Copom meeting. On the other hand, neither has the situation in the interbank markets of the mature economies reached normality, nor have the developments of this crisis over real economy completely materialized. The magnitude of the crisis is not completely known – especially the effects over the US economic growth and, to a lesser extent, over the European economies. Notwithstanding the remaining difficulties in financial markets and the uncertainties regarding global economy developments, the recovery in risk appetite has been relatively fast, including that regarding Brazilian assets. In fact, the price behavior of Brazilian assets

in the last episode of stress in international financial markets, similarly to the observed in February and in March this year, and in May and June 2006, evidences the consolidation of international investors confidence in the Brazilian economy. The main central banks reacted to the financial turbulence providing liquidity in the interbank market and, in the case of US, easing the monetary policy aiming at minimizing the risk that the impact of the real state sector over credit would lead to a more pronounced economic deceleration. On its turn, inflation expectations in the US (derived from financial assets) slightly increased in the last weeks, reacting to the weakening of the US dollar vis-à-vis the main currencies and to the upward trend in the prices of raw materials. In short, the long monetary tightening cycle comes to an end in the US, and the current debate seems to be centered in the duration and magnitude of additional reductions in the interest rates. In Europe and in the major Asian countries, economic activity continues to record robust expansions, despite the increase in the risk of deceleration, caused by the uncertainties regarding the US domestic macroeconomic scenario, the impact of difficulties of real state market over financial institutions and credit conditions in these regions. In this context, it bears emphasizing that the current vigor of emerging economies has importantly counterbalanced the economic deceleration in the US. The Brazilian economy, specifically, does not seem to have significantly been impacted by the recent turmoil, and should continue its growth trajectory, essentially sustained by domestic demand, in the upcoming quarters.

11. Oil prices, a systematic source of international uncertainty, which remained at historically high levels in the last months, had important additional increase since the last Copom meeting. This behavior reflects not only structural shifts in global energy markets, but also geopolitical tensions, which recently intensified. Despite the significant uncertainties surrounding the expectations about the future trend for oil prices, the main scenario considered by the Copom, which attributes no change to domestic gasoline prices in 2007, remains plausible. The prices of other commodities have also presented high volatility in the last weeks, driven by the heightened uncertainty about the prospects for global growth and by the turmoil on global markets. Nevertheless, the main raw material

price indices have presented an upward trend in the last weeks. In this context, the strong acceleration of food prices in several countries should be highlighted, which has made the control of inflation by several central banks a more difficult task.

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 September Copom meeting, the projection for gasoline and bottled gas prices adjustments in 2007 were both maintained at 0%;

b) The projections for electricity price adjustments in 2007 remained at -4.4%, the same considered in the September Copom meeting, while the projections for fixed telephone price adjustments for the same year were modified to 2.3%, down from 2.8%;

c) The projection for regulated prices inflation in 2007 was modified to 2.9%, down from 3.2%, considered in the September Copom meeting. These items, according to the weights released by the IBGE, represent 30.66% of the total September IPCA;

d) The projection for regulated prices inflation in 2008 was also maintained, at 4.5%. This projection is based on the endogenous determination model for regulated prices. This model considers the effects of seasonal components, exchange rate changes, 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, estimates a -8 bps spread, under the benchmark scenario, in the fourth quarter of 2007, reaching 47 bps in the last quarter of 2008. The identified shocks and their impacts were reassessed according to newly available information.

13. Regarding fiscal policy, it is assumed that the consolidated public sector primary surplus target of 3.8% of GDP in 2007 and 2008 will be achieved, adjusted by the possibility of a 0.45 p.p. reduction in

this percentage due to the implementation of the PPI (Investment Pilot Program). The related assumptions considered in the previous meeting were maintained.

14. Since the September Copom meeting, median IPCA inflation expectations for 2007, compiled by the BCB's Investor Relations Group (Gerin), slightly decreased to 3.91%, down from 3.92%. This reduction was mainly driven by the addition of the September inflation result, below market expectations. Twelve-month ahead inflation expectations reached 3.83%, down from 3.87%, considering the composition of monthly inflation market expectations. For 2008, inflation expectations increased to 4.1%, up from 4.0% projected on the eve of the last Copom meeting.

15. Considering the hypotheses under the benchmark scenario – which assumes the maintenance of the Selic rate at 11.25% and the exchange rate at R\$1.80/US\$ during the forecast period – the projection for the 2007 IPCA decreased compared to the value considered at the September Copom meeting, and remained below the 4.5% target established by the CMN for the year. According to 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 – IPCA inflation forecast for 2007 remained stable compared to the value considered at the September Copom meeting, and therefore, remain below the central target for the year. Both the projections for 2008 based on the benchmark scenario and on the market scenario decreased compared to the value considered at the September Copom meeting, and remain below the 4.5% target established for 2008.

Monetary policy decision

16. The Copom reaffirms the view expressed in previous Minutes, that in addition to containing short-term inflationary pressures, monetary policy has also contributed significantly for the consolidation of a favorable long-term macroeconomic environment. Economic activity data indicate that the pace of demand expansion remains robust, and may increase the probability of significant inflationary pressures on short-term inflation. Investment

expansion and imports growth have contributed to retard this process, limiting potential inflationary effects stemming from aggregate demand sustained growth. Moreover, despite uncertainties regarding the continuity of strong growth in the international economy and the heightened volatility in global markets in the last months, the prospects for Brazilian external financing in the forecast period suggest, according to the information available until now, that the balance of payments should not present a risk to the inflation scenario. On the other hand, some recent evidences point to an intensification of the risks on the global inflation outlook, as suggested by the evolution of some raw materials prices. Therefore, although inflation prospects remain in line with the targets path, additional uncertainty surrounds this outlook. As in recent meetings, the Copom emphasizes that the main challenge of the monetary policy in this context is to guarantee the consolidation of positive developments anticipated for the future.

17. The Copom evaluates that the probability that emerging local inflationary pressures will represent risks to domestic inflation trajectory has increased, because the heated demand can increase the pass-through of wholesale prices over consumer price inflation. Additionally, although the external sector can restrain the inflationary pressures in the tradable sector, the heated domestic demand can trigger inflationary pressures in the non-tradable sector. The Copom also observes that even though the upward movement of IPCA inflation expectations for 2008 has stabilized over the recent weeks at a level below the target established for 2008, this process must be carefully monitored. In this context, 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, 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 the persistence of a cautious monetary policy stance has been critical to increase the probability that inflation will continue to evolve according to the targets path. For this to materialize, however, it is important that forward-looking inflation indicators, in particular the expected dynamic of aggregate supply and demand, remain consistent with the recent benign inflation outlook observed in the last quarters.

19. The Committee 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 850 b.p., with the bulk of the reduction concentrated in the last nine months. Consequently, neither has the activity level completely mirrored the effects of the interest rates cuts yet, nor have the effects of the economic activity on inflation 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, credit growth and payroll expansion should continue to bolster economic activity. As mentioned in recent Copom Minutes, activity level should also reflect the effects of governmental transfers and other fiscal impulses expected for the next quarters of the year and for 2008. 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. These issues become even more relevant considering the clear signs of heated aggregate demand, and the fact that the monetary policy decisions will have limited effects in 2007 and predominant impacts in 2008.

21. The Copom recognizes the contribution of investment, enlarging the productive capacity, and of the external sector to mitigate inflationary pressures, but evaluates that the pace of domestic demand expansion, which should continue to be sustained by factors such as the impulse derived from the monetary

policy easing implemented this year, may bring non-insignificant risks to the inflationary dynamics.

22. Aiming at consolidating a stable and predictable environment, the Copom has privileged a strategy to avoid a volatile inflationary trajectory. This strategy takes into consideration the lags in the transmission mechanisms and has been the most adequate to deal with the uncertainty inherent to the process of monetary policy formulation. That is the reason why variables such as inflation projections, the balance of risks associated to the prospective scenario and the preventive stance in the decision-making process of the Copom are so important. Prudence assumes an even more important role in this process, like at the current moment, when the deterioration of the balance of inflationary risks reduces the safety margin of the monetary policy.

23. Under this context, considering the uncertainties associated with both the transmission mechanisms of the monetary policy and the prospective growth pace of aggregate supply and demand, the Copom decided to pause the monetary policy easing process. This decision aims to preserve the gains in inflation control and to ensure that the strengthening of economic activity continues to be underpinned by solid fundamentals. Therefore, the Committee unanimously decided to maintain the Selic target rate at 11.25% p.a., without bias.

24. Under the inflation-targeting regime, the Copom decides according to inflation prospects, the analysis of several alternative scenarios for the evolution of the main variables that determine price prospective dynamics and its balance of risks. Domestic demand continues to expand vigorously, backing-up economic activity strength. This expansion encompasses some sectors little exposed to external competition, at a time when the effects of important incentive factors, such as the monetary easing already implemented, are still not fully perceived. In spite of not being an imminent threat to inflation prospects, the contribution of the external sector to the maintenance of a benign inflationary scenario may become less effective, at a moment when the effects of investment over the productive capacity of the economy still need to consolidate. In such environment, the monetary authority must

remain vigilant, so that short-term uncertainties do not contaminate longer time horizons.

25. At the conclusion of the meeting, it was announced that the Copom would reconvene on December 4th 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. The IPCA increased 0.18% in September, down from 0.47% in August, totaling increases of 2.99% in the year through September and 4.15% in the last twelve months. The IPCA deceleration was mainly driven by the price behavior of food and beverages, which increased 0.44%, down from 1.39% in August, contributing 0.09 p.p. for the index, in comparison to 0.3 p.p. in the previous month. Conversely, housing, health and personal care and clothes registered higher rates than in the previous month. It also bears emphasizing the downturn in the prices of communication, mainly the 1.01% decline in fixed telephone tariffs, after a 1.14% increase in August.

27. Market prices inflation increased 0.28% in September, down from 0.62% in August, while regulated prices inflation totaled -0.04%, down from 0.12%, in the same period. On a twelve-month trailing basis, market prices increased 5.07%, and regulated prices, 2.12%. Among market prices, the prices of non-tradable goods increased 5.20%, while the prices of tradable goods totaled 4.92%, according to the same comparison basis.

28. The several IPCA core inflation measures declined on a month-on-month basis and showed relative stability on a twelve-month trailing basis. The smoothed trimmed means core rose 0.34% in September, down from 0.40% in August. In the last twelve months, the change totaled 3.82%, against 3.80% in August. The non-smoothed trimmed means core reached 0.19%, down from 0.43% in August, totaling 3.03% in the last twelve months through September, up from 2.94% in the last twelve months through August. Finally, the core excluding

household food and regulated prices reached 0.25% in September, down from 0.35% in August, totaling 3.60% in the last twelve months through September, compared to 3.58% in August.

29. The IPCA diffusion index, which indicates the proportion of items with positive change in the month result, stood at 56.77% in September, compared to 63.28% in August and 58.13% in 2007 average terms.

30. The IGP-DI increased 1.17% in September, down from 1.39% in August, totaling 4.44% in the year through September and 6.16% in the last twelve months. Considering the index components, the IPA-DI and the IPC-Br decelerated in September, while the INCC accelerated. The IPA-DI increased 1.64%, down from 1.96% in August, reaching 4.79% in the year through September and 6.92% in twelve months. The inflation measured by the IPC-Br totaled 0.23% month-on-month in September, down from 0.42%, totaling 3.46% in the year through September and 4.50% in the last twelve months. The INCC increased 0.51%, up from 0.26% in August, reflecting the increase in the prices of materials and services, while the cost of labor was almost unchanged month-on-month. In the year through September, the INCC increased 4.62% and in the last twelve months, 5.46%.

31. The lower change of IPC-Br in September was driven by the price deceleration in many items, mainly food, which increased 0.19% in September, down from 0.99% in August. The IPC-Br core inflation measure increased 0.24%, down from 0.37% in August, totaling 2.55% in the year through September and 3.31% in the last twelve months.

32. The deceleration of IPA-DI in September reflected the lower change in industrial and agricultural prices. The agricultural IPA elevated 5.27%, down from 6.15% in August, while the industrial prices increased 0.41%, down from 0.61%, according to the same comparison bases. The main drivers for upward agricultural price pressures in September were the prices of soy, corn, fruit and legumes, perishable milk and wheat. The deceleration in the agricultural IPA stemmed mainly from the prices of perishable milk and poultry, the downturn in the prices of

bovines and the recurrent fall in the price of sugar cane, compared to the previous month. Among the prices of industrial products, it bears emphasizing the increase in the prices of mining industry products and fertilizers and the fall in the prices of non-ferrous metals.

Economic activity

33. According to IBGE's monthly survey (PMC), retail sales increased month-on-month seasonally adjusted 0.5% in July. Among the activities included in the general indicator, only the sales of hyper- and super-markets, food products, beverages and tobacco expanded on month-on-month basis. Sales of vehicles and motorcycles, parts and pieces, which are not part of the general retail sales index, grew 0.6% in the month. Regionally, 9 out of 27 Federation units reached positive results in July.

34. Retail sales expanded by 9.2% in July, year-over-year, driven by increases in all its components segments, mainly in furniture and home appliances (18.2%) and textiles, clothing and shoes (10.4%). Expanded retail sales increased 13.3%, with highlights to the 22.8% expansion in the sales of vehicles and motorcycles, parts and pieces.

35. Retail sales performance reflects the continuity of payroll growth and better credit conditions, together with the impacts of social programs and the recovery of the agricultural sector. Retail sales increased 9.7% in the first seven months of 2007, compared to the same period of 2006, while expanded retail sales, which include vehicles, motorcycles, parts and pieces and construction material, increased by 13.6%. It bears emphasizing the increase in the sales of vehicles (22.9%) and furniture and domestic appliances (16.7%), in the same period. On a regional basis, all states but Piauí recorded growth in retail sales in 2007, with the most significant expansions in the Northeastern and Northern regions.

36. According to São Paulo Trade Association (ACSP) data, related to the city of São Paulo and seasonally adjusted by the BCB, the consultations to the Usecheque system decreased by 1.7% in September, while the database consultations for credit sales increased 0.4%, on a month-on-month basis. In

the year through September, these indicators rose by 5.4% and 5.5%, respectively.

37. Regarding investment indicators, construction inputs production and capital goods production increased month-on-month seasonally adjusted 0.1% and 4% in August, respectively, while the imports of capital goods expanded by 12.2%. In the year through August, these indicators increased by 4.2%, 17.6% and 33%, in the same order. Considering the domestic production of capital goods during this period, it bears emphasizing the increases of 42.5% in the production of capital goods for agriculture; 19.7% for energy; 19.1% for serial industrials, 15.9% for construction and 15.3% for transportation.

38. Industrial production increased month-on-month 1.3% in August, according to IBGE's Monthly Industrial Survey (PIM) seasonally adjusted data, reaching a new record high in the historical series and evidencing the punctual aspect of the fall observed in July. Industrial production rose by 6.5%, compared to August 2006, and expanded by 5.3% in the year through August and 4.5% in the last twelve months.

39. Considering seasonally adjusted data, manufacturing and extractive industry production increased 1.5% and 0.1%, respectively, in the month. All use categories increased in the month: capital goods production, 4.0%; durable consumer goods production, 2.7%; intermediate goods production, 0.9%; and non-durable goods production, 0.6%. In the year through August, capital goods production led industrial expansion, increasing by 17.6%, followed by durable consumer goods production (6.9%), intermediate goods production (4.2%), and non-durable consumer goods production (3.2%).

40. The disaggregated analysis of industrial activity showed that, in August, seventeen out of the 26 activities with seasonally adjusted series increased, with highlights to food, vehicles, machines and equipment, and electronic material and communication equipment. The main negative drivers stemmed from the decreases in the edition and printing sector and pharmaceutical industry.

41. Still regarding the industrial sector, according to CNI data seasonally adjusted by the BCB, real

industrial sales and hours worked in production increased month-on-month 1.6% and 0.4%, respectively, in August. In the year through August, these indicators increased by 4.3% and 3.8%, respectively, compared to the same period of 2006. Installed capacity utilization reached 82.5% in August, up from 82.3% in July, after seasonal adjustment. Considering observed data, installed capacity utilization reached 83.6% in the month, 1.7 p.p. above the August 2006 level.

42. Vehicles production reached 252.8 thousand units in September, according to Anfavea. Total production increased 0.2% month-on-month, according to data seasonally adjusted by the BCB, and 23.9% compared to the same month of 2006. Considering the seasonally adjusted series, domestic sales and exports decreased 8.4% and 0.8%, in September, respectively. Compared to the data of the first nine months of 2006, vehicles production increased 10.6% in 2007, and domestic sales, 22.5%, while exports decreased 7.9%. Still according to Anfavea, the production of agricultural machines and trucks increased 34.9% and 26.2%, respectively, according to the same comparison basis, reflecting the agricultural sector recovery and investments increase.

43. According to IBGE, the September estimate for the grains harvest pointed to lower growth in 2006/2007, year-over-year, compared to the August estimate, overall due to the reduction of around 508 tons (1%) in corn estimate production, which exceeded the little increases in the forecasted production of other grains. National production of grains (cereals and legumes) may reach 133.3 million tons, 14% above the previous year harvest, due to good weather conditions and the production incentive stemming from the increase in the international prices of agricultural products. Compared to the 2005/2006 harvest, the most significant increases should occur in the production of wheat (62.1%), cottonseed (32.9%), corn (21.3%) and soy (11.3%), while the most prominent decreases should happen in the production of rice and beans (3.7% and 1.8%, respectively). Considering other agricultural products, in addition to grains, the IBGE pointed to a 15.3% decrease in coffee production and a 12.9% increase in sugar-cane production.

Surveys and expectations

44. The Fecomercio-SP monthly survey showed a 1.2% increase in the Consumer Confidence Index (ICC) in September, month-on-month. Among the two ICC components, the Current Economic Conditions Index (Icea) increased month-on-month 3.5%, while the Consumer Expectation Index (IEC) decreased 0.4%. In September, for the ninth consecutive month, the Icea remained above the IEC. Compared to September 2006, the ICC and the Icea increased 0.5% and 13.3%, respectively, while the IEC decreased 7.3%.

45. According to the FGV survey, which encompasses two thousand homes in the seven main state capitals of the country, the ICC remained almost stable in September (109 points compared to 109.3 points in August). This result was due to the combination of less favorable assessments regarding current situation and more optimistic expectations for the next months. Compared to September 2006, the ICC increased 5.7%, with expansions of 5% in the current situation index and 6.1% in the expectations index.

46. Still according to the FGV, the Industry Confidence Index (ICI) increased to 123.1 in September 2007, up from 121.9 in August, reaching a new record high of the series begun in April 1995. The ICI increased 11.9% compared to September 2006 and expanded by 11.8% in the year through September, compared to the same period of 2006. Among the ICI issues related to the current situation, the most significant increase in the last twelve months was due to the assessment on the demand level, mainly influenced by the domestic market. Regarding the expectations for the next three months, 37% of the companies foresee increase in personnel hirings, while 6% forecast reduction. The installed capacity utilization reached 86.1% in September, compared to 84.6% in the same month of 2006.

Labor market

47. According to the Ministry of Labor and Employment, 133.3 thousand new formal jobs were created in August, a 0.5% increase month-on-month. All the main sectors presented positive changes, except for agriculture and live stock sector, which

reflected the inter-harvest period in the Middle-South period of the country. After the seasonal adjustment of the series, the employment index in August increased month-on-month 0.4%. In the year through September, 1.6 million jobs were created, a 5% elevation relative to the same period of 2006, with highlights to the higher volume of hirings in the services sector. In relative terms, it bears emphasizing the expansions of construction and manufacturing industries (4.9% and 7%, respectively).

48. According to the IBGE employment survey (PME) in the six main metropolitan areas of the country, the unemployment rate, in August, remained at 9.5%. The stability of the unemployment rate reflected the increases of 1% in employed population and 1.1% in economically active population (PEA). Considering the population employed in the private sector, there was a 1.7% increase in the month, due to the 2.5% expansion in the number of formal workers and the 0.7% reduction in the number informal workers. The number of employers increased 10.3%, while self-employed workers decreased 1.2%. In the year through August, the number of employed workers expanded 2.9%, mainly due to the increases of 4.5% in the number of formal workers and 5% in number of self-employed workers.

49. According to the same survey, real average earnings reached R\$1,109.40 in August, decreasing 0.5% month-on-month. Compared to August 2006, real average earnings increased 1.2% and, in the year through August, the expansion reached 3.8%. Real payroll, the result of the average earnings times the number of occupied workers, grew 0.6% in the month, increasing by 4.1% year-over-year.

50. According to CNI data seasonally adjusted by the BCB, manufacturing employment increased 0.4% in August, month-on-month. In the year through August, this indicator expanded by 3.6%, while real manufacturing payroll raised 4.8%.

Credit and delinquency rates

51. Credit operations in the financial system reached R\$841.5 billion in August, or 33.1% of GDP. In the month, the expansion reached 2.9%, increasing 14.9% in the year through August and

24.8% in the last twelve months. Earmarked credit operations increased 2.3% in the month and 16.6% in the last twelve months, while the non-earmarked ones expanded by 3.1% and 28.6%, in the same periods. Among non-earmarked credit operations, it bears emphasizing the twelve-month trailing leasing operations again, due to the expansions of 79.8% and 70.5% in credit to individuals and credit to corporate, respectively. Regarding earmarked credit, the most significant expansions in the last twelve months are related to housing (22.6%) and the agricultural sector (20.6%). Among agricultural sector credit operations, although it still represents a small share, it bears emphasizing the 50.6% growth in credit destined to cooperatives in this period. Considering credit operations by economic activity, loans to industries, other services and commerce increased above the overall average in August. Credit operations to individuals, equivalent to 34.2% of the total, increased by 2.7% in the month and continued to record the most significant increases in the year and on a twelve-month trailing basis (22% and 30%, respectively).

52. Non-earmarked credit, used as reference for interest rates, reached 35.7% p.a. in August, a record low for the historical series, standing 6.2 p.p. below the rate recorded in August 2006. The average rate for individuals decreased to 46.6% p.a. in August, down from 53.9% p.a. in the same month of 2006. The average rate for corporate decreased 4.8 p.p. in twelve months, reaching 23.1% p.a.

53. The average tenure of credit operations for individuals reached 414 days in August, compared to 344 in the same month of the previous year. The average tenure of personal credit operations totaled 441 days, a 90-day extension relative to August 2006, reflecting the increasing share of payroll-deducted contracts. In addition, it bears emphasizing the elevation of the twelve-month trailing average tenure of real estate financing and vehicles acquisition operations, which reached 1833 days and 571 days, up from 1403 days and 517 days, respectively.

54. Delinquency rates in the financial system (non-earmarked loans in arrears for more than ninety days) remained unchanged at 4.7% in August

relative to the two previous months, and 0.3 p.p. below the August 2006 rate. Delinquency rate for corporate credit operations remained unchanged at 2.4% and decreased 0.2 p.p. in the last twelve months. Delinquency rate for credit operations with individuals reached 7.2% in August, 0.4 p.p. below the same month of 2006.

55. Net delinquency rate for retail credit, measured by the ACSP, reached 5.2% in September, compared to 5.1% observed in the same month of 2006 and to the 5.3% average rate in 2006.

External environment

56. International financial market business overcame the stress levels that characterized the operations in July and August, momentarily absorbing the exacerbations provoked by the crisis in the US subprime mortgage market. After the central banks interventions through open market operations, providing short term funding in order to regulate the liquidity and reduce the interest rates volatility, it bears emphasizing the actuation of the Federal Reserve Bank (Fed), in its meeting on September 18, in which the Fed funds target was reduced for the first time since June 2003. The 50-basis-point reduction, followed by the same cut in the rediscount rate, contributed to the improvement of the financial conditions in several assets markets, although there is no consensus about the intensity of this crisis effects over the US real economy and, consequently, over the global economy.

57. The recovery in the prices of commodities reinforces the uncertainties regarding inflationary pressures triggered by energy and food prices. The recent falls in consumer confidence indexes already capture the feeling of these effects over consumption intentions. Despite the current contraction of inflation in developed countries, the central banks still worry about these inflationary risks and will gradually return to prioritize inflation combat in their monetary policies stance.

Foreign trade and international reserves

58. Between January and September 2007, Brazilian external trade confirmed the ongoing expansion,

reaching record highs in exports and imports. In the year through September, the trade surplus reached US\$30.9 billion, accumulating US\$43.2 billion in the last twelve months, while the external trade totaled US\$202.3 billion and US\$263.7 billion, respectively, in the same periods. In the first two weeks of October, the trade balance reached US\$1.5 billion, with exports reaching US\$6.4 billion (daily average of US\$705.9 million), and imports, US\$4.8 billion (daily average of US\$534.4 million).

59. In September, exports reached US\$14.2 billion, reaching a US\$745.6 million daily average record, 18.6% above the observed in the same month of 2006. The exports of manufactured products totaled US\$7.6 billion, recording a US\$402.6 million daily average, 22.2% above the observed in the same month of the previous year. The exports of basic products totaled US\$4.4 billion, and of semi-manufactured products, US\$1.8 billion, with respective increases of 16.8% and 8.9% in daily average values, which reached record levels for the three products categories.

60. Imports totaled US\$10.7 billion in September, with record daily average value of US\$562.9 million, 38.8% above the observed in the same month of 2006. All products categories expanded according to the same comparison basis: fuels and lubricants (60%); capital goods (49%); consumer goods (32.2%); and raw materials and intermediate goods (30.1%). Regarding this group, it bears emphasizing the acquisitions of primary food products, mineral, chemical and pharmaceuticals products, and transportation equipment accessories. Regarding the consumer goods segment, the main increases were observed in vehicles imports (72%), clothing and furniture. Amongst the imports of capital goods, it bears emphasizing the acquisition of industrial machines, machines and equipments for office and scientific service, and parts and pieces for capital goods.

61. International reserves totaled US\$163 billion in September, with increases of US\$1.9 billion in the month and US\$77.1 billion in the year.

Money market and open market operations

62. Since the September Copom meeting, the future

interest rates decreased, especially in longer terms. This movement was mainly due to the improvement in external financial markets conditions and the reduction in the risk aversion, after the Federal Open Market Committee (FOMC) decision to reduce the US economy basic interest rate by 0.50 p.p. The BRL appreciation also contributed to the interest rates decrease in the period. Between September 3 and October 15, one-, three- and six-month rates decreased, respectively, 0.14 p.p., 0.10 p.p. and 0.09 p.p. One-, two- and three-year rates decreased 0.15 p.p., 0.44 p.p. and 0.46 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 reduced to 7.06% on October 15, down from 7.31% on September 3.

63. On September 25, the BCB carried out reverse FX swap auctions amounting US\$2.2 billion, with the total rollover of the October 1st redemption.

64. In its open market operations, the BCB carried out, from September 4 to October 15, weekly five- and seven-month long fixed rate repo operations. The average daily balance of these operations reached R\$92.2 billion, of which R\$65.9 billion were seven-month operations. In the same period, the BCB conducted 24 borrowing and one lending overnight repo operations. The BCB also conducted daily liquidity management operations with tenures up to two working days. Operations with tenors less than thirty days, including daily liquidity management operations, averaged R\$13.3 billion, borrowing. In addition, on September 6 and October 1st, the BCB conducted borrowing operations with tenures of 28 and 12 working days, amounting R\$75.4 billion and R\$37.8 billion, respectively.

65. Between September 4 and October 15, the National Treasury raised a total of R\$56.0 billion, of which R\$20.9 billion in fixed-rate securities: R\$16.3 billion via issuance of LTNs maturing in 2008, 2009 and 2010, and R\$4.6 billion in NTN-Fs maturing in 2011, 2013 and 2017. Issuance of LFTs totaled R\$19.6 billion, for securities maturing in 2010, 2011 and 2013. Issuance of inflation-linked NTN-Bs reached R\$15.5 billion, for securities maturing in 2009, 2012, 2017, 2024, 2035 and 2045,

of which R\$5.7 billion were settled in other National Treasury securities.

66. In the same period, the Treasury conducted auctions to sell LTNs maturing in April, July and October 2008 and bought LTNs or NTN-Fs, both

maturing in January 2008, totaling R\$5.4 billion. The Treasury also conducted auctions to sell LFTs maturing in 2010, 2011 and 2013, totaling R\$4.8 billion, receiving LFTs maturing in 2007 as payment, and to buy LTNs and NTN-Bs, totaling R\$2.9 billion and R\$53 million, respectively.

Minutes of the 131st Meeting of the Monetary Policy Committee (Copom)

Date: December 4th, from 5:20PM to 7:20PM, and December 5th, from 5:30PM to 7:20PM

Place: BCB Headquarters meeting rooms – 8th floor on December 4th and 20th floor on December 5th – Brasília – DF

In attendance:

Members of the Committee

Henrique de Campos Meirelles – Governor
Alexandre Antonio Tombini
Antonio Gustavo Matos do Vale
Mário Gomes Torós
Mário Magalhães Carvalho Mesquita
Paulo Sérgio Cavalheiro
Paulo Vieira da Cunha

Department Heads (present on December 4th)

Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on December 5th)
João Henrique de Paula Freitas Simão – Open Market Operations Department
Luiz Fernando Cardoso Maciel – 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 December 4th)

Adriana Soares Sales – Deputy Head of the Research Department
Alexandre Pinheiro de Moraes Rego – Press Secretary
Alexandre Pundek Rocha – Advisor to the Board
Flávio Pinheiro de Melo – Advisor to the Board
Katherine Hennings – Advisor to the Board
Sergio Almeida de Souza Lima – Executive Secretary

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 increased 0.30% in October, up from 0.18% in September, totaling 3.30% in the year through October, compared to 2.33% in the same period of last year. Twelve-month trailing inflation reached 4.12% in October, up from 3.26% in the same period of 2006. The acceleration of consumer price inflation essentially mirrors the behavior of market prices, which have increased more rapidly than regulated prices in 2007, a reversal in the dynamics observed in the recent years. In fact, market prices and regulated prices increased 4.24% and 1.20% in the year through October, and 5.05% and 2.04% in the last twelve months. Despite the BRL appreciation in 2007, amongst market prices, the prices of tradable goods showed the sharpest acceleration. In the twelve months through October, tradable goods inflation totaled 4.47%, up from 0.77% observed in the same period of last year, whereas non-tradable goods inflation reached 5.60%, up from 4.49% in the same period of 2006. Notwithstanding the recent occurrence of inflation developments less benign than previously anticipated, price dynamics still indicates that inflation should continue to evolve according to the targets path.

2. Similarly to headline inflation, the three IPCA core inflation measures accelerated in October. The core inflation by exclusion of household food items

and regulated prices and smoothed and non-smoothed trimmed means core inflation measures increased 0.40%, 0.43% and 0.35% in October, up from 0.25%, 0.34% and 0.19% in September. It bears emphasizing that headline inflation acceleration in the year was followed by only one of the three core inflation measures. Core inflation by exclusion of household food items and regulated prices shows slight increase in the year through October (3.11%, against 2.97% in 2006), smoothed trimmed means core inflation decelerated (3.25%, against 3.95% in 2006) and the non-smoothed trimmed means core inflation increased more significantly (2.79%, against 2.37% in 2006). On a twelve-month trailing basis, despite remaining below the central target, all inflation core measures accelerated in October, compared to September, standing at levels remarkably higher than the record lows reached in previous months.

3. The General Price Index (IGP-DI) inflation dampened in October (0.75%) after reaching high rates for two consecutive months (1.17% in September and 1.39% in August), but increased again in November (1.05%). As a result, IGP-DI inflation increased 6.32% in the year through November, up from 3.52% in the same period of last year. On a twelve-month trailing basis, inflation measured by IGP-DI totaled 6.60%, up from 3.59% in 2006. The strong IGP-DI increase reflects both the behavior of the Consumer Price Index – Brazil (IPC-Br), which totaled 4.53% in the last twelve months through November, up from 1.88% in the same period of 2006, and also of the IPA-DI, whose variation totaled 7.51%, up from 4.04% in the same periods, respectively. The Civil Construction National Index (INCC) increased 5.92% (5.05% in the same period of 2006), suggesting some persistence of inflation as measured by the INCC. Regarding agricultural IPA, prices reached 18.93% in the twelve months through November (16.72% in October). On its turn, industrial prices continue to present less unfavorable behavior, but also record significant acceleration in the last twelve months (3.76%, up from 2.71% in 2006) and higher monthly rates since August. As highlighted in previous Copom Minutes, the effects of wholesale prices over consumer inflation will depend on current and prospective demand conditions and price-setters' expectations for the future inflation path.

4. On a three-month moving average basis, according to data seasonally adjusted by the IBGE, industrial output grew 1.2% in October, the fourteenth consecutive expansion according to this comparison basis, an evidence of the solid performance of industrial sector. Still considering the seasonally adjusted series, after the 0.6% fall observed in September, industrial output recorded 2.8% robust growth month-on-month in October and 10.3% compared to October 2006. On a twelve-month trailing basis, industrial output grew 5.3%, and in the year through October, 5.9%. On its turn, manufacturing industry production reached 5.2% in the last twelve months (5.9% in 2007), while mining industry production expanded by 6.1% (5.6% in 2007). For November, statistical adjustments due to the lesser number of working days, compared to the same month of previous years, could determine the retreat of the industrial production index. However, the trend points to the continuity of the industrial production expansion cycle, which will continue to be favored by the several incentive factors that influence economic activity, such as employment and credit expansion, the monetary easing already implemented, the fiscal impulse and, in some sectors, the reduced inventory levels.

5. Among the use categories, the production of intermediate goods increased by 2.7% in October, of capital goods, 1.8%, and of consumer goods, 1.5%, according to data seasonally adjusted by the IBGE. The acceleration of intermediate goods production can be, to some extent, associated to signs of inputs shortage, as shown by the Manufacturing Industry Outlook Survey, carried out by the Getúlio Vargas Foundation (FGV). The dynamism of durable consumer goods production, which expanded 8.7% in 2007, reflects, predominantly, the remarkable improvement in credit conditions, when compared to historical patterns. Regarding capital goods production, the 18.8% steady expansion in 2007 (16.9% in the last twelve months) is, to a large extent, due to the consolidation of positive prospects for the continuity of domestic demand growth, which has reflected both the improvement of income and the expansion of credit, underpinned by the perception of macroeconomic stability consolidation. Finally, it bears emphasizing that 75% of the industrial activities surveyed by the IBGE expanded in October.

6. Labor market continues to present favorable developments. The unemployment rate in the six metropolitan regions covered by the Monthly Labor Survey (PME) maintained a downward trend and reached 8.7% in October, 1.1 p.p. below that observed in 2006, and a record low for the month reached after the methodological recalculation of the survey (May 2002). Therefore, in the year through October the average unemployment rate stood 0.6 p.p. below that observed in the same period last year. The unemployment rate seasonally adjusted by the BCB also reduced, reaching 8.9%, a record low for the series. After retreating for three consecutive months, the purchasing power of workers increased month-on-month 0.3% and 0.5% in September and October, respectively, and 2.5% and 1.2% compared to the same months last year. As a consequence, real payrolls expanded by 6.4% in the year through October, compared to the same period of last year, a key driver for sustained aggregate demand growth. According to the National Industry Confederation (CNI) data seasonally adjusted by the BCB, manufacturing employment increased month-on-month 0.5% in October and 4.6% compared to October 2006. Regarding formal employment, data from the Ministry of Labor and Employment (MTE) confirm the continuity of strong expansion. In October, job creation grew month-on-month seasonally adjusted 0.6%, expanding by 5.0% both in the year through October and in the last twelve months, with highlights to employment expansions in the construction industry (7.5%) and in the retail sector (6.0%). In absolute terms, the creation of formal jobs exceeds 1.8 million in the year through October and 1.5 million in the last twelve months.

7. In line with the positive developments in labor market, and with credit expansion, retail sales continue to record positive performance, indicating that the pace of domestic demand growth remains robust, and signs of cooling cannot be perceived. Retail sales increased month-on-month 1.1% in August and 1.4% in September, according to data seasonally adjusted by the IBGE, a record high for the series initiated in 2000. Compared to the same month of 2006, retail sales increased by 10.3% in August and 8.5% in September. In the year, retail sales grew robustly by 9.6%, and in the last twelve months, by 8.9%. The steady growth of retail sales in the year

reflects the performance of both the sectors more sensitive to income and employment expansions and those more sensitive to credit conditions. In fact, in the year through September, it bears emphasizing the expansion in the sales of “furniture and domestic appliances” (16.3%), and “fabric, clothing and shoes” (10.1%). Amongst expanded retail sales, which include the sales of “vehicles, motorcycles, parts and pieces” and “construction material”, the strong growth of the first group should be highlighted (22.9% in the year). For the next quarters, the continuity of the current expanding cycle is expected, whose boosting factors will continue to be employment and income growth, credit expansion and the increase in consumer confidence.

8. The installed capacity utilization rate in the manufacturing industry reached an 83.1% record high in October (82.3% in September), according to CNI data seasonally adjusted by the BCB. Without the seasonal adjustment, the rate stood 2.2 p.p. above the level registered in the same month of 2006, while the average installed capacity utilization rate in the year through October reached 1.7 p.p. above the observed in the same period of 2006, and 0.9 p.p. and 1.5 p.p. above the average rates registered in the same periods of 2004 and 2005, respectively. The reduction of idle capacity occurs in several sectors, despite the significant increase of investment. Indeed, in the year through October, the absorption of capital goods increased firmly (20.9%), due to the significant growth of capital goods imports (35.3% in volume), as well as of capital goods production (18.8%). Furthermore, the production of construction inputs increased 5.0% in the year through October, and shows acceleration at the margin. The most recent data indicate that although investment has been contributing to soften the elevation of capacity utilization rates, it has not been sufficient to stop this process. Considering the recent behavior of capacity utilization rates, the acceleration of investment projects, and particularly their timely maturation, will be crucial to avoid relevant mismatches regarding the evolution of aggregate supply and demand. As stressed in previous Copom Minutes, the inflation trajectory is closely linked to current and prospective developments related to the expansion of supply of goods and services, to adequately meet demand conditions.

9. The trade balance continues to present robust performance in 2007, despite the expected deceleration at the margin, in line with the evaluations present in Inflation Reports and previous Copom Minutes about important structural changes in the Brazilian foreign trade. In the year through November, the trade surplus reached US\$36.4 billion, a 12.1% decrease relative to the same period of 2006. Exports and imports rose to US\$146.4 billion and US\$110.0 billion, equivalent to 16.6% and 30.8% growth, respectively, compared to the same period of 2006. As highlighted in previous Copom Minutes, imports have been growing faster than exports, both due to the strengthening of the BRL and to the robust economic activity in the country. The current account surplus reached US\$5.6 billion in the year through October and US\$7.4 billion in twelve months (0.6% of GDP).

10. Regarding the external scenario, high uncertainties still remain, particularly concerning the effects of the crisis in the US subprime mortgages market over global economic activity, as well as over the international financial market. Volatility and risk aversion indicators worsened again since the last Copom meeting. Despite recently issued data were, to some extent, positive, economic activity in Europe and in the US is expected to slow down. Consequently, the scenario points out to an easing monetary stance in mature economies, at different paces in each region. On the other hand, strong economic growth of main Asian emerging economies, which were apparently little affected by the US mortgage crisis, as well as the strength and steadiness of current expansion of other emerging economies, even under increasing inflationary pressures and tight monetary cycles, have been fundamental factors to offset the effects of US economic deceleration. The Brazilian economy, more specifically, does not seem to have been significantly affected by the recent turmoil, and should sustain its growth trajectory, essentially driven by domestic demand.

11. Oil prices, a systematic source of international uncertainty, not only remained at historically high levels but also continued highly volatile. This behavior reflects, in addition to structural changes in global energy markets, recurrent geopolitical tensions. Despite the significant uncertainties inherent to expectations about the future trend for oil

prices, the main scenario considered by the Copom remains plausible, in which domestic gasoline prices remain unchanged in 2007. However, apart from the trajectory of domestic gasoline prices, one should recognize that the elevation of international oil prices impacts the domestic economy, both through productive chains, such as the petrochemical, as well as by the deterioration of inflation expectations. The prices of other commodities have also presented high volatility in the last months, reflecting the increased uncertainty about the prospects for global demand growth and the turmoil on global financial markets. In this context, the strong acceleration of food prices in several countries should also be highlighted, as it makes the control of inflation by several central banks a more difficult task.

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 October Copom meeting, the projections for gasoline and bottled gas prices adjustments in 2007 were both maintained at 0%;

b) Considering the previous meeting, the projections for electricity and fixed telephone prices adjustments in 2007 were changed to -6.0% and 0.8%, respectively;

c) The projection for regulated prices variation in 2008 remained at 4.5%, unchanged relative to the October meeting. This projection is based on the endogenous determination model for regulated prices, which computes seasonal components, exchange rate changes, market prices inflation and the IGP variation;

d) The projection for the spreads over the Selic rate, using a Vector Autoregressive model based on the Selic and 180-day swap rates, estimates a -1 bps spread in the fourth quarter of 2007, under the benchmark scenario. The swap rate trajectory points to a 47bps spread in the last quarter of 2008. The identified shocks and their impacts were reassessed according to newly available information.

13. Regarding fiscal policy, the projections assume the achievement of the 3.8% target for the consolidated public sector primary surplus in 2007 and 2008, adjusted by the possibility of a 0.45 p.p. reduction in this percentage due to the implementation of the PPI (Investment Pilot Program). The related assumptions considered in the previous meeting were maintained.

14. Since the October Copom meeting, median IPCA inflation expectations for 2007, compiled by the BCB's Investor Relations Group (Gerin), slightly increased to 3.96%, up from 3.91%. This elevation was due to the addition of the October inflation result and the raise of expected inflation in December. Twelve-month ahead inflation expectations changed more significantly, to 3.95%, up from 3.83%, considering the composition of monthly inflation market expectations. For 2008, inflation expectations remained at 4.10%.

15. Considering the hypotheses under the benchmark scenario – which assumes the maintenance of the Selic rate at 11.25% and the exchange rate at R\$1.80/US\$ during the forecast period – the projection for the 2007 IPCA increased compared to the value considered at the October Copom meeting, but remained below the 4.5% target established by the CMN for the year. According to 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 – IPCA inflation forecast for 2007 also increased compared to the value considered at the October Copom meeting, but remains below the central target for the year. The projection for 2008 based on both the benchmark and the market scenarios also increased in relation to the October meeting, but both remained below the 4.5% target.

Monetary policy decision

16. The Copom reaffirms the view expressed in previous Minutes, that in addition to containing short-term inflationary pressures, monetary policy has also contributed significantly for the consolidation of a favorable long-term macroeconomic environment. Economic activity data indicate that the intensity of demand expansion continue quite robust and can increase the probability of important pressures

over inflation in the short-run. However, imports growth and the benign investment behavior, which continues to expand robustly, have contributed to slow down this process. Moreover, despite uncertainties regarding the continuity of the rapid growth recorded in the international economy in the last years and the volatility increase observed in global markets in the last months, the prospects for Brazilian external financing in the forecast period suggest, according to newly available information, that the balance of payments may not represent imminent risk to the inflation scenario. On the other hand, the relevant inflation increase both in mature and emerging economies in recent months evidences the intensification of the inflationary risks on the global outlook. Therefore, although inflation prospects remain in line with the targets trajectory, additional uncertainties surround the inflation path. The Copom emphasizes that the main challenge of monetary policy in this context is to guarantee the maintenance of positive results reached in the last years.

17. The Copom evaluates that the probability that emerging local inflationary pressures will represent risks to the domestic inflation trajectory has increased, because the heated demand and market of factors can increase the pass-through of wholesale prices over consumer price inflation. The Committee understands that the prospects for this pass-through, as well as for the generalization of the pressures initially focused on consumer price inflation, depend mostly on inflation expectations, which remain carefully monitored. Additionally, although the external sector can restrain the inflationary pressures in the tradable sector, the heated domestic demand can trigger inflationary pressures in the non-tradable sector, for instance, such as in the services sector. In this context, 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, as well as inflation expectations within the forecast period, 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. As a consequence of this improved perception, the scope for a reduction in real interest rates in the future will naturally follow. The Copom evaluates that the persistence of a cautious monetary policy stance has been critical to increase the probability that inflation will continue to evolve according to the targets path. For this to materialize, however, it is important that forward-looking inflation indicators, in particular the expected dynamic of aggregate supply and demand, evolve in a harmonic way.

19. The Committee 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 850 b.p., with the bulk of the reduction concentrated in the last nine months. Consequently, neither has the activity level completely mirrored the effects of the interest rates cuts yet, nor have the effects of the economic activity on inflation completely materialized. Therefore, the evaluation of alternative monetary policy stances should necessarily focus on the forward-looking inflation scenario and its risks, instead of current inflation indicators.

20. During the coming months, credit growth and payroll expansion should continue to bolster economic activity. As mentioned in recent Copom Minutes, activity level should also reflect the effects of the possibly more intense expansion of governmental transfers and other fiscal impulses expected for the next quarters. 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. These issues become even more relevant considering the clear signs of heated aggregate demand, and the fact that the monetary policy decisions will have effects as of 2008.

21. The Copom recognizes the important contribution of investment to expand productive capacity. This factor, together with the external sector, has helped to mitigate inflationary pressures. However, the

Copom evaluates that the pace of domestic demand expansion, which should continue to be sustained, among other factors, by the impulse derived from the monetary policy easing implemented this year, may bring non-insignificant risks to the inflationary dynamics. In this context, the consistent reduction of the mismatch between the rhythm of expansion of supply of goods and services and demand is even more relevant to the assessment of possibilities of monetary policy stance.

22. Aiming at consolidating a stable and predictable environment, the Copom adopts a strategy to avoid a volatile inflationary trajectory. This strategy takes into consideration the lags in the transmission mechanisms and has been the most adequate to deal with the uncertainty inherent to the process of monetary policy formulation and implementation. That is the reason why variables such as inflation projections, the balance of risks associated to the forward-looking scenario and especially the preventive stance in the decision-making process of the Copom are so important. Prudence assumes an even more important role in this process, like at the current moment, when the deterioration of the balance of inflationary risks reduces the safety margin of the monetary policy.

23. In this context, considering the uncertainties associated with both the transmission mechanisms of the monetary policy and the prospective growth pace of aggregate supply and demand, the Committee unanimously decided to maintain the Selic target rate at 11.25% p.a., without bias. This decision aims to preserve the gains in inflation control and to ensure that the strengthening of economic activity continues to be underpinned by solid fundamentals.

24. Under the inflation-targeting regime, the Copom decides according to inflation prospects, the analysis of several alternative scenarios for the evolution of the main variables that determine price prospective dynamics and its balance of risks. Domestic demand continues to expand vigorously, backing-up economic activity dynamism, including sectors little exposed to external competition, at a time when the effects of important incentive factors, such as the monetary easing already implemented, are still not fully perceived. The contribution of the external sector

to a benign inflationary scenario may become less effective, at a moment when the effects of investment over productive capacity of the economy still need to consolidate. In such environment, the monetary authority must remain vigilant to avoid that short-term uncertainties contaminate longer time horizons. If the risk profile change and imply shifts in the inflation prospective scenario, the Committee will promptly adjust the monetary policy stance to the circumstances.

25. At the conclusion of the meeting, it was announced that the Copom would reconvene on January 22nd 2008, for technical presentations, and on the following day, to discuss the monetary policy decision, as established in Communiqué 16,051 of September 3rd, 2007.

Summary of data analyzed by the Copom

Inflation

26. The IPCA-15 increased 0.23% in November, down from 0.24% in October and 0.29% in September, totaling increases of 3.64% in the year through November and 4% in the last twelve months. Food and beverage prices increased 0.25% in November, down from 0.54% in October, mainly due to the retreat in the prices of milk and its by-products (-6.32%), contributing -0.15 p.p. for the headline IPCA-15 result. This effect offset the increases in prices of beans and bovines, 18.59% and 3.01% respectively. In the other groups, it bears emphasizing the acceleration in the prices of clothing, 0.74%, up from 0.41% in October, and the increases, higher than the headline index, in the prices of personal outlays and health and personal care, 0.48% and 0.35% respectively, in November, up from 0.45% and 0.40% in October.

27. Market prices inflation increased 0.29% in November, down from 0.32% in October, while regulated prices inflation totaled 0.09%, up from 0.06%, in the same periods. On a twelve-month trailing basis, market prices increased 4.84%, and regulated prices, 2.14%. Among market prices, the prices of non-tradable goods increased 5.44%, while the prices of tradable goods totaled 4.18%, according to the same comparison basis.

28. The several IPCA-15 core inflation measures increased in November, both on a month-on-month basis and on a twelve-month trailing basis. The smoothed trimmed means core rose 0.37% in November, up from 0.35% in October. In the last twelve months, the change totaled 3.80%, against 3.70% in October. The non-smoothed trimmed means core reached 0.29% in November, up from 0.24% in October, totaling 3.15% in the last twelve months through November. Finally, the core excluding household food and regulated prices reached 0.33% in November, up from 0.28% in October, totaling 3.65% in the last twelve months.

29. The IGP-DI increased 1.05% in November, up from 0.75% in October, totaling 6.32% in the year through November and 6.6% in the last twelve months. Considering the three index components, only the INCC decelerated in November. The IPA-DI increased 1.45%, up from 1.02% in October, reaching 7.4% in the year through November and 7.51% in twelve months. The inflation measured by the IPC-Br totaled 0.27% month-on-month in November, up from 0.13%, totaling 3.87% in the year through November and 4.53% in the last twelve months. The INCC increased 0.36%, up from 0.51% in October, accumulating 5.53% in the year through November and 5.92% in the last twelve months.

30. The higher change of IPC-Br in November was driven by the acceleration in food prices (0.25%, up from 0.19% in October), health and personal care (0.25%, up from 0.06%), and clothing (1.3%, up from 1.21%). The IPC-Br core inflation measure increased 0.25%, up from 0.24% in October, totaling 3.05% in the year through November and 3.37% in the last twelve months.

31. The acceleration of IPA-DI in November reflected the higher change in agricultural prices. The agricultural IPA elevated 4.32%, up from 2.73% in October, while industrial prices increased 0.41%, stable relative to October. The main drivers for upward agricultural price pressures in November were the prices of corn (0.42 p.p.), bovines (0.38 p.p.), soy (0.31 p.p.), and beans (0.2 p.p.). In spite of the higher IPA change, it is important to highlight the 9.55% fall in the prices of perishable milk in November. Amongst industrial prices, it bears emphasizing the increase in

the prices of fuel oil (0.1 p.p.) and moisturized ethylic alcohol (0.1 p.p.), and the 0.07 p.p. fall in the prices of non-ferrous metals.

Economic activity

32. According to IBGE's monthly survey (PMC), retail sales increased month-on-month seasonally adjusted 1.4% in September. Among the activities included in the general indicator, sales of hyper- and super-markets, food products, beverages and tobacco expanded on month-on-month basis (3%), as well as furniture and home appliances (0.1%). Sales of vehicles and motorcycles, parts and pieces, which are not part of the general retail sales index, decreased 1.1% in the month. Regionally, 22 out of the 27 Federation units reached positive results in September.

33. Retail sales expanded by 8.5% in September, year-over-year, driven by increases in all its components segments, mainly in office material and equipment, computers and communication (30.4%), and furniture and home appliances (12.7%). Expanded retail sales, which include the activities vehicles and motorcycles, parts and pieces, and construction material, increased 11.9%, with highlights to the 19.8% expansion in the sales of automotive sector.

34. Retail sales performance reflects the continuity of payroll growth, better credit conditions, the impacts of social programs and the recovery of the agricultural sector. Retail sales increased 9.6% in the first nine months of 2007, year-over-year, while expanded retail sales increased by 13.6%. It bears emphasizing the increase in the sales of vehicles (22.9%) and furniture and domestic appliances (16.3%), in the same period. On a regional basis, retail sales grew in all states but Piauí in 2007, with the most significant expansions in the Northeastern region, mainly due to the impact of the Federal Government social programs.

35. According to São Paulo Trade Association (ACSP) data, related to the city of São Paulo and seasonally adjusted by the BCB, the consultations to the Usecheque system and database consultations for credit sales increased by 1.2% and 0.7% in November, respectively, on a month-on-month

basis. Compared to the same month last year, these indicators rose by 7.1% and 7.3%, respectively.

36. Regarding investment indicators, the production of construction inputs and capital goods production increased month-on-month seasonally adjusted 2.6% and 1.8%, respectively, in October. Compared to October 2006, the expansions reached 10.2% for construction inputs production and 26.8% for capital goods production and accumulate increases of 5.0% and 18.8%, respectively, in the year through November, compared to the same period of the previous year.

37. Imports of capital goods decreased 5% in October, seasonally adjusted, after significant expansion of 15.3% in the previous two-month period. Actually, in August and September, imports of capital goods increased 49.4% and 48.6%, respectively, year-over-year. In October, imports of capital goods increased 38.5%, according to the same comparison basis, and in the year through October, the expansion reached 35.3%, which demonstrate the strong growth of these imports, reflecting the favorable conditions for investment expansion in Brazilian economy in 2007.

38. According to IBGE's Monthly Industrial Survey (PIM), industrial production increased month-on-month seasonally adjusted 2.8% in October, after decreasing 0.6% in the previous month. On a seasonally adjusted three-month moving average basis, industrial production increased 1.2%, the highest growth rate since June 2005. Compared to October 2006, industrial activity increased 10.3%, accumulating 5.9% in the year through October and 5.3% in twelve months.

39. The comparison between October and September seasonally adjusted data reveals generalized growth among use categories. Intermediate goods production increased 2.7%, followed by the production of capital goods (1.8%); durable consumer goods (1.4%) and semi and non-durable consumer goods (1.3%). In the year, the production of capital goods production grew 18.8%, recording a two-digit expansion since the beginning of 2007. For the other categories, the expansions were: durable consumer goods (8.7%), intermediate goods (4.3%) and semi and non-durable consumer goods (3.0%).

40. In the industrial sector, hours worked in production increased 0.3% and real industrial sales increased 1.3% in October, compared to the previous month, according to CNI statistics seasonally adjusted by the BCB. In the year, these indicators increased, respectively, 4.0% and 4.7%, compared to the same period of 2006. Installed capacity utilization reached 83.1% in October, up from 82.3% in September, seasonally adjusted. Considering observed data, the utilization level reached 84.3% in the month, 2.2 p.p. above the October 2006 level. According to FGV data, in November, the industrial installed capacity utilization reached 87.2%, up from 84.7% in the same month of 2006.

41. Vehicles production reached 299.3 thousand units in October, a new monthly record, according to Anfavea. Total production increased 9.0% month-on-month, according to data seasonally adjusted by the BCB, and 31.6% compared to the same month of 2006. Domestic sales increased 4.7% seasonally adjusted, while exports grew 19.4%. Compared to the first ten months of 2007, vehicles production increased 12.8% in 2007, and domestic sales, 25.0%, while exports decreased 6.4%. Still according to Anfavea, the production of agricultural machines increased 37.8%, in the same period, while trucks production grew 29.0%, reflecting the recovery of agricultural income in the current harvest and investments increase in the sector.

42. According to IBGE, the October estimate for the grains harvest pointed to a 13.9% increase in 2007, compared to 2006. National grains production – cereals and legumes – may reach 133.3 million tons, due to favorable weather conditions and the incentives stemming from the elevation of international agricultural prices, mainly corn and soy. Considering other agricultural products, in addition to grains, the IBGE pointed to a 16.0% decrease in coffee production, mainly driven by the biennial periodicity of the harvest, and to a 13.1% increase in sugar cane production, reflecting the 10.5% expansion of the planted area, motivated by the increasing interest in alcohol production. In October, the IBGE carried out the first prognosis of planted area and production for the 2008 harvest, including Southeast, South and Middle-West regions and the states of Rondônia, Maranhão,

Piauí and Bahia. The initial estimate for 2008 grains production reached 137.1 million tons, 2.9% above the 2007 estimate.

Surveys and expectations

43. The Fecomercio-SP monthly survey showed a 2% increase in the Consumer Confidence Index (ICC) in November, month-on-month. Both components of ICC registered positive changes in the month: the Consumer Expectation Index (IEC) increased 1.8%, and the Current Economic Conditions Index (Icea), 2.2%. Compared to November 2006, the ICC and the Icea increased 1.5% and 19.6%, respectively, while the IEC decreased 9.3%.

44. According to the FGV survey, the ICC increased month-on-month 1.3% in November, reaching a record high for the series begun in September 2005. This result reflected the 4.3% increase in the Current Situation Index (ISA), while the Expectations Index (IE), which measures the expectations for the next six months, decreased 0.2%. Compared to November 2006, the ICC grew 4.6%, with increases of 7.3% in ISA and 3.1% in IE.

45. Still according to FGV, the Industry Confidence Index (ICI) decreased to 121.3 in November down from 123.4 in October. Compared to November 2006, the ICI increased 14.1% and expanded by 12.1% in the year through November, year-over-year.

46. According to the October FGV Manufacturing Industry Survey – Special Issues, 53% of the consulted companies affirmed that they intend to raise investments in 2008, up from 38% in October 2006, regarding 2007 investments. The current survey also showed increase in labor force hiring, compared to last year (46%, up from 40%). Regarding the revenues for the next year, the 2008 forecast pointed out that 75% of the companies foresee sales real growth, up from 71% in the October 2006 survey.

Labor market

47. According to the Ministry of Labor and Employment, 205 thousand new formal jobs were

created in October. In the year through October, 1,812 thousand jobs were created, a 6.6% elevation relative to the same period of 2006. As a consequence, employment grew 5.0% in the period, year-over-year, with expansion in all the main sectors of economic activity, with highlights to the 7.5% increase in the construction sector and 6.0% in the retail sector. Employment also grew 0.6% month-on-month seasonally adjusted in October, with expansion in all sectors.

48. According to the IBGE employment survey (PME) in the six main metropolitan areas of the country, the unemployment rate, in October, reached 8.7%, down from 9.0% in the previous month. The retreat of the unemployment rate reflected the 0.2% increase in employed population and 0.1% decrease in economically active population (PEA). In the year through October, the average unemployment rate stood at 9.6%, down from 10.2% in the same period of 2006, with elevations of 2.9% in the number of occupied workers and 2.2% in PEA. The number of workers employed in the private sector increased 0.6% in the month, due to the expansions of 0.7% in the number of formal workers and 0.5% in the number of informal workers. The number of employers decreased 1.8%. In the year through October, the average number of employed workers reached 2.9%, mainly due to the increases of 4.9% in the number of formal workers and 4.7% in the number of self-employed workers.

49. According to the same survey, real average earnings reached R\$1,123.60 in October, increasing 0.5% month-on-month. Compared to October 2006, real average earnings increased 1.2% and, in the year through October, the expansion reached 3.4%. Real payroll grew 0.8% month-on-month and 4.4% year-over-year, accumulating a 6.4% increase in the year through October.

50. According to CNI data seasonally adjusted by the BCB, manufacturing employment increased 0.5% in October, month-on-month. In the year through October, this indicator expanded by 3.7%, while real manufacturing payroll raised 5.2%.

Credit and delinquency rates

51. Credit operations in the financial system increased by 2.7% in October, expanding 20.2% in the year through October and 26.3% in the last twelve months. Earmarked credit operations increased 2.8% in the month and 30.1% in the last twelve months, while non-earmarked credit operations expanded by 2.5% and 17.9%, in the same periods. Among non-earmarked credit operations, it bears emphasizing the twelve-month trailing leasing operations again, due to the expansions of 86.2% in credit to individuals and 82.5% in credit to corporate. Regarding earmarked credit, the most significant expansions in the last twelve months were related to housing (23.5%) and to the agricultural sector (18.1%). Considering credit operations by economic activity, loans to industries increased 3.1% in October and 28.5% in the last twelve months, while loans to commerce grew 3.3% and 20.8%, according to the same comparison bases.

52. The average interest rate on credit rates reached 35.4% p.a. in October, a record low for the historical series, standing 6 p.p. below the rate recorded in October 2006. The average rate for individuals decreased to 45.8% p.a. in October, down from 53.5% p.a. in the same month of 2006. The average rate for corporate decreased 4 p.p. in twelve months, reaching 23.4% p.a.

53. The average tenure of credit operations for individuals reached 419 days in October, compared to 349 in the same month of the previous year. The average tenure of personal credit operations totaled 443 days, an 88-day extension relative to October 2006, reflecting the increasing share of payroll-deducted contracts. In addition, it bears emphasizing the elevation of the twelve-month trailing average tenure of real estate financing and vehicles acquisition operations, which reached 1909 days and 577 days, up from 1445 days and 524 days, respectively.

54. Delinquency rates in the financial system (non-earmarked loans in arrears for more than ninety days) reached 4.5% in October, a 0.1 p.p. decrease relative to the previous month, and 0.6 p.p. below the same month of 2006. Delinquency rate for corporate credit operations remained unchanged

at 2.3%, after decreasing 0.5 p.p. in the last twelve months. Delinquency rate for credit operations with individuals remained almost stable between September (7.1%) and October (7%), but stood 0.6 p.p. below the October 2006 rate.

55. Net delinquency rate for retail credit, measured by the ACSP, reached 6.1% in October, remaining unchanged relative the same month of 2006. In the year through October, the average net delinquency rate reached 6.2%, up from 5.9% in the same period of 2006.

External environment

56. Global economic growth continued to show robust expansion in the third quarter of 2007. The three main economic areas expanded in the third quarter, quarter-on-quarter, contradicting the expectations of greater deceleration based upon the recent finance turmoil episodes. Despite this positive evolution, recent data point to a moderation in global growth.

57. Despite the turmoil in financial markets, the US still benefit from the productivity growth, the lack of unbalances in others sectors beyond the real state sector and the still robust labor market performance, which reinforces the resilience of economic activity (Q3 GDP grew 4.9%). Emerging economies continue to present positive economic performance, with highlights for the strong growth observed in Asia. A lot of uncertainties still affect the international economy, reflecting the stress provoked by the crisis in the US subprime mortgage market. Moreover, with the increasing oil and commodities prices, in addition to the dollar weakness, concerns about a less benign scenario for inflation increased.

58. The main central banks maintained interventions through open market operations during the turmoil financial period, providing short term funding in order to regulate the liquidity and provide an efficient, safe and flexible environment concerning the liquidity management in the banking system. However, volatility in financial markets remained high. Concerns about inflationary pressures made several central banks, such as Canada, Sweden, Norway, Switzerland, Chile, South Africa, South Korea, India and Russia, increase their basis interest

rates. On the other hand, the Federal Reserve Bank (Fed) reduced again the Fed funds target in its October meeting. The central banks in the Euro Area and Japan still keep on waiting the extension of the international financial turmoil to return to their gradual tightening monetary policies stance.

Foreign trade and international reserves

59. Between January and November 2007, Brazilian external trade continued the ongoing expansion both in exports and mainly in imports. Due to greater dynamics of imports, the trade surplus totaled US\$ 36.4 billion in the year through November, a 12.1% retreat in year-over-year terms. On a twelve-month trailing basis, the trade surplus reached US\$ 44.5 billion, 13.3% below the record high registered in May. External trade totaled US\$256.4 billion and US\$275.9 billion, respectively, in the year through November and in the last twelve months.

60. In November, exports totaled US\$14.1 billion, reaching a US\$702.6 million daily average, 18.1% above the observed in the same month of 2006. Exports of manufactured products totaled US\$7.5 billion, a US\$376.4 million daily average, 17.1% above the observed in the same month of the previous year. Exports of primary products totaled US\$4.3 billion, and of semi-manufactured products, US\$1.9 billion, with respective increases of 25.2% and 7.4% in daily average values.

61. Imports totaled US\$12 billion in November, with an average daily record value of US\$601.3 million, 38.9% above the observed in the same month of 2006. All products categories expanded according to the same comparison basis, with highlights to the expansion of capital goods (47.1%) and raw materials and intermediate goods (39.1%). Regarding this group, it bears emphasizing the imports of transportation equipment accessories, and also of mineral products, non-food farming products and chemical and pharmaceutical products. Amongst the imports of capital goods, industrial machines, machines and equipment for office and scientific service, and parts and pieces for capital goods should be highlighted. Regarding the imports of consumer goods, whose expansion reached 36.8%

year-over-year, the main increases were for vehicles, clothing, furniture, machines and equipment for domestic use. In November, imports of fuel and lubricants increased 31.9%, compared to the same month of the previous year.

62. International reserves totaled US\$167.9 billion in October, with increases of US\$4.9 billion in the month and US\$82 billion in the year.

Money market and open market operations

63. In the period between the October and December Copom meetings, the future interest rates increased, especially in longer terms. In the external scenario, money inflows for emerging markets reduced and the country risk increased due to two main reasons: the recognition of significant losses of US financial institutions related to the crisis in the subprime mortgage market and the increase of risk aversion, due to the fear of recession in the US economy. In the domestic scenario, strong figures for economic activity and inflation gave support to a steepening of the yield curve. Between October 15th and December 3rd, one-, three-, and six-month rates went up 8 bps, 14 bps and 25 bps, respectively. Moreover, one-, two and three-year rates increased 44 bps, 89 bps and 113 bps, respectively. Real interest rates measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month ahead inflation expectations increased to 7.34% on December 3rd, up from 7.06% on October 15th.

64. On October 26th and November 27th, the BCB carried out reverse FX swap auctions amounting US\$4.2 billion, with the total rollover of the November 1st and December 3rd redemptions.

65. In its open market operations, the BCB carried out, from October 16th to December 3rd, weekly five- and seven-month fixed rate repo operations, borrowing. The average daily balance of these operations reached R\$88.8 billion, of which R\$66.5 billion were seven-month operations. In the same period, the BCB conducted 30 borrowing and two lending overnight repo operations. The BCB also conducted daily liquidity management operations with tenures up to two working days. Operations with tenors less than thirty days, including daily liquidity management operations, averaged R\$16.3 billion, borrowing. In addition, on October 18th, the BCB conducted borrowing operations with tenure of 33 working days, amounting R\$80.5 billion.

66. Between October 16th and December 3rd, the National Treasury raised a total of R\$36.0 billion, of which R\$23.0 billion in fixed-rate securities: R\$21.5 billion via issuance of LTNs maturing in 2008, 2009 and 2010, and R\$1.5 billion in NTN-Fs maturing in 2011, 2013 and 2017. Issuance of LFTs totaled R\$9.9 billion, for securities maturing in 2011 and 2013. Issuance of inflation-linked NTN-Bs reached R\$3.1 billion, for securities maturing in 2009, 2012, 2017, 2024, 2035 and 2045.

67. In the same period, the Treasury conducted auctions to sell LTNs maturing in July and October 2008 and bought LTNs or NTN-Fs, both maturing in January 2008, totaling R\$5.3 billion. The issuances of NTN-Bs, for the same tenures of the traditional auctions, settled against the reception of other fixed income instruments, totaled R\$5.0 billion. The Treasury also conducted auctions to sell LFTs maturing in 2011 and 2013, totaling R\$3.3 billion, receiving LFTs maturing in 2007 as payment, and to buy LTNs and NTN-Fs, totaling R\$2.5 billion and R\$519 million, respectively.

Appendix

Banco Central do Brasil Management

Members of the Monetary Policy Committee (Copom)

Banco Central do Brasil Management

Board

Henrique de Campos Meirelles
Governor

Alexandre Antonio Tombini
Deputy Governor

Alvir Alberto Hoffmann
Deputy Governor

Anthero de Moraes Meirelles
Deputy Governor

Antonio Gustavo Matos do Vale
Deputy Governor

Mário Gomes Torós
Deputy Governor

Mário Magalhães Carvalho Mesquita
Deputy Governor

Paulo Vieira da Cunha
Deputy Governor

Members of the Monetary Policy Committee (Copom)

Voting members

Henrique de Campos Meirelles
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Alexandre Antonio Tombini
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Anthero de Moraes Meirelles
Deputy Governor

Antonio Gustavo Matos do Vale
Deputy Governor

Mario Gomes Torós
Deputy Governor

Mário Magalhães Carvalho Mesquita
Deputy Governor

Paulo Vieira da Cunha
Deputy Governor

Non-voting members

Altamir Lopes
Head of the Department of Economics (Depec)

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

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

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

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

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

Acronyms

| | |
|----------------------|--|
| Abramat | Brazilian Association of the Construction Material Industry |
| ACSP | São Paulo Trade Association |
| Aladi | Latin American Integration Association |
| Anfavea | National Association of Automotive Vehicle Manufacturers |
| BDIA | Brazilian Direct Investments Abroad |
| BNDES | National Bank of Economic and Social Development |
| Bovespa | São Paulo Stock Exchange |
| Caged | General File of Employed and Unemployed Persons |
| CDI | Interfinance Deposit Certificate |
| CDS | Credit default swap |
| CMN | National Monetary Council |
| CNI | National Confederation of Industry |
| Cofins | Contribution to Social Security Financing |
| Conab | National Supply Company |
| Copom | Monetary Policy Committee |
| CPMF | Provisional Contribution on Financial Operations |
| CUT | Unit Labor Cost |
| CUTR | Real Unit Labor Cost |
| CVM | Securities and Exchange Commission |
| DAX | Deutscher Aktienindex |
| DI | Interbank Deposit |
| DPMFi | Internal Federal Public Securities Debt |
| ECB | European Central Bank |
| Embi+ | Emerging Markets Bond Index Plus |
| FAT | Worker Support Fund |
| Fecomercio SP | Trade Federation of the State of São Paulo |
| Fed | Federal Reserve |
| Fenabrave | National Federation of Automotive Vehicle Distribution |
| FGTS | Employment Compensation Fund |
| FGV | Getulio Vargas Foundation |
| FIDC | Receivables-Backed Investment Funds |
| Fiesp | Federation of Industries of the State of São Paulo |
| Finame | Special Industrial Financing Agency |
| FIP | Stock Investment Fund |
| FMP-FGTS | Mutual Privatization Funds – Employment Compensation Fund |
| FMP-FGTS-CL | Mutual Privatization Funds – Employment Compensation Fund – Free Portfolio |
| FOMC | Federal Open Market Committee |
| FPM | Municipal Revenue Sharing Funds |
| FTSE 100 | Financial Times Securities Exchange Index |

| | |
|--------------------|---|
| Funcex | Foreign Trade Studies Center Foundation |
| GDP | Gross Domestic Product |
| Gerin | Investor Relations Group |
| GFCF | Gross Fixed Capital Formation |
| GGGD | Gross General Government Debt |
| IBGE | Brazilian Institute of Geography and Statistics |
| ICC | Consumer Confidence Index |
| Icea | Current Economic Conditions Index |
| ICI | Industrial Confidence Index |
| ICMS | Tax on the Circulation of Merchandise and Services |
| IE | Expectations Index |
| IEC | Consumer Expectations Index |
| IFL | Production Growth Limiting |
| IGP | General Price Index |
| IGP-DI | General Price Index – Domestic Supply |
| IMF | International Monetary Fund |
| INC | National Confidence Index |
| INCC | National Cost of Construction Index |
| INCC-DI | National Cost of Construction Index – Internal Availability |
| Inec | National Consumer Expectations Index |
| INSS | National Social Security Institute |
| IPC | Índice de Precios y Cotizaciones |
| IPCA | Extended National Consumer Price Index |
| IPC-Br | Consumer Price Index – Brazil |
| IPI | Industrialized Products Tax |
| Ipsos | Ipsos Public Affairs |
| ISA | Current Situation Index |
| LSPA | Systematic Farm Production Survey |
| LTN | National Treasury Bills |
| MTE | Ministry of Labor and Employment |
| MYDFA | Multi-Year Deposit Facility Agreement |
| NTN-B | National Treasury Notes – Series B |
| Nuci | Installed Capacity Utilization Level |
| p.p. | Percentage points |
| PAC | Growth Incentive Program |
| PAF | Annual Financing Plan |
| PBC | People's Bank of China |
| PEA | Overall Labor Force |
| PIM | Monthly Industrial Survey |
| PIM-PF | Monthly Industrial Survey – Physical Production |
| PMC | Monthly Retail Trade Survey |
| PME | Monthly Employment Survey |
| POA | Salaried Working Population |
| PPI | Pilot Investment Program |
| PSND | Public Sector Net Debt |
| S&P 500 | Standard and Poor's 500 |
| SCIT | Manufacturing Industry Survey |
| SCPC | Credit Protection Service Center |
| Selic | Special System of Clearance and Custody |
| TJLP | Long-Term Interest Rate |

| | |
|--------------|---|
| TN | National Treasury |
| USA | United States of America |
| VIX | Chicago Board Options Exchange Volatility Index |
| WTI | West Texas Intermediate |
| XU100 | Istanbul Stock Exchange National 100 Index |