

Inflation Report

December 2015
Volume 17 | Number 4



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ISSN 1517-7289
CGC 00.038.166/0001-05

Inflation Report	Brasília	v. 17	n. 4	Dec.	2015	P. 1-111
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Inflation Report

Quarterly publication of the Monetary Policy Committee, according to Decree 3,088, dated 6.21.1999.

The following departments are responsible for the English version of the text and the respective tables and graphs:

Department of Economics (Depec)

(E-mail: depec@bcb.gov.br);

Research Department (Depep);

(E-mail: conep.depep@bcb.gov.br); and

Investor Relations and Special Studies Department (Gerin)

(E-mail: gerin@bcb.gov.br).

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Banco Central do Brasil
Secre/Surel/Cogiv
SBS – Quadra 3 – Bloco B – Edifício-Sede – 1º andar
Caixa Postal 8.670
70074-900 Brasília – DF – Brazil
Phones: + 55 (61) 3414-3710 and 3414-3565
Fax: + 55 (61) 3414-3626
E-mail: editor@bcb.gov.br

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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Banco Central do Brasil Information Bureau

Address: Secre/Surel/Diate
SBS – Quadra 3 – Bloco B – Edifício-Sede – 2º subsolo
70074-900 Brasília – DF – Brazil
DDG: 0800 9792345
Fax: + 55 (61) 3414-2553
Internet: <http://www.bcb.gov.br>

Contents

Foreword	5
Executive summary	7
Activity level	13
1.1 Commerce	13
1.2 Production	15
Industrial output	15
Services	16
Central Bank Economic Activity Index – Brazil (IBC-Br)	16
1.3 Labor market	17
1.4 Gross Domestic Product	18
1.5 Investments	19
1.6 Conclusion	19
Prices	23
2.1 General indexes	23
2.2 Consumer price indexes	24
2.3 Cores	24
2.4 Market expectations	25
2.5 Conclusion	26
Credit, monetary and fiscal policies	31
3.1 Credit	31
Interest and delinquency rates	32
3.2 Monetary aggregates	33
Real interest rates and market expectations	34
Capital market	34
3.3 Fiscal policy	35
Public sector borrowing requirements	36
Central Bank operations in the open market	38
Federal securities debt	38
Public sector net debt	39
3.4 Conclusion	40

International economy	41
4.1 Economic activity	41
4.2 Monetary policy and inflation	43
4.3 International financial markets	45
4.4 Commodities	46
4.5 Conclusion	47
Foreign sector	49
5.1 Exchange movement	49
5.2 Trade in goods	50
5.3 Services and income	51
5.4 Financial account	52
5.5 External sustainability indicators	54
5.6 Conclusion	54
Inflation outlook	61
6.1 Inflation determinants	62
6.2 Associated risks and monetary policy implementation	67
6.3 Assumptions and inflation forecast	76
Boxes	
Projection for GDP in 2016 and revision of 2015	20
<i>El Niño</i> , rainfall, and major inflationary impacts	27
Projection for the Balance of Payments of 2015 and 2016	56
Price-setting in Brazil	80
Recent behavior of the services inflation	86
Annex	91
Appendix	105

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 Inflation outlook. 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

In the international environment, the Copom considers that, since the previous report, the external outlook remains complex, and in spite of identifying low probability of occurrence of extreme events in the international financial markets, there are events of higher volatility affecting important emerging markets.

In the relevant horizon for monetary policy, the Committee assesses that global risk aversion and the volatility of international financial markets tend to react to the continuation of the gradual normalization process of the monetary conditions in United States. On the other hand, highlights that domestic factors, especially the uncertainties regarding the process of fiscal result recovery and the development of non-economic events, are influencing and will remain influencing, if not promptly addressed, the financial asset prices. Hence, it is important to highlight, once more, that possible increases in the volatility and in the risk aversion in the international markets tend to be transmitted to domestic assets, discontinuously and incrementally, with possible amplifications, depending on the perception regarding the domestic macroeconomic and financial soundness.

In general, since the previous report, prospects of global activity have shown moderation through the relevant horizon for monetary policy. In this regard, note that evidence points to growth rates relatively more homogeneous in mature economies, though low and below potential growth, notably in the euro area. In international markets, prospects point to moderation in the dynamics of commodities prices.

In the internal environment, the Copom reinforces that, in accordance with the ongoing process of macroeconomic adjustment, the available indicators show that the growth rates of domestic absorption and of GDP continued to line up and confirm that the pace of expansion of domestic activity this year will be below potential. This process is intensified by uncertainties related to non-economic events.

However, for the Committee, after a necessary period of adjustments, which seems to be more intense and longer than anticipated, the pace of activity tends to intensify, to the extent that the confidence of firms and households strengthens. Regarding the external component of aggregate demand, the global growth scenario, though moderate, combined with the depreciation of the Brazilian real, tends to favor the rebalancing of external accounts and the sustainable growth of the Brazilian economy.

Relevant for the domestic environment, beside the adjustment of domestic prices relative to international prices and the adjustment of administered prices relative to market prices, are the impacts, on the asset prices, of uncertainties regarding the paths of fiscal variables, both in terms of the speed of recovery of results and its composition, especially after the downgrade of the credit rate of the Brazilian sovereign bonds, announced by a second credit rating agency.

Still regarding internal activity, the Copom assesses that, in the medium-term, important changes may occur in the composition of aggregate demand and supply. Consumption tends to grow at a moderate pace and the investments tend to gain momentum. In the Committee's view, these changes indicate that there is room for composition and pace of growth in the medium-term that may lead to the potential growth.

The Copom highlights that the central scenario envisages moderate credit expansion, which had already been noticed and tends to persist. In this regard, note that, after years of strong expansion, the credit market directed toward consumption underwent a period of moderation, leading in the last quarters, on the one hand, to lesser exposure of banks and, on the other hand, to household deleveraging. Taken together, therefore, one concludes that risks have been mitigated in the consumer credit segment. In another dimension, following implemented actions, the Committee considers appropriate to reinforce initiatives aiming to moderate the concession of subsidies through credit operations.

In this context, the credit transactions remain in a decelerating trend in the quarter ended in October. This result reflected increasing interest rates and the outlook of economic activity downturn, and the deterioration of both indicators of confidence and of employment and income. The reduction in the dynamism of credit markets was partially mitigated by the performance of earmarked portfolios, especially those focused on housing and farm credit.

Regarding the public accounts, the primary deficit projected for the public sector in 2015 reflects, especially, the impacts of the deceleration of the economic activity on the level of public revenues. Such scenario – worsened by the recurrent increasing of non-economic events and by the perspective of payments of expenses cumulated from past calendar years, mainly the ones related to the programs for equalization of the rates and subsidies –, tends to be attenuated, in medium run, by the impacts of fiscal adjustment measures recently adopted.

The results of the balance of payments are still confirming the view of significant reduction of current account deficit, consistent with the scenario of depreciation of the Real, the slowdown of internal demand, and recovery, yet moderate, of the economy of important trader's partners. The continuity of the process of macroeconomic adjustment in place should still strengthen, in 2016, the path of current account. Net capital inflows from abroad have been financing properly the current account deficit, with particular reference to the net inflows of direct investment in the country. Moreover, we highlight the roll-over of bonds and loans at 106%, during the first eleven months of this year.

Concerning prices, the inflation measured by the twelve-month accumulated Broad National Consumer Price Index (IPCA) reached 10.48% in November, 3.92 p.p. higher than the rate recorded until November 2014. On the one hand, market prices accumulated variation of 8.28% in twelve months (6.76% up to November 2014); on the other hand, the regulated prices increased 17.95% (5.83% up to November 2014).

Regarding inflation projections, following the usual procedures and taking into account the information set available up to the cutoff date of December 18, 2015, the baseline scenario – which assumes constant exchange rate over the forecast horizon at R\$3.90/US\$ and target for the Selic interest rate at 14.25% p.a. – projects inflation of 10.8% in 2015, 6.2% in 2016, and 4.8% in 2017. In the market scenario – which uses consolidated information from the expectations survey undertaken by Banco Central's Investor Relations and Special Studies Department (Gerin) with a significant group of institutions – the projections indicate inflation of 10.8% in 2015, 6.3% in 2016 and 4.9% in 2017.

Concerning GDP growth, the projection for 2015, according to the baseline scenario, is -3.6% (0.9 p.p. lower than the estimate considered in the previous Inflation Report) and -1.9% for 2016.

The Copom emphasizes that the international evidence, in which it is ratified by the Brazilian experience, shows that high inflation rates generate distortions that lead to higher risks and depress investment. These distortions are manifested, for example, in shortening the planning horizons of households, firms and governments, as well as in the deterioration of the businessmen's confidence. The Committee also emphasizes that high inflation rates subtract the purchasing power of wages and transfers, with negative repercussions over households' confidence and consumption. Hence, high inflation rates reduce the growth potential of the economy, as well as of jobs and income generation.

For the Copom, the high level of the current inflation reflects, in a large part, the effects of the two important and necessary relative-price adjustment processes in the economy – the regulated price adjustment relative to market prices and the domestic price adjustment relative to international prices, as well as uncertainties regarding the speed of fiscal recovery and its composition.

In this context, according to the projections presented in this report, the Committee notes, as anticipated, that these price adjustments made inflation increase in 2015, requiring determination and perseverance to avoid its transmission to longer terms. At the same time that the Committee understands that adjustments in relative prices have direct impact on inflation, it reaffirms its view that monetary policy can, must and is containing the second-order effects of these adjustments. In the same way, although recognizing that other macroeconomic policy actions can influence the price dynamics, the Copom reaffirms its view that it is, specifically, the monetary policy that should be particularly vigilant, to assure that pressures perceived in shorter horizons do not spill over to longer horizons.

The Committee observes that the expectations for 2016 have been increasing since August, reverting its previous declining path. This increasing in inflation expectations – which happened at the same time as the increasing of the uncertainties regarding the fiscal results – is also observed, though in lower intensity, in the market forecasts for 2017 and 2018. These facts constitute a clear and important signal about the recent deterioration of the balance of risks of the economy, and demand monitoring to define the next steps of the strategy of monetary policy.

Evaluating the macroeconomic outlook and the inflation perspectives, the Copom considers that there are still uncertainties related to the balance of risks, mainly,

regarding the velocity of the process of fiscal results recovery and its composition, and that the process of relative price adjustment has been more intense and slow than anticipated.

The Copom reaffirms that the aggregate demand will remain moderate in the relevant horizon for the monetary policy. From one hand, the household consumption tends to be influenced by factors as employment, income and credit; on the other, the public services concession and the increase of the rural income, between others, tend to favor the investments. The net exports have been presenting better results, either due to the higher exports, benefited by the perspectives of higher growth of important trade partners and for the Real depreciation, or due to the process of imports substitution in place. For the committee, the joint effects of these elements, the development in the fiscal and non-fiscal environments, and in the assets market, and, in 2016, the regulated prices dynamics, are important factors of the context in which future monetary policy decisions will be taken.

The Committee highlights that there are uncertainties related to the balance of risks, mainly, regarding the speed of the process of fiscal recovery and its composition, and that the process of relative price adjustment has been more intense and slow than anticipated. In this context, regardless of the delineations of the other policies, the Committee will adopt the necessary actions to ensure the delivery of the objectives of the inflation targeting regime, i.e. to circumscribe the inflation into the limits established by the CMN, in 2016, and to make the convergence of the inflation to the target of 4.5%, in 2017.

Activity level

Table 1.1 – Sales volume index

	% change			
	2015			
	Jul	Aug	Sep	Oct
In the month^{1/}				
Retail sector	-1.5	-0.8	-0.3	0.6
Fuel and lubricants	-1.1	-1.4	-0.8	-2.6
Supermarkets	-1.5	-0.2	0.4	2.0
Fabrics, apparel and footwear	-1.4	-2.4	-1.4	1.9
Furniture and home appliances	-2.4	-2.1	0.2	0.6
Pharmac., medical, orthop. and perfumery articles	-0.9	0.5	-1.0	1.5
Books, newspaper, magazines	-1.2	-2.7	-1.4	0.7
Office, comp./communic. equip.	-6.1	0.3	-2.5	-9.2
Other art. of personal use	-1.1	-0.6	-3.1	-0.6
Broad retail sales	0.4	-2.2	-1.6	-0.1
Building materials	-2.9	-2.6	-1.7	-2.9
Automobiles, motorcycles, parts and spares	6.2	-6.1	-4.2	-0.9
3-Month Period/Previous 3-Month Period^{1/}				
Retail sector	-2.6	-2.6	-2.8	-2.0
Fuel and lubricants	-0.8	-2.5	-3.0	-3.8
Supermarkets	-1.4	-1.5	-2.0	-0.4
Fabrics, apparel and footwear	-2.7	-3.3	-3.9	-4.1
Furniture and home appliances	-6.5	-5.9	-5.3	-3.9
Pharmac., medical, orthop. and perfumery articles	-0.8	-1.0	-1.1	-0.3
Books, newspaper, magazines	-4.6	-4.5	-5.0	-4.6
Office, comp./communic. equip.	-8.7	-8.4	-7.5	-9.1
Other art. of personal use	-2.9	-2.4	-2.6	-3.8
Broad retail sales	-3.4	-3.0	-2.9	-3.4
Building materials	-5.2	-2.7	-4.1	-4.9
Automobiles, motorcycles, parts and spares	-4.7	-3.7	-3.4	-6.4
In the year				
Retail sector	-2.4	-3.0	-3.3	-3.6
Fuel and lubricants	-3.4	-3.9	-4.4	-5.2
Supermarkets	-1.9	-2.3	-2.3	-2.1
Fabrics, apparel and footwear	-5.5	-6.6	-7.3	-7.5
Furniture and home appliances	-11.5	-12.4	-13.0	-13.3
Pharmac., medical, orthop. and perfumery articles	4.7	4.2	3.6	3.1
Books, newspaper, magazines	-8.3	-9.1	-9.6	-9.6
Office, comp./communic. equip.	7.9	5.8	4.0	0.6
Other art. of personal use	3.4	2.6	1.5	0.3
Broad retail sales	-6.5	-6.9	-7.4	-7.9
Building materials	-5.0	-5.6	-6.4	-7.4
Automobiles, motorcycles, parts and spares	-15.3	-15.4	-16.1	-16.9

Source: IBGE

^{1/} Seasonally adjusted data.

Economic activity continues to underperform in relation to its potential. This performance reflects the impacts of the ongoing macroeconomic adjustment process and the effects of non-economic events.

In this context, GDP decreased 1.7% in the third quarter of 2015 against the second quarter of 2015, according to seasonally adjusted data. Importantly, from the perspective of supply, there was contraction in industry and services activity, and from the perspective of demand, there was decrease of investment and consumption expenditure, partially offset by positive contribution from the external component, compatible with the context of domestic market downturn and Brazilian currency depreciation.

The latest statistics, notably the coincident indicators of sales and the industry production data, do not suggest activity upturn in the fourth quarter.

1.1 Commerce

Broad retail sales dropped 3.4% in the quarter ended in October, compared to that ended in July, when there was similar decline in the same type of comparison, non seasonally adjusted data. Decreased sales in the ten segments surveyed (office, computer, and communication equipment and supplies, 9.1%; automobiles, motorcycles, parts, 6.4%; construction supplies, 4.9%).

Retail¹ sales declined 2.0% in the period, the ninth consecutive quarterly decrease, with lesser sales in all regions, with emphasis to those observed in the South Region (3.2%) and Northeast Region (2.8%).

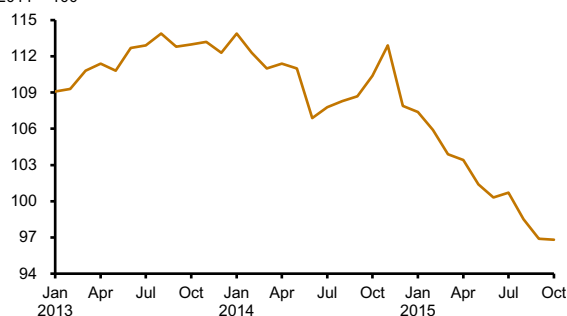
Real sales of supermarkets, segment with approximate weight of 33.0% in the Monthly Retail Trade Survey (PMC),

^{1/} Concept that excludes from the broad retail sales the segments of automobiles and motorcycles, parts, and construction supplies.

Figure 1.1 – Broad retail sales

Seasonally adjusted data

2011 = 100

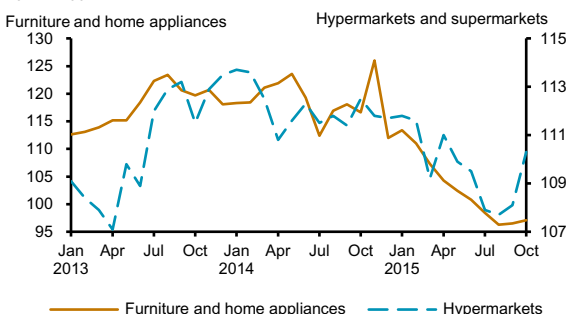


Source: IBGE

Figure 1.2 – Retail sales

Seasonally adjusted data

2011 = 100

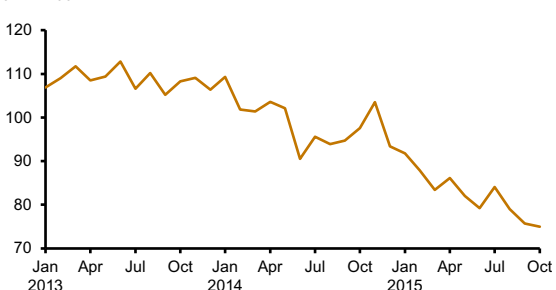


Source: IBGE

Figure 1.3 – Sales volume index – Automobiles and motorcycles, parts and spares

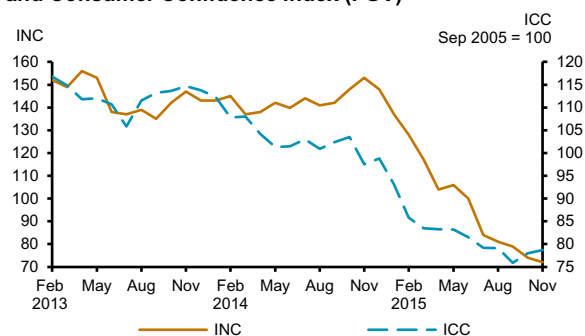
Seasonally adjusted data

2011 = 100



Source: IBGE

Figure 1.4 – National Consumer Confidence (ACSP) and Consumer Confidence Index (FGV)



Sources: ACSP/IPSOS and FGV

declined 0.3% in the quarter ended in October, compared to that ended in July, according to non seasonally adjusted data from the Brazilian Association of Supermarkets (Abrás). In the same line, according to the National Federation of Automotive Vehicle Distribution (Fenabrave), sales of automobiles and light commercial vehicles decreased 7.8% in the quarter ended in November (-7.7% in that ended in August). The Serasa Experian Trade Activity Index – of national scope and compiled from monthly queries to Serasa registers performed by commercial establishments – declined 4.8% in the quarter ended in November, compared to that ended in August, when it had declined 1.7% in this type of comparison.

The ratio between the number of checks returned due to insufficient funds and the total of checks paid reached 7.5% in October, compared to 6.3% in the same month of 2014, suggesting an increase in delinquency rates.

Confidence indicators are at historically low levels. The Consumer Confidence Index (CCI), of the Getulio Vargas Foundation (FGV), declined 7.2% in the quarter ended in November, compared to that ended in August, the lowest level since the beginning of the series, in September 2005. The Current Situation Index (ISA) decreased 8.8% and the Expectations Index (IE), 6.1%.

The National Consumer Expectation Index (Inec), released by the National Confederation of Industry (CNI), declined 12.0% in the last quarter of 2015, compared to the same period of the previous year. Negative contributions from the components personal income expectation and financial situation were significant.

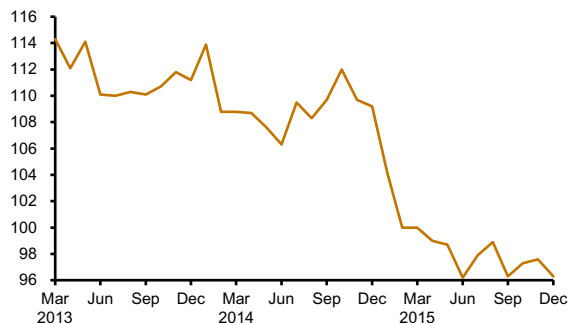
The National Confidence Index (INC), prepared by Ipsos Public Affairs for the São Paulo Trade Association (ACSP), decreased 49.2% in the quarter ended in November, compared to the same period in 2014. There were decreases in all regions: Northeast (42.8%); Southeast (50.1%); North/Central-West (48.2%), and South (61.6%).

The Trade Confidence Index (ICOM), published by the Getulio Vargas Foundation, declined 7.7% in the quarter ended in November, compared to that ended in August. There were decreases of 14.1% in the Current Situation Index (ISA-COM) and 1.3% in the Expectations Index (IE-COM).

1.2 Production

Industrial output

Figure 1.5 – National Consumer Confidence Index
2001 = 100



Source: CNI

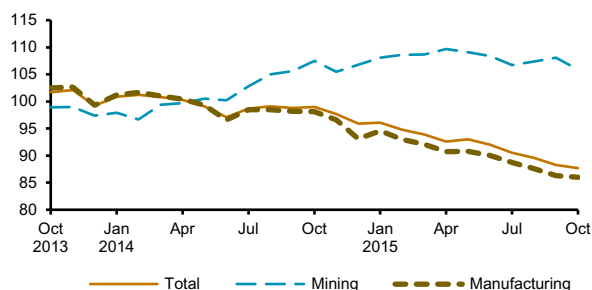
Table 1.2 – Industrial production
3-Month Period/Previous 3-Month Period^{1/}

	2015				%
	Jul	Aug	Sep	Oct	
Industry	-2.1	-2.6	-3.3	-3.6	
By section					
Mining	-0.9	-1.5	-1.5	-0.9	
Manufacturing	-2.3	-2.7	-3.3	-3.6	
By category of use					
Capital goods	-8.7	-10.2	-9.7	-10.0	
Intermediate goods	-2.0	-2.2	-2.9	-2.7	
Consumer goods	-1.4	-1.5	-2.1	-2.8	
Durables	-7.2	-8.3	-4.6	-8.9	
Semi and nondurables	-0.6	-0.5	-1.8	-1.7	

Source: IBGE

1/ Seasonally adjusted data.

Figure 1.6 – Industrial production^{1/}
Total and sections
2012 = 100



Source: IBGE

1/ Seasonally adjusted data.

The physical production of the industry decreased by 3.6% in the quarter ended in October, in relation to that ended in July, when it had decreased by 2.1%, in this basis of comparison, according to seasonally adjusted data from the Monthly Industrial Survey – Physical Production (PIM-PF) from the Brazilian Institute of Geography and Statistics (IBGE). The extractive industry declined 0.9% and the manufacturing industry, 3.6%, reflecting reductions in 19 of the 23 activities surveyed (motor vehicles, trailers and truck bodies, -15.9%; furniture, -10.8%; general products, -9.3%). Conversely, emphasis on the 13.3% increase in the production of tobacco.

In the same basis of comparison, analysis by category of use indicates significant decline in the production of capital goods (10.0%), following those in the industries of durable consumer goods (8.9%), intermediate goods (2.7%), and of semi-durable and nondurable consumer goods (1.7%).

Employed persons in industry decreased by 2.2% and the actual payroll, by 3.3%, in the quarter ended in October, compared to that ended in July, according to seasonally adjusted data from the Monthly Industrial Survey – Employment and Wages (Pimes) from IBGE.

The Installed Capacity Utilization Level (Nuci)² of the manufacturing industry reached 74.9% in the quarter ended in November (75.4% in that ended in August), considering the seasonally adjusted data from the FGV Industrial Survey. There were declines in the industries of capital goods (0.6 p.p.), intermediate goods (0.5 p.p.), and nondurable consumer goods (0.4 p.p.) and increase of 0.9 p.p. in the indicator of the durable consumer goods industry.

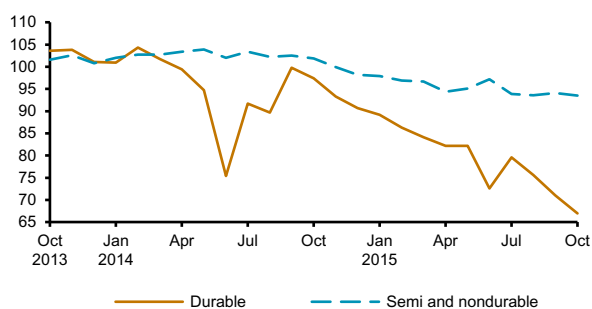
The industry inventory index, calculated by the FGV, declined 4.1 points, to 125.9 points³, in the quarter ended in November, considering seasonally adjusted data. There were decreases in the indicators of industries of capital goods (5.8 points), intermediate goods (4.1 points), nondurable consumer goods (2.7 points), and durable consumer goods (0.5 point).

2/ The FGV Industrial Survey series that include the Installed Capacity Utilization Level (Nuci) series, inventories index and the Industry Confidence Index (ICI) were adapted for the National Economic Activity Classification 2.0 (NCEA 2.0) in last November.

3/ Complement of 200 points of the original index released by the FGV. Values above 100 points indicate excess of inventories.

Figure 1.7 – Industrial production^{1/}

Consumer goods
2012 = 100

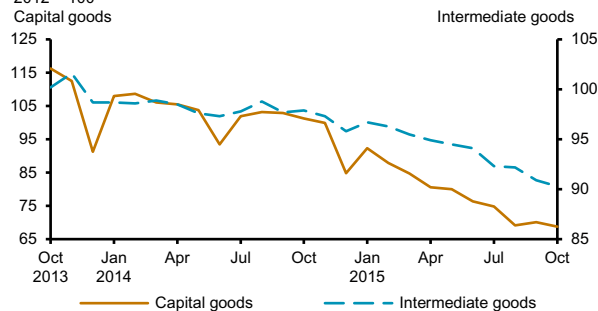


Source: IBGE
1/ Seasonally adjusted series.

Figure 1.8 – Industrial production^{1/}

Capital and intermediate goods

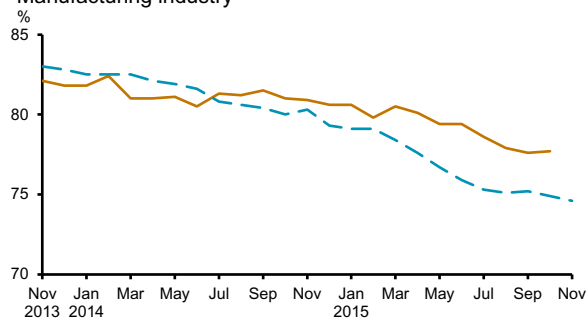
2012 = 100



Source: IBGE
1/ Seasonally adjusted series.

Figure 1.9 – Capacity utilization

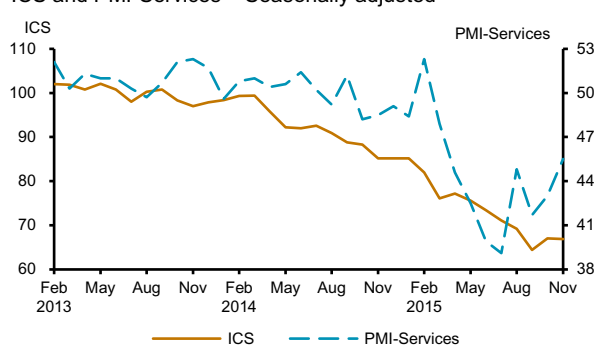
Manufacturing industry



Sources: CNI and FGV
1/ Seasonally adjusted series.

Figure 1.10 – Service Confidence Index

ICS and PMI-Services – Seasonally adjusted



Sources: FGV and Markit

The Industrial Confidence Index⁴ (ICI) declined from 76.2 points, in October, to 74.8 points, in November, according to seasonally adjusted data from the FGV. The mean ICI of the quarter ended in November increased by 1 point, compared to the mean ICI of the quarter ended in August, evolution resulting from increases in the industries of nondurable consumer goods (2.5 points) and intermediate goods (1 point) and decreases in the industries of durable consumer goods (0.8 point) and capital goods (0.3 point).

The Purchasing Managers Index⁵ (PMI) of the industry reached 43.8 points in November, according to seasonally adjusted data from Markit, still indicating a moderate performance of the activity.

Services

The volume of services declined 4.7% in the quarter ended in October, compared to the same period in 2014, according to the Monthly Survey of Services (PMS), from IBGE⁶. The indicator decreased by 1.0% compared to the second quarter, according to seasonally adjusted data by Depec, with emphasis on reductions in the segments of professional, administrative, and complementary services (2.4%), other services (1.7%), and information and communication services (0.9%).

The Services Confidence Index (ICS) declined 7.2% in the quarter ended in November, compared to that ended in August, according to seasonally adjusted data from the FGV, reflection of decreases by 7.9% and 6.2%, respectively, in the ISA-S and IE-S. The indicator declined 24.1% compared to the same quarter in 2014 (ISA-S, -23.1%; IE-S, -23.8%).

The Purchasing Managers Index (PMI-Services) for business activity reached 45.5 points in November (43 points in October), according to seasonally adjusted data, remaining for the ninth month in the area of activity downturn.

Central Bank Economic Activity Index – Brazil (IBC-Br)

The IBC-Br declined 1.71% in the quarter ended in October, compared to that ended in July, when it had decreased by

4/ Values above 100 points indicate optimism.

5/ The PMI synthesizes the monthly evolution of indicators of new orders, production, employment, delivery time, and input inventory. Values above 50 represent monthly expansion of activity.

6/ In October 2015, the IBGE started the release of services volume data, retroactive to January 2012.

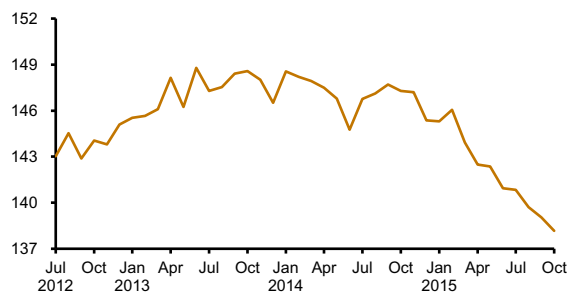
Table 1.3 – Volume of services

	Quarter over same quarter in previous year (%)			
	2015			
	Jul	Aug	Sep	Oct
Total	-3.2	-3.3	-4.2	-4.7
Services rendered to families	-4.5	-4.3	-5.6	-6.5
Information and communication services	-0.2	-0.3	-0.2	-1.2
Professional, administrative and complementary services	-2.5	-3.4	-5.7	-6.9
Transportation, support activities for transportation and mailing activities	-6.1	-5.5	-6.4	-5.8
Other services	-7.8	-9.6	-10.4	-12.1

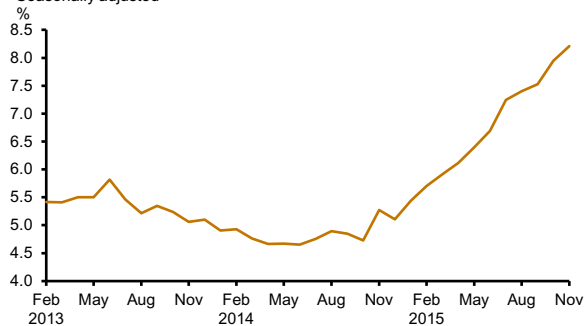
Source: IBGE

Figure 1.11 – Central Bank Economic Activity Index – Brazil – IBC-Br

Seasonally adjusted data

**Figure 1.12 – Unemployment rate**

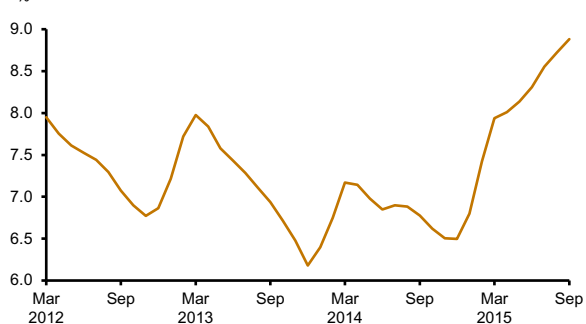
Seasonally adjusted



Source: IBGE (PME)

Figure 1.13 – Unemployment rate

%



Source: IBGE (PNADC)

1.92%, in this type of analysis, according to non seasonally adjusted data. The IBC-Br declined 5.8% compared to the same quarter in 2014 and 3.2% in twelve months.

1.3 Labor market

The process of labor market adjustment has intensified in recent months, with increase in the unemployment rate and reductions in formal jobs and in incomes from work.

The unemployment rate, considering the six metropolitan areas covered by the IBGE Monthly Employment Survey (PME), reached 7.7% in the quarter ended in November (4.8% in the same period in 2014). Considering seasonally adjusted data, the unemployment rate totalled 7.9% in the period (7.1% in the quarter ended in August), resulting from declines of 1.5% in the employed population and of 0.7% in the economically active population.

The unemployment rate, considering the IBGE nationwide Continuous National Household Sample Survey (PNADC), reached 8.9% in the third quarter of 2015 (8.3% in the second and 7.9% in the first quarter of 2015). The level of employment – ratio between employed population and active age population – reached, respectively, 56.0%, 56.2%, and 56.2% in the aforementioned periods.

The country's economy eliminated 395.4 thousand jobs in the quarter ended in November (creation of 101.9 thousand in the same period in 2014), according to the General File of Employed and Unemployed Persons (Caged) of the Ministry of Labor and Employment (MTE). Significant reductions occurred in the manufacturing industry (136.7 thousand), in the construction sector (133.6 thousand), and in the services sector (103.1 thousand). A total of 1 million workers were laid off in the first 11 months of the year, the highest reduction, in that basis of comparison, since the beginning of the series, in January 1985.

The real average income, usually earned in the main job, declined 6.7% in the quarter ended in November 2015, compared to the same period in 2014, according to the PME. The reductions in the construction sector (9.2%), trade sector (7.8%), and in the services sector (8.2%) were significant. Real overall wages, product of the usual average income and the number of employed persons, declined 9.6% over the same period.

Table 1.4 – Formal employment

	Job openings (in thousand)			
	2014		2015	
	Quarter ^{2/}	Year ^{3/}	Quarter ^{2/}	Year ^{3/}
Total	101.9	708.2	-395.4	-1 029.3
Manufacturing industry	-30.7	-14.8	136.7	-413.3
Commerce	174.2	139.4	31.1	-207.7
Services	94.3	521.8	-103.1	-136.5
Building	-74.0	-13.3	-133.6	-311.4
Crop and livestock	-60.6	43.2	-42.2	53.0
Public utilities	0.4	5.4	-3.8	-6.5
Others ^{1/}	-1.8	26.4	-7.1	-7.0

Source: MTE

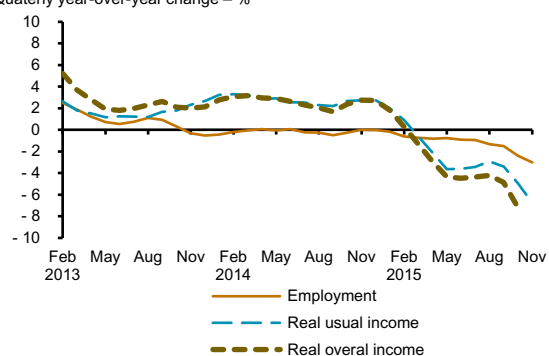
1/ Includes mining, public administration and others.

2/ Quarter ended in November.

3/ Accumulated in the year until November.

Figure 1.14 – Employment, income and payroll

Quarterly year-over-year change – %



Source: IBGE

Table 1.5 – Gross Domestic Product

Quarter/previous quarter

Seasonally adjusted

	% growth				
	2014		2015		
	II Q	III Q	I Q	II Q	III Q
GDP at market prices	-0.1	0.1	-0.8	-2.1	-1.7
Crop and livestock	1.1	1.3	3.4	-3.5	-2.4
Industry	-0.2	-0.4	-1.3	-3.7	-1.3
Services	0.2	-0.0	-0.9	-1.0	-1.0
Household consumption	0.0	1.4	-2.0	-2.4	-1.5
Government consumption	0.5	-0.8	-0.7	0.7	0.3
Gross fixed capital formation	-2.2	-1.5	-3.5	-6.6	-4.0
Exports	3.9	-13.8	16.1	3.1	-1.8
Imports	3.5	-6.3	-0.5	-8.0	-6.9

Source: IBGE

Considering data from the PNADC, the usual average income of all occupations had actual reduction of 1.3% in the quarter ended in September, compared to that ended in June, and stability in the interannual comparison. The real overall wages of all occupations declined 1.2% and presented stability, considering the same basis of comparison.

1.4 Gross Domestic Product

GDP declined 1.7% in the third quarter of 2015, compared to the second, according to seasonally adjusted data from the IBGE. Analysis from the perspective of supply reveals declines of 2.4%, 1.3%, and 1.0%, respectively, in the agriculture, in the industry, and in the services sector. The performance of the industrial sector reflected, in particular, the declines of 3.1% in the manufacturing industry and of 0.5% in the construction sector.

From the perspective of demand, the decrease of 4.0% in Gross Fixed Capital Formation (GFCF) was significant, a result consistent with the declines of the confidence indicators. Government consumption increased by 0.3% and household consumption decreased by 1.5% (third consecutive quarterly decline). Exports and imports decreased by 1.8% and 6.9%, respectively, in the quarter.

GDP declined 4.5% compared to the third quarter of 2014, result of reductions, from the perspective of production, of 2.0% in the agriculture, 2.9% in the services, and 6.7% in the industry. In this segment, there was significant impact from the respective declines of 11.3% and 6.3% in the manufacturing industry and in the construction sector, mitigated by the respective growths of 4.2% and 1.5% in the extractive industry and in the production and distribution of electricity, gas, and water. The negative performance of the tertiary sector was influenced by declines in the sectors of trade (9.9%) and transportation, storage, and mailing (7.7%).

In the context of aggregate demand, the internal component contributed with -7.4 p.p. to the interannual variation of the GDP (-1.3 p.p. in the quarter ended in September 2014), a result of the respective declines of 0.4%, 4.5%, and 15.0% in government consumption, household consumption, and GFCF. The external sector, reflecting respective variations of 1.1% and -20.0% in exports and imports, contributed with 2.9 p.p.

Table 1.6 – Gross Domestic Product
Quarter/same quarter of the previous year

	% growth				
	2014		2015		
	III Q	IV Q	I Q	II Q	III Q
Crop and livestock	0.3	2.2	5.4	2.2	-2.0
Industry	-2.9	-2.1	-4.4	-5.7	-6.7
Mining	10.0	10.4	12.5	8.2	4.2
Manufacturing	-4.2	-6.0	-7.3	-8.1	-11.3
Construction	-7.6	-2.2	-8.3	-10.6	-6.3
Public utilities	-6.7	-4.4	-6.6	-1.6	1.5
Services	-0.3	-0.3	-1.4	-1.8	-2.9
Commerce	-2.6	-1.8	-5.9	-7.1	-9.9
Transportation	2.0	1.7	-4.0	-5.2	-7.7
Communications	5.9	2.5	3.5	-0.1	-1.5
Financial institutions	-0.9	0.8	0.7	0.1	0.4
Other services	-0.5	-1.0	-1.2	-2.0	-3.5
Rents	0.4	0.9	0.1	0.8	0.3
Public administration	-0.4	-0.6	-0.4	0.5	0.9
Value added at basic prices	-1.0	-0.7	-1.7	-2.5	-3.8
Taxes on products	-1.7	-0.4	-3.8	-5.9	-8.3
GDP at market prices	-1.1	-0.7	-2.0	-3.0	-4.5
Households consumption	0.1	1.7	-1.5	-3.0	-4.5
Government consumption	1.4	-0.5	-0.5	-0.3	-0.4
Gross fixed capital formation	-7.7	-6.9	-10.1	-12.9	-15.0
Exports	4.6	-10.7	3.3	7.7	1.1
Imports	2.0	-4.4	-5.0	-11.5	-20.0

Source: IBGE

Table 1.7 – Industrial production

	Quarter over same quarter in previous year (%)			
	2015			
	Jul	Aug	Sep	Oct
Building inputs	-11.6	-12.1	-15.5	-17.4
Capital goods	-23.7	-26.1	-30.5	-32.2
Typically industrialized	-5.1	-0.6	-2.9	-5.0
Agricultural	-24.0	-27.6	-27.7	-28.2
Agricultural parts	-20.7	-21.0	-24.9	-27.0
Building	-48.3	-52.7	-55.5	-58.1
Electricity	-21.7	-21.1	-18.8	-15.4
Transportation equipment	-27.6	-30.6	-36.4	-38.1
Mixed	-23.8	-28.5	-35.6	-35.9

Source: IBGE

1.5 Investments

Investments, excluding variations in inventories, decreased by 15.0% in the third quarter of 2015, compared to the same period in 2014, according to the IBGE Quarterly National Accounts. In the margin, considering seasonally adjusted data, the GFCF varied -4.0% in relation to the second quarter of the year, the ninth consecutive quarterly decline, accumulating a decline of 21.2% since the second quarter of 2013.

The absorption of capital goods decreased by 32.8% in the quarter ended in October 2015, compared to the same period in 2014, a result of the respective declines of 32.2%, 25.8%, and 0.4% in the production, import, and export of these goods. The decreased production of capital goods reflected the modest performance of the categories for the areas of construction, transportation equipment, and of mixed use. Production of typical construction inputs decreased by 17.4% compared to the quarter ended in October 2014.

1.6 Conclusion

Domestic economic activity keeps showing negative results – a performance that reflects effects of the ongoing macro-economic adjustments –, which have been intensified by non-economic events. The expansion of uncertainties arising from these events affects the confidence of economic agents and affects significantly the investment and consumption decisions, in particular those concerning higher value added goods.

The rhythm of activity tends to increase in the medium term, when the adjustment process – which has been more intense and longer than the expected – and the overcoming of the non-economic events previously mentioned create appropriate conditions for the resumption of confidence of companies and households and favor the expansion of consumption and investments. In addition, the external component of the aggregate demand, in the context of greater global growth and exchange rate depreciation, corroborates the prospect of reaction of the activity in the medium term.

Projection for GDP in 2016 and revision of 2015

This table presents projections from the Brazilian Central Bank for the growth of gross domestic product (GDP) in 2015 and 2016.

Revision of the projection for 2015

The revised projection for the growth of GDP in 2015 incorporates the results released by the Brazilian Institute of Geography and Statistics (IBGE) for the third quarter of the year, the revision of the time series of quarterly national accounts and statistics available for the current quarter. The estimate was revised from -2.7%, in the previous Report, to -3.6%.

Agricultural production is expected to grow 1.7%, down from the previous estimate of 2.6%, a downturn consistent with the revision for the production of important cultures, which was conducted in the IBGE Systematic Survey of Agricultural Production (LSPA). The estimate of decline for industry production rose from 5.6% to 6.3%, worsening due to revisions in projections for the manufacturing industry (-0.9 p.p.), for the construction sector (-1.0 p.p.), and for the extractive industry (-1.6 p.p.), this one reflecting effects from the strike of oil and gas extraction workers and the shutdown of one of the major mining companies in the country, after environmental accident in Minas Gerais. The services sector is expected to decline 2.4% (-1.6% in the previous Report), with emphasis on the revisions for activities related to real estate and leasing, -2.2 p.p., trade, -1.7 p.p., and other services, -0.7 p.p.

In the context of internal demand, significant reductions in projections for households consumption (from -2.4% to -3.8%), which incorporates the result from

the third quarter and coincident indicators for October and November; and for Gross Fixed Capital formation (GFCF), from -12.3% to -14.5%, consistent with the performance of the construction sector and of the absorption of capital goods. The contribution of domestic demand to the variation of the GDP in 2015 is estimated at -6.2 p.p.

In relation to the external component of the aggregate demand, the annual growth of exports was revised from 8.0% to 5.1%, alteration consistent with the performance of the third quarter and with preliminary information for October and November. The variation of imports was revised to -14.4% (-10.7% in the previous Report). The contribution of the external sector to the variation of GDP in 2015 is expected to reach 2.6 p.p., the highest since 2003.

Projection for 2016

The projection for the variation of GDP in 2016 reaches -1.9%. The result, which incorporates the scenario of uncertainties associated with non-economic events, is close to the estimated statistical load for the year.

Agricultural production is expected to increase by 0.5%, in line with prospects released by the IBGE and by the National Supply Company (Conab). The prospect of growth for the crop of soybeans is significant.

The variation of industry production is estimated at -3.9%, third consecutive annual decline. Projections point to reductions in the extractive industry (4.0%), consistent with the goals for the production of oil and iron ore announced by major companies in the sector and, in particular, with the negative impact from the aforementioned environmental accident; in the manufacturing industry (-3.8%), consistent with the impact from the context of historically reduced level of confidence of businessmen and still high level of inventories, which can be mitigated by potential competitiveness gains resulting from currency depreciation; and in the construction sector (-5.0%), demonstrating the still negative dynamics of the housing segment, impacted by high inventories of real estate and the restriction of financing.

Table 1 – Gross Domestic Product
Accumulated in 4 quarters

	% growth		
	2015		2016
	III Q	IV Q ^{1/}	III Q ^{1/}
Crop and livestock	2.1	1.7	0.5
Industry	-4.7	-6.3	-3.9
Mining	8.7	4.5	-4.0
Manufacturing	-8.2	-9.1	-3.8
Construction	-6.9	-8.8	-5.0
Public utilities	-2.9	-1.8	0.4
Services	-1.6	-2.4	-1.2
Commerce	-6.1	-8.4	-3.3
Transportation	-3.8	-5.8	-3.0
Communications	1.1	0.1	-0.5
Financial institutions	0.5	-0.0	-0.3
Other services	-1.9	-2.5	-1.7
Rents	0.5	0.3	0.0
Public administration	0.1	0.3	0.2
Value added at basic prices	-2.2	-3.1	-1.7
Taxes on products	-4.6	-6.5	-3.1
GDP at market prices	-2.5	-3.6	-1.9
Households consumption	-1.8	-3.8	-2.0
Government consumption	-0.4	-0.3	0.4
Gross fixed capital formation	-11.2	-14.5	-9.5
Exports	0.1	5.1	2.0
Imports	-10.4	-14.4	-11.0

Source: IBGE

1/ Estimated.

The tertiary sector is expected to decrease by 1.2% in 2016, following the dynamics of industrial production and households consumption. Activities of trade, transport, and other services and information services are expected to decrease by 3.3%, 3.0%, 1.7%, and 0.5%, respectively.

Importantly, from the perspective of demand, the estimates of less significant decreases, compared to projections for 2015, in household consumption and in GFCF. The increase of 1.8 p.p., to -2.0%, in the estimate for the annual variation in consumption, considers the effects from the more favorable evolution of the extended overall wages (overall wages and social assistance received by households), which should reflect the significant increase expected for the minimum wage, and the more benign trajectory of inflation. The growth of 5 p.p., to -9.5% in the projection for the annual variation of GFCF (third consecutive annual decline) reflects, in part, the prospect that shocks that impacted heavily the evolution of this component of demand in 2015 will not repeat with the same intensity in 2016. The annual downturn reflects, in particular, the negative context for the construction sector and the significant decline in the absorption of capital goods, in an environment of expensive credit and historically low levels of capacity utilization. Domestic demand is expected to contribute with -3.7 p.p. for the variation of GDP in 2016.

The low dynamism of the Brazilian economy will keep impacting imports of goods and services, which are expected to decrease by 11.0% in 2016, contrasting with the projection of 2.0% growth for exports. The contribution of the external sector to the annual variation of GDP in 2016 is estimated, therefore, at 1.8 p.p.

Consumer inflation accelerated in the quarter ended in November, still reflecting the processes of adjustments to relative prices – domestic in relation to international ones and regulated in relation to market ones – which have been more time consuming and more intense than anticipated.

The producer price indices accelerated in the quarter, reflecting, mostly, the effects of currency depreciation on prices of agricultural and industrial products.

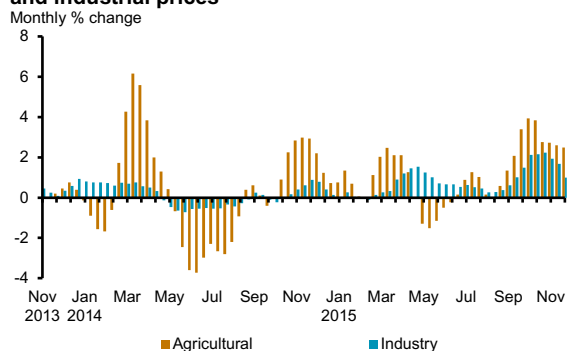
2.1 General indexes

Table 2.1 – General price indices

	% monthly change				
	2015				
	Jul	Aug	Sep	Oct	Nov
IGP-DI	0.58	0.40	1.42	1.76	1.19
IPA	0.61	0.44	2.02	2.38	1.41
IPC-Br	0.53	0.22	0.42	0.76	1.00
INCC	0.55	0.59	0.22	0.36	0.34

Source: FGV

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



Source: FGV

The General Price Index (IGP-DI), released by FGV, varied 4.44% in the quarter ended in November (1.68% in that ended in August). The variation of the Broad Producer Price Index (IPA) rose from 1.49% to 5.92%; the variation of the Consumer Price Index (IPC) rose from 1.58% to 2.19%; and the variation of the National Cost of Construction Index (INCC) declined from 3.00% to 0.92%.

The acceleration of the IPA reflected, in particular, the devaluation of the exchange rate, resulting in increased variations in prices of industrial products, from 1.38% to 4.78% (petroleum and alcohol products, 6.94%; sugar, 42.16%) and of agricultural products, from 1.76% to 8.88% (cattle products, 4.31%; corn, 20.74%; potatoes, 66.41%). Considering periods of twelve months, agricultural and industrial prices rose 14.72% and 9.95%, respectively, in November (10.45% and 5.94%, respectively, in August).

The acceleration of the IPC in the quarter was conditioned, mainly, by the rises in prices of gasoline (7.82%), bottled gas (16.49%), and alcohol fuel (18.28%). The deceleration of the INCC reflected, in particular, the stability in labor costs. The prices of materials and services varied 1.97% in the quarter.

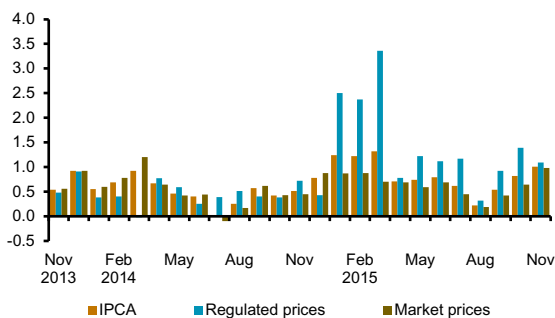
Table 2.2 – Consumer prices

	% monthly change				
	2015				
	Jul	Aug	Sep	Oct	Nov
IPCA	0.62	0.22	0.54	0.82	1.01
Non regulated prices	0.45	0.19	0.42	0.64	0.98
Tradables	0.50	0.42	0.46	0.99	1.14
Nontradables	0.40	-0.01	0.38	0.34	0.85
Services	0.54	0.32	0.67	0.62	0.46
Regulated prices	1.17	0.32	0.92	1.39	1.09

Sources: IBGE and Banco Central

Figure 2.2 – IPCA

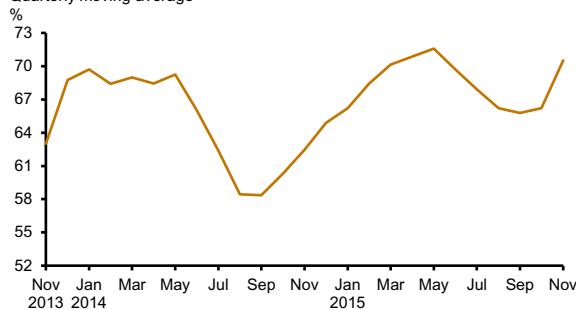
% monthly change



Sources: IBGE and Central Bank

Figure 2.3 – IPCA diffusion index

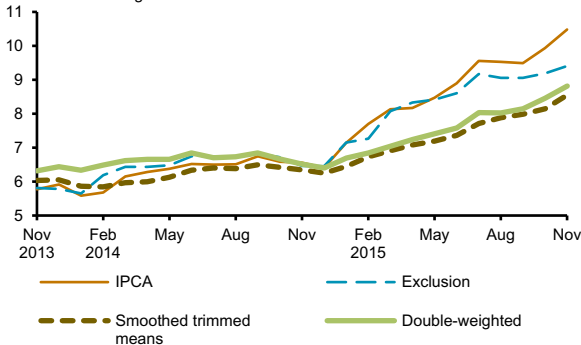
% of subitems with increase
Quarterly moving average



Source: IBGE

Figure 2.4 – Core inflation

12-month % change



Sources: IBGE and Banco Central

Considering twelve-month intervals, the IGP-DI rose 10.64% in November (7.80% in August and 4.10% in November 2014).

2.2 Consumer price indexes

The IPCA, released by IBGE, varied 2.39% in the quarter ended in November (1.64% in that ended in August), a result of accelerations of monitored prices (from 2.63% to 3.44%) and of free prices (1.34% to 2.05%). Considering twelve-month periods, the variation of the IPCA rose from 9.53%, in August, to 10.48%, in November, as a result of accelerations of regulated prices, from 15.75% to 17.95%, and of free prices, from 7.70% to 8.28%.

The quarterly evolution of free prices reflected the rises in variations of prices of tradables (from 1.61% to 2.61%), with an emphasis on ethanol and apparel; and of prices of non-tradables (from 1.08% to 1.58%), particularly of fresh food and airfare.

The rise in the quarterly variation of regulated prices reflected, mostly, the impact of the higher rises in the items gasoline and bottled gas, mitigated by the decline of the effects of adjustments in the prices of the items games of chance and water and sewage fee.

The prices of services increased by 1.76% in the quarter ended in November (1.66% in that ended in August), with emphasis on the increase in the prices of airfare and food away from home. Considering twelve-month periods, the prices of services increased by 8.34% in November (8.24% in August).

The monthly average of the IPCA diffusion index reached 70.51% in the quarter ended in November (66.22% and 62.47%, respectively, in those ended in August 2015 and in November 2014).

2.3 Cores

The core IPCA, which excludes ten items of the subgroup food at home and fuels, increased by 1.62% in the quarter ended in November (1.93% in that ended in August). In 12 months, the variation of the core reached 9.41% in November (9.06% in August).

Table 2.3 – IPCA – Regulated items

	Weights	% monthly change					
		2015					
		Jul	Aug	Sep	Oct	Nov	Year
IPCA	100.00	0.62	0.22	0.54	0.82	1.01	9.62
Market prices	75.63	0.45	0.19	0.42	0.64	0.98	7.33
Regulated prices	24.37	1.17	0.32	0.92	1.39	1.09	17.45
Main items							
Pipeline gas	0.07	0.86	0.96	0.15	0.46	-0.17	7.35
Urban bus	2.56	0.00	0.60	0.10	0.10	1.11	14.86
Water and sewage	1.47	2.44	1.07	1.48	-0.04	0.40	14.64
Health plans	3.31	1.59	1.08	1.06	1.06	1.06	10.98
Gasoline	3.99	-0.29	0.67	-0.23	5.05	3.21	18.61
Tolls	0.11	2.69	2.04	0.49	0.03	0.40	5.44
Medicine	3.28	0.21	-0.11	0.30	0.15	0.02	6.63
Electricity	4.04	4.17	-0.42	0.28	0.87	0.98	50.48
Natural gas vehicle	0.12	2.65	2.56	2.25	1.28	0.14	14.81
Bottled cooking gas	1.23	-0.04	-0.44	12.98	3.27	0.81	22.39
Diesel fuel	0.15	-0.25	0.03	-0.12	3.26	1.76	12.76

Sources: IBGE and Central Bank

Table 2.4 – Consumer prices and core inflation

	% monthly change				
	2015				
	Jul	Aug	Sep	Oct	Nov
IPCA	0.62	0.22	0.54	0.82	1.01
Exclusion ^{1/}	0.41	0.33	0.55	0.63	0.59
Exclusion ^{2/}	0.71	0.32	0.55	0.53	0.53
Smoothed trimmed means	0.67	0.56	0.64	0.66	0.75
Trimmed means	0.55	0.42	0.48	0.61	0.65
Double-weighted	0.63	0.43	0.69	0.73	0.71
IPC-Br	0.53	0.22	0.42	0.76	1.00
Core IPC-Br	0.58	0.58	0.42	0.76	0.69

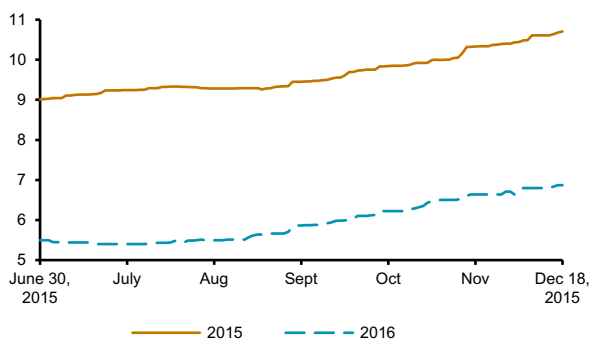
Sources: IBGE, Banco Central and FGV

1/ Removed items: regulated prices and all items of food at home group.

2/ Removed items: 10 items of the food at home group, vehicle fuel and household fuel.

Figure 2.5 – IPCA

Median (%)



7/ The criterion used to compute this indicator excludes the items whose monthly variation is, in the distribution, above the percentile 80 or below the percentile 20, in addition to smoothing over 12 months the fluctuation of items whose variations are concentrated in few periods of the year.

8/ The criteria used to compute this indicator is the reweighting of the original weights – based on the importance of each item to the IPCA basket – by their respective degrees of relative volatility, a procedure that reduces the importance of the more volatile components.

The core that excludes the monitored items and all items of the subgroup food at home varied 1.78% (1.43% in the quarter ended in August). Considering twelve-month intervals, the indicator varied 7.33% in November (6.84% in August).

The cores computed by smoothed⁷ and non-smoothed trimmed means varied 2.06% and 1.75%, respectively, in the quarter ended in November (1.96% and 1.60%, respectively, in that ended in August). Considering twelve-month periods, these cores varied, respectively, 8.55% and 7.69% in November (7.88% and 7.15%, respectively, in August).

The double weighted indicator⁸ increased by 2.15% in the quarter ended in November (1.84% in that ended in August). In twelve months, the indicator varied 8.82% in November (8.02% in August).

The core inflation from the IPC released by the FGV, computed by the method of smoothed trimmed means, increased by 1.88% in the quarter ended in November (1.88% in that ended in August). Considering twelve-month periods, the indicator varied 8.07% in November and 7.55% in August.

2.4 Market expectations

According to the Focus Survey – Market Report, December 18, the median of the projections for the annual variation of the IPCA in 2015 rose from 9.49%, at the end of September, to 10.70%, and the median of the projections for 2016 rose from 5.89% to 6.87%. The median of the expectations for inflation 12 months ahead – smoothed – rose from 6.05% to 7.04% in the same period.

The medians of the estimates for the variations in the General Price Index – Market (IGP-M) in 2015 and 2016 were, respectively, 10.72% and 6.48% on December 18 (8.32% and 5.76%, respectively, at the end of September), and those relating to the IPA-DI reached 11.40% and 6.64% (7.97% and 6.26%, respectively, at the end of September).

The medians of the expectations for the rise in the prices administered or monitored by contracts in 2015 and 2016

Figure 2.6 – IGP-M and IPA-DI

Median (%)

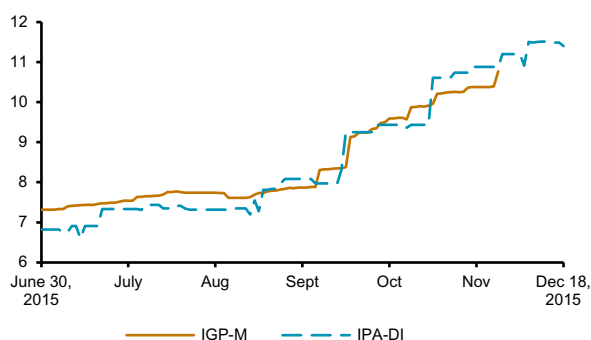


Figure 2.7 – Exchange rate

Median (R\$/US\$)

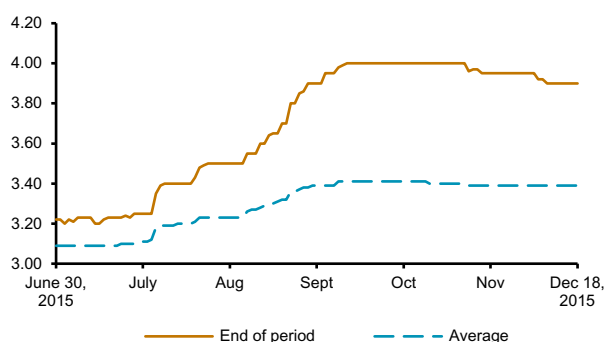


Table 2.5 – Summary of market expectations

	6.30.2015		9.30.2015		12.18.2015	
	2015	2016	2015	2016	2015	2016
In percentage						
IPCA	9.01	5.50	9.49	5.89	10.70	6.87
IGP-M	7.32	5.50	8.32	5.76	10.72	6.48
IPA-DI	6.82	5.50	7.97	6.26	11.40	6.64
Regulated Prices	14.70	5.96	15.55	6.00	18.00	7.50
Selic (end-of- period)	14.50	12.00	14.25	12.50	...	14.75
Selic (average)	13.72	13.36	13.63	13.63	...	15.09
GDP growth	-1.50	0.50	-2.82	-1.00	-3.70	-2.80
In R\$/US\$						
Exchange rate (end-of-period)	3.22	3.40	3.98	4.00	3.90	4.20
Exchange rate (average)	3.09	3.30	3.41	3.99	3.39	4.11

reached, respectively, 18.00% and 7.50% on December 18 (15.55% and 6.00%, respectively, on September 30).

The medians of the exchange rate projected by the market for the ends of 2015 and 2016 reached R\$3.90/US\$ and R\$4.20/US\$, respectively, on December 18 (R\$3.98/US\$ and R\$4.00/US\$, respectively, at the end of September). The medians of the projections for the average exchange rate of 2015 and 2016 were, respectively, R\$3.39/US\$ and R\$4.11/US\$ (R\$3.41/US\$ and R\$3.99/US\$), respectively, on September 30).

2.5 Conclusion

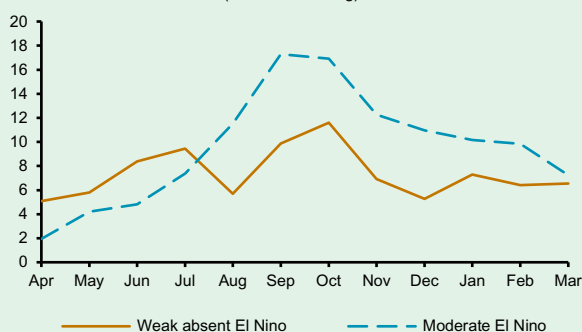
The monthly consumer inflation rates accelerated in the quarter ended in November, reflecting, mostly, rises in fuel and food prices. In twelve months, inflation measured by the IPCA had a new acceleration, remaining above the upper limit of the target set by the National Monetary Council (CMN) in the context of the inflation target regime.

Prospectively, although the recent currency depreciation and the inflationary inertia represent relevant risks, the moderation of regulated prices and the effects from recently implemented monetary policy actions should favor the deceleration of consumer inflation. In the first quarter of 2016, in particular, significant deceleration is expected for inflation in 12 months, reflecting the absence of the high monthly rates observed in the same period in 2015.

El Niño, rainfall, and major inflationary impacts

Figure 1 – ENA in South region

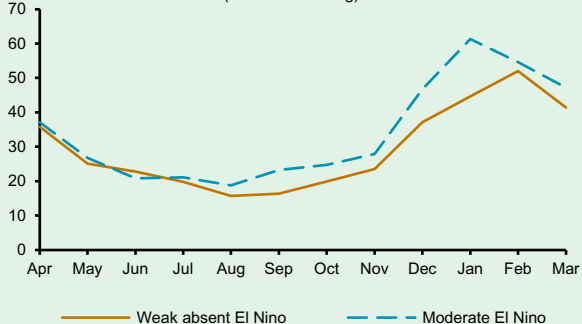
Median 2000/2001-2014/2015 (thousand MWavg)



Sources: ONS and BCB

Figure 2 – ENA in the Southeast and Central-West regions

Median 2000/2001-2014/2015 (thousand MWavg)



Sources: ONS and BCB

The climate event called *El Niño* is characterized by a rise in the temperature of surface waters on the coast of the Pacific Ocean, causing drought or excessive rainfall in the tropics and subtropical zones. In Brazil, the phenomenon causes alterations in the rainfall pattern of different regions, impacting inflation, either by increasing costs in food production or by reducing electricity rates in contexts of high levels in reservoirs. The aim of this box is to evaluate the effect from *El Niño* on consumer prices.

El Niño occurs without defined periodicity and its duration ranges from 12 to 15 months. The phenomenon manifested with strong intensity in 2015 and the expectation, according to the WMO¹, is that it will intensify in December², and should consolidate as one of the four most intense recorded since 1950³ and the strongest of the last 15 years.

In Brazil, *El Niño* is associated with increased rainfall in the South, Southeast, and Central-West, which can be observed in the evolution of the median of Affluent Natural Energy (ENA)⁴ in years with moderate *El Niño* and in the other years (Figures 1 and 2).

In the South, the difference in rainfall standard intensifies from August, in years with moderate *El Niño*, and in the Southeast and Central-West, from December to March of the following year⁵.

1/ World Meteorological Organization.

2/ Typically, the intensity of *El Niño* reaches its peak during the months from October to January of the following year, persisting until at least the end of the first quarter.

3/ More intense events occurred in 1972-1973, 1982-1983, and 1997-1998.

4/ Affluent natural energy, measured in average megawatt (MWavg), serves as a proxy for the volume of rainfall. These data are released by the National Electricity System Operator (ONS) since January 2000.

5/ Importantly, however, based on statistical test of difference of means, the difference in the affluent natural energy in the cases considered is not statistically significant at 5%, which can be attributed, primarily, to the small sample size, from 2000/2001 to 2014/2015 (or 15 observations) and to the occurrence of only 2 moderate *El Niños* during the period (2002/2003 and 2009/2010). Data regarding affluent natural energy prior to January 2000 are not made available by ONS.

Figure 3 – Monthly ENA evolution in the South region

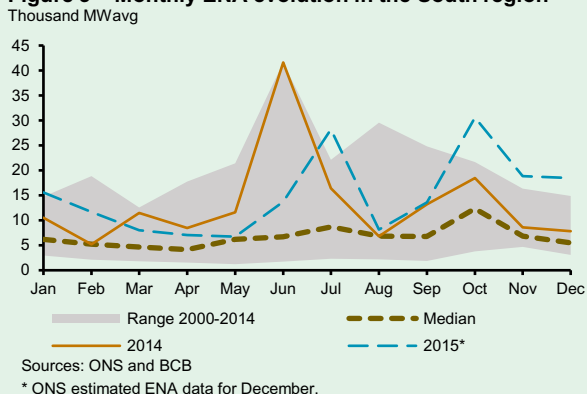


Figure 4 – Monthly ENA evolution in the Southeast and Central-West regions

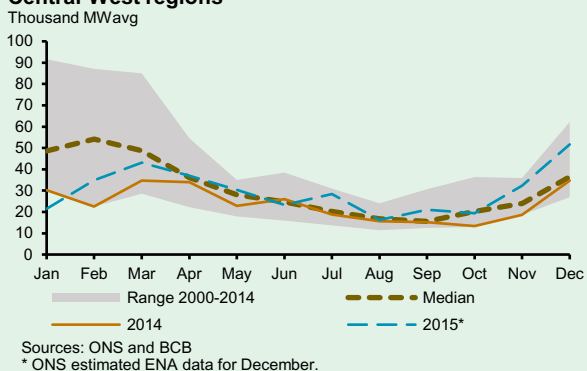
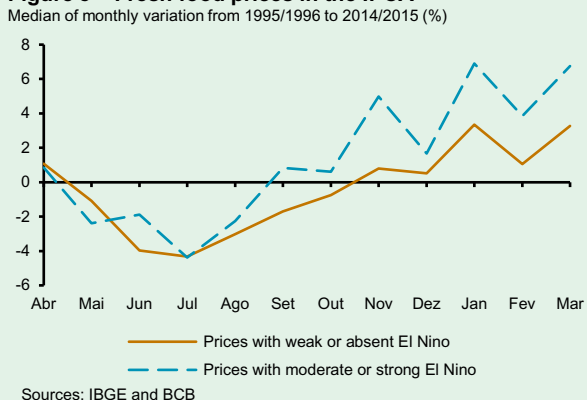


Figure 5 – Fresh food prices in the IPCA



The expectation is that the climate effects that occur in years with *El Niño* of moderate intensity and/or strong intensity recur in 2015 and 2016. In this sense, Figure 3 shows that the excessive rainfall registered in the South from August to November 2015 repeats the standard of other *El Niños* of moderate intensity. In the Southeast and Central-West (Figure 4), the historical standard indicates that the increase in rainfall occurs from December, lasting until the first quarter of the following year.

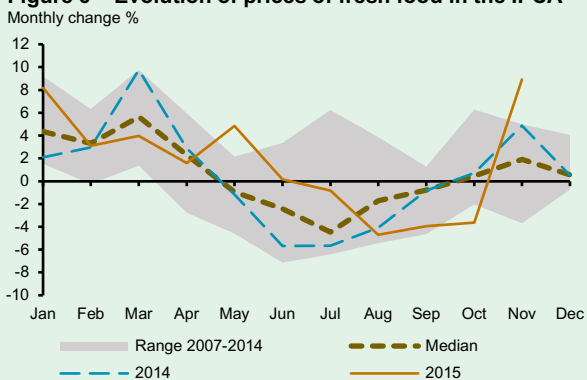
The increase of rainfall in the South, Central-West, and, mainly, Southeast could harm supplies of fresh food⁶ and affect their prices, which are sensitive to inadequate weather conditions (Figure 5). It is observed that, in fact, the median of inflation for fresh products is higher than when moderate or strong *El Niño* occurs, noting that the difference among the variations of these prices increases in the last months of the year and in the first quarter of the following year⁷.

Excessive rainfall in the South⁸ impacted the prices of fresh food (Figure 6), noting that additional factors, such as reduction of planted and harvested area, also influenced the trajectory of these prices. Additionally, if the rainfall pattern expected for the Southeast is confirmed in the coming months, it is expected that prices of fresh food continue increasing above the seasonal pattern until early 2016, although with lower intensity than that observed in November this year⁹.

The pressure that the climate event can have on inflation through food prices may be offset by the positive impact of rainfall on electricity rates. In this sense, a possible increased level of reservoirs of the Southeast and Central-West¹⁰ regions by the end of 2015 and early 2016 may enable the shutdown of some of the thermal power plants, which generate more expensive electricity, creating

6/ Including the items “tubers”, “greens”, “roots and legumes”, and “fruits”, in addition to the component “chicken egg”, of the IPCA.
7/ The sample, in this case, comprised the years from 1995/1996 to 2014/2015. In this period, there were occurrences of moderate *El Niño* in 2002/2003 and 2009/2010; and of strong *El Niño* in 1997/1998.
8/ The South accounts for 34.5% of the total potatoes produced in Brazil and for 67.0% of the total onions. These items have significant weight in the total weight of fresh products in the IPCA, and are the ones with the highest rises, with tomatoes, among these products in November.
9/ Fresh foods are produced, mostly, in the Southeast.
10/ Which correspond to approximately 70% of the total of the country’s reservoirs.

Figure 6 – Evolution of prices of fresh food in the IPCA



Sources: IBGE and BCB

conditions for alteration in the electricity flag rates, from red to yellow or green.¹¹

It is estimated that the impact from the rise in prices of fresh food on the variation of the Extended National Consumer Price Index (IPCA) in 2016 will reach approximately 0.19 p.p. in the first quarter, decreasing to 0.13 p.p. before the year ends.¹² In the context of electricity flag rates, the possible change from red to yellow would result in a contribution of -0.18 p.p. to the IPCA variation in 2016 (-0.36 p.p. if there is change from red to green).

Based on the evidence presented, the *El Niño* phenomenon impacts the prices of fresh foods, with effects on the IPCA. This impact is expected to be more intense in early 2016. The *El Niño* phenomenon may also create conditions for changes in electricity flag rates, with favorable effects on inflation. The net effect of these two factors on the IPCA tends to be neutral or, depending on the evolution of electricity rates, favorable to the trajectory of inflation in 2016.

11/ It is noteworthy that the transfer of water shortage risk from electricity-generating companies to electricity flag rates can cause a rise in the value of MW/hour of electricity consumed, even in the case of green or yellow flag.

12/ To project the contribution of fresh products to the IPCA, an ARIMA model (1,1,4) was estimated with seasonal dummies and a dummy for the occurrence of moderate or strong *El Niños* (November, December, January, February, and March in 1997/1998, 2002/2003, 2009/2010, and 2015/2016).

Credit, monetary and fiscal policies

Table 3.1 – Credit operations

	2015				R\$ billion	
	Aug	Sep	Oct	Nov	% change	
					3 months	12 months
Total	3 135.2	3 164.3	3 157.4	3 176.8	1.3	7.4
Non-financial corp.	1 655.0	1 677.5	1 667.2	1 676.3	1.3	6.8
Nonearmarked	804.6	813.2	805.9	812.8	1.0	4.3
Earmarked	850.3	864.3	861.3	863.4	1.5	9.2
Households	1 480.2	1 486.8	1 490.2	1 500.5	1.4	8.2
Nonearmarked	796.7	797.3	796.8	801.5	0.6	3.8
Earmarked	683.6	689.5	693.3	699.1	2.3	13.7
% participation:						
Total/GDP	53.6	54.0	53.7	53.8		
Non-fin. corp/GDP	28.3	28.6	28.4	28.4		
Households/GDP	25.3	25.4	25.3	25.4		
Nonearmarked/GDP	27.4	27.5	27.3	27.3		
Earmarked/GDP	26.2	26.5	26.4	26.5		

Figure 3.1 – Balance of Financial System credit operations by capital control

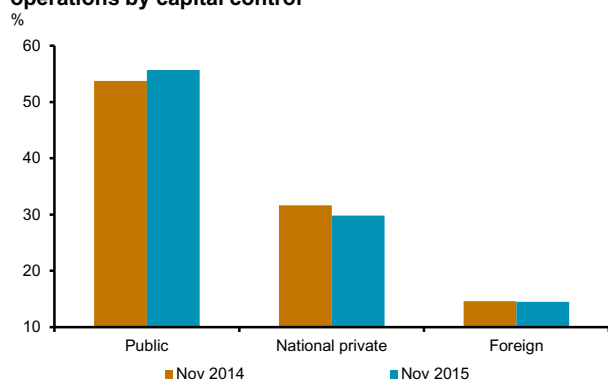
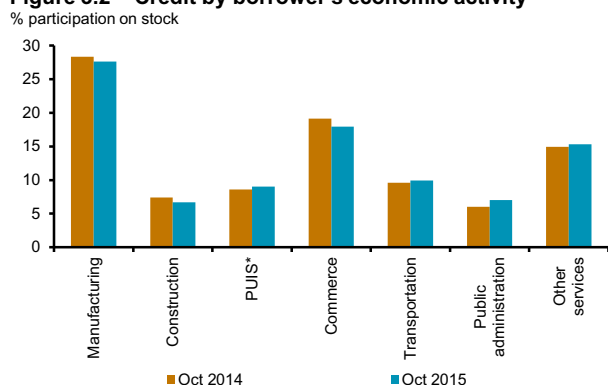


Figure 3.2 – Credit by borrower's economic activity



* Utilities.

The financial system credit transactions deceleration trajectory persisted in the quarter ended in November, both in the corporate and household segments. Importantly, this evolution, influenced by the context of increased interest rates and decreases in disposable income and in the confidence of economic agents, occurred despite the seasonal effects typical of end of year on demand for loans.

3.1 Credit

Credit operations of the financial system, including nonearmarked and earmarked resources, totaled R\$3,177 billion in November, increasing 1.3% in the quarter and 7.4% in twelve months (respective increases of 1.7% and 9.7% in the quarter ended in August). The corporate and household portfolios amounted to, respectively, R\$1,676 billion and R\$1,501 billion, with respective increases of 1.3% and 1.4% in the quarter, and of 6.8% and 8.2% in twelve months. The credit-to-GDP ratio reached 53.8% in November (53.6% in August and 52.2% in November 2014).

The portfolios of public financial institutions, national private financial institutions, and foreign private financial institutions accounted for, in order, 55.7%, 29.8%, and 14.5% of the total credit of the financial system in November (53.7%, 31.6%, and 14.6%, respectively, in the same period in 2014). In the quarter, there were increases in portfolios of foreign institutions (2.1%), of national public institutions (1.8%), and of national private institutions (0.2%).

The allocation of credit per economic activity⁹ indicates that the balance of operations contracted by the manufacturing industry (in particular for the oil and fuel activity) and by the extractive industry increased by 1.6% and 6.8%, respectively, in the quarter ended in October. In the same

9/ Loans with nonearmarked and earmarked resources for companies of the private and public sectors are included.

sense, the balances of contracts in the segments public administration, transport, and trade increased by 5.8%, 2.1%, and 0.6%, respectively.

The total credit for the private sector amounted to R\$2,904 billion. The quarterly increase of 1.1% reflected increases of 1.5% in the household segment and of 0.7% in the corporate segment. The credit for the public sector amounted to R\$253 billion, noting that the quarterly expansion of 6.5% reflected respective variations of 8.0% and 5.1% in the loans to the federal government, and to states and municipalities.

Table 3.2 – Credit do households

	R\$ billion						
	2015				% change		
	Aug	Sep	Oct	Nov	3 months	12 months	
Nonearmarked resources	796.7	797.3	796.8	801.5	0.6	3.8	
Personal credit	376.6	378.9	379.0	380.2	1.0	8.0	
Of which:							
Payroll-deducted	270.2	272.0	272.2	273.3	1.1	9.4	
Auto loans	168.6	166.8	164.9	163.1	-3.3	-11.1	
Credit card	159.6	158.1	159.6	164.6	3.1	9.7	
Overdraft	27.6	27.4	27.5	27.1	-1.9	5.0	
Others	64.2	66.0	65.9	66.5	3.5	9.8	
Earmarked resources	683.6	689.5	693.3	699.1	2.3	13.7	
BNDES	45.0	45.2	45.5	45.7	1.5	8.3	
Real estate financing	481.9	486.3	490.8	494.9	2.7	17.1	
Rural	148.8	150.3	149.7	151.1	1.6	6.7	
Others	7.8	7.7	7.5	7.4	-5.7	-9.5	

Table 3.3 – Credit to non-financial corporations

	R\$ billion						
	2015				% change		
	Aug	Sep	Oct	Nov	3 months	12 months	
Nonearmarked resources	804.6	813.2	805.9	812.8	1.0	4.3	
Working capital	381.6	379.5	377.2	377.8	-1.0	-3.0	
Guaranteed overdraft account	43.7	42.1	42.2	42.7	-2.4	-8.8	
Advances on exchange contracts	64.7	65.9	65.8	65.5	1.3	25.7	
Exports financing	66.8	67.3	67.5	67.5	1.0	18.4	
Others	247.7	258.4	253.2	259.2	4.6	11.1	
Earmarked resources	850.3	864.3	861.3	863.4	1.5	9.2	
BNDES	621.4	626.6	623.3	624.8	0.5	8.8	
Real estate financing	70.8	71.6	72.1	72.4	2.2	11.1	
Rural	73.5	78.8	78.3	77.7	5.8	5.2	
Others	84.6	87.4	87.6	88.6	4.7	13.9	

Credit operations with nonearmarked resources (50.8% of the total financial system) amounted to R\$1,614 billion in November, increasing by 0.8% in the quarter and 4.1% in twelve months. The corporate portfolio (R\$813 billion) varied 1.0% in the quarter, noting the respective increases of 13.3% and 10.9% in discount of trade bills and other credits (notably, acquisition of receivables), both influenced by seasonality, and the decreases in working capital (1.0%) and guaranteed overdraft account (2.4%), consistent with the reduced dynamism of activity. The household portfolio (R\$802 billion) grew 0.6% in the quarter, with emphasis on the increases in payroll-deducted loans (1.1%) and credit card – non-financing (3.1%). Importantly, contracts associated with payroll loans decreased by 8.6% in the quarter.

Operations with earmarked resources totaled R\$1,563 billion in November, increasing by 1.9% in the quarter and by 11.2% in twelve months. The credit contracted by households reached R\$699 billion, noting that the quarterly increase of 2.3% reflected expansions of 1.6% in rural credit and of 2.7% in real estate financing, whose concessions decreased by 12.2% and 14.9%, respectively, in the quarter.

The loans contracted by corporations totaled R\$863 billion. The quarterly increase of 1.5% reflected, in particular, the increases of 5.8% in the rural credit portfolio and of 4.7% in the other earmarked credits. The balance of financing for investments of the Brazilian Development Bank (BNDES) grew 0.5% in the quarter.

Interest and delinquency rates

The average interest rate of the financial system credit operations reached 30.4% p.y. in November – the highest level of the series initiated in March 2011 –, with increases

Figure 3.3 – Interest rates – Credit to households

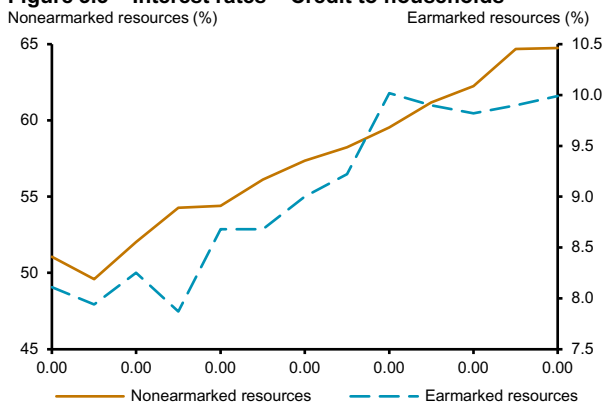


Figure 3.4 – Interest rates – Credit to non-financial corporations

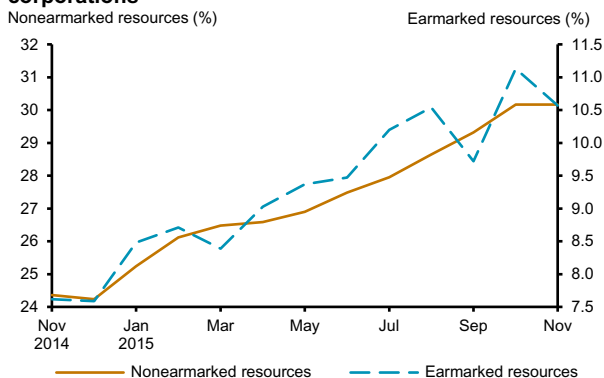
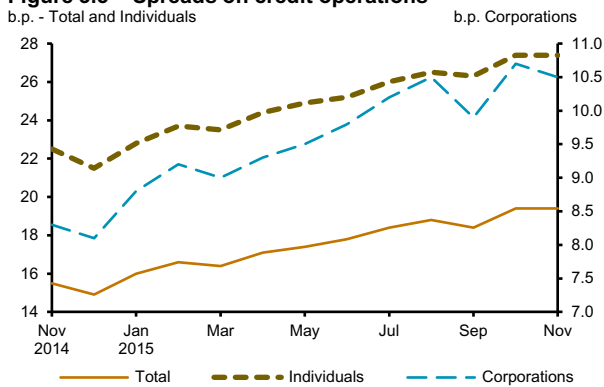
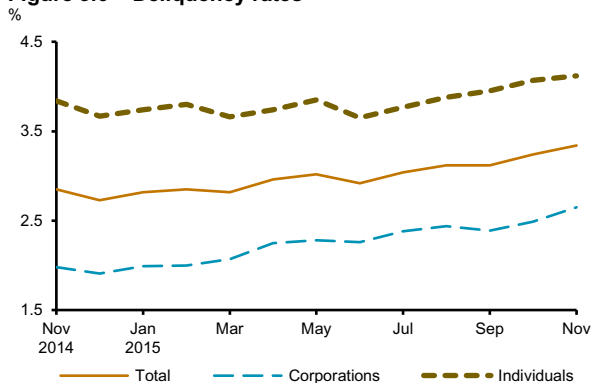


Figure 3.5 – Spreads on credit operations



Sources: BM&FBOVESPA, Dow Jones and Nasdaq

Figure 3.6 – Delinquency rates^{1/}



^{1/} Credit operations overdue for more than 90 days.

of 1.4 p.p. in the quarter and of 6.1 p.p. in 12 months. The quarterly increase reflected respective variations of 2.7 p.p. and 0.1 p.p. in operations with nonearmarked and earmarked resources, which had respective mean rates of 48.1% p.y. and 10.3% p.y., in the period.

In the household segment, the average interest rate was at 38.7% p.y., increasing by 1.7 p.p. in the quarter and 7 p.p. in 12 months. The quarterly evolution reflected increases of 3.6 p.p., to 64.8% p.y., in contracts with nonearmarked resources (overdraft, 31.6 p.p.; credit card – revolving, 11.8 p.p.), and of 0.1 p.p., to 10.0%, in contracts with earmarked resources.

In the corporate segment, the average interest rate amounted to 21.2% p.y. in November, increasing by 0.8 p.p. in the quarter and 4.6 p.p. in 12 months. The increase in the quarter reflected growths in loans with nonearmarked resources (1.5 p.p., to 30.2%), noting the variations in working capital (0.7 p.p.) and guaranteed overdraft account (2.8 p.p.); and in loans with earmarked resources (0.1 p.p., to 10.6%), with emphasis on the increase of 0.2 p.p. in rural credit.

The bank spread of the financial system credit operations reached 19.4 p.p. in November, increasing by 0.6 p.p. in the quarter and 3.9 p.p. in 12 months. The indicator reached 27.4 p.p. in the household segment and 10.5 p.p. in the corporate segment, with increase of 0.9 p.p. and stability, respectively, in the quarter. The spread reached 33.3 p.p. in contracts with nonearmarked resources and 3.5 p.p. in those with earmarked resources, varying 1.3 p.p. and -0.2 p.p., respectively, in the quarter.

The financial system delinquency, considering operations with delay of more than 90 days, was at 3.3% in November, increasing by 0.2 p.p. in the quarter and 0.5 p.p. in 12 months. The rate reached 4.1% in the household segment, increasing by 0.2 p.p. in the quarter and 0.3 p.p. in twelve months, and 2.6% in the corporate segment, with respective variations of 0.2 p.p. and 0.6 p.p., in the same periods. Delinquency reached 5.2% in contracts with nonearmarked resources and 1.5% in those with earmarked resources, increasing by 0.3 p.p. in both segments.

3.2 Monetary aggregates

The mean daily balance of the restricted money supply (M1) reached R\$302.5 billion in November, varying 0.9% in the

Figure 3.7 – Monetary base and M1 – Average daily balances

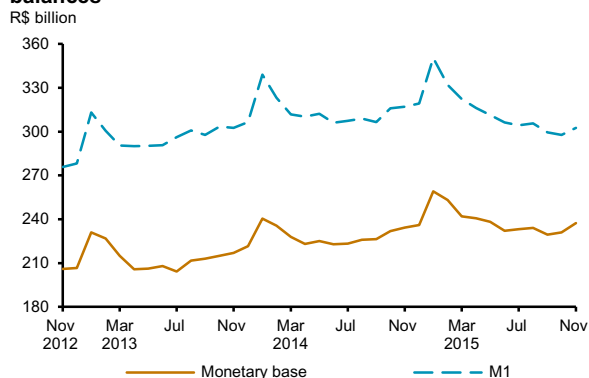


Figure 3.8 – Broad money supply

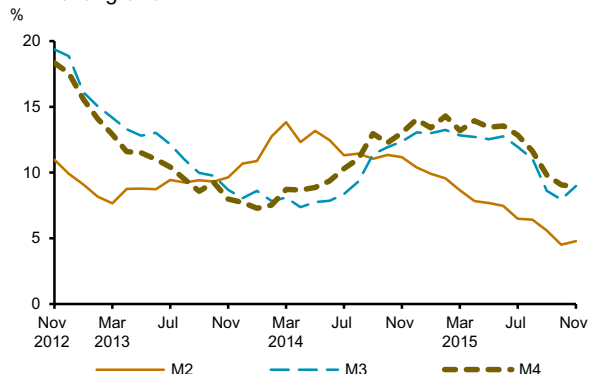
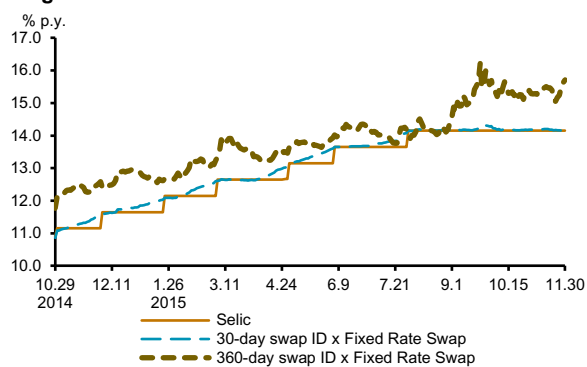
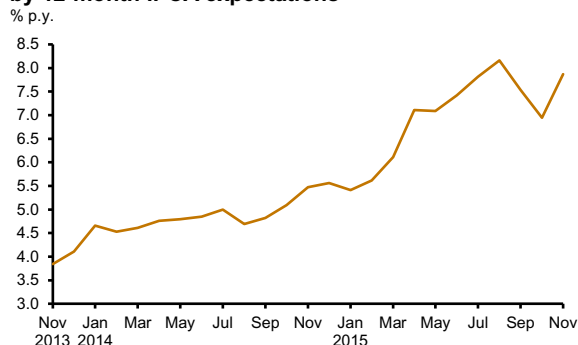


Figure 3.9 – Interest rate



Sources: BM&FBOVESPA and Banco Central

Figure 3.10 – Ex-ante real interest rate – Deflated by 12-month IPCA expectations



quarter and -5.3% in twelve months, and that of the monetary base amounted to R\$237.1 billion, increasing by 3.3% and 0.4%, respectively, on the same basis of comparison.

Considering balances at the end of period, the monetary base amounted to R\$242.8 billion in November. The quarterly expansion of 4.8% reflected expansionary impacts of adjustments in the operations with derivatives (R\$7.6 billion), of the operations with federal government securities (R\$35.8 billion) and of the operations of the National Treasury (R\$28 billion), neutralized, in part, by the contracting effects of the Central Bank foreign currency net sales (R\$37.4 billion) and of the reserve requirements (R\$23.8 billion).

The money supply, in the M2 concept, totaled R\$2,2 trillion in November (increases of 2.3% in the quarter and 5% in twelve months), with noteworthy variations of 3.1% in the stock of private securities and of -0.1% in savings deposits. M3 reached R\$4.6 trillion, increasing by 2.9% in the quarter and 8.6% in twelve months, and the M4 aggregate totaled R\$5.4 trillion, with respective increases of 2.2% and 8.6%, on the same basis of comparison.

Real interest rates and market expectations

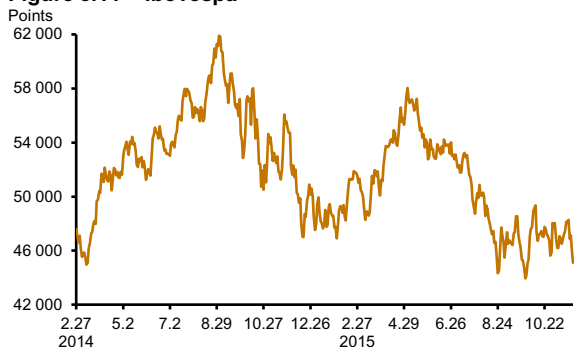
The rates of DI swap contracts x pre of 30 days and of 360 days had, in order, stability (at 14.2%) and increase of 1.3 p.p. (to 15.7% p.y.) in the quarter ended in November. This trajectory suggests that the expectation of increase in basic interest rate intensified in the quarter.

The market's expectation for the IPCA in the next 12 months, based on survey conducted by the Central Bank on the financial market, in late November, increased by 1.54 p.p., to 7.26% p.y., in the quarter. Considering as base scenario the current target of 14.25% p.y. for the Selic rate, the projection points to real interest rate of 6.5% p.y. for the next twelve months (8.2% p.y. in August).

Capital market

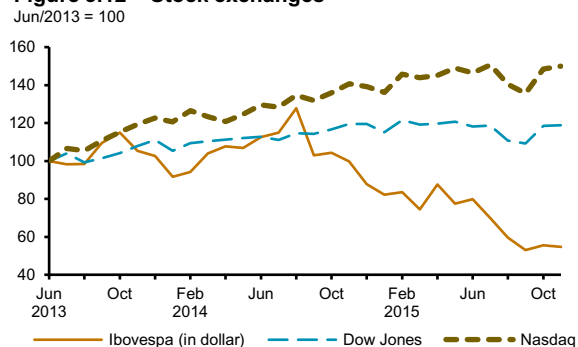
The São Paulo Stock Exchange Index (Ibovespa) declined by 3.2% in the quarter ended in November, with 45,120 points at the end of the period. Mean daily volume traded increased from R\$6.3 billion to R\$6.9 billion, in the quarter.

Figure 3.11 – Ibovespa



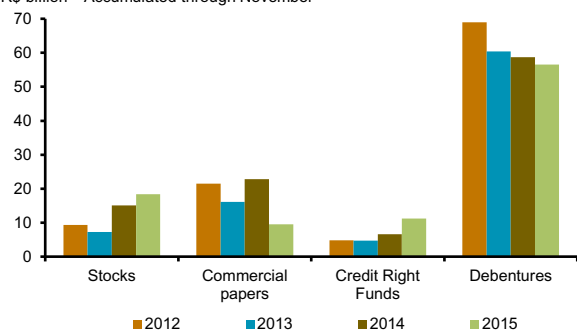
Source: BM&FBOVESPA

Figure 3.12 – Stock exchanges



Sources: BM&FBOVESPA, Dow Jones, Nasdaq

Figure 3.13 – Primary issues in the capital market
R\$ billion – Accumulated through November



Sources: CVM and ANBIMA

Table 3.4 – Public sector borrowing requirements –

Primary result

Twelve-month accumulated

	2013		2014		Oct 2015	
	R\$	%	R\$	%	R\$	%
	billion	GDP	billion	GDP	billion	GDP
Central Government	-75.3	-1.5	20.5	0.4	39.9	0.7
Sub-national governments	-16.3	-0.3	7.8	0.1	-4.0	-0.1
State companies	0.3	0.0	4.3	0.1	5.0	0.1
Total	-91.3	-1.8	32.5	0.6	40.9	0.7

Profitability of Ibovespa evaluated in US dollars, reflecting, in part, exchange rate depreciation of 5.6%, declined by 8.4% in the quarter, compared to respective increases of 7.2% and 7.0% in the Dow Jones and Nasdaq indexes.

Issuances of stocks, debentures, promissory notes and placement of receivables-backed securities, registered in the Securities and Exchange Commission (CVM), totaled R\$95.5 billion in the first eleven months of 2015 (R\$145.3 billion in the same period in 2014). Of this total, R\$18.3 billion refer to variable income and R\$77.2 billion, to fixed income, with emphasis on the issues of debentures (R\$56.5 billion, with R\$10 billion by leasing companies).

3.3 Fiscal policy

The Government, considering the scenario of lower tax revenue and difficulty in expanding the contingency restriction of expenses, submitted a Bill to the National Congress establishing a new primary outcome goal for 2015, through alterations in the Budget Guidelines Law. The proposal was approved in December and establishes that the goal for the Central Government changes from surplus of R\$5.8 billion to deficit of R\$51.8 billion, which may total up to R\$119.9 billion if there is frustration in the collection performance – revenue decrease – expected with concessions and permissions or payments of expenses of equalization of rates and/or subsidies accumulated from prior years. For regional governments, the primary surplus goal of R\$2.9 billion remains.

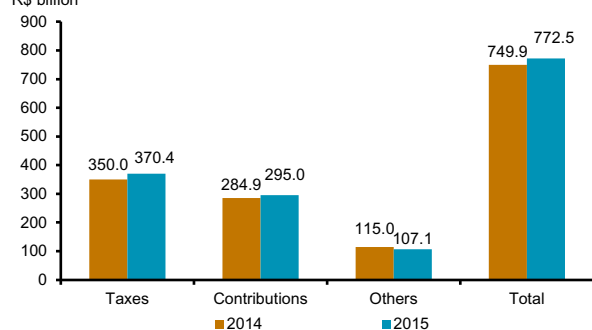
In October, several measures were announced to promote the Central Government’s primary surplus in 2016. Among the significant measures pending legislative approval, there is the implementation of the public service pay cap, extinction of the retention bonus paid to public servants that meet the requirements to retire (Constitutional Amendment Proposal – PEC 139/2015), postponement of the public servants payment rise, restoration of collection of Provisional Contribution on Financial Operations – CPMF (PEC 139/2015), and extension of the Release of Federal Government Resources Entitlements (PEC 87/2015).

The calculation of pensions supported by the General Social Security System was changed, in November, by Law 13,183. This Law also establishes that public servants are automatically enrolled in the pension plan upon joining the public service.

Figure 3.14 – National Treasury revenue

Accumulated up to October

R\$ billion



Source: MF/STN

Table 3.5 – National Treasury expenditures

January-October

	2014		2015	
	R\$ million	% GDP	R\$ million	% GDP
Total	524 561	11.5	532 843	11.1
Personnel and payroll charges	175 325	3.8	186 819	3.9
Capital/current expenditures	347 066	7.6	344 067	7.2
Workers Support Fund	47 430	1.0	40 190	0.8
Subsidies and economic subventions	7 707	0.2	22 521	0.5
Loas/RMV	32 013	0.7	35 363	0.7
Investment	68 807	1.5	45 851	1.0
Other capital expenditures	191 109	4.2	200 142	4.2
National Treasury transfers to the Central Bank	2 170	0.0	1 957	0.0

Source: Ministry of Finance/STN

Table 3.6 – Social security primary result

January-October

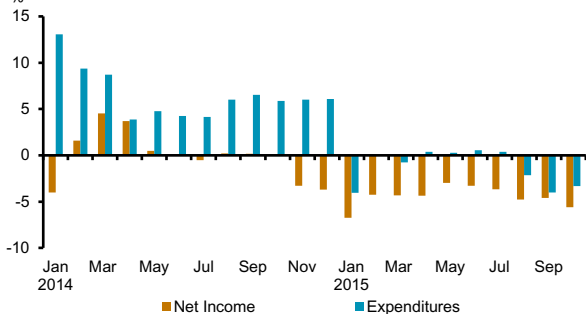
	R\$ billion		
	2014	2015	% change
Net inflow	265.0	275.6	4.0
Social Security benefits	315.5	349.7	10.8
Primary result	-50.6	-74.1	46.5
Net inflow/GDP	5.8%	5.7%	
Social Security benefits/GDP	6.9%	7.3%	
Primary result/GDP	-1.1%	-1.5%	

Source: Ministry of Finance/STN

Figure 3.15 – Central Government income and expenditure real growth rate (IPCA)

Accumulated in the year

%



Source: MF/STN

The National Congress concluded, on December 17, the voting procedure for the Budget Guidelines Law and for the Annual Budget Law for 2016. The consolidated primary surplus goal was set at R\$30.6 billion, of which R\$24 billion will be of responsibility of the Central Government and R\$6.6 billion of responsibility of regional governments. There is no provision in the Law for reduction in the goal, even in case of frustration in the collection performance (revenue decrease).

Public sector borrowing requirements

The public sector primary deficit totaled R\$20 billion over the first ten months of 2015, increasing by 72.6% compared to the same period in 2014. The Central Government and state-owned companies had deficits of R\$40.5 billion and R\$3.1 billion, respectively, and regional governments had surplus of R\$17.1 billion. The public sector presented primary deficit of R\$40.9 billion (0.71% of GDP) in the twelve-month period ended in October.

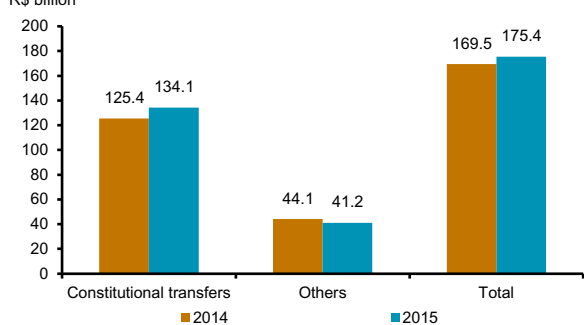
The Federal Government's gross revenue reached R\$772.5 billion in the first ten months of 2015, increasing by 3.0% compared to the same period in 2014. There were noteworthy rises in the tax revenue from Income Withholding Tax on capital returns (27.8%), because of the higher tax revenue from fixed income funds and swap operations, and from the Financial Operations Tax – IOF (18.4%), explained mainly by the increase in the tax rate levied on loans to individual entities. Conversely, there were decreases in dividend income (66.0%) and share of financial compensation (29.7%), the latter influenced by reduction in the international price of oil.

The National Treasury expenditure totaled R\$532.8 billion. The increase of 1.6% compared to the total accumulated in the first 10 months of 2014 reflected the impact from the rise of 6.6% in expenditures with personnel and tax, mitigated by the decline of 0.9% in expenses and capital. In this group, noteworthy increase of R\$14.8 billion in payments of subsidies and subventions, specially in expenses related to the Investment Support Program (R\$7.3 billion), and reductions of R\$18.7 billion in expenses of the Growth Incentive Program (PAC) and of R\$7.7 billion in aid to the Energy Development Account (CDE).

The Social Security System had a deficit of R\$74.1 billion in the first ten months of 2015. The increase of 46.5% compared to the same period in 2014 reflected rises of 4.0% in net tax

Figure 3.16 – Transfers to states and municipalities

Accumulated Jan-Oct
R\$ billion



Source: MF/STN

Figure 3.17 – Regional governments: Cumulative 12-month primary surplus and net debt

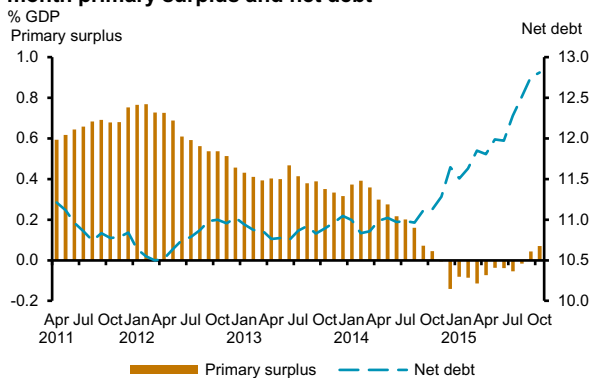
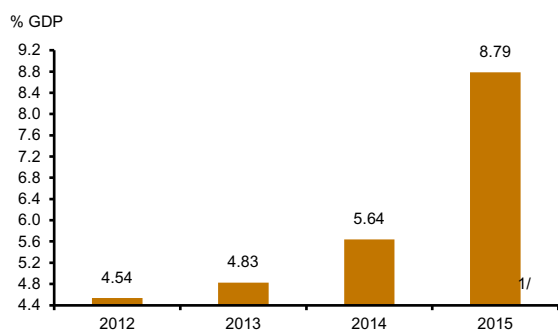


Figure 3.18 – Nominal interest



1/ Twelve-month accumulated up to October.

Table 3.7 – Public sector borrowing requirements

	2013		2014		Oct 2015 ^{1/}	
	R\$ billion	% GDP	R\$ billion	% GDP	R\$ billion	% GDP
Uses	157.5	3.1	343.9	6.2	547.9	9.5
Primary	-91.3	-1.8	32.5	0.6	40.9	0.7
Interest	248.9	4.8	311.4	5.6	506.9	8.8
Sources	157.5	3.1	343.9	6.2	547.9	9.5
Domestic financing	179.1	3.5	334.9	6.1	563.0	9.8
Securities financing	113.8	2.2	434.3	7.9	523.3	9.1
Bank financing	45.7	0.9	-118.7	-2.2	23.5	0.4
Others	19.6	0.4	19.3	0.3	16.3	0.3
External financing	-21.6	-0.4	9.0	0.2	-15.2	-0.3

1/ Twelve-month accumulated.

revenue, influenced by the growth of overall wages, and of 10.8% in spending on social security benefits, arising from increases of 8.8% in the minimum wage and of 2.8% in the number of benefits approved.

The revenue and expenditure of the Central Government (National Treasury, Social Security, and Central Bank) had respective increases of 2.7% and 5.1% in the first ten months of the year, compared to the same period in 2014. In real terms, considering the IPCA as deflator, the total revenue and expenditure of the Central Government declined by 5.4% and 3.3% respectively in the period.

The impact from reduction in the pace of activity on tax revenue keeps contributing so public revenues grow slower than expenditures, despite the rises in some tax rates, such as the Contribution on Intervention in the Economic Domain (Cide) and Financial Operations Tax (IOF), and despite the reversal of discharges. It is worth emphasizing, in addition, the delayed effects of some measures adopted to contain spending, such as the alterations in the rules for granting labor and social security benefits.

Transfers to regional governments totaled R\$175.4 billion in the first ten months of 2015. The rise of 3.4% compared to the same period in 2014 reflected, mainly, the growth of constitutional transfers and transfers related to Cide-fuels.

The primary surplus of the states and municipalities amounted to R\$17.1 billion, compared to R\$5.3 billion in the first ten months of 2014. Tax revenues from the Tax on Circulation of Merchandise and Services (ICMS) and from the Tax on Automotive Vehicle Proprietorship (IPVA) amounted to R\$296 billion and R\$31.7 billion, respectively, in the first nine months of 2015, increasing, in order, by 4.5% and 8.8% compared to the same period in 2014.

State-owned enterprises had primary deficit of R\$3.1 billion in the first ten months of the year, compared to R\$2.3 billion in the same period in 2014, evolution influenced, in particular, by the performance in the state sphere.

The nominal interest, appropriated on an accrual basis totaled R\$426.2 billion in the first ten months of 2015, compared to R\$230.7 billion in the same period in 2014. The increase reflected, in particular, the impacts from the rise in the Selic rate and the variation of the IPCA, of a significant portion of the net debt, and the unfavorable result of R\$93.8 billion in exchange swap operations, which had generated profit of R\$8.4 billion in the same period in 2014.

Figure 3.19 – Net financing position of the federal public securities – Daily average

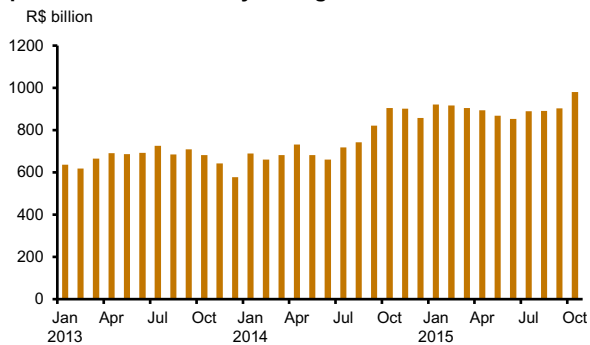


Figure 3.20 – Central Bank repo operations – Maturity – Average daily balances

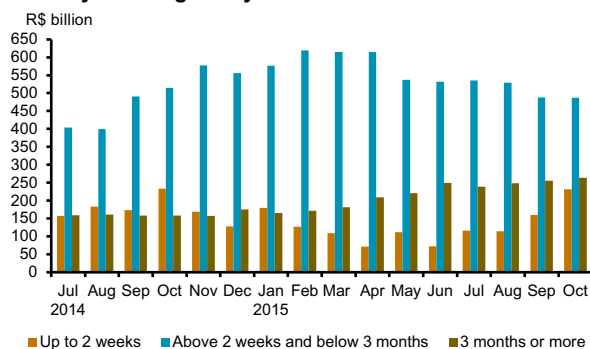
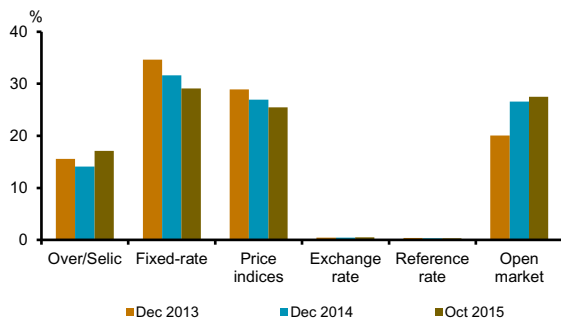
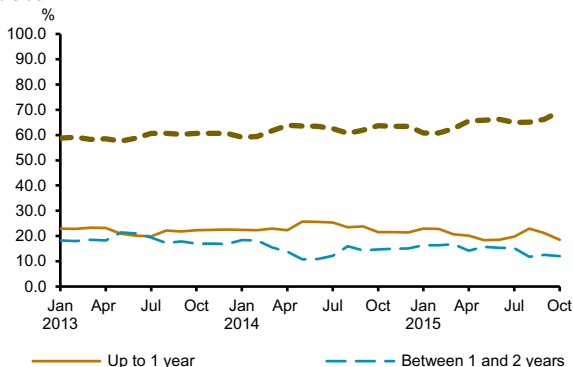


Figure 3.21 – Federal securities debt structure by indexing factor^{1/}



^{1/} It does not include swap.

Figure 3.22 – Profile of maturities of the securities debt



The public sector deficit – sum of the primary result and the appropriated nominal interest – amounted to R\$446.2 billion in the first ten months (R\$242.2 billion in the same period in 2014). Its funding occurred through expansions of internal securities debt and net bank debt, neutralized, in part, by reductions in the net external financing and in the other internal sources of financing, which include the monetary base.

Central Bank operations in the open market

The primary operations of the National Treasury with federal government securities determined net redemptions, with expansionary monetary impact, of R\$54.1 billion in the quarter ended in October, result of placements of R\$171.1 billion and redemptions of R\$225.2 billion. In the secondary market, purchasing operations totaled R\$2.8 billion, 15.5% with National Treasury Notes – B series and 84.5% with National Treasury notes – F series, and those of exchange totaled R\$1 billion, all carried out with National Treasury Notes – B series.

The average daily balance of the financing and go around operations performed by the Central Bank amounted to R\$980.9 billion in October, increasing by 10.3% compared to the July mean. This performance reflected rises in very short term operations, from R\$115.8 billion to R\$231.1 billion, and in those with terms of three to seven months, from R\$238.7 billion to R\$263.2 billion; and reduction, from R\$535.2 billion to R\$486.6 billion, in those with terms of two weeks to three months.

Federal securities debt

The domestic federal securities debt, evaluated by portfolio position, totaled R\$2,504.1 billion in October (43.4% of GDP), remaining stable compared to July and growing 5.9% in twelve months. The quarterly evolution reflected net redemptions in the primary market (R\$48.7 billion), incorporation of nominal interest (R\$75.3 billion), and increase resulting from exchange rate depreciation of 13.7% in the period (R\$2.2 billion).

The participation, in the total of the federal securities debt, of securities indexed to the Selic rate and of open market operations had respective increases of 1.4 p.p. and 1.2 p.p. in

October, compared to July, and those of fixed-rate securities and of securities indexed to price indices, declines of 2.6 p.p. and 0.1 p.p.

The amortization schedule of the domestic federal securities debt in market, except for financing operations, had the following structure of maturities in October: 0.01% of the total in 2015; 18.49% in 2016; and 81.50% from January 2017. Securities falling due in twelve months accounted for 18.5% of the total securities debt in market (19.8% in July) and the average maturity term of the debt reached 55.7 months (53.9 months in July).

The net stock of foreign exchange swap operations totaled R\$402.3 billion in October. The result obtained in the quarter (difference between DI profitability and exchange variation plus coupon) was unfavorable to the Central Bank by R\$36.8 billion, in the cash concept.

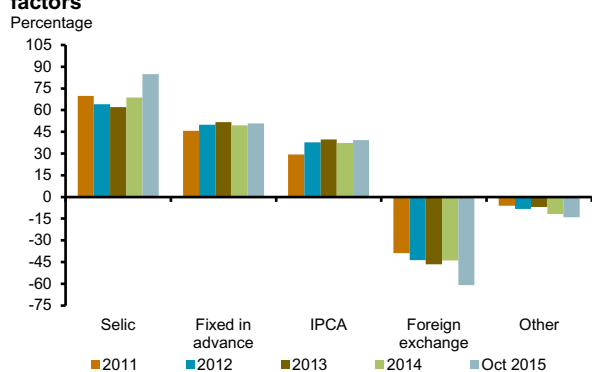
Table 3.8 – Net debt growth
Conditioning factors

	2013		2014		Oct 2015	
	R\$ million	% GDP	R\$ million	% GDP	R\$ million	% GDP
Total net debt –						
Balance	1626 335	31.5	1883 147	34.1	1972 514	34.6
Flows						
Net debt – Growth	76 252	-1.4	256 812	2.6	89 367	0.1
Conditioning factors						
PSBR	157 550	3.1	343 916	6.2	446 156	7.7
Primary	-91 306	-1.8	32 536	0.6	19 953	0.3
Interest	248 856	4.8	311 380	5.6	426 203	7.4
Exchange adjustment						
Domestic securities debt ^{1/}	-4 643	-0.1	-2 835	-0.1	-16 004	-0.3
External debt	-91 280	-1.8	-93 239	-1.7	-355 740	-6.2
Others ^{2/}	17 600	0.3	12 481	0.2	12 847	0.2
Skeletons	-2 427	0.0	-3 511	-0.1	2 107	0.0
Privatizations	- 547	0.0	0	0.0	0	0.0
GDP growth effect		-2.8		-2.1		-1.5

1/ Domestic dollar – Indexed securities.

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

Figure 3.23 – PSND – Percentage share of indexing factors



Public sector net debt

The Public Sector Net Debt (PSND) amounted to R\$1,972.5 billion in October (34.2% of GDP). The GDP rise of 0.1 p.p. compared to December 2014 reflected the impacts of the nominal interest appropriation (7.4 p.p.), of the primary deficit (0.3 p.p.), of the exchange rate depreciation of 45.3% accumulated in the year (-6.4 p.p.), of the parity adjustment of the net foreign debt (0.2 p.p.), and of the nominal GDP growth (-1.5 p.p.).

The most significant alterations observed in the PSND composition in the first ten months of 2015 occurred in the tranche linked to the Selic rate (16 p.p.) and in the creditor tranche linked to the exchange (-17 p.p.). The implicit interest rate of the PSND, accumulated in 12 months, amounted to 30.6% in October (19.3% in December 2014).

The General Government Gross Debt (Federal Government, Social Security, State Governments, and municipalities) amounted to R\$3,813.9 billion (66.1% of GDP) in October 2015. The GDP rise of 7.2 p.p. compared to December 2014 reflected the impacts of net debt issuances (1.9 p.p.), of the incorporation of nominal interest (6.3 p.p.), of the exchange rate depreciation accumulated in the year (1.5 p.p.), of the nominal GDP growth (-2.5 p.p.), and of the parity adjustment of the gross foreign debt currency basket (-0.1 p.p.).

3.4 Conclusion

Credit operations kept a trend of deceleration in the quarter ended in October. This behavior reflected rises in interest rates and the context of decline in economic activity and deterioration of indicators for both confidence and employment and income. The loss of dynamism in the credit market was partially mitigated by the performance of portfolios with earmarked resources, particularly in real estate and rural financing.

The primary deficit projected for the public sector in 2015 reflects, in particular, the impact of the deceleration of economic activity on the level of public revenues. This context – compounded by the recurrent increase of noneconomic events and by prospects of payments of expenses accumulated from prior years, especially those linked to programs of equalization of rates and subsidies –, tends to be mitigated, in the medium term, by the effects of the fiscal adjustment measures adopted recently.

The recovery process of the global economy remained heterogeneous in the third quarter of the year. Economic activity kept in expansion, although with less dynamism, in the United States, United Kingdom, and in the Euro area, contrasting with the volatility observed in Japan. The pace of economic expansion of China showed accommodation, although in a level significantly higher than the mean of the world economy, and the growth of most other emerging economies remained at a level lower than expected.

The recent improvement in perception of risk in the international financial markets and the surprisingly positive data from the labor market in the United States (U.S.) intensified expectations that the beginning of the normalization process regarding monetary policy (liftoff) in that country would occur still in 2016, a hypothesis ratified at a meeting held by the Federal Reserve (Fed) on December 16. In this context, the divergence among the major global economies as for posture concerning monetary policy intensifies, considering the prospects of increase in the accommodation character of the monetary policy in the Euro Area, Japan, and China.

4.1 Economic activity

The annualized quarterly growth rate of the United States GDP amounted to 2.1% in the third quarter of 2015 (3.9% in the second), noting the contributions from household consumption (2.1 p.p.) and gross fixed capital formation (0.5 p.p.), which increased by 3.0% and 3.4%, respectively, in the period. The impact from the external sector totaled -0.2 p.p., reflecting increases of 0.9% in exports and 2.1% in imports.

Industrial production declined by 0.4% in October, compared to the previous month, a period in which capital goods orders

Table 4.1 – Major countriesGDP components^{1/}

	% annualized quarterly rate							
	2014				2015			
	I	II	III	IV	I	II	III	IV
GDP								
United States	-0.9	4.6	4.3	2.1	0.6	3.9	2.1	
Euro Area	0.9	0.2	1.2	1.5	2.2	1.6	1.2	
United Kingdom	2.5	3.8	2.6	3.0	1.5	2.6	1.9	
Japan	5.0	-7.2	-2.8	1.8	4.4	-0.5	1.0	
China	6.6	7.4	7.8	7.0	5.3	7.4	7.4	
Household consumption								
United States	1.3	3.8	3.5	4.3	1.8	3.6	3.0	
Euro Area	0.1	0.7	1.7	2.1	1.8	1.3	1.7	
United Kingdom	2.5	2.9	2.8	2.3	3.1	3.7	3.0	
Japan	9.6	-17.8	0.0	1.4	1.2	-2.2	1.5	
Non-residential Gross Fixed Capital Formation (GFCF)								
United States	8.3	4.4	9.0	0.7	1.6	4.1	2.4	
Euro Area ^{2/}	1.7	-2.1	1.6	2.4	6.2	0.3	-0.0	
United Kingdom ^{2/}	9.0	5.6	5.6	-2.1	6.3	4.2	5.4	
Japan	19.0	-15.4	-1.7	0.9	11.4	-4.9	2.3	
Residential investment								
United States	-2.8	10.4	3.4	10.0	10.1	9.3	7.3	
Euro Area ^{3/}	3.8	-9.1	nd	nd	nd	nd	nd	
United Kingdom	45.4	-2.7	0.0	-2.9	2.6	-13.2	14.0	
Japan	8.8	-35.9	-24.8	-2.7	8.1	10.4	8.1	
Exports of goods and services								
United States	-6.7	9.8	1.8	5.4	-6.0	5.1	0.9	
Euro Area	3.1	4.1	6.6	4.8	5.4	6.5	0.8	
United Kingdom	6.7	10.0	-6.0	16.2	-4.7	7.8	3.6	
Japan	25.5	1.5	6.5	12.0	8.0	-16.1	11.1	
Imports of goods and services								
United States	2.8	9.6	-0.8	10.3	7.1	3.0	2.1	
Euro Area	4.8	4.5	6.0	4.8	7.7	3.5	3.7	
United Kingdom	3.5	-6.9	3.1	11.5	2.5	-10.4	23.8	
Japan	26.3	-16.2	4.4	3.2	7.1	-10.2	7.1	
Government expenditures								
United States	0.0	1.2	1.8	-1.4	-0.1	2.6	1.7	
Euro Area ^{4/}	0.9	0.9	1.3	0.9	2.1	1.1	2.4	
United Kingdom ^{4/}	0.1	5.7	1.8	-1.4	4.4	1.6	5.3	
Japan	-1.8	-2.7	2.5	0.4	-0.7	3.5	-0.3	

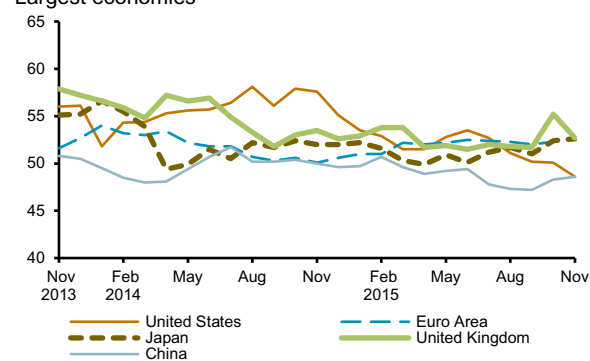
Sources: BEA, Thomson, Cabinet Office and Eurostat

1/ Available data regarding China solely for GDP.

2/ GFCF total.

3/ GFCF.

4/ Government consumption only.

Figure 4.1 – Manufacturing PMI
Largest economies

Source: Thomson

increased by 11.7%. Considering twelve-month intervals, the indicator rose by 0.3% compared to October 2014, with emphasis on the expansion of 1.9% of the manufacturing sector, favored by the growth of 10.9% of the automotive industry. The PMI of the manufacturing sector reached 48.6 points in November (50.1 points in October), a level indicating contraction of activity after 35 months.

The U.S. economy generated 654 thousand jobs in the quarter ended in November (894 thousand in that ended in November 2014), month in which the unemployment rate remained at 5.0%, the lowest level since February 2008. The consumer confidence index, measured by the Conference Board, declined for the second consecutive month, to 90.4 points, the lowest level of the year.

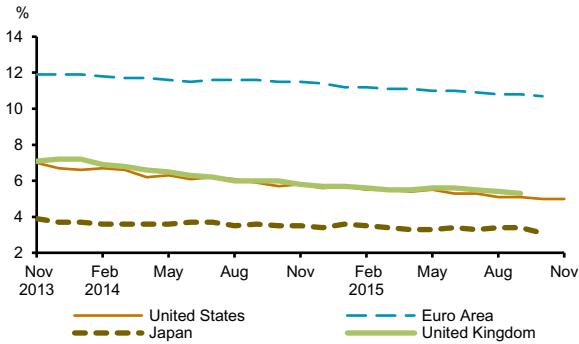
Annualized variations of personal consumer expenditures and of real disposable personal income amounted to 3.0% and 3.9%, respectively, in the quarter ended in September, a period in which the interest rate of household savings increased to 5.2%.

In the euro area, the annualized GDP variation reached 1.2% in the third quarter of 2015 (1.6% in the second), noting the expansions in Spain (3.2%), France (1.4%), Germany (1.3%), and Italy (0.8%). Reflecting the economic recovery of the bloc, the unemployment rate reached 10.7% in October, the lowest level since January 2012, and the composite PMI for November was at 54.2 points.

Annualized GDP variation of the United Kingdom reached 1.9% in the third quarter of 2015 (2.6% in the second), noting, in the context of supply, the expansions of 0.8% of the industry and 3.0% of the services sector. Unemployment rate was at 5.3% in the quarter ended in September (6.0% in that ended in September 2014) and the manufacturing sector PMI declined to 52.7 points in November.

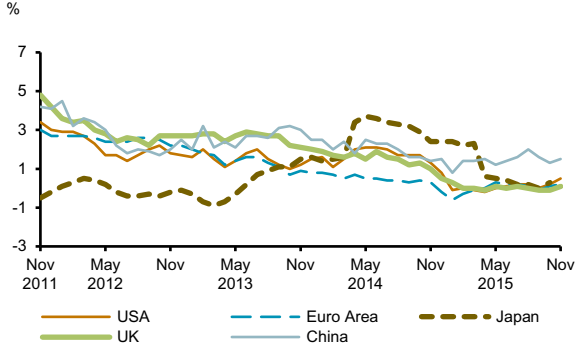
In Japan, the annualized quarterly GDP grew 1.0% in the third quarter of 2015 (variation of -0.5% in the second). Importantly, in the context of internal demand, there were positive contributions from gross fixed capital formation (1.0 p.p.) and household consumption (0.9 p.p.). Impact from the external sector totaled 0.5 p.p., noting that imports and exports had annualized expansion rates of 7.0% and 11.1%, respectively. In October, industrial production and retail sales increased, in order, 1.4% and 1.2%, evolution that is consistent with the increase of 1.1 point, to 52.3 points, in the composite PMI.

Figure 4.2 – Unemployment rate growth
Largest developed economies



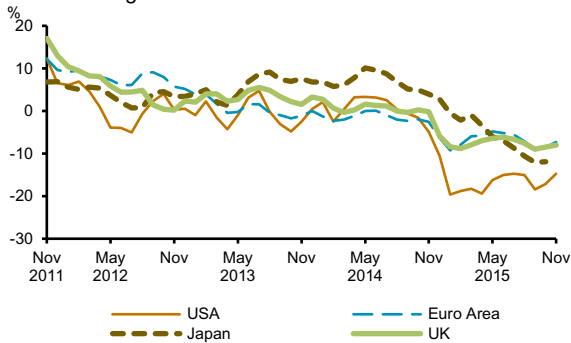
Source: Bloomberg

Figure 4.3 – Consumer inflation
Annual change



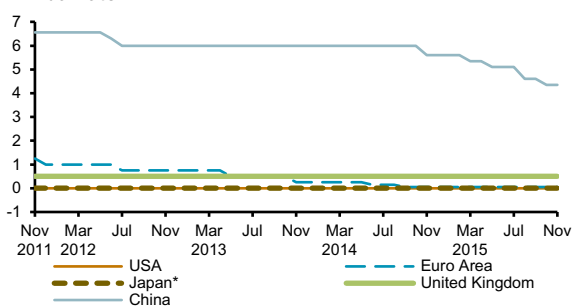
Sources: BLS, Eurostat, Bloomberg and ONS

Figure 4.4 – Energy prices
Annual change



Source: Thomson

Figure 4.5 – Official interest rates
Annual rate



Sources: Fed, ECB, BoJ, BoE and PBC

* BoJ changed to a monetary-base target in April 2013.

In China, annualized GDP variation reached 7.4% in the third quarter of 2015, same variation observed in the second quarter. Considering interannual variations, GDP grew 6.9% and 7.0%, respectively, in the same periods. In November, evidencing the continuity of the local economy accommodation process, the interannual growth rates of fixed assets investments, retail sales, and industrial production were, in order, 10.2%, 11.2%, and 6.2% (15.8%, 19.5%, and 7.2%, respectively, in November 2014) and the balance of trade surplus totaled US\$54.1 billion, in a context of 8.7% reduction in imports. In November, the industrial sector Caixin PMI reached 48.6 points, being, for the ninth consecutive month, at a level below 50 points.

4.2 Monetary policy and inflation

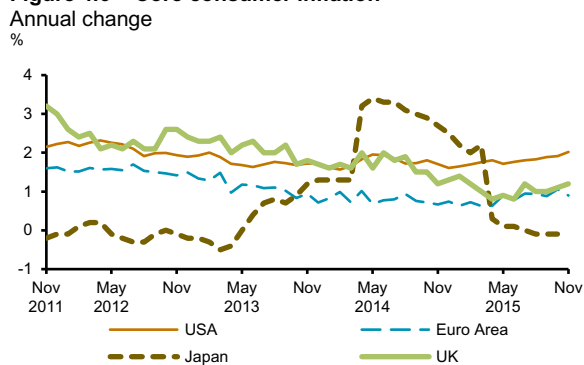
Annual consumer inflation in the United States, measured through CPI, reached 0.5% in November (0.2% in October). Energy prices varied -14.7% and food prices, 1.3%, contributing so the annualized variation of the core CPI, which excludes energy and food, totaled 2.0% in the period.

Fed's Federal Open Market Committee (FOMC) maintained, at the October meeting, the goal range for the Fed funds rate between 0% p.y. and 0.25% p.y. At the December meeting, the Committee decided unanimously to raise the goal range for the Fed funds rate to between 0.25% p.y. and 0.50% p.y. According to the Committee, the next monetary policy decisions will keep depending on the progress, both achieved and expected, towards the objectives of maximum employment and inflation of 2.0% p.y., and should incorporate only gradual increases in interest rate.

In the Euro area, the annual variation of the Harmonized Consumer Price Index (HCPI) reached 0.2% in October (0.1% in September). Energy prices varied -7.3% and the price of food, alcoholic beverages, and tobacco varied 1.5%. The annual variation of the core HCPI – which excludes energy, food, alcohol beverages, and tobacco – was 0.9% in the period.

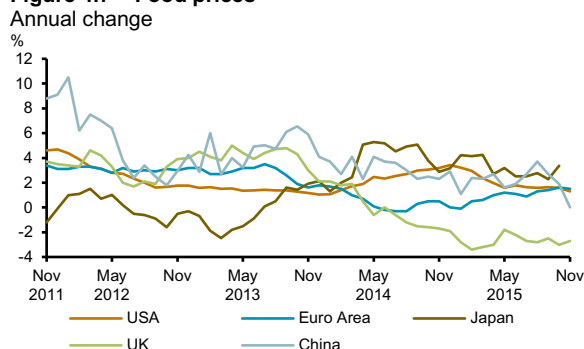
The Governing Council of the European Central Bank (ECB) kept the interest rates of the main refinancing operations and of the marginal lending facility at the respective historical minimum rates of 0.05% p.y. and 0.30% p.y., and reduced, from -0.20% to -0.30% p.y., the

Figure 4.6 – Core consumer inflation



Sources: BLS, Eurostat, Bloomberg and ONS

Figure 4.7 – Food prices^{1/}



Source: Thomson
1/ For the Euro Area, data include alcohol & tobacco.

deposit facility. With regard to the unconventional monetary policy measures, the Council reaffirmed that the monthly purchases of assets of € 60 billion should continue until the end of March 2017 or, if necessary, until the trajectory of inflation is consistent with the inflation goal below, yet close to, 2.0% p.y in the medium term.

In the United Kingdom, the annual variation of the CPI amounted to 0.1% in November (-0.1% in October). Energy prices declined by 8.0% and food prices increased by 2.7%. The annual variation of the core CPI, which excludes energy, food, alcoholic beverages, and tobacco, reached 1.2% in November.

The Monetary Policy Committee of the Bank of England (BoE), in the December meeting, kept the interest rate paid to commercial banks reserves (Bank rate) in 0.5% p.y. and the total of the asset purchase program (Quantitative Easing – QE) in £ 375 billion.

In Japan, the annual variation of the CPI reached 0.3% in October (null variation in September), with food prices varying 3.4% and energy prices varying -11.8%. The annual variation of the core CPI, which excludes fresh food, was -0.1% in October, same level of August and September.

In the November meeting, the Monetary Policy Committee of the Bank of Japan (BoJ) maintained, in the framework of the quantitative and qualitative monetary easing program, the guidelines for the money market operations that provide for annual expansion, of both the monetary base and the balance of Japanese Government Bonds (JGB) in the portfolio, at approximately ¥ 80 trillion; and the extension of the remaining mean maturity of these securities for 7 to 10 years. In addition, the BoJ ratified that it must conduct the purchases of Exchange-Traded Funds (ETF) and of real estate investment funds (Japan Real Estate Investment Trusts – J-REIT) to increase the country's balances by approximately ¥ 3 trillion and ¥ 90 billion, respectively, per year. The balances of commercial papers and corporate bonds will be kept, respectively, around ¥ 2.2 trillion and ¥ 3.2 trillion.

In China, the annual consumer inflation amounted to 1.5% in November (1.3% in October). Food prices varied 2.3% and energy prices varied -1.9%. In October, the People's Bank of China (PBC) announced new cuts in the benchmark interest rate of one-year lending and in the deposit rate within one year, both, by 0.25 p.p., to 4.35% and 1.5%, respectively. Additionally, reserve requirement rates on deposits of small

and large financial institutions were reduced by 0.5 p.p., to 15.5% and 17.5%, respectively¹⁰. Also in October, the PBC extended the the elimination of the upper limit for deposit interest rates, previously valid only for long-term deposits, to all deposits in commercial banks and rural cooperatives.

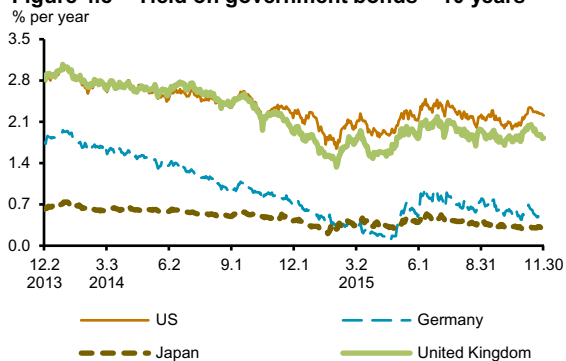
4.3 International financial markets

Ratification of expansionary policies in China and the expectations of expansion in the Euro area and Japan favored the reduction in the perception of risk in the international financial markets observed in the quarter ended November. Noteworthy, from mid-October, the greater consistency of the fundamentals of the U.S. economy resulted in the Fed's indications as to the imminent start of liftoff, implying new appreciation of the dollar and expansion of the spread between the returns of long-term securities of the U.S. and of European economies.

The annual returns of the 10-year securities issued by mature economies showed volatile and heterogeneous behavior in the quarter ended in November. In this context, after decreasing to 1.97% in mid-October, the annual returns of the United States ten-year sovereign bonds, under the Fed's prospect of imminent liftoff, amounted to 2.21% at the end of the period, remaining stable in the quarter. ECB's indications of probable enhancement of the monetary loosening policy favored the annual decreases of similar papers of the United Kingdom (14 b.p.), Germany (33 b.p.), Spain (59 b.p.), and Italy (60 b.p.), which amounted to 1.83%, 0.47%, 1.52%, and 1.17%, respectively, at the end of November. Returns of similar securities of Japan decreased by 7 b.p., to 0.31%, in the period.

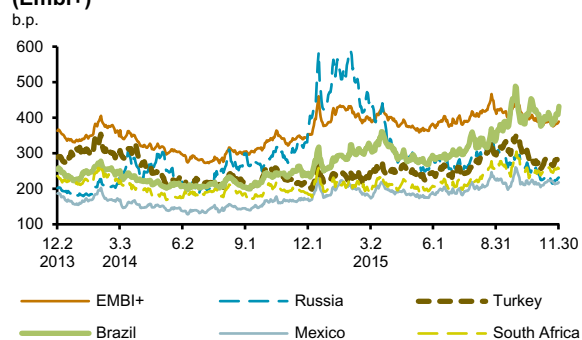
The sovereign risk indicator Emerging Markets Bond Index Plus (Embi+) decreased by 21 b.p., to 390 b.p., in the quarter ended in November. There were noteworthy reductions in the indicators of Mexico (6 b.p.), Turkey (7 b.p.), and Russia (67 b.p.), to 218 b.p., 288 b.p., and 232 b.p., respectively. In the same period, the South Africa and Indonesia indicators increased, respectively, by 3 b.p. and 2 b.p., to 257 b.p. and 287 b.p., respectively. Brazil's indicator increased by 92 b.p., to 432 b.p., in the quarter.

Figure 4.8 – Yield on government bonds – 10 years



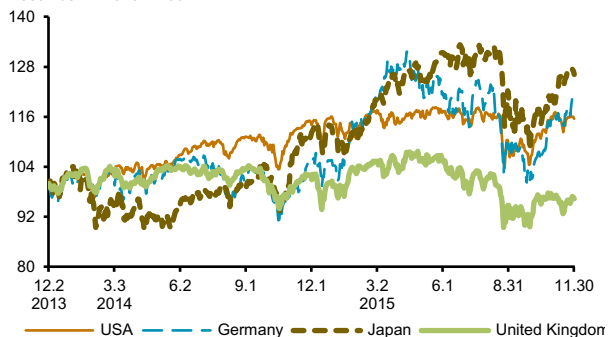
Source: Bloomberg

Figure 4.9 – Emerging Markets Bond Index Plus (Embi+)



Source: Thomson Reuters

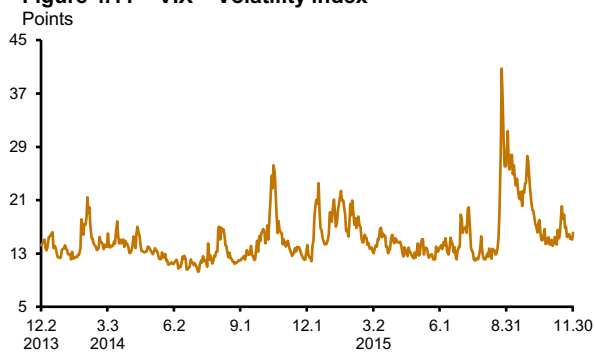
Figure 4.10 – Stock exchanges: US, Europe and Japan



Source: Bloomberg

10/ Importantly, there was additional reduction of 0.5 p.p. in the reserve requirement rate in the case of institutions that meet specific requirements with regard to rural credit and credit for micro and small enterprises.

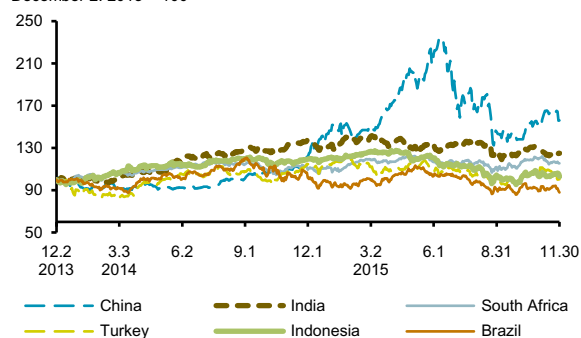
Figure 4.11 – VIX – Volatility index



Source: Bloomberg

Figure 4.12 – Stock exchanges: Emerging markets

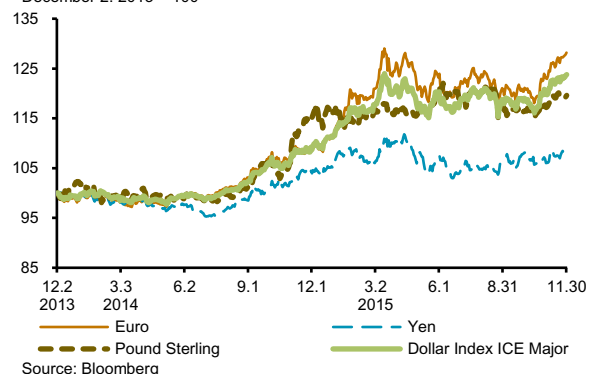
December 2. 2013 = 100



Source: Bloomberg

Figure 4.13 – U.S. dollar exchange rates

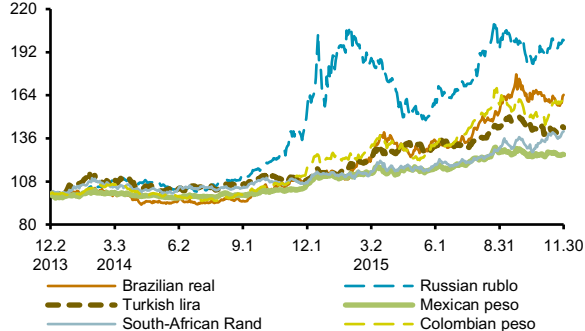
December 2. 2013 = 100



Source: Bloomberg

Figure 4.14 – Emerging market currencies against U.S. dollar

December 2. 2013 = 100



Source: Bloomberg

Influenced by ratification of expansionary policies in the Euro area, China, and Japan, indicators of stock exchanges of the main mature economies recovered in the quarter ended in November. In this context, there were noteworthy rises in the indices DAX, of Germany (10.9%); S&P500, of the U.S. (5.5%); Nikkei, of Japan (4.5%); FTSE 100, of the United Kingdom (1.7%); FTSE MIB, of Italy (3.5%).

The Chicago Board Options Exchange Volatility Index (VIX) decreased by 43.3% over the same period, and was at 16.1 points at the end of the period. The indicator had a mean of 19.2 points in the quarter, compared to 16.0 points in the quarter ended in August.

In this context of lower risk aversion, the indices of stock exchanges of important emerging economies showed recovery in the quarter ended in November, noting the variations in the Shanghai Composite, of China (7.5%), and in the FTSE/JSE ALL, of South Africa (3.3%). The IDX Composite, of Indonesia, decreased by 1.4% in the quarter.

In the same period, the U.S. dollar appreciated in relation to the euro (6.1%), to the yen (1.6%), and to the British pound (1.9%), and the Dollar Index Major¹¹ varied 4.5%. This trajectory reflected both the prospect of expansion of the divergence between the postures concerning monetary policy of the Fed and the ECB/BoJ and the greater dynamism of the U.S. economy in relation to those of the main countries in the Euro area and of emerging countries. In this context, the U.S. dollar also appreciated in relation to the South African rand (8.8%), to the Brazilian real (6.8%), and to the Russian ruble (3.4%).

4.4 Commodities

The Commodities Index – Brazil (IC-Br), computed by the Central Bank, varied 5.48% in November, compared to August, result of respective increases of 6.49%, 0.08%, and 5.18% in agricultural, energy, and metal commodities. Measured in U.S. dollars, the IC-Br decreased by 1.96% in the period¹². Considering quarterly means in real, the IC-Br increased by 13.13% in relation to the quarter ended in August.

11/ Exchange rate index computed by Intercontinental Exchange (ICE) expresses the U.S. dollar in relation to a basket of six currencies: euro, yen, British pound, Canadian dollar, Swiss franc, and Swedish krona.

12/ The indicator considers monthly means of daily observations. Therefore, the reduction of 1.96% mentioned is impacted by the daily exchange rates of August and November 2015.

Figure 4.15 – Brazil Commodities Index (IC-Br)

Dec/2005 = 100 (monthly average – R\$)

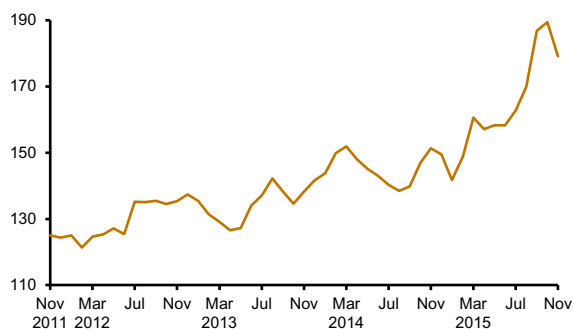


Figure 4.16 – IC-Br segments

Dec/2005 = 100 (monthly average – R\$)

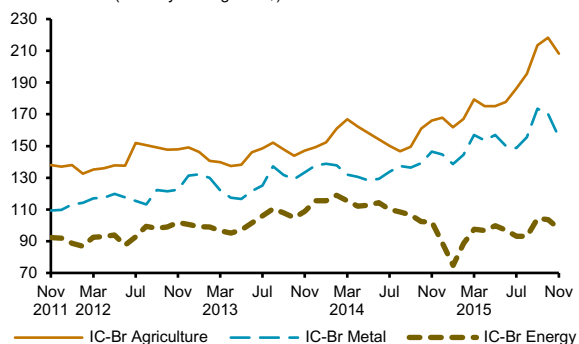
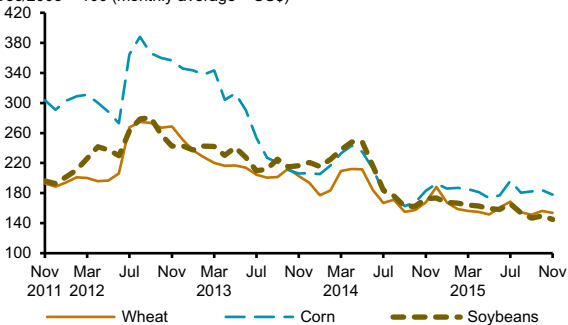


Figure 4.17 – Commodities: wheat, corn and soybeans

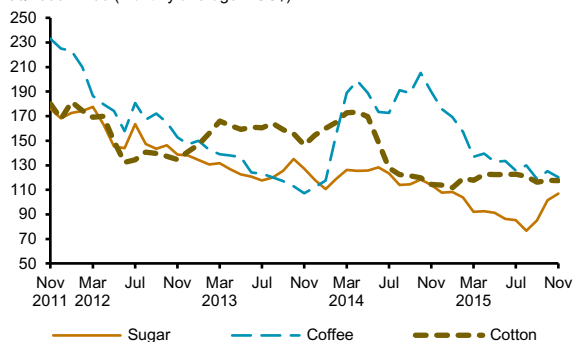
Dec/2005 = 100 (monthly average – US\$)



Source: S&P GSCI

Figure 4.18 – Commodities: sugar, coffee and cotton

Dec/2005 = 100 (monthly average – US\$)



Source: S&P GSCI

The monthly average of the S&P and Goldman Sachs Spot index declined by 4.14% in November, compared to August, result of respective variations of 1.25%, -7.03%, and -4.32% in the segments of agricultural, energy and metal commodities.

The increase in the segment of agricultural commodities reflected, in particular, the variation of 39.47% in the price of sugar, which reflected the impact of bad weather on crops in Brazil, India, and Thailand, and the rise in the consumption of hydrous ethanol in Brazil. The mean prices of wheat, corn, and soy declined by 0.73%, 1.25%, and 5.41%, respectively, in the quarter, a development consistent with favorable yields observed in the U.S. and with positive prospects for crops in Latin America, in extensive stocks. Cotton prices declined by 2.68% and coffee prices declined by 7.37% .

In the sphere of metal commodities, the average prices of aluminium, copper, lead, nickel, and zinc declined, in order, 6.08%, 6.39%, 5.10%, 10.82%, and 11.80%, in the quarter ended in November. This performance kept reflecting the improvement of the conditions of supply of these products and the uncertainties about the evolution of Chinese demand and about the performance of global economic activity.

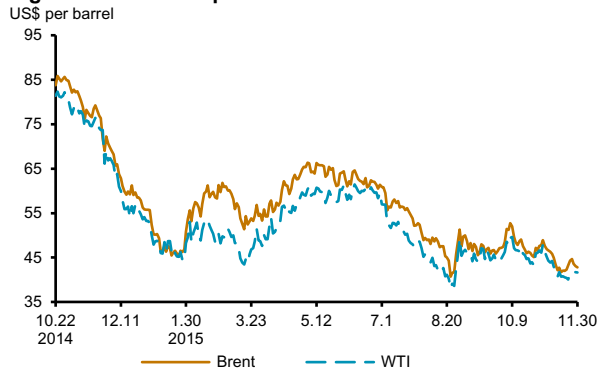
The average price of iron ore (Fe 65%) in the Chinese spot market declined by 21.88%, to US\$50, in the quarter ended in November, according to the Shanghai Steelhome Information. This new decline in price reflected the continuous increase in low cost supply (especially in Australia and Brazil) and the lower dynamism of the world consumption of steel, particularly in China.

Average prices of oil barrel from the Brent and WTI types reached, respectively, US\$44.42 and US\$42.70 in November, declining by 5.47% and 0.37%, respectively, compared to August. This trajectory reflected the context of wide supply, with high stock in the U.S., and of global economic downturn, especially of emerging economies.

4.5 Conclusion

The renewed indications of dynamism in the U.S. economy, observed during the third quarter of 2015, reinforced the assessment of the transitional character of the negative performance of that economy at the beginning of the year. At the same time, the continuous downturn of activity in China and uncertainties about the force and sustainability of

Figure 4.19 – Oil – Spot market



Source: Bloomberg

the growth in Europe suggest the increase of the asynchrony between the action of the central banks of these economies and the action of the Fed. In spite of this heterogeneity, global economic activity shows prospects of moderation in the coming months.

The results of the external sector keep reflecting the impacts of the ongoing macroeconomic adjustment process, with reflections on the trajectories of exchange rate and economic activity. In this sense, the relevant decline in the deficit in current transactions in the first eleven months of the year, compared to the same period in 2014, showed reversal of negative results in the balance of trade, in addition to reductions in net expenses of services and in net remittances of profits and dividends. The foreign direct investments and the liabilities of portfolio investments remained at a level appropriate for the financing of current transactions.

5.1 Exchange movement

The contracted exchange market surplus amounted to US\$11.6 billion in the first eleven months of 2015 (US\$4.8 billion in the same period in 2014). There was a surplus of US\$18.4 billion in the trade segment, with declines of 20.4% in contracts of exports and of 28.1% in imports; and deficit of US\$6.8 billion in the financial segment, reflecting expansions of 1.1% in purchases and of 2.8% in sales of foreign currency.

Intervention by the Central Bank in the exchange market, through lines with repurchase commitment, resulted in net sales of US\$1.5 billion in the first eleven months of 2015, including operations of return of foreign currency provided in 2014. At the end of November 2015, the stock of repurchase lines reached US\$12 billion. The position sold of banks in foreign currency in the lump-sum market, which reflects transactions with customers and with the Central Bank, went from US\$28.3 billion, at the end of 2014, to US\$18.3 billion, in November 2015.

Table 5.1 – Foreign exchange flows

Itemization	US\$ billion				
	2014			2015	
	Nov	Jan- Nov	Year	Nov	Jan- Nov
Trade operations	-1.4	3.6	4.1	1.2	18.4
Exports	14.7	204.7	222.3	11.8	162.9
Imports	16.0	201.0	218.1	10.6	144.6
Financial operations ^{1/}	-2.1	1.1	-13.4	2.7	-6.8
Purchases	35.2	467.9	513.2	37.9	473.2
Sales	37.3	466.7	526.6	35.2	480.0
Net flows	-3.5	4.8	-9.3	3.9	11.6

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

Table 5.2 – Trade balance – FOB

January-November

Itemization	US\$ million		
	2014	2015	% change
Exports	207 610	174 351	-16.0
Imports	211 952	160 918	-24.1
Balance	-4342	13 433	-409.4
Trade flow	419 562	335 269	-20.1

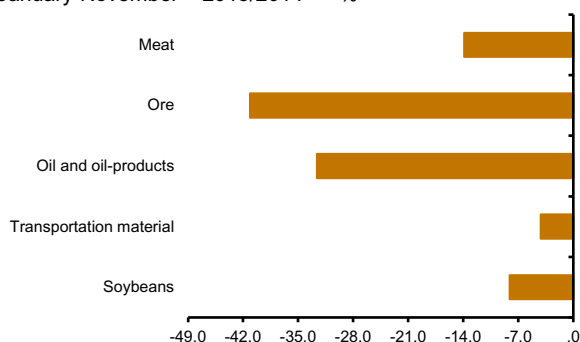
Source: MDIC/Secex

Table 5.3 – Exports by aggregate factor – FOB

Daily average – January-November

Itemization	US\$ million		
	2014	2015	% change
Total	898.7	764.7	-14.9
Primary products	441.2	354.0	-19.8
Industrial products	432.4	391.6	-9.4
Semimanufactured goods	114.9	105.2	-8.4
Manufactured goods	317.4	286.4	-9.8
Special operations	25.2	19.0	-24.4

Source: MDIC/Secex

Figure 5.1 – Main exports by group of productsJanuary-November – 2015/2014^{1/} – %

Source: MDIC/Secex

^{1/} Change over the same period of the previous year.**Table 5.4 – Imports by end-use category – FOB**

Daily average – January-November

Itemization	US\$ million		
	2014	2015	% change
Total	917.5	705.8	-23.1
Capital goods	191.2	154.0	-19.4
Raw materials	414.6	334.5	-19.3
Consumer goods	155.7	127.7	-18.0
Durable	81.7	62.1	-24.0
Passenger vehicles	30.7	20.9	-31.9
Nondurable	74.0	65.6	-11.3
Fuels	156.1	89.6	-42.6
Crude oil	61.8	29.9	-51.7
Others	94.3	59.7	-36.7

Source: MDIC/Secex

5.2 Trade in goods

The balance of trade had a surplus of US\$13.4 billion in the first eleven months of 2015, compared to deficit of US\$4.3 billion in the same period in 2014¹³. This reversal reflected declines of 16.0% in exports and of 24.1% in imports, which totalled, in order, US\$174.3 billion and US\$160.9 billion. The total trade – sum of the country's imports and exports – declined by 20.1%, to US\$335.3 billion in the period.

Average daily exports declined by 14.9% on the same basis of comparison, with reduction of 19.8% on exports of commodities (iron ore, -45.6%; oil, -25.9%; and soy; -9.6%). Shipments of manufactured products decreased by 9.8% (fuel oils, -62.1%; platforms for oil extraction, -42.5%; motor for vehicles and parts, -10.4%) and those of semimanufactured products, 8.4% (hides and skins, -22.1%; raw sugar, -21.5%; iron-alloys, -16.1%). Sales in these categories of aggregate factor corresponded, in order, to 46.3%, 37.5%, and 13.8% of the total exports in the period.

The daily average of imports declined by 23.1% in the first eleven months of 2015, compared to the same period in 2014. The evolution reflected declines in acquisitions in all categories: fuels and lubricants, 42.6%; durable consumer goods, 24.0% (cars, -31.9%; household machinery and appliances, -24.3%); capital goods, 19.4% (office machines and devices, -21.1%); industrial machinery, -19.6%); raw materials, 19.3% (parts, -23.4%; mineral products, -22.9%); and nondurable consumer goods, 11.3% (food products, -15.1%; pharmaceuticals, -8.5%). Acquisitions of these categories represented, in order, 12.7%, 8.8%, 47.4%, 21.8%, and 9.3% of the total.

Daily average of the country's total trade – imports and exports – with the major countries and economic blocs decreased by 19.0% in the first eleven months of 2015, compared to the same period in 2014. There were noteworthy reductions in trade with Africa, 35.3%; Eastern Europe, 32.1%; European Union, 19.8%; Mercosur, 19.6%; U.S., 16.9%; Middle East, 17.0%; China, 13.3%.

Asia remained as the main destination for Brazilian exports (33.3% of the total), followed by Latin America and Caribbean (20.6%), European Union (17.9%), and U.S.

13 Since April 2015, the Central Bank started to disseminate statistics of the external sector according to the 6th Edition of the Balance of Payments and International Investments Position Manual (BPM6). In the balance of payments, the goods account is based on data from the Ministry of Development, Industry, and Foreign Trade (MDIC), added with additional sources. The objective is to respect the BPM6 definition, according to which exports and imports occur when there is change in ownership of goods, between resident and non-resident. However, this topic of the Inflation Report comprises only the foreign trade statistics released by the MDIC. Further information on the methodological changes introduced by the BPM6 are available on the Central Bank website at <http://www.bcb.gov.br/ftp/infecon/nm2bpm6p.pdf>.

Figure 5.2 – Raw material imports x industrial production – 3-month moving average
Seasonally adjusted indices

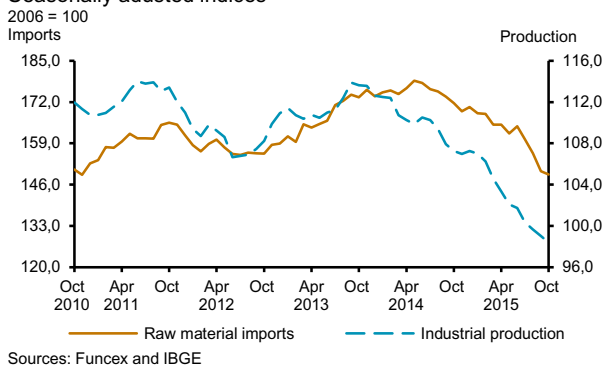
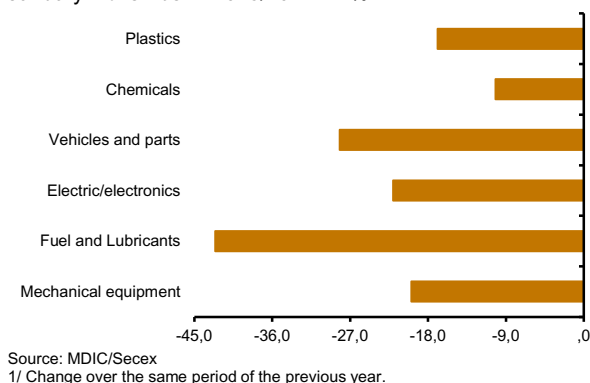


Figure 5.3 – Capital goods imports x industrial production – 3-month moving average
Seasonally adjusted indices



Figure 5.4 – Main imports by group of products
January-November – 2015/2014^{1/} – %



(12.6%). These shares varied 0.4 p.p., 0.3 p.p., -0.9 p.p., and 0.7 p.p., respectively, compared to the same period in 2014. China was the main country of destination for Brazilian exports in the period (19.2% of the total, up from 18.6% in the first eleven months of 2014).

Imports by Brazil in the first eleven months of 2015 were, specially, from Asia (32.9% of the total), European Union (21.1%), Latin America (15.9%), and U.S. (15.5%). It is noteworthy, in relation to the first eleven months of 2014, the increase of 1.8 p.p. in the share of acquisitions of Asian products – same expansion as for those from China, which increased by 11.0% in the period – and the decline of 47.2% in imports from Africa, determined, in particular, by the decline of 53.5% in purchases of Nigerian oil.

The reduction of 16.0% in exports, in the period from January to November 2015, reflected variations of -21.4% in prices and of 7.2% in quantum, according to the Foreign Trade Studies Center Foundation (Funcex). There were reductions in prices in all categories of the aggregate factor: basic products, 29.9%; semimanufactured products, 15.2%; and manufactured products, 10.9%. Volumes exported of commodities, semi-manufactured products, and manufactured products varied 13.4%, 6.8%, and 0.2%, respectively, in the period.

On the same basis of comparison, the reduction of 24.1% in imports resulted from declines of 11.7% in the prices and of 14.2% in the quantum. No decline in prices was observed in all categories of use: fuel and lubricants, 38.8%; nondurable consumer goods, 10.0%; raw materials, 5.1%; durable consumer goods, 3.8%, and capital goods, 3.2%. The categories mentioned had declines of 10.0%, 2.8%, 14.8%, 25.1%, and 19.0% in the respective imported volumes. Importantly, the reductions in the quantum of raw materials and capital goods imported are consistent with the trajectory of investments in the country.

5.3 Services and income

The deficit in current transactions totaled US\$56.4 billion in the first eleven months of 2015 (US\$92.5 billion in the same period in the previous year) and US\$68 billion in the twelve-month period ended in November (3.70% of GDP).

Net expenses of services reached US\$34.5 billion. The decline of 20.3% compared to the same period in 2014

Table 5.5 – Exports and imports by area – FOB

Daily average – January-November

Itemization	US\$ million							
	Exports			Imports			Balance	
	2014	2015	% change	2014	2015	% change	2014	2015
Total	899	765	-14.9	918	706	-23.1	-19	59
L.A. and Caribe	183	158	-13.8	150	112	-25.3	33	45
Mercosur ^{1/}	100	86	-14.3	73	54	-26.8	26	32
Argentina	57	52	-9.1	56	42	-24.4	1	10
Other	42	33	-21.4	17	11	-34.6	25	22
Other	83	72	-13.2	77	58	-23.9	6	14
USA ^{2/}	107	97	-9.6	141	109	-22.5	-34	-13
EU	169	137	-19.0	188	149	-20.5	-19	-13
E. Europe	18	12	-37.6	16	12	-25.9	2	-1
Middle East	41	39	-4.0	32	22	-33.4	9	18
Asia	296	255	-13.9	286	232	-18.7	10	22
China	167	147	-12.1	150	128	-14.6	17	19
Other	129	108	-16.2	136	104	-23.2	-7	4
Africa	38	33	-14.3	67	35	-47.2	-29	-3
Others	47	36	-24.2	37	33	-9.2	11	2

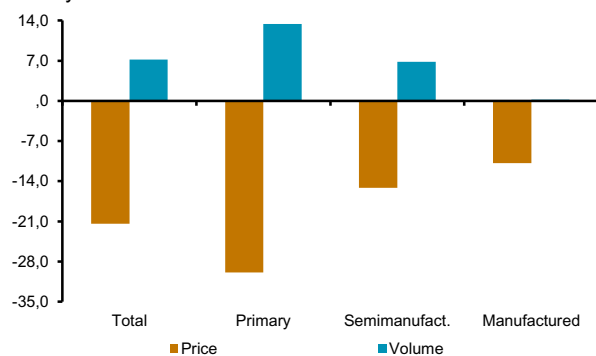
Source: MDIC/Secex

1/ Includes Venezuela.

2/ Includes Puerto Rico.

Figure 5.5 – Exports – Price and volume index

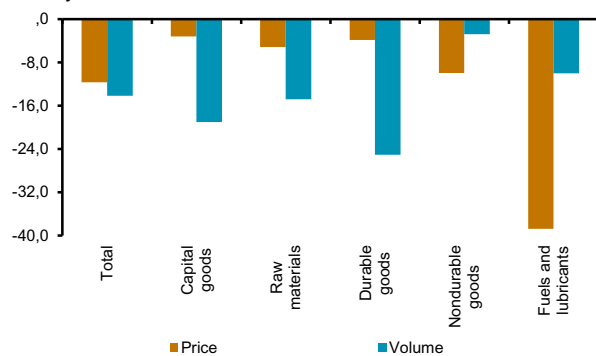
January-November – 2015/2014 – %



Source: Funcex

Figure 5.6 – Imports – Price and volume index

January-November – 2015/2014 – %



Source: Funcex

reflected, especially, the declines in international travel (36.5%) and transport (32.1%). Expenditures of Brazilians abroad and of foreign tourists in Brazil totaled, in order, US\$16.1 billion and US\$5.3 billion, with respective reductions of 31.2% and 16.7% in the period. Expenditures in equipment rental retreated declined by 2.3%, to US\$19.4 billion.

Primary income – including salaries, interest, profits and dividends – amounted to US\$35.9 billion, down 20.2% compared to the first eleven months of 2014. Net remittances with interest remained stable, while interest payments abroad and interest earnings receded, respectively, 2.3% and 12.8%. Revenues from returns of international reserves decreased by 14.9%. Considering twelve-month periods, interest revenues associated with returns from international reserves amounted to US\$2.6 billion in November (US\$3 billion in November 2014).

Net remittances of profits and dividends totaled US\$16.8 billion in the first eleven months of the year. The decrease of 35.2% compared to the same period in 2014 reflected, mostly, the exchange rate depreciation and the decline in domestic activity. Companies in the services sector and industrial sector accounted, respectively, for 50.0% and 42.8% of the gross remittances of profits and dividends from foreign direct investment (FDI) in the period, including the segments of financial services, beverages, and trade.

Net secondary income totaled US\$2.3 billion in the first eleven months, decreasing by 1.6% compared to the same period in 2014. Net inflows of personal transfers, driven by the Brazilian real depreciation, increased by 76.8% in the period.

5.4 Financial account

Net borrowings exceeded net lendings by US\$54.3 billion over the first eleven months of 2015 (US\$88.2 billion in the same period in 2014). Net capital lendings in the form of Direct Investments Abroad (DIA) amounted to US\$10.8 billion (US\$26.1 billion over the first eleven months of 2014). Net borrowings of FDI amounted to US\$59.9 billion in the period, of which US\$43.3 billion refer to increased participation in capital of companies and US\$16.6 billion to intercompany loans. The inflow of foreign direct investment accumulated in twelve months amounted to US\$69.9 billion in November (3.81% of GDP).

Table 5.6 – Current account

Itemization	US\$ billion						
	2014			2015			2016
	Nov	Jan- Nov	Year	Nov	Jan- Nov	Year ^{1/}	Year ^{1/}
Current account	-9.1	-92.5	-104.1	-2.9	-56.4	-62.0	-41.0
Balance on goods	-2.7	-6.6	-6.5	1.0	11.7	15.0	30.0
Exports	15.6	206.7	224.1	13.7	173.3	190.0	190.0
Imports	18.3	213.3	230.6	12.7	161.6	175.0	160.0
Services	-3.7	-43.3	-48.1	-2.4	-34.5	-38.7	-33.4
Transportation	-0.7	-8.0	-8.7	-0.4	-5.5	-6.0	-5.0
Travel	-1.2	-17.1	-18.7	-0.5	-10.9	-11.7	-9.0
Computer, information and telecommunication	-0.1	-2.0	-2.2	-0.1	-1.7	-1.9	-1.5
Operational leasing	-1.6	-19.8	-22.6	-1.6	-19.4	-22.0	-21.0
Other	0.0	3.7	4.2	0.1	2.9	2.9	3.1
Primary income	-3.1	-45.0	-52.2	-1.7	-35.9	-40.9	-40.5
Interest	-1.0	-19.3	-21.3	-0.9	-19.4	-21.2	-20.9
Dividends	-2.1	-26.0	-31.2	-0.9	-16.8	-20.0	-20.0
Compensation of employees	0.0	0.3	0.4	0.0	0.3	0.4	0.4
Secondary income	0.3	2.4	2.7	0.3	2.3	2.6	2.9

1/ Forecast.

Table 5.7 – Financial account

Itemization	US\$ billion						
	2014			2015			2016
	Nov	Jan- Nov	Year	Nov	Jan- Nov	Year ^{1/}	Year ^{1/}
Financial account	-8.7	-88.2	-100.5	-2.8	-54.3	-61.7	-40.6
Direct investments	-4.1	-60.8	-70.9	-5.9	-49.0	-54.0	-53.0
Abroad	1.7	26.1	26.0	-1.0	10.8	12.0	7.0
In Brazil	5.8	86.9	96.9	4.9	59.9	66.0	60.0
Equity capital	3.2	49.9	57.9	4.0	43.3	51.0	45.0
Intercompany loans	2.5	37.0	39.0	0.9	16.6	15.0	15.0
Portfolio investments	-0.7	-47.4	-38.7	-6.1	-24.2	-16.0	-11.2
Assets	-0.5	3.4	2.8	0.2	-1.4	-	-
Liabilities	0.2	50.8	41.5	6.2	22.9	16.0	11.2
Derivatives	0.9	0.7	1.6	-0.3	3.2	-	-
Other investments	-5.2	-1.4	-3.3	11.5	14.1	6.7	9.3
Assets	-0.5	48.2	50.6	9.9	39.9	40.4	31.9
Liabilities	4.7	49.6	54.0	-1.6	25.8	33.7	22.7
Reserve assets	0.4	20.7	10.8	-1.9	1.6	1.6	14.3

1/ Forecast.

Portfolio investment abroad – assets had net returns of US\$1.4 billion (net applications of US\$3.4 billion in the first eleven months of 2014). Net borrowings of liability investments in portfolio amounted to US\$22.9 billion (US\$50.8 billion over the first eleven months of 2014), with emphasis on net inflows of investments in stocks and shares of investment funds (US\$11.4 billion) and in fixed income securities traded in the country (US\$17.5 billion), which had had net inflows of US\$12.1 billion and of US\$35.6 billion, respectively, over the first eleven months of 2014.

Rollover rate of long-term securities traded abroad was at 78% in the first eleven months of 2015 (101% in the same interval of 2014). Net amortizations of long-term securities, except for sovereign papers, amounted to US\$2.9 billion, with outlays of US\$10.2 billion and amortizations of US\$13.1 billion. Short-term securities had net inflows of US\$183 million and the net amortizations of Republic bonds, including repurchase operations in the secondary market, totaled US\$3.3 billion.

Other investments – assets totaled US\$39.9 billion, with noteworthy expansions of US\$10.2 billion in deposits owned by non-financial companies and of US\$3.9 billion in deposits held by Brazilian banks abroad. Trade credits totaled net lendings of US\$24.9 billion (US\$33.8 billion from January to November 2014).

Other investments – liabilities – trade credits, deposits, direct loans from banks and other loans from international bodies – totaled net inflows of US\$25.8 billion in the first eleven months of 2015 (US\$49.6 billion in the same period in 2014). Net outlays of short-term trade credits to suppliers amounted to US\$23.9 billion and net inflows of long-term loans, US\$2.6 billion. Emphasis on net inflows concerning direct loans (US\$4.6 billion), with rollover rate of 112%. Short-term loans had net amortizations of US\$331 million (US\$21.5 billion from January to November 2014).

At the end of November, the stock of international reserves reached US\$357 billion in cash and US\$369 billion in liquidity, respective decreases of US\$6.5 billion and US\$5.1 billion compared to December 2014. During the period, there were net sales of US\$1.5 billion of operations of repurchase lines. The revenue of interest that remunerates the assets of reserves totaled US\$2.3 billion; variations by prices decreased the stock of reserves by US\$263 million; and changes in parities determined impact of -US\$7.9 billion.

Table 5.8 – Foreign capitals

Net flows – Selected items

Itemization	US\$ billion						
	2014		2015		2016		
	Nov	Jan- Nov	Nov	Jan- Nov	Year ^{1/}	Year ^{1/}	
Long-term funds	2.1	18.3	19.3	-1.5	-1.6	-1.0	-0.8
Public bonds	-0.1	2.5	2.5	0,0	-3.3	-3.3	-0.8
Priv. debt securities	0.7	0.1	-0.3	0.8	-2.9	-3.7	-
Direct loans	1.5	15.7	17.1	-2.2	4.6	6.0	-
ST loans ^{2/}	1.4	21.5	24.4	-0.1	-0.3	-	-
ST debt securities ^{2/}	0.1	0.5	0.5	-0.1	0.2	-	-
Debt sec. in Brazil and equity securities	-0.5	47.7	38.8	5.6	28.9	24.0	12.0
Rollover rates (%) ^{3/}							
Total	287%	156%	155%	72%	103%	104%	100%
Debt securities	369%	101%	98%	153%	78%	75%	100%
Direct loans	262%	187%	188%	38%	112%	115%	100%

1/ Forecast.

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

3/ Equals the ratio between long-term disbursements and amortizations.

Table 5.9 – Statement of international reserves

Itemization	US\$ billion				
	2014		2015		2016
	Jan- Nov	Year	Jan- Nov	Year ^{1/}	Year ^{1/}
Reserves position in previous period	358.8	358.8	363.6	363.6	357.7
Banco Central interventions	16.8	6.5	-1.5	-1.0	11.5
Forward	-	-	-	-	-
Spot	-	-	-	-	-
Repo lines of credit	16.8	6.5	-1.5	-1.0	11.5
Foreign currency loans					
Disbursements ^{2/}	0.4	0.4	0.2	0.2	-
Amortizations	-	-	-	-	-
Interest expense	-	-	-	-	-
Interest income	2.8	3.0	2.3	2.6	2.8
Price changes	2.3	1.7	-0.3	-0.3	-
Exchange rate changes	-6.3	-7.8	-7.9	-7.9	-
Others ^{3/}	0.8	1.0	0.6	0.6	-
Total changes	16.6	4.7	-6.5	-5.8	14.3
Reserves position – Cash	375.4	363.6	357.0	357.7	372.0
Outstanding repo lines of credit	0.2	10.5	12.0	11.5	-
Outstanding foreign currency loans	-	-	-	-	-
Reserves position – Liquidity ^{4/}	375.6	374.1	369.0	369.2	372.0

1/ Forecast.

2/ Includes inflows from multilateral organizations.

3/ Includes receipt/payment under reciprocal credits agreement (CCR), acceptance/payment of premium/discount of fees, reclassifications, SDR allocations and fluctuations of financial derivatives assets (forwards).

4/ Includes repo lines of credit and foreign currency loans positions.

Considering the impact from expectable events, international reserves totaled US\$372 billion in cash and liquidity, at the end of 2016, with emphasis on reserves remuneration revenue of US\$2.8 billion.

5.5 External sustainability indicators

Considering the position estimated for November 2015, foreign debt service increased by 71.5% compared to the position observed of December 2014. Exports of goods decreased by 14.9% and the ratio between these indicators reached 60.0% (29.8% in December 2014). Gross foreign debt decreased by 3.4% and GDP in U.S. dollars declined by 24.0%, resulting in growth of 4.0 p.p., to 18.6%, in the gross foreign debt/GDP ratio. The net foreign debt/GDP ratio went from -1.9% to -2.8%, in the period.

The gross foreign debt/exports ratio rose from 1.6 to 1.8; the ratio for net foreign debt/exports of goods and services remained stable, in -0.2; and the ratio between international reserves (liquidity) and gross debt increased from 106.1% to 108.3%, in the period.

5.6 Conclusion

Results from the balance of payments keep confirming the prospect of significant reduction in the current transactions deficit, consistent with the context of exchange rate depreciation, decline in domestic demand, and, albeit moderate, recovery of the economies of major trading partners. Continuity of the ongoing macroeconomic adjustment process is expected to keep promoting, in 2016, the trend of strengthening of the current account.

The net inflows of foreign capital keep funding the deficit properly, especially the net inflow of direct investment in the country and of investments in portfolio. Additionally, it is noteworthy the securities and loans rollovers in 103%, in the first eleven months of this year.

Table 5.10 – Sustainability indicators^{1/}

Itemization	US\$ billion				
	2013	2014	2015		
	Dec	Dec	Jun	Sep	Nov ^{2/}
Exports of goods	241.5	224.1	207.9	194.9	190.7
Exports of goods and services	279.7	264.1	245.2	229.8	225.2
Debt service	85.1	66.7	100.3	107.6	114.4
Gross external debt	312.5	352.7	349.2	344.9	340.6
Net external debt	-90.5	-45.9	-44.4	-48.3	-51.0
International reserves (liquidity)	375.8	374.1	372.2	370.6	369.0
International reserves (cash)	358.8	363.6	368.7	361.4	357.0
GDP	2 461	2 416	2 111	1 946	1 835
Indicators					
Gross external debt/GDP (%)	12.7	14.6	16.5	17.7	18.6
Net external debt/GDP (%)	-3.7	-1.9	-2.1	-2.5	-2.8
Gross external debt/exports	1.3	1.6	1.7	1.8	1.8
Gross external debt/exports of goods and services	1.1	1.3	1.4	1.5	1.5
Net external debt/exports	-0.4	-0.2	-0.2	-0.2	-0.3
Net external debt/exports of goods and services	-0.3	-0.2	-0.2	-0.2	-0.2
Debt service/exports (%)	35.2	29.8	48.3	55.2	60.0
Debt service/exports of goods and services (%)	30.4	25.3	40.9	46.8	50.8
Reserves (liquidity) / Gross external debt (%)	120.2	106.1	106.6	107.4	108.3
Reserves (cash) /Gross external debt (%)	114.8	103.1	105.6	104.8	104.8

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

2/ Estimated data.

Projection for the Balance of Payments of 2015 and 2016

Table 1 – Balance of payments forecasts

Itemization	US\$ billion						
	2014			2015			2016
	Nov	Jan- Nov	Year	Nov	Jan- Nov	Year ^{1/}	Year ^{1/}
Current account	-9.1	-92.5	-104.1	-2.9	-56.4	-62.0	-41.0
Trade balance	-2.7	-6.6	-6.5	1.0	11.7	15.0	30.0
Exports	15.6	206.7	224.1	13.7	173.3	190.0	190.0
Imports	18.3	213.3	230.6	12.7	161.6	175.0	160.0
Services	-3.7	-43.3	-48.1	-2.4	-34.5	-38.7	-33.4
Travel	-1.2	-17.1	-18.7	-0.5	-10.9	-11.7	-9.0
Others	-2.4	-26.2	-29.4	-1.9	-23.6	-27.0	-24.4
Primary income	-3.1	-45.0	-52.2	-1.7	-35.9	-40.9	-40.5
Interest	-1.0	-19.3	-21.3	-0.9	-19.4	-21.2	-20.9
Dividends	-2.1	-26.0	-31.2	-0.9	-16.8	-20.0	-20.0
Others	0.0	0.3	0.4	0.0	0.3	0.4	0.4
Secondary income	0.3	2.4	2.7	0.3	2.3	2.6	2.9
Capital account	0.0	0.2	0.2	-0.1	0.2	0.3	0.4
Financial account	-8.7	-88.2	-100.5	-2.8	-54.3	-61.7	-40.6
Investment assets ^{2/}	0.7	77.8	79.5	9.0	49.3	52.4	38.9
DI assets	1.7	26.1	26.0	-1.0	10.8	12.0	7.0
Banks' assets	-4.1	-0.7	-1.4	6.8	2.2	7.4	1.9
Other assets	3.1	52.4	54.9	3.2	36.4	33.0	30.0
Investment liabilities ^{2/}	10.7	187.3	192.4	9.6	108.5	115.7	93.8
DI liabilities	5.8	86.9	96.9	4.9	59.9	66.0	60.0
Total shares	-0.3	12.1	11.8	0.9	11.4	10.0	6.0
Debt sec. in Brazil	-0.2	35.6	27.1	4.7	17.5	13.0	6.0
Loans and debt sec.							
abroad long term	2.3	20.3	21.1	-2.7	-3.6	-1.3	-7.8
Debt sec. public	-0.1	2.5	2.5	-0.0	-3.3	-	-
Debt sec. private	0.7	0.1	-0.3	0.8	-2.9	-7.0	-0.8
Direct loans	1.5	15.7	17.1	-2.2	4.6	6.0	-
Others ^{4/}	0.2	1.9	1.8	-1.3	-2.0	-0.3	-6.9
Loans and debt sec.							
abroad short term	1.5	22.0	24.9	-0.2	-0.1	-	-
Other liabilities ^{5/}	1.6	10.5	10.6	2.0	23.5	27.9	29.6
Financial derivatives	0.9	0.7	1.6	-0.3	3.2	-	-
Reserve assets	0.4	20.7	10.8	-1.9	1.6	1.6	14.3
Errors and omissions	0.4	4.1	3.4	0.2	1.9	-	-
Memo:							
Current account/GDP (%)		-4.2	-4.3		-3.4	-3.4	-2.7
FDI / GDP (%)		3.9	4.0		3.7	3.8	3.9

1/ Forecast.

2/ Includes direct investment, portfolio investment and other investments.

3/ Includes equities traded in stock exchanges in Brazil and abroad.

4/ Includes banks', buyers', bilateral and multilateral loans

5/ Includes trade credit liabilities and other liabilities.

This table presents the revision of the projections for the balance of payments of 2015 and the first estimates for 2016. The revisions considered data published since the Inflation Report of September, updates of the international and Brazilian economic context, and more recent statistics relating to the stock and service of external debt.

For 2015, the projection for the deficit in current transactions was reduced to US\$62 billion (3.48% of gross domestic product – GDP). The revision reflects, in the context of depreciation of the Brazilian currency and decreased domestic activity, increase from US\$12 billion to US\$15 billion in the surplus in the balance of trade, with exports amounting to US\$190 billion and imports, to US\$175 billion (respective reductions of 15.2% and 24.1% compared to the result of 2014).

The projection for the deficit in the services category declined from US\$40.3 billion, in the previous Report, to US\$38.7 billion. Important declines in net expenses of international travels (from US\$13 billion to US\$11.7 billion), compatible with the decline in gross expenses, influenced by the trajectories of the disposable income and of the exchange rate; of transport (from US\$7 billion to US\$6 billion), reflecting the lower trade flows; and of equipment rentals (from US\$23 billion to US\$22 billion).

Net expenses with primary incomes are projected at US\$40.9 billion for 2015 (US\$52.2 billion in 2014); net interest expenses, at US\$21.2 billion (US\$21.3 billion in 2014), considering the debt position schedule for September 2015; and the net remittances of profit and dividends, at US\$20 billion (US\$31.2 billion in 2014), included reinvested profits. Net

expenses of profits and dividends declined by 35.2% in the first eleven months of 2015, compared to the same period in 2014.

The estimate for net inflow of the secondary income account was reduced from US\$2.9 billion, in the previous Inflation Report, to US\$2.6 billion. The net inflows of secondary income totaled US\$2.3 billion in the first eleven months of 2015.

In the financial account, it is projected that net borrowings exceed net lendings by US\$61.7 billion. The estimate for direct investments abroad (DIA) sums net remittances of US\$12 billion (US\$17 billion in the previous projection and US\$26 billion in 2014), and the estimate related to net inflows of foreign direct investments (FDI) increased from US\$65 billion, in the previous projection, to US\$66 billion (3.70% of GDP). It is estimated, therefore, that foreign direct investment finance integrally the deficit projected for current transactions in 2015.

The estimate for net inflows in liabilities of portfolio investments was reduced by US\$11.9 billion, to US\$16 billion. There were important inflows related to fixed income securities traded in the domestic market, US\$13 billion, and to stocks, US\$10 billion (US\$20 billion and US\$11 billion, respectively, in the Inflation report of September).

Reflecting the Brazilian companies' access to the international market of credit and the result occurred in the first eleven months of 2015, the projection for the rollover rate of direct loans and fixed income securities traded abroad was increased to 104%, consisting of 75% in long-term securities and 115% in long-term direct loans.

The stock of operations of line with repurchase reached US\$11.5 billion on December 17, 2015, resulting from net sales of US\$975 million, during the year.

Considering the estimated surplus of US\$6.4 billion for the financial gap of the balance of market payments, the assets held abroad, by banks in Brazil, are expected to increase by US\$7.4 billion in 2015.

The deficit in current transactions for 2016 is estimated at US\$41 billion (2.66% of GDP). Projections point

to trade surplus of US\$30 billion, with stability in exports, at US\$190 billion, and decline of 8.6% in imports, to US\$160 billion.

The services account deficit is expected to reach US\$33.4 billion, with important projections for net expenses related to equipment rental (US\$21 billion), international travels (US\$9 billion) and transportation (US\$5 billion). Net remittances of profits and dividends and net payments of interest were projected in US\$20 billion and US\$20.9 billion, respectively, and the net inflows of secondary income, at US\$2.9 billion.

Foreign direct investment (FDI) net inflows of US\$60 billion are estimated for 2016. Direct Investment Abroad (DIA) is expected to have net applications of US\$7 billion; net investments in stocks, US\$6 billion; and the fixed income securities traded

Table 2 – Balance of payments – Financial gap^{1/}

Itemization	US\$ billion						
	2014*			2015*			2016
	Nov	Jan- Nov	Year	Nov	Jan- Nov	Year ^{2/}	Year ^{2/}
Current account	-9.1	-92.5	-104.1	-2.9	-56.4	-62.0	-41.0
Interest on debt securities issued in the country – expenses	-0.2	-7.6	-7.6	-0.1	-6.9	-6.9	-6.8
Interest on international reserves – receipts	0.2	2.8	3.0	0.2	2.3	2.6	2.8
Reinvested earnings – receipts	0.6	5.5	6.0	0.3	4.3	4.5	4.0
Reinvested earnings – expenses	0.0	-9.0	-10.7	0.0	-5.7	-6.0	-5.0
Current account – financial gap	-9.8	-84.2	-94.7	-3.4	-50.4	-56.2	-36.0
Financial account	-5.7	95.1	-99.8	-8.0	-51.1	-62.6	-49.4
Assets	4.1	73.1	74.9	1.9	42.9	40.5	33.0
Direct investment assets, except reinvested dividends	1.1	20.7	20.0	-1.3	6.5	7.5	3.0
Portfolio investment, except banks	-0.3	2.4	2.2	0.2	0.4	-	-
Other investment, except banks	3.3	50.0	52.6	3.1	35.9	33.0	30.0
Liabilities	10.5	170.7	174.1	9.5	95.9	102.8	82.0
Direct investment liabilities, except reinvested dividends	5.8	77.9	86.2	5.0	54.1	60.0	55.0
Portfolio investment, except reinvested interest	-0.0	43.2	33.9	6.1	16.0	9.1	4.4
Other investment	4.7	49.6	54.0	-1.6	25.8	33.7	22.7
Others	0.6	-2.5	-0.7	-0.4	1.8	-0.3	-0.4
Financial gap ^{3/}	-4.1	2.7	5.1	4.6	0.7	6.4	13.4
Net Banco Central interventions ^{4/}	-	4.0	6.5	-2.2	-1.5	-1.0	11.5
Banks: asset changes ^{5/}	-4.1	-1.3	-1.4	6.8	2.2	7.4	1.9

1/ Excludes all transactions settled through international reserves or in domestic currency, except for foreign exchange market interventions, and domestic transaction settled in reais.

2/ Forecast.

3/ + = surplus in the foreign exchange market; - = deficit in the foreign exchange market.

4/ + = increase of international reserves; - = decrease of international reserves.

5/ + = increase in the assets owned by banks; - = decrease in the assets owned by banks.

* Preliminary data.

in the domestic market, US\$6 billion. Rollover rates are expected to be at 100%.

In 2016, the financial gap of the balance of market payments is expected to reach a surplus of US\$13.4 billion. It is expected that banks that operate in the Brazilian exchange market liquidate their liabilities in lines with repurchase, returning US\$11.5 billion to Brazil's Central Bank (BCB) and rising by US\$1.9 billion the balance of their deposits kept abroad.

This chapter of the Inflation Report presents the Monetary Policy Committee's (Copom) assessment of the behavior of the Brazilian economy and of the international scenario since the release of the previous Report in September 2015. The chapter also presents the analysis of the inflation prospects up to the fourth quarter of 2017 and of the Gross Domestic Product (GDP) growth up to the fourth quarter of 2016. Inflation projections are presented in two major scenarios. The first scenario, termed baseline scenario, assumes that the Selic rate will remain unchanged over the forecasting horizon at 14.25% per year, which is the level set by the Copom at its most recent meeting on November 25, and that the exchange rate will remain at R\$3.90/US\$. The second scenario, termed market scenario, employs the expected paths for the policy interest rate and for the exchange rate drawn from the survey carried out by the Banco Central do Brasil's Investor Relations and Special Studies Department (Gerin) among independent analysts. It is important to stress that these scenarios are used only as support for monetary policy decisions and that their assumptions should not be viewed as Copom forecasts about the future behavior of interest and exchange rates. The projections released here are based on the information set available up to the cutoff date December 18, 2015.

The projections for inflation and for GDP growth released in this Report are not point estimates. They consist of probability intervals that embody the degree of uncertainty existing at the above mentioned cutoff date. Inflation projections depend not only on assumptions about interest and exchange rates, but also on a set of assumptions about the behavior of exogenous variables. The most likely set of assumptions considered by the Copom is used to build the scenarios to which the Committee attaches the greatest weight on making its interest rate decisions. On setting out these assumptions, the Copom seeks to foster transparency to monetary policy, thereby contributing to the effectiveness of policy decisions in controlling inflation, which is its primary objective.

6.1 Inflation determinants

The twelve-month inflation measured by the change in the Extended National Consumer Price Index (IPCA) reached 10.48% in November, 3.92 p.p. higher than the value recorded up to November 2014. On the one hand, market prices have accumulated a twelve-month change of 8.28% (6.76% until November 2014). On the other hand, regulated and monitored prices increased 17.95% (5.83% up to November 2014). Within the set of market prices, non-tradable increased 8.51% in twelve months (7.45% up to November 2014), and tradable goods increased 7.97% (6.02% up to November 2014). Twelve-month inflation in the food and beverage group was 11.54% (7.83% up to November 2014) and in the services sector – around one-third of the consumption basket of IPCA – it was 8.34% (8.29% up to November 2014).

The average monthly change of underlying inflation measures calculated by the Central Bank was 0.65% in November, from 0.63% in October, reaching 8.36% in twelve months (1.93 p.p. higher than the rate recorded in November 2014). Specifically, the non-smoothed trimmed mean core changed 0.65% in November from 0.61% in October; and the smoothed trimmed mean core changed to 0.75% from 0.66%. In turn, the exclusion core – which excludes ten items from the groups food at home and fuels – remained at 0.53%; the core that excludes the prices of monitored goods and food at home changed to 0.59% from 0.63%; and the double weighted core changed to 0.71% from 0.73%. The IPCA diffusion index reached 78.0% in November (16.6 p.p. higher than November 2014), and the three-month average reached 70.5% (8.0 p.p. above the average observed from September 2014 to November 2014).

Broader inflation, measured by the General Price Index (IGP-DI) and characterized by higher volatility when compared to the IPCA, was 1.76% in October and 1.19% in November. Accordingly, the twelve-month inflation reached 10.64% (4.10% until November 2014). The IPA, which is the main component of the IGP-DI, registered a variation of 11.27% in twelve months up to November, as the result of 14.72% inflation in the agricultural sector and of 9.95% in the industrial sector. In turn, the change in the IPC, which is the second most important component of the IGP-DI, reached 10.39% in twelve months (6.81% up to November 2014). The INCC, which is the price index with the smallest weight in the IGP-DI, increased 7.47% in twelve months (6.97% up to November 2014), due to the 8.09% change

in labor cost and the 6.76% change in the cost of materials, equipment and services.

The high frequency coincident indicator of economic activity, IBC-Br, which provides monthly production estimates for the three sectors of the economy, decreased 0.63% in October, compared to the previous month, considering seasonally adjusted series. Therefore, the IBC-Br growth rate was -3.20% in the last twelve months. In turn, the PMI for Brazil shifted from 42.7 in October to 44.5 in November, pointing to a less pronounced contraction of the private sector activity.

The Industry Confidence Index (ICI) and the Services Sector Confidence Index (ICS), computed by FGV, decreased 1.4% and 1.2%, respectively, in November compared to October. On the other hand, the Consumer Confidence Index (ICC) increased 1.3% in the same period.

According to the seasonally adjusted data of IBGE, the industrial production decreased 0.7% in October, accumulating a negative change of 7.2% in twelve months. Considering non-seasonally adjusted series, the industrial production decreased 11.2% in October compared to the same month of the previous year, with negative results in the four end-use categories and in 24 of the 26 surveyed activities. Among the end-use categories and comparing the industrial production of October and September based on seasonally adjusted series, the durable consumer goods sector showed the largest reduction (-5.6%), followed by the capital goods sector (-1.9%), the intermediate goods sector (-0.7%) and the semi and non-durable consumer goods sector (-0.6%). Comparing the industrial production of October with the one for the same month of 2014, there was reduction in the four categories: capital goods (-32.6%), durable consumer goods (-28.7%), intermediate goods (-7.5%) and semi and non-durable consumer goods (-7.4%). According to seasonally adjusted data from the National Confederation of Industry (CNI), the manufacturing industry revenues decreased 4.0% in real terms from September to October of 2015 to reach a level 15.3% lower than the one observed in October 2014.

The Installed Capacity Utilization Level (Nuci) in the manufacturing sector, computed and seasonally adjusted by FGV, reached 74.6% in November. In terms of sectoral distribution, capacity utilization is more intense in the construction materials sector (78.9% according to seasonally adjusted data), and less strong in the capital goods sector (68.3%). With regard to inventories, the indicator for the

manufacturing sector, calculated and seasonally adjusted by FGV, decreased in the last months. In November, 20.0% of the surveyed establishments had excessive inventories (23.6% in August), and 3.7% had insufficient inventories (3.3% in August), according to seasonally adjusted data. Still regarding the FGV survey, inventories remain at high levels, in particular, in the capital goods and non-durable consumer goods sectors.

The narrow retail sales volume index decreased 5.6% in October, compared to the same month of the previous year, while the broader retail sales volume index contracted 11.8% in the same basis of comparison (the monthly rates were 0.6% and -0.1%, respectively, considering seasonally adjusted series). Accordingly, the twelve-month growth rate was -2.7% for the narrow retail index and -6.8% for the broader retail index. In October, retail sales volume increased in five of the ten segments surveyed by IBGE, taking into account the seasonally adjusted index.

The Brazilian GDP at market prices decreased 1.7% in the third quarter of 2015 compared to the previous quarter (after decreasing 2.1% in the second quarter), according to seasonally adjusted data from the IBGE. Compared to the same quarter of 2014, there was a reduction of 4.5% (-3.0% in the second quarter under the same comparison basis). Brazilian GDP fell 2.5% in the last four quarters (contraction of 2.2% in the value added and of 4.6% in direct taxes). In terms of components, the production in the agricultural sector increased 2.1% in four quarters; decreased 1.6% in the services sector; and decreased 4.7% in the industrial sector.

From the aggregate demand perspective, household consumption – the largest component of aggregate demand – decreased 1.5% in comparison to previous quarter, according to seasonally adjusted data, and 4.5% compared to the same quarter of 2014. Government consumption increased 0.3% at the margin and decreased 0.4% with respect to the same quarter of 2014. The Gross Fixed Capital Formation (GFCF) decreased 4.0% compared to the previous quarter and 15.0% compared to the third quarter of 2014. With respect to the foreign trade sector, exports of goods and services decreased 1.8%, whereas imports decreased 6.9% in comparison to the second quarter of 2015 and according to seasonally adjusted data. On a year-over-year basis, exports increased 1.1%, while imports decreased 20.0%, both influenced by the depreciation of the Brazilian Real during the period.

According to the Continuous National Household Sample Survey (PNADC) of IBGE, the estimated unemployment

rate was 8.9% in the moving quarter that ended in September 2015, which is 2.1 p.p. higher than in the same period of the previous year. According to the Monthly Employment Survey (PME) of IBGE, which covers six metropolitan regions, the unemployment rate was 7.5% in November (7.9% in October), and increased 2.7 p.p. in relation to November 2014 (4.8%). Considering seasonally adjusted data, the unemployment rate increased from 7.9% to 8.2% at the margin. Still according to the PME, the average real labor income received on a regular basis decreased 1.3% in November compared to October and decreased 8.8% with respect to the same month of the previous year. With respect to formal employment, according to the data released by the Ministry of Labor and Employment (MTE), 130.6 thousand jobs were closed in November and 945.4 thousand jobs were closed in 2015. In short, available data confirm the acceleration of a process of distension in the labor market.

Total credit to households reached R\$1,490.6 billion in October, with 8.4% nominal growth relative to October 2014. In particular, earmarked housing loans for households increased 18.4% and reached R\$490.7 billion, which is equivalent to 8.5% of GDP. In general, delinquency rates have shown moderate increase at the margin, at levels consistent with the phase of the cycle.

Total credit to corporations amounted to R\$1,666.4 billion in October (7.9% higher than registered in October 2014) and the average interest rate reached 21.5% (4.9 p.p. higher than the average rate observed in October 2014). In particular, loans and financing granted to corporations by the National Bank of Economic and Social Development (BNDES) amounted to R\$623.3 billion – an increase of 10.1% relative to October 2014.

Regarding the capital market, the volume of primary issues of shares registered in the Securities and Exchange Commission of Brazil (CVM) reached R\$16.1 billion in twelve months up to November 2015 (R\$15.1 billion up to November 2014). In turn, debenture issues, excluding the issuance of leasing companies, totaled R\$47.1 billion in twelve months up to November 2015 (R\$51.8 billion in the same period of the previous year). Total corporate financing from issuances of shares, debentures, commercial papers and receivables in credit rights reached R\$82.9 billion in twelve months up to November 2015 (R\$106.1 billion in the same period of 2014).

With regard to foreign trade, data from the Ministry of Development, Industry and Foreign Trade of Brazil (MDIC)

shows that the twelve-month trade surplus reached US\$13.7 billion in November (compared to US\$1.7 billion deficit in November 2014). This result stemmed from US\$191.8 billion in exports and US\$178.1 billion in imports, which represented decreases of 16.0% and 22.6%, respectively, in relation to the twelve-month period that ended in November 2014. Considering the twelve months up to October, exports volume increased 3.7% and the average price of exports decreased 19.6%, while imports volume decreased 11.9% and the average price of imports reduced 10.1%.

The twelve-month current account deficit reached US\$74.2 billion in October 2015, which is equivalent to 4.0% of GDP. Net Profits and dividends remittances amounted to US\$20.9 billion (US\$27.4 billion in October 2014) and “operational leasing services” expenses, which are mostly related to oil and minerals exploitation, reached US\$22.4 billion (US\$21.9 billion in October 2014). It is also worth noting that imports of oil and its derivatives reached US\$20.5 billion in twelve months up to October (US\$34.6 billion up to October 2014), while export revenues with these products fell to US\$18.5 billion from US\$26.7 billion.

Foreign direct investment, which has been the main financing source of the balance of payments, amounted to US\$70.7 billion in twelve months up to October, or 3.8% of GDP.

Regarding global activity, for most mature economies the prospects are of moderated growth. In Europe, despite recent monetary policy actions, investment and growth have been restrained by high unemployment rates, along with fiscal consolidation and political uncertainties. In the United States and the United Kingdom, recent data suggests that the economic recovery process continues. In emerging economies, the highlight remains with the loss of economic activity strength in China, although some signs of stabilization are perceptible. With respect to monetary policy, in general the accommodative stance prevails in mature and emerging economies, despite the beginning of the normalization process of monetary conditions in the United States. The 0.25 p.p. increase in the United States base interest rate was expected and new adjustments are likely to occur gradually. Inflation rates remain low in mature economies and relatively high in emerging markets.

Brent oil prices decreased since the release of the previous Report to levels close to US\$37. The geopolitical complexity that surrounds the oil sector tends to boost volatility in prices, which also reflects the low predictability of some global demand and supply components. Regarding the

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

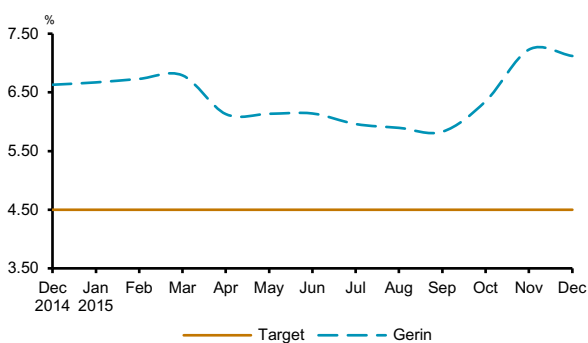
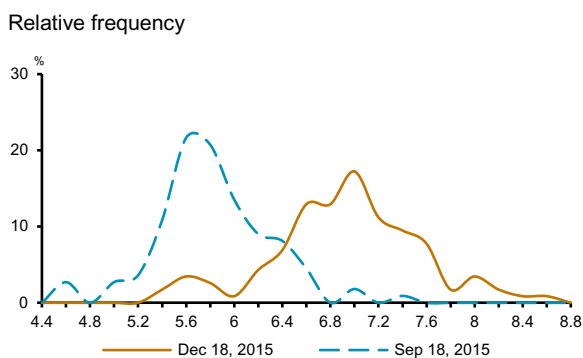


Figure 6.2 – Dispersion of inflation expectations for 2016



other commodities, prices of metal commodities decreased 16.34% and agricultural prices fell 3.90%. In this context the price index based on 22 commodities, published by the Commodity Research Bureau (CRB), dropped 6.71% at the cutoff date of December 18 in relation to the cutoff date of the September 2015 Report.

Median expectations of market analysts for GDP growth in 2015 deteriorated to -3.70% from -2.70% between September 18, cutoff date of the previous Report, and December 18. For 2016, the growth rate deteriorated to -2.80% from -0.80%. In the same period, the median inflation expectations for the IPCA increased to 10.70% from 9.34% for 2015; and to 6.87% from 5.70% for 2016. The non-smoothed projected inflation for the next twelve months increased 1.29 p.p., to reach 7.12% from 5.83%, as illustrated in Figure 6.1. Since the release of the September 2015 Report, the dispersion around the central inflation expectations trend for 2016 increased, as shown in Figure 6.2. The standard deviation of these projections increased to 0.62% from 0.48%.

6.2 Associated risks and monetary policy implementation

The projections used by the Copom are based on a set of assumptions about the behavior of the main macroeconomic variables. This set of assumptions, as well as the risks associated with them, underpin the main prospective scenario based on which the Committee makes policy decisions.

International evidence, which is confirmed by the Brazilian experience, suggests that high inflation rates generate distortions that elevate risks and depress investment. These distortions manifest, for instance, in the shortening of households, businesses and governments planning horizons of as well as in the deterioration of business confidence. The Committee also emphasizes that high inflation rates reduce the purchasing power of wages and income transfers, with negative repercussions on household confidence and consumption. Therefore, high inflation rates reduce the growth potential of the economy as well as of jobs and income generation.

In view of this, the Copom appraises that monetary policy should contribute to consolidate favorable macroeconomic conditions in longer horizons. Along these lines, the

Copom stresses that, under the inflation targeting regime, the Committee guides its decisions according to inflation projections made by the Banco Central do Brasil and based on the analysis of alternative scenarios for the evolution of main economic variables that determine price dynamics. The Committee also understands that low risks associated with core inflation in the short term tend to reduce uncertainties with respect to the future behavior of full inflation, help the monetary authority appraise scenarios, as well as, contribute to the expectations-coordination process of economic agents, in particular of price-setters. In addition, it is noteworthy that low risks associated with core inflation in the short term tend to enhance the effects of monetary policy actions, causing them to affect full-inflation dynamics more lastingly in the future. Even though the Copom acknowledges that other macroeconomic policy actions might influence price trajectory, it restates its view that monetary policy must remain especially vigilant, so as to ensure that pressures observed in shorter horizons should not propagate to longer horizons.

On the external front, the trend for global activity since the previous Report, showed moderation, in general, in the relevant horizon for monetary policy. In this regard, evidence points to relatively more homogeneous growth rates in mature economies, albeit low and below potential growth, notably in the euro area. In international markets, prospects point to moderation in the dynamics of commodity prices. On the domestic front, in line with the ongoing macroeconomic adjustment process – which has proven to be more intense and longer than anticipated –, the central scenario envisages lower than potential pace of activity expansion. The realignment of domestic prices to international prices and of monitored prices to market prices are also relevant aspects on the domestic front, along with the impact on assets prices of uncertainties about the trend of fiscal variables, both in terms of the speed of improvement of fiscal results and in terms of its composition, especially after the downgrading of the country's sovereign rating by a second rating agency.

On the international front, the prospects are of recovery of activity in some mature economies although they remain with limited space for monetary policy actions and a constrained fiscal scenario prevails. In the United States, recent data on economic growth in the third quarter confirms the trend for economic recovery reflected particularly in the labor market, in an environment of moderate levels of inflation, favored, in great part, by the fall in the prices of energy commodities. In Japan, the central bank maintains the monetary stimulus program aimed at increasing the pace of

economic expansion and at avoiding the risk of a deflationary spiral. In the euro area, the ECB initiated a new round of the monetary expansion program in order to reduce the risks of deflation and stimulate economic activity.

The Copom assesses that the developments in mature economies transmit to emerging economies aggregate demand with an intensity proportional to trade and capital flows, among other factors. In this sense, recent events – on one hand, the gradual improvement in the pace of economic activity in important trade partners; and, on the other hand, volatility spots in international financial markets – are opposing forces. The Committee also highlights the importance of the transmission through the expectations channel, which affects investment, in the case of entrepreneurs, and consumption, in the case of households. In this context, the Committee notices that, despite improvements in important mature economies, a relevant set of emerging economies have shown a period of higher moderation in the pace of economic activity. Recent indicators suggest greater disparity in growth rates of emerging economies and lower levels compared to recent years.

In short, the Committee assesses that, in the relevant horizon, the scenario is of moderate global growth – despite the heterogeneity in its distribution –, combined with the depreciation of the Real against important commercial partners currencies, which contributes to a more favorable external demand that more favorable to the growth of the Brazilian economy.

The Copom considers that the external environment has remained complex since the last Report and that, despite assigning low probability for the occurrence of extreme events in international financial markets, episodes of greater volatility affecting important emerging economies have been observed.

Aggregate commodity price indices measured in US Dollars reduced slightly after a period of strong drops between June and September, notably in the metals sectors. The Committee highlights that prospects indicate a moderation in commodity price dynamics. Regarding oil prices, the Committee points out that, regardless of the behavior of domestic gasoline prices, the evolution of international prices tends to affect transmit to the domestic economy both through the productive chains, such as the petrochemical, and through inflation expectations.

On the domestic front, the Committee restates that, aligned with the ongoing macroeconomic adjustment, the available indicators of domestic absorption and GDP growth rates continued to line up and confirmed that the pace of domestic activity growth in 2015 will be below potential. This process is intensified by uncertainties originating in non-economic events. In particular, investment retracted mainly influenced by these events and private consumption also contracted in line with recent data on credit, employment and income. Nevertheless, the Committee believes that, after a necessary period of adjustments that can be more intense and longer than anticipated, the pace of economic activity tends to increase to the extent that the confidence of firms and households strengthen. In addition, the Committee assesses that, in the medium term, important changes should occur in the composition of aggregate demand and supply. Consumption tends to grow at a moderate pace and investment tends to gain momentum. Regarding the external component of aggregate demand, the scenario of global growth, though moderate, combined with the depreciation of the Real, tends to favor the adjustment of the external accounts and the Brazilian economy growth. On the supply side, the Committee evaluates that, in longer horizons, prospects become more favorable for the competitiveness of the Brazilian industry and agriculture. The services sector, in turn, tends to grow at lower rates than those recorded in recent years.

According to the Copom's view, the changes mentioned in the previous paragraph indicate that there is space for the pace and composition of economic growth to reach the potential in the medium term. In this context, in longer horizons, the Committee understands that there is ground for expansion of investment ratios, for a more efficient allocation of production factors and, consequently, for actual and potential GDP growth to return to higher rates. Notwithstanding, the Committee highlights that the speed at which the above mentioned changes and the gains derived from them will be achieved depends, fundamentally, on a path of primary surplus that strengthens the perception of sustainability of the public sector accounts, as well as on lower uncertainties with respect to the domestic market.

In terms of factor markets, the Copom considers that the idle margin in the labor market has increased at a higher pace and some data have confirmed the acceleration of a distension process in this market. However, the Committee ponders that a significant risk prevails, particularly related to the possibility of nominal wage increases, this year and next, not compatible with productivity growth, with negative

repercussions on the inflation dynamics and on the perception regarding the sustainability of consolidated public sector accounts. At this point, it is worth noting that, according to economic theory, which is endorsed by the international experience, wage moderation is a key element to achieve a macroeconomic environment with price stability.

Still regarding the labor market, the Copom understands that there are risks stemming from the presence of mechanisms in the Brazilian economy that favor inflation persistence, derived from the possibility that wage bargaining give excessive weight to past inflation in detriment to future inflation, especially in the context of the ongoing adjustment of monitored prices. In this context, despite real wage gains consistent with estimates of productivity gains and notwithstanding the current distension process in the labor market, the Committee evaluates that the wage dynamics continues to originate inflationary cost pressures.

Concerning the capital factor, the twelve-month investment rate of the economy, calculated from National Accounts of IBGE, fell for the sixth consecutive quarter in the third quarter of 2015. Specifically in the corporate segment, several factors might be associated with the poor performance of the fixed capital formation, among which is the low business confidence level, intensified by uncertainties about non-economic events and the speed of the recovery and composition of fiscal results, the evidence of narrowing profit margins and the volatility in the currency markets. Still related to the capital factor, one should note that the capacity utilization continued to drop in the quarter ending in October, remaining – on a seasonally adjusted basis – on levels below those observed during the acute phase of the 2008-2009 crisis. This process occurred despite the reduction in the sectoral heterogeneity of utilization, in the comparison with the levels observed in the previous Inflation Report.

In terms of the set of idleness indicators for the economy, the Copom points out that conventional measures of the output gap are in a disinflationary zone, in line with recent economic activity growth rates – smaller than the estimates of potential economic growth and lower than what was initially anticipated. Considering the growth prospects (according to Section 6.3), the Committee assesses that in the next quarters these output gap measures tend to remain in the disinflationary region.

Regarding fiscal policy, the Copom reiterates that the materialization of the fiscal paths and the expectations about the speed of the fiscal adjustment affect the baseline

scenario for inflation. In this sense, regarding the structural fiscal balance and depending on the economic cycle, the Copom considers that, in the relevant horizon for monetary policy, the balance of the public sector tends to move to the neutral zone, not ruling out the hypothesis that it shifts to the constrained zone, albeit slowly and with less intensity than previously predicted. However, the Copom notes that indefiniteness and significant changes in the trajectory of primary results generation, as well as in its composition, not only impact the working assumptions underlying inflation projections – making the balance of risks more unfavorable –, but also impact asset pricing and risk perception in the economy, contributing to create a negative assessment about the macroeconomic environment, and just as it has negatively influenced inflation expectations.

In this regard, the Copom understands that the generation of primary surpluses that strengthen the perception of public sector accounts sustainability contributes to create a positive perception about the macroeconomic environment in the medium and long run, therefore decreasing the cost of public debt financing. Moreover, a more constrained fiscal policy will have favorable implications for the cost of capital in general, which, in turn, will stimulate private investment in the medium and long runs. Given that the process of recovery of fiscal balances has occurred at a lower speed than originally predicted, it is essential to keep the commitment to resume achieving primary surpluses and that they gradually reach a level that is sufficient to stabilize and, later, to shift down the path of public debt as a share of GDP. Since the fiscal adjustment also has its own lags between the discussion and the adoption of the measures and their outcomes, the more timely the implementation of the ongoing process is, the faster is the resumption of a favorable trajectory for the public debt and for household and corporate confidence. Specifically on the issue of inflation control, the Committee highlights that the literature and the international best practices recommend a consistent and sustainable fiscal policy design, in order to allow monetary policy actions to be fully transmitted to prices.

The Copom understands that a source of inflation risk lies on the behavior of inflation expectations, negatively affected in the last months by the high level of current inflation, by the dispersion of price increases, by the ongoing processes of relative price adjustment, and mainly by the uncertainties about the speed of the recovery process regarding the fiscal outcomes and its composition. Still regarding inflation expectations, the Committee observes that expectations for 2016 have risen since August, reversing the declining

trend that was observed up until then. The upward move in expectations – that took place together with the rise in uncertainties related to fiscal results – is also observed, although to a lesser extent, in market projections for 2017 and 2018. These facts are a clear and important signal of the recent worsening of the economy's balance of risks and they demand monitoring in order to define the next steps in the monetary policy strategy.

The Copom highlights that the main scenario envisages moderate credit expansion, which has already been noticed and tends to persist. In this regard, it is worth mentioning that after years of strong expansion, the credit market oriented to consumption underwent moderation, so that, in the last quarters, there was, on the one hand, a decline in bank exposure and, on the other, household deleveraging. Therefore, in the aggregate, one may infer that risks in the consumer credit segment have been mitigated. In another dimension, in line with instances of implemented actions, the Committee considers appropriate to reinforce initiatives aiming to moderate the concession of subsidies through credit operations.

The Copom highlights that, since the previous Report, the prices of domestic assets evolved in line with the risk aversion in international financial markets, but mainly reflecting changes in the perception of risk with respect to the Brazilian economy. In a context of increasing global risk aversion, reflecting uncertainties associated to the changes introduced in the Chinese exchange rate policy, the pace of recovery of global activity and the beginning of the normalization of the monetary policy in the United States, domestic risk premia increased more sharply than the other emerging economies throughout the first semester of 2015. In the relevant horizon for monetary policy, the Copom assesses that this global risk aversion and the volatility of international financial markets tend to react to the follow up of the gradual process of normalization of monetary conditions in the USA. However, it points out that domestic factors, especially the uncertainties related to the recovery process of fiscal balances and to the development of non-economic events influence and will continue to influence, if not promptly addressed, the prices of financial assets. As such, it is important to emphasize, once again, that eventual rises in volatility and risk aversion in international markets tend to be transmitted to domestic assets, in a discrete and incremental fashion, but that can possibly be amplified due to the lack of perception of domestic macroeconomic and financial soundness.

Specifically on the dynamics of this transmission, it is noteworthy that, on the one hand, some elements help reduce the effects of the exchange rate devaluation on domestic prices. Among these elements are, above all, the cyclical position of the economy, with the current performance and the new outlook for 2016 weaker than initially anticipated, the current level of inventories, the more benign behavior of commodity prices in international markets and the restrictive stance of monetary policy. On the other hand, the perception of agents about the perennial nature of asset prices, in particular the current levels of the exchange rate, operates in the opposite direction, increasing the potential for transmission of risk premia and currency devaluations to domestic prices.

The Copom highlights that, in market economies and in the long run, prices tend to show relatively similar growth rates. In this sense and in line with projections reported in the next section, the Copom reiterates the effects of a realignment process between regulated and market prices. From another perspective, the Committee points out that the Real depreciated during the last three years against the currencies of important Brazilian trade partners and hence, also reiterates the effects of a realignment process between domestic and international prices. Prospectively, the Committee reaffirms that one of the monetary policy roles is to restrain the effects of these realignments on inflation to the short run, so that they do not transmit to longer horizons.

From the viewpoint of the Copom, the fact that inflation currently stands at high levels reflects, in a large part, the effects of the two-mentioned significant and necessary relative price adjustment processes in the economy, as well as the uncertainties about the speed and composition of the recovery process of fiscal results.

In this context, as the projections presented in the next section show, the Committee points out, as previously anticipated, that these price adjustments caused inflation to rise in 2015, which requires determination and perseverance in order to prevent inflation transmission to longer horizons. While recognizing the direct impacts of these relative price adjustments on inflation, the Copom reaffirms the view that monetary policy can, should and is effectively restraining the derived second order effects resulting therefrom.

In this context, the Copom decided unanimously to maintain the rate at 14.25% p.a., without bias, at the

October meeting; and, by six votes in favor and two votes for increasing the Selic rate by 0.50 p.p., to maintain the rate at 14.25% p.a., without bias, at the November meeting.

Evaluating the macroeconomic outlook and the inflation prospects, the Copom considers that uncertainties related to the balance of risks remain, mainly regarding the velocity of the process of improving fiscal results and their composition, and that the process of relative price adjustment has been slower and more intense than anticipated. At the November meeting, part of its members argued that it would be appropriate to immediately adjust monetary conditions in order to reduce the risks of non-compliance with the objectives of the inflation targeting regime. However, most members of the Copom preferred to monitor the evolution of the macroeconomic scenario until the next meeting, and then to define the next steps of the monetary policy strategy.

In October, the following Copom members voted for the decision of keeping the Selic rate at 14.25% p.a.: Alexandre Antonio Tombini (Governor), Aldo Luiz Mendes, Altamir Lopes, Anthero de Moraes Meirelles, Luiz Edson Feltrim, Otávio Ribeiro Damaso, Sidnei Corrêa Marques and Tony Volpon. In November, the following Copom members voted for the decision of keeping the Selic rate at 14.25% p.a.: Alexandre Antonio Tombini (Governor), Aldo Luiz Mendes, Altamir Lopes, Anthero de Moraes Meirelles, Luiz Edson Feltrim and Otávio Ribeiro Damaso. The following Copom members voted for the decision of increasing the Selic rate to 14.75% p.a.: Sidnei Corrêa Marques and Tony Volpon.

The Copom reaffirms that the aggregate demand will remain moderate in the relevant horizon for monetary policy. On one hand, household consumption tends to be influenced by factors such as employment, income and credit; on the other hand, public-service concession and the expansion of agricultural income, among other factors, tend to favor investments. Net exports, in turn, present a better performance, either through export growth, benefiting from the scenario of higher growth of important trade partners and from the Real depreciation, or through the ongoing import substitution process. For the Copom, the joint effects of these elements, in addition to the fiscal, parafiscal and the asset market developments, and, in 2016, the dynamics of monitored prices are important factors for the context in which the future monetary policy decisions will be made with the objective of ensuring inflation convergence to the 4.5% target established by the National Monetary Council (CMN), in the end of 2017.

The Copom emphasizes that there are uncertainties regarding the balance of risks, mainly with respect to the speed of the recovery process of fiscal results and its composition, and that the process of relative price adjustment seems to be more intense and longer than anticipated. In this context, regardless of the delineations of the other policies, the Committee will adopt the necessary actions to ensure the achievement of the objectives of the inflation targeting regime, i.e. to circumscribe the inflation into the limits established by the CMN, in 2016, and to make the convergence of inflation to the target of 4.5%, in 2017.

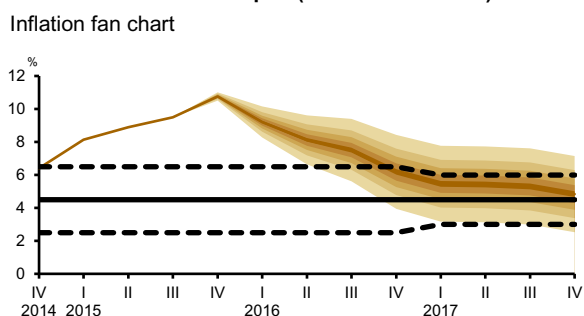
6.3 Assumptions and inflation forecast

According to traditional procedures, and taking into account the available information set, up to the cutoff date of December 18, 2015, the baseline scenario assumes that the exchange rate remains unchanged over the forecast horizon at R\$3.90/US\$, and the target for the Selic rate at 14.25% p.a. – the level set by the November 2015 Copom meeting – the same values considered in the September 2015 Inflation Report.

The market scenario, in turn, incorporates data from the expectations survey carried out by Gerin with a representative group of institutions up to the cutoff date. In this scenario, average exchange rate expectations increased compared to the values released in the previous Inflation Report. For the last quarter of 2015, the average rate moved from R\$3.86/US\$ to R\$3.85/US\$. For the end of 2016, the average exchange rate moved from R\$4.00/US\$ to R\$4.20/US\$. For the end of 2017, market participants project an average exchange rate of R\$4.20/US\$, compared to R\$3.93/US\$ in the previous Inflation Report.

Regarding the evolution of the average Selic rate, the expectations for the fourth quarter of 2015 decreased from 14.25% p.a. to 14.18% p.a. and, for the fourth quarter of 2016, shifted from 12.25% p.a. to 15.08% p.a. For the end of 2017, the expectations shifted from 11.00% p.a. to 12.25% p.a. This trajectory of the average Selic rate is consistent with 360 days pre-DI swap spreads of 19 b.p., 72 b.p. and -154 b.p. with respect to the current target for the Selic rate (14.25% p.a.), in the fourth quarters of 2015, 2016 and 2017, respectively.

Figure 6.3 – Projected IPCA-inflation with interest rate constant at 14.25% p.a. (Baseline scenario)



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

Table 6.1 – Projected IPCA-inflation with interest rate constant at 14.25% p.a. (Baseline scenario)

Year	Q	Probability Interval					Central projection	
		50%						
		30%			10%			
2015	4	10.7	10.7	10.7	10.8	10.8	10.9	10.8
2016	1	8.8	9.0	9.1	9.3	9.4	9.6	9.2
2016	2	7.5	7.8	8.0	8.2	8.5	8.7	8.1
2016	3	6.7	7.1	7.4	7.7	8.0	8.3	7.5
2016	4	5.3	5.7	6.0	6.4	6.7	7.1	6.2
2017	1	4.5	4.9	5.3	5.6	6.0	6.4	5.5
2017	2	4.5	4.9	5.2	5.6	6.0	6.4	5.4
2017	3	4.4	4.8	5.1	5.5	5.8	6.2	5.3
2017	4	3.9	4.3	4.7	5.0	5.4	5.8	4.8

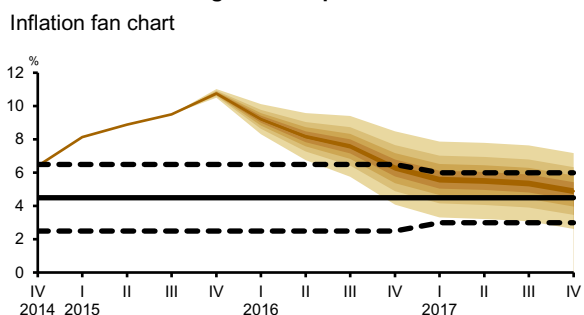
Note: accumulated inflation in 12 months (% p.a.).

The projection for the change in the set of regulated and monitored prices, in both scenarios, is 18.2% for 2015, compared to 15.4% considered in the last Report. This projection is based on the variations, for the accumulated in 2015, of gasoline (20.7%), as well as on the increase of 51.6% in electricity rates. For 2016, the projected variation in the prices of the set of regulated and monitored prices in both scenarios is 5.9%, compared to 5.7% considered in the last Inflation Report. This projection considers, for fuels, that domestic prices of gasoline and diesel are higher than international prices, constraining eventual rises. For energy prices, the projection of increase of 4.6% in 2016 considers the decrease, in dollars, of Itaipu electricity rates and the absence of changes in the system of electricity tariff bands in 2016, although risks from water resources have decreased advantageously and high-cost thermal plants were switched off. It should be highlighted that, regarding items for which more information is available, price changes were estimated individually. For the remaining items, the projections are based on models of endogenous determination of regulated prices, which consider, among other variables, seasonal components, market price inflation and General Price Index (IGP) inflation. According to these models, the projected adjustment in the set of regulated and monitored prices in both scenarios is 5.0% in 2017.

The structural primary result that derives from the primary deficit trajectory of 0.85% of GDP in 2015 and from the primary surplus of 0.50% of GDP in 2016 is considered as the fiscal indicator. For a given period, the fiscal impulse is equivalent to the change of structural result, compared to the previous period.

Based on the above assumptions and using the information set available until the cutoff date, projections were constructed for the four-quarter IPCA inflation, consistent with the interest rate and exchange rate paths that characterize the baseline and market scenarios.

Figure 6.4 – Projected IPCA-inflation with market interest and exchange rates expectations



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

The central projection associated with the baseline scenario indicates inflation of 10.8% in 2015, 1.3 p.p. above the projection informed in the Report of September 2015 and above the central target level of 4.5% determined by the CMN. In 2016, as can be seen in the Figure 6.3 and in the Table 6.1, in the baseline scenario, the projection for the first quarter of 2016 is at 9.2%. For the second quarter of 2016, projection reduces to 8.1%, continues to decline to 7.5% in the third quarter, and ends the year in 6.2%. In 2017, the projection for the first quarter is 5.5%, reduces

Table 6.2 – Projected IPCA-inflation with market interest and exchange rates expectations 1/

Year Q	Probability Interval						Central projection
	50%		30%		10%		
2015 4	10.7	10.7	10.7	10.8	10.8	10.9	10.8
2016 1	8.8	9.0	9.1	9.3	9.4	9.6	9.2
2016 2	7.6	7.8	8.1	8.3	8.5	8.7	8.2
2016 3	6.8	7.2	7.4	7.7	8.0	8.3	7.6
2016 4	5.4	5.8	6.1	6.4	6.8	7.2	6.3
2017 1	4.6	5.0	5.4	5.8	6.1	6.5	5.6
2017 2	4.6	5.0	5.3	5.7	6.0	6.4	5.5
2017 3	4.4	4.8	5.2	5.5	5.9	6.3	5.4
2017 4	4.0	4.4	4.7	5.1	5.4	5.8	4.9

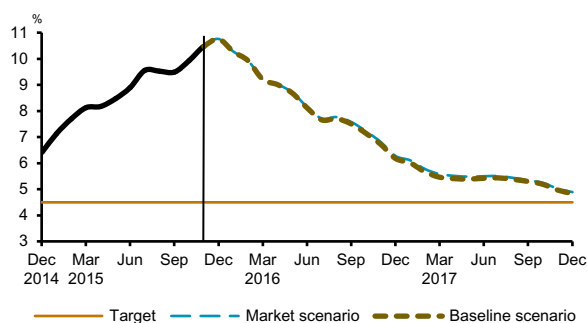
Note: accumulated inflation in 12 months (% p.a.).

1/ According to Gerin.

Table 6.3 – September 2015 Inflation Report projections

Period	Baseline scenario	Market scenario
2015 III	9.5	9.5
2015 IV	9.5	9.5
2016 I	7.7	7.7
2016 II	6.5	6.4
2016 III	5.8	5.8
2016 IV	5.3	5.4
2017 I	4.8	5.1
2017 II	4.7	5.1
2017 III	4.0	4.6

Figure 6.5 – Projections and target path for twelve-month cumulative inflation



to 5.4% and 5.3% in the second and third quarters, and ends the year in 4.8%.

Still in the baseline scenario, the estimated probability that inflation will breach the upper tolerance level of the target in 2016 stays around 41% and, in 2017, around 20%.

In the market scenario, the projection indicates inflation of 10.8% in 2015, same value of the baseline scenario and 1.3 p.p. above the projection informed in the last Report. As may be seen in Figure 6.4 and Table 6.2, the projection for the twelve-month inflation rate in the first quarter of 2016 is 9.2%. For the second and third quarters of 2016, the projection reduces to 8.2% and 7.6%, respectively, ending the year at 6.3%. In 2017, the projection reduces to 5.6%, in the first quarter, shifts to 5.5% and 5.4% in the second and third quarters, and ends the year at 4.9%.

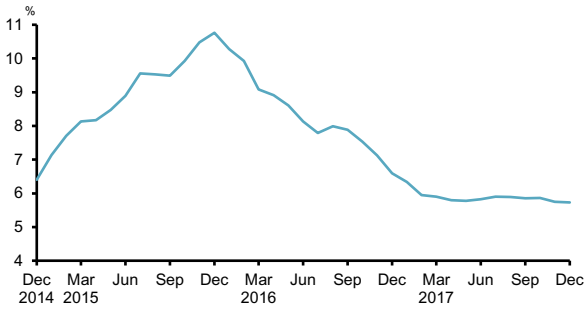
Still in the market scenario, the estimated probability that inflation will breach the upper tolerance level of the target in 2016 stays around 43% and, in 2017, around 21%.

The comparison of the trajectories presented in this Report with those released in the previous one – the latter shown in Table 6.3 –, in the baseline scenario, shows increase in inflation projections from the fourth quarter of 2015 on. This is partly due to higher projections for regulated and monitored prices and to actual inflation higher than previously projected. In the market scenario, the comparison of trajectories follows the same pattern of the trajectories of baseline scenario.

Figure 6.5 shows the path of the twelve-month inflation, according to the baseline and the market scenarios, up to the fourth quarter of 2017, as well as the inflation target path. Up to November 2015, the figures are actual inflation and, from then on, projections corresponding to the respective scenarios are used to compose the twelve-month values. In both scenarios, projections indicate that twelve-month inflation is in an ascending path until December 2015, starting a long declining path in January 2016.

The average forecast generated by the Vector Autoregressive (VAR) models, for the twelve-month inflation is presented in Figure 6.6. Up to November 2015, the values refer to actual inflation and, from then on, to forecasts. According to these models, the inflation declines in the course of 2016, converging to a value close to the unconditional mean at the end of the forecast horizon.

Figure 6.6 – Inflation forecast: VAR models



Note: Accumulated inflation in 12 months (% p.a.).
Average forecast generated by the VAR models.

Figure 6.7 – Projected GDP growth with interest rate constant at 14.25% p.a. (Baseline scenario)

Output fan chart

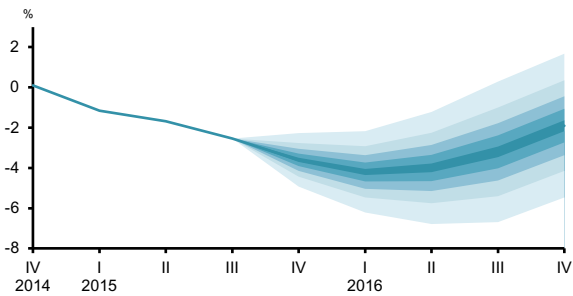


Figure 6.7 illustrates the output growth fan chart built under baseline scenario assumptions. Considering that the GDP growth projection process uses two variables that are not directly observable – potential output and output gap –, the forecast errors associated with these projections are considerably higher than the errors related to inflation projections. According to this scenario, the projected four-quarter GDP growth is -3.6% for 2015 (0.9 p.p. lower than the one considered in the previous Report) and -1.9% for 2016.

Price-setting in Brazil¹

The way the monetary policy affects the real economy and inflation depends, at least on the short-term, of the characteristics of the price adjustment process. In particular, the macroeconomic effects of nominal shocks measured through models frequently used by central banks for the analysis of the monetary policy depend on the assumption of price rigidity in the modeling process. That is why price-setting in the economy has been a research subject of wide literature².

Although the exploration of large microeconomic databases that measure price behavior has provided relevant results for the characterization of nominal rigidity³, there is still price-setting aspects that are not fully understood yet. Following the seminal work of Blinder (1991) and Blinder *et al* (1998) for the United States, several articles have explored qualitative data produced by interviews with firm's managers about practices for price adjustment⁴. Such qualitative information complement studies based on micro data and help understanding the price adjustment decision by the firms, and, therefore, the price-setting process in the economy.

This box aim to show the results about the price-setting process in Brazil, obtained by means of a survey carried out by the Banco Central do Brasil. The survey involved interviews conducted from July 2011 to April 2012 with managers of 7,002 firms of the five geographic regions of the country belonging to the three economic sectors: 2,424 firms in industry, 2,488 in services and 2,090 in

1/ This box presents some results of the article "Price-setting behavior in Brazil: Survey Evidence" by Arnildo Correa, Myrian Petrassi and Rafael Santos, to be released in the Banco Central do Brasil Working Paper Series.

2/ Especially, and more recently, of the literature focused on micro data (see Bils and Klenow, 2004; Dhyne *et al.* 2006; Klenow and Malin, 2011, among others). Research about price-setting in Brazil using micro data include Gouvea (2007) and Barros *et al.* (2009).

3/ See, for example, Klenow and Malin (2011).

4/ Examples of national surveys on strategies of price-setting include Apel *et al.* (2005) for Sweden; Fabiani *et al.* (2006) for the Euro Area; Amirault *et al.* (2006) for the Canada and Greenslade and Parker (2010) for the United Kingdom.

commerce. The sample was build so as the represent the whole country, in each sector and its main segments.

In the analysis of results for Brazil, the international practice was followed, in which the price-setting decision process is typically divided in two stages. The first stage involves the revision of prices, which consists in the following evaluation: the current price is the best price to be chosen by the firm, given the current conditions? The second stage consists in the implementation of the effective price change, if this is the conclusion of the first stage, and considering likely costs associated with price changes.

Specifically for price revisions in Brazil, the firms' answers were split in two categories: those that revise prices frequently; and those that revise prices in fixed time intervals, thus indicating lower frequency. For the economy as a whole, answers indicated that nearly 50% of firms re-evaluated prices frequently and 50% at fixed intervals. There are differences across sectors: price re-evaluations are less frequent in services than in commerce and industry – 66% of firms in services report re-evaluating prices at fixed intervals, compared with 39% in commerce and 42% in industry. This result is clearer in cases like educational services, whose prices are, in general, re-evaluated annually. This heterogeneity reinforces the importance of monitoring inflation subgroups, which effectively follows uneven trajectories.

Firms have also been asked about the frequency of price changes in their products. Table 1 shows that nearly 20% of Brazilian firms change their prices at least once a month, whereas 42% change them annually. Considering the economy's average, data suggest that there is significant nominal rigidity in Brazil, although lower than in developed countries⁵. Firms change prices, on average, 3.6 times a year, i.e., settled prices last, on average, 3.3 months. These results are consistent with the evaluation based on microeconomic data – Gouvea (2007) reports an average duration between 2.7 and 3.8 months, using micro data relative to consumer prices⁶.

It should be highlighted sectoral differences reported in Table 1. Firms in services sector change prices less frequently than in other sectors – 65% answered that

5/ See Fabiani *et al.*, 2005; Greenslade and Parker, 2010; Apel *et al.*, 2005; Amirault *et al.*, 2006.

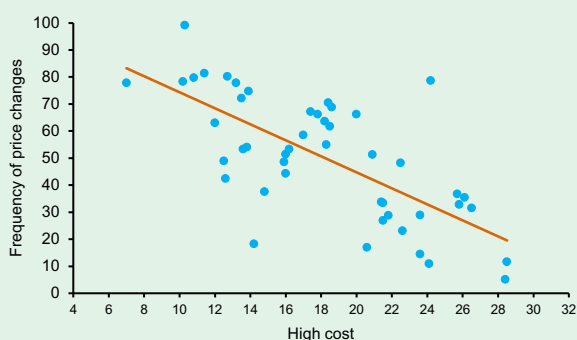
6/ This result is also consistent with the interpretation that the Brazilian economy is more frequently impacted by shocks than advanced economies.

they change prices once a year. As for commerce, 40% of firms change prices at least once a month. Some characteristics of firms and markets also seem to affect the price-setting strategy. Concerning the firms' characteristics, the firm's size seemed relevant. Larger firms, in the case the size is measured by the number of employees, re-evaluate prices more frequently. From the point of view of market characteristics, the degree of competitiveness is important. Firms that reported a high competitiveness degree change prices more frequently.

Table 1 – Frequency of price changes – percentage of firms

Number of days in the interval of price changes	Sectors			Brazil
	Commerce	Industry	Services	
1 -30	40%	15%	5%	19%
31 - 90	18%	17%	5%	13%
91 - 180	18%	21%	12%	17%
181 - 360	20%	37%	65%	42%
> 360	4%	10%	12%	9%

Figure 1 – Information cost and frequency of price changes



Another relevant variable for price-setting by firms is the cost for collecting and processing information (denominated herein generically as menu cost). Most firms (57%) reported that the cost for revising prices is low. Figure 1 shows the relationship between the cost for collecting and processing information and the price adjustment frequency⁷. The horizontal axis shows the percentage of firms, in each subsector, reporting a high menu cost. The vertical axis indicates the percentage of firms that mention price changes at least once every six months. Figure 1 shows an inverse relationship between price adjustment and the cost for collecting and processing information: the higher the cost, the lower the frequency of price adjustment.

The survey also evaluated the price-setting strategies and the price-decision factors. Based on these answers, one may conclude that the strategy of adding a markup to costs is quite important. Overall, 49% of interviewed firms declared that they somehow follow this rule. Another relevant element affecting the firms' price-setting refers to the prices of competitors. Out of total sample, 67% of firms consider as important to change their prices just after being informed about the price adjustment implemented by the competitor; and 66% considered relevant the information about the number of competitors in their sector.

^{7/} With this aim, the economy was divided into 47 subsectors using the National Economic Activity Classification (CNAE).

Table 2 – Importance of several factors for price-setting decisions

Factors	Sectors			Brazil
	Commerce	Industry	Services	
Exchange rate	41%	48%	20%	36%
Wages	33%	36%	54%	41%
Intermediate goods	70%	85%	0%	50%
Inflation	51%	44%	56%	50%
Interest rates	47%	37%	37%	40%

As for key determinants for price changes, firms have been asked about the importance of five factors: exchange rate, wages, costs of intermediate goods, inflation, and interest rates. Table 2 presents, for each determinant, the percentage of firms that consider this factor very important in their price-decision making. For the aggregate economy, the two most important factors are the prices of intermediate goods and inflation. In both cases, 50% of firms indicated that these factors are highly important. These results reaffirm the assumption already discussed in the previous paragraph that the cost of inputs is a determinant factor for the firm's price decisions. The importance of inflation, reported in Table 2, is in line with the high inflation historical path in Brazil.

Summing up, results, which are relevant under the prism of monetary policy, suggest that, in fact, price-setting decisions are likely to be taken in two stages, as foreseen in the international literature. Moreover, there is significant price rigidity in Brazil, although, apparently, lower than in advanced economies. There is also heterogeneity in the price rigidity across sectors, and the strategy of adding a markup to costs seems to be dominant in the price-setting process. Finally, the costs of intermediate inputs and inflation are important factors for price-setting, as well as the degree of competitiveness of firms.

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Recent behavior of the services inflation

Services inflation has been higher than the Extended National Consumer Price Index (IPCA) since 2005 and, despite declining slightly recently, is still at high levels. This box aims to understand the trajectory of services inflation, which seems to show a certain resistance, even in the current economic scenario and after the recent monetary policy measures.

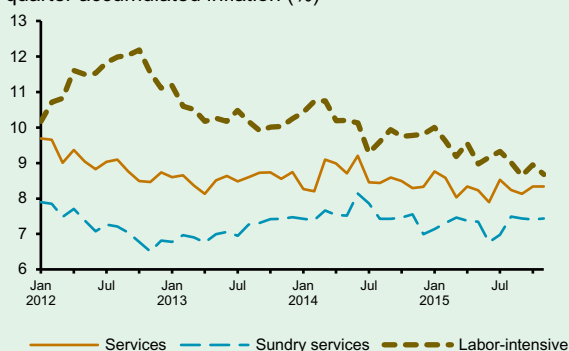
To better understand its dynamics, the services sector was broken down, and the analysis focused on the trajectory of two subsectors: labor-intensive services and sundry services. The subgroup food-away-from-home and the subitem airfare ticket were eliminated from the analysis due to the fact that their evolution is greatly influenced by factors with little impact on the other services, as food cost and aviation fuels¹.

Figure 1 shows the recent evolution of inflation of the sectors under analysis. Considering the group of services as a whole, one observes a slight downward trend in the 12-month inflation, from levels above 9.0% in the first half of 2012 to levels below 8.5% as of August 2015, still quite high when compared with the inflation targeting regime.

One observes that both subsectors present distinct dynamics. The series “Labor-intensive” has been following a downward trend since late 2012. However, this trend begins at a very high level (above 11.0%), so as, even after the downward period, the levels continue at nearly 9.0%. As for “sundry services”, an upward trend is observed at late 2012 and mid-2014, followed by a period of relative stability.

Figure 1 – Services inflation

4-quarter accumulated inflation (%)



1/ This services sector breakdown was used in the box “Breakdown of the services inflation”, of the December 2013 Inflation Report. The labor-intensive subsectors and sundry services correspond to 24% of the 51% services sector, respectively. The remainder (25%) corresponds to airfare ticket and food-away-from-home.

With the purpose of better understanding the services inflation, market prices were broken down into three sectors: “labor-intensive” services, “Sundry services” and other market prices², and a Phillips curve was estimated jointly with each component and an aggregate curve for market prices:

$$(1) \quad \pi_t^{SI} = \sum_{i=1}^4 \alpha_i^{SI} D_i + \beta_1^{SI} \frac{\sum_{i=1}^4 \pi_{t-i}}{4} + (1 - \beta_1^{SI}) E_t \pi_{t+1} + \beta_2^{SI} \frac{\sum_{i=2}^3 h_{t-i}}{2} + \beta_3^{SI} \Delta RR_{t-1} + \varepsilon_t^{SI}$$

$$(2) \quad \pi_t^{SD} = \sum_{i=1}^4 \alpha_i^{SD} D_i + \beta_1^{SD} \frac{\sum_{i=1}^2 \pi_{t-i}}{2} + (1 - \beta_1^{SD}) E_t \pi_{t+1} + \beta_2^{SD} \frac{\sum_{i=3}^6 h_{t-i}}{4} + \beta_3^{SD} \Delta RR_{t-1} + \varepsilon_t^{SD}$$

$$(3) \quad \pi_t^{RL} = \sum_{i=1}^4 \alpha_i^{RL} D_i + \beta_1^{RL} \pi_{t-1} + \beta_2^{RL} \pi_{t-1}^* + (1 - \beta_1^{RL} - \beta_2^{RL}) \frac{\sum_{i=1}^2 E_t \pi_{t+i}}{2} + \beta_3^{RL} h_{t-1} \\ + \beta_4^{RL} \frac{\sum_{i=2}^4 \Delta RR_{t-1}}{3} + \varepsilon_t^{RL}$$

In equations (1) and (3), the terms π , π^* , π^{SI} , π^{SD} and π^{RL} correspond, respectively, to the headline inflation, imported inflation, and the inflation of the labor-intensive subsectors of the services inflation, sundry services and the group corresponding to the other market prices. The term $E_t \pi_{t+i}$ is the expectation at t of inflation in the quarter $t+i$, h corresponds to the output gap, ΔRR to the variation of the real usual earning, D_i are seasonal dummies and ε^{SI} , ε^{SD} and ε^{RL} are error terms. The aggregate equation of market prices correspond to the combination of the previous equations, weighted by the weighting factor of each group.

Table 1 presents the main results of the regression of the subsectors that compose the market prices inflation³. Comparing the subgroups “labor-intensive” and “sundry services”, one may observe that the first presents higher inertia and is more influenced by the output gap. Another difference is related to the initial impact of the real usual income – nearly 50% higher in “labor-intensive” than in “sundry services”. This difference drops to nearly 20% for longer horizons, due to the higher inertial component of the subgroup “sundry services”.

2/ One considered the more recent classification of the services sector and the time series were recalculated by using as reference the weighting structure of the Household Budget Survey (POF) 2009. Further details about this updating in the box “Updating IPCA and INPC weighting structures and IPCA classifications groups”, of the December 2011 Inflation Report.

3/ All reported coefficients were significant at 5%.

Table 1 – Estimated coefficients

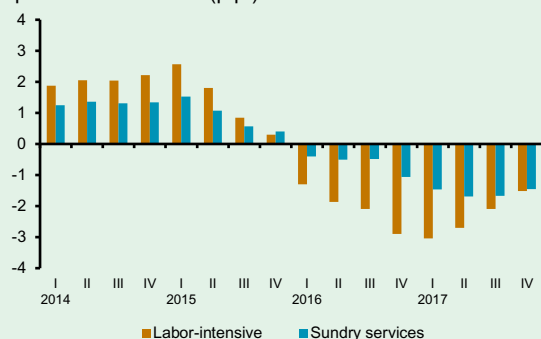
Group		Inertia ^{1/}	Gap	Real income ^{2/}
Labor-intensive	Coefficient	0.46	0.31	0.24
	Lags	1 a 4	2 e 3	1
Sundry services	Coefficient	0.73	0.12	0.17
	Lags	1 e 2	3 a 6	1
Other market services	Coefficient	0.42	0.09	0.05
	Lags	1	1	2 a 4

1/ Inertia lags refer to the headline IPCA.

2/ Percentage change.

The difference of the impact of real earnings of these groups, obtained through estimation, might be one of the reasons for their uneven trajectories. Recently, one may identify three distinct periods for the trajectory of real earnings: acceleration, from 2002 to 2006; steady growth, from 2007 to 2012; and deceleration, from 2012 on. The latter deceleration period would have a greater impact on the series of labor-intensive services, which is in line with the trend observed on the inflation of this sector.

Figure 2 – Gap and real income – estimated contribution^{1/}
4-quarter accumulated (p.p.)



1/ Estimated contribution to inflation in each sector.

The exercise allows, in light of the estimated model, to obtain a measurement of the contribution of the observed trajectories of the output gap and real earnings on the inflation of both services subsectors. Figure 2 shows the estimated contributions for the period since 2014 for the four-quarter accumulated inflation based on the values observed for the output gap and real earnings⁴.

One may observe that the output gap and the real earnings may exert higher pressure on the inflation of labor-intensive services until 2015Q3, partially explaining the higher inflation level registered in this subsector in the period. Estimates indicate a sharper reversal of the effects on this subsector, in 2015 and 2016, in response to the deceleration of real earnings and the economic activity decline, represented by the output gap, which becomes negative as of 2015Q2. The movement is slightly slower and less strong in the subsector “sundry services”.

Results suggest that the effects of a decline in the output gap and deceleration of real earnings should contribute

4/ For the actual output gap, one considered a measure based on a production function; for the period since 2015Q4, was used the autoregressive coefficient of the benchmark gap of the Banco Central do Brasil semi-structural model. As for real earnings, a growth equal to zero was assumed as of 2015Q4.

to reduce services inflation as of the first quarter of 2016. The existence of lags partially explains the persistence that has been observed in the services inflation, since the recent decline of the output gap and in real earnings have not had significant impacts yet.

Summing up, this box presents an analysis of the services inflation based on two of its segments. The estimated effects suggest that services inflation will tend to recede in the next year. It is noteworthy, though, that other factors influence directly the services inflation, as expectations, or indirectly, through the pass-through of price increases of other IPCA groups. Moreover, the results presented in this box are based on estimations and, therefore, are subject to uncertainties inherent to the modeling process.

Annex

Minutes of the 194th Meeting of the Monetary Policy Committee (Copom)

Date: October 20th 2015, from 4:12PM to 7:23PM, and October 21st, 2015, from 4:40PM to 8:19PM

Place: BCB Headquarters meeting rooms – 8th floor on October 20th and 20th floor on October 21st – Brasília – DF

In attendance:

Members of the Committee Alexandre Antonio Tombini – Governor Aldo Luiz Mendes
Altamir Lopes
Anthero de Moraes Meirelles
Luiz Edson Feltrim
Otávio Ribeiro Damaso
Sidnei Corrêa Marques
Tony Volpon

Department Heads (present on October 20th)

Ariosto Revoredo de Carvalho – Department of Foreign Reserves
Bruno Walter Coelho Saraiva – International Affairs Department
Eduardo José Araújo Lima – Research Department (also present on October 21st)
Flávio Túlio Vilela – Department of Banking Operations and Payments System
João Henrique de Paula Freitas Simão – Open Market Operations Department
Renato Jansson Rosek – Investor Relations and Special Studies Department
Tulio José Lenti Maciel – Economic Department

Other participants (present on October 20th)

Gustavo Paul Kurrle – Press Officer
Maurício Costa de Moura – Chief of Governor’s Staff

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

Recent Economic Developments

1. Monthly inflation measured by the Extended Consumer Price Index (IPCA) reached 0.54% in September, 0.32 percentage points (p.p.) above the one recorded in the previous month. As a consequence, inflation accumulated in 12 months reached 9.49% in September (6.75% in September 2014), with market prices increasing by 7.48% (7.17% in September 2014), and regulated prices, 16.35% (5.32% in September 2014).

Specifically regarding market prices, the prices of tradable goods increased 6.41% in twelve months through September (6.86% in September 2014) and the prices of non-tradable goods, 8.38% (7.46% in September 2014). It bears noticing that the prices of the food and beverages group increased 10.04% in twelve months through September (8.21% in September 2014), and the prices of services rose 8.13% (8.59% in September 2014). In short, available information suggests some persistence of inflation, which partially reflects the dynamics of prices in the services sector and, in the short run, the realignment process of regulated prices and temporary supply shocks in the food and beverages group.

2. The average of the underlying monthly inflation measures, calculated by the BCB, changed from 0.41% in August to 0.58% in September. As a consequence, on a twelve-month trailing basis, average core inflation reached 7.82% (1.06 p.p. above the one registered in September 2014). The double weight core inflation changed from 0.43% in August to 0.69% in September; the core by exclusion, which excludes ten household food items and fuels, changed from 0.32% to 0.55%; and the core inflation by exclusion of regulated prices and household food, from 0.33% to 0.55%; the non-smoothed trimmed means IPCA core inflation changed from 0.42% to 0.48%; and the smoothed trimmed means IPCA core inflation from 0.56% to 0.64%. The diffusion index stood at 66.5% in September (5.4 p.p. above the one recorded in September 2014).
3. The General Price Index (IGP-DI) increased 1.42% in September, reaching 9.31% on a twelve-month trailing basis (3.24% in September 2014). The main component of this indicator, the Wholesale Price Index (IPA), changed 9.52% in twelve months (1.29% in September 2014), with increases of 14.66% in the prices of agricultural products and 7.62% in the prices of industrial products. Inflation measured by the Consumer Price Index (IPC), the second most important component of the IGP-DI, changed 9.65% in twelve months through September (6.97% in September 2014). The Civil Construction National Index (INCC), component with the lowest weight in the IGP-DI, increased 7.38% (6.96% in September 2014), partially driven by pressures stemming from labor costs, which changed 8.59% in the period. On its turn, the Producer/Manufacturing Industry Price Index (IPP/IT), calculated by the Brazilian Institute of Geography and Statistics (IBGE), increased 0.97% in August, changing 7.27% in twelve months. The Copom considers that the effects of the behavior of wholesale prices on consumer inflation will depend on the current and prospective demand conditions and on the price setters' expectations regarding the future inflation path.
4. The Economic Activity Index of the BCB (IBC-Br) incorporates estimates for the monthly production of the three sectors of the economy, as well as for taxes on products, and constitutes important coincident indicator of the economic activity. In August 2015, the IBC-Br decreased 4.47% year-over-year and 0.76% month-on-month, seasonally adjusted. The composite Purchasing Managers' Index (PMI) regarding Brazil changed from 44.8 in August to 42.7 in September, indicating strong contraction. The Industry Confidence Index (ICI) and the Consumer Confidence Index (ICC), from the Getúlio Vargas Foundation (FGV), decreased 2.9% and 5.3%, respectively, between August and September. On its turn, the Services Confidence Index (ICS) decreased 8.4%, reaching a new historical minimum. Regarding agriculture, the Agricultural Production Systematic Assessment (LSPA), carried out by the IBGE, projected, in September, an increase of 8.8% in the grains production in 2015, relative to the 2014 harvest.
5. The industrial activity decreased 1.2% in August, month-on-month, according to the seasonally adjusted series released by the IBGE. Therefore, the industrial production accumulates a change of -5.7% in the last twelve months through August. According to the observed series, the industrial production decreased 9.0% in August, year-over-year, with negative results in the four use categories and in 23 out of the 26 surveyed activities. According to data released by the National Confederation of Industry (CNI), real revenue in

the manufacturing industry increased 0.7% between July and August, according to the seasonally adjusted series, and it stands 7.2% lower than the one registered in August 2014. The PMI of the industrial sector, on its turn, changed from 45.8 in August to 47.0 in September.

6. Among the use categories, comparing August and July productions, according to seasonally adjusted data series, capital goods (-7.6%) and durable consumer goods (-4.0%) presented the sharpest decreases. The semi and non-durable goods production also decreased in August (-0.3%). On its turn, the intermediate goods production presented the only positive result in this month (0.2%). Regarding year-over-year growth, there was a decrease in the production of the four categories: capital goods (-33.2%), durable consumer goods (-14.6%), semi and non-durable consumer goods (-7.6%) and intermediate goods (-5.5%).
7. According to the Continuous National Household Sample Survey (Continuous PNAD), the unemployment rate in the moving quarter ended in July was estimated at 8.6%, an increase of 1.7 p.p. compared to the same period last year. According to the Monthly Employment Survey (PME), covering six metropolitan areas, the unemployment rate stood at 7.6% in August, increasing 0.1 p.p. month-over-month and 2.6 p.p. year-over-year. Data released by the Ministry of Labor and Employment (MTE) showed reduction of 86.5 thousand formal jobs in August, while 572.8 thousand formal jobs were destroyed in the year. In short, the set of available data confirm a process of distension in the labor market.
8. According to the retail monthly survey (PMC), released by the IBGE, the retail sales volume decreased 6.9% in August, year-over-year. On its turn, broad retail sales volume, which includes vehicles and construction inputs, decreased 9.6% in August, according to the same comparison basis. The month-on-month changes were -0.9% and -2.0%, respectively, according to the seasonally adjusted series, with retraction in eight of the ten sectors surveyed. In twelve months, the retail sales growth rate fell by 1.5% and the broad retail sales decreased 5.2%. The Trade Confidence Index (ICOM), measured by the FGV, decreased 4.1% between August and September. After the fifth consecutive drop, the index reached the lowest level for the historical series started in March 2010.
9. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by the FGV, without seasonal adjustment, reached 77.4% in September and, according to the seasonally adjusted series, 76.5%. Among the industry use categories, according to the seasonally adjusted series, the ones showing the highest Nuci are intermediate goods (81.5%) and construction material (78.1%), followed by non-durable consumer goods (74.3%), durable consumer goods (69.1%) and capital goods (64.4%). On its turn, the absorption of capital goods decreased 18.1% in the last twelve months through August.
10. According to the Ministry of Development, Industry and Foreign Trade (MDIC), the twelve-month trailing trade balance surplus reached US\$6.9 billion in September 2015. This result stemmed from US\$196.0 billion in exports and US\$189.0 billion in imports, with retreats of 17.7% and 19.5%, respectively, relative to the cumulative results through September 2014. On its turn, the current account deficit accumulated in twelve months reached US\$84.5 billion in August 2015, equivalent to 4.3% of the GDP. Foreign Direct Investment (according to the Direct Investment Liabilities concept) totaled US\$73.6 billion, according to the same comparison basis, equivalent to 3.8% of the GDP.
11. Regarding the global economy, leading indicators signal, in the horizon relevant for monetary policy, growth prospects in line with the trend in important advanced and emerging economies. For most advanced economies, the signs are of moderate growth. Particularly about Europe, despite recent monetary policy actions, high unemployment rates, coupled with the fiscal consolidation and political uncertainties, constitute elements restraining investments and growth. In the United States, the view of sustainability

of the economic recovery consolidates. In the emerging economies, the activity pace has been revised downwards, with highlight for the loss of strenght in China. Regarding the monetary policy, in general, accommodative stances prevail in advanced and emerging economies, despite the ongoing advances in the debate on the normalization of monetary conditions. The inflation rates remain at low levels in the advanced economies; and, in the emerging ones, they stand at relatively high levels.

12. The price of the Brent oil barrel has remained around US\$50 since the previous Copom meeting. It bears highlighting that the geopolitical complexity that involves the oil sector tends to heighten the volatile behavior of prices. This volatile behavior also reflects the low predictability of some global demand and supply components. Since the last Copom meeting, the international prices of agricultural commodities have risen 2.14%, while metal commodities prices have fallen 6.81%. On its turn, the Food Price Index, calculated by the Food and Agriculture Organization of the United Nations (FAO), fell 18.9% in the twelve months through September 2015.

Assessment of Inflation Trends

13. The identified shocks, and their impacts, were reassessed according to the new set of available information.
14. For the set of regulated prices inflation, the projected adjustment is 16.9% in 2015, up from 15.2% considered at the September Copom meeting. Among other factors, this projection considers the hypothesis of changes of 15.0% in the price of gasoline, of 19.9% in the price of bottled gas and of 51.7% in electricity prices. The items for which there are more information available were projected individually and, for the others, the projections are based on endogenous determination models for regulated prices, which compute, among other factors, seasonal components, market prices inflation and the IGP (General Price Index) change. Based on these models, the projected regulated prices change is 5.8% for 2016, 0.1 p.p. higher than the valued considered at the September Committee meeting.
15. The estimate path for the spreads over the Selic rate, based on the 360-day swap rates, on the baseline scenario, projects -27 basis points (bps) and 12 bps for the fourth quarters of 2015 and 2016, respectively.
16. The structural primary surplus is considered as the fiscal indicator. It derives from the primary surplus trajectories set at 0.15% of the GDP for 2015 and 0.70% of the GDP for 2016. It also bears emphasizing that, in a given period, the fiscal impulse corresponds to the variation of the structural surplus in comparison to the observed in the previous period.
17. Since the last Copom meeting, the median of the projections compiled by the Investor Relations and Special Studies Department (Gerin) for the 2015 IPCA changed from 9.28% to 9.75% and, for 2016, from 5.51% to 6.12%.
18. The baseline scenario considers the maintenance of the exchange rate at R\$3.85/US\$1.00 and the Selic rate at 14.25% p.a. during the forecast period. Under this scenario, the inflation projection increased, compared to the value considered at the previous Copom meeting, both for 2015 and for 2016, and remains above the 4.5% midpoint target established by the National Monetary Council (CMN). According to the market scenario, which incorporates the market expectations for the exchange and Selic rates trajectories collected by Gerin, in the period immediately prior to the Copom meeting, the inflation projections for 2015 and 2016 also increased relative to the value considered at the September meeting, and remain above the inflation target.

Monetary Policy Decision

19. The Copom emphasizes that the international evidence, which is ratified by the Brazilian experience, indicates that high inflation rates generate distortions that lead to higher risks and depress investments. These distortions are manifested, for example, in the shortening of the planning horizons of households, companies and governments, as well as in the deterioration of the businessmen confidence. The Committee also emphasizes that high inflation rates reduce the purchasing power of wages and transfers, with negative repercussions over the households' confidence and consumption. As a consequence, high inflation rates reduce the potential of economic growth, as well as of jobs and income generation.
20. In view of this, the Copom evaluates that the monetary policy should contribute to the consolidation of a favorable longer-term macroeconomic environment. In this respect, the Copom reassures that, under the inflation targeting regime, it guides its decisions according to BCB projected inflation and based on the analysis of alternative scenarios for the evolution of the main variables that determine prices dynamics. The Committee also understands that low risks for the underlying inflation in the short run tend to reduce uncertainties regarding the future behavior of headline inflation, facilitate the assessment of scenarios by the monetary authority, as well as help the process of coordination of economic agents' expectations, particularly prices setters'. Additionally, it is noteworthy that low risks for the underlying inflation in the short run tend to intensify the effects of monetary policy actions, enabling them to affect, in a more long-lasting manner, the dynamics of headline inflation in the future. Although the Copom recognizes that other macroeconomic policy actions may influence the prices trajectory, it reaffirms its view that it is particularly under the responsibility of the monetary policy to remain especially vigilant, to guarantee that pressures detected in shorter horizons do not spread to longer horizons.
21. The Committee considers that the external environment remains complex, with episodes of higher volatility affecting important emerging economies, despite identifying low probability of occurrence of extreme events in the international financial markets. For the Committee, the trend for global activity shows more moderation throughout the monetary policy relevant horizon. The prospects continue to indicate activity recovery in some advanced economies and acceleration in the pace of growth in others, although, in general, the room to use monetary policy in these economies remains limited and a fiscal restraint scenario prevails. Important emerging economies experience a transition period and, therefore, of more moderation in the activity pace, despite the resilience of the domestic demand.
22. Still regarding international financial markets, the Copom highlights evidence of new sources of volatility in the currency and fixed income markets, as well as moderation in the dynamics of commodities prices. Regarding oil, the Committee highlights that, regardless of the behavior of the domestic prices of gasoline, the evolution of international prices tends to be transmitted to the domestic economy both through productive chains, such as the petrochemical, and through inflation expectations.
23. The Copom reaffirms that, in accordance to the macroeconomic adjustment process underway, the available indicators show that the domestic absorption and GDP growth rates have continued to adjust and confirm that the domestic activity expansion pace this year will be lower than the potential. This process is being intensified by the uncertainties arising from the effect of non-economic events. In particular, investment has retreated, mainly influenced by the occurrence of these events, and private consumption also shows contraction signals, in line with recent data regarding credit, employment and income. However, for the Committee, after a necessary period of adjustments, which has been more intense and may be longer than the anticipated, the activity expansion pace tends to intensify, as companies' and households' confidence strengthen. Moreover, the Committee evaluates that, in the medium term, important changes should take

place in the composition of aggregate supply and demand. Consumption tends to grow at a moderate pace and investments tend to gain momentum. These changes, coupled with other ones currently underway, anticipate a composition for aggregate demand growth in the medium term more favorable to potential growth. Regarding the external component of aggregate demand, the scenario of higher global growth, combined with the depreciation of the BRL, contributes to make this component more favorable to the Brazilian economic growth. Regarding the supply side, the Committee evaluates that, in longer horizons, more favorable prospects for the competitiveness of industry, agriculture and livestock have emerged. The services sector, on its turn, tends to grow at rates lower than those recorded over the recent years. For the Committee, it is plausible to claim that these developments – coupled with advances in terms of qualification of the labor force and with the program of public services concession - will be reflected in a more efficient allocation of the production factors of the economy and in productivity gains. However, the speed of materialization of these changes and of the gains resulting from them depends fundamentally on a path of primary surpluses that strengthens the perception of the public sector balance sustainability, in addition to reducing uncertainties surrounding the domestic environment.

24. The Copom observes that the main inflation scenario considers the materialization of the assumed trajectories regarding fiscal variables. Relative to the structural fiscal result and depending on the economic cycle, the Committee considers that, during the relevant horizon for the monetary policy, the balance of the public sector tends to shift to the neutral zone, and does not rule out the hypothesis of migration to the fiscal restraint area, even if more slowly and with lower intensity than previously anticipated. However, the Committee notes that the lack of definition, the significant changes in the trajectory of primary surpluses, as well as in its composition, impact the working hypotheses considered for inflation projections and contribute to create a negative perception regarding of the macroeconomic environment. Regarding inflation control, the Committee highlights that the literature and the best international practices recommend a consistent and sustainable fiscal policy framework, in order to allow monetary policy actions to be fully transmitted to prices.
25. The Copom highlights that the main scenario also considers moderate credit expansion, which had already been observed and tends to persist. Regarding this issue, it is important to highlight the fact that, after years of strong expansion, consumer credit has moderated, so that, over the last quarters, there was, on the one hand, exposure reduction by banks, and, on the other hand, deleveraging of the households. In the aggregate, therefore, it can be inferred that the risks in the consumer credit segment have been mitigated. In another dimension, as illustrated by actions that were implemented, the Committee considers as opportune the initiatives with the aim of moderating concessions of subsidies through credit operations.
26. In the factors' market, as anticipated by previous Minutes, the Copom observes that the idleness margin in the labor market has increased at a faster pace, with data confirming the acceleration in the process of distension in this market. However, a significant risk still prevails related, particularly, to the possibility of concession of wages' increases incompatible with productivity growth, with negative impacts over inflation. In spite of the occurrence of real wage changes more consistent with the gains estimates for the labor productivity, the Committee evaluates that the wages dynamics remains originating inflationary cost pressures.
27. For the Copom, the fact that inflation stands at high levels reflects, in large part, the occurrence of two important relative prices adjustment processes underway in the economy - the realignment of domestic prices relative to international prices and the realignment of regulated prices relative to market prices. The Committee also considers that, over 2015, these relative prices adjustments in the economy, among other factors, have made the balance of risks to inflation unfavorable. In this context, as anticipated in previous

Minutes, these price adjustments cause inflation to rise in the short term and to tend to remain high in 2015, requiring determination and perseverance to prevent its transmission to longer horizons. While recognizing that these relative prices adjustments have direct impacts over inflation, the Committee reaffirms its view that the monetary policy can, should and is containing the second order effects stemming from them.

28. Given the above, assessing the macroeconomic scenario, the inflation prospects and the current balance of risks, the Copom unanimously decided to maintain the Selic rate at 14.25% p.a., without bias. The Committee understands that the maintainence of this basic interest rate at this level, for a sufficiently long period, is necessary for the convergence of inflation to the target in the relevant horizon for the monetary policy. The Copom emphasizes that monetary policy will remain vigilant to achieve this goal.
29. The following members of the Committee voted for this decision: Alexandre Antonio Tombini (Governor), Aldo Luiz Mendes, Altamir Lopes, Anthero de Moraes Meirelles, Luiz Edson Feltrim, Otávio Ribeiro Damaso, Sidnei Corrêa Marques and Tony Volpon.
30. The following members of the Committee voted for this decision: Alexandre Antonio Tombini (Governor), Aldo Luiz Mendes, Altamir Lopes, Anthero de Moraes Meirelles, Luiz Edson Feltrim, Otávio Ribeiro Damaso, Sidnei Corrêa Marques and Tony Volpon.
31. The Copom reaffirms that the aggregate demand will continue to be moderate in the relevant horizon for the monetary policy. On the one hand, household consumption tends to be influenced by factors such as employment, income and credit; on the other hand, the concession of public services and the expansion of agricultural income, among other factors, tend to benefit investments. On its turn, the net exports show better results, either by increasing exports, benefited by the scenario of higher growth of major trading partners and the depreciation of the BRL, or by the ongoing import substitution process. For the Committee, the combined effects of these elements, the developments in the fiscal and quasi fiscal framework and in the assets market, and, this year, the dynamics of the regulated prices adjustment, are important factors in the context in which future monetary policy decisions will be taken, aiming to ensure the convergence of inflation to the 4.5% target established by CMN, in the relevant horizon for the monetary policy.
32. The Committee emphasizes that there are uncertainties associated with the balance of risks, mainly on the speed of the recovery process of fiscal results and its composition, and that the relative price realignment process has been slower and more intense than the previously anticipated. In this context, the Committee understands that, regardless of the outline of the other policies, the monetary policy must remain vigilant, in order to ensure the compliance with the inflation targeting regime objectives and the convergence of inflation to the target of 4.5% on the relevant horizon.
33. At the end of the meeting, it was announced that the Committee will reconvene on November 24th 2015, for the technical presentations, and on the following day, to deliberate on monetary policy, as established in the Communiqué 26,042, of June 24th, 2014.

Minutes of the 195th Meeting of the Monetary Policy Committee (Copom)

Date: November 24th 2015, from 4:16PM to 8:08PM, and November 25th, 2015, from 4:48PM to 7:47PM

Place: BCB Headquarters meeting rooms – 8th floor on November 24th and 20th floor on November 25th – Brasília – DF

In attendance:

Members of the Committee Alexandre Antonio Tombini – Governor Aldo Luiz Mendes

Altamir Lopes

Anthero de Moraes Meirelles Luiz Edson Feltrim

Otávio Ribeiro Damaso

Sidnei Corrêa Marques

Tony Volpon

Department Heads (present on November 24th)

Ariosto Revoredo de Carvalho – Department of Foreign Reserves

Bruno Walter Coelho Saraiva – International Affairs Department

Eduardo José Araújo Lima – Research Department (also present on November 25th)

Flávio Túlio Vilela – Department of Banking Operations and Payments System

João Henrique de Paula Freitas Simão – Open Market Operations Department

Renato Jansson Rosek – Investor Relations and Special Studies Department

Tulio José Lenti Maciel – Economic Department

Other participants (present on November 24th)

Gustavo Paul Kurrle – Press Officer

Maurício Costa de Moura – Chief of Governor's Staff

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

Recent Economic Developments

1. Monthly inflation measured by the Extended Consumer Price Index (IPCA) reached 0.82% in October, 0.28 percentage points (p.p.) above the one recorded in the previous month. As a consequence, inflation accumulated in 12 months reached 9.93% in October (6.59% in October 2014), with market prices increasing by 7.71% (6.88% in October 2014), and regulated prices, 17.52% (5.57% in October 2014). Specifically regarding market prices, the prices of tradable goods increased 7.06% in twelve months through October (6.25% in October 2014) and the prices of non-tradable goods, 8.23% (7.47% in October 2014). It bears noticing that the prices of the food and beverages group increased 10.38% in twelve months through October (7.60% in October 2014), and the prices of services rose 8.34% (8.50% in October 2014). In short, available information suggests some persistence of inflation, which partially reflects the dynamics of prices in the services sector and, in the short run, the realignment process of regulated prices and temporary supply shocks in the food and beverages group.

2. The average of the underlying monthly inflation measures, calculated by the BCB, changed from 0.58% in September to 0.63% in October. As a consequence, on a twelve-month trailing basis, average core inflation reached 8.03% (1.40 p.p. above the one registered in October 2014). The double weight core inflation changed from 0.69% in September to 0.73% in October; the core inflation by exclusion of regulated prices and household food, changed from 0.55% to 0.63%; the non-smoothed trimmed means IPCA core inflation changed from 0.48% to 0.61%; and the smoothed trimmed means IPCA core inflation, from 0.64% to 0.66%. On its turn, the core inflation by exclusion of ten household food items, as well as fuel, changed from 0.55% to 0.53%. The diffusion index stood at 67.0% in October (2.1 p.p. above the one recorded in October 2014).
3. The General Price Index (IGP-DI) increased 1.76% in October, reaching 10.58% on a twelve-month trailing basis (3.21% in October 2014). The main component of this indicator, the Wholesale Price Index (IPA), changed 11.31% in twelve months (1.31% in October 2014), with increases of 15.23% in the prices of agricultural products and 9.84% in the prices of industrial products. Inflation measured by the Consumer Price Index (IPC), the second most important component of the IGP-DI, changed 10.01% in twelve months through October (6.84% in October 2014). The Civil Construction National Index (INCC), component with the lowest weight in the IGP-DI, increased 7.58% (6.87% in October 2014), partially driven by pressures stemming from labor costs, which changed 8.59% in the period. On its turn, the Producer/Manufacturing Industry Price Index (IPP/IT), calculated by the Brazilian Institute of Geography and Statistics (IBGE), increased 1.78% in October, changing 11.58% in twelve months. The Copom considers that the effects of the behavior of wholesale prices on consumer inflation will depend on the current and prospective demand conditions and on the price setters' expectations regarding the future inflation path.
4. The Economic Activity Index of the BCB (IBC-Br) incorporates estimates for the monthly production of the three sectors of the economy, as well as for taxes on products, and constitutes important coincident indicator of the economic activity. In September 2015, the IBC-Br decreased 6.18% year-over-year and 0.50% month-on-month, seasonally adjusted. The composite Purchasing Managers' Index (PMI) regarding Brazil remained at 42.7 between September and October, standing below 50 for the eighth consecutive month. The Industry Confidence Index (ICI) and the Services Confidence Index (ICS), from the Getúlio Vargas Foundation (FGV), increased 2.3% and 4.5%, respectively, between September and October. On its turn, the Consumer Confidence Index (ICC) increased 1.3% between October and November. Regarding agriculture, the Agricultural Production Systematic Assessment (LSPA), carried out by the IBGE, projected, in October, an increase of 8.2% in the grains production in 2015, relative to the 2014 harvest.
5. The industrial activity decreased 1.3% in September, month-on-month, according to the seasonally adjusted series released by the IBGE. Therefore, the industrial production accumulates a change of -6.5% in the last twelve months through September. According to the observed series, the industrial production decreased 10.9% in September, year-over-year, with negative results in the four use categories and in 24 out of the 26 surveyed activities. According to data released by the National Confederation of Industry (CNI), real revenue in the manufacturing industry increased 1.2% between August and September, according to the seasonally adjusted series, and it stands 8.4% lower than the one registered in September 2014. The PMI of the industrial sector, on its turn, decreased from 47.0 in September to 44.1 in October, registering the lowest value in the last seventy nine months.
6. Among the use categories, comparing the September and August productions, according to seasonally adjusted data series, durable consumer goods (-5.3%) presented the sharpest reduction. Intermediate

goods production (-1.3%) also decreased. On the other hand, capital goods (1.0%) and semi and non-durable goods (0.5%) presented increases in September. Regarding year-over-year growth, there was a decrease in the production of the four categories: capital goods (-31.7%), durable consumer goods (-27.8%), semi and non-durable consumer goods (-7.4%) and intermediate goods (-7.2%).

7. According to the Continuous National Household Sample Survey (Continuous PNADC), the unemployment rate in the moving quarter ended in September was estimated at 8.9%, an increase of 2.1 p.p. compared to the same period last year. According to the Monthly Employment Survey (PME), covering six metropolitan areas, the unemployment rate stood at 7.9% in October, increasing 0.3 p.p. month-over-month and 3.2 p.p. year-over-year. Data released by the Ministry of Labor and Employment (MTE) showed reduction of 95.6 thousand formal jobs in September, while 657.8 thousand formal jobs were destroyed in the year. In short, the set of available data confirm a process of distension in the labor market.
8. According to the retail monthly survey (PMC), released by the IBGE, the retail sales volume decreased 6.2% in September, year-over-year. On its turn, broad retail sales volume, which includes vehicles and construction inputs, decreased 11.5% in September, according to the same comparison basis. The month-on-month changes were -0.5% and -1.5%, respectively, according to the seasonally adjusted series, with retraction in eight of the ten sectors surveyed. In twelve months, the retail sales volume fell by 2.1% and the broad retail sales volume decreased 6.0%. The Trade Confidence Index (ICOM), measured by the FGV, decreased 2.3% between September and October. After the sixth consecutive drop, the index reached the lowest level for the historical series started in March 2010.
9. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by the FGV, without seasonal adjustment, reached 77.7% in October and, according to the seasonally adjusted series, 76.7%. Among the industry use categories, according to the seasonally adjusted series, the ones showing the highest Nuci are intermediate goods (81.3%) and construction material (75.1%), followed by non-durable consumer goods (74.1%), durable consumer goods (69.8%) and capital goods (67.5%). On its turn, the absorption of capital goods decreased 20.4% in the last twelve months through September.
10. According to the Ministry of Development, Industry and Foreign Trade (MDIC), the twelve-month trailing trade balance surplus reached US\$10.1 billion in October 2015. This result stemmed from US\$193.7 billion in exports and US\$183.6 billion in imports, with retreats of 17.1% and 20.6%, respectively, relative to the cumulative results through October 2014. On its turn, the current account deficit accumulated in twelve months reached US\$79.3 billion in September 2015, equivalent to 4.2% of the GDP. Foreign Direct Investment (according to the Direct Investment Liabilities concept) totaled US\$71.8 billion, according to the same comparison basis, equivalent to 3.8% of the GDP.
11. Regarding the global economy, leading indicators signal, in the horizon relevant for monetary policy, growth prospects in line with the trend in important advanced and emerging economies. For most advanced economies, the signs are of moderate growth. Particularly about Europe, despite recent monetary policy actions, high unemployment rates, coupled with the fiscal consolidation and political uncertainties, constitute elements restraining investments and growth. In the United States, some cooling in the dynamics of growth is anticipated, although from relatively high levels of activity. In the emerging economies, the activity pace has been revised downwards, with highlight for the loss of strength in China. Regarding the monetary policy, in general, accommodative stances prevail in advanced and emerging economies, despite the ongoing advances in the debate on the normalization of monetary conditions. The inflation rates remain at low levels in the advanced economies and relatively high in the emerging ones.

12. The price of the Brent oil barrel fell to levels around US\$44 since the previous Copom meeting. It bears highlighting that the geopolitical complexity that involves the oil sector tends to heighten the volatile behavior of prices. This volatile behavior also reflects the low predictability of some global demand and supply components. Since the last Copom meeting, the international prices of agricultural commodities have fallen 0.51%, while metal commodities prices have fallen 11.10%. On its turn, the Food Price Index, calculated by the Food and Agriculture Organization of the United Nations (FAO), fell 16.0% in the twelve months through October 2015.

Assessment of Inflation Trends

13. The identified shocks, and their impacts, were reassessed according to the new set of available information.
14. For the set of regulated prices inflation, the projected adjustment is 17.7% in 2015, up from 16.9% considered at the October Copom meeting. Among other factors, this projection considers the hypothesis of changes of 17.6% in the price of gasoline, of 21.7% in the price of bottled gas and of 52.3% in electricity prices. The items for which there are more information available were projected individually and, for the others, the projections are based on endogenous determination models for regulated prices, which compute, among other factors, seasonal components, market prices inflation and the IGP (General Price Index) change. Based on these models, the projected regulated prices change is 5.9% for 2016, 0.1 p.p. higher than the valued considered at the October Committee meeting.
15. The estimate path for the spreads over the Selic rate, based on the 360-day swap rates, on the baseline scenario, projects 10 basis points (bps) and -2 bps for the fourth quarters of 2015 and 2016, respectively.
16. The structural primary surplus is considered as the fiscal indicator. It derives from the trajectories of primary deficit set at 0.85% of the GDP for 2015 and of primary surplus set at 0.70% of the GDP for 2016. It also bears emphasizing that, in a given period, the fiscal impulse corresponds to the variation of the structural result in comparison to the observed in the previous period.
17. Since the last Copom meeting, the median of the projections compiled by the Investor Relations and Special Studies Department (Gerin) for the 2015 IPCA changed from 9.75% to 10.33% and, for 2016, from 6.12% to 6.64%.
18. The baseline scenario considers the maintenance of the exchange rate at R\$3.80/US\$1.00 and the Selic rate at 14.25% p.a. during the forecast period. Under this scenario, the inflation projection increased, compared to the value considered at the previous Copom meeting, both for 2015 and for 2016, and remains above the 4.5% midpoint target established by the National Monetary Council (CMN). According to the market scenario, which incorporates the market expectations for the exchange and Selic rates trajectories collected by Gerin, in the period immediately prior to the Copom meeting, the inflation projections for 2015 and 2016 also increased relative to the value considered at the October meeting, and remain above the inflation target. For 2017, both the projections under the baseline and market scenarios stand around and above the 4.5% midpoint target, respectively.

Monetary Policy Decision

19. The Copom emphasizes that the international evidence, which is ratified by the Brazilian experience, indicates that high inflation rates generate distortions that lead to higher risks and depress investments. These distortions are manifested, for example, in the shortening of the planning horizons of households,

companies and governments, as well as in the deterioration of the businessmen confidence. The Committee also emphasizes that high inflation rates reduce the purchasing power of wages and transfers, with negative repercussions over the households' confidence and consumption. As a consequence, high inflation rates reduce the potential of economic growth, as well as of jobs and income generation.

20. In view of this, the Copom evaluates that the monetary policy should contribute to the consolidation of a favorable longer-term macroeconomic environment. In this respect, the Copom reassures that, under the inflation targeting regime, it guides its decisions according to BCB projected inflation and based on the analysis of alternative scenarios for the evolution of the main variables that determine prices dynamics. The Committee also understands that low risks for the underlying inflation in the short run tend to reduce uncertainties regarding the future behavior of headline inflation, facilitate the assessment of scenarios by the monetary authority, as well as help the process of coordination of economic agents' expectations, particularly prices setters'. Additionally, it is noteworthy that low risks for the underlying inflation in the short run tend to intensify the effects of monetary policy actions, enabling them to affect, in a more long-lasting manner, the dynamics of headline inflation in the future. Although the Copom recognizes that other macroeconomic policy actions may influence the prices trajectory, it reaffirms its view that it is particularly under the responsibility of the monetary policy to remain especially vigilant, to guarantee that pressures detected in shorter horizons do not spread to longer horizons.
21. The Committee considers that the external environment remains complex, with episodes of higher volatility affecting important emerging economies, despite identifying low probability of occurrence of extreme events in the international financial markets. For the Committee, the trend for global activity shows more moderation throughout the monetary policy relevant horizon. The prospects continue to indicate activity recovery in some advanced economies and acceleration in the pace of growth in others, although, in general, the room to use monetary policy in these economies remains limited and a fiscal restraint scenario prevails. Important emerging economies experience a transition period and, therefore, of more moderation in the activity pace, despite the resilience of the domestic demand.
22. Still regarding international financial markets, the Copom highlights moderation in the dynamics of commodities prices. Regarding oil, the Committee highlights that, regardless of the behavior of the domestic prices of gasoline, the evolution of international prices tends to be transmitted to the domestic economy both through productive chains, such as the petrochemical, and through inflation expectations.
23. The Copom reaffirms that, in accordance to the macroeconomic adjustment process underway, the available indicators show that the domestic absorption and GDP growth rates have continued to adjust and confirm that the domestic activity expansion pace this year will be lower than the potential. This process has been intensified by the uncertainties arising from the effect of non-economic events. In particular, investment has retreated, mainly influenced by the occurrence of these events, and private consumption also shows contraction signals, in line with recent data regarding credit, employment and income. However, for the Committee, after a necessary period of adjustments, which has been more intense and longer than the anticipated, the activity expansion pace tends to intensify, as companies' and households' confidence strengthen. Moreover, the Committee evaluates that, in the medium term, important changes should take place in the composition of aggregate supply and demand. Consumption tends to grow at a moderate pace and investments tend to gain momentum. These changes, coupled with other ones currently underway, anticipate a composition for aggregate demand growth in the medium term more favorable to potential growth. Regarding the external component of aggregate demand, the scenario of higher global growth, combined with the depreciation of the BRL, contributes to make this component more favorable to the Brazilian economic growth. Regarding the supply side,

the Committee evaluates that, in longer horizons, more favorable prospects for the competitiveness of industry, agriculture and livestock have emerged. The services sector, on its turn, tends to grow at rates lower than those recorded over the recent years. For the Committee, it is plausible to claim that these developments – coupled with advances in terms of qualification of the labor force and with the program of public services concession - will be reflected in a more efficient allocation of the production factors of the economy and in productivity gains. However, the speed of materialization of these changes and of the gains resulting from them depends fundamentally on a path of primary surpluses that strengthens the perception of the public sector balance sustainability, in addition to reducing uncertainties surrounding the domestic environment.

24. The Copom observes that the main inflation scenario considers the materialization of the assumed trajectories regarding fiscal variables. Relative to the structural fiscal result and depending on the economic cycle, the Committee considers that, during the relevant horizon for the monetary policy, the balance of the public sector tends to shift to the neutral zone, and does not rule out the hypothesis of migration to the fiscal restraint area, even if more slowly and with lower intensity than previously anticipated. However, the Committee notes that the lack of definitions and the significant changes in the trajectory of primary surpluses, as well as in its composition, impact the hypotheses considered for inflation projections and contribute to create a negative perception regarding the macroeconomic environment and have negatively impacted inflation expectations. Concerning inflation control, the Committee highlights that the literature and the best international practices recommend a consistent and sustainable fiscal policy framework, in order to allow monetary policy actions to be fully transmitted to prices.
25. The Copom highlights that the main scenario also considers moderate credit expansion, which had already been observed and tends to persist. Regarding this issue, it is important to highlight the fact that, after years of strong expansion, consumer credit has moderated, so that, over the last quarters, there was, on the one hand, exposure reduction by banks, and, on the other hand, deleveraging of the households. In the aggregate, therefore, it can be inferred that the risks in the consumer credit segment have been mitigated. In another dimension, as illustrated by actions that were implemented, the Committee considers as opportune the initiatives with the aim of moderating concessions of subsidies through credit operations.
26. In the factors' market, as anticipated by previous Minutes, the Copom observes that the idleness margin in the labor market has increased at a faster pace, with data confirming the acceleration in the process of distension in this market. However, there is still the prevalence of a significant risk related, particularly, to the possibility of concession of high nominal wages' increases, with negative impacts over inflation. In spite of the occurrence of real wage changes more consistent with the gains estimates for the labor productivity, the Committee evaluates that the wages dynamics remains originating inflationary cost pressures.
27. For the Copom, the fact that inflation stands at high levels reflects, in large part, the occurrence of two important relative prices adjustment processes underway in the economy - the realignment of domestic prices relative to international prices and the realignment of regulated prices relative to market prices. The Committee also considers that, over 2015, these relative prices adjustments in the economy, among other factors, have made the balance of risks to inflation unfavorable. In this context, as anticipated in previous Minutes, these price adjustments caused inflation to rise in 2015, requiring determination and perseverance to prevent its transmission to longer horizons. While recognizing that these relative prices adjustments have direct impacts over inflation, the Committee reaffirms its view that the monetary policy can, should and is containing the second order effects stemming from them.

28. Given the above, assessing the macroeconomic scenario and the inflation prospects, the Copom considers that uncertainties surrounding the balance of risks remain, mainly on the speed of the recovery process of fiscal results and its composition, and that the relative price realignment process has been slower and more intense than the previously anticipated. Part of its members argued that it would be appropriate to adjust, immediately, the monetary conditions, in order to reduce the risks of non-compliance of the inflation targeting regime objectives. However, most of the Copom members considered monitoring the evolution of the macroeconomic scenario until its next meeting, to then define the next steps in its monetary policy strategy.
29. The Copom, then, decided to maintain the Selic rate at 14.25% p.a., without bias, by six votes in favor and two votes for raising the Selic rate by 0.50 p.p.
30. The following members of the Committee voted for maintaining the Selic rate at 14,25%: Alexandre Antonio Tombini (Governor), Aldo Luiz Mendes, Altamir Lopes, Anthero de Moraes Meirelles, Luiz Edson Feltrim and Otávio Ribeiro Damaso. The following members of the Committee voted for raising the Selic rate to 14.75%: Sidnei Corrêa Marques and Tony Volpon.
31. The Copom reaffirms that the aggregate demand will continue to be moderate in the relevant horizon for the monetary policy. On the one hand, household consumption tends to be influenced by factors such as employment, income and credit; on the other hand, the concession of public services and the expansion of agricultural income, among other factors, tend to benefit investments. On its turn, the net exports show better results, either by increasing exports, benefited by the scenario of higher growth of major trading partners and the depreciation of the BRL, or by the ongoing import substitution process. For the Committee, the combined effects of these elements, the developments in the fiscal and quasi fiscal framework and in the assets market, and, in 2016, the dynamics of the regulated prices adjustment, are important factors in the context in which future monetary policy decisions will be taken, aiming to ensure the convergence of inflation to the 4.5% target established by the CMN, in 2017.
32. The Committee emphasizes that there are uncertainties associated with the balance of risks, mainly on the speed of the recovery process of fiscal results and on its composition, and that the relative price realignment process has been slower and more intense than the previously anticipated. In this context, the Committee understands that, regardless of the outline of the other policies, it will take the necessary measures in order to ensure the compliance with the objectives of the targeting regime, that means, to bring inflation as close as possible to 4.5% in 2016, circumscribing it to the limits established by the CMN, and to make inflation converge to the 4.5% target in 2017.
33. At the end of the meeting, it was announced that the Committee will reconvene on January 19th 2016, for the technical presentations, and on the following day, to deliberate on monetary policy, as established in the Communiqué 28,079, of June 26th, 2015.

Appendix

Banco Central do Brasil Management

Members of the Monetary Policy Committee (Copom)

Banco Central do Brasil Management

Board

Alexandre Antonio Tombini

Governor

Aldo Luiz Mendes

Deputy Governor

Altamir Lopes

Deputy Governor

Anthero de Moraes Meirelles

Deputy Governor

Luiz Edson Feltrim

Deputy Governor

Otávio Ribeiro Damaso

Deputy Governor

Sidnei Corrês Marques

Deputy Governor

Tony Volpon

Deputy Governor

Members of the Monetary Policy Committee (Copom)

Voting members

Alexandre Antonio Tombini
Governor

Aldo Luiz Mendes
Deputy Governor

Altamir Lopes
Deputy Governor

Anthero de Moraes Meirelles
Deputy Governor

Luiz Edson Feltrim
Deputy Governor

Otávio Ribeiro Damaso
Deputy Governor

Sidnei Corrêas Marques
Deputy Governor

Tony Volpon
Deputy Governor

Non-voting members

Tulio José Lenti Maciel
Head of the Department of Economics (Depec)

Eduardo José Araújo Lima
Head of the Research Department (Depep)

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

Flávio Túlio Vilela
Head of the Department of Banking Operations and Payments System (Deban)

Ariosto Revoredo de Carvalho
Head of the Department of International Reserve Operations (Depin)

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

Acronyms

Abras	Brazilian Association of Supermarkets
ACSP	São Paulo Trade Association
b.p.	Basis points
BCB	Banco Central do Brasil
BNDES	Brazilian Development Bank
BoE	Bank of England
BoJ	Bank of Japan
BPM6	IMF Balance of Payments 6th Issue
Caged	General Registry of Employed and Unemployed Persons
CDE	Energy Development Account
Cide	Contribution on Intervention in the Economic Domain
CMN	National Monetary Council
CNAE	National Classification of Economic Activities
CNI	National Confederation of Industry
Conab	National Supply Company
Continuous PNAD	Continuous National Household Sample Survey
Copom	Monetary Policy Committee
CPI	Consumer Price Index
CPMF	Provisional Contribution on Financial Operations
CRB	Commodity Research Bureau
CVM	Securities and Exchange Commission
DAX	Deutscher Aktienindex
DI assets	Direct Investment Assets
DI liabilities	Direct investment liabilities
ECB	European Central Bank
Embi+	Emerging Markets Bond Index Plus
ENA	Affluent Natural Energy
ETF	Exchange-traded funds
Fed	Federal Reserve
Fenabrave	National Federation of Automotive Vehicle Distribution
FGV	Getulio Vargas Foundation
FOMC	Federal Open Market Committee
FTSE 100	Financial Times Securities Exchange Index
FTSE MIB	FTSE Milano Italia Borsa Index
FTSE/JSE	FTSE/JSE Africa Index Series
Funcex	Foreign Trade Studies Center Foundation
GDP	Gross Domestic Product
Gerin	Investor Relations and Special Studies Department
GFCF	Gross fixed capital formation

HICP	Harmonized Index of Consumer Prices
IBC-Br	Central Bank Economic Activity Index – Brazil
IBGE	Brazilian Institute of Geography and Statistics
IC-Br	Commodities Index – Brazil
ICC	Average Cost of Outstanding Loans
ICE	New York Intercontinental Exchange
ICI	Industrial Confidence Index
ICMS	Tax on the Circulation of Merchandises and Services
ICOM	Trade Confidence Index
ICS	Services Confidence Index
ID	Interbank Deposit
IDX	Indonesia Stock Exchange
IE	Expectations Index
IGP-DI	General Price Index
IGP-M	General Price Index – Market
INC	National Confidence Index
INCC	National Cost of Construction Index
Inec	National Consumer Expectations Index
INSS	National Social Security Institute
IOF	Financial Operations Tax
IPA-DI	Producer Price Index – Domestic Supply
IPCA	Extended National Consumer Price Index
Ipsos	Ipsos Public Affairs
IPVA	Tax on Automotive Vehicle Ownership
ISA	Current Situation Index
JGB	Japanese Government Bonds
J-REIT	Japan Real Estate Investment Trust
LSPA	Systematic Survey of Agricultural Production
MDIC	Ministry of Development, Industry and Foreign Trade
MTE	Ministry of Labor and Employment
NASDAQ	National Association of Securities Dealers Automated Quotation
Nuci	Industry Installed Capacity Usage Level
ONS	National Power System Operator
p.a.	Per annum
p.p.	Percentage points
PAC	Growth Incentive Program
PBC	People's Bank of China
PEC	Constitutional Amendment Proposal
Pimes	Monthly Industrial Survey – Employment and Wages
PIM-PF	Monthly Industrial Survey – Physical Production
PMC	Monthly Retail Trade Survey
PMI	Purchasing Managers Index
PMS	Monthly Survey of Services
PPI	Producer Price Index
PSND	Public Sector Net Debt
QE	Quantitative Easing
S&P	Standard & Poor's
Selic	Special System for Clearance and Custody
SME	Small and Medium-sized Enterprises
U.S.	United States of America

VAR	Autoregressive Vector
VIX	Chicago Board Options Exchange Volatility Index
WMO	World Meteorological Organization
WTI	West Texas Intermediate