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BANCO CENTRAL
DO BRASIL

Inflation
Report

2007

June 2007
Volume 9 – Number 2

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Inflation Report

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Statistical Conventions

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

Hiphen (-) between years (1970-75) 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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There are no references to sources in tables and graphs originated in the Banco Central do Brasil.

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Foreword

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

The *Report* is divided into six chapters: Economic activity; Prices; Credit, monetary and fiscal policies; International economy; External 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

To a great extent, the robust performance of the Brazilian economy in the first quarter of 2007 was driven by internal demand that, in turn, was powered by the dynamics of household consumption and, more recently, raising investments. To a lesser degree, the pace of economic activity also mirrored greater than expected external demand for Brazilian exports. In more specific terms, growth in household consumption, the major component underlying aggregate demand, has been sustained by rising income and employment and much improved credit conditions. Parallel to these developments, the positive performance of investments has been driven at least partly by expanding imports of capital goods, reflecting recovery in farm income, renewed business community confidence, a declining country risk rating, together with the ongoing process of monetary policy easing. In this framework, recent growth in utilization of installed industrial output capacity is not expected to restrict continuation of the current growth process over the short-term.

Labor market had also good evolution, marked by expanding formal employment and higher overall real wages. The latter factor has evidently been impacted positively by inflation rates compatible with the target path.

In the external environment, imports have expanded more rapidly than exports due both to the dynamics of the domestic consumer market and to expanding investment opportunities. Here, it is important to stress that, on the one hand, new loan operations borrowed by families has remained strong while, on the other hand, imports of capital goods have expanded in terms of volume at a more rapid pace than average growth in overall imports, with evident positive repercussions in terms of expansion of the economy's productive capacity.

For the most part, the evolution of loan operations with individual borrowers has been sustained by personal loans, mainly reflecting the performance of payroll-deducted loans. In their turn, corporate loan operations have followed the pattern registered in the early months of 2006, with significant growth in operations backed by foreign currency.

The scenario for public accounts remains positive, with expectations of reductions in nominal interest compatible with continued downward movement in the Selic rate. Expectations also indicate compliance with primary surplus targets, considered consistent with a steady reduction in the Net Public Sector Debt (DLSP) as a proportion of Gross Domestic Product (GDP), even when one considers the possibility of deductions resulting from the Investment Pilot Project (PPI). One should also stress the outlook for growth in public sector investments as the projects included in the Accelerated Growth Program (PAC) are gradually implemented, a process considered essential to expectations of sustained economic expansion.

Evolution of the Broad National Consumer Price Index (IPCA) indicates that the dynamics of inflation in the first five months of 2007 remained fully compatible with the target path or, in other words, aligned with the benign price scenario that has gradually materialized since last year. Actually, the 12-month accumulated inflation has remained in the range of 3% since the fourth quarter of 2006, despite the upward pressures registered toward the end of that year and in the early months of 2007, mostly as a result of food prices. Though leading indicators signaled that June inflation would be somewhat higher than initially expected, together with some degree of pressure at the wholesale price level, it was the understanding of the Monetary Policy Committee (Copom) that consumer inflation would continue evolving according to the target path.

Trade balance surpluses remained strong and, for the third consecutive year, will close above US$40 billion. Though the volume of imports has expanded more rapidly than exports, trade surpluses have remained relatively stable as a result of growth in the prices of exported goods, reflecting the positive dynamics of the terms of trade. In keeping with what was said in previous *Reports* and in Copom Minutes, the growing dynamics of the import sector suggests that the nation's current accounts with the rest of the world have begun gradually shifting into a new reality. Evidently, this is a welcome shift, since it reflects the existence of a natural and healthy process of external account adjustment in the pursuit of long-term equilibrium. This adjustment has been influenced both by the price effect, as reflected in nominal interest rates, and by the income effect, driven by sharper growth in aggregate demand.

The process of accumulating international reserves has progressed according to the parameters defined by the Central Bank of Brazil. Improvement in this and other economic fundamentals has been important to help increasing the nation's economy resilience to the impact of international financial market turbulence. This assessment is supported, for example, by record reductions in the country risk premium and progressively higher ratings attributed by rating agencies to Brazilian sovereign bonds negotiated on domestic and international financial markets. The greater resistance to shocks is also reflected in the fact that authorities have continued easing monetary policy, at the same time in which the economy has expanded in the midst of a long process of interest rate adjustments in the major international economies.

As affirmed in previous *Reports*, in the wake of the unequivocal progress achieved in the process of disinflation of the economy in recent years, the Brazilian inflation target regime shifted into a new phase of consolidation of economic stability, reflected in a target path with a central value of 4.5% per year through 2008. In the context of this new phase of stabilization of price dynamics, it is natural and consistent with international experience that effectively observed inflation rates will fluctuate over time in the range of the central value of the upper and lower parameters defined for the monetary authority. This situation contrasts sharply with performance during the process of disinflation that has marked recent years when inflation remained systematically above the central value of the target path, although, since 2004, within the tolerance interval.

The central forecast based on the benchmark scenario indicates inflation of 3.5% in 2007, well below the central target value of 4.50% defined by the National Monetary Council (CMN). In a similar way to what was stated in the most recent *Inflation Report*, one notes a trend toward convergence of cumulative 12-month IPCA growth toward the central inflation target value over the forecasting horizon, basically reflecting the effects of cutbacks in the Selic rate. The projection for 12-month trailing inflation closes at 3.5% and 3.7% for the second and third quarters of 2007, respectively, dropping back to 3.5% in the final quarter. Going further, inflation is expected to spike to 4.1% in the final quarter of 2008, still well below the central value of 4.50%.

In the market scenario, forecasts for the four quarters of 2007 are in general quite similar to those of the benchmark scenario. Projections for 12-month trailing inflation indicate acceleration in the second and third quarters of 2007 and deceleration in the final quarter, closing the year at 3.5%, a pattern quite similar to projections in the benchmark scenario. Projections for four quarters cumulative inflation rise in 2008, closing the final quarter at 4.6%.

A comparison of the figures presented in this *Report* with those released in the previous *Report* indicate a 0.3 p.p. reduction in inflation projections for both 2007 and 2008, based on the benchmark scenario. This movement occurs despite a 75 b.p. reduction in the Selic rate since March 2007 and, for the most part, results from revisions of projections for growth in regulated prices in 2007 (from 4.5% to 3.6%) and in 2008 (from 5.6% to 4.5%), as well as exchange rate appreciation since March (R$1.95, compared to R$2.10 considered in the March *Report*). In so far as the market scenario is concerned, the drop in inflation projections is slightly more accentuated than in the benchmark scenario, with 0.5 p.p. for 2007 and 0.4 p.p. for 2008. Aside from the factors mentioned above, the reduction in expectations of nominal exchange depreciation over the forecasting horizon considered also contributed to this shift.

According to the benchmark scenario, the GDP growth projection in 2007 was revised upward from 4.1% to 4.7%.

1 Economic activity

For the most part, economic growth in the first quarter of 2007 reflected internal demand, driven by the dynamics of household consumption and, more recently, by expanding investments. At the same time, there is no denying the importance of the ongoing process of monetary policy easing to improvement in credit conditions, one of the primary factors underlying current sustained economic expansion.

Continued economic growth has already been discussed in recent Inflation Reports, highlighting accelerated growth in internal demand at rates above Gross Domestic Product (GDP) expansion, coupled with a negative external sector contribution, in an environment of exported volume growth and a continued strong surplus in trade in goods and services.

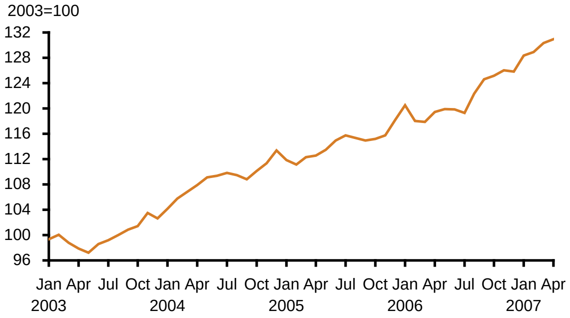
The labor market is clearly immersed in a virtuous cycle, with steady growth in formal job openings and overall real wages. Low rates of inflation have played a role of essential importance to positive gains in worker wages. Continued job market improvement and the impact of monetary policy easing are the main factors underlying consolidation of activity growth over the course of 2007.

1.1 Retail sales

The major factors undergirding recent retail sector expansion have been labor market evolution, sharp improvement in consumer expectations, increased farm income, price stability and improved credit conditions. Expectations that this process will continue throughout the entire year point to steady growth in overall sales volume, as already mentioned in the previous Inflation Report.

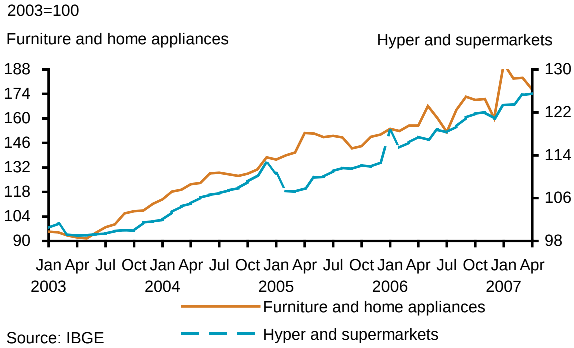
According to data released in the Brazilian Institute of Geography and Statistics (IBGE) Monthly Retail Trade Survey (PMC), the volume of retail sales expanded 9.2% in the first four months of 2007, compared to the same period of 2006, following in the wake of 5.7% growth in

Figure 1.1 – Retail sales
Seasonally adjusted data



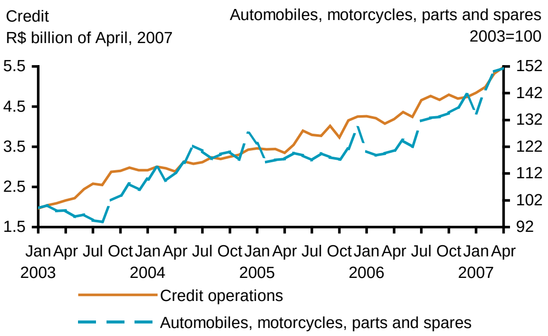
Source: IBGE

Figure 1.2 – Retail sales
Seasonally adjusted data



Source: IBGE

Figure 1.3 – Retail sales
Seasonally adjusted data



Source: IBGE and Banco Central do Brasil

Table 1.1 – Retail sales
April 2007

	% accumulated growth in 2006		
	Nominal revenue	Volume	Price
Retail sector	9.4	9.2	0.2
Fuels and lubricants	1.5	5.3	-3.6
Hyper and supermarkets	9.1	6.4	2.5
Fabrics, apparel and footwear	10.6	7.3	3.1
Furniture and home appliances	13.5	18.5	-4.2
Broad retail sector	12.2	12.6	-0.4
Automobiles and motorcycles	18.5	21.3	-2.3
Building materials	10.8	7.2	3.4

Source: IBGE

the first half of 2006 and 6.6% in the second, compared to the corresponding periods of 2005. Using the broad retail trade sector concept, which incorporates the segments of building materials and automobiles, motorcycles, parts and spares, sales growth becomes even more evident, with 12.6% expansion in the first four months of 2007 and 4.1% and 8.4% in the first and second halves of 2006, respectively.

Based on seasonally adjusted data, an analysis at the margin suggests a continued positive performance. In this sense, sales expanded 2.6% in the three-month period ended in April, compared to the November-January period, with increases of 3.8% under furniture and home appliances, 2.4% under fuels and lubricants and 2.2% in the case of hypermarkets, supermarkets, food products, beverages and tobacco.

Using the same basis of comparison, sales of automobiles, motorcycles, parts and spares increased 7.9%. To some extent, increased sales in this segment, which has registered successive new sales records in recent months, as well as under furniture and home appliances, reflected the importance of improved credit conditions to the current upturn in retail sector sales.

Since the data series on sales of building materials has only been published since 2004, the resulting statistics have not been seasonally adjusted. Nonetheless, sales in this segment expanded 6% in the February-April 2007 period compared to the same three-month period of the previous year. Though sales have not picked up in recent months, operations tend to keep pace with ongoing improvements in credit conditions and increases in overall wages.

A breakdown at the state level shows across-the-board expansion in retail sales in the first four months of 2007, compared to the corresponding period of 2006. The most accentuated increases occurred in Alagoas, 32.8%; Acre, 20%; Maranhão, 17.6%; Ceará, 15.1%; and Mato Grosso do Sul, 14.1%. Sales in the southern states of the country, which had turned in only modest results in 2006, were positively impacted by recovery in the farm sector and machines and equipment segment, posting increases of 11.8% in Santa Catarina, 7.5% in Paraná and 5.1% in Rio Grande do Sul.

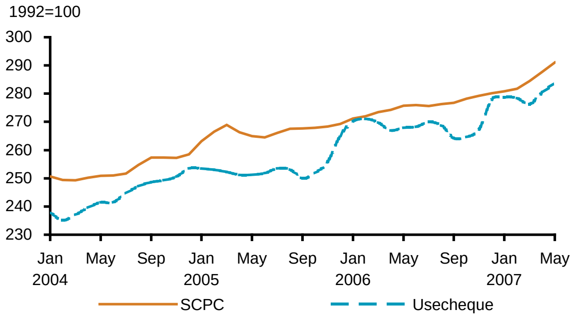
In cumulative terms for the year, regionally consolidated retail sales expanded 12.4% in the north of the country and 11.4% in the northeast, followed by the central-west region, with 8.8%; the southeast, with 9.5% and the south, with 7.6%. Despite accentuated growth in the north and northeast

Table 1.2 – Retail sales

	2007			% change
	Jan	Feb	Mar	Apr
In the month[1/]				
Retail sector	2.0	0.4	1.1	0.4
Fuels and lubricants	2.7	1.1	-0.2	-1.5
Hyper and supermarkets	2.0	0.1	1.4	0.2
Fabrics, apparel and footwear	3.0	-2.7	2.4	-1.7
Furniture and home appliances	19.5	-4.4	0.1	-3.6
Automobiles and motorcycles	-4.9	6.8	4.5	0.9
3-month period/previous 3-month period[1/]				
Retail sector	2.2	1.9	2.8	2.6
Fuels and lubricants	2.6	3.8	4.4	2.4
Hyper and supermarkets	1.2	0.8	2.0	2.2
Fabrics, apparel and footwear	3.6	1.3	2.3	-0.5
Furniture and home appliances	2.9	3.9	11.1	3.8
Automobiles and motorcycles	3.0	3.7	3.7	7.9
In the year				
Retail sector	8.5	8.8	9.7	9.2
Fuels and lubricants	2.5	3.7	4.8	5.3
Hyper and supermarkets	4.9	5.9	7.2	6.4
Fabrics, apparel and footwear	6.5	5.1	6.8	6.1
Furniture and home appliances	24.1	21.8	20.3	18.5
Automobiles and motorcycles	14.3	16.8	17.4	21.3

Source: IBGE
1/ Seasonally adjusted data.

Figure 1.4 – Retail sales indicators
Seasonally adjusted data – Quarterly moving average



Source: ACSP

Table 1.3 – Default rates

	2007					%
	Jan	Feb	Mar	Apr	May	Year[1/]
Returned checks[2/]						
Brazil	6.3	6.5	6.9	...	...	6.6
Northern region	9.6	9.6	10.4	...	...	9.9
Northeast region	8.6	9.3	10.0	...	...	9.3
Southeast region	5.8	5.9	6.3	...	...	6.0
Central-western region	7.3	7.3	7.7	...	...	7.4
Southern region	6.1	6.2	6.6	...	...	6.3
SCPC (SP)[3/]	5.6	6.3	7.1	8.1	8.0	7.0

Source: Banco Central do Brasil and ACSP
1/ Annual average.
2/ Returned checks/cleared checks.
3/ [New registrations (-) registrations cancelled]/[consultations (t-3)].

regions, it is important to stress that nationwide growth figures mainly reflected upturns in the south and central-west regions of the country, following only modest performances in the first four months of 2006. To some extent, this movement can be explained by rising farm income.

In the broad concept, regional sales followed the pattern registered in the restricted concept, with growth in all of the various states. The best performance, however, occurred in the north and northeast regions, while Mato Grosso and Rio Grande do Sul closed with the lowest rates of growth.

Based on seasonally adjusted data for the three-month periods ended in April and January, analysis at the margin shows more accentuated growth in Amapá, 5.3%; São Paulo, 4.8%; Rondônia, 4.5%; Maranhão, 54.3%; Espírito Santo, 4.2%; and Mato Grosso, 4.1%; with the downward movement only in Acre, 8.7%; Goiás, 2.7%; and Paraíba, 0.5%.

Compared to the same period of 2006, nominal retail trade revenues increased 9.4% in the first four months of 2007, for growth of 9.2% in sales volume and 0.2% in prices. With the sole exception of fuels and lubricants, nominal revenues posted by other segments of the retail sector surpassed the 2.99% rate of IPCA inflation registered in the period.

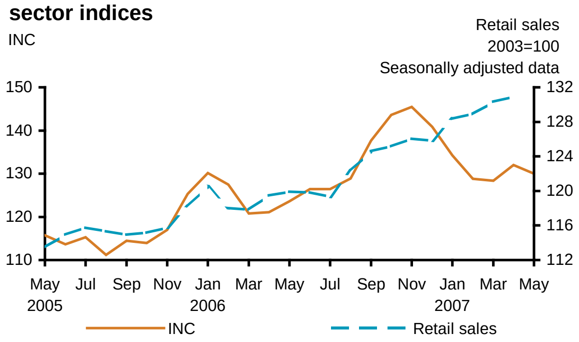
The number of contacts with the Credit Protection Service Center (SCPC), used as an indicator of installment purchases, expanded 1.2% between the three-month periods ended in May and February, while contacts with the Usecheque system, an indicator of check-based purchases, increased 0.5%.

The delinquency indicator used by the São Paulo Trade Association (ACSP) averaged 7% in the first five months of the year, compared to 6.7% in the same period of 2006. This growth was considered compatible with the rise in installment sales during the period under analysis and, at this point in time, does not represent any significant obstacle to further sales growth.

Nationwide consumer confidence surveys indicate that expectations in the early months of 2007 were higher than in the corresponding period of 2006. The National Confidence Index (INC), prepared by Ipsos Public Affairs (Ipsos) for the ACSP, reached 130 points in the month of May, against 128.8 points in March and 123.6 points in May 2006, registering growth in all of the various regions, with the sole exception of the Southeast, where the index remained stable.

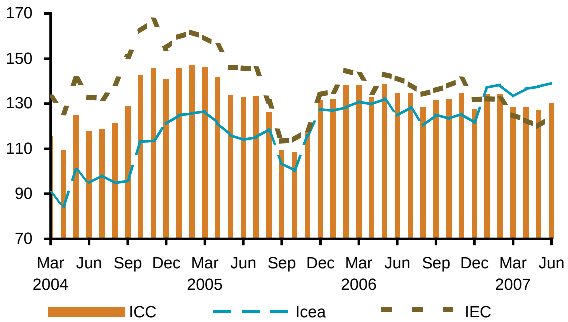
The Getulio Vargas Foundation (FGV) released its Consumer Confidence Index (ICC), showing month-on-month growth

Figure 1.5 – National Consumer Confidence and retail sector indices



Source: ACSP and IBGE

Figure 1.6 – Consumer Confidence Index



Source: Fecomercio SP

of 2.6% in May 2007, with highs of 1% in the component that assesses the current situation and 3.5% in that involving expectations for the coming months.

As released by the Trade Federation of the State of São Paulo (Fecomercio SP), the ICC, restricted to the metropolitan region of São Paulo, showed a quarter-on-quarter decline of 2.8% in the second quarter of the year. Despite this drop, the indicator closed at 128.6 points, well above the 100-point standard, considered the level of indifference. When the various components are analyzed, the Consumer Expectations Index (IEC), which accounts for 60% of the general index, dropped 5.6% and the Current Economic Conditions Index (Icea), which represents the remainder of the general index, increased 1.1%.

1.2 Output

Crop/Livestock

According to IBGE's Quarterly National Accounts, crop/livestock sector output expanded 2.1% in the first quarter of 2007, compared to the same quarter of the previous year. In the case of the 2007 harvest, the Systematic Farm Production Survey (LSPA) indicates positive results for such crops as corn, beans, soybeans, wheat and sugarcane, among others. The livestock segment is expected to continue the positive performance that has marked recent years, with important repercussions on exports, particularly involving poultry and pork.

Crops

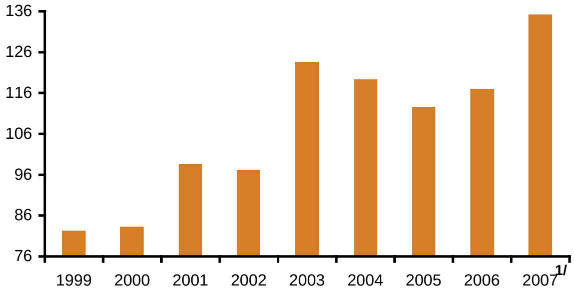
The LSPA estimate for the 2007 harvest indicates 135.1 million tons of grain, 15.5% more than in the previous year. Growth is forecast in all of the various regions, particularly in the south, 24.6%, and central-west region, 12.1%.

Soybean production is forecast at 58.5 million tons, for annual growth of 11.7%. The area under cultivation is expected to decline 6.7%, as some producers migrate into higher income crops, such as corn and sugarcane. Productivity is expected to increase 19.8%, reflecting utilization of more productive land and favorable climatic conditions during the planting period.

The corn harvest was estimated at 52.9 million tons. Annual growth of 24.1% is sustained by 10.2% expansion in the

Figure 1.7 – Grain production

In million tons



Source: IBGE
1/ Estimate.

Table 1.4 – Farm production

In 1,000 tons

	Production		% change
	2006	2007 1/	2007/2006
Grain production	116 993	135 118	15.5
Cotton (seed)	1 816	2 373	30.7
Rice	11 505	11 044	-4.0
Beans	3 437	3 715	8.1
Corn	42 632	52 916	24.1
Soybean	52 356	58 490	11.7
Wheat	2 482	4 028	62.3
Others	2 765	2 552	-7.7

Source: IBGE
1/ Estimate.

area under cultivation and 12.7% in productivity. The major determining factors underlying this performance were favorable climatic conditions and price evolution, reflecting the rise in international demand generated partially by expectations of growth in corn-based ethanol production in the United States.

The bean and herbaceous and arboreous cottonseed harvests are expected to reach 3.7 million and 2.4 million tons, respectively, in 2007, corresponding to increases of 8.1% and 30.7%. Rice production is estimated at 11 million tons, 4% less than in 2006, reflecting both unfavorable price trends and reductions in average yield.

Sugarcane production for 2007 is estimated at 513.3 million tons, 12.7% more than in the previous harvest. The area under cultivation is evaluated at 6.7 million ha, for 8.9% annual growth, while average productivity is expected to expand 3.5%. The development projected for this crop reflects excellent climatic conditions and greater external demand for sugar and alcohol. According to the Foreign Trade Secretariat (Secex), subordinated to the Ministry of Development, Industry and Commerce (MDIC), sugar exports (both raw and refined) and ethyl alcohol came to 6.7 million tons and 1.3 billion liters, respectively, in the first five months of 2007, corresponding to growth of 31.1% and 80.5% compared to the same period of 2006.

The coffee bean harvest is projected at 2.2 million tons. In annual terms, this represents a reduction of 13.4% caused basically by a 13.3% drop in average yield in the two-year low production cycle.

Wheat production is forecast to close at 4 million tons, with annual growth of 62.3%. To some extent, this performance reflects the results of the previous harvest, which was impacted by climatic adversities and clearly uncompetitive prices for the national crop. The area under cultivation is expected to grow 14.1%, while average productivity should increase 42.2%.

Table 1.5 – Livestock production

Total slaughters

% accumulated growth in the year

Itemization	2006						
	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Cattle	5.5	5.2	5.5	6.3	8.3	8.5	8.1
Swine	5.4	6.2	6.4	5.8	6.3	6.4	6.6
Poultry	5.8	5.6	5.4	4.8	4.6	4.1	3.4

Source: IBGE

Livestock

According to the Quarterly Animal Slaughter Survey released by IBGE in April 2007, beef production totaled 6.9 million tons in 2006, up 8.1% compared to 2005. When the same basis of comparison is used, poultry and pork production reached 8.1 million and 2.3 million tons, for growth of 3.4% and 6.6%, respectively.

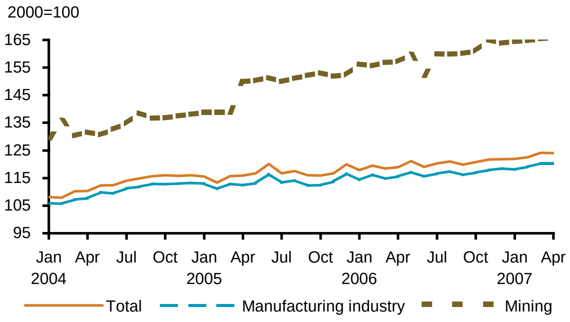
Exports of beef totaled 1.2 million tons in 2006 and continued expanding in the early months of 2007. Data available through April indicate 41.5% growth in the year, compared to the same period of 2006. Exports of poultry and pork, which had declined 6.4% and 16.4% in 2006, recovered in 2007, posting respective growth rates of 16.3% and 39.1% in the year through April.

Industrial output

The industrial growth cycle begun in 2006 gained added momentum in the early months of the current year, driven by expanding investments which, in turn, reflected interest rate cutbacks and expectations of a period of sustained economic growth. High levels of confidence among industry executives indicate that industrial output will continue expanding in the coming six months. The outlook for medium-term expansion in the nation's productive capacity is backed by strong growth in capital goods output, most of which is absorbed by the domestic market.

Figure 1.8 – Industrial production

Seasonally adjusted data



Source: IBGE

According to IBGE's Monthly Industrial Survey – Physical Production (PIM-PF), industrial output accelerated in early 2007. Utilizing seasonally adjusted data, industrial production increased 1.5% in the three-month period ended in April, compared to the November-January period, when growth closed at 1% using the same basis of comparison. In 2006, industrial output registered average three-month growth of 0.8%.

Growth in industrial output in 2006 was sustained by mining sector performance, which expanded at an average quarterly rate of 1.7% compared to 0.7% in the case of manufacturing. In the early part of this year, the ratio reversed course, as manufacturing sector output expanded 1.5% in the three-month period ended in April, compared to the November-January period, and mining sector production rose 0.6%.

The incentive generated by the 2006 reduction in medium and long-term credit costs became even more evident in early 2007. Viewed in terms of seasonally adjusted data, capital goods production, which had registered average quarterly growth of 1.9% in 2006, jumped to 2.9% in the February-April period, compared to the three-month period ended in January. In the same context, production of consumer durables, intermediate goods and semidurable and nondurable consumer goods, which had expanded at an average quarterly rate of 1.2%, 0.6% and 0.8%, respectively, in 2006, posted rates of 4.3%, 1.6% and 0.7% in the three-month period ended in April, in the same order.

Table 1.6 – Industrial production

% change

	2007			
	Jan	Feb	Mar	Apr
Industry (total)				
In the month1/	0.0	0.5	1.3	-0.1
3-month period/previous 3-month period1/	1.0	1.1	1.2	1.5
Same month of the previous year	4.5	3.0	3.9	6.0
Accumulated in the year	4.5	3.7	3.8	4.3
Accumulated in 12 months	2.9	2.8	2.7	3.3
Manufacturing industry				
In the month1/	-0.3	0.8	1.1	0.0
3-month period/previous 3-month period1/	1.1	1.3	1.2	1.5
Same month of the previous year	4.4	2.8	3.8	6.0
Accumulated in the year	4.4	3.6	3.7	4.3
Accumulated in 12 months	2.7	2.6	2.5	3.1
Mining				
In the month1/	0.4	0.2	0.4	0.3
3-month period/previous 3-month period1/	2.6	1.4	1.0	0.6
Same month of the previous year	5.1	6.3	5.6	5.6
Accumulated in the year	5.1	5.7	5.6	5.6
Accumulated in 12 months	6.7	6.2	5.7	5.7

Source: IBGE

1/ Seasonally adjusted data.

Table 1.7 – Industrial production by use category

% change

	2007			
	Jan	Feb	Mar	Apr
In the month1/				
Industrial production	0.0	0.5	1.3	-0.1
Capital goods	1.5	0.3	-0.4	-1.2
Intermediate goods	-0.2	0.6	1.9	-0.6
Consumer goods	-0.6	1.2	0.5	0.3
Durables	2.3	1.9	2.0	-1.4
Semi and nondurables	-0.7	0.8	-0.4	0.8
3-month period/previous 3-month period1/				
Industrial production	1.0	1.1	1.2	1.5
Capital goods	6.4	9.4	6.9	2.9
Intermediate goods	1.2	1.5	1.6	1.6
Consumer goods	0.7	0.9	0.7	1.4
Durables	0.9	2.8	4.1	4.3
Semi and nondurables	0.4	0.8	0.3	0.7
In the year				
Industrial production	4.5	3.7	3.8	4.3
Capital goods	17.7	16.1	14.8	15.4
Intermediate goods	3.2	3.3	3.8	4.2
Consumer goods	2.9	1.5	1.5	2.3
Durables	4.4	0.8	2.3	3.1
Semi and nondurables	2.5	1.7	1.3	2.0

Source: IBGE

1/ Seasonally adjusted data.

Among the various activities surveyed in the PIM-PF, distribution of physical industrial output is clearly compatible with the incentives generated by both demand and relative prices. In this framework, compared to the corresponding period of 2006, growth in the 12-month moving average for the period ended in April indicates that production in the segment of office machines and computer equipment increased 40.5%, followed by furniture, 11.2%; machines and equipment, 9.1%; medical, hospital, optical and other instrumentation equipment, 7.8%; beverages, 7.5%; machines, apparatuses and electric equipment, 6.7%; basic metallurgy, 6.2%; and food products, 3.5%. In the opposite situation, mention should be made of reductions in the output of electronic equipment, communications equipment and apparatuses, 8%, mainly due to declining exports of cell telephone devices; footwear and leather goods, 2.8%; and apparel and accessories, 3.8%.

Recovery in farm income led to growth in the production of goods for that sector. When one considers the average indices for the three-month periods ended in April 2007 and April of the previous year, output of fertilizers and soil correction products increased 17%, while production of herbicides and pesticides increased 16.8% and output of tractors, farm machines and equipment rose 22.2%.

Regional production indicators (PIM-PF Regional) demonstrate that the process of accelerated industrial output growth noted between the end of 2006 and early months of the current year was more accentuated in the southern region. Compared to the same period of the previous year, growth in average production in the three-month period ended in April reached 7.9% in Paraná, 6.4% in Rio Grande do Sul and 2.5% in Santa Catarina. This performance was impacted by the dynamics of the segments of automotive vehicles, other chemical products and publishing and printing in the state of Paraná; automotive vehicles, oil refining and alcohol production and machines and equipment in Rio Grande do Sul; and food products in Santa Catarina. Physical production of the states located in the Amazon region dropped 2.5% in the period under consideration, reflecting the falloff in output of cell telephone devices and television sets.

Even in a framework of growing capital goods absorption, the increased dynamics of industrial output raised the level of utilization of installed production capacity. According to the Manufacturing Industry Survey (SCIT) carried out by the FGV, the utilization level of installed industrial capacity moved to 84.5% in May, 1.8 p.p. above the level for the same month of the previous year.

Alterations in South X Northeast Industrial Behavior

Industrial output in the southern and northeast regions of Brazil showed highly distinct dynamics in the 2005/2006 period, with implications for evolution of the job market and retail sector sales. While the southern states showed declines or only very slight growth in industrial output, the northeastern states were considerably more dynamic, particularly in 2006. The underlying determinants of this behavior were increased concentration of southern industries on foreign trade; the greater weight of commodities in northeastern industrial output; higher income growth in the northeast; and reductions in agricultural income with important impacts on industrial production in the south of the country.

According to IBGE's Regional Industrial Survey (PIR), while industrial product declined 0.9% in the southern region[1] in 2005 and 1.3% in 2006, the northeast posted positive growth of 2.5% and 3.3%, respectively.

Analysis of data broken down by activity reveals that the heading "food and beverages", which accounts for 24.1% of northeastern industrial output and 23.9% in the south, is the major factor underlying this performance. In 2006, this industrial segment posted a high of 3.7% in the northeast and only 1% in the south, primarily as a result of larger income gains in the northeast generated as much by higher overall wages as by federal government assistance programs. In this framework, data from IBGE's Monthly Employment Survey (PME) indicate a high of 8.5% in overall wages in the northeast of the country (metropolitan regions of Recife and

1/ Industrial output indices in the southern region, calculated by Depec, consider the production indices of each one of the southern states, weighted by relative participation of their manufacturing sectors in each of the regions, according to IBGE's Annual Industrial Survey (PIA) – Company 2005.

Salvador) and 4.9% in the south (metropolitan region of Porto Alegre).

Table 1 – Industrial production by activity

% change

Itemization	2006				2007 (up to April)			
	Growth		Contribution		Growth		Contribution	
	Northeast	South	Northeast	South	Northeast	South	Northeast	South
Food and beverages	3.7	1.0	0.9	0.3	9.2	8.7	2.2	2.1
Basic mettalurgy	10.9	...	0.9	...	2.5	...	0.2	...
Celullose, paper and paper products	16.6	2.6	0.6	0.1	-3.3	0.0	-0.1	0.0
Textiles	5.5	-0.5	0.4	0.0	-5.5	0.5	-0.4	0.0
Non-mettalic mineral products	7.3	-4.2	0.4	-0.1	7.6	12.7	0.4	0.4
Coke, oil refining and alcohol production	2.3	0.6	0.3	0.1	-3.5	2.9	-0.4	0.3
Leather, travel accessories and footwear	5.2	-8.8	0.2	-0.4	-0.8	-10.3	0.0	-0.5
Other chemical products	1.0	-0.2	0.2	0.0	2.3	13.5	0.5	1.2
Machines, apparatuses and electric equipment	1.2	6.1	0.0	0.1	-5.7	6.5	-0.1	0.2
Mining industries	-4.4	...	-0.4	...	-3.7	...	-0.3	...
Apparel and accessories	-14.5	-10.0	-0.4	-0.2	-4.9	-15.4	-0.1	-0.4
Publishing, printing and copy of recordings	...	4.4	...	0.1	...	19.7	...	0.3
Rubber and plastic products	...	8.8	...	0.4	...	4.2	...	0.2
Furniture	...	3.7	...	0.1	...	10.6	...	0.3
Machinery and equipment	...	-3.8	...	-0.4	...	16.0	...	1.6
Wood products	...	-14.4	...	-0.6	...	-10.0	...	-0.4
Metal products – Excluding machinery and equipment	...	-6.7	...	-0.2	...	-1.5	...	-0.1
Tobacco products	...	-7.3	...	-0.2	...	10.0	...	0.3
Automotive vehicles, tows and bodyworks	...	-3.2	...	-0.3	...	18.9	...	1.8
Total	3.2	-1.2	...	...	1.7	7.3	...	...

Source: IBGE

In the same sense, the segment of textile products posted highly differentiated behaviors in the two regions, with a 5.5% high in the northeast (weight of 7.7%) and a decline of 0.5% in the south (weight of 2.1%).

Other activities driving northeastern industrial growth were cellulose, paper and paper products, basic metallurgy and nonmetallic mineral products. In the northeast, the Ceará industrial sector expanded 8.2% in 2006, the best performance among all of the states of the region. These results were driven by the sectors of machines, apparatuses and electric equipment; chemical products; and textiles.

In the case of the southern region, Rio Grande do Sul was the only state surveyed by IBGE data to register consecutive negative industrial output figures in 2005 and 2006, with 3.6% and 2%, respectively. This performance reflected reductions in the sectors of machines and equipment, principally those focused on the farm sector, metal goods and footwear and leather articles. The behavior of the automotive vehicle industry contributed to the weak performance of industry in the State of Paraná, while the segments of wood, apparel and accessories and food products were decisive elements in the stagnation of industry in the State of Santa Catarina.

There is a direct relationship between the behavior of regional industrial production and the exported volume of significant products in the industrial profile of these regions. According to the Foreign Trade Studies Center Foundation (Funcex), exported volumes of automotive vehicles, wood and furniture, and machines and tractors, sectors that, when taken together, accounted for 23.1% of southern region output and were not included in the surveys carried out in northeastern industry, declined 8.5%, 7.8% and 5.1%, respectively, in 2006, contributing with -1.2 percentage points (p.p.) to the annual industrial performance result in the South.

An additional determining factor underlying the recent behavior of production in the southern region were the effects of farm sector income losses in the 2005/2006 period. In this sense, output of agricultural capital goods turned in negative growth under machines, 16.5%, and parts, 38.9%, for the second consecutive year. Parallel to this, mention should also be made of the impact of avian flu on world consumption of chicken meat, a segment of enormous importance to the southern region.

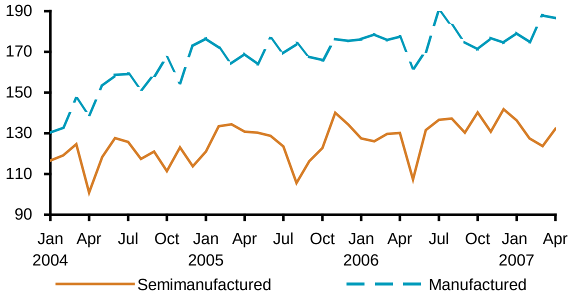
Output in northeastern industry benefited from the behavior of commodities, similarly to what occurred in the segments of steel and metallurgy, which were positively impacted by increased domestic demand, particularly in the second half of 2006; as well as cellulose, as evident in annual growth of 7% in the exported volume of cellulose, paper and printing.

Results for industrial output in the first four months of 2007 included in the National Accounts elaborated by IBGE suggest recovery in the southern region, impacted by income gains in the farm sector, reaching as much as 19.4% in the first quarter of the year when compared to the same period of 2006. In this sense, southern production showed growth of 7.3% in the first four months of 2007, compared to the same period of the previous year, in contrast to 1.7% expansion in the northeast of the country.

The enhanced dynamics in that region were generated by the performance of the sectors of automotive vehicles, machines and equipment and food products, with respective growth rates of 18.9%, 16% and 8.7% in the four-month period under consideration. Viewed as a whole, these segments accounted for 5.4 p.p. of industrial expansion in the south of the country during the period under analysis. The more moderate performance registered by industrial production in the northeast of Brazil reflected declines under textiles and oil refining and alcohol production.

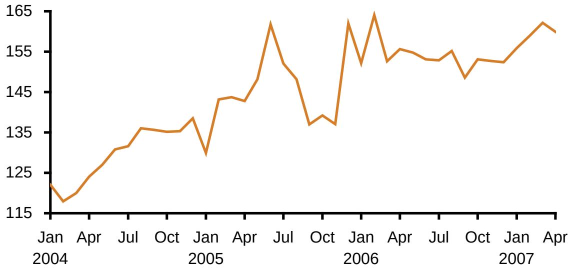
In this context, though the pace of growth in such segments as wood, apparel and leather, remains relatively low, recovery in farm income and its impact on the production of agricultural machines and food production have guaranteed a more robust recovery in the southern industrial structure. In the northeast, income gains remain as a determining factor for continued growth in the industrial sector. This behavior suggests that industrial performance in these important regions should be less heterogeneous in 2007 than in recent years.

Figure 1.9 – Industrial exports – Volume
Seasonally adjusted data
2002=100



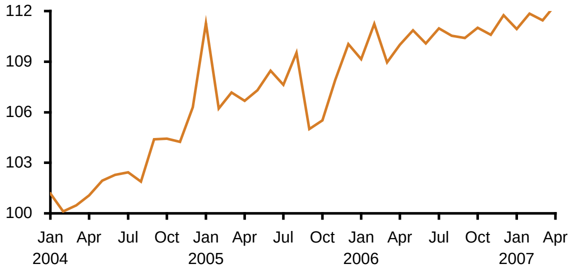
Source: Funcex

Figure 1.10 – Industrial production
Durable consumer goods
Seasonally adjusted data
2000=100



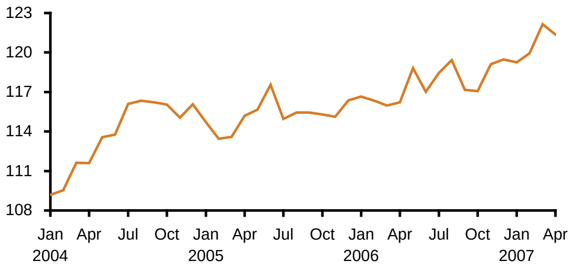
Source: IBGE

Figure 1.11 – Industrial production
Semi and nondurable goods
Seasonally adjusted data
2000=100



Source: IBGE

Figure 1.12 – Industrial production
Intermediate goods
Seasonally adjusted data
2000=100



Source: IBGE

According to seasonally adjusted quarterly data, the level of industrial capacity utilization climbed to 85.3% in April, up 2.1 p.p. compared to the January level and quite close to the April 1995 record of 85.4%. Using the same type of analysis, industrial capacity utilization in the consumer goods segment reached a record level of 83.4%, while the sectors of metallurgy and food products also set records, with respective levels of 94.4% and 87.9%.

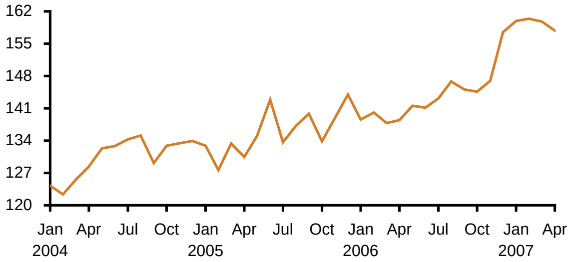
According to the National Confederation of Industry (CNI), the average level of capacity utilization in the manufacturing sector closed April at 81.7%. In the February-April period, the level averaged 81.4%, 2.1 p.p. above the same period of the previous year. Here, the strongest increases occurred in preparation of leather and production of leather goods and footwear, 5.4 p.p.; coke, fuel refining and alcohol production, 4.8 p.p. In the opposite sense, the sharpest reductions occurred under automotive vehicles, 3.2 p.p., and electronic and communications equipment, 2.5 p.p.

In general, production has increased more rapidly than industrial employment, reflecting productivity gains typical of a period of economic expansion that is taking full advantage of capital goods absorption. According to CNI data, industrial productivity rose 3% between the three-month periods ended in April 2007 and in April 2006, closing at 4.3% in the mining industry and 2.9% in manufacturing.

In sectoral terms, stress should be given to productivity gains in the segments of machines and equipment, 12.5%, reflecting increases of 14.4% in physical production and 1.6% in the number of hours paid; and tobacco, 9%, resulting from 1.2% growth in production; and a 9.1% decline in the number of hours paid. Productivity declined in the segments of coke, oil refining, nuclear fuels and alcohol, 13.5%, reflecting a 1.2% drop in production and growth of 14% in the quantity of hours paid; and food and beverages, 2.9%, with increases of 6.4% in hours paid and 5.3% in output.

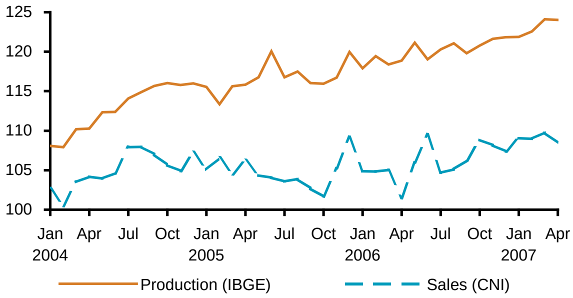
The confidence level among industry executives remains high with regard to the current situation and expectations for the near future of the economy. The Industry Businessmen Confidence Index (Icei), calculated by CNI, reached 59.4 points in April. Here, one should clarify that 50 points correspond to stability in industrial activity. FGV's Industrial Confidence Index (ICI), which has a stability level of 100 points, dropped to 118.2 in May, down 2.5 points compared to April, when the index had reached its highest level since it was first calculated in April 1995.

Figure 1.13 – Industrial production
Capital goods
Seasonally adjusted data
2000=100



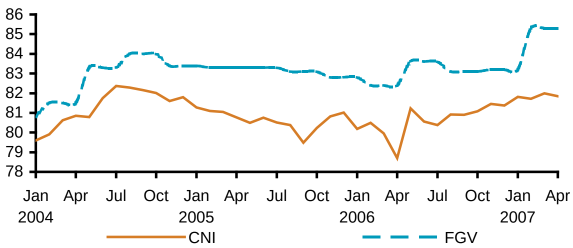
Source: IBGE

Figure 1.14 – Industrial production and sales
Seasonally adjusted data
2003=100



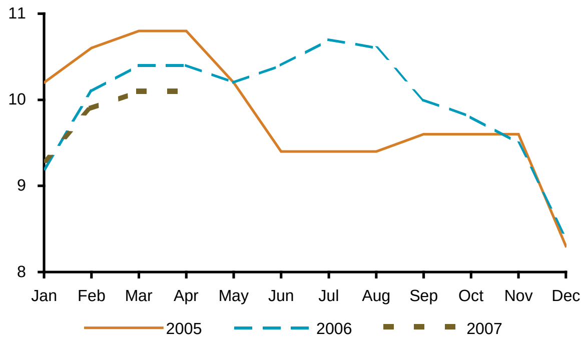
Source: IBGE and CNI

Figure 1.15 – Utilization of installed capacity in the manufacturing industry
Seasonally adjusted data
%



Source: CNI and FGV

Figure 1.16 – Unemployment rate
%



The optimism of industrial executives is reflected in both current investment intentions and those for the near future. According to FGV's Manufacturing Industry Survey – Special Queries (SCIT-QE), carried out in April, 34% of the companies contacted stated that they were investing more in the first half of this year than in the previous half-year period, while 21% were doing precisely the opposite. With regard to the second half of 2007, 34% of the companies contacted manifested the intention of increasing investments, while 14% intended to reduce them.

1.3 Labor market

Employment

Labor market indicators in the first four months of 2007 were clearly positive, particularly in terms of formal employment, with positive impacts on real earnings and real overall wages. It should be stressed that this scenario tends to stimulate people to look for jobs, reducing the number of those who have simply given up hope of finding work. The natural consequence of this change is growth in official unemployment figures. This is a phenomenon already noted in other cycles of economic expansion in recent years.

According to IBGE'sPME, which encompasses six metropolitan regions, the rate of open unemployment remained on a predictable upward curve and closed the first four months of 2007 at 10.1%, against 8.4% in December 2006. Basically, this increase reflected unfavorable seasonal factors, resulting in elimination of 258,000 job positions.

Compared to the same period of 2006, the average rate of unemployment dropped 0.17 p.p., reflecting 2.9% growth in the number of employed persons and 0.9% in the number of those unemployed. Using data for April 2007 and the same month of the previous year, 640,000 job openings were created, at the same time as the quality of these jobs improved. This is evident in the fact that the number of formal job opportunities increased 361,000, while the informal market contracted 90,000 employees.

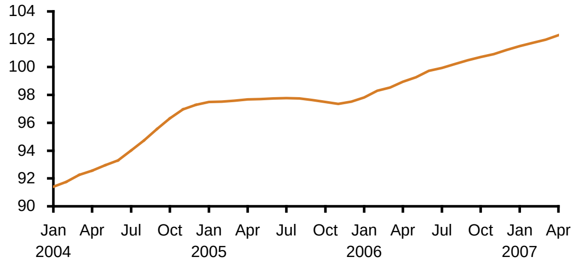
According to the General File of Employed and Unemployed Persons (Caged), calculated by the Ministry of Labor and Employment (MTE), 701,619 job positions were created in the year through April. This was a new record for the four-month period since this series was first calculated in January 1985. The volume of new jobs represented a 4.8% increase in total registered employees, reflecting growth of 6.4% in

Table 1.8 – Formal employment

Job openings – Accumulated in the period (1,000 employees)	2007				
	Jan	Feb	Mar	Apr	Year
Total	105.5	148.0	146.1	302.0	701.6
Manufacturing industry	39.1	30.8	40.5	103.8	214.2
Commerce	- 9.9	11.8	12.9	36.9	51.6
Services	47.3	62.8	56.5	82.8	249.4
Construction	11.7	5.5	17.3	30.9	65.4
Crop/livestock	17.2	22.0	11.3	41.2	91.8
Public utilities	0.8	1.0	0.7	1.3	3.8
Others[1/]	- 0.8	14.2	6.9	5.1	25.3

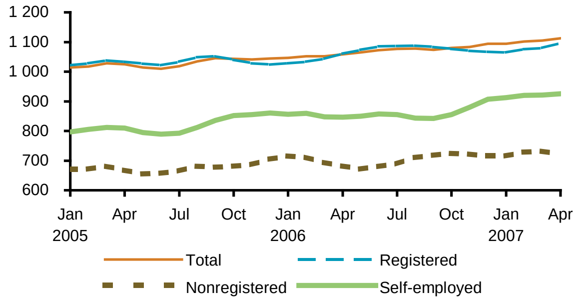
Source: MTE
1/ Includes mining, public administration and others.

Figure 1.17 – Employment in the manufacturing industry – Quarterly moving average
Seasonally adjusted data
2003=100



Source: CNI

Figure 1.18 – Average real regular earnings[1/]
In R$ of April 2007, deflated by INPC



Source: IBGE
1/ Quarterly moving average.

the construction industry; 5.9% in the commerce; 4.8% in the service sector; and 4.6% in manufacturing.

According to data gathered by CNI among twelve state federations, employment in the manufacturing sector expanded 3.4% in the first four months of 2007, compared to the same period of 2006. In much the same way, analysis at the margin utilizing seasonally adjusted data shows an increase in jobs in this segment of the economy, reaching 0.8% in the three-month period ended in April, compared to the November-January period.

Earnings

Average real earnings regularly received by workers in the six major metropolitan regions covered by the PME posted average growth of 5% in the first four months of the year, compared to the same period of 2006. Average earnings closed April at R$1,114.00, a nominal increase of 10% compared to the same month of 2006, while overall real wages, the product of the real average wages regularly received by workers times the number of persons occupied, increased 8.4%.

1.4 Gross Domestic Product

According to seasonally adjusted data drawn from IBGE's Quarterly National Accounts, GDP expanded 0.8% in the first quarter of the year, compared to the final quarter of 2006. At the margin, GDP growth ratified perceptions of recovery in the pace of economic expansion, driven mainly by steady growth in real income and employment, the excellent performance of the farm sector and the impact of the ongoing process of monetary policy easing.

Using the same basis of comparison, the industrial and service sectors posted increases of 0.3% and 1.7%, respectively, coupled with a 2.4% drop in crop/livestock output. With regard to the various demand components, it is important to stress continued growth in Gross Fixed Capital Formation (GFCF), reaching 2.1%. Household consumption increased 0.9% and government consumption rose 3.5%, while exports expanded 1.2% and imports increased to 4.1%, a level fully compatible with the uptick in the activity level.

Compared to the first quarter of 2006, GDP expanded 4.3%. Basically, this result reflects the dynamics of the economic upturn that began in the second half of 2006, marked by across-the-board growth at the component level in both output and demand.

Crop/livestock production increased 2.1% in the first quarter of 2007, compared to the same period of the previous year. This result reflected a positive performance by crops of considerable weight in the first quarter of the year, including, for example, cotton, corn and soybeans, with estimated output growth of 30.7%, 24.1% and 11.7%, respectively, in 2007. To some extent, the overall result was impacted by the decline in the rice harvest, a component of particular importance in the first quarter of the year. The positive outlook for the grain harvest points to significant expansion in 2007 production. Another factor of significance was the positive performance of beef cattle, the most important component of the livestock sector.

Table 1.9 – Gross Domestic Product at market prices

% growth

	2006				2007
	I Q	II Q	III Q	IV Q	I Q
Accumulated in the year	4.1	2.7	3.3	3.7	4.3
Accumulated in 4 quarters	3.3	2.9	3.3	3.7	3.8
Quarter/same quarter of the previous year	4.1	1.5	4.5	4.8	4.3
Quarter/previous quarter 1/	1.3	-0.4	2.7	1.1	0.8
Crop/livestock	1.8	0.0	5.9	0.5	-2.4
Industry	1.2	-2.0	3.5	0.9	0.3
Services	1.2	0.3	1.3	1.1	1.7

Source: IBGE
1/ Seasonally adjusted data.

Table 1.10 – Gross Domestic Product
Accumulated in the year

% growth

	2006				2007
	I Q	II Q	III Q	IV Q	I Q
Crop/livestock	-2.7	-2.5	2.4	4.1	2.1
Industry	5.0	1.9	2.5	2.8	3.0
Mining	14.0	6.8	6.1	6.0	4.1
Manufacturing	3.4	0.2	1.1	1.6	2.8
Construction	7.3	4.8	5.2	4.6	2.4
Public utilities	3.0	2.6	3.3	3.6	3.9
Services	4.4	3.7	3.7	3.7	4.6
Commerce	6.2	4.0	4.1	4.8	6.0
Transportation	5.0	3.1	3.0	3.2	3.5
Communications	1.2	0.2	1.9	2.3	7.3
Financial institutions	9.2	9.8	7.9	6.1	9.2
Other services	2.9	2.5	2.4	2.6	3.7
Rentals	4.2	4.3	4.5	4.3	4.2
Public administration	3.2	2.8	2.9	3.1	2.1
Value added at basic prices	3.9	2.5	3.1	3.5	3.9
Taxes on products	5.3	4.4	4.6	5.2	6.9
GDP at market prices	4.1	2.7	3.3	3.7	4.3

Source: IBGE

In the first quarter, the industrial sector expanded 3% compared to the corresponding period of 2006, with emphasis on growth in the production and distribution of electricity, gas and water, 3.9%; manufacturing industry output, 2.8%; construction, 2.4%, driven by an increased flow of funding into the housing sector through real estate financing operations. Mining activity increased 4.1%, reflecting growth in the production of iron ore, 7.9%, and oil and gas, 2.6%.

In the face of rising domestic demand, the service sector expanded 4.6% in the first quarter of 2007, compared to the same period of the previous year. This process was led by financial intermediation services, insurance, private pension funds and related services, 9.2%; computer services, 7.3%; commerce, 6%; and real estate activities, 4.2%. The sectors of transportation, storage and postal services, together with administration, health and public education also turned in 3.5% and 2.1% positive growth rates, respectively, in the period.

Just as occurred under supply, all of the various demand components turned in positive performances in the first quarter of 2007, compared to the corresponding period of the previous year. Household consumption increased 6%, the 14th consecutive positive result when the corresponding quarters of subsequent years are compared. In this case, growth was caused mainly by rising real overall wages, employment and the volume of financial system credit channeled to individuals. Government consumption increased 4% and, in line with the performance of the construction industry and production and imports of machines and equipment, GFCF expanded 7.2%. Exports rose 5.9% and imports increased 19.9%. External demand contributed a -1.5 p.p. to 4.3% GDP

Revision of 2007 GDP

The GDP growth estimate for 2007 was revised upward from 4.1% in the last "Inflation Report" to 4.7%. The reasons underlying this shift were the recently announced first-quarter results, recent evolution of the economy and methodological alterations instituted by the IBGE[1].

Reflecting annual growth of 7% compared to the previous estimate of 4.8%, the current forecast incorporates a more optimistic scenario for the farm sector. This alteration mirrors expansion of 15.5% (against 11% in March) projected by IBGE's LSPA for the farm harvest, mainly involving the soybean, corn and bean crops, coupled with a continued positive outlook for the sugarcane harvest and crop output as a whole.

Growth estimates in the industrial sector dropped 0.3 p.p. to 4.4%, incorporating the first quarter 2007 result. In the coming months, the mining sector is expected to increase its output, particularly in the segments of iron ore and production and distribution of electricity, gas and water. In this framework, projected growth for the farm sector, stronger domestic demand and a continued effort on the part of exporters are projected to result in added momentum during the course of the year.

The estimate for service sector growth was altered from 2.3% to 4.3%, the component primarily responsible for the expected increase in 2007 GDP. This alteration was based mainly on methodological changes in important subsectors and strong growth in domestic demand which, in the case of services, will be met basically by domestic output.

1/ In this regard, see box "System of National Accounts – Reference 2000", released in the March 2007 Inflation Report".

Table 1 – Gross Domestic Product – Demand side

%

Period	GDP at market prices	Household consumption	Government consumption	Total consumption	GFCF	Exports	Imports
2001	1.3	0.7	2.7	1.2	0.4	10.0	1.5
2002	2.7	1.9	4.7	2.6	-5.2	7.4	-11.9
2003	1.1	-0.8	1.2	-0.3	-4.6	10.4	-1.6
2004	5.7	3.8	4.1	3.9	9.1	15.3	14.4
2005	2.9	4.7	1.9	4.1	3.6	10.1	9.3
Contribution (p.p.)		2.8	0.4	3.2	0.6	1.7	-1.2
2006	3.7	4.3	3.6	4.2	8.7	4.6	18.1
Contribution (p.p.)		2.6	0.7	3.4	1.4	0.7	-2.1
2007 (estimated)	4.7	6.1	2.9	5.3	8.5	5.7	18.8
Contribution (p.p.)		3.7	0.6	4.3	1.4	0.8	-2.2

Source: IBGE and Banco Central

Table 2 – Gross Domestic Product

Cumulative growth in the year

	2006	2006				2007	2007 1/
	Weights	I Q	II Q	III Q	IV Q	I Q	
Crop/livestock	4.4	-2.7	-2.5	2.4	4.1		7.0
Industry	26.6	5.0	1.9	2.5	2.8		4.4
Mining	2.5	14.0	6.8	6.1	6.0		6.2
Manufacturing	15.8	3.4	0.2	1.1	1.6		4.2
Construction	4.7	7.3	4.8	5.2	4.6		4.1
Public utilities	3.5	3.0	2.6	3.3	3.6		4.8
Services	55.1	4.4	3.7	3.7	3.7		4.3
Commerce	8.9	6.2	4.0	4.1	4.8		6.7
Transportation	4.4	5.0	3.1	3.0	3.2		5.1
Communications	3.6	1.2	0.2	1.9	2.3		3.4
Financial institutions	6.1	9.2	9.8	7.9	6.1		6.7
Other services	11.8	2.9	2.5	2.4	2.6		3.2
Rentals	7.6	4.2	4.3	4.5	4.3		4.1
Public administration	12.7	3.2	2.8	2.9	3.1		2.5
Value added at basic prices		3.9	2.5	3.1	3.5		4.5
Taxes on products	13.9	5.3	4.4	4.6	5.2		6.0
GDP at market prices	100.0	4.1	2.7	3.3	3.7		4.7

Source: IBGE and Banco Central

1/ Estimated.

Consequently, the good performance of the service sector reflects methodological improvements aimed at measuring the performance of this sector, as well as recouping in other segments of the economy that, among other areas, have a direct impact on the subsectors of commerce, transportation, storage and postal services.

Viewed under the prism of demand, growth estimates for GFCF shifted from 7.1% to 8.5%. For the most part, this increase reflects first quarter expansion under investments and is considered clearly consistent with the increased optimism found within the business community and ongoing reductions in investment costs.

Alterations in the weighting of the various GFCF components became an additional determinant underlying the increase in the annual projection. In this sense, in the current GDP calculation methodology, the participation of the capital goods segment has become more relevant than the construction industry, since the former has demonstrated considerably greater dynamics.

Projections for imported volume closed at 18.8%. Growth of 4.8 p.p. compared to the previous estimate not only incorporated recent results but also considered continuation of the current trajectory of domestic demand.

Estimates for household consumption, government consumption and exports were revised upward to 6.1%, 2.9% and 5.7%, respectively, with relatively small changes compared to previous projections.

In this scenario, the contribution of domestic demand to GDP growth is estimated at 6.1 p.p., including changes in stock volumes, while the contribution of the external sector is expected to be a negative 1.4 p.p., marking the second consecutive year in which economic expansion has depended exclusively on burgeoning domestic demand.

growth in the quarter, while the overall impact of domestic demand reached 5.8 p.p., using inventory changes as the measuring rod.

1.5 Investments

As released by IBGE, the Quarterly National Accounts indicate that investments – excluding inventory changes – expanded 7.2% in the first quarter of 2007, compared to the same period of 2006. This was the 13th consecutive quarter of positive growth using this type of comparison. In much the same way, an analysis at the margin based on seasonally adjusted data reveals the dynamics of this segment, with 2.1% growth compared to the quarter ended in December 2006.

The positive performance of investments in the first quarter of the year was anticipated by the trajectory of monthly GFCF indicators. Absorption of capital goods, the major component of GFCF continued expanding in the quarter, a period during which domestic output rose 14.8%; exports increased 11.2%; and imports grew 30.9%.

Viewed against the same period of 2006, quarterly growth in capital goods output reflected across-the-board sectoral expansion, led by mixed use capital goods, 18.3%; typically industrialized products, 15.9%; and products channeled to the farm sector, 13%. Powered by recovery in farm income, the latter sector is expected to post accentuated growth over the course of the year, as suggested by more recent National Association of Automotive Vehicle Manufacturers (Anfavea) data, pointing to 17% cumulative growth in the year through May in farm machine output, compared to the same period of 2006.

Parallel to this, it is important to stress more recent evolution in the production of building industry inputs and capital goods, with respective annual growth rates of the 3.5% and 15.4% through April, together with 8.4% and 32% expansion in exports and imports of capital goods, respectively, in the same period, thus further reinforcing the already positive outlook for 2007 investments. This benign scenario is further strengthened by the evolution of such leading indicators as Brazil risk, measured by the Emerging Markets Bond Index Plus (Embi+), released by J.P. Morgan, by the already historically low level of interest and by continued growth in farm income.

Table 1.11 – Gross Domestic Product[1/]
Accumulated in the year

% growth

	2006				2007
	I Q	II Q	III Q	IV Q	I Q
GDP at market prices	4.1	2.7	3.3	3.7	4.3
Household consumption	4.0	4.1	4.1	4.3	6.0
Government consumption	5.0	4.3	4.1	3.6	4.0
GFCF	11.8	8.5	8.4	8.7	7.2
Exports	8.2	3.0	4.5	4.6	5.9
Imports	15.6	14.4	16.5	18.1	19.9

Source: IBGE
1/ Seasonally adjusted.

Table 1.12 – Gross Domestic Product
Quarter/previous quarter
Seasonally adjusted

% growth

	2006				2007
	I Q	II Q	III Q	IV Q	I Q
GDP at market prices	1.3	-0.4	2.7	1.1	0.8
Crop/livestock	1.8	0.0	5.9	0.5	-2.4
Industry	1.2	-2.0	3.5	0.9	0.3
Services	1.2	0.3	1.3	1.1	1.7
Household consumption	-0.2	2.1	1.2	1.7	0.9
Government consumption	2.7	-0.2	0.4	-0.2	3.5
GFCF	4.8	-1.6	4.6	1.8	2.1
Exports	0.7	-4.0	10.0	-1.2	1.2
Imports	7.1	1.9	8.3	3.8	4.1

Source: IBGE

1.6 Conclusion

Since the second half of 2006, economic growth has been driven by the dynamics of domestic demand. The growth cycle registered under household consumption has been sustained both by increased income and employment and by improved credit conditions.

Strong growth in investment flows in the early months of 2007 reveals recovery in farm income, high levels of business confidence, an already low Brazil risk rating, the volume of capital goods imports, together with the ongoing process of monetary policy easing. In this context, the recent upturn in utilization of installed industrial output capacity, a factor fully compatible with the increased dynamics of production, is not expected to raise any obstacles whatsoever to continued strong and sustained economic activity over the short-term. Over the medium-term, conditions remain benign, particularly when one considers the already positive posture adopted by the business community, most notably in segments with lesser degrees of idleness, when viewed against growth in productive capacity.

On the external front, imports have expanded more rapidly than exports, due to the dynamics of the internal market and the opportunities that have arisen to expand productive capacity. Here, one should note that growth in capital goods imports surpassed total average volume expansion of imports, thus reinforcing expectations that installed output capacity will progressively adjust to the scenario of continued expansion in domestic demand.

Prices

2

Compared to the three-month period ended in February, inflation declined in the March-May period. Basically, benign evolution of general price indices was a consequence of lower farm prices, while the prices of industrialized products increased.

Deceleration in consumer prices mainly reflected lesser pressures in the segments of food and education. However, one should stress that, in the first case, the underlying cause was a decline in the prices of perishable foodstuffs while, in the second, the cause was exhaustion of the impact of annual increases in monthly tuition payments. Cumulative 12-month consumer inflation has remained close to 3% since October 2006, reinforcing expectations of continuation of the current cycle of the Brazilian economic growth.

2.1 General indices

Table 2.1 – General price indices

Monthly % change

	2007				
	Jan	Feb	Mar	Apr	May
IGP-DI	0.43	0.23	0.22	0.14	0.16
IPA	0.32	0.19	0.11	0.02	-0.04
IPC-Br	0.69	0.34	0.48	0.31	0.25
INCC	0.45	0.21	0.27	0.45	1.15

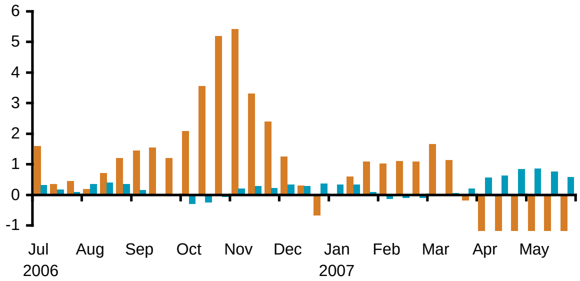
Source: FGV

FGV's General Price Index (IGP-DI) increased 0.51% in the three-month period ended in May, against 0.93% in the previous three-month period, with a 4.5% reduction in wholesale farm prices. The IGP-DI posted a cumulative 12-month high of 4.38%, compared to 3.79% in the 12-month period ended in February. To some extent, this reflected a 0.05% drop in the March-May 2006 period.

The Wholesale Price Index (IPA-DI) expanded 0.09% in the three-month period ended in May, compared to 0.62% in the previous three-month period and -0.52% in the corresponding three-month period of 2006. Farm prices dropped 4.5%, compared to a 1.49% high in the December-February period. Here, it is important to stress downward movement in the prices of fruits and vegetables, 15.84%; corn, 14.66%; and soybeans, 7.98%. The underlying causes of the rise in industrial prices in the March-May period (1.63%, compared to 0.34% in the December-February period) were price hikes in the segments of mechanics, 14.3%; diesel oil, 11.85%; and gasoline, 17.01%. Moving in the opposite direction,

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

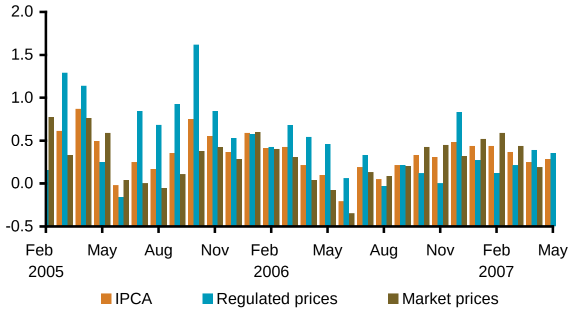
Monthly % change



Source: FGV

Figure 2.2 – IPCA

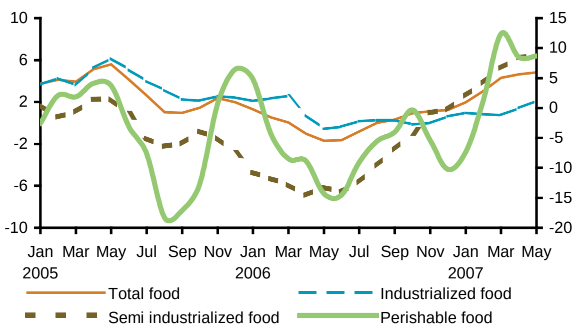
Monthly % change



Source: IBGE

Figure 2.3 – IPCA – Food

12-month % change



Source: IBGE

reductions were posted under perfumes and soaps, 16.13%; and oils and lubricants, 2.84%.

Cumulative 12-month IPA-DI growth closed May at 4.76%, against 4.12% in February.

2.2 Consumer price index

IBGE's IPCA rose 3.18% in the 12-month period ended in May, with increases of 2.88% in the prices of regulated goods and services and 3.3% under market prices.

Compared to 1.37% growth in the three-month period ended in February, the March-May index closed at 0.9%, reflecting downward movement under both market and regulated prices. Growth in market prices dropped from 1.43% to 0.88% in the period under consideration. This result indicated, on the one hand, a reduction from 2.29% to 0.82% in the prices of nontradable goods and services coupled, on the other hand, with growth from 0.52% to 0.95% in the prices of tradables.

Though caused mainly by the seasonal nature of perishable food prices and education outlays, three-month deceleration in the prices of tradables reflected a downturn of 1.26 p.p. in service prices to 0.82% in the period. Cumulative 12-month growth in the prices of services reached 4.88% in May, against 5.12% in February, the lowest percentage since October 2002 despite an increase from 10.85% to 12.15% under the item of household employees, in the period.

In the three-month period ended in May, the prices of regulated goods expanded 0.88%, compared to 1.22% in the December-February period. This performance was driven by an accentuated drop under urban bus fares, 0.36% against 8.05%, in the three-month periods under consideration.

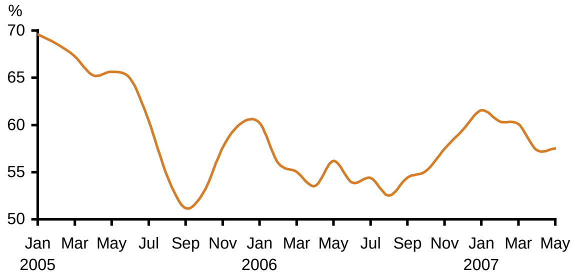
As regards market prices as a whole, the items that made the greatest contribution to the process of deceleration in the final three months were condominium fees, -0.74% against the 3.24%; oils and fats, -3.34% against 7.15%; perishable food products, 0.11% against 10.32%; and courses, 0.24% compared to 4.28%.

The diffusion index, which measures the proportion of IPCA components with positive growth results, posted an average of 57.47% in the three-month period ended in May, against 60.33% in the December-February period, a performance considered compatible with deceleration in prices during the period.

Figure 2.4 – IPCA diffusion index

% of subitems with increase[1/]

Quarterly moving average

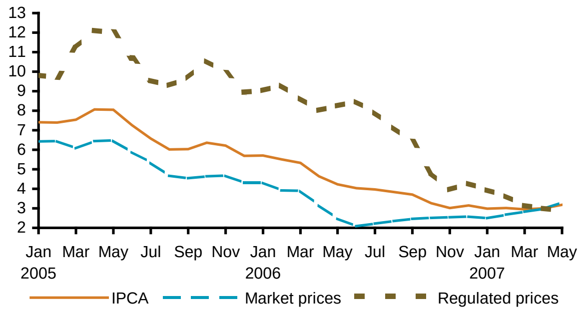


Source: IBGE

1/ IPCA is composed of 384 subitems.

Figure 2.5 – IPCA

12-month % change



Source: IBGE

Table 2.2 – IPCA

% change

	Weights	2007					
		Jan	Feb	Mar	Apr	May	Year
IPCA	100.0	0.44	0.44	0.37	0.25	0.28	1.76
Market prices	68.85	0.52	0.59	0.44	0.19	0.21	1.95
Regulated prices	31.15	0.27	0.12	0.21	0.39	0.35	1.34
Main items		0.00	0.00	0.00	0.00	0.00	0.00
Electricity	3.81	-1.04	-0.10	-0.46	0.37	0.47	-0.77
Water and sewage	1.61	0.00	0.00	1.24	0.72	0.19	2.16
Urban bus	3.78	1.66	1.60	0.09	0.03	0.24	3.66
Air ticket	0.28	0.27	0.27	0.03	-0.83	-0.43	-0.69
Gasoline	4.68	-0.57	-0.86	0.72	0.66	0.33	0.27
Bottled gas	1.21	-0.04	-0.05	-0.26	0.23	-0.25	-0.37
Medicine	2.99	0.30	0.00	-0.26	0.50	0.68	1.22
Health plans	3.26	0.75	0.75	0.76	0.76	0.75	3.83

Source: IBGE

The outlook regarding IPCA evolution is quite favorable for the coming months, considering not only the absence of any significant pressures on specific items, with the sole exception of dairy products, but also the fact that price behavior should reflect the expected cutback in the prices of fuel alcohol, as a result of a sharp upturn in seasonal supply of the product.

2.3 Regulated prices

In the three-month period ended in May, regulated prices increased 0.95%, accounting for 0.29 p.p. of 0.9% growth in the IPCA for the period. The greatest pressures originated under gasoline, 1.72%; health plans, 2.29%; water and sewage rates, 2.16%; cell telephone service, 1.83%; and postal services, 9.08%.

Above all else, the behavior of regulated prices reflected the lesser rigidity of these prices, making it possible to more precisely predict medium and long-term inflation. Cumulative 12-month growth in regulated prices has dropped since December 2006, closing May at 2.88%, a figure that was only higher than the 2.63% growth rate registered in November 1988.

Expectations regarding regulated prices in the coming months remain positive. Reductions are expected under both anhydrous alcohol prices and electricity rates in the Eletropaulo region of the country, considering the proposal put forward by the Brazilian Electricity Regulatory Agency (Aneel) regarding the possibility of a 5.4% rate reduction as of July.

2.4 Cores

Inflation cores accompanied deceleration in the headline index in the three-month period ended in May. The core measurement calculated through exclusion of regulated prices and household food posted a high of 0.86% in the period, against 1.28% in the three-month period ended in February, with cumulative 12-month growth of 3.04% and 2.9%, respectively.

The smoothed trimmed-means core accumulated a high of 0.88% in the three-month period ended in May, compared to 1.01% in the December-February period, with respective rates of 12-month growth equivalent to 3.68% and 4.14%.

Table 2.3 – Consumer prices and core inflation

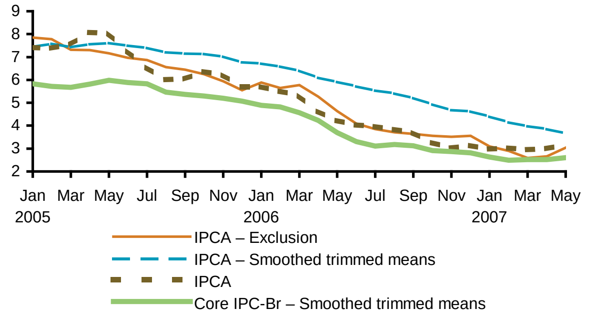
Monthly % change

	2007				
	Jan	Feb	Mar	Apr	May
IPCA	0.44	0.44	0.37	0.25	0.28
Exclusion	0.41	0.52	0.23	0.29	0.33
Trimmed means					
Smoothed	0.39	0.24	0.29	0.29	0.30
Non smoothed	0.35	0.22	0.24	0.28	0.30
IPC-Br	0.69	0.34	0.48	0.31	0.25
Trimmed means	0.26	0.16	0.27	0.32	0.30

Source: IBGE, Bacen and FGV

Figure 2.6 – Core inflation

12-month % change



Source: IBGE, Bacen and FGV

Figure 2.7 – IPCA

Median

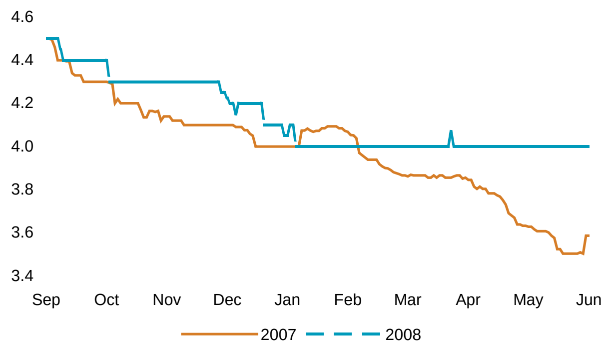
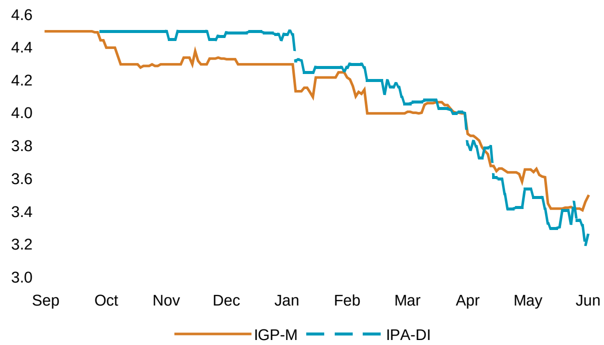


Figure 2.8 – IGP-M and IPA-DI

Median 2007



The non-smoothed trimmed-means core rose 0.83% in the three-month periods considered, with cumulative 12-month growth of 2.39% in the period ended in May, against 2.29% in the December-February period.

FGV's Consumer Price Index – Brazil (IPC-Br) core, calculated according to the trimmed-means methodology, rose 0.89% in the March-May period, against 0.73% in the period extending from December 2006 to February 2007.

2.5 Market expectations

As gathered by BCB's Executive Investor Relations Group (Gerin), median expectations for 2007 IPCA dropped from 3.9% at the end of the first quarter of the current year to 3.6% in the second week of June. For 2008, inflation expectations remained at 4%. These projections are consistent with the 4.5% inflation target, with a two percentage point margin, as defined by the CMN.

Expectations of 12-month ahead IPCA evolution diminished from 3.7% at the end of March to 3.4% in the second week of June, thus confirming perceptions of a benign inflation scenario. The outlook for both lesser inflationary inertia and compliance with inflation targets for the fifth consecutive year have certainly aided in lowering future inflation expectations to sharply lower levels.

With regard to 2007 and 2008 general price indices, estimates point to slight downward movement. For 2007, median estimates for the General Price Index – Market (IGP-M) and the IPA-DI reached 3.6% and 3.3%, respectively, in the second week of June, compared to 4.1% and 4% at the end of March. For 2008, median market projections for the IGP-M and the IPA-DI remained at 4%.

The outlook for smaller increases in regulated prices has aided greatly in consolidating a scenario of lesser inflationary inertia and facilitating anchoring of expectations to the target path. Median expectations regarding correction of regulated prices in 2007 closed the second week of June at 3.2%, compared to 3.8% at the end of March. For 2008, the projection diminished from 4% to 3.8%.

Market projections for the rate of exchange fell during the period under consideration, reflecting perceptions that the positive external account scenario will continue. In 2007, the median for average and end-of-period exchange rates moved from R$2.10/US$ and R$2.11/US$, respectively, at

Figure 2.9 – Exchange rate

Median 2007

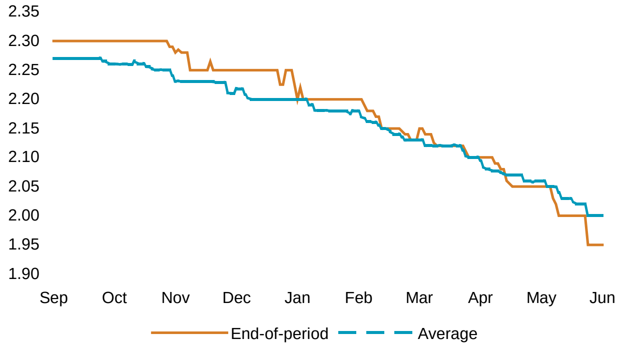


Table 2.4 – Summary of market expectations

	12.29.2006		3.30.2007		6.15.2007	
	2007	2008	2007	2008	2007	2008
IPCA	4.0	4.1	3.9	4.0	3.6	4.0
IGP-M	4.3	4.2	4.1	4.0	3.6	4.0
IPA-DI	4.5	4.3	4.0	4.0	3.3	4.0
Regulated Prices	4.0	4.0	3.8	4.0	3.2	3.8
Selic (end-of-period)	11.8	11.0	11.5	10.5	10.8	9.8
Selic (average)	12.3	11.5	12.2	11.0	11.8	10.3
Exchange rate (end-of-period)	2.25	2.35	2.11	2.20	1.93	2.00
Exchange rate (average)	2.20	2.30	2.10	2.17	1.99	2.00
GDP growth	3.5	3.5	3.5	3.6	4.3	4.0

the end of March, to R$1.99/US$ and R$1.93/US$, in the second week of June. Using the same basis of comparison, median expectations for average 2008 exchange dropped from R$2.17/US$ to R$2.00/US$, while expectations regarding the end-of-period rate shifted from R$2.20/US$ to R$2.00/US$.

Projections for the Selic rate kept pace with the downward trend in inflation indicators. The Selic rate projected for end-2007 was revised downward from 11.5% per year at the end of March to 10.8% per year in the second week of June, while the forecast for the average Selic rate dropped 0.4 p.p., closing at 11.8% per year. Parallel to this, Selic rate projections for the end of 2008 dropped 0.7 p.p. in the period, closing at 9.8% per year, while the forecast for the average rate in the coming year was revised downward from 11% per year to 10.3% per year.

Using the same basis of comparison, forecasts of GDP growth for 2007 increased from 3.5% to 4.3%, while the forecast for 2008 rose from 3.6% to 4%.

2.6 Conclusion

Above all else, the positive evolution of prices in recent months reflected the end of seasonal pressure generated by perishable food products and courses. It should be stressed that 12-month trailing inflation has remained at a level of 3% since the fourth quarter of 2006, despite upward pressures at the end of the year and early months of 2007 caused by rising food prices in a framework of climatic adversities and rising international demand.

As far as inflation is concerned, the outlook for the coming months remains positive, even when the accelerated pace of economic growth is taken into account. Internally, one should emphasize the positive aspects of price reductions under several important items, such as electricity rates. Nonetheless, expectations indicate that continued world economic expansion will generate added pressures on international food and energy prices, while greater domestic demand will contribute to pressures on the prices of nontradable goods and services.

Credit, monetary and fiscal policies

3

3.1 Credit

Consistent with the expanding pace of economic activity, declining interest and longer loan maturities, financial system credit operations continued expanding in the three-month period ended in April. Growth was sustained by the performance of nonearmarked credit portfolios and, more specifically, by increased corporate loan operations.

Including both nonearmarked and earmarked resources, financial system loans and financing totaled R$777.3 billion in April, up 5.3% in the three-month period and 21.9% over twelve months. The ratio between total loan volume and GDP closed at 32%, compared to 30.9% in January and 28.9% in April 2006. A breakdown of financial institutions according to capital control shows that operations by private national banks accounted for 41.5% of the total loan portfolio, followed by public institutions, 36.3%, and foreign banks, 22.2%.

In terms of distribution among the various economic activity sectors, financial system credit operations with the private sector totaled R$758.3 billion in April, with growth of 5.4% compared to January. Operations with the trade sector increased 6.4% in the three-month period, followed by loans to industry, 5.9%, and other services, 3.7%.

In the month of April, operations with the public sector totaled R$19 billion, up 0.8% in the three-month period. This performance reflected 2.7% growth in the banking debt of state and municipal governments, totaling R$15 billion, together with a 5.6% cutback in loans granted to the federal government, in an overall amount of R$4 billion.

The volume of provisions set aside by financial institutions accounted for 6.1% of the total loan portfolio in April, corresponding to a 0.2 p.p. reduction compared to January. This result was also driven by declining loan portfolio delinquency from 3.8% to 3.6% in the same period.

Table 3.1 – Credit operations

R$ billion

	2007				% growth	
	Jan	Feb	Mar	Apr	3 months	12 months
Total	738.5	748.5	759.2	777.3	5.3	21.9
Nonearmarked	501.3	511.3	521.2	537.7	7.3	24.8
Earmarked	237.2	237.2	238.0	239.7	1.1	16.0
% participation:						
Total/ GDP	30.9	31.1	31.4	32.0		
Nonearmarked/GDP	20.9	21.3	21.6	22.1		
Earmarked/GDP	9.9	9.9	9.9	9.9		

Figure 3.1 – Credit by capital control of financial institutions

% of balance

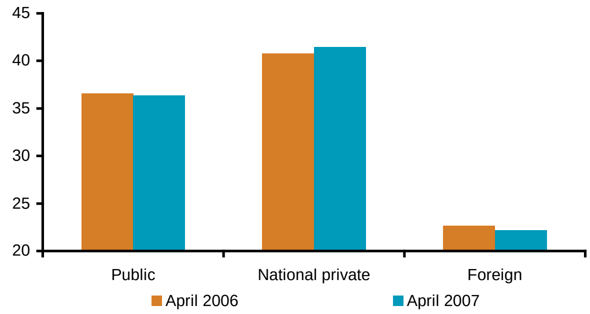


Figure 3.2 – Credit by borrower's economic activity – National private institutions

%

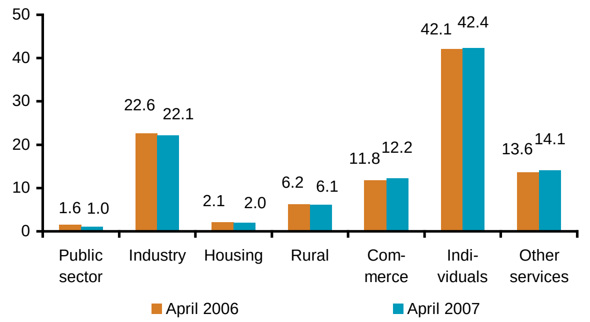


Figure 3.3 – Credit by borrower's economic activity – Public institutions

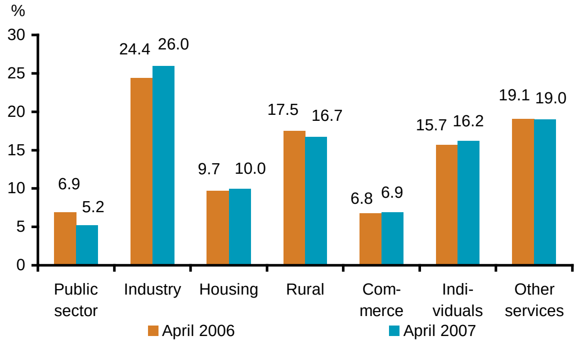


Figure 3.4 – Credit by borrower's economic activity – Foreign institutions

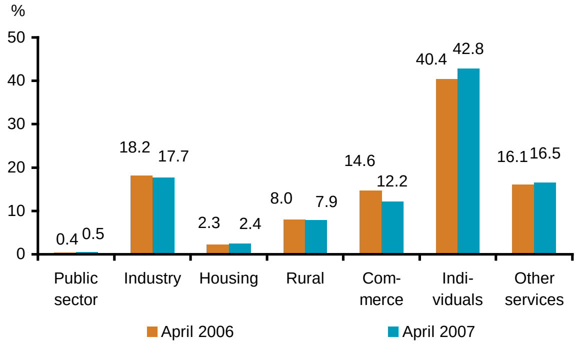


Figure 3.5 – Provisions of total financial system credit

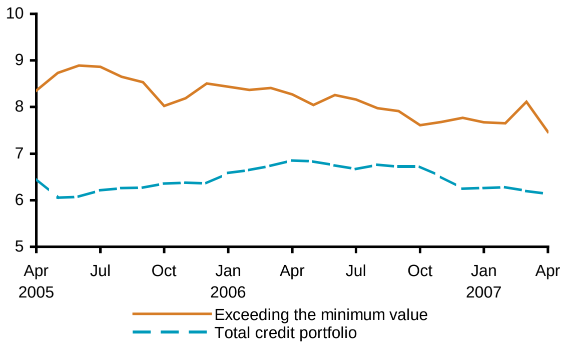


Table 3.2 – Earmarked credit operations

R$ billion

	2007				% growth	
	Jan	Feb	Mar	Apr	3 months	12 months
Total	237.2	237.2	238.0	239.7	1.1	16.0
BNDES	140.9	140.1	139.5	139.8	-0.8	12.5
Direct	73.2	72.9	71.3	70.6	-3.6	7.2
Onlendings	67.7	67.2	68.2	69.2	2.3	18.5
Rural	54.5	54.8	55.4	56.0	2.7	21.0
Banks and agencies	52.0	52.3	52.8	53.3	2.6	20.1
Credit unions	2.5	2.5	2.6	2.7	6.0	43.3
Housing	35.4	35.9	36.7	37.3	5.5	22.8
Others	6.4	6.5	6.5	6.6	2.6	13.7

Earmarked credit

Loan operations based on earmarked resources totaled R$239.7 billion in April, for growth of 1.1% compared to January and 16% over the last twelve months. The three-month result basically reflected growth of 5.5% and 2.7% in financing granted to the housing and rural sectors.

Financing targeted to housing reached R$37.3 billion in April, up 5.5% over January. The rural sector credit portfolio amounted to R$56 billion, up 2.7% in the three-month period, with a particularly strong increase in funding targeted to agricultural investments.

In the three-month period ended in April, the stock of National Bank of Economic and Social Development (BNDES) operations declined 0.8%, to a total of R$139.8 billion. Moving in the opposite direction, BNDES disbursements increased 39.8% in the January-April period, compared to the same period of the preceding year, and closed at R$14.9 billion. At the sectoral level, one should stress 53% growth in disbursements to industry, with R$7.4 billion, heavily concentrated in operations with the sector of basic metallurgy, an area that has been operating with high levels of output capacity utilization. Financing contracted by commerce and services rose 30.6% to R$6 billion, focused mainly on land transportation. Disbursements to farming activities totaled R$1.5 billion, an increase of 21.9% in the period.

Consultations with BNDES, considered a measuring rod of potential medium and long-term investments by the productive sector, totaled R$36.3 billion in the first four months of the year, corresponding to 42.5% growth over the same period of 2006. This performance was impacted by 102% growth in demand in the sector of commerce, including services, with an overall volume of R$18 billion. For the most part, this result reflected a greater number of consultations originating in the sectors of construction, energy and electricity. Requests on the part of industry totaled R$17 billion, an increase of 10.5%, led by the segments of oil refining, coke and alcohol, metal products and food and beverages.

Nonearmarked credits

In the month of April, loans based on nonearmarked resources totaled R$537.7 billion, reflecting growth of 7.3% compared to January and 24.8% over twelve months. Participation of

Figure 3.6 – Credit to housing with resources from savings deposits – January-February

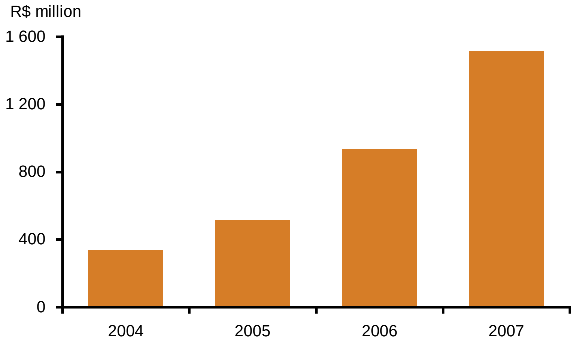


Table 3.3 – BNDES disbursements

R$ million

	Jan-Apr		% growth
	2006	2007	
Total	10 625	14 852	39.8
Industry	4 826	7 386	53.0
Other transportation equipment[1/]	1 501	247	-83.5
Motor vehicles	536	602	12.3
Basic metallurgy	185	2 248	1115.1
Food and beverages	686	1 201	75.1
Chemical	139	338	143.2
Petroleum, coke and alcohol refining	52	450	765.4
Commerce and services	4 574	5 973	30.6
Overland transportation	2 071	2 630	27.0
Electricity, gas and hot water	675	1 003	48.6
Construction	379	416	9.8
Commerce and vehicle repairs	377	550	45.9
Crop/livestock	1 225	1 493	21.9

Source: BNDES

1/ Includes aircraft industry.

Table 3.4 – Nonearmarked credit operations

R$ billion

	2007				% growth	
	Jan	Feb	Mar	Apr	3 months	12 months
Total	501.3	511.3	521.2	537.7	7.3	24.8
Corporations	258.4	264.3	269.1	279.0	8.0	24.2
Domestic funding	205.9	211.1	214.3	219.3	6.5	25.9
Reference credit[1/]	163.0	166.3	169.6	172.1	5.6	20.3
Leasing	21.0	21.3	21.6	22.3	6.1	60.8
Rural	2.0	2.0	1.9	1.9	-1.9	-19.0
Others	19.9	21.5	21.1	23.0	15.4	54.7
External funding	52.4	53.2	54.8	59.7	13.8	18.5
Individuals	242.9	247.0	252.0	258.7	6.5	25.4
Reference credit[1/]	196.4	200.6	204.4	209.0	6.4	21.5
Credit unions	10.0	10.3	10.4	10.6	6.3	20.5
Leasing	14.6	15.3	16.4	17.4	18.8	66.9
Others	21.9	20.9	20.8	21.6	-1.3	44.0

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

these loans in the total financial system credit stock moved to 69.2% in April, against 67.9% in January.

Credit operations with corporations totaled R$279 billion in April, for growth of 8% in the three-month period and 24.2% in twelve months. Operations backed exclusively by external resources consisted entirely of interest rate reference credits, registering expansion of 13.8% and 18.5%, respectively, using the same bases of comparison. It is important to stress that, to a great extent, growth in the three-month period resulted from 23.7% expansion in Advances on Exchange Contracts (ACC).

The portfolio backed by domestic resources expanded 6.5% in the three-month period and 25.9% in twelve months, closing at R$219.3 billion. The volume of interest rate reference credits, which accounted for 78.5% of total domestic resources in April, reached R$172.1 billion, up 5.6% in the three-month period. Following the same line, leasing operations expanded 6.1% while operations targeted to the rural sector dropped 1.9% in the same period.

The stock of credit operations targeted to individuals reached R$258.7 billion in April, with growth of 6.5% compared to January and 25.4% in twelve months. For the most part, the three-month result was generated by 6.4% expansion in reference credits, registering a balance of R$209 billion, accounting for 80.8% of the overall volume of operations with individuals. The modalities of personal credit and auto loans rose 7.6% and 5.6% in the three-month period, in that order.

The volume of loans targeted to individuals by credit unions reached R$10.6 billion in April, for an increase of 6.3% over the January figure. In much the same way, leasing operations expanded 18.8%, totaling R$17.4 billion.

The average interest rate of nonearmarked reference credit operations dropped 1.8 p.p. in the three-month period, closing at 38.1% per year, the lowest level since the statistical series was first calculated in June 2000. This result reflects declines of 3.2 p.p. in the segment of individuals and 0.9 p.p. in that of corporations, with reductions of 1.1 p.p. in fixed rate charges and 0.9 p.p. in postset charges. The banking spread reached 26.4 p.p., for a reduction of 1 p.p. compared to the month of January.

The delinquency rate in the credit portfolio based on nonearmarked resources reached 4.8% in April, down 0.2 p.p. compared to January. This result mainly reflected a 0.4 p.p. decrease in arrears on operations with individuals

Figure 3.7 – Interest rates on nonearmarked credit

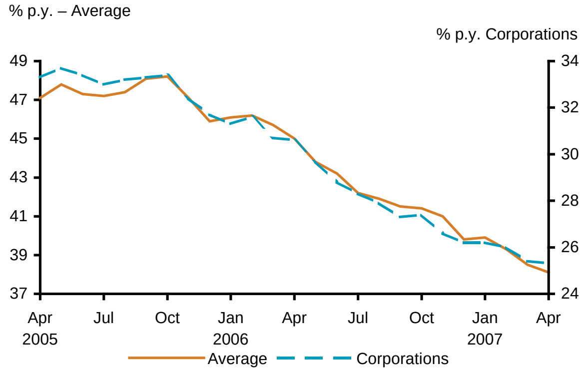


Figure 3.8 – Interest rates on fixed rate credit – Individuals

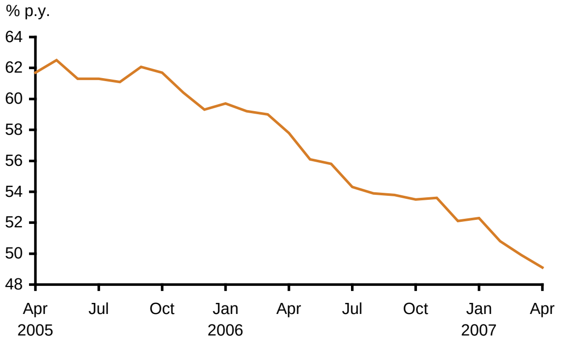


Figure 3.9 – Average spread on nonearmarked credit

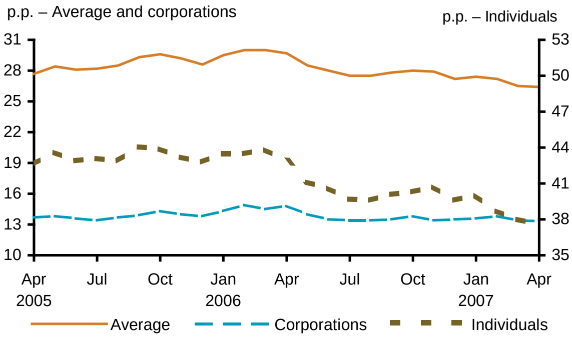
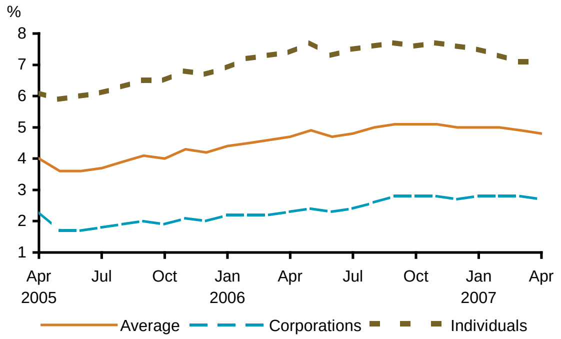


Figure 3.10 – Credit default rates[1/]



1/ Nonearmarked credit in arrears of more than ninety days.

resulting, to some extent, from assigns of higher risk credits to institutions that are not financial system members, as well as renegotiations and write-offs of unpaid debts. Parallel to this, delinquency rates in corporate credit operations declined 0.1 p.p.

Excluding operations involving special overdraft checks and guaranteed overdraft accounts, the average maturity of the interest rate reference credit portfolio reached 348 days in April 2007, up 45 days (15%) over the same period of 2006. In operations with individuals, average maturity came to 416 days, representing an increase of 67 days (19%), attributed mainly to growth in payroll-deducted loans and financing of product acquisitions, both of which are longer-term modalities. In the corporate segment, average maturities closed at 281 days, an increase of 24 days (9%) in the same period. In this case, the highlights were working capital operations.

3.2 Monetary aggregates

Based on average daily balances, the restricted money supply (M1) reached R$158.5 billion at the end of May, for growth of 20.1% in the last twelve months. This growth resulted from increases of 20.8% in the average balance of currency held by the public and 19.6% in demand deposits.

Analysis of seasonally adjusted data deflated by the IPCA in the three-month period ended in May indicates a continued upward trend under M1 in 2007. Growth of 3.7% compared to the three-month period ended in February was consistent with real growth in overall wages, particularly the minimum wage, and the pace of growth in loan operations.

In May, average daily monetary base balances reached R$111.3 billion. Growth of 22.6% over twelve months was generated by 21.7% expansion in the average balance of currency issued and 24.8% under banking reserves.

With regard to the sources of primary currency issues in the March-May period, external sector operations generated a R$68.8 billion expansionary impact as a result of net Bacen purchases on the interbank exchange market. Moving in the opposite direction, National Treasury operating account transactions resulted in a R$14.7 billion decline, while other operations with the financial system expanded R$3.2 billion. Coupled with net placements of federal public securities amounting to R$54.2 billion, this behavior resulted in a R$3.1 billion increase in the monetary base in

Figure 3.11 – Average term of credit operations – Calendar day

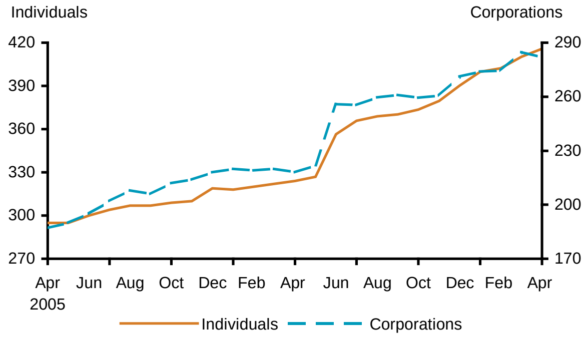


Figure 3.12 – Monetary base and M1 – Average daily balances

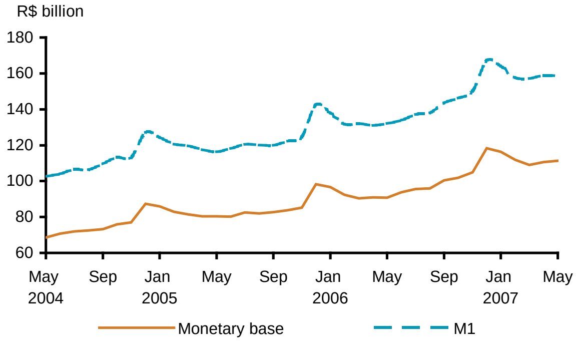
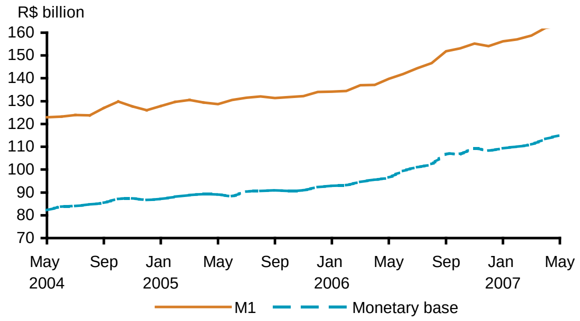
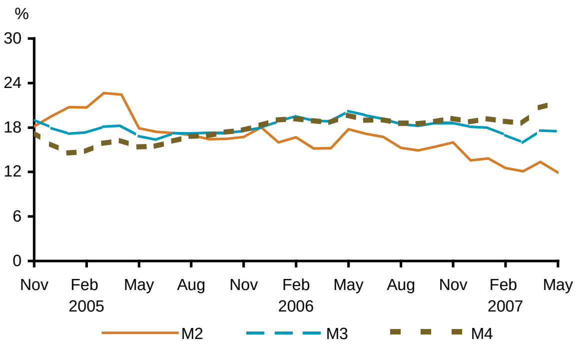


Figure 3.13 – M1 and monetary base at May 2007 seasonally adjusted prices[1/]



1/ Deflated by IPCA.

Figure 3.14 – Broad money supply 12-month growth



the three-month period, based on the criterion of end-of-period balances.

In the M2 concept, which aggregates investment deposits, savings deposits and securities issued by financial institutions, the month of May registered 11.9% growth over the same period of 2006. In the period, growth in the savings account balance reached 4.4%, while time deposits expanded 1.9%.

The M3 concept, which aggregates into M2 investment fund quotas and federal public securities used as backing for the net financing position in repo operations between the financial sector and nonfinancial public sector, expanded 4.1% compared to the February position and 17.5% over twelve months, closing with a total amount of R$1.5 trillion. The M4 concept, which incorporates public securities held by the nonfinancial sector into M3, expanded 21.4% over the same period of the previous year, closing with a total of R$1.7 trillion. Here, it is important to stress 52.8% growth in federal public securities belonging to nonfinancial institutions. To this point, the strong growth registered under the various monetary aggregates has met demand for currency without generating inflation, in an environment of enhanced predictability and lesser risk.

Federal public securities and Bacen open market operations

Primary National Treasury operations with federal public securities generated net placements of R$18.3 billion in the three-month period ended in May, with placements of R$155.2 billion and redemptions of R$136.9 billion. The strategy of lengthening average debt terms in an environment of enhanced stability made it possible to exchange securities in an amount of approximately R$40.8 billion, of which 48% were National Treasury Notes – Series B (NTN-B).

The lengthening of public debt bond maturities, coupled with substitution of FX-indexed papers and Selic rate bonds with fixed rate and inflation-linked securities, considered two of the major guidelines set out in the National Treasury's Annual Financing Plan (PAF), became feasible exclusively as a consequence of growing confidence in Bacen monetary policy. The fact of the matter is that the average term of the Internal Federal Public Securities Debt (DPMFi) increased from 31.64 months in February to 33.28 months in May, partly reflecting issuance of NTN-B, a longer-term security. In the same sense, acceptance of fixed-rate securities by the public resulted in an important shift in the DPMFi profile,

Figure 3.15 – Net financing position of the federal public securities – Daily average

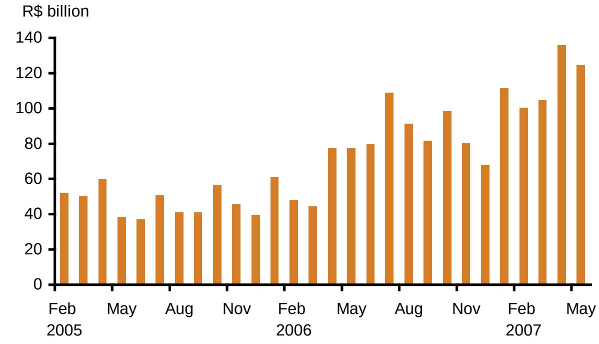


Figure 3.16 – Central Bank repo operations – Volume by maturity – End-of-period

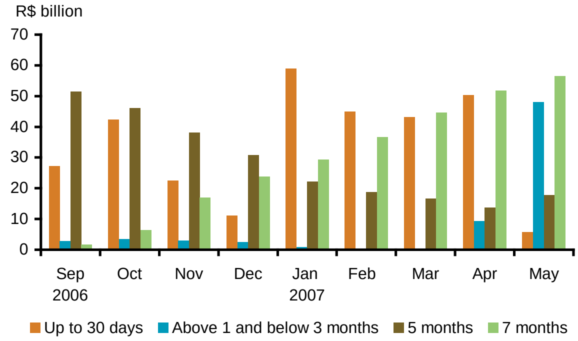


Figure 3.17 – Ex-ante real interest rate – Deflated by 12-month IPCA expectations

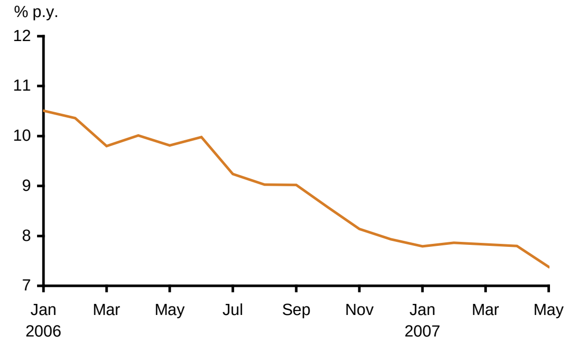
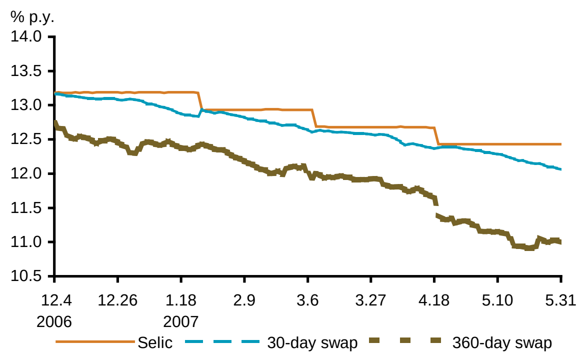


Figure 3.18 – Selic x swap DI x Pre



Source: BM&F

with greater participation of these papers in total end-May composition.

With the impact of primary National Treasury operations and foreign currency purchases by the monetary authority during the period, the average daily balance of financing and go-around operations carried out by Bacen dropped from R$45 billion in early March to R$5.7 billion at the end of May, with the objective of adjusting system liquidity. It should be stressed that this drop occurred parallel to growth in the average daily balances of longer-term operations, considered a trend consistent with the longer horizon of predictability implicit in the macroeconomic scenario, providing the monetary authority with enhanced freedom in its task of liquidity management. In structural terms, following the R$136 billion April peak explained by maturities of National Treasury Bills (LTN), the net Bacen financing position on the open market increased from R$100.5 billion in March to R$124.6 billion in May.

Consolidating the asset position in federal public debt exchange exposure, monetary authority placements of reverse exchange swaps totaled US$11.3 billion in the three-month period ended in May, while redemptions in this modality accounted for US$3.3 billion.

Real interest rates and market expectations

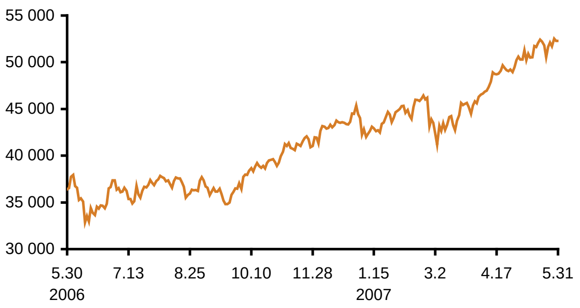
In the three-month period ended in May, interest rate futures in DI x pre swap contracts moved downward in all of the different vertices, with the sharpest falloffs registered under longer-term contracts. This movement reflected consolidation of the benign domestic inflation scenario coupled with a drop in country risk, averaging 163 points in the three-month period, compared to 194 points in the three-month period ended in February. Rates on 360 day DI x pre swap contracts closed at 10.99% per year at the end of May, for a reduction of 111 basis points compared to the end of February.

The real ex-ante Selic interest rate for the coming twelve months, calculated according to Bacen's Market Report survey dated May 31, reached 7.4% per year, compared to 7.9% per year at the end of February. The decline in the real rate mainly reflected adjustments in expectations regarding evolution of the Selic rate, in light of the ongoing process of monetary policy easing which, coupled with a scenario or price stability, clearly favors attenuation of uncertainties and, consequently, of risk premiums.

Capital markets

Figure 3.19 – Ibovespa

Points



Source: Bovespa

Figure 3.20 – Stock exchanges

May 2006 = 100

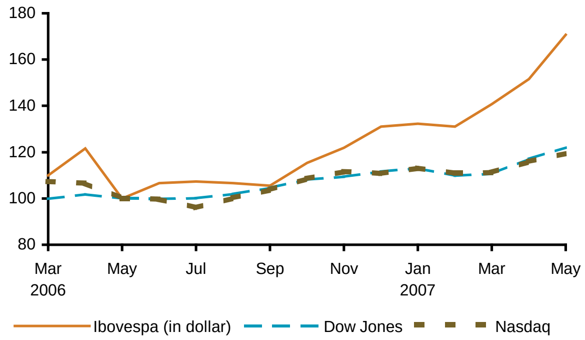
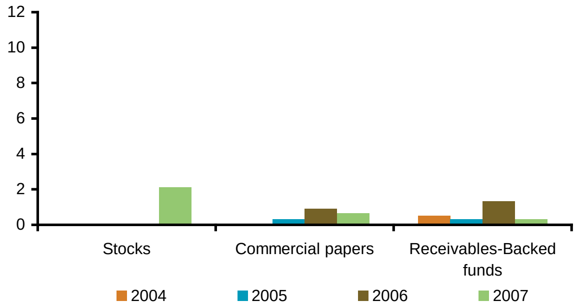


Figure 3.21 – Primary issues in the capital market

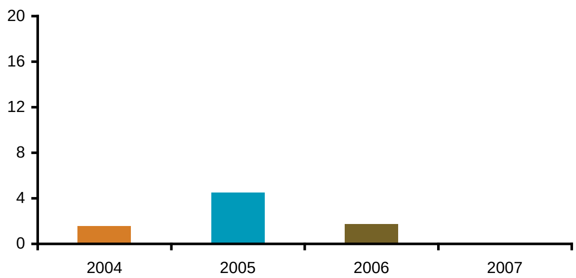
R$ billion – Accumulated through May



Source: CVM

Figure 3.22 – Debenture primary issues in the capital market

R$ billion – Accumulated through May



Source: CVM

The São Paulo Stock Exchange Index (Ibovespa) ended the month of May with a 19.1% gain over the February position, closing at 52,268 points. Performance of the index, which has set successive closing records since the month of March, resulted from benign evolution of the macroeconomic scenario, coupled with recent improvements in Brazil's sovereign risk rating, expectations of receiving an investment grade classification from international rating agencies and maintenance of the highly favorable external scenario. In this aspect, one must stress the very positive outlook regarding interest rate evolution in the United States, as a consequence of stability in inflation and unemployment indicators in that country.

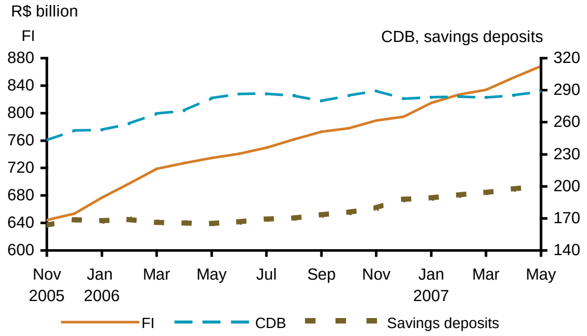
The average daily volume of transactions on the São Paulo Stock Exchange (Bovespa) totaled R$4 billion in the three-month period ended in May, with growth of 15.3% compared to the December-February period. In dollar terms, Ibovespa expanded 30.3% in the period, primarily as a result of exchange appreciation. In the same period, the Dow Jones and Nasdaq indices expanded 11.1% and 7.8%, respectively.

The impacts of interest rate reductions on the profitability of public securities and reductions in capital market funding costs have clearly favored private corporate security issuances. Capital market business sector financing through stock, debenture, promissory note issues and placements of credit rights receivables reached a total of R$14.5 billion in the three-month period ended in May. At this point, particular emphasis should be given to strong primary issuance of stocks with a cumulative total of R$10.4 billion in the year, against R$4.7 billion in the same period of 2006. In the three-month period under consideration, capital market inflows through stocks and receivables-backed funds reached respective totals of R$6.4 billion and R$2.7 billion, compared to R$2.6 billion and R$1.6 billion in the same period of 2006. Nonetheless, new issuances of debentures totaled R$4 billion in the three-month period and R$4.3 billion in the year, representing a drop of 33.3% compared to the same period of the previous year.

Financial investments

Considering investment funds, time deposits and savings accounts, the balance of resources in financial investments reached R$1.4 trillion in May, a 5% increase over the

Figure 3.23 – CDB, FI[1/] and savings deposits



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

Figure 3.24 – Participation of public securities in investment funds – Portfolio by indexing factor

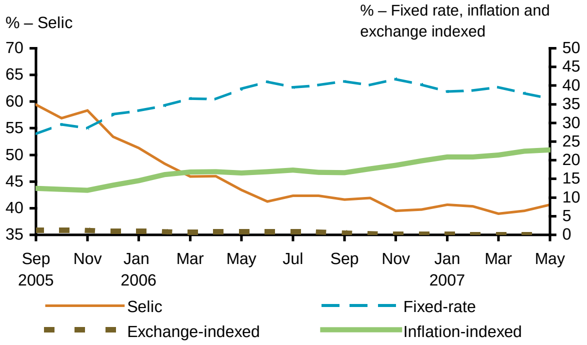
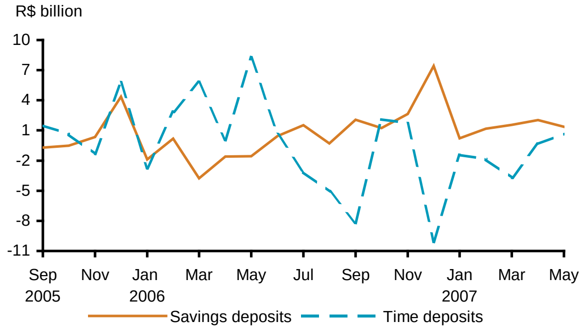


Figure 3.25 – Net inflow – Savings deposits and time deposits



February result. Of this total, 71.9% corresponded to the various classes of investment funds, while 14.3% involved savings accounts and 13.8% referred to time deposits.

Incorporating fixed rate, short-term and exchange-indexed securities, as well as multimarket and referenced operations, the net worth of investment funds totaled R$868.6 billion in the month of May, for growth of 5.1% compared to February. Particular note should be taken of steady growth in the relative participation of multimarket funds, which moved from 21.9% in May 2006 to 25.2%.

The participation of public sector securities in the aggregate portfolios of these funds reached 59.2%, followed by repo operations with 19.5%, and private securities, 16.1%.

The net worth of extramarket investment funds, which manage the resources belonging to the indirect federal administration, totaled R$24.3 billion in May. The increase of 1.3% compared to February reflected net redemptions of R$413 million and incorporation of R$718 million in earnings.

Resources invested in variable income funds reached R$108.8 billion in April, up 18% over the month of February. Net inflows of these funds totaled R$5 billion, reflecting the positive stock exchange performance. The net worth of Mutual Privatization Fund-Employment Compensation Fund (FMP-FGTS) and Mutual Privatization Funds-Employment Compensation Fund-Free Portfolio (FMP-FGTS-CL) totaled R$12.1 billion, for growth of 12.4% in the quarter.

The balance of savings accounts reached R$200 billion in May, up 4.4% in the three-month period, while time deposits reached R$288.8 billion, an increase of 1.7%. Net inflows of savings accounts totaled R$5 billion in the period, while net redemptions involving time deposits totaled R$3.4 billion. The nominal profitability of savings accounts closed the three-month period at 2%, while time deposits closed at 2.9%.

3.3 Fiscal policy

Law 11,477, dated 5.29.2007, altered the 2007 Budget Guidelines Law (LDO), setting a public sector primary surplus target of R$95.9 billion, previously set at 4.25% of GDP. The new target, which includes the previously utilized public sector revenue and expenditure projections, has been adjusted to increases in nominal GDP values resulting from the methodological alterations introduced into the calculation of this variable by IBGE. The target expressed in real by Law 11,477/2007 corresponds to 3.8% of the projected 2007 GDP. This is the same percentage stipulated for 2008 by budget guidelines legislation.

Following the guidelines defined in the PAC, the volume of investments specified in the PPI announced at the start of the year was increased from R$4.6 billion to R$11.3 billion. The resources that can be deducted from the primary surplus target were increased, since budget legislation introduced this possibility for outlays in the framework of the PPI.

Public sector borrowing requirements

In April, the consolidated public sector primary surplus reached R$23.5 billion, the best monthly result since the series was first calculated in 1991. The cumulative surplus for the first four months of the year closed at R$50.7 billion. This result was 0.89 p.p. of GDP greater than in the corresponding period of 2006 and was generated mainly by growth of 0.61 p.p. of GDP in the cumulative regional government surplus.

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

	2004		2005		2007	
	R$ billion	% GDP	R$ billion	% GDP	R$ billion	% GDP
Central government	-32.1	-4.8	-28.5	-4.0	-33.3	-4.3
Sub-national government	-9.3	-1.4	-8.0	-1.1	-13.4	-1.7
State companies	-2.6	-0.4	-3.9	-0.5	-4.0	-0.5
Total	-44.0	-6.6	-40.4	-5.6	-50.7	-6.5

Compared to the first four months of 2006, the Central Government surplus expanded 0.31 p.p. of GDP. Analysis shows improvement in the Federal Government result, in contrast to the steadily growing Social Security deficit that has marked recent years, despite a rapidly expanding formal job market.

The Central Government result reflected both 13.3% expansion in Treasury revenues, which rose to 20.3% of GDP, 0.88 p.p. above the January-April 2006 result, and 12.3% growth in expenditures, corresponding to 0.34 p.p. of GDP. It should be stressed that the revenue increase occurred despite measures adopted in 2006 with the aim of reducing taxation on specific sectors, with repercussions on the economy forecast for the current fiscal year.

Revenue performance in the first four months of 2007 resulted primarily from 31.2% growth in the Individual Income Tax (IRPF) inflow, generated by more intense control of capital gains on property transfers, increased net gains on stock market operations and growth in payments of judicially determined amounts.

In the same sense, mention should be made of 19.8% growth in the Corporate Income Tax (IRPJ) inflow, together with 18.5% expansion in the Social Contribution on Net Profits (CSLL). Both of these increases involved larger recoveries of debts in arrears referring to administrative and judicial deposits, coupled with recommencement of regular payments by financial corporations. The latter factor also resulted in 9% growth in the inflow of the Contribution to Social Security Financing (Cofins).

Compared to the first four months of 2006, inflow of the Income Withholding Tax (IRRF) expanded 12.7%, primarily as a result of growth in overall wages, increased earnings on the part of those rendering services and a larger volume of interest and commission remittances abroad. Aside from these factors, the increase in the volume of taxed imports and 3.35% growth in the average effective rate of the Import Tax (II) resulted in an inflow increase of 22.5%.

With regard to spending, outlays on personnel and payroll charges rose 11.8% in the four-month period ended in April, compared to the same period of 2006, rising to 4.77% of GDP. Executive branch outlays rose 14.8%, mainly as a result of the restructuring of civil-service and military careers, while spending by the legislative and judiciary branches, together with those of the Office of the Public Prosecutor increased 3%, partly as a consequence of a 29.6% reduction in outlays on judicially determined personnel payments at the Federal and Labor Court levels.

Current and capital spending rose 13% in the first four months of 2007. Outlays on assistance benefits (Social Assistance Law – Loas/Lifetime Monthly Income – RMV) increased 22.5%, primarily as a result of the minimum wage increase and 8% growth in the number of benefits paid. Outlays through the Worker Support Fund (FAT), which are also tied to the minimum wage, increased 16.1%. Moving in the opposite direction, spending on subsidies, grants and restructuring of liabilities declined in the period, due to the fact that the 2006 capitalization of Asset Management Company (Emgea) was not repeated in 2007.

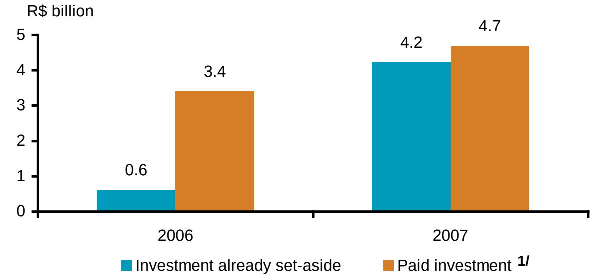
Other current and capital spending increased 19.1% compared to the first four months of 2006, mostly as a result of R$2.8 billion growth in discretionary spending. Investments paid, which may include possible amounts to be paid from previous fiscal years and money orders from the immediately previous fiscal year, increased 37.9% in the period under analysis, closing at R$4.7 billion, while investments already set aside moved from R$614 million to R$4.2 billion. PPI outlays totaled R$695.3 million in the first four months of 2007, most of which involved transportation projects included in the PAC.

Table 3.6 – National Treasury expenditures
Jan-Apr

Itemization	2006		2007	
	R$ million	% GDP	R$ million	% GDP
Total	66 797	9.3	75 028	9.6
Personnel and payroll charges	33 279	4.6	37 216	4.8
Current expend. and capital	33 330	4.6	37 650	4.8
Worker Support Fund (FAT)	3 384	0.5	3 930	0.5
Subsidies and subventions	3 007	0.4	1 524	0.2
Social Assistance Law /				
Lifetime Monthly Income	3 434	0.5	4 206	0.5
Others	23 504	3.3	27 991	3.6
Transfers to Bacen	188	0.0	161	0.0

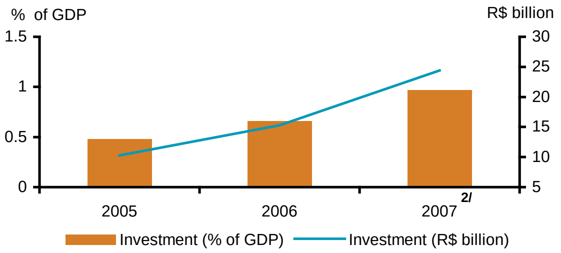
Source: STN

Figure 3.26 – Federal Government: investment in the first 4-month period of the year



1/ Includes amounts to be paid from previous fiscal year and money orders issued on the final day of the previous fiscal year.
Source: STN

Figure 3.27 – Federal Government: investment payments in the year[1/]



1/ Includes amounts to be paid.
2/ Estimates.
Source: STN

Figure 3.28 – Social Security revenues and benefits – Jan-Apr
As % of GDP

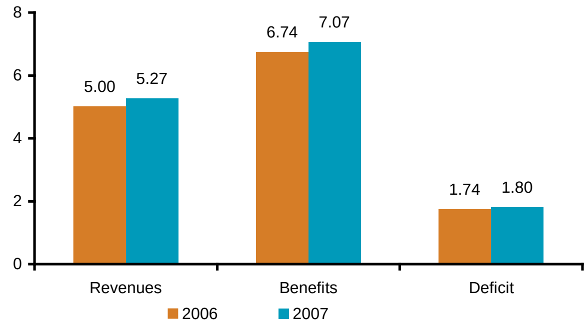
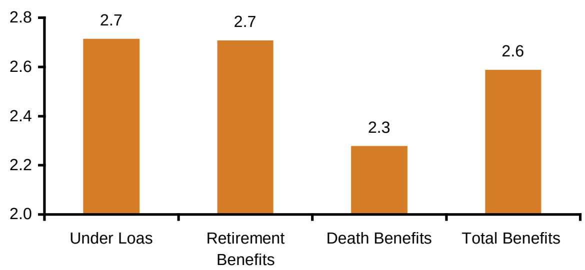


Figure 3.29 – Growth in the average number of benefits issued by Social Security (Jan-Apr 2007/Jan-Apr 2006)
Percentage



Source: STN

Outlays forecast for 2007 investments totaled R$24.4 billion, 60% more than in the previous year and equivalent to 0.97% of GDP. Of this total, 0.63 p.p. of GDP referred to PAC investments, including 0.45 p.p. in the PPI framework.

In the January-April 2007 period, the Social Security revenue inflow expanded 14.1%, compared to the same period of the preceding year. This growth was fully consistent with expansion in overall wages and payroll charges. Benefit outlays increased 13.6% in the period, partly as a result of increased payments of judicially determined amounts. Though the percentage increase registered under outlays was less than in the case of revenues, the calculation base was significantly broader, resulting in an increase in the cumulative deficit equivalent to 0.06 p.p. of GDP to a level of 1.8%.

Growth in outlays on Social Security benefits also resulted from increases in both the volume and average value of benefits paid and from 24.4% growth in spending consequent upon judicially determined payments. The average monthly number of benefits issued reached 21.6 million in the first four months of 2007, with particularly strong growth under retirement and assistance benefits.

Outlays on transfers to states and municipalities added up to R$33.2 billion through April, reflecting growth of 14.1% over the corresponding period of 2006. Transfers resulting from reductions in taxation on exports increased 118.9%, as a result of the alterations included in Provisional Measure 355/2007, while transfers to constitutionally defined funds increased 12.7%, as a result of the performance of shared taxes.

In a manner consistent with growth in transfers, the primary surplus of regional governments closed the January-April 2007 period at R$13.4 billion, against R$8 billion in the same period of 2006. This result was driven by R$4.5 billion expansion in inflow of the Tax on the Circulation of Merchandise and Services (ICMS) in the period under consideration, as well as by the impact of the fiscal adjustment adopted by regional governments in recent years (See box "Evolution of Subnational Finance").

The primary surplus of state-owned companies shifted from R$3.9 billion in the first four months of 2006 to R$4 billion in the same period of 2007. Outlays on payments of dividends to the federal government totaled R$2.2 billion, up R$608 billion compared to the previous year.

Nominal interest appropriated in the first four months of 2007 totaled R$51.1 billion, the lowest amount since 2004,

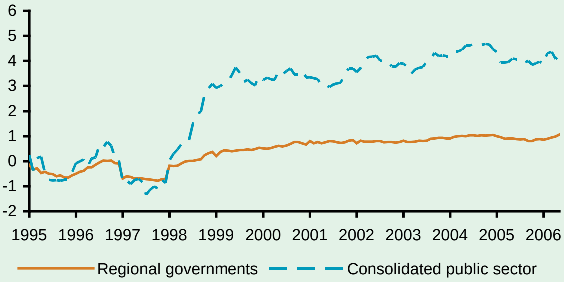
Evolution of Subnational Finance

The states and municipalities have played an important role in the fiscal adjustment implemented by the public sector since the end of the 1990s. Adjustment programs have made it possible to generate strong primary surpluses in recent years, coupled with steady declines in the debt/GDP ratios of subnational governments. With this, they overcame a long history of fiscal crises and repeated processes of federal government debt assumptions and refinancing. The major factor underlying this adjustment has been improvement in tax management, reflected in greater inflows and more efficient control of outlays in a framework of systematic cutbacks in the ratio between administrative spending and net revenues. The objective of this box is to analyze the evolution of subnational finances in recent years, highlighting the major determinants of the adjustments implemented and their contribution to the stability of the nation's public accounts.

The fiscal situation of state governments began deteriorating in the second half of the 1990s, at the same time in which restrictions were imposed on market financing operations as a result of excessively high nominal deficits. It was in this context that the federal government elaborated a wide ranging program of assistance to state governments, culminating in publication of Law 9,496 in September 1997.

The Law permitted refinancing of security debts and part of the contractual debt of the states, restricting servicing of the debt to a share of net revenues in such a way as to avoid jeopardizing other obligations assumed by the states. Compared to previous experiences in debt refinancing, the major difference consisted in the fact that the federal government required states to implement fiscal adjustment

Figure 1 – Primary result of the consolidated public sector and regional governments
% of GDP



(+) Surplus (-) Deficit

Figure 2 – Net debt of the consolidated public sector and regional governments
Percentage of GDP

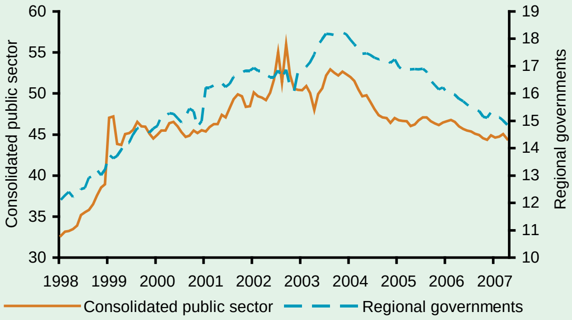
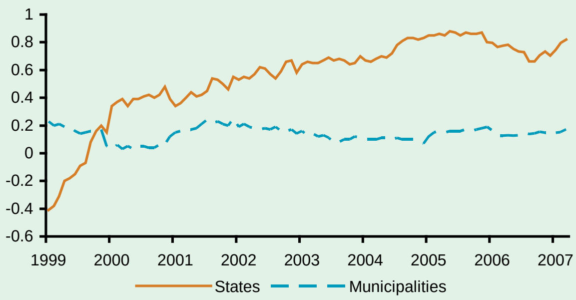


Figure 3 – Primary result of states and municipalities
12-month accumulated
% of GDP



(+) Surplus (-) Deficit

programs with specific provisions limiting the ratio of debt to net revenues, while defining revenue collection targets and primary result targets.

A provisional measure was issued in 1999 allowing the federal government to assume and refinance municipal debts[1]. The purpose of this measure was to resolve the problem of a rapidly expanding securities debt that had become an excessively large burden for some municipalities. Though not required to implement adjustment programs as occurred in the case of the states, the refinancing contracts established limits and conditions for contracting new debts, together with specific penalties for those municipalities that did not make the necessary adjustments, for example, restricting personnel spending.

At a later date, the Fiscal Responsibility Law (Complementary Law 101/2000) forbid new debt refinancing operations between the federal government and regional governments, defining a series of rules for the sustainable management of public finance, strengthening and consolidating the adjustment initiated on the basis of these agreements.

The evolution of the net debt and primary results of regional governments reflects alterations in their fiscal situations and changes introduced as of the second half of the 1990s. In this regard, the cumulative 12-month primary result of regional governments moved into a surplus position as of June 1998, making a fundamental contribution to compliance of the consolidated public sector with the specified primary surplus targets.

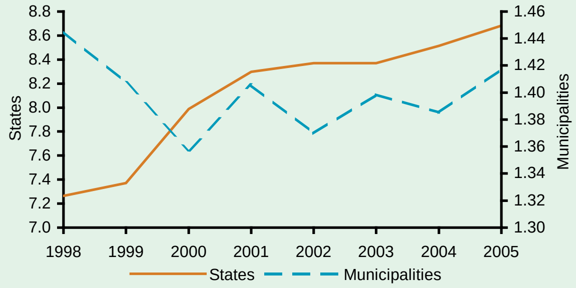
One should stress that the fact that the ratio between net indebtedness and net current revenues was higher at the state level than at the municipal level was a determining factor in heightening the intensity of the fiscal adjustment at the state level.

The adjustment introduced by regional governments was initially based on a tax increase that, in the case of the states, moved from 7.3% of GDP in 1998 to 8.7% in 2005. Though the tax load of the municipalities remained relatively stable in that period, they also

1/ Provisional Measure 1,811, dated February 25, 1999, subsequently re-issued.

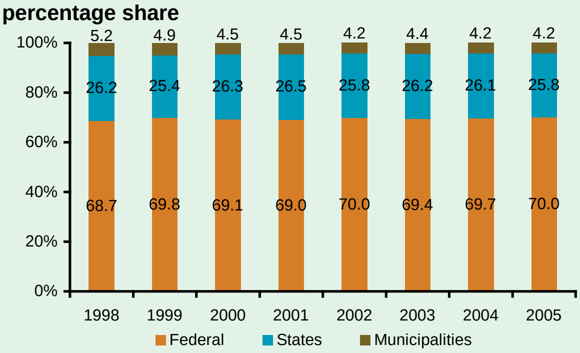
Figure 4 – Gross tax burden of states and municipalities

Percentage of GDP



Source: SRF and Bacen

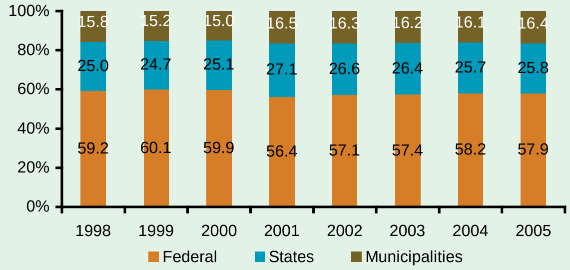
Figure 5 – Gross tax burden by government level: percentage share



Source: SRF

Figure 6 – Gross tax burden: final distribution by level of government[1/]

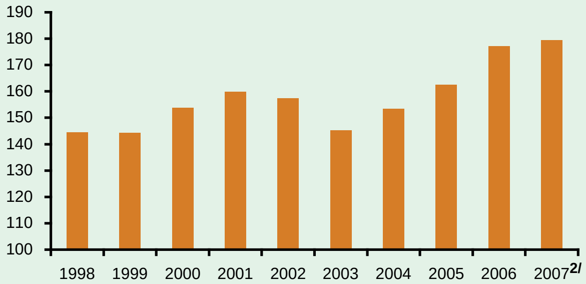
Percentage share



1/ After constitutional transfers.
Source: SRF

Figure 7 – ICMS collection at constant prices[1/]

R$ billion



1/ At April 2007 prices (IGP-DI).
2/ Cumulative twelve-month inflow through April.

benefited from growth in state and federal government revenue inflows, thus maintaining their participation in the final distribution of these resources. To some extent, this performance reflected a real increase[2] of 24.2% in the inflow of ICMS, the principal state tax of which 25% of inflow is targeted to the municipalities, between 1998 and the 12-month period ended in April 2007.

Reordering of subnational government financing also reflected increased control over administrative outlays in relation to the funds collected. In the case of the states, the ratio between executive branch personnel outlays, the most significant of all expenditure headings, and current net revenues dropped from 45.5% in 2002 to 40.8% in 2006. At the municipal level, though the proportion was smaller, the ratio also tended downward in the 2002-2005 period.

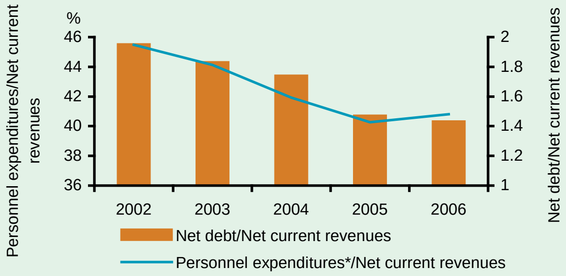
With respect to investment outlays, considered a heading of essential importance to economic growth, these operations have expanded steadily since 2003 at the state level.

With revenue growth and increased control over new credit operations, the ratio between the net debt of the states and net current revenue also dropped, closing 2006 at 1.43, compared to 1.95 in 2002. The proportion dropped even more sharply at the municipal level, moving from 0.24 in 2002 to 0.16 in 2005.

In summary, the fiscal situation of states and municipalities has gone through a significant process of adjustment since the end of the 1990s. This was particularly true at the state level, as revenues expanded and both administrative outlays and net debt posted relative reductions. This evolution reflects conditions agreed upon with the federal government and subsequently reinforced by rules established by the Fiscal Responsibility Law. This institutional framework, as well as firm and responsible action at the various levels of government, has aided in overcoming chronic fiscal difficulties at the subnational level, which had previously generated highly negative macroeconomic impacts in the 1980s and 1990s. With expectations of positive evolution

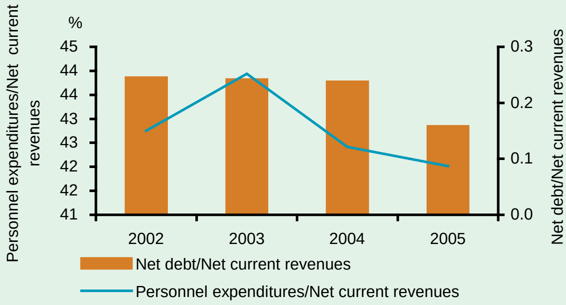
2/ Using the IGP-DI as deflator.

Figure 8 – State governments: net debt and personnel expenditures in comparison to net current revenues



* Only the Executive Branch is included.
Source: STN

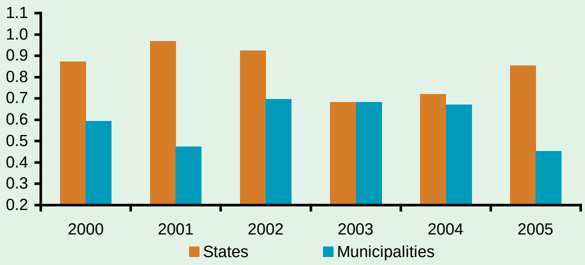
Figure 9 – Local governments: net debt and personnel expenditures in comparison to net current revenues



Source: STN

Figure 10 – States and municipalities investment expenditures[1/]

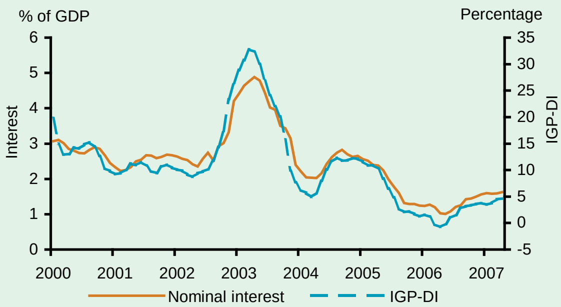
% of GDP



1/ Expenditures related to paid investments.
Source: STN and Bacen

Figure 11 – Appropriated nominal interests of regional governments and IGP-DI

12-month accumulated



in the indices that correct regional government debts and continued responsible management of state and municipal finances, expectations now indicate that debt in relation to GDP and to net revenues will continue declining in coming years, aiding in maintaining a similar trajectory in relation to the consolidated public sector debt.

Figure 3.30 – Cumulative nominal interest up to April

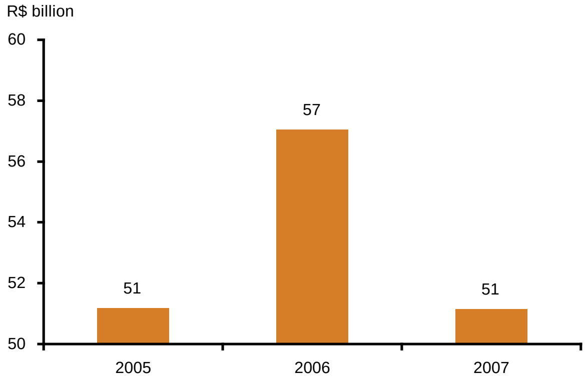


Figure 3.31 – Nominal interest and cumulative 12-month Selic rate

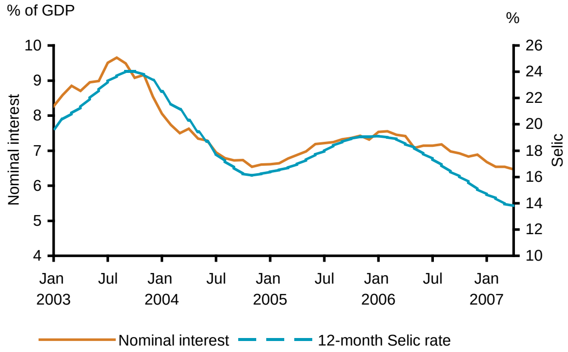
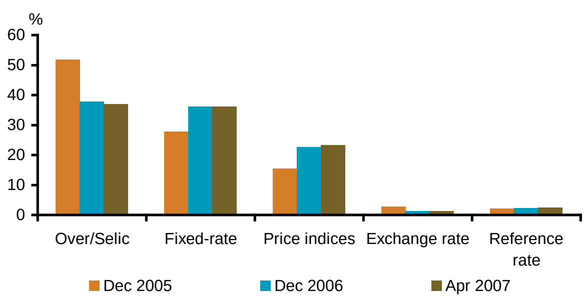


Table 3.7 – Public sector borrowing requirements January-April

Itemization	2006		2007	
	R$ billion	% GDP	R$ billion	% GDP
Uses	16.6	2.3	0.4	0.1
Primary	-40.4	-5.6	-50.7	-6.5
Interest	57.0	7.9	51.1	6.6
Sources	16.6	2.3	0.4	0.1
Domestic financing	56.0	7.8	94.1	12.1
Securities debt	75.4	10.5	114.2	14.6
Bank debt	-7.8	-1.1	-13.3	-1.7
Others	-11.6	-1.6	-6.7	-0.9
External financing	-39.4	-5.5	-93.7	-12.0

Figure 3.32 – Federal securities debt structure by indexing factor[1/]



1/ It does not include swap.

using this basis of comparison. The reduction in interest appropriated has occurred at a lesser pace than the reduction in the Selic rate, as a consequence of alterations in the net debt profile which now prioritizes fixed-rate securities. Expressed in percentages of GDP, 12-month nominal interest has moved steadily downward, reflecting cutbacks in the Selic rate.

The nominal surplus of the nonfinancial public sector, which includes the primary result and nominal interest appropriated, reached R$11.2 billion in April, the best monthly result since this series was initiated in 1991. The cumulative nominal deficit through April 2007 totaled R$405 million, 2.26 p.p. of GDP, below the figure for the same period of 2006.

With regard to financing of the cumulative nominal deficit, it is important to stress reductions of R$93.7 billion in external financing and R$13.3 billion in the banking debt, coupled with growth of R$114.2 billion in the securities debt, the major source of public sector financing during the year.

Federal securities debt

Evaluated according to the portfolio position, the DPMFi stock closed at R$1151.5 billion, 47.4% of GDP in April 2007, reflecting R$63.3 billion growth compared to January. This result reflected net issues of R$30.1 billion on the primary market and R$34.1 billion in incorporation of interest, coupled with the financial impact of approximately R$0.6 billion as a result of 4.3% appreciation of the real against the United States dollar in the period.

The DPMFi profile clearly reflects the guidelines and strategies adopted by the Federal Government, based on the principles of minimizing long-term borrowing costs and maintaining prudent risk levels. In this framework, participation of fixed rate securities, inflation-linked securities and Selic rate-indexed papers in total DPMFi shifted from 34.5%, 23% and 38.9%, respectively, in January, to 36.2%, 23.3% and 37% in April.

Based on the April position, analysis of the amortization schedule of the securities debt on the market indicates that 20.4% of the total matures in 2007; 25.2% in 2008; and 54.4% as of January 2009. The average maturity of DPMFi shifted from 31.9 months in January to 32.7 months in April.

Exchange swap operations closed April in a negative position of R$29.3 billion. Defined as the difference between

Table 3.8 – Repo operations – Open market
Balances and percentage share

R$ million

	Up to 1 month		More than 1 month		Total	
	Balance	%	Balance	%	Balance	%
2003 Dec	43 742	78.5	11 975	21.5	55 717	100
2004 Mar	47 718	72.1	18 440	27.9	66 158	100
Jun	46 509	58.8	32 578	41.2	79 088	100
Sep	34 839	47.0	39 250	53.0	74 089	100
Dec	7 797	16.5	39 410	83.5	47 207	100
2005 Mar	5 239	11.5	40 506	88.5	45 744	100
Jun	4 099	12.3	29 165	87.7	33 264	100
Sep	-6 857	-16.4	48 591	116.4	41 734	100
Dec	-24 430	-106.9	47 286	206.9	22 856	100
2006 Mar	-8 399	-18.3	54 395	118.3	45 996	100
Jun	7 241	10.3	62 821	89.7	70 062	100
Sep	19 120	26.6	52 779	73.4	71 899	100
Dec	5 800	9.7	54 231	90.3	60 030	100
2007 Jan	46 943	47.0	52 882	53.0	99 825	100
Feb	41 464	42.2	56 883	57.8	98 347	100
Mar	41 656	39.3	64 281	60.7	105 937	100
Apr	43 143	37.3	72 555	62.7	115 698	100

Figure 3.33 – Swap and open market position
R$ billion

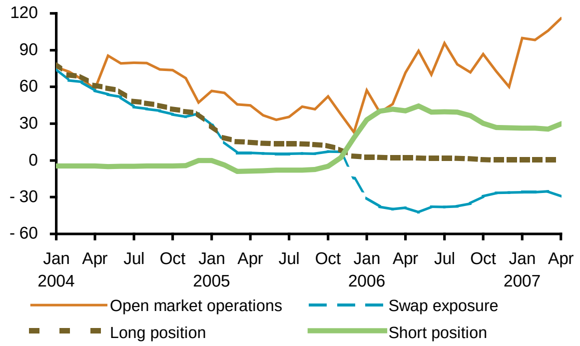
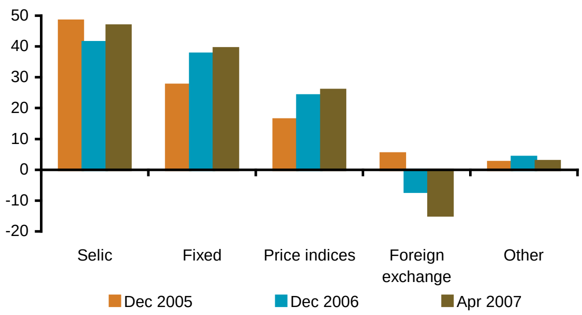


Figure 3.34 – PSND – Percentage share by indexing factor
Percentage



DI profitability and exchange variation plus coupon and calculated according to the cash criterion, these operations closed with a cumulative January-April 2007 negative result of R$2 billion for Bacen, reflecting depreciation of the United States dollar against the real in the period. Since early 2002, the cumulative result of these operations has generated a positive amount equivalent to R$6 billion for Bacen.

Public Sector Net Debt

In April, PSND reached 44.4% of GDP, a drop of 0.5 p.p. compared to December 2006. The major determining factor underlying this decline was the primary surplus, accounting for 2.1 p.p., followed by valued GDP growth, with 1 p.p. Moving in the opposite direction, the contribution of nominal interest appropriated to growth in this ratio reached 2.1 p.p., while the contributions of adjustments caused by appreciation of exchange and the parities of the basket of currencies underlying the net external debt totaled 0.2 p.p. and 0.3 p.p., respectively.

With regard to the evolution of the PSND profile in the first four months of 2007, it is important to note growth in net external credits from R$63.5 billion in December 2006 to R$145.3 billion in April, corresponding to 6% of GDP. Ratifying the benign macroeconomics scenario, the fixed-rate and inflation-linked shares also expanded during the period.

In the month of April, the Gross General Government Debt (DBGG) came to R$1,602.4 billion, representing 66% of GDP, against R$1,556.5 billion in December 2006, 65.5% of GDP. The increase in the securities debt was the major factor underlying DBGG expansion in the period.

3.4 Conclusion

In the three-month period ended in April, the evolution of financial system credit operations confirms continuation of the growth trajectory that has marked the last two years. Steady growth in loans contracted at consistently lower average interest rates, coupled with a stable rate of delinquency, longer maturities, increased overall real wages in the economy and improvements in consumer expectations have clearly driven domestic demand.

Household credit demand has been powered by longer-term operations at lower rates of interest, particularly personal

Table 3.9 – Net debt growth
Conditioning factors

Itemization	2005		2006		2007-Apr	
	R$ million	% GDP	R$ million	% GDP	R$ million	% GDP
Total net debt – Balance	1002 485	46.5	1067 363	44.9	1079 527	44.4
Flows	**Accumulated in the year**					
Net debt – Growth	45 488	-0.5	64 879	-1.5	12 163	-0.5
Conditioning factors	45 488	2.1	64 879	2.7	12 163	0.5
PSBR	63 641	2.9	69 883	2.9	405	0.0
Primary	-93 505	-4.3	-90 144	-3.8	-50 732	-2.1
Interest	157 146	7.3	160 027	6.7	51 136	2.1
Exchange adjustment	-18 202	-0.8	-4 881	-0.2	4 154	0.2
Domestic securities debt[1/]	-4 554	-0.2	-2 222	-0.1	- 696	0.0
External debt	-13 648	-0.6	-2 659	-0.1	4 850	0.2
Others[2/]	-2 258	-0.1	2 302	0.1	7 092	0.3
Skeletons	3 262	0.2	- 375	0.0	513	0.0
Privatizations	-954	0.0	-2049	-0.1	0	0.0
GDP growth effect		-2.6		-4.3		-1.0

1/ Federal dollar-indexed securities debt.
2/ Parity of the basket of currencies underlying the net external debt.

loans and auto loans, gradually supplanting the revolving credit modality in importance. At the same time, corporate loans expanded as the pace of activity increased, including both operations based on domestic resources and those tied to foreign currencies.

Parallel to these factors, one should note that businesses have increasingly turned away from bank loans and resorted to alternative financing sources. Favored by lower earnings on public sector securities and declining capital market funding costs, private issuances have greatly diversified the array of financial investment alternatives available to companies, while channeling significant volumes of funding into the productive sector.

For 2007, the fiscal outlook remains positive, with good perspectives as regards decreasing appropriation of nominal interests. This evolution is consistent with the downward trend of both the Selic rate and the PSND/GDP ratio.

Despite growth in public expenditures, the primary surplus targets have been fully met. In this context, it should be highlighted the consolidation of subnational government fiscal adjustment process. Also, fiscal targets are compatible with a steady reduction in the PSND/GDP ratio, even when the priority investments in the PPI framework are deducted from the primary surplus.

International economy

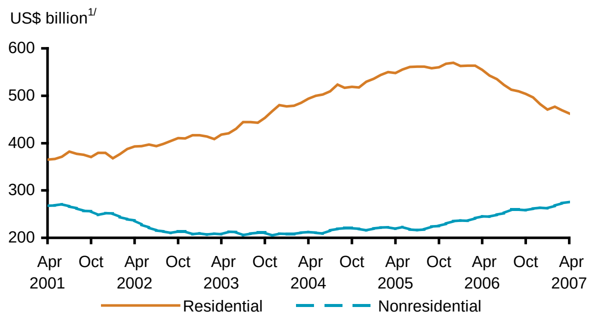
4

World economic activity remained strong in the early months of 2007, as the less robust performance of the United States economy was offset by strong growth in other regions. Activity in the United States was somewhat dampened by a steady decline in residential investments, the ongoing cycle of adjustment in business stock levels and the negative contribution of net exports. On the other hand, economic indicators for other regions of the world remained positive, resulting in upward revisions of growth forecasts.

In China, the pace of GDP growth has forced the government to adopt restrictive measures aimed at curtailing productive sector and capital market imbalances. In the Euro Area, solid investment growth has offset lesser consumer spending while, in Japan, rising production has been sustained by domestic consumption and external demand. In both regions and in the United States, stronger labor markets suggest positive growth in household consumption in the second half of the year.

4.1 Economic activity

Figure 4.1 – USA – Construction spending

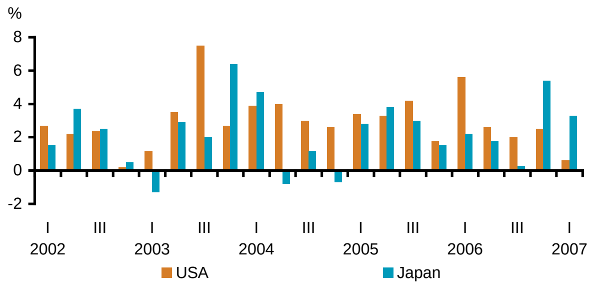


1/ Annualized. January/2000 constant prices.
Source: Bureau of Census

Economic activity in the United States posted annualized growth of 0.6% in the first quarter of 2007, the lowest level since 2002 using this basis of comparison. Deceleration since end-2006 has been a direct result of lesser activity in the real estate market, marked by weak sales. With a huge stock of units for sale, coupled with the recent high in mortgage rates, new housing starts remain severely depressed. In contrast, outlays on nonresidential construction rose sharply at the beginning of the year. So far, there is no evidence that the crisis in the subprime mortgage market has had any significant impact on consumer spending.

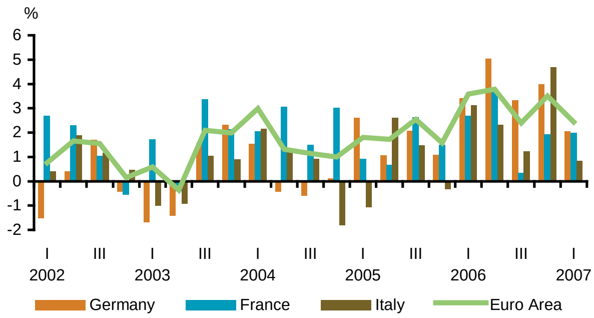
In the 12-month period up to May, United States industrial output expanded 1.6%, as the level of utilization of installed output capacity dropped. Vehicle sales in April and May, obviously an oil-sensitive segment, closed well

Figure 4.2 – USA and Japan – GDP[1/]



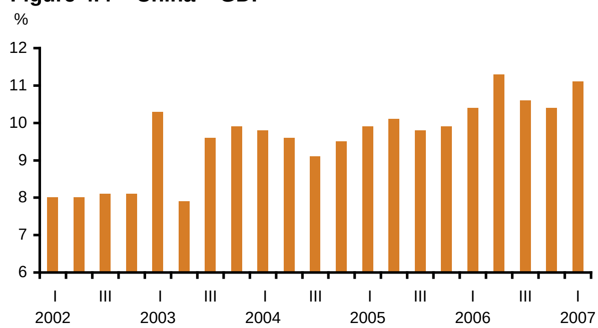
Sources: Bureau of Economic Analysis and Economic and Social Research Institute
1/ Quarterly growth. Seasonally adjusted annualized rates.

Figure 4.3 – Euro Area – GDP[1/]



Source: Eurostat
1/ Quarterly growth. Seasonally adjusted annualized rates.

Figure 4.4 – China – GDP[1/]



Source: Bloomberg
1/ Growth rate over the same period of previous year.

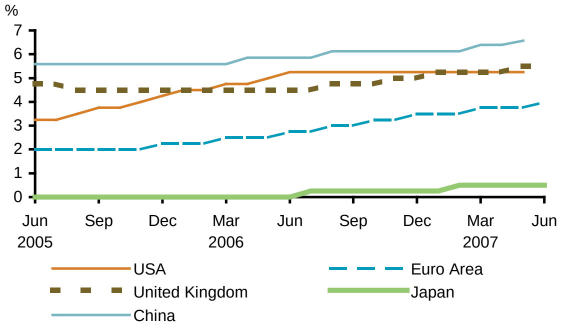
below the first quarter average. On the other hand, orders placed with industry turned sharply upward as of March, indicating that the period of inventory adjustments that had negatively impacted GDP in the last two quarters has reached its end. Though still moderate, the positive process of job creation has aided in generating expectations and, therefore, has stimulated household consumption. Having gradually overcome the negative impacts of real estate sector difficulties, coupled with a process of industrial recovery, the outlook for second quarter activity remains strong.

In Japan, signs of growing consumption and expanding industrial indicators, coupled with positive job market results, have aided in generating annualized 3.3% economic growth in the first quarter, despite an only modest performance under industrial output. One should note that declining inventory levels will act as an added incentive to renewed industrial activity in the coming months.

Euro Area GDP expanded 2.4% in the first quarter of 2007 in annualized terms. This result reflected investment growth that was more than sufficient to offset the downturn in domestic consumption, impacted by the increase in the value added tax rate from 16% to 19% on merchandise marketed in Germany. Driven by growth in investments in machines and equipment, as well as construction sector activity, the German economy expanded at an annualized rate of 2.1%, despite a 5.6% downturn in private consumption. Strengthened by expectations of rising private consumption in the coming months powered by job market improvement, the positive results of the first quarter resulted in upward revision of the region's GDP growth forecast in 2007 from 2% in January to 2.7% in June, according to Consensus Forecasts.

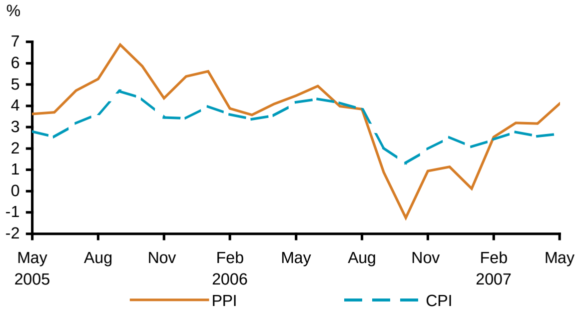
Chinese GDP has been driven by both domestic and external demand, registering 11.1% growth in the first three months of 2007 compared to the same period of the preceding year. At the domestic level, strong expansion in fixed asset investments raised renewed concerns with overheating of that segment of activity. In the case of the external sector, despite measures announced to curtail export growth, the trade surplus increased 84% in the first five months of 2007, compared to the same period of 2006. For the coming months, the government is expected to reinforce its strategy of curtailing possible excess demand growth.

Figure 4.5 – Official interest rates
Annual rates



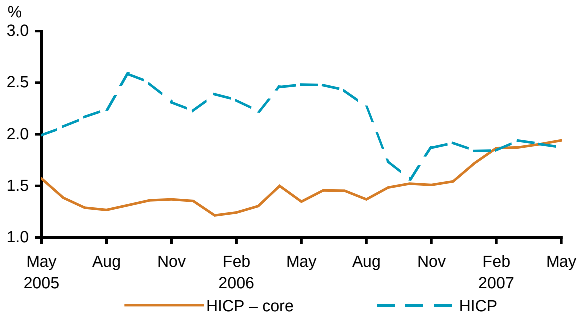
Sources: Fed, ECB, BoJ, Bank of England and The People's Bank of China.

Figure 4.6 – Inflation – USA
Annual growth



Source: Bureau of Labor Statistics

Figure 4.7 – Consumer inflation – Euro Area
Annual growth



Source: Eurostat

4.2 Monetary policy and inflation

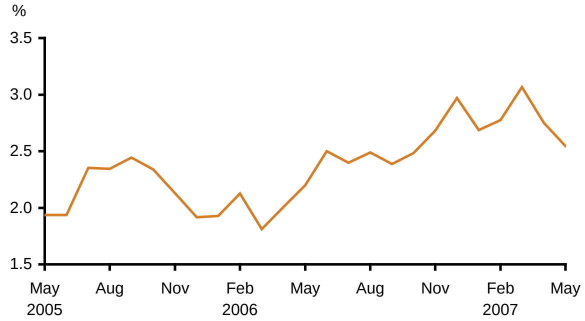
Since early 2007, several major central banks have taken steps to curtail inflation expectations consequent upon both rising commodity prices and, with the exception of the United States, higher than expected economic expansion. This is evident both in the more aggressive stances taken by these institutions in their press releases and in the more restrictive monetary policies they have adopted.

Though annual inflation reached 2.7% in May, compared to 4.2% in the corresponding period of 2006, and economic expansion, dampened by real estate sector adjustments, has remained well below its potential, concerns persist in the United States regarding growth in the inflation core which, since mid-2004, has remained above or at the upper limits of the 1% to 2% comfort zone defined by the Federal Reserve System (Fed). The Fed's decision to hold the annual fed fund target unchanged at 5.25% per year has been based on such aspects as already high oil and metallic commodity prices, depreciation of the dollar, high levels of utilization of installed output capacity and low unemployment. By making it feasible to hold economic growth below its potential level, this stance clearly favors a gradual reduction in the inflation core. On the other hand, expectations of renewed activity in the USA in a framework of still high inflation, viewed in terms of the monetary authority comfort zone, implies a risk of new interest rate hikes.

In the Euro Area, 12-month trailing inflation remained below 2% in May, for the ninth consecutive month. Despite this, the European Central Bank (ECB) raised its basic interest rate to 4% in June, with an upward bias. The contractive stance adopted by the ECB reflects its position with respect to strong credit and currency growth, expanding inflation expectations and a strong job market, as mirrored in the 7.1% April jobless rate, the lowest ever registered. Though some signs do exist of somewhat more moderate monetary expansion at the margin, the "economic pillar" of the ECB analysis or, in other words, the prospective analysis of activity and inflation, would seem to point in the direction of a continued monetary adjustment.

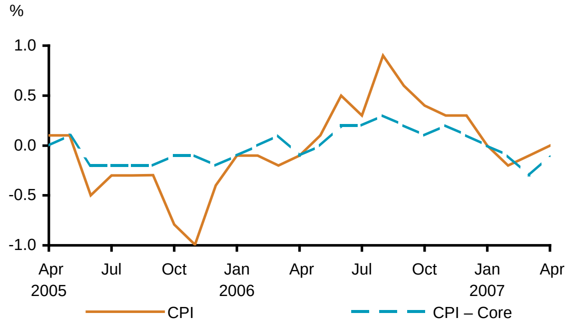
In the United Kingdom, cumulative 12-month inflation reached 2.5% in May, surpassing the 2% level for the 15th consecutive month. In this scenario, The Bank of England's Monetary Policy Committee (MPC) raised the repo rate to 5.5% per year in the month of May, the highest level since 2001.

Figure 4.8 – Consumer inflation – United Kingdom
Annual growth



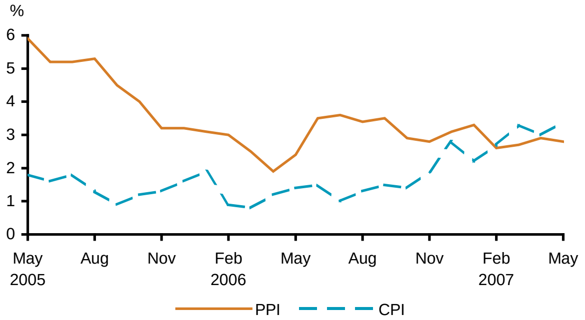
Source: Bloomberg

Figure 4.9 – Consumer inflation – Japan
Annual growth



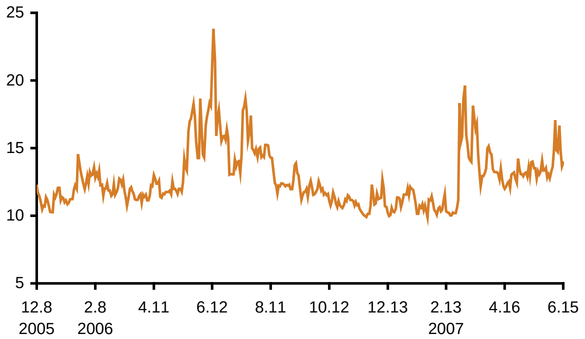
Source: Bloomberg

Figure 4.10 – China – Inflation
Annual growth



Source: Bloomberg

Figure 4.11 – VIX



Source: Bloomberg

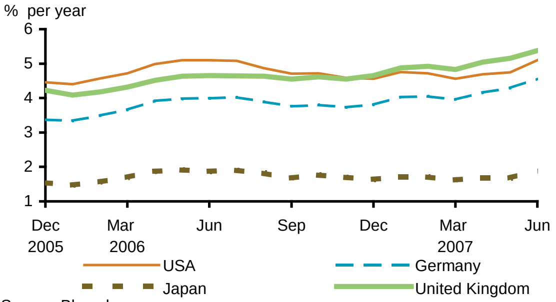
Notwithstanding the evolution of oil prices, the Japanese economy has experienced negative inflation rates or rates tending towards zero since the start of the year. This result, evident in the performance of headline indices or their cores, was to some extent generated by declines in average wages, despite falling unemployment rates. In this context, the Bank of Japan (BoJ) decided not to alter its 0.50% per year overnight rate.

In China, overheated economic activity and the exuberant stock market have given rise to intense concern regarding inflation, which, in annual terms, reached 3.4% in May compared to 1.4% in May 2006. In order to reduce internal liquidity and impose limits on credit growth, the People's Bank of China has intensified adoption of both administrative and monetary measures since early 2007, including an increase in the tax on stock market transactions and expanded possibilities of financial investments abroad, coupled with higher reserve requirements, now equivalent to 11.5%, expansion of the daily fluctuation interval of the renminbi against the dollar and increase of the basic interest rate, now defined at 6.57% per year.

4.3 International financial markets

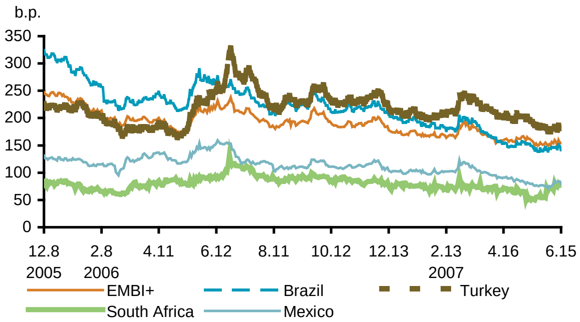
Between March 1 and June 15, the Volatility Index of the Chicago Board Options Exchange (VIX), which measures the short-term implicit volatility of Standard & Poor's 500 (S&P 500) and is viewed as a thermometer of investor risk aversion, fluctuated at a level above that in effect in the three-month period ended in February. This result reflected the sharp February 27 increase in the index, as a result of devaluation at the Shanghai Exchange and, to a lesser extent, uncertainties regarding the intensity of the slowdown in the United States economy. This cycle persisted during the first fifteen days of March as the VIX rose to the maximum level of the period, 19.63 points, on March 5. Between March 16 and June 15, the VIX varied between 11.98 and 17.06, peaking once again on June 7. Though the Shanghai Exchange posted two days of sharp losses – declines of 6.5% on May 30 and 8.3% on June 4, the devaluation that occurred in China did not provoke a chain reaction in other stock exchanges as had previously happened, while the high in the VIX index reflected expectations that inflationary pressures could lead the major central banks to adopt a new cycle of interest rate increases.

Figure 4.12 – Yield on government bonds[1/]



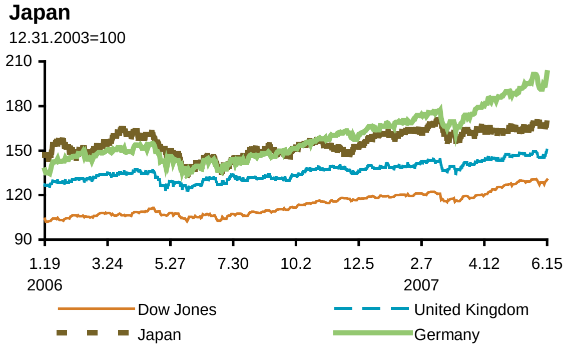
Source: Bloomberg
1/ Monthly average of nominal yields on 10-year bonds, up to June 15, 2007.

Figure 4.13 – Emerging Markets Bond Index Plus (Embi+)



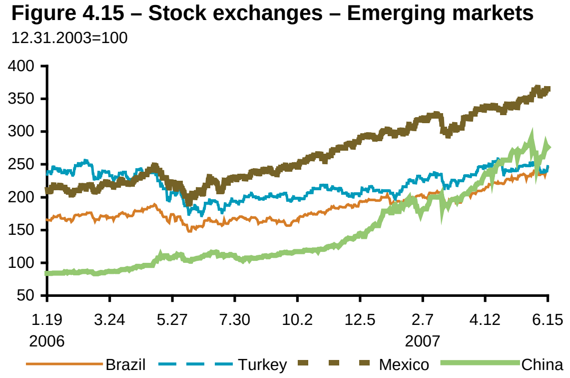
Source: Bloomberg

Figure 4.14 – Stock exchanges – USA, Europe and Japan



Source: Bloomberg

Figure 4.15 – Stock exchanges – Emerging markets



Source: Bloomberg

Concern regarding the possibility of a new monetary squeeze in the world's major economies generated repercussions on government bond markets in the United States, Germany, Japan and the United Kingdom, as returns on 10-year bonds issued by these countries rose sharply between February 28 and June 15, particularly in May and June. Annual earnings on long-term United States bonds reached 5.16% on June 15, against 4.57% on February 28, having reached 5.29% on June 12, the highest level in the last five years. Returns on long-term German and British bonds indicated a similar trend, with respective growth of 70 basis points and 69 basis points between February 28 and June 15 to levels of 4.66% per year and 5.48% per year. It should be stressed that this rate was the highest registered in the United Kingdom in the last seven years. In the same period of analysis, annual earnings on Japanese bonds rose 31 basis points to a level of 1.94%.

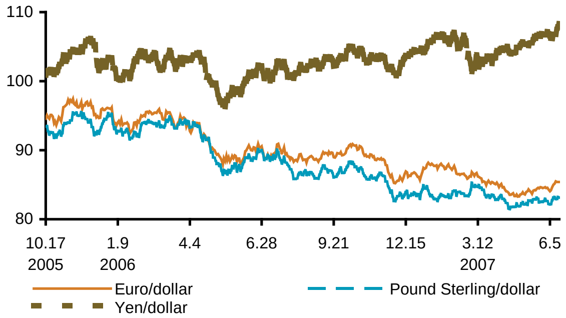
The Embi+, the emerging market risk indicator, registered an average of 164 points between February 28 and June 15, against 173 points in the three-month period ended in February. On March 22, the indicator dropped to a new historical low of 149 points, a level repeated on June 1, before rising to 154 points on June 15. Since mid-April, the Embi+ rating for Brazil dropped 27.7% in the period under analysis, closing at 141 points on June 15, a level well below the average index of the emerging countries. The Embi+ indicators for Turkey, South Africa and Mexico dropped 23.4%, 6.1% and 29.8%, respectively, in the same period.

Between February 28 and June 15, the major stock exchanges posted strong highs, as the United States Dow Jones, the United Kingdom's Financial Times Securities Exchange Index (FTSE 100), Germany's *Deutscher Aktienindex* (DAX) and Japan's Nikkei registered highs of 11.2%, 9.1%, 19.6% and 2.1%, respectively. Among the emerging countries, despite strong losses between May 30 and June 4 as a result of levying of a tax on stock operations, the Shanghai index in China expanded 43.4% using the same basis of comparison. The Brazilian Ibovespa index, Mexico's *Índice de Precios y Cotizaciones* (IPC) and the Istanbul Exchange National 100 Index (XU100) in Turkey increased 24.2%, 20.6% and 11%, respectively, in the period.

Though optimism has increased regarding the activity level in the United States and market interest rates in that country have clearly favored appreciation of the dollar against the major currencies, this tendency was not sufficient – with the sole exception of the dollar rate against the yen – to reverse the ongoing process of depreciation of the dollar since mid-February when pessimistic expectations regarding the

Figure 4.16 – Dollar exchange rates

9.19.2003=100

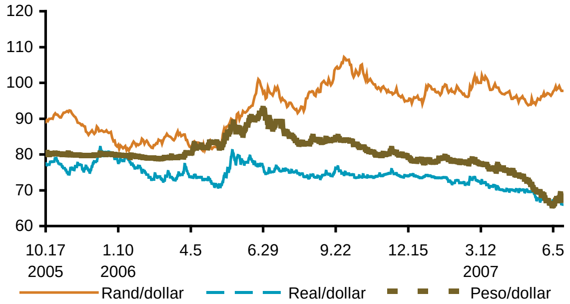


Source: Bloomberg

Figure 4.17 – Emerging markets currencies

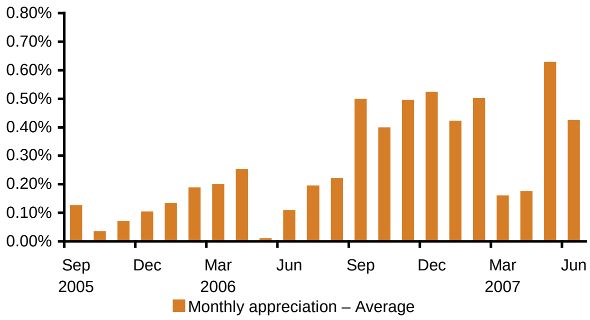
Brazil, Colombia and South Africa

9.19.2003=100



Source: Bloomberg

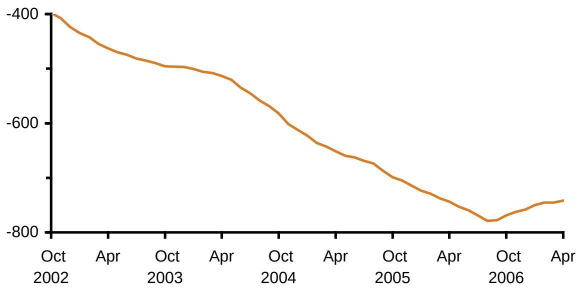
Figure 4.18 – Renminbi/dollar exchange rate
Monthly appreciation – Average



Source: Bloomberg

Figure 4.19 – USA – Trade balance accumulated in 12 months

US$ billion



Source: Bloomberg

evolution of that country's economy dominated international investor evaluations.

On June 15, the dollar rate against the pound sterling and euro increased 1.62% compared to the April 18 position. However, the rate remained 1.5% and 3.3% below the rates in effect on February 12, respectively. Appreciation of the dollar against the yen began in early March, when international investors gradually reinitiated carry trade operations financed on the Japanese credit market. On June 15, the dollar rate surpassed that in effect on March 7, 6.4%, and February 12, 1.2%.

As of early March, the dollar began losing value once again against the currencies of the emerging countries. This movement was particularly important in relation to the currencies of countries for which international agencies had raised their ratings during the period, including Columbia and Brazil, since the dollar had depreciated against these currencies 14.1% and 9.5%, respectively, between March 7 and June 15.

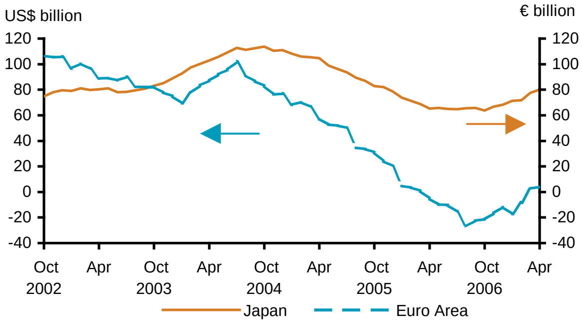
Another important event on emerging country exchange markets was the increase in the daily float band permitted for the renminbi rate against the United States dollar from 0.3% to 0.5%, implemented on May 18. After two months of downward movement, average appreciation of the renminbi against the dollar reached 0.62% in May, the largest growth since the process of exchange rate easing began. Through June 15, the Chinese currency appreciated 0.42% against the average May rate.

4.4 World trade

In the early months of the current year, the evolution of world trade demonstrated the decreasing importance of United States demand in determining its pace of growth. This phenomenon is more consistent in the Asian economies, particularly China, and reveals penetration into such new markets as the European Union and non-Asian emerging markets, reflecting consolidation of operations with nontraditional partners.

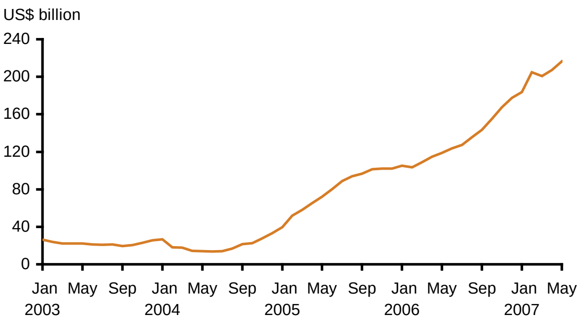
Driven by the uptick in global activity levels and dollar depreciation, United States exports expanded at a sharper pace than imports in the eight-month period through April. This performance resulted in a reduction in the ratio between the United States current account deficit and GDP from 6.6% in the first quarter of 2006 to 5.7% in the corresponding quarter of 2007.

Figure 4.20 – Japan and Euro Area – Trade balance accumulated in 12 months



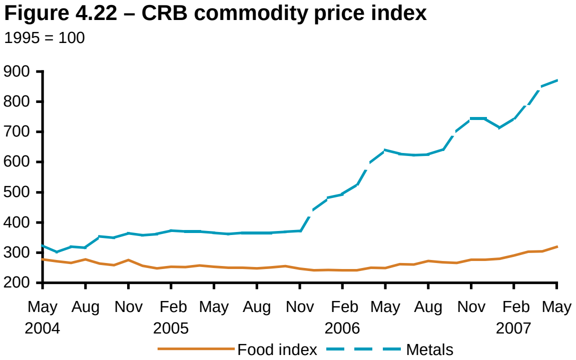
Source: Bloomberg

Figure 4.21 – China – Trade balance accumulated in 12 months



Source: Bloomberg

Figure 4.22 – CRB commodity price index



Source: Commodity Research Bureau (CRB)

In April, the American trade balance registered a US$58.5 billion deficit, 6.2% less than in the previous month and US$9.2 billion below the record deficit set in August 2006. Foreign sales expanded 0.2% to a record high of US$129.5 billion, while imports fell 1.9% to US$188 billion, despite a US$4.28 increase in the average per barrel price of oil to US$57.28.

In the Euro Area, the balance of trade closed with a surplus of €1.8 billion in April, compared to a €7.6 billion surplus in the previous month and a €2.7 billion deficit in April 2006. Based on seasonally adjusted data, exports expanded 0.6% in April compared to the previous month, while imports rose 2.2%.

The Japanese trade balance surplus closed at ¥926.7 billion in April, up 51.8% over the same month of 2006. However, this result reflected a drop of 8.2% compared to the previous month. The volume of exports channeled to the United States trended downward, and was offset by sales to the countries of Asia.

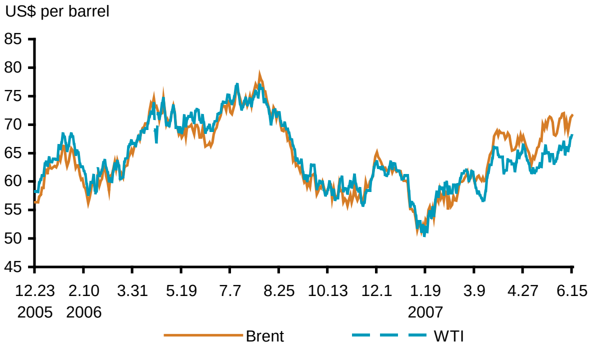
Chinese trade flows have registered increasingly more robust results, with a May total of US$165.6 billion. The trade surplus totaled US$22.5 billion, with exports of US$94 billion, up 28.7% over the May 2006 figure, and growth of 19.1% under imports.

4.4.1 Commodities

The prices of metallic commodities were strongly impacted by a robust performance under world economic activity. In the month of May, metal prices registered highs of 16.8% over the February result and 40.3% compared to the average 2006 price. Using the latter basis of comparison, the price of nickel rose 98%, while the price of copper increased 24% in a quarter-on-quarter comparison.

The prices of farm commodities expanded 9.5% in May, compared to the February result, and closed 23% above the average prices in effect in 2006. Using this basis of comparison, the major increases were as follows: corn, 45%; soybeans, 34.8%; and wheat, 26.5%. On the other hand, sugar prices dropped 35.7%.

Figure 4.23 – Oil – Spot market



Source: Bloomberg

4.4.1.1. Oil

The price of Brent type oil on the international spot market increased 18% between February 28 and June 15, closing at US$71.60 per barrel, compared to the average 2006 price of US$65.40. In a framework of stronger than expected world economic activity, this trajectory reflected geopolitical tensions in the Middle East and production problems in Nigeria, considered the major market risks, as well as measures taken by the Organization of the Petroleum Exporting Countries (Opec) with the objective of rejecting any possible supply increases.

In the case of futures markets, contracts negotiated on February 28 for delivery of Brent type oil in December 2007 were closed at US$66.26. On June 15, these contracts hit US$73.08, reflecting a 10.3% high in the period. The International Energy Agency (IEA) revised its estimate of world oil demand in 2007 to 86.1 million barrels/day, reflecting 1.7 million barrels/day growth, compared to 2006.

4.5 Conclusion

As has happened in the last five years, the outlook for continued world economic growth at a rate above 4% has given rise to concerns regarding the sustainability of this rate and its repercussions on the prices of the economy. Sustained growth will benefit from renewed investments, particularly in the countries of Asia, which have acted as the major driving force underlying the current cycle of economic growth.

With respect to prices, inflation expectations remain well anchored, demonstrating efficient monetary policy management. Nonetheless, mention should be made of the persistent risks consequent upon possible new oil and commodity price hikes.

5 External sector

As stressed in recent issues of the "Inflation Report", the solidity of the nation's external accounts has clearly enhanced the freedom accorded to economic policy management. Driven by the sustained dynamics of the export sector, the country is expected to register its third consecutive trade balance surplus in excess of US$40 billion, a result that becomes even more impressive when one considers that imports have increased at a rate consistent with the upturn in economic activity. In this context, burgeoning trade surpluses have accompanied expanding trade flows, stimulating further opening of the Brazilian economy to the world market, albeit on a still relatively limited basis.

Trade balance performance is reflected in consecutive current account surpluses, expected to reach US$10.7 billion in the current year. At the same time, strengthening of the nation's macroeconomic fundamentals, including stabilization of inflation and rapidly accelerating growth, should stimulate voluminous inflows of foreign direct investment, coupled with investments in stocks and fixed income securities negotiated in the country. Evidently, together with consecutive current account surpluses, these inflows will aid in preserving the already high overall balance of payments surplus.

In this scenario, measures are being implemented to improve the nation's capacity to withstand possible external adversities. The Central Bank has taken advantage of positive exchange market balances to further strengthen Brazil's international reserve position, following the announced policy of not imposing limits nor tendencies on exchange rate fluctuations while avoiding measures that could increase market volatility. International market issuance of sovereign bonds in national currency continued at steadily decreasing interest rates, thus reducing external debt exposure to exchange rate variations. Parallel to this, the National Treasury has insisted on its policy of external debt buyback operations, designed to improve the debt profile in the coming years.

5.1 Foreign exchange flows

In the first four months of the year, currency markets generated net inflows of US$28.1 billion, against US$18.3 billion in the corresponding period of the previous year. In the export segment, contracted resources reached US$60.6 billion – including anticipated payment of US$6 billion in exports by a mining company to refinance short-term debt generated by acquisition of a foreign-based company, while the import segment contracted US$30.1 billion, corresponding to increases of 42.8% and 18.2%, respectively, in the same four-month period. Consequently, the exchange surplus in this segment reached US$30.5 billion, up 79.8% in the period under consideration.

Table 5.1 – Foreign exchange flows

US$ billion

	2006			2007	
	Apr	Jan-Apr	Year	Apr	Jan-Apr
Operations with clients in Brazil	0.6	18.3	37.3	10.7	28.1
Trade operations	3.3	16.9	57.6	9.8	30.5
Exports	10.1	42.4	144.4	17.1	60.6
Imports	6.8	25.5	86.8	7.3	30.1
Financial operations[1/]	-2.7	1.4	-20.3	0.9	-2.3
Purchases	11.1	58.8	195.4	24.0	87.2
Sales	13.8	57.5	215.7	23.1	89.6
Net flows	0.6	18.3	37.3	10.7	28.1

1/ Excluding interbank operations and Central Bank foreign operations.

Financial segment contracting operations posted net outflows of US$2.3 billion in the January-April period, against US$1.4 billion in January-April 2006, for growth of 48.3% in foreign currency purchases and 55.9% in sales.

The cumulative four-month exchange surplus made it possible for Bacen to purchase a net total of US$32.9 billion in the period, compared to US$34.3 billion in all of 2006. The difference between the exchange market balance and net Bacen acquisitions was caused by expansion of the US$7.5 billion in the short position held by banks at the end of April, compared to US$2 billion at the end of 2006.

5.2 Trade in goods

The trade balance surplus set a new record for the month of May, with US$3.9 billion. Exports totaled US$13.6 billion, compared to imports of US$9.8 billion, with an overall trade flow of US$23.4 billion, all of which represented new records for the month of May.

Table 5.2 – Trade balance – FOB

US$ million

Period		Exports	Imports	Balance	Total trade
Jan-May	2007	60 013	43 244	16 769	103 257
Jan-May	2006	49 466	34 131	15 335	83 596
% change		21.3	26.7	9.4	23.5

Source: MDIC/Secex

In much the same way, average daily exports broken down by aggregate factor registered record levels for the month under all three categories. The exported value of basic products increased 49.7% compared to May 2006, followed by semimanufactured products, with 46.9%, and manufactured goods, with 22.4%.

For the most part, the increased dynamics of basic product sales reflected exports of soy meal, 105%; iron ore, 94.8%; chicken meat, 85.9%; and oil, 54.5%. At the same time, one should highlight strong growth under exports of corn, 214%. Though these operations still represent a relatively small percentage of overall foreign sales, the outlook for this

Table 5.3 – Exports by aggregate factor – FOB

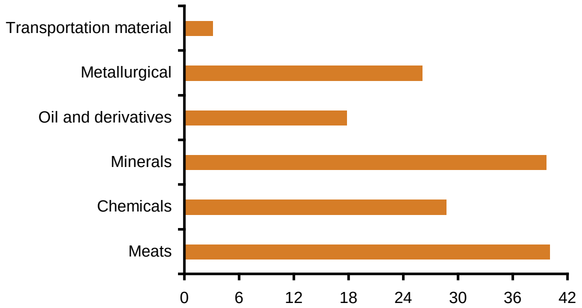
Daily average – January-May

US$ million

	2006	2007	% change
Total	480.2	577.0	20.2
Primary products	133.3	176.7	32.5
Industrial products	334.8	388.7	16.1
Semimanufactured goods	63.9	80.2	25.5
Manufactured goods	270.8	308.4	13.9
Special operations	12.1	11.6	- 4.2

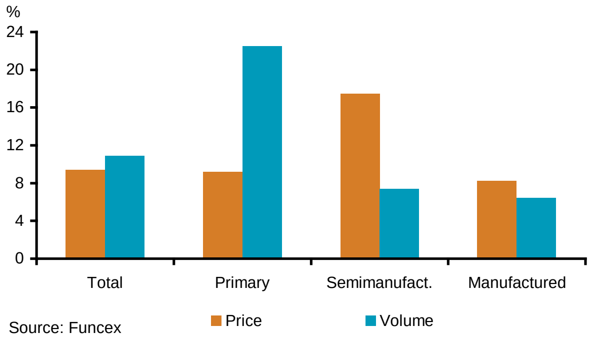
Source: MDIC/Secex

Figure 5.1 – Main exports
January-May – 2007/2006 – % growth



Source: MDIC/Secex

Figure 5.2 – Exports – Price and volume index
January-May – 2007/2006



Source: Funcex

product is considered highly positive in light of the trend toward increased demand for biofuels.

Expanded exports of semimanufactured goods were generated by increased sales of soybean oil, 198%; iron and steel semimanufactured goods, 79.8%; and cast iron, 108%; while the dynamics of manufactured product exports at least partially reflected upturns in sales of orange juice, 84.4%; aircraft, 62.9%; and flat rolled steel, 43.4%. Furthermore, particular mention should be made of the fact that gasoline exports in the month expanded more than 1,000%, closing May 2007 at US$270 million.

Cumulative foreign sales in the first five months of the year totaled US$60 billion with record levels of US$32.1 billion in manufactured goods, US$18.4 billion in basic products and US$8.3 billion in semimanufactured goods.

In January-May 2007, the volume of foreign sales expanded sharply, becoming a factor of greater importance than price increases to growth in the final value of exports. According to the Funcex, price and volume indices of Brazilian exports expanded 9.4% and 10.9%, respectively, from January to May 2007, compared to the same period of the previous year. This behavior differed among the various aggregate factors. The increased dynamics of exported volume was particularly evident under basic products, 22.5%, while manufactured goods and semimanufactured products posted growth rates of 6.5% and 7.4%. Price growth was stronger under semimanufactured goods, 17.5%, while growth in the prices of basic goods reached 9.2%, with 8.3% under manufactured products.

Analysis of foreign sales value by product segment indicates that only electric and electronic equipment registered declines in the first five months of 2007, compared to the same period of the previous year. Exports leveled off in the textile sector, an industry directly impacted by competition from Chinese products. At the same time, however, foreign sales of the six sectors with the greatest weight in the nation’s exports turned in the following rates of growth: meats, 40.1%; ore, 39.7%, chemicals, 28.7%; metallurgical goods, 26.1%; oil and derivatives, 17.8%; and transportation equipment, 3.1%. It is important to underscore that sales of these six sectors plus soybean marketing operations accounted for 62.6% of total Brazilian exports in the period.

In keeping with performance in recent years, imports continued expanding. This behavior – a clear demonstration of the virtuous cycle through which the Brazilian economy is

Table 5.4 – Imports by final use category – FOB

Daily average – January-May

US$ million

Itemization	2006	2007	% change
Total	331.4	415.8	25.5
Capital goods	71.0	87.7	23.4
Raw materials	164.5	208.6	26.8
Naphtha	6.1	7.5	23.5
Consumer goods	41.3	55.7	34.9
Durables	20.2	26.3	30.3
Passenger vehicles	5.3	8.1	52.1
Nondurables	21.1	29.4	39.4
Fuels and lubricants	54.5	63.8	17.0
Crude oil	34.8	31.3	- 10.2

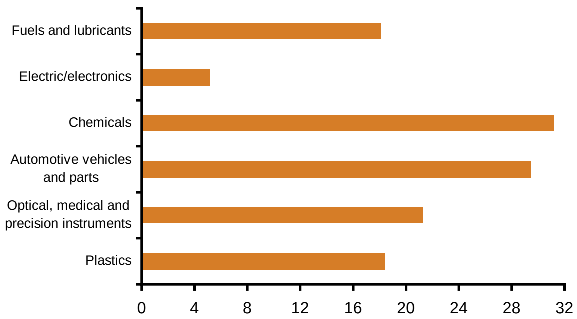
Source: MDIC/Secex

passing – is reflected in US$43.2 billion in cumulative foreign purchases in the first five months of the year. In the month of May, foreign purchases expanded 34.2% over May 2006, with across-the-board growth in all of the various use categories. The imported value of raw materials and intermediate products, representing approximately half of the nation's imports, increased 37.6% in the period, led by accessories for transportation equipment, 36.9%; mineral products, 26.9%; and chemical and pharmaceutical goods, 26%.

Consumer goods imports rose 33.5% compared to May 2006, with growth of 31.5% under consumer durables, particularly automobiles, 59.9%; personal use and adornment articles, 22.3%; and machines and apparatuses for home use, 20.9%; together with 35.5% under nondurable consumer goods, mostly involving imports of pharmaceutical products, 31.6%; food products, 9.4%; and apparel, 142%.

In the month of May, foreign purchases of capital goods increased 29% compared to May 2006, with across-the-board growth under all of the various components of this segment. With this result, imports of parts and spares for capital goods expanded 89.6% in the period, followed by industrial machinery and office machines and apparatuses, both of which expanded 38.3%. Imports of fuels and lubricants increased 31.3% in the period, with a 3.5% decline in foreign oil purchases.

Figure 5.3 – Imports by main products
January-May – 2007/2006 – % change

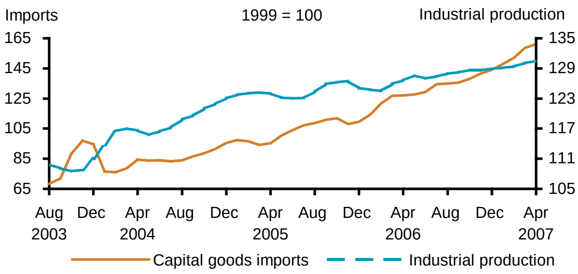


Source: MDIC/Secex

A breakdown of import operations in the January-May 2007 period shows generalized growth in the major headings of Brazilian imports. Looking only at the major sectors, responsible for 60.4% of the country's overall imports in the period, foreign purchases of organic and inorganic chemical products increased 31.2%, followed by automotive vehicles and parts, 29.5%; mechanical equipment, 27.1%; optical, precision and medical instruments, 21.3%; and fuels and lubricants, 18.1%. Parallel to these results, imports expanded sharply in the sectors of fertilizers, 130%; aircraft and parts, 59.6%; and grains and grinding products, 58.9%.

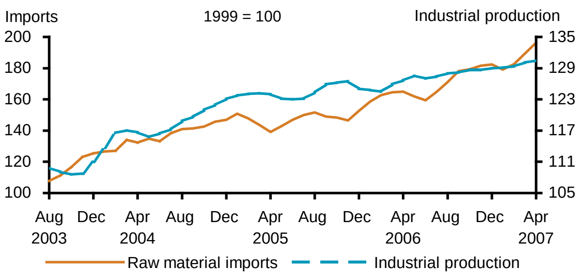
According to Funcex data, 26.8% growth in the value of Brazilian exports in the January-May 2007 period, compared to the same period of 2006, resulted from a 3% rise under prices and 23.1% under imported volume. This positive growth scenario for foreign purchases as regards particularly expanded volume was noted in all of the various final use categories. Imports of nondurable consumer goods registered 11.2% price growth in the period, compared to reductions of 0.4% under consumer durables and 2.2% under capital goods. Raw materials and intermediate goods and fuels and lubricants

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



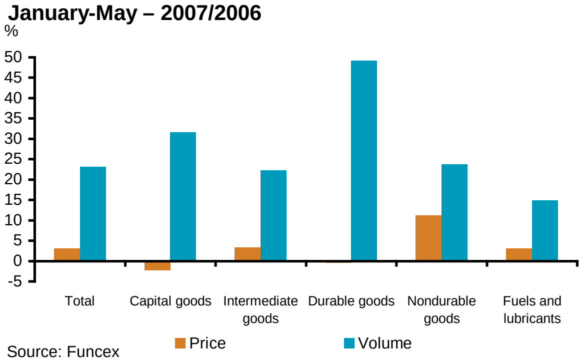
Source: Funcex and IBGE

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



Source: Funcex and IBGE

Figure 5.6 – Imports – Price and volume index January-May – 2007/2006



Source: Funcex

registered price growth in the range of 3%. With respect to the performance of imported volume, foreign purchases of raw materials and intermediate goods expanded 22.3%, with 49.1% in operations involving consumer durables. Evidently, these operations were driven by exchange appreciation, expanding income and growth in the domestic credit supply. Imported volume of capital goods, nondurable consumer goods and fuels and lubricants expanded 31.7%, 23.7% and 15%, respectively, in the period.

With the sole exception of Asia, Brazil registered positive balances in operations with all of the major blocs and regions. A comparison of daily averages registered in January-May 2007 and the same period of 2006 shows 36% growth in exports to China, while those channeled to the European Union and Latin American Integration Association (Aladi) increased 32.3% and 14.8%, respectively. The major markets of destination for Brazilian exports in the first five months of the year were the European Union, absorbing 25.1% of total Brazilian foreign sales, and the Aladi member countries, with 22.3%; while the major individual buyer was the United States, 16.5%. These data indicate that the rate of exchange between the real and euro cannot be ignored in any analysis of the profitability of Brazilian exports.

Analysis of operations with the different countries of origin indicates growth of 47.3% in imports from China, when the same period of comparison is utilized. This result raised the participation of Asia in overall Brazilian imports to 24.9%, ensuring that the region would continue as the largest supplier of goods to Brazil. Imports from the European Union and Aladi countries accounted for 22.6% and 17.4%, respectively, of total Brazilian foreign purchases. Here, it is important to stress that, in the Aladi framework, imports from Mexico and Argentina increased 50% and 33.9% in that order. Imports from the United States, the major individual supplier, rose 24.8% in the period, accounting for 16.4% of total Brazilian imports.

5.3 Services and income

The current accounts result accumulated a positive balance of US$15.1 billion in the 12-month period ended in April 2007, equivalent to 1.37% of GDP, compared to US$13.3 billion in the same period of the previous year, 1.42% of GDP. Though the service account deficit has accelerated when this comparison is used, the trade balance surplus combined with reductions in the income account deficit has generated growth in the cumulative current account surplus.

Table 5.5 – Exports and imports by area – FOB

Daily average – January-May

US$ million

Itemization	Exports			Imports			Balance	
	2006	2007	% change	2006	2007	% change	2006	2007
Total	480	577	20.2	331	416	25.5	149	161
Latin America	112	128	14.8	56	72	29.0	56	56
Mercosur	50	59	18.9	31	41	33.3	19	18
Argentina	42	49	16.9	28	37	33.9	14	12
Other	8	10	30.0	3	4	27.5	4	6
Mexico	17	16	- 8.4	4	7	50.0	13	9
Other	45	53	19.2	21	24	18.2	24	29
USA1/	90	95	5.8	55	68	24.8	35	27
EU	109	145	32.3	75	94	24.9	34	51
E. Europe	12	15	25.6	4	8	128.1	8	7
Asia	71	89	26.0	85	104	22.0	- 14	- 14
Japan	14	16	12.9	15	17	9.0	- 1	0
South Korea	7	8	1.6	13	12	- 4.4	- 5	- 5
China	27	37	36.0	28	41	47.3	- 1	- 4
Other	22	29	30.4	29	34	16.2	- 7	- 5
Others	86	104	21.0	57	69	21.9	29	35

Source: MDIC/Secex

1/ Includes Puerto Rico.

Table 5.6 – Current account

US$ billion

	2006			2007		
	Apr	Jan-Apr	Year	Apr	Jan-Apr	Year1/
Current account	0.1	1.7	13.3	1.8	3.5	10.7
Trade balance	3.1	12.3	46.1	4.2	12.9	40.0
Exports	9.8	39.2	137.5	12.4	46.4	152.0
Imports	6.7	26.8	91.4	8.2	33.5	112.0
Services	-0.6	-2.4	-9.7	-0.9	-3.1	-10.4
Transportation	-0.2	-0.8	-3.1	-0.3	-1.1	-3.6
International travel	-0.1	-0.1	-1.4	-0.2	-0.4	-1.8
Computer and informat.	-0.2	-0.7	-1.9	-0.2	-0.7	-2.1
Operational leasing	-0.3	-1.4	-4.9	-0.4	-1.7	-5.0
Other	0.1	0.7	1.7	0.2	0.9	2.1
Income	-2.7	-9.6	-27.5	-1.8	-7.6	-23.4
Interest	-1.1	-4.4	-11.3	-0.7	-3.5	-7.9
Profits and dividends	-1.6	-5.2	-16.4	-1.1	-4.2	-15.7
Compensation of employment	0.0	0.1	0.2	0.0	0.2	0.2
Current transfers	0.3	1.3	4.3	0.3	1.3	4.5

1/ Forecast.

In the first four months of the year, net remittances of services totaled US$3.1 billion, while income remittances came to US$7.6 billion. Compared to the first four months of 2006, these figures represented growth of 33.1% and a decline of 21.3%, in the same order. Parallel to growth in the deficit, one must stress the continued trend toward increasingly larger service account transactions, including both revenues and expenditures, significantly increasing the flow of trade in international services.

From January to April of this year, revenues on international travel reached US$1.7 billion and spending closed at US$2.2 billion, for respective growth rates of 10.4% and 28.3% compared to the same period of 2006. Net outlays totaled US$433 million in the period, compared to a US$119 million deficit in the same period of 2006.

With regard to the income account, the highlight was growth in interest revenues due to expanded Brazilian assets abroad and, particularly, larger international reserves. Net interest outlays registered a cumulative January-April total of US$3.5 billion, against US$4.4 billion in the corresponding period of the previous year. Earnings on reserves increased 116.1% using the same basis of comparison and closed at US$1.5 billion.

From January to April of this year, net remittances of profits and dividends added up to US$4.2 billion, compared to US$5.2 billion in the corresponding period of 2006. Over 12 months, net remittances accumulated a total of US$15.4 billion, remaining stable at that level since June of last year.

Net unrequited transfers added up to US$1.3 billion in the first four months of the year, remaining at the level posted in the same period of the previous year. In the 12-month period ended in April, however, net inflows expanded 15.9%.

5.4 Financial account

The balance of payments financial account registered a surplus of US$8.9 billion in April, with a cumulative balance of US$30.8 billion in the year. Brazilian Direct Investments Abroad (BDIA) generated net returns of US$2.8 billion in the year through April. BDIA equity capital continues to show increase in assets abroad, with US$3.5 billion in the period under analysis, while intercompany loans posted net amortizations of US$6.2 billion.

Table 5.7 – Financial account

Itemization	2006 Apr	2006 Jan-Apr	2006 Year	2007 Apr	2007 Jan-Apr	2007 Year[1/]
						US$ billion
Capital account	-3.9	0.2	15.5	8.9	30.8	28.0
Direct investments	0.4	1.3	-9.4	4.3	12.8	15.0
Abroad	-0.3	-3.5	-28.2	0.8	2.8	-10.0
In Brazil	0.8	4.7	18.8	3.5	10.0	25.0
Equity capital	0.7	3.3	15.4	2.6	8.3	25.0
Intercompany loans	0.1	1.4	3.4	0.9	1.8	0.0
Portfolio investments	-5.5	1.2	9.6	5.3	14.7	19.8
Assets	-0.2	0.2	0.5	-0.2	0.2	-1.2
Liabilities	-5.3	1.0	9.1	5.5	14.5	21.0
Derivatives	0.1	0.2	0.4	0.1	0.1	0.0
Other investments	1.0	-2.5	14.9	-0.9	3.2	-6.8
Assets	1.2	-4.8	-8.9	-3.2	-7.0	-15.9
Liabilities	-0.2	2.3	23.8	2.3	10.2	9.1

1/ Forecast.

Table 5.8 – BP financing sources
Selected items

	2006 Apr	2006 Jan-Apr	2006 Year	2007 Apr	2007 Jan-Apr	2007 Year[1/]
						US$ billion
Medium and long-term funds	0.5	5.4	33.5	2.3	6.1	23.5
Public bonds	0.0	1.4	4.8	0.5	2.1	2.9
Private debt securities	0.2	3.3	10.3	1.5	3.3	15.4
Direct loans	0.3	0.7	18.4	0.2	0.7	5.2
Short-term loans (net)[2/]	-0.5	-0.8	-0.5	0.4	-0.8	8.5
Short-term securities (net)	0.0	-0.6	0.1	0.4	-0.6	2.0
Roll-over rates (%)						
Private sector:	128%	326%	206%	56%	60%	100%
Debt securities	86%	397%	206%	161%	226%	188%
Direct loans	175%	165%	205%	11%	16%	42%

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

Net inflows of Foreign Direct Investments (FDI) totaled US$10 billion in the first four months of the year, compared to US$4.7 billion in the corresponding period of 2006. When cumulative 12-month values are considered, FDI also registered positive growth, with a total of US$24.1 billion through April, the highest value in this series since October 2001. This was the ninth consecutive month of positive growth using this basis of comparison. Equity capital net inflows reached R$8.3 billion in the year through April, while intercompany loans totaled US$1.8 billion.

Portfolio investments, stocks and fixed income securities posted a surplus of US$5.7 billion in April, raising net inflows in the year to US$10.7 billion. Net inflows to stock exchanges reached US$2.7 billion in the month and US$5.3 billion in the year. Net revenues on fixed income securities negotiated in the country accelerated over the course of the year, reaching US$3.1 billion in April alone, compared to US$3.5 billion in the first quarter of the year.

As far as foreign investments negotiated abroad are concerned, with the exception of bonds which were impacted by the National Treasury buyback program, the major headings posted surpluses in both April and in cumulative terms for the year. In the month of April, medium and long-term bonds registered net outflows of US$1.2 billion, based on disbursements of US$525 million resulting from reopening of Global 17 and amortizations of US$1.8 billion. Of this total, US$957.7 million referred to the face value of repurchased securities and US$283.9 billion to premiums on these operations. In the year, net outflows of bonds reached US$2.8 billion.

With regard to private medium and long-term securities, net inflows reached US$564 million in April and US$2.8 billion in the four-month period, while net disbursements of short-term securities added up to US$2.5 billion in the January-April 2007 period.

Other Brazilian investments corresponded to assets abroad in the amount of US$3.2 billion in April and a cumulative total of US$7 billion in the first four months of the year.

Other foreign investments posted surpluses of US$2.3 billion in April, with a cumulative balance of US$10.2 billion in the year. A breakdown of this result shows that short-term trade credit lines accounted for the entire surplus in the month, registering net cumulative inflows of US$4.2 billion, at the same time in which direct loans closed with a deficit of US$2.1 billion. Short-term loans posted net disbursements of US$360

Table 5.9 – Statement of international reserves

	2006		2007	
	Jan-Apr	Year	Jan-Apr	Year[1]
Reserve position in previous period	53.8	53.8	85.8	85.8
Net Banco Central purchases	10.1	34.3	32.9	32.9
Debt servicing (net)	-16.7	-22.8	-4.9	-6.5
Interest	-2.2	-2.8	-0.7	-0.2
Credit	0.7	2.8	1.5	4.5
Debit	-2.9	-5.6	-2.2	-4.7
Amortization	-14.6	-20.0	-4.2	-6.3
Disbursements	1.9	6.6	2.1	3.5
Multilateral organizations	-	1.2	-	0.6
Sovereign bonds	1.9	5.5	2.1	2.9
Others[2]	0.3	1.5	-0.5	-0.5
Treasury's purchases	7.2	12.3	6.3	10.9
Change in assets	2.8	32.0	36.0	40.3
Gross reserve position	56.6	85.8	121.8	126.1

US$ billion

1/ Forecast.

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

million. In the first four months of the year, short-term trade credit lines reflected the dynamics of export-related exchange contracting operations, accumulating a positive balance of US$10.1 billion. The performance of direct loans varies according to the length of maturities. In the case of medium and long-term operations, net outflows totaled US$7.9 billion, including amortization of US$8.3 billion in bridge loans contracted by a Brazilian mining company with the objective of financing direct investments abroad. Over the short-term, net inflows from January to April totaled US$7.8 billion.

At the end of April, international reserves totaled US$121.8 billion, up US$36 billion in the first four months of 2007. Bacen purchases on the exchange spot market reached US$32.9 billion. Among external operations, the highlights were disbursements of US$2.1 billion in bonds of the Republic and amortizations of US$4.2 billion, with US$69 million involving the Multi-Year Deposit Facility Agreement (MYDFA) and US$4.1 billion derived from sovereign bonds. The latter figure includes US$2.4 billion in National Treasury buyback operations involving external debt securities. Net interest outlays in the amount of US$688 million resulted from payments of US$2.2 billion in bond interest and revenues of US$1.5 billion in earnings on reserves. Settlements of National Treasury purchases reached US$6.3 billion, while other operations resulted in US$460 million in spending.

At the end of 2007, estimates indicate that the international reserves stock will reach US$126.1 billion, up US$40.3 billion compared to the final 2006 position. Including what occurred in the first four months of the year, payments of external debt service are forecast at US$6.5 billion, while disbursements by international organizations are predicted at US$600 million, coupled with sovereign bond disbursements in the amount of US$2.9 billion. Settlements of Central Bank purchases, all of which have already occurred, are estimated at US$32.9 billion, with US$10.9 billion by the National Treasury on the domestic exchange market.

5.5 External sustainability indicators

For the most part, external sustainability indicators remained on a positive trajectory, when external debt estimates for April 2007 are compared to those of December of the previous year. These factors indicate a benign performance on the part of exports, GDP and international reserves, more than offsetting the impact of increases in total external debt in the period.

Table 5.10 – Sustainability indicators

US$ billion

	2005		2006			2007
	Sep	Dec	Jun	Sep	Dec	Apr[1/]
Exports of goods	112.9	118.3	125.5	132.3	137.5	144.6
Exports of goods and services	128.0	134.4	143.2	151.0	156.9	162.4
Debt service	52.8	66.0	76.8	67.7	56.9	56.5
Total external debt	183.2	169.5	156.7	159.6	172.6	182.8
Net external debt	110.0	101.1	79.4	70.8	74.8	48.8
International reserves	57.0	53.8	62.7	73.4	85.8	121.8
GDP	827	883	969	1017	1067	1102
Indicators						
Total external debt/GDP (%)	22.2	19.2	16.2	15.7	16.2	16.6
Net external debt/GDP (%)	13.3	11.5	8.2	7.0	7.0	4.4
Total external debt/exports	1.6	1.4	1.2	1.2	1.3	1.3
Total external debt/exports of goods and services	1.4	1.3	1.1	1.1	1.1	1.1
Net external debt/exports	1.0	0.9	0.6	0.5	0.5	0.3
Net external debt/exports of goods and services	0.9	0.8	0.6	0.5	0.5	0.3
Debt service/exports (%)	46.7	55.8	61.2	51.1	41.4	39.0
Debt service/exports of goods and services (%)	41.3	49.2	53.6	44.8	36.2	34.8
Reserves/total external debt (%)	31.1	31.7	40.0	46.0	49.7	66.6

1/ Estimated data.

The external debt expanded US$10.3 billion in the period, exclusively as a result of greater short-term indebtedness, while the net overall debt dropped US$26 billion. Considering the US$34.5 billion increase in GDP expressed in dollars, the ratio between total debt and GDP moved from 16.2% in December to 16.6% in April, while the ratio between total net debt and GDP dropped from 7% to 4.4%, the lowest level since the series was first calculated in 1970.

The coefficient between total debt and exports remained at 1.3 in April, while the ratio between total net debt and exports dropped from 0.5 to 0.3, reaching its lowest level since the start of the series in 1970.

In the same period, the percentage of total external debt backed by international reserves increased from 49.7% to 66.6%, the highest level ever registered. This is a clear demonstration of the impact of US$36 billion growth in the international reserve position in the four-month period.

5.6 Conclusion

The cumulative balance of payments surplus registered in the early months of the year is already sufficient to finance 2007 external accounts. Internally, this result was generated by adoption of consistent and credible macroeconomic policies and, on the external front, by the favorable international situation, marked by still abundant liquidity and significant demand growth. With the strengthening of the country's external accounts, the government has implemented a policy of expanding its reserve position at the same time in which measures are being taken to reduce external indebtedness. One example would be buyback operations and qualitative international market issuances, including bonds denominated in real. In this way, the risk levels attributed to Brazilian securities have registered historic lows, creating the conditions needed both for obtaining investment grade ratings and for consolidating the highly positive medium-term outlook for the macroeconomic scenario.

Balance of Payments Projections

Table 1 – Uses and sources

US$ billion

	2006			2007		
	Apr	Jan-Apr	Year	Apr	Jan-Apr	Year[1/]
Uses	-8.2	-17.5	-30.8	-3.8	-15.4	-23.7
Current account	0.1	1.7	13.3	1.8	3.5	10.7
Amortizations ML-term[2/]	-8.3	-19.2	-44.1	-5.7	-18.9	-34.3
Securities	-7.1	-14.4	-25.6	-2.7	-7.7	-15.6
Paid	-7.1	-14.3	-24.2	-2.7	-7.5	-15.4
Refinancing	0.0	0.0	-0.7	0.0	0.0	0.0
FDI conversions	0.0	-0.1	-0.7	0.0	-0.2	-0.2
Suppliers' credits	-0.1	-0.5	-1.7	-0.2	-0.5	-1.9
Direct loans[3/]	-1.0	-4.3	-16.9	-2.8	-10.7	-16.8
Sources	8.1	17.4	30.6	3.8	15.4	23.7
Capital account	0.1	0.3	0.9	0.1	0.3	1.0
FDI	0.8	4.7	18.8	3.5	10.0	25.0
Domestic securities[4/]	1.2	6.9	14.7	4.7	9.5	15.0
ML-term disbursem.[5/]	1.0	10.6	43.7	2.8	10.7	31.1
Securities	0.2	6.2	15.8	2.0	7.7	18.3
Suppliers' credits	0.0	0.3	0.8	0.1	0.2	1.2
Loans[6/]	0.7	4.1	27.1	0.7	2.7	11.7
Brazilian assets abroad	0.7	-7.8	-36.1	-2.5	-3.9	-27.1
Other[7/]	0.6	4.8	19.4	7.3	24.1	18.3
Reserve assets	3.8	-2.0	-30.6	-12.0	-35.3	-39.6

1/ Forecast.
2/ Registers amortization of medium and long-term suppliers' credits, loans and securities placed abroad minus refinancing and discounts. Excludes amortizations referring to IMF and intercompany loans.
3/ Registers amortizations of loans granted by foreign banks, buyers, agencies and multilateral organizations.
4/ Includes foreign investment in equity and in debt securities traded in the domestic market.
5/ Excludes intercompany loans disbursements.
6/ Includes multilateral and bilateral financing and buyers' credits.
7/ Registers net values of bond swaps, short-term securities, short-term trade credit, financial derivatives, nonresident deposits, other liabilites and errors & omissions.

This box presents projections for the 2007 balance of payments. Compared to the forecasts published in the previous quarter's "Inflation Report", these updatings are based on the observed trajectories of the major headings; net Bacen purchases on exchange markets and the results of the National Treasury external bond buyback program, both of which considered only data up to the month of April. Consequently, the major modifications are found under exports, direct investments, foreign portfolio investments, short-term capital inflows, deposits in banks abroad and changes in reserve assets.

Projections indicate that current accounts will close 2007 with a surplus of US$10.7 billion. Growth of US$3 billion compared to the previous forecast reflects nothing more than a review of the projection for Brazilian exports in the year. Despite the environment of renewed activities and the consequent rise in imports, the country posted a strong trade surplus for the third consecutive year, moving from US$44.7 billion, in 2005, to US$46.1 billion in 2006 and US$40 billion in 2007.

In the year through May, cumulative exports totaled US$60 billion, corresponding to a daily average of US$577 million. Considering the value exported per business day, external sales expanded 20.2% in relation to the same period of 2006. Based on these data and projecting some degree of deceleration before the end of the year, 2007 exports were revised to US$152 billion, US$3 billion more than in the previous "Inflation Report". For the second consecutive year, imports are expected to expand at a more rapid pace than foreign sales. Overall cumulative imports in the year through May reached US$43.2 billion, for a daily average of US$415.8

million, 25.5% higher than in the equivalent period of 2006. This performance is consistent with 22.6% growth in the year, implicit in the US$112 billion projection for 2007 foreign purchases.

Projections regarding other current account headings were not altered. The service account deficit is estimated at approximately US$10.4 billion, with net outflows of US$5 billion in equipment rentals, US$3.6 billion in transportation and US$2.1 billion in computer and information services.

The income account deficit is forecast at US$23.4 billion, based on net outflows of US$7.9 billion in interest and US$15.7 billion in profits and dividends. In both cases, reductions occurred in projections of deficits compared to the previous year, basically as a result of increased credits. Interest revenues are forecast at US$6.5 billion in 2007, for growth of 27.7% compared to 2006, mostly as a result of increased earnings on international reserves. Revenues on profits and dividends should reach US$1.5 billion during the course of the year, compared to US$949 million last year, as a result of sharp growth in Brazilian assets abroad.

Net revenues on current unilateral transfers are expected to close the year at US$4.5 billion.

In 2007, the financial account should close with net inflows of US$28 billion, compared to US$10.5 billion forecast in the March "Inflation Report". For the most part, this increase is due to growth of US$5 billion in FDI; US$6.5 billion in foreign portfolio investments and US$14.8 billion in other foreign investments. In the opposite sense, the outlook for new BDIA also increased to a level of US$10 billion in the year.

Forecasts for net inflows of FDI in 2007 were revised upward from US$20 billion to US$25 billion. From January to April of this year, these flows reached US$10 billion, significantly more than the US$4.7 billion level registered in the same period of the previous year. Aside from growth in past data, the outlook for new investments in such sectors as steel, sugar-alcohol and real estate, among others, has become considerably brighter, justifying growth in investments projected for the year.

With respect to foreign portfolio investments, it is important to stress that projected medium and long-term flows negotiated in the country involving fixed income securities and stocks were revised from US$12 billion to US$15 billion. Parallel to these alterations, recent issuance of sovereign bonds were also incorporated, with increases in projected disbursements from US$1.6 billion to US$2.9 billion, all of which were concluded by the month of June. In the case of short-term papers, the premise of 100% rollover in the year was altered to a projection of net inflows of US$2 billion.

In much the same way as short-term securities, alterations in projections of other foreign investments were generated to some extent by the performance of short-term foreign direct loans. The original projection of 100% rollover of these liabilities in the year was altered to net inflows of US$8.5 billion. Parallel to this, inflows of revenues under short-term trade credit lines were revised to US$6 billion.

The rollover rate of the private medium and long-term external debt forecast for this year remained stable at 100%.

As a result of this new projection, private balance of payments flows will increase financial sector assets abroad by US$11.9 billion, a figure higher than that projected in the March "Inflation Report", US$8.4 billion.

Finally, the positive balance of payments performance makes it possible to forecast an overall surplus result of US$39.6 billion, reflected in growth in the nation's international reserve position. It should be stressed that this projection is based on assumptions drawn from data through April involving net Bacen purchases on exchange markets, maintaining a null value for the projected months.

Table 2 – Balance of payments – Market

US$ billion

Itemization	2006			2007		
	Apr	Jan-Apr	Year	Apr	Jan-Apr	Year[1/]
Current account	-0.1	1.2	10.6	1.3	2.0	6.3
Capital (net)	0.7	11.1	21.9	9.7	31.1	38.5
FDI	0.8	4.7	18.8	3.5	10.0	25.0
Portfolio investments	1.2	6.9	14.7	4.7	9.5	15.0
ML-term loans	-1.0	-0.2	6.9	-3.4	-10.2	-6.3
SML-term trade credits	-0.4	1.9	6.9	4.6	17.9	14.2
Banks	-0.6	-2.6	-3.5	0.5	8.0	9.0
Other	0.1	4.5	10.4	4.0	9.9	5.2
BDIA	-0.9	-5.7	-32.3	-2.5	-3.8	-15.2
Other	1.0	3.4	6.9	2.9	7.6	5.8
Financial gap	0.6	12.3	32.5	11.0	33.1	44.8
Banco Central net intervent.	-2.2	-10.1	-34.3	-11.0	-32.9	-32.9
Bank deposits	1.6	-2.2	1.9	0.0	-0.2	-11.9

1/ Forecast.

Inflation outlook

6

This chapter of the *Inflation Report* presents Copom's assessment of the Brazilian economy performance and international scenario since release of the March 2007 *Report*, together with the outlook for inflation through 2008 and for GDP growth to end-2007. Inflation projections are presented in two main scenarios. The benchmark scenario assumes that the Selic rate will remain unchanged over the forecast horizon at 12% per year (the rate defined by Copom at its June 5-6 meeting) and that the exchange rate will remain in the same range observed in the days immediately prior to that meeting (R$1.95 per US dollar). The second scenario is designated the market scenario and utilizes consensus interest and exchange rate expectations expressed by private sector analysts and compiled in recent weeks by BCB's Investor Relations Group (Gerin). These scenarios are mere tools used to support the monetary policy decision-making process and their assumptions should not be understood as Copom's forecasts of future interest and exchange rate behavior.

The inflation and GDP growth forecasts in this *Report* are not point estimates. They incorporate probability intervals that highlight the degree of uncertainty that existed when the interest rate decision was taken. Inflation forecasts depend not only on interest and exchange rate assumptions, but also on the behavior of other exogenous variables. The set of most probable hypotheses considered by Copom is used to construct the scenarios to which the Committee attributes the greatest weight on making its interest rate decisions. On presenting these assumptions, Copom seeks to enhance monetary policy transparency while improving its effectiveness in curbing inflation, which is its primary objective.

6.1 Inflation determinants

Based on seasonally adjusted IBGE data and utilizing the new National Accounts methodology, GDP posted growth of 0.8% at market prices in the first quarter of 2007, compared to the fourth quarter of 2006 (growth revised from 0.9% to 1.1%), and 4.3% over the same quarter of the preceding year. Following revision of preliminary quarterly growth rate estimates, IBGE data indicate GDP expansion of 3.7% in 2006, 0.8 p.p. above the 2005 level. For the first time since the fourth quarter of 1986, the performance of the Brazilian economy in the first quarter of 2007 represented the 21st consecutive quarter of positive growth, compared to the same period of the previous year. After fluctuating somewhat in the first half of 2006, GDP has expanded at a more consistent pace in the last three quarters, indicating consolidation of the growth cycle. The Committee ratified the scenario presented in recent *Inflation Reports*, according to which the pace of Brazilian economic expansion will enhance in 2007. Such factors as price stability, strengthening of the labor market, growth in real income, improved investment intentions, credit expansion, reduction of external vulnerability, attenuation of macroeconomic uncertainties and the ongoing easing of monetary policy are viewed as sufficient to ensure acceleration of Brazilian economic growth in coming quarters. Together with these factors, one should recall that the impact of the PAC will also be felt over the course of the year, particularly with respect to investments.

After closing 2006 at 3.14%, IPCA inflation dropped to 2.96% in the 12-month period ended in March 2007, before accelerating to 3.18% in May, using the same basis of comparison. This rate was well below the central target (4.5%) and within the tolerance interval defined by the CMN. With this result, inflation dropped 1.05 p.p. compared to the 12-month period through May 2006. As indicated in previous *Reports* and in the Minutes of Copom's meetings, these figures reflect an increasingly more benign consumer inflation scenario. This situation, which is expected to continue over the coming quarters, clearly reflects the intertemporal effects on inflation of the monetary policy stance adopted in recent years. By providing an environment in which economic agents can take decisions with a smaller degree of macroeconomic uncertainty, price stability allows them to extend these decisions over a longer temporal horizon, with gradual reductions in risk premiums. Copom's position is that an improved macroeconomic environment is the best and most important contribution that monetary policy can make to sustainable economic development.

Cumulative 12-month IGP-DI inflation shifted from 3.79% in December 2006 to 4.38% in May 2007 (compared to 0.14% deflation in May 2006) and has remained higher than consumer inflation. Compared to May 2006, 12-month inflation increased 4.52 p.p. Considering that cumulative 12-month IPC-Br inflation rose 3.12% through May, analysis shows that, using this basis of comparison, the rise in IGP-DI inflation was generated mainly by increases in the Wholesale Price Index (IPA-DI) and National Cost of Construction Index (INCC), with rates of 4.76% and 5.18%, respectively. More specifically, IPA-DI growth was caused basically by farm prices, which rose 9.13%, while the prices of industrial goods increased 3.46%. To some extent, the increase in farm prices reflects the impact of upward movement in international commodity market prices, particularly soybeans, rice and beef. Despite valuation of the real, wholesale industrial prices have reflected a rising bias on several metallic commodities and fertilizer prices. In summary, aside from the impact of price fluctuations on the domestic supply of farm products, wholesale prices have also been impacted by the contradictory effects of two major factors: higher international raw material prices, which have generated added pressure on price indices, and appreciation of the real, which has tended to mitigate these pressures. Up to the present, the net effect of these factors has been higher wholesale inflation compared to the result in the same period of 2006.

As far as the external scenario is concerned, evidence accumulated in the last few months suggests that the global economy will continue expanding at a robust pace, despite the slowdown in the United States. Whatever may be the underlying cause of this performance – a smaller than originally expected slowdown in the US or a more dynamic than expected upturn in the Euro Area and major Asian economies, or even a combination of both – the facts would seem to support the thesis of rotating international economic growth centers. However, one cannot ignore the possibility of an even more intense downturn in the US economy, perhaps as a result of intensification of current real estate sector difficulties, with potentially negative repercussions on the global economy. Nonetheless, if the predictions of some analysts are correct, the American economy will turn upward in the second quarter of the year as the real estate market crisis bottoms out and industrial output picks up, the outlook for even more intense global economic activity would improve considerably. By the way, one should stress that continued historically high growth rates in various regions of the world have generated increased inflationary pressures, particularly in the segments of raw materials and food. In this context, more intense global economic activity would certainly tend to aggravate these pressures.

The behavior of some commodity prices has supported this position. The Commodity Research Bureau (CRB) index, for example, increased approximately 6% in the 12-month period through May. A closer look, however, shows that the subindex for grains and oil crops spiraled 40% (8% in the April/May period alone). In that two-month period, the CRB component that portrays the behavior of industrial commodity prices increased 4%. International oil prices (Brent type), in their turn, have risen 18% since the end of 2006, returning to the levels in effect in the middle of last year. Recent international price levels for this commodity would seem to reflect structural shifts in global energy demand, together with recurrent episodes of geopolitical turmoil. The pressures on international market farm prices would seem to reflect the current stage of the global economic cycle, as well as such more persistent factors as increasingly greater allocation of arable land to biofuel production and growing global protein demand as a result of improved consumption standards in large Asian population centers.

In general, higher commodity prices have generated a positive impact on the Brazilian balance of payments, particularly since the country reduced its dependence on imported oil. In more specific terms, Funcex data on Brazil's terms of trade (ratio between the price indices of exports and imports) show a 6.1% increase in the first five months of the year, compared to the same period of 2006, based on 10.6% growth in the prices of exports (10% for basic goods and 20.7% for semi manufactured products) and 4.3% in the prices of imports. On the other hand, the behavior of domestic market wholesale prices suggests some degree of sensitivity to upward global price trends, if they persist.

The behavior of international financial markets, particularly the bond market, has been consistent with increased concerns at the possibility of higher inflation and reductions in uncertainties regarding continued global economic growth. In the USA, Euro Area, Japan and the United Kingdom, the slope of term structure of interest rate has increased with greater intensity since March. In more specific terms, in the case of the United States, in the period extending from end March to June 20, the spread between the two-year rate and the basic interest rate shifted from -68 b.p. to -27 b.p., while the spread between the 10-year rate and the short-term rate moved from -61 b.p. to -11 b.p. Shifts in forward structures in the Euro Area, United Kingdom and Japan were considerably smoother, but pointed in the same direction as in the USA.

Market expectations regarding monetary policy measures to be taken in those economies have followed a pattern compatible with concerns of higher inflation. In the United States, expectations of a more flexible monetary policy in the second half of 2007 were, at the very least, postponed to 2008. According to some analysts, the Fed may even raise interest rates once again. Authorities at the European Central Bank have indicated that Euro Area monetary policy is not yet restrictive, while some Bank of England authorities have stated publicly that they are willing to raise interest rates. In those economies, inflation expectations implicit in asset prices (more specifically, the break-even rates calculated according to differences in returns on fixed rate securities and inflation-linked securities in the USA, France and United Kingdom) for two and 10-year horizons, have shown some degree of stability in recent months. However, it is important to stress that these rates have stabilized in the interval between 2% and 3.5%, consequently above the levels generally considered desirable in mature economies. Even in Japan, where inflationary pressures have been moderate, the trend would seem to be toward a gradual rise in interest rates.

More recently, the volatility of American loan-based security markets worsened, particularly in the case of housing loans, with potentially significant but difficult to quantify impacts on demand for risk assets. Considering that the price structures of assets in recent quarters has been based on the notion that the current benign scenario will persist well into the future, one can not completely ignore the possibility of initially sectoral and localized problems generating much broader repercussions.

Despite the uncertainties cited in the previous paragraphs, the external scenario continues benign, with well-founded expectations of continued improvement in the Brazilian balance of payments. As a matter of fact, since publication of the March *Inflation Report*, average projections gathered by Gerin for the trade balance and current account surplus in 2007 shifted from US$39.5 billion and US$8.0 billion to US$42 billion and US$10 billion, respectively, at the same time in which end-of-year exchange rate projections were altered from R$2.11 to R$1.95.

Given this scenario, in the second quarter of the year, Copom continued the process of monetary policy easing begun in September 2005. After reducing the basic interest rate target 700 b.p. between the September 2005 and March 2007 meetings, the Committee cut the Selic rate target an additional 75 b.p. at its April and June 2007 meetings, raising the total reduction to 775 b.p. In the last nine months alone, the overall cutback totaled a very significant 225 b.p., generating impacts on economic activity and inflation that will be felt in the near future. The Selic rate now stands at 12% per year, the lowest level since its creation in 1986.

IPCA evolution indicates that the dynamics of inflation in the first five months of 2007 were compatible with the target path or, in other words, with the benign price scenario that has become increasingly more evident since last year. Inflation in April and May decelerated to 0.25% and 0.28%, respectively, compared to 0.37% in March. Consequently, cumulative inflation in the first five months of 2007 closed at 1.79%, slightly above the 1.75% level registered in the same period of the preceding year. Regulated prices, which increased 1.35% compared to 2.70% in the January-May period of 2006, played an important role in attenuating inflation. This becomes evident when one considers that market prices rose 2.01% in January-May 2007, well above the 1.27% rate in the same period of 2006. Twelve-month inflation through May reached 3.18% (4.23% through May 2006), market prices rose 3.32% (2.48%) and regulated prices increased 2.88% (8.24%). The April and May reductions in monthly inflation were caused by smaller market price growth, 0.19% and 0.25%, respectively, compared to 0.44% in the month of March, while regulated price inflation increased from 0.21% in March to 0.39% in April and 0.35% in May. Viewed from a different angle, one notes that growth in the prices of tradables moved from 0.21% in March to 0.25% in April and 0.48% in May, while the prices of nontradables dropped to 0.13% in April and 0.03% in May, compared to 0.66% in March. The prices of services rose 0.18% in April and 0.26% in May (4.87% in the last 12 months). Despite the fact that leading indicators suggest that June inflation will be higher than expected due to added pressures on wholesale prices, the Committee has taken the position that consumer inflation will continue evolving according to the target path.

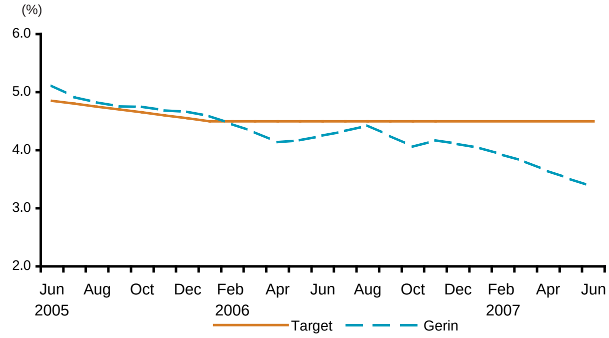
The favorable evolution of headline inflation in recent months is reflected in the core measurements taken by Bacen. The core by exclusion of regulated prices and household food moved from 0.23% in March to 0.29% in April and 0.33% in May. The trimmed-means core with smoothing of preselected items remained close to the March rate of 0.29%, while the trimmed-means core without smoothing of preselected items shifted from 0.24% to 0.28% in April and 0.30% in May. In the first five months of the year, the cores by exclusion and the trimmed-means cores with and without smoothing posted inflation of 1.80%, 1.51% and 1.40%, respectively, all of which were lower than the cumulative growth rates registered in the same period of 2006. Cumulative 12-month growth of the trimmed-means core with smoothing dropped from 3.98% in March to 3.86% in April and 3.68% in May. In contrast, the cores by exclusion and the trimmed-means core without smoothing posted highs in both April and May, compared to the month of March, but still remained below the central target of 4.5% in 2007.

It is important to underscore that, to a great extent, the historically low numbers registered in the January-March period for cumulative 12-month headline inflation and inflation cores were due to substitution of relatively high inflation rates registered in early 2006 with considerably more favorable rates posted in recent months. Thus, the record lows must not be viewed as a permanent drop in either the cores or headline inflation. With this factor in mind, 12-month inflation accelerated in April and May and will continue to do so in the coming months, due to this statistical substitution factor. So, when viewed over 12 months, both core measurements and headline inflation will gradually come to reflect the behavior of these two measurements with greater precision. There are several other factors that sustain this conclusion, including the impacts of fiscal impulses on aggregate demand, the effects of self-sustaining growth factors, such as rising real wages and the delayed impacts of the monetary policy easing process underway since September 2005.

IGP-DI inflation has dropped steadily at the margin since the start of the year, falling from 0.43% in January to 0.23% in February, 0.22% in March, 0.14% in April and the 0.16% in May. The cumulative 12-month results through May totaled 4.38%, below the March (4.49%) and April (4.61%) rates, but still substantially higher than the 12-month IPCA or IPC-DI inflation rates in the same time span (3.18% and 3.12%, respectively). More recent figures suggest that inflation, viewed according to the broader concept, has remained higher than consumer inflation, thus reversing the trend toward convergence registered between November 2006 and January 2007. In recent months, with the sole exception of the IPA-DI, the monthly dynamics of the various IGP-DI components were quite different from the aggregate index. Just as occurred with the general index, IPA-DI growth dropped steadily from one month to the next, until registering deflation in the month of May. The IPC-DI only turned downward as of April, while the INCC turned sharply upward as of March, due to pressures brought to bear by cost increases under both building materials and labor. The cumulative 12-month IPA-DI moved from 4.29% in December to 5.27% in April, dropping to 4.76%

in May. Preliminary evidence suggests that wholesale farm prices rose sharply in June, following strong April and May declines. This behavior is viewed as a result of fluctuating international prices that could signal a persistent trend. Strengthening of the real has aided in curbing wholesale industrial price inflation, though this index has also been impacted by highs under certain metallic commodities. As a result of exchange appreciation, expectations are that wholesale prices will continue playing an important role in pushing inflation toward the target path in the coming quarters, but not with the same confidence. This contribution will depend on the prospective conditions of demand and the expectations of price-setters regarding the future path of inflation.

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



As expected, the accommodative tendency of inflation since early 2007 is reflected in the inflation outlook for this and the coming year. Median expectations for IPCA growth in 2007 gathered by Gerin dropped from 3.88% in the period immediately prior to the March Copom meeting to 3.50% on the eve of the June meeting, before shifting later on to 3.59%. Median expectations for 2008 remained anchored at 4.00% since January, despite the fact that average projections recently fell below that level. As stressed in previous Copom documents, these developments indicate consolidation of an increasingly more favorable macroeconomic environment over a longer term horizon.

At market prices, GDP data released by IBGE indicate continuation through the first quarter of 2007 of the growth cycle that began in the second half of 2006. The fact of the matter is that, based on seasonally adjusted IBGE data, the Brazilian economy expanded at a quarter-to-quarter rate of 0.8%, with 4.3% when viewed against the same quarter of 2006. As a result, cumulative GDP expanded 3.8% in the last four quarters, compared to the immediately previous four quarters, clearly suggesting stronger growth when viewed against the 3.7% result posted in the final quarter of 2006, using the same type of comparison. The new series of National Accounts released by IBGE shows more dynamic economic performance in recent years than originally thought. Since 1999, the year in which the inflation target regime was adopted, annual average growth of the economy closed at 2.8% in the new series, against 2.4% in the former series. More important is that, following the intense balance of payments adjustment between 2001 and 2003, annual growth accelerated to an average of 4.1% in the 2004-2006 period (3.4% in the former series). The increased dynamism shown by the new IBGE series suggests that the economy has drawn benefits not only from the medium-term impact of the reforms adopted in the 1990s, but also from consolidation of macroeconomic stability in recent years. The ongoing growth process suggests that the erratic growth that characterized the Brazilian economy for several decades has finally remained in the past. Consequently, the new reality has resulted in expectations that the Brazilian economy has entered an unprecedented phase of sustained growth. This evaluation is, among other factors, backed by a sharp downturn in inflation rates, improved labor market indicators, higher real wages, the performance of gross fixed capital formation, coupled with investment intentions, lower external vulnerability and a decline in macroeconomic uncertainties.

In the supply side, a comparison of the first quarter of 2007 with the first quarter of 2006 shows 2.1% growth in farm production, 2.8% under manufacturing and 4.1% in the case of mining. In the service sector, which is the component of greatest weight in GDP, the highlights were the segments of financial intermediation (9.2%, using the same basis of comparison) and information services (7.3%). Viewed under the prism of demand, domestic absorption contributed 5.8 p.p. to GDP growth, compared to a net negative external sector contribution of 1.5 p.p. The performance of gross fixed capital formation has been very encouraging, registering growth of 7.2%. Household consumption expanded 6.0%, a figure well above the average, primarily as a result of increased wages and credit market improvements. As expected, analysis of national accounts shows that imports of goods and services rose sharply (19.9%), while exports of goods and services increased 5.9%.

Balance of trade results have frustrated less optimistic expectations. Despite valuation of national currency since 2006, the balance of trade closed the first five months of 2007 with very robust results and without any systematic slowdown in the resulting surpluses. Though the cumulative US$8.7 billion first-quarter surplus was 6% lower than in the same period of 2006, the April and May surpluses turned upward once again, raising the cumulative surplus for the year to US$16.8 billion against US$15.3 billion in the first five months of 2006. Here, it should be mentioned that the latter figure was impacted by a customs strike in 2006. In the 12-month period ended in May, the trade surplus reached US$47.5 billion, compared to US$44.4 billion in the same period of 2006. One should note that, despite the increased surpluses posted in recent months, the fact that imports expanded 26.7% in the year compared to 21.3% for exports suggests that the nation’s trade transactions with the rest of the world, as anticipated by previous *Inflation Reports* and Copom Minutes, are gradually shifting into a new dynamics.

This change is welcome, since it reflects the existence of a natural and healthy process of external accounts adjustment in pursuit of long-term equilibrium. This adjustment has been impacted as much by the price effect, reflected in nominal exchange rate fluctuations, as by the income effect, materialized in growing aggregate demand.

Though the volume of imports has expanded more rapidly than exports, the relative stability of trade surpluses has been sustained by growth in the export prices or, in other words, by a tendency that clearly favors the terms of trade. As a matter of fact, exported values have set new records, reaching the unprecedented level of US$148.0 billion in the 12-month period through May, 19.1% more than in the same period of the preceding year. The value of imports, in turn, grew at an even stronger pace of 25.8% over the figure for the 12-month period through May 2006, closing at a cumulative 12-month total of US$100.5 billion in the 12-month period ended in May 2007. With these results, Copom forecasted a 2007 trade balance surplus below those of the last two years, though still quite significant by Brazilian historical standards. In other words, Copom foresees no significant reversal in the successive trade balance surpluses registered in the recent past. The current account balance posted surpluses of US$817 million and US$1,821 million in March and April, respectively, posting cumulative 12-month growth of US$15.1 billion through April, equivalent to 1.4% of GDP.

According to CNI data with no seasonal adjustments, utilization of installed industrial capacity in the manufacturing sector averaged 81% in the first four months of 2007, against 79.1% in the same period of 2006. The rate of capacity utilization registered by the CNI series seasonally adjusted by Bacen closed at 81.8% in April, 3.1 p.p. above the April 2006 rate and 0.5 p.p. below the series maximum in July 2004. Using seasonally adjusted CNI data, utilization of installed capacity in April reached 82.6%, setting a new record for the series. Detailed data calculated by CNI for the month of April indicated that 15 of 19 sectors operated at levels higher than average utilization rates, compared to 11 sectors in April 2006. This movement reflects intensified economic activity and occurred despite recently collected data on production and capital goods absorption, indicating strong growth under investments. In the first four months of the year, compared to the same period of 2006, capital goods absorption registered strong growth equivalent to 20.1%. This result reflects growth in imports of capital goods (32% in volume), as well as capital goods output (15.4%). Production of inputs for the construction industry expanded 3.5%. Considering the recent behavior of industrial capacity utilization rates, continued investment growth will be of fundamental importance to avoiding any significant lags between supply and aggregate demand.

According to seasonally adjusted IBGE data, industrial output expanded steadily between October 2006 and March 2007, before leveling off somewhat in the month of April. The quarterly moving average of the series increased 0.6% in April compared to the previous month, thus maintaining the growth pace observed in March. This was the 13th consecutive month of positive growth, considered a clear demonstration of the dynamics of industrial activity. Performance in recent quarters suggests that the lag that had been observed between industrial output and sales has gradually narrowed. In the January-April 2007 period, output of industry in general and, more specifically, of the manufacturing sector registered increases of 4.3% and 4.1%, respectively, while the mining sector expanded 5.6%. Here, the highlight was strong 15.4% growth in capital goods production, despite the April downturn. This performance is viewed as a positive sign for economic growth in general, which has been sustained basically by domestic demand.

The increase in the pace of activities in recent quarters has had positive repercussions on the labor market, particularly in terms of income growth. Open unemployment closed at 10.1% of the overall labor force in May, reflecting a situation of stability when compared to the April and March results (10.2% in May 2006). The unemployment rate remained stable between April and May, reflecting stability in the employed population (growth of 21,000 workers, 0.1%) and in the overall labor force (increase of 22,000, 0.1%). In the Bacen seasonally adjusted series, month-to-month unemployment increased slightly in May (9.8% compared to 9.6% in April). The quarterly moving average of unemployment has stabilized since January 2007 at 9.7% of the overall labor force. In the month of May, real average earnings habitually received by workers continued expanding when compared to the previous month (0.3%), closing at R$1,120.30. Compared to May 2006, this figure represented an increase of 3.9%, with cumulative growth of 4.8% in the year. Overall wages – calculated as the product of real average earnings and the employed population – grew 6.8% in May 2007, when viewed against May 2006, and increasing.7.8% on the year, holding high levels compared to 2006. The relative stability of unemployment is a natural consequence of balanced growth between job demand and supply. At the same time, the increase in the overall labor force is a partial consequence of increased optimism among the jobless regarding the probability of finding work, an attitude that is typical of periods of economic expansion. Once this “relief effect” has passed, expectations are that unemployment rates will decline with greater intensity.

In the manufacturing sector, employment expanded 3.4% in the first four months of the year, according to Bacen adjusted CNI data. After cooling somewhat in January and February, industrial hirings accelerated in March and April. With regard to formal employment, data released by the Ministry of Labor and Employment show that the strong growth registered in 2006 enhanced in 2007. In the first five months of the year, 914,000 jobs were created, a new record in the historical statistical series for the period. With this result, the formal employment level expanded 4.9% in the year, led by the construction industry (6.6%) and commerce (5.9%), with significant expansion under manufacturing (4.7%). In an environment of moderate inflation, rising employment levels have resulted in additional purchasing power for workers. Overall real wages of the working population expanded at a significant 6.4% rate in 2006, with 7.9% in the March-May period compared to the same months of 2006.

The seasonally adjusted volume of retail sector sales rose at a month-to-month pace of 0.4% in April, following strong growth in the first quarter of the year (1.1% in March, 0.4% in February and 2% in January). In the first four months of 2007, retail sales expanded 9.2% compared to the same period of 2006. Using the same comparison, the segment of vehicles, motorcycles, parts and spares, which are not included in the general index, expanded 21.3%. Compared to the same period in 2006, the February–April period posted 9.4% volume growth in sales, led by other personal and household articles (24.4%) and furniture and home appliances (16.5%), impacted by steady growth in overall wages and improved credit conditions. The outlook for coming three-month periods indicates continued expansion under retail sales, driven by rising employment and income, increase on credit supply and the ongoing process of monetary policy easing, coupled with burgeoning consumer confidence.

6.2 Baseline scenario: assumptions and risks

Copom’s projections are founded upon a set of assumptions on the behavior of key macroeconomic variables. This set of assumptions and the associated risks constitute the baseline scenario upon which the Committee bases its decisions.

The Committee evaluate that, since publication of the last *Report*, the impacts of both external and internal factors on risks to the expected inflation path have been exacerbated, generating pressures in opposite directions. The influence of the external sector, an important factor in expanding aggregate demand, has been predominantly benign, while rapid growth in domestic demand could generate risks to medium-term inflation dynamics.

The external scenario remains positive and is characterized by robust growth in important economic blocs – albeit with less intensity than in 2006 – and emergence of a certain degree of inflationary pressure. Doubts persist regarding the trajectory of United States monetary policy, though uncertainties regarding the evolution of economic activity in that country seem to have reduced. Signs that inflation may be consolidating at higher levels than those desired by American monetary authorities, without generating signs of an intensified economic slowdown, indicate that expectations of a less restrictive monetary policy as of early 2007 may well have been premature. At present, one cannot totally exclude the possibility of the American Federal Reserve raising interest rates once again. In the Euro Area, both the measures taken by the European Central Bank and public statements made by its directors clearly reflect concerns with the level of utilization of resources and inflation in that region of the world, as well as continued confidence in the strength of economic activity. In this regard, the same assessment applies to the United Kingdom.

In the United States, the impact of the real estate sector adjustment, reflected in declining home investments and reduction on property prices and the consequent weakening of economic activity in recent quarters, has apparently diminished. Though one cannot totally exclude the possibility of a sharper-than-expected economic slowdown, most analysts have recently tended toward the position of a gradual upturn in economic growth at a level closer to its potential rate, against the previous "hard landing" belief. The fact is that some activity indicators remained quite positive, including, for example, those involving the labor market and installed industrial capacity utilization, while pressures on consumer prices have clearly not been eliminated. In this regard, though not yet totally discarded, the hypothesis of adoption of a more flexible monetary policy in the USA in 2007 is certainly losing ground, while expectations of renewed interest rate hikes are becoming increasingly more convincing.

In contrast, continued recovery in Japan and Europe despite ongoing processes of monetary contraction in both regions, coupled with strong growth in several important emerging economies. Without ignoring the possibility of restrictive economic measures in China, the outlook for continued world economic expansion remains positive, though somewhat less optimistic than in 2006, but considerably more benign than was presumed at the start of the current year. With respect to monetary policy in Europe, the major market of destination for Brazilian foreign sales, since last *Report* was made public, both the ECB and the Bank of England have begun raising their basic interest rates once again.

As mentioned in the previous section, the behavior of international financial markets, particularly in the fixed yield segment, has been consistent with growing concerns regarding future inflation and standing back the fears of a more profound economic slowdown in the USA. At the margin, volatility has increased in specific segments of the American securities market, particularly in the case of loan-based liabilities, generating possible significant impacts on demand for risk assets.

However, it is important to underscore that, with improvement in the nation's economic fundamentals, particularly external solvency indicators, the Brazilian economy has demonstrated its capacity to face the impact of international financial market turbulence. This conclusion is backed, for example, by the record reduction in the nation's country risk premium, together with new raises in the ratings granted by international rating agencies to Brazilian bonds on domestic and international financial markets, and, at least, the improvement in bond classifications has placed the country quite close to investment grade ratings. Increased resistance to shocks is also reflected in the fact that the domestic economy has continued the ongoing process of monetary policy easing, at the same time in which the economy has expanded steadily in the middle of a long process of interest rate adjustments in the major international economies. Parallel to this, it is important to stress that Brazil remains an important destination not only for portfolio investments, but also for an increasingly major volume of foreign direct investment. In this context, Copom has reaffirmed its position that the solid reductions in inflation, the persistent and voluminous trade surpluses, the adequate primary surpluses, the accumulation of international reserves and the improvement in the internal public debt profile have without doubt made the country increasingly more resistant to external shocks. As a result, the Committee attributes very low probability to a scenario in which deterioration in international financial markets would be sufficient to jeopardize private sector financing conditions. Here, it is important to stress that, by complementing internal output and facilitating investment growth, imports have made a fundamental contribution to curtailing short-term inflationary pressures, sharply improving the country's ability to restrict the inflationary impacts of sustained aggregate demand growth.

Oil prices have been a constant source of uncertainty on the international scenario in recent years. On a quarter-to-quarter basis, prices rose even further, as volatility increased in the period under consideration. Recent increases in the international prices of this commodity would seem to reflect structural shifts in global energy demand, coupled with recurrent episodes of geopolitical turbulence. Though it is evidently difficult to predict future oil price trends, the working scenario of zero growth in gasoline prices in 2007 adopted by Copom is considered plausible.

As far as the domestic scenario is concerned, Copom has taken the position that data on economic activity suggest only a very low probability of significant short-term inflationary pressures, mainly due to the fact that 2007 and 2008 inflation expectations are firmly anchored.

On the other hand, the Committee has assumed the position that, though it does not yet reflect the full impact of the monetary incentives injected into the economy, the pace of growth in domestic demand could place current inflationary dynamics at risk. In this context, one must acknowledge that the fiscal impulses of the current year have been an additional incentive to domestic demand, coupled with the fact that demand for Brazilian exports has been greater than originally expected. Other factors that tend to sustain consumers spending must also be considered, such as growth in real overall wages. In line with Copom's evaluation presented in previous *Reports*, uncertainties have grown with regard to the future dynamics of inflation, as well as the intensity and lags with which the monetary policy transmission mechanism operates, particularly when one considers the cumulative nature of the effects of the easing of monetary policy now underway for almost two years.

From the point of view of wholesale prices, the reduction in farm price was the major change in relation to the previous three-month period, interrupting the trajectory of strong raises throughout the second half of 2006. This reduced a significant potential source of pressure on consumer prices, despite the fact that the cumulative 12-month impact was significant. At the same time, the behavior of farm prices on international markets and, at the margin, on the domestic market leaves no room for complacency with respect to this potential source of inflationary pressure. Wholesale industrial prices increased somewhat in April and May. As a result, the IPA-DI posted relatively high cumulative 12-month results (4.76% in May, lower than the 5.27% mark in April). In any case, the impact of wholesale price variations on consumer prices will depend basically on prospective supply and demand conditions and the expectations of price-setters with respect to the future inflation path.

In the specific case of market prices, significant pressures on the prices of nontradable goods remain, particularly with respect to services. In contrast, the situation of regulated prices is significantly more comfortable. Without ignoring any facets of these two major inflation components, Copom will continue implementing measures aimed to ensure the permanence of the gains achieved during recent years in combating inflation. In doing so, the Committee will keep a close eye on inflation in the coming months, without losing sight of its core measurements, distinguishing between occasional increases and persistent or generalized price rises and taking immediate measures to adjust its monetary policy stance to the circumstances.

An important part of the prospective dynamics of the process of price formation is related to possible lags between aggregate demand and supply. Production continues expanding at a sustained pace, despite some degree of deceleration in the first quarter of 2007, compared to growth in the previous quarter. More specifically, it was noticed a slight growth from 3.7% to 3.8% in the last four quarters compared with the four immediately previous quarters. Viewed in terms of adjustments in supply conditions, one must note the rapid pace of gross fixed capital formation, which expanded 7.7%, using this type of comparison. This performance signals progressive expansion of the economy's productive capacity in coming quarters. This evaluation has gained increasingly greater support as a result of analysis of the recent dynamics of production and capital goods absorption, as well as production of inputs for the construction industry. Actually, estimates on capital goods absorption point growth of 20.1% in the first four months of the year, against the same period of the previous year. Despite this, the level of installed output capacity utilization in the manufacturing sector has increased since the second half of 2006, climbing to record levels. In this sense, continued growth in investments will be crucial to avoiding significant lags in terms of aggregate supply and demand.

Inflation expectations for 2007 diminished in relation to the figures published in the most recent *Report*. Median expectations dropped from 3.9% in March to 3.6% in June, while it indicates stabilization at 4.0% for 2008. Nonetheless, when one recalls that average expectations diminished, similar median movement can be expected. Consequently, thanks to the evident commitment of monetary policy to compliance with the inflation targets defined by the CMN, the forecast scenario is one in which short-term inflationary pressures remain firmly under control, as the positive outlook over the longer term is consolidated.

It is Copom's position that, through construction of a benign inflationary scenario, the monetary policy posture adopted in recent years has contributed significantly to consolidation of a favorable macroeconomic environment, even over a long term horizon. In light of this new reality, the major challenge before monetary policy is that of guaranteeing that the positive developments predicted for the future are brought effectively in place. Inflation rates consistent with the target path and resulting solidification of a scenario of lasting macroeconomic stability stand as factors of decisive importance to ensure the process of progressive reductions in macroeconomic risk perceptions that has marked recent years. Greater space for lower real interest rates in the future will come about naturally, as a consequence of these perceptions. These positive developments will drive investments, particularly for long term projects, and may well contribute to ensuring the sustainability of the growth process now present in the Brazilian economy.

On the other hand, Copom insists, once again, that important lags exist between monetary policy implementation and its impacts on activity levels and inflation. Consequently, considering that the basic interest rate has dropped 775 b.p. (475 b.p. in 2006) since the start of the current cycle of monetary policy easing in September 2005, the tendency over time will be for the lagged impact of last year's interest rate reductions to be felt before the initial impacts of reductions adopted in 2007 (125 b.p.). Though the pace of activity has certainly enhanced since the third quarter of last year, a significant share of the effects of these cutbacks on interest has yet to be felt in terms of activity levels, in the same way that the impact of activity on inflation has not fully materialized yet.

Consequently, evaluation of alternative monetary policy decisions must necessarily focus on an analysis of the prospective scenario for inflation and its associated risks, instead of give priority to current values registered by this variable. In this regard, aggregate demand in the coming quarters will still be driven by growth in employment and income, coupled with a larger credit supply. Added to these factors, one must consider the impact of increased government spending and transfers and other fiscal impulses, the effects of interest rate cutbacks on aggregate demand as cited in the previous paragraph, the signs of overheated demand and the fact that recent monetary policy decisions will generate their primary impacts on economic performance only in 2008. Therefore, the degree of monetary policy easing already achieved, the remaining uncertainties regarding the lagged impacts of the monetary incentive already injected into the economy, the expected behavior of the other factors underlying overall spending, such as growing income, in a framework of solid growth in domestic demand for tradable and nontradable goods and services and the strengthening of economic activity, all together recommends that additional easing must be introduced with considerable care.

On the other hand, it is important to stress that the contribution of the external sector to consolidation of a benign inflation scenario over the projection horizon may be greater than initially thought, particularly considering market discipline over tradable goods prices and expanded investments in an environment of strong demand. Although the quantum exported remains growing, the contribution of the external sector (more precisely, net exports) in terms of a broader supply of goods and services, has sharply attenuated upward demand pressures on domestic output. This contribution enlarges the scope for growth in aggregate demand and domestic supply both come back to balance on a relevant time for monetary policy decisions, without damaging convergence to the inflation target path.

In light of these considerations, Copom decided to cut an additional 0.25 p.p. and 0.5 p.p. from the Selic rate target at its April and June meetings, respectively. The Committee will continue monitoring the evolution of the internal and external scenarios together with the risk associated to its inflation projections, taking measures as needed to ensure that inflation will continue at levels compatible with the target path.

The projection for contractually regulated and monitored prices in 2007 was revised downward to 3.6%, against 4.5% stated in the March 2007 *Inflation Report*. This projection is founded on the assumption of null cumulative growth in the prices of gasoline and bottled gas in 2007, coupled with -0.9% growth in average electricity rates and 3.3% in fixed telephone rates. The projection for contractually regulated and monitored prices for 2008 was altered from

5.6% in the previous *Report* to 4.5%. The items for which a larger volume of information is available were projected individually, while projections for other items followed the endogenous determination model of regulated prices, which gives due consideration to seasonal components, exchange rate variations, market price inflation and IGP inflation.

Based on traditionally adopted procedures, the benchmark scenario assumes a constant rate of exchange over the forecasting horizon at R$1.95, a figure quite close to that in effect in the period immediately prior to the June Copom meeting, and a Selic target rate of 12%, defined on that occasion. This information reflects the expected paths for 180-day swap pre x DI rates with spreads of 16 b.p. and 73 b.p., in relation to the Selic rate for the final quarters of 2007 and 2008, respectively.

Expectations for the exchange rate gathered by Gerin among private-sector analysts declined when compared to the data released in the March *Inflation Report*. For the final quarter of 2007, expectations moved from R$2.14 to R$1.95 and from R$2.21 to R$2.04 for the final quarter of 2008. Expectations regarding evolution of the average Selic rate also dropped. For the final quarter of 2007, the shift was from an average of 11.55% to 10.98%, with a decline from an average of 10.57% to 10% for the final quarter of 2008. This is consistent with spreads of -23 b.p. for six month pre x DI swap operations in the final quarter of 2007 and -102 b.p. in the final quarter of 2008. In the market scenario, assumptions indicate growth of 3.6% for regulated prices in 2007. Reflecting the effects of forecast exchange depreciation, the change in regulated prices is forecast at 4.8% for 2008.

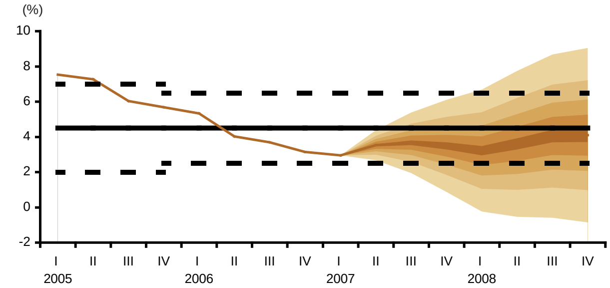
As regards fiscal policy, the projections in this *Report* assume compliance with the 3.8% of GDP primary surplus target in 2007 and 2008, adjusted by the possibility of this percentage being reduced by a maximum of 0.45 p.p., as a result of implementation of the Pilot Investment Program.

6.3 Inflation forecast

Based on the assumptions and associated risks stated above, together with available information, projections were constructed for cumulative four-quarter IPCA growth compatible with the interest and exchange rate paths used in the benchmark and market scenarios. The benchmark scenario considers maintenance of the 12% Selic rate target, as determined at the June Copom meeting, together with a constant R$1.95 exchange rate over the forecasting horizon.

Figure 6.2 – Forecasted IPCA-inflation with interest rate constant at 12% p.a. (Benchmark scenario)

Inflation fan chart



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

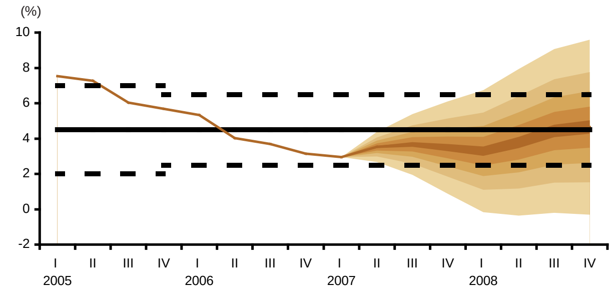
Table 6.1 – IPCA-inflation with interest rate constant at 12% p.a. (Benchmark scenario)

Year	Q	Confidence interval						
		50%						
			30%					Central
				10%				projection
2007	1	3.0	3.0	3.0	3.0	3.0	3.0	3.0
2007	2	3.2	3.3	3.5	3.6	3.7	3.9	3.5
2007	3	3.0	3.3	3.5	3.8	4.1	4.4	3.7
2007	4	2.4	2.9	3.3	3.7	4.1	4.6	3.5
2008	1	1.8	2.4	3.0	3.5	4.0	4.6	3.2
2008	2	1.9	2.6	3.3	3.9	4.6	5.3	3.6
2008	3	2.1	3.0	3.7	4.4	5.1	6.0	4.0
2008	4	2.1	2.9	3.7	4.5	5.3	6.1	4.1

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

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

Inflation fan chart



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

Table 6.2 – IPCA-inflation with market expected interest and exchange rates [1]

Year	Q	Confidence interval						
		50%						
			30%					Central
				10%				projection
2007	1	3.0	3.0	3.0	3.0	3.0	3.0	3.0
2007	2	3.2	3.3	3.5	3.6	3.7	3.9	3.5
2007	3	3.0	3.3	3.5	3.8	4.1	4.4	3.7
2007	4	2.4	2.9	3.3	3.7	4.1	4.6	3.5
2008	1	1.9	2.5	3.0	3.6	4.1	4.7	3.3
2008	2	2.1	2.8	3.5	4.1	4.8	5.5	3.8
2008	3	2.5	3.3	4.1	4.8	5.5	6.3	4.4
2008	4	2.6	3.5	4.3	5.0	5.8	6.7	4.6

Note: accumulated inflation in 12 months (% p.a.).
1/ According to Gerin.

In the market scenario, based on research data gathered by Gerin with a significant number of institutions, the interest rate trajectory expected by these agents indicates an average Selic rate of 11.53% per year in the third quarter of 2007, dropping to 10.98% per year in the final quarter of 2007 and 10% per year in the final quarter of 2008. The exchange rate path starts with an average of R$1.93 in the third quarter of 2007, moving to R$1.95 and R$2.04 in the final quarters of 2007 and 2008, respectively.

The forecasts associated to the benchmark scenario indicate 3.5% inflation in 2007, well below the 4.5% central value defined by the CMN for the target. Figure 6.2 shows the tendency toward convergence of cumulative 12-month IPCA growth to the central value of the inflation target over the forecasting horizon, basically reflecting the effects of Selic rate reductions. Table 6.1 shows acceleration in cumulative 12-month inflation in the second and third quarters of 2007, reaching 3.5% and 3.7%, in that order. This movement is a consequence of larger projections for market prices in the second quarter and for regulated prices in the third quarter, compared to the levels in effect in the same periods of 2006. With respect to the final quarter of 2007, Table 6.1 indicates a 0.2 p.p. reduction in the cumulative 12-month inflation projection, due to a smaller contribution on the part of both market prices and regulated prices, compared to the values in the fourth quarter of 2006. According to the benchmark scenario, the estimated probability that inflation will surpass the upper limit of the tolerance interval of the target in 2007 stands at 3%, compared to 10% in March. Furthermore, one should stress that the projection for cumulative 12-month inflation in the final quarter of 2008 is 4.1%, still below the central value of the 4.5% target.

In the market scenario, the cumulative inflation projection for 2007 also dropped to 3.5% and, therefore, remains below the 4.5% central value for the target. Projections for cumulative 12-month inflation presented in Table 6.2 and illustrated in Figure 6.3 indicate an upturn in cumulative 12-month inflation in the second and third quarters of 2007, followed by a decline in the final quarter of the year, just as occurs in the benchmark scenario. In general, the projections associated to the market scenario are similar to the values found in the benchmark scenario for all 2007 quarters. To a certain extent, this is due to the fact that projections for the market scenario utilize an exchange rate equal to that used in the benchmark scenario for the end-2007. Viewed against the value stated in the most recent *Inflation Report*, the drop in the 2007 inflation projection in the market scenario indicated a reduction in the probability that inflation would surpass the upper limit of the tolerance interval from 12% to 3%. Observe that, despite the fact that projections for four-quarter cumulative inflation show a rise over the course of 2008, they still closed the year quite near to the central target value of 4.5%.

Table 6.3 – March 2007 *Inflation Report* forecasts

Period	Benchmark scenario	Market scenario
2007 I	2.8	2.8
2007 II	3.5	3.6
2007 III	4.0	4.1
2007 IV	3.8	4.0
2008 I	3.8	4.0
2008 II	4.1	4.4
2008 III	4.3	4.7
2008 IV	4.4	5.0

Table 6.3 shows the central values stated in the March 2007 *Inflation Report*. Comparing these figures with current projections, one observes a reduction of 0.3 p.p. in the estimates of 2007 and 2008 inflation according to the benchmark scenario. This movement occurs notwithstanding a 75 b.p. reduction in the Selic rate since release of the most recent *Report* and, to a great extent, is the result of revision of projections for growth in regulated prices in 2007 (from 4.5% to 3.6%) and 2008 (from 5.6% to 4.5%), as well as exchange appreciation since March (from R$2.10 to R$1.95). In the market scenario, the fall down in inflation projections is slightly more accentuated than in the benchmark scenario, with 0.5 p.p. for 2007 and 0.4 p.p. for 2008. Aside from the factors cited above, the fall back in expectations regarding nominal exchange depreciation over the projection horizon considered also contributed to this shift.

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

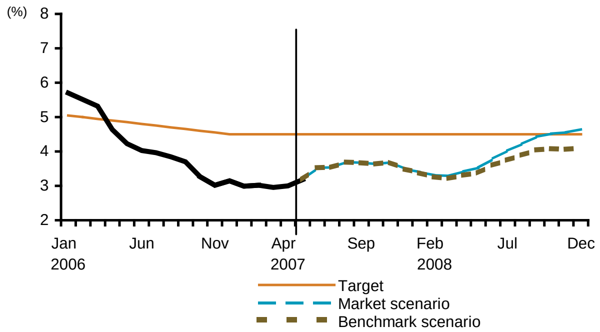


Figure 6.4 shows the evolution of the cumulative 12-month inflation projection for the benchmark and market scenarios, together with the target path through the fourth quarter of 2008. As diagnosed in previous *Reports*, following the first quarter of 2007, there is a persistent tendency toward growth in cumulative 12-month inflation projections over the horizon analyzed. In both scenarios, there is a slight inflection in the 12-month cumulative inflation projection in the final quarter of 2007 and first quarter of 2008. However, one should note that, despite the upward trend in both scenarios, projections remain below the central value of the target path in almost the entire projection horizon. More specifically, in the market scenario, projections surpass the central target path value for inflation, but only in the final quarter of 2008.

Figure 6.5 – GDP growth with interest rate constant at 12% p.a. (Benchmark scenario)

Output fan chart

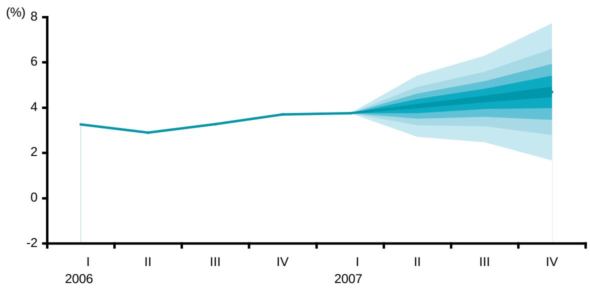


Figure 6.5 shows the production growth fan chart based on the assumptions of the benchmark scenario. Considering that the model utilizes two components that are not directly observable – potential output and output gap – one should stress that forecasting errors for GDP growth are significantly greater than in the case of inflation projections. According to this scenario, GDP growth forecast for 2007 is 4.7%, 0.6 p.p. above that projected in the March 2007 *Inflation Report*.

Selic Rate Projection: an Econometric Exercise

A box included in the June 2006 *Inflation Report* presented a model used to project the nominal exchange rate trajectory based on econometric methods and simulation. In a very similar manner, this box presents the Diebold and Li model (2006)[1], together with its application to a projection exercise of the Selic rate path implicit in the interest rate term structure. This model was successfully utilized in exercises designed to project the United States interest curve and generate more precise projections than those obtained through use of the VAR, VECM and similar models, among others. In the case of the Brazilian economy, Vicente and Tabak (2007)[2] compared the performance of the aforementioned model with important benchmarks, such as the random walk.

Diebold and Li (2006) assume the existence of a functional form for the interest curve, given by a constant added to the product of a polynomial and to a term of exponential decline:

$$y_t(\tau) = \beta_{1,t} + \beta_{2,t}\left(\frac{1-e^{-\lambda_t\tau}}{\lambda_t\tau}\right) + \beta_{3,t}\left(\frac{1-e^{-\lambda_t\tau}}{\lambda_t\tau} - e^{-\lambda_t\tau}\right), \quad (1)$$

in which $y_t(\tau)$ corresponds to the interest rate at instant t with maturity on τ, λ_t governs the rate of exponential decline and $\beta_{1,t}$, $\beta_{2,t}$ and $\beta_{3,t}$ are the coefficients to be determined.

One can interpret coefficients $\beta_{1,t}$, $\beta_{2,t}$ and $\beta_{3,t}$ to be latent factors that govern the dynamics of the interest rate term structure. In this sense, coefficient $\beta_{1,t}$ would

1/ Diebold, F. and Li, C., 2006. Forecasting the Term Structure of Government Bond Yields. Journal of Econometrics 130, 337-364.

2/ Vicente, J. and Tabak, B.M., 2007. Forecasting Yields in the Brazilian Fixed Income Market: Central Bank of Brazil Working Paper Series.

govern the dynamics of the level of interest rates for any maturity (it does not depend on τ), while coefficients $\beta_{2,t}$ and $\beta_{3,t}$ would relate respectively to the slope and curvature of the interest curve.

In the estimation proceedings, the latent factors in equation (1) follow first-order autoregressive processes:

$$y_{t+h|t}(\tau)=\beta_{1,t+h|t}+\beta_{2,t+h|t}\left(\frac{1-e^{-\lambda_t\tau}}{\lambda_t\tau}\right)+\beta_{3,t+h|t}\left(\frac{1-e^{-\lambda_t\tau}}{\lambda_t\tau}-e^{-\lambda_t\tau}\right), \quad (2)$$

in which

$$\hat{\beta}_{i,t+h|t}=\hat{c}_i+\hat{\gamma}_i\hat{\beta}_{i,t}, \qquad i=1,2,3 \quad (3)$$

and $\hat{c}_i$ and $\hat{\gamma}_i$ are obtained regressing each latent coefficient in its first order lag.

The sample utilized involves weekly information on Selic interest rate and pre x DI swap contracts for vertices of 30, 60, 90, 180, 360 and 540 days. The sample interval extends from the month of May 2005 to May 2007.

Figure 1 – Inflation Expectations, Selic Interest Rate Evolution and six months-ahead forecasts (Monetary tightening)

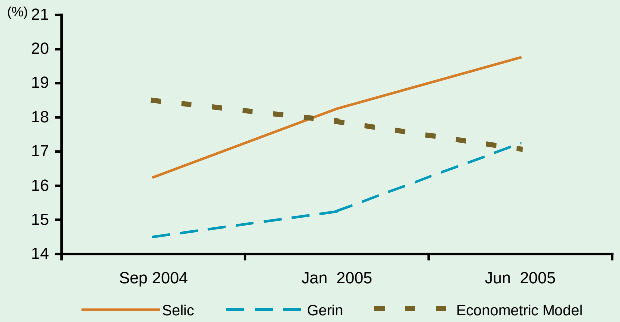
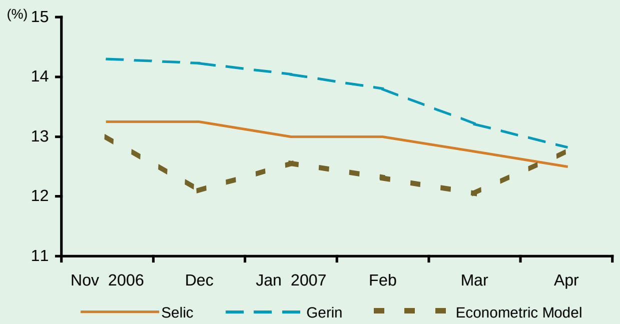


Figure 2 – Inflation Expectations, Selic Interest Rate evolution and six months-ahead forecasts (Monetary easing)



Based on the estimated model, projections outside the sample were constructed for the six months ahead Selic rate path. Figure 1 (for a period of monetary tightening) and Figure 2 (for a period of monetary easing) contain projections generated by the model, as well as median expectations gathered by Gerin and the Selic rate path. One should note that, in general, in periods of monetary tightening, the model generates projections higher than median expectations and that just the contrary occurs in periods of monetary easing. Though significant, the model's projection errors are less than those associated to median expectations gathered by Gerin. Parallel to this, it is important to stress that the effective Selic rate has generally positioned itself between the model's projections and median expectations gathered by Gerin.

Let the path implicit in the term structure represent the expectations of players in the fixed income market. Having said this, the results suggest that, in periods of monetary easing, economists – the group targeted by Gerin – tend generally to be less optimistic than market players in terms of monetary policy evolution, while economists tend to be less pessimistic in periods of monetary tightening.

This box presented the Diebold and Li (2006) model, together with its application to the Brazilian economy. The econometric exercise suggests that the model performs well and can be used as a significant tool in projecting the Selic rate path implicit in the interest rate term structure. However, the results do not assume the existence of negative and/or positive shocks in the period. Thus, to the extent shocks affect the Brazilian economy, the model must be re-estimated and the exercise must be repeated.

Annex

Minutes of the 126th Meeting of the Monetary Policy Committee (Copom)

Date: April 17th, from 4:30PM to 7:30PM, and April 18th, from 5:00PM to 7:00PM
Place: BCB Headquarters meeting rooms – 8th floor on April 17th and 20th floor on April 18th – Brasília – DF

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

Department Heads (present on April 17th)
Altamir Lopes – Economic Department
Beatriz da Costa Lourenço Florido – Open Market Operations Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on April 18th)
José Antonio Marciano – Department of Banking Operations and Payments System
Márcio Barreira de Ayrosa Moreira – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations Group

Other participants (present on April 17th)
Adriana Soares Sales – Deputy Head of the Research Department
Alexandre Pinheiro de Moraes Rego – Special Advisor to the Governor
Alexandre Pundek Rocha – Advisor to the Board
Flávio Pinheiro de Melo – Advisor to the Board
Jocimar Nastari – Press Secretary

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

Recent Economic Developments

1. IPCA inflation declined in March and reached 0.37%, down from 0.44% in the previous month and in January. As a consequence, inflation totaled 1.26% in the first quarter of the year, above the expectations that prevailed at the close of 2006, but below inflation registered in the same period last year (1.44%). The main driver of the quarterly IPCA inflation result was the behavior of regulated prices, which increased 0.59%, compared to 1.69% in the same period of 2006, while market prices increased 1.55% in the first quarter, up from 1.31% in the same quarter of 2006. Twelve-month trailing inflation through March reached 2.96%, compared to 5.32% in March 2006; for this result, market prices contributed 2.82%, whilst regulated prices accounted for 3.15% (compared to 3.90% and 8.66%, respectively, in March 2006). Month-on-month inflation deceleration in March was a result of market prices inflation decline (0.44%, down from 0.59%), in contrast with regulated prices inflation acceleration (0.21%, up from 0.12%). In March, it bears emphasizing the upward pressure of food and clothing. The prices

of tradable goods increased 0.21% in March, up from -0.10% in February, while the prices of non-tradable goods increased 0.66% in March, compared to 1.23% in February. Services inflation reached 0.38% in the month and 5.09% in the last twelve months (costs of courses increased 4.62%, while other services increased 5.19%). Despite the recent inflation acceleration observed at the end of 2006 and the start of 2007, the most likely scenario is that inflation evolves according to the targets path.

2. IPCA core inflation by exclusion of household food items and regulated prices also decreased month-on-month in March 0.23%, down from 0.52% in February, in line with the headline IPCA inflation decline. On the other hand, the other underlying core inflation measures calculated by the BCB slightly increased: smoothed trimmed means core increased 0.29% in March, up from 0.24% in February and continued to record the strongest rigidity among the three core measures, while the non-smoothed trimmed means core increased 0.24%, up from 0.22%. In the first quarter, core inflation by exclusion recorded 1.16%, the lowest level since 2002, while smoothed and non-smoothed trimmed means core measures totaled 0.92% and 0.81%, respectively, record lows for the series. This behavior is also present on the twelve-month trailing basis through March, when cores reached 2.59%, 3.97% and 2.23%, respectively.

3. The General Price Index (IGP-DI) inflation remained virtually unchanged on a month-on-month basis in March (0.22% compared to 0.23 in February). Leading indicators, such as the IGP-10, suggest that the stability should continue. In the first quarter, the index increased by 0.88%, up from 0.21% in the same period last year. In the twelve months through March, it reached 4.49%, up from 3.79% in February. This behavior was driven, among other factors, by the recovery of agricultural prices, which presented monthly deflation results last year. Among the IGP-DI components, the IPC-Br increased by 0.48% in March, up from 0.34% in February, while the INCC-DI increased 0.27%, up from 0.21%. On the other hand, the Wholesale Price Index (IPA-DI) inflation increased 0.11% in March, down from 0.19% in February. The decline in IPA-DI inflation was due to agricultural prices deflation, which recorded -0.18%, after increasing 1.07% and 1.08%, respectively in January and February. As highlighted in previous Copom Minutes, the effects of wholesale prices over consumer inflation will depend on prospective demand conditions and price-setters' expectations for the future inflation path.

4. After the last Copom meeting, the IBGE released new GDP figures, as a result of the implementation of comprehensive methodological revision. The new data showed significant adjustments in the GDP level (roughly 11% increase) and in growth rates, with the last five-year average rate increasing to 3.2%, up from 2.5% and, in 2006, to 3.7%, up from 2.9%. Among other important changes, there was a substantial decline in the investment rate. The new set of data also suggests that the economy, at least recently, could be using the factors of production in a more efficient way. Another important change was the expansion of services in the GDP composition, which suggests that the Brazilian economy profile is closer to those of other important economies. According to the new 2006 GDP data, on the supply side, agriculture grew 4.1%, as against 3.2% previously released, and services increased by 3.7%, as against 2.4%, while industrial growth declined, recording 2.8%, as against 3.0%. On the demand side, there were increases in gross fixed capital formation (8.7%, as against 6.3%), household consumption (4.3%, as against 3.8%) and in government consumption (3.6%, as against 2.1%), while exports growth declined (4.6%, as against 5.0%) and imports expansion was kept unchanged (18.1%). Moreover, according to IBGE seasonally adjusted data for 2006, Q4 GDP increased 0.9% quarter-on-quarter, slightly below the 1.1% rate previously released, while Q3 GDP increased 2.6%, well above the 0.8% rate previously released, in line with the analysis of previous Copom Minutes.

5. After expanding in the three last months of 2006 and declining in January, industrial production resumed growth in February, increasing by 0.3% month-on-month, with manufacturing industry and mining expanding by 0.6% and 0.3%, respectively, according to IBGE seasonally adjusted data. Compared to February 2006, industrial production increased by 3.0%, the eight consecutive month of aggregate industrial production expansion. In the last twelve months, industrial production expanded

by 2.8%, with 2.6% for manufacturing industry and 6.2% for mining. On a three-month moving average basis, industrial output grew by the eleventh consecutive month in February. The expansion of manufacturing industry in February reached 14 out of 23 activities with seasonally adjusted data. For March, leading and coincident indicators suggest the continuity of the ongoing expansion. The several incentive factors to economic activity, including the monetary easing already implemented, suggest that the expanding trend in industry shall continue in the upcoming months.

6. Disaggregated industrial data showed month-on-month seasonally adjusted expansion of 1.2% in durable consumer goods production in February. Compared to the same month last year, capital goods production strongly expanded by 14.3%, while intermediate goods production increased by 3.5%. According to the same comparison basis, durable goods production contracted by 2.9%. In the first two months of the year, capital goods production outperformed, expanding by 16.0%, and the pace of intermediate goods production accelerated, increasing by 3.3%. The dynamics of capital goods production reflects positive prospects for the growth of domestic demand and the influence of favorable international prices in several sectors. In addition, the expansion of intermediate goods production suggests a more generalized acceleration in industrial activity.

7. After declining between August and December last year, reaching 8.4%, the unemployment rate reached 9.3% in January and 9.9% in February, in line with the seasonal pattern at the start of the year. However, compared to the same month last year, unemployment showed stability. The number of workers grew 2.5% in the twelve months through February, indicating robust pace of job creation. The purchasing power of workers increased 2.5% month-on-month and 6.1% compared to the same month last year. This dynamics is also present in real payrolls, which increased 8.8% in February (8.1% in the year), compared to February 2006, maintaining the upward trend and sustaining the growth of aggregate demand. According to the National Industry Confederation (CNI) data seasonally adjusted by the BCB, manufacturing employment increased month-on-month 0.2% in February, the fifteenth consecutive monthly expansion. Compared to February 2006, manufacturing industry increased by 3.3%. Regarding formal employment, data from the Ministry of Labor and Employment (MTE) confirms the continuity of expansion in February, with the creation of 148 thousand jobs, a 0.4% expansion on a month-on-month seasonally adjusted basis. In the first two months of the year, formal job creation grew 4.7%, and 4.8% in the last twelve months.

8. After the slight 0.1% decline in December, which interrupted a four-consecutive-month expansion period, retail sales strongly increased in the first two months of the year, according to data seasonally adjusted by the IBGE. Retail sales expanded month-on-month 1.9% and 0.4% in January and February, respectively. When compared to the same months last year, retail sales expanded robustly: 8.5% in January and 9.4% in February. Still under this comparison basis, both months reached record highs for the series begun in January 2000. In the year through February, retail sales expanded significantly by 8.9%, compared to the same period last year, a record high for this period since the start of the series. In addition to the strong expansion of sales more linked to credit, it bears emphasizing the positive performance of items more sensitive to income and employment. For instance, hyper- and supermarket sales expanded by 6.8% in the first two months of the year. Expanded retail sales, which include the sales of civil construction material and vehicles, motorcycles, parts and pieces, increased 11.0% in the first two months of the year, compared to the same period of 2006. For the rest of the year, it is expected the continuity of retail sales expansion, boosted by the increase in employment and income, credit expansion, the monetary easing process and by the recovery of consumer confidence.

9. Installed capacity utilization in the manufacturing industry reached 81.8% in February, 1.3 p.p. above that observed in the same month of 2006, according to the new series released by CNI and seasonally adjusted by the BCB. Compared to the same month last year, the February result reached the seventh consecutive monthly expansion. This rate was 0.56 p.p. below the record high of the new series, observed in July 2004 (this difference totaled 0.62 p.p. in January). Disaggregated indicators

compiled by the FGV signaled a record in the capacity utilization of capital goods in March. The higher average capacity utilization recently observed reflects the intensification of economic activity. Moreover, data regarding investment, such as the 21.2% increase in the absorption of capital goods in the first two months of the year, suggest a robust ongoing expansion of capacity, sustained by both imports and capital goods production. The production of inputs for civil construction also increased, despite at a lower pace, and expanded by 1.8% in the first two months. Therefore, relevant imbalances between aggregate supply and demand are not anticipated yet. However, as stressed in previous Copom Minutes, the inflation trajectory is closely linked to current and prospective developments with regard to the expansion of supply of goods and services to adequately meet demand conditions.

10. Trade balance continues to record robust results at the start of 2007, confirming analysis expressed in previous Copom Minutes about important structural changes in the Brazilian external trade. In the first quarter, the trade surplus reached US$8.7 billion, 6.0% lower than that observed in the same period last year. This cooling was expected, and was due to US$33.9 billion exports and US$25.2 billion imports in the period, 15.4% and 25.3% higher than the amounts recorded in the first quarter of 2006. Despite robust, lower trade surpluses are a natural consequence of both higher activity level and strengthened BRL, showing a healthy process of external adjustment The current account surplus stood at US$1.7 billion in the first quarter, totaling US$13.3 billion in the twelve months through March, or 1.2% of GDP.

11. With regard to the international scenario, uncertainties surrounding the monetary policy stance in the US persist. Although additional interest rate increases cannot be discarded, the consensus points to the fact that an easing monetary policy cycle could start this year. Similarly, the possibility of a stronger-than-expected deceleration in the US economy cannot be discarded, and likewise, its effects on the global economy. On the other hand, Brazilian economy and asset prices have been showing significant resilience against swings in international financial markets, due to better fundamentals in recent years, and favorable exports prices. In addition to showing resilience to market oscillations, the Brazilian economy trails a growth cycle with price stability. Therefore, the Copom continues to consider that international financial market conditions are favorable.

12. Oil prices, another systematic source of international uncertainties, still present high volatility, with a slight increase since the last Copom meeting, reflecting, among other factors, geopolitical tensions. Despite the uncertainties surrounding the future oil prices trajectory, the main scenario considered by the Copom, which attributes no change to domestic gasoline prices in 2007, continues plausible.

Assessment of Inflation Trends

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

a) Compared to the values considered in the March Copom meeting, the projection for gasoline and bottled gas prices adjustments in 2007 were both maintained at 0%;

b) Considering the same comparison basis, the projection for fixed telephone price adjustments in 2007 decreased to 3.4% from 3.9%, while the projection for household electricity price adjustments decreased to 2.2% from 3.3%;

c) The projection for regulated prices inflation in 2007 decreased to 4.2% from 4.5% (projection of the March Copom Meeting). These items, according to the weights released by the IBGE, represented 30.99% of the total March IPCA;

d) The projection for regulated prices inflation in 2008 decreased to 5.2% from 5.6%. This projection is based on the endogenous determination model for regulated prices. This model considers the effects of seasonal components, exchange rate change, market prices inflation and the General Price Index (IGP);

e) The projection for the spreads over the Selic rate, using a Vector Autoregressive model based on the Selic and 180-day swap rates on the eve of the meeting, stood at 38 b.p. in the fourth quarter of 2007, reaching 71 b.p. in the last quarter of 2008.

14. Regarding fiscal policy, it is assumed that the consolidated public sector primary surplus target of 3.8% of GDP in 2007 and 2008 will be achieved, adjusted by the possibility of a 0.45 p.p. reduction in this percentage due to the implementation of Investment Pilot Program (PPI). The related assumptions considered in the previous meeting were maintained.

15. Since the March Copom meeting, median IPCA inflation expectations for 2007, compiled by the BCB's Investor Relations Group (Gerin), decreased to 3.80% from 3.88%. This reduction was mainly driven by lower estimates for Q2 and Q3 inflation. Twelve-month ahead inflation expectations decreased to 3.64% down from 3.80%. For 2008, inflation expectations remained at 4%. As mentioned in previous Minutes, these developments suggest the consolidation of a more favorable long-term macroeconomic scenario.

16. The 2007 inflation forecast under the benchmark scenario – which assumes the maintenance of the Selic rate at 12.75% and the exchange rate at R$2.05/US$ during the forecast period – slightly increased compared to the values considered at the March Copom meeting, remaining below the 4.5% target established by the CMN for the year. The forecast based on the market scenario – which incorporates the consensus exchange and Selic rates trajectories collected by Gerin on the eve of the Copom meeting – slightly decreased relative to the values considered in the March Copom meeting, remaining below the central target for the year. The projection for 2008 inflation slightly reduced in relation to the March projection, remaining below the 4.5% target in the benchmark scenario and above the 4.5% target in the market scenario.

Monetary Policy Decision

17. The Copom reaffirms the view expressed in previous Minutes, that in addition to containing short-term inflationary pressures, monetary policy has also contributed significantly for the consolidation of a favorable long-term macroeconomic environment. Economic activity data still do not suggest high probability of important pressures over inflation in the short-run. Imports expansion has contributed significantly to this process, complementing domestic production and, therefore, limiting potential inflationary effects of aggregated demand sustained growth. Moreover, despite the prospects of lower liquidity in international markets, due to the interest rates increase in industrialized economies, and the volatility increase in the global markets, the external outlook remains favorable. Particularly regarding Brazilian external financing, the Copom continues to assign low probability to a significant deterioration in international financial market conditions. Therefore, the prospects for the inflation trajectory remain benign. As in recent meetings, the Copom emphasizes that the main challenge of the monetary policy in this context is to guarantee the consolidation of positive developments anticipated for the future.

18. The Copom evaluates that the relatively high inflation monthly rates, which have persisted since the end of 2006, do not represent yet a risk to the medium-term inflation trajectory. Part of the inflation increase at the start of the year is due to one-off factors, such as the elevation of food prices, and seasonal components, such as tuition fees readjustments, in addition to certain pressures over services prices. Due to the nature of such pressures, they are expected to dampen throughout time, without necessarily affecting longer-time horizons. However, the Copom will continue to manage the monetary policy stance so that the gains obtained in inflation control in recent years become permanent. In this respect, the Copom will carefully monitor the evolution of inflation and the several core inflation measures in the upcoming months, discriminating between one-off and persistent or generalized price increases, and promptly adjusting the monetary policy stance to the circumstances.

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

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

20. The Copom emphasizes, once again, that there are important time lags in the transmission of monetary policy stance to economic activity and inflation. Since the beginning of the monetary easing cycle, in September 2005, the Selic rate has already been reduced by 700 b.p., with the bulk of the reduction concentrated in the last nine months. Consequently, the activity level has not completely mirrored the effects of the interest rates cuts, as well as the effects of the economic activity resumption on inflation have not completely materialized. Therefore, the evaluation of alternative monetary policy stances should necessarily focus on the prospective inflation scenario and its risks, instead of current inflation indicators.

21. During the coming months, employment and income expansions and credit growth will continue to bolster economic activity. As mentioned in recent Copom Minutes, activity level should also reflect the effects of governmental transfers and other fiscal impulses occurred in 2006 and expected for the next quarters of the year. Consequently, the lagged effects of interest rates cuts on an increasingly robust aggregate demand will add up to other factors that will continue to contribute to this expansion. These issues become even more relevant considering the signs of heated aggregate demand, short-term inflation pressures, and the fact that the monetary policy decisions should have concentrated effects in the last months of 2007 and, progressively, in 2008.

22. In light of the existing incentives for expanding aggregate demand, the uncertainties surrounding the monetary policy transmission mechanisms, the lower distance between the current Selic rate and the medium-term equilibrium interest rates, and the interest rate cuts implemented since September 2005, the Copom members understood that the preservation of important achievements in disinflation and in preserving economic growth, with job creation and rising real income, demands a more cautious monetary easing stance.

23. Even in this context, Copom participants believe that there are several signs showing that the imports contribution to the consolidation of a benign scenario for inflation, through the limits exerted on tradable prices in a robust aggregate demand environment, may be stronger than initially thought. As a result, during the decision process regarding the monetary easing pace, three members of the Committee understood that the balance of risks to the evolution of the future inflation trajectory, considering the perspectives for both market and regulated prices, would justify a 50 b.p. reduction in the Selic target rate.

24. However, the majority of the Committee maintained the assessment that, considering the extension of the easing process already implemented, the remaining uncertainties regarding the lagged impacts of the monetary easing, the expected behavior of the other sustaining factors of expenditure, such as income growth, in a scenario of solid expansion of the domestic demand for tradable and non-tradable goods and services, and of economic activity strengthening, continued to recommend the maintenance of the 25 b.p. reduction pace in the Selic target rate.

25. Given the reasons stated above, the Copom decided to continue the monetary easing cycle, started in the September 2005 meeting, and reduced the Selic target rate to 12.50% p.a., without bias. Four votes were for the Copom monetary policy action, while three votes were in favor of reducing the Selic target by 50 basis points.

26. Under an inflation-targeting regime, the monetary authority decides according to inflation prospects, analyzing alternative scenarios for the evolution of the main variables that determine price dynamics and the balance of risks associated to the forecasts. Although uncertainties regarding the US economic performance persist, the international scenario remains favorable, contributing to a positive domestic inflation outlook. On the other hand, price pressures, apparently punctual and temporary, hit the economy at a moment when domestic demand already expands vigorously, sustaining the economic activity recovery, including sectors little exposed to external competition, when the effects of important incentive factors, such as the monetary easing already implemented, have not completely materialized.

In such environment, the monetary authority must remain vigilant, so that short-term uncertainties do not contaminate longer time horizons.

27. At the conclusion of the meeting, it was announced that the Copom would reconvene on June 5th 2007, for technical presentations, and on the following day to discuss the monetary policy decision, as established in Communiqué 15,011 of October 31, 2006.

Summary of Data Analyzed by the Copom

Inflation

28. The IPCA inflation increased 0.37% in March, down from 0.44% in February. The slight decrease was mainly driven by the exhaustion of the education costs readjustments impact, after the seasonal increase that influenced the February IPCA inflation. Food and beverages prices increased 0.98%, up from 0.78% in the previous month, and are responsible for 0.2 p.p. of the IPCA monthly result, overall for the higher elevation of perishable food prices. With the monthly result, the IPCA maintained the deceleration trajectory, totaling 2.96% in twelve months and 1.26% in the first quarter of the year.

29. Market prices inflation totaled 0.44% in March, down from 0.59% in February, while regulated prices increased 0.21%, up from 0.12%, in the same period. In twelve months, market prices accumulated 2.82%, and regulated prices, 3.15%. Among market prices, non-tradable goods prices increased 4.51%, mainly because of the 5.09% elevation in the prices of services, while the prices of tradable goods increased 1.10%.

30. The trimmed means core measures slightly increased in March, month-on-month, while the core excluding household food and regulated prices decreased significantly. On a twelve-month trailing basis, all core measures maintained a declining trend. The non-smoothed trimmed means core reached 0.24% in the month, up from 0.22% in February, totaling 2.23% in twelve months. Smoothed trimmed means core increased 0.29% in March, up from 0.24% in February, totaling 3.97% in twelve months. Finally, the core excluding household food and regulated prices reached 0.23% in March, down from 0.52% in the previous month, and accumulated 2.59% in twelve months.

31. The IGP-DI increased 0.22% in March, compared to 0.23% in February, totaling 0.88% in the year through March and 4.49% in the last twelve months. Among the IGP-DI components, only the IPA (Wholesale Prices Index, the sub-index with the largest weight in the IGP-DI) decelerated in March, totaling 0.11%, down from 0.19% in February. The IPC-BR increased 0.48% in the month, up from 0.34% in February, mainly driven by higher rates in 5 of its 7 composing groups, mainly food. The IPC-Br core under the smoothed trimmed means method calculated by FGV increased 0.27% in March, up from 0.16% in the previous month, totaling 0.69% in the year through March and 2.52% in twelve months. The INCC-DI increased 0.27% in March, up from 0.21% in February, as a consequence of higher labor costs driven by wage increases in Salvador and Rio de Janeiro. Services and materials increased 0.19% in March, down from 0.40% in February. The INCC-DI changed 0.94% in the year through March, and 5.25% in the last twelve months.

32. The lower IPA inflation in March reflected the reduction of agricultural prices, which offset the impact of industrial prices acceleration. The Agricultural IPA inflation totaled -0.18%, down from the 1.08% rise in February, while the Industrial IPA grew 0.20%, up from -0.10% in the previous month. According to the three stages of production, only raw materials showed a negative price change, -0.80%, after a 0.42% growth in the previous month. The prices of final goods increased 0.55%, up from 0.42% in February, while the prices of intermediate goods totaled 0.31%, up from -0.08%, in the same period. In the twelve months through March, the prices of raw materials grew 15.28%, pressuring the IPA result in the period; the prices of intermediate and final goods increased by 3.21% and 0.69%, respectively.

Economic Activity

33. GDP grew 3.7% in 2006, according to IBGE's new methodology, in comparison to 2.9% in the previous series. Expansion was generalized through all production components. Regarding

the production side, the crop and livestock sector expanded by 4.1%, while industrial and service sectors grew by 2.8% and 3.7% respectively. On the demand side, there were increases in gross fixed capital formation (8.7%), household consumption (4.3%), government consumption (3.6%), exports (4.6%) and imports (18.1%). The external sector contributed -1.4% to GDP growth, while domestic demand (consumption plus GFCF) was responsible for 4.8 p.p. in product expansion, with a 0.3 p.p. variation due to inventories adjustment.

34. According to IBGE's monthly survey, retail sales increased 0.40% in February, on a month-on-month seasonally adjusted basis. Among the activities composing the general index, there were increases in the sales of fuel and lubricants (1.3%), and hyper- and supermarkets, food products, beverages and tobacco (0.1%); there were decreases in the sales of fabric, clothing and shoes (-2.5%) and furniture and home appliances (-4.2%). Vehicles and motorcycles, parts and pieces, comprised in the expanded retail sales, increased 5.3% in February. On a regional basis, 26 out of the 27 Brazilian states showed positive results in February, compared to February 2006; Piauí (-0.1%) was the only exception.

35. Compared to February 2006, retail sales increased 9.4%. This figure results from growth in all sales segments, mainly furniture and home appliances (19.1%) and hypermarkets (6.9%). Regarding the expanded retail sales, it bears emphasizing the performance of automobiles sales (19.5%). Retail sales performance reflects the continuity of payroll growth and better credit conditions. In the first two months of 2007, retail sales expansion reached 8.9%, compared to the same period of 2006.

36. Still compared to February 2006, expanded retail sales, which include civil construction inputs and vehicles and motorcycles, their parts and pieces, increased 11.9% in last February. In the first two months of 2007, the expanded index grew 11.0%, mainly due to the increases of 16.7% and 6.1% in the sales of vehicles and civil construction inputs, respectively.

37. São Paulo Trade Association (ACSP) data, relative to the city of São Paulo and seasonally adjusted by the BCB, showed increases in database consultations for credit sales (1.8%) and in consultations to the Usecheque system (2.2%) in March, month-on-month. Compared to March 2006, there were increases of 4.5% and 5.5%, respectively.

38. Regarding investment indicators, domestic production of capital goods and civil construction inputs increased 0.1% and 0.3% in February 2007, respectively, on a month-on-month seasonally adjusted basis. Capital goods imports fell 6.0% according to the same comparison basis, after two consecutive months of accelerated growth. In twelve months through last February, these indices grew 6.9%, 3.6% and 24.4% respectively. According to the same comparison basis, capital goods production for energy increased 18.3%; for mixed use, 12.4%; for typically industrial sectors, 7.7%; and for civil construction, 6.6%. Capital goods production for agriculture reduced 11.2% in the twelve months through February, after a 14.6% fall in the twelve months through the previous month, signaling a marginal trend reversion.

39. BNDES's credit operations for mid- and long-term investments reached R$11.3 billion in the first quarter of 2007, exceeding by 66.5% those disbursed in the first quarter of 2006. In the twelve months through March, total operations increased 26.0%, emphasizing the recent acceleration of this indicator. The growth in demand for mid- and long-term financing is also evident by the total amount involved in financing consultations registered by the BNDES in March 2007, R$15 billion, around 190% above the figure recorded in March 2006.

40. According to IBGE's Monthly Industrial Survey (PIM), industrial production increased 0.3% in February on a month-on-month seasonally adjusted basis, reaching the record high of December 2006. Industrial production increased 3.0%, compared to February 2006, with cumulative changes of 3.7% in the first two months of 2007 and 2.8% in the twelve months through February.

41. Considering seasonally adjusted data, industrial output in February was driven by increases of 0.3% and 0.6% in mining and manufacturing sectors, respectively. All use categories recorded production increases in the period, with highlights to durable

consumer goods (1.2%), non-durable consumer goods (0.7%) and intermediate goods (0.5%). Capital goods production remained roughly stable in February (+0.1%), after three consecutive positive changes. On a yearly basis, capital goods expanded by 14.3%, with a 16.0% elevation in the first two months of the year.

42. Disaggregated analysis of seasonally adjusted industrial activity data showed that 14 of the 23 sectors surveyed grew in February, with highlights, according to their respective contributions to overall result, to oil refining and alcohol production (4.1%), electronic materials and communication equipment (7.4%) and food (1.8%). The main negative drivers were machines and electric equipment (-5.7%), machines and equipment (-2.6%) and basic metallurgy (-2.9%).

43. Still considering the industrial activity, according to CNI data, seasonally adjusted by the BCB, hours worked in production rose 2.2% and real sales remained stable in February, in comparison to the previous month. In the first two months of 2007, these indicators increased 3.0% ad 4.9% respectively, in comparison to the same period of 2006. Installed capacity utilization posted at 81.8% in February, close to the 81.7% of January, in the seasonally adjusted series; considering the observed data, installed capacity utilization reached 80.3% in last February, leveling 1.3 p.p. above the February 2006 result.

44. Vehicles production reached a monthly record high in March 2007: 246.5 thousand units, according to the Anfavea. This figure corresponds to a 7.4% increase compared to the same month of 2006, and to a 5.5% month-on-month growth, according to BCB's seasonally adjusted series. Also in seasonally adjusted terms, domestic sales rose 6.7%, while exports decreased 2.5%, month-on-month. Compared to the first quarter of 2006, vehicles production and domestic sales increased 4.0% and 11.4%, respectively, and exports fell 9.5%. The production of agricultural machines rose 8.3% in the first quarter of 2007, compared to the same period of 2006, reflecting the sector's recovery in the current period.

45. According to the IBGE, the March estimate for crops harvest in the year 2006-7 is 11.8% above the previous year result. National production of cereals, legumes and vegetables should reach 130.7 million tons, due to good weather conditions and the production incentives resulting from the elevation of international prices of agricultural goods. Second-harvest soy and corn are the main drivers of the expansion in grains production this year. It bears emphasizing the increase in land occupation for sugar cane production, driven by the growing interest in ethanol production. Sugar cane lands increased 7.0% in 2007, and the estimate production is 7.9% higher than that recorded in the previous harvest.

Surveys and Expectations

46. The Fecomercio-SP survey showed stability in the Consumer Confidence Index (ICC) in April, after a significant drop in March. The Current Economic Conditions Index (Icea) increased 2.5%, and the Consumer Expectation Index (IEC) decreased 1.8%, signalizing that consumers are more cautious with the future economic expectations. In fact, for the fourth consecutive month, the Icea remained above the IEC.

47. According to the FGV survey, which encompasses two thousand homes in the seven main state capitals of the country, the ICC declined 2.8% month-on-month in March. This result is due to the deterioration in both the assessment of the present situation and in the 6-month ahead expectations.

48. Still according to FGV, the Industry Confidence Index (ICI), which encompasses six items of the Manufacturing Industry Survey, increased 4.7% month-on-month in March, for an 8.1% cumulative increase in the first quarter of 2007, compared to the same quarter of 2006. On a month-on-month basis, there were increases of 2.4% in the assessment about the present situation and 7.4% in the expectations for the upcoming months.

Labor Market

49. According to the Ministry of Labor and Employment, 148,019 new jobs were created in February 2007. The result is the second best for the month, since the beginning of the series in 1985, only below the February 2006 result, when 176,632 new jobs were created. In the first two months

of the year 253 thousand new jobs were created, compared to 263 thousand in the same period of 2006. After seasonal adjustment, the employment index increased 0.4% in the month, with increases in all sectors. In the last twelve months, the expansion reached 4.8%, with highlights to the 7.8% increase in civil construction employment.

50. According to the IBGE employment survey (PME) in the six main metropolitan areas of the country, the unemployment rate reached 9.9% in February, compared to 9.3% in the previous month and 10.1% in February 2006. The month-on-month unemployment rate change reflects mainly the 6.5% non-occupied population increase, as economically active population (PEA) has remained almost stable (a 0.2% increase) in the period. The number of employed workers decreased 0.4% in February, totaling about 91 thousand people. However, the number of formal employed workers in the private sector increased 0.2%, while the number of informal workers decreased 2.8%, confirming the increase trend of formal of labor market, with positive results over productivity and labor conditions. In the first two months of 2007, the number of informal workers fell 3.0%, while the number of formal workers increased by 4.1%.

51. According to the same survey, real average earnings reached R$1,096.30 in February, a 2.5% month-on-month increase and a 6.1% elevation compared to February 2006. Real payrolls increased 2% month-on-month in February, and maintained a yearly rising trend, with an 8.8% increase in February, compared to the same month last year.

52. According to CNI, industrial employment increased 0.2% month-on-month in February, seasonally adjusted. In the first two months of 2007, expansion totaled 3.4%. Real payrolls in industry increased 6.4% in February, compared to the same month in 2006, accumulating a 7% expansion in the first two months.

Credit and Delinquency Rates

53. Credit operations in the financial system increased 1.3% in March, accumulating a 21.0% expansion in the last twelve months. Non-earmarked credit increased 1.9% in the month and 23.5% in twelve months, while earmarked credit remained stable and increased 15.9%, according to the same comparison bases. In the non-earmarked credit market, it bears emphasizing leasing operations in the last twelve months, with a 54.1% increase in operations for individuals and 62.6% for corporate. Among operations for earmarked credit, the most significant expansions on a twelve-month basis were for operations directed to housing (22.8%) and to agriculture (21.3%).

54. Non-earmarked credit, used as reference for interest rates, increased 2.1% in March and 20.1% in the last twelve months. Credit for individuals increased 2.0% in March, totaling a 21.7% increase in twelve months. Corporate credit operations with domestic funding increased 2.0% in the month and increased 20.8% in twelve months, while externally funded operations increased 3.1% and 12.3%, according to the same comparison bases.

55. The average interest rate on credit operations reached 38.5% p.a. in March, a record low for the historical series, 1.2 p.p. below the February rate and 7.2 p.p. below the March 2006 result. The average rate on credit for individuals reached 49.9% p.a., down from 59.0% p.a. in the same month of 2006. The average rate on corporate credit decreased 5.3 p.p. in the last twelve months, reaching 25.4% p.a.

56. The average tenure of credit operations for individuals, excluding overdraft account, reached 410 days in March, compared with 347 in March 2006. The average tenure of personal credit modality reached 402 days, increasing 76 days compared to the previous year, reflecting the increasing weight of payroll-deducted in this credit modality. Moreover, the average tenure of credit directed to vehicles acquisition increased to 549 days up from 500 days in the last twelve months.

57. Delinquency rate in the financial system (non-earmarked loans in arrears for more than ninety days) reached 4.9% in February, decreasing 0.1 p.p. in the month and increasing 0.3 p.p. in the last twelve months. Delinquency rate for corporate credit operations remained stable in the month and increased 0.6 p.p. compared to February 2006, reaching 2.8%. Delinquency rate for credit operations

with individuals reached 7.1%, decreasing 0.2 p.p. in the month and in the last twelve months.

58. Net delinquency rate for retail credit, measured by the ACSP, reached 7.1% in March, compared to 7.3% in the same month of 2006 and to the 5.3% average in 2006.

External Environment

59. After the turbulence in the stock markets at the end of February, concerns returned to the degree of downturn in the US economy – mainly in the residential housing sector – and to the evolution of US inflation, which were present in the last Federal Open Market Committee (FOMC) Minutes. In the Euro Zone, the European Central Bank (ECB) maintained the interest rate at 3.75% p.a. in the last meeting, but stressed that the risks to the inflation dynamics persist and that the monetary authority will be vigilant to any price movements. Other Central Banks issuing international currencies reaffirmed their intention to contain inflationary pressures.

60. In terms of global economic activity performance, the International Monetary Fund (IMF) presented new projections to world growth, forecasting two more years of vigorous economic growth – 4.9% in 2007 and 2008 – with developing countries reaching higher growth rates than developed countries – 7.5% and 2.5%, respectively. According to the IMF, the risks to global growth declined and are moderate. The main risks are concentrated in the performance of the US economy, with special reference to the housing market, and in the possibility of a disorganized adjustment in global imbalances. Therefore, at the same time that the IMF recognizes that global economic conditions have underpinned a favorable financial environment, also admits that the underlying risks can potentially weaken the financial stability. In general, the IMF points out to a reduction in the macroeconomic risks and a slight increase in financial risks.

Foreign Trade and International Reserves

61. In the first quarter of 2007, Brazilian foreign trade continued to expand. Trade surplus reached US$8.7 billion in the period, and US$45.5 billion in the twelve months through March, while total external trade totaled US$59.1 billion and US$238.5 billion, according to the same bases. Trade surplus reached US$1,763 million in the first 9 working days of April: exports totaled US$5,449 million whereas imports reached US$3,686 million.

62. Exports reached US$12.9 billion in March, a record high for the month, with a daily average of US$584.3 million, an 18.2% increase over March 2006. Manufactured goods exports reached US$7.3 billion in the month, an 18.3% increase in the year, considering daily averages. Primary products exports totaled US$3.7 billion, and semi-manufactured ones, US$1.6 billion, with respective increases of 23.6% and 10.6%, according to the same comparison bases. In addition to shipment records, some important export products continued to present prices increases, with highlights to orange juice (75.5%); metal laminates (40.3%); raw soy oil (35.7%); fuel alcohol (29.5%) and iron/steel semi-manufactured (28.9%). In the first quarter of 2007 exports continued to show diversification in terms of products, particularly regarding manufactured items with low share in total exports, and expansion of exports destinations.

63. Imports totaled US$9.5 billion in March, a record high for the month, recording a 28.9% increase considering daily averages, over March 2006. All categories expanded, particularly consumer goods imports (44.6%), mainly reflecting the 79.2% increase in automobiles imports. Imports of raw materials, capital goods, and fuels and lubricants grew 33.1%, 23.3%, and 13.0%, respectively, considering daily averages.

64. In March, international reserves reached US$109.5 billion, totaling a US$8.5 billion increase in the month, US$23.7 billion in the year, and US$49.7 billion compared to March 2006.

Money Market and Open Market Operations

65. The period after the March Copom meeting through mid-March, the yield curve remained stable, influenced by the negative behavior of US subprime's housing sector companies. Since then, the yield curve shifted downward continuously, due to lower concerns about the US economic performance, in light of the positive results of labor

market and activity level. The release of the FOMC statement on March 21 contributed to deepen the fall of the yield curve, due to its positive spillovers for international stock markets and capital flows for emerging economies. The performance of several macroeconomic indicators, including recent GDP growth and Debt-to-GDP ratio – resulting from the new measurement methodology by IBGE boosted investors' optimism and contributed to the decline of the Brazil country risk, reaching new record lows, and of the interest rates, mainly longer-term rates. Between March 5 and April 16, one-, two- and three-year rates reduced 0.41 p.p., 0.73 p.p. and 0.92 p.p., respectively. One-, three- and six-month rates declined 0.27 p.p., 0.29 p.p. and 0.26 p.p., respectively, influenced by the favorable current inflation trajectory and inflation expectations. The real interest rate measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month ahead inflation expectations decreased to 7.79%, on April 16, down from 8.00%, on March 5.

66. On March 22 and on April 11, the BCB conducted a reverse exchange rate swap auction, aimed at anticipating the redemption of the swaps due April 2 and May 2, respectively, totaling US$2.9 billion.

67. In its open market operations, the BCB carried out, from March 6 to April 16, weekly five- and seven-month long fixed rate repo operations. The average daily balance of these operations amounted R$64.1 billion, of which R$48.3 billion were seven-month operations. In the same period, the BCB also conducted 24 overnight repo operations, of which 23 aimed at draining the excess liquidity from the market. The BCB also conducted daily liquidity management operations with tenures up to two working days. Operations with tenors less than thirty days, including daily liquidity management operations, averaged R$53.5 billion, borrowing.

68. Between March 6 and April 16, the National Treasury raised a total of R$61.7 billion, of which R$34.2 billion in fixed-rate securities: R$22.3 billion via issuance of LTNs maturing in 2007, 2008 and 2009 and R$11.9 billion in NTN-Fs maturing in 2010, 2012 and 2017. Issuance of LFTs totaled R$14.5 billion, for securities maturing in 2010 and 2012. Issuance of inflation-linked NTN-Bs reached R$13.0 billion, for securities maturing in 2009, 2011, 2015, 2024, 2035 and 2045.

69. In the same period, the Treasury conducted auctions to sell LTNs maturing in October 2007 and April and July 2008, conjugated to the purchase of shorter-term LTNs, totaling R$9.1 billion. The Treasury also conducted auctions to sell LFTs maturing in 2010 and 2012, totaling R$2.7 billion, accepting as payment LFTs maturing in 2007. In addition, the Treasury conducted auctions to buy LTNs maturing in April 2007, totaling R$1.2 billion and NTN-Bs maturing in 2024 and 2045, totaling US$85 million.

Minutes of the 127th Meeting of the Monetary Policy Committee (Copom)

Date: June 5th, from 5:00PM to 7:30PM, and June 6th, from 5:00PM to 8:00PM
Place: BCB Headquarters meeting rooms – 8th floor on June 5th and 20th floor on June 6th – Brasília – DF

In attendance:
Members of the Committee
Henrique de Campos Meirelles – Governor
Alexandre Antonio Tombini
Antonio Gustavo Matos do Vale
Mario Gomes Torós
Mário Magalhães Carvalho Mesquita
Paulo Sérgio Cavalheiro
Paulo Vieira da Cunha

Department Heads (present on June 5th)
Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on June 6th)

Ivan Luis Gonçalves de Oliveira Lima – Open Market Operations Department
José Antonio Marciano – Department of Banking Operations and Payments System
Renato Jansson Rosek – Investor Relations Group

Other participants (present on June 5th)
Adriana Soares Sales – Deputy Head of the Research Department
Alexandre Pinheiro de Moraes Rego – Special Advisor to the Governor
Alexandre Pundek Rocha – Advisor to the Board
Flávio Pinheiro de Melo – Advisor to the Board
Katherine Hennings – Advisor to the Board
Jocimar Nastari – Press Secretary

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

Recent Economic Developments

1. IPCA inflation totaled in April and May 0.25% and 0.28%, respectively, down from 0.37% in March. As a consequence, inflation through May stood at 1.79%, above the 1.75% rate reached in the same period of last year. Regulated prices totaled 1.35%, down from 2.70%, according to the same comparison basis, contributing to contain inflation, once market prices reached 2.01% in the period, above the 1.27% observed in the same period of 2006. Twelve-month trailing inflation through May reached 3.18% (compared to 4.23% through May 2006), while market prices increased 3.32% and regulated prices grew by 2.88% (2.48% and 8.24%, respectively, through May 2006). Month-on-month inflation deceleration in April and May was a result of market prices inflation decline (0.19% and 0.25%, respectively, down from 0.44% in March), in contrast with regulated prices inflation acceleration (0.39% and 0.35% in April and May, respectively, up from 0.21% in March). In addition, tradable goods price inflation accelerated 0.25% and 0.48%, respectively, in April and May, up from 0.21% in March, in contrast with non-tradable price inflation, which totaled 0.13% and 0.03%, down from 0.66%, according to the same comparison basis. Services inflation reached 0.18% in April and 0.26% in May, totaling 4.87% in the last twelve months. Dampened inflationary pressures at the end of 2006 and at the start of 2007 indicate that inflation should evolve according to the targets path.

2. IPCA core inflation measures did not follow the declining headline inflation behavior. Core inflation by exclusion of household food items and regulated prices increased month-on-month 0.29% in April and 0.33% in May, up from 0.23% in March. On the other hand, smoothed trimmed means core stood at 0.29%, virtually unchanged relative to March, while the non-smoothed trimmed means core increased 0.28% in April and 0.30% in May, up from 0.24% in March. In the year through May, core inflation by exclusion and smoothed and non-smoothed trimmed means core measures recorded 1.80%, 1.51% and 1.40%, respectively, below the rates observed at the same period of 2006. In the last twelve months, smoothed trimmed means core totaled 3.68% in May and 3.86% in April, down from 3.98% in March. On the other hand, on a twelve-month trailing basis, core inflation by exclusion and non-smoothed trimmed means core increased in April and May, relative to March, but stood below the 4.5% central target for 2007.

3. The General Price Index (IGP-DI) inflation averaged 0.29% in the first quarter of the year (0.07% in the same period of 2006), but decelerated in April and May, averaging 0.15%. This deceleration influenced similarly the behavior of two out of the three great IGP-DI components: the Consumer Price Index-Brazil (IPC-Br) reached 0.28%, down from 0.50%, while the Wholesale Price Index (IPA-DI) declined to -0.01%, down from 0.21%. On the other hand, the Civil Construction National Index, which averaged 0.31% in the first quarter of the year, averaged 0.81% in the two months ended in May, due to pressures stemming from raw material costs and wage adjustments. In the last twelve months through May, the IGP-DI reached 4.38%, up from -0.14% in the same period of 2006. In light of the 3.12% elevation of the IPC-Br in the last twelve months through May, the IGP-DI increase in the same period was, to a large extent, influenced by the IPA-DI and the INCC changes, which totaled 4.76% and 5.18%, respectively. The IPA-DI acceleration was mainly

driven by agricultural prices, which increased 9.13%, while industrial prices only increased 3.46%. As highlighted in previous Copom Minutes, the effects of wholesale prices over consumer inflation will depend on prospective demand conditions and price-setters' expectations for the future inflation path.

4. Despite recording some accommodation in April, industrial output continues to present robust growth trend. On a three-month moving average basis, according to data seasonally adjusted by the IBGE, industrial output grew 0.6%, compared to the previous month, maintaining the growth pace observed in March, and registered the thirteenth consecutive expansion. Compared to the same month of last year, industrial output grew 6%, the highest rate observed since June 2005 under this comparison basis, reflecting the expansion in 20 out of the 27 activities surveyed. In the last twelve months, industrial output expanded by 3.3%, with 3.1% for manufacturing industry and 5.7% for mining. For May, the few leading and coincident indicators available for industrial production suggest the continuity of the ongoing expansion. The several incentive factors to economic activity, including the monetary easing already implemented, suggest that the expanding trend in industry shall continue in the upcoming months.

5. Disaggregated industrial data showed month-on-month seasonally adjusted expansion of 15.4% in capital goods production and 4.2% in the production of intermediate goods. Compared to the same month last year, capital goods production expanded by 17.4%, while intermediate goods production increased by 5.3%. According to the same comparison basis, durable goods production increased by 5.4%. The dynamics of capital goods production reflects the consolidation of positive prospects for domestic demand growth and the influence of favorable international prices in some sectors. In addition, the expansion of intermediate goods production in the first four months of the year suggests a more generalized acceleration in industrial activity.

6. In line with the usual seasonal pattern at the start of the year, the unemployment rate increased in the first months of 2007 to 10.1% in March and April up from 8.4% in December 2006. However, in the year through April, the average unemployment rate stood 0.2 p.p. below that observed at the same period last year. The purchasing power of workers increased 5% according to the same comparison basis, a record high for the series. Real payrolls increased 8% in the year through April, compared to the same period last year, an important factor sustaining the growth of aggregate demand. According to the National Industry Confederation (CNI) data seasonally adjusted by the BCB, manufacturing employment increased month-on-month 0.4% in April and March, after totaling 0.2% in February, reaching a record high for the series started in 2003. In addition, manufacturing employment expanded by 3.1% in April, compared to the same month of last year. Regarding formal employment, data from the Ministry of Labor and Employment (MTE) confirms the continuity of expansion in April, with the creation of 302 thousand new jobs (0.5% growth on a month-on-month seasonally adjusted basis) and 1,361 thousand jobs in the last twelve months. As a consequence, in the year through April, as well as on a twelve-month trailing basis, formal job creation grew 4.8%, with highlights for civil construction (7.5%) and mining (4.8%).

7. Retail sales increased 1.1% month-on-month in March, after expansions of 0.4% in February and 2% in January, according to data seasonally adjusted by the IBGE. With this result, retail sales expanded 2.8% in the first quarter, quarter-on-quarter. Compared to the same quarter of 2006, retail sales expansion reached 9.7% in the first quarter of the year, outpacing the 7.0% expansion recorded in the last quarter of 2006. For this robust performance of retail sales, which indicates strong growth of domestic demand, contributed both items more sensitive to payroll expansion, such as "other items of personal and domestic use" (21.8% expansion, according to this comparison basis) and those that are usually more sensitive to credit conditions, such as furniture and domestic appliances (20.5% expansion in the period). Expanded retail sales, which include the sales of civil construction material and vehicles, motorcycles, parts and pieces, increased 13.2% in March, compared to the same month of 2006, the ninth consecutive month that expanded retail sales exceeded retail sales. For the rest of the year, it is expected the continuity

of retail sales expansion, boosted by the increase in employment and income, credit expansion, the monetary easing process and by the recovery of consumer confidence.

8. Installed capacity utilization in the manufacturing industry averaged 81.0% in the year through April, up from 79.1% in the same period of 2006, according to CNI data without seasonal adjustment. The installed capacity utilization rate, according to CNI data seasonally adjusted by the BCB, stood at 81.8% in April, 3.1 p.p. above that observed in the same month of 2006, and 0.5 p.p. below the record high for the series observed in July 2004. According to CNI data seasonally adjusted by the CNI, installed capacity utilization reached 82.6% in April, a new record high for the series. Disaggregated indicators calculated by CNI indicated that 15 out of 19 sectors exceeded the average installed capacity utilization, compared to eleven sectors at the same month of last year. This dynamics reflects the intensification of economic activity, although recent data relative to production and absorption of capital goods indicate that investment expansion remains robust. In the year through April, the absorption of capital goods robustly increased 20.1%, compared to the same period of 2006. This result reflects the increase in capital goods imports (32% in volume), as well as capital goods production (15.4%). The production of inputs for civil construction increased 3.5%. In light of the recent installed capacity utilization rates, the continuity of investment expansion will be essential to avoid relevant imbalances between aggregate supply and demand. As stressed in previous Copom Minutes, the inflation trajectory is closely linked to current and prospective developments with regard to the expansion of supply of goods and services to adequately meet demand conditions.

9. The trade balance continues to present robust performance, confirming the evaluations based upon Inflation Reports and previous Copom Minutes that depict important structural changes in the Brazilian foreign trade. After reaching in 2006 a US$46.1 billion record high, a 3.2% increase over the 2005 result, the trade balance continuous to register vigorous surpluses that encourage analysts to review positively their forecasts. In the year through May, the trade surplus reached US$16.9 billion, a 9.3% increase relative to May 2006. Exports rose 21.2%, to US$60.1 billion, while imports increased 26.7% to US$43.2 billion. As observed in previous Copom Minutes, imports have been growing more rapidly than exports at the margin, due not only to higher level of economic activity, but also to the strengthening of the BRL, which points to a healthy adjustment process of the trade balance.

10. With regard to the international scenario, uncertainties surrounding the monetary policy stance in the US persist. Signals that inflation could be running above the FOMC comfort zone indicate that expectancies of an easing cycle starting this year may have been premature. Moreover, additional interest rate increases in the US cannot be discarded. Similarly, the possibility of stronger-than-expected economic deceleration and its potential effects over the other worldwide economies cannot be ignored. On the other hand, the strengthening of economic activity in Europe and the continuity of the robust expansion of the major countries in Asia have so far compensated for the moderate economic deceleration in the US. The maintenance of growth rates at historically high levels has caused higher inflationary pressures especially over raw materials and food prices. In this context of robust global growth, the economy and prices of Brazilian assets have shown both remarkable resilience to the fluctuations in international financial markets, thanks to the improvement in economic fundamentals in the recent years, and to a very benign behavior of export prices. In this sense, in addition to showing more resilience to changes in international markets sentiment, the Brazilian economy trails a growth cycle with price stability. Considering all this factors, the Copom continues to consider that the international scenario is favorable.

11. Oil prices, another external source of uncertainty, rose since the last Copom meeting and still present volatility. The recent levels of international prices of this commodity seem to be reflecting both structural shifts in global demand for energy and recurrent episodes of geopolitical tensions. Despite significant risks inherent to forecasts on future oil prices trajectory, the main scenario considered by the Copom, which attributes no change to domestic gasoline prices in 2007, continues plausible.

Assessment of Inflation Trends

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

a) Compared to the values considered in the April Copom meeting, the projection for gasoline and bottled gas prices adjustments in 2007 were both maintained at 0%;

b) The projection for electricity and fixed telephone price adjustments in 2007 were modified relative to the April forecasts. The new projections for electricity and fixed telephone are -0.9% and 3.3% respectively;

c) The projection for regulated prices inflation in 2007 decreased to 3.6% from 4.2% (projection of the April Copom meeting). These items, according to the weights released by the IBGE, represent 30.99% of the total May IPCA;

d) The projection for regulated prices inflation in 2008 was also changed, to 4.8%. This projection is based on the endogenous determination model for regulated prices. This model considers the effects of seasonal components, exchange rate change, market prices inflation and the IGP;

e) The projection for the spreads over the Selic rate, using a Vector Autoregressive model based on the Selic and 180-day swap rates on the eve of the meeting, estimates a 6 bps in the fourth quarter of 2007, reaching 70 bps in the last quarter of 2008.

13. Regarding fiscal policy, it is assumed that the consolidated public sector primary surplus target of 3.8% of GDP in 2007 and 2008 will be achieved, adjusted by the possibility of a 0.45 p.p. reduction in this percentage due to the implementation of PPI (Investment Pilot Program). The related assumptions considered in the previous meeting were maintained.

14. Since the April Copom meeting, median IPCA inflation expectations for 2007, compiled by the BCB's Investor Relations Group (Gerin), decreased to 3.5% from 3.8%. This reduction was mainly driven by a decrease of inflation expectations for the third quarter of 2007. The twelve-month ahead inflation expectations decreased to 3.37% down from 3.64%. For 2008, inflation expectations remained at 4%. As mentioned in previous Minutes, these developments suggest the consolidation of a more favorable long-term macroeconomic scenario.

15. Considering the hypotheses under the benchmark scenario – which assumes the maintenance of the Selic rate at 12.5% and the exchange rate at R$1.95/US$ during the forecast period – the projection for the 2007 IPCA reduced compared to the values considered at the April Copom meeting, remaining below the 4.5% target established by the CMN for the year. The forecast based on the market scenario – which incorporates the consensus exchange and Selic rates trajectories collected by Gerin on the eve of the Copom meeting – situated below the values considered in the April Copom meeting and below the central target for the year. The projection for 2008, based on the benchmark scenario, stayed relatively stable in relation to the April projection, remaining below the 4.5% target. Under the market scenario, the projection still remains above the 4.5% target.

Monetary Policy Decision

16. The Copom reaffirms the view expressed in previous Minutes, that in addition to containing short-term inflationary pressures, monetary policy has also contributed significantly for the consolidation of a favorable long-term macroeconomic environment. Economic activity data point to strengthened demand expansion, but still do not suggest high probability of important pressures over inflation in the short-run. Imports expansion has contributed significantly to this process, complementing domestic production and, therefore, limiting potential inflationary effects of aggregate demand sustained growth. Moreover, despite the uncertainties regarding the continuity of the strong growth recently observed in the international economy, the prospects of lower liquidity in important international markets, and the volatility increase in the global markets, the external outlook remains favorable. Particularly regarding Brazilian external financing, the combination of significant trade surpluses and increasing capital inflows suggests that the balance of payments will continue to perform robustly. Therefore, the prospects

for the inflation trajectory remain benign. As in recent meetings, the Copom emphasizes that the main challenge of the monetary policy in this context is to guarantee the consolidation of positive developments anticipated for the future.

17. The Copom evaluates that the more benign behavior of inflation in the recent months, in contrast with relatively high monthly rates that had persisted since the end of 2006, confirms the convergence of inflation trajectory to the targets path. The emergency of global inflationary pressures still does not present risks for the domestic inflation trajectory in the short run, but a heated demand could increase the pass-through of wholesale prices pressures to consumer prices. In this sense, the Copom will continue to manage the monetary policy stance so that the gains obtained in inflation control in recent years become permanent. In this respect, the Copom will carefully monitor the evolution of inflation and the several core inflation measures in the upcoming months, discriminating between one-off and persistent or generalized price increases, and promptly adjusting the monetary policy stance to the circumstances.

18. The preservation of inflation rates in line with the targets path and the consolidation of a long-lasting stable macroeconomic scenario will contribute to the progressive reduction of macroeconomic risk perception underway. The scope for a reduction in real interest rates in the future will naturally follow as a consequence of this improved perception. The Copom evaluates that its cautious monetary policy stance has been critical to increase the probability of inflation convergence to the targets path. For this to materialize, however, it is important that forward-looking inflation indicators remain consistent with the recent benign inflation outlook observed in the last quarters.

19. The Copom emphasizes, once again, that there are important time lags in the transmission of monetary policy stance to economic activity and inflation. Since the beginning of the monetary easing cycle, in September 2005, the Selic rate has already been reduced by 725 b.p., with the bulk of the reduction concentrated in the last nine months. Consequently, the activity level has not completely mirrored the effects of the interest rates cuts, as well as the effects of the economic activity resumption on inflation have not completely materialized. Therefore, the evaluation of alternative monetary policy stances should necessarily focus on the prospective inflation scenario and its risks, instead of current inflation indicators.

20. During the coming months, employment and income expansions and credit growth will continue to bolster economic activity. As mentioned in recent Copom Minutes, activity level should also reflect the effects of governmental transfers and other fiscal impulses occurred in 2006 and expected for the next quarters of the year. Consequently, the lagged effects of interest rates cuts on an increasingly robust aggregate demand will add up to other factors that will continue to contribute to this expansion. These issues become even more relevant considering the signs of heated aggregate demand, and the fact that the monetary policy decisions should have limited effects in 2007 and predominant impacts in 2008.

21. In light of the existing incentives for expanding aggregate demand, the uncertainties surrounding the monetary policy transmission mechanisms, the lower distance between the current Selic rate and the medium-term equilibrium interest rates, and the interest rate cuts implemented since September 2005, the Copom members understood that the preservation of important achievements in disinflation and in preserving economic growth, with job creation and rising real income, demands a cautious monetary easing stance.

22. The Copom evaluated that, since the last meeting, influences of internal and external factors on the balance of risks for the expected inflation trajectory exacerbated, and in opposite directions. External sector, acting importantly to widen aggregate supply, continues to influence inflation prospects in a predominantly benign way. On the other hand, expansion of domestic demand may increase the risks to inflation dynamics on the medium-run.

23. Some participants of the Committee understood that, considering the extension of the easing process already implemented, the remaining uncertainties regarding the lagged impacts of the monetary easing, the expected behavior of the other sustaining factors of the expenditure, such as income growth,

in a scenario of solid expansion of domestic demand for tradable and non-tradable goods and services, and of economic activity strengthening, the maintenance of the 25 b.p. reduction pace in the Selic target rate would contribute to extend the easing process over time.

24. However, the majority of the Committee argued that the contribution of the external sector for the consolidation of a benign outlook for inflation could be higher than previously expected, especially by controlling the prices of tradable goods and by increasing investments in a heated demand environment. Such contribution is favoring the equilibrium between aggregate demand and domestic supply growth rates at a pace in line with monetary policy decisions, without compromising the convergence for the inflation targets trajectory. Therefore, five members of the Committee understood that the risk balance to the evolution of future inflation would justify a 50 b.p. reduction in the Selic target rate.

25. Given the reasons stated above, the Copom decided to continue the monetary easing cycle and reduced the Selic target rate to 12.00% p.a., without bias. Five votes were for the Copom monetary policy action, while two votes were in favor of reducing the Selic target by 25 basis points.

26. Under an inflation-targeting regime, the monetary authority decides according to inflation prospects, analyzing alternative scenarios for the main variables that determine price dynamics and the balance of risks associated to the forecasts. Despite the remaining uncertainties regarding the US economy, the international scenario remains favorable, and benefits the external sector contribution for the maintenance of a benign inflationary outlook. On the other hand, a set of price pressures arises when domestic demand expands vigorously, backing-up the economic activity recovery. This expansion encompasses some sectors little exposed to external competition, when the effects of important incentive factors, such as the monetary easing already implemented, are not fully perceived. In such environment, the monetary authority must remain vigilant, so that short-term uncertainties do not contaminate longer time horizons.

27. At the conclusion of the meeting, it was announced that the Copom would reconvene on July 17th 2007, for technical presentations, and on the following day to discuss the monetary policy decision, as established in Communiqué 15,011 of October 31, 2006.

Summary of Data Analyzed by the Copom

Inflation

28. The IPCA increased 0.28% in May, up from 0.25% in April, accumulating 3.18% growth in twelve months. In the year through May, the index increased 1.79%, above the 1.75% rise recorded in the same period of 2006. This rise in May reflected distinct behavior among the large groups. The main increases were for food and beverages, especially *in natura* milk; personal outlays, especially household workers; and clothing, as a result of seasonal pressures. In an opposite side, the lowest rates were for communication, housing, and transportation, due to the cooling of oil prices rises.

29. Market prices inflation increased 0.25% in May, up from 0.19% in April, while regulated prices decreased totaled 0.35%, down from 0.39%, in the same period. In the last twelve months, market prices increased 3.32%, and regulated prices, 2.88%. Among market prices, the prices of non-tradable goods increased by 4.42%, mainly because of the 4.88% elevation in services prices, while the prices of tradable goods prices increased by 2.14%.

30. On a twelve-month trailing basis, smoothed trimmed means core measure maintained a downward trend, while the core excluding household food and regulated prices and the non-smoothed trimmed means core recorded rises. Even recording rises under these two criteria, the cores changes stood below the target for the IPCA. The smoothed trimmed means core increased 0.30% in the month, up from 0.29% in April, totaling 3.68% in the twelve months through May, down from 3.85% in April. The non-smoothed trimmed means core reached 0.30% in May, up from 0.28% in April, accumulating 2.39% in twelve months, compared to 2.33% in April. Finally, the core excluding household food and regulated prices

reached 0.33% in May, up from 0.29% in the previous month, and accumulated 3.04% in twelve months, compared to 2.66% in the previous month.

31. The IGP-DI increased to 0.16% in May, up from 0.14% in April, accumulating 1.18% in the year through May and 4.38% in twelve months. Considering the main components of the index, the rate increase was, exclusively, a result of the INCC elevation, which reached 1.15% in the month, up from 0.46% in the previous month. The INCC result was mainly driven by the 1.81% increase in the cost of the workforce, due to wage readjustments in Brasília, Fortaleza, Florianópolis, Goiânia and São Paulo. The IPC-Br increased 0.25% in May, down from 0.31% in April, while the IPA-DI (Wholesale Prices Index) totaled -0.04% in May, down from 0.02% in the previous month.

32. The lower IPA inflation in May reflected the continuous reduction of agricultural prices, despite at a lower pace, and the cooling of industrial prices. The Agricultural IPA totaled -1.94% in May, compared to -2.44% in April, while the Industrial IPA recorded 0.58% and 0.84% for the same period. The main negative drivers were legumes and fruit, sugar cane, poultry and eggs, among agricultural prices, and moisturized ethylic alcohol and sugar, among industrial prices. The main pressures in May stemmed from the prices of *in natura* milk, fuel oil, non-ferrous metals, iron, steel and steel by-products and fertilizers. The IPA-DI increased 0.61% and 4.76%, in the year through May and in twelve months, respectively. According to the processing stages of production, the prices of final goods declined 0.15%, after a 0.85% elevation in April, mainly mirroring the deceleration of fuel prices, which totaled -1.10% in May, compared to 2.76% in April. The prices of intermediate goods increased 1.01% in May, up from 0.96% in April, with highlights to the prices of manufacturing materials and components. The prices of raw materials recorded -1.89% in May, compared to -2.78% in the previous month.

Economic Activity

33. According to IBGE's monthly survey, retail sales increased 1.1% in March, on a month-on-month seasonally adjusted basis. Among the activities composing the general index, only fuel and lubricants sales decreased (0.1% growth). The remaining segments expanded, with highlights to fabric, clothing and shoes (2.7% growth), and hyper- and supermarkets, food products, beverages and tobacco (1.2% growth). Vehicles, motorcycles, parts and pieces, which do not compose the general retail sales index, increased 4.4% in the month. On a regional basis, 18 out of the 27 Brazilian states showed positive results in March, compared to February, seasonally adjusted, while all the units recorded rises in comparison to March 2006, with highlights to the increases recorded in the South and Mid-West, mirroring the effects of the income recovery in the agricultural sector.

34. Compared to March 2006, retail sales grew 11.5%, driven by the increases in all segments, mainly furniture and domestic appliances (18.1%) and hypermarkets (9.3%). Expanded retail sales increased 13.2%, highlighting the sales of vehicles, motorcycles, parts and pieces (18.5%).

35. Retail sales performance reflects the continuity of payroll growth and better credit conditions, together with the recovery of the crop and livestock sector. Retail sales increase reached 9.7% in the first quarter of 2007; expanded retail sales, which include civil construction inputs and vehicles, motorcycles, parts and pieces, increased by 11.8%, under the same comparison basis. It bears emphasizing the performance of furniture and domestic appliances (20.5%) and vehicles (17.4%).

36. São Paulo Trade Association (ACSP) data, related to the city of São Paulo and seasonally adjusted by the BCB, showed a 0.8% increase in database consultations for credit sales, and a 0.7% reduction in consultations to the Usecheque system in May, on a month-on-month basis. In comparison to May 2006, there were increases of 5.6% and 6.1%, respectively.

37. Regarding investment indicators, civil construction inputs production expanded month-on-month 1.3% in April, while capital goods domestic production fell 1.2%, seasonally adjusted. Capital goods contraction should not be interpreted as a trend change, in view of the 15.4% and 8.5%

expansions registered in the first four months of 2007 and in the last twelve months, respectively. In the first four months of the year, capital goods production for mixed use increased by 17.0%; typically manufactured capital goods expanded by 17.7%, while capital goods production for energy and for civil construction grew 14.4% and 10.7%, respectively. Production of capital goods for agriculture expanded by 19.1% in the same period, while the negative twelve-month trailing production reduced to -4.3% in April, compared to -8.9% in March, confirming the upturn of the trend at the margin.

38. BNDES funding for medium- and long-term investment totaled R$14.9 billion in the first four months of 2007, 39.8% above the amount disbursed in the same period of 2006. The recent acceleration of this indicator is also evident in the 21.9% expansion observed in the twelve months through April.

39. Industrial production declined 0.1% in April, according to IBGE's Monthly Industrial Survey (PIM) seasonally adjusted data. On a 3-month moving average basis, which attenuates punctual oscillations, industrial activity reached a record high for the thirteenth consecutive month, in April. Moreover, industrial production rose by 6.0%, compared to April 2006, and expanded by 4.3% and 3.3%, in the first four months of 2007 and in the last twelve months, respectively.

40. Considering seasonally adjusted data, mining production expanded by 0.3%, while manufacturing industry production remained stable. Regarding use categories, production of capital goods, intermediate goods and durable consumer goods reduced by 1.2%, 0.6% and 1.3%, respectively, while semi and non-durable goods production increased by 0.8%. Despite the reduction in April, capital goods production expanded by 15.4% in the year through April.

41. Disaggregated data of seasonally adjusted industrial activity showed that 12 of the 23 sectors surveyed grew in April, with highlights to beverages (4.3%) and other chemical products (2.3%). The main negative drivers were food (-1.9%), perfumes, soaps and cleaning products (-5.7%) and electronic materials and communication equipment (-3.4%).

42. Still considering the industrial activity, according to CNI data, seasonally adjusted by the BCB, hours worked in production expanded by 1.0% and real industrial sales declined 1.2% in April, month-on-month. In the year through April, these indicators increased by 3.6% and 4.8%, respectively, compared to the same period of 2006. After seasonal adjustment, installed capacity utilization stood at 81.9% in April, almost unchanged compared to the previous month (82.0%). Considering observed data, utilization level reached 81.7%, 3.2 p.p. above the April 2006 figure.

43. According to Anfavea, vehicles production reached 258.9 thousand units in May, a monthly record high, a 7.2% increase relative to the same month of 2006. According to data seasonally adjusted by the BCB, vehicles production expanded by 3.0%, after a 1.7% reduction in April, on a month-on-month basis. Sales of overall automotive industry increased 13.3%, relative to May 2006, totaling 263.8 thousand units, a monthly record high. As exports reduced by 7.6%, such performance was exclusively due to the domestic absorption, which increased 23.8% (also a record high for the series). Considering the month-on-month seasonally adjusted series, domestic sales increased by 4.7%, while exports expanded by 7.1%.

44. According to the IBGE, the current estimate for the crops harvest in the 2006-7 period pointed to a 13.0% increase, compared to the previous harvest. National production of grains should reach 132.3 million tons, due to good weather conditions and the production incentive driven by the increase of international agricultural commodities prices. In April's survey, the main forecast increases related to wheat (52.3%), cottonseed (30.1%), corn (20.6%), bean (10.2%) and soy (9.2%), while the main decreases related to coffee and rice production (15.3% and 4.1%, respectively). It still bears emphasizing the increase in land occupation for sugar cane production, driven by the growing interest in ethanol production. Sugar cane plantations increased by 8.9% in 2007, and the production should expand by 12.7%, year-on-year.

Surveys and Expectations

45. The Fecomercio-SP survey showed declines of 1% in the Consumer Confidence Index (ICC) in May, month-on-month, and 8.4%, compared to May

2006. The Current Economic Conditions Index (Icea) increased month-on-month 0.7% in May, while the Consumer Expectation Index (IEC) declined by 2.3%. In fact, the Icea remained above the IEC for the fifth consecutive month.

46. According to the FGV survey, which encompasses two thousand homes in the seven main state capitals of the country, the ICC increased 2.6% month-on-month in May. This result is due to the improvement in both the assessment of the present situation and in the 6-month ahead expectations. Compared to May 2006, the ICC rose 7.3%, mainly because of the 8.9% increase in the IEC.

47. Still according to FGV, the Industry Confidence Index (ICI), which encompasses six items of the Manufacturing Industry Survey, declined 1.8% month-on-month in May, after the record high observed in April. The ICI rose 15.9% relative to May 2006, totaling an 8.1% expansion in the first four months of 2007, compared to the same period of 2006. This result is due to the positive assessments about the expected level of demand and the predictions of higher hiring in industry. The level of installed capacity utilization reached 84.8% in May, up from 82.7% in May 2006.

48. According to the Manufacturing Industry Survey, carried out by FGV in April 34% of the companies surveyed affirmed that their investment in fixed capital is higher in the first half of 2007 than that observed in the previous half, while 21% affirmed that their investment is lower. The prediction of higher investment in the second half of 2007 also reached 34% of the companies, while 14% of the companies intend to invest less. The main reasons to invest in fixed capital quoted by the firms were: the expansion of production capacity (47%), and the increase in production efficiency (31%). The high tax burden was the main factor for inhibiting investments in fixed assets, totaling 49% of the answers, 4 p.p. above the proportion registered last year. The cost of credit was quoted by 18% of the companies, the lower relative frequency of the historical series started in 1998.

Labor Market

49. According to the Ministry of Labor and Employment, 302 thousand new formal jobs were created in April, a record high for the month, since the beginning of the series in 1985. In the first four months of the year, 701.6 thousand new jobs were created, 23.2% above the figure observed in the same period of 2006, driving employment expansion by 4.8%. In the last twelve months, expansion also reached 4.8%, with highlights to the 8.0% increase in civil construction employment and 5.7% in commerce employment. After seasonal adjustment, employment increased month-on-month 0.5% in April, with increases in all sectors.

50. According to the IBGE employment survey (PME) in the six main metropolitan areas of the country, the unemployment rate stayed unchanged at 10.1% in April 2007. The unemployment rate stability reflects mainly the 0.33% and 0.34% decreases in employed population and economically active population (PEA), respectively. The reduction of 68 thousand employed workers was due to reductions of 2.4% in the number of informal workers and 3.0% in the number of civil and military servants and increase of 0.7% in the number of workers in the private sector. In the first four months of 2007, the average number of workers increased by 2.9%, relative to the same period of 2006, reflecting an expansion of investments and recovery of the agricultural sector. Among the workers in the private sector, the number of formal workers increased by 4.1%, while the number of informal workers remained stable, highlighting a qualitative improvement in the labor market.

51. According to the same survey, real average earnings reached R$1,114.00 in April, a 0.3% month-on-month increase and a 5% elevation compared to April 2006. Real payrolls decreased 0.1% month-on-month in April, reflecting the reduction in the number of formal workers, but maintained a yearly rising trend, with an 8.4% increase in April, compared to the same month last year, and 8.0% in 2007.

External Environment

52. The global economic environment remains favorable and with controlled risks. Recent data shows steady consumption in the US and slight acceleration of GDP growth in Europe and Asia. Despite the lower expansion (17% in 2006, compared to 34% in 2005),

net private capital inflows for emerging markets reached a US$647 billion record high.

53. In the US, the revised GDP growth rate in the first quarter decreased to 0.6% from 1.3%, the lowest rate since the 0.2% rate reached in the last quarter of 2002. However, important aggregate demand components remain robust, and can sustain larger expansion throughout the year. The consumption expansion, whose weight in total demand exceeds 2/3, increases to 4.4%, up from 3.8%. Combined with a reduction in inventories, this acceleration makes room to an increase in production. In the housing sector, the sales of new real state properties increased month-on-month 16.2% in April, smoothing the depressing effects over the economy. These data confirm the Federal Reserve Bank (Fed) perception of moderate acceleration of growth in the next quarters.

54. The confidence indices that measure consumers' sentiment point to the same direction: the *Conference Board* rose to 108.0 in May, up from 106.3 in April, and the one from the Michigan University rose to 88.7, up from 87.1. The confidence index of the manufacturing industry increased to 54.7 in April, up from 50.9 in March, and reached the highest level of the last months. Month-on-month industrial production rose 0.7% in April, above market expectations, and the installed capacity utilization increased to 81.6%, up from 81.2%. The recent behavior of inflation reduces the expectations of inflation pressures. The consumer price index (CPI) increased 2.6% in the last twelve months through April, and its core, 2.3%, at a lower pace than the observed in the previous month. The producer price index (PPI) increased 0.7% and its core remained unchanged.

55. In the Euro zone, first quarter GDP grew 3.1%, relative to the same quarter of 2006, above market expectations. The German GDP also increased above expectations, 3.6% in the year and 0.5% in the quarter. The consumer confidence index reached 119.9 in May, up from 111 in April, the highest level observed since January 2001. However, twelve-month trailing inflation through May remained stable at 1.9%, in line with the European Central Bank (ECB) target. In Japan, despite below the 2.7% market expectations, GDP grew by 2.4% p.a. in the first quarter, confirming the maintenance of the growth pace.

56. In China, economy has continued to record robust expansion. Industrial production grew 17.4% in April, relative to April 2006, accumulating an 18% increase in 2007. Trade surplus reached US$16.9 billion in April, a 144% increase over March, totaling US$63.3 billion in the first four months of 2007, an 88% increase over the same period of 2006. The strong pace of activity has reflected in inflation. The Consumer Price Index increased 3% in the twelve months through April, while the Wholesale Price Index reached 2.9%, under the same comparison basis, up from 2.7% in March.

57. The Bank of England (BoE) raised its interest rate by 0.25 b.p., to 5.5% p.a., as a consequence of inflationary pressures, mainly stemming from services prices. The Consumer Price Index increased by 3.1% in the twelve months through March, exceeding the upper limit of the inflation target. However, with the 0.3% increase in April, the Consumer Price Index decreased to 2.8% in the twelve months through April. The Wholesale Price Index increased month-on-month 0.5% in April, down from 0.6% in March. On a twelve-month trailing basis, the index totaled 2.5% in April, down from 2.7% in March.

58. At the end of May, the Chinese government tripled a stamp tax on securities transactions to 0.3%, to cool the growth in the stock markets. As a consequence, the Shangai composite share index fell by 6.5%, but spillovers for other international stock markets were limited. On May 31, the main European share index (FTEurofirst 300) reached a record high for the last six and a half years, boosted by mining and oil companies. Strong swings prevailed in FX markets, with devaluation of the US dollar.

Foreign Trade and International Reserves

59. In the first five months of 2007, Brazilian foreign trade continued to expand. Trade surplus reached US$16.8 billion in the period, and US$47.9 billion in the twelve months through May, while total external trade totaled US$103.3 billion and US$248.8 billion, according to the same comparison bases.

60. Exports reached US$13.6 billion in May, a record high for the month, with a daily average of US$620.4 million, a 32.4% increase over May 2006. Manufactured goods external sales reached

US$7.1 billion in the month, a 21.9% increase over May 2006, considering daily averages. Primary products exports totaled US$4.4 billion, and semi-manufactured ones, US$1.9 billion, with respective increases of 49.6% and 46.9%, according to the same comparison basis. In addition to shipment records, international prices of important export products continued to increase, with highlights to orange juice (80.4%); raw soybean oil (34.6%); poultry (34.1%); metal laminates (32.7%) and iron/steel semi-manufactured (31.9%). In the first five months of 2007, exports continued to show diversification in terms of products, particularly regarding manufactured items with low share in total exports, and expansion of exports destinations.

61. Imports totaled US$9.8 billion in May, a record high for the month, a 34.2% increase over May 2006. All categories expanded: raw materials (38.6%); consumer goods (33.5%); capital goods (28.8%); and fuels and lubricants (28.5%), according to the same comparison basis. Among imports of raw materials, it bears emphasizing imports of food, transportation equipment parts, mining products, non-food farming, chemicals and pharmaceutical products. Among consumer goods imports, it bears emphasizing the imports of clothes, beverages and tobacco, vehicles, furniture, beauty products and pharmaceutical products. Amongst capital goods imports, one should highlight imports of industrial machinery, machines and equipment for office and scientific service, and parts and pieces for capital goods.

Money Market and Open Market Operations

62. After the April Copom meeting, the yield curve shifted downward, mainly driven by Brazilian positive economic indicators and by the revised Brazil's sovereign ratings by two rating agencies. In light of an also favorable external environment, reflected in the persistent highs of the international stock markets, the positive FX flow allowed the appreciation of the real against the US dollar, contributing to a downward movement of domestic interest rates, mainly for the short term. In the last week of May, evaluations that Chinese stock markets were overheated led to profit realization in international stock markets, affecting the domestic interest rate market. Between April 16 and June 4, one-, two- and three-year rates reduced by 0.73 p.p., 0.90 p.p. and 0.95 p.p., respectively. One-, three- and six-month rates also declined 0.37 p.p., 0.44 p.p. and 0.60 p.p., respectively. The real interest rate measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month ahead inflation expectations fell to 7.31%, on June 4, down from 7.79%, on April 16.

63. Between April 17 and June 4, the BCB conducted 11 reverse exchange rate swap auctions, totaling US$11 billion.

64. In its open market operations, the BCB carried out, from April 17 to June 4, weekly five- and seven-month long fixed rate repo operations. The average daily balance of these operations amounted R$73.1 conducted 28 overnight repo operations, of which 25 aimed at draining the excess liquidity from the market. In addition, in one repo operation aimed at draining the excess liquidity, the tenure totaled 32 working days. The BCB also conducted daily liquidity management operations with tenures up to two working days. Operations with tenors less than thirty days, including daily liquidity management operations, averaged R$14.6 billion, borrowing.

65. Between April 17 and June 4, the National Treasury raised a total of R$76.9 billion, of which R$37.2 billion in fixed-rate securities: R$18.1 billion via issuance of LTNs maturing in 2008 and 2009 and R$19.2 billion in NTN-Fs maturing in 2010, 2012 and 2017. Issuance of LFTs totaled R$13 billion, for securities maturing in 2010 and 2012. Issuance of inflation-linked NTN-Bs reached R$26.7 billion, for securities maturing in 2009, 2011, 2012, 2015, 2017, 2024, 2035 and 2045, of which R$13.1 billion were settled via delivery of other securities.

66. In the same period, the Treasury conducted auctions to sell LTNs maturing in April, July and October 2008 conjugated to the purchase of shorter-term LTNs, totaling R$9.0 billion. The Treasury also conducted auctions to sell LFTs maturing in 2010 and 2012, totaling R$4.5 billion, accepting as payment LFTs maturing in 2007. Moreover, the Treasury conducted auctions to buy LTNs maturing in July 2007, totaling R$5.9 billion and NTN-Bs totaling US$246 million.

Appendix

Banco Central do Brasil Management

Members of the Monetary Policy Committee (Copom)

Banco Central do Brasil Management

Board

Henrique de Campos Meirelles
Governor

Alexandre Antonio Tombini
Deputy Governor

Antonio Gustavo Matos do Vale
Deputy Governor

Mario Gomes Torós
Deputy Governor

Mário Magalhães Carvalho Mesquita
Deputy Governor

Paulo Sérgio Cavalheiro
Deputy Governor

Paulo Vieira da Cunha
Deputy Governor

Members of the Monetary Policy Committee (Copom)

Voting members

Henrique de Campos Meirelles
Governor

Alexandre Antonio Tombini
Deputy Governor

Antonio Gustavo Matos do Vale
Deputy Governor

Mario Gomes Torós
Deputy Governor

Mário Magalhães Carvalho Mesquita
Deputy Governor

Paulo Sérgio Cavalheiro
Deputy Governor

Paulo Vieira da Cunha
Deputy Governor

Non-voting members

Altamir Lopes
Head of the Departament of Economics (Depec)

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

Ivan Luis Gonçalves de Oliveira Lima
Head of the Departament of Open Market Operations (Demab)

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

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

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

Acronyms

ACC	Advance on Exchange Contracts
ACSP	São Paulo Trade Association
Aladi	Latin American Integration Association
Aneel	Brazilian Electricity Regulatory Agency
Anfavea	National Association of Automotive Vehicles Manufacturers
BDIA	Brazilian Direct Investments Abroad
BNDES	National Bank of Economic and Social Development
BoJ	Bank of Japan
Bovespa	São Paulo Stock Exchange
Caged	General File of Employed and Unemployed Persons
CCR	Reciprocal Credit and Payment Agreement
CMN	National Monetary Council
CNI	National Confederation of Industry
Cofins	Contribution to Social Security Financing
Copom	Monetary Policy Committee
CSLL	Social Contribution on Net Profits
DAX	*Deutscher Aktienindex*
DBGG	Gross General Government Debt
DPMFi	Internal Federal Public Securities Debt
ECB	European Central Bank
Embi+	Emerging Markets Bond Index Plus
Emgea	Asset Management Company
FAT	Worker Support Fund
FDI	Foreign Direct Investments
Fecomercio SP	Trade Federation of the State of São Paulo
Fed	Federal Reserve System
FGV	Getulio Vargas Foundation
FMP-FGTS	Mutual Privatization Funds – FGTS
FMP-FGTS-CL	Mutual Privatization Funds – FGTS – Free Portfolio
FTSE 100	Financial Times Securities Exchange Index
Funcex	Foreign Trade Studies Center Foundation
GDP	Gross Domestic Product
Gerin	Executive Investor Relations Group
GFCF	Gross Fixed Capital Formation
IBGE	Brazilian Institute of Geography and Statistics
Ibovespa	São Paulo Stock Exchange Index
ICC	Consumer Confidence Index
Icea	Current Economic Conditions Index
Icei	Industry Businessmen Confidence Index

ICI	Industrial Confidence Index
ICMS	Tax on the Circulation of Merchandise and Services
IEA	International Energy Agency
IEC	Consumer Expectations Index
IGP-DI	General Price Index
IGP-M	General Price Index – Market
II	Import Tax
INC	National Confidence Index
INCC	National Cost of Construction Index
IPA-DI	Wholesale Price Index
IPCA	Extended National Consumer Price Index
IPC	*Índice de Precios y Cotizaciones*
IPC-Br	Consumer Price Index – Brazil
Ipsos	Ipsos Public Affairs
IRPF	Individual Income Tax
IRPJ	Corporate Income Tax
IRRF	Income Tax Withholdings
LDO	Budget Guidelines Law
Loas	Social Assistance Law
LSPA	Systematic Farm Production Survey
LTN	National Treasury Bills
MDIC	Ministry of Development, Industry and Foreign Trade
MPC	Monetary Policy Committee
MTE	Ministry of Labor and Employment
MYDFA	Multi-Year Deposit Facility Agreement
Nasdaq	National Association of Securities Dealers Automated Quotation
NTN-B	National Treasury Notes – Series B
Opec	Organization of the Petroleum Exporting Countries
p.p.	Percentage points
p.y.	Per year
PAC	Growth Incentive Program
PAF	Annual Financing Plan
PBC	People's Bank of China
PEA	Overall Labor Force
PIA	Annual Industrial Survey
PIM-PF	Monthly Industrial Survey – Physical Production
PIR	Regional Industrial Survey
PMC	Monthly Retail Trade Survey
PME	Monthly Employment Survey
PPI	Pilot Investment Project
PSND	Public Sector Net Debt
RMV	Lifetime Monthly Income
S&P 500	Standard and Poor's 500
SCIT	Manufacturing Industry Survey
SCIT-QE	Manufacturing Industry Survey–Special Queries
SCPC	Credit Protection Service Center
Secex	Foreign Trade Secretariat
Selic	Special System of Clearance and Custody
VIX	Chicago Board Options Exchange Volatility Index
XU 100	Istanbul Stock Exchange National 100 Index