

The inflation, considering the behavior of consumer and wholesale price indices, continued to expand in the quarter ended in May. This movement, although mostly influenced by the pressures originated in the segment of foodstuffs, in line with a global process of increase in food prices (see box Food Inflation, pages 67 to 72), was also impacted by the performance of other economy prices, as confirmed by the behavior of the inflation cores and diffusion index. In this framework, the monetary policy is still targeted at preserving the gains derived from the process of economic stabilization.

2.1 General indices

The FGV General Price Index (IGP-DI) increased by 3.73% in the quarter ended in May, against 2.86% in the one ended in February, an upturn due to greater increase in both wholesale and consumer price indices.

Wholesale prices, measured by the Wholesale Prices Index (IPA-DI), with participation of 60% in the IGP-DI, increased by 4.38%, against 3.53% in the quarter ended in February, registering acceleration in industrial prices. The IPA-DI increase mirrored the upward movement in prices of industrial raw materials and the absence of seasonal cutbacks on farming prices, which increased by 3.02% in the quarter ended in May, against 5.73% in the one ended in February, following a cutback of 4.51% in the same period of 2007. The performance of this segment was a consequence of increments in the prices of rice, tomato, beef, milk, wheat, sugar cane and potatoes, offset, in part, by decreases in the prices of soybeans, orange, egg, cassava, beans, coffee and papaya.

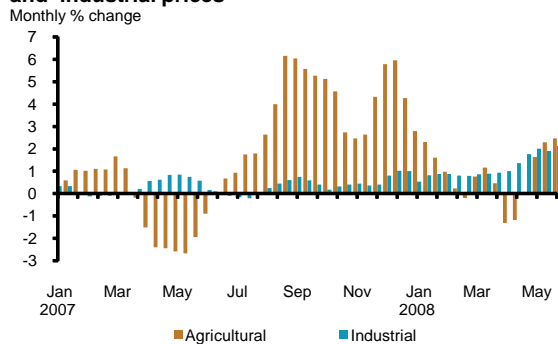
Industrial prices increased by 4.9% in the quarter ended in May, against 2.7% in that ended in February. This was the highest quarterly rate registered since October 2004 and was consequent upon sharp increases in the prices of iron ore, fertilizers, milled rice, wheat flour, diesel oil and soybean oil.

Table 2.1 – General price indices

	Monthly % change				
	2008				
	Jan	Feb	Mar	Apr	May
IGP-DI	0.99	0.38	0.70	1.12	1.88
IPA	1.08	0.52	0.80	1.30	2.22
IPC-Br	0.97	0.00	0.45	0.72	0.87
INCC	0.38	0.40	0.66	0.87	2.02

Source: FGV

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



Source: FGV

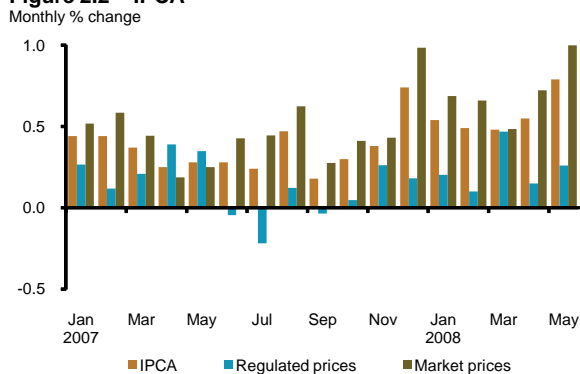
The performance of wholesale industrial prices evinced once again the impact of nonfood items in the inflation.

The Consumer Price Index – Brazil (IPC-Br) and the National Cost of Construction Index (INCC), with respective weights of 30% and 10% in the IGP-DI, showed variation of 2.05% and 3.59% in the quarter ended in May, against 1.69% and 1.37% in the quarter ended in February. The acceleration registered by the IPC-Br resulted in pressures associated to the foodstuffs, clothing and housing, while that related to INCC was due to pressures related to the components of services, labor force and materials.

The IGP-DI variation accumulated in twelve months reached 12.14% in May, against 7.89% in December 2007. In the same order, IPA-DI increased by 15.36% and 9.44%; the IPC-Br, 5.59% and 4.60%; and the INCC, 8.06% and 6.15%.

One should highlight that the 5.92 p.p. growth observed in the IPA-DI variation in twelve months was particularly associated to the growth in farming prices, which expanded by 33.65% in the twelve month period ended in May, the highest rate since July 2003. The evolution of prices in the wholesale segment represents growth of costs that will certainly affect consumer prices.

Figure 2.2 – IPCA

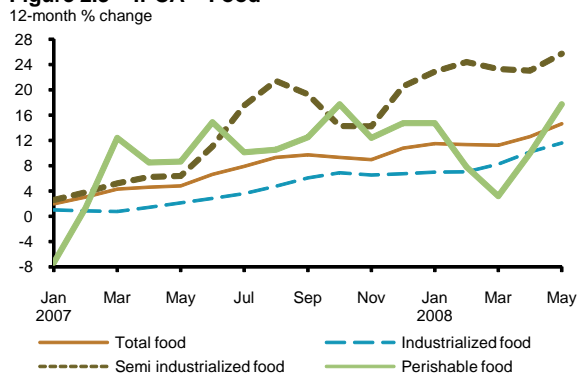


Source: IBGE

2.2 National Consumer Price Index

The accumulated IPCA increased 2.88% in the first five months of 2008, against 1.79% and 1.75%, respectively, in the same periods of 2007 and 2006. The indicator variation in 2008 mirrored growths of 3.62% in market prices and of 1.18% in regulated prices, against 2% and 1.34%, respectively, in the previous year.

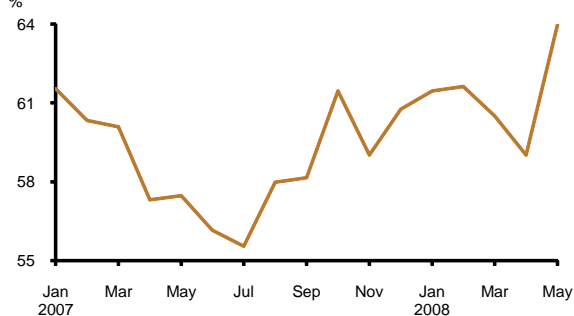
Figure 2.3 – IPCA – Food



Source: IBGE

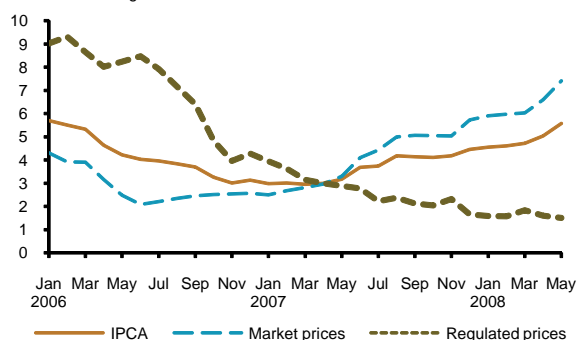
IPCA increased by 1.83% in the quarter ended in May, against 1.78% in that ended in February and 0.9% in the same period of 2007. This acceleration was registered even with the end of the seasonal pressure exercised by the item courses – which had not occurred, on this basis of comparison, since 2002. To a large extent, the performance of the IPCA is a consequence of increases in the prices of the foodstuffs, with emphasis on the segments of bakery, clothing and pharmaceuticals.

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



Source: IBGE

Figure 2.5 – IPCA
12 month % change



Source: IBGE

Table 2.2 – IPCA

	Weights	% change					
		2008					
		Jan	Feb	Mar	Apr	May	Year
IPCA	100.00	0.54	0.49	0.48	0.55	0.79	2.88
Market prices	70.03	0.69	0.66	0.48	0.72	1.02	3.62
Regulated prices	29.97	0.20	0.10	0.47	0.15	0.26	1.18
Main items							
Electricity	3.37	-0.53	0.14	1.40	-0.49	-0.60	-0.09
Water and sewage	1.61	0.00	0.00	1.43	0.41	0.23	2.08
Urban bus	3.77	1.19	0.49	0.06	0.10	0.31	2.16
Air ticket	0.28	0.12	0.31	0.36	0.31	2.26	3.39
Gasoline	4.31	-0.38	-1.42	0.76	-0.14	0.05	-1.14
Bottled cooking gas	1.13	0.29	-0.07	-0.21	-0.17	1.55	1.39
Medicine	2.87	0.15	0.39	0.14	1.18	0.97	2.86
Health plans	3.37	0.52	0.52	0.52	0.52	0.52	2.63

Source: IBGE

IPCA rates registered in the quarter ended in May 2008 and accumulated in the year reflected, mainly, the performance in the food and beverage segment, 4.18% against 1.17%, and clothing, 3.28% against 1.49%, offset, in part, by cutbacks registered in the transportation segment, 0.70% against 0.76%, and communication, 0.07% against 0.32%.

The diffusion index, that measures the number of items with positive variation in the IPCA, registered about 64% in the quarter ended in May, against 61.6% in that ended in February and 57.5% in 2007, highlighting the greater dissemination of price increases.

2.3 Government regulated prices

The 12-month accumulated variation of regulated prices, which has followed a declining trend since the second half of 2006 and has been registering levels lower than 3.00% since April 2007, reached 1.50% in May, the lowest percentage of the historical series.

The monitored prices increased by 0.88% in the quarter ended in May, accounting for 0.26 p.p. of the total variation of the IPCA in the period. The more accentuated variations occurred in the items diesel oil, 7.42%, air tickets, 2.95%; pharmaceuticals, 2.3%; and water and sewage tariffs, 2.08%. On the other hand, cutbacks were registered in the prices of the items intermunicipal bus, 1.35%, and public telephone, 0.31%.

The gasoline and diesel oil prices were readjusted, respectively, by 10% and 15% by Petrobras, since the first day of May. The increase in gasoline, fully offset by the Contribution on Intervention in the Economic Domain (Cide), will not have any effect on the consumer prices, while diesel readjustment will represent an increment of approximately 8%.

2.4 Inflation cores

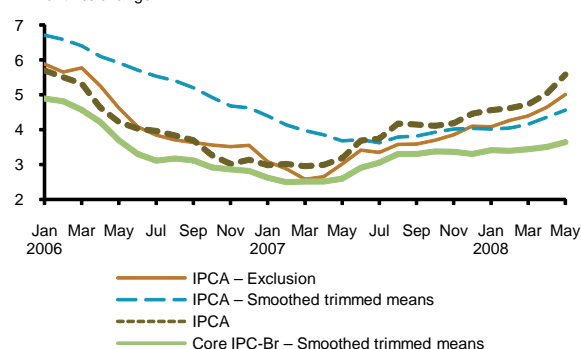
The 12-month accumulated inflation core variations, repeating the trend initiated in the second half of 2007, showed acceleration during the quarter ended in May. The average variations accumulated in 12 months of the three core indicators calculated by the Central Bank increased by 4.66% in May, against 3.92% in December 2007.

Table 2.3 – Consumer prices and core inflation

	Monthly % change				
	2008				
	Jan	Feb	Mar	Apr	May
IPCA	0.54	0.49	0.48	0.55	0.79
Exclusion	0.40	0.69	0.36	0.53	0.68
Trimmed means					
Smoothed	0.37	0.27	0.39	0.48	0.50
Non smoothed	0.41	0.36	0.41	0.41	0.55
IPC-Br	0.97	0.00	0.45	0.72	0.87
Core IPC-Br	0.36	0.15	0.31	0.38	0.44

Sources: IBGE, Bacen and FGV

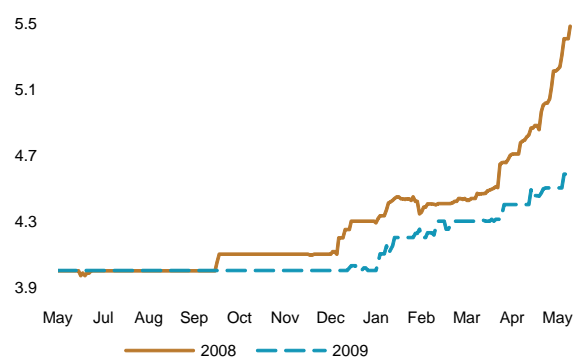
Figure 2.6 – Core inflation
12-month % change



Sources: IBGE, Bacen and FGV

Figure 2.7 – IPCA

Median



The core by excluding the regulated prices of goods and services and the prices of household food grew by 2.70% in the first five months of 2008, against 1.8% in the corresponding period of 2007. The indicator reached 1.58% in the quarter ended in May, against 1.7% in that ended in February, period of unfavorable seasonality, reflecting the impact of increase in school monthly tuition. The 12-month accumulated rate grew 5.03% in May, the highest level since April 2006.

The accumulated smoothed trimmed means increased by 1.38% in the quarter ended in May, against 1.05% in that ended in February, the most accentuated quarterly result registered since 2006. The variation accumulated in 12 months totaled 4.56% in May, against 4.05% in February, the highest rate observed since December 2006. The smoothed trimmed means quarterly variation reached 1.37% in May, against 1.23% in February, accumulating increments of 4.39% and 3.84% in twelve months.

The inflation core related to the FGV IPC-Br, calculated by trimmed means, increased by 1.13% in the quarter ended in May, against 0.76% in the quarter ended in February, the highest quarterly rate registered since July 2005.

2.5 Market expectations

The forecast for inflation expectations gathered by the Executive Investor Relations Groups (Gerin) increased since the end of the first quarter of the year. According to the Focus report, the median forecasts for the IPCA in 2008 rose from 4.50% to 5.50% (end of May). For 2009, the inflationary expectations also increased, from 4.30% to 4.60%, surpassing for the first time the center of the fixed target of 4.5%. The forecasts are in line with the 4.5% target with a tolerance margin of two points up or down established by the CMN.

The forecasts for twelve-month IPCA confirm the trend of deteriorating inflation expectations in the country. Over the last months, the expectations for the 12-month IPCA increased from 4.40% to 4.80% (last week of May).

The recent change in expectations for the variation of the general price index, stimulated by the performance of the prices of commodities, reinforced the perception of persistent inflationary pressures present on a global scale. For 2008, measures related to IGP-M and IPA-DI at the end of May increased 8.70% and 9.90%, respectively,

Figure 2.8 – IGP-M and IPA-DI

Median 2007

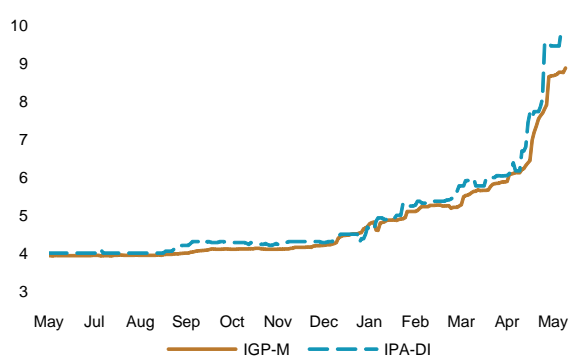


Figure 2.9 – Exchange rate

Median 2007

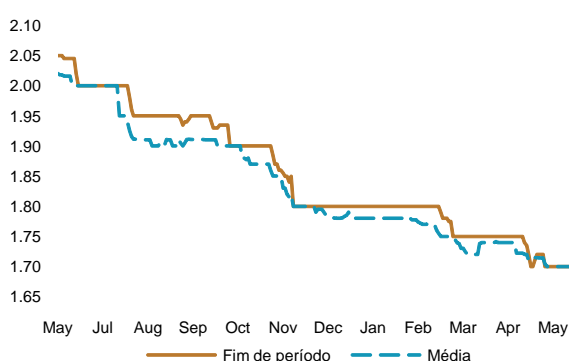


Table 2.4 – Summary of market expectations

	12.31.2007		3.31.2008		5.30.2008	
	2008	2009	2008	2009	2008	2009
IPCA	4.3	4.0	4.5	4.3	5.5	4.6
IGP-M	4.6	4.2	5.8	4.4	8.7	4.7
IPA-DI	4.5	4.0	5.8	4.4	9.9	5.0
Regulated Prices	3.7	4.0	3.5	4.0	3.7	4.5
Selic (end-of-period)	10.8	10.0	12.0	10.8	13.8	12.5
Selic (average)	11.2	10.2	11.7	10.8	12.5	12.8
Exchange rate (end-of-period)	1.80	1.90	1.75	1.85	1.70	1.77
Exchange rate (average)	1.78	1.86	1.74	1.80	1.70	1.76
GDP growth	4.5	4.1	4.6	4.0	4.8	4.0

compared to the 5.80% forecast at the end of March for the two indices. For 2009, the medians of the market forecasts for IGP-M and for IPA-DI climbed from 4.40% to 4.70% and 5%, respectively.

The expectation for regulated prices, which represent almost one third of the IPCA composition, contributes to adjusting the future inflation expectation to lower levels. According to the Focus Report, the median of expectations forecasted a 3.70% correction for regulated prices in 2008 (at the end of May), compared to the previous forecast of 3.50% (end of March). For 2009, the readjusted forecast for regulated prices increased from 4 to 4.5%, in the same period.

Market forecasts for the foreign exchange rate maintained the expectations of continuity of a favorable scenario for the Brazilian external accounts. By considering both the average and the end-of-period rates, the medians for the foreign exchange rate in 2008 reached R\$1.70/US\$ (at the end of May), a higher decrease in comparison to the rates projected to the end of March, respectively, R\$1,74/US\$ and R\$1,75/US\$. In the same period, expectations for the average of foreign exchange rate projected for 2009 reduced from R\$1.80/US\$ to R\$1.76/US\$. Considering the end-of-period exchange rate, the cutback went from R\$1.85/US\$ to R\$1.77/US\$.

The revised forecast for the target of the Selic rate followed the trend of deteriorating inflation expectations. For the end of 2008, the market started to forecast a Selic of 13.75% p.y., considering the previous forecast (at the end of March) of 12% p.y. In addition, market forecasts a rate of 12.5% p.y. for the Selic at the end of 2009, against a previous forecast of 10.75 p.y (at the end of March).

Recently, the market revised its GDP growth forecast in 2008 from 4.6% to 4.8%, considering the medians registered in the end of March and May. However, the median of GDP forecast remained stable at 4% for 2009.

2.6 Conclusion

The acceleration of the inflation process initiated at the end of 2007 persisted during the first five months of 2008. This trend is a result of the continuous domestic demand upturn in activity in an environment of increasing credit volume and income gains by the labor force in a context of an external shock associated to increments in international prices of farm and metal commodities.