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Inflation Report

June 2009

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BANCO CENTRAL DO BRASIL

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Inflation Report

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

Department of Economics (Depec);
(E-mail: depec@bcb.gov.br)

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

Investor Relations Group (Gerin);
(E-mail: gerin@bcb.gov.br).

General Control of Publications

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

Statistical Conventions:

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

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

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Banco Central do Brasil Information Bureau

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

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Foreword

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

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

Executive summary

The trajectory of the world economy in the quarter ended in May, although revealing the continuous process of reduced production and employment, also showed that the coordination of counter-cyclical measures are translating into an improvement in indicators related to consumer and business confidence. Despite these movements exerting a favorable impact, on the margin, over the development of the real sector indicators, it should be noted that, in the environment of conditionalities for the effective stabilization of world economic activity, it still lacks the conclusion of the cycle of inventory adjustment and the consolidation of the process of sustaining consumption levels, especially in major developed economies.

The Brazilian economy is showing signs of a gradual recovery in relation to the deterioration marked by the intensification of the crisis in international financial markets since last September. Although the performance of the industrial sector, especially in those segments that are more dependent on investment and international trade, still displayed signs of weakness, recent monthly indicators generally suggest that the cycle of economic slowdown in the country may be less pronounced than in several other economies. The sustained economic resumption activity in coming months, and its intensification, will benefit by maintaining the trend of less stress in international financial markets, expressed as a reduction of restrictions in the credit market, the return of external capital flows to the country, the perspective of return of firms to capital markets, as well as the lagged and cumulative effects of monetary easing promoted since January.
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The unfavorable development of investments reflects the worsening business environment and, in the coming months, its recovery will depend on the improvement of the context of prevailing uncertainties in the current economic scenario. Household consumption, favored by the preservation of purchasing power caused by controlled inflation, the intensification of income transfer programs, as well as the reduction in credit constraints and temporary tax relief measures, recorded a positive performance in recent months.

In quarter ended in April, interest rates in the credit market remained on a downward trend, especially in loans to individuals, a segment with relativly stable default records. This situation, however, contrasts with the conditions prevalent in the corporate segment, where the reduction in the cost of borrowing was less expressive and defaults, though at a moderate level, showed an upward trend since the beginning of the year. In any event, the prospect of observing a declining trend in interest rates to the borrower, consistent with the reversal of the default and the loosening of monetary conditions, is expected to strengthen the credit market, which had decisive role in sustaining domestic demand in recent years.

The dynamics of fiscal accounts in the first four months of the year reflected both the impact of reduced activity on government revenues as well as the impact on costs associated with tax cuts and public investment policy adopted in order to promote the recovery aggregate demand. It should be noted that the impact of these counter-cyclical actions on the reducing trend of the Public Sector Net Debt (DLSP) as a proportion of Gross Domestic Product (GDP), even in the scenario of decline in primary surplus targets, will be offset by the effects of a reduction of the Selic rate, which reduces the cost of financing the domestic public debt.

The performance of the country's external accounts during the year has been more favorable than suggested by the macroeconomic environment that followed the intensification of the crisis in financial markets, thereby contradicting pessimistic predictions. The stability of international reserves and the reduction of the relative share of external debt in total external liabilities of the country, in favor of direct investments and portfolio, reinforce the perception of solidity of the balance of payments and also the perception of the resistance of the economy to shocks. The latest scenario, while still incorporating a high degree of uncertainty, reveals more favorable external accounts and anticipates positive developments on the flows of foreign investment. Incidentally, the current account deficit for 2009 is shown below the previous year´s and should be fully financed by net inflows of Foreign Direct Investment (FDI). In this scenario, the resumption of cash purchases by the Central Bank in the currency market was possible – maintaining the policy of not setting floors or ceilings for the rate – aimed at strengthening the country's international reserves.

The prospects related to the behavior of prices in the coming months incorporates the continuity, possibly at a faster rate, of the convergence of the Broad National Consumer Price Index (IPCA) to the target set by the National Monetary Council (CMN). This dynamic was favored, in part, by the decrease of activity occurred in the last two quarters. On the other hand, the potential impacts of a pickup in domestic demand in a recovery scenario in the domestic economy during the second half of the year must be considered, as well as possible impacts of increased prices of raw materials.

The central forecast associated with the baseline scenario indicates inflation of 4.1% in 2009, a level 0.1 percentage point higher than what had been projected in the March *Inflation Report*. From the third quarter of 2009 on, four-quarters inflation is positioned below the 4.5% target for 2009 and 2010. This fundamentally reflects the lagged effects of higher idle production factors verified since the fourth quarter of 2008. Note, however, that this impact was partly offset by reductions in the Selic rate and the fiscal impulses implemented this semester. Twelve-month inflation starts at 4.7% in the second quarter of 2009 and reaches 4.1% in the last quarter. In 2010, it reaches 3.9% and then stays around 4.0% in the first and second quarters of 2011.

In the market scenario, the forecast of 4.2% for inflation in 2009 is 0.1 percentage point higher than the value associated to the baseline scenario, and to the last Inflation Report. The projections indicate a continued decline in twelve-month inflation in 2009, with 5.6% recorded in the first quarter, moving to 4.7% in the second, 4.4% in the third, and ending (closing?) the year at 4.2%, below the 4.5% target. For 2010, the market scenario projects, in the first semester, a drop in twelve-month inflation, which, however, will return to the level of 4.2% in the fourth quarter, but still below the 4.5% target set by the National Monetary Council. In the first two quarters of 2011, the twelve-month inflation projection will stay around this value. As in the baseline scenario, the estimated probability of inflation exceeding the upper limit of the tolerance range of the target in 2009 in the market scenario is residual.

According to the baseline scenario, GDP growth forecast for 2009 was revised to 0.8%, compared to 1.2% contained in the March *Inflation Report*.

Economic activity

1

In the first quarter of 2009, the Brazilian economy showed signs of recovery from the accentuated deterioration occurred with the intensification of the international financial market crisis. The performance of the industrial sector, especially of those segments more dependent on the dynamics of investments and international trade flows, reflected the slowdown recorded in major developed economies in a scenario of reduced capacity utilization and the need for adjusting inventories. Notwithstanding, the trajectory of GDP in the quarter ended in March and the performance of the latest monthly indicators suggest that the cycle of economic slowdown in the country may be less pronounced than in many other mature and emerging economies.

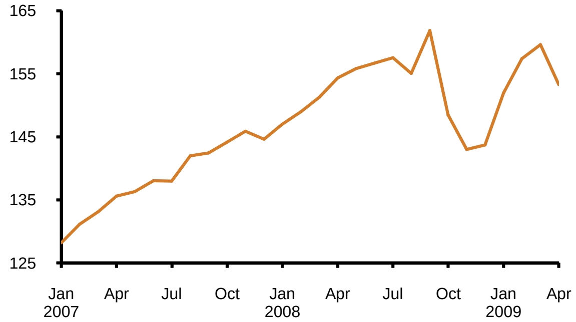
The expansion of investments, which respond more slowly to economic changes, continued to reflect the deterioration of the business environment. Over the coming months, the investment trajectory will depend on the level of uncertainties present in the international scenario. Household consumption, helped by the maintenance of the purchasing power consequent upon the lower inflation rates, the strengthening of cash transfer programs promoted by the government, and real wage gains, as well as by the reduction in credit constraints and the temporary tax relief measures, reported a recovery in recent months.

In this scenario, the degree of recovery of the Brazilian economy in the months ahead will largely depend on the impact of the reduction of uncertainties related to the performance of the global economy on external trade flows and, internally, on investment and consumption decisions.

1.1 Commerce

Retail sales indicators, showing the impact of specific measures aimed to encourage the sector, expressed in reduced taxes and improved access to credit markets, registered a relative recovery in sales at the end of the first and beginning of the second quarters. Even though the indicators related to consumer expectations remained at historically low levels, they have shown some improvement at the margin. The outlook for the sector over the next months is the persistence of the sales recovery, a trajectory in line with the incorporation of the workers' real wage gains.

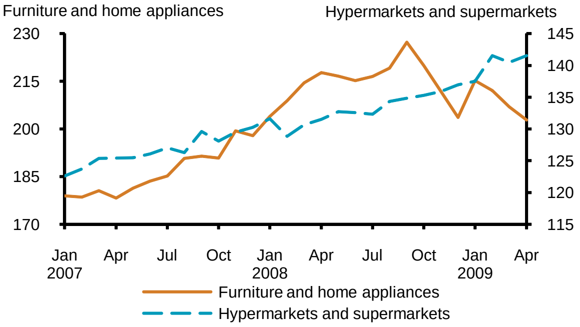
Figure 1.1 – Extended retail sales
Seasonally adjusted data
2003 = 100



Source: IBGE

According to the Monthly Trade Survey (PMC), published by the Brazilian Institute of Geography and Statistics (IBGE), seasonally adjusted expanded retail sales increased 7.2% in the 3-month period ended in April, compared to that ended in January. This result reflected, in particular, the growth of sales of automobiles, motorcycles, parts and spares, 14.8%; other articles of personal and domestic use, 7%; equipment and office supplies, computer and communications, 4.1%, and pharmaceutical, medical, orthopedic and perfumery, 3.3%, in contrast with the accentuated decreases in books, newspapers, magazines and stationery, 3%, and furniture and appliances, 1.4%. In addition, sales related to hypermarkets, supermarkets, food products, beverages and tobacco, a segment with weight exceeding 50% the volume of retail sales, rose 3.2% in the period, the twelfth consecutive positive rate.

Figure 1.2 – Retail sales
Seasonally adjusted data
2003 = 100

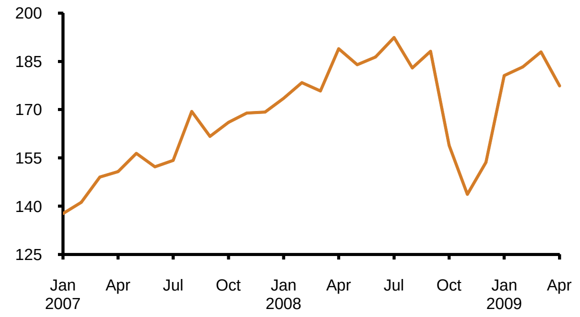


Source: IBGE

Valid until the first fortnight of July 2009, fiscal measures such as the reduction of the Industrialized Products Tax (IPI) levied on civil construction products and electrical appliances, should positively impact the sales of these segments in the coming months.

Other industry-related indicators ratified the favorable performance of sales of automotive vehicles evinced by IBGE surveys. Seasonally adjusted statistics from the National Federation of Vehicle Distributors (Fenabrave) revealed that sales of cars and light commercial vehicles grew by 19.3% in the 3-month period ended in May, compared to the 3-month period ended in February, returning to the level of the months prior to the intensification of the international financial crisis. Similarly, national automobile sales on the domestic market, released by the National Association of Automotive Vehicle Manufacturers (Anfavea), amounted to 25.9% in the period. Over the next months, the trajectory of sales is expected to continue reflecting the incentive measures applied to the sector, as well as the somewhat eased credit scenario.

Figure 1.3 – Sales volume index (automobiles, motorcycles, parts and spares)
Seasonally adjusted data
2003 = 100



Retail sales rose 2.4% in the 3-month period ended in April, compared to that endend in January. This performance reflected the growth of 3% in the Northeast; 2.9% in the

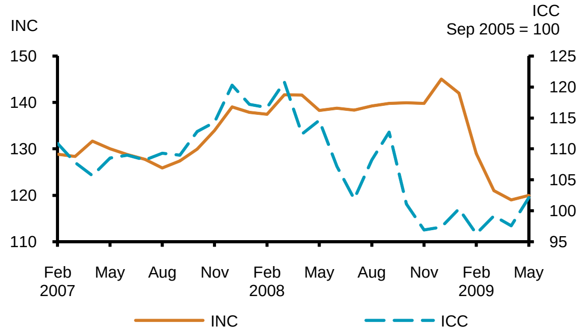
Table 1.1 – Sales volume index

	2009			% change
	Jan	Feb	Mar	Apr
In the month[1/]				
Retail sector	1.7	1.9	-0.5	-0.2
Fuel and lubricants	-1.4	2.9	1.1	-0.8
Supermarkets	0.4	2.9	-0.7	0.8
Fabrics, apparel and footwear	2.3	-1.0	1.8	-1.7
Furniture and home appliances	5.7	-1.5	-2.4	-2.0
Pharmac., medical, orthop. and perfumery articles	1.5	1.7	1.7	-1.0
Books, newspaper, magazines,	9.1	-9.3	1.5	-2.7
Office, comp./comunic. equip.	-10.7	4.9	1.0	8.9
Other art. of personal use	6.1	4.6	0.3	-2.4
Broad trade sector	5.8	3.5	1.4	-4.0
Building materials	-2.5	3.8	1.0	-3.5
Automobiles, motorcycles, parts and spares	17.6	1.5	2.5	-5.6
3-Month Period/Previous 3-Month Period[1/]				
Retail sector	-1.1	0.2	2.1	2.4
Fuel and lubricants	-2.8	-2.0	-0.2	2.1
Supermarkets	1.4	2.4	2.8	3.2
Fabrics, apparel and footwear	-6.9	-3.5	1.1	1.6
Furniture and home appliances	-5.3	-4.3	-0.2	-1.4
Pharmac., medical, orthop. and perfumery articles	1.9	1.2	3.1	3.3
Books, newspaper, magazines,	6.8	6.1	5.0	-3.0
Office, comp./comunic. equip.	-2.2	-1.0	-3.5	4.1
Other art. of personal use	-2.5	0.6	6.4	7.0
Broad trade sector	-5.7	-0.1	7.8	7.2
Building materials	-9.3	-9.5	-5.1	-0.9
Automobiles, motorcycles, parts and spares	-9.8	5.5	21.0	14.8
In the year				
Retail sector	6.0	4.9	3.7	4.5
Fuel and lubricants	3.8	2.3	3.1	3.2
Supermarkets	7.0	6.3	4.0	6.5
Fabrics, apparel and footwear	-4.7	-5.7	-6.6	-7.5
Furniture and home appliances	6.3	2.4	1.3	-1.6
Pharmac., medical, orthop. and perfumery articles	8.9	10.4	12.2	12.0
Books, newspaper, magazines,	23.9	13.1	12.3	9.4
Office, comp./comunic. equip.	15.4	13.2	15.0	18.1
Other art. of personal use	5.0	7.6	6.5	8.3
Broad trade sector	2.8	2.2	3.6	2.5
Building materials	-12.5	-12.6	-9.9	-11.4
Automobiles, motorcycles, parts and spares	-0.3	-0.2	6.0	1.3

Source: IBGE

1/ Seasonally adjusted data.

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



Source: ACSP and FGV

North, and 2.3% in the Southeast, followed by 1.9% in the South and 0.8 % in the Central-West. Retail sales were favorable in 23 out of 27 states, with emphasis on the performance observed in Roraima, 9.4%; Maranhão, 5.3%; Alagoas, 5.1%, Ceará, 4.2%, and Rondônia, 3.7%, as opposed to the reduction observed in Mato Grosso do Sul, 3.8%; Acre, 3.4%, and the Federal District, 0.8%.

The nominal revenue of expanded retail sales, reflecting increases of 2.5% in volume and 2.6% in prices, grew 5.2% in the first four months of 2009, in comparison to the same period of the previous year. The most significant results occurred in the following sectors: other articles of personal use and household goods, 17.7%, pharmaceutical, medical, orthopedic and perfumery, 17.6%, hypermarkets, supermarkets, food products, beverages and tobacco, 15.1%; books, newspapers, magazines and stationery, 12.7%, and equipment and office supplies, computer and communications 9.9%, reaching a higher level in comparison to the average growth of 5.7% registered by the IPCA (released by IBGE) in the period. The less dynamic sectors were vehicles, motorcycles, parts and spares, -3.4%; furniture and appliances, -1.6%, and textiles, clothing and footwear, -0.6%.

A relative improvement was observed in the results at the margin of research targeted to assess consumer confidence, especially at the beginning of the second quarter, a trend basically expressed by the more favorable results obtained by the components related to expectations.

The Consumer Confidence Index (ICC) of the Getulio Vargas Foundation (FGV), increased 2.8% in the 3-month period ended in May, compared to that ended in February, reflecting an increase of 6.7% in the Expectations Index (IE) and a decrease of 2.5% in the Current Situation Index (ISP), considering seasonally adjusted data. Despite the recovery at the margin, the indicator reached a level lower than the 14.1% reported in May 2008, reflecting declines of 18.1% in the ISP and 11.7% in IE.

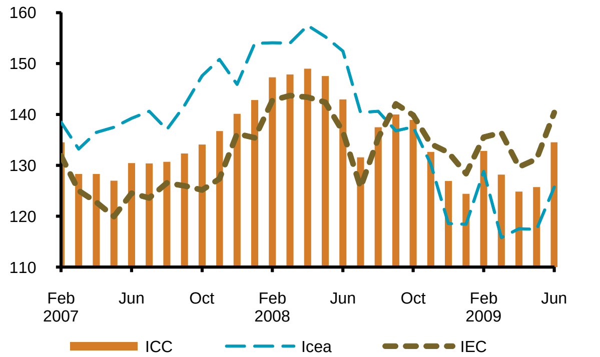
The National Confidence Index (INC), measured by the Ipsos Public Affairs (Ipsos) to the Commercial Association of São Paulo (ACSP), reached 120 points in May, for a 0.8% increase in the month and a 13.2% reduction in comparison to the same period in 2008. The regional analysis shows that consumers are less optimistic in the Northeast, where the INC dropped 21.5% compared to May 2008, followed by

Table 1.2 – Retail sales
2009, April

	% accumulated growth in 2009		
	Nominal revenue	Volume	Price
Retail sector	10.6	4.5	5.8
Fuel and lubricants	4.9	3.2	1.6
Supermarkets	15.1	6.5	8.1
Fabrics, apparel and footwear	-0.6	-7.5	7.5
Furniture and home appliances	-1.6	-1.6	0.0
Pharmac., medical, orthop. and perfumery articles	17.6	12.0	5.0
Office, comp./comunic. equip.	9.9	18.1	-6.9
Books, newspaper, magazines	12.7	9.4	3.0
Other art. of personal use	17.7	8.3	8.7
Broad retail sector	5.2	2.5	2.6
Automobiles, motorcycles, parts and spares	-3.4	1.3	-4.6
Building materials	0.9	-11.4	13.9

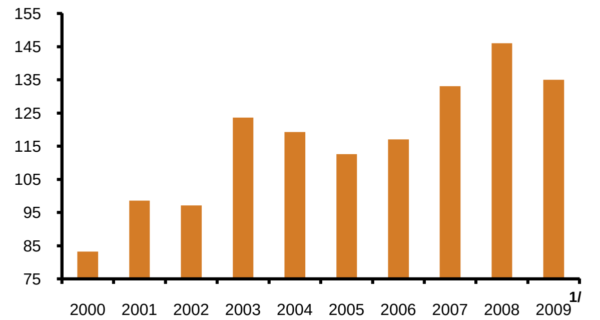
Source: IBGE

Figure 1.5 – Consumer Confidence Index



Source: Fecomercio SP

Figure 1.6 – Grain production
In million tons



Source: IBGE
1/ Estimate.

significant reductions in the North and Central-West,[1] 19.4%, in the South, 17.4%, and in the Southeast, 3.8%.

The National Index of Consumer Expectations (Inec), released quarterly by the National Confederation of Industry (CNI), showed recovery of consumer confidence in the second quarter of the year. In the period from May 29 to June 1, the indicator increased by 3.8% in comparison to the previous quarter and 0.5% in comparison to the same period in 2008. The segmentation of the quarterly Inec change reveals an increase in optimistic expectations regarding inflation and unemployment levels.

The ICC, released by the São Paulo Trade Federation (SP Fecomercio) and restricted to the metropolitan region of Sao Paulo, revealed a monthly increase of 7% in May, reflecting the increases observed in the Index of Current Economic Conditions (Icea) of 7.1%, and the Consumer Expectation Index (IEC) of 6.9%. Despite the positive results at the margin, the ICC reported an accumulated drop of 12.2% in the first six months of the year, a period in which the Icea fell 21.9% and the IEC, 5%.

1.2 Production

Farming

The crop/livestock prroduction fell by 1.6% in the quarter ended in March, compared to the same period in 2008, according to the IBGE Quarterly National Accounts.

Crops

The total grain harvest is expected at 135 million tons in 2009, according to the Systematic Survey of Agricultural Production (LSPA) from the IBGE. The prospect of a 7.5% reduction in relation to the previous harvest reflects the contraction of 7.5% in average productivity, an evolution consistent with the new relationship between the international prices of major commodities and inputs, and with the impact of adverse climatic conditions on the outcome of important crops.

Soybean production, after increasing 3.4% in 2008, is expected to reach 57.2 million tons in 2009. The annual

1/ The INC analyses agreggate statisticss from the North and Center-West regions.

reduction of 4.5% reflects a 6.5% decline in average productivity and growth of 2.1% in the cultivated area.

The corn crop is estimated at 50.9 million tons. The 13.8% reduction for the year includes a 3.7% decline in cultivated area and 10.5% in average productivity. It should be highlighted that the first harvest was affected by the drought recorded in the South as well as by the reduction in the crops of the Southeast and Center-West regions.

The crops os beans and rice are projected at 3.6 million and 12.8 million tons, for repective annual increases of 5.2% and 5.8%. Cultivated areas should grow, respectively, by 9.4% and 1.9%, while respective average productivities are estimated to change by -3.8% and 3.7%.

Table 1.3 – Farm production

In 1,000 tons

	Production		% change
	2008	2009[1/]	2009/2008
Grain production	145 986	134 984	-7.5
Cotton (seed)	2 422	1 834	-24.3
Rice	12 101	12 797	5.8
Beans	3 460	3 640	5.2
Corn	59 012	50 894	-13.8
Soybean	59 917	57 196	-4.5
Wheat	5 886	5 715	-2.9
Others	3 188	2 909	-8.8

Source: IBGE
1/ Estimate.

Sugar cane production is expected to reach 690.4 million tons in 2009. The annual increase of 6.4% is a result of a 5.6% expansion in cultivated area and 0.7% in average productivity.

The coffee harvest, as a consequence of the effect of its characteristic biannual cycle, should decrease by 13.8% in the year. Forecasts project a 2.8% contraction in the cultivated area and 11.2% in average productivity.

Livestock

According to the Quarterly Survey of Animal Slaughter, published by IBGE, beef production totaled 6.6 million tons in 2008, falling 6.1% over the previous year. Using the same basis of comparison, the production of poultry and pigs totaled 10.2 million tons and 2.6 million tons, respectively, for growth rates of 13.2% and 6.2%.

Table 1.4 – Livestock production
Total slaughters

% accumulated growth in the year

Itemization	2008					
	Jul	Aug	Sep	Oct	Nov	Dec
Cattle	-5.5	-5.9	-5.6	-5.3	-5.9	-6.1
Swine	4.8	3.9	4.7	5.0	4.9	6.2
Poultry	17.1	15.4	15.9	15.0	13.7	13.2

Source: IBGE

Beef exports totaled 289,900 tons in the first four months of the year, dropping 15.3% over the same period of 2008. In the same period, exports of pork and poultry totaled, in this order, 165,500 tons and 1.1 million tons, for respective expansions of 15.6% and 3.6%.

Industrial production

Industrial production in the first quarter of the year reveals a partial recovery of the sector, which was heavily impacted in the last quarter of 2008 by the deterioration of expectations inherent to the international financial crisis. Industrial revival has been supported by the buoyant segment of consumer durables, favored especially by government measures aimed

Table 1.5 – Industrial production

% change

	2009			
	Jan	Fev	Mar	Abr
Industry (total)				
In the month1/	2.1	1.9	0.9	1.1
3-Month Period/Previous 3-Month Period1/	-14.8	-15.6	-7.8	-0.4
Same month of the previous year	-17.5	-16.8	-9.7	-14.8
Accumulated in the year	-17.5	-17.2	-14.6	-14.7
Accumulated in 12 months	1.0	-1.0	-1.9	-3.9
Manufacturing industry				
In the month1/	2.2	1.4	0.3	1.0
3-Month Period/Previous 3-Month Period1/	-13.3	-14.6	-7.3	-1.2
Same month of the previous year	-17.4	-16.7	-2.6	-13.5
Accumulated in the year	-17.4	-17.1	-14.5	-14.7
Accumulated in 12 months	1.0	-1.0	-1.9	-3.9
Mining				
In the month1/	3.4	2.0	2.3	1.1
3-Month Period/Previous 3-Month Period1/	-17.3	-16.1	-6.9	2.0
Same month of the previous year	-18.4	-18.8	-10.3	-11.5
Accumulated in the year	-18.4	-18.6	-15.8	-14.7
Accumulated in 12 months	1.6	-0.6	-1.8	-3.0

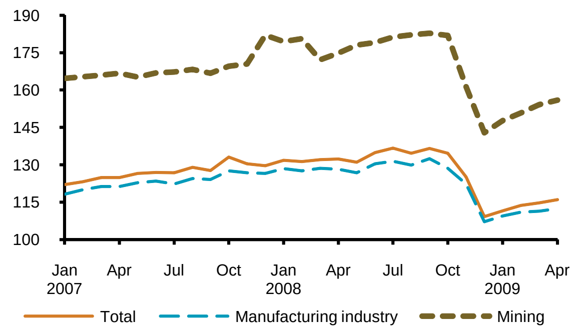
Source: IBGE

1/ Seasonally adjusted data.

Figure 1.7 – Industrial production

Seasonally adjusted data

2000 = 100



Source: IBGE

to stimulate the consumption of goods with higher added value, while the production of capital goods, which led industrial growth up to the first half of 2008, continue to be negatively impacted by the slowdown in demand and the shortage of corporate credit.

The recovery of industrial output has impacted all other industrial activity indicators. Accordingly, the levels of capacity utilization and the indices of business confidence in the industrial sector, both in relation to observed and forecast data, reported a gradual recovery throughout the year, as opposed to the trend of industrial employment, which registered the seventh consecutive monthly decline in April.

Industrial production, after experiencing a sharp falloff in the fourth quarter of 2008, recorded monthly growth in the first four months of the year, accumulating an expansion of 6.2% compared to December, according to seasonally adjusted data from the Monthly Industrial Survey (PIM-PF) of IBGE. This recovery, however, is not yet evident in the behavior of the quarterly series, which showed an industrial decrease of 0.4% during the 3-month period ending in April, compared to the 3-month period ended in January, reflecting a decrease of 1.2% in manufacturing and a growth of 2% in mining. It should be observed that the quarterly industrial production had retracted 14.8% in the 3-month period ended in January.

The pace of recovery in the manufacturing industry was impacted by the weak performance of the segment of capital goods. Since this segment reflects the trajectory of investment, it tends to react more slowly to unexpected shocks that follow a scenario of continued growth of productive capacity. Thus, the production of capital goods decreased by 14.2% in the 3-month period ended in April, compared to the 3-month period ended in January, when it had fallen by 17%. It should be also highlighted the negative performance of the sectors of machinery and equipment, office machinery and computer equipment, machinery, appliances and equipment, instrumentation equipment medical, hospital and other transportation equipment.

The impact of the persistent negative performance in the production of capital goods was largely offsett by the recovery of the segment of durable consumer goods, which, after falling 33.3% in the 3-month period ended January, compared to that ended in October 2008, began to reflect the impact of provisional measures implemented by the government to stimulate the sector, with emphasis on the IPI exemption for the purchase of cars, and somewhat eased credit conditions for individuals. In this new scenario, the

Table 1.6 – Industrial production by category of use

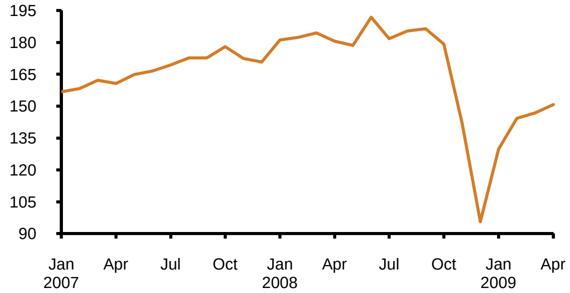
% change

	2009			
	Jan	Feb	Mar	Apr
In the month[1/]				
Industrial production	2.1	1.9	0.9	1.1
Capital goods	5.6	-6.9	-4.6	2.6
Intermediate goods	1.1	1.5	0.4	1.1
Consumer goods	3.6	3.9	1.4	0.9
Durables	35.8	11.2	1.8	2.7
Semi and nondurables	-0.9	2.8	0.8	0.3
Quarter/previous quarter[1/]				
Industrial production	-14.8	-15.6	-7.8	-0.4
Capital goods	-17.0	-24.5	-18.6	-14.2
Intermediate goods	-13.5	-14.6	-7.8	-1.6
Consumer goods	-11.2	-10.1	-1.7	4.2
Durables	-33.3	-27.2	1.0	20.3
Semi and nondurables	-4.8	-5.2	-2.0	1.3
In the year				
Industrial production	-17.5	-17.2	-14.6	-14.7
Capital goods	-14.4	-19.5	-20.2	-22.6
Intermediate goods	-20.4	-20.7	-18.1	-17.5
Consumer goods	-13.9	-11.3	-7.9	-8.2
Durables	-30.9	-27.6	-22.5	-22.2
Semi and nondurables	-8.6	-6.0	-2.9	-3.2

Source: IBGE

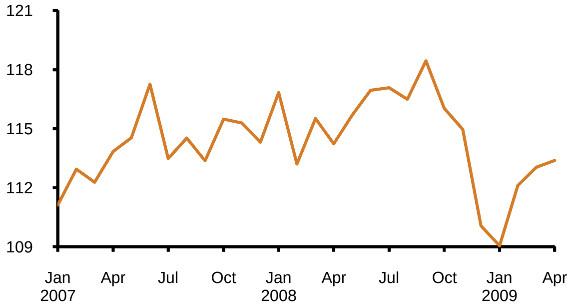
1/ Seasonally adjusted data.

Figure 1.8 – Industrial production
Consumer goods
Seasonally adjusted data
2000 = 100



Source: IBGE

Figure 1.9 – Industrial production
Semi and nondurable goods
Seasonally adjusted data
2000 = 100



Source: IBGE

production of consumer durables registered a seasonally adjusted growth of 20.3% in the 3-month period ended in April, with emphasis on the performance of the segments of furniture and automotive vehicles.

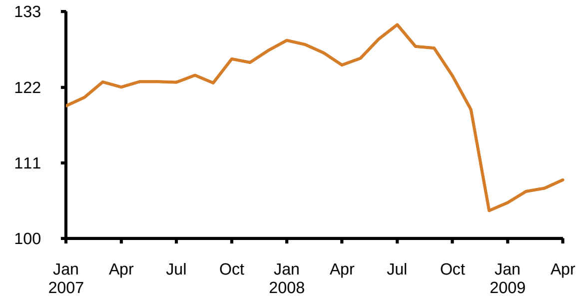
The production of semi and non-durable consumer goods grew 1.3% in the 3-month period ended in April, compared to the previous 3-month period up to January, when it had slipped 4.8% in the same type of comparison. Meanwhile, the segment of intermediate goods decreased by 1.6% and 13.5%, respectively, in the period under analysis. The performance of the segments of consumer and semi and non-nondurable goods was favored by the enhanced dynamics of the food, beverage, publishing, printing, and perfumery and cleansing products, as opposed to the decreases related to the sectors of footwear, apparel and pharmaceuticals.

The analysis of the production of capital goods according to their destination reveals a widespread negative performance in the 3-month period ended in April, compared to the 3-month period ended in January, considering seasonally adjusted data. The decreases were more pronounced in the categories of goods for the sectors of construction (52.6%), electricity (28.2%) and crop/livestock (27.2%), whose investment maturity cycles are longer, while the less significant reduction, 0.7%, occurred in the production of capital goods for mixed use. The production of typical construction inputs fell 2.3% in the period, evincing a relatively moderate decline in this industry, given the reduced demand for capital goods, partly associated to the decline in the sector's exports.

The production of industrial capital goods fell 9% in the period, registering a 4% reduction in the output of goods produced on an order basis, which include capital goods with longer production process, and 10% in the output of goods produced in series. Probably this difference is related to the completion of units that were already at advanced production stage at the time that the international financial crisis begun to intensify.

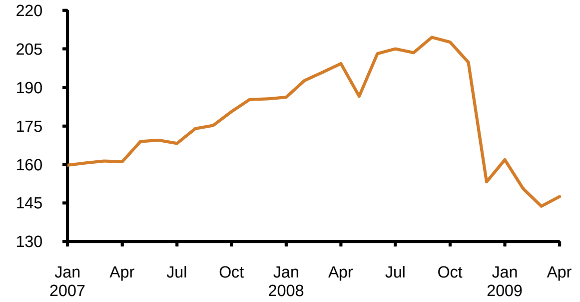
The recovery in the automotive industry was favored by the temporary reduction of the IPI in the sector and improved access to credit. In this scenario, the production of light vehicles rose 40% in the 3-month period ended in May, compared to the 3-month period ended in February, according to seasonally adjusted data from Anfavea.

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



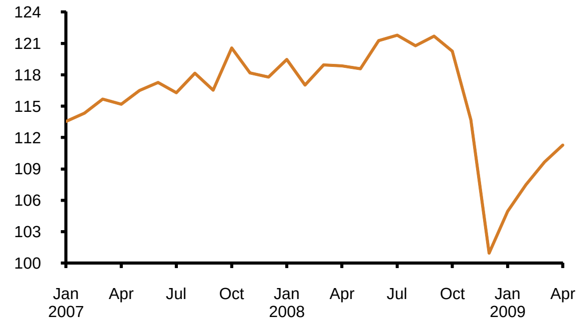
Source: IBGE

Figure 1.11 – Industrial production
Capital goods
Seasonally adjusted data
2000 =100



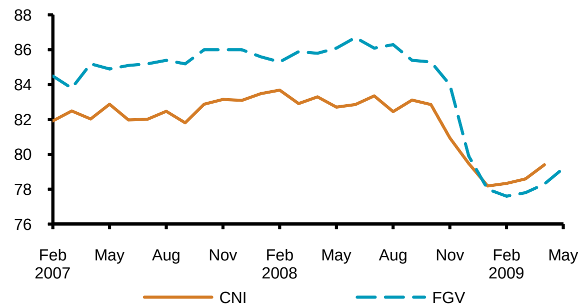
Source: IBGE

Figure 1.12 – Labor productivity
Seasonally adjusted data
2002 = 100



Source: IBGE

Figure 1.13 – Utilization of installed capacity in the manufacturing industry
Seasonally adjusted data
%



Sources: CNI and FGV

Industry continues eliminating jobs, a trajectory ratified by the decrease of 3.6% recorded by the seasonally adjusted index of employed persons from the IBGE Monthly Industrial Survey – Jobs and Wages (Pimes), in the 3-monh period ended in April, compared to the 3-month period ended in January. This was the most intense reduction observed in this type of comparison since the start of the series, in January 2003. In addition, the indices related to the number of hours paid and the total real wages reported respective decreases of 3% and 1.3% in the period.

Labour productivity, defined as the ratio between the indices of physical production and the number of hours paid, increased by 2.8% in the 3-month period ended in April, compared to the previous 3-month period ended in January, when it had fallen 11.9% in the same type of comparison, considering seasonally adjusted data.

The Level of Utilization of Installed Capacity (Nuci) from the manufacturing industry reached 79.2% in May, registering its third consecutive monthly increase, according to seasonally adjusted data from the FGV Manufacturing Industry Survey (SCIT), but keeping at a level 6 percentage points lower than the average of 2008. The analysis by categories of use shows that the growth in the Nuci in the last three months particularly reflected a growth of 5.1 p.p. in the segment of consumer goods and stability in the capital goods industry, a growth consistent with the recent trajectories of these segments.

The Industrial Confidence Index (ICI) reached 59.6 points in May, a growth of 13.4 points in relation to February, according to seasonally adjusted data from the FGV SCIT. With the exception of capital goods, advances were registered in all categories of use in the period. The confidence index of the consumer goods industry, 102.6 points, surpassed the historical average of the respective series, which began in January 1993, by 2 points.

The changes occurred in the ICI in the period under analysis were due to generalized increases in its components. The Current Situation Index (ISA), driven by a growth of 22.9 points observed in the component level of global demand, rose 15.3 points in the period, notwithstanding the performance of the component inventory levels, which indicates the completion of the process of adjustment, had risen by 6.6 points in the period. The IE, reflecting increases in the component forecast physical production, 14.6 points; forecast employment, 13.4 points, and the business situation for the next six months,13.1 points, reached 11.5 points in the period.

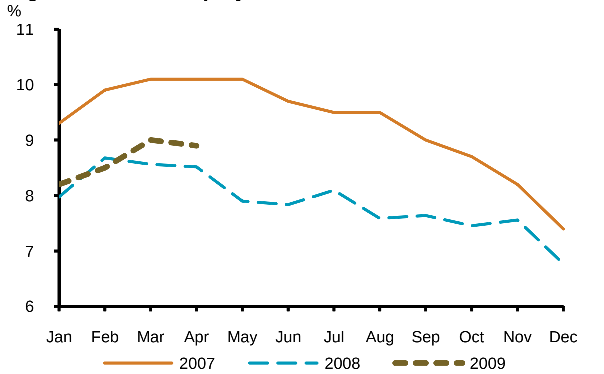
Table 1.7 – Industry Confidence Index[1/]

	2009				
	Jan	Feb	Mar	Apr	May
Industry Confidence Index	75.3	76.2	77.8	84.5	89.6
By component:					
Current Situation Index	78.1	77.8	79.5	86.5	93.1
Global demand level	72.0	67.7	71.8	80.1	90.6
Inventory level	78.2	82.6	83.9	89.4	89.2
Business situation	72.9	71.3	70.8	77.1	86.5
Expectations Index	72.5	74.6	76.1	82.5	86.1
Business situation	77.0	85.7	78.6	89.9	98.8
Employment	82.6	82.4	84.6	94.0	95.8
Physical production	98.3	98.3	107.8	109.8	112.9

Source: FGV

1/ The average of the last ten years is equal to one hundred. Seasonally adjusted series.

Figure 1.14 – Unemployment rate



Source: IBGE

Table 1.8 – Formal employment

In the year

	2008	2009			
	Year	Jan	Feb	Mar	Apr
Total	1 452.2	-101.7	-92.6	-57.8	48.5
Manufacturing industry	178.7	-55.1	-111.6	-147.4	-147.2
Commerce	382.2	-50.8	-61.1	-70.8	-65.1
Services	648.3	2.5	60.0	109.3	168.5
Building	197.9	11.3	14.2	30.3	43.7
Crop and livestock	18.2	-12.1	-11.1	-3.9	18.8
Public utilities	8.0	0.7	1.5	2.0	2.6
Others[1/]	19.0	1.8	15.6	22.7	27.2

Source: MTE

1/ Includes mining, public administration and others.

1.3 Labor market

Employment

The average unemployment rate, measured by the IBGE Monthly Employment Survey (PME), reached 8.8% in the 3-month period ended in April, compared to 7.5% in the 3-month period ended in January and 8.6% in the same period of 2008.

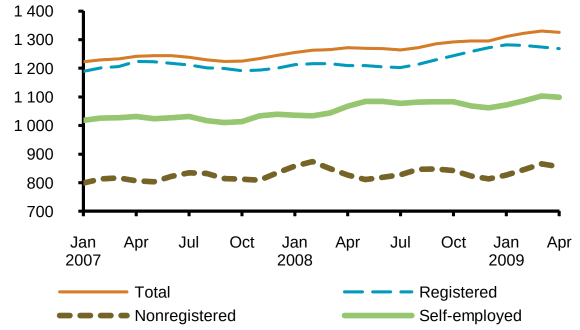
The growth of unemployment, in annual terms, reflected the expansion of 0.8% in the employment level and 1.1% in the economically active population. By categories of occupation, formal employment and unregistered employment in the private sector registered respective rates of 2.6% and -3.3%. The rate of formal employment, defined as the ratio between the number of registered workers in the private sector and the total number of employed persons, reached 45% in April, compared to 44.3% in April 2008.

According to the General Register of Employed and Unemployed Persons (Caged) from the Ministry of Labor and Employment (MTE), 48,500 formal jobs were created in the first four months of the year, compared to 849,000 in the same period of 2008, the less significant result for the period since 1999. Considering the major economic sectors, employment decreased by 0.9% in the manufacturing industry in the period, the worst result in ten years, while the segments of trade, services, and construction recorded respective increases of 4.7%, 4.8% and 8.4%.

Earnings

The average real income usually earned in the six metropolitan areas covered by the PME, after increasing 4.5% in the 3-month period ended in January, compared to the same period in 2008, grew 4.3% in the 3-month period ended in April, on the same comparison basis. The real wages, the product of average real income usually earned by the number of employed persons, increased by 5.1%, compared to 7% in the 3-month period ended in January, a slowdown consistent with the recent retreat recorded in the level of employment. The average income reached R$1,318.40 (per month) in April, the highest figure recorded for the month since the series began in March 2002.

Figure 1.15 – Average real regular earnings[1/]
In R$ of April 2009, deflated by INPC



Source: IBGE
1/ Quarterly moving average.

Table 1.9 – Gross Domestic Product at market prices

% growth

	2008				2009
	I Q	II Q	III Q	IV Q	I Q
Accumulated in the year	6.1	6.2	6.4	5.1	-1.8
Accumulated in 4 quarters	5.9	6.0	6.3	5.1	3.1
Quarter/same quarter of the previous year	6.1	6.2	6.8	1.3	-1.8
Quarter/previous quarter[1/]	1.9	1.6	1.4	-3.6	-0.8
Crop and livestock	1.4	1.6	-0.2	-1.0	-0.5
Industry	3.6	1.2	1.6	-8.2	-3.1
Services	1.4	0.8	0.8	-0.4	0.8

Source: IBGE
1/ Seasonally adjusted data.

Table 1.10 – Gross Domestic Product
Accumulated in the year

% growth

	2008				2009
	I Q	II Q	III Q	IV Q	I Q
GDP at market prices	6.1	6.2	6.4	5.1	-1.8
Households consumption	6.3	6.1	6.5	5.4	1.3
Government consumption	6.5	5.3	5.7	5.6	2.7
Gross fixed capital formation	15.4	16.0	17.3	13.8	-14.0
Exports	-2.3	1.4	1.6	-0.6	-15.2
Imports	18.8	22.5	22.6	18.5	-16.0

Source: IBGE
1/ Estimated.

1.4 Gross Domestic Product

GDP fell 1.8% in the first quarter of 2009 over the same period of last year, according to the Quarterly National Accounts from IBGE. This performance reflected the occurrence of negative results in all product components, except the sector of services. Under the prism of of demand, in contrast with the behavior started in 2006, the contribution of domestic demand reached -1.9 p.p., while the external sector contributed with 0.1 percentage points, although exports have exerted a negative impact of 2.2 percentage points. In the first quarter of 2008, the contributions of domestic demand and external sector for the 6.1% expansion of GDP were, respectively, of 8.7 p.p. and -2.6 pp.

The contribution of domestic demand reflected in particular the accentuated reduction of investments, expressed in a decrease of 14% recorded in the Gross Fixed Capital Formation (GFCF), contrasting with the significant increases in household and government consumption, 1.3% and 2.7%, respectively. The persistent deterioration of foreign trade flows, in line with the recessive environment of major developed economies, resulted in reductions of 15.2% in exports and 16% in imports in the quarter.

The analysis of the annual decrease of GDP from the perspective of production reveals the persistent loss of industrial dynamism. Industry fell by 9.3% over the first quarter of 2008, a decrease associated to reductions in the manufacturing industry, 12.6%, impacted by the negative results of the segments of machinery and equipment, metallurgy, automobiles, furniture, and clothing and footwear, as well as in construction industry, 9.8%. Moreover, it should be highlighted the reduction of 4.2% in the production and distribution of electricity, gas and water, and 1.1% of the mining industry, the latter as a result of the impact of a more pronounced decrease of 38.1% observed in the production of iron ore, compared to a 6.5% increase in oil and natural gas.

The sector of services increased by 1.7% in the same basis of comparison, a growth consistent with the positive results registered in the segments related to the domestic market, with emphasis on other services, 7%, financial intermediation, insurance, pension funds and related services, 5.8%, and information services, 5.4%. Conversely, as a consequence of the impact of the slowdown in economic activity experienced by primary and secondary sectors, the segments of trade and transportation, storage and postal services decreased by 6% and 5.6%, respectively.

Revision of the GDP Projection for 2009

Estimated growth of the Gross Domestic Product (GDP) for 2009 was revised from 1.2%, in the Inflation Report of March, to 0.8%. Even in a scenario in which the results of GDP for the first quarter of the year suggest that the economic slowdown that followed the intensification of international crisis, this change might be less intense than the initially expected, reflecting in particular the impact of fewer favorable projections compared to the industrial performance.

Considered from the perspective of production, one should highlight the less optimistic prospects about the performance of primary and secondary sectors, contrasting with the more favorable estimate for the tertiary sector. The projection related to farm production indicates that the sector should undergo an annual decline of 0.8% against 0.1% contraction expected in the previous report, a move consistent with the incorporation of the effects of both bad weather drought in the south and excessive rains in the north and northeast – on the crops, and the recession environment on the external demand for livestock products.

The industrial activity, which is the sector most affected by the deterioration of expectations, is expected to drop 2.2% in 2009 compared to an increase of 0.1% predicted in the previous report. This reversal reflects the downturn in the projections for the performance of the entire sector' segments, except for the mining industry, which, driven by oil production, should grow 2.9% this year, against a previous projection of 2.4%. The decline of the manufacturing industry is expected to reach 4.2%, compared to a previous estimate of 1.6%, a move consistent with the pace of recovery presented by the segment at the beginning of the year. The construction activity is expected to record a decrease of 0.5% in 2009, in contrast with the projected growth of 2.7% indicated in the previous report. The new projection, although incorporating the perspective of recovery in the sector as of the second quarter – consistent with the introduction of new real estate credit lines and the effects of the governmental program for housing construction and investments in the Growth Incentive Program (PAC) – reflects, in particular the decrease of 9.8% recorded in construction in the first quarter of the year, compared to the same period in 2008.

The projection on the variation of production and distribution of electricity, gas and water was reduced from 2.1% to -1.2%, reversal due to both the incorporation of a 4.2% decline shown by the segment in the first quarter, and the intensification of the estimated annual decline of the manufacturing industry, accounting for approximately 45% of electricity consumption.

The annual performance of the services sector was estimated from 1.7% to 2.1%. This evolution

Table 1 – Gross Domestic Product

Cumulative annual variation

	2008	2008				2009	
	Weights	I Q	II Q	III Q	IV Q	I Q	IV Q[1/]
Crop and livestock	5.7	3.8	6.7	6.7	5.8	-1.6	-0.8
Industry	23.6	6.9	6.2	6.5	4.3	-9.3	-2.2
Mineral extraction	3.0	3.6	4.5	5.6	4.3	-1.1	2.9
Manufacturing	13.5	7.4	6.2	6.1	3.2	-12.6	-4.2
Construction	4.3	8.9	9.3	10.2	8.0	-9.8	-0.5
Public utilities	2.7	5.4	4.6	4.9	4.5	-4.2	-1.2
Services	55.2	5.2	5.3	5.5	4.8	1.7	2.1
Commerce	10.3	7.9	8.1	8.6	6.1	-6.0	-0.9
Transportation	4.6	4.3	4.7	5.0	3.2	-5.6	-1.3
Communications	3.0	8.0	8.1	8.8	8.9	5.4	5.0
Financial institutions[2/]	5.7	13.2	11.7	10.7	9.1	5.8	4.2
Other services	11.4	3.3	4.1	4.7	4.5	7.0	3.5
Rents	7.3	3.8	3.5	3.3	3.0	1.6	2.9
Public administration	12.9	1.4	1.7	2.0	2.3	3.1	2.5
Value added at basic prices	84.5	5.6	5.8	5.9	4.7	-1.5	0.7
Taxes on products	15.5	9.1	8.6	9.1	7.4	-3.3	1.0
GDP at market prices	100.0	6.1	6.2	6.4	5.1	-1.8	0.8

Source: IBGE and Banco Central

1/ Estimated.

2/ Includes insurance, complementary social security and related sevices.

is associated, in particular, to the performance observed in the first quarter. Positive revisions have been performed in all subsectors, except for marked reductions in estimates regarding trade, from -0.4% to -0.9%, and transportation, from -0.5% to -1.3%, which are segments particularly impacted by a supply reduction represented by the performance of industry and imports.

Considering the demand side, the main setting in the projection was related to the performance of the Gross Fixed Capital Formation, which moved from an annual growth of 0.7% to a drop of 5.1%. The review of this component, which is the most sensitive to changes in expectations and in the product, was largely associated to the interannual decrease of 14% observed in the first quarter of the year and to the limited prospects for recovery of investments in an environment of idleness in the domestic level of capacity utilization and an incipient recovery of more developed economies. An estimate for household consumption reached 1.5% against 1.6% in the previous report, while the one regarding the government consumption, reflecting in part a counter-cyclical spending policy of the federal government, increased from 2.4% to 2.8%. The projected decline in imports increased 1.4 p.p. to 7.8%, while the falloff regarding exports decreased on 0.9 p.p. to 5.7%, thus enhancing the prospects for a positive contribution of the external sector to the GDP.

Table 2 – Gross Domestic Product – Demand side

%

Period	GDP at market price	Private consumption	Government consumption	Total consumption	Gross Fixed Capital Formation	Exports	Imports
2002	2.7	1.9	4.7	2.6	-5.2	7.4	-11.8
2003	1.1	-0.8	1.2	-0.3	-4.6	10.4	-1.6
2004	5.7	3.8	4.1	3.9	9.1	15.3	13.3
2005	3.2	4.5	2.3	3.9	3.6	9.3	8.5
2006	4.0	5.2	2.6	4.5	9.8	5.0	18.4
2007	5.7	6.3	4.7	5.9	13.5	6.7	20.8
Contribution (p.p.)		3.8	0.9	4.7	2.2	1.0	-2.4
2008	5.1	5.4	5.6	5.4	13.8	-0.6	18.5
Contribution (p.p.)		3.3	1.1	4.4	2.4	-0.1	-2.2
2009 (estimated)	0.8	1.5	2.8	1.8	-5.1	-5.7	-7.8
Contribution (p.p.)		0.9	0.6	1.5	-1.0	-0.8	1.1

Source: IBGE and Banco Central

Table 1.11 – Gross Domestic Product
Accumulated in the year

% growth

	2008				2009
	I Q	II Q	III Q	IV Q	I Q
Crop and livestock	3.8	6.7	6.7	5.8	-1.6
Industry	6.9	6.2	6.5	4.3	-9.3
Mining	3.6	4.5	5.6	4.3	-1.1
Manufacturing	7.4	6.2	6.1	3.2	-12.6
Construction	8.9	9.3	10.2	8.0	-9.8
Public utilities	5.4	4.6	4.9	4.5	-4.2
Services	5.2	5.3	5.5	4.8	1.7
Commerce	7.9	8.1	8.6	6.1	-6.0
Transportation	4.3	4.7	5.0	3.2	-5.6
Communications	8.0	8.1	8.8	8.9	5.4
Financial institutions	13.2	11.7	10.7	9.1	5.8
Other services	3.3	4.1	4.7	4.5	7.0
Rents	3.8	3.5	3.3	3.0	1.6
Public administration	1.4	1.7	2.0	2.3	3.1
Value added at basic prices	5.6	5.8	5.9	4.7	-1.5
Taxes on products	9.1	8.6	9.1	7.4	-3.3
GDP at market prices	6.1	6.2	6.4	5.1	-1.8

Source: IBGE

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

% growth

	2008				2009
	I Q	II Q	III Q	IV Q	I Q
GDP at market prices	1.9	1.6	1.4	-3.6	-0.8
Crop and livestock	1.4	1.6	-0.2	-1.0	-0.5
Industry	3.6	1.2	1.6	-8.2	-3.1
Services	1.4	0.8	0.8	-0.4	0.8
Households consumption	1.5	0.7	1.8	-1.8	0.7
Government consumption	4.2	-0.2	1.5	0.5	0.6
Gross fixed capital formation	5.0	4.3	4.3	-9.3	-12.6
Exports	-7.6	6.8	-2.4	-3.2	-16.0
Imports	5.5	6.8	1.9	-6.6	-16.8

Source: IBGE

Agricultural production fell by 1.6% in the first quarter of 2009 over the same period of last year, as a result of negative performances associated to crops with relevant weight in the production of the period. Accordingly, in accordance with the April LSPA, it should be highlighted the falloff in the crops of cotton, 19.7%, corn, 13.2%, soybean, 3.9%, and tobacco, 1.2%, compared with an increase of 6.2% observed in the production of rice.

According to seasonally adjusted data, GDP fell by 0.8% in the quarter ended in March, compared to the quarter ended in December, a result that suggests the start of a recovery process after the decrease observed in the previous quarter, 3.6%, interrupting a cycle of twelve consecutive positive results. This improvement at the margin reflected, in particular, the less significant impact of the deterioration of expectations and constraints in the credit market on the performance of the industry, which carried out an expressive adjustment in the level of stocks and investments.

The analysis of GDP at the margin, from the prism of production, shows an overall improvement in the performance of all segments. Thus, the decline of industry reached 3.1%, against 8.2% in the previous quarter, while the changes recorded in the sector of services and agriculture reached, respectively, 0.8% and -0.5%, compared to -0.4% and -1%, respectively, in the last quarter of 2008.

As for the demand, it should be highlighted the intensification of the quarterly decline of 9.3% in the quarter ended in December to 12.6% in the quarter ended in March in the GFCF, and the reversal of the decline of 1.8% to an increase of 0.7% in household consumption. Government consumption rose 0.6% in the quarter, while imports and exports recorded respective reductions of 16% and 16.8%.

1.5 Investments

According to the IBGE Quarterly National Accounts, investments, excluding changes in inventories, fell 14% in the quarter ended in March, compared to the same period of last year, the first decline observed in twenty quarters. The 12-month investment growth rate continue to follow a significant downward trend, from 17% in the quarter ended in September 2008 to 13.8% at the end of that year, and 6.3% in the first quarter of 2009.

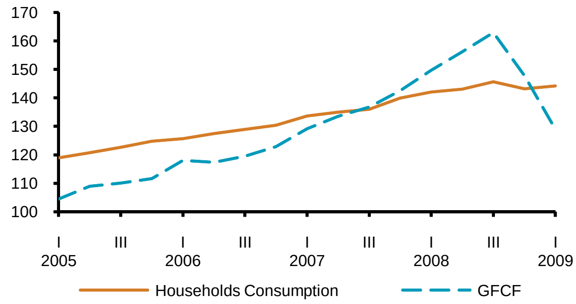
Analysis at the margin shows the persistent decline in investments. After falling 9.3% in the quarter ending in

December 2008, compared to September of that year, investments decreased by 12.6% in the first quarter of 2009, a movement anticipated by the performance of leading indicators. Accordingly, utilizing the same basis of comparison, production of construction inputs decreased by 6.3%. In addition, production, exports and imports of capital goods decreased, respectively, by 19.3%, 38.9% and 11.9%, resulting in a falloff of 20.1% in the absorption of this category of goods in the period under analysis.

Although most recent indicators related to April point to an accentuated reduction of investment in comparison to the same month of last year, they register monthly recovery. Thus, production, exports and imports of capital goods varied by respectively rates of 2.6%, -3%, and -0.9%, compared to March, resulting in a monthly expansion of 5.1% in the absorption of this category of goods, while the seasonally adjusted production of construction inputs rose 0.2% on the same basis of comparison.

Figure 1.16 – Households Consumption and Gross Fixed Capital Formation[1/]

1995 = 100



Source: IBGE
1/ Seasonally adjusted data.

The total disbursements of the BNDES system, which constitutes a relevant indicator of the trajectory of investments, increased by 3.6% in the first four months of the year over the same period of 2008, representing a significant reduction compared to annual growth of 44.2% recorded in 2008. This movement reflected, in particular, a decrease of 3.6% observed in disbursements directed to the manufacturing industry, which had increased 29.4% in 2008. Disbursements related to agricultural activity recorded changes of -6.3% and 13.1% in the period under analyss.

1.6 Conclusion

The less intense decline in GDP observed in the first quarter of 2009 compared to the end of 2008 reflected the lowered impact of the deterioration of expectations and constraints in the credit market crisis associated with the international crisis on the level of domestic activity. This recovery trend was confirmed by sectoral results of industrial production, trade and investment expenditures in the month of April. It should be observed that this movement was supported by the performance of domestic demand, driven by ad hoc measures and the maintenance of macroeconomic stability, while external demand, notwithstanding the improvement in the exports of basic products, continued to show contraction.

The resumption of a sustained economic activity expansion over the coming months, as well as its intensity, will be therefore subject to the persistence of the recovery in domestic and foreign markets expectations. This movement could be benefited by the maintenance of the trend of reduction of stress in international financial markets, evinced by the less restrictive credit access, return of foreign capital flows to the country with the perspective of companies to regain access to capital markets, as well as the lagged and cumulative effects of the monetary easing in place since January.

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Prices

2

Inflation trended downward in the quarter ended in May (compared to February quarter end) expressed both in a decelerated performance in consumer prices as well as the more pronounced downfall experienced by the general indices. This is primarily evident in the impact of the reduced level of global economic activity on wholesale prices of both farm and industrial goods.

The deceleration recorded in the change in consumer prices mainly reflected the cooling of pressure from the food and beverages segments, with an emphasis on the decline in prices of semi-manufactured products, as well as education, which was favored by an exhaustion of the impact of annual increases in school fees. The rate of consumer inflation in the following accumulated twelve months showed a downward trend and displayed a slow convergence to the annual target set by the CMN in the framework of inflation targeting system, a development particularly related to the deceleration in the prices of durable goods, which reflected reduced demand and the impacts of tax unburdening measures, in contrast to the acceleration in prices of services and regulated goods

2.1 General indices

The General Price Index (IGP-DI) from FGV ranged -0.62% for May quarter end, compared to -0.55% in February, an outcome from recorded reductions in wholesale prices, agricultural and industrial, as well as a deceleration in consumer prices. In a 12-month period, the IGP-DI accumulated growth of 2.99% in May – the lowest rate since August 2006 when the index recorded an increase of 2.78% against 7.50% in February, registering a general slowdown in the variations of the three components of the indicator.

Table 2.1 – General price indices

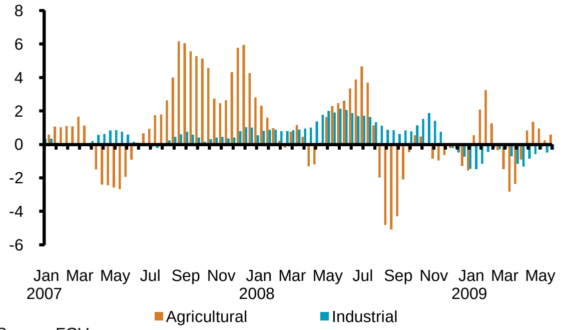
Monthly % change

	2009				
	Jan	Feb	Mar	Apr	May
IGP-DI	0.01	-0.13	-0.84	0.04	0.18
IPA	-0.33	-0.31	-1.46	-0.10	-0.10
IPC-Br	0.83	0.21	0.61	0.47	0.39
INCC	0.33	0.27	-0.25	-0.04	1.39

Source: FGV

The drop of the Producer Price Index (IPA-DI) reached 1.65% for the quarter ended May, up from 1.51% in February quarter end. Agricultural prices fell by 0.47%in the period, compared to an increase of 0.37% in the quarter ended in February, with an emphasis on variations in items such as beans -27.21%, permanent crops -5.92%; and rice, 17.95%. Industrial prices recorded decreases of 2.04% and 2.16% in the quarters considered, a move particularly associated with the larger impact of the reductions observed in the segments of basic metallurgy 7.81%; chemicals 5.05%; and non-metallic minerals products 2.79%, compared to increases experienced by cigarette items 24.55%, dairy products 7.98%, and pharmaceuticals 5.40%. The accumulated variation of the IPA-DI in12 months was 1.18% in May, against 7.39% in February.

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



Source: FGV

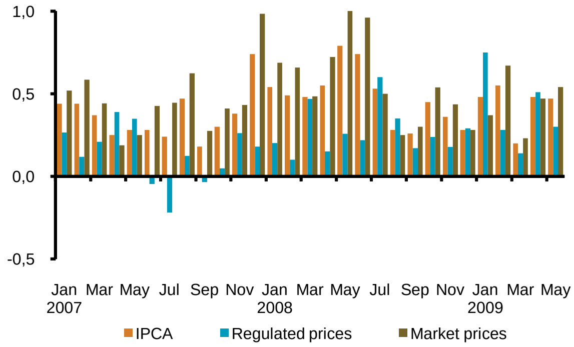
The change in the Consumer Price Index – Brazil (IPC-Br), showing, mostly, the cooling of pressure from the Education and Transportation groups decelerated, going from 1.57% in the quarter ended in February to 1.48%. As periods of 12 months, the indicator had respective highs of 6.15% and 5.55% in February and May.

The National Cost of Construction (INCC), after registering a growth of 0.77% in the quarter ended in February, rose 1.09% in the month ending in May. This result reflected an increase of 4.19% in the prices of labor, in contrast to a reduction of 1.52% observed in the prices of materials and services, favored by both lower demand and temporary tax relief measures. Considering a 12 month period, the INCC had elevations of 11.67% in February and 8.98% in May.

2.2 Consumer price indices

The IPCA, released by the IBGE, grew 1.15% in the quarter ended in May, compared to 1.32% in the previous quarter. emphasized by a reduction from 1.39% to 0.89% in the prices of food and beverages. The segmentation of IPCA shows that the quarterly performance indicator reflecting deceleration in the variations of market prices, from 1.31% to 1.24%, and regulated prices, from 1.32% to 0.95%, translating into decreases observed in the prices of items such as gasoline, 1.69%, and airfares of 2.31%, which had increased in the order of 0.29% and 3.03% in the quarter ended in February.

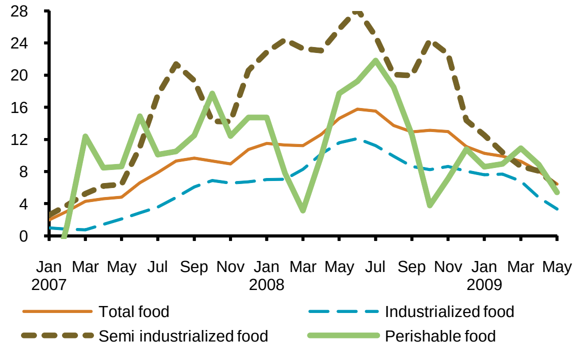
Figure 2.2 – IPCA
Monthly % change



Source: IBGE

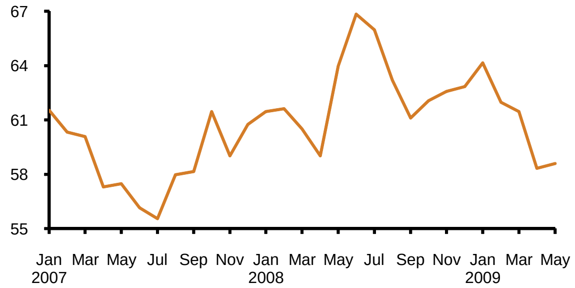
The trajectory of market prices reflected a more accentuated reduction, from 2.46% to 1.03%, in the variation in the prices of nontradable goods and services, in relation to increases of 0.08% to 1.47% in that concerning prices of tradable goods and services. The quarterly performance of prices of nontradable items was mainly associated to

Figure 2.3 – IPCA – Food
12-month % change



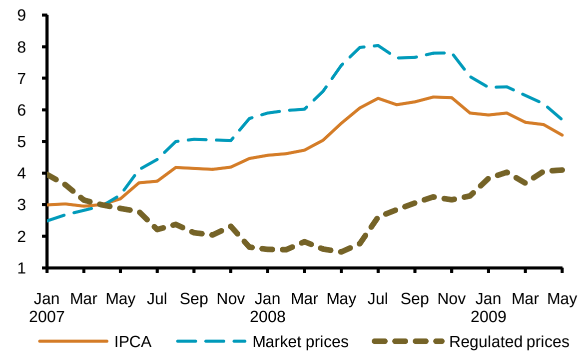
Source: IBGE

Figure 2.4 – IPCA
% of items with increase[1/]
Quarterly moving average
%



Sources: IBGE and Bacen
1/ The IPCA is formed by 384 sub-items.

Figure 2.5 – IPCA
12 month % change



Sources: IBGE and Bacen

the seasonal nature of prices in the segments in perishable foods and education.

Considering 12-month periods, the IPCA, highlighting the convergence process towards the goal set by the CMN, registered an increase of 5.20% in May, up from 5.90% in February, a result of an increase from 4.02% to 4.09% in prices, and a slowdown of 6.71% to 5.68% in market prices.

It should be noted that the trajectory of market prices shows the recent reduction experienced by the prices of goods, particularly durable goods, in response to the environment of decreasing demand, contrasting with the recurring increases in the twelve month variation of service prices, which reached 7.23% in May, up from 7.09% in February, the highest percentage since November 2003. This trend reflects both the relative lag in these prices in relation to the evolution of economic activity as the contributions of accumulated changes in 12 months of items such as domestic help and personal services, which moved, in that order, from 10.38% and 7.61% in February to 12.30% and 9.46% in May.

The diffusion index, which shows the proportion of the number of components of the IPCA price index, which has registered a positive growth in a certain period, has increased positively over time, reaching an average of 58.59% in the quarter ended in May, against 61.98% from February and 63.98% from the same period last year, a performance consistent with a slowdown in prices in the period.

2.3 Regulated prices

Regulated prices increased 0.95% in the quarter ended in May, accounting for 0.28 percentage points of variation from1.15% recorded by the IPCA in the period. The greatest pressure came from 4.64% in the adjustments in medicines, 1.42% in electricity, pressured by marked increases in Fortaleza 10.13%, Salvador 8.19%, Porto Alegre 5.49 %, and Belo Horizonte of 4.59%; 1.96% in water and sewage fees, highlighting the highs seen in Salvador of 17.97%, Brasilia 6.24%, and in Porto Alegre of 3, 93%; and 1.47% in health insurance.

The accumulated variation in 12 months of regulated prices reached 4.09% in the quarter ended in May, compared to 4.02% in February, constituting the highest rate since December 2006. In the first five months of the year, regulated prices accumulated an increase of 1.99% against 1.18% in the same period last year.

Table 2.2 – IPCA

% change

	Weights	2009					
		Jan	Feb	Mar	Apr	May	Year
IPCA	100.00	0.48	0.55	0.20	0.48	0.47	2.20
Market prices	70.36	0.37	0.67	0.23	0.47	0.54	2.29
Regulated prices	29.64	0.75	0.28	0.14	0.51	0.30	1.99
Main items							
Electricity	3.24	-0.14	-0.36	-0.27	0.87	0.82	0.92
Natural gas vehicle	0.13	4.13	-1.12	-0.92	-2.32	-1.61	-1.95
Pipeline gas	0.10	4.47	-1.10	-0.15	0.00	-1.17	1.96
Diesel fuel	0.09	0.33	-0.34	-0.03	0.35	-0.23	0.08
Electricity	0.14	0.94	0.05	0.00	0.00	0.00	0.99
Tolls	1.35	0.00	0.13	0.10	0.17	0.00	0.40
Water and sewage	1.62	0.00	0.00	0.00	0.61	1.34	1.96
Urban bus	3.77	3.24	1.03	0.11	0.14	0.41	4.99
Air ticket	0.30	0.87	0.82	0.00	-1.13	-1.19	-0.65
Gasoline	4.20	0.42	-0.04	-0.34	-0.46	-0.90	-1.32
Bottled cooking gas	1.11	0.13	-0.41	1.73	2.41	0.64	4.55
Medicine	2.83	0.61	0.34	0.37	2.89	1.33	5.64
Health plans	3.38	0.47	0.48	0.47	0.48	0.51	2.43

Source: IBGE

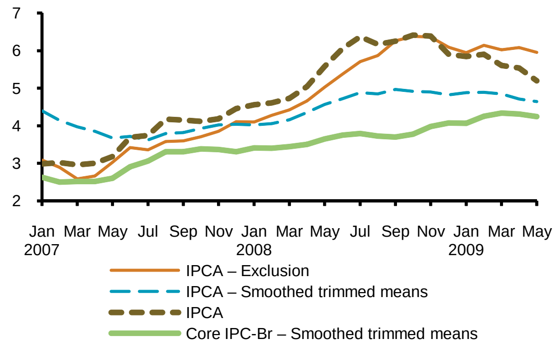
Table 2.3 – Consumer prices and core inflation

Monthly % change

	2009				
	Jan	Feb	Mar	Apr	May
IPCA	0.48	0.55	0.20	0.48	0.47
Exclusion	0.27	0.88	0.25	0.58	0.56
Trimmed means					
Smoothed	0.42	0.29	0.35	0.35	0.44
Non smoothed	0.44	0.27	0.21	0.27	0.39
IPC-Br	0.83	0.21	0.61	0.47	0.39
Core IPC-Br	0.35	0.33	0.39	0.36	0.37

Source: IBGE, Bacen and FGV

Figure 2.6 – Core inflation
12-month % change



Source: IBGE, Bacen and FGV

2.4 Inflation core

The calculated core measure, excluding regulated prices and home food prices, registered a growth of 1.40% for the quarter ended May, up from 1.49% in that ended in February, reaching its variations 5.96% and 6.14% in 12 months.

The core smoothed trimmed means increased 1.14% compared to 1.04% in the quarter ended in February, totaling 12-month respective increases of 4.65% and 4.89%. The quarterly changes of the core by smoothed trimmed means attained, in the same period, 0.87% and 1.04% respectively, while those accumulated in 12 months stood, in order, 4.34% and 4.85 %.

The core CPI inflation-Br FGV, as calculated by the trimmed mean, rose 1.12% in the quarter ended in May, compared to 1.02% that ended in February.

2.5 Market expectations

Since March quarter end, inflation expectations for 2009, collected by the Investor Relations and Special Studies Department (Gerin), have stayed slightly below the annual target of 4.5% established by CMN for IPCA. On June 5, the median of forecasted projected an annual range of 4.3% for the indicator for both 2009 and 2010, compared to 4.3% and 4.5% in late March. The median of expectations for inflation in the twelve months ahead – smoothed – fell to 4.0% in the period.

The medians for the IGP-M and IPA-DI for 2009 decreased, respectively, from 2.7% and 2.4% at the end of March, to 1.5% and 0.5% on June 5, while those for 2010 also remained at 4.5%.

The median related to expectations regarding the evolution of prices administered or regulated by contracts in 2009 and 2010 reached, in order, 4.3% and 4.0% on June 5, in view of 4.5%, at the end of March.

Forecasts for the exchange rate fell sharply in recent months. The medians of forecasts on exchange rates from the end of 2009 and 2010 moved from R$2.30/US$ at the end of March, to R$2.00/US$ and R$2.10/US$, respectively, on June 5. The median of forecasts for the average exchange rates for 2009 and 2010 decreased in the order of US$2.30/US$ and R$2.28/US$ at the end of March to R$2.10/US$ on June 5.

Figure 2.7 – IPCA

Median

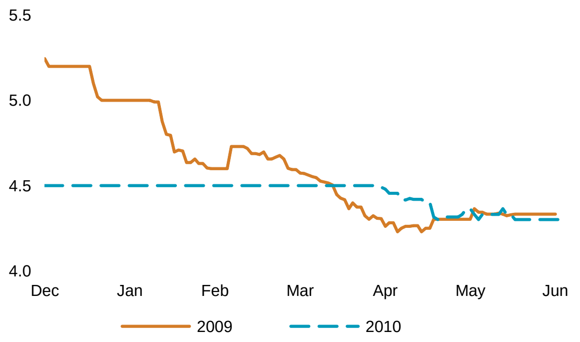


Figure 2.8 – IGP-M e IPA-DI

Median 2009

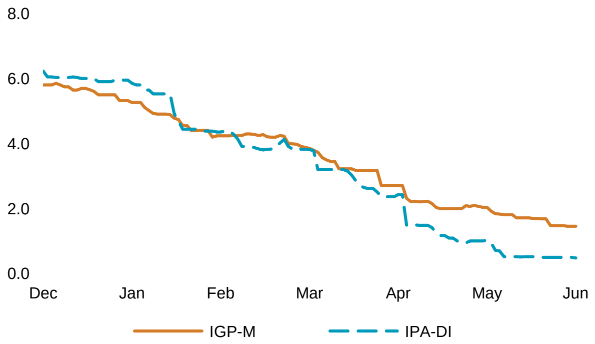


Figure 2.9 – Exchange

Median 2009

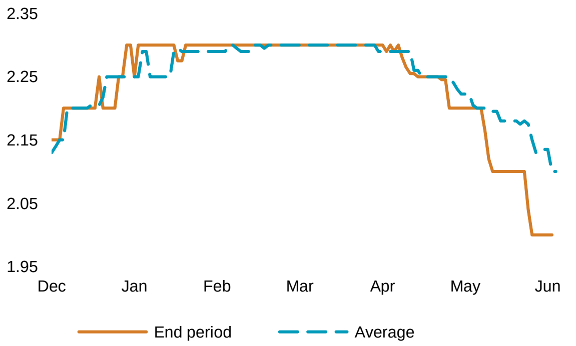


Table 2.4 – Summary of market expectations

	12.31.2008		3.31.2009		6.5.2009	
	2009	2010	2009	2010	2009	2010
IPCA	5.0	4.5	4.3	4.5	4.3	4.3
IGP-M	5.3	4.5	2.7	4.5	1.5	4.5
IPA-DI	6.0	4.7	2.4	4.5	0.5	4.5
Regulated Prices	5.1	4.5	4.5	4.5	4.3	4.0
Selic (end-of-period)	12.0	11.5	9.3	9.5	9.0	9.2
Selic (average)	12.4	12.0	10.1	9.5	10.0	9.2
Exchange rate (end-of-period)	2.30	2.25	2.30	2.30	2.00	2.10
Exchange rate (average)	2.25	2.22	2.30	2.28	2.10	2.10
GDP growth	2.4	3.9	0.0	3.5	-0.7	3.5

The median forecast for GDP growth in 2009 was revised downwards from 0% at the end of March to -0.7% in the first week of June, while remaining at 3.5% in 2010.

In this scenario of a slowdown in prices and economic activity, the research participants posted higher projection of the cuts benchmark interest rate. In this sense, the median rate on the Special Settlement and Custody (Selic) for the end of 2009 decreased to 9.25% per year at the end of March to 9% per year in the first week of June, while 2010 increased from 9.5% per year to 9.15% per year.

2.6 Conclusion

The behavior of the relatively favorable prices in recent months mainly reflected the depletion of seasonal pressures related to the education group, especially in courses, and a continuing decline of prices of semi-industrialized foodstuffs. It should be noted, additionally, the downward trend of inflation in 12 months, even in a scenario of upward pressures recorded during the first months of 2009, associated with the behavior of prices of services and some regulated items.

The outlook for the coming months incorporates the continuity, possibly at a faster rate, of convergence of the IPCA to the goal set by the CMN. This performance has been favored both by the impact on the exchange rate derived from the resumption of inflows of external resources in the country and by the persistence of the environment of recession in the major mature economies. Conversely, possible impacts of the pickup in domestic demand in a recovery scenario in the domestic economy during the second half of the year should be considered, as well as possible impacts of increased prices of raw materials.

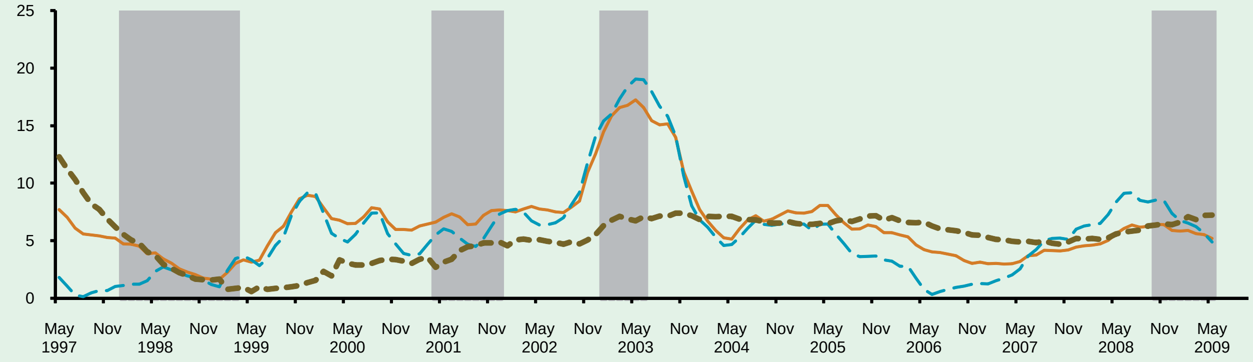
The Evolution of Prices of Goods and Services in Economic Crisis

The analysis of changes in relative prices in periods of crisis makes it possible to assess the behavior of the relevant mechanisms of transmission, such as the impacts of the downturn in the economic activity, movements of exchange rate pass-through and the presence of inertial components of inflation. In general, prices of items of services, vis-à-vis those of other products, tend to respond with greater delay and lower intensity and volatility to marked temporary changes that are typical of periods of crisis. This aspect is partly explained by the greater influence of the rigidity of contracts and the lower mobility of factors in this segment.

According to the Economic Cycles Dating Committee (Codace), an entity linked to the Getulio Vargas Foundation (FGV), the current economic crisis was preceded by three other recessive cycles over the past thirteen years: in 1998, when the maintenance of the exchange rate prevailed and there was also the coping with the Russian crisis; in 2001, due to the supply shock caused by energy restriction; and in 2003 in response to the crisis of investors' confidence due to the uncertainty surrounding the presidential election. In all these periods, prices of services followed the behavior of prices of goods, but with less volatility, as illustrated in Figure 1. This behavior, however, has not been observed in the present moment, which shows the trajectory of relative detachment groups.[1] In this scenario, this box assesses the determinants of this change in pattern, drawing parallels between the current crisis and the other recession periods.

1/ The price breakdown in this box regards the items of the IPCA nonearmarked price segment, weighting 23.80% in the case of services and 46.65% in the case of goods.

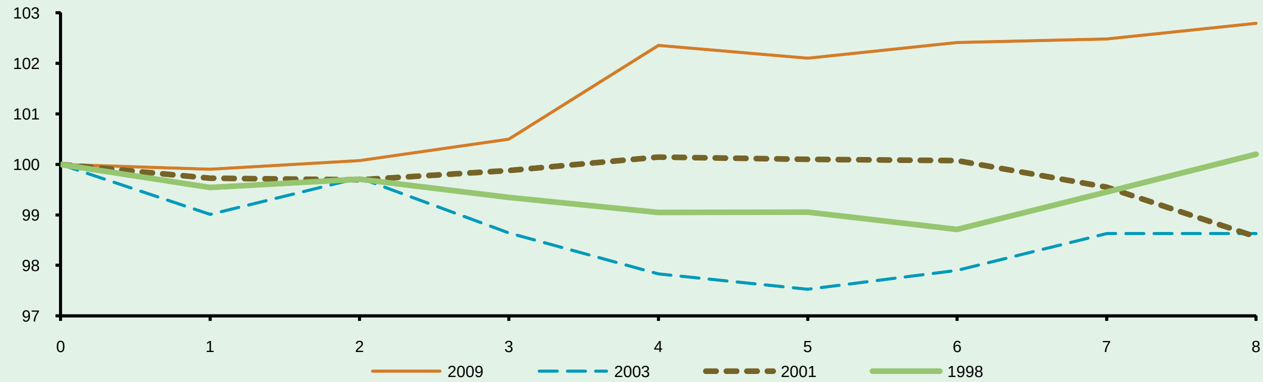
Figure 1 – IPCA – Goods and Services
12-months % variations



Sourcee: IBGE

The separate behavior of relative prices in the current period is shown in Figure 2, which shows the evolution of the parity price of services and goods in the various crises. In the recent situation, parity evolves all the time above the base level (100) and, –reflecting the rise in prices of items in the service sector and the cooling of prices of other products –increases the level from the sixth month. This trajectory is markedly different from those observed in the crises of 2003 and 1998. In the first case, it was due to the sharp exchange depreciation in the period, and, in the second, due to the impact of the long periods of recession on prices. The evolution of parity in 2001 initially displays a behavior similar to the current crisis, reflecting, as expected, the lagged impact of lower activity on the deceleration of prices of services, which is six months in that specific case. In the seventh and eighth months, however, the behavior differs in the two crises, with the relative price of services slowing in 2001 and continuing to increase in the current crisis.

Figure 2 – Relative prices in economic crisis – Services/Goods
Beginning of the crisis = 100



Source: IBGE

The recent downturn in the prices of goods, in which case twelve-month cumulative variation decreased from 8.37%, in September 2008, to 4.89%, in May 2009, mainly reflected the impact of recession in major developed economies on international prices, which, in other recession periods, recorded a significant acceleration in response to processes of exchange depreciation observed on those occasions. According to the same basis of comparison, the prices of services have accelerated from 6.27% to 7.23%. This development is associated partially to the lagged adjustment of the segment to the variation in the economic activity, to the minimum wage real increase, and to the impact of high inflation during the period preceding the crisis – the 12-month change of the General Price Index – Market (IGP-M) reached 12.3 %in September 2008 – on the adjustments in various services, also highlighting the presence of indexation mechanisms.

The opening of the group of services, as shown in Table 1, favors the identification of the mechanisms underlying the behavior of prices in that segment. It is worth mentioning that only on the item personal service that responds more readily to the activity level a sharp deceleration in prices was recorded in the current crisis, as demonstrated by the reduction of their cumulative 12-month change, from 7.14% in September 2008, to 5.24% in May 2009. These

Table 1 – IPCA – goods, services and regulated – and IGP-M

12-month variation

Itemization	Weights	Period prior to the outset of the crisis				Eight months after the outset of the crisis			
	May-2009	Crisis I	Crisis II	Crisis III	Crisis IV	Crisis I	Crisis II	Crisis III	Crisis IV
		Dec-1997	Mar-2001	Dec-2002	Sep-2008	Aug-1998	Nov-2001	Aug-2003	May-2009
IPCA	100.0	5.2	6.4	12.5	6.3	2.6	7.6	15.1	5.2
Goods	46.6	1.0	4.7	14.1	8.4	2.2	6.2	16.7	4.9
Services	23.8	6.2	3.6	5.5	6.3	2.2	4.8	7.1	7.2
Repairs	1.3	-1.7	6.2	8.5	5.4	0.0	5.9	7.3	8.8
Domestic help	3.3	7.1	11.0	8.7	10.2	8.3	8.1	8.3	12.3
Personal	2.1	0.9	2.6	5.4	7.1	-0.1	1.7	6.6	5.2
Healt	1.6	6.3	0.2	4.3	6.7	3.0	1.5	6.0	6.6
Education	6.1	12.1	5.5	7.9	4.9	7.0	6.4	10.0	5.7
Housing	4.8	8.8	-0.7	1.9	5.8	1.4	2.9	4.3	6.8
Transportation	2.2	6.0	3.8	5.6	6.5	1.1	4.5	8.6	8.5
Leisure	2.5	5.1	4.8	6.9	5.1	2.7	6.1	7.8	5.6
Regulated	29.6	18.3	12.7	15.3	3.0	4.4	12.8	18.4	4.1
IGP-M	100.0	7.7	9.6	25.3	12.3	4.0	10.8	22.9	3.6

Sources: IBGE and FGV

prices displayed a similar performance in other crises, except for the 2003 crisis when, in general, all price indicators showed acceleration.

The segments of domestic help and repairs and alterations, with joint participation of 19% in the group showed accelerations, respectively, from 3.38 p.p. and 2.10 p.p. on the same basis of comparison. This movement reflected, in particular, the impact of minimum wage increase and the maintenance of purchasing power due to the process of reducing inflation. The transmission channel of real income to the prices in the two segments mentioned had exerted a corresponding effect in previous crises.

In the case of the spending on education and housing, accounting for 46% in the service sector, prevails the effect of high inflation prevails in the period preceding the crisis, which serves as a reference for indexing contracts, particularly in residential rents and school fees, usually based on the IGP-M. The remaining segments, health services, leisure and transportation, which accounts for 26% of the service sector, are more dependent on movements in demand but they tend to react with some lag to changes in economic activity.

In broader terms, inflation in services presents relative rigidity and responds with a lag to the pace of activity and to the process of slowing inflation. Moreover, key segments such as education, have annual adjustments rules that are the transmission mechanism of inflation recorded in prior periods. In this scenario, the perspective is that the prices of services remain at a relatively high level in 2009, particularly when considering the 12-month variations. However, such prices outline a gradual cooling throughout this year and even more intensely in 2010. The explanation for the difference in the behavior of relative prices of services in this episode of contraction is probably due, on one hand, to the warming of the labor market in the period prior to the crisis and, on the other, to the effect of the global economic downturn on prices of tradable goods.

Credit, monetary and fiscal policies

3

Table 3.1 – Credit operations

						R$ billion
Itemization	2009				% growth	
	Jan	Feb	Mar	Apr	3 months	12 months
Total	1 229.4	1 229.1	1 242.7	1 249.0	1.6	22.7
Nonearmarked	871.5	866.8	875.8	878.8	0.8	21.2
Earmarked	357.9	362.3	366.9	370.1	3.4	26.4
% participation:						
Total/ GDP	41.5	41.9	42.6	42.8		
Nonearmarked/GDP	29.4	29.5	30.0	30.1		
Earmarked/GDP	12.1	12.3	12.6	12.7		

Figure 3.1 – Credit by capital control of financial institutions

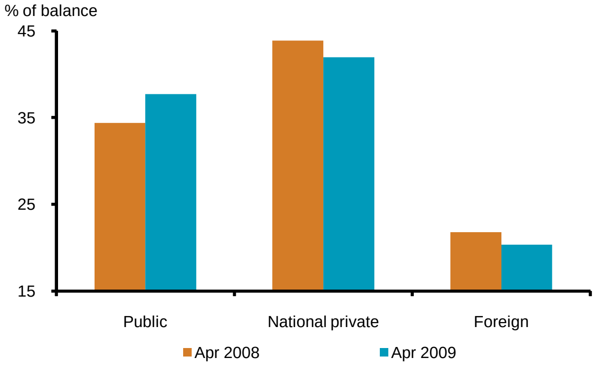
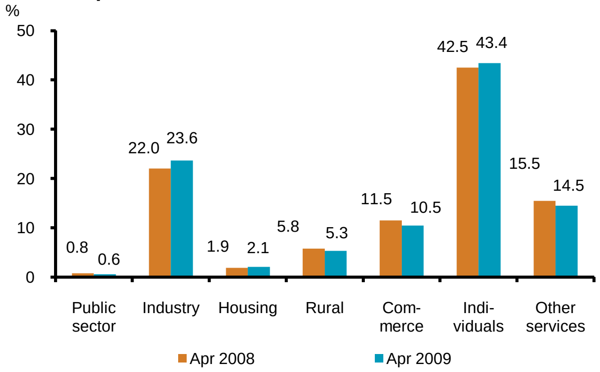


Figure 3.2 – Credit by borrower's economic activity – National private institutions



3.1 Credit

In the 3-month period ended in April, the credit growth was still conditioned by the pace of economic activity. Accordingly, the demand for credit by corporations reflected the scenario of uncertainties associated with the recession observed particularly in mature economies, as well as the recent retreat in the level of capacity utilization in the country. It also reflected the seasonality of the period, expressed in the accommodation of hirings by the trade segment. On the other hand, household demand registered a gradual recovery, driven by the trajectory of the payroll-deducted loans and purchase of vehicles modalities. Earmarked credit operations, notwhithstanding the slowdown observed in comparison to the previous 3-month periods, driven by home financing, showed a more enhanced dynamics in comparison to those contracted in the segment of nonearmarked resources.

In this environment, the financial system loans, including earmaked and nonearmarked resources, totaled R$1,249 billion in April, increasing 1.6% from January and 22.7% in twelve months. The credit/GDP ratio reached 42.8%, rising 1.3 percentage points in the period and 7 percentage points compared to April 2008.

With regard to the distribution of credit according to the capital control of financial institutions, the share of public sector banks moved upward, accounting for 37.7% of the total in April, compared to 36.5% in January and 34.4% in the same period of 2008. The participation of national private institutions reached 41.9% and that of foreign banks, 20.4%, compared to 42.7% and 20.8%, in January, and 43.9% and 21.7% in April of the previous year.

The balance of loans granted to the private sector, considering earmarked and nonearmarked resources, totaled R$1,221 billion in April, increasing 1.6% from January and 22.2% over the same period in 2008. Loans granted to the industry, driven by the buoyant segments of energy,

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

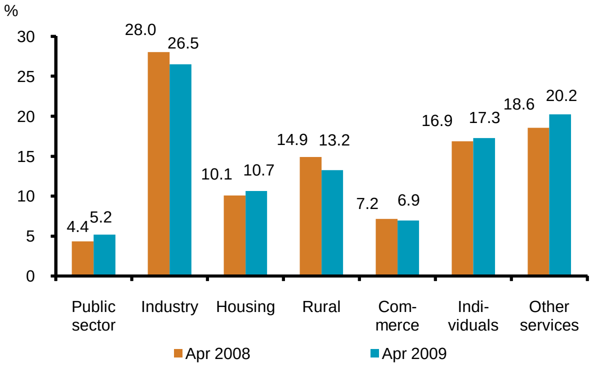


Figure 3.4 – Credit by borrower's economic activity – Foreign institutions

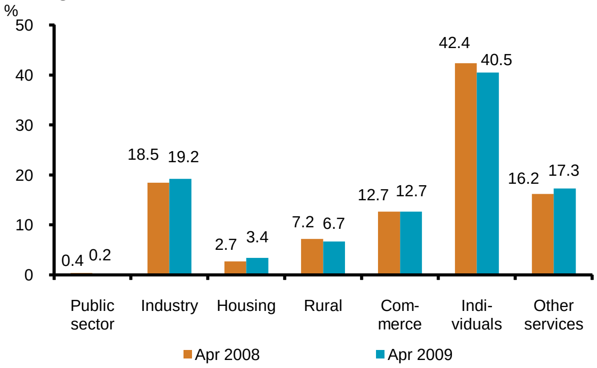


Figure 3.5 – Provisions of total financial system credit

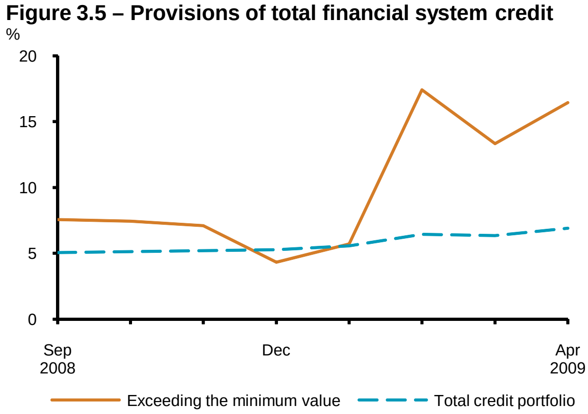


Table 3.2 – Earmarked credit operations

R$ billion

	2009				% growth	
	Jan	Feb	Mar	Apr	3 months	12 months
Total	357.9	362.3	366.9	370.1	3.4	26.4
BNDES	209.9	212.6	215.4	216.5	3.1	27.3
Direct	108.1	110.7	112.7	112.5	4.1	37.0
Onlendings	101.9	102.0	102.7	104.0	2.1	18.3
Rural	78.2	78.1	78.2	78.6	0.5	14.9
Banks and agencies	73.2	73.1	73.2	73.4	0.3	13.8
Credit unions	5.0	5.0	4.9	5.2	4.8	34.4
Housing	60.9	62.6	64.1	65.7	8.0	40.2
Others	8.9	9.0	9.2	9.3	5.2	23.5

chemicals and agribusiness, increased 1.1% in the period, reaching R$297.4 billion. Conversely, the operations related to the sector of trade and services decreased by 2.3% and 2.1%, amounting to R$119.8 billion and R$215.1 billion, respectively.

Financing to the public sector totaled R$28.3 billion in April, an increase of 2.4% in the 3-month period and 45.2% in twelve months. The federal government's bank debt decreased by 0.6% in comparison to January, to R$9.5 billion, while the portfolios referring to states and municipalities, reflecting the contracts of the sectors of housing, transportation and energy, with resources from the Employment Guarantee Fund (FGTS), grew 3.9%, to R$18.8 billion.

The amount of provisions set aside by the financial system totaled R$85.7 billion in April, representing 6.9% of the total portfolio, compared to 5.5% in January and 5.4% in the same period in 2008. The default rate of the financial system loans, related to delays of more than ninety days, closed at 4%, registering variations of 0.7 percentage points in the 3-month period and 0.9 percentage points in twelve months.

Credit operations with earmarked resources

The balance of loans in the segment of earmarked resources totaled R$370.1 billion in April. Expansions in the 3-month period, 3.4%, and in twelve months, 26.4%, reflected increases of 8% and 40.2% in the housing segment. The balance of operations of the Brazilian Bank for Economic and Social Development (BNDES) totaled R$216.5 billion, a growth of 3.1% in the 3-month period and 27.3% in twelve months.

Rural credit operations, except those performed by the BNDES, totaled R$78.6 billion in April, rising 0.5% in the 3-month period and 14.9% in twelve months. The participation of funds related to agricultural investments, funding and marketing operations reached, in the order, 48.6%, 42.1%, and 9.3% of the total, remaining at the same level observed in January.

Housing loans amounted to R$65.7 billion in April, rising 8% in comparison to February and 40.2% in twelve months. Disbursements carried ou with funds from savings accounts reached R$5.8 billion in the quarter ended in March, increasing 32.3% over the same period in 2008. This expansion was associated with a 43.7% increase observed in the financing granted in the framework of

Figure 3.6 – Credit to housing with resources from saving deposits – From Dec/2008 to Feb/2009

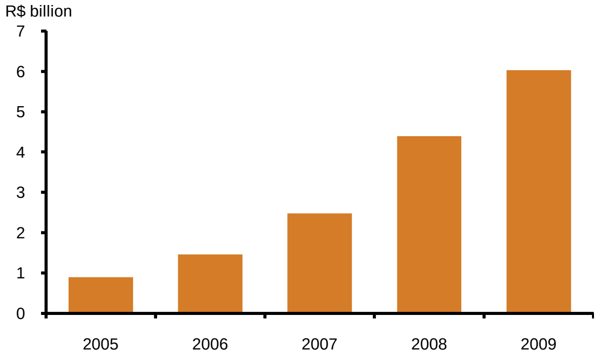


Table 3.3 – BNDES disbursements[1/]

R$ million

Itemization	2008	2009	% growth
Total	25 827	25 634	-0.7
Industry	12 312	10 860	-11.8
Food products	3 399	1 298	-61.8
Vehicle, towing truch and wagon	2 044	707	-65.4
Petroleum and alcohol refining	755	1 647	118.1
Cellulose and paper	399	2 640	561.7
Commerce/services	11 751	13 042	11.0
Overland transportation	4 753	4 639	-2.4
Electricity and gas	2 271	4 029	77.4
Construction	820	1 703	107.7

Source: BNDES
1/ Refers to April.

Table 3.4 – Nonearmarked credit operations

R$ billion

Itemization	2009 Jan	Feb	Mar	Apr	% growth 3 months	12 months
Total	871.5	866.8	875.8	878.8	0.8	21.2
Corporations	472.3	463.0	465.2	462.2	-2.1	22.1
Reference credit[1/]	384.6	385.4	388.1	386.3	0.4	23.5
Domestic funding	296.7	297.8	301.7	304.2	2.5	28.8
External funding	87.9	87.6	86.3	82.0	-6.7	7.2
Leasing[2/]	55.7	50.2	50.5	49.9	-10.4	17.8
Rural[2/]	3.8	3.9	3.9	3.8	1.2	84.8
Others[2/]	28.2	23.5	22.8	22.2	-21.1	3.5
Individuals	399.2	403.8	410.6	416.6	4.4	20.2
Reference credit[1/]	274.5	276.9	281.5	285.7	4.1	10.7
Credit unions	17.1	17.1	17.8	18.0	5.2	30.7
Leasing	57.3	63.0	63.6	64.1	11.9	64.8
Others	50.3	46.8	47.7	48.8	-3.0	35.7

1/ Interest rate reference credit, defined according to Circular n. 2,957 dated 12.30.1999.
2/ Operations backed by domestic resources.

Financial Housing System (SFH), which accounted for 87.4% of the credit granted to the segment in the period, contrasting with a decrease of 14.5% in transactions indexed to market interest rates. Operations involving FGTS totaled R$1.6 billion, rising 20.7% in the period.

BNDES disbursements totaled R$25.6 billion in the first four months of the year, dropping 0.7% over the same period in 2008. This movement reflected the more accentuated impact of the 11.8% decrease in the financing granted to industry, reflecting the slowed demand in the food and vehicles, trailers and bodies sectors as compared to the 11% increase in the financing granted to the segment of trade and services, led by large operations with the electricity and gas segments, and 4.5% with micro, small and medium-sized enterprises.

Consultations formalized with the BNDES, which is an indicator of potential demand for medium and long-term investments, totaled R$77.1 billion in the first four months of the year. The increase of 33.7% over the same period of 2008 largely reflected the increase of 106.8% observed in the consultations from industry, which totaled R$46.3 billion. It should be highlighted the requests from the coke, petroleum and fuel, as well as other transportation equipment sectors. Requests from the segment of trade and services, evincing the drop in the segments of construction and electricity and gas, fell by 14% in the period, totaling R$28.7 billion.

Credit operations with nonearmarked resources

The balance of loans with nonearmarked resources, representing 70.4% of the financial system's credit operations, reached R$878.8 billion in April, rising 0.8% in the 3-month period and 21.2% in twelve months. In the same basis of comparison, the corporate credit operations recorded variations of -2.1% and 22.1%, totaling R$462.2 billion. Of this total, 83.6% occurred in the framework of the referential credit, with emphasis on the performance of operations contracted with domestic resources, which reflected the higher demand by large enterprises for working capital as an alternative to raising funds in foreign markets. Loans backed by foreign funds totaled R$82 billion, decreasing by 6.7%, in line with the foreign exchange appreciation occurred in the period, and 7.2% in twelve months.

Loans to individuals totaled R$416.6 billion in April. Expansions observed in the 3-month period, 4.4%, and in twelve months, 20.2%, reflected, in particular, the

Figure 3.7 – Interest rates on nonearmarked credit

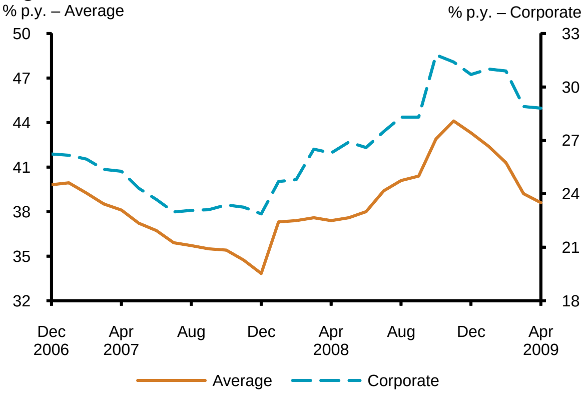


Figure 3.8 – Interest rates on fixed rate credit – Individuals

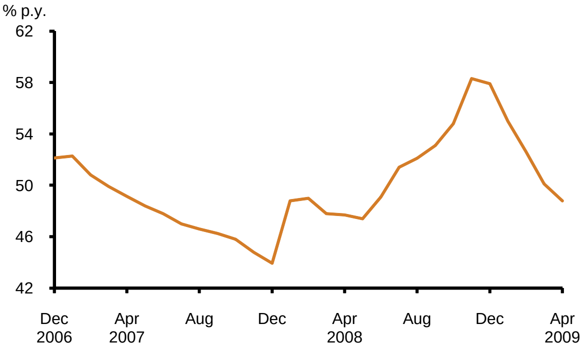


Figure 3.9 – Average spread on nonearmarked credit

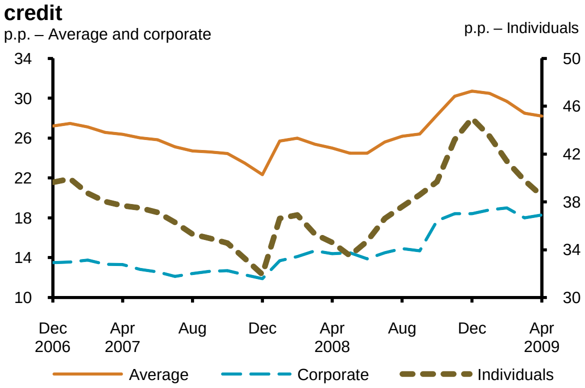
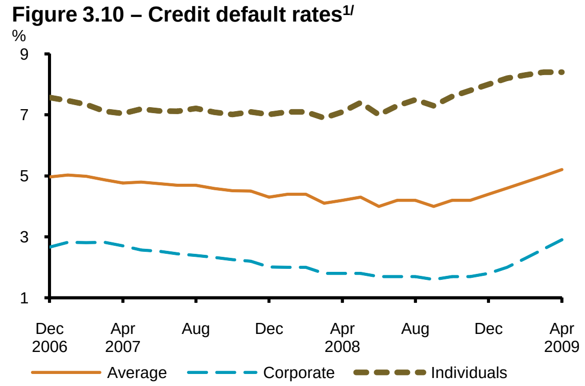


Figure 3.10 – Credit default rates1/



1/ Percentage of the portfolio with non earmarked resources in arrears for more than ninety days.

performance of leasing operations – a consequence of the recovery in the sales of the automotive sector – which totaled R$64.1 billion, an expansion of 11.9% and 64.8% in the same comparison periods.

Operations concentrated in the referential credit segment totaled R$285.7 billion, of which 48.6% related to personal credit, registering respective increases of 7.3% and 23.1%, on the same basis of comparison. Payroll-deducted loans, which accounted for 55.1% of the portfolio of personal loans in the month, increased by 7.5% in the 3-month period ended in April and 21.9% in twelve months. This performance was favored by lower interest rates, which moved downward from 30.8% per year in January to 28.9% per year in April, as well as by the re-establishment of theo 30% threshold for income commitment of retired persons under the INSS.

The average interest rate charged in credit operations reached 38.6% per year in April, dropping 3.8 percentage points in the 3-month period, reflecting reductions in the segment of individuals, emphasing the accentuated decreases observed in personal loans and overdraft accounts, 6.2 p.p. to 48.8% per year, and in corporate loans, 2.2 pp to 28.8% per year. The banking spread closed at 28.2 percentage points in April, registering a reduction of 2.3 p.p. in the 3-month period and a growth of 3.2 percentage points in twelve months. The performance in the period resulted in lower spreads for both the segment of individuals, 5 p.p., and corporations, 0.5 p.p., reaching, in the order, 38.5 p.p. 18.3 p.p.

The credit default rate, maintaining the upward trend began in September 2008, reached 5.2% in April, rising 0.6 percentage points in the 3-month period and 1 percentage point in twelve months. The observed delays in operations related to individuals and corporations represented, in the order, 8.4% and 2.9% of the referential credit of the respective segments, registering variations of 0.2 p.p. and 0.9 p.p, in the 3-month period, and 1.3 p.p. and 1.1 p.p., in twelve months (see box “The Evolution of Default, Indebtedness and Commitment of Household Income”).

3.2 Monetary aggregates

The restricted money supply (M1), considering the concept of average daily balances, totaled R$197.7 billion in May, a decrease of 0.6% in the 3-month period and expansion of 5.4% in twelve months. The annual variation resulted from growth of 13.3% in currency outside banks and 0.2% in demand deposits. According to seasonally adjusted data,

Figure 3.11 – Average term for credit operations – Calendar day

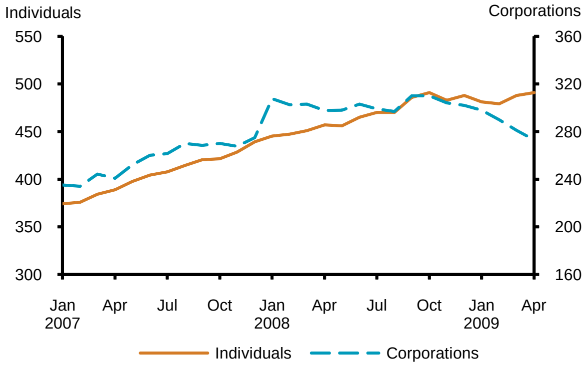


Figure 3.12 – Monetary base and M1 – Average daily balances

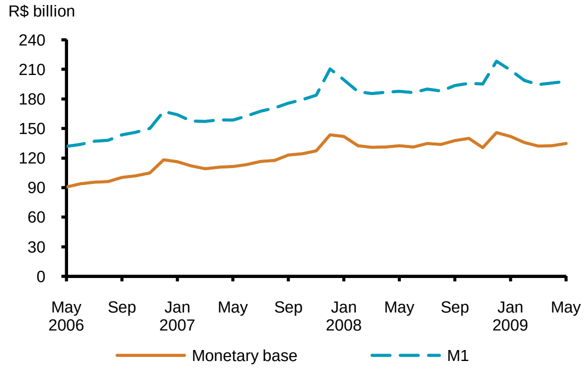
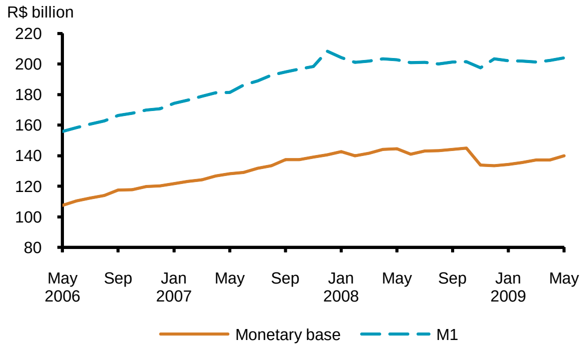
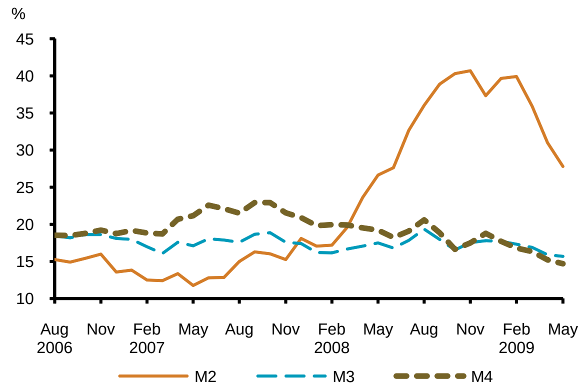


Figure 3.13 – Monetary base and M1 at May 2009 prices seasonally adjusted1/



1/ Deflated by: IPCA.

Figure 3.14 – Broad money supply – 12-month growth



deflated by the IPCA, the M1 grew 1.1% in comparison to February and 0.7% in twelve months.

The average daily balance of the monetary base totaled R$134.8 billion in May, for a 0.8% drop in comparison to February and a 1.6% growth in twelve months. The annual result reflected the impact of the more robust growth of 12.4% recorded in the average balances of currency issued, as compared to the 22.1% falloff in banking reserves, still reflecting the reduction in the rate of reserve requirements on deposits.

With regard to the end-of-period balances, the monetary base totaled R$133.3 billion in May. The retreat of R$2.9 billion in relation to February reflected the contractionary impact of Treasury operations, R$23 billion, and adjustments in operations with derivatives, R$1.9 billion, partly offset by net redemptions of R$10.3 billion in Treasury securities and by net Central Bank purchases of R$11.1 billion of foreign currency in the interbank foreign exchange market.

The CMN, through Resolution no. 3,692, dated March 26, 2009, established the Special Guaranteed Time Deposits (DPGE), a modality for funding time deposits guaranteed up to R$20 million by the Credit Guarantee Fund (FGC), carried out for periods of at least six months and a maximum of sixty months. This Resolution allowed the collection of total deposits worth R$6.8 billion by the end of May. In addition, Resolution no. 3,729, dated May 28, 2009, with the objective of strengthening the predictability of time deposits inflows and outflows, forbidden the partial or complete anticipated redemption of these deposits.

M2, which adds to M1 the investment and savings deposits, as well as the bonds issued by financial institutions, totaled R$1.1 trillion in May, rising 1.3% in the 3-month period and 27.8% in twelve months. Among its components, it should be highlighted the growth in the stock of private bonds, 1.5%, and in the balance of savings deposits, 1.6%, which reached, in the order, R$596.9 billion and R$279,2 billion.

M3, the concept that adds to the M2 the shares of fixed income funds and public securities that back the net position of funding in repurchase agreements between the public and the financial sector, reached R$2 trillion in May, posting increases of 3,6% in comparison to February and 15.7% in twelve months. The M4 concept, which includes the M3 and the government securities held by the nonfinancial public totaled R$2.3 trillion, resulting in respective expansions of 3.3% and 14.7%, on the same basis of comparison (see box "Recent Developments of Key Financial Investments").

Evolution of Default, Indebtedness and Commitment of the Household Income

Figure 1 – Credit operations with individuals – Interest rates and average terms

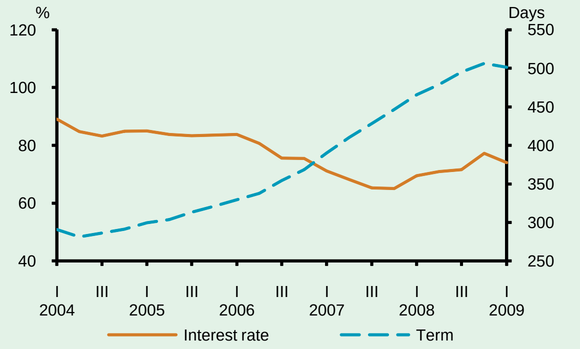


Figure 2 – Credit operations with individuals – Default and grantings

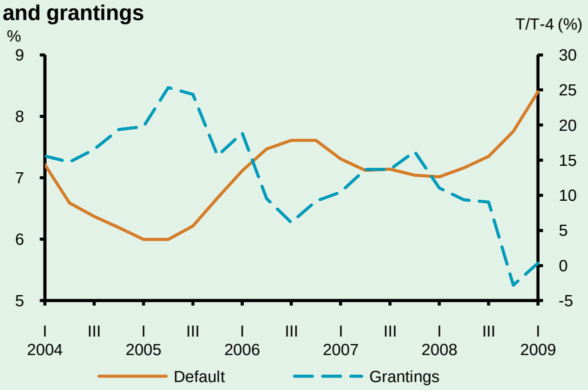


Table 1 – Default

April 2009

Modality	%	Change		
		t-1	t-3	t-12
Individuals	8.4	0.0	0.2	1.3
Special overdraft checks	10.0	0.3	-0.2	1.7
Personal credit	5.7	-0.1	0.0	0.6
Automotive vehicles	5.2	0.2	0.6	1.7
Purchase of goods	14.6	0.4	0.8	1.7

In recent years, the expansion observed in the segment of credit to individuals was led by the dynamism of lower risk modalities, with emphasis on payroll deducted loans and operations targeted to the purchase of vehicles. This trajectory which, as shown in Figure 1, occurred in an environment of reduced interest rates and increase of medium terms, was interrupted as of the intensification of the crisis in financial markets, when in a scenario of deteriorating credit conditions, the external funding became more scarce and expensive and, domestically, liquidity constraints have hindered temporarily the financing of small and medium sized companies in the interbank market.

Additionally, highlighting the aggravation of the balance of risks, financial institutions have promoted an immediate reduction of new hires, with shorter deadlines and rising interest rates, as recorded in Figure 2. In this context, from mid-2008, a rise in default under the credit reference for individuals, which reached 8.4% in April 2009, compared to 7% in December 2007, a move due to general increase in arrears in all credit modalities, especially in personal credit, auto loans and credit card (Table 1).

This set of recent changes in the macroeconomic scenario makes it relevant to revisit the box published in the Inflation Report September 2008 issue, which addressed the trajectory of household indebtedness and the commitment of their income in the period prior to the restriction in the channels of credit.

The compilation of credit statistics was unchanged when compared to the previous survey, also using the quarterly averages of end-of-month balances in the modalities interest rate reference credit, to leasing operations and those carried out by credit cooperatives. As regards the interest rates and the terms of the modalities not belonging to reference credit, proxies were estimated adjusted to tax specificities: to leasing, parameters of the mode of acquisition of vehicles were adopted; for cooperatives, were adopted those ones related to the type of personal credit. Channeled housing credit was not included because of the lack of regular statistics on interest rates and maturities for these operations.

Household income, which is called Extended Overall Wage (MSA), was estimated from the aggregation of the overall wages, calculated in the Monthly Employment Survey (PME),[1] with transfers from the official social security. Similar to the previous study for the final calculation of the MSA, the average of the last four quarters was used to mitigate seasonal effects on income. A methodological change in the compilation of income resulted in achieving higher levels estimated for the indebtedness and commitment of income, since the MSA corresponds to an amount about 20% lower than the one of the indicators used in the previous study.

The household indebtedness was estimated as the ratio of debt stock in a given period and the average income of the previous four quarters. For the construction of an indicator of income commitment, the value of disbursements to the principal, corresponding to the ratio of the balance and the average maturity of the portfolio during that period, was calculated for each modality. In terms of revolving credit, overdraft check and credit card, it was considered only the income commitment for the payment of interest. In addition to the main payments with the estimated debt service, it also includes interest payments, given by multiplying, for each modality, the average monthly interest rate by the respective balance. Finally, the income commitment was obtained by dividing the debt service for the MSA of the respective period. It is important to note that the statistics available to the average maturity of the portfolio does not match the period running until the expiration of the last installment, but the average time of benefits weighted

1/ Since the PME encompasses the metropolitan areas of Belo Horizonte, Porto Alegre, Recife, Rio de Janeiro, Salvador and São Paulo, the indicator referring to the overall national wages was obtained by multiplying the ratio of Brazil GDP to the GDP of each of the six metropolitan areas by the PME's overall wages.

by their respective values. In this concept, the average term of a loan with 24 equal monthly installments will be 12.5 months. In terms of income commitment, the use of the term to come would reflect more faithfully the period in which the borrower is overtaxed by the credit operation. Therefore, it was used in this study the period to come, obtained by the approximation from the medium term.

Figure 3 – Indebtedness and income commitment

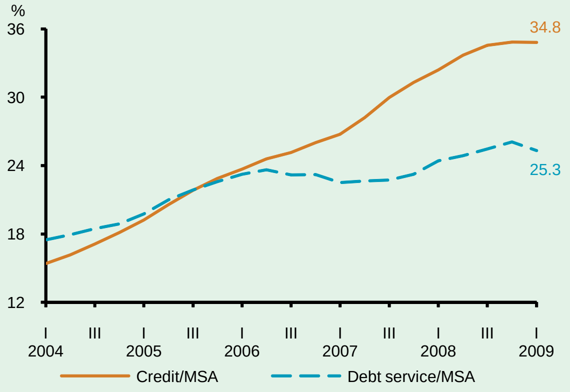
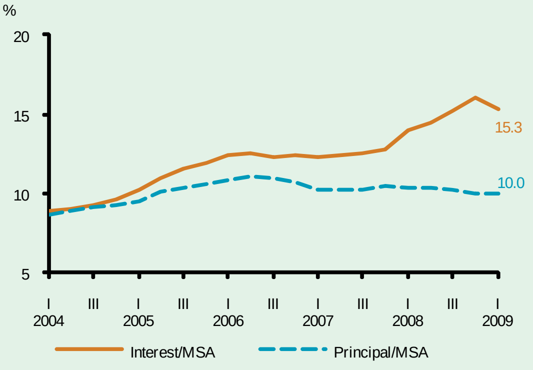


Figure 3 shows the significant increase of the level of indebtedness over the past few years, a movement associated with the very development of the credit market, which was incipient before the consolidation of macroeconomic stability. In March, the level of household indebtedness reached 34.8% of the annual earned income in the last twelve months, recording increases of 2.4 p.p. over the same period of the previous year and of 8.1 p.p. over the past two years. From the third quarter of 2008, the indebtedness starts to present a deceleration trend, a behavior consistent with the slowing of hires.

Figure 4 – Income commitment with interests and principal



The income commitment level with the debt service, reached 25.3% in March, dropping 0.8 p.p. in the quarter, recording increases of 0.9 p.p. in twelve months and of 2.8 p.p. in two years, as expressed in Figure 4. This indicator evolves in a less remarkable manner, reflecting the combined effects of changes in balances, terms and interest rates. In this sense, the income commitment decreased from the second quarter of 2006 and the first quarter of 2007, when the increase in time and the reduction in interest rates offset the expansion of credit. From mid 2007, the indicator began to record growth, mainly explained by the rapid expansion of sales. Throughout 2008, this growth rate became more pronounced, driven particularly by high interest rates. In 2009, there was further decline, primarily explained by lower rates.

The analysis of the income commitment from its components shows that the amount paid regarding the principal remains relatively stable over the past two years, which indicates that balances respond more slowly to overcooling in grants and lengthening of terms. Different behavior is shown by the commitment resulting from interest payments, which showed expansion, interrupted only in early 2009, when it was observed a decline of 0.8 p.p., reflecting the impact of monetary policy on bank interest in this period.

As in the study published in September 2008, it is important to note that the estimated construction of the indicators requires the adoption of various hypotheses and assumptions, besides the subjection to significant limitations. Therefore, the focus of the analysis should be on the behavior of these indicators over time, in its variations and trends rather than on their absolute levels. Even with these reservations, it should be noted that, as shown by Figures 2 and 3, the latest indicators of income commitment show stability and fall, indicating a cooling off of the growth trend of the household leverage.

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

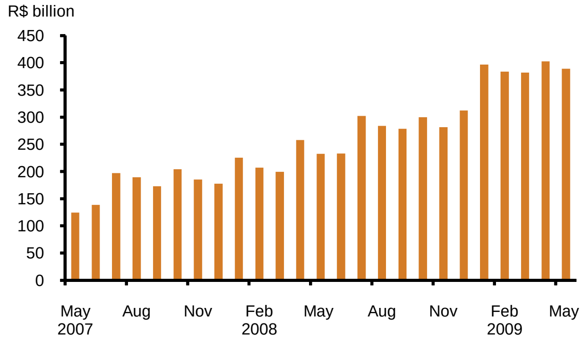


Figure 3.16 – Central Bank repo operations – Maturity – Aveage daily balances

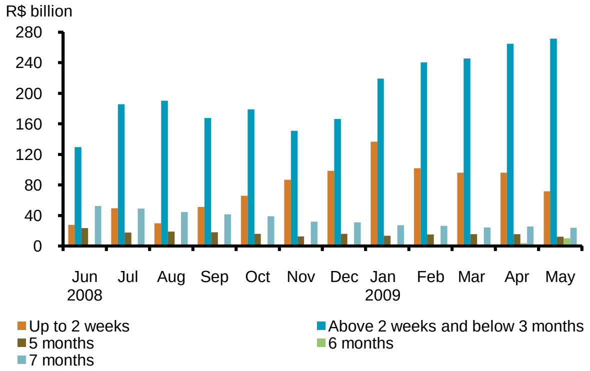
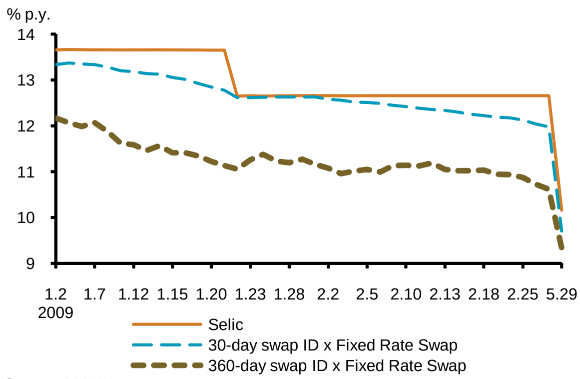
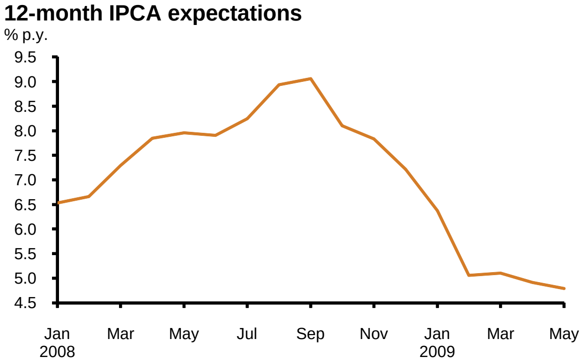


Figure 3.17 – Interest rate



Source: BM&F

Figure 3.18 – Ex-ante real interest rate – Deflated by 12-month IPCA expectations



Federal public securities and Central Bank open market operations

The monetary impact of Treasury primary operations with federal securities grew R$17.3 billion in the 3-month period ended in May, with placements totaling R$82.2 billion and redemptions, R$99.5 billion. Swap operations, concentrated in National Treasury Notes – Series B (NTN-B), reached R$9.1 billion, while anticipated redemptions totaled R$4.8 billion.

The Central Bank net financing position in the open market, based on the average daily balances, totaled R$389.3 billion in May, increasing 1.4% in comparison to February. The average short-term operations decreased from R$101.8 billion in February to R$71.8 billion in May, while those relating to transactions with maturities of five and seven months declined from R$15.1 billion and R$26.3 billion, respectively, to R$12.1 billion and R$23.8 billion. Conversely, medium-term operations from two weeks to three months increased from R$240.7 billion to R$271.6 billion in the period. In addition, operations with 6-month terms at the start of the period reached R$10.1 billion in May. These movements largely reflect a renewed confidence by financial agents, after the deterioration of the expectations inherent to the international financial crisis.

Real interest rates and market expectations

The curve of future interest rates for contracts of swap DI x fixed-rate, maintaining the trend observed since the last quarter of 2008, shrank in all vertices in the 3-month period ended in May (compared to February), with emphasis on the reductions observed in the rates for contracts with maturity of less than 360 days. This movement, consistent with expectations of persintent reduction in the benchmark interest rate, was also evident in the decline of 128 basis points observed in the period to 9.3% per year – the lowest level of the series – related to the rate for contracts of 360 days, the most traded on the BM&F.

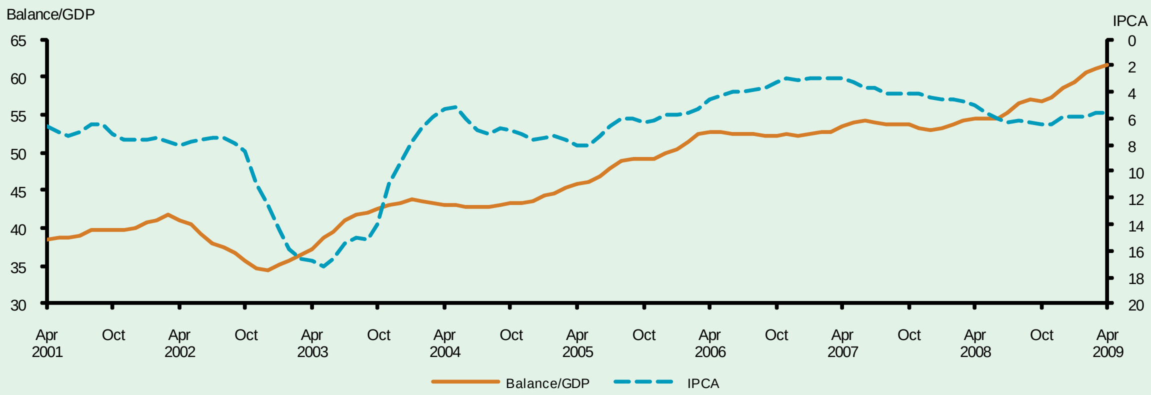
The real Selic rate ex-ante for the next twelve months, calculated by the Central Bank Market Report surveyed on May 29, reached 4.8% per year – the lowest value of the series, compared to 5.1% per year at the end of February. This movement reflected the larger impact of a reduction of 9.88% per year to 9.09% per year on expectations for the 12-month Selic rate, compared to the decrease of 4.57% per year to 4.14% per year on the IPCA expectations.

Recent Developments of Key Financial Investments

The main of financial investment available in the domestic market – savings accounts, investment funds and time deposits – have been posting altogether a significant expansion of inflows in recent years, movement associated, especially, with the increasing macroeconomic stability. The evolution of these investments, expressed as a proportion of GDP, is in Figure 1, which shows both the decline recorded in the second half of 2002, in response to the instability related to political transition, and the cooling observed from July 2007 associated with the impact of the subprime crisis in the U.S.

Figure 1 – Financial investments – Balance/GDP

%



The evolution of the balances and net borrowings of the three financial investments (Figures 2 and 3) clearly expresses the impact of financial instability, as well as institutional factors that determine significant moves by investors. The most significant event in this regard was the establishment of reserve requirements on interbank deposits from leasing companies in January 2008, through Circular no. 3,375, which aimed to match the fundraising by such companies, through the issuance of debentures to time deposits, in respect to the levying of gatherings. This measure prompted the gathering of CDBs (Bank Deposit Certificates), from March 2008, which accumulated the expansion of 97.4% during the two years period ended in May 2009, totaling R$300.9 billion.

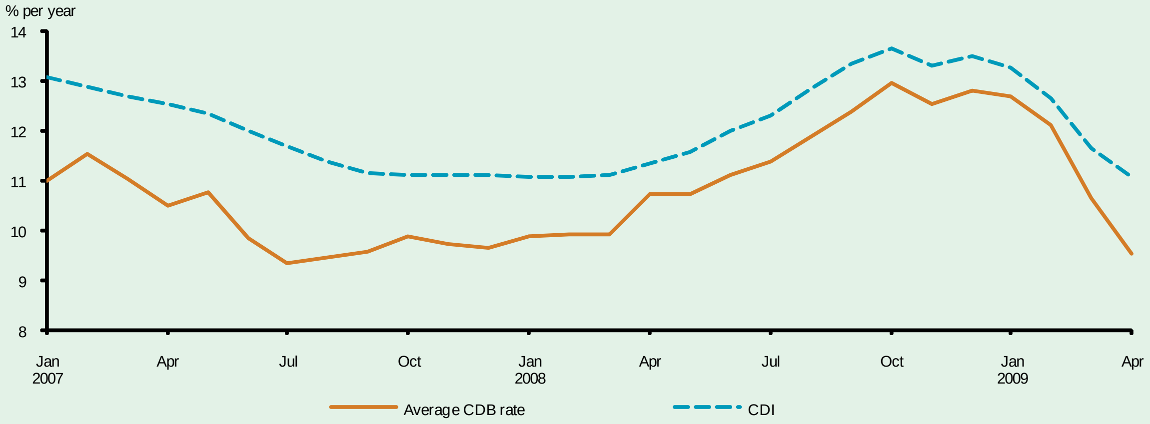
Figure 2 – Financial investments – Balances
R$ billion

Figure 3 – Financial investments – 12-month accumulated net flows
R$ billion

The funding inflow requirements by the banking system in an environment of greater resource scarcity, and until September 2008, strong credit growth, required an increased CDB's earnings rate, which were very close to the rate of CDBs between March 2008 and February 2009. However, the successful measures taken by the Central Bank as of September 2008, aiming at providing liquidity to markets, facilitated the decline of the average funding cost to 9.5% per year in April, a level lower than the one recorded in the end of 2007 (Figure 4).

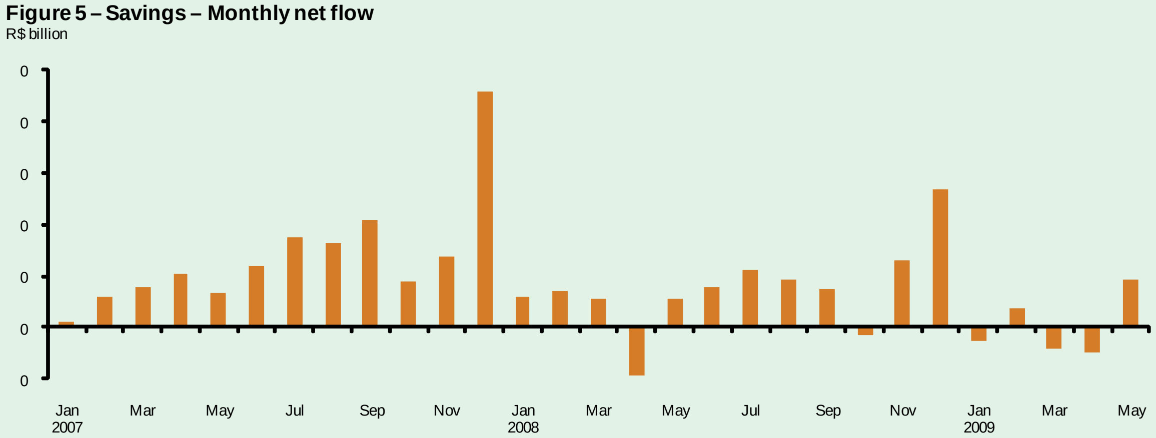
Deposits in savings accounts grew 39.3% between May 2007 and May 2009, a period during which the net inflows totaled R$45.1 billion (Figures 2 and 3). In 2009, net outflows recorded in January, March and April were offset by net inflows of R$1.9 billion in

Figure 4 – CDBs – Yield



May. This resulted in a net inflow of R$357 million in the first five months of the year. The series of monthly net flows confirms the stability of growth of savings deposits, which was interrupted only in April and October 2008 and, due to the effects of the slowdown in the economic activity level in early 2009 (Figure 5). Accordingly, the expected economic recovery should result in continued growth trend of deposits, which, moreover, tends to be stimulated by a favorable profitability from savings in the current outlook of monetary policy. Given the current unprecedented level of interest rates, major changes in borrowings of various instruments can occur and should be closely monitored by authorities.

Figure 5 – Savings – Monthly net flow



Investments in investment funds, including fixed income, short-term, foreign exchange, multimarket and referenced funds, evolved in the opposite direction, accumulating net outflows totaling R$75.2 billion between March 2008 and February 2009, which resulted in an expansion of only 12.2% in its consolidated net worth. The expansion of the balance, despite the negative net flow is explained by the incorporation of profitability to the amounts invested. The negative net inflow was due to the expansion of the uncertainties perceived in financial markets, which resulted in the search for applications with greater predictability regarding their remuneration. Throughout 2008, the biggest losses occurred in fixed-income funds and in hedge funds, a segment that tends to provide larger variations in its profitability as a result of greater diversity of assets that comprise their portfolios. From January 2009, however, the net flow of investment funds became positive, driven by recoveries of fixed-income funds, short-term and multimarket funds (Figures 6 and 7).

Figure 6 – Investment funds – Monthly net flows

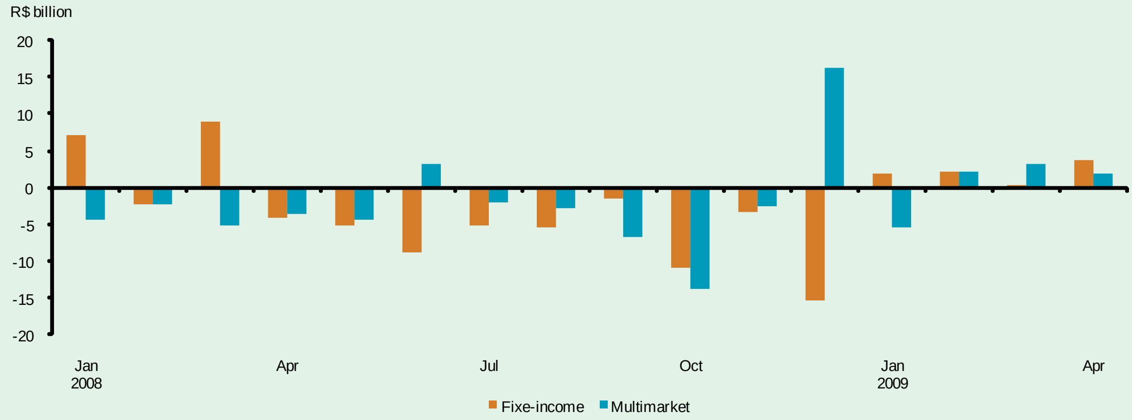


Figure 7 – Investment funds – Monthly net flows

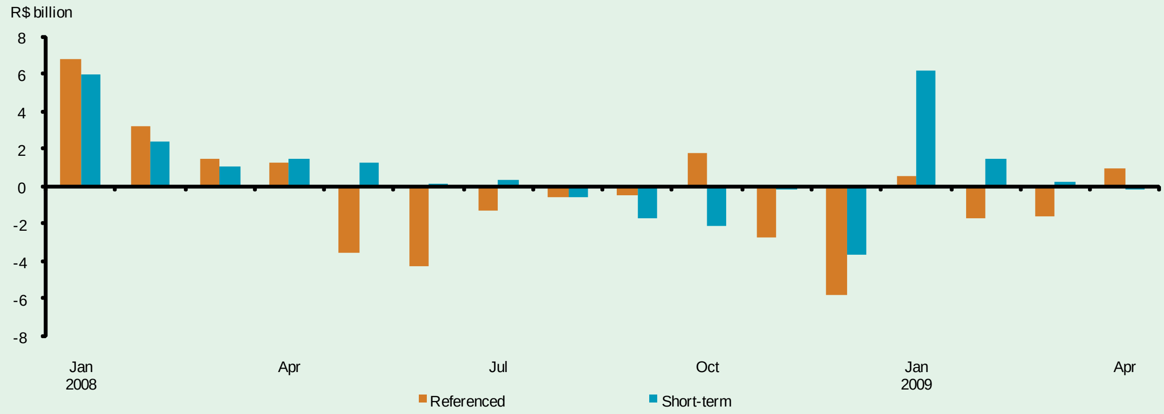


Figure 6, which has a time span that covers both the moment of euphoria as a result of granting the degree of investment to Brazil and the worsening of the international financial crisis, shows net redemptions in fixed-income funds and multimarket funds in almost all the months in 2008. In cumulative terms for the year, a combination of factors involving the relative attractiveness of other financial investments, especially of time deposits, besides fluctuations in preference for liquidity and uncertainties, have contributed to the occurrence of net redemptions of R$46 billion and R$28.7 billion, respectively, in these two asset classes. The other classes of funds did not display the same uniform behavior throughout the year. In early 2008, growing uncertainties increased the demand for quotas of referenced funds and short-term funds. This scenario was reversed in recent months, during the most critical period of the international crisis, due to the renewed expansion of instability in the financial markets (Figure 7).

Stock funds have accumulated a net inflow of R$26.6 billion between May 2007 and May 2009, reaching a balance of R$129.5 billion. This form of investment received large inflows of resources in the first half of 2008, being highlighted the monthly net inflow of R$4.7 billion in June, following the announcement of investment grade for Brazil (Figure 8). In the second half-year, despite the unfavorable performance of the stock market, there was the occurrence of massive withdrawals of these investments. This fact demonstrates the maturity of the Brazilian investors who avoid making investment decisions based solely on very short-term scenarios.

Figure 8 – Stock funds – Monthly net flows

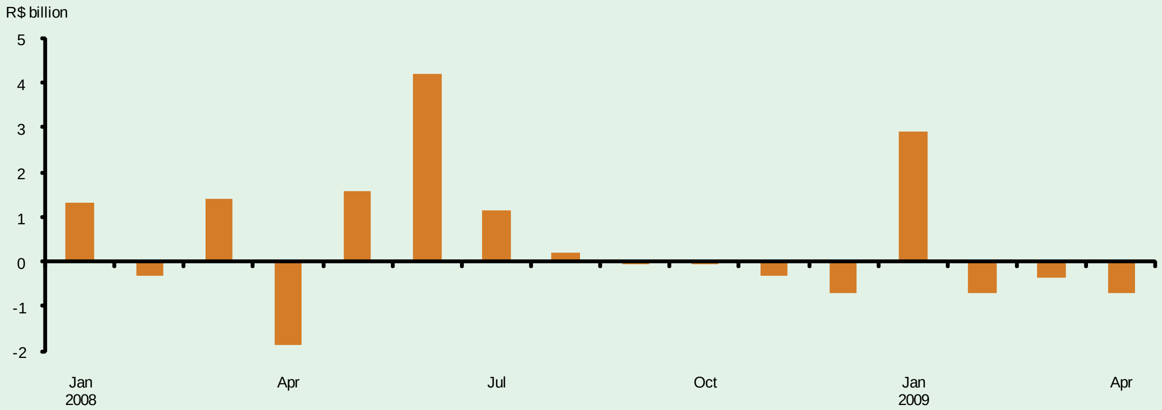
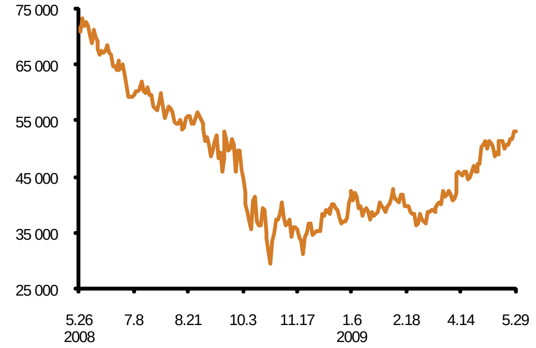


Figure 3.19 – Ibovespa
Points



Source: Bovespa

Figure 3.20 – Stock exchanges
July 2008 = 100

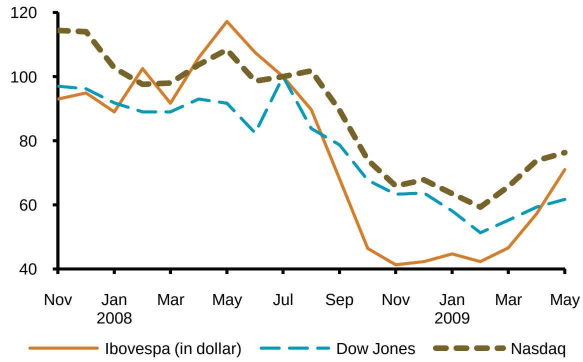
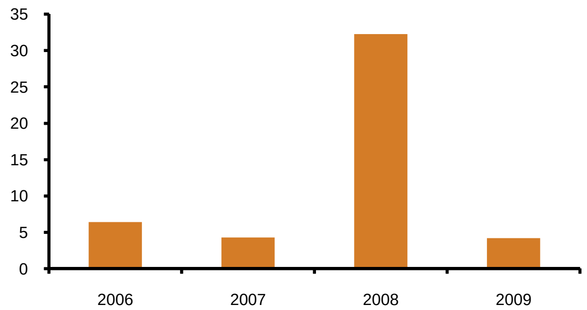
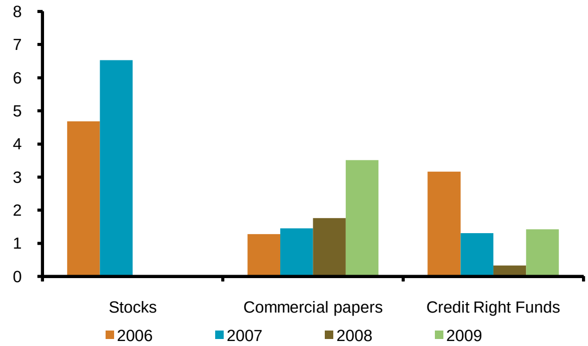


Figure 3.21 – Debenture primary issues in the capital market
R$ billion – Accumulated through May



Source: CVM

Figure 3.22 – Primary issues in the capital market
R$ billion – Accumulated through May



Source: CVM

Capital markets

The São Paulo Stock Exchange Index (Ibovespa), showing signs of recovery in the domestic activity and the return of foreign capital inflows, accumulated successive increases in the 3-month period ended in May, when the average daily volume traded on the Bovespa rose 23 2% in comparison to February. The Ibovespa reached 53,197 points at the end of May, for a a 39.3% growth in the 3-month period. In this period, the market value of listed shares increased by 28.1%, closing at R$1.81 trillion.

The Ibovespa, measured in dollars, grew 67.9% in the 3-month period ended in May, aided by the persistent dollar appreciation observed in the period. In the United States, the Dow Jones and Nasdaq, influenced by more positive expectations in relation to the effects of the international financial crisis, rose respectively 20.4% and 28.8% in the same comparison period.

Business financing through issues of shares, debentures, promissory notes and placement of receivables-backed rights totaled R$9.1 billion in the first five months of 2009 compared to R$49.2 billion in the same period in 2008. This movement reflected, in particular, sharp reductions in issues of registered debentures, from R$32.6 billion to R$4.2 billion, and promissory notes, from R$8.8 billion to R$3.5 billion.

3.3 Fiscal policy

In March, in an attempt to ensure more favorable conditions for the recovery of domestic economic activity, the federal government expanded the temporary tax relief measures implemented in December 2008. In this sense, temporary reductions in IPI rates on several construction products were introduced and the original deadline set for the reductions related to the acquisition of new cars and trucks was extended by three months.

Moreover, in order to mitigate the impacte of the lower collection of federal taxes on funds transferred to regional governments, the Federal Government released, in the month of May, a measure that guarantees in 2009 the maintenance of the nominal value of resources transferred to municipalities in 2008 under the Municipalities Participation Fund.

Also in the month of May, the Ministry of Planning announced updated forecasts of Central Government nonfinancial revenues and expenditures for 2009. Net Treasury income was revaluated to R$439.4 billion, representing a decrease of R$9.4 billion compared to estimates released in March. Conversely, the projections for Treasury obligatory expenditures and to Social Security benefits were increased, respectively, by R$3.1 billion and R$2.1 billion. These revisions, coupled with a reduction of R$23.7 billion for the primary surplus target provided an increase of R$9.1 billion in the Federal Government discretionary expenditures. It should be highlighted that the government had announced in March, as a preventive measure, a R$21.6 billion reduction of expenditures.

It should be mentioned that the reduction from 3.8% of GDP to 2.5% of GDP introduced in the primary surplus target for the public sector incorporates the exclusion of the Petrobras Group from the fiscal statistics (see Box: "The Trajectory of the PSND/GDP Ratio").

Public sector borrowing requirements

The public sector primary surplus, excluding the Petrobras Group, totaled R$30.8 billion in the first four months of 2009, accounting for 3.32% of GDP. The reduction of R$32.1 billion in comparison to the same period of the previous year, when it accounted for 7.01% of GDP, reflected widespread retractions in all public sector components, with emphasis on the decrease of R$26.3 billion recorded by the Central Government. The surplus accumulated in twelve months up to April reached 2.54% of GDP, 0.04 percentage points above the target set for the year.

Table 3.5 – Public sector borrowing requirements – Primary result

Segment	2007		2008		Apr 2009	
	R$ billion	% GDP	R$ billion	% GDP	R$ billion	% GDP
Central Government	-59.4	-2.3	-71.3	-2.5	-22.4	-2.4
Sub-national governments	-29.9	-1.2	-30.6	-1.1	-9.6	-1.0
State companies	-0.4	-0.0	-4.5	-0.2	1.2	0.1
Total	-89.7	-3.5	-106.4	-3.7	-30.8	-3.3

The decline registered in the Central Government surplus reflected both a decrease of R$23.7 billion, 2.78% of GDP, observed in the Federal Government result due to a combination of reduced revenues and increased expenditures, and a growth of R$2.6 billion, 0.24% of GDP, reported in the Social Security deficit, due to the larger impact of increased expenditures with the payment of benefits as against the expansion of revenues.

National Treasury revenues decreased 5.2% in the first four months of the year over the same period in 2008, a performance related to the effects of the global economic crisis on the level of economic activity and fiscal waives associated with temporary tax incentives implemented by the government.

Figure 3.23 – National Treasury gross revenue
Jan-Apr

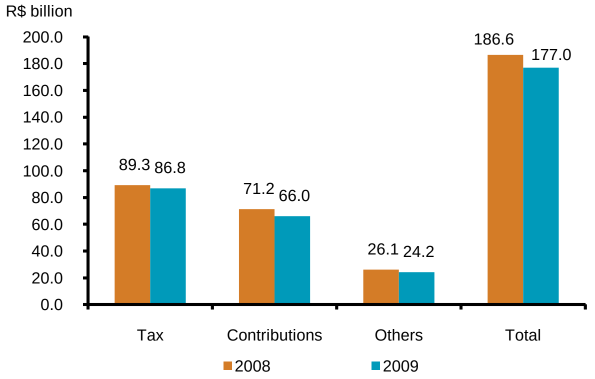
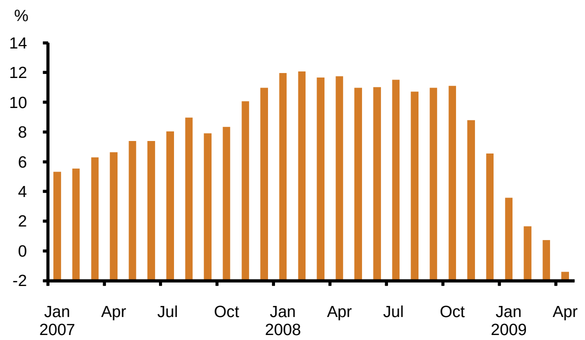


Figure 3.24 – 12-month real growth rate of Treasury revenues[1/]



1/ Updated by IPCA.

Table 3.6 – National Treasury Expenditures
Jan-Apr

Itemization	2008		2009	
	R$ million	% GDP	R$ million	% GDP
Total	82 991	9.3	102 115	11.0
Personnel and payroll charges	40 184	4.5	49 921	5.4
Capital and current expenditures	42 559	4.7	51 840	5.6
Workers Support Fund	4 852	0.5	6 790	0.7
Subsidies and economic	1 648	0.5	587	0.7
subventions	1 648	0.2	587	0.1
Loas/RMV	4 994	0.6	6 051	0.7
Investment	5 374	0.6	6 761	0.7
Other capital expenditures	25 690	2.9	31 650	3.4
National Treasury transfers				
to the Central Bank	248	0.0	354	0.0

Source: Minifaz/STN

In this scenario, the collection of Income Tax (IRPJ) decreased by 5.6% in the period, while the resources associated with the Contribution to Social Security Financing (Cofins) and PIS/Pasep recorded respective declines of 9.9% and 5.3%.

IPI revenues decreased by 23.5% in the first four months of the year. The nominal reduction of R$2.9 billion was due to the changes introduced in the rates levied on the automotive industry, in the calculation period of taxes levied on the beverage sector, which was increased from ten days to 30 days, and the impact of the industrial production slowdown observed in period.

Similarly, revenues related to concessions, as a result of bidding for exploration of blocks of oil and natural gas held in March 2008, without correspondence in 2009, and the financial compensation as a result of the reduction in international oil prices, declined by R$4.5 billion over the first four months of 2008.

The collection of the Contribution of Intervention in the Economic Domain (CIDE-Fuels) dropped R$2.2 billion in the four-month period, reflecting a reduction in the rate charged per cubic meter of gas and diesel, as of taxable events of May 2008, as well as of compensation occurred between January and March of the current year.

Conversely, collections associated with the Income Withholding Tax (IRRF), highlighting the growth of labor income and remittances abroad, and the Social Contribution on Net Profits (CSLL), reflecting an increase in the tax rate on financial institutions, registered respective increases of 8.6% and 9.7% in the four-month period, totalling R$3.9 billion.

The real growth rate of federal revenues accumulated in twelve months has moved downward, expressed in the reversal of the 6.5% growth registered in December 2008 over the same period of 2008, to a decline of 1.4% in April.

National Treasury expenditures totaled R$102.1 billion in the first four months of 2009, increasing 23%, equivalent to 1.75% of GDP, over the same period of the previous year. Personnel expenses and payroll taxes rose 24.2% in the period, a performance associated with the impact of the restructuring of careers in the Executive and Judiciary branches, as well as large disbursements of payments referring to judicial demands.

Expenditures related to the Worker Support Fund (FAT) rose 39.9% in the four-month period, due to increases in

Figure 3.25 – Central Government expenditures
Jan-Apr

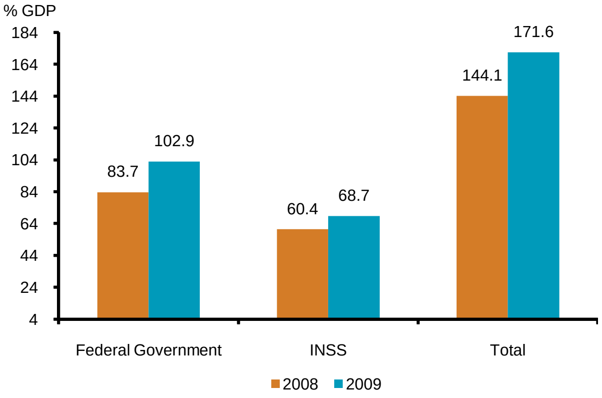


Figure 3.26 – Federal Government: investment expenditures paid
Jan-Apr

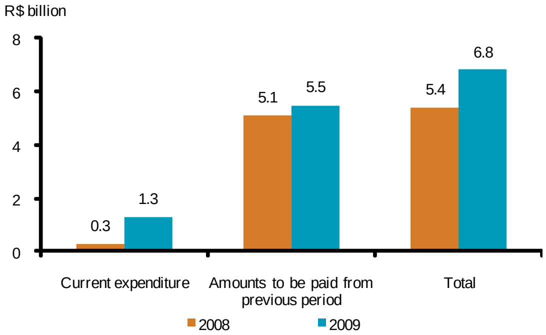


Figure 3.27 – Basic Investment Plan (PPI) expenditures
Jan-Apr

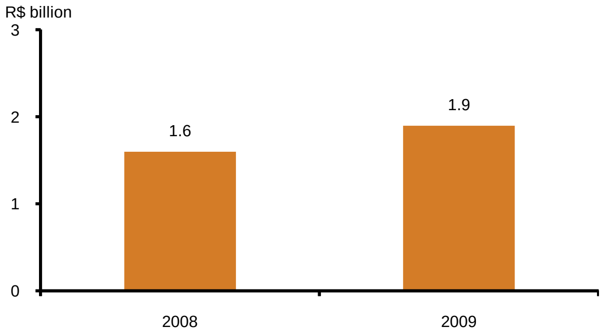


Table 3.7 – Social security primary result
January-April

R$ billion

Itemization	2008	2008	Var. %
Gross inflow	53.9	60.4	12.1
Cash refunds	-0.1	-0.2	100.0
Transfers to third parties	-5.9	-6.7	13.6
Net inflow	47.9	53.5	11.7
Social Security benefits	60.4	68.7	13.6
Primary result	-12.5	-15.2	20.9
Net inflow/GDP	5.3%	5.8%	
Social Security benefits/GDP	6.7%	7.4%	
Primary result/GDP	-1.4%	-1.6%	

expenditures associated with salary bonuses, in line with an increase in the minimum wage and unemployment insurance, a result of the shrinkage recorded in the formal labor market. The increase in minimum wage contributed with an additional 21.2% growth in expenditures on welfare benefits related to the Organic Law of Social Assistance (Loas) and Lifetime Monthly Income (RMV).

Investment expenditures, highlighting the government's effort to raise the GFCF in the country, grew 25.8% in the first four months of the year, totaling R$6.8 billion. The expenditures included in the Pilot Project Investments, subject to a deduction of the primary surplus, increased 18.4%, to R$1.9 billion. O the total expenditures on investments, 80.5% refers to amounts to be paid from previous years.

In relation to expenditures, the reduction of 64.4% in heading allowances and subsidies reflected the net return on operations conducted by the National Development Fund.

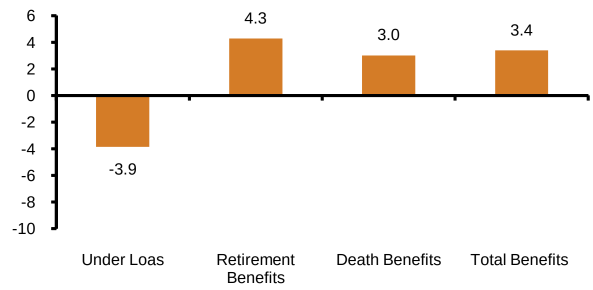
The primary Social Security deficit increased by 0.24 percentage points of GDP in the first four months of 2009, consequent upon an increase of 11.7% in net inflows, due to the increase in contributions on payroll, and a growth of 13.6% in expenditures, resulting from the impact of the minimum wage increase, coupled with the 24.1% growth in the payment of judicial proceedings plus 3.4% in average monthly amount of benefits paid.

Transfers to regional governments totaled R$38.9 billion in the first four months of the year, compared to R$41.9 billion in the same period in 2008, a reduction due to lower revenues of those taxes that make up the constitutional funds, to the international price of oil (which impacts the transfers of royalties), and transfers of the CIDE-Fuels, as a result of the rate reduction and compensation of revenues.

Collections related to the Tax on the Circulation of Goods and Services (ICMS), the main regional tax collection, increased by 3.4% in the first four months of the year, compared to the same period in 2008. The revenues related to the Tax on Automotive Vehicles (IPVA) recorded a growth of 15.3%, on the same basis of comparison.

The primary surplus of states and municipalities totaled R$9.6 billion in the first four months of 2009, falling 0.35 percentage points of GDP over the same period of the previous year, emphasizing the unfavorable outcome observed in the municipal sphere.

Figure 3.28 – Growth in the number of benefits issued by Social Security (Jan-Apr 2009 average/Jan-Apr 2008 average)



Source: STN

Figure 3.29 – Transfers to states and municipalities
Jan-Apr

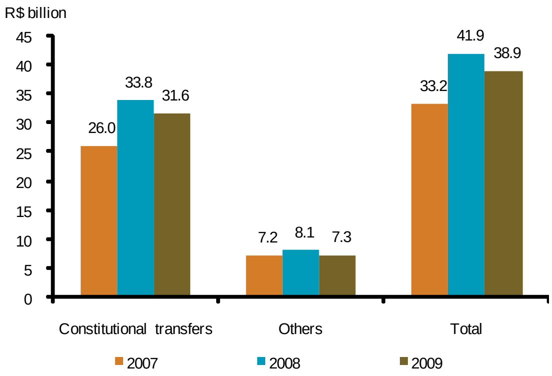


Figure 3.30 – ICMS and IPVA inflow
Jan-Apr

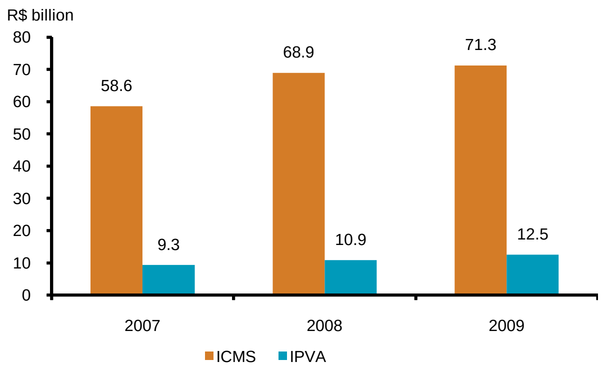
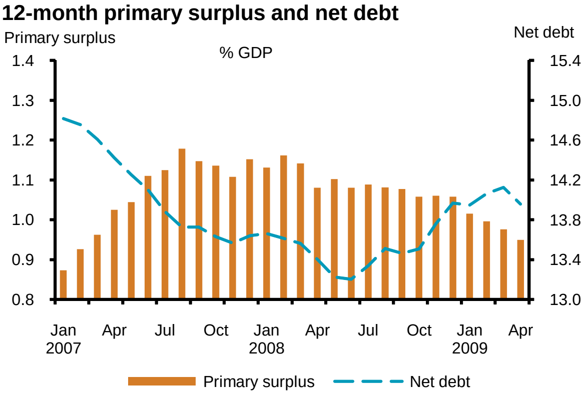


Figure 3.31 – Regional governments: cumulative 12-month primary surplus and net debt



State owned enterprises, excluding Petrobras, recorded a primary deficit equivalent to 0.13% of GDP in the first four months of the year, against a surplus of 0.20% of GDP in the same period in 2008.

The nominal interest appropriated totaled R$52.8 billion in the first four months of the year, compared to R$55.5 billion in the same period in 2008. This reduction, equivalent to 0.49 percentage points of GDP, reflected especially the reversal of the unfavorable result obtained with currency swap operations in the first four months of 2008, while the impact exerted by the monetary easing is expected to be more intense over the next months, considering that the interest accrued during the period still reflect the level of fees charged at the time that monetary policy suited to the environment of the gap between domestic supply and demand.

The public sector nominal deficit reached R$22.1 billion in the first four months of the year, against a surplus of R$7.4 billion in the same period of 2008, equivalent to 3.21% of GDP. The financing of the negative result accumulated in the year reflected, in particular, the expanded domestic debt, equivalent to R$68.7 billion. Conversely, reductions in bank debt and other net domestic financing sources, including the monetary base, were also observed.

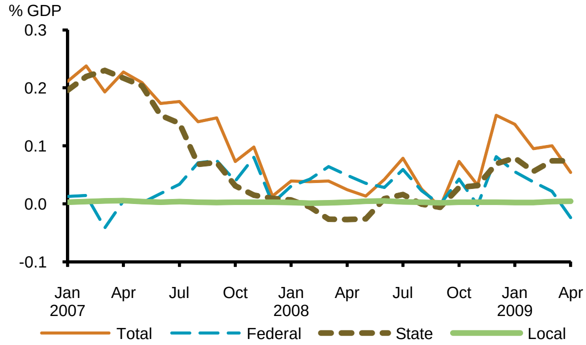
Federal securities debt

The federal securities debt, as measured by portfolio position, reached 43.1% of GDP in April, rising 1.8 percentage points of GDP in comparison to January, for a 0.8 percentage points of GDP reduction as compared to the same period of 2008. This performance reflected the expansion of net issues on the primary market, the financial effects of currency appreciation of 6% observed in the period, and the incorporation of nominal interest of R$33.7 billion.

The participation of securities tied to the Selic rate, indexed to price indices and fixed-rate securities in the total federal securities debt reached, in the order, 29.6%, 23.6%, and 22% in April, compared to 29.4%, 23.4 %, and 21.4% in January, while, conversely, exchange-indexed securities dropped 0.84% to 0.76%.

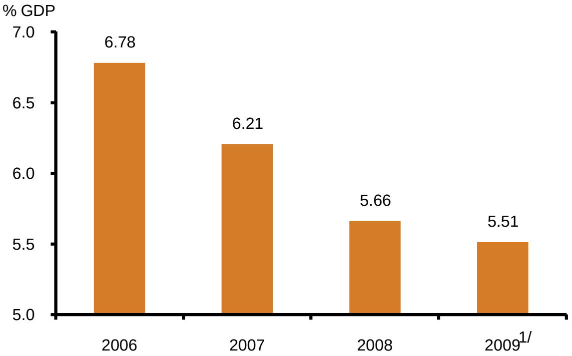
The 2009 Annual Financial Plan (PAF) defined the participation of the indexing factors in relation to total public debt in the following ranges: fixed-rate, from 24% to 31%, price indices, from 26% to 30%, over/Selic rate, from 32% to 38%, and exchange rate, from 7% to 11%. In

Figure 3.32 – Primary surplus of public enterprises
12-month cumulative data



(+) Surplus (-) Deficit

Figure 3.33 – Nominal interest

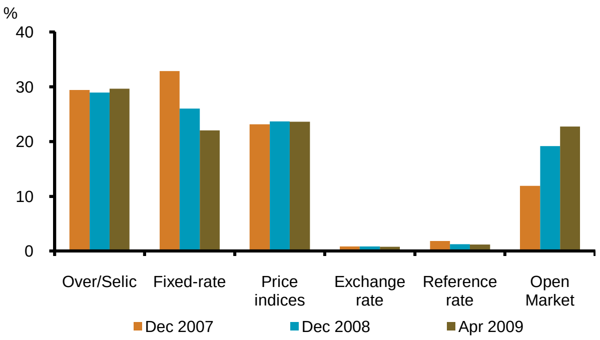


1/ Twelve-month accumulated up to april.

Table 3.8 – Public sector borrowing requirements

Itemization	2007		2008		Apr 2009	
	R$ billion	% GDP	R$ billion	% GDP	R$ billion	% GDP
Uses	71.5	2.8	57.2	2.0	22.1	2.4
Primary	-89.7	-3.5	-106.4	-3.7	-30.8	-3.3
Interest	161.2	6.2	163.7	5.7	52.8	5.7
Sources	71.5	2.8	57.2	2.0	22.1	2.4
Domestic financing	263.5	10.1	82.3	2.8	19.7	2.1
Securities financing	239.4	9.2	171.1	5.9	68.7	7.4
Bank financing	-4.4	-0.2	-92.9	-3.2	-48.1	-5.2
Others	28.5	1.1	4.1	0.1	-0.9	-0.1
External financing	-192.0	-7.4	-25.0	-0.9	2.4	0.3

Figure 3.34 – Federal securities debt structure by indexing factor[1/]



1/ It does not include swap.

April, these percentages reached, respectively, 22%, 23.6%, 29.6%, and 0.8%.

In accordance with the amortization schedule of debt securities on the market, except for financing transactions, 16.4% of the total debt in April matures in 2009; 22.8% in 2010; and 60.8%, in January 2011. This schedule represents a reduction of maturities in comparison to the same period in 2008, when 15% of the outstanding debt matured in the same year, 22.1% the following year, and 62.8% as of the second year.

The maturity schedule for securities maturing in 12 months closed at 27.4% in April, within the range between 25% and 29% established by the PAF for 2009. The average debt maturity reached 40.1 months, lower than the ceiling of 40.8 months set in the PAF 2009.

The result of currency swap operations, defined as the difference between the yield of the Interbank Deposit (DI) and exchange rate plus coupon was favorable to the Central Bank in the amount of R$1.4 billion in the 3-month period ended in April. The cumulative result since the beginning of these operations in 2002 is favorable to the Central Bank in the amount of R$7.1 billion.

Net and gross debt

The public sector net debt reached R$1,207.4 billion in April (41.4% of GDP) rising 2.5 percentage points of GDP in comparison to the end of 2008. The Central Government net debt increased by 2.5 percentage points of GDP in the period, while those relating to regional governments and state enterprises remained unchanged (see box "The Trajectory of the PSND/GDP Ratio").

The increase recorded in the PSND/GDP ratio reflected the impacts associated with the appropriation of nominal interest rates, 1.8 percentage points of GDP, the adjustment resulting from exchange rate appreciation, 0.7 percentage points of GDP, the change of parity of the basket of currencies that compose of the net foreign debt, 0.4 percentage points of GDP, and the drop in the GDP valued by the centered IGP-DI, 0.7 percentage points of GDP, partly offset by the contribution of 1.1 pp of GDP of the primary surplus accumulated in the year.

The participation of the net debt indexed to the Selic rate increased from 58.2%, in December 2008, to 63.3% in April,

The Trajectory of the PSND/GDP Ratio

The Bill amending the Budget Guidelines Law (LDO), 2009, sent to Congress in May, and the Decree no. 6,867, published in the same month, is about monetary and financial programming of the Federal Executive, introducing major changes in the country's fiscal accounts.

In this sense, the companies forming the Petrobras Group[1] are no longer to be considered in the context of fiscal statistics and the target for public sector primary surplus in 2009, evidencing that fact and also the impact of the international crisis on the level of activity and consequently on the level of was reduced from 3.8% of Gross Domestic Product (GDP) to 2.5% of GDP. It should be noted that this reduction considered the purpose of maintaining, over the medium term, the downward trend of the ratio Public Sector Net Debt (PSND)/GDP, an outlook strengthened both by the impact of the current process of monetary easing, and by the establishment of primary surplus target for 2010 at 3.3%.

The aim of this box is to examine the impact of such changes in a scenario of monetary easing and changing market expectations regarding the evolution of exchange rates and of price indices, on the dynamics of PSND/GDP IN 2009 and in the subsequent year. The projections made for the biennium consider as parameters[2] the medians of market expectations disclosed in the Central Bank Focus Bulletin.

1/ The exclusion of Petrobras of fiscal statistics is consistent with its specific characteristics, considering that, in the case of one of the ten largest oil companies in the world, it follows corporate governance rules similar to those experienced by private companies, having the autonomy to raise funds in domestic and foreign markets. By not being part of the fiscal indicators, the company ensures greater autonomy in managing its investment projects, which are fundamental to the development of the country.

2/ See Table1.

Table 1 – Parameters for the projection of the PSND/GDP ratio[1/]

	2008	2009	2010
GDP (% annual growth rate)	5.10	-0.57	3.50
IGP-DI (%)	9.11	1.53	4.50
IPCA (%)	5.90	4.40	4.30
Average Selic rate (%)	12.48	9.84	9.13
Exchange rate (R$/US$) – End-of-period	2.34	2.00	2.00
Primary surplus (% GDP)	3.68	2.50	3.30

1/ Parameters released by the Boletim Focus of 5.19.2009, except the primary surplus.

Figure 1 – Public sector net debt

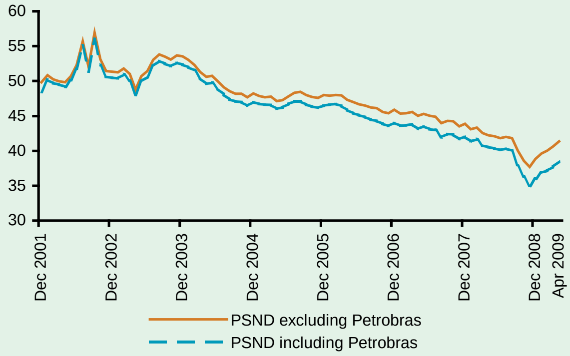
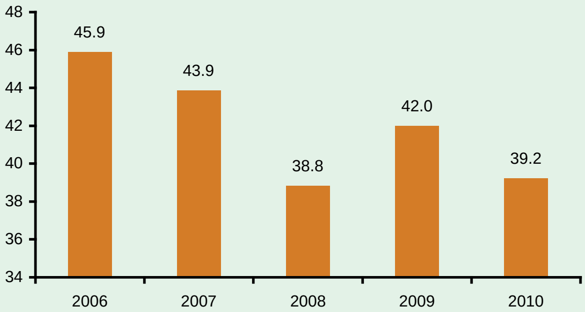
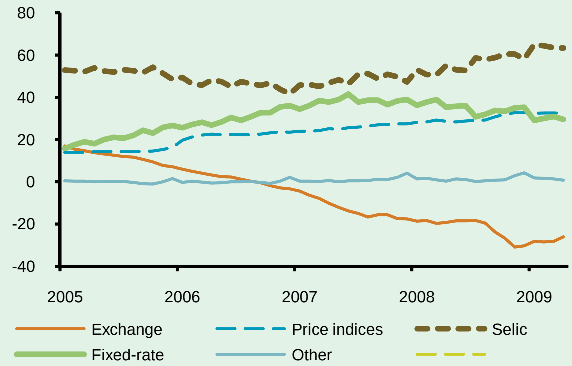


Figure 2 – PSND – Effective and projected data[1/]



1/ Effective data up to 2008 and projected data for 2009 and 2010.

Figure 3 – PSND – Participation by indexing factor



The trajectory of the ratio between PSND and the GDP, with and without the exclusion of Petrobras,[3] is expressed in Figure 1, which shows the downward movement recorded in the two concepts, between late 2003 and 2008, when the indicators began to reflect, in particular, the impact exerted by the international crisis on the evolution of the exchange rate and of the consolidated primary result of the public sector. It is worth mentioning that the level of such ratios is closely matching the period considered, and that their difference reflects the net creditor balance recorded by Petrobras in the period.

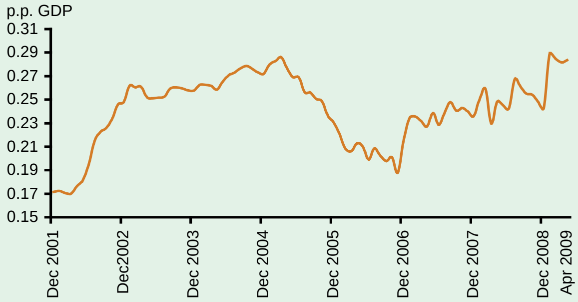
Considering the reprogramming of fiscal targets and the parameters defined in Table 1, the projection of the ratio PSND/GDP in the 2009-2010 period recorded an increase of 3.2 p.p. in the first year, expressed in percentage of 42% reached in December. It should be noted that, although it turns in an increase on an annual basis, the ratio is expected to be in December at a level similar to that observed in April 2009. The representativeness of the net indebtedness to GDP is expected to resume, in 2010, the downward trend recorded in recent years, reaching 39.2% in December, as recorded in Figure 2.

The projection of the ratio PSND/GDP translates, beyond the targets set for the primary result, its sensitivity to interest rates and exchange rates, and to the pace of GDP growth.

The effect of monetary easing on the evolution of the indicator PSND/GDP is primarily associated to the debt composition, recording directly relationship with the participation of securities indexed to the Selic rate in its total. It should be noted that by highlighting the confidence of investors in the country's macroeconomic fundamentals and the policy of the government aiming at separating the national debt from the foreign exchange movements, the share of PSND indexed to the Special System of Clearance and Custody (Selic) has been reporting an increase in recent years, from 41.7% in December 2006 to 63.3% in April 2009, as seen in Figure 3.

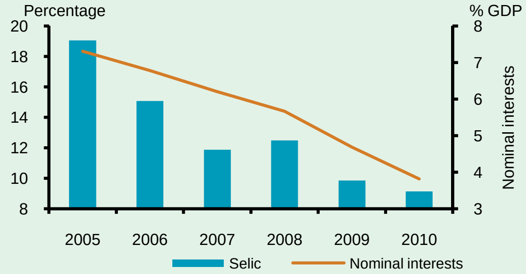
3/ The exclusion of Petrobras from fiscal statistics began to be performed from May 2009. The new primary surplus target for the year considers the new concept.

Figure 4 – Sensitiveness of the PSND/GDP ratio to the Selic rate[1/]



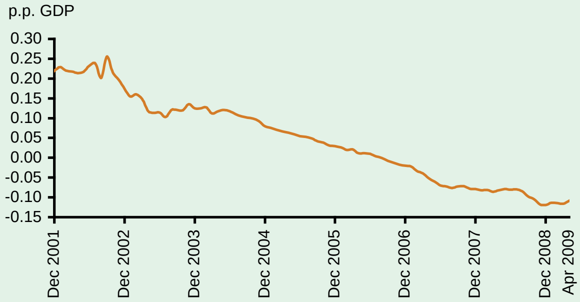
1/ 12-month PSND/GDP ratio change in response to a a positive 1 p.p. change in the Selic rate.

Figure 5 – Appropriated nominal interests and Selic rate[1/]
12-month accumulated



1/ Projected values for 2009 and 2010.

Figure 6 – Sensitiveness of the PSND/GDP ratio to the exchange rate[1/]



1/ 12-month PSND/GDP ratio change in response to a 1% devaluation of the exchange rate (R$/US$).

In this context, a change of 1 p.p. in the Selic rate, considering the possibility of maintaining it in the subsequent twelve months, now provides, in April 2009, a movement, in the same direction, of 0.28 p.p. in PSND/GDP. This means an impact of 0.06 p.p. higher than in the recorded in December 2006 (Figure 4).

One should note, however, that given the existence of significant portion of PSND tied to the price index, 32.3% in April 2009, the total impact of monetary policy on its dynamics is complex. This is because after periods of monetary contraction (expansion), inflation tends to fall (rise), reducing (increasing) the nominal interest incorporated to the debt.

In this scenario, appropriation of 12-month cumulative nominal interests, which also reflects the process of raising interest rates observed in the first three quarters of 2008, considered the market expectation for the Selic rate, will begin to register a declining trend during 2009 and 2010, reaching, in this order, 4.7% of GDP – the lowest percentage since 1997 – and 3.8% of GDP, compared to 5.7% of GDP in 2008, as shown in Figure 5.

The susceptibleness of PSND to the fluctuations in the exchange rate reflects, just as occurred in relation to interest rate, changes experienced by the composition of net indebtedness, which had, by mid-2006, a share linked to the exchange with net debtor balance. Thus, a 1% depreciation in the exchange rate (R$/US$), which, at the end of 2004 determined an increase of 0.08 percentage points in PSND/GDP ratio has come to mean a reduction of 0.11 p.p. in the mentioned indicator (Figure 6). The market scenario projects that the real is expected to record an appreciation of 14.4% in 2009, a movement responsible for variation of 1.4 p.p. in the ratio PSND/GDP and for providing stability in 2010, thus exerting no impact on the indicator. In 2008, depreciation amounted to 32%, accounting for a decrease of 2.6 p.p. of GDP in net indebtedness.

The change in GDP valued by the General Price Index (IGP-DI) Centered should exert a negative contribution to the evolution of PSND/GDP in 2009, 1 p.p., and in 2010, 3.2 p.p., compared to -3.5 p.p. in 2008. The projections reflect, indeed, the impact

Table 2 – Net debt growth[1/]
Conditioning factors

	% GDP		
	2008	2009	2010
PSND – Balance	38.8	42.0	39.2
PSND – % change	-5.0	3.2	-2.8
Factors (accumulated flows in the year):	-1.6	4.2	0.4
PSBR	1.9	2.2	0.5
Primary	-3.6	-2.5	-3.2
Nominal interests	5.5	4.6	3.7
Exchange rate adjustment	-2.6	1.4	0.0
Domestic exchange securities debt[2/]	0.1	-0.1	0.0
Foreign debt – Methodological adjustment	-2.7	1.5	0.0
Other adjustments	-0.9	0.6	0.0
Foreign debt[3/]	-0.9	0.4	0.0
Acknowledgment of debts	0.0	0.2	0.0
Privatizations	-0.0	-0.0	0.0
Effect GDP growth – Debt	-3.5	-1.0	-3.2

1/ In 2009 and 2010, projected data.
2/ Domestic dollar-indexed securites debt.
3/ Parity of the basket of currencies that compose of the foreign net debt.

related to estimates for real growth of the product and of the IGP-DI.

In summary, the projection on the growth of the ratio PSND/GDP in 2009 incorporates the most pronounced effect of reducing the primary surplus target and of the impacts of currency appreciation estimated for the year and of the lower contribution associated with the valued GDP growth in comparison to that provided by the reduction in nominal interest appropriation. The falloff forecasted projected for the 2010 ratio, returning to a level lower than the one recorded prior to the crisis, reflects the atmosphere of recovery in the rate of growth of the product and increase of the primary surplus. The individual contributions of determinants of the evolution of PSND/GDP ratio in the two-year period are shown in Table 2.

It is worth mentioning, therefore, that the projection for the PSND/GDP ratio, essentially based on market parameters, by ensuring the continued reduction of public indebtedness over the medium-term, shows the benign nature of the fiscal measures adopted by the government in order to strengthen relevant sectors to the recovery of the level of internal activity, provided that they are temporary, as the authorities in charge have indicated.

Figure 3.35 – Profile of maturities of the securities debt

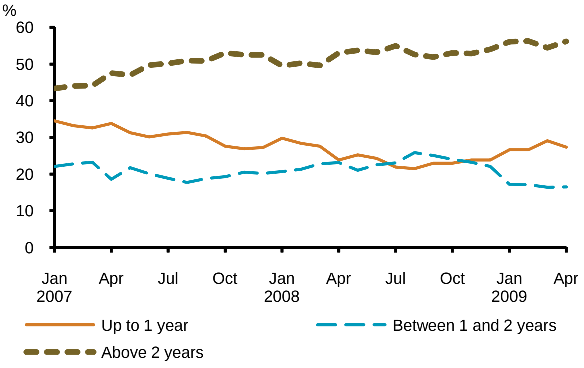


Figure 3.36 – Swap and open market position

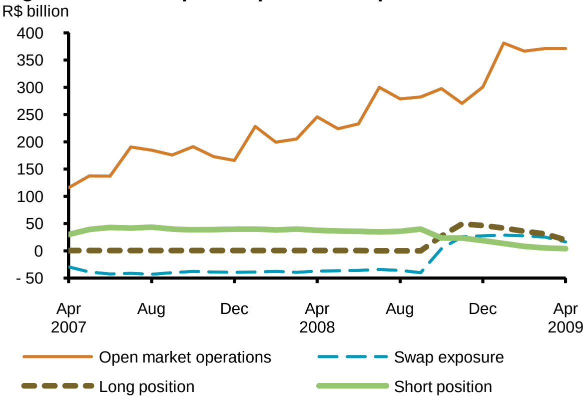


Table 3.10 – Net debt growth

Conditioning factors

Itemization	2007		2008		Apr 2009	
	R$ million	% GDP	R$ million	% GDP	R$ million	% GDP
Total net debt – Balance	1200 799	43.9	1153 631	38.8	1207 377	41.4
Flows	**Accumulated in the year**					
Net debt – Growth	88 098	-2.0	-47 168	-5.0	53 745	2.5
Conditioning factors	88 098	3.2	-47 168	-1.6	53 745	1.8
PSBR	71 492	2.6	57 240	1.9	22 078	0.8
Primary	-89 730	-3.3	-106 420	-3.6	-30 760	-1.1
Interest	161 222	5.9	163 660	5.5	52 838	1.8
Exchange adjustment	21 016	0.8	-77 373	-2.6	20 735	0.7
Domestic securities debt1/	-2 432	-0.1	3 180	0.1	- 915	0.0
External debt	23 449	0.9	-80 553	-2.7	21 650	0.7
Others2/	-2 516	-0.1	-26 404	-0.9	11 227	0.4
Skeletons	- 630	0.0	135	0.0	329	0.0
Privatizations	-1265	0.0	-767	0.0	-624	0.0
GDP growth effect		-5.2		-3.5		0.7

1/ Domestic dollar – Indexed securities.
2/ Parity of the basket of currencies in the net external debt.

while the participation of the fixed-rate net debt and credit position referenced to the dollar decreased, in the order, from 35.3% to 29.6%, and from 30.3% to 26%, in the same comparison period. Also, net issues worth R$66.1 billion of debt tied to the Selic rate and net redemptions of R$74.8 billion in fixed-rate debt were observed.

The General Government Gross Debt (GGGD), which includes the Federal Government, the Social Secutiry and the regional governments, reached R$1,797.1 billion in April, 61.6% of GDP. The growth of 3.0 pp of GDP recorded in December reflected, in particular, the impact of the incorporation of nominal interest and growth in valued GDP, partly offset by exchange rate adjustments due on debts.

3.4 Conclusion

In the 3-month period ended in April, the credit market continued to reflect the slowdown in in the pace of economic activity. Interest rates kept a downward trend, especially in credit operations with individuals, a segment in which defaults remained relatively stable. By contrast, in the corporate credit segment, the reduction in the cost of borrowing was less expressive and the default rate, though at a moderate level, is moving upward since the beginning of the year. The perspective of maintenance of a downward trend for interest rates, consistent with the evolution of default and basic interest rates, should help to restore the credit market, a prerequisite for a sustained economic recovery.

The recent performance of economic activity has been partly conditioned by the impact of temporary tax relief measures implemented in specific sectors for boosting the aggregate demand. In this framework, the evolution of fiscal accounts in the first four months of the year reflected both the effect of reduced activity and the aforementioned tax measures on the government revenues, as well as the impact of the policy of public investments adopted with the objective of promoting the recovery of the stock of capital and expand the aggregate demand.

It should be highlighted that the impact of these counter-cyclical policies on the downward trend of PSND/GDP, even against the backdrop of a decline in the primary surplus targets, should be neutralized by the process of easing monetary policy, favoring the maintenance of the declining trajectory over the medium term.

Figure 3.37 – NPSD – Percentage share of indexator

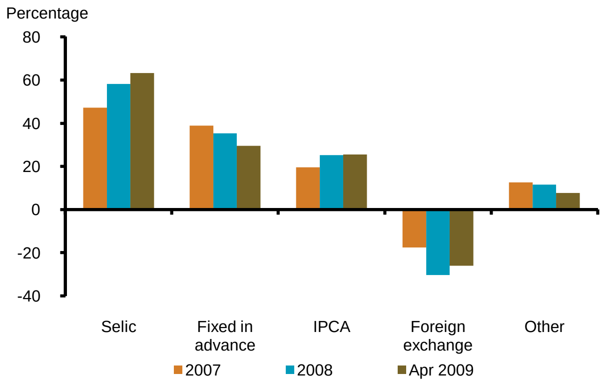


Table 3.10 – General government gross debt
Conditioning factors

Itemization	2007		2008		Apr 2009	
	R$ million	% GDP	R$ million	% GDP	R$ million	% GDP
GGGD – Balance	1 542 852	56.4	1 740 888	58.6	1 797 074	61.6
Flows	**Accumulated in the year**					
GGGD – Growth	206 207	1.2	198 036	2.2	56 186	3.0
Conditioning factors	206 207	7.5	198 036	6.7	56 186	1.9
GGGD borrowing requirements	222 097	8.1	158 976	5.4	64 282	2.2
GGGD net issue	42 958	1.6	-41 963	-1.4	- 280	0.0
Interest	179 139	6.5	200 938	6.8	64 562	2.2
Exchange adjustment	-27 462	-1.0	38 473	1.3	-10 855	-0.4
Indexed internal securities debt[1/]	-2 432	-0.1	3 180	0.1	- 915	0.0
External debt	-25 029	-0.9	35 293	1.2	-9 940	-0.3
Others[2/]	7 123	0.3	-2 662	-0.1	2 513	0.1
Skeletons	4 448	0.2	3 250	0.1	247	0.0
Privatizations	0	0.0	0	0.0	0	0.0
GDP growth effect		-6.3		-4.4		1.0

1/ Domestic dollar – Indexed securities.
2/ Parity of the basket of currencies in the external debt.

4 International economy

In the March-May period, the trajectory of the world economy, although confirming the outlook anticipated in the previous Inflation Report of a continued process of severe reduction in output and employment with negative consequences on the performance of world GDP, has shown signs that economic policies undertaken in anti-cyclical reaction to the intensification of the crisis in international financial markets had begun to show favorable results.

In this sense, important indicators showed a reversal of the recent trajectory, registering growth in the prices of commodities and the indices of stock markets in several countries. Regarding the pace of economic activity, although GDP growth of major developed economies produces sharp downturns in the first quarter, more recent results suggest that the pace of contraction in the activity of the global economy would deteriorate. This movement can be observed in the USA, where there are indications of stabilization in the housing market, household consumption and advances in the adjustment of the inventory cycle.

In this scenario, where the prospects for a recovery in the stock market and in specific segments of the financial market coexist with an environment of a continuity of credit restrictions, weak consumption and reductions in inflation rates, the stance of the central banks of major developed and emerging economies continued favoring the adoption of measures providing for the continuity of the expansionary character of monetary policy, in many cases by non-conventional instruments that should be of temporary use.

4.1 Economic activity

Reflecting the lagged effects of reduced household wealth, the conditions still restricting access to credit, the continued increase in unemployment and reduction of final demand for goods and services, the downturn in major economies remained severe in early 2009. This recession framework

Table 4.1 – Major developed countries
GDP components and other indicators

% rate anualised

	2007		2008				2009
	III	IV	I	II	III	IV	I
GDP							
United States	4.8	-0.2	0.9	2.8	-0.5	-6.3	-5.7
Euro Area	2.5	1.6	2.8	-1.0	-1.4	-6.8	-9.7
United Kingdon	2.4	3.6	1.6	-0.4	-2.8	-6.2	-7.4
Japan	0.8	1.8	3.4	-3.5	-2.5	-14.4	-15.2
Household consumption							
United States	2.0	1.0	0.9	1.2	-3.8	-4.3	1.5
Euro Area	1.9	1.1	0.2	-1.2	0.2	-1.6	-1.9
United Kingdon	4.9	2.0	3.2	-1.5	-0.9	-4.1	-4.7
Japan	-1.0	0.6	5.8	-3.9	0.5	-3.2	-4.3
Non-residencial investment							
United States	8.7	3.4	2.4	2.5	-1.7	-21.7	-36.9
Euro Area[1/]	3.8	3.9	4.3	-5.2	-3.8	-16.1	-15.7
United Kingdon[1/]	1.2	14.3	-12.9	-2.3	-10.8	-5.4	-14.2
Japan	2.4	5.0	6.8	-11.2	-16.4	-24.2	-35.5
Residencial investment							
United States	-20.6	-27.0	-25.1	-13.3	-16.0	-22.8	-38.7
Euro Area[2/]	-0.4	3.6	-8.0	-6.5	-6.5	-15.2	-2.0
United Kingdon	-4.3	-4.3	-14.2	-10.6	-17.8	-17.8	nd
Japan	-31.0	-36.8	20.7	-7.7	13.2	23.7	-20.0
Exports of goods and services							
United States	23.0	4.4	5.1	12.3	3.0	-23.6	-28.7
Euro Area	7.1	2.9	6.5	-1.2	-2.3	-25.9	-28.8
United Kingdon	8.8	0.6	3.5	-6.0	0.8	-14.9	-22.1
Japan	11.3	7.8	9.8	-3.2	4.0	-47.1	-70.1
Imports of goods and services							
United States	3.0	-2.3	-0.8	-7.3	-3.5	-17.5	-34.1
Euro Area	8.5	-0.3	4.9	-3.2	4.3	-18.9	-25.7
United Kingdon	20.2	1.3	-0.9	-5.6	-0.6	-21.5	-21.5
Japan	-2.4	1.5	10.1	-15.7	6.3	13.1	-47.7
Manufacturing output							
United States	2.4	-	-1.2	-5.4	-9.2	-18.1	-21.9
Euro Area	2.0	3.9	6.9	-7.3	-11.2	-23.4	-27.9
United Kingdon	-1.8	2.8	-1.4	-4.6	-6.8	-16.7	-19.4
Japan	6.8	3.6	1.1	-4.8	-12.3	-38.0	-63.3
Unemployment rate[3/]							
United States	4.7	4.9	5.1	5.6	6.2	7.2	8.5
Euro Area	7.3	7.3	7.3	7.5	7.7	8.2	8.9
United Kingdon	5.3	5.2	5.2	5.4	5.8	6.3	7.1
Japan	4.0	3.7	3.8	4.1	4.0	4.3	4.8

Source: BEA, Cabinet Office, Eurostat
1/ Includes residencial and public investment expenditures.
2/ Total construction expediture.
3/ End of the quarter rate.

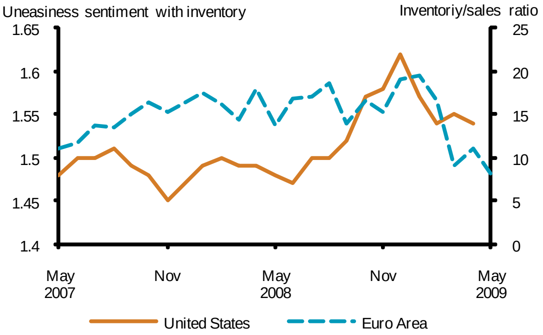
translated, in particular, into an acceleration observed in the annualized contractions of the rates of investment, which reached a level above 35% in the U.S. and Japan in the quarter ended March, compared to December quarter end.

The investment performance was consistent both with the formation of expectations associated with the intensification of international crisis and with the environment to reduce the level of capacity utilization and profits. In this scenario, although the pace of the downturn experienced by the U.S. economy presented some slowing in the quarter ended in March, the country's GDP recorded a drop of 5.7% annualized in the quarter, while those for Japan, the countries of the Euro Area and the United Kingdom presented their retractions of 15.2%, 9.7% and 7.4%, all higher than those indicated in the last quarter of 2008.

The relatively more favorable performance of the U.S. GDP reflected an annualized growth of 1.5% recorded by household consumption in the period – the first positive result in the last three quarters, a growth consistent with the impact on disposable income derived from tax reduction on income, wage increases for civil servants, social security transfers and government income programs implemented since January. The monthly analysis, although revealing a decrease of these expenditures in March and April, stayed above the level in December 2008. Contrasting with the development observed in the U.S., household spending in other developed economies, showed stronger annualized contraction in the quarter ending in March than in that ended in December last year.

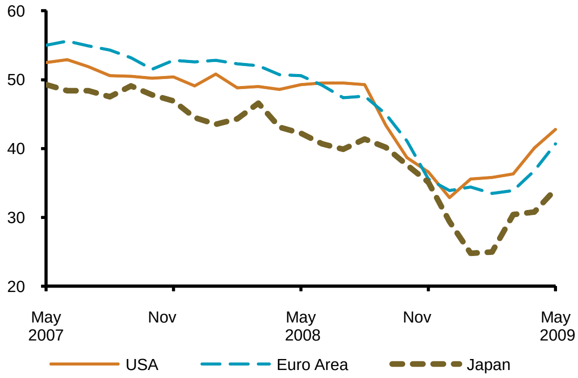
The falloff in demand in the economies of the G-3 and the United Kingdom contributed to the deterioration of the current international trade in these countries and other world economies. Real exports of major developed economies recorded decreases of more than 22% annualized in the quarter ended March, compared to December, always above the level reported in the December quarter. In the Euro Area, the downturn in external sales reached 28.8%, while the drop in imports reached 25.7%. Considering the same comparison basis, the decreases in imports observed in the U.S. and Japan surpassed those recorded by its exports and provided acceleration in the quarter, provided in the U.S., a positive contribution of 2.2 percentage points to an annualized growth of GDP in the quarter ended in March. The rate of decline of foreign purchases in the UK remained stable in the quarters concerned.

Figure 4.1 – Retail sector – Inventory indicators
USA and Euro Area



Source: European Commition

Figure 4.2 – Manufacuring PMI
Largest developed economies



Stock indicators suggest that the major developed economies showed progress in the adjustment of supply to demand conditions. In this sense, the process of reducing retail inventories made significant progress in the U.S. and, since February, in the Euro Area – the main consumer markets worldwide. Within industry, however, despite the sharp drop experienced by the sector in the first quarter, the adequacy of stocks had shown to be limited up to March, when indicators of business sentiment started to incorporate the possibility of recovery in orders and, therefore, adjustment of inventories. The trajectory of the inventory level in the first three months of the year resulted in important contributions to the annualized real GDP growth in the UK and the U.S., both of -2.3 percentage points, and the Euro Area and Japan, both -1 percentage point in the quarter ended in March.

The annualized growth rate of China's GDP, has been slowing down since the third quarter of 2007, and reached 6.1% in the quarter ended in March, showing a more pronounced impact of the slowdown in the growth of household consumption and the recurrent decline in exports, in relation to the momentum provided by the investments foreseen in the plan of government fiscal stimulus and by the continued easing of monetary policy. It should be noted that tax incentives for purchase of cars and household items in a scenario of sharp increase in urban unemployment, have mitigated the slowdown in retail sales in the first quarter and, more recently, has supported the recovery of growth rates in this demand component. Looking at the supply side, industry-related indicators showed recovery of the sector – which represents about 40% of the Chinese GDP – from February, with positive repercussions on exports of South Korea and Taiwan – which are important suppliers of intermediate goods for the Chinese industry.

The resumption of exports to China has not avoided, however, a downward trend in foreign sales in these countries, with negative impacts on their products. In Korea, the economic stimulus package introduced by the government provided relative growth of gross fixed capital formation and a recovery of household consumption, expressed in the stability recorded by the Korean GDP in the first quarter of 2009. In Taiwan, the intensification of the reduction in GFCF was a determinant for the acceleration in the rate of annualized contraction of GDP, which stood at 10.2% in the quarter ended in March, compared to an 8.6% decresase in that ended in December.

Table 4.2 – Emerging economies
GDP components and other indicators

% rate [(Q)/(Q-4)]

	2007		2008				2009
	III	IV	I	II	III	IV	I
GDP							
South Koreia[1/]	5.4	5.2	4.4	1.7	1.0	-18.8	0.2
China	13.0	12.0	10.6	10.1	9.0	6.8	6.1
India	8.8	9.4	9.0	8.2	7.8	4.8	4.1
Taiwan	7.0	6.4	6.2	4.6	-1.0	-8.6	-10.2
Household consumption							
South Koreia[1/]	3.7	1.6	4.5	-0.7	-0.1	-17.8	1.9
China[2/]	12.0	12.9	13.2	13.4	15.8	15.7	14.8
India	7.5	8.9	5.7	4.5	2.1	2.3	2.7
Taiwan	3.1	1.6	2.1	0.5	-2.1	-1.7	-1.4
Non-residencial investment							
South Koreia[1/]	-4.3	13.1	-6.4	0.4	0.2	-23.6	0.7
China	25.8	22.3	20.3	20.1	20.2	23.8	38.8
India	16.0	14.1	9.3	9.2	12.5	5.1	6.4
Taiwan	3.8	-0.8	3.7	-8.0	-11.8	-22.6	-33.8
Exports of goods and services							
South Koreia[1/]	7.0	28.9	-0.1	11.3	-1.6	-31.2	-15.6
China	24.8	18.3	17.2	17.1	18.3	4.4	-10.8
India	-4.8	6.1	12.6	25.6	24.3	7.1	-0.8
Taiwan	11.6	12.9	12.7	9.9	-0.6	-19.2	-27.2
Imports of goods and services							
South Koreia[1/]	2.2	24.2	-3.0	12.3	4.3	-45.8	-30.4
China	21.2	22.1	15.6	17.1	10.6	-2.1	-3.8
India	-3.6	6.7	27.2	27.4	35.3	21.7	-5.7
Taiwan	7.3	5.8	9.6	0.2	-2.6	-21.4	-30.9
Manufacturing output							
South Koreia[1/]	11.3	16.1	7.3	0.3	-8.1	-56.9	-11.4
China	18.2	17.5	16.3	15.9	12.9	6.4	5.5
India	8.7	8.3	7.0	5.3	4.7	0.8	- 0.9
Taiwan	9.8	13.5	12.6	7.1	0.5	-23.4	-32.4
Unemployment rate[3/]							
South Koreia[1/]	3.2	3.1	3.1	3.2	3.2	3.3	
China[4/]	4.0	4.0	4.0	4.0	4.0	nd	
India	nd	nd	nd	nd	nd	nd	
Taiwan	4.0	3.9	3.9	3.9	4.3	5.0	

Source: Thomson Financial
1/ QoQ annual rate.
2/ Retail sales growth rate.
3/ End of the quarter rate.
4/ Urban unemployment.

4.2 Monetary policy and inflation

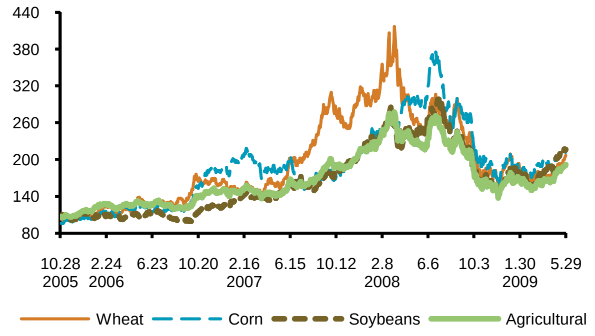
The impact of the global recession on the prices of agricultural commodities and energy, particularly oil, was decisive for maintaining the downward trend of prices, expressed during the quarter ended in May, in deflation in the U.S., Japan, Sweden, Switzerland and China, and disinflation in the United Kingdom, Canada, Euro Area, the Philippines, Russia and Chile.

In this scenario, central banks in the U.S., Switzerland and Japan, attentive to the possibility of the occurrence of a more lasting deflationary process and liquidity needs of financial systems expanded the accommodative stance of their monetary policy, including the injection of new resources. Similarly, aiming to stimulate aggregate demand and reduce the unemployment rate, the central banks of other mature economies as well as emerging economies, except China, have intensified the policy of reducing basic interest rates, registering since early March, cuts of 350 b.p in Chile as well as 225 bp in Mexico, Peru and Turkey.

The cumulative twelve–month variation of the Consumer Price Index (CPI) in the U.S. reached -0.75% in April, the lowest rate since March 1955, with an emphasis on decreases of 25.2% and 13.4% observed in energy and transportation items. The prospects for short and medium term related to the development of the indicator, in an environment of reduced Nuci, increased the supply of labor, deflation of 3.74% in the prices received by producers in the twelve–month period ending in April, and reductions in the prices of imported goods and services, incorporating the continuity of the deflation process recorded earlier this year. In this scenario, the Federal Reserve (Fed) kept the limits of the fluctuation band from the target for the Fed Funds rate unchanged at 0% and 0.25%.

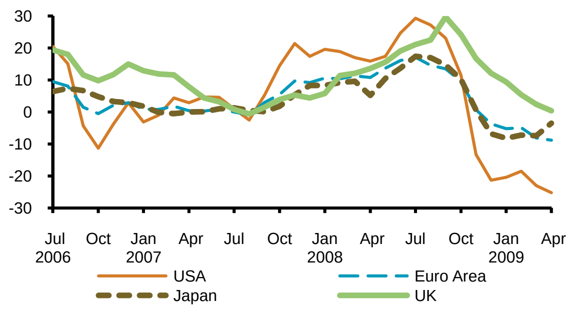
Aiming to promote conditions of credit, reducing stress in financial markets and facilitating the recovery of the pace of economic activity, the Fed began making direct purchases of long-term Treasury, a move that could total US$300 billion, and intensive liquidity assistance programs. Thus, in addition to continuing to purchase assets under the Term Asset-Backed Securities Loan Facility (TALF), the Fed included commercial mortgage-backed securities (CMBS), including the legacy CMBS (bonds issued before the beginning of this year), and bonds backed by insurance premium finance loans on the list of collateral accepted by the program. With the same objective, the monetary

Figure 4.3 – Agricultural Index
12.31.2004 = 100



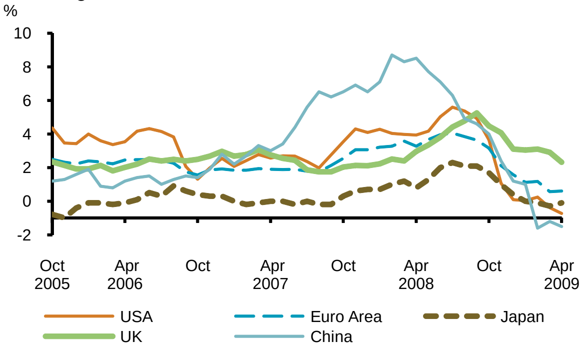
Source: Thomson

Figure 4.4 – Energy inflation
Annual growth
%



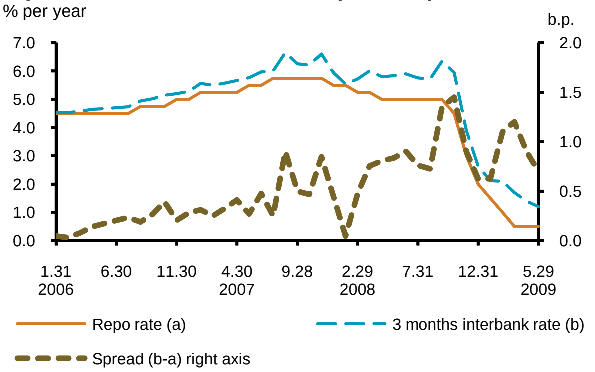
Source: Thomson

Figure 4.5 – Consumer inflation
Annual growth
%



Source: BLS, Eurostat, Bloomberg and ONS

Figure 4.6 – UK: Interbank and repo rate spread
% per year



Source: Thomson

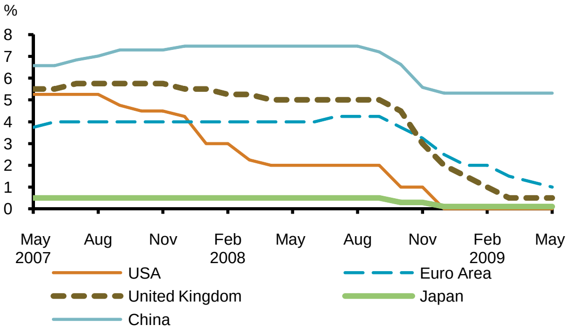
authority extended for up to five the term of these loans Additionally, to provide the market with foreign currency liquidity, the Fed announced, together with the central banks of England, Japan, Switzerland and the European Union, the establishment of currency swap lines of, respectively, £30 billion, ¥10 trillion, CHF40 billion and €80 billion, running until October 30, 2009.

The 12-month cumulative variation of the index of consumer prices in the UK, impacted by an increase of 7% observed in food prices, reached 2.3% in April, standing, despite the recessionary environment and the disinflationary process in progress in the country, at a higher level than that recorded in similar indicators of major mature economies. The Bank of England (BoE), given the expectation that in the medium term, inflation could fall below the target of 2%, maintained the basic interest rate unchanged at 0.5%, the lowest rate charged in the entire history of the institution. In the financial market, despite the reduction in the spread between interest rates in the interbank and repo rate, the BoE has intensified the policy of increasing the money supply and credit by increasing, by £50 billion, the purchases of government and corporate bonds, raising the program's goal to £125 billion.

In the Euro Area, the 12-month variation in the price index reached 0.6% in March and April, the lowest rate on record, pointing to changes relating to food and energy reached in the order of 1.54% and -8.7% in March, up 6.73% and 29.3% respectively in July 2008, before the intensification of the crisis in financial markets. In an environment of inflation below the 2% target and economic activity at a level significantly below potential, the European Central Bank (ECB) increased the policy of basic interest rate cuts, setting it at 1% in May, a historically low level. Additionally, the monetary authority announced it will expand the new long-term liquidity through the purchase of covered bonds denominated in euro and issued in the Euro Area, in an amount up to € 60 billion, and that from July, will include the European Investment Bank as counterparty in monetary policy operations.

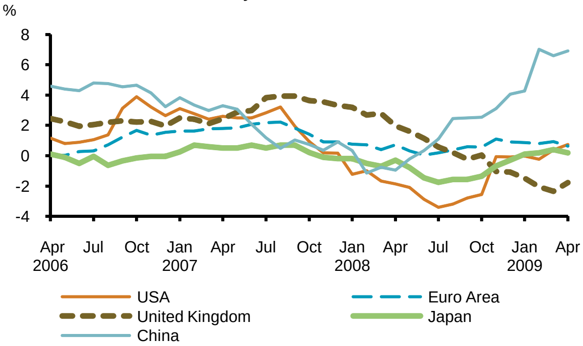
In Japan, after four consecutive quarters of economic contraction, the annual change in the consumer price index recorded its third negative result in a row, reaching 0.1% in April. In this scenario, the Bank of Japan (BoJ) continued the process of quantitative easing of monetary policy through the direct purchase of commercial paper and government bonds (JGBs), expanded the range of collateral accepted in its loans, and announced that it will accept bonds issued by the U.S., UK, Germany and France governments as eligible collateral for financing operations.

Figure 4.7 – Official interest rates
Annual rates



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

Figure 4.8 – Real interest rates
Annual rates – Deflated by CPI



Source: Fed, BCE, BoJ, BoE, BPC, BLS, Eurostat, ONS e Bloomberg.

Table 4.3 – Bank writedowns & credit losses x capital raised

US$ billion

	Accumulated since 2007		Accumulated since 1.1.09 1/	
	Writedowns & credit losses	Capital raised	Writedowns & credit losses	Capital raised
Worldwide	1 481.4	1 234.0	151.6	297.6
Banks	1 052.0	998.3	104.4	194.9
Insurers	243.4	128.1	14.4	31.6
GSEs 2/	152.8	107.5	32.8	71.1
Americas	957.6	720.7	104.1	195.4
Banks	583.0	497.0	58.7	95.5
Insurers	206.9	115.4	12.6	28.8
GSEs 2/	152.8	107.5	32.8	71.1
Europe	462.7	440.4	41.1	81.5
Banks	427.6	427.7	39.2	78.7
Insurers	35.1	12.8	1.8	2.8
Asia	44.3	74.4	6.6	21.0
Banks	42.8	74.4	0.0	21.0
Insurers	1.5	-	-	-

Source: Bloomberg
1/ Updated on May 28th, 2009.
2/ Government Sponsored Enterprises – Fannie Mae and Freddie Mac.

In China, the annual change in the consumer price index, trending downward since February 2008 when it reached 8.7%, stood at -1.5% in April, the third consecutive negative result, with an emphasis on reductions recorded in the prices of food and energy. In this context, and considering that the recent slowdown in economic activity in the country, pointing out the performance of domestic demand, it was proven not to be as intense as in other economies, the People's Bank of China (PBC) has kept basic interest rates unchanged at 5.31% per year, and reserve requirements, at 14.5%. Additionally, in order to strengthen the position of the renminbi between convertible currencies, the PBC has authorized its use in international commercial contracts and currency swaps set up to trade with South Korea, Hong Kong, Malaysia, Indonesia, Belarus and Argentina.

4.3 International financial markets

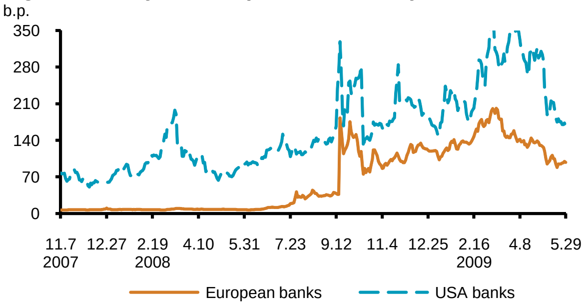
Since the beginning of 2007,[1] banks, securities firms, insurers and government-sponsored enterprises (GSE) have accumulated losses and writedowns of US$1.48 trillion, compared to absorption of US$1.23 trillion in new capital. It is noteworthy that these flows represented in the order of US$365 billion and US$281 billion for the quarter ended in May.

The average premiums of Credit default swap (CDS), which measure the cost of insurance against defaults, reversed an upward trend observed until the last Inflation Report. The indicators relating to five major U.S. banks and five major European banks, selected from the viewpoint of total assets, dropped from 245 basis points and 169 bp, respectively, at the end of February to 172 bp and 99 bp at the end of May.

Increased confidence in the U.S. banking industry reflected both the interruption of the trend of quarterly losses by major U.S. banks, the disclosure of the results of stress tests conducted by the Supervisory Capital Assessment Program (SCAP), which involved the 19 largest financial institutions in the country and revealed that its need for additional capital to face the most adverse macroeconomic scenario reaches US$75 billion, less than initially projected. Additionally, some major banks have announced preparations to repay the loans charged under the Troubled Asset Relief Program (TARP).

1/ Data provided by Bloomberg on 5/28/2009.

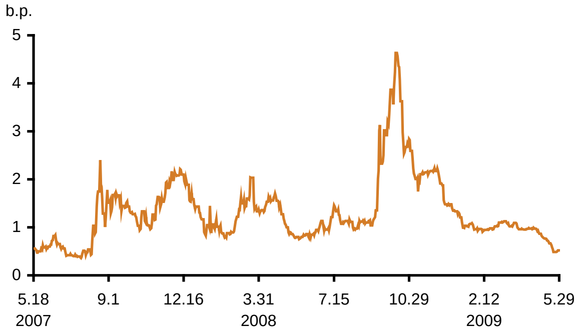
Figure 4.9 – 5 year CDS premiums of major banks1/



Source: Thomson

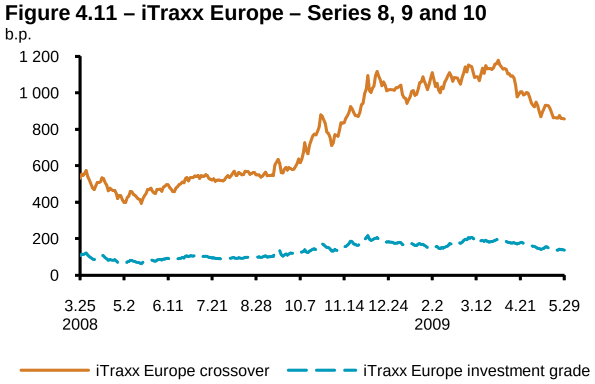
1/ Aritmethic average of 5-year CDS premiums for major European and USA banks. Since it's not a random sample, it may not reflect the behavior of the financial system as a whole.

Figure 4.10 – TED Spread



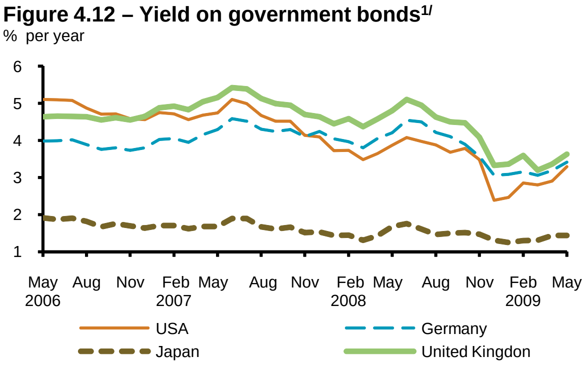
Source: Bloomberg

Figure 4.11 – iTraxx Europe – Series 8, 9 and 10



Source: Thomson

Figure 4.12 – Yield on government bonds1/



Source: Bloomberg

1/ Monthly average of nominal yields on 10-year bonds, up to February 27, 2009.

Reflecting the effects of expansionary policy implemented by the Fed and aid programs to the banking system of the U.S. government, liquidity conditions in the financial system registered a significant improvement in recent months. Accordingly, the TED spread – the difference between the three-month Treasury Bill rate, short-term risk free, and the same term LIBOR rate, short-term risk – fell from 101 basis points on Feb. 27 to 52 bp at the end of May, reaching its lowest level since August 2007.

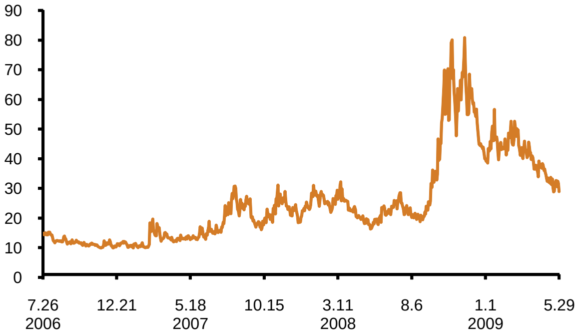
In Europe, the iTraxx Crossover, which represents the premium required to guarantee loans from European companies considered high risk, and iTraxx IG, which represents the premium required for companies classified as investment grade, reached, in order, 857 basis points and 139 bp at the end of May, recording decreases of 225 bp and 42 bp towards the end of February and reaching the lowest level of the year.

The yields of long-term paper of the major mature economies, highlighting increasing concerns about the sustainability of their fiscal accounts and some reversal of the movement of flight for quality coupled with the slowdown in the deterioration of macroeconomic conditions, recorded an increase between the late February and May. Accordingly, the income of ten year paper in Germany, USA, Japan and the UK had respective highs of 48 bp, 45 bp, 21 bp and 12 bp in the period, standing, in order, at 3.59%, 3.46%, 1.49% and 3.75% at the end of May.

The Chicago Board Options Exchange Volatility Index (VIX) which measures the implied volatility of short-term from Standard and Poor's (S&P500) fell 46.4 points at the end of February to 28.9 points at the end of May, compared to 31.7 points in mid-September 2008. The average index in 2007, before the worsening of the crisis in financial markets, reached 17.5 points.

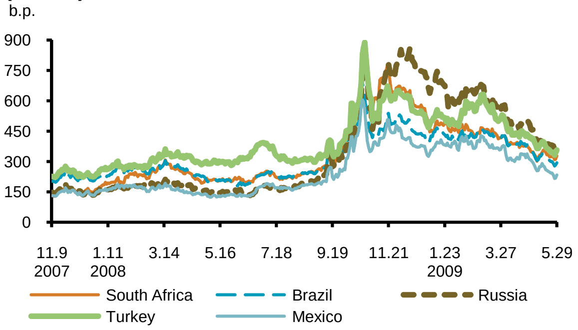
The Emerging Market Bond Index Plus (Embi +), an indicator of risk associated with emerging markets, reached 459 basis points at the end of May, compared to 639 basis points on February 27. This reduction reflected decreases reported in the indicators for Russia of 261 bp; Turkey, 194 bp; Mexico, 138 bp; and Brazil, 127 bp, revealing both the reduction of risk aversion and the recovery of commodity prices, increasing US$250 billion to US$750 billion of resources available on the Flexible Credit Line (FCL) of the IMF for countries to maintain sound macroeconomic policies. The increase in resources mentioned reduces the likelihood of sovereign default events that could

Figure 4.13 – VIX



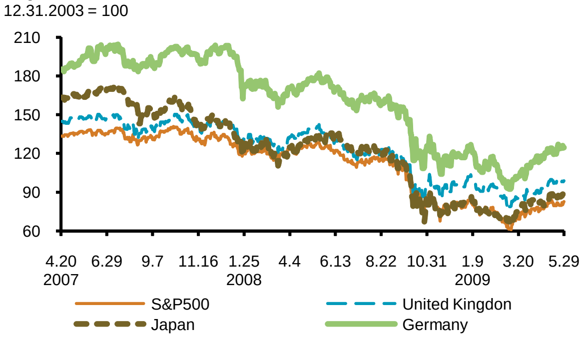
Source: Thomson

Figure 4.14 – Emerging Markets Bond Index Plus (EMBI+) – Countries



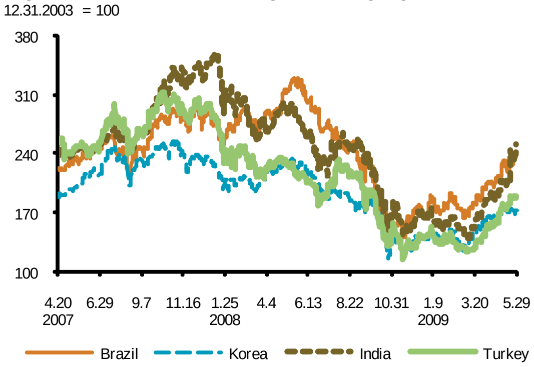
Source: Bloomberg

Figure 4.15 – Stock exchanges: USA, Europe and Japan



Source: Bloomberg

Figure 4.16 – Stock exchanges: emerging markets



Source: Bloomberg

replenish the financial crisis and restrict capital flows to emerging markets.

The improvement in liquidity conditions, the reduction in risk aversion and the recent results of the banking system boosted equity markets around the world. Accordingly, the DAX of Germany, the Japanese Nikkei, S& P500 in the US and FTSE 100 in the UK recorded respective increases of 28.5%, 25.8%, 25% and 15.3% between late February and late May, totaling, in order, variations of 2.7%, 7.5%, 1.8% and -0.4% in the year.

Stock markets in emerging economies, benefiting from a recovery in commodity prices, showed equally good performance in the quarter ended in May. The Kospi index in South Korea; Ibovespa in Brazil; XU100 in Turkey, and Sensex in India, recorded respective increases of 31.3%, 39.3%, 45.7% and 64.5% in the quarter, accumulating gains of 24.1%, 41.7%, 30.3% and 51.6% in the year, respectively.

In contrast to the trend in the last inflation report, the dollar recorded, in May quarter end the dollar registered a depreciation trend versus the currencies of major developed economies and emerging markets. The value of U.S. currency fell against the yen, 2.3%, the euro, 10.5% and the pound sterling, 11.6%. Additionally the dollar was reduced by 8%, 9.8%, 13.8% and 17.4% against the Indian rupee, the Turkish lira, the Russian ruble and the Brazilian real, respectively.

4.4 Commodities

Showing an improvement in expectations about the performance of economic activity, the depreciation of the dollar[2] and the resumption of imports from China,[3] the international prices of commodities saw, according to the Commodity Research Bureau Index (CRB), an average increase of 16.2% between the end of February and May, reaching 24.8% at a level below the maximum value indicated on July 2, 2008. Considering the average of the quarters ended in May 2009 and last year, the reduction of the CRB reached 28.3%.

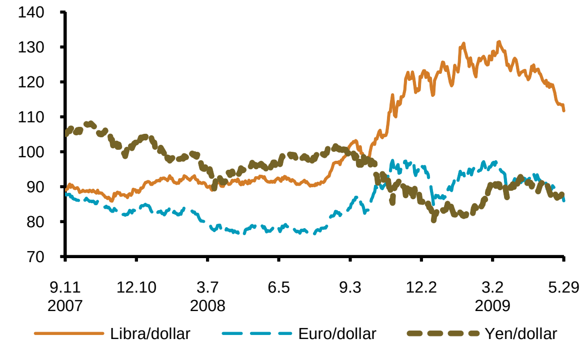
According to the S&P GSCI from Standard & Poor's in conjunction with Goldman Sachs, the increase registered in commodity prices between late February and late May

2/ Between February 27 and May 29, the U.S. currency had devalued by 10% against a basket of six currencies (Euro, Yen, Pound, Canadian Dollar, Swedish Krona and Swiss Franc), thus favoring a search of protection through commodity futures contracts.

3/ Chinese imports of aluminum, soybeans, copper and iron ore posted respective increases of 173.5%, 60.9%, 54.7% and 33.6% in the March-April period, when compared to the same period of 2008.

Figure 4.17 – Dollar exchange rates

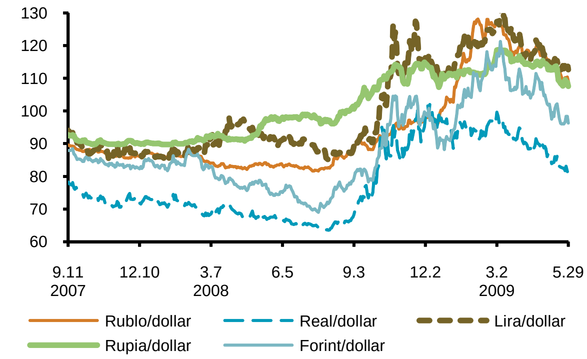
6.1. 2005 = 100



Source: Bloomberg

Figure 4.18 – Emerging markets currencies

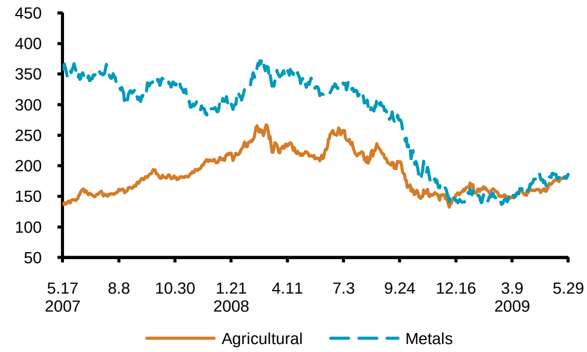
6.1 2005 = 100



Source: Bloomberg

Figure 4.19 – Commodity price index

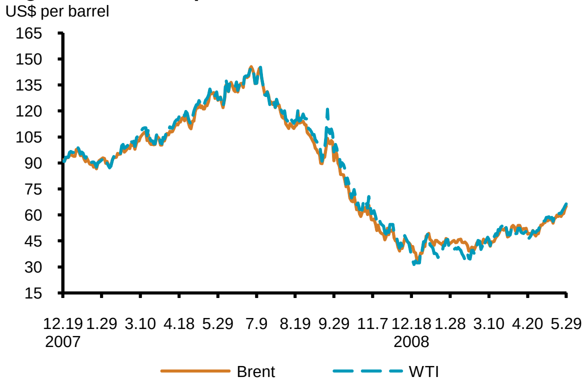
Jan/2003 = 100



Source: S&P GSCI

Figure 4.20 – Oil – pot market

US$ per barrel



Source: Bloomberg

totaled 31.8%, reflecting increases noted in the sectors of agricultural commodities of 23,5%, energy of 39%, and metallic of 28.8%. According to the London Metal Exchange (LME), there were widespread increases in prices of major commodity metals during this period, emphasized by changes relating to Zinc of 39.8%, nickel of 39.7 %, aluminum of 7.5% and copper of 40.7%.

Besides an expansion of Chinese imports, the increase seen in the prices of agricultural commodities between late February and late May showed a reduction of grain production in Latin America due to the drought that severely damaged Argentine production, and delayed planting of the 2009/2010 crop in the US, also affected by bad weather. The first futures contracts for delivery recorded widespread increases in prices of major agricultural commodities during this period, with emphasis on wheat of 24.8%, corn of 24.4%, and soybeans of 35.4% traded on the Chicago Board of Trade, and coffee at 25.5% and 15.7% for sugar traded on the Intercontinental Exchange in New York. The price of sugar since December 2008, affected by crop failure in India, recorded, the highest level of the last thirty-four months on May 26.

4.4.1 Petroleum

The international prices of WTI and Brent oil barrels rose 48.1% and 44.7% respectively between late February and late May, when it reached (in the same order) US$66.31. And US$64.98, staying at a level similar to that observed in the second half of October 2008. This development was associated with improvements in prospects for the global economic scenario, the depreciation of the dollar and pressures coming from the Chinese demand.

According to the Department of Energy (DOE), the average price per barrel of West Texas Intermediate (WTI) is expected to register relative stability in the second half of the year at about US$66. The DOE also projects an annual fall of 2.5% in the world supply of crude oil, with emphasis on a prediction of an 8.4% reduction in the production from the Organization of Petroleum Exporting Countries (OPEC). Additionally, an annual decline of 2.1% is projected for world oil consumption, highlighting a decline of 4.2% estimated in the countries of the Organisation for Economic Co-operation and Development (OECD).

4.5 Conclusion

The adequate coordination of measures of monetary and fiscal stimulus implemented in the major mature and emerging economies have resulted in improvements in indicators related to consumer and business confidence, with positive repercussions, in the margin, on the evolution of the indicators of the real sector.

Although uncertainty persists regarding the foundations of the world economy, the main financial market indicators showed a benign trajectory for the quarter ended in May, with emphasis on the impact of reduced risk aversion on asset prices and interest rates to final borrower's credit. It is worth mentioning also, the positive outlook for a relatively lax international credit conditions for a possible resumption of global economic activity.

However, in this framework of conditioning factors for the effective stabilization of the world economic activity, remain outstanding a successful completion of the inventory adjustment cycle and a consolidation of the support consumption process, especially in major developed economies.

External sector

5

The performance of the country's external accounts during the year has been more favorable than suggested by the macroeconomic environment that followed the intensification of the crisis in financial markets, with an emphasis on the adjustment capacity of the current account. The trade balance, while registering a significant reduction intrade flow, remains above the surplus from the same period of 2008, while the income account, which accounts for a significant portion of the adjustment, posted results most linked to domestic economic cycle. There was a return of the net inflow of foreign investors in the financial account in fixed income securities and stocks, while FDI flows continued to show relevant and sufficient flows for full funding of current transactions.

The reduction of stress in international financial markets observed in recent months, evidenced in retractions in risk aversion and volatility indicators, led to the recovery of the domestic foreign exchange surpluses, allowing the central bank to resume the reserve accumulation policy as of May. The nominal exchange rate appreciation recorded in the last month and the indicator of country risk, which had reached 688 bp on October 23 of 2008, returned to levels prior to the aggravation of the international financial crisis, reaching 285 points on June 19.

The projections for the balance of payments presented in this report are expected to maintain suitable conditions for financing the external accounts for the year. The changes registered in these projections (detailed in the specificboxe) arose from the incorporation of results that occurred up to May, including net interventions carried out by the Central Bank in the market, and the new external indebtedness position, referring to March.

5.1 Exchange

The foreign exchange contract, after recording net outflows of US$3 billion for the quarter ended March, generated net inflows of US$4.6 billion in the two months ended in May, resulting in a surplus of US$1.6 billion in the first five months of the year compared with US$15.8 billion in same period of 2008.

Table 5.1 – Foreign exchange flows

US& billion

Itemization	2008			2009	
	May	Jan-May	Ano	May	Jan-May
Trade operations	2.9	24.9	47.9	1.6	13.0
Exports	14.7	78.5	188.0	12.4	59.1
Imports	11.8	53.7	140.1	10.8	46.2
Financial operations[1/]	-2.8	-9.0	-48.9	1.6	-11.4
Purchases	33.9	166.6	421.2	27.5	105.6
Sales	36.7	175.6	470.1	26.0	117.0
Net flows	0.1	15.8	-1.0	3.1	1.6

1/ Excluding interbank operations and Central Bank foreign operations.

Net inflows in the commercial segment, reflecting respective reductions of 24.7% and 14% in contracts of exports and imports, reached US$13 billion, decreasing 47.8% in the period. The financial segment recorded net outflows of US$11.4 billion from US$9 billion in the first five months of 2008, showing reductions in foreign currency purchases 36.6%, and sales of 33.4%.

In May, the Central Bank resumed purchases of foreign exchange in the spot market with the aim of strengthening international reserves, which had discontinued operations in September last year due to the aggravation of the international financial crisis. For the month, there were settlements of purchase interventions of US$2.7 billion. During the year, the Central Bank made net sales of US$693 million in the spot market.

The banks' foreign exchange long position, which dropped US$1 billion in December 2008 to US$145 million in March, reached US$1.3 billion in the end of May.

5.2 Trade in goods

Table 5.2 – Trade balance – FOB

US$ million

Period		Exports	Imports	Balance	Total trade
Jan-May	2009	55 484	46 111	9 373	101 595
Jan-May	2008	72 051	63 478	8 573	135 529
% change		-23.0	-27.4	9.3	-25.0

Source: MDIC/Secex

In the first five months of the year, the results of the trade balance reflected the impact of the recession experienced by the world economy on external trade flows. In this environment, exports totaled US$55.5 billion and imports US$46.1 billion, representing respective decreases of 23% and 27.4% over the same period of 2008, which resulted in an increase of 9.3 % in the trade balance. Total external trade declined 25% in the period.

The trade surplus reached US$2.6 billion in May. The decrease of 34.9% recorded over the same month last year reflected retractions of 38.7% and 37.9% in average daily values of purchases and sales abroad. It should be mentioned that these percentages are skewed by the effect of regularization, in May 2008, of the records relative to operations carried out in March and April of that year, a period in which customs tax inspectors underwent standard operation.

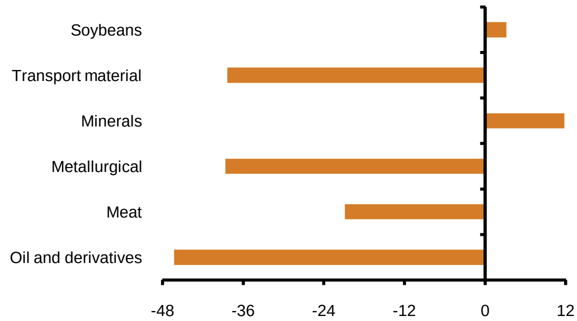
Table 5.3 – Exports by aggregate factor – FOB
Daily average – January-May

US$ million

Itemization	2008	2009	% change
Total	706.4	549.3	-22.2
Primary products	239.4	223.9	-6.5
Industrial products	448.0	314.2	-29.9
Semimanufactured goods	98.1	71.0	-27.7
Manufactured goods	349.9	243.2	-30.5
Special operations	19.0	11.3	-40.6

Source: MDIC/Secex

Figure 5.1 – Main exports
January-May – 2009/2008[1/] – % growth



Source: MDIC/Secex
1/ Change in value over the same period of the previous year.

Considering cumulative data from January to May and, thus, eliminates the mentioned distortion, the average of exports recorded a reduction in all categories of aggregate factor over the same period in 2008. Shipments of basic products showed the smallest decline in the period of 6.5%, resulting in an increase of 6.9 percentage points to 40.8% of its share in exports, while manufactured showed a decrease of 30, 5% in these shipments, a decrease of 5.3 percentage points to 44.3%. Additionally, exports of semi-manufactured decreased 27.7% while its share in total foreign sales fell by 1 percentage point, reaching 12.9%.

Regarding basic products in the period, there was a growth in average daily value of shipments of iron ore of 21.3%, tobacco leaves of 19.3%, and soybeans of 12.8%, while those for oil, beef and chicken recorded respective decreases of 40.2%, 31.4% and 19.7%. The average sales performance of semi-manufactured goods reflected, in particular, decreases in shipments of manufactured iron and steel of 57.6%, hides and skins of 55.3%, and casted iron of 38.5%, contrasting with an increase of 83.6% in raw sugar, benefiting from reduced production of the commodity in India, Australia and China.

The performance of exports of manufactured goods was associated with the impact of decreases observed in average daily sales of fuel oil of 58.8%, freight vehicles of 47.8%, flat rolled iron and steel of 41.2%, and auto parts of 40%, offset in part by a 23% growth in shipments of refined sugar.

Average daily exports of the six most representative sectors of the export basket were responsible altogether for 56.4% of foreign sales in the first five months of the year, registering reductions over the same period in 2008, in shipments for the sectors of oil and oil products, 46.3; meat, 20.9%; metallurgical products, 38.7%; and transportation equipment, 38.4%; as well as increases in the sectors of ore, 11.8%; and soybeans of 3 2%.

The import daily average fell 26.6% in the first five months of the year over the same period of 2008, reflecting the impact of the observed declines in fuel and lubricants of 48.7%, indicating a decrease of 528% recorded in international oil prices during the period, raw materials and intermediate goods of 31.3%, durable consumer goods of 14.6% and capital goods of 10.5%. Conversely, the average daily purchases of consumer nondurables rose 8.5% in the period.

The reduction in imports of raw materials and intermediate goods, which accounted for 45.8% of imports of the period

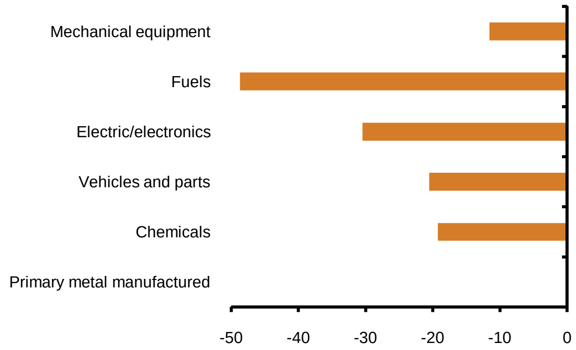
Table 5.4 – Imports by end-use category – FOB
Daily average – January-May

US$ million

Itemization	2008	2009	% change
Total	622.3	456.5	-26.6
Capital goods	129.4	115.8	-10.5
Raw materials	304.3	209.3	-31.2
Naphtha	11.0	5.5	-50.1
Consumer goods	78.3	74.8	-4.5
Durable	43.4	37.0	-14.6
Passenger vehicles	17.6	16.0	-9.2
Nondurable	34.9	37.8	8.1
Fuels	110.3	56.6	-48.7
Crude oil	59.2	10.5	-82.2

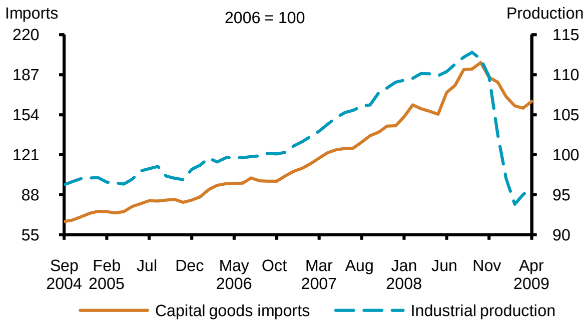
Source: MDIC/Secex

Figure 5.2 – Imports by main products
January-May – 2009/2008 – % change



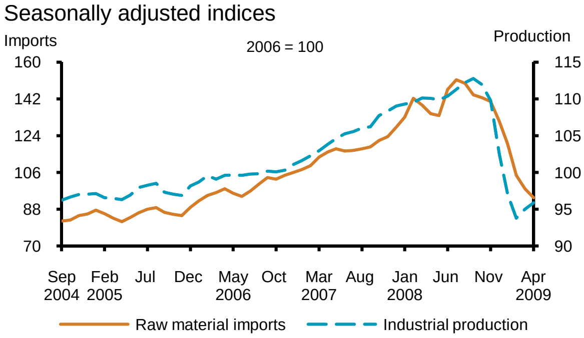
Source: MDIC/Secex

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



Sources: Funcex and IBGE

Figure 5.4 – Raw material imports x industrial production – 3-month moving average
Seasonally adjusted indices



Sources: Funcex and IBGE

compared to 48.9% in the first five months of 2008 reflected, decreases seen in purchases of mineral products of 38.3%; spares and parts of intermediate goods of 32.1% and non-food farm products of 29.2%. The trajectory of the purchases of raw materials and intermediate goods highlights the recent developments in industrial production, an indicator closely correlated with the performance of this category of use.

The decline in purchases of capital goods especially showed the impact of marked decreases in the purchases of machinery and office and scientific services equipment (28.9%) and parts and accessories of capital goods for industry (30.8%), partly offset by respective increases of 7.7% and 30.7% recorded in imports of industrial machinery and movable transportation equipment, which had benefited from the acquisition of aircraft by domestic airline company.

The decline in imports of durable consumer goods was associated mainly to the negative performance of the purchases of cars, which fell 9.2% in the period, accounting for 43.1% of purchases of this category of use. Additionally, imports of machinery and household appliances and parts and accessories for consumer nondurables fell by 32% and 23.4%, respectively.

The average daily purchases of six major importing sectors, accounting for 61.2% of total imports in the first five months of the year, showed an overall decline over the same period of 2008, except for those relating to the steel sector, which remained stable. Purchases of fuels and lubricants decreased 48.7%; followed by 30.5% in the sectors related to electronics; 20.5% in motor vehicles and parts; 19.2% in organic and inorganic chemicals, and 11.6% in mechanical equipment.

The geographical breakdown of exports revealed, in the first five months of the year, that Asia has acquired 25.7% of Brazilian products targeted to foreign markets, compared to 17.9% in the same period in 2008, followed by the European Union, of 23 1%; Latin America and the Caribbean, of 21.2%; and the USA, of 10.8%. The rise of the Asian market, as opposed to relative reduction in the participation of the North-American market, reflected the momentum of sales to China, which accounted for more than half of Brazilian sales to the region, taking the lead as an individual importer. This movement reflected, in particular, exporting patterns directed at China and the US, the first focusing on commodities and the second, on manufacturing, and the enhanced dynamics of the Chinese economy.

The daily average for Mercosur exports fell 41.1%in the period. This movement reflected the effect of barriers imposed by Argentina on sales to that country, whose share in total exports decreased by 2.7 percentage points, to 7% in the period, accounting for more than half the reductions registered by the countries of Latin America and the Caribbean.

Brazil's average daily imports, considered by major blocs and regions, registered a general decline in the first five months of 2009 over the same period last year. The biggest decrease occurred in purchases originating from Eastern Europe, 77%, followed by Latin America and the Caribbean, 25.7%; Asia 24.8%, and the EU, 22.9%. The share of purchases from the US, the main single market of origin of the country's imports, increased 3.2 percentage points in the period, reaching 17.9%. Purchases from Asia, the main supply region to the country, accounted for 28% of Brazilian imports, of which 12.3% were from China, followed by the European Union with 22.1%, and Latin America and the Caribbean with 17.1%.

According to the Foreign Trade Studies Center Foundation (Funcex), a reduction of 23% recorded by exports in the first five months of 2009 over the same period of the previous year, resulted from decreases of 9.7% in prices and 14.5% in export volume. The export prices of semi-manufactured goods fell 16.6%, followed by contractions seen in basic products of 11.4%, and manufactured products of 3.3%, while the quantities exported of goods recorded respective variations of – 14.1% and 4.8% -28.9%.

The reduction of 27.4% observed on the same comparison basis in the value of imports reflected declines of 22.3% in volume and 6.7% in prices, indicating the larger impact of a shrinkage of 46.2% observed the category of fuels and lubricants, as opposed to that provided by the price increases in other categories, ranging from 7% in consumer durables to 0.6%, in capital goods.

The development of the imported volume reflected decreases recorded in purchase quantities of raw materials and intermediate goods of 31.9%; fuels and lubricants, of 14.7%; capital goods, of 2.2%; and durable consumer goods, of 15.9%; offset in part by an increase on purchases of consumer nondurables, of 5%. It should be mentioned that, although recent developments in commodity prices are exerting a more pronounced impact on the price structure of exports than on imports from Brazil, its trajectory at the margin suggests the prospect of the country's improved terms of trade.

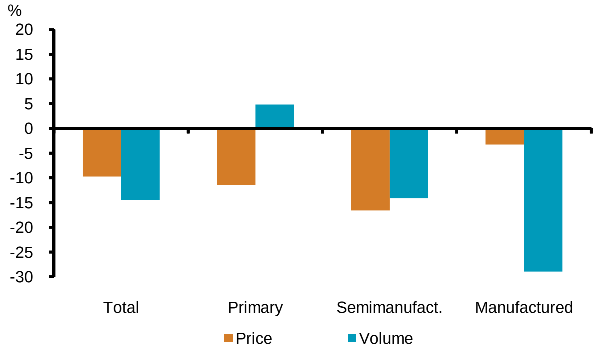
Table 5.5 – Exports and imports by area – FOB
Daily average – January-May

US$ million

Itemization	Exports			Imports			Balance	
	2008	2009	% change	2008	2009	% change	2008	2009
Total	706	549	-22.2	622	457	-26.6	84	93
L.A. and Caribe	182	116	-35.8	105	78	-25.7	77	38
Mercosur	83	49	-41.1	58	45	-22.2	24	3
Argentina	68	39	-43.7	52	39	-25.1	16	0
Other	14	10	-29.0	6	6	1.3	8	4
Other	99	68	-31.4	47	33	-30.0	52	35
USA[1/]	100	59	-40.7	91	82	-10.7	9	-22
EU	176	127	-28.0	131	101	-22.9	45	26
E. Europe	20	12	-40.7	18	4	-77.0	2	8
Asia	127	141	11.2	170	128	-24.8	-43	13
China	56	76	35.6	70	56	-20.1	-14	20
Other	71	65	-8.1	100	72	-28.1	-29	-7
Others	102	94	-7.7	107	64	-40.3	-6	30

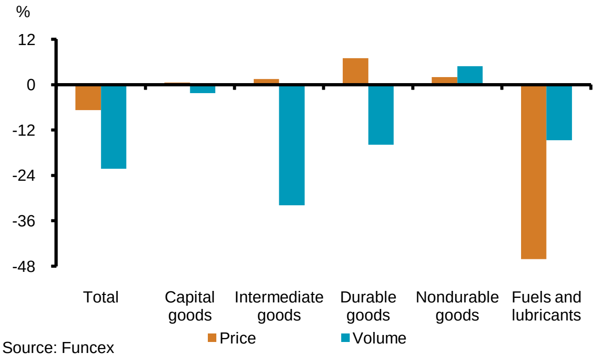
Source: MDIC/Secex
1/ Includes Puerto Rico.

Figure 5.5 – Exports – Price and volume index
January-May – 2009/2008



Source: Funcex

Figure 5.6 – Imports – Price and volume index
January-May – 2009/2008



Source: Funcex

5.3 Services and income

The current account deficit, after reaching US$28.2 billion in December 2008, has shown a trend of reversing the deterioration that began in mid-2007. This adjustment, evidenced by the deficit of US$6.6 billion reported in the first five months of the year, compared with US$14.1 billion in the same period last year, expressed improvement in trade balance, reducing the income account deficit and stability in net spending on services.

The trade surplus reached US$9.4 billion from January to May, increasing 9.3% over the same period in 2008. Net expenses of the income account reached US$11.2 billion, shrinking 37.8% in the period, while net remittances on the service account fell 2.4% to US$6.1 billion, and net revenues on unilateral transfers dropped 16.2%, to US$1.3 billion.

Revenues from international travel reached US$2.2 billion and expenses, US$3.5 billion, respective decreases of 12.5% and 22.7% over the first five months of 2008. Net expenditures, although lowering from US$2 billion to US$1.3 billion in the period, returned to be influenced over the past two months by the recent appreciation of the exchange rate.

Net remittances related to the account for equipment rental totaled US$3.6 billion, rising 46.7% in the first five months. Net payments abroad for royalties and licenses, including the provision of technology services, copyrights, licenses and registrations for trademark use and exploitation of patents, franchises, among others, reached US$771 million, decreasing 23.4%.

The income account deficit has been influenced by the trajectory of net remittances on income from direct investment, which respond to the increased stock of such investments in the country;to the profitability of enterprises and the needs of their respectiveheadquarters, and to the level of the exchange rate. Reflecting the reduction of external indebtedness, net remittances of profits and dividends remained more significant than the net interest expenses for the third consecutive year. This behavior reveals the predominance of the stocks of foreign direct investment and portfolio investment on the country's total external liabilities.

Net remittances of profits and dividends totaled US$7.8 billion from January to May, falling 49.8% over the same period in 2008, a movement consistent with the scenario of reducing the stock of foreign investment in the country – depending

Table 5.6 – Current account

US$ billion

Itemization	2008			2009		
	May	Jan-May	Year	May	Jan-May	Year[1/]
Current account	-0.8	-14.1	-28.2	-1.7	-6.6	-15.0
Trade balance	4.1	8.6	24.8	2.7	9.4	20.0
Exports	19.3	72.1	197.9	12.0	55.5	158.0
Imports	15.2	63.5	173.1	9.3	46.1	138.0
Services	-1.8	-6.3	-16.7	-1.7	-6.1	-13.0
Transportation	-0.7	-2.1	-5.0	-0.3	-1.2	-2.7
International travel	-0.6	-2.0	-5.2	-0.4	-1.3	-3.0
Computer and informat.	-0.2	-1.2	-2.6	-0.2	-1.0	-2.7
Operational leasing	-0.6	-2.5	-7.8	-0.7	-3.6	-8.5
Other	0.1	1.4	3.9	0.0	0.9	3.9
Income	-3.3	-18.0	-40.6	-2.9	-11.2	-25.0
Interest	-0.1	-2.6	-7.2	-0.4	-3.6	-8.6
Profits and dividends	-3.2	-15.6	-33.9	-2.6	-7.8	-17.0
Compensation of employees	0.0	0.2	0.5	0.1	0.3	0.6
Current transfers	0.3	1.6	4.2	0.2	1.3	3.0

1/ Forecast.

both on net remittances of portfolio flows and a reduction in their prices – and on exchange depreciation.

Net interest expenses totaled US$3.6 billion in the year through May, rising 41% over the same period in 2008, empahsized by a reduction of 31.1% recorded in revenues. Earnings on reserves – the main determinant of interest revenue and constrained by the monetary easing measures adopted worldwide in response to the global financial crisis – totaled US$2.4 billion, decreasing 23.1% over the first five months of 2008. Expenditure on interest payments abroad totaled US$6.7 billion, falling 4.9% in the period.

Net remittances of income on direct investment reached US$5.9 billion. The net expense of profits and dividends closed at US$5.3 billion, decreasing 51.6% over the first five months of 2008, while net remittances of interest on intercompany loans and portfolio investment amounted to US$604 million and US$3.2 billion, repsectively, with respective variations of -31.9% and 211.8% for the year. Net remittances related to other investments, including interest from supplier credits, loans, deposits and other assets and liabilities, totaled US$2.4 billion, remaining stable in the period. Companies in the industrial and services sectors were responsible, in order, for the sending of 53.6% and 45.1% of gross remittances of profits and dividends from FDI in the early five months of 2009, emphasizing the significance of remittances on financial intermediation segment of 24.1%, manufacturing and assembling of motor vehicles of 12.1%, and metallurgy of 10.7%.

Net unrequited transfers amounted to US$1.3 billion in the first five months of 2009, decreasing 16.2% over the same period last year.

5.4 Financial account

The capital and financial accounts reported a surplus of US$11.1 billion in the period ended in May, a performance associated with the larger impact of FDI inflows and stock, compared to that provided by the outflows of foreign capital related to fixed income securities and loans, especially the short–term ones.

The adverse conditions of international financial markets affected the Brazilian direct investment flows abroad earlier this year, which added up to US$20.5 billion in 2008, totaled US$944 million in the period ended in May. The creation of new direct investments abroad reached US$197 million,

Table 5.7 – Financial account

US$ billion

Itemization	2008 May	2008 Jan-May	2008 Year	2009 May	2009 Jan-May	2009 Year[1/]
Capital account	4.0	34.4	28.3	5.4	10.6	28.0
Direct investments	-0.1	6.4	24.6	3.9	10.3	25.0
Abroad	-1.4	-7.5	-20.5	1.5	-0.9	0.0
In Brazil	1.3	14.0	45.1	2.5	11.2	25.0
Equity capital	0.3	8.3	30.1	1.8	6.3	12.5
Intercompany loans	1.0	5.7	15.0	0.7	5.0	12.5
Portfolio investments	2.5	12.9	1.1	3.3	-0.4	-0.8
Assets	0.3	0.0	1.9	-0.4	-0.9	0.0
Liabilities	2.3	12.9	-0.8	3.7	0.5	-0.8
Derivatives	0.0	-0.3	-0.3	0.0	0.2	0.0
Other investments	1.6	15.4	2.9	-1.9	0.4	3.8
Assets	0.9	-1.3	-5.3	-4.1	-7.4	1.0
Liabilities	0.7	16.6	8.1	2.2	7.8	2.8

1/ Forecast.

Table 5.8 – BP financing sources

Selected items

US$ billion

Itemization	2008 May	2008 Jan-May	2008 Year	2009 May	2009 Jan-May	2009 Year[1/]
Medium and long-term funds	1.5	7.3	13.5	1.3	4.8	11.7
Public bonds	0.5	0.5	0.5	0.8	1.8	1.8
Private debt securities	0.7	3.9	7.3	0.4	2.2	6.0
Direct loans	0.3	2.8	5.7	0.2	0.8	4.0
Short-term loans (net)[2/]	1.4	1.3	-8.1	0.1	-3.0	0.0
Short-term sec. (net)	0.0	-1.0	-3.9	-0.1	-1.5	0.0
Portfolio (net)	1.6	14.7	4.4	3.5	2.5	3.0
Roll-over rates (%)[3/]						
Private sector:	227%	222%	111%	35%	58%	75%
Debt securit.	434%	194%	85%	49%	59%	75%
Direct loans	107%	281%	193%	22%	53%	75%

1/ Forecast.
2/ Includes direct loans and trade credits transferred by banks.
3/ It is equivalent to the ratio between medium-and long-term disbursements and amortizations, excluding amortizations resulting from debt-equity conversion.

compared with US$5.5 billion in the equivalent months of 2008, while intercompany loans declined 63.2%during that period, totaling $748 million.

Net inflows of FDI reached US$11.2 billion, compared with US$14 billion in the first five months of 2008. Net flows in equity ownership totaled US$6.3 billion and intercompany loans US$5 billion, respectively declining 24.5% and 12.7% in the period.

Foreign portfolio investment totaled net inflows of US$462 million in the first five months of the year, compared with US$12.9 billion in same period of 2008. Net inflows for foreign investment in stock of Brazilian companies totaled US$3.1 billion, compared with US$5.2 billion from January to May 2008, while foreign investments in fixed income securities amounted to net outflows of US$2.7 billion compared with net inflows of US$7.6 billion, with emphasis on a reversal of net inflows of US$9.3 billion in remittances from US$621 million of foreign investments in fixed income securities in the country.

The sovereign bond market recorded net disbursements of US$1.1 billion in the year through May, reflecting the issuance of US$1 billion on the launch in January of the Global 19N bonds and its relaunch in May of US$750 million. Amortizations for the original schedule of maturities and early redemptions of debt totaled US$724 million.

The operations of notes and commercial papers posted net repayments of US$1.6 billion through May, compared with net disbursements of US$1.8 billion in the corresponding range of 2008. The short-term securities recorded net repayments of US$1.5 billion in the period.

The performance of other Brazilian investment showed net granting of short-term borrowings of US$8.2 billion. Deposits abroad dropped by US$1 billion in the first five months of the year, a result of the formation of US$268 million by the banking sector and returns of US$1.2 billion related to the other sectors.

Other foreign investments, including direct loans to banks and international organizations, trade credits and creation of assets as deposits, reported net income of US$7.8 billion in the first five months of the year, compared with net disbursements of US$16.6 billion in the same period of 2008. Net inflows of commercial loans totaled US$9.1 billion, consisting of short-term funds. Loans

Table 5.9 – Statement of international reserves

US$ billion

Itemization	2008		2009	
	Jan-May	Year	Jan-May	Year[1/]
Reserve position in previous period	180.3	180.3	193.8	193.8
Net Banco Central purchases	13.2	-5.4	2.0	8.8
Spot	13.2	7.6	-0.7	-0.7
Repo lines of credit	-	-8.3	4.8	8.3
Foreign currency loans	-	-4.7	-2.0	1.1
Debt servicing (net)	-1.9	-0.4	-0.3	-0.9
Interest	0.9	2.8	0.4	1.2
Credit	3.1	7.2	2.4	5.2
Debit	-2.2	-4.4	-2.0	-4.0
Amortization	-2.7	-3.2	-0.6	-2.1
Disbursements	0.5	1.3	-	-
Multilateral organizations	-	0.8	-	-
Sovereign bonds	0.5	0.5	-	-
Others[2/]	0.6	10.4	-2.9	-2.9
Treasury's purchases	5.0	7.6	2.6	6.1
Change in assets	17.4	13.4	1.5	11.0
Gross reserve position	197.8	193.8	195.3	204.8
Repo lines of credit position	-	8.3	3.6	-
Foreign currency loans position	-	4.7	6.7	3.6
Reserves position - liquidity	197.8	206.8	205.6	208.4

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.

saw a deficit of US$1.7 billion, reflecting medium and long-term net inflows of US$1.3 billion and net repayments of US$3 billion related to short-term operations.

The rollover of medium and long-term private sector external debt, whose rate reflects new disbursements in relation to amortizations, stood at 58% from January to May. The percentages relative to the rollover of securities and medium and long-term direct loans ranged, respectively, 59% and 53%.

International reserves, considered the liquidity concept, which includes the repurchase lines and foreign currency credit operations, totaled US$205.6 billion in May, falling US$1.2 billion in the year. During this period, net purchases of the central bank foreign exchange market amounted to US$2 billion, resulting from cash sales of US$693 million, purchases of US$4.8 billion in transactions with repurchasecommitments, and sales of US$2 billion in in foreign currency loans abroad. Highlights among foreign operations are revenues of US$2.4 billion from earnings on reserves, while the other operations exerted a negative impact of US$2.9 billion in the period. The stock of foreign currency sale operations with repurchase agreement totaled US$3.6 billion at the end of May, while business loans against collateral in foreign currencies amounted to US$6.7 billion.

Considering the cashcriterion, international reserves reached US$195.3 billion in May, rising US$1.5 billion in the year.

5.5 External sustainability indicators

The external sustainability indicators, in line with the new environment experienced by the world economy registered as a whole an interruption of the steady improving movement that occurred until the end of 2008. In this framework and considering the December 2008 and May 2009 positions, one should highlight the impact of falloffs in exports and the US dollar GDP, partly offset by the reduction verified in total foreign debt.

The share of debt service in exports reached 21.2% in May, up 19% in December, an increase consistent with a decrease of US$16.6 billion marked in exports in the period.

The total external debt declined US$4.4 billion, while the surplus position of net total external debt rose from US$27.7 billion to US$28.8 billion, and the estimated GDP

Table 5.10 – Sustainability indicators[1/]

US$ billion

Itemization	2006	2007	2008			2009
	Dec	Dec	Jun	Sep	Dec	May[2/]
Exports of goods	137.8	160.6	178.1	194.9	197.9	181.4
Exports of goods and services	157.3	184.6	205.1	224.3	228.4	210.7
Debt service	56.9	52.0	40.5	38.9	37.6	38.5
Total external debt	172.6	193.2	205.5	211.4	198.3	194.0
Net external debt	74.8	-11.9	-19.2	-20.6	-27.7	-28.8
International reserves						
Cash concept	85.8	180.3	200.8	206.5	193.8	195.3
Liquidity concept	85.8	180.3	200.8	207.5	206.8	205.6
GDP	1 089	1 334	1 458	1 526	1 573	1 373
Indicators						
Total external debt/GDP (%)	15.8	14.5	14.1	13.9	12.6	14.1
Net external debt/GDP (%)	6.9	-0.9	-1.3	-1.4	-1.8	-2.1
Total external debt/exports	1.3	1.2	1.2	1.1	1.0	1.1
Total external debt/exports of goods and services	1.1	1.0	1.0	0.9	0.9	0.9
Net external debt/exports	0.5	-0.1	-0.1	-0.1	-0.1	-0.2
Net external debt/exports of goods and services	0.5	-0.1	-0.1	-0.1	-0.1	-0.1
Debt service/exports (%)	41.3	32.4	22.8	19.9	19.0	21.2
Debt service/exports of goods and services (%)	36.2	28.2	19.8	17.3	16.5	18.3
Reserves – Cash concept/ total external debt (%)	49.7	93.3	97.7	97.7	97.7	100.7
Reserves – Liquidity concept/ total external debt (%)	49.7	93.3	97.7	98.2	104.3	106.0

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

in US dollars dropped by US$200 billion. As a result, the ratio total debt to GDP increased 1.5 percentage points to 14.1% in the period. One should note an increase to 2.1 in the surplus ratio total net debt to GDP.

The ratios total debt to exports and total net debt to exports came to, in the same order, 1.1 and -0.2, the latter in the best level ever seen since the series was initiated in 1970.

The indicator that evaluates the representativeness of international reserves, in the liquidity concept, in external debt rose from 104.3% in December to 106% in May, developments arising from reductions recorded in the period in international reserves of US$1.2 billion and total external debt of US$4.4 billion.

The relationship between international reserves, in the liquidity concept and the M2 aggregate, after reaching 46.8% in November 2008 and remaining at that level in the first quarter, the highest value since the introduction of the Real, showed successive declines in two months ended in May, impacted by exchange rate appreciation and ending the period at 37.8%. Utilizing the reserves in the cash concept, this indicator reached 35.9% at the end of May.

5.6 Conclusion

After nine months of an aggravating crisis on international financial markets, the stability of international reserves and a reduction of the relative share of external debt in total country's liabilities on behalf of investments, both direct and portfolio, reinforce the argument of the appropriate management of the domestic economic policy in recent years as a key element to maintaining the soundness of the balance of payments and, hence, the resistance of the external sector to the global financial crisis.

The most recent scenario, while still incorporating high degrees of uncertainty, reveals more favorable conditions for the country's external accounts. Accordingly, there's a reduction of stress in financial markets, expressed by the performance of risk indicators, which are close to the level recorded prior to the aggravatin of the crisis, exerting positive impact on foreign investments flows and surpluses on the exchange market.

The current account deficit projected for the balance of payments in 2009, lower than that reported in previous years, should be fully financed by inflows of FDI, an environment compatible with the return of cash purchases by the Central Bank in the currency market – maintaining the policy of not setting floors or ceilings for the rate – aimed at strengthening the country's international reserves.

Balance of Payments Projections

The international crisis and the uncertainties inherent to this process, even considered the improvement indicators observed in recent months, expressed by net flows of foreign investment, by the return of surpluses of foreign exchange market and by the behavior of risk indicators, remained conditioning the accounts of the balance of payments. The global recession and external credit crunch led to adjustments, expressed as reductions in trade flows and net remittances of profits and dividends, and as the downward trend of deficit in current accounts. Additionally, there was a decline in net inflows of the financial account, with lower flows of Foreign Direct Investment (FDI) and net outflows related to external debt amortizations. Despite the seriousness of the crisis and its consequences, the conditions for financing the balance of payments remain adequate.

This box records the projections for the balance of payments in 2009, revised in comparison to those in the March Inflation Report. This new projection considers the most favorable results observed in recent months, changes in external debt service consistent with its stock in March, the Central Bank intervention in foreign exchange and foreign sovereign debt repurchases of Treasury, to take effect up to May.

The deficit projected for the current accounts for 2009 was reduced from US$16 billion in the previous Inflation Report, to US$15 billion. The annual projection for the trade surplus was raised, from US$17 billion to US$20 billion, reflecting the stability in the estimate for exports, at US$158 billion, and reduced to US$138 billion in those estimates regarding imports. Estimates are consistent with increases recorded in accumulated

Table 1 – Uses and sources

US$ billion

	2008			2009		
	May	Jan-May	Year	May	Jan-May	Year[1/]
Uses	-1.8	-22.7	-50.6	-4.2	-16.5	-41.2
Current account	-0.8	-14.1	-28.2	-1.7	-6.6	-15.0
Amortizations ML-term[2/]	-1.0	-8.6	-22.4	-2.5	-9.9	-26.2
Securities	-0.3	-5.1	-12.4	-0.8	-4.5	-11.6
Paid	-0.3	-5.1	-12.4	-0.8	-4.5	-11.6
FDI conversions	0.0	0.0	0.0	0.0	0.0	0.0
Suppliers' credits	-0.1	-0.7	-1.7	-0.2	-1.1	-2.2
Direct loans[3/]	-0.6	-2.9	-8.3	-1.4	-4.2	-12.3
Sources	1.8	22.7	50.6	4.2	16.5	41.2
Capital account	0.1	0.3	1.1	0.1	0.5	1.0
FDI	1.3	14.0	45.1	2.5	11.2	25.0
Domestic securities[4/]	1.4	12.7	6.3	3.4	3.1	3.0
ML-term disbursem.[5/]	3.1	14.9	31.6	2.9	10.6	25.1
Securities	1.2	4.5	7.8	1.2	4.0	7.8
Supliers' credits	0.2	1.1	2.2	0.2	1.1	3.2
Loans[6/]	1.6	9.3	21.6	1.5	5.5	14.2
Brazilian assets abroad	-0.3	-8.8	-23.5	-3.0	-8.9	1.0
Other[7/]	0.2	6.3	-6.9	2.1	4.4	0.0
Reserve assets	-4.0	-16.6	-3.0	-3.7	-4.4	-14.0

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

surplus up to May, compared to the same period of 2008, with the recession in the global economy, with the prospect of gradual recovery of commodity prices, and with the slowdown of the Brazilian Gross Domestic Product (GDP).

The services accounts should present a deficit of US$13 billion in 2009. The expansion of US$400 million over the previous projection reflects, in particular, the projected increase in the deficit in the international travel item, from US$2.5 billion to US$3 billion, driven by currency appreciation in the second quarter of 2009. The projection of net spending on equipment rentals increased to US$8.5 billion, considered the existing deals, which involve rigidity in expenditures, and the results of this heading in recent months.

The projection for net interest expenses in 2009 reaches US$8.6 billion, slightly higher than the one of the previous Inflation Report. Gross expenditure, estimated from the position of the March debt stock, highlighting the impact of the reduction of international interest rates (Libor) on part of the debt subject to floating charges, came to US$15.4 billion. Revenues are forecast at US$6.8 billion, of which US$5.2 billion relate to the remuneration of the country's international reserves.

The estimate for net remittances of profits and dividends has been revised from US$15 billion to US$17 billion, a move consistent with the impact of some improvements in the domestic scenario, with the return of foreign investors and with the recent currency appreciation. It is worth mentioning that the stock of foreign investment in the Sao Paulo Stock Exchange (Bovespa), which had declined from the record level of US$200.9 billion in May 2008 to US$70.7 billion in November that year, amounted to US$121.7 billion by the end of April 2009.

Unilateral transfers were maintained at US$3 billion predicted in March, as reflected on the behavior of this account in recent months.

The financial account surplus, estimated at US$27.7 billion in March, dropped to US$28 billion, with emphasis on the reversal of the projection related to foreign portfolio investments in the country, medium and long term, on the remittances of US$10 billion in net inflows of US$3 billion in this report. The performance of the financial account also reflects the maintenance of net FDI inflows at US$25 billion, after the historical record of US$45 billion recorded in 2008.

Amortization of medium- and long-term external debt were revised up from US$24.6 billion to US$26.2 billion, due to depreciation foreseen in the new scheme of the external debt in March 2009. Payments to suppliers should total US$2.2 billion, compared TO US$1.1 billion in the previous forecast, and those regarding securities (bonds, notes and commercial papers), US$11.6 billion, compared to US$11.3 billion in March. The projection for direct loans increased slightly to US$12.3 billion.

The projection for the rollover rate of medium- and long-term foreign indebtedness of the private sector was maintained at 75%, resulting in net repayments of foreign debt. It should be noted that this projection for the average rollover rate for the year implies an improvement on the percentage observed in recent months.

In this scenario, the balance of payments – market will record a surplus of US$6.9 billion. The Central Bank will absorb US$8.8 billion of that amount, due to repurchases of lines and loans in foreign currency while the assets of commercial banks abroad will decrease by US$1.9 billion, against US$13.8 billion in the previous projection.

International reserves, when viewed in the liquidity concept, are expected to total US$208.4 billion at the end of 2009, increasing US$1.6 billion compared to the previous year. For the year, the projection for the interest revenue of US$5.2 billion has been maintained due to reserve earnings. Considering the cash concept, which incorporates the effects of the measures adopted by the Central Bank to provide liquidity in foreign currency, reserves should rise to US$11 billion in the year, reaching US$204.8 billion by the end of 2009, with emphasis on returns of lines and loans and in the spot market interventions held in May.

Table 2 – Balance of payments – Market

US$ billion

Itemization	2008			2009		
	May	Jan-May	Year	May	Jan-May	Year[1/]
Current account	-1.4	-17.2	-35.3	-2.2	-9.0	-20.2
Capital (net)	2.3	29.7	26.5	5.9	11.3	27.1
Foreign direct investment	1.3	14.0	45.1	2.5	11.2	25.0
Portfolio investment	1.4	12.7	6.3	3.4	3.1	3.0
Medium and long term loans	0.4	1.7	1.6	-0.4	-0.6	-3.6
Trade credits – Short, medium and long term	0.9	13.7	2.8	2.8	7.5	2.5
Banks	2.3	4.8	-1.6	0.9	-1.6	1.6
Other	-1.3	8.9	4.5	1.9	9.1	1.0
Brazilian investment abroad	-1.9	-9.5	-27.0	-2.6	-8.6	-0.9
Other	0.1	-2.9	-2.3	0.1	-1.3	1.0
Financial gap	0.9	12.5	-8.9	3.7	2.3	6.9
Banco Central net intervent.	-2.5	-13.2	5.4	-3.2	-2.0	-8.8
Bank deposits	1.6	0.7	3.4	-0.4	-0.3	1.9

1/ Forecast.

Inflation outlook

6

This chapter of the *Inflation Report* presents the Monetary Policy Committee's (Copom) assessment of the behavior of the Brazilian economy and of the international scenario since the release of the last *Report* in March 2009, as well as the inflation outlook up to the second quarter of 2011 and the GDP growth by the end of 2009. The projections for inflation are presented in two main scenarios. The first scenario, called the baseline scenario, assumes that the Selic rate will remain unchanged over the forecast horizon, at the 9.25% per year, the level set by Copom at its most recent meeting on June 9th and 10th, and the exchange rate will remain at R$1.95 per US dollar. The second scenario, named the market scenario, is based on expected paths for the Selic rate and the exchange rate drawn from the survey carried out by Banco Central do Brasil's Investors Relations Group (Gerin) among independent analysts. It is important to stress that these scenarios serve only as support for monetary policy decisions, and their assumptions should not be viewed as Copom forecasts about the future behavior of interest and exchange rates. The projections released here are based on the information set available up to the cutoff date of June 12, 2009.

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

6.1 Inflation determinants

After reaching 6.41% in October 2008, inflation in twelve months as measured by the by the change in the Broad National Consumer Price Index (IPCA) is receding, while remaining at a level situated above the central target. In fact, after finishing last year at 5.90% – rate 1.44 percentage points (p.p.) higher rate than in 2007 (4.46%) – inflation moved to 5.20% in May. In 2009 until May, the IPCA recorded inflation of 2.20%, a rate 0.68 p.p. lower than that observed in the same period last year. Initially, this dynamic was influenced by a decline in commodity prices observed in the second half of 2008 and subsequently by the slowing domestic economy recorded since the last quarter of last year, a result of the deepening crisis in international financial markets. So far, it is plausible to claim that the effects of these two factors more than offset price pressures, arising from exchange rate depreciation since August last year. Nonetheless, more recently, commodity prices have shown signs of recovery, while the exchange rate came into path of appreciation, after overcoming the threshold of R$2.50 per US dollar in December.

By May, the set of regulated and monitored prices accumulated a variation of 1.99% and market prices of 2.29%. In the set of market prices, there was a change in the price of non-tradable items (3.13%), much higher than that found in the case of tradable goods (1.38%), despite the slowing of the economy. This phenomenon points out the importance of evaluating the price of imports in R$, instead of considering only the exchange rate as a proxy for the behavior of tradable goods. The recent dynamics of prices has led to a narrowing of the difference between inflation in twelve months of market prices and the set of regulated and monitored prices, which rose from 6.21 p.p. in June 2008 to 1.57 p.p. in May. Moreover, showing some resilience in domestic demand as well as the presence of widespread indexation mechanisms in the informal economy, the prices of services have been recording an acceleration in both the criterion of the accumulated variation in twelve months (7.23% in May, against 6 39% in December 2008, and 5.58% in the same month last year) and in the accumulated year variation (3.92% between January and May, against 3.10% in the same period of 2008). In short, the behavior of inflation confirmed the assessment, included in the *Inflation Report* of March that, despite the expected decline of inflation in 2009, it should provide some resistance given the demand conditions.

After decreasing 3.6% in the last quarter of 2008, compared with the previous one, according to seasonally adjusted data by the Brazilian Institute of Geography and Statistics (IBGE), the GDP at market prices fell by 0.8% in the first quarter of 2009. Note that since the third quarter of 2003, GDP has not diminished by two consecutive quarters, in this basis of comparison. In the same period of 2008, the decrease amounted to 1.8% in the first quarter of 2009, interrupting twenty-eight quarters of expansion according to that criterion. The slowdown of activity reflects the contractionary effects of the deepening world economic crisis starting in September, particularly in relation to declining exports and the credit crunch, which provoked sharp reactions in the levels of output and employment. However, expectations of market participants point to the recovery of activity in the second quarter of 2009, a move that reverberates, in large part, the resilience of household consumption.

From the production viewpoint, the decline in the industrial sector stands out which, after falling 8.2% in the fourth quarter of last year, compared to the previous quarter (according to seasonally adjusted data by the IBGE) recorded a further contraction (3.1%) in the first quarter. The performance of this sector was strongly influenced by a reduction in demand for durable goods and investment, besides the fall in external demand, reflecting intensely on some key industries such as metallurgy, automobiles and machinery and equipment. Moreover, because of the discontinuity in the pace of demand expansion, the industry entered the most severe period of global financial crisis with high inventories, which hampered the speed of recovery in progress. In turn, the agricultural sector declined by 0.5% in the first quarter, compared to the previous quarter, while the service sector – the largest in GDP – has shown some resilience and has grown 0.8%, recovering from a downturn of 0.4% in the previous quarter. Over the same period last year, these sectors recorded a decrease of 1.6% and a growth of 1.7%, respectively.

With regard to demand, a negative highlight came from the Gross Fixed Capital Formation (GFCF) that, according to seasonally adjusted data, fell by 12.6% compared to the fourth quarter, even after shrinking 9.3% in the last quarter of 2008. Thus, GFCF, which expanded 19.7% in the third quarter last year, compared to the same quarter of 2007, grew only 3.8% in the fourth quarter and fell 14.0% in the first quarter of this year (using the same basis of comparison). In turn, household consumption expanded 0.7% from the previous quarter, after decreasing 1.8% in the fourth quarter. On the same basis of comparison, government expenditure recorded, respectively, increases of 0.6% and 0.5%. Compared to the same period last year, both grew

1.3% and 2.7%, respectively. In turn, contrary to what has happened since the first quarter of 2006, in the first quarter of 2009 the external sector contributed positively to GDP growth (0.1 p.p.), while imports fell 16.0% (contribution of 2.3 p.p.), exports fell by 15.2% (-2.2 p.p. contribution). Nevertheless, given the unpromising outlook for global economic growth and recovery in the domestic economy, as well as the expected effects of monetary easing already in place, the Committee believes that domestic demand will remain the key factor for sustaining economic activity.

The resilience of domestic demand has been a stabilizing element of the Brazilian economy. The data of retail sales, which have faded production data in recent months – partly due to high inventory levels that industry began the year with – corroborate this assessment. Retail sales recorded a growth of 4.5% in the first four months of the year, compared with the same period last year. While showing deceleration in relation to the expansion in 2008, when the increase reached 11.0%, growth remains high. In fact, the expansion in the twelve months decreased from 10.3% in September, when the international crisis intensified, to 7.0% in April. It is noticeable the strong increase of sales in the segment "equipment, office supplies, computer and communication" whose growth reached 18.1% in the first four months of the year. Expanded retail sales – which includes "vehicles, motorcycles, parts and accessories" and "construction material" (sectors more sensitive to credit conditions) – has also shown resilience by growing 2.5% over the same period. Thus, the Committee understands that, although it should provide less momentum than that observed in the first three quarters of 2008, retail sales should continue to record positive results over the coming quarters.

Unemployment rate, measured by the monthly survey of IBGE, which had been consistently falling over recent years (annual average of 10% in 2006, 9.3% in 2007 and 7.9% in 2008), has increased in recent months, reflecting the effects of an economic slowdown. According to seasonally adjusted data, after reaching the minimum in October (7.5%) since the beginning of the unemployment series under the current methodology, unemployment rose to 8.3% in April. On the other hand, the deterioration of the labor market did not affect in a clear way the labor income. According to IBGE, the average real earnings usually received by the employed population, which increased 3.2% in 2007 and 3.4% in 2008, continued to soar in 2009 and by April showed an increase of 4.1%. In turn, the average number of employed persons, which grew 2.6% in 2007 and 3.4% in 2008, rose 2.6% in the year to April. As a result, real payroll – important factor driving aggregate demand in recent years – which had advanced 5.8% in 2007 and 6.9% in 2008, increased by 5.9% in the year to April. According to the National Confederation of Industry (CNI), the level of employment in manufacturing, which increased 3.6% in 2007 and 4.0% in 2008, fell 2.0% in 2009 up to April. This reflects, in large part, the decline in industrial production in recent quarters. With regard to the evolution of formal employment, data from the Ministry of Labor and Employment (MTE) showed marginal recovery, after heavy falls at the end of last year and early this year. The losses in early 2009 reversed, provided that up to April, the figures from MTE show the creation of 48,500 new jobs. Note also that after five consecutive months of decline, the manufacturing sector showed stability in the creation of formal jobs in April.

In addition to the rising payroll, the availability of credit to households – largely determined by macroeconomic stability and institutional reforms – was an important driving force of the growth in household consumption in recent years. Since the intensification of the global economic crisis, financing conditions have deteriorated sharply from September 2008 (either through higher rates or shorter maturities). Additionally, given the greater macroeconomic uncertainty and a weakening of the labor market, agents have become more reluctant to get credit. This more restrictive scenario began to dissipate in a more pronounced way since the release of last *Report*. In addition to increased credit supply via state-owned banks, private companies are returning to raise funds either abroad or through capital markets, a channel that had been closed after September. In comparison to the same month last year, in April earmarked loans from the financial system to individuals grew by 18.7% (23.2% in January), with emphasis on the expansion of leasing operations (64.8%, compared to 84.1% in January). There is also an ongoing recovery of credit to individuals, especially payroll-deductible loans. Importantly, this credit expansion has been characterized by a modest elevation, so far, in delinquency rates. The expectations of market analysts and representatives of the banking sector indicate that, although there should be slowing down compared to 2008, the volume of credit will continue to expand in 2009.

Investment, which until the third quarter of 2008 was shaping up as the most dynamic component of domestic demand, turned out to be the one that showed the biggest decrease in the last two quarters, following the cyclical pattern. In fact, during this period, while GFCF shrank 20.8%, government expenditure rose by 1.1%. The worsening of world financial crisis led to revaluation of investment plans of businesses, either because of the worsening outlook for demand growth, because of greater macroeconomic uncertainty, or even the deterioration in financing conditions, both in terms of maturities as the price of credit. The heavy losses in the stock market after September 2008 caused the loss of attractiveness of financing via the capital market, further intensifying the funding restrictions. Another factor limiting investment was the depreciation of the Real, leading to increased costs of imported capital goods. However, in both cases, there are signs of a reversal of the scenario. In fact, the stock market recorded a good recovery in 2009 and the exchange rate appreciated. In this context, the Committee understands that the most likely scenario contemplates recovery of investments in the Brazilian economy over the coming quarters.

Capital markets were strongly affected by the intensification of global economic crisis. After the significant volume of initial public offerings of shares in the first half of last year, and the virtual absence of significant funding in the second half of 2008 (R$31.7 by August and R$32.1 billion in 2008), encouraging signs that companies will again use this funding channel are beginning to emerge. In fact, several of them have already announced plans to undertake new financing, including initial public offerings of shares. In turn, the bond issuance (excluding emissions by leasing companies) has proved to be relatively stable. After having raised R$6.3 billion in 2008 through this financial instrument, the companies have already picked up R$4.2 billion up to May. In turn, loans and financing with resources from The Brazilian Development Bank (BNDES) totaled R$25.6 billion in the first four months of the year, volume that was 1.1% below the same period in 2008.

Regarding the external sector, after recording a surplus of US$40 billion in 2007 and US$24.8 billion in 2008, the trade balance reached US$9.4 billion by May this year, an increase of 9.3% over the same period last year, contradicting more negative predictions prevailed in the beginning of the year. Despite this increase in the trade balance, both imports and exports show significant reductions in the year, in line with the contraction that has occurred in world trade. After hitting a record US$197.9 billion in 2008 (23.2% increase over 2007), exports reached US$55.5 billion in the first five months of the year, a figure 23.0% lower than in the same period last year. Likewise, after the record of US$173.1 billion in 2008 (an increase of 43.5% over 2007), imports fell to US$46.1 billion by May, falling 27.4% over the same period last year. Thus, the declining trend observed in the trade surplus during the last *Report* was reversed.

Nevertheless, even this dynamic is maintained over the years, the effects of global economic crisis on the global flow of trade – both by lower global economic activity as a fall in prices, especially of commodities – allow to anticipate a decrease of the exported volume in 2009 – something that has not happened since 1999, despite the average exchange rate depreciation – as imports.

After decreasing 2.5% in 2008, the quantum of exports decreased 10.6% by April, clearly reflecting the effects of the slowdown in external demand. Moreover, after increasing 26.3% in 2008, the average price of exports declined by 7.9% up to April, and did not offset, as occurred last year, the fall in quantum of exports. In turn, after growing 17.7% in 2008, the quantum of imports shrank by 20.2% in April, clearly reflecting the effects of global crisis on the domestic economy, on both by the demand as the exchange rate. On the other hand, after a strong increase of 22.0% in 2008, the price of imports shows a reduction of 4.9% by April.

Since the release of the last *Report*, the global economic crisis began to show the first signs of cooling, albeit weakly and heterogeneously, among the mature economies. In addition, there are signs that its effects on some developing countries could dissipate quicker than expected. These facts are starting to be clearly reflected in commodity prices, which showed significant recovery in 2009, particularly regarding oil prices, which recently surpassed the US$70 barrier. Another indicator has been the appreciation of currencies of emerging countries, partly reflecting lower fears about the evolution of their economies and reducing global risk aversion. The current account deficit, after registering US$28.2 billion, or 1.8% of GDP in 2008, reached US$4.9 billion in April, falling to 1.4% of GDP (1.4% in twelve months), strongly contradicting the predictions made by independent analysts earlier this year, which envisioned figures of much higher magnitude. This deficit was fully financed by the net inflow of foreign direct investments, which totaled US$8.8 billion up to April and accounted for 2.6% of GDP.

After nearly two years since its onset, the effects of the "subprime crisis" – which began in the US housing market and had spreaded to the US financial and credit markets and other mature economies – could be starting to cool, especially with regard to the impacts on the momentum of emerging economies, including Brazil. In this context, the various measures implemented by the Federal Reserve and other central banks, including setting targets for the basic interest rates near zero and the adoption of monetary policy strategies based in quantitative easing, in some cases supplemented by aggressive fiscal measures, indicate a depletion of the contractive trend observed in previous quarters, although the process is subject to reversal. The problems of the international financial system persist and, therefore, persists an ongoing risk of further intensification of the slowdown. In summary, the outlook for the global economy has stabilized since the release of the previous *Report*, and the most likely scenario remains that the global economic recovery will only be consolidated in 2010.

Regarding aggregate supply, after registering a decrease in the fourth quarter of 2008 compared to the third one, according to seasonally adjusted data, both the industrial and agriculture sectors returned to recede in the first quarter of 2009 (3.10% and 0.5%, respectively). In turn, after declining in the last quarter of last year (-0.4%), the service sector, which has the greatest weight in the economy, regained its growth in the first quarter (0.8%). Comparing to the same period last year, the shrinkage of the manufacturing sector reaches 9.3%, and 1.6% by agriculture. The service sector registered growth of 1.7%.

Industrial production suffered a significant slowdown after the worsening global economic crisis in September 2008. Up to this month, it recorded an increase of 6.4% in the year, a rate which was reduced to 3.1% by the end of 2008, following falls in respect to the previous month of 7.1% and 12.7% in November and December, respectively, according to seasonally adjusted data. Although growing since January (at monthly rates of 2.1%, 1.9%, 0.9% and 1.1%), industrial production is still at levels well below those recorded in the same period last year. In fact, up to April, industrial production decreased 14.7% in comparison to the same period last year. The decline was equally severe in both the manufacturing industry and in the mining industry. However, the sectors most dependent on credit, such as automotive and construction, which were initially hit hardest by the global economic crisis, showed recovery in large part due to the effects of counter-cyclical measures implemented by government, such as tax reduction of the IPI over the white line goods and cars, as well as the gradual restoration of access to credit. Incidentally, the auto industry, which exhibited excess inventory at the end of last year, faces a shortage of localized models.

On the demand side, GDP shrank 1.9% in the first quarter of 2009, with the external sector showing positive contribution of 0.1 p.p. After falling below the 100 level in August – implying that the number of companies who evaluate stocks as excessive surpasses that of assessing that they are insufficient – the indicator from the Manufacturing Industry Survey of FGV continued to fall and reached the level of 81 in December and January – the lowest level since July 2003. Since then, the indicator had rose again and reached 88 points in May, suggesting that the normalization process of inventories is ongoing. The adjustment of inventory levels has apparently generated a discrepancy between the dynamics of production and sales, and partly explains the lack of momentum in the industry early this year. It is expected that, as the inventory level comes close to its equilibrium level, the growth of industrial production gains force, with positive effects on employment and income levels. In this sense, besides the natural dynamics of adjustment, the measures taken by the government, such as the tax reduction of the IPI for automotive sector and white line goods, and monetary easing, have contributed to set the effective inventories closer to the respective planned levels.

After reaching 86.6% in August last year, the monthly Level of Utilization of Installed Capacity (Nuci), without seasonal adjustment, computed by FGV moved to 78.7% in May, falling 6.9 p.p. compared to the same month last year, constituting the eighth consecutive reduction using the same basis of comparison. With regard to the expansion of capacity following consecutive increases over the past years (5.1% in 2005, 13.5% in 2006 and 19.3% in 2007) the growth of the absorption of capital goods reduced to 17.7% in December 2008, after reaching 22.2% in September. The reversal observed at the end of last year has intensified in the early months of 2009. In fact, up to April there was a strong contraction (18.6%) in the absorption of capital goods, due to the decrease of 7.5% in imports of capital goods and of 22.6% in the production of these goods. It should be noted that, on the same basis of comparison, the production of inputs for construction also fell sharply in January (-11.1%). Despite the large increase in idleness, considering the interannual basis of comparison, recent figures for industrial production, in conjunction with automobile sales and retail figures, suggest a recovery of industrial activity. In fact, the indicator of the level of global demand from the Economic Outlook Survey of FGV for the manufacturing industry shows that, after falling from a 121 level in September to 65 in January, the indicator rose to 85 in May.

After a long period of acceleration in prices of the construction sector, the National Cost of Construction Index – Domestic (INCC-DI) began to show signs of cooling in the last quarter of 2008, whose intensity has increased in recent months. After peaking in November (12.34%), in twelve-months the INCC receded to 8.98% in May.

This level is still slightly higher than that observed in the same period of 2008 (8.06%). These developments reflect higher inflation persistence, despite the marked slowdown in the sector since the global financial crisis intensified in September last year, partly derived from the rising costs of manpower.

After two consecutive years of reduction (10% in 2006, 9.3% in 2007 and 7.9% in 2008) the average unemployment rate rose to 8.7% in the first four months of the year, a level 0.2 p.p. higher than that observed in the same period last year. This reversal becomes clear when looking at the average rate of unemployment for the last twelve months, with their 23 straight months of reduction discontinued in January. This trend should persist over the next months, when the labor market will tend to more clearly reflect the effects of the global crisis on the level of activity. In fact, the adverse repercussions on the labor market are clearly registered in the figures of formal employment and in statistics on manufacturing employment. So far, however, the granting of collective vacations, declining working hours and other emergency measures, beyond the discouragement effect, have mitigated the rise in unemployment rates.

The price of oil, a source of systematic uncertainty arising from the international scene, remains at levels below those prevailing until the middle of last year, although it shows a clear reversal against the downward trend observed in the second half of 2008. In fact, after reaching nearly US$150 in mid 2008, the price of oil per barrel fell to levels around US$40, but recently rose above US$70. This recovery reflects not only the reduction of macroeconomic uncertainty, reflected in the assessment that the inflection point of the financial crisis already occurred or would be about to occur, but, above all, the comments of the first signs of economic recovery, which have appeared more clearly in developing countries. As far as the considerable uncertainty regarding oil price projections is concerned, the main scenario adopted by Copom, which assumes unchanged domestic gasoline prices for the remainder of 2009, remains plausible. It should also be noted that the influence of international oil prices on domestic inflation is not transmitted solely through the fuel prices for the consumer, but also by other channels such as transport costs for industry, the production chain of the petrochemical industry, as well as the expectations of consumers and entrepreneurs. It is worth mentioning that, just as what happened with the price of oil since the beginning of the year, prices of agricultural commodities, which are important from the standpoint of the dynamics of food costs, such as soybeans and wheat, have shown consistent recovery, although in different intensities.

After more than doubling in 2007 (7.89% against 3.79% in 2006) and the continued growth in 2008 (when it reached 9.10%) the broader inflation – measured by the General Price Index IGP-DI – slowed sharply in recent months. In fact, inflation accumulated in twelve months, which in July 2008 was at the level of 14.81%, moved to 2.99% in May. In addition, until May 2009 there was a deflation of 0.73%, compared to inflation of 5.16% over the same period last year. The deceleration of this index mainly reflected the IPA-DI (the main component of the index), whose variation in twelve months moved from 18.91% in July 2008 to 1.18% in May this year, despite the exchange rate depreciation in the recent past. Contrary to observed since the last *Inflation Report*, the National Cost of Construction Index (INCC) also came to exhibit the reduction of inflationary pressures. After reaching 12.34% in November 2008, inflation in the construction sector reduced to 8.98% in May. In turn, in the same period, inflation measured by IPC-Br reduced from 6.27% to 5.55%. The dynamics of the IPA-DI is explained largely by the changing behavior of agricultural prices, whose variation in twelve months moved from 37.91% in June 2008 to a deflation of 1.52% in May. Moreover, industrial prices, which accelerated during most of 2008, also declined with intensity. In this case, the variation in twelve months moved from 15.41% in October 2008 to 2.24% in May this year. As highlighted in previous *Reports*, the Committee evaluates that the effects of the behavior of wholesale prices over consumer price inflation will depend on current and prospective demand conditions, as well as on price setters' expectations for the future path of inflation.

The deterioration of the consumer prices, which had been occurring since mid-2007 and intensified during 2008, showed a reversal after the worsening of the global crisis in September. The initial fears regarding the current magnitude of pass-through to prices of final goods and services were not confirmed, as a result of both the behavior of foreign currency prices of imports and, in particular, of the degree of slowing economic activity. While commodity prices have showed recovery, especially oil, the prospective scenario does not contemplate a return to the previous inflationary cycle. Nonetheless, the Committee reaffirms that it will continue to conduct its actions to ensure that the gains achieved in reducing inflation in recent years become permanent.

As with headline inflation, all three measures of core inflation computed by the Central Bank show a reduction in twelve months cumulative rates. The exclusion core measure (excluding regulated prices and food prices) registered inflation of 5.96% in twelve months up to May, after reaching

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

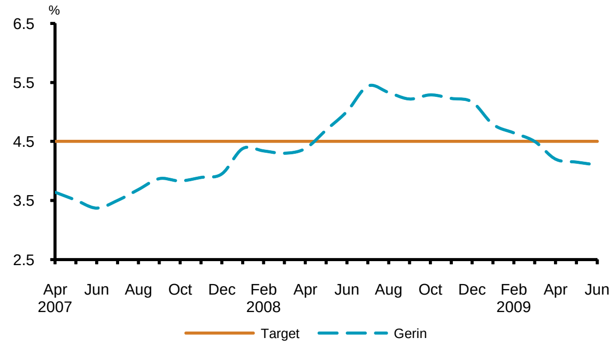
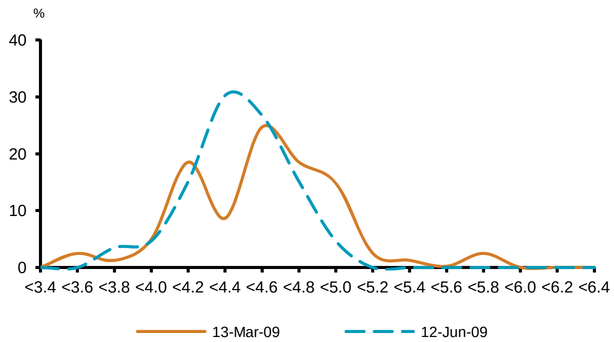


Figure 6.2 – Dispersion of inflation expectations for 2009
Relative frequency



6.38% in October. Nevertheless, compared with the same period last year, there is an increase of 0.93 p.p. In turn, core inflation measured by the trimmed means and smoothed trimmed means of predetermined items fell, respectively, from 4.97% and 5.15% in September, to 4.65% and 4.34% in May, virtually equal to the levels observed in the same period last year. Thus, measures of core inflation exhibit high persistence, and two of them are still above the central target, despite the reduction observed in recent months.

Inflation expectations for 2009 declined slightly since the release of the last *Report* and, at the cutoff date of June 12, were at 4.39%, against 4.52% in March 13. In turn, expectations for 2010 moved from 4.50% to 4.30% in the same period. For 2011, expectations are at 4.50%. As shown in Figure 6.2, it is worth mentioning the decline, since the release of the last *Report*, of the dispersion around the central tendency of inflation expectations, particularly for 2009, which, besides the typical pattern of convergence over the calendar year, aligns with the evaluation that the prospective outlook for inflation was slightly less uncertain since the release of the last *Report*.

6.2 Main scenario: associated risks and monetary policy implementation

The Copom projections are based on a set of assumptions about the behavior of main macroeconomic variables. This set of assumptions, and risks associated with them, comprises the main prospective scenario based on which the Committee makes policy decisions. On the whole, this prospective scenario, embodied in the projections to be presented in the following section, contemplates continuity of the global downturn in 2009, with recovery in 2010, on the external side, and gradual recovery of economic activity, within a still benign scenario for inflation, on the domestic side. From the standpoint of the balance of risks to the outlook for inflation, the main risks associated with the main scenario are the duration and magnitude of the global crisis, as well as its consequences in the path of domestic economic activity. In particular, in the short term, a disinflationary risk consists in a recovery of domestic activity at a slower pace than considered in the main scenario. On the other side, a major risk lies in the role of institutional mechanisms that inhibit a more intense response to inflation to higher idleness in resources of the economy. Another risk relates to the effects of a recovery in commodity prices on domestic inflation, for instance, through food prices. In turn, in a medium-term perspective, a risk to be monitored is associated with the possibility of cumulative and lagged effects of monetary easing reaching maximum intensity in a period of less significant idleness of factors.

The external environment includes a continuing global economic downturn, especially in developed countries. The period since the last *Report* was marked by the reduction of stress in international financial markets, originated in the US and Europe, whose impact on emerging economies were significant. The unprecedented actions by US and European authorities, who used a wide range of instruments in order to ensure minimum conditions of operation and liquidity in asset markets, reduced the systemic risk perception. In this environment, there were signs of reduced risk aversion, but the return of confidence remains fragile and subject to reversals. The decrease in risk aversion and the scarcity of capital flows, as well as some concerns among investors about the tax situation in the US, continued to encourage the recovery of the currencies of emerging and mature economies, against the US dollar.

Yet in the global scene, trends of contractive activity prevail over inflationary pressures. The current predominant view points to contraction of the global economy in 2009, with recovery only in 2010. The consensus projections for 2009 indicate intense shrinkage of activity in the US, Europe and Japan (G3), which would not be totally offset by the economic dynamism of some emerging economies, especially in Asia. There is evidence that economic activity in G3 could be stabilizing, with some improvement in disposable income and demand for durable goods in the US, recovery of business confidence in Europe and real exports in Japan. However, the problems of the international financial system can be exacerbated by a cyclical deterioration in credit quality, focused in the US and Europe, which would tend to strengthen the contraction of financial conditions and, therefore, the risk of a further intensification of the slowdown. In mature economies, where the anchoring of inflation expectations is stronger and the economic activity is weakening over time, inflationary pressures have reduced rapidly. Strictly speaking, in emerging economies the process of disinflation appears to have gained momentum, despite the greater persistence of inflation dynamics. In this context, while that in mature economies the monetary policy stance is strongly expansionary, even with the use of unconventional measures, emerging economies expansionary stance has been more moderate. Simultaneously, authorities in the US, Western Europe and Asia have been announcing a series of initiatives aimed at sustaining economic activity through tax incentives, which could contribute to a gradual economic recovery. Note, however, that estimates of the fiscal costs of macroeconomic stimulus packages and support to the financial sector have been increasing, which has caused pressure on the rating of several sovereign credits, including advanced economies. The accumulation of signs that the world economy would be close to an inflection, as well as the deterioration of public finances, has resulted in the elevation of the term structure of interest rates in major developed economies.

As highlighted in recent *Reports*, the effects of the global crisis on the Brazilian inflation have signaled *a priori* ambiguousness. On the one hand, the reduction in exports, while acting as a factor in restraining aggregate demand, and the retreat in commodity prices, helped ease domestic inflationary pressures. Second, the intensification of global risk aversion and the consequent reduction in demand for assets of emerging economies have led to sharp depreciation of several national currencies against the US dollar, which eventually pushed up prices in these economies. Within this context, although the Brazilian economy markedly became more resistant to changes of perceptions in international financial markets, the ability of the external sector to help mitigating the risk of inflation has been compromised.

It is plausible to claim, however, that the net effect of global slowdown on the domestic inflation path remains, so far, mostly benign, with the effects on domestic demand dominating the impacts of exchange rate depreciation. In fact, the global crisis is affecting the activity level of the Brazilian economy not only by reduced foreign demand, but also, given the restriction on external financing sources, by the indirect effect, but not least important, on the domestic financial conditions, and formation of a general framework of uncertainty that adversely affects the confidence of agents and leads them to a postponement of decisions on consumption and investment. Incidentally, the main element of uncertainty and risk factor on the external side refers to the duration of the global crisis, for which it is worth considering two alternative scenarios. In the first case, if the crisis persists longer, for example, extending to 2010, the contractionary effects and repercussions on the domestic economy would last throughout the inflation forecast horizon. In the second case, the recovery occurring faster than it is anticipated; the restoration of financial conditions and confidence, aligned to the recovery of commodity prices, would increase the risk of inflation. The resilience of activity in emerging economies, especially in Asia, and certain return of appetite for risk in international financial markets, suggests that the probability attributed to the second scenario increased, although the first remains likely.

It is worth mentioning that the expansion of public debt and monetary aggregates in mature economies, in reaction to the crisis, may cause changes in the behavior of asset prices and the term structure of interest rates, which would have potentially significant implications for foreign funding of the Brazilian economy in the most distant part of the forecast horizon.

From the standpoint of commodity prices, there were changes in the scenario of the last *Report*. In general, since then, both oil and other commodities prices had significant elevation. The future path of these prices, however, is still quite uncertain because it depends on the duration of the contraction of economic activity in mature economies and on the pace of reaction of the most important emerging economies. Until now, when converted into local currency, commodity prices still show some stability, given the recent appreciation. However, a new source of inflationary pressure could arise if the recent trend of rising commodity prices continues. Anyway, as mentioned in previous *Reports*, the analysis of the possible inflationary effects of recent trends in prices of raw materials cannot be detached from the analysis of pressures that they exert on the Brazilian asset prices.

The scenario for the exchange rate has changed over the last two *Reports*, given the exchange rate appreciation in the current quarter. However, despite this finding, the nominal exchange rate is still above baseline values before the current global crisis worsened in September last year. Therefore, it is also worthwhile an analysis of possible factors affecting the magnitude of pass-through to consumer prices. To date, monitoring of price developments shows no significant effect of the depreciation of the exchange rate, confirming issues addressed in recent *Reports*. First, the institutional consolidation, notably the inflation targeting regime, acts to dampen the pass-through. It should be also noted that the current context deviates enough from verified, for example, in 2002, when agents even considered the possibility of change in monetary regime, which exacerbated inflation expectations, boosting its own exchange rate pass-through. A second aspect is the decline in prices of commodities in foreign currency occurring until the beginning of this year, which to some extent, offset the impact of exchange rate depreciation and contained the change in prices of such goods in domestic currency. The third factor was the contraction of domestic economic activity observed in the last quarter of last year and the first quarter of this year. In fact, there is empirical evidence that the magnitude of pass-through depends on the economic cycle, being more marked when the economy is booming, and *vice versa*. The fourth element refers to initial conditions in terms of real effective exchange rate. When the nominal exchange rate represents, to a large extent, an adjustment of real exchange rate towards a historical average, the pass-through tends to be lower. It is also possible that the currency appreciation in previous years and the first half of 2008 has generated margin in price levels that would allow agents to absorb an exchange rate depreciation with less pass-through.

It should also be emphasized the existence of risk associated with the lag between exchange rate variation and its impact on consumer prices. First, because there is a chain that goes from the price at customs of imported products in national currency, passes to transports, through wholesale, and finally achieves the final consumer. Second, because due to the intense volatility of the exchange rate and, consequently, to the uncertainty about the level around which this rate would stabilize, the price setters may be waiting for a clearer picture before defining possible adjustments. In contrast, in the event that the exchange rate levels previously seen as transitional become permanent, increases the likelihood that the pass-through will intensify. In this case, monetary policy should avoid that price movements resulting from the exchange rate depreciation affect inflation expectations or induce second-round effects stemming from an attempt to realign prices, including wages, to pre-depreciation values. Given these caveats, it is worth acknowledging that the price movements observed so far at both the consumer and wholesale levels, and the recent exchange rate appreciation, indicate a reduced risk associated with exchange rate pass-through, compared with the existing ones prevailing at the release of two most recent *Reports*. However, in the medium term, as the recovery of activity intensifies, the monetary authority must be aware of possible delayed pass-through effects. In other words, if the recent contraction in activity restricted the scope for the exchange rate pass-through, it can be inferred that once reversed the contraction increases the scope for the development of such transfers.

Another risk for the prospective scenario is related to growth prospects of the Brazilian economy. After two consecutive quarters of GDP shrinkage, coincident and leading indicators point to the start of recovery this quarter, although gradually. In fact, some indicators support this assessment, such as industrial production, confidence indices, the level of utilization of installed capacity and the granting of loans to individuals. Indeed, the fall in GDP in the first quarter this year of intensity lower than market analysts expected led, until now, to some upward revision of GDP growth expectations for 2009, or at least to stop its deterioration. From the standpoint of the components of aggregate demand, the behavior has been very different. Investment and exports declined significantly in the first quarter, the government expenditure remained at positive rates, and household consumption grew.

The prospect of economic recovery is mainly based on three elements. Firstly, in contrast to what happened in previous oil shocks, even of less intensity, there was no break in the Balance of Payments, crisis in the public sector, high inflation, or fear of regime change. In summary, as pointed out on several occasions, the Brazilian economy is more resilient to external shocks. Secondly, monetary policy, without jeopardizing the commitment to inflation targeting, and fiscal policy tend to contribute to the resumption of economic activity. Thirdly, consumption, the largest portion of aggregate demand, is relatively resistant, partly due to the decline in inflation. Also, it is worth mentioning that, in respect to the previous quarter, the overall confidence has changed for the better in the country and seems to emerge some consensus that the worst of the crisis had been overcome. However, some uncertainty remains about the projections of economic growth. The risk here is that the recovery might be slower than that assumed in the current projections. Despite the improvement in confidence sentiment, investment should recover slowly in the light of current low levels of utilization of installed capacity. Exports, in turn, continue to suffer the effects of a global economic downturn that still shows signs of persistence. Consumption, despite the improvement in credit conditions and reduced tax rates on certain items, can still be affected by a worsening in labor market conditions and the reversal of tax exemptions.

From the standpoint of inflation, there is still the possibility of a risk of growth, represented by price adjustment mechanisms that contribute to lengthen over time inflationary pressures observed in the past, as evidenced by the behavior of service prices and items of regulated and monitored prices since the beginning of the year. In fact, despite the contraction in economic activity for two consecutive quarters, the service prices grew by 3.92% in the first five months of the year (7.23% for the accumulated rate in twelve months), against 3.10% in the same period of 2008, when the economy was rapidly expanding. As it is well known, the presence of price indexation mechanisms, even informal, reduces the sensitivity of inflation to fluctuations in demand. Note specifically that by containing the disinflation process of the economy, such mechanisms could increase the "initial condition" of inflation rate within a cycle of economic recovery, thus helping to increase the risks for the prospective inflation scenario.

In a medium-term perspective, however, the risk for the inflationary trajectory comes from the effects, cumulative and lagged, of the easing in financial conditions on the evolution of domestic demand in the context of a gradual resumption of the use of production factors. The Selic rate reached a historical low (9.25% per year), with a cumulative reduction in the present cycle of 450 basis points. Much of the effects of the easing in financial conditions will further materialize over the next few quarters (see box "The lagged transmission mechanism of monetary policy to prices" in this *Report*). Uncertainties regarding the magnitude and the lag of the transmission mechanisms of monetary policy tend to be stronger in the current context due to the global crisis and the resulting contraction of credit conditions. Anyway, in the medium term, the outlook points out that some of these effects will possibly materialize given the idleness of the factors much smaller than the current one, which must be taken into account by the monetary authority.

On the fiscal side, the uncertainty over the behavior of GDP translates into uncertainty about future tax revenues, in the framework of rigidity in government spending, which is transmitted to the evolution of the primary surplus of the consolidated public sector. Even so, the Copom understands, based on the current available information set, that there should not be a significant and consistent inflection in the reduction trend of the public debt to GDP ratio.

As noted in the last *Report*, the Brazilian economy is facing the global crisis with no disruptions, no change in economic policy regime, unlike what occurred in early 1999. The basic framework of economic policy, based on the tripod of inflation targeting, fiscal adjustment and floating exchange rate is consolidated and combines resilience and flexibility. Moreover, the strong external financial position, with the significant volume of international reserves, trade surpluses and external financing, mainly based on direct investment, strengthen the view that the current turmoil may be overcome without disruption.

By decomposing the IPCA into market prices and regulated and monitored prices, note that the latter will probably no longer play the role of cooling inflationary pressures seen in the last two years. In fact, for 2009, the main scenario assumes changes in regulated prices above the inflation target, given that these prices are mainly due to past movements of the price level, particularly, of wholesale prices, and are less sensitive to the economic cycle. For 2010, however, in view of the slowdown in wholesale prices recorded in the first half this year and the expectations of independent analysts that these prices will remain contained until late this year, the scenario for regulated and monitored prices appears relatively benign, even though the effect of the slowdown in the IGP-DI on the future trajectory of these items should not be overestimated. In particular, with respect to gasoline prices, as the recent decrease in price at the refinery was roughly fully offset by a tax increase of Cide, and as the oil price in international market has significantly risen since March, apparently, the possibility of relevant change in gasoline prices in 2009 is limited.

By the third quarter of last year, job growth (partly based on macroeconomic stability) had been one of the pillars of growth of real wages at a robust pace. The last few months have seen shrinkage of the labor market, partly seasonal, but it might eventually intensify, since employment generally reacts with some lag to developments in economic activity. A larger cooling in jobs creation can amplify initial movements of slowing demand and, therefore, act as a mitigator of possible inflationary pressures.

Credit, whose growth was an important element of sustaining aggregate demand, exerted a central role in the process of deceleration. The widening of banking spreads and shortening of the contract maturities (possibly associated with quantitative restrictions) have helped to contain aggregate demand. However, conditions in the credit market developed positively in recent months. Interest rates of loans to individuals are already at levels similar to or lower than those in force in August last year. The volume of loans is also in recovery. Thus, the main scenario assumes continued recovery of domestic credit market, although many uncertainties remain about the evolution of external credit.

The possibility that changes in inflation dynamics, which appear to be transitory in a preliminary assessment, will have an effect on agents' expectations about the inflationary trajectory in the medium and long term constitutes a perennial risk for the implementation of monetary policy and, therefore, deserves continuous monitoring. In principle, short-term concentrated effects may give rise to the spread of second-order effects, since significant variations in relative prices, which translate into higher rates of inflation, tend to generate responses for recovery of real income by agents, which in its turn, feeds the inflationary process. International experience, as well as inflation history in our country, recommends that the monetary authority's stance remains cautious in order to address potential secondary effects.

The strategy adopted by the Copom aims to bring inflation, which ended 2008 near the upper limit of tolerance allowed by the regime, back to the central target of 4.5% determined by the National Monetary Council (CMN) in 2009, and keep it at a level consistent with the target path in 2010. This strategy, which will show its results over time, takes into account the lags in the transmission mechanism, and is the most adequate to deal with the uncertainty inherent to the process of formulating and implementing monetary policy.

The Committee continued to consolidate the prospects of achieving a benign inflation scenario, in which IPCA return to evolve consistently with the inflation targets. Incidentally, this evolution of the prospective scenario is consistent with inflation projections considered by the Monetary Policy Committee and on inflation expectations set by independent analysts. Thus, despite having room for a residual process of easing, monetary policy should be cautiously in order to ensure convergence of inflation to the target path. The Committee understands that the demand slowdown, driven by the tightening of financial conditions and the deteriorating confidence of the agents, although in both cases some improvement at the margin can be observed, as well as by the contraction of the global economy, has created significant idleness in production factors, which should not be eliminated quickly in a scenario of gradual recovery of economic activity. This development should help to contain inflationary pressures. On the other hand, the Committee notes that the significant easing of monetary policy implemented since January will have cumulative effects that will be highlighted over time on the economy.

In light of these considerations, the Committee decided to reduce the Selic rate from 11.25% per year to 10.25% and 9.25% in April and June meetings, respectively. This adjustment of the basic interest rate has lagged and cumulative effects on economic activity and inflation. In this context, any additional monetary easing should be implemented in a more parsimonious manner.

6.3 Inflation forecasts

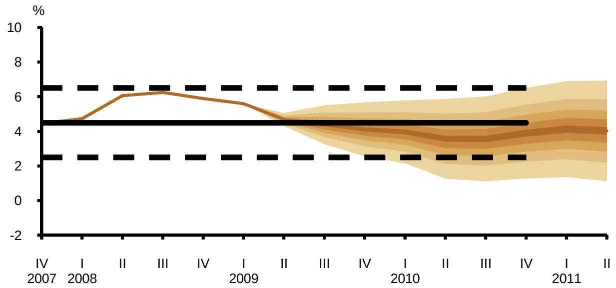
According to traditionally adopted procedures, and taking into account the available information up to the cutoff date of June 12, 2009, the baseline scenario assumes the exchange rate remains unchanged over the forecast horizon at R$1.95/US$, and the target for the Selic rate stays at 9.25% per year – the level set by the June Copom meeting – against R$2.35/US$ and 11.25% per year considered in the *Inflation Report* of March 2009. The projection for the change in 2009 of the set of regulated and monitored prices reduced to 4.8%, compared to 5.5% seen in the last *Report*. This projection is based on the hypotheses, for accumulated in 2009, of stable prices for gasoline and bottled gas, increase of 4.7% for electricity rates, and of 5.0% in the fixed telephone rates. The items for which more information is available, price changes were estimated individually, whereas for the others, the projections are based on models of endogenous determination of regulated prices, which consider seasonal components, exchange rate variations, market price inflation and General Price Index (IGP) inflation, among others. According to these models, the projected increase of regulated and monitored prices for 2010 is 4.5%, against the rate of 4.8% presented in the March *Report*, and for 2011 is at 4.5%.

The market scenario, on the other hand, is based on data from the expectations survey carried out by Gerin with a representative group of institutions up to the cutoff date. In this scenario, average exchange rate expectations reduced in comparison to the values released in the March *Inflation Report*. For the last quarter of 2009, those expectations moved from R$2.30/US$ to R$2.00/US$, and for the last quarter of 2010, from R$2.30/US$ to R$2.09/US$. For the second quarter of 2011, survey expectations project exchange rate of R$2.13/US$. The expectation about the average Selic rate declined when compared to figures in the last *Report*. For the last quarter of 2009, it moved from 9.75% to 9.00% and, for the last quarter of 2010, from 9.61% to 8.98%. For the second quarter of 2011, analysts' projection for the average Selic rate is 9.50%. This trajectory for the average Selic rate is consistent with a twelve-month pre-DI swap spread, with respect to the current target for the Selic rate, of -3 b.p. and 31 b.p., in the last quarter of 2009 and 2010, respectively. Additionally, the market scenario assumes variations of 4.4%, 4.7% and 4.5% for the set of regulated and monitored prices in 2009, 2010 and 2011.

Regarding fiscal policy, the projections presented in this *Report* are based on the working hypothesis of accomplishment of the primary surplus targets of 2.5% of GDP in 2009 and 3.3% of GDP in 2010, in both cases adjusted by the possibility that the percentages are reduced by up to 0.5 p.p., due to the implementation of the Pilot Investment Project (PPI).

Figure 6.3 – Forecasted IPCA-inflation with interest rate constant at 9.25% p.a. (Benchmark scenario)

Inflation fan chart



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

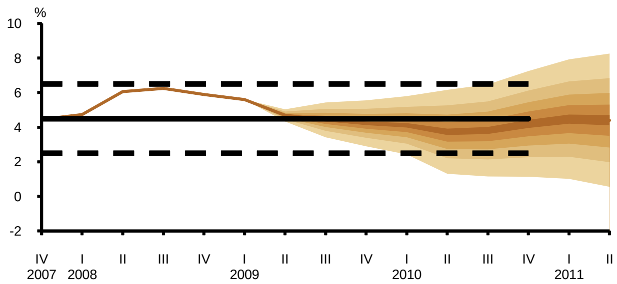
Table 6.1 – IPCA-inflation with interest rate constant at 9.25% p.a.
(Benchmark scenario)

Year	Q	Probability Interval 50%	30%	10%	10%	30%	50%	Central projection
2009	2	4.5	4.6	4.7	4.7	4.8	4.8	4.7
2009	3	3.9	4.1	4.3	4.5	4.6	4.8	4.4
2009	4	3.5	3.8	4.0	4.2	4.5	4.8	4.1
2010	1	3.2	3.5	3.8	4.1	4.4	4.7	4.0
2010	2	2.6	3.0	3.4	3.7	4.1	4.5	3.6
2010	3	2.6	3.0	3.4	3.8	4.1	4.6	3.6
2010	4	2.8	3.3	3.7	4.1	4.5	5.0	3.9
2011	1	3.0	3.5	3.9	4.3	4.8	5.3	4.1
2011	2	2.8	3.3	3.8	4.2	4.7	5.2	4.0

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

Figure 6.4 – Forecasted IPCA-inflation with market expected interest and exchange rates

Inflation fan chart



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

Based on the above assumptions and using the available information set, projections were constructed for the IPCA inflation accumulated over four quarters, consistent with the interest and exchange rate paths of the baseline and market scenarios.

The central projection associated with the baseline scenario indicates inflation of 4.1% in 2009, an increase of 0.1 p.p. in comparison to the projection presented in the *Report* of March, and below the central value of 4.5% for the target determined by the CMN. As shown in Figure 6.3, from the third quarter of 2009, inflation accumulated over four quarters is positioned below the central value of 4.5% for the inflation target in 2009 and 2010. This reflects, essentially, the lagged effects of higher idleness of production factors observed from the fourth quarter of 2008. Note, however, that this impact was partly offset by reductions in the Selic rate and the fiscal stimulus implemented this semester. The inflation accumulated in twelve months moved from 4.7% in the second quarter of 2009 to 4.1% in the last quarter. In 2010, inflation stays at 4.0% in the first quarter, and below this level in the remaining quarters. In the first two quarters of 2011, the inflation projection is around 4.0%.

The data shown on Table 6.1 indicates, for 2009, a decrease of 0.9 p.p. in twelve-month accumulated inflation in the second quarter, compared to 5.6% observed in the first quarter, and of 0.3 p.p. in the third and fourth quarters, when compared, respectively, to the second and third quarters. In the first case, the move reflects an inflation projection for the second quarter of 2009 lower than the inflation observed in the same period in 2008 (2.09%), indeed an outlier and which was due mainly to the surging prices of commodities recorded in that period. In the second case, inflation projections for market prices, in the third and fourth quarters of 2009, lower than the values achieved in the corresponding quarters of 2008, considering that for the regulated and monitored prices the opposite occurs. According to confidence intervals shown in Table 6.1, the estimated probability of inflation exceeding the upper tolerance level of the target in 2009 is residual, according to the baseline scenario.

In the market scenario, the projection of 4.2% for inflation in 2009 is 0.1 p.p. higher than that associated to the baseline scenario, and higher than the figure presented in the last *Report*. As can be inferred from Figure 6.4 and Table 6.2, the projections indicate continued decline in twelve-month accumulated inflation in 2009, which moves from 5.6%, recorded in the first quarter, to 4.7% in the second quarter, reaches 4.4% in the third one, and ends the year

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

Year	Q	Probability Interval 50%	30%	10%		30%	50%	Central projection
2009	2	4.5	4.6	4.7	4.7	4.8	4.8	4.7
2009	3	4.0	4.2	4.4	4.5	4.7	4.8	4.4
2009	4	3.7	3.9	4.1	4.3	4.5	4.8	4.2
2010	1	3.4	3.7	4.0	4.2	4.5	4.8	4.1
2010	2	2.7	3.2	3.6	3.9	4.3	4.7	3.7
2010	3	2.7	3.2	3.6	4.0	4.4	4.9	3.8
2010	4	2.9	3.5	4.0	4.4	4.9	5.5	4.2
2011	1	3.1	3.7	4.2	4.7	5.3	5.9	4.5
2011	2	2.8	3.5	4.1	4.7	5.3	6.0	4.4

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

Table 6.3 – March 2009 *Inflation Report* forecasts

Period	Benchmark scenario	Market scenario
2009 I	5.7	5.7
2009 II	4.7	4.6
2009 III	4.1	4.1
2009 IV	4.0	4.1
2010 I	4.3	4.4
2010 II	4.0	4.3
2010 III	4.2	4.6
2010 IV	4.0	4.4
2011 I	3.9	4.4

Figure 6.5 – Forecasts and target path for twelve-month cummulative inflation

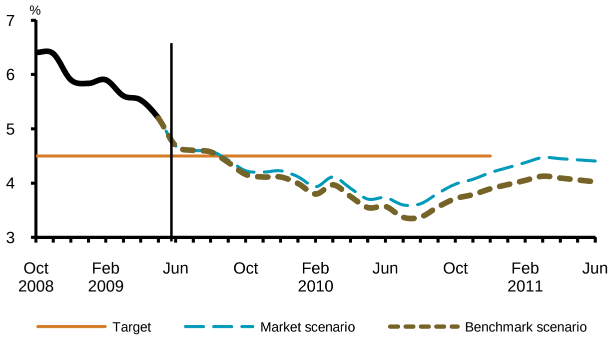
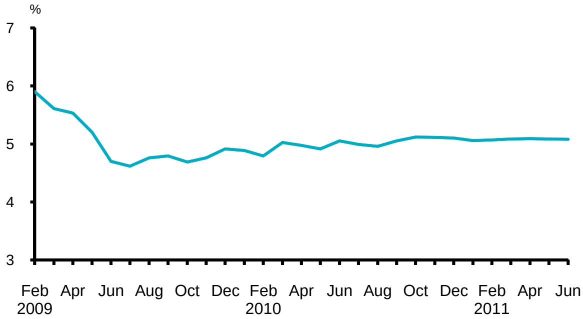


Figure 6.6 – Inflation Forecast: VAR models



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

at 4.2%, below the central value of 4.5% for the target. In comparison with the baseline scenario, the slight increase in the projection for inflation in 2009 is explained, primarily, by analysts' expectations that the exchange rate ends 2009 at R$ 2.00/US$, against the R$ 1.95/US$ level assumed in the baseline scenario. As in the baseline scenario, in the market scenario is residual the estimated probability of inflation exceeding the upper tolerance level of the target in 2009. For 2010, the projection in the market scenario, in the first semester, drop in twelve-month accumulated inflation, which, however, returns to the level of 4.2% in the fourth quarter, still below the central value of 4.5% for the target determined by the CMN. In the first two quarters of 2011, the inflation projection for the last twelve months stands around that value. It is worth mentioning that the projection of inflation, both in the last quarter of 2010 as in the first one of 2011, takes into account the fact that inflation expectations for 2011 are at 4.5%.

The comparison of the trajectories presented in this *Report* with those released in the previous *Report*, contained in Table 6.3, shows the projected paths intersect at several points, indicating a change in the distribution of projected inflation. In the market scenario, the current projection points to higher inflation rates in 2009 and first quarter of 2011, interspersed by a lower rate in 2010. Similar assessment applies to the baseline scenario.

Figure 6.5 shows the evolution of inflation accumulated in twelve months, according to the baseline and market scenarios until the second quarter of 2011, along with the inflation target by the end of 2010. By May 2009, figures refer to actual twelve-month inflation and, thereafter, projections according to the two scenarios for the construction of the accumulated values. The projections recede almost monotonically until reaching the minimum in the second quarter of 2010 (around 3.6% in the baseline scenario, and 3.7% in the market scenario). From this quarter projections rise, but remain below 4.5%. The fact that the trajectory of projections, according to the market scenario, stand above the respective trajectory of the baseline scenario reflects, in part, expected exchange rate depreciation.

The average forecast generated by the Vector Autoregression (VAR) models for the twelve-month accumulated inflation is presented in Figure 6.6. By May 2009, figures refer to actual twelve-month inflation and, thereafter, refer to forecasts. A downward trend of the forecasts is observed for twelve-month accumulated inflation up to the third quarter of 2009, from the fourth quarter onwards there is a slight reversal of this trend, such that from the last quarter of 2010 forecasts virtually stabilize around 5.0%, without converging to the central target.

Figure 6.7 – GDP growth with interest rate constant at 9.25% p.a. (Benchmark scenario)

Output fan chart

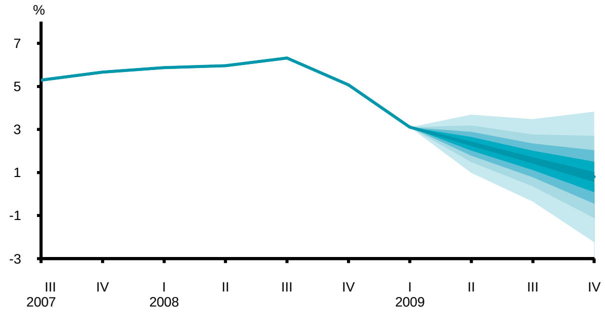


Figure 6.7 illustrates the output growth fan chart built under the baseline scenario assumptions. Considering that the model which generates GDP growth projections uses two variables that are not directly observable, potential output and the output gap, the forecast errors associated to these projections are considerably higher than the errors related to the inflation projections. According to this scenario, the GDP growth projected for 2009 is 0.8%, thus, a decrease of 0.4 p.p. in comparison to the projection presented in the *Inflation Report* of March 2009. This change reflects, in part, a recovery of economic activity slower than what was previously anticipated.

Forecasting the Yield Curve: a statistical model with macroeconomic variables

Research about term structure of interest rates (TSIR) basically rests on two classes of models, usually known as statistical models and equilibrium models. In the first group the TSIR is constructed through an interpolation process and forecasts are done using time series models. In the second group, the models incorporate equilibrium arguments, such as no-arbitrage, and forecasts are produced by the dynamics implied in the model.

Despite the lack of economic theory grounds, statistical models are preferred in practical problems due to their lesser estimation complexity. Following this trend, this box, based on Leite et al. (2009), presents a statistical model of the yield curve (premium/expectation model) that incorporates three ingredients: macroeconomic information, data collected in market survey and risk premium of forward rates. This model is used to forecast the Brazilian yield curve six months ahead and its performance is confronted with the performance of three other well known methods: the random walk, forward rate and Diebold and Li (2006) model (henceforth, DL model).[1]

Each new day the time to maturity of an ID future contract decreases by one day. Thus, the time to maturity of the yields changes from one observation to the next. In order to eliminate this variability of times to maturity, yields are interpolated yields the Svensson parametric model (1994):

1/ The database used is composed of 1day ID future yields extracted from contracts traded on the Brazilian Mercantile and Futures Exchange (BM&F) and inflation expectations (measured by the National Index of Consumer Prices), collected by the Central Bank, observed in the first working day of each month during the period of December 2002/December 2007.

$$R_t(\tau) = \beta_{1t} + \beta_{2t}\left(\frac{1-e^{-\lambda_{1t}\tau}}{\lambda_{1t}\tau}\right) + \beta_{3t}\left(\frac{1-e^{-\lambda_{1t}\tau}}{\lambda_{1t}\tau} - e^{-\lambda_{1t}\tau}\right) + \beta_{4t}\left(\frac{1-e^{-\lambda_{2t}\tau}}{\lambda_{2t}\tau} - e^{-\lambda_{2t}\tau}\right). \quad (1)$$

Figure 1 – Evolution of spot rates

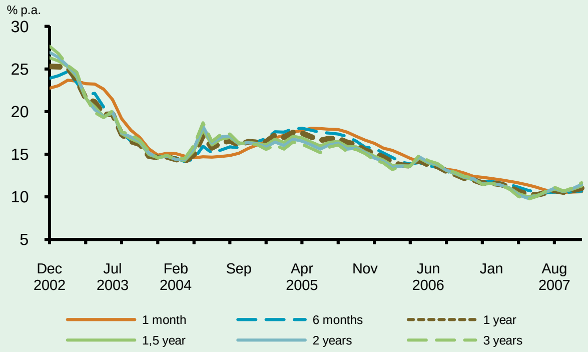
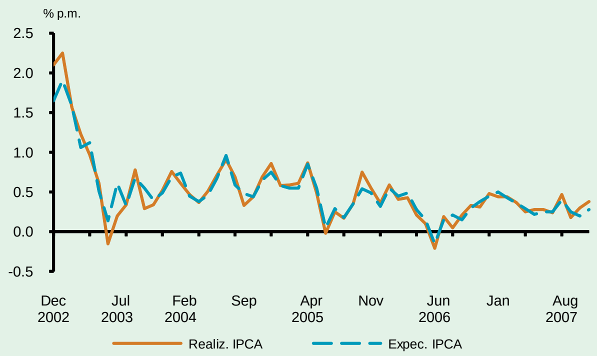


Figure 2 – Evolution of inflation and inflation expectations



The lambda (l) is fixed according to the approach suggested by Almeida et al (2007), which implies l_{1t} = 3.58 and l_{2t} = 7.17, for all *t*. Then, using OLS, beta coefficients (b) are estimated. Figure 1 shows the evolution of spot rates for maturities of 1 month, 6 months, 1 year, 1.5 years 2 years and 3 years over the sample period considered.

Figure 2 shows the evolution of the inflation expectation median of the institutions listed in the Top 5 group, as well as the observed inflation. It should be noted that the inflation rate refers to the month immediately previous to the date of collection of information on the ID future and inflation expectation. The two series present strong positive correlation and a preliminary analysis allows one to infer that inflation expectations would be a good leading indicator of actual inflation.

If R_t (t) is the spot rate at *t* for the time to maturity t and P(t, t) = exp {- Rt (t) t} is the value at *t* of one monetary unit at t + t, then the instantaneous forward rate at *t* for the term *t* is

$$f(t,\tau) = -\frac{\partial \log(P(t,\tau))}{\partial \tau}.$$

From Equation 1:

$$f(t,\tau) = \beta_1 + \beta_2 e^{-\lambda_1\tau} + \beta_3\lambda_1\tau e^{-\lambda_1\tau} + \beta_4\lambda_2\tau e^{-\lambda_2\tau}.$$

Considering the Selic rate as the instantaneous short-term rate, the risk premium of the forward rate should be defined as:

$$\eta(t,\tau) = f(t,\tau) - Selic_t$$

Ludvigson and Ng (2007) show that the risk premium return on bonds is strongly related to macroeconomic fundamentals such as price indices. Using this result, a linear relationship between the risk premium of the forward rate and the inflation expectation is specified:

$$\eta(t,\tau) = \gamma_1 IPCA_t + \gamma_0, \quad (2)$$

where the $IPCA_t$ is the inflation expectation measured by the IPCA in t for the first IPCA not yet announced.

The estimations and forecasts were performed using data from December 2002 and the month until the forecasting time. The forecasts for six months ahead start in December 2005 (forecast for June 2006), and extend until June 2007 (forecast for December 2007), with a total of 19 forecasts.

Using Equation 2 and the estimated values of g_0 and g_1, it is possible to forecast the forward rate risk premium six months ahead. To do that, it is necessary to know the expectation of the first unknown IPCA six months ahead. The forecast for the seventh unknown IPCA provided by the Central Bank survey is used as a proxy for this expectation. Then, to forecast yields it is also necessary to know the expectation of the Selic rate six months ahead. Once more, this variable is provided by the Central Bank survey.

Table 1 – Bias for out of sample forecasts (p.b.)

	6 months	1 year	1,5 year	2 years	3 years
PE	47	70	88	99	110
RW	-136	-120	-110	-104	-98
FR	-96	-101	-98	-96	-92
DL	24	51	-77	95	113

Table 2 – Mean-square error for out of sample forecasts

	6 months	1 year	1,5 year	2 years	3 years
PE	68	98	119	133	148
RW	144	139	144	151	162
FR	122	153	167	173	177
DL	129	143	158	169	181

Tables 1 and 2 present, respectively, the six month ahead forecasting bias and the RMSE, both in basis points, from the premium/expectation model and three other competitors: the random walk, the forecasts based on forward rates and the DL model. This latest forecasting technique adjusts the yield curve on each day via a parametric form similar to equation 1, but with only three factors (it does not consider the second curvature). The forecasts are performed by applying an autoregressive process for beta coefficients. The decay factor of the yield curve (l) was set at 3.58 for the DL model.

The results presented indicate that the premium/expectation model outperforms the three other competitors for all maturities when the comparison criterion is the RMSE. However, when bias (observed value minus forecast value) is used as a metric to compare the models, none of the models is clearly superior, despite the slight superiority of the DL model.

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The Lags in the Transmission of Monetary Policy to Prices

Considering its uncertain and variable nature, the lags in the effects of monetary policy on activity and prices are a constant concern for policymakers. Among the various channels most often cited as relevant to the monetary policy transmission, the demand channel, the channel associated with external variables and the expectations channel receive special attention from the Central Bank. Historically, these channels have been the most effective ones, despite the growing importance of the credit channel in recent years. This box discusses issues regarding the lags of the monetary policy transmission mechanism in the Brazilian economy, with particular attention to estimates from economic models in use at the Central Bank.

In a way, the demand channel reflects the institutional arrangement of the production sector, in the sense that the lags in the transmission mechanism are determined by the duration of contracts between agents (firms, individuals and governments) and the frictions that slow down the propagation of shocks along the production chain. The exchange rate channel is primarily based on two no-arbitrage conditions: one in the asset market and the other in the market of internationally tradable goods. Due to relatively lower transaction costs, the first mechanism, in principle, would operate quickly. However, due to the difficulties in accurately assessing the risks associated with both the domestic and foreign assets, it is not a simple task to identify arbitrage opportunities. This makes highly unpredictable the movements of the exchange rate that are related to the functioning of asset markets. In turn, the channel capturing expectations – which are directly implicated by the structure of the economy in models with rational expectations –

of the three, is perhaps the easier to understand. Nevertheless, the uncertainty that this channel adds to the analysis is significant – although the evidence for the Brazilian case suggests that expectations respond to policy decisions in an important way.[1]

Due to the maturity of Brazilian institutions and the perception of the consolidation of macroeconomic stability, expectations regarding the evolution of the Brazilian economy seem to be well anchored. This phenomenon could be illustrated by the resilience of the economy to the recent turmoil in international financial markets. Indeed, expectations regarding economic activity, exchange rate and the premium on Brazilian sovereign bonds experienced much lower deterioration compared to the levels observed in the past, even when the shocks were smaller. In such circumstances, with expectations better anchored, hence less volatile, the demand channel becomes more important.

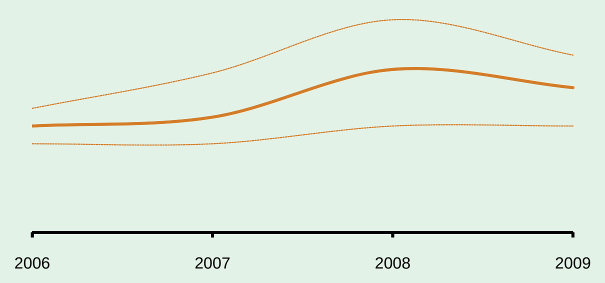
As explained in previous boxes and other publications of the Central Bank, the transmission of monetary policy to prices through the demand channel occurs in two steps. Initially, through the mechanism described in the Investment and Savings Curve (IS Curve),[2] a monetary policy easing (a reduction of the base interest rate Selic) leads to a fall of the long-term interest rates. Lower rates allow individuals and companies to finance consumption and investment at lower cost, which ultimately boosts aggregate demand. According to the estimates of the Central Bank in recent years, the maximum effect of the policy rate on aggregate demand would take something like two to three quarters to materialize. In the second step, and given a constant aggregate supply in the short run, the Phillips curve implies that the increase in demand puts upward pressure on the market prices of goods and services. Due to the wage rigidity inherent in labor contracts, the maximum effect on prices would take around three to four quarters to materialize, according to the estimates of the Central Bank.

1/ See, eg, A. S. Bevilaqua, M. Mesquita and A. Minella (2007), "Brazil: taminginflation expectations," Central Bank of Brazil, Working Paper Series N. 129; F. A. Carvalho and A. Minella (2009), "Market Forecasts in Brazil: performance and determinants," Central Bank of Brazil, Working Paper Series N. 185.

2/ IS = Investment and Savings.

Figure 1 – Lags in the demand channel

Estimated minimum, average and maximum values



The two main pieces of the small structural models used by the Central Bank are the aggregate demand equation (IS curve) and the aggregate supply equation (Phillips curve). Figure 1, drawn from a broad set of different specifications for the IS and Phillips curves, illustrates how the lags (minimum, average and maximum) in the transmission of monetary policy to prices have evolved in recent years. The figure considers the combined effect of interest rates on aggregate demand and the effects of the latter on prices.

It should be noted that in recent years, there was an increase in the lags of the monetary policy transmission mechanism, as a result of the longer duration of contracts over the same period. In this regard, the maximum effect on economic activity of the ongoing monetary policy easing, which started in January 2009, will take place next semester, whereas the effect on prices will materialize by the end of this year and early 2010.

The lags in the transmission mechanism can also be evaluated through the lens of the medium-sized semi-structural models used by the Central Bank. These models allow decomposing the total effects of monetary policy into the contributions of the three aforementioned channels: exchange rate channel, expectations channel and demand channel.[3] According to the medium-sized models, using information for the inflation-targeting period, the maximum effect of changes in the Selic rate on output and inflation takes, respectively, 3-4 quarters and 5-6 quarters to materialize.[4] In addition, three points should be highlighted: (1) there are no large differences between the lags implied by the small structural models and those implied by the medium-sized semi-structural models; (2) the effect of monetary policy through the expectation channel occurs relatively faster than through the other channels; and (3) according to the medium-sized models the lags associated with the exchange rate channel are relatively long, contrary to the common sense. This suggests that the exchange rate channel operates more intensively

3/ In the medium-sized models, the demand channel is represented by the channels associated with the interest rates that are relevant for consumption and investment. For details, see André Minella and Nelson F.Souza-Sobrinho (2009). "Monetary Channels in Brazil through the Lens of a Semi-Structural Model." Central Bank of Brazil Working Paper Series N. 181.

4/ Roughly speaking, these ranges can be seen as average lags for the period 1999/2008.

through the market of tradable goods market than through the asset market.

To conclude, it should be noted that the estimates presented in this box refer to the maximum effect of monetary policy on economic activity and prices through the aggregate demand channel. On the other hand, in statistical sense, the initial impact on activity and prices occurs after 1-2 quarters and 2-3 quarters, respectively.

Annex

Minutes of the 142nd Meeting of the Monetary Policy Committee (Copom)

Date: April 28th, from 5:50PM to 8:10PM, and April 29th, from 5:30PM to 7:40PM
Place: BCB Headquarters meeting rooms – 8th floor on April 28th and 20th floor on April 29th – Brasília – DF

In attendance:
Members of the Committee
Henrique de Campos Meirelles – Governor
Alexandre Antonio Tombini
Alvir Alberto Hoffmann
Anthero de Moraes Meirelles
Antonio Gustavo Matos do Vale
Maria Celina Berardinelli Arraes
Mário Gomes Torós
Mário Magalhães Carvalho Mesquita

Department Heads (present on April 28th)
Adriana Soares Sales – Department of Banking Operations and Payments System
Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on April 29th)
João Henrique de Paula Freitas Simão – Open Market Operations Department
Márcio Barreira de Ayrosa Moreira – International Reserves Operations Department
Renato Jansson Rosek – Investor Relations Group

Other participants (present on April 28th)
Alexandre Pundek Rocha – Advisor to the Board
Eduardo José Araújo Lima – Deputy Head (to the Research Department)
Flávio Pinheiro de Melo – Advisor to the Board
José de Ribamar Oliveira Júnior – Press Secretary
Katherine Hennings – Advisor to the Board

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

Recent economic developments

1. IPCA inflation decelerated from 0.48% in January and 0.55% in February to 0.20% in March. As a consequence, inflation accumulated in the first quarter of 2009 reached 1.23%, decreasing 0.28 p.p. relative to the level registered in the same period of the previous year. In the last twelve months, inflation declined from 5.90% in December to 5.61% in March (4.73% in March 2008). The deceleration of twelve-month consumer price trailing inflation in the first three months of the year mirrored the behavior of market prices, as regulated prices increased. Considering market prices, both prices of tradable goods and non-tradable goods cooled on a twelve-month trailing basis, reaching 6.10% and 6.74%, respectively, in March, down from 6.99% and 7.10% in December 2008, despite the acceleration relative to the levels observed in the same month of the previous year. According to the same comparison basis, the prices of services, whose dynamics tends to show more persistence than that of the prices of goods, increased from 6.39% in December to 6.63% in January and 7.09% in February, and decreased to

6.83% in March (5.11% in March 2008). Preliminary data for April point to consumer inflation above that observed in March. In short, information available suggest that the inflationary cycle observed in the last year has been gradually overcome by a process that should continue to be led by the behavior of market prices, while regulated price inflation should show more persistence.

2. The three main underlying inflation measures calculated by the BCB showed divergent behavior in the first three months of the year. The core inflation by exclusion of household food items and regulated prices increased from 0.27% in January to 0.88% in February, reflecting seasonal factors, and then decreased to 0.25% in March. On the other hand, smoothed and non-smoothed trimmed means core inflation measures showed lower variation, recording 0.42% and 0.44% in January, 0.29% and 0.27% in February and 0.35% and 0.21% in March, respectively. The twelve-month trailing inflation measures changed from 6.09%, 4.82% and 4.92% in December to 6.02%, 4.85% and 4.64% in March, for the core inflation by exclusion, smoothed and non-smoothed trimmed means core inflation, respectively, remaining in levels above the midpoint of the target. Moreover, it bears emphasizing that the behavior of the IPCA diffusion index reduced to 60.2% in March down from 61.7% in December (compared to 58.6% in March 2008).

3. The General Price Index (IGP-DI) inflation changed -0.13% in February and -0.84% in March, down from 0.01% in January. On a twelve-month trailing basis, the IGP-DI inflation decreased from 9.10% in December to 5.86% in March, compared to 9.18% in March 2008. The slowdown of the IGP-DI has reflected the behavior of its main component, the Wholesale Price Index (IPA-DI), which decreased from 9.80% in December to 4.98% in March, on a twelve-month trailing basis (11.39% in March 2008). On its turn, the Consumer Price Index-Brazil (IPC-Br) increased 6.32% (4.52% in March 2008) and, according to the same comparison basis, the Civil Construction National Index (INCC) increased 10.66% (6.69% in March 2008). Regarding the IPA-DI, the inflationary deceleration, under this comparison basis, derives basically from the behavior of agricultural prices. The agricultural IPA reached -0.93% in March (24.70% in March 2008), while the elevation of wholesale industrial prices reached 7.22% (6.98% in March 2008). It bears noticing that, despite the effects of the exchange rate depreciation that has occurred since the third quarter of last year, wholesale industrial prices have showed deflation at the margin. As mentioned in previous Copom Minutes, the Copom evaluates that the effects of wholesale prices over consumer price inflation will depend on current and prospective demand conditions and price-setters' expectations for the future inflation path.

4. On a three-month moving average basis, according to data seasonally adjusted by the IBGE, industrial output decreased 3.3% in February, after falling by 6.3% in the previous month. Still considering the seasonally adjusted series, according to the month-to-month comparison, industrial output increased by 1.8% in February, after the 2.2% expansion observed in January. On a year-over-year basis, industrial output retreated by 17% in February, with respective falls of 18.8% and 16.9% in mining and manufacturing industries. The analysis of the behavior of IBGE industrial output series and its components, at the margin, according to data available, suggests that production would have reached its lowest level in December-January. However, the industrial activity continues to be influenced by the international crisis, due to its effects both over exports and credit conditions, and over business and households' expectations. In this context, some industrial segments have been led to adjust inventories and reduce production, a process that has recently been particularly evident in the intermediate goods industry.

5. Among the use categories, according to data seasonally adjusted by the IBGE, the production of capital goods decreased by 6.3% in February, after increasing 4.9% in January. Regarding the other use categories, intermediate goods production increased 1.5% in February and 0.9% in January; semi-durable consumer goods production increased 1.7% in February and decreased 0.5% in January; and the production of durable goods, strongly influenced by the automotive sector increased by 10.5% in February, after a 36.2% increase in January. The recent slowdown in capital goods production reflects the persistence of the international financial turmoil

and its consequences over business confidence. On its turn, the recover, at the margin, in the pace of durable goods production expansion reflects, predominantly, the exemption tax measures and also some easing of credit conditions. The future trajectory of industrial production should continue to be influenced by these factors, which counterbalance the deterioration of external demand and the process of inventories adjustment mentioned above.

6. Labor market has continued to record ambiguous indicators, combining positive aspects with signs of loss of vigor. The unemployment rate in the six metropolitan regions covered by the Monthly Labor Survey (PME) changed from 8.5% in February to 9.0% in March (8.6% in March 2008). According to the seasonally adjusted series, the unemployment rate increased 0.2 p.p., reaching 8.5%. Average real earnings increased by 4.6% in February, in year-over-year terms, and increased 5.0% in March, according to the same comparison basis, due to, in part, inflation deceleration. Employment, on its turn, expanded by 1.4% in February and 0.9% in March, in year-over-year terms. As a consequence, real payroll increased 6.6% in January and 6.2% in February, continuing to constitute a key driver for domestic demand growth. According to the National Industry Confederation (CNI) data seasonally adjusted by the BCB, manufacturing employment retreated by 0.9% in February, after decreasing by 0.8% in January and by 0.9% in December 2008. In year-over-year terms, employment declined 1.5%, and expanded by 3%, on a twelve-month trailing basis. According to data seasonally adjusted by the IBGE, manufacturing employment fell 1.3% in February (after falling 1.3% in January 2009 and 1.9% in December 2008), totaling a 1.0% increase in twelve months and a 4.2% decline year-over-year. Still regarding the labor market, data from the Ministry of Labor and Employment (MTE) indicate some recover in the generation of formal employment, despite below the seasonal pattern. In March, 34,818 jobs were created (compared to the positive result of 9,179 in February). The manufacturing industry recorded the highest dismissal rate in March, with the reduction of 35,775 jobs, followed by the commerce sector, which habitually hires in this period of the year, with the reduction of 9,697 positions. On the other hand, the civil construction sector and the services sector hired workers in the month: 16,123 and 49,280 jobs, respectively. The result for the civil construction was above the average of the last five years (13,958 jobs).

7. According to data seasonally adjusted by the IBGE, expanded retail sales increased by 2.5% in February, after increasing 5.3% in January. On a year-over-year basis, the indicator increased by 1.6%, growing by 2.2% in the year. The three-month moving average of expanded retail sales increased 2.6% in February, quarter-over-quarter, according to seasonally adjusted data, after expanding by 1.1% in January. On a month-on-month basis, according to seasonally adjusted data, it bears emphasizing the expansion in the sales of “vehicles, motorcycles, parts and pieces” (4.6%) and “other personal and domestic articles” (4.3%). The negative key drivers were “books, newspapers, magazines and stationary” (-9.1%) and “furniture and appliances” (-1.2%). In the year, cumulative growth was more significant in “office material and equipment” (13.3%) and “books, newspapers, magazines and stationary” (13.1%). After falls in October, November and December, expanded retail sales data for January and February evidence a recovery influenced mainly by the increase in the sales of vehicles, in response to the sector incentives granted by the government and some recover in the access to vehicle credit supply. For the next quarters, the retail sales trajectory will continue to be sustained by fiscal transfers, as well as by real payroll growth, whose evolution should be favored by the reduction of inflation, but it will also be affected by the evolution in the access to credit supply and by the behavior of consumer confidence.

8. The installed capacity utilization rate (Nuci) in the manufacturing industry reached 77.8% in February, below the level observed in January, according to CNI data seasonally adjusted by the BCB. According to data seasonally adjusted by CNI, the Nuci in the manufacturing industry remained stable at 77.8% in January and February. Without the seasonal adjustment, in February the Nuci stood 5.5 p.p. below the level registered in the same month of 2008. On its turn, the monthly non-seasonally adjusted Nuci calculated by Fundação Getúlio Vargas (FGV) remained stable in March at 77.0%, standing 8.2 p.p. below the level registered in the same month of 2008. The reduction in the Nuci, year-over-year, is

also observed in the production of consumer goods (-5.1 p.p.), intermediate goods (-9.6 p.p.), capital goods (-15.8 p.p.) and civil construction inputs (-9.3 p.p.). The reduction on Nuci calculated by CNI and FGV seems to be a result of a combination between the maturity of investment projects and accommodation of economic activity, and points to significant increase of the idle capacity level of the manufacturing industry. On the other hand, data about the absorption of capital goods indicate continuity of retraction at the margin and compared to the same periods of last year. The absorption of capital goods decreased 6.7% in February, according to seasonally adjusted data, and by 25.5% in year-over-year terms, according to observed data. In its turn, the production of civil construction inputs showed stability at the margin in February, after decreasing 0.5% in January, falling 13.5% year-over-year. In short, evidences suggest an ongoing process of reduction in demand pressures over the productive capacity level of the manufacturing industry, although the speed of decline in the utilization rates has reduced. As stressed in previous Copom Minutes, the inflation trajectory is closely linked to current and prospective developments related to the expansion of supply of goods and services, to adequately meet demand conditions.

9. The twelve-month cumulative trade balance has been showing moderate growth at the margin. Under this comparison basis, the trade surplus reached US$23.3 billion in January and increased to US$ 24.2 billion in February and to US$25.1 billion in March. This total resulted from US$ 190.4 billion in exports and US$ 165.3 billion in imports, equivalent to 15.2% and 26.0% growth, respectively, year-over-year. The adjustment in relative prices and the accommodation in the pace of expansion of domestic demand contribute to the recovery of the trade surplus, but the deterioration in the terms of trade acts on the opposite direction. The reduction in remittances of profits and dividends has contributed to limit the current account deficit, which reached US$ 28.2 billion in December 2008, decreasing to US$ 23.0 billion in March, equivalent to 1.6% of GDP. On its turn, foreign direct investment reached US$41.6 billion in the twelve months through March, equivalent to 2.9% of GDP.

10. The period since the last Copom meeting was marked by the continuity of stress on international financial markets, which originated in the US and Europe, but whose impact on emerging economies has continued to be significant. However, the unprecedented actions taken by the authorities in the US and Europe, using wide range of instruments, in order to ensure minimum conditions of operation and liquidity in monetary markets, have moderated the perception of systemic risk. In this environment, there are signs, albeit incipient, of reduction in risk aversion, but the return of confidence remains fragile, due to the susceptibility of the markets to the flow of economic and non-economic news. Despite incipient, the decrease both in the risk aversion and in the scarcity of capital flows in the recent weeks encouraged the recovery of emerging economies' currencies against the US dollar.

11. Regarding the global macroeconomic scenario, contraction trends prevail over inflationary pressures. The currently predominant view points to the contraction of global economic activity in 2009, which would recover just in 2010. The consensual projections point to an intense retraction of activity in the US, Europe and Japan, which wouldn't be totally offset by the economic dynamism of some emerging economies, especially in Asia. There are evidences that the deeper weakening of economic activity in Europe and parts of Asia was in a significant manner due to the negative shock in the terms of trade caused by the elevation of commodities prices in 2008, which was reverted, allowing an increase in available income in these regions. On the other hand, the problems in the international financial system have continued to be aggravated by a cyclical deterioration in the quality of credit, focused on the US and Europe, which tends to reinforce the contraction in the financial conditions and, as a consequence, the risk of intensification in the deceleration. In mature economies, where inflation expectations are better anchored and economic activity has decelerated considerably and for a longer period, inflationary pressures have reduced rapidly. The disinflation process seems to have gained momentum also in the emerging economies, in spite of greater persistence of the inflation dynamics. In this context, monetary policies stances have become highly expansionist in the mature economies, while the expansionary

stance in the emerging economies has been more moderate. At the same time, the authorities in the US, Western Europe and Asia have been announcing a series of important initiatives aimed at sustaining economic activity through fiscal incentives, which could contribute to a gradual economic recovery. It's important to notice, however, that the estimates on the fiscal costs for macroeconomic stimulus and support packages to the financial sector have been increasing, which has caused pressures over the risk assessment of several sovereign credits, even in advanced economies.

12. Oil prices remain volatile, but showed important elevation relative to the levels observed at the last Copom meeting. Future markets quotations also increased. Uncertainty concerning these quotations remains high, as the prospective scenario depends on the evolution of demand, especially in emerging economies, on the prospects for the evolution of global supply, in a scenario of uncertainty regarding the implementation and maturation of investments in the sector, in addition to the geopolitical issues that affect the price of this commodity. Nonetheless, despite the high uncertainty inherent to the projections regarding the trajectory of oil prices, the main scenario adopted by the Copom, which assumes unchanged gasoline prices in 2009, remains plausible, but if the current scenario in the oil market persists, it does not seem prudent to completely disregard the hypothesis of price reductions in 2009. However, it bears highlighting that, regardless of the behavior of domestic gasoline prices, the reduction in international oil prices, observed since the second half of 2008, can eventually affect domestic prices both through productive chains, such as the petrochemical, as well as through the potential effect over inflation expectations. The behavior of agricultural commodity prices, which have particularly important impact in the evolution of food costs, such as wheat, soybeans and corn, was heterogeneous since the last Copom meeting, with a predominantly upward trend, though.

Assessment of inflation trends

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

a) similarly to the March Copom meeting, the projected adjustments for gasoline and bottled gas prices for 2009 were kept unchanged at 0%;

b) the projected adjustments for fixed telephone for 2009 was kept unchanged at 5.0% relative to the March Copom meeting, while the expected adjustment for electricity prices was reduced to 6.3%;

c) the projection for regulated prices inflation for 2009, based on individual items, was reduced to 5.0%, down from 5.5% considered at the March Copom meeting. This set of prices, according to data released by the IBGE, corresponded to 29.56% of the total March IPCA;

d) the projection for regulated prices inflation for 2010 remained unchanged at 4.8%, compared to the March Copom meeting. Such projection is based on the endogenous determination model for regulated prices, which computes, among other factors, seasonal components, foreign exchange rate changes, market prices inflation and the IGP (General Price Index) variation;

e) the projection for the spreads over the Selic rate, based on the 360-day swap rates, on the benchmark scenario, estimates a 22 bps spread in the fourth quarter of 2009 and 60 bps in the last quarter of 2010.

14. Regarding fiscal policy, the projections assume the achievement of a public sector primary surplus target of 2.5% of GDP in 2009, in comparison to 3.8% considered at the March Copom meeting. The additional assumptions considered in the previous meeting remained unchanged.

15. Since the last Copom meeting, according to the median IPCA inflation expectations compiled by the BCB's Investor Relations Office (Gerin), the 2009 IPCA reduced to 4.30%, down from 4.57%. For 2010, inflation expectations reduced to 4.30%, down from 4.50%, collected on the eve of the March Copom meeting.

16. Considering the hypotheses under the benchmark scenario – which assumes the maintenance of the exchange rate at R$/US$ 2.20 and the Selic rate at 11.25% p.a. during the forecast period – the

projection for the 2009 IPCA decreased relative to the figure considered at the March meeting and is significantly below the 4.50% target established by the National Monetary Council (CMN). According to the forecast based on the market scenario – which incorporates the consensus exchange and Selic rates trajectories collected by Gerin on the eve of the Copom meeting – IPCA inflation forecast for 2009 also decreased compared to the figure considered in the previous Copom meeting and is also significantly below the central inflation target. Inflation projection for 2010, based on the benchmark and market scenarios, showed stability relative to the last Copom meeting. On the benchmark scenario, the projection remained significantly below the 4.5% central target, while on the market scenario it is around the central target.

Monetary policy decision

17. The Copom evaluates that the monetary policy should contribute to the consolidation of a favorable long-term macroeconomic environment. Available data indicate that the pace of domestic demand expansion has significantly cooled since the third quarter of 2008, partially as a reaction to the substantial and generalized economic activity deceleration in other developed and emerging economies. On its turn, the increase in risk aversion and the constraint observed in liquidity conditions prevailing in the international markets observed so far, despite some marginal improvements, continue to impose adjustments in the balance of payments. Nevertheless, since the last Copom meeting, some early signs of a global risk aversion reduction, although still subject to reversion, have arisen, with impacts on both Brazilian assets and commodities, and also influencing financial conditions. However, it bears emphasizing that the trajectory of price indices, in several economies, evidences significant reduction of external inflationary pressures, especially over mature economies, but also over some emerging economies. Consequently, the net impact of the global deceleration over the domestic inflation path continues to be, until the present moment, predominantly benign. The Copom emphasizes that the main challenge of the monetary policy in such context is to ensure that the favorable results obtained over the last years are preserved.

18. The Copom evaluates that the probability that initially localized inflationary pressures may cause risk to the domestic inflation trajectory continues to diminish. Evidences of substantial accommodation of domestic demand and moderation of pressures over the market of factors, despite remaining subject to uncertainties, should reduce the risk of pass-through of upward pressures stemming from wholesale prices (which, apart from that, have showed deflation over the past few months) over consumer prices. The Committee evaluates that the materialization of such pass-through, as well as the generalization of pressures initially located over consumer prices, still depends critically on economic agents' inflation expectations. Inflation expectations for 2009 and 2010 retreated since the last Copom meeting to levels below the target, but continue to be closely monitored. Additionally, it is worth noticing that, according to available data, domestic demand behavior should exert less pressure over prices of non-tradable items, such as services, in the upcoming quarters. Anyhow, the Committee reaffirms that it will continue to conduct its actions in order to ensure that the gains obtained in inflation control in recent years become permanent.

19. The Copom emphasizes, once more, that there are important time lags between the implementation of monetary policy and its effects on economic activity and inflation. Therefore, the evaluation of alternative options for monetary policy should necessarily focus on the forward-looking inflation scenario and its risks, instead of current inflation indices. These considerations become even more relevant in periods surrounded by heightened uncertainty.

20. Prospects for the evolution of economic activity have improved since last Copom meeting, although industrial data still partially reflects an inventories' retreat process. In light of the international crisis effects over domestic financial conditions, the credit contribution to sustain domestic demand severely diminished, although there are some early signs of recovery, in particular relative to credit to individuals. The severity of the international crisis negatively influenced consumers and businessmen confidence, but there are also signs of recovery. Under such circumstances, despite some improvement on financial conditions, the resumption of economic

activity will strongly depend on real payroll expansion and the effects of governmental transfers that should occur in 2009. In short, the contracting effects of the international financial crisis over the domestic economy dynamism and, consequently, over the context on which monetary policy has been acting, can become persistent, but will not be permanent. These considerations become even more relevant considering the fact that the current monetary policy decisions will have concentrated impacts in the second half of 2009 and in 2010.

21. The Copom understands that the loss of domestic demand dynamism has generated an increase in the idleness margin of factors, resulting on reduction of inflationary pressures. On the other hand, remaining risks to the inflationary dynamics derive from the trajectory of Brazilian assets prices, despite some recent recovery, associated to the partial recovery of commodities prices, amidst a process of decreasing external funding sources, as well as price adjustment mechanisms that contribute to lengthen inflationary pressures observed in the past, as evidenced by the behavior of the prices of services and regulated items since the beginning of 2009. The balance of those influences over the prospective trajectory of inflation will be crucial to the assessment of the various alternatives available for the monetary policy stance.

22. International evidence, as well as the Brazilian experience, indicates that high inflation rates leads to increase in risk premiums, both for private and public funding, to the shortening of planning horizons and, consequently, to lower potential economic growth, besides having regressive effects over income distribution. Therefore, the Copom strategy aims to ensure that inflation resumes the 4.5% midpoint target path in 2009, as established by the CMN, and to keep it in a level consistent with the target path for 2010. Such strategy, which should have its results evidenced throughout time, takes into account the time lags in the transmission mechanisms and is the most adequate to deal with the uncertainty inherent to the process of monetary policy formulation and implementation.

23. The Copom evaluates that, in light of signs of economic activity slowdown, regarding, for instance, industrial production indicators (which were, however, exacerbated, in some sectors, by the continuity of the inventory adjustment process), of data available for the labor market and industrial capacity utilization rates, as well as for businessmen and consumers confidence, and of lower inflation expectations for relevant horizons, the prospects for the materialization of a benign inflation scenario, in which the IPCA would resume evolution in line with the target path, have continued to increase. Indeed, the evolution of the prospective scenario is reflected on inflation projections considered by the Committee, as well as on inflation expectations set by independent analysts. The Committee also understands that the improvement on the inflation prospective scenario for 2009 and 2010 has not been, so far, incorporated into the interest rate forward structure. Nevertheless, although there is still some scope for an easing process, the monetary policy should be cautiously conducted, aiming to assure the convergence of inflation to the targets path.

24. The Committee understands that the demand slowdown, stimulated by tightening of financial conditions and by the deterioration of the agents' confidence, although some marginal improvement has been observed in both cases, as well as by the global economic activity contraction, has created a significant idleness margin of production factors that may not be rapidly eliminated in a scenario of gradual recovery of economic activity. Such development should contribute to restrain the inflationary pressures, even in light of the consequences of the adjustment process of the balance of payments and the presence of mechanisms of inflation feedback in the economy, making room for a monetary policy easing process. The Copom assessment over the scope for additional monetary easing, which depends on the inflation prospects relative to the targets path, takes into account the fact that changes on the basic interest rate have effects over activity and inflationary dynamics that accumulate over time. Additionally, the Committee understands that the continuity of the monetary easing process makes urgent the update of aspects, resulting from the long period of high inflation, still embedded within the financial system institutional framework.

25. In such context, taking into account the macroeconomic scenario and aiming to enlarge

the monetary easing process, the Copom has unanimously decided to reduce the Selic rate to 10.25% p.a., without bias.

26. Under the inflation targeting regime, the Copom guides its decisions according to projected inflation, the analysis of several alternative scenarios for the evolution of the main variables that determine the forward-looking dynamics for prices, and the balance of risks associated to the projections. After a long period of expansion, domestic demand has started to exert a contractionist influence over economic activity, despite the persistence of incentive factors, such as income growth. Additionally, it bears noticing that inflation expectations for 2009 and 2010 have decreased since the last Copom meeting. On the other hand, the deceleration of global economy has generated downward pressures over wholesale industrial prices, despite the exchange rate adjustment. Under such environment, the monetary policy can be eased without jeopardizing inflation convergence to the targets path. If the risk profile deteriorates in such a manner that implies shifts to the inflation prospective basic scenario considered by the Committee at this moment, the monetary policy stance will be promptly adjusted to the circumstances.

27. At the end of the meeting, it was announced that the Committee would reconvene on June 9th, 2009, for technical presentations and on the following day, to discuss the monetary policy decision, as established in Communiqué 17.327 of August 27th, 2008.

Summary of data analyzed by the Copom

Inflation

28. The IPCA increased 0.20% in March, up from 0.55% in February, reaching 1.23% in the first quarter of 2009. In the last twelve months through March, the IPCA increased 5.61% compared to 5.90% in February. In March, there was deceleration on market prices (0.23%, up from 0.67% in February) and on regulated prices (0.14%, up from 0.28% in the previous month). In the last twelve months, market prices reached 6.44% and regulated prices increased 3.68%, compared to 6.71% and 4.02%, respectively, in February.

29. The core excluding household food items and regulated prices increased 0.25% in March, decelerating relative to the 0.88% increase observed in February, reaching 6.02% on a twelve-month trailing basis. The smoothed trimmed means core reached 0.35%, up from 0.29% in February, increasing 4.85% in the last twelve months. The non-smoothed trimmed means core reduced in March (0.21%) relative to the previous month (0.27%), reaching 4.64% in the last twelve months. The diffusion index reached 60.16%, up from 58.07% observed in February.

30. The IGP-DI decreased 0.84% in March, after a 0.13% decrease in February, reaching -0.95% in the first quarter of 2009 and 5.86% in the last twelve months. The IPA (Wholesale Price Index) decreased 1.46% in March, reflecting the reduction both in crop and livestock sector prices (2.37%) and in industrial prices (1.16%). On a twelve-month basis, the IPA increased 4.98%, with a 7.22% increase in industrial products prices and a 0.93% decrease in agricultural prices. It bears highlighting that IPA's significant deceleration in the last twelve months through September, December and March, totaling 14.33%, 9.80% and 4.98%, respectively. The IPC-Br increased 0.21% in February and 0.61% in March, reaching 6.15% and 6.32%, respectively on a twelve-month basis. The INCC recorded -0.25% in March, a record low for the series since April 1998. On a twelve-month trailing basis, the INCC reached 10.66%. IPC-Br core increased 0.39% in March, up from 0.33% in February, reaching 4.33% in the last twelve months.

31. Analyzing the IPA by stages of processing, the prices of final and intermediate goods and gross raw material reduced 0.07%, 1.84% and 2.69%, respectively, in March. In the last twelve months through March those prices increased 4.25%, 5.97% and 4.16%, respectively.

32. Partial inflation results for April indicate increase on consumer prices and a slowdown on the deceleration pace of wholesale prices, month-on-month. The IPCA-15 increased 0.36% in April, reflecting higher increases on personal expenses, housing and clothing. As for wholesale, according to the April IGP-M (Market General Price Index), there was an upturn in the prices of

agricultural products, which increased in the month, and continuity of the fall in industrial prices.

Economic activity

33. According to seasonally adjusted data from the IBGE's monthly survey (PMC), expanded retail sales, which include construction supplies and vehicles and motorcycles, parts and pieces, increased 2.5% in February, month-on-month, reflecting the increase in the sales of seven out of the ten segments surveyed, with highlights for the performance of vehicles and motorcycles, parts and pieces (4.6%), which benefited from the IPI (Industrialized Products Tax) reduction. Sales of construction material grew 3.8% month-on-month, after four consecutive months of falling prices. Among the segments that presented decrease in sales relative to February, it bears emphasizing the negative performance of books and newspapers, magazines and stationary were highlighted, which fell 9.1%.

34. Considering comparisons between identical periods of 2009 and 2008, the increase on expanded retail sales increased 1.6% in February, growing by 2.2% in the first two months of 2009. In February, year-over-year, it bears emphasizing the performance of pharmaceuticals and medical supplies (12%); office material and equipment (11.3%); and other personal and domestic items (10.5%). The negative drivers were construction material (-12.8%); fabric, clothing and shoes (-6.9%) and furniture and home appliances (-2.1%).

35. São Paulo Trade Association (ACSP) data, related to the city of São Paulo, indicate the continuity of expansion on retail sales, with increases of 1.9% on database consultation for credit sales (SCPC) and 0.3% on consultations to the Usecheque system in March, on a month-on-month seasonally adjusted basis. Year-over-year, those indicators showed in March a 5.1% decrease and a 0.5% increase, respectively. In the first quarter of 2009 the indicators decreased 7.8% and 3.2%, respectively.

36. Automobile sales by dealers, which take into account automobiles, light commercial vehicles, trucks and buses, increased 8.3% in March, month-on-month seasonally adjusted, according to Fenabrave (Brazilian Federation of Auto Vehicles Distribution). On the first quarter of 2009, sales reached 668 thousand units, a 3.1% increase year-over-year, despite the 16.6% reduction on trucks sales.

37. Regarding investment indicators, capital goods production decreased 6.3% in February, month-on-month, while the production of construction typical inputs remained stable in the period, seasonally adjusted. Relative to the same period of 2008, those indicators decreased 24.4% and 13.5% in February and 19.5% and 12.3% in the first two months of 2009.

38. Capital goods imports increased 13.1% in March, month-on-month, according to the Funcex quantum indices, seasonally adjusted by the BCB. The March indicator increased 32.4% year-over-year, expanding by 4.6% in the first quarter of 2009, compared to the same period of last year, interrupting the downturn trend observed in the last months.

39. According to IBGE's Monthly Industrial Survey (PIM), industrial production increased 1.8% in February, month-on-month seasonally adjusted. Sixteen out of the 27 activities surveyed reported monthly production increase, with highlights to the performance of automobile vehicles (8.7%), other chemical products (8%), publishing and printing (10.3%) and electronic material and communication equipment (8.7%). By use categories, still considering seasonally adjusted data, it bears highlighting the increases in the production of durable consumer goods (10.5%), semi- and non-durable consumer goods (1.7%) and intermediate goods (1.5%).

40. Industrial production decreased 17% in February, year-over-year, as a reflex of a decline in all use categories: capital goods (24.4%), durable consumer goods (24.3%), intermediate goods (21%) and semi- and non-durable consumer goods (3.3%). The twelve-month cumulative industrial production declined 1% in February, compared, to the twelve months through January, when industrial production expanded by 1%, according to the same comparison basis.

41. CNI indicators showed a recovery in the industrial activity in February, month-on-month, with increases of 3.6% in real revenues and 1% in hours worked in production, according to data seasonally adjusted by the BCB. The installed capacity utilization declined 0.1 p.p. in the same period. These indicators decreased 10%, 8.3% and 5.5 p.p., respectively, year-over-year.

42. Vehicles production reached 272.4 thousand units in March, according to Anfavea, decreasing 4% year-over-year. Considering seasonally adjusted data, the production of vehicles increased 10% in March, month-on-month, for a 19.4% increase in the first quarter of this year, quarter-over-quarter. The cumulative production of vehicles decreased by 0.6% and the production of agricultural machinery increased 12.2%, in the last twelve months through March, compared to the last twelve months through February. The domestic sales of vehicles increased 8.7% in March 2009, year-over-year, accumulating a 3.9% growth in twelve months, while the exports of vehicles decreased 46.8% and 18.7%, according to the same comparison bases.

43. The LSPA survey carried out by the IBGE in March pointed to the production of 136.4 million tons in 2009, up from 135.3 million tons estimated in February. The new estimate represents a 6.5% decrease relative to the 2008 production. Declines of 12.6% and 2.3% in the production of corn and soybean, respectively, were also projected. The production of grains directly related to the basic food basket, such as rice and beans, should expand by 4.7% and 9.8%, respectively.

Surveys and expectations

44. According to the Fecomercio-SP survey, the Consumer Confidence Index (ICC) decreased 2.6% in April, month-on-month, reflecting a 4.9% reduction in the Consumer Expectations Index (IEC) and the 1.5% increase in the Current Economic Conditions Index (Icea). The ICC declined 16.2% year-over-year, mainly due to the retraction of 25.4% in the Icea.

45. According to the Consumer Expectations Survey carried out by the FGV, the ICC increased 2.5% in April, month-on-month. The confidence increase reflected the monthly increase in the components relative to consumer expectations (5%), whose impact in the composition of the general index overcame the effect of the 1% decline observed in the component concerning the current situation. The ICC declined 13.7% year-over-year.

46. In relation to the expectations for the manufacturing industry, the FGV Manufacturing Industry Survey showed, in March, for the third consecutive month, a slight improvement in the businessmen confidence, although the Industry Confidence Index (ICI) is at a relatively low level, when compared to the average of 2008. The ICC reached 77.9 points, after seasonal adjustment, with increase of 1.7 p.p., month-on-month, reflecting the increases of 2.2% increase in the Current Situation Index (ISA) and 2.3% in the Expectations Index (IE). According to the same survey, the installed capacity utilization (Nuci) reached 77% in March, 8.2 p.p. below the March 2008 level. Considering the seasonally adjusted series, the Nuci observed in March, 77.7%, stood 0.1 p.p. above the level registered in February.

Labor market

47. According to the Ministry of Labor and Employment (MTE), 34.8 thousand formal jobs were created in March after a 9.2 thousand balance in February, totaling 840 thousand jobs in twelve months. Among economic activities, services and the construction sectors registered an increase in the number of jobs in the period (49.3 thousand and 16.1 thousand, respectively), while the manufacturing industry and the retail sector recorded 35.8 thousand and 9.7 thousand dismissals, respectively. Seasonally adjusted data showed a 0.2% decline in the employment level in March, month-on-month. In the first quarter of the year, this indicator increased 3.4% influenced by increases of 8.2% in the construction sector, 4.7% in the services sector and 4.5% in the retail sector.

48. According to the IBGE employment survey (PME), carried out in the six main metropolitan areas of the country, the unemployment rate increased in March 2009 to 9%, up from 8.5% in February and 8.6% in March 2008. The monthly increase reflected the 0.7% increase in the economically

active population (PEA), due to the stability in the employment level. Year-over-year, the increase in the unemployment rate was driven by the higher increase in the PEA (1.4%), relative to the 0.9% increase in the number of employed workers. The same survey pointed out that average real earnings of employed workers reached R$ 1.321,40 in April, decreasing 0.2% month-on-month, but continued to expand significantly on a year-over-year basis (5.1%).

Credit and delinquency rates

49. Outstanding credit in the financial system reached R$1,241 billion in March, increasing by 1% in monthly terms and 25% on a twelve-month trailing basis. This volume corresponded to 42.5% of GDP, compared to December (41.3%) and March 2008 (35.5%). Non-earmarked credit operations increased 0.9% month-on-month and 23.9% in the last twelve months. Among the non-earmarked operations, which represent a share of 70.5% in the total of the financial system, credit operations to individuals increased 1.2% month-on-month and 20.9% in the last twelve months, while non-earmarked credit operations to corporate increased 0.6% and 26.7%, respectively. Earmarked credit operations increased 1.2% month-on-month and 27.5% on a twelve-month trailing basis, with highlights to the 2.5% monthly increase in housing loans.

50. Despite the 1.3% month-on-month expansion, the leasing operations in the individuals segment continue losing momentum at the margin, with a reduction of growth on a twelve-month trailing basis from 116.3% in October to 77.2% in March. Considering the segmentation by economic activity, the loans to industry increased 0.4% month-on-month and expanded 30.1% in the last twelve months.

51. The average interest rate on non-earmarked credit operations, used as reference for interest rates, reached 39.2% p.a. in March, compared to 43.3% p.a. in December and 37.6% p.a. in March 2008. The average rate on credit for individuals decreased 7.8 p.p. relative to December, reaching 50.1%. The average rate on corporate credit decreased by 1.8 p.p. relative to December, reaching 28.9%.

52. Delinquency rates in the financial system (non-earmarked loans, used as reference for interest rates, in arrears for more than ninety days) stood at 5% in March, a 0.9 p.p. increase year-over-year. Delinquency rates for credit operations with corporate and individuals reached 2.6% and 8.3%, respectively, compared to 1.8% and 6.9% in March 2008.

53. Net delinquency rate for retail credit, measured by the ACSP, reached 9.2% in March, up from 7.6% in the same month of 2008.

External environment

54. Although many international financial market indicators have improved since the last Copom meeting, the sustainability of this movement is still uncertain. The conditions of credit markets in mature economies are still under stress, with banks limiting the access to credit. The spreads of Credit Default Swaps (CDS) of banks and corporate remain in high levels, although they have shown significant reduction in April. The final demand for goods and services, especially the one related to household consumption, signalizes stability in the US and in the Euro Area. However, the increase in the family savings continues to be the main theme in the definition of consistency and pace of consumption recovery. Private investment continues in collapse, leading to unemployment rate growth, both in mature and emerging economies. The recent estimates of the International Monetary Fund (IMF) point to 1.3% decline in global GDP in 2009 – 1.8 p.p. contraction in relation to the last January estimate -, as well as to an 11% decline in international trade in 2009.

55. Regarding inflation, the global recession outlook has contributed to disinflation and, in some cases, to deflation of energy and food prices, which has been confirmed by the disinflation trend, for example, in Canada, the Euro area and Chile, or deflationary, as observed in Swiss, Japan, China and in the US. In the US, the CPI accumulated in twelve months, pressured by the 23% reduction in energy prices, declined to -0.38% in March. In the same period, the respective CPIs indicate deflation of 1.2% in China and inflation of 0.6% in Euro area, regions where inflation reached 7.1% and 4%, respectively, in June 2008.

56. Considering the maintenance, or even a deepening, of credit restrictions, the crisis in the financial systems and the behavior of inflation, central banks from mature economies and also from emerging economies furthered the monetary policy easing. In addition to the continuous injections of capital in their local systems, the annual interest rates were lowered to 0.5%, 1.25% and 0.5% in the UK, Euro Area and Canada, respectively. The same stance was adopted, for instance, by the central banks of Chile, Turkey, New Zealand and South Africa, with interest rates at 2.25%, 9.75%, 3.0% and 9.5%, respectively. Japan and the United States continue to work with a nominal interest rate policy close to zero. It bears highlighting that in the United States, Japan and in the UK, the central banks have already started the long-run bond purchase program, aiming to facilitate the reduction of interest rates and the reduce the spread of corporate funding, which should be able to create some impulse in private investment. Additionally, in Japan, where the economic prospects have deteriorated significantly, the government, in addition to the monetary liquidity measures, announced the release of a new fiscal package totaling 15.4 trillion yens, around 3% of local GDP.

Foreign trade and international reserves

57. The Brazilian trade surplus reached US$1.8 billion in March, totaling US$3 billion in the first quarter of 2009. In the month, exports reached US$11.8 billion, and imports, US$10 billion, decreasing by 14.9% and 21.5%, respectively, year-over-year, on a daily average basis. Total external trade recorded US$21.8 billion in March, an 8.1% decrease year-over-year, on a daily average basis.

58. The 19.4% decline in exports in the first quarter signals the cooling of global economic activity and the effects over the prices of the main exports products. According to the Funcex indices, the prices of exports products declined 6.3% in the period, while the volume exported reduced 14.2%. In the case of Brazilian imports, the contraction of 21.6% in the same period reflected more intensely the slowdown of domestic economic activity, once the volume index decreased 20.4%, once the price index reduced 1.9%.

59. Based on the liquidity concept, international reserves, which encompass the repurchase lines and borrowing operations in foreign currencies, reached US$ 202 billion in March, recording a US$3.0 billion increase month-on-month. Under the cash concept, international reserves totaled US$190 billion, recording a US$3.5 billion increase in comparison to the end of February.

Money market and open market operations

60. In the period between the March and April Copom meeting, the short-term interest rates reduced significantly, influenced by the benign behavior of the current inflation indices, by the decline in inflation expectations and by the disclosure of data regarding the activity level and the labor market, considered weak. The medium- and long-term rates showed inverse movement, mainly since the beginning of April, in reaction to the investors' expectation of a faster recovery of the domestic and international economies, in response to fiscal and monetary stimuli implemented until now. Between March 9 and April 27, one-, three-, six-month and one-year rates decreased by 124 bps, 99 bps, 56 bps and 12 bps, respectively. On the other hand, the rates for two- and three-year maturity increased by 36 bps and 56 bps, respectively. Real interest rates, measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month-ahead inflation expectations, increased from 5.51% on March 9, to 5.67% on April 27.

61. In its open market operations, the BCB carried out, between March 10 and April 27, five-, six- and seven-month long fixed rate repo operations, borrowing. The six-month repo operation was carried out for the first time on April 24 and absorbed R$4.0 billion. The average daily balance of these operations reached R$41.2 billion, of which R$25.2 billion were seven-month operations. In the same period, the BCB conducted borrowing operations with tenures of 33 and 16 working days on March 12; of 14 working days on March 23 and 30; of 12 working days on April 1; of 17 working days on April 3; of 16 working days on April 6 and of 12 working days on April 13. These operations draw from the market the following amounts: R$203.0 billion, R$39.0 billion, R$5.5 billion, R$5.0 billion, R$8.8 billion, R$47.9 billion,

R$0.4 billion and R$4.0 billion respectively. The average daily balance of these short-run borrowing operations reached R$256.6 billion. The BCB also borrowed money through 33 overnight repo operations and conducted daily, at the end of day, one- and two-working-day-tenure liquidity management operations. Operations with tenors less than thirty days, including daily liquidity management operations, averaged R$97.6 billion, on a daily basis, borrowing.

62. On March 26, the BCB carried out traditional FX swap auctions for rolling over the contracts maturing on April 1. These operations totaled US$4 billion, around 52% of maturing contracts. As a result, the net short position on FX swap contracts reduced from US$ 11 billion to US$ 7.4 billion, in notional values.

63. Between March 10 and April 27, the National Treasury issuance regarding the traditional auctions raised a total of R$32.9 billion. The issuance of fixed-rate securities reached R$15 billion, being R$12.3 billion via issuance of LTNs maturing in 2009, 2010 and 2011, and R$2.7 billion in NTN-Fs maturing in 2013 and 2017. Issuance of LFTs totaled R$15.6 billion, for securities maturing in 2013 and 2015. Issuance of inflation-linked NTN-Bs reached R$2.3 billion, for securities maturing in 2011, 2014, 2020, 2024, 2035 and 2045.

64. In the same period, the Treasury conducted auctions to sell LTNs maturing in October 2009 and April 2010 combined with purchases of LTNs maturing in April and July 2009, totaling R$0.6 billion; and conducted auctions to sell LFTs maturing in September 2013, combined with the purchase of LFTs maturing in March and June 2009, totaling R$0.3 billion. The sales of NTN-Bs settled in other National Treasury securities maturing in 2011, 2014, 2020, 2024, 2035 and 2045 totaled R$2.0 billion. The Treasury also conducted purchase auctions of LTNs and NTN-Bs totaling R$0.4 billion and R$0.2 billion, respectively.

Minutes of the 143rd Meeting of the Monetary Policy Committee (Copom)

Date: June 9th, from 4:40PM to 6:50PM, and June 10th, from 5:40PM to 7:50PM
Place: BCB Headquarters meeting rooms – 8th floor from June 9th and 20th floor on June 10th – Brasília – DF

In attendance:
Members of the Committee
Henrique de Campos Meirelles – Governor
Alexandre Antonio Tombini
Alvir Alberto Hoffmann
Anthero de Moraes Meirelles
Antonio Gustavo Matos do Vale
Maria Celina Berardinelli Arraes
Mário Gomes Torós
Mário Magalhães Carvalho Mesquita

Department Heads (present on June 9th)
Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on June 10th)
João Henrique de Paula Freitas Simão – Open Market Operations Department
Jose 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 June 9th)
Alexandre Pundek Rocha – Advisor to the Board
Eduardo José Araújo Lima – Deputy Head (to the Research Department)
Fábio Araujo – Advisor to the Research Department
Flávio Pinheiro de Melo – Advisor to the Board
José de Ribamar Oliveira Júnior – Press Secretary

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

Recent economic developments

1. IPCA inflation increased 0.47% in May, down from 0.48% in April. As a consequence, inflation accumulated in the first five months of 2009 reached 2.20%, decreasing 0.68 p.p. relative to the level registered in the same period of the previous year. In the last twelve months, inflation increased 5.20% in May, down from 5.53% in April (5.90% in December 2008 and 5.58% in May 2008). The deceleration of twelve-month consumer price trailing inflation in the first five months of the year mirrored the behavior of market prices, as regulated prices increased. Considering market prices, both prices of tradable goods and non-tradable goods cooled on a twelve-month trailing basis, reaching 4.96% and 6.31%, respectively, in May, down from 6.99% and 7.10% in December 2008 (7.09% and 7.70% in the same month of the previous year). According to the same comparison basis, the prices of services, whose dynamics tends to show more persistence than that of the prices of goods, increased from 6.39% in December to 7.23% in May (5.58 in May 2008). Preliminary data for June point to consumer inflation below that observed in May. In short, information available suggest that the inflationary cycle observed last year has been gradually overcome by a process that should continue to be led by the behavior of market prices, while regulated price inflation should show more persistence.

2. The three main underlying inflation measures calculated by the BCB increased in the last months. The core inflation by exclusion of household food items and regulated prices increased from 0.25% in March to 0.58% in April and 0.56% in May. Smoothed and non-smoothed trimmed means core inflation measures also raised, recording 0.35% and 0.21% in March, 0.35% and 0.27% in April and 0.44% and 0.39% in May, respectively. The twelve-month trailing inflation measures changed from 6.09%, 4.82% and 4.92% in December to 5.96%, 4.65% and 4.34% in May, for the core inflation by exclusion, smoothed and non-smoothed trimmed means core inflation, respectively, evidencing convergence for the midpoint of the target. Moreover, it bears emphasizing that the behavior of the IPCA diffusion index reduced from 61.7% in December to 58.9% in May (compared to 71.4% in May 2008).

3. The General Price Index (IGP-DI) inflation changed from –0.84% in March to 0.04% in April and 0.18 in May. On a twelve-month trailing basis, the IGP-DI inflation decreased from 5.86% in March to 4.74% in April and 2.99% in May, compared to 12.14% in May 2008. The slowdown of the IGP-DI has basically reflected the behavior of its main component, the Wholesale Price Index (IPA-DI), which decreased from 4.98% in March to 1.18% in May, according to the same comparison basis (15.36% in May 2008). On its turn, the Consumer Price Index-Brazil (IPC-Br) increased 5.55% up to May (5.59% in May 2008) and the Civil Construction National Index (INCC) increased 8.98% (8.06% in May 2008). Regarding the IPA-DI, the inflationary deceleration, under this comparison basis, derives basically from the behavior of both agricultural and industrial prices. The agricultural IPA reached -1.52% (33.65% in May 2008), while the elevation of wholesale industrial prices reached 2.24% (9.63% in May 2008). As mentioned in previous Copom Minutes, the Copom evaluates that the effects of wholesale prices over consumer price inflation will depend on current and prospective demand conditions and price-setters' expectations for the future inflation path.

4. The IBGE released information from Q1 2009 GDP. Data showed contraction in activity, under the criterion of cumulative change in the year (-1.8%, the same level recorded for the year-over-year comparison). From the aggregate demand side, expansion was led by public administration consumption, which increased 2.7% year-over-year. Gross fixed capital formation contracted 14.0%, and household consumption reached 1.3%, according to the same comparison basis, supported by real payroll. The contribution of domestic absorption to output growth was -1.9 p.p. in the first quarter of 2009, year-over-year, overweighing the 0.1% p.p. positive contribution of the external sector. From the aggregate supply side,

still according to the year-over-year basis, the service sector performed positively, with a 1.7% growth, year-over-year, while all other sectors contracted. The GDP deflator measured by market prices, according to the same comparison basis, decreased from 7.4% in the fourth quarter of 2008 to 4.7% in the first quarter of 2009.

5. On a three-month moving average basis, according to data seasonally adjusted by the IBGE, industrial output increased 1.3% in April, after increasing by 1.6% in the previous month. Still considering the seasonally adjusted series, industrial output increased by 1.1% in April month-on-month, after expanding by 0.9% in March. On a year-over-year basis, industrial output retreated by 14.8% in April, with respective falls of 11.5% and 15.0% in mining and manufacturing industries. The analysis of the behavior of IBGE industrial output series and its components, at the margin, according to data available, suggests that production reached its lowest level in December-January, and was followed by gradual recovery. However, industrial activity recovery continues to be influenced by the international crisis, due to its effects both over exports and credit conditions, and over business and households' expectations.

6. Among the use categories, according to data seasonally adjusted by the IBGE, the production of capital goods increased by 2.6% in April, after decreasing 4.6% in March. Regarding the other use categories, intermediate goods production increased 1.1% in April and 0.4% in March; non-durable and semi-durable consumer goods production increased 0.3% in April and 0.8% in March, while the production of durable goods, strongly influenced by the automotive sector, increased by 2.7% in April, after increasing by 1.8% in March. The loss of dynamism in capital goods production reflects the persistence of the international financial turmoil and its consequences over business confidence. On its turn, the recovery, at the margin, in the dynamism of durable goods production reflects, predominantly, exemption tax measures and also some easing of credit conditions. The future trajectory of industrial production will depend on these factors, which counterbalance the deterioration of external demand and a remaining process of inventories adjustment.

7. Labor market has continued to record ambiguous indicators, combining positive aspects with signs of loss of strength. The unemployment rate in the six metropolitan regions covered by the Monthly Labor Survey (PME) changed from 9.0% in March to 8.9% in April (8.5% in April 2008). According to the seasonally adjusted series, the unemployment rate decreased 0.2 p.p., reaching 8.3%. Average real earnings increased by 3.2% in April, in year-over-year terms. Employment, on its turn, expanded by 0.2% in April and 0.9% in March, according to the same comparison basis. As a consequence, real payroll reached 5.9% in March and 3.4% in April, continuing to constitute a key driver for domestic demand growth. According to the National Industry Confederation (CNI) data seasonally adjusted by the BCB, manufacturing employment decreased by 3.7% in April, in year-over-year terms, and expanded by 1.7% on a twelve-month trailing basis. According to data seasonally adjusted by the IBGE, manufacturing employment increased by 0.3% in twelve months and fell 5.2% in year-over-year terms. Still regarding the labor market, data from the Ministry of Labor and Employment (MTE) indicate some recovery in the generation of formal employment, despite below the seasonal pattern. In April, 106,205 jobs were created (compared to the positive result of 34,818 in March). After five consecutive months of job losses, manufacturing industry showed stability in April. The commerce sector performed positively after four consecutive months of negative results: 5,647 jobs were created. On the other hand, the civil construction sector and the services sector continued hiring workers this month: 13,338 and 59,279 jobs, respectively.

8. According to data seasonally adjusted by the IBGE, expanded retail sales increased by 2.0% in March, after increasing 2.7% in February. On a year-over-year basis, the indicator increased by 6.5%, growing by 3.7% in the year. The three-month moving average of expanded retail sales increased 3.4% in March, according to seasonally adjusted data, after reaching 2.7% in February. On a month-on-month basis, according to seasonally adjusted data, it bears emphasizing the expansion in the sales of "vehicles, motorcycles, parts and pieces" (3.9%) and "construction inputs" (3.0%).

The negative key drivers were “furniture and appliances” (-2.2%) and “hyper, supermarket and food articles” (0.0%). In the year, cumulative growth was more significant in “office material and equipment” (15.0%) and “books, newspapers, magazines and stationary” (12.3%). After consecutive falls in the last months of 2008, expanded retail sales data have evidenced recovery influenced mainly by the increase in the sales of vehicles since the beginning of the year, in response to the sector incentives granted by the government and to some improvement in the access to vehicle credit supply. For the next quarters, the retail sales trajectory will continue to be sustained by fiscal transfers, as well as by real payroll growth, whose evolution should be favored by the reduction of inflation, but it will also be affected by the recovery in the access to credit supply and by the behavior of consumer confidence.

9. The installed capacity utilization rate (Nuci) in the manufacturing industry reached 79.4% in April, above the level observed in March, according to CNI data seasonally adjusted by the BCB, and 1.22 p.p. above the minimum level recorded in January. The series seasonally adjusted by CNI showed an increase from 78.8% to 79.2% between March and April. Considering the monthly series without seasonal adjustment, in April the Nuci was 3.9 p.p. below the level registered in the same month of 2008. On its turn, the monthly Nuci without seasonal adjustment, calculated by Fundação Getúlio Vargas (FGV), increased in May to 78.7%, 6.9 p.p. below the level observed in the same month of 2008. The reduction in the Nuci according to the year-over-year comparison is also observed in the production of consumer goods (-3.4 p.p.), intermediate goods (-7.7 p.p.), capital goods (-14.7 p.p.) and construction inputs (-5.7 p.p.). The reduction on the Nuci calculated by CNI and FGV, according to the same comparison basis, seems to be a result of a combination between the maturity of investment projects and accommodation of economic activity, and points to significant increase in the idle capacity margin of the manufacturing industry. Regarding the absorption of capital goods, data indicate continuity of retraction year-over-year and expansion at the margin. The absorption of capital goods increased 5.1% in April, according to seasonally adjusted data, and decreased 23.3% in year-over-year terms, according to observed data. On its turn, the production of construction inputs has been showing relative stability since February, accumulating a 10.6% fall in the year. In short, evidences suggest that demand pressures over the productive capacity level of the manufacturing industry reduced, although the ones regarding the utilization rates have increased in the last months. As stressed in previous Copom Minutes, the inflation trajectory is closely linked to current and prospective developments related to the expansion of supply of goods and services to adequately meet demand conditions.

10. The twelve-month cumulative trade balance retreated at the margin. Under this comparison basis, the trade surplus reached US$27.1 billion in April and decreased to US$25.6 billion in May. This total resulted from US$ 181.4 billion in exports and US$155.7 billion in imports, equivalent to 5.1% and 10.6% growth, respectively, year-over-year. The adjustment in relative prices and the accommodation in the pace of expansion of domestic demand contribute to the recovery of the trade surplus, but the deterioration in the terms of trade acts on the opposite direction. The reduction in remittances of profits and dividends has contributed to limit the current account deficit, which reached US$28.2 billion in December 2008, decreasing to US$19.8 billion in April, equivalent to 1.4% of GDP. On its turn, foreign direct investment reached US$41.1 billion in the twelve months through April, equivalent to 2.9% of GDP.

11. The period since the last Copom meeting was marked by the reduction of stress on international financial markets, which originated in the US and Europe, but whose impact over emerging economies had been significant. The unprecedented actions taken by the authorities in the US and Europe, using a wide range of instruments, in order to ensure minimum conditions of operation and liquidity in monetary markets, have moderated the perception of systemic risk. In this environment, there have been signs of reduction in risk aversion, but confidence recovery remains fragile and subject to reversals. The decrease in both the risk aversion and the scarcity of capital flows, as well as some concern about tax situation in US, continued to encourage the recovery of currencies, both from emerging and mature countries, against the US dollar.

12. Regarding the global macroeconomic scenario, contraction trends prevail over inflationary pressures. The currently predominant view points to the contraction of global economic activity in 2009, with recovery only in 2010. The consensual projections point to an intense retraction of activity in the US, Europe and Japan (G3), which wouldn't be totally offset by the economic dynamism of some emerging economies, especially in Asia. There are evidences that economic activity in G3 could be stabilizing, with some improvement in disposable income and in demand for durable goods in the US and recovery of confidence of businessmen in Europe and real exports in Japan. However, the problems in the international financial system have continued to be aggravated by a cyclical deterioration in the quality of credit, focused on the US and Europe, which tends to reinforce the contraction in the financial conditions and, as a consequence, the risk of new intensification in the deceleration. In mature economies, where inflation expectations are better anchored and economic activity has decelerated considerably and for a longer period, inflationary pressures have reduced rapidly. The disinflation process seems to have gained momentum also in the emerging economies, in spite of greater persistence of the inflationary dynamics. In this context, monetary policies stances have become highly expansionist and focused on non-traditional instruments in the mature economies, while the expansionist stance in the emerging economies has been more moderate. At the same time, the authorities in the US, Western Europe and Asia have been announcing a series of important initiatives aimed at sustaining economic activity through fiscal incentives, which could contribute to a gradual economic recovery. It's important to notice, however, that the estimates on the fiscal costs for macroeconomic stimulus and support packages to the financial sector have been increasing, which has caused pressures over the risk assessment of several sovereign credits, even in advanced economies. The increasing signs that global economy would be close to an inflexion point, as well as the deterioration of public finance, have resulted in the elevation of interest rate forward structure in advanced mature economies.

13. Oil prices showed important elevation relative to the levels observed at the last Copom meeting. Future markets quotations also increased. Uncertainty concerning these quotations remains high, as the prospective scenario depends on the evolution of demand, especially in emerging economies, on the prospects for the evolution of global supply, subject to the rhythm of maturation of investments in the sector, in addition to the geopolitical issues that affect the price of this commodity. Nonetheless, despite the high uncertainty inherent to the projections regarding the trajectory of oil prices, the main scenario adopted by the Copom assumes unchanged gasoline prices in the rest of 2009. However, it bears highlighting that, regardless of the behavior of domestic gasoline prices, the evolution of international oil prices can eventually affect domestic prices both through productive chains, such as the petrochemical, as well as through the potential effect over inflation expectations. It bears emphasizing that the behavior of agricultural commodity prices, which have particularly important impact in the evolution of food costs, such as wheat, soybeans and corn, recorded significant increases since the last Copom meeting.

Assessment of inflation trends

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

a) similarly to the April Copom meeting, the projected adjustments for gasoline and bottled gas prices for 2009 were kept unchanged at 0%;

b) the projected adjustments for fixed telephone for 2009 was kept unchanged at 5.0% relative to the April Copom meeting, while the expected adjustment for electricity prices was reduced to 4.7%;

c) the projection for regulated prices inflation for 2009, based on individual items, was reduced to 4.8%, down from 5.0% considered at the April Copom meeting. This set of prices, according to data released by the IBGE, corresponded to 29.55% of the total May IPCA;

d) the projection for regulated prices inflation for 2010 reduced to 4.5%, against 4.8% relative to the April Copom meeting. Such projection is based on the endogenous determination model for regulated prices, which computes, among other factors, seasonal components, foreign exchange rate changes, market prices inflation and the IGP (General Price Index) variation;

e) the projection for the spreads over the Selic rate, based on the 360-day swap rates, on the benchmark scenario, estimates a 20 bps spread in the fourth quarter of 2009 and 61 bps in the last quarter of 2010.

15. Regarding fiscal policy, projections assume the achievement of a public sector primary surplus target of 2.5% of GDP in 2009 and 3.3% in 2010, unchanged from the April Copom meeting. The additional assumptions considered in the previous meeting remained unchanged.

16. Since the last Copom meeting, according to the median IPCA inflation expectations compiled by the BCB's Investor Relations Office (Gerin), the 2009 IPCA remained relatively stable, increasing from 4.30% to 4.33%. For 2010, inflation expectations remained at 4.30%.

17. Considering the hypotheses under the benchmark scenario – which assumes the maintenance of the exchange rate at R$/US$1.95 and the Selic rate at 10.25% p.a. during the forecast period – the projection for the 2009 IPCA increased relative to the figure considered at the April Copom meeting, but it is still below the 4.50% target established by the National Monetary Council (CMN). According to the forecast based on the market scenario – which incorporates the consensus exchange and Selic rates trajectories collected by Gerin on the eve of the Copom meeting – IPCA inflation forecast for 2009 also increased compared to the figure considered in the previous Copom meeting, but is also below the central inflation target. Inflation projection for 2010 based on the benchmark scenario increased relative to the last Copom meeting but it is still significantly below the 4.5% inflation target. On the market scenario, the projection for 2010 remained stable, close to target.

Monetary policy decision

18. The Copom evaluates that the monetary policy should contribute to the consolidation of a favorable long-term macroeconomic environment. The pace of demand expansion has significantly cooled since the third quarter of 2008, partially as a reaction to the substantial and generalized economic activity deceleration in other developed and emerging economies. On its turn, the increase in risk aversion and the constraint observed in liquidity conditions prevailing in the international markets continue to impose adjustments in the balance of payments, but show some marginal improvements. In fact, since last Copom meeting, signs of a global risk aversion reduction continue to accumulate, despite still subject to reversion, with impacts on both Brazilian asset and commodities prices and also influencing domestic financial conditions. However, it bears emphasizing that the trajectory of price indices still evidences reduction of external inflationary pressures, especially in mature economies, but also in some emerging economies. Consequently, despite the recent increase in commodities prices, the net impact of the global deceleration over the domestic inflation path continues to be, until present, predominantly benign. The Copom emphasizes that the main challenge of monetary policy in such context is to ensure that the favorable results obtained over the last years are preserved.

19. The Copom evaluates that the probability that initially localized inflationary pressures may cause risk to the inflationary trajectory has diminished. Evidences of substantial accommodation of domestic demand and moderation of pressures over the market of factors, despite remaining subject to uncertainties, should reduce the risk of pass-through of upward pressures stemming from wholesale prices (which, apart from that, have showed deflation over the past few months) over consumer prices. The Committee evaluates that the materialization of such pass-through, as well as the generalization of pressures initially localized over consumer prices, still depends critically on economic agents' inflation expectations. Inflation expectations for 2009 and 2010 have remained below the target since the last Copom meeting and continue to be closely monitored. Additionally, it is worth noticing that, according to available data, domestic demand behavior should exert less pressure over the prices of non-tradable items, such as services, in the upcoming quarters. Anyhow, the Committee reaffirms that it

will continue to conduct its actions in order to ensure that the gains obtained in inflation control in recent years become permanent.

20. The Copom emphasizes, once more, that there are important time lags between the implementation of monetary policy and its effects on economic activity and inflation. Therefore, the evaluation of alternative options for monetary policy should necessarily focus on the forward-looking inflation scenario and its risks, instead of current inflation indices. Such considerations become even more relevant in periods surrounded by heightened uncertainty. The Committee reaffirms that specific asset price movements are only relevant for monetary policy if they impact the forward-looking inflationary path.

21. Prospects for the evolution of economic activity have improved since the last Copom meeting, although industrial data still partially reflect a process of inventories retreat and the accommodation of external demand. In light of the international crisis effects over domestic financial conditions, credit contribution to sustain domestic demand severely diminished although there are some early signs of recovery, in particular regarding credit to individuals. The severity of the international crisis negatively influenced consumers and businessmen confidence, but there are also signs of recovery. Under such circumstances, the resumption of economic activity strongly depends on real payroll expansion and on the effects of government transfers that should occur in 2009, but it should also benefit from the gradual easing of financial conditions. It bears noticing, in short, that the contracting effects of the international financial crisis over the domestic economy dynamism and, consequently, over the context on which monetary policy has been acting, can become persistent but, as suggested by the recent behavior of capital markets (despite still subject to reversal), as well as by certain economic indicators, will not be permanent. These considerations become even more relevant considering the fact that the current monetary policy decisions will have concentrated impacts in the final months of 2009 and, particularly in 2010.

22. The Copom understands that the loss of domestic demand dynamism has caused an increase in the idleness margin of factors, resulting in reduction of inflationary pressures. On the other hand, the risks to the consolidation of a benign inflationary scenario derive, on the short term, from price adjustment mechanisms that contribute to lengthen inflationary pressures observed in the past, as evidenced by the behavior in the price of services and regulated items since the beginning of 2009, as well as, if it persists, from the recent trend of increased commodities prices. In the medium-term, the risk to the inflationary trajectory stems from the cumulative and lagged effects of the financial conditions easing over the evolution of domestic demand in a context of gradual recovery of the utilization of production factors. The balance of those influences over the inflationary prospective trajectory will be crucial to the assessment of the various alternatives available for the monetary policy stance.

23. International evidence, as well as the Brazilian experience, indicates that high inflation rates leads to increase in risk premium, both for private and public funding, to the shortening of planning horizons and, consequently, to lower potential economic growth, besides having regressive effects over income distribution. Therefore, the Copom strategy aims to ensure that inflation resumes the 4.5% midpoint target in 2009, as established by the CMN, and to keep it in a level consistent with the target path for 2010. Such strategy, which should have its results evidenced throughout time, takes into account the time lags in the transmission mechanisms and is the most adequate to deal with the uncertainty inherent to the process of monetary policy formulation and implementation.

24. The Copom evaluates that, in light of signs of economic activity slowdown, regarding, for instance, industrial production indicators, labor market and industrial capacity utilization rates, as well as businessmen and consumers confidence, and of inflation expectations for relevant horizons, the prospects for the materialization of a benign inflationary scenario, in which the IPCA would resume evolution in line with the target path, have continued to consolidate. Regarding this issue, the evolution of the forward-looking scenario is reflected on inflation projections considered by the Committee, as well as on inflation expectations set by independent analysts. Therefore, despite the residual margin for an easing process, the monetary policy should maintain

a cautious stance, aiming to assure the convergence of inflation to the targets path.

25. The Committee understands that the demand slowdown, motivated by tightening of financial conditions and by the deterioration of agents' confidence, although some marginal improvement has been observed in both cases, as well as by the global economic activity contraction, has created a significant idleness margin of production factors that may not be rapidly eliminated in a scenario of gradual recovery of economic activity. Such development should contribute to restrain the inflationary pressures. On the other hand, the Copom highlights that the significant monetary policy easing process that has been implemented since January, will have cumulative effects over the economy and will be evidenced after some time lag.

26. The Committee evaluates that decisions regarding the evolution of the basic interest rate have to take into account the magnitude of the total adjustment made since January, whose impacts on several economic indicators will be evident over time. In such context, a few Copom members considered to be appropriate, under such circumstances, to immediately reduce the pace of the monetary easing process, implementing in a more smooth way the remaining portion of the adjustment process. However, the majority of the Copom members, taking into account inflation projections, which have already incorporated the magnitude of the movement already made since January, decided, at this time, to maintain the adjustment pace unchanged. It bears noticing, on the other hand, that there was consensus among the Committee members, taking into account the information available so far, relative to estimates regarding the scope for residual easing, which depends on the prospective scenario for inflation in light of the targets path and on the balance of risks for such scenario. The Copom also understands that the preservation of benign inflationary prospects will demand that the economy and financial system behavior under a different interest rate level should be closely monitored.

27. In such context, taking into account the inflation prospects relative to targets path, the Copom has decided to reduce the Selic rate to 9.25% p.a., without bias. Six votes in favor of the monetary policy action while two votes were in favor of reducing the Selic rate by 75 bps. Taking into account the fact that changes on the basic interest rate have effects over the economic activity and over the inflationary dynamics that accumulate over time, the Committee agrees that any additional monetary easing should be implemented in a more parsimonious way. The Copom will closely monitor the evolution of the forward-looking inflationary scenario up to its next meeting, in order to then define the following steps on its monetary policy strategy.

28. Under the inflation targeting regime, the Copom guides its decisions according to projected inflation, the analysis of several alternative scenarios for the evolution of the main variables that determine the forward-looking dynamics for prices, and the balance of risks associated to the projections. After a long period of expansion, domestic demand started to exert a contractionist influence over economic activity, despite the persistence of incentive factors, such as income growth. Additionally, it bears highlighting that inflation expectations for 2009 and 2010 remain in a level consistent with the targets path. It is noteworthy that the deceleration of global economy has generated downward pressures over wholesale industrial prices. Under such environment, the monetary policy could be significantly eased since January, without jeopardizing inflation convergence to the targets path. If the risk profile deteriorates in such a manner that implies shifts to the inflation prospective basic scenario considered by the Committee at this moment, the monetary policy stance will be promptly adjusted to the circumstances.

29. At the end of the meeting it was announced that the Committee would reconvene on July 21st, 2009 for technical presentations and on the following day, to discuss the monetary policy decision, as established in Communiqué 17,327 of August 27th, 2008.

Summary of data analyzed by the Copom

Inflation

30. The IPCA increased 0.47% in May, down from the IPCA-15 (0.59%) and stayed virtually unchanged relative to the April IPCA (0.48%). In the last twelve

months through May, the IPCA increased 5.20%, down from 5.53% in the last twelve months through April, totaling 2.20% in the year. The May result was influenced by the increase in the groups personal outlays (1.57%, down from 2.14%, with a 0.16 p.p. contribution for the index) and beverages and food (0.44%, up from 0.15%, with a 0.10 p.p. contribution).

31. Market prices accelerated, increasing 0.54% in the month, up from 0.47% in April, while regulated prices reached 0.30%, down from 0.51% in the same period. On a twelve-month trailing basis, market prices increased 5.67%, down from 6.17% in April, while regulated prices reached 4.09%, up from 4.05% in the previous month. The diffusion index reached 58.85%, up from 56.77% in April.

32. The core excluding household food items and regulated prices increased 0.56% in May, decelerating relative to the 0.58% increase observed in April, reaching 5.96% on a twelve-month trailing basis, down from 6.08% in the last month. The smoothed trimmed means core reached 0.44%, up from 0.35% in April, increasing 4.65% in the last twelve months, down from 4.71% in the previous month. The non-smoothed trimmed means core increased in May (0.39%) relative to the previous month (0.27%), reaching 4.34% in the last twelve months, down from 4.50% in the previous month.

33. The IGP-DI increased 0.18% in May, up from 0.04% in April, reaching -0.73% in the year through May and 2.99% in the last twelve months. The IPA (Wholesale Price Index) decreased 0.10% in May, reflecting the increase in crop and livestock sector prices (0.58%) and the fall in industrial prices (-0.32%). On a twelve-month basis, the IPA increased 1.18%, with a 2.24% increase in industrial products prices and a 1.52% decrease in agricultural prices. It bears highlighting IPA's significant and continuous deceleration according to a twelve-month trailing basis, since October 2008, when it totaled 14.72%. The IPC-Br decelerated, decreasing from 0.47% in April to 0.39% in May, totaling 5.55% in the last twelve months. The INCC increased 1.39% in May, up from -0.04% in April, reaching 8.98% in the last twelve months. The IPC-Br core increased 0.37% in the month, up from 0.36% in April, reaching 4.24% in the last twelve months.

Economic activity

34. According to seasonally adjusted data from the IBGE's monthly survey (PMC), expanded retail sales, which include construction supplies and vehicles and motorcycles, parts and pieces, increased 2.0% in March, month-on-month, after increasing by 2.7% in February and 5.5% in January. As a result, expanded retail sales increased 7.4% in the first quarter, quarter-on-quarter. The expansion observed in March reflected the increase in the sales of nine out of the ten segments surveyed, with highlights to the monthly performance of vehicles and motorcycles, parts and pieces (3.9%), as a response to sectoral stimulus conceded by the government, which enabled the return to September 2008 sales levels. Sales of construction inputs grew 3.0% month-on-month, recording the second consecutive monthly increase. The only negative driver was furniture and home appliances (-2.2%).

35. The comparison between identical periods of 2009 and 2008 revealed expansion of 6.5% in expanded retail sales in March and 3.7% in the first quarter of 2009. In March, year-over-year, it bears emphasizing the performance of office material and equipment (18%); vehicles and motorcycles, parts and pieces (17.1%); pharmaceutical and perfumery products (15.2%); and books, newspapers, magazines and stationary (10.5%). The negative drivers were fabric, clothing and shoes (-8.2%); construction inputs (-4.1%); and furniture and home appliances (-0.9%). In the year, it bears noticing the performance of office material and equipment (15%); books, newspapers, magazines and stationary (12.3%) and pharmaceutical and perfumery products (12.1%). Only construction inputs and fabric, clothing and shoes fell in Q1 sales (-9.8% and -6.6%, respectively).

36. São Paulo Trade Association (ACSP) data, related to the city of São Paulo, indicated a decrease of 4% on database consultation for credit sales (SCPC) and a 2% increase on consultations to the Usecheque system in May, on a month-on-month seasonally adjusted basis. Year-over-year, those indicators showed in May respective falls of 17.7% and 1%, while in the year through May these indicators reached 12.1% and 4.1%, respectively.

37. Automobile sales by dealers, which take into account automobiles, light commercial vehicles, trucks and buses, decreased 0.1% in May, month-on-month seasonally adjusted, according to Fenabrave (Brazilian Federation of Auto Vehicles Distribution). Year-over-year, sales increased 2%, despite the 22.9% fall in trucks sales. In the year through May, automobile vehicles sales decreased 0.2% relative to the same period of 2008, with significant fall in trucks sales (19.9%). According to the same comparison basis, automobiles sales fell 0.1%, while light commercial vehicles sales expanded by 4.9%.

38. Regarding investment indicators, capital goods production and the production of construction typical inputs increased 2.6% and 0.2% in April, month-on-month, according to seasonally adjusted data. Relative to the same period of 2008, those indicators decreased 29.3% and 11.6%, respectively, in April, and 22.6% and 10.6% in the year through April.

39. Capital goods imports retreated 3.0% in April, month-on-month, according to the Funcex quantum indices, seasonally adjusted by the BCB. The April indicator increased 10.7% year-over-year, expanding by 2.7% in the first four months of 2009, compared to the same period of last year.

40. According to IBGE's Monthly Industrial Survey (PIM), industrial production increased 1.1% in April, month-on-month seasonally adjusted, the fourth consecutive monthly growth. It bears emphasizing the durable consumer goods production, particularly automobile vehicles production. Sixteen out of the twenty-seven activities surveyed reported monthly production increase, with highlights to the performance of tobacco (13.7%), electrical machinery, devices and materials (8.3%), metal products (6.8%), rubber and plastic (6.7%) electronic material and communication equipment (5.2%) and basic metallurgy (5.1%). All the use categories increased according to this comparison basis: production of durable consumer goods (2.7%), capital goods (2.6%); intermediate goods (1.1%) and semi- and non-durable consumer goods (0.3%).

41. Industrial production decreased 14.8% in April, year-over-year, due to the decline in all use categories: capital goods (29.3%), durable consumer goods (21.6%), intermediate goods (15.5%) and semi- and non-durable consumer goods (4.2%). The twelve-month cumulative industrial production declined 3.9% in April, compared to the twelve months through March, deepening the fall relative to the twelve months through February and March, when industrial production decreased by 1% and 1.9%, respectively, according to the same comparison basis.

42. CNI indicators showed a smooth retraction in the industrial activity in April, month-on-month, with decrease of 1.3% in real revenues and stability in the hours worked in production, according to data seasonally adjusted by the BCB. The installed capacity utilization increased 0.82 p.p. in the same period, reaching 79.4%. Year-over-year these indicators decreased 10.7%, 10% and 3.9 p.p., respectively.

43. Vehicles production reached 270.2 thousand units in May, according to Anfavea, decreasing 8% year-over-year. Considering seasonally adjusted data, the production of vehicles decreased 0.2% in May, month-on-month, for a 14.7% decrease in the first five months of this year, compared to the same period of 2008. The cumulative production of vehicles decreased by 6.4% and the production of agricultural machinery increased 3%, in the last twelve months through May, compared to the last twelve months through April. Domestic sales of vehicles decreased 4.8% in May 2009, year-over-year, accumulating a 1.5% decrease in twelve months, while the exports of vehicles decreased 33.7% and 25%, according to the same comparison bases.

44. The LSPA survey carried out by the IBGE in February pointed to the production of 135 million tons in 2009, up from 134.7 million tons estimated in January. The new estimate represents a 7.5% decrease relative to the 2008 production. Declines of 13.8% for the production of corn and of 4.5% for soybean were also projected. The production of grains directly related to the basic food basket, such as rice and beans, should expand by 5.8% and 5.2%, respectively.

45. The IBGE released data for Q1 2009 GDP. Data showed negative growth rates in the first quarter of 2009, both for quarter-over-quarter results (-0.8%, compared to -3.6% for Q4 2008), and for year-over-year results (-1.8% as against 1.3% in the previous quarter). According to the year-over-year comparison, on the aggregate supply side, only the services sector expanded (1.7%). The agriculture sector and the manufacturing industry retreated 1.6% and 9.3%, respectively. On the aggregate demand side, household and government consumption increased, respectively, 1.3% and 2.7%, whereas gross fixed capital formation decreased 14%, resulting in negative contribution of domestic demand to GDP (-1.9 p.p.), interrupting a cycle of twenty one consecutive quarters of positive contribution. Moreover, exports and imports decreased 15.2% and 16%, respectively, resulting in positive contribution of the external sector to GDP (0.1 p.p.), the first one after twelve quarters of negative contribution.

Surveys and expectations

46. According to the Fecomercio-SP survey, the Consumer Confidence Index (ICC) increased 0.7% in May, month-on-month, reflecting just a 1.2% increase in the Consumer Expectations Index (IEC), considering the 0.1% decrease in the Current Economic Conditions Index (Icea). The ICC declined 14.8% year-over-year, mainly due to the retraction of 24.4% in the Icea.

47. According to the Consumer Expectations Survey carried out by the FGV, the ICC increased 1.3% in May, month-on-month seasonally adjusted, representing the third consecutive month of increase and showing a trend towards a gradual recovery of consumer confidence. The confidence increase reflected the monthly increase in consumer expectations (1.6%) and current situation (1.1%). The ICC declined 10.9% year-over-year.

48. In relation to the expectations for the manufacturing industry, the FGV Manufacturing Industry Survey showed, in May, for the fifth consecutive month, strong improvement in the businessmen confidence, although the Industry Confidence Index (ICI) stood below the level recorded in the period immediately prior to the international financial crisis. The ICI reached 89.6 points, seasonally adjusted, with increase of 5.1 p.p., month-on-month, reflecting the increases of 7.6% in the Current Situation Index (ISA) and of 4.4% in the Expectations Index (IE). According to the same survey, the installed capacity utilization (Nuci) reached 78.7% in May, 6.9 p.p. below the May 2008 level. Considering the seasonally adjusted series, the Nuci observed in May (79.2%) stood 0.9 p.p. above the level registered in April.

Labor market

49. According to the Ministry of Labor and Employment (MTE), 106.2 thousand formal jobs were created in April after 34.8 thousand jobs were created in March, totaling 48.5 thousand jobs in the first four months of 2009 and 651.7 thousand jobs in twelve months. Among economic activities, the services and the agriculture sectors registered the highest net hires in April (59.3 thousand and 22.7 thousand, respectively), while in the manufacturing industry and the mining sector the dismissals exceeded the hires in 582 jobs. Seasonally adjusted data showed relative stability in the employment level in April, month-on-month. The average of the first quarter showed a 3.2% increase in employment, influenced by the increases of 8.4% in the construction sector, 4.8% in the services sector and 4.7% in the retail sector, whereas in the manufacturing industry it declined 0.9%.

50. According to the IBGE employment survey (PME), carried out in the six main metropolitan areas of the country, the unemployment rate reached 8.9% in April 2009, decreasing 0.1 p.p. month-on-month and increasing 0.4 p.p. year-over-year. The monthly unemployment decrease reflected a decrease in the economically active population (PEA) higher than the number of employed workers, which totaled 76 thousand and 40 thousand jobs, respectively. Year-over-year, the increase in the unemployment rate was driven by the higher increase in the PEA (0.6%), than the increase in the number of employed workers (0.2%), a record low since the start of this series in March 2002, according to this comparison basis. The same survey pointed out that average real earnings of employed workers decreased 0.2% in

April, month-on-month, but increased 3.2% on a year-over-year basis, accumulating a 4.7% growth in 2009.

Credit and delinquency rates

51. Outstanding credit in the financial system reached R$1,248 billion in April, increasing by 0.4% in the month and 22.6% on a twelve-month trailing basis. This volume corresponded to 42.6% of GDP, compared to December (41.3%) and April 2008 (35.8%). Non-earmarked credit operations increased 0.5% in the month and 20.8% in the last twelve months. Among the non-earmarked operations, which represent a share of 70.2% in the total of the financial system, credit operations to individuals increased 1.1% in the month and 18.7% in the last twelve months, while non-earmarked credit operations to corporate decreased 0.1% in the month and increased 22.7% in the last twelve months. Earmarked credit operations increased 0.4% in the month and 27.2% on a twelve-month trailing basis, with highlights to the 2.6% monthly increase in housing loans.

52. The leasing operations in the individuals segment continue losing momentum at the margin, with a reduction of growth on a twelve-month trailing basis from 116.3% in October 2008 to 64.8% in April. Considering the segmentation by economic activity, loans to industry decreased 0.3% in the month and expanded 26% in the last twelve months, whereas loans to the retail sector decreased 0.2% and expanded 14.1%, according to the same comparison bases.

53. The average interest rate on non-earmarked credit operations, used as reference for interest rates, totaled 38.6% in April, down from 43.3% in December. The average annual rate on credit for individuals decreased 9.1 p.p. relative to December, reaching 48.8%. The average rate on corporate credit decreased by 1.9 p.p. relative to December, reaching 28.8%.

54. The average tenure on non-earmarked credit operations, used as reference for interest rates reached 366 days in April, down from 378 days in December. The average tenure of corporate credit operations reached 273 days in April, down from 302 reached in December, while the average tenure for credit operations to individuals totaled 491 days in April, up from 488 days observed in December.

55. Delinquency rates in the financial system (non-earmarked loans used as reference for interest rates, in arrears for more than ninety days) reached 5.2% in April, a 0.8 p.p. increase compared to December. Delinquency rates for credit operations with corporate and individuals reached 2.9% and 8.2%, respectively, compared to 1.8% and 8% in December.

56. Net delinquency rate for retail credit, measured by the ACSP, reached 9.7% in May, up from 9% in the same month of 2008.

External environment

57. Although the stress in the international financial markets has been reduced, which can be deduced from the reduction of risk aversion indicators, the high prices of the shares, the retraction of the spreads of Credit Default Swaps (CDS) for banks and corporations and the decline in the rates of interbank loans, the conditions of operation of banking systems are still far below the normal, limiting access to the final credit borrower. Regarding economic activity, the most recent data already suggest that the pace of global economic activity contraction has decreased. The US economic activity, for instance, has shown signs of stabilization in household consumption and in the housing market. Likewise, the process of inventories adjustment, particularly in the retail sector, has advanced, making room for production recovery in the near future. On the other hand, the recent hike in oil prices and the continuing rise in the rates of households' savings and unemployment constitute risk factors for the recovery of consumption. The key issue for the medium term is whether the positive signs stemming from financial markets will find, indeed, sustainability in economic activity.

58. Regarding inflation, despite the hike at the margin for annual prospects, the decline in the prices of commodities and the global recession still suggest the reduction of consumer price indices (CPI). In this sense, the ongoing deflationary process, for example, in the US, Japan and China, and the disinflation process, for example, in the UK and in most emerging

economies, should still continue over 2009, due to the still uncertain recovery of economic activity and the fact that the prices of commodities, particularly oil, remain depressed when compared to the levels prevailing a year ago. In Japan, the deflationary process is expected to last for some quarters. In the US, where core inflation is expected to retreat to 0% this year, the CPI, in annual deflation since March, declined 0.74% in the last twelve months through April, when the price of energy decreased 25.2%. In the UK, the annual CPI increased 2.3% in April, a record low for the series recorded since early 2008.

59. Considering this scenario, in which signs of improvement in stock markets and in some segments of financial markets still coexist with credit restrictions, weak consumption and inflation decline, central banks from mature economies, and also from emerging economies, continued strengthening measures focused on monetary policy easing. The US Federal Reserve and the central banks of Japan, UK and Switzerland, which already operate with nominal interest rates close to 0%, expanded their programs to purchase public or private securities, including the expansion in the range of collateral accepted in funding operations. On the other hand, central banks in Europe (ECB), Canada (BoC) and of emerging economies, except for the People's Bank of China, where domestic absorption has restricted the expansion of product gap, the monetary policy easing has been made through the systematic reduction of basic interest rates. Thus, the basic interest rates of the ECB, BoC and the central banks of Chile, South Africa and Turkey were reduced to 1%, 0.25%, 1.25%, 7.5% and 9.25 %, respectively.

Foreign trade and international reserves

60. The Brazilian trade surplus reached US$2.7 billion in May, totaling US$9.4 billion in the first five months of the year. In the month, exports reached US$12 billion, and imports, US$9.3 billion, decreasing by 37.9% and 38.7%, respectively, year-over-year, on a daily average basis. Total external trade recorded in May a 38.3% decrease year-over-year, on a daily average basis.

61. The decline in exports in May was amplified by the effect of a new comparison basis, due to the regularization of the exports registers recorded during the strike of the Brazilian state tax agency auditors between March and April 2008. All products categories decreased on a daily average basis: primary products (-35.8%), semi-manufactured products (-45.1%) and manufactured products (-36.8%). Regarding Brazilian imports, it bears highlighting the contraction of intermediate goods (-40.9%) and fuels and lubricants (-60.1%), which reflected the slowdown of domestic industrial output and the decrease in the prices of oil and byproducts in international markets.

62. Based on the liquidity concept, international reserves, which encompass the repurchase lines and borrowing operations in foreign currencies, reached US$205.6 billion in May, recording a US$4.3 billion increase in the month. Under the cash concept, international reserves totaled US$195.3 billion, recording a US$4.7 billion increase according to the same comparison basis.

Money market and open market operations

63. In the period between the April and June Copom meetings, the future interest rates reduced significantly, especially short-term interest rates, reflecting the retreat in current inflation indices, the decline in inflation expectations and GDP growth projections. The medium- and long-term rates showed similar trend, also influenced by expectations of an extended monetary policy easing cycle and by an increasing financial inflow coming from foreign investors. After June 5, however, part of the downward movement of the curve was reversed, especially in its long segment, in reaction to the increase in the US Treasury bonds yield and the US dollar appreciation in the international market, noticeably after the disclosure of better-than-expected data on the US labor market. Between April 27 and June 8, one-, three- and six-month rates decreased by 82 bps, 74 bps and 71 bps, respectively. The one-, two- and three-year rates decreased by 64 bps, 48 bps and 30 bps, respectively. Real interest rates, measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month-ahead inflation expectations, decreased from 5.67% on April 27, to 5.17% on June 8.

64. In its open market operations, the BCB carried out, between April 28 and June 8, long fixed rate repo operations, borrowing R$15.6 billion for a six-month period. The average daily balance of the five-, six- and seven-month operations reached R$47 billion, of which R$23.9 billion were seven-month operations. In the same period, the BCB conducted borrowing operations with tenures of 29 working days on April 30; of 15 working days on May 4; of 23 working days on May 11; of 18 working days on May 18 and of 13 working days on May 25. These operations drained from the market R$245.7 billion, R$10.5 billion, R$10.6 billion, R$12 billion and R$12 billion, respectively. The average daily balance of these short-run borrowing operations reached R$272.1 billion. The BCB also borrowed money through 29 overnight repo operations and conducted daily, at the end of day, one- and two-working-day-tenure liquidity management operations. Operations with tenors less than thirty days, including daily liquidity management operations, averaged R$71 billion, on a daily basis, borrowing.

65. On April 28, the BCB carried out traditional FX swap auctions for rolling over the contracts maturing on May 4. These operations totaled US$2 billion, around 35% of maturing contracts. On May 5, the BCB carried out reverse FX swap auctions maturing on June 1, aiming to anticipate the redemption of the traditional FX swap contracts maturing on the same date. This operation totaled US$3.4 billion. As a result, the net short position on FX swap contracts reduced from US$7.4 billion, on April 27, to US$315 million, on June 8, in notional values.

66. Between April 28 and June 8, the National Treasury issuance regarding the traditional auctions raised a total of R$41.9 billion. The issuance of fixed-rate securities reached R$24.2 billion, being R$17.5 billion via issuance of LTNs maturing in 2009, 2010 and 2011, and R$6.7 billion via NTN-Fs maturing in 2013 and 2017. Issuance of LFTs totaled R$15.1 billion, for securities maturing in 2013 and 2015. Issuance of inflation-linked NTN-Bs reached R$2.6 billion, for securities maturing in 2011, 2014, 2020, 2024, 2035 and 2045.

67. In the same period, the Treasury conducted auctions to sell LTNs maturing in October 2009 and April 2010 combined with purchases of LTNs maturing in July 2009, totaling R$1.9 billion; it also conducted auctions to sell LFTs maturing in March 2013 and in March 2015, combined with the purchase of LFTs maturing in June and in September 2009, totaling R$1.3 billion. The sales of NTN-Bs settled in other National Treasury securities maturing in 2011, 2014, 2020, 2024, 2035 and 2045 totaled R$3.6 billion. The Treasury also conducted purchase auctions of LTNs maturing in July 2009, totaling R$2.9 billion.

Appendix

Banco Central do Brasil Management

Members of the Monetary Policy Committee (Copom)

Banco Central do Brasil Management

Board

Henrique de Campos Meirelles
Governor

Alexandre Antonio Tombini
Deputy Governor

Alvir Alberto Hoffmann
Deputy Governor

Anthero de Moraes Meirelles
Deputy Governor

Antonio Gustavo Matos do Vale
Deputy Governor

Maria Celina Berardinelli Arraes
Deputy Governor

Mario Gomes Torós
Deputy Governor

Mário Magalhães Carvalho Mesquita
Deputy Governor

Members of the Monetary Policy Committee (Copom)

Voting members

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Antonio Gustavo Matos do Vale
Deputy Governor

Maria Celina Berardinelli Arraes
Deputy Governor

Mario Gomes Torós
Deputy Governor

Mário Magalhães Carvalho Mesquita
Deputy Governor

Non-voting members

Altamir Lopes
Head of the Departament of Economics (Depec)

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

João Henrique de Paula Freitas Simão
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

ACSP	São Paulo Trade Association
Anfavea	National Association of Automotive Vehicle Manufacturers
BNDES	Brazilian Development Bank
BoE	Bank of England
BoJ	Bank of Japan
Caged	General File of Employed and Unemployed Persons
CDs	Distribution Centers
Cide	Contribution on Intervention in the Economic Domain
CMN	National Monetary Council
CNI	National Confederation of Industry
Cofins	Contribution to Social Security Financing
Copom	Monetary Policy Committee
CRB	Commodity Research Bureau
CSI	Current Situation Index
CSLL	Social Contribution on Net Corporate Profits
Depec	Department of Economics
DPGE	Deposits with Special Guarantee
ECB	European Central Bank
EI	Expectations Index
Embi+	Emerging Markets Bond Index Plus
FAT	Worker Support Fund
FCL	Flexible Credit Line
FDI	Foreign Direct Investments
Fecomercio SP	Trade Federation of the State of São Paulo
Fed	Federal Reserve
Fenabrave	National Federation of Automotive Vehicle Distribution
FGC	Credit Guaranty Fund
FGTS	Employment Compensation Fund
FGV	Getulio Vargas Foundation
Funcex	Foreign Trade Studies Center Foundation
GDP	Gross Domestic Product
Gerin	Executive Investor Relations Group
GFCF	Gross Fixed Capital Formation
GGGD	Gross General Government Debt
IBGE	Brazilian Institute of Geography and Statistics
Ibovespa	São Paulo Stock Exchange Index/ Bovespa Index
ICC	Consumer Confidence Index
Icea	Current Economic Conditions Index
ICI	Industrial Confidence Index
ICMS	Tax on the Circulation of Merchandise and Services

ID	Interbank Deposit
IEC	Consumer Expectations Index
IGP-DI	General Price Index
INC	National Confidence Index
INCC	National Cost of Construction Index
INCC-DI	National Cost of Construction Index – Domestic Supply
Inec	National Consumer Expectations Index
IPA-DI	Producer Price Index
IPC	Consumer Price Index
IPCA	Extended National Consumer Price Index
IPCA	Extended National Consumer Price Index
IPC-Br	Consumer Price Index – Brazil
IPI	lndustrialized Products Tax
Ipsos	Ipsos Public Affairs
IPVA	Tax on Automotive Vehicle Proprietorship
IRPJ	Corporate Income Tax
IRRF	Income Withholding Tax
ISP	Current Situation Index
LDO	Budget Guidelines Law
LME	London Metal Exchange
Loas	Social Assistance Law
LSPA	Systematic Farm Production Survey
MBS	Mortgage-backed securities
MTE	Ministry of Labor and Employment
NTN-B	National Treasury Note – Series B
Nuci	Installed Capacity Utilization Level
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries
PAF	Annual Financing Plan
PBC	People's Bank of China
PEA	Overall Labor Force
Pimes	Monthly Industrial Survey – Employment and Wages
PIM-PF	Monthly Industrial Survey – Physical Production
PMC	Monthly Retail Trade Survey
PME	Monthly Employment Survey
PPI	Pilot Investment Project
PSND	Public Sector Net Debt
PSND	Public Sector Net Debt
RMV	Lifetime Monthly Income
SBPE	Brazilian System of Savings and Loans
SCAP	Supervisory Capital Assessment Program
SCIT	Manufacturing Industry Survey
SCR	Credit Information System
Selic	Special System of Clearance and Custody
SFH	Housing Financing System
TALF	Term Asset-Backed Securities Loan Facility
TARP	Troubled Asset Relief Program
USA	United States of America
VaR	Value at Risk
WTI	West Texas Intermediate