BANCO CENTRAL DO BRASIL

Minutes of the 96th Meeting of the Monetary Policy Committee (Copom)

Date: May 18th, from 4:45PM to 7:00PM, and May 19th, from 3:30PM to 6:15PM
Place: BCB's Headquarters meeting room of the 8th floor (on May 18th) and 20th floor (on May 19th) – Brasília – DF

In attendance:
Members of the Committee
Henrique de Campos Meirelles – Governor
Afonso Sant'Anna Bevilaqua
Alexandre Schwartsman
Antônio Gustavo Matos do Vale
Eduardo Henrique de Mello Motta Loyo
João Antônio Fleury Teixeira
Luiz Augusto de Oliveira Candiota
Paulo Sérgio Cavalheiro
Sérgio Darcy da Silva Alves

Department Heads (present on May 18th)
Altamir Lopes – Economic Department
Daso Maranhão Coimbra – International Reserves Operations Department
José Antonio Marciano – Department of Banking Operations and Payments System
José Pedro Ramos Fachada Martins da Silva – Investor Relations Group
Marcelo Kfoury Muinhos – Research Department (also present on May 19th)
Sérgio Goldenstein – Open Market Operations Department

Other participants (present on May 18th)
Alexandre Pundek Rocha – Advisor to the Board
Flávio Pinheiro de Melo - Advisor to the Board
Hélio José Ferreira – Executive Secretary
João Batista do Nascimento Magalhães – Special Advisor to the Governor
Jocimar Nastari – Press Secretary
Katherine Hennings – Advisor to the Board

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

Recent Evolution of Inflation

1. Consumer inflation showed a new deceleration in April. The Broad National Consumer Price Index (IPCA) rose 0.37%, compared to 0.47% in March, accumulating 2.23% in the January-April period. The IGP-DI registered a 1.15% change in April (0.93% in March), totaling a 4.02% variation in the first four months of the year. The IGP-DI rise is explained by the behavior of the Wholesale Price Index (IPA-DI), which presented a 1.57% variation in the month (1.09% in March and 4.92% accumulated until April). The accumulated IPCA variation in twelve months reached 5.26% in April, the lowest rate since the second half of 1999, at the same time as the IGP-DI and the IPA-DI stood at 5.71% and 5.14%, respectively.

2. The lower IPCA variation was largely caused by the turnaround in food prices, which registered a 0.34% decline in April, compared to a 0.43% increase in March. This reversal reflected the supply increase due to the harvest period.

3. The main individual contribution for the 0.37% IPCA change stemmed from medicine prices (a 3.0% rise), partly capturing the 5.7% average readjustment granted by the *Regulation Chamber* to certain controlled products. Among other pressures, electricity prices, pasteurized milk, clothes and bottled cooking gas were the main contributors for the IPCA change. In contrast, among items with price decreases, the most important ones were meat, gasoline, fuel alcohol and rice.

4. Further to the IPCA in April, market prices increased 0.39% (0.69% in March), accounting for 0.28 percentage points of the monthly IPCA rate, while the 0.32% variation in regulated prices contributed for the remaining 0.09 percentage points. After a 0.82% variation in March, market prices excluding food presented a 0.75% change in April, showing that deceleration in market prices' increases occurred mainly due to food prices. Concerning regulated prices, the most significant contribution came from the rise of electricity prices in six state capitals and urban buses fares in Curitiba and Porto Alegre, besides the increase of bottled cooking gas prices. These increases prevailed over the negative variations in the prices of fuel alcohol and gasoline, though in lower magnitude than the contribution registered in March.

5. The increase in wholesale prices, as captured by the IPA-DI, was a result of higher pressures from industrial prices (a 1.86% rise in April, compared to 0.94% in March), once there was a deceleration in agricultural prices, from 1.48% in March to 0.8% in April. Increasing commodity prices were the main cause of pressure on industrial wholesale prices. Fuel, sugar, medicine and agricultural machinery presented the highest price changes.

6. All measures of IPCA core inflation declined in April. The core calculated excluding household food items and regulated prices posted a 0.72% change (0.85% in March), accumulating 7.0% in twelve months.

7. IPCA core inflation calculated by the smoothed trimmed-mean method decreased to 0.57% in April from 0.76% in March, totaling 8.90% in the last twelve months. Without the smoothing procedure for pre-selected items, the IPCA core reached 0.45% in the month and 5.68% in the last twelve months, compared to 0.65% and 6.11%, respectively, in March.

8. IPC-Br core inflation, calculated by the Getúlio Vargas Foundation (FGV) using the symmetric trimmed-mean method, stood at 0.53% in April, the same change recorded in March, accruing 7.15% in twelve months.

9. In May, consumer inflation should still be affected by medicine, health insurance and clothes prices, as well as by the adjustment in electricity prices in various state capitals and the recovery of fuel alcohol prices. Moreover, an unexpected turnaround in the downward trend of food prices has been noticed in the first weeks of the month, as shown in the partial IPC-S and IPC-Fipe results.

Assessment of Inflation Trends

10. The identified shocks and their impacts were reassessed according to new available information. The scenario considered in the simulations assumes the following hypotheses:

    a. The projections for the evolution of gasoline and bottled cooking gas prices in 2004 were maintained at 9.5% and 6.9%, respectively;

    b. The projections for household electricity prices increased to 11%. For fixed telephone prices, the Copom maintained the adjustment estimate at 6.7% for the year;

    c. Regarding all regulated prices, with a total weight of 28.6% in the April IPCA, a 7.7% rise is projected, 0.3 p.p. above the projection made in the previous meeting;

d. The projection for the readjustment of all regulated prices for 2005 was maintained at 6.0%. This figure is endogenously determined, taking into account seasonal components, the exchange rate, market prices inflation and the IGP-DI change;

e. The projection for the 6-month spread over the Selic rate, following the specification of a Vector Autoregressive model based on the Selic and the swap rates on the eve of the Copom meeting, increases from -38 basis points in the second quarter of 2004 to 59 basis points in the fourth quarter of 2005.

11. Regarding fiscal policy, it is assumed that the consolidated public sector primary surplus target of 4.25% of the GDP for 2004 and the following two years will be achieved. The related assumptions considered in the previous meeting were maintained.

12. Considering the benchmark scenario hypotheses - the Over-Selic rate at 16.0% p.a. and the exchange rate at the level seen on the eve of the Copom meeting (R$3.10), and also considering the hypothesis of a lower degree of inflation persistence, as assumed by the Copom since March, IPCA inflation was projected slightly above the 5.5% target for 2004 and below the 4.5% target for 2005. According to the market scenario, which takes into account the consensus exchange rate and Selic rate as surveyed by the BCB´s Investor Relations Group (Gerin) on the eve of the Copom meeting, inflation is projected above the central targets for both 2004 and 2005.

Monetary Policy Decision

13. The inflation measured by the IPCA decreased in April for the third month in a row. As in recent months, market prices inflation has been higher than regulated prices inflation (0,39% compared to 0.32%). Amongst market prices, for the first time since October 2003, tradable goods inflation (0.50%) was higher than non-tradable goods inflation (0.25%). However, for the year to April, non-tradable goods prices increased 3.59% and were the ones that most contributed to the 2.23% IPCA inflation. Prices of tradable goods rose 1.80% in the period, while regulated prices rose 1.35%. In April, other national consumer inflation measures registered inflation similar to the IPCA, such as the Consumer Price Index – Domestic Supply (IPC-DI). However, general price indices have recorded higher rates. The IGP-DI increased 1.15% in April, accumulating a 4.02% increase in the year. Industrial wholesale inflation has continued to increase, though the pass-through to consumer inflation has remained lower than usual.

14. Core consumer inflation in April also declined compared to March. The smoothed trimmed-mean core fell to 0.57% in April from 0.76% in March. The non-smoothed trimmed-mean core declined to 0.45% in April from 0.65% in March. Core inflation excluding household food items and regulated prices still posted a high rate (0.72%), albeit lower than the previous month (0.85%).

15. Certainly, the April's IPCA result does not imply that inflation is accommodating at a lower level. Still, it is an evidence of the seasonal relief that had already been incorporated to the Copom's forecasting exercises. The IPCA behavior has been consistent with the Copom´s assessment and projections, under a hypothesis of low inflation persistence in the first quarter of the year.

16. Economic activity has sustained the recovery trend since the second half of 2003, as confirmed by several indicators. Industrial production increased 2.1% in March compared to February, seasonally adjusted. In comparison with the first quarter of 2003, industrial output grew 5.8%, led by capital and durable goods. According to the industrial survey, all regions showed a positive performance, except Rio de Janeiro. Industrial sales remained strong throughout the quarter and inventories diminished, in line with the results of the FGV industrial survey, in which only 7% of the firms recorded excessive inventories in the first quarter of the year, compared to 10% in the previous quarter and 12% in the first quarter of 2003.

17. According to IBGE data, seasonally adjusted by the BCB, retail sales have maintained an uninterrupted growth trend since March 2003. In March 2004, retail sales reached the highest level in the last two years, up 1.1% in comparison to February. Sales in the first quarter increased 3.3% compared to the last quarter of 2003, seasonally adjusted. The improvement in activity can also be depicted from the Fecomercio-SP consumer sentiment survey. Consumer confidence improved in May to a level similar to January and February – the highest since the survey began, in March 1999.

18. Labor market indicators, which usually react with a lag in recovery cycles, have also improved. According to data from *Cadastro Geral de Empregados e Desempregados* (Caged) of the Ministry of Labor and Employment, the average formal employment between January and April stood 3.5% above the same period of last year. In the first four months of 2004, 535 thousand jobs were created, the best performance since 1995. For comparison, during last year 645 thousand jobs were created. The National Industry Confederation (CNI) and the Federation of Industries of the State of São Paulo (Fiesp) data for employment and industrial wages in March also grew, compared to February. Similarly, industrial employment data published by the IBGE show an employment expansion of 0.4% in March and 0.9% in the first quarter (s.a.), while worked hours grew 1.5% in the quarter. According to the IBGE survey, industrial wages increased 9.3% in the first quarter of 2004, year-on-year, while CNI estimated a 6.6% increase.

19. It is important to notice that the activity rebound continued during the first quarter of 2004, despite the widespread apprehension that the Copom's decision to keep unchanged the Over-Selic rate in January and February could have halted the process. Such concerns were probably enhanced by the negative industrial output figures for January and February. However, variables directly linked to demand, such as retail and industrial sales, together with industrial output for March, confirmed that the recovery process had not lost momentum. Several indicators released since then have indicated that the expectational effects of the Copom decision in January and February, as anticipated by the Committee, were successful in influencing the inflation dynamics in the short-run, without damaging the cyclical rebound that was already spread out.

20. Brazilian external accounts have continued posting expressive positive results. In April, the trade balance reached US$2.0 billion, totaling US$ 8.1 billion in the year, compared to US$5.5 billion in the same period of 2003. The Central Bank estimates a 2004 trade surplus similar to 2003. The current account accumulated a US$0.9 billion surplus in 2004, despite a negative result in April, a consequence of Brady bonds interest payments. The improvement in both the trade balance and the current account has continued reflecting exports growth (25% in the first four months of the year), regardless of the imports increase (18%). First quarter data indicate that exports growth is mainly a result of higher quantities.

21. The most meaningful alteration in the economic environment since the April Copom meeting has occurred in the external scenario, due to the change in market sentiment regarding the US monetary policy and the increase in oil prices. Although some reallocation of investment portfolios had already been anticipated, the move was more abrupt than expected. The short-term instability impacted several currencies, as well as emerging markets risk premiums. From April to May Copom meetings, the exchange rate depreciated to R$3.10 from R$2.89 per US dollar, and the country-risk measured by the JP Morgan Embi+ increased to 728 basis points from 543 basis points. However, this greater instability does not characterize a crisis, due to both its temporary nature and the sound fundaments of the Brazilian economy.

22. Brazil is in a much better situation to react to external events than it was in the past, given the substantial fiscal and external adjustments it has achieved. The Brazilian government has been giving solid proof of fiscal responsibility, as noted in the recent decision about the minimum wage readjustment. Moreover, economic activity indicators, including the ones referring to the labor market, have been providing unquestionable evidence of the Brazilian sustained economic recovery, diminishing concerns that have fuelled volatility in the last weeks.

23. Since the last Copom meeting, crude oil prices have exacerbated the upward trend that had already been observed beforehand. If this trend results from higher demand perspectives, and not from exogenous supply constraints, it will find natural limits in its own effects over the world economic growth. Given the recent record levels, the most likely scenario for the next months is some accommodation in prices. The Copom has been explicitly including in its projections an increase in domestic gasoline prices. Specifically, Copom's scenarios incorporate a 9.5% increase in gasoline prices in 2004, which would translate into an increase of 11.8% during the remaining of the year, considering the prices' fall since January. If oil prices remain high in the medium-term, characterizing a supply shock of a more permanent fashion, it will be necessary to revaluate this projection and its likely primary and secondary inflationary impacts.

24. In addition to the increase in oil prices and to the uncertainty related to the US monetary stance, there has been a certain concern regarding the possibility of a slowdown in China, a country responsible for a significant share of Brazilian exports growth. In the last twelve months, exports to China represented around 6% of total Brazilian exports. Exports to China increased US$381 million in 2004, equivalent to 7% of the exports increase this year. Regarding the magnitude of the expected deceleration of the Chinese economy (to around 7.0% from 9.5%), the direct effect on Brazilian exports does not seem to be strong. There are also indirect effects, due to the reduction of Brazilian exports prices. However, it is important to notice that export prices increases have accounted for just 25% of exports expansion in the last twelve months to March. In other words, prices explain just US$3.5 billion out of the US$14 billion exports growth. Thus, there are reasons to believe that the Brazilian exports performance won't be strongly affected by a possible reduction in the pace of the Chinese economic growth.

25. Market inflation expectations increased, reflecting an environment of greater uncertainty. However, the increase was small and expectations remained properly anchored. The median of inflation expectations for 2004 reached 6.22% on the eve of the meeting, compared to 6.00% at the end of December. For the first time this year, 2005 inflation expectations increased, to 5.06% from 5.00%. The median of inflation expectations for the next 12 months increased to 5.67% from 5.48%, between the eves of the last two Copom meetings.

26. As in previous meetings, the Copom examined chiefly the inflation outlook under the hypothesis of a low degree of persistence of the first quarter inflation. This hypothesis is based on a seasonal relief in market prices inflation in the second and third quarters, as observed in previous years. Inflation projections in the benchmark scenario, based on an unchanged Over-Selic rate at 16.0% and the exchange rate at R$3.10 throughout the projection horizon, point out to an inflation rate slightly above the target of 5.5% for 2004 and below the 4.5% target for 2005. In relation to April, there was an increase in the 2004 inflation projection, mainly caused by a more depreciated exchange rate. In the market scenario, which takes into account the exchange rate and Over-Selic rate expected by the market on the eve of the Copom meeting, inflation projections remain above the targets for 2004 and 2005. In fact, for 2004 inflation projections for the benchmark and for the market scenarios are close to each other, because, if on the one hand, interest rates are lower in the market scenario, on the other hand, the exchange rate is also more appreciated. For 2005, the market scenario projects higher inflation than the benchmark one, because the former supposes a declining interest rate path and a slightly depreciated exchange rate.

27. The Copom also analyzed the inflation projections for the next 12 months, corresponding to the second half of 2004 and the first half of 2005. This is a period when inflation outcomes will be more sensitive to monetary policy decisions taken in the next months, and at the same time, it presents more reliable inflation projections than the ones already available for 2005. The projected inflation for this 12-month period, on both the benchmark and market scenarios, remains within the central targets established by the National Monetary Council for 2004 and 2005.

28. Although the recent realignments in the exchange rate and in oil prices may have a long-lasting component, the Copom members were unanimous in considering that the Brazilian economy, due to the soundness of its fundaments, is in a position to absorb this external shock without damaging the macroeconomic stability and growth perspectives. The significant adjustment of the current account, the reduction of the FX-linked debt, the adjustment of the consolidated public sector accounts, the combination of floating exchange rate with inflation targeting, the economic activity rebound in the last quarters and the credibility gains in macroeconomic management help to absorb the consequences of the external shock.

29. Even in less favorable scenarios than the most likely ones analyzed by the Copom, it is possible to be optimistic about economic growth with price stability prospects in the medium-term. Considering that oil prices and the exchange rate remain unchanged, and assuming the maintenance of the Over-Selic rate at 16.0%, the Copom forecasts an inflation rate closer to the target (5.5%) than to the upper limit of the tolerance interval (8.0%) for 2004. The same forecast indicates a convergence of inflation to the target of 4.5% in 2005. Therefore, considering this less likely hypothesis, the flexibility of the inflation targeting regime, when cautiously used, would avoid high costs in terms of inflationary acceleration.

30. In an inflation targeting regime, the Central Bank policy-making is based on the assessment of different scenarios for the most important variables affecting inflation dynamics. The uncertainties about the external scenario have been responsible for a short-term volatility that increased the uncertainty about future inflation behavior. As a consequence, both the assessment of alternative scenarios by the monetary authority and the coordination of private agent's expectations become more difficult. In this environment, the volatility triggered by risk factors that should not prevail in the medium-term, when the external scenario will be cleared, could affect inflation expectations for a longer period.

31. Three members of the Copom considered relatively low the risk of a contagion of inflation expectations by the short-term volatility and voted for a decrease of 25 basis points in the Over-Selic rate. However, six members considered that this risk could increase substantially if the monetary policy did not take into account the even remote possibility that some changes in the external scenario might be permanent. In addition, the majority judged that, as the uncertainties in the projection scenarios increased significantly, the best policy to be adopted is the one usually taken by Central Banks in similar circumstances: not to change the monetary instruments as much as they could be in a situation without this additional uncertainty. Therefore, these six members understood that the most adequate decision would be to keep the Over-Selic rate unchanged.

32. As a result, the Committee decided, by six votes to three, to maintain the target for the Over-Selic rate at 16.0% p.a.

33. At the closing of the meeting, it was announced that the Copom would meet again on June 15, for technical presentations and on the following day, in order to discuss the monetary policy decision, as established in Communiqué 11,516, of October 15, 2003.

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SUMMARY OF DATA ANALYZED BY THE COPOM

Economic Activity

34. The production and sales data for March 2004 should be carefully analyzed, as the carnival holiday in 2004 was in February. As a consequence, there were more working days in March 2004 (23) than in the same period of the previous year (19). This effect has different impacts among the sectors and can distort the monthly and annual comparisons of production and sales. Such distortions are not completely eliminated by usual seasonally adjusted methods.

35. According to IBGE's retail monthly survey, retail sales maintained the recovery trend in March and increased 1.1% compared to the previous month (seasonally adjusted data). This result was better than the ones released by regional Trade Federations. However, it is important to notice that the methodology and the geographic coverage of these surveys are rather distinct.

36. IBGE estimated that retail sales increased 9.9% in the first quarter of the year, in comparison with the same quarter of 2003, above the 6.75% inflation in the period.

37. According to Fecomercio-SP, real retail sales in the great São Paulo grew 2.8% in March, compared to the same month of 2003. The expansion in the first quarter of the year was 4.4%, led by the growth in sales of appliances, clothing, fabric and shoes.

38. The consultations to the São Paulo Trade Association and the Usecheque, in April, decreased 1.8% and 2.1%, respectively, compared to the previous month, after seasonal adjustment. In the year, up to April, these same indicators expanded 7.8% and 0.5%, respectively.

39. The Fecomercio-SP survey pointed to a recovery of consumer confidence in May, after three consecutive monthly falls. The Consumer Confidence Index increased 18% compared to the previous month, reaching 124.4 points, in a scale ranging from 0 to 200. The recovery was due to the increases of 24.5% in current conditions and of 15.6% in expectations. This result reflected, mostly, the improvement in expectations of consumers with earnings up to ten minimum wages, while consumers with higher earnings were more cautious in assessing the current and future economic scenario.

40. Regarding investment, in March, capital goods domestic production and construction industry inputs recovered, accumulating, in the first quarter, increases of 20.9% and 0.5%, respectively, compared to the same period of 2003. Capital goods absorption increased 6.6% in the same period, despite the significant expansion of 54.1% in exports, mainly agricultural machinery. Another investments indicator, the BNDES credit operations, increased 74.3% from January to April 2004, compared to the first four months of 2003. Credit for the industrial sector, which represents around 46% of the total, grew 74.5%, while credit for the agricultural sector for the commerce and services sectors increased 157.2% and 51.1%, respectively.

41. The IBGE estimated an increase of industrial production of 2.1% in March, compared to February (seasonally adjusted). This increase was widespread, encompassing eighteen out of the twenty-three activities, and three out of the four use categories. Considering the quarterly moving average, output remained unchanged from February to March, after a decline at the beginning of the year. In the first quarter of 2004, industrial production increased 5.8% compared to the same period of 2003, with production expansion in twenty of the surveyed activities and in all use categories. The increases of 20.9% in capital goods production and of 20.5% in durable goods production should be highlighted.

42. The CNI data regarding industry performance in March, compared to the previous month, showed an increase of 3.5% in real sales and a decrease of 0.1% in worked hours, considering seasonally

adjusted series. Real sales and worked hours increased 12.1% and 2.5%, respectively, compared to the first quarter of 2003. The installed capacity utilization level increased 3.1%, compared to February, s.a., and 1% in the first quarter of 2004, compared to the same period of 2003.

43. The industrial output expansion in March is likely to persist, according to an FGV survey carried out in April, with 1,005 companies all over the country. According to this survey, industrial inventory levels are well balanced, ending an adjustment process initiated in July 2003.

44. According to the FGV survey, business sentiment improved in regard to both demand and employment, considering a 3-month horizon.

45. In April, the automotive sector output increased 11.6%, with the production of around 170 thousand units, compared to the same month of 2003. In the first four months of 2003, vehicles output, domestic sales and exports increased 13.2%, 18.1% and 4.2%, respectively, in comparison to the same period of last year.

Labor Market

46. Formal employment increased 0.4% in April compared to March (seasonally adjusted), and 3.5% in the first four months of 2004, according to the Ministry of Labor and Employment. In the first four months of the year, 535 thousand jobs were created, the highest number ever registered for this period of the year.

47. According to the IBGE’s employment survey, the unemployment rate in the six main metropolitan areas increased to 12.8% in March compared to 12.0% in the previous month. The result was due to an increase of 1.4% the economically active population. The same survey registered in March a 1.4% increase in average real earnings, posting a third consecutive month increase.

48. In the industrial sector, according to CNI seasonally adjusted data, employment and real payroll increased 0.5% and 0.9% in March, respectively, compared to the previous month. In the first quarter of 2004, employment and real payroll increased by 0.3% and 6.6%, respectively, compared to the same period of last year.

Credit and Delinquency Rates

49. Non-earmarked credit increased 3.1% in April, collaborating for a continuous trend in the credit expansion, with a special contribution of the acquisition of goods operations, corporate credit and operations linked to external resources, for companies and personal credit as well. The portfolio balance for companies with domestic and external resources increased 2.6% and 5.5%, respectively and for household operations, 2.3%.

50. The average interest rate on non-earmarked credit registered a decrease of 0.6 p.p., in April, reaching 44.7% p.a. The result was due to declines of 0.5 p.p. and 0.7 p.p. in average lending rates to companies and to households, respectively. The delinquency rate on non-earmarked credit decreased 0.2 p.p. in April, to 7.7%, as a consequence of the 0.5 p.p. fall in non-performing credit to individuals. Non-performing credit to companies increased 0.1 p.p. in April.

51. Regarding delinquency in the retail sector, in April there were falls of 14.6% in the number of new files and 10.9% in the number of cancelled files, compared to the previous month. The net default rate remained practically stable at 6.4% in April. In the year to April, the number of new files increased 4.2%, but the number of cancelled files increased 7.7%, bringing the net default rate in 2004 to a level 8.7% below the one in the same period of 2003.

External Environment

52. In the first quarter of this year, GDP grew 4.2% in the US, 2.4% in the Euro Area, 5.6% in Japan, and 9.8% in China. In Germany, GDP growth presented the highest figure since the first quarter of 2001, boosted by exports.

53. In the U.S., labor market data showed new jobs creation, reduction of the unemployment rate and fall of unemployment claims. Other economic indicators point to the sustainability of GDP growth, such as the expansion of industrial orders, industrial production, installed capacity and productivity.

54. In the U.S., business sentiment in the services sector improved in April, while those from the industrial sector remained stable. In Europe, business sentiment also improved. In Japan, the Shoko Chukin index, for small and medium corporations, remained above the optimistic level, in spite of having slowed down in April. Consumer sentiment improved in the US and Japan, and remained stable in Europe.

55. The Bank of England raised the repo rate by 25 basis points on May 6. In the US, inflationary pressures were moderate in April, in spite of the vigorous economic growth. In China, consumer inflation rose again in April, increasing the concern of monetary authorities with respect to the inflation effects of the significant economic growth.

56. Global markets suffered with high volatility in the past weeks, anticipating the effects of the expected increase in the US interest rates and the measures adopted by the Chinese government to decelerate economic growth. US Treasuries yields increased, a trend followed by the Treasuries of Japan and Europe. Emerging markets bonds fell, with generalized increases in country risk indicators, currency depreciations against the US dollar and sharp falls in stock exchanges indices. In the FX market, the US dollar appreciated against other hard currencies, in spite of high US fiscal and trade deficits.

57. Apart from oil, commodity prices fell after peaking in March, even though current levels are still well above the historical averages. Oil prices, on the contrary, increased in the past weeks, mainly as a result of political tensions in the Middle East, of heated world demand, and of the fact that refineries are operating close to capacity in a period of high seasonal consumption of gasoline in the US.

Foreign Trade and Balance of Payments

58. The Brazilian trade balance posted a US$2 billion surplus in April. Exports and imports increased 15.4% and 16.1%, respectively, compared to the April 2003 daily averages. In the first two weeks of May, the trade surplus totaled US$1.2 billion, with exports and imports increasing by 11.9% and 20.9%, respectively, compared to the average figures of May 2003.

59. In April, total exports totaled US$6.6 billion, led by manufactured goods exports (US$3.8 billion, +23.3% compared to April 2003). Semi-manufactured and primary products reached US$0.8 billion (+13.3%) and US$1.9 billion (6.3%), respectively. Imports totaled US$4.6 billion in the month. All import categories increased as compared to April 2003 results, with highlight to raw material and intermediate goods (+19.6%).

60. The current account registered a US$735 million deficit in April, accumulating a US$948 million surplus in the year, compared to a US$821 million deficit in the same period of 2003. In the first four months of this year, the trade balance posted a US$8.1 billion surplus, services and income account posted a US$8.2 deficit, and current transfers posted a US$1 billion surplus. Net FDI accumulated US$3.1 billion in the year, compared to US$2.8 billion in the same period of last year. In the first four months of 2004, the rollover rate of private debt was slightly above 100%. At the

end of April, international reserves reached US$50.5 billion, and adjusted net reserves, according to the IMF concept, stood at US$22.4 billion.

Money Market and Open Market Operations

61. The market perception of a tighter U.S. monetary policy triggered a movement of portfolio reallocations, affecting emerging markets' assets and, particularly, Brazil's assets. Domestic interest rates rose significantly in the period, and the futures yield curve reverted the downward slope that had been observed since April 2003. From April 14 to May 19, the 3-month, 1-year and 2-year rates increased to 0.09 p.p. from –0.46 p.p., to 2.23 p.p. from –0.68 p.p., and to 3.67 p.p. from –0.17 p.p., respectively. As a consequence, the ex-ante real interest rate increased to 11.8%.

62. The BCB did not carry out auctions to rollover securities and Fx swaps maturing in the period. Including interests, the net redemption of these instruments in the year, up to the end of May, will amount to US$17.6 billion.

63. The National Treasury carried out four selling auctions of LTNs and four auctions of LFTs, totaling R$11.3 billion and R$3.1 billion, respectively. No bidding was accepted on the auction of May 4, and the auctions scheduled for the coming two weeks were canceled, given market volatility. For the same reason, the Treasury carried out three auctions to buy LFTs maturing in 2007, 2008, and 2009, totaling R$3.4 billion. The issue of National Treasury Notes – Series C (NTN-Cs) amounted to R$ 2.3 billion, of which R$1.5 billion settled in exchange for other National Treasury's securities.

64. The BCB maintained in its open market operations the weekly post-fixed repo operations, with tenure of two weeks, the fixed operations, with tenure of three months, as well as the 2-working-day liquidity management operations. The BCB also carried out in this period 7 fixed rate repos falling due between 1 and 2 working days. The excess liquidity drained from the market with operations shorter than 30 days averaged R$41.3 billion.

65. In April, the net securitized domestic public debt increased R$7.8 billion. Due to the net redemption of R$11.6 billion of securities and FX swaps, the dollar-linked share decreased to 16.3%. The fixed rate share increased to 15.8% from 15.4%.