



BANCO CENTRAL DO BRASIL

Minutes of the 119th Meeting of the Monetary Policy Committee (Copom)

Date: May 30th, from 4:30PM to 7:30PM, and May 31st, from 4:30PM to 6:30PM

Place: BCB Headquarters meeting rooms - 8th floor on May 30th and 20th floor on May 31st – Brasília – DF

In attendance:

Members of the Committee

Henrique de Campos Meirelles – Governor
Afonso Sant'Anna Bevilaqua
Alexandre Antonio Tombini
Antônio Gustavo Matos do Vale
João Antônio Fleury Teixeira
Paulo Sérgio Cavalheiro
Rodrigo Telles da Rocha Azevedo

Department Heads (present on May 30th)

Altamir Lopes – Economic Department
Carlos Hamilton Vasconcelos Araújo – Research Department (also present on May 31st)
Daso Maranhão Coimbra – International Reserves Operations Department
Ivan Luís Gonçalves de Oliveira Lima – Open Market Operations Department
José Antônio Marciano – Department of Banking Operations and Payments System
José Pedro Ramos Fachada Martins da Silva – Investor Relations Group

Other participants (present on May 30th)

Alexandre Pinheiro de Moraes Rego – Special Advisor to the Governor
Alexandre Pundek Rocha – Advisor to the Board
André Minella – Deputy Head of the Research Department
Flávio Pinheiro de Melo – Advisor to the Board
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 Economic Developments

1. Inflation as measured by IPCA (Broad National Consumer Price Index) continues to converge to targets established by the National Monetary Council (CMN). Such performance confirms assessments made in previous Minutes, which highlighted prospects for a benign scenario going forward. After presenting some stability in February (0.41%) and March (0.43%), inflation fell substantially in April (0.21%) thus providing for an accumulated 1.65% in the first four months of the year, comparing to 2.68% for the same period of 2005. Trailing twelve-month inflation was down from 5.70% in January to 4.63% in April, a record low since July 1999. The April performance was greatly favored by virtual stability in market prices, as well as deceleration in regulated prices rises. After increasing 27.65% in the first quarter, fuel alcohol prices reversed course, and diminished 0.11% in the month. Food prices continued to fall, a tendency that will probably revert in coming months. A benign inflation scenario consolidates, with ever more favorable prospects for target attainment in 2006, and positive spillovers to performance in coming years.



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2. Benign headline inflation performance in April was also reflected in BCB's core inflation measurements. Core inflation by exclusion of household food items and regulated prices fell strongly from 0.53% in March to 0.22% in April, a record low since July 2002. Also, the non-smoothed trimmed means core fell from 0.30% to 0.19%, the lowest since November 2000. The smoothed trimmed means core fell only marginally, from 0.45% to 0.41%. In trailing twelve-months, core inflation has been decreasing since January, accumulating reductions in excess of 60 basis points. In the year, core inflation in its three measures (exclusion, non-smoothed and smoothed trimmed means) stands at 2.35%, 1.53% and 1.97%, respectively, as compared to 2.64%, 2.23% and 2.60% in the first four-months of 2005.

3. After contracting for two months, the General Price Index (IGP-DI) was largely stable in April (0.02%) accumulating 0.23% in the year so far, against the 2.25% registered last year. In the twelve months to April, IGP-DI registers negative 0.77%, the lowest ever since beginning of calculation in 1944. As had already happened in February and March, the wholesale price component (IPA-DI) was the main driver of the IGP-DI performance, falling 0.15% in April. Such contraction was facilitated by continued deflation in agricultural prices (0.85%), on top of the 3.24% negative in March. April also saw twelve-month trailing IPA-DI standing at -3.14%, and -0.29% for the year so far. Agricultural IPA was of remarkable -12.52% in twelve months, and -4.18% to the year through April. In spite of recent international commodity pricing trends, wholesale may continue to contribute favorably to consumer price accommodation, both in the near and in the longer term. As stated in recent Minutes, continuity and strength of this pass-through will depend on demand conditions and price-setters' expectations for future inflation path.

4. GDP at market prices grew 3.4% in the first quarter, as compared to the same period of 2005, the highest rate since the first quarter of 2005. Over the previous quarter, seasonally adjusted data from the Brazilian Institute of Geography and Statistics (IBGE) indicates 1.4% growth, the highest since fourth quarter of 2004, year when a 4.9% expansion was registered. As compared to the first quarter of 2005, mining had an outstanding performance with 12.6%. Construction was up 7%, and aggregated manufacturing was up 5%. Services grew 2.8%, and agricultural and farming sectors went 0.5% down.

5. Domestic absorption led the GDP expansion, and all demand components grew as compared to the first quarter of 2005. Capital formation was up 9%, and imports grew 15.9%. External demand contribution to GDP was negative in 0.4 percentage points, highlighting domestic demand relevance. Inventories contributed 0.5% negative, in line with the much-commented adjustment process initiated in the second half of 2005. Household consumption went up robust 4%, making for approximately 55% of GDP.

6. According to seasonally adjusted data from IBGE, industrial production was slightly down in March, both in comparison to February and using three-month moving averages. If compared to March last year, though, production is up 5.2%. On quarter-on-quarter basis it is up 4.6%, confirming a recovery initiated in the last quarter of 2005. Prior Minutes had mentioned the fact that industry should grow in 2006 at a pace superior to that of 2005. Twelve-month data also let clear the rebound; after eleven months of moderation of growth, February presented a reversal, largely confirmed in March data. Industry recovery was expected, in view of the monetary easing lagged effects. Moreover, inventories adjustment is near completion. Leading and coincident April data show moderate growth in comparison with March.

7. In comparison to March last year, capital goods production expanded brisk 10.1%, and durable goods went along with 11.4%. Capital goods production accelerated for the second consecutive month in a twelve-month period, after a 16-month deceleration season. Fundação Getúlio Vargas (FGV) survey on investor sentiment reveals over half consulted companies have an intention to invest more this year than they did in 2005. Indeed, capital goods up to March present significant 9.2% growth, as compared to the last year's first quarter. In similar terms, durable goods grew even more (14.9%), on account of real income and credit expansion.

8. Unemployment was stable at 10.4% in April, as measured by IBGE. Nonetheless, this is the lowest April figure since beginning of the series, in the format it has been calculated from 2001 on. There was a reduction of 0.4 p.p. if compared to April 2005, in spite of a 1.0% expansion in the economically active population. Employed persons were up 1.4%, also against April 2005. Evidence suggests improvement in labor market conditions, partly reflecting macroeconomic advances. Workers' real income was 0.4% higher in April as compared to March, and 4.7% as compared to April last year, helped by lower inflation. According to the National Industry Confederation



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(CNI), manufacturing employment rose 0.88% in March, against March 2005. In the first quarter of 2006, over the same period of 2005, employment reached 0.85%. Formal employment accelerated at the start of 2006, as measured by the Ministry of Labor and Employment (MTE). It expanded 0.34% from February to March, seasonally adjusted. April saw an increment of some 0.42% over March, and of 5.23% over the twelve-month period.

9. Retail sales increased 3.0% in March, as compared to March last year. The first two months of the year had been very strong, standing out of patterns observed since May 2005. Hence, first quarter growth pulled back to 5.0%, against the same period of 2005. Whether or not March deceleration means a return to the previous pattern is an issue that will have to wait for clarification. In recent months, however, performance of sales more sensitive to income and employment has been remarkable. The favorable dynamics of credit-sensitive sales also seems to be part of this general trend, which has developments in real wages as a backdrop. Preliminary April-May data already suggest continuity and strengthening of the movement, supported by further credit, income, and employment expansion. To the remainder of the year, other factors must also concur, namely the ongoing monetary easing, a recovery in consumer confidence, and the new minimum wage.

10. Manufacturing capacity utilization was practically stable in March (81.1%, against 81.2% recorded in February), according to CNI seasonally adjusted data. First quarter average was 1.36 p.p. below the average for 2005 first quarter. At least partially, this reflects capacity enlargement. Indeed, recent data points to investment acceleration, both related to capital goods and construction supplies. In the first quarter, capital goods absorption increased 13.1%, as to the same period of last year. Capital goods imports contributed strongly to such result, growing 33.6% in volume, as well as construction supplies, which grew 6.9%, on the same basis. Hence, in spite of evidence pointing to aggregate demand advancing, supply side developments apparently head off the possibility of any potentially relevant mismatch. Prior Minutes have emphasized the importance of current and prospective developments in aggregate supply and demand conditions, in defining future inflation path.

11. Recent data confirm the strong performance of the trade balance in 2006, underscoring the point made by Copom in previous Minutes, referring to the important structural changes in the economy's trading links with the rest of the world. Through April, the 2006 trade surplus hit US\$12.4 billion, 2.16% higher than in the same period of last year. For the first time since 2001, though, the twelve-month trading balance result of a month was inferior to previous month's. Such moderation was already expected, and is not to pose any threat to 2006 prospects. Incidentally, exports just set a new record high of US\$123.8 billion in the twelve-months through April. The same was valid for imports in the period (US\$78.8 billion). The current account surplus was of US\$241 million in April. Its twelve-month trailing registered US\$12.8 billion, equivalent to 1.54% of GDP.

12. The external environment changed significantly since the April meeting. Volatility increased markedly as sizable portfolio shiftings have taken place, consequent upon uncertainty to the timing and magnitude of the ongoing US tightening cycle. Short run instability had an impact on many currencies, as well as on emerging markets risk premiums. Over the intermeeting period, the exchange rate went from R\$2.11 to R\$2.30 per US dollar, and Brazilian sovereign risk, as measured by the Emerging Markets Bond Index Plus (Embi+), increased from 225 basis points to 267. Copom members see such instability as most likely a short-lived phenomenon. Moreover, the sound fundamentals of the Brazilian economy should contribute to weather the storm: consistent inflation reduction, robust trade surpluses, adequate primary fiscal surpluses, international reserves accumulation, domestic public debt profile improvements, and the buyback of external sovereign debt. A noticeable progress in the country's resilience to shocks is evidenced by its unabated growth performance in the face of US interest rate adjustment cycle. Copom continues to assign low probabilities to a significant deterioration in international financial market conditions, one that could measurably affect Brazilian external financing conditions.

13. Another concern regards oil prices, which have retreated somewhat in the intermeeting period, but still standing high and presenting huge volatility. Recent performance reinforces the idea that prices may, indeed, sustain longer at levels previously deemed unlikely. Great uncertainty continues to prevent reliable forecasting of future oil prices. On the other hand, past Minutes pointed out that these developments also widen risks to materialization of baseline scenarios, which have become less feasible themselves. Irrespective of what happens to domestic gasoline prices, international oil price hikes eventually find their way to the domestic economy, either through an impact on specific production chains (such as petrochemicals, for instance), or through deterioration in inflation expectations.



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Assessment of Inflation Trends

14. Identifiable shocks and their consequences were reassessed according to newly available information. The scenario considered in the simulations utilized the following assumptions:

a) Projections for gasoline and bottled gas prices' adjustments in 2006 remained unchanged at 0%, as compared to the April meeting assessment;

b) Projections for fixed telephone lines and household electricity pricing in 2006 underwent slight changes: electricity up from 3.6% to 3.7%, phone lines down from 3.1% to 2.6%;

c) For all regulated prices, Copom maintained a 4.6% adjustment projection for 2006. These items stand for 33.4% of total April IPCA;

d) The endogenous determination model keeps indicating 6.2% inflation for regulated prices in 2007. Such modelling takes into account market prices' inflation, the General Price Index (IGP), the exchange rate, and seasonal components;

e) The VAR model, based on Selic rate levels and 180-day swaps, estimates a spread of –70 basis points for the second semester of 2006, in the baseline scenario. Accordingly, spreads should reach 18 basis points in the last quarter of the year, and 57 b.p. in the last quarter of 2007.

15. Regarding fiscal policy, it is assumed that the consolidated public sector primary surplus target of 4.25% of GDP in 2006 and 2007 will be achieved. Related assumptions considered in the previous meeting are maintained.

16. Since the March meeting, median IPCA inflation expectations for 2006, as compiled by BCB's Investors Relations Group (Gerin), have been decreasing consistently. From April to May, they diminished from 4.43% to 4.32%. This reduction was mainly driven by downward revision of market inflation expectations for the second quarter. Twelve-month ahead inflation expectations were relatively stable. For 2007, inflation expectations remained in line with the 4.50% target established by CMN. As mentioned in previous Minutes, these developments suggest that the recent monetary policy stance has both contained short-term inflationary pressures and contributed to the consolidation of a more favorable longer-term macroeconomic scenario.

17. The 2006 inflation forecast under the benchmark scenario – assuming maintenance of the Selic rate at 15.75% and the exchange rate at R\$/US\$ 2.30 during the forecast period - raised relative to the forecast presented in the April meeting, but remained below the 4.5% target for the year. The forecast based on the market scenario – which incorporates consensus exchange rate and Selic rate trajectories collected by Gerin – declined relative to the April forecast, and is also below target. For 2007, the benchmark forecast increased as compared to April, keeping below the 4.5% target for that year. On the other hand, the forecast under the market scenario decreased, but is still above target.

Monetary Policy Decision

18. Copom reaffirms the view that current and expected inflation numbers demonstrate that the monetary stance adopted since September 2004 has both contained short-term inflationary pressures and consolidated a more favorable long-term macroeconomic environment. Economic activity gains momentum at a pace consistent with supply conditions, such that it will not trigger significant inflationary pressures. In spite of continued volatility in international financial markets due to uncertainties regarding monetary policy in developed countries, and the record highs reached by oil prices, the external outlook remains favorable, particularly with regard to Brazilian external financing conditions. A benign inflation environment continues to prevail, despite the likely reversal of favorable factors that subdued short-term inflation, and the increased risk stemming from important commodity prices. As in the April meeting, the Committee emphasizes that the main challenge for monetary policy is to ensure consolidation of these favorable developments.



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19. Uninterrupted convergence of inflation to the target path and the resulting consolidation of long lasting macroeconomic stability will contribute to the progressive reduction in perceived macroeconomic risk, a process already underway for several years. Wider scope for reduction of real interest rates in the future will naturally follow. Copom considers that its cautious monetary policy stance has been critical to increase the probability of inflation convergence to the target path. For this to materialize, however, it is important that forward-looking inflation indicators remain consistent with the current benign inflation outlook.

20. Copom emphasizes that there are important lags in monetary policy transmission to economic activity and inflation. Since the start of the monetary easing cycle, in September 2005, the Committee has reduced the Selic rate by 400 basis points. Activity levels have not completely mirrored the effects of the interest rates cuts, just as effects of the recent activity resumption on inflation have not fully materialized.

21. In the coming months, employment and income expansion and credit growth will continue to sustain economic activity. As mentioned in the April Minutes, the activity level should also reflect effects of the new minimum wage and the fiscal impulse of the last quarter of 2005, and first half of 2006. Consequently, effects of interest rate cuts will add up to other factors that also contribute to demand expansion.

22. Given the uncertainties surrounding monetary policy transmission mechanisms, and the narrowed gap between current and medium-term Selic equilibrium rates, Copom understands that preservation of the important achievements in disinflation and economic growth, along with job creation and rising real income, may demand a more cautious monetary stance. This argument is even more relevant in light that monetary policy decisions of the coming months will produce impacts more concentrated in 2007.

23. The Committee's members, therefore, unanimously decided to continue the monetary easing process begun in the September 2005 meeting, reducing the Selic target rate to 15.25% p.a., without bias, and closely follow the evolution of the macroeconomic scenario until its next meeting, at which time it will define the next steps in its monetary policy strategy.

24. In an inflation targeting framework, authorities make decisions taking into account projected inflation, and using alternative scenarios to macroeconomic variables that have an impact on price dynamics. Even as we consider that recent increases in international market volatility are probably of transitional nature, their consequences in heightening uncertainties associated to future inflation may well impair both authorities' ability to evaluate scenarios and private sector expectations coordination. Hence, monetary policy must remain vigilant so that short-run uncertainty does not feed into the longer-term horizon. Should potentially higher risks affect currently benign prospective scenarios, policy strategy will promptly be adapted to those, eventually new, circumstances.

25. At the conclusion of the meeting, it was announced that Copom would reconvene on July 18, for technical presentations, and on the following day to discuss the monetary policy decision, as established in Communiqué 13,821 of October 31, 2005.



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SUMMARY OF DATA ANALYZED BY THE COPOM

Inflation

26. IPCA increased 0.21% in April, decelerating relative to first quarter results. Fuel prices hikes refrained and food prices continued to fall. Medicine prices were the biggest contributor to April inflation, with a 0.08 percentage point impact. Clothing and electricity followed, with 0.06 p.p. each. IPCA rose an accumulated 1.65% in the first four months of the year, and 4.63% in the last twelve months.

27. Regulated prices grew 0.54% in April and 8.02% in the last twelve months, while market prices increased by 0.04% and 3.16%, in similar periods. Tradables were down in 0.17% in the month, while non-tradables were up 0.28%. In twelve-month terms, increases were of 1.41% and 5.28%, respectively, on account of exchange rate variation, among other factors.

28. In April, IGP-DI raised only 0.02%, for accumulated 0.23% in the first four months of 2006. In twelve months it accumulates -0.77%, the lowest figure for this series, as measured since 1944. Among its components, the IPC-Br grew 0.34% in the month (compared to 0.22% in March), highlighting a reversal of the downward trend of food prices, which increased 0.36% (following declines of 0.32% in March and 0.30% in February). Also added up to IPC-Br rises in clothing, health care, and conveniences. INCC increased 0.36%, comparing to 0.20% in March. IPA, the sub-index with the largest weight in IGP-DI, fell 0.15%, after retreating 0.82% in March, making for changes of -0.29% in the year and -3.14% in the twelve months through April.

29. A decline in agricultural prices pushed overall wholesale to -0.15% in April. Agricultural IPA fell 0.85%, due to decreases in rice, beans, corn, soy, manioc, poultry, and pork. Such smaller decrease, relative to the steep -3.25% registered in March, reflects moderation in corn prices, reversal of continued falling in beef, and rises in sugar cane. The industrial prices average was again quite steady, posting 0.06%, against -0.05% in March. According to the processing stages, only final goods prices rose, however confirming their own deceleration (0.12% in April, down from 0.44% in the previous month). Intermediate goods and raw material also moderated decreases: -0.01% and -0.85%, respectively, against the -0.34% and -3.52% of March.

30. Again, all IPCA core inflation measures declined in the month. April saw the core under the smoothed trimmed means method standing at 0.41%, compared to 0.45% in March. The rise in twelve months retreated to 6.10%. The non-smoothed trimmed means core was down to 0.19% in April (from 0.30% in March), and 4.58% in twelve months. The core excluding household food and regulated prices reached 0.22%, against previous 0.53%, and 5.27% in the 12-month trailing measure.

31. IPC-Br core inflation, calculated by FGV under the symmetric trimmed means method, hit 0.32% in April, up from the 0.25% of March. Expansions were of 1.3% in the first four months of 2006, and 4.23% in the last twelve months.

32. The IPCA diffusion index (measuring the number of items registering price increases in the basket) stood at 54.9% in April, comparing to 56.1% in March.

33. Recent developments in consumer prices warrant optimism as to another good performance in May. Favorable trends may benefit from continued falling of fuel prices (particularly fuel alcohol), which should compensate for moderation in food price decreases.

Economic Activity

34. GDP is expanding in the first quarter of 2006, exhibiting seasonally adjusted 1.4% growth, as compared to last quarter. This is the biggest quarter-on-quarter variation since the end of 2004, when a 1.6% variation was recorded. As to the first quarter of 2005, GDP is growing at 3.4%, on impact of 5% growth in manufacturing and 2.8% in services. Farming activities contracted 0.5%. On the demand side, disaggregation reveals across-the-



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board expansion: 4% in household consumption, 1.6% in government, 9% on capital investment, 9.3% in exports, and 15.9% in imports. Domestic demand contributed 3.8 p.p. to GDP, and external demand contributed negative 0.4 p.p.

35. According to IBGE's monthly survey, retail sales decreased a month-on-month seasonally adjusted 0.1% in March. The result makes for a retail sales expansion of 5% in the first quarter, with highlights to the 4.9% growth in furniture and appliances, and 4.4% for hyper- and super-market sales.

36. April data from the São Paulo Trade Association (ACSP) showed a seasonally adjusted 0.3% increase in database consultations for credit sales and a 0.3% fall in the number of Usecheque consultations, month-on-month. In the first four months, the indicators expanded 2.5% and 6.1%, respectively, compared to the same period of 2005.

37. As for investment indicators, seasonally adjusted production of capital goods and construction supplies retreated by 2.2% and 1.1%, respectively, in March. The volume of capital goods imports raised 8.1% s.a., according to Funcex. In the first quarter, compared to the same period of 2005, these indicators amount to rises of 9.2%, 6.9%, and 33.6%, respectively. In similar period, energy-sector capital goods production raised 45.2%. Construction-sector capital goods went up 21.4% and capital goods for mixed use, 17.3%. Production of equipment dedicated to agriculture was diminished in 17.5%. Growth in manufacturing capital goods was below average (0.4%) reflecting, in part, acceleration of imports.

38. According to IBGE, overall industrial production decreased 0.3% in March, on a month-on-month seasonally adjusted basis, but accumulates a rise of 5.2% as to March 2005. In the first quarter, industrial production grew 4.6%. Processing industries fell 1.1%, and mining raised 0.9%, in March s.a. In this quarter, compared to the same period of 2005, these sectors have grown 4.1% and 13.2%.

39. Three of the four manufacturing categories retreated in March. Seasonally adjusted, durable goods production fell 5.1%. Intermediate goods raised 0.2% (after falling 0.6% in the previous month). In the first quarter, however, compared to the first quarter of 2005, all categories exhibit positive results: consumer goods, 6.4% (remarkable 14.9% in durable goods alone); capital goods, 9.2%; intermediate goods, 2.8%.

40. Disaggregated seasonally adjusted data for manufacturing showed that only 6 of the 23 surveyed segments increased production in March. Month-on-month, the percentage of such growing-performance segments has therefore fallen to 26%, from 43% in January and 61% in February.

41. With March results, manufacturing on a three-month moving average basis fell 0.2%, after three consecutive months of growth. A direct consequence of falls in three out of four categories, the decline was mitigated by a largely stable performance of the most important category, intermediate goods.

42. CNI manufacturing data also showed cooling activity in March. Sales and worked hours declined respective 0.8% and 1.3%, on a month-on-month seasonally adjusted basis. In the first quarter, compared to the same period of last year, they are both on positive territory: 2.6% and 2.1%. Capacity utilization was stable against February, at 81.2% seasonally adjusted. Unadjusted data points to 82.1%, 0.9 p.p. below March 2005.

43. Automotive production was down 1.1% in April, s.a. Domestic auto sales decreased 6.7%, while exports went back 1.8%. In the first four months, against same period of 2005, growth stood at 5% for production, 7.7% for domestic sales, and 1.7% for export sales.

44. Other coincident industrial indicators signal deceleration in April. Both corrugated cardboard shipments and highway tolls contracted, in s.a. terms.



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Surveys and Expectations

45. The Fecomercio-SP survey recorded a month-on-month elevation of 4.2% in consumer confidence in May. Its two components grew, namely consumer expectations (5.9%) and current economic conditions (1.7%); this series is now at a peak since beginning of calculation in March 1999). For the state of Rio de Janeiro, Fecomercio-RJ survey had registered a 2.3% decrease in consumer expectations in March versus February, and a 1.1% decrease relative to March 2005.

46. According to FGV, consumer confidence declined 3.4% in April, relative to previous month. The component of current situation perception was down equal 3.4%, while expectations for the future contracted by 3.3%. This survey is conducted for a sample of 2,000 households in seven large cities of the country.

Labor Market

47. According to the Ministry of Labor and Employment, 229,803 new jobs were created in the formal market in April, largely spread among the many sectors of the economy. On month-on-month seasonally adjusted basis, formal employment increased 0.4%. Manufacturing was on the high with 0.6%. In the year through April, it is 569.5 thousand new hires, improving on the 558.3 thousand recorded last year.

48. According to the IBGE's survey in the six main metropolitan regions, the unemployment rate was stable at 10.4% in April, and 0.4 p.p. below than April 2005. Such stability results from a decline in the labor force (reduced by 84 thousand), coupled with a proportional fall in the number of unemployed people (17 thousand). Employment also fell by 67 thousand jobs. As compared to April 2005, the labor force, the employed and the not employed have varied 1.0%, 1.4%, and -2.8%, respectively.

49. On account of the same survey, real average earnings were estimated at R\$1,012.50 in April, expanding 0.4% in the month and 4.7% from April 2005. Real payrolls increased by 0.1% in the month, and 4.9% in twelve months.

50. According to BCB's seasonal adjustment of CNI data, industrial employment grew 0.2% in March, accumulating 0.8% in the first quarter and 2.9% in trailing twelve months.

Credit and Delinquency Rates

51. Non-earmarked credit used as reference for interest rates, grew 2.4% in April. Credit for individuals rose 2.1%, and corporate credit 2.6% (2.5% in its parcel funded domestically, 3.1% the externally-funded).

52. The average interest rate on credit operations decreased 0.7 p.p. in April. The average rate on credit for individuals downed 1.3 p.p. to 57.7% p.a., whilst on corporate credit it diminished 0.1 p.p., to 30.6% p.a.

53. Delinquency rates in the financial system (loans in arrears for more than ninety days) hit 4.7% in April. Delinquency for corporates reached 2.3%, while on individuals it signalled 7.4%.

54. Net delinquency rates for retail credit, measured by the ACSP, went back to 6.9% in April, against the 7.3% of March, due to a 10.1% fall in new negative filing, combined with 4.2% increase in cancelled filing. In the first four months of the year, average default rates are at 6.3%, compared to 6.4% in the same period of 2005.



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External Environment

55. Downside risks to the benign international outlook, related to US interest rates and oil prices, have gained attention in recent weeks. The Federal Reserve meeting at May 10th highlighted uncertainty as to future interest rate trajectory, in tandem with less comfortable inflation and oil prices figures. Between May 10th and May 23rd, stock markets experienced a period of turbulence. The Nasdaq and Dow indexes fell 2.2% and 6.3%, while European stocks in Germany, the UK, and Spain shed 5.5%, 5.7%, and 6.2%, respectively. Emerging markets were hit the most. Brazilian and Mexican stocks declined 10.5% and 7.6%, respectively, whilst Argentinean and Russian ones sunk 15.3% and 15.7%.

56. As to oil price behavior, relative stability is the norm since mid-April, meaning prevalence of trading above the USD 70 threshold, for the WTI barrel. The commodity has been sustained this high by the beginning of the hurricane season in the Gulf of Mexico. In addition to weather concerns, US stocks of oil-related products and expectations over the next OPEC meeting (to be held in June, in Venezuela), also played a role.

Foreign trade and international reserves

57. The first four months of 2006 saw strong expansion of Brazilian external trade, as all relevant accumulated figures reached their record highs. The trade balance surplus peaked at US\$12.4 billion, US\$45.0 billion for the trailing twelve months. Total external trade was of US\$65.9 billion and US\$202.7 billion, similarly. The first four weeks of May (19 working days into the month) had the trade surplus hitting US\$2.8 billion, for exports at US\$9 billion and imports totaling US\$6.2 billion.

58. April exports amounted to US\$9.8 billion, averaging record US\$544.7 million per working day, 18.4% higher than in April 2005. Manufactured, semi-manufactured and primary products reached daily averages of US\$302 million, US\$70 million and US\$157 million, respectively. These are increases of 21.7%, 12.9% and 10.9% over average daily levels of April last year. In addition to higher volumes, rising international prices helped performance in sugar, orange juice, tobacco leaves, fuel, and aluminum, amongst others. Such pattern has not prevented continued diversification of markets, as well as an amplifying product base.

59. Imports totaled US\$6.7 billion in the month. It was another record high of daily averages (US\$372.6 million), 39.8% above April 2005. In similar terms, all import categories expanded, with high notes to increases of 90.8% in fuel and lubricants, 52.4% in consumer goods, 39.3% in capital goods, all measured in daily averages. Imports of raw materials and intermediate goods, which represent about half of total imports, grew 25.1% in April and 15.9% in the first four months, compared to the same periods of 2005. For the third consecutive month, import growth outpaced exports, as compared to the same months of 2005.

60. At the end of April, international reserves stood at US\$56.6 billion, US\$3.3 billion below balances of the previous month. Such reduction has to do with exercising of call options on Brady bonds, amounting to US\$5.8 billion.

Money Market and Open Market Operations

61. After the April meeting, the interest rate yield curve shifted slightly downwards for short term tenors and rose steeply for the longer end. The fall in the short end was mainly attributable to current inflation and inflation expectations. By mid-May, rates started to present higher volatility, especially going to the long end, which followed the swings in external markets. Uncertainty related to US inflation and the Fed's tightening cycle unleashed a wave of risk aversion, taking devaluation not only to stock prices, but also to emerging market currencies and debt. Between April 17th and May 29th, one- and three-month rates shed 0.43 and 0.11 p.p. respectively. Six month-rate was up 0.31 p.p. One-, two-, and three-year rates raised respective 0.69, 1.06, and 1.12 p.p. Real interest rates measured by the differential between the one-year forward nominal interest rate and the smoothed twelve-month ahead inflation expectation went up from 10.09% on April 17th to 10.72% on May 29th.



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62. On April 19th, the BCB conducted an exchange rate reverse swap auction, in which the Bank is long in exchange variation and short in domestic interest rate. The amount (US\$604.2 million) was enough to roll on part of other reverse swaps due May 2nd. Net settlement of exchange rate instruments totals US\$ 12.5 billion in the year through May 29th.

63. In the open market, the BCB continued to conduct weekly three- and five-month fixed rate repo operations, as well as daily liquidity management operations with tenure up to two working days. Also, between April 18th and May 29th, 25 shorter-term repos were put into effect (19 of them with the Bank draining liquidity). Daily averages on three- and five-month instruments were of R\$65.2 billion and R\$54.9 billion. Operations with tenors less than thirty days, including the daily liquidity draining management, averaged R\$10.8 billion.

64. In its strategy of managing liquidity, looking forward to the third quarter, BCB conducted six auctions to sell from its portfolio LTNs maturing in October 2006, buying LTNs due July 2006. These operations totaled R\$4.2 billion.

65. Between April 18th and May 29th, the National Treasury raised a total of R\$24.2 billion in fixed-rate securities: R\$22.1 billion via issuance of LTNs maturing in 2007, 2008, and 2009; and R\$2.1 billion in NTN-Fs maturing 2010, 2012, and 2014. Issuance of inflation-linked NTN-Bs by traditional auctioning totaled R\$6.5 billion, with maturities spanning from 2008 to 2045. Due to heightened volatility, the Treasury also conducted simultaneous buy/sell auctions in NTN-Bs, intent on facilitating price formation in secondary markets. These operations took place on May 24th, 25th, and 26th, comprising sales of R\$2.3 billion and purchases in the order of R\$4.0 billion.