BANCO CENTRAL DO BRASIL

Minutes of the 107th Meeting of the Monetary Policy Committee (Copom)

Date: April 19th, from 5:30PM to 8:00PM, and April 20th, from 4:43PM to 7:03PM
Place: BCB's Headquarters meeting rooms - 8th floor on April 19th and 20th floor on April 20th – 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
Paulo Sérgio Cavalheiro
Rodrigo Telles da Rocha Azevedo
Sérgio Darcy da Silva Alves

Department Heads (present on April 19th)
Altamir Lopes – Economic 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
Marcelo Kfoury Muinhos – Research Department (also present on April 20th)
Renato Jansson Rosek – International Reserves Operations Department

Other participants (present on April 19th)
Alexandre Pundek Rocha – Advisor to the Board
Eduardo Fernandes – Advisor to the Board
Flavio Pinheiro de Melo – Advisor to the Board
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. While most goods and services in the consumer basket decelerated in March, consumer price inflation remained high mainly due to isolated price increases (specifically certain regulated prices). In particular, Broad National Consumer Price Index (IPCA) inflation was virtually unchanged in March compared to February, due to the aforementioned acceleration of some regulated prices. Wholesale agricultural prices also increased, reflecting the effects of the drought on grain harvests.

2. In March, the IPCA rose 0.61%, compared to 0.59% in February. The accumulated increase in the quarter reached 1.79%, and in the twelve months through March totaled 7.54%. Regulated prices rose 1.29% in the month and accounted for 0.38 p.p. of the monthly change in the IPCA, driven by adjustments to urban bus fares in São Paulo and Porto Alegre (contributing 0.25 p.p.), and water and sewage in six capital cities (contributing 0.08 p.p.). Market prices rose 0.33% (versus 0.77% in February), accounting for the remaining 0.23 p.p. of the IPCA monthly

change. Education, which increased 0.4% in March compared to 5.3% in February, contributed significantly to the deceleration in market prices.

3. The General Price Index (IGP-DI) rose 0.99% in March, compared to 0.40% in February, for an accumulated 1.73% in the first quarter of the year, and a 10.92% increase in twelve months. Among the IGP-DI components in March, the Consumer Price Index – Brazil (IPC-Br) rose 0.70%, after a 0.43% increase in February, reflecting the same transport and housing price pressures that impacted the IPCA. The National Index of Civil Construction (INCC) rose 0.67%, above the 0.44% increase in February, due to labor cost increases. The Wholesale Price Index (IPA-DI) rose 1.14%, versus 0.39% in February, accumulating a twelve-month increase of 12.80%.

4. The acceleration of IPA-DI inflation in March was mainly due to the 3.59% increase in agricultural prices (up 1.29% in February), driven by increases in the prices of rice, corn, wheat and soy. Industrial prices rose 0.30% (versus 0.08% in February). IPA inflation for final and intermediate goods cooled from February to March, while raw material prices increased 2.91%, after falling 1.1% in February, mainly due to agricultural components.

5. IPCA core inflation, calculated under the trimmed means methods, accelerated in March. The smoothed core reached 0.62%, compared to 0.60% in the previous month, and totaled 7.42% in the twelve months through March. The non-smoothed core rose to 0.49% from 0.43% in February, with an accumulated twelve-month increase of 6.33% through March.

6. IPCA core inflation calculated by the exclusion of household food and regulated prices fell to 0.41% in March, from 0.93% in February, due to the easing of seasonal education price pressures. This measure of core inflation increased 7.31% in the twelve months through March.

7. IPC-Br core inflation, calculated by the Getúlio Vargas Foundation (FGV) under the symmetric trimmed means method, reached 0.49% in March from 0.36% in February, for a cumulative twelve-month increase of 5.68%.

8. The IPCA diffusion index fell for the second consecutive month, reaching 63.9% in March (64.6% in February and 73.2% in January).

Assessment of Inflation Trends

9. The inflation shocks and their impacts were reassessed according to newly available information. The scenario considered in the simulations used the following assumptions:

a) The projection for the adjustment of both gasoline and bottled gas prices for 2005 remained unchanged at 0%;

b) Projections for adjustments of fixed telephone rates for 2005 fell to 7.9% from 8.7% as of the previous meeting, while projections for adjustments of household electricity increased to 10.8% from 9.5%;

c) For all regulated prices, which represented a total weight of 29.4% in the March IPCA, a 7.2% increase is projected for 2005 (0.3 p.p above the prior projection);

d) The projection for regulated price adjustments in 2006, following the model of endogenous determination, which takes into account seasonal components, the exchange rate, market price inflation, and the change in the IGP-DI, stands at 5.1%;

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 34 basis points in the second quarter of 2005 to 44 basis points in the last quarter of 2006.

10. Regarding fiscal policy, it is assumed that the consolidated public sector primary surplus target of 4.25% of GDP for 2005 and 2006 will be achieved. The related assumptions considered in the March Copom meeting were maintained.

11. Assuming the maintenance of the Selic rate at 19.25% p.a. and the exchange rate at the level prevailing on the eve of the Copom meeting (R$/US$2.60), the IPCA inflation rate was projected above the 5.1% objective for 2005, but below the 4.5% central target for 2006. Using the consensus Selic rate and exchange rate projections compiled by the BCB's Investor Relations Group (Gerin) on the eve of the Copom meeting, inflation was also projected above the 2005 objective and above the 2006 central target.

Monetary Policy Decision

12. IPCA inflation rose 0.61% in March, virtually unchanged compared to the two previous months. The March IPCA was significantly influenced by adjustments in urban bus fares and water and sewage fees. On the other hand, the impact of the annual adjustment of school tuition fees dissipated, and as a result, market prices decelerated, especially non-tradables. Even though inflation remained at a level similar to that of January and February, a reduction in the number of items registering price increases occurred, as had happened in February.

13. IGP-DI inflation accelerated for the second consecutive month, reaching 0.99% in March, mainly driven by the IPA upsurge. As happened in February, the increase in wholesale price inflation was due to strong pressure from agricultural prices (up 3.59%, versus 1.29% in February and -0.63% in January), owing to adverse weather conditions. Agricultural price increases may continue in the coming months, reflecting the recent increase in international agricultural commodity prices. Industrial IPA has posted only modest changes since December, but recently registered a slight acceleration. As highlighted in the March Copom Minutes, the minimal increases in the industrial IPA in recent months partially reflects the exchange rate appreciation and the effects of monetary policy, and may positively affect the future evolution of consumer prices. Naturally, the intensity of the pass-through will depend on prospective demand conditions and price setters' expectations relative to the inflation trajectory.

14. Core IPCA inflation calculated by excluding household food items and regulated prices decelerated strongly in March, due to the end of the effects of school tuition fee increases and the fact that this core measure does not consider the recent sharp increases in regulated prices. Had education costs also been excluded, this core would have decelerated steadily in recent months. In turn, trimmed-means core inflation, both with and without smoothing, accelerated in March when compared to February, partially incorporating items affected by seasonal factors. Throughout the first quarter, the trend of underlying core inflation remained above the target path, even considering the deceleration observed relative to the fourth quarter of 2004.

15. According to seasonally adjusted data from the Brazilian Institute of Geography and Statistics (IBGE), industrial output declined for the second consecutive month in February. While this result contradicted that suggested by leading and coincident indicators, the accommodation of industrial activity is unsurprising given its elevated levels at the close of 2004. In addition, specific factors, such as the delay in the sugar-cane harvest and the slowdown in oil refining, could have influenced the February result. February industrial performance could also be reflecting fluctuations inherent to the series and the seasonal adjustment process for moving holidays. As emphasized in the March Copom Minutes, the economy continues to show signs of expansion; however, at a slower pace than that registered in 2004. Analyzing the more stable three-month moving average series, which smoothes the seasonal and calendar effects, industrial output remained stable in recent months. Leading and coincident indicators signal industrial production expansion in March.

16. In terms of the composition of industrial activity, consumer goods continued to expand on a three-month moving average basis, relative to January. Consumer durable goods production expanded most strongly, at 3.2%, driven by the strong growth in production of exports goods – such as cell phones and cars. The production of consumer semi-durables and non-durables grew at a slower pace, of 0.84%. The other categories registered deceleration. The pattern registered in February, in which consumer durables posted strong performance while more income-sensitive sectors lost dynamism and even declined in month-on-month seasonally adjusted terms, appears inconsistent with the current stage of the economic cycle. Given the recent monetary policy stance and the positive evolution of the labor market, one would expect economic activity to be increasingly sustained by

income-sensitive sectors. The aforementioned specific factors that negatively impacted industrial production in February also had a particularly strong impact on the more income-dependent categories, making it more difficult to assess both aggregate and disaggregated industrial activity data. More data will be necessary to better characterize changes in the pattern of industrial activity.

17. The labor market has followed the seasonal pattern observed in prior years, with the unemployment rate increasing for the second consecutive month to 10.6% in February, from 10.2% in January, but remaining below the level of last year. The number of employed workers declined slightly from January to February, while payrolls and real average earnings rose in the period. National Industry Confederation (CNI) data, seasonally adjusted by the BCB, shows that industrial employment continued the expansion begun in December 2003, while real industrial payrolls held steady in February relative to January, but at a level significantly above that of February 2004. Data from the Ministry of Labor and Employment (MTE) on formal employment showed a 6.4% increase in the first two months of the year.

18. After expanding significantly through 2004, retail sales have shown some accommodation in the initial months of 2005. In February, sales fell 3.2%, according to IBGE data, seasonally adjusted by the BCB. This result could have been influenced by the same seasonal adjustment problems discussed for industrial production. Furniture and household appliance sales posted the strongest growth, at 0.7%, while all other categories contracted. On a three-month moving average basis, sales continued to grow, driven by the expansion in furniture and household appliances, while the other categories declined. This contrast between the performance of consumer durable and non-durable sales is similar to that observed for industrial production, and is equally out of tune with what one would expect at this stage of the economic cycle. As in the case of industrial output, more data will be necessary to better characterize changes in the pattern of retail sales.

19. As repeatedly emphasized in prior Copom Minutes, given the strong expansion of economic activity since 2003, the performance of aggregate supply in the coming quarters remains a key point of concern with regard to prospective inflation dynamics. Installed capacity utilization, measured by CNI and seasonally adjusted by the BCB, declined in February (81.9%), potentially reflecting the maturation of new investments made in recent months and also the accommodation in economic activity. Despite the recent evolution, the index remains at historic highs. Capital goods absorption grew a cumulative 2.8% in the first two months of the year, in seasonally adjusted terms. Given the strong growth of investment in 2004, one can expect that there will be a reduction in its pace of growth as results will be compared to a higher base.

20. Strong trade surpluses continued in March, reinforcing the favorable outlook for the year. Exports and imports continued to expand at a strong pace in the first quarter of the year, relative to the same period of 2004. In the twelve months through March, exports grew 31.0%, relative to the preceding twelve months, while imports grew 30.3%, on the back of strong domestic demand. In monthly terms, both exports and imports grew in March at a pace slightly below that of February. The trade balance reached a twelve-month cumulative US$35.9 billion surplus in March, an increase of 32.2% over the same period of 2004. In volume terms, manufacturing exports continued to post the strongest growth, when comparing the first two months of 2005 with the same period of 2004. The robust performance of the trade balance contributed to the current account surplus of US$12.7 billion in the twelve months through March, equivalent to 2.1% of GDP. External demand, therefore, continues to contribute to the economic expansion.

21. International capital market conditions have remained volatile since the last Copom meeting. In addition to the uncertainties regarding U.S. monetary policy, market instability has been driven by risk aversion in U.S. credit markets, due to difficulties faced by some large companies that could lead to portfolio reallocations unfavorable to emerging markets. As a consequence, Brazilian country risk was very volatile, posting the highest spreads in recent months. The *real*, after depreciating in mid-March, appreciated to February levels. As stressed in prior Copom Minutes, abundant international liquidity and market stability remain tied to macroeconomic conditions in the industrialized countries, especially the U.S., and to the Fed´s potential monetary policy response to economic developments. Despite the volatility of recent weeks, the Committee's members continue to assign a low probability to a significant deterioration in international financial markets driven by abrupt changes in the conduct of U.S. monetary policy.

22. International oil prices have recently registered a slight decline, after reaching record highs at the end of March and beginning of April. Oil prices have continued to be driven by news related to demand conditions and available oil inventories in the main consumer countries, as well as possible supply restrictions among producing countries. Despite the slight decline observed since the last Copom meeting, international gasoline prices have remained above domestic prices. The persistence of prices at these levels remains surrounded by a considerable degree of uncertainty, such that the Committee maintained the assumption in its benchmark scenario that domestic fuel prices will not be upwardly adjusted in 2005. However, oil prices represent a bigger risk to the future inflation trajectory. Even if this recent uptick in international prices does not translate into an increase in domestic gasoline prices, it affects the prices of oil derivatives and market inflation expectations.

23. Since the March meeting, the median of market expectations for 2005 IPCA inflation deteriorated to 6.10% from 5.77%. As mentioned in prior Copom Minutes, inflation expectations for 2005 remain high, despite favorable developments that could dampen inflationary pressures, such as signs of a deceleration in economic growth, the decline in wholesale industrial prices, the reassessment of market expectations for the exchange rate trajectory, and the more restrictive monetary stance.

24. The marginal increase in 2005 inflation expectations, however, is mainly tied to higher-than-expected adjustments of some regulated prices, such as urban bus fares, to higher inflation expectations to April, and to less favorable external conditions. The impact of bad weather conditions on short-run food prices also contributed to higher inflation expectations for the year, although these effects tend to reverse as soon as normal agriculture supply conditions are reestablished. The expectations for twelve-month ahead inflation also deteriorated in the last weeks. However, these upward adjustments were of the same magnitude as those for second quarter inflation expectations, suggesting that the more restrictive monetary policy stance has prevented short-term inflationary pressures from contaminating longer forecast periods. The existence of well-anchored inflation expectations is strengthened by stable 2006 inflation forecasts.

25. Under the benchmark scenario – which assumes the maintenance of the Selic rate at 19.25% p.a. and the exchange rate at R$/US$ 2.60 during the forecast period – projected inflation rose in comparison to the March meeting projection, standing above the 5.1% objective for the year. The deterioration was due to a range of factors, such as the revision of estimates for regulated price changes in 2005, which resulted mainly in an upward adjustment to April inflation estimates. The forecasts based on the market scenario – which incorporates the consensus exchange rate and Selic rate trajectories on the eve of the Copom meeting – exceeded the benchmark scenario forecast, and also rose relative to the previous month, due to the same reasons stated for the benchmark scenario. For 2006, the inflation forecasts declined, with the benchmark scenario forecast below the target established by the National Monetary Council (CMN) for the year, and the market scenario forecast above the target. The improvement in projections for 2006 reflects the longer time horizon for the consolidation of the effects of the monetary tightening process begun in September 2004.

26. The Copom also analyzed inflation forecasts for the 12-month periods ending in March, June and September of 2006. The results for these periods will be more responsive to current monetary policy decisions than those of calendar year 2005, and the available inflation projections are more reliable than those for calendar year 2006. The benchmark scenario forecast for the twelve-month period ending in March 2006 is above the value interpolated from the 5.1% inflation objective for 2005 and the 4.5% target for 2006. This forecast is also above the forecast made at the March meeting. On the other hand, the benchmark scenario forecasts for the twelve-month periods ending in June and September are below the inflation target path for these periods. The forecast for the twelve-month period ending in June is the same of that made at the March meeting, while the forecast for the twelve-month period ending in September is below the estimate made at that time.

27. The Committee reaffirms that, as stated in the February and March Minutes, the effects of the monetary tightening begun last September are already influencing first quarter inflation results as well as future inflation expectations. Economic activity continues to expand, although at a slower pace and more in line with supply conditions, so that there are no significant pressures on inflation. However, as in the March meeting, the Copom identified some factors that heightened the risks to inflation convergence with the target path. These risks are associated with the persistence of some isolated pressures on current inflation and the deterioration in the external

environment, given the persistence of high oil prices and the possibility of ongoing volatility in international capital markets.

28. The Committee also reiterates that, under the inflation-targeting regime, its decision-making is oriented toward forecasted future inflation, analyzing alternative scenarios for the evolution of the main variables that affect price dynamics. The continuation of heightened risks to short-term inflation tends to increase the uncertainty regarding future inflation, so that both the monetary authority's assessment of inflation dynamics and the coordination of private sector expectations are more difficult. In such circumstances, heightened uncertainty caused by factors that could reverse in the short term, could nevertheless have a more lasting effect on longer-term inflation expectations. Therefore, monetary policy should remain vigilant so that short-term pressures do not contaminate longer time horizons.

29. Due to the short-term risks and their persistence in recent months, the Copom assessed that just maintaining rates for a sufficiently long time at the level established in the March meeting would not ensure inflation convergence to the target path. Thus, the Committee's members unanimously decided to increase the Selic rate target to 19.50% p.a., without bias, and closely follow the inflation outlook until the next meeting, to then define the next steps in the monetary policy strategy implemented since September. As highlighted in the March Copom Minutes, the monetary authority must remain ready to adapt the pace and magnitude of the interest rate adjustment process to the prevailing circumstances, in case of an exacerbation of the inflation risk factors.

30. At the conclusion of the meeting, it was announced that the Copom will reconvene on May 17 for technical presentations, and on the following day to discuss the monetary policy decision, as established in Communiqué 12,631 of October 29, 2004.

BANCO CENTRAL DO BRASIL

SUMMARY OF DATA ANALYZED BY THE COPOM

Economic Activity

31. Seasonally adjusted retail sales fell 3.2% in February, month-on-month, according to the IBGE nationwide survey. Among all sectors included in the index, only furniture and appliance sales expanded in the period (0.7%). Autos, motorcycle and spare parts sales, which are not included in the general index, declined 4.8%. Despite the negative February result, sales increased in the first two months of the year, although showing signs of accommodation. Still under the effects of the high increase in December sales, the three-month moving average reached a record level in February and expanded 8.9% in the last twelve months.

32. In March, data from the São Paulo Trade Association (ACSP) showed a 2.6% increase in the number of database consultations for credit sales and a 1.5% increase in consultations of the Usecheque system, both on a month-on-month seasonally adjusted basis. In the year through March, these indicators increased 6.3% and 4.0%, respectively, compared to the same period in 2004.

33. The Fecomercio-SP survey showed a 3% month-on-month fall in the Consumer Confidence Index in April, attributable to a 4.1% decline in perceptions of current economic conditions and a 2.5% decline in consumer expectations.

34. The Consumer Expectations National Index (INEC), calculated quarterly by the CNI in a nationwide survey, declined 2.2% in March, compared to December 2004, influenced by deterioration in expectations regarding the evolution of 2005 employment and inflation.

35. Regarding seasonally adjusted investment indicators, the production of construction inputs, domestic capital goods production, and capital goods imports fell 1.3%, 3.1% and 6.9%, respectively, in February. Domestic capital goods output decelerated in the first two months of the year, due to the sharp fall in agricultural machinery production, in turn driven by the drop in orders from producers in the South because of the prolonged summer drought.

36. The partial and preliminary release of the FGV quarterly industrial survey showed that entrepreneurs' perceptions regarding the general business environment in April were similar to that observed in April 2004. Regarding expectations for the coming months, a slight decline was observed in expected demand. The production and industrial employment indicators continue to suggest a favorable outlook. However, compared to the January 2005 survey, there was an increase in the number of respondents who considered current inventory levels to be excessive.

37. According to the IBGE monthly industrial survey, industrial production fell 1.2% in February in month-on-month seasonally adjusted terms. The decline was driven by the 1.1% contraction in manufacturing, while extractive mineral production remained virtually stable. Key drivers of the negative industrial activity results for February were the decline in the sugar-ethanol industry (a drop of 25.4% in sugar production and refining, and 5.6% in ethanol production, seasonally adjusted) and the 4.6% contraction in oil refining. These results negatively influenced the monthly result and were caused by restrictions related to the production process, which should be overcome in the next month.

38. Analysis of industrial production by activity reveals that the fall in February industrial output reflected declines in 11 of the 23 activities, and 3 of the 4 use categories, in seasonally adjusted terms. The most notable declines were in the sectors of pharmaceuticals, food, beverages, oil refining and ethanol production. Regarding the use categories, durable goods were the only category to record a positive performance in February, with an increase of 11.8% in the month-on-month seasonally adjusted series, mainly resulting from the positive growth rates observed in automotive production and cell phone production. Semi- and non-durable goods production declined 4.3% in February, after having reached a record peak in January.

39. CNI manufacturing data showed an increase of 1% in real industrial sales and a decline of 0.2% in hours worked in February, on a month-on-month seasonally adjusted basis. Compared to the same month of 2004, real industrial sales and hours worked increased 5.9% and 7.2%, respectively. Installed capacity utilization reached 81.9% in February, with a 0.3% decline in the month-on-month seasonally adjusted series, and an increase of 1.1% compared to the same month of 2004.

40. Leading indicators for the industrial sector suggest some recovery in March compared to February. Particularly notable are the strong growth rates in automotive production, the highest level since January 1979, and the strong growth of corrugated cardboard shipments.

Labor Market

41. In February, formal employment rose 0.2% (seasonally adjusted, month-on-month) according to the Ministry of Labor and Employment. Compared to the same month of 2004, there was a 6.2% expansion in formal employment, with the creation of 1,473 thousand jobs, led by manufacturing.

42. According to the IBGE survey in the six main metropolitan regions of the country, the unemployment rate reached 10.6% in February, versus 10.2% in January and 12% in February last year. The increase in unemployment was seasonal, with a 5.0% monthly increase in the number of unemployed individuals and a 0.3% decline in the number of employed individuals. The labor force, estimated at 21.7 million individuals, increased 0.2% in February.

43. In the industrial sector, according to the CNI indices seasonally adjusted by the BCB, employment rose 0.2% and real payrolls were unchanged in February, on a month-on-month basis. Compared to the same month of 2004, real payroll and employed workers grew 8.1% and 6.8%, respectively.

Credit and Delinquency Rates

44. Non-earmarked credit grew 2.1% in March. Credit operations with individuals increased 3.5%, driven mainly by the expansion in personal credit, as a result of the increase in payroll-deducted loans. Corporate credit with domestic funding expanded by 0.9%, while corporate credit with external funding increased 1.9%.

45. The average interest rate on non-earmarked credit increased from 47.5% p.a. in February to 47.8% p.a. in March. The average corporate rate stood at 32.9% p.a., a 0.5 p.p. increase in the month. The average rate for credit to individuals was unchanged at 64.0% p.a.

46. The default rate on non-earmarked credit (considering payments delinquent for 15 days or more) stood at 12.7% in March, a 0.3 p.p. increase month-on-month. The corporate default rate rose to 3.8% in March from 3.7% in February.

47. The retail sales default rate measured by the ACSP declined to 6.4% in March, from 7.0% in February, roughly the same level of March last year (6.5%). The number of new negative registers rose 21.6%, while the number of cancelled registrations increased 23.2%. In the year to March, the average default rate stood at 6.0%, versus 6.1% in the first quarter of 2004. The number of returned checks, compared to the total number of checks, reached 6.3% in March, the highest rate ever.

External Environment

48. Global economic growth was robust in 2004, presenting the highest rate in the last fifteen years, driven by the United States and China. For 2005, the forecast is for lower, but sustained growth; however, projections point to less evenly distributed growth across countries. The United States and China will continue to lead the global expansion, whereas Japan and the Euro Area are expected to post more moderate growth.

49. According to the International Monetary Fund, global trade grew 9.9% in 2004, and is forecasted to grow 7.4% for 2005. For the World Trade Organization (WTO), global trade will expand 6.5% in 2005, compared to the

9% increase last year. The International Institute of Finance (IIF) projects an increase in net capital flows to emerging markets, with a particular increase in foreign direct investment. However, there are some risks to this scenario, such as high oil prices, higher-than-expected interest rate increases, and a hard landing of the Chinese economy.

50. Results thus far in 2005 have confirmed the multilateral organizations' projections for the year. In the U.S., industrial production grew 0.3% in March, the same pace recorded in February. Installed capacity stood at 79.4%, an increase of 0.1 p.p. compared to February and the highest result since December 2000. U.S. business expectations, despite declining, continue to point to robust economic growth. The current level of the manufacturing ISM indicator is compatible with a 4.5% GDP growth rate, while the services indicator is compatible with a 5% GDP expansion. Regarding Japan, industrial production recorded a 2.3% decline in March, with business expectations (Tankan) declining, the same trend recorded in Germany, France and Italy.

51. Despite the pressures from commodity price increases, especially metals and oil, there has not been an acceleration of inflation in the main economies, with consumer price indices remaining within the limits established by the monetary authorities.

52. In the international financial markets, yields on 10-year U.S. Treasuries fell in late-March (after rising in late-January), with significant volatility in the period. The moves in U.S. Treasuries affected emerging market debt, which recorded volatility and relative deterioration at the beginning of April.

Foreign Trade and Balance of Payments

53. In March, the Brazilian trade balance posted record highs – on monthly, year-through-March accumulated, and twelve-month accumulated bases. In the month, the trade balance posted a US$3.3 billion surplus. Exports and imports rose 22.0% and 15.5%, respectively, compared to March 2004 daily averages, to reach US$9.3 billion and US$5.9 billion. In twelve months, the trade balance and total external trade reached US$35.9 billion and US$167.1 billion, respectively. In the first eleven working days of April, the trade balance totaled US$2.3 billion, with exports and imports growing by 42.0% and 12.2%, respectively, compared to April 2004 daily averages.

54. in addition to the increase in export volumes, key export products have registered price increases. Furthermore, this increase has been accompanied by an increase in growth of typically low-participation items, underscoring the export diversification currently under way. In addition, it is important to highlight the broadening of export destinations, even to markets with low participation in Brazilian exports.

55. Import growth in March and in the first quarter of 2005 was broadly disseminated, with notable increases in imports of fuel and lubricants (41.6%), capital goods (27.4%), non-durable consumer goods (26.6%), and raw-material and intermediate goods (17.5%), compared to the daily averages of the same period of 2004.

56. International reserves increased US$2.9 billion in March, to US$62.0 billion, while adjusted net reserves stood at US$39.5 billion, recording a US$4.7 billion increase compared to the same period of 2004.

Money Market and Open Market Operations

57. After the March Copom meeting, the yield curve shifted upward in response to the Committee decision, rising inflation expectations, and concerns regarding the external outlook. The upward shift was partially reversed, especially in the short end, by the release of both the March Copom Minutes and the IPCA-15 result. However, the subsequent release of higher-than-expected headline and core inflation results put pressure on future interest rates, while IBGE's announcement of production and retail sales data put opposite pressure on rates. The volatility in the external outlook and the increase in risk-aversion also affected the long end of the yield curve. As a result, the increase of the yield curve between the March and April meetings was higher in the long end of the yield curve. Between March 16 and April 20, 1-month and 6-month interest rates increased by 0.39 p.p. and 0.48 p.p., respectively, while 1-year, 2-year and the 3-year rates increased by 0.58 p.p., 0.68 p.p. and 0.85 p.p., respectively. In the same period, the real interest rate measured by the ratio between the one-year nominal interest rate and the 12-month-ahead inflation expectations reached 12.86% from 12.42%.

58. The BCB did not rollover any FX instruments maturing since the March meeting. As a result, the net redemption of FX instruments, including interest payments, totaled US$224 million in April and US$14.7 billion in the first four months of the year.

59. The National Treasury raised a total of R$21.9 billion via auctions of LTNs, maturing in October 2005, April 2006, July 2006, and January 2007. The Treasury raised an additional R$500.5 million via five NTN-F auctions, with maturities in January 2008 and January 2010. The Treasury also conducted ten auctions of LFTs maturing in 2007, 2008 and 2009, five of which were sales and five of which were exchanges. The five sales of LFTs totaled R$18.1 billion, and the five exchanges totaled R$2.1 billion.

60. Aimed at reducing excess liquidity projected for the next quarter, on March 23 the BCB sold LTNs maturing in July 2005 from its portfolio, and bought LTNs maturing in April 2005. Similarly, on April 6, April 13 and April 20 the BCB sold LTNs maturing in October 2005, and bought LTNs maturing in July 2005. These operations totaled R$5.1 billion.

61. In its open market operations, the BCB intervened in the open market on a weekly basis with 3-month fixed-rate repo operations and 1-month floating-rate repo operations, and conducted daily liquidity management operations. The BCB also conducted twenty fixed-rate overnight repo operations, seven of which were overnight borrowings; three were borrowings with a two-to-five-working-day tenure; and ten of which were overnight lending. The excess liquidity sterilized from the banking reserves market via operations with tenors less than 30 days averaged R$19.2 billion, and the amount sterilized via operations with three-month tenors averaged R$39.9 billion.

62. In March, net securitized domestic public debt grew 3.3%, due to the accrual of interest and the net placement of R$14.5 billion in securities. The dollar-linked share in net domestic debt fell to 4.9% in March from 6.0% in February, mainly due to the net redemption of FX-linked securities and due to the reverse swap auctions in which the BCB assumed long FX position.