BANCO CENTRAL DO BRASIL

Minutes of the 104th Meeting of the Monetary Policy Committee (Copom)

Date: January 18th, from 4:30PM to 7:09PM, and January 19th, from 4:20PM to 6:30PM
Place: BCB's Headquarters meeting rooms - 8th floor on January 18th and 20th floor on January 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
Paulo Sérgio Cavalheiro
Rodrigo Telles da Rocha Azevedo
Sérgio Darcy da Silva Alves

Department Heads (present on January 18th)
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
Luiz Sampaio Malan – Economic Department
Marcelo Kfoury Muinhos – Research Department (also present on January 19th)
Renato Jansson Rosek – International Reserves Operations Department

Other participants (present on January 18th)
Eugênio Pacceli Ribeiro – Advisor to the Board
Flavio Pinheiro de Melo – Advisor to the Board
Hélio Mori – Advisor to the Board
Jocimar Nastari – Press Secretary

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 price inflation accelerated again in December, due to stronger increases in market prices and the continuation of regulated prices readjustments at high levels. Wholesale price inflation declined, mainly due to the deceleration of industrial price increases, the effect of which counterbalanced higher agricultural prices.

2. The Broad National Consumer Price Index (IPCA) increased 0.86% in December, compared to 0.69% in November, totaling a 7.60% change in the year. The December IPCA reflected pressures on both market and regulated prices. The main drivers were gasoline, meat, urban bus fares, clothing, chicken, housemaid services, fuel-alcohol, and water and sewage prices, responsible for 0.61 p.p. of the monthly index.

3. The General Price Index (IGP-DI) rose 0.52% in December, compared to 0.82% in November, for an accumulated 12.14% increase in 2004. Among the IGP-DI components in December, the Consumer Price Index – Brazil (IPC-Br) increased 0.63%, compared to 0.37% in November. The National Index of Civil Construction (INCC) increased 0.51%, decelerating from the 0.71% registered in November, due to a decline in construction materials inflation. The Wholesale Price Index (IPA-DI) declined to 0.48% from 1.0% in November, for a 14.67% cumulative increase in the year.

4. Market prices increased 0.62% in the December IPCA, compared to 0.39% in November, accounting for 0.44 p.p. of the monthly index change. Regulated prices increased 1.43%, with a 0.42 p.p. share in the overall result, of which 0.24 p.p. was due to fuel prices.

5. The wholesale price deceleration in December, as measured by the IPA-DI, was mainly caused by industrial prices, which decelerated to 0.38% compared to 1.30% in November, due to lower rises for chemical, metallurgical, mechanical and electrical products. Agricultural price inflation rose significantly, to 0.75% in December from 0.14% in November, mainly due to an increase in the prices of fruits and legumes. Prices of animal products continued to exert pressures, due to the inter-harvest period, while the prices of cereals and grains maintained a downward trend, impacted by international prices and the exchange rate. In the IPA-DI measured according to the production stage, final and intermediate goods price increases decelerated in December, while the increase in the prices of raw materials was virtually unchanged.

6. IPCA core inflation remained at high levels in December. Excluding household food items and regulated prices, the core reached 0.67%, compared to 0.57% in November, for a cumulative 7.95% increase in the year. The core calculated under the smoothed trimmed-means method reached 0.67%, compared to 0.62% in the previous month, and totaled 7.52% in 2004. The same core measure, calculated without the smoothing procedure, increased to 0.66% from 0.57% in November, for a cumulative 6.38% increase in 2004.

7. The IPC-Br core inflation, calculated by the Getúlio Vargas Foundation (FGV) under the symmetric trimmed-means method, reached 0.48% in December, compared to 0.41% in November, for a total increase of 5.87% in 2004.

8. In December, the IPCA diffusion index increased to 68.0%, compared to 67.6% in November and 66.4% in October. The persistence of high core inflation and the behavior of the diffusion index indicate the dissemination of price increases across several sectors of the economy.

9. The variation of the IPCA in January should be lower than December, but still at a level inconsistent with the 2005 inflation target. Electricity in Rio de Janeiro, meat and clothing prices will exert inflationary pressures.

Assessment of Inflation Trends

10. The inflation shocks and their impacts were reassessed according to newly available information. The scenario considered in the simulations assumed the following hypotheses:

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

b) Projections for readjustments to both household electricity and fixed telephone prices for 2005 were also unchanged, at 9.5% and 7.7% respectively;

c) An increase of 6.7% in all regulated prices, which represented a total weight of 29.4% in the December IPCA, is projected for 2005, in line with the previous meeting;

d) The projection for the readjustment of all regulated prices for 2006, following the model of endogenous determination, which takes into account seasonal components, the exchange rate, market price inflation, and the IGP-DI change, 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 Over-Selic and the swap rates on the eve of the Copom meeting, declines from 77 basis points in the first quarter of 2005 to 51 basis points in the last quarter of 2006.

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

12. Assuming the maintenance of the Over-Selic rate at 17.75% p.a. and the exchange rate at the level prevailing on the eve of the Copom meeting (R$/US$2.70), the IPCA inflation rate was projected above the 5.1% objective for 2005. Using the consensus Over-Selic rate and exchange rate compiled by the BCB's Investor Relations Group (Gerin) on the eve of the Copom meeting, inflation was also projected above the 2005 objective.

Monetary Policy Decision

13. IPCA inflation stood at 0.86% in December, well above market consensus, accelerating for the third consecutive month. The acceleration occurred across all three components – tradable, non-tradable and regulated prices. The increase in regulated prices, notably fuel, continued to put pressure on inflation. Household food prices reversed the downward trend observed in recent months, ceasing to contribute to lower inflation. Nonetheless, IPCA inflation accelerated in December even excluding household food prices.

14. In 2004, IPCA inflation accumulated a 7.60% increase, below the upper limit (8.0%) of the tolerance interval set by the National Monetary Council, and also below the 9.30% inflation registered in 2003. Market prices increased by 6.55% (7.79% in 2003), while the increase in regulated prices averaged 10.19% (13.20% in the prior year). Therefore, market prices contributed 4.66 p.p. while regulated prices contributed the remaining 2.94 p.p. to the annual inflation, corresponding to 61.3% and 38.7% of the rate, respectively. In 2003, market prices and regulated prices were responsible for 59.6% and 40.4% of the IPCA, respectively. Hence, the contribution of market prices to inflation increased in 2004. Additionally, of the 1.70 p.p. reduction in the 2004 IPCA, 0.9 p.p. was due to the drop in market price inflation, and 0.8 p.p. was due to lower regulated price inflation.

15. In December, the IGP-DI decelerated to 0.52%, from 0.82% in November. Wholesale prices were the main contributor to the IGP-DI reduction, declining to 0.48%, from 1.00% in November. Deceleration of industrial wholesale prices (0.38% in December compared to 1.30% in November) offset higher inflation in agricultural prices. In the year, the cumulative increase in industrial wholesale prices stood at 19.50%. In the IPA-DI by the production stage, intermediate goods prices increased 25.84%. Despite the recent deceleration of the Industrial component, cumulative wholesale price inflation in 2004 continues to represent a potential pressure on consumer prices in the coming months. The intensity of the pass-through will depend on prospective demand conditions and market inflation expectations, as assessed in previous Copom Minutes.

16. IPCA core inflation measures continued to accelerate in December, according to the three criteria – by excluding regulated prices and household food, by smoothed, and by non-smoothed trimmed-means. Similarly to that observed for the headline index, this acceleration has occurred for the third consecutive month. The cumulative change in core inflation excluding regulated prices and household food was above the headline IPCA in 2004, for the first time since 1996. The cores, in addition to presenting an underlying inflation trend incompatible with the medium-run inflation target, accelerated in recent months.

17. Industrial output declined 0.4% in November in seasonally adjusted terms, in line with the projection in previous Copom Minutes. However, considering revised monthly industrial production data released by the Brazilian Institute of Geography and Statistics (IBGE) for October, which demonstrate stability instead of the original 0.4% drop, the level of the series increased as compared to previous estimates. The seasonally adjusted quarterly moving average series shows output declining in November for the first time since February. The decline was led by the drop in intermediate goods, which represent the heaviest weight in the industrial production index, while groups directly linked to final demand have grown. In the year to November, industrial output grew 8.3%, compared to the same period of the previous year. Durable and capital goods have continued to be the highlights, with growth rates above 20%. For semi- and non-durable consumer goods, the seasonally adjusted quarterly moving average series have posted the highest output level since August 2003, when these sectors resumed growth. This behavior confirms the change in the composition of economic activity, with growth being increasingly sustained by more income- and employment-sensitive sectors.

18. Leading and coincident indicators of industrial activity signal an increase in output in December. This expectation, in addition to the upward revision of the October figure, is consistent with the continuity of the expansion of industrial output observed since the second half of 2003, although not necessarily at the same pace as observed in the initial phases, given the relative accommodation registered in recent months. As noted in prior Copom Minutes, it is normal that, after the initial strong impulse, the growth process converges to rates consistent with the pace of output capacity expansion. Furthermore, it is reasonable to expect a temporary accommodation after a monthly sequence of high growth rates.

19. The labor market continues to show signs of improvement. The unemployment rate remained stable in November (10.6%), due to an increase in the labor force relative to the total employed population. The November unemployment rate was among the best results observed under the new IBGE methodology introduced in 2001, and well below the 12.2% rate of November 2003. According to the Ministry of Labor and Employment, formal employment increased 5.1% in 2004, with the creation of 1,523,276 jobs. In December, however, net hires were negative. According to the IBGE, the number of workers and payroll increased 3% and 2% in the year to November, respectively, while real average wages declined 1% in the same period. Data from the National Industry Confederation (CNI) indicate continued growth of industrial employment and real wages in November.

20. According to the IBGE, retail sales increased 0.4% in November, seasonally adjusted by the BCB. Sales and nominal revenue increased 8.33% and 12.08%, respectively, in twelve months. Sales of furniture and appliances, and vehicles and motorcycles continue to present the strongest growth (26.19% and 17.45%, respectively). Supermarket sales, although increasing at lower rates, continue to support growth at the margin. On a quarterly moving average basis, aggregate sales continued to increase, although at lower rates and tending toward stability. The Consumer Confidence Index measured by the Federação do Comércio do Estado de São Paulo (Fecomercio-SP) remained at high levels in January. The positive results for employment and wages suggest that sales dynamism will be sustained.

21. As repeatedly emphasized in prior Copom Minutes, and due to the significant activity expansion observed since end-2003, the performance of aggregate supply in the coming quarters remains an important concern for prospective inflation dynamics. The CNI's installed capacity index decreased modestly in November in seasonally adjusted terms for the third consecutive month. The domestic absorption of capital goods increased 7.3% from January to November compared to the same period of last year, despite the decrease in October caused by the required registration of an oil platform, produced and managed domestically, as an exported product. Capital goods output maintained robust growth rates in the year. In the third quarter of the year, fixed capital investment as a share of GDP remained stable, when compared to the cumulative data up to the second quarter of 2004. Recent performance of the activity level, capacity utilization and fixed capital investment do not demonstrate a significant change from the scenario discussed in prior Copom meetings, of a closure of the output gap despite the recovery in investment from the low levels of recent years. Therefore, monetary policy must remain particularly vigilant with regard to the pace of additional demand expansion.

22. The external trade surplus increased 36.0% in 2004. Exports increased 32.0%, while imports expanded 29.9%, as a consequence of stronger domestic demand. Among exports, manufactured sales continue to present the highest volume growth rate (22.6% from January to November). Raw materials and durable consumer goods imports registered notable volume increases, growing 21.3% and 27.2%, respectively, in the same period. The favorable trade surplus supported the 2004 current account surplus of US$ 11.7 billion, equivalent to 1.9% of GDP.

23. The international capital market environment, despite still favorable, has deteriorated slightly compared to the December Copom meeting. The Brazilian country risk premium, which had declined at the end of last year, increased modestly in the first half of January, following the release of the December FOMC Meeting Minutes. International liquidity and markets stability remain tied to macroeconomic conditions in the industrialized countries, especially the United States, and to the possible response of the Fed's monetary policy to these economic developments. Thus, new information suggesting an economic scenario that would alter the Fed's current policy of gradual interest rate increases will result in greater asset price volatility. This instability could be exacerbated if the major economies' exchange rates undergo sharp adjustments due to the imbalance in these countries' external accounts.

24. International oil prices reverted the downward trend observed between October and the middle of December. Prices have been volatile due to news regarding possible supply restrictions among exporting countries, the available of oil reserves in the main consuming countries, and the severity of the northern hemisphere winter. This recent evolution, besides underscoring the uncertainty regarding oil price trends, pushed again international gasoline prices above domestic prices, leaving small room for a reduction of domestic fuel prices throughout 2005. However, the Copom continues to assume there will be no change in domestic fuel prices in 2005.

25. Since the December Copom meeting, the median of market expectations collected by Gerin for the 2005 IPCA inflation declined to 5.70% as of January 14, from 5.78%. Expectations, however, increased marginally if compared to the level in the week ending on January 7 (5.67%). The decline in inflation expectations remains modest, considering the favorable events that could contribute to dampen inflationary pressures in 2005, such as the signs of deceleration in economic growth, exchange rate appreciation, the decline in international commodity prices, and the signaling of a more restrictive monetary policy.

26. The Copom´s inflation forecast for 2005 presented a minimal decline compared to those released in the December Inflation Report. In the benchmark scenario – which considers the maintenance of the Over-Selic rate at 17.75% p.a. and the exchange rate at R$/US$ 2.70 during the forecast period – exchange rate appreciation, an increase in the yield curve, and the modest decline in inflation expectations compensated the inertial effects of the up tick in December inflation. Nevertheless, the inflation forecast for 2005 remains above the 5.1% objective. The forecasts based on the market scenario – which incorporates the consensus exchange rate and Over-Selic rate trajectories on the eve of the Copom meeting – exceed the benchmark scenario forecasts, due to the expected exchange rate depreciation and decline in the interest rate during the forecast period. For 2006, the benchmark scenario forecast is below the target established by the National Monetary Council (CMN) for the year, while the market scenario forecast is above the target.

27. Since the beginning of the monetary policy adjustment process, in September, the deviation between the Copom's inflation forecasts and the inflation target trajectory has narrowed. Some factors, however, represent risks to the process of inflation convergence to the target trajectory during the coming months. First, it is possible that self-propagating forces stimulate aggregate demand more than expected in the forecast exercises. The uncertainty surrounding the intensity of these forces in the Brazilian economy is similar to those related to the immediate monetary policy transmission, especially because the country did not experience sustained growth in the last years. Second, the stickiness of inflation, given current aggregate demand conditions, could also prove more intense than that estimated with data available for the Brazilian economy. The recent acceleration of core inflation and the upward revision of industrial output could evidence risks to the monetary management, or, alternatively, could only reflect the usual transmission lags between monetary policy, activity and inflation.

28. Considering the likelihood that recent consumer price dynamics could actually represent a deterioration of the risks to meet the inflation target trajectory, the Copom examined the possibility of accelerating the pace of interest rate adjustment. However, there was consensus among the Committee members that available data would not justify such acceleration. The members of the Copom confirm their conviction that additional phases of the current process of monetary adjustment, followed by a sufficiently long period of stable interest rates, will be sufficient to align the future path of inflation with the monetary policy objective. Clearly, if the inflationary process proves resistant to the monetary stance adopted since September, or if other risk factors deteriorate, the monetary authority will be prepared to adjust the pace and magnitude of the interest rate adjustment process to the circumstances.

29. Considering the reasons stated above, the Copom unanimously decided to increase the Selic rate target to 18.25%, with no bias.

30. At the close of the meeting, it was announced that the Committee would meet again on February 15, 2005, for technical presentations, and on the following day, to discuss the monetary policy decision, as established in Communiqué 12,631 of October 29, 2004.

SUMMARY OF DATA ANALYZED BY THE COPOM

Economic Activity

31. According to the IBGE retail survey, which covers all states of the country, retail sales (seasonally adjusted by the BCB) expanded moderately in November. All components of the index increased in the month, with particularly notable and continued growth in furniture and electrical appliance sales. Auto, motorcycle and parts sales, which are not included in the general index, declined again in November. In the year to November, retail activity expanded 9%, compared to the same period of 2003. Meanwhile, retail activity expanded 6.4% in the month of November, on a year-over-year basis, with growth recorded in 26 out of the 27 states in the country.

32. In December, São Paulo Trade Association (ACSP) data registered a 0.9% seasonally adjusted month-on-month increase in both the number of credit sales consultations and of the Usecheque system. In the year to December, the same indicators rose by 6% and by 2.2%, respectively.

33. The Fecomercio-SP consumer sentiment survey indicated that the Consumer Confidence Index increased by 3.3% in January to a record level of 145.7 points (range 0 to 200), due to increases of 3.2% in the Index of Current Economic Conditions and 3.3% in the Index of Consumer Expectations.

34. Regarding fixed capital investment, the indicators showed a recovery in November compared to the previous month. Domestic output and capital goods imports increased 0.2% and 9.9%, respectively, in seasonally adjusted terms. However, the 24.8% fall in capital goods exports was the main reason driving the 20.2% increase in the domestic absorption of capital goods in the month. It is important to highlight that, in October, capital goods exports were driven by the sale of a domestically-produced oil exploration platform-ship, which remained leased in Brazil. The growth of the domestic absorption of capital goods, cumulative to November, was 7.3%, despite an increase of 52.5% in capital goods exports. This growth was a result of a 20.4% increase in domestic output and 4% growth in imports. Production of construction inputs fell 2.7% month-on-month in November, seasonally adjusted, but registered a cumulative increase of 5.7% in the year to November.

35. The IBGE registered a 0.4% decline in industrial output in November, seasonally adjusted, relative to the prior month. On a quarterly moving average basis, industrial output stood at a level slightly below that of October (when an historic high was recorded), signaling an accommodation trend after the notable expansion recorded in recent months.

36. The breakdown of industrial output data showed the decline in November was a result of the performance of 16 out of the 23 components, seasonally adjusted. The most notable declines were in the sectors of pharmaceuticals, metallurgy, electrical equipment and materials and metal products. The sectors that demonstrated notable growth were electronic material, communications equipment and food. Regarding the use categories, intermediate goods – with the heaviest weight in industrial production - were the sole category to record a decline (1.1%), for the third consecutive month. The production of capital and durable goods increased 0.2% in November, accumulating the highest expansion rate in the year. Semi- and non-durable goods production grew 0.5% in the month.

37. In the year to November, industrial output grew 8.3%, when compared to the same period of 2003. Output expanded in all use categories and in 26 out of the 27 industrial activities surveyed. Capital goods and intermediate goods output grew 20.4% and 7.4%, respectively, supported by the increase in exports and in fixed capital investment. The production of durable goods increased 22.3%, and semi- and non-durable goods production grew 3.8% in the same period, reflecting the expansion of credit and the gradual recovery of labor income.

38. In November, the CNI recorded a 0.2% decline in real industrial sales and a 0.2% increase in industrial hours worked, compared to October, in seasonally adjusted terms. In the year to November real sales and hours worked increased by 14.9% and 5.7%, respectively, compared to the same period of 2003. The average level of industrial capacity utilization, in seasonally adjusted terms, reached 82.9% in November, with a 0.1 p.p. decline relative to October. In the year to November, capacity utilization expanded by 3.2%, compared to the same period of 2003.

39. Leading indicators suggest expansion in industrial output in December, compared to November, in seasonally adjusted terms. Increases in steel output and auto manufacturing led the expansion. Packaging paper shipments, the number of road tolls paid by trucks, and electrical energy also expanded.

Labor Market

40. In December, formal employment increased by 0.1% seasonally adjusted, month-on-month, according to the Ministry of Labor and Employment. In the year, there was a 5.1% expansion in employment, with the creation of 1,523 thousand jobs, led by manufacturing.

41. The unemployment rate, measured by the IBGE in the six main metropolitan areas of the country, reached 10.6% in November, compared to 10.5% in the previous month. The increase in the unemployment rate, despite the 0.4% monthly expansion in the employed workers rate, was due to growth of the labor force, possibly led by the gradual improvement in general labor market conditions.

42. In the industrial sector, according to seasonally adjusted data from CNI, employed workers and real wages increased by 0.5% and 1.2%, respectively, in November, compared to October. In the year to November, real wages and employed workers increased by 8.9% and 3.2%, respectively, compared to the same period of 2003.

Credit and Delinquency Rates

43. Non-earmarked credit operations declined 0.3% in December, as a result of the 7.3% decline in exchange rate-linked credit, driven by BRL appreciation. Corporate credit with domestic funding expanded by 1.4% in the month, mainly as a result of the seasonal growth of credit demand in the period. In the year, this segment grew by 27.1%, driven by more robust economic activity. Credit operations with individuals increased by 1.1% in December and by 28.9% in the year, driven mainly by the expansion in personal credit, and particularly payroll-deducted loans.

44. The average interest rate on non-earmarked credit declined to 45.0% p.a. in December from 45.7% p.a. in November. The average corporate rate stood at 31.0% p.a., recording a 0.1 p.p. rise in the period. Regarding credit to individuals, the average rate stood at 61.5% p.a., recording a 1.9 p.p. decline.

45. The default rate on non-earmarked credit fell by 0.7 p.p., to 6.7% in December compared to November. The use of the 13th wage to pay debts was the main contributor to the 1.2 p.p. drop in the individuals default rate, which stood at 11.7% in December. In corporate operations, the default rate recorded a 0.1 p.p. decline and was 3.1% at the end of 2004.

46. The default rate measured by the ACSP fell to 3.4% in December from 3.8% in November. The number of cancelled files exceeded new files in the month. This occurred just once more in the historical series, in December 1967. The meaningful growth of cancelled files was a result of a campaign to recover credits in arrears for more than two years. In the year to December, the average default rate stood at 4.2%, below the 5.2% registered in 2003.

External Environment

47. The U.S. current account deficit and oil price volatility remain the main focus of global financial markets. Despite the dollar depreciation, the U.S. trade deficit has increased, reaching a new record of US$60.3 billion in November. Given the inflexibility of exchange rate in Asian countries, especially China, the euro continues to absorb the majority of pressure from the U.S. currency depreciation.

48. Regarding oil, although the short-term outlook anticipates strong price volatility, the marginal recovery of the OECD and particularly U.S. stocks and the slower growth of demand signal the stability of prices this year. Agricultural and metal commodity prices recorded a decline, with the exception of coffee, sugar and steel.

49. In the U.S., the fall of the Producer Price Index in December somewhat cooled expectations for a faster pace of monetary tightening. Thus, the Fed should maintain the gradual pace of monetary tightening throughout the year. Considering the expected maintenance of interest rates in the Euro Area, the yield differential of U.S. dollar-denominated assets should increase during the year, facilitating the financing of the U.S. current account deficit.

Foreign Trade and Balance of Payments

50. In December, the Brazilian trade balance posted a US$3.5 billion surplus, and a historical cumulative balance of US$33.7 billion surplus for the year (US$24.8 billion in 2003), of which US$96.5 billion were exports and US$ 62.8 billion were imports. In December, exports and imports increased by 30.3% and 36.0%, respectively, compared to December 2003 daily averages. Total external trade reached US$14.9 billion in December, or a cumulative US$159.3 billion for the year, compared to US$121.4 billion in 2003, signaling a new plateau for external trade. In the first two weeks of January (ten working days), the trade surplus reached US$916 million, with exports and imports growing by 29.5% and 32.6%, respectively, compared to January 2004 daily averages.

51. Brazilian exports totaled US$9.2 billion in December, posting the highest level of the series for this month. Manufactured, primary and semi-manufactured goods exports totaled US$5.7 billion, US$2.1 billion and US$1.2 billion, respectively. In addition to the increase in volumes, key export products have registered price increases and shipments have continued to expand, both to traditional markets and new destinations. Imports reached a record level in December, totaling US$5.7 billion in the month, with increases in all categories compared to the same month of 2003.

52. International reserves increased US$3.6 billion in 2004, to a level of US$52.9 billion, while adjusted net reserves stood at US$25.3 billion (IMF concept), recording an US$ 8.0 billion increase compared to the same period of 2003.

Money Market and Open Market Operations

53. After the December Copom meeting, futures interest rates increased, particularly for maturities from six months up to 1 year. The positive slope of the yield curve widened up to the nine month vertices. This behavior was influenced by the following factors: the perception of market participants from the December Copom Minutes that the monetary tightening cycle would continue; the release of inflation indices and respective cores above market expectations; and the persistence of 2005 inflation expectations at high levels. The yield curve was also influenced by several external factors, especially the revision of expectations regarding the pace of the Fed´s tightening, after the release of the December FOMC Meeting Minute. Between December 15 and January 19, the 1-month and 6-month interest rates increased by 0.65 p.p. and 0.87 p.p., respectively, while the 1-year, 2-year and the 3-year rates increased by 0.86 p.p., 0.56 p.p. and 0.26 p.p., respectively. In the same period, the real interest rate measured by the ratio between the one-year nominal interest rate and 12-month-ahead inflation expectation reached 12.0%.

54. The BCB did not carry out auctions to roll over FX securities and swaps maturing in January. As a result, the net redemption of FX-linked securities and swaps totaled US$4.9 billion, including interest paid.

55. Between the December and January Copom meetings, the National Treasury carried out selling auctions of LTNs maturing in October 2005, January 2006 and July 2006, for a total placement of R$14.4 billion. The National Treasury also carried out four NTN-Fs auctions maturing in January 2008, totaling R$783 million, and seven LFTs auctions maturing in 2005, 2006 and 2007, four of which were selling auctions and three of which were exchange auctions. The selling auctions of LFTs totaled R$20.7 billion, and the exchange auctions totaled R$18.4 billion.

56. In its open market operations, on December 17 the BCB carried out an operation aimed at reducing liquidity in the first quarter of 2005. This operation consisted of a selling auction of LTNs maturing in April 2005, linked to a buying auction of LTNs maturing in January 2005. Similarly, on January 7 and January 14, the BCB carried out a selling auction of LTNs maturing in July 2005, linked to a buying auction of LTNs maturing in April 2005. The operations totaled R$5.3 billion. In addition, the BCB maintained the weekly Selic-indexed repo operations (1-month tenure) and the fixed-rate repo operations (3-month), as well as its daily liquidity management

operations (two-working-day tenure). The BCB also carried out 16 very short-term repos, of which, nine were overnight borrowings, three were borrowings with a two- to five-working-day tenure, and four were overnight lending. In the period, the excess liquidity drained from the market with operations shorter than 30 days averaged R$19.5 billion, and with 3-month-tenure operations averaged R$41.6 billion.

57. In December, net securitized domestic public debt grew 3.4%, due to a R$15.8 billion net placement and accrued interest. The dollar-linked share in net securitized domestic debt decreased to 9.9% in December from 10.3% in November.