BANCO CENTRAL DO BRASIL

Minutes of the 111th Meeting of the Monetary Policy Committee (Copom)

Date: August 16th, from 4:55PM to 7:15PM, and August 17th, from 4:30PM to 6:30PM
Place: BCB's Headquarters meeting rooms - 8th floor on August 16th and 20th floor on August 17th – Brasília – DF

In attendance:
Members of the Committee
Henrique de Campos Meirelles – Governor
Afonso Sant'Anna Bevilaqua
Alexandre Antonio Tombini
Alexandre Schwartsman
Antônio Gustavo Matos do Vale
João Antônio Fleury Teixeira
Paulo Sérgio Cavalheiro
Rodrigo Telles da Rocha Azevedo
Sérgio Darcy da Silva Alves

Department Heads (present on August 16th)
Altamir Lopes – Economic Department
Daso Maranhão Coimbra – International Reserves Management Department
Ivan Luís Gonçalves de Oliveira Lima – Open Market Operations Department
José Pedro Ramos Fachada – Investor Relations Group
Marcelo Kfoury Muinhos – Research Department (also present on August 17th)
Radjalma Costa – Department of Banking Operations and Payments System

Other participants (present on August 17th)
Alexandre Pundek Rocha – Advisor to the Board
Flavio 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 Evolution of Inflation

1. Despite the seasonal rise in consumer price inflation in July, the overall inflation outlook in the month suggests continued cooling of inflationary pressures. Consumer price increases in the month were mainly restricted to specific regulated prices, such as fixed-line telephone rates, gasoline, and health plans. Wholesale prices contracted for the third consecutive month, driven by a reduction in agricultural and industrial prices.

2. The IPCA rose 0.25% in July (versus –0.02% in June), for an accumulated increase of 3.42% in the year through July, and 6.57% in the last twelve months. The main driver of the July result was the 4.21% increase in fixed-line telephone rates, which contributed 0.14 p.p. to the monthly result. Overall, regulated prices drove the July IPCA increase, as market prices remained stable. The drop in food and beverage prices (-0.77%) compensated for other price increases, and explains the stability in market prices.

3. The General Price Index (IGP-DI) fell 0.40% in July, contracting for the third consecutive month. In the year and in cumulative twelve months, IGP-DI inflation rose 1.12% and 4.88%, respectively. The Consumer Price Index-Brasil (IPC-Br) rose 0.13% (versus -0.05% in June), driven primarily by the increase in its housing component, due,

in turn, to the increase in fixed-line telephone rates. The increase in the National Index of Civil Construction (INCC) reached 0.11%, down from the 0.76% increase registered in June, due to the dissipation of labor cost pressures. The Wholesale Price Index (IPA-DI) contracted for the third consecutive month, -0.69%, posting a -0.53% result in the year, and a twelve-month trailing increase of 3.84%.

4. The drop in the IPA-DI in July reflected declines in agricultural and industrial prices. Agricultural wholesale prices fell 1.6%, following a 0.98% contraction in June, driven by the reduction in prices of animal and animal derivative products and by the stronger drop in export food product prices. Of note, prices of legumes, fruits, cereals, and grains rose in the month, reversing the downward trend of prior months. The weaker decline in industrial prices, down 0.38% in July versus a 0.71% contraction in June, was due to the 1.78% rise of fuel and lubricant prices (declines of 1.10% in May and 0.12% in June). Meanwhile, important manufactured products – such as foodstuffs, metals, and plastics – continued to register price declines. The IPA-DI by production stage showed downward movement in prices of final, intermediate, and primary goods, despite the reversal in fuel prices.

5. Smoothed trimmed-means core inflation fell to 0.45% in July, from 0.49% in June, for a twelve-month trailing increase of 7.4%. Non-smoothed trimmed-means core inflation rose to 0.31% in July, from 0.26% in June, for a twelve-month trailing increase of 6.08%. Core inflation calculated by the exclusion of household food and regulated prices remained practically stable in July at 0.37%, with a twelve-month cumulative increase of 6.87%.

6. IPC-Br core inflation, calculated by the Getúlio Vargas Foundation (FGV) under the symmetric trimmed means method, was 0.3% in July, the lowest monthly result since October 2000. Year-to-date through July, IPC-Br inflation reached 3.61%, with a trailing twelve-month increase of 5.83%.

7. The IPCA diffusion index (measuring the number of items in the IPCA registering price increases) posted a significant drop, to 53.7% in July, from 61.7% in June.

Assessment of Inflation Trends

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

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

b) Projections for fixed telephone rate adjustments in 2005 were reduced to 6.1% from 6.5%, and remained unchanged for household electricity at 8.2%;

c) For all regulated prices, which represented a total weight of 29.6% in the July IPCA, the Copom maintained its projection for adjustments in 2005 at 7%;

d) The projection for regulated price adjustments in 2006 was maintained at 5.7%. To arrive at this value, individual projections were made for some of the items for which 2005 adjustments have already occurred. For the other items, the projection continued to follow the model of endogenous determination, which takes into account seasonal components, the exchange rate, market price inflation, and the change in the IGP;

e) The projection for the six-month spread over the Selic rate, using a VAR model based on the Selic and swap rates on the eve of the Copom meeting, increases from an average of –83 basis points in the third quarter of 2005, to 35 basis points in the fourth quarter of 2006.

9. 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 July meeting were maintained.

10. In the benchmark scenario – maintenance of the Selic rate at 19.75% p.a. and the exchange rate at the level prevailing on the eve of the meeting (R$/US$ 2.35) – the IPCA inflation rate was projected above the 5.1%

objective for 2005, but below the 4.5% central target for 2006. In the market scenario – using the consensus Selic rate and exchange rate expectations compiled by the BCB's Investor Relations Group (GERIN) on the eve of the meeting – inflation was projected above the 5.1% objective for 2005 and above the 4.5% central target for 2006.

Monetary Policy Decision

11. IPCA inflation in July (0.25%) continued to show signs of accommodation, despite rising above the June rate. In the May-July period, IPCA inflation stood at 0.72%, versus 2.08% in the February-April period. Twelve-month trailing IPCA inflation fell to 6.57%, 0.70 p.p. below the June level and 1.5 p.p. below the peak reached in April. As in June, market prices were stable in July; the IPCA increase was driven by the rise in regulated prices, particularly fixed-line telephone rates. Tradable goods prices dropped, but were counterbalanced by the acceleration of non-tradable goods inflation.

12. Core inflation also showed signs of accommodation at lower levels. Smoothed trimmed-means core inflation decelerated again in July, despite its implicit inertial component, but nevertheless continued to post the highest year-to-date and twelve-month trailing inflation of all the core inflation measures monitored by the Copom. Core inflation by exclusion remained stable. Meanwhile, non-smoothed trimmed-means core inflation accelerated slightly in July, but remains the core measure with the lowest year-to-date and twelve-month trailing inflation. Following the deceleration in May and June, and relative stability in July, core inflation measures posted another drop in twelve-month trailing terms, and have come even closer to levels compatible with the inflation target path.

13. The IGP-DI registered deflation for the third consecutive month, dropping 0.40% in July. The result was driven by the sharp drop in wholesale price inflation (-0.69%), which brought twelve-month trailing IPA-DI to 3.84% in July, down from 5.97% in June. Wholesale price deflation resulted from the reduction in consumer goods (including consumer durables) and producer goods prices. IGP-M data for the first ten days of August suggest the fourth consecutive, and largest, monthly decline in the index, due to ongoing declines in industrial prices and a sharp drop in agricultural prices. IPA-DI inflation remains below IPCA inflation, for both year-to-date and twelve-month trailing, indicating a consistent accommodation of wholesale prices with positive implications for consumer price inflation. As emphasized in prior Copom Minutes, the intensity and continuity of this pass-through will depend on demand conditions and price-setters' expectations for the future inflation path.

14. Industrial production rose a month-on-month seasonally adjusted 1.6% in June, confirming the trend suggested by leading and coincident indicators. With the June result, industrial production increased for the fourth consecutive month, and reached a record high for the second consecutive month, with year-to-date growth of 5.0%. The three-month moving average also posted a record high for the second consecutive month, growing 1.0% relative to May. Industrial production rose a cumulative 6.7% over the last twelve months. Leading and coincident indicators suggest a month-on-month decline in July, but continuing growth in three-month moving average terms.

15. All use categories of industrial production registered growth in June, driven primarily by consumer durable goods production (8.1%) and capital goods production (4.2%). Semi- and non-durable goods production posted the lowest seasonally adjusted growth, at 0.7%. After a volatile start to the year, capital goods production rose for the second consecutive month in June, with year-to-date growth of 3.8%. Meanwhile, consumer durables production remained robust, with a year-to-date increase of 16.7%. In three-month moving average terms, capital goods production rose 1.9% and consumer durables production rose 4.2%, both reaching record highs. Semi- and non-durable goods production grew for the second consecutive month, rising 6.7% in the first half of 2005 relative to the same period of 2004, and 0.4% in three-month moving average terms relative to May. The June results show more broadly disseminated growth across categories, vis-à-vis the beginning of the year, and underscore the favorable outlook for industrial production going forward.

16. June labor market data remained favorable. The unemployment rate measured by the Brazilian Institute of Geography and Statistics (IBGE) stood at 9.4%, the lowest level for the series as measured since October 2001, and 2.3 p.p. below the rate registered in June 2004. The number of employed individuals rose 3.7% in the first half of the year, relative to the same period of 2004. After declining for two months, real average incomes rose 1.5% in June, versus May. Manufacturing employment rose 0.1% in June, as measured by the National Industry Confederation (CNI) and seasonally adjusted by the BCB. Real manufacturing payrolls rose 0.5%, for year-to-date

growth of 9.0%. Formal employment, measured by the Ministry of Labor and Employment (MTE), also expanded, with the creation of 195,536 jobs in June, for cumulative year-to-date job creation of approximately 1 million positions.

17. Retail sales rose 1.2% in June, according to seasonally adjusted data from the IBGE, for a year-to-date increase of 4.6%. As in prior months, and in line with the recent performance of industrial production, growth was driven by furniture and household appliance sales, which rose 4.3% in June, month-on-month. IBGE also upwardly revised retail sales data for May, showing a much stronger growth of 1.2% (versus 0.4% in the first reporting). As a result, the three-month moving average series showed growth of 0.9% in June, relative to May. Considering the May data revision, all retail sectors posted two consecutive months of growth, with the exception of fabric, clothing, and shoes. In particular, hyper- and supermarket sales in May were upwardly revised, from a contraction of 0.4%, to an increase of 0.7%. As in the case of industrial production, the June retail sales data show more broadly disseminated growth across sectors and, together with the performance of employment, income, and credit, underscores the favorable outlook going forward.

18. Installed capacity utilization in the manufacturing sector, as measured by the CNI and seasonally adjusted by the BCB, rose to 82.8% in June, reaching levels comparable to the beginning of 2005 and, for the first time in the year, rising for two consecutive months. After a period of accommodation at historically high levels, one could envision a scenario for the second half of the year in which capacity utilization expands even more. As emphasized in prior Copom Minutes, in an environment of historically high levels of installed capacity utilization, the inflation path will depend on the capacity of current and prospective supply increases to meet demand conditions. With regard to investment, capital goods absorption rose 2.5% in June, and 4.3% in the first half of the year. Despite a considerably elevated comparison base (given the robust investment expansion in 2004), the indicator suggests ongoing strong growth, particularly for capital goods imports, which grew 28.3% in volume terms through July, when compared to the same period of 2004, and for domestic capital goods production, with seasonally adjusted growth of 5.2% in May and 4.2% in June. While signs of an investment recovery are mounting, the performance of aggregate supply in the coming quarters remains a key concern with regard to inflation dynamics.

19. Exports and the trade surplus continued to post record highs in July, confirming the favorable outlook for the year. The twelve-month accumulated trade balance reached US$ 39.9 billion in July, an increase of more than US$ 1.5 billion over the previous month. In the twelve months trough July, export growth slowed modestly to 26.2% in value terms, relative to the preceding twelve months, while import growth was 24.5%. Despite the spike in oil prices, recent import growth has decelerated more than export growth, with the exception of capital goods imports (a 24% twelve-month expansion, the strongest growth rate since March 1998). The robust performance of the trade accounts in the twelve-month period through July underpinned the current account surplus of US$ 13.4 billion, equivalent to 1.9% of GDP. The data suggest that external demand is providing more support to the economic expansion than was expected at the beginning of the year.

20. International financial market volatility remained elevated, but there was no significant change in the scenario considered by the Copom at its July meeting. The long-awaited adjustment in the Chinese exchange rate regime occurred without significant implications for the main global financial assets. Brazilian country risk fell close to the historic lows reached in October 1997, but remained at these levels for only a brief time. The volatility in Brazilian country risk was accompanied by similar volatility in the exchange rate. Liquidity conditions and financial market stability remain tied to macroeconomic conditions in the industrialized countries, especially the United States, and to the Fed's potential monetary policy response to economic developments. In general, recent indicators suggest a favorable outlook, in the sense that the Fed will continue to raise interest rates at a measured pace. An additional point of concern is the current account imbalances in some of the largest economies, and the possibility that eventual adjustments will result in significant currency movements. Despite these concerns, about which there is a significant degree of uncertainty, the Copom continues to assign a low probability to a significant deterioration in international financial markets.

21. The main concern with regard to the external scenario is the recent spike in oil prices. The recent deterioration reinforces concerns that international prices could spike even higher, and that, even after moderating, could remain at higher-than-expected levels for an extended period of time. As in prior months, oil price projections remain subject to a considerable degree of uncertainty, prompting the Copom to maintain its baseline scenario that

there will be no adjustment to domestic fuel prices in 2005. The Copom has maintained this scenario, given evidence that speculative positions have likely driven recent oil price increases, and could reverse in the near term, regardless of possible specific geopolitical tensions. It is important to emphasize that, since the July meeting, the baseline scenario for the oil price outlook has become increasingly implausible and the risks to the scenario are mounting, such that there could be an increase in domestic gasoline prices in the year. In addition, independently of what occurs with domestic gasoline prices, international oil price trends continue to represent a risk to the future inflation path via the effects on oil-intensive products as well as private sector inflation expectations.

22. In August, inflation expectations fell for the third consecutive month, reflecting the larger than expected deceleration in the July IPCA. Since the July Copom meeting, median IPCA inflation expectations for 2005 declined to 5.40% from 5.66%, increasingly in line with the 5.1% inflation objective for 2005. Twelve-month ahead inflation expectations have fallen marginally in recent weeks, while inflation expectations for 2006, after remaining stable at 5.0% for 64 weeks, fell slightly to 4.98%. In addition, since the June meeting, there was a progressive reduction in the average and standard deviation of the distribution of projections, suggesting an increase in optimism with regard to the 2006 inflation outlook. This could be seen as evidence that inflation expectations for longer time horizons continue to be influenced by favorable developments that are cooling inflationary pressures, including the monetary policy stance and improved market expectations for the exchange rate path. As mentioned in prior Copom Minutes, these developments suggest that the monetary policy stance has both contained short-term inflationary pressures and contributed to the consolidation of a more favorable longer-term macroeconomic environment.

23. The 2005 inflation forecast under the benchmark scenario – which assumes the maintenance of the Selic rate at 19.75% p.a. and the exchange rate at R$/US$ 2.35 during the forecast period – declined relative to the July Copom meeting, but remains above the 5.1% inflation objective for the year. The improvement is primarily due to the lower than expected inflation result for July, the reduction in inflation expectations, and the reassessment of projections for regulated price adjustments in the rest of the year. The forecasts based on the market scenario – which incorporates the consensus exchange rate and Selic rate trajectories on the eve of the Copom meeting – remain above the benchmark scenario, but declined relative to the July meeting. For 2006, the benchmark scenario inflation forecast declined slightly and remained below the central target established by the National Monetary Council. The forecast under the market scenario remained stable, and above the central target.

24. The Copom also analyzed inflation forecasts for the twelve-month periods ending in March, June, and September 2006. The forecasts for these periods will be more responsive to current monetary policy decisions than those for calendar year 2005, and also more reliable than those for calendar year 2006. The forecasts under the benchmark scenario for the twelve months ending in March, June and September 2006 were below the target inflation path values interpolated from the 5.1% objective for 2005 and the 4.5% target for 2006.

25. The Committee reaffirms the view, expressed in prior Copom Minutes, that the effects of the interest rate tightening cycle begun in September 2004 continue to be reflected in both year-to-date inflation results and forward-looking inflation forecasts. Economic activity continues to expand, but at a pace more compatible with supply conditions, such that it will not exert significant inflationary pressures. In addition, the Committee maintains the view that the external scenario remains supportive, despite the recent spike in oil prices, which now represent a significantly higher risk to the inflation path than at the July meeting. Therefore, there are more definite signs of a benign inflation scenario. As in the July meeting, the Copom emphasizes that the main challenge of monetary policy in this environment is to guarantee the consolidation of the favorable developments anticipated for the future.

26. In an inflation-targeting regime, the monetary authority assesses alternative scenarios for the evolution of the principal variables that shape price dynamics, in order to orient its decision-making process. The recent consolidation of favorable inflation dynamics should significantly reduce uncertainties regarding future inflation, and make it easier for the monetary authority to evaluate potential scenarios and coordinate private sector expectations. Furthermore, the persistence of a tighter monetary policy stance should help to bring inflation in line with the short-term objectives, in an environment in which activity indicators have demonstrated consistent strength and short-term inflation results owe to specific factors that may reverse in the future. Such a policy should have more lasting effects on longer-term inflation expectations, thereby significantly reducing the costs associated with the monetary authority's efforts to bring inflation in line with the target path.

27. The Copom therefore unanimously decided to maintain the Selic target at 19.75% p.a., without bias, and closely follow the evolution of the inflation outlook until the next meeting, at which time it will define the next steps in the monetary policy strategy implemented since September 2004.

28. At the conclusion of the meeting, it was announced that the Copom would reconvene on September 13 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

29. According to the IBGE national survey (seasonally adjusted), retail sales increased 1.2% in June, compared to the previous month. Compared to June 2004, retail sales expanded 5.3%, driven by increases in six out of the eight surveyed activities. The main contribution to this result came from furniture and household appliance sales, which increased 21.4%.

30. Data from the São Paulo Trade Association (ACSP) showed a seasonally adjusted 0.6% decline in database consultations for credit sales in July, compared to June, while the number of consultations of the Usecheque system rose 0.1%. In the year through July, these indicators increased 5.7% and 3.7%, respectively, compared to the same period in the previous year.

31. The Fecomercio-SP survey showed a 5.4% month-on-month decline in the Consumer Confidence Index in August, due to a 9.9% drop in consumer expectations, while the perceptions of current economic conditions increased 3.1%.

32. Investment expanded in June. Domestic production and capital goods imports rose 4.2% and 2.5%, respectively, on a month-on-month seasonally adjusted basis. Construction output increased 2.7%, the best monthly performance of the year. In the first half of 2005, compared to the same period in 2004, these indicators expanded 3.8%, 26.3% and 2%, respectively.

33. According to IBGE, Brazilian industrial production expanded a seasonally adjusted 1.6% in June, compared to May, reaching a new record high. Manufacturing output rose 1.5%, while mining increased 0.2% (both reached the highest level of the IBGE series). In the first half of 2005, industrial production expanded 5%, driven by a 4.7% rise in manufacturing and a 10.4% increase in mining.

34. Seasonally adjusted data for industrial production by activity shows that 18 of the 23 sectors surveyed grew in the month. The strongest growth rates were vehicles and electronic materials and communication. The weakest sectors were petroleum refining and alcohol and other chemicals. All use categories expanded in June, particularly consumer durables (8.1%) and capital goods (4.2%). Intermediate goods production, which has the largest participation in the overall result, and semi- and non-durable consumer goods production rose 0.9% and 0.7%, respectively.

35. CNI manufacturing data showed increases of 1.2% and 2.4% in real sales and hours worked in June, respectively, on a month-on-month seasonally adjusted basis. Compared to the same month of 2004, real sales and hours worked increased 2.9% and 8.0%, respectively. Installed capacity utilization reached 82.8% in June, in the seasonally adjusted series, with a 1.1% rise in comparison to the previous month. The non-seasonally adjusted result was 82.9%, standing 0.3% below the data of June 2004.

36. Seasonally adjusted leading indicators (corrugated paper shipments, vehicle production, energy consumption and heavy vehicles traffic) point to a slowdown in industrial activity in July, compared to June.

Labor Market

37. The formal employment index rose 0.4% in June (month-on-month, seasonally adjusted), according to the Ministry of Labor and Employment. Compared to June 2004, there was a 6% increase in formal employment, with a net creation of almost 1.5 million jobs, mainly in manufacturing and commerce.

38. According to the IBGE survey in the six main metropolitan regions of the country, the unemployment rate declined to 9.4% in June, from 10.2% in May, and 2.3 p.p. below the June 2004 rate. The month-on-month decline reflected the 8.6% fall in the number of unemployed individuals (193,000 people), and the 0,8% reduction (181,000

people) in the labor force, estimated at 21.9 million individuals. Real average earnings, at R$945.80, showed a 1.5% increase in June, compared to May (-0.3% compared to June2004).

39. According to the BCB's seasonal adjustment of the CNI indices, industrial employment and real payrolls increased 0.1% and 0.5% in June, respectively, compared to May, and rose 5.3% and 8.7%, respectively, relative to June 2004. Industrial employment in the first half of 2005, relative to the same period of 2004, rose 6.4%, while real payrolls rose 9.0%.

Credit and Delinquency Rates

40. Non-earmarked credit grew 1.6% in July (month-on-month). Credit operations with individuals rose 2%, driven mainly by the expansion of personal credit, due to the continued increase of payroll-deducted loans. Corporate credit with domestic funding increased 1.2%, while externally funded operations rose 1.6%.

41. The average interest rate on non-earmarked credit fell in July. The average rate on personal credit operations declined 0.2 p.p., to 64.5% p.a., while the average rate on corporate credit dropped 0.4 p.p., to 33% p.a.

42. Delinquency rates for non-earmarked credit (loans in arrears for more than fifteen days) rose 0.1 p.p. in July, to 7.4%. Delinquency rates for credit operations with individuals fell to 12.0% in July, from 12.4% in June. Delinquencies in corporate credit operations increased to 3.5% in July, from 3.4% in June.

43. Net delinquency rates for retail credit, measured by ACSP, fell to 4.2% in July, from 5.1% in June, due to the 4.1% expansion in the number of cancelled registers and the 2.5% decline in the number of new registers in the month.

External Environment

44. Recent indicators show sustained, although slightly uneven, global economic growth in the second quarter. Whereas China and the U.S. grew 6.7% and 3.4%, respectively, on an annualized basis, Japan and the Euro Area grew 1.1% and 1.2%, respectively.

45. Monthly economic activity indicators suggest the continuation of this growth pace in the third quarter. The slight improvement in the data from the Euro Area and Japan corroborates expectations for a more promising macroeconomic scenario in the second semester. However, the outlook could be affected by the constant increases and volatility of oil prices (reaching US$ 65 per barrel), driven by concerns about capacity constraints.

46. Despite high international oil prices, the global inflation outlook, according to consumer price indices, remains stable, suggesting that there are no changes expected for the monetary policy stance in the main global economies. In the U.S., the FED raised the benchmark interest rate by 25 basis points, to 3.5%, indicating that it plans to remove monetary stimulus at a measured pace. In the U.K., the Bank of England decided to cut the interest rate by 25 basis points, to 4.5%, in order to offset the slowdown of its economy. The European Central Bank held rates unchanged at 2%.

47. Exchange rate policy changes in China did not significantly impact international financial markets, despite some volatility on the day that the measures were announced. Following the announcement from China, Malaysia also adopted a new exchange rate regime that will be administered with reference to a basket of currencies, allowing fluctuation within a narrow band.

48. Generally, inflation remains under control. In the U.S., the June CPI registered no change (0%), while the PPI was stable as compared to the previous month, in spite of higher oil prices. In the U.K., the CPI rose 2% in June, year-on-year. Thus, there are no predicted changes in the monetary policy stances of the main economies.

49. In the oil market, prices remain high, and very volatile, mainly due to the oil and oil by-product inventory estimates in the U.S., in addition to geopolitical tensions in producing countries.

Foreign trade and international reserves

50. The trade balance reached new record highs in July and in the twelve-month period ending in July. In the month, the trade balance reached a surplus above US$5 billion for the first time. For the twelve months, the trade balance and total external trade reached US$39.9 billion and US$178 billion, respectively, with growth rates of 29.4% and 27.1% over the previous twelve-month period. In the first 10 working days in August, the trade balance reached US$1.7 billion, with export and import growth of 16.2% and 18.8%, respectively, over the average daily levels reached in August 2004.

51. Exports totaled US$11.1 billion in July, surpassing the US$11 billion threshold for the first time, and presenting the highest daily average ever registered (US$526.7 million), up 28.9% compared to July 2004. Primary product exports set a monthly record of US$3.8 billion. The main export product was crude oil, reaching US$850 million. Due to the increase in both prices and volumes of important manufactured and semi-manufactured export products, records were set in July. Considering the first seven months of the year, manufactured products represented 55% of Brazilian exports, compared to 53.1% in the same period of 2004. Exports continue to be diversified, and expand for all regions, with significant increases in sales to new markets.

52. Imports totaled US$6.1 billion in July, up 14.7% in daily average terms, compared to July 2004. Except for fuel and lubricants, all import categories expanded in the month, compared to the same month of last year. In the year up to July, there was a 27.6% increase in capital goods imports, 19% for consumer goods, 17.9% for raw material and intermediate goods, and 13.7% for fuel and lubricants, all measured in daily averages compared to the same period last year.

53. At the end of July, international reserves totaled US$54.7 billion, US$5.2 billion less than at end-June, mainly due to repayments to the IMF (US$5 billion). Net adjusted reserves totaled US$40.5 billion, holding steady in the month.

Money Market and Open Market Operations

54. In the period following the July Copom meeting, the yield curve shifted upward, particularly at the long end, driven by concerns about the domestic outlook, and the volatility of US treasuries and international oil prices. However, in early-August, the yield curve returned to levels registered before the July meeting, due to the drop in current inflation, as well as inflation expectations, and the improved external outlook, with the decline in Brazilian country risk and currency appreciation. The recent release of favorable inflation indicators contributed to the steeper negative slope in the yield curve. For this reason, between July 20 and August 17, the differential between the Selic and the 6-month forward rate declined from –0.83 p.p. to –1.15 p.p. In the same period, the one-, three- and six-month, and one-year interest rates fell 0.11 p.p., 0.21 p.p., 0.32 p.p., and 0.04 p.p., respectively; while two- and three-year interest rates increased 0.19 p.p. and 0.15 p.p., respectively.

55. In August, the net redemption of FX instruments, including interest payments, totaled US$5.7 million, and US$15.1 billion in the year through August.

56. Since the last Copom meeting, the National Treasury raised a total of R$10.2 billion via sales of LTNs, maturing in 2006, 2007 and 2008. The Treasury raised an additional R$594.5 million via NTN-F auctions, with maturities in 2010 and 2012. The Treasury also conducted three auctions of LFTs, maturing in 2008 and 2009, totaling R$6.1 billion.

57. In its open market operations, the BCB conducted weekly three-month fixed rate repo operations, as well as daily liquidity management operations. The BCB also conducted eighteen short-term repo operations, two of which were overnight borrowings and sixteen of which were overnight lendings. The excess liquidity sterilized from the banking reserves market via operations with tenors of three months averaged R$41.6 billion. Operations with tenors less than thirty days averaged R$4.8 billion.

58. Aimed at reducing excess liquidity projected for the fourth quarter, the BCB sold LTNs from its portfolio and purchased, at a pre-established price, LTNs of shorter tenors. On July 20, July 27, August 3 and August 10, the BCB sold LTNs maturing in January 2006, and bought LTNs maturing in October 2005. These operations totaled R$3.3 billion.

59. In July, net securitized public debt grew 1.1% compared to the previous month, due to accrued interest of R$12.6 billion and net placement of R$2.4 billion. The dollar-linked share of net domestic debt remained unchanged at 4.1% at end-July.