BANCO CENTRAL DO BRASIL

Minutes of the 110th Meeting of the Monetary Policy Committee (Copom)

Date: July 19th, from 4:30PM to 7:00PM, and July 20th, from 4:36PM to 7:30PM
Place: BCB's Headquarters meeting rooms - 8th floor on July 19th and 20th floor on July 20th – 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
Rodrigo Telles da Rocha Azevedo
Sérgio Darcy da Silva Alves

Department Heads (present on July 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 – Investor Relations Group
Marcelo Kfoury Muinhos – Research Department (also present on July 20th)
Daso Maranhão Coimbra – International Reserves Operations Department

Other participants (present on July 19th)
Alexandre Pundek Rocha – Advisor to the Board
João Batista 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. In June, consumer and wholesale inflation were negative. Consumer price deflation was most driven by the fall in perishable food and fuel prices, while wholesale price deflation was driven by the drop in both industrial and agricultural prices.

2. The IPCA fell 0.02% (versus a 0.49% increase in May), with an accumulated increase of 3.16% and 7.27% in the first half of 2005 and in twelve months, respectively. Key drivers of the June result were the 2.91% drop in fuel prices and the 0.67% contraction in food prices, combined contributing –0.31 p.p. to the monthly result. Market prices rose 0.04% (versus 0.59% in May), and were responsible for 0.03 p.p. of the monthly change. Regulated prices fell 0.16% (after rising 0.25% in May), contributing –0.05 p.p. to the overall IPCA result.

3. The General Price Index (IGP-DI) fell 0.45% (-0.25% in May), for a cumulative 1.53% increase in the first half of 2005 and a 6.50% increase over the twelve months through June. Among the IGP-DI components, the Consumer Price Index-Brasil (IPC-Br) fell 0.05% (versus a 0.79% increase in May), due to declines in food and transportation prices. The National Index of Civil Construction (INCC) rose 0.76% (2.09% in May), driven by the deceleration in input and service prices, in addition to the dissipation of the labor cost increases that affected the

index in May. The Wholesale Price Index (IPA-DI) fell 0.78% (-0.98% in May), for a cumulative increase of 0.16% in the year and 5.97% over twelve months.

4. The negative wholesale price inflation reflected a fall in both agricultural and industrial prices. Agricultural wholesale prices fell 0.98% (-2.76% in May), with price reductions registered across most items in the index. The stronger contraction in industrial prices – falling 0.71% in June, versus a 0.38% decline in May – reflected the decline of prices in manufacturing, food products, chemicals, and metals, and occurred across final, intermediate, and primary goods. The drop in primary goods prices occurred for mineral and agricultural products, although the latter at a lower intensity than that observed in May.

5. Core IPCA inflation fell in June. Smoothed trimmed-means core inflation was 0.49% (0.65% in May), for a cumulative increase of 7.50% over the past twelve months. Non-smoothed trimmed-means core inflation fell to 0.26% from 0.46% in May, with a cumulative 6.38% rise over the last twelve months. Core inflation calculated by the exclusion of household food and regulated prices fell to 0.36%, from 0.57% in May, with a twelve-month cumulative increase of 6.96%.

6. IPC-Br core inflation, calculated by the Getúlio Vargas Foundation (FGV) under the symmetric trimmed means method, reached 0.42% in June, down from 0.73% in May, for a cumulative twelve-month increase of 5.89%.

7. The IPCA diffusion index (measuring the number of items in the IPCA registering price increases) fell to 61.7% in June, from 65.8% in May.

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 6.5% from 8.6%, and for household electricity to 8.2% from 10.8%;

c) For all regulated prices, which represented a total weight of 29.6% in the June IPCA, the Copom reduced its projection for adjustments in 2005 to 7% from 7.3%;

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 –50 basis points in the third quarter of 2005, to 38 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 June 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 fell for the second consecutive month in June, after rising from January through April. The 0.02% contraction in June reflected deflation in regulated and tradable goods prices, as well as the lowest inflation registered since October 2004 for non-tradable goods. The June deflation was a result of the favorable confluence of two atypical events: regulated prices fell, due to the drop in fuel prices (especially fuel alcohol); and market prices were stable, due to the strong drop in food prices (especially perishable foods).

12. Core IPCA inflation decelerated in June, under all measures monitored by the Copom – by exclusion and trimmed means (smoothed and non-smoothed). The smoothed trimmed means measure was again the measure that decelerated the least (reflecting its implicit inertial component), and it continued to post the highest twelve-month cumulative value. Core inflation by exclusion decelerated the most, even though it excludes the items that registered the largest price drops in June (regulated prices and household food items). Non-smoothed trimmed means core inflation presented the least variation, both for year-to-date 2005 and over the last twelve months. With the deceleration of the last two months, core inflation measures began to approach levels compatible with the target path.

13. In June, the IGP-DI posted deflation for the second consecutive month in June, with a drop of 0.45%, primarily due to the fall in wholesale prices. The IPA-DI contracted 0.78%, with a faster drop of industrial prices and a slower decline of agricultural prices. The decline in the wholesale price index also reflected the reduction of consumer non-durable and manufactured goods prices, and occurred despite the modest increase in consumer durable goods prices. IGP-M data for the second 10-day period of July suggest some deceleration in the pace of industrial and agricultural prices contraction. Overall, throughout the second quarter there has been more evidence of a consistent accommodation of wholesale prices, with positive implications for consumer prices in the coming months. As emphasized in prior Copom Minutes, the intensity and continuity of this pass-through will depend on prospective demand conditions and price-setters' expectations for the future inflation path.

14. Industrial production rose 1.3% in May, in month-on-month seasonally adjusted terms, significantly above expectations derived from leading and coincident industrial indicators. Thus, industrial production reached a new record level (above that achieved in December) and also registered the third consecutive monthly increase, accumulating a 2.8% growth in the February–May period. On a year-on-year basis, industrial production rose 5.5%, the twenty-first consecutive monthly increase. The more stable three-month moving average series also showed a significant increase for May, after three months of relative stability. Leading and coincident indicators for the series suggest industrial production will expand at a similar pace in June.

15. All industrial categories grew in May. Consumer durable goods posted the highest growth, followed by capital goods – and both of these categories recovered from the declines registered in April. Similarly, all categories in the three-month moving average series for industrial activity increased, suggesting a generalized expansion. Under this criterion, capital goods production posted the highest growth, reversing its three-month downward trend. Throughout the year, more credit-sensitive sectors (like consumer durables) sustained strong growth, while more income-sensitive sectors lost dynamism.

16. Recent labor market data maintained the favorable performance observed in recent quarters. The unemployment rate measured by the IBGE survey dropped to 10.2% in May (the lowest level in the year) from 10.8% in April, and two percentage points below the value posted in May 2004. The number of employed individuals rose 1.24% in month-on-month terms, and 3.77% in year-on-year terms for the January-May period. On the other hand, there was a drop in real payrolls and average incomes, potentially associated with the higher than expected increase in the INPC price index. Manufacturing employment rose 0.1% in May, as measured by the National Industry Confederation (CNI) and seasonally adjusted by the BCB, continuing the growth trajectory begun in the first quarter of 2004. Real manufacturing payrolls rose 0.9%, for a cumulative 9.1% increase in the year. Formal employment, measured by the Ministry of Labor and Employment (MTE), also continued to rise. With the creation of 195,536 jobs in June, formal employment generation totaled almost one million new positions in 2005, despite the deceleration in the expansion of economic activity in recent quarters.

17. Retail sales rose 0.4% in May, according to IBGE data seasonally adjusted by the BCB, for a cumulative 4.5% increase in 2005. Similar to industrial activity, furniture and household appliances posted the largest month-on-month expansion. Retail sales also rose in three-month moving average terms, after three consecutive declines, reaching record levels similar to those posted at the beginning of the year. The Fecomercio-SP consumer confidence index rose 0.2% in July relative to June, and was 12.3% above that of the same month in 2004.

18. In May, installed capacity utilization in the manufacturing sector, measured by CNI and seasonally adjusted by the BCB, rose to 81.8%. In the last few months, capacity utilization trended sideways, suggesting a potential accommodation at a historically elevated level, despite the expansion of industrial production in the period. In this context, the inflation trajectory will depend on the capacity of current and prospective supply increases to meet demand conditions. Capital goods absorption expanded a cumulative 2.6% in the year through May. Despite a considerably higher comparison base (after the strong investment expansion in 2004), capital goods absorption showed a stronger pace of growth at the margin, driven mainly by the increase in capital goods production, as well as by the increase in net capital goods imports. Capital goods production rose 2.7% in the year to May and 10.9% in the twelve-months ending in May. While the consolidation of a recovery in investment appears likely, the performance of aggregate supply in the coming quarters remains a key concern with regard to inflation dynamics.

19. The achievement of a record high trade surplus in June reinforced the favorable outlook for the external accounts this year. The twelve-month accumulated trade balance reached US$ 38.3 billion and exceeded the median market expectation for 2005 by more than US$ 2 billion. In the twelve months through June, exports grew 28.1% in value terms, relative to the same period in 2004. Imports expanded 26.9% reflecting, in part, the rise in oil prices, despite the fact that this commodity’s share in total imports has been diminishing. While exports and imports grew at high rates in the first half of the year, at the margin, there appears to be signs of cooling in the pace of growth. The strong performance of the trade accounts in the first six months of the year contributed to a current account surplus of US$ 12.5 billion in the period, equivalent to 1.8% of GDP.

20. While international financial market conditions remained volatile, there was an improvement vis-à-vis the scenario considered at the June meeting. Brazilian country risk fell and the domestic currency appreciated. Nevertheless, 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 U.S. economic developments. An additional point of concern is the current account imbalances in some of the major 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. Oil prices spiked in early-July, and then fell sharply (albeit to still high levels) in the days preceding the Copom meeting. The increase in the level and volatility of oil prices occurred in response to new information on demand conditions, potential supply restrictions among producer countries, and inventory data for the main consumer countries. As in prior months, oil price projections remain subject to a considerable degree of uncertainty, which prompted the Committee to maintain its baseline scenario, assuming that there will be no adjustment to domestic fuel prices in 2005. Nevertheless, while the recent increase in international oil prices has not translated into an increase in domestic fuel prices, international oil price continues to represent a risk to the future inflation path via the potential effects on oil-intensive products as well as private sector inflation expectations. Despite the recent reduction, international oil prices continue to represent an important risk to the future inflation path.

22. There was a significant reduction (for the second consecutive month) in the median IPCA inflation expectations for 2005, to 5.66% from 6.21%. The drop largely reflects the higher-than-expected deceleration in IPCA inflation in June. In addition, expectations for 2005 inflation appear to be influenced by favorable developments that have cooled inflationary pressures, such as improved market expectations for the exchange rate path and the more restrictive monetary stance. Expectations for twelve-month ahead IPCA inflation also fell in recent weeks, but to a lesser degree than full-year 2005 Inflation expectations. IPCA expectations for 2006 remained stable at 5%. 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 June "Inflation Report" forecast, but remained above the 5.1% inflation objective for the year. The improvement was primarily due to the lower than expected inflation result for June, and exchange rate appreciation. The forecasts based on the market scenario – which incorporates the consensus exchange rate and Selic rate trajectories on the eve of the meeting – remain above those of the benchmark scenario, but also fell relative to the June "Inflation Report" forecasts. For 2006, the benchmark scenario inflation forecast rose slightly, but remained below the central target established by the National Monetary Council. The forecast under the market scenario also increased, but it remained above the central target.

24. The Committee 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 next year 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 are being reflected in both year-to-date inflation results and forward-looking inflation forecasts. Economic activity should continue to expand, but at a pace more compatible with supply conditions, such that it will not exert significant inflationary pressures. In addition, the Committee sees an improvement in the external scenario, despite the continuation of international oil prices at high levels. Therefore, there are more definite signs of the emergence of a benign inflation scenario. In this context, monetary policy will shift toward ensuring consolidation of the favorable developments anticipated for the future.

26. The Copom determined that maintaining interest rates at the level established in May, for a sufficiently long period of time, would create the conditions necessary to assure inflation convergence to the target path. The Committee therefore unanimously decided to maintain the Selic target unchanged at 19.75% p.a., without bias. Clearly, if there is a change in the inflation scenario, the monetary stance will be quickly adapted to the circumstances.

27. At the conclusion of the meeting, it was announced that the Copom would reconvene on August 16 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

28. According to the IBGE national survey (seasonally adjusted by the BCB), retail sales expanded 0.4% in May, month-on-month, driven by the 2.1% increase in furniture and household appliance sales and the 0.9% rise in fuel and lubricant sales. The category of hypermarkets, supermarkets, food, beverages and tobacco sales (the highest weight in the index), dropped 0.4%, while fabric, clothing and shoe sales fell 13%. In comparison to May 2004, retail sales expanded 2.7%, due to the credit-driven 18.3% rise in furniture and household appliance sales. Auto, motorcycle and spare parts sales, which are not included in the general index, increased 1.8%. In the first five months of the year, retail sales as a whole increased 4.5%, as compared to the same period of 2004.

29. Regional retail trade association data showed relative stability in retail sales activity in June. According to Fecomercio-RJ data, real sales grew 0.3%, in month-on-month seasonally adjusted terms. Data from the São Paulo Trade Association (ACSP) showed a rise of 1.1% and a fall of 0.8%, respectively, for database consultations for credit sales and of the number of consultations of the Usecheque system, on a month-on-month seasonally adjusted basis. In the first half of the year, these indicators rose 6.3% and 4.5%, respectively, in comparison to the same period of the previous year.

30. The Fecomercio-SP survey showed a 0.2% month-on-month increase in the Consumer Confidence Index in July, with a 1.1% increase in perceptions of current economic conditions and a 0.3% decline in consumer expectations.

31. Construction input and domestic capital goods production increased 0.8% and 3.4% in May, respectively, on a month-on-month seasonally adjusted basis. Capital goods imports rose 5%, in the same period. Following robust growth in 2004 (19.7%), capital goods output decelerated in the first five months of 2005, rising 2.7% compared to the same period of the previous year. This result reflects the sharp fall in capital goods production for the agricultural sector. Capital goods imports, however, accelerated, up 24.3% in the year through May, above the 10.2% expansion observed in 2004.

32. According to IBGE, industrial production rose 1.3% in May, in month-on-month seasonally adjusted terms, reaching a new peak level. Extractive industry production rose 2%, the highest level reached since survey inception, driven mainly by the oil and mining sectors. Manufacturing output grew 1.1% in the same period. In the first five months of the year, industrial production accumulated an expansion of 4.7%, due to the increases of 9.4% and 4.4%, respectively, in extractive industry production and manufacturing output.

33. Analysis of seasonally adjusted data for industrial production by activities shows that 15 of the 23 sectors surveyed registered increases in May. The strongest sectors were petroleum refining and fuel-alcohol production, electronic materials and communication, tobacco, machinery, beverages, and extractive industries. The weakest sectors were food, metal products, and perfume, soap and cleaning products. In terms of use categories, all categories posted increases in May, particularly consumer durables (3.7%) and capital goods (3.4%). Intermediate goods production, which has the largest participation in the overall result, and semi- and non-durable consumer goods production rose 0.8% and 0.6%, respectively.

34. CNI manufacturing data showed a 0.7% decline and a 0.5% increase, respectively, for real sales and hours worked in May, on a month-on-month seasonally adjusted basis. Compared to the same month of 2004, real sales fell 1.5% and hours worked increased 7.6%. Installed capacity utilization reached 81.8% in May, in the seasonally adjusted series, increasing 0.2 p.p. compared to the previous month. The non-seasonally adjusted result of 82.3% for May was relatively unchanged compared to May 2004 (82.8%).

35. For June, leading indicators of industrial activity posted strong seasonally adjusted growth. Vehicle production registered a cumulative 15.8% increase in the first semester of 2005. Also, corrugated paper shipments, energy consumption and the heavy vehicle tolls index rose in June.

Labor Market

36. Formal employment rose 0.4% in May (month-on-month, seasonally adjusted), according to the Ministry of Labor and Employment. Compared to May 2004, there was a 6.1% expansion in formal employment, with the net creation of almost 1.5 million jobs. The largest increases in employment were observed in commerce and manufacturing.

37. According to the IBGE survey in the six main metropolitan regions of the country, the unemployment rate fell to 10.2% in May from 10.8% in April (2 p.p. below the May 2004 rate). The month-on-month reduction was due to the increase in the number of employed individuals (242,000), and the 5.1% drop in the number of unemployed individuals (121,000). The labor force increased by 121,000, to an estimated 22.1 million individuals. The same survey indicated that real average earnings remained stable in May, compared to the same month in 2004. In comparison to April, however, real earnings fell 1.5%, the second consecutive monthly reduction, which is partially due to the increase of inflation rates in the period.

38. Industrial sector employment and real payrolls expanded 0.1% and 0.9%, in month-on-month terms in May, according to data from CNI, seasonally adjusted by the BCB. In comparison to May 2004, the same indicators increased 5.7% and 9.2%, respectively. In the year through May, these indicators showed increases of 6.5% and 9.1%, respectively, compared to the same period of 2004.

Credit and Delinquency Rates

39. Non-earmarked credit grew 1.6% in June. Credit operations with individuals rose 2.1%, driven mainly by the expansion of personal credit, which was in turn driven largely by payroll-deducted loans contracted by retirees. Corporate credit with domestic funding expanded 1.9%, while corporate credit with external funding fell 0.6%.

40. The average interest rate on non-earmarked credit fell in June. The average rate on personal credit operations declined 1 p.p., reaching 64.7 % p.a., while the average rate on corporate credit dropped 0.3 p.p., to 33.4% p.a.

41. Delinquency rates for non-earmarked credit fell 0.4 p.p. in June, to 7.3%. Delinquency rates for credit operations with individuals reached 12.2% in June, 0.7 p.p. below the May level. Delinquencies in corporate credit operations fell to 3.4% in June from 3.5% in May.

42. Net delinquency rates for retail credit, measured by ACSP, fell to 5.1% in June from 7.4% in May, due to the 2.9% expansion in the number of cancelled registers and the 4% decline in the number of new registers in the month. In the first half of the year, the average delinquency rate increased to 6.4%, versus 5.7% for the same period of 2004, mainly due to the deceleration in the number of cancelled registers.

External Environment

43. Recent indicators show sustained global economic growth, especially in the U.S. and China, and a moderate recovery in the Euro Area and Japan.

44. In the U.S., the latest data on industrial production, employment, consumer confidence and retail sales reinforce the view that economic activity levels remain strong, and above forecasted levels.

45. In the Euro Area, economic activity recovered in the first quarter of the year, with growth of 0.5% compared to the previous quarter and 1.4% compared to the same quarter of the previous year. Business confidence in the twelve Euro Area countries rose in June for the first time in nine months, and the industrial production index rose, driven by the exchange rate depreciation.

46. The terrorist attacks in London did not affect the economic environment. The initial impacts were limited to the financial markets, especially the stock markets, and were overcome quickly as trading normalized. The European stock markets were down sharply on the day of the attacks, but asset prices in the U.S. and emerging markets were largely unaffected after the impact of the initial news wore off.

47. The global inflation outlook remains stable. In the U.S., the June CPI was 0%, while the PPI rate remained stable, despite high international oil prices. In the United Kingdom, the consumer price index rose 2% in June, compared to June 2004, 0.1 p.p. above the forecast rate. There are no changes expected for the monetary policy stance in the main global economies.

48. Oil prices remain high, with high volatility, mainly due to the release of oil inventory estimates in the U.S., and also due to geopolitical tensions in producer countries.

Foreign Trade and Balance of Payments

49. New record highs for the trade balance were reached in the month of June and in the twelve-month period ending in June. In the month, the trade balance registered a surplus of US$4 billion. For the twelve months, the trade balance and total external trade reached US$38.3 billion and US$175.4 billion, respectively, with growth rates of 30.4% and 27.6% over the previous twelve-month period. In the first 11 working days in July, the trade balance reached US$2.7 billion, with export and import growth of 28% and 10.6%, respectively, over the average daily levels reached in the same month of 2004.

50. Exports totaled US$10.2 billion in June (new historical record) and posted the second largest daily average ever recorded (US$464 million), an increase of 4.4% compared to June 2004. The shipments of manufactured and semi-manufactured goods posted records for the month of June, as a result of higher prices and an increase in export volumes. The fall of primary product exports was a result of reduced shipments of oil and soybeans, as well as the decline of international soy prices. Strong growth has been registered across export products, including traditionally low-participation items, confirming the export diversification process under way in the last two years. In addition, it is important to highlight the expansion of exports to all continents in the first half of 2005 - even to Asia, despite the drop in exports to China.

51. Imports totaled US$6.2 billion in the month (second largest monthly result recorded), growing 6.6% in terms of daily averages, compared to June 2004. In the first half of the year, there was a 27.2% increase in imports of capital goods, 20.5% for consumer goods, 18.3% for primary and intermediate goods, and 17.3% for fuel and lubricants, all measured in daily averages compared to the same period last year.

52. At the end of June, international reserves totaled US$59.9 billion and net adjusted reserves totaled US$40.5 billion, a reduction of US$824 million and an expansion of US$1.3 billion, respectively, relative to end-May.

Money Market and Open Market Operations

53. In the period following the June Copom meeting, the yield curve shifted downward in response to: the drop in consumer price inflation; the IGP index deflation; the drop in 2005 and twelve-month ahead inflation expectations; and currency appreciation. The mix of these factors contributed to the negative slope in the yield curve, including for the short term. Between June 15 and July 20, one-, three- and six-month, one- and two-year interest rates fell 0.13 p.p., 0.27 p.p., 0.42 p.p., 0.25 p.p., and 0.19 p.p., respectively. The real interest rate, measured by the ratio between the one-year nominal interest rate and the twelve-month-ahead inflation expectation, fell to 12.43% from 12.52%.

54. In July, the net redemption of FX instruments, including interest payments, totaled US$49 million, and US$15.1 billion in the first six months of the year.

55. Since the last meeting, the National Treasury raised a total of R$33 billion via sales of LTNs, maturing in 2006 and 2007. The Treasury raised an additional R$798 million via NTN-F auctions, with maturities in 2010 and 2012. The Treasury also conducted four auctions of LFTs maturing in 2008 and 2009, totaling R$12.5 billion.

56. 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 twenty-one short-term repo operations, nineteen of which were overnight borrowings and two of which were overnight lendings. The excess liquidity sterilized from the banking reserves market via operations with tenors of three months averaged R$35.3 billion. Operations with tenors less than thirty days averaged R$12.7 billion.

57. Aimed at reducing excess liquidity projected for the third and fourth quarters, the BCB sold LTNs from its portfolio and purchased, at a pre-established price, LTNs of shorter tenors. On June 22, the BCB sold LTNs maturing in October 2005, and bought LTNs maturing in July 2005. Similarly, on July 6, July 13 and July 20 the BCB sold LTNs maturing in October 2005 and bought LTNs maturing in January 2006. These operations totaled R$7.4 billion.

58. In June, net securitized public debt grew 2% compared to the previous month, due to the net placement of R$5.7 billion in securities. The dollar-linked share of net domestic debt fell to 4.1% at end-June from 4.3% at end-May, mainly due to the effect of exchange rate appreciation.