BANCO CENTRAL DO BRASIL

Minutes of the 105th Meeting of the Monetary Policy Committee (Copom)

Date: February 15th, from 4:44PM to 6:52PM, and February 16th, from 4:00PM to 6:30PM
Place: BCB's Headquarters meeting rooms - 8th floor on February 15th and 20th floor on February 16th – 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 February 15th)
Altamir Lopes – Economic Department
Daso Maranhão Coimbra – International Reserves Operations Department
Ivan Luís Gonçalves de Oliveira Lima – Open Market Operations Department
José Antônio Marciano – Department of Banking Operations and Payments System
José Pedro Ramos Fachada Martins da Silva – Investor Relations Group
Marcelo Kfoury Muinhos – Research Department (also present on February 16th)

Other participants (present on February 15th)
Alexandre Pundek Rocha – Advisor to the Board
Eugênio Pacceli Ribeiro – Advisor to the Board
Flavio Pinheiro de Melo – Advisor to the Board
Katherine Hennings – Advisor to the Board
João Batista do Nascimento Magalhães – Special Advisor to the Governor
Jocimar Nastari – Press Secretary
Hélio Mori – 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. Consumer price inflation decelerated in January, but remained at a relatively high level, given the target set by the National Monetary Council. Reduced pressures from regulated prices were an important driver of the deceleration, while market prices remained virtually unchanged versus the previous month – except those inflation indices that capture seasonal adjustments in education prices in January. Regarding wholesale prices, the deceleration in industrial price increases was accompanied by a decline in agricultural prices.

2. The Broad National Consumer Price Index (IPCA) increased 0.58% in January, compared to 0.86% in December, bringing the twelve-month cumulative change to 7.41% in January, versus 7.60% in the previous month. The deceleration in regulated prices was notable in the period – a 0.51% increase (contributing 0.15 p.p. in the index) compared to 1.43% in December. The result in January was mainly due to the conclusion of fuel price readjustments, which had been important at the end of 2004.

3. Market prices in the IPCA increased 0.61% in January, compared to 0.62% in the previous month, thus contributing 0.43 p.p. to the monthly increase of the index. In this segment, perishable food prices increased 3.73% in the month, after four consecutive declines. Due to this increase, overall food prices increased 0.78% in January, despite the deceleration of animal products prices. Market prices excluding food prices increased 0.53% in January, compared to 0.61% in December, reflecting the behavior of clothing prices, which increased 0.23% compared to 1.59% in December.

4. The General Price Index (IGP-DI) rose 0.33% in January, compared to 0.52% in December, accumulating 11.61% in twelve months. Among the IGP-DI components in January, the Consumer Price Index – Brazil (IPC-Br) increased 0.85%, compared to 0.63% in December, mainly due to food and education prices. The National Index of Civil Construction (INCC) increased 0.75%, accelerating from the 0.51% registered in December, due to increases in the prices of construction inputs and labor costs. The Wholesale Price Index (IPA-DI) declined to 0.08% from 0.48% in December, for a 13.9% cumulative increase in twelve months.

5. The wholesale price deceleration in January, as measured by the IPA-DI, was mainly caused by agricultural prices, which declined 0.63% compared to a 0.75% increase in December. In this group, despite price increases for vegetables, fruits, beans, corn and coffee, the declines in wheat and animal products prices prevailed. Besides the decline in agricultural prices, the favorable evolution of the IPA-DI in January was also due to continued cooling in industrial prices, which increased 0.33% in January compared to 0.38% in the previous month, mainly due to the deceleration in the prices of plastic materials, processed meat and fish and fuel. In the IPA-DI measured according to the production stage, final and intermediate goods price increases slowed in January, while prices of raw materials declined.

6. IPCA core inflation decelerated slightly in January, but remained at high levels. Excluding household food items and regulated prices, the core reached 0.56% in January, compared to 0.67% in December, for a cumulative increase of 7.85% in twelve months. The core calculated under the smoothed trimmed-means method reached 0.66%, compared to 0.67% in the previous month, and totaled 7.45% in twelve months. The same core measure, calculated without the smoothing procedure, decreased to 0.59% from 0.66% in December, for a cumulative 6.34% increase in twelve months.

7. The IPC-Br core inflation, calculated by the Getúlio Vargas Foundation (FGV) under the symmetric trimmed-means method, reached 0.61% in January, compared to 0.48% in December, for an accumulated twelve-month increase of 5.83%.

8. In December, the IPCA diffusion index increased to 73.6%, compared to 68% in December and November, despite lower inflation in the period. The persistence of high core inflation and the behavior of the diffusion index indicate the dissemination of price increases across the economy.

9. The IPCA tends to come under pressure in February, due to the seasonal impact of education costs and the projected readjustments for regulated prices. Perishable food prices should continue on the upward trend begun in January, due to unfavorable weather conditions during the harvest. In wholesale prices, besides the influence of perishable food prices, prices of iron, steel and byproducts should continue to exert pressure. On the other hand, the declines in the prices of animal products tend to continue. Moreover, the exchange rate appreciation should favorably influence domestic prices, mainly commodities such as soy, corn and wheat.

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 of both gasoline and bottled gas prices for 2005 remained unchanged at 0%;

b) Projections for readjustments of fixed telephone rates for 2005 increased to 8.7% from 7.7%, while projections for the readjustment of household electricity remained unchanged at 9.5% for 2005;

c) An increase of 6.7% in all regulated prices, which represented a total weight of 29.6% in the January IPCA, is projected for 2005, as in 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 Selic and the swap rates on the eve of the Copom meeting, declines from 70 basis points in the first quarter of 2005 to 49 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 GDP for 2005 and 2006 will be achieved. The related assumptions considered in the January Copom meeting were maintained.

12. Assuming the maintenance of the Selic rate at 18.25% p.a. and the exchange rate at the level prevailing on the eve of the Copom meeting (R$/US$2.60), the IPCA inflation rate was projected above the 5.1% objective for 2005, but below the central target for 2006. Using the consensus 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 and the 4.5% target for 2006.

Monetary Policy Decision

13. The IPCA rose 0.58% in January, breaking the acceleration trend observed since last October. The deceleration in IPCA headline inflation was mainly due to the deceleration in clothing and transportation price inflation, with the latter influenced by the absence of fuel price increases (a key driver of transportation price rises during the fourth quarter of 2004). The category of food, beverage, and housing continued to post high monthly inflation rates. Relative to December, regulated price inflation decelerated, while market prices continued to increase at a pace similar to previous months. The IPCA deceleration in January was also due to a break in the trend of high monthly increases in tradable goods prices, in contrast to non-tradable goods, which continued to increase for the fourth consecutive month. Despite the deceleration in the monthly IPCA inflation, the dissemination of price increases in recent months across the consumer basket continues to expand.

14. IGP-DI inflation decelerated again in January, to 0.33% from 0.52% in December. The main contributor to the deceleration was again the IPA-DI, which rose 0.08%, versus 0.48% in December. According to production stage criteria, the IPA result for January was particularly influenced by the deceleration in the prices of gross raw materials, agricultural goods, final goods, food and fuel. The low changes in the IPA in recent months are, in part, due to the recent exchange rate appreciation and may affect positively the future evolution of consumer prices. Naturally, the intensity of this pass-through will depend on prospective demand conditions and price setters' expectations regarding the future inflation path, as highlighted in previous Copom Minutes.

15. In January, core IPCA inflation calculated by excluding household food items and regulated prices broke the acceleration trend observed in recent months. Twelve-month accumulated inflation under this measure, however, remains above IPCA headline inflation. Core IPCA inflation calculated under the non-smoothed trimmed means method also slowed, while core inflation calculated under the smoothed method remained virtually unchanged. Despite the marginal deceleration, the annualized rates of core inflation under all three criteria remain high and incompatible with the inflation target path.

16. Industrial output increased 0.6% in December, in month-on-month seasonally adjusted terms. The increase was over a higher base, following IBGE's upward revision of the series. The revision modified the prevailing view regarding recent industrial performance, since, contrary to what was suggested by October and November

preliminary data, the fourth quarter result increased compared to the third quarter. The highlight of the December result was the 3.4% seasonally adjusted increase in semi- and non-durable consumer goods production. This performance confirms the recent shift in the composition of economic activity, as growth has increasingly been sustained by the more income- and employment-sensitive sectors. In December, on a quarterly moving average basis, industrial output continued the growth trend observed since February, although at a lower pace in recent months. In the year, industrial output increased 8.3%, the highest rate since 1986. Capital goods and consumer durables presented the highest growth rates, of 19.7% and 21.8%, respectively. Non-durable and semi-durable goods production increased at a slower pace (4.0%), suggesting that there is room for a continued improvement in the performance of these sectors.

17. The result for December and the subsequent series revisions show that industrial output increased more than expected in recent months. For January, leading and coincident indicators signal an accommodation in industrial activity. Real industrial sales measured by the National Industry Confederation (CNI) increased less than IBGE manufacturing industry output in recent months, suggesting a shift in the pace of inventory accumulation in the sector. However, inventory indicators show that they remain at desirable levels, compatible with economic growth. One should expect temporary accommodation in the pace of industrial output growth, but still consistent with a scenario in which there is a continuation of the expansion begun in the second half of 2003. As noted in previous Copom Minutes, it is normal that, after the initial strong impulse at the outset of the economic recovery, the growth process tends to converge to rates more compatible with the pace of output capacity expansion.

18. According to IBGE data, the unemployment rate declined to 9.6% in December from 10.6% in the previous month. This seasonal pattern is typically observed at the end of the year, and tends to reverse in the first quarter. The unemployment rate observed in December, however, is lower than the level observed in December 2003 (10.9%) and is the lowest level observed under the new IBGE methodology introduced in 2001. The number of employed workers has continually increased during the year, accumulating growth of 3% in 2004. Payrolls increased 2.3% in the year, while the real average earnings declined 0.8%. Formal employment measured by the Ministry of Labor and Employment increased with the creation of 115,972 jobs in January, or 1.539 million on a twelve-month accumulated basis. Data from the CNI indicate continued growth of manufacturing employment since December 2003. The CNI also showed that real industrial payrolls have continued to grow in December, sustaining the trend begun in March 2003.

19. Preliminary data for retail sales suggest a strong expansion in December. According to data from the Federação do Comércio do Estado de São Paulo (Fecomercio-SP), real sales grew 5.0% in December year-on-year. Data from Fecomercio-RJ and Fecormercio-MG, seasonally adjusted by the BCB, indicate month-on-month increases of 6.9% and 1.1% in real sales in December for the metropolitan regions of Rio de Janeiro and Belo Horizonte, respectively. The Consumer Confidence Index (ICC) measured by the Fecomercio-SP remains at high levels in February. This index, associated with the increase in employment and wages, suggests that retail sales momentum will be sustained, particularly sales of semi- and non-durable goods.

20. 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. Average installed capacity utilization, measured quarterly by the FGV and seasonally adjusted by the BCB, remains at high levels, despite the modest reduction in January, to 84.5%, versus 85.2% in October 2004. The level of capacity utilization for capital goods production increased again in January, after declining in October, while the level of capacity utilization for intermediate goods production remained practically unchanged and at high levels. In terms of composition, a decline in capacity utilization is evident among credit-sensitive sectors, while income-sensitive sectors, such as clothes and footwear, remain at high or increasing levels. CNI's installed capacity index (seasonally adjusted by the BCB) increased 0.2% p.p. in December to 83.0%, remaining at the elevated levels observed since June, in a context of ongoing industrial production expansion. In regard to fixed-capital investment, domestic absorption of capital goods increased 6.7% in 2004, with a notable 19.7% growth in capital goods production in the period. The positive trend of the business confidence index for the manufacturing sector, as well as the continuation of Brazilian sovereign risk at reduced levels, suggests a favorable environment for the continuity of fixed-capital investment growth.

21. Brazil continued to register large surpluses in the external trade accounts in the beginning of the year. Exports grew 32.5% in January on a twelve-month accumulated basis. As a result of strong domestic demand, imports grew 30.6%. The trade balance totaled US$34.3 billion, a 36% twelve-month accumulated expansion relative to the same period through January 2004. In volume terms, comparing December figures to the same month of 2003, manufactured goods exports have continued to post record growth rates, while fuels and lubricants and durable consumer goods were the main drivers of imports. The favorable trade surplus supported the US$11.8 billion current account surplus, equivalent to 1.9% of GDP, in the cumulative twelve months through January.

22. The international capital market environment has remained favorable. After the release of the December Federal Open Market Committee (FOMC) Minutes, markets registered some turbulence, leading to an increase in the Brazilian country risk. However, with market stabilization, the Brazilian country risk premium has gradually declined, recently reaching 400 basis points. As mentioned in the last Copom Minutes, abundant international liquidity and market stability remain tied to macroeconomic conditions in the industrialized countries, especially the United States, and to the Federal Reserve's potential monetary policy response to economic developments. New information suggesting an economic scenario that would alter the Fed's current stance could 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.

23. International oil prices have moved to higher levels since the December Copom meeting. Price volatility has mirrored news regarding possible supply restrictions among exporting countries, demand conditions and available oil reserves in the main consumer countries. In the context of a highly volatile oil price scenario, international oil prices stand below domestic oil prices. However, given the oil price volatility observed in recent months, these developments do not mean that there will be sufficient room to reduce domestic oil prices during the year. The committee continues to assume there will be no change in domestic fuel prices in 2005.

24. Since the December Copom meeting, the median of market expectations for the 2005 IPCA inflation increased slightly to 5.72% from 5.70%. As mentioned in prior Copom Minutes, inflation expectations for 2005 remain high, despite favorable events that could dampen inflationary pressures, such as the signs of deceleration in economic growth, exchange rate appreciation, the decline in important commodity prices, and the signaling of a more restrictive monetary stance in the last months.

25. Under the benchmark scenario – which considers the maintenance of the Selic rate at 18.25% p.a. and the exchange rate at R$/US$ 2.60 during the forecast period – inflation forecasts remained virtually stable, presenting a marginal reduction compared to the January meeting inflation forecast, but still above the 5.1% inflation objective for the year. The exchange rate appreciation and the increase in the yield curve balanced the effects of higher-than-expected January inflation and anticipated increases in regulated prices during 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 – exceeded the benchmark scenario forecasts, but were lower than last month's forecasts, owing to the lower-than-expected exchange rate depreciation and the expectation of a higher interest curve. For 2006, the forecasts also showed improvement at the margin, with the benchmark scenario forecast below the target established by the National Monetary Council for the year, and the market scenario forecast above the target.

26. Since the beginning of the monetary policy adjustment process, inflation expectations and forecasts have improved, although the current headline and core inflation are still incompatible with the medium-term targets. The more restrictive monetary policy stance adopted since September 2004 will increase the likelihood that the deceleration of wholesale price inflation positively influences consumer price inflation. Moreover, there is the possibility that the positive seasonal effects of food prices will be registered earlier this year than in prior years. Combined, these factors may contribute to attainment of inflation rates in the first half of the year that bolster confidence in the convergence of 2005 inflation to the target path.

27. This increase in the likelihood of inflation convergence to the target path is tied to the response of economic activity and inflation to the monetary policy stance. In the January Minutes, the Copom mentioned specific factors, among the uncertainties regarding macroeconomic projections, which could harm the convergence process. Of particular concern was the intensity of self-propagating forces in the economic cycle, tied mainly to income and employment dynamics, and the possibility of greater inflation persistence, given aggregate demand

conditions. In the evaluation of the committee members, data released thus far, including signs of a break in the inflation acceleration registered in the fourth quarter, reduce the likelihood of realization of the risks mentioned in January.

28. These risk factors should not be interpreted as evidence of the loss of monetary policy effectiveness as a result of recent credit and fiscal developments. Independent of the specific importance of these developments to current performance, it is important to highlight that every expansionary impulse requires an adequate monetary policy response, but does not necessarily represent the loss of effectiveness of conventional monetary instruments. Credit growth as a result of the introduction of new personal loan contracts is an important structural advance that, in addition to making a permanent contribution toward improving the efficiency of financial intermediation, should also increase monetary policy effectiveness in the medium run. In the opinion of the Copom members, there is no evidence to suggest that monetary policy will be unable to assure convergence to the inflation target path during the period required to consolidate this structural change. Furthermore, the monetary stance implemented in recent months takes into consideration the fiscal policy impact on aggregate demand and, ultimately, on inflation. It is undeniable that reductions in fiscal expenditures reinforce monetary policy's efforts to control inflation, and that improvements in the public accounts contribute to further reductions in real interest rates in the medium run. However, again, it does not mean that the current fiscal policy stance makes conventional monetary policy instruments inefficient in the control of inflation.

29. With a reduction in the risks of convergence of inflation to the target path, the Copom understood that the process of interest rate adjustment should be maintained at the originally projected pace. The committee members still agree that this 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.

30. Considering the reasons stated above, the Copom unanimously decided to increase the Selic rate target to 18.75%, with no bias.

31. Although the current monetary policy decision brings the Selic interest rate close to a level that, according to the Copom's opinion, will promote inflation convergence to the target path, the Copom recognizes that it is still not possible to assume, with this decision, the conclusion of the adjustment process initiated in September. The extent of additional tightening will depend on confirmation in the data of the favorable scenario that is beginning to materialize, and on economic agents' perception that interest rates will remain constant for a sufficiently long period of time at the conclusion of the process.

32. Clearly, in the case of a reversal in the evolution of the projected inflation outlook or of an exacerbation of the other risk factors followed closely by the Copom, the monetary authority will be prepared to adjust the pace and magnitude of the interest rate adjustment process to the circumstances.

33. At the conclusion of the meeting, it was announced that the Copom will reconvene on March 15 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

34. Regional retail trade association data showed that the expansion in retail sales activity continued in December. According to Fecomercio-SP, real sales grew 5.0% on a year-on-year basis in December in São Paulo, driven by household appliances and automobile sales. In Rio de Janeiro, data from Fecomercio-RJ showed a 6.9% month-on-month seasonally adjusted increase in sales in December. The retail sales survey of Fecomercio-MG also showed a real month-on-month seasonally adjusted increase of 1.1% in sales in Belo Horizonte.

35. In January, São Paulo Trade Association (ACSP) data showed a 3.5% increase in the number of database consultations for credit sales and a 1.5% reduction in consultations of the Usecheque system, both on a month-on-month seasonally adjusted basis. Together, these indicators showed a 1.6% month-on-month seasonally adjusted increase, signaling the continuity of retail sales growth in early 2005.

36. The favorable outlook for retail sales is further confirmed by the evolution of consumer expectations at the beginning of the year. The February Fecomercio-SP survey showed a 1.1% month-on-month increase in the Consumer Confidence Index (ICC), above the record level reached in January. The increase in the month was attributable to increases of 0.6% in the Current Economic Conditions Index and 1.4% in the Consumer Expectations Index.

37. Investment indicators registered month-on-month expansion in December. Domestic production and capital goods imports increased 1.6% and 9.9% respectively, in seasonally adjusted terms, accumulating growth of 19.7% and 10.2% in 2004. The production of construction inputs grew 1.8% in December, in seasonally adjusted month-on-month terms, accumulating growth of 5.7% in the year.

38. According to IBGE, in December industrial production grew 0.6%, month-on-month seasonally adjusted, with a 0.8% increase in manufacturing, and a 0.3% decrease in mining. Industrial production reached a new record level in the month.

39. Analysis of industrial production by activity reveals that the growth in production in December reflected increases in 16 of the 23 activities, and growth in all use categories. In the month, notable growth was registered in petroleum refining and fuel-alcohol production, as well as metal products, food, vehicles, and pharmaceutical products. By categories of use, semi- and non-durable consumer goods production stood out with the highest growth rate in the month and a record production level, confirming recovery in domestic demand.

40. In 2004, industrial production increased 8.3%, with a broad-based expansion that encompassed all use categories and the 13 states included in the survey. Production of capital goods and intermediate goods grew 19.7% and 7.4%, respectively, accompanying the increase in exports and fixed-capital investment. Intermediate goods production growth was below that of the industrial average, due to lower growth in the production of construction inputs (5.7%) and packaging (2.9%), and the 3.8% contraction in the production of fuel and lubricants. Consumer durable goods production increased 21.8%, while semi- and non-durable goods production grew 4.0%, reflecting the expansion of credit and the gradual improvement of labor market conditions.

41. CNI manufacturing data showed increases of 2.0% in industrial sales and 2.5% in hours worked in December, on a month-on-month seasonally adjusted basis. In the year, industrial sales increased 14.3% and hours worked increased 6.2%. Installed capacity utilization reached 83.0% in December, with a seasonally adjusted monthly increase of 0.2%, and 3.1% for the year.

42. The CNI quarterly Industrial Business Confidence Index reached 64.9% in January, up from 63.8% in October, on a scale of 0 to 100, with values above 50 indicating an improving situation or optimistic expectations. According to the same survey, final goods inventories grew relative to October, with levels slightly above companies' projections. Stocks of raw materials and intermediate goods also increased in the fourth quarter of 2004, remaining, however, within projected levels.

43. Inventory data from the quarterly Manufacturing Industry Performance Survey, conducted by FGV, also demonstrated inventory growth at the beginning of this year, relative to that observed in October. Despite the increase, the data suggest normalization relative to the historical series. Furthermore, according to this survey, the level of installed capacity utilization reached 84.5% in January, a decline of 0.7 p.p. in seasonally adjusted terms versus October.

44. Leading indicators for the industrial sector signal some decline in January, compared to December, in seasonally adjusted terms. Particularly notable are the negative monthly variations in automotive production, the number of road tolls paid by trucks, and shipments of corrugated cardboard.

Labor Market

45. According to the IBGE survey in the six main metropolitan regions of the country, the unemployment rate reached 9.6% in December, versus 10.6% in November and 10.9% in December 2003. The decline in unemployment stemmed from the 0.1% monthly increase in the number of employed individuals and the 1.1% decline in the labor force, estimated at 21.6 million individuals.

46. In the industrial sector, according to the CNI indices seasonally adjusted by the Central Bank, employment and real payrolls increased 0.2% and 0.6%, respectively, in December on a month-on-month basis. In 2004, real payroll grew 9.0% and employed workers grew 3.5%.

Credit and Delinquency Rates

47. Non-earmarked credit operations expanded 2.3% in January. Credit operations with individuals increased 3.3%, driven mainly by the expansion in overdrafts, credit cards and personal credits – all instruments typically used to pay expenses at the beginning of the year. Corporate credit with domestic funding expanded by 1.2% in the month, as a result of low seasonal demand and sizeable loan repayments by corporates, mainly in vendor and trade bill discount lines. Corporate credit with external funding increased 2.6%, after consecutive declines since June 2004.

48. The average interest rate on non-earmarked credit increased from 45.0% p.a. in December to 46.8% p.a. in January. The average corporate rate stood at 32.2% p.a., recording a 1.2 p.p. increase in the period. Regarding credit to individuals, the average rate stood at 63.4% p.a., recording a 1.9 p.p. increase in the period.

49. The default rate on non-earmarked credit (considering payments delinquent for 15 days or more) increased 0.4%, reaching 7.3% in January. This seasonal growth was a result of the 0.5% increase in individuals credit arrears, which stood at 12.4%, as well as the 0.2% increase in corporate credit arrears, which reached 3.6%.

50. The default rate in retail sales measured by the ACSP increased to 4.7% in January, the same level as January 2004 and above the 2004 average of 4.2%.

External Environment

51. In the US, despite the deceleration in the fourth quarter, estimates of real GDP growth exceed 4% for 2004 and are expected above 3.5% for 2005. The favorable outlook is also evident in the containment of inflation and the moderate interest rate increases in the long end of the Treasury yield curve. In addition, it has become consensual that the Federal Reserve will maintain its measured pace of interest rate increases during the year.

52. Inflation has remained under control in Europe, despite the recent surge. In the Euro Area, core inflation is slightly below the 2% target and, in the United Kingdom, at the target. In China, annualized consumer price inflation recorded a notable decline to 2.4% in December, from 5.3% in the middle of the year, while GDP growth exceeded expectations, reaching 9.5% in 2004.

53. Prices of agricultural commodities continued to decline, driven by an expected increase in the year's harvest. Regarding oil, although futures prices have moved to levels below the October lows, there are still uncertainties regarding future supply and demand dynamics, which keep prices above US$40 per barrel.

Foreign Trade and Balance of Payments

54. In January, the Brazilian trade balance posted a US$2.2 billion surplus, the highest monthly result ever recorded in the first month of the year. Exports and imports increased 28.3% and 24.8%, respectively, compared to January 2004 daily averages, to reach US$7.4 billion and US$5.3 billion. In the first two weeks of February (seven working days), the trade surplus reached US$1,049 million, with exports and imports growing by 34.0% and 32.4%, respectively, compared to February 2004 daily averages.

55. In the twelve months through January, total external trade, the trade surplus, and exports reached record levels, of US$161.9 billion, US$34.3 billion and US$98.1 billion, respectively. The three categories of export goods reached record twelve-month cumulative levels; of particular note was the US$ 54.3 billion level recorded by manufactured goods exports.

56. International reserves increased US$1.1 billion in January, to a level of US$54.0 billion, while adjusted net reserves stood at US$27.1 billion (IMF concept), recording a US$ 1.8 billion increase compared to the same period of 2004.

Money Market and Open Market Operations

57. After the January Copom meeting, the yield curve shifted upward for maturities up to 2 years and downward for longer maturities. The upward shift was accentuated by the release of the January Copom Minutes, of core inflation rates that were considered high by the market, and by the persistence of 2005 inflation expectations at levels close to 5.7%. On the other hand, the downward shift in the long end of the yield curve was driven by the reduction of the country risk, the BRL appreciation and by inward foreign capital flows. Between January 19 and February 16, the 1-month, 6-month and 1-year interest rates increased by 0.58 p.p., 0.55 p.p., and 0.43 p.p., respectively, while the 2-year and the 3-year rates decreased by 0.04 p.p. and 0.40 p.p., respectively. In the same period, the real interest rate measured by the differential between the one-year nominal interest rate and the 12-month-ahead inflation expectations reached 12.32%.

58. With the objective of accelerating the reduction in the public sector's foreign exchange exposure, on February 2 the Banco Central began to conduct FX swap auctions, in which the Banco Central assumes a long FX position and short interest rate position. The two auctions conducted thus far totaled US$1.4 billion. As a result, the net redemption of FX instruments totaled US$6.3 billion since the beginning of 2005.

59. Between the January and February Copom meetings, the National Treasury raised a total of R$12.9 billion via auctions of LTNs, with maturities in January 2006, April 2006, July 2006 and July 2007. The National Treasury raised an additional R$764 million via three NTN-Fs auctions, with maturities in January 2008 and January 2010. The Treasury also conducted seven auctions of LFTs maturing in 2006 and 2007, four of which were sales and three of which were exchanges. The four sales of LFTs totaled R$12.2 billion, and the three exchanges totaled R$6.4 billion.

60. In its open market operations – aimed at reducing excess liquidity projected for the first quarter – on January 21, February 2 and February 16, the BCB sold LTNs with maturities in July 2005 and purchased LTNs maturing in April 2005. These operations totaled R$1.9 billion. In addition, on January 28, February 4, and February 11, the BCB also sold LTNs maturing in July 2005, totaling R$5.6 billion.

61. The BCB also intervened in the open market on a weekly basis with 3-month fixed-rate repo operations and 1-month floating-rate repo operations, and conducted daily liquidity management operations. The BCB also conducted fourteen fixed-rate overnight repo operations, five of which were overnight borrowings and nine of which were overnight lending. The excess liquidity sterilized from the banking reserves market via operations with tenors

less than 30 days averaged R$13.2 billion, and the amount sterilized via operations with three-month tenors averaged R$42.0 billion.

62. In December, net securitized domestic public debt grew 2.0%, due to an R$5.4 billion net placement and accrued interest. The dollar-linked share in net securitized domestic debt decreased to 8.0% at the end of January from 9.9% on December 31, due to the BRL appreciation and the net redemption of R$13.3 billion in FX instruments.