BANCO CENTRAL DO BRASIL

Minutes of the 114th Meeting of the Monetary Policy Committee (Copom)

Date: November 22nd, from 4:55PM to 7:15PM, and November 23rd, from 4:30PM to 7:30PM
Place: BCB Headquarters meeting rooms - 8th floor on November 22nd and 20th floor on November 23rd – 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 November 22nd)
Altamir Lopes – Economic Department
Ivan Luís Gonçalves de Oliveira Lima – Open Market Operations Department
José Antônio Marciano – Department of Banking Operations and Payments System
José Pedro Ramos Fachada Martins da Silva – Investor Relations Group
Marcelo Kfoury Muinhos – Research Department (also present on November 23rd)
Renato Jansson Rosek – International Reserves Management Department

Other participants (present on November 22nd)
Alexandre Pinheiro de Moraes Rego – Special Advisor to the Governor
Alexandre Pundek Rocha – Advisor to the Board
Carlos Hamilton Vasconcelos Araújo – Deputy Head of the Research Department
Flávio Pinheiro de Melo – Advisor to the Board
Jocimar Nastari – Press Secretary

The members of the Monetary Policy Committee analyzed the recent performance of and prospects for the Brazilian and international economies under the monetary policy framework, which is designed to comply with the inflation targets established by the government.

Recent Economic Developments

1. IPCA monthly inflation reached 0.75% in October, 0.40 percentage points above the September result. As was the case in September, the acceleration in inflation was primarily due to the rise in regulated prices (particularly transportation) and the prices of food and beverages (up 0.27% in October, versus average deflation of 0.61% in the June-September period). With the rise in food and beverage prices, market prices rose 0.38%. Both the rise in fuel prices and the reversal of the downward trend in food prices were expected, but the magnitude of the changes surprised on the upside. The divergence between the October IPCA and the median of market expectations on the day preceding publication of the result was the largest in two years. IPCA inflation is expected to ease in November, with the dissipation of the impact from the fuel price increase.

2. Core inflation has accelerated in recent months, after reaching record lows in August. Core inflation remains at levels below those of the beginning of the year, but above levels consistent with the inflation target path. In the last five months, core inflation by exclusion, smoothed trimmed means and non-smoothed trimmed means core inflation rose, on average, 0.33%, 0.48%, and 0.34%, respectively, versus 0.64%, 0.64%, 0.53% in the first five months of the year. Core inflation by exclusion of household food items and regulated prices rose 0.38% in

October, versus 0.36% in June and 0.37% in July, when IPCA inflation was –0.02% and 0.25%, respectively. This behavior suggests that, in recent months, IPCA inflation has been dominated by the behavior of regulated and food prices. In October, twelve-month trailing core inflation continued to trend downward (as has been the case since May 2005).

3. After five months of contraction, the General Price Index (IGP-DI) rose 0.63% in October, but remains near levels registered at the start of the year. The result was primarily due to the 0.79% increase in the Wholesale Price Index (IPA-DI), which, in turn, was driven by the 0.32% rise in consumer goods prices (particularly non-durables) and the 1.02% increase in capital goods prices. The IGP-DI rose just 0.82% in the year through October and 2.17% on a twelve-month trailing basis, while the IPA-DI fell 1.07% in the year-to-date and rose only 0.40% on a twelve-month trailing basis.

4. The increase in wholesale prices in October was due to the reversal of the downward trend in agricultural prices and a modest acceleration in industrial prices. Industrial and agricultural price increases made a similar contribution to the overall wholesale price result, rising 0.78% and 0.80%, respectively. Twelve-month trailing wholesale agricultural price inflation was –6.64%, while wholesale industrial price inflation rose only 2.82% (the smallest increase since January 2004). Wholesale price inflation therefore remains significantly below IPCA inflation. IGP-10 data for November suggest an acceleration of wholesale agricultural price inflation and a deceleration of industrial price inflation. In general, however, there are signs of a consistent accommodation in wholesale price inflation, with potentially positive spillovers for consumer prices in the coming quarters. As emphasized in prior Copom Minutes, the intensity and continuity of this pass-through in the coming months will depend on demand conditions and price-setters' expectations for the future inflation path.

5. Industrial production fell a seasonally adjusted 2% in September, according to data from the Brazilian Institute of Geography and Statistics (IBGE). Despite the September downturn, industrial production rose 3.8% in 2005 and 4.4% in the twelve months through September. Industrial production has been uneven since June but, in general, has remained at elevated levels (even with the drop in September). The three-month moving average series also posted a decline in September. Leading and coincident indicators suggest a likely decline in activity in October, in both the monthly seasonally adjusted series and the three-month moving average series.

6. The use categories of industrial production registered divergent performance in September. Capital goods production rose 1.1%, while intermediate goods production declined 0.4% and consumer goods production fell 4.5% (driven mainly by durable goods). All three categories declined on a three-month moving average basis. Similar to August, consumer durables underperformed semi- and non-durables. Non-durables production rose 5.6% in 2005, and 5.2% on a twelve-month trailing basis – a path that reflects the relatively stronger importance of income in sustaining growth. Despite the negative performance in September, consumer durable production rose 13.8% in 2005 and 14.1% in the twelve months through September, well above the average for overall industrial production.

7. The third quarter result for industrial production, dropping a seasonally adjusted 0.7% and rising 1.5% over the third quarter of 2004, suggests a deceleration in GDP growth in the period. It bears emphasis that this performance follows a quarter of strong expansion in economic activity. In addition, industrial indicators did not evolve in line with sales, employment, and investment, suggesting the role of inventory adjustment in shaping recent industrial sector results. Therefore, industrial activity is expected to resume growth in the coming months, with positive implications for economic activity.

8. The labor market remained firm in September, in line with the more stable macroeconomic environment and the historically elevated levels of economic activity. The unemployment rate measured by the IBGE was 9.6% in September. Compared to September 2004, unemployment was 1.3 p.p. lower and the number of employed individuals was 2.3% higher. After rising for three consecutive months, the purchasing power of workers remained stable, such that the value estimated for September was 2% above that of September 2004, and 4.7% above that of May of this year, reflecting, in part, the positive effect of lower inflation on real incomes. Manufacturing employment rose 5.2% in the year through September and 5.6% over twelve months, according to National Industry Confederation (CNI) data. Real manufacturing payrolls rose 8.8% in the year and 9.2% in the twelve months through September, underscoring that the increase in jobs is being accompanied by an improvement in the

quality of industrial employment. Formal employment, measured by the Ministry of Labor and Employment (MTE), also continued to rise. With the creation of 118,175 jobs in October, year-to-date formal job creation exceeded 1.5 million positions.

9. Seasonally adjusted data from the IBGE showed retail sales were stable in September. Items whose sales are more income- and employment-sensitive performed well, and counterbalanced the negative performance of items whose sales are more credit-sensitive – a reversal of the situation that had prevailed in prior months. Three-month moving average retail sales were also stable, after five months of expansion, and remained at record levels. Retail sales rose 5% in the year through September, compared to the same period of 2004. This performance largely reflects favorable labor market developments and the ongoing credit expansion. Preliminary indicators for October suggest that sales will continue to rise. The favorable outlook for retail sales in the coming months is based on labor market performance and its effects on payroll growth, the credit expansion, and the recovery in consumer confidence.

10. Installed capacity utilization in the manufacturing industry, as measured by the CNI and seasonally adjusted by the BCB, declined in September. Recent data on production and capital goods absorption suggest that capacity utilization could be reflecting, in part, the maturation of investments realized in recent years. As emphasized in prior Copom Minutes, the inflation path remains directly related to current and prospective developments with regard to the expansion of supply to adequately meet demand conditions. With regard to investment, capital goods absorption rose 4.6% in the year through September, driven by the increase in capital goods imports (up 29.6% in volume terms in the year through September, versus the same period of 2004). While there is stronger evidence of a recovery in investment, the performance of aggregate supply in the coming quarters remains a key point of concern with regard to future inflation dynamics.

11. Recent data confirm that external trade performance in 2005 will outpace that of last year. In October, twelve-month cumulative exports reached US$114 billion, driven primarily by the growth in manufactured exports. The twelve-month cumulative trade balance reached US$41.9 billion, with imports totaling US$72 billion. In value terms, exports rose 24.1% over the preceding twelve months, while imports rose 21.5%. Capital goods imports rose 26.3% in October compared to the same month of 2004, accumulating a 29% expansion both in 2005 and over the past twelve months. Over the course of 2005, the relative participation of capital goods imports in total imports has risen, to the detriment of raw materials and intermediate goods. The favorable performance of the trade accounts in the twelve months through October brought the current account surplus to US$13.6 billion, or 1.8% of GDP. While the contribution of external demand to the ongoing economic expansion has diminished somewhat in recent months, it remains important and above that expected at the start of the year.

12. International financial markets remained characterized by relatively high volatility; however, there was an improvement in the scenario considered by the Copom at its October meeting. In the last week of September, Brazilian country risk fell close to the historic lows reached in 1997, retraced somewhat, and then resumed a persistent decline since mid-October, despite ongoing concerns about the United States' inflation outlook. In the short term, liquidity conditions and financial market stability remain tied to macroeconomic conditions in the U.S., and to the Fed's potential monetary policy response. In general, it appears that the Fed will likely continue to raise interest rates at a measured pace. In the Euro zone, after two and a half years of holding interest rates steady at a low level by historical standards, the European Central Bank has indicated that, if necessary, it can take a tightening stance. Despite this outlook, about which there is a significant degree of uncertainty, the Copom continues to attribute a low probability to a significant deterioration in international financial market conditions.

13. International oil prices, after reaching record highs in August, fell sharply and today are at levels close to those of the beginning of the year. Despite the considerable drop, however, prices remain at elevated levels. Given the increase in fuel prices implemented in mid-September, the Copom continues to work with a domestic fuel price scenario in which there is no further change to domestic prices in 2005. Nevertheless, due to the uncertainties about international oil prices, they remain a risk factor for the future inflation path, because these prices can be transmitted to the domestic economy via their effects on oil-intensive products, as well as economic agents' expectations.

Assessment of Inflation Trends

14. 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 projection for gasoline price adjustments in 2005 was increased to 7.6% from 7.5%. The projection for bottled gas prices was increased to –0.9% from –1.2%;

b) The projection for fixed line telephone rate adjustments in 2005 remained unchanged at 6.7%, while the projection for household electricity adjustments was increased to 7.8% from 7.6%;

c) For all regulated prices, which represented a total weight of 30.1% in the October IPCA, the Copom increased its projection for 2005 adjustments to 8.2% from 7.8%;

d) The projection for regulated price adjustments in 2006 was reduced to 4.9% from 5.1%. There was an increase in the number of items for which price changes were individually projected, contributing to greater precision in the 2006 projections. For the remaining 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 Vector Autoregressive model based on the Selic and swap rates on the eve of the Copom meeting, increases from an average of –113 basis points in the last quarter of 2005, to 28 basis points in the last quarter of 2006.

15. 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 October meeting were maintained.

16. Since the October Copom meeting, median IPCA inflation expectations for 2005, compiled by the Investor Relations Group at the BCB, rose from 5.24% to 5.52%. The increase is mainly due to the fact that the survey on the eve of the October meeting had underestimated October inflation (actual 0.75%, versus expectations of 0.45%). For 2006, expectations have fallen slightly, to 4.55% from 4.60%, closer to the 4.50% target established by the National Monetary Council (CMN) for the year. As mentioned in prior Copom Minutes, these developments suggest that the recent monetary policy stance has both contained short-term inflationary pressures and contributed to the consolidation of a more favorable longer-term macroeconomic scenario.

17. The 2005 inflation forecast under the benchmark scenario – which assumes the maintenance of the Selic rate at 19% p.a. and the exchange rate at R$/US$ 2.20 during the forecast period – is above the 5.1% inflation objective for the year, due to the higher than expected October inflation result. The forecasts based on the market scenario – which incorporates the consensus exchange rate and Selic rate trajectories on the eve of the Copom meeting – increased relative to the October Copom meeting and are above the 5.1% inflation objective. For 2006, the benchmark forecast remained below the 4.5% target established by the CMN, but increased relative to October, as the inertial effect of the uptick in October inflation and the effect of the reduction in the interest rates outweighed the impacts of exchange rate appreciation and reduced projections for regulated price inflation. The forecast under the market scenario increased (but to a lesser degree) for the same reasons, remaining above the 4.5% inflation target.

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

Monetary Policy Decision

19. The Copom reaffirms the view expressed in prior Minutes, that actual and expected inflation results demonstrate that the monetary tightening cycle begun in September 2004 has contained short-term inflationary pressures and consolidated a more favorable long-term macroeconomic environment. Economic activity should recover in the coming months and continue to expand at a pace consistent with supply conditions, such that it will not introduce significant inflationary pressures. In addition, despite continued volatility in international financial markets and the persistence of high oil prices, the external environment remains favorable, particularly with regard to external financing conditions for the country. Therefore, a benign inflation environment continues to evolve. As in the October meeting, the Committee emphasizes that the main challenge for monetary policy is to ensure the consolidation of these favorable developments.

20. The Copom considers that the increase in short-term inflation is being driven largely by the domestic fuel price adjustment implemented in mid-September, as well as by the partial reversal of the favorable food price dynamics observed in recent months and envisaged in recent Copom Minutes. The effects of these factors have not been fully reflected and will therefore likely affect inflation measures to be released in the coming weeks. Since these are transitory pressures, it is expected that they will ease over time without necessarily contaminating longer time horizons. Nevertheless, while the uptick in inflation was broadly expected, the magnitude significantly exceeded expectations prevailing at the time of the September Copom meeting. The Committee will continue to closely monitor the evolution of core and headline inflation in the coming months, distinguishing between one-off and more generalized or persistent price adjustments and adapting its monetary stance to the circumstances, in order to ensure that the gains achieved thus far in reducing inflation are made permanent.

21. The uninterrupted convergence of inflation to the target path and the resulting consolidation of a more lasting macroeconomic stability will contribute to the progressive reduction in perceived macroeconomic risk, a process already underway for several years in Brazil. The scope for a reduction in real interest rates in the future will naturally follow. The Copom considers that its cautious monetary policy stance has been critical to increasing the probability of inflation convergence to the target path. For this to materialize, however, it is important that forward-looking inflation indicators remain compatible with the more recent benign inflation outlook. In this way, the gradual easing of the monetary stance will not compromise the important achievements made in lowering inflation and preserving economic growth with job creation and rising real incomes.

22. The Copom therefore unanimously decided to continue the monetary easing process begun in the September 2005 meeting, reducing the Selic target rate to 18.50% p.a., without bias.

23. At the conclusion of the meeting, it was announced that the Copom would reconvene on December 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

Inflation

24. The IPCA rose 0.75% in October, compared to 0.35% in September, accumulating increases of 4.73% and 6.36% in the year and in the last twelve months, respectively. The higher monthly change was primarily due to the increase in regulated prices, which rose 1.62%, contributing 0.49 p.p. to the monthly result. Gasoline and fuel alcohol prices rose 4.17% and 10.48%, respectively, contributing a combined 0.28 p.p. to the monthly change. Market prices rose 0.38%, above the 0.1% increase in September, reflecting, mainly, the reversal of the downward trend in food prices.

25. The IGP-DI rose 0.63% in October, after contracting for five consecutive months. IGP-DI inflation reached 0.82% in the year-to-date and 2.17% in the last twelve months. The IPC-Br component rose 0.42% in the month, due to the higher rates observed in 5 out of the 7 sub-index components, mainly the food group. The National Index of Civil Construction (INCC) increased 0.19%, compared to 0.24% in September. The IPA-DI, the sub-index with the largest weight in the IGP-DI, rose 0.79% in October, after five consecutive monthly declines, with deflation of 1.07% in the year and an increase of 0.4% in twelve months. Wholesale price behavior in October was due to the reversal in the downward trend of agricultural prices and the slight increase in industrial prices. The agricultural IPA rose 0.8% in the month, mainly due to the increase in animal and animal by-product prices, especially bovines, with an 8.1% increase due to the inter-harvest period. Industrial IPA rose to 0.78% in October from 0.67% in September, reflecting primarily the performance of chemicals, wood and furniture prices. Other important manufacturing segments, such as food and metal products, registered declines in prices. All components of the IPA-DI according to processing stage posted increases. Intermediate goods prices rose 1.03%, compared to 0.91% in September. Final goods and raw material prices increased 0.42% and 0.8%, respectively, in October from –0.57% and –2.23% in September.

26. All IPCA core inflation measures rose in October, compared to the prior month. Smoothed trimmed means core inflation rose to 0.58% (0.51% in September), for a twelve-month trailing increase of 7.13%. Non-smoothed trimmed means core inflation increased to 0.50% in October from 0.34% in September, bringing twelve-month trailing inflation to 5.72%. Core inflation calculated by the exclusion of household food and regulated prices reached 0.38%, compared to 0.30% in the prior month, for twelve-month trailing inflation of 6.25%.

27. The IPCA diffusion index (measuring the number of items in the IPCA registering price increases) was 59.2% in October, confirming the interruption in the downward trend observed in September, after four consecutive months of declines.

28. The IPC-Br core inflation, calculated by the FGV under the symmetric trimmed means method, reached 0.37% in October, compared to 0.29% in September. Year-to-date through October, IPC-Br inflation was 4.37%, with a trailing twelve-month increase of 5.30%.

29. Consumer price inflation is expected to decline in November, as regulated price pressures cool (principally due to fuel price adjustments) and outweigh the acceleration in food price inflation (evident since the second half of October).

Economic Activity

30. According to the IBGE's survey, seasonally adjusted retail sales were stable in September, compared to the previous month. By categories, only fabric, clothing and shoes sales increased in the month (4.4%), while hypermarkets, supermarkets, food products, beverages and tobacco sales, which have a higher weight in the general index, remained stable. Sales in the other segments fell in the month, primarily furniture and appliance sales, which dropped 2.6%. Retail sales have risen 5.0% year-to-date and 6.1% on a cumulative twelve-month basis.

31. Automotive sales also declined. Data from the Federação Nacional de Distribuição de Veículos Automotores (Fenabrave) showed a 1.4% decline in sales in September, and 4.1% in October, on a month-on-month seasonally adjusted basis. Vehicles sold rose 8.8% and 8.2%, respectively, in the year through October compared to the same period of 2004, and in the twelve months through October.

32. Investment indicators expanded in September. Domestic production of capital goods and construction inputs increased 1.1% and 0.3%, respectively, on a month-on-month seasonally adjusted basis. In the year through September, compared to the same period of 2004, these indicators increased 3.3% and 0.7%, respectively. According to the Fundação Centro de Estudos do Comércio Exterior (Funcex), the volume of capital goods imports rose 2.6% in September, on a month-on-month seasonally adjusted basis, and 29.6% in the year through September. Medium- and long- term loans disbursed by the Banco Nacional de Desenvolvimento Econômico (BNDES), reached R$31.2 billion in the year through September, exceeding by 12.3% those disbursed in the same period of 2004.

33. According to the IBGE's Monthly Industrial Survey (PIM), industrial production decreased a month-on-month seasonally adjusted 2% in September. This result was due to the 2.4% drop in manufacturing output. Mining increased 0.6%. In the year through September, industrial production rose 3.8%, due to the 3.4% increase in manufacturing and the 10.2% increase in mining.

34. Seasonally adjusted data for industrial production showed that 15 of the 23 sectors surveyed decreased in September, with tobacco, medicine, machinery and equipment, oil refining, alcohol production and automotive vehicles as the main drivers of the result. Except for capital goods production, which expanded 1.1%, all other use categories declined. Consumer goods production decreased 4.5%, due to the declines of 8.9% in durable consumer goods production and of 3.4% in semi- and non-durable consumer goods production. Intermediate goods production, with the largest weight in the industrial production index, fell 0.4%, for a 1.4% cumulative increase in the year through September.

35. CNI manufacturing data showed a decline of 0.4% in real sales and of 0.9% in hours worked in September, respectively, on a month-on-month seasonally adjusted basis. In the year through September, these indicators increased 2.9% and 5.7%, respectively. Installed capacity utilization reached a seasonally adjusted 79.9% in September, down 2 p.p. relative to August. Without seasonal adjustments, installed capacity utilization reached 80.7%, 3.4% below that posted in September 2004.

36. Leading indicators point to a fall in industrial activity in October. Data related to automobile production and oil refining, corrugated cardboard shipment and highway tolls confirm this trend.

Surveys and Expectations

37. The Fecomercio-SP survey showed a month-on-month increase in the Consumer Confidence Index in November, due to the 15.6% increase in current economic conditions and the 4% improvement in consumer expectations.

38. The CNI Quarterly Business Sentiment Survey pointed out improved confidence in October. The Business Confidence Index reached 52.7% in October, above the 50.7% level registered in the July survey. The result remained above 50, in a range between 0 and 100, indicating strengthening the business confidence.

39. According to the FGV Industrial Survey, published in October, industrial production should continue to grow although at a slower pace than observed last year. However, regarding the current situation, global demand and inventory levels were viewed similarly to the last survey, after two consecutive quarters of deterioration prospects. Forecasts for the coming months highlighted concerns regarding external demand, but also demonstrated positive expectations for an ongoing expansion of domestic demand and higher levels of employment.

Labor Market

40. According to the Ministry of Labor and Employment, formal employment increased 0.4% in October (month-on-month, seasonally adjusted). With the net creation of 1.3 million jobs, the overall index rose 5.0% in comparison to October 2004.

41. According to the IBGE survey in the six main metropolitan regions of the country, the unemployment rate increased to 9.6% of the labor force in September, after remaining stable at 9.4% for three consecutive months. This level is 1.3 p.p. below that of September 2004. The number of employed individuals, estimated at 20.1 million, increased 0.9%, while the number of unemployed workers increased 3.6%. The labor force reached 22.2 million people, a monthly increase of 1.1%. Real average earnings of employed individuals remained stable at R$974.90, compared to August, and rose 2.0% in comparison to September 2004.

42. According to the BCB's seasonal adjustment of the CNI indices, real industrial payrolls rose 0.2% in September, on a monthly basis, while industrial employment decreased 0.1%. In the year through September, these indicators rose 8.8% and 5.2%, respectively.

Credit and Delinquency Rates

43. Non-earmarked credit grew 2.3% in October (month-on-month). Credit operations with individuals rose 2.4%, still driven by the expansion of payroll-deducted loans. Corporate credit with domestic funding increased 1.5%, while externally funded operations increased 4.4%.

44. The average interest rate on non-earmarked credit increased 0.1 p.p. in October, reaching 48.2% p.a. The average rate on personal credit operations declined 0.4 p.p. to 61.7% p.a., while the average rate on corporate credit increased 0.1 p.p., to 33.4% p.a.

45. Delinquency rates for non-earmarked credit (loans in arrears for more than ninety days) remained unchanged at 4.0% in October. Delinquency rates for credit operations with individuals increased to 6.5% in October, from 6.4% in September. Delinquencies in corporate credit operations decreased 0.1 p.p., to 1.9%.

46. Net delinquency rates for retail credit, measured by the ACSP, decreased to 4.5% in October, from 4.9% in September, due to the declines of 2.2% and 1.1% in the number of cancelled registers and in the number of new registers in the month, respectively.

External Environment

47. Following a period in which long-term international interest rates rose due to mounting inflationary pressures, mainly in the U.S., international interest rates have stabilized. In the U.S., the recent behavior of interest rates reflects the dampening of inflation expectations, due to the release of the core CPI for October in line with expectations, confirming the limited pass-through of rising energy costs.

48. Despite the initially favorable reading and the reduced uncertainty regarding the pace of U.S. monetary tightening, expectations are that, in the short term, core inflation measures in the U.S. will remain above those observed in the six months through September.

49. In other developed countries, with lower growth rates, increases in price indices have been lower than that observed in the U.S. Nevertheless, monetary authorities remain concerned about inflationary pressures and, if it proves necessary, will be prepared to adjust the monetary stance.

Foreign trade and international reserves

50. Results for the external trade accounts in October confirmed the ongoing expansion, with both twelve-month cumulative and year-to-date results exceeding record highs. In October, the trade surplus reached a record monthly high of US$ 3.7 billion, bringing the year-to-date surplus to US$36.4 billion and the twelve-month cumulative surplus to US$41.9 billion. For the same periods, total external trade reached US$ 16.1 billion,

US$156.9 billion and US$ 186.0 billion, respectively. In the first twelve working days of November, the trade balance reached US$ 2.8 billion.

51. Exports totaled US$ 9.9 billion in October, recording average daily levels of US$495 million, a 12% increase over October 2004. All export categories registered records for October, due to the increase in both export prices and volumes. Exports continue to be diversified, with significant increases in sales to new markets.

52. Imports totaled US$6.2 billion in October, a 6.5% increase in daily average terms, compared to the same month of 2004. Except for fuel and lubricants, which fell 11.9%, all import categories expanded in the month. Of note were increases of 38.2% and 26.5% in consumer and capital goods imports, respectively. In the year through October, there was a 28.9% increase in capital goods imports, 22.3% for consumer goods, 15.8% for fuel and lubricants and 14.1% for raw material and intermediate goods, all measured in daily averages compared to the same period last year.

53. At the end of October, international reserves totaled US$60.2 billion and net adjusted reserves totaled US$46.5 billion, an increase of US$3.2 billion and US$3.5 billion, respectively, relative to end-September.

Money Market and Open Market Operations

54. In the period following the October Copom meeting, the yield curve shifted downward across all tenors, and particularly for tenors in the 1-3 year range, due to: the release of weaker-than-expected September industrial production data; the favorable inflation outlook; currency appreciation; and the increase in foreign direct investment flows. Between October 19 and November 23, one-, three-, and six-month and one-, two-, three-year interest rates fell 0.88 p.p., 0.96 p.p. 1.02 p.p., 0.94 p.p., 0.59 p.p., and 0.31 p.p., respectively. Real interest rates measured by the differential between the one-year forward nominal interest rate and smoothed twelve-month ahead inflation expectations decreased to 11.78% on November 23 from 12.64% on October 19.

55. From October 20 to November 23, the net redemption of FX instruments, including interest payments, totaled US$1.1 billion, and US$16.5 billion in the year through November. With the objective of reducing the public sector's foreign exchange exposure, the BCB resumed FX swap auctions, in which the BCB assumes a long FX position and short interest rate position. The auctions conducted on November 18 and 22 totaled US$905.7 million.

56. Since the October meeting, the National Treasury raised a total of R$21.6 billion via fixed-rate securities issuance: R$21.2 billion via issuance of LTNs maturing in 2006, 2007, and 2008; and R$0.4 billion via issuance of NTN-Fs maturing in 2010 and 2012. Issuance of floating-rate LFTs, with maturities in 2009 and 2010, totaled R$1.8 billion, while the issuance of inflation-linked NTN-Bs, maturing in 2007, 2008, 2009, 2015, 2024 and 2045, totaled R$2.6 billion.

57. In its open market operations, the BCB conducted six three- and five-month fixed rate repo operations, as well as shorter-term repo operations (eleven of which were overnight lendings, and five of which were overnight borrowings). The BCB also conducted daily liquidity management operations. The excess liquidity sterilized from the banking reserves market via operations with tenors of three and five months averaged R$48.4 billion. Operations with tenors less than thirty days averaged R$1.1 billion.

58. Aimed at reducing excess liquidity projected for the first quarter of 2006, the BCB sold from its portfolio in five auctions, LTNs maturing in April 2006, and purchased LTNs, maturing in January 2006. These operations totaled R$6.9 billion.

59. In October, net securitized public debt stood at R$937 billion, a 0.4% increase compared to the previous month. Net redemptions totaling R$6.9 billion partially offset accrued interest. Due to the sizeable LTN maturities at the beginning of the month, the share of fixed-rate debt fell to 24.5%, from 25.8% at the end of September.