BANCO CENTRAL DO BRASIL

Minutes of the 99th Meeting of the Monetary Policy Committee (Copom)

Date: August 17th, from 4:45PM to 7:00PM, and August 18th, from 3:45PM to 6:25PM
Place: BCB's Headquarters meeting room of the 8th floor (on August 17th) and 20th floor (on August 18th) – 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
Sérgio Darcy da Silva Alves

Department Heads (present on August 17th)
Altamir Lopes – Economic Department
Daso Maranhão Coimbra – International Reserves 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 August 18th)
Sérgio Goldenstein – Open Market Operations Department

Other participants (present on August 17th)
Eduardo Fernandes – Advisor to the Board
João Batista do 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 July, the Broad National Consumer Price Index (IPCA) rose 0.91%, up from 0.71% in June and 0.51% in May. The IPCA accumulates a 4.42% change in the first seven months of the year, and a 6.81% variation in twelve months. The IPCA rise in July can be ascribed to the increase in specific regulated prices. Some important components of the IPCA in fact decelerated, as in the case of food.

2. The General Price Index (IGP-DI) rose 1.14% in July, compared to 1.29% in June, thus accumulating an 8.11% change in the first seven months of 2004. The deceleration of the IGP-DI in July was due to lower pressures at both the wholesale and the consumer levels. The Wholesale Price Index (IPA-DI), which accounts for 60% of the General Index, rose by 1.35%, down from 1.57% in June. The Consumer Price Index – Brazil (IPC-Br) rose by 0.59%, compared to 0.78% in the previous month. Finally, the National Index of Civil Construction (INCC), with a 10% weight in the IGP-DI, rose by 1.12%, up from 0.70% in June.

3. The main individual contributions to the July IPCA inflation was electricity (0.17 p.p.) and fixed telephone tariffs (0.16 p.p.). Auto-fuel contributed with 0.12 p.p., partially reflecting the 10.8%

gasoline price increase to distributors on June 15, as well as the rise in alcohol-based fuel prices. Food prices rose 0.67% (0.72% in June), accounting for 0.15 p.p. of the monthly IPCA change. The inter-harvest period was responsible for specific pressures on the prices of milk and dairy products. Potatoes, sugar, black beans, wheat flour and bread also suffered price increases, while soy oil, vegetables, *carioca* beans and rice prices fell.

4. In July, market prices increased 0.52% (0.58% in June), accounting for 0.37 p.p. of the monthly IPCA variation, while the increase of 1.89% in regulated prices was responsible for the remaining 0.54 p.p. The deceleration of market prices inflation was disseminated in both food and non-food prices. In fact, 50.3% of the goods and services included in the IPCA basket increased at a lower monthly rate in July, compared with 43.2% in June. Regarding regulated prices, besides gasoline, alcohol-fuel, electricity and fixed telephone prices, road tolls and urban and interstate buses fares also contributed to the rise.

5. The IPA-DI deceleration in July reflected lower rises in both agricultural and industrial prices. The Agriculture-IPA changed 0.26% in July (0.52% in June). This reduction was a consequence of the decrease in prices of cereals and export-oriented crops, as well as lower pressures from the prices of animals and by-products, vegetables, fruit and vegetal oils. In the same period, the industry-IPA decreased to 1.76% from 1.97%, mainly due to the deceleration of chemical prices (to 2.96% from 5.37% in June). Other segments that registered lower changes in July, compared to June, include mechanical, electrical material, leather, personal care, and tobacco.

6. In July, the IPCA core inflation, measured by excluding household food items and regulated prices, registered a 0.47% variation (0.53% in June), accumulating 5.02% in the year and 7.27% in 12 months. The smoothed trimmed-mean core decreased to 0.55% from 0.60% in June, totaling 4.36% in the year and 8.05% in the last 12 months. Without the smoothing procedure for pre-selected items, the core recorded 0.59% (0.48% in June), 3.56% in the year and 5.76% in twelve months.

7. The IPC-Br core, calculated by the Getúlio Vargas Foundation (FGV) under the symmetric trimmed-mean method, stood at 0.36% in July (0.50% in June), accumulating 6.21% in the last twelve months.

8. In August, consumer-prices inflation should fall, mainly due to lower regulated-prices inflation. Regarding wholesale inflation, a deceleration is also expected as anticipated by the results of the IGP-10 and the first ten-day period of the IGP-M, notwithstanding the continuity of specific adjustments due to increases in international commodity prices.

Assessment of Inflation Trends

9. The identified shocks and their impacts were reassessed according to new available information. The scenario considered in the simulations assumes the following hypotheses:

   a. The Copom's projection for the increases of oil and of cooking gas prices in 2004 were maintained at 9.5% and 6.8%, respectively;

   b. The projections for the readjustment of household electricity prices and fixed telephone tariffs in 2004 were also unchanged at 11.6% and 12.8%, respectively;

   c. Regarding all regulated prices, with a total weight of 28.7% in the July IPCA, the Copom maintained the projection of an 8.3% average rise for 2004;

   d. The projection for the readjustment of all regulated prices for 2005, following the model of endogenous determination, which takes into account seasonal components, the exchange rate, market prices inflation and the IGP-DI change, was increased to 6.3% from 6.0%;

e. The projection for the 6-month spread over the Over-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, decreases from 88 basis points in the third quarter of 2004 to 61 basis points in the fourth quarter of 2005.

10. Regarding fiscal policy, it is assumed that the consolidated public sector primary surplus target of 4.25% of the GDP for 2004 and the following two years will be achieved. The related assumptions considered in the previous Copom meeting were maintained.

11. Considering the benchmark scenario hypotheses, including the maintenance of the Over-Selic rate at 16.0% p.a. and of the exchange rate close to the level prevailing on the eve of the Copom meeting (R$3.00), the IPCA inflation was projected above the 5.5% target for 2004 and above the 4.5% target for 2005. According to the market scenario, which takes into consideration the consensus Over-Selic rate and the exchange rate as surveyed by the BCB's Investor Relations Group – Gerin on the eve of the Copom meeting, inflation is projected above the targets for both 2004 and 2005.

Monetary Policy Decision

12. In July, the IPCA inflation acceleration was strongly influenced by the 1.89% increase in regulated prices. Market prices inflation remained high (0.52%), albeit slightly lower than in June (0.58%). Regulated prices have accumulated a 4.69% increase in the first seven months of 2004, compared to 4.42% in the IPCA, thus reverting the trend observed up to June, when market prices changes systemically surpassed regulated prices variations. As to the wholesale inflation, there has been some deceleration since June, both in the agricultural and industrial segments, even though it has remained high. The IPA-DI increased 1.35%, accumulating 9.84% in the year.

13. The smoothed trimmed-mean core IPCA stood at 0.55% in July. Although this has been the lowest rate since February 2004, it is incompatible with the medium-term inflation targets. The non-smoothed trimmed-mean core posted 0.59%, for the first time since February 2003above the smoothed trimmed-mean core. In the first seven months of the year, the smoothed and non-smoothed trimmed-mean cores registered 4.36% and 3.56%, respectively, equivalent to annualized figures of 7.59% and 6.19%. Core inflation excluding household food items and regulated prices stood at 0.47% in July, the lowest rate in the year. However, the core by exclusion accumulated in the January-July period (5.01%) is well above the headline inflation.

14. Economic activity has continued to grow vigorously, as proved by different production, sales and employment indicators. According to the Brazilian Institute of Geography and Statistics – IBGE, industrial output grew 7.7% in the first half of the year, compared to the same period of 2003. In monthly terms, industrial production grew 0.5% in June (seasonally adjusted), reaching a new historical high, approximately 12% above the recent trough observed in June 2003. Several leading and coincident indicators suggest that the industrial rebound gained momentum in July, as signaled by the shipments of packaging paper (up 3.4% compared to June, s.a.) and by the production of vehicles (up 5.2%, same comparison basis).

15. According to the National Industry Confederation – CNI, industrial sales rose by 16.8% in the first half of the year, compared to the same period of 2003. In June, industrial sales increased 1.2%, s.a., compared to the previous historical high in May. The CNI data have continued to point out a higher growth pace for industrial sales than for industrial production.

16. According to the IBGE, retail sales have also expanded, not only in nominal terms (up 10.92% in the first half of the year, compared to the same period of 2003) but also in volume (up 9.33%).

These are the highest growth rates for retail sales since 2001. According to the National Association of Autovehicles Manufacturers – Anfavea, domestic car sales increased 3.2% in July, month-on-month seasonally adjusted, and 21.4% in the January-July period, compared to the same period of 2003.

17. The labor market has benefited from the activity rebound. According to the IBGE, the unemployment rate fell in June for the second consecutive month, to 11.7%. Data from CNI and from the Federation of Industries of São Paulo State – Fiesp confirm a continuous expansion in the level of employment and in the real payroll in the manufacturing industry. According to CNI, real payroll grew 7.8% in the first half of the year. The level of formal employment, according to the Ministry of Labor and Employment, surged 0.5% in June, with more than 1 million jobs created in the first half of the year.

18. As a natural consequence of what has been occurring in the labor market, the recovery process disseminated, reaching not only the credit-sensitive and exports-oriented activities, but also activities dependent on labor market conditions. According to the IBGE, sales in supermarkets, hypermarkets, food, beverages and tobacco rose by 2.8% in the second quarter (seasonally adjusted) and accumulated a 5.4% expansion in the first half of the year, compared to the same period of 2003. In the same comparison basis, sales of fabrics, clothing and shoes increased 3.1% and 7.3%, respectively. Non-durable goods output has also been reacting to the increase in demand and grew 2.1% in the first half of the year, compared to the same period of 2003. In other words, different indicators demonstrate that the activity level is now less supported by the monetary stimulus that triggered the recovery and more dependent on the labor market, as well as on gains in real earnings ensured by the reduction of inflation.

19. Meanwhile, the sectors more sensitive to credit conditions, that have led the economic rebound, have not yet shown any accommodation in the growth pace. According to the IBGE, furniture and appliances sales increased 9.4% in the second quarter (quarter-on-quarter, s.a.), following a 7.2% expansion in the first quarter of the year. Cars and autoparts sales rose by 6.3% against –0.3% in the same periods. The same trend is noticed for durable consumer goods, whose growth rate increased to 7.2% in the second quarter of this year.

20. The quarterly FGV industrial survey reported a capacity utilization of 84.1% in July, s.a., close to the 85.2% historical peak reached in the first quarter of 1995. The level of idle capacity varied heterogeneously among the sectors. From July 2003 to July 2004, capital goods industry increased its capacity utilization to 82.0% from 71.6%, approaching its historical peak of 84.7%. Consumer goods industry performed similarly, raising its capacity utilization to 83.9% from 76.0%, compared to a historical peak of 87.8%. On the other hand, capacity utilization in the intermediate goods industry remained flat in the period, in the range between the average and the historical peak, an interval much narrower than in other sectors. The heterogeneity is even clearer when the data are disaggregated by industrial subsector, with some subsectors close to historical highs and some others that have not yet reached their average levels (the series starts in 1990).

21. Capital goods absorption (domestic production plus net imports) has continued its expansionary trend. Comparing the first half of the year with the same period of 2003, capital goods absorption grew 13.8%. The consolidation of this trend is crucial for the economy to broaden its growth potential. At this stage, however, it is particularly difficult to project the output gap, in an environment of a sharp expansion of demand, as has been observed in the last few quarters.

22. Exports, which are still expanding at a fast pace, accumulated a 34% increase in the first half of the year, compared to the first half of 2003. In the same period, total imports grew 27% and non-oil imports grew 23%, reflecting the strong recovery of domestic demand. The trade balance accumulated a US$18.5 billion surplus in the first seven months of the year, while the current account registered a US$6.2 billion surplus in the same period. Evidence that the U.S. economy may be growing below what was previously expected, with weaker inflationary pressures, lessened

the risk of a faster monetary tightening by the Federal Reserve. As a consequence, market volatility has diminished in the last few weeks, what contributed to the maintenance of the Brazilian sovereign risk below 600 basis points. The exchange rate oscillated around the July average (R$3.04/US$), appreciating to around R$3.00/US$ on the eve of the Copom meeting.

23. Oil prices are the main concern in the external front. The recent trend reinforces the fears that oil prices may reach and persist for a longer period of time at higher levels than the ones recently considered as the most likely scenario, even if some reversion in relation to the recent hikes occurs. The Copom's projection for the increase of gasoline prices in 2004 was maintained at 9.5%, which is enough to eliminate the gap between domestic and international prices, considering crude oil at around US$35 per barrel. This benign scenario has been sustained due to the diagnosis that part of the recent volatility in oil prices is due to speculative factors that may dissipate, even in the presence of some geopolitical risks. However, since the last Copom meeting, the balance of risks regarding oil prices increased. These risks may cause a higher-than-expected increase in gasoline prices in 2004, or a greater lag between domestic and international prices to be corrected in 2005. Moreover, regardless of the evolution of domestic gasoline prices, the increase in international oil prices is transmitted to the domestic economy, partly through the intermediate productive chains, such as the petrochemical, and also through the deterioration in inflation expectations of the private sector.

24. The deterioration of market inflation expectations for 2004, initiated in May, has continued since the last Copom meeting. The median IPCA expectation increased to 7.18% from 7.10%. The median expectation for the next twelve months decreased to 6.22% from 6.27%, and the main reason why this happened lies in the fact that the inflation expectation for July 2005 was lower than the one for July 2004. The median of inflation expectations for 2005 remained steady at 5.50%, albeit the mean and the standard deviation of the surveyed sample increased somewhat, a clear evidence of a more pessimistic sentiment of the private sector regarding the 2005 inflation.

25. The Copom's inflation projections, both in the benchmark and in the market scenarios, have slightly increased compared to last month. The impact caused by the combination of higher market inflation expectations for 2004 and the increase in projected regulated prices in 2005, to 6.3% from 6.0%, more than offset the effect on the inflation projections caused by the increase in the yield curve. The benchmark scenario projections, based on unchanged Over-Selic and exchange rates throughout the projection horizon (at 16% p.a. and R$3.00/US$, respectively), point out to an inflation rate above the 5.5% target for 2004 and above the 4.5% target for 2005. It should be stressed that the projected deviation in relation to the 2005 target is much lower than the one projected for 2004. The market scenario, which takes into account the consensus Over-Selic and exchange rates on the eve of the Copom meeting, projects inflation rates above the ones of the benchmark scenario (i.e., above the targets for 2004 and 2005), since it considers a reduction of the Over-Selic rate and a more depreciated exchange rate. The Copom also assessed a third hybrid scenario, considering an unchanged Over-Selic rate and the exchange rate path expected by the market. Compared to the market scenario, inflation projections were identical for 2004 and slightly below for 2005.

26. As in previous meetings, the Committee also analyzed the inflation projections for the next 12 months, corresponding to the second half of 2004 and the first half of 2005. The projected inflation for this period, both in the benchmark and market scenarios, stood above the interval between the central inflation targets for 2004 and 2005.

27. The strong and continuous economic rebound, which already reaches historical highs, requires extra caution in the conduct of monetary policy, aimed at preserving the balance between aggregate supply and demand. The level of capacity utilization has rapidly increased, approaching historical records in some sectors. Recent data for capital goods domestic absorption and for civil construction activity indicate that fixed capital investment is recovering. However, during periods of reversion in the economic activity cycle, in which fast expansion follow the slow and erratic growth

pattern of the last few years, it is natural to have a high degree of uncertainty regarding the speed of growth of the productive capacity in sectors whose current levels of capacity utilization are already high, and also regarding the potential growth trend. In this scenario, with the fast increase in aggregate demand, it is fundamental to carefully assess the risk of an eventual narrowing of the output gap.

28. In the previous Copom´s meetings, the Committee´s members stressed that the maintenance of the current Over-Selic rate for a long period would consolidate a favorable inflation scenario, with the convergence of the actual inflation rate to the inflation targets. However, the monetary authority admitted that a more active policy stance could be adopted if inflation projections deviated from the targets, due to an eventual deterioration of the underlying factors that led to the increase in inflation projections. The Committee´s members understand that since the last meeting two factors enhanced the risks that could jeopardize the accomplishment of the inflation targets. The first one is the increase in oil prices. The possibility of a higher and longer rise in oil prices than previously projected, not accompanied by an adjustment of the monetary policy, could produce second-order effects incompatible with the inflation-targeting regime. The second factor, partially a consequence of the increase in oil prices, is the deterioration of inflation expectations for 2005, which had been steady for some time. As the scenario is not consolidated yet, the Copom will be cautious to the new developments of these factors.

29. Even if the inflationary scenario should require an adjustment of the Over-Selic rate in the future, it is important to reiterate that it should not impact the sustainable growth process of the Brazilian economy. On the contrary, monetary policy contributes to growth by fighting second-order effects of the supply shocks, and by promoting the balance between the expansion of aggregate demand and the broadening of the economy's productive capacity. Moreover, sustaining inflation in a path consistent with the inflation targets is essential to preserve real earnings, fundamental for the continuous and balanced expansion of the domestic demand, and for the dissemination of the economic growth benefits to the population.

30. Considering the reasons stated above, the Committee decided, unanimously, to maintain the target for the Over-Selic rate at 16.0% p.a., without bias.

31. At the closing of the meeting, it was announced that the Copom would meet again on September 14, for technical presentations, and on the following day to discuss the monetary policy decision, as established in Communiqué 11,516, of October 15, 2003.

SUMMARY OF DATA ANALYZED BY THE COPOM

Economic Activity

32. According to IBGE's retail survey, sales expanded for the sixth consecutive month in June, increasing by 0.17% month-on-month, seasonally adjusted. Compared to June 2003, real sales and nominal revenues increased 12.8% and 15.6%, respectively. The regional distribution of growth was generalized, encompassing all States in the country, except Roraima. All groups encompassing the retail sector posted year-on-year growth rates in June, with highlights to furniture and electrical appliances, which increased 36.3%.

33. The São Paulo Trade Association (ACSP) data for July registered a 1.2% increase in credit retail sales, while the Usecheque system consultations rose 3.4%, both compared to June, seasonally adjusted. In the year up to July, the same indicators rose by 7.0% and 1.8%, respectively.

34. The Federation of Commerce of São Paulo (Fecomercio) consumer sentiment survey showed that the Consumer Confidence Index (ICC) increased 2.2% in August, standing at 121.3 points (range 0 to 200). This increase was due to improved future expectations by consumers.

35. Regarding fixed capital investment, capital goods output and construction inputs continued to grow in June, accumulating year-on-year expansions of 25.2% and of 3.4%, respectively. Capital goods imports increased 8.9% in the same comparison basis. The domestic capital goods absorption rose by 13.8%, despite the 52.3% increase of exports, mainly agriculture machinery. The National Bank for Economic and Social Development (BNDES) credit operations increased 47.7% in the first half of the year, compared to the same period of 2003. Credit operations to industry (about 41% of total credit outstanding) expanded by 27.7%. Credit to commerce and the services sector increased by 52.8%, and credit to the agriculture sector grew 101.3%.

36. The IBGE's monthly industrial survey registered a 0.5% increase in industrial output in June, compared to May (seasonally adjusted). The manufacturing industry expanded 0.4%, while mining activity increased 1.8%. Out of the 23 activities surveyed, 13 registered increases in output, while out of the 4 categories, 3 expanded. Intermediate goods output decreased 0.4%, after five consecutive months of increase. In the year up to June, industrial output increased 7.7%, compared to the same period of 2003, with output expansion in 22 out of the 26 activities and in all use categories, with highlights to export-oriented and agribusiness activities, as well as credit-sensitive activities. Semi and non-durable goods production increased 2.1%, reflecting the gradual recovery of the labor market.

37. In June, the CNI recorded a 1.2% increase in real industrial sales and a 0.9% increase in industrial worked hours, in comparison to May, seasonally adjusted. Compared to the same month in 2003, real sales and worked hours increased 27.7% and 8.2%, respectively. The level of average capacity utilization in industry reached 83.2%, the highest ever, with a 1.7% monthly increase (seasonally adjusted). In the first half of the year, capacity utilization expanded 2.1%, compared to the same period of 2003.

38. According to the FGV industrial survey nationwide, the average level of capacity utilization stood at 84.1% in July, s.a. This level is the highest since 2000 and is approximately 4 p.p. above the 1990-2004 historical average, albeit still below the record high of 85.2% registered in April 1995. The mechanic industry is in the historical high, while other six industries are close to the historical peaks. Transportation material and pharmaceutical products are the only two industries that remain below the respective historical average.

39. The FGV survey and the CNI business sentiment survey pointed out improved confidence in July. These surveys also perceived a better prospect in terms of domestic demand.

40. In July, leading indicators anticipate a continued expansion in industrial output. Packaging paper shipments expanded 3.8% in the month, s.a., accumulating a 13.0% growth in the year. The car industry produced 189 thousand vehicles, up 5.2% compared to June (seasonally adjusted), and 38.8% above July 2003. In the year to July, car production increased 18.0%, while domestic sales and exports expanded 21.5% and 12.5%, respectively, compared to the same period of last year.

Labor Market

41. The formal employment increased 0.5% in June, compared to May, s.a., and 4.8% compared to June 2003, according to the Ministry of Labor and Employment. In the first half of 2004, there was a 3.9% expansion in formal employment compared to the same period of last year. This result corresponded to 1,034,656 new employed workers in the first half of the year, compared to 560,907 in the first half of 2003.

42. The unemployment rate, measured by the IBGE in the six main metropolitan regions of the country, decreased in June for the second consecutive month, standing at 11.7% after peaking to 13.1% last April. Total employed workers increased 0.4% in June, while unemployed workers fell 4.1%.

43. In industry, seasonally adjusted CNI data showed expansions of 0.7% in employed workers and 1% in real payroll in June, compared to May. In the first half of the year, real payroll and employed workers increased 7.8% and 1.2%, respectively, compared to the same period of 2003.

Credit and Delinquency Rates

44. Non-earmarked credit operations increased 1.2% in July. Individual credit operations increased 1.8%, while corporate credit expanded 0.8%, led by the increase of 1.3% in credit with domestic funding. Corporate credit with external funding fell 0.2%.

45. The average interest rate on non-earmarked credit decreased 0.1 p.p. in July, standing at 43.9% p.a. Corporate interest rates remained stable at 29.7% p.a., while the average rate for individuals decreased 0.4 p.p. to 62% p.a. Total delinquency in non-earmarked credit maintained the downward trend in July, falling to 7.1% from 7.2% in June, specially due to the 0.3 p.p. fall in individual default rate.

46. The default rate measured by the ACSP fell in July to the lowest level of the year. The total number of cancelled and new files increased 10.4% and 6.5%, respectively, in the year to July. The number of returned checks, compared to the total number of checks, decreased to 5.1% in June, also reaching the lowest level of the year.

External Environment

47. Recent indicators suggested some deceleration of the world economy growth, partially attributed to oil prices increases. The second quarter U.S. GDP stood at 3.0% in annual terms, below expected. The Japanese GDP grew 0.4% in the second quarter, also below expectations, while the Euro Zone economy grew 0.5%, below the 0.6% rate recorded in the first quarter of the year.

48. The slower U.S. GDP growth in the second quarter of the year was led by the reduction in consumption growth, which increased 1.0% in the second quarter, compared to 4.1% in the first quarter. In China, industrial production increased 15.5% in July, year-on-year, the lowest rate in the last twelve months. On the other had, the Economic Commission for Latin America and the Caribbean (ECLAC) revised the growth forecast for the region in 2004 to 4.5% from 4.0% estimated in May.

49. Regarding monetary policy, the Bank of England raised its repo rate by 25 b.p., to 4.75%, while the European Central Bank decided to maintain its basic interest rate unchanged at 2.0%, regardless of the increase in oil prices. In the U.S., the Federal Reserve decided to raise the target for the fed funds rate by 25 b.p., considering that the weaker activity level in June and July was transitory, owing primordially to the rise in energy prices, and that the economy was prepared to resume a stronger pace of expansion in the near future.

50. The continuous increases in oil prices posed risks to global economic growth and price stability, as well as limited the recovery of asset prices. The interaction between geopolitical factors (tensions in the Middle East, uncertainties about the future of Yukos and the referendum in Venezuela), growing demand and constrained supply contributed to increase oil prices, reaching record levels in August.

Foreign Trade and Balance of Payments

51. The Brazilian trade balance posted a US$3.5 billion surplus in July. Exports and imports increased 54.0% and 42.3%, respectively, compared to July 2003 daily averages. Total external trade reached US$14.5 billion in July, accumulating a historical high for a 12-month-period (US$141.7 billion). In the first two weeks of August (10 working days), the trade balance surplus totaled US$1.7 billion, with increases of 34.9% for exports and of 34.7% for imports, year-on-year.

52. In July, Brazilian exports totaled US$9.0 billion, registering historical records for manufactured and semi-manufactured goods. Manufactured exports reached US$4.7 billion, while primary exports totaled US$2.8 billion and semi-manufactured exports amounted to US$1.3 billion, with increases of 47.3%, 71.5%, and 43.7%, respectively, compared to the same period of 2003.

53. Imports totaled US$5.5 billion, maintaining the upward trend initiated at the end of 2003. All categories grew, led by fuel (up 121.5%), consumer goods (+38.3%), raw material and intermediate goods (+34.6%) and capital goods (+23.8%).

54. In July, the current account registered a US$1.9 billion surplus, accumulating a US$6.2 billion surplus in the year. In the first seven months of the year, the trade balance and current transfers posted US$18.5 billion and US$1.9 billion surpluses, respectively, while the services and income account posted a US$14.1 billion deficit. Net foreign direct investment reached US$1.5 billion in July, accumulating US$5.5 billion in the first seven months of the year. At the end of July, international reserves stood at US$49.7 billion, while adjusted net reserves stood at US$23.0 billion (IMF concept).

Money Market and Open Market Operations

55. After the July Copom's meeting, the domestic yield curve moved upwards, mainly in its longer end. The determinant factor justifying the yield curve move was the market's interpretation about the July Copom's minutes, but international markets volatility and some internal political noises also contributed for the move. From July 21 to August 18, the spread on the 3-month and 6-month rates in relation to the Over-Selic rate increased 0.13 p.p. and 0.38 p.p., respectively, while the 1-year and the 2-year rates increased 0.56 p.p. and 0.47 p.p. In the same period, the real interest rate measured by the ratio between the one-year nominal interest rate and the 12-month-ahead inflation expectations increased to 10.6% from 10.1%.

56. In the period between the last Copom meetings, the BCB carried out an auction to rollover securities and Fx swaps coming due on August 12. In this auction, US$281 million in swaps were contracted (18% of the principal coming due), with tenures of 11 and 17 months. The net redemption of Fx-linked securities and swaps in the year to August totals US$23.4 billion.

57. The National Treasury carried out four offerings of LTNs, totaling R$5.5 billion. Four LFTs auctions were also carried out (three selling and one buying, the latter simultaneously to the second selling auction), placing net R$3 billion maturing in 2005, 2006 and 2007. In the same period, there were one buying auction and one selling auction for National Treasury Notes – Series B and C (NTN-Bs and NTN-Cs), which amounted R$737 million in net sales.

58. The BCB maintained in its open market operations the weekly post-fixed repo operations (2-week tenure) and the fixed repo operations (3-month tenure), as well as its daily liquidity management operations. The BCB also carried out in this period 16 fixed rate overnight repos. The higher frequency of these operations after July 28 enabled the reduction of the gap between the Over-Selic rate and its target, from 0.25 p.p. on July 27 to 0.13 p.p. on August 18. In the period after the July Copom's meeting, the excess liquidity drained from the market with operations shorter than 30 days fell to R$34.5 billion on average, while with the 3-month-tenure operations, it rose to R$46.9 billion on average.

59. In July, the net securitized domestic public debt was stable. The fixed share decreased to 15.1% from 16.8% in June, due to the net redemption in the month. The dollar-linked share also decreased, to 14.1% from 15.8% in June.