BANCO CENTRAL DO BRASIL

Minutes of the 103rd Meeting of the Monetary Policy Committee (Copom)

Date: December 14th, from 4:50PM to 7:09PM, and December 15th, from 4:40PM to 7:00PM
Place: BCB's Headquarters meeting rooms - 8th floor on December 14th and 20th floor on December 15th – 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 December 14th)
Altamir Lopes – Economic Department
Daso Maranhão Coimbra – International Reserves Operations Department
José Pedro Ramos Fachada Martins da Silva – Investor Relations Group
Luiz Fernando Maciel – Department of Banking Operations and Payments System
Marcelo Kfoury Muinhos – Research Department (also present on December 15th)
Sérgio Goldenstein – Open Market Operations Department

Other participants (present on December 14th)
Alexandre Pundek Rocha – Advisor to the Board
Flavio Pinheiro de Melo – Advisor to the Board
Hélio Mori – 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. Consumer price inflation accelerated in November, due to market and regulated price increases. Wholesale prices also increased, mainly due to the growing season effect, which caused a reversion of the prior months´ downward trend in agricultural prices. Industrial prices, although decelerating, sustained a relatively high change.

2. The Broad National Consumer Price Index (IPCA) increased 0.69% in November, compared to 0.44% in October, accumulating a 6.68% change in the year and a 7.24% change in twelve months. The monthly result of the IPCA mainly reflected regulated prices increases, in particular, fuel, telephone, airplane tickets and urban bus fares. The impact of these increases was partially offset by the continued decline of fresh food prices.

3. The General Price Index (IGP-DI) rose 0.82% in November, compared to 0.53% in October, totaling an 11.56% increase in the year. Among the IGP-DI components, the Consumer Price Index – Brazil (IPC-Br) increased 0.37% in November, after a 0.10% increase in October. The National Index of Civil Construction (INCC) increased 0.71%, below the 1.19% increase in October, due to the reduction of construction material prices and the

stability in labor costs. The Wholesale Price Index (IPA-DI) increased to 1.00% in November from 0.61% in October, accumulating a 14.13% change in the year. In the period of twelve months ended in November, the IGP-DI and the IPA-DI accumulated changes of 12.23% and 14.97%, respectively.

4. Regarding the November IPCA, regulated prices increased 1.41%, with a 0.41 p.p. share in the overall result, of which 0.22 p.p. was due to fuel prices. Fuel-alcohol prices increased 11.2%, and gasoline prices rose 2.6%. Additionally, bottled cooking gas increased 1.5% and telephone tariffs rose 2.7%, as a consequence of the second installment of the extraordinary readjustment determined by the Supreme Judicial Court.

5. Market prices in the IPCA increased 0.39% in November, compared to 0.29% in October, accounting for 0.28 p.p. of the monthly index change. The increase in market prices was mainly due to tradable goods, the prices of which increased 0.47%; non-tradable goods increased 0.29%. The smaller change in non-tradable goods prices was due to the 5.0% decrease in fresh food prices, which alleviated the increases in other items, in particular, vehicle repairs and condominium taxes. Among tradable goods, the increases in clothes, cattle and chicken meat, tobacco and automobiles prices should be highlighted.

6. The acceleration of the IPA-DI in November was due to the reversion in agricultural prices, which increased 0.14%, after declining 2.73% in October and 0.64% in September. The prices of cattle, eggs and coffee were key drivers, while the prices of rice, soy, corn, vegetables and fruit continued to decline. Wholesale industrial prices inflation moderated in the period, reaching 1.30% in November, compared to 1.83% in October. The price increase was less intense among some intermediary goods, mainly iron, steel and derivatives, wood, plastic material and plastic material products, while final consumer goods and investment goods increased in the month.

7. The IPCA core inflation remained at high levels in November. Excluding household food items and regulated prices, the core reached 0.57% in November, compared to 0.55% in October, accumulating 7.90% in twelve months. The core calculated under the smoothed trimmed-mean method increased to 0.62%, compared to 0.60% in the previous month, and totaled 7.58% in the last twelve months. The same core measure, calculated without the smoothing procedure, increased to 0.57% in November from 0.55% in October, accumulating 6.25% in twelve months.

8. The IPC-Br core inflation, calculated by the Getúlio Vargas Foundation (FGV) under the symmetric trimmed-mean method, reached 0.41% in November, compared to 0.43% in October, totaling an increase of 5.85% in the last twelve months.

9. The IPCA diffusion index has shown an increase in the number of items with positive price rises. In November, the index increased to 67.6% compared to 66.4% in October and 60.4% in September. The persistence of high core inflation and the recent behavior of the diffusion index indicate the dissemination of price increases across several sectors of the economy.

10. In December, the IPCA should persist at a relatively high level. Further increases of fuel-alcohol prices, the readjustment of gasoline prices announced on November 26, and the urban bus fare increases in Recife and Belo Horizonte should be emphasized. Among market prices, the favorable contribution of food might be lower, mainly due to fresh products prices.

Assessment of Inflation Trends

11. The inflation shocks and their impacts were reassessed according to new available information. The scenario considered in the simulations assumed the following hypotheses:

a) The projection for the readjustment in gasoline prices during 2004 was increased to 13.0% from 9.5%. Regarding bottled cooking gas, the projected readjustment for 2004 was revised to 6.5% from 5.0%. For 2005, the Copom projects the prices of gasoline and bottled gas to remain unchanged;

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b) Regarding household electricity prices, the Copom reduced the 2004 projections by 0.2 p.p. to 10.0%. For 2005, a 9.5% increase is estimated. The projections for the fixed telephone prices in 2004 were not changed, remaining at 14.8%. For 2005, a readjustment of 7.7% is projected;

c) For all regulated prices, which represented a total weight of 29.2% in the November IPCA, a 9.8% increase for 2004 is projected (0.8 p.p. above the previous meeting projection);

d) Still regarding all regulated prices, it is estimated an increase of 6.7% in 2005, down from 7.2% in the November Copom meeting;

e) The projection for the 6-month spread over the Over-Selic rate, following the specification of a Vector Autoregressive model based on the Over-Selic and the swap rates on the eve of the Copom meeting, stood at 52 b.p. in the fourth quarter of 2004, 56 b.p. in the last quarter of 2005 and 53 b.p. at the end of 2006.

12. Regarding fiscal policy, it is assumed that the consolidated public sector primary surplus target of 4.5% of GDP for 2004 and of 4.25% for the following two years will be achieved. The related assumptions considered in the previous Copom meeting were maintained.

13. Assuming the maintenance of the Over-Selic rate at 17.25% p.a. and of the exchange rate at the level prevailing on the eve of the Copom meeting (R$/US$2.75), the IPCA inflation rate was projected above the 5.5% central target for 2004 and above the 5.1% objective for 2005. Taking into account the consensus Over-Selic rate and exchange rate as surveyed by the BCB's Investor Relations Group (Gerin) on the eve of the Copom meeting, inflation was also projected above the central target for 2004 and above the objective for 2005.

Monetary Policy Decision

14. IPCA inflation accelerated for the second consecutive month in November, increasing to 0.69% from 0.44% in October and 0.33% in September. This acceleration was mainly due to regulated price increases, especially fuel prices. This acceleration happened despite the decline in household food prices for the third consecutive month. The IPCA inflation acceleration between September and November was observed in its three components: tradable, non-tradable and regulated prices.

15. The IGP-DI also accelerated in November for the second consecutive month, increasing 0.82%, compared to 0.53% in October and 0.48% in September. Industrial IPA-DI inflation accumulated a 19.05% change between January and November. In the IPA-DI measured according to the production stage, intermediary goods increased 25.34% in the same period. This wholesale price inflation continues to represent a potential pressure on consumer prices in the coming months. The intensity of the pass-through will depend on prospective demand conditions and market inflation expectations; the evidence that this transmission has not happened yet with the intensity and velocity observed in the past does not mean that the pressure has definitely vanished.

16. IPCA core inflation continued to accelerate in November, according to the three criteria – by excluding regulated prices and household food, by smoothed and by non-smoothed trimmed-means. Also according to two of the three criteria (exclusion and smoothed trimmed-mean), the accumulated change in core inflation in 12 months was above the IPCA in the same period. The cores remain at levels incompatible with the medium-run inflation targets.

17. The significant activity rebound mentioned in the Copom Minutes during the year, based on monthly indicators of industrial output, sales, and employment, was ratified by the third quarter GDP result. GDP grew 5.3% in the first three quarters of the year compared to the same period of 2003, and 1.0% from the second to the third quarter in seasonally adjusted terms. Industry was the sector that increased most according to both criteria. The GDP data also confirmed that growth is being supported by domestic demand. Considering quarter-on-quarter seasonally adjusted data, families' consumption increased the same or more than GDP, both in the second and third quarters of 2004. Fixed capital investment also outpaced GDP growth for four consecutive quarters, increasing 11.8% in the year, and 6.7% quarter-on-quarter, seasonally adjusted. After the release of the third quarter data by the Brazilian Institute of Geography and Statistics (IBGE), the median of market expectations for

the 2004 GDP growth was adjusted upwards, to 5.08% from 4.60% in the week previous to the November Copom meeting.

18. Industrial output declined 0.4% in October in seasonally adjusted terms. This decline, however, was lower than suggested by the behavior of leading and coincident industrial indicators. The decline in October was led by the credit sensitive industries (durable and capital goods), which had been growing at very high rates for several months. Industry has shown an already anticipated qualitative change, being stimulated progressively by the sectors that are more income sensitive. In the year to October, industrial output grew 8.3% compared to the same period of the previous year, the highest rate since the beginning of the 90´s. In twelve months, industry grew 7.4%.

19. Leading and coincident indicators for November anticipate a new decline in the industrial output seasonally adjusted series. However, as discussed in previous Copom Minutes, this specific performance does not signal a reversion in the industrial output growth trend, as a strong isolated increase cannot be considered as an indicator of acceleration in production. After a sequence of growth rates as witnessed in the recent past, it is reasonable to observe some temporary accommodation, since industrial activity rates are volatile, with short-run variations around the growth trend.

20. The variation of the number of working days makes the analysis of the monthly economic activity data even more difficult, particularly regarding industrial output. In October 2004 there were only 20 working days, compared to 23 working days in the same month of 2003 and an average of 21.5 in the last eleven years, distorting both the comparison between years and the seasonally adjusted data series. The correction of this distortion is not trivial, because the number of working days obviously affects industries that produce only on these days, though there is no direct impact for the industries with continuous production cycles. The same problem will happen in December, but inversely, because the month will have 23 working days compared to only 21 in 2003. Thus, recent monthly activity indicators will be clearer just after the release of new data in the coming months.

21. The labor market has continued to improve significantly. According to the IBGE, urban employed workers and real wages increased 2.9% and 1.6%, respectively, between January and October. The unemployment rate decreased to 10.5% in October, compared to 10.9% in the previous month and 12.9% in October 2003. The October result was equal to that of December 2002, the lowest value since the IBGE changed the methodology in 2001, and the expectation is for additional declines in the last two months of the year. According to the Ministry of Labor and Employment, formal employment increased 4.8% in the first ten months of the year, compared to the same period of 2003, with increases in all sectors, especially the manufacturing sector. Data from the National Industry Confederation (CNI) indicate a continuous increase in employment and real wages in the manufacturing in the year up to October.

22. Retail sales increased 0.3% between September and October, according to IBGE data, seasonally adjusted by the BCB. Sales and nominal revenues increased 7.8% and 11.9%, respectively, in twelve months. According to quarterly moving averages, the sales of automobiles and motorcycles, along with supermarket sales, continued to grow, while the sales of appliances and furniture, and fabric, clothes and shoes decreased. However, appliances and furniture, and vehicles and motorcycles continue to present the highest growth rates over twelve months. Even with the recent accommodation, retail sales accumulated a growth rate of 9.3% in the ten first months of 2004, compared to the same period of 2003. The increase varies from 5.2% in the fabric, clothes and shoes sector, to 27.6% in the appliances and furniture sector.

23. Due to the significant activity expansion in recent quarters, the performance of aggregate supply in the coming quarters continues to be an important concern for the Copom. Investment performance has been promising, though the level of capacity utilization remains high. The domestic absorption of capital goods increased 12.2% between January and October, despite a decrease in October caused by the required registration of an oil platform, produced and managed domestically, as an exported product. The CNI installed capacity index declined in October for the second consecutive month in seasonally adjusted terms, after reaching an historical high in August. The different output gap measures continued to narrow, even after the inclusion of the third quarter GDP data. Thus, monetary policy has to continue monitoring the additional expansion of demand.

24. The external trade surplus has remained robust despite the increase in domestic activity. Exports have maintained high growth rates, accumulating 31.6% in the year up to November, compared to the same period of 2003. The export volume of manufactured goods, which represent the largest share among exports (around 56% of the total), expanded by 22.9% between January and October, compared to the same period of the previous year. Due to the activity rebound, imports demonstrated similar dynamism, with an increase of 28.9% between January and November. The import volume of raw materials and durable consumer goods grew 21.1% and 22.5%, respectively, in the year to October. In the period of twelve months ended in November, the trade surplus totaled US$32.9 billion, providing a positive balance in the current account of US$10.7 billion, or 1.8% of the GDP.

25. In a more favorable global environment, the Brazilian country risk premium continued to decline and the BRL appreciated against the dollar. The prospects remain positive, in large part because the Federal Reserve (Fed) will probably continue its moderate tightening. Actually, in 2004, liquidity remained favorable, except for a short period in the second quarter, when the markets expected a change in the Fed's stance. Since the end of 2003, the Copom has been working with a scenario of a low probability of abrupt movements in the U.S. fed funds rate, which actually happened. The continuity of this favorable environment will depend on new economic data for industrialized economies, especially the United States, and on international oil prices. The recent exchange rate moves represent an additional concern, since a process of disorderly adjustment, which is not likely to happen, would cause significant instability in the international financial markets.

26. In the beginning of December, the Central Bank resumed the purchase of foreign currency. As emphasized in a Communiqué released last January, the BCB aims at increasing the country's international reserves in the medium-run and not at attaining any quantitative target. This policy will continue to be based on liquidity conditions, and will objective not to add volatility to the exchange rate market and not to interfere in the floating exchange rate trend. This process should be understood, therefore, as an effort to rebuild international reserves in an inflation-targeting regime with a floating exchange rate. It should not be understood as the establishment of other targets, such as a ceiling or a floor to the foreign exchange rate. The BCB has also achieved, since May 2003, extremely positive results regarding the decrease of the share of the public debt linked to the exchange rate.

27. After reaching record levels in October, international oil prices have fallen; nevertheless, they still remain at high levels. Oil price prospects remain highly uncertain, primarily due to uncertainties regarding the continuity and the magnitude of the recent price correction. In any case, the reduction in oil prices since October supports the Copom forecasting scenario, which treats the sharp oil price deterioration as a latent risk and not as a baseline scenario hypothesis. On the domestic front, the Copom projects that there will be no fuel price adjustments in 2005. If a more favorable international oil price scenario materializes, it is possible that there may actually be downward adjustments to domestic oil product prices next year. As emphasized in the September Copom Minutes, having set the 5.1% inflation objective for 2005, new inflation shocks will be treated asymmetrically. This means that the Copom will take full advantage of favorable shocks, such as unanticipated reductions in fuel prices, as an opportunity to achieve the 4.5% inflation target set by the CMN.

28. Since the November Copom meeting, the median of IPCA inflation expectations for 2004 has deteriorated to 7.38% from 7.19%. In contrast, the median of IPCA inflation expectations for 2005 improved, falling to 5.78% from 5.90%. Nevertheless, this improvement could be considered relatively modest in light of the recent developments that reduced inflationary pressures for the next year, such as signs of moderation in the pace of economic growth, the exchange rate appreciation, the reduction of important international commodity prices, and unequivocal signs of a more restrictive monetary policy stance.

29. The Copom inflation projections for 2004 increased mainly due to the end-of-November adjustment in gasoline prices. For 2005, projections for both the benchmark and market scenarios declined in relation to the November meeting. In the benchmark scenario – which assumes an Over-Selic rate of 17.25% p.a. and an exchange rate of R$/US$2.75 – the exchange rate appreciation, the increase in the short end of the yield curve, the anticipation for 2004 of the readjustment of gasoline prices, and a small reduction in inflation expectations more than compensated for the narrowing of the output gap, causing a reduction in the projected inflation. However, the projection still remains above the 5.1% objective. In other words, even if the Over-Selic rate and the exchange rate remain unchanged throughout 2005 at the levels preceding the December Copom meeting, inflation would be above the 2005 monetary policy objective. The projections based on the market scenario, which incorporates the

Over-Selic rate and exchange rate projected by the market on the eve of the Copom meeting, stand above the benchmark scenario, due to the exchange rate depreciation and the interest rate decline expected through the projection period. In this case, the projected inflation would be even more distant from the 5.1% targeted by monetary policy.

30. Since September, the deviation between the Copom inflation projections and the inflation target has narrowed. However, the projected inflation persists above the 5.1% objective for 2005, despite the disinflation contributions of the reduction in international oil prices, the appreciation of the exchange rate and some evidence of more balanced economic growth. In order to ensure the convergence of inflation to the targeted path, the Copom members determined that the gradual interest rate adjustment process should continue at the originally foreseen pace. The Committee assumes that the combination of the ongoing adjustment process followed by a sufficiently long period of unchanged interest rates should significantly reduce the likelihood that the future inflation path diverges from the targets.

31. Considering the reasons stated above, the Copom unanimously decided to increase the Selic rate target to 17.75%, with no bias.

32. As stressed in the November Minutes, the Committee emphasizes that the persistence of the monetary adjustment process in the originally foreseen pace and magnitude requires that there is not an exacerbation of the risk factors that the Committee has closely monitored in the recent months, and that there is not an interruption in the process of convergence of the private sector inflation expectations to the inflation targets. The Copom will be prepared to change the pace and magnitude of the monetary adjustment process if it assesses that there are risks for the inflation to deviate from the target path.

33. At the close of the meeting, it was announced that the Committee would meet again on January 18, 2005, 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. According to the IBGE's retail survey, which encompasses all the states of the country, retail sales were stable in October, seasonally adjusted by the BCB. Hyper and supermarket sales maintained their growth trend, while the sales of fuel and of fabric, clothing and shoes fell in the month in seasonally adjusted terms. Furniture and electrical appliances, which had been showing notable growth rates in the year, expanded again in October after falling in September. In the year to October, the retail activity expanded 9.3% compared to the same period of 2003; compared to the same month of 2003, the retail activity expanded 8.5% in October. The year-on-year growth in retail sales occurred in 25 out of the 27 states in the country.

35. In September, the São Paulo Trade Association (ACSP) registered increases of 0.5% and 2.5% in the number of credit sales consultations and of the Usecheque system, respectively, both compared to the previous month, seasonally adjusted. In the year to November, the same indicators rose by 6.4% and by 1.4%, respectively.

36. The Federação do Comércio do Estado de São Paulo (Fecomercio-SP) consumer sentiment survey indicated that the Consumer Confidence Index decreased by 3.1% in December to 141.1 points (range 0 to 200). This was a result of an improvement of 6.6% in the Index of Current Economic Conditions and a 7.6% decrease in the Index of Consumer Expectations.

37. Regarding fixed capital investment, the domestic absorption of capital goods declined 22.0% in October, compared to September, on a seasonally adjusted basis. The increase of 51.6% in capital goods exports was the main reason behind this decline, along with the reductions of 1.3% and 7.7% in domestic output and capital goods imports, respectively. The sharp jump in exports was driven by the sale of a domestically-produced oil exploration platform-ship, which remained leased in the country. The domestic absorption of capital goods accumulated a 12.2% growth in the year to October, as a result of the 21.8% growth in domestic output and 3.5% growth in imports. Production of civil construction inputs fell 1.3% month-on-month in October, seasonally adjusted, accumulating an increase of 5.8% in the year to October.

38. The IBGE's registered a 0.4% decline in industrial output in October, seasonally adjusted, relative to the prior month. Considering the quarterly moving average, industrial output recorded an historic high in October, slightly above the level recorded in September

39. The breakdown of industrial output data showed the October decline was a result of the performance of 14 out of the 23 activities, seasonally adjusted. The most notable declines were in the sectors of food, rubber and plastic, vehicles, and perfumes. The sectors that demonstrated notable growth were oil refining and alcohol production, chemical products, machines and electrical materials and metallurgy. Regarding the use categories, capital and durable goods production recorded the most important declines, although these categories have recorded the greatest expansion along the year.

40. In the year to October, industrial output grew 8.3%, when compared to the same period of 2003. Output expanded in all use categories and in 26 out of the 27 industrial activities surveyed. Capital goods and intermediary goods output grew 21.8% and 7.3%, respectively, favored by the increase in exports and in fixed capital investment. The production of durable goods increased 22.6%, and semi- and non-durable goods production grew 3.5% in the same period, reflecting the expansion of credit and the gradual recovery of labor income.

41. In October, the CNI recorded a 0.5% increase in real industrial sales and a 0.3% decrease in industrial worked hours, compared to September, in seasonally adjusted terms. Compared to the same month of 2003, real sales and worked hours increased by 6.0% and by 4.5%, respectively. The average level of industrial capacity utilization reached 82.9% in October, with a 0.1 p.p. decline relative to September. In the year to October, capacity utilization expanded by 3.1%, compared with the same period of 2003.

42. Leading indicators suggest stability in industrial output in November, seasonally adjusted. Auto manufacturing increased 1.5% and the number of road tolls paid by trucks increased 0.5% in November. On the other hand, both packaging paper shipment and oil shipment decreased by 0.6%.

Labor Market

43. Formal employment increased by 0.5% month-on-month in October, seasonally adjusted, and by 6.5% compared to October 2003, according to the Ministry of Labor and Employment. In the year to October, there was a 4.8% expansion in formal employment, with the creation of 1,796 thousand jobs. Job creation was led by manufacturing. Data have also continued to indicate that employment has increased at a higher pace outside large metropolitan areas.

44. The unemployment rate, measured by the IBGE in the six main metropolitan areas of the country, fell to 10.5% in October, the lowest level of the series since a new methodology was adopted in 2001. The fall in the unemployment rate reflected the effects of the activity rebound on the labor market. The number of employed workers increased by 0.2% in October and the number of unemployed workers fell 4.1%. The work force totaled 21.7 million people, corresponding to a 0.3% fall in the month.

45. Still regarding the employment survey, average real earnings totaled R$900.20 in October. Average nominal earnings grew by 8.3% year-on-year, and 2.6% in real terms when deflated by the National Consumer Price Index (INPC).

46. In the industrial sector, according to seasonally adjusted data from CNI, employed workers and real wages increased by 0.5% and 0.6%, respectively, in October, compared to September. In the first ten months of the year, real wages and employed workers increased by 8.7% and 2.8%, respectively, compared to the same period of 2003.

Credit and Delinquency Rates

47. Non-earmarked credit operations increased by 1.7% in November. Corporate credit with domestic funding expanded by 2.5% in the month, mainly as a result of the seasonal growth of credit demand in the period. In twelve months, this segment grew by 28.1%, driven by more robust economic activity. Corporate credit with external funding fell by 4.2% in November, as a result of the BRL appreciation. Credit operations with individuals increased by 3.7% in November and by 28.6% in the year, mainly driven by the expansion in personal credit operations.

48. The average interest rate on non-earmarked credit recorded a small increase of 0.1 p.p. in November, reaching 45.7% p.a. This increase was a result of the 0.2 p.p. rise in the average rate for individuals, which stood at 63.4% p.a. The average corporate rate stood at 30.9% p.a., recording a 0.2 p.p. fall in the period.

49. The default rate measured by the ACSP fell to 3.8% in November from 4.1% in October, mainly due to the decline of new registers in the month. In the year to November, the average default rate recorded a 10.7% decline compared to the same period of 2003.

External Environment

50. Indicators suggest that global economic growth has continued to build momentum, although at a more moderate pace due to the lower growth of the Japanese and the Euro Area economies in the third quarter. The U.S. and China have continued to lead global growth. High oil prices and concerns regarding the sustainability of the U.S. fiscal and current account deficits suggest a moderate global expansion in 2005.

51. The third quarter U.S. GDP growth of 3.9%, seasonally adjusted, confirmed the country's growth sustainability, led by household consumption and fixed capital investment. In Japan, a new methodology led to a downward revision of GDP growth rates, with an expansion of just 0.2% in the third quarter. In Europe, the recovery remains slow. The recovery is jeopardized by high energy prices and the Euro appreciation, which affects exports.

52. Inflation has remained under control in the main economies, although price indices rose in October, as a result of the ongoing increases in oil prices. Regarding Japan, the price indices signaled the end of a long deflation trend. In China, consumer price inflation stood at 2.8% in the year to November.

53. The Bank of England maintained its repo rate unchanged at 4.75% p.a. in December. In the Euro-Area, the European Central Bank kept the interest rate at 2% p.a., despite the fact that inflation exceeded the ECB´s target. In the U.S., the Federal Reserve decided to raise the target for the fed funds rate to 2.25% p.a., the fifth consecutive increase this year. It is expected that the Federal Reserve will continue its policy of gradual tightening in 2005.

54. Oil prices have fallen since the second week of October, though they still represent a risk of volatility to the markets, particularly the stock market. The dollar has continued to depreciate against other currencies, mainly against the euro and the yen. The issuance of emerging market sovereign and corporate bonds has continued to benefit from favorable global liquidity conditions and by the reduction in spreads over U.S. Treasuries.

Foreign Trade and Balance of Payments

55. In November, the Brazilian trade balance posted a US$2.1 billion surplus, accumulating a US$30.2 billion surplus in the year and US$32.9 billion in twelve months. Exports and imports increased by 36.4% and by 42.6%, respectively, compared to the November 2003 daily averages. Total external trade reached US$14.2 billion in November, accumulating US$144.4 billion in the year to November and US$155.1 billion in twelve months. In the first two weeks of December (eight working days), the trade surplus reached US$1.1 billion, with exports and imports growing by 32.6% and 51.3%, respectively, compared to December 2003 daily averages.

56. Brazilian exports totaled US$8.2 billion in November. Manufactured, primary and semi-manufactured goods exports totaled US$4.7 billion, US$2.1 billion and US$1.3 billion, respectively. Besides the increase in volumes, important export products have registered price increases. Imports reached the highest level in the year, totaling US$6.1 billion in the month, with increases in all categories.

57. At the end of November, international reserves stood at US$50.1 billion, while adjusted net reserves stood at US$22.2 billion (IMF concept).

Money Market and Open Market Operations

58. After the November Copom meeting, futures interest rates for maturities up to six months increased, while rates for longer maturities decreased. On December 15, the yield curve showed a negative slope from the 6-month vertices. The perception of market participants that the monetary tightening cycle would persist influenced the short end of the yield curve. The long end of the yield curve was influenced by falling oil prices, the reduction in the sovereign risk, evidence of decelerating economic activity, and operations in the derivatives market. Between November 17 and December 15, the 1-month and 6-month interest rates increased by 0.35 p.p. and by 0.04 p.p., respectively, while the 1-year, 2-year and the 3-year rates decreased by 0.22 p.p., 0.49 p.p. and 0.60 p.p., respectively. 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 reached 10.9%.

59. The BCB did not carry out auctions to roll over FX securities and swaps maturing in December. As a consequence, the net redemption of FX-linked securities and swaps in the year totaled US$27.8 billion, including interest paid to debt holders.

60. Between the November and December Copom meetings, the National Treasury carried out four selling auctions of LTNs maturing between October 2005 and July 2006, totaling a placement of R$15.1 billion. The National Treasury also carried out four NTN-Fs auctions maturing in January 2008, totaling R$518.6 million, and seven LFTs auctions maturing in 2005, 2006 and 2007, four of which were selling auctions and three of which were exchange auctions. The net sales of LFTs totaled R$11.3 billion, and the exchange auction totaled R$5.7 billion.

61. In its open market operations, the BCB carried out a weekly operation aimed at reducing the liquidity at the beginning of 2005. This operation consisted of a selling auction of LTNs maturing in April 2005, linked to a buying auction of LTNs maturing in January 2005. The operation totaled R$6.7 billion. In addition, the BCB maintained the weekly post-fixed repo operations (4-week tenure) and the fixed repo operations (3-month), as well as its daily liquidity management operations (two-working-day tenure). The BCB also carried out in the period 10 repos, five of which were overnight borrowings, four were borrowings with a two-working-day tenure and one was an overnight lending. In the period, the excess liquidity drained from the market with operations shorter than 30 days averaged R$25.0 billion, and with 3-month-tenure operations averaged R$41.3 billion.

62. In November, net securitized domestic public debt grew 1.1%, due to an R$1.0 billion net placement and accrued interest. On the other hand, the dollar-linked share decreased to 10.3% in November from 11.2% in October, due to the net redemption of FX instruments and to the BRL appreciation.