



# BANCO CENTRAL DO BRASIL

## Minutes of the 98<sup>th</sup> Meeting of the Monetary Policy Committee (Copom)

**Date:** July 20<sup>th</sup>, from 4:45PM to 7:00PM, and July 21<sup>st</sup>, from 4:00PM to 6:15PM

**Place:** BCB's Headquarters meeting room of the 8<sup>th</sup> floor (on July 20<sup>th</sup>) and 20<sup>th</sup> floor (on July 21<sup>st</sup>) – Brasília – DF

### **In attendance:**

#### **Members of the Committee**

Henrique de Campos Meirelles – Governor  
Afonso Sant'Anna Bevilacqua  
Alexandre Schwartzman  
Antônio Gustavo Matos do Vale  
Eduardo Henrique de Mello Motta Loyo  
João Antônio Fleury Teixeira  
Luiz Augusto de Oliveira Candiota  
Paulo Sérgio Cavalheiro  
Sérgio Darcy da Silva Alves

#### **Department Heads (present on July 20<sup>th</sup>)**

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 July 21<sup>st</sup>)  
Sérgio Goldenstein – Open Market Operations Department

#### **Other participants (present on July 20<sup>th</sup>)**

Alexandre Pundek Rocha – Advisor to the Board  
Flávio Pinheiro de Melo - Advisor to the Board  
Hélio José Ferreira – Executive Secretary  
Jocimar Nastari – Press Secretary  
Katherine Hennings – Advisor to the Board

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

### **Recent Evolution of Inflation**

1. In June, the Broad National Consumer Price Index (IPCA) rose 0.71%, up from 0.51% in May, accumulating a 3.48% change in the first half of the year, and a 6.06% variation in twelve months. The monthly IPCA acceleration in June was mainly due to the increase in the prices of fuel and food.
2. The General Price Index (IGP-DI) rose 1.29% in June, compared to 1.46% in May, accumulating a 6.90% change in the first half of 2004. In June, the deceleration of the IGP-DI was a consequence of a lower increase in wholesale prices and in construction industry costs, while consumer-price inflation registered a slight increase. The Wholesale Price Index (IPA-DI) rose by 1.57% in the month and 8.38% in the first half of the year. Regarding 12-month rates, the IGP-DI and IPA-DI reached 10.13% and 11.76% in June, respectively.
3. The main individual contributor to the IPCA inflation was gasoline (0.14 p.p.), reflecting the pass-through to consumers of the gasoline price increase by distributors on June 15 (10.8%), and the



## BANCO CENTRAL DO BRASIL

11.35% surge in alcohol-based fuel prices. As a consequence, transportation prices increased 1.58% in June, contributing with 0.33 p.p. to the monthly IPCA change.

4. Food prices rose 0.72% and accounted for 0.17 p.p. of the June IPCA change. Climate adversities affected the supply of some products such as onions, tomatoes and vegetables. The inter-harvest period was responsible for the increase in the prices of milk and dairy products, such as cheese, yogurt and powdered milk.
5. Market prices increased 0.58%, compared to 0.57% in May, accounting for 0.42 p.p. of the monthly IPCA, while the increase of 1.03% in regulated prices was responsible for the remaining 0.29 p.p. The relative stability in market prices inflation was a consequence of the deceleration in non-food prices, which attenuated the impact of the acceleration in food prices. Concerning regulated prices, urban and interstate transport fares contributed to the surge, together with gasoline and alcohol-fuel prices.
6. In June, the IPA-DI grew 1.57% (1.71% in May). This reduction was a consequence of the deceleration of agriculture wholesale inflation, which rose 0.52% in June compared to 2.71% in May. In the same period, industrial wholesale inflation increased to 1.97% from 1.32%, mainly pressured by the price readjustment of fuel and fertilizers, which caused an increase of 5.37% in chemical prices, compared to 1.72% in May.
7. The IPCA core inflation, calculated by excluding household food items and regulated prices, registered a 0.53% variation in June (0.70% in May), accumulating 7.17% in 12 months.
8. The IPCA core inflation, calculated under the smoothed trimmed-mean method, increased to 0.60% in June from 0.59% in May, totaling 8.16% in the last 12 months to June. Without the smoothing procedure for pre-selected items, the core IPCA recorded 0.48% in June and 5.56% in twelve months, compared to 0.43% and 5.46% rates in May.
9. The Consumer Price Inflation - Brazil (IPC-Br) core, calculated by the Getúlio Vargas Foundation (FGV) under the symmetric trimmed-mean method, stood at 0.50% in June, compared to 0.57% in May, accumulating 6.39% in the last twelve months.
10. In July, consumer inflation should be affected by the readjustment in regulated prices (electricity, gasoline, alcohol-fuel, fixed telephone and urban bus in Rio de Janeiro). Among market prices, food is expected to continue affecting inflation, especially meat and dairy products, still pressured by the inter-harvest period. Moreover, due to seasonal reasons, school vacation time is expected to raise entertainment prices. Regarding wholesale inflation, pressures over the prices of animals and by-products, fuels and fertilizers are expected to continue. These pressures should be partially offset by the deceleration of other industrial prices.

### Assessment of Inflation Trends

11. 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 increase of oil prices in 2004 was maintained at 9.5%. The projection for the increase of cooking gas prices was slightly reduced to 6.8% from 6.9%;
  - b. The projections for the readjustment of household electricity prices in 2004 increased to 11.6% from 11.0% in the previous Copom meeting. Regarding fixed telephone services, the Copom revised its estimate for the annual adjustment to 12.8% from 6.1%. This revision follows the Supreme Judicial Court decision to reinstate the IGP-DI index



## BANCO CENTRAL DO BRASIL

instead of the IPCA index for purposes of the annual adjustment in 2003, overturning a lower court ruling;

- c. Regarding all regulated prices, with a total weight of 28.6% in the June IPCA, a 8.3% rise is projected, 0.6 p.p. above the projection made in the previous meeting;
  - 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 maintained at 6.0%;
  - e. The projection for the 6-month spread over the Selic rate, following the specification of a Vector Autoregressive model based on the Selic and the swap rates on the eve of the Copom meeting, increases from 51 basis points in the second quarter of 2004 to 58 basis points in the fourth quarter of 2005.
12. 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 meeting were maintained.
13. Considering the benchmark scenario hypotheses, including the maintenance of the Over-Selic interest 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), IPCA inflation was projected above the 5.5% target for 2004 and slightly above the 4.5% target for 2005. According to the market scenario, which takes into consideration 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 is projected above the targets for both 2004 and 2005.

### Monetary Policy Decision

14. In June, market prices inflation registered the highest rate for the month in the last several years. From February to May, market prices increased systematically above regulated prices, accumulating 2.42% against 0.86% of the regulated. In June, however, inflation was pressured not only by market prices (up 0.58%) but also by regulated prices (up 1.03%, partly due to the rise in gasoline prices), thus resulting in the 0.71% IPCA variation for the month. In the first half of the year, market prices surged 3.77%, equivalent to a 7.69% annualized rate. Other nationwide consumer-inflation indices also posted high changes in the last two months, as in the case of the IPC-DI (0.71% and 0.78% in May and June, respectively). The IPA-DI has also recorded high changes throughout this year, mainly pressured by industrial prices, up 9.96% in the January to June period.
15. IPCA trimmed-mean core measures have stood relatively stable in the past few months, albeit at figures incompatible with the medium-term inflation targets. In the first half of the year, the smoothed and non-smoothed trimmed-mean cores posted 3.79% and 2.96%, respectively, or annual figures of 7.72% and 6.00%, respectively. Core inflation excluding household food items and regulated prices stood at 4.52% in the same period (9.24% in annual terms), well above the 3.48% headline inflation.
16. Economic activity has continued to present a vigorous growth rate, outstripping every month the growth rate projected at the end of 2003. Several leading and coincident indicators anticipate continuous growth for the near future. For instance, packaging paper shipments, which have been growing since the second half of 2003, rose 1.5% in June compared to May (data from the Corrugated Paperboard Association - ABPO, seasonally adjusted by the BCB).
17. In May, industrial production posted a historical high, overcoming the previous peak of November 2003. Industrial production grew 2.2% month-on-month, seasonally adjusted, and 7.8% compared



## BANCO CENTRAL DO BRASIL

to May 2003, the eighth consecutive positive year-on-year rate. In the January-May period, industrial output increased 6.5% compared to the same period of last year. Real industrial sales increased 3.0% in May compared to April, reaching the highest figure ever recorded for the series, which began to be released in December 1991 (data from the National Industry Confederation - CNI, seasonally adjusted by the BCB).

18. Retail sales have also kept its growth trend initiated in the second half of 2003. Similarly to the industrial output, sales have also overcome historical records. After reaching the highest figure for the index in April, sales grew 0.7% month-on-month in May, seasonally adjusted, a 10.0% increase compared to the same month of the previous year. Sales expansion comprises almost all retail sectors, not only the ones more credit-sensitive but also the ones that respond to the evolution of real earnings. In July, consumer confidence measured by the *Federação do Comércio do Estado de São Paulo* (Fecomercio-SP) increased 4.9% compared to June.
19. The economic activity rebound has caused an increase in the manufacturing industry level of capacity utilization, which reached record highs for the recent years. According to data seasonally adjusted by the BCB, the quarterly FGV industrial survey reported a capacity utilization of 81.9% in April (the highest rate in the last three years), while the monthly CNI survey recorded 81.8% in May (the second highest level of the series since December 1991). The marginal production growth deserves special attention, considering that it has been increasing continuously for the last months, suggesting a faster occupation of the existing idle capacity.
20. Conversely, capital goods sector has presented the highest growth rates amongst the industrial sectors. In the year up to May, capital goods output grew 22.5% compared the same period of 2003. Capital goods absorption (domestic production plus net imports) grew 11.4% in the same period. In such an environment, which combines fast demand growth with the recovery of fixed capital investment, the estimate of the output gap, crucial to evaluate inflationary pressures, becomes more uncertain. As stressed in the June *Inflation Report*, there is strong evidence that the capacity utilization is heterogeneously distributed among the different productive sectors, making it important to maintain a favorable environment for fixed capital investment, mainly on those sectors with lower idle capacity, thus enabling output to increase without causing inflationary pressures.
21. Although external demand has played a paramount role to the initial cyclical rebound, domestic demand has been increasingly important. This is not unexpected, considering the relatively small share of the external sector on the Brazilian GDP. There are two major factors behind the increase in domestic demand: credit expansion and the recovery of the labor market. According to data produced by CNI, seasonally adjusted by the BCB, employment in the manufacturing sector, after recording in February the highest level of the series since the end of 1998, still presented continuous growth in the following three months (0.3% in May, compared to April). A similar trend has also been observed for real payroll, which attained levels equivalent to those verified in the first half of 2001. In June, according to the Ministry of Labor and Employment, formal employment increased again, accumulating a growth rate of 3.9% in the first half of 2004, compared to the same period of 2003, which corresponds to the creation of 1 million jobs, the highest job creation in the first half of any year.
22. In the June minutes, the Copom emphasized some reasons why the current economic recovery lagged its effects on the urban unemployment rate estimated by the Brazilian Institute of Geography and Statistics (IBGE). Those reasons include the unemployment rate seasonal behavior, the labor force increase and the higher expansion of employment out of the largest urban areas. However, in May these factors were offset by other factors that caused the reduction in the unemployment rate, to 12.2% from 13.1% in April.
23. The Brazilian external sector has continued to post sizeable results. The trade balance registered a US\$3.8 billion surplus in June, a new historical high, accumulating a US\$15.0 billion surplus in the first half of the year. Both marginal exports and imports have grown significantly. The BCB's trade



## BANCO CENTRAL DO BRASIL

balance projection remains at a high level (US\$ 26 billion in 2004), despite the economic activity rebound. As to the current account, the first half of 2004 surplus reached US\$2.5 billion.

24. The external scenario has improved since the last Copom meeting, although some tension has persisted, mainly due to new hikes in oil prices. The pressures on the exchange rate and the country risk have subdued. As a consequence, the exchange rate has appreciated to R\$3.00/US\$ from R\$3.16/US\$, with reduced volatility, and the country risk measured by the JP Morgan Chase's Embi+ decreased to 587 b.p. from 705 b.p. On the other hand, the Brent oil price, after falling in June, increased 12.8%. Even considering a more favorable outlook in the last few weeks due to a less uncertain monetary policy in the U.S., the scenario is not completely consolidated, indicating that new episodes of volatility might occur in the future.
25. The deterioration of market inflation expectations, initiated in May, has continued in July, especially for 2004. The median market expectations for IPCA for this year rose to 7.10% from 6.71%, and for 2005, to 5.5% from 5.44%. Inflation expectations for the next twelve months increased to 6.27% from 6.03%.
26. Despite the recent exchange rate appreciation, the deterioration of inflation expectations, the higher-than-expected June inflation and the increase in the expected annual adjustment of fixed telephone services explain the increase in the Copom's inflation projections for 2004 and 2005. The benchmark scenario projections, based on unchanged Over-Selic and exchange rates throughout the projection horizon, point out to an inflation rate above the 5.5% target for 2004 and slightly above the 4.5% target for 2005. 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). The Committee also assessed a third hybrid scenario, considering the market exchange rate expectations and an unchanged Over-Selic rate, coming to an inflation projection that stands between the inflation outcomes estimated on the two usual scenarios.
27. 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. This is a period in which inflation will be more sensitive to monetary decisions taken in the next few months, and at the same time, it presents more reliable inflation projections than the ones for the full 2005. The projected inflation for this 12-month period, both on the benchmark and market scenarios, stood slightly above the interval between the central inflation targets for 2004 and 2005.
28. As highlighted in previous Copom's minutes, the unstable external scenario has generated a short-term volatility that tends to broaden the uncertainty about the future behavior of inflation. On the one hand, this uncertainty has diminished in the last weeks. On the other hand, several other factors were responsible for the deterioration of the Copom's inflation projections since the last meeting, despite the exchange rate appreciation in the period. Those factors include the increase of the private-sector inflation expectations, the upward review of fixed telephone tariffs and the acceleration of the economic activity pace.
29. Regarding economic activity, although fixed capital investment has been recovering, the level of capacity utilization has also increased, reaching historical highs. The fast increase in aggregate demand and in fixed capital investment have generated higher uncertainty about the capacity to expand the supply of goods and services without triggering inflationary pressures. Even considering that monetary policy must be oriented to accommodate the primary effects of supply shocks as those recently observed, it is important to avoid the secondary effects of inflation increases, containing the upward revision of inflation expectations. In addition, it is also essential to carefully evaluate the current and future supply and demand conditions of the economy.
30. The Committee's members believe that the maintenance of the current Over-Selic rate for a long period should consolidate a favorable inflation scenario, with the convergence of market inflation



## **BANCO CENTRAL DO BRASIL**

expectations and the actual inflation rate to the inflation targets. However, the monetary authority restates that a more active policy stance will be adopted if the projected inflation deviates from the targets, due to an eventual deterioration of the factors that were responsible for the recent increase in inflation projections for 2004 and 2005.

31. Even with a deteriorated inflationary environment, and the respective change in the required monetary policy stance, there are no reasons to review economic growth expectations. Indeed, by fighting the second-order effects of the shocks recently observed, the monetary policy is aimed at preserving the medium-term sustainable growth, promoting the balance between the aggregate demand expansion and the broadening of the productive capacity of the economy.
32. 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.
33. At the closing of the meeting, it was announced that the Copom would meet again on August 17, for technical presentations, and on the following day to discuss the monetary policy decision, as established in Communiqué 11,516, of October 15, 2003.





## **BANCO CENTRAL DO BRASIL**

### **SUMMARY OF DATA ANALYZED BY THE COPOM**

#### **Economic Activity**

34. According to IBGE's retail survey, sales increased 10.0% in May, compared to the same month of 2003. In the year up to May, retail sales and the retail nominal revenue increased 8.5% and 9.8%, respectively, compared to the same period of 2003. The regional distribution of growth was generalized, encompassing all States in the country, except Roraima. All groups encompassing the retail sector showed year-on-year growth in May, with highlights to furniture and electrical appliances.
35. The São Paulo Trade Association (ACSP) data for June registered a 0.2% increase in credit retail sales, while the Usecheque system consultations decreased 2.2%, both compared to May and seasonally adjusted. In the first half of 2004, the same indicators rose by 7.0% and 1.2%, respectively.
36. The Fecomercio-SP consumer sentiment survey showed that confidence improved in July, after falling in June. In the month, the Consumer Confidence Index (ICC) increased 0.9%, standing at 118.7 points (range 0 to 200).
37. Regarding fixed capital investment, capital goods output and construction inputs continued to grow in May, accumulating year-on-year expansions of 22.5% and of 1.8%, respectively. Domestic capital goods absorption increased 11.4% in the same comparison basis. The National Bank for Economic and Social Development (BNDES) credit operations increased 47.7% in the first half of 2004. Credit operation to the industrial sector (about 41% of the total credit outstanding) expanded by 27.7%, while credit to commerce and services sector increased by 52.8%, and credit to agriculture sector increased 101.3%.
38. The IBGE's monthly industrial survey registered a 2.2% increase in industrial output in May, compared to April, seasonally adjusted. The manufacturing industry expanded 2.4%, while mining activity remained stable. Out of the 23 activities surveyed, 18 increased output, and all categories of use expanded. In the year up to May, industrial output increased 6.5%, 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 the activities benefited from the favorable performance of the exports and agribusiness sectors, as well as from credit expansion. The recovery of semi and non-durable goods production, albeit less intense, have increased in tandem with the gradual improvement of domestic demand.
39. In May, the CNI recorded a 3.0% increase in real industrial sales and a 1.3% increase in industrial worked hours, in comparison to April, seasonally adjusted. Compared to the same month in 2003, real sales and worked hours increased 20.3% and 3.8%, respectively. The level of capacity utilization reached 81.8%, with a 0.8% monthly increase, seasonally adjusted, and a 1.6% growth in the yearly average up to May, compared to the same period of 2003.
40. In June, already published indicators point to a continued expansion in industrial output. Steel output grew 2.5%, seasonally adjusted, accumulating a 5.4% growth in the first half of the year. The car industry produced 187 thousand vehicles, up 4.5% compared to May (seasonally adjusted), and 27.7% above June 2003. In the first half of 2004, car production increased 14.8%, while domestic sales and exports expanded 20.7% and 3.8%, respectively, compared to the same period of last year.

#### **Labor Market**



## **BANCO CENTRAL DO BRASIL**

41. The seasonally adjusted formal employment index increased 0.5% in June, compared to May, and 4.8% compared to June 2003, according to the Ministry of Labor and Employment. In the first half of the year, a 3.9% expansion was recorded, corresponding to the creation of more than 1 million jobs.
42. According to the IBGE, the unemployment rate in the six main metropolitan areas of the country declined to 12.2% in May from 13.1% in April. The number of employed workers increased 0.8%, the highest change in the year, while the number of unemployed workers declined 6.7%. The estimated labor force totaled 21.5 million people, with a decline of 0.2%. The same survey registered that the average real earning (deflated by the INPC) in May was 1.4% below the one in May 2003. Real payroll, however, grew 1.5% in the month, year-on-year, reflecting the employment growth.
43. According to CNI seasonally adjusted data, real payroll and employed workers increased 0.2% and 0.3% in May, respectively, compared to April. In the year up to May, real payroll and employed workers increased 7.5% and 0.7%, respectively, compared to the same period of 2003.

### **Credit and Delinquency Rates**

44. Non-earmarked credit operations grew 1.5% in June. Corporate credit with domestic funding increased 3.9%, while credit with external funding decreased 2.6%. Individuals credit outstanding increased 1.8% in June, accumulating a 21.9% rise in twelve months.
45. The average interest rate on non-earmarked credit decreased 0.2 p.p. in June to 44% p.a. The result was due to a decline of 0.3 p.p. in the average lending rates to companies, which fell to 29.7% p.a., while the average rate to individuals remained stable at 62.4% p.a.
46. Regarding delinquency in the retail sector, the net default rate measured by ACSP decreased to 4.3% in June, the lowest level in the year. In the year up to June, the number of cancelled files and new negative files increased 10.2% and 6.5%, respectively. The number of checks returned in comparison to the total number of checks decreased to 5.1% in June, the lowest level of the year.

### **External Environment**

47. World economic growth continued to gain momentum at the end of the first half of 2004. In Japan, the economy has firmly recovered, mainly boosted by the vigorous regional trade, with improvements in the corporate sector transmitted to consumers. Economic recovery in Europe is still slow, while in the U.S. the economy has expanded at a moderate pace, reinforcing expectations of a gradual monetary policy adjustment. Consumers' and producers' inflation showed declines in June in the main industrialized economies.
48. In June, the U.S. industrial production declined 0.3%, the sharpest fall since April 2003 and immediately after a 0.9% increase in May. The capacity utilization level decreased to 77.2% compared to 77.6% in May. The manufacturing activity registered its first monthly decline in thirteen months. There was also a decline in retail sales, the highest in eighteen months, mainly due to a decrease of 4.3% in vehicles sales.
49. Further to the U.S. economy, labor market registered an increase of 112 thousand jobs in June, against the average of 300 thousand in the previous three months. However, the number of new unemployment claims has stood below 350 thousand since March, which is historically consistent with the creation of around 200 thousand new jobs. The trade balance registered a lower-than-expected US\$46 billion deficit in May, a trend explained by the dollar depreciation, with exports and imports increasing 4.2% and 0.5%, respectively. The federal government registered a US\$19.1 billion budget surplus in June, accumulating a US\$326.6 billion deficit in the fiscal year to June.





## **BANCO CENTRAL DO BRASIL**

50. Regarding business confidence, the services BAI index in the U.S. declined in June. In Japan, the Tankan indicator increased for the fifth consecutive month, registering a record high since 1991. In Europe, business confidence remained flat, although consumer confidence increased. The US consumer confidence increased in June to 101.9, after remaining nearly unchanged at 93.1 in the previous month. In Japan, consumer confidence also rose significantly.
51. After the FOMC's decision to increase the fed funds rate in 25 b.p. at the end of June, the markets reacted positively, with some volatility in the stock market due to the release of corporate balances. The main commodity prices registered some accommodation in the international market, but still remaining above historical averages. Oil prices have maintained an upward trend, influenced by new attacks to Iraq oil pipelines and by the problems faced by the Russian oil company Yukos.
52. In China, the 9.6% annual growth in the second quarter, although expressive, was below the expected 10% rate. The monetary and credit measures adopted by the Chinese government have been limiting investment in the most dynamic sectors, aiming at controlling inflationary pressures. Consumer prices increased 5.0% in June compared to the same month of 2003, and producer prices grew 6.4% in the same comparison basis.

### **Foreign Trade and Balance of Payments**

53. The Brazilian trade balance posted a US\$3.8 billion surplus in June and the external trade totaled US\$14.8 billion. Exports and imports increased 51.2% and 49.2%, respectively, compared to June 2003 daily averages. In the first three weeks of July (12 working days), the Brazilian trade surplus totaled US\$1.7 billion, an increase of 47.2% and 42.5% in exports and imports, respectively, compared to the average figures of July 2003.
54. In June, the current account registered a US\$2.1 billion surplus, accumulating a US\$4.4 billion surplus in the year. In the first half of the year, the trade balance and the current transfers posted US\$15.0 billion and US\$1.6 billion surpluses, respectively, while the services and income account posted a US\$12.2 billion deficit. Net Foreign Direct Investment reached US\$737 million in June, accumulating US\$4.0 billion in the first half of the year. In the same period, external direct loans and private securities rollover rates reached 136% and 64%, respectively. At the end of June, international reserves stood at US\$49.8 billion, while net reserves stood at US\$22.8 billion (IMF concept).

### **Money Market and Open Market Operations**

55. The improvement in the external environment after the June Copom's meeting influenced the domestic yield curve. From June 16 to July 21, the spread on the 6-month rate in relation to the Over-Selic rate decreased to 0.78 p.p. from 1.06 p.p.; the spread on the 1-year rate decreased to 1.25 p.p. from 2.01 p.p.; and the spread on the 2-year rate decreased to 1.95 p.p. from 2.98 p.p. As a consequence, the real interest rate measured by ratio of the one-year nominal interest rate to the 12-months-ahead inflation expectations declined to 10.1%.
56. In the period between the last Copom meetings, the BCB carried out an auction to rollover Fx swaps. In this auction, US\$673.6 million in swaps were contracted (27% of the principal coming due on July 1st), with tenures of 6 and 24 months. The BCB decided not to rollover the maturing of around US\$1 billion on July 15, due to the low demand for Fx hedge. Therefore, the net redemption of Fx linked securities and swaps will total US\$3.6 billion at the end of July and US\$22.0 billion in the year to July.
57. Due to lessened market volatility, the National Treasury resumed LTNs placements, carrying out five offerings of securities maturing in January and July 2005, totaling R\$12.1 billion. Five LFTs



## **BANCO CENTRAL DO BRASIL**

auctions were also carried out, totaling R\$17.6 billion maturing in 2005, 2006 and 2007. The issuance of National Treasury Notes – Series B and C (NTN-Bs and NTN-Cs) amounted R\$ 2.5 billion, R\$1.1 billion of which settled in currency and the rest settled in exchange for other National Treasury's securities.

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 the 2-working-day liquidity management operations. The BCB also carried out in this period 16 fixed rate repos falling due between 1 and 2 working days. In the period, the excess liquidity drained from the market with operations shorter than 30 days and with 3-month tenure averaged R\$55.2 billion and R\$34.2 billion, respectively.
59. In June, the net securitized domestic public debt increased R\$9.8 billion due to interest rates accrual. The dollar-linked share decreased to 16.6%, which represented a fall of 0.8 p.p. in the month and 6.3 p.p. in 2004.