December 3rd, 2001

MINUTES OF THE 65th MEETING OF THE BANCO CENTRAL DO BRASIL MONETARY POLICY COMMITTEE (COPOM)

Summary

Date: November 20th and 21st, 2001
Place: Central Bank's Headquarters 8th floor meeting room (on 11.20th) and 20th floor (on 11.21st) - Brasília - DF
Called to Order: 4:00 PM on 11.20th and 4:26 PM on 11.21st
Adjourned: 7:51 PM on 11.20th and 7:10 PM on 11.21st

In attendance:
Members of the Board
Arminio Fraga Neto - **President**
Carlos Eduardo de Freitas
Daniel Luiz Gleizer
Edison Bernardes dos Santos
Ilan Goldfajn
Luiz Fernando Figueiredo
Sérgio Darcy da Silva Alves

Department Heads (all present on Nov.20th)

Altamir Lopes – Economic Department (DEPEC)

Daso Maranhão Coimbra - International Reserve Operations Department (DEPIN)

Gustavo Bussinger - Research Department (DEPEP)

José Antônio Marciano - Department of Banking Operations and Payment System (DEBAN)

Sérgio Goldenstein - Open Market Operations Department (DEMAB)

Other participants (all present on Nov.20th)

José Pedro Ramos Fachada Martins da Silva – Advisor to the Board

João Borges - Press Secretary (ASIMP)

Fabia Aparecida de Carvalho - Coordinator of the Investor Relations Group

The Board analyzed the recent performance and prospects for the Brazilian and international economies under the monetary policy framework, designed to comply with the inflation targets established by the government.

Economic activity

The most recent released data indicate that the economic activity has stabilized between the third and fourth quarters of the year, interrupting the declining trend in place since April. The economic stability reveals that the adjustment of demand to the several shocks that occurred this year may be over, as indicated by the behavior of retail sales and consumer intentions.

Short term expectations of consumers improved. The Consumer Intentions Index (IIC), surveyed by the Federation of Commerce of the State of São Paulo(FCESP), increased by 0.2% in November compared to the previous month. The component that measures current consumption intentions rose by 7%, revealing that customers have overcome the negative emotional impacts caused by recent international events. Nonetheless, the survey also revealed that consumers remain cautious in regard to the future economic environment, fearing an increase in unemployment and inflation, important reasons explaining the 3.4% fall in future consumption intentions.

Retail sales in October increased for the third consecutive month. Retailers turnover in the Metropolitan Region of São Paulo, measured by FCESP and seasonally adjusted by Central Bank's

Economic Department (Depec), increased by 1.2%, as a result of the recovery of car and light vehicle sales through dealers chains to final consumers, basically due to special financing . As the other segments surveyed presented lower sales in comparison to September, the overall retailers' turnover was lower than in the same period last year.

The National Confederation of Industries (CNI) registered a 3.79% expansion of real industrial sales in September (seasonally adjusted series), which led to a 14.5% growth year to date. Seasonally adjusted industrial sales moved back by 0.3% in September, reflecting the negative performance of twelve out of the twenty industrial sectors, and three out of four categories of use, the exception being the production of semi-durable and non-durable consumer goods, which registered a 0.2% increase due to the performance of food producers, mainly the ones directed to external markets. In the year, industrial production accumulates a 3.1% expansion.

The utilization rate of industrial capacity reached 79.15% in September showing a reduction for the seventh consecutive month in September (0.57%), as informed by CNI (data seasonally adjusted by Depec). Nonetheless, year to date results are still 0.29% above the levels of the same period last year.

The open unemployment rate, calculated by the Brazilian Institute of Geography and Statistics (IBGE) for six Metropolitan Regions, was of 6.15% in September, compared to 6.18% in August. The average rate for the first three quarters of the year reached 6.24%, contrasting with the 7.54% in the same period of 2000. It should be noted the 0.2% expansion in the seasonally adjusted series of formal employment, leading to a 3% increase year to date, corresponding to 772.7 thousand new labor positions up to September.

Investment indicators still show a favorable performance, despite the 4.9% and 11.3% decline observed in September in the production and imports of capital goods, respectively. Domestic production of such goods, specifically intended to face the energy crisis, grew by 46.4% ytd, compared to a 15.2% expansion of the overall production of capital goods. It is also worth emphasizing the 18.2% increase in the production of agricultural machinery, partly due to exports. Production of inputs for the civil construction industry also declined in September (2.3% in the seasonally adjusted series), leading to a 0.4% fall ytd. Based on the performance of investment indices, gross capital formation reached 21.5% of the GDP in September, as estimated by Depec.

Exports of the soybean and by products grew by 25.7% from January to October, in comparison to the same period of 2000. It should be highlighted that this result was due to the increase of the shipped *quantum*, since average prices fell on the same comparison basis. Besides the performance of soybean and by products, exports of meat were also strong thanks to the qualification of Brazilian products that conquered new markets that had been left unserviced due to the diseases in European cattle herds. The 23.7% and 2.4% increase in the sales of basic products and manufactured goods, respectively, created the 7.3% daily average increase in overall exports in the aforementioned period.

Considering just ten working-days up to the third week of November, the trade balance totaled US$ 213 million, increasing the year to date accumulated surplus to US$1.7 billion. This improvement in the trade surplus is a result of reduced imports, as a consequence of both the depreciation of the Real and the deceleration of domestic activity. Furthermore exports of manufactured goods are expanding at a slower pace, given the constraints in foreign markets.

The outstanding balance of the financial system credit operations increased by 0.8% in October, reaching R$ 335.4 billion, of which R$199.1 billion refer to operations with freely allocated resources, which increased by 0.6%. Such growth was caused by the 0.2% reduction in operations with corporations, where the outstanding balance of Anticipated Exchange Contracts (ACC) plummeted, while credit to households increased by 2.2%.

As for new loans, a 14.4% increase was registered in operations with corporations in October. The outcome reflected more working-days in October in relation to September, and also seasonal patterns of the period, particularly operations with working capital (capital de giro) and authorized overdraft (conta garantida). In relation to household credits, their overall balance increased by 14.1%, to a great extent due to the performance of credit card operations.

The collection of taxes and contributions administered by the Federal Revenue Secretariat totaled R$17.1 billion in October, an increase of 17.3% in the month and 14.7% ytd compared to the same period last year**.** These increases were mainly due to the growth of the collection of Income Tax Withholdings (IRRF), especially on capital gains, to the Provisional Contribution on Financial Transactions (CPMF), to the Income Tax (IR) and to the Social Contribution on Net Income

(CSLL) of financial entities, influenced by their enlarged profits. It should be mentioned that taxes that are more directly related to the level of economic activity performed below the overall average collection, reflecting the deceleration of economic activity.

In summary, there are indicators showing that economic activity has already absorbed the impacts caused by the deterioration of the external environment and the energy crisis, what points to a gradual recovery in growth. This interpretation is also supported by the favorable performance of formal employment, enhanced by positive expectations related to year-end sales, previously postponed by the uncertainties affecting decisions of consumers and producers.

External environment

Economic indicators in industrialized countries show that the deceleration of the economic activity, in place since the beginning of this year, has been replaced by a contraction, beginning **at** the end of the third quarter. In the United States, GDP declined by 0.4% this quarter, compared with the previous quarter (seasonally adjusted and annualized data). In the Euro area, national and regional indicators available point to a significant reduction in the growth rate for the third quarter. Japan's GDP declined in the second quarter, leading the Bank of Japan to reduce its growth projections for the current fiscal year.

In the United States, GDP in the third quarter contracted for the first time since 1993 (0.4%), reflecting the impacts of economic weakening made worse by the terrorist attacks of September 11th. The result was affected by the private investment behavior, -10.7%, which has declined by over 10% for the past three quarters. Consumer consumption, which had been supporting output, grew by 1.2%, after reaching 2.5% in the previous quarter. The 1.1% reduction in industrial production in October, the 13th consecutive contraction, reducing the variation in the 12-month accumulated figures to -1.4% from -0.5% in the previous month. The unemployment rate increased half of a percentage point, reaching 5.4% in October, when there were 415,000 less job offers in the non-agriculture sector.

Demand indicators are still showing decline. Personal expenditures with consumption declined by 1.3% in September, and increased by 3.4% in the last 12 months, maintaining the downward trend. Orders to the factories and production of capital goods were negative in 5.8% and 2.3% respectively in September, with the accumulated variation over 12 months registering -5.7% and 1.8%. Retail sales increased by 7.7% in October, after having declined by 2.2% in the previous month, a result coming mainly from the 25.9% increase in the automobile sales. The core index, which excludes vehicles and autoparts and components increased by 1%, in line with market expectations. Credit to consumers increased by 0.2% in September, and the accumulated in 12 months declined to 6.8% from 7.4%, between August and September. Finally, although the initial construction of residential homes indicator presented a contraction of 1.3% in October, the accumulated result over 12 months was positive for the first time since February 2000, reaching 0.4%. Mirroring the slowdown in the economic activity and the new government policy, plus the initial impacts of the fiscal measures adopted after September 11th, the federal government fiscal result was lower than in the previous year from June on, reverting the trend of increasing surpluses observed since 1998. The fiscal year of 2001 represented a $127.2 billion surplus, 46.3% below the record result of $236.7 billion in 2000.

The terrorist attacks hit market expectations, captured by surveys with entrepreneurs (NAPM) and consumers (Conference Board). Expectation indicators in the manufacturing sector, as measured by NAPM, declined to 39.8 in October from 47 in September, once more indicating economic contraction. In the services sector the reduction measured by NAPM in the same period was from 50.2 to 40.6. Consumer confidence was also affected, and the index declined by 28.5 points between August and October reaching 85.5.

With the slowdown in the economic activity and the reduction in the energy prices, especially petroleum, inflation indices declined, widening the space for a more expansionist monetary policy. Consumer prices (IPC) declined by 0.3% in October, with an annual growth of 2.6% in September and 2.1% in October. The IPC core in October increased by 0.2% in the month, and 2.6% ytd. Producer Prices (IPP) declined the most, -1.6% in October, with a negative variation of 0.4% ytd.

Several U.S. statistics indicate a scenario which lacks dynamism, with the likely repetition of the negative GDP result in the two following quarters. Recovery should start from the second quarter of 2002 on with the full effects of the fiscal and monetary policy measures.

In the Euro area, world economic slowdown negatively affected the activity level. Notwithstanding, retail sales and trade balance results increased in August. In regard to the first, annual growth increased to 1.8% from 1.5%, while trade balance surplus reached $18.7 billion accumulated in the last 12 months until August, $5.6 billion above the result in the previous month. In September, industrial production registered the third negative variation in the year, 0.6%, while the unemployment rate remained stable at 8.3% in September. Harmonized Consumer Price Index (IPCH) declined to 2.4% ytd in October from 3.4% in May. The quarterly moving average of the M3, first pillar of the monetary policy in the region, however, accelerated from March on and reached a 6.9% growth in August, above the 4.5% reference. In the main countries of the Euro area, business expectations remain unfavorable, with emphasis on the 12 percentage points reduction in the Italian indicator, between August and September.

In Japan, the contraction of the main indicators of domestic demand – factory orders, residential home construction initiations and spending-, together with the cooling down of the external demand, the deflation, and the lack of supply reaction to the zero interest rate monetary policy, form a scenario of continued recession. The Bank of Japan revised its expectations of GDP growth for the fiscal year to a range of –0.6% and –1.6% from a range of 0.3% to 0.8%.

In Argentina, continued recession makes it more difficult to reach the "zero deficit" target between October and December, mainly due to the reduction in tax collection. The government initiated a debt swap program with local creditors, aiming at reducing interest rate burden. This program was interpreted by the rating agencies as a "selective default", resulting in additional lowering of the country's ratings. The difficulties in Argentina reflected in the sovereign risk indicators, with the spread of the Argentine bonds and US securities surpassing 3,000 basis points.

Prices

In October, the inflation rate measured both by the general and the consumer price indices increased once again. This upward movement reflected mainly the readjustment of fuel prices and the increase in the prices of cigarettes, rice – due to a smaller than expected harvest -, and meat - caused by off-season problems and exchange rate effects related to export growth.

The IPCA rose by 0.83% in October compared to 0.28% in September, accumulating 6.22% ytd and 7.19% in 12 months. Food prices increased by 1.15%, mainly due to the 10.7% and the 5.23% increase in the prices of rice and meat, respectively, responsible for 0.23 percentage points in the monthly variation of index. The prices of non-food products increased by 0.74%, with the 3.58% increase in gasoline prices being the largest individual contribution to the IPCA of the month (0.16 percentage point). The prices of cigarettes went up by 6.38%, reflecting a 14% average readjustment in place since October 12th .

The IGP-DI increased by 1.45% in October, compared to 0.38% in September, accumulating 9.36% ytd and 10.62% in 12 months. In relation to the previous month, there was an acceleration in all of its component indices, more intensively in the IPA, which increased by 1.88% from 0.48%, responding for 1.13 percentage points of the IGP result. The growth in October wholesale prices reflected the behavior of agricultural prices, which increased by 1.74% from 0.48%, as well as industrial products, which rose by 1.94% from 0.75%. The lower supply of important agricultural products, caused by off-season problems and by smaller than expected harvests, together with the influence of the depreciated exchange rate and the readjustment of fuel prices were the main reasons which explain the hike in wholesale prices, especially beef, rice, oranges, and fuel. In the retail segment, the main influence came from food (0.27 pp), transport (0.16 pp), housing (0.13 pp) and personal expenditures (0.1 pp).

For November, a smaller increase is expected for all indices, although the results will still be influenced by pressures posed by October readjustments, particularly of fuel and cigarettes. The prices of meat and its by-products will continue to increase due to the reduction in supply, affected by off-season problems and the increase in exports. The readjustments of electric energy in Light's distribution area, added to urban bus fares hikes in Rio de Janeiro and prices of medicines , will also be observed in November results.

Money market and open market operations

Since the last Copom meeting, the slope of the interest rate curve showed continued reduction. The reduction in interest rates was stimulated by improvements in the prospects for the domestic economy. The more optimistic forecasts for the Balance of Payments, the exchange rate appreciation, and the expressive fiscal surplus built up the basis for a more favorable perception of the fundamentals of the domestic economy, leading to the decoupling of Brazil's sovereign risk from Argentina's. As a result, the spread between the Over-Selic rate and the three-month Futures

DI to February declined to 13 bps on November 19th from 210 bps on October 17th. Likewise, the one-year interest rate spread decreased to 150 bp from 560 bp.

After a massive selling of R$23.4 billion in exchange rate indexed securities placed between September 13th and October 10th, there was a sole unscheduled offer of NTN-D on October 25th, amounting to R$ 1.6 billion. The improvement in the domestic scenario led to a lower demand for hedging. In addition, there were three auctions to rollover expiring exchange rate indexed securities in November. The strategy adopted was to lengthen the issuance tenure. The resulting financial volume transacted was of R$5.5 billion, 83% of which with securities maturing between 3 and 7 years.

The National Treasury continued to offer six-month LTN on a weekly basis, recommencing at the beginning of October. Five LTN public offers were carried out since October 23rd, totaling R$ 7.3 billion. The improved prospects for the domestic economy accentuated the demand for fixed rate securities. The average yields presented a downward trend, decreasing to 20.02% on November 20th from 23.04% on October 23rd. The demand/supply ratio in the auctions oscillated between 1.6 and 2.7.

As a result of the financial settlements which occurred between October 17th and November 20th, a R$5.2 billion expansionist monetary impact was observed in the period. This impact resulted from the net liquidations of R$3.2 billion in LTN, R$1.2 billion in LFT and R$1.1 billion in exchange rate indexed securities.

During a 21 working day period, the Central Bank intervened nine times in the open market, aiming at administering the very short-term interest rate. In all operations, the Central Bank provided liquidity to the market at a hurdle yield of 19.05%. The average volume of the interventions was of R$18.3 billion, at a 2.3 day average tenure.

Assessment of inflation trends

The identified shocks and their impacts were reassessed in the light of newly available information. The scenario considered in the simulations considering the following hypotheses:

1. October inflation rate, measured by the IPCA, reached 0.83%, above the expected result;

2. The forecast for prices of oil-by products was calculated based on the term structure of prices implied in the Brent crude oil futures contracts. The expectation for the trajectory of the average price of the Data Brent barrel was substantially reduced to US$19 in the last quarter of 2001, reaching US$20 at the end of 2002. This trend projects a 4.9% reduction in fuel prices to consumers in 2002;

3. For a wider set of contractual prices, the expected readjustment in 2001 increased to 10.8% in November from 10.0% in October. For 2002, the expected readjustment is of 5.8%;

4. The forecast for the readjustment of electricity tariffs in 2001 remained at approximately 20%. For 2002, a higher readjustment is expected, which may reach 30%;

5. The projected slope of the domestic yield curve, measured as the difference between the 180-day term DI rate and the 1-day Selic rate, was significantly reduced to an average of 297 basis points in the fourth quarter of 2001, linearly declining to an average of 250 b.p. in the first quarter of 2002, and remaining stable until the end of the year;

6. The path of the U.S. fed funds rate projected based on the maturity of futures contracts was altered to reflect an average rate of 2.2% in the fourth quarter of 2001, declining to 1.9% in the first quarter of 2002 and showing a moderate increase thereafter;

7. On the external front, the assumption for the average risk premium, using Brazil's Global 04 Bonds, incorporates a declining path from current levels to a plateau near 700 b.p. from the second quarter on, with stability thereafter;

The core inflation of the IPCA, calculated under the symmetric trimmed-mean method, remained stable at 0.57% in October. Accumulated in 12 months, the core index increased by 6.57%. The core inflation of the IPC-BR, calculated under the symmetric trimmed mean-method, rose by 0.56% in October. Accumulated in 12 months, this core increased by 6.42%. The inflation core calculated with the exclusion of contractual prices – considering the wide set weighing 30.6% in the IPCA in October – and of household food prices increased by 0.48% in October, with accumulated variation of 4.28% in 12 months.

Year-to-date, the IPCA increased by 6.22% in October, reflecting the 2.8% contribution from contractual prices (9.5% variation) and 3.4% from free prices (4.8% variation). For the remainder of the year, a 0.4% contribution is expected from contractual prices (1.3% variation). The evolution of the contractual prices is expected to directly contribute with 3.2% for the year inflation, compared to the 2.9% estimated in October. In 2002, the contractual prices are expected to increase by 5.8% (with a direct contribution of 1.8%, which excludes the second-round effects on inflation), influenced by the 30% hikes in electricity for the residential consumer.

Regarding fiscal policy, it was assumed that the primary surplus targets for the consolidated public sector stated in the Government Economic Program will be achieved. The remaining assumptions made in the previous meeting were maintained.

Simulation exercises with several specifications of the structural model led to the conclusion that the maintenance of the interest rate at the current level of 19.0% p.a. and of the exchange rate at the same plateau as of the eve of the Copom meeting would result in inflation above the upper limit of the target for 2001. For 2002, the projected inflation is around 4.0%.

Monetary Policy Guidelines

Positive expectations regarding the Brazil's economic performance in 2001 and 2002 contributed to the appreciation of the Real as well as to the reduction in Brazil's risk. The Real significantly appreciated since the last COPOM meeting, changing to R$ 2,50-2,55/US$ on the eve of the meeting. Brazil's risk premium as measured by the yield's differential between the Global 04 and the U.S. Treasury bond of equivalent duration also improved, as may be observed by the drop higher than 250 bps in the period. Therefore, the upward trend observed until mid-October reversed, which becomes more important when compared to the increased risk of emerging countries, specially that of Argentina. Particularly, the expectation of a reduction in the current account deficit and an improvement in the country's external financing, supported by the monetary and exchange policy adjustments, contributed to the appreciation of the Real as well as to the reduction of Brazil's risk.

This improvement was also followed by a significant reduction in the international prices of Brent crude oil to US$ 19/barrel from US$ 22/barrel since the last meeting. Besides the direct benefit of the drop of international crude oil prices on inflation, there is still an indirect benefit caused by the lower pressure on the exchange rate market, given the weight of this item in our imports.

The expectation regarding the economic growth also improved. There are signs of a smooth reversion of the cooling trend that followed the effects of the shocks that hit the economy, such as the deceleration of the world economy, the Argentine crisis, the September 11th attacks in the U.S. and the energy rationing, in addition to the effects of the more restrictive domestic monetary policy after March 2001. The reversion, yet incipient, can be observed in the increases in the retail commerce in São Paulo, in the number of requests to the Credit Protection Service (SPC) and in the Consumer Intentions Index, as well as in the stability observed in industrial activity.

A reduction in the slope of the term interest rate came along with a lower exchange rate pressure and a drop in Brazil's risk. The slope for 6 month-tenure fell to around 130 bps on the eve of the last Copom meeting from an average of 524 bps in the third quarter.

Despite the favorable performance of the economy, there was not a correspondent improvement in the prospects for inflation. The median expectations for the IPCA variation, considering the sample comprising the aggregate of the surveyed financial institutions collected daily by the Central Bank, showed an increase to 7.1% from 6.6% for 2001 and to 5.1% from 5.0% for 2002.

There are several factors which might have contributed to the worsening of the inflation forecasts. Firstly, the IPCA in October registered an increase higher than that expected, reflecting a higher passthrough of the exchange rate depreciation occurred during the year to prices. The increase in inflation in 2001 tends to feed the expected inflation for 2002 through its inertial component. Indeed, the indicators of the core inflation, calculated under the symmetric trimmed-mean average method, remains at a high plateau.

Secondly, the lower slope of the term structure of the interest rate also contributes to demand recovery, what could lead to larger pressure on the prices in 2002. This effect may attenuate the downward impacts of the recent appreciation of the Real upon the inflation in 2002.

Finally, the perspectives regarding the readjustment of the contractual prices next year remain high. Particularly, the increase in electricity prices may reach 30%. Besides, the reduction of the subsidies to the cooking gas prices is being considered, which implies in price increase. These increases mean an important supply shock for the economy in 2002. In general terms, the behavior of the contractual prices should directly contribute with 3.2% of the inflation in 2001 and, at least, with 1.8% in 2002 (even excluding the second-round effects of these increases on inflation).

In summary, the improvement in several Brazilian economic indicators was not accompanied by an improvement in inflation forecasts despite the favorable effects of the exchange rate appreciation and the drop in international oil prices. The hikes in contractual prices expected for 2002 represent a supply shock that adds to the secondary impact of the shocks occurred this year on the prices. This imposes narrow limits to the free prices inflation indicator next year. In this context, the incipient recovery of the demand, which might be stimulated by the lower slope of the interest rate curve and by an improvement in the expectations in general, must be monitored to avoid the passthrough of the shocks of 2001 for the inflation in 2002.

Accordingly, COPOM unanimously decided to maintain the target for the Selic rate at 19%.

At the close of the meeting, it was announced that the Committee would meet again on December 18th , at 3:00 p.m, for technical presentations and, on the following day, at 4:30 p.m., in order to discuss monetary policy guidelines, as set in Calendar of Copom's Ordinary Meetings, published in the Central Bank Communiqué n. 8018, of 11.22.2000.

Acronyms

ac 12m accumulated in 12 months

ACC Anticipated Exchange Rate Contracts

BM&F Mercantile and Futures Exchange

CDI Interbank Futures Contract

CETIP Center for Financial Custody and Settlement of Private Securities

CNI National Confederation of Industries

CPMF Provisory Contribution on Financial Transactions

CSLL Social Contribution on Net Profit

DI Interbank Deposit

FCESP Commerce Federation of the State of São Paulo

FED Federal Reserve System

FOMC Federal Open Market Committee

FRA Forward Rate Agreement

GDP Gross Domestic Product

IBGE Brazilian Institute of Geography and Statistics

IF Financial Institution

IGP-DI General Price Index – Domestic Supply

IIC Consumer Intentions Index

IPA Wholesale Price Index

IPC Consumer Price Index

IPCA Consumer Price Index – Extended

IPCH Consumer Price Index – Harmonized

IPP Producer Price Index

IR Income Tax

IRF-M Market Fixed Income Index

IRRF Withholding Income Tax

NAPM National Association of Purchasing Managers

NTN-D National Treasury Note – D Series

p.a. per annum

p.m. per month

PEA Active Working Population

pp percentage point

STN National Treasury Secretariat

ytd year-to-date