

August 30, 2002

**BANCO CENTRAL DO BRASIL (BCB)
MINUTES OF THE 74th MEETING OF
THE MONETARY POLICY COMMITTEE (COPOM)**

Summary

Economic activity

External Environment

Prices

Money market and open market operations

Assessment of inflation trends

Monetary policy guidelines

Acronyms

Date: August 20 and 21, 2002

Place: Central Bank's Headquarters 8th floor Meeting room (on August 20) and 20th floor (on August 21) -Brasília - DF

Called to Order: 5:10 PM on August 20 and 11:47 AM on August 21

Adjourned: 7:51 PM on August 20 and 2:29 PM on August 21

In attendance:

Members of the Board

Arminio Fraga Neto - Governor

Beny Parnes

Carlos Eduardo de Freitas

Edison Bernardes dos Santos

Information for unrestricted disclosure. It is not intended to bind Banco Central do Brasil in its monetary or foreign exchange policy actions. Questions and comments to gerin@bcb.gov.br

Ilan Goldfajn

Luiz Fernando Figueiredo

Sérgio Darcy da Silva Alves

Tereza Cristina Grossi Togni

Department Heads (all present on August 20)

Altamir Lopes – Economic Department (DEPEC)

Daso Maranhão Coimbra - International Reserve Operations Department (DEPIN)

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

Marcelo Kfoury Muinhos - Research Department (DEPEP)

Sérgio Goldenstein - Open Market Operations Department (DEMAB)

Other participants (all present on August 21)

Antônio Carlos Monteiro - Executive Secretary

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

Alexandre Pundek Rocha - Advisor to the Board

João Borges - Press Secretary (ASIMP)

Tarsila Segalla Afanasieff – Investor Relations Group

The Board analyzed the recent performance of, 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

Recently released indicators confirmed the loss of dynamism of economic activity - signaled after May - due to the adverse conditions in the financial markets and as a result of uncertainties created by the Presidential elections campaign. Such factors reflected

significantly on consumer and business expectations, with impact on expenses, mainly those related to goods of relatively higher value. In spite of that, the FGTS (Time in Service Guarantee Fund) disbursements and significant improvement of the agricultural income this year, amongst others, supported the level of consumption, mainly of non-durable or durable goods of low value.

Preliminary figures released by São Paulo State's Federation of Commerce (Fecomércio-SP) showed a 3.5% increase in real turnover of retail commerce, seasonally adjusted data, in the metropolitan region of São Paulo in July. This performance is due particularly to the increase in sales of goods with lower unitary value. Sales of non-durable consumer goods increased by 3.4%, of semi-durable 3.3%, and of durable goods 3.2%, boosted by optical, film, photo and sound items. The sales of vehicles in general showed a decline of 9.6% in the month. The increasing trend of retail commerce had been shown by the indicators of São Paulo Trade Association (ACSP), regarding consultations of its Credit Protection Service (SPC) and the Usecheque with 3.5% and 3.2% variations respectively, compared to June, seasonally adjusted series.

Besides the payment of the remaining balance of the FGTS and the increase in agricultural sector income, the recent expansion of commerce turnover could be associated to factors such as increasing promotions and special sales in the period.

Another possible effect of the previously mentioned factors was the reduction of defaults to 7.2% in July from 8.3% in June, according to ACSP, mainly due to an increase of 23.4% of canceled registers (reinstatement). Also, in the financial market, the default data was favorable in July, when the percentage of returned checks due to insufficient funds showed a decline in relation to the total of cleared checks, reaching 4.7% as compared to 5% in June.

The volume of credit supplied remained stable in July. In addition to tighter selectivity imposed by financial institutions, demand remains constrained due to the uncertain

economic scenario, together with higher interest rates, which reflected on the movement of the futures market.

The outstanding credit operations provided by the financial system registered an increase of 2.2% in the month, totaling R\$359.5 billion, of which R\$213.1 billion referred to operations contracted by freely established rates, representing an increase of 1.7%. This outcome was related, for the third successive month, to resources with external funding, which registered a monthly nominal growth of 5.3%, basically due to exchange rate variation of 20.5% in the period.

Credit contracted by private individuals with freely allocated resources totaled R\$75.9 billion, in July, showing a decline of 0.8%. The daily average of new credits declined 4.7%, influenced by the payment of debts and commitments with the use of the FGTS reimbursements and of tax returns from the Internal Revenue (IR). In the period, the reduction in demand for personal credit and for borrowings for acquisition of vehicles should be highlighted.

The credit market had stagnated in part because of worsening of expectations in the last few months. The Index of Consumer Intentions (IIC) released by Fecomércio-SP, declined 5.5% in August, recording the second worst level of the year. Above all, the result was due to perceived deterioration of current economic environment, influenced mainly by the volatility in foreign exchange market. It should be noted that the August survey was carried out before the announcement of Brazil's new agreement with the International Monetary Fund (IMF).

The National Confederation of Industries', (CNI) and Getulio Vargas Foundation's (FGV) business surveys also registered the deterioration of expectations. The Confidence Index of the Industry Entrepreneur (ICEI), composed by the results of the CNI Industrial Survey, declined to 48.5 points in July, from 58.9 points in April, showing the same level as July

2001, at the peak of uncertainty due to the energy crisis. But, the perceptions of entrepreneurs, like those of consumers, regarding future expectations are less pessimistic than in respect to the current economic conditions. Another point to be noted in relation to those surveys was the fact that the entrepreneurs were referring to the general economic situation, and not to their own companies, as the main factor responsible for the recent behavior of the expectations.

In the last few months, the activity in industry clearly illustrated the deteriorating expectations. The industrial production that, in May, showed a 5.2% decline from the previous month, registered a variation of 0.8% in June, according to IBGE seasonally adjusted data. The results confirmed that the decline of production to a lower level was already becoming apparent in the previous month, reaching the same production level of July 2001, when the economy was facing the effects of the electricity rationing. It should be noted that the categories of durable consumer goods and capital goods were significantly affected in the 3rd bimester - May/June -, when the average levels of production were, respectively, 6.6% and 3.6% lower than the averages registered in the first four months of the year.

In fact, the general investment indicators are showing deceleration, influenced especially by lack of dynamism in the civil construction industry. Imports of capital goods declined significantly in May and June, but partially due to the customs strike. The domestic production of machinery and equipment showed a decline of 1.1% in the semester, but the hike in non-serial machinery for industry, transport equipment, and agricultural machinery and its related equipment should be mentioned. Regarding financing through the Brazilian Development Bank (BNDES), the resources directed to the sectors of infrastructure and agriculture merit note.

The loss of economic dynamism in the last few months reflected on the labor market. Although the average of open unemployment rate measured by IBGE had declined to 7.5% in June, from 7.7%, in May, the Economically Active Population (PEA) declined for the

first time this year, indicating that the perception of those who were looking for job that opportunities had diminished. The decline in the unemployment rate was due to the decline of 0.2% in the number of employed workers and of 3% in the number of unemployed workers. It must be pointed out that the average rate of unemployment reached 7.3% in the first semester, with prominence to the increase of 22% in the number of people looking for jobs and of 2.4% in the level of employed workers, in relation to the same period in the previous year. In the area of formal employment, according to the Ministry of Labor and Employment, there was a growth of 3%, compared to the first semester of 2001.

Regarding the external sector, the trade balance registered a surplus of US\$1.2 billion in July, with US\$6.2 billion of exports and US\$5 billion of imports. Thus, the accumulated surplus in the year reached US\$3.8 billion and the accumulated surplus of twelve months to July 2002, reached US\$6.4 billion. The trade balance surplus of twelve-month to July 2002 was the best result for equivalent periods since 1995.

In August, considering twelve business days, the trade balance accumulated a surplus of US\$831 million, with daily average exports of US\$256 million, against US\$217 million average for the whole year. The daily average of imports in August, of US\$187 million, is almost the same level as observed for the whole year average. The increase of exports of commodities and semi-manufactured goods in July should be noted, and, the fact that even after incorporating the rise in the prices of some products such as soy beans, crude oil, crude soy oil and cellulose, a significant increase of exported quantities of the main products of these categories was maintained.

In summary, the economic activity registered, by the end of the first semester and beginning of the second, a relatively low productivity plateau, due to the deterioration of expectations as a result of the unfavorable external environment and due to the increase of uncertainties related to the elections period. However, there are factors that contributed to suggest favorable prospects for the evolution of economic activity, such as the performance of retail trade – supported, amongst other factors, by the FGTS disbursements and by the

agricultural income - and the improved, even if partial, expectation, as a result of the new IMF agreement.

External environment

Despite the recent improvements, global financial markets remained volatile and averse to risk, reflecting uncertainty as a result of corporate results, due to accounting frauds and bankruptcies of large conglomerates, mainly in the United States. As a result, the financing conditions for emerging market countries have worsened, especially for Turkey and for those in Latin America. Expectations concerning a possible attack on Iraq have contributed to the uneasiness in the oil market, and prices returned to the level of US\$30 per barrel. This scenario was aggravated by the further delay in the recovery of advanced countries, increasing protectionism and the decline in international trade.

In the United States, macroeconomic indicators continued to show contradictory signals, predominating indication of deceleration in the pace of economic recovery. There were signs that the contagion of recent financial instability to the real economy was still underway. In its last meeting, the Federal Reserve kept the basic rate at 1.75% p.y., and the downward bias signals concern with the fragility of the economic recovery. The slower economic growth in the second quarter has contributed to keeping inflation under control. The business confidence indicators continued positive, although having presented a strong reversal in July. Consumer confidence indices also worsened in the last surveys, reflecting recent falls in the stock markets and higher unemployment rates.

Pessimistic expectations regarding the performance of the Japanese economy have been gradually easing, as a result of the external trade performance. The Asian countries growth has stimulated Japanese exports, particularly of final goods. Despite the appreciation of the yen, reduction in imports has also contributed to the growth of the trade balance. Domestically, however, demand continued stagnant, since lower income constrains sustainable growth, and factory orders declined again in June, after showing expansion in

the previous three months. Industrial production kept an upward trend in the 12-month accumulated figures, but at a declining rate.

In the Euro Area, economic growth has shown itself to be weaker than projected. Domestic demand continued its slow recovery and industrial production remained stagnant. Despite the Euro appreciation, the trade balance accumulated over the 12 months up to May continued to expand, with higher imports and exports, especially sales to Great Britain and Asia. CPI annual variation reached 1.9% in July, slightly higher than in the previous month, but below the ceiling of 2% established by the European Central Bank. The main confidence indices point to declining expectations of both businesses and consumers.

In Argentina, despite the slow pace of economic activity, some demand indicators, such as supermarket sales and shopping center sales, increased in the third quarter. Industrial production, in June, declined 1.4% compared to May and by 17.4% compared to June 2001. Figures for May indicated that 21.5% of the Economically Active Population was unemployed. The recession and the contraction of demand have been the cause of restrained prices, leading to declining inflation rates in the last three months. Administered prices were not revised since the floating of the peso at the beginning of the year. The trade balance registered a US\$8.1 billion surplus in the first half of 2002, reflecting mainly the reduction of imports.

Prices

The inflation rate measured by the main price indices accelerated in July, due to a mix of factors such as the concentration of readjustments in monitored prices in the period, the beginning of off-season period of agriculture and the effects of the recent exchange rate depreciation especially on wholesale prices.

The Consumer Price Index - Extended (IPCA) inflation was 1.19% in July, accumulating a 4.17% variation in the year and a 7.51% variation in 12 months. Similar to 2000 and 2001, July is likely to register the highest monthly variation in the year, mainly reflecting the readjustments in the public services tariffs. The monitored prices increased 2.52% and contributed individually with 0.78 of a percentage point to the general index variation. In addition to the readjustments in the fixed telephone tariffs approved on June 26, the IPCA reflected an average increase of 10.54% in electricity tariffs in São Paulo and Curitiba. Added to these factors, there were increases in the prices of oil-by products at the refineries (6.2% in bottled gas and 6.75% in gasoline), partially offset by the drop of 6.42% in the prices of hydrated alcohol. Furthermore, the effect of the rise in the minimum wage in April on the cost of housekeeper services is reflected in the IPCA mainly in July, for methodological reasons.

The food prices showed the second highest increase in July, with a 1.05% rise (a 0.23 percentage point contribution), compared to a 0.08% rise in June. In addition to the continued recovery in agricultural prices since the end of harvest time, the recent exchange rate depreciation caused an increase in the prices of French rolls and soy oil, which were the items that most increased in the month. The IPCA was also under pressure of prices of clothing that have significantly impacted the index since April, accumulating a rise of 4.7% in the last four months. It should be registered that the monthly inflation would have reached a significantly lower level if there had been no increases in monitored prices. The free prices, though they have increased in relation to May and June, varied 0.59% in the period.

In July, the General Price Index - Domestic Supply (IGP-DI) rose by 2.05%, reaching a 6.21% variation in the year and a 10.17% variation in the last 12 months. The Wholesale Price Index (IPA-DI) increased 2.82%, due to the 4.39% rise in the agricultural prices and 2.23% rise in the industrial prices, reflecting the beginning of the off-season period of agriculture and the evolution of the exchange rate. Amongst the industrial products, the evolution of the prices of refined soy oil, fertilizers and rice was notable. Amongst the

agricultural prices, out soy, cattle, wheat, beans, eggs, fresh milk, cocoa, tobacco and corn should be highlighted. The Consumer Price Index (IPC-DI) rose by 1.03%, which was the highest monthly increase in the year. The IPC-DI was under pressure basically from the same factors mentioned for the IPCA.

In August, the IPCA variation may retract, due to the declining contribution of the monitored prices, mainly because of less impact as a result of the readjustments in fixed telephone tariffs and fuel. Nevertheless, this group may still increase, due to the rises in water and sewage tariffs in São Paulo and in airline fares, in addition to the residual effects of the readjustments in electricity tariffs in July and the absorption of the increase of the minimum wage on the housekeepers' wages. The food prices will continue to be pressured, due mainly to rises in the prices of items with relevant weight in the index, like milk and its by-products, beef and poultry, that have increased at wholesale level. The group of other items that make up the free prices may fall in relation to July, mainly influenced by the prices of clothing. These prices may reflect the typical sales season.

One aspect to be noted in the trend of the IPCA until December is that the main impact of the monitored prices forecasted for the year – communications (telephones), electricity and urban transport - has already occurred. There remains to be implemented some readjustments in electricity tariffs in some capitals, but these readjustments would have a relatively small effect. Thus, considering no new increases in fuel prices in the coming months, the monthly variations, till the end of the year, would basically result from the evolution of the free prices.

Monetary Market and Open Market Operations

The perception of scarce foreign capital due to the reduction of the external credit lines and to the deterioration of the country's risk have resulted in a steepening of the slope of the yield curve. The spread between the 1-year interest rate and the Over-Selic target reached 1.234 bps on July 29 from 878 bps on July 16. After the announcement of the agreement

with the IMF, the slope reverted somewhat and, on August 20, the spread narrowed to 765 bps.

Between July 17 and August 20 the BCB carried out two partial rollovers of the BCB's Notes - E Series (NBCE), by offering exchange rate swaps with varied maturities. For the rollover of R\$1,9 billion in NBCEs, due on July 25, the reference value of the swap contract reached R\$1,1 billion. For the rollover of the R\$7.6 billion NBCE maturing on August 15 the equivalent of R\$4,7 billion exchange rate swaps were placed. The BCB also offered exchange rate swaps against the R\$2,3 billion National Treasury Note – D Series (NTN-D), maturing on August 7, but these were not placed due to low demand. It should be pointed out that in this period only 50% of the exchange rate indexed debt was rolled over as a result of the weak demand for exchange rate hedging.

The National Treasury carried out five National Treasury Bills (LTN) and National Treasury Financial Bills (LFT) auctions, limiting the total offer to 500 thousand securities for each one. In the first two, securities maturing in September were auctioned, and, in the others, the maturity was October 2002. The total financial volume was R\$2.6 billion, of which R\$2.1 billion were in LTN.

In order to reduce financial market exposure to the LFT's price volatility, the BCB purchased bills maturing in 2003 on four occasions amounting to R\$10.0 billion, and another R\$3.0 billion, maturing in 2004. Those purchases were linked to the sale of securities with repurchase agreements in November and December 2004. Besides that, the BCB redeemed R\$0.8 billion of LFT, due in 2002, and carried two exchange operations by placing LFT maturing in 2003 and repurchasing securities in the amount of R\$2.46 billion maturing in 2004, R\$2.28 billion maturing in 2005 and R\$9.66 billion maturing in 2006.

Throughout the 24 working day period between July 18 and August 20, BCB intervened in the open market by withdrawing and providing liquidity at one and three working day tenure and yields of 17.9% and 18.0% p.a., and average daily volumes of R\$20.7 billion and R\$3.3 billion, respectively. There were also selling operations of five long term securities with repurchase agreement, with a total financial value of R\$13.3 billion and an average tenure of 78 working days — four of these operations (R\$13.0 billion) were simultaneously placed with the purchase of LFT by the BCB, as mentioned above.

As regards the financial settlements between July 18 and August 20, the monetary impact was expansionary by R\$35.1 billion, resulting mainly from the R\$13.0 billion redemptions of LTN and the R\$17.0 billion net redemptions of exchange rate indexed securities and R\$3.9 billion of LTN.

In the process of reducing the volatility of investment funds composed by exchange rates indexed securities and DI x USD swaps, four exchange operations of NBCE and NTN-D by LFT and exchange rate swaps of equivalent tenure were carried out reaching R\$19.2 billion.

In July, the domestic federal securitized debt increased by R\$20.7 billion (+3,2%). The exchange rate indexed securities grew by R\$33.1 billion, due to the 20.5% appreciation of the USD in the period.

Assessment of inflation trends

The identified shocks and their impact were assessed according to newly available information. The scenario considered in the simulations covers the following hypotheses:

1. For the year 2002, still as a result of the price drop in January and February, a reduction of 0.8% is forecast for the price of gasoline, albeit at a higher value than the previous one forecast in the last Copom meeting (-2,0%). For bottled gas, an increase of 25% is projected for 2002, a significantly lower increase than the 42% projected in the last meeting. This change is due in part to the 12% decline in the bottled gas price at refineries in August.
2. For the electricity tariffs, an increase of 20.1% for 2002 is projected, in comparison to the 19.2% projected in July. The forecast for the readjustment of electricity tariffs for 2003 increased substantially, to 20.7% in August from 14.4% in July, mainly due to the exchange rate depreciation.
3. Regarding the set of prices administered by contracts and monitored, with a weighting of 31.05% in the IPCA, the inflation forecast for 2002 fell 0.1 p.p. in relation to the previous Copom meeting. For 2002 as a whole, a readjustment of 8.8% is projected for the prices administered by contracts and monitored. The reduction in the projection is due to the expected decline of the consumer price of bottled gas in August and September. The fall in the total of the prices administered by contracts and monitored is not larger due to the effects of exchange rate depreciation. For 2003, the inflation forecast for the prices administered by contracts and monitored is 7.6%. In July, the same forecast was 6.6%. The increase in the projection for 2003 is mainly due to the revision of the readjustments projected for electricity.
4. The projection of the 6-months spread over the Selic rate, applying a model specification based on an error correction forecasting method and maintaining constant the Selic rate at 18.0% p.a., starts from approximately 600 b.p. in the third quarter of 2002 and declines to -70 b.p. in the last quarter of 2003.

The monthly inflation rate, measured by IPCA, reached 1.19% in July, in comparison to 0.42% registered in June. The core inflation of the IPCA, calculated by the symmetric

trimmed-mean method, increased to 0.51% in July from 0.40% in June. In the last twelve months, this core varied 7.08%. In turn, the core inflation of the Consumer Price Index-Brazil (IPC-BR), calculated by the symmetric trimmed-mean method, fell to 0.40% in July from 0.41% in June. In the last twelve months, this core registered a 6.62% variation. The core inflation calculated by excluding the prices administered by contracts and monitored and household food prices registered a variation of 0.39% in July, accumulating a variation of 6.12% in twelve months.

The variation accumulated by the IPCA in twelve months registered 7.51% in July, below the observed in June (7.66%) and in May (7.77%). Free market prices contributed to inflation with 4.11 p.p. and the prices administered by contracts and monitored with 3.40 p.p.

The inflation expectations surveyed by BCB's Investor Relations Group (Gerin) for 2002 increased to 6.4% in August from 5.8% in July. For 2003, the expectations increased to 4.6% in August from 4.2% in July.

Regarding the fiscal policy, the hypothesis considered is to achieve the primary surplus of 3.75% for the consolidated public sector. The other assumptions considered in the previous meeting were maintained.

From the simulation exercises with several specifications of the structural model, it has been concluded that the maintenance of the interest rate at 18.0% p.a. and the exchange rate at the level observed on the eve of the Copom meeting indicates an inflation rate over 6.0% in 2002 and below the target of 4.0% in 2003.

Monetary policy guidelines

The economic activity continues to show loss of dynamism, already identified in the last few months, due to the recent volatility of the financial markets and to its impact on

aggregate demand. In fact, comparing the seasonally adjusted data of June to those of May, one perceives that industry does not show signs of recovery. According to the CNI, there was a decline in employment (0.07%), in the real payroll (0.25%) and in the utilization of installed capacity (0.36%).

There are factors that have softened the pace of deceleration of the level of activity. Firstly, agricultural production in 2002 should exceed 2001. Secondly, one may perceive an improvement in the commercial sector: the real turnover of the retail commerce in São Paulo rose approximately 3.5% in July, mainly in non-durable consumption goods. In this segment, demand has been sustained by the increase of agricultural income, the liberation of balances of the Time in Service Guarantee Fund (FGTS) and the social programs expenditures, in spite of the 5.49% decline of the Consumer Intentions Index between July and August.

The improvement in commerce may not influence industry due to increase in inventories of finished products in the last months. According to data released by the CNI, the indicator of finished products inventory rose to 53.1 in August from 50.4 in July, compared to the desirable value of 50 for the inventories level.

The current account of the balance of payments had registered substantial improvement in the last twelve months. The trade balance showed a US\$ 1.2 billion surplus in July. Its surplus totaled US\$ 6.4 billion in the twelve months to July, which represented an increase of approximately US\$ 1.1 billion in relation to the value registered in June. The current account deficit has continuously declined since August 2001 and reached US\$ 16.7 billion in the twelve months to July. This deficit was more than entirely financed by the net inflows of foreign direct investment, which totaled approximately US\$ 20.6 billion in the twelve months to July. However, the ongoing adjustment in the current account was not sufficient to neutralize the international liquidity shortage that had recently occurred, affecting even the funding of foreign trade. The contraction of external financing was reflected in the pressures on the exchange rate, which had intensified in July.

The inflation expectations surveyed by the Investor Relations Group (Gerin) of the BCB rose since the Copom's meeting of July. For 2002, the expectations increased by 0.6 p.p., reaching 6.4% from 5.8%, probably due to the exchange rate depreciation observed in the period. For 2003, the inflation expectations were revised by 0.4% p.p., rising to 4.6% from 4.2%.

The inflation measured by the IPCA was 1.19% in July, above the 0.42% registered in June, due to the behavior of administered by contracts or monitored prices, which increased by 2.52%, and to the behavior of free market prices, whose inflation was 0.47 p.p. higher than in the previous month. The inflation of administered or monitored prices was mainly influenced by the readjustments of bottled gas (4.42% in July and 38.3% year-to-date), of gasoline (2.87% in July and -0.2% year-to-date) and of fixed-line telephone tariffs (10.54%) and electricity (4.26%). The administered or monitored prices would lead to weaker inflationary pressures in August and September, mainly because of the 9.9% price reduction expected for bottled gas.

The inflation of the free market prices in July was mainly due to the pass-through of the exchange rate depreciation. After showing a 0.64% variation in February and decreasing significantly in the following months, the free prices inflation reached 0.59% in July. When household food items of the free market prices were excluded, which corresponds to the core inflation measured with the exclusion of the administered prices and of household food items, the inflation increases to 0.39% in July, from 0.13% in June. The variation of the core inflation measured by the symmetric trimmed-mean method also increased, reaching 0.51% in July, from 0.40% in June.

The higher variations of the free market and administered prices in July were already expected, thus they did not cause upward revisions in the inflation projection for 2002. However, there was an increase in the inflation projection for 2002 and 2003 due to the exchange rate depreciation that has occurred since the Copom's July meeting. For 2002, an

inflation above 6.0% is expected and, for 2003, the projected inflation is still below the 4.0% target.

The lower inflation in 2003, in comparison to 2002, may be explained by a set of factors. Firstly, the existing idle capacity in the economy tends to reduce the inflation of non-tradable goods prices. Secondly, administered and monitored prices are forecasted to increase by 7.6% in the coming year that is equivalent to a 1.2% decline in relation to the increase of 2002. Finally, in the basic scenario one assumes the maintenance of the exchange rate in 2003 at the level observed on the eve of the Copom's meeting, and so, the absence of additional depreciation. Furthermore, it is predicted that the larger part of the impact of the recent exchange rate depreciation should still occur in 2002. Due to the magnitude of the depreciation and of the current exchange rate level, the existence of idle capacity in the economy may be insufficient to soften the exchange rate pass-through to prices in the course of this year. Based on the analysis of the behavior of the free prices inflation in the first seven months of the year, one may conclude that up to this moment, there are no signs of a significant accumulation of exchange rate pass-through to prices that would be carried over to 2003.

Despite the projected inflation for 2003 being below the target, the Copom recognizes that there was an increase of uncertainties in relation to the realization of the basic scenario hypotheses until the end of next year. The increase in the risk perception, both in relation to Brazil and to the industrialized countries, has caused higher volatility in the financial markets and foreign capital inflows. In this context, the interventions in the foreign exchange market have been necessary to manage the excessive volatility of the exchange rate in a liquidity short environment, and to avoid perverse dynamics in the foreign exchange market.

The increase of uncertainty in relation to the country's future, aggravated by deterioration in the risk perception regarding the world economy since the Copom's meeting of July, has negatively influenced the asset prices in foreign and local currencies. The risk measured by

the Embi+ reached more than 2000 b.p. and the thirty-day volatility of the exchange rate increased to 49.0% from 20.3% between the Copom's meetings of July and August. The exchange rate depreciated 9.4% in the same period.

However, the agreement with the IMF and with its general principles being supported by the main presidential candidates, the reduction of discounts of public securities and the recent evolution of the mutual funds sector, and an improvement in the liquidity conditions of international credit lines for Brazil, provide an adequate environment to revert expectations in the financial market.

In the light of these facts, the Copom unanimously decided to maintain the target for the Selic interest rate at 18% p.a., with a downward bias.

At the close of the meeting, it was announced that the Committee would meet again on September 17, 2002, at 3:00 pm, for technical presentations and, on the following day, in order to discuss the monetary policy guidelines, as scheduled in the BCB Communiqué n. 8911, of Oct 3, 2001, and in the BCB Communiqué n. 9586, of June 6, 2002.

Acronyms

ac 12m accumulated in 12 months

ACC Anticipated Exchange Rate Contracts

BM&F Mercantile and Futures Exchange

bp Base Points

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

Fecomércio Federation of Commerce 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

LFT National Treasury Letters (floating)

LTN National Treasury Notes (fixed rate)

NAPM National Association of Purchasing Managers

NBC-E Central Bank Note - E Series (indexed to the exchange rate variation)

NTN-D National Treasury Note – D Series (indexed to the exchange rate)

p.a. per annum

p.m. per month

PEA Economically Active Population

pp percentage point

Selic Central Bank's Custody and Settlement Center

STN National Treasury Secretariat

ytd year-to-date