

September 27, 2002

**BANCO CENTRAL DO BRASIL (BCB)
MINUTES OF THE 75th MEETING OF
THE MONETARY POLICY COMMITTEE (COPOM)**

Summary

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Acronyms

Date: September 17 and 18, 2002

Place: Central Bank's Headquarters 8th floor Meeting room (on September 17) and 20th floor (on September 18) -Brasília - DF

Called to Order: 3:40 PM on September 17 and 11:49 AM on September 18

Adjourned: 7:20 PM on September 17 and 1:37 PM on September 18

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

Department Heads (all present on August 20)

Altamir Lopes – Economic Department (DEPEC)

Carlos Yoshitaka Urata - 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

The recently released economic indicators related to retail activity and external trade, show favorable signs. Domestically, the results are a consequence of the measures implemented with the objective of normalizing the foreign exchange market (IMF agreement among others), and a reflex of the effects of the Time in Service Guarantee Fund (FGTS)

extraordinary disbursements initiated in June. The positive performance of international sales is closely related to the exchange rate stimulus.

Preliminary data from São Paulo State's Federation of Commerce (Fecomércio-SP) indicate an expansion of 4.1% in real turnover of retail commerce in the metropolitan region of São Paulo in August, not considering the seasonal factors. The higher increases were observed in sales of non-durable consumer goods and construction materials. The monthly growth of 1.7% of Usecheque consultations, released by São Paulo Trade Association (ACSP), pointed in the same direction.

Vehicle sales also reacted in August, stimulated in part by the sales promotions, taking advantage of the reduction of the Industrialized Products Tax (IPI), which momentarily altered the sales mix in favor of more expensive vehicles. This movement, however, should not be considered a trend as yet, since the vehicle concessionaires registered, in August, an expansion in cash sales. Credit sales, which normally are more significant in relation to more expensive durable consumer goods, are not progressing due to the unfavorable credit conditions and consumer caution (as registered by the credit sales consultations to the Service Protection Service - SPC - from the ACSP, which declined 3.5% in August) and the retraction in the volume of new concessions to private individuals by the financial system.

Another positive piece of information from commerce refers to the consumers confidence level recuperation as related to the economic conditions. Consumers Intentions Index (IIC) grew 9.6% in September, reaching 100.4 in a scale from 0 to 200, the best result since May 2001. The result was due to the perception of improvement of current and future conditions.

Defaults have declined significantly in August, possibly due to the continuity of the use of part of the values released from FGTS resources to pay off debts. According to ACSP, the

maintenance of the reinstatement registers at much higher levels than the previous average permitted the decline of the default rate to 4.7% in August from 7.2% in July and in the year. In the financial market, the default decline could be verified by the reduction of returned checks to 4.3% in August from 4.7% in July due to insufficient funds in relation to the total of cleared checks.

As regards the credit market, the default of the credit portfolio with freely allocated resources fell 0.2 p.p. in August, reaching 7.8% of the portfolio, the lowest value since last November. The implementation of more conservative credit policies by the financial institutions, such as the reduction of individual limits, credit line cutoffs for certain clients and additional guarantee requests, also contributed to the default decline.

This higher selectivity in the credit offer has diminished the volume of new concessions, making the balance of these operations decline. Credit operations inventory with legal entities contracted by free established rates fell 3.8% in the month, reaching R\$132.0 billion. The volume of resources with internal funding declined 1.9% and those with external funding declined 7.2%, reflecting the exchange rate appreciation of 11.85% in the month.

The volume of credit to private individuals totaled R\$76.2 billion, rising 0.4% in August. The daily average concessions grew 0.5%, while the new concessions flow declined 3.9% in the month, due to the lower number of business days in August in comparison to July. The relative stability of the balance of this segment continued to be influenced by debt liquidations from Income Tax (IR) returns and FGTS reimbursements, besides the deteriorating credit conditions in the last months.

Industrial activity maintained in July the same production level observed in the previous month, according to the seasonally adjusted indexes from the Brazilian Institute of Geography and Statistics (IBGE). The result confirmed the lower production level in comparison to the first months of the year, but is still considered favorable, since the increase of industrial stocks and the lowering of entrepreneur expectancy levels, registered in the same period, which could mean a decline of the industrial activity in the month.

This leveling off of industrial production in the last months interrupted the stronger recovery trend that had been occurring since the beginning of the year. However, taking into account the turbulences that negatively affected the entrepreneurs and consumers confidence in June and July, the recent results are favorable, since they have exceeded the expectations outlined by some previous variables that had indicated a fall in production.

In July, the National Confederation of Industries (CNI) statistics confirmed the idea that the activity level in the industrial sector is showing a tendency to be self-sustaining. For the second consecutive month industrial sales grew, 0.9% in comparison to June, and the installed capacity utilization level was 0.85% above that registered in the previous month, both in seasonally adjusted series.

In the labor market, the average rate of open unemployment, measured by IBGE, remained stable at 7.5% in July. This result was due to equivalent percentage growth rates in the number of employed workers and in the Economically Active Population (PEA). Regarding the formal work environment, according to the Ministry of Labor and Employment, there was a 0.2% growth in July and a 3.2% growth accumulated over twelve months.

In relation to the external sector, the commercial surplus of US\$1.6 billion registered in August was the highest since May 1990, and has accumulated US\$7.4 billion in twelve

months. The current account deficit in twelve months, reached US\$16.7 billion, up to July. This was the lowest result for this kind of comparison since July 1996.

The trade balance totaled a surplus of US\$931.0 million up to the 15th day of September, as exports registered another increase in the daily average, reaching US\$284.0 million, in comparison to US\$224.0 million in the year. The US\$190.0 million daily imports average in September is almost at the same level observed in the January to August period. Thus, the surplus for the year reached US\$6.3 billion, in comparison to US\$0.8 billion occurred in the same period in 2001. Exports reached US\$39.9 billion while the imports totaled US\$33.6 billion, falling 4.4% and 18.0%, respectively, in comparison with the values registered in the same period in 2001.

This trade balance result reversion reveals the importance of deeper modifications in the economic structure, such as imports substitution and higher exports profitability, which is enabling the diversification of the trade products and the entry into new markets. Some current factors, such as the depreciation of the Real and the level of deceleration of the economic activity, have also contributed to this scenario.

In summary, the activity level indicators show signs of retail commerce recuperation, which have shown sales growth, reduction in default levels and consumers confidence recuperation. The industrial activity, however, remains stable and reflects the stocks' adjustment process.

External environment

The international scenario continues very unstable, with a corresponding reflection in the various segments of the international financial market by increased volatility. The

accumulated losses in the stock exchanges in the last two years and the impact provoked by the accounting scandals of big U.S. corporations increased the fragility of the global economy. More recently, the 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. In this framework of instability and risk aversion, financing conditions have worsened for emerging economies, also affected by the decline in international trade.

In the United States, macroeconomic indicators continue to show contradictory signs, reinforcing the uncertainties about the sustainability of the economic recovery. The business confidence indicators remain positive, although having presented a new decline in August. Consumers confidence indices also worsened in the last surveys, reflecting the recent falls in the stock market and the unemployment rates, which remain high, in spite of the fall to 5.7% in August, compared to 5.9% in July. Retail sales increased by 0.8% in August, stimulated by the favorable vehicle purchase financing conditions. Factory orders increased by 4.7% in July, the largest expansion since October 2001, led by durable goods orders, particularly transport equipment and industrial machinery. Inflationary pressures remain weak but budget deficit increase, that may reach 1.5% of GDP in the fiscal year ending in September, is a cause for concern.

In Japan, the good performance of the external trade has contributed to reduce pessimistic expectations. The growth of Asian countries has boosted Japanese exports, especially of finished goods, in spite of the yen appreciation. Factory orders declined by 8.5% compared to those of July 2001 and the beginning of new constructions declined by 6.7%, also compared annually. The accumulated variation over 12 months of industrial production reached 3.3%, maintaining an upward trend, but at a declining rate.

Economic growth is slower in the Euro area, in line with the expected fragility of global recovery. Domestic demand remains retracted, as shown by retail sales, which declined by

0.9% in the 12-month accumulated figure up to June. Industrial production does not show any reaction, with negative annual variations since September 2001.

Unemployment rate remained stable at 8.3% in July. In spite of the euro appreciation, the trade balance accumulated in the 12 months up to June continued to grow, with higher exports and imports. The main confidence indicators registered a decline in the expectations of both consumers and businesses. The estimates for the growth/variation of prices in August indicate an annual rate of 2.1%, above the ceiling of the European Central Bank (ECB).

Regarding Argentina, recession and demand contraction have been responsible for restraining price increases, leading the inflation rates to decline in the past three months, but administered prices have not yet been readjusted since the floating of the peso, at the beginning of the year. The trade balance registered a US\$2.2 billion surplus in July, still reflecting on the whole the contraction of imports.

Regarding the Mexican economy, the Economic Activity Global Indicator has been showing a downward trend, in spite of the positive variations in the second quarter of 2002, reflecting the increase of the link with the U.S. economic performance in the past years. About 90% of the exports go to the U.S., coming from the “maquiladoras”. The Mexican GDP grew by 2.1% in the second quarter, led by the growths of 2.5% in the industrial sector and of 2.2% in services.

Prices

Inflation remained high in August, mainly reflecting the effects of the between harvest period in agriculture and the impacts of the recent exchange rate depreciation. Nevertheless,

the consumer price indices showed smaller variation in comparison to the previous month, mainly due to the end of the impacts of the recent readjustments in monitored prices.

The Consumer Price Index - Extended (IPCA) increased by 0.65% in August, accumulating variations of 4.85% year-to-date and 7.46% over 12 months. The monthly result was influenced by a 1.94% rise in food and beverage prices, due to the exchange rate depreciation and the between harvest period. The French roll was the product with the highest individual contribution to the result of the month, corresponding to 0,14 p.p. in the IPCA rate. Still in the food and beverage group, the increases in prices of cattle and chicken meat, soy oil and milk, should be highlighted. The decline in the monthly variation in comparison to July (1.19%) was due to the smaller variation of monitored prices (0.22% as against 2.52% in the previous month). In August, despite the rises in airline fares and in water and sewage tariffs, smaller increases in the tariffs of telephone and electricity and in housekeepers' wages were registered, whilst the prices of gasoline, alcohol and bottled gas have declined.

The effects of the exchange rate depreciation and between harvest period were stronger in the General Price Index – Domestic Supply, due to their impact on wholesale prices of agricultural and industrial goods. The monthly variation increased to 2.36% in August from 2.05% in July, accumulating 8.75% in the year and 11.76% in 12 months. The Wholesale Price Index - Domestic Supply (IPA-DI) rose by 3.32% in the month, reflecting the increases of 5.48% in agricultural prices and of 2.5% in industrial prices. The Consumer Price Index (IPC) followed the IPCA deceleration, due to the smaller pressure of monitored prices. The IPC rose by 0.76% and the IPC-core increased 0.65%.

The maintenance of the pressures derived from the recent exchange rate depreciation and from the continuity of the increase of food prices should be the main factors to influence the indices in September. Nevertheless, the rates of the main price indices should continue

decelerating, if the effect of the reduction of the bottled gas price in September and the prospect of smaller increases in food prices, in the next few months, are considered.

Monetary Market and Open Market Operations

During the week after Copom's August meeting, the interest rate curve steepened significantly. Subsequently, this curve fluctuated as a result of the internal and external environment. On September 17, the spread between the 1-year interest rate and the Over-Selic target reached 710 bps from 765 bps in August 20.

Between August 21 and September 17 the foreign exchange instruments rollover reached 90%. For the rollover of US\$0.3 billion in National Treasury Notes – D Series (NTN-D) and US\$1.3 billion exchange rate swaps maturing on September 1 and 2 respectively, the equivalent of US\$1.5 billion exchange rate swaps was placed, of which 72% due on 2002 and 28% on 2003. For the rollover of US\$0.5 billion in National Treasury Notes – D Series (NTN-D) and US\$1.5 billion exchange rate swaps maturing on September 11, the reference value of the swap contract reached US\$1.8 billion, of which 80% due on 2003 and 20% on 2002.

The National Treasury carried out four National Treasury Bills (LTN) and National Treasury Financial Bills (LFT) auctions. Securities maturing in 2002 were auctioned in the first two, with a 500 thousand securities total offer limit for each one. In the other two auctions the National Treasury altered its strategy, by offering just LTN maturing in November 2002 and January 2003 and by raising the limit to a million securities. The total operation amounted to R\$2.9 billion, of which R\$2.0 billion were in LTN redeeming in 2002 and another R\$0.9 billion in LTN redeeming in 2003.

In the same period, aiming to reduce LFT price volatility, Banco Central carried out ten selling auctions of LFT due on August 2003, which could be settled by delivering LFT

maturing in 2004 and 2006. Furthermore, the purchaser had the choice of contracting forward operations maturing in December 2002, up to the limit of 20% of the purchased LFT. Those operations totaled R\$3.9 billion. With the same objective, Banco Central carried out ten redeeming auctions of LFT with several maturities between 2002 and 2003. In these operations the equivalent of R\$5.6 billion of LFT were taken from the market, of which R\$5.2 billion were due on 2003.

Throughout the 19 working day period between August 22 and September 17, BCB intervened in the open market by withdrawing and providing liquidity at yields of 17.9% and 18.0% p.a., and average daily volumes of R\$32.4 billion and R\$4.5 billion, respectively. The tenures oscillated from one to two working days. There were also three selling operations of long-term securities with repurchase agreement, with a total financial value of R\$8.3 billion and an average tenure of 21 working days.

Regarding the financial settlements between August 22 and September 17, the monetary impact was expansionary by R\$16.7 billion, mainly as a result of the net redemptions of R\$6.7 billion of LTN, R\$6.0 billion of LFT and R\$3.8 of exchange rate indexed securities.

In August, the domestic federal securitized debt declined by R\$51.6 billion (7.7%). The exchange rate indexed securities stock declined by R\$31.9 billion, basically due to the 11.85% appreciation of the Real in the period.

Assessment of Inflation Trends

The identified shocks and their impacts were assessed according to newly available information. The scenario considered in the simulations encompasses the following assumptions:

1. For the year 2002, an increase of 3.3% in the price of gasoline is expected, representing a higher value than the one forecasted in the last Copom meeting (-0.8%). This revision is a consequence of the pass-through of the international petroleum price increase and the new exchange rate level to the gasoline consumer price. For bottled gas, a growth of approximately 25% in 2002 is maintained, as forecasted at the last Copom meeting, since the 12% reduction of the bottled gas price at the refineries in August had already been considered in the forecasts.

2. For the readjustment of the residential electricity tariffs, an increase of 20.6% in 2002 is projected, of which 16.2% has already occurred between January and August. The value projected in September is slightly higher than the one projected in August. For the next few months, a readjustment of 3.8% is forecasted. The electricity readjustment forecast for 2003 remained at 20.7%.

3. Regarding the set of prices administered by contracts and monitored, with a 31.5% weight in the IPCA in August, the inflation forecast in 2002 grew by 0.5 p.p. in relation to the last Copom meeting. For the year 2002 as a whole, an increase of 9.3% in the prices administered by contracts and monitored is projected, in comparison to 8.8% in August and 8.9% in July. The increase of the projection is due to the exchange rate pass-through and the revision of the gasoline forecast. For 2003, the inflation forecast for the prices administered by contracts and monitored is 7.9%, while in August this forecast was 7.6%. The increase in the projection for 2003 is a consequence of the exchange rate depreciation and the revision of the expectations regarding the IGP-M, which influence the forecasts of some prices administered by contracts and monitored, especially those linked to transport.

4. The forecast of the 6-month spread over the Selic rate, based on an error correction model specification. Maintaining constant the Selic rate in 18.0% p.a., the 6-month spread

projection starts at 510 bp. in the third quarter of 2002, and, afterwards, declines up to the end of 2003.

The monthly inflation rate measured by the IPCA reached 0.65% in August, in comparison to 1.19% in July. The core inflation of the IPCA, calculated under the symmetric trimmed-mean method, grew to 0.65% in August from 0.51% in July. In the last twelve months, this core registered a variation of 7.17%. In turn, the core inflation of the Consumer Price Index - Brazil (IPC-BR), calculated under the symmetric trimmed-mean method, increased to 0.65% in August from 0.40% in July. In twelve months, this core registered a variation of 6.69%. The core inflation calculated by excluding prices administered by contracts and household food registered a variation of 0.38% in August and 6.10% in twelve months.

The IPCA variation in twelve months has been showing a declining trend since May and registered 7.46% in August, a value below the ones observed in July (7.51%) and June (7.66%). In these twelve months, the free market prices contributed to inflation with 4.35 p.p., while the prices administered by contracts and monitored contributed with 3.11 p.p.

Regarding fiscal policy, the hypothesis assumed is to achieve a 3.88% primary surplus for the consolidated public sector this year. For the following years the target is 3.75%. The remaining assumptions established 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 same level as on the eve of the Copom meeting (R\$3.20) lead to an inflation rate considerably above the upper limit of the tolerance interval in 2002 and above the target center in 2003.

Monetary policy guidelines

Indicators of production continue to show the loss of dynamism of the economic activity. According to the IBGE, the seasonally adjusted series of the industrial production remained almost stable in July, compared to June. A 0.4% increase was registered in the year, up to July. Seasonally adjusted data from CNI corroborate these results, showing relative stability in employment (0.01% decline), in the hours worked in production (0.19% fall) and in the payroll (0.12% increase), between June and July.

Contrasting with the indicators of production, those related to sales have registered positive results. The monthly variation of the industrial sales was 0.9% in July, according to the CNI, and the real turnover of the retail commerce in the city of São Paulo increased by 4.12% in August, according to preliminary data of the Fecomércio (seasonally adjusted series). At the end of the second quarter, also according to the CNI, there were excessive inventories of finished goods in the manufacturing industry, with the corresponding indicator leveling close to 53, above the reference-value of 50, which represents the adequate level for those inventories. Considering the sales and production results of July, inventories of finished goods are tending to the levels considered adequate by businessmen, favoring the recovery of industrial activity in the medium-term. Other factors that tend to favor industry in the medium-term are the liberation of balances of the Time in Service Guarantee Fund (FGTS) and the 9.6% increase of the Consumer Intentions Index in September. One highlights that the sub-item “future intentions index” reached 108.6 in that month, whilst the reference-value of 100 indicates stability. However, the slow growth of credit, the high interest rates and the instability of the financial market tend to inhibit the recovery of economic growth.

The more recent data about the performance of the foreign sector accounts show that the Balance of Payments has fast adjusted to the adverse conditions of the international market, characterized by the reduction of world economic growth, and by the reduction of foreign financing. However, the magnitude of the Balance of Payments adjustment has not been

sufficient to avoid the pressure on the exchange rate caused by the reduction of international financing and by the uncertainties still present in the market, related to the future management of the macroeconomic policy in the country.

The inflation expectations surveyed by the Investor Relations Group (Gerin) of the Banco Central do Brasil increased since the Copom's meeting of August, noticeably for 2003. For 2002, the expectations reached 6.6%, from 6.4%. As for 2003, the inflation expectations were revised by 0.6 p.p., reaching 5.2% from 4.6%. The most important factors to explain such revisions are the accentuated exchange rate depreciation and the recent price increases of oil by-products in the international markets.

Copom also increased the projections of inflation for 2002 and 2003, partly due to the revision of the readjustments of administered prices, to 9.3% from 8.8% this year, and to 7.9% from 7.6% in the coming year. According to the models used by the Banco Central, the behavior of the free prices inflation up to August is compatible with the exchange rate depreciation observed in the period. However, taking into account the size of the exchange rate depreciation registered during the year, its pass-through coefficient to prices may increase. Especially in the case of growth recovery, the possibility of a higher pass-through increases. However, in such a context of recovery of the activity level and of better expectations it would be reasonable to expect an exchange rate appreciation. Notwithstanding, Copom considered adequate to add an exchange rate pass-through not yet accounted for in the projection of inflation for the next year.

There was a reduction of the discounts of federal securities, and a positive evolution of the financial funds industry, in the financial market. However, the uncertainties persisted. The *real* depreciated by 2.3% since the Copom's meeting of August and the country risk measured by the Embi+ continued at high levels. This scenario of uncertainties reflects not only an adverse international environment, but also remaining doubts of some economic agents about the coherence of the macroeconomic policy in the coming years. Thus, in spite of the projected inflation for 2003 being below the target (adjusted for the shocks of the

administered and monitored prices and for part of the inertia), the Copom understands that the maintenance of the volatility in the financial markets increases the risk related to the confirmation of this projection.

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

At the close of the meeting, it was announced that the Committee would meet again on October 22, 2002, for technical presentations and, on the following day, in order to discuss the monetary policy guidelines, as set in the Communiqué 8911, of Oct.3.2001.

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