October 18, 2002

BANCO CENTRAL DO BRASIL (BCB)
MINUTES OF THE 76th MEETING OF
THE MONETARY POLICY COMMITTEE (COPOM)

Summary

Date: October 14, 2002

Place: Central Bank's Headquarters 20th floor - Brasília - DF

Called to Order: 1:10 PM

Adjourned: 2:25 PM

In attendance:

Members of the Board

Arminio Fraga Neto **-** Governor

Beny Parnes

Carlos Eduardo de Freitas

Edison Bernardes dos Santos

Ilan Goldfajn

Luiz Fernando Figueiredo

Sérgio Darcy da Silva Alves

Tereza Cristina Gross Togni

Department Head

Paulo Springer de Freitas - Research Department (DEPEP)

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

Monetary policy guidelines

Several price indices released recently have shown a rise in inflation caused mainly by exchange rate depreciation. The IPCA recorded 0.72% in September, higher than the value expected by the Copom and the 0.65% variation observed in August. This increase was a consequence of the inflation of free prices, with an increase of 1.05%. In contrast, there was deflation of the administered and monitored prices (0.01%), due to the reduction of 7.6% of the consumer price of bottled gas.

The indicators of core-inflation have reflected this rise in the IPCA. Measured under the trimmed-mean method, the core increased to 0.78% in September from 0.65% in August, while the core calculated excluding administered and monitored prices and food items increased to 0.61% from 0.38%, in the same period.

Preliminary data related to other price indices have also indicated a rise in inflation in October. According to IPC-Fipe, the inflation increased to 0.81% in the four-week period ended in the first week of October, from 0.73% in the four-week period ended in the third week of September and, regarding the IPC-M, the inflation registered in the first ten days of October increased to 0.49% from 0.42%.

Since the Copom meeting in September, the trend of several economic indicators has changed inflation expectations for 2002 and 2003. According to the Investor Relation Group (Gerin), the median of the market expectations for the IPCA in 2003 rose to 5.9% from 5.2% since the September 16.

The inflation forecast of the Copom for 2003 was also increased. The Copom had been basing its projections on a basic scenario in which the transition to the future government would occur without exaggerated or prolonged turbulences. The higher degree of uncertainty observed in the last months has lowered the probability of the materialization of this basic scenario. In fact, at the Copom meeting in September, the inflation forecasts were made based on an exchange rate of R$3.20/US$ and an inflation expectation (collected by Gerin) of 5.2% for 2003. Neither assumptions have been occurring.

Between the last two Copom meetings, an additional depreciation of the *Real,* with the dollar reaching figures around R$3.90, and a rise in inflation expectations to 5.9% (surveyed by Gerin) for 2003 were observed. The IPCA projection was increased considerably, as a consequence. Despite the increase in the estimated primary shocks of administered and monitored prices, and the impact of inflation inertia of 2002 on the 2003 inflation, the projected inflation for 2003 is above the target adjusted to these factors.

The increase in inflation - actual and forecasted - in the last months implies that, if the target for Selic-rate were maintained at 18% p.a., the real interest rate - *ex-ante* and *ex-post* - would be reduced significantly, which could stimulate the pass-through of exchange rate depreciation and the propagation of price adjustments.

The rise of inflation projection over the adjusted target rate for 2003 recommends a tighter monetary policy, even if the primary cause of inflation were not related to an increase in demand, but rather to the effects of a significant exchange rate depreciation on domestic prices. A tighter monetary policy reduces the exchange rate pass-through to prices and improves inflation expectations. In this way, the conditions to restore sustainable growth – i.e., non-inflationary – would be in place as early as next year.

The calling of a Copom extraordinary meeting had the objective of not postponing decisions that seem to be natural for the BCB committed to inflation targeting in a more adverse scenario.

The members of Copom emphasized that, in spite of the relevance of recent exchange rate depreciation to the rise in inflation expectations, the monetary policy continues to be calibrated exclusively to maintain inflation in a trajectory within the targeted range; therefore, the monetary policy does not aim at targeting the exchange rate level. This does not mean that a reversion of the depreciation of the exchange rate in excess would not have meaningful consequences to the inflation trend and, consequently, to the monetary policy management. Obviously, an exchange rate appreciation, resulting from the restoration of confidence in future economic policy management, would reduce pressures over prices and improve the inflation expectations.

Thus, the Copom unanimously decided to increase the target for the Selic interest rate to 21% p.a. from 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 October 3, 2001.

Acronyms

IPC - Consumer Price Index
IPCA - Consumer Price Index – Extended
p.a. - per annum