BANCO CENTRAL DO BRASIL

Minutes of the 93rd Meeting of the Monetary Policy Committee (Copom)

Date: February 17th, from 4:10PM to 6:15PM, and February 18th, from 3:30PM to 6:45PM
Place: BCB's Headquarters meeting room of the 8th floor (on February 17th) and 20th floor (on February 18th) – Brasília – DF

In attendance:
Members of the Committee
Henrique de Campos Meirelles – Governor
Afonso Sant'Anna Bevilaqua
Alexandre Schwartsman
Antônio Gustavo Matos do Vale
Eduardo Henrique de Mello Motta Loyo
João Antônio Fleury Teixeira
Luiz Augusto de Oliveira Candiota
Paulo Sérgio Cavalheiro
Sérgio Darcy da Silva Alves

Department Heads (present on February 17th)
Altamir Lopes – Economic Department
Carlos Yoshitaka Urata – International Reserves Operations Department
José Antonio Marciano – Department of Banking Operations and Payments System
José Pedro Ramos Fachada Martins da Silva – Investor Relations Group
Marcelo Kfoury Muinhos – Research Department (also present on February 18th)
Sérgio Goldenstein – Open Market Operations Department

Other participants (present on February 17th)
Alexandre Pundek Rocha – Advisor to the Board
Flávio Pinheiro de Melo - Advisor to the Board
Hélio José Ferreira – Executive Secretary
João Batista do Nascimento Magalhães – Special Advisor to the Governor
Jocimar Nastari – Press Secretary
Katherine Hennings – Advisor to the Board

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

Recent Evolution of Inflation

1. The main price indicators showed an inflation increase in January. The Broad Consumer Price Index (IPCA) rose 0.76% in January, compared to 0.52% in December, registering three consecutive monthly increases. The General Price Index – Domestic Supply (IGP-DI) rose 0.80% in January, after a 0.60% increase in December and a 0.48% increase in November. The IGP-DI change was influenced by the 0.75% increase in the Wholesale Price Index (IPA-DI) and by the 1.08% increase in the Consumer Price Index – Brazil (IPC-Br). The accumulated changes of the IPCA, IGP-DI and IPA-DI in twelve months sustained a downward trend in January, registering 7.71%, 6.22% and 4.75%, respectively.

2. Concerning the São Paulo Consumer Price Index (IPC-Fipe), inflation diminished to 0.46% in the first week of February, from 0.65% in January. However, this decrease in the IPC-Fipe is not necessarily representative of the IPCA trend, as the indices encompass different geographical

areas, different basket of goods and different methodologies. Both indices have also presented different behaviors in the recent past. In the last twelve months, the IPC-Fipe posted a 6.53% change, 1.18 p.p. lower than the IPCA change over the same period. The gap in the changes of prices in São Paulo and in the other areas in Brazil is also detected in the IPCA regional breakdown: in the last twelve months, the accumulated change of the São Paulo IPCA rose by 6.26%, while the average change in the other 10 cities surveyed rose by 8.51%.

3. The more important individual contributions for the IPCA result in January were electricity tariffs, car prices, fresh food products, rice, beans and bottled gas, which altogether accounted for 0.28 p.p. of the total change of the index. Market prices changed 0.73% in the month, contributing 0.52 p.p. to the overall result of IPCA, while the 0.84% increase in regulated prices contributed 0.24 p.p. Among the latter, the higher contributions came from electricity, bottled gas, gasoline, alcohol-based auto fuel and health insurance plans.

4. Concerning wholesale prices, the IPA-DI remained roughly stable at 0.75% in January. This behavior resulted from the reduction of agricultural prices and from the increase of industrial prices. The Agricultural IPA registered a -0.34% variation in January, after rising 0.58% in December, mainly reflecting the falls in the prices of meat, chicken, milk and egg products, which more than compensated the price increases of fresh food items, coffee and beans. The Industrial IPA posted a 1.20% change, compared to 0.80% in December, the third consecutive acceleration. The higher contributions to the Industrial IPA acceleration came from the metallurgy industry (iron, non-iron metals, steel and by-products), chemical industry (plastics, fertilizers and others) and transportation industry. For fabrics, clothing and shoes, the monthly change remained stable, albeit in a high level for the third consecutive month, still reflecting the effects of cotton price increase.

5. Core IPCA inflation, calculated excluding household food items and regulated prices, posted a 0.64% increase in January, remaining relatively stable in comparison to the 0.63% variation in December. Transportation and personal expenses have contributed more intensely to this result. Considering the accumulated change in twelve months, the core registered a 7.39% variation in January, compared to an 8.17% variation in December.

6. The variation of the IPCA core inflation, calculated under the smoothed trimmed-mean method, reached 0.73% in January compared to 0.72% in December. The 12-month accumulated change posted 10.47%. The same measure, without the smoothing procedure, showed acceleration for the third consecutive month, reaching 0.63% in comparison to 0.54% in the previous month.

7. Core IPC-Br inflation calculated under the symmetric trimmed-mean method by Fundação Getúlio Vargas (FGV) reached 0.65% in January, compared to 0.46% in December, accumulating an increase of 8.95% in the last 12 months.

8. The effects of the food prices recent slowdown – reflecting the beginning of the harvest period and the fall of fresh food prices – is likely to moderate the remaining pressures on inflation in February. Such trend is already noticeable in the partial results already disclosed for February wholesale inflation. As to industrial prices, it should continue to reflect the costs increases. Regarding the IPCA, the favorable evolution of food prices should be offset by the price increases in education, health insurance plans and telephone tariffs.

Assessment of Inflation Trends

9. The identified shocks and their impacts were reassessed according to newly available information. The scenario considered in the simulations assumes the following hypotheses:

a. Gasoline and bottled cooking gas price projections for 2004 were maintained at 9.5% and 10%, respectively;

b. Household electricity tariffs are expected to increase 6.3% in 2004, a reduction of 0.5 p.p. compared to the expectation in the last Copom meeting. The projections for telephone tariffs were slightly risen, by 0.2 p.p., reaching 6.8%;

c. Regarding all regulated prices, with a total weight of 28.9% in the January IPCA, the Copom maintained the projection for 2004 nearly unchanged at 7.7%;

d. The projection for the readjustments of regulated prices in 2005, based on the endogenous determination model, increased to 6.0% from 5.4%. This model takes into account seasonal factors, the exchange rate behavior, market prices change and the IGP inflation rate;

e. The projection for the trajectory of the 6-month spread over the Selic rate, following the specification of a Vector Autoregressive model using the Selic and swap rates on the eve of the Copom meeting, reached 17.1% in the fourth quarter of 2005.

10. Regarding fiscal policy, it is assumed that the primary surplus target of 4.25% of the GDP for 2004 and the following two years will be achieved. The related assumptions considered in the previous meeting were maintained.

11. Considering the benchmark scenario hypotheses, including the maintenance of the Selic interest rate at 16.5% p.a. and of the exchange rate close to the level prevailing on the eve of the Copom meeting (R$2,91), IPCA inflation was projected below the 5.5% target for 2004. Inflation projections based on the trajectories of the exchange rate and Selic rate expected by market participants on the eve of the meeting, gathered by the BCB´s Investor Relations Group (Gerin), were above the central targets of 5.5% and 4.5% for 2004 and 2005, respectively.

Monetary Policy Decision

12. The inflation rate accelerated from December to January. The 0.76% IPCA variation in January was significantly higher than market consensus on the eve of the December Copom meeting (0.60%). Inflation for the three groups in the IPCA – tradable, non-tradable and regulated items – stood high and/or increased in January. For tradable goods, the January result remained similar to the one observed in December, around 0.5%. Non-tradable and regulated prices changes departed from an already high level in December and increased about 0.4 p.p. in January, posting 0.97% and 0.84%, respectively, the third consecutive rise for both series.

13. The IPC-Br accelerated to 1.08% in January, from 0.43% in December. Inflation measured by the general price indices (IGP-M and IGP-DI) and by the IPA-M also rose in January. Inflation measured by the IPA-DI remained practically stable from December to January, but at a high rate (0.75%), in spite of being strongly favored by the Agricultural IPA 0.34% fall. The Industrial IPA rose for the third month in a row and reached 1.20% in January, the highest figure since March 2003.

14. Core inflation measures remained practically stable in January, in a level inconsistent with the inflation targets. The core IPCA calculated by excluding household food items and regulated prices posted 0.64% in January, close to the variation observed in December, but higher than that of November (0.38%). The core IPCA calculated under the smoothed trimmed-mean method presented a similar behavior: 0.56% in November, 0.72% in December and 0.73% in January. The core IPC-Br calculated under the symmetric trimmed-mean method rose to 0.65% in January, from

0.46% in December. The ratio of items with positive variations in the IPCA increased to 70.9% in January, from 64.8% in December, the highest level since April 2003.

15. Economic activity indicators remain consistent with the economic recovery scenario that the Copom has been working with in the last months. After a significant fall in the first half of 2003, industrial production presented strong growth in the second half of the year. The industrial production quarterly moving average accumulated a 5.1% growth from June to December, seasonally adjusted. For the same period, durable goods and capital goods output production presented an 18.4% and 12.3% growth, respectively.

16. In the same period, the semi and non-durable goods output, strongly influenced by real earnings, registered a 1.8% drop (quarterly moving average). The Copom stresses the remarks made in the January meeting minutes that these sectors recovery will come naturally, as a consequence of the gradual dissemination of growth throughout the economy. An excessive monetary easing with the objective of pushing these specific sectors forward would intensify, in the short run, the recovery gaps amongst sectors, and would allow for inflationary pressures to arise from leading sectors.

17. In December, industrial output presented a 1% fall, seasonally adjusted, in relation to the previous month. When the quarterly moving average is taken, the output decrease in December diminishes to 0.1%, month-on-month, and is close to the December 2000 historical peak. Volatility around the underlying output trend is normal in periods of economic recovery. This volatility does not indicate that the economic rebound process is losing steam, especially because the monetary easing that took place in the second half of 2003 has not yet fully materialized.

18. Industrial sales growth surpassed industrial production growth for the third consecutive month. In the second half of 2003, industrial sales increased 2.5 p.p. more than industrial output. This gap augmented in the fourth quarter, when industrial sales increased 4.3 p.p. more than output. The different growth rates suggest a higher expansionary stimulus for industrial output in the short-term, coming from the inventories build-up dynamics, as well as from improved consumer confidence, real earnings growth and credit expansion.

19. According to IBGE data seasonally adjusted by the BCB, retail sales quarterly moving average grew 0.5% in December, compared to November, and 2.9% from June to December. As for industrial sales, retail sales growth was led by sectors directly favored with credit expansion, as furniture and appliances (14.4% from June to December), and automobiles and motorcycles (16.2% for the same period). The most likely scenario is a continuous recovery in consumption as a consequence of improved consumer sentiment, higher real payrolls and lower consumer default rates.

20. As in previous months, the external sector continued to post a positive performance. In January, exports and imports increased 26.5% and 20.9%, respectively, compared to January 2003. The trade balance and the current account registered an US$1.6 billion and a US$0.7 billion surplus, respectively. There was an increase in the sovereign risk perception due to market concern about an earlier-than-expected rise in US interest rates and its impact in emerging markets liquidity. As a consequence, the Brazil Embi+ increased nearly 100 b.p., to 520 b.p. between the January and the February Copom meetings. In the same period, private external funding diminished and the dollar appreciated from R$2.84 to R$2.91. Nonetheless, the external scenario remains positive, with favorable perspectives for global growth, increase in demand for Brazilian exports and adequate liquidity conditions.

21. First quarter market inflation expectations have been increasing since December. The inflation in January was higher than market consensus and preliminary data suggest that February inflation will also be higher than the previous forecast. Considering the eves of the Copom meetings, the median of the first quarter inflation expectations for the five most accurate short-term forecasters (the Top 5 short-term forecasters) increased to 1.98% in February from 1.68% in January and

1.48% in December. The median of the market inflation expectations rose to 1.90% in February from 1.51% in December. Despite higher expectations for the first quarter inflation, the medians for 2004 and 2005 inflation remained stable at 6.0% and 5.0%, respectively.

22. The BCB inflation forecasts, according to the benchmark scenario (assuming unchanged Over-Selic rate at 16.5% p.a. and exchange rate at R$2,91/US$), are below the 5.5% target for 2004 and below the 4.5% target for 2005. Compared to January, there was an increase in the inflation projection for 2004, due to higher-than-anticipated inflation in January and due to the impact of the exchange rate depreciation. The forecast for 2005 remained unaltered. Under the market scenario, which takes into account the path for the exchange rate and the Over-Selic rate expected by market participants on the eve of the Copom meeting, the BCB inflation estimates are above the targets for 2004 and 2005.

23. The Copom also examined the inflation projections produced according to the same methodology and according to the same benchmark and market scenarios, taking into account the Top 5 short-term inflation expectations for February and March, and hence projecting inflation for the following months. In this exercise, the projected inflation for 2004 is slightly above the target even in the benchmark scenario, although the projection for 2005 remains below the target. The same procedure considering the market scenario shows an increased difference between the projected inflation rate and the targets for 2004 and 2005.

24. Considering the post-Real Plan period, the January inflation was the highest in the first quarter in 7 out of 9 years. It is justified to expect that this seasonal behavior persists and that the February inflation shows some reversion in relation to January. However, since the January meeting, the Copom has not yet identified factors that could reduce the risks of an inflation higher than the 5.5% target for 2004. First, the IPCA and the different core measures in January, as well as the expectations for February, do not point out any reduction trend. Preliminary evidence of an inflation deceleration can be found in the partial results of the IPC-Fipe and the weekly IPC-S. For the IPC-S, however, inflation persists at a high level; for the IPC-Fipe, the reduction was more intense, and yet, due to the reasons described in paragraph 2 above, this pattern may not be the same for the IPCA. Second, inflation measured by the Industrial IPA remained high and accelerated, influenced by an increase in some commodities prices, by a higher demand for inputs and by the relative price realignment, favoring the sectors that benefited from stronger demand. Although a higher wholesale inflation will not necessarily be transmitted to consumers with the same intensity, a higher passthrough would happen as a consequence of the perception of a lenient monetary policy and of an over-optimistic scenario produced by the recovery of certain sectors.

25. Even considering that the recent inflation increase was caused by seasonal and one-off factors, and considering the return of inflation to a path consistent with the inflation target in the near future, the achievement of the 5.5% target for 2004 will require a more cautious monetary policy, as a result of higher inflation in January and of higher short-term inflation expectations.

26. Consequently, and considering the uncertainties about the magnitude and the lags on the output gap and on inflation of the 10 p.p. reduction in the Over-Selic rate that took place from June to December, the Copom maintains the January minutes diagnosis, that there is a real likelihood that inflation deviates from the target, requiring an extra concern in monetary policymaking.

27. The balance between the risks of inflation deviating from the target and the interruption in the economy recovery process has not changed significantly since January. Resuming monetary easing prematurely can significantly increase the risk that actual inflation deviates from the target, which could force a change in monetary stance in the medium run, with strong interest rates movements and a significant effect on economic activity. On the other hand, an unchanged Over-Selic rate causes a substantial lower risk of damaging the process of economy recovery.

28. As a result, the Committee decided, unanimously, to maintain the target for the Over-Selic rate at 16.5% p.a., without bias, looking forward to consistent signals of low risk of inflation deviating from the target path.

29. At the closing of the meeting, it was announced that the Copom would meet again on March 16, for technical presentations and on the following day, in order to discuss the monetary policy decision, as established in Communiqué 11,516, of October 15, 2003.

SUMMARY OF DATA ANALYZED BY THE COPOM

Economic Activity

30. Retail sales decreased 0.3% in December, month-on-month, considering seasonally adjusted data. After twelve consecutive decreases, sales grew 3.2% in December compared to the same month of 2003.

31. Consultations to the São Paulo Trade Association and the Usecheque increased 4.6% and 0.2%, respectively, in the first half of February, compared to the same period of 2003, indicating the continued expansion of the retail activity.

32. The Federação de Comércio de São Paulo survey on consumer confidence showed in February a 0.5% decrease of consumption intentions, after a substantial increase in the three previous months. However, the result of 126.7, in a scale ranging from 0 to 200, reflects an overall positive sentiment, mainly regarding future consumption intentions.

33. Regarding investment data, for the second consecutive month, capital goods output decreased in December, compared to the previous month. Machines and equipments production and capital goods imports decreased 5.3% and 15.2%, respectively (seasonally adjusted). The construction industry input also decreased by 1.2% in December.

34. The Brazilian industrial production decreased 1% month-on-month in December, seasonally adjusted, interrupting a sequence of five positive results. Out of the twenty surveyed segments, fifteen decreased, as well as in three out of four use categories. Capital goods production fell 5.3%, while semi and non-durable goods production decreased 3.6%, and durable goods production declined 2.1%. Intermediary goods production, the only category showing a positive change, increased 0.9%, maintaining the upward trend for the sixth consecutive month. Compared to the same month of the previous year, industrial production increased 2.9% in December, completing four months of positive changes in this comparison. In 2003, compared to 2002, industrial production grew 0.3%.

35. The National Confederation of Industry (CNI) statistics regarding the performance of the manufacturing activity in December showed recovery continuity. Real sales changed 1.3% in the month (seasonally adjusted), increasing for the sixth consecutive month and accumulating an expansion of 14.8% in the period. Comparing to the same month of 2002, real sales increased 10.9%, registering the second consecutive positive rate. After five months increasing, the worked hours decreased 2.1% in December. The level of capacity utilization, however, increased slightly to 80.3% in December from 79.7% in November.

36. According to CNI, business confidence increased 12.4% in January, compared to the previous survey in October. The 62.4 result, in a scale ranging from 0 to 100, reflected greater optimism of businessmen in relation to both current conditions and next six months expectations.

37. In the automotive sector, vehicles production and external sales increased 0.3% and 50.2%, respectively, month-on-month, while domestic sales fell 2% (seasonally adjusted data).

Labor Market

38. The index of employment increased 0.1% month-on-month in December compared to November (seasonally adjusted), and 3% year-on-year, according to the Ministry of Labor. According to the IBGE's survey, the unemployment rate in the six main metropolitan areas decreased to 10.9% in

December from 12.2% in November, indicating the second fall in a row. This fall was mainly a result of a greater reduction in the number of unemployed workers relatively to the fall of economic population. The same survey also registered that the average wage, earned by employed workers in November, increased 2.8% compared to the previous month and posted a 13.1% fall compared to the same month of 2002.

39. In the industrial sector, according to the CNI, there was a 0.24% decrease in employment in December, compared to the previous month. Industry real payroll sustained the recovery trend, increasing 0.5% in December compared to November, completing seven months of growth. Compared to the same month of 2002, real payroll recorded a 4.0% growth in December, the second consecutive positive rate in 2003, considering the same basis.

Credit and Delinquency Rates

40. Non-earmarked credit increased 0.2% in January. This modest increase reflected low corporate financing needs, due to seasonal factors. As a consequence of lower demand, there was a 1.6% fall in domestically funded operations, whereas external funded operations recorded a 0.8% fall. Regarding credit to households, there was a 1.7% increase, reflecting higher demand due to expenditure on vacation, schooling and tax payment.

41. The average interest rate on non-earmarked credit fell 0.4 p.p. in January, reaching 45.4% p.a. The decline in rates was more significant for households, which fell 1.2 p.p., reaching 65.4% p.a. The average interest rate on credit provided to companies reached 30.1% p.a., stable in relation to last month (30.2%). The delinquency rate on non-earmarked credit increased 0.1 p.p. in January, reaching 8%, as a consequence of the 0.3 p.p. seasonal increase in non-performing credit of individuals. Regarding credit to companies, there was a 0.1 p.p. decrease.

42. Regarding the retail sector, there was an improvement in the default figures of January, compared to same month in 2003. Net default rates declined to 4.7% in January from 6.2% in January 2003. The average default rate stood at 5.2% in 2003.

External Environment

43. Recent GDP growth figures for the central economies reinforce the global economy recovery scenario. U.S. growth rate stood at 4% in the last quarter of 2003, accumulating a 3.1% annual growth rate. In the second half of 2003, private investment replaced government expenditures as the component with the highest growth. The Euro Area grew 0.4% in 2003, after registering a growth rate of 1.2% in the last quarter of the year.

44. In the U.S., recent figures confirm the growth trend, despite the 0.3% decrease in retail sales in January. Wholesale sales increased in December for the seventh consecutive month (1%), accumulating 8% in the year, mainly due to the performance of durable goods. The unemployment rate declined to 5.6% in January, but the number of unemployed benefit claims remained stable. In the Euro Area, the unemployment rate stood stable in 8.8%, while in Japan and in the other OECD countries this rate fell.

45. Business sentiment in the US, Japan and Europe continued to improve. Consumer confidence declined in the U.S. but increased in Japan and remained flat in the Euro Area (except in Italy due to the Parmalat affair). However, in general, consumer confidence remained weak due to the labor market conditions in the respective countries.

46. In the absence of inflationary pressures, the basic interest rates remained steady in the central economies, except for the United Kingdom, where there was an increase of 25 b.p of the Bank of England's repo rate. The U.S. fixed income market has not reacted to the signs of economic recovery in the country. However, the change in the Federal Reserve's statement caused negative reactions in the sovereign bonds market, in the FX market and in the stock market.

47. In the FX markets, there is a near consensus about the continuity of the dollar depreciation due to the increasing U.S. current account deficit. The dollar depreciation together with strong Chinese demand is affecting commodities prices, which reached record levels in January. The oil price increased again in February, reflecting the producers' decision to reduce output by 1 million barrels/day, starting April 1st.

Foreign Trade and Balance of Payments

48. The Brazilian trade balance posted a US$1.6 billion surplus in January, a new record for this month. Exports and imports increased 26.5% and 20.9%, respectively, compared to the December 2003 daily averages. In the first 10 working days of February, the trade surplus totaled US$873 million.

49. In January, Brazilian exports totaled US$5.8 billion. The three categories – basic, semi-manufactured and manufactured – registered record exports. Imports amounted to US$4.2 billion, expanding in all categories.

50. The results in 12 months to January for the trade balance and for exports were historical records: US$25.3 billion and US$74.1 billion, respectively.

51. The current account registered a US$0.7 billion surplus in January. Income and services registered a US$1.2 billion deficit, the same level of January 2003. Financial account balance increased substantially, to a US$3.8 billion surplus from US$550 million in January 2003, expressing better rollover rates not only for direct loans (to 92% from 29%) but also for private securities placed abroad. Net FDI totaled US$993 million in January, slightly above the result for the same month of 2003 (US$905 million). At the end of January, international reserves stood at US$53.3 billion, and the net adjusted international reserves (IMF agreement concept) stood at US$21.5 billion.

Money Market and Open Market Operations

52. After the January's Copom meeting, volatility in the money market increased significantly. Between January 21st and February 17th, the 3-month, 6-month and 1-year interest rates increased 0.27 p.p., 0.20 p.p. and 0.08 p.p., respectively, while the 2-year rate decreased 0.13 p.p. The ex-ante real interest rate increased to 9.1% on the eve of the February Copom meeting, from 8.7% in January.

53. As in the previous month, the BCB decided not to rollover the FX debt and swaps maturing on February 11th. Consequently, the net redemption of FX securities and swaps in the first two months of the year totaled US$7.6 billion.

54. The National Treasury carried out four fixed rate LTN auctions, totaling R$10.5 billion, with maturities in January and July 2005. Placement rates oscillated, following the volatility of the yield curve. A NTN-F auction was also carried out totaling R$427.6 million and maturing on January 1st, 2008. The placement rate decreased to 15.67% from 17.19% in a similar event in December. In regard to Selic-indexed LFTs, only one auction was carried out, offering securities maturing in

2009. Total sales reached R$936.9 million. Auctions of inflation-indexed securities (NTN-C and NTN-B) reached R$2 billion.

55. The BCB maintained in its open market operations the 3-month fixed and the 2-week indexed repurchase operations, as well as the daily liquidity management operations. The BCB also carried out in the period 11 fixed rate repos with 1-working day tenure. The excess liquidity drained from the market averaged R$57 billion.

56. In January, the net securitized domestic public debt increased R$5.9 billion, or 0.8%. The dollar-linked share decreased to 21%, the lowest level since July 2000.