BANCO CENTRAL DO BRASIL

Minutes of the 95th Meeting of the Monetary Policy Committee (Copom)

Date: April 13th, from 4:45PM to 7:30PM, and April 14th, from 3:30PM to 4:15PM
Place: BCB's Headquarters meeting room of the 8th floor (on April 13th) and 20th floor (on April 14th) – 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 April 13th)
Altamir Lopes – Economic Department
Daso Maranhão Coimbra – 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 March 14th)
Sérgio Goldenstein – Open Market Operations Department

Other participants (present on April 13th)
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 inflation recorded deceleration in March, confirming the expectations for the period. The Broad National Consumer Price Index (IPCA) registered 0.47% in March, compared to 0.61% in February, accumulating 1.85% in the first quarter of 2004. The IGP-DI reached 0.93% in March, compared to 1.08% registered in the previous month, totaling 2.84% in the first quarter of the year. This performance was mainly a consequence of the Wholesale Price Index (IPA-DI) behavior, with an increase of 1.09% in the month and of 3.30% in the first quarter of the year. The 12-month accumulated changes of the IPCA, IGP-DI and IPA-DI remained in a downward trend in March, standing at 5.89%, 4.94% and 3.59%, respectively.

2. Regarding the IPCA, the reduction of the monthly change was mainly due to the smaller impact of the school fees readjustment in the month. This readjustment was the main factor of pressure in February. In addition, fuel-alcohol prices remained on a declining trend (-12.87%), reflecting a favorable harvest of sugar cane.

3. The main individual contribution to the March IPCA inflation came from new cars prices, 0.07 p.p., due to a 2.33% increase registered as a consequence of rise in production costs, as well as of the end of the special tax on industrialized products regime. Amongst the items with greater price increase, one highlights cigarettes, with a total contribution of 0.06 p.p., and sewage and water supply, with price readjustment in four cities, with 0.05 p.p. Food and beverages registered a 0.43% increase, compared to the 0.15% increase in February, mainly driven by the prices of soy oil and eggs.

4. Regarding regulated prices, there has recently been above-than-expected price increases in certain items. As an example, the price readjustments for sewage and water supply in Brasília and Belo Horizonte reached 20% and 21%, respectively, much higher figures than any 12-month accumulated inflation index. In addition to this item, recent announcements of price readjustments of electricity in Minas Gerais and Pernambuco are also above previously expected. These increases consider inflation-indexed costs, price increases due to investments in the distribution and a part of the 2003 readjustment that is being applied this year.

5. Still regarding the IPCA evolution in March, market prices changed 0.69%, accounting for 0.49 p.p. of the monthly variation of the index, while the 0.07% fall in the regulated prices contributed with – 0.02 p.p. In the first group, the rise of tradable goods prices contributed 0.27 p.p. for the IPCA monthly change, while non-tradable goods contributed with 0.22 p.p. Regarding regulated prices, the negative change was due to the reduction of fuel prices, which prevailed over the increases of water and sewage tariffs and bottled gas prices.

6. The IPA-DI decreased 1.09% in March, in comparison to 1.42% in February. This result followed the industrial prices trajectory, as the Agricultural IPA reverted its trend in March, after reductions of 0.76% an 0.34% in February and January, respectively, mainly due to price increases of 10.98%, 12.17% and 7.01% of soy, eggs and fresh food items, respectively. However, the prices of rice, cattle and sugar cane remained in a downward trend.

7. Industrial IPA rose 0.94% in March, compared to 2.29% in February, mostly influenced by prices of the following items: chemicals (decrease in alcohol prices and deceleration of price rises of both plastic and fertilizers); food products (with the effects of oil and fat losing ground); mechanics; electric material; wood and furniture; paper and cardboard; rubber; and fabric, clothing and shoes (deceleration of rises). Price increases in the metallurgy sector (iron, steel and by-products and non-ferrous metals) continued to present the highest contributions to the absolute Industrial IPA change (0.37 p.p.) in March, when the variation stood at the same level registered in the month, 4%.

8. The core IPCA inflation calculated excluding household food items and regulated prices was the only core measure to decrease in March, to 0.85% compared to a 1.00% rise in February, partially due to the end of school fees rises that had been pressuring the previous month results. The 12-month accumulated change reached 7.09% in March.

9. The core IPCA inflation calculated under the smoothed trimmed-mean method rose to 0.76% in March from 0.48% in February, posting a 9.47% accumulated variation in the last 12 months. The result calculated without the smoothing procedure for pre-selected items reached 0.65% in March, accumulating 6.11% in 12 months. As occurred with the full IPCA, the 12-month accumulated core indices registered in March the lowest changes since the end of 2002, despite being above the full IPCA change.

10. Core IPC-BR inflation, calculated under the symmetric trimmed-mean method by Fundação Getúlio Vargas (FGV), rose to 0.53% in March, compared to 0.46% in February, accumulating 7.87% in the last 12 months.

11. In April, consumer price indices should be influenced by price rises of medicine and clothing, and, among regulated items, of water and sewage and household electricity. The magnitude and the pace of the pass-through of wholesale industrial price increases to consumer prices have been unsurprised.

Assessment of Inflation Trends

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

    a. The projections for the evolution of gasoline prices in 2004 were maintained at 9.5%. The projections for bottled cooking gas were revised to 6.9% in the year, 3.1 p.p. below March projections;

    b. The projection for household electricity tariffs increased to 8.5% from 6.9% since the last Copom meeting. Regarding telephone tariffs, the Copom maintained its projections practically unchanged, from 6.8% in the previous meeting to 6.7%;

    c. Regarding all regulated prices, with a total weight of 28.8% in the March IPCA, a 7.4% rise is projected, 0.1 p.p. above the projection made in the previous meeting;

    d. The projection for the readjustment of all regulated prices for 2005 was maintained at 6.0%. This figure results from a model of endogenous determination, which takes into account seasonal components, the exchange rate behavior, market prices inflation and the IGP change;

    e. The projection for 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, starts from a -81 b.p. in the second quarter of 2004 and reaches 55 b.p. in fourth quarter of 2005.

13. 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.

14. Considering the hypothesis of a lower persistence of inflation, considered by the Copom since March, and the benchmark scenario hypotheses, including the maintenance of the Over-Selic rate at 16.25% p.a. and of the exchange rate close to the level prevailing on the eve of the Copom meeting (R$2.88), IPCA inflation was projected slightly below the 5.5% target for 2004 and below the 4.5% target for 2005. According to the market scenario, which takes into account the consensus exchange rate and Selic rate as surveyed by the BCB´s Investor Relations Group (Gerin) on the eve of the Copom meeting, inflation is projected above the central targets for both 2004 and 2005.

Monetary Policy Decision

15. The inflation registered by the IPCA decreased by the second consecutive month, to a level close to the ceiling of market expectations for the month. The pressure has been higher among market prices with a change of 0.68% and 0.69% in tradable and non-tradable items, respectively. Regulated prices fell (-0.07%) and contributed significantly to the March inflation reduction. So far, non-tradable items have contributed more intensely to inflation in 2004, with a 3.33% variation in the first quarter of 2004, while tradable and regulated items changed 1.29% and 1.03%, respectively. As a consequence of this increase to 3.33% (1Q04) from 1.19% (4Q03) in the non-tradable inflation rate, the contribution of this group to the IPCA increased 0.66 p.p. in first quarter

of this year compared to the last quarter of 2003, explaining almost all inflation acceleration in 2004. Inflation measured by other national consumer indices was close to the ones observed in the IPCA. However, general price indices have shown relatively higher rates. The IGP-DI increased 0.93% in March, after increasing 0.80% and 1.08% in January and February, respectively.

16. In contrast with the deceleration of the headline index, the various core IPCA measures calculated under the trimmed-mean method increased in March, reversing the February fall. Core inflation calculated with smoothing of pre-selected items increased to 0.76%, from 0.48%, and the core inflation calculated without the smoothing procedure rose to 0.65, from 0.28%. Core inflation calculated by excluding household food items and regulated prices decreased to 0.85% in March, from 1.00% in February. The ratio of items of the IPCA with positive variation in the month increased to 66.0%, from 60.4%, but kept within the usual range. It should be noted that increases in the measures of core inflation and inflation dispersion could be justified as a consequence of recent increases in wholesale prices, even if the pass-through remains moderate, as expected, and compatible with a favorable inflation scenario.

17. Economic activity continues its recovery trend, despite the 1.8% fall in industrial production in February, compared to January. This fall, anticipated in the March minutes, is fully consistent with usual economic recovery cycles and is related to the sharp rebound of the second half of 2003. The recovery was fast and intense, which became clear in the new industrial output series released in April by the IBGE. According to this new series, in the second half of 2003 the industrial production was 4.2% higher than in the first half of 2003, while the old series recorded a 2.3% growth for the same period. The highest industrial production level in Brazilian history was reached in November, with a seasonally adjusted growth of 9.6%, compared to the trough observed in June. However, according to the new series, industrial production has been declining since November, in spite of signals showing a continuous economic recovery. The new series also shows a higher growth in the semi and non-durable goods sectors. While the old series indicated December 2003 as the month with the lowest output in 2003, according to the new series, there was a peak in this month, with a seasonally adjusted growth of 9.2% compared to the trough in July.

18. Several leading and coincident indicators confirm the Copom's evaluation regarding the positive activity trend. Packaging paper production sustained the upward trend initiated in September. Automobile production increased again in March. Average real earnings in the six metropolitan areas in the IBGE's monthly employment survey increased in February for the second consecutive month. According to data from the CNI to Brasil and Fiesp to São Paulo, real earnings in the industry are currently in higher levels than the ones observed in 2002. Regarding Fiesp data, employment growth in the first quarter of 2004 was the highest since 1999, indicating that industrial production growth is already affecting job creation. Retail sales, according to IBGE data seasonally adjusted by the BCB, increased 2.1% in January compared to the previous month, reaching a level 6.1% higher than the same month of 2003. According to Fecomércio-SP data seasonally adjusted by the BCB, real sales in the greater São Paulo continue to increase, showing a 2.0% growth in February, compared to the previous month. Credit operations also sustained an upward trend. Despite the fall in consumer sentiment in March and April, retail sales have apparently not been affected.

19. Brazilian external accounts continue to show very impressive positive results. The trade balance in March was 73.3% higher than in the same month of 2003, and reached US$6.2 billion in the first quarter of the year, compared to US$ 3.8 billion in the same period of 2003. Despite economic growth this year, the BCB projects a trade balance surplus similar to 2003. The current account remains positive, accumulating a US$ 1.7 billion surplus in the first quarter of 2004. The country-risk measured by the Brazil Embi+ stabilized again, after increasing in the January-February period. From the eve of the Copom meeting in March to April, the Brazil Embi+ fell to a level close to 540 b.p., from 560 b.p. The exchange rate remained almost stable, around R$2.90/US$1.00.

20. In general, the external environment remains favorable. World growth perspectives help the Brazilian trade balance. Furthermore, the anticipation of an interest rate hike in the U.S. after the disclosure of sales and consumer inflation data in March, should not change significantly costs and availability of external funding to Brazil in 2004, despite eventual turbulence in the short run. The scenario of a rise in the fed funds is already incorporated in asset prices. In addition, the remarkable adjustment in the Brazilian current account and the reduction of the FX-linked public debt contribute significantly to mitigate not only the effects of a deterioration in international liquidity to the financing of the Balance of Payments, but also its effects on the foreign exchange market.

21. Although inflation in the first quarter was higher than expected, market expectations remained relatively stable. The small increase in expected inflation is mainly due to the incorporation of the January-March actual rates. At the end of December, according to the Gerin, inflation expectations for the first quarter of 2004 stood at 1.51%, while actual inflation reached 1.85%. The effect on expectations to 2004 was marginal, as expectations remained satisfactorily anchored. Inflation expectations for 2005 remained steady at 5.00%. Inflation expectations for the next 12 months rose slightly to 5.48%, from 5.41%, since the last Copom meeting.

22. Copom considered BCB's inflation projections under the hypothesis of a low degree of persistence of the first quarter inflation, following the seasonal inflation pattern observed in the last years. According to the benchmark scenario, which supposes the maintenance of the Selic rate at 16.25% p.a. and the exchange rate at R$2.88 during the forecasting horizon, inflation is slightly below the 5.5% target for 2004 and below the 4.5% target for 2005. According to the market scenario, which incorporates consensus exchange rate and Selic rate on the eve of the Copom meeting, the BCB's projections are above the targets for 2004 and for 2005. Accumulated inflation for 2004 rose in the two scenarios because inflation was higher-than-expected in March. The market scenario projects higher inflation rates than the benchmarked scenario because it assumes a declining trend for the interest rate, as well as a small increase of the exchange rate.

23. As the projected inflation for April in the two scenarios was very close to the one expected by the Top 5 forecasting institutions (institutions with more accurate forecasts in the short run), incorporating these expectations into projection scenarios, as recently done by Copom, does not change projected inflations for 2004 and 2005 significantly.

24. Considering these inflation scenarios, the Committee decided, unanimously, to reduce the target for the Over-Selic rate to 16% p.a., without bias. The Committee understood that this reduction is coherent with the last meeting diagnosis, which considers more likely the benign scenario of low inflation persistence in the next months, and the low pass-through from wholesale prices to retail prices.

25. The Copom evaluated that the cautious monetary stance has been essential to increase the likelihood of inflation converging to the target. Accordingly, inflation indicators must continue consistent with the low inflation-persistence hypothesis that has been considered.

26. The monetary stance is different during crises periods, such as the one observed at the end of 2002 and the beginning of 2003, or during times of greater macroeconomic stability, as the one recently established. Therefore, when the crisis is reverted, as the interest rate is still considerably high, interest rate cuts are larger. However, a different interest rate dynamics should take place during times of greater macroeconomic stability, when inflation convergence to the targeted path, along with sustained economic recovery, should be monitored more carefully.

27. The Committee stresses that it is pointless to infer that the more moderate cut of interest rate corresponds to a negative evaluation about the future behavior of inflation, or that it should cause pessimism about the future path of economic activity. On the contrary, a natural result of the progressive normalization of the economic environment is precisely the fall in the average interest rate cuts. In addition to allowing further monetary easing, this procedure enables a smooth

transition to a scenario of price stability with economic growth, with smaller market interest rates volatility in the medium run.

28. At the closing of the meeting, it was announced that the Copom would meet again on May 18, 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

29. The statistics concerning the output and sales in February 2004 should be analyzed with caution, once that in this year, differently from the previous year, Carnival holidays happened in February. The smaller number of working days in February 2004 (18), compared to 2003 (20), in spite of having different impact throughout the economic sectors, might cause misleading month-on-month and year-on-year comparisons of the output and sales flows. These distortions may not be completely eliminated with the application of usual seasoning adjustment procedures and tend to diminish February 2004 results and increase those of March.

30. According to Federação de Comércio do Estado de São Paulo, retail sales increased 2% in February compared to January, seasonally adjusted. In the year up to February, there was a 5.9% increase compared to the same period in 2003.

31. The consultations to the São Paulo Trade Association and the Usecheque showed increases of 3.7% and 4.3% month-on-month, respectively, in February, seasonally adjusted. In the year up to March, the same indicators revealed expansions of 7.2% and 0.8%, respectively.

32. The Federação de Comércio do Estado de São Paulo survey on consumer confidence showed a decrease of 9.1% in April, the third consecutive fall. The result reflects the decrease of both present and future consumption intentions. The index decreased to 105.2, in a scale ranging from 0 to 200.

33. Regarding investment data, the capital goods output decreased in February (compared to the previous month). Machinery and equipment production and construction industry input decreased 2.4% and 3.1%, respectively, while capital goods imports and exports increased 18.9% and 1.2%, respectively

34. The first release of the Brazilian industrial production, according to the new methodology of IBGE research, showed a decrease of 1.8% in the s.a. industrial activity in February compared to January. Considering categories of use, this movement was generalized, with higher intensity in the productions of durable consumption goods and capital goods, which had been increasing in the last six months. Therefore, the negative results in February reflect mostly the last month's production high level. Compared to the same month of the previous year, industrial production grew 1.8% in February, the sixth consecutive positive change in this comparison basis.

35. In March, the automotive sector output presented a 0.3% increase. Vehicles external sales increased 18.6%, while internal sales decreased 6.1% compared to last month (seasonally adjusted data). In 2004, up to March, the automotive production, the vehicles external and internal sales increased 13.5%, 13.4% and 18.4%, respectively.

Labor Market

36. The index of employment increased 0.4% month-on-month in February compared to January (seasonally adjusted), and 3.4% compared to the same month of 2003, according to the Ministry of Labor. According to the IBGE's survey, the unemployment rate in the six main metropolitan areas reached 12% in February, compared to 11.7% in the previous month. The result was due to an increase of the economic population while the number of employed workers remained practically stable from January to February. The same IBGE research registered, in February, a 0.5% increase (compared to January) in the employed workers average real earning, deflated by the INPC.

37. In the industrial sector, according to the CNI s.a. data, the employment and the industry real payroll increased 0.4% and 1.1% in February, respectively, compared to the previous month. Compared to the same month of the previous year, industry real payroll increased 7.2%, the fourth consecutive positive change in this comparison basis.

External Environment

38. World economic indicators signal to the maintenance of the global economy growth, mainly in the U.S. and Asia. More recent estimates point to more vigorous economic growth in 2004, despite the low reaction of the European economy. However, economic optimism can be harmed by an eventual worsening of the politic environment.

39. In the U.S., employment data signal to the recovery of labor market, with the creation of 308 thousand new job positions – therefore, above the expectations. The initial requests of job claims have also been presenting weekly decreases. However, it is still early to conclude about a steady recovery trend, since the unemployment rate increased to 5.7% in March from 5.6% in February. Other economic indicators point to the maintenance of the economic growth in the first quarter, such as the increase of 0.7% in the industrial production in February, and the expansion of 1.8% of the retail sales in March, which was greater than the one-year result.

40. The recovery remains low in Europe, due to the lack of reaction of the domestic demand components in the region, especially in Germany. According to the European Commission, around six countries in the region should surpass the fiscal deficit limit of 3% established by the Stability and Growth Agreement. The impossibility to broaden the fiscal and monetary stimulus adds more skepticism to the recovery in the Euro Area.

41. Business confidence improved in the U.S. and in Japan in March, but remained stable in Europe. Consumer expectations remained stable in the U.S. and Europe and presented slight improvement in Japan.

42. In the absence of inflationary pressures, the basic interest rates remain steady in the central economies. However, the most prominent indicators of labor market in the U.S. anticipated the market expectations that the Federal Reserve would initiate the process of increasing the interest rates this year. There was positive reaction among the rates of the US government securities and the treasuries of the European economies. The futures markets have showed high volatility. In the FX markets, there is a consensus about the continuity of the dollar depreciation due to the increasing U.S. current account deficits.

43. Prices of commodities reached the highest levels in March. Grain inventories have been maintained in historically low levels due to the atmospheric conditions of the last years and to the recent harvest shock in the South hemisphere. Along with the strong world demand, this fact has pressured the prices. Metal prices have also been kept above the historical averages, reflecting the demand pressures and low inventories. Regarding oil, pressure over prices is also a result of the increase in the tensions in Iraq.

Foreign Trade and Balance of Payments

44. The Brazilian trade balance posted a US$2.6 billion surplus in March. Exports and imports increased 25% and 18.8%, respectively, compared to the March 2003 daily averages. In the first 2-weeks (6 working days) of April, the trade surplus totaled US$576 million, and US$6.7 billion in the year, compared to US$4.5 billion registered in the same period of 2003.

45. Considering the first quarter, exports totaled US$19.4 billion, and imports, US$13.3 billion, with daily averages of US$313.7 million and US$214.2 million, respectively. Compared to the same period of last year, exports and imports increased 27.2% and 16.2%, respectively. In the accumulated of the year, considering the six working days of April, exports amounted US$21.5 billion and imports, US$14.7 billion, registering a positive balance of US$6.7 billion. The daily average of exports reached US$315.9 million in the period, 27% above the value observed in the same period of 2003. Considering imports, the daily average of US$216.6 million was 17.6% above the value registered in the same period of last year.

Money Market and Open Market Operations

46. After the March Copom meeting, the futures yield curve registered significant change in its slope, with reduction in the short-term interest rates and increase in the rates with tenures longer than one year. The main factors that contributed to the slowdown movement of the short part of the curve were the reduction of the Over-Selic Target and the favorable expectations of the inflation trajectory. This movement was partially reverted by the fact that the IPCA and its cores were above market expectations. Yet, the long part of the yield curve was influenced by the greater placement of National Treasury Bills (LTN) by the National Treasury and by the increase of interest rates of U.S. treasuries. Between March 17 and April 13, the 1-month and 6-month interest rates decreased 0.23 p.p. and 0.16 p.p., respectively, while the 1-year, 2-year and 3-year rates increased 0.11 p.p., 0.33 p.p. and 0.48 p.p., respectively. The ex-ante real interest rate, measured by the quotient between 12-month nominal interest rate and the 12-month ahead inflation expectations, remained at 9.4%.

47. Similarly to what has been occurring since the middle of December of last year, the BCB did not carry out auctions to rollover securities and Fx swaps maturing in the period. Thus, including interests, the net redemption of these instruments in the year, up to the end of April, will amount US$14.1 billion, of which US$3.8 billion only in this month.

48. The National Treasury carried out four selling auctions of LTNs, maturing in April 2005 and January 2006 and totaling R$19.1 billion. The issue of National Treasury Notes – Series C (NTN-Cs) amounted to R$ 2.2 billion, of which R$1.3 billion settled in local currency.

49. The BCB maintained in its open market operations the weekly post-fixed repo operations, with tenure of two weeks, and the fixed operations, with tenure of three months, as well as the 2-working-day daily liquidity management operations. The BCB also carried out in this period 11 fixed rate repos falling due between 1 and 3 working days. The excess liquidity drained from the market and sterilized by the operations maturing before 30 days averaged R$50.9 billion in the period.

50. In March, the net securitized domestic public debt increased 2.2%, basically due to the net placement of R$6.1 billion of securities and the interest appropriation. The fixed rate share increased to 15.4% from 13.6%, while the dollar-linked share decreased to 17.7% from 19%.