BANCO CENTRAL DO BRASIL

Minutes of the 91st Meeting of the Monetary Policy Committee (Copom)

Date: December 16th, from 3:30PM to 6:00PM, and December 17th, from 3:30PM to 6:00PM
Place: BCB's Headquarters meeting room of the 8th floor (on December 16th) and 20th floor (on December 17th) – 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 December 16th)
Altamir Lopes – Economic Department
Daso Maranhão Coimbra – International Reserves Operations Department
José Pedro Ramos Fachada Martins da Silva – Investor Relations Group
Luiz Fernando Cardoso Maciel – Department of Banking Operations and Payments System
Marcelo Kfoury Muinhos – Research Department (also present on December 17th)
Sérgio Goldenstein – Open Market Operations Department

Other participants (present on December 16th)
Alexandre Pundek Rocha – Advisor to the Board
Flávio Pinheiro de Melo - Advisor to the Board
Hélio José Ferreira – Executive Secretary
Hélio Mori – Advisor to the Board
João Batista do Nascimento Magalhães – Special Advisor to the Governor
Jocimar Nastari – Press Secretary

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 inflation indicators remained stable in November, compared to October, presenting low rates and low dispersion. This behavior confirms the favorable recent inflationary outlook, in which the main disturbing factors are seasonal and temporary.

2. The IPCA increased 0.34% in November compared to 0.29% in the previous month, totaling 8.74% in the year and 11.02% in the last twelve months. The IGP-DI changed 0.48%, after an increase of 0.44% in October, influenced by the IPA-DI and the IPC-Br increases (0.46% and 0.33%, respectively). The IGP-DI and IPA-DI changes accumulated in twelve months to November decreased for the eighth consecutive month, to 9.92% and 8.79%, respectively.

3. Regarding the IPCA, lotteries and urban bus fares in Rio de Janeiro were the main individual contributors to the November result (contributing 0.06 p.p. and 0.05 p.p., respectively). Clothing,

under seasonal factors influence, presented an average increase of 0.99% in November, compared to 0.92% in October, contributing 0.05 p.p. to the IPCA result. Food prices increased 0.25%, compared to 0.46% in the previous month, mainly due to the deceleration of meat and chicken prices increase.

4. Still regarding the IPCA in November, market prices changed 0.33% and regulated prices increased 0.36%, contributing 0.24 p.p. and 0.10 p.p. to the overall result, respectively. In the first group, the increases were concentrated in clothing, meat and chicken prices. Regarding regulated prices, besides lottery and urban bus fares in Rio de Janeiro, electricity tariffs were increased in Rio de Janeiro, Porto Alegre and Goiânia. On the other hand, gasoline, fuel-alcohol and bottled gas prices decreased during the month.

5. The IPA-DI reached 0.46% compared to 0.50% in October, with divergent behaviors for agricultural and industrial prices. The Agricultural-IPA decelerated 0.26%, after an increase of 1.30% in the previous month, due to lower increase in soybean prices and drop in prices of milk, eggs and pork. On the contrary, rice prices increased.

6. On the other hand, wholesale industrial prices presented a slight acceleration, increasing 0.54% in November compared to 0.18% in October. This acceleration was caused by chemical prices, especially oil and lubricating products, paint products, and fertilizers and pesticides. Also important were the increases in prices of cotton fabrics, reflecting the increase in the raw material, and of steel.

7. The IPCA core inflation, excluding food and regulated prices, remained stable in November for the fifth consecutive month, at 0.38%. In the last 12 months, the core accumulates a 9.28% change.

8. Core IPCA inflation calculated under the smoothed trimmed-mean method reached 0.56% in November compared to 0.77% in October. The accumulated variation in 12 months reached 11.82%, still affected by the inflation upsurge at the end of 2002. The non-smoothed trimmed-mean core stood at 0.31% in November and 9.36% in 12 months.

9. Core IPC-Br inflation calculated under the symmetric trimmed-mean method by FGV reached 0.36% in November, accumulating an increase of 10.69% in the last twelve months.

10. In December, both consumer and wholesale inflation are likely to register changes close to November. At the wholesale level, some pressure is expected in prices of vegetables, fruit, rice and corn, while prices of milk, eggs, soybeans and sugar cane are expected to fall. For the IPCA, the December result will be affected by rises in regulated prices (lotteries and urban bus fares in Belém and Fortaleza), as well as a slight acceleration in food prices.

Assessment of Inflation Trends

11. 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 prices are projected to accumulate increases of 0.9% and 3.7%, in 2003, respectively. For 2004, the changes in gasoline and bottled cooking gas prices are projected to reach 9.5% and 3.5%, respectively. The readjustment of gasoline prices encompasses an increase in the CIDE rate to partially compensate the federal government for sharing this tax with states and municipalities, as part of the recently enacted tax reform;

b. The projection for the readjustment of household electricity tariffs in 2003 decreased 0.1 p.p., reaching 21.6%. For 2004, the readjustment is expected to be 7.2%. Concerning telephone tariffs, there was no change in the projection for 2003 since the last Copom meeting. For 2004, Copom estimates an increase of 6.6%, assuming that the judicial injunction which limited the readjustment of the tariffs authorized for 2003 will not be reverted;

c. For the inflation of regulated prices in 2004, which weighted 28.9% in the November IPCA, the BCB projection decreased 0.7 p.p., reaching 7.8%;

d. The projection for the readjustment of regulated prices for 2005 was based on the model of endogenous determination that was used until the September Copom meeting to estimate 2004 readjustments. This model, which considers seasonal components, the exchange rate behavior, market prices inflation rate and the IGP-DI variation, forecasts a 5.5% change for regulated prices in 2005;

e. The projection for the 6-month spread over the Selic rate, following the specification of the Vector Autoregressive model using the Selic and swap rates on the eve of the Copom meeting was –70 b.p. for the fourth quarter of 2003, gradually rising to 20 b.p. in the last quarter of 2004 and 50 b.p. at the end of 2005.

12. Regarding fiscal policy, it is assumed that the primary surplus target of 4.25% of the GDP for this year and the following two years will be accomplished. The other related assumptions established in the November meeting were maintained.

13. Considering the baseline scenario hypotheses, including the maintenance of the Selic interest rate at 17.5% p.a. and the exchange rate at the level prevailing on the eve of the Copom meeting (R$2.94), inflation is projected above the adjusted target of 8.5% for 2003 and below the target of 5.5% for 2004.

Monetary Policy Decision

14. November inflation results confirmed the convergence of inflation to the target path. Regarding the IPCA, the 0.34% inflation in November was just 0.05 p.p. higher than October. When the IPCA change is decomposed into three groups – regulated, tradable and non-tradable prices – low price dispersion is noticed in November, with changes for the three groups between 0.25% and 0.44%. Perishable food prices grew 0.5% due to weather factors, after two consecutive months of falling prices. This behavior is likely to repeat in the first quarter of 2004, without causing a generalized disturbance on market prices. Other consumer inflation indicators, such as the IPC-Fipe and the IPC-Br, also showed inflation around 0.3% in November.

15. Core inflation measures also posted positive results, falling or remaining stable in moderate levels (from 0.3% to 0.4%) for the different methodologies – exclusion, smoothed trimmed mean and non-smoothed trimmed mean. The IPC-Br core also fell in November, reaching 0.36%.

16. Considering accumulated inflation for the year until November and market inflation expectations for December, the IPCA change in 2003 may be slightly above 9%. This rate is close to the 8.5% adjusted inflation target and almost 3.5 p.p. lower than the 2002 inflation rate. This result confirms the monetary policy effectiveness in curbing the extremely negative outlook in the beginning of the year.

17. Recent indicators provide additional evidence of the rebound in economic activity already outlined in previous Copom's meetings. Industrial output maintains the upward trend. Seasonally adjusted

results for October showed growth or stability for all categories of use, although total industrial output fell 0.5%. This apparently contradictory result is explained by the seasonal adjustment methodology. The 3-month moving average for October is 1.8% higher than the September average. Leading indicators suggest the continuation of the upward trend for November. The recovery has spread among different industrial sectors, and the diffusion index reached 79% (64% in September) in a scale where 100% indicates that all the 61 sub-sectors surveyed by the IBGE posted positive growth.

18. Consumption recovery is becoming clearer, despite its slower growth compared to production growth. The IBGE retail survey shows an unambiguous marginal improvement, although the accumulated performance for the year is still being affected by the results in the first half of this year. Year-on-year accumulated sales are still negative, but its fall diminished to 5.0% in October from 5.2% in September. Furniture and appliances remain leading the retail segment, with positive performance for the second consecutive month (a 5.2% growth in comparison to October 2002). The assessment of the 3-month moving average of seasonally adjusted primary data of IBGE proves the gradual recovery of retail sales. Another evidence of consumption recovery is the increase in consultations to the Credit Protection System and Usecheque in October. Due to the improvement in credit conditions of the economy, durable goods are leading the recovery, which is expected to strengthen in view of the improvement in consumers' confidence, the gradual recovery in real earnings and low delinquency indicators.

19. Investment data surprised positively. Capital goods domestic absorption increased 22% in October compared to September. Considering this result, investment rate, although still at a historically low level, confirmed the rebound trend already outlined in the third quarter GDP data. Investment increase reinforces the Copom's expectation of a well-balanced growth recovery, based on expansion in credit to consumers, increase in real earnings and expansion of productive capacity in the tradable goods sector, which idle capacity presents low levels due to exports growth.

20. As in previous months, the external accounts performance remained positive. In the fourth quarter, daily exports grew 20% on average, compared to the same period of 2002, while imports increased 17% in the same period. The trade surplus may be close to US$ 24 billion in 2003, far above previous estimates. The positive performance should repeat in 2004, when a US$ 19 billion surplus is expected, despite the significant imports growth caused by the recovery of economic activity. The current account is expected to post a US$ 4 billion surplus this year, the first positive result since 1992. The country-risk has continued to fall since the last Copom meeting to close to 480 basis points, together with the drop in several international risk aversion indicators. The exchange rate remained roughly stable between the last Copom meetings.

21. There was no alteration in the recovery external scenario assessed in the November meeting. The Copom shares the concerns of several international observers that a monetary tightening cycle may initiate in mid-2004 in the United States. However, considering the recent behavior of US inflation and productivity growth, it is not likely that an increase in US interest rates aborts the global recovery process and drastically reduces international liquidity. The Copom also fears that the widespread improvement of emerging markets risk perception may be reverted in case some countries suffer more intensively the effects of the worsening of the international scenario in 2004. Even so, Brazil is in better conditions than in previous years to face these situations, due to the significant improvement of its fundamentals and the government decision to extend the IMF agreement.

22. The median of market inflation expectations for 2004 stabilized at 6%. As the mode and the median of market inflation expectations are equal, marginal variations only affect the mean, which fell below 6% for the first time in the year between the November and December Copom's meetings. On the eve of the December meeting, the mean stood at 5.88%. The median of market expectations for GDP growth in 2004 increased to 3.5% from 3.4%.

23. Inflation projections by the BCB for 2003 are above the adjusted target of 8.5%, assuming the maintenance of the Over-Selic rate at 17.5% p.a. and of the exchange rate at R$2.94. Considering the same hypotheses for the exchange rate and for the Over-Selic rate, inflation projections are below the target for 2004 and 2005. In comparison to November estimates, there was a slight reduction in inflation projected for 2004, due to the reduction to 7.8% from 8.5% in regulated prices.

24. The positive trend of inflation, the well-balanced recovery of economic activity and the favorable external scenario led the Copom's members to endorse the monetary easing. The Copom unanimously decided to reduce the target for the Over-Selic rate to 16.5% p.a., without bias.

25. However, it is important to emphasize once again that there are important lags between monetary decisions and its effects on economic activity and inflation. Since the beginning of the ease cycle, the Over-Selic rate has been reduced by 10 p.p. Part of the effects of this cut has not materialized on the activity level yet. Nor has the recent recovery of activity shown its effects on inflation.

26. The Copom evaluates that the reduction in the real yield curve, which accompanied the reduction of the Over-Selic rate, will sustain the recovery in economic activity in the coming months. The continuous convergence of inflation to the targets and the resulting consolidation of a long-lasting scenario of macroeconomic stability will contribute to a progressive reduction of risk perception. This environment will naturally create the conditions required for a lower real interest rate in the coming years.

27. Considering the uncertainties in the transmission mechanism of monetary policy, the Copom understands that the sustainability of the disinflation gains in recent months and of the economic recovery process requires a careful assessment in future monetary decisions. In particular, monetary policy should not endorse the inflationary impact of the readjustment of prices in those sectors that now lead the recovery process. This is the only way to ensure the continuous convergence of inflation to the target path, in an environment of sustained economic growth.

28. At the end of the meeting, it was announced that the Copom would meet again on January 20th, 2004, for technical presentations, and on the following day in order to discuss the monetary policy decision, as set by the Communiqué 11,516, of October 15th, 2003.

SUMMARY OF DATA ANALYZED BY THE COPOM

Economic Activity

29. According to IBGE data, retail sales decreased 3.0% in October and 5.0% from January to October, compared to the same period of 2002.October sales performance, although still negative, presented significant improvements when compared to the previous months, as already observed in September. Growth remained negative for four out of the five activities surveyed by the IBGE, while the furniture and appliances sector grew 5.2%.

30. According to Fecomércio-SP, retail sales in the greater São Paulo grew 0.7% in October, compared to September, considering seasonally adjusted series. This result was favored by the increase of 1% in consumer goods sales, mainly durable goods, demonstrating the recovery of domestic consumption triggered by better credit conditions.

31. Consultations to the ACSP regarding credit purchases and check purchases increased 10.6% and 10%, respectively, in the first half of December, compared to the same period of 2002.

32. The monthly Fecomércio-SP survey on consumer confidence registered a 6.8% increase on its indicator in December, reaching 110.7 in a scale from 0 to 200. Consumers' optimism reflects both current and future consumption intentions due to more positive economic environment.

33. Regarding investment data, a generalized and expressive improvement was observed in October, considering seasonally adjusted data. Compared to September, machines and equipments output increased 3.8%. Capital goods imports increased 47.6% and exports grew 0.6%. As a consequence, capital goods domestic absorption increased 22% in October. Construction output also rebounded in October, growing 1.2% as against September (seasonally adjusted data). Finally, it should be highlighted the increase of BNDES disbursements to medium and long terms investments, which reached R$9.5 billion in the October/November period (R$28.5 billion accumulated in the year until November).

34. According to IBGE, Brazilian industrial output remained stable in October, after the expressive recovery from June to September. Industrial output decreased 0.5% (s.a.). Manufacturing industry output fell 0.1%, while mineral extraction production increased 0.3%. Seventeen out of the twenty sectors surveyed grew, with highlights to the metallurgical and transport industries, which have increased output for six consecutive months. Among the categories of use, the highest monthly increases were registered for capital goods (3.8%) and durable consumer goods (1.8%). Intermediate goods production increased 0.3% and semi and non-durable goods production remained stable.

35. Data released by the CNI regarding the manufacturing industry performance in October confirmed the sector recovery. Real sales increased 3.1% and hours worked in production increased 0.7%, both seasonally adjusted. The level of industrial capacity reached 80.2% in October, compared to the peak of 81.3% in October 2002.

36. In the automotive sector, vehicles production and domestic sales increased 7.3% and 6.2% respectively, in November (s.a.), benefiting from the temporary tax reduction on cars and improved credit conditions. External sales decreased 7.9% in November. However, up to November, the increase of 31.7% in vehicles exports contributed to the expansion of 1.8% in output, counterbalancing the internal sales fall of 6.5%.

Labor Market

37. The index of employment increased 0.3% month-on-month in October (s.a.), and 3% year-on-year, according to the Ministry of Labor. In accordance with the new methodology of the IBGE's employment survey, the unemployment rate in the six main metropolitan areas remained stable at 12.9%, in October, due to the 0.4% fall of both the number of employed people and the labor force. Still according to the same source, average real earnings (deflated by the IPCA) reached R$686 in September, representing a decrease of 15.9% compared to the same month of 2002, a better result than the 17.3% fall registered between June 2002 and June 2003.

38. In the industrial sector, according to the CNI, there was a 0.2% increase (s.a.) in employment in October, compared to the previous month. Total real wages increased for the sixth consecutive month, but remained 2.8% below the result of the same month of 2002.

Credit and Delinquency Rates

39. Non-earmarked credit rose 1.8% in November, with highlight to the recovery of external funded operations. Lending to companies increased 2.1%, again under the influence of seasonal factors as the harvest and the orders of the end of the year, being worth mentioning the operations with overdraft accounts, vendor and discount of trade bills. Credit to households expanded 1.4%, more noticeably in auto financing and personnel credit, favored by the decline of interest rates.

40. The average interest rate on non-earmarked credit decreased again in November, by 0.6 p.p. to 48% p.a., in response to the consistent downward trend of the Selic rate. The effect was more intense on lending to households, which fell 1.2 p.p. to 68.2%, the lowest level since June 2001. The average rate on corporate lending was 32.3% p.a., falling 0.2 p.p. in comparison to the previous month, the lower result since December 2002. The delinquency rate on non-earmarked banking credit fell 0.2 p.p. in November, reaching 8.4%, due to the reduction of non-performing credit of companies and individuals, whose respective rates stood at 4.6% and 14.2%.

41. Regarding default rates on retail trade, the net delinquency rate of ACSP reduced to 4.2% in November, from 5.4% in October. The new default registrations fell 4.1% and the number of cancelled default registrations increased 4.1%, in comparison to October data.

External Environment

42. For the first time since 2000, the three main economic areas in the world - the United States, Europe and Japan - show signs of a simultaneous pickup in activity. The signs of world growth recovery have been favored by the economic performance in Asia, particularly China, which is now the main destination of exports of Japan, South Korea and Australia.

43. In the United States, the most recent economic indicators confirm that growth sustained momentum, following the 8.2% growth rate in the third quarter. Retail sales increased 0.9% in November, reversing the negative trend experienced in the two previous months. The unemployment rate fell to 5.9% in November from 6% in October, at the same time that unemployment benefit claims fell. The fiscal deficit diminished to US$43 billion in November from US$69.5 billion in October, and the trade deficit rose 1% in October.

44. Industrial production in the Euro area grew 1.3% in October compared to the previous month, particularly benefited from the 1.3% growth in France. Notwithstanding, the euro appreciation is affecting exports growth, bringing doubts about the sustainability of the recovery. In Germany, exports fell 6.6% in October, the largest drop in more than a decade.

45. In Japan, activity has been favored by exports growth, especially vehicles sales to Asian countries. Growth in Asia has been led by China, which posted growth rates of 8.2% in the first half of the year and 9.1% in the third quarter.

46. With inflationary pressures subdued, interest rates remained low across the globe. The equity markets sustained the upward trend, albeit at a slower pace. Ample liquidity in the international market and continued positive risk appetite favored the demand for emerging markets assets. Expectations concerning global growth and world trade have increased food and metal prices, benefiting emerging markets. Oil prices remained volatile and above the upper limit of the Opec band mechanism.

Foreign Trade and Balance of Payments

47. Trade balance registered a US$1.7 billion surplus in November, totaling US$22.1 billion in the year and US$23.9 billion in 12 months. Exports grew 16.6% in November and 20.4% accumulated in the year, compared to the same periods in 2002. Imports grew 10.4% in November and 1.1% in the year, also compared to the same periods in 2002. Up to the second week of December (10 working days), trade surplus totaled US$1.3 billion. Accounting for this period, accumulated surplus in the year to December 14 reached US$23.4 billion.

48. In November, exports reached US$6.0 billion, the highest level ever for the month. Manufactured exports (US$3.5 billion) and basic goods exports (US$1.6 billion) also posted the highest figures ever for November. Imports grew in November, compared to the same month in 2002, with highlights to the increases in raw materials and intermediate goods (19.1%), and capital goods (10.9%), confirming the scenario of investment and activity rebound.

49. As in previous months, in November there was a consistent evolution of exports of goods with a small share in the total, particularly manufactured goods. This strategy of exports and markets diversification and the increase of non-traditional products in total exports reflect the gain in competitiveness of the economy and support projections of a continuous growth in exports.

50. Current account registered a US$3.8 billion surplus in the year up to November, reversing the US$7.6 billion deficit registered in the same period of 2002. The deficit in the services and income account reached US$20.9 billion in the year up to November, compared to US$21.1 billion last year. Financial account balance reached US$12 billion in the January/November period, compared to US$6.4 billion in the same period in 2002. In November, net FDI reached US$2 billion, accumulating US$8.7 billion in 2003. At the end of November, international reserves stood at US$54.4 billion and net adjusted reserves (IMF agreement) stood at US$17.2 billion.

Money Market and Open Market Operations

51. In the period between the November and the December Copom meetings, the yield curve shifted downward in its whole extension. The main factors underlying this behavior, besides the reduction in the Over-Selic rate above market consensus, were the release of lower-than-expected GDP data for the third quarter, improved inflation expectations and the fall of the sovereign country-risk. Between November 19th and December 16th, the 6-month, 1-year and 2-year interest rates decreased 1.44 p.p., 1.39 p.p. and 1.42 p.p., respectively. The 1-year interest rate, deflated by the median of inflation expectations 12 months ahead, fell to 9.3% from 10.6%.

52. The BCB did not carry out the rollover auction of Fx linked securities and swaps maturing on December 18, the last of the year. Consequently, the net redemption of Fx securities and swaps totaled US$19.1 billion for the year.

53. The National Treasury carried out four LTN auctions, totaling R$11.8 billion. Following the downward shift of the yield curve and the higher demand for fixed rate securities, auction rates fell sharply. In tandem with the National Treasury's strategy of improving the profile of the debt, increasing its fixed rate share and decreasing its Over-Selic indexed share, only two auctions of LFT totaling R$1.1 billion were carried out. The placement of inflation-indexed securities (NTN-C and NTN-B) reached R$5.2 billion in the period, R$1.4 billion of which paid in currency. The NTN-B rate maturing in August 2006 fell to 8.99% in the December auction, compared to 9.95% in the previous month.

54. The BCB, in its open market interventions, maintained the 2-week indexed and the 3-month fixed repurchase operations, as well as the daily bank liquidity management operations. The BCB also carried out in this period five fixed-rate repurchase agreements, maturing between 1 and 4 working days. The average excess of banking liquidity drained from the market reached R$48.4 billion.

55. In November, the net securitized domestic public debt increased 1.5%. The fixed rate share increased to 11.3% from 9.9% in October, while the share linked to the dollar decreased for the sixth consecutive month to 23.8%.

Acronyms

ACSP	São Paulo Trade Association
BCB	Banco Central do Brasil
b.p.	basis points
CIDE	Contribution on Intervention in the Economic Domain
CNI	National Confederation of Industry
Fecomércio-SP	São Paulo State’s Federation of Commerce
FGV	Getúlio Vargas Foundation
IBGE	Brazilian Institute of Geography and Statistics
IGP–DI	General Price Index – Domestic Supply
IPA-DI	Wholesale Price Index
IPCA	Broad Consumer Price Index - Brazil
IPC–BR	Consumer Price Index – Brazil
LFT	National Treasury Bills (floating)
LTN	National Treasury Bills (fixed rate)
NTN-B	National Treasury Notes – Series B
NTN-C	National Treasury Notes – Series C
Opec	Organization of the Petroleum Exporting Countries
p.a.	per annum
p.p.	percentage point
s.a.	seasonally adjusted