BANCO CENTRAL DO BRASIL

Minutes of the 83rd Meeting of the Monetary Policy Committee (Copom)

Date: April 22nd, from 3:30PM to 6:30PM, and 23rd, from 11:30AM to 1:30PM
Place: Central Bank's Headquarters meeting room of the 8th floor (on Apr 22nd) and 20th floor (on Apr 23rd) – Brasilia – DF

In attendance:
Members of the Committee
Henrique de Campos Meirelles – Governor
Beny Parnes
Ilan Goldfajn
João Antônio Fleury Teixeira
Luiz Augusto de Oliveira Candiota
Paulo Sérgio Cavalheiro
Sérgio Darcy da Silva Alves

Department Heads (all present on Apr 22nd)
Altamir Lopes – Economic Department
Daso Maranhão Coimbra – International Reserve Operations Department
Ivan Luis Gonçalves de Oliveira Lima – Open Market Operations Department
José Antonio Marciano – Department of Banking Operations and Payment System
José Pedro Ramos Fachada Martins da Silva – Investor Relations Group
Marcelo Kfoury Muinhos – Research Department (also present on Apr 23rd)

Other participants (all present on Apr 22nd)
Antônio Carlos Monteiro – Executive Secretary
Alexandre Pundek Rocha – Advisor to the Board
Flávio Pinheiro de Melo – Advisor to the Board
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. Consumer price inflation slowed in March, although by less than expected by the estimates of both the Central Bank and market participants. Monthly inflation remains relatively high. Despite the deceleration in the prices of agricultural products, wholesale inflation increased due to the behavior of industrial goods prices.

2. The IPCA increased 1.23% in March, as compared to 1.57% in the previous month, accumulating 5.13% in the first quarter of 2003, and 16.57% in 12 months. The deceleration in the monthly rate of IPCA inflation was due to fewer readjustments in urban transportation fares, to the dissipation of the impact of the seasonal readjustments of school fees, to the slight fall of gasoline prices, and to lower inflation in the price of alcohol-based motor fuel, items that have put pressure on the index in February.

3. Regulated prices increased 1.07% in March, as compared to 2.71% in February. Free market prices increased 1.29% in March as compared to 1.11% in the previous month, mainly due to the acceleration of

price increases for food, particularly perishable food, medicines, cleaning and personal hygiene products, and clothing.

4. The IGP-DI increased 1.66% in March, as compared to 1.59% in February, accumulating 5.52% in the quarter, and 32.75% in 12 months. The upward pressure on the IGP-DI resulted from the behavior of wholesale prices, which increased 1.93% as compared to 1.71% in February. The IPC-Br increased 1.06%, as compared to 1.37% in the previous month, while the INCC remained stable.

5. The agricultural component of the IPA increased 0.32%, pressured by prices of legumes and fruit, as a result of adverse weather conditions. Other important items such as cereals and grains, vegetable oils, , and export crops registered nominal price decreases, due to the exchange rate appreciation and the behavior of international prices. The industrial component of the IPA increased 2.56% as compared to 1.91% in February, reflecting increases in the prices of chemicals (fuel and plastic raw materials), metal products (iron, steel and by-products), pharmaceutical products (medicines and hygiene), and plastic (resins).

6. Core IPCA inflation calculated by excluding household food items and regulated prices reached 1.13% in March, as compared to 1.00% in February, breaking the deceleration observed since December. The accumulated change in 12 months reached 10.2%, as compared to 9.4% in February.

7. Core IPCA inflation calculated under the trimmed-mean method registered a 1.23% increase in March, as compared to 0.93% in the previous month. In the last 12 months, trimmed-mean core inflation accumulated a 10.8% increase, as compared to 10.1% in February.

8. Core IPC-BR inflation calculated under the symmetric trimmed-mean method increased 1.07% in March, as compared to 0.93% in the previous month, slightly above the 1.06% increase in the headline index for the month. In 12 months, core IPC-Br inflation accumulated a 10.6%increase, as compared to 9.94% in February.

9. In April, inflation may continue its recent declining trend, reflecting the dissipation of the effects of the recent increase in the prices of medicines, the reduction of agricultural prices and the recent behavior of the exchange rate, whose influence can be seen mainly in wholesale food prices. However, the drop in inflation will be attenuated by new readjustments of regulated prices, particularly household electricity tariffs, with increases in Belo Horizonte, Fortaleza, Salvador, Recife, and Porto Alegre.

Assessment of Inflation Trends

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

    a. Estimated price adjustments for gasoline and bottled gas for 2003 have fallen since the last Copom meeting to 8.4% from 12.4% and to 1.6% from 4.2%, respectively. These projections incorporate the adjustments of the first months of the year and price reduction from May onward.

    b. With respect to household electricity tariffs, estimated readjustments have decreased by 3 p.p. to 24.5%. This decrease is the result of the appreciation of the real observed since the last Copom meeting.

    c. Regulated prices, which had a 28.6% weight in the March IPCA, are forecast to increase 15.3% in 2003. The appreciation of the real, lower adjustments for electricity and the decrease in the price of oil by-products were mostly responsible for the fall of 1.5 p.p. from the March projections for regulated prices.

d. For 2004, the estimated readjustment for the set of regulated prices is 8.5%, a 0.5 p.p. fall compared to the projections at the last meeting. This result is a consequence of the decrease in the expectation of 2004 IGP-M.

e. The projection for the 6-month spread over the Selic rate, following the specification of the VAR model using the Selic and swap rates in levels, is at 60 b.p. in the 3Q03, gradually rising until the end of 2004.

11. Regarding fiscal policy, it is assumed that the public sector will accomplish primary surplus target for this year and the following two years (4.25% of the GDP). The other related assumptions established in the March Copom meeting were maintained.

12. Considering the baseline scenario hypotheses, including a steady interest rate at 26.5% p.a. and the exchange rate at the level prevailing on the eve of the Copom meeting, inflation is projected above the adjusted target of 8.5% for 2003.

Monetary Policy Decision

13. Inflation remains on a downward trend. However, recent inflation results were above Copom projections and the medians of both market expectations and *Top 5* (best forecasters) market expectations. The current results indicate a higher degree of inflation persistence, which is key for the disinflation outlook.

14. In March, free market prices increased as a result of price increases in items that are sensitive to past exchange rate changes, such as medicines and cleaning and hygiene products, as well as increases in perishable food prices. With the exception of 'Services' prices, which have a 20.6% weight in the index, all the other sub-groups in the IPCA posted relatively high levels of inflation. As a result, the monthly increase of core inflation was above 1%.

15. The slower decline in inflation indicates a higher degree of inertia in the formation of prices in the economy, although this may be a temporary phenomenon. The degree of inflation inertia depends directly on the link between price and wage readjustments. There is a risk of future price and wage readjustments being based on accumulated inflation instead of on future inflation.

16. Other factors that impact consumer price inflation, such as the exchange rate and economic activity, have been contributing to a more rapid convergence of inflation to its targets.

17. Recent figures on economic activity, when adjusted for the distortions provoked by the timing of the Carnival holiday this year, show signs of a downturn in the first quarter of 2003. This trend has materialized despite the increase of exports and domestic production of import-substituting goods. The decline in activity can be attributed to the decrease in real wages and tightening of credit conditions for consumers. Leading indicators for March suggest that the level of activity will remain weak.

18. The nominal exchange rate appreciated around 12% in the period following the last Copom meeting as a result of improvement in the BoP. The trade surplus increased, and the current account registered a surplus in 1Q03, indicating a deepening of the external adjustment of the Brazilian economy. The sustainability of this trend, however, is dependent on a reduction of inflation, which is needed in order to preserve the change in relative prices that has occurred in the last year.

19. External funding conditions have improved. Brazil risk measured by the Embi+ has decreased more than 200 b.p. since the last Copom meeting, in line with the onshore yield curve. External funding from private sources has resumed, and March rollover rates for notes and commercial paper reached 82%, as compared to 65% in the same period of 2002. It is important, however, to achieve an improvement in the quality of external funding, with longer tenors and lower costs. Indeed, in April, new issues were announced with a slight lengthening of tenors. Demand for domestic securities has also increased, allowing the Treasury to issue LTNs and LFTs with longer maturities.

20. These factors contributed to an improvement in the inflation outlook, even taking into consideration the failure of inflation to fall more sharply in recent months. As a result, the Copom decided to maintain the target for the Selic rate at 26.5%.

21. The Copom also decided to withdraw the upward bias, which allowed the Governor to increase the Selic rate anytime between regular Copom meetings. Although there are doubts about the speed of the decline in inflation and questions regarding the extent to which the increase in inflation inertia is temporary or permanent, they will not be clarified between the monthly meetings, but over the longer term.

22. At the closing of the meeting, it was announced that the Committee would meet again on May 20, for technical presentations and on the following day, in order to discuss the monetary policy decision, as established in the Communiqué 10,187, of October 2, 2002.

Summary of Data Analyzed by the Copom

Economic Activity

23. Output and retail sales indicators grew in February as compared to January, s.a., and compared to February 2002. These results should be taken with caution, however, since the Carnival holidays occurred in March rather than in February as in 2002.As a result of more working days in February of 2003 (20) as compared to the previous year (18), comparisons of monthly and yearly production and sales data are statistically distorted, and will tend to overestimate the results of February this year and to underestimate the results of March, even after standard seasonal adjustment

24. According to the IBGE, the national retail sales index fell 1.98% in February, compared to February last year; in January, the index fell 4.87% compared to the same month of 2002. This result is also affected by the calendar-effect, which will tend to reduce the fall. Adjusting for working days, sales would have fallen 6.1% in February. In the first two months of 2003, the volume of retail sales decreased 3.47%, accumulating a 1.02% fall in 12 months. The major segments responsible for the negative results were “hypermarkets,” supermarkets, food products, beverage and tobacco. These declines reflect decreases in worker’s real incomes due to higher prices of food and cleaning and personal hygiene products.

25. Brazilian industrial production increased 0.7% in February as compared to the previous month, s.a., and 4.1% as compared to February 2002, according to the IBGE’s monthly survey. Discounting the calendar-effect, industrial production would have fallen 0.7% month-on-month (s.a.) and 1.1% year-on-year in February. 10 out of the 20 sectors surveyed expanded in March, with the biggest increase in mineral extraction (2.4%), as compared to the 0.6% in manufacturing. By categories of use, the production of intermediate goods was stable while other categories registered increases: 1.1% in capital goods, 1.2% in durable consumer goods, and 5.1% in semi-durable and non-durable consumer goods.

26. Manufacturing data released by the CNI indicated a recovery of industrial activity in February as compared to the previous month, with real sales increasing by 7.4% and hours worked rising by 0.7%, s.a. These indicators increased 11.5% and 3.3% year-on-year respectively.

27. In the auto sector, March production and sales fell close to 20% from February, partially reflecting the effect of the Carnival holiday.

28. Investment expanded again in February, mainly due to increased production and imports of capital goods. The domestic production of machinery and equipment and the volume of both imports and exports of capital goods registered increases of 1.1%, 35.4%, and 26.3% in the month, respectively, s.a. The production of inputs for construction, however, decreased 2% month-on-month.

29. The monthly Fecomércio-SP survey showed an improvement in consumer confidence in April, with the Consumer Intentions Index reaching 100.3, as compared to 97.8 in March (on a 0-200 scale). Both components increased: current intentions rose 6.2 points and future intentions rose 0.8 points. This recovery, after two months of decreases, was due to the improvement of expectations about unemployment, inflation and the political scenario, despite increasing concerns about the external front.

Labor Market

30. Legally registered employment increased 0.2% month-on-month in February, s.a., and 3.5% compared to February 2002, according to the Ministry of Labor and Employment. According to the new methodology for the IBGE’s employment survey, the unemployment rate in the six main metropolitan areas reached 11.6% in February, compared to 11.2% in January.

31. According to the survey, workers' real average income in January 2003 was 8.3% below the January 2002 level, using the INPC as a deflator. According to the CNI, in the industrial sector the real payroll in February this year was 7.2% lower than in February 2002.

Credit and Delinquency Rates

32. Total non-earmarked bank credit was nearly stable in March relative to February (+0.3%), as a result of the deceleration of economic activity and higher interest rates. Domestically funded credit to companies increased 1.5%, while externally funded credit to companies decreased 2.1%, mainly as a result of the 5.9% exchange rate appreciation in the month. Credit to individuals increased 0.7% month-on-month, reflecting the concentration of taxes and school fee expenses in the beginning of the year. Moreover, the fall in real income is contributing to an increase in household indebtedness, particularly with short term credit.

33. The delinquency rate on non-earmarked bank credits increased 0.6 p.p. in March to 8.7%. For individuals the rate increased 0.8 p.p. to 15.7%, while for companies it increased 0.3 p.p. to 4.5%. The average interest rate on bank loans increased 1.3 p.p. to 57.8% p.a., the highest rate since June 2000.

34. Regarding defaults on retail credit, ACSP statistics reveal that the number of new delinquency registrations and the amount of cancelled registrations increased 18.8% and 10.5% respectively in March, compared to February, raising the net delinquency rate to 7.2% from 6.8% in February. The volume of returned checks reached 5.9% of total settled checks in March, the highest in the last 10 years.

External Environment

35. After the beginning of the war in Iraq, uncertainties on the external front subdued with indications that the war would be short and that there would be no significant damage to Iraqi oil fields. However, after some initial improvement in the international financial scenario, uncertainties about the future performance of the global economy resumed.

36. The recovery of the global economy continues to depend on a recovery of growth in the U.S. So far this year, the degree of this recovery has been unclear, as the most recent indicators were influenced by the uncertainties related to the war in Iraq.

37. With the end of the war, consumer and business expectations may improve in the short-run, allowing some recovery in retail sales, reduction in inventories and resumption of industrial production, which may help the labor market.

38. The stabilization in oil prices may revert inflationary pressures recently observed in the OECD economies, although it is premature to infer a trend for petroleum prices, given the recent announcement of cuts in output from OPEC members, and uncertainties about the rhythm of exports from Iraq.

39. Finally, the spread of SARS is a new concern for the world economy, and growth in China and the countries of Southeast Asia may be significantly damaged, after they experienced the highest global GDP growth rates in 2002.

Foreign Sector

40. The trade surplus was US$1.5 billion in March, accumulating a US$3.8 billion surplus in the first quarter of 2003, and US$15.9 billion in 12 months. Considering daily averages, exports increased 29.4% in March and 24.5% in 1Q03, compared to 2002. Imports increased 8% and 2.2% year-on-year, respectively, in the same periods. Up to the 3rd week of April (13 working days), the trade surplus totaled US$1.1 billion, with a 29.7% increase in exports and a 1% increase in imports compared to the daily averages in April 2002.

41. The expansion of exports in the first quarter occurred for all categories of products and the main consumer markets, mainly due to higher volumes and a slight increase in prices of important exported products. The increase in the value of imports was mainly due to the rise in oil prices.

Money Market and Open Market Operations

42. After the last Copom meeting, the yield curve shifted upwards, and the spreads of the 1-month and 6-month interest rates increased to 25 b.p. from 5 b.p. and to 69 b.p. from 22 b.p. respectively. Subsequently, with the reduction of country risk, new external funding, the appreciation of the exchange rate and the quick end of the war in Iraq, the yield curve shifted downwards and inverted through January 2004. On April 22nd, the spreads of the 1-month and 6-month rates were –40 b.p. and –168 b.p. respectively.

43. Exchange rate linked securities and FX swaps maturing since the previous meeting were fully rolled with FX swaps. The US$3.1 billion in FX instrument maturing on April 1st were rolled over with terms ranging from 2 to 58 months (9 months on average). The US$0.9 billion maturing on April 17th was rolled over through swaps with terms ranging from 6 to 57 months (18 months on average). The US$1.1 billion maturing on April 23rd was rolled over through swaps with terms ranging from 4 to 57 months (15 months on average).

44. Since the March Copom meeting, the Treasury has offered LTNs five times and placed a total of R$5.8 billion of these securities. The significant demand for these securities allowed higher offers and the lengthening of tenures up to 15 months. Moreover, the reduction in the slope of the yield curve opened up room for placements at lower rates than those observed in the previous period. Longer term LFTs were also issued.

45. The settlement of securities between March 20th and April 23rd produced an expansionary impact of R$5.8 billion on the monetary base as a result of net redemptions of R$8.8 billion of FX-indexed securities and R$6.3 billion in LTNs, partially offset by net placements of R$9.4 billion of LFTs.

46. In the same period, the BCB intervened in the money market with 1-week and 1-month repo operations, and conducted daily liquidity management operations with maturities of 2 working days. These operations withdrew excess liquidity of R$69.3 billion on average.

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Acronyms

ACSP	São Paulo Trade Association
b.p.	basis points
BoP	Balance of Payments
CNI	National Confederation of Industry
Embi+	Emerging Markets Bond Index Plus
Fecomércio-SP	São Paulo State's Federation of Commerce
GDP	Gross Domestic Product
IBGE	Brazilian Institute of Geography and Statistics
IGP–DI	General Price Index – Domestic Supply
IGP–M	General Price Index – Market
INCC	National Index of Civil Construction
IPA	Wholesale Price Index
IPC–BR	Consumer Price Index – Brazil (Getúlio Vargas Foundation)
IPCA	Broad Consumer Price Index
LFT	National Treasury Letters (floating)
LTN	National Treasury Letters (fixed rate)
OECD	Organization for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
p.a.	per annum
p.p.	percentage point
s.a.	seasonally adjusted
SARS	Severe Acute Respiratory Syndrome
VAR	Vector AutoRegressive