BANCO CENTRAL DO BRASIL

Banco Central do Brasil

Minutes of the 80th Meeting of the Monetary Policy Committee (Copom)

Date: January 21st and 22nd
Place: Central Bank's Headquarters meeting room of the 8th floor (on Jan. 21st) and 20th floor (on Jan. 22nd) - Brasília - DF

Called to Order: 4:00 PM on Jan. 21st and 12:23 AM on Jan. 22nd
Adjourned: 7:57 PM on Jan. 21st and 2:40 PM on Jan. 22nd

In attendance:

Members of the Committee
Henrique de Campos Meirelles - Governor
Beny Parnes
Carlos Eduardo de Freitas
Edison Bernardes dos Santos
Ilan Goldfajn
Luiz Fernando Figueiredo
Sérgio Darcy da Silva Alves
Tereza Cristina Grossi Togni

Department Heads (all present on January 21st)
Altamir Lopes - Economic Department
Carlos Yoshitaka Urata - International Reserve Operations Department
Fábia Aparecida de Carvalho - Investor Relations Group
José Antonio Marciano - Department of Banking Operations and Payment System
Marcelo Kfoury Muinhos - Research Department (also present on January 22nd)
Sérgio Goldenstein - Open Market Operations Department

Other participants (all present on January 21st)
Antônio Carlos Monteiro - Executive Secretary
Alexandre Pundek Rocha - Advisor to the Board
João dos Reis Borges Muniz - Press Secretary
José Pedro Ramos Fachada Martins da Silva - 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, designed to comply with the inflation targets established by the government.

Economic Activity

The moderate upward trend in the level of economic activity that had been outlined over the second half of the year was sustained at the end of 2002. Key factors supporting the expansion were the increase in exports and import substitution. Domestic consumption was stable in the last two months of the year, although at a relatively high level due to continued support from the extraordinary disbursements from the FGTS.

According to seasonally adjusted data from Fecomércio, real retail sales in greater São Paulo were roughly stable in December as compared to the previous month, a trend that has been maintained since August, when sales registered remarkable growth. For the year, sales grew 5.1%, with significant expansion in sales of consumption goods, particularly non-durables, reflecting the effects of disbursements from the FGTS on the demand for lower value goods.

The IIC was stable in January as compared to December, according to the survey by Fecomércio. The index stood at 106.7 points, on a scale ranging from 0 to 200, and consumers' current and future intentions both remained steady. The relatively high level of the index in December and January can be attributed to the improved political scenario and to reduced concerns over unemployment.

Regarding default rates, data from the ACSP revealed a significant fall at the end of 2002, repeating this indicator's seasonal pattern. The number of cancelled default registrations grew by 30% in December, confirming that debtors usually take part of the 13th wage to pay for debts in arrears. Assessing the seasonally adjusted data, the level of default reached 4.2% in December, below the annual average in the last five years. This is partially due to the regularization of debtors' status, reflecting settlements of debts using disbursements from the FGTS.

Outstanding credit operations with freely established interest rates declined by 0.4% in December, as a result of a 1.2% reduction in credit to individuals, and no change in credit lines to corporations. The volume of new concessions grew by 9.8% in the month. This fact is associated with the high volume of renewals in short-term operations to meet the typical demand in this period.

The fall in outstanding operations to individuals is explained, in addition to the FGTS, by the seasonal payment of debts, mainly those with higher costs, using the 13th wage. In December, balances of overdraft accounts and credits for individuals decreased by 5.5% and 2.5% respectively, while acquisition of goods and of vehicles increased by 5.7% and 0.2% respectively.

Although the level of credit operations with corporations has been stable, internally funded operations grew by 2.8% or R$2.2 billion, the same amount by which externally funded operations decreased. This reduction was due to the payment of obligations and the foreign exchange appreciation observed in December.

Investment indicators improved slightly in recent months, though not enough to reverse the accumulated negative results for the year, which were associated with the uncertain macroeconomic environment. Capital goods output grew by 2.7% in November, reducing the accumulated decrease in the year to 1.3%. On the other hand, after consecutive increases between August and October, the production of inputs for civil construction decreased by 0.1% in November, leading to accumulated growth of 3.4% in the year.

In November, industrial production expanded for the sixth consecutive month, increasing by 0.5% as compared to the previous month, according to seasonally adjusted data from IBGE. In the year to November, industrial production grew by 2.1% as compared to the same period of 2001. By categories of use, the monthly increases were 0.6% in the production of durable consumption goods, and 0.3% in intermediate goods, in addition to the already-mentioned expansion of 2.7% in capital goods. The November result was negatively affected by the 7.6% decrease in oil and natural gas output, basically because an oil platform was taken off-line.

In the labor market, the average unemployment rate measured by IBGE dropped from 7.4% in October to 7.1% in November. This result was essentially due to a 1% fall in the labor force, since the number of employed workers declined by 0.7% in the month. According to the Ministry of Labor, legally registered employment grew by 0.2% in November, on a seasonally adjusted basis, and by 3.2% over the past 12 months.

With respect to the external accounts, after the US$1.8 billion surplus in December, the trade balance accumulated a US$13.1 billion surplus in 2002. Exports grew 3.7%, totaling US$60.4 billion, while imports fell 15%. In the first three weeks of January (12 working days), the trade surplus continued on its upward trend, with exports growing and imports falling as compared to the same period of 2002. For the period, the trade surplus reached US$508 million.

In brief, the level of activity continued to be positively influenced by the adjustment in the external sector while domestic demand was stable at a higher level, supported by the disbursements from the FGTS. Prospects for sustaining the current level of consumption are supported by the continuity of the disbursements of the FGTS, which will increase in 2003, the reduction in default rates, the payment of debts in the second half of 2002, and the improvement in consumers' expectations.

External Environment

The external scenario remained critical in recent weeks, reflecting the growing tension between the US and Iraq. The increase in oil prices, also influenced by the political crisis in Venezuela, may hinder the effort to control inflation and create new obstacles to expansionist fiscal and monetary policies aimed at boosting the global economy. Stock markets have been reflecting this tension. With weak corporate results, markets have failed to rebound. In the currency market, the US dollar has depreciated notably against the Euro and Yen recently.

In the US, there are doubts about the real impact of the new fiscal measures on the economy, which has performed modestly in the last quarter. Unemployment remained in a high level, 6%, and new job creation was very low. Industrial production decreased by 0.2% in December, as a result of weak demand for industrial products, and the level of installed capacity utilization remained at 75.4%. Retail sales increased by 1.3% in December, as compared to November, but decreased by 0.1% when automobiles are not considered. Industrial and retail inventories expanded by 0.2% in November, in the seasonally adjusted figures. Consumer and producer prices were stable in December, showing that inflation is unlikely to be a risk to the economy. Confidence indicators generally point to an improvement of business sentiment in the manufacturing sector.

In the Euro area, economic stagnation continues. Low GDP growth is expected in 2003, mainly due to the economic scenario in Germany, the biggest economy in the region. With inflation subdued, the 0.5 pp reduction in the main refinancing rate in December revealed that the ECB is concerned with this scenario. However, the high interest differential between the US dollar and the Euro, in addition to the fragility of the US economy, led to a significant appreciation of the Euro in the recent weeks. The currency movement may sharpen the worsening of the Euro area's trade balance that has been seen recently. Confidence indicators reflect the pessimism of both businesses and consumers.

In Japan, the most recent data have not helped to reduce the pessimism regarding economic recovery. In November, an unexpected improvement in exports compensated for the weak performance in other sectors. Relative to October, equipment orders decreased by 7.4% and industrial production fell by 2.2%. The consumer price index decreased for the 38th consecutive month.

In Argentina, the provisional agreement with the IMF, which will last until the end of August 2003, provides refinancing for overdue and upcoming debt maturities to the IMF, the IDB and the World Bank but does not provide new disbursements of funds to the country.

Prices

In December, inflation rates fell somewhat, although the increases in both wholesale and consumer prices were still high. The IPCA increased 2.10% compared to 3.02% in November, accumulating 12.53% for the year. The IGP-DI reached 2.70% in December compared to 5.84% in the previous month, accumulating a 26.41% increase in 2002.

The lower increase of the IPCA resulted from reduced pressure from monitored prices, which posted a 1.53% increase in December compared to 4.29% in November, and contributed 0.43 p.p. to December inflation. With respect to free prices, tradable goods produced the strongest pressure, although the increase in tradable prices fell from 3.58% in November to 3.28% in December (contributing 1.31 p.p. to the overall December IPCA). Price increases were particularly notable in: beans, cigarettes, chicken, rice, medicines, milk and dairy products, beef and electronics. Non-tradable goods prices increased 1.14% in December (contributing 0.36 p.p. to overall inflation), compared to 1.27% in the previous month, reflecting lower pressure from fresh food prices.

With respect to the IGP-DI, the wholesale price component of the index posted a sharp deceleration in December, rising by 3.14%, in comparison to 7.45% in November. The increase in the consumer price component also decelerated, averaging 1.94% compared to 3.14% in November. This was the result of smaller increases in food prices, transportation and housing. The INCC increased 1.7% compared to 2.45% in November, reflecting the lower rise in the prices of construction inputs.

In the beginning of 2003, inflation is expected to fall further. However, inflation rates will remain at relatively high levels. In January, price indices will still be impacted by the adjustment of monitored prices in December, particularly for oil byproducts. Additionally, inflation will also be pushed up through March by the seasonal adjustment of education expenses.

Money Market and Open Market Operations

On the eve of the Copom meeting in December, the spreads between the Over-Selic target and the 1-month and the 1-year interest rates were 253 b.p. and 717 b.p., respectively. The 300 b.p. target increase exceeded market expectations, causing the reduction of the spreads to 9 b.p. and 296 b.p, respectively. Subsequently, the announcement of private external borrowings at the beginning of the year and improved risk perceptions reduced the spread of the 1-year interest rate to 176 b.p. on January 21.

A total of US$5.7 billion in securities and foreign exchange rate swap contracts matured from December 19 to January 22. The rollover of the three maturities, through swap contracts with terms ranging from one month and two years, totaled US$5.2 billion. A significant reduction in the slope of the exchange rate coupon curve across all maturities allowed lower rates in the auctions when compared to rates attained during the period of the previous meeting.

The Treasury carried out three LFT auctions, which totaled R$13.1 billion, with an average maturity of 363 days. The increasing demand for LFTs seen since October declined after the last Copom meeting, though there is evidence of growing appetite for fixed income securities.

The BCB intervened in the open market 21 times from December 19 to January 21, in order to withdraw and provide liquidity. The rates were 24.90% and 25.00%, respectively, and the average daily volumes were R$59.1 billion and R$3.2 billion, respectively. The BCB carried out eight longer-tenure repo operations, with average tenure of 15 business days and average amount of R$3.1 billion.

The financial settlements from December 19 to January 21 caused a contractionary monetary impact of R$1.2 billion, basically due to net placements of R$9.2 billion of LFTs, partially offset by net redemptions of FX-indexed securities (R$5.1 billion), of LTNs (R$1.7 billion) and of NTN-Cs (R$0.9 billion).

Assessment of Inflation Trends

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

1. As mentioned in previous Copom minutes, the projections for the prices of oil by-products are still based on the changes in international oil prices and the exchange rate since the last price adjustment. Already taking into consideration the effects of the last adjustments in the January IPCA, an increase of 0.2% in the consumer price of gasoline is expected for 2003. For bottled gas, the price is expected to decline by 1.6% in 2003.

2. The projection for an increase in household electricity tariffs of 30.3% in 2003 was unchanged.

3. For the set of prices administered by contracts and monitored, which had a weight of 28.0% in the December IPCA, increases of 14% and 8% are expected for 2003 and 2004, respectively. In relation to the projections at the last meeting, there was a rise of 1 p.p. for 2003, due mainly to the revision of the estimated adjustments in the prices of gasoline, urban transport and alcohol. For 2004, the increase of 0.4 p.p. was a consequence of the revision of the expectations for the IGP-M, since the Copom assumes that all the prices administered by contracts and monitored follow the change of the IGP-M for the specified year.

4. The projection for the 6-month spread over the Selic rate, which utilizes an error correction-based model specification, was 150 b.p. for the first quarter of 2003 and through the end of this year.

Core inflation calculated with the exclusion of household food items and of administered prices - considering the broadened set of these items which had a weight of 28.0% in the December IPCA - registered a 1.66% increase in December, a significant rise in comparison to the observed changes of 1.17% in November, 0.74% in October and 0.61% in September. The 12-month accumulated change in December was 8.30%. Core inflation calculated under the trimmed-mean method registered a 1.36% increase in December, a small change in relation to November (1.32%) but significantly higher than in October (0.78%). For the year, the trimmed-mean core measure increased 8.84%. Regarding core inflation of the IPC-BR, calculated under the symmetric trimmed-mean method, the inflation rate reached 1.39% in December and 8.76% in 12-months.

The increase of the IPCA accumulated in 12 months rose to 12.53% in December, after reaching 10.93% in November, 8.44% in October and 7.93% in September. In the last twelve months, free market prices contributed 7.95 p.p. to inflation, while prices administered by contracts and monitored contributed 4.58 p.p.

Regarding fiscal policy, it is assumed that the primary surplus target for this year and for the next years will be achieved. The other related assumptions established in the previous meeting were maintained.

From the simulation exercises with several specifications of the structural model, it has been concluded that the maintenance of the interest rate at 25.0% p.a. and of the exchange rate at a level close to the level on the eve of the Copom meeting indicates inflation slightly above the adjusted target of 8.5% for 2003, as specified in the Open Letter of the Governor of the Banco Central do Brasil to the Minister of Finance on January 21, 2003.

Monetary Policy Guidelines

Economic activity has stabilized at a higher level than at the beginning of last year. In November, industrial production increased for the sixth consecutive month, supported by sectors linked to exports and non-durable goods.

Economic indicators have been signaling that consumption should also continue to grow moderately in the upcoming months. Since August, the retail sector's revenues have remained stable in real terms at a relatively high level, slightly above the figures observed in 2000. Defaults are falling and, in January, future consumption intentions repeated the level of December, the highest since 2000. The disbursements of around R$10 billion from the FGTS during 2003 will also help to support consumption growth this year.

Besides consumption, the growth of net exports is another factor that has been supporting aggregate demand, although its contribution to growth in 2003 may be lower than in 2002, considering the substantial expansion of the trade surplus last year.

Last year, the large contraction in capital flows due to the increase in global risk aversion and the confidence crisis related to the Brazilian economy led to a strong adjustment in the current account deficit and, therefore, a more depreciated real exchange rate. In fact, the more depreciated exchange rate produced the external adjustment, with the current account deficit below US$8 billion in the year. On the other hand, there was great pressure on inflation in the last months of 2002. Despite the high inflation – considering only the last quarter the increase in IPCA reached 6.5% – inflation in 2002 can be more appropriately characterized as a change in relative prices, considering that the prices of tradable goods increased more than the prices of non-tradables. Accordingly, monetary policy has been conducted in order to limit the effects of the exchange rate depreciation to the change in relative prices, preventing the propagation of this shock and facilitating the convergence of inflation to its targets.

Since the last Copom meeting in December and, more visibly in the first weeks of January, an improvement in local financial markets has been observed as a consequence of lower risk perception. Mutual funds received net inflows, the FX coupon and fixed interest rates declined, and Brazilian banks and companies recovered access to external funding. Reflecting this better perception of Brazilian risk, the exchange rate appreciated, reaching the minimum level of R$3.28 per US dollar on January 14. However, during the days before the Copom meeting, the BRL started to depreciate again, mainly due to the possibility of war between the United States and Iraq.

The median of 2003 inflation expectations surveyed by the Investor Relations Group has remained relatively stable at a high level. Expectations of the "top 5" institutions for the IPCA fell to 10.23% on January 17 from 13.49% on December 30, 2002. Moreover, the median of the expectations for the next two months indicate a decline of inflation to 1.12% in February and 0.65% in March.

In fact, inflation indices have shown clear signs of deceleration. The increase in the IPCA fell to 2.10% in December from 3.02% in November. The increase in the IGP-DI declined to 2.70% in December from 5.84% in November. The increase in the IGP-10 fell to 2.29% in January from 4.87% in December. The increase in the IPA-10 declined to 2.60% in January from 5.91% in December. Finally, the increase in the IPC/Fipe fell to 1.83% in December and to 1.79% in the four-week period ended in the second week of January from 2.65% in November.

Moreover, preliminary price data collected in recent weeks indicate that inflation is falling in January, most visibly in the segment of food and beverages, which slowed the most in the week previous to the Copom meeting. Inflation expectations for the year should decrease as soon as this trend is confirmed, in a context where monetary policy demonstrates its strong commitment in driving inflation to the targets.

There will be no changes in the adjusted target during the year, except in the case of a relevant change in the forecast (upward or downward from the 14% already expected) for prices administered by contracts or monitored (excluding the exchange rate change), since these prices are not directly affected by monetary policy.

Although inflation has declined recently, inflation indices reached high levels at the end of last year, and the convergence of inflation to the adjusted targets depends on the speed at which inflation continues to fall. In this context, it is important to evaluate the impact on inflation of the accumulated 7 p.p. increase in the Selic rate that occurred in the last quarter of 2002. The maintenance of the target for the Selic rate at 25% would result in an inflation projection a little above the adjusted target of 8.5% in 2003.

As a result, the Copom decided, unanimously, to increase the target for the Selic rate to 25.5% p.a.

At the close of the meeting, it was announced that the Committee would meet again on February 18th, for technical presentations and on the following day, in order to discuss the monetary policy guidelines, as established in Communiqué 10,187, of October 2, 2002.

BANCO CENTRAL DO BRASIL

Acronyms

ACSP São Paulo Trade Association
BCB Banco Central do Brasil
b.p. basis points
BRL Brazilian Real
ECB European Central Bank
Fecomércio São Paulo State's Federation of Commerce
FGTS Time in Service Guarantee Fund
GDP Gross Domestic Product
IBGE Brazilian Institute of Geography and Statistics
IDB Interamerican Development Bank
IGP-DI General Price Index – Domestic Supply
IGP-M General Price Index – Market
IIC Consumer Intentions Index
IMF International Monetary Fund
INCC National Index of Civil Construction
IPA-DI Wholesale Price Index – Domestic Supply
IPC-BR Consumer Price Index - Brazil
IPC/FIPE Consumer Price Index of the Economic Research Institute Foundation
IPCA Consumer Price Index – Extended
LFT National Treasury Letters (floating)
LTN National Treasury Letters (fixed rate)
NTN-C National Treasury Note - C Series (price index)
p.a. per annum
p.m. per month
p.p. percentage point