

September 3, 2001

**MINUTES OF THE 62nd MEETING OF THE BANCO CENTRAL DO
BRASIL MONETARY POLICY COMMITTEE (COPOM)**

Summary

Economic activity

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Money market and open market operations

Prospective assessment of inflation

Monetary policy guidelines

Date: August 21 and 22, 2001

Place: Central Bank's Headquarters 8th floor meeting room (on 08.21) and 20th floor (on 08.22) -
Brasília - DF

Called to Order: 4:12 PM on 08.21 and 6:24 PM on 08.22

Adjourned: 7:36 PM on 08.21 and 8:13 PM on 08.22

In attendance:

Members of the Board

Arminio Fraga Neto - **President**

Carlos Eduardo de Freitas

Daniel Luiz Gleizer

Edison Bernardes dos Santos

Ilan Goldfajn

Luiz Fernando Figueiredo

Sérgio Darcy da Silva Alves

Tereza Cristina Grossi Togni

Department Heads (all present on 08.21)

Altamir Lopes - Economics Department (DEPEC)

Daso Maranhão Coimbra - International Reserve Operations Department (DEPIN)

Gustavo Bussinger - Research Department (DEPEP)

José Antônio Marciano - Department of Banking Operations and Payments System (DEBAN)

Sérgio Goldenstein - Open Market Operations Department (DEMAB)

Other participants (all present on 08.21)

Alexandre Pundek Rocha - Senior Advisor to the Board

Antônio Carlos Monteiro - Executive Secretary

Thais Matos de Herédia - Press Secretary (ASIMP)

Fabia Aparecida de Carvalho - Coordinator of the Investor Relations Group

The Board analyzed the recent performance and outlook for the Brazilian and international economies in the framework of the country's new monetary policy regime, which is designed to ensure compliance with government defined inflation targets.

Economic activity

Recent data on the economic activity level have confirmed the continuity of the process of economic deceleration commencing at the end of the first quarter. This mirrors the evolution of the international economy scenario in addition to the impacts of the energy crisis, and its effects on the interest and exchange rates.

Such factors impacted economic agents' expectations. The deterioration of entrepreneurs' and consumers' expectations throughout the second quarter of the year triggered demand indicators to more intensively reflect this adjustment path of the economy, showing negative variation both in the seasonally adjusted monthly results and in the comparisons with the same months of the previous year.

The information on the retail activity in São Paulo, released by the Trade Federation of the State of São Paulo (FCESP), illustrates this evolution. In July, still with preliminary data, a 5.5% fall was

observed in the seasonally adjusted series, the fifth consecutive one, accumulating negative variation of 1.7% in the year. Compared to the same period of 2000, in the first three months of the year the retail sales in São Paulo expanded, reverting to show negative results from April until July.

The overall evolution of the retail commerce mainly reflects the weak performance, in the year, of the durable goods segment (-2.8%) and the autovehicles commerce (-11%), according to FCESP. However, the retail sales of autovehicles have presented accentuated oscillations in the monthly outcomes as a result of peculiar features, such as sales promotions to reduce inventory. In the past monthly results, special notice should be attributed to the distinct evolution of supermarket, pharmacy and perfumery sales, with some recovery in June and July after falling in May. A survey carried out at a national stance by the Brazilian Institute of Geography and Statistics (IBGE) also confirms the lower pace of the retail activity in the year. Available information for the first semester indicates that the volume of retail sales declined by 0.9% compared to the same period of 2000.

The Consumer Intentions Index (IIC), also measured by FCESP, retreated once again in August, reaching 89.9, still within the pessimistic band (below 100, in a 0 to 200 scale). Noteworthy was the distinct evolution of its two components, with current intentions posing some recovery, possibly due to the perception that the effects of the energy rationing were not so drastic as previously expected, and with future intentions declining once more, associated with more pessimistic expectations due to the reduction of the real income and to the worsened conditions of consumer credit.

Second quarter GDP figures, released by the Brazilian Institute of Geography and Statistics (IBGE), confirmed the deceleration of the activity level, with a 0.99% fall (seasonally adjusted series) compared to the first quarter of the year. Even though the direction of the GDP evolution could be anticipated, given the presence of factors unfavorable to the economic conjuncture in the second quarter, the magnitude of the reduction was larger than expected. Among other factors, the weak performance of the processing industry and communications were pointed out as the main drivers of the frustration of the expectations concerning the GDP evolution in the period. With this result, a 2.5% growth was achieved in the first semester, comparatively to 2000, as a consequence of positive performance in all sectors, under the same comparison basis.

To a large extent, the GDP outcome reflected the evolution of the industrial sector. According to the Monthly Industrial Survey carried out by the Brazilian Institute of Geography and Statistics (IBGE), the industrial production fell for the fourth consecutive month, by 1.2% in the seasonally adjusted series. Among the categories, an expressive reduction was observed in the production of durable consumer goods and intermediate goods. In the semester, the industrial production expanded by 4.9% compared to the same period in the previous year, although in June the production level was lower than in the same month of 2000, interrupting a sequence of positive variation commencing in August 1999.

The retreat in industrial production led to a lower usage of installed capacity, as reported by both the National Confederation of Industries (CNI) survey in June, with 80.1% compared to 81.1% in May, seasonally adjusted data, and the Processing Industry Conditions Survey in July carried out by Fundação Getúlio Vargas (FGV), with 81.1% compared to 83.9% in the previous survey (April). Worked hours in the production reduced by 1.2% in June, CNI's seasonally adjusted series, indicating the preference for this alternative in adjusting production in the short run in relation to position cuts, what has been confirmed by labor market data.

In fact, employment indicators have evolved more favorably than expected. Thus, the unemployment rate was of 6.38% in June, from 6.86% in May, reflecting the hiring of 57 thousand workers in the surveyed metropolitan regions along with the 35 thousand reduction in the employable population (PEA). Information from the Ministry of Labor and Employment confirmed the favorable evolution in the job market in June. In regard to formal employment, monthly figures showed a 0.15% growth (seasonally adjusted series), mainly in the services and commerce sectors. In the manufacturing sector, however, industrial surveys indicated trend reversal, with the number of positions being reduced in June.

According to the Industrial Confidence Index, released on a quarterly basis by CNI, the perspective for the industry for the next months is not favorable. Surveyed on a quarterly basis, the indicator declined in July, basically motivated by the energy crisis and persistent hikes in the exchange and interest rates. Nevertheless, the companies' process of adapting to the new conditions in order to counteract restrictions imposed by the crisis (via installation of electric energy generators and the intensification of transactions in the wholesale market, among others) tend to evolve positively, compared to the conditions observed at the beginning of the energy rationing period.

The outstanding banking credit stock grew by 1.8% in July. In the same period, the stock of non-earmarked operations elevated by 2%, due to a 2.4% increase in the operations with corporations and 1.4% in the operations carried out with the individuals segment. This performance was due to interest accrued to the stock of operations previously settled, as new concessions fell significantly as to the daily average concession to both corporations and households, by 4.9% and 9.1%, respectively. The evolution of new operations reflects contained demand for consumption and investment, given the rise of credit costs and higher selectivity of financial institutions, associated with the rise of uncertainties and default rates.

Concerning fixed-rate credit operations contracted with the individuals segment, the ratio of credit in arrears increased in the last quarter to reach 6.5% in July (15 to 90 days in arrears) and to 4.9% (above 90 days in arrears). According to the Credit Protection Service of the São Paulo Trade Association (ACSP), the net rate of default reached 7.3% in July, contributing to a 8.7% average in the year from 6.3% recorded in the same period of 2000. The ratio of number of checks returned due to insufficient funds and cleared reached 5.1% in July, with a 5.8% average in the year, 30% higher than in the same period of 2000.

The trade balance recorded a US\$ 108 million surplus in July, accumulating a US\$ 38 million surplus in the year. Nonetheless, both exports and imports decreased in July, considering daily averages, remaining on the downward trend of growth commencing in May, compared to the same period of 2000.

In July, exports decreased mainly due to semi-manufactured products, led by pulp, iron, steel and crude aluminum, products more directly affected by the electric energy rationing. The shipment of soy and soy bran in July was hindered by strong rains in the region of the Paranaguá Harbor, the main soy shipment harbor in Brazil, causing shipped volumes to fall if compared to July 2000. In August, the shipment of soy returned to normal conditions. It shall be stressed the continuity of increased shipment of exported chicken meat, beef and pork meat, raw tobacco and corn, the latter not exported in 2000 due to problems in the harvest.

Regarding imports, only durable consumer goods rose in July, especially due to increased imports of auto-vehicles. Reflecting the cooling of the domestic industrial growth, imports of raw material

and intermediate products fell, in particular transportation equipment and accessories, and, to a smaller degree, capital goods.

Relatively to investments in the country, the index which takes into account domestic absorption of capital goods and production of inputs to the civil construction declined at the end of the first half of 2001, even though indices accumulated in 2001 still show growth. Accordingly, the estimates for the gross fixed capital formation as a share of GDP reached 19.3% in June 2001 (accumulated in the last twelve months) from 18.4% in June 2000. It shall be noticed that the production of capital goods for the electric energy generation continued to grow, accumulating a 40.1% expansion in the first half of 2001.

To conclude, the activity level in the last months reflects the agents' reaction to the electric energy crisis and to adverse shocks arising from the international scenario. The mechanisms to adjust to these shocks should be mentioned. Firstly, the fast and substantial worsening of expectations which highly impacted consumption expenditures, especially regarding the items sensitive to credit, which require commitment of future income. This fact, associated with high interest rates and the perspective of a deepening of the Argentina crisis, reflected in the industrial output and investment flows. Nonetheless, three positive aspects should be noticed in this picture. The first one is related to the evolution of employment indicators, which, although mirror adverse shocks, do so discretely. The second refers to price evolution, not evidencing generalized hikes as a consequence of supply shocks, as previously speculated. The last one refers to the recovery of the trade balance, although incipient.

Prices

Administered price readjustments, partially influenced by the exchange rate devaluation, were the main factors to determine the evolution of inflation in July. Food prices also influenced the index, by continuously reflecting off-season effects and the impact of the exchange rate variation in some items, such as soybean oil and wheat by products.

The IPCA rose by 1.33% in July, accumulating an increase of 4.32% in 2001 and 7.05% in the last twelve months. The non-food products segment increased by 1.52% in the month, mostly influenced by the rise in gasoline prices and cooking gas and by the readjustment in urban bus

tariffs, in the electric energy in São Paulo and Curitiba and in fixed telephony throughout the country. As a consequence of these hikes, the administered prices solely contributed to 0.9 percentage point of the monthly variation of the IPCA.

The IGP-DI recorded a 1.62% variation in July, compared to 1.46% in June, accumulating 6.43% in 2001 and 10.78% in the last twelve months. The 1.93% variation in the IPA – Wholesale Price Index, practically stable as compared to the 1.96% variation in June, was the main factor determining the evolution of the IGP-DI. The evolution of the IPA reflected, notably, the recent exchange rate devaluation, with special notice to monthly results in “crops for exports” and “oleaginous”, among the agricultural products, and “oil and grease”, “flower and by-products” and “fuel and lubricants”, among the industrial others.

External environment

The decelerating pace of US economic activity does not show signs of reversal in the short run, contributing to the dissemination of the economic deceleration in other countries. In this context, the Euro Area presents signs of deceleration, with the possibilities of a Japanese economic recovery in the short run tending to be minimized. The emerging economies are affected both by the direct negative impact of the reduction of the external demand and by unfavorable change in the risk perception of international investors.

Official forecasts of the US GDP performance show an expansion of 0.7% in the second quarter, relatively to the previous one, in the seasonally adjusted series and annual variation, reflecting the adjustment of industrial inventory and reductions in the pace of exports and consumption. The domestic demand remains on a downward trajectory, with the retail sales, orders to industries and consumer credit decreasing in July by 0.1%, 2.4%, and 0.1%, respectively, compared to the previous month in the seasonally adjusted series. The investments tend to remain contracted, with the production of capital goods decreasing during the first seven months of 2001 and the orders of new telecommunication equipment and computers significantly negative in June. The unfavorable expectations of entrepreneurs and consumers signal, in conjunction with the other analyzed indicators, the trend of delayed economic recovery relatively to initial expectations.

The industrial production fell in July, for the tenth consecutive month, reducing the expansion accumulated in the last twelve months to 1.7%, after reaching 5.9% in October 2000. Although the adjustment of inventory levels, expressively high in 2000, has been partially realized, the perspectives of increased production are small, since the expectations of demand growth are fragile, reflecting the deterioration of the labor market, the contraction of corporate profits and the deceleration of the activity pace of other countries, which negatively influences exports. The wholesale and consumer price indices in July presented negative variation, which may be associated with the evolution of international energy prices and the domestic price of gasoline, as well with the reduction of the demand.

The Euro Area economies have shown a reducing trend in the growth rates of retail sales, what has contributed, jointly with the performance of exports, to the contraction of the industrial production. Therefore, industrial output decreased in four of the first six months of the year, 1.4% higher than the same period of the previous year. The weaker performance of these economies has reflected in the descending trajectory of price indices, which have also been responding to lower oil prices. In this context, the confidence indicators of the three main economies follow on a descending path, reaching 90 in Germany (IFO) and 93 in Italy (ISAE) in June, and 99 in France in July, after reaching 92, 95 and 102, respectively, in the previous month.

The Japanese economy remains with no signs of recovery. In June, the orders to the industries contracted by 18.7% relatively to the previous month, seasonally adjusted series, with the construction sector index falling by 10.5% compared to the same month in 2000. The external trade balance reached US\$ 5.3 billion in June, 50% lower than in the same month of 2000, with contracting trend in exports and deterioration of the balance, considering accumulated figures in the last 12 months. The industrial production fell by 0.7% in June, the fifth reduction in the first half of the year, 8.7% lower than the level achieved in June 2000. As a consequence of this scenario, the Central Bank of Japan increased the liquidity of the Financial System to ¥6 trillion from ¥5 trillion in the meeting of August 14, along with the increase of long-term public securities purchases to ¥600 billion from ¥400 billion per month. It shall be stressed that the yen has shown appreciating trend vis-a-vis the American dollar inasmuch as the perspectives for longer deceleration in US become more evident.

In sum, despite the actions implemented aiming to revert the decelerating scenario of economic activity in industrial countries, no clear signs of reversal until the end of this year can be observed.

In Argentina, the congress approved the zero deficit program and the government still tries to preserve the credibility in its capacity to recover economy growth. Demand and production indicators do not reveal the retrieval of economic activity, although the fiscal result of June positively contributed to the accomplishment of the target agreed with the IMF in December. It shall be emphasized that the US\$ 767 million trade balance in June, accumulating a surplus of US\$ 2 billion in the first half of the year, compared to a positive balance of US\$ 1.2 billion in 2000. This result reflects the 6% expansion of exports and the 19% reduction in imports.

Money market and open market operations

Copom's decision in the prior meeting to increase the Over-Selic target by 75 basis points did not lead to significant changes in the slope of the interest rate curve. Afterwards, the announcement of the new agreement with the IMF and the release of data indicating deceleration in the economic activity translated into the main reasons for the downward move of the slope of the interest rate curve. In the period between July 16 and August 20, a significant reduction was observed in the interest curve slope in regard to tenures shorter than 90 days. The spread between the Over-Selic rate and the Futures DI to October reduced to 140 bp from 660 bp, reverting the expectations of an eventual interest rate shock in the short run. For tenures higher than 180 days, the spread reached approximately 150 bp.

In regard to exchange rate pegged securities, the Central Bank of Brazil maintained the strategy of integrally rolling over principal and final interest payments. In the beginning of August, the Central Bank offered one-year securities to roll over redemptions amounting to R\$ 1.1 billion. For the R\$ 5.2 billion redemption in August 16, three five-year NBC-E offers were carried out (totaling 68% of that volume) and one last offer of one-year securities, after the demand for such securities had evidenced saturation for longer tenures. The average yields for the one-year NBC-E reached 7.62% and 6.38% p.a.. For the five-year securities, average yields were of 12% p.a..

The five LFT offers placed between July 19 and August 22 totaled R\$12 billion, with the average demand over offer ratio reaching 1.25. The securities were auctioned at five-year tenures and showed increasing trend in the maximum discounts over face values, from 0.34% to 0.42% p.a..

Resulting from improvements in the expectations due to the new IMF agreement, the National Treasury resumed the placements of fixed rate securities at the beginning of August. In this context, there were three offers of five-month fixed rate securities. R\$3.2 billion were settled with the average demand over offer ratio achieving 2.2.

In regard to the financial settlements between July 18 and August 21, a R\$10.5 billion expansionist monetary impact was observed in the period, determined by operations with National Treasury securities. Noteworthy were the net redemptions of R\$5.7 billion in LTN and R\$4.2 billion in LFT.

Within a 25 working day period, the Central Bank intervened six times in the open market, aiming at administering the short-term interest rate. In five of those interventions, the Central Bank carried out sales of federal securities with repurchase agreements, at maximum yields of 18.90% p.a., with the average volume of the interventions reaching R\$3.5 billion. The remaining operation constituted a purchase of federal securities, with a resale agreement, of R\$4.0 billion at the minimum rate of 19.05% p.a.

Prospective assessment of inflation

The identified shocks and their impacts were reassessed in light of newly available information. The scenario considered in the simulations encompasses the following hypotheses:

1. July inflation rate, measured by the IPCA, reached 1.33%, slightly above the expected;
2. considering the price schedule implied by Brent crude oil futures contracts, the expectations for the average price of the barrel were reduced to US\$ 24.9 in the third quarter of 2001 and to US\$ 24.5 in the fourth quarter. After 2002, the hypothesis that the prices of oil by-products in the domestic market shall follow market inflation is considered;

3. the definition of administered prices was altered to include a wider set of items, weighting 29.9% of the IPCA (formerly, the projection was based on a set weighting 22.6%, which basically included items to which projections were more straightforward). For this set of prices, the expected readjustment in 2001 remained relatively stable at 10% for August, from 10.5% in July. Such prices accumulate a 6.7% variation from January to July with further 3.1% being expected for the remaining of the year. The evolution of these prices is expected to directly contribute with 2.9% for the year inflation, compared to the 3.0% estimated in July;
4. the forecast for the readjustment of electrical energy tariffs in 2001 remained at 20%;
5. the slope of the domestic yield curve – defined as the difference between the 180 day swap rate and the one day Selic rate - is forecasted at an average below 500 basis points in the third quarter of 2001, linearly declining to an average slightly above 200 basis points in the second quarter of 2002, with stability thereafter;
6. the hypothesis for the path of the Fed Funds interest rate was altered to incorporate a reducing trajectory in the average rate until the end of the year and a slight increase after the second quarter of 2002, accordingly to the futures market projections for the rate;
7. on the external front, the hypothesis for the average risk premium – measured as the difference between the adjusted yield of Brazil's Global Bonds and the United States Treasury Bonds, both with approximate duration of 4 years – was revised to incorporate a declining trajectory from current levels to a plateau near 600 points after the second quarter of 2002.

The hypotheses reflect in an exchange rate stable around current levels for 2001 and a gradual appreciation in 2002.

The IPCA core, calculated under the symmetric trimmed-mean method, slightly declined to 0.65% in July. Accumulated in 12 months, the core index increased by 6.3%. The inflation core calculated with the exclusion of administered and food prices increased by 0.49% in July, with 4.0% accumulated variation in 12 months as of July, compared to 3.78% in the previous month.

The median of market expectations for the IPCA, as surveyed by the Central Bank on a daily basis, was revised to 6.3% from 6.0% for 2001 and to 4.5% from 4.0% for 2002.

The fiscal accounts have overperformed the targets currently set for the fiscal policy and is in line with the new proposal of a 3.35% of GDP primary surplus in 2001 and 3.5% in 2002.

The remaining assumptions established in the previous meeting were maintained.

Simulation exercises with the scenario considered in the basic (structural) model leads to the conclusion that the maintenance of the interest rate at the current level of 19.0% p.a. would result in inflation slightly above 6% for 2001. However, for 2002 the projected inflation is below the 3.5% target.

Monetary Policy Guidelines

Recent data and other indicators regarding the activity level have confirmed the continuity, in the last months, of the cooling economic trend observed since the end of the first quarter. This reflects the impact of both the international scenario and the energy crisis on expectations and domestic economy.

The contribution of each of the various factors to the economic deceleration is difficult to be assessed. Nonetheless, the reduction in the aggregate demand seems to have been the main factor to respond for the worsening economic performance, if compared to the restriction imposed to aggregate supply stemming from the energy crisis. The reduction in the demand may be explained by the worsening of the external scenario, by the reflex of the energy shortage on the expectations and by the recent tightening of the monetary policy. The perception that the deceleration of the world economy shall be longer than forecasted in the beginning of the year, in conjunction with the evolution of the Argentina crisis have contributed to the downward revision of expectations concerning the Brazilian economic growth, with negative impacts on the aggregate demand. These expectations were also influenced by the energy crisis, which affected entrepreneurs' and consumers' confidence. Monetary policy actions, in addition to the direct impact of the interest rate hikes on the demand, also reflected in market's expectations, as revealed by the steepening of the slope of the interest rate curve since last March. The shift in expectations accelerated the impact of

the monetary policy. This cooling in the demand may pose downward pressure to the inflation rate in 2001 and 2002.

Notwithstanding the fall in inflation expected in the near future due to the scenario of economic deceleration, the response of the exchange rate continues to be a source of concern. There are still risks of an exchange rate passthrough to domestic prices stemming from accumulated depreciation since the beginning of the year. These risks become more intense as the depreciation starts to be perceived as permanent and the demand recovers.

In the short run, uncertainties concerning the exchange rate market have not been dissipated. In the medium run, given the transitory nature of the shocks and economic policy reaction, it is reasonable to assume that an improvement in the Balance of Payments will materialize. Moreover, in order to reduce the impact of the unfavorable international conjuncture and its eventual adverse impacts on the economy, the Brazilian government counts with a new IMF program contemplating US\$15 billion in financial resources.

The core inflation remains at a high level, although having presented some decline. The analysis of the items incorporated into the calculation of the core inflation in July points out to a pressure on prices, distributed among various categories of products. In 2001, the IPCA accumulated a 4.32% variation until July, led by administered prices evolution (6.7%, with a contribution of 2% for the IPCA). Free prices increased by 3.3% (with a contribution of 2.4% for the IPCA), with food prices rising by 5.1% (with a contribution of 0.9% for the IPCA). Inflation expectations may stabilize. The IPCA accumulated variation and the forecast of the contribution of administered prices to the index in the remainder of the year (0.92%) indicate that the inflation will be slightly above 6% in 2001. For 2002, the forecasts generated from various simulation exercises within Central Bank's structural model, considering a constant interest rate trajectory, indicate an inflation rate comfortably below the target.

Copom concluded that, if on the one hand the cooling economic activity impose downward pressure onto inflation forecasts, yet to be confirmed, on the other hand, the increase of the core inflation in the last months and the existing risks of passthrough pressures, inclusively via administered prices, recommend caution on managing the monetary policy. Under these circumstances, Copom decided that the monetary policy is currently adequate to assure convergence of the inflation to the targets.

Accordingly, Copom unanimously decided to maintain the Selic rate target in 19% p.a..

At the close of the meeting, it was announced that the Committee would meet again on September 18, 2001, at 3:00 PM, for technical presentations and, on the following day, at 4:30 PM, in order to discuss monetary policy guidelines, as set in the Calendar of Copom's Ordinary Meetings, published in the Central Bank Communiqué n. 8,018, of 11.22.2000.