November 29, 2002

BANCO CENTRAL DO BRASIL (BCB)
MINUTES OF THE 78th MEETING OF
THE MONETARY POLICY COMMITTEE (COPOM)

Summary

Date: November 19 and 20, 2002

Place: Central Bank's Headquarters meeting room of the 8th floor (on November 19) and 20th floor (on November 20) -Brasília - DF

Called to Order: 3:30 PM on November 19 and 12:00 PM on November 20

Adjourned: 7:00 PM on November 19 and 1:30 PM on November 20

In attendance:

Members of the Board

Arminio Fraga Neto **-** Governor

Beny Parnes

Carlos Eduardo de Freitas

Edison Bernardes dos Santos

Ilan Goldfajn

Luiz Fernando Figueiredo

Sergio Darcy da Silva Alves

Department Heads (all present on November 19)

Altamir Lopes – Economic Department (DEPEC)

Renato Jansson Rosek – International Reserve Operations Department (DEPIN)

José Antonio Marciano - Department of Banking Operations and Payment System (DEBAN)

Marcelo Kfoury Muinhos - Research Department (DEPEP)

João Henrique de Paula Freitas Simão - Open Market Operations Department (DEMAB)

Other participants (all present on November 20)

Hélio Jose Ferreira - Executive Secretary

Alexandre Pundek Rocha - Advisor to the Board

José Pedro Ramos Fachada Martins da Silva - Advisor to the Board

João dos Reis Borges Muniz - Press Secretary (ASIMP)

Fabia Aparecida de Carvalho – Manager of the Investor Relations Group

The Board 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 indicators of the level of activity showed a recovery between the third and fourth quarters. Part of this behavior was due to a continuation of the effects of disbursements from the Time in Service Guarantee Fund (FGTS) on the consumption of semi and non-durable goods, to the increase in earnings in the agricultural sector, and to the acceleration of export growth, as well as of the import-substitution process. More recently, there was an improvement in consumer confidence, and the demand for durable goods was boosted by sectoral promotions.

In retail commerce, preliminary seasonally adjusted data from São Paulo State's Federation of Commerce (Fecomércio-SP) point to a 0.1% increase in the retail sector's real revenues in the Metropolitan region of São Paulo in October. The largest increases were observed in the sales of semi and non-durable consumption goods, and cars. October sales grew 4.1% compared to the same month of 2001. The national survey carried out by the Brazilian Institute of Geography and Statistics (IBGE) also showed a recovery of retail sales in recent months.

The improved performance of car sales registered by the Fecomércio-SP is confirmed by data from the National Federation of Auto Distributors (Fenabrave), which registered a 9.2% increase in sales in September, in the seasonally adjusted series. Car dealers' sales increased a further 2.5% in October, as a result of the promotions started by the reduction of the Industrialized Products Tax (IPI) on vehicles.

The favorable performance of the retail sector appears set to continue, considering the factors affecting expectations and defaults. Consumer confidence improved in November, according to a survey of the Fecomércio-SP. The Federation's Consumer Intentions Index (ICC) increased by 5.95% to reach 101.7 points on a scale ranging from 0 to 200. The increase in the ICC resulted from an improvement in consumers' expectations about the future, which brought the level of the future intentions index close to the series' peak. The perception of an improvement in the political scenario was the main factor underlying this result, together with a decline in concerns about higher unemployment. With respect to current intentions, the increase was more modest and the index still remains at a low level (81.2), consistent with the perception that the current economic situation remains unfavorable.

Regarding defaults, the São Paulo Trade Association's (ACSP) Usecheque indicator decreased to 4.4% in October from 6.7% in September. It should be highlighted that this decline resulted from both a smaller number of new default registrations and the maintenance of a high number of cancelled default registrations. The number of returned checks due to insufficient funds as a share of cleared checks continued to decline, falling to 4.6% in October, compared to the peak of 5.5% in this series registered in March 2002.

The default rate in financial institutions' credit portfolio of freely allocated resources remained steady in October at 7.9%, the lowest value since November of last year. The declining trend in defaults, especially on credits to individuals, is due to banks' selectivity in providing credit in recent months, as well as to the use of disbursements from the Time in Service Guarantee Fund (FGTS), which were freed because of an agreement to settle liabilities. The average interest rate on fixed income credit operations increased 2 p.p. in October, following the increase of the Selic target by the same amount.

Outstanding credit operations contracted by corporations with freely established rates declined 3.5% in the last month to R$137 billion. The volume of resources with domestic and external funding decreased 1.9% and 6.3%, respectively, despite the growth of 2.1% in the operations of Anticipated Exchange Rate Contracts (ACC), which are determined by the demands of agricultural business. The volume of credit to private individuals totaled R$77 billion, rising by 0.3% in October. Due to the different number of working days, 23 in October compared to 21 in September, the total accumulated disbursements increased by 7.1% in the last month, whereas the daily average of new concessions declined by 4.3%.

The behavior of general investment indicators continued to show a declining trend, reflecting the carryover effect of the election process on new investment decisions. However, the production of material used in civil construction registered an improvement for the second consecutive month.

Industrial production increased by 0.9% in September on a seasonally adjusted basis, according to data from the Brazilian Institute of Geography and Statistics (IBGE), mainly due to a 1.4% expansion in the transformation industry, while the mineral extraction industry registered a decline of 2.8%. The performance of the metal-mechanical industry, stimulated by the automobile sector, was a key component of the positive result. The transportation material group, in which vehicle production, metallurgy and mechanics have a heavy weight, registered increases of 8.1%, 1.5%

and 2.1%, respectively, on a seasonally adjusted basis. The large increase in vehicle sales in August and September favored the stock adjustments in the sector and the expansion of production. This result was also repeated in October, as mentioned before. The furniture sector was also important in the September results, posting an increase of 8.6%. This sector has also shown a significant expansion in recent months stimulated among other factors by an increase in exports. Another important contribution to industrial performance in recent months has been the growth of sales to the agricultural sector - especially agricultural machines and fertilizers.

Data from the National Confederation of Industries (CNI) on the performance of the industrial sector in September showed an increase in industrial sales for the fourth consecutive month on a seasonally adjusted basis. This increase was due mostly to external sales. According to CNI, between the second and the third quarters of 2002 stocks of raw materials increased slightly, while stocks of final goods fell significantly relative to the levels desired by businesses. This reduction in the stocks of final goods helps to explain the difference between the expansion of industrial sales and industrial production in the third quarter of the year.

In the labor market, the average open unemployment rate measured by the IBGE increased to 7.5% in September, from 7.3% in August, as a result of a 0.2% fall in the number of employed workers and a 0.1% increase in the Economically Active Population (PEA). According to the Ministry of Labor, in September legally registered employment grew by 0.7% from the previous month on a seasonally adjusted basis, and by 3.7% over the past 12 months.

With respect to the external accounts, from November 1 to the 17 the trade balance surplus totaled US$816 million, with average daily exports of US$273 million, in comparison to US$238 million for the year. November's average daily imports of US$192 million are 1.7% higher than the average observed year-to-date, considering the period from January to November 17. As a result, the accumulated trade surplus in the year-to-date reached US$10.9 billion, in comparison to the US$1.7 billion in the same period of 2001. Exports reached US$52.7 billion, 2% higher than in the same period of 2001, while imports reached US$41.8 billion, 16.2% below the corresponding figure last year.

In summary, economic activity is showing signs of increasing dynamism, associated with the growth in sales of consumer goods with lower unit values since the beginning of the second half of the year – and attributable, among other factors, to the extraordinary resources coming from the FGTS, to the expansion of exports and import substitution, to sales directed to the agricultural sector and to the recent increase in sales of durable goods, especially vehicles. Going forward, the adjustment in stocks observed in the industrial sector, the relatively low level of defaults, and the recovery in both consumer and business confidence are elements that should contribute to a continuation of this process of recovery.

External Environment

The international economic scenario has changed little in recent weeks and remains adverse for emerging economies. Capital flows are still being influenced by risk aversion and the high volatility of financial asset prices, which has resulted in part from weaker-than-expected corporate results. Expectations for a recovery of the global economy have declined due to the release of the latest economic indicators, which have strengthened forecasts that a new recessionary period may be in course, particularly after the terrorist attack in Indonesia and with the possibility of a United States attack on Iraq.

In the United States, macroeconomic indicators are still sending contradictory signals, increasing concerns regarding prospects for an economic recovery. At its last meeting, the Federal Reserve decreased the basic interest rate by 50 points, to 1.25% p.a., and withdrew the downward bias, signaling that the easing cycle may have ended. On this point it should be highlighted that there is increasing concern among academics about the imminence of a deflationary cycle that would make monetary policy ineffectual in stimulating the economy. The FED's recent actions indicate that it may believe that recent outcomes are much more the result of very large productivity gains than excessive weakness in demand, justifying its recent monetary easing. Indicators of business and consumer confidence registered large declines in recent months, reflecting increasing uncertainties over the prolonged cycle of financial market losses and the labor market slow down, and increased fears regarding new terrorist attacks and the imminent military action against Iraq.

In Japan, the recovery of GDP growth was verified in the third quarter. However, a new deceleration is expected in the final months of the year. The uncertainty regarding global economic growth and the drop in demand for information technology-intensive goods has impacted Japan's export performance in recent months, transferring to internal demand the burden of sustaining economic activity. The unemployment rate has stabilized at a high level (5.4% from August to October) and the country is still waiting for the implementation of structural reforms to overcome deflation and the fragility of the banking system.

The performance of economic activity in the countries of the euro area has been worse than the results observed in the USA, causing forecasts for a more broad-based recovery to be abandoned. The economic situation in Germany appears worse than in the other countries of the region, including in the areas of economic activity, the fiscal accounts and the results of the banking system, and due to the country's importance, it has been influencing the euro area's overall results and investor expectations. The maintenance of the basic interest rate of the region indicated the European Central Bank's (ECB) concern with inflation, which stood at an annual rate of 2.3% in October, the third month that inflation has remained above the ECB's target of 2.0% p.a.. This decision about the interest rate, in turn, contributed to the continuity of the euro's appreciation, with the exchange rate once again surpassing US dollar parity in recent days.

Prices

The inflation rate showed a significant acceleration in October, mainly reflecting the evolution of the exchange rate. The Consumer Price Index - Extended (IPCA) increased by 1.31%, accumulating a 6.98% increase in the year to October and a 8.45% variation in 12 months. Due to the impact of agricultural and industrial prices on wholesale prices, the effects of the exchange rate depreciation, recent increases in the international prices of some commodities, and the impact of the off-season period on agricultural prices were even more notable in the General Price Index -

Demand Supply (IGP-DI). The monthly variation in the IGP-DI increased to 4.21% in October, from 2.64% in September, accumulating an increase of 16.3% in the year to October and 17.4% in 12 months.

The significant rise of the IPCA was due to the continuation of increases in free prices and to the impact of hikes in some monitored prices. The increase in free prices was responsible for 0.98 percentage points of the monthly variation and was mainly a consequence of pressure from food prices linked to the exchange rate, such as cattle meat, French roll, chicken, soy oil and rice. Among non-food products, prices of electronic devices, clothing, cigarettes, furniture and personal hygiene products posted the largest increases. Monitored prices contributed 0.33 percentage points to the monthly variation of the IPCA, reflecting increases in the prices of alcohol, gasoline, airline fares, health insurance and urban transportation in Rio de Janeiro.

Within the IGP-DI, the Wholesale Price Index –(IPA) rose 6.02% in October as a result of an 8.65% increase in agricultural prices and a 4.96% in industrial prices. Among the agricultural components, increases in the prices of soy, coffee beans, cattle meat, eggs, rice, poultry, wheat and corn were most notable. In the industrial components, price hikes were most notable mainly in metallurgical products, mineral extracting, electrical parts, paper, cardboard, chemical and food products. The National Civil Construction Index (INCC), also a sub-index of the IGP-DI, rose 1.13% in October, primarily reflecting a 1.79% increase in the costs of building materials such as steel, tile, cement, ironware and wood.

The exchange rate depreciation in recent months will continue to produce strong pressure on prices. This fact, combined with the impact of increases occurring in administered prices like fuel (gasoline, diesel and bottled gas) and electric energy (in Rio de Janeiro), will put upward pressure on consumer price indices again in November, with the possibility of a reversal only from the following month on.

Monetary Market and Open Market Operations

The spread between the Over Selic target and the 1-year interest rate, which stood at 787 b.p. on October 22, increased to 1,139 b.p. on November 13, its highest level since the October Copom meeting, before declining to 1,045 b.p. at the end of the period on November 19. The increase in the slope of the yield curve was caused by the rise in inflationary pressure and uncertainties about the exchange rate and the country's risk behavior, amongst other factors.

Between October 23 and November 19, Banco Central carried out ten auctions of Fx swaps contracts for the rollover of US$6.1 billion of Fx-linked securities and Fx swaps. The rollover of these instruments reached 82% or US$5.0 billion, with maturities on newly issued swaps ranging between 1 month and two years.

In the same period, the National Treasury carried out four auctions, placing R$21.1 billion in LFTs with an average tenor of 128 days. LTNs were offered at just one of these auctions. The attractiveness of the yield on LFTs maturing in the beginning of 2003, and the stabilization of the price discount for LFTs across all maturities due to the Banco Central's exchange and repurchase program, explain the increase in demand for these securities noted since October. On the other hand, concerns about a possible increase in the Selic rate target reduced interest in fixed income securities, resulting in no placements of LTNs in the period. Placements of NTN-Cs reached R$4.1 billion.

Continuing the program to reduce LFT price volatility, the Banco Central carried out ten selling auctions of securities maturing in 2003, allowing settlement to be carried out with LFTs and LFT-Bs maturing from 2004 to 2006. In addition, Banco Central carried out nine purchase auctions of LFTs maturing in 2003. The former auctions totaled R$1.1 billion, while the latter withdrew the equivalent of R$0.3 billion in securities from the market. In both cases, decreasing interest in the auctions has been observed, consistent with the already mentioned increase in market interest for LFTs.

Banco Central do Brasil intervened in the open market on a daily basis between October 24 and November 19, withdrawing and providing one day liquidity at respective yields of 20.90% p.a. and

21.00% p.a. The average daily volumes of the auctions to reduce and increase liquidity were R$40.2 billion and R$4.2 billion, respectively.

The financial settlements between October 24 and November 19 had an expansionary monetary impact of R$3.0 billion, resulting from net placements of LFTs (R$14.0 billion) and NTN-Cs (R$6.2 billion) and net redemptions of LTNs (R$13.6 billion) and exchange rate indexed securities (R$9.7 billion).

In October, the domestic federal securitized debt declined by R$26.7 billion (4.1%), due mainly to the appreciation of the exchange rate and the net redemption of R$27.1 billion in securities.

Assessment of Inflation Trends

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

1. As mentioned in previous releases, the forecasts for the price readjustments of petroleum by-products are based on the changes in international petroleum prices and the exchange rate since the last readjustment. Because of the exchange rate appreciation that has occurred since the price readjustment announced in the beginning of November and the decrease in the international price of petroleum and its by-products, there was a downward revision to the forecasted values for 2003. For gasoline, a decrease of about 1.5% was forecast, in comparison to the increase of 9% forecast at the last Copom meeting. For bottled gas, the price is forecast to increase by approximately 6%, a much smaller increase than was projected at the ordinary meeting in October. For the last two months of 2002, the prices of gasoline and bottled gas are projected to remain stable, based on the values announced by Petrobras on November 1st.

2. Regarding electricity tariffs, an increase of 20% is forecasted for 2002, of which 17.2% already occurred between January and October. This value is lower than the forecast at the last meeting and this revision is a result of the exchange rate appreciation observed in the period. The projection of the electricity readjustment for 2003 increased to 27% in November from 25% in October, as a consequence of the increase in the projections for the IGP-M index, which has a significant impact on the readjustments of electricity prices.

3. The set of prices administered by contracts and monitored was redefined, and now excludes charcoal, school transportation and housekeepers' wages. Considering the new definition, the weight of the prices administered by contracts and monitored in the IPCA stood at 27.7% in October, instead of 31.1%. According to this new definition, the forecasts for these prices came to 13.4% and 12.1% for 2002 and 2003, respectively, in comparison to the 12.0% and 12.7% projected previously. The lower 2003 projection for the inflation of the prices administered by contracts and monitored is due mainly to the new projection for petroleum by-products.

4. The forecast for the spread of the 6-month interest rate over the Selic rate, which utilizes a model specification based on the error correction method of estimation, and which assumes the maintenance of the Selic rate at a constant 21.0% p.a., starts at 490 b.p. in the fourth quarter of 2002, and, afterwards, shows a declining trend up to -100 b.p. at the end of 2003.

The monthly inflation rate measured by the IPCA reached 1.31% in October, higher than the 0.72% increase in September and above the projection at the October Copom meeting. Core inflation of the IPCA, calculated under the symmetric trimmed-mean method, remained at 0.78% in October. In the last twelve months, core prices registered an increase of 7.62%. In its turn, the core inflation of the Consumer Price Index - Brazil (IPC-BR), calculated under the symmetric trimmed-mean method, increased to 0.97% in October, from 0.67% in September. In twelve months, core prices of the IPC-BR registered an increase of 7.30%. Core inflation calculated by excluding prices administered by contracts and household food prices registered a variation of 0.74% in October, and an accumulated variation of 6.75% over twelve months.

The accumulated IPCA variation over twelve months, which had been presenting a declining trend from May to August, registered increases in September (7.93%) and October (8.44%). In these twelve months, free market prices contributed 5.47 p.p. to inflation, while prices administered by contracts and monitored contributed 2.98 p.p.

Regarding fiscal policy, it was assumed that the consolidated public sector achieves a 3.88% of GDP primary surplus for this year and 3.75% for the coming years. 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 21.0% p.a. and the exchange rate at the same level as on the eve of the Copom meeting (R$3.55) indicates an inflation rate above the upper limit of the tolerance interval in 2002 and 2003.

Monetary Policy Guidelines

Economic activity has started to show signs of recovery, led by the increase in consumption and net exports observed in recent months. Preliminary data from Fecomércio show that the Sao Paulo retail sector's real revenues remained basically stable in October (seasonally-adjusted data), but were up 12.5% relative to October 2001. Reflecting in part the proximity of year-end festivities and the improvement of expectations about the future government, in November the IIC increased by almost 6% in relation to the previous month, mainly due to an increase in its future intentions component. According to seasonally adjusted data from CNI, real industrial sales have been rising since May, and in the most recent monthly comparison for September increased by 1.7%.

The monthly change in industrial production measured by IBGE has been positive since June. In the last three months, the growth rate has increased, rising to 0.9% in September from 0.13% in

July (seasonally-adjusted data). In line with the industrial production results, the Pimes survey, carried out by the IBGE, shows an increase of 1.3% in industrial employment in September in relation to August, the highest monthly growth rate since the start of the series in December 2000. As mentioned in the Minutes of the Copom's October meeting, the increase in industrial production in September may be explained by the reaction of industry to the increase in demand and the reduction of inventories, which fell from 53.1 to 48.5 between the second and third quarters of 2002. For the inventory index, figures above 50 correspond to inventories greater than the level desired by the firms.

The current account of the balance of payments continues to adjust as a consequence of the steep exchange rate depreciation. The projected deficit for 2002 is below US$9 billion. This forecast is due mainly to a projected trade surplus of US$12.5 billion for 2002. For 2003, the projected current account deficit is even lower, at US$8 billion, while the projected trade surplus is US$15 billion. The improvement in the balance of payments and in expectations for the future conduct of economic policy since the Copom's last meeting allowed the dollar to fall from R$3.90 to R$3.55 in the period. The appreciation of the real was limited to some degree by the risk aversion prevailing in international markets.

Since the October Copom meeting, there have been other positive results in the financial markets aside from the appreciation of the real. Country-risk measured by the Embi+ declined from 1,987 b.p to 1,655 b.p. between October 21 and November 18. Discounts on the prices of public securities diminished. Public securities were placed with greater ease, and finally, in October the mutual fund industry posted its best results in terms of financial inflows since January 2002.

However, there was deterioration in inflation expectations for 2003. The median of inflation expectations for 2003 surveyed by the Investor Relations Group of the Banco Central do Brasil rose to 7.0% in October from 5.2% in September and it reached 9.8% on the eve of the most recent meeting. This increase was driven by a number of factors which include: i) a reaction to the deep depreciation of the exchange rate, which reached R$3.96/US$ in October; ii) the disclosure of indices – IGP, IPC-FIPE and IPCA - showing increased inflation in October and November; iii) questions related to the future conduct of monetary policy; and iv) a greater risk of margin recovery and pass-through of the exchange rate depreciation to prices in an environment of economic recovery.

The Copom has also has also made an upward adjustment to its inflation projections for 2002 and 2003, mainly due to the increase in inflation expectations in the economy. However, Copom's forecasts are meaningfully below the median of market expectations. As there was a reduction in the forecast for the readjustment of administered prices for 2003, to 12.1% from 12.7%, the higher IPCA forecast is due to a higher forecast for inflation in free prices. It is important to highlight that although the inflation forecasts of nearly 100 financial and non-financial institutions surveyed by the Investor Relations Group are a relevant parameter for price formation in the economy, they are not the only source of information used by the Copom to evaluate inflation expectations in the Brazilian economy. Among other factors that were evaluated it should be noted that the October industrial survey of the Getúlio Vargas Foundation (FGV), found that 48% of firms are willing to raise their prices. Also, recent collective wage adjustments were taken into account.

The Copom focuses on the concept of an adjusted inflation target, in which the target of 4% set for 2003 is adjusted by adding the primary impact of administered price shocks, and half the impact of inflationary inertia inherited from 2002. The adjusted target for 2003 has not changed since October (around 6%). The current inflation forecast is above this value. In summary, in light of the increase in inflation expectations for 2003, as well as the risk of higher passthrough of the exchange rate depreciation to prices, and the fact that the inflation forecast is above the adjusted target, the Copom decided, unanimously, to increase the target for the Selic rate to 22% p.a., with no bias.

At the close of the meeting, it was announced that the Committee would meet again on December 17, 2002, for technical presentations and, on the following day, in order to discuss the monetary policy guidelines, as set in Communiqué 8911, of Oct 03, 2001.

Acronyms

ac 12m accumulated in 12 months

ACC Anticipated Exchange Rate Contracts

BM&F Mercantile and Futures Exchange

bp Base Points

CDI Interbank Futures Contract

CETIP Center for Financial Custody and Settlement of Private Securities

CNI National Confederation of Industries

CPMF Provisory Contribution on Financial Transactions

CSLL Social Contribution on Net Profit

DI Interbank Deposit

Fecomércio Federation of Commerce of the State of São Paulo

Fenabrave National Federation of Automotive Vehicles Distribution

FED Federal Reserve System

FOMC Federal Open Market Committee

FRA Forward Rate Agreement

GDP Gross Domestic Product

IBGE Brazilian Institute of Geography and Statistics

IF Financial Institution

IGP-DI General Price Index – Domestic Supply

IIC Consumer Intentions Index

INCC National Civil Construction Index

IPA Wholesale Price Index

IPC Consumer Price Index

IPCA Consumer Price Index – Extended

IPCH Consumer Price Index – Harmonized

IPP Producer Price Index

IR Income Tax

IRF-M Market Fixed Income Index

IRRF Withholding Income Tax

LFT National Treasury Letters (floating)

LFT-B National Treasury Letters - B series (selic rate)

LTN National Treasury Letters (fixed rate)

NAPM National Association of Purchasing Managers

NBCE Central Bank Note - E Series (exchange rate variation)

NTN-C National Treasury Note - C Series (price index)

NTN-D National Treasury Note – D Series (exchange rate)

p.a. per annum

PEA Economically Active Population

Pimes Monthly Industrial Survey on Employment and Salary

p.m. per month

pp percentage point

Selic Central Bank's Custody and Settlement Center

SPC Credit Protection Service

STN National Treasury Secretariat

ytd year-to-date