BANCO CENTRAL DO BRASIL – *FOCUS*

December 07, 2000

MINUTES OF THE 53rd

MEETING OF THE BANCO CENTRAL DO BRASIL MONETARY POLICY COMMITTEE (COPOM)

Summary

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Monetary policy guidelines

Date: 11.21 and 22.2000

Place: 8th floor (11.21) and 20th floor (11.22) meeting rooms Banco Central Headquarters – Brasília – DF

Called to order: 4:20 PM on 11.21 and 6:20 PM on 11.22

Adjourned: 8:25 PM on 11.21 and 8:05 PM on 11.22

In attendance:

Members of the Board

Armínio Fraga Neto – **Governor**

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 11.21)

Altamir Lopes – Department of Economics **(DEPEC)**

Daso Maranhão Coimbra – International Reserve Operations Department **(DEPIN)**

José Antonio Marciano - Department of Banking Operations **(DEBAN)**

Alexandre Antonio Tombini – Research Department **(DEPEP)**

Eduardo Hitiro Nakao – Open Market Operations Department **(DEMAB)**

Other participants (all present on 11.21)

Alexandre Pundek Rocha – Advisor to the Board

Gustavo Bussinger – Advisor to DEPEC

João Borges – Press Advisor **(ASIMP)**

Sérgio Goldstein – Executive Secretary of COPOM

The Board analyzed the recent evolution 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.

Aggregate demand and supply

The major indicators of aggregate demand remained high at the start of the fourth quarter of the year. However, one should note that growth rates in recent months have been lower than those registered since the second half of 1999. According to the National Confederation of Industry, overall industrial sales in September remained practically stable (+0.1%) following a 1.5% decline in August. For the year up to October, accumulated growth in comparison to the same period of the previous year came to 10%.

Industrial sales of automotive vehicles, which had expanded sharply over the course of the year, dropped by 5.7% in September due, to some extent, to a lesser volume of foreign market sales. In October, however, the growth curve turned upward once again, registering accumulated expansion of 20.9% in the year, based on increases of 41.5% in exports and 16.1% in internal market sales. In much the same way, increased exports drove overall sales of farm machinery and motorcycles up by respective rates of 23.1% and 33%, when compared to the same period of 1999.

According to data seasonally adjusted by the Economic Department/Banco Central and released by the Trade Federation of the State of São Paulo (FCESP), real revenues of the São Paulo retail trade sector expanded in recent months at a pace of about 11% over the same 1999 period. To a great extent, this was due to expanded sales of items of greater unit value with the added stimulus of an increasingly greater flow of credit.

In November, the Consumer Confidence Index (ICC) stabilized in the range of 104.5 on a scale of 0 to 200. This index, which is also released by FCESP, registered a decline under current economic conditions and an increase under the item of future consumer expectations.

Based on preliminary data, the balance of business credits involving nonearmarked funding increased by 9.4% in the July-October period. Here, one should stress 20.5% growth in the discounting of trade bills, coupled with growth of 5% under exchange operations, which are much more significant in terms of value. Credits granted to individual persons have risen at an accelerated pace, registering growth of 28.1% in the same period. Of these, particular mention should be made of financing for acquisition of goods, with growth of 36.2% in the period under analysis. This performance was driven by such factors as longer average maturities in financing operations, interest rate reductions and lower levels of default in comparison to last year.

Information up to October on the number of consultations with the Trade Association of São Paulo (ACSP) points to stronger growth in installment sales when compared to sales with immediate payment in checks, with respective increases of 8.5% and 7.3%. According to the same source, the net default rate in São Paulo closed October at 5.8% or practically the same level as in the previous month.

Investment indicators have expanded in recent months, particularly under capital goods output. The strongest growth occurred under farm equipment, transportation equipment and products for the electrical energy sector. According to IPEA estimates, the investment rate came to 20% of GDP in the third quarter, continuing the steady positive growth curve that began from a low of 18.2% in June of last year.

Investment growth would have been even more accentuated had it not been for the still somewhat sluggish performance of the building industry, as evident in growth of just 2% under output of construction inputs in the January-September 2000 period when compared to the same period in 1999. In contrast to these results, capital goods output has accelerated briskly, reaching an accumulated 12.3% in the year up to September, at the same time in which the volume of capital goods imports has expanded steadily since July.

In the year up to October, the balance of trade turned in a surplus of US$ 194 million, as against a deficit of US$ 931 million in the same period of 1999. An analysis of bilateral trade shows a similar reversal of positions in operations with the European Union and the United States, while the surplus in trade operations within the Laia framework increased slightly. One of the factors that contributed to this result was a larger bilateral surplus in operations with Mexico, which was more than enough to offset an increased deficit in trade with Venezuela and Argentina.

Imports increased by 13.8% in relation to the January-October 1999 period, due mostly to 55% growth in outlays on fuels/lubricants caused by increases in international oil prices. Growth of 20% in purchases of raw materials was caused by expanded industrial production and greater exports of manufactured products. Total exports, in turn, expanded by 17% utilizing the same base of comparison. This growth was generated mostly by an increase of 23.7% in sales of manufactured products, principally involving aircraft, automobiles and transmission/reception equipment. Iron ore is the lead product among Brazil’s exports, with an accumulated total of US$ 2.6 billion in the January-October period.

Aggregate supply indicators point to steady growth throughout the year, with upturns under average utilization of installed output capacity, employment and industrial productivity.

According to IBGE, GDP in the third quarter of the year registered its seventh consecutive positive result – at market prices – when compared to the previous quarter. In accumulated terms for the year, real growth closed at 3.89% as a result of 3.36% expansion under crop/livestock farming, 4.62% under industry and 3.29% under services.

In terms of physical output, industrial production increased by 6.5% in the year up to September. Output of durable consumer goods led the way with expansion of 19.1%.

Production of capital goods accelerated in September, raising accumulated growth in the year to 12.3%. Output of intermediate goods followed the same 7% to 8% pace that has characterized recent months, while output of semi and nondurable goods fell by 1.6% in the same period of comparison.

According to the FGV Survey, the utilization level of installed output capacity in the manufacturing sector came to 84.4% in October. The sector of intermediate goods reached a mark of 87.4% and came the closest to exhausting installed capacity. The same survey indicates that 37% of businesses are in a position to expand output with no apparent difficulties. This is the highest level under this indicator since October 1980.

According to a September IBGE survey, the grain harvest is expected to expand by 2% in the 1999/2000 harvest year, reaching a level of 84 million tons. Output of the north and northeast regions accounted for 12% of the total and registered expansion of 28.2%, offsetting the estimated 0.68% decline in the production of the south, southeast and central-west regions brought about by adverse climatic factors.

Insofar as the job market is concerned, data accumulated up to September confirm the trend toward growth in both employment and productivity with no additional cost pressures. For the eleventh consecutive month, formal employment expanded in the month of September, with creation of 867 thousand job positions in the year. With exception of the building industry, all sectors turned in positive growth. Open unemployment fell for the eighth consecutive month and closed September at 6.68%.

External environment

Despite Opec's recent decision to increase petroleum output, the upward price trend continued. Price formation in this market is strongly impacted by the political unrest in the Middle East, as well as by reports involving oil and derivative stock levels held by the United States, particularly in light of expectations of a sharp rise in consumption as winter weather begins to grip the northern hemisphere. However, the price curve on the futures market still points to a decline starting in the early months of 2001.

Insofar as the American economy is concerned, the Federal Open Market Committee met on

November 15 and decided to maintain the basic interest rate target (fed funds) at 6.5% per year. The Committee recognized the risk of increased inflationary pressures generated by an expanding job market and higher energy prices. However, recent signs of a slowdown in demand growth coupled with financial market adjustments suggest that the economy may well continue expanding as a result of sharp growth in productivity while avoiding such pressures.

In the third quarter of the year, GDP expanded by 2.7% in annualized terms purged of seasonal influences, when compared to the previous quarter. Though industrial output declined by 0.1% in October, the accumulated figure for the last 12 months reflected 5.5% positive growth. Housing starts were 6% lower in September when compared to the same month of 1999. In 12 month terms, the accumulated decline closed at 2.95%. Finally, unemployment remained stable at 3.9% in October.

Insofar as inflation is concerned, the producer price index expanded by 0.4% in October, while core inflation dropped by 0.1%. At the consumer level, both the full and core indices registered growth of 0.2% in October, raising the year-over-year increases to 3.4% and 2.5%.

In Japan, more recent indicators point to a still incipient process of recovery. In September, housing starts increased by 2.1%, while family spending rose by 2.9% and industrial output fell by 3.4% when set against the previous month.

With regard to the Euro zone countries, indicators point to a slight slowdown in economic activity with some degree of upward movement under inflation. The single currency has come under significant pressure, leading the European Central Bank to intervene in the market three times in the month of November. The falloff in the euro, coupled with higher international oil prices, has contributed to higher inflation in the region, as demonstrated by growth of 0.5% in the harmonized consumer price index (CPI) and expansion of 0.9% under the producer price index in September.

In Argentina, the trade balance registered a surplus of US$ 1 billion in the January-September 2000 period, as compared to a deficit of US$ 1.3 billion in the same period of the previous year. At the same time, current revenues and expenditures expanded by 1.1% and

1.6%, respectively, when compared to the previous year's results.

Uncertainties regarding fundamental aspects of the Argentine economy have come to the surface in recent weeks, resulting in increased sovereign risk perceptions and higher internal rates of interest. In this context, the government announced two sets of measures, one on October 23 and the other on November 10. The October initiatives were aimed at fostering private investment and, basically, stimulating economic activity, as the key to expanding employment and recovering previous tax inflow levels. The measures taken in November featured structural reform of the social security and labor systems and called for a pact between the central government and the provinces aimed at stabilizing public spending for five years. The reaction of financial markets to these measures was no more than lukewarm and financing costs remained very high. There was a better reaction to announcement of a possible financial assistance agreement with the IMF in an amount between US$ 10 billion and US$ 20 billion. However, this agreement will depend on congressional approval of measures aimed at bringing greater discipline to fiscal affairs, including passage of the 2001 budget and the social security reform bill, as well as the agreement already signed between the central government and the provinces.

Prices

Inflation declined once again in October, mostly as a result of a slowdown under farm prices and a drop in fuel prices.

The Broad Consumer Price Index (IPCA) turned in growth of 0.14% in October, with accumulated expansion of 5.02% in the year and 6.65% in the last 12 months. The 0.09 percentage point drop in relation to September was due to reductions in the growth pace of food prices from 0.53% in September to 0.16% in October. Other factors that contributed to this result were declines in the prices of fuel alcohol, cooking gas, gasoline, personal hygiene products and hairdresser services.

The General Price Index – Internal Supply (IGP-DI) turned in growth of 0.37% in October (0.69% in September), as a consequence of highs of 0.56% in the wholesale price index, 0.02% in the consumer price index and 0.33% in the cost of construction index. At the wholesale level, the greatest pressures were generated by farm prices, with growth of 0.8%, while industrial goods closed with an increase of 0.45%. A breakdown of the Consumer Price Index (IPC) indicates a falloff in the prices of goods classified under the groupings of foodstuffs, transportation and health/personal care. Utilizing the methodology of rounded averages, the core index closed with growth of 0.21%, above the rate for the full index.

Prospective assessment of inflation trends

Identified shocks and their impacts were reassessed in light of newly available information. The scenario considered in the simulations is based on the following hypotheses:

a. October inflation (0.14%), measured by the IPCA, closed below both market and Banco Central expectations. The subgrouping of meals taken at home registered growth of 0.16%, thus confirming the previous analysis that the shock that occurred in the July-August period was a passing phenomenon. Preliminary data on inflation measured by the other indices (IGP, IPC-Fipe) point to a downturn in food prices. Based on this evidence, the working hypothesis indicates stability in food prices up to the end of the year;

b. the petroleum market has come under strong pressure that has sharply aggravated price volatility. Consequently, the working hypothesis incorporates the price increase approved for November 23, which is expected to produce an impact of about 8% on consumer prices. This impact will be incorporated into the IPCA at a rate of about one-fourth in November and three-fourths in December. At the same time, an additional factor is that oil prices in 2001 will follow the mean implicit in the futures market curve;

c. with regard to government managed prices, due account was taken of the impact of adjustments in urban bus fares in those capital cities in which this year's prices have not increased in line with the average adjustments perceived by the IPCA. It is estimated that the total value of the adjustments in government managed prices will come to about 12% in 2000. The hypothesis for 2001 is that public service rates will be adjusted above inflation measured by the IPCA and that other government administered prices will follow the average of the other prices of the economy;

d. with respect to the minimum wage in 2001, several hypotheses for the rate of increase, as well as different alternatives for scheduling these increases were utilized;

e. the working hypothesis for November is a projection of inflation in line with market projections, coupled with recent evidence generated by preliminary inflation data;

f. despite uncertainties on the external scenario, it is expected that interest rates in the United States will not change. This working hypothesis is consistent with the trajectories implicit in fed fund futures contracts.

The other hypotheses considered at the previous meeting were maintained, particularly that calling for a primary surplus based on the targets defined by fiscal policy. The average level of exchange for October and November was adjusted in light of the recent depreciation of the real.

Based on simulations with the scenario used in the basic model (structural), it was concluded that maintenance of interest rates at the current level of 16.5% per year will make it possible to comply with inflation targets for 2000 and 2001. At the same time, inflation projections for the current year were revised downward to a level closer to the 6% target.

Without considering the impact of the authorized increase in the prices of oil derivatives, the short-term nonstructural models project inflation at monthly rates below 0.4% up to the end of the year. In terms of the accumulated result for the year up to December, these models project inflation slightly above 6% when adjusted to perceive the recent increase in fuel prices.

IPCA core inflation calculated by Banco Central remained stable in October (0.42%), thus confirming the downturn that followed in the wake of the July-August increase. Core inflation measured by the Consumer Price Index – Brazil (IPC-Br), released by the Getúlio Vargas Foundation, came to 0.21%, which was close to the monthly average registered in the first half of the year (0.28%).

The daily survey carried out by Banco Central points to average IPCA growth expectations of 6.15% in 2000 and 4.28% in 2001. The relative stability of expectations in recent months confirms the temporary character of the July and August supply shocks.

Money market and open market operations

For the fourth consecutive month, COPOM maintained the Selic rate target at 16.50% per year at its most recent meeting, with no indication of a bias.

In the period between October 18 and November 21, NBCE were offered on six occasions in placements totaling R$ 6.1 billion, or a nominal updated redemption value of R$ 5.9 billion or R$ 6.9 billion when intermediate and final interest payments are included. These operations were in keeping with the objective of fully rolling the maturing exchange security debt, considering only final interest and the nominal updated redemption value. In the first two auctions, papers with five year terms were offered. These terms were later reduced to three and two years so as to meet the specific needs of exchange hedging.

The National Treasury carried out seven competitive sales of LTN, with a financial value of R$ 5.2 billion. Redemptions added up to R$ 6.1 billion, with R$ 0.4 billion in anticipated redemptions through a public purchase offer with two maturities – November 2000 and January 2001. For purposes of comparison, from September 20 to October 17, LTN placements surpassed redemptions by R$ 1.1 billion, even though redemptions totaled a full R$ 8.5 billion.

The five public offers of LFT came to R$ 8.2 billion, while redemptions of these papers totaled R$ 12.6 billion. In the first case, placements involved papers with maturities of three years at an average discount of 0.04% per year. Starting with the second auction, sales were limited exclusively to LFT with terms of four years at a discount in the range of 0.10% per year. One should note that, in the period from September 20 to October 17, LFT redemptions and placements came to respective totals of R$ 4.2 billion and R$ 4.7 billion.

One should also consider the renewed offer of five year NTN-C in two steps on October 30 and 31 with a total value of R$ 0.3 billion. Only 3.2% of this amount was liquidated with the use of securitized credits for which the National Treasury was liable.

The balance of definitive operations with federal public securities resulted in an expansionary monetary impact of R$ 5.9 billion. Contrary to what had occurred on previous occasions, this excess liquidity was not offset by the National Treasury cash surplus, but rather by the reduction in the volume of security purchases in open market operations carried out by Banco Central. These interventions, which were made with the objective of managing very short-term interest rates, occurred on four occasions for a total of 23 business days.

Monetary policy guidelines

Despite a temporary slowdown in September output indices, more recent data confirm continued growth in aggregate demand and a steady pace of overall economic expansion. Consumption indicators reflect an increased supply of credit with lesser spreads and longer terms. Aggregate supply has reacted in a consistent manner, registering growth in employment levels, productivity and average utilization of installed industrial output capacity.

The prospects of growth in the coming year are positive. Industrial production indicators confirm that expansion has been powered by the performance of durable consumer goods as a result of both increased foreign sales and an expanding internal market, stimulated by a more ample flow of consumer credit. The outlook for growth in the farm sector in 2001 is also quite positive.

Analysis of supply and demand conditions reveals no significant pressures on inflation. Quite to the contrary, the recent behavior of inflation confirms Copom's perception of a low degree of inertia built into the process of domestic price formation. Following the July and August supply shocks when inflation neared three percentage points in the two month period, the September and October results point to a rapid downturn and an accumulated rate of just 0.4 percentage points in the period.

In light of recent inflation results, Copom revised its expectations for inflation in the current year downward to a level close to the 6% target, even taking due account of the recently authorized increase in the prices of petroleum derivatives. For 2001, expectations are that inflation will close slightly below the target.

However, there are lingering doubts regarding the impact of a minimum wage increase on inflation. At the same time, one should also note that – in terms of the internal scenario - growing imports and an ample supply of foreign financing have contributed significantly to internal equilibrium. The increasingly more intense pace of economic growth has fired demand for goods and brought pressure to bear on the average level of utilization of the manufacturing sector's installed output capacity, particularly under the heading of intermediate goods. The increased utilization of installed capacity in the intermediate goods industry has already begun impacting imports and the trade balance.

However, part of the recent upturn in imports is targeted at expanding exports, with an obvious beneficial impact on the trade balance. The year's trade balance result should improve in relation to the past year, despite the direct negative impact on the balance of approximately US$ 2 billion generated by the high in petroleum prices. Over the medium term, further improvement in the trade balance is expected, given that investment flows have been reacting positively and, consequently, paving the way for steady and sustained growth in the economy.

The recent privatization of Banespa confirmed the economy's potential for attracting long-term foreign resources. However, the external sector is a risk factor that must be considered. Though some uncertainties have been dissipated, the international financial market is marked by a high degree of aversion to risk and this could contribute to reductions in capital flows. Aside from this, pressures on international oil prices clearly tend to dampen the growth capacity of the world economy in 2001.

Consequently, Copom resolved to maintain the Selic rate target at 16.5% per year.

At the close of the meeting, it was announced that, based on the Schedule of Ordinary COPOM Meetings, released by Banco Central Communiqué no. 7,228, dated 01.19.2000, the Committee would meet again on December 19, 2000 at 3:00 PM, for technical presentations and on the following day, at 4:30 PM in order to discuss monetary policy guidelines.