BANCO CENTRAL DO BRASIL – *FOCUS*

November 01, 2000

MINUTES OF THE 52nd

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

Summary

Aggregate demand and supply

External environment

Prices

Prospective assessment of inflation trends

Money market and open market operations

Monetary policy guidelines

Date: 10.17 and 18.2000

Place: 8th floor (10.17) and 20th floor (10.18) meeting rooms Banco Central Headquarters – Brasília – DF

Called to order: 3:55 PM on 10.17 and 4:00 PM on 10.18

Adjourned: 7:30 PM on 10.17 and 6:00 PM on 10.18

In attendance:

Members of the Board (10.17 and 18.2000)

Armínio Fraga Neto – **Governor**

Carlos Eduardo de Freitas

Daniel Luiz Gleizer

Edison Bernardes dos Santos

Ilan Goldfajn

Luiz Fernando Figueiredo

Tereza Cristina Grossi Togni

Department Heads (17.10.2000)

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 (17.10.2000)

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 monetary policy regime, which is designed to ensure compliance with government defined inflation targets.

Aggregate demand and supply

Aggregate demand indicators demonstrate that industrial sales in the retail trade sector have continued at record levels, though the pace did slacken somewhat in the third quarter of the year.

Indicators issued by the National Confederation of Industry (CNI) and Federation of Industries of the State of São Paulo (FIESP) for the month of August revealed a certain leveling off of the growth trajectory under industrial sales. However, analysis of the accumulated figures for the year shows growth rates of 10.8% and 12.8%, respectively. Up to the month of September, sales by the automotive industry rose by 18.5% in accumulated terms for the year, with increases of 40.3% under exports and 13.5% in internal sales. The larger increase in foreign sales accounted for the growth in overall sales of farm machinery and motorcycles, as exports of the first item grew by 47.6% while the second racked up 103.6% in the same period.

According to seasonally adjusted data released by the Trade Federation of the State of São Paulo (FCESP), real revenues of the retail trade sector in the metropolitan region of São Paulo have been relatively stable in the last four months. Once seasonal factors are eliminated, growth has held firm in the range of 11% in relation to the same period of 1999. This result was considerably better than in other capital cities and, to some extent, can be attributed to the performance and weight of São Paulo industry.

The balance of credit operations based on nonearmarked resources increased by 4% in September, with accumulated growth of 8.2% in the third quarter. Total credits channeled to legal entities increased by 4.9% in the month and 6.8% in the quarter, while credits granted to individuals rose by 2.4% in September and 10.8% in the July-September period. One should stress that increased financing for acquisitions of goods was driven by longer average terms, lesser interest and lower default rates than in 1999.

Data on the number of consultations with the São Paulo Trade Association up to September continue pointing to more accentuated growth under installment sales than cash sales, with respective rates of 9% and 7.7%. Parallel to these results, one should also note 27.6% growth in the number of credit card transactions up to September, raising the participation of this type of payment to approximately 1/3 of overall transactions.

The Consumer Confidence Index (ICC) moved upward once again in October, closing at 104.5. This index, which is released by FCESP, registered recovery in both of its main components. This improvement was particularly strong under current economic conditions, which increased by 10.1% to its highest level since February. The item consumer expectations, which accounts for 60% of the index, rose by 5.9% in the month, though the average for the year is still 6% below the 1999 level.

With respect to investment indicators, output of capital goods in the month of August intensified (+7.4%, data purged of seasonal factors), raising accumulated growth to 11.4% in comparison to the January-August 1999 period. Production of building industry inputs has also increased over the course of the year, albeit at a pace that was considerably more moderate, accumulating just 2.3% using the same basis of comparison. Insofar as capital goods imports are concerned, imported volumes have followed a gradual upward curve in recent months, indicating that investments in the Brazilian economy have also shifted into a growth curve.

Up to the month of September, the balance of trade registered a surplus of US$ 717 million, as compared to a US$ 775 million deficit in the same period of 1999. Foreign sales increased by 18.2% in relation to the January-September 1999 period, principally as a result of growth of 25.1% in sales of manufactured goods. Here, one should stress increased sales of aircraft, automobiles and transmission/reception equipment. Taken together, in the period under consideration these items accounted for more than 40% of the growth in export revenues involving manufactured products. Iron ore continued as the major export product, accumulating revenues of US$ 2.3 billion in the year up to September.

Utilizing the same basis of comparison, imports increased by 13.6%, due mostly to greater outlays on fuels/lubricants and raw materials. In the first case, imports expanded by 57.1% as a result of higher international prices. Purchases of the latter item expanded by 20.3%, with accentuated growth under imported raw materials. This result was a consequence of increased industrial output and growth in foreign sales of those manufactured goods that are more dependent on imported inputs.

Aggregate supply indicators have registered steady growth during the year, as idle industrial output capacity has declined and both productivity and employment have moved upward.

Industrial output increased by an accumulated rate of 6.9% up to August, based on growth in all use categories. Production of consumer durables continues as the performance leader, with growth of 21.5%, followed by capital goods with expansion of 11.4% in the year. In recent months, output of intermediate goods has expanded at a steady rate of approximately 8% in accumulated terms for the year, while production of semidurable and nondurable consumer goods dropped by 1.1% in the same period of comparison.

According to the National Confederation of Industry (CNI), the level of utilization of installed capacity reached 81.8% in the month of August. Though this is the highest level registered by the statistical series, the possibility of bottlenecks in the flow of goods is limited to a few intermediate goods subsectors.

In the primary sector, IBGE estimates for the month of August indicated growth of 1.9% in the 1999/2000 grain harvest, with a total of 83.9 million tons. Since the previous forecast for the soybean harvest was revised upward by a volume greater than the reduction for the wheat harvest estimated in the most recent survey, the final result was greater than the overall output volume forecast in the previous month.

With regard to the labor market, accumulated data up to the month of August indicate that both employment and productivity have been moving steadily upward, without generating undue cost pressures. Formal employment expanded for the tenth consecutive month, with creation of 775 thousand job positions in the year. With the sole exception of the building industry, all sectors of the economy registered positive employment growth. Open unemployment dropped to 7.14% in August, the seventh consecutive monthly reduction.

External Environment

In recent weeks, concern has mounted as to the real possibility of increasing the supply of crude oil and its derivatives over the coming months, particularly at a time in which demand is also expanding. The result of this worrisome situation has been a high degree of price volatility in recent weeks. The stock levels of these products are considered insufficient, since they were allowed to dwindle as potential buyers initially sought to avoid importing at higher prices. At the same time, the political tensions that have surfaced in the Middle East recently have contributed to a very jittery market.

In the case of the United States economy, the Federal Open Market Committee decided to hold the basic interest target (fed funds) at 6.5% per year at its October 3 meeting. The Committee concluded that recent data point to a more moderate pace of growth under aggregate demand, bringing this variable more into line with the growth potential of the economy. Greater productivity gains have also aided in curtailing costs and attenuating pressures on core inflation, despite a situation of very low unemployment.

The increase in energy costs was noted in a 5.3% high under raw materials in September, resulting in growth of 0.9% in the Producer Price Index (IPP), a level that was considerably higher than the originally forecast rate of 0.5%. Twelve month expansion moved from 3.2% in the previous month to 3.3%. The IPP core rose by 0.3% in September (0.1% in August) as against a forecast level of 0.2%. The accumulated result over twelve months dropped from 1.5% to 1.2% in September.

More recent indicators for the Japanese economy point to improvement in the economic environment. The Tankan Business Confidence Index for the manufacturing sector expanded from 3 to 10 in the period, a full 6 points above the expected mark. At the same time, the index that measures supply and demand conditions increased from –24 to –18 in the period from the second to the third quarters of this year. The jobless rate dropped to 4.6% in August, after holding steady at 4.7% in both June and July. In the month of August, the headings of orders placed with industry, industrial output and new housing starts also moved into a positive growth curve.

Going on to the euro zone countries, signs of increased economic activity are becoming increasingly clearer. Just as expected, July industrial output expanded by 0.5%, raising annual growth to 5.1%, as against 3.7% in June. Unemployment held steady at 9% in August, thus matching the revised June and July figures. On September 22, the Federal Reserve, European Central Bank and Bank of Japan moved to shore up the euro. However, this effort, coupled with an October 5 increase in interest rates, was not sufficient to reverse the slide in the value of the single European currency. The euro’s performance and international oil price highs have contributed importantly to higher inflation in the region, as confirmed by the 0.5% hike in the Harmonized Consumer Price Index for the month of September, which raised accumulated inflation over 12 months from 2.3% to 2.8%. The September result for this index was fully in keeping with expectations.

In Argentina, the oil price high was the item most responsible for growth in exports and the consequent reduction in the country's trade balance deficit. Industrial output in August declined by 2.9%, pushing annual growth down to 1.7%, as against 2.2% in July. Current revenues and expenditures increased by 2% and 1.9%, respectively, from January to August 2000, compared to the same 1999 period.

Prices

Lesser farm product prices and dissipation of the impact of recent increases in government managed prices pushed inflation into a downward curve in September.

The Broad Consumer Price Index (IPCA) rose by 0.23% in September, with 4.87% growth in the year and 7.77% in the last 12 months. The 1.08 percentage drop in relation to August growth was mostly due to a falloff in the growth pace of food and alcohol prices, coupled with a reduction in gasoline and bottled gas prices. The grouping of food and beverages registered a high of 0.53% in the month. The pressures generated in recent months by higher alcohol prices – median increases of 13.44% in July and 16.7% in August – were greatly attenuated in September, as the month closed with growth of just 0.81%. Negative growth in the month was also registered under residential rents, personal hygiene products, pharmaceutical goods and new automotive vehicles.

The September General Price Index – Internal Supply (IGP-DI) increased by 0.69% in September, as against 1.82% in August. This result was due to lesser growth in the

Wholesale Price Index (1.09% against 2.56%), Consumer Price Index (0.04% compared to 0.86%) and Cost of Construction Index (0.26% against 0.39%). The greatest pressures on the Wholesale Price Index (IPA) were generated by farm prices. Though these prices cooled somewhat in the month, they still closed with 2.03% positive growth, while the prices of industrial products rose by 0.67%. An analysis of the Consumer Price Index (IPC) shows that the major product groupings closed quite close to the median range. The IPC core ended September with 0.13% growth, with an accumulated total of 3.81% in the year and 4.39% in the last 12 months.

Prospective assessment of inflation trends

Based on newly available information, already identified shocks and their impacts on the economy were subjected to review. The scenario considered in simulation exercises was based on the following hypotheses:

a. inflation in September (0.23%) was slightly below the expected level (0.4%). The subgrouping of Meals at Home increased by 0.61%, confirming the previous analysis that the shock that had occurred under this heading would be short-lived and its effects rapidly absorbed. Consequently, the forecast of an increase of one percent for food prices in general in the fourth quarter of 2000 was maintained;

b. oil market prices are in the midst of a period of great volatility, as already existent worries have been worsened by growing turmoil in the Middle East. However, notwithstanding slight growth in futures market prices, the structure of futures still points to a succession of monthly declines in 2001. With this, the hypothesis of an additional increase in domestic fuel prices in the current year was maintained in the basic scenario;

c. with regard to other government managed prices, the scenario incorporates the impact of a possible rise in public transportation rates in those municipalities that have not yet authorized an annual increase. The same situation exists in the case of Rio de Janeiro electricity rates. These hypotheses point to an average increase of 12.2% for government managed prices in general in 2000, with a direct impact of 2.8 percentage points on inflation for the year. Insofar as 2001 is concerned, the hypothesis that public service rates will follow the growth pattern estimated for the general indices used in the respective contracts and that other government managed prices will accompany the median increase of the other prices of the economy was maintained;

d. despite increased uncertainty regarding the external environment, particularly the slowdown in the United States economy and devaluation of the euro, the federal fund interest rate trajectory implicit in futures contracts has not changed from the previous level of 6.5% per year, the level utilized in the simulations.

The other hypotheses considered at the previous meeting were maintained, particularly with respect to a primary surplus in keeping with the targets defined in fiscal policy and GDP growth compatible with a state of equilibrium between aggregate supply and demand.

The conclusions drawn from the simulation exercises with this scenario confirm that interest at the current level of 16.5% per year will make it possible to comply with inflation targets up to 2002.

The short-term nonstructural models project inflation at monthly rates of less than 0.4% up to December 2000. In accumulated terms for the year, these models point to a median level of IPCA growth just under 6%.

IPCA core inflation was also presented. The result was a monthly average of 0.4% in the first half of the year, increasing to 0.58% in July and 0.6% in August, before dropping to 0.42% in September. Core inflation measured by the Consumer Price Index – Brazil (IPC-BR), which is released by the Getúlio Vargas Foundation, dropped from 0.27% in August to 0.13% in September, or approximately half the monthly median rate of 0.28% registered in the first six months of the year.

The daily Banco Central market survey indicates that median expectations regarding IPCA growth dropped slightly since the previous Copom meeting. For 2000 as a whole, estimates were revised downward from 6.3% to 6.2%, while the expected rate for 2001 was cut from 4.4% to 4.3%.

Money market and open market operations

For the third consecutive time, the September 20 Copom meeting was marked by a decision to hold the Selic rate target to 16.50% per year with no indication of a bias.

This decision was expected by practically all the financial institutions consulted by DEMAB. Among other factors, this rather conservative posture was justified by the continued volatility of international market oil prices, always at very high levels.

In the period between September 20 and October 17, definitive operations with papers issued by Banco Central and the National Treasury registered contraction of R$ 0.9 billion.

NBCE offers were made on three occasions, with a total placement value of R$ 3.3 billion. In the first two, these papers were negotiated with terms of four years, while the third offer was placed with a five year term.

The National Treasury effected eight LTN sales, with a total financial value of R$ 9.6 billion. Redemptions came to R$ 8.5 billion, of which R$ 2.2 billion represented early redemptions through public purchase offers encompassing three maturities. Interest on LTN placements with maturities of six months and one year followed a slightly downward curve.

LFT were offered on four different occasions, with a total value of R$ 4.7 billion, while redemptions added up to R$ 4.2 billion. There was also a renewed offer of five year NTN-C, with a total value of R$ 0.5 billion.

Banco Central acted on seven different occasions over a total period of 19 business days, with the aim of managing very short-term secondary market interest rates. In all of these interventions, federal securities with resale commitments were purchased, in order to eliminate excess banking reserve market demand.

Monetary policy guidelines

The growth pace of economic activity has remained solid and steady and well within parameters considered compatible with continued price stability. With the increased supply of credit and greater consumer confidence, aggregate demand indicators point to robust expansion. The value of imports has risen in comparison to last year, principally as a consequence of increased outlays on fuels and lubricants, but also due to larger purchases of raw materials. One of the driving forces underlying this expansion has been growth in exports of manufactured products.

Industry has responded adequately to increased demand by expanding not only average utilization of output capacity, but output capacity itself. Potential bottlenecks in the future output flow of some productive sectors of the economy should be avoided through increased investments. At the same time, the prospects of a plentiful farm harvest will certainly contribute to favorable expectations regarding next year's total output.

Following a brief peak in previous months, the September decline in inflation further strengthens the thesis that there is a very low degree of inertia in the economy at present. This thesis supports expectations of a further decline in inflation in October. For the year, Copom has maintained its expectations, even considering the possibility of an increase in government managed prices by the end of the year (public transportation and fuels).

Nonetheless, there is a significant risk factor in the external scenario. The volatility of international oil prices has worsened. Though futures market operations have pointed in the direction of a price decline during the course of the year, one should not expect anything less than US$ 27 per barrel for Brent crude up to the end of next year. Parallel to this, the prices of the foreign securities of emerging markets, particularly in Latin America, have been marked by increasing volatility, due to a great extent to uncertainties generated by the troubles in the Middle East and by devaluation of the euro. It was concluded, however, that the underlying conditions of the international economy do not seem to have changed in any substantial way since the previous Copom meeting. Growth prospects have improved for Japan and are still quite good for the euro zone, despite the considerable uncertainty generated by the steady weakening of the new currency. In the United States, the trajectory implicit in futures contracts does not point to any probability of a change in basic interest rates in coming months.

In the light of these factors, Copom decided to maintain the basic interest rate of 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 November 21, 2000 at 3:00 PM, for technical presentations and on the following day, at 4:30 PM in order to discuss monetary policy guidelines.

Ilan Goldfajn