BANCO CENTRAL DO BRASIL – *FOCUS*

March 30, 2000

MINUTES OF THE 45th MEETING OF THE BANCO CENTRAL DO BRASIL MONETARY POLICY COMMITTEE (COPOM)

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Date: 03.21-22.2000

Place: 8th floor meeting room Banco Central Headquarters – Brasília – DF

Called to order: 4:15 PM on 03.21 and 5:25 PM on 03.22

Adjourned: 5:20 PM on 03.21 and 7:30 PM on 03.22

In attendance:

Members of the Board

Armínio Fraga Neto – **Governor**

Carlos Eduardo de Freitas

Daniel Luiz Gleizer

Edison Bernardes dos Santos

Luiz Fernando Figueiredo

Sérgio Darcy da Silva Alves

Department Heads

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:

Alexandre Pundek Rocha – Advisor to the Board

Gustavo Bussinger – Consultant to DEPEC

Sérgio Goldenstein – Advisor to the Board and Executive Secretary of COPOM

João dos Reis Borges Muniz – Press Advisor **(ASIMP)**

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

Demand indicators in the first two months of 2000 registered positive results, with clear signs of expanding consumption. Consumer credit demand continued on an upward curve. Investment indicators show that the recovery begun toward the end of 1999 has continued. Parallel to these results, the ongoing fiscal adjustment process is evident in the January primary consolidated public sector surplus.

Industrial sales of automotive vehicles in February expanded by 18.3% in comparison to the previous month, with 9.3% growth under exports and 20.1% under internal sales. Sales of farm machinery increased by 7.4% (87.9% under foreign sales and 4.8% under internal market sales) when compared to January. In accumulated terms for the year, sales of automotive vehicles expanded by 64.5% while marketing of farm machinery dropped by 7.3%. One should note that these figures were impacted by the greater number of business days in February 2000.

Sales by factory authorized vehicle outlets rose by 11.4% in February, based on data purged of seasonal influences. This performance was led by trucks (40.5%) and light commercial vehicles (11.3%). Sales of automobiles, farm machinery and buses increased by 10.9%, 9% and 5.5%, respectively. In the month of February, stocks increased by 11.8% to 85.6 thousand units.

According to the Credit Protection Service (SPC), the net default rate in São Paulo came to 12.3%, as compared to 7.3% in January. In Rio de Janeiro, defaults came to 2.7%, as against 1.7% in January, according to Teledata.

With the sole exception of construction industry inputs, investment indicators for February showed positive growth. In the seasonally adjusted statistical series, production and imports of capital goods expanded by 2.3% and 14% in January, respectively, as against 2.7% and –11.3% in the preceding month.

Private sector credits declined by 0.3% in January. However, in the case of consumer credit operations, growth came to 2.1%. Even more important, the 12 month period ended with expansion of 17% under this heading and a stable level of defaults.

In the month of January, the consolidated public sector registered a primary surplus of R$ 4.1 billion and a nominal deficit of R$ 2.7 billion. The net debt totaled R$ 523 billion, corresponding to 47.2% of GDP. The total securities debt reached a January level of R$ 435 billion, equivalent to 39% of GDP. The debt indexed to exchange has been declining steadily and reached a January total of 22.9%, the lowest point since December 1998.

In the first two months of the year, exports expanded by 21.9% in comparison to the same 1999 period. Foreign sales of manufactured goods increased by 30% and marketing of semimanufactured products rose by 22.1%. Basic products turned in the lowest rate of growth, with 0.5%. In terms of the markets to which these goods were shipped, sales to the United States increased by 37.9%, while operations with Japan expanded by 40% and growth of 28.5% was registered in operations with the Laia countries. In the two month period under consideration, imports increased by 11.5%, with growth of 78.9% under purchases of fuels and 21.9% under raw materials, while imports of capital goods and consumer goods dropped by 7.9% and 7.7%.

In 1999, the price index for export operations declined by 12.8%, while the quantum index for the foreign sales sector increased by 7.7%. In January, the prices of semimanufactured goods turned in recovery of 4.2% when set against January 1999, in the series from which seasonal impacts have been eliminated. The price index for import operations increased by 0.4% in 1999, with the most important growth occurring under fuel prices (19.9%). The quantum index for imports dropped by 15% in 1999, with a reduction of 49.5% under consumer durables and 22% under nondurables. The imported volumes of capital goods, raw materials and fuels decreased by respective rates of 18.9%, 8.4% and 16.8%.

Supply indicators point to continued upward growth, with high levels of utilization of installed output capacity and industrial production, coupled with an ongoing process of job generation in the industrial sector. At the same time, expectations of growth in this year’s grain harvest remain solid.

In the month of January, industrial output expanded by 5.4% when compared to the same month of the previous year. Output levels are quite close to those of the third quarter of 1997, while the average level of utilization of installed output capacity is nearing that of the first quarter of 1995, the highest since implementation of the Real Plan. Based on figures purged of seasonal influences, the tendency under industrial production in February is positive, particularly in light of clear signs of improvement in automotive production, consultations with SPC/Telecheque, shipments of corrugated cardboard, gross steel output, hours worked in the manufacturing sector and the sector's consumption of electric energy. The FGV's Industrial Survey of the Manufacturing Sector was able to perceive intentions to increase installed output capacity by 10% by the end of this year.

The rise in the jobless rate from 6.28% in December to 7.63% in January was clearly seasonal in nature and in no way jeopardizes the tendency to recovery. The National Confederation of Industry (CNI) registered growth in industrial employment since October, while the Federation of Industries of the State of São Paulo has perceived this trend since September. The weekly Fiesp survey in the month of February confirmed this trend, registering creation of 2,230 new job positions in São Paulo.

In the month of January, formal employment rose by 0.2% (+0.3%, when purged of seasonal factors), with 31.2 thousand new jobs, compared to January 1999 which was marked by the loss of 41.1 thousand. On a sector-by-sector basis, a comparison with the month of December points to employment increases of 0.4% under commerce, 0.3% under manufacturing and 0.2% in the construction industry and service sector. All of these results are based on data from which seasonal factors have been gleaned.

External environment

In the fourth quarter of 1999, the United States GDP expanded by 6.9%, reflecting annual growth of 4.1% in the year as against 4.3% in the previous year. Aggregate demand has continued expanding, based on the first demand indicators for 2000. Consumer credit operations increased at an annualized monthly rate of 14.6% in January. Retail sales expanded by 0.39% in January and 1.09% in the following month, based on seasonally adjusted data. In 1999, exports and imports increased by 1.9% and 12.3%, respectively, in relation to 1998, as the trade deficit closed at a level of US$ 347.1 billion, as compared to US$ 247 billion in the previous year.

February industrial output expanded by 5.6% over a 12 month horizon, without generating any perceptible pressures on the job market. The jobless rate increased from 4% in January to 4.1% in February, while average hourly wages increased by 3.6% in comparison to February 1999. The price trajectory reflected the impact of petroleum price hikes. The producer price index rose by 1% in February and closed at a twelve month level of 4%. The consumer price index expanded by 0.5% in February (3.16% in twelve months), though the core increased by only 0.2% (2.1% in twelve months). In this framework, the federal fund interest rate target was raised by 0.25 percentage points on

March 21 to a level of 6% per year.

In the fourth quarter, data purged of seasonal impacts indicate that the Japanese GDP declined by 5.5% in annualized terms in relation to the previous quarter. Consequently, reflecting the no more than modest reaction of private spending, it is estimated that the Japanese economy closed 1999 with growth of just 0.3%, as compared to a decline of 2.5% in the previous year. In 1999, exports expanded by 8.3% and imports grew by 10.9%, with growth of 1.4% in the trade surplus expressed in dollars. New housing starts increased by 16.8% in January, when compared to the same month of 1999.

The Euro Zone economy has registered sustained growth, with rising internal and external demand. In 1999, the regional GDP expanded by 2.1%, as consumer spending increased by 2.6% and the trade surplus came to US$ 63.1 billion. Industrial output increased by 3.1% in December and 4.4% in January, when compared to the same months of 1998 and 1999. During this period, the jobless rate held steady at 9.6%. The M3 monetary aggregate increased by 5.7% in January, surpassing the reference rate of 4.5%. In the month of February, the harmonized consumer price index closed at 2%, the upper limit of the informal target range defined by the European Central Bank. In February and March, that institution raised the basic interest rate by 0.5 percentage points to a level of 3.5%.

The Argentine GDP declined by 4.1% in the third quarter of the year in comparison to the same quarter of the previous year. However, activity indicators point to recovery in the fourth quarter. In 1999, foreign sales decreased by 12% in value, while imports dropped by 19%, resulting in a 56% drop in the trade deficit. Industrial output fell by 1.7%, in comparison to December, with growth of 3.2% when compared to the same period of 1999. In 2000, a stronger reduction in interest rates on peso deposits cut the differential in relation to earnings on dollar deposits.

Prices

For the most part, the downward trajectory under general price indices has resulted from deceleration in wholesale prices, concentrated mostly under farm prices. Despite currency valuation, the lesser pace of deceleration in industrial prices was due to price rises under plastics, iron, steel and derivatives and sugar. Viewed over a twelve month horizon, growth in the general price index – 10 (IGP-10), general price index – market (IGP-M) and general price index – domestic supply (IGP-DI) closed at February levels of 18.03%, 16.78% and 14.96%, respectively, as compared to December results of 20.09%, 20.1% and 19.98%, in the same order.

The performance of consumer prices in the month of February demonstrated that the seasonal pressures generated by *in natura* foodstuffs and education outlays evident in the previous month had been dissipated. Another cause of the sharp downturn in these indices were clothing clearance sales and the ongoing downward movement in the prices of other food products. The accumulated 12 month rates closed at 6.95%, 8.04% and 7.86% in the month of February, viewed against corresponding December figures of 8.64%, 9.12% and 8.94%.

In the first two months of the current year, the inflationary pressures that had marked the final months of 1999 were dissipated, principally with regard to primary sector prices. The reasons underlying these results were the start of the current annual farm harvest and gradual normalization of the supply of animal protein. In the current quarter, there are no significant signs of other factors with the potential for altering the downward trajectory of inflation, with the sole exception of the direct impacts of the recent upward movement in fuel prices.

The Getúlio Vargas Foundation has begun issuing its figures for core inflation expressed by the IPC-Br. The methodology chosen is that of recalculating inflation for each month, after removing the highest and lowest price changes from the index components (percentiles below 20 and above 80). In the case of prices that normally increase just once per year, the increase is spread over 12 months, thus avoiding the systematic withdrawal of this result from the core. The resulting indicator confirms the analysis above: the core did in fact remained steady in the range of 0.5% between October and January, dropping to 0.17% in February.

Prospective assessment of inflation trends

An evaluation of the inflation outlook required identification of shocks with potential for generating impacts on future price level trajectories. Those identified are basically the same as discussed at the previous Copom meeting, though their impacts were re-evaluated in light of information that has become available since that meeting. Consequently, the basic scenario analyzed is premised by the following hypotheses: fed fund rates and international petroleum price trajectories based on those implicit in the respective futures contracts for these two segments; average increase of 11.2% in government managed prices in 2000, with a direct impact of 2.6 percentage points on growth in the broad consumer price index (IPCA), corresponding to a marginal contribution of 1.8 percentage points to annual inflation; rise in the minimum wage to R$ 150; farm sector neutrality as regards pressures on prices during the entire year, though the expected seasonal increase in the supply of farm products in the first half of the year was given due consideration; and a fiscal policy that complies with the target for the accumulated consolidated public sector primary surplus of 3.25% of GDP in 2000, thus making a highly positive contribution to price stability; outlook for positive growth in the world economy, thus generating international market liquidity conditions that will ensure a comfortable margin for financing the balance of payments.

Once the central scenario had been presented, simulations were made of the different economic models based on alternative scenarios. The major differences in relation to the first scenario were concentrated under oil prices and the so-called Brazil risk. Based on the simulation exercises with the central scenario, the conclusion was drawn that maintenance of interest rates at their current level would make it possible to comply with inflation targets for 2000 and 2001. The impact of the shocks foreseen for the second and third quarter influence this conclusion. Should the intensity of these shocks be less than expected, the greater will be the leeway for complying with the targets. However, given the lag that exists in terms of the aggregate demand passthrough mechanism, current monetary policy will generate impacts only in the final quarter of this year.

Short-term forecasts were made together with leading indicators for inflation. The results point to an upward trend in the second quarter of 2000. More specifically, the leading indicators foresee pressure on prices starting in the month of April.

Measured by the IPCA, median inflation expectations gathered through the daily Banco Central survey were still slightly above the inflation target for 2000 (6.5% as against the target of 6%) on March 21. since the month of February, these expectations have been consistently revised downward.

Money market and open market operations

At its meeting on February 15 and 16, COPOM maintained The Selic rate unaltered at 19% per year, with no indication of a bias.

From February 16 to March 21, definitive operations with papers issued by Banco Central generated a contractive monetary impact of R$ 0.4 billion, based on net redemptions of debt indexed to exchange. One should note that NBCE with terms of four years were placed.

From February 15 to March 20, the National Treasury held 10 traditional LTN auctions, with total placements of R$ 18.4 billion, as compared to redemptions of R$ 8.5 billion. In the five auctions of six month LTN, the average rates were systematically reduced from 19.94% to 19.10% per year. In the other events in which papers with terms of one year were negotiated, the average rates also moved downward, fluctuating between 20.35% and 19.44% per year. In the case of the secondary market, the National Treasury held two LTN purchase auctions with the objective of lessening the concentration of redemption volumes. These events were forecast in the schedule released at the end of the month of February.

As part of the National Treasury’s efforts to create the conditions required for development of the secondary market for these papers, the third NTN-C offer was implemented in two stages on February 28 and 29. Total sales came to one million securities, of which 62% had three year maturities and the remainder had seven year maturities. The new format adopted for the auction in question made it possible for the liquidation percentage for securitized credits to reach 35.26% of the total sale of R$ 279 million, as compared to 25.84% in the previous event.

The Central Bank operated on the open market on seven occasions spanning a period of 22 business days. All of these operations were designed to withdraw funding. The shift downward of the forward interest rate structure can be attributed to improvement in the internal scenario, particularly as regards inflation. On the day following the Copom meeting, February 17, the future interest rate curve was positive, with 18.75% per year, for the first maturity, and 19.25% per year for maturity in one year. On March 20, the inclination had turned negative: 18.64% per year and 18.22% per year, respectively.

Monetary policy guidelines

An analysis of supply and demand demonstrates that there are no significant imbalances capable of generating pressures of importance as regards the relevant horizon of the inflation target system. Consumption and credit indicators confirm the outlook for strong improvement during the course of 2000, but do not point to any risks for the balance of supply and demand and, therefore, cannot be considered a source of inflationary pressures. The austere fiscal policy has contributed positively to price stability and to reduction of the Brazil risk. The foreign sector, particularly the balance of trade, has evolved at a more favorable pace since December and has been marked by substantial improvement under exports, especially in volume terms. In these early months of 2000, foreign capital flows have confirmed improvement in foreign financing conditions. In much the same way, a careful analysis of the farm harvest reveals no expected pressures for the year.

The overall framework is one of price stability, though the supply shock represented by the international oil price hike and increases in government managed prices, forecast for the second and third quarters of the year, are risk factors that deserve careful analysis. Aside from these factors, due consideration should be given to the possibility of an increase in the value of the minimum wage coupled with delegation of authority to the states to define higher regional minimum wage parameters.

The principal mechanism for monetary policy transmission to inflation is aggregate demand. The estimated lag between a change in interest rates and the impact of that change on price levels is between six and nine months. Thus, current policy will impact inflation in a way that will be perceptible only in the final quarter of the year. The monetary policy followed in the last six months was designed as an advance reaction to the increase expected in inflation in the two quarters of this year expected to be impacted by the aforementioned shocks, as well as to other factors considered to constitute risk to future inflation trends, such as the tendency toward increasingly more restrictive monetary policies in the major industrial economies.

Though the possibility of a cutback in interest rates was considered possible, Copom decided to hold the Selic rate at 19% per year and indicate a downward bias. This prerogative is used when the level of uncertainty recommends adoption of a more flexible stance on the part of the monetary authority. In this case, the lessening of the uncertainties surrounding oil prices (the upcoming OPEC meeting) and a solution to the minimum wage question in the coming days should make it possible to create a more solid foundation for an interest rate cutback.

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 April 18, 2000, at 3:00 PM, for technical presentations and on the following day, at 4:30 PM in order to discuss monetary policy guidelines.

Sérgio Goldenstein

Executive Secretary of COPOM