BANCO CENTRAL DO BRASIL – *FOCUS*

February 04, 2000

MINUTES OF THE 43nd MEETING OF THE BANCO CENTRAL DO BRASIL MONETARY POLICY COMMITTEE (COPOM)

Date: 01.18.2000 and 01.19.2000
Place: 8th floor meeting room Banco Central Headquarters – Brasília – DF
Called to order: on date 01.18 at 3:55 PM and on date 01.19 at 06:40 PM
Adjourned: on date 01.18 at 7:10 PM and on date 01.19 at 7:20 PM

In attendance:
Members of the Board
Armínio Fraga Neto – **Governor**

Carlos Eduardo de Freitas
Edison Bernardes dos Santos
Luiz Fernando Figueiredo
Sérgio Darcy da Silva Alves
Sérgio Ribeiro da Costa Werlang

Department Heads

Altamir Lopes – Department of Economics **(Depec)**
Daso Maranhão Coimbra – International Reserve Operations Department **(Depin)**
José Antônio 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 – Senior Advisor to the Board
Sérgio Goldenstein – Senior 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 supply and demand

Signs of expansion in aggregate demand began to appear toward the end of 1999. Growth occurred under industrial sales and check and credit card transactions and was accompanied by a moderate increase under banking credit, all in a framework of declining default levels.

In November, the supermarket segment and wholesale trade sector turned in nominal growth of 16.4% and 20.9%, respectively, when compared to the same month of the preceding year. In the retail sector, real revenues in five metropolitan regions accumulated a 4.41% drop in the year up to November. However, when one excludes factory authorized vehicle sales outlets from this calculation, the final result was very close to stability (0.23%).

In December, automotive sales expanded by 2.9%, with growth of 10.2% under exports and a 1% decline under internal market sales. Marketing of farm machines increased by 12.2%, with positive growth under both exports (28.6%) and internal market sales (7.8%).

With exception of the São Paulo retail trade sector, the first signs of credit growth became evident and were paralleled by a generalized drop in default levels. Based on expanded credit operations with the trade (4.2%) and rural sectors (2.6%), normally performing loans extended to the private sector by the financial system increased by 0.8% in November. Defaults in the private financial system have followed a downward trajectory since May 1999. In the public financial system, the default level moved into a downward curve in the September-November quarter. In the month of December, credit card transactions increased by 30.6% and the volume of checks cleared expanded by 1.9%. A comparison with December 1998 shows growth figures of 20% and –5.3% in the same order, indicating considerably less intense utilization of checks as a payment instrument.

In the month of January, the consumer confidence index (ICC), which is released by the Trade Federation of the State of São Paulo (FCESP), turned upward. The highlights of this index were the items expectations, with an increase from 120.8 to 128.7, and current economic conditions, with growth from 65.4 to 72.7.

In accumulated terms for the year up to November, investment indicators registered negative growth rates. Output of capital goods and building industry inputs dropped by 10.2% and 3.9% in the year, with a less intense decline in the final six months. The rate of gross fixed capital formation in the third quarter of the year came to 17.9% of GDP at current prices, as against 18.1% of GDP in the previous quarter.

In the month of November, the consolidated public sector primary surplus came to R$ 758 million, raising the accumulated total in the year to R$ 32.8 billion, compared to the target of R$ 27.8 billion specified in the agreement with the IMF. When one excludes the impact of alterations in the rate of exchange on the internal debt indexed to exchange, the nominal public sector deficit closed at R$ 3.1 billion.

In 1999, export and import operations declined by 6.1% and 14.8% in relation to the previous year. The trade balance registered a deficit of US$ 1.2 billion in the year, as against US$ 6.6 billion in 1998. One should stress, however, that export volumes have increased since July while foreign market prices have shown signs of recovery since August. In the case of imports, the volume index registered moderate growth in October and November, while average prices have risen sharply since the second quarter of the year, mostly as a consequence of oil price hikes. In 1999, the service account accumulated a deficit of US$ 25 billion, as against US$ 28.8 billion in the preceding year. The 27.7% increase in interest payments was more than offset by a 42.3% reduction under net outlays on other headings, particularly international travel, profits and dividends and transportation. The 1999 current account deficit of US$ 24.4 billion was easily financed by an inflow of US$ 30 billion in direct foreign investments (23% greater than the deficit).

Supply indicators suggest a moderate degree of recovery toward the end of 1999. In the seasonally adjusted series, November industrial output remained stable, with growth of just –0.1%, while expansion in December is estimated at 2.4%. A breakdown of November industrial output by category of utilization shows that production of capital goods increased by 1.2% and output of intermediate goods expanded by 0.7%. Reflecting stability in the output of consumer durables and a 1.8% reduction in semidurable and nondurable consumer goods, the heading of consumer goods in general closed with a decline of 2%.

Labor market indicators now point to a gradual decline in the jobless rate. In 1999, average unemployment closed at 7.56% as compared to 7.60% in the previous year. In the month of December, unemployment dropped to 6.28% following 7.32% in November, reflecting growth of 0.84% in the number of jobholders and a reduction of 0.29% in the economically active population.

External environment

In the United States, indicators point to a high level of aggregate demand with potential imbalances in relation to the pace of growth in supply. However, it should be noted that price indices have not revealed any significant sources of consistent pressures. Retail sector sales increased by 1.2% in December and closed with 9.7% expansion in the year, with record vehicle sales of 16.8 million units in 1999. In the series purged of seasonal factors, consumer credit operations expanded by 4.6% in October and 13.7% in November. Real estate construction rose by 0.12% in October. The October balance of trade (goods) closed with a negative US$ 33.7 billion and an accumulated deficit of US$ 283.5 billion in the year.

The growth trajectory under output remained strong. Based on seasonally adjusted data, GDP expanded by an annualized rate of 5.7% in the third quarter (revised) in relation to the previous quarter. Industrial production expanded by 0.4% in December, closing with accumulated growth of

5% in 1999. Average hourly wages increased by 0.15% in November, in comparison to the previous month and 3.9% when compared to November 1998. The rate of unemployment has remained stable at 4.1% since October.

Price trends continue favorable. The consumer price index (CPI) increased by 0.2% in December, with accumulated growth of 2.7% in the year. The CPI core increased by 0.1% and 1.9%, in the same periods. The producer price index (PPI) and its core increased by 0.1% in December, accumulating respective growth rates of 3% and 0.9% in 1999. A breakdown of the PPI pointed to expansion of 15.8% under raw materials and 3.9% under intermediate goods.

In Japan, growth in aggregate demand is still highly tenuous and reflects moderate growth in private consumption, downward movement in public and private investments and foreign sales that were impacted negatively by valuation of the yen. The trade surplus dropped to US$ 6.3 billion in November, reflecting growth in import demand and valuation of exchange. On the supply side, the situation can be summarized in low stock levels and high levels of utilization of installed production capacity. The rate of unemployment continued on a downward curve and closed November at 4.5%, when compared to 4.9% in July. Real wages have registered positive growth in recent months.

In the Euro Zone, the economy has begun expanding at a more consistent pace and this has been reflected in both product and industrial output. In the third quarter of the year, GDP expanded by a seasonally adjusted rate of 4.2% in annualized terms, in relation to the previous quarter. Unemployment has moved steadily downward and closed November at 9.8%. The monetary aggregate M3 increased by 6.2% in November in comparison to the same month of 1998. The harmonized IPC expanded by 1.5% in twelve months up to November, as compared to 1.4% up to October.

Based on data from which seasonal factors have been removed, GDP in England expanded by 3.1% in the third quarter in annualized terms, when compared to the preceding quarter. In the face of doubts regarding the possibility of sustaining the rate of growth, the Bank of England introduced a preventive increase in basic interest rates of 25 base points to a level of 5.75% in January 2000.

Industrial output in Argentina increased by 1.5% in November, registering the fourth consecutive month of positive growth. However, in accumulated terms for the year, the final result was a decline of 8.3%. The 1999 fiscal deficit came to US$ 6.9 billion or considerably more than the US$ 5.9 billion level predicted by the government. At the provincial level, the deficit came to US$ 3.7 billion, as against an expected negative result of US$ 1.7 billion.

Prices

In 1999, the broad consumer price index (IPCA) expanded by 8.9%. This result was consistent with the annual inflation targeting system that has been used as the basic monetary policy guideline since the month of June. The target defined for 1999 was annual IPCA growth of 8%, with upward or downward deviations of up to two percentage points.

In December, the pace of price increases slowed. Wholesale price indices reflected drops in farm and industrial prices, while consumer price indices showed that the impact of earlier alcohol and gasoline price increases had been fully absorbed. In December, IPCA expanded by 0.6%, as compared to 0.95% in the previous month.

In 1999, the general price index – internal supply (IGP-DI) and general price index – market (IGP-M) increased by 19.98% and 20.10%, respectively. However, the strongest growth occurred under the wholesale price index – internal supply (IPA-DI), with 28.9% in the year. The consumer price index – Fipe (IPC-Fipe) accumulated growth of 8.6% in the period.

According to a Banco Central survey, the expectations of analysts with regard to the major price indices in the first quarter of 2000 point to lower inflation, particularly in general price indices.

Prospective assessment of inflation trends

Any evaluation of the inflationary outlook should begin with identification of shocks capable of impacting the future price level trajectory. The potential shocks cited in both the December Inflation Report and at the previous Copom meeting remain essentially valid. The basic scenario considers an increase in federal fund rates that has already been absorbed by futures markets; an average 9.2% increase in prices set by the public sector in 2000; farm sector neutrality with respect to price pressures during the year, already taking due account of the seasonal increase in agricultural products in the first half of the year; and fiscal policy compliance with the R$ 36.7 billion target for the consolidated public sector accumulated primary surplus in 2000, with highly positive influence in terms of price stability.

In relation to the macroeconomic environment considered in the December Inflation Report, the major difference is elimination of the doubts that had generated considerable wariness within highly computerized sectors of the economy as regards transition to the new century. With respect to the rate of exchange, the process of valuation of the nation’s currency that began in December was confirmed in average terms in the first half of January. This process has been further strengthened by sharp declines registered in the value of the risk premium on Brazilian sovereign debt papers since the fourth quarter of 1999.

Based on alternative scenarios that deviate slightly from the core scenario, economic models were subjected to a series of simulations. These simulations lead to the conclusion that maintenance of interest at current levels will, with a high degree of probability, make it possible to comply with inflation targets in 2000 and 2001.

Short-term forecasts as well as antecedent inflation indicators were presented. Analysis of these results leads to the conclusion that inflation will tend downward in the early months of 2000. In more specific terms, antecedent indicators suggest a more abrupt drop in inflation in the month of February. It should be noted that January results still tend to reflect the supply problems that occurred under fruit and vegetables as a result of prolonged rain in the southeast region. At the same time, they also incorporate the seasonal factors characteristic of the start of the school year.

According to the daily survey carried out by Banco Central, expectations of inflation according to the IPCA, measured on January 18, indicated a median rate higher than the target for 2000 (6.94% as against a target of 6%).

Money market and open market operations

On December 15, 1999, Copom not only maintained the Selic rate target unaltered at 19% per year but also resolved, once again, not to indicate a bias. This decision was in keeping with the expectations of practically all the participating market institutions consulted.

Between December 16, 1999 and January 18, 2000, the National Treasury carried out three LTN sales auctions, one LTN purchase auction and two LFT sales auctions. No alterations were introduced into the programming of market security placements previously announced by the National Treasury.

Definitive operations with Banco Central papers were, once again, restricted to sales of two year NBCE. The three NBCE auctions were carried out at uniform prices and had the objective of rolling the maturing debt since they resulted in net placements of just R$ 49 million. One should note that, since December 28, 1999, the NBCE coupon has been defined in each issue notification.

Continuing its efforts to construct a more dynamic federal securities secondary market, Banco Central intervened in the money market on ten different occasions for a total of 24 business days. The objective was to manage the financing cost of these papers in situations marked by imbalances in banking reserves.

Analyzing the January 17 position of interest rate forward operations, one notes a shift into a downward curve. At the same time, one perceives that the interest curve is practically horizontal, with one year swap operations generating 20.65% per year as compared to the Selic rate target of 19% per year.

Monetary policy guidelines

Analysis of supply and demand reveals an absence of imbalances capable of generating inflationary pressures for the inflation targeting system in the foreseeable future. Consumption and credit indicators point to a process of still tenuous recovery with an outlook for considerable improvement during the course of 2000. However, they do not stand as risks to supply and demand equilibrium and, consequently, are not considered sources of inflationary pressures. Fiscal policy will remain austere and will contribute positively to price stability. Since December, the foreign sector – and, more precisely, the trade balance – has performed well and one can expect strong improvement in export operations. Having overcome the sense of wariness that dominated highly computerized systems during the transition to the new century, the early days of 2000 were marked by strong capital inflows and improvement in foreign financing conditions. Monitoring of the farm harvest reveals no significant price pressures during the year.

The overall scenario is more conducive to price stability than in the period prior to the previous meeting of the Committee. Monetary policy decisions are taken on the basis of evaluation of a series of factors that, one way or another, introduce risks in terms of the future evolution of inflation, including: 1) growth in public sector prices and tariffs during the course of the year, with potential for exerting pressure on the inflation trajectory independently of supply and demand conditions; 2) a trend to gradually more restrictive monetary policies in the United States, England and Euro Zone during the year; and 3) the behavior of international oil prices which, at the moment, are being pressured by the harsh winter season in the United States.

The decline in inflation measured by the IPCA from November to December points to convergence to a trend that is more compatible with inflation targets. However, the first figures for January inflation, particularly as measured by the consumer price index (IPC) of the general price index – market (IGP-M), suggest a rather modest drop in relation to December 1999. However, it should be noted that several seasonal factors – such as those consequent upon the start of the school year and fruit and vegetable supply problems caused by heavy rain in the southeast region – have impacted this performance.

Having analyzed the economic scenario and the outlook for 2000, Copom resolved to maintain the Selic rate target at 19% per year, with no indication of a bias.

At the close of the meeting, it was announced that the Committee would meet again on February 15, 2000, at 5:00 PM, for the technical presentations and on the following day, at 4:30 PM in order to discuss monetary policy guidelines, as called for in the Schedule of Ordinary COPOM Meetings, released by Banco Central Communiqué no. 7,228, dated 01.19.2000.

Sérgio Goldenstein

Executive Secretary of COPOM
