BANCO CENTRAL DO BRASIL – FOCUS

July 6, 2000

MINUTES OF THE 48th MEETING OF THE BANCO CENTRAL DO BRASIL MONETARY POLICY COMMITTEE (COPOM)

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Date: 06.19 and 20.2000

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

Called to order: 3:50 PM on 06.19 and 5:05 PM on 06.20

Adjourned: 7:15 PM on 06.19 and 7:30 PM on 06.20

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

Sérgio Ribeiro da Costa Werlang

Tereza Cristina Grossi Togni

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 – Advisor to the Board
Gustavo Bussinger – Advisor 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
In the first four months of the year, growth in consumption and investment indicators was driven by expanded exports, improved expectations on the part of economic agents, an increased credit supply and declining banking system interest rates. However, more recent information points to a lesser growth pace in aggregate demand.

In the metropolitan region of São Paulo, real revenues of the retail trade sector expanded by 12.4% in April in the seasonally adjusted series, raising accumulated growth for the year to 10.6%, despite an only moderate increase in May (0.2%). In accumulated terms for the first four months of the year, sales of goods of higher unit value accounted for growth in real revenues, particularly in light of the improved conditions available on the credit market. Sales of durable consumer goods increased by 21.4% in relation to the same period of the previous year, while sales of construction material increased by 9%, with 8.7% expansion under automotive sales.

In the month of May, credit card transactions dropped by 2.3% following a 6.5% rise in the preceding month, while the volume of checks cleared in the month increased by 0.6%, as against 0.9% in the previous month. Consultations with the Credit Protection Service (SPC) came to 9.6% in May, following 13.6% growth in April. It should be emphasized that data for the month of June, accumulated up to the 13th of the month, registered reductions of 12.2% in consultations with the SPC and 2% in those with the Telecheque service, in comparison to the same period of the previous year.

The balance of credit operations with nonearmarked resources increased by 4.9% in May, raising accumulated twelve month expansion to 35.7%. Credits granted to individuals rose by 6.6% in the month, with accumulated expansion of 60.7% in the year and 58.4% over 12 months. The most important components of this heading were personal credit operations and financing of acquisitions of goods. Operations channeled to businesses increased by 3.6% in the month, with accumulated expansion of 22.3%

in the last 12 months.

According to SPC figures, the net rate of default in São Paulo came to 9.6% in May, as compared to 16.7% in the same month of last year. A ten city survey performed by Teledata revealed a default level of 1.8% in comparison to 2% in May 1999.

Following three consecutive months of decline, the Consumer Confidence Index (ICC), released by the Trade Federation of the State of São Paulo (FCESP), came TO 99.5 in June, compared to 94.4 in May, with growth of 3.6% over June 1999. In relation to May, the index rose by 7.7% under the item of current economic conditions and 4.5% under consumer expectations.

Insofar as industrial sales are concerned, the automobile industry turned in growth of 23% in the year up to the month of May, with expansion of 54.9% in exports and 16.3% in internal sales. Foreign sales of farm machinery increased by 27.5% in the same period.

Investment indicators closed the first four months of 2000 with positive growth. In the seasonally adjusted series, production of construction inputs increased by 2% in April and 1.8% in accumulated terms for the year. Output of capital goods expanded by 6% in the first four months of the year, while the volume of capital goods imports declined by 7.2% in the same period, reflecting the impact of the change in the nation’s exchange system on national capital goods production.

The consolidated public sector result turned in a surplus of R$ 17.3 billion in the year up to April, a total that was R$ 1.1 billion above the target defined for the first half of the year in the government's economic program. The net public sector debt came to R$ 536.2 billion in April, corresponding to 47.5% of GDP.

From January to May, the trade balance registered a surplus of US$ 601 million, reducing the accumulated 12 month deficit to US$ 132 million. In the current year, bilateral trade deficits with such important partners as the United States and France were reversed, while deficits in operations with Argentina, Germany, Japan and Italy declined sharply. The nation's surplus position in trade operations with Mexico, the United Kingdom and Chile increased further, while the deficit in operations with Venezuela also grew, in this case as a consequence of higher outlays on crude oil.

Exports increased by 17.4% in relation to the first five months of 1999 and were driven principally by growth of 23.2% under sales of manufactured goods. Among these products, the most important were aircraft, transmission / reception devices and passenger cars, with revenue growth of 105.4%, 144.7% and 66.3%, respectively. Foreign sales of semimanufactured products increased by 11.9% while exports of basic goods grew by 3.5%. Iron ore was the principal product among the nation's exports, with an accumulated total of US$ 1.2 billion, for growth of 13.5%.

In the same period of comparison, imports increased by 11.2%. Outlays on purchases of fuels and lubricants increased by 49.6%, due to the increase in petroleum prices. Imports of raw materials and intermediate goods expanded by 22.4%, as a consequence of an upturn in industrial output.

Aggregate supply indicators continued expanding in relation to the same period of the previous year, with steady growth in utilization of installed production capacity and industrial employment opportunities. In the first four months of this year, industrial output was 6.6% higher than in the same period of the preceding year. Production of consumer durables held the lead position, with expansion of 19.7%. Output of intermediate goods increased by 7.9% and production of capital goods grew by 6%, while output of semimanufactured goods and nondurables dropped by 0.3% in the same period of comparison.

Production of consumer durables, capital goods and semimanufactured products in April was still a long way from the most recent output peak, demonstrating that there is still considerable idleness in industrial capacity to be tapped. Output of intermediate goods, on the other hand, has climbed to the highest point since the start of the Real Plan. However, expansion in production capacity and productivity gains achieved in recent years have created considerable additional leeway for continued growth under this heading. According to CNI data, the average level of utilization of installed capacity came to 80.17% in April according to data from which Depec has culled seasonal factors.

In the 1999/2000 agricultural year, the grain harvest is expected to expand by 3.8%, according to IBGE estimates calculated in April. The strongest growth is predicted for the northeast region, with 32.9%, while expansion in the southern region, which accounts for about 46% of the total, is forecast at 1.6%.

Insofar as the labor market is concerned, data point to a trend toward employment and wage growth, without generating additional pressures on costs. In April, formal employment increased for the seventh consecutive month, with creation of 284 thousand jobs in the year. The rate of open unemployment dropped from 8.1% in March to 7.8% in April, despite 1.1% growth in the economically active population.

External environment

The first signs of a slowdown in demand growth in the United States can already be perceived. Retail sales dropped by 0.2% in April, when compared to the previous month. When automotive sales are excluded, marketing remained practically stable. Consumer credit increased by 7.8% in March in annualized terms, after reaching a growth figure of 15.7% in January. In May, new housing starts dropped by 3.9% in annualized seasonally adjusted terms, while construction permits issued dropped for the fourth consecutive month. The balance of trade registered a record deficit of US$ 35.7 billion in March, accumulating a US$ 100 billion negative result in the first quarter of the year. At the same time, the country achieved a strong fiscal result of US$ 159.5 billion, for a total surplus of US$ 123.9 billion in the fiscal year up to April.

Output indicators point to more intense growth, suggesting that productivity gains are being definitively incorporated into the output structure. Consequently, industrial production expanded by 0.4% in May, compared to April, raising accumulated growth for 12 months to 4.6%, even though utilization of industrial capacity has leveled off at 82.1%. Unemployment inched upward from 3.9% in April to 4.1% in May, while annual growth in wages came to 3.6%. The prices of imported goods increased by 0.6% in May, reflecting increases in energy prices as evinced by the fact that the index drops to 0.2% when petroleum is excluded. The consumer price index rose by 0.1% in May, lifting 12 month accumulated expansion to 3.1%. When energy and foodstuffs are excluded, the index rose by 0.2% in the month, with 2.3% over 12 months.

In Japan, the first estimate of GDP expansion came to 10% in the first quarter of 2000, based on the annualized seasonally adjusted series. The trade surplus expanded by 7.9% in the first third of the year. Industrial output continued on a growth trajectory in the first four months of the year, registering accumulated growth of 4.03% in the 12 month period ended in June. The unemployment rate dropped to 4.8% in April, while family wages and expenditures increased in relation to the same month of the preceding year, possibly suggesting growth in short-term internal demand.

In the euro zone, GDP expanded by 3.2% in the first quarter of this year, when compared to the same period of 1999. In the month of March, industrial output remained on the 5% growth trajectory registered in February, in comparison to the same period of the previous year.

In the first quarter, foreign sales expanded by 1.7% and imports by 10.9% in relation to the same period of 1999, as the foreign trade sector has shown increasingly clearer signs of improvement since February. This result was driven by depreciation in the euro/dollar exchange rate, which came to about 20% in the period from January 1999 to April 2000. The unemployment rate declined once again in April and closed at 9.2%. The harmonized consumer price index (IPC) increased by 0.1% in May, with growth of 2% in the last 12 months. The moveable quarterly average of annual M3 growth set a record in April at 6.3%, with a reference rate of 4.5%, leading the European Central Bank to raise its basic interest rate by 50 base points at its June 8 meeting, increasing the total increase in 2000 by 125 base points.

In Argentina, in the seasonally adjusted series, industrial output expanded by 0.2% in April, when compared to the month of March, and held stable in relation to March 1999. Exports increased by 12.9% and imports expanded by 0.5%, with both registering increases in price indices and falloffs in volume indicators. The consumer price index dropped by 0.4% in May, closing the last 12 months with a 1% decline. The differential between interest rates on peso deposits and dollar deposits turned downward once again following announcement of government measures aimed at cutting public spending, and closed at 0.7 percentage points on June 13, compared to 1 percentage point at the end of May.

Prices

The general price index – internal supply increased by 0.67% in May as a result of growth of 0.69% in the wholesale price index (IPA), 0.4% under the consumer price index (IPC) and 1.35% in the national cost of construction index (INCC). The rise in the wholesale price index was explained by climatic / seasonal factors and by the rise in the value of the dollar, both of which impacted farm and industrial prices. At the retail level, despite a drop in food prices, the increase in the index was due to growth in the prices of apparel and housing. In the later case, the index incorporated the full impact of the increase in the value of the minimum wage on such items as condominial fees and monthly wages of household employees. The increase in the national cost of construction index was due to wage increases negotiated in construction industry collective bargaining processes.

The broad consumer price index remained stable in May (0.01%). The product grouping most responsible for this result was foodstuffs/beverages, with deflation of 0.67%, which was sufficient to offset growth in all the other groupings. The grouping of housing registered a high of 0.45% as a result of growth in electric energy rates. The IPCA has accumulated growth of 1.41% in the year and 6.47% in the last 12 months, representing a monthly average of 0.52%.

In a Banco Central survey of market analysts, the predominant opinion pointed to a downward trend in inflation in 2000, despite the upward pressures generated by increases forecast for the coming months in several categories of government administered prices.

Prospective assessment of inflation trends

The first step in an assessment of the inflation outlook is identification of shocks capable of impacting the future trajectory of price levels. The shocks identified and their impacts were reevaluated on the basis of newly available information. The basic scenario is founded upon the following hypotheses.

a. Food prices: the grouping foodstuffs/beverages accumulated 0.9% deflation from January to May, a result that was not expected. There are two implications here. First of all, the initial point of the future inflation trajectory has shifted downward. Secondly, due consideration must be given to the possibility of this deflation being offset in the coming months. Thus, it can be conservatively estimated that growth in food prices in the final quarter of this year will surpass the 2% mark, a level above projected inflation for the IPCA in that period.
b. International oil prices: the price levels adopted in futures contracts point to a gradual price decline from now to the end of the year, with the average per barrel price of Brent type petroleum closing 2000 in the range of US$ 27. Consequently, internal prices for petroleum derivatives will tend to move upward at a pace above that previously forecast.
c. Government administered prices: the already announced increases in energy and telephone rates are quite close to those expected. The conclusion is that the grouping of government managed prices (including petroleum derivatives) will undergo an average increase of 12.2% in 2000 (as compared to 11.2% estimated in the March *Inflation Report*). This result is equivalent to a direct impact of 2.8% on inflation for the year and a marginal contribution of 1.8 percentage points. At the same time, hypotheses for the performance of public utility rates for 2001

were also introduced, based on estimated growth for the general indices stated in the respective contracts.

d. External environment: the most recent indicators for the American economy have not only aided in reducing the volatility of international financial markets, but also increased the probability of smooth deceleration and a sustained process of world economic expansion. It is assumed that interest on fed funds will follow the trend implicit in futures contracts, which would mean an additional rise of approximately 50 base points up to the end of the year. Coupled with the outlook for an increasing trade balance surplus and a continued inflow of direct foreign investments, these factors are expected to generate positive repercussions on the Brazilian sovereign risk, just as happened in early June.

e. Credit channel: reductions in compulsory reserves on demand resources in March and June stimulated credit operations and their impact was incorporated into the models of monetary policy passthrough mechanisms. The reduction in compulsory reserves produces repercussions on interest rates to final borrowers and, consequently, on consumer decisions.

f. Fiscal policy: the targets for the consolidated public sector accumulated primary surplus will be reached in both this year and next year.

Simulations performed with the basic scenario lead to the conclusion that the inflation targets specified for 2000 and 2001 will be met with considerable leeway if interest rates are held at their current level of 18.5% per year. Simulations of the economic models based on alternative scenarios for the exogenous external variables were also carried out, concluding that maintenance of a constant rate of interest at 18.5% would make it possible to comply with the specified inflation targets with a high level of probability. Parallel to this, exercises were also presented involving the modeling of alternatives for the formation of inflation expectations and for exchange rate evolution. The results confirmed the solidity of the previous conclusions.

Leading indicators were presented for inflation, together with short-term forecasts. The leading indicators point to growth in inflation in both June and July, followed by a downturn as of August. The nonstructural short-term models indicate a moderate inflation high in the third quarter, followed by a reduction at the end of the year. These models indicate that accumulated inflation for the year will, in average terms, close below the specified target of 6%.

The median of IPCA expectations as gathered by the daily Banco Central survey has been consistently revised downward, dropping from 6.1% at the end of May to 6.0% at the start of June.

Money market and open market operations

On May 24, COPOM once again decided to hold the Selic rate target steady at 18.5% per year, with no bias.

In the period extending from May 24 to June 19, the monetary impact of definitive operations with Banco Central securities was contraction of R$ 0.9 billion, while operations for which the National Treasury is liable had an expansionary impact of R$ 1.9 billion.

The strategy of rolling exchange securities as they mature continued in the period under analysis. On three different opportunities, two year NBCE were offered. Public offers with preset profitability were reinitiated on June 13, when six month LTN were sold with a financial value of R$ 0.9 billion, while the only LTN redemption in the period came to R$ 2.5 billion. The four LFT public offers totaled R$ 11 billion, while redemptions came to R$ 11.2 billion, including NTN-S.

On five different opportunities, Banco Central entered the banking reserve market for the purpose of taking resources, always with the objective of preserving the equilibrium of financial system liquidity, for a total of eighteen business days. Two definitive LFT secondary market sales with a total value of R$ 1.3 billion were also utilized.

Monetary policy guidelines

An analysis of supply and demand leads to the conclusion that there are no imbalances significant enough to produce inflationary pressures within a time span relevant to the inflation targeting system.

Growth in aggregate demand has occurred in an organized and sustained manner. The pace of growth under consumption registered signs of a slight downturn in May, following upward movement in the first four months of the year. The trade balance turnaround has been slow but consistent and based for the most part on strong growth in the volume of exports. Fiscal results up to April clearly confirm the government’s commitment to austerity and ensure compliance with the targets stated in the Economic

Program.

Aggregate supply has kept pace with expanding demand. Despite growth in the economically active population, the rate of unemployment has begun dropping as a result of generation of new job openings. In the first quarter of the year, industrial output expanded sharply, though the level of utilization of installed capacity remained far from its maximum. In short, there are currently no signs of a lag between aggregate supply and demand.

The overall picture points to price stability. Accumulated IPCA growth in the last five months came to 1.41%. Inflation for the month of May was well below both market and Copom estimates. Once it had been incorporated into the different forecasting estimates available to Copom, the new information contained in more recent price indicators resulted in a downward revision of the expected 2000 inflation figures. This information confirmed Copom's position, as expressed in the Minutes of a previous meeting, that the real rate of interest is not neutral and is above the medium and long-term equilibrium level for the Brazilian economy.

The major factors of uncertainty analyzed during recent meetings underwent considerable change. Petroleum was the only factor to close with a negative performance. It became clear that that the price shock is persistent or, in other words, that prices were well above the level expected in the wake of the March OPEC meeting and it can now be forecast that they will close the year at a high average level, thus implying sharp increases in domestic prices for petroleum derivatives in the second half of the year. On the other hand, the probability of satisfactory resolution of the other uncertainties increased during the period. The American economy has begun showing signs of a gradual slowdown in its growth pace.

Though these signs are still insufficient to characterize a smooth deceleration of the US economy, there is no doubt that the volatility of financial markets has been dampened in recent weeks as a result of these signs, particularly as regards the perception of risk in the emerging nations. On Tuesday, June 20, the Republic contracted a total of Eur 750 million at a rate of 9.2% per year (417 points above the French Treasury rate) and confirmed Copom's evaluation regarding the favorable evolution of the external scenario and the Brazil risk premium. Aside from the Republic issue, the private sector managed to contract approximately US$ 1.4 billion on the international market in recent weeks. One should note that, in the period of greatest volatility in April and May, the difference between the upper and lower exchange rate levels came to just 7%, with no significant pressures generated by hedge demand.

Copom discussed the IPCA in various scenarios, evaluating the implication of internal and external risk factors for the future trajectory of inflation. Considering the high level of probability that the inflation target for this year will be attained in all of the scenarios analyzed and that expectations regarding 2001 inflation are highly favorable, Copom concluded that there was room for an interest rate reduction.

At the same time, Copom gave due attention to the fact that two important decisions were to be taken in the following week: the OPEC meeting called to discuss a possible increase in output and the meeting of the Federal Open Mark Committee (FOMC) to discuss US basic interest rates. It was the understanding of Copom that, despite the positive expectations regarding these two variables, there was still some uncertainty that would justify introduction of the downward bias.

The preponderant position within Copom was that, independently of any future decision, the time was ripe for an accentuated cut in the interest rate, considering that recent inflation results had significantly changed Copom's expectations with respect to inflation for 2000, even in the framework of the aforementioned risk factors. Another point of view was raised in the sense that uncertainties as to the two decisions cited above required a more moderate interest rate cutback that could be further deepened with the adoption of a downward bias and utilization of that bias should the two events produce positive results. This position would have cloaked Copom's decision with a more conservative and cautious character. From this point of view, a more moderate move in the context of current uncertainties would create space for a more aggressive approach in the future. However, Copom decided not to adopt this suggestion.

Consequently, Copom voted by seven to one to reduce the Selic rate target to 17.5% per year, with a downward bias. The contrary vote supported a reduction to 18% per year and a downward bias.

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 July 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