MINUTES OF THE 44TH MEETING OF THE BANCO CENTRAL DO BRASIL MONETARY POLICY COMMITTEE (COPOM)

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Executive Secretary of COPOM

Date: 02.15-16.2000

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

Called to order: 5:15 PM on 02.15 and 4:50 PM on 02.16

Adjourned: 7:50 PM on 02.15 and 7:10 PM on 02.16

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

Department Heads

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

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

Luiz Gustavo da Matta Machado – 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

Antonio Carlos Monteiro – Executive Secretary of the Board

Gustavo Bussinger – Consultant to DEPEC

Sérgio Goldenstein – Consultant 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

The early days of the year were marked by signs of moderate growth in aggregate demand. Upward movement was detected under industrial and trade sector sales, as well as consumer credit operations. In a framework of more dynamic world economic growth, the drop in the accumulated twelve month trade deficit in the December-January period suggests a positive turnaround in this area as well.

In the month of January, industrial sales of automotive vehicles and farm machines expanded by 6.3% and 0.7%, in that order, when compared to the previous month. Data on factory authorized vehicle sales outlets from which seasonal factors have been eliminated point to growth of 16.3% in sales. The best performance occurred under automobiles (27.3%) and buses (34.3%). Credit card transactions and check clearing operations expanded by 6.6% and 2.7% in relation to December, with growth of 10.6% and 7.9% in comparison to January 1999, respectively.

The Consumer Confidence Index (ICC), released by the Trade Federation of the State of São Paulo (FCESP), has risen steadily since November. In February, it hit the mark of 109.9, the highest level of the past twelve months, reflecting improvement in the overall economic situation as perceived by consumers. The item current economic conditions moved from

72.2% in January to 86.5% in February, while expectations remained stable at 128.6% in the last two months.

Following a sharp decline in the second half of 1999, default indicators have begun leveling off. At the São Paulo Consumer Protection Service (SPC), the net default rate came to 7.2% in January, as compared to 8.5% in December. According to Teledata, the company that operates the Tele-Cheque system, defaults in Rio de Janeiro closed the first month of the year at 1.35%, following 1.2% in December and 1.9% in November. Checks returned for insufficient backing in the month of January came to 3.2% of checks cleared (nationwide). In December, this ratio had closed at 2.9%.

In 1999, investment indicators registered negative growth, though the intensity of the drop was less intense in the second half of the year. Production and imports of capital goods dropped by 8.9% and 15.8% up to December, respectively, when compared to accumulated declines of 10.7% and 15.6% up to November. Production of construction industry inputs fell by 2.9% and BNDES disbursements dropped by 4.9%, as compared to negative rates of 3.2% and 16.4%, respectively, up to November. With these results, it is estimated that the rate of gross fixed capital formation in 1999 closed at 18.3% of GDP at current prices (19.9% in 1998).

Normally performing financial system loans to the private sector declined in December, mostly as a result of cutbacks in credits granted to industry (0.7%), housing (2.4%) and commerce (1%). However, growth in the balances of loans to individuals (1.3%) and other services (3.5%) continued. Defaults in the private financial system closed December at 4.3% and have declined steadily from a May level of 5.4%.

Despite a December deficit of R$ 1.8 billion in the consolidated public sector primary fiscal result, the surplus for the year closed at R$ 31.1 billion, surpassing the R$ 30.2 billion target in the IMF agreement. In 1999, the consolidated public sector nominal deficit came to R$ 96.1 billion, equivalent to 10% of GDP. The net public sector debt totaled R$ 516.6 billion in December, or 47% of GDP.

In the month of January, the trade balance registered a deficit of US$ 94 million, the best performance for that month in the last three years. Exports expanded by 17.1% and imports dropped by 2.7% in relation to January 1999. Manufactured goods outstripped other foreign sales segments with growth of 22.4%, led by transmission and reception equipment and transportation goods, mostly automobiles, aircraft and engine chassis. Marketing of semimanufactured goods rose by 13.7%.

The products that accounted for the major share of this growth were cellulose, semimanufactured iron and steel goods and aluminum. Primary products closed with the lowest growth rate (6.3%) with a substantial value increase in shipments of chicken meat, beef and iron ore. Insofar as markets for Brazilian goods are concerned, the country expanded its operations with Asia, the United States and the Laia countries, principally Mexico.

Supply indicators would seem to suggest a speedup of the growth process toward the end of 1999. Industrial production expanded by 3.1% in December in the seasonally adjusted series, with positive growth in all use categories. Output of capital goods increased by 4.6%, intermediate goods by 2.7% and consumer goods by 1.9%. The latter figure reflects growth of 0.4% in the production of consumer durables and 2.9% in semidurable and nondurable consumer goods.

The average level of utilization of installed production capacity in the manufacturing sector moved to 82% in January, practically the same level as in January 1995. The intermediate goods production sector is utilizing 85% of its output potential, an evident sign of the ongoing process of import substitution. Parallel to this, the consumer goods and capital goods sectors have been operating in the range of 75%

and have positioned themselves to respond rapidly to upturns in demand.

Signs of a turnaround in labor market indicators have become increasingly evident. A good example of this trend is creation of 954 job positions in São Paulo industry in January, the first positive result in that month since 1995.

External environment

Spurred mostly by expanding internal demand, production in the United States has continued thriving. In the seasonally adjusted series, consumer credit expanded by an annualized rate of 9.7% in December, in comparison to the month of November, while retail sales increased by 1.25% in the final month of the year. At the same time, the balance of trade in goods registered a US$ 34.3 billion deficit in November, raising the accumulated deficit for the year to a level 39.1% above the 1998 result.

In the fourth quarter of the year, seasonally adjusted annualized figures indicate that GDP expanded by 5.8% in the United States in relation to the previous quarter, while industrial output grew by 0.4% in December and 1% in January in the series purged of seasonal factors. The growth trajectory has been sustained by absorbing available labor –

unemployment closed January at just 4% - and increasing productivity. With this, labor market pressures have not engendered upward price movement. In the fourth quarter of 1999, productivity in the manufacturing sector increased by an annualized rate of 10.7%, when compared to the previous quarter, while the nonfarm sector managed to maintain a steady 5% pace, utilizing the same basis of comparison. In 1999, the productivity of the economy rose by 2.9%.

In 1999, the producer price index increased by 3%, while the index core - excluding increases in food and energy prices - moved upward by 0.9%. Increases in the prices of raw materials (15.8%) and intermediate goods (3.9%) suggest possible pressures further down the line. The consumer price index rose by 2.7% in 1999, with a core increase of 1.9%.

In Japan, sluggish recovery in private spending and cutbacks in public sector outlays resulted in diminishing aggregate demand at the end of 1999. It should be stressed that industrial growth has been sustained by exports. The trade surplus came to US$ 11 billion in December, raising the accumulated surplus to US$ 108.9 billion in the year, corresponding to an increase of 1.4% above the final 1998 figure. The gradual downward slide in the jobless rate was interrupted as December closed with 4.6%, compared to 4.5% in November.

The Euro Zone economy registered a consistently positive growth trajectory. In the third quarter, GDP increased at an annualized pace of 4.1% in the seasonally adjusted series, in comparison to the previous quarter, while industrial output expanded by 2.8% in November when set against the same month of the previous year. Unemployment moved steadily downward and closed December at 9.6%. The M3 monetary aggregate increased by 5.8% in October, 6.2% in November and 6.4% in December, as against the same months of 1998. By way of comparison, the European Central Bank had defined the three month moveable average reference rate at 4.5%. The harmonized consumer price index – IPC increased by 1.7% in 1999, as compared to an informal target of 2%.

In England, GDP expanded by an annualized rate of 3.1% in the third quarter, based on the series purged of seasonal factors, when viewed against the second quarter. Wariness with regard to the possibility of sustaining this growth pace led to adoption of a 0.25 percentage point increase in the basic interest rate to 6% per year in February. One should recall that an increase of the same magnitude was introduced in January 2000.

In Argentina, industrial production expanded by 3.8% in December, when compared to November, and 8.9% when seen against the December 1998 result, closing the year with an accumulated output sag of 6.9%. The trade deficit remained stable in December at US$ 279 million, as 1999 closed with an accumulated deficit of US$ 2.2 billion, a downturn of 55.9% when compared to 1998. One should note that exports declined by 11.7% in 1999 and imports dropped by 18.7%.

Prices

In January, the upward movement in general price indices shifted into a downward curve, reflecting lesser wholesale price pressures, particularly under farm products. The general price index – internal supply (IGP-DI) dropped from 1.23% in December to 1.02% in January, while its major components, the wholesale price index – internal supply (IPA-DI) and the consumer price index (IPC) increased by 1.02% and 1.01%, respectively.

Consumer price indices rose slightly in the month of January, as a result of seasonal pressures on *in natura* food products and, principally, school enrollments and monthly payments. The broad consumer price index (IPCA) rose by 0.62% in January as compared to 0.6% in December and the consumer price index – Fipe (IPC-Fipe) expanded by 0.57%, as against 0.49%.

According to a Banco Central survey, most analysts expect the major price indices to continue on a downward inflation trajectory in the first quarter of 2000.

Prospective assessment of inflation trends

An assessment of the inflation outlook must begin with identification of the shocks capable of impacting future price trends. The shocks identified are practically the same as those delineated at the previous Copom meeting. Consequently, the basic scenario reflects the federal fund rate implicit in futures contracts; an average 9.2% increase in government managed prices in 2000; farm sector neutrality as regards price pressures during the year, assuming that the seasonal growth in the supply of farm products expected in the first half of the year will effectively come about; and a fiscal policy fully in compliance with the R$ 36.7 billion target defined for the accumulated primary surplus of the consolidated public sector in 2000, a factor of overriding importance to price stability. Several scenarios involving increases in the minimum monthly wage were also analyzed.

Following presentation of the central scenario, simulations were performed using economic models based on alternative scenarios. The major differences in relation to the central scenario are found in the evolution of oil prices and the Brazil risk. Based on simulations that utilize the hypotheses of the central scenario, it was concluded that maintenance of interest rates at their current level will make it possible to comply with inflation targets for 2000 and 2001. Even though the simulations that utilize alternative hypotheses also demonstrate the feasibility of compliance with the stated targets, the probability of compliance would be lower than in the central scenario.

Both short-term forecasts and the leading inflation indicators were presented. The results confirm the trend toward a reduction in the first quarter of 2000. More specifically, the leading indicators suggest a steady decline in the early part of the year. Though other short-term forecasts ratify this trend for the first quarter of 2000, they also point to a small increase in inflation in the second quarter of the year caused by seasonal factors.

Measured by the broad consumer price index (IPCA), the median inflation expectations perceived in the daily Banco Central survey on February 14 remained above the inflation target for 2000 (6.88% as against a target of 6%). However, in relation to the forecast median at the end of January (6.94%), the February figure indicated downward movement.

Money market and open market operations

At its most recent meeting held on January 19, COPOM resolved to maintain the Selic Rate target at 19% per year with no indication of a bias.

Between January 19 and February 15, definitive operations with Banco Central papers generated an expansionary monetary impact of R$ 0.4 billion. On the other hand, definitive operations with National Treasury securities produced a R$ 3.2 billion contractive impact. These results reflect ongoing implementation of the policy of gradually withdrawing Banco Central from the grouping of public security issuers, with the sole exception of papers updated according to exchange rate variations.

Between January 18 and February 14, the National Treasury sponsored nine LTN sale auctions totaling R$ 18.6 billion, as against R$ 17.5 billion in redemptions. Among these auctions, one should highlight the first firm offer of one year LTN on January 20 and 21. Offers of these papers had not occurred since July 1999 and their return to the market should be viewed in the context of the government's intention of lengthening the average term of the federal securities debt. On January 31, the National Treasury held two NTN-C uniform price auctions. Insofar as December auctions are concerned, the share of operations with financial liquidation through securitized credits moved from 20% to 26%.

Once again, definitive operations with Banco Central securities were restricted to sales of NBCE. The seven uniform price auctions were targeted at rolling over the maturing debt, since they resulted in R$ 155 million in net redemptions. In a total of 18 business days, Banco Central entered the money market on 11 occasions with the aim of managing the financing costs of public securities held by the market in situations of banking reserve imbalances.

Monetary policy guidelines

Since December 1999, aggregate demand indicators have been steadily converging, suggesting that the process of economic recovery is gaining in momentum. Parallel to this, an analysis of supply indicators (labor market, overall wages, utilization of production capacity) reveals no signs of imbalances capable of generating short-term inflationary pressures. Fiscal policy has made a major contribution to price stability. Since December, trade balance results have improved sharply, with a strong upturn under exports generated by increased demand. Net capital inflows confirmed improvement in foreign financing conditions in the early days of 2000. Growth in the farm harvest suggests that there will be no significant price pressures on this front during the current year.

More recent price indicators confirm the downward trend in consumer inflation in February. Nevertheless, with regard to future inflation, certain risk factors do exist and have either not been dissipated or have actually worsened since the most recent Copom meeting. Among these, one should stress the following: 1) uncertainties regarding the evolution of government managed prices and other cost pressures; 2) the trend toward sharper interest rate hikes in the developed countries; and 3) recent surges in international oil prices on both the spot and futures markets.

Following a detailed analysis of the overall economic situation and the outlook for 2000, Copom decided to hold the Selic rate target steady at 19% per year, with no indication of a 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 March 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.

Sérgio Goldenstein

Executive Secretary of COPOM