

BANCO CENTRAL DO BRASIL – *FOCUS*

August 1, 2000

MINUTES OF THE 49TH MEETING OF THE BANCO CENTRAL DO BRASIL MONETARY POLICY COMMITTEE (COPOM)

Summary

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Date: 07.18 and 19.2000

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

Called to order: 3:15 PM on 07.18 and 5:35 PM on 07.19

Adjourned: 6:10 PM on 07.18 and 6:20 PM on 07.19

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 - Advisor to the Board

Gustavo Bussinger - Advisor to DEPEC

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

Thais Matos de Herédia - 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 second quarter of the year, the pace of demand growth was less intense than in the first quarter. However, due mainly to increased exports and installment sales, most indicators remained above the levels registered in the same period of 1999. In the automotive industry, industrial sales expanded by 22.6% in the first half of the year, when compared to the same 1999 period. Exports grew by 50.2% and domestic sales by 16.6%. In the segment of motorcycles, sales accumulated up to June registered a high of 28.5%, as exports grew by 104.4% and domestic market sales by 23.8%.

At the retail level, information on the real revenues of the retail trade sector in the metropolitan region of São Paulo for the month of June, based on data from which seasonal factors have been culled, indicates a decline of 0.92% when compared to the previous month, and an increase of 11.3% in comparison to the same month of the previous year. The result for the first half of the year was 11.1% above that of the same 1999 period. Utilizing these bases of comparison, particular attention should be given to the strong 20.2% growth in sales of consumer durables, followed by 12.6% expansion under nondurable consumer goods and 10.4% in the automotive trade. Sales of building materials expanded by 6.6%, while revenues on

semidurable consumer products declined by 28% (apparel, footwear and fabrics).

The number of consultations with the Trade Association of the State of São Paulo (ACSP) indicated that the first half of the year was marked by more accentuated growth under installment sales (10.3%) than under sales with immediate payment-in-full (5.4%). This performance was consistent with the results that pointed to the segment of durable consumer goods as the leader in retail sector revenues. More generic demand indicators also pointed to a favorable performance in the first half of the year. Here, one should mention that the number of credit card transactions increased by 22.2%, while the quantity of checks cleared increased by 2.5%.

Information on default levels clearly indicates that favorable conditions exist for growth in demand. Rates for June were lower than in May for all indicators. In comparison to the same period of 1999, defaults declined with the sole exception of the proportion of checks returned for reasons of insufficient backing in relation to total checks cleared.

Investment indicators registered across-the-board growth, with a particularly strong performance under capital goods, with expansion of 7.5% up to May. The decline in imports of

machines and equipment became less intense as the year passed, dropping from 10.1% at the end of the first quarter to 5.7% up to May. In the same period, output of construction industry inputs accumulated expansion of 1.9%.

In the month of April, the consolidated public sector registered a primary surplus of R\$ 3.7 billion, closing the first four months of the year with a surplus of R\$ 17.3 billion (4.65% of GDP). The net public sector debt came to R\$ 536.2 billion in April, corresponding to 47.5% of GDP. In relation to the month of May, the outlook is for continued positive evolution in the primary result and net public sector debt for all spheres of government.

In the first half of the year, the trade balance accumulated a surplus of US\$ 856 million, with growth of 16.5% in exports and 9.8% under imports, in contrast to a US\$ 620 million deficit in the same period of 1999. For the first time since the shift in exchange policy, the 12 month balance turned in an accumulated surplus of US\$ 267 million. A factor of fundamental importance to this result was the performance of the export sector, particularly in the segments of transportation and electric-electronic goods. In the case of imports, growth is explained by increased purchases of intermediate goods, as well as by higher international oil

prices.

The performance of supply has been compatible with the pace of expanding demand. In this context, the current grain harvest has registered increasingly better results with each successive survey carried out by IBGE, and is now expected to total 85.8 million tons, for growth of 4.2%. Despite a May reduction of 1.7% when calculated on the basis of data purged of seasonal factors, positive growth in the first five months of the year came to 6.6%, when compared to the same 1999 period. A breakdown by categories of usage indicates that output of durable consumer goods rose by 21.4% in the period, followed by increases of 7.7% under intermediate goods and 7.5% under capital goods.

According to a CNI survey, utilization of installed output capacity remained above 80% in the period between December and May.

In the series free of seasonal factors, the formal labor market has registered positive growth for seven consecutive months and closed the period with 447.2 thousand additional jobs. Employment growth occurred in all sectors, with the single exception of the building industry. The household survey carried out by IBGE pointed to positive employment growth in

recent months, as unemployment slipped from 7.84% in April to 7.79% in May.

External environment

No important changes capable of altering expectations regarding overall performance occurred in the external environment. In the United States economy, the real estate sector has shown the first signs of a growth slowdown. Japan has not yet been able to achieve a consistent pace of recovery driven by private demand, though there are clear signs of an upturn in business confidence. The eurozone has moved into a vigorous growth pace, though the risks of greater inflation cannot be ignored.

In the United States, retail sales in June increased by 0.5%. However, when automotive sales are excluded, this figure drops to 0.2%. Consumer credit expanded at an annualized pace of 7.4% in April, followed by 9.8% in May. Sales of new homes in May remained practically stable in relation to April and were 2% below the level for the same month of 1999. The trade deficit for the month of April came to US\$ 32.8 billion, raising the accumulated negative result for the first four months of the year to US\$ 132.7 billion. The accumulated result for public accounts in the fiscal year (October/September) up to May was a surplus of US\$ 120.3 billion, as compared to US\$

123.9 billion up to April. Industrial production expanded by 0.2% in June, following 0.5% growth in May. With these results, the growth level remained 5.8% higher than in the same month of the preceding year and accumulated expansion of 4.8% in 12 months. Utilization of installed output capacity in May and June held steady in the range of 82%. Unemployment, which had totaled 4.1% in May, dropped to 4% in June, while nominal annual growth in earnings remained at 3.6%.

The producer price index (IPP) expanded by 0.6% in June after remaining stable in May. Over 12 months, this index accumulated growth of 4.3%, while the core index declined by 0.1% in June, with accumulated 12 month expansion of 1.3%. A breakdown of the Producer Price Index (IPP) indicates that raw materials and intermediate goods increased by 5.8% and 0.9% in the month, respectively, raising accumulated 12 month expansion up to June to 25.1% and 5.5%. The consumer price index (IPC) and core-IPC increased by 0.6% and 0.2% in the month of June, raising accumulated 12 month increases to 3.7% and 2.4%.

In Japan, industrial output expanded by 0.2% in May, following a decline of 0.4% in April, with 7.5% expansion in relation to the same month of the previous year. The segments of electric

machinery and iron and steel turned in the best performances in this sector. Building investments declined by 1.1% in May, in relation to the same month of the previous year. Consumer prices expanded by 0.1% in May, though they closed the 12 month period with a reduction of 0.7%. The labor market turned in positive growth, as unemployment dropped to 4.6% in May, as compared to 4.8% in April.

Industrial output in the eurozone expanded by 0.7% in April and 6.5% in 12 months and generated a positive impact on unemployment which declined from 10% in May 1999 to 9.2% in May of the current year. Annual growth in labor costs came to 3.5% in the first quarter of the year, when compared to the same period of the previous year. This was the best performance of the last four years. In the month of April, exports expanded by 11% and imports by 13% when seen against the April 1999 performance. In the four month period, exports expanded by 19% and imports by 27%, compared to the same period of 1999. In the month of May, the harmonized consumer price index repeated its April results, with monthly growth of 0.1% and twelve month expansion of 1.9%. When the energy sector is excluded, the index registered stability with accumulated expansion of 1% in 12 months. The producer price index registered a high of 0.8% in May and accumulated expansion of 6.5% in 12 months. In the month of May, the

quarterly moveable average rate of annual growth under M3 remained at the April level of 6.3%.

Prices

General price indices increased in the month of June due to the impact of higher farm product prices (beef, sugar cane and milk *in natura*) on wholesale price indices. Consequently, the wholesale price index - domestic supply (IPA-DI) expanded by 1.45%, as against 0.69% in May. In contrast to this performance, growth in retail prices slowed as a consequence of a continued downturn in the prices of foodstuffs and transportation, which offset the seasonal high registered under apparel. One should highlight the 0.73% expansion under the National Consumer Price Index - INCC, caused by a 1.27% rise in labor costs.

Insofar as consumer price indices are concerned, one should note that accumulated growth in the half-year period was the lowest since these surveys were first carried out. Consequently, the Consumer Price Index - Fipe (IPC-Fipe) registered a rate of 0.87% in the period, followed by the National Consumer Price Index (INPC) with 1.13% and the Broad Consumer Price Index (IPCA), with 1.64%.

Following a period of stability in May, price growth measured

by the IPCA turned upward by 0.23% in June and accumulated a twelve month high of 6.51%. For the most part, acceleration was caused by recovery in the prices of foodstuffs, following four consecutive months of decline; an increase in fixed telephone service rates, which went into effect as of June 22; and growth of 0.92% in apparel prices.

Insofar as 2000 is concerned, a survey carried out by Banco Central among various institutions showed that estimates on the performance of the IPCA have become somewhat more optimistic, when compared to previous surveys basically due to the fact that inflation in the first half of the year was less than expected.

Prospective assessment of inflation trends

Assessment of the inflation outlook requires identification of those shocks capable of impacting the future price level trajectory. These shocks and their potential impacts were re-evaluated in light of information that has become available since the last Copom meeting. Their incorporation into the basic scenario resulted in a reduction of projected inflation for 2000 and 2001. In summary, these data are as follows:

- a) as measured by the IPCA, June inflation closed 0.07 percentage points below the level expected in the most recent Inflation Report;

- b) growth in government managed prices, particularly petroleum derivatives, was below the previously forecast level. Up to publication of the most recent Inflation Report, the rise in government managed prices in 2000 was estimated at 12.2%. In light of the newly available information, this estimate was revised downward to 11.2%, a full percentage point below the previous estimate;
- c) positive developments also occurred on the external front, particularly the fact that the magnitude of the expected rise in fed fund interest rates seems to have decreased when one analyzes the rates implicit in futures contracts. Such an analysis would seem to point to an increase of just 25 base points up to the end of the year (the high had previously been estimated at 50 base points);
- d) the more moderate growth pace of the Brazilian economy in the second quarter has aided in reducing possible inflationary pressures in coming months.

The other hypotheses considered at the previous meeting were maintained: increase of more than 2% in foodstuff prices in the final quarter of 2000, a rate well above the IPCA projection for the period; and a primary surplus consistent with fiscal policy targets.

Simulations performed with the basic scenario lead to the conclusion that maintenance of interest rates at the current level of 17% per year will make it possible to meet inflation targets up to 2002 with considerable leeway. Simulations of the various economic models with alternative scenarios involving exogenous variables were also performed concluding that, should interest rates be held at their current level of 17%, it is highly probable that the country will comply with inflation targets.

Leading indicators for inflation were presented, together with short-term forecasts. The leading indicators point to an upturn in inflation in the third quarter, followed by a decline in the final quarter. 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, in average terms, accumulated inflation for the year will close at a level below the established target of 6%.

Median expectations for IPCA growth gathered by the daily Banco Central survey have been revised steadily downward. Since the most recent meeting, the median has decreased from 6% to 5.9% in estimates for 2000 and from 4.3% to 4.2% for 2001.

Money market and open market operations

At its most recent meeting on June 20, Copom reduced the Selic rate target from 18.5% to 17.5% per year with a downward bias. On July 7, the bias was implemented and the rate was cut by an additional half a point to 17%.

In the period from June 20 to July 18, definitive operations with securities issued by Banco Central and the National Treasury produced an expansionary impact of R\$ 1.4 billion.

In the period under consideration, there was only one NBCE placement effected for purposes of rolling the full value of maturing exchange securities for which Banco Central and the National Treasury were liable. The National Treasury sold LTN on seven different occasions, with a total value of R\$ 8.5 billion. Redemptions came to R\$ 5.4 billion, of which R\$ 0.4 billion were effected early through two purchase auctions. The five LFT placements in public offers totaled R\$ 8.5 billion, while redemptions came to R\$ 12.7 billion. The National Treasury sold five year NTN-C with a total value of R\$ 0.2 billion.

Banco Central carried out secondary market operations on eleven different occasions during the period, covering a total

of eighteen business days, with the objective of administering very short-term interest rates. On July 5, the first competitive security sale auction was held with a resale commitment assumed by the buyer, permitting free operation with these papers. The financial volume of the operation came to R\$ 1.2 billion.

Monetary policy guidelines

An analysis of supply and demand indicates an absence of imbalances capable of generating inflationary pressures of significance to the inflation targeting system over the foreseeable horizon. More specifically, the recent more moderate pace of consumer and investment growth would seem to indicate a climate highly conducive to continued price stability.

Growth in net exports has been slow but consistent. Fiscal results up to April have been quite strong and all indications are that May results will also be highly satisfactory, thus confirming the government's commitment to austerity and ensuring compliance with the targets defined in the Economic Program.

Inflation figures were better than expected in the month of June, as the rate closed below both market and Copom

estimates. This result reinforces the position taken in previous Copom meetings that the real rate of interest has remained above the medium and long-term point of equilibrium for the Brazilian economy and, consequently, is not a neutral factor. Accumulated inflation over twelve months declined by 2.4 percentage points in the first half of the year and closed at 6.51%. As already stated, inflation in July will be relatively high due to the impact of contractual adjustments in telephone and electricity rates, increases in the prices of petroleum derivatives and higher prices for *in natura* foodstuffs, which were impacted by adverse climatic factors in the south and southeast regions. However, the effective high under government managed prices was less than expected. Consequently, the average increase over the course of the current year was revised downward. As a result, inflation projections for this and the coming year were also revised downward.

In recent meetings, the major factors of uncertainty analyzed point to highly positive results. On the external horizon, signs of deceleration in the American economy have had positive repercussions, particularly in terms of less volatility on international financial markets. With regard to petroleum, upward price movement seems to have run out of steam. With this, the perception of risk among emerging economies has

improved as demonstrated by the drop in the cost of contracting foreign funding by both the private sector and the Republic. Internally, despite a number of political difficulties, expectations have not been altered as evinced by the stability of the Brazil risk, an absence of demand pressures for exchange hedging and lessened volatility in exchange market rates. This low level of volatility not only reflects the absence of a significant stock of short-term capital, but also mirrors the growing maturity of the floating rate exchange system in Brazil, since exchange flows have responded relatively quickly to exchange rate shifts and this has aided in attenuating the volatility of these movements.

Based on these considerations, Copom voted unanimously to reduce the Selic rate target to 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 August 22, 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

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