BANCO CENTRAL DO BRASIL – FOCUS

June 9, 2000

MINUTES OF THE 47th MEETING OF THE BANCO CENTRAL DO BRASIL MONETARY POLICY COMMITTEE (COPOM)

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Date: 05.23-24.2000

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

Called to order: 4:00 PM on 05.23 and 4:45 PM on 05.24

Adjourned: 6:50 PM on 05.23 and 9:00 PM on 05.24

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)**

Luis 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:

Gustavo Bussinger – Advisor to DEPEC

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 early months of the year, aggregate demand indicators pointed to higher consumption and investment levels than in the same period of 1999. Among the factors that contributed to this performance, one should stress increased consumer and business credit operations and expanded foreign sales.

The balance of credit operations based on nonearmarked resources increased in April, mostly as a result of a cutback in compulsory reserves on demand deposits. Interest rates on these operations continued on a downward trajectory. Credits granted to individuals expanded by 6.5% in the month, raising accumulated growth for the year to 28.6%, with 50.8% expansion in the last 12 months. Here, the two leading categories were personal credit and financing for acquisitions of goods. Business credit operations expanded by 6.6% in the month and accumulated 8.6% growth in the year.

According to the Consumer Protection Service (SPC), the default level in São Paulo came to 13.6% in the month of April, as against 20.2% in the same month of last year. Utilizing Teledata figures, based on information gathered in 10 different cities, the default rate closed at 2.1%, as against 2.4% in April 1999.

Real revenues of the retail trade sector in the metropolitan region of São Paulo increased by 9.5% in the first four months of the year, when compared to the same 1999 period. To a great extent, this result was generated by increased sales of goods of higher unit value, reflecting improved credit market conditions. In the same period of comparison, sales of consumer durables increased by 18.9%, while sales in the building material and automotive sectors expanded by 9.7% and 2.3%, respectively.

In the case of industrial sales, the automotive industry registered an increase of 22.4% in the four month period as a result of 61.7% growth in exports and 15.1% expansion in internal sales. Foreign sales of farm machinery increased by 13.8% in the same period.

Investment indicators registered growth in the first quarter of the year. Monthly output of construction industry inputs expanded by an accumulated 2.3% in the year, while production of capital goods grew by 9.4%. The volume of capital goods imports declined by 7%, based on information available up to April.

In the first quarter of the year, the consolidated public sector result registered a surplus of R$ 13.6 billion, which was a full R$ 6.3 billion higher than the target defined for the period in the Government Economic Program. The net public sector debt closed at R$ 527.2 billion in the month of March, corresponding to 47% of GDP.

In the first four months of the year, the trade balance registered a surplus of US$ 209 million, reducing the accumulated 12 month deficit to US$ 217 million. Here, one should emphasize the importance of the turnaround in the balance of bilateral trade with such important partners as the United States and France, as well as a growing surplus in trade operations with Mexico and the United Kingdom and a shrinking deficit in operations with Germany and Italy. The increase in the trade deficit with Argentina and Venezuela resulted from increased crude oil purchases.

Foreign sales increased by 18% in relation to the first four months of 1999 and were powered by 24.5% expansion under manufactured goods and 15.2% growth under semimanufactured products. Among the major Brazilian export products, particular mention should be made of aircraft, transmission/reception equipment and passenger cars, cellulose, iron ore and iron/steel semimanufactured products which, taken together, accounted for 58.4% of the growth in overall foreign sales.

In the same period of comparison, imports increased by 10.2%, mostly as a result of the 49.8% high under fuels and lubricants caused by petroleum price increases. Another important factor was 22.4% growth in imports of raw materials, directly reflecting the upward movement in industrial output.

Aggregate supply indicators have continued expanding, pointing to steady growth in the level of utilization of installed industrial output capacity and recovery in industrial employment levels. Aside from this, the most recent IBGE estimate points to 2.3% growth in the annual grain harvest, with a particularly strong performance in the northeast of the country, as a consequence of improved climatic conditions in that region.

In the first quarter of the year, GDP registered growth of 3.08%, compared to the same 1999 period. This performance resulted from 5.69% growth under industry, 2.28% under services and a drop of 0.84% under crop/livestock production. An analysis by subsectors of activity shows growth of 6.62% in livestock production, 4.67% under mineral extraction, 7.61% under manufacturing, 8.73% under communications and a drop of 5.26% under crop output.

Industrial production expanded by 8% in the first quarter of the year, with growth in all of the different use categories and particularly strong performances under consumer durables (21.6%) and capital goods (9.4%). The indicator accumulated in the last 12 months has been moving steadily upward from 1.4% in February to 1.9% in March. Of the twenty industrial segments, seventeen registered growth, with the best results under the metal-mechanics sector: transportation equipment, mechanics, metallurgy and electric and communications material.

The average level of utilization of installed output capacity in the manufacturing sector came to 83.1% in April, according to a survey carried out by the Getúlio Vargas Foundation (FGV). On a sector-by-sector basis, the utilization level in the intermediate goods industry moved to 87%, with particularly strong performances under pulp, paper and cardboard (92.6%), metallurgy (89.1%) and textiles (88.5%). The same survey noted that businesses were increasingly moving to expanding their investments in greater output capacity.

With respect to the labor market, data indicate a trend toward recovery with no significant pressure on costs. In the month of March, formal employment expanded by 0.1% in the seasonally adjusted series, reflecting creation of 159 thousand jobs during the year. In relation to February, all sectors registered positive growth, led by the manufacturing industry with growth of 1%.

External environment

In the first quarter of the year, the United States GDP expanded by 5% in comparison to the same period of 1999 and by 5.4% in relation to the previous quarter. Growth in aggregate demand has been stronger than the response capacity of internal supply, though there have been no signs of an upturn in inflation. The inflation trajectory has clearly reflected productivity gains and upward movement in the value of the dollar against the euro and the yen. On the other hand, this vigorous rate of growth has contributed to a surplus in public accounts. In this scenario, the basic interest rate target (fed funds) was raised by 0.5 percentage points to 6.5% per year on May 16.

Demand growth has been powered by expanded personal credit and increased overall labor earnings. Recently, stock market volatility increased as a result of uncertainties with regard to the sustainability of stock prices, particularly the high tech stocks quoted on the Nasdaq index. To some extent, the period of adjustment through which the stock market is passing could dampen consumer spending.

In the first three months of the year, the balance of trade registered a deficit of US$ 100 billion, while the fiscal surplus came to US$ 123.9 billion in the fiscal year up to March. In April, industrial production expanded by 0.9%, compared to March and accumulated 4.4% expansion in 12 months. In the month of April, unemployment dropped to 3.9%, following 4.1% in March, with continued annual growth in earnings in the range of 3.6%. The prices of imported goods dropped by 1.6% in that month as a result of lesser growth in energy prices. When petroleum is excluded from this calculation, growth came to just 0.1%. The consumer price index was stable in April and registered 12 month growth of 3%. When energy and foodstuffs are excluded from the calculation, the index rose by 0.2% in the month and just 2.2% in 12 months.

In Japan, economic indicators for the month of March did not confirm the positive signs of recovery that marked the first two months of the year. In relation to February, industrial production fell by 1% and the pace of annual growth declined to 4.7%, as against 8.4% in the previous month. In March, housing starts declined by 3.6% when compared to the same month in 1999. By way of comparison, January had registered expansion of 16.8% followed by 2.4% in February. The balance of trade turned in a surplus of US$ 26.2 billion in the first quarter of the year. However, imports expanded at a more rapid pace than exports in the period. Unemployment held steady at 4.0%.

In the euro region, the economic growth pattern was more consistent. Industrial production increased by 5.5% in February, in relation to the same month of 1999. The rate of unemployment diminished from 9.5% in February to 9.4% in March. Credits channeled to the private sector expanded by an annualized rate of 10.9% in April, following positive growth of 10.4% in March. The annual rate of growth of the quarterly moveable average of M3 closed at 6%, as compared to 5.9% up to February. GDP in the euro region in 1999 increased by 2.4%, when compared to 2.8% growth in 1998.

In Argentina, industrial output has shown some signs of recovery, registering growth of 4.1% in March and 0.1% in April, in comparison to the same months of 1999. In the first quarter of the year, exports increased by 11.5% and imports by 0.12% in relation to the same period of the previous year. As a result, the trade deficit dropped from US$ 760 million to US$ 180 million. Keeping pace with international market trends, internal interest rates moved upward once again, closing with a slightly broader gap in the spread between deposits in pesos and in dollars on the 30 day interbank market. In the fourth quarter of 1999, GDP registered growth of 0.1%, compared to the same period of the preceding year, following reductions of 4.9% and 4.1% in the second and third quarters. The overall federal deficit came to $ 2 billion in the January to March period, reflecting compliance with the fiscal performance criterion worked out with the IMF. In accumulated terms up to April, the deficit came to $ 2.5 billion, while the criterion agreed upon for the first half of the year was $ 2.69 billion.

Prices

In the month of April, the drop in wholesale price indices was caused by the ongoing decline in farm product prices and deceleration in industrial growth. At the retail level, the increase was a consequence of higher apparel prices, a lesser drop under food costs and the impacts of the minimum wage increase. In the case of the broad consumer price index (IPCA), the 11.03% minimum wage increase accounted for 0.34 percentage points of the 0.42% growth registered in the month. This was due to the methodology of calculating the costs of the item “domestic employee”.

In terms of annual growth, the indices have continued downward, as the IPCA dropped from 8.94% up to December to 6.77% in April. In the case of the general price index – internal supply (IGP-DI), the decline was even more accentuated, dropping from 19.98% to 13.05% in the same period.

A survey carried out by Banco Central among economic analysts points to a position that inflation will follow a downward curve in 2000, despite the impact of increases in some government managed prices in the coming months.

Prospective assessment of inflation trends

An assessment of the inflation outlook must begin with identification of the shocks capable of generating impacts on future price trajectories. The shocks thus identified are listed below and their impacts were reassessed in light of new information, particularly as regards petroleum prices. The basic scenario considers the following hypotheses: the trajectories of fed fund rates and international oil price quotations implicit in futures contracts, considering that the latter trajectory increased since the end of April, representing growth of US$ 3 in the average per barrel price in futures contracts for the second half of the year; neutrality on the part of the farm sector in terms of the pressures that could be brought to bear on prices during the course of the year, without ignoring the importance of normal seasonal fluctuations; fiscal policy in compliance with the accumulated primary surplus target of the consolidated public sector corresponding to 3.25% of GDP in 2000, with a significant contribution to continued price stability; short-term persistence of international market volatility at the present level; and an outlook for growth in the world economy.

Based on simulations with the central scenario, it was concluded that maintenance of interest at the current level is compatible with the inflation targets defined for 2000 and 2001. Once the central scenario had been presented, simulations were made with the different economic models based on alternative scenarios. The major differences in relation to the central scenario involved the passthrough of international petroleum price increases to internal prices.

Short-term forecasts and leading indicators for inflation were also presented. The results point to an upturn in inflation in the second and third quarters of 2000. More specifically, the leading indicators suggest greater pressure on prices in July and August, while the short-term nonstructural models point to a moderate high in inflation in the second quarter when compared to the first.

Analysis of the inflation core must still be added to this equation. A comparison of the median of this indicator in the final quarter of 1999 with the median in the first four months of 2000 leads to the conclusion that the decline in inflation registered by consumer price indices is a result of a reduction in the underlying process of inflation revealed by the core.

The median of inflation expectations as measured by the IPCA and gathered by the daily Banco Central survey came to 6.10% on May 24, indicating an ongoing process of convergence to the target of 6.00%.

Money market and open market operations

In the period extending from April 19 to May 23, the monetary impact of public offers and redemptions with Banco Central issued securities was contraction of R$ 0.2 billion. NBCE were offered on three occasions for purposes of rolling maturing exchange securities. In the case of operations with papers for which the National Treasury was liable, the result was an expansionary impact of R$ 7.5 billion.

The National Treasury effected six LTN sales in the period under consideration, registering a financial value of R$ 9.9 billion. Redemptions came to R$ 9.2 billion, of which R$ 2.0 billion were carried out in advance through a single public purchase offer with three maturities. The average rates of the one year LTN moved from 19.83% per year on April 18 to 20.29% on May 2. The five placements of three year LFT totaled R$ 16.5 billion, while redemptions added up to R$ 18.6 billion.

Banco Central operated on the open market on 12 different occasions and always with the purpose of injecting resources. The purpose of these operations was to preserve the liquidity equilibrium of the financial system for a total of twenty three business days.

Monetary policy guidelines

Analysis of supply and demand indicates an absence of imbalances capable of generating significant inflationary pressures on the horizon pertinent to the inflation target system.

Growth in aggregate demand has occurred in an organized manner. On the one hand, consumption increases as a result of greater sales of consumer durables which, in turn, is a natural consequence of increased credit availability and a slight reduction in borrower interest rates. At the same time, investments have shown clear signs of recovery, as evident in growth under capital goods production. The increase in net exports, led by sales of manufactured and semimanufactured goods, has not been even more expressive due to the high in international oil prices. On the other hand, continued fiscal austerity, with primary surpluses higher than originally forecast, has reduced the risks of noncompliance with the fiscal targets defined for the year.

Aggregate supply has accompanied growth in demand and contributed to deceleration of price indices in recent months. Expanded industrial sector employment, which is one of the primary characteristics of the current moment, is still not sufficient to be reflected in declining rates of joblessness. The reason underlying this conclusion is that improvement in the climate of confidence in the economy also encourages greater participation of the labor force. The average real earnings of persons employed have been recovering gradually without creating undue cost pressures. Though quite high in several sectors of the economy, the average level of utilization of installed capacity is consistent with the performance of industry in general and the current outlook for greater investments in productive capacity would seem sufficient to offset possible supply lags.

Though the general situation would seem to favor price stability, the supply shock generated by international oil prices, which increased in May in both spot and futures contracts, and by higher government managed prices forecast for the second and third quarters, are factors that reflect pressures on the future trajectory of inflation. At the same time, the short-term persistence of a highly volatile international financial market, coupled with such other factors as the trend to an increasingly tighter monetary policy in the United States, should also be seen as negative shocks on the future trajectory of inflation. These factors have contributed to a significant increase in the Brazil risk premium. At the same time, the question of uncertainties regarding the value of indexing of the Employment Compensation Fund (FGTS) also generates a negative impact on perceptions of the Brazil risk, even though it exerts no pressures on current public sector expenditures. However, to a great extent, this potential impact has already been incorporated into market expectations.

Despite acknowledging the risks listed above, an alternative posture gives due consideration to the fact that the country managed to reverse the consumer inflation trend in the first four months of the year. At the moment, the inflation expectations (IPCA) of economic agents for 2000 are concentrated in the range of the 6% target and below those notified in the month of April. Another indicator of importance to this turnaround is the inflation core which declined in the first four months of 2000 when compared to the end of 1999. The rapid reversal in the trajectory of domestic prices evident in a drop of more than five percentage points in annualized inflation in the first four months of the year in comparison to the final four months of 1999 (4.25% as against 9.54%) suggests there is room for a reduction in the nation's current rates of interest.

In light of the potential impact of recent and future events on the expected inflation trajectory, Copom voted by seven to one to maintain the Selic rate target unchanged at 18.5% per year. The dissenting vote favored a reduction to 18% 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 June 19, 2000, at 3:00 PM, for technical presentations and on the following day, at 4:30 PM in order to discuss monetary policy guidelines.

Daso Maranhão Coimbra

Executive Secretary of COPOM

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