BANCO CENTRAL DO BRASIL – *FOCUS*

January 10, 2001

MINUTES OF THE 54th

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

Summary

Aggregate demand and supply. External environment. Prices. Prospective assessment of inflation trends. Money market and open market operations. Monetary policy guidelines

Date: 12.19 and 20.2000

Place: 8th floor (12.19) and 20th floor (12.20) meeting rooms Banco Central Headquarters – Brasília – DF

Called to order: 3:20 PM on 12.19 and 5:00 PM on 12.20

Adjourned: 7:02 on 12.19 and 6:15 PM on 12.20

In attendance:

Members of the Board

Armínio Fraga Neto – Governor

Carlos Eduardo de Freitas

Daniel Luiz Gleizer

Edison Bernardes dos Santos

Ilan Goldfajn

Luiz Fernando Figueiredo

Sérgio Darcy da Silva Alves

Tereza Cristina Grossi Togni

Department Heads (all present on 12.19)

Altamir Lopes – Department of Economics (DEPEC)

Daso Maranhão Coimbra – International Reserve Operations Department (DEPIN)

José Antonio Marciano - Department of Banking Operations (DEBAN)

Alexandre Antonio Tombini – Research Department (DEPEP)

Eduardo Hitiro Nakao – Open Market Operations Department (DEMAB)

Other participants (all present on 12.19)

Gustavo Bussinger – Advisor to DEPEC

João Borges – Press Advisor (ASIMP)

Sérgio Goldstein – Advisor to DIPOM.

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

Demand indicators showed increase over the fourth quarter, a change favored by credit and exports expansion, better expectations and, more recently, by a recovery in employment levels.

Industrial sales of automotive vehicles expanded 22.2% in the yearly aggregate up to November, increasing 36.6% in exports and 18.7% in domestic sales. The increased exports have also driven total sales of agricultural machines and motorcycles, which grew 27.4% and 34.7%, respectively, as against the same period of 1999. Still regarding industrial sales, October seasonally adjusted data from the National Confederation of Industry (CNI) and the São Paulo Federation of Industries (FIESP) point towards a monthly growth of 2.1% and 1.8%, respectively, and of 10.6% and 13.3% in the yearly aggregate up to October, as against the same period of 1999.

In October, according to the Trade Federation of the State of São Paulo seasonally adjusted data, real revenues of the retail trade increased 0.4% as against the previous month and 8.7% as against October 1999. All segments surveyed, except building materials, displayed expansion when compared to September. In accumulated terms for the year, the rate of growth kept around 11% above the same period of 1999. Consumer durables and automobiles led the sales. The recent expansion in supermarket sales increased the sales of non-durables to 14.7% in the yearly aggregate up to November.

The Consumer Confidence Index (ICC) increased from 104.5 in November to 105.5 in December, on a 0 to 200 range. This indicator, also published by FCESP, displayed an increase of 6.2% in the item current economic conditions and a decrease of 1.2% in the consumer's future expectations.

The balance of credit operations with non-earmarked funding increased 4.8% in November, aggregating 20% along the second half of the year. Credits granted to individual persons increased at a more accelerated pace, registering growth of 27.5% in the same period. Credit for the purchase of vehicles expanded 72.6%, fostered by an increase in average credit terms, drop in interest rates and a reduction in average default levels.

Production of capital goods kept accelerating in October, reaching 12.9% in the yearly aggregate, while imports of capital goods resumed growth in quantity by the monthly comparison since the beginning of the second half of the year. The building industry displayed a less dynamic performance, as shown by an expansion of 2% in production of inputs in the period January-October when compared to the same period of 1999.

The trade balance recorded a negative balance of US$ 630 million in November, aggregating a deficit of US$ 478 million over the year. An increase in petroleum prices is to blame for these results, reflecting the increase in this product price.

Imports of raw materials increased 18.9% in the yearly aggregate up to November, as against equal period of 1999, as a consequence of an increase in quantities. This performance was partially due to the economy growth and to an expansion of 22% in manufacture exports, which incorporated imported components. Exports of basic products grew 8% up to November, also reflecting an expansion in quantities shipped, with still decreasing prices. Regarding semi-manufactures, an increase in prices was observed while quantities exported diminished in past months.

Aggregate supply indicators point to a growth throughout the year, with upturns under average utilization of installed output capacity, employment and industrial productivity.

In October, industrial production resumed growth, overcoming the drops observed in August and September. The monthly production was the higher in 2000, second in the seasonally adjusted series only to the result of December 1994. The yearly aggregate growth reached 6.6% in October, keeping relatively constant since the middle of the year, even when considering a comparison period in which the production was under recovery. Among industrial sectors, transportation material recorded the higher growth rate, followed by mechanical industry, rubber, electric materials, and by communication and mineral extraction sectors.

An analysis by use categories confirms the better yearly performance of consumer durables and capital goods production, reflecting improved credit conditions, increased investment and better exports performance. Production of intermediary goods keeps following the increase in the manufacture of final goods, growing from 7% to 8% and recording higher levels of output. It is worth mentioning a 35.1% expansion in production of capital goods parts and spares, 12.1% in vehicle parts, and 11% in petroleum and gas extraction, as well as sub-sectors producing industrial inputs, such as iron and steel mills, petrochemicals, fertilizers and textiles.

According to seasonally adjusted CNI data, the utilization level of installed output capacity in the manufacturing sector came to 80.9% in October. Some industrial categories which manufacture intermediate goods are operating close to their full installed capacity.

According to an October IBGE survey, the grain harvest is expected to expand by 1.9% in the 1999/2000 harvest year, reaching a level of 83.9 million tons. Regarding sowing intentions and already sowed areas for the 2001 harvest, a survey performed in October indicated an increase of 0.4% in sowed area as against the 2000 harvest.

As regards the labor market, the trend of increased employment and productivity persisted, accommodating the recent salary negotiations without affecting costs. For the thirteenth consecutive month, formal employment expanded in the month of October, with creation of 883 thousand job positions in the year. With exception of the building industry, all sectors displayed employment growth. Open unemployment rates remained fairly stable at 6.7% in October.

External environment

Since the end of November, the increased price trend in the petroleum market was reverted, with the OPEP basket reducing from about US$ 31.50/b to US$ 25/b. Market conditions suggest an excess of global supply, in spite of the recent exports suspension by Iraq. The market kept volatile, with sharp drops in prices, a movement amplified by commodities investment funds, which inverted their positions in the derivatives market and turned to bet in lower petroleum prices.

Insofar as the American economy is concerned, the last Federal Open Market Committee (FOMC) meeting kept the base interest rate (Fed funds) at 6.5% p.a., a decision supported by still persistent inflationary risks, though lessened by a sluggish economic activity. The FOMC explanations of its decision strengthened expectations on future interest rate drops, as evidenced by futures interest rate contracts.

The signs of recovery in the Japanese economy are still weak. The estimated GDP for the third quarter increased 1% as against the previous quarter, and 1.5% when compared to the same period of 1999. Household expenditures do not display a clear trend, and net exports lost strength in the third quarter.

Regarding the Euro Zone countries, economic activity keeps indicating deceleration while inflation keeps its upward trend, reflecting increased import prices, mainly of petroleum. The European Central Bank kept unchanged in 4.75% p.a. the interest rate on main refinancing operations. In the exchange market, after three European Central Bank interventions in the first half of November, the Euro appreciated in the second half of the month and reached, in the first week of December, its higher price against the United States Dollar over the past three months.

In Argentina, domestic demand remained weak. The confidence crisis of the past months increased the sovereign risk premium and domestic interest rates. In response, the Government adopted two sets of economic measures. The first, in October, aimed at encouraging investment and consumption, favoring, in consequence, fiscal revenue and employment. The measures taken in November were turned towards the necessary structural reforms in labor and social security legislation. The pact agreed between the central Government and those of the Provinces, coupled with approval of the 2001 budget, enabled the completion of the IMF financial assistance agreement. Under the agreement, the country was granted access to funds estimated in US$ 39.7 billion, sufficient to secure foreign funding over the next year, restore the necessary confidence climate and attract the investments needed to recover the country's economy.

Prices

The higher price indices in November reflected the partial effects of fuel price readjustment, effective as from the 23rd, while agricultural prices displayed a negative change over the month.

The Broad Consumer Price Index (IPCA) turned in growth of 0.32% in November, with accumulated expansion of 5.35% in the year and 5.99% in the last 12 months. The 0.18 percentage point increase in the monthly change of the index resulted from a 0.43% rise in non-food products, softened by a drop of 0.07% in the food and beverage group. The rise in price of non-food products was restricted to some products only, with emphasis to gasoline and electric energy, which contributed with 0.21 percentage point to the total index change. In the case of electric energy, the increase resulted from rate adjustments in Rio de Janeiro and Porto Alegre.

IGP-DI rose 0.39% in November (0.37% in October), with equivalent changes in wholesale, consumer and construction prices. Regarding wholesale prices, it shall be mentioned a drop of 0.07% in agricultural prices, as against a rise of 0.8% in October. Insofar as IPC is concerned, the impact of gasoline, and that of electricity and urban bus price adjustments in Rio de Janeiro reached 0.41 percentage point. Similarly to IPCA, the food item, with a drop of 0.51%, softened the index variation. The IPC core increased 0.35%, aggregating 3.95% in the twelve months change.

Prospective assessment of inflation trends

Identified shocks and their impacts were reassessed in light of newly available information. The scenario considered in the simulations is based on the following hypotheses:

a. the November inflation (0.32%) was in keeping with the expected value (0.30%). For this reason and the estimate from 0.6% to 0.7% for the December inflation, the yearly rate of inflation shall be very close to the goal of 6%.

b. despite its volatility, the international petroleum price is falling both in spot and in futures markets. By the new adjustment mechanism for domestic fuel prices, establishing automatic quarterly changes based on the price of R$ 55.00 for the Brent, the price curve implicit in futures contracts implies a decrease of gasoline prices in 2001;

c. the average readjustment for the set of administered prices in 2001 shall reach 6%, for a direct contribution of 1.3 percentage point to the yearly inflation. This includes fuels and the 19.2% rise of the minimum salary next April, which will represent 0.62 percentage points in that month’s inflation.

d. the increase of grain harvest in 2001 shall foster a smaller change in food prices when compared to the average of other prices in the year, with deflationary pressure in the second quarter.

e. according to futures contract forecasts, the hypothesis for the path of fed funds rate includes two reductions of 25 basis points in the first quarter of 2001. Therefore, the rate would drop from the current 6.5% p.a. to 6% p.a., remaining stable at such level.

f. in the foreign sector, the normal deceleration of the U.S. economy tends to induce smaller world growth, of about 3%, a drop in petroleum prices and a less restrictive monetary policy in the United States. The combination of these factors may enable a better perception of the Brazil risk and promote international liquidity conditions in line with the need to finance the current transactions balance of payment deficit. Even though, the working hypothesis keeps being the one of maintaining the Brazil risk premium at its current level.

All other hypothesis considered in the previous meeting were maintained, in special the one of attaining primary surplus according to the fiscal policy goals and GDP growth in line with balanced aggregate demand and supply.

Based on simulation exercises with the basic (structural) model scenario, one reached the conclusion that maintaining the interest rate at the current level of 16.5% enables complying with the inflation goal with ease in 2001 and 2002.

The IPCA core inflation, calculated by the method of rounded averages, dropped to 0.32% in November, from 0.42% in October, confirming the downturn of the last two months and suggesting levels of monthly inflation in line with the 2001 goal. However, the core inflation measured by IPC-BR, published by the Getúlio Vargas Foundation, had an opposing behavior, increasing from 0.21% to 0.36%, though close to the monthly average of 0.28% measured in the first half of the year.

The median of expectations for IPCA changes collected by a daily Central Bank survey was 6.07% for 2000 and 4.30% for 2001. The stable inflation expectations over the past months, a period when the Real loss strength before the Dollar, confirms a perception that the effect of exchange variations on domestic prices is limited and that its magnitude seems to be diminishing.

Money market and open market operations

Between November 22 and December 19, the monetary effect of definite operations with Central Bank securities was contractive in R$ 2.7 billion. These operations were in keeping with the objective of fully rolling the maturing exchange security debt, considering final interest and the nominal updated redemption value.

The definite operations with LTN were expansionary in R$ 4.5 billion. The eight sales added up to R$ 5.2 billion, contrasting with R$ 9.7 billion in redemptions, computing, in this amount, R$ 1.0 billion of previous sales. Six-months and one-year LTN both displayed maximum interest rates at the opening in November 28, and retreated systematically over the following days.

The four LFT offers totaled R$ 6.9 billion, while redemptions added up to R$ 9.9 billion. One should also consider the renewed offer of five-year NTN-C in two steps on November 29 and 30 with a total value of R$ 0.3 billion. Only 15% of this amount was liquidated with the use of securitized credits for which the National Treasury was liable.

Taken together, definite operations with federal public securities indicated a monetary expansion of R$ 8.0 billion. This excess liquidity was partially offset by payment, to the Sole Account, of amounts related to privatization of Banespa and increased selling position of securities, from the Central Bank, in its committed operations.

Monetary policy guidelines

Analysis of supply and demand conditions reveals no significant pressures on inflation. Indicators of aggregate demand display expressive growth over the year, a trend reinforced by preliminary data on the fourth quarter. With this, in the year 2000, the beginning of a more vigorous and sustainable period of growth is consolidated. The increased aggregate demand is driven by higher exports of manufactures and growth in the consumption of durable goods.

Investment indicators, in turn, fail to display expressive growth in 2000. However, an itemized analysis of these indicators indicate that this performance is mainly due to the stagnation of the relatively highly-weighted construction industry. This means that the higher contribution to investment comes from sectors concerned with increasing production and installed capacity, helping diminishing potential unbalances between supply and demand, with effects on prices.

Regarding fiscal policy, the goals established for the consolidated public sector primary result keep being permanently and consistently achieved, building a fundamental buttress of economic stability. The continued fiscal effort, reflected in the goals established for the subsequent years, is playing a relevant role in strengthening the confidence of agents in the set of public policies, in particular, adding more freedom to conduction of the monetary policy and contributing to curb inflation.

Aggregate supply indicators point to a growth throughout the year, with upturns under average utilization of installed output capacity, employment and industrial productivity.

In the external sector, recent developments have been positive, though the main uncertainties are far from vanishing. Petroleum prices started a sharp decline, in both the spot and the futures market, suggesting the closing of a two-year cycle in which this commodity was responsible for the main foreign shock affecting the Brazilian economy. The U.S. economy seems to confirm lower growth, although there are doubts on how smooth this process will be. Given the strong fiscal conditions and the careful monitoring history of the U.S. monetary authority, the slowdown tends to be moderate.

These two factors contribute towards a reduction in the growth level of the world economy to about 3% in 2001, resulting in an environment of diminishing inflation, making room for a gradually softer monetary policy in the main industrialized countries. This less strict monetary policy, in a context of soft slowdown, in case it comes to be confirmed, tends to favor international liquidity. Perception of sovereign risk shall also gradually improve in line with the perception that the Brazilian economy fundamentals are solid is consolidated. Still regarding the foreign sector, among the uncertainties that were mitigated, the ones related to the foreign funding of Argentina may be included. The recent agreement reached with international banks and organizations improved the funding profile and opened avenues to resume the country's growth in the next year.

The recent behavior of inflation confirms Copom's perception of a low degree of inertia built into the process of domestic price formation. Inflation rate measured by IPCA shall be very close to the goal of 6% at the end of 2000, for a reduction of almost three percentage points as against the previous year. This reduction happened despite a strong influence of administered prices, which increased 12% in the year, and exchange devaluation of 9.5% (more recent value compared to the one at the end of 1999), which had a relatively weak impact on domestic prices. The stability of inflation expectations along the year ratifies the ability of the economy to absorb shocks without excessive welfare costs.

An analysis of the domestic and foreign macroeconomic scenario, including all potential risks associated, leads to a conclusion that the perspectives for 2001 favor a decline in inflation in about two percentage points when compared to the current year, as required by the inflation goal established in 1999. One may list, as main causes: an expected drop in gasoline prices, a result of declining petroleum international prices; an increase of about 6% in the set of administered prices, about half of the percentage for 2000; a substantial agricultural harvest increase; the stable expectations of market agents; and the lack of pressures on prices in the economy.

Consequently, Copom resolved to reduce the Selic rate target to 15.75% per year.

At the close of the meeting, it was announced that the Committee would meet again on January 16, 2001, for technical presentations and, on the following day, at 4:30 PM, in order to discuss monetary policy guidelines as set in the Calendar of Copom's Ordinary Meetings, published in the Central Bank Communiqué no. 8,018, of 01.22.2000.

Alexandre Antonio Tombini.

Notes revised by the Board.
