BANCO CENTRAL DO BRASIL – *FOCUS*

February 21, 2001

MINUTES OF THE 55th

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: 01.16 and 17.2001.

Place: 8th floor (01.16) and 20th floor (01.17) meeting rooms   Central Bank Headquarters – Brasília – DF

Called to order: 04:00 PM on 01.16 and 05:20 PM on 01.17

Adjourned: 07:30 PM on 01.16 and 07:00 PM on 01.17

In attendance:

Members of the Board

Armínio Fraga Neto – Governor

Carlos Eduardo de Freitas

Edison Bernardes dos Santos

Ilan Goldfajn

Luiz Fernando Figueiredo

Sérgio Darcy da Silva Alves

Tereza Cristina Grossi Togni

Department Heads (all present on 01.16)

Fernando Antônio de Moraes Rego Caldas, Economic Research Department (DEPEC)

Carlos Yoshitaka Urata– 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 01.16)

Alexandre Pundek Rocha – Advisor to the Board

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 monetary policy regime, which is designed to ensure compliance with government defined inflation targets.

Aggregate demand and supply

The economic activity sustained a stable growth rate along the second half-year, in spite of the higher base of comparison in equal period of 1999. Despite substantial expansion of aggregate demand, there were no inflationary pressures.

According to the National Confederation of Industry (CNI) and Federation of Industries of the State of São Paulo (FIESP) data, seasonally adjusted industrial sales increased 2.5% and 0.8% in November, aggregating growths of 10.7% and 13.4%, respectively, on the first eleven months of the year. Following a similar trend, industrial sales of vehicles increased 23.8% in 2000, with expansions of 33.9% in exports and 21.2% in domestic sales.

According to preliminary statistics released by the Trade Federation of the State of São Paulo (FCESP), in December real sales of the retail sector, deflated by IPCA, grew 5.8% in seasonally adjusted data as against the previous month. Over the year, retail sales aggregated an expansion of 11.6%. This growth was driven by sales of non-durables (increase of 15.8%), vehicles (14.9%) and durables (14.8%), contrasting to a substantial drop (34.1%) in sales of semi-durables.

Aggregate demand followed these increased sales. The indicators reveal a positive behavior for industrial production, coupled with a trend of continued employment expansion and gradual recovery of real salaries.

Industrial production increased 6.4% in November, with emphasis for the categories of durable consumables and capital goods, with growths of 19% and 13%, respectively.

The labor market in November displayed a growth in formal employment for the fourteenth consecutive month. As a whole, all activity sectors indicate increase in occupation, with the exception of construction industry. The rate of open unemployment, measured in six metropolitan regions, reduced to 6.19% in November, from 6.75% in October.

The level of installed capacity utilization in the manufacturing industry, calculated by CNI, reached 82% in November, the higher level ever recorded by this series.

This increased level of utilization stimulated the demand for investments. Production of capital goods expanded 13% in the year up to November, and imports of capital goods, though experiencing a drop of 5.5% in the year up to November, exhibited a reversal of this trend (up to July the drop aggregated 13.6%). Loans granted by BNDES increased 27.7% in the year. In contrast, production of construction industry inputs increased just 2.2% from January to November 2000, as against the same period of 1999. However, a recovery of this sector can be observed in the last months of the year, with growths of 1.6% in October and 0.6% in November.

An increased aggregate demand, including exports, and larger fuel expenditures have impacted the trade balance, which recorded a negative balance of US$ 213 million in December, for an aggregate deficit of US$ 698 million in the year. There was a significant increase in exports over the month, a result of the high in sales of manufactures, with a daily average 23.5% above that of December 1999. In turn, the daily average of imports increased 25.9%, reflecting growths in all product categories. As against November, the daily average of imports reduced as a result of lower expenditures in fuels and lubricants, raw materials and consumption goods.

Imports of intermediary goods recorded a growth in 2000, in keeping with expanded exports of manufactures and domestic demand. In December, the main imports were those of naphthas, fertilizers, chemical products, electronic components, iron and steel products, papers and plastic resins. Expenditures with fuels were impacted by higher international petroleum prices. However, imports of petroleum diminished 8.1% in December, as against the same month in the previous year, explained by the downturn of 34.3% in the volume imported.

External environment

In December, international petroleum prices experienced a substantial decline, with the Brent ending the month at US$ 22.6/barrel. This downwards trend was interrupted in January, in response to expectations of production cuts by OPEC country members. However, the actual price is still about 10% below the average price recorded in the last year.

Recent demand and supply indicators in the United States support the expectations of deceleration in the economy. Retail sales, new buildings and orders to manufacturers, when analyzed according to the twelve-month change, show a declining path. Consumer credit, that was displaying growing rates until October, recorded stability in November.

The deceleration trend failed to reflect in aggregate labor market statistics up to this moment. The unemployment rate was 4% in December, stable as against November, and the average nominal income for hour worked increased 0.4% in this same month. However, the increase in industrial employment in December was significantly lower that the yearly average. The inflation rate remained under control, and the producer price index (PPI) was stable in December, for a growth of 3.6% in 12 months. The consumer price index changed 0.2%, aggregating a growth of 3.4% over the year. With the exclusion of food and energy, the change of the PPI core reached 1.2% in the year, and that of CPI, 2.6%.

On January 3, the Federal Reserve Open Market Committee (FOMC) announced a reduction on the target for the base interest rate (fed funds) to 6.0%, from 6.5%. In the same week, the rediscount rate was reduced to 5.5%, from 6.0% p.a., in two stages.

In Japan, the signs of economic recovery kept feeble, with weakened consumption, decelerated trend in industrial growth and drop in monthly trade balances. In this environment, the unemployment rate increased to 4.8% in November, from 4.7% in October. Consumer prices reduced 0.5% in the twelve months up to November, while in the same period the change in wholesale prices was 0.3%.

Regarding the countries in the Euro area, the growth trend shows some evidence of deceleration. Retail sales sustained positive, though decreasing, rates when compared to those of the same period of the previous year. Performance has been uneven among associated countries, with an expressive consumption increase in France *vis-à-vis* a milder expansion in Germany. The twelve-month aggregate trade surplus diminished to US$ 15.9 in October, from US$ 20.1 billion in September. Industrial production increased 0.5% in November, aggregating a growth of 3.8% over the year, while the unemployment rate remained stable at 8.8% in the same month. Inflationary pressures tend to weaken with the reduced petroleum prices and the recent appreciation of the Euro. In the twelve-month period up to November, the harmonized consumer price index changed 2.9% and prices to producer increased 6.3%.

In Argentina, a renewed confidence climate reduced the spread between Peso and Dollar operations to 1% in mid-January, from 3.9% at the end of November, for thirty-day operations. The domestic interest rates receded due to the announced accord with the International Monetary Fund in December, reflecting, in addition, the drop of interest rates in the United States. Economic activity level indicators failed to catch the upturn in growth, a fact that, coupled with the increased petroleum prices, contributed towards a trade surplus of US$ 600 million over the twelve-month period up to November.

Prices

Regarding general price indices, the December increase was led by wholesale prices, especially industrial products, resulting from the impact of readjusted fuel and lubricant prices (6.1%). Regarding consumer prices, the increase was pulled by administered prices, including electricity prices and urban bus fares in Rio de Janeiro, alcohol and higher gasoline prices at the end of November.

IGP-DI elevated 0.76% in December, as against a growth of 0.39% in November. Among its components, there were changes of 0.85% in wholesale price index, 0.62% in consumer price, and 0.64% in cost of construction indices. Industrial wholesale prices recorded an advance of 1.15%, while that of farm prices changed 0.17%, after a reduction of 0.07% in November. The aggregated IGP-DI increase in 2000 reached 9.81%, while that of IPA-DI and IPC accumulated changes of 12.06% and of 6.21%, respectively.

IPCA displayed a change of 0.59% in December, as against 0.32% in November. The index was pressed by administered prices, with a growth of 2.09%, with emphasis for adjustments in water and sewer, energy, bottled gas, alcohol and gasoline. The group food and beverages recorded a negative change of 0.48%, before a drop of 0.07% in November. Over the year, IPCA aggregated a change of 5.97%, fulfilling the 6% target established by the Government.

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 December inflation (0.59%) was slightly below what was expected (0.65%), which secured compliance with the 6% target (5.97%);
b. an expected 5% petroleum production cut by countries member of OPEC (meeting of 01.17) is unlikely to cause unrest in international petroleum prices. Under the new fuel domestic price adjustment mechanism, that sets automatic quarterly changes based on the price of R$ 55.00 for the Brent barrel, and considering the implicit price schedule of futures petroleum contracts, we forecast a 6.5 % drop in gasoline prices for the consumer (corresponding to a drop of 8.65% in refinery prices) in the second quarter of 2001, being the occurrence of additional reductions during the rest of the year likely.
c. the average price adjustment for administered prices shall reach 6% in 2001. this includes fuels and a minimum wage increase to R$ 180 in April.
d. according to futures contracts forecasts, the hypothesis for the path of fed funds rate includes two reductions of 50 basis points in the first half of 2001. Therefore, the rate would drop from the current 6% p.a. to 5.0% p.a., remaining stable at such level.
e. in the foreign environment, the Federal Reserve decision to cut off 50 basis points in the interest rates, although evidencing the risk of a stronger deceleration, shows resoluteness of the monetary authority to act in a timely way in order to avoid brisk movements that would affect the world economy. A stronger deceleration in the United States economy tends to generate a more favorable trend for interest rates and petroleum prices. Depending on the magnitude of such effects, the risks to the Brazilian economy stemming from future developments of the United States economy may offset each other. Given this fact and a favorable perception on the Brazilian economic fundamentals, a stable Brazil risk premium

was taken as working hypothesis, after the slight improvements occurred since the last meeting are taken into account.

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.

Simulation exercises with the scenario considered in the basic (structural) model suggest that maintaining the interest rate at the current level of 15.75% p.a. (effective until January 17) enables the fulfillment of the 2001 and 2002 inflation targets. This last conclusion holds when one uses the nominal interest path expected by the market (14% p.a. at the end of 2001), recorded by the monthly survey performed by the Central Bank.

The IPCA core inflation, calculated by the method of rounded averages, kept practically stable at 0.33% in December (0.32% in November) , 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 increased from 0.36% to 0.50%, well above the monthly average of 0.28% measured in the first half of the year. IPCA core inflation indicators, using the method of exclusion (i.e., excluding administered prices and foodstuffs) indicate rates in keeping with the compliance of targets.

The median of expectations for IPCA changes, collected by a Central Bank daily survey, was 4.20% for 2001, below the level of 4.3% observed in the last COPOM meeting. For 2002, the median of expectations is 3.82%.

Money market and open market operations

In the period from December 19 and January 15, the Central Bank fully rolled the maturing exchange securities, including updated principal and final interests. With this purpose, two auctions were held of NBC-E, totaling R$ 4.1 billion.

It shall be stressed that, along the past two years, there was increased exposure of the Central Bank in exchange securities and, simultaneously, a reduction of the National Treasury exposure. A slight downwards trend was observed in the aggregate of both issuers.

The National Treasury held in the period three public offers of LTN, with two maturity alternatives in each case: in the first and second offers, six or twelve months; in the third, terms of twelve or eighteen months. Sales reached R$ 7.4 billion which compares to scheduled redemptions of R$ 4.8 billion and anticipated redemptions of R$ 1.9 billion, resulting from a single public offer to purchase. The average rate of LTN placements displayed a systematic drop for all terms. In the specific case of eighteen months LTN, the average rate reached 16.47% p.a.

Three LTN public offers were made with a term of four years, totaling R$ 5.4 billion as against a redemption of R$ 10.3 billion. This total redemption includes R$ 4.2 billion corresponding to the LFT-B used in paying NTN-C. The average discount in all auctions was 0.10% p.a.

Regarding the National Treasury domestic securities debt management policy, a deepening can be observed in the process of restructuring, the main results of which are: (1) increased issues of predetermined yield debt, in which yields are linked to price indices, contrasting to net redemptions of debt with yield linked to the Selic rate; and (2) extended terms of new issues.

The first offer of thirty years NTN-C deserves mention, held in two phases on December 27 and 28. The sale reached R$ 4.8 billion, fully settled by the use of CFT-A and LFT-B. It is noticeable that the demand for such securities had reached R$ 14.8 billion, evidencing a demand for much longer terms and an expansion of the horizon of analysis enabled by expectations of a long-lasting stability.

In the period, the monetary impact of definite operations with federal public securities was null. This way, contrasting to what had happened in recent times, the net redemption of competitive debt was not significant.

Monetary policy guidelines

Available aggregate demand indicators show a consumption demand practically at the same level along the second half of 2000. The demand for investment, on the other hand, is displaying signs of recovery in the second half of the year. The targets set for fiscal policy are being consistently attained since the end of 1998. The increase in exports, although not sufficient to secure surplus in the trade balance, had been an important factor for the growth of aggregate demand. Summarizing, the aggregate demand is adequate, with its composition indicating recovery of investment levels. Such investments are not higher because of a sluggish recovery in the building industry that, notwithstanding this, is showing a positive reaction along recent months.

Aggregate supply displays favorable behavior, with industrial production expanding over 6% up to November 2000. The perspectives for the 2000/2001 agricultural harvest are positive, with forecasts of a high in grain production. The labor market keeps its expansion trend, without displaying imbalances that may suggest pressures from the costs side of the economy. Formal employment increased for the fourteenth consecutive month in November, and the unemployment rate reduced to about 6.2% over the same period.

Summarizing, the supply and demand balance fails to suggest any pressure on price indices over the horizon relevant to the inflationary targets regime. However, the steady economic growth has impacted the trade balance. Particularly, as already stressed by this Committee, the expanded level of activity is pulling the imports of intermediary goods and, in the second half of 2000, came to significantly affect the imports of consumer goods. This behavioral trend of the trade balance has, as its counterpart, a perspective of lower international petroleum prices and global conditions for the balance of payment funding, confirmed by recent placement of securities by the Republic totaling US$ 2.5 billion and improved assessments of the Brazil risk.

The foreign environment prevalent in the beginning of this year is positive, in spite of some ongoing uncertainties. The recent behavior of international petroleum prices, despite the production cuts announced by OPEC, suggests a weakening of the upward price trend started two years ago. In Argentina, a new wave of confidence made possible a reduction in domestic interest rates and spread between operations in pesos and American dollars in this beginning of year. In the United States economy, a reduction in the rhythm of growth is being confirmed. However, the intensity of this deceleration remains uncertain. The recent softening of the United States monetary policy, although being an evidence of a stronger deceleration risk, demonstrates the resoluteness of the monetary authority in avoiding brisk movements that would affect the whole world economy. Therefore, the risks for the Brazilian economy stemming from future developments in the United States seem to be balanced, despite depending on the magnitude of different effects. A stronger deceleration jeopardizes our foreign financing and exports and, consequently, our perspectives of growth, while tending to generate lower interest rates in the United States and a more favorable path for international petroleum prices, thus favoring lower inflation.

The recent behavior of inflation is in keeping with COPOM perceptions. The inflation in December, measured by IPCA, was 0.59%, within the expectations of this Committee. With this result, we end the year 2000 complying with the 6% target set by the Government. The 2001 market expectations regarding inflation experienced a slight drop since the last COPOM meeting, and are in line with the inflation target for the next two years. The recent inflation results, as well as the stable market expectations regarding the future behavior of inflation, confirm the Committee perception that domestic prices have already incorporated, to a large extent, the depreciation experienced by the Real in the last quarter of 2000

Considering this analysis of the macroeconomic domestic and foreign environment in this beginning of year and the main risks associated with it, a conclusion was reached that the perspectives for 2001 and 2002 are in keeping with the declined inflation required by the inflation targets set.

Consequently, COPOM resolved to reduce the Selic rate target to 15.25% per year.

At the close of the meeting, it was announced that the Committee would meet again on February 13, 2001, at 3:00 PM, 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.