BANCO CENTRAL DO BRASIL – *FOCUS*

March 28, 2001

MINUTES OF THE 56th

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

Summary

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

Date: 02.13 and 14.2001.

Place: 8th floor (02.13) and 20th floor (02.14) meeting rooms Central Bank Headquarters – Brasília – DF

Called to order: 03:40 PM on 02.13 and 05:40 PM on 02.14

Adjourned: 06:40 PM on 02.13 and 07:00 PM on 02.14.

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 02.13)

Altamir Lopes – Department of Economics (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 02.13)

Alexandre Pundek Rocha – Advisor to the Board

Antônio Carlos Monteiro – Central Bank of Brazil Executive Secretary.

Gustavo Bussinger – Advisor to DEPEC

João Borges – Press Advisor (ASIMP)

The Board analyzed the recent performance 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

By the end of the last year, indicators of aggregate supply displayed a strong expansion, with increased average utilization of installed capacity and expansion of industrial employment.

IBGE published the 2000 GDP figures, exhibiting a growth of 4.2%, led by a 4.8% industrial product expansion, with emphasis to the manufacturing industry. Farm products and services exhibited a positive though less intense evolution, of 2.9% and 3.6%, respectively. It shall be stressed that IBGE rectified the third quarter results, whose growth changed to 4.1%, from 3.8%.

In December, industrial production grew 7.2% as against November considering the seasonally adjusted series. The production growth in December was generalized, reaching 14 of the 20 branches surveyed and all use categories. Regarding use categories, consumer durables exhibited the higher growth (23%). Over the year, industrial production aggregated an expansion of 6.5%.

Insofar as the labor market is concerned, employment and productivity kept their increasing trend. The open unemployment rate diminished to 6.0% in December, from 6.8% in November, in the seasonally adjusted series, reflecting mainly a diminished number of the Active Working Population (PEA). All economic activity sectors exhibited a unemployment reduction in December. Data on labor productivity growth, available up to October, exhibited an aggregated growth in the year of 6%.

The level of installed capacity utilization reached 82% in January, after having arrived to 84.1% in October 2000, according to the Manufacturing Industry Short-Term Survey held by the Getúlio Vargas Foundation. Disregarding seasonal influences, the measured growth was 0.6%. The level of January, even exceeding that of January 2000 (81%), is well below the high of 86% occurred in April 1995.

Broken down by activity sectors, the level of 77% reached by consumer good industries kept below the average for this month and the high of 87% recorded in October 1995. In the same way, for capital good industries the level of January (81%) was lower than that of the industry average and below the peak of 86% reached in October 1997. Out of the 23 industrial sectors surveyed, nine of them exhibited a capacity utilization below 80%, with emphasis to pharmaceuticals, 64.4%, transportation materials, 77.4%, and mechanics, 75.5%. The textile industry was the only displaying a high of capacity utilization in January (91%). It shall be noticed that in some industrial sectors, as paper and cardboard and rubber, an intense utilization of installed capacity is a behavior typical of such industries.

The expansionist rhythm was kept in this beginning of year, evidenced by higher aggregate demand, a trend sustained by credit expansion and improved consumer expectations, given the favorable results of main macroeconomic indicators.

Industrial sales of automotive vehicles increased 28.1% in January as against the same month of the previous year, exhibiting an expansion of 29.1% in the domestic market and 23.5% in exports.

According to the Trade Federation of the State of São Paulo (FCESP) preliminary data, real retail sales in the metropolitan region increased 1.3% in January as against the previous month, and 16.3% in the comparison with January 2000, in the seasonally adjusted series. Sales of consumer durables and non-durables led the expansion, driven by better credit conditions.

Indeed, according to a preliminary survey related to January, the balance of free fund credits increased 1.9% in the month, a result from a drop of 0.2% in credits channeled to juristic persons and increase of 6.3% in those channeled to natural persons. This result indicates a continued contribution of credit operations in support of aggregate demand. Total credit in the economy, including free and earmarked funds, reached R$ 315.9 billion (28.7% of GDP), for a drop of 0.4% in the month.

Despite the credit growth, defaults in the banking system kept moderate. Credits with payment at maturity corresponded to 92.8% of the total in January this year, and those above 90 days late reached 3.1%. In contrast, commerce recorded a possibly transitory increase in the net rate of default, which in São Paulo reached 9.3% in January, as against 4.2% in December, according to the Credit Protection Service of the São Paulo Trade Association. The share of checks returned for insufficient funds on the total checks cleared also increased in January to 4.2%, following the 3.5% recorded in December.

The strong growth of aggregate demand encouraged investments. Investment indicators kept expanding, with emphasis to the production of capital goods, which increased 12.7% in 2000, especially those related to serially industrialized goods and those channeled to agriculture and transports. Capital good imports increased 6.8% in December and 33.1% in January in the seasonally adjusted series. Increased BNDES disbursements to the productive sector of 57.1% in January 2000, as against the same month of 2000, are worth mentioning.

Construction industry, with an expressive weight in investments and GDP estimates, exhibited a less dynamic performance over the last year, as shown by a yearly expansion of 2% in the production of inputs. However, production of capital goods for construction increased 15% in 2000, and the level of activity has been recovering over the past months. Unemployment rate in the sector came to 5.7% in December, from 7.5% in November (observed data), and sales of construction materials in January increased 24.3% as against the same month of the previous year.

The increase in aggregate demand has been partially met by goods produced abroad. In January, the trade balance resulted in a deficit of US$ 479 million, partially offset by a surplus of US$ 17 million in the first two weeks of February. Imports experienced a generalized increase, with emphasis to capital goods (+54.3%) and raw materials and intermediate goods (+29.0%). International trade experienced a noticeable increase in volume. In January, the trade balance recorded average daily exports of US$ 206.3 million and imports of US$ 228 million, increasing 25.5% and 34.2%, respectively, as against the same month of 2000. Main increases were observed in the exports of primary products, such as soybean, iron ore, cellulose and sugar, reflecting a continued expansion in volumes shipped. Over the two first weeks of February, daily averages experienced an increase of 6.1% for exports and 6.9% for imports, as against February 2000.

Part of the trade balance deficit in January is likely to result from temporary factors. Imports of fuels and lubricants in January were 14.9% above the monthly average of 2000. In turn, the higher purchases of capital goods in January may be associated not only to the increase in industrial product but also, starting on that month, to a reduction to 14% of the import duty, from 18% (this category's Mercosul Common Foreign Duty), and extension of the off-duty schedule, which established in 4% the import duty for 1,584 items, mainly those related to sectors such as chemical, petrochemical, paper and cellulose, textile, vehicle manufacturing and vehicle parts and spares. Such items, added to 384 computer and telecommunication items also included in the off-duty schedule, were responsible by around 8% of capital goods imports up to September 2000.

External environment

The growth in production of industrialized countries is likely to decelerate this year, led by a slowing down of the United States growth to a range of 1.75% to 2.5%, according to current market expectations. In the United States, the NAPM index of purchase managers, related to the manufacturing industry, reached 41.2% in January, the lowest level in the past two years. Industrial production in the seasonally adjusted series reduced 0.6% in December, as against the previous month. In turn, unemployment rate increased to 4.2% in January, from 4.0% in December.

In its January meeting, the Federal Open Market Committee decided in favor of a new drop of 50 basis points in the base interest rate target, reduced to 5.5% p.a. The Committee's communiqué referred to the need of a swift and firm response to be given by monetary policy in an environment of stronger reduction in consumer and company confidence, which is already affecting industrial production. On that same date, the rediscount rate was reduced in 50 basis points, to 5% p.a.

Regarding the countries in the Euro Area, one expects a growth between 2.3% and 2.8% in 2001, probably above the one to be experienced by the United States. In December, unemployment rate remained stable at 8.7%. Industrial production increased 0.6% in November, aggregating a yearly expansion of 4.7%. Inflation, measured by the harmonized consumer price index, reached 2.6% in 2000, exhibiting a decline as against the yearly 2.9% recorded up to November. However, confidence indicators kept the downward trend started in September 2000.

In Japan, consumption remains weak while investment indicators display some reaction: industrial orders increased 15.4% in November, as against the same month of the previous year, and starts of housing buildings increased 10.6% in December as against December 1999. The trade balance aggregated in twelve months recorded a drop of 4.4% in December, keeping a downward trend, while the unemployment rate remained at 4.8% over the last two months of 2000. Industrial production recorded an increase of 5.2% over the year.

Petroleum international price keeps volatile. Prices in the demand market were higher in the first weeks of February, yet futures markets exhibit expectations of lower prices along the year.

Finally, Argentina is recovering the agent's confidence in the country, as suggested by the performance of interest rates and cost of Treasury securities placements held since the beginning of the year. In this line, the difference between interests in thirty days operations in Dollars and Pesos was 0.375% on February 13, with rates reaching 6.875% p.a. and 7.25% p.a., respectively, levels below those in effect before the crisis.

Prices

IPCA recorded an increase of 0.57% in January, as against 0.59% in December. A reduction in the fuel variation rate, that had a significant impact in December, was offset by an increase in foodstuffs and school fees, both of seasonal character. Important also were pressures stemming from price adjustments in urban bus fares of some capital cities, higher electricity prices, and incidence of ICMS on energy, in Belém. With the January result, the IPCA change over the past twelve months reached 5.92%.

The General Price Index – Internal Supply (IGP-DI) turned in growth of 0.49% in January, because of a change of 0.40% in the wholesale price index, 0.64% in the consumer price index and 0.58% in the cost of construction index. In the wholesale, emphasis shall be given to the drop of 0.62% in prices of agricultural products, resulting mainly from a reduction of 2.9% in prices of animals and by-products, especially birds. The change in industrial prices reduced to 0.78% in January, from 1.15% in December. Regarding IPC, the increase was mainly due to items such as education, foodstuffs and miscellaneous expenses, in addition to the contribution given by urban bus fares in some capital cities. The IPC core increased 0.44%, as against 0.50% in December.

Money market and open market operations

The period from January 17 to February 13 was marked by a contractive monetary impact (of R$ 1.8 billion in definite operations with federal securities) and an extension of terms.

In four traditional public offers, the National Treasury sold LTNs maturing in twelve and eighteen months. Yet, in a single firm offer auction, twenty-six months LTNs were sold, the most extended term for securities of this type. The financial volume of such placements reached R$ 10.4 billion, against redemptions of R$ 10.2 billion, considering R$ 2.5 billion resulting from two purchase auctions.

The Central Bank performed in the period a full rollover of exchange securities updated principal to mature, by means of three NBC-Es auctions with maturities of two, three and four years, respectively. The result of such events makes evident that economic agents are demanding exchange hedge for longer terms.

In addition, four competitive offers of LFTs took place in the period, the first with a term of four years and the remaining three with five-year terms. Even with the extended terms, a systematic discount reduction was recorded, from 0.09% to 0.04% p.a., from the first to the last auction.

Still regarding the primary market, and ratifying the trend of larger terms, the National Treasury held the second offer of thirty-year NTN-C. Sales totaled R$ 2.5 billion, of which 52% of the total amount was settled with the use of securitized credits of National Treasury responsibility and LFT-B.

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. inflation measured in January (0.57%) was slightly above the expected value (0.50%);

b. the price schedule currently implicit in futures Brent petroleum contracts displaced about US$ 2.00 up, as against the one observed in the previous COPOM meeting. With this, and the current market exchange rate level, the 6.5% drop previously expected for gasoline prices to consumers in the second quarter may not occur, but instead just smaller reductions over the last two quarters of 2001.

c. electric energy prices were reassessed in the light of authorizations already granted by ANEEL this year. Total adjustments of electric energy in 2001 came to 15.8%, from 12%, with higher increases in the two last quarters. Regarding the set of administered prices, including fuels and minimum salary, the expected average adjustment reaches 8.5%, with a direct contribution to this year’s inflation of 1.9 percentage point;

d. according to futures contract forecasts, the hypothesis for the path of fed funds rate includes an additional reduction of 50 basis points in the second quarter of 2001. Therefore, the rate would drop from the current 5.5% p.a. to 5% p.a., remaining stable at such level;

e. other hypothesis considered at the previous meeting was maintained, namely the calling for a primary surplus based on the targets defined by fiscal policy. This hypothesis, coupled with lower interest rates in the United States, drop of petroleum prices and an appreciation of the Euro before the Dollar, may enable a gradually improved perception of the Brazil risk

The GDP growth was adjusted according to data published by IBGE.

Simulation exercises with the scenario considered in the basic model (structural) enable the conclusion that maintaining the interest rate at its current level of 15.25% p.a. permits fulfilling the inflation targets for 2001 and 2002. When based on the path of market-expected nominal interest rates (expressed in the monthly survey held by the Central Bank), which reaches 13.8% p.a. at the end of 2001, inflation forecasts become slightly above the 2001 target, though keeping comfortably within the ±2% margin.

The IPCA core inflation, calculated by the method of rounded averages, was back to the level of 0.42% in January, after remaining at about 0.33% in the two previous months. However, the majority of excluded items, for being in the upper tail of the distribution, belong to food in the household and education. The increases observed in such items are typically temporary, that is to say, not likely to repeat in the next months. This analysis is corroborated by the IPCA cores calculated by exclusion. Once the influence of administered prices is removed, the cumulative IPCA change over the past twelve months dropped to 3.2% in January, and keeps the downward trend started in September. In turn, the core of inflation measured by IPC-BR, published by the Getúlio Vargas Foundation, dropped to 0.44%, from 0.50%, following the same declining pattern observed in the same period of 2000.

The IPCA change expectation median, collected by a daily survey performed by the Central Bank, kept in 4.20% for 2001, yet reduced from 3.82% to 3.75% in 2002.

Monetary policy guidelines

Available aggregate demand indicators keep exhibiting a balanced growth among their different components. Consumption demand keeps steady, supported by credit expansion and improved expectations. Investment demand, that had being channeled to durable goods, gives signs of turning also towards the construction industry, judging by the increase in demand for capital goods and other inputs of such industry. Public sector consumption keeps stable, with a consistent fulfillment of the targets set to the fiscal policy. The faster rhythm of exports is in keeping with expectations for this time of the year, though still insufficient to reach a trade balance surplus, given the fast pace of imports, mainly those related to intermediary and capital goods.

Aggregate supply is following the rhythm of increased demand. Industrial production keeps vigorous, reflecting an increased utilization of installed capacity, though failing to imply detectable hindrances to the maintenance of growth in an environment of price stability. Perspectives for the 2000/2001 agricultural harvest remain positive, with a high in grain production forecasts, though for some crops, such as rice and beans, estimates have been revised downwards. The labor market exhibits improvements, with smaller unemployment rates and without unbalances that may imply pressures from the cost side.

Summarizing, the supply and demand balance fails to suggest any pressure on price indices over the horizon relevant to the inflationary targets regime. However, a firm economic growth has affected the trade balance, the aggregate result of which is declining since the last third of 2000, affecting expectations of the exchange market. In contrast, conditions for the trade balance financing keep favorable and the Brazil risk evaluation abroad keeps improving, given the quality of domestic fundamentals and despite a reduction in the flow of direct investments forecasted for this year.

The prevalent foreign environment exhibits relevant ongoing uncertainties. The recent behavior of petroleum international prices, after the production cut by the OPEC member countries, resumed a significant volatility. The pace in which petroleum international prices are dropping has been lower than the one forecasted by futures markets. Since the domestic petroleum by-products price adjustment arrangement for 2001 is directly linked to international prices, and since such by-products have significant weight in IPCA, this foreign price volatility make domestic inflation estimates imprecise. Regarding the world economy, perspectives of lower growth in industrialized countries seems to be ratified, given a deceleration in the rhythm of activity in the United States, as shown by recent statistics. As expected by the markets, these perspectives have led to a milder monetary policy in the United States with the aim of avoiding undesirable brisk moves.

The recent behavior of inflation is in keeping with COPOM perceptions. However, for the third consecutive year, the change of administered prices, in whose formation inertial components are predominant, shall largely exceed the value of the inflation target for this year. Readjustments in electrical energy prices granted at the beginning of this year to regions not included in IPCA, for instance, were above the aggregate inflation measured by general price indices in the twelve previous months. Another important price is that of fuels, which shall change on a quarterly basis according to the average petroleum price and the exchange rate. Considered these factors, administered prices contribute with about half of the value of the 2001 target. Market expectations for inflation in 2001 and 2002 keep practically unchanged since the last COPOM meeting, in keeping with the targets for these two years.

Consequently, COPOM resolved to maintain the SELIC rate target at 15.25% per year.

At the close of the meeting, it was announced that the Committee would meet again on March 20, 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 11.22.2000.

Alexandre Antonio Tombini.

Notes revised by the Board.

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