3 – Credit, monetary and fiscal policies

3.1 – Credit

Financial system credit operations totaled R$343.4 billion in the month of May, for growth of 2.7% in the quarter and 3.3% in the year. The tendency that marked the early months of the year was consistent with signs of a slowdown in the pace of recovery. In this context, the participation of loans in relation to GDP remained stable in the range of 27.2%.

Stability in the credit stock reflected postponement of funding demand, principally by the business sector as a result of changing expectations and current loan costs. As far as loans granted to families are concerned, the very moderate growth in the balance when compared to the same period of the previous year reflected downward movement in real earnings and relatively unfavorable labor market conditions.

With regard to the supply of funding, default levels are considered as a major factor that has limited the possibility of more significant cutbacks in interest rates charged on credit operations and, consequently, on banking spreads. With this, the increased credit risk justifies greater financial institution selectivity in the channeling of their operations and preference for borrowers able to present higher quality guaranties.

Of total credits, the share of operations based on earmarked resources totaled R$121.3 billion in May, with growth of 2.5% in the quarter. This performance was, to some extent, a consequence of 3% expansion in BNDES System operations, particularly financing related to infrastructure projects.

Growth in credit operations

R$ billion

Itemization	2002				Growth	
	Feb	Mar	Apr	May	3 months	12 months
Total	334.4	335.5	338.8	343.4	2.7	-3.0
Nonearmarked	196.0	197.1	199.5	201.8	3.0	11.3
Legal entities	123.4	123.3	124.2	125.3	1.6	6.7
Ref. to exchange	41.5	41.0	41.5	43.3	4.4	2.9
Individuals	72.6	73.8	75.3	76.5	5.3	19.6
Earmarked	118.3	118.3	119.2	121.3	2.5	-16.9
Housing	21.4	21.3	21.3	21.4	0.3	-54.9
Rural	27.4	27.3	27.5	27.7	1.1	-2.5
BNDES	66.9	67.2	67.6	69.0	3.0	14.6
Others	2.7	2.5	2.8	3.2	19.9	-67.6
Leasing	10.6	10.4	10.3	10.3	-2.3	-20.3
Public sector	9.5	9.8	9.9	10.0	5.4	-26.9
% participation:						
Total/ GDP	26.9	26.9	27.0	27.2		
Nonearm./GDP	15.8	15.8	15.9	16.0		
Earmarked/GDP	9.5	9.5	9.5	9.6		

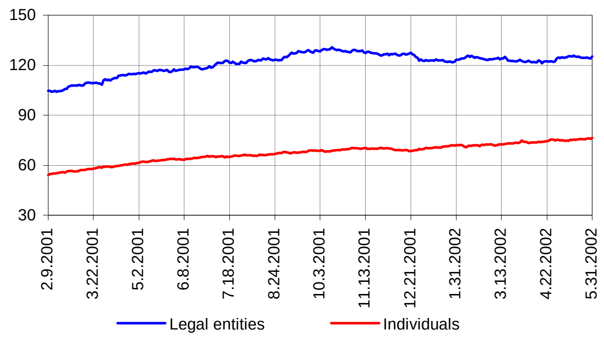
The disbursements effected by this development bank came to an accumulated total of R$6 billion in the quarter, for growth of 8% when compared to the result in the same 2001 period. It should be stressed that 25% of these resources were channeled to micro, small and medium businesses. With respect to the segment of services and commerce, the flow closed at R$1.9 billion, compared to R$1.5 billion from March to May 2001. The sectors that played the largest role in these operations were electricity, gas and transportation. Disbursements to the manufacturing sector, however, fell by 16.3% with particularly strong downturns under metallurgy, transportation equipment and paper and pulp. It is important to note that the drop in the flow of resources to this sector resulted from GDP performance and the high basis of comparison in the previous year when macroeconomic conditions were more propitious to productive activity.

Based on consultations with BNDES, investment demand accumulated R$8.2 billion in the quarter, compared to R$5.2 billion in the corresponding period of the previous year. The results indicates a positive outlook for investments in the sectors that have traditionally taken the greatest advantage of the institution’s disbursements.

Financing channeled to the rural sector totaled R$27.7 billion in May for growth of 1.1% in the last three months. For the most part, this increase was concentrated under larger releases of funding for current expenditures for the 2002 harvest and for the marketing of the harvest planted in the second half of the previous year. Credit to the housing sector fell by 0.3% in the quarter. This performance resulted from the ongoing process of liquidation of operations with individual borrowers, which began in 1999 and has been partially offset by increased operations with legal entities. The public sector banking debt came to R$10 billion, for growth of 5.4% in the same period.

Credits with nonearmarked resources - stock

R$ billion

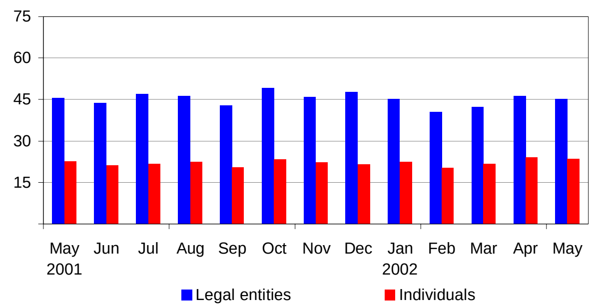


The volume of operations with nonearmarked resources came to R$201.8 billion in May, corresponding to 59% of the overall financial system stock. The result reflected expansion of 3% in the quarter, compared to 12% in the corresponding period of 2001.

Operations contracted by legal entities came to R$125.3 billion, for growth of 1.6% in the quarter, compared to 11.1% in the same period of the previous year. Growth in 2002 was a result of expanded credits referenced to foreign currency, with a balance of R$43.3 billion and growth of 4.4% in the quarter. This performance reflects 7.4% exchange devaluation accumulated in the period, since operations granted in the movable quarter dropped by 5.5%. In this sense, operations based on external onlendings expanded by 6.6%, while average new contracting operations dropped by 23.4%.

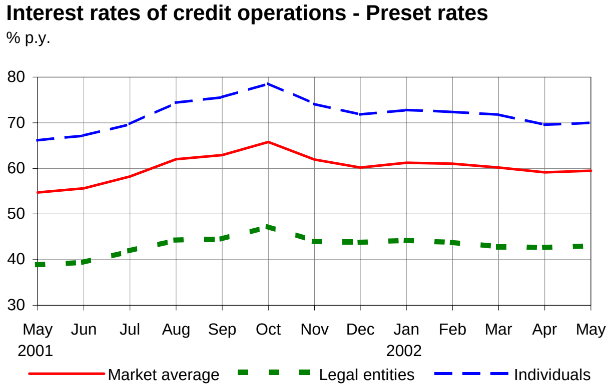
Credits with nonearmarked resources - total grantings in the month

R$ billion



The volume of operations involving internal resources came to R$82 billion, remaining at the level that had marked the end of February. Performance in the period resulted from a drop of 3.1% in operations granted and demonstrates that businesses have continued postponing their credit demand. Despite stability in the overall balance when compared to the previous quarter, May was marked by reductions of 1.3% in the volume of special overdraft accounts and 0.8% in vendor operations.

Operations with individuals totaled R$76.5 billion in the month of May, with quarterly growth of 5.3% compared to 13.6% in the same quarter of 2001. The highlights of the period were growth of 6.6% in the stock of personal credit, resulting from a credit line that anticipates the value of income tax refunds and renegotiation of debts originating in special overdraft checks. One should further note growth of 5% in vehicle financing, mostly as a result of the promotional campaigns undertaken by the major manufacturers.



In the course of the second quarter of 2002, the average rate on preset credit operations involving nonearmarked resources remained on the downward curve that dated to November 2001. This decline was less intense than previously due to high levels of default and medium and long-term market uncertainties. The reduction in the Selic target and the drop in futures market operations over the course of the period aided in pushing the credit rate down to 59.5% per year in May, reflecting a 6.3 p.p. drop in relation to October of the previous year and 1.5 p.p. in the quarter.

In the segment of legal entities, interest rates came to 43% per year in May, reflecting a decline of 0.8 p.p. in relation to February. Reductions were registered in all categories and, particularly, under vendor operations (1.3 p.p.), with a final figure of 23.5% per year. Since this product provides higher quality guaranties, the larger financial institutions began prioritizing this type of operation and were able to offer clients more competitive rates.

The cost of credit operations with individual persons came to 70% per year in May, for a drop of 2.4 p.p. in the quarter. In that period, several automobile manufacturers announced “zero interest” financing campaigns by their respective banks, particularly in April of this year. In the quarter, the rate on vehicle financing declined by 3 p.p. and closed the month of May at 38.9% per year. The rate on special overdraft checks fell by 2 p.p. in the quarter, representing the first significant drop since October of last year.

The reduction in the rate on credit operations resulted in a decline in the spread on preset credit operations. Defined as the difference between the loan rate and the funding rate of financial institutions, the banking spread came to 40.3 p.p. in May, for a reduction of 1.5 p.p. in relation to February.

In operations with legal entities, the spread fell to 24.9 p.p. in May, for a reduction of 0.3 p.p. in the quarter. In that period, the spread in the segment of individual persons dropped by 2.7 p.p.

Floating interest rate

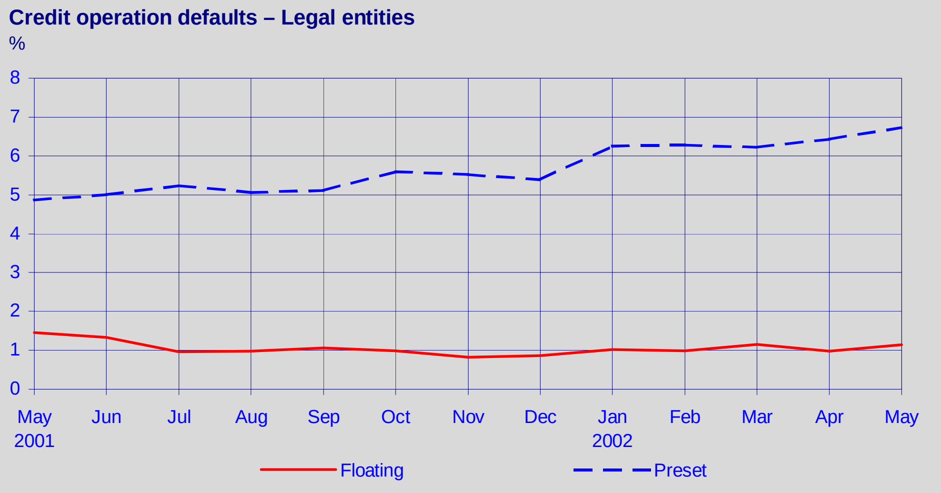
The systematic monitoring of interest rates and the banking spread – a policy adopted by Banco Central do Brasil in 1999 – is based on credit operations that utilize nonearmarked resources with earnings at preset interest rates. With introduction of Circular 2,905, dated June 1999, operations based on floating interest rates were permitted with minimum terms of less than 120 days. With this measure, the participation of these contracts in the funding and lending operations of financial institutions increased.

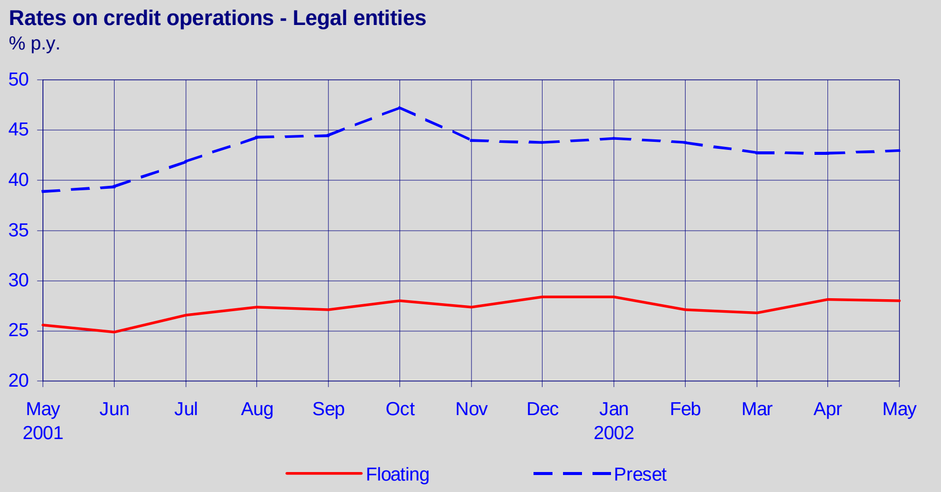
In December 1999, Banco Central issued Circular 2,957 and, aside from operations referenced to preset and postset operations, began a process of regular verification of data on floating rates particularly on business financing operations. The balance of operations at floating rates came to R$20 billion in May, corresponding to 10% of the credits based on nonearmarked resources and 15% of business loans utilizing nonearmarked resources.

Considering that floating rates have a significantly lesser degree of market risk than preset rates, the major financial institutions offer preferential clients more competitive forms of credit, referenced principally to the DI rate. Generally, these clients are large companies and receive differentiated treatment due to their enormous volumes of resources and capacity to generate new business opportunities, such as payroll management, stock and security issues and diverse forms of financing. The banks define this market niche as the corporate segment. Since the companies in question operate with a large number of institutions, there is an extremely sharp degree of market competition to attract their business.

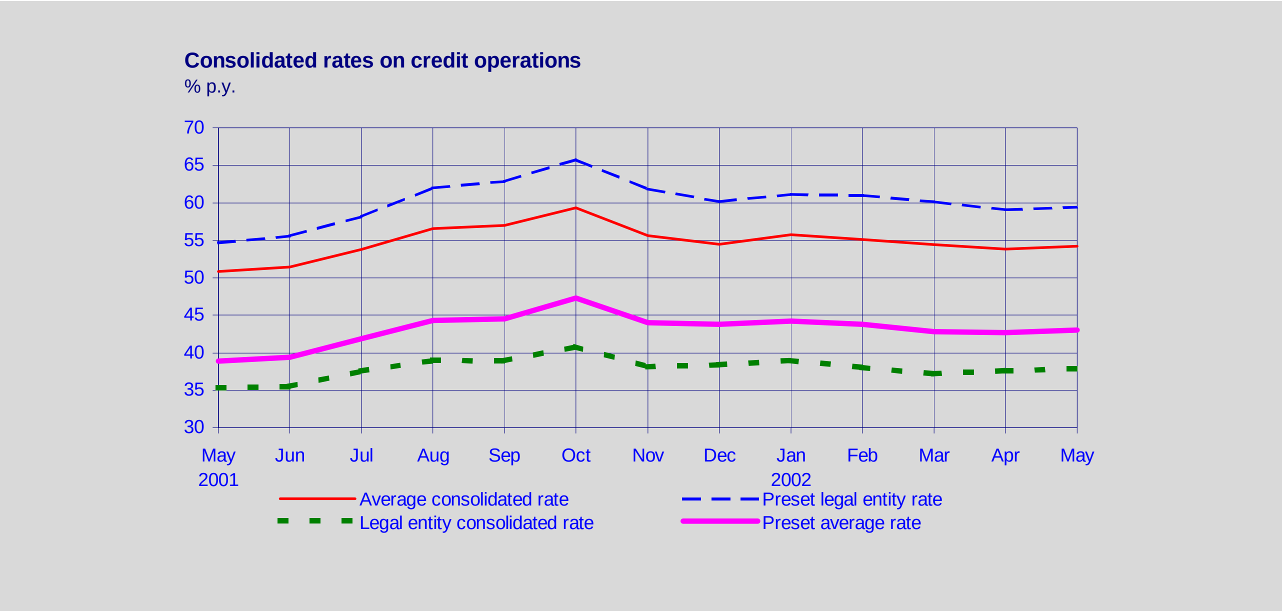
In light of the characteristics of these clients, floating rate operations have low default levels, when compared to the rates found in the case of preset operations. Not only are they lower, but default rates in operations referenced to floating rate operations tend to be more stable. While arrears on preset contracts increased by 27% since May 2001, as the default rate moved from 4.9% to 6.7% in May 2002, defaults in floating rate operations remained stable, as shown in the graph in the next page.

These characteristics have made it possible for financial institutions to offer more competitive rates of interest, in light of the reduced cost of provisions and the gains in scale obtained as a result of the volume of these operations. In May, the average rate of business financing with interest referenced to floating rates came to 28% per year, 15 p.p. below the average rate of preset operations for legal entities.





Thus, when operations at floating rates are incorporated into the calculation of the average interest rate, one perceives that banking credits are contracted at rates below those currently published. As a matter of fact, over the last twelve months, the rates of credit operations with preset and floating interest came to an average 5.4 p.p. below the published rate, coming to 54.2% per year in May. Rates on loans channeled to the business segment in the period were 5.2 p.p. below the rate for preset operations and ended May at 37.9%.



Spread between lending and funding interest rates in operations with preset rates

p.p.

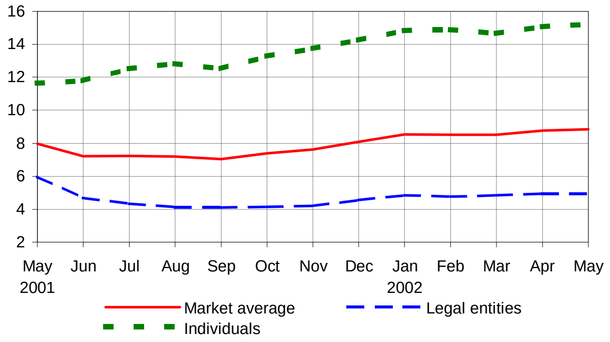
Period		Market average	Legal entities	Individuals
2001	May	34.6	20.1	45.0
	Jun	35.2	20.4	45.9
	Jul	34.4	19.9	44.8
	Aug	38.9	23.0	50.2
	Sep	39.6	23.3	51.0
	Oct	42.7	26.2	54.3
	Nov	41.5	24.5	53.1
	Dec	39.9	24.4	51.0
2002	Jan	41.6	25.3	52.7
	Feb	41.8	25.2	52.9
	Mar	41.9	24.7	53.4
	Apr	40.6	24.6	50.8
	May	40.3	24.9	50.2

and closed at 50.2 p.p. The more accentuated decline under this heading is attributed to the May increase in futures market interest rates, which are used to calculate medium and long-term funding costs. Since the portfolio of loans with individual persons has a longer average term than that of legal entities, the reference cost of operations with individuals registered growth of 0.3 p.p. in the quarter, while that on operations with legal entities dropped by 0.5 p.p.

The average term of the credit portfolio involving nonearmarked resources went unchanged for the seventh month and closed at 233 days. The average term of the segment of legal entities reached the mark of 184 days while that of individual persons came to 313 days. To a great extent, the latter was impacted by vehicle financing, a credit portfolio that has an average terms of 514 days.

Following growth in the second half of 2001, defaults on credit operations with nonearmarked resources remained relatively stable in the early months of the current year, closing at 8.9% in May, for growth of 0.4 p.p. in relation to February.

Default rate of credit



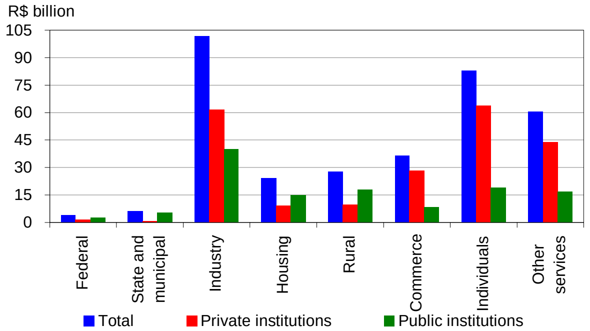
The percentage of arrears in the market reserved to legal entities totaled 4.9%, matching the February result. Insofar as operations with individual persons are concerned, the default rate, which had registered accentuated growth in the second half of 2001, remained stable in 2002, with 15.2% in May and growth of 0.3 p.p. in the quarter.

Sector-by-sector distribution and credit quality

Credit operations contracted by the private sector came to R$333.4 billion in May, registering growth of 2.6% in the quarter and 3.4% in the year. Loans granted by the state financial system accounted for 35.1% of the total, with growth of 4.3% in the quarter, mostly concentrated under operations with individuals and other services. With respect to the credit portfolios of private financial institutions (R$216.4 billion), growth came to 1.7% and interrupted the downward trajectory begun in November 2001. It should be stressed that this movement occurred for the most part in operations related to vehicle financing and personal credits.

The volume of financial system credits targeted to the industrial sector came to R$101.7 billion, for expansion of 1.2% in the quarter. Among the factors that contributed to this performance, one should mention exhaustion of the seasonal process of stock replenishment, as well as a lesser volume of disbursements for the financing of manufacturing sector investments. Loans granted to the sector of commerce came to R$36.5 billion, with growth of 2.3% in the quarter, a figure that was consistent with the cautious stance adopted by consumers in the face of the deteriorating purchasing power of wages and earnings.

Credit operations in the financial system by borrowers - May 2002



The volume of financing for other services came to R$60.5 billion in May, for growth of 3.2% in the quarter. Among the factors that contributed to this result, mention should be made of government funding in the form of onlending operations for infrastructure investments, particularly in the areas of energy and telephone services.

Housing financing – including both operations with individuals and housing cooperatives – totaled R$24.1 billion. To some extent, stability in the quarter reflected liquidation of contracts and the write-off of operations classified under risk level H that had matured more than 180 days previously. Disbursements to the housing system in the February to April quarter totaled R$441 million, for growth of 5.1% in relation to the same period of the previous year. Of these resources, 68.5% were channeled into acquisitions of real estate, while 31.5% were targeted to construction. Financing contracted at interest rates defined according to the rules of the Housing Finance System (SFH) totaled R$342 million, while new operations contracted at market rates added up to R$99 million.

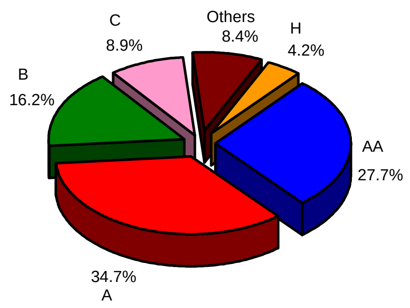
Credits to the rural sector came to R$27.7 billion in the month of May, for growth of 1.1% in the quarter. This performance reflected the targeting of public sector bank funding into current expenditures of the 2002 harvest and the marketing of the 2001/2002 summer harvest. On the other hand, private banks reduced the credit supply to the minimum rural investment level required by National Monetary Council (CMN) rules.

The relative participation of rural credits granted for current expenditure and marketing purposes came to 42.4% and 4.2%, respectively, while investment funding accounted for 53.5% of the credit channeled to this segment. Greater investment demand in the crop/livestock sector is related to the additional supply of R$350 million channeled through the Program for Modernization of the Farm Tractor Fleet and Related Implements and Harvesters (Moderfrota) to meet the sector’s programming for the 2002/2003 harvest. These resources have contributed to the continued process of technological absorption in the sector, as is evident in the increased level of farm income.

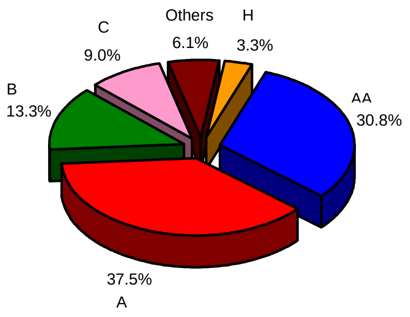
The state and municipal banking debt – including that of the indirect administration and government business sector – reached R$6 billion, with growth of 3.7% in the quarter. Here, emphasis should be given to the resources released for investments in the highway system and electric energy. In relation to credits channeled to the states, the CMN withdrew financing related to urban development programs to be implemented by development agencies from its forecast of conditioned resources. The purpose here is to ensure the utilization of World Bank funding. Aside from this, the states were authorized to contract resources up to an overall limit of R$200 million, for operations previously specified in Fiscal Adjustment Programs, as determined in Law 9,496, dated 9.11.1997.

Credits contracted by the federal government came to R$4 billion in May. The 7.9% increase in the quarter reflected the accounting of debts originating in the rural sector under the terms of the Special Program of Asset Restructuring (Pesa) plus exchange indexing of contracts with the state electricity company.

Credit operations in the financial system by levels of risk - May 2002



Credit operations in the private financial system by levels of risk - May 2002

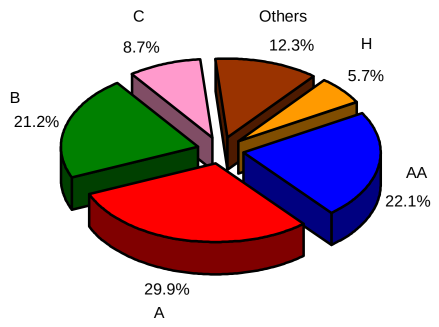


With regard to the profile of the overall financial system credit portfolio, operations classified as normal risk (levels AA and C) accounted for 87.4% of the total in the month of May, with an overall volume of R$300.3 billion.

Loans registered under risk level 1 (levels D to G) corresponded to 8.4% of the total, with R$28.7 billion, while 4.2% were classified under risk level 2 (level H), with a balance of R$14.4 billion. In February, the corresponding levels of participation came to 87.9%, 7.8% and 4.3%.

Private financial system operations totaled R$218.6 billion in the month of May, for growth of 1.8% in the quarter and 1.1% in the year. In this context, it should be stressed that growth of 5.1% in credits extended to individual persons included personal credit operations and vehicle financing. A breakdown by risk levels shows that 68.3% of the credit assets were classified under levels AA and A and 3.3% under H.

Credit operations in the public financial system by levels of risk - May 2002



Loans granted by the public financial system totaled R$124.8 billion, for growth of 4.2% in three months and 7.5% in the year. Here, particular emphasis should be given to operations with individual persons, as well as growth in credits granted to the industrial sector and other services. With respect to the classification of credits by risk level, 52% were registered under levels AA and A and 5.7% under level H.

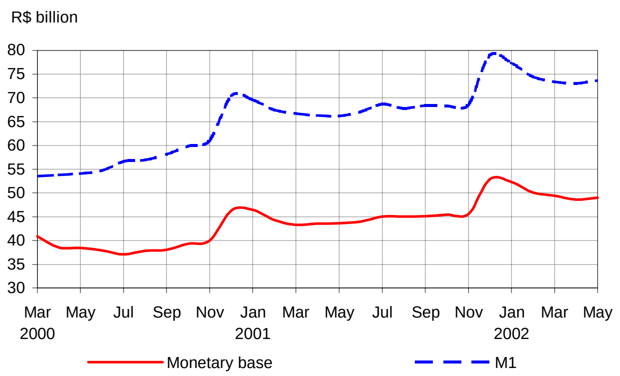
Total financial system provisioning came to R$26 billion in May, for growth of 1.8% in the quarter. This variation was impacted by expansion in the private financial system, due basically to incorporation of nonfinancial company assets by a credit, finance and investment company. Consequently, this should not be viewed as an inflow of additional capital to cope with new hard-to-recover credits. The relative participation of provisions in relation to total credits came to 7.6%. Other provisioning by public and private banks registered participation levels of 9.7% and 6.4%, respectively.

3.2 – Monetary policy

Monetary aggregates

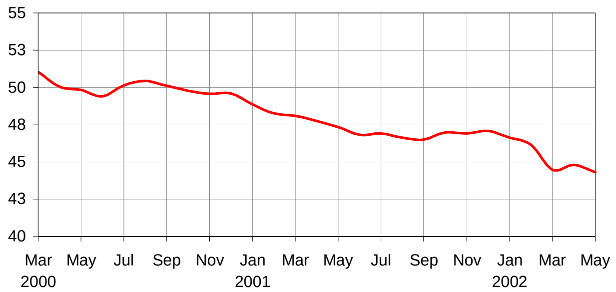
When one considers the concept of average daily balances, the money supply totaled R$73.7 billion at the end of May. Growth of 11.3% in the twelve month period corresponds to expansion of 13.5% in currency held by the public and 10.1% under demand deposits. The income speed of the two components has been declining in a manner fully consistent with the pace of economic activity and the behavior of credit operations.

Monetary base and M1 - average daily balances



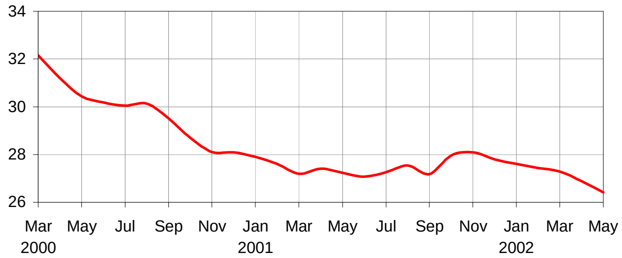
The daily average balance of demand deposits added up to R$46.4 billion at the end of May. The drop of 3.8% in the year reflected the seasonal factors that marked the period.

Currency outside banks seasonally adjusted - income-velocity[1/]



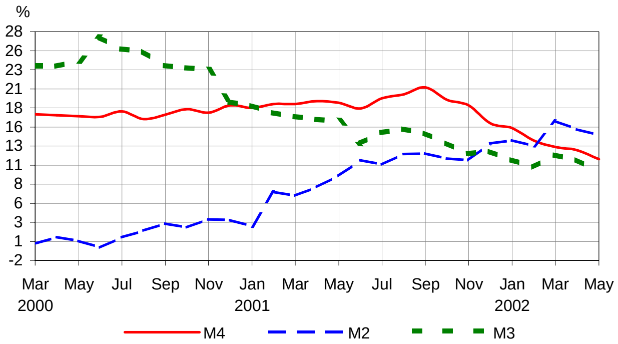
1/ Defined as the ratio between 12 month accumulated GDP (valuated by IGP-DI) and the monthly average balance of the seasonally adjusted monetary aggregate.

Demand deposits seasonally adjusted - income-velocity[1/]



1/ Defined as the ratio between 12 month accumulated GDP (valuated by IGP-DI) and the monthly average balance of the seasonally adjusted monetary aggregate.

Broad money supply - 12 month percentage growth



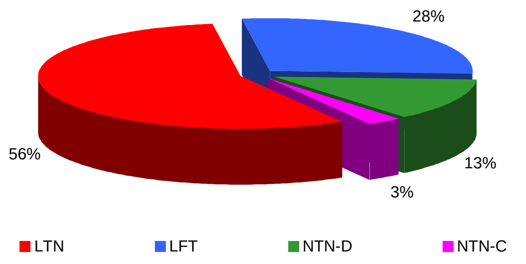
In a manner compatible with demand for demand deposits, average daily balances of the monetary base came to R$49.3 billion in the same period, a reduction of 6.8% in relation to December. Among their components, currency issued closed at R$32.5 billion and banking reserves totaled R$16.7 billion, corresponding to reductions of 9.3% and 1.5% in the year, respectively.

With respect to the broad money supply, the M2 concept, which is equivalent to the sum total of M1, savings deposits and securities issued by financial institutions, registered an increase of 2.6% in the March-May quarter. For the most part, this was a consequence of growth in net inflows of Bank Deposit Certificates (CDB). M3 – defined as the sum of M2, the share of the fixed income fund portfolio not included in the more restricted concepts and committed operations with federal securities – expanded by 1.5% or less than the capitalization of its components, as a result of net redemptions in fixed income funds. The M4 concept, which aggregates public securities held by the nonfinancial sector to M3, increased 1.2% totaling R$766.9 billion in May. Consequently, this performance is classified as a primary reduction in the quarter. Fundamentally, the result reflects the performance of National Treasury accounts.

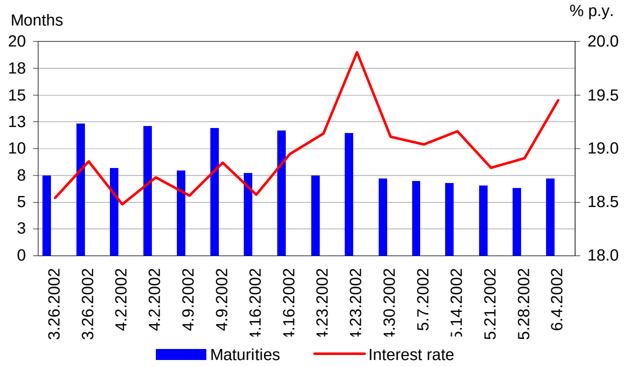
Public securities

Over the course of the second quarter of the year, the objective of the National Treasury was to maintain the strategy of federal securities debt management targeted at placements of preset securities, in such a way as to reduce the ties that bond the public debt to interest rate variations. In April and May, preset papers represented 56% of total securities issued, thus increasing their

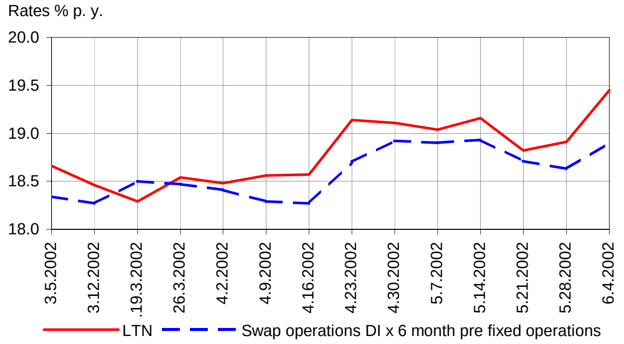
Competitive issues of federal public securities
4.1.2002 to 6.4.2002



National Treasury Bills - LTN



LTN and *swap* operations DI x 6 month prefixed operations



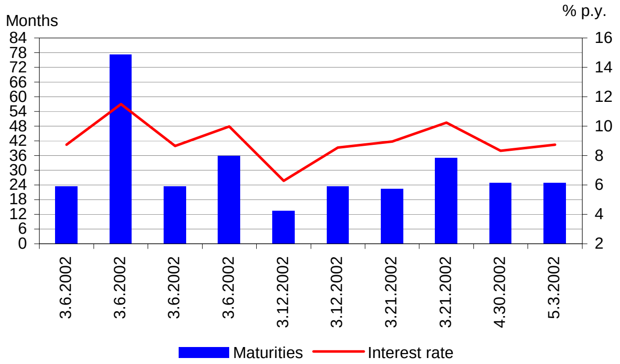
participation in the total stock of competitively issued papers, which moved from 13.1% in March to 13.8% at the end of May. The average annual rate on six month preset papers placed at the beginning of April held firm in the range of 18.5%, equivalent to the Selic rate target, while the rate for one year preset papers closed at approximately 18.9% per year.

The second quarter of 2002 witnessed introduction of a new system of debt management referenced to exchange variation, as Banco Central held a series of exchange swap contract auctions. At the end of May, these operations had reached a financial value equivalent to R$14 billion. Initially, the swap auctions were tied to Treasury Financing Bill (LFT) auctions, which are indexed by the Selic rate. In this way, parties interested in assuming long positions in swap contracts should acquire LFT in primary National Treasury offers. This is an operation in which buyers of exchange swap contracts and LFT received the Selic rate as earnings on the LFT and, with the swap contracts, exchanged the DI rate, which is normally quite close to the Selic rate, for exchange variation. The result is an earnings level quite close to an exchange security.

Mention should be made to net redemptions of LFT in the course of the year, when redemptions surpassed placements in respective amounts of R$5.2 billion and R$16.8 billion.

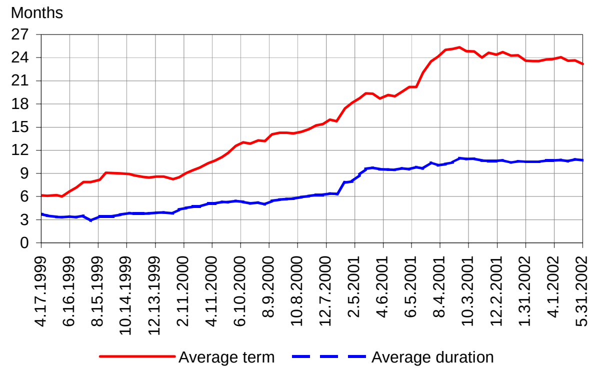
At the end of April, there was a reduction in demand for LFT, as evinced by the increase in the discount demanded for placement purposes and by the reduction in the value of secondary market operations with these papers. To avoid compromising the liquidity of these papers and in keeping with the basic guideline of reducing securities debt exposure to interest rate fluctuations, an option was made to offer "single" exchange swap contracts not earmarked to primary issues of LFT. In this way, buyers of swap contracts should resort to the secondary market in order to acquire papers indexed to the overnight rate.

Exchange securities - NTN-D



Aside from the swap auctions, others involving National Treasury Notes – Series D (NTN-D), which are papers tied to exchange variations, were also held with the purpose of rolling the large volume of exchange maturities scheduled for the second half of the year. The participation of NTN-D in total securities issued in the period from April 1 to June 4 came to 13%. With respect to LFT, which are indexed by the Selic rate, participation came to 28%.

Public securities - duration and term



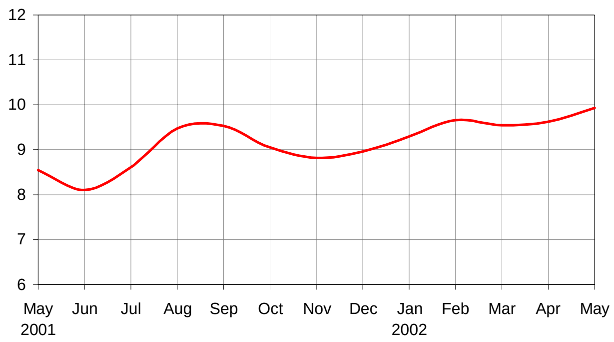
With regard to the management of the long-term securities debt, the National Treasury maintained its strategy of holding auctions of National Treasury Notes – Series C (NTN-C), which are indexed to the IGP-M, at the end of each month. The rates demanded on these operations rose slightly from the range of 10.5% per year to 10.79% in the April and May auctions, thus signaling an increase in expectations of the real long-term interest rate. In the quarter, NTN-C with maturities in 2008 and 2017 were offered. Stress should also be given to the unprecedented placement of National Treasury Notes – Series B (NTN-B), which are indexed to the IPCA, in public offers with maturities in 2023, at the rate of 11.05% per year.

Placements of securities indexed to price indices have contributed to the medium-term stability of the competitively issued securities debt, despite the difficulties inherent to the current situation for issues of other longer term papers. At the end of May, the average term of the competitively issued securities debt came to 23.18 months, compared to 23.83 months in March. The average duration of the debt came to 10.72 months in May, compared to 10.68 months in March.

Real interest rate and market expectations

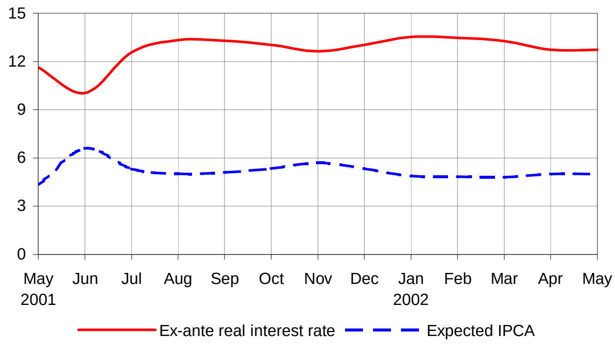
Real interest rate deflated by IPCA

% accumulated in 12 months



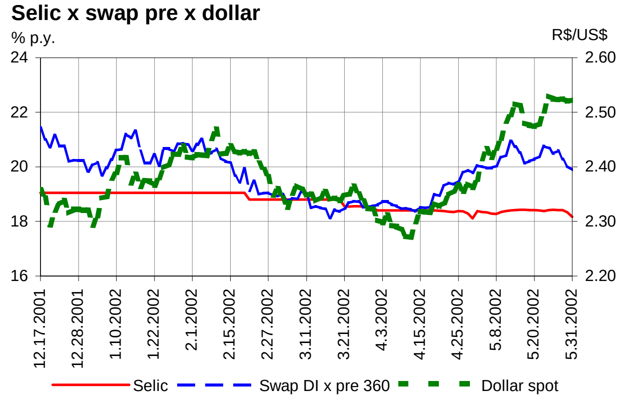
Ex-ante real interest rate

For 12 months



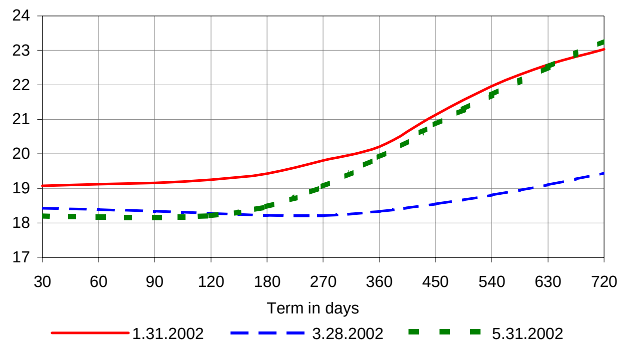
Selic x swap pre x dollar

% p.y.



Yield curve - swap pre

% p.y.

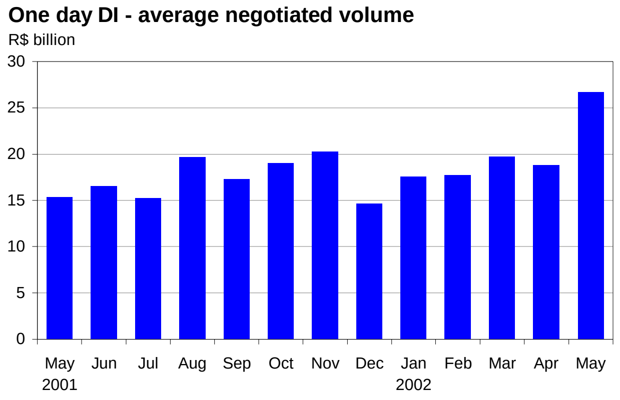


Deflated by the IPCA, the accumulated twelve month Selic rate came to 9.9% per year in May, or 0.2 p.p. above the February mark. This rate has held firm below the 10% per year level for the past sixteen months.

The ex-ante real rate of interest, defined as the ratio between the effective Selic rate in the month and market expectations of IPCA growth for the coming twelve months, dropped by 0.8 p.p. from February to May and closed at 12.7% per year.

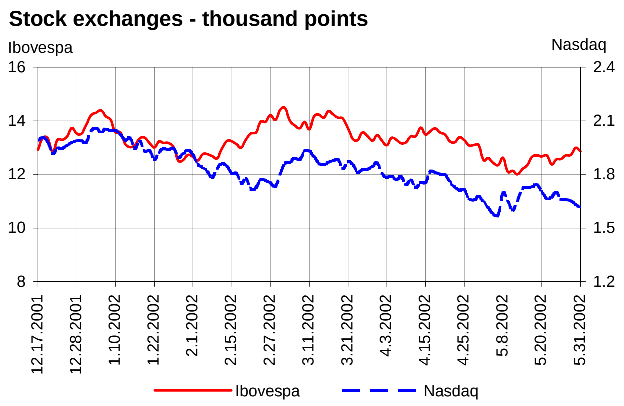
Expectations of an interest rate decline were favored by cutbacks in the Selic rate target and pushed rates on one year DI swap x pre to be negotiated in March below the Selic rate. However, difficulties at that time, including approval of the extension of the Provisional Contribution on Movements or Transmission of Values and Credits and Rights of a Financial Nature (CPMF), less than expected economic growth and upward movement in the country risk inverted market expectations and impacted the value of the dollar as well as interest rate futures.

The change in the scenario generated repercussions on the interest rate curve of DI swap contracts x pre, principally in the case of medium and long-term contracts. At the end of March, the curve registered a negative incline for terms of up to one year. Deteriorating expectations readjusted the premium charged on contracts with terms of more than 120 days. From March to May, the rate on one year contracts increased by 160 base points, reaching a level of 19.9% per year, while that on two year contracts rose by 380 base points to a level of 23.3% per year.



In the month of May, the average negotiated volume in one day DI futures contracts registered accentuated growth, reaching R$26.7 billion per day, compared to R$18.8 billion in April. Aside from increased volatility, this movement was also due to migration of forward contract trading away from DI with adjustment to one day DI contracts. This process had begun in January in light of lesser operational costs, thus consolidating these contracts as the reference for future interest rates. The increase in the exchange coupon contract rate also contributed to increased market volatility, adding to pressure on long term contracts.

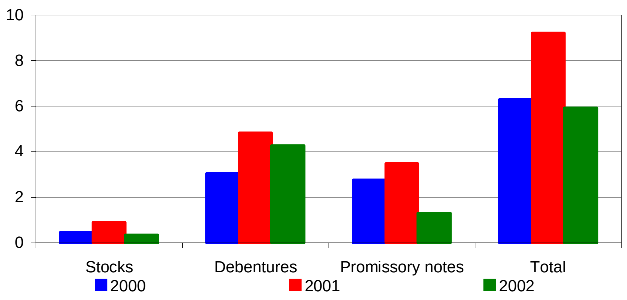
Capital market



At the end of February, the favorable outlook for the São Paulo Stock Exchange (Bovespa) was not transformed into reality. Among the factors that contributed to this, mention should be made of a reduction in the country's growth forecast, increased financial market volatility and uncertainties regarding the economic guidelines of the next federal administration. Aside from these points, voting of the constitutional amendment extending levying of the CPMF was delayed. One of the major items in this measure is an exemption for stock market operations. On the external scenario, the major event was the poor performance of American stock exchanges in the April-May period.

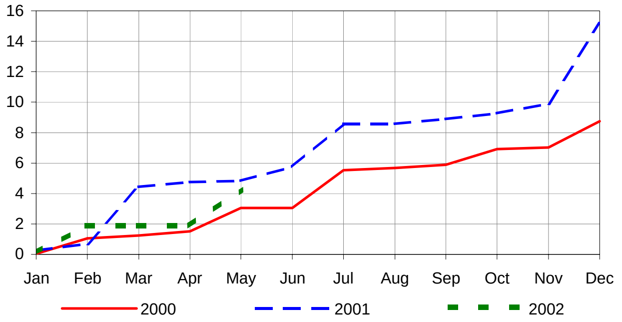
In this context, the São Paulo Stock Market Index (Ibovespa) dropped by 8.4% from February to May. At the start of the month of May, the period of greatest volatility, the Ibovespa hit 12,002 points before recovering in the following days and closing at 12,861 points. In that quarter, the Nasdaq index registered a drop of 6.7%.

Primary issues in capital market
R$ billion - accumulated until May



Source: CVM

Corporate bonds
R$ billion - accumulated in the year



Source: CVM

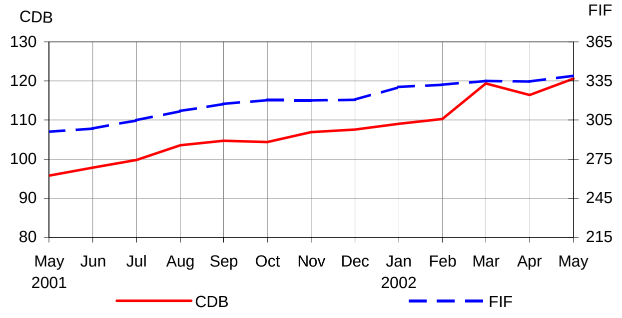
The funding obtained by companies on the capital market through issues of stocks, debentures and promissory notes registered a strong decline in the first five months of the year, in relation to the same period in 2001. However, the level achieved in the year was equivalent to that obtained in 2000.

In the same period of time, issues of debentures continued as the major instrument for obtaining market resources and totaled R$4.3 billion, representing a decline of 11.5% in relation to the same period of last year. It should be emphasized that, in the same period of 2001, large scale operations consequent upon the restructuring of the capital of the Companhia Siderúrgica Nacional (CSN) and financing of petroleum prospecting operations, contributed a total of R$3 billion to total issues in the period.

Financial investments

Internal financial savings, composed of resources invested in savings accounts, investment funds and time deposits, totaled R$580.1 billion in May, for growth of 1.8% in relation to February 2002. In the period, emphasis should be given to increased CDB inflows and adjustments in investment funds, related to changes in evaluation criteria applied to their assets.

Portfolio evolution of time deposits and FIF
R$ billion



In the month of May, the equity of Financial Investment Funds (FIF) came to R$335.9 billion, for growth of 1.2% in the quarter. Moderate expansion resulted from withdrawals made by pension funds for purposes of retroactive income tax payments on their financial investments, increases in demand for CDB investments, market volatility, with losses in certain derivative funds, and alterations in the system of accounting these portfolios.

Circulars 3,086, dated 2.15.2000, and 3,096, dated 3.6.2002, determined the obligation of marking to market the securities included in the FIF portfolios, with the aim of increasing the transparency of the fund industry, by adopting a uniform system of updating assets to market prices and not by the interest rate curve of the paper as had previously been done. The rules state that stocks and securities included in investment funds classified as fixed income funds should be registered at their effectively paid value, including brokerage and fees, and should be classified into categories of securities for trading and securities to be held to maturity. In the latter category, the exclusive funds (sole investor) were exempted from marking to market.

The different fixed income funds have adapted to these rules at varying speeds, thus provoking profitability distortions among similar funds. Securities and Exchange Commission (CVM) Instruction 365. dated 5.29.2002, anticipated the period permitted for adaptation from 9.30.2002 to 5.31.2002, requiring immediate adjustment of the FIF quotas.

Since the LFT – public securities indexed to the Selic rate – were being negotiated at a discount on the secondary market, adjustments in the net worth of the funds occurred proportionately to the quantity of LFT held in portfolio. It should be stressed that the magnitude of the change in the equity of the funds was a function of the degree to which they had anticipated the aforementioned measures. Consequently, in May, the FIF registered profitability of 0.8%, accumulating 6.3% in the year.

Joint BCB/CVM Decision 10, dated 5.2.2002, determined that the CVM would bear responsibility for elaborating the rules and performing supervisory and inspection activities over Investment Fund. Previously, Banco Central had been charged with this task. The change was a consequence of the new corporate legislation and Law 10,411, dated 2.26.2002, which defined CVM's responsibilities.

Coupled with stock market volatility, the equity of Stock Funds came to R$26.1 billion in May or 1.3% more than the February position. In 2002, this segment registered profitability of 4.3%. The best

The new Brazilian Payments System

Introduction of the Reserve Transfer System (STR) in April of this year represented a new stage in the development of the Brazilian Payments System (SPB). With this Banco Central operated system, Brazil has joined the select group of countries in which interbank fund transfers can be liquidated in real time and in an irrevocable and unconditional manner. This fact in itself will make it possible to reduce the risks involved in liquidation of interbank operations and, consequently, reduce the degree of systemic risk, that is, the risk that a failure on the part of one bank could trigger a "domino effect" chain reaction of other bank failures.

The STR is also important in the sense of reducing the credit risk incurred by Banco Central, since a fund transfer is always conditioned to the existence of a sufficient balance in the liquidation account belonging to the issuer of the corresponding payment order. Orders that have not yet been liquidated are maintained in a waiting line and are processed on the basis of the principle "first in first out". In order to make it possible for the SPB to operate in this new liquidation framework, Banco Central grants intra-day credits to STR participants, in the form of committed operations with federal public securities and no financial costs.

Operation-by-operation real time liquidation is also used in operations processed through the Special System of Clearance and Custody (Selic), which became possible once this system and the STR had been interconnected. Liquidation of these operations complies with the so-called model 1 of delivery against payment .

Reform of the SPB, however, goes well beyond implementation of the STR. The reduction of systemic risk, which is the ultimate goal of the reform, required important recently adopted legal and regulatory alterations . In this sense, one should highlight the demand that, in the entire system of liquidation considered systematically important by Banco Central, the operating entity must act as the central entity and, abstracting from the issuer risk, ensure liquidation of all of the operations processed. These systems must have adequate protection mechanisms, which are evaluated through a case-by-case Banco Central examination.

Based on regulatory demands, final liquidation of the results verified in the liquidation systems that are considered systemically important is the direct task of Banco Central.

1/ In the STR framework, liquidation accounts are Bank Reserves, the National Treasury Operating Account and the accounts maintained at Banco Central by clearance and liquidation entities and service providers.

2/ Denomination used in Bank for International Settlements (BIS) reports. In this model, final liquidation at the two ends of the operation – financial liquidation and the security in question – occurs simultaneously, operation-by-operation over the course of the day.

3/ These alterations were implemented principally as a result of Law 10,214, Resolution 2,882 and Circular 3,057.

Currently, the following systems are fostering final liquidation of operations through the STR:

System	Operator	Type	Operating Market
Selic	Banco Central	LBTR	Federal public securities
Compe	Banco do Brasil[2/]	LDL	Check, DOC and charging
BM&F Derivatives	BM&F	LDL	Physical, futures, options and forward; referenced to interest rates, exchange, stock index, exchange cupon, commodity prices etc.
BM&F Exchange	BM&F	LDL	Interbank exchange operations
CBLC	CBLC	LDL	Stocks
Private securities Stock Derivatives Cetip	Cetip	LDL	Private securities; derivatives on over-the-counter market; securities issued bu National Treasury not earmarked to Selic
Tecban	Tecban	LDL	Electronic fund transfers (debit and credit cards)

Note: The Tecnologia Bancária S.A. (Tecban) system is not considered systemically important. In the case, liquidation is done directly by Banco Central at the option of the entity.

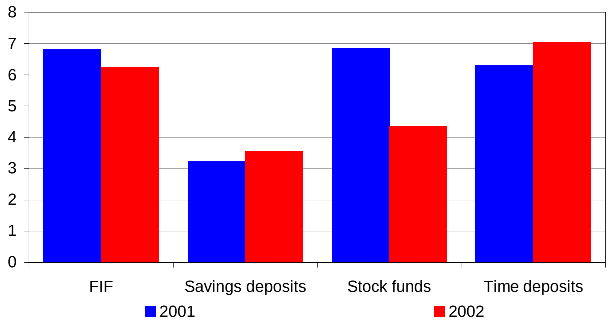
The following systems are now in the process of examination / approval by Banco Central:

System	Operator	Type	Operating Market
Sitraf	CIP	Hybrid	Interbank fund transfers
BM&F Assets	BM&F	LDL	Public and private securities
Central	Central clearing	LDL	Public and private securities

The new liquidation environment produced by the STR and, in the near future, by the Fund Transfer System (Sitraf) of the Interbank Payments Center (CIP), resulted in creation of a new banking product called Available Electronic Transfer (TED). Operating through this fund transfer order, transferred funding is placed at the disposal of the receiving party on the same day as issued. This product is expected to replace a major share of transfers in larger values that have normally been made through the use of checks and credit document, thus reducing the importance of the Central Clearing House of Checks and Other Papers (Compe) from the point of view of the systemic risk.

performance occurred under Mutual Privatization Funds (FMP), with resources drawn from the Employment Compensation Fund (FGTS). In this case, equity came to R$4 billion and accumulated profitability to 28.2% in the year.

Financial investments earnings
% accumulated until May



In May, the balance of savings accounts totaled R$119.6 billion, an increase of 0.3% in relation to February. This performance mirrored more attractive profitability levels than in other financial investments. Here, one should note that the recent alteration introduced into the FIF may act as an incentive to savings account growth in coming months, should demand for investments shift into a more conservative stance.

CDB registered strong inflows in the March to May period and closed the quarter with a balance of R$118.4 billion or 7.3% above the February result. This performance was a result of financial institution demand for liquidity in the wake of implementation of the Brazilian Payments System (SPB) and migration of FIF funding. Accumulated profitability up to May closed at 7%, the most attractive level registered in the period.

3.3 – Fiscal policy

In the first four months of the year, the Central Government registered a primary surplus of R$16.3 billion, equivalent to 4% of estimated GDP for the period, compared to a surplus of R$13.4 billion, 3.6% of GDP, in the same period of 2001. The National Treasury turned in a surplus of R$20.7 billion, while the Social Security System and Banco Central registered deficits of R$4.3 billion and R$191 million, respectively.

The National Treasury surplus was R$4.5 billion higher than in the corresponding period of the previous year. Fundamentally, this was a consequence of favorable growth under revenues, which moved from R$68.7 billion to R$82.7 billion. To some extent, this performance was generated by atypical operations that were not present in the preceding year. Among these, the following deserve mention:

a) payment of taxes in arrears made by pension funds in the amount of R$5.6 billion;
b) taxation of operations involving exchange of Petrobras public securities, R$1.1 billion;
c) increase in the CPMF rate from 0.30% to 0.38% as of 3.19.2001, with an impact of R$1.3 billion on the inflow; and
d) inflow of judicial deposits totaling R$435 million. At the same time, it should be noted that, while revenues registered 20.4% nominal growth, spending increased by 18.2%.

Transfers to states and municipalities added up to R$18.9 billion, corresponding to growth of 24.6% compared to the first four months of 2001. This increase is directly related to the performance of the income tax, which registered an inflow increase of 44%.

Disbursements on personnel and social charges came to R$23.4 billion or 13.8% more than in the first quarter of 2001. The underlying reasons for this were the following:

a) impact of the general revision of 3.5% as of February of this year in the earnings and subsidies of federal civil servants, as determined by Law 10,331, dated 12.18.2001;
b) creation, restructuring and organization of careers in the context of the federal public administration;
c) January 2002 impact of payment of the second installment referring to the liabilities of the additional on employment compensations due to workers governed by labor legislation who were transferred to the Civil Service System (RJU);
d) as of February of this year, extension of 3.17% to the civil servants included in the Career Classification Plan (PCC), based on the terms of Provisional Measure 2,225, dated 9.4.2001;
e) full payment of liabilities of 28.86% to civil servants who have retired as a consequence of incapacitation or grave illness, as of November 2001. The terms of this measure are defined in Ministry of Planning, Budget and Management Directives 179, dated 8.30.2001, and 256, dated 11.7.2001.

The Social Security deficit increased by R$1.6 billion in the four month period, compared to the corresponding period of 2001.

Social security contributions increased by R$2.1 billion and benefits by R$3.7 billion due for the most part to increases of 13.3% in the average value of benefits and 3% in the average quantity of benefits paid in 2002.

Public sector borrowing requirements (NFSP)

The consolidated public sector registered a primary surplus of R$20.5 billion or 5.1% of GDP in the first four months of the year, when compared to R$23.3 billion or 6.3% of GDP in the same period of the previous year. The central government, which includes the federal government, Banco Central do Brasil and National Social Security Institute (INSS), turned in sharp improvement in its accounts, as the surplus rose from R$14.1 billion, or 3.8% of GDP, to R$17.2 billion, or 4.2% of GDP in the period. Up to April 2002, state governments accumulated a surplus of R$3.9 billion or 1% of GDP, compared to R$3.3 billion, equivalent to 0.9% of GDP in 2001. In the case of municipal governments, the surplus dropped from R$1.7 billion, 0.47% of GDP, to R$838 million, or 0.2% of GDP, in the period. In the opposite sense, the result for state companies declined from a surplus of R$4.1 billion, 1.1% of GDP, to a deficit of R$1.4 billion, or 0.4% of GDP.

Appropriation of nominal interest came to R$30.4 billion or 7.5% of GDP in the first four months of the current year, compared to R$27.1 billion, or 7.3% of GDP, in the corresponding period of the previous year. In the case of the Central Government, interest appropriated increased from R$14.9 billion, or 7.3% of GDP, to R$21.8 billion, or 5.4% of GDP. At the state and municipal levels, there was a reduction from R$9.7 billion, 2.6% of GDP, to R$7.5 billion, 1.8% of GDP. In the same sense, interest appropriated by businesses dropped from R$2.5 billion, 0.4% of GDP, to R$1.2 billion, corresponding to 0.3% of GDP in the period.

The reduction in interest appropriated by subnational governments and government companies was mostly a result of declines of 2.79% and 1.18% between the respective four month periods, in IGP-DI growth, which is the index used to update state and municipal internal debts, and from 11.7% to 1.8% in the value of the American currency, used to update the amounts renegotiated involving external loans taken by the various states (MF Notification 30, Brazil Investment Bond – BIB), Paris Club and Program of Modernization of the Water and Sewage Sector – PMSS).

In the nominal concept, Public Sector Borrowing Requirements totaled R$9.9 billion or 2.5% of GDP in the first four months of 2002, compared to R$3.8 billion, or 1% of GDP, in the same period of 2001.

Federal securities debt

Evaluated according to portfolio position, the federal securities debt diminished from R$635.1 billion in January to R$633.3 billion in April, despite incorporation of interest in the period. In this context, the most important factors were net redemptions of R$22.8 billion and 2.3% upward movement in the value of the real against the dollar in the period.

The federal securities debt indexed to the rate of exchange fell from R$186.5 billion in January to R$175.8 billion in April, based on net redemptions of R$10.7 billion in exchange securities and appreciation of the real against the dollar. Participation of this heading in the total federal securities debt dropped from 29.4% to 27.8% in the period. The participation of the preset debt moved from 7.6% to 9.8% and the Selic reference rate from 52.6% to 51.2%.

Net public sector debt

The net public sector debt, which totaled R$660.9 billion or 53.3% of GDP in December 2001, moved to a level of R$684.6 billion, or 54.5% of GDP in the month of April 2002. Aside from the nominal deficit of R$9.9 billion accumulated in the year, this increase reflected the impact of exchange variations on the internal securities debt earmarked to exchange (R$5.4 billion) and on the foreign debt (R$2.9 billion) and recognition of debts in the amount of about

R$11.8 billion. To some extent, these factors were offset by alterations in the parity of the basket of currencies upon which the nation's international reserves and external debt are based, in the amount of R$3.2 billion, and by privatizations in the period, with R$183 million.

The gross debt of the general government, which includes federal state and municipal governments came to R$928.7 billion or 74% of GDP in April 2002, compared to R$885.3 billion or 71.3% of GDP in December 2001. Among the factors that contributed to this increase were issues of papers by the National Treasury to substitute the R$21.1 billion in Banco Central Notes – Special Series (NBCE) redeemed in the first four months of 2002, as well as exchange depreciation of 1.8% in the period.

3.4 – Conclusion

The discreet growth in credit operations in the second quarter marked continuation of the performance registered since the start of the year and clearly reflects the cautious posture adopted by the diverse economic agents, particularly in view of the uncertainties of the world scene and less than desirable credit costs.

In this sense, companies have concentrated new operations in short-term transactions and postponed commitments to longer term credit operations. With regard to families, access to new credits has been limited by declining real earnings. Particularly in operations with families, the default level has imposed restrictions on a more rapid falloff in credit interest rates, though the default rate has risen at a rather moderate pace in the period. This fact alone has been enough to ensure a rather conservative posture on the part of banking institutions in their credit operations. However, one should note that the volume of BNDES disbursements, mostly channeled to infrastructure, has increased considerably, generating a favorable outlook for investments in this area.

The continuity of the trajectory of the primary surplus in 2002 reflects not only the efficacy of the fiscal adjustment measures adopted but the consolidation of the basic premises of Fiscal Responsibility Law in the management of public finance by the different levels of government.

The fiscal equilibrium that has been attained has been a determining factor in maintaining public sector indebtedness at manageable levels. However, situational factors not directly connected to fiscal performance indicators, could result in fluctuations in the debt/GDP ratio, principally as a result of alterations in the exchange rate.

Here, one should cite the measures recently adopted by the government to curtail the impact of these factors. Thus, the increase in the primary surplus target to 3.75% of GDP in 2002; the possibility of utilization of funding made available by the International Monetary Fund (IMF) and anticipated redemptions of external debt papers due to mature, together with other ongoing macroeconomic policies, should have the effect of inhibiting the speculative processes that resulted in the recent depreciation of the real and provide conditions considered favorable to renewed sustainable growth, with the start of a downward curve in the debt/GDP ratio.