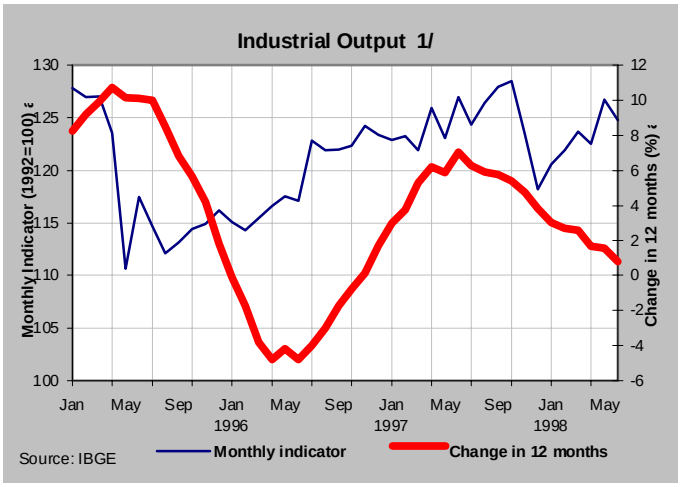
Monetary program for the fourth quarter of 1998

A. The economy in the third quarter of 1998

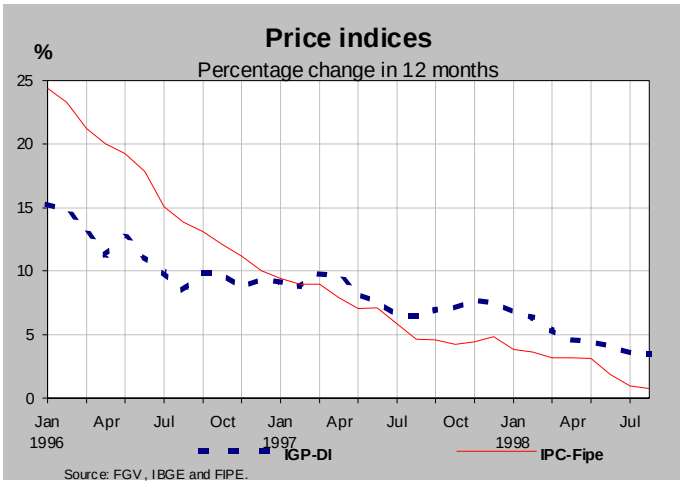
1. In the second quarter of 1998, industrial production turned in growth of 2.1% above the previous quarter. This performance resulted from positive results in the capital goods sector (4.7%) and 4.3% expansion in the segment of consumer goods. Here, one should note that the basis of comparison was sharply depressed as a result of the interest rate hike that followed outbreak of the Southeast Asian crisis. In July, industrial production remained stable in comparison to the April-June quarter, as growth under capital goods production was offset by reductions in consumer goods output. In accumulated terms for the year, industry registered a decline of 0.4%, with growth of 5.9% in the production of capital goods and a 4.2% drop under consumer goods output. This decline was a consequence of the results achieved under the heading of durable consumer goods (-19.3%), since, leveraged by the food industry, the segment of nondurable goods and semidurable consumer goods expanded by 0.6%.



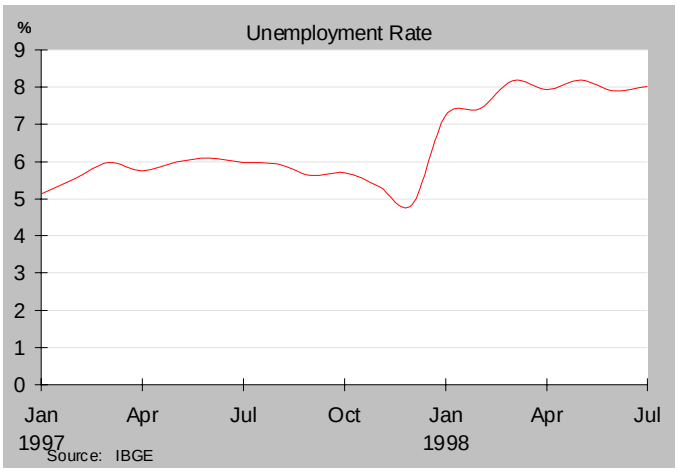
2. According to data released by the National Association of Automotive Vehicle Manufacturers (Anfavea), production of the automotive industry came to 282.4 thousand vehicles in the July/August 1998 period, reflecting a decline of 23.9% in comparison to the same period of the previous year. This result can be interpreted as a sign that the third quarter of the year will not witness recovery in the level of economic activity. In the first eight months of the year, production of the automotive industry registered a drop of 17.1%, with a 23.7% decline in internal sales. Foreign market sales registered a high of 11.2% in the period.

3. During the course of the year, data on the billings of the sector of commerce indicate a drop in retail sales and a high in wholesale sales. Information released by the Federation of Commerce of the State of São Paulo (Fcesp) for the retail commerce sector of the metropolitan region of São Paulo points to an accumulated drop of 8.7% up to July, while data on the Brazilian wholesale sector published by the Brazilian Association of Wholesalers and Distributors of Industrialized Products (Abad), registered 5.9% growth in the same period. This difference in the results registered by the sector of commerce can be partially ascribed to production performance in the consumer goods industrial sector.

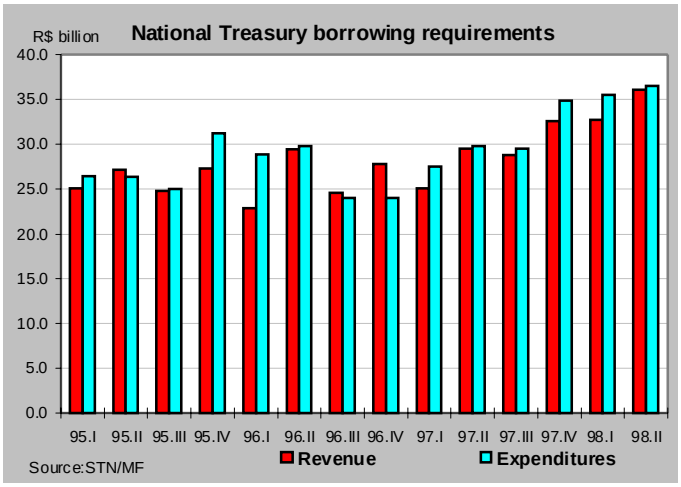
4. The major price indices registered declines in July and August. The general price index – internal supply (IGP-DI), turned in rates of –0.38% and –0.17%, respectively and an accumulated total of 0.95% up to August. The consumer price index – Fipe registered a drop of 0.61% in the period from January to August and declines of 0.77% and 1% in the final two months of the period. In 12 month terms, the rates came to 3.45% and 0.73%, respectively. For the most part, the results for July and August reflect both the downturn under food prices at both the wholesale and retail levels and favorable seasonal factors in the apparel sector.



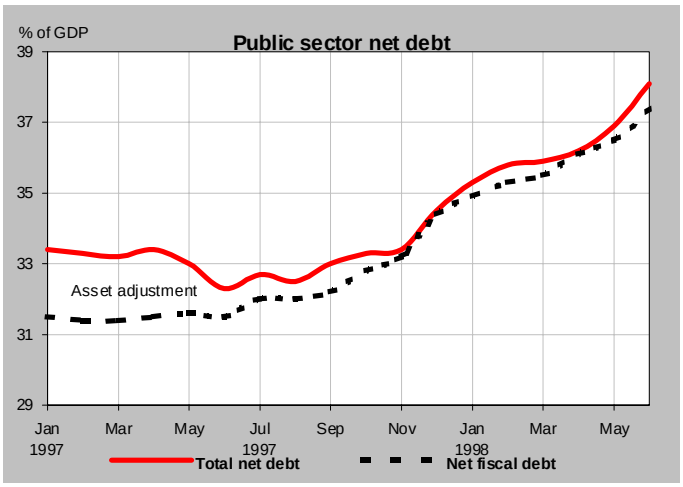
5. In the month of July, basic unemployment measured by IBGE came to 8% as compared to 7.9% in the previous month. Upward movement in the rate of unemployment was caused by a cutback in job openings and a rise in layoffs. In the first seven months of the year, the average rate of unemployment came to 7.8%, with growth of two percentage points in relation to the same 1997 period. This result is explained by the lesser pace of growth in economic activity and by the ongoing process of restructuring productive sectors of the economy, particularly industry.



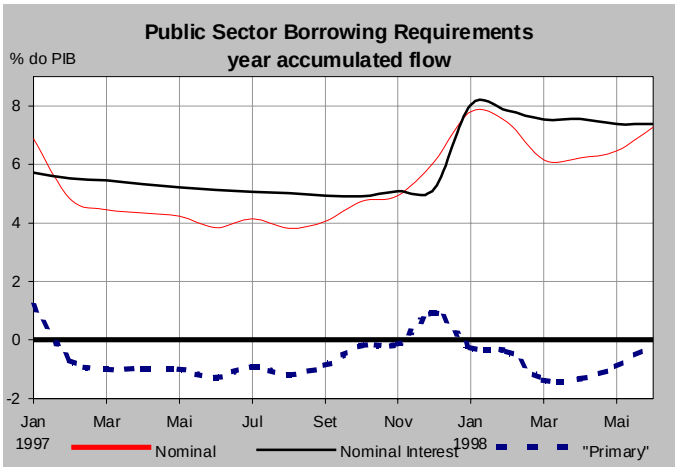
6. In June, National Treasury budget operations turned in a deficit of R$ 2.7 billion, based on revenues of R$ 9 billion and expenditures of R$ 11.7 billion. In the first half of the year, the accumulated deficit totaled R$ 3.2 billion, reflecting revenues of R$ 68.8 billion and spending of R$ 72 billion. In comparison to the same period of 1997, revenues registered real growth of 19.8% due, to some extent, to band-B mobile telephone service concessions, an increase in income tax rates and changes in the system of taxation levied on fixed income funds in the month of January. The real rise in spending came to 19.4% in the period due to a great extent, to growth in charges on the federal securities debt.



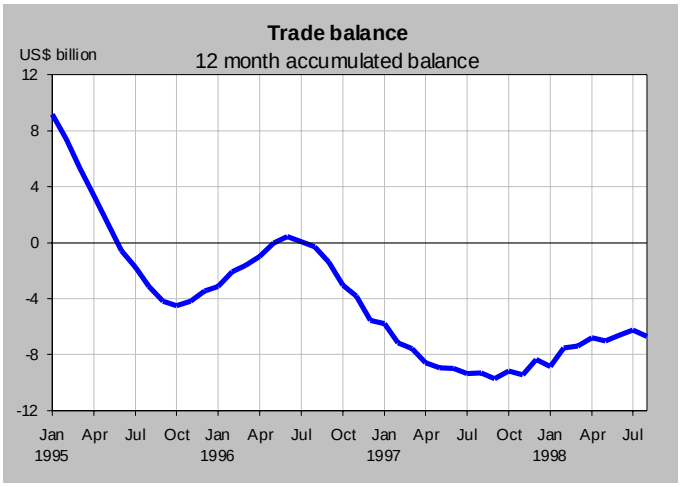
7. The net public sector debt totaled R$ 346.6 billion in June, reflecting 38.1% of GDP. Internal indebtedness closed at 35.9% of GDP, with 21.7% for the central government, 13% for the states and municipalities and 1.2% for state companies. The net foreign debt came to 2.2% of GDP.



8. In the primary concept, public sector borrowing requirements in the first six months of the year registered a surplus of 0.1% of GDP. The central government obtained a surplus of 0.3% of GDP, while regional governments closed with a deficit equivalent to 0.2% of GDP. The inclusion of nominal interest, which totaled 7.4% of product, resulted in a nominal deficit of 7.3% of GDP.

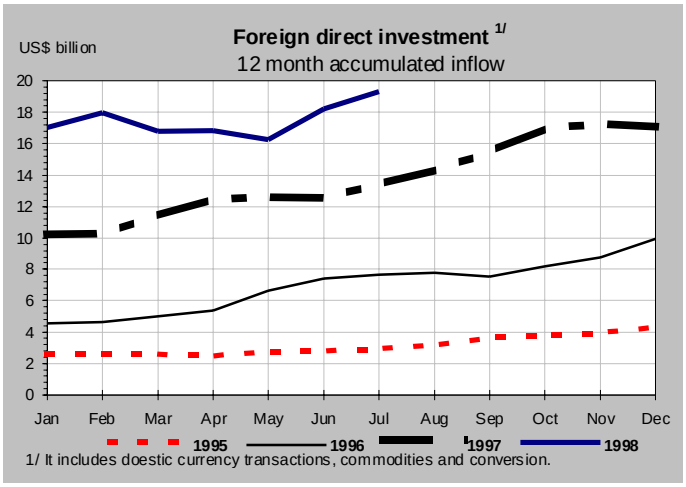


9. The balance of payments current account deficit in the January-July 1998 period came to US$ 16 billion, as compared to US$ 18 billion in the same 1997 period. This reduction was a consequence of the lesser trade deficit, since outlays on services remained at the same level as in the preceding year. Exports added up to US$ 30.9 billion, for growth of 3% in relation to the same period of the previous year. Foreign sales of manufactured products rose by 12.6%. Import operations closed the period at US$ 33.3 billion for a decline of 3.4% and generated an accumulated deficit of US$ 2.4 billion between January and July 1998. In the July-August period, foreign sales and purchases came to respective levels of US$ 9 billion and US$ 10 billion, representing declines of 13.2% and 11.5%, in relation to the same 1997 period.

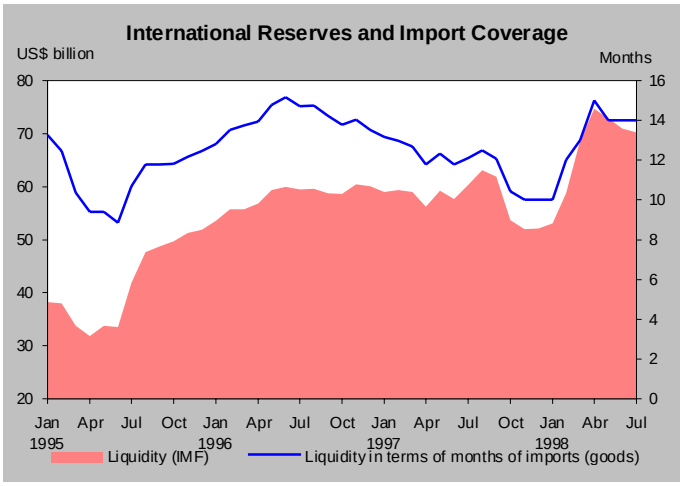


10. In the first seven months of the year, net spending on services totaled US$ 14.8 billion, remaining at the same level as in January-July of the previous year. The increase of US$ 272 million in net interest payments was offset by a falloff in net outlays on other services. In July, net spending on services declined by 26.2% in relation to July 1997 as a result of lesser net interest payments and cutbacks in profit and dividend remittances.

11. With respect to capital flows in the January-July 1998 period, net investment inflows to the capital market came to US$ 9.5 billion, for growth of 34.6% in comparison to the same period of the preceding year, while net direct foreign investments reached a level of US$ 11.1 billion, for growth of 25.2%. Inflows consequent upon the privatization program added up to US$ 3.2 billion, corresponding to 26.1% of gross investments. Net inflows of financial loans came to US$ 20.5 billion, with operations heavily concentrated in placements of notes.



12. In the month of July, net direct foreign investments totaled US$ 2.5 billion, as compared to US$ 1.4 billion in the same 1997 period. The net inflow of portfolio investments in the period closed at US$ 1.2 billion or 42.6% more than in July of the previous year. In the case of financial loans, net inflows finished at US$ 46.9 million as a result of high levels of amortizations on bond and loan operations. Banco Central exchange market operations, concentrated in supplying net foreign exchange to the market, coupled with the net result of its primary operations generated a drop of US$ 688 million in the July international reserve position, closing the month at US$ 70.2 billion in the international liquidity concept.



13. The upper and lower exchange float miniband parameters moved by 4.212% and 4.550% from January to July 1998, closing at respective levels of R$ 1.1630/ US$ and R$ 1.1720/US$. In the free rate segment of the exchange market, the average sale rate devalued by 4.21%.

B. Monetary policy in the second quarter of 1998

14. Viewed under the prism of average daily balances, the restricted monetary base came to R$ 33.1 billion at the end of June, well within the parameters specified in monetary programming for the second quarter (R$ 30.2 billion – R$ 35.5 billion). In June, the monetary base expanded by 2.3%, raising 12 month accumulated growth to 34%. Currency issued and banking reserves turned in growth of 2.8% and 1.8%, respectively, in the month of June and closed at R$ 17.9 billion and R$ 15.2 billion, with accumulated 12 months growth rates of 14.4% and 67.6%, in the same order.

15. The expanded monetary base, which corresponds to the restricted base plus compulsory cash deposits and federal public securities outside Banco Central do Brasil reached a June level of R$ 340 billion, closing squarely within the parameters specified in monetary programming (R$ 320.4 billion – R$ 376.1 billion). Thus, the rate of monthly growth in the expanded base came to 6.5% and the rate of accumulated 12 month growth closed at 67.3%.

Table 1. Observed results and forecast monetary program for the second quarter of 1998

Itemization	Forecast		Observed	
	R$ billion	Percentage change in 12 months 1/	R$ billion	Percentage change in 12 months
M1 2/	37.9 - 44.5	12.1	42.4	15.4
Restricted base 2/	30.2 - 35.5	33.0	33.1	34.0
Expanded base 3/	320.4 - 376.1	71.4	340.0	67.3
M4 3/	405.8 - 476.3	25.5	431.1	22.7

1/ Percentage changes are based on the medium point of forecast.

2/ Working-day balance average of last month in the period.

3/ End-of-period balances.

16. The money supply (M1) totaled R$ 42.4 billion in June in terms of average daily balances, with positive growth of 1.9% in the month and growth of 15.4% in 12 months, closing within the parameters defined in monetary programming (R$ 37.9 billion – R$ 44.5 billion). The average balances of currency held by the public and demand deposits expanded by 2.5% and 1.6% in the month, closing at respective levels of R$ 15.6 billion and R$ 26.9 billion, with expansion of 13.9% and 16.2%, respectively, in the 12 month period ended in June.

17. The broader monetary aggregate (M4) closed out the month of June at R$ 431.1 billion, a figure well within the upper and lower limits defined in monetary programming (R$ 405.8 billion – R$ 476.3 billion), with growth of 1.4% in the month and 22.7% in 12 months.

18. Downward movement in basic interest rates continued in the second quarter of 1998 and was accompanied by a reduction in the spread between the TBC and TBAN. In this period, the TBC and TBAN dropped from average levels of 25.48% per year and 36.55% per year in April to 22.72% per year and 33.3% per year in May and 21.61% per year and 29.41% per year in June, respectively. This movement was accompanied by the over-Selic rate which moved from an April level of 25.16% per year to 22.6% per year in May and 21.02% per year in June.

C. Monetary policy in July-August 1998

19. Seen under the concept of average daily balances, the restricted monetary base came to a total of R$ 33.9 billion at the end of August, registering positive growth of 1.4% in the month and 35.8% in 12 months. Currency issued and banking reserves totaled R$ 18.4 billion and R$ 15.6 billion, with growth of 0.6% and 2.3% in the month and 15.7% and 70.6% in 12 months, respectively.

20. The end-of-period expanded monetary base balance came to R$ 341.5 billion in August, for a reduction of 0.8% in the month and growth of 60.9% in 12 months.

Table 2. Observed May and forecast monetary program for the third quarter of 1998

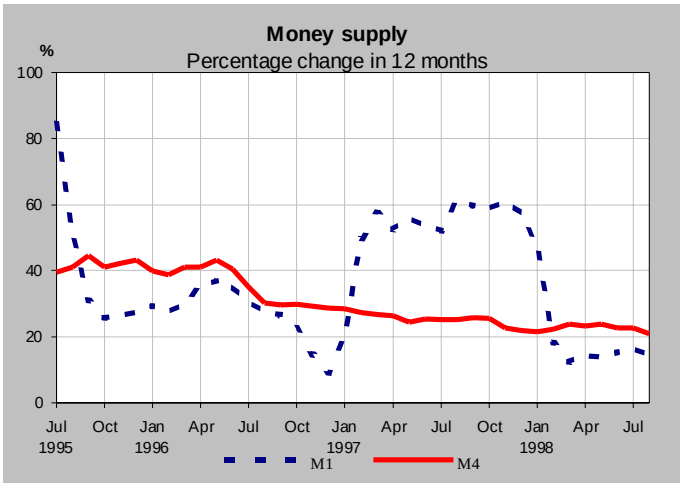
Itemization	Forecast		Observed	
	R$ billion	Percentage change in 12 months 1/	R$ billion	Percentage change in 12 months
M1 2/	39.7 - 46.6	11.1	43.4	14.5
Restricted base 2/	31.0 - 36.4	28.8	33.9	35.8
Expanded base 3/	309.0 - 362.8	50.0	341.5	60.9
M4 3/	406.4 - 477.0	18.2	439.2	20.9

1/ Percentage changes are based on the medium point of forecast.

2/ Working-day balance average of last month in the period.

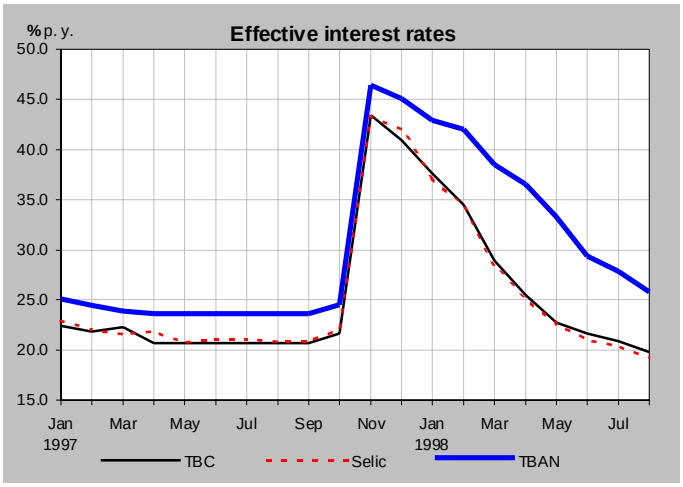
3/ End-of-period balances.

21. The money supply balance (M1) totaled R$ 43.4 billion in August, with growth of 0.8% in relation to July. In the 12 month period, M1 growth came to 14.5%. Currency held by the public added up to R$ 16 billion, with monthly growth of 0.4% and accumulated 12 month expansion of 15.2%. Demand deposits totaled R$ 27.4 billion for growth of 1% in the month and 14.1% in 12 months.



22. Trade balance of the broader money supply (M4) came to R$ 439.2 billion in August for monthly growth of 0.13% and accumulated 12 month expansion of 20.9%.

23. The downward movement of basic interest rates continued in the July-August period. In average terms, the TBC and TBAN dropped from 20.89% per year and 27.8% per year in July to 19.75% per year and 25.75% per year in August. In the same period, the average over-Selic dropped from 20.33% per year to 19.23% per year and closed below the level of the TBC as a consequence of greater interbank market liquidity. On September 2, the Monetary Policy Committee (Copom) met and defined new basic interest rate levels, setting the Banco Central Base Rate (TBC) at 19% per year and the Banco Central Assistance Rate (TBAN) at 29.75% per year. However, at an extraordinary meeting held on the 10th of the same month, Copom raised the TBAN from 29.75% per year to 49.75% per year. At the same time, Banco Central altered the operational conditions for discount window operations, specifying the TBAN as the minimum financial charge for these transactions. The raise in basic rates, coupled with a sudden turnaround in interbank market liquidity conditions, generated an increase in the interest rates carried out on the spot market in the month of September.



D. Outlook for the fourth quarter of 1998

24. In the fourth quarter of the current year, the developments of the Brazilian economy will depend on the outcome of the international financial crisis and, even more specifically, on events in Russia. However, since the ongoing crisis is in no way restricted exclusively to the emerging economies, enormous short-term changes can be expected in the world economic scenario as a result of the alterations that have occurred in foreign financing conditions. In this sense, the increase in capital remittances abroad that has occurred since the end of August led government authorities to adopt a series of measures aimed at creating more attractive conditions for foreign capital investment. Among these measures, one should highlight a cutback in the minimum average amortization terms of financial loans and loan renewal operations, coupled with a reduction in the income tax rate on the earnings of foreign capital fixed income funds and an income tax exemption on conversions of foreign credits into direct investments in Brazil.

25. Aside from these measures, monetary policy was implemented with the overall objective of ensuring consolidation of the stabilization process, particularly in light of the volatile environment that characterized world financial markets. In this framework, following the example of what occurred in the final days of October of last year, interest rates were raised as a way of discouraging speculative attacks on the nation's currency. As a matter of fact, in the days immediately following the extraordinary September 10 Copom meeting, demand for exchange dropped sharply to a level more compatible with the objective of preserving a comfortable foreign reserve position.

26. Obviously, forecasts of GDP performance in the final months of the year will have to take the situation of international instability into account. For this reason, activity is expected to slow, particularly in the manufacturing segment and commerce. However, expectations are that the mineral extraction industry, construction and communications will continue expanding. In this setting, the downward movement in price levels will certainly continue and current forecasts now point to the different annual price indices closing the year in the range of just 3%.

27. Despite the highly unfavorable international context, the foreign capital inflow has been maintained, particularly under the heading of direct foreign investment. In this light, one can see that the process of qualitative improvement in the financing of the balance of payment current account balance has continued. Expectations for 1998 with respect to inflows of direct investments now stand at US$ 22 billion, signaling that the country has managed to preserve its credibility among international investors. Parallel to this, the willingness of government authorities and multilateral organizations to adopt coordinated measures targeted at managing the repercussions of the financial crisis has clearly favored efforts to overcome the instability now affecting the Brazilian economy.

28. Evincing the government's constant efforts to improve the country's macroeconomic underpinnings, particularly in terms of a fiscal adjustment, measures were adopted to effect a cutback of about R$ 6.8 billion in spending in the final months of the year. One of the measures taken to achieve the aforementioned target was creation of the Fiscal Control and Management Commission (CCF). At the same time, the first steps in the process of elaborating the Fiscal Adjustment Program for 1999-2001 were taken and will define successive targets for growing primary surpluses. In this context, one must highlight the very positive performance of the privatization process that has ensured a steady and voluminous inflow of resources that are being utilized solely for purposes of reducing the public debt.

E. Growth targets for the monetary aggregates in the forth quarter of 1998

29. Programming of monetary aggregates in the fourth quarter of 1998 was based on forecasts of the probable results of inflation, GDP, interest rates, the monetary impacts of National Treasury operations and restructuring of state-level debts, Banco Central interventions in the exchange market and in the financial system and rediscount and open market transactions. Chart 3 shows the projection for the monetary aggregates at the end of 1998.

Table 3. Monetary program for the fourth quarter 1998 [1/]

R$ billion

Itemization	Forth quarter	Percentual change in 12 months
M1 [2/]	45.0 - 52.8	7.2
Restricted base [2/]	34.6 - 40.7	16.6
Expanded base [3/]	347.7 - 408.2	35.0
M4 [3/]	435.1 - 510.7	20.4

1/ Refers to the final month in the period.

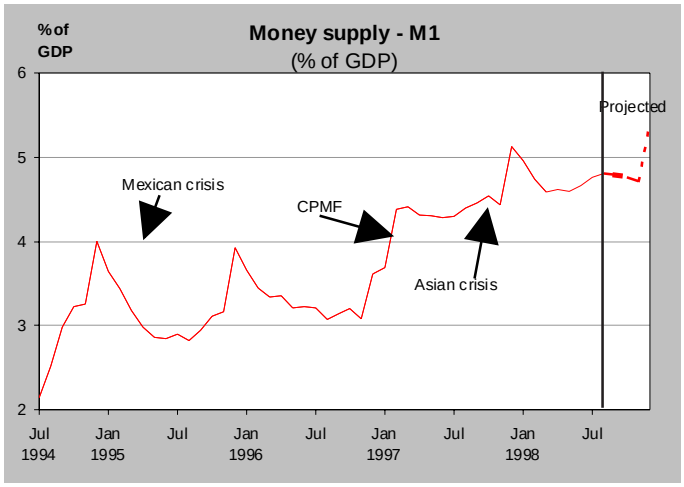
2/ percentual change from the medium point of the interval.

3/ Working-day balance average in month.

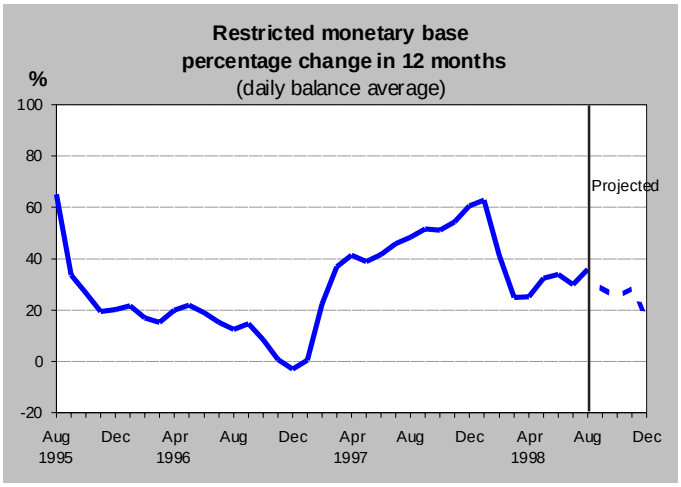
4/ End-of-period balances.

30. The scenario adopted for internal interest rates and growth in nominal income in coming months, coupled with other factors that impact the money supply stock, resulted in a 7.2% twelve month growth projection for average daily balances of the M1 aggregate (currency held by the public plus demand deposits) in December 1998.

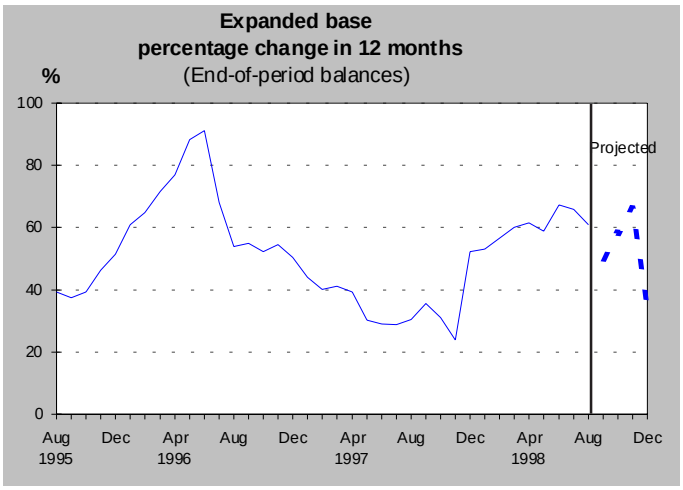
31. Initially, upward movement in the M1/GDP ratio since implementation of the Real Plan can be ascribed to the process of monetization of financial assets that began in 1997 and to the new money supply level generated by the impact of the CPMF. For coming months, it is expected that this ratio will decline up to November as a result of the high cost of opportunity that results from retaining currency. In the month of December, the M1/GDP ratio should turn upward again as a consequence of the increased seasonal demand for currency consequent upon end-of-year holiday festivities.



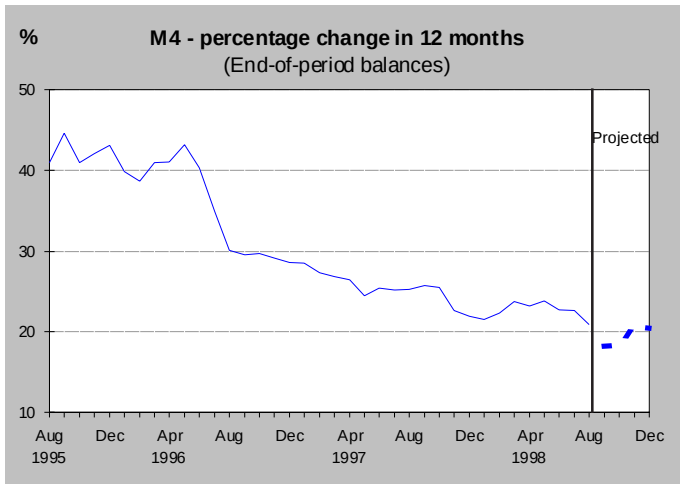
32. Based on an analysis of expected M1 and currency demand, as well as of the behavior of compulsory deposits on demand resources, growth in the average balance of the monetary base (currency issued plus banking reserves) over 12 months is projected at 16.6% in December 1998.



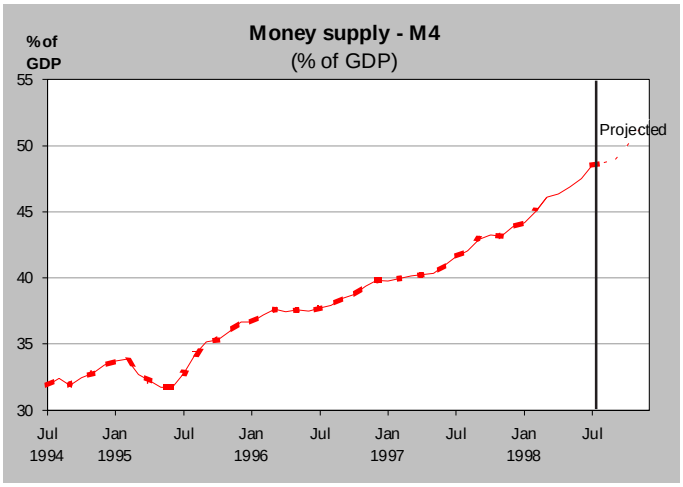
33. Projection of the expanded base (a measurement of the federal internal debt in currency and securities), which presupposes the neutrality of the factors that condition the restricted monetary base, took due account of such major expansionary factors as interest on the federal securities debt in coming months and the operations involved in restructuring state debts. Thus, projections for this monetary aggregate in 1998 were set at 35%.



34. In much the same way and in keeping with the behavior of the other aggregates, M4 growth for this year was projected at 20.4%.



35. In coming months, the M4/GDP ratio is expected to continue the growth process initiated with the 1994 stabilization program, reflecting the interest rate levels required by the dominant conditions of that time as well as the surpluses registered in the balance of payments.



36. Growth in the monetary aggregates is summarized in the following chart, which also presents the results for 1997 and the July-August 1998 period, together with projections for the fourth quarter of 1998.

Table 4. Evolution of monetary aggregates [1/]

Itemization	1997		1998			
	Year		*July - August*		Forth quarter [2/]	
	R$ billion	% change in 12 months	R$ billion	% change in 12 months	R$ billion [3/]	% change in 12 months
M1 [4/]	45.6	57.4	43.4	14.5	48.9	7.2
Restricted base [4/]	32.3	60.6	33.9	35.8	37.7	16.6
Expanded base [5/]	280.1	52.2	341.5	60.9	378.0	35.0
M4 [5/]	392.8	21.9	439.2	20.9	472.9	20.4

1/ Refers to the final month in the period.

2/ Projected.

3/ Medium point of forecasts.

4/ Working-day balance average in month.

5/ End-of-period balances.

37. Growth of the different multipliers implicit in monetary programming is summarized in the following chart:

Table 5. Monetary multiplier [1/]

Itemization	1997		1998		1998	
	Year		July - August		Forth quarter [2/]	
	Multiplier	% change in 12 months	Multiplier	% change in 12 months	Multiplier	% change in 12 months
M1 / Restricted base [3/]	1.413	-2.0	1.279	-15.7	1.299	-8.1
Banking reserves / Demand deposits [3/]	0.438	88.8	0.569	49.7	0.542	23.7
Currency / M1 [3/]	0.384	-24.0	0.369	0.5	0.382	-0.5
M4 / Expanded base [4/]	1.402	-19.9	1.286	-24.9	1.251	-10.8

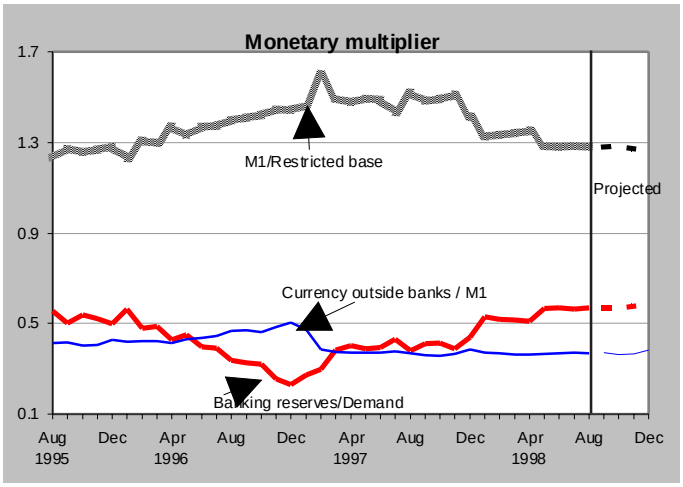
1/ Refers to the final month in the period.

2/ Projected.

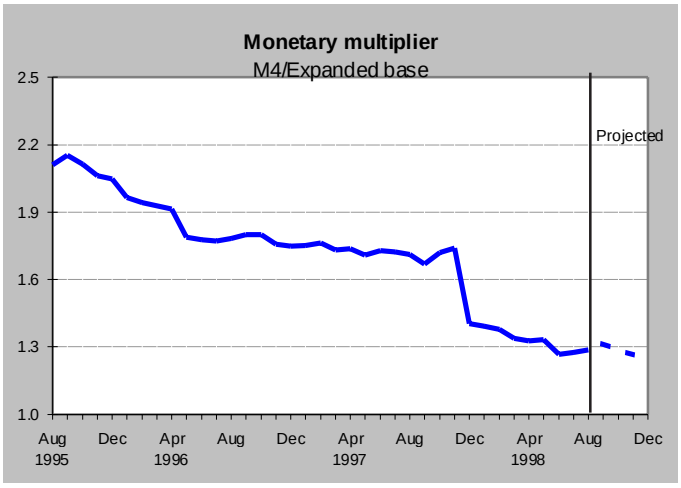
3/ Working-day balance average in month.

4/ End-of-period balances.

38. In light of the now rather lengthy period of price stability, one should not expect significant volatility in the future values of the monetary base multiplier, even though the process of monetization of the economy has not yet fully run its course.



39. The expanded base multiplier is expected to continue downward in coming months, mirroring operations consequent upon restructuring of state debts and that have had a greater impact on the expanded base than on M4.



Summary of projections

Table 1. Observed results and forecast monetary program for the second quarter of 1998

Itemization	Forecast		Observed	
	R$ billion	Percentage change in 12 months 1/	R$ billion	Percentage change in 12 months
M1 2/	37.9 - 44.5	12.1	42.4	15.4
Restricted base 2/	30.2 - 35.5	33.0	33.1	34.0
Expanded base 3/	320.4 - 376.1	71.4	340.0	67.3
M4 3/	405.8 - 476.3	25.5	431.1	22.7

1/ Percentage changes are based on the medium point of forecast.

2/ Working-day balance average of last month in the period.

3/ End-of-period balances.

Table 2. Observed May and forecast monetary program for the third quarter of 1998

Itemization	Forecast		Observed	
	R$ billion	Percentage change in 12 months 1/	R$ billion	Percentage change in 12 months
M1 2/	39.7 - 46.6	11.1	43.4	14.5
Restricted base 2/	31.0 - 36.4	28.8	33.9	35.8
Expanded base 3/	309.0 - 362.8	50.0	341.5	60.9
M4 3/	406.4 - 477.0	18.2	439.2	20.9

1/ Percentage changes are based on the medium point of forecast.

2/ Working-day balance average of last month in the period.

3/ End-of-period balances.

Table 3. Monetary program for the fourth quarter 1998 [1/]

R$ billion

Itemization	Forth quarter	Percentual change in 12 months
M1 [2/]	45.0 - 52.8	7.2
Restricted base [2/]	34.6 - 40.7	16.6
Expanded base [3/]	347.7 - 408.2	35.0
M4 [3/]	435.1 - 510.7	20.4

1/ Refers to the final month in the period.

2/ percentual change from the medium point of the interval.

3/ Working-day balance average in month.

4/ End-of-period balances.

Table 4. Evolution of monetary aggregates [1/]

Itemization	1997		1998			
	Year		*July - August*		Forth quarter [2/]	
	R$ billion	% change in 12 months	R$ billion	% change in 12 months	R$ billion [3/]	% change in 12 months
M1 [4/]	45.6	57.4	43.4	14.5	48.9	7.2
Restricted base [4/]	32.3	60.6	33.9	35.8	37.7	16.6
Expanded base [5/]	280.1	52.2	341.5	60.9	378.0	35.0
M4 [5/]	392.8	21.9	439.2	20.9	472.9	20.4

1/ Refers to the final month in the period.

2/ Projected.

3/ Medium point of forecasts.

4/ Working-day balance average in month.

5/ End-of-period balances.

Table 5. Monetary multiplier [1/]

Itemization	1997		1998		1998	
	Year		July - August		Forth quarter [2/]	
	Multiplier	% change in 12 months	Multiplier	% change in 12 months	Multiplier	% change in 12 months
M1 / Restricted base [3/]	1.413	-2.0	1.279	-15.7	1.299	-8.1
Banking reserves / Demand deposits [3/]	0.438	88.8	0.569	49.7	0.542	23.7
Currency / M1 [3/]	0.384	-24.0	0.369	0.5	0.382	-0.5
M4 / Expanded base [4/]	1.402	-19.9	1.286	-24.9	1.251	-10.8

1/ Refers to the final month in the period.

2/ Projected.

3/ Working-day balance average in month.

4/ End-of-period balances.