Inflation Report

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Inflation Report

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Statistical Conventions:

...	data not available.
-	nil or non-existence of the event considered.
0 ou **0.0**	less than half the final digit shown on the right.
*	preliminary data.

Hiphen between years indicates the years covered, including the first and the last year.
A bar (/) between years (1970/1975) indicates the average of the years covered, including the first and the last year or even crop or agreement year, when mentioned in the text.

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Foreword

Inflation Report is a quarterly publication of the Banco Central do Brasil with the objective of evaluating the performance of the inflation targeting system and providing a prospective scenario for inflation. The national and international economic conditions underlying decisions taken by the Monetary Policy Committee (Copom) concerning the monetary policy management are presented.

The report is divided into five chapters: Aggregate Demand, Aggregate Supply, International Economy, Prices and Prospects for Inflation. Basically, the analysis of aggregate demand involves consumption, investments, budget operations and the gap of foreign resources. With regard to supply, the analysis is centered on the behavior of the production indicators of the farm and industrial sectors and the labor market. In the chapter dealing with the international economy, the report presents an analysis of the world's major economies and seeks to identify those conditions capable of impacting the Brazilian balance of payments. The chapter referring to price analysis focuses on the results obtained in the quarter as a consequence of monetary policy decisions and the real conditions of the economy outside the realm of government action. Finally, prospects on inflation growth are analyzed.

Executive Summary

Brazilian GDP grew 4.2% in 2000, driven by the expansion of manufacturing, especially of durable and capital goods. The fast pace of expansion continued in the first two months of 2001, still led by the same sectors. Durable and capital goods were the industries that benefited most directly from the improvement in expectations and from the increase in credit in the unfettered market. The latter was a result of the reduction of reserve requirements in 1999-2000, the decline in lending rates and the lengthening of the average maturity of loans.

The inflation rate has remained above expectations in the last two months. The year-over-year IPCA rose by 0.3 percentage point in February compared to last December, while the general price indices (IGP-DI and IGP-M) fell in the same period. The trimmed-mean IPCA core, which has been rising since November, reached 0.54% in February.

Under the current economic conditions, there are no imbalances between supply and demand exerting direct pressure on prices. The average capacity utilization is still below historical peaks and there is no evidence of cost pressure due to wage rises above productivity.

The main impact of aggregate demand expansion has been on the trade balance. Although imports partially respond to the increase in manufactured exports, it is undeniable that the demand pressure has affected the imported quantum. The net effect in the first two months of the year was a US$ 360 million increase in the trade deficit when compared to the same period of 2000.

However, the prospects for the second and third quarters of this year are of improvement in foreign trade, due to the beginning of shipments of agricultural products. For the whole year, the trade balance will

essentially depend on the growth differentials between Brazil and its main trade partners, on the path of the real exchange rate, and on the behavior of the terms of trade.

The growth in the trade deficit and the corresponding increase in the current account deficit have contributed to weaken the exchange rate, despite the fact that external financing needs have increased only moderately. More recently, the exchange rate has been affected by the uncertainty in the external conjuncture, particularly in relation to the magnitude of the downturn in the United States' economy and to the political crisis in Argentina.

Even under adverse external conditions, Brazil carried out several sovereign bond issues on favorable terms during the first quarter. These issues in the international market, along with the collateral released after the bonds swap in March and the IDB loan, totaled US$ 4.2 billion. This is equivalent to total amortization payments of the public sector's external debt scheduled for 2001.

The main sources of uncertainty regarding future inflation behavior are related to the external economic environment, in particular to the economic performance of the United States and Argentina, to oil prices, and, domestically, to the adjustment of some institutionally backward-looking prices (also known as government-managed prices), and to the passthrough from the exchange rate to consumer prices. Each of these topics is examined in detail in the baseline scenario set out by the Monetary Policy Committee in this *Report*.

The recent currency depreciation raises the important issue of the passthrough from the exchange rate to domestic prices. Since the floating of the *real* in 1999, the degree of passthrough has been declining steadily, given that only the part of the exchange rate variation perceived as permanent is transmitted to prices, without changing significantly inflation expectations. However, sharp exchange rate depreciations, albeit reflecting the large uncertainty in the markets, can increase the degree of passthrough, to the extent that part of the depreciation is perceived as long-lasting by society.

In this context of uncertainty regarding the passthrough, and given the strong acceleration in the pace of economic activity in the last months,

the rise in the measures of core inflation, together with higher than expected inflation in the beginning of the year, indicate risks to the achievement of the 4%-target in 2001.

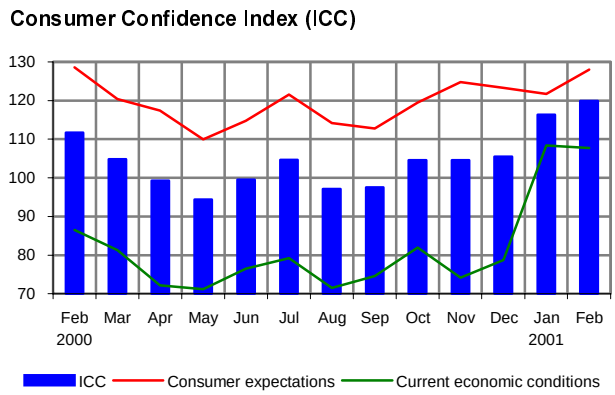
The inflation fan chart presented in this *Inflation Report* shows a central projection of 4.8% for the IPCA in 2001. This forecast is based on the assumption that the basic interest rate remains constant throughout the forecasting horizon at 15.75% per year, rate set by the Monetary Policy Committee at its March meeting. The expressive increase in the central projection compared to that presented in the last *Report* is largely due to the effects of the passthrough from the recent exchange rate depreciation.

1 – Aggregate demand

1.1 – Consumption

Demand indicators for early 2001 demonstrate that the growth process initiated in late 1999 has continued, registering rates that were sharply higher than in the same months of the previous year.

One should note, however, that the depressed basis of comparison has given an added boost to this trajectory. Consequently, over the course of the year, the distances between these rates are expected to decline as comparisons are made between periods in which activity levels achieved higher rates of growth. In this context, it should be mentioned that GDP expansion in the final quarter of 2000 closed at 0.22% compared to 2.14% in the third quarter. These data have been purged of seasonal impacts and are expressed in terms of comparisons to the previous period.



According to the Consumer Confidence Index (ICC), issued by the Trade Federation of the State of São Paulo (FCESP), consumer expectations continued high for the sixth consecutive month and closed at a February level of 119.9. Basically, the ICC mirrors consumer expectations and, consequently, has been impacted positively by steadily declining interest rates and lower unemployment, as well as by a minimum wage hike to R$ 180.00, effective as of April. In principle, this performance clearly suggests that one should not expect any downturn in consumption in the coming months.

Just as occurred in other indicators, the real revenues of the retail trade sector in the metropolitan region of São Paulo moved sharply upward

Real sales of the retail sector in São Paulo

Percentage change

Itemization	2000				2001
	Sep	Oct	Nov	Dec	Jan
In the month[1/]					
General	-0.50	0.36	2.41	0.37	-1.04
Consumer goods	0.55	1.50	-0.06	1.44	-0.35
Durable	0.15	2.90	1.18	7.66	-6.83
Semidurable	-5.40	0.96	-2.04	5.17	-7.14
Nondurable	0.58	2.33	-1.26	0.82	1.87
Automotive trade	0.79	4.27	-4.78	-1.25	-9.14
Building materials	2.60	-0.44	3.43	15.17	-4.23
In 12 months					
General	9.68	10.18	10.86	10.41	10.74
Consumer goods	10.98	10.85	11.19	10.33	10.50
Durable	17.15	15.98	15.99	13.75	13.67
Semidurable	-23.42	-25.55	-29.04	-34.54	-36.49
Nondurable	11.97	13.15	14.45	15.68	16.47
Automotive trade	1.92	7.34	10.70	13.77	14.67
Building materials	3.91	3.57	3.22	4.47	5.37

Source: FCESP
1/ Seasonally adjusted.

SPC and Telecheque consultations

Percentage change

Itemization	2000			2001	
	Oct	Nov	Dec	Jan	Feb
In the month[1/]					
SPC	4.25	0.21	6.70	5.30	0.16
Telecheque	-4.29	5.35	-3.36	1.61	3.94
Aggregate	-0.04	1.46	1.98	4.23	2.10
In 12 months					
SPC	6.87	7.35	8.53	9.59	8.13
Telecheque	4.14	5.67	7.16	8.47	7.69
Aggregate	5.42	6.46	7.81	9.00	7.90

Source: ACSP
1/ Seasonally adjusted.

Average interest rates effective in the retail sector

Rate

Itemization	2000			2001	
	Oct	Nov	Dec	Jan	Feb
Average interest rates	6.93	6.90	6.85	6.80	6.76
By financing terms					
In 6 installments	5.02	4.96	4.91	4.85	4.85
In 12 installments	7.33	7.30	7.26	7.24	7.22
In 18 installments	7.42	7.39	7.35	7.31	7.28
Above 18 installments	7.95	7.95	7.88	7.80	7.69

Source: Anefac

at the start of 2001, compared to the January 2000 result. One of the most important components of this growth was a strong upturn in credit operations, as demonstrated in data released by the Trade Association of São Paulo. However, in comparison to the month of December, real sales purged of seasonal factors turned in a decline of 1% due mostly to decreased sales of consumer durables, automotive vehicles and building materials. When the figures for January are incorporated into the total, accumulated twelve month expansion closed at practically the same level as in the period up to December (10.7% and 10.4%, respectively). For the month of February, growth in consultations with the Telecheque system reflected increased trade operations based mostly on lump sum payments and the use of postdated checks, as evinced by the fact that contacts with the Credit Protection Service (SPC) diminished.

In general, demand was sustained by improved results under employment and income and a gradual downward slide in interest rates in the retail sector, as demonstrated by figures released by the National Association of Finance, Administration and Accounting Executives (Anefac). Average interest charged by the retail trade sector came to 6.76% per month in February as compared to 7.5% per month in February 2000.

On the other hand, it is possible that the growth trend in demand at the retail level may be curtailed by sharp growth in default levels, particularly in the metropolitan region of São Paulo, where the net default rate climbed from 4.2% in December to 9.3% in January and 9.8% in February. All of these results were higher than in the corresponding months of 2000. In the same context, Teledata figures generated by two surveys, one of which was limited to Rio de

Default rates

Rate

Itemization	2000				2001	
	Jan	Feb	Nov	Dec	Jan	Feb
SPC (SP)[1/]	5.00	8.41	6.30	4.20	9.30	9.77
Returned cheques[2/]	3.20	3.50	4.00	3.49	4.17	4.05
Teledata (RJ)[3/]	2.49	2.47	0.79	0.83	1.89	1.92
Teledata (National)[4/]	2.54	3.55	1.48	1.24	2.12	2.18
Wholesale sector[5/]	3.20	2.60	2.70	2.00	...	...

Source: ACSP, Bacen, Teledata, Abad and Anefac
1/ New registrations - registrations cancelled out/effected consultations (t-3).
2/ Cheques returned due to insufficient funds/cleared cheques.
3/ Returned cheques/cleared cheques.
4/ Average in the following cities: Belém, Fortaleza, Recife, Salvador, Belo Horizonte, São Paulo, Curitiba, Porto Alegre, Ribeirão Preto and Rio de Janeiro.
5/ Percentage of delayed payments/total net payments.

Janeiro while the other covered a total of ten major cities[1], and the ratio of bad checks returned by reason of insufficient backing to total checks cleared, which is considered a more reliable indicator, point to an increase in the default level in the two month period.

Credit card operations turned in growth in the range of 30% when viewed in terms of accumulated twelve month growth up to January, approximately the same level that has been registered since October. In comparison to January 2000, growth came to 11.6%. Expansion has been less intense when viewed in comparison to checks cleared, with 2% in terms of twelve month accumulated growth and 8.6% when set against January 2000. One should note that part of the increase in credit card operations resulted from their utilization in transactions previously carried out with checks. However, this did not reflect a drop in the use of checks, which expanded by 9.3% in January, compared to the same month of 2000. In February, the number of checks cleared dropped by 6% on the same basis of comparison, though the result for the two month period remained positive at 1.5%.

Sales of autovehicles

Percentage change

Itemization	2000			2001	
	Oct	Nov	Dec	Jan	Feb
In the month[1/]					
Industry	18.76	1.10	7.98	-10.06	8.25
Domestic sales	31.94	6.02	2.50	-12.95	13.55
Foreign sales	8.27	-16.62	28.71	-4.24	-12.94
In the company's outlet	5.40	2.77	7.90	-4.84	1.45
In 12 months					
Industry	28.70	30.55	23.82	24.96	18.71
Domestic sales	22.71	26.12	21.22	22.96	17.33
Foreign sales	53.92	48.68	33.96	32.66	24.06
In the company's outlet	7.58	14.88	20.34	24.80	22.19

Source: Anfavea and Fenabrave
1/ Seasonally adjusted.

Over the course of 2000, the relatively higher growth registered under sales of consumer durables, particularly in the case of automotive vehicles and home appliances, was generated by the greater availability of credit. In the first two months of 2001, sales of the automotive industry registered growth of 16.7%, compared to the corresponding period of 2000. This growth was concentrated in the internal market, as export operations declined. At the retail level, statistics released by the National Automotive Vehicle Distribution Federation (Fenabrave) pointed to growth of 26.7% in the same period.

1 Cities surveyed: Belém, Fortaleza, Recife, Salvador, Belo Horizonte, São Paulo, Ribeirão Preto, Rio de Janeiro, Curitiba and Porto Alegre.

Demand for semidurable and nondurable consumer goods turned upward, mostly as a result of growth in the working population. The increased vitality of demand is evident in the results of real supermarket sales in January, which were 7.7% greater than in January 2000, according to figures released by the Brazilian Association of Supermarkets (Abras).

1.2 – Credit

Growth in financial system credit operations has been generated by strong expansion in transactions with the private sector at freely negotiated rates, while other operations increased at a considerably more moderate pace. This performance reveals that credit growth was generated by the upswing in economic activity, parallel to a downward slide in the volume of public sector banking debt as a result of privatizations and renegotiation of state and municipal debts. For the current year, expectations point to even greater credit market vitality, particularly considering that the restrictive factors that have hampered the segment of targeted funding have run their course.

In the November-January 2001 quarter, credit operations with the private sector expanded steadily, principally as a result of reductions in both basic interest rates and lending rates, contributing importantly to the steady rise in the pace of economic activity. With the prudential measures taken to streamline and strengthen banking activity while reducing compulsory reserve levels, this macroeconomic scenario has stimulated financial institutions to return to their classic role as suppliers of credit, breathing new life into this channel of monetary policy transmission.

Growth in credit operations

R$ billion

Itemization	2000			2001	Quarterly
	Oct	Nov	Dec	Jan	growth %
Total	302.9	310.3	319.0	319.0	5.3
Nonearmarked	143.0	150.4	153.9	157.0	9.8
Legal entities	94.9	99.7	102.6	102.3	7.8
Individuals	48.1	50.7	51.3	54.6	13.5
Earmarked	133.7	133.7	139.6	136.0	1.7
Housing	51.7	49.6	50.2	48.1	-7.0
Rural	25.6	26.2	27.1	27.1	5.9
BNDES	51.9	54.5	57.1	57.3	10.4
Others	4.5	3.4	5.2	3.5	-22.2
Leasing	14.2	13.7	12.9	13.4	-5.6
Public sector	12.0	12.5	12.6	12.6	5.0

In January, the overall volume of financial system credit operations came to R$ 319 billion, for growth of 5.3% in the quarter and 10.5% in the 12 month period. Viewed on a segment-by-segment basis, the participation of resources invested at freely negotiated rates in that total expanded from 47.2% in October 2000 to 49.3% in January 2001. In the latter period, specifically targeted credits accounted for 42.7%, while those channeled into leasing operations and public sector credits came to a total of 8%.

Growth in the total credit stock was based on 9.8% expansion in operations with nonearmarked resources. For the most part, these were operations with individual consumers and were generated by greater demand for vehicles and other goods, as well as personal loans. Growth in operations with legal entities has, to some extent, been a result of the privatization process since the companies transferred to the private sector are no longer subject to restrictions imposed on public sector spending.

The balance of credit operations with earmarked resources increased at a more moderate pace of 1.8% in the quarter, mostly as a result of a 7% falloff in housing financing operations generated by the incentives offered to mortgage holders to prepay their contracts in full. Though the quarter did register positive growth, the balance of operations involving the public sector still reflects the decline brought about by the process of renegotiation of state and municipal debts. Credit operations in the leasing modality dropped by 5.9% in the same period, with a particularly strong downturn in operations with individual consumers.

BNDES System financing totaled R$ 57.3 billion in January, for 9.3% growth in the quarter. Increased demand for these credits mirrors the fact that the more dynamic pace of economic activity, coupled with a drop in the Long-Term Interest Rate (TJLP), which was set at 9.25% per year for the first quarter, has generated highly positive investment decisions on the part of the business community.

Credits with nonearmarked resources

Interest rates on freely negotiated credit operations continued downward as the Selic rate target was gradually reduced and competition among financial institutions became more intense. In this context, the weighted average market interest rate dropped from 53.2% per year in October 2000 to 49.2% per year in January 2001, at the same time in which the average cost of funding dropped from 16.3% per year to 15% per year, based on Bank Deposit Certificates (CDB). With this result, the average differential between lending rates and funding rates dropped from 37% per year to 34.3% per year.

In the segment of credits granted to legal entities, the average differential between lending and funding rates remained stable at approximately 18% per year in the quarter. Despite this stability, there was a 1.4 percentage point reduction in the differential in operations involving the discounting of commercial invoices, offset by growth of 0.2 p.p and 0.6 p.p. in the differential in working capital operations and those involving guarantied overdraft accounts, respectively. At the end of the year, the rates levied on legal entities were pressured by seasonal growth in demand for business credits to be used both in adjusting inventory levels to orders received in the period and in coping with seasonal payments, such as the annual Christmas bonus.

The average differential between lending and funding rates dropped sharply in operations with individual consumers, moving from 54.7% per year to 48.5% per year. This was a result of the strategy adopted by financial institutions to reduce interest while launching new products in this segment of the market, all with the objective of expanding the client base and increasing market share.

To a great extent, the reduction in the average differential in operations with individual persons was due to a falloff of 3.8 p.p. in the differential registered in personal credit operations, which account for a third of the total in this credit segment. In contrast, the average differential in operations involving vehicle acquisitions increased by 2 p.p. in the period from October 2000 to January 2001. This increase marked the end of the campaign carried out in the October/November period by factory authorized vehicle outlets to unload their older model vehicle stocks by offering clients more advantageous financing conditions.

In preset operations, default level indicators moved from 7% to 7.2% in terms of average arrears and kept pace with the seasonal increase in credit demand in the quarter. In operations with legal entities, rates on arrears expanded from 4.2% to 4.4%, while those related to the operations with individual persons remained stable in the mark of 9,3%. Thus, the rate of default has remained stable and has not become an obstacle to further growth in credit operations in this segment.

Lesser market uncertainties and steadily declining interest aided in lengthening the terms of credit operations with both individuals and legal

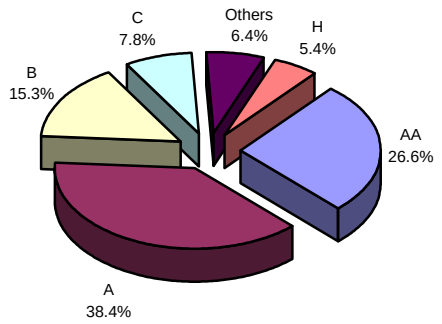
entities. In the segment of individual persons, average terms increased in all credit modalities, moving from a level of 260 days in October 2000 to 282 days in January 2001. In the case of legal entities, the average increased from 95 to 98 days in the same period.

The volume of resources channeled to individual persons increased by 13.6% in the quarter, corresponding to 34.8% of total credits granted at freely negotiated rates. The balance of operations in this segment moved to R$ 54.6 billion in January, with particularly strong performances under acquisitions of goods and vehicles, as well as personal credit. In these two headings, growth closed at respective levels of 29.2% and 9.3%, in the period from October to January. Growth in personal credit reflected substitution of revolving credit operations based on issue of special overdraft checks with longer term, lower cost credits, coupled with increased seasonal demand for resources to meet commitments contracted in December, particularly with the nonfinancial sector.

Insofar as credits channeled to legal entities are concerned, increased demand among the different productive sectors reflected the need for stock replenishment that intensified as the pace of economic activity picked up in the final months of the year. The overall value of resources channeled to this segment came to R$ 102.3 billion, with growth of 7.8% in relation to the October 2000 figure. The credit modalities more closely connected to the financing of companies' end-activities such as working capital and very short-term operations, registered significant growth of 10.6% and 10.7%, respectively, in the period.

Overall financial system credit

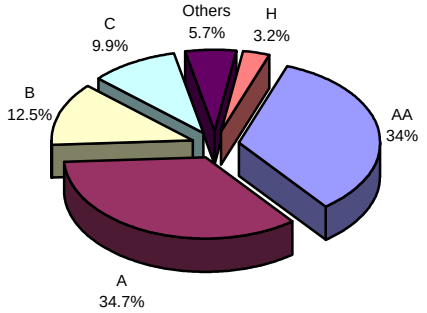
Credit operations in the financial system by levels of risk - January 2001



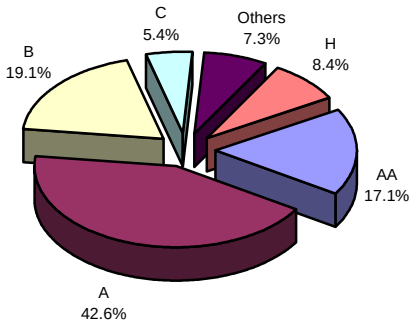
A breakdown of the R$ 319 billion January financial system credit portfolio balance on the basis of risk levels indicates that 65% of lending operations are classified as AA and A and 5.4% as H.

Total credit granted by the private financial system came to R$ 179.8 billion, with growth of 11.1% in the quarter, with a particularly strong performance in operations with individual persons. One should

Credit operations in the private financial system by levels of risk - January 2001



Credit operations in the public financial system by levels of risk - January 2001



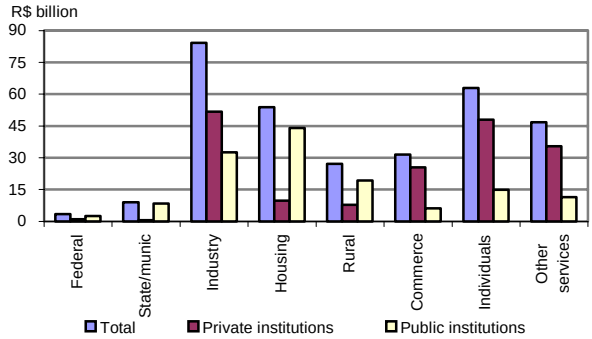
note that private financial institutions increased their participation in total credits granted by the system from 48.9% in March 2000 to 56.4% in January of this year. To some extent, this resulted from incorporation of Banespa and Banestado into the private sector as of the month of November. With regard to credit risk, 68.7% were concentrated under levels AA and A, while just 3.2% of these credits were registered under level H.

The balance of credits granted by the public financial system came to R$ 139.2 billion, for a reduction of 1.3% in the quarter due mostly to a drop-off in housing portfolio operations. Analyzed according to risk levels, 60.2% were concentrated under levels AA and A while 8.2% were listed under level H. One should note that credits classified under the latter level totaled R$ 11.5 billion, for a reduction of 8.8% in the quarter.

The balance of total credits granted to individuals came to R$ 63 billion, for growth of 12% in the quarter due mostly to expansion in the volume of personal credit operations as well as credits targeted to acquisition of goods, principally automotive vehicles. A breakdown by risk levels indicates that operations were concentrated under levels AA and A (69.8%), while loans classified under level H closed at 4.7%.

Total credit targeted to other services came to R$ 46.8 billion, for growth of 11.7% in the quarter. The largest share of resources (63.7%) was classified under AA and A, while operations under the heading of total risk (H) accounted for 3.6%.

Credit operations in the financial system by borrowers - January 2001



Despite a 1.9% decline in January, credit operations with the industrial sector expanded by 4.6% in the quarter, closing with a balance of R$ 84.2 billion. This performance reflected seasonal factors characteristic of the period as strong growth in the final months of the year is followed closely by a downturn in the pace of activity. In January, credits

classified under risk levels AA and A totaled 62% while those registered under level H totaled 2.8%.

The balance of housing financing, including both with individual persons and housing cooperatives, reached R$ 54 billion, a reduction of 6.1% in the quarter. This behavior was impacted by the process of prepayment of contracts formalized under the terms of the Wage Variation Compensation Fund (FCVS). Distribution by risk level shows 65% under levels AA and A and 13.5% classified under level H.

In the sector of commerce, credits came to R$ 31.5 billion in January, for growth of 7.7% in three months as a result of the seasonal characteristics of the period. In January, 68.4% of total credits channeled to this segment were classified under levels AA and A, with a balance of R$ 21.5 billion. Operations registered under level H have been declining steadily since March 2000, dropping to 3.6% in the period under consideration in relation to total credits granted.

The volume of financing targeted to the rural sector came to R$ 27.1 billion for growth of 5.8% in the quarter. Here, one should note that this result still reflects the final stage of coverage of 2000/2001 summer harvest current expenditures in November of last year. With regard to lesser risk operations granted to the sector, 59% were classified under levels AA and A. Credits grouped under the heading of level H totaled R$ 1.2 billion, repeating the 4.6% participation level registered in the previous month.

With regard to the origin of financial system resources channeled to the rural sector in January, compulsory investments accounted for 51.9% of the total, including R$ 8.1 billion targeted to current expenditure operations. Funding originating in onlending and refinancing operations accounted for 42.9% and was concentrated in investment operations, with a total of R$ 7.4 billion. Resources based on nonearmarked funding and agroindustrial operations accounted for a joint total of 5.2%.

Credits channeled to the public sector added up to R$ 12.6 billion, for growth of 4.4% in the quarter. In the same time span, credits contracted by the federal government diminished by 5% and closed with a balance

of R$ 3.5 billion. For the most part, this performance reflected payment-in-full of contracts referenced to foreign currencies effected by a company that operates in the energy sector. With respect to risk levels, 71.4% of the debt in this segment was registered under levels AA and A, while 0.3% was classified under level H.

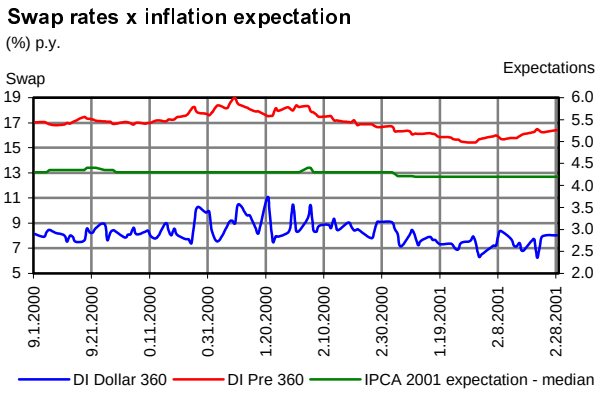
The state and municipal banking debt came to a balance of R$ 9.1 billion, for growth of 8.5% in the period. Broken down by risk levels, the major share of state and municipal debts was classified under levels AA and A, with 61.7%, while level H encompassed 5.4%.

In the month of December, operations based on BNDES resources and targeted to the Tax Management Modernization Program (PMAT) were excluded from the restrictions imposed on credit operations with the public sector. The purpose of this program is to enhance fiscal efficiency at the municipal level by introducing systems of managerial modernization and reducing the dependence of local government on federal and state fund transfers.

The overall balance of provisions set aside by the financial system came to R$ 21.9 billion, reducing participation in total credits from 7.1% in October to 6.9% in January. On a segment-by-segment basis, the participation of the provisions of the private financial system in relation to total credits came to 6%, as compared to 8.1% in the case of public sector financial institutions.

1.3 – Monetary policy

In the first quarter of 2001, monetary policy was implemented with the aim of achieving inflation targets without restricting the possibilities of economic expansion. Consistently positive internal macroeconomic fundamentals coupled with increased international stability made it possible to reduce the Selic rate target by 75 basis points on December 20 and 50 basis points on January 17, cutting the rate to 15.25% per year. This more flexible monetary policy approach had to be slowed in the following period, as uncertainties rooted in the external sector worsened and several unexpected supply shocks had to be faced.



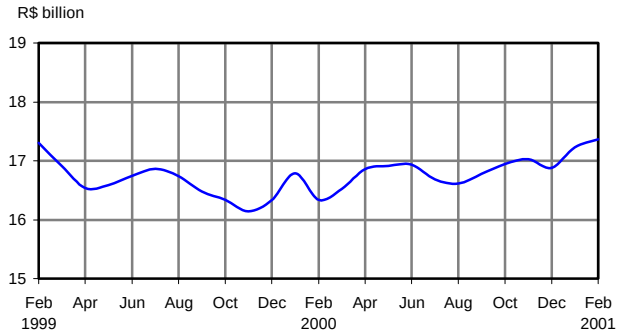
Among the most meaningful signs of the credibility garnered by current monetary policy, one should cite the fact that market expectations for the Broad Consumer Price Index (IPCA) for 2001 and 2002 indicate very little volatility and are quite close to the parameters adopted as policy targets. The fact that these expectations have not incorporated fluctuations on interest and exchange rate futures markets is a clear indication that current uncertainties have in no way undermined market confidence in monetary policy.

However, one should underline the fact that, despite obvious signs of lessened vulnerability to internationally generated shocks, a deepening of foreign market concerns - particularly as regards the Argentine crisis - could provoke undesirable speculative movements in the Brazilian economy. Therefore, though product has continued growing without any evidence of direct pressures on prices, it has become increasingly clear that the credit market and the rate of exchange, viewed as a component of production costs, must be closely monitored, particularly in light of the interest rate levels that have been achieved following successive reductions in the target.

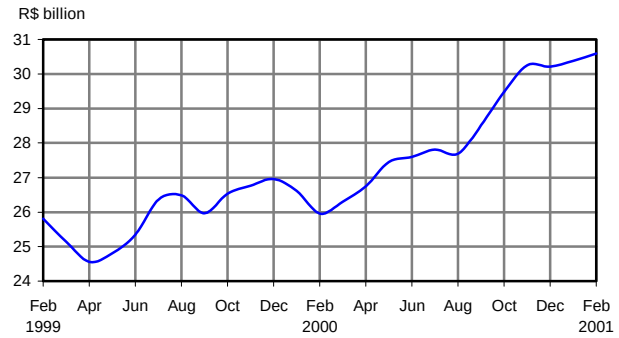
At the same time, even though indexing mechanisms were severely restricted in the wake of introduction of the new monetary standard, government managed prices still contain a considerable component of inertia and account for approximately half of the change in the IPCA. In this sense, unexpected shocks on several of the determinant factors of government managed prices - as occurred in the case of wholesale prices - have generated some degree of uncertainty regarding the future trajectory of these prices. A good example of this is that of fuel price components, which are a major element in the composition of the IPCA. Starting in February, the volatility of international oil prices increased sharply and the pace of decline in these prices was below what futures markets had predicted for the period.

Monetary aggregates

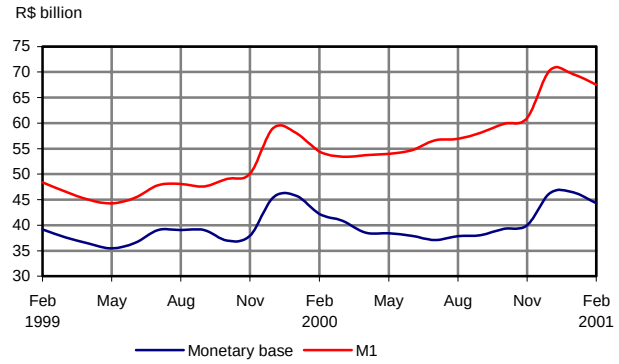
Currency outside banks - seasonally adjusted and deflated



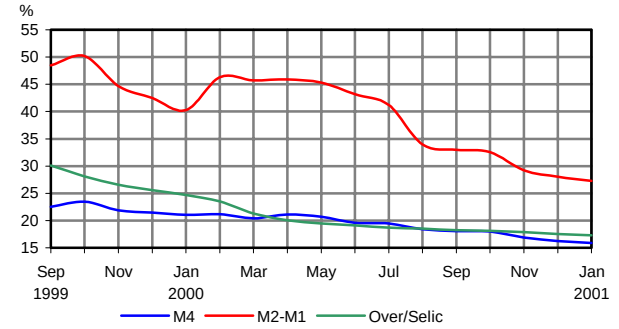
Demand deposits - seasonally adjusted and deflated



Monetary base and M1 - average daily balances



M4, Selic and M2-M1 - 12 month percentage growth



Viewed under the prism of the monthly average of daily balances, the money supply in its restricted concept closed February at R$ 67.5 billion, for a decline of 4.1% in relation to the December result. Among the various components, the stock of currency outside banks has continued adjusting to growth in price levels. At the same time, when one considers the statistical series purged of seasonal factors, this heading has shown considerable volatility, with a slight upward trajectory since February 2000 as a result of the upturn in the level of economic activity.

Demand deposits have grown sharply since the first quarter of 2000. To some extent, this has resulted from more voluminous credit operation funds transiting through these accounts and, once compulsory reserve rates had been lowered, to financial system efforts to encourage clients to maintain their resources in these accounts.

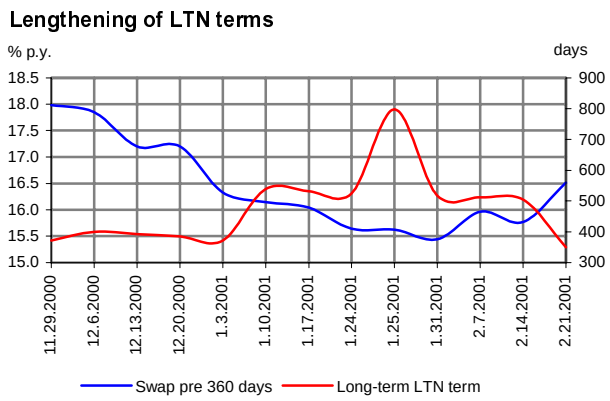
The average monetary base balance came to R$ 44.3 billion in February, for a reduction of 4.3% in the year. Growth of 1.7% in the average daily balance of banking reserves in the month despite a 2.4% drop in demand deposits occurred as a result of a temporal lag in demand for these aggregates at the start of the year, caused by the then current system of compulsory reserves.

The broad monetary base, which is defined as federal internal monetary and securities liabilities came to R$ 555.8 billion, with growth of 3.2% in the year. For the most part, this result reflected an expansionary impact of R$ 13.9 billion caused by growth generated by updating of the federal securities debt held by the market.

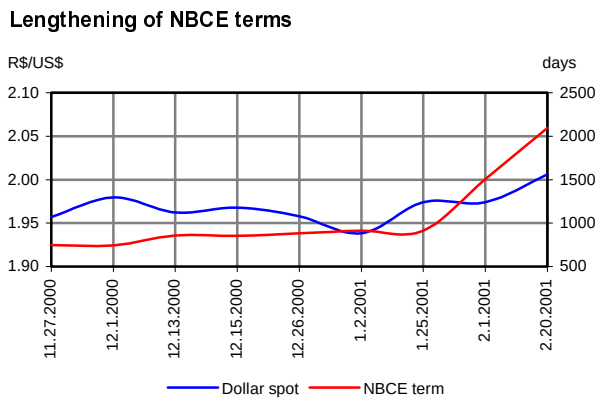
Viewed in terms of M4, the money supply came to R$ 650.4 billion in January, for growth of 15.9% in twelve months. This performance reflects growth in internal financial savings consequent upon the rechanneling of financial institution investments into lesser risk private sector credit operations. With this, the sum total of the balance of short-term funds backed mostly by federal securities, and public securities held by the nonfinancial sector increased by 9.4% in the period. Savings deposits and private securities issued by the financial system remained stable.

Federal public securities

National Treasury announcement of the Annual Public Debt Financing Plan for 2001 seeks to increase foreseeability and transparency in debt management by defining clear objectives, strategies and instruments aimed at making it possible for society to understand the principles underlying restructuring of the federal public debt profile.



The process of restructuring the debt profile should be viewed in the context of market expectations, since it will result in a lesser degree of concentration of maturities and longer average terms and duration of public securities, making it possible to reduce the costs involved in rolling the federal public internal debt.

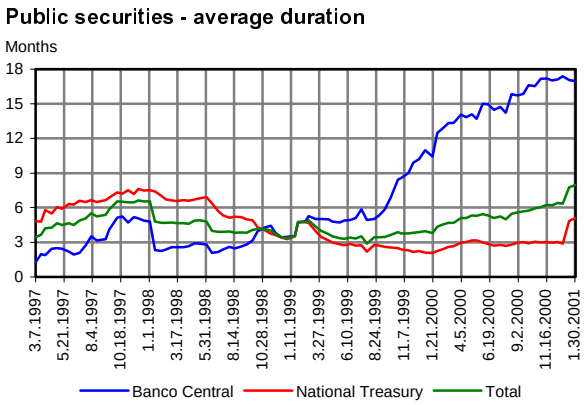


With regard to the level of market concentration of maturities, data from early March indicate that 40% of the debt will mature in the coming 12 months. In this period, 91% of preset papers (National Treasury Bills - LTN) are scheduled to mature. The continue supply of LTN with increasingly longer terms will have the effect of substantially reducing this concentration over the course of the year.

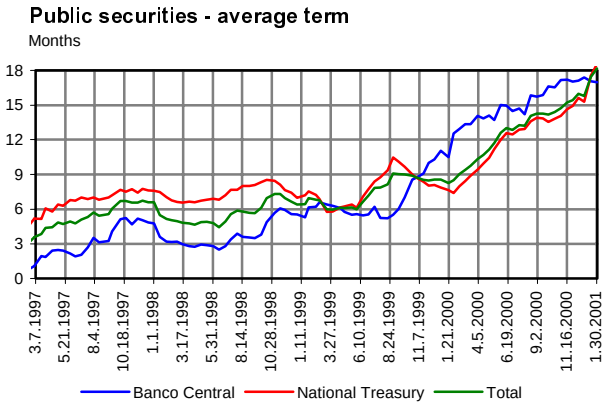
Increased uncertainties regarding interest rates generated by a worsening international situation as of mid-February were reflected in a rise in 360 day pre swap rates, thus temporarily interrupting the trajectory of longer debt terms for preset papers that had marked recent months.

Consequently, LTN that were previously placed with terms of 18 months were offered with terms of one year, since 360 day preset swap rates increased to approximately 16.5% per year, which is equivalent to a premium of 125 basis points in relation to the Selic rate target. On the other hand, the terms of Treasury Financing Bills (LFT), referenced to the Selic rate, and Banco Central Notes Special Series (NBCE), which are referenced to the rate of exchange, were lengthened to more than five years.

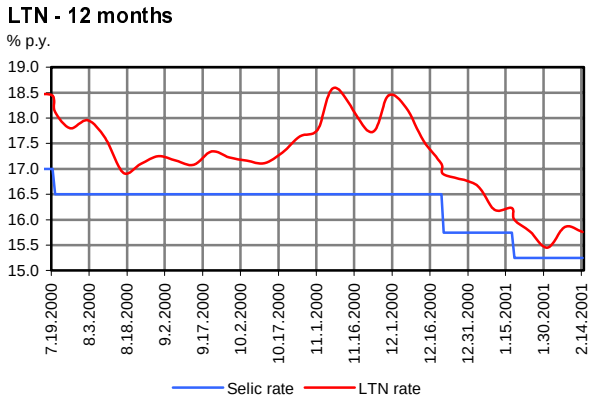
Recent placement of 4.5 million National Treasury Notes Series C (NTN-C), which are thirty year papers referenced to the General Price Index – Market (IGP-M), repeated offers of LTN with terms between 12 and 18 months and placement of these same papers with terms of 26 months, on January 25 of this year, made it possible to lengthen the average term of National Treasury papers to 18.5 months at the end of January.



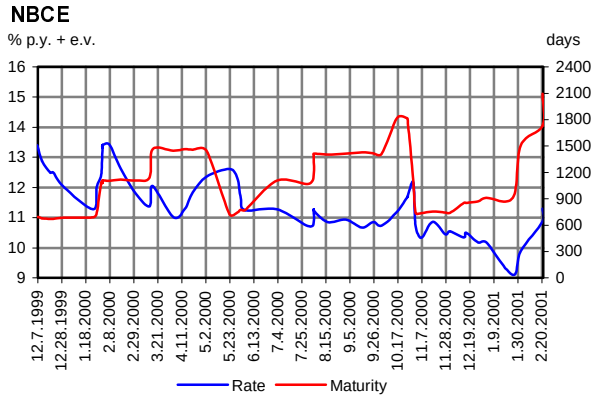
Consequently, the average duration of federal public securities issued in public offer (sensitivity of the value of the public debt to changes in short-term interest rates) came to the unprecedented level of eight months, based on the combination of 17 months duration for Banco Central papers and 5.1 months for National Treasury securities.



Keeping pace with the downward movement of the Selic rate, LTN were placed at declining rates, registering higher premiums in relation to the basic rate of interest only at the end of February. One year LTN were placed at 15.45% per year on January 31, with a premium of 20 basis points in relation to the Selic rate target. At the close of February, the premium charged by the market increased to 93 basis points. A solid offer of 26 month LTN on January 25 obtained a rate of 16.04% per year.



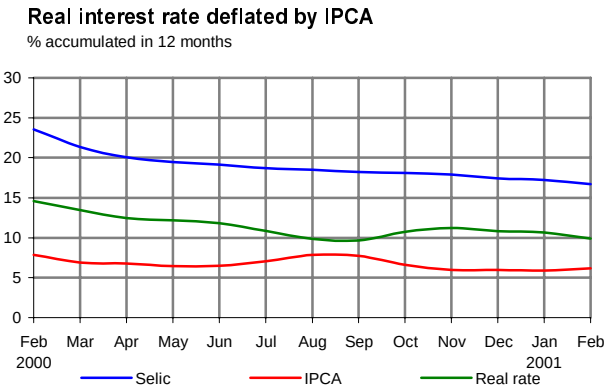
NBCE, which are papers used by Banco Central for purposes of monetary and exchange policy



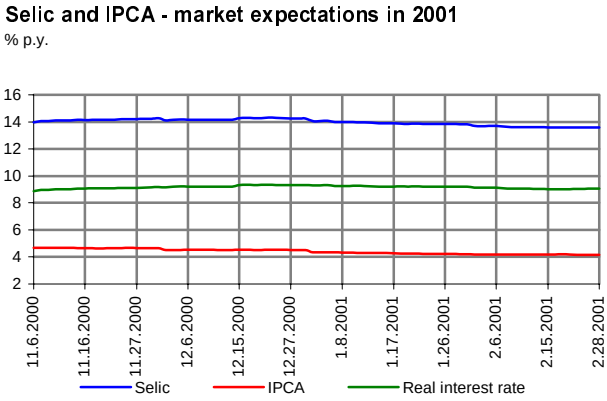
management, were offered with terms of six years and were well accepted by the market. The definitive operation effected on February 20 resulted in an average rate of 11.3% per year, plus exchange indexing. In much the same way, LFT operated with a reduction in the discount from 0.10% at the start of the year to 0.04% in February.

In the current year, two lots of NTN-C with maturity on January 1, 2031 were offered. The rates obtained were 11.97% and 10.64% per year in January and February, respectively, indicating a reduction in expectations regarding long-term real interest rates.

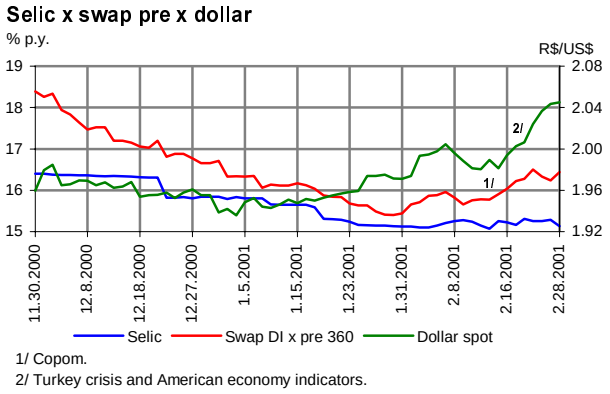
Real interest rates and market expectations

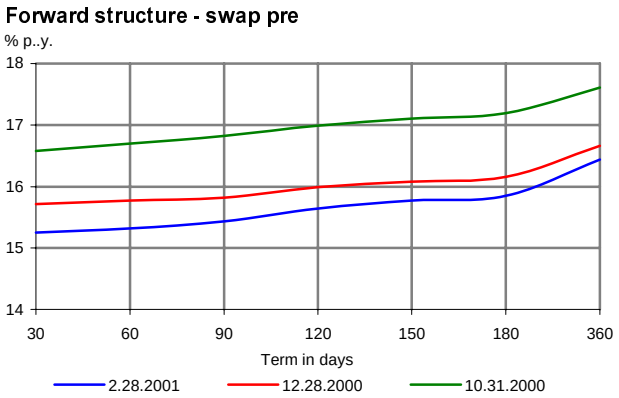


Deflated by the IPCA, the accumulated Selic rate came to 10.8% per year in 2000, compared to 15.3% in the previous year. In 2001, the 12 month accumulated Selic rate moved into a downward trajectory, as the real accumulated rate for the previous 12 months reached 9.9% per year in the month of February. Market expectations in that month as regards the evolution of the Selic rate and the IPCA indicate a reduction in real interest rates over the course of the year, with an accumulated rate of 9.1% per year for 2001.



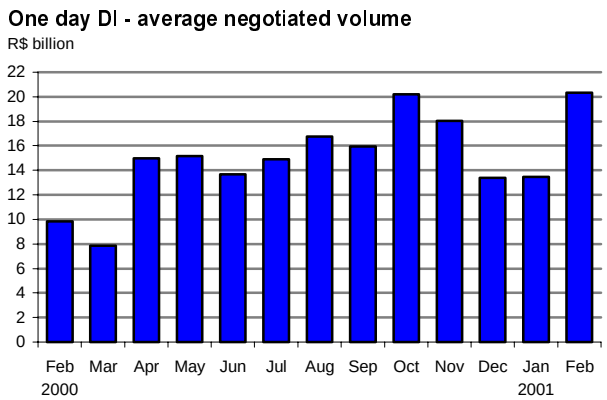
In the case of the derivatives market, a more favorable scenario for petroleum prices and the possibilities of overcoming the Argentine crisis led agents to gradually reduce the premiums charged in futures market operations, thus creating positive expectations in January. The rate on one year DI swap x pre contracts came to 15.4% per year, as a result of the possibilities of a Selic rate decline in February.





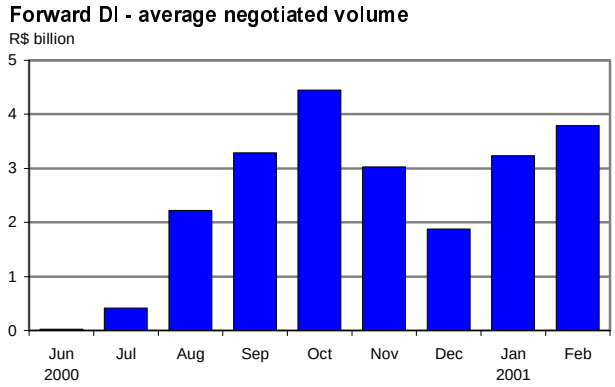
Copom's decision to maintain the Selic rate target at 15.25% per year at its meeting ended on February 14 reflected a less favorable external scenario and an upward revision in forecast increases in government managed prices and led the market to adjust its positions in futures contracts. In the wake of that process, announcement of higher than expected inflation figures for the American economy, the outbreak of the Turkish exchange crisis and uncertainties on the internal political scene caused by the electoral dispute for the position of Speaker at the two houses of congress, were among the factors that contributed to a reversal in the downward trajectory in futures market premiums. With this, the preset one year swap rate was negotiated at 16.4% per year at the end of February.

The forward interest rate curve defined by the rates negotiated in DI swap x pre contracts on the final day of February was more steeply inclined than in December, indicating a lesser reduction in the rate on one year contracts, in relation to contracts with shorter terms. This can be exemplified by the 46 point reduction registered in the rates on 30 day contracts, compared to 22 points for one year contracts.



The average financial volume negotiated in one day DI futures contracts, which had expanded sharply from October to November as a result of intensified demand for hedging, dropped by 26% in December and stabilized at R$ 13 billion up to the end of January. The fact that interest rates were held at their then current level in February altered short-term expectations and generated an increase in negotiated volumes as a result of the process of contract realignment. The result was an increase in the average to R$ 20.3 billion, the same as registered in November 2000.

In the profitability exchange market, DI forward contract with adjustment registered growth, as the daily average increased from R$ 1.9 billion in

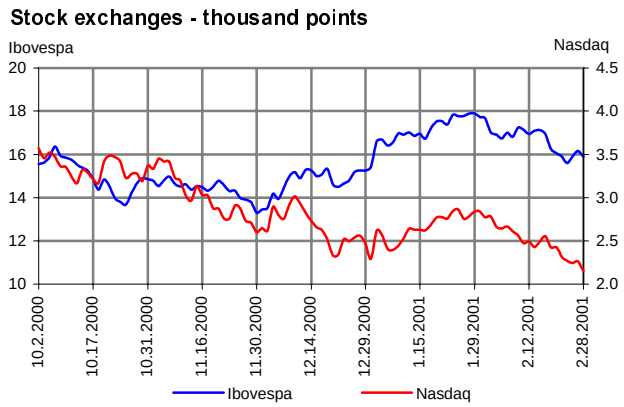


December to R$ 3.8 billion in February. On February 12, this contract registered the highest daily volume since its issue last June and registered a volume of R$ 7.7 billion.

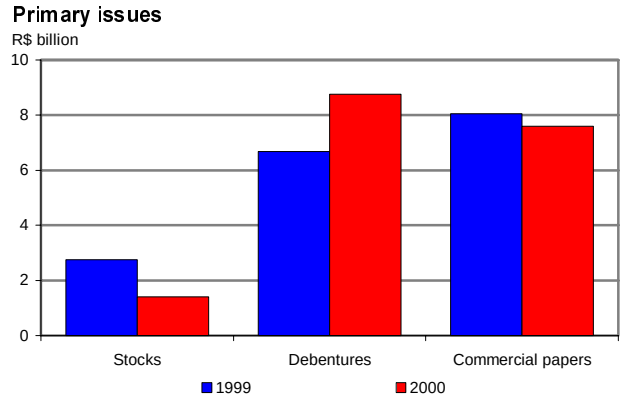
Capital market

Following the sharp 23% devaluation in the São Paulo Stock Exchange Index between September and November 2000, the exchange managed to achieve strong recovery in the December/January period, as the index climbed by 33% to a level close to the March 2000 mark, the highest in the history of the market. However, investors soon took advantage of the situation for profit-taking and the market fell below the still-too-difficult hurdle of 18,000 points.

December Ibovespa growth of 14.8% reflected positive expectations regarding the growth of the Brazilian economy and contrasted sharply with the negative performance of the Nasdaq index in the month. In January, external variables - principally in the case of interest, growth and inflation in the United States - impacted the market as the Nasdaq closed with 12.2% expansion and the Ibovespa gained 15.8%.



In February, changing expectations regarding a Selic rate reduction, coupled with announcement of poorer-than-expected results in the US led the Ibovespa into a 10% decline, fully in keeping with the 22.4% Nasdaq plunge.



Business financing operations on the capital market in 2000, carried out through primary issues of stocks, debentures or promissory notes remained stable in comparison to the previous year. One should note that the participation of debentures increased, in detriment to the other instruments, particularly stocks. For the most part, growth in debenture issues resulted from lower interest rates, since these papers are tied to the profitability of CDI plus premium and,

therefore, constitute a more enticing source of financing. In the first two months of the year, the volume of debentures issued plus requests for authorizations of new issues came to R$ 5.7 billion or 65% of total 2000 issues.

Financial investments

Keeping pace with growth in economic activity and improvements in liquidity conditions, total financial investments, including the sum total of savings account, time deposit and investment fund balances, continued on a growth trajectory from November 2000 to February 2001.

In February, the net worth of Financial Investment Funds (FIF) came to R$ 286 billion, for growth of 6.4% in relation to the November 2000 result. January 2001 registered a high volume of net inflows with a total in the range of R$ 11 billion. For the most part, this was attributed to investments of revenues earned on end-of-year sales by businesses.

In keeping with the trajectory of stock market operations, stock funds registered strong growth in their assets in both December 2000 and January 2001, reaching a volume of R$ 27 billion. In February 2001, the exchanges registered consecutive declines as a result of growing international uncertainties. With this, the period closed with negative earnings of 4% of the stock funds, as their assets dropped to R$ 26.7 billion.

The balance of savings accounts came to R$ 112 billion in February 2001, for growth of 3% in the quarter. This performance resulted from net inflows of R$ 2.8 billion in December 2000, mostly as a result of payment of the Christmas bonus. Average savings account profitability closed at approximately 0.60% between the months of November 2000 and February 2001.

Here, one should stress the importance of the change in the calculation methodology of the TR reduction factor introduced by Resolution no. 2,809, dated 12.21.2000. According to this Resolution, factor “b”, which is a component of the formula used to calculate the reduction factor, is to be automatically altered according to adjustments in the

Selic target. With this, it will be possible to avoid disparities among the profitability levels of financial investments tied to this rate, particularly savings accounts, and those of other financial investments.

In February 2001, Bank Deposit Certificates (CDB) registered a balance of R$ 92.2 billion, with growth of 0.2% in relation to November 2001. The balance of this type of operation has remained stable, though it has shown a lesser degree of attractiveness when compared to other investment funds, particularly as a consequence of levying of the CPMF at each maturity. From November 2000 to February 2001, CDB registered average gross profitability of 1.15% per month.

1.4 – Investments

Investment indicators

% accumulated growth in year

Itemization	2000					2001	
	1st half	Sep	Oct	Nov	Dec	Jan	Feb
Production of capital goods	8.5	12.5	12.9	13.1	12.7	24.7	...
Inputs for the building industry	1.9	2.0	2.0	2.1	2.0	8.1	...
Imports of capital goods	-6.8	1.3	1.7	2.0	3.1	65.9	...
Exports of capital goods	43.3	42.9	39.2	37.4	36.8	27.1	...
BNDES financing	-7.2	10.7	17.9	30.2	27.7	57.1	33.9

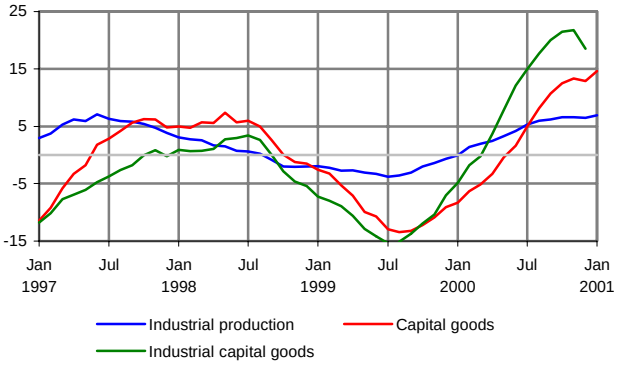
Source: IBGE, Funcex and BNDES

Steadily rising consumption has been matched by growth in industrial output, as the level of idle production capacity has moved downward. If the country is to maintain this trajectory over the course of 2001 without generating price pressures, it will have to expand its industrial facilities and/or increase the volume of imports. In this context, capital goods output in 2000 registered a growth pace that was significantly higher than both GDP growth and expansion of the industrial sector as a whole. This result is interpreted as a sign of growth in the output capacity of both industry and the farm sector. Expansion accelerated in the second half of the year when the average output rate was 10.3% higher than in the first six months, when the seasonally adjusted statistical series is utilized. This marks continuation of the already significant 6.4% expansion registered in the first six months of the year, when compared to the final half-year period of 1999. With this, output of capital goods, which had accumulated 12 month growth of 8.5% up to the end of the first half of the year, closed with growth of 12.7%.

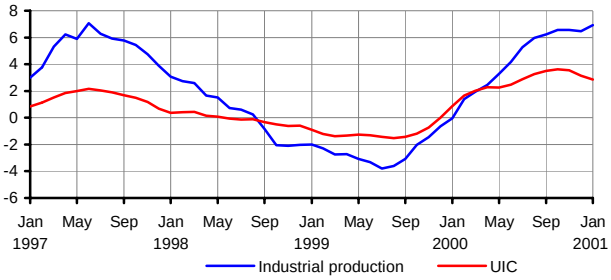
In January 2001, capital goods output registered growth of 0.5% compared to production in December of the previous year. This result is based on the series purged of seasonal impacts. Compared to the same month of 2000, the rate came to 24.7% while the accumulated twelve

month total closed at 14.6% compared to 12.7% up to December. Consequently, the growth trend of the previous year and the difference between the growth rates of this category and that of total industrial output became more accentuated.

% change of the 12 month moving average



Industrial production evolution and utilization of installed capacity (UIC)
% change of the 12 month moving average



Source: IBGE and CNI

Production of capital goods

% accumulated growth in year

Itemization	2000					2001
	1st half	Sep	Oct	Nov	Dec	Jan
Capital goods	8.5	12.5	12.9	13.1	12.9	24.7
Industrial	22.9	22.3	22.0	20.7	19.0	5.5
Serial	28.0	26.3	25.7	24.0	21.9	4.0
Nonserial	3.4	6.5	7.3	7.6	7.3	11.1
Agricultural	6.3	14.6	16.1	19.7	19.3	20.3
Farm parts	9.9	16.0	17.3	15.6	14.6	6.5
Building	8.8	8.5	9.3	10.5	15.0	37.3
Electric energy	0.7	4.5	3.9	2.8	3.2	39.1
Transportation	18.0	23.4	24.1	23.0	22.8	33.3
Mixed	1.9	6.2	7.0	7.9	7.9	27.7

Source: IBGE

Expansion was more intense under production of transportation equipment, followed by capital goods produced in series for the industrial sector and farm equipment. Strong growth was also registered in equipment for the building industry and parts for farm equipment.

This across-the-board growth in the output capacity of various industrial segments was more moderate in the case of equipment for the electricity sector. In this sector, despite strong expansion in January that resulted mostly from a very low comparison base, investments in more recent periods have most likely not kept in line with the pace of economic activity.

A comparison between the evolution of industrial production and utilization of installed capacity indicates growth in industrial facilities, since the pace of expansion in industrial output has clearly intensified.

Data released by the National Association of Automotive Vehicle Manufacturers (Anfavea) for the first two months of the year demonstrate the intensity of growth in the output of farm machines and equipment, which expanded by 44.8% compared to the corresponding period of 2000. High growth was also achieved in the output of trucks and buses, both of which surpassed the increase registered by automotive vehicles as a whole. These figures suggest that demand for transportation equipment and farm machines has, in principle, been met. In the segment of factory authorized sales outlets, operations involving trucks, buses and farm machines expanded by 17.1%, 35% and 31.6%, respectively.

Following growth of 3.1% in 2000, volume indicators demonstrate that imports of capital goods registered monthly expansion of 40.7% in January, expressed in terms of the seasonally adjusted series, and 49.6% when compared to the volume of the inflow in January 2000. This high level of growth mirrors the need to provide internal industry with the parts and components it does not yet produce either for technological reasons or questions of production scale. When one analyzes the value of capital goods imports in the first two months of the year, growth came to 28.7% compared to the corresponding period in 2000. This result was higher than for total imports in the period (18.4%).

In 2000, the building industry registered growth that was well below the average for the economy. Given its importance in the context of Gross Fixed Capital Formation (GFCF), this behavior provoked stability in the ratio between investment outlays and GDP in 2000, in relation to 1999. However, when one compares half-yearly averages expressed in data free of seasonal impacts, there are evident signs of recovery in the final half of the year when inputs for this sector expanded by 1.5%, compared to the first half, when growth came to 0.7% over the previous half-year period.

Inputs for the building industry

Percentage change

Itemization	2000						2001
	Jul	Aug	Sep	Oct	Nov	Dec	Jan
Month[1/]	-0.1	1.3	-2.4	1.5	1.1	0.8	2.1
Year	1.8	2.3	2.0	2.0	2.1	2.0	8.1
12 months	0.3	1.0	1.3	1.5	2.0	2.0	2.5

Source: IBGE

1/ Seasonally adjusted.

Aggregate savings and investment

As percentage of GDP

Itemization	1995	1996	1997	1998	1999	2000[1/]
Investment	22.3	20.9	21.5	21.2	20.4	20.4
External savings	2.8	3.1	4.1	4.3	4.5	4.2
Gross internal savings	19.5	17.8	17.4	16.9	15.9	16.2
Public	-3.0	-1.0	-1.6	-4.0	-5.6	-3.6
Private	22.4	18.8	18.9	20.8	21.6	19.8

Source: IBGE

1/ Depec estimates.

In January 2001, the recovery process continued as demonstrated by positive results in the production of inputs, no matter what basis of comparison is utilized. More optimistic current expectations regarding performance of the construction industry in 2001 are based on steady growth in employment and downward movement in interest rates. Expectations for 2001 have received an additional boost from expanded output of equipment for the construction industry in 2000. However, one should note that the sector also depends on an increase in the still insufficient supply of real estate credit, particularly for the lower income population.

With respect to the sources of investment financing, recent years have witnessed increased participation on the part of external savings and private internal

savings, at the same time that the negative contribution of the public sector seems to have diminished in 2000.

Following growth of 27.6% in 2000, disbursements by the BNDES System, which includes BNDES, Finame and BNDESpar, increased by 33.9% in the first two months of the year, when compared to the same period of the previous year, reflecting growth of 77% in financing channeled to the manufacturing industry. Consequently, the participation of this sector in total resources disbursed grew from 47.7% in the first two months of 2000 to 66.5% in the same period of the current year. The volume of funding received by the crop/livestock sector was 67.7% more than in 2000. In the case of the mineral extraction industry, growth of 219% is explained mostly by the favorable basis of comparison. The only decline in the two month period (31.1%) occurred in the sector of commerce/services. One should note that the increase in the volume of BNDES resources has been accompanied by a drop in the Long-Term Interest Rate (TJLP), which fell from 9.75% per year in the final three months of 2000 to 9.25% per year in the first quarter of 2001.

The industrial sector registered a decline in inventory levels, a component of GFCF. In this framework, the FGV Manufacturing Industry Survey for the period from October 2000 to January 2001, indicates that 19% of the companies contacted increased their stocks, while 27% reduced them, reflecting the most intense process of inventory reduction in the last eight quarters. In this context, when one considers that the companies involved have the objective of operating with an adequate stock level, it is possible to forecast a short-term process of replenishment.

The indicator of final product stocks issued by the National Confederation of Industry (CNI) declined from 50.3 in the third quarter to 47.1 in the subsequent period. This result is attributed to factors of a seasonal nature, as indicated by the fourth quarter of 1999 result of 46. On a sector-by-sector basis, mechanics, electric material and paper and cardboard registered the lowest stock levels in relation to the levels considered desirable. In terms of raw material stocks, an even more intense decline was registered as the index moved to 49.8 in the fourth quarter, compared to 50.4 in the previous period and 49 in the same period of 1999. Nonmetallic minerals, wood and furniture registered the lowest stock levels when compared to planned levels.

The stock of vehicles at factory authorized outlets dropped in the final quarter of the year and reflected factors of a seasonal nature. In the January/ February period of 2001, however, these inventories increased by 24% over the level registered in the same period of 2000. Growth was particularly strong under light commercial vehicles (43.4%), trucks (21.1%) and automobiles (21%). The only decline occurred under buses (25.3%).

Growth in major investment indicators suggests increased productive capacity. These expectations are backed by intensification of output growth under capital goods, recent signs of recovery in the building industry and a trend toward replenishment of inventory levels.

1.5 – Central government fiscal result

In 2000, revenues and expenditures, expressed as a percentage of GDP, remained practically constant in comparison to the 1999 results. The first of these items increased its participation from 21.9% to 22.1%, while the latter dropped from 19.7% to 19.5%.

The primary surplus of the central government - National Treasury, General Social Security Regime and Banco Central - came to R$ 21.2 billion, compared to R$ 20.3 billion in 1999. As a proportion of GDP, the 2000 surplus came to 1.98% as against 2.11% in the previous year. Taken by itself, the National Treasury turned in a surplus for 2000 equivalent to R$ 31.7 billion, while the Social Security System and Banco Central closed with deficits of R$ 10 billion and R$ 477 million.

In 2000, the Secretariat of Federal Revenue registered an inflow of R$ 176 billion in taxes and social contributions, for growth of 16.2% in relation to the 1999 figure. When one considers data deflated by the IGP-DI, growth closed at 2.2%. This performance was positively influenced by alterations in fiscal legislation in 1999 that produced the brunt of their impact in the following year as a result of strong growth in judicially and administratively determined deposits and the sharp upturn in the pace of economic activity.

The inflow generated by legislative changes, coupled with resources in the form of judicially determined deposits, came to an overall total of

R$ 33.3 billion in 2000 as against R$ 28.1 billion in 1999, for growth of 17.8% in the period.

If one were to highlight major changes in tax legislation, the most important would be the increase in the Social Security Financing Contribution (Cofins) from 2% to 3% and the fact that the obligation to pay has been extended to financial institutions, effective as of March 1999. This was the principal factor responsible for the increase in the revenue inflow from R$ 32.2 billion in 1999 to R$ 39.9 billion in 2000, for real growth of 9.5% in the period. Another item that deserves mention is reintroduction of the Provisional Contribution on Financial Transactions (CPMF), as of June 1999. Inflow of the CPMF came to R$ 14.5 billion in 2000, as against R$ 8 billion in the previous fiscal year. Conversion of judicially determined deposits into federal government revenues accounted for R$ 4.9 billion of the total inflow, for nominal growth of 133.3% in relation to the 1999 fiscal year. For the most part, the increase was generated by anticipated deposits since contributors who contest charging of the tax are now obligated to effect payment before resorting to the courts.

The taxes that registered the best performances in 2000 were those most directly related to the upturn in the pace of economic activity. Among these, the following deserve mention: IPI-vehicles, with real growth of 113.9%, the income tax on legal entities, with 13%, and the income tax on labor-related income, 5.2%.

Among outlays, the heading “Transfers to States and Municipalities” registered the strongest nominal growth, with 15.4%, reflecting expansion of R$ 5.4 billion in the amount transferred by the federal government to the other levels of the federation.

Payments of social security benefits totaled R$ 65.8 billion, which is equivalent to 30.6% of outlays. This result corresponded to nominal growth of 12.4% compared to 1999. For the most part, growth was impacted by upward movement in the average value of social security benefits paid in the period. This growth, in turn, was caused by an increase in the minimum wage, the indexing factor to which benefits are tied.

Finally, disbursements on personnel and social charges came to R$ 55.6 billion for nominal growth of 13%. To a great extent, this reflects wage

Bills pending approval at the National Congress – Position on 2.28.2001

1 – Administrative Reform Regulations

1.1 - legal instrument: complementary law (PLC no. 43, 9.1.1999) – regulates dismissal from civil service positions for reasons of insufficient performance and defines careers typical of the state;

- status of voting at National Congress: approved at the Chamber of Deputies and Federal Senate. However, since alterations were introduced by the Senate, the bill has been returned to the Chamber.

1.2 - legal instrument: constitutional amendment (PEC no. 137-A/1999) – defines ceilings on earnings at the three levels of government. The substitute bill elaborated by the rapporteur of the Special Committee of the Chamber of Deputies determines that the salaries paid to civil servants may not be greater than the amount paid to the respective state or Federal District governor. However, state assembly deputies, councilpersons, magistrates and civil servants employed by the Office of the Public Prosecutor are exempt from this limited. The ceiling for these positions is the highest wage paid to a Minister of the Federal Supreme Court, including the perquisites to which such Ministers are entitled. In the case of civil servants, an additional amount of up to a maximum of 35% is permitted under the heading of time of service, independently of the sub-ceiling level defined for the civil servant's position;

- status of voting at National Congress: approved at the Constitution and Justice Committee of the Chamber of Deputies on 11.3.1999. The Special Committee charged with deliberating on the merits of this bill was created on 11.17.2000. A favorable statement of position was issued together with the substitute bill presented by the rapporteur on 1.12.2000. It is now awaiting voting at a full session of the Chamber.

2 – Social Security Reform Regulations

2.1 - legal instrument: complementary law (PLC no. 1/2000) – Disciplines relations among the federal government, states, municipalities and Federal District and their respective closed complementary social security entities. Major points included in the reform:

a) minimum grace period of 60 monthly contributions to the programmed installment benefit plan (except for benefits involving risk of death or pension as a consequence of death) and interruption of the tie with the sponsoring entity;

b) benefit adjustments will be effected according to criteria defined in the regulations of benefit plans;
c) the contribution of the sponsoring entity will not exceed that of the participant;
d) plan review every two years for purposes of actuarial adjustments;
e) companies are prohibited from transferring productivity gains, advances and advantages of any nature whatsoever to benefits;

- status of voting at National Congress: approved at the Chamber of Deputies and sent to the Federal Senate. It is now before the Social Affairs Committee for analysis of the amendments submitted to the Constitution and Justice Committee.

2.2 - legal instrument: complementary law (PLC no. 63/1999) – treats of the system of complementary private social security. The bill approved by the Special Committee includes the following innovations:
a) creation of the figure of the instituting entity, permitting representative entities, unions and professional associations to form pension funds for their members;
b) transferability or, in other words, the sum total of contributions may be transferred among the different funds whenever the beneficiary changes his/her employment bond;
c) amounts deposited in the fund will continue being capitalized, even after the employment bond has been interrupted;
d) regulations of the specified contribution and specified benefit;

- status of voting at National Congress – approved at the Chamber of Deputies and sent to the Federal Senate. Approved by the Constitution and Justice Committee on 2.10.2000. Currently, it is before the Social Affairs Committee.

2.3 - legal instrument: constitutional amendment (PEC no. 136/1999) – Institutes social security contributions on the part of civil service and military retirees;

- status of voting at National Congress – admissibility approved at the Constitution and Justice Committee of the Chamber of Deputies on 11.10.1999. The Special Committee charged with examining the matter was created on 11.18.1999.

2.4 - legal instrument: complementary law (PLC no. 9/1999) – defines general norms for institution of the complementary social security system at the levels of the federal government, states, Federal District and municipalities. The major aspects of the substitute bill approved by the full Chamber on 11.28.2000, are as follows:

a) definition of a RGPS ceiling for civil servants who enter public service after the law is sanctioned. The ceiling is optional for those admitted prior to sanctioning;
b) guaranty that the contribution rate will be equivalent to that of the RGPS;
c) equal contributions to the social security fund on the part of the sponsoring entity and the participant;
d) institution of benefit plans in the form of specified contributions;

- stage of voting at National Congress – when the substitute bill elaborated by the Special Committee was approved by the Chamber of Deputies, 13 amendments were submitted for separate voting (DVS), of which four were voted upon while the others are still awaiting conclusion.

3 – Tax on Large Fortunes

- legal instrument: complementary law (PLP no. 202/1989) – introduces a special tax for those with worth of more than R$ 1 million. The revenues of this tax would be channeled to the Fund for Eradicating Poverty;

- stage of voting at National Congress – approved at the Constitution and Justice and Composition Committee on 12.6.2000. Awaits voting by the full Chamber of Deputies.

4 – Mandatory budget

- legal instrument: constitutional amendment (PEC no. 77/1999) – defines the obligation of budget law implementation and requires that at least 80% of budget allocations must be effectively used up to the level of project, with exception of cancellations previously authorized by law;

- state of voting at National Congress – now before the Constitution and Justice Committee of the Federal Senate.

5 – Law on Corporations

- legal instrument: ordinary legislation (PL no. 3,115/1997) – defines rights and advantages for minority stockholders who have preferential shares; determines that dividends to be distributed by companies must be equivalent to 25% of net profits in the fiscal year and strengthens the oversight role of the Securities and Exchange Committee by transforming it into a regulatory agency. The alterations defined in the bill affect the flow of dividends to the National Treasury;

- stage of voting at National Congress – approved at the Economy Committee on 4.19.2000 and the Finance Committee on 6.7.2000. Now awaiting voting before the full Chamber of Deputies.

6 – Prohibition of sale of Petrobras, Banco do Brasil and Federal Savings Bank shares

- legal instrument: ordinary legislation (PLS no. 263, 4.27.1999) – excludes Banco do Brasil, the Federal Savings Bank, Petrobras and other public companies or joint capital corporations that perform activities that are the exclusive responsibility of the federal government, as specified in indents XI and XXIII of article 21 and line "c" of indent I of article 159 of the Federal Constitution, from the National Privatization Program. Stockholdings belonging to these entities are not covered by this prohibition, provided that there is no legal restriction on transfer of such stocks;

- stage of voting at National Congress – approved at the Constitution and Justice Committee on 12.15.1999 and rejected by the Economic Affairs Committee on 5.23.2000. On 9.13.2000, the bill was returned to the Economic Affairs Committee for further examination and is currently before that body.

7 – Tax Reform

- legal instrument: constitutional amendment (PEC no. 175-A/1995) – the most recent position of the substitute bill elaborated on the basis of the results of the tripartite committee, emphasizes the following:

a) agreement: extinction of the IPI, ICMS and ISS; extinction of PIS/Pasep and Cofins; creation of the Value Added Tax (IVA) or adaptation of the ICMS; transfer of the ITR from the federal government to the states; and creation of the Tax on Retail Sales (IVV), to be charged at the municipal level;

b) disagreement: conception of the IVA model; adoption of the selective tax; adoption of the Financial Operations Tax (IMF); and system of calculating social contributions;

- stage of voting at National Congress – presentation of final report on substitute bill on 10.17.1999; basic text approved by the Special Committee on 11.23.1999; proposal elaborated by tripartite committee reformulated at Special Committee on 2.16.2000; amendment aimed at consolidating diverse aspects of these measures negotiated with Ministry of Finance and state secretariats on 3.13.2000; consolidating amendment suggestion presented by the Secretariat of Federal Revenue on 8.1.2000.

realignment and the restructuring of strategic careers within the civil service system over the course of 2000.

In the month of January, the primary surplus totaled R$ 2.5 billion, as the National Treasury registered a surplus of R$ 3.2 billion and the Social Security System and Banco Central turned in deficits of R$ 640 million and R$ 30 million, respectively. As a proportion of GDP, the surplus expanded from 1.8% in January 2000 to 2.7% in January 2001.

Public sector borrowing requirements

The steadily improving fiscal results obtained during the year were generated by sharp upward movement in inflows, as a result of expanding economic activity, and reallocation of public sector surpluses brought about by more significant contributions on the part of state companies and regional governments.

Just as occurred in 1999, the fiscal effort undertaken by the public sector was clearly reflected in compliance with the targets agreed upon with the International Monetary Fund, with a considerable amount of leeway. This was a major factor in ensuring continued economic stability and reducing the county's risk level. Following the same trajectory, the surplus registered in January 2001 surpassed the result achieved in the same period of 2000 by R$ 1.5 billion.

Public sector surpluses registered in 2000 and January 2001 were a consequence of a strong inflow generated by more intense economic activity and the results achieved by state companies. The public sector primary surplus, which excludes outlays on nominal interest on the public debt stock, came to R$ 38.2 billion, corresponding to 3.6% of GDP in 2000, compared to R$ 31.1 billion or 3.2% of GDP in 1999. In January 2001, the consolidated public sector registered a surplus of R$ 5.6 billion or 6.1% of GDP, compared to R$ 4.1 billion or 5% of GDP in the same month of the previous year. A breakdown of the primary January surplus indicates that R$ 3.2 billion referred to the central government, including federal state companies. Regional governments and their state companies turned in surpluses totaling R$ 2.4 billion.

Insofar as the various public sector levels are concerned, one should note that the fiscal effort achieved results that were somewhat different from the previous year. In 1999, the central government, including the federal government, social security system and Banco Central, accounted for 72.93% of the overall public sector primary surplus, while state companies accounted for 20.3% and regional governments for the remaining 6.77%. In 2000, the participation of the central government dropped to 53.55%, while that of state companies and regional governments increased to respective levels of 30.66% and 15.79%. In January 2001, the participation of the central government in the overall public sector primary surplus declined once again, closing at 46.4%. This trajectory is expected to change into the future since the National Congress has approved a bill aimed at avoiding fiscal elision at the same time in which the participation of state companies has dropped sharply, particularly at the federal level, due to a projected decline in oil prices.

With respect to regional governments, the favorable impact registered in 2000 was due to approval of the Fiscal Accountability Act (LRF), which consolidated the fiscal account adjustment needs within these spheres. The LRF is expected to generate a positive impact on the results of coming years. Parallel to this, regional governments were positively impacted by growth in the economy, since this process had direct impact on the inflow of the Tax on the Circulation of Merchandise and Services (ICMS), which is charged on a value added basis and is the principal source of revenues at that level of government. In January 2001, the surplus registered by the states and municipalities came to R$ 2.2 billion.

Appropriation of nominal interest in 2000 came to R$ 87.4 billion, corresponding to 8.1% of GDP compared to R$ 127.2 billion or 13.6% of GDP in the previous year. This result reflects downturns in all spheres of government. The federal government and Banco Central registered a reduction of R$ 34 billion, or 4.5% of GDP, due to lesser exchange devaluation and downward movement in the Selic interest rate, and were the factors most responsible for this performance. In January 2001, appropriations of nominal interest totaled R$ 9.3 billion, compared to R$ 5 billion in December 2000, mostly as a consequence of exchange devaluation in the month.

In the case of regional governments, interest appropriation in 2000 totaled R$ 31.6 billion, compared to R$ 35.7 billion in 1999. This resulted from a reduction of approximately 10 percentage points in inflation, as measured by the IGP-DI, the indexing factor used for a considerable share of the liabilities of these levels of government. State enterprise interest declined as a consequence of the nominal reduction in rates and the cutback in the net debt generated by favorable primary results in recent years.

In this framework, public sector borrowing requirements (NFSP) totaled R$ 49.3 billion, or 4.5% of GDP in 2000, in the nominal concept, compared to R$ 96.2 billion, or 10.3% of GDP, in 1999. Of the aforementioned total, R$ 34.5 billion, or 3.1% of GDP, represented federal government and Banco Central liabilities, R$ 20 billion or 1.8% of GDP reflected state government liabilities, R$ 3 billion, or 0.3% of GDP, were municipal government obligations, and -R$ 8.1 billion, -0.7% of GDP, were liabilities of state companies. In January 2001, public sector borrowing requirements totaled R$ 3.6 billion, equivalent to 3.91% of GDP.

In 2000, the net public sector debt came to R$ 563.2 billion or 49.5% of GDP, thus maintaining a situation of stability in the debt/GDP ratio, which had increased in recent years. A breakdown on the basis of public sector spheres indicates that the federal government and Banco Central registered growth in the debt/GDP ratio, while the other spheres of government closed with reductions in this ratio.

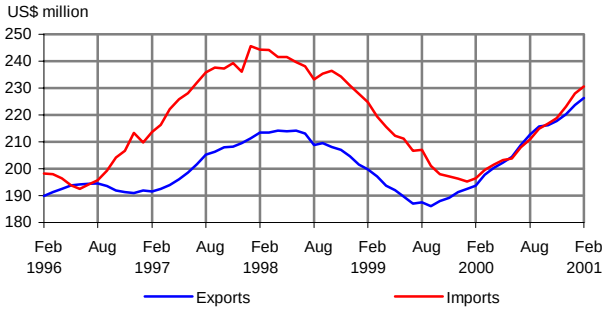
With regard to the federal government and Banco Central, the primary result and privatization resources were not sufficient to offset the volume of interest appropriated, external debt methodological adjustments and asset adjustments. It should be stressed that debt growth due to net methodological and asset adjustments in privatizations came to R$ 4.8 billion. Regional governments registered a debt reduction of approximately R$ 8.3 billion as a result of these adjustments. For the most part, the reduction resulted from an increase in the intensity of privatizations at the state level. The primary result for state companies neutralized interest appropriations and adjustments in an amount of about R$ 3.6 billion, generating a nominal surplus and consequently a reduction in net indebtedness.

1.6 – Internal demand

Measured in terms of twelve month periods over the course of 2000, analysis of growth in the major components of internal demand - consumption and GFCF - indicates that the participation of these headings in GDP remained relatively stable. However, a closer look demonstrates that the share of GFCF increased from 18.7% in January to 19% in December, while the relative importance of consumption declined from 82.4% in January to 82% in December, utilizing the same basis of comparison.

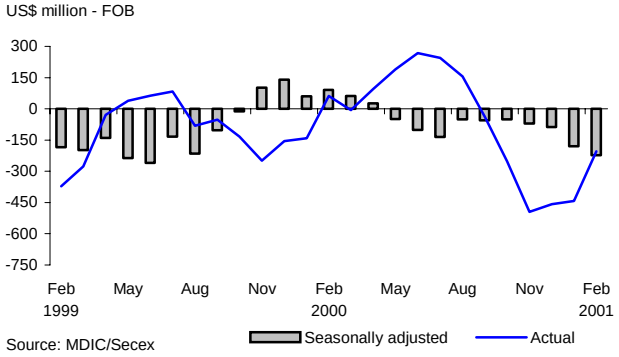
As a percentage of GDP, internal demand dropped from 101.15% at the start of the year to 100.97% at the end of 2000. This downward slide has been noted since June (101.3%) and can be explained more by growth in exports than in imports in the period under analysis. While foreign sales moved from 10.65% of GDP at the start of the year to 10.86% in December, for growth of 1.97%, the participation of imports registered less intense expansion of just 0.25%, with 11.8% in January and 11.83% in December.

Daily average of exports and imports - FOB
Accumulated in last 12 months



Source: MDIC/Secex

Trade balance-3 month moving average



Source: MDIC/Secex

1.7 – Balance of goods and services

Trade in goods

Accumulated twelve month growth in daily average exports and imports in 2001 points to a steady cutback in the nation's trade deficit since the midpoint of 1999. One should note that this trajectory was paralleled by growth in trade flows that followed upon competitive gains in export industries provoked by changes in the exchange rate system and intensification in economic activity levels.

At the start of this year, imports continued at the same pace as in the second half of 2000 as a

Trade balance - FOB

US$ million

Period		Exports	Imports	Balance	Trade flow
Jan-Feb	2001	8 621	9 020	- 399	17 641
	2000	7 576	7 616	- 40	15 192
% change		13.8	18.4		16.1

Source: MDIC/Secex

Exports by aggregate factor - FOB

Main products - January-February

US$ million

Itemization	Daily average 2000	Daily average 2001	% change
Primary products	33.7	46.3	37.4
Iron ore	10.6	12.7	19.3
Soymeal	4.0	7.9	98.1
Coffee in beans	7.1	4.4	-38.2
Chicken meat	3.0	4.3	43.9
Tobacco in leaf	1.3	2.0	55.5
Soybeans	0.4	2.0	388.6
Unprocessed beef	1.5	1.7	18.0
Semimanufactured products	33.4	36.3	8.7
Cellulose	6.9	7.8	13.6
Raw sugar	3.3	5.6	72.8
Steel/Iron semimanuf. goods	5.4	4.9	-9.3
Leather and hide	2.7	3.5	29.4
Primary aluminum	3.8	3.4	-11.2
Manufactured products	109.5	122.4	11.7
Aircrafts	10.4	10.3	-0.5
Footwear	6.0	6.9	14.7
Passenger vehicles	4.0	6.1	53.6
Transm./reception equipments	5.3	5.8	8.1
Fuel-oil	0.9	5.7	525.9
Car parts	4.0	3.7	-6.0
Car engines	3.4	3.6	6.1
Orange juice	5.6	3.6	-36.9
Flat rolled steel	3.5	2.9	-17.8
Pumps and compressors	2.5	2.4	-3.3
Cardboard and paper for writing	2.1	2.1	2.4
Tyres	2.1	1.8	-16.1
Cargo vehicles	2.1	1.7	-21.3
Chassis with engines	1.3	1.6	25.3
Ethylene polymers	1.5	1.6	4.6
Furniture	1.6	1.6	-4.3
Electric engines and generators	1.0	1.5	51.9
Special operations	3.8	10.6	180.0
Oil and fuels	3.5	7.1	103.5
Total	180.4	215.5	19.5

Source: MDIC/Secex

consequence of increased internal consumption and strong industrial expansion in recent months. These factors accounted for more intense purchases of raw materials and intermediate goods. Aside from this, oil prices did not decline in the period and contributed to a high level of outlays on fuels and lubricants, closing at 41.3% above the result for the first two months of 2000. In the period, the average daily imports expanded by 24.4%, as a result of increases in purchases of fuels and lubricants, 48.4%, capital goods, 35.1%, intermediate goods, 16.9%, and consumer goods, 18%.

Growth in average exports came to 19.5% in the two month period. All groupings of exported products turned in positive growth, with a particularly strong performance under basic goods (37.4%), mostly soy meal and soybeans. Sales of semimanufactured products rose by 8.7%, while manufactured goods increased by 11.7%. Among the specific products that deserve highlighting, one should include passenger cars and fuel oils with respective growth levels of 53.6% and 526% in average foreign sales. In terms of the destination of these goods in the two month period, exports to the USA increased by 14.5%, while those shipped to the European Union (EU) and the Laia countries rose by 7% and 3.5%, in that order.

Insofar as the balance of trade is concerned, a favorable performance was observed in February 2001, with a surplus of US$ 80 million. This was the first surplus since August 2000 and resulted from exports of US$ 4.1 billion and imports of US$ 4 billion, practically the same level as in February of last year. This performance can be viewed as particularly positive when compared to the deficit of US$ 479 million in January 2001.

Exports by category of goods - FOB
January-February

US$ million

Itemization	Accumulated			Daily average		
	2000	2001	% change	2000	2001	% change
Primary products	1 415	1 851	30.8	33.7	46.3	37.4
Industrial products	6 001	6 346	5.7	142.9	158.6	11.0
Semimanuf. goods	1 402	1 452	3.5	33.4	36.3	8.7
Manufactured goods	4 599	4 894	6.4	109.5	122.3	11.7
Special operations	160	424	164.9	3.8	10.6	178.1
Total	7 576	8 621	13.8	180.4	215.5	19.5

Source: MDIC/Secex

Exports and imports by economic blocs - FOB
January-February

US$ million

Itemization	Exports			Imports			Balance	
	2000	2001	% change	2000	2001	% change	2000	2001
Total	7 576	8 621	13.8	7 616	9 020	18.4	- 40	- 399
Laia	1 715	1 775	3.5	1 528	1 739	13.8	186	36
Mercosur	1 066	1 056	-0.9	1 081	1 228	13.6	- 15	- 172
Argentina	844	832	-1.4	938	1 084	15.6	- 94	- 251
Others	222	224	1.2	144	145	0.8	78	80
Mexico	198	220	11.4	96	123	27.3	101	97
Others	451	499	10.5	351	388	10.6	101	111
USA[1/]	1 964	2 249	14.5	1 849	2 062	11.5	115	187
EU	2 023	2 164	7.0	2 090	2 341	12.0	- 67	- 177
Eastern Europe2/	163	218	33.3	141	136	-3.0	23	81
Asia	857	896	4.6	1 082	1 535	41.9	- 225	- 638
Japan	388	334	-13.8	390	539	38.4	- 2	- 205
South Korea	75	71	-5.9	178	270	51.5	- 103	- 199
China	88	194	119.8	133	192	44.4	- 45	2
Others	305	297	-2.7	381	533	40.1	- 75	- 236
Sundry	855	1 318	54.2	927	1 207	30.2	- 72	111

Source: MDIC/Secex

1/ Includes Puerto Rico.
2/ Albania, Bulgaria, Hungary, Poland, Slovak Republic, Czech Republic, Romania and countries of the former Soviet Union.

However, the February surplus was not sufficient to avoid a trade balance deficit of US$ 399 million in the first two months of the year, compared to US$ 40 million last year. Exports expanded by 13.8% in the period compared to the corresponding period of 2000, with a total of US$ 8.6 billion. Imports increased by 18.4% to a total of US$ 9 billion.

Services

In the first two months of 2001, the service account was marked by strong growth in net remittances of income abroad. However, this result should not be seen as a change in spending patterns since it was a consequence of such specific events as anticipated payments of interest.

International trade in services resulted in net outlays of US$ 1.1 billion in the first two months of 2001, reflecting an increase of US$ 276 million in relation to the same period of the previous year. The sharpest expansion (US$ 207 million) occurred under equipment rentals, while outlays on international travel came to US$ 86 million as a consequence of increased Brazilian tourist expenditures, which have followed a steadily upward curve. Net outlays on transportation, which respond to changes in international trade flows, registered an increase of US$ 56 million, while spending on computer and information services partially offset these results, registering a decline of US$ 27 million in payments. The same thing occurred under other services, as increased revenues generated an additional net inflow of US$ 189 million.

Net income remittances abroad totaled R$ 2.7 billion in the first two months of 2001, for an increase of US$ 1.2 billion compared to the

Imports by category of products - FOB
January-February

US$ million

Itemization	Accumulated			Daily average		
	2000	2001	% change	2000	2001	% change
Consumer goods	986	1 108	12.4	23.5	27.7	18.0
Durable	386	562	45.6	9.2	14.0	52.9
Cars	76	223	193.6	1.8	5.6	208.3
Nondurable	600	546	- 9.0	14.3	13.7	- 4.4
Raw materials	4 060	4 519	11.3	96.7	113.0	16.9
Naphta	272	270	- 0.5	6.5	6.8	4.5
Fuels	683	965	41.3	16.3	24.1	48.3
Oil	377	467	23.9	9.0	11.7	30.1
Others	306	498	62.6	7.3	12.5	70.7
Capital goods	1 887	2 428	28.7	44.9	60.7	35.1
Total	7 616	9 020	18.4	181.3	225.5	24.4

Source: MDIC/Secex

Current account

US$ billion

Itemization	1999	2000		2001
	Year	Jan-Feb	Year	Jan-Feb
Current account	-25.4	-2.1	-24.6	-4.0
Trade balance	-1.3	0.0	-0.7	-0.4
Exports	48.0	7.6	55.1	8.6
Imports	49.3	7.6	55.8	9.0
Services	-7.0	-0.8	-7.5	-1.1
Transportation	-3.1	-0.4	-3.3	-0.5
International travel	-1.5	-0.2	-2.1	-0.3
Computer and information	-1.0	-0.2	-1.1	-0.2
Equipment rental	-0.6	-0.1	-1.2	-0.3
Other	-0.8	0.1	0.1	0.1
Income	-18.8	-1.5	-17.9	-2.7
Interest	-14.9	-1.5	-14.6	-2.0
Profits and dividends[1/]	-4.1	-0.1	-3.3	-0.7
Compensation of employees	0.1	0.0	0.1	0.0
Current transfers	1.7	0.2	1.5	0.2

1/ Includes reinvested profits.

same period of the previous year. An analysis of several individual items indicates that this evolution does not reflect a change in the level of interest expenditures. One should note in the first place that profit and dividend revenues declined, following a high volume of inflows in the first two months of 2000. Secondly, interest payments to the Paris Club, which are traditionally made in December, were effected in January 2001 for a variety of calendar-related reasons. Finally, one should mention payment of US$ 398 million in interest on Bonds of the Republic (Global 40) issued in August 2000, in exchange for foreign debt restructuring bonds (Bradies). This operation required anticipated payment of interest that would normally be scheduled for April.

Profit and dividend remittances abroad added up to US$ 723 million in the two month period, for growth of US$ 258 million. These operations were concentrated in earnings on direct foreign investments.

Current transactions accumulated a deficit of US$ 4 billion in the first two months of the year, for expansion of US$ 1.8 billion compared to the same period of 2000. External borrowing requirements accumulated in the 12 month period up to February 2001 came to 0.5% of GDP, for a reduction of 0.11 percentage point in relation to the rate for the same month of the preceding year.

Financial account

The financial account registered a net inflow of US$ 3.6 billion in the first two months of 2001, for a decline of US$ 1.8 billion compared to the same period of 2000, registering a drop of US$ 1 billion in the contracting of resources and an increase of US$ 885 million in outflows related to investments abroad by Brazilians.

Financial account

US$ billion

Itemization	1999	2000		2001
	Year	Jan-Feb	Year	Jan-Feb
Financial account	17.0	5.5	19.6	4.0
Direct investment	26.9	4.2	30.8	2.6
Abroad	-1.7	-0.6	-2.3	-0.1
In reporting economy	28.6	4.7	33.1	2.6
Equity[1/]	30.0	4.5	30.3	2.0
Intercompany loans	-1.4	0.2	2.8	0.6
Portfolio investment	3.8	1.8	6.9	2.3
Assets	0.3	-0.1	-1.7	-0.3
Liabilities	3.5	1.8	8.6	2.6
Derivatives	-0.1	0.0	-0.2	0.0
Other investments	-13.6	-0.4	-17.9	-0.9
Assets	-4.4	0.9	-1.9	0.1
Liabilities	-9.2	-1.3	-16.0	-0.9

1/ Includes reinvestments.

Uses and sources

US$ billion

Itemization	1999	2000		2001	
	Year	Jan-Feb	Year	Jan-Feb	Year[F/]
Uses	-69.7	-6.6	-52.7	-8.4	-54.0
Current account	-25.4	-2.1	-24.6	-4.0	-26.3
Trade balance	-1.3	0.0	-0.7	-0.4	1.0
Services and income	-25.8	-2.3	-25.4	-3.8	-29.8
Interest	-14.9	-1.5	-14.6	-2.0	-16.8
Profits and dividends	-4.1	-0.1	-3.3	-0.7	-4.9
International travel	-1.5	-0.2	-2.1	-0.3	-2.4
Other	-5.4	-0.6	-5.4	-0.8	-5.6
Current unrequited transfers	1.7	0.2	1.5	0.2	2.5
Amort. medium- long-term	-44.3	-4.5	-28.1	-4.4	-27.6
Bonds, notes & com. papers	-14.8	-1.3	-7.0	-1.3	-10.6
Suppliers' credits	-8.2	-1.2	-5.7	-0.6	-3.0
Direct loans[1/]	-19.5	-1.7	-13.2	-2.2	-10.4
Intercompany loans	-1.8	-0.3	-2.2	-0.2	-3.6
Sources	69.7	6.6	52.7	8.2	54.0
Capital account	0.3	0.0	0.3	0.1	0.0
Foreign direct investment	34.6	5.1	36.9	2.9	23.5
Domestic long-term securities	1.3	-0.1	2.8	0.6	2.0
Medium- & long-term disburs.[2/]	37.6	5.5	31.2	5.8	35.2
Bonds, notes & com. papers	16.7	3.3	12.5	2.9	15.3
Suppliers' credits	3.4	0.5	2.7	0.5	6.1
Direct loans	17.5	1.8	16.0	2.5	13.8
Brazilian assets abroad	-5.2	0.3	-5.5	-0.1	-1.5
Loans to Banco Central do Brasil	2.8	0.0	-10.4	0.0	0.0
Other[3/]	-9.6	-1.9	-4.9	1.3	-2.5
Reserve assets	7.8	-2.3	2.3	-2.5	-2.7

F/ Forecast.

1/ Registers amortization of loans from foreign banks, buyers, government agencies and multilateral organizations.

2/ Does not include intercompany loan disbursements.

3/ Registers net bond refinancing, short-term securities, short-term loans, short-term trade credit, derivatives, loans converted into FDI (until 2000), non-resident deposits, other liabilities and errors and omissions.

Direct foreign investments in the country dropped by US$ 2.1 billion, with reductions totaling US$ 2.5 billion in inflows channeled into acquisitions of stockholdings in Brazilian companies, a figure that was partly offset by an increase of US$ 442 million in net intercompany loans.

Portfolio investments added up to US$ 2.3 billion, for growth of US$ 595 million. Foreign investments expanded by US$ 750 million to US$ 2.6 billion. Here, one should highlight the US$ 2.4 billion inflow through a January placement of Bonds of the Republic. To some extent, Brazilian investments offset this increase, registering growth of US$ 155 million in investments abroad.

Other investments registered a net outflow of US$ 1.3 billion in the two month period, for growth of US$ 848 million compared to the corresponding period of the previous year. Brazilian investments of funding abroad, which had declined by US$ 880 million in the first two months of 2000, turned upward in the same period of 2001, resulting in a net outflow of US$ 327 million. This increase was partially offset by a reduction of US$ 358 million in resources that had been invested in Brazil and were returned to investors abroad.

1.8 – Conclusion

At the start of the year, consumption and investment indicators pointed to continuity in the growth trajectory initiated in 2000. For the most part, these figures registered higher results than in the corresponding months of the previous year. The differential between the two periods is expected to narrow during the course of the year, as the basis of comparison becomes progressively higher. Analysis

of data from which the impact of seasonal factors has been withdrawn points to results that are by no means homogeneous, with declines in consumption indicators and increases in those involving investments.

Among the factors that tend to stimulate consumption, one should note the favorable performance of wage and income indicators and interest rates, coupled with optimistic expectations on the part of consumers. Taken together, these factors would seem to suggest that growth will continue over the course of the year. In contrast to this scenario, default levels increased sharply in comparison to recent months and the early months of 2000. This fact could have the impact of curtailing the number of credit operations. In the same framework, the ratio between bad checks by reason of insufficient backing and the number of checks cleared also increased.

Investment demand continued concentrated mostly in capital goods, signifying that the productive capacity of the economy is expanding, particularly in the industrial sector. It should be noted that the construction industry has recovered in the last months, as demonstrated by growth in the production of the sector-related inputs. The reduction demonstrated by inventory level indicators was not significant, considering that, for the most part, they surpassed the early 2000 levels. A process of replenishment in inventory levels has been also noticed.

Current economic policy has clearly made an important contribution to the targeting of economic development, in such a way as to expand private sector participation in overall outlays. In this context, the role of monetary policy has been one of stimulating the credit market by reducing financial system funding costs and margins in relation to costs, requiring improvements in risk management at the level of financial intermediation. Consequently, in the November/January quarter, credit operations continued expanding in the segment of credit with individual persons, except in the case of housing credit operations. Among the different credit modalities, one should highlight vehicle financing. In the segment of credit operations with legal entities, growth was registered in the sector of services, with important participation on the part of BNDES financing.

Fiscal policy in the last two years has produced results that have contributed importantly to stability and a strong upturn in economic growth. Primary surpluses registered in this period avoided the possibility

of explosive growth in the debt/GDP ratio in the wake of devaluation and the January 1999 interest rate hike. It should be stressed the highly positive contribution given by state companies and regional goverments. Aside from this, last year, downward movement in interest rate levels and the relative stability of exchange were determining factors in reducing borrowing requirements from 10.3% of GDP in 1999 to 4.5% of GDP, and in holding the debt/GDP ratio at 49.5%.

Continued primary surpluses in 2001 based on inflow growth generated by economic performance, coupled with lower interest rates, produced a further reduction in borrowing requirements. Viewed under the prism of expenditures, more effective control of public spending that has resulted from introduction of the Fiscal Accountability Act will certainly aid in achieving further cutbacks, particularly in the framework of state and municipal governments.

The success obtained by fiscal policy has generated new and positive prospects for approval of still pending structural reforms, principally in the areas of social security and taxation. And steps such as these will represent important progress in consolidating fiscal results and regaining the savings capacity of the public sector, creating improved conditions for steady growth in an environment of stability.

Insofar as the foreign sector is concerned, the growth that occurred in the nation's trade flows demonstrates the increased penetration of Brazilian products into foreign markets, as well as strong upward movement in the pace of internal economic activity. Analysis of daily accumulated averages for exports and imports over twelve months indicates a trend toward equilibrium. In the case of the service account, the negative result registered in the first two months of the year was caused by such episodic events as the downturn in the flow of direct foreign investments in the period. With this, the outlook for the year points to stability of the current account deficit and financing of the resulting amount through long-term capital inflows.

2 – Aggregate supply

2.1 – Crop and livestock farming

Crops

Crop production

1000 t

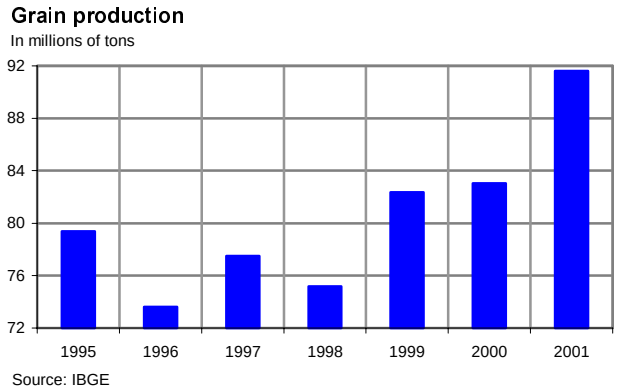
Itemization	2000	2001[1/]	% growth 2001/2000
Grain production	83 028	91 614	10.34
Cotton (seed)	1 250	1 478	18.24
Rice (in husk)	11 144	10 741	-3.62
Beans	3 006	2 921	-2.83
Corn	31 717	38 026	19.89
Soybean	32 679	35 104	7.42
Wheat	1 670	1 670	0.00
Others	1 562	1 674	7.17

Source: IBGE

1/ It refers to the January Systematic Survey on Agricultural Production (LSPA).

The outlook for crop production in 2001 is positive and no undue pressures on farm product prices are expected. The only exceptions are forecasts of declines in rice and beans output. According to early January IBGE data released through the Systematic Survey on Agricultural Production (LSPA), the current grain harvest may expand by 10.3%. Due to the characteristics of the farm calendar in Brazil, these forecasts are still based on simulations for winter crops, as well as for the second and third harvests of such crops as beans and corn. In the south, southeast and central-west regions, which account for about 90% of output, growth is predicted at 10.7%. In the north and northeast regions, this figure drops to 7.4%. One should stress that the basis of comparison is quite favorable for the south, southeast and central-west regions, since output declined by 0.8% in the previous harvest. Just the opposite is true in the other regions of the country, since the most recent harvest turned in growth of 28.3%.

An analysis of expectations on a product-by-product basis indicates that the sharpest growth can be expected in the corn harvest (22.8%), which has accounted for an average of 85% of the total harvest in the last four years. One should note that an adequate supply of corn has a favorable impact on livestock prices. Significant rates of growth are also forecast for herbaceous cotton and soybeans. On the other hand, strong declines are expected in the first bean harvest (5.8%) and the rice harvest



(3.6%). In the case of beans, the drop in the first harvest, which accounts for about 50% of total output, is mostly related to low marketing prices registered in the previous harvest, as well as to a 50% failure of the harvest in the region of Irecê, Bahia, as a result of adverse climatic factors. In the case of rice, the low prices received by producers in the previous harvest have generated a cutback in the area under cultivation. Among other crops of importance in the calculation of crop product and price performance, one should stress estimated 4.5% growth in sugar cane output, mostly as a result of advantageous prices paid for the major derivatives in the most recent marketing period.

One should note that higher average income is expected for most products. This outlook has also received an added boost from high levels of production and sales of farm machines in 2000, with final growth figures of approximately 25.1% and 26%, respectively, according to Anfavea data. Other factors that point in the same direction are growth in national production and imports of fertilizers (4.6% and 46.4%, respectively), based on figures released by the National Association of Fertilizer Promotion (Anda).

Livestock

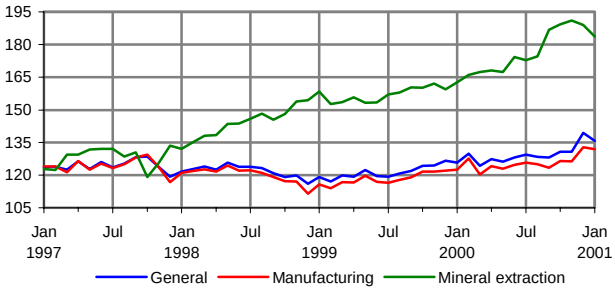
According to IBGE data, livestock output increased by 3.3% in 2000, following growth of 6.4% in 1998 and 6.9% in 1999. Over the course of last year, foreign market performance was consistently positive with across-the-board growth in foreign sales, especially pork (46.5%), followed by beef (27.4%) and chicken (19.3%). For 2001, expectations are that growth will continue both as a result of greater internal demand, generated by improved employment and income figures, and steady growth in foreign sales. A promising sign that this forecast will be fulfilled was registered in January 2001, a month in which exports were 23.3% higher than in January 2000. Utilizing the same basis of comparison, an analysis of the major groupings shows that foreign sales of pork doubled, while those involving beef and chickens rose by respective rates of 68.7% and 7.2%.

Data on livestock-related industrial production in January 2001 provided solid backing to these expectations. Thus, the activities of slaughter – excluding poultry – and preparation of meats expanded by 8.2% when viewed against the January 2000 results. This was the same level registered by the slaughter and preparation of poultry. In the case of inputs, output of animal feed increased by 10%, using the same bases of reference.

2.2 – Industry

Industrial output

Industrial production
Seasonally adjusted data
1992=100



Source: IBGE

Industrial production increased by 6.5% in 2000, the best result since 1994, clearly signaling that the sector has begun moving forward again following two years of decline. In this context, output of the mineral extraction industry expanded by 11.9%, mostly as a result of increased production of crude oil and natural gas, while production of the manufacturing industry, which accounts for about 90% of total output, expanded by 5.9%. Of the twenty industrial segments surveyed, fifteen turned in output growth. The strongest expansion occurred under transportation equipment (18.9%), followed by mechanics (18%), rubber (13%), electric and communications equipment (11.9%), furniture (7.8%) and metallurgy (7.6%). Five segments closed with declines, led by leather and hides (8%) and tobacco (7.8%).

Industrial production by category of use

12 month accumulated rate

Itemization	2000					2001
	Aug	Sep	Oct	Nov	Dec	Jan
Industrial production	5.97	6.22	6.57	6.56	6.46	6.93
Capital goods	8.15	10.70	12.50	13.32	12.88	14.62
Intermediate goods	7.39	7.53	7.57	7.17	6.76	6.96
Consumer goods	2.06	1.79	2.31	2.62	3.00	3.55
Durable	15.28	16.07	17.58	18.24	20.56	21.26
Semidurable and nondurable	- 0.91	- 1.41	- 1.13	- 0.94	- 1.02	- 0.53

Source: IBGE

For the most part, the performance of the industrial sector mirrored the expanded production capacity of the economy, coupled with strong growth in demand for consumer durables. Both of these factors were heavily impacted by increased internal and external demand, together with growth in available credit and employment levels. In January 2001, industrial production fell by 2.7%, based on data purged of seasonal factors, a performance that, to some extent, can be explained by the sharp rise that occurred in

December 2000. Among the factors that contributed to this result, one should mention falloffs in the output of durable and intermediate goods (19.6% and 1.2%, respectively), which were higher than the 0.5% rate of growth in the output of capital goods and semidurables and nondurables. A breakdown on a segment-by-segment basis shows declines in eleven of the twenty segments researched. Still using data from which seasonal influences have been removed, comparisons of averages for the November-January quarter with those for the immediately previous quarter indicated increases in all use categories, meaning that the January result did not reverse the overall growth trajectory. In the case of semidurable and nondurable goods, the only category to register a decline in 2000, recovery is also evinced by a lesser reduction in accumulated twelve month figures from 1% up to December to 0.5% up to January.

Industrial production

Percentage change

Itemization	2000					2001
	Aug	Sep	Oct	Nov	Dec	Jan
In the month[1/]	- 1.00	- 0.20	1.90	- 0.20	7.20	- 2.70
Same month of the previous year	7.81	3.32	7.07	4.91	7.11	11.18
Accumulated in the year	6.94	6.50	6.56	6.40	6.46	11.18
Accumulated in 12 months	5.97	6.22	6.57	6.56	6.46	6.93

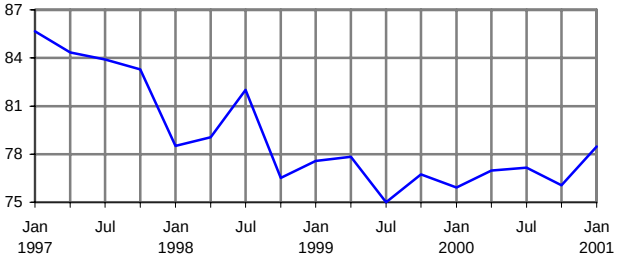
Source: IBGE

1/ Seasonally adjusted.

Also in terms of industrial output in January 2001, the month registered expansion of 11.2% compared to the corresponding month of the previous year. This rate is similar to those registered by a substantial share of consumer indicators. Parallel to this, the rate of accumulated growth in twelve months came to 6.9%, the highest rate since September 1995, reflecting an improvement over the 2000 result.

Growth is also expected for the month of February, as is evident in 2.7% growth in the energy load of the State of São Paulo, 7.1% in the output of the automotive industry and 1.1% in the production of farm machines, while production of corrugated cardboard dropped by 7.5%. All of these figures are based on data from which seasonal impacts have been eliminated.

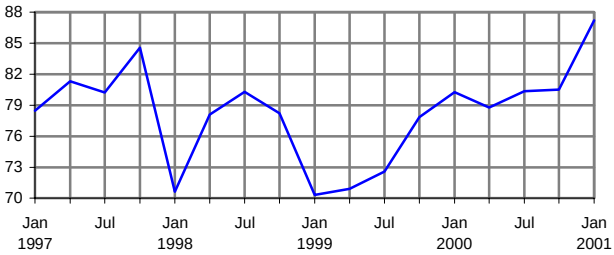
Utilization of installed capacity
Consumer goods
Seasonally adjusted data
Average percentage



Source: FGV

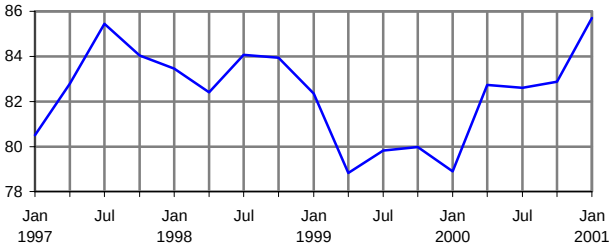
Studies of the level of utilization of installed output capacity have mirrored the effects of the growing pace of economic activity, as the average level of recent months has been marked by production peaks under some indicators. However, there is still no generalized evidence of exhaustion in the use of industrial facilities since these have been steadily expanding as is evident in investment demand indicators. Aside from this, the average installed capacity of the manufacturing

Utlization of installed capacity
Capital goods
Seasonally adjusted data
Average percentage



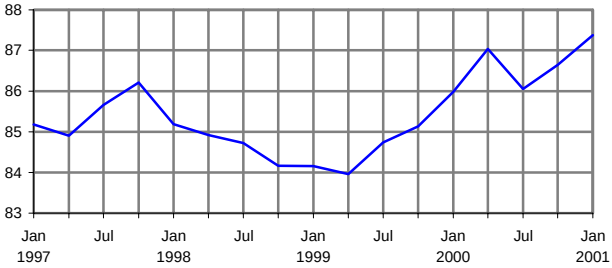
Source: FGV

Utilization of installed capacity
Building materials
Seasonally adjusted data
Average percentage



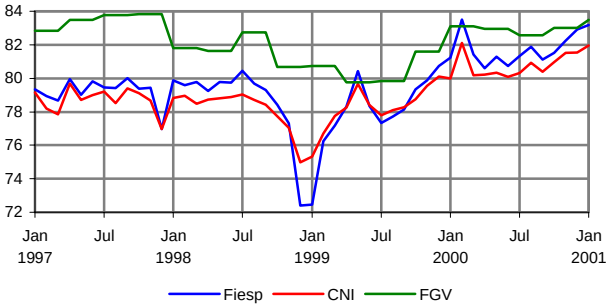
Source: FGV

Utilization of installed capacity
Intermediate consumer goods
Seasonally adjusted data
Average percentage



Source: FGV

Utilization of installed capacity
Seasonally adjusted data
Average percentage



industry has not restricted growth in factory production. This is evident when one considers that the rates of utilization of output facilities have been lower than production, signaling not only that capacity has increased but also that gains in both scale and productivity have been incorporated into the production process.

The quarterly Getulio Vargas Foundation's Manufacturing Industry Survey registered growth in the average percentage level of utilization in the period from the first to the final quarters of 2000. The average rose from 81.3% to 84.1%, before receding to 82% in January 2001. Though high, these levels did not match the 86% peak registered in April 1995. However, in the series purged of seasonal factors, the January 2001 level was 0.6% above that of October of last year, indicating that there is still considerable room for growth under consumer goods, with some degree less for intermediate goods and building materials.

An analysis based on industrial segments shows that ten of the 21 segments analyzed by the Getulio Vargas Foundation registered utilization levels above the overall average, as compared to eight in the October survey. A closer look shows that industries working with wood, cellulose, paper and cardboard, rubber and textiles registered levels above the 90% mark. On the other hand, ten segments were marked by more than 20% leeway in terms of space for further growth. This was particularly true under mechanics, plastics, pharmaceutical and veterinary products and perfumes, soaps and candles.

The twelve state CNI survey carried out by industrial federations pointed to growth of 3.2% in the level of utilization of installed production capacity, when one compares the average for 2000

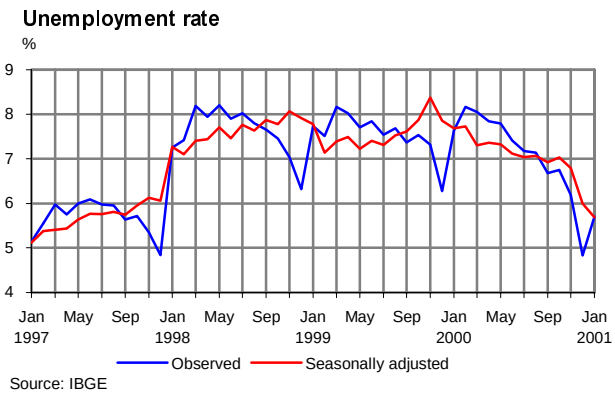
with that of 1999. Analyzing data from which seasonal impacts have been withdrawn, January registered growth of 0.53% when compared to December, marking the fourth consecutive positive monthly result. With respect to January 2000, growth came to 2.4%. On a state-by-state basis, data points to levels above the national average (80.3%) in the states of the south and southeast regions, with the sole exception of Rio de Janeiro. The highest level was registered in Santa Catarina (85.1%), followed by Minas Gerais and Rio Grande do Sul, both with 81.6%. In the other states, the percentages varied between 70.7% and 80%.

The average level of utilization of installed capacity also moved upward in the specific case of São Paulo industry, reaching the mark of 80.6% in January when compared to 78.8% in January 2000. The average for the November-January quarter was 1.6% higher than in the immediately previous quarter, expressed in terms of seasonally adjusted data.

2.3 – Labor market

Employment

Labor market indicators for the month of January suggest an ongoing process of recovery, following the trend defined in the previous year. Industrial surveys point to growth in the first month of 2001, no matter what basis of comparison is utilized, at the same time in which household surveys registered declines when compared to the previous month, but positive growth when set against January 2000.

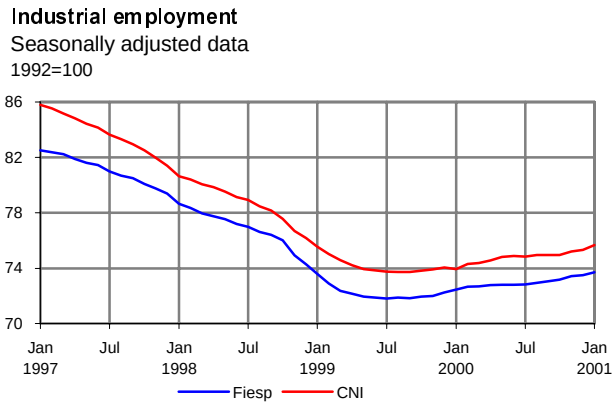


Source: IBGE

In January, IBGE's Monthly Employment Survey confirmed the gradual drop in the jobless rate, when compared to the same month of the previous year. The ratio between the number of unemployed persons and the overall work force closed at 5.7%, or less than in the period from January 1998 to December 2000. Reflecting favorable movement in the activity level, the rate of unemployment has closed consistently below the previous year's result since May of last year. Utilizing this basis of

comparison, the number of persons employed has expanded consistently since October 1999, while the decline in the unemployed population began in June 2000. This result illustrates the fact that, to the extent in which employment levels increase, working age people who had been sidelined by the economy tend to return to the market in search of work, thus initially increasing the number of those classified as unemployed.

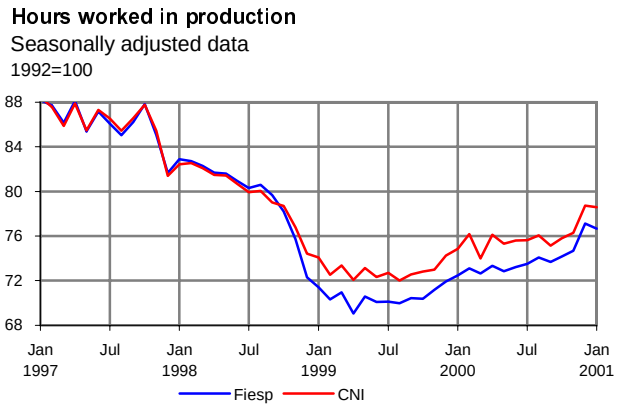
The reduction in the number of working people in the first month of the year is a phenomenon that has been repeated every year since 1991, when research data first made it possible to make this type of comparison. The January 2001 result under this heading was a contingent of 171.4 thousand workers. Nevertheless, the working population in the period was the highest registered in any month of January since 1990. In individual terms, the only sector to turn in similar results was that of services.



Though employment in the industrial segment is higher than in the period from 1998 to 2000, industrial employment as a whole has never returned to the level registered between 1991 and 1997. This result may well be a consequence of structural changes that followed in the wake of the process of opening the Brazilian economy to the world market, since this had the result of shifting rather large contingents of labor out of the industrial sector and into services, the sector that registered particularly sharp growth in employment. As far as the different worker categories are concerned, the number of unregistered workers and the self-employed came to a level that surpassed every month of January since the survey was first carried out, pointing to possible expansion in the informal job market. In comparison to the month of December, all categories registered declines of more than 1%, with the exception of that encompassing registered workers, which closed at 0.03%.

Fiesp's manufacturing industry employment indicator for the month of January points to continued growth since October 1999 when expressed in the series purged of seasonal factors, closing at 0.31%. In comparison to the same month of the previous year, the increase was even more

significant (1.76%). The CNI survey, which encompasses eleven states aside from São Paulo, has registered recovery in employment levels in the manufacturing sector since April 2000, when each month of the year is compared to the corresponding month of the previous year. Aside from this, growth since May has consistently surpassed the mark of 1%, with a peak of 2.28% in the final month. In both series, however, the index is still below the average registered in 1992. Since December 1998, the index has been below 75% in São Paulo industry and 76% in the case of the CNI survey.



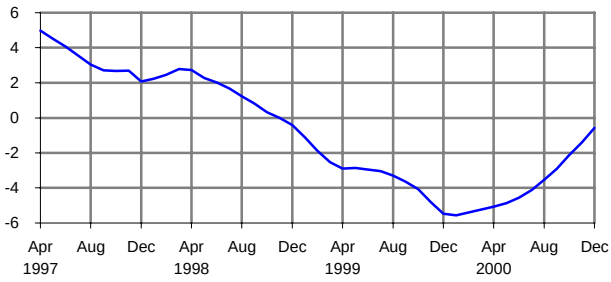
Since December 1999, growth in hours worked in production has surpassed employment levels in both the Fiesp and CNI surveys, when the comparison is made between one month and the corresponding month of the previous year. Though this variable encompasses workers that perform functions not directly related to production, the result suggests that the increase in industrial product has generated adjustments in the number of workers employed as well as in the number of hours worked. In the month of January, in the case of São Paulo industry, hours worked in production expanded by 7.68%, compared to January 2000.

Confirming the positive results of household and industrial surveys, the level of formal employment also moved along a positive curve in 2000, with growth of more than 2% in the second half of the year, when each month is compared to the same month of the preceding year. Though December registered the loss of 225.8 thousand jobs, the year 2000 as a whole witnessed creation of 657.6 thousand positions. One should note that since 1985 when the series was first announced by the Ministry of Labor, the month of December has always registered declines in formal employment. This phenomenon is strongly impacted by the manufacturing sector, which has systematically registered declines in employment rolls during that month. In January, 48.8 thousand job positions were generated, for an increase of 3.19% in relation to the same month of the previous year, and 0.27% when viewed against the result for last December. These figures clearly support the ongoing trend toward recovery in formal employment levels begun in February of last year.

Wages and earnings

Though wages and earnings indicators were by no means uniform in 2000, there is no denying that a process of recovery is underway. In the industrial sector, in which formal labor relations predominate, overall wages expanded in comparison to 1999. With respect to the results of household surveys, the losses registered at the end of the year were much less intense that at the end of the first six months.

Real average earnings
12 month moving average

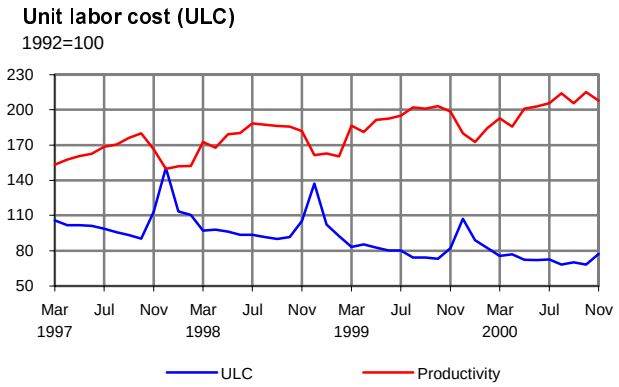


Source: IBGE

According to the IBGE household survey, a comparison of the annual averages registered by the indices indicates a drop of 0.57% in real earnings in 2000, a significantly lesser rate than in 1999 (5.48%). Comparisons with the same month of the previous year exemplify the improved performance: while 1999 was marked by declines of more than 2.8% in all months of the year, the following year registered five months of positive growth in the range of 1%, while October closed with a resounding 2.07%. In the series purged of seasonal factors, average real earnings turned in small increases in seven months of the year. In June, growth surpassed the mark of 1%.

For the fourth consecutive month, the Fiesp survey indicates growth in real wages in the manufacturing sector, with expansion of 1.64% in January, the highest level since March 2000. In this case, the results are expressed in terms of the statistical series from which seasonal impacts have been eliminated. Comparison with the same month of the previous year points to a growth trend initiated in February of last year and rising to 8.61% in January, the largest increase since November 1996. With the 1.76% increase in the employment level, overall wages expanded by 10.49% in relation to January 2000, setting a record in relation to August 1995. The growth trend in these variables becomes evident when one views a comparison of averages in the twelve month indices ended in January: 3.71% growth under real average wages and 5.03% under overall wages.

Unit labor cost and productivity



Source: IBGE and Bacen

Calculated on the basis of IBGE's Industrial Survey, data on productivity growth in the manufacturing and mineral extraction sectors point to a clear sustained growth trajectory. In November, the productivity index rose by 4.61% compared to the same month of the previous year, while the average up to November was 5.46% above that of 1999. The unit labor cost (ULC), which expresses the ratio between industrial payroll, deflated by the IPA-DI, and the physical industrial output index, continued along a downward curve. In relation to November 1999, the reduction came to 9.25%, though there was a 5.98% increase in payroll in real terms. This result, coupled with 4.85% growth in physical industrial output and continued productivity gains, signals an absence of cost pressures generated by the industrial labor factor. A comparison of the average for the first eleven months of the year shows a much more accentuated drop in the unit labor cost (14.73%), thus confirming the downward trajectory that marked the entire year. The IBGE Industrial Survey also shows that the ratio between payroll and production value - both expressed in nominal terms - dropped by 6.12% in November, when compared to the same month of the previous year. An analysis of annual averages shows negative growth of 9.4%.

Since February 2000, productivity gains calculated in relation to the corresponding month of the previous year were a consequence of growth in industrial output at rates that surpassed hours paid in production. This result, together with those referring to industrial employment as released by CNI and Fiesp, points to recovery in the sector following a long period of declining employment. In the series for the São Paulo industrial sector, comparisons with the same month of the previous year indicate a downward trajectory between August 1995 and February 2000. According to the CNI survey, this trajectory, which also began in August 1995, continued up to March 2000. A comparison of the first eleven months of 2000 with the corresponding period of the previous year indicates across-the-board productivity growth in the industrial sector: the 5.46% result for industry in general was backed by positive rates of 4.95% for manufacturing and 9.24% for mineral extraction. Of the nineteen industrial segments surveyed, declines were registered in only

GDP deflator and median IGP-DI

In 1999, average growth in the GDP deflator (4.33%) was lower than in FGV's general price indices (11.34%, measured by the IGP-DI), as well as IBGE's consumer price indices (4.86%, measured by the IPCA). One implication of these results was Banco Central do Brasil's projection of nominal GDP, which utilizes the IGP-DI as deflator proxy, at a level higher than announced by IBGE. Utilization of IGP-DI is based on the larger number of products covered by its methodology which, historically, brings it closer to the change in the prices of GDP.

Considerations on the results of 1999 and 2000 indicators

The differences that occurred between growth in the deflator and in major price indices can be understood in terms of the concepts underlying each index. These concepts stress the objectives of each index and, in this way, explain the reasons behind the 1999 discrepancy.

General price indices have the objective of measuring inflation in relation to the overall supply of goods and services in the economy, taking in all transactions carried out in this process. Thus, these indicators are composed of the products marketed by the wholesale and retail trade sectors, while also taking account of construction costs, since these impact the fixed capital formation deflator.

Consumer price indices have the objective of measuring growth in the prices of the goods and services consumed by families and do not encompass those items reserved to the public administration and gross fixed capital formation.

The implicit GDP deflator has the objective of mirroring changes in prices in value added terms. It differs from the other price indices in terms of its coverage and the treatment given to imports. Thus, growth in the prices of imports in reals means growth in price indices due to higher prices for products involved in internal transactions in both the wholesale and retail segments. The impact of this increase is different on the deflator since imports do not constitute added value. If the increase in import prices is fully transferred to final agents, the impact on growth in the deflator will be nil. However, if part of this increase is absorbed by productive agents – reflecting a reduction in margins – the impact on the growth of the deflator will be negative. And the principal reason for the distinct performance registered in 1999 is found precisely in this difference of treatment by prices indices and by the deflator[1].

1 This argument can be proved by the 10.19% growth registered in National Accounts overall supply prices, which is compatible with both IGP-DI variation and scope.

Intermediary transactions also receive differentiated treatment by the different indices, though with little impact on the overall result of the deflator. These transactions reflect the weighted sum total of growth in final demand prices less growth in the prices of imports. If changes in the prices of intermediary consumption goods were below those that effectively occurred - all other values being constant - there would be a reduction in median growth of the IGP-DI, with no alteration in consumer price indices and the deflator.

The differences between the behavior of GDP deflator and price indices in 1999 can be exemplified with the price growth associated to each of GDP components seen under the prism of expenditure. The following table shows price changes of the GDP components, as well as their respective contributions for the deflator composition.

GDP deflator by components - variations and contributions

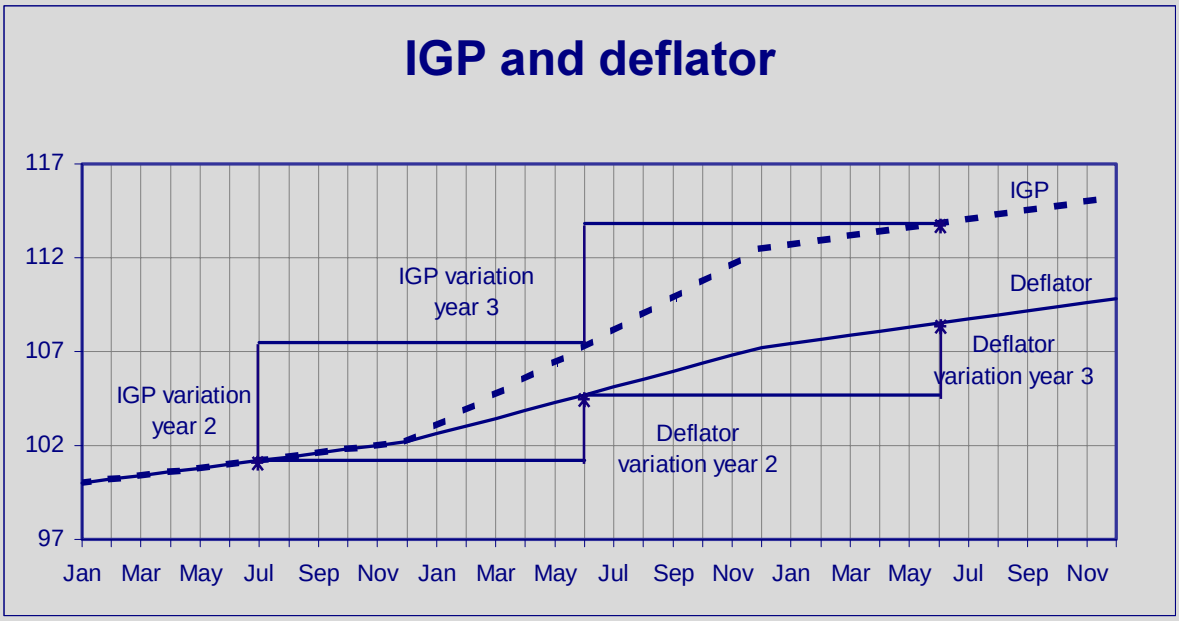
%

Year	Personal consumption		GFCF		Stock variation		Public administr.		Exports		Imports		GDP
	Var.	Cont.	Var.	Cont.	Var.	Cont.	Var.	Cont.	Var.	Cont.	Var.	Cont.	
1995	70.90	42.84	70.77	14.54	-7.52	-0.13	100.32	19.66	53.37	4.12	36.65	-3.48	77.55
1996	21.33	12.81	11.69	2.40	-6.30	-0.06	12.14	2.38	7.35	0.57	7.26	-0.69	17.41
1997	8.39	4.74	5.31	1.05	15.03	0.20	7.80	1.25	7.03	0.53	5.30	-0.52	7.25
1998	4.45	2.77	4.51	0.89	-2.66	-0.04	5.83	1.08	0.11	0.01	-0.20	0.00	4.71
1999	5.83	3.55	9.67	1.74	-4.21	-0.07	3.10	0.59	30.32	2.57	49.73	-4.06	4.33

An analysis of the past three years shows that the contribution of each component remained stable. This was less evident in 1999 as a consequence of the January exchange devaluation. As a matter of fact, the magnitude of the contribution consequent upon import and export deflators, which varied in the range of 0.5% in the period from 1996 to 1998, closed at 2.57% and 4.06%, respectively, in 1999.

On the other hand, to a great extent the deterioration of the terms of trade that occurred in 1999 (increase in the prices of imports that was higher than in the prices of exports) explains the value obtained for the GDP deflator. If the change in export prices were identical to that of import prices, the GDP deflator would be 5.98%, which would therefore be situated at a point between the average growth of the IPCA and the IGP-DI.

With regard to 2000, two aspects deserve emphasis with respect to the behavior of the deflator in relation to price indices. The first concerns the so-called carry-over effect. Since IGP-DI and the deflator did not keep pace one with the other over the course of 1999 and since these are indices for which changes are calculated by comparing median against median (median prices in 1999 compared to median prices in 2000), the effects of the mismatch are distributed over two years. The following graph illustrates this effect.



The graph shows the hypothetical behavior of the IGP-DI and the deflator over three years. In the first year, it is assumed that both evolve together starting from the same base so that the two indicators are represented by a single line. In the second year, following what occurred in 1999, IGP-DI expanded more than the deflator and, in the third, the two indicators registered the same performance, with the difference that they originated in different bases as a result of the previous year's results. The asterisks along the curves indicate average prices for the two indices in each year. The median growth of the indices in each year is obtained in terms of the graph by the difference between median prices of the year in relation to median prices of the previous year. Though the separation between the curves occurred only in year two, the growth of the IGP-DI measured by this criterion is greater in both year two and year three or, in other words, the difference noted by the point-to-point concept produces an impact in two consecutive years.

The other aspect refers to the behavior of terms of trade, a factor of utmost importance to explaining the differences between the price indices and the deflator in 1999. However, Funcex data for 2000 show that changes in the prices of imports and exports were not significant in that year. Aside from this, the average dollar registered upward movement in 2000, thus provoking a drop in the prices of imports expressed in real. Taken by itself, the latter impact should increase the change in the deflator in comparison to price indices, a result that is symmetrical with what occurred in 1999. However, the magnitude of the upward movement in the value of the dollar was only slight and had little impact on the deflator.

Consequently, average growth in the IGP-DI, which came to 13.77% in 2000, is expected to surpass growth in the deflator, principally as a result of the carry-over effect. This effect was estimated at almost six percentage points, generating an estimate of about 7.5% for the GDP deflator.

One should note that, with IBGE's announcement of the nominal quarterly GDP as of June 2000, the differences between the deflator and IGP-DI were incorporated quarterly into Banco Central's estimates of nominal GDP. Thus, since information for the first three quarters is available, the difference between the median growth of the IGP-DI and the GDP deflator in 2000 will have little impact on the value of GDP projected for the year by Banco Central.

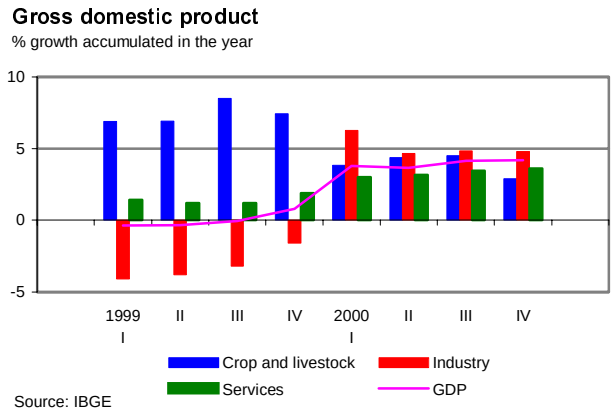
five: 4.42% in food products, 4.15% under tobacco, 3.87% in plastics, 3.47% under wood and 3.42% in the case of leather and hides. The sharpest growth occurred under transportation equipment and mechanics: 13.43% and 13.63%, respectively.

Both Fiesp and CNI indicators confirmed the productivity gains indicated by IBGE, as industrial sales rose at rates considerably higher than hours worked in production, when the results of each month are compared with those of the same month of the previous year. This performance occurred in every month of 2000 and in January 2001, when São Paulo industrial sales increased by 18.61% and hours worked rose by 7.68%. The CNI series indicated increases of 15.81% and 7.65%, in the same order.

Gross domestic product - accumulated rate in the year

Itemization	1999				2000			
	I	II	III	IV	I	II	III	IV
GDP	-0.36	-0.36	-0.07	0.79	3.80	3.65	4.14	4.20
Crop and livestock	6.89	6.92	8.48	7.41	3.84	4.36	4.51	2.90
Industry	-4.09	-3.79	-3.20	-1.60	6.26	4.66	4.84	4.79
Services	1.40	1.19	1.18	1.89	3.01	3.17	3.46	3.61

Source: IBGE

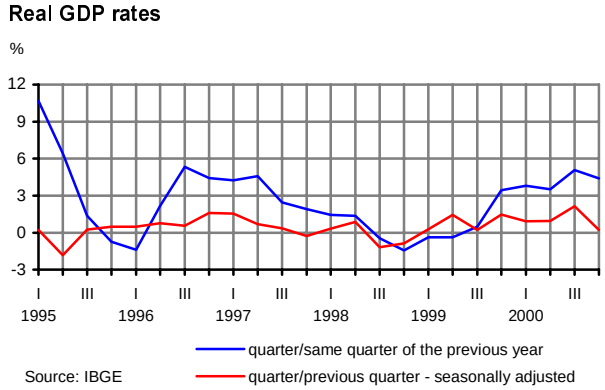


Source: IBGE

2.4 – Gross domestic product

At market prices, GDP expanded by 4.2% in 2000, following growth of 0.2% in 1998 and 0.8% in 1999. This rate reflected not only a favorable comparison base but also confirmed the process of recovery in the activity level. A quarterly analysis shows that growth calculated according to seasonally adjusted data was more intense in the third quarter. From that point forward, the rate was practically stable when the accumulated results of the year are compared to 1999. At the end of the first six months, GDP had expanded by 3.65%, rising to 4.14% up to September.

This result was generated by growth in all sectors, with the heaviest concentration under industry. In this case,



Source: IBGE

the best performances were registered by manufacturing, due to its weight in the calculation of the overall result, and mineral extraction, as a consequence of its sharp 11% rate of expansion. In the sector of services, which accounts for approximately 60% of GDP, one should underscore the performances of communications (16.8%) and other services (5.7%).

2.5 – Conclusion

Growth in supply indicators has been compatible with the performance of demand in the early months of 2001 in both the farm and industrial sectors. Consequently, in the first quarter of the year, there are no perceptible signs of price increases as a direct result of bottlenecks in the output of goods. In January and February, monthly inflation reflected the restructuring of rates charged on electricity, public transportation and water and sewage, as well as school enrollments and monthly payments, together with seasonal increases in the prices of in natura foodstuffs. However, one factor that has been noted by all the surveys is a reduction in the idle capacity of several industrial segments.

On the other hand, investment demand has expanded both in terms of industrial facilities and sectors such as transportation and agriculture and this would seem to minimize the possibility of a generalized output gridlock.

With regard to the impact of labor costs on the prices of industrial goods, the trajectory of both productivity and the unit labor cost have remained favorable. Growth in the value of output has surpassed the rise in payroll costs. In much the same way, growth in the real sales of the industrial sector has been greater than the increase in hours worked. Thus, the process of recovery in industrial employment has occurred at a pace and under conditions that, at least at the moment, do not reflect any undue pressures on the wages.

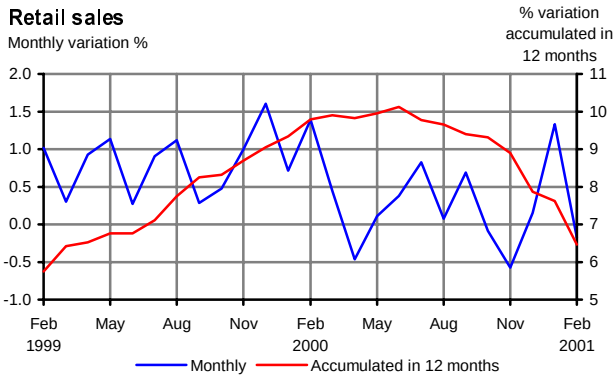
With respect to the farm sector, no significant problems are expected in the supply of most of the basic staples, with the sole exception of rice and beans, since output of these crops is expected to decline below the 2000 level. On the other hand, growth is forecast under sugar cane and could generate positive impacts on alcohol prices.

3 – International economy

3.1 – The United States

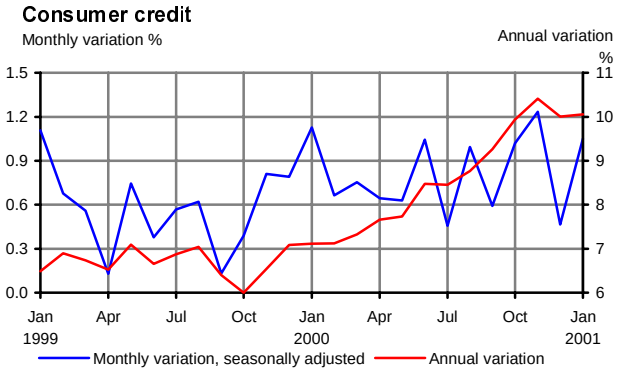
Aggregate demand in the United States (USA) in the fourth quarter of 2000 either declined or decelerated in all of the various components, with the sole exception of government spending. The pace of activity slowed as a consequence of the coming together of a series of different factors, such as the impact of the 1999-2000 rise in interest rates on the pace of aggregate investment growth. The persistent increase in energy costs provoked by rising international oil prices cut into business profit margins and available private sector income. At the same time, capital market volatility aggravated uncertainties regarding family wealth and reduced consumer confidence in the economy. Evidently, this process had a highly negative impact on aggregate consumption. Aside from all this, one must also factor in declining foreign demand for American products, generated by expectations of lesser economic growth in the rest of the world.

The downward trajectory led to a reduction of one percentage point in the basic interest rate target in January, thus interrupting a period of interest stability dating back to the second half of 2000.

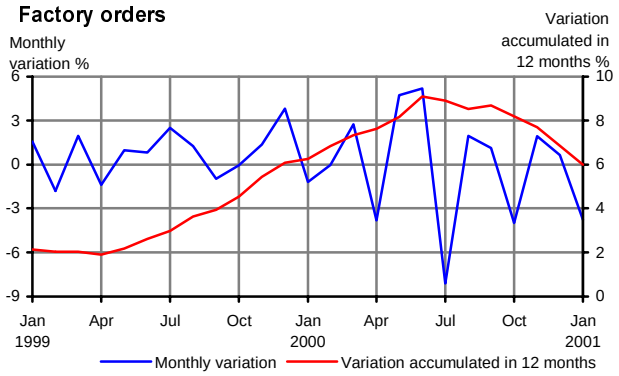


Source: Bureau of the Census

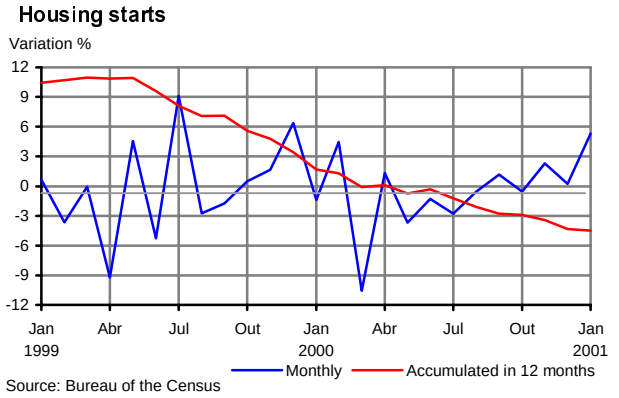
Consumption indicators point to steady deceleration in the pace of growth as of the second half of 2000, though the overall rate remained high. Thus, retail sales, which had expanded by an average of 7.9% in 2000 following 9% in 1999, registered 7.5% in January when compared to the same period of the preceding year. The stock of consumer credit in November was 10.4% above that of the same month of 1999. However, in the following months, the rate



Source: Federal Reserve System



Source: Bureau of the Census



Source: Bureau of the Census

was considerably more moderate, possibly signaling a reversal in the growth trend. However, one should emphasize that the January result was still 10.1% higher than the stock registered in January of the preceding year.

Orders placed with factories in 2000 were 6.9% above the level registered for the previous year, when expansion came to 6.1%. The downward trajectory in orders which had begun in the second half of 2000 continued in January, with a falloff of 3.8% in comparison to the previous month, when viewed under the prism of figures from which seasonal factors have been purged. In accumulated twelve month terms, the final result was positive growth of 6%. In the same period, inventories of the manufacturing sector increased by 0.7%, following growth of 0.2% in November and -0.1% in the month of December, according to data free of seasonal factors published by the Bureau of the Census.

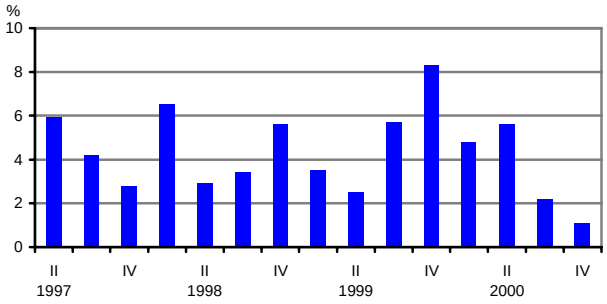
Though housing starts declined by 4.3% in 2000, this is the first component of demand to signal recovery. In this context, one should note growth of 5% in the number of housing starts in the month of January, according to the Bureau of the Census, based on data free of seasonal factors expressed in annualized figures.

Government spending has not had an anticyclical impact, since the maintenance of large surpluses has limited the private sector's net available income and neutralized the expansionary effects of these outlays. Up to January, the surplus accumulated in the fiscal year initiated in October 2000 came to US$ 74 billion, compared to surpluses of US$ 41.5 billion and US$ 16 billion in the corresponding periods of the 2000 and 1999 fiscal years, in that order. Though government spending has continued along an upward curve, this has occurred in the context of a revenue increase of 7.5% between October and January, while spending expanded by just 2.5%. One should note

that the United States Treasury has forecast a reduction in the surplus for the 2001 fiscal year to US$ 228 billion, compared to US$ 237 billion in 2000, as a consequence of the tax load cutback recently approved for the current fiscal year.

According to data released by the Department of Commerce, foreign trade operations closed with a December deficit of US$ 34.2 billion, based on exports of US$ 65.5 billion and imports of US$ 99.6 billion, for growth of 4.1% and 8.2% when compared to 1999 and 1998 figures, respectively. The 2000 trade balance closed with a deficit of US$ 449.5 billion or 30% and 82.1% more than in 1999 and 1998, respectively. For the most part, growth in foreign sales is attributed to capital goods, while increased imports have been generated basically by acquisitions of capital goods and industrial inputs, including petroleum.

Gross domestic product[1/]

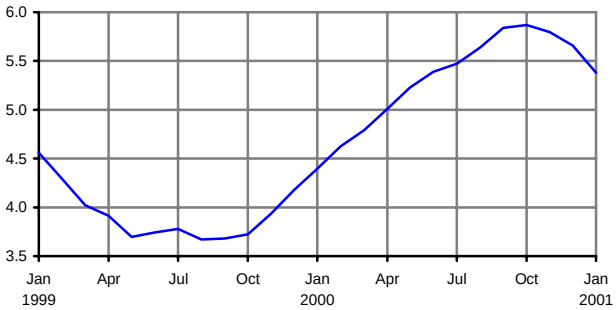


Source: Bureau of Economic Analysis
1/ Growth over previous quarter, seasonally adjusted, annualized rate.

In the fourth quarter of 2000, real Gross Domestic Product (GDP) purged of seasonal impacts expanded at an annualized rate of 1.1%. According to preliminary estimates released by the Bureau of Economic Analysis, this result has been sustained by growth in consumption - albeit at a decelerated pace since the first quarter of 2000 - and government spending. In the first three quarters of the year, the corresponding rates had closed at 4.8%, 5.6% and 2.2%. As a result, median growth for the year came to 5% as against 4.2% in the preceding year.

Industrial production

% variation accumulated in 12 months



Source: Federal Reserve System

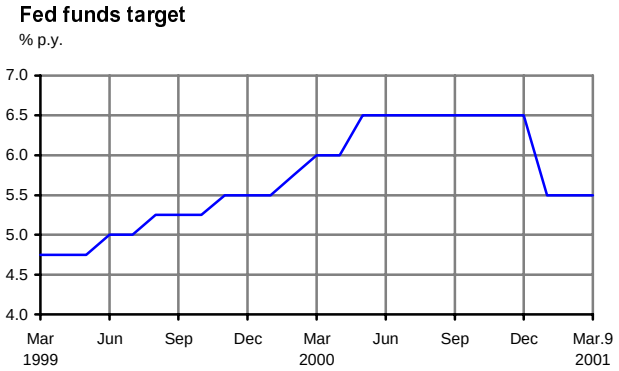
Industrial output in 2000 expanded by 5.7% following growth of 4.2% in 1999. In the month of January, output declined by 0.3%, based on the monthly statistical series purged of seasonal influences, registering the fourth consecutive monthly decline. In this scenario, accumulated output over 12 months, which had moved upward up to the month of October, turned downward, registering 5.4% in January. Utilization of installed industrial capacity has followed the same trajectory, closing January at 80.2% following levels of 80.7% in December and 81.9% in January 1999, in the series from which seasonal influences have been removed.

Labor market indicators indicate that the manpower supply has become somewhat more plentiful, a fact that is expected to aid in reducing wage pressures. In this context, unemployment increased in 2001 to 4.2% in January and February after fluctuating between 3.9% and 4.1% in the fifteen previous months, according to the Bureau of Labor Statistics.

Productivity in the nonfarm sector, which had increased by 3.4% in the fourth quarter when compared to the same period of the previous year, turned in a result of 4.3%, the highest annual rate since 1983. However, in relation to the growth pattern registered since the end of 1999, this figure reflected deceleration. In this scenario, pay per hour worked in the nonfarm sector increased by 5.7% in nominal terms and 2.2% in real terms, reflecting a real increase of 2.2% in the Unit Labor Cost (ULC). Productivity in the manufacturing sector has also turned in positive growth coupled with deceleration in the pace of that growth. In the fourth quarter, the increase in output per hours worked came to 6.5%, while hourly wages increased by 6.2%. With this, the ULC remained constant in the period, in contrast to the 2.5% decline in the previous two quarters.

The Consumer Price Index (CPI) registered annual growth of 3.4% in 2000, compared to 2.7% in the preceding year, according to the Bureau of Labor Statistics. The core index, which excludes the influence of food and energy prices, expanded by 2.6% compared to 1.6% in 1999. In January, the CPI and its core increased by 0.6% and 0.4%, with accumulated expansion of 3.7% and 2.6% in 12 months. The Producer Price Index (PPI) expanded by 3.6% in 2000, following an increase of 2.9% in the previous year, while the core index expanded by 1.1%. In the month of January, the PPI increased by 1.1%, closing the last twelve months with expansion of 4.8%.

At its ordinary meeting on December 19, 2000, the Federal Reserve Open Market Committee (FOMC) decided to maintain the basic interest rate target (federal funds) at the same level in effect since May 2000 (6.5% per year). However, evidence that the cost of energy and deteriorating consumer expectations were aiding in reducing private spending and profit markets led to a more flexible monetary policy approach in early 2001. Thus, the basic interest rate target was reduced by 0.5 percentage points on January 3 and an additional 0.5 percentage



Source: Federal Reserve Board

point at the ordinary meeting held on the 31st of the same month. With this, the month closed with a basic interest rate target of 5.5%. What is important is that the FOMC stated that it was aware that there was a risk of a period of weakened economic performance, generating expectations of further cutbacks in interest rates in the near future.

The steps taken by the Fed may have contributed to recovery in the Purchasing Managers Index (NAPM), which came to 41.9% in February, compared to 41.2% in January, though this level still signals expectations of a downturn in the pace of manufacturing activity in the United States. The Consumer Confidence Index declined by 7.7% in January. This was the fifth consecutive monthly drop and lowered the index to 106.8, the lowest point since June 1996.

The Fed's forecasts for 2001 indicate economic growth between 2% and 2.5% and consumer inflation between 1.75% and 2.25%. Aside from these forecasts, unemployment for the fourth quarter of 2000 is expected to expand to 4.5%, according to that institution's half yearly report.

3.2 – Japan

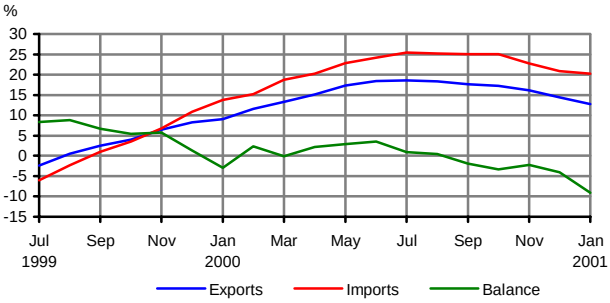
The Japanese economy has shown signs of further fragility, principally as a result of cutbacks in imports by Southeast Asian nations and the deceleration of the American economy, the two major markets for Japanese exports. The reduced contribution of the foreign sector to attempts to breathe new life into the nation's economy has imposed a damper on industrial output, since private consumption has remained sluggish as a result of no significant improvement in employment and income conditions.

One should stress that the recent turn to a more expansionary monetary policy has serious limitations, since the financial system is in need of profound structural reforms. At the same time, these limitations are further aggravated by the low quality of the loan portfolios held by banks.

Family spending closed 2000 without any clearly defined direction. In terms of figures free of seasonal influences, November and December registered growth rates of -1.5% and 2.1%, respectively, in spending, when compared to the previous month. On the same basis of comparison, the spending of workers increased by 0.6% and dropped by 4%.

In their turn, orders placed with factories registered growth of 12.3% in the fourth quarter of the year, in relation to the same quarter of 1999. However, in the month of January, orders declined by 9.6% in comparison to December, and 1.2% when set against the same month of the preceding year. One should note that the Economic Planning Agency (EPA) estimates a drop of 3.2% in orders in the first quarter of the year. The number of new building starts, which had increased by 4.7% in the fourth quarter of 2000, compared to the corresponding period of the previous year, declined by 11.1% in January, when the same comparison base is utilized.

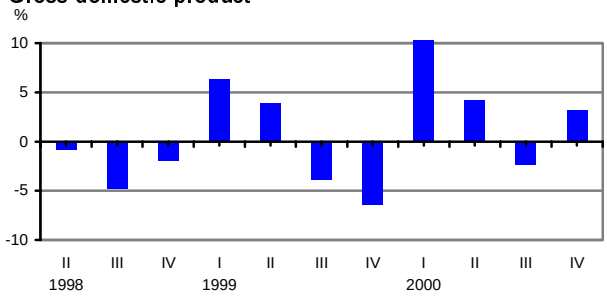
Trade balance
Accumulated variation in 12 months



Source: Bank of Japan and Bloomberg

In 2000, foreign sales totaled US$ 480 billion, for growth of 14.4% in relation to those registered in the preceding year, while imports expanded by 21% and closed with a total of US$ 376 billion. With this, the trade surplus declined by 4% in relation to the 1999 result. This situation worsened in January, when the falloff came to 9.1% over 12 months.

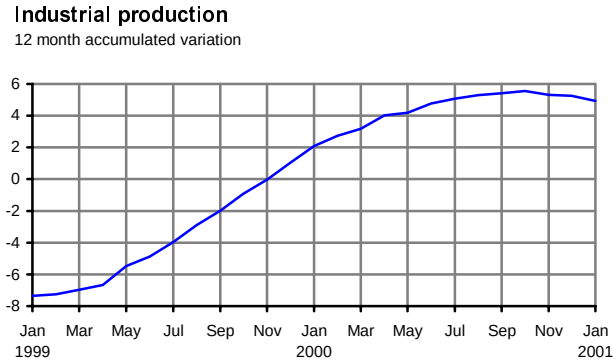
Gross domestic product[1/]



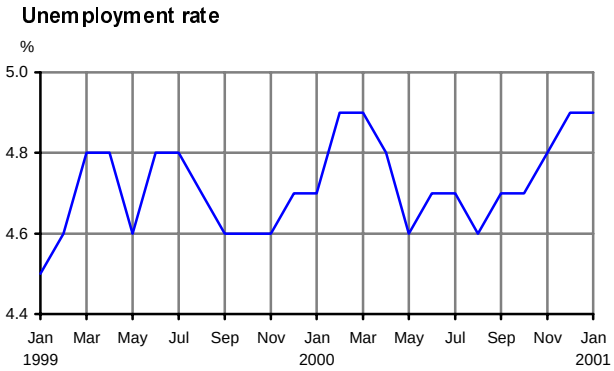
Source: Economic Planning Agency and Bloomberg
1/ Growth over previous quarter seasonally adjusted, annualized rate.

GDP estimates for the fourth quarter of 2000 announced by the EPA indicate growth of 2.3% in comparison to the same period of 1999 and 0.8% in relation to the previous quarter, for an annualized rate of 3.2%. Confirmation of this estimate represents growth of 1.6% in Japanese GDP in 2000.

In the final quarter of 2000, industrial output expanded by 4.4% in relation to the same quarter of the preceding year. One should emphasize that, in October 2000, accumulated 12 month expansion came to its highest level of the year with 5.6%, reflecting a process of deceleration that began in November. In January, production increased by 4.9% over twelve months, mostly as a result of downward movement



Source: Ministry of Economy, Trade and Industry - Meti



Source: Statistics Bureau & Statistics Center

in external demand for transportation equipment, electric machines and machines in general.

Unemployment terminated 2000 at 4.75%, compared to 4.68% in the previous year. In December and January, the rate stabilized at 4.9%, following the upward trend noted since the month of August, raising the jobless rate to a level close to 5%, a figure considered critical by Japanese standards. This scenario takes on an even more critical guise when one recall that the business community is convinced that there are still too many jobs in the country.

Government outlays in 2000 dropped by 10% in relation to the total for the preceding year. Expectations for 2001 incorporated the rise in public sector outlays resulting from the October 2000 announcement of the government's plan to avoid a brusque reduction in public demand, so as to be able to sustain the pace of activity until such time as self-sustaining private sector demand is able to take up the slack.

The Consumer Price Index (CPI), which declined by 0.2% in 2000, has followed a deflationary trajectory since February 1999, when Banco Central implemented its zero interest policy. In January, monthly growth in consumer prices was nil, though the result did reflect positive growth of 0.1% when viewed against January of the preceding year. The Wholesale Price Index (WPI) increased by 1.1% in 2000, compared to negative growth of 1.5% in 1999. In the month of January, the WPI increased by 0.2%, closing with Annual growth of 1.2%. One should stress that the recent depreciation of that nation's currency has tended to exert pressure on prices.

The central bank reduced the annual basic interest rate from 0.25% to 0.15% on February 28, in order to avoid the return of a recessive scenario. One of the factors that led to the more flexible monetary policy stance was the situation of financial system debility that has been aggravated by the stock market exposure of banks, as the value of their

shares has plunged steadily downward. In 2000, the Nikkei stock index, which is the principal reference index for the Japanese stock market, declined by 27%, the worst performance of the decade.

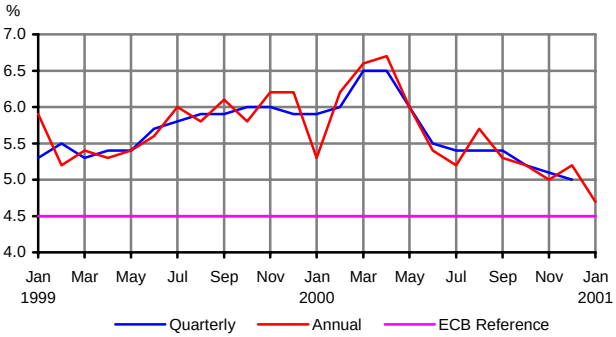
Expectations of continued economic doldrums coupled with political instability impacted the interest rate trajectory, which has been caught up in a process of steady devaluation since December of the previous year. On March 14, the yen was quoted at Y 121,1/US$, compared to Y 108/US$ and Y 112/US$ at the end of November and December 2000, respectively.

The deterioration of expectations is evinced by the business confidence index (Tankan) for the manufacturing sector in the final quarter of 2000. The result contrasted sharply with the upward trend that had been registered since the first quarter of 1999. The Tankan component, which evaluates the outlook for supply and demand conditions, declined from -18 to -21.

3.3 – Euro Zone

Expectations for the Euro Zone countries pointed to continued moderate growth, relative price stability and more balanced trade relations with the rest of the world.

M3 - quarterly and annual variation



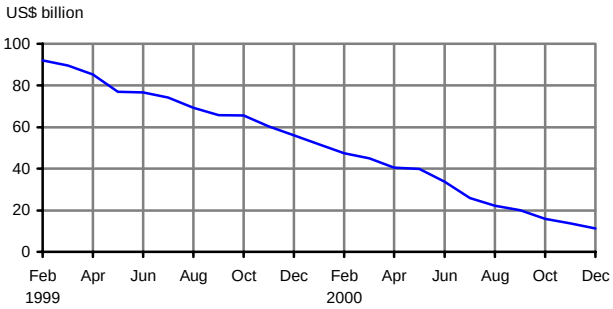
Source: ECB and Eurostat

From the point of view of internal demand, retail sales declined by 0.4% in October 2000 followed by increases of 0.3% in November and 0.1% in the month of December, reflecting annual growth rates of 0.8%, 1.2% and 1.7% for those months. Growth in M3 remained on a downward curve and closed January at 4.7% in annualized terms, compared to 5.2% in December 2000.

Insofar as trade operations are concerned, there has been a clear trend to lower monthly and accumulated 12 month surpluses, as reflected in data on trade between the Euro Zone countries and the rest of the world.

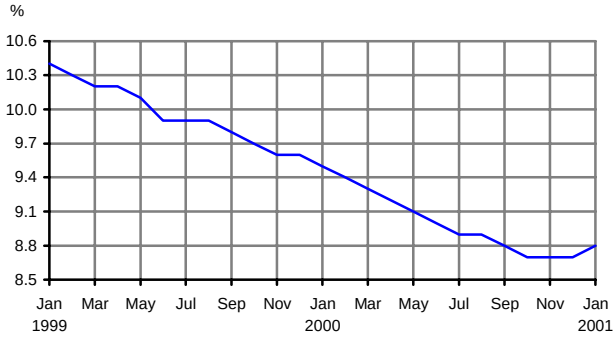
Industrial output, which had declined by 0.2% in October in monthly terms, increased by 1.2% in November and 2% in December,

Trade balance
Accumulated in 12 months



Source: Eurostat

Unemployment rate



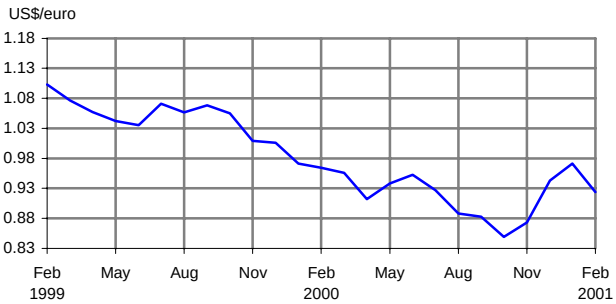
Source: Eurostat

remaining above the levels registered in the same period of the preceding year, by respective rates of 3.7%, 4.3% and 8%, respectively. These data would seem to suggest a reaction in the final two months of 2000. Estimates of GDP growth for 2001 were slightly lower than the 3% level attained in 2000.

The average rate of unemployment in 2000 came to 9%, compared to 10% in the previous year. In January, the rate came to 8.8%, after holding steady at 8.7% from October to December 2000. In the third quarter of 2000, the behavior of labor costs and productivity suggests possible inflationary pressures. In the period, the Unit Labor Cost increased by 1.2%, compared to 0.6% in the previous quarter. This performance was a result of a decline in the pace of productivity increases from 1.3% in the second quarter to 1.1%.

Though data for the fourth quarter are not yet available, this growth is clearly consistent with the concerns announced by the European Central Bank (ECB), when referring to second tier pressures on inflation generated by the labor market. In this context, the ECB has called attention to the adverse effects of possible demand for wage increases caused by higher prices for petroleum and imports in general, within a scenario of a devaluating currency. This was thought to be particularly significant in relation to the second quarter of 2000.

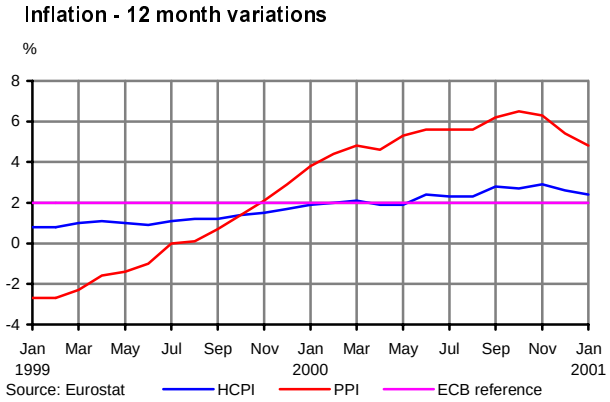
Dollar/euro exchange rate[1/]



Source: Bloomberg
1/ End of the month position.

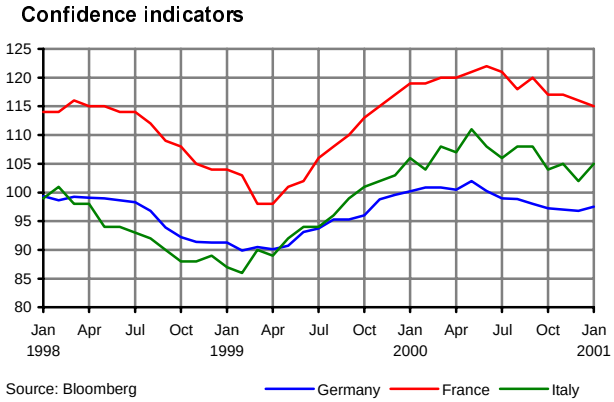
The dollar/euro exchange rate recovered as of December 2000, closing with a monthly average of 0.9018 US$/E in the month, compared to 0.8555 US$/E in November. In the first two months of 2001, the median rate of exchange increased to 0.9384 US$/E and 0.9211 US$/E, respectively, thus signaling relative stability at this new level. Exchange recovery was a consequence of the perception of deceleration in the American economy, while growth in the Euro Zone countries

has remained stable. At the same time, it is being increasingly perceived that the single currency economy has achieved a significant level of consolidation, clearly mirroring the tremendous effort made by the member countries in the two years since introduction of the euro.



With regard to inflation, 12 month growth in the Harmonized Consumer Price Index (HCPI) remained at a level of approximately 2.7% in the final quarter of 2000 and dropped to 2.4% in January 2001, reflecting pressures rooted in the combination of currency depreciation and higher petroleum prices. Though these variations are higher than the ceiling defined by the ECB, the institution declared that its objectives of medium term price stability can still be attained. The PPI expanded by 6.5% in the 12 month period up to October, 6.3% up to November and 5.4% up to December 2000, dropping to 4.8% in January of the current year.

The scenario of ongoing economic growth – albeit at a somewhat lesser pace – and increased exchange and price stability recommends continuation of the monetary policy profile, despite the fragility of the Japanese economy and the downward slide in the United States. Thus, the ECB stabilized the minimum refinancing rate at 4.75% per year; the deposit rate (minimum rate) at 3.75% per year and the punitive (punitive and compulsory) rate at 5.75% per year, since October 2000.



The major Euro Zone confidence indices registered similar performances in the fourth quarter of the year. The General Business Climate Index, calculated by the IFO Institute of Germany, the French Industrial Trends Survey, elaborated by INSEE of France, the Italian Business Confidence Indicator, calculated by ISAE, have registered downward movement since March 2000. However, in January 2001, the German and Italian indices moved upward to 97.5 and 105, while the French index dropped to 115.

3.4 – Emerging economies

3.4.1 – Asian economies

China

The Chinese economy expanded by 8% in 2000, sustained principally by trade operations. In the period, China received the largest volume of direct foreign investments of all the emerging economies (US$ 40.7 billion), or practically the same amount that entered the country in 1999. At the same time, foreign reserves climbed to US$ 166 billion.

Foreign sales totaled US$ 294 billion while imports came to US$ 225 billion in 2000, reflecting growth of 27.8% and 35.8%, respectively, when compared to the 1999 performance. In the month of January, the country was unable to maintain this pace of growth as exports rose by just 0.8%, in relation to the same month of the previous year, and imports expanded by 1.9%. This deceleration was not unexpected, since the 2000 trade performance was truly exceptional and will certainly not be matched in the current year, particularly as a result of China's admission to the World Trade Organization (WTO) and a generalized falloff in the pace of international economic activity.

Internal demand has been powered to a great extent by government spending, particularly in terms of investments in fixed assets by state companies. This expenditure heading accounted for more than 70% of total outlays in 2000.

Industrial output increased by 9.9% in January when compared to the same month of 2000. This figure excludes the seasonal impact of the celebration of the Lunar New Year and was accompanied by unemployment in the range of 3.1%.

The consumer price index registered monthly growth of 1.5% in December, 1.3% in November and 1.5% in the month of January, resulting in accumulated expansion of 0.4% in the year. One should stress that the more recent trajectory indicates a reversal in the deflationary process which had lasted for about 30 months.

The Chinese government defined an annual growth target of 7% for the next five years, making it clear that it expects the average growth rate of the previous five years (8.3%) to decline somewhat. With this, the government announced that it intends to invest in infrastructure projects and raise civil service wages and, in this way, provide a further boost to economic growth by stimulating internal demand. In this framework, the government expects a fiscal deficit of 2.9% of GDP, the same level as occurred in 2000.

South Korea

In early 2001, the signs of a downturn in the Korean economy became even more evident, particularly as of the final quarter of the previous year. This growth originated in a decline in aggregate internal and external demand. The increased sluggishness of the world and United States economies, coupled with a downward trend in the prices of electronic chips, has braked the growth process of Korean foreign sales. At the domestic level, the process of restructuring the financial sector has resulted in a drop in liquidity and the credit supply, further dampening the vitality of economic activity.

Wholesale and retail sales remained stable in January when compared to the same month of 1999. This performance confirmed the tendency toward deceleration when compared to previous months when the same series registered increases of 5% in October, 3.2% in November and 2.2% in the month of December.

In 2000, the trade surplus came to US$ 12.1 billion, for a decline of 49.3% in the year. Exports increased by 5.9% in January, in comparison to the previous month, while imports dropped by 4.8% when viewed in terms of data free of seasonal impacts. International reserve came to US$ 95.2 billion on February 15.

International Monetary Fund estimates point to GDP growth of 8.8% in 2000, despite an estimated decline of 3.6% in the fourth quarter of the year, when compared to the previous quarter. These figures are based on the statistical series purged of seasonal factors. Government expectations of product growth in 2001 came to 5.1%.

Utilizing data free of seasonal factors, industrial output turned in a monthly reduction of 2.7% in December, registering the fourth consecutive decline. In the final quarter of 2000, the drop came to 14.2% in comparison to the previous period. The deceleration of activity becomes evident when one analyzes the downward trend in twelve month industrial production from 11.4% in October to 4.7% in December. The rate of unemployment came to 4% in December, compared to 4.1% in November and 3.9% in October. It is estimated that the rate will close 2001 at approximately 4%.

In the twelve month period up to January, the consumer price index rose by 4.2%, compared to 3.2% up to the month of December. The economic slowdown tends to minimize inflationary pressures and facilitate compliance with the 3% target defined for 2001.

At the start of February, the Monetary Policy Committee of the Bank of Korea reduced the target for the basic rate of interest from 5.25% per year to 5% per year. The more flexible monetary policy was justified by growing concern with an ongoing decline in economic vitality, as demonstrated by the falloff in industrial output and exports.

The process of restructuring the financial and business sectors that began in the wake of the 1997/1998 crisis achieved considerable progress in 2000. The government raised the capital adequacy level of the banking sector above the 8% limit, which is the minimum recommended by the Bank for International Settlements (BIS). Aside from this, there was a cutback in the number of commercial banks and an increase in state participation in the sector. The nonbanking financial sector declined significantly, thus reducing the possibility of systemic risk. Progress was also registered in the areas of financial system supervision and regulation.

The government took steps to reduce the degree of business sector indebtedness by requiring sales of assets and subsidiaries, coupled with issues of rights. Such large groups as Daewoo and Hyundai were divided and the crossed guaranties of the thirty largest conglomerates (chaebols) and their subsidiaries were eliminated. However, the sector remains vulnerable, since it still holds a considerable volume of liabilities. This is a situation that will tend to worsen as the American economy slows.

The government took strong measures to stimulate the economy. The special loan system created for small and medium companies in 2000 with the objective of increasing the supply of liquidity was extended to business conglomerates in 2000, excluding the four largest in the country. These resources are transferred through the banking system at interest rates below the interbank market overnight rate. Measures were also announced with the objective of increasing government guaranties to business debt aimed at attenuating the shortage of credit caused by the restructuring process. It should be noted that the new policies introduced tend to produce favorable macroeconomic impacts over the short-term, but could accentuate moral risk, as a consequence of increased government participation in the credit market as the implicit guarantor and/or provider of subsidized resources.

3.4.2 – Turkey

In November, Turkey came face-to-face with a crisis of confidence provoked by a cutback in the financing lines provided by international banks to domestic banks that had been transferred to government control. There was an intense outflow of resources in the period, coming to a total of US$ 6.2 billion in two weeks, while interest rates increased to levels between 100% per year to 200% per year and, at a later date, to a level above 1000% per year. Approximately US$ 6 billion in international reserves were used to support the rate of exchange. As a result, reserves came to a total of US$ 24.4 billion on November 17. Pressures on the exchange market only lessened when the country announced a new agreement with the IMF, calling for the providing of US$ 7.5 billion in addition to the final installment of US$ 2.9 billion from the previous agreement.

With growing political difficulties, a new crisis of confidence exploded in the month of February, raising questions regarding the government's capacity to comply with internationally assumed commitments. The central bank's efforts to preserve the exchange system led to a rapid loss of US$ 7.6 billion in reserves. Efforts to recover these funds through a cutback in internal liquidity resulted in an increase in overnight interest rates on the interbank market to 6,200% per year and a state of veritable paralysis in the system of payments.

The measures adopted were unable to halt the process of capital flight, as international reserves declined by approximately US$ 4.5 billion up to February 22, when the government abandoned its efforts to defend exchange parity and allowed the Turkish lira to float freely. In the wake of this decision, the nation's currency underwent an immediate devaluation of 28%, generating fear of an upturn in inflation and a worsening of the banking crisis as a result of the sector's foreign currency debts totaling US$ 15 billion.

Following adoption of floating exchange, the Turkish stock market registered a high of 10%, following an accumulated drop of 29% in the three previous days. At the same time, overnight interest rates dropped to 1,400% per year. In early March, the value of the lira had depreciated by 25% in relation to the parity in effect prior to adoption of the floating exchange rate.

The effects of the alteration in exchange policy tend to generate added difficulties for the banking sector by raising the volume of liabilities in foreign currency, making it more difficult to comply with the inflation target. However, there is little possibility of this very unfavorable scenario generating impacts on the Brazilian economy due to the magnitude of the Turkish economy and the uncertainties that have marked its development in recent years.

3.4.3 – Latin America

Argentina

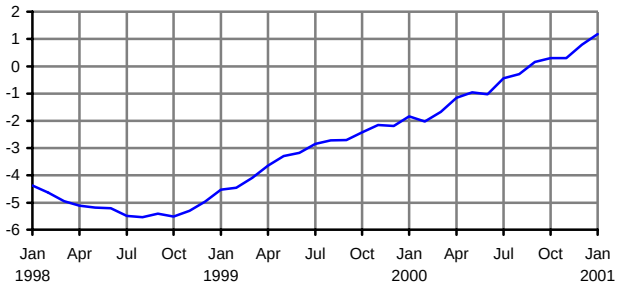
The Argentine economy has had a great deal of difficulty in regaining the process of economic growth. The major positive result achieved has been a trade balance surplus at a time of declining internal demand. The government's capacity to stimulate the activity level is limited by the fiscal targets defined in the agreement with the IMF and by the need for implementing structural reforms that effectively contribute to reorganization of the economy. In this scenario, the signing of a new agreement with the IMF in December 2000 had a highly positive impact on the perception of international investors and generated a process of cutbacks in internal and external financing costs, reductions in the spread

between assets denominated in local currency and those in foreign currency, while also provoking a sharp decline in earnings rates on internal market security placements to 1999 levels. As of the month of February, however, the scenario entered a new period of deterioration as a result of growing uncertainties with respect to the government's capacity to achieve the proposed reforms and stimulate a growth upturn. This process culminated with substitution of the nation's economic authorities.

In the third quarter of 2000, aggregate demand registered a decline of 0.3% in relation to the same period of the preceding year, as a result of 0.8% growth in exports of real goods and services and negative growth of 10.6% in gross fixed capital formation, 0.3% in private consumption and 1.2% in public consumption. In early 2001, consumption indicators followed the same downward trend as noted during all of 2000. Supermarket and shopping center sales turned in negative growth in comparison to the corresponding previous months. The Synthetic Indicator of Construction Activity (ISAC) also moved on a downward curve, registering a drop of 6.2% in January in relation to the same month of the previous year, expressed in terms of data purged of seasonal impacts.

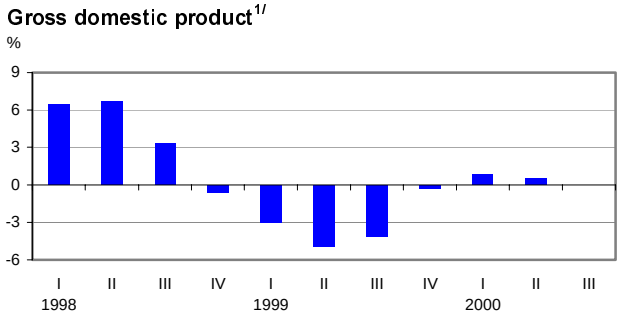
In the month of January, the public sector registered a negative fiscal result of US$ 984 million or 68% more than in the same period of the previous year. Revenues increased by 4.2% and spending expanded by 10.8% as a result of 57% growth in interest outlays and expansion of 6.4% in current transfers. The overall deficit, which includes the central bank and excludes privatizations, came to US$ 985 million. Here, one should note that the target agreed upon with the IMF in the financial assistance agreement signed in December was US$ 2.1 billion for the first quarter of 2001.

Trade balance
Accumulated in 12 months
US$ billion



Source: Ministry of Economy/Indec

The trade balance in 2000 registered a surplus of US$ 1.1 billion, for growth of 13% in exports, closing with a total of US$ 26.2 billion. Imports declined by 1% and added up to a total of US$ 25.1 billion in the period. Export growth is due to the joint effect of 9% price growth and 3% expansion in volume. One should note that 43% of the increase in foreign sales originated in expansion in the value of petroleum exports.

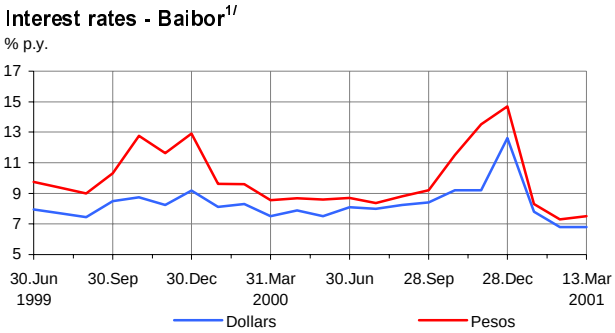


Source: Ministry of Economy/DNCC
1/ Change over the same quarter of previous year.

In the third quarter of 2000, GDP remained stable in relation to the same period of 1999, compared to growth of 0.5% and 0.8% in the first and second quarters of the year, when compared to the same periods of the previous year. Estimates for 2000 state that GDP will expand at a pace between 0% and -0.3%, while the target defined with the IMF predicted annual growth of 2.5% in 2001.

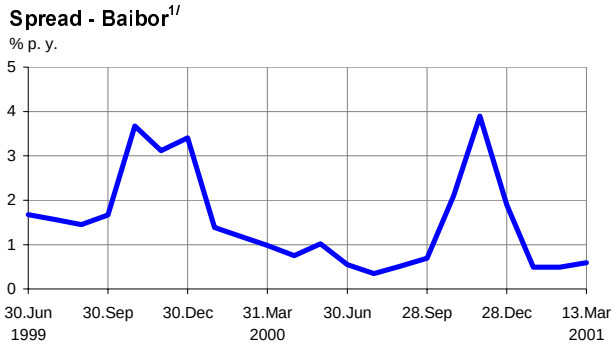
There are no signs of recovery in the pace of industrial output. The Monthly Industrial Estimator (EMI) in the month of January registered a decline of 6.4% in relation to December and 4.2% when compared to January of the previous year, when measured on the basis of data free of seasonal influences. This index had remained stable in average terms in 2000, when compared to 1999 performance.

Consumer prices measured by the National Institute of Statistics and Census (Indec) increased by 0.1% in January in relation to the previous month, thus maintaining the downward trajectory in accumulated twelve month terms, with a reduction of 2.9%. The wholesale price index turned in growth of 0.12% and 1.4% on the same bases of comparison.



Source: Ministry of Economy/BCRA
1/ 30-day interbank market offered rates.

The December financial assistance agreement with the IMF and the reduction of basic interest rates in the United States in early January created a favorable climate for a decline in Argentine interest rates. Thus, the Baibor interest rate for 30 day operations, which had climbed to 8.3% per year at the end of January and 7.3% per year in February, remained stable over the course of the month of March. In much the same way, the differential between lending rates in local currency and in foreign currency dropped sharply and closed in the range of 0.5% per year in January and February, after moving as high as 3.9% per year in November 2000. Funding rates on the local market followed the same trend, with four placements of Treasury Bills (Letes) on January 9 and 22 and February 6 and 20, reaching annual rate levels of 8.47%, 6.75%, 6.71% and 6.86%. These figures were sharply less than the 12.18% per year rate registered in the final issue in 2000. The Buenos Aires Stock Exchange revealed the



Source: Ministry of Economy/BCRA
1/ 30-day interbank market offered rates.

volatility of financial market expectations, registering gains of 28% in January, the best result since April 1999, and reversing the 19% loss registered in the month of February.

In early March, the Minister of the Economy resigned and the nation's principal economic authorities were replaced. Analysis of financial market reactions indicates that there was little expectation of significant alterations in the major Argentine economic policy parameters, including the system of convertibility. The challenge is that of recovering the process of economic growth combined with the fiscal austerity program needed to comply with the targets defined in the international financial assistance program.

A possible economic crisis in Argentina tends to generate repercussions on the Brazilian economy, basically following two vectors. The first – international trade – is expected to produce limited impacts, since Argentina absorbs less than 15% of Brazilian foreign sales. The second vector – financial operations - tends to produce impacts on funding flows to the country since it does have potential for worsening the perceptions and the traditional aversion that international creditors and investors have in relation to the emerging economies. However, one should note that the negative impact tends to be temporary, given that the Brazilian economy has been evaluated separately from the emerging economies in general and has been able to garner considerable credibility as a result of the consistently positive performance of its economic fundamentals.

Mexico

In 2000, the Mexican economy was strongly impacted by growth in the United States, particularly in the earlier quarters of the year, by higher oil prices and by more favorable conditions for contracting funding on international capital markets. The result was an overall performance that was considerably better than had been expected at the start of the year.

At market prices, GDP growth came to 6.9%, compared to 3.8% in the previous year. It is important to note that growth in the first three quarters of the year, which came to respective rates of 7.7%, 7.6% and 7.3%, when viewed against the corresponding periods of 1999, was followed by more moderate 5.1% expansion in the final quarter of the year. This performance is fully consistent with the deceleration of the American economy in the period.

Compared to the same period of the previous year, industrial output registered strong deceleration in the fourth quarter of the year, moving from an increase of 7.1% in October to a reduction of 0.5% in December. This decline is ascribed to the behavior of the manufacturing and construction industries. In the opposite sense, exports by American companies that have relocated just across the border turned in significant growth in the final quarter of the year.

In 2000, growth in the consumer price index came to 8.9%, compared to 12.3% in 1999, resulting in compliance with the inflation target for the second consecutive year. Accumulated growth in the producer price index in the year – excluding crude oil for export – registered a slight decline, closing at 7.38% in 2000, compared to 8.66% in the previous year.

The 2000 trade balance registered a deficit of US$ 8.1 billion, which was 44.2% higher than in the preceding year. Exports increased by 22% to US$ 166.4 billion, while imports increased by 22.9% to US$ 174.5 billion. One should emphasize that foreign sales of petroleum grew by 65% and accounted for 9.8% of the country's total exports, closing at US$ 16.4 billion.

Market interest rates varied between 12.5% per year and 18.5% per year over the course of 2000 and were one of the questions taken into account in the central bank's efforts to restrict the money supply on six separate occasions with the aim of ensuring compliance with the 10% inflation target for 2000 and preparing the way to achieve the 2001 target of 6.5%. Thus, nominal interest rates closed 2000 slightly higher than at the start of the year (18% per year). However, the decline in the inflation trajectory provoked a sharp rise in real interest rates from 7% per year in January to 10.5% per year in the month of December.

Chile

Reflecting dynamic external demand for Chilean products, the nation's economy recovered from the downturn that had marked the previous year, when GDP dropped by 1.1%. Thus, following growth of 5.4%, 6.1% and 5.8% in the first three quarters of the year, and 4.3% expansion in the final quarter, Chile's central bank estimated the year's GDP growth at 5.4%.

The Monthly Indicator of Economic Activity (Imacec) registered average growth of 5.4% in 2000, compared to a 1.2% decline in the preceding year. These figures are based on the series from which the central bank has purged seasonal influences. Using the same basis of comparison, the national output index which is calculated by the National Institute of Statistics (INE) expanded by an average of 4.2% in contrast to a 1.3% drop in 1999. One should stress that growth in industrial output in 12 months followed a downward trajectory, reaching a level of 3.4% in the month of January compared to 5.9% growth in October 2000.

With respect to the foreign sector, the trade surplus came to US$ 1.4 billion, which was 14.3% less than in 1999, despite the pressure of external demand on the growth of the economy. Foreign sales came to US$ 18.2 billion, for growth of 16.3%, and reflected expansion rates of 6.2% and 9.5% in volume and prices, respectively. Growth of 19.6% in imports, which came to US$ 16.7 billion, reflects the rise in oil prices as well as reactivation of the economy.

The wholesale price index declined in 2000, registering growth of 7.9% compared to 13.5% in 1999. In twelve month terms up to February 2001, wholesale prices accumulated growth of 8.1%. The consumer price index came to 4.5% in 2000, compared to 2.3% in the previous year. This result was achieved in the midst of accelerating inflation and reflected upward movement in fuel prices during the year and exchange devaluation in the fourth quarter. In the month of February, consumer prices accumulated an increase of 3.8% in 12 months, compared to 4.7% in January.

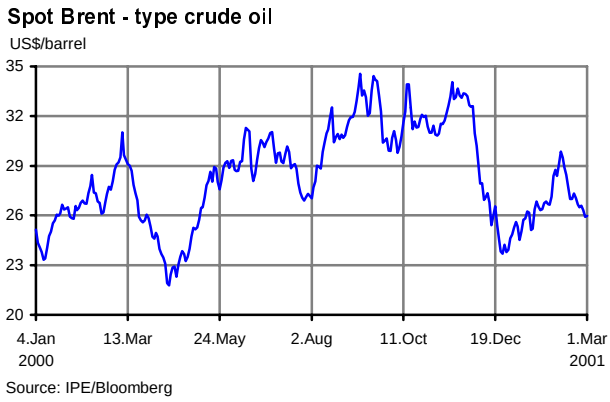
Monetary policy moved into an expansionary curve as of the second half of the year, thus reversing the credit squeeze that had marked the

previous period. In the month of August, the central bank reduced the basic interest rate by 50 basis points to a level 5 percentage points above the expansion of the Unit of Development. From that point forward interest rates remained stable to the close of the year. In the month of January, there was an additional reduction of 0.25 basis points, justified by evidence of dissipation of inflationary pressures.

3.5 – Petroleum

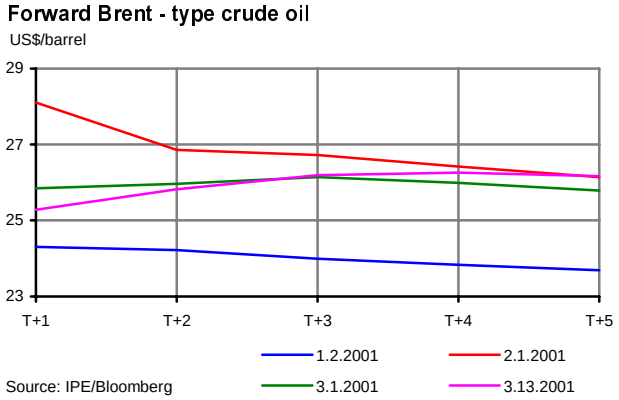
Following sharp increases in international petroleum prices in 1999, when the price of Brent-type crude moved from US$ 10.91/barrel to US$ 25.56/barrel, spot operations were highly volatile during the course of 2000 and this behavior was repeated in the early months of the current year. Thus, prices moved upward through to the second half of February, reaching a level of US$ 29.85/barrel on the 9th, for an increase of 24.8%. Following that, prices declined by 17.2%, hitting a level of US$ 25.62/barrel on March 7.

This type of price behavior was strongly impacted by expectations based on reports concerning stocks of petroleum and derivatives coupled with demand projections, since the Organization of Petroleum Exporter Countries (OPEC) came to a decision in 1998 to define the level of production in such a way as to maintain international prices per barrel within the lower and upper limits of US$ 22 and US$ 28. In this scenario, forecasts of less severe winters, cooler summers, declines in activity levels and so forth tend to impact the expectations of agents who then seek to anticipate the decisions taken by the members of OPEC, which accounts for about one third of world output.



According to the International Energy Agency, projections of global demand for petroleum this year have been dropping steadily. Expectations of expanded demand in 2002 were cut by 140 thousand barrels/day in February and 110 thousand barrels/day in March and currently stand at 1.41 million barrels/day. This decline has been partially attributed to higher prices and to a general slowdown in the world economy, particularly in the United States.

The outlook for lesser demand has not yet impacted price levels but has tended to encourage OPEC members to impose a new cutback in production at their March 16 meeting. Expectations point to a cutback between 500 thousand and one million barrels per day, based on the level of 25.2 million barrels/day defined at the January 17 meeting of the organization. However, one should underscore the fact that the 1.5 million barrel/day reduction called for at the January meeting did not occur in February, since output of the OPEC member countries in that month dropped by 1.02 million barrels per day. This calculation does not include Iraq, which expanded output by 320 thousand barrels/day. Thus, world production in February came to 77.25 million barrels/day.



In the futures market, per barrel prices for June increased over the course of the year. On January 2, the price for delivery in June came to US$ 23.69, increasing to US$ 26.42/barrel on February 1 and US$ 26.67/barrel in average terms up to March 13. On the latter date, the per barrel price came to US$ 26.26 and US$ 26.17 for July and August, respectively.

3.6 – Conclusion

The outlook for the world economy is one of a generalized slowdown as a result of the deceleration process in the United States and the debility of the Japanese economy. The only true exception is Europe which has managed to achieve a process of self-sustained growth. One should note that one of the major factors underlying the decline in the activity level has been the persistent volatility of oil prices.

As a result, Japan has had to cope with even more severe obstacles to an economic upturn, as the net value of its exports has moved downward, at the same time in which the country faces serious uncertainties regarding the solidity of its financial system.

In the case of the emerging economies, despite the recovery that many have achieved following the 1997 and 1998 crises, these countries are also being negatively impacted by the loss of vitality in world trade and

possible increases in foreign investors' traditional aversion to risk, coupled with a higher level of international uncertainties.

In this context, one should note that the turbulence that has marked the Turkish and Argentine economies has basically been a result of specific problems. Current expectations are that the governments of these nations will adopt more severe measures in the short-term, in such a way that the adverse impacts on the Brazilian economy should be short-lived. Aside from this, United States monetary policy has shifted into an expansionary mode following the sudden slowdown of that nation's economy in recent months. There is no doubt that this decision will have a highly beneficial impact on the performance of the world economy before the current year is out.

4 – Prices

Inflation in 2000 reflected, on the one hand, accentuated rises in government managed prices and, on the other, a favorable performance on the part of food prices, particularly in the first half of the year. Notwithstanding seasonal pressures generated by in natura foodstuffs, increased outlays on education and upward movement in gasoline prices, consumer price indices turned in record lows for the first half of the year. At the start of the second half, price indices shot upward as a result of the off-season harvest period and strong growth in fuel prices, though the latter was fully absorbed by the end of the third quarter.

Inflation increased once again in the final month of 2000 mostly as a consequence of pressures brought to bear by increases in government managed prices, particularly fuel prices. Despite the December surge, annual growth in these indices was below what had been expected by the market, partly as a consequence of continued downward movement under food prices in the retail sector.

In the first two months of 2001, price indices were impacted most heavily by a number of seasonal factors - off-season harvest period and increased outlays on school enrollments and monthly school tuition payments - as well as adjustments in the prices of public transportation at the level of municipal governments.

4.1 – General indices

The Getulio Vargas Foundation's general indices, which had followed a steadily downward curve in the second half of 2000, were significantly impacted by a series of prices increases at the end of the year, particularly

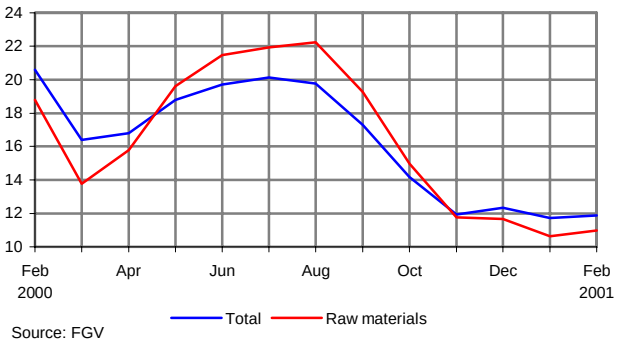
General indices

% monthly growth

Itemization	2000			2001	
	Oct	Nov	Dec	Jan	Feb
IGP-10	0.5	0.4	0.5	0.6	0.4
IPA	0.8	0.5	0.5	0.8	0.3
IPC	0.0	0.0	0.6	0.4	0.6
INCC	0.2	0.3	0.4	0.3	0.6
IGP-M	0.4	0.3	0.6	0.6	0.2
IPA	0.6	0.4	0.7	0.7	0.1
IPC	0.0	0.1	0.6	0.6	0.4
INCC	0.3	0.3	0.5	0.4	0.6
IGP-DI	0.4	0.4	0.8	0.5	0.3
IPA	0.6	0.4	0.8	0.4	0.3
IPC	0.0	0.4	0.6	0.6	0.4
INCC	0.3	0.4	0.6	0.6	0.3

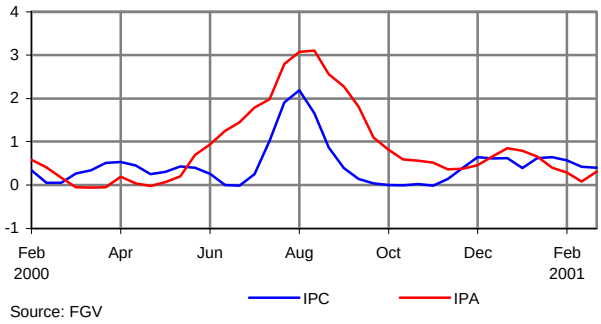
Source: FGV

IPA-DI: production goods
% growth in 12 months



Source: FGV

Sequential price indices
% monthly growth



Source: FGV

in the case of petroleum derivatives, an item of considerable weight in these indices. In this context, the General Price Index - Internal Supply (IGP-DI) increased by 0.78% in the month, as against 0.4% in November, while the prices of industrial products at the wholesale level, which account for 43.6% of the general index, moved up by 1.15%. In the case of consumer prices, one should note the pressures generated by spending on education and transportation due mostly to higher outlays on urban bus tickets in Rio de Janeiro. The IGP-DI accumulated 2000 growth of 9.81% or slightly less than the level projected by the market in November (10%) and significantly less than the corresponding 1999 rate of 19.98%.

At the start of the year, IGP-DI growth rates moved downward once again and closed January and February at respective levels of 0.57% and 0.34%, mostly as a result of slower growth in the wholesale prices of industrial goods and the favorable seasonal period for such relevant farm products as soybeans, meat and corn. Despite this downward movement, significant pressures were exerted, particularly under consumer prices, by increases in urban bus fare prices in the major state capitals, which were sufficient to be noted by FGV indices, and by outlays on education particularly as a consequence of enrollments at the start of the year. The Consumer Price Index - Brazil (IPC-Br) turned in growth of 0.62% in January and 0.4% in February.

4.2 – Consumer price indices

Government managed prices were responsible for the major share of December growth in consumer price indices, most as a result of increases under fuels and public transportation. At the start of the year, aside from upward movement provoked by the off-season harvest

Methodological alteration in the Getulio Vargas Foundation's general indices

As of January 2001, the Getulio Vargas Foundation introduced alterations into the calculation of its general price indices. The methodological changes incorporated into the three components of the indices - the Wholesale Price Index (IPA), Consumer Price Index (IPC) and National Cost of Construction Index (INCC) - mostly involved aspects related to geographic scope, composition and weight structure of the various items.

The IPA sampling was reduced from 477 to 462 products. The weighting structure, which had been based on the 1985 Economic Census, shifted to data generated by the 1996 Farm Census and 1999 Gross Domestic Product, as published by the IBGE. In the case of prices, the number of companies that provide information on industrial products was increased from 1651 to 1764.

Aside from Rio de Janeiro and São Paulo, another ten state capitals - Belém, Belo Horizonte, Brasília, Curitiba, Florianópolis, Fortaleza, Goiânia, Porto Alegre, Recife and Salvador - were incorporated into the sampling, making the index significantly more representative in national terms. The new structure of goods and services used by the index involves 425 subitems, drawn from the Family Budget Survey (POF) for 1999-2000. The previous POF covered the 1997-1998 period and was based on 361 subitems. In the segment of Goods and Special Services, the costs of such items as domestic employees and residential condominiums, which had previously been evaluated on the basis of increases in the minimum wage in the major cities covered by the survey, now are evaluated, in the case of residential employees, on the basis of information gathered at the level of employment agencies and local residences and, in the case of condominiums, on that of data regarding payments of wages and social charges, maintenance and repair costs, water and sewage services, electrical energy, operating material, cleaning material and administrative fees.

The scope of the monthly INCC price survey was reduced from 20 to 12 metropolitan regions. In terms of cost composition, the number of items selected was increased from 701 to 723, with 659 related to building materials and 64 to labor. With respect to price surveys carried out directly with wholesalers, large retail outlets and construction companies, the listing of informants increased from 1,150 to 1,607, reaching a total of 14,628 responses.

Among the implications of these alterations, one should note that the general indices have become less sensitive to seasonal factors. The new weighting structure is important since it reduces the

Price Indices (IPA and IPC) and seasonality

Items	Weight		
	Dec 2000	Jan 2001	Difference
IPA			
Legumes and fruits	2.6	1.7	-0.9
Grains	6	3.5	-2.5
Oil-bearing crops	0.1	0.1	-0.1
Roots and tubers	1.1	0.7	-0.3
Animal products	12.7	14.6	1.9
Meat and fish	1.3	1.2	-0.1
Milk and dairy products	0.8	0.7	-0.1
IPC			
Rice and bean	0.8	1	0.2
Vegetables and legumes	2.2	2	-0.2
Fruits	2	1.8	-0.2
Apparel	3.3	3.2	-0.1
Education	4.6	5.6	1
Total	37.7	36.2	-1.5

Source: FGV

IPA and exchange rate

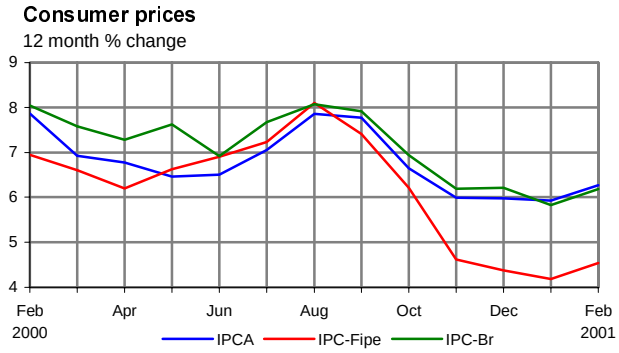
Items	Weight		
	Dec 2000	Jan 2001	Difference
Agricultural products			
Grains	6	3.5	-2.5
Oil-bearing crops	0.1	0.1	0
Export crops	2.4	3.3	0.9
Industrial products			
Metallurgy	7.9	7.9	-0.1
Mechanics	5.3	6.3	1
Electric material	4.1	3.2	-0.8
Motor vehicles	2.4	1.9	-0.5
Paper and cardboard	1.9	3.4	1.5
Chemical	18.3	17.7	-0.7
Total	48.5	47.2	-1.3

Source: FGV

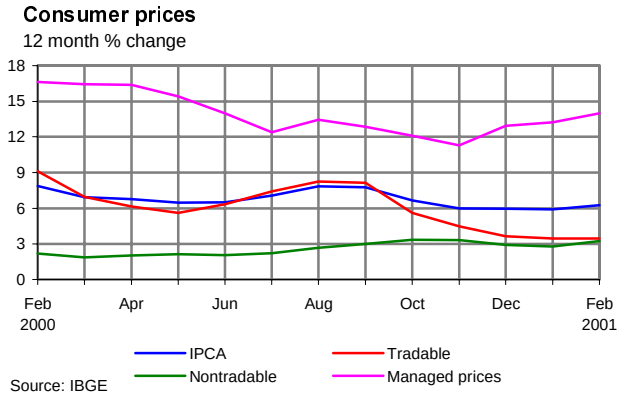
importance of headings that are clearly impacted by the seasons of the year, both at the wholesale and retail levels. The following chart indicates the major products that have strongly seasonal characteristics together with their respective weights in December 2000 and January 2001, when the new system was introduced.

With regard to the influence of exchange rates on the index, the methodological alterations have not produced any significant changes. The following table indicates the items that are most sensitive to exchange variations and their respective weights in the two weighting structures. The selection criterion used was that of the values of the coefficients of the correlation between the series of components of the IPA-DI and exchange rate variations.

One should note that the participation of IPA items with prices that are impacted by exchange rate variations was cut back by just 1.3 percentage point out of a total of 48.5%. The difference between the two structures does not allow one to conclude that the index has become less sensitive to exchange rate changes. Proof of this is obtained by recalculating the IPA for the first half of 1999, when the process of exchange devaluation was strongest. With the new weighting structure, the final result would have been only slightly higher than effectively calculated at the time (12.36%, as against 11.97%). Therefore, this result is just the opposite of what is suggested by the weight decline indicated in the chart above.



Source: IBGE, Fipe and FGV



Source: IBGE

Consumer prices

% growth

Itemization	2000			2001	
	Oct	Nov	Dec	Jan	Feb
Monthly					
IPCA	0.1	0.3	0.6	0.6	0.5
IPC-Fipe	0.0	-0.1	0.3	0.4	0.1
IPC-Br	0.0	0.4	0.6	0.6	0.4
Accumulated in the year (annualized)					
IPCA	6.1	5.9	6.0	7.1	6.4
IPC-Fipe	5.0	4.5	4.4	4.7	3.0
IPC-Br	6.2	6.1	6.2	8.0	6.4
12 months					
IPCA	6.7	6.0	6.0	5.9	6.3
IPC-Fipe	6.2	4.6	4.4	4.2	4.5
IPC-Br	7.0	6.2	6.2	5.8	6.2

Source: IBGE, Fipe and FGV

period under some of the most important grain products, coupled with increases in spending on education, the prices of fruit and vegetable products also increased as a consequence of the strong rains that fell in the period.

Broad National Consumer Price Index (IPCA)

In the month of December, the contribution of government managed prices to the IPCA came to 0.6%, or more than the change in the index itself (0.59%) or, in other words, all of the other component items of the IPCA taken together made a negative contribution to formation of the result. In 2000, the IPCA accumulated growth of 5.97%, which was less than the level registered by the market in the month of November (6.07%) and below that defined by the system of inflation targeting for the year.

In early 2001, the performance of the index was influenced principally by seasonal factors, with growth of 0.57% in January and 0.46% in February. In the first month of the year, one should note increases in the prices of rice and beans (5.88% and 8.35%, respectively) as well as for in natura foodstuffs (2.81%). Other factors that contributed to the result were increases in electricity rates and urban bus fares, which accounted for 0.15 percentage point. Aside from these items, outlays on education increased by 1.41%, compared to 0.21% in December. The impact of increases in the costs of school material and tuitions extended into the February result, when the heading of education registered a high of 2.88%. Other items that registered important impacts in the month were increases in the prices of medicines (1.77%) and public transportation (1.64%).

Calculation methodology of the cost of the subitem "domestic employees" in the IPCA

On February 19, 2001, the IBGE announced that the calculation methodology applied to the subitem "domestic employees", an element included in both the INPC and IPCA, would be altered as of April 2001.

Until now, the calculation has been based on annual increases in the minimum wage, fully appropriated in the month in which the increase occurs. However, studies submitted to the Consultative Council of the National System of Consumer Price Indices (SNIPC) indicated that, in the last three years, increases in the earnings of domestic employees has been less than growth in the minimum wage. In order to reduce this discrepancy, as of April 2001 IBGE will perform this calculation on the basis of information gathered in the Monthly Employment Survey (PME), which investigates the earnings effectively received by those employed in the rendering of domestic services.

Each month's change under this subitem of consumer price indices will aggregate the rates noted in the metropolitan regions encompassed by the PME: Recife, Salvador, Belo Horizonte, Rio de Janeiro, São Paulo and Porto Alegre. The accumulated result for each year, including 2001, will fully reflect the twelve month growth figures perceived by the PME. In this sense, IBGE will apply statistical treatment suited to resolving such questions as, for instance, incorporation of growth in the first quarter of 2001 into the calculation for the year, and growth in earnings in December, a month that involves a strong seasonal component.

Based on monthly information on the nominal average earnings of domestic employees in the 1996-1999 period, broken down by metropolitan region, Depec estimated the impact of the announced methodological change. This information includes earnings received by those who are paid monthly, daily and even those who are classified as self-employed.

Were this methodological alteration not to be adopted in April 2001, the IPCA result would be pressured by an impact of 0.62 percentage point as a consequence of multiplication of the minimum wage adjustment of 19.21% by the weight of the subitem of domestic employees in the IPCA (3.25%).

The following table itemizes annual changes in the value of the minimum wage and the nominal earnings of domestic employees. For December of each year, changes free of seasonal factors were considered. Based on this information, three hypotheses were generated.

Probable transfer to IPCA of minimum wage adjustment in 2001

%

Annual variations	1997	1998	1999	2000	2001	Average 1997-1999	Proportion of transfer	Transfer[2/] (variation)	Effect on IPCA[3/]
Minimum wage	7.14	8.33	4.62	11.03	19.21	6.70	...	...	...
PME (domestic employee)	6.78	5.92	2.58	...	...	5.10	...	...	...
Transfer hypothesis									
average 1997-1999[1/]	...	...	...	...	...	...	0.76	14.62	0.48
equal to 1999	...	...	...	...	...	...	0.56	10.76	0.35
downward trend	...	...	...	...	...	...	0.45	8.64	0.28

1/ Average of PME annual variations divided by the average of minimum wage increase.
2/ Result of the multiplication of the proportion of transfer by the 19,21% increase of the minimum wage.
3/ Result of the variation considered for the item domestic employee weighted by its share in the index (3,255%).

In the first, the transfer proportion of 76% resulted from the ratio between the average minimum wage in the 1997-1999 period and average earnings of domestic employees. With this, there is an impact of 0.48 percentage point on the IPCA, which is taken as the upper limit of the interval. One should observe that this impact is less than the 0.62 percentage point that would have occurred if the methodological change had not been adopted.

The second hypothesis is based on the assumption that 56% of the minimum wage adjustment will be transferred. This figure is equivalent to the ratio between growth in the minimum wage and earnings of the category of domestic employees over the course of 1999. One should stress here that the proportion between these two variables has been low for quite some time, a fact that, to some extent, is explained by the enhanced stability of the economy. Aside from this, the increase granted in 2001 is much higher than those of recent years. Consequently, it is licit to assume a lesser proportion of transfer.

Finally, assuming that the downward trend in the ratio between increases in the minimum wage and average nominal earnings of domestic employees will be maintained, one comes to the hypothesis that this ratio stands at about 45% and its impact on the IPCA at 0.28 percentage point.

The National Consumer Price Index (INPC), which is also calculated by IBGE, accumulated 5.27% growth in 2000. This indicator is quite different from the IPCA, principally in the aspect of the target public, which corresponds to families with monthly income between 1 and 8

times the minimum monthly wage. In January and February 2001, this indicator registered inflation of 0.77% and 0.49%, respectively.

Consumer Price Index - Fipe (IPC-Fipe)

The Consumer Price Index calculated by the Institute of Economic Research Foundation (Fipe) registered declining rates of growth as of September and deflation in November. Following the example of other consumer price indicators, the index turned upward as of December, mostly as a consequence of upward movement in the prices of petroleum derivatives, especially gasoline. In this context, the increase in the prices of this product as registered on November 23 contributed 0.20 percentage point to the index of 0.26% for the month and, therefore, was the most important item among all those surveyed. The increase in the index continued in January 2001, as a result of growth in spending on schooling and seasonal increases in food prices as a result of rains and higher temperatures. Despite having climbed to 0.38%, the January result was the second lowest for this month in the post-Real Plan period. In February, once the aforementioned factors had been dissipated and the clothing clearance sales so typical of the start of the year had begun, the index dropped back to 0.11%.

4.3 – Government managed prices

In 2000, those goods and services for which prices are either directly or indirectly defined by federal, state or municipal governments accounted for about 58% of the growth in the IPCA, a level equivalent to 3.46 percentage points of the increase of 5.97% registered by the index in the year. The largest sources of pressure were concentrated under fuel prices, urban bus transportation and fixed telephone services, while growth in the prices of gasoline and hydrated alcohol accounted for approximately 40% of the growth in the prices of these items. One should further note that increases in electricity rates, as measured by the IPCA, turned in an average increase of 12.66%, corresponding to about 11.7% of the contribution of the entire grouping of government managed prices.

In the first two months of 2001, significant increases occurred under urban bus fares, with increases in six of the eleven regions covered by the IPCA. These increases ranged from 7.06% in Porto Alegre to 25% in Goiânia. Aside from this, the rates charged for water and sewage services were increased in six regions, varying from 5.24% in Salvador to 13.49% in Rio de Janeiro. Furthermore, increases in electricity rates in four regions, ranging from 0.36% in Goiânia to 11.98% in Belém, should also be added to these factors. In the latter city, there was also a sharp increase in the ICMS rate on electricity, cooking gas, alcohol, gasoline and fixed telephone services, which, taken together, generated the largest increases in the regional IPCA in both January and February, with respective rates of 2.57% and 2.1%.

The increases granted in the two month period contributed with 0.37 percentage point in the accumulated 1.03% IPCA rate in the period. Here, one should note that government managed prices of goods and services contributed 0.1 percentage point to the rate of 0.75% inflation in the first two months of 2000.

IPCA simulation of electric energy price increases in 2001

Region	Weight of the city in the IPCA	Weight of electric energy in the city	Forecast increase of electric energy prices	Effect on the IPCA
São Paulo	36.3	3.1	12.0	0.14
Rio de Janeiro	13.4	5.5	14.0	0.10
Belo Horizonte	9.2	3.3	15.2	0.05
Belém	3.9	4.3	21.3	0.04
Goiânia	3.8	3.6	9.6	0.01
Brasília	3.1	2.3	12.5	0.01
Porto Alegre	9.2	2.9	11.2	0.03
Curitiba	7.5	2.6	13.9	0.03
Salvador	6.2	2.7	10.0	0.02
Fortaleza	3.3	2.9	9.9	0.01
Recife	4.3	2.6	14.9	0.02
Brazil	100.0	3.4	13.0	0.44

Source: IBGE

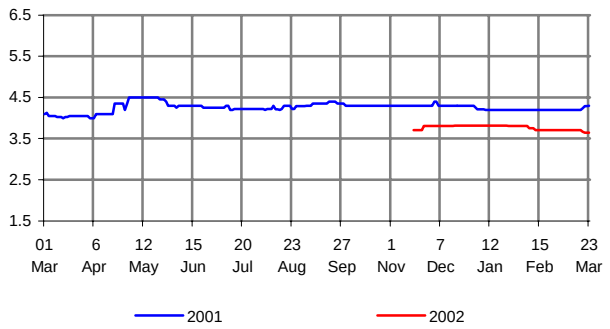
The Secretariat of Economic Monitoring of the Ministry of Finance has performed studies with the objective of estimating the impact on IPCA of the increases in electricity distribution rates to be granted over the course of 2001, in order to identify the levels of these increases and probable impacts on a region-by-region basis.

Rate increases varied between 7.2% and 13.4% and, if confirmed, will provoke an impact of 0.4046 percentage point on the IPCA. One should note that these increases will not be granted simultaneously, as occurred in the case of fixed telephone rates.

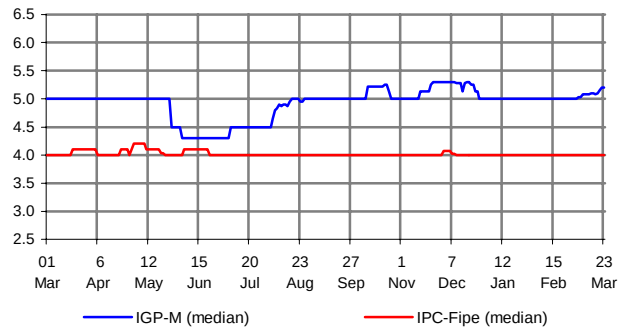
4.4 – Market expectations

The Institutional Communications Group (GCI) of Banco Central do Brasil carries out a daily survey based on an average sampling of about 100 consulting and financial institutions. The purpose of this effort is to

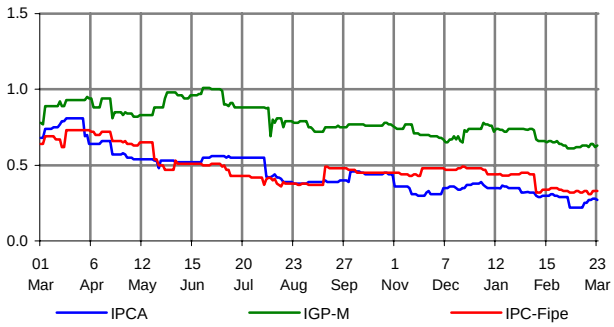
Daily evolution of market's inflation expectations (IPCA)



Daily evolution of market's inflation expectations for the year 2001



Standard deviation of inflation forecasts for 2001



detect expectations with regard to the major economic variables. As far as inflation measured by the IPCA is concerned, the March 20 survey indicates expectations of 4.24% for 2001, reflecting downward movement since early in the month of January when the median level came to 4.3%. In the same context, expectations for 2002 as a whole dropped from 3.8% in mid-January to 3.66%.

With respect to growth in the IGP-M, expectations for 2001 point to a slight rise over the last three months. Thus, the rate predicted by the market moved to 5.03% at the end of the first week of March and 5.1% in the beggining of the last ten day period of the same month, compared to 5% in early January. In the case of the IPC-Fipe, expectations for 2001 and 2002 remained at 4% and 3.5%, respectively.

Declining standard deviations for 2001 indicate that expectations have converged in the quarter. At the start of January of this year, the average IPCA registered a deviation of 0.38%, with 0.48% for the IPC-Fipe and 0.74% for the IGP-M. These values declined to 0.27%, 0.31% and 0.64% on March 20, respectively.

4.5 – Conclusion

Inflation rates were higher than expected in early 2001, as a consequence of the off-season harvest period, particularly in the cases of rice and beans, and increased outlays on education. The nature of these impacts is such that they had practically run their course by February, together with the impact of government managed price increases granted in the first two months of the year.

Thus, despite being relatively high, inflation for January and February did not result from across-the-board increases in the various economic sectors. However, one should stress that some products that are normally

impacted quite strongly by the off-season period, such as beef and milk, registered growth in 2000 that was well below the normal level. The reason for this is thought to be the fact that the rainy season began earlier than usual. Consequently, in the first half of the current year, when the supply of these products has been normalized, their contribution to reducing inflation may well be less than that of previous years.

Furthermore, inflation for the month of June should reflect the impact of contractually specified increases in fixed telephone services. Over the course of the second quarter and, principally, the third quarter, electricity rates are expected to rise in all of the state capitals. In the specific case of the municipality of São Paulo, one can also expect increases in urban bus fares, which have remained stable for a full two years.

Consequently, the management of the monetary policy shall consider such conditioning factors as the prospects for managed price growth and exchange rate performance.

5 – Prospects for inflation

This chapter of the *Inflation Report* presents the Monetary Policy Committee (Copom) assessment of Brazilian economic performance since the December *Report,* together with its prospects for inflation up to 2002. The projections are based on the assumption that the basic interest rate will remain unchanged during the period under analysis at 15.75% per year, rate set by Copom in its March 20th and 21st meeting. It is important to note that this is a strictly technical procedure. Hence, this hypothesis should not be taken as a forecast of future interest rate outcomes.

The inflation and output growth forecast presented in this *Report* are not meant to be restricted to point estimates. They are projected within probability intervals, reflecting the degree of uncertainty when setting the basic interest rate. Inflation forecasts are based not only on a fixed nominal interest rate, but also on the baseline scenario, which summarizes the future behavior of key economic variables and their associated risks. The forecasts are presented in this *Report* in order to enhance monetary policy transparency.

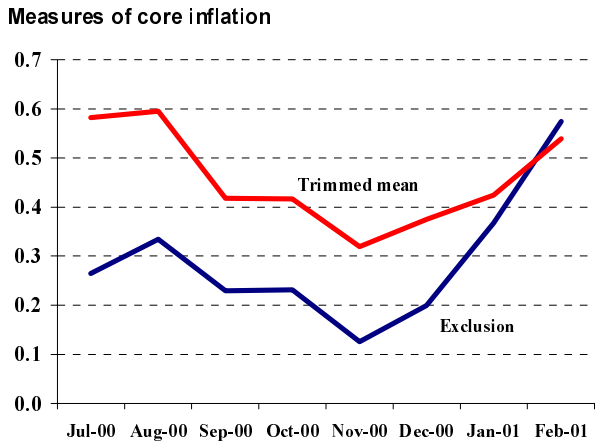
5.1 – Determinants of inflation

Aggregate demand and aggregate supply

The inflation rate has remained above expectations in the beginning of the year. IPCA accumulated a 1.03% variation in the last two months, due to pressures in two groups: Public Transportation, whose 1.5% rise was a result of the readjustment of urban bus fares in some surveyed cities; and Education, whose 4.33% increase was typical of the start of regular school year. For the 12-month period to February, IPCA inflation

rose 6.27%, slightly above the end-of-2000 figure. In contrast, year-over-year general price indices have been falling since December. IGP-DI and IGP-M have declined 0.4 and 0.8 percentage points, respectively.

Core inflation – measured by a 20% symmetric trimmed-mean of the distribution of the price variations of IPCA's sub-groups – has been trending upwards since November, when it fell to a low of 0.32%, reaching 0.54% in February. In the last 12 months, core inflation accumulated 5.34%, while headline IPCA inflation was 6.27%.



A comparison of the trimmed-mean core with the core constructed by exclusion – removing from the headline IPCA the variations of government-managed prices and food at home prices – shows similar movements since July 2000, although in different levels. The recent upward trend in the trimmed-mean core is also present in the exclusion core. Moreover, their values in February were very close: 0.57% for the exclusion core and 0.54% for the trimmed-mean.

Brazilian GDP grew 4.2% in 2000, led by the 4.8% expansion of manufacturing. Preliminary indicators show that, in the first two months of 2001, output sustained the fast growth rate observed in the end of 2000, still led by manufacturing, especially the sectors of durables and capital goods. The prospect for the year as a whole is of somewhat higher growth than last year's, although more balanced among the several activity sectors and the several categories of use in the industrial sector.

The growth in aggregate demand is to a large extent explained by credit expansion and improved confidence. Non-regulated credit increased 62.0% in the 12-month period to February, particularly credit to households. That rise was triggered by a set of factors, including the reduction in reserve requirements, the drop in loan rates and banking spreads, the lengthening of credit operations and the improvement in expectations which favored the demand for credit. The average lending rate fell 10.4 percentage points in the last 12 months to February, while the average loan maturity increased from 150 days in June 2000 to 209 days in February, again led by the lengthening maturity of household credit.

The inflation rate path suggests that, in the current conditions of the Brazilian economy, there is no direct pressure on prices due to aggregate demand. Indicators of capacity utilization and labor market data reinforce this assessment. Average capacity utilization in January was 80.3%, according to the National Confederation of Industry survey, or 82%, according to the Getulio Vargas Foundation (FGV), which corresponds to an increase of 0.7 percentage point compared to January 2000. The FGV survey indicates that the number of sectors with low idle capacity, such as paper and rubber, is limited. Furthermore, the average capacity utilization is below historical peaks in most sectors. These figures, together with the growth in GDP observed in 2000, show that the production capacity of the economy is also going through an expansion process.

Notwithstanding the increase in formal employment and the decline in the unemployment rate (5.7% in January, the lowest figure for that month since 1997), real wage bill increases are still incipient and the average real wage remains steady. In other words, there is no indication that the increase in labor demand has pushed up labor costs.

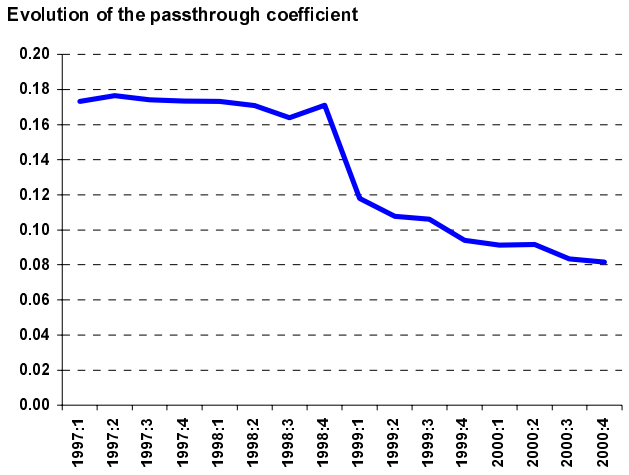
The main impact of the growing aggregate demand has been perceived in the trade balance. The accumulated trade deficit in this year up to the third week of March reached US$ 689 million. Although exports grew 13.8% in January-February as compared to the same period of last year, imports rose at a higher pace (18.4%). The effect of the economic growth becomes clear in disaggregated imports data: in the last 12 months, the *quantum* of intermediate goods increased 25.9%, and the *quantum* of capital goods 9.0%. Part of the imports growth reflects not only greater domestic demand but also the *quantum* expansion of manufactured exports, with a positive but lagged net effect on the trade balance. The prospects for the next months are of improvement in the trade balance, due to the beginning of shipments of agricultural products. For the whole year, however, the trade balance will essentially depend on the growth differentials between Brazil and its main trade partners, on the path of the real exchange rate, and on the behavior of the terms of trade.

The current account deficit in the 12-month period to February reached 4.45% of GDP, not only due to a larger trade deficit but also to the increase in services account deficit. Foreign direct investment fell from last year's record level, causing a rearrangement in the composition of

external financing: although still based on long-term capital, there was an increase in the share of private sector bonds. During the first quarter, sovereign bond issues in the international market, along with the collateral released after the bonds swap in March and the IDB loan, totaled US$ 4.2 billion. This is equivalent to total amortization payments of the public sector's external debt scheduled for 2001.

The growth in the trade deficit and the corresponding increase in the current account deficit have contributed to weaken the exchange rate, which averaged R$ 2.02 this year up to March 21st, compared to R$ 1.81 in the third quarter of 2000. This movement has occurred despite the fact that external financing needs have increased only moderately, and that the accumulated overall balance of payments has been positive in the last months. The explanation for the accelerated weakening of the exchange rate seems to transcend the strictly economic fundamentals of the country, encompassing as well some transitory domestic and external events. In particular, the increasing uncertainty in relation to the magnitude of the downturn in the United States' economy, partially reflected in the fast decline of share prices in its stock markets, and the confidence crises in important emerging markets such as Argentina and, to a lesser extent, Turkey.

The recent currency depreciation brings to the fore the important issue of the passthrough from the exchange rate to domestic prices. The low passthrough observed in 1999 was a positive surprise to most macroeconomic analysts. That year, the average depreciation of the *real* was of roughly 60%, while IPCA inflation was 8.9%. Two main arguments were advanced to explain the low passthrough. The first, related to the then prevailing economic environment, stressed that since the economy's output was well below potential, there was little room for price adjustments. The second was associated with the level of the real exchange rate and with the realignment of the relative prices of tradable and non-tradable goods. This realignment was reflected directly on final prices, and indirectly on production costs. Given that the share of prices directly linked to the foreign exchange variation in the consumer price indexes, especially IPCA, is small, it was to be expected that consumer inflation would be much lower than the exchange rate depreciation. Regarding production costs, with the currency depreciation, imported inputs would be replaced with the domestically produced intermediate goods whose prices were adjusted below the exchange rate variation.

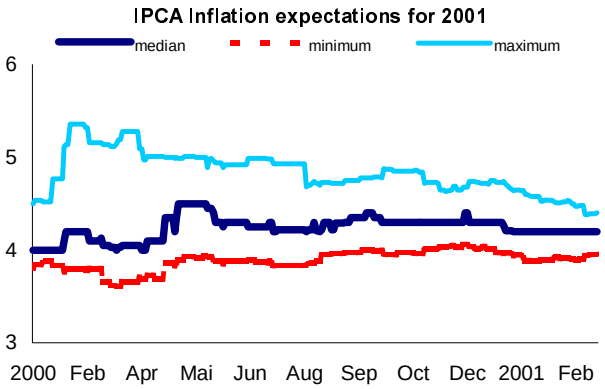


With more than two years having passed since the introduction of the floating exchange rate regime, it is possible to have a clear view of the passthrough. The chart on the left shows the evolution of the passthrough coefficient since 1997. In econometric terms, it describes the behavior of the estimated exchange rate coefficient, while controlling for factors like the state of the economy, inflation expectations, and price inertia (augmented Phillips curve). The estimations are carried out with sample periods that begin in the third quarter of 1994 (the *Real* Plan) and end in the quarter shown in the horizontal axis. The coefficient has been declining throughout the period and there is a structural break in the first quarter of 1999, coinciding with the shift in the exchange rate regime. Specifically, the short-term passthrough, which reflects only the contemporaneous first order effects of the exchange rate variation on inflation, fell from 17% to little more than 8%.

The significant reduction of the passthrough coefficient in the first quarter of 1999 can be attributed to the shift in the exchange rate regime. In the former semi-fixed exchange rate regime, any devaluation was perceived as permanent and, therefore, price-makers had less uncertainty about the medium and long-term costs of imported (or tradable) goods. In the current floating exchange rate regime, price-makers tend to interpret as permanent only part of the exchange rate variation and, in order to avoid the negative effects of frequent price adjustments, they do not pass on all the cost changes of imported inputs to their final prices.

The chart also shows that, after falling significantly in the first quarter of 1999, the passthrough coefficient sustained a downward trend. This may be a result of two factors. The first is the increasing weight of the floating period in the sample, which, as discussed above, tends to reduce the passthrough coefficient. In this case, it is possible that the passthrough coefficient fell immediately after the introduction of the new regime, but the econometric estimates were still capturing the influence of the previous higher passthrough. The second factor is related to the growing experience with the floating regime in Brazil. In this case, the passthrough would be in fact steadily decreasing, to the extent that price-makers become convinced that not all exchange rate variations are permanent. Therefore,

the less accommodative is monetary policy in the present, the smaller will be the passthrough in the future.



Unlike the short-run, the estimate of the long-run passthrough is not so simple to obtain, given that it incorporates the second-order effects brought about by inflationary inertia and by the impact of the exchange rate variation on expectations about future inflation. In the extreme case where inflation expectations are reviewed upwards immediately after any exchange rate depreciation, in the long run the passthrough will reach 100%. In the opposite extreme case, where agents believe that the inflation will never deviate from the target, expectations of future inflation will not change after an exchange rate variation and the passthrough will be significantly lower. According to the Central Bank's models, if inflation expectations do not change, the long-term passthrough is around 16%, and more than 90% of this effect is already incorporated into prices after one year. A comparison of the recent behavior of exchange rate and IPCA inflation expectations suggests that Brazil is closer to the second extreme: since October 2000, expectations for IPCA inflation in 2001 have remained essentially unchanged around 4.2% (see chart on the left), despite the 8% depreciation of the exchange rate observed between that month and the average of the first week of March.

It is important to stress that the passthrough cannot be determined from some fixed historical relationship. As argued above, there are several factors that influence the degree of passthrough, such as the rhythm of economic activity, the level of the real exchange rate, the magnitude and duration of observed shocks, and the credibility of monetary policy (by not allowing adverse shocks to translate into higher inflation).

International economy

During the first quarter, oil prices remained highly volatile due to the same factors that prevailed in the second half of 2000: (i) uncertainty concerning demand in the medium term, due to the global economic deceleration; (ii) uncertainty about OPEC output, given the possibility of production cuts in order to offset the fall in demand; (iii) global

stockpiles, though being built-up, are still low in historical terms; (iv) an exceptionally harsh and long winter in the Northern Hemisphere; and (v) political instability in the Middle East, due to the deterioration of relations between Iraq and Western countries.

The current oil prices, between US$ 24 and US$ 26 for the *Brent* crude barrel, are more than 10% below last year's average price. This decline reflects the higher output from non-OPEC countries and expectations of a slowing world economy. To support prices, OPEC has already announced two output cuts this year, totaling 2.5 million barrels per day. This strategy is the opposite of last year's, when OPEC was forced to increase output to compensate for excess demand. However, the outlook for oil prices is still uncertain in relation to both the actual production volume (preliminary data for February indicate that OPEC output quotas were breached by most members) and global demand.

In the United States, uncertainty regarding economic prospects in the medium term was amplified after recent data showed falling industrial production and sales, lower corporate profits and only moderately higher unemployment. The inflation rate was unexpectedly high in January, mostly due to increases in energy costs. However, inflation fell back in February to last year's average. The year-over-year CPI inflation reached 3.5% in February, while its core was up 2.7%.

The main leading indicators suggest a rather pessimistic outlook for the near future, with the NAPM index falling to the lowest level since the first quarter of 1991 and consumer confidence showing a declining trend. The deterioration of confidence was also reflected in the plunge in share prices. The Federal Reserve has interrupted the monetary tightening initiated in 1999, reducing the fed funds rate thrice during the current quarter from 6.5% to 5% per year. This reduction should allow the economy to recover, although the magnitude and duration of the current slowdown may be larger than expected by most analysts some weeks ago.

In Japan, GDP grew 3.2% in annual terms in the fourth quarter of 2000, although private consumption fell 0.6% in the period. Aggregate demand was led by growth in non-residential investment (6.8%) and government consumption (0.9%). The economic recovery is still constrained by the ineffectiveness of fiscal and monetary policy in fostering consumption, in

a scenario aggravated by price deflation, growing unemployment and deteriorating confidence. The Bank of Japan decided at the end of February to reduce the short-term interest rate to 0.15% per year, returning in practice to the zero interest rate policy carried out from 1999 to August 2000. The pessimistic outlook was reflected in the Nikkei index's plunge to the lowest level in 16 years and in the yen's depreciation against the dollar and the euro.

In Europe, industrial production and retail sales sustained an upward trend amid a slightly higher unemployment rate in January. Confidence indicators, however, anticipate some worsening in economic conditions in the near future. The annual inflation rate reached 2.6% in February, still influenced by higher oil prices. The European Central Bank kept the interest rate unchanged at 4.75% per year.

In Argentina, the economic scene has been characterized by two distinct phases during the first quarter. In the beginning of the year, the external confidence in the economy had improved – as attested by the reduction in the sovereign risk premium – still benefiting from the financial support program signed with the IMF at the end of 2000. Consequently, domestic interest rates also fell. This phase was followed by a period of growing uncertainty about the economy's growth outlook in the short run, as well as the political support for the government's intended fiscal adjustment. This uncertainty led to two cabinet reshuffles in March and affected the external risk perception, interrupting the improvement in sovereign spreads.

The external outlook was also aggravated by the currency and banking crisis in Turkey, which moved in February from a managed to a floating exchange rate regime. The lira's depreciation was roughly equal to 40% in the first month. Turkish officials have asserted the intention of complementing the new exchange rate policy with the introduction of an inflation-targeting system.

5.2 – Baseline scenario: assumptions and associated risks

The Monetary Policy Committee forecasts are based on a set of assumptions about the behavior of key economic variables, as well as

their associated risks. This set of assumptions forms the baseline scenario under which Copom makes monetary policy decisions.

As in the last *Inflation Reports*, the main sources of uncertainty concerning the outlook for inflation over the next two years refer to the evolution of oil prices, to the behavior of domestic government-managed prices and to the external economic environment, especially the economies of the United States and Argentina.

In relation to oil prices, Copom's projections are based on the price curve of Brent crude futures (see box *Efficiency in the Oil Futures Market*), which depicts relative stability around US$ 25 per barrel throughout this year, with more substantial declines only in 2002. The projected average price remains in the same range discussed in the December *Inflation Report*, indicating a 12% fall compared to last year's average. However, as analyzed in the previous section, oil prices should remain volatile due to the possibility of new reductions in OPEC output to defend the price band mechanism, as well as uncertainty as to the extent of the slowdown of the global economy.

Considering the oil futures price curve and the new mechanism for quarterly adjustments in domestic prices of by-products introduced in November - adjustments for non-subsidized by-products are based on the difference between the average dated Brent price in *reais* and the reference price of R$ 55.00 - the baseline scenario assumes a 4.5% drop in gasoline prices at the retail level in the beginning of April and small additional reductions in July and September.

As to the other government-managed prices, the scenario discussed in the December *Inflation Report* was reviewed. The 19.2% minimum wage increase in April will not have the impact formerly predicted on inflation due to the new methodology for the calculation of the item 'Domestic Employee' starting from April. Unlike common practice, the previous methodology attributed to that item the full variation of the minimum wage, but studies by the IBGE have shown that domestic employees' wages did not follow this variation in the last three years. By the new methodology, the domestic employee's wages will be collected through the Monthly Employment Survey (PME), so that the accumulated yearly rate by year-end will equal the annual PME variation. Thus, the

estimated variation for this item this year is around 11%, distributed along the remaining quarters of the year.

The assumption that telephone fees will follow the variation of the general indices involved in the concession contracts, respecting the adjustment schedule, was maintained. Electricity fees, however, should undergo higher adjustments, of about 12.8% in 2001, due to the peculiarities of their concession contracts, which include compensation for dollar costs and other indirect costs. Also, the estimated increase in urban bus fares was reviewed upwards, since in some cities there were no adjustments last year.

The bulk of managed price adjustments should take place, as in the last two years, in the beginning of the third quarter. The estimate for the set of government-managed prices for which there is relevant information is of a 6.1% variation in 2001, with a direct contribution of 1.4 percentage point to IPCA inflation this year. These figures differ only slightly from the estimates presented in the last *Inflation Report*.

Regarding food prices, the hypothesis for the increase in the grains crop in 2001 rose from 9% to 10%. This should result in food prices running below headline IPCA inflation, with deflationary pressure in the second quarter of the year.

Output and employment data confirm the inexistence, as of yet, of direct inflationary pressure due to excess demand. The economy still operates with a moderate degree of idle capacity and can sustain the current growth rate. However, the deceleration of global growth and the increase in external uncertainty may moderate the rate of domestic growth.

Concerning the trade balance, the reduction of oil prices, the substitution of oil imports and the increase in the crop all favor a recovery. Note that agricultural exports are concentrated in the second and third quarters of the year, contributing to improve the trade balance in the next few months.

As to the external environment, Copom's baseline scenario assumes a slowdown in the United States economy, with growth reduction concentrated in the first half of the year, followed by a recovery starting in the second half, or, at the latest, in the last quarter of the year. The

lower output growth, higher unemployment rate and falling oil prices should result in stable or slightly lower inflation. According to the projections implicit in the futures contracts, the assumption for the fed funds rate in the December *Inflation Report* was reviewed. The baseline scenario assumes two additional 25 basis point cuts in the second quarter, with the rate then stabilizing at 4.5% per year.

In Argentina, the cabinet reform made room for the government to obtain political support for its intended fiscal measures and economic stimulus policies, complementing the measures announced in October and November. The subsequent improvement in confidence, mirroring what happened in the beginning of the year, would allow a reduction of the risk premium and domestic interest rates, with a modest recovery in growth.

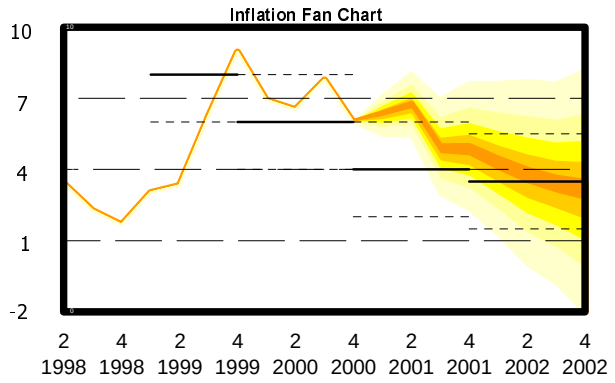
The Brazil risk premium rose due to the increase in external uncertainty and the negative perception as to the speed of progress towards the domestic structural reforms, contrary to the outlook depicted in the December *Inflation Report*. However, Copom understands that the apprehensive atmosphere prevailing in the markets is unlikely to persist in the medium term, so that the sovereign risk should resume the downward path it followed until February. The recent decoupling between the risk premium's and the exchange rate's evolution also suggests that there is room for currency appreciation as soon as the objective discernment of the quality of the domestic fundamentals prevails again in the markets.

Fiscal policy should continue to meet the targets for the consolidated public sector primary surplus established in the Government's Economic Program, contributing to keep price stability and to a consistent assessment of the Brazil risk.

5.3 – Inflation forecast

Based on available information and the assumptions with associated risks considered by Copom, a projection of the 12-month IPCA inflation rate was constructed. This projection considers that interest rate will remain constant at the level of 15.75% per year set out at the Committee's March 20th and 21st meeting. This report also presents an inflation forecast conditional on the interest rate path expected by the market.

Forecasted IPCA-inflation with interest rate fixed at 15.75% p.y.



(accumulated inflation in 12 months)

IPCA with 15.75% p.y. fixed interest rate

Year	Q	Probability Intervals						Central Projection
		50%						
			30%					
				10%				
2001	1	5.9	6.1	6.2	6.3	6.5	6.6	6.3
2001	2	6.1	6.3	6.5	6.7	6.9	7.2	6.7
2001	3	4.0	4.3	4.6	4.9	5.3	5.7	4.9
2001	4	3.7	4.1	4.5	5.0	5.4	5.9	4.8
2002	1	2.9	3.4	3.9	4.4	5.0	5.6	4.3
2002	2	2.1	2.8	3.4	4.0	4.6	5.3	3.7
2002	3	1.6	2.3	3.0	3.6	4.3	5.1	3.3
2002	4	0.9	1.9	2.7	3.5	4.3	5.2	3.0

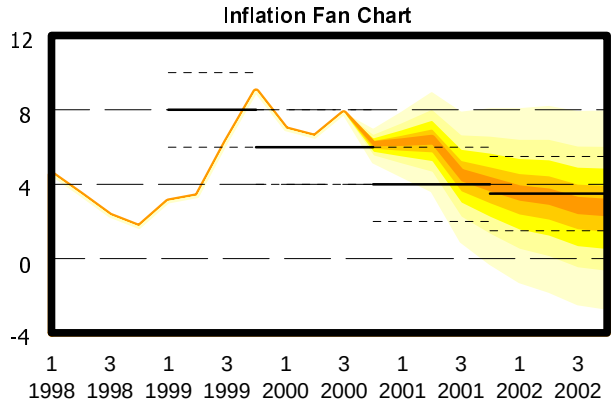
Note: Accumlulated inflation in 12 month, in % p.y. The values correspond to the ones shown in inflation fan chart.

Both projections incorporate the impact of government-managed prices as follows. The first step is to project inflation according to the baseline scenario but with no hypothesis regarding managed prices. This is akin to stating that these prices will behave like the average of all other prices in the economy. The following step is to calculate for each quarter the difference between the projected inflation rate and the overall out-of-the-model adjustment in managed prices. This difference is then duly weighted and incorporated into the model. The result is an expected set of quarterly shocks, with a probability distribution as assessed by Copom.

The central projection for 12-month inflation presents a slight upward slope in the first half of 2001, with IPCA inflation reaching 6.7% in the second quarter. This behavior is due to the same two statistical effects discussed in the December *Inflation Report*. The first is that the extremely low variations observed in the first half of 2000 will drop out when calculating the accumulated 12-month inflation, and will be replaced by higher variations for the same period of 2001. The second is the presence of the high inflation of the third quarter of last year in the computation of the accumulated rate. This latter effect should disappear in the third quarter, when accumulated inflation should experience a 1.8 percentage point fall, since the magnitude of the adjustments to government-managed prices in the period will be roughly half that of 2000, and will almost surely not coincide with a strong increase in food prices, as occurred last year. However, according to the central trajectory, inflation should decline only 0.1 percentage point in the fourth quarter, ending 2001 at 4.8%, within the tolerance interval for the inflation target. Notice that the probabilities of deviations are asymmetrically distributed around the median: the dispersion of outcomes below the central projection is higher than the dispersion above. For 2002, the central path declines monotonically, reaching 3% by year-end.

Comparing the current projection with the one in the December *Inflation Report*, here republished, there is a significant alteration in the expected

Forecasted IPCA-inflation with interest rate fixed at 15.75% p.y. (December Report)

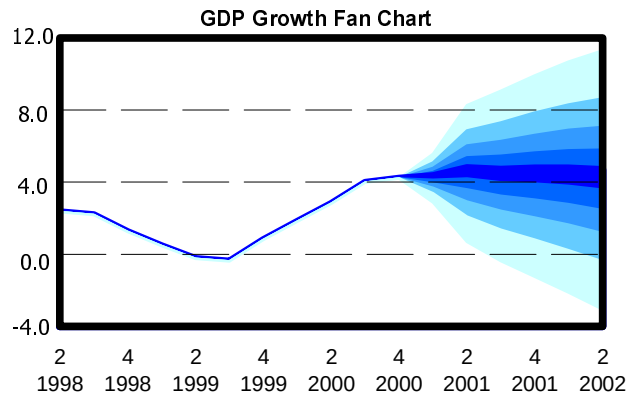


(accumulated inflation in 12 months)

trajectory of inflation. Although a direct comparison cannot be made since the projections are based on different assumptions regarding scenario and asymmetry, a few points are worth mentioning. First, the inflation rate in the January-February period was higher than expected by the Monetary Policy Committee in December. This led to an upward revision of 0.2 percentage point in the central trajectory's starting point.

Second, and more important, there were major changes in the baseline scenario, especially concerning the exogenous variables that affect the behavior of the exchange rate, such as the external uncertainties. Moreover, the average exchange rate escalated from R$ 1.93 in the last quarter of 2000 to R$ 2.02 in the current quarter, and since mid-March the exchange rate has been above R$ 2.10. The currency depreciation in this short period of time reflects the combination of lasting trends and temporary shocks. The exchange rate set by the market, while regulating the equilibrium of the balance of payments, absorbs most part of the external shocks, as is the case now. However, since there is uncertainty about the intensity and duration of the shocks' impact, the degree of passthrough to domestic prices from the part of the exchange rate depreciation perceived as permanent may rise. Therefore, the transmission channel through the exchange rate gains in importance, even more so because the output gap is currently much lower than it was until the third quarter of 2000. Hence, the significant rise in the central inflation projection for 2001, from 3.9% in the December *Inflation Report* to 4.8% now, is largely due to the effects of the passthrough in the context of robust economic growth.

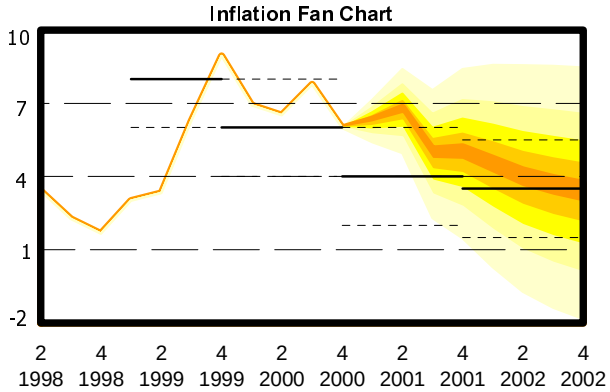
GDP growth with 15.75% p.y. fixed interest rate



(GDP variation, 12 months over previous 12 months)

As in previous *Reports*, this issue also presents the fan chart for output growth. It is constructed on the basis of the same assumptions used in the baseline scenario. It should be stressed that the forecasting errors associated with GDP growth projections are considerably larger than in the case of inflation projections. This happens because GDP growth projections involve the trajectories of two non-

Forecasted IPCA-inflation with market interest rate expectation.



(accumulated inflation in 12 months)

IPCA with market interest rate expectation 1/

Year	Q	Probability Intervals						Central Projection
		50%						
			30%					
				10%				
2001	1	5.9	6.1	6.2	6.3	6.5	6.6	6.3
2001	2	6.1	6.3	6.5	6.8	7.0	7.2	6.7
2001	3	4.1	4.4	4.7	5.0	5.4	5.7	4.9
2001	4	3.8	4.3	4.7	5.1	5.5	6.0	5.0
2002	1	3.1	3.6	4.1	4.6	5.1	5.7	4.4
2002	2	2.3	3.0	3.6	4.2	4.8	5.5	3.9
2002	3	1.8	2.6	3.2	3.9	4.6	5.3	3.6
2002	4	1.3	2.2	3.0	3.8	4.6	5.5	3.3

Note: Accumlulated inflation in 12 month, in % p.y. The values correspond to the ones shown in inflation fan chart.

1/ From Investor Relations Group - 03/22/2001

observable components, namely potential output and output gap. Moreover, the estimation of output is, by definition, more complex and less precise than the measurement of inflation. The central projection for output growth in 2001 is approximately 4.3%, under the hypothesis that the basic interest rate remains constant at 15.75% per year.

This issue also presents the inflation fan chart taking into account the interest rate expectations of the private sector on March 22nd. As in the last *Inflation Report*, interest rates are taken directly from the median of market expectations collected by the Central Bank's Investor Relations Group (GCI), summarizing information gathered from approximately 70 financial institutions and consultancy firms on March 22nd. The market-expected interest rate curve was downward-sloped, starting from the current 15.75% rate and falling to 13.8% and 12.5% at the end of 2001 and 2002, respectively. Except for this assumption for the interest rate, all other hypotheses in the baseline scenario were maintained. The inflation trajectory resulting from this interest rate assumption is different from the central projection only from the last quarter of 2001 on, essentially due to the lags involved in the transmission of monetary policy through the aggregate demand channel.

Efficiency in the Oil Futures Market

This box deals with the efficiency of the Brent crude oil futures contracts. The futures oil market is said to be efficient when futures prices are unbiased predictors of *ex post* realized spot prices.

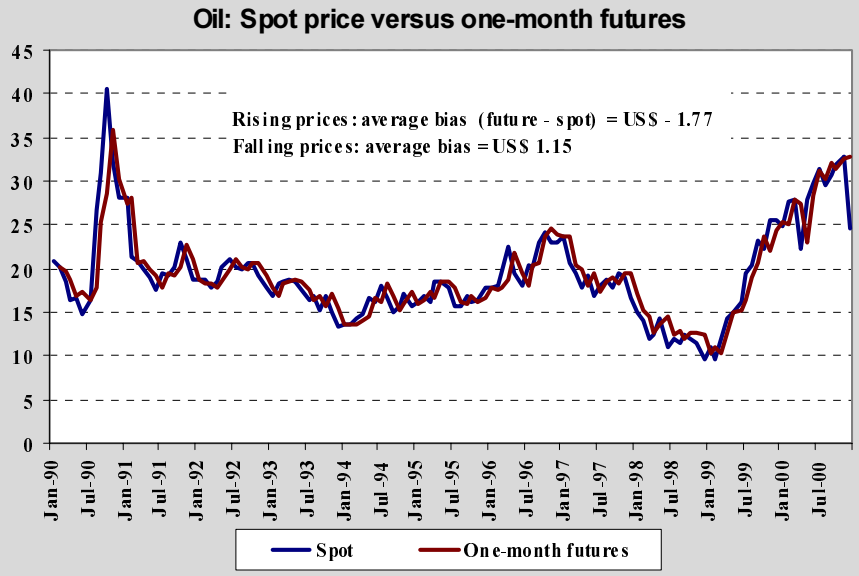
To test the efficiency hypothesis, it is usual to estimate a simple cointegration model between futures prices and realized spot prices. The estimated model may simply be:

$$Spot_t = \alpha + \beta \; Futures_t$$

Unit root tests cannot reject the non-stationarity of both series, while cointegration tests indicate that spot and futures prices cointegrate. Hence, there is an equilibrium relationship between these prices, that is, they should not deviate from each other in the long run.

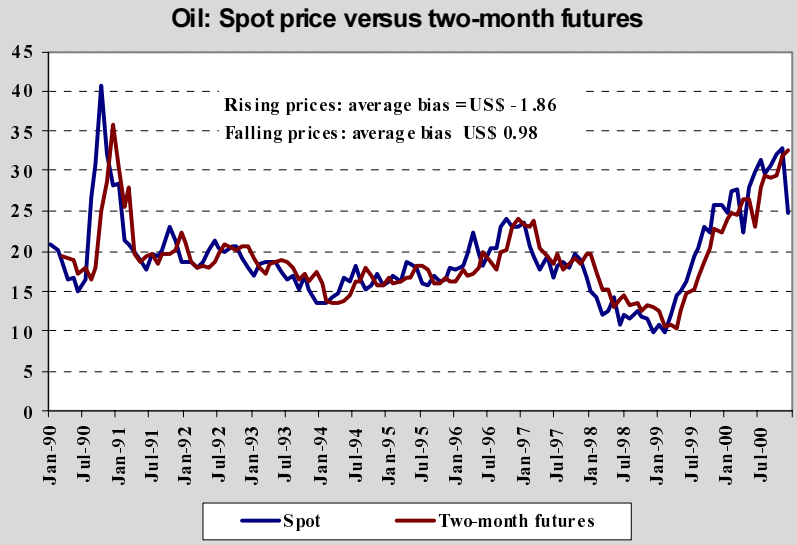
A likelihood ratio test on the coefficients supports the hypothesis that the one-month futures contracts are unbiased estimators of realized spot prices (test of the joint hypotheses $\alpha = 0$ and $\beta = 1$). Also, by estimating an error correction model for these variables, one finds that, in the short-run dynamics, it is futures prices that adjust to variations in spot prices. However, futures prices with a lag of one maturity are significant in the equation for spot prices, implying bicausality between spot and futures prices.

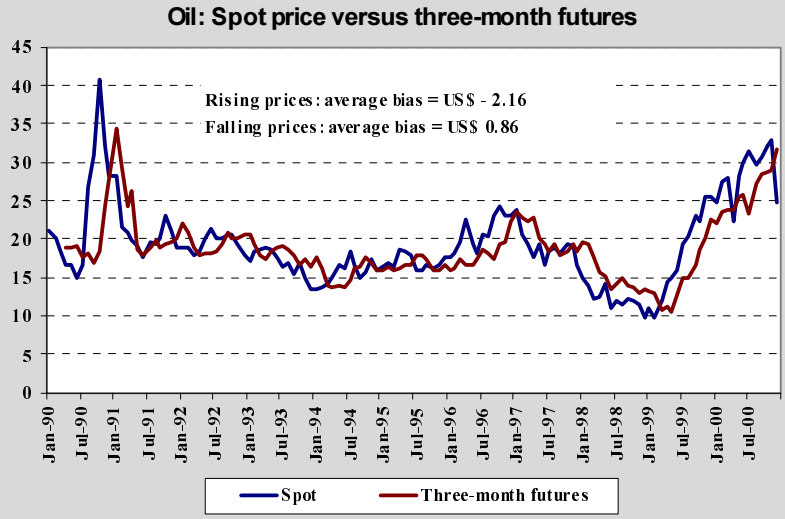
The chart below shows the evolution of spot and one-month futures prices during the 90's. Notice that, during lasting periods of upward price movements, futures prices tend to underestimate the realized spot prices, while during periods of downward movements, futures prices tend to overestimate spot prices.



The average bias is defined as the average difference between futures and spot prices. Restricting attention to upward price movements, the average bias equals minus US$ 1.77. The average bias for downward movements is positive and equal to US$ 1.15. It is important to highlight that the efficiency hypothesis is rejected for some sub-periods, such as the last two years of rising oil prices.

A similar pattern is found in the two- and three-month contracts, as the charts below show.





In conclusion, futures contracts are unbiased estimators of realized spot prices. The unbiasedness hypothesis cannot be rejected by usual econometric methods, when the full sample is used. However, when the sample is divided into sub-periods, unbiasedness is rejected. There is a positive average bias in upward price movements and a negative bias in downward movements. Therefore, when using futures contracts to predict spot prices, there is a tendency to overestimate prices if the *ex post* price trend proves negative, and to underestimate them if the trend proves positive.

Annex

Minutes of the 54th Meeting of the Banco Central do Brasil Monetary Policy Committee (Copom)

Date: 12.19 and 20.2000
Place: 8th floor (12.19) and 20th floor (12.20) meeting rooms Banco Central Headquarters – Brasília – DF
Called to order: 3:20 PM on 12.19 and 5:00 PM on 12.20
Adjourned: 7:02 on 12.19 and 6:15 PM on 12.20

In attendance:
Members of the Board
Arminio Fraga Neto – **Governor**
Carlos Eduardo de Freitas
Daniel Luiz Gleizer
Edison Bernardes dos Santos
Ilan Goldfajn
Luiz Fernando Figueiredo
Sérgio Darcy da Silva Alves
Tereza Cristina Grossi Togni

Department Heads (all present on 12.19)
Altamir Lopes – Department of Economics (Depec)
Daso Maranhão Coimbra – International Reserve Operations Department (Depin)
José Antonio Marciano - Department of Banking Operations (Deban)
Alexandre Antonio Tombini – Research Department (Depep)
Eduardo Hitiro Nakao – Open Market Operations Department (Demab)

Other participants (all present on 12.19)
Gustavo Bussinger – Advisor to Depec
João Borges – Press Advisor (Asimp)
Sérgio Goldstein – Advisor to Dipom.

The Board analyzed the recent evolution and outlook for the Brazilian and international economies in the framework of the country's new monetary policy regime, which is designed to ensure compliance with government defined inflation targets.

Aggregate demand and supply

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

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

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

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

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

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

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

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

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

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

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

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

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

As regards the labor market, the trend of increased employment and productivity persisted, accommodating the recent salary negotiations without affecting costs. For the thirteenth consecutive month, formal employment expanded in the month of October, with creation of 883 thousand job

positions in the year. With exception of the building industry, all sectors displayed employment growth. Open unemployment rates remained fairly stable at 6.7% in October.

External environment

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

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

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

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

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

Prices

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

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

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

Prospective assessment of inflation trends

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

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

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

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

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

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

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

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

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

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

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

Money market and open market operations

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

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

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

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

Monetary policy guidelines

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

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

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

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

In the external sector, recent developments have been positive, though the main uncertainties are far from vanishing. Petroleum prices started a sharp decline, in both the spot and the futures market, suggesting the closing of a two-year cycle in which this commodity was responsible for the main

foreign shock affecting the Brazilian economy. The U.S. economy seems to confirm lower growth, although there are doubts on how smooth this process will be. Given the strong fiscal conditions and the careful monitoring history of the U.S. monetary authority, the slowdown tends to be moderate.

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

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

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

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

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

Alexandre Antonio Tombini.

Notes revised by the Board.

Minutes of the 55th Meeting of the Banco Central do Brasil Monetary Policy Committee (Copom)

Date: 01.16 and 17.2001.
Place: 8th floor (01.16) and 20th floor (01.17) meeting rooms Central Bank Headquarters – Brasília – DF
Called to order: 04:00 PM on 01.16 and 05:20 PM on 01.17
Adjourned: 07:30 PM on 01.16 and 07:00 PM on 01.17

In attendance:
Members of the Board
Arminio Fraga Neto – **Governor**
Carlos Eduardo de Freitas
Edison Bernardes dos Santos
Ilan Goldfajn
Luiz Fernando Figueiredo
Sérgio Darcy da Silva Alves
Tereza Cristina Grossi Togni

Department Heads (all present on 01.16)
Fernando Antônio de Moraes Rego Caldas, Economic Research Department (Depec)
Carlos Yoshitaka Urata– International Reserve Operations Department (Depin)
José Antonio Marciano - Department of Banking Operations (Deban)
Alexandre Antonio Tombini – Research Department (Depep)
Eduardo Hitiro Nakao – Open Market Operations Department (Demab)

Other participants (all present on 01.16)
Alexandre Pundek Rocha – Advisor to the Board
Gustavo Bussinger – Advisor to Depec
João Borges – Press Advisor (Asimp)
Sérgio Goldstein – Advisor to Dipom

The Board analyzed the recent evolution and outlook for the Brazilian and international economies in the framework of the country's monetary policy regime, which is designed to ensure compliance with government defined inflation targets.

Aggregate demand and supply

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

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

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

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

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

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

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

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

An increased aggregate demand, including exports, and larger fuel expenditures have impacted the trade balance, which recorded a negative balance of US$ 213 million in December, for an aggregate deficit of US$ 698 million in the year. There was a significant increase in exports over the month, a result of the high in sales of manufactures, with a daily average 23.5% above that of

December 1999. In turn, the daily average of imports increased 25.9%, reflecting growths in all product categories. As against November, the daily average of imports reduced as a result of lower expenditures in fuels and lubricants, raw materials and consumption goods.

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

External environment

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

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

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

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

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

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

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

Prices

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

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

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

Prospective assessment of inflation trends

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

a. the December inflation (0.59%) was slightly below what was expected (0.65%), which secured compliance with the 6% target (5.97%);

b. an expected 5% petroleum production cut by countries member of OPEC (meeting of 01.17) is unlikely to cause unrest in international petroleum prices. Under the new fuel domestic price adjustment mechanism, that sets automatic quarterly changes based on the price of R$ 55.00 for the Brent barrel, and considering the implicit price schedule of futures petroleum contracts, we forecast a 6.5 % drop in gasoline prices for the consumer (corresponding to a drop of 8.65% in refinery prices) in the second quarter of 2001, being the occurrence of additional reductions during the rest of the year likely.

c. the average price adjustment for administered prices shall reach 6% in 2001. this includes fuels and a minimum wage increase to R$ 180 in April.

d. according to futures contracts forecasts, the hypothesis for the path of fed funds rate includes two reductions of 50 basis points in the first half of 2001. Therefore, the rate would drop from the current 6% p.a. to 5.0% p.a., remaining stable at such level.

e. in the foreign environment, the Federal Reserve decision to cut off 50 basis points in the interest rates, although evidencing the risk of a stronger deceleration, shows resoluteness of the monetary authority to act in a timely way in order to avoid brisk movements that would affect the world economy. A stronger deceleration in the United States economy tends to generate a more favorable trend for interest rates and petroleum prices. Depending on the magnitude of such effects, the risks to the Brazilian economy stemming from future developments of the United States economy may offset each other. Given this fact and a favorable perception on the Brazilian economic fundamentals, a stable Brazil risk premium was taken as working hypothesis, after the slight improvements occurred since the last meeting are taken into account.

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

Simulation exercises with the scenario considered in the basic (structural) model suggest that maintaining the interest rate at the current level of 15.75% p.a. (effective until January 17) enables

the fulfillment of the 2001 and 2002 inflation targets. This last conclusion holds when one uses the nominal interest path expected by the market (14% p.a. at the end of 2001), recorded by the monthly survey performed by the Central Bank.

The IPCA core inflation, calculated by the method of rounded averages, kept practically stable at 0.33% in December (0.32% in November) , suggesting levels of monthly inflation in line with the 2001 goal. However, the core inflation measured by IPC-BR published by the Getúlio Vargas Foundation increased from 0.36% to 0.50%, well above the monthly average of 0.28% measured in the first half of the year. IPCA core inflation indicators, using the method of exclusion (i.e., excluding administered prices and foodstuffs) indicate rates in keeping with the compliance of targets.

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

Money market and open market operations

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

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

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

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

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

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

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

Monetary policy guidelines

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

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

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

The foreign environment prevalent in the beginning of this year is positive, in spite of some ongoing uncertainties. The recent behavior of international petroleum prices, despite the

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

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

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

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

At the close of the meeting, it was announced that the Committee would meet again on February 13, 2001, at 3:00 PM, for technical presentations and, on the following day, at 4:30 PM, in order to discuss monetary policy guidelines as set in the Calendar of COPOM's Ordinary Meetings, published in the Central Bank Communiqué no. 8,018, of 01.22.2000.

Alexandre Antonio Tombini.

Notes revised by the Board.

Minutes of the 56th Meeting of the Banco Central do Brasil Monetary Policy Committee (Copom)

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
Arminio 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.

Economic policy measures

Measures related to the financial system and credit market

Resolution no. 2,789, 11.30.2000 – multiple banks with commercial and real estate credit portfolios and the Federal Savings Bank are permitted to operate with a new leasing modality that has the objective of facilitating refinancing of properties purchased through auction or repossessed by financial institutions that operate with real estate credit. This is a special type of lease defined as an operation in which the lessee assumes the commitment of effecting monthly payments to the lessor for a specific period of time in exchange for the right to occupy the property. At conclusion of the specified period of time, the lessee is entitled to exercise a purchase option, under the terms of Provisional Measure no. 1,981-53, dated 10.26.2000, transformed into Law no. 10,150, dated 12.21.2000.

Circular no. 3,017, 12.6.2000 – altered norms on processes related to incorporations, mergers and split-ups that involve financial institutions. The objective of the measure is to adapt the recording of premiums and discounts to prudential considerations, as well as to foster enhanced transparency when alterations are introduced into the stock holding structure of such institutions.

Resolution no. 2,802, 12.21.2000 – determined a new calculation base for specifying the operational limits to be observed by financial institutions, denominated the Asset Reference (PR). Previously, the calculation base for all limits – except for the capitalization limit based on risk levels (Basle limit) – corresponded to the value of net worth adjusted by creditor and debtor result accounts. The definition of PR is based on the concept of adjusted net worth used in the Basle limit, which is composed of two

levels of capital classified according to different leverage potentials: level I (principal capital) and level II (supplementary capital).

Resolution no. 2,803, 12.21.2000 – reduced the Long-Term Interest Rate (TJLP) for the first quarter of 2001 from 9.75% per year to 9.25% per year. This measure was taken in light of the pro-rata inflation target for the next 12 months (4%) plus a risk premium of 5.25% per year.

Resolution no. 2,804, 12.21.2000 – defined the procedures to be adopted by financial institutions within the framework of their internal control systems, so that liquidity risk can be correctly identified and managed. These institutions were given six months to adapt their respective systems. Liquidity risk is a consequence of the degree of incompatibility between negotiable assets and callable liabilities in terms of the currency, term and rates involved in operations. Such incompatibility has the potential for generating financial imbalances within these institutions.

Resolution no. 2,807, 12.21.2000 – credit operations carried out by municipalities with the National Financial System, with BNDES funding, were excluded from the conditioning factors imposed on the public sector, when such operations take place in the framework of the Tax Management Modernization Program (PMAT) and are exclusively targeted to implementation of programs involving investments in tax modernization.

Resolution no. 2,808, 12.21.2000 – determined that, as of 4.2.2001, financial institutions are to provide their clients with reference information, encompassing personal data, average monthly value maintained in current account and the average balance of financial investments and other types of investments, as well as background information on credit operations, including data on contracting and the regularity of payments. Parallel to this, financial institutions are obligated to supply their clients with information on charges and other expenditures levied on operations involving the opening of credit through the use of special overdraft checks.

Resolution no. 2,809, 12.21.2000 – created a mechanism for automatic alteration of factor "b", a component in calculating the Reference Rate (TR) reduction factor. This mechanism involves reducing the value of

this factor as the Selic rate target is reduced. The intention here is to avoid the possibility of the TR reaching near zero levels, while generating more favorable profitability conditions for interest bearing financial investments based on the TR, particularly savings accounts.

Resolution no. 2,810, 12.28.2000 – alters article 4 of Resolution no. 2,791, dated 11.30.2000, which deals with financial market investment of the resources of private social security entities. The objective here is to permit investment of these resources in any financial investment fund (FIF) or fund involving investments in investment fund quotas (FAQ), while removing the demand that these operations be referenced to specific investments. Aside from this, the Resolution also defines rules for charging of the FIF and FAQ performance fee and prohibits investments in investment funds based on stocks and securities (FITVM) that call for charging of the performance fee. Initially, this measure was to go into effect as of 2.28.2001, but was later postponed to 4.30.2001, as determined by Resolution no. 2,818, dated 2.22.2001.

Resolution no. 2,814, 1.24.2001 – deals with the procedures to be followed by financial institutions on receiving deposits consigned to payments, within the framework of the National Program of Administrative Modernization. Issue of this Resolution was aimed at providing a more detailed definition of the procedures and responsibilities inherent to reception of deposits consigned to payments. The major benefit of this measure is to reduce the number of judicial litigations and smooth the way to more efficient and rapid resolution of any questions raised, since debts are considered paid-in-full when a creditor who has been duly notified of the deposit does not submit an appeal within the stipulated time period. Thus, government financial institutions are obligated to accept such deposits. Multiple banks with commercial portfolios and private commercial banks, as well as credit cooperatives permitted to accept demand deposits, must accept these deposits when such government institutions are not available.

Resolution no. 2,817, 2.22.2001 – deals with the opening and operation of deposit accounts exclusively through the use of electronic means (Internet, automatic terminals, phone and other means of communication at a distance). These accounts can be opened only by individual persons and legal entities resident or domiciled in the country, holders of demand

deposit accounts or savings accounts. It should be noted that they are permitted only to receive deposits originating in debits to demand deposit accounts or savings accounts of the same account holders or related to liquidation of investments made on the account and at the orders of the holders of the respective accounts.

Fiscal policy measures

Law no. 10.174, 1.9.2001 – permitted the Secretariat of Federal Revenue to use information concerning the Provisional Contribution on Financial Transactions (CPMF) to establish procedures to verify the occurrence of tax credits originating in federal taxes and contributions, as well as to register the existing tax credits in the framework of the fiscal lawsuit.

Complementary Law no. 104, 1.10.2001 – permitted the administrative authority to consider nul and void judicial acts or affairs carried out with the purpose of concealing the occurrence of a taxable event or the nature of constitutive elements of the tax obligation.

Complementary Law no. 105, 1.10.2001 – indicates the cases in which banking secrecy may be violated, whenever it is necessary to determine any illegal event.

Measures related to the foreign sector

Provisional Measure no. 2,062-61, 12.28.2000 – reduced the income tax rate to zero on remittances abroad to be used in payment of expenditures related to market research activities involving Brazilian export products, as well as remittances consequent upon participation in expositions, fairs and similar events. Implemented a component of the Export Program 2001.

MF Directive no. 464, 12.26.2000 – altered the ad valorem rates of the Import Tax to 4% effective as of 1.1.2001 on capital goods (ex-tariff) cited in the directives specified therein. These rates are to remain in effect until 6.30.2001.

MF Directive no. 465, 12.26.2000 - altered the ad valorem rates of the Import Tax to 4% on the capital goods (ex-tariff) specified therein. These rates are to remain in effect from 1.1.2001 to 12.31.2002.

Decree no. 3,704, 12.27.2000 – determined that, effective as of 1.1.2001, the Import Tax rates of the Common External Tariff (TEC) are to be increased by 2.5 percentage points, except for the codes stipulated in Appendix II of this Decree and for the capital goods codes; in Appendices III and IV, defined the List of Exceptions to the TEC and the List of Convergence of the Informatics and Telecommunications Sectors, together with the respective rates; and altered the Common Mercosul Nomenclature (NCM) and the Import Tax on the products cited.

Law no. 10,176, 1.11.2001 (Informatics Law) – extended fiscal incentives to this sector up to 12.31.2009 and defined a schedule for the gradual elimination of these incentives, according to the regions in which the different companies are located. The informatics goods and services to which the law applies were defined and included cell telephone devices and video monitors.

Provisional Measure no. 2,113-27, 1.26.2001 – among other measures, defined the jurisdiction of the Foreign Trade Chamber (Camex). This entity is charged with deliberating on taxes in the area of foreign trade, defining Import and Export Tax rates. Previously, these functions were performed by sectors of the Ministry of Finance. The question of the rules governing application of trade defense measures, such as antidumping rights and countervailing duties, was also transferred to Camex. Previously, the Ministry of Finance and Ministry of Development, Industry and Commerce were responsible for this area. Secex/MDIC will be responsible for administrative proceedings aimed at assessing dumping margins or volumes of subsidies, the existence of damage and the relations among these factors. Finally, Camex will also define provisional or definitive rights, as well as decide on suspension of eligibility for provisional rights. The Ministry of Finance no longer participates in these activities.

Decree no. 3,756, 2.21.2001 – deals with the new structure and jurisdiction of the Foreign Trade Chamber which, among other responsibilities, will be charged with defining foreign trade policy

guidelines and procedures, as well as with coordination and orientation of the activities of entities with responsibilities in the sector of foreign trade.

Circular no. 3,027, 2.22.2001 (National Administrative Modernization Program) – instituted and regulated the Electronic Declaratory Record (RDE) of loans between parties resident or domiciled in the country and parties resident or domiciled abroad and the contracting of funding operations abroad tied to export activities.

Appendix

Banco Central do Brasil Management

Members of the Monetary Policy Committee (Copom)

Banco Central do Brasil Management

Board

Armínio Fraga Neto
Governor

Carlos Eduardo de Freitas
Deputy Governor

Daniel Luiz Gleizer
Deputy Governor

Edison Bernardes dos Santos
Deputy Governor

Ilan Goldfajn
Deputy Governor

Luiz Fernando Figueiredo
Deputy Governor

Sérgio Darcy da Silva Alves
Deputy Governor

Tereza Cristina Grossi Togni
Deputy Governor

Members of the Monetary Policy Committee (Copom)

Voting members

Armínio Fraga Neto
Governor

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Deputy Governor

Daniel Luiz Gleizer
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Edison Bernardes dos Santos
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Ilan Goldfajn
Deputy Governor

Luiz Fernando Figueiredo
Deputy Governor

Sérgio Darcy da Silva Alves
Deputy Governor

Tereza Cristina Grossi Togni
Deputy Governor

Non-voting members

Alexandre Antonio Tombini
Head of the Research Department (Depep)

Altamir Lopes
Head of the Department of Economics (Depec)

Daso Maranhão Coimbra
Head of the Department of International Reserve Operations (Depin)

Eduardo Hitiro Nakao
Head of the Department of Open Market Operations (Demab)

Luis Gustavo da Matta Machado
Head of the Department of Banking Operations (Deban)

Sérgio Goldenstein
Board of Directors Consultant