Inflation Report

ISSN 1517-7289
CGC 00.038.166/0001-05

Inflation Report	Brasília	v. 3	no. 4	Dec	2001	P. 1 - 182

Inflation Report

Quarterly publication of the Monetary Policy Committee, according to Decree 3,088, dated 6.21.1999.

The texts and respective statistical tables and graphs are under the charge of the following component parts:

Department of Economics (Depec) and
(e-mail: depec@bcb.gov.br)

Research Department (Depep)
(e-mail: conep.depep@bcb.gov.br)

General Control of Subscription:
Banco Central do Brasil
DEMAP/DISUD/SUBIP
SBS - Quadra 3 - Bloco B - Edifício-Sede - 2° Subsolo
Caixa Postal 8670
70074-900 - Brasília (DF) - Brazil
Phone 55. 61. 414-3165
Fax 55. 61. 414-1359

Number printed: 500 copies

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.

Occasional discrepancies between constituent figures and totals as well as percentage changes are due to rounding.

There are no references to sources in tables and graphs originated in the Banco Central do Brasil.

Banco Central do Brasil Information Bureau

Address:	Secre/Surel/Dinfo Edifício-Sede, 2º subsolo SBS - Quadra 3, Zona Central 70074-900 - Brasília (DF)
Phones:	(61) 414 (....) 2401, 2402, 2403, 2404, 2405, 2406
DDG	0800 992345
FAX	55.61. 321-9453
Internet:	http://www.bcb.gov.br
E-mail:	cap.secre@bcb.gov.br

Contents

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 six chapters: Activity level; Credit, monetary and fiscal policies; International economy; Foreign sector; Prices; and Prospects for inflation. With regard to the activity level, growth in demand, supply and labor market are investigated. The chapter referring to the credit, monetary and fiscal policies, the analysis is centered on the behavior of credit, financial and budget operations. 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. Insofar as the foreign sector chapter is concerned, analysis is targeted at economic-financial relations with the international community, with emphasis on trade results and foreign financing conditions. In the following chapter, 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

The economic environment has improved in the last months. The exchange rate has appreciated rapidly in response to the positive performance of the external accounts and to the perception of the severance of the Brazil risk premium with respect to that of Argentina. The projections for the readjustment of government-managed prices have been revised downwards because of lower readjustment for electric energy prices, liberalization of the market for oil by-products and changes in taxation of this sector that should imply significant reductions in prices. The projected slope of the term structure of the interest rate has declined, affecting positively economic growth.

The performance of GDP in the third quarter shows evidence of deceleration and accommodation of the economic activity level at a lower level. Economic indicators by sector point possibly out to a smooth recovery. The negative effects of the unfavorable international environment, exchange rate depreciation and energy crisis have been in part offset by the good results of grain crop and exports in some sectors. The good performance of agriculture more than compensate the negative growth of industry. Investments is being maintained at a high level, which points to an increase in the future productive capacity of the economy.

In spite of the shocks that hit the economy over 2001, GDP should grow at around 2.0%. Expected growth for 2002 is slightly higher, around 2.5%, as a result mainly of the mitigation of the energy crisis and of the recovery of the world economy as off the second semester of 2002. Furthermore, the maintenance of fiscal adjustment will allow to accelerate the fall of the debt to GDP ratio, contributing to economic growth with stability.

The performance of exports, notably of commodities, such as soybeans, meat and sugar, has been significant, while imports have declined since the beginning of the second semester. These factors should contribute to a trade balance in excess of US$ 2 billion in 2001.

The reduction of the inflows related to the main sources of the balance of payments financing responded to an uncertain scenario formed since the events in the United States in September. Recently, there has been a recovery of capital inflows, mainly of foreign direct investments and disbursements greater than amortizations. One expects an improvement in the current account for 2002, which should affect positively the financing of the balance of payments.

The evolution of the price indexes in the last months has reflected basically the performance of market prices, which were impacted by the exchange rate pass-through and recomposition of profit margins. For the coming months, expectations are favorable. The IPCA inflation should reach 7.4% in 2001, above the upper limit of the tolerance interval for this year. For 2002, the effects via inertia of greater inflation in the fourth quarter of 2001, the readjustment of 5.2% (contribution of 1.6 percentage points) of the set of government-managed prices, and the possibility of decompression of profit margins have led to a projection of a 3.7% inflation in the baseline scenario. For 2003, an inflation of 2.5% is projected, encompassing a rise of around 3.1% for government-managed prices.

The market expectations for inflation in 2002 are being reduced over the last weeks towards a level below 5.0%. It is important to stress that a significant part of the difference between market projections and those of Copom is explained by a more depreciated exchange rate path used by the market.

The assessment of the previous *Report* is maintained. Considering the shocks that hit the Brazilian economy over 2001, the unfavorable evolution of inflation this year and the slightly above the target projection for 2002 are fully justifiable and compatible with the commitment of the Central Bank to maintain price stability. The monetary policy has been efficacious in controlling the demand pressures on inflation and the propagation of supply shocks to the other prices in the economy.

1 – Activity level

Based on recently released indicators, the loss of dynamics detected in the Brazilian economy in the last several months may well have bottomed out or even begun reversing course. One sign is the stability registered in Gross Domestic Product (GDP) in the third quarter of the year compared to the previous quarter, when the influence of seasonal factors is eliminated. This behavior demonstrates that many of the negative repercussions of the shortfall in the electricity supply and the critical situation of the Argentine economy have been overcome, while the effects of the grave international situation are being gradually dissipated. At the same time, this result indicates that the dynamics of internal economic activity have not been lost, despite the slowdown that has marked the world economy. In Brazil, this is evident in increased farm sector earnings and rising overall wages, a process that was generated basically by increased formal employment.

1.1 – Aggregate demand

1.1.1 – Consumption

The falloff in retail trade sector sales that had marked economic performance up to the start of the second half of the year as a consequence of interest and exchange rate variations coupled with deteriorating expectations leveled off in August and September, albeit at a relatively lower level than in 2000. The clearest sign of recovery in consumer demand is found in October data, as real revenues of the São Paulo metropolitan region retail trade sector gained ground for the third consecutive month.

According to data purged of seasonal factors released by the Trade Federation of the State of São Paulo (FCESP), the sector's revenues in

Real sales of the retail sector in São Paulo

Percentage change

Itemization	2001				
	Jul	Aug	Sep	Oct	Nov*
In the month[1/]					
General	-2.9	0.7	0.4	2.9	1.8
Consumer goods	0.5	-1.3	2.2	0.5	3.7
Durable	1.7	-1.4	2.1	1.8	4.6
Semidurable	-4.0	-9.2	-4.1	-5.0	-1.7
Nondurable	1.9	-1.3	3.7	-1.0	3.1
Automotive trade	-10.3	-7.8	6.3	8.5	-1.1
Building materials	-5.3	1.8	-6.2	0.2	-7.6
Accumulated in the year					
General	-1.8	-3.3	-4.3	-4.7	-4.8
Consumer goods	-1.1	-2.4	-3.3	-3.7	-3.8
Durable	-2.1	-3.8	-5.0	-5.5	-5.9
Semidurable	-20.2	-20.1	-20.7	-20.8	-21.3
Nondurable	3.6	2.4	1.7	1.3	1.3
Automotive trade	-12.0	-14.7	-16.0	-16.1	-16.2
Building materials	7.8	6.4	4.1	3.3	1.0

Source: FCESP

1/ Seasonally adjusted.
*Preliminary.

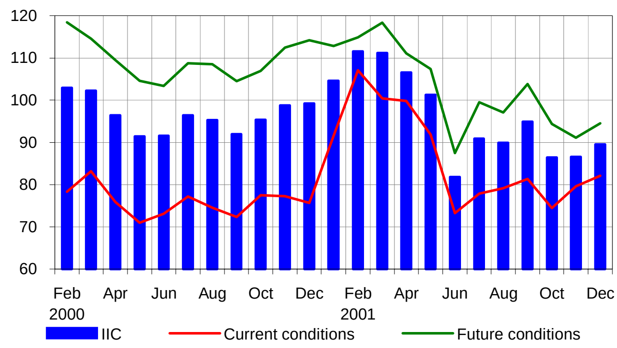
August and September turned in respective growth rates of 0.7% and 0.4%. Analysis shows that, in the first month, this turnaround was due to sales of building inputs while, in the second, it was generated by recovery under durable and nondurable consumer goods and by automotive sector sales. In October, the sector turned in even sharper growth (2.9%), with increased sales through factory authorized vehicle outlets for the second month in a row (11.4%) and significant recovery under consumer durables and, particularly, department stores (0.72%) and articles for the home (1.22%). The reduction in vehicle inventories on factory lots was due mostly to special financing conditions, while improvement under consumer durables can be explained by an upturn in sales once the restrictions on the energy supply had been attenuated.

Preliminary results for November confirm the trend toward recovery under consumption. Based on data free of seasonal factors, real revenues increased by 1.77% as a result of increased sales of consumer goods, particularly durable and nondurable products, while sales of semidurables turned downward. The automotive trade sector declined in the month following strong positive growth in September and October. A comparison of the average for the September-November quarter with that of the previous quarter indicates growth of 2.41%, once seasonal factors are ignored. Consequently, the November results provided further support to evidence of recovery in the sector. However, it is important to note that the upturn will not be enough to avoid a falloff under revenues in 2001, when compared to 2000. The only segments to register higher growth than in 2000 were sales of nondurable consumer goods and building inputs, explained basically by increased formal employment and the consequent positive impact of greater overall wages in the year.

The national sales volume indicator elaborated by IBGE pointed to a drop of 1.1% up to October, when compared to the same period of 2000. The most important declines were registered under “other articles for personal and household use” (6.3%) and “fuels and lubricants” (3.4%).

To some extent, these reductions were attenuated by the rise in sales through hypermarkets, supermarkets, food products and beverages and tobacco (1.8%) and fabrics, apparel and footwear (1.8%).

Consumer Intentions Index (IIC)



The behavior of the Consumer Intentions Index (IIC), which is calculated by FCESP, adequately mirrored evolution in consumption over the course of 2001. More specifically, the gradual decline from March to May was followed by an accentuated falloff in June, reflecting announcement of the measures taken to cope with the energy crisis. The new level was maintained up to September when the curve turned upward once again, only to be struck down once again by the international events of that month, the effects of which were felt in October statistics. In November, the index edged upward when compared to the previous month, reflecting recovery under current consumer intentions, with growth of 6.7%. This result was somewhat offset by a decline under future expectations caused by upward movement in the rate of inflation and fear of unemployment.

The December IIC calculated by FCESP reflected recovery in consumer perceptions when compared to the current situation and the outlook for the future. Just as normally occurs in this period of the year, the indicator was impacted by payment of the Christmas Bonus and the nearness of the Christmas and New Year commemorations. The December index also reflected the fact that the Brazilian economy was managing to move forward despite the Argentine crisis and the United States economic slowdown. Worry at the possibility of unemployment also lessened as companies began opening temporary positions, as normally occurs toward the end of the year. The 3.44% increase in the index when compared to November resulted from growth of 3.69% under future intentions and 3.05% under current intentions.

In the month of October, the average rate of interest on the retail trade sector declined for the third consecutive month to a level of 6.79%. It should be noted that, until recently, this rate had accompanied the Selic rate trajectory. The average monthly rate for the year came to 6.83% compared to 7.26% in the same period of 2000. Net default rates measured by the São Paulo Trade Association (ACSP) moved in precisely

Average interest rates effective in the retail sector

Rate

Itemization	2001						
	Apr	May	Jun	Jul	Aug	Sep	Oct
Average interest rates	6.82	6.85	6.87	6.88	6.86	6.85	6.79
By segment							
Large stores	5.85	5.92	5.94	5.96	5.92	5.89	5.78
Medium stores	7.09	7.12	7.14	7.16	7.12	7.09	7.03
Small stores	7.76	7.79	7.79	7.79	7.78	7.71	7.66

Source: Anefac

Default rates

Rate

Itemization	2001				
	Jul	Aug	Sep	Oct	Nov
SPC (SP)1/	7.33	5.99	5.99	6.17	8.39
Returned cheques2/	5.13	5.09	5.04	5.11	5.17
Teledata (RJ)3/	1.98	2.72	2.49	2.81	2.18
Teledata (National)4/	2.59	3.05	2.98	2.64	2.36

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.

the opposite direction of interest rates, registering sharp growth in November to 8.4%, in contrast to 6.2% in October. According to the ACSP, the major reasons for this behavior were increases in unemployment and the reduction in average real earnings. ACSP expectation is that the rate will decline further in December as a result of seasonal factors before turning up to the level of 6%. The reasons for this trend are payments of the Christmas bonus and normal consumer behavior in this period of the year as they seek to recover their credit standing for purposes of end-of-the-year purchases. Though it did not reach the highest point of the statistical series, the default rate remained about 2 p.p. above the average for 2000, thus reflecting the crisis that hit the nation's productive activity. At the same time, the proportion of checks returned due to insufficient backing to total checks cleared increased in November, moving to 5.2% compared to 5.1% in the previous month and 4% in November 2000.

1.1.2 – Investments

Investment indicators turned in highly differentiated performances over the course of 2001. In the first quarter of the year, the productive capacity of the economy expanded, continuing a process that had begun in the previous year. As of April, several indicators began registering signs of a slowdown, more or less accompanying the level of economic activity in general.

The outlook for 2002 suggests upward movement in investments together with recovery in the pace of activity. However, to some extent, the percentage rise in investments against GDP will be conditioned to an upturn in investments in the building sector.

Output of capital goods, which had expanded by 17.3% in accumulated terms for the year up to July when compared to the same period of 2000, registered growth of 15.7% up to October. This growth is

Investment indicators

% accumulated growth in year

Itemization	2000	2001 May	Jun	Jul	Aug	Sep	Oct
Capital goods							
Production	12.9	19.5	17.5	17.3	16.8	15.2	15.7
Imports	3.1	36.1	31.5	26.9	24.2	20.0	19.1
Exports	36.8	-7.3	-8.4	-11.3	-11.2	-12.3	-13.8
Inputs for the building industry	2.2	4.0	2.3	1.3	0.4	-0.4	-1.1
BNDES financing	27.7	52.2	57.3	23.8	39.5	38.7	29.0

Source: IBGE, Funcex and BNDES

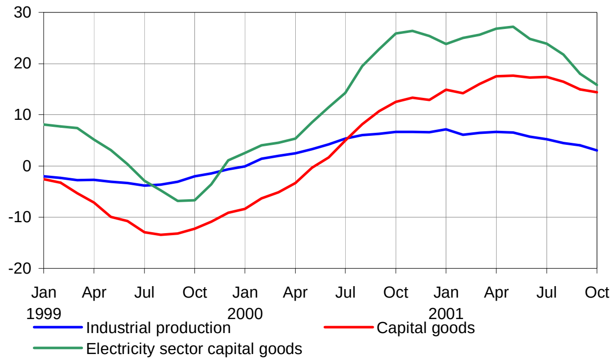
considered quite strong, particularly when compared to the average of 2.5% for industry in general, and was sufficient to consolidate the change in the industrial output profile in 2001, when viewed against the previous year, a period in which the lead position was held by production of consumer durables.

Based on monthly data and abstracting from seasonal factors, an analysis of capital goods output figures shows a reduction of 1% in September and a drop of 4.7% in October. In the month of October, the falloff was concentrated under output of industrial goods produced in series (10.8%), mixed equipment (7.1%) and electricity generation equipment (5.8%). A comparison of the average of the last two quarters shows a level 1.7% higher in the August-October period when viewed against the three previous months, mostly as a consequence of expansion in the month of August. Utilizing these bases of comparison, it is evident that output was driven by the sectors of construction equipment, with expansion of 13%, followed by equipment for electricity generation, with 11.6%, and industrial goods not produced in series, with 7.1%.

The results accumulated in the year clearly reveal the response of the electricity generation equipment industry to the energy supply crisis. Output of equipment for this end grew by 48.7% up to October, a figure that was sharply higher than the production of construction equipment, which was ranked in the immediately following position with growth of 26.8%. Though the latter sector had registered rather mediocre results up to the end of the third quarter of the year, the figures generated under equipment output would seem to signal better days in the coming months. Output of farm machinery expanded by 19.3% and strengthened expectations of an excellent 2002 harvest, now in the planting stage. Finally, expansion of 14.6% in the output of transportation equipment also deserves attention.

Data for the month of November released by the National Association of Automotive Vehicle Manufacturers (Anfavea) and purged of seasonal factors by the Banco Central Department of Economics (Depec) point to monthly growth of 1.6% in the output of farm machines, a result that raised accumulated production for the year by 25.1%, when compared

% change of the 12 month moving average



Production of capital goods

% accumulated growth in year

Itemization	2000	2001			
		Jul	Aug	Sep	Oct
Capital goods	12.9	20.5	19.5	17.5	15.7
Industrial	19.0	11.0	11.3	9.5	5.7
Serial	21.9	11.6	11.9	10.0	5.7
Nonserial	7.3	10.5	10.7	9.1	6.0
Agricultural	19.3	14.0	13.1	11.8	19.3
Farm parts	14.6	13.1	12.3	11.0	3.8
Building	15.0	14.3	14.1	13.1	26.8
Electric energy	3.2	21.1	22.0	21.6	48.7
Transportation	22.8	21.1	21.6	20.8	14.6
Mixed	7.9	20.0	20.3	19.4	7.2

Source: IBGE

Production of automotive vehicles

Percentage change

Itemization	2001				
	Jul	Aug	Sep	Oct	Nov*
In the month 1/					
Farm machines	11.2	-3.0	15.4	4.1	1.6
Buses	-4.7	7.8	-5.1	21.7	24.0
Trucks	-9.5	2.3	-10.4	6.1	6.5
In the year					
Farm machines	30.7	27.2	26.1	26.7	25.1
Buses	-2.6	-2.9	-3.9	-1.1	1.7
Trucks	19.7	14.9	10.5	8.0	7.5

Source: Anfavea

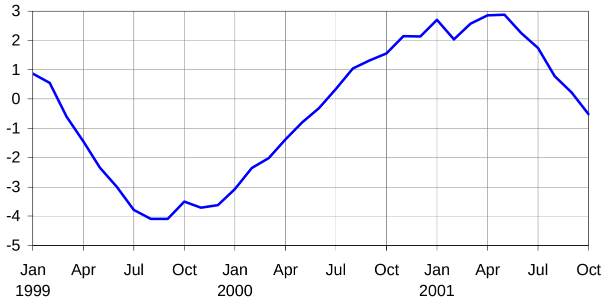
1/ Seasonally adjusted.
* Preliminary.

to the same period in the previous year. Part of this performance can be attributed to external market demand, since sales of these products abroad increased by 49.3% compared to 19.4% in overall sales. Anfavea data point to significant growth in the nation's highway cargo transportation fleet, as production of trucks increased by 7.5% in the year. On the other hand, output of buses expanded by just 1.65% up to November.

The volume of capital goods imports registered 19.1% expansion up to October, compared to 36.1% at the end of the first six months of the year. Analysis of the composition of the dollar value of imports indicates accentuated growth in purchases of fixed equipment for mobile telephone services (26%), industrial machinery (22%) and parts and spares for industrial capital goods (21.5%).

Output of the construction industry turned downward as of the first quarter of the year. According to quarterly GDP data, the sector accumulated growth of 4.5% up to March, compared to the corresponding period of the previous year. This result dropped to 2.4% at the end of the first half of the year and to 0.76% in the third quarter. The accumulated rate of GDP growth up to September closed at 2.17%. When one considers the significant participation of this heading in gross capital formation, this result inhibited growth in the percentage of outlays on investments compared to GDP. With regard to output of building inputs, data from which seasonal influences have been eliminated reveal that the first positive monthly result registered after February occurred only in September. The final figure for the first ten months of the year was a falloff of 1.1%, compared to 2.1% growth in the corresponding period of the previous year and a decrease of 3.6% in 1999. The lack of dynamism in

Production of construction inputs
% change of the 12 month moving average



Source: IBGE

this sector in recent years was generated to some extent by cutbacks in public sector investments, as well as the high costs of financing residential construction.

The resources disbursed by the BNDES System – National Bank of Economic and Social Development (BNDES), the Special Industrial Financing Agency (Finame) and BNDES Participações S.A. (BNDESpar) – expanded by 29% up to October, compared to the same period of 2000. On a sector by sector basis, increased growth was registered in total resources channeled to the crop and livestock sector (44.5%), followed by the manufacturing industry (39.3%) and commerce and services (12.9%). The mineral extraction industry registered a decline of 22%. The Long-Term Interest Rate (TJLP), which reflects the cost of the loans granted by the BNDES System, moved from 9.5% per year in the third quarter to 10% per year in the fourth.

Inventory indicators registered differentiated trajectories in the various indices and sectors analyzed. Thus, the Manufacturing Sector Survey carried out in October by the Getulio Vargas Foundation (FGV) registered high stock levels caused by weak third quarter demand.

On the other hand, the 20th Bic Banco Survey pointed to an across-the-board reduction in stock levels, as the 67.3 index for the second quarter slipped to 62.4 in the third. A sector-by-sector analysis showed declines in stock levels in the capital goods and nondurable consumer goods industries and in the wholesale trade sector. The intensity of these declines was sufficient to offset upward movement in the stock levels of the crop and livestock sector, intermediate and consumer durables industries and the retail trade sector.

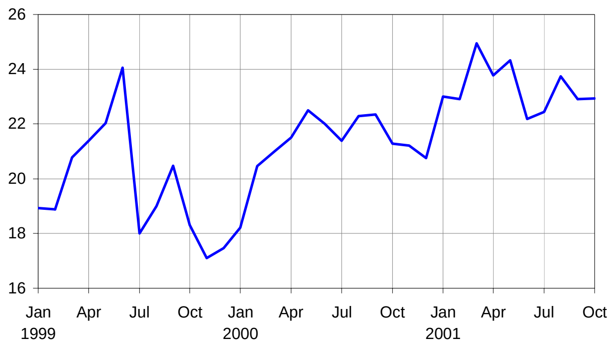
Data released by the National Federation of Automotive Vehicle Distribution (Fenabrave) registered the fifth consecutive month of downward movement in the stock of factory authorized vehicle sales outlets which, in the month of November, closed at a level 14.4% below the same month in 2000.

Analysis of investment indicators allows one to conclude that installed output capacity expanded in all sectors of the economy in 2001. In the industrial sector, growth was below the 2000 level, while expansion in the other sectors was higher. The most important components of the increase in capital goods production were the sectors of electricity generation, construction and agriculture. Demand for electricity generating equipment is expected to decline in the coming months as rationing measures are attenuated. However, expectations of upward movement in electricity rates should stimulate the search for energy self-sufficiency by the industrial sector. In recent years, output of farm equipment has accompanied growth in the harvest of grain and other crops. This tendency is expected to continue in 2002. The lag between production of equipment for the building industry and the effective performance of the sector suggests that the conditions needed for recovery are present, particularly in terms of output capacity. Emphasis should be given to the fact that the behavior of the construction sector is a determining factor in raising the proportion of investments to GDP.

1.1.3 – Internal demand

Gross capital formation as % of GDP

In the month



Reflecting the fact that imports of goods and services surpassed exports in monthly comparisons up to October, internal demand followed an upward trajectory over the course of the year. Thus, the representativeness of internal demand against GDP moved from 101.08% in the twelve month period ended in October 2000 to 101.82% in October 2001, according to estimates issued by Depec.

Gross capital formation is expressed as a percentage of GDP increased from 21.3% in October 2000 to 22.9% in October 2001. When one considers gross fixed capital formation, which does not include the items “others” and “stock variations”, the rates came to 19.2% and 19.6%, respectively. With exception of the building sector, investment indicators registered growth rates that were higher than most of the consumer demand indicators. The estimate of consumption in relation to GDP, which includes stock variations, dropped from 82.39% in the twelve month period ended in October 2000 to 82.13% in the same period up to October 2001.

Gross capital formation and gross fixed capital formation

Gross capital formation or investment results from the algebraic sum of gross fixed capital formation and inventory variations. In its turn, gross fixed capital formation is subdivided into three groups: construction, machines and equipment and others.

Indicators exist for the sectors of construction and machines and equipment that make it possible to monitor their monthly growth curves. Construction is monitored by the IBGE statistical series on production of inputs for the sector. In the case of machines and equipment, data for industrial production as announced by IBGE are combined with exports and imports of capital goods. With these three series, it is possible to come to the concept of capital goods absorption.

These two sectors represent the major share of gross capital formation. According to national accounts for the 1995-1999 period, construction accounted for an average of 13.3% of GDP and 62.6% of gross capital formation. In the case of machines and equipment, the corresponding figures came to 5.3% and 25%, respectively.

No monthly indicators exist for the item “others”, which mostly encompasses activities related to forestry, formation of permanent crops and animals for breeding, traction and dairy cattle.

At a given moment, stocks include all goods, with the exception of fixed assets belonging to the resident producer units. Information periodically released on changes in stock positions is mostly provided on a sector-by-sector basis. Evaluation of the behavior of this variable is difficult as a result of the lack of the data needed to monitor the trajectory of this variable in aggregate terms.

Considering the limited data available for any evaluation of the item “others” and stock variations, Depec investment estimates were restricted to the concept of gross fixed capital formation.

In the second half of 2001, IBGE began publishing quarterly national accounts, going back to the first quarter of 1991. Based on the concept of fixed capital formation, the series provides data on investments, without itemizing their composition. In annual terms, the data for national accounts were published for the 1995-1999 period. Based on this information, it can be seen that, in terms of the average for the period, outlays on the items included under “others” represented about 1% of GDP and stock variations accounted for 1.6%.

The following table presents monthly data showing the percentage participation of gross capital formation and gross fixed capital formation in GDP in 2001. The figures are based on indicators for output, imports and exports of machines and equipment, inputs for the building industry and, furthermore, projections of the items "others" and stock variations, utilizing data from 1995 forward as well as sector-by-sector information on stock evolution.

Gross capital formation

		Percentage of GDP
Itemization	Gross capital formation	Gross fixed capital formation
2001		
Jan	23.0	19.7
Feb	22.9	19.3
Mar	24.9	21.2
Apr	23.8	20.3
May	24.3	20.9
Jun	22.2	18.6
Jul	22.4	19.2
Aug	23.7	20.4
Sep	22.9	19.4
Oct	22.9	19.6

Source: IBGE and Banco Central do Brasil

1.1.4 – Conclusion

With the signs of a leveling off in consumer demand at the start of the second half of the year, indicators started a slow but steady upturn in more recent months. Factors such as income generated by the primary sector and additional job positions created among registered workers in every month of the year explain this performance. The recovery of consumer purchase intentions demonstrated that the effects of the energy crisis and the deteriorating external scenario have been absorbed, suggesting a positive environment for growth in end of the year sales. The falloff in average earnings will certainly bar any possibility of demand growth beyond the productive sector's capacity to respond.

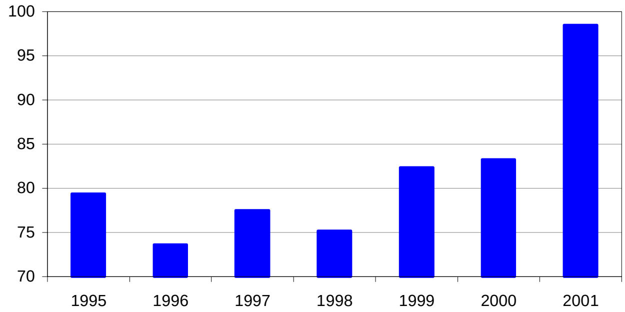
With regard to investment demand, capital goods absorption – defined as output plus imports less exports of equipment – remains high, with growth of 22% up to October, when compared to the first ten months of 2000. This behavior contrasts with the diminishing dynamism of the building industry since the early months of the year.

1.2 – Aggregate supply

1.2.1 – Crop and livestock farming

Crops

Grain production
In million of tons



Source: IBGE

The current grain harvest totaled 98.5 million tons, the largest in the history of the nation. In comparison to 2000, growth came to 18.3%, according to the November Systematic Farm Production Survey (LSPA) carried out by IBGE. Analysis of regional distribution of the harvest indicates that the southern region accounted for 50.1%, with expansion of 37.9%, followed by the central-west region, with 29.2% of output and growth of 11.2%, when compared to 2000. The southeast region registered growth of 8.6% and accounted for 12.8% of the total harvest. Finally, the north and northeast regions turned in relative participation levels of 2.1% and 5.7%, with output declines of 4.3% and 27.6%, respectively.

It is important highlight the fact that the performance of the harvest was generated basically by sharp growth in average yield, since the total area under cultivation increased by only 1.2% when viewed against the previous year. The crops that turned in growth in planted area registered more accentuated yield levels, as occurred in the case of corn. Even those harvests – rice, for example - that closed with lesser output and area planted managed to achieve productivity gains.

Crops

Itemization	2001 percentage change		
	Production	Area	Average production
Grain production	18.3	1.1	...
Cotton (seed)	31.2	9.3	20.1
Rice (in husk)	-8.0	-13.9	6.9
Beans	24.2	-20.0	5.1
Corn	29.9	6.4	29.1
Soybean	15.1	2.2	12.7
Wheat	92.8	59.7	20.7
Others	17.8	-2.1	...

Source: IBGE

1/ It refers to the November LSPA.

The failures that occurred in the bean and rice harvests impacted the prices of these products during the year. In more specific terms, the prices of black beans and rice increased at respective rates of 174.37% and 43.77% up to the month of November, as shown by the Broad Consumer Price Index (IPCA).

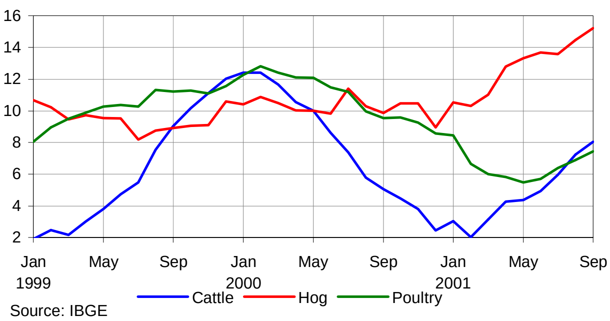
For the coming year, the second survey of planting intentions and area planted for nine different products in the southeast, south and central-west regions and

Rondônia turned in growth of 1.1%. Mention should be made of the favorable estimates of the area to be occupied by soybean (11.1%) and first bean harvest production (9.8%). On the other hand, a reduction is expected in the area planted in rice (2.4%), manioc (10.1%) and the first corn harvest (13%). In the case of manioc, the reduction was a consequence of marketing prices, considered very low in the previous harvest. The lesser area given over to the first corn crop is also explained by the same reasons, coupled with expansion of the area planted in soybeans.

Livestock

Livestock production moved upward over the course of 2001. In the first six months, growth came to 4% and more recent indicators demonstrated that 2001 will be the fourth consecutive year of positive results in this sector. As a matter of fact, since 1990 the only year in which the livestock sector turned in negative growth was 1997.

Livestock
Total weight
Percentage change in 12 months



Source: IBGE

An analysis of the major components of this sector point to generalized growth. Thus, data available up to September indicate expansion of 13.9% in the production of cattle, 16.4% in that of hogs and 11.5% for chicken. Milk production increased by 11.3% in the same period. The segment of the food industry that operates with livestock has continued producing performance levels well above the average for the manufacturing sector in general. Up to October, slaughter (excluding poultry) and trimming operations expanded by 6.8%. In the case of poultry, the increase was 8.5% while the cooling and preparation of milk and milk products grew by 5.1%. When one considers the inputs for the sector, the same tendency is perceived as production of animal feed increased by 6.7%.

Just as occurred in recent years, the results for the export sector in 2001 were quite good. In accumulated terms for the year up to October, total foreign sales of meat and giblets increased by 50.8%. Analysis of the most relevant items shows that growth came to 117.2% under hogs and derivatives, followed by expansion of 78.2% under cattle and 35.8% for poultry.

The upward movement in exports has impacted internal prices, particularly in the case of beef. Consequently, in both October and November, the IPCA registered increases in meat prices equivalent to 5.23% and 2.87%, respectively, and accumulated expansion of 11.26% in the year.

1.2.2 – Industry

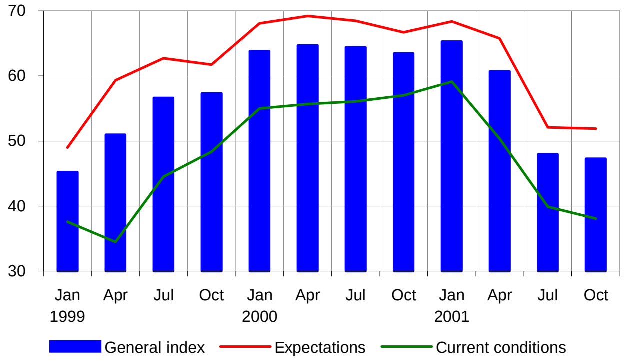
Industrial output

A breakdown of industrial output indicators in recent months shows that the negative impact of the restrictions imposed on electricity consumption have been almost entirely absorbed by the sector. October results were strongly impacted by a work stoppage by oil workers, with repercussions on the mineral extraction industry and the chemical industry. Once these effects are eliminated from the calculation, the October result remains negative, albeit with considerably less intensity. This result is compatible with the leveling off of the pace of industrial activity below the figures for the first half of the year, though sufficiently high to ensure positive results when compared to the preceding year.

The various studies and surveys carried out among industrialists confirmed that their concerns has shifted from the energy crisis to such questions as the profit margin squeeze and questions of demand in the latter months of 2001 and first quarter of 2002.

A comparison of the results of the Manufacturing Industry Survey carried out by FGV in October with those of the July survey indicated a perception among businesspersons that the behavior of demand for industrial products has shifted from “drastically weak” to “stabilized”. The October survey registered high stock levels as a result of several factors such as the weak demand that marked the month of July and, with regard to the business situation in general, the profit margin squeeze, which is basically explained by devaluation of the real. As regards the final quarter, businesspersons expect moderate growth in demand which, as a consequence of high inventory levels, will not be matched by growth in production. The FGV has also detected replacement of demand for imported products with internal production as a consequence of exchange devaluation.

Industrial Business Confidence Index



Industrial production

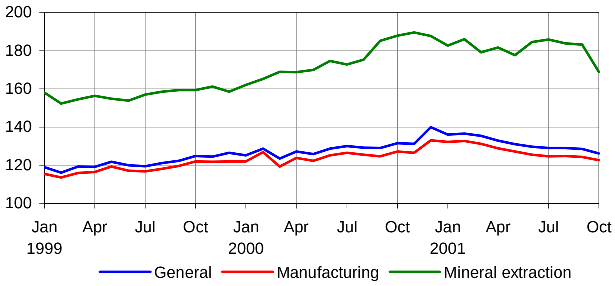
Percentage change

Itemization	2001			
	Jul	Aug	Sep	Oct
In the month[1/]	- 0.57	- 0.02	- 0.31	- 1.92
Same month of the previous year	1.27	- 0.40	- 1.87	- 3.43
Accumulated in the year	4.47	3.79	3.13	2.50
Accumulated in 12 months	5.24	4.47	3.99	3.12

Source: IBGE

1/ Seasonally adjusted.

Industrial production
Seasonally adjusted data
1992=100



Source: IBGE

Industrial production by category of use

12 month accumulated rate

Itemization	2001					
	May	Jun	Jul	Aug	Sep	Oct
Industrial production	6.55	5.80	5.30	4.54	4.08	3.12
Capital goods	18.57	18.40	18.59	17.61	16.13	15.34
Intermediate goods	5.53	4.59	3.88	3.04	2.40	1.34
Consumer goods	4.01	3.63	3.46	2.98	3.26	2.53
Durable	17.85	15.63	13.11	9.71	8.48	5.86
Semi and nondurable	0.58	0.60	0.99	1.22	1.89	1.64

Source: IBGE

In October, the Industrial Business Confidence Index, which is elaborated quarterly by the National Confederation of Industry (CNI), on the basis of information provided by industrial federations in 19 different states, remained practically stable when compared to the July result. The permanence of this index below the 50 point mark reflects such questions as the economic slowdown and high levels of interest and exchange rates. The falloff in the confidence level has been more closely related to negative perceptions than to expectations, since the index for the latter factor has remained above 50, despite the drop in relation to July.

Despite a monthly drop of 1.92% in industrial output in October, considering data seasonally adjusted, the accumulated results for the year remained positive, with a rise of 2.5% compared to the first ten months of 2000. Analysis of the major segments shows that the strike of oil workers in the extraction and refining segments had a strong impact on the results of the mining and chemical industries. The weights of these industries in the overall context of industrial output are 10.4% and 18.2%, respectively. The most important items in these segments are crude oil and gasoline, with respective drops of 7.8% and 7.5%. When the effects of these factors are withdrawn from the result, the decline in industrial output came to 0.11%.

Despite the negative result of the general indicator, one notes that twelve of the twenty one segments surveyed turned in positive growth, with the strongest performances under perfumes, soaps and candles (7.9%), tobacco (6.4%), furniture (5.4%) and rubber (5.3%). In terms of use categories, however, comparisons with the September result pointed to an across-the-board downturn, with the sole exception of consumer durables, which registered positive output growth after seven consecutive declines.

Accumulated results for the year show that twelve of the twenty one segments registered negative results, with the sharpest downturns under leather and hides (10.5%), apparel, footwear and cloth goods (6.3%) and tobacco (4.9%), which correspond basically to semidurable consumer goods. On the other hand, the highest growth figures were detected under electric and communications equipment (9.6%), mechanics (7.8%) and transportation equipment (7.5%), all of which are segments related to the capital goods industry. As already stated, it was the capital goods sector that occupied the lead position in terms of output throughout 2001. Composition of the growth rate shows that these segments accounted for 1.97 p.p. of the 2.5% growth rate turned in by general industry.

Industrial production according to electricity consumption

Percentage change

Itemization	2001			
	Jul	Aug	Sep	Oct
Month in the previous year				
High intensity sector	- 3.94	- 4.60	- 5.48	- 5.50
Medium intensity sector	4.42	3.56	2.16	0.90
Low intensity sector	2.87	0.11	- 2.03	- 3.00
In the year				
High intensity sector	- 0.17	- 0.77	- 1.32	- 1.80
Medium intensity sector	5.35	5.11	4.78	4.40
Low intensity sector	7.29	6.23	5.22	4.10
In 12 months				
High intensity sector	0.98	0.06	- 0.64	- 1.40
Medium intensity sector	5.18	4.90	4.98	4.60
Low intensity sector	8.30	7.46	6.78	5.30

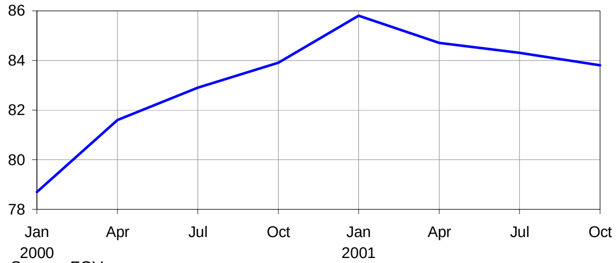
Source: IBGE

According to the intensity of electricity consumption, comparisons between 2001 and 2000 showed more intense growth for the medium and low intensity sectors, which account for 33.2% and 40.1% of the value of the output of the manufacturing sector and closed with expansion of 4.4% and 4.1% respectively. In the high intensity sector, which account for 26.6% of industry, output dropped by 1.8%.

A comparison between the results accumulated in the twelve month period up to October with those registered at the end of the first half of the year pointed to deceleration in the output of capital, intermediate and consumer goods. Basically, the performance of the latter category was caused by less intense growth in the production of consumer durables, which dropped from 15.6% up to June to 5.9%, reflecting continued high rates of interest and energy supply restrictions. At the same time, the trend toward gradual upward movement in the production of semidurable and nondurable consumer goods continued, as expansion moved from 0.6% up to June to 1.6% up to October. This movement has been sustained by both the domestic market, as evident in the upturn in employment, and the external market, as food exports also expanded.

Sector-by-sector data for November revealed that the automotive industry produced 153.5 thousand vehicles. With this, the accumulated result for the year expanded by 8.5%. Once seasonal factors are purged, monthly growth came to 12.6%. Sales totaled 148.1 thousand vehicles, for growth of 13.2% in the month, based on the statistical series devoid of seasonal influences. Output of farm machines and equipment expanded by 1.6% in November, the third consecutive month of positive results. In the year, growth came to 25.1%, a result that clearly suggests that productivity gains will also be achieved in the coming harvest which is now in the sowing stage.

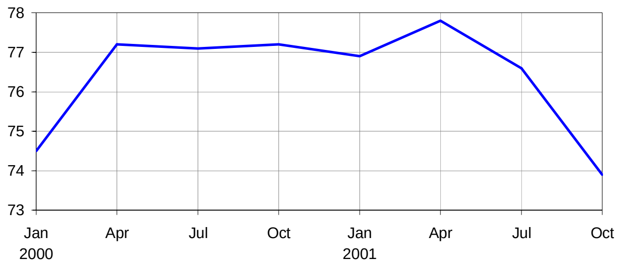
Utilization of installed capacity
Building materials
Seasonally adjusted data
Average percentage



Source: FGV

The level of utilization of installed output capacity reflected the leveling off of industrial production in recent months. The pace of reduction in utilization of industrial facilities has declined up to September. However, according to data released for the month of October by the Federation of Industries of the State of São Paulo (Fiesp) and CNI, there are increasingly clearer signs of a turnaround.

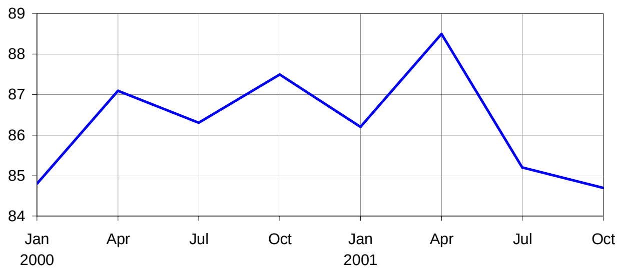
Utilization of installed capacity
Consumer goods
Seasonally adjusted data
Average percentage



Source: FGV

In this sense, the FGV study, which had revealed a downturn of 3 p.p. from April to June in the utilization level of industrial capacity, indicated a 1 p.p. falloff in the October survey. In the statistical series from which seasonal factors have been removed, the declines came to 3.1% in the second quarter and 2.3% in the third, when compared to the immediately previous periods. A comparison with October 2000 shows an accentuated drop, reflecting the behavior of the consumer and capital goods industries, since the levels registered by construction material and intermediate goods stabilized.

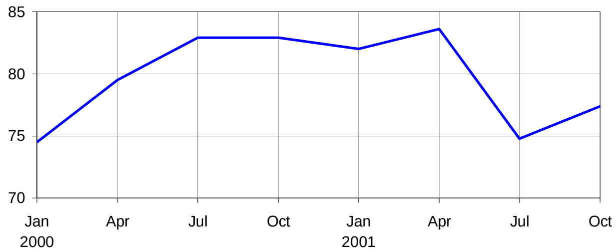
Utilization of installed capacity
Intermediate consumer goods
Seasonally adjusted data
Average percentage



Source: FGV

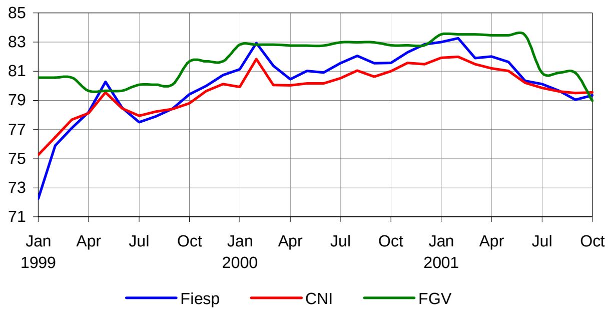
Aside from this, of the twenty one segments covered by the October FGV survey, eleven turned in higher levels of utilization of productive capacity in comparison to the July results. The highest expansion occurred in industries that produce rubber (4.5 p.p.) and apparel, footwear and cloth goods (8.1 p.p.). On the other hand, the sharpest declines occurred under tobacco (38.1 p.p.), perfumes, soaps,

Utlization of installed capacity
Capital goods
Seasonally adjusted data
Average percentage

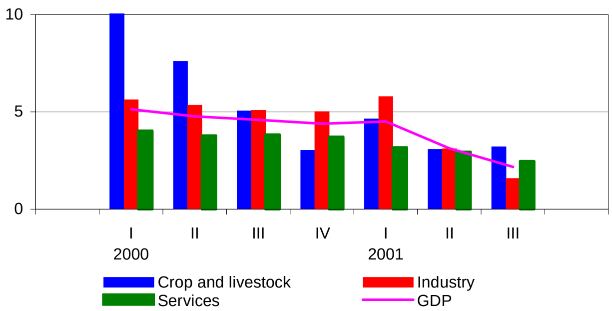


Source: FGV

Utilization of installed capacity
Seasonally adjusted data
Average percentage



Gross Domestic Product
% growth accumulated in the year



Source: IBGE

detergents and candles (11.4 p.p.) and leather and hides (2.6 p.p.), all of which are classified under semidurable and nondurable consumer goods.

The level of utilization of installed capacity declined from April to September in the industries located in the twelve states covered by the CNI survey and then stabilized in October according to figures from which seasonal factors have been purged. In the case of São Paulo industry, utilization of installed capacity increased by 0.38% in October following a reduction from May to September. In relation to the level registered in October 2000, declines of 1.87% and 2.76% were recorded in the industries analyzed by the CNI and Fiesp, in that order.

1.2.3 – Gross Domestic Product (GDP)

At market prices, GDP expanded by 2.17% up to the end of the third quarter, when compared to the same period in 2000. Expansion in the first half of the year closed at 3.12%. Once seasonal impacts have been excluded, GDP remained stable in the second and third quarters. Compared to the third quarter of 2000, growth came to 0.34%. In general, the results show that the effects of the energy crisis and depreciation of the real were initially overestimated as is evident in the fact that the economy stabilized, with no drastic slowdown as many observers had predicted.

Observation of the behavior of the rates accumulated over the course of the year indicates positive results in all sectors, with particularly strong performances in both crop and livestock output. In the industrial sector, it should be noted that the only segment to register an output decline was that of public utility industrial services, clearly reflecting the restrictions imposed on electricity consumption. Notwithstanding this

GDP outlook for 2002

Based on an analysis of sector-by-sector economic performance, the scenario presented in the table on the following page was created for 2002 GDP growth. This analysis took due account of the expectations of various entities on growth in their own specific areas of activity, research findings of various institutions, statistical questions – seasonality and reference bases – as well as situational factors, particularly with respect to the evolution of external and internal demand.

For the primary sector, expectations are considered highly positive, particularly in light of early harvest forecasts released by Conab/MAPA and IBGE's survey of planting intentions among rural producers. The studies carried out by these institutions point to a record grain harvest, with growth in the range of 2% over the previous harvest. Aside from this, crops of considerable weight in the composition of the nation's primary sector product, such as coffee, oranges and sugar cane, are expected to turn in high growth levels in the coming year. Livestock production will keep pace with the results of recent years, particularly in view of highly favorable international market demand for meat exports in general. These operations will be further stimulated by increased external demand for the Brazilian product and evolution of the rate of exchange. Since it is strongly impacted by the steel sector, plant extraction is also expected to generate growth above the figure for 2000.

In the context of industry, important segments of the manufacturing sector have projected high levels of expansion for the coming year either as a result of their participation in the aggregate value of the nation's production structure and/or their role in other subsectors of the economy. The automobile industry expects to sell 1.9 million cars, with growth in the range of 8%. The sectors of steel and the food industry are projecting similar results, albeit at a slightly less intense pace. Despite these positive expectations, the growth of the manufacturing industry is limited by the statistical effects of the decline registered in 2001, since this will generate an unfavorable basis of comparison known as a negative carry over. Insofar as the outlook for other secondary subsectors is concerned, the mining industry should close with higher growth than in 2001 as a result of the serious problems faced in the area of prospecting in the year. For public utility industrial services, which basically involve electricity generation, projections based on Eletrobrás data point to strong growth.

In the tertiary sector of the economy, projections for the subsectors of transportation and commerce were based on the growth figures calculated for the manufacturing industry and farm sector, using the criteria employed by IBGE in its calculation of GDP. Among the other subsectors, emphasis should be given to real estate leases, public administration and other services, which account for about 70% of the product of the tertiary sector. Quarterly results for recent years were used to calculate the first two of these, since they have registered relatively stable figures in the period. For other services, the outlook for growth in formal employment as foreseen by Ministry of Labor data was incorporated into the projection.

Gross Domestic Product

Itemization	2001[1/]	2002
	% change	
Crop and livestock	3.2	3.5
Industry	1.6	2.5
Mineral extraction	6.4	7.5
Manufacturing industry	2.0	1.9
Construction	0.8	1.7
Public utility industrial services	-2.5	5.2
Services	2.5	2.1
Commerce	2.2	0.8
Transportation	1.3	0.8
Communications	12.5	8.0
Financial institutions	1.4	1.9
Other services	1.6	2.4
Real estate leases	2.2	2.3
Public administration	1.6	2.0
Financial dummy	2.3	1.9
Value added at basic prices	2.2	2.4
Taxes on products	2.1	2.6
GDP at market prices	2.2	2.5

Source: IBGE and Banco Central do Brasil

1/ Up to the third quarter.

Gross Domestic Product

Percentage change

Itemization	2000		2001		
	III	IV	I	II	III
Accumulated in the year	4.60	4.39	4.50	3.12	2.17
Accumulated in four quarters	4.28	4.39	4.24	3.57	2.56
Quarter/same quarter of the previous year	4.28	3.77	4.50	1.82	0.34
Quarter/previous quarter seasonally adjusted	0.82	0.89	0.17	0.02	0.05

Source: IBGE

result, the 2.5% drop was less than originally expected, particularly in light of the scope of the rationing measures adopted. Even in the building industry, the results were less somber than originally predicted, as output of building inputs declined by 0.39% up to September. All of the service subsectors closed with positive growth, led by communications with 12.5% and “other services” with 3.6%.

1.2.4 – Conclusion

With announcement of GDP results for the third quarter of the year, it became evident that the deceleration in the pace of activity that marked the first half of the year has leveled off at a point below the results for the early months of the year. Sector-by-sector indicators for October and

November indicate that the process of stabilization in the pace of activity at a slightly lower level could soon be transformed into gradual recovery.

To some extent, the adverse impact of the highly negative international scenario, high interest rates, exchange devaluation and the energy crisis were offset by the good results achieved in the farm harvest and in foreign sales of several productive sectors. Growth in farm income coupled with the dynamics of the foreign trade sector generated a positive influence on the pace of activity and employment and aided in diluting the adverse impacts created in the industrial sector, particularly in manufacturing, which is traditionally more sensitive to such shocks.

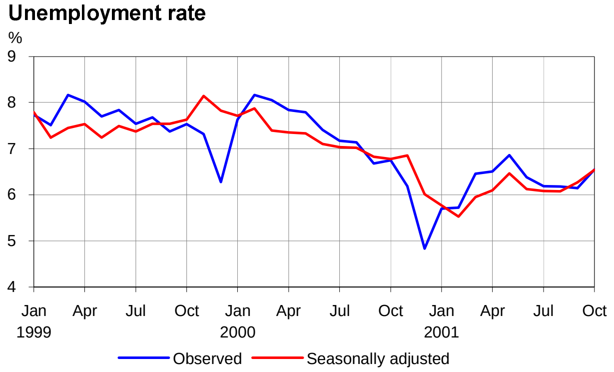
With the exception of such circumstances as the reduction in the rice and bean harvests and the energy crisis, supply in the course of the year has kept pace with the demand trajectory. Despite the stimulus produced by the positive crop and livestock farming results and increasingly higher levels of formal employment in the country, wages and real earnings turned downward. Even in the hypothesis of a strong upturn in demand for industrial goods, the economy has approximately 20% idle capacity to meet such demand over the short-term.

1.3 – Labor market

1.3.1 – Employment

Analysis of employment indicators demonstrates that formal employment in the country has been growing, while unemployment has remained stable. In the industrial sector, surveys have shown that the number of layoffs has been less than initially suggested by the economic scenario. However, indicators for the month of October reveal that this trend have been reversed.

Unemployment rate



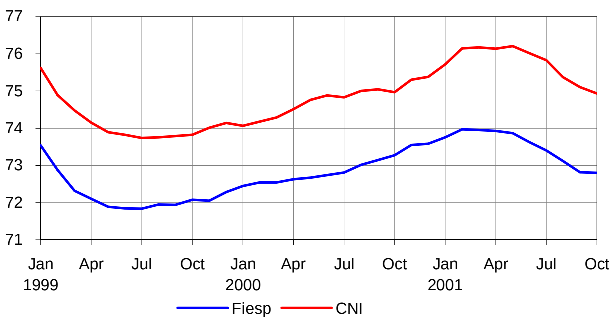
Source: IBGE

The rate of open unemployment calculated by IBGE in six metropolitan regions has remained above the 6% mark since March. In October, the rate closed at 6.55% compared to 6.15% in the previous month. This result reflects a combination of 0.45% growth in the working population and stability in the number of those employed, resulting in a rise of 7.19% in the number of unemployed. Up to October, average unemployment in the year came to 6.27% compared to 7.46% in the same period of the preceding year. The average time during which people seek work increased to 21.76 weeks in October compared to 20.47 weeks in September.

Despite stability in the number of working people, there has been a significant shift in employment patterns among the sectors surveyed. Employment in the manufacturing sector increased by 0.51%, while the construction industry, commerce and services turned in declines of 1.23%, 1.2% and 0.05%, respectively. Analysis of the results accumulated up to October pointed to average growth of 0.79% in the number of working people, with 1.59% in the service sector and 0.97% in manufacturing. Construction industries and commerce in the metropolitan regions analyzed cut their employment rolls back by respective rates of 2.81% and 0.77%.

Looking at the various occupational categories, October witnessed a falloff of 0.99% in jobs held by registered workers and a drop of 0.84% among employers. However, the IBGE household survey confirms data gathered by the Ministry of Labor and Employment (MLE), indicating accumulated 4.4% growth in the year in formal employment, compared to downturns of 6.77% in the number of employers, 1.75% in unregistered employees and 0.62% in the number of self-employed workers.

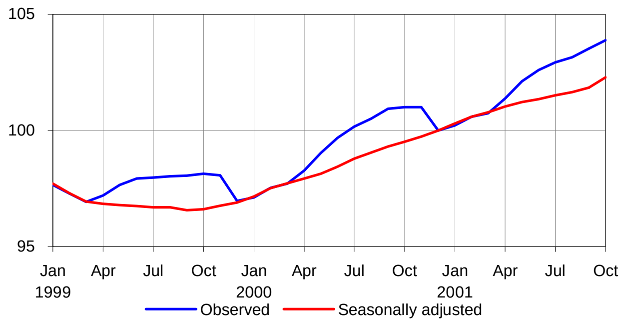
Industrial employment
Seasonally adjusted data
1992=100



Industrial employment has followed a downward curve in recent months according to CNI and Fiesp data. In the industries of the twelve states monitored by CNI, employment dropped in the period from June to October, with more accentuated declines in August (0.59%) and September (0.36%), utilizing data from which Depec has eliminated seasonal impacts. This behavior reflects the defensive stance adopted by employers in relation to the financial implications of layoffs, recalling that the costs of such decisions increased as of October when alterations were introduced into the Employment Compensation Fund (FGTS). It is important to note that employment declined during that month, albeit at a significantly less accentuated pace of 0.22%. In the industries affiliated with Fiesp, employment began moving downward in March, with the most expressive losses being registered in August (0.38%) and September (0.42%), before stabilizing in October. It is important to perceive that, despite the unfavorable performance cited above, employment in the manufacturing sector in 2001 was higher than in the first ten months of 2000 when measured by both Fiesp (1%) and CNI (1.47%).

Formal employment

December 2000=100



Source: Ministry of Labor and Employment

Contrary to the other employment indicators, which have been quite volatile in 2001, formal employment figures calculated on the basis of the MLE General File of the Employed and Unemployed (Caged) showed only positive results up to October. Consequently, in the first ten months of the year, 849.9 thousand formal employment positions were created, representing growth of 2.9% compared to 2000. In the sector of services, 336.6 thousand jobs were created in the year, followed by industry with 164.3 thousand and commerce with 156.9 thousand. In the month of October, once seasonal factors have been eliminated, new job openings came to 77.1 thousand, indicating a rise of 0.34%.

It should be underscored that formal employment showed very little reaction to the impact of the energy and foreign sector crises. In the case of industry, which is the sector most sensitive to this type of occurrence, the only month in which it registered a negative balance between hirings and layoffs was July. The elimination of 2.2 thousand job positions in that month was more than offset by renewed hirings in the following months, totaling 59.6 thousand from August to October.

According to the MLE, the total number of formal employment positions in the month of October came to 23,830 thousand. In that month, the number of employed persons in the six metropolitan regions analyzed by IBGE totaled 17,258 thousand. It should be noted that MLE indicators are national in scope and cover a larger number of workers, while the IBGE figures make it possible to monitor both formal and informal employment. The only opportunity on which IBGE issues statistics for the country as a whole is when it announces the results of the National Household Sampling Survey.

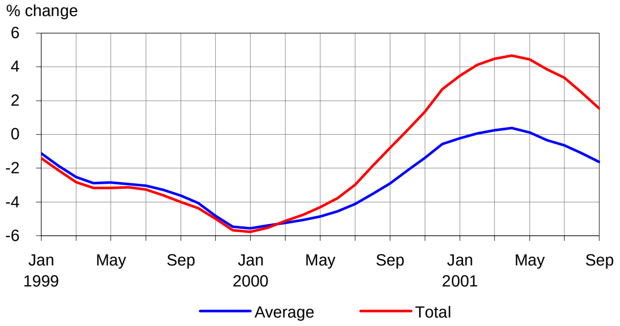
1.3.2 – Wages and earnings

Reflecting the impact of the downturn in the level of activity and the rise in inflation, the behavior of real wages and earnings indicators has been rather negative in the last several months. Even in this context, however, industrial wages accumulated gains in the year, in contrast to the results of household surveys.

According to the IBGE household survey in six metropolitan regions, real average earnings declined at monthly rates of 0.84% in August and 1.63% in September, based on figures from which seasonal factors have been purged. These results point to a 1.6% downturn in the third quarter of the year, compared to the previous quarter. In comparison to the same period of 2000, the reduction up to the end of the third quarter reached 2.5%. Analysis by sector of activity indicates an across-the-board reduction in real earnings using the same bases of comparison, as the earnings of those employed in the sectors of commerce, manufacturing and construction dropped by respective rates of 5%, 3.52% and 3.28%. From the point of view of employment positions, the only category to achieve improvement in earnings in the year was that of the self-employed when compared to 2000 and, even in this case, the increase came to a meager 0.13%. The largest falloff (3.1%) was registered by the earnings indicator of the formal employment sector, followed by a 2% loss for employers and a drop of 0.92% for those in the informal sector of the economy.

Growth in overall wages and earnings in the metropolitan regions analyzed by IBGE was positive up to May, when the accumulated twelve month figure closed with growth of 10.57%. As of that point, however, the earnings curve turned downward. In monthly terms, the largest loss occurred in August (2.1%), followed by 0.3% in September, based on figures from which seasonal factors have been eliminated. In accumulated terms for the year, the increase closed September at 7.13%. Utilizing seasonally adjusted figures, real overall wages declined by 2.76% in August and 0.98% in September, though the accumulated result for the year remained positive at just 0.18%. The difference between average earnings and overall earnings reflects growth in the number of job positions, which was higher on average than the number existent in 2000.

Real earnings - average and total
12 month moving average



Source: IBGE

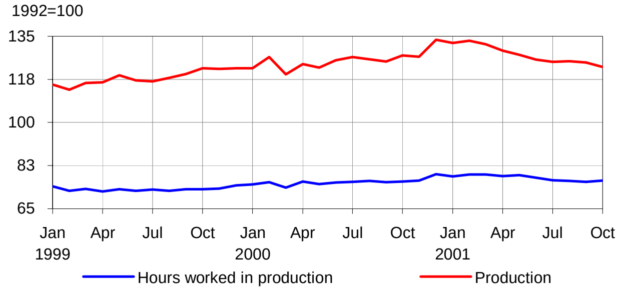
According to figures released by Fiesp and purged of seasonal influences, real average salaries in the São Paulo industrial sector remained stable in October, compared to monthly reductions in August and September. A similar performance was registered under overall wages, which dropped by 0.13% in October after two consecutive months of accentuated reductions. Despite the negative results, these variables accumulated real gains of 6.5% and 7.2% in 2001.

CNI industrial indicators, which encompass surveys carried out in twelve states, also pointed to positive growth in real overall wages in 2001, albeit at a less accentuated pace. In the month of October, this variable registered a drop of 0.5% compared to September, when measured on the basis of data devoid of seasonal influences, accumulating 3.93% growth in the year.

1.3.3 – Unit labor cost and productivity in the manufacturing sector

Calculated as the ratio between the sector's output, as announced by IBGE, and hours worked in production, calculated by CNI, the productivity of the manufacturing sector dropped by 0.2% up to October, when viewed against the same period in the previous year. By the end of the first half of the year, growth had totaled 1%. For São Paulo industry, the indicator for the state's industrial productivity rate was calculated according to output, as announced by IBGE, and hours worked as defined by Fiesp. The final result of this calculation was a 1.9% increase in productivity up to September when compared to the corresponding period in 2000. At the end of the first half of the year, growth had moved to 2.2%. The conclusion to be drawn is that productivity gains slowed for the nation's industry as a whole and for that of São Paulo. Manufacturing in the State of São Paulo continues registering positive results, a fact that can be partially explained by employment adjustments in recent months, particularly elimination of 19.8 thousand jobs up to October, according to figures released by employer associations from the state.

Manufacturing industry: hours worked in production and production
Seasonally adjusted data

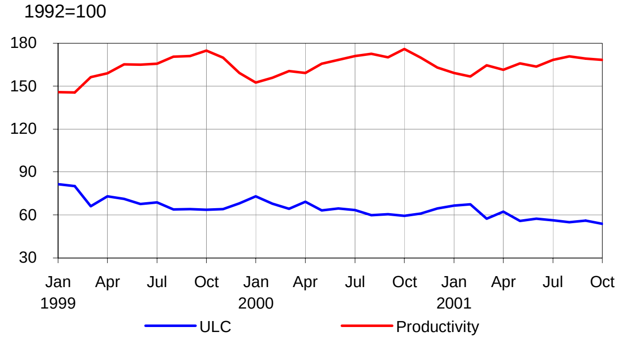


Source: CNI and IBGE

The downward slide in productivity in 2001 resulted from the fact that growth in hours worked was greater than expansion in industrial output. Once seasonal factors are removed, analysis shows positive productivity growth only in July and August.

The Unit Labor Cost (ULC), which is based on the ratio between total wages paid by the industries covered by CNI and the output of the manufacturing sector, as measured by IBGE, which is transformed into nominal values through application of the Wholesale Price Index – Overall Supply – Industrial Products (IPA-OG-PI), indicated a decline of 2% up to October, when compared to the same period of 2000, as against a falloff of 3.4% up to June. One should observe the fact that the 9.96% growth achieved by the IPA-OG-PI up to October was partly generated by exchange devaluation, which has no effect on wages.

ULC and productivity



Source: IBGE, CNI and Banco Central

On the other hand, real ULC became positive as of June. Analysis of the series free of seasonal impacts points to growth in 5 of the monthly surveys up to October, the month in which the ULC turned in a reduction of 2.1%, lowering the average for the August-October quarter below the preceding quarter.

The less favorable evolution of productivity and ULC when compared to previous years points to a reduction in the capacity of the labor factor to absorb the higher costs generated by such factors as exchange devaluation and higher government managed prices.

1.3.4 – Conclusion

The behavior of formal employment in recent months came as a pleasant surprise. To a certain extent, generation of new job openings stimulated demand. The IBGE indicator, which encompasses other occupational categories, registered stability in unemployment at a level below the same period of 2000. However, parallel to growth in the working population, real average earnings dropped and dampened the possibilities of an accentuated upturn in demand. Growth in consumer indicators ratifies this conclusion.

On the other hand, the evolution of the ULC and industrial productivity in recent months suggests low capacity on the part of the labor factor to absorb the costs generated by exchange devaluation and higher government managed prices.

2 – Credit, monetary and fiscal policies

2.1 – Credit

Following a period of downward movement in April, the stock of financial system credits expanded in the September-November quarter as a result of a seasonal upturn in the pace of productive activity. In this context, borrowers opted for a highly cautious stance before the uncertainties of the international scenario. With this, loan demand was basically concentrated in short-term resources and funding to meet the needs of end of the year sales. With regard to the supply of funding, increased credit risk and growth in defaults led financial institutions into an even more selective strategy, demanding additional guaranties and more rigorous analysis of credit operations.

Growth in credit operations

R$ billion

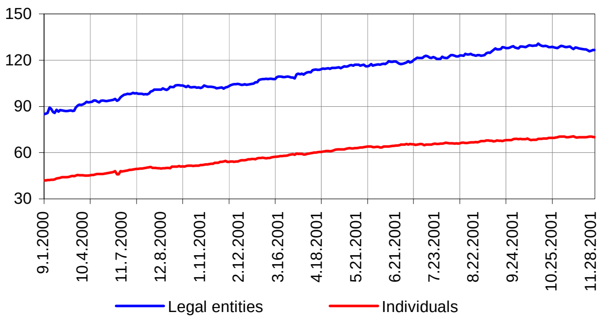
Itemization	2001				Growth	
	Aug	Sep	Oct	Nov	3 months	12 months
Total	324.7	332.7	335.3	336.1	3.5	7.4
Nonearmarked	192.4	197.9	199.1	196.8	2.3	30.9
Legal entities	124.5	129.0	128.7	126.6	1.7	26.9
Referenced to foreign currency	44.8	45.7	44.8	42.4	-5.3	28.9
Individuals	67.9	68.9	70.4	70.2	3.5	38.6
Earmarked	109.9	112.4	113.9	117.3	6.7	-13.2
Housing	20.2	20.7	20.9	21.2	4.6	-58.5
Rural	24.0	25.0	26.0	26.7	11.5	2.0
BNDES	64.3	65.5	65.0	67.5	5.0	23.8
Others	1.4	1.2	2.0	1.9	36.1	-43.8
Leasing	12.6	12.6	12.6	12.3	-2.0	-9.6
Public sector	9.7	9.9	9.8	9.6	-1.7	-30.1

The overall balance of financial system credits came to R$336.1 billion in November, for growth of 3.5% in the quarter, corresponding to relative participation of 27.2% in GDP, compared to 26.6% in August.

A breakdown of these operations shows that targeted credits came to R$117.3 billion, with growth of 6.7% in the quarter. For the most part, this expansion was generated by 5% growth in operations carried out by the BNDES system and to some extent reflects incorporation of financial charges on operations indexed to exchange, as well as financing granted to the industrial and service sectors. From January to November, disbursements from the BNDES system accumulated a total of R$22 billion, for growth of 13.9% compared to the same period of the previous year. Of this total, 52.5% were allocated to industry and 35.4% to the service sector, including the segment of commerce.

Credits to the rural sector expanded at a quarterly rate of 11.5%, corresponding principally to releases of financing to cover the current expenditures of the 2001/2002 summer harvest. Housing financing increased by 4.6% in the quarter to a total of R$21.2 billion. In the same period, overall operations including those in the form of leasing and those granted to the public sector totaled R$21.9 billion, for a 2.2% reduction in relation to August.

Credits with nonearmarked resources - stock
R$ billion



Financial system operations with nonearmarked resources, which accounted for 58.6% of the total, came to R$196.8 billion in November, for expansion of 2.3% in the quarter. It should be stressed that 2000 was a period marked by more intense economic activity and, consequently, by strong growth in the volume of credits. In the quarter under analysis, growth in these operations came to 15.5% in the corresponding period of 2000.

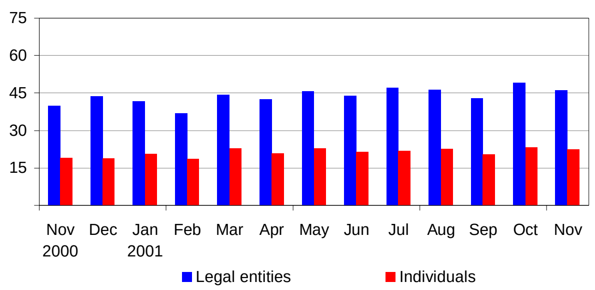
Credits channeled to legal entities came to R$126.6 billion in November, with expansion of 1.7% in relation to the August figure and 14.6% when compared to the corresponding period in 2000. This increase was generated by the performance of credit modalities backed by internal resources, signaling a probable process of migration due to the limitations imposed on access to the international financial market. The volume of operations based on external resources, which includes advances on exchange contracts (ACC), export notes and external onlending operations, dropped by 5.3% in the quarter. This result reflected the effects of exchange appreciation on the balance of these modalities, at the same time in which the flow of new operations dwindled significantly.

In November, the balance of operations with individual persons came to R$70.2 billion, for growth of 3.5% in relation to August compared to an increase of 17.4% in the same quarter of 2000. Fundamentally, this difference is explained by the performance of vehicle acquisition financing operations which was clearly compatible with the 2001 falloff in sales through factory authorized automotive vehicle outlets. In the same periods, these operations registered respective growth levels of 6% and 37.9%.

Insofar as credits to legal entities are concerned, the modalities based on internal resources expanded by 3.6% in November, when compared to the August level. New operations were focused primarily on the need for recomposing cash flows and meeting needs related to end of the year sales and orders. In this sense, working capital, vendor and trade note discounting operations registered the most significant growth of 38.3%, 10.5% and 2.5%, respectively.

In the opposite sense, operations backed by external resources dropped by 21.2% in the November total when compared to the month of August. This was a consequence of the seasonal decline in demand for export financing normally observed at this time of year and of exchange rate fluctuations in the months under consideration.

Credits with nonearmarked resources - total grantings in the month
R$ billion



In operations with individual persons, credit contracting operations registered in November dropped by 1.1% in relation to those of August. Emphasis should be given to the fact that special overdraft check operations and personal credits, which account for 70% of total credits channeled to these borrowers, turned in declines of 0.8% and 16.3%, respectively. These results demonstrated that borrowers were making less use of banking credits due, principally, to payment of the Christmas bonus to the nation's workers.

The upward movement in interest rates on operations based on nonearmarked resources that began in the month of May reversed course toward the end of the August to November quarter.

It is important to note that, up to the month of October, rates on lending operations were strongly impacted by interest rate volatility on the futures market, particularly in long-term operations. However, in November, as uncertainties surrounding the financial market waned, rates dropped to 61.9% per year, or slightly less than in the month of August. The costs of

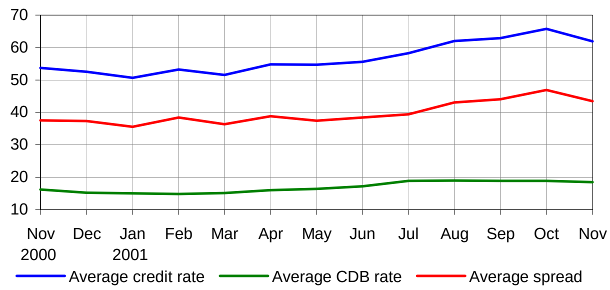
Spread between lending and funding interest rates in operations with preset rates

% p.y.

Period		Market average	Legal entities	Individuals
2000	Jan	42.0	29.7	65.3
	Feb	44.3	31.3	67.4
	Mar	40.3	28.1	60.2
	Apr	40.1	27.7	59.8
	May	39.2	25.9	56.9
	Jun	40.5	23.4	59.1
	Jul	39.7	23.3	56.9
	Aug	39.5	22.9	55.7
	Sep	39.1	22.1	55.2
	Oct	38.6	21.2	54.7
	Nov	37.6	21.2	52.5
	Dec	37.3	22.4	51.3
2001	Jan	35.6	20.6	48.6
	Feb	38.4	22.6	51.4
	Mar	36.3	21.3	48.3
	Apr	38.8	23.2	50.7
	May	38.2	22.4	49.7
	Jun	38.4	22.2	50.0
	Jul	39.4	23.1	50.9
	Aug	43.1	25.3	55.4
	Sep	44.0	25.7	56.7
	Oct	46.9	28.4	59.6
	Nov	43.5	25.6	55.6

Spread between interest rates of credit operations - market average

% p.y.



financial institution funding operations, represented by the rates on Bank Deposit Certificates (CDB), dropped by 0.5 p.p., closing November at 18.5% per year. Consequently, the general spread increased by 0.4 p.p. and closed at a level of 46.9% per year in November.

In the segment of business credits, the average rate moved to a November level of 44% per year, for a drop of 0.2 p.p. in relation to August. The changes in these rates, however, were not uniform as evinced by the high of 2.2 p.p. in guarantied overdraft accounts and a reduction of 2 p.p. in credits for acquisitions of goods. The increase in the cost of revolving credit operations can be attributed to greater business demand for short-term funding, as well as to increased use of special legal entity overdraft checks, a type of instrument that has higher rates than the other products under this credit modality.

The average rate on operations with individual persons declined by 0.3 p.p., closing at 74.1% per year. This result was impacted by 4.4 p.p. growth in the rates on personal credits which, in turn, was caused by the more conservative posture adopted by financial institutions, coupled with the 4 p.p. drop in the cost of vehicle acquisition financing as the major banks connected to vehicle assembly factories initiated campaigns aimed at reducing interest and powering sales.

In the quarter under analysis, the average term of credit operations remained relatively stable in contrast to the same period of the previous year, when lending terms increased considerably, principally in operations with individuals. Stability in the terms of credit operations with both individuals and legal entities has been noted since January of this year. In this sense, the average term in business credit operations came to 100 days in November or 5 days more than in August. In the case of credits

Banking spread in Brazil: factors of persistence and situational impacts

Starting in 1999, when measures were adopted to reduce both interest and the banking spread, in the context of a favorable overall scenario, we witnessed a steady and significant downturn in these rates. However, the downward trend was reversed in early 2001 as a result of the various shocks that hit the Brazilian economy in the intervening period. The result was an increase in both interest and the banking spread. To better understand the impact of the unfavorable scenario on the long-term tendency of the banking spread, Banco Central developed a study* with the aim of investigating the reasons underlying the behavior of this variable, while identifying the situational factors that affect it, on the one hand, and the existence of inertial behavior on the other.

The method adopted in the study was the ARFIMA (*p,d,q*) which, by allowing for the possibility of its differentiation parameter, *d*, assuming non-whole values, manages to perceive the existent correlations among amounts that are quite distant one from the other - termed the long memory - when situated within the interval (0; 0.5). The component of persistence is associated to this long memory effect.

Explanatory variables were included as a way of perceiving the macroeconomic effects and segregating the share referring to the component of persistence, with the ultimate aim of generalizing the model in question. Consequently, the adjusted model was as follows:

$$\begin{cases} spread_t = \beta_1 \Delta selic_t + \beta_2 \Delta \pi_t + \beta_3 \Delta \ln indsa_t + \beta_4 \Delta \ln adm_t + \beta_5 \Delta \ln comp_t \\ \qquad\qquad + \beta_6 \Delta risk_t + \beta_7 \Delta imp_t + \omega_t \\ \omega_t \approx ARFIMA(p,d,q) \end{cases}$$

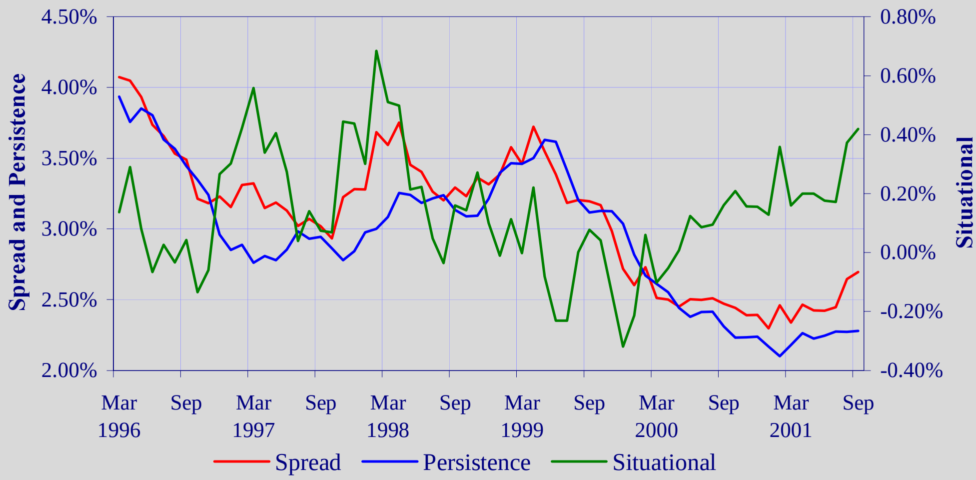
in which:

spread	is the difference between preset average interest rates on loan operations based on nonearmarked resources and the average rate for preset 30 day CDB;
selic	is the monthly average of daily Selic rates;
π	is the rate of inflation, measured by the IGP-DI calculated by the FGV;
indsa	is the level of economic activity purged of seasonal factors and announced by IBGE;
adm	is the participation of administrative expenditures in the volume of loans based on nonearmarked resources;

* Koyama, S. M. e Nakane, M. I. O *Spread* Bancário Segundo Fatores de Persistência e Conjuntura. **In:** BANCO CENTRAL DO BRASIL. **Juros e *Spread* Bancário no Brasil** – avaliação de 2 anos do projeto, pp.31-36. Brasília: BCB, Novembro 2001.

comp	is the average rate of compulsory deposits calculated on the basis of callable Banco Central reserves;
risk	is the daily average capitalized monthly of the earnings difference between C-Bonds issued by Brazil and United States Treasury bonds;
imp	is the measurement of the weight of indirect taxes (PIS, Cofins, IOF and CPMF) in 30 day loans financed with CDB with the same maturity.

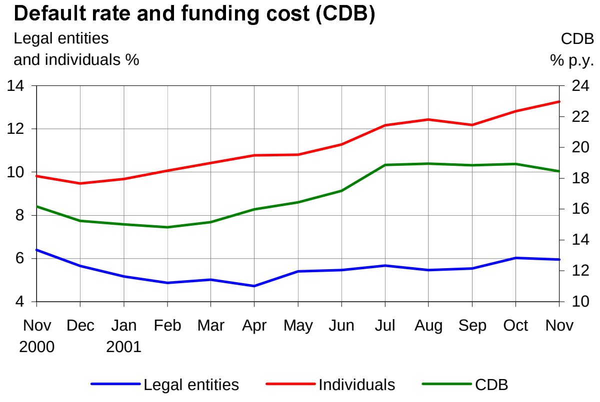
In order to estimate the parameters of the model, monthly data for the period from March 1996 to September 2001 were utilized. Consequently, the graph below shows the breakdown of the banking spread in its two components.



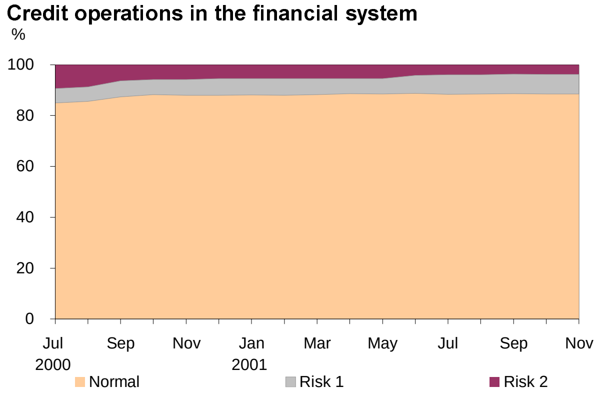
Analysis of the behavior of the factor of persistence demonstrates that, in the period subsequent to May 2000, this factor was consistently below the spread series, as a consequence of the results of the previous period in which constant declines occurred. On the other hand, the situational component, which registered a downward trajectory in the period between February 1998 and December 1999, reversed course in 2000 and in early 2001 brought strong upward pressure to bear on the banking spread. Close analysis of the final period of the series subsequent to August 2001 indicates an increase in the spread exclusively as a result of the situational component.

In summary, the study concludes that the strong recent changes in the spread caused by the situational component have not had repercussions on its long-term tendency (persistence), indicating that the banking spread should begin moving downward again once the period of turbulence has passed.

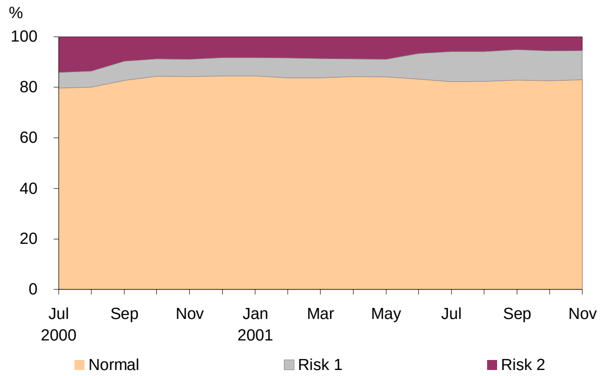
Default rate and funding cost (CDB)



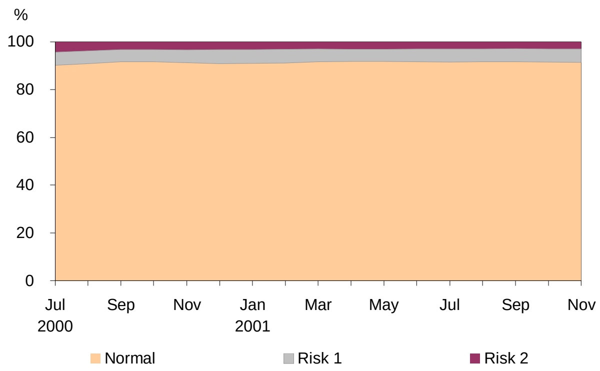
Credit operations in the financial system



Credit operations in the public financial system



Credit operations in the private financial system



granted to individuals, the term averaged 298 days, reflecting a reduction of 3 days.

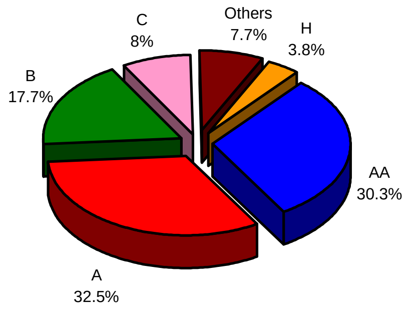
Default rates rose moderately in operations with businesses and individuals. In November, the percentage of arrears on operations with legal entities came to 5.9% compared to 5.5% in August. In the segment of credits to individual persons, growth in arrears was more accentuated. In this case, the increase in defaults closed at 0.8 p.p. and a total level of 13.3%. In this market, increased deterioration was registered under special overdraft check operations and acquisitions of goods and vehicles, as the percentage of arrears grew by 0.9 p.p.

Sector-by-sector distribution and quality of credit operations

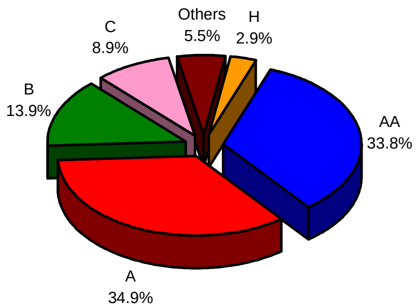
In November, total credits to the private sector came to R$326.5 billion, for growth of 3.5% in the quarter. Here, the most important operations in the period were those with the segments of other services and industry. The relative distribution of loans by risk levels shows that R$205.5 billion of the total granted were registered under levels AA and A, reflecting growth of 4.7% compared to August. At the same time, credits classified under level H remained stable at 3.9%.

In relation to productive sectors, credits contracted by the segment of other services reached a November level of R$60.6 billion, representing an increase of 6.8% in the quarter. The most important operations here were releases of funding for telecommunications, telephone services, transportation and energy. In the same period, credits targeted to industry increased by 0.3% to a level of R$101.3 billion. In this case, the largest

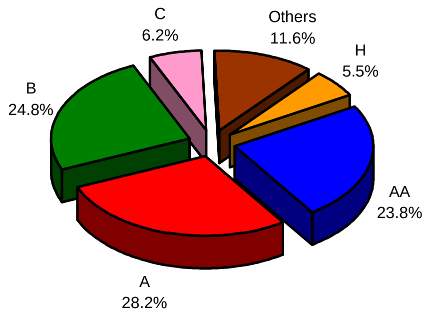
Credit operations in the financial system by levels of risk - November 2001



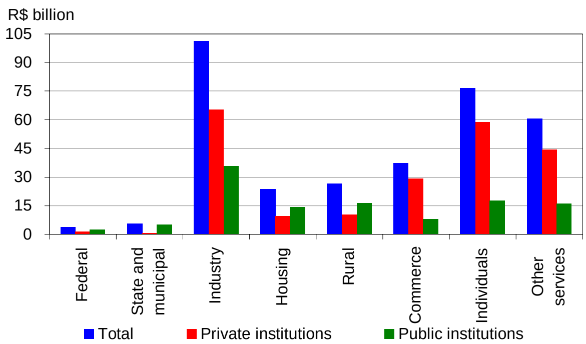
Credit operations in the private financial system by levels of risk - November 2001



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



Credit operations in the financial system by borrowers - November 2001



disbursements were channeled into petrochemicals, automotive production and energy.

The volume of loans to commerce came to R$37.3 billion, with growth of 3.8% in the September to November period, compared to growth of 8.2% in the same period of 2000. This result was a consequence of the formation of high inventory levels when the economy turned downward, thus hindering contracting of such commercial operations as vendor and trade bill discounting.

Financing for the rural sector closed at R$26.8 billion, for growth of 11.5% in the quarter. This result reflected the channeling of a greater volume of obligatory resources into coverage of current expenditures for the 2001/2002 summer harvest and for acquisitions of farm equipment with BNDES resources. The disbursements of this institution to rural investments increased by 49.5%. The participation of financing granted for investment purposes closed at 47.8% of the total, while current expenditure financing came to 42.2%.

Provisional Measure 9 was issued on 10.31.2001 with the objective of making it possible for the rural sector to attain economic-financial equilibrium. This measure extended the maturity of the share of the debt securitized by the National Treasury from October to November and dealt with a 32.5% reduction in the value of the debt. Acting on the basis of Resolution 2,902, dated 11.21.2001, the National Monetary Council (CMN) authorized maintenance of the current risk levels of these debts during the period under consideration.

Total financing to the housing sector, including both individual operations and those with housing cooperatives, totaled R$23.9 billion, for growth of

3.3% in the quarter. To some extent, the lesser growth under this heading is attributed to the temporary suspension of financing for the middle income bracket as of the end of August, which occurred after issue of Provisional Measure 2,155, dated 6.22.2001, introducing the Program of Strengthening Federal Financial Institutions.

With these measures, the distribution of risks in the housing portfolio improved considerably as assets classified under level A increased by 78.2%, while those under levels C and D declined by 38.9%. The participation of credits under risk level H increased from 9% to 9.4% in the period.

The state and municipal banking debt registered a balance of R$5.7 billion, for quarterly growth of 1.2%. The highlights of these operations were the indexing of contracts as well as programs in the sectors of tourism (Prodetur) and basic sanitation. With regard to federal government debts, the stock came to a November level of R$3.9 billion, with a reduction of 5.8% in the quarter due to cutbacks in the credit stock tied to exchange rate variations.

Private financial system operations represented 65.3% of the total and came to a November volume of R$219.6 billion, with quarterly growth of 1.8%. The most important segments here were credits to other services and the rural sector. A breakdown of the credit portfolio according to risk levels indicates that R$148.7 billion were classified under levels AA and A, representing 68.4%, while the relative participation of level H, which demands 100% provisioning, closed at 3%.

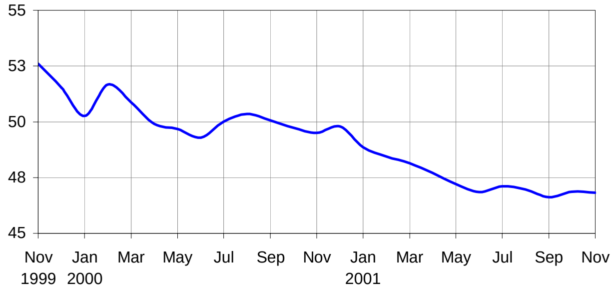
The public financial system credit portfolio totaled R$117 billion for growth of 6.9% in the quarter. In this case, the most significant operations were those with the sectors of other services and the rural sector. In terms of risk levels, 41.4% were registered under levels AA and A, while level H accounted for 5.5%.

The volume of provisions constituted by the financial system totaled R$22.8 billion in November, with quarterly growth of 5%. For the most part, this growth was targeted at accompanying the risk level trajectory in operations with individual persons and in housing operations. The relative participation of provisions to total credits came to 6.8%, or practically the same level as November 2000. Total provisions set aside by public and private sector banks registered respective participation levels of 8.8% and 5.7%.

2.2 – Monetary policy

Monetary aggregates

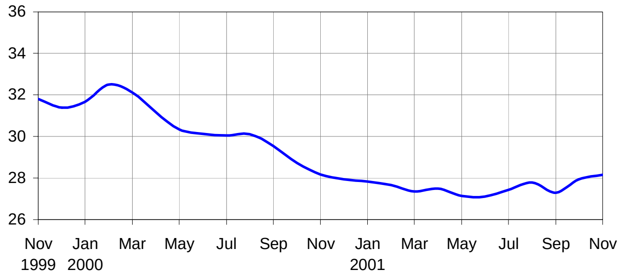
Currency outside banks seasonally adjusted - income-velocity[1/]



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

At the end of November 2001, average daily money supply balances totaled R$68.6 billion, with growth of 12.3% in the twelve month period. The average balance of currency outside banks added up to R$25.4 billion, while demand deposits came to R$43.1 billion. In terms of twelve month growth, these figures corresponded to 16% and 10.3%, respectively. Adjusted according to growth in price levels, currency outside banks turned in stable income-velocity as of the second half of the year. The income-velocity of demand deposits closed the month of November at the same level as December 2000, turning in a performance that was fully consistent with the pace of economic activity and growth in the volume of credit operations.

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

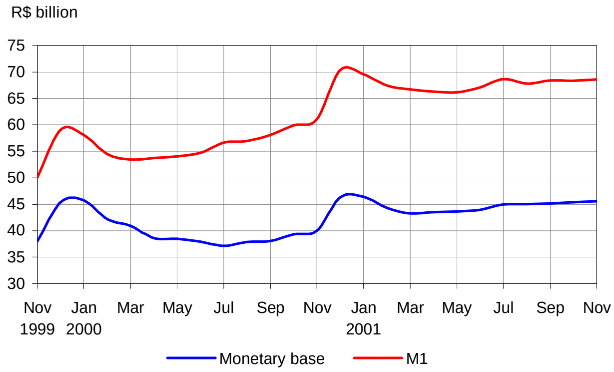


1/ Defined as the ratio between 12 month accumulated GDP (valuated by IGP-DI) and the monthly average balance of the seasonally adjusted monetary aggregate.

The average monthly monetary base balance remained practically stable in 2001 when expressed in monthly average balances. As of July, the balance rose very slightly and reached R$45.6 billion at the end of November. The 14% percentage increase in twelve months was due to greater demand for demand deposits as a result of the changes introduced into compulsory reserve rates on demand resources. Among the components, the average balance of currency issued increased by 17.1% while bank reserves grew by 8.4%.

With regard to monetary policy in September, measures were adopted with the aim of reducing liquidity. It was with this in mind that Circular

Monetary base and M1 - average daily balances

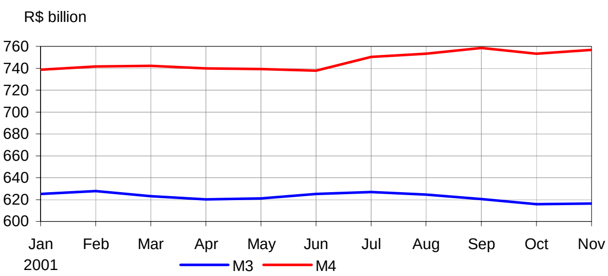


3,062 was issued on 9.21.2001, reintroducing compulsory reserves on time deposits and raising the rate from zero to ten percent. These reserves are required on federal securities tied to Banco Central and generate a cutback in financial system liquidity, since compliance with this requirement results in a reduction in the nonearmarked portfolios of federal securities operated by the financial system or, alternatively, in elimination of other asset positions, including external assets.

Parallel to this measure, Circular 3,063 was issued on 9.26.2001 but only went into effect on the first of October. This measure raised the minimum compulsory reserve requirement on demand resources to be maintained in cash by the banks creating the currency from 60% to 80%. It should be noted that the rate of the compulsory reserve on demand deposits was held at 45%, calculated according to the criterion of average positions in two weeks of operation. Viewed over a medium and long term horizon, bank investments are not affected. The measure impacted the daily management of treasury operations, since the share obligatorily maintained in cash up to the second last day of the operating period was raised by 20% of the requirement on demand resources. The result of this measure was a reduction in the margin of liquidity for retention of foreign currency over the short-term.

At the same time, toward the end of September, the CMN cut the limits for the exchange exposure of financial institutions and gave them fifteen days to adjust their positions to the new requirements. The restrictive circumstances of the period and the short time periods permitted for adjustment led these institutions to make the adjustment by reducing their foreign currency positions instead of taking measure to capitalize or alter other positions.

Broad money supply - primary[1/]
Base: November/2001

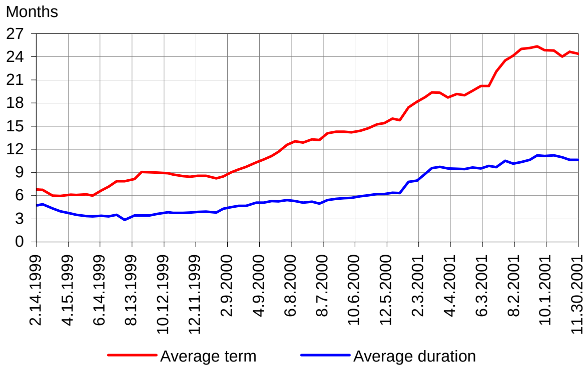


1/ Nominal balance minus the average capitalization of components.

In its broader concept, the money supply expanded by 3.5% in the quarter, which was a level equivalent to the capitalization of its components, and closed November at R$756.7 billion. While the growth of M3 pointed toward primary contraction caused basically by the federal government fiscal result and net sales of exchange to the nonfinancial sector, net credit operations granted by the financial system reestablished the level of financial savings.

Federal public securities

Public securities - duration and term

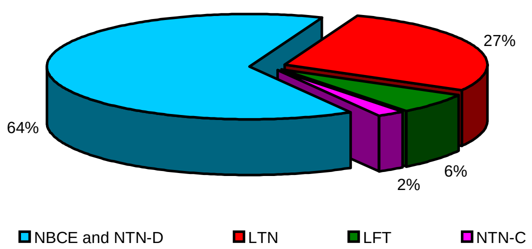


The long term objectives of lengthening the maturities profile and reducing ties to interest rate variations were interrupted in September as financial costs grew due to the increasingly unfavorable circumstances for these operations. In the following months, improvement in expectations made it possible to recommence the process.

The shortening of the terms of federal securities made it difficult to extend the duration of the securities debt, even though 94% of the volume placed from September to December 18 were not indexed to interest rates. Among competitively issued federal securities, an analysis of the period between August 31 and November 30 shows that the average term dropped from 25.1 months to 24.4 months and the average duration increased from 10.6 months to 10.7 months.

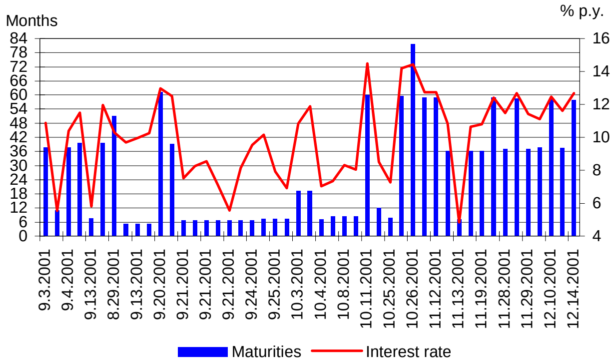
Definitive operations involving Banco Central papers in the period from September to December 18 resulted in placements of R$16.5 billion, effected exclusively in the first month of the quarter and restricted to exchange securities (NBCE), and redemptions of R$25.6 billion. Definitive operations with National Treasury securities registered at Selic showed placements of R$58 billion and redemptions of R$46 billion, in the same period. Net definitive placements of federal securities in the period were not targeted at offsetting monetary growth of other sources, since the movement of the National Treasury operating account and external sector operations generated contractive impacts.

Competitive issues of federal public securities
9.1.2001 to 12.18.2001



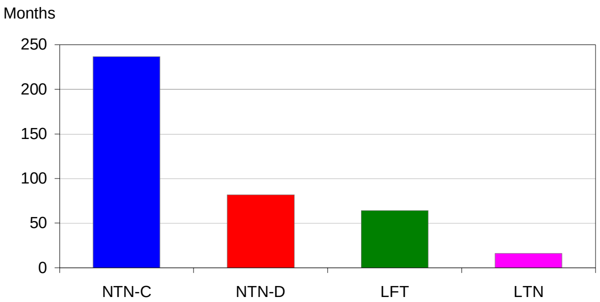
The major reason underlying net placements was the need to supply the market with additional hedging instruments as a result of the excessive level of exchange rate volatility. In this sense, net placements of exchange papers totaled R$13.1 billion in September and R$7.6 billion in October. This trend reversed course to net redemptions of R$3.6 billion from November to December 18, as the rate of exchange moved downward, partly in response to the placements made in previous months. In the period under consideration, papers indexed to exchange accounted for 64% of the volume of federal securities placed.

Exchange securities - NBCE and NTN-D



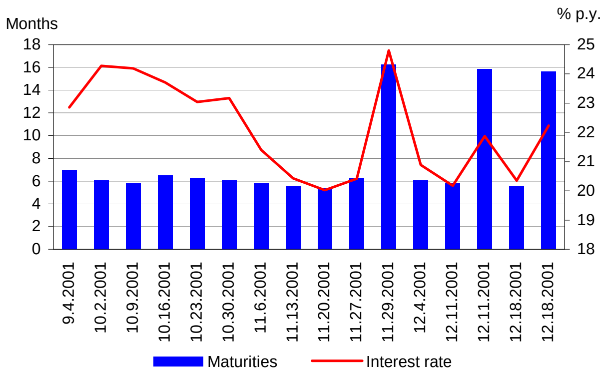
As of mid-October up to December 18, the maturities of federal securities indexed to exchange expanded as a result of placements of National Treasury Notes – Series D (NTN-D) with 5 year terms, issued at average rates between 12.4% per year and 14.4% per year, and a term of 7 years issued at an average rate of 14.4% per year in the October 26 auction. National Treasury Notes – Series C (NTN-C), indexed to growth in the General Price Index – Market (IGP-M) continued being placed with terms between 4 and 20 years at rates in the range of 10.5% per year, signaling maintenance of market expectations regarding the real long-term rate of interest.

Maximum maturity of security issues
9.1.2001 to 12.18.2001



Issues of preset federal securities with terms in the range of 6 months continued through to the end of November. In September and October, their placement rates varied at approximately 23.5% per year. With the more favorable circumstances that existed as of November, rates dropped to the range of 20.5% per year. On November 29, National Treasury Bills (LTN) were offered once again with terms of one year at an average rate of 24.8% per year. This issue was effected through an auction based on firm offers and marked the return of these papers to the market after being suspended since the month of March.

National Treasury Bills - LTN



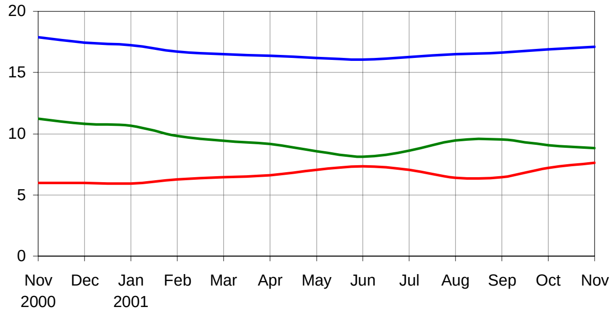
Postset National Treasury papers - Treasury Financing Bills (LFT) - were suspended on October

10. This decision is considered not only as part of the strategy aimed at reducing the ties between the federal securities debt and interest rates but also a step toward reducing market demand for this type of security. In the month of September, the average premium over the Selic rate came to about 0.34% per year, while the month of October witnessed reductions in the average premium to 0.16% per year and 0.24% per year, as a result of cutbacks in the volume offered.

Real interest rates and market expectations

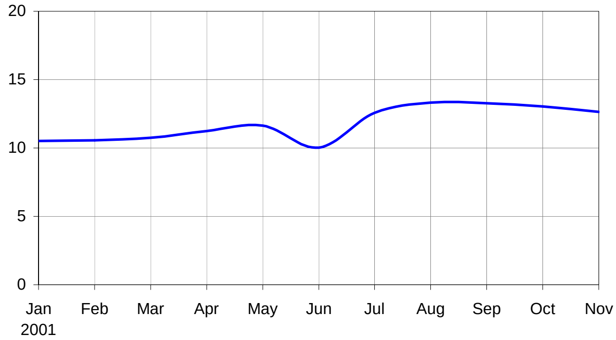
Real interest rate deflated by IPCA

% accumulated in 12 months

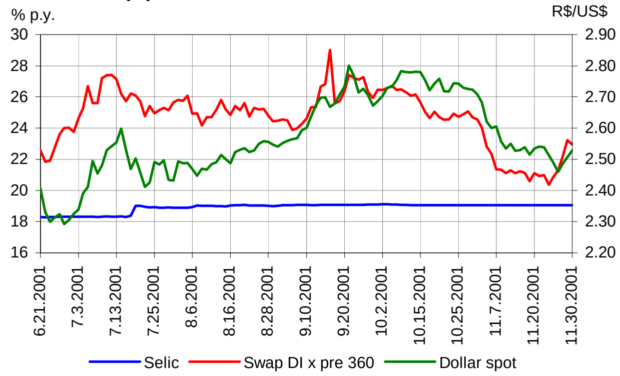


Ex-ante real interest rate

For 12 months



Selic x swap pre x dollar



The real ex-post Selic rate accumulated in 12 months and deflated by the IPCA remained below the 10% mark since February. Growth of the October IPCA resulted from upward movement under the headings of food and fuels and aided in attenuating growth of the real rate.

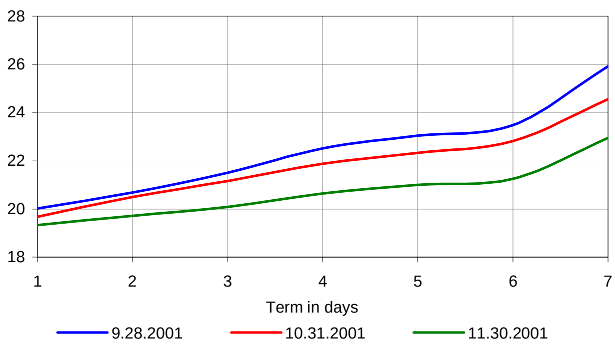
Market expectations regarding growth in the real rate of interest, defined as the ratio between the effective Selic rate in the month and expectations for the IPCA in twelve months, remained stable at 10% per year in the first half of the year. With the increase in the basic interest rate in July, the ex-ante real rate registered growth of approximately 3 p.p. in the following four month period. In November, the rate moved to 12.6%, reflecting less favorable expectations as regards price performance.

The measures adopted by Banco Central with the aim of restricting financial system liquidity and reducing the exchange exposure of financial institutions produced their effects in October, reversing the movement leveraged by the events of September 11. Among the other factors that contributed to this result, mention should be made of the differentiation of the Brazil risk from the Argentine risk, the positive trade balance results and the decrease in balance of payments financing requirements. In this context, the rate of exchange, which had passed the mark of R$2.80 retreated into the range of R$2.30 in mid-December.

Futures market interest rates defined by the rate on one year DI x pre swap contracts reached a level of 29% per year soon after the attack on the United States. The upward movement in the rate mirrored the risk level at that moment and opened a differential of 10 p.p. in relation to the Selic rate.

Forward structure - swap pre

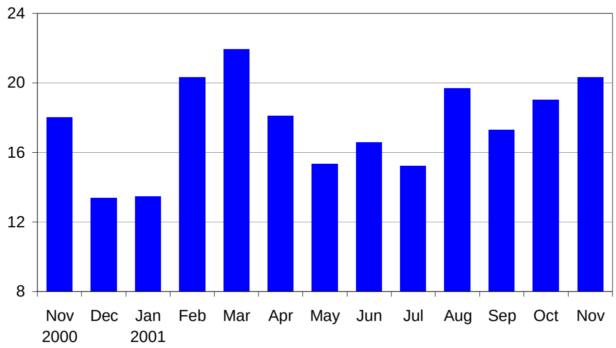
% p.y.



Evolution of the international scenario and improvements in the fundamentals of the Brazilian economy contributed to stock market recovery and upward movement in the value of the real, thus reversing the pessimistic expectations that had dominated the market since the second quarter of the year. Preset one year swap rates diminished and were negotiated at 23% per year at the end of November.

One day DI - average negotiated volume

R$ billion

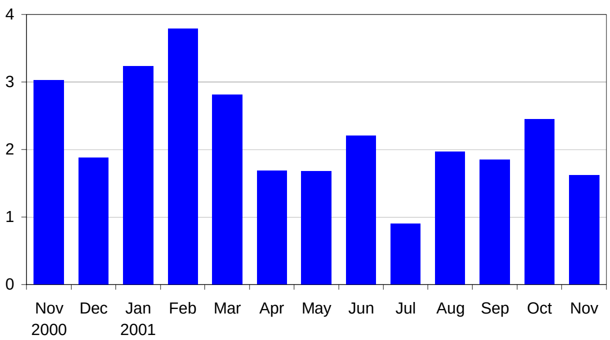


The reversal in expectations resulted in a more accentuated inclination in the interest curve as of December 2000. The one year contract rate registered a reduction of 1.6 p.p., while the 30 day contract rate fell by 0.4 p.p. The difference between these contracts fell to 3.6 p.p.

The volume negotiated on the Commodities and Futures Market (BM&F) in one day DI futures contracts registered a November daily average of R$20.3 billion, with growth for the second consecutive month. The elements most responsible for this increase were migration to contracts with maturity in March 2002 and the opening of new contracts with lesser rates, accompanying the drop in interest rates.

Forward DI - average negotiated volume

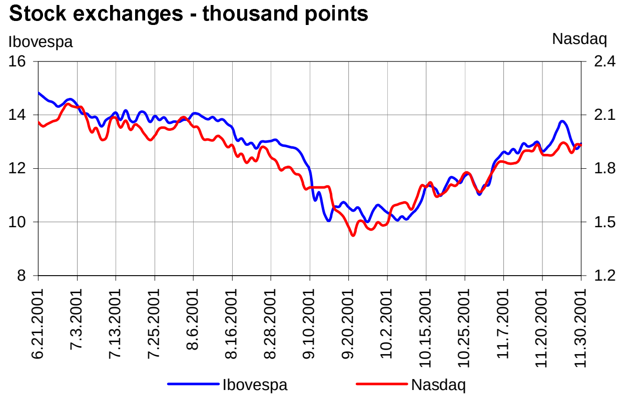
R$ billion



The adverse scenario found to exist as of the month of March diminished the volume negotiated in forward DI contracts with adjustment, reaching the minimum level in July. The increase in uncertainties led investors to maintain their positions in contracts due to mature in April 2002 in the period between March and the second half of October, reducing the term from 13 months to less than 6 months. At the end of October, agents migrated to contracts with maturity in July 2002, increasing the term to 8 months.

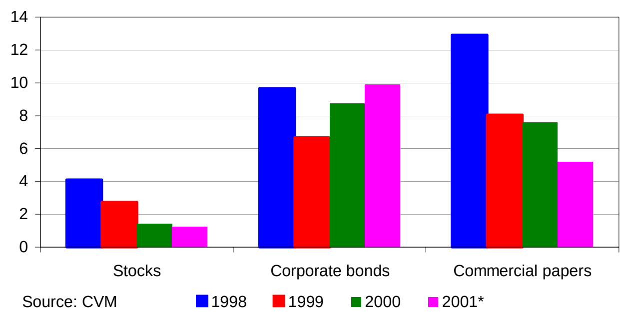
Capital market

Stock exchanges - thousand points



Primary issue in capital market

R$ billion - accumulated in the year

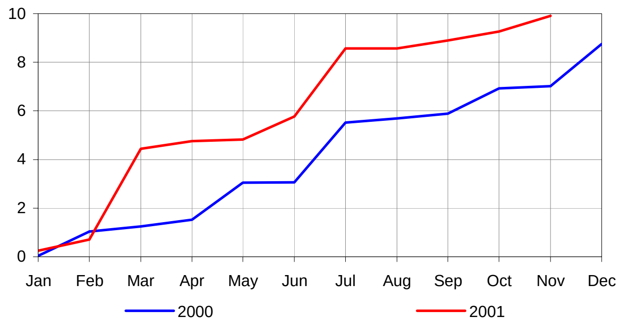


Source: CVM

* Until November.

Corporate bonds

R$ billion - accumulated in the year



Source: CVM

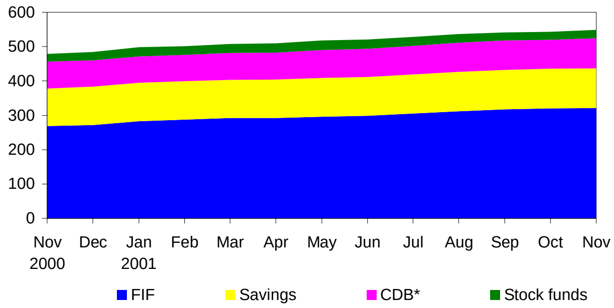
Accentuating the process begun in the month of August, the São Paulo Stock Market Index (Ibovespa) plunged in September. The low dollar value of companies represented an excellent investment opportunity, particularly in light of the upward movement in the value of the real and improvements in market expectations. In this context, the index recovered 6.9% in October and 13.8% in November, closing that month at the August level prior to the downturn. Analysis shows increased interest in Brazilian papers, as evident in growth in the average volume of trading in November, which came to approximately R$683 million or 28% more than in the previous month.

The increase in the cost of banking credit and greater restrictions on foreign resources led companies to seek alternative sources of capital market financing. Consequently, they turned to debenture operations to such an extent that significant reductions were noted in the use of new stock issues or promissory notes.

Debenture operations increased sharply in the last two years. In the current year, they surpassed total 1998 issues, precisely the period in which the primary market registered its best performance. Companies are utilizing this instrument for investment projects, capital reorganization and debt restructuring, exchanging banking debt for security debt with average term of five years. Up to the month of November, contracting operations totaling R$9.9 billion were registered by the Securities and Exchange Commission (CVM), of which 64% were referenced to DI, 23% to the IGP-M and 13% to the TJLP.

Financial investments

Equity growth - financial investments
R$ billion



* Excludes CDB from FIF´s portfolio.

The total balance of resources channeled into savings accounts, financial investment funds (FIF), stock funds and time deposits (CDB) totaled R$546.5 billion in November, for growth of 1.9% when compared to August. In the period, two specific factors should be highlighted: the loss of FIF resources and the value loss suffered by stock funds as a consequence of high market volatility.

FIF turned in net worth of R$320.2 billion in November, for growth of 2.6% in the quarter. In that period, the growth of FIF assets diminished as resources migrated to CDB, direct investments in federal government exchange instruments and increased debt payments by companies. In the year, FIF accumulated nominal profitability of 16.2% and real profitability of 8.6%, when the IPCA is used as deflator, compared to 9.9% in the same period of the previous year.

Stock funds closed November with R$24.5 billion in net worth, registering a loss of 2% in relation to August. In the month of September, the segment registered negative profitability of 7% and was impacted by the drop in the Ibovespa. The change in the economic scenario in October and November generated an upturn in the performance of these funds, as profitability turned positive at respective rates of 2.6% and 4.9%. Consequently, stock funds registered profitability of 0.1% in the quarter, accumulating a gain of 0.7% in the year.

From September to November, the balance of savings accounts increased by 1.9%, closing the quarter at a level of R$116.4 billion. This performance resulted from net inflows of R$1.3 billion in November, caused mostly by payment of part of the Christmas bonus. Average earnings on savings accounts came to 0.7% per month and it was precisely this earnings level that acted as the major obstacle to increasing the competitiveness of this type of investment when seen against other investment options.

CDB registered strong inflows, particularly those referenced to DI and postset CDB, since these instruments have greater flexibility when there is a need for adjustment to new interest rate levels. In the quarter, the balance expanded by 3.2%, reaching a level of R$106.9 billion at the end of November. Nominal profitability of CDB came to 16.1% in the year.

2.3 – Central Government fiscal result

The Central Government, a heading that includes the National Treasury, the Social Security System and Banco Central, registered a primary surplus of R$2.2 billion in October. A breakdown of this figure indicates a surplus of R$3.2 billion for the National Treasury and deficits of R$954 million and R$51 million for the Social Security System and Banco Central, in that order.

With the October result, the Central Government surplus accumulated in the year increased to R$25.9 billion or R$4.6 billion more than the figure originally forecast for the government in 2001. As a proportion of GDP, the surplus totaled 2.7%, reflecting an increase of 0.3 p.p. compared to the same period of the previous year. This growth benefited from the increase in National Treasury revenues, which moved from 16.5% of GDP up to October 2000 to 17.6% in the current year. Among the factors that contributed to this performance, the following should be underscored:

a) change in the system of taxing the fuel sector and in the payment by substitution system used by the automotive sector, generating positive impacts in terms of the inflow of the Contribution to Social Security Financing (Cofins) and the Social Integration Plan/Civil Service Asset Formation Program (PIS/Pasep);
b) depreciation of the rate of exchange, which impacted Income Withholding Tax (IRRF) revenues;

c) payment of royalties on petroleum and special participation payments (Law 9,478/1997);
d) dividends paid to the federal government, as well as revenues and parafiscal fees.

The accumulated National Treasury surplus up to October totaled R$35 billion, corresponding to 3.6% of GDP and surpassing the total for the same period in 2000 by a full R$6.2 billion. Revenues came to R$172.2 billion, for growth of 1.2 p.p., while transfers to states and municipalities increased by 0.2 p.p. of GDP, mostly as a consequence of the income tax increase. Spending grew from 9.6% of GDP to 10.2% of GDP in the period under analysis.

In accumulated terms for the year, spending totaled R$156.9 billion, or 15.6% more than in 2000. The headings "personnel and charges" and "current and capital spending" increased by 15.2% and 17.8%, respectively, and closed at 5.2% and 5% of GDP. The rise in personnel outlays was to a great extent due to realignment of wages for some strategic public sector careers. The increases in resources targeted to the area of health and farm and export subsidies accounted for the growth in current and capital spending.

Up to the month of October, the Social Security deficit totaled R$8.6 billion, for growth of 28.5% in relation to the total for the same period of 2000. Inflows increased by 12.1% and totaled R$48.8 billion. Note should taken of the fact that part of this gain resulted from efforts to rebuild the System's revenue structure and to changes in contribution rates. As far as spending is concerned, social security benefits added up to R$57.4 billion, for an increase of 14.3%, basically as a result of an 11.4% increase in the average value of the benefits paid.

Public sector borrowing requirements

The target for the consolidated public sector primary surplus defined for the current year with the International Monetary Fund (IMF) was surpassed by R$4 billion in October. Aside from confirming the fiscal effort made by the public sector during the course of 2001, this result showed that fiscal policy is an element of fundamental performance for

Bills pending approval at the National Congress
Status on 11.30.2001

1. Administrative Reform Regulations

1.1. legal instrument: complementary law (PLC 43, dated 9.1.1999) – regulates the loss of public employment positions due to insufficient performance and defines the positions typical of the state;

- stage of voting at National Congress – approved at the Chamber of Deputies and Federal Senate. However, since alterations were introduced into the bill at the Senate, it has been returned to the Chamber of Deputies where it was approved on 11.22.2000 by the Constitution and Justice Committee. It is now awaiting approval at the Labor Committee.

1.2. legal instrument: constitutional amendment (PEC 137-A/1999) – defines the limit for earnings at the three levels of government. The substitute bill submitted by the rapporteur of the Special Chamber Committee determines that wages paid to employees may not be greater than the wages of the governor of the respective state or the Federal District. However, state assembly members, members of town councils, judges and those working at the Office of the Public Prosecutor are all exempted from these limits. The limit in these cases is the highest wage paid to a Federal Supreme Court Judge, including the perquisites to which they are entitled. Independently of the limit defined as the secondary ceiling, additional amounts under the heading of time of service are permitted up to the limit of 35%.

- stage of voting at National Congress – approved at the Constitution and Justice Committee of the Chamber of Deputies on 11.3.1999 and at the Special Committee on 1.12.2000. It is now awaiting voting in the full Chamber and will then be remitted to the consideration of the Federal Senate.

2. Social Security Reform Regulations

2.1. legal instrument: constitutional amendment (PEC 136/1999) – institutes social security contributions for retired civilian and military personnel;

- stage of voting at National Congress – admissibility accepted by the Chamber of Deputies' Constitution and Justice Committee on 11.10.1999. It is now in the stage of public hearings at the Special Committee for later remittance to the full session of the Chamber of Deputies and, following that, to the Federal Senate for its deliberations.

2.2. legal instrument: complementary law (PLP 9/1999) – defines general norms for the institution of the complementary social security system by the federal government, states, Federal District and municipalities. The major aspects of the substitute bill approved by the full Chamber of Deputies on 11.28.2000 are as follows:

a) determination of a ceiling for the General Social Security System (RGPS) for those civil servants who have entered after passage of the law. The new ceiling is optional for those already covered by the system;
b) guaranty of equivalence between the contribution rate and that of the RGPS;
c) equality between the contribution of the social security fund sponsoring institution and that of the participant;
d) institution of benefit plans in the modality of defined contributions.

- stage of voting at National Congress – now being voted in a single round of voting at the Chamber of Deputies.

3. Tax on Large Fortunes

- legal instrument: complementary law (PLP 202/1989) – required charging of a special tax for those holding assets of more than R$1 million. The proceeds of this tax would be channeled to the Fund for Combating and Eradicating Poverty;

- stage of voting at National Congress – approved at the Federal Senate and at the Constitution and Justice Committee of the Chamber of Deputies and now awaiting voting by the full session of the Chamber of Deputies.

4. Mandatory Budget

- legal instrument: Constitutional Amendment (PEC 77/1999) – defines the government's obligation of implementing budget law and requires that a minimum of 80% of budget allocations be effectively utilized up to the project level, with the sole exception of those cancellations previously authorized by law;

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

5. Exclusion of the electricity sector from the privatization process

- legal instrument; ordinary law (PLS 32/2001), alters Law 9,491, dated 9.9.1997, in order to exclude companies from the electric power generation and transmission sector from the privatization process. In article 3, the law specified that Banco do Brasil, the Federal Savings Bank and government companies or joint capital enterprises that perform activities that are the exclusive responsibility of the federal government, as defined in indents XI and XXIII of article 21 and line "c" of indent I of article 159 of the Federal Constitution, are also to be excluded from the National Privatization Program. The prohibition does not apply to stock participation held by these entities, provided that there are no legal restrictions on the sale of such shares.

- stage of voting at National Congress – approved at the Federal Senate Constitution and Justice Committee and sent to the Economic Affairs Committee on 4.24.2001.

6. Tax Reform

- legal instrument: constitutional amendment (PEC 175-A/1995) – the most recent position of the substitute bill, elaborated on the basis of the results of the tripartite committee underscores the following:

  a) agreement: extinction of the Industrialized Products Tax (IPI), Tax on the Circulation of Merchandise and Services (ICMS) and Tax on Services (ISS); extinction of the Social Integration Program/Civil Service Asset Formation Program (PIS/Pasep) and Cofins; creation of the Value Added Tax (VAT) or alteration of the ICMS; transfer of the Rural Land Tax (ITR) from the federal government to the states; and creation of the Retail Sales Tax (IVV), which would be levied at the municipal level;
  b) disagreement: conception of the VAT model; adoption of the selective tax; adoption of the Tax on Financial Transactions (IMF); and system of calculating social contributions.

- stage of voting at National Congress – the position report of the rapporteur of the Chamber of Deputies' Special Committee was approved on 12.16.1999. Awaiting remittance to the full house for voting.

7. National guidelines for basic sanitation services

- legal instrument: ordinary law (PL 4,147/2001) – institutes national guidelines for basic sanitation services, as follows:

a) definition of the fundamental principles that will guide the rendering of special sanitation services;
b) definition of the holders of title to such services;
c) definition of growth targets and rate structure;
d) institution of guidelines relevant to regulation and inspection of the services rendered.

- stage of voting at National Congress – now in the phase of public hearings at the Special Chamber of Deputies Committee.

8. Fiscal Management Council/Fiscal Responsibility Law

- legal instrument: ordinary law (PL 3,744/2000) – institutes the Fiscal Management Council, based on the provision in article 67 of Complementary Law 101, dated 5.4.2000 (Fiscal Responsibility Law) and treats of its objective, composition and system of operation;

- stage of voting at National Congress – approved at the Labor, Administration and Public Service Committee of the Chamber of Deputies on 4.18.2001. Awaits voting in the plenary session.

9. Extension of the Provisional Contribution on Financial Transactions (CPMF)

- legal instrument: constitutional amendment (PEC 382/2001) – extends the validity of this contribution from 6.16.2002 to 12.31.2003.

- stage of voting at National Congress – approved by the Special Committee of the Chamber of Deputies on 12.11.2001. Awaiting two rounds of voting in the Chamber of Deputies before remittance to the Federal Senate.

10. Tax on the Circulation of Merchandise and Services (ICMS) and Tax on Services (ISS)

- legal instrument: constitutional amendment (PEC 383/2001) – alters the National Tax System with the fundamental aim of defining specific legislation for the ICMS, in the form of a complementary law, in such a way as to avoid the fiscal disputes waged under the terms of the ISS, which is levied by the municipalities.

- stage of voting at National Congress - now before the Constitution and Justice Committee of the Chamber of Deputies.

11. Elimination of levying of PIS/Pasep and Cofins

- legal instrument; ordinary law (PL 4,941/2001) – fosters diversification of the nation's energy matrix, encouraging utilization of natural gas and mineral coal in electricity generation, by eliminating the levying of the PIS/Pasep and Cofins contributions on the marketing chain of those inputs.

- stage of voting at the National Congress – approved at the Chamber of Deputies on 9.19.2001 and now before the Economic Affairs Committee of the Federal Senate.

12. Law on bankruptcy and receivership

- legal instrument: law (PL 4,376 – A/1993) – institutes and regulates the process of judicial recovery and liquidation of commercial and civil entities that have economic objectives, joint capital companies, cooperatives and individual persons that perform economic activities in their own name and in an organized manner for profit-making purposes.

  The proposal broadens the objective of current legislation by extending its application – now limited to those involved in commercial activities – to all persons or legal entities involved in economic activity.

  The new law alters the approach taken to receivership by treating this situation as a period in which efforts are made to recovery a company in crisis. No longer is it considered to be a pre-bankruptcy stage as occurred in the past.

  Another important change is that which subjects creditors holding mortgages, credit notes, fiscal and tax credits to the moratorium. Currently these creditors are not subject to the effects of the receivership, which is limited exclusively to creditors holding papers without guaranties. The exceptions are labor debts of up to R$30 thousand for large companies and R$15 thousand for micro and small companies.

  In the case of judicial liquidation, two basic changes were proposed: the first obligates the company to sell assets immediately after the bankruptcy decree; the second is the end of the receivership with the effect of suspending debts or, in other words, a moratorium decreed in bankruptcy processes after creditors have been duly defined. The exception occurs in the case in which the company is leased to workers who hold credits against the company.

It also determines that companies in recovery will not pay any type of fine. In cases of judicial liquidation, the fines are to be paid after debts have been paid off with all of the creditors.

- stage of voting at the National Congress – approved at the Special Committee of the Chamber of Deputies, awaiting voting in the full session for later remittance to the Federal Senate.

13. National Financial System regulations

- legal instrument: constitutional amendment (PEC 53/1999) – the proposal alters indent V of article 163 and article 192 of the Federal Constitution, as well as article 52 of the Transitory Constitutional Provisions. Article 192 was simplified by revoking the indents and paragraphs and the provision that determines that regulations are to be defined in enabling legislation with the objective of facilitating the task of introducing appropriate regulations. It will now be possible to do this on a piecemeal basis in terms of both content and time, allowing the authorities to deal separately with the disciplining of the different financial system markets.

- stage of voting at the National Congress – approved at the Federal Senate and remitted to the Chamber of Deputies for deliberation. The report of the rapporteur of the Special Committee was approved on 8.8.2001. Awaiting voting at the full session of the Chamber.

14. Taxpayer Defense Code

- legal instrument: Enabling legislation (PLC 646/1999) – deals with taxpayer rights and guaranties in such a way as to attenuate or eliminate the fragility of the taxpayers position in his/her relationship with the state apparatus.

- stage of voting at the National Congress – awaiting voting at the Federal Senate for later remittance to the Chamber of Deputies.

the country to be able to cope with the external adversities that have marked the world economy, since it plays a highly important role in reducing risk and maintaining economic stability.

The primary public sector surplus up to October 2001 can be explained mostly by government inflows, even at a time of relative economic stability. Thus, the result closed at R$44.2 billion or 4.6% of GDP, compared to a surplus of R$36.1 billion or 4.1% of GDP in the same period of the previous year.

The good primary performance of the nation's public accounts was evident in all public sector spheres. The federal government, Banco Central do Brasil and the National Social Security Institute (INSS) registered a surplus of R$27.1 billion or 61.2% of the total, while state governments closed with R$7 billion (15.7%), municipal government ended with a figure of R$2.7 billion (6.1%) and state companies closed the period at R$7.5 billion, corresponding to 17% of the overall surplus.

In the first ten months of 2001, appropriation of nominal interest came to R$71 billion or 7.3% of GDP when compared to R$67.3 billion, or 7.5% of GDP, in the previous year. The relative stability of appropriated interest was mostly due to evolution of the Selic rate, which accumulated 14.6% in the first ten months of 2000, compared to 14% in the corresponding period of 2001.

Public sector borrowing requirements (NFSP) in the nominal concept declined as a result of improved primary results, which absorbed part of the appropriation of interest. Thus, up to October 2001, the nominal result came to R$26.7 billion or 2.7% of GDP, an amount R$4.5 billion below that of the same period of 2000.

Incorporating the impact of exchange devaluation on the stock of the securities debt indexed to exchange, borrowing requirements come to R$74.5 billion or 7.6% of GDP for the first ten months of 2001. In the same period of 2000, the nominal result hit the mark of R$38 billion or 4.2% of GDP. This difference reflects 38.5% depreciation of the real in 2001, compared to 6.7% up to October 2000.

Net public sector debt and gross government debt

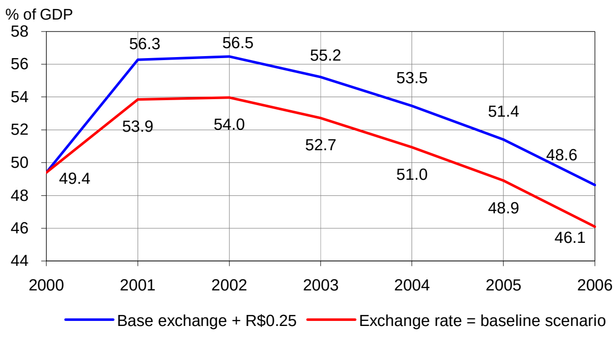
In October, the net public sector debt (DLSP) came to R$675 billion, corresponding to 54.4% of GDP, compared to R$563.2 billion or 49.4% of GDP in December 2000. Expansion of 5 p.p. reflects depreciation of the real and growth in the Selic rate as of March, in response to aggravation of the international economic scenario.

Depreciation of the real was the primary cause of the increase in the debt/GDP ratio. Methodological adjustments of the internal debt indexed to exchange and of the external debt came to R$87.7 billion, reflecting an impact of 7.4% of GDP on DLSP. Consequently, once this impact is eliminated, the debt would come to 47% of GDP or, in other words, a reduction of 2.4 p.p.

With respect to the rise in the Selic rate, the direct impact totaled 0.4 p.p. of GDP, demonstrating the more accentuated immediate exposure of the debt to the rate of exchange. However, it should be emphasized that the interest rate rise impacts growth of the economy, with repercussions in terms of the deterioration of the debt/GDP ratio.

The impact of the rate of exchange on DLSP can be observed in the results of projections in two distinct scenarios. The baseline scenario considers the fixed nominal rate of exchange, while the alternative scenario uses the initial rate plus R$0.25/US$.

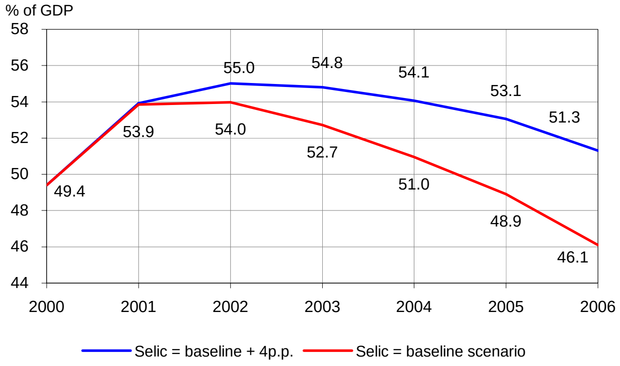
DLSP projections



In the baseline scenario, the debt/GDP trajectory shows upward movement in 2001 as a result of exchange depreciation; stability in 2002; and downward movement in the other years, closing 2006 at a level of 46.1%. With growth of R$0.25/US$ in exchange, the debt/GDP ratio would turn in similar results, though at a significantly higher level, closing 2006 at 48.6%. This scenario demonstrates the impact of exchange devaluation on the debt, revealing that it is not a question of change in the debt trajectory but alteration in its level.

In the case of growth in the Selic rate, the effect on the debt/GDP ratio is quite different, as shown in the analysis of the graph that specifies the

DLSP projections



performance of the debt/GDP ratio between 2001 and 2006. In this case, the 4 p.p. rise in the Selic rate indicates a sharp reduction in the speed of the decline of the debt/GDP ratio in the period from 2003 to 2006, thus moving some distance away from the projections of the baseline scenario.

The gross general government debt, which includes the federal government and state and municipal governments, came to R$900.9 billion or 72.6% of GDP, with growth of 7.2 percentage points of GDP in relation to the December 2000 position. This increase, which surpassed the rise of the DLSP, is principally related to exchange devaluation. However, as of the month of September, it reflects exchanges of Banco Central papers on the market for National Treasury securities, which are neutral in relation to DLSP, but produce an impact on the gross general government debt.

Federal securities debt

In the July-October 2001 period, the federal securities debt evaluated in terms of portfolio position increased from R$597.3 billion to R$637.1 billion. The factors underlying this result were incorporation of interest and net sales of exchange securities in the amount of R$19.6 billion.

In the aforementioned period, exchange depreciation of 11.3% against the dollar resulted in an increase in the exchange securities debt from R$165.8 billion to R$209.3 billion, as reflected in the increase in the participation of these papers in the total federal securities debt from 27.8% to 32.9%. The same period witnessed redemptions of papers not indexed to exchange totaling R$18.5 billion, with participation of the preset debt moving from 10.2% to 8.3% and that of the debt indexed to the Selic rate dropping from 51.5% to 48.8%.

2.4 – Conclusion

The evolution of the credit stock contracted with the financial system in the September to November period was a result of the uncertainties that prevailed on the economic scenario. Evidently, this was marked by a great deal more caution on the part of borrowers – including both companies and individuals – before committing future income, as they sought to avoid medium and long-term commitments. With respect to financial institutions, they tended to become considerably more selective in granting credits at the same time in which they increased spreads.

The role of the interest rate trajectory in the increase in the 2001 debt/GDP ratio was quite limited, since the major factor responsible for this growth is exchange devaluation. Thus, exchange valuation at the end of the year will make it possible to reduce the debt/GDP indicator. Aside from this, the continuity of the fiscal adjustment will permit to accelerate the downward trajectory in the debt/GDP ratio and consequently contribute significantly to the process of economic growth with stability.

3 – International economy

The repercussions of the September terrorist attacks in the United States further aggravated already serious international market uncertainties. Even before those events, economic activity had turned downward, stock market and commodity prices were slipping and investors were becoming increasingly wary of assuming any type of risk in the emerging economies.

Despite the measures taken to lessen monetary restrictions in the major advanced economies, the activity level continued on a clearly downward curve. In this sense, the budding recession in the United States and a worsening slowdown in both Japan and Europe have generated expectations of a longer and more severe crisis.

The fact that the crisis has hit so many of the developed nations at practically the same time has had a particularly damaging impact on the developing economies as demand has plunged in all parts of the world, capital flows have been curtailed and – perhaps worst of all – the volatility of basic product prices has worsened considerably.

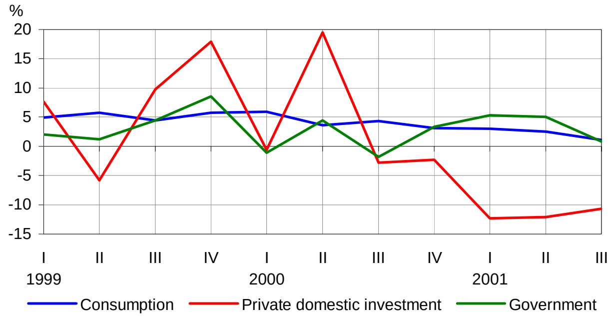
It was precisely in this framework that the IMF issued its most recent report on the world economic outlook, revising its forecast for world economic growth in 2001 downward from 3.2% in May of the current year to 2.4%. At the same time, the Fund stated that it was projecting world growth in 2002 at 2.4%.

It should be stressed that, despite significant variance in market forecasts for 2002, there is a consensus that the recovery in world economic growth will occur as of the third quarter of next year.

3.1 – United States

According to the Business Cycle Dating Committee, which operates under the auspices of the National Bureau of Economic Research, the ten year growth cycle in the United States ground to a halt in March of this year as the country moved into a period of recession. However, the various sectors and economic agents active in the American economy have behaved in highly varied manners. By way of example, the industrial sector has turned in negative growth for four consecutive quarters, while the service sector has registered consistently positive results in the same quarters. While businesses in general began cutting investments, reducing output and laying off workers about six months ago, families have taken much longer to digest and react to the new economic environment, as is evident in the fact that it was only in the third quarter that personal consumer spending, retail sales and consumer credit operations showed the first signs of deceleration.

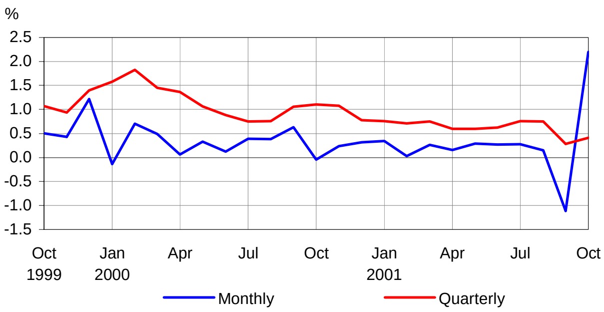
Aggregate demand - components[1/]



Source: Bureau of Economic Analysis
1/ Annualized quarterly change, seasonally adjusted and deflated.

According to preliminary data on aggregate demand released by the Bureau of Economic Analysis, the United States economy declined by 1.1% in the third quarter of the year. The data utilized in coming to this conclusion were drawn from the annualized deflated series already purged of seasonal factors. The major sources of contractive pressures were investments, with a cutback of 10.7%, and foreign sales which declined by 17.7%. Family consumption expanded by 1.1% and government outlays grew by 0.8%. Both of these figures reflected deceleration when compared to the 2.5% and 5% positive growth results in the previous quarter, respectively.

Personal consumption expenditures[1/]



Source: Bureau of Economic Analisys
1/ Deflated, seasonally adjusted data.

Personal outlays on consumption decelerated in the third quarter as the annualized real rate of growth – based on the statistical series purged of seasonal factors – came to 0.3%, as against 0.6% in the second quarter. In October, personal spending on consumption increased by 2.2%, compared to a 1.1% falloff in September.

In the third quarter, retail sales dropped by 0.4%, following 1.3% growth in the second quarter. Viewed in terms of quarterly movable averages, this was the first downturn since June 1997. In the month of October, retail sales – excluding the automotive sector – increased by 1% despite the strong negative expectations generated by the events of September 11.

Orders placed with factories have followed a downward curve since the second half of last year. Based on data free of seasonal influences, the decline came to 3.3% in the third quarter of the current year, as compared to a falloff of 1.8% in the previous period.

The upward movement in new housing starts evident at the start of the year was rapidly reversed. Consequently, according to data from which seasonal impacts have been eliminated, 5.7% expansion in the first quarter was followed by declines of 0.2% in the second and 1.6% in the third. The 1.3% reduction in October can be taken as a likely indicator of continued decline in the fourth quarter of the year.

Credit conditions deteriorated in the second half of the year and it was considered probable that they would do the same in the third quarter. The Federal Reserve (Fed) estimated that financial charges corresponded to 14% of available family income in the second quarter, a level unmatched in the last two decades. Default rates came to 2.15% for real estate loans and 3.7% for consumer financing in the second quarter of the year. These were the highest levels registered since the first quarter of last year. According to a survey carried out by the Fed, the number of banks that restricted access to credit in the September-November period increased sharply, compared to the previous quarter. The major underlying causes of these results are less favorable short-term expectations regarding economic conditions in general. Consumer credit registered a 6.8% increase in September, when viewed against the same month of the previous year. The corresponding figures for March and June were 10.1% and 8.8%. The September figure reflects not only the restricted credit environment but also the general downturn in aggregate family consumption.

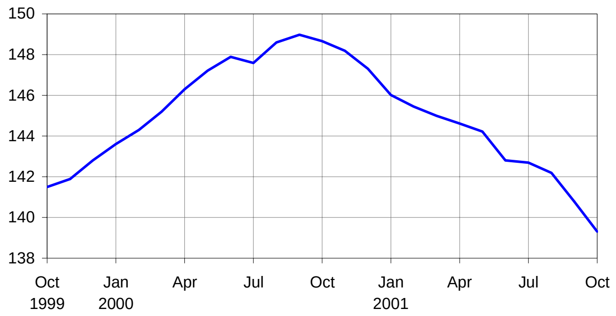
In the third quarter of the year, fixed nonresidential investment dropped by 11.9%, following a drop of 14.6% in the second quarter. Here, it should be noted that these are annualized figures that have been deflated and purged of seasonal impacts. This movement contrasts sharply with fixed residential investment, which increased by 5.9% in the second quarter and 1.9% in the third. Also based on figures from which seasonal influences have been withdrawn, the value of construction completed dropped by 2.6% in the third quarter of the year, following a drop of 0.5% in the second. However, in contrast to this result, October closed with positive growth of 1.6%.

In fiscal year 2001, the federal government obtained a surplus of US$127 billion in the period ended in September. This result was based on an inflow of US$1.99 trillion and outlays of US$1.86 trillion. The 2001 fiscal surplus declined by 46.3% compared to the previous year's figure and closed below the estimate of US$153 billion elaborated by the Congressional Budget Office (CBO). The underlying determinants of this result were deceleration in the intensity of economic activity and the tax reform measures implemented during the Bush administration. The CBO projects a fiscal result of US$176 billion for fiscal year 2002.

Insofar as foreign trade is concerned, the downward movement registered under exports and imports was a result of declining economic activity in the United States and the rest of the world. Foreign sales of goods dropped by 6.5% in the third quarter, following a 4.7% downturn in the second quarter, while imports of goods fell by 4.7% after a 4.5% reduction in the previous period. With this, the balance of trade in goods dropped by 1.7% in the third quarter, following a decrease of 4.3% in the second.

Analysis of the United States economy indicates that productive factors involved in the output of goods are being reallocated into the service sector. Consequently, while output of goods in the third quarter turned in the fourth consecutive quarterly falloff, the pace of service activities moved upward and has not registered a single negative quarter since 1997. Gross domestic product declined by 1.1% in the third quarter of the year following expansion of 0.3% in the second quarter. It should be noted that the figures used in arriving at this result were annualized data, duly deflated and purged of seasonal impacts. This result mirrors growth of 2.3% in the service sector and falloffs of 4.6% in the output of goods and 6.3% in the building industry.

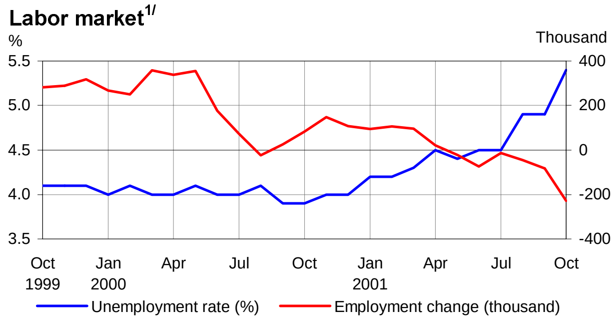
Industrial production
Index 1992=100



Source: Federal Reserve System

Industrial output has followed a downward trajectory since October of last year, with a drop of 1.1% in the second quarter of this year and a reduction of 1.4% in the following period. There are no signs of a reversal in this trend in the near future. In the third quarter, output of capital goods fell by 3.9%, following a reduction of 2.7% in the second, and was impacted rather severely by the falloff in aggregate investment. In the month of October, industrial production fell by 1.1% in relation to the month of September, pointing to a continued downward slide in the industrial sector in the fourth quarter of the year.

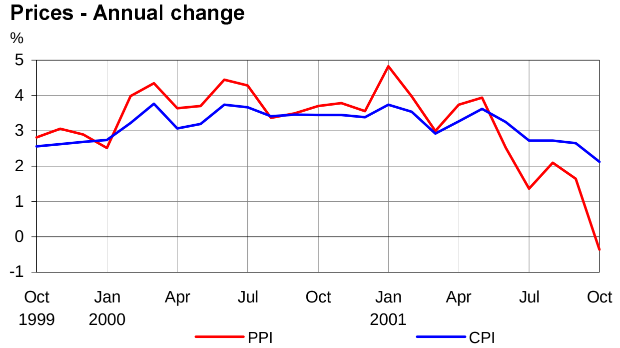
Labor market[1/]



Source: Bureau of Labor Statistics
1/ Seasonally adjusted; quarterly moving average of the employment change.

Going on to the labor market, employment in the manufacturing sector has registered negative monthly figures since August 2000. However, job generation in other sectors of the economy had clearly surpassed layoffs in the industrial sector up to the month of September, when this heading also turned downward. Consequently, the nonfarm sector registered a loss of 249 thousand job positions in the third quarter of the year, compared to 223 thousand in the second. In October, layoffs accelerated sharply, registering a loss of 415 thousand positions in just one month. Parallel to these results, October unemployment came to 5.4%, following a 4.5% result in June and 4.9% in September.

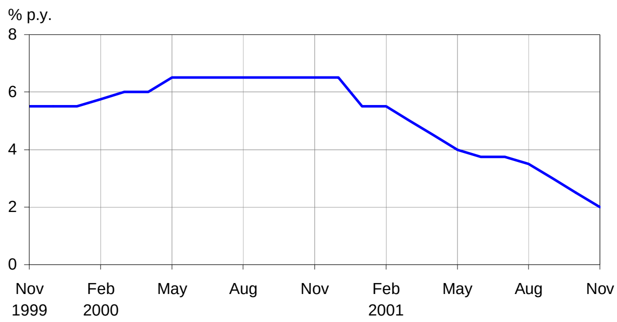
Prices - Annual change



Source: Bureau of Labor Statistics

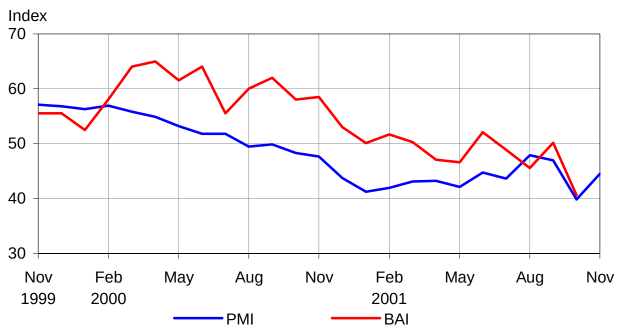
With the drop in international oil prices in the second half of the year, the rate of inflation also turned downward. In the 12 month period up to October, the Consumer Price Index (CPI) increased by 2.13%, compared to 2.65% in September and 3.62% in May. The core index increased by 2.6% in the twelve month period up to October. The Producer Price Index (PPI) fell by 1.63% in October, while the core dropped by 0.53%. With this, growth in the PPI in the twelve month period up to October came to a negative 0.36%, reversing the 1.65% rise registered in September. The PPI energy heading declined by 10% in October and 9.5% in twelve months.

Federal funds rate target



Source: Federal Reserve System

NAPM Indicators



Source: National Association of Purchasing Managers

The Federal Open Market Committee reduced the interest rate target for federal funds by 0.5 percentage points to 2% per year on November 6, compared to 6.5% per year in December of last year.

Expectation indicators were evidently impacted by the September terrorist attacks. Insofar as the manufacturing sector is concerned, the Purchasing Managers Index (PMI), which is released by the National Association of Purchasing Managers (NAPM), registered gradual recovery up to September when it closed at 47, before turning down by 7.2 points in October and recovering in November, ending the period at 44.5. The Business Activity Index (BAI) for the service sector, which had oscillated between 45 and 52 since January, ended the month of September at 50.2 and dropped to 40.6 in October, the lowest level ever registered by this index. The Consumer Confidence Index, which is elaborated by the Conference Board, fell sharply in the period from August, when it closed at 114, to the month of November, ending the period at 82.2.

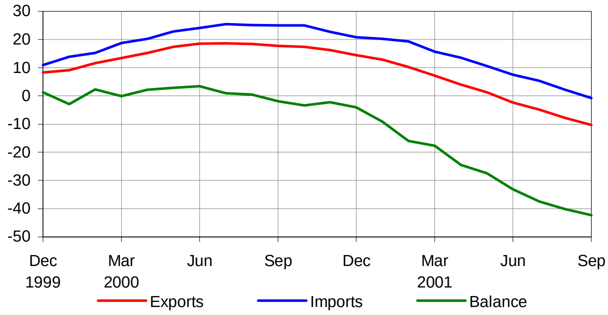
3.2 – Japan

As a result of stagnated employment and income levels, consumption in Japan has been very weak making it extremely difficult to achieve any significant degree of recovery. In this context, the adjustments being introduced into the Japanese economy have increased in intensity, while the Bank of Japan (BoJ) maintained its zero interest monetary policy in a framework of increased public sector spending.

Fixed investments have dropped sharply, particularly in the manufacturing sector, while forecasts of demand for technology intensive goods have been consistently revised downward. In the third quarter of the year, real available income and worker spending fell by 1.6% and 0.8%, when compared to the figures for the same quarter of the previous year. Orders placed with factories and new nonresidential building starts dropped by 12.5% and 0.1%, respectively, during the third quarter of the year, when compared to the corresponding quarter of the previous year.

Trade balance

Accumulated variation in 12 months

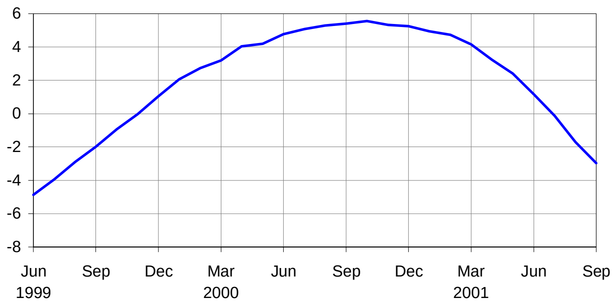


Source: Bank of Japan and Bloomberg

Reflecting lesser demand in Asia and the United States, together with a falloff in orders for technology intensive goods, the balance of trade followed a declining trajectory. In the third quarter of the year, export revenues came to US$96.9 billion, for a reduction of 20.3% in relation to the same quarter of 2000. At the same time, imports fell by 13% to a level of US$95.4 billion. This performance was clearly reflected in the downward trajectory followed by the accumulated 12 month balance, which closed September with a falloff of 42.3%.

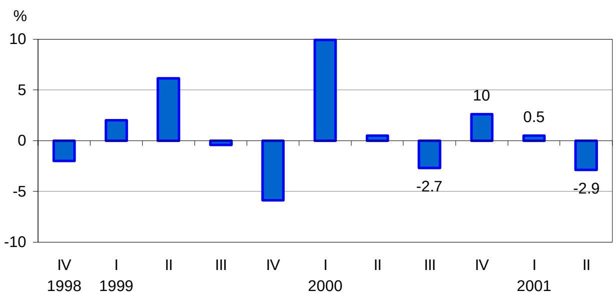
Industrial production

Accumulated variation in 12 months



Source: METI

Gross domestic product[1/]



Source: Economic Planning Agency

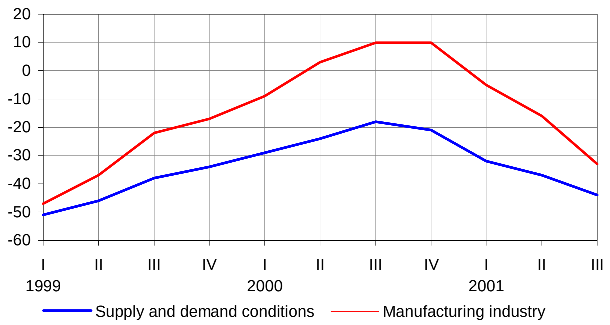
1/ Growth over previous quarter seasonally adjusted, annualized.

In the third quarter of the year, industrial output fell by 5.2%, in comparison to the same quarter of the previous year. In the month of September, industrial output fell by 12.7% when compared to the same period of 2000, accumulating a reduction of 3% in twelve months. At the same time, unemployment, which had stabilized at a level of 5% in July and August, closed the month of September at 5.3%, one of the highest rates of the last 34 months. In the second quarter, GDP dropped by 2.9% in annualized terms, compared to the previous quarter, and by 0.8% when compared to the same quarter of the preceding year. In the light of these circumstances, the BoJ revised its economic growth forecasts to a decline between 1.6% and 0.6% for fiscal year 2001, as compared to previous forecasts of growth between 0.3% and 0.8%. For fiscal year 2002, which will close in March 2003, government forecasts point to figures between a 1.7% decline and positive growth of 0.2%.

In September, wholesale prices dropped by a monthly rate of 0.6% and an annual rate of 0.2%, reflecting the influence of seasonal factors on the prices of electricity, gas and water, as the summer months drew to a close. Annual accumulated growth up to September 2001 closed at -5.1%. Consumer prices remained low as a result of decreases in the prices of private services, as September closed with a monthly reduction of 0.2% and an annual drop of 0.8%. Up to September 2001, accumulated deflation totaled 4.32%.

On October 19, the government approved additional budget funding totaling ¥11 trillion (US$90 billion) for fiscal year 2001, which is scheduled to end in March 2002. The areas that received the strongest financial inflows were investments in social infrastructure (US$38 billion), small and medium business financing (US$36 billion) and building financing and strengthening of employment generation programs (US$9 billion).

Industrial confidence index - Tankan



Source: Bank of Japan

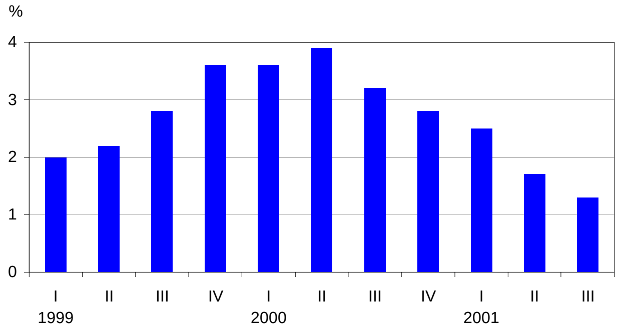
In this context, the unfavorable economic environment is reflected in the Tankan index, which measures short-term expectations for the manufacturing sector. This index moved from -16 in the second quarter of the year down to -33 in the subsequent period. The same index for supply and demand conditions dropped from -37 to -44 in the corresponding periods.

3.3 – Euro Zone

Continuing the trajectory begun in mid-2000, economic activity in the Euro Zone remained on a downward curve in the third quarter. The region has suffered the result of less dynamic external demand in a framework of a global drop in the pace of activity. Internally, the region has been immersed in the downside of the economic cycle, marked by declining supply, inventory corrections and unfavorable expectations on the part of economic agents. With this, GDP growth in relation to the same periods of the preceding years dropped from 3.9% in the second quarter of 2000 to 1.3% in the third quarter of 2001. With the economic slowdown and negative growth in energy prices, inflation indicators for the region have also dropped, as the Harmonized Consumer Price Index

(HCPI) has converged to the 2% reference mark, thus providing authorities with considerably greater monetary policy maneuvering room. In this context, the European Central Bank (ECB) reduced its basic interest rate three times in the second half of the year for a total cutback of 125 basis points to a final level of 3.25% per year.

GDP



Source: Eurostat

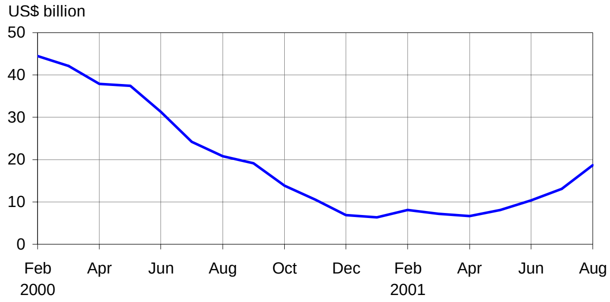
In the third quarter of 2001, the Euro Zone GDP expanded by 1.3% in relation to the same period of the previous year, compared to 1.7% growth in the second quarter, using the same basis of comparison. Consumer and government spending expanded by 1.8%. Exports rose by 1.4%, while gross fixed capital formation dropped for the second consecutive quarter to a level of -1.4%. In terms of the percentage contribution to the final GDP result, gross fixed capital formation and stocks accounted for -0.3% and -0.6%, respectively. The contribution of foreign sales operations dropped by 0.5%. Consumer and government spending remained at the same levels with final figures of 1% and 0.4%, in that order.

An analysis of the various sectors of economic activity indicates that both industry and services in the areas of commerce, transportation and communications clearly reflected the slowdown in the Euro Zone. While the aforementioned services expanded by 3.7%, 2.8% and 2.6% in the first three quarters of 2001, industry grew by 3.7%, 1.6% and 0.2% in the same periods. The results for the building industry, however, remained negative for the entire year and closed the third quarter will a falloff of 1.5%.

Among demand indicators, data released by Eurostat indicate that retail sales continued on a stable growth curve that ensured the level of consumer spending required to sustain GDP growth. The index showed monthly growth of 0.3% in July and August. Annual expansion moved from 1.5% in June and July to 1.8% in August.

The trade surplus turned upward as of the month of April, as the accumulated 12 month result moved from US$6.6 billion in that month to US$18.7 billion in August. This result was provoked by a sharper

Trade balance
accumulated in 12 months

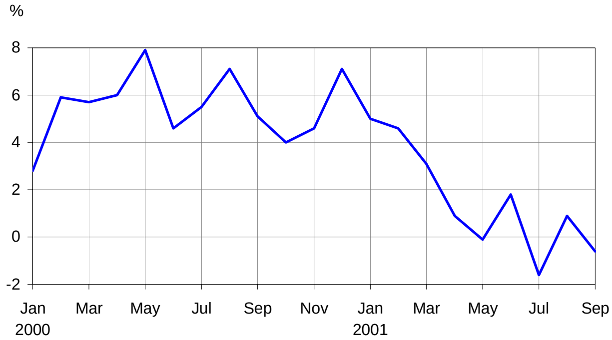


Source: ECB

drop under imports than under exports. In the case of foreign sales, compared to the second quarter average, the average for July and August reflected a drop of 1.4%, while import operations turned in negative growth of 7% in the same period. A comparison of the July and August averages with the same months of 2000 points to expansion of 1.2% in foreign sales and a 4.4% decrease in imports.

In relation to the dollar, the euro exchange rate appreciated in the third quarter, as the monthly average rose from US$0.8537/€ in the month of June to US$0.9125/€ in September. In the subsequent two month period, this trajectory was reversed as the average rate came to US$0.9062/€ in October to US$0.888/€ in November.

Annual variation of industrial production



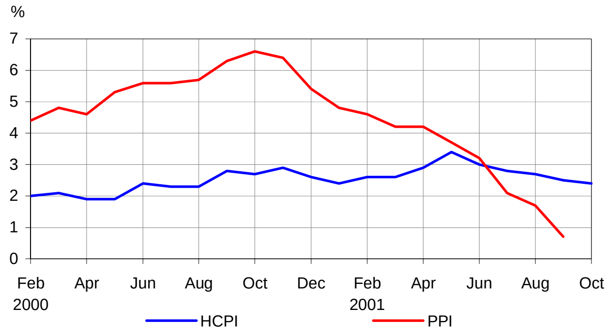
Source: Eurostat

With respect to supply, industrial output moved downward throughout 2001. Annual growth, which had reached a level of 5% in January, fell by 0.6% in September. In the third quarter of the year, negative monthly growth was registered in July (1.7%) and September (0.5%). Third quarter labor market performance was very sluggish as unemployment remained steady at 8.4% in both September and October.

The HCPI in the quarter benefited from the reduction in energy costs and weakened demand. In this context, though still above the 2% reference level defined by the ECB, the HCPI moved along a converging trajectory. Annual growth in the HCPI, which had reached 3.4% in May, totaled 2.5% at the end of the third quarter and 2.4% when October came to a close.

In contrast to HCPI performance, the annualized average monetary aggregate (M3) for the movable quarter, understood as a leading indicator of consumer inflation, moved upward during the period, rising from 6% in June to 6.9% in August, when compared to the 4.5% reference level. Following revision, annual M3 growth came to 6.9% in September and 7.4% in October.

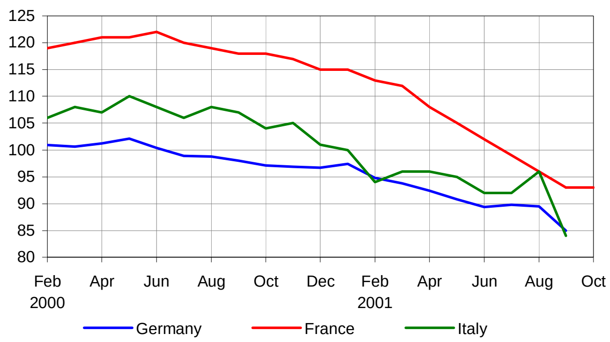
Prices - annual variations



Source: Eurostat

Producer prices registered sharper reductions than consumer prices. The monthly result for the Producer Price Index (PPI) was negative in both July and August, followed by positive growth of just 0.1% in September, and a new negative figure of -0.6% in October. When compared to the increases registered in the same period of 2000, price deceleration becomes even sharper. Annual PPI growth remained on a downward trajectory over the course of the entire year, closing August at 1.7%, September at 0.7% and October at -0.6%.

Confidence indicators



Source: Bloomberg

Business confidence indicators in the three largest Euro Zone countries reflected the dominant pessimism that reigned economic agents with regard to the region's economic performance in the near future. The negative results revealed by the indices worsened considerably following the events of September 11 and ended that month at their lowest level since 1998. In Germany, the General Business Climate Index, which is calculated by the Institute for Economic Research (IFO), dropped by 4.4 percentage points to 85 in the period from August to September and then dipped to 84.7 in October. In its turn, the French Industrial Trends Survey, which is compiled by the *Institut National de la Statistique et des Études Économiques* (Inséé), declined by 3 percentage points in September, closing at 93 points. The same result was repeated in the following month. In Italy, the Business Confidence Indicator, issued by the *Istituto di Studi e Analisi Economica* (Isae) dropped by 13 points in September and closed at a level of 83 points. This result was partially reversed in the following month, rising to 86.

In this scenario of a generalized economic slowdown, weakening inflationary pressures and low business confidence, the ECB decided to cut the minimum rate for refinancing operations (refi rate) by 125 basis points. This was done in three successive stages as of August 31, including the September 17 cutback coordinated with the Federal Reserve. As of November 9, the refi rate came to 3.25% per year.

3.4 – Emerging economies

3.4.1 – Asian economies

China

Following 15 years of negotiations, China's access to the World Trade Organization (WTO) was approved on November 10 at the 4th Interministerial Conference in Qatar. The country will be formally admitted on December 11. Access will permit China to participate in the new round of negotiations announced during the course of the Conference.

Though China's participation in the WTO will certainly expand its export markets, it will also impose a series of new challenges on the Chinese economy. With the now concluded trade negotiations, the process of economic liberalization is expected to move forward at a steady, albeit gradual, pace and will include economic restructuring aimed at adapting to a new competitive reality in the banking sector and automotive industry, among other sectors. Once the liberalization program has been concluded, average imports tariffs are to drop to 15% for farm products and 8.9% for industrialized goods. Foreign banks will be able to transact in local currency with Chinese companies within two years and with individuals within a period of five years. In order to prepare themselves to compete with foreign institutions, it is expected that the country's banks, which are in the hands of the state, will have to reduce their default rates, improve their administrative and credit evaluation systems and open their capital.

Steadily rising internal demand has powered economic activity and offset the slowdown in external demand generated by the spreading recession in the world's major economies. With the moderate rate of inflation (just 0.2% in October), the government has considerable space for adoption of expansionary policies. The government's forecast of GDP growth in 2001 is 7.3% with a similar result in 2002. Retail sales moved upward in the August-October period, in comparison to the same months of the previous year, with respective monthly growth rates of 9.6%, 9.9% and 10.5% in the period. Industrial output turned in a rise of 8.8%, compared to October 2000, following increases of 8.1% and 9.5% in August and

September, using the same basis of comparison. In the month of October, investments in fixed assets expanded by 17.4% while real estate investments rose by 29.6% when compared to October 2000.

Direct foreign investments registered a rise of 18.6% in the first ten months of the year, compared to the same period of 2000, and closed at a level of US$37.3 billion. For the coming months, expectations are that these flows will decline as a result of the world economic slowdown. However, at the same time, the country's entry into the WTO is also expected to stimulate new investments.

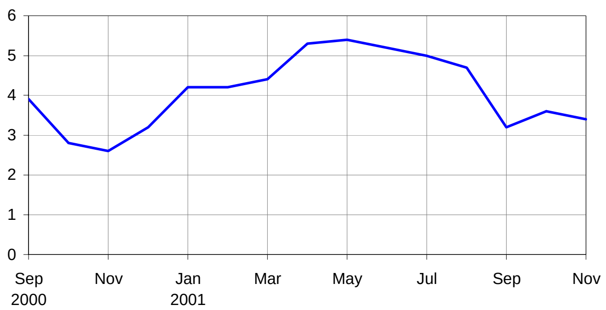
In the month of October, foreign sales increased by 0.1% in relation to October 2000, while imports fell by 0.2%. The trade surplus totaled US$3.9 billion in the month, compared to US$2.1 billion in September.

South Korea

The Korean GDP registered real growth of 1.8% in the third quarter of the year, when compared to the same period of the previous year. Analysis shows that this result is below the 3.7% mark for the first quarter and the 2.7% level registered in the second quarter, though it is still higher than in the other economies of the region. Expansion was sustained by internal demand, which has offset the persistent downturn in exports, and has been led by the sectors of construction and services, with respective growth levels of 7.3% and 3.8%. The factor most responsible for the high level of internal demand was adoption of two supplementary fiscal budgets that resulted in additional outlays of US$5.3 billion during the course of the year, coupled with a cutback in taxes on consumer goods. In the January-September 2001 period, the consolidated central government result was a surplus of US$8 billion, equivalent to 7.8% of GDP.

Consumer price index

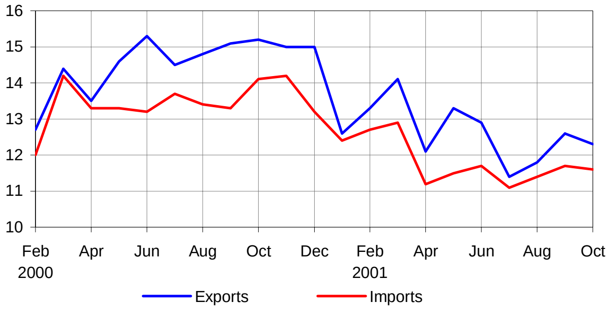
% change in 12 months



Source: Bank of Korea

In November, the Consumer Price Index dropped by 0.5%, accumulating positive 3.4% growth in twelve months, compared to 3.6% up to October and 3.2% up to September.

Trade balance
US$ billion



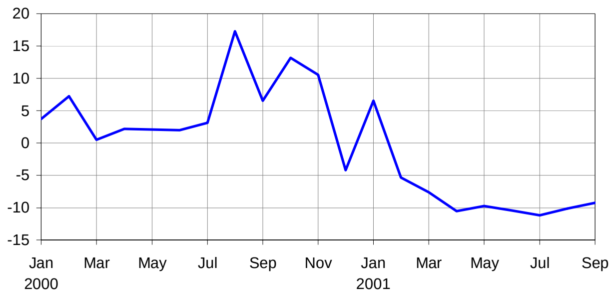
Source: Ministry of Finance and Economy

Exports and imports followed a downward trajectory, registering negative growth since the month of March. In October, foreign sales declined by 19.3% in relation to October 2000, following contraction of 17% in September and 20.3% in August. Imports fell by 13.5% in October, 13.7% in September and 13.3% in August, using the same reference base as above. The trade surplus accumulated up to the month of October 2001 totaled US$8.3 billion.

Accumulated foreign direct investment in the first three quarters of 2001 came to US$9.7 billion, or 6.9% less than in the equivalent period of the previous year.

3.4.2 – Turkey

Industrial output
% change in 12 months

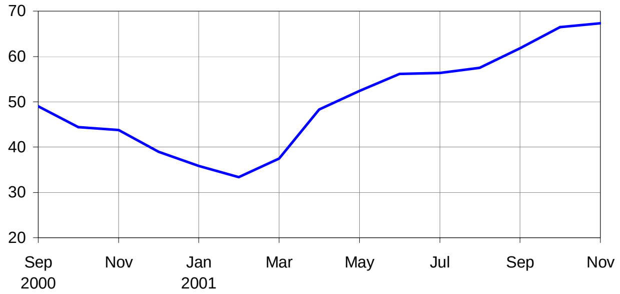


Source: National Institute of Statistics

In comparison to the third quarter of 2000, GDP registered a drop of 7.1% in the same period of 2001. However, it should be stressed that the country has begun showing signs of recovery. In relation to the previous quarter, GDP turned in growth of 1.8%, based on figures from which seasonal impacts have been purged. Utilization of installed output capacity came to 74.6% in October, compared to 72.8% in September and 71.4% in August. The best performances occurred under textiles for export and in the metallurgical industry. In the month of September, industrial output declined by 9.2%, when compared to the same month of the previous year. However, when viewed against the previous month's result, output expanded by 2.4%. Another indication of upward movement in the pace of activity is the increased October tax inflow, with 70% growth in the value added tax and 153% in the tax on petroleum consumption, when compared to October 2000.

The November consumer price index rose at a monthly pace of 4.2%, compared to 6.1% in October and 5.9% in September. The accumulated 12 month high hit the mark of 67.3%. The items that accounted for the

Consumer price index
% change in 12 months



Source: National Institute of Statistics

sharpest inflationary pressures were food, tobacco and communications. Parallel to these results, wholesale prices registered growth of 6.7% as a result of expanding internal demand and the passthrough effect of exchange devaluation in the immediately previous months.

The government announced measures to rein in spending and generate additional public revenues in 2002. These measures include the closing of regional government offices, cutbacks in farm subsidies, with the exception of those extended to soybean and canola producers, ceilings on civil service wage increases, suspension of new personnel hirings and increases in the rates of several tax headings.

Following growth of 26% in August, foreign sales increased by 6.5% in September when compared to the corresponding month in 2000, utilizing the same basis of comparison. Imports tended downward, registering reductions of 30.6% and 28.7% in August and September, respectively. The trade balance accumulated a deficit of US$7.5 billion from January to September of this year. In this period, foreign sales registered expansion of 11.8% and imports dropped by 23.3%, in relation to the same period of the previous year.

On November 28, the IMF approved the release of US$3 billion to Turkey in the framework of the agreement in effect since December 1999. With inclusion of additional resources in December 2000 and May 2001, the total amount made available came to roughly US$19 billion, of which US$11.7 billion have already been drawn down. Following the tenth review of the agreement, the IMF underscored the highly positive results of the government's fiscal efforts and the progress made in restructuring the banking sector. At the same time, it justified the need for delaying adoption of the inflation targeting mechanism to 2002, when it is expected that the country will have strengthened its fiscal position, resolved the remaining banking sector difficulties and reduced inflation. The managing director of the IMF, Horst Köhler, announced that the organization intends to negotiate an additional US$10 billion for Turkey with the objective of making it possible to meet the country's external financing requirements in 2001 and 2002. It is important to underline the fact that these necessities increased in the wake of the September events in the United States.

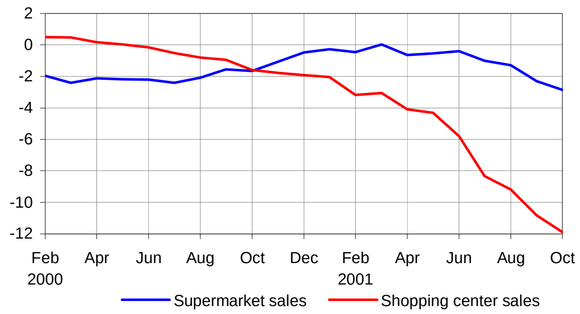
3.4.3 – Latin America

Argentina

Analysis of economic indicators make it very clear that the Argentine recession is steadily worsening, at the same time in which the fiscal environment has deteriorated and the present difficulties faced by the country have deepened. In this context, the fourth quarter of the year has been marked by eroding market perceptions of the sustainability of the Argentine economy, contributing to a severe worsening of the instability that has marked the nation in the course of the entire year.

Consumer indicators

Percentual growth accumulated in 12 months



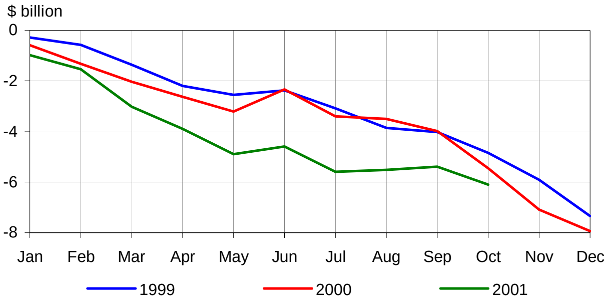
Source: Ministry of Economy/Indec

Sales and construction indices show no signs of recovery in internal demand. In this context, supermarket sales dropped by 10.3% in October, when compared to the same month of the previous year. In 12 month terms, figures released by the *Instituto Nacional de Estadísticas Y Censos* (Indec) point to a 2.9% reduction. The same index shows that shopping center sales fell by 20.1% in October, compared to the same month of 2000, with a falloff of 11.9% in accumulated 12 month terms. The Synthetic Index of Construction Activity (Isac), which indicates demand growth in the building sector, registered an October decrease of 15.6% in relation to the same month of the previous year and a decline of 7.3% in accumulated 12 month terms.

Public sector financial result

Accumulated in the year

$ billion



Source: Ministry of Economy/Secretaria de Hacienda

In the fiscal framework, the public sector financial result registered an October deficit of $697 million, compared to a deficit of $472 million in the same month of the previous year. These figures reflect the 5.6% reduction in the tax inflow in the January-October period, when compared to the same period of the preceding year. Up to October, the overall public sector result accumulated a deficit of US$6.9 billion. One should note that the target defined in the IMF agreement for 2001 is US$6.5 billion.

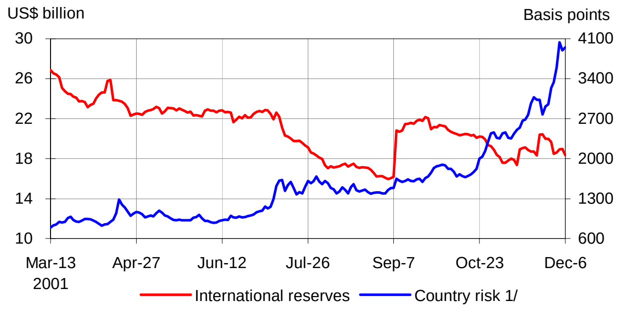
Trade balance results in October were positive once again, registering a surplus of US$587 million. In the year, the accumulated surplus closed at US$4.5 billion, reflecting export growth of 3% and a 14% decline under imports in relation to the same period of the previous year. Growth in foreign sales resulted from increased transactions involving primary products and industrial manufactured goods, principally to the countries of Latin America, coupled with a falloff in imports, as well as declining capital goods purchases from the North American Free Trade Association (Nafta) and the European Union. Insofar as bilateral trade with the Southern Common Market (Mercosul) is concerned, Argentine foreign sales declined by 6% and imports dropped by 11%. In the specific case of trade with Brazil, exports dropped by 5.3% and imports plunged by 14%.

Industrial output has been marked by a steady decline in the pace of activity. In the month of October, the Monthly Industrial Estimator (EMI), which is measured by Indec and utilizes data from which seasonal factors have been removed, turned in a 1.7% decline when compared to September. Viewed against the same month of the previous year, EMI dropped by 8.8% and closed with an accumulated 12 month drop of 3.8%. Among the various industrial segments analyzed by Indec, the automotive, metal-mechanics and fabric industries registered the most accentuated drop-off.

The price level has persistently reflected the decelerating pace of economic activity and maintained the trend toward deflation. The Consumer Price Index (IPC), which is measured by Indec, registered an accumulated 1.7% twelve month reduction. The *Índice de Precios Internos al por Mayor* (Ipim), which measures price growth at the wholesale level, accumulated a 12 month decline of 5.7%.

The difficulties involved in fostering policies capable of leading to a balanced public accounts position, coupled with highly negative demand and supply indicators that clearly point to a worsening recession, have resulted in growing investor wariness regarding the nation's capacity to honor its external commitments. In this context, financial indicators were marked by strong volatility. To demonstrate this, it is enough to state that the Baibor rate for 30 day operations in pesos climbed from a September 28 position of 26.3% to 133.7% on November 2, before plunging to 57.7% on November 23. Sovereign risk measured by the

International reserves and Country risk



Source: BCRA and Ambito Financiero Journal
1/ Measured by JP Morgan's Embi+ Index.

Embi Index + issued by JP Morgan closed November above 3,000 basis points. According to that criterion, Argentina is placed in the position as the country with the greatest investor risk of all of the nations analyzed. In the September to November period, bank deposits dropped by US$5 billion while the international reserve position held by the central bank slipped from US$21.2 billion to US$18.3 billion.

The situation of the Argentine provinces, which are strongly dependent on federal government transfers, has become a source of difficulties faced by the government in its efforts to curtail public spending. The reduction imposed on these transfers coupled with the difficulties faced by the provinces in their efforts to obtain the resources needed to meet their payment obligations, including civil service wages, led provincial governments to adopt what could be termed a monetary ploy that consisted of issuing local public securities as a type of quasi-money that substitutes the peso in payments made to civil servants and in commercial transactions. Currently, eleven Argentine provinces issue local public securities. The government issues a freely circulated paper called the Provincial Liabilities Cancellation Bill (Lecops), which are to be used in effecting transfers to the provinces.

In the month of October, the central government began negotiating a new fiscal pact with the provinces that includes renegotiation of their debts with private banks and reductions in the amounts to be transferred by the central government. Both the government and the international market view the new fiscal pact as an essential condition for attaining the target of a zero deficit which, in turn, is fundamental for the Argentine government to seek the support of multilateral organizations. By mid-November, 20 of the 24 provinces had formalized their adhesion to the fiscal pact with the government.

In early November, following the legislative elections that gave the opposition a majority of both houses of Congress, the government announced a new series of measures aimed at reactivating internal demand and restructuring the public debt. The government introduced a six percentage point reduction in social security contribution rates, restructured social programs to broaden the coverage of the benefits provided and adopted other measures aimed at restructuring private debts, all with the aim of stimulating demand. The restructuring of the total national public debt of US$132 billion consists of exchanging federal and provincial government papers that pay interest between 9% and 14% per year for loans with maximum interest of 7% per year, which are guarantied by the fiscal inflow. In addition, the amortization date has been extended by 3 years. Phase I, restricted to internal creditors, was concluded in the first week of December, with a result of US$55 billion. Of this total, US$14 billion were represented by provincial securities, accounting for 67% of the total debt eligible to participate in this exchange, US$82.2 billion. With this, the country is expected to economize US$4 billion in debt service payments in 2002. Phase II will involve external creditors and its success will depend on the response of international organizations, since greater guaranties will have to be offered to creditors, and on the fiscal inflow, which has suffered strong deterioration in the recent past.

However, announcement of the public debt restructuring operation was not sufficient to rebuild confidence in the Argentine economy and, in December, the government announced another series of measures targeted at stanching the drain on financial deposits and international reserves. Among these measures, particular attention should be given to the US$1,000 ceiling imposed on individual monthly cash withdrawals from banks, while the remainder would be available to account holders for transactions based on checks, credit and debit cards; restrictions on outflows of dollars from the country through controls imposed on remittances abroad and international travel; dollarization of new bank loans; equalization of time deposit rates in pesos and dollars; and extinction of interbank operations in pesos and futures market operations involving foreign currencies.

In early December, IMF announced the withholding of a US$1.24 billion loan tranche to the country due to noncompliance with the zero deficit target. According to IMF’s view, the deterioration of public accounts has worsened as of 1999 at the same time that the policies implemented by the Argentine government have not succeeded in restoring market confidence.

On December 19, the Chamber of Deputies approved two laws, one revoking the sweeping powers granted to the Executive Branch in March to deal with economic policy and other reversing a limit on monthly banking withdrawals for wages and pensions.On December 20, in the wake of growing social turmoil registered in several cities of the country, the economy minister resigned together with all ministers. The deepening of Argentine crisis was reflected in continued social disturbance followed by the resignation of the President of the Republic.

Mexico

Accompanying the growing recession in the United States, the Mexican economy also moved into a downward trajectory. In this context, GDP dropped by 1.6% in the third quarter when compared to the same quarter of the previous year. This result reflects drops of 4.7% in the industrial GDP and 0.4% in the service sector GDP, coupled with 5.8% growth in the farm sector GDP. These results are based on figures released by the *Instituto Nacional de Estadística, Geografia e Informática* (Inegi).

Demand indicators confirm the trend toward an economic slowdown. In the month of August, retail sales dropped by 0.6% when compared to the same month of the previous year. Using the same reference base, operations on the wholesale market dropped by 6.7%. At the same time, investment indicators show no signs of economic recovery. Consequently, in August, fixed capital investments dropped by 10.3% when compared to the corresponding figure of 2000. For the most part, these results mirror downturns in the sectors of machines and equipment, as well as the performance of investments in the building sector (5%).

In the fiscal framework, the Mexican government achieved a primary surplus of $9 billion in September, corresponding to 0.16% of GDP. Despite the deceleration of economic activity, total revenues expanded by 7% in relation to the September level of the previous year. Currently, the government has been working with the National Congress to approve a fiscal reform bill that would increase the tax inflow by as much as 2% of GDP.

The Mexican balance of trade evolved more or less in step with the economic situation in the United States, since 90% of Mexico's foreign sales are channeled to that market. In this sense, the October balance of trade closed with a negative US$989 million, compared to a deficit of US$870 million in the same month of the previous year. In accumulated terms for the year, exports closed at US$133.9 billion and imports at US$140.6 billion, for a deficit of US$6.7 billion, compared to a deficit of US$5.2 billion in the same period of 2000.

Industrial output declined by 5.4% in the month of September, when viewed against the same month of the previous year. This result was generated mostly by reductions of 6.2% in the output of the manufacturing sector and 4.6% in that of the building industry.

The falloff in economic activity has generated impacts on the level of formal employment. As measured by the Inegi, the rate of open unemployment in the month of October came to 2.9%, compared to 2.5% in September and 2% in October of the previous year. It is important to note that unemployment has increased in the more modern manufacturing segments of the Mexican economy.

In the second quarter of the year, the balance of payments registered a deficit of US$3.3 billion in current account. The underlying components of this result were deficits of US$1.8 billion in the balance of trade and US$3.9 billion in the service balance and a surplus of US$2.4 billion in the transfer account.

The price trajectory declined in the period. In the month of October, the National Consumer Price Index (INPC) increased by 0.45%, compared to 0.93% in September, accumulating a twelve month rise of 5.9%. Interest rates have also dipped, as 28 day Treasury Certificates (Cetes) generated earnings of 8.36% per year, compared to 9.32% per year in September.

For the coming year, the Mexican government has projected GDP growth of 1.7%, based on 4.6% expansion in investments, 1.2% in total consumption and 2.4% in exports.

Chile

Despite increasingly consistent signs of a downturn in the pace of economic activity, the Chilean peso seems to have moved into a period of recovery. Though hard hit by the world economic slowdown, the peso has benefited from recovery in copper prices and lower oil prices in the final quarter of the year. Another important factor has been the interest rate differential which has widened recently as a consequence of successive central bank decisions to maintain the basic interest rate level, in contrast to monetary authorities in other countries, most of whom have adopted rather aggressive policies of interest rate reductions in the wake of the events of September 11. As a matter of fact, the average nominal rate of exchange dropped to $689.40/US$ in November, compared to $681.24/US$ in September and $708.10/US$ in October.

Mirroring the weak performance of both industrial output and farm activity, the *Indicador Mensual de Actividad Económica* (Imacec) increased by 2.4% in the month of September, compared to the same month of the previous year. August of this year closed at 2.8%. The result of this performance was accumulated growth of 3.3% in the first nine months of the year. In the statistical series purged of seasonal factors, monthly growth came to 1.2%.

According to the Chamber of Commerce, real sales in the retail sector increased by 2.2% in the third quarter of the year when compared to the same period of the previous year.

In the third quarter, internal demand declined by 0.8% or less than the 2.8% falloff registered in the preceding quarter. Gross fixed capital formation increased by 3.3%, while the other demand components – particularly inventory growth – moved sharply downward. To some extent, the latter result reflected continuation of the negative performance under imports of goods and services, principally involving intermediate goods, the volume of which declined by 1.6%. Exported volume expanded by 6.5% in relation to the same quarter of the previous year, with especially strong performances under industrial and nontraditional exports.

Industrial output, which had registered annualized growth of 0.3% in July in the original series released by the *Instituto Nacional de*

Estadísticas (INE), expanded by 1.7% in August, 0.1% in September and 1.5% in the month of October. In real terms, GDP expanded by 2.6% in the third quarter of 2001, using the same period of the previous year as the basis of comparison. This was the lowest quarterly result since the 1999 recession. In relation to the previous quarter, the series free of seasonal influences turned in a decline of 1.8%. When one considers the three quarters of the year, GDP registered accumulated real growth of 3.3%.

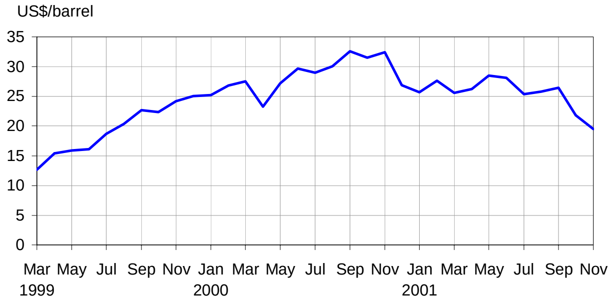
According to the INE survey, the jobless population, which had reached a level of 9.7% in August and 9.8% in terms of the moving average for the previous quarter, ended the month of September at 10.1% before dropping slightly to 9.9% in October.

The twelve month trade surplus has moved into a downward curve. In August, the surplus closed at US$1.55 billion, dropping to US$1.45 billion in September and US$1.42 billion in October. In the year, the trade surplus came to US$1.16 billion up to October.

In its most recent meeting held on November 8, the *Consejo del Banco Central* decided to hold the basic interest rate at its then current level of 6.5% per year.

3.5 – Petroleum

Brent-type crude oil
Average in the period



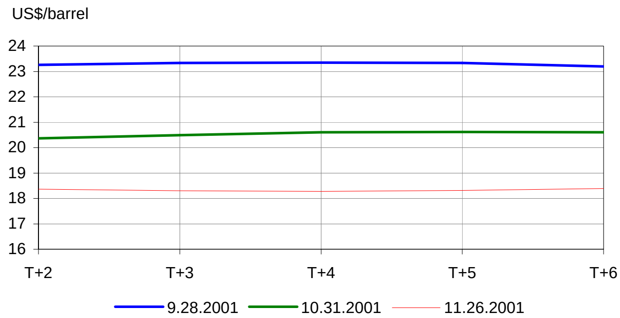
Source: Bloomberg

It is estimated that global petroleum demand dropped by 750 thousand barrels/day in the third quarter of 2001, mostly as a consequence of the slowdown in world economic activity and the uncertainties that have marked the international scenario since September. A new evaluation of demand for this year carried out in the month of October pointed to a reduction of 400 thousand barrels/day to a level of 76 million barrels/day. For 2002, the estimated increase was cut by 200 thousand barrels/day to total demand of 76.6 million barrels/day.

Spot Brent-type crude oil

Source: Bloomberg

Forward Brent-type crude oil



Source: Bloomberg

In the month of October, world oil output totaled 76.7 million barrels/day or virtually the same as in the previous month. Daily production of the eleven member states of the Organization of Petroleum Exporting Countries (Opec) dropped by 350 thousand barrels to 24.1 million barrels/day. However, it should be noted that this figure was still 0.9 million barrels above the target of 23.2 million barrels a day. Iraqi output increased by 300 thousand barrels/day.

Following an analysis of the oil market and supply and demand expectations, Opec met on November 14 and decided to reduce the daily production target by 1.5 million barrels, as of January 1, 2002. Implementation of this decision was conditioned to a simultaneous decision on the part of the non-Opec exporting countries to cut their output by 500 thousand barrels/day. With this result, the total reduction in the petroleum supply will come to 5.5 million barrels/day when compared to January 2001, since Opec had already cut production in the current year by 3.5 million barrels/day. However, there is continuing concern with the possibility that these cuts may not be effective in reversing the downward movement under prices if such non-Opec countries as Mexico, Norway and Russia resolve not to curtail their output.

The spot market price of Brent-type petroleum declined from US$25.40/barrel at the end of the first six months of the year to US$29.99/barrel at the end of the third quarter of the year. On December 10, the price stood at US$17.92/barrel, reflecting a reduction of 29.4% in the period.

In the case of the futures market, petroleum prices have remained practically stable for the various delivery periods negotiated on the same date. The November price level came to US$18.30/barrel, compared to US$20.50/barrel at the end of October and US$23.30/ barrel at the end of September.

3.6 – Conclusion

Recent events have demonstrated the speed and intensity with which such grave happenings as those of September 11 reverberate throughout the world economy. This is clear in the deteriorating outlook for world economic growth, despite the efforts taken by the world's major economies to change this situation through adoption of expansionary monetary and fiscal policies. In this context, the world macroeconomic scenario is one of economic decline in a context of reduced inflationary pressures and lesser confidence on the part of economic agents.

United States economic indicators further intensified the downturn in the economic activity level. It should be noted that downward movement varied in strength from one sector to the other. In the third quarter of the year, United States GDP registered a drop of 1.1%, reflecting declines of 10.7% in private investments and 17.7% in exports. Consumption, which had sustained output, expanded by 1.1% while government spending increased by 0.8%, reflecting deceleration in comparison to the previous quarter. On the supply side, production factors are being shifted out of the production of goods and into the service sector. While the first heading turned in declines since the fourth quarter of 2000, the second has held firmly on a consistent growth trajectory since 1997. Expectations on the part of economic agents as perceived by surveys carried out among businesspeople (NAPM) and consumers (Conference Board) showed distinct performances in November. Following downward movement in October, the indicator of manufacturing industry expectations recovered somewhat in November. However, this index has remained below 50 points for 16 consecutive months, a clear sign of an overall decline. The index that measures consumer confidence dropped by 31.8 points from August to November, reflecting glaring uncertainties regarding short-term economic conditions. This would seem to suggest that any recovery in the United States economy will not be particularly vigorous, with market expectations pointing to a sustained recovery only as of the third quarter of 2002.

Growth in economic activity in the Euro Zone economies has been steadily diminishing, particularly as a result of continued negative business expectations and slack world demand. The result of this process could be a reversal of the region's surplus trade position.

In Japan, the major supply and demand indicators point to a worsening of that country's recession. Maintenance of the zero interest monetary policy, coupled with adoption of fiscal measures aimed at economic recovery, has not produced the expected positive results. The Bank of Japan projects a GDP falloff between 1.6% and 0.6% for fiscal year 2001.

Simultaneous economic deceleration in the world's three major economies has clearly impacted the emerging economies. In this sense, economic growth in China and Korea has been sustained by internal demand, which has offset the downturn in external demand. Approval of China's admission to the WTO on November 10 will certainly expand that country's export market, though it will also impose a series of new challenges on the nation as a consequence of the profound transformations that will have to occur in key sectors of the Chinese economy.

Insofar as Latin America is concerned, the downturn on the international financial market – caused by the environment of uncertainty and investor aversion to risk – and the falloff in trade sector operations as a result of lesser international demand are the factors of greatest importance. In Argentina, this scenario has accentuated the deepening recession in that country, making it even more difficult to achieve the targets agreed upon with the IMF and to implement a public debt restructuring program. Difficulties mounted and have further aggravated the social unrest. A 30-day state of siege was declared and the ministry resigned.The deepening of Argentine crisis was reflected in continued social turmoil followed by the resignation of the President of the Republic.

4 – Foreign sector

The major determinant factors underlying balance of payments results in the second half of the year were a generalized economic slowdown and – even more important – devaluation of the real, coupled obviously with the grave events that marked the international scenario in the period. Reacting to this environment, the current account balance clearly mirrored the positive performance of both exports and imports of goods and services.

More recent balance of trade results confirmed the surplus expected for the year as a whole, while investments rose and demand for exchange hedging declined as investors demonstrated an increasingly higher degree of confidence in the economy.

4.1 – Trade in goods

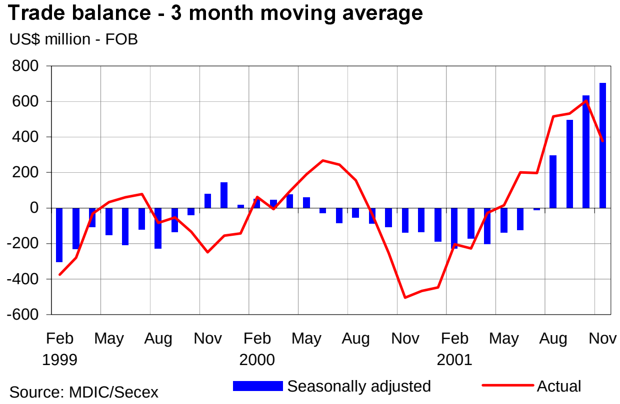
Trade balance - FOB

US$ million

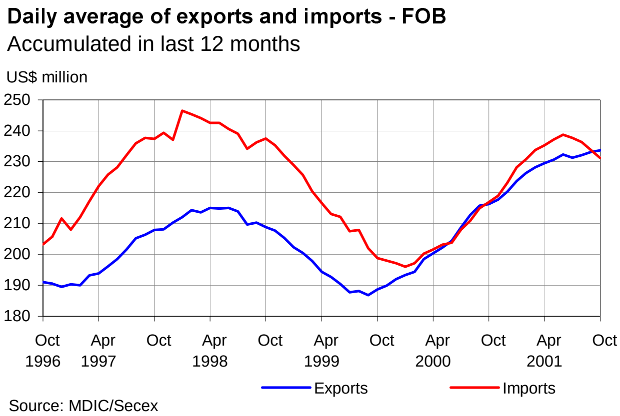
Period		Exports	Imports	Balance	Trade flow
Jan-Oct	2001	49 377	47 878	1 499	97 254
	2000	46 037	45 902	134	91 939
% change		7.3	4.3		5.8

Source: MDIC/Secex

The series of monthly trade surpluses that began in April has continued in recent months as import operations decreased and exports were driven by sales of important basic and semimanufactured goods. In the first half of 2001, foreign sales increased by 11.6%, compared to the same period of 2000, while imports rose by 15.1%. However, when one considers the results for the following four months, the final figures came to 1.8% and -9.3%, in the same order. In the January-October period, exports totaled US$49.4 billion and imports closed at US$47.9 billion, representing growth of 7.3% and 4.3% when compared to the same period in 2000. The trade surplus moved from US$134 million in 2000 to US$1.8 billion in 2001, with growth of 5.8% in the trade flow during the period.



The favorable performance of foreign sales was generated by depreciation of the real. Deflated by the Wholesale Price Index – Internal Supply (IPA-DI), the downturn in the rate of exchange came to 17.2% in the period from January to October 2001, compared to the same period of the previous year. Among the products that made the strongest contribution to this result, the most important were soybeans and derivatives, animal protein, sugar and petroleum derivatives. The falloff in imports was due to exchange depreciation and a reduction in internal demand.



A number of interdependent events impacted foreign trade operations, particularly in the second half of the year. The most important of these were slowdowns in both the internal and international economies and exchange depreciation, both of which had strong repercussions on export and import price indices. Consequently, in the month of October, foreign sales registered price reductions of 2.6% in the year and 5.8% when viewed against the same period of 2000. At the same time, import prices dropped by 1.8% and 3.7%, respectively. The volume of foreign sales increased in the two periods compared (10.1% and 14.3%, respectively) while the volume of imports, which had increased by 6.2% in the January-October period, dropped by 4.5% when one compares the October 2001 performance with that of the same month of the previous year. The reduction in export prices – particularly in the cases of basic products and semimanufactured goods – was more intense than the falloff under import prices and generated deterioration in terms of trade during the course of the year.

In the final three months of the year, exports continued climbing as imports slipped downward, thus reversing the results normally registered in that period of the year. In this context, particular attention should be given to the performance of foreign sales of basic and semimanufactured goods, with volume growth of 40.9% and 34% in October compared to the

Exports by category of goods - FOB
January-October

US$ million

Itemization	Accumulated 2000	Accumulated 2001	% change	Daily average 2000	Daily average 2001	% change
Total	46 037	49 377	7.3	219.2	235.1	7.3
Primary products	10 714	13 255	23.7	51.0	63.1	23.7
Industrial products	34 038	34 537	1.5	162.1	164.5	1.5
Semimanuf. goods	7 010	6 868	- 2.0	33.4	32.7	- 2.0
Manufactured goods	27 028	27 670	2.4	128.7	131.8	2.4
Special operations	1 284	1 585	23.4	6.1	7.5	23.4

Source: MDIC/Secex

Exports by category - FOB
Main products - January-October

US$ million

Itemization	Daily average 2000	Daily average 2001	% change
Total	219.2	235.1	7.3
Primary products	51.0	63.1	23.7
Soybeans	10.0	12.6	25.8
Iron ore	12.3	12.0	-2.4
Soybeans, oil-cake and other residues	6.6	8.3	25.5
Chicken meat	3.2	5.1	60.8
Coffee in beans	6.3	4.8	-23.0
Tobacco, unmanufactured	3.2	4.0	24.2
Bovine meat in natura	2.0	2.9	43.5
Semimanufactured products	33.4	32.7	-2.0
Cane sugar, raw	2.6	5.4	112.3
Chemical wood pulp	6.8	5.1	-24.7
Iron or nonalloy steel semifinished goods	5.6	4.0	-28.4
Hides and skins	2.9	3.4	19.1
Aluminum, unwrought	3.6	2.9	-18.9
Manufactured products	128.7	131.8	2.4
Airplanes	12.1	11.5	-5.0
Passenger motor vehicles	6.9	8.0	15.5
Footwear	6.4	6.9	6.9
Transmission and reception apparatus	6.3	6.7	5.2
Parts and accessories for motor cars	4.8	4.8	-0.9
Passenger motor vehicles engines	4.3	4.4	1.9
Fuel-oils	1.2	3.3	171.9
Cane sugar, refined	1.6	3.3	103.6
Orange juice	4.3	3.2	-25.5
Pumps, compressors, fans	2.9	2.6	-9.3
Iron or nonalloy steel flat-rolled products	3.5	2.4	-30.5
Paper and paperboard for writing, printing	2.1	2.2	3.6
Gasoline	1.5	2.1	41.3
Furniture and parts thereof	1.9	1.9	0.8
Pneumatic rubber tires	2.1	1.9	-10.6
Electric motors, generators, transf.; parts	1.4	1.8	25.2
Special operations	6.1	7.5	23.4
Oil and fuels, onboard consumption	3.8	4.5	16.4

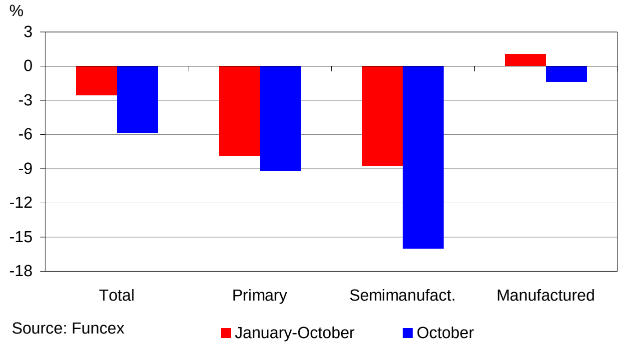
Source: MDIC/Secex

same month in 2000, respectively. These results accentuated the trade balance result, expressed in amounts from which seasonal impacts have been eliminated, and were partially responsible for the US$8.4 billion surplus – in annualized data free of seasonal factors – registered in November 2001.

One of the major factors underlying export growth was the 23.7% increase in sales of basic goods, with a total of US$13.3 billion in the January-October 2001 period. This result was based on 34.1% greater volume and a 7.8% price decline. At the component level, the most important were sales of soybeans and soy meal, with growth of 25.5% in the period, coupled with sales of animal protein, particularly chicken meat (60.8%) and beef (43.5%). International demand for these products rose sharply with the serious outbreak of disease in the European livestock market. Other basic product exports that deserve mention are those involving tobacco, with growth of 24.2%, and coffee, with a decline of 23%.

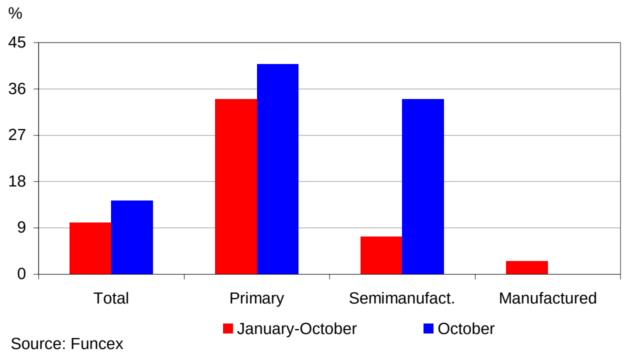
Foreign sales of semimanufactured goods came to US$6.9 billion, reflecting downward movement of 2%, when compared to the accumulated total in the January-October 2000 period. Analysis shows that the period was marked by a price decline of 8.7%, while the volume of shipments expanded by 7.4%. Among the major semimanufactured goods, the international economic slowdown had negative impacts on demand for such important inputs as cellulose, with a foreign sales drop of 24.7%, and semimanufactured products in iron or steel and unwrought aluminum, with respective falloffs of 28.4% and 18.9%. On the other hand, external sales of sugar expanded by 112.3%, principally as a result of sharp growth in the volume of shipments. This performance reflected a change in

Exports - price index
Change over the previous year



Source: Funcex

Exports - quantum index
Change over the previous year



Source: Funcex

the position adopted by producers who, in 2000, had opted for the increased profitability generated by alcohol production.

Growth in the foreign sales of manufactured goods has continued declining, closing the January-October period at 2.4%, with total revenues of US$27.7 billion. In terms of total exports, the participation of this product category fell from 58.7% in 2000 to 56% in 2001. Marginal declines occurred in both prices and volume, as growth under these two headings came to 1.1% and 2.5% in the period, compared to 1.7% and 6.7%, respectively, in accumulated terms for the first half of 2001, compared to the same period of the previous year. Exports of automobiles were the heading of greatest importance in maintaining export growth in the positive range. These sales rose by 15.5% in the January to October 2001 period, when compared to the same period of 2000. The factors that powered this growth performance were lower production costs in the country, in comparison to other automobile production centers, and the nation's participation in bilateral automotive agreements. Foreign sales of fuel oils and gasoline increased by 171.9% and 41.3% in the period, as a result of both new market strategies and increased Petrobras refining capacity. External sales of refined sugar increased by 103.6% as a result of increased internal output generated by a decline in the alcohol production profit margin, coupled with greater demand in the Middle East, Africa and Russia. Finally, exports of aircraft and orange juice dropped by respective rates of 5% and 25.5%.

Imports by end-use category - FOB
January-October

US$ million

Itemization	Accumulated			Daily average		
	2000	2001	% change	2000	2001	% change
Total	45 902	47 878	4.3	218.6	228.0	4.3
Capital goods	10 994	12 563	14.3	52.4	59.8	14.3
Raw materials	23 729	23 889	0.7	113.0	113.8	0.7
Consumer goods	5 973	6 086	1.9	28.4	29.0	1.9
Durable	2 734	3 081	12.7	13.0	14.7	12.7
Nondurable	3 239	3 005	- 7.2	15.4	14.3	- 7.2
Fuels	5 207	5 339	2.5	24.8	25.4	2.5

Source: MDIC/Secex

In the January-October period, imports increased by 4.3% when compared to the total for the corresponding period of the previous year and closed with a final result of US$47.9 billion. Monthly imports have decreased since July when one compares the results with the corresponding

Imports by end-use category - FOB
Main products - January-October

US$ million

Itemization	Daily average		
	2000	2001	% change
Total	218.6	228.0	4.3
Capital goods	52.4	59.8	14.3
Industrial machinery	15.2	18.5	22.3
Machines/apparat.for offices, scientific serv.	9.8	10.8	10.1
Parts for industrial capital goods	6.2	7.5	21.5
Accessories for industrial machinery	3.7	4.2	10.8
Others	17.5	18.8	7.9
Intermediate products and raw materials	113.0	113.8	0.7
Chemical and pharmaceutical products	31.4	32.7	4.1
Intermediate products - parts and spares	19.3	19.6	1.7
Mineral products	19.4	18.9	- 2.6
Naphthas	7.2	5.8	- 19.4
Accessories for transportation equipment	16.3	17.7	8.9
Inedible farm products	9.9	8.1	- 18.6
Foodstuffs	6.6	6.5	- 2.3
Others	10.1	10.3	1.8
Durable consumer goods	13.0	14.7	12.7
Passenger vehicles	4.4	6.0	38.0
Articles of adornment	2.7	2.9	5.3
Machines, apparatuses for domestic use	2.2	1.9	- 10.9
Durable consumer goods parts and spares	2.1	1.8	- 10.7
Furniture and other house equipments	0.7	1.0	39.8
Others	1.0	1.0	2.3
Nondurable consumer goods	15.4	14.3	- 7.2
Foodstuffs	5.9	4.7	- 19.8
Pharmaceutical products	4.5	4.6	3.1
Beauty products	1.0	0.9	- 5.2
Apparel and other textil clothing	0.7	0.7	9.2
Beverage and tobacco	0.6	0.7	26.4
Others	2.9	2.7	- 8.5
Fuels and lubricants	24.8	25.4	2.5
Crude oil	13.2	13.0	- 1.7
Others	11.6	12.4	7.4

Source: MDIC/Secex

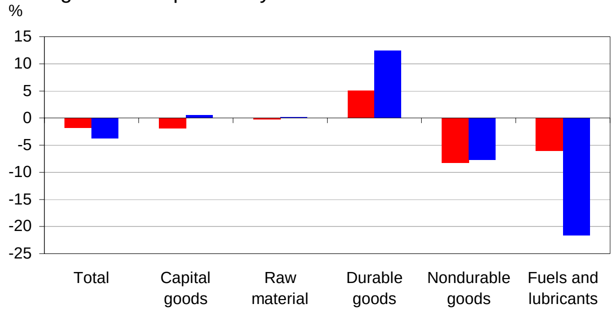
months of 2000, while downward movement under this heading has coincided with the slowdown under GDP in the same period.

The increase registered in annual outlays on imports was due to a greater volume of inflows, since prices – with the exception of consumer durables - followed a downward curve. In October 2001, the sharpest price drops occurred under fuels and lubricants and nondurable consumer goods, mostly as a result of the fall in oil prices. From the point of view of imported volume, the most dynamic performance occurred under capital goods, the heading that registered the strongest growth in both October and the year as a whole. The volume of intermediate goods and consumer durables dropped in comparison to the October 2000 level, despite growth in accumulated annual terms.

Imports of industrial machinery, office/scientific service machines and apparatuses, parts for industrial capital goods, chemical and pharmaceutical products, passenger cars and diesel oil exerted strong pressure on the trade balance result during the course of the year. With the downturn in the pace of economic activity in October, imports declined under all of the different use categories when compared to the same month of 2000. The only exception occurred under capital goods as a consequence of cutbacks in the import tax in the framework of the ex-tariff system and of the need for alternative sources of electricity generation to supplement the output of the nation’s hydroelectric system. In the year, imports of capital goods contributed 79.4% of the total increase in imports.

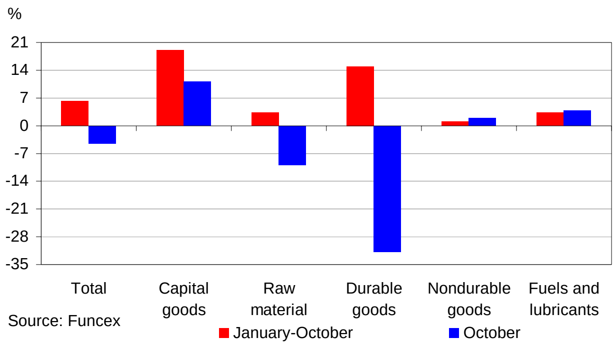
The September/October falloff in purchases of consumer durables was due to lesser acquisitions of machines and apparatuses for the home, mostly as a result of energy shortages, and of passenger cars, reflecting the generalized slowdown in the pace of economic activity. Imports of

Imports - price index
Change over the previous year



Source: Funcex

Imports - quantum index
Change over the previous year



Source: Funcex

Exports and imports by geographic area - FOB
January-October

US$ million

Itemization	Exports			Imports			Balance	
	2000	2001	% change	2000	2001	% change	2000	2001
Total	46 037	49 377	7.3	45 902	47 878	4.3	134	1 499
Laia	10 632	10 429	-1.9	9 764	8 660	-11.3	868	1 769
Mercosur	6 377	5 594	-12.3	6 474	6 052	-6.5	- 97	- 459
Argentina	5 135	4 432	-13.7	5 687	5 384	-5.3	- 552	- 953
Others	1 242	1 162	-6.4	787	668	-15.1	455	494
Mexico	1 425	1 515	6.3	602	601	-0.1	824	914
Others	2 830	3 320	17.3	2 688	2 006	-25.4	142	1 314
USA 1/	11 187	11 969	7.0	10 707	11 195	4.6	480	774
EU	12 623	12 843	1.7	11 653	12 746	9.4	970	97
W. Europe 2/	733	1 424	94.3	950	960	1.1	- 217	464
Asia	5 367	5 908	10.1	6 995	7 697	10.0	-1 629	-1 789
Japan	2 156	1 688	-21.7	2 460	2 658	8.1	- 303	- 969
South Korea	488	597	22.3	1 158	1 402	21.1	- 670	- 805
China	868	1 682	93.7	969	1 109	14.5	- 101	572
Others	1 854	1 942	4.7	2 409	2 528	4.9	- 555	- 587
Others	5 495	6 803	23.8	5 834	6 619	13.5	- 338	184

Source: MDIC/Secex

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

nondurable consumer goods remained below the 2000 level, with a particularly strong plunge under foodstuffs. An equally strong falloff occurred under foreign sales of raw materials and intermediate products, particularly mineral goods. The causes of this reduction were concentrated in lesser purchases of naphtha, nonfood farm products and parts and spares for intermediate goods.

The reduction in the value of petroleum imports was caused by declining prices, as is evident in the fact that the volume of imports increased. It is interesting to note that, if the median import price of this product in 2000 had been in effect in the July-October period of the current year, the value of petroleum imports for the four month period in question would increase by an additional US$100 million.

An analysis of Brazilian trade operations indicates that the surplus in commerce with the Laia countries moved from US$868 million in the January to October 2000 period to US$1.8 billion in the corresponding period of 2001. Basically, this increase was brought about by a drop of 11.3% in Brazilian imports, particularly from Venezuela (47.8%), as a result of the downturn in the international prices of petroleum and derivatives. In the Mercosul framework, it is important to underscore the 13.7% reduction that occurred under foreign sales to Argentina.

Insofar as the United States is concerned, growth came to 7% under exports and 4.6% under imports, raising the trade surplus from US$480 million to US$774 million. Increases were registered under sales of aircraft, footwear, transmission and reception devices, automobiles and, above all, under fuel oils and gasoline, the major products shipped to the USA in the period.

Operations with the European Union (EU) turned in 9.4% growth under imports and 1.7% under exports. As a result, the surplus dropped from a level of US$970 million in the January-October 2000 period to US$97 million in 2001.

Foreign sales of sugar were the major factor in the 94.3% increase in exports to Eastern Europe. The trade balance with the bloc reversed position from a US$217 million deficit to a surplus of US$464 million in the period under consideration.

Going on to trade with the countries of Asia in the January-October period, the deficit increased from US$1.6 billion to US$1.8 billion, principally as a result of a cutback of 21.7% in sales to Japan. It is important to highlight increased trade with South Korea and, principally, China. In the case of Korea, exports increased by 22.3% and imports rose by 21.1%, resulting in an increase in the trade deficit from US$670 million to US$805 million. In relation to China, exports expanded by 93.7%, and were particularly strong under soybeans, soy meal and automobiles, while imports increased by 14.5%.

4.2 – Services and income

The net flow of services and income with the international community resulted in payments totaling US$22.7 billion in the January-October 2001 period, reflecting an increase of 10.6% in relation to the same period of the previous year. For the most part, this increase was due to greater net income remittances abroad, particularly under the heading of profits and dividends.

In the period under consideration, services turned in a deficit of US$6.5 billion. The 11.8% growth was due to an increase of US$822 million in net outlays on equipment rentals and the deficit of US$197 million on insurance, compared to a surplus of US$6 million in the previous year. Net spending on transportation dropped by US$203 million, with

Current account

US$ billion

Itemization	1999	2000		2001
	Year	Jan-Oct	Year	Jan-Oct
Current account	-25.4	-19.1	-24.7	-19.9
Trade balance	-1.3	0.1	-0.7	1.5
Exports	48.0	46.0	55.1	49.4
Imports	49.3	45.9	55.8	47.9
Services	-7.0	-5.9	-7.6	-6.5
Transportation	-3.1	-2.7	-3.3	-2.5
International travel	-1.5	-1.7	-2.1	-1.3
Computer and information	-1.0	-0.9	-1.1	-0.9
Operational leasing	-0.6	-0.9	-1.3	-1.7
Other	-0.8	0.4	0.2	-0.1
Income	-18.8	-14.7	-17.9	-16.1
Interest	-14.9	-12.1	-14.6	-12.5
Profits and dividends	-4.1	-2.6	-3.3	-3.7
Compensation of employees	0.1	0.1	0.1	0.1
Current transfers	1.7	1.2	1.5	1.3

growth of US$42 million in net spending on freights and a US$245 million in cutbacks on other transportation services. Net spending on international travel registered a reduction of US$394 million as a consequence of a falloff in Brazilian outlays on foreign travel, caused by increased costs consequent upon exchange devaluation and, later in the period, the events of September 11.

Net remittances of income abroad came to US$16.1 billion, with growth of US$1.5 billion concentrated in profits and dividends with an increase of 43.2%. Net remittances of profits and dividends on direct investments and portfolio investments expanded by US$869 million and US$253 million, respectively. Net payments of interest increased at a lesser pace (3.1%) and added up to US$12.5 billion. This increase was concentrated mostly under interest on fixed income papers, as net outlays expanded by US$751 million. Increases occurred under payments of interest on bonds (US$651 million), notes (US$433 million), commercial papers (US$64 million) and intercompany loans (US$194 million). These increases were partially offset by a reduction of US$767 million in interest payments on other investments. In this case, the most important item was the US$450 million drop in Banco Central interest payments.

4.3 – Financial account

Financial account

US$ billion

Itemization	1999	2000		2001
	Year	Jan-Oct	Year	Jan-Oct
Financial account	17.0	12.9	19.1	24.4
Direct investment	26.9	22.9	30.5	18.5
Abroad	-1.7	-1.9	-2.3	1.9
In Brazil	28.6	24.8	32.8	16.6
Equity capital	30.0	22.5	30.0	13.5
Intercompany loans	-1.4	2.2	2.8	3.1
Portfolio investment	3.8	6.2	7.0	2.4
Assets	0.3	-1.8	-1.7	-0.8
Liabilities	3.5	8.0	8.7	3.3
Derivatives	-0.1	-0.1	-0.2	-0.4
Other investment	-13.6	-16.0	-18.2	3.8
Assets	-4.4	-0.5	-3.0	-5.5
Liabilities	-9.2	-15.6	-15.2	9.3

In the first ten months of 2001, the financial account registered a net inflow of US$24.4 billion. Foreign direct investments added up to US$16.6 billion, mirroring a drop of 32.9% when compared to the same period of 2000. The net flow of investments into the stock of Brazilian companies totaled US$13.5 billion, for a reduction of 40.2%, a figure partially offset by the US$919 million rise in net disbursements of intercompany loans.

Foreign portfolio investments registered net inflows of US$3.3 billion. Stock investments came to US$2.5 billion, with net inflows of US$2.8 billion into stocks traded abroad and outflows of US$363 million involving stock traded in the country.

Uses and sources

US$ billion

Itemization	2000	2001		2002
	Year	Jan-Oct	Year[1/]	Year[2/]
Uses	-56.6	-48.8	-56.4	-47.7
Current account	-24.7	-19.9	-23.4	-20.6
Trade balance	-0.7	1.5	2.0	5.0
Services and income	-25.5	-22.7	-27.0	-27.2
Interest	-14.6	-12.5	-14.9	-14.5
Profits and dividends	-3.3	-3.7	-4.4	-4.8
International travel	-2.1	-1.3	-1.4	-1.2
Other	-5.4	-5.1	-6.2	-6.7
Current transfers	1.5	1.3	1.6	1.6
Amort. medium- long-term[3/]	-32.0	-28.9	-33.1	-27.1
Bonds, notes & com. papers	-13.1	-14.8	-17.1	-9.6
Paid	-7.0	-12.6	-15.0	-9.6
of which nat. debt (Bradies)	-	-3.1	-3.1	0.0
Refinanced	-6.1	-2.2	-2.2	0.0
Suppliers' credits	-5.7	-2.7	-2.7	-2.9
Direct loans[4/]	-13.2	-11.4	-13.1	-14.6
Sources	56.6	48.8	56.4	47.7
Capital account	0.3	0.2	0.3	0.0
Foreign direct investment	32.8	16.6	20.0	18.0
Domestic long-term securities	2.8	2.2	2.6	3.1
Medium- & long-term disburs.[5/]	37.3	30.2	33.7	27.7
Bonds, notes & com. papers	18.7	15.3	16.0	10.8
Suppliers' credits	2.7	2.2	2.7	2.8
Direct loans	15.9	12.7	15.1	14.1
Brazilian assets abroad	-6.6	-3.9	-3.6	-1.1
Bank deposits	1.3	-2.3	-3.4	2.2
Others assets	-7.9	-1.7	-0.1	-3.3
Loans to Banco Central do Brasil	-10.4	6.7	6.7	-2.5
Other[6/]	-1.8	1.1	0.4	0.0
Reserve assets	2.3	-4.4	-3.6	2.5

1/ Estimated.
2/ Forecast.
3/ Registers amortization of medium and long term supliers' credit, loans and securities placed abroad. Excludes amortizations referring to loans to Banco Central and intercompany loans.
4/ Registers loans borrowed from foreign banks, buyers, agencies and multilateral organizations.
5/ Excludes intercompany loan disbursements.
6/ Registers short term securities, short term trade credit, financial derivatives, nonresident deposits, other liabilites and errors and omissions.

Investments in fixed income securities came to US$798 million, with outflows of US$236 million invested in papers negotiated in the country and net outflow of US$1 billion involving stock traded abroad. Net placements came to US$2.1 billion in bond operations and US$541 million in short-term securities, partially offset by net amortizations of US$1.6 billion in notes and commercial papers.

Other Brazilian investments abroad registered net outflows of US$5.5 billion. These outflows were concentrated in the net increase of US$5 billion in deposits on the part of residents abroad, with banks accounting for US$4.2 billion and other sectors for US$808 million.

Other net foreign investments in the country added up to US$9.3 billion, of which US$6.8 billion referred to the Financial Assistance Program (PAF). Net trade credits granted to residents totaled US$2.7 billion, with net amortizations of US$135 million in long-term resources and net short-term funding totaling US$2.9 billion. Net loans to residents added up to US$7.4 billion, including resources disbursed to Banco Central by the IMF in the PAF framework. Loans to other sectors of the economy resulted in net inflows of US$708 million, with net disbursements of US$1.6 billion in long-term resources and net amortizations of US$930 million in short-term funds. An analysis of long-term loans shows net disbursements of US$1.1 billion from international organizations and US$1.5 billion in the form of direct loans, coupled with net amortization of US$904 million in buyers' credits. Finally, the outflow of US$772 million in deposits abroad should also be underscored.

Balance of payments projections for 2002

Balance of trade

Utilizing the method of minimum squares, the balance of trade projection was based on three equations for exports and four for imports, as follows: exports of basic products, semimanufactured and manufactured goods and imports of capital goods, raw materials, consumer durables and nondurable consumer goods. The calculations were based on the Funcex quarterly series of volume indices for each category.

The estimate of fuel and lubricant imports utilized the same growth factor expected for petroleum prices, namely, about -23.7%, with an average price level of US$18.50 per barrel for 2002 (World Economic Outlook – WEO/IMF) and an increase of 4% in domestic consumption.

Viewed against this scenario, exports would expand by 5.8% and imports by 1.3% and the trade balance would close at US$4.7 billion. In the case of exports, growth rates are moderate since the pace of world economic recovery in 2002 will be slow. Insofar as imports are concerned, recovery is also expected to be small due to the sluggish activity level of domestic economy, exerting a restrictive impact on foreign purchases, which have already been hampered by currency devaluation.

Viewed under the prism of the average balance expressed in amounts from which seasonal impacts have been purged, the trade surplus in the September-November quarter totaled US$704 million. Should the balance of trade repeat this performance in the same quarter of 2002, the annual surplus will close at US$8.4 billion.

Projections based on the behavior of determinant variables or, simply, recent performance of the export and import sectors, provide clues as to what can be expected in 2002. In both cases, there are clear signs of strong recovery in the trade balance surplus, thus justifying the US$5 billion surplus included in the balance of payments projection.

Trade balance projection for 2002

Item	Explanatory variables				Results	
	World output	Domestic output	Real exchange rate	Dependent variable (-1)	Percentual change	Value (US$ billion)
			Regression coefficients			
Exports	-	-	-	-	5.8	61.6
Primary products	-	1.24	-	0.63	15.1	17.5
R2 = 0.905	-	*(4.45)*	-	*(4.63)*		
Semimanufac.products	1.14	-0.90	0.14	0.39	-0.4	8.2
R2 = 0.94	*(6.71)*	*(-2.93)*	*(2.06)*	*(4.63)*		
Manufactured products	0.26	-	0.24	0.52	3.2	35.9
R2 = 0.94	*(4.09)*	-	*(4.10)*	*(6.85)*		
Imports	-	-	-	-	1.3	56.9
Consumption goods	-	-	-	-	3.2	5.9
Durables	-	1.51	-0.60	0.83	9.5	2.3
R2 = 0.983	-	*(2.92)*	*(-3.07)*	*(15.27)*		
Nondurables	-	1.61	-0.61	0.35	-0.3	3.7
R2 = 0.983	-	*(3.92)*	*(-6.79)*	*(4.24)*		
Ind. supplies/materials	-	1.92	-0.31	0.47	3.7	33.8
R2 = 0.984	-	*(8.97)*	*(-3.68)*	*(7.95)*		
Fuels and lubricants	-	-	-	-	-20.7	5.7
Capital goods	-	1.19	-0.26	0.42	7.4	11.5
R2 = 0.985	-	*(2.51)*	*(-2.90)*	*(4.46)*		
Balance	-	-	-	-	-	4.7

Uses and sources

Insofar as the other balance of payments items are concerned, projections for 2002 indicate a small increase in net spending on services and income. The item that generated this increase is profit and dividend remittances since the projection for 2002 is higher than remittance occurred for 2001 due not only to accumulation of maturing investments in recent years, but also to a scenario of enhanced exchange market stability. Net interest payments are expected to decline slightly despite a 2002 increase in the overall external debt as a result of lower basic interest rates. The average interest rate considered for the external debt in September 2001 was 7% per year and the average for new disbursements from October 2001 to June 2002 with an impact on outlays in the coming year was 5.9% per year. In this case, the basis of calculation was a basic rate of 2% per year plus a variable spread depending on the type of indebtedness. The highest spread (5.5% per year) was attributed to bond operations, since these have the longest terms, and the lowest spread (3.5% per year) to suppliers' credits and intercompany loans, which are operations normally carried out among companies belonging to the same group.

Hypotheses for projection of interest on external debt - 2002

Modality	Interest rates on total external debt and on new disbursements[1/]		
	External debt September 2001	New disbursements Oct-2001/Jun-2002	
		Rate (annual)	Spread
Bonds	Given	7.5%	5.5%
Currency loans	8.5%	7.0%	5.0%
Notes and Commercial papers	8.5%	7.0%	5.0%
Direct loans	8.5%	7.0%	5.0%
Suppliers	5.0%	4.0%	2.0%
Buyers	6.5%	5.5%	3.5%
Multilateral organizations (except IMF)	5.6%	5.5%	3.5%
Bilateral agencies	6.5%	5.5%	3.5%
Intercompany loans	6.4%	4.0%	2.0%

1/ Basic rate: 2% per year.

Insofar as services are concerned, net outlays on international travel are also expected to decline as a result of devaluation of the real during the year, while other services are expected to increase, particularly those related to direct investments, such as equipment rentals and technical assistance.

Given the stability registered in unrequited transfers in 2001 and 2002, the current account deficit for 2002 is projected at US$20.6 billion, considering the trade balance surplus of US$5 billion. This result is US$3 billion less than forecast for 2001 due principally to the larger trade surplus.

The heading of uses of resources in 2002 is composed of the balance in current account and external debt amortizations, projected at US$47.9 billion or US$8.5 billion less than the amount forecast for 2001. Aside from the lesser current account deficit, amortizations are expected to be lower. Once refinanced amortizations and nationalized debt are excluded, payments projected for the coming year will decline by US$800 million compared to 2001.

The calculation of amortizations took account of the medium and long-term external debt in September 2001, which defines part of the payment schedule for the coming year, and October 2001 to September 2002 disbursements. On average, 15% of the new disbursements mature in the period between 3 months and 12 months, 20% in the period between 12 and 24 months and 65% after two years. This standard is considered plausible in view of the performance of disbursements effected in the third quarter of 2001. Insofar as new disbursemets are concerned, there are no maturities in the first three months.

Hypotheses for projection of amortizations - 2002

Modalities	Maturity of medium- and long-term debt and of new medium- and long-term disbursements			
	External debt	New disbursements (Oct-2001/Dec-2002)		
	September	Maturity (%)		
	2001 (US$ million)	Up to 1 year	Between 1 and 2 years	Greater than 2 years
Bonds	2 406	0%	0%	100%
Currency loans	9 920	13%	24%	63%
Suppliers	2 126	40%	30%	30%
Buyers	3 667	40%	30%	30%
Multilat. Org. (exc. IMF)	3 071	0%	0%	100%
Bilateral agencies	1 768	0%	0%	100%
Intercompany	4 027	9%	30%	61%

The major sources of financing have been foreign direct investments and medium and long-term disbursements. Foreign direct investments total US$18 billion and do not include privatization resources and, therefore, are lower than the total in 2001, also excluding privatizations. Medium and long-term loans, including bonds of the Republic, consider that an average of 134% of the maturities will be rolled and 10% of the imports will be financed for periods of more than one year. Projections also include US$5.8 billion in financing from international organizations (IBRD and IDB) and agencies.

Roll-over and financing percentage

Itemization	2000	2001 1/	2002 2/
Proportion of import financing by suppliers and buyers	11%	13%	10%
Roll-over rate			
Medium- and long-term loans			
Banks	158%	140%	110%
Securities	141%	77%	100%
Intercompany	167%	176%	122%
Bonds	257%	225%	205%

1/ Estimate.
2/ Forecast.

Brazilian investments abroad, composed of direct investments, portfolio investments and other investments, are expected to contribute net outflows of US$1.1 billion. Returns on bank deposits abroad are forecast at US$2.2 billion, a figure somewhat inflated by the scenario of uncertainty created over the course of the second half of 2001.

Brazilian investments abroad

US$ billion

Itemization	2000	2001 1/	2002 2/
Brazilian investments abroad	-6.6	-3.6	-1.1
Direct investments abroad (net)	-2.3	1.4	-1.3
Portfolio investments (net)	-1.7	-0.8	-1.0
Derivatives	0.4	0.5	0.0
Other investments (net)	-3.0	-4.7	1.2
Bank deposits	1.3	-3.4	2.2
Other sectors	-4.3	-1.2	-1.0

1/ Estimate.
2/ Forecast.

Statement of international reserve flows in 2001 and 2002

US$ million

Itemization	2001 1/	2002 2/
Reserve position in previous year	33 011	36 659
Net reserves in previous year	**31 541**	**28 432**
Debt servicing (net)	-8 171	-7 117
Interest	-4 061	-3 842
Credit	1 884	1 600
Debit	5 945	5 442
Amortization	-4 110	-3 275
Disbursements	8 236	6 500
Multilateral organizations (IDB/IBRD)	1 555	1 500
Medium- and long-term loans (Sovereign Bonds)	6 681	5 000
Exceptional financing (IMF)	6 757	-2 473
Guarantees	548	0
Privatization (minor shares)	0	600
Banco Central net interventions	-6 905	0
National Treasury acquisitions	839	0
Other (includes pre-payment of Poland in November 2001)	2 345	0
Change in reserves	3 648	-2 491
Reserve position	36 659	34 169
Net reserves	**28 432**	**28 415**

1/ Estimate.
2/ Forecast.

International reserves are also to be used as a source of funding, but only to provide for net external Central Government (Banco Central and National Treasury) payments, projected at US$2.5 billion for the coming year. Among scheduled inflows that will affect the reserve position are interest revenues on reserves, US$1.6 billion, funds originating in sale of minority stock positions belonging to the National Treasury, which are to be classified in the balance of payments as portfolio investments (stocks), US$0.6 billion, financing from international organizations (IDB/IBRD), in the framework of the Financial Assistance Program, US$1.5 billion, and funds raised through placement of Bonds of the Republic, US$5 billion. Payments include outlays on Central Government foreign debt service, of which US$5.4 billion of interest and US$3.3 billion of principal, and, finally, the payment of principal to the IMF, US$2.5 billion.

4.4 – Conclusion

The downward trend registered for imports since the beginning of the second half of the year has become more accentuated as of September. Since foreign sales of commodities like meat, soybeans and sugar has remained in a high level during the year, the trade surplus for 2001 should be higher than US$2 billion. Spending under international travel, one of the most important headings under services, fell sharply due to the economic slowdown and, principally, devaluation of the real.

Inflows related to the major sources of balance of payments financing, foreign direct investments and medium and long-term loans, considering both direct loans and inflows through security placements, reacted adversely to the uncertainties that reigned in the world economy following the September 11 terrorist attack in the United States. According to November data, however, the flow of foreign capital into the country has increased in volume to the extent that uncertainties were gradually dissipating. Foreign direct investments surpassed the mark of US$2 billion and loan disbursements were greater than amortizations.

The outlook for 2002 has become increasingly brighter. The current account result should improve as a consequence of a strong trade surplus and it is expected that, even in the context of rather conservative estimates, the sources of financing will be sufficient to meet the country external requirements. Any changes in international reserve positions in the coming year are expected to result exclusively from the central government's foreign net payment requirements.

5 – Prices

Analysis of the factors underlying inflation in the September-November quarter indicates growth in freely determined prices, mostly as a consequence of the exchange devaluation passthrough effect and the rebuilding of profit margins. Insofar as government managed prices are concerned, the fact that the July increase in telephone rates and fuel prices have been fully absorbed attenuated inflation in the month of September. Outlays on food were impacted by upward movement in the prices of semi-elaborated products caused by the off-season harvest period, particularly in the cases of grains and meat, and in those of such specific items as bakery products, as a consequence of exchange rate fluctuations registered in recent months.

5.1 – General indices

General indices

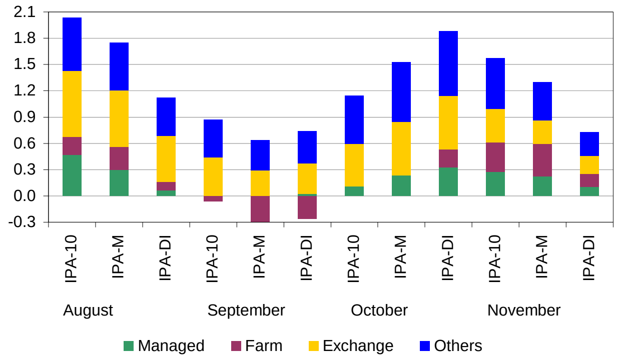
% monthly growth

Itemization	2001				
	Jul	Aug	Sep	Oct	Nov
IGP-10	1.3	1.7	0.6	0.9	1.3
IPA	1.6	2.0	0.8	1.2	1.6
IPC	0.8	1.3	0.3	0.3	0.8
INCC	1.1	0.5	0.6	0.9	0.6
IGP-M	1.5	1.4	0.3	1.2	1.1
IPA	1.7	1.8	0.3	1.5	1.3
IPC	1.1	0.9	0.1	0.5	0.8
INCC	1.1	0.6	0.6	0.9	0.6
IGP-DI	1.6	0.9	0.4	1.5	0.8
IPA	1.9	1.1	0.5	1.9	0.7
IPC	1.4	0.5	0.1	0.7	0.8
INCC	0.5	0.6	0.6	0.9	0.7

Source: FGV

Growth in the prices of primary sector goods was the major factor in the formation of indices issued by the FGV in the September-November period, with great impact in the wholesale and consumer segments. In the month of September, reductions in the prices of milk and its derivatives, as well as under *in natura* products, generated negative growth under foodstuffs, as measured by the IPC-DI, and farm prices, calculated according to the IPA-DI. These results were important to reducing inflation measured by the General Price Index – Internal Supply (IGP-DI) to 0.38% in the month, compared to 0.9% in August. In the two following months, however, farm product prices began generating upward pressures, as consumer outlays on food rose by 1.05% in

IPA-10, IPA-M and IPA-DI - % monthly contributions

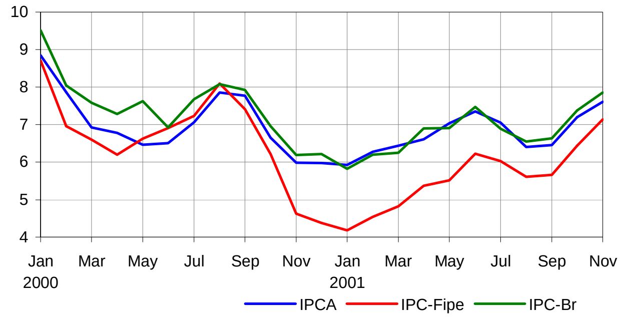


October and 1.07% in November. A breakdown of these results shows that the strongest increases occurred under rice, beans and meat. In the wholesale sector, the period was marked by upward price movement, particularly in goods of animal origin, especially in the month of October. Aside from farm products, attention should be given to the impact of exchange rate fluctuations on the index and, particularly, on manufactured goods. This influence was significant in October, when the industrial Wholesale Price Index (IPA) rose by 1.94%, compared to 0.75% in the previous month. With the impact of the primary sector and exchange rate variations, the IGP-DI registered rates of 1.45% in October and 0.76% in November, raising accumulated growth for the year to 10.2%.

5.2 – Consumer price indices

Broad Consumer Price Index (IPCA)

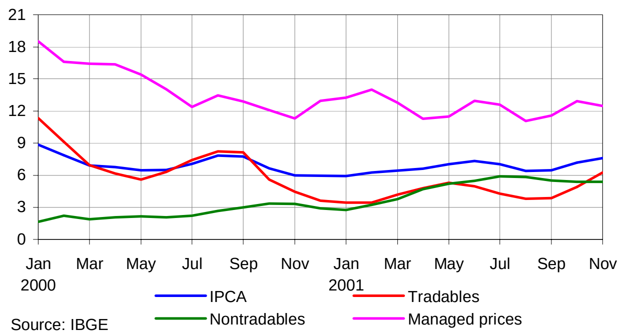
Consumer prices
12 month % change



Source: IBGE, Fipe and FGV

The IPCA declined in the September-November period, as accumulated growth closed at 1.83%, compared to 2.57% in the previous quarter. This was due mostly to the lesser impact of government managed prices, which contributed 0.59 p.p. and 1.57 p.p., respectively, to formation of the rates registered in the aforementioned periods. The drop would have been even more intense had it not been for the sharp upward movement in food prices in October and November.

Consumer prices
12 month % change



Source: IBGE

In September, the IPCA registered the year's lowest rate of monthly growth (0.28%) in the year, as all of the major components of the index turned downward. Particular mention should be made of the reduction in food prices, which were impacted by declines under milk and *in natura* products. Despite this favorable performance, food prices reflected the effects of the off-season harvest period

Consumer prices

% growth

Itemization	2001				
	Jul	Aug	Sep	Oct	Nov
Monthly					
IPCA	1.3	0.7	0.3	0.8	0.7
IPC-Fipe	1.2	1.2	0.3	0.7	0.6
IPC-Br	1.4	0.5	0.1	0.7	0.8
Accumulated in the year (annualized)					
IPCA	7.5	7.7	7.2	7.5	7.6
IPC-Fipe	6.8	7.7	7.3	7.5	7.5
IPC-Br	8.4	8.2	7.4	7.6	7.9
12 months					
IPCA	7.1	6.4	6.5	7.2	7.6
IPC-Fipe	6.0	5.6	5.7	6.4	7.1
IPC-Br	6.9	6.6	6.6	7.4	7.9

Source: IBGE, Fipe and FGV

and exerted strong pressures in the subsequent months, registering highs of 1.25% and 1.31% in the grouping of foodstuffs in October and November. With this behavior, these products became the most important elements in the monthly IPCA figure in the two periods in question, with respective totals of 0.83% and 0.71%. Other results that should be stressed in those months are increases under apparel, home appliances and, in October, fuel.

Consumer Price Index – Institute of Economic Research Foundation (IPC-Fipe)

Measured by the Consumer Price Index – Institute of Economic Research Foundation (IPC-Fipe), consumer prices in the metropolitan region of São Paulo turned in results quite similar to those measured by FGV and IBGE indices for the last three months, with a decline in September, when the rate dropped by 0.83 p.p., and highs of 0.74% and 0.61% in the following two months, respectively. The rates measured by Fipe were relatively lower, mostly as a result of the fact that the city of São Paulo did not adopt a series of increases in public tariffs and government managed prices. The IPC-Fipe accumulated growth of 6.86% up to November.

5.3 – Government managed prices

Increases under government managed prices accounted for 32% of the growth in the IPCA in the September to November period, compared to 60% in the previous quarter.

The 4.08% increase in fuel prices at the refinery level on October 5 represented the major impact on the grouping of government managed prices, followed by electricity rates which were raised by percentages between 14.07% and 20.59% in the cities of Rio de Janeiro, Brasília, Porto Alegre, Belém and Goiânia.

Managed prices: major items affecting IPCA

Itemization	Weight [1/]	Variation Sep	Oct	Nov	Accumulated contribution Sep-Nov
IPCA (A)	100.0	0.28	0.83	0.71	1.83
Gasoline	4.5	-0.6	3.6	0.3	0.14
Urban bus	4.6	1.2	0.1	0.5	0.08
Electric energy	3.8	0.7	0.3	1.8	0.11
Barreled cooking gas	1.4	-0.7	4.3	0.5	0.05
Long-distance bus	1.1	2.1	0.5	-0.1	0.03
Water and sewage rate	1.6	1.6	0.1	0.1	0.03
Air ticket	0.5	1.8	8.4	1.2	0.05
Others	13.2	0.1	0.6	0.1	0.10
Contribution					
Managed prices (B)	30.7	0.1	0.3	0.1	0.59
Sharing (B/A)	...	0.43	0.41	0.18	0.32

Source: IBGE

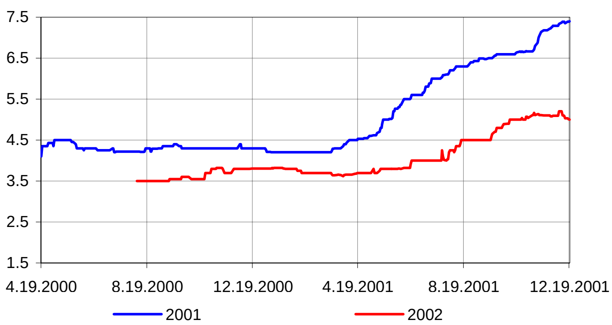
1/ Weighted in November.

In the framework of municipal tariffs, urban bus fares were readjusted by 12.5% in Recife, 10.32% in Salvador and 10% in Rio de Janeiro. Water and sewage service rates increased by 14.8% as of September 1st in Rio de Janeiro. Aside from this, intermunicipal bus fares were increased in Rio de Janeiro, Porto Alegre, Recife, Belém and Salvador, registering average growth of 2.06% under this heading of the IPCA in the month of September. In addition, airline tickets increased by 11.72% in the quarter, though this item has relatively small weight on the composition of the IPCA.

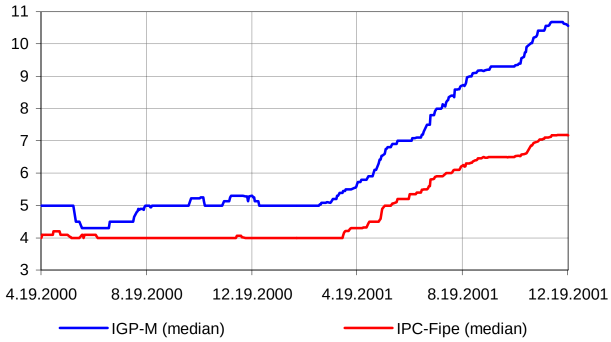
5.4 – Market expectations

The Banco Central Investor Relations Group (GCI) carries out a daily survey of a sampling of approximately 100 consulting companies and institutions with the objective of detecting market expectations regarding the evolution of the major economic variables.

Daily evolution of market's inflation expectations (IPCA)



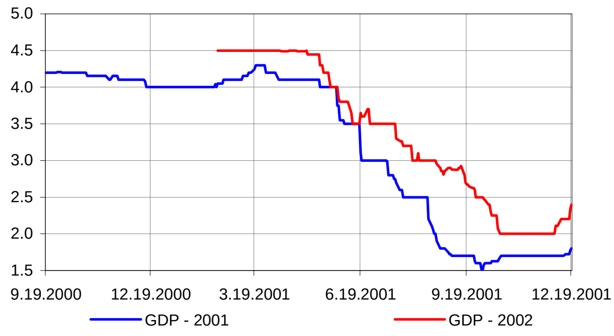
Daily evolution of market's inflation expectation for 2001



Median expectations of inflation for 2001 measured by the IPCA increased from 6.48% on September 13 to 7.4% on December 19, moving 1.4 p.p. beyond the upper limit of the inflation target for the year. For 2002, expectations increased from 4.5% per year to 5% per year in the same period. With regard to the median rates of the so-called Top five, their expectations rose from 6.65% to 7.41% for 2001 and from 4.6% to 5.31% for 2002.

Insofar as evolution of the IGP-M is concerned, expectations for 2001 pointed to the same upward trend registered in the previous quarter, shifting from 9.16% on September 13 to 10.57% on December 19. For 2002, median expectations moved from 6% to 6.8%. Expectations regarding the IPC-Fipe for 2001 registered a trend similar to that indicated for

Daily evolution of market's real GDP growth expectations for 2001 and 2002

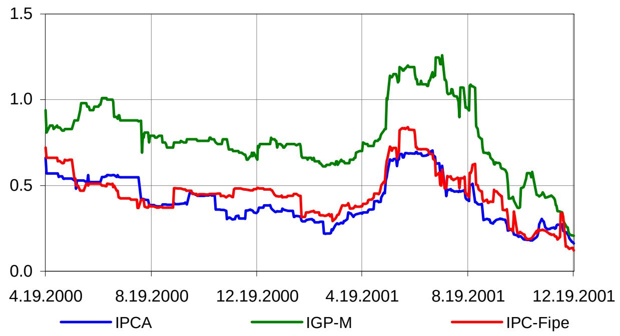


the IGP-M, with movement from 6.5% on September 13 to 7.17% on December 19. For 2002, expectations rose from 4.5% to 4.99% in the same period.

Insofar as the median expectations of the Top five are concerned, in the case of the IGP-M the rates moved from 9.13% to 10.52% for 2001, while expectations for the IPC-Fipe moved from 6.2% to 7.23% for 2001 and from 4.46% to 4.72% for 2002.

Median expectations for growth in economic activity increased from 1.7% on September 13 to 1.8% on December 19. For 2002, there was a reduction from 2.9% to 2.4% in expectations for the same period.

Standard deviation of inflation forecasts for 2001



The standard deviation of the various price indices moved from 0.30% for the IPCA, 0.68% for the IGP-M and 0.40% for the IPC-Fipe on September 13 to respective levels of 0.16%, 0.21% and 0.12% on December 19, thus maintaining the tendency begun in the previous quarter toward lesser dispersion in inflation expectations for 2001.

The standard deviation for real growth in GDP in 2001 dropped from 0.36% on September 13 to 0.2% on December 19. For 2002, there was a slight decline from 0.59% to 0.53% in the same period.

5.5 – Conclusion

The major influences on price indices in recent months were exchange devaluation and the performance of government managed prices. With these two factors, there was no real possibility of a sharper decline in prices. This decline is expected as the impact of increases in government managed prices in the period is exhausted.

For the coming months, the outlook for prices is rather bright, due to such factors as the following: recent behavior of exchange rates;

deceleration observed in the prices of farm products, such as grains and beef, both of which are important in terms of the composition of the index, particularly at the wholesale level; and the outlook for a decline in gasoline and diesel oil prices as a result of elimination of price controls on fuels at the refinery level. Consequently, despite the fact that prices in the coming months will come under such seasonal pressures as increases in school payments and, furthermore, upward movement in the price of bottled gas for cooking, the impact of the factors listed above are expected to more than offset possible upward pressures and force inflation downward to a lower level than registered in the last two months.

6 – Prospects for inflation

This chapter of the Inflation Report presents the Monetary Policy Committee (Copom) assessment of Brazilian economic performance since the September *Report*, as well as prospects for inflation through 2003. The projections are based on the assumption that the basic interest rate will remain unchanged during the period under analysis at 19% per year, rate set by Copom in its December 18th and 19th meeting. In addition, an alternative forecast is presented, taking into account the market expectations for the interest rate and exchange rate paths. It is important to note that these procedures are strictly technical. Hence, these assumptions should not been taken as forecasts of the future interest rate path.

The inflation and GDP growth forecasts 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 depend are based not only on the interest rate assumption, but also on assumptions concerning the behavior of the relevant exogenous variables. The baseline scenario, based on which Copom makes its decisions regarding interest rates, depend on the set of assumptions considered as the most likely by Copom. The forecasts are presented in this *Report* in order to enhance monetary policy transparency, contributing to its efficacy to control inflation, which is its main objetive.

6.1 – Determinants of inflation

Aggregate demand and aggregate supply

The economic environment has improved since the last Copom meeting. The exchange rate has appreciated rapidly in response to the positive evolution of the external accounts and to the severance of Brazil's risk premium from that of Argentina. Government projections for the government-managed prices in 2002 have been revised downwards because of the lower readjustments of electric energy prices, the liberalization of the market for oil by-product and changes in taxation of this sector that should imply significant reduction in prices. The projected slope of the term structure of interest rate has decreased, affecting positively economic growth.

The indicators of the level of economic activity in the third quarter of 2001 show a weakening of the trend of deceleration of the economic growth previously observed. Agricultural activity has contributed positively to GDP growth in contrast to the negative performance of the industrial sector. This signals a recovery of economic growth for 2002.

The Brazilian economy grew 0.5% in the third quarter of 2001 in comparison with the same period of the previous year. In comparison with the second quarter of 2001, seasonally adjusted GDP grew 0.13%. Considering the first three quarters of 2001, the economy grew at an accumulated rate of 2.25% (figures revised by IBGE).

According to the Monthly Industrial Survey released by IBGE, the industrial production, in October 2001, decreased 3.4% in comparison with October 2000, but fell 1.9% in comparison with September 2001 (seasonally adjusted series). In spite of that, the accumulated growth in the year is positive: 2.5%. The positive growth was mainly a consequence of the production of investment goods, such as, farm tractors, high-tension transformers and railway coaches. This signals an increase in productive capacity of the economy next year.

The GDP figures do not corroborate assessments whereby the shocks that affected the economy in the first semester would result in an economic recession. The deceleration of economic activity in the second quarter was followed by a tendency to stabilization in the third quarter. The expansion of GDP should be around 2% in 2001.

In line with the industrial production indicators, the open unemployment rate calculated by IBGE, considering the six main metropolitan areas in Brazil, increased from 6.15% in September to 6.55% in October. However, the unemployment rate average in the first ten months of 2001 decreased from 7.46% to 6.27% in comparison with the same period in the previous year.

The performance of the industrial sector affected the real income of employed personnel: it decreased 1.6% in the third quarter of 2001 in comparison with the previous quarter.

The contribution of the external sector to economic growth has been increasing. The trade balance accumulated a US$ 1.9 billion surplus until the second week of December as a consequence mainly of the exchange rate depreciation, which accumulates 18% in the year. As monetary policy acts to limit the inflationary effects of depreciation, the real exchange rate generates strong incentives to the improvement of the trade balance in spite of the foreign demand contraction.

The recently released statistics reflect the worsening of the deceleration of the global economy. The U.S. GDP has decreased by 0.4% in the third quarter - first negative growth since 1993. Furthermore, the industrial production decreased by 1.1% in October, the eleventh consecutive monthly reduction. In Japan, the main indicators of domestic demand and price deflation indicate that the "zero interest rate" policy has not been effective to generate a recovery in economic growth. Besides, the negative environment may worsen in case rating agencies downgrade Japanese public debt. The Euro Zone was apparently contaminated by the fragility of the other economic areas, although, similarly to the previous month, the growth rates of the retail sales and the trade balance were positive in September. Industrial production, in September, fell by the third time in 2001.

The difficulties faced by the Argentinean economy are still present. Even though the "contagion" has decreased recently, the unfolding of the Argentinean crisis still deserves attention. The increase of liquidity promoted by the Fed in the American market—the basic interest rate was again reduced and is currently at the level of 1.75%—should help the recovery of economic growth in the US and in the world.

A recovery of the global demand in the middle of the next year is expected, strengthening the perspective for improvements in Brazilian external accounts in 2002, compatible with a greater GDP growth.

Concerning the interest rate movement in the credit market, like that observed in the second quarter, the lending rates rose in the third quarter. The borrowing rates, in turn, grew at a lower intensity, leading to a small increase in the spread. For the fourth quarter, however, the available statistics show a reversion of this movement, and the spread in December should be close to that verified in August. With regard to loans, the balance of credit operations in the free segment grew significantly over the year—more than 27% until October.

The slope of the term structure of interest rate—defined as the difference between the six-month interest rate swap and the one-day Selic rate, both at annual rates—has decreased significantly. Currently, the slope is at about 100 base points in contrast to the 540 base points observed when the last *Inflation Report* was released. This movement reflects the change in perception of the risk related to the Brazilian economy. The flattening of the term structure may lead to a reduction in the cost of credit in a not so distant future and, as a consequence, may lead to higher aggregate demand.

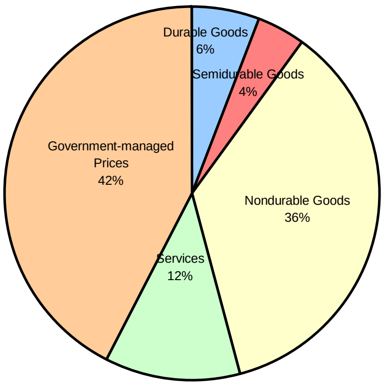
It is ratified the assessment of the previous Inflation Report that the negative effect on aggregate supply of the measures to rationalize the use of electric energy would be smaller than initially forecasted. Therefore, it is possible that aggregate supply does not constrain the recovery of economic growth.

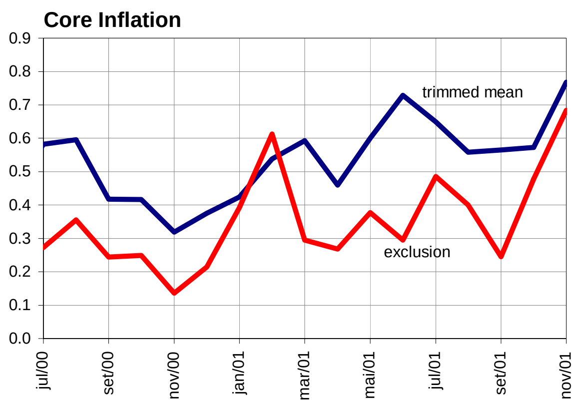
Similarly, the lower level of capacity utilization (79.9% in October against 83.9% and 80.9% in April and July, respectively) indicates favorable conditions for a higher level of economic activity without pressuring prices. Besides, production of capital goods grew 15.7% between January and October compared to the same period of the previous year.

The pressure of the exchange rate depreciation on inflation, in particular, its effect on readjustment of government-managed prices, should be monitored carefully. However, the recent fall of the exchange rate, as well as of the price of the barrel of oil—the Brent crude oil price presented an average price of US$ 20.3 in the fourth quarter until December 17th, against US$ 26.20 in the third quarter—indicate lower pressure on fuel prices in 2002. Regarding market prices, the contraction in domestic and external demand counteracts the pressure of the pass-through from the exchange rate depreciation accumulated over the year.

Despite the difficulty to assess the stage of the adjustment of relative prices, this Report considers that the higher than expected increases in the IPCA in October (0.83%) and November (0.71) are in part a result of the exchange rate pass-through not occurred in the previous months. If inflation in the third and fourth quarters already incorporates partially or totally the exchange rate pass-trough not occurred—which was expected for 2002 as a result of economic recovery—the effect on 2002 inflation should be smaller. On the other hand, the greater inflation in the fourth quarter affects positively the inflation in 2002 by means of inflation inertia.

Contribution by category in the change of IPCA from Jan to Nov 2001





Up to November, the inflation rate measured by the Broad Consumer Price Index (IPCA) accumulated 6.98%. The government-managed prices—which comprise about 30% of the index—grew 9.96%, contributing to around 42% of the rise in IPCA in the period. The chart to the left shows the contribution of each of the categories for the IPCA growth observed between January and November, 2001.

Regarding the IPCA core inflation, both indexes, the exclusion core—which excludes food-at-home and government-managed prices—and the core calculated by the trimmed mean methodology, showed a significant rise in November (about 0.2 percentage point). Considerable part of this increase could be a consequence of the pass-through from exchange rate to the durable good prices, which rose 0.80% in November.

The several shocks that affected the economy in 2001 resulted in an inflation above the upper limit of the target established by the Government. According to Decree no. 3088, of 21.06.1999, the Governor of the Central Bank should write an open letter to the Minister of Finance explaining the reasons for the non fulfillment of the target, the measures to be taken and the necessary period for those measures to produce effect. For 2002, the return of inflation to the path of its targets should be eased by favorable conditions in the next quarters.

6.2 – Baseline scenario: assumptions and associated risks

The Copom 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 is part of the baseline scenario under which Copom makes monetary policy decisions.

The main sources of uncertainty concerning the evolution of inflation in the next two years relate to the behavior of government-managed prices, to the evolution of the world economy and its impact on the exchange rate. With respect to the set of government-managed prices, the projected scenario has improved since the previous Inflation Report, presenting a fall of almost 2 percentage points for 2002. There is no significant change in the prospective world economic growth since September, maintaining the assumption of a recovery only after the middle of 2002. There was, however, a deterioration of the Argentinean economic situation. Nevertheless, it is important to stress the recent appreciation of the domestic currency in the last two months and the severance of the risk premium of the two countries.

The prices of oil by-products are still being estimated based on futures market quotations. In contrast to the previous *Report*, which assumed the readjustments in the first quarter of 2002 would follow the parametric rule established in the Joint Ministerial Decree MF/MME No. 2, of 04.01.2001, the current projections assume the liberalization of oil by-product prices as of January 2002. Taking into account the price of a barrel of oil around US$ 18.6 for the next quarter, the recent appreciation of the real, and the CIDE (Contribution on the Intervention in the Economic Domain), it is expected an average reduction for the basket comprised by gasoline and diesel in 2002, of 16.7% in the first quarter and 15.2% over the year.

Nevertheless, because of the liberalization of oil by-product prices, the baseline scenario conveys the elimination of the subsidy to cooking gas, implying an important readjustment in 2002 concentrated in the first quarter of the year.

With respect to the previous *Report*, the present issue also revised the price of electric energy. The current projections assume a rise of 19% for the consumer in 2002, with a direct effect of 0.72 percentage point on the IPCA. The projections also incorporate an indirect effect of 0.21 percentage points on IPCA stemming from an increase of 24% in the price of industrial electric energy. This effect reflects the fact that electric energy represents a cost for firms, but, because of the estimated output gap, the firms will be able to pass through only part of the increase to consumers.

Besides the direct and indirect effects on inflation resulting from the adjustments of electric energy prices, other effects related to the restriction of aggregate supply are not being considered. First, the rationing of electric energy affected aggregate supply less than initially expected. Besides, the recovery of the levels of the reservoirs and the additional supply of energy coming from other sources have increased the probability that supply conditions comes back to normal in the medium run.

For the set of government-managed prices, which comprises 30.7% of the IPCA in November, it is forecasted an inflation of 10,7%, 5,3% e 3.1% for 2001, 2002, and 2003, respectively. For 2003, most of the government-managed prices should follow market inflation, except telephones and electric energy, whose prices should increase by around 5,5%, based on the IGP-M. The government-managed prices should contribute with 3.1, 1.6 and 0.9 percentage points in these three years.

The baseline scenario conveys a stable path for exchange rate in 2002. Specifically, the exchange rate maintains a stable level with respect to the one that prevailed the day before the Copom meeting. Because of this treatment for the exchange rate and its recent appreciation, the average exchange rate in the next quarter should be more appreciated when compared to the current quarter, contributing to lower inflation in 2002.

The baseline scenario assumes that Brazil's risk, measured by the spread over Treasury of the Global 04, should decline from a 870 base point average in the last quarter of 2001— 719 base points on December 17th, 2001—to about 700 base points until the end of the first quarter of 2002. For the Fed funds rate, based on the behavior of futures markets, it is assumed the maintenance of the current level for the following quarter, a gradual increase reaching 2.25% by the end of 2002, and stability thereafter.

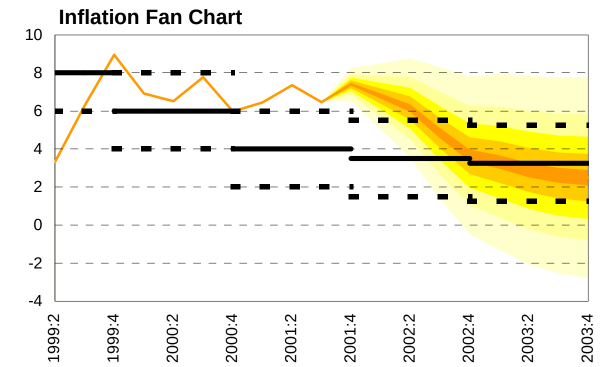
The current exchange rate implies a 18% depreciation since the beginning of the year. Exports are reacting satisfactorily. The trade balance should be near to US$ 2 billion in 2001, and, in the next year, should reach US$ 5 billion. Furthermore, one notes a new impulse in foreign issues, which may continue over the next year as the international markets situation normalizes.

The baseline scenario assumes that agricultural prices should evolve according to market inflation in the next two years. The 3.5% growth forecast for the agricultural production in 2002 should be in line with the rise of demand and, therefore, the agricultural sector should be neutral with respect to the inflation.

Concerning the slope of the interest rate term structure, measured by the difference between the 6-month interest rate swap and the Selic rate, one assumes this difference will decline from the average of 2.9 percentage points in the fourth quarter, reaching 1 percentage point as of the second quarter of 2002 and slightly decreasing then on.

Finally, regarding fiscal policy, one maintains the assumption of fulfillment of the targets for the primary surplus of the consolidated public sector established in the Government's Economic Program.

Forecasted IPCA-inflation with interest rate fixed at 19% p.y.



(accumulated inflation in 12 months)

IPCA with 19% p.y. fixed interest rate

Year	Q	Confidence Intervals						Central Projection
		50%						
			30%					
				10%				
2001	4	7.0	7.2	7.3	7.5	7.6	7.7	7.4
2002	1	6.1	6.4	6.6	6.9	7.2	7.5	6.8
2002	2	5.1	5.5	6.0	6.3	6.8	7.2	6.1
2002	3	3.4	4.0	4.6	5.1	5.6	6.3	4.8
2002	4	2.0	2.7	3.3	4.0	4.6	5.4	3.7
2003	1	1.4	2.2	3.0	3.7	4.4	5.2	3.3
2003	2	0.9	1.7	2.5	3.3	4.0	4.9	2.9
2003	3	0.5	1.4	2.2	3.0	3.8	4.7	2.6
2003	4	0.3	1.3	2.1	2.9	3.7	4.7	2.5

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

6.3 – 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 the basic interest rate will remain constant at the level of 19% per year set out at the Committee's December 18th and 19th, 2001 meeting.

This *Report* includes, for the first time, inflation projections until 2003. The central path expected for the 12-month inflation decreases monotonically from 7.4% in 2001 to 3.7% in 2002 and 2.5% in 2003. Note that the probabilities of deviations are symmetrically distributed around the median, reflecting Copom's judgment on the balance of risks associated with the projection.

The combined effect of the several identified shocks hitting the economy this year moved the forecasted inflation path away from the central target. As a result, the central projection for 2001 is above the upper limit of the tolerance interval. This is mainly a consequence of the behavior of government-managed prices and of exchange rate depreciation. Government-managed prices should increase by 10.7% in 2001, with a contribution of 3.1 percentage points for the inflation of the year. For the remaining prices, which comprise about 70% of the IPCA, inflation in 2001 should be close to 6.0%, with a contribution of 4.3 percentage points. The contribution of the exchange rate for inflation this year is estimated in almost 3%, taking into account the effect on both market and government-managed prices.

For 2002, the relative contribution of the government-managed prices (1.6 percentage points) should be similar, between 40 and 45% of the forecasted inflation of 3.7%. Market inflation should, in turn, remain restrained, at 3%. For 2003, projected inflation is 2.5%. In the absence of more accurate information about the behavior of government-managed prices, it was assumed that most of them will evolve according to market price inflation. Only telephones and electricity, because of contractual adjustments rules, should rise in line with IGP-M, estimated around 5.5% for that year. Total inflation for government-managed prices should reach 3.1% in 2003, with a contribution of 0.9 percentage point, and market price inflation should reach 2.2%. One maintains the interpretation of the last *Report* that, considering the shocks that hit the Brazilian economy in 2001, the unfavorable evolution of inflation this year and the slightly-above-target projection for 2002 are fully justifiable and compatible with the commitment of the Central Bank to maintain price stability. For 2003, confirming the current scenario, inflation should be comfortably below the central target. In this case, there may be room for future reductions in the target for the Selic rate. Monetary policy has been effective in controlling demand pressures on inflation and in containing propagation of supply shocks to the other prices in the economy.

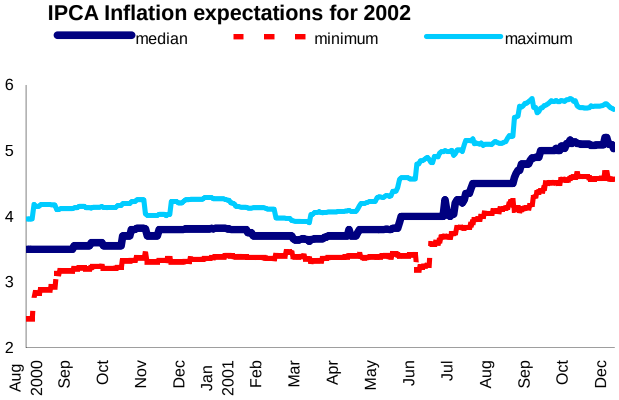
Comparing the current projection with that of the September *Report*, one notes a change in the expected path. Even though it is not possible to compare them directly, because projections are based on different assumptions of scenario, asymmetry, and interest rate, it is worthwhile to comment some issues.

First, the central projection for 2001 has increased from 6.5% to 7.4% and, for 2002, has decreased from 3.9% to 3.7%. While in the September

Report, the initial inflation was lower and remained stable until the third quarter of 2002, in the current projection, inflation starts from a higher level, but declines more rapidly. Inflation in the last quarter of 2001 will be above of that projected in September, probably due to anticipation of the exchange rate pass-through to prices. As it was discussed in the Notes of the 64th Copom meeting, part of the pass-through to the prices stemmed from the depreciation of the real in 2001 could take place in the next year, when aggregate demand could be higher. The signals, still tenuous, of stabilization, or even of a slight recovery of economic activity, are consistent with an anticipation of this pass-through, already affecting negatively inflation in 2001.

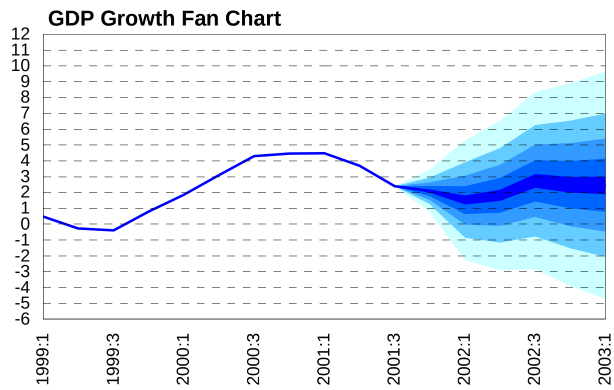
For 2002, the increase in forecasted inflation for the first quarter is mainly a result of the inertial effect of the more than the previously forecasted inflation at the end of 2001. Nevertheless, because of the appreciation of the real and of the lower forecasted inflation for the set of government-managed prices, there was a reduction in the projected inflation for 2002, since the last Report, from 3.9% to 3.7%.

IPCA Inflation expectations for 2002



The chart to the left shows the evolution of the expected inflation for 2002, that are being reduced to a level below 5.0%. It is important to stress out that a significant part of the difference between market projections and those of the Copom is explained by a more depreciated exchange rate path used by the market.

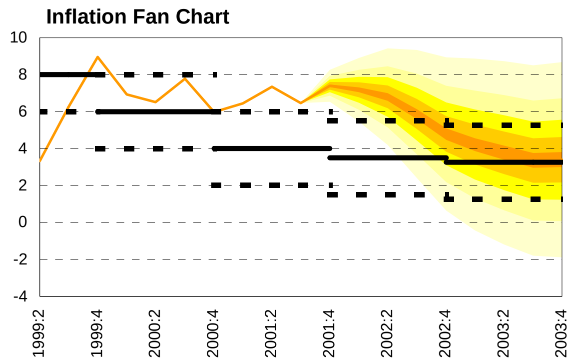
GDP growth with 19% p.y. fixed interest rate



(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 based on the same assumptions used in the baseline scenario. It should be stressed that the forecasting errors associated with GDP growth projections are considerably larger that in the case of inflation projections. This happens because GDP growth projections involve the trajectory of two non-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 and 2002 is approximately 2.0% and 2.5%, respectively, under the hypothesis that the basic interest rate remains constant at 19% per year.

Forecasted IPCA-inflation with market interest rate and exchange rate expectation. 1/



(accumulated inflation in 12 months)

1/ From Investor Relations Group - 12/18/2001

IPCA with market interest rate and exchange rate expectation /1

Year	Q	Confidence Intervals						Central Projection
		50%						
			30%					
				10%				
2001	4	7.0	7.2	7.3	7.5	7.6	7.7	7.4
2002	1	6.5	6.8	7.0	7.3	7.6	7.9	7.2
2002	2	5.7	6.2	6.6	7.0	7.4	7.9	6.8
2002	3	4.4	5.1	5.6	6.1	6.7	7.3	5.9
2002	4	3.1	3.8	4.5	5.1	5.8	6.5	4.8
2003	1	2.3	3.1	3.9	4.6	5.3	6.1	4.2
2003	2	1.7	2.6	3.4	4.2	4.9	5.8	3.8
2003	3	1.2	2.1	3.0	3.7	4.6	5.5	3.4
2003	4	1.2	2.2	3.0	3.8	4.6	5.6	3.4

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 - 12/18/2001

This issue also presents the inflation fan chart for inflation taking into account the interest rate expectations of the private sector on December 14th. As in the two previous *Reports*, it was used the median of the market expectations collected by the Investor Relations Group until that day. The market-expected interest rate path was downwardly-sloped, starting from the current level of 19% per year, reaching 17% per year at the end of 2002, and 15% at the end of 2003. Besides the interest rate assumptions, this fan chart has assumed a depreciation of the real that reaches 2.7 at the end of 2002 and 2.76 at the end of 2003. The projected inflation under these assumptions is 4.8% at the end of 2002 and 3.4% at the end of 2003. The remaining assumptions are the same as those spelled out in the baseline scenario.

Modeling Exchange Rate and Risk Premium

The Central Bank of Brazil Research Department has been working on a medium-scale macroeconomic model intended to be used as a complementary model to the small scale structural model (SSSM), used by the Central Bank of Brazil authorities, Copom members, as a supporting tool for the monetary policy decision process. In this box, some preliminary results, related to nominal exchange rate, defined here as the domestic price of the foreign currency, and sovereign risk premium, are presented. The nominal exchange rate is modeled by an *Uncovered Interest Parity* (UIP) derived equation, monthly estimated with post exchange rate floating (Jan/1999) information. As a sovereign risk premium measure, we used the C-Bond spread over treasury, regressed against fiscal, liquidity/solvency and external variables and a few domestic and foreign shocks.

1.Exchange Rate

The small scale structural model (SSSM), used by the Central Bank of Brazil authorities as a supporting tool for the monetary policy decision process, can be resumed in a 4-equation model as quoted in *Bogdanski et alli* (2000)[1] . Among them, the Uncovered Interest Parity (UIP) is represented as in **Equation 1.**

$$E_t(e_{t+1}) - e_t = i_t - i_t^f - x_t \qquad \textbf{(1)}$$

where: $\mathbf{E_t(e_{t+1})}$ *is the natural logarithm of the expected nominal exchange rate in instant t+1,made with information available up to instant t:ln[*$E_t(XRate_{t+1})$*];*

$\mathbf{e_t}$ *is the natural logarithm of the nominal exchange rate in instant t: ln(*$XRate_t$*);*

$\mathbf{i_t}$ *is the natural logarithm of the domestic nominal interest rate along period t, between instants t and t+1: ln[(1+nom.int.*$rate_t$*)];*

$\mathbf{i_t^f}$ *is the natural logarithm of the foreign nominal interest rate along period t, between instants t and t+1: ln[(1+nom.int.*$rate^f_t$*)];*

$\mathbf{x_t}$ *is the natural logarithm of the sovereign risk premium along period t, between instants t and t+1: ln(1+*$risk_t$*).*

An arbitrage relation between domestic and foreign bonds originates **Equation 1**. The expected depreciation is explained by the internal and external interest rate differential, considering the risk premium embodied in the domestic bond.

[1] *Bogdanski, Joel, Alexandre Tombini and Sergio Werlang (2000) "Implemeting Inflation Targeting in Brazil"* ***Banco Central do Brasil Working Paper Series*** *nº1.*

Despite the fact of being derivated by an arbitrage condition, empirical results indicate that UIP relation is not observed in several situations. In econometric exercises applied to industrialized countries data, whose risk premium are supposed to be zero, the estimated coefficient to the (i_t - i_t^f) term are often close to zero or even negative and, in some cases, the results reject the null hypothesis that this coefficient equals one. Other results indicate that the UIP empirical observation depends on the considered horizon length, as well on the fact of whether the country is industrialized or emerging, or even on the adopted exchange rate regime. Other causes are information asymmetry, imperfect asset mobility and market inefficiency.

Aiming to adequately estimate the nominal exchange rate we might consider an UIP rewriting in order to achieve a higher empirical support. Indeed, we might consider a more flexible way by which interest rate differential and risk premium affect exchange depreciation.

In an attempt to explain the exchange rate (US$/R$) movement, using monthly average data, we considered plausible to assume that the correct UIP domestic and foreign nominal interest rates are combinations of certain domestic and foreign bond yields, respectively. However, for the sake of simplification, we modeled a linear approach explaining the differential of such nominal interest rates as a function of the Brazilian Selic and the US Federal Funds rates differential. On an analogous way, we assumed the actual UIP sovereign risk measure as a linear function of C-Bond[2] spread over treasury. These considerations are presented in **System 2**.

$$
\begin{aligned}
i_t - i_t^f &= \alpha_0 + \alpha_1 \cdot (Selic_t - FFunds_t) + u_t \\
x_t &= \beta_0 + \beta_1 \cdot SCBond_t + v_t
\end{aligned}
\qquad \textbf{(2)}
$$

where: **Selic$_t$** *is the natural logarithm of the average Brazilian Selic rate in period t: ln(1 + Selic%$_t$);*

FFunds$_t$ *is the natural logarithm of the average US Federal Funds rate in period t: ln(1 + FedFunds%$_t$);*

SCBond$_t$ *is the natural logarithm of the average C-Bond yield spread related to the average US Treasury bond in period t:*

$$\ln\left(\frac{1+Yield_t^{C-Bond}}{1+Yield_t^{US.Treasury}}\right);$$

$\left.\begin{matrix} u_t \\ v_t \end{matrix}\right\}$ *are white noise errors.*

[2] *We chose C-Bond for three reasons: first, it was the longest bond series available at the time this exercise was made; second, due to the fact that its maturity is on April 2014, its price is still maturity unbiased; and third, C-bond spread explanation power performed better than the others risk measures we tested.*

To model $E_t(e_{t+1})$, we considered a simple univariate function described as follows. Due the fact that this expectation is obtained with known information up to instant t, the most recent lag to explain it is in period *t-1*. Therefore, we modeled this expectation as in **System 3**.

$$\begin{aligned} e_{t+1} &= \gamma_0 + \gamma_1 \cdot e_{t-1} + z_t \\ E_t(e_{t+1}) &= \gamma_0 + \gamma_1 \cdot e_{t-1} \end{aligned} \qquad \textbf{(3)}$$

where: γ_i *are the approach parameters;*
z_t *is a white noise error.*

Considering the first difference equation[3] originated from **Equation 1** and **Systems 2** and **3** and incorporating a long-run equilibrium condition based on purchase power parity (PPP) hypothesis, we could specify the nominal exchange rate dynamics according to **Equation 4**, assuming that the errors combination $(v_t - v_{t-1} - u_t + u_{t-1})$ follows a white noise process. According to **Equation 4**, long-run Δe_t equals inflation rate differential, considering Brazilian IPCA and US PPI, as described in **Equation 5,** once considering that long-run movements of nominal interest rate differential and risk must be close to zero.

$$\Delta e_t = \gamma_1 \cdot \Delta e_{t-1} - \alpha_1 \cdot \Delta(Selic_t - FFunds_t) + \beta_1 \cdot \Delta SCBond_t + (1-\gamma_1)\cdot(\pi_t - \pi_t^f) + \varepsilon_t \qquad \textbf{(4)}$$

where: $\Delta\cdot$ *is a first difference operator:* $\Delta\varphi_t \equiv \varphi_t - \varphi_{t-1}$ *;*
ε_t *is a error combination* $(v_t - v_{t-1} - u_t + u_{t-1})$ *, supposed to follow a white noise process;*
π_t *is the natural logarithm of the Brazilian IPCA inflation rate in period t:* $ln(1+\Pi_t)$*;*
π^f_t *is the natural logarithm of the US PPI inflation rate in period t:* $ln(1+PPI\%_t)$*.*

$$\Delta e_{eq} = \frac{1}{1-\gamma_1}\cdot(1-\gamma_1)\cdot(\pi_{lp} - \pi_{lp}^f) \therefore \Delta e_{eq} = (\pi_{lp} - \pi_{lp}^f) \quad \text{Conditioned to: } \gamma_1 < 1 \qquad \textbf{(5)}$$

We estimated **Equation 4** using post exchange rate floating data, excluding the first months to avoid any regime changing noise. All estimated parameters showed expected signal and statistical tests indicated good significance. The residual correlogram indicated a white noise process.

***Table 1** Estimated Results for Equation 4*

Method: *OLS* **Sample:** *May/1999 to May/2001*

Variable	Estim. Value	St. Deviation	t	P-Value
Δe_{t-1}	0.594	0.105	5.667	0.000
$\Delta(Selic_t - FFunds_t)$	-9.419	2.698	-3.492	0.002
$\Delta SCBond_t$	34.415	7.608	4.523	0.000
$(\pi_t - \pi_t^f)$	0.406	0.105	3.874	0.001

$R^2 = 0{,}634$ $R^2_{Ajust.} = 0{,}601$

[3] *We couldn't reject the null hypothesis that the exchange rate series has a unit root along post floating period.*

Table 1 shows output result. Nominal interest rates differential risings generate exchange rate appreciations while risk premium risings are associated to exchange rate depreciations.

Although interest rates differential and risk coefficients are significant, its absolute values are much higher than the predicted by UIP relation. However, due to the small sample length, nothing guarantee us that the real exchange rate obtained by the **Equation 5** projections should converge to a long-run equilibrium. The fact that the domestic interest rate and the risk premium have been considered far from the supposed equilibrium values, during all sample period, supports the last assertive**.**

2.Risk Premium

In this second part, we will try to endonize the sovereign risk premium proxy considered in **Equation 4**, the C-Bond spread over treasury. Although literature indicates several economic variables to explain risk perceptions, it's necessary to use a parsimonious criterion. We decided to estimate a C-Bond spread over treasury explained by fiscal, foreign trade and liquidity/solvency variables. Intending to follow a parsimonious criterion, we needed to pursue relevant variables avoiding, on the other hand, an over fitting bias, mainly when including dummy variables related to domestic and foreign economic shocks.

In the best specification, represented on **Equation 6**, three variables, representing fiscal, foreign trade and liquidity/solvency variables, explained the risk premium: foreign exchange reserves (% of GDP), net public sector debt (% of GDP) and current account balance (% of GDP). In order to capture economic shocks, we used pulse dummies related to Mexico crisis, whose bigger effects were felt on January 1995, Russia moratorium on August 1998 and speculative attack to Real on December 1998, that culminated on an exchange rate regime change in the following month.

$$\begin{aligned} SCBond_t = a_0 + a_1 \cdot SCBond_{t-1} + a_2 \cdot \Delta \mathrm{Re}s / GDP_t + a_3 \cdot \Delta NPD / GDP_t + \\ + a_4 \cdot \Delta CurAc / GDP_t + \sum_j a_j \cdot DUMMY_J + \eta_t \end{aligned} \tag{6}$$

where: **Res/GDP_t** *is the 12 month* foreign exchange reserves (% of GDP);

NPD/GDP_t *is the 12 month* net public sector debt (% of GDP)*;*

$CurAc/GDP_t$ *is the 12 month* current account balance (% of GDP)*;*

$DUMMY_j$ *are pulse dummy variables related to economic shocks (Jan/95, Aug/98 and Dec/98);*

η_t is a white noise error.

Considering that the higher the foreign exchange reserves level, the better is the economy liquidity/solvency situation. Thus, a negative Res/GDP_t coefficient is expected. Analogously, the higher the net public sector debt or the lower the current account balance, the higher is the sovereign risk premium expectation**,** that leads us to an expectancy of positive and negative coefficients signals, respectively. Estimated output is shown in **Table 2**.

Table 2 Estimated Results for Equation 6

Method: OLS		Sample: July/1994 to September/2001		
Variable	**Estim. Value**	**St. Deviation**	**t**	**P-Value**
α_0	0,006	0,003	2,356	0,027
$SCBond_{t-1}$	0,896	0,034	26,342	0,000
$\Delta Res/GDP_t$	-0,503	0,125	-4.038	0,000
$\Delta NPD/GDP_t$	0,117	0,045	2,599	0,011
$\Delta CurAc/GDP_t$	-0,779	0,446	-1,747	0,085
$Dummy_{Jan/95}$	0,018	0,006	2.985	0,004
$Dummy_{Aug/98}$	0,025	0,006	4.088	0,000
$Dummy_{Dec/98}$	0,016	0,006	2,625	0,011
	R^2 = 0,916		$R^2_{Ajust.}$ = 0,908	

The sovereign risk output presented intuitive and robust results, although it was necessary to include dummy variables. The results indicate that a better government account and a lower current account deficit bring down the Brazilian sovereign risk premium.

Annex

Minutes of the 63rd Meeting of the Banco Central do Brasil Monetary Policy Committee (Copom)

Date: September 18 and 19, 2001
Place: Central Bank's Headquaters 8th floor meeting room (on 09.18) and 20th floor (on 09.19) -Brasília - DF
Called to Order: 4:17 PM on 09.18 and 5:41 PM on 09.19
Adjourned: 8:01 PM on 09.18 and 7:58 PM on 09.19

In attendance:
Members of the Board
Arminio Fraga Neto - **President**
Carlos Eduardo de Freitas
Daniel Luiz Gleizer
Edison Bernardes dos Santos
Ilan Goldfajn
Luiz Fernando Figueiredo
Tereza Cristina Grossi Togni

Department Heads (all present on 09.18)
Altamir Lopes - Economics Department (DEPEC)
Daso Maranhão Coimbra - International Reserve Operations Department (DEPIN)
Gustavo Bussinger - Research Department (DEPEP)
José Antônio Marciano - Department of Banking Operations and Payments System (DEBAN)
Sérgio Goldenstein - Open Market Operations Department (DEMAB)

Other participants (all present on 09.18)
José Pedro Ramos Fachada Martins da Silva - Senior Advisor to the Board
Alexandre Pundek Rocha - Senior Advisor to the Board
Antônio Carlos Monteiro - Executive Secretary
João Borges - Press Secretary (ASIMP)
Fabia Aparecida de Carvalho - Coordinator of the Investor Relations Group

The Board analyzed the recent performance of, and prospects for the Brazilian and international economies under the monetary policy framework, designed to comply with the inflation targets determined by the government.

Economic activity

Domestic economic activity continues to indicate deceleration, following the trend observed since the end of the first quarter. This has been reflecting the deterioration in the external economic situation and the energy crisis and, the resulting impact on expectations and on the behavior of interest and exchange rates.

The demand indicators exhibited relative stability in August and September, partly due to their prompt and stronger response to the changes in the economic environment. Nevertheless, the signs are still incipient to affirm that the deceleration process is near the end. In addition, the repercussion of the attacks to the U.S.A. has not yet reflected in the economic indicators released so far. It shall be stressed, however, that the likely unraveling of this crisis creates new uncertainties regarding the external economic environment, which is unfavorable for recovery in the domestic economic activity in the current circumstances.

Preliminary data released by the Trade Federation of the State of São Paulo (FCESP), showed that the retailers turnover in the Metropolitan Region of São Paulo increased by 1% in August compared to July, but accumulated a 3% drop year-to-date compared to the same period of 2000. The outcome in August was affected by the 7.2% increase in the sales of construction material, which offset the 1.3% decline in the sales of consumer goods and 8.3% in the auto-vehicle sales.

The Consumer Intentions Index (IIC), also measured by FCESP, partially recovered in September to reach 94.9, still within the pessimistic range – below 100, in a 0 to 200 scale. This recovery featured the positive evolution of both components, current and future intentions, mirroring a less negative perception of domestic economic and political environment at the end of August, when the survey was carried out. Therefore, the result in September still does not reflect the repercussion of the attacks to the U.S.A. on the formation of domestic expectations.

The overall investment indicators in the country exhibited signs of cooling in July, mainly regarding imports and exports of capital goods, whereas domestic production of capital goods still showed some dynamism, geared by the effects of the energy rationing, which bolstered the production of energy generation equipments. The production of raw material for the building industry leveled off in the month, after plunging in the previous bimester.

The industrial production decelerated for the fifth consecutive month in July, with a 1.2% decline in the seasonally adjusted series. In the year, the industrial production grew by 4.3%, with the accumulated change reaching 5.1% in the twelve months to July, from 5.7% in June. In the month, negative growth was observed in 13 of a total of 20 industrial sectors and 3 of the 4 usage categories. Positive growth was observed solely in the production of capital goods. Noteworthy, in the two first months under the energy rationing program, the industrial production diminished by 0.1% compared to the same months last year, as a result of the 4.7% reduction in the production of durable consumer goods and 1.6% in intermediate goods. Considering the intensity of electrical energy expenditures, highly intensive sectors cut down on production by 10.1% in the June-July period, whereas medium and low intensive sectors expanded by 4.4% and 4%, respectively, compared to the same period of 2000.

The weaker performance in industrial production resulted in a new reduction of productive capacity, as surveyed by the National Confederation of Industries (CNI), reaching 79.7% in July in the seasonally adjusted basis. It was the fifth consecutive drop since the recent 82% peak observed in February 2001. Working hours in the production reduced by 1.5% in July, in the seasonally adjusted basis, as reported by CNI, revealing that the overtime cuts and the collective vacation have constituted the preferred alternative as compared to job cuts to adjust to deceleration in t industrial activity. Notwithstanding, industrial surveys indicate reduction in employment in this sector. The unemployment rate reached 6.19% in July, versus 6.38% in June, though as a result of reduction of 49 thousand positions and of 91 thousand people in the employable population (PEA).

Regarding credit operations, the outstanding stock of free resources increased by 2.4% in August, due to a 2.6% increase in the operations with corporations and 2.1% with households. This performance, however, continued to reflect a positive flow resulting from transactions settled previously, as new loans fell for the second consecutive month, a response to the environment of uncertainties together with the maintenance of lending rates on an upward trend. The daily average of credit concession to corporations and households dropped by 6.1% and 1.3% in August, respectively, compared to the previous month.

On the fiscal front, the increase of the primary surplus to R$ 34.4 billion up to September confirms the maintenance of austerity. In August, collection of taxes and contributions remained at a growing pace, mainly due to the effects of tax collection on capital income and financial turnover, as tax collection on corporate revenue has been growing at a lower pace, reflecting the deceleration of the economic activity.

As to the external transactions of the Brazilian economy, the trade balance recorded a US$ 663 million surplus in August and a US$ 120 million surplus on the first two weeks of September, accumulating a positive result of US$ 779 million year to date. Noteworthy, after May, exports and imports started to grow at lower rates, reflecting, simultaneously, but at a different intensity, the effects of deceleration in the Brazilian and global economies.

In August, exports was improved by aircraft re-exports, similarly to August 2000, although growth in sales of basic products continued to be remarkable, mainly poultry, beef and pork, together with the recovery in exports of semi-manufactured products, resulting from the recovery in sales of iron and steel products and the continuing sugar export growth. Shipment of manufactured products fell once again compared to the same month of 2000. As to market destination, the best results were achieved with countries holding a smaller share of Brazilian exports, confirming the diversification of destination of Brazilian sales in 2001, at the same time as the sales to the main markets, United States and Mercosur, slowed.

Regarding total import volumes, purchases of capital goods were the sole segment to increase comparing to August 2000. In terms of daily average volumes , only the acquisition of fuel and oil surpassed August 2000 results. The reduction in purchases of consumption and intermediate goods reflects the slower industrial output growth in the country and the recent depreciation of the exchange rate.

To conclude, the deterioration in the external front and the adjustment of the economy to the energy crisis triggered a process deceleration in economic activity, which is still on. As a result, the observed and projected growth rates for the Brazilian economy for 2001 is lower. The labor market is starting to adjust, albeit gradually, to this environment, which shall exert additional pressure to the real wage bill, already affected by the impact from administered price adjustments. The deterioration of credit conditions, with more selectivity, shorter maturities and higher interest rates, does not favor demand recovery. The fiscal position remains favorable, yet with prospect for continued decelerating revenue growth. The recent trend in trade suggests recovery of surpluses, mainly reflecting the downward trend of imports inasmuch as the international environment, even prior to the attacks to the United States, was unfavorable for exports .

External environment

To evaluate the world economic outlook after the attacks to the United States on September 11 is more difficult as it tends to be tightly linked to the impact of such actions upon the North American economy. Although premature, the analysis is based on the acute expectation of unfavorable influence on consumer confidence and the prospects for deepening the slowing in the short run. This led the Federal Reserve to reduce basic interest rates by 50 bp, for the eighth time in the year, on September 17, currently standing at 3% . Alongside monetary loosening, the government signals the adoption of expansionary fiscal policy, partially using the primary surplus, which tends to produce positive impacts over the medium term, fostering the recovery stimulated by an easier monetary policy.

Until early September, U.S. economy remained on a decelerating process and statistics released did not signal recovery in the short run. The consumption remained as the main pillar of demand, albeit on a downward trend, as investments decreased significantly since the end of 2000. The accentuated drop in investments has been recorded in the levels of inventory and fixed assets, such as facilities, machinery and software. It shall be stressed that this adjustment is considered relevant for the correction of imbalances impelled by the high growth period. The positive fiscal results have been inferior to initially expected, reflecting tax reduction, the change in collecting dates and the lower activity level. Trade has also been influenced by the deceleration growth , resulting in lower rates of import growth. Additionally, global repercussion of the fall in U.S. economic activity has translated into lower export growth rates. The evolution of price indices does not evidence existence of inflation pressures, enabling interest rate reduction. It shall be stressed that the expectations of manager's purchases (NAPM) in the manufacturing sector had improved substantially in July, differently from the expectations of the managers in the services sector and consumers.

In the Euro Area, statistics point to the contagion from the deceleration process in the United States. The Gross Domestic Product in the second quarter expanded by 1.7% relatively to the same period in the previous year, after a 2.4% rise in the first quarter. Country specific indicators relative to July and August and entrepreneurs' perception, translated into the fall in confidence indicators of the three major economies in the region – Germany, Italy and France-, suggest the maintenance of this trend in the next quarter. It shall be emphasized that, in coordination with the Federal Reserve, the European Central Bank reduced basic interest rates by 50 basis points on September 17th, after which the main rediscount rate stood at 3.75% p.a.

The Japanese economy remains with no signs of recovery in the activity level although the yen has been showing appreciation trend. Eastern Asian economies, which tend to present high dependence on both American and Japanese demand, are searching for measures to countervail external sector retraction, with China and South Korea featuring as the most successful.

Latin American economies are undergoing the unfavorable impacts from the international markets via trade and tighter liquidity in financial markets, resulting in higher uncertainty and risk aversion from investors. The Argentine economy remains in recession, despite internal efforts and financial support programs by international financial institutions.

In synthesis, the trend of cooling in economic activity is observed at a global level, led by the United States. This scenario tends to become deepen in the short run, as a function of the recrudescence of American consumer and corporate spending contraction, in response to the attacks on September 11. Nonetheless, the easing, already in progress, of monetary and fiscal policies in the United States should contribute to mitigate the contracting output trend in the medium term, with positive impacts for the world economy.

Prices

In August, the adjustment of the administered prices continued to exert pressure on the main inflation indices, albeit at a lower intensity, thus contributing to lower monthly changes as compared to July. Considering consumer prices, electricity price adjustments in São Paulo, Curitiba and Belém, together with the rise of fuel prices at a national level put forth the most significant impact on the monthly outcome. As to wholesale prices, in addition to the impact from fuel prices, it shall be stressed the pressure from the increase in cereals and grains and crops for exports, among agricultural products, reflecting, in part, the effects of the exchange rate variation.

The IPCA rose by 0.70% in August, compared to 1.33% in July, accumulating 5.06% in the year and 6.41% in the last twelve months. The retreat in the monthly outcome was due to the lesser impact of administered price adjustments, which concentrated in July. Food prices increased by 0.83%, geared by the 21% hike in soy oil prices, mostly led by the rise in international prices which had impacted wholesale prices in July. The impressive hikes in wheat flour, bread and pasta prices reflected both wheat price increases and the exchange rate variation. Still in the food sector, price increases were associated with off-season effects. The item domestic employee, which incremented by 2.38%, featured as the main individual contribution for the monthly variation (0,08 pp). This percentage reflects the variations in the labor market after the minimum wage adjustment in May. Regarding the item electricity , the 1.21% variation was a consequence of a 10.79% increase recorded in Belém, where the tariffs were readjusted by 14%, after August 7.

The IGP-DI rose by 0.9% in August, compared to 1.62% in July, accumulating 7.4% in the year and 9.8% in the last twelve months. The 1.13% variation in IPA was the main determinant of the IGP-DI result, whereas the IPC rose by 0.54%, still reflecting the hike in administered prices. The INCC increased by 0.62%, exclusively as a result of the hikes in civil construction prices inasmuch as labor costs remained stable.

Based on the analysis of July and August indices, a conclusion may be drawn that the hikes observed stemmed from pressures arising from specific groups. A generalized rise among sectors is not evident, nor are continuous upward movements, which evinces the absence of indexation mechanisms in the economy. Taking into account this fact, together with the waning of pressures derived from administered price adjustments, a prospect for significant reduction in inflation rates is expected for the coming months.

Money market and open market operations

The trend of reduction in the slope of the interest rate yield curve continued some weeks after last Copom meeting, motivated by the interpretation that the 19% Over-Selic target would be an interest rate ceiling and by the favorable news on the external front¾increase in the Purchasing Manager's Index (NAPM) in August, indicating smaller retraction in the activity level, and tax collection in Argentina at a level higher than expected. Between August 22 and September 9, the spread between the Over-Selic rate and the Futures DI to January reduced to 190 bp from 340 bp. Nonetheless, after the attacks to the U.S. on September 11, this trajectory reverted, with the spread increasing to 320 bp on September 17. On that date, a higher slope was observed in the whole extension of the curve.

In September, the strategy of rolling over integrally the principal and final interest payments of exchange rate indexed securities, preferably with placements of NTN-D, has started. As a means to roll over the R$5.8 billion in NBCE redeeming on September 6, three auctions of 3-year NTND were carried out, at a financial volume equivalent to 67% of the total redeemed, in addition to an 11-month placement, matching the demand for long term securities. The yield for the three-year securities reduced to 10.38% p.a. in the last auction from 10.87% p.a. in the two first ones. For shorter maturity securities, the average yield was of 5.54% p.a..

The rollover of the R$3.7 billion redemption on September 17 was carried out with two auctions of three-year NTND (totaling 69% of the redemption), at rates of 11.50% and 11.95%, and an 8-month security offer at an average yield of 5.81%. On August 29, there was still a 3-year NBCE auction to rollover R$1.1 billion in NTND maturing on September 3. The average yield was of 10.29% p.a.. On September 13 and 14, a total of three placements of five-month NBCE was realized to meet the demand for hedge. The resulting financial volume transacted was of R$6.7 billion and the average yields were of 9.69%, 9.96% and 10.26%. The large quantities offered and the yields accepted sanctioned an increase of the exchange rate coupon.

On August 29, a five-month LTN auction was settled. The financial volume transacted was of R$0.9 billion at an average yield of 22.6%, which presented reduction relatively to similar auction carried out in the previous week, under the expectation that the Selic target would not be elevated. In this scenario, on September 4, the National Treasury placed R$1.3 billion in 7-month LTN, at the average yield of 22.86%.

On September 5, a five-year LFT auction was settled, totaling a financial volume of R$1.2 billion. Demand outstripped the offer (2.2), due to the lower volumes offered and investment funds' needs to recompose their portfolios, which led to a halt in the upward movement of average discounts over face values, reducing to 0.34% from 0.40%.

Stemming from the effects of the terrorist attack on September 11 in the market, the National Treasury decided to cancel the LFT and LTN auctions scheduled for that day. The auction was resumed on September 18, with the sale of R$1.2 billion five-year LFT, at an average discount slightly below the previous auction (0.33%) and with a demand again superior to the offer (1.6 ratio). Considering the financial settlements between August 22 and September 18, a R$142 million expansionary monetary impact was observed in the period. The additional placements of NBCE offset the net redemption of National Treasury securities.

Within a 19 working day period, the Central Bank intervened for ten times in the open market, aiming at administering the short-term interest rate. In all interventions, the Central Bank carried out purchases of federal securities with resale agreements, at a minimum yield of 19.06% p.a.. The average volume of the interventions reached R$5.3 billion.

Prospective assessment of inflation

The identified shocks and their impacts were reassessed in light of newly available information. The scenario considered in the simulations encompasses the following assumptions:

1. August inflation rate, measured by the IPCA, reached 0.70%, near the expected results for the month;

2. the forecasts for the prices of oil products was calculated based on the price structure implied by Brent crude oil futures contracts. The expectation for the average price of the barrel was raised to US$ 26.2 on the third quarter and to US$ 28.1 on the fourth quarter of 2001. For 2002, it was assumed that the prices of oil by-products in the domestic market would be adjusted based on the structure of costs determined by the average prices effective on the last quarter of 2001. From the second quarter on, these prices wouldfollow market inflation.

3. for a wider set of administered prices, weighting 30.4% of the IPCA in August, the expected inflation in 2001 remained relatively stable at 11.0%, from 10.0% in August. Price variation from January to August accumulates 7.9% with further 3.0% being expected for the remainder of the year. The evolution of these prices is expected to directly contribute with 3.2% for the year inflation, compared to the 2.9% estimated in August.

4. the forecast for the adjustment of electricity tariffs in 2001 remained at 20%. For 2002, the expected readjustment is of 20%, considering residential and non-residential consumers;

5. the slope of the domestic yield curve - defined as the difference between the 180 day swap rate and the one day Selic rate - is projected at an average of nearly 500 basis points on the third quarter of 2001, linearly declining to an average of 300 basis points at the end of 2002;

6. the path for the Fed funds interest rates was projected based on the maturity of forward contracts that indicate a decrease in the rate until the end of the second quarter of 2002 and a slight increase in the remainder of the year;

7. on the external front, the ssumption for the average risk premium – measured as the difference between the yield of Brazil's Global Bonds and the United States Treasury Bonds with equivalent duration calculated by linear interpolation – was revised to incorporate a declining path from current levels to a plateau near 700 basis points from the second quarter of 2002 on.

It was assumed a stable exchange rate, in 2001 and 2002, around the levels observed on the eve of the Copom meeting.

The core inflation of the IPCA, calculated under the symmetric trimmed-mean method, declined in August to 0.56%, from 0.65% in July. Accumulated in 12 months, the core index increased by 6.25%. The core inflation of the IPC-BR, calculated under the symmetric trimmed-mean method, declined to 0.59% in August. Accumulated in 12 months, this core increased by 3.73%. The inflation core calculated with the exclusion of administered prices – considering the wide set weighting 30.4% of the IPCA in August - and of household food prices increased by 0.40% in August, with accumulated variation of 4.04% in 12 months.

The median of market expectations for the IPCA variation, as surveyed by the Central Bank on a daily basis, was revised to 6.5% from 6.3% for 2001 and remained stable at 4.5% for 2002.

In relation to the fiscal policy, it was assumed that the primary surplus targets for the consolidated public sector would be met, as stated in the Economic Program of the Government.

The remaining assumptions established in the previous meeting were maintained.

Simulation exercises with several specifications of the structural model allowed for the conclusion that the maintenance of the interest rate at the current level of 19.0% p.a. would result in inflation above the upper limit of the target for 2001. For 2002, the projected inflation is slightly above the 3.5% central target for the year.

Monetary Policy Guidelines

Recently released indicators confirm the slowdown trend in demand as a result of the set of shocks that affected the Brazilian economy. The drop in demand may be explained by the worsening in the external scenario, by effects of the energy crisis on expectations and by the recent tightening in monetary policy, yet enough for GDP to grow moderately this year. As addressed in the last

Copom meeting, the balance between aggregate supply and demand has been exerting downward pressure on inflation, since the slowdown in demand has outstripped the effect of the energy rationing on the aggregate supply. After an expected increase in inflation in July and August , basically due to the hike in administered prices, the IPCA and other indices already show marginal decrease, with reduced variation in market prices.

Notwithstanding the downward pressure on inflation stemming from the activity slowdown, the exchange rate remains under pressure. In the international scenario, adverse expectations prevail. The recovery of the U.S. economy had been postponed as indicated by recent released data. With the recent attacks on September 11th, the probability that this recovery will be delayed for the third quarter of next year is higher. In Europe, following the developments in the U.S. economy, the reduction trend in the pace of economic activity will be accentuated. The Japanese economy will not present signals of recovery in the short run.

It is still premature to predict the effects of U.S. crisis in the world economy and in Brazil. Nonetheless, it is possible that the recent international scenario has two consequences in the short run: i) doubts about the world economic situation, aggravated by the attacks to the U.S., may weaken consumers' confidence, increase the volatility in stock markets and oil prices, and reduce capital flows; and ii) the level of global economic activity shall retract, global trade flows.

The improvement in the result of the trade balance, as a result of weaker aggregate domestic demand and depreciation of the real, and the recovery of economic growth on the second half of next year will intensify the ongoing narrowing of current account deficit and improve the quality of its financing. In the meantime, the new agreement between the IMF and Brazil will provide support for the financing of the Balance of Payments.

The IPCA core inflation registered the second consecutive monthly reduction. Nonetheless, August outcome remains high (+0.56%). Inflation expectations, as surveyed daily by the Central Bank with the participation of a number of institutions, exhibited small marginal increase for 2001 and indicate a downward trend for inflation in 2002. In 2001, the IPCA accumulated a 5.06% variation until August, led by the evolution of administered prices (7.86%), with a contribution of 2.30% for the IPCA. The remaining prices, weighting 69.6% of IPCA, increased by 3.86% in the period, with a contribution of 2.76%.

For 2002, the forecasts derived from Central Bank's structural model, built upon the assumption of a constant interest rate trajectory, indicate an inflation rate above 3.5%. The increase in the projected inflation for the next year results exclusively from the path of exchange rate and energy and oil products prices . In this sense, the shocks that affected the Brazilian economy this year will still have reflexes on next year inflation. The forecast for market price inflation, upon which monetary policy has the major impact, remains significantly below 3.5%.

Copom recognizes that there are risks of a passthrough of the recent exchange rate devaluation on domestic prices next year, as long as the exchange rate remains under pressure. However, Copom understands that the monetary policy is currently adequate to maintain market prices under control and to neutralize secondary effects of the supply shocks.

Accordingly, Copom unanimously decided to maintain the Selic rate target in 19% p.a. .

At the close of the meeting, it was announced that the Committee would meet again on October 16, 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 n. 8,018, of 11.22.2000.

Minutes of the 64th Meeting of the Banco Central do Brasil Monetary Policy Committee (Copom)

Date: October 16 and 17, 2001
Place: Central Bank's Headquaters 8th floor meeting room (on 10.16) and 20th floor (on 10.17) -Brasília - DF
Called to Order: 4:08 PM on 10.16 and 4:35 PM on 10.17
Adjourned: 8:32 PM on 10.16 and 6:58 PM on 10.17

In attendance:
Members of the Board
Arminio Fraga Neto - **President**
Carlos Eduardo de Freitas
Daniel Luiz Gleizer
Edison Bernardes dos Santos
Ilan Goldfajn
Luiz Fernando Figueiredo
Sérgio Darcy da Silva Alves

Department Heads (all present on 10.16)
Altamir Lopes - Economics Department (DEPEC)

Daso Maranhão Coimbra - International Reserve Operations Department (DEPIN)
Gustavo Bussinger - Research Department (DEPEP)
Luis Gustavo da Matta Machado - Department of Banking Operations and Payments System (DEBAN)
Sérgio Goldenstein - Open Market Operations Department (DEMAB)

Other participants (all present on 10.16)
Antônio Carlos Monteiro - Executive Secretary
João Borges - Press Secretary (ASIMP)
Fabia Aparecida de Carvalho - Coordinator of the Investor Relations Group

The Board analyzed the recent performance and prospects for the Brazilian and international economies under the monetary policy framework, designed to comply with the inflation targets determined by the government.

Economic activity

Economic activity has leveled off at a lower pace in August and September, after having slowed since April. Indicators of consumption recovered slightly in August and September, after falling steeply in the previous quarter. Consumers, however, have remained cautious in the face of tighter credit conditions, decline in real earnings and worsening of external environment. Industrial production is slowing gradually, still sustained by placement of orders, particularly those related to deal with the energy crisis.

The Index of Consumer Intentions (IIC), surveyed by the São Paulo State's Federation of Commerce (FCESP), continued to fall in October, particularly affected by the turbulent environment prevailing after the events of September 11th in the United States. The surveyed sample also evidenced increasing concern on unemployment. The fall in the index by 9% affected its two components – current and future intentions – halting the rebound observed since June when the index reached its minimum by the time the energy rationing began.

Retailers turnover expanded by 0.8% in September from August, according to FCESP. This result reflected mainly the sales of non-durable consumer goods. Nonetheless, retailers turnover dropped by 4% year to date, reflecting particularly a reduction of 19.4% in car sales.

A more dynamic sales of non-durable goods is shown by an increase of 2.7% in September in the enquiries to the Telecheque, a leading indicator for cash and predated check payment sales, surveyed by the São Paulo Association of Commerce (ACSP), while enquiries to the Credit Protection Service (SPC), a leading indicator for credit sales, declined by 2.8%. Default rate in commerce, as measured by ACSP, remained stable at 6% in September, with both the number of new registries and cancellations falling. In the financial sector, the ratio of checks returned due to insufficient funds remained stable at 5% as compared to the previous months, though 30% higher than the level observed in 2000.

Investment spending has evolved favorably throughout the year. According to the Brazilian Institute of Geography and Statistics (IBGE), the share of investments in the GDP in the first half of 2001 reached 24.7% compared to 23% in the same period of 2000. Monthly indicators of gross capital formation continue to perform positively in recent months, partly reflecting the effects of investment decisions to face the energy crisis. Output of capital goods grew by 17% in the year-to-August, with an expansion of 6.1% in August (seasonally adjusted). Equipment for electricity generation showed expansion of 46.5% and 15.5%, respectively. It should be underscored the performance of production of agricultural machinery, with expansion of 26.1% in the year and 16.6% in September. Imports of capital goods showed a similar trend, growing by 24% in the year and 5.8% in August (seasonally adjusted). Construction industry, the main component of gross capital formation, however, performed differently, contracting by 1% in August and showing stability in the year (0.4%).

After 5 months of decline, industrial production stabilized in August (+0.2%, seasonally adjusted), mainly driven by growth in the production of capital goods, and at a lesser extent by production of semi-durable and non-durable consumer goods. It should be noted that industrial production showed stability in August compared to August 2000, evidencing that this sector overcame the restrictions in energy supply through the rationalization of consumption, substitution of energy sources, and trading of excess energy among industrial sectors.

Despite these favorable results, some industrial sectors are being affected more intensely by the difficulties of the current economic conditions, as is the case of the production of durable goods, which declined by 7.1% in August compared to July, and 14.5% compared to August 2000. Year-to-date, it grew by 5.2%, but at a sharp slowing pace. Among the durable goods, it should be noted especially the performance of car industry. Even after the reduction in the production, inventory is still increasing, as a result of plummeting car sales in recent months. In September, the production of cars fell by 5% (seasonally adjusted), sales to car dealers dropped by 6.2%, and the inventory of vehicles in the stores was approximately 100,000 units (or around 28 days of sales). Inventory in the factories is also high, which may lead to a cut down in production, as attested by recent decisions of collective holidays determined by several carmakers.

In August, despite positive evolution of industrial production, capacity utilization declined as compared to July. In the seasonally adjusted series, capacity utilization in the industrial sector in São Paulo fell by 0.32% and 0.4%, according to CNI and FIESP, respectively. Industrial employment and real wage also fell in August.

Open unemployment, as computed by IBGE in six metropolitans regions, was 6.18% in August, after recording 6.19% in the previous month. The number of employed increased by 0.44% (or 75,000 jobs), though not sufficient to absorb growth of 0.42% in the employable population (PEA), resulting in an increase of 0.16% in the number of unemployed. This information, and the fact that the upward trend in formal employment remained rising by 0.1% in August (seasonally adjusted), indicated that the impact of the energy crisis on the labor market was less intense than previously projected.

In September, in terms of daily average, new lending provided by the domestic financial system from its free resources presented an expansion in general compared to August. Even though this expansion could indicate the addition of new borrowers, it resulted in part from the concentration of demand in fewer working days (19 in September compared to 23 in August), as the accumulated flows in September reduced for almost all credit lines.

Daily average of new credit to households in September expanded by 9.6% and accumulated flows fell by 6.2%, while in terms of volume increased by 2%. The primary contraction in the month is consistent with slowing economic activity, the level of interest rates, and uncertainties in the external environment.

As to the external sector of the Brazilian economy, the trade balance recorded a surplus of US$ 594 million in September, and a surplus of US$ 29 million for the first two weeks in October, accumulating a surplus of US$ 1.3 billion in the year. This recent improvement in the overall trade balance is associated with the slowing in domestic economic activity and the exchange rate depreciation, leading to import reduction and maintenance of the export growth, even though at a moderate pace. The expansion in commodity sales remains notable, mainly meat and soy, as a consequence of an enlarged market opportunity resulting from livestock diseases in Europe. On the other hand, the sales of manufactured goods are decelerating, as a result of weaker demand in the major export markets (the United States and Argentina).

In concluding, economic activity remains at a low level, due to the slowing process started by the end of the first quarter of the year. Recent outcome which might indicate a possible reversal of this trend, as shown particularly by the consumption indices, is still incipient, and has not yet incorporated fully the effects of the international crisis. Therefore, one cannot draw any conclusion as to the start of a new trend. In addition, in shaping the expectations for coming months, the decision of carmakers to reduce their output should be incorporated, as well as the impact of such a decision on the other sectors of industry.

A slowing demand due to the lower credit expansion, and to the drop in consumers confidence, have more than offset the effect of the energy crisis on the aggregate supply, generating an output gap which contains inflationary pressures and improves the trade balance mainly by means of reduction in imports in view of difficulties in the international environment to expand exports.

External environment

Data released last month showed that the U.S. economy has been in a slowing trend since the second half of 2000, even before the attacks of September 11th. In this regard, capital spending remained declining, with a reduction in the output of capital goods and stability in orders to factories. Data on the evolution of consumption suggest that the consumption was slowing, with retail sales declining by 2.1% in September compared to the previous month (seasonally adjusted), and a reduction of accumulated growth in 12 months to 1.8% from 3% up to August. In this context, consumer credit, which increased by US$ 2.3 billion in September, remains in a downward trend in terms of 12 month growth rate.

The events of September 11th in the United States and the following actions have contributed considerably to the increase of uncertainties in the economic environment. In this context, and taking into account the absence of inflationary pressures, monetary and fiscal policies were loosened. After 50 points cut in the fed funds rate in an unscheduled meeting on September 17th, the Federal Reserve cut interest rates further by another 50 basis points in the regular meeting of October 2nd, after which the basic interest rate stood at 2.5%. Simultaneously, the government decided to grant a financial support of US$ 15 billion to airlines, to be disbursed in 2001 through 2002, and was also authorized by Congress to spend US$ 40 billion for assistance and recovery, which should be used during this year and the next. This financial support, added to the tax refund proposal, may represent a considerable fiscal incentive.

Expectations that government measures to support recovery in the economic activity will be effective in the medium run are not yet explicit in the business outlook, as measured by the indices of the National Association of Purchase Managers. Overall index for the manufacturing sector remained below 50 in September, for the 14th consecutive month. The index relative to the services sector reached 50.2 in September, which was still regarded as insufficient to indicate a consistent reversal of trend. Consumers' expectations as surveyed by the Conference Board have deteriorated, falling to 97.6 in September from 114 in August. Consumers' sentiment, as evaluated by the University of Michigan, suggested an improvement as the preliminary figure for the index rose to 83.4 in October from 81.8 in September.

It should be pointed out that the military reaction to the attacks and fears for further offensive actions in the U.S. territory have increased the uncertainties regarding the recovery in economic activity, contributing to an even weaker performance than it would be expected for the short run in this stage of economic cycle.

In the euro area, indicators showed that the slowing economic activity has persisted in the period. Retail sales recorded an expansion of 1.3% in July, compared to 1.5% in the previous month. Industrial production, after expanding by 1.8% in June relative to the same month last year, contracted by 1.1% in July, unemployment remained stable at a rate of 8.3% in July and August. Regarding inflation, the harmonized consumer price index has indicated a downward trend since May, when it reached 3.4% (2.7% in August, still above the reference rate of 2%). Considering the producers price index, the downward trend is even more apparent, reducing to 1.7% in August from 4.8% in January. The recent increase in the annualized quarterly moving average of the M3-- a leading indicator of inflation and first pillar of the monetary policy conducted by the European Central Bank— is being interpreted as a transitory phenomenon and resulting from statistical problems in the measurement of the indicator, thus not regarded as a deterioration in inflation prospects. Entrepreneurs' expectations about the economic outlook of the major countries in the region remain low. In this scenario, the European Central Bank cut the basis rate by 25 points on August 30th and, in September, decided on another reduction of 50 points, to 3.75%, jointly with the Federal Reserve.

The evolution of the Japanese economy has not been favored by the international scenario, leading the Bank of Japan to intervene in the foreign exchange market in an attempt to hold the Japanese currency against the dollar, as well as to increase the liquidity in the domestic market to stimulate the economy.

In Argentina, uncertainties regarding the ability of its economy to recover remain, together with the maintenance of a downward trend in demand and supply. In this context, the trade balance registered a surplus of US$ 692 million in August, accumulating a surplus of US$ 3 billion in the year. This performance reflects mainly a contraction of 7.8% in imports, while exports increased by 4%. The widening of spread of Argentine securities has affected other emerging market papers, as perceived by international investors.

In summary, the process of slowing in the U.S. economy, which had already affected other industrial countries, with negative impact on the emerging economies, mostly for those within its area of influence, tends to be exacerbated by the consequences of the September attacks, delaying therefore the start of economic recovery.

Prices

In September, inflation measured by the main price indices abated, reflecting the reduction in agricultural prices and, especially, the easing of pressures derived from adjustment of administered prices which weighed considerably on these indices in the two previous months.

The IPCA rose by 0.28% in September, compared to 0.70% in August, accumulating 6.46% in 12 months. This result was due to a smaller increment in the administered prices and to a fall in agricultural prices, particularly fresh products. Food prices decelerated to 0.39% in September from 0.83% in August. Still, higher cost pressures on food prices persisted, coming from off-season effects and/or climate problems, and effects from the exchange rate depreciation. Prices of non-food products eased to 0.25% in September, compared to 0.66% in August in view of the ending of the period where controlled price adjustments are concentrated. Nevertheless, this sector contributed to 0.19 percentage point in the IPCA variation, affected by the rise in urban bus fares in Recife and Salvador, intermunicipal bus fares in five of the eleven capitals surveyed for the price collection, water and sewage in Rio de Janeiro and electricity prices in Belém, Brasilia and Goiânia.

The IGP-DI recorded a deceleration to 0.38% in September, from 0.9% in August, accumulating 7.81% in 2001 and 9.44% in the 12 month period. Compared to the previous month, the deceleration was observed in all components, led by the IPA, which declined to 0.48%, from 1.13%. This result was associated with the negative variation in the agricultural IPA in September (minus 0.21%) from 1.33% in August driven by the reductions in the prices of milk and eggs, affecting also their retail prices as food prices in the CPI decreased by 0.37%. Upward pressures from exchange rate, however, persisted on the prices of soy and its by-product, in addition to supply problems due to off-season effects in some products such as rice, beans and cattle. The monthly variation of the Industrial IPA slowed to 0.75% in September, from 1.05% in August, with the main determining factors being the price behavior of processed food products and chemicals. The INCC rose by 0.55% simply as a result, for the third consecutive month, of increases in civil construction prices and services (1.07% from 1.22% in August), while labor costs remained stable.

A larger increase in all indices is expected for October, basically as a consequence of the fuel price adjustment on October 5th. It should be pointed out also the pressures on agricultural products, especially regarding those still affected by off-season factors. Nonetheless, these pressures are localized, and there are no expectations of a generalized price increase, taking into account the weak demand and the absence of indexation mechanisms in the economy.

Money market and open market operations

The volatility in the interest rate yield curve increased since the last Copom meeting, due to the effects of the attacks in the USA and increased uncertainties in Argentina. The slope of the interest rate yield curve, as measured by the spread between the Over Selic rate and the 90 day Futures DI rate widened by 255 basis points to 370, between September 19th to October 9th. Nonetheless, after the parliamentary elections in Argentina, the slope reverted partially and the spread narrowed to 300 basis points on October 15th.

Between September 11th and October 11th, 21 unscheduled offers of exchange rate indexed securities were carried out by the central bank, amounting to R$23.4 billion in financial volumes. Since end-September, the unscheduled placements have been carried out with NTN-D. On October 3rd and 4th, the National Treasury attempted to lengthen the tenure of the outstanding securities by offering maturities to 2003 and 2004. Low demand and increased bid yields, however, were observed, leading to further placements of NTN-D with maturity in 2002.

In addition, four auctions of federal securities were carried out between September 19th and October 16th to roll over maturing exchange rate indexed securities. As a means to roll over the R$1.2 billion maturing on September 25th, two auctions were carried out. In the first, R$0.2 billion was placed through 3-year NTN-D. In spite of the shortened maturity, demand was below supply. The rollover of the R$4.1 billion in NBC-E on October 18th was made through two placements of NTN-D. The first offer, of 5-year securities, was placed only partially, due to the high bid yields. The second, with a shorter maturity, was fully sold. The longer maturity issues represented only 7% of the total maturing value.

On October 2nd, the National Treasury proceeded with the offers of LTN, which had been interrupted as a result of the effects of the attacks in the US on the market. Until October 16th, three auctions of 6-month papers were carried out, totaling R$3.1 billion. Average yields have been reduced from 24.28%, to 24.19%, and then to 23.71%. Demand/offer ratios were higher (2.5, 3.4, and 2.0), as the future DI yield curve presented a significant premium over the Selic rate.

On September 25th, an auction of five-year LFT was carried out, totaling a financial volume of R$0.6 billion, at an average discount of 0.33%. In October, in spite of the shortening of maturity of the securities to 2 years from 5 years, demand was below the supply in both events in the month. In the auction of October 2nd, R$1.3 billion were placed at an average discount of 0.16%. In the following week, R$0.5 billion was placed at an average discount of 0.24%.

Considering the financial settlements between September 19th and October 16th, a contractionary monetary impact of R$5.1 billion was observed in the period. The net placement of R$14.8 billion in exchange rate indexed securities offset the net redemptions of LTN and LFT.

Within 19 working day period, the central bank intervened for sixteen times in the open market, aiming at administering the short-term interest rate. In all interventions, the central bank carried out purchases of federal securities with resale agreements, at minimum yields ranging from 19.05% p.a. to 19.10% p.a.. The average volume of the interventions reached R$14.2 billion. In addition, the central bank carried out two go-arounds to purchase LFT to reduce the liquidity shortage in the system. In the first operation, on October 2nd, no bids were accepted. In the second, however, on October 5th, R$4.3 billion were purchased at the average discount of 0.06%.

Prospective assessment of inflation

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

1. September's inflation rate, measured by IPCA, recorded 0.28%, which was lower than expected;

2. the projection for prices of oil by-products was computed based on the term structure of prices implied in the Brent crude oil futures contracts. The expectation for the average price of the barrel of the Dated Brent was substantially reduced to US$20.4 in the fourth quarter of 2001. For 2002, it was assumed that the prices of oil by-products prices in the domestic market will show an important reduction as compared to the assumption of substantial rise made in the last Copom meeting;

3. for a wider set of administered prices, the expected adjustment in 2001 reduced to 10.0% in October from 11.0% in September;

4. the projection for the adjustment of electricity prices in 2001 and 2002 remained at approximately 20% p.a.;

5. the slope of the domestic yield curve - measured as a difference between the 180-day term DI rate and the 1-day Selic rate - is projected at an average of 450 basis points in the fourth quarter of 2001, declining linearly to an average of 300 basis points in the last quarter of 2002;

6. the path for the fed funds rate was projected based on the maturity of futures contracts, which indicates a reduction in the rate to 2.5% through the end of the first quarter of 2002 with stability thereafter;

7. on the external front, the assumption for the average risk premium was revised to incorporate a declining path from current levels to a plateau near 700 basis points from the second quarter of 2002 on.

GDP growth in the second quarter of 2001 was modified to reflect the revision made by the IBGE, to 1.82% from 0.79% compared to the same period of previous year.

The core inflation of the IPCA, calculated under the symmetric trimmed-mean method, remained stable at 0.57% in September. Accumulated in 12 months, the core index increased by 6.41%. The core inflation of the IPC-BR, calculated under the symmetric trimmed-mean method, declined to 0.50% in September. Accumulated in 12 months, this core increased by 6.05%. The inflation core calculated with the exclusion of administered prices – considering the wide set weighing 30.6% of the IPCA in September - and of household food prices increased by 0.25% in August, with accumulated variation of 4.04% in 12 months.

The median of market expectations for the IPCA inflation, as surveyed by the central bank in a daily basis, was revised upwards to 6.60%, from 6.50% for 2001 and to 5.00% from 4.50% for 2002.

Year-to-date, the IPCA increased by 5.35% in September, of which 2.4% referred to administered prices (8.3% variation) and 2.9% to free prices (4.1% variation). For the remaining of the year, it is expected a 0.5% contribution from administered prices (for 1.6% variation). The evolution of the administered prices is expected to contribute directly to 2.9% for the year inflation, compared to the 3.2% estimated in September.

In relation to the fiscal policy, it was assumed that the primary surplus targets for the consolidated public sector will be met, as stated in the Economic Program of the Government.

The other assumptions made in the previous meeting were maintained.

Simulation exercises with several specifications of the structural model led to a conclusion that the maintenance of the interest rate at the current level of 19.0% p.a. would result in inflation above the upper limit of the target for 2001. For 2002, the projected inflation will be near the 3.5% central target for the year.

Monetary Policy Guidelines

Industrial production in August shows signs of accommodation of the economic activity at a level lower than the one registered at the beginning of the year, as a result of the decelerating trend starting in the first quarter. This deceleration has implied an asymmetric decrease in the use of factors of production. On the one hand, capacity utilization in the industry has been lower in various regions of the country, falling for the fifth consecutive month. On the other hand, employment indicators have indicated stability in the number of job opening in August, after a period of increases from March to May this year. Likewise, seasonally adjusted open unemployment rate presented a slight reduction in August.

A more accentuated reduction in capacity utilization may be reflecting the lagged reaction of employment to the pace of economic activity and the effect of the energy crisis. Alternatively, the stability in the employment may indicate that the slowing economy is perceived as temporary. This possibility is reinforced by consumption indicators, which signaled a slight recovery in August and

September, after strong reduction in the previous quarter, what could point to a possible reversal in the trend.

However, these consumption indicators are incipient, not incorporating fully the impact of the international turmoil, mainly after September incidents. Consumers remain cautious, as indicated by the Index of Consumer's Intention in October, in the face of tighter credit conditions, reduced real income and deteriorated external scenario. Industrial production has been sustained by placement of orders, particularly those dealing with the energy crisis. In addition, as the prospects for the coming months are drawn, the decision of the carmakers in reducing their production should be considered, as well as the impact on the other sectors of industry. Therefore, under the effects of several shocks on the economy, and particularly the recent events in the United States, it is premature to conclude on the recovery in the level of activity.

Uncertainties on the external scenario increased recently. In the industrial countries, as a response to the incidents of September 11th in the United States, a slowdown in the consumption is observed, notwithstanding the drastic cut in interest rates made by the major central banks. Financial assets' markets remain volatile, after sharp falls observed in the weeks that followed the September events. Capital flows responded negatively to the events and a decrease in the flows of international trade is projected as a result of a lower level of activity in the world economy. In Argentina, the difficulties remain. The sovereign risk premium reached a level as high as 1,800 basis-points in the weeks before the elections of October 14th. In Brazil, deterioration in the external scenario and concerns on capital flows put pressure on exchange rate. On positive side, oil prices may respond to the slower growth in demand, by remaining at levels significantly lower than those observed this year.

Inflation expectations for 2002, measured by the medians of the responses surveyed by the central bank, were raised recently and reached a plateau considerably higher than those of Copom. Since these expectations may be interpreted as indicators of the actual projections made by price and wage setters in the Brazilian economy, the recent rise might indicate future pressure on prices. In fact, entrepeneurs' expectations indicated in polls seem to reflect more intensely the current difficulty in passing through cost increases to prices.

In comparing analysts' expectations and the Copom's projections, three relevant factors should be considered. First, inflation expectation in the survey tends to consider an additional depreciation in the exchange rate in 2002. Copom considers exchange rate level in the day before its meeting as a methodological reference to the period of projection. There is the risk that additional depreciation may cause a passthrough to prices and an increase in the projected inflation for this year and the next. In the relevant horizon, some factors may contribute more directly to stabilize exchange rates. For instance, recent measures taken to reduce liquidity in the financial system and a lower demand for hedging from companies seeking protection for their liabilities' exposure to exchange rate risk. In this sense, lower volatility in the exchange rate tends to minimize such a defensive behavior. Moreover, improvements in trade balance and current account may indicate increasingly a trend towards a larger and permanent supply of resources in foreign currency over the medium-term, and increased confidence in the Brazilian economy for a sustainable growth in the coming years.

Second, analysts' projections consider a higher passthrough of the recent or year-to-date accumulated depreciation to prices next year. Copom considers that the risk of the depreciation being passed through to prices depends on demand levels (see empirical evidences on the Inflation Report – September 2001). Therefore, in the Copom's evaluation, slowing demand due to lower credit expansion and to lower consumers confidence has more than offset energy crisis effect on aggregate supply. This has produced an output gap whose effect may contain inflation pressures. Moreover, Copom uses Selic rate constant over its projection period as a methodological reference while the median of the analysts' projections considers a gradual reduction of this rate.

And finally, some analysts believe that higher inflation in 2001 shall put pressure on inflation next year. It is important to observe, however, that the increase in inflation this year is due primarily to a combination of adverse shocks which would not necessarily persist over the coming months. There are solid evidence of a smaller inflation inertia in the Brazilian economy in recent years. The projected fall in inflation for the fourth quarter this year, after a higher level in the third quarter, reinforces this assumption.

Copom remains alert to higher risk of an additional passthrough to prices and/or more than expected levels of inflation inertia in Brazil. Copom understands, however, that monetary policy is adequate to meet the inflation target for the next year. This conclusion contemplates external uncertainties, demand stability in a level lower than expected early this year, associated to a still unclear prospects for economic recovery, which may limit the possibility of passthrough of exchange rates to the inflation.

Accordingly, Copom unanimously decided to maintain the Selic rate target in 19% p.a. .

At the closing of the meeting, it was announced that the Committee would meet again on November 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 n. 8,018, of 11.22.2000.

Minutes of the 65th Meeting of the Banco Central do Brasil Monetary Policy Committee (Copom)

Date: November 20th and 21st , 2001

Place: Central Bank's Headquarters 8th floor meeting room (on 11.20th) and 20th floor (on 11.21st) - Brasília - DF

Called to Order: 4:00 PM on 11.20th and 4:26 PM on 11.21st

Adjourned: 7:51 PM on 11.20th and 7:10 PM on 11.21st

In attendance:

Members of the Board

Arminio Fraga Neto **- President**

Carlos Eduardo de Freitas

Daniel Luiz Gleizer

Edison Bernardes dos Santos

Ilan Goldfajn

Luiz Fernando Figueiredo

Sérgio Darcy da Silva Alves

Department Heads (all present on Nov.20th)

Altamir Lopes – Economic Department (DEPEC)

Daso Maranhão Coimbra - International Reserve Operations Department (DEPIN)

Gustavo Bussinger - Research Department (DEPEP)

José Antônio Marciano - Department of Banking Operations and Payment System (DEBAN)

Sérgio Goldenstein - Open Market Operations Department (DEMAB)

Other participants (all present on Nov.20th)

José Pedro Ramos Fachada Martins da Silva – Advisor to the Board

João Borges - Press Secretary (ASIMP)

Fabia Aparecida de Carvalho - Coordinator of the Investor Relations Group

The Board analyzed the recent performance and prospects for the Brazilian and international economies under the monetary policy framework, designed to comply with the inflation targets established by the government.

Economic activity

The most recent released data indicate that the economic activity has stabilized between the third and fourth quarters of the year, interrupting the declining trend in place since April. The economic stability reveals that the adjustment of demand to the several shocks that occurred this year may be over, as indicated by the behavior of retail sales and consumer intentions.

Short term expectations of consumers improved. The Consumer Intentions Index (IIC), surveyed by the Federation of Commerce of the State of São Paulo(FCESP), increased by 0.2% in November compared to the previous month. The component that measures current consumption intentions rose by 7%, revealing that customers have overcome the negative emotional impacts caused by recent international events. Nonetheless, the survey also revealed that consumers remain cautious in regard to the future economic environment, fearing an increase in unemployment and inflation, important reasons explaining the 3.4% fall in future consumption intentions.

Retail sales in October increased for the third consecutive month. Retailers turnover in the Metropolitan Region of São Paulo, measured by FCESP and seasonally adjusted by Central Bank's Economics Department (Depec), increased by 1.2%, as a result of the recovery of car and light vehicle sales through dealers chains to final consumers, basically due to special financing . As the other segments surveyed presented lower sales in comparison to September, the overall retailers' turnover was lower than in the same period last year.

The National Confederation of Industries (CNI) registered a 3.79% expansion of real industrial sales in September (seasonally adjusted series), which led to a 14.5% growth year to date. Seasonally adjusted industrial sales moved back by 0.3% in September, reflecting the negative performance of twelve out of the twenty industrial sectors, and three out of four categories of use, the exception being the production of semi-durable and non-durable consumer goods, which registered a 0.2% increase due to the performance of food producers, mainly the ones directed to external markets. In the year, industrial production accumulates a 3.1% expansion.

The utilization rate of industrial capacity reached 79.15% in September showing a reduction for the seventh consecutive month in September (0.57%), as informed by CNI (data seasonally adjusted by Depec). Nonetheless, year to date results are still 0.29% above the levels of the same period last year.

The open unemployment rate, calculated by the Brazilian Institute of Geography and Statistics (IBGE) for six Metropolitan Regions, was of 6.15% in September, compared to 6.18% in August. The average rate for the first three quarters of the year reached 6.24%, contrasting with the 7.54% in the same period of 2000. It should be noted the 0.2% expansion in the seasonally adjusted series of formal employment, leading to a 3% increase year to date, corresponding to 772.7 thousand new labor positions up to September.

Investment indicators still show a favorable performance, despite the 4.9% and 11.3% decline observed in September in the production and imports of capital goods, respectively. Domestic production of such goods, specifically intended to face the energy crisis, grew by 46.4% ytd, compared to a 15.2% expansion of the overall production of capital goods. It is also worth emphasizing the 18.2% increase in the production of agricultural machinery, partly due to exports. Production of inputs for the civil construction industry also declined in September (2.3% in the seasonally adjusted series), leading to a 0.4% fall ytd. Based on the performance of investment indices, gross capital formation reached 21.5% of the GDP in September, as estimated by Depec.

Exports of the soybean and by products grew by 25.7% from January to October, in comparison to the same period of 2000. It should be highlighted that this result was due to the increase of the shipped *quantum*, since average prices fell on the same comparison basis. Besides the performance of soybean and by products, exports of meat were also strong thanks to the qualification of Brazilian products that conquered new markets that had been left unserviced due to the diseases in European cattle herds. The 23.7% and 2.4% increase in the sales of basic products and manufactured goods, respectively, created the 7.3% daily average increase in overall exports in the aforementioned period.

Considering just ten working-days up to the third week of November, the trade balance totaled US$ 213 million, increasing the year to date accumulated surplus to US$1.7 billion. This improvement in the trade surplus is a result of reduced imports, as a consequence of both the depreciation of the Real and the deceleration of domestic activity. Furthermore exports of manufactured goods are expanding at a slower pace, given the constraints in foreign markets.

The outstanding balance of the financial system credit operations increased by 0.8% in October, reaching R$ 335.4 billion, of which R$199.1 billion refer to operations with freely allocated resources, which increased by 0.6%. Such growth was caused by the 0.2% reduction in operations with corporations, where the outstanding balance of Anticipated Exchange Contracts (ACC) plummeted, while credit to households increased by 2.2%.

As for new loans, a 14.4% increase was registered in operations with corporations in October. The outcome reflected more working-days in October in relation to September, and also seasonal patterns of the period, particularly operations with working capital (capital de giro) and authorized overdraft (conta garantida). In relation to household credits, their overall balance increased by 14.1%, to a great extent due to the performance of credit card operations.

The collection of taxes and contributions administered by the Federal Revenue Secretariat totaled R$17.1 billion in October, an increase of 17.3% in the month and 14.7% ytd compared to the same period last year**.** These increases were mainly due to the growth of the collection of Income Tax Withholdings (IRRF), especially on capital gains, to the Provisional Contribution on Financial Transactions (CPMF), to the Income Tax (IR) and to the Social Contribution on Net Income

(CSLL) of financial entities, influenced by their enlarged profits. It should be mentioned that taxes that are more directly related to the level of economic activity performed below the overall average collection, reflecting the deceleration of economic activity.

In summary, there are indicators showing that economic activity has already absorbed the impacts caused by the deterioration of the external environment and the energy crisis, what points to a gradual recovery in growth. This interpretation is also supported by the favorable performance of formal employment, enhanced by positive expectations related to year-end sales, previously postponed by the uncertainties affecting decisions of consumers and producers.

External environment

Economic indicators in industrialized countries show that the deceleration of the economic activity, in place since the beginning of this year, has been replaced by a contraction, beginning **at** the end of the third quarter. In the United States, GDP declined by 0.4% this quarter, compared with the previous quarter (seasonally adjusted and annualized data). In the Euro area, national and regional indicators available point to a significant reduction in the growth rate for the third quarter. Japan's GDP declined in the second quarter, leading the Bank of Japan to reduce its growth projections for the current fiscal year.

In the United States, GDP in the third quarter contracted for the first time since 1993 (0.4%), reflecting the impacts of economic weakening made worse by the terrorist attacks of September 11th. The result was affected by the private investment behavior, -10.7%, which has declined by over 10% for the past three quarters. Consumer consumption, which had been supporting output, grew by 1.2%, after reaching 2.5% in the previous quarter. The 1.1% reduction in industrial production in October, the 13th consecutive contraction, reducing the variation in the 12-month accumulated figures to -1.4% from -0.5% in the previous month. The unemployment rate increased half of a percentage point, reaching 5.4% in October, when there were 415,000 less job offers in the non-agriculture sector.

Demand indicators are still showing decline. Personal expenditures with consumption declined by 1.3% in September, and increased by 3.4% in the last 12 months, maintaining the downward trend. Orders to the factories and production of capital goods were negative in 5.8% and 2.3% respectively in September, with the accumulated variation over 12 months registering -5.7% and 1.8%. Retail sales increased by 7.7% in October, after having declined by 2.2% in the previous month, a result coming mainly from the 25.9% increase in the automobile sales. The core index, which excludes vehicles and autoparts and components increased by 1%, in line with market expectations. Credit to consumers increased by 0.2% in September, and the accumulated in 12 months declined to 6.8% from 7.4%, between August and September. Finally, although the initial construction of residential homes indicator presented a contraction of 1.3% in October, the accumulated result over 12 months was positive for the first time since February 2000, reaching 0.4%. Mirroring the slowdown in the economic activity and the new government policy, plus the initial impacts of the fiscal measures adopted after September 11th, the federal government fiscal result was lower than in the previous year from June on, reverting the trend of increasing surpluses observed since 1998. The fiscal year of 2001 represented a $127.2 billion surplus, 46.3% below the record result of $236.7 billion in 2000.

The terrorist attacks hit market expectations, captured by surveys with entrepreneurs (NAPM) and consumers (Conference Board). Expectation indicators in the manufacturing sector, as measured by NAPM, declined to 39.8 in October from 47 in September, once more indicating economic contraction. In the services sector the reduction measured by NAPM in the same period was from 50.2 to 40.6. Consumer confidence was also affected, and the index declined by 28.5 points between August and October reaching 85.5.

With the slowdown in the economic activity and the reduction in the energy prices, especially petroleum, inflation indices declined, widening the space for a more expansionist monetary policy. Consumer prices (IPC) declined by 0.3% in October, with an annual growth of 2.6% in September and 2.1% in October. The IPC core in October increased by 0.2% in the month, and 2.6% ytd. Producer Prices (IPP) declined the most, -1.6% in October, with a negative variation of 0.4% ytd.

Several U.S. statistics indicate a scenario which lacks dynamism, with the likely repetition of the negative GDP result in the two following quarters. Recovery should start from the second quarter of 2002 on with the full effects of the fiscal and monetary policy measures.

In the Euro area, world economic slowdown negatively affected the activity level. Notwithstanding, retail sales and trade balance results increased in August. In regard to the first, annual growth increased to 1.8% from 1.5%, while trade balance surplus reached $18.7 billion accumulated in the last 12 months until August, $5.6 billion above the result in the previous month. In September, industrial production registered the third negative variation in the year, 0.6%, while the unemployment rate remained stable at 8.3% in September. Harmonized Consumer Price Index (IPCH) declined to 2.4% ytd in October from 3.4% in May. The quarterly moving average of the M3, first pillar of the monetary policy in the region, however, accelerated from March on and reached a 6.9% growth in August, above the 4.5% reference. In the main countries of the Euro area, business expectations remain unfavorable, with emphasis on the 12 percentage points reduction in the Italian indicator, between August and September.

In Japan, the contraction of the main indicators of domestic demand – factory orders, residential home construction initiations and spending-, together with the cooling down of the external demand, the deflation, and the lack of supply reaction to the zero interest rate monetary policy, form a scenario of continued recession. The Bank of Japan revised its expectations of GDP growth for the fiscal year to a range of –0.6% and –1.6% from a range of 0.3% to 0.8%.

In Argentina, continued recession makes it more difficult to reach the "zero deficit" target between October and December, mainly due to the reduction in tax collection. The government initiated a debt swap program with local creditors, aiming at reducing interest rate burden. This program was interpreted by the rating agencies as a "selective default", resulting in additional lowering of the country's ratings. The difficulties in Argentina reflected in the sovereign risk indicators, with the spread of the Argentine bonds and US securities surpassing 3,000 basis points.

Prices

In October, the inflation rate measured both by the general and the consumer price indices increased once again. This upward movement reflected mainly the readjustment of fuel prices and the increase in the prices of cigarettes, rice – due to a smaller than expected harvest -, and meat - caused by off-season problems and exchange rate effects related to export growth.

The IPCA rose by 0.83% in October compared to 0.28% in September, accumulating 6.22% ytd and 7.19% in 12 months. Food prices increased by 1.15%, mainly due to the 10.7% and the 5.23% increase in the prices of rice and meat, respectively, responsible for 0.23 percentage points in the monthly variation of index. The prices of non-food products increased by 0.74%, with the 3.58% increase in gasoline prices being the largest individual contribution to the IPCA of the month (0.16 percentage point). The prices of cigarettes went up by 6.38%, reflecting a 14% average readjustment in place since October 12th .

The IGP-DI increased by 1.45% in October, compared to 0.38% in September, accumulating 9.36% ytd and 10.62% in 12 months. In relation to the previous month, there was an acceleration in all of its component indices, more intensively in the IPA, which increased by 1.88% from 0.48%, responding for 1.13 percentage points of the IGP result. The growth in October wholesale prices reflected the behavior of agricultural prices, which increased by 1.74% from 0.48%, as well as industrial products, which rose by 1.94% from 0.75%. The lower supply of important agricultural products, caused by off-season problems and by smaller than expected harvests, together with the influence of the depreciated exchange rate and the readjustment of fuel prices were the main reasons which explain the hike in wholesale prices, especially beef, rice, oranges, and fuel. In the retail segment, the main influence came from food (0.27 pp), transport (0.16 pp), housing (0.13 pp) and personal expenditures (0.1 pp).

For November, a smaller increase is expected for all indices, although the results will still be influenced by pressures posed by October readjustments, particularly of fuel and cigarettes. The prices of meat and its by-products will continue to increase due to the reduction in supply, affected by off-season problems and the increase in exports. The readjustments of electric energy in Light's distribution area, added to urban bus fares hikes in Rio de Janeiro and prices of medicines , will also be observed in November results.

Money market and open market operations

Since the last Copom meeting, the slope of the interest rate curve showed continued reduction. The reduction in interest rates was stimulated by improvements in the prospects for the domestic economy. The more optimistic forecasts for the Balance of Payments, the exchange rate appreciation, and the expressive fiscal surplus built up the basis for a more favorable perception of the fundamentals of the domestic economy, leading to the decoupling of Brazil's sovereign risk from Argentina's. As a result, the spread between the Over-Selic rate and the three-month Futures DI to February declined to 13 bps on November 19th from 210 bps on October 17th . Likewise, the one-year interest rate spread decreased to 150 bp from 560 bp.

After a massive selling of R$23.4 billion in exchange rate indexed securities placed between September 13th and October 10th , there was a sole unscheduled offer of NTN-D on October 25th , amounting to R$ 1.6 billion. The improvement in the domestic scenario led to a lower demand for hedging. In addition, there were three auctions to rollover expiring exchange rate indexed securities in November. The strategy adopted was to lengthen the issuance tenure. The resulting financial volume transacted was of R$5.5 billion, 83% of which with securities maturing between 3 and 7 years.

The National Treasury continued to offer six-month LTN on a weekly basis, recommencing at the beginning of October. Five LTN public offers were carried out since October 23rd , totaling R$ 7.3 billion. The improved prospects for the domestic economy accentuated the demand for fixed rate securities. The average yields presented a downward trend, decreasing to 20.02% on November 20th from 23.04% on October 23rd . The demand/supply ratio in the auctions oscillated between 1.6 and 2.7.

As a result of the financial settlements which occurred between October 17th and November 20th , a R$5.2 billion expansionist monetary impact was observed in the period. This impact resulted from the net liquidations of R$3.2 billion in LTN, R$1.2 billion in LFT and R$1.1 billion in exchange rate indexed securities.

During a 21 working day period, the Central Bank intervened nine times in the open market, aiming at administering the very short-term interest rate. In all operations, the Central Bank provided liquidity to the market at a hurdle yield of 19.05%. The average volume of the interventions was of R$18.3 billion, at a 2.3 day average tenure.

Assessment of inflation trends

The identified shocks and their impacts were reassessed in the light of newly available information. The scenario considered in the simulations considering the following hypotheses:

1. October inflation rate, measured by the IPCA, reached 0.83%, above the expected result;

2. The forecast for prices of oil-by products was calculated based on the term structure of prices implied in the Brent crude oil futures contracts. The expectation for the trajectory of the average price of the Data Brent barrel was substantially reduced to US$19 in the last quarter of 2001, reaching US$20 at the end of 2002. This trend projects a 4.9% reduction in fuel prices to consumers in 2002;

3. For a wider set of contractual prices, the expected readjustment in 2001 increased to 10.8% in November from 10.0% in October. For 2002, the expected readjustment is of 5.8%;

4. The forecast for the readjustment of electricity tariffs in 2001 remained at approximately 20%. For 2002, a higher readjustment is expected, which may reach 30%;

5. The projected slope of the domestic yield curve, measured as the difference between the 180-day term DI rate and the 1-day Selic rate, was significantly reduced to an average of 297 basis points in the fourth quarter of 2001, linearly declining to an average of 250 b.p. in the first quarter of 2002, and remaining stable until the end of the year;

6. The path of the U.S. fed funds rate projected based on the maturity of futures contracts was altered to reflect an average rate of 2.2% in the fourth quarter of 2001, declining to 1.9% in the first quarter of 2002 and showing a moderate increase thereafter;

7. On the external front, the assumption for the average risk premium, using Brazil's Global 04 Bonds, incorporates a declining path from current levels to a plateau near 700 b.p. from the second quarter on, with stability thereafter;

The core inflation of the IPCA, calculated under the symmetric trimmed-mean method, remained stable at 0.57% in October. Accumulated in 12 months, the core index increased by 6.57%. The core inflation of the IPC-BR, calculated under the symmetric trimmed mean-method, rose by 0.56% in October. Accumulated in 12 months, this core increased by 6.42%. The inflation core calculated with the exclusion of contractual prices – considering the wide set weighing 30.6% in the IPCA in October – and of household food prices increased by 0.48% in October, with accumulated variation of 4.28% in 12 months.

Year-to-date, the IPCA increased by 6.22% in October, reflecting the 2.8% contribution from contractual prices (9.5% variation) and 3.4% from free prices (4.8% variation). For the remainder of the year, a 0.4% contribution is expected from contractual prices (1.3% variation). The evolution of the contractual prices is expected to directly contribute with 3.2% for the year inflation, compared to the 2.9% estimated in October. In 2002, the contractual prices are expected to increase by 5.8% (with a direct contribution of 1.8%, which excludes the second-round effects on inflation), influenced by the 30% hikes in electricity for the residential consumer.

Regarding fiscal policy, it was assumed that the primary surplus targets for the consolidated public sector stated in the Government Economic Program will be achieved. The remaining assumptions made in the previous meeting were maintained.

Simulation exercises with several specifications of the structural model led to the conclusion that the maintenance of the interest rate at the current level of 19.0% p.a. and of the exchange rate at the same plateau as of the eve of the Copom meeting would result in inflation above the upper limit of the target for 2001. For 2002, the projected inflation is around 4.0%.

Monetary Policy Guidelines

Positive expectations regarding the Brazil's economic performance in 2001 and 2002 contributed to the appreciation of the Real as well as to the reduction in Brazil's risk. The Real significantly appreciated since the last COPOM meeting, changing to R$ 2,50-2,55/US$ on the eve of the meeting. Brazil's risk premium as measured by the yield's differential between the Global 04 and the U.S. Treasury bond of equivalent duration also improved, as may be observed by the drop higher than 250 bps in the period. Therefore, the upward trend observed until mid-October reversed, which becomes more important when compared to the increased risk of emerging countries, specially that of Argentina. Particularly, the expectation of a reduction in the current account deficit and an improvement in the country's external financing, supported by the monetary and exchange policy adjustments, contributed to the appreciation of the Real as well as to the reduction of Brazil's risk.

This improvement was also followed by a significant reduction in the international prices of Brent crude oil to US$ 19/barrel from US$ 22/barrel since the last meeting. Besides the direct benefit of the drop of international crude oil prices on inflation, there is still an indirect benefit caused by the lower pressure on the exchange rate market, given the weight of this item in our imports.

The expectation regarding the economic growth also improved. There are signs of a smooth reversion of the cooling trend that followed the effects of the shocks that hit the economy, such as the deceleration of the world economy, the Argentine crisis, the September 11th attacks in the U.S. and the energy rationing, in addition to the effects of the more restrictive domestic monetary policy after March 2001. The reversion, yet incipient, can be observed in the increases in the retail commerce in São Paulo, in the number of requests to the Credit Protection Service (SPC) and in the Consumer Intentions Index, as well as in the stability observed in industrial activity.

A reduction in the slope of the term interest rate came along with a lower exchange rate pressure and a drop in Brazil's risk. The slope for 6 month-tenure fell to around 130 bps on the eve of the last Copom meeting from an average of 524 bps in the third quarter.

Despite the favorable performance of the economy, there was not a correspondent improvement in the prospects for inflation. The median expectations for the IPCA variation, considering the sample comprising the aggregate of the surveyed financial institutions collected daily by the Central Bank, showed an increase to 7.1% from 6.6% for 2001 and to 5.1% from 5.0% for 2002.

There are several factors which might have contributed to the worsening of the inflation forecasts. Firstly, the IPCA in October registered an increase higher than that expected, reflecting a higher passthrough of the exchange rate depreciation occurred during the year to prices. The increase in inflation in 2001 tends to feed the expected inflation for 2002 through its inertial component. Indeed, the indicators of the core inflation, calculated under the symmetric trimmed-mean average method, remains at a high plateau.

Secondly, the lower slope of the term structure of the interest rate also contributes to demand recovery, what could lead to larger pressure on the prices in 2002. This effect may attenuate the downward impacts of the recent appreciation of the Real upon the inflation in 2002.

Finally, the perspectives regarding the readjustment of the contractual prices next year remain high. Particularly, the increase in electricity prices may reach 30%. Besides, the reduction of the subsidies to the cooking gas prices is being considered, which implies in price increase. These increases mean an important supply shock for the economy in 2002. In general terms, the behavior of the contractual prices should directly contribute with 3.2% of the inflation in 2001 and, at least, with 1.8% in 2002 (even excluding the second-round effects of these increases on inflation).

In summary, the improvement in several Brazilian economic indicators was not accompanied by an improvement in inflation forecasts despite the favorable effects of the exchange rate appreciation and the drop in international oil prices. The hikes in contractual prices expected for 2002 represent a supply shock that adds to the secondary impact of the shocks occurred this year on the prices. This imposes narrow limits to the free prices inflation indicator next year. In this context, the incipient recovery of the demand, which might be stimulated by the lower slope of the interest rate curve and by an improvement in the expectations in general, must be monitored to avoid the passthrough of the shocks of 2001 for the inflation in 2002.

Accordingly, COPOM unanimously decided to maintain the target for the Selic rate at 19%.

At the close of the meeting, it was announced that the Committee would meet again on December 18th , at 3:00 p.m, for technical presentations and, on the following day, at 4:30 p.m., in order to discuss monetary policy guidelines, as set in Calendar of Copom's Ordinary Meetings, published in the Central Bank Communiqué n. 8018, of 11.22.2000.

Acronyms

ac 12m accumulated in 12 months
ACC Anticipated Exchange Rate Contracts
BM&F Mercantile and Futures Exchange
CDI Interbank Futures Contract
CETIP Center for Financial Custody and Settlement of Private Securities
CNI National Confederation of Industries
CPMF Provisory Contribution on Financial Transactions
CSLL Social Contribution on Net Profit
DI Interbank Deposit
FCESP Commerce Federation of the State of São Paulo
FED Federal Reserve System
FOMC Federal Open Market Committee
FRA Forward Rate Agreement
GDP Gross Domestic Product
IBGE Brazilian Institute of Geography and Statistics
IF Financial Institution
IGP-DI General Price Index – Domestic Supply
IIC Consumer Intentions Index
IPA Wholesale Price Index
IPC Consumer Price Index
IPCA Consumer Price Index – Extended
IPCH Consumer Price Index – Harmonized
IPP Producer Price Index

IR Income Tax
IRF-M Market Fixed Income Index
IRRF Withholding Income Tax
NAPM National Association of Purchasing Managers
NTN-D National Treasury Note – D Series
p.a. per annum
p.m. per month
PEA Active Working Population
pp percentage point
STN National Treasury Secretariat
ytd year-to-date

Economic policy measures

Measures related to the financial system and credit market

Resolution 2,889, dated 9.26.2001 – Altered the Long-Term Interest Rate (TJLP) for the final quarter of 2001 from 9.5% per year to 10% per year, taking account of the pro-rata inflation target for the next 12 months equivalent to 3.625% per year, plus the risk premium of 6.375% per year.

Resolution 2,891, dated 9.26.2001 – Altered the criterion for calculating Required Net Worth (PLE) for coverage of risks consequent upon the exposure of financial market operations. Banco Central was authorized to alter parameters when deemed necessary, as well as to announce the calculation methodology for determining the value of each one of the representative shares of the value of the PLE for coverage of interest market risk in a specific currency/ earnings base. The objective of this measure was to enhance Banco Central's agility in fostering new and occasional adjustments in the parameters used in calculating PLE. The institution was also authorized to ascribe risk factors to the accounting headings used in Cosif and to alter the exposure limit in gold and in assets and liabilities referenced to exchange rate changes, as dealt with in article 1 of Resolution 2,606, dated 5.27.1999.

Circular 3,063, dated 9.26.2001 - Raised the minimum percentage of the compulsory reserves on demand resources from 60% to 80%. Such reserves are to be held in cash by the banks creating the currency. These resources will be registered in the Cash account when they are maintained in manual currency or in the banking reserve account when in accounting currency.

Resolution 2,892, dated 9.27.2001 – This instrument altered the procedures followed in the contracting of operations and rendering of services to clients. The overall purpose was to improve the regulatory structure between financial institutions and the public in general. The most important of these measures were as follows:

a) determines that clients are to receive copies of contracts and that the financial institution is to make such copies available to clients at the office in which the operation is formalized or by electronic means;
b) financial institutions are to make information available to clients in their offices and in those in which their products are negotiated in such a way as to ensure that the clients will be fully informed as to the situations in which the institution may refuse to receive documents or effect payments, as well as the information specified in Resolution 2,303, dated 6.25.1996;
c) restricted the scope of the forecast of anticipated payments with proportional reduction of interest to personal credit operations and direct consumer credit operations;
d) the reverse entries required to correct undue entries consequent upon operational errors made by financial institutions should be notified within a period of two days and not immediately in order to avoid potential problems of interpretation;
e) financial institutions must require that their clients and users clearly and objectively confirm their acceptance of the product or service offered or made available to clients and such institutions are not permitted to assume that the silence of their clients and users is to be interpreted as a sign of agreement;
f) instituted the Financial and Buyer Group Services Client and User Manual, consolidating Banco Central norms on the contracting of operations and rendering of services to clients and the public in general.

Circular 3,065, 10.10.2001 – Introduced more flexible banking hour schedules for bank offices located in states that did not institute daylight savings time, permitting them to anticipate the start and finish of their activities by one hour. A one hour delay in the start and/or finish of operations at bank branches was also authorized in those localities in which the service provided to the public lasts for less than six hours, provided that the minimum period of five daily hours of uninterrupted services be respected.

Resolution 2,893, dated 10.17.2001 – Defined the general conditions for sale of stocks belonging to the federal government and issued by the Banco do Estado de Goiás S.A. (BEG). The most important of these conditions are as follows:

a) approval of the minimum economic value for the totality of the shares issued by BEG and, consequently, that of the shares belonging to the federal government;
b) defined the minimum value of the federal government shares to be sold in auction, corresponding to approximately 84.46% of the capital stock held by the federal government;
c) obligated the future controller of BEG to carry out what is known as a tag along operation or, in other words, to make a public offer for purchase of the shares belonging to minority stockholders at a minimum price of 80% of the price obtained in the auction;
d) determined that, should BEG be in any manner partially or totally released from the potential liabilities existent in the BEG Pension Fund, the future controller will be obligated to pay to the federal government an amount additional to the price of the shares obtained in auction, to be classified as compensation;
e) approved the stock offer to BEG employees and retirees in the manner defined in the Sale Notice. The volume of these shares corresponds to 10% of the capital stock held by the federal government, with a discount of 50% of the economic value stated in line "a". Each employee or retiree will be entitled to acquire the same number of shares under equal conditions, independently of the position occupied by that person and the time in which the person was in the employ of the institution.

Circular 3,066, dated 10.18.2001 – With the objective of enhancing the liquidity conditions of credits securitized by the National Treasury and of the Certificates of Bank Credit Bills (CCCB) and adjusting demand for securitized credits to the strategy of lengthening the public debt maturity profile, this instrument permitted committed operations with these papers.

Resolution 2,901, dated 10.31.2001 – The criteria for application of penalties, consequent upon the failure to supply, delay in supplying or rectification of information due to Banco Central by financial institutions, as well as upon noncompliance with the terms and procedures for exchange operations and international transfers in reals were redefined and standardized in order to create a system of common rules that would guaranty equal treatment to financial institutions. Procedures were defined for analyzing the defense and requests for reconsideration submitted by institutions and for the review of penalties in order to ensure that such institutions will have full rights to defense.

Circular 3,067, dated 11.1.2001 – Sets the procedures for examining pleas as well as requests for reconsidering and reviewing the application of penalties, with the purpose of assuring the right of the adversary system.

Circular 3,068, dated 11.8.2001 – Defined new criteria for accounting recording and evaluation of securities acquired by financial institutions, with the exception of credit cooperatives, development agencies and micro-entrepreneur credit companies. These papers are to be recorded at the value effectively paid, including brokerage fees and other payments, so as to make it possible to adequately measure the portfolio of these institutions in a manner compatible with international standards. The following periodic classification and evaluation criteria are to be observed:

a) securities for trading: when they are acquired for the purpose of being actively and frequently traded. They are to be adjusted to market value, at least at the time of balance sheets and statements, and the valuation or devaluation of the same is to be calculated as a counterpart entry;
b) securities maintained until maturity: with the exception of redeemable stocks, when the financial institution has the intention and capacity to maintain them, understood as the availability of third party resources, except subordinated debts and hybrid capital instrument and eligible debts referenced to the same currency and with maturities equal to or greater than those of the corresponding securities. They are to be evaluated at acquisition cost, plus earning, which are to impact the result of the period;

c) securities available for sale: when not classified in the categories above. These are to be evaluated periodically according to the system specified in line “a”.

Resolution 2,902, dated 11.21.2001 – Authorized renegotiation of the lengthened rural sector debt, in the framework of Provisional Measure 9, dated 10.31.2001, dealing with the extension of the maturity of the share of the debt securitized by the National Treasury from October to November, with minimum payment of 32.5% of the value of the share matured on October 31, 2001.

Resolution 2,907, dated 11.29.2001 – Constitution and operation of credit rights investment funds and funds for application in credit rights investment funds, according to the terms of regulations to be issued by the Securities and Exchange Commission (CVM), were duly authorized with the objective of creating improved conditions for managing the liquidity of financial institution credit rights. The managing institution of the fund is to provide information to the Credit Risk Center on the credits acquired without co-liability or any other form of risk retention on the part of the assignor institution.

Resolution 2,908, dated 11.29.2001 – Defined the general conditions for selling stock issued by the Banco do Estado do Amazonas S.A. (BEA) and belonging to the federal government. The most important of these are as follows:

a) definition of the minimum economic value for the totality of the BEA issued stock and of the shares belonging to the federal government at R$195.400.000,00 and R$192.540.600,00, respectively;
b) approval of the stock offer to BEA and BEA Pension Fund employees and retirees (Cabea) in the manner defined in the sale notice, representing 10% of the capital stock held by the federal government, at a discount of 50% of the economic value specified in the previous item;
c) definition of the minimum value of the federal government’s shares to be sold in auction, corresponding to 88.68% of the capital stock held by the federal government;
d) obligation of the future BEA controller to hold a public offer for purchase of the shares of minority stockholders (common and preferred) for at least 80% of the price obtained in the auction;

e) extension of the obligation stated in the previous item to the privatization processes involving the Banco do Estado do Ceará S.A. (BEC), Banco do Estado do Maranhão S.A. (BEM), Banco do Estado do Piauí S.A. (BEP) and Banco do Estado de Santa Catarina S.A. (BESC).

Fiscal policy measures

Provisional Measure 2,222, dated 9.4.2001 – Determined that, as of January 1, 2002, earnings and gains on investments of provisions, technical reserves and funds belonging to open complementary social security entities and insurance companies that operate benefit plans classified within the same grouping will be subject to the income tax, according to the tax norms applicable to individuals and nonfinancial legal entities. According to the legislation in effect up to that time, only the Individual Programmed Retirement Funds (FAPI) and closed social security entities (EFPP) were subject to tax on their portfolio earnings. With adoption of the aforementioned measure, the Free Benefit Generation Plans (PGBL) and open private social security entities (EAPP) were included under this rule.

The Provisional Measure defined two taxation options:

a) the special taxation system (RET) at the rate of 12% on the quarterly inflow of the resources channeled to the fund by employers. This rate is the result of the difference between the sum total of the rates of the Income Tax on Legal Entities (IRPJ) and the Social Contribution on Net Profits (CSLL), including the additional levies, and 80% of the maximum rate of the progressive Individual Income Tax (IRPF). Currently, closed entities and insurance companies that sell Fapi pay tax equivalent to 34% (25% income tax plus 9% CSLL); the special system will permit them to defer the 22% related to 80% of the maximum IRPF rate (27.5%), levied at the time of redemption;
b) those entities that do not opt for the RET system will pay a rate of 20% on the earnings of operations in their fixed and variable income investments in each calendar quarter.

Social security plans that do not have the participation of employers or, in other words, those constituted exclusively of the resources of individuals or individuals and immune legal entities are exempt from payment of the tax. Redemptions will remain subject to the withholding tax at the progressive rates of the IRPF.

Law 10,303, dated 10.31.2001 – Altered and added provisions to Law 6,404, dated 12.15.1976 – Corporate Law – with the objective of strengthening the stock market and protecting minority stockholders. These changes created the conditions required for the Securities and Exchange Commission to be transformed into the sector's regulatory and oversight agency. The major alterations were as follows:

a) in the case of sale of a controlling interest in a specific enterprise, the Law ensures that the price effectively paid to minority stockholders will be equivalent to 80% of that negotiated by the majority stockholders, through a public stock offer;
b) extends the right of electing a member to the board of administration of the company to the preferred stockholders who hold at least 10% of the company's capital stock;
c) allows minority stockholders with common and preferred shares to choose one of the three members of the company's fiscal council;
d) permits the trading of preferred shares on the stock market, when such shares have at least one of the following characteristics:
   - right to participate in dividends representing a total of at least 25% of the net income of the fiscal year;
   - payment of dividends per preferred share that are at least 10% greater than those attributed to common stock;
   - right to be included in public offers involving the sale of company stock control, receiving 80% of the price paid for the shares included in the controlling block of shares and the dividend should be at least equal to that of the common stock;
e) grants the Securities and Exchange Commission, the semi-autonomous agency classified within a special system, independent administrative authority, without hierarchical subordination, with its own budget so as to ensure financial autonomy, fixed terms in office and stability for its directors; and
f) defines new crimes against the capital market, as follows: crime of market manipulation, undue use of insider information and irregular exercise of a position, profession, activity or function.

Law 10,305, dated 11.7.2001 – Defined norms for registering net negative results consequent upon adjustment in the value of liabilities and credits expressed in real, when such adjustment is made as a result of exchange rate alterations in the course of calendar year 2001. The law permitted legal entities to register the net negative result in the account of the deferred asset, and the value of the entry is to be amortized at a rate of at least 25% per calendar year as of 2001.

The legal entity that adopts this procedure should exclude from net income the difference between the value of the outlay registered under deferred assets and amortized in the same period for purposes of determining real income and from the calculation base of the social contribution on net profits for calendar year 2001. The value amortized in the periods of calculation subsequent to that of the exclusion will be added to net profit.

Law 10,306, dated 11.8.2001 – Added paragraph VI to article 3 of Law 9,311, dated 10.24.1996, which deal with the charging of the provisional contribution on financial transactions (CPMF). With insertion of the stated paragraph, the CPMF is no longer levied on debit entries in the current deposit accounts, when the holders of such accounts are:

a) diplomatic missions;
b) official consular offices;
c) representative offices of international and regional organizations of a permanent nature in which Brazil holds membership;
d) foreign employees of diplomatic missions or consular offices;
e) international organizations entitled to tax privileges or exemptions as a result of agreements formalized with Brazil.

Law 10,312, dated 11.27.2001 – Reduced the rates of contribution to the Social Integration Program and Civil Service Asset Formation Program (PIS/Pasep) and to the Social Security Financing Program (Cofins), levied on the gross revenues generated by the sale of piped natural gas to be used in production of electricity by plants covered by the Thermoelectric Program, to zero according to the terms and conditions defined in a joint active of the State Ministers of Mines and Energy and Finance. The rates of these contributions are reduced to zero on gross revenues generated by the sale of mineral coal to be used in generating electricity. These measures will only produce their due effects for generating facts that occur as of 3.1.2002.

Constitutional Amendment 33, dated 12.11.2001 – Determines that the contribution on intervention in the economic domain may be levied on imports of goods and services from abroad, including electric power, telecommunications services, petroleum derivatives, fuels, even when the receiving party is a natural person. In this case, according to the terms of the law, the natural person may be considered equivalent to the legal entity.

The law determining the contribution on intervention in the economic domain related to activities of import and trade of petroleum and derivatives, natural gas and derivatives and fuel alcohol should comply with the following:

a) the contribution rate may be differentiated by product or use, reduced or reestablished by Executive Branch act;
b) the resources collected will be channeled to the payment of subsidies to prices or transportation of fuel alcohol, natural gas and derivatives and petroleum derivatives; financing environment projects related to the petroleum and gas industries and financing of transportation infrastructure programs.

Measures related to the foreign sector

Camex Resolution 32, dated 8.29.2001 (Ex-tariff) – Alters the ad valorem Import Tax rate to 4% for a period of two years on Capital Goods, Informatics and Telecommunications Goods and components of Integrated Systems.

Law 10,274, dated 9.10.2001 – Authorizes creation of a compensation mechanism with the objective of making it feasible to maintain natural gas prices at a constant level, and takes other measures. The acts practiced on the basis of Provisional Measure 2,149-2, dated 7.27.2001, were expressly validated.

Law 10,276, dated 9.10.2001 – Deals with the refunding of contributions to the Social Integration Program and the Civil Service Asset Formation Program (PIS/Pasep) and to the Social Security Financing Program (Cofins) levied on inputs used in the manufacture of products for the export market. The acts practiced on the basis of Provisional Measure 2,202-1, dated 7.26.2001, were expressly validated.

MAPA/MDIC Interministerial Directive 485, dated 9.19.2001 – Alters MAA/MDIC Interministerial Directive 197/00, which instituted the retention system for exports of raw coffee beans, with shipment negotiated as of June 2000. The retention is to be corroborated on the basis of the volume of coffee held by MAPA, the Certificates of Retention or statements of Producer Agreement and the volume of coffee covered by financing guaranties with resources drawn from the Coffee Economy Defense Fund (Funcafé).

Decree 3,937, dated 9.25.2001 – Regulates Law 6,704, dated 10.26.1979, which deals with Export Credit Insurance and takes other measures. Decrees 2,369, dated 11.10.1997, and 2,877, dated 11.15.1998, are hereby revoked.

Decree 3,981, dated 10.24.2001 – Deals with the Foreign Trade Board (Camex), which is subordinated to the Council of Government, and takes other measures.

Camex Resolution 34, dated 10.30.2001 – Approves the Price Commitment for imports of coated double and triple semi-rigid cardboard for packaging in densities equal to or greater than 200 g/m^2 originating in Chile, with the consequent suspension of the antidumping investigation.

Camex Resolution 36, dated 10.30.2001 (Ex-tariff) – Alters the ad valorem rates of the Import tax to 4% on Capital Goods and Informatics and Telecommunications Goods and components of specified Integrated System, effective as of the entry into force of this Resolution and scheduled to remain in effect for two years. This tariff treatment applies exclusively to import operations involving the totality of the components specified in each system and to be utilized jointly in the productive activity of the importer.

Decree 4,015, dated 11.13.2001 – Deals with implementation of the Third Additional Protocol to Economic Complementation Agreement 39 between Brazil and the Andean Community member countries, namely Colombia, Ecuador, Peru and Venezuela.

Camex Resolution 38, dated 11.28.2001 – Terminates the review investigation of the definitive antidumping rights applied to imports of padlocks, except those for use on bicycles, classified under item 8301.10.00 of the Common Mercosul Nomenclature, when such goods originate in the Peoples Republic of China, setting the ad valorem rate at 60.3%.

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

Arminio 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

Non-voting members

Altamir Lopes
Head of the Department of Economics (Depec)

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

Gustavo Alberto Bussinger
Head of the Research Department (Depep)

José Antonio Marciano
Head of the Department of Banking Operations and Payments System (Deban)

Sérgio Goldenstein
Head of the Department of Open Market Operations (Demab)

Acronyms

p.a.	per annum
p.m.	per month
ac.12m.	accumulated in 12 months
ac.a.	in accumulated terms for the year
Abimaq	Brazilian Association of Machinery and Equipment Industry
ACC	Antecipated Exchange Rate Contracts
ACSP	São Paulo Trade Association
Anfavea	National Association of Automotive Vehicle Manufacturers
BAI	Business Activity Index
ECB	European Central Bank
BM&F	Commodities & Futures Exchange
BNDES	National Bank of Economic and Social Development
BNDESpar	BNDES Participações S. A.
BoJ	Bank of Japan
Caged	General File of the Employed and Unemployed
CBO	Congressional Budget Office
CDB	Bank Deposit Certificates
CDI	Interbank Futures Contract
Cetes	Treasury Certificates
Cetip	Center for Financial Custody and Settlement of Private Securities
CMN	National Monetary Council
CNI	National Confederation of Industry
Cofins	Contribution to Social Security Financing
CPI	Consumer Price Index
CPMF	Provisional Contribution on Financial Transactions
CSLL	Social Contribution on Net Profit
ULC	Unit Labor Cost
CVM	Securities and Exchange Commission
Depec	Department of Economics
DI	Interbank Deposit

DLSP	Net public sector debt
EMI	Monthly Industrial Estimator
FCESP	Trade Federation of the State of São Paulo
Fed	Federal Reserve System
Fenabrave	National Federation of Automotive Vehicle Distribution
FGTS	Employment Guaranty Fund
FGV	Getulio Vargas Foundation
Fiesp	Federation of Industries of the State of São Paulo
FIF	Financial Investment Fund
Finame	Special Industrial Financing Agency
IMF	International Monetary Fund
FOMC	Federal Open Market Committee
FRA	Forward Rate Agreement
GCI	Investor Relations Group
GDDS	General Data Dissemination System
IBGE	Brazilian Institute of Geography and Statistics
Ibovespa	Quotation Index of the São Paulo Stock Exchange
IF	Financial Iinstitution
IFO	Institute for Economic Research
IGP-DI	General Price Index-Domestic Supply
IGP-M	General Price Index-Market
IIC	Consumer Intentions Index
Imacec	Monthly Economic Activity Indicator
Indec	Instituto Nacional de Estadísticas y Censos
INE	*Instituto Nacional de Estadísticas*
Inegi	*Instituto Nacional de Estadística, Geografia e Informática*
INPC	National Consumer Price Index
Inséé	*Institut National de la Statistique e des Études Économiques*
INSS	National Social Security Institute
WPI	Wholesale Price Index
IPA-DI	Wholesale Price Index - Internal Supply
IPA-OG-PI	Wholesale Price Index - Overall Supply - Industrial Products
CPI	Consumer Price Index
IPCA	Broad Consumer Price Index
IPC-Fipe	Consumer Price Index - Institute of Economic Research Foundation
IPCH	Harmonized Consumer Price Index
Ipim	*Índice de Precios Internos al por Mayor*
IPP	Price Index of the Final Goods Producer
IR	Income Tax

IRF-M	Market Fixed Income Index
IRRF	Withholding Income Tax
Isac	Synthetic Index of Construction Activity
Isae	*Istituto di Studi e Analisi Economica*
Lecops	Provincial Liabilities Cancellation Bill
LFT	National Treasury Financing Bills
LSPA	Systematic Farm Production Survey
LTN	National Treasury Bill
Mercosul	Southern Common Market
MTE	Ministry of Labor and Employment
Nafta	North American Free Trade Agreement
NAPM	National Association of Purchasing Managers
NFSP	Public Sector Borrowing Requirements
NTN-C	National Treasury Note - Series C
NTN-D	National Treasury Note - Series D
WTO	World Trade Organization
Opec	Organization of Petroleum Exporting Countries
PAF	Financial Assistance Program
Pasep	Program of Asset Formation of Public Employees
PEA	Working Population
GDP	Gross Domestic Product
PIS	Social Integration Plan
PMI	Purchasing Managers Index
b.p.	Basis point
p.p.	Percentage point
PPI	Price Index of the Final Goods Producer
STN	National Treasury Secretariat
TJLP	Long-Term Interest Rate
EU	European Union