Inflation Report

ISSN 1517-7289
CGC 00.038.166/0001-05

Inflation Report	Brasília	v. 4	no. 1	Mar	2002	P. 1 - 168

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°ss
Caixa Postal 8.670
70074-900 Brasília (DF) – Brazil
Phone: (5561) 414-3165
Fax: (5561) 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	(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; Prices; Credit, monetary and fiscal policies; International economy; Foreign sector; and Prospects for inflation. With regard to the activity level, growth in retail sales, inventories, output, labor market and investments are investigated. 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. 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. Finally, prospects on inflation growth are analyzed.

Executive Summary

The evolution of economic activity indicates the maintenance of economic growth, although in a moderate pace. The industrial production has been recovering since November, supported by the increase in business and consumer confidence and by the end of the restrictive effects of the energy crisis on industrial production. Investment has been growing at a positive, but declining rate, while consumption has been increasing slowly, motivated by the improvement in expectations as well as by the reduction in interest rates.

However, the reduction in workers' real total compensation and the credit sluggishness are factors that can restrain economic growth. On the other hand, they can allow an economic recovery without demand pressures on inflation.

According to the baseline scenario, GDP should grow by 2.5% in 2002.

The Brazilian trade balance keeps showing superavits, reflecting a more intense fall in imports. The world's economic contraction and the economic troubles faced by Argentina have been having a negative impact on Brazilian exports. However, indicators suggest a stronger world recovery and a market diversification for Brazilian products that will contribute to minimize the reduction of exports to some trade partners. The maintenance of exchange rate in the present level and the world economic recovery will contribute to a better performance of the external sector. Foreign capital flows have been enough to finance external payments, resulting in low exchange rate volatility.

From the assumptions of the baseline scenario, inflation path was projected through 2003. Inflation should decrease monotonically, reaching 4.4% in 2002 and 2.8% in 2003. In the previous *Report*, the projections for 2002 and 2003 were 3.7% and 2.5%, respectively. The factors contributing for such revision were new forecasts for monitored and administered by contracts prices – administered prices, for short – and a flatter slope of the interest rate term structure.

For the group of administered prices, whose weight is 30.5% in the February IPCA, it is forecasted a 6.8% inflation for 2002 and 4.5% for 2003. Those figures represent increases of 1.3 p.p. and 1.4 p.p., respectively, compared to the last *Report*. For 2002, the factors contributing for the revision are a lower decrease in the gasoline and diesel prices and a higher increase in cooking gas price. For 2003, the upward revision for administered prices was basically due to the increase in the proportion of prices whose forecasted adjustments are based on specific assumptions. For market prices, which represent about 70% of the IPCA, it is forecasted a 3.4% growth in 2002 and 2.1% in 2003. Therefore, it is forecasted a reduced inflation for market prices as a function of the following factors: i) the exchange rate has appreciated since the last quarter of 2001 and remains stable; ii) energy rationing has finished; iii) the labor market and the existence of idle capacity do not exert pressure on prices; iv) the effects of inflation inertia of 2001 tend to fade away; and v) the expectation of a good harvest in 2002 has a downward influence in food prices.

Considering both the interest rate and exchange rate paths projected by the market, according to a survey carried out by the Central Bank's Investor Relation Group, the forecasted inflation is 5.3% at the end of 2002 and 4.1% at the end of 2003.

1 – Activity level

In 2002, most economic activity indicators have clearly pointed to a process of recovery, consistent with the results of the final months of 2001. Among the factors that have contributed to this turnaround, mention should be made of increased consumer confidence, the relatively positive performance of the labor market, diminishing negative impacts generated by the ongoing Argentine crisis and the end of electricity rationing measures.

1.1 – Retail sales

Retail sector sales declined in 2001 when compared to the previous year. According to analysts, this performance was caused by the highly adverse conditions that marked the end of the third quarter of the year. However, it is important to note that the final weeks of the year pointed to a possible upturn in the pace of activity. Between May and October, consumer expectations deteriorated, interest rates remained high and real income declined.

Sales volume index in the retail sector - Brazil

% accumulated in the year

Itemization	2001			2002
	Oct	Nov	Dec	Jan
Retail sector	-1.1	-1.1	-1.3	-1.2
Fuel and lubricants	-3.5	-3.0	-2.7	4.6
Supermarkets	1.4	1.3	1.0	-1.2
Textiles, clothing	1.8	1.7	1.6	-0.4
Furniture and white goods	-0.2	-0.9	-1.4	1.0
Other domestic goods	-6.3	-6.4	-6.4	-5.7
Vehicles, motorcycles	-0.5	-2.0	-3.5	-20.1

Source: IBGE

The Monthly Trade Survey (PMC), calculated by the Brazilian Institute of Geography and Statistics (IBGE) in all the states of the Union, also registered downward movement in 2001 corresponding to a drop of 1.3% compared to 2000. For the most part, this was caused by negative performances in the segments of automotive vehicles, home and personal items, fuels and lubricants and furniture and home appliances. On the other hand, positive results were registered under sales in the segments of supermarkets, food products, beverages and tobacco, as well as fabrics, apparel and footwear, all of which are items classified under nondurable and semidurable consumer goods.

Data for January 2002 pointed to a drop of 1.2% in retail sales, compared to the same month of the preceding year. Among the factors that had a positive impact on this result, mention should be made of fuels and lubricants and furniture and home appliances, while all the other segments turned in declines. Therefore, available data point to a trend toward upward movement in demand for home appliances once electricity rationing measures were eliminated.

Real sales of the retail sector in São Paulo

Percentage change

Itemization	2001			2002	
	Oct	Nov	Dec	Jan	Feb*
In the month 1/					
General	1.3	1.5	-1.5	1.4	-1.5
Consumer goods	0.4	3.3	-2.3	4.2	-4.1
Durable	2.0	4.2	-1.2	3.3	-3.3
Semidurable	-4.4	-2.1	4.6	-0.9	-3.4
Nondurable	-1.4	2.6	0.0	0.2	0.3
Automotive trade	8.0	-2.9	0.0	-7.5	1.9
Vehicle concessionaries	11.1	-4.2	1.2	-10.6	1.4
Autoparts and accessories	2.0	-1.6	-8.2	7.3	3.6
Building materials	-0.2	-2.1	-9.0	4.7	-12.2
In the year					
General	-4.7	-4.9	-5.5	-5.5	-8.2
Consumer goods	-3.7	-3.8	-4.4	-2.6	-5.6
Durable	-5.5	-5.8	-7.0	-5.3	-7.3
Semidurable	-20.8	-21.5	-21.5	-20.9	-23.2
Nondurable	1.3	1.2	0.9	-0.3	-0.7
Automotive trade	-16.1	-16.5	-16.3	-19.5	-20.0
Vehicle concessionaries	-18.9	-19.3	-19.0	-23.3	-24.8
Autoparts and accessories	-1.3	-2.0	-2.7	-1.5	4.4
Building materials	3.3	2.0	-1.3	-24.0	-30.1

Source: Fecomercio SP

1/ Seasonally adjusted data.
* Preliminary.

According to the Trade Federation of the State of São Paulo (Fecomercio SP), retail trade sales in the Metropolitan Region of São Paulo (RMSP) fell by 5.5% in 2001, mainly as a result of accentuated falloffs under sales of automotive vehicles and consumer durables. It is important to note that these two segments are particularly sensitive to increases in interest rates and electricity rationing. However, one must also recognize that, despite the negative annual result, real revenues of the retail trade sector leveled off as of the month of August, following an accentuated drop in July. From that point forward, the sector turned in four consecutive months of positive growth.

Following a new reduction in December, the January 2002 result turned upward once again, as evident in monthly expansion of 1.4% in real sales, based on data from which seasonal factors have been eliminated. However, preliminary data for the month of February point to a reduction of 1.5%, explained by decreases in the real revenues of consumer goods and building materials. Both of these sectors had registered positive growth in January. On the other hand, the automotive sector expanded as a result of growth in real sales of auto parts and accessories (3.6%) and sales through vehicle concession companies (1.4%).

In comparison to the first two months of 2001, real revenues of the retail sector declined by 8.2%. Utilizing the same basis of comparison, emphasis should be given to sharp declines in real sales of building materials, automotive vehicles, despite growth of 5.2% in revenues on auto parts and accessories, and semidurable consumer goods. It should be noted that the decline registered by consumer goods in general was impacted by negative results under consumer durables. Real sales of nondurable consumer goods turned in a less accentuated drop in the two month period.

Average interest rates effective in the retail sector

% p.m.

Itemization	2000	2001				2002	
	Dec	Sep	Oct	Nov	Dec	Jan	Feb
Average interest rates	6.85	6.85	6.79	6.74	6.72	6.70	6.66
By segment							
Large stores	5.83	5.89	5.78	5.72	5.70	5.67	5.64
Medium stores	7.16	7.09	7.03	6.99	6.94	6.91	6.88
Small stores	7.85	7.71	7.66	7.60	7.57	7.54	7.52

Source: Anefac

According to the National Association of Finance, Management and Accounting Executives (Anefac), the average rate of interest practiced in the trade sector moved gradually downward since September 2001 and closed the month of December at 6.72% per month, compared to 6.85% in December of the previous year. In the first two months of 2002, the rate charged in the retail trade sector remained on a downward curve closing January at 6.7% per month and February at 6.6% per month.

Despite recent downward movement, the rate of interest is still considered high, to some extent reflecting the level of payment defaults. Though the number of commitments in arrears in recent months cannot be classified as having reached a new peak for the series, there has been a clear upward trend in total defaults.

Default rates

Rate

Itemization	2000	2001				2002	
	Average	Oct	Nov	Dec	Average	Jan	Feb
SPC (SP)[1/]	5.7	6.2	7.9	2.3	7.4	5.4	8.2
Returned cheques[2/]	3.6	5.1	5.2	4.8	4.9	5.5	5.2
Teledata (RJ)[3/]	1.9	2.8	2.2	1.4	2.0	3.4	3.1
Teledata (National)[4/]	2.3	2.6	2.4	1.7	2.5	3.4	3.1

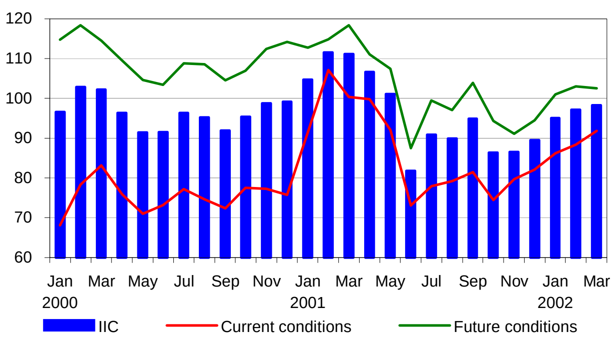
Source: ACSP, Bacen and Teledata

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.

Consequently, the net default rate in the retail trade sector, measured by the Credit Protection Service (SPC) which operates under the auspices of the São Paulo Trade Association (ACSP), came to a level of 7.4%, in terms of the average for 2001, compared to 5.7% in 2000. Despite the relatively higher level registered during the course of the year, defaults dropped sharply in December, moving from 7.9% in November to just 2.3%. In January and February, the default level moved upward once again, reaching respective marks of 5.4% and 8.2%. This behavior is, to some extent, explained by seasonal factors in the period. Nevertheless, it should be stressed that, though following an upward curve, these rates were still below those of the corresponding months of 2001, when they closed at respective levels of 9.3% and 9.8%. The indicator released by Teledata also registered a sharp decline in December, before increasing once again in the first two months of 2001. What is important to note is that this indicator then moved to levels that surpassed those of the same periods of 2001, which had registered 2.1% in January and 2.2% in February.

Financial sector defaults, measured by the ratio of checks returned due to insufficient backing to total checks cleared, followed an increasingly upward trajectory in 2001. In terms of the year's average, this ratio closed at 4.9% as against 3.6% in 2000. After hitting a mark of 4.8% in 2001, the indicator moved upward once again, climbing to 5.5% and 5.2% in January and February 2002, respectively.

Consumer Intention Index (IIC)

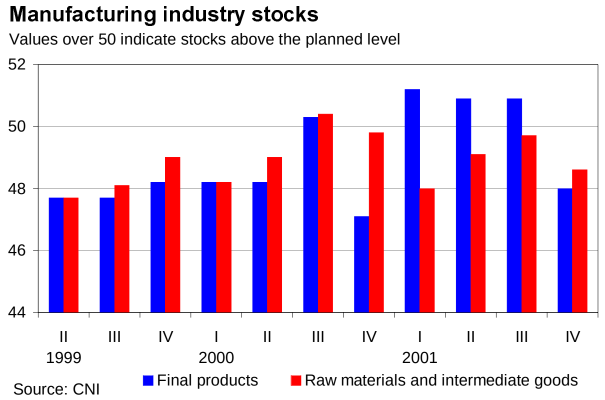


Source: Fecomercio SP

The Consumer Intention Index (IIC), which is released by the Fecomercio SP, started to recover as of November 2001. This movement was detected both in relation to future intentions, which account for 60% of the index, and current intentions. In the first two months of 2002, the favorable growth of this indicator reflected adjustment of expectations to internal and external restrictions. The two major factors here were the leveling off of the pace of the American economy and the perception on the part of foreign investors that one must clearly differentiate between risk in Brazil and risk in Argentina. On the other hand, concerns with regard to unemployment and inflation, both of which showed some degree of deterioration in the early months of the year, acted as a damper on this index, principally as regards future expectations.

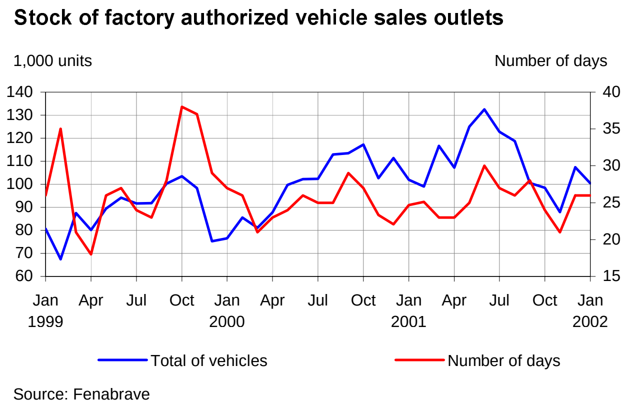
In the month of March, the IIC came to 98.25, for growth of 1.14% compared to February. It should be stressed that a result below the one hundred mark is considered a sign that consumers have shifted into a cautious mode. The result of the month was based on growth of 3.9% in the Current Intentions Index (IIA), which came to 91.81, and a drop of 0.44% in the Future Intentions Index (IIF), which closed at 102.54.

1.2 – Inventories



In the final quarter of 2001 and early months of 2002, inventory indicators pointed to across-the-board reductions following the high levels accumulated in the second and third quarters of 2001. Thus, the Manufacturing Industry Survey which is calculated quarterly by the Getulio Vargas Foundation (FGV) perceived a slow reduction in inventory levels at the end of 2001, at a pace that was considered compatible with the upturn in industrial output.

In the same sense, the Industrial Survey of the National Confederation of Industry (CNI) for the final quarter of the year identified a drop in stock levels of final products and raw materials and intermediate goods. On a sector-by-sector basis, the CNI Survey noted that stocks were higher than desired in the timber industry and paper and cardboard segment. On the other hand, pharmaceutical and chemical industries held inventories considered below the desirable level.



According to data released by the National Federation of Automotive Distribution (Fenabrave), the total stock of vehicles held by the network of factory authorized sales outlets registered a downward trajectory over the course of the second half of 2001, despite the December positive spurt. In January, the indicator slid downward once again both in relation to December and when compared to the same month of the previous year. In percentage terms, these reductions came to 6.5% and 1.5%. The number of days required for inventory turnover came to 26 in the two month period, compared to 25 in January 2001.

Over the short-term, the downward trajectory registered by inventory levels in the diverse sectors of the economy points to probable positive growth in industrial output, precisely for the purpose of replenishing stocks.

1.3 – Output and GDP

1.3.1 – Industrial output

Over the course of 2001, the level of industrial activity registered fluctuations that reflected the repercussions of the energy crisis and adverse external scenario, the two factors that were responsible for the major share of the falloff in the performance of the sector. Thus, following growth of 6.5% in 2000, industrial output expanded by 1.4% in 2001, based on growth of 1.2% in the manufacturing sector and 3.5% in the mining industry. The latter figure was adversely affected by the accident that occurred at the P-36 petroleum production platform in the month of March and by the October oil workers strike.

Of the twenty segments analyzed by the IBGE survey, seven registered positive output growth in 2001. The highest rates were registered by electric and communications equipment (6.7%), mechanics and transportation equipment, both with growth of 5.3%, and food products with 5.1%. The final figure benefited from exports of crystal sugar and slaughtered poultry. Among the thirteen segments that registered production below the level in 2000, the most accentuated falloffs occurred under leathers and hides (9.4%), apparel, footwear and cloth goods (6.5%) and textiles (5.7%).

A breakdown by categories of usage shows that output of capital goods turned in the highest growth level, with expansion in all the major groupings, indicating a generalized rise in productive capacity.

Output of intermediate goods turned in a reduction of 0.3% in the year, following expansion of 6.9% in 2000, while consumer goods closed with growth of 1.2%. In this category, growth in the production of

Industrial production

Percentage change

Itemization	2000	2001			2002
	Dec	Oct	Nov	Dec	Jan
Industry (total)					
In the month[1/]		- 1.9	1.4	1.0	1.3
Same month of the previous year		- 3.2	- 1.8	- 6.7	- 1.3
Accumulated in the year		2.5	2.1	1.4	- 1.3
Accumulated in 12 months		3.2	2.5	1.4	0.5
Manufacturing industry					
In the month[1/]		- 1.1	1.2	0.2	2.0
Same month of the previous year		- 2.4	- 1.7	- 7.4	- 2.4
Accumulated in the year		2.3	1.9	1.2	- 2.4
Accumulated in 12 months		2.7	2.2	1.2	0.1
Mineral extraction					
In the month[1/]		- 7.8	8.3	1.1	5.7
Same month of the previous year		- 9.9	- 2.4	- 1.2	7.1
Accumulated in the year		4.7	4.0	3.5	7.1
Accumulated in 12 months		6.9	5.2	3.5	3.1

Source: IBGE

Industrial production by segment[1/]

Percentage change

Itemization	2001			2002	
	Nov	Dec	In the year	Jan	In the year
Industrial production	1.4	1.0	1.4	1.3	- 1.3
Mineral extraction	8.3	1.1	3.5	5.7	7.1
Manufacturing industry	1.2	0.2	1.2	2.0	- 2.4
Nonmetallic minerals	- 0.3	0.8	- 2.1	- 1.0	- 6.1
Metallurgy	- 1.9	0.7	0.8	2.9	- 1.3
Mechanics	0.0	- 2.1	5.3	2.6	- 2.4
Electric and comm. equip.	5.1	- 5.7	6.7	9.7	- 2.7
Transportation equipment	4.7	7.6	5.3	- 1.6	2.2
Wood	- 0.7	- 2.1	- 0.3	1.7	- 4.8
Furniture	- 0.5	- 2.9	- 1.1	2.6	1.0
Paper and cardboard	0.6	- 1.1	0.1	2.6	1.4
Rubber	- 8.5	- 17.2	- 4.5	25.2	- 8.0
Leather and hides	- 0.1	- 2.4	- 9.4	0.1	- 9.4
Chemicals	1.7	0.4	- 0.7	6.4	- 1.2
Pharmaceuticals	8.8	18.8	- 2.1	- 9.4	14.5
Perfumes, soaps, candles	- 4.8	- 13.4	- 1.8	9.8	- 12.5
Plastics	2.0	- 1.5	- 5.0	2.2	- 5.2
Textiles	- 1.5	2.1	- 5.7	1.2	- 3.5
Clothing, footwear, cloths	- 1.9	1.7	- 6.5	- 1.8	- 5.8
Food products	1.7	- 3.3	5.1	1.6	- 5.8
Beverages	0.9	1.8	- 0.8	- 7.1	- 11.8
Tobacco	4.0	17.1	- 4.7	17.9	20.4

Source: IBGE

1/ In the months, seasonally adjusted change.

Industrial production by category of use

Percentage change

Itemization	2000 Dec	2001 Oct	Nov	Dec	2002 Jan
In the month[1/]					
Industrial production	7.2	- 1.9	1.4	1.0	1.3
Capital goods	1.4	- 1.0	- 3.1	- 2.1	1.1
Intermediate goods	5.8	- 2.1	0.6	0.3	3.5
Consumer goods	8.1	- 0.5	3.7	2.2	0.9
Durable	23.0	6.9	3.4	6.1	- 2.1
Semi and nondurable	4.9	- 2.5	3.9	0.8	1.3
Quarterly moving average[1/]					
Industrial production	6.5	- 0.7	- 0.1	0.4	1.4
Capital goods	12.6	- 0.7	- 3.5	- 2.2	- 1.4
Intermediate goods	7.0	- 1.0	- 0.5	- 0.1	1.8
Consumer goods	3.0	0.1	1.3	1.7	2.0
Durable	19.1	0.1	4.3	6.2	2.8
Semi and nondurable	- 0.7	0.1	0.6	0.3	1.5
In the year					
Industrial production	6.6	2.5	2.1	1.4	- 1.3
Capital goods	13.1	15.7	14.1	12.7	- 4.0
Intermediate goods	6.8	0.8	0.3	- 0.3	- 2.0
Consumer goods	3.5	1.9	1.8	1.2	1.3
Durable	20.8	2.1	1.1	- 0.6	- 2.9
Semi and nondurable	- 0.4	1.8	2.0	1.7	2.5

Source: IBGE

1/ Seasonally adjusted data.

semi and nondurable consumer goods closed at 1.7%, while production of consumer durables – the sector most sensitive to electricity rationing and interest rates – fell by 0.6%.

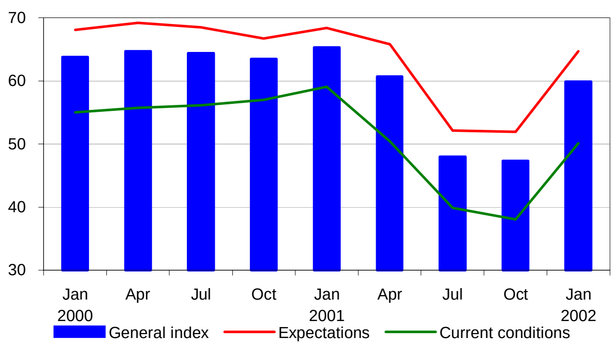
In January 2002, production of industry in general expanded by 1.3%, compared to the month of December. The data used in this calculation were drawn from the series purged of seasonal influences and, since it was the third consecutive month of positive growth, the result suggests that the recovery process is under way. This figure reflected growth of 2% in the manufacturing industry and 5.7% in the mining sector. Analysis of the movable quarterly average shows a level that was 1.4% higher in the November-January quarter than in the quarter ended in December. This growth is a sign that industrial output has begun rising following the negative impact of the oil workers strike in October, an event that had an accentuated impact on the output of the extraction and chemical industries. A breakdown by use categories, utilizing the same basis of comparison, points to expansion of 2.8% in the output of consumer durables, a result that is explained by the easing of restrictions on energy consumption The same factor was the element most responsible for the 1.4% drop in the production of capital goods between the two quarters indicated.

Fourteen of the twenty segments and the use categories surveyed by the IBGE registered monthly output growth in January. Here, the most important elements were growth of 3.5% in intermediate goods, followed by semidurable and nondurable consumer goods (1.3%) and capital goods (1.1%). The exception was a 2.1% drop in the output of consumer durables, which occurred following strong growth in the second half of 2001. The output index of the industrial sector for the month of January surpassed the May 2001 level, the first month that was impacted by the restrictions imposed on electricity consumption.

In comparison to the same month of 2001, industrial output declined by 1.3% in January 2002, a performance that is partly explained by the high basis of comparison, since the index for January 2001 was the highest for that month in the entire historical series. Negative results prevailed in fourteen segments, principally nonmetallic minerals (6.1%) and food products (5.8%). On the other hand, the leading positive growth segments were mining (7.1%), reflecting output of petroleum and natural gas, transportation equipment (2.2%), with emphasis on rolling stock for the railway industry and motorcycles, and the pharmaceutical industry (14.5%). Analysis of use categories shows that consumer goods registered growth of 1.3%, reflecting a positive performance on the part of semidurable and nondurable consumer goods, and fuels, while the output of consumer durables turned downward. In the other categories, downward movement came to 2% for intermediate goods and 4% for capital goods.

Surveys and studies carried out with the aim of measuring the confidence level among businesspersons from the industrial sectors, together with their opinions on the general business climate and economic conditions produced highly positive results in early 2002. Thus, the Manufacturing Industry Survey carried out by the FGV in January 2002 made it possible to perceive a more favorable scenario than that which prevailed in October 2001. In this sense, the survey identified the existence of a process of normalizing demand, coupled with stock reductions, growth in the utilization level of installed output capacity, an improved business climate and expectations of additional demand over the medium term. It should be stressed that internal demand was considered more dynamic than external demand.

Industrial Business Confidence Index



Source: CNI

The Industrial Business Confidence Index, which is calculated quarterly by the CNI on the basis of information supplied by industrial federations from 19 states, showed that the difficulties that had affected the economy in 2001 were clearly being overcome in January 2002. In both July and October, the index slipped below 50 points before rising to 59.9 in January, a clear sign of growing optimism. Compared to October, the index increased by 12.6 p.p.. The index that measures expectations for the

Vehicles - production and sales

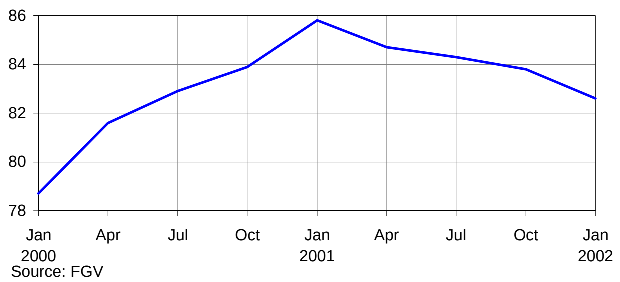
Percentage change

Itemization	2001 Oct	Nov	Dec	2002 Jan	Feb
In the month[1/]					
Production	- 5.4	14.0	2.7	2.0	- 5.9
Sales	10.4	17.6	- 5.2	- 5.2	1.4
Domestic sales	24.2	23.3	3.8	- 14.8	4.5
External sales	10.2	- 6.2	- 32.3	39.4	- 9.6
In the year					
Production	9.5	8.6	6.8	4.3	- 4.3
Sales	8.9	8.3	7.1	- 4.0	- 7.8
Domestic sales	9.8	9.0	8.3	- 4.6	- 9.1
External sales	5.8	6.0	2.7	- 0.4	- 1.0

Source: Anfavea

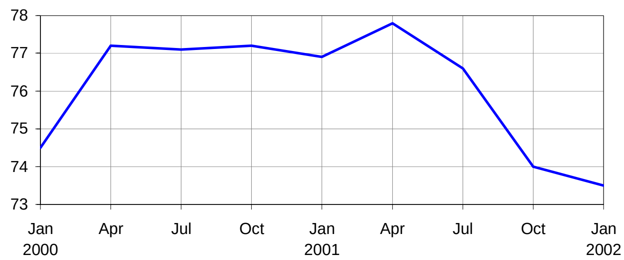
1/ Seasonally adjusted data.

Utilization of installed capacity
Building materials
Seasonally adjusted data
Average percentage



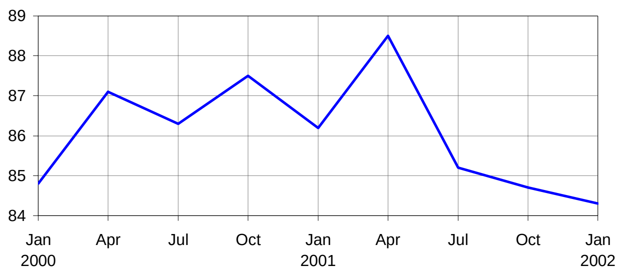
Source: FGV

Utilization of installed capacity
Consumer goods
Seasonally adjusted data
Average percentage



Source: FGV

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



Source: FGV

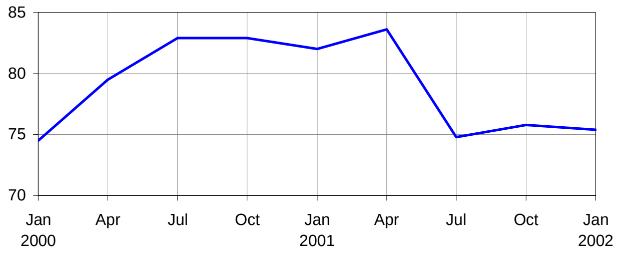
coming six months moved from 51.9 to 64.7, while that used to measure current conditions increased from 38.1 to 50.1. When these figures are analyzed in the context of the size of the companies involved, positive growth in confidence was perceived among large, medium and small businesspersons.

For the first two months of the year, sector-by-sector data indicated that the output of the automotive industry came to 254.3 thousand vehicles, reflecting a drop of 4.3% in relation to the same period of 2001. Using the statistical series purged of seasonal impacts, January registered growth of 2% compared to December, and was followed by a drop of 5.9% in the following month. Total sales in the two month period came to 199.2 thousand vehicles, a drop of 7.8% in relation to 2001. It should be noted that the largest reduction occurred under internal sales, with 9.1%, compared to 1% under the heading of exports.

The average utilization level of installed industrial output capacity declined over the course of 2001, before increasing once again in early 2002. This result accompanied the trajectory of other indicators that pointed to a gradual upturn in the pace of economic activity.

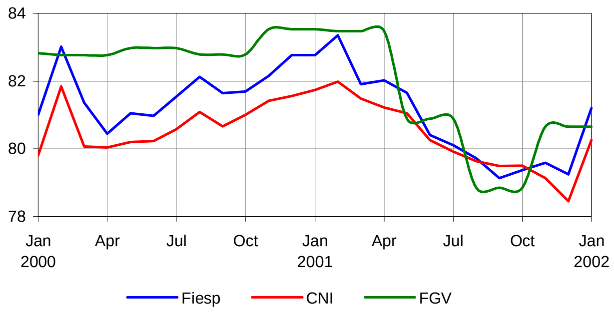
Thus, according to the FGV, which carries out a quarterly survey of the manufacturing sector that is national in scope, the indicator moved from 82.1% at the start of January 2001 to 79.5% in January 2002. Once seasonal factors had been purged from the series, the results were a decline of 3% in July and 2.7% in October 2001, with positive growth of 2.3% in January. On a category-by-category basis, there was a generalized downturn when compared to January 2001, principally in the case of capital goods (6.6 p.p.), followed by consumer goods (3.4

Utlization of installed capacity
Capital goods
Seasonally adjusted data
Average percentage



Source: FGV

Utilization of installed capacity
Seasonally adjusted data
Average percentage



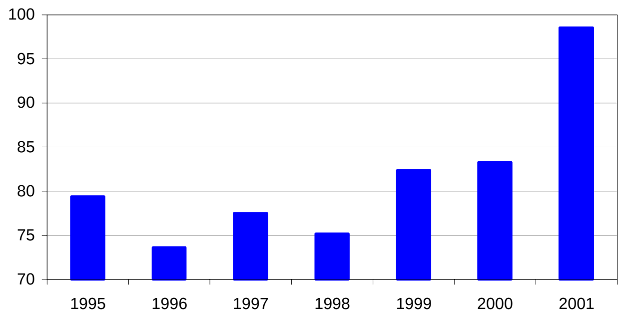
p.p.), building materials (3.2 p.p.) and intermediate consumer goods (1.9 p.p.).

CNI indicators encompass data on the manufacturing industry from 12 different states. According to these figures, the average level of utilization of installed capacity dropped over the course of 2002 and, in December of that year, closed at 77.1% compared to 80.7% in the same month of the previous year. In January 2002, this indicator expanded by 2.3% when calculated on the basis of the statistical series purged of seasonal influences. This result was clearly compatible with the level of output expansion in the period. Compared to January 2001, however, there was a reduction of 1.8% in the utilization of industrial facilities. In the same context, utilization of installed output capacity in the São Paulo industrial sector turned in monthly growth of 2.5% in January (data free of seasonal influences). Compared to January 2001, the result was a reduction of 1.9%.

1.3.2 – Crop and livestock output

Crops

Grain production
In million of tons



Source: IBGE

The 2001 grain harvest came to 98.5 million tons. Not only was this the largest in the nation's history, it was a full 18.4% above that of the preceding year. For the most part, this growth resulted from incorporation of technologies and highly favorable climatic conditions, since the area cultivated was practically identical to that of the previous harvest.

For 2002, early estimates drawn from the Systematic Farm Production Survey (LSPA) carried out by the IBGE in the month of January in the south, southeast and central-west regions, indicated that output could reach as high as 97.5 million tons, for a reduction of 1% in relation to the previous harvest. The IBGE explains that, to some extent, this forecast involves simulations, principally for the winter crops and for the second and third harvests of some products. The reduction is partly explained by the severe drought that hit the states of Rio Grande do Sul and Santa Catarina, with particularly strong impacts on the corn, bean and soybean crops.

Crops in 2001

Percentage change

Itemization	Production	Area	Average production
Grain production	18.4	1.1	17.1
Cotton (seed)	31.4	8.5	21.2
Rice (in husk)	-8.4	-14.0	6.5
Beans	-20.1	-20.2	0.1
Corn	28.3	6.6	20.4
Soybean	14.8	2.1	12.4
Wheat	88.7	61.8	16.6
Others	103.2	-0.5	104.2

Source: IBGE

Grain production - estimate for 2002

In thousands of tons

Itemization	Production		Percentage change
	2001	2002	
Grain production	98 533	97 545	-1.0
Cotton (bush)	1 716	1 498	-12.7
Rice (in husk)	10 195	10 538	3.4
Beans (1st. harvest)	1 202	1 771	47.3
Corn (1st. harvest)	34 646	29 615	-14.5
Soybean	37 687	41 068	9.0

Source: IBGE

A breakdown by individual products shows that national output of herbaceous cotton is expected to decline in terms of both output and area under cultivation (12.7% and 9.7%, respectively). The reasons underlying these reductions are the difficulties faced in the marketing of the 2002 harvest, high production costs and low market prices. Consequently, areas once occupied by cotton have given way to soybeans.

Following a reduction of 8.4% in 2001, the rice crop is expected to expand by 3.4% to 10.5 million tons in the current year. For the most part, this growth will reflect more attractive prices at planting time, coupled with improved climatic conditions. One should note that, according to the Broad National Consumer Price Index (IPCA), rice prices increased by 43.77% in 2001. The increased production expected for this year should contribute to a downturn in price levels over the course of the current year.

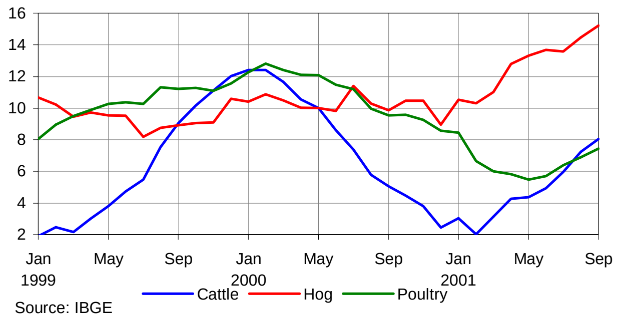
Data on the first corn harvest points to a total of 29.6 million tons, of 14.5% less than in the previous year. This forecast is based on a reduction of 10.4% in the area under cultivation and to highly unfavorable climatic conditions in the southern region of the country. The result was a falloff of approximately 14% in average expected yield.

In the case of soybeans, expectations point to growth of 9% in output and 13.7% in the area under cultivation. One should note that expansion will be less accentuated in the south, which is the second largest producer region. The cause of this – as already mentioned – was severe drought, while in the case of the state of Mato Grosso do Sul, the crop was impacted by excess rain and a lack of sunlight. Consequently, these two production regions turned in significantly lower rates of growth (1.3% and 1.2%, respectively). In the other regions, output benefited from favorable climatic conditions.

Reflecting the positive performance of marketing prices obtained in 2001, the first bean harvest is expected to grow by 47.3% to a level of 1.8 million tons, following a 30.8% drop in the previous year. If this expectation is forthcoming, the harvest will surpass the 1998 record. Another factor that deserves mentions is the fact that the prices of black beans grew by 174.37% in 2001, according to the IPCA. This tendency could very well reverse course in 2002.

Livestock

Livestock production
Total weight
Percentage change in 12 months



Source: IBGE

In the last four years, the livestock sector has registered highly positive results, mostly as a consequence of increased exports. In January 2002, the same trend continued and was marked by growth of 34.6% in total meat exports, compared to the same month of 2001. When one considers the major product groupings, growth closed at 66.6% in foreign sales of beef and 37.2% and 27.4% in sales of pork and chicken, respectively.

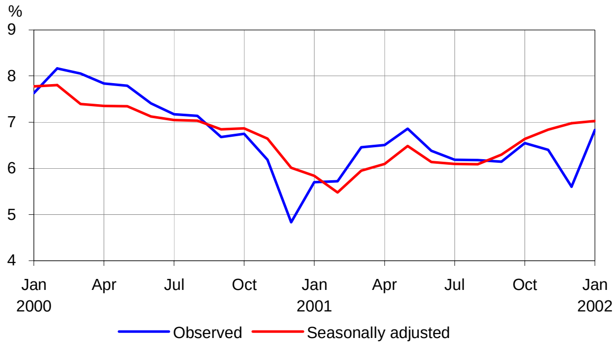
Industrial production indicators also demonstrate that the livestock sector turned in positive results in the production of inputs and that of products using raw materials supplied by the sector. Thus, output of food for animal consumption increased by 7.1% in January 2002, compared to the same month of 2001. Even more positive results were achieved by industries involved in livestock slaughtering (excluding poultry) and the preparation of meat products (10.8%) and for the slaughter and preparation of poultry (16.2%). The only segment to register downward movement in January 2002, when compared to the same period of 2001, was the cooling and preparation of milk and dairy products, with a decline of 7.4%.

1.3.3 – Labor market

Employment

Data on job market evolution in early 2002 pointed to a positive performance when compared to the same period of 2001. This was true under both formal employment and that segment of employment perceived by household surveys. However, prior to December 2001, unemployment moved upward as a result of both an increase in the economically active population and a decline in the number of available job positions.

Unemployment rate



Source: IBGE

According to the Monthly Employment Survey issued by the IBGE, the rate of open unemployment totaled 6.83% in January of this year, as compared to 5.7% in the corresponding month of 2001. This result reflected growth of 1.23% in the number of persons working and 2.53% in the economically active population, corresponding to inclusion of 250 thousand unemployed persons in the labor force in the six metropolitan regions surveyed. In December 2001, the unemployment rate had closed at 5.6%. Compared to that month, the rise in the level of unemployment was a consequence of 0.91% growth in the economically active population and a drop of 0.41% in the number of persons effectively working.

Occupied people by activity and by categories of employment

% accumulated growth in year

Itemization	2001				2002
	Sep	Oct	Nov	Dec	Jan
Total of occupied people	0.9	0.8	0.7	0.7	1.2
By activity					
Manufacturing industry	1.2	1.0	0.6	0.6	-0.7
Building	-2.8	-2.8	-2.5	-2.8	-8.5
Commerce	-0.4	-0.8	-0.8	-0.7	2.5
Services	1.7	1.6	1.5	1.5	2.5
By categories of employment					
Registered	4.7	4.4	4.0	3.8	2.0
Nonregistered	-1.9	-1.7	-1.4	-1.2	4.6
Self-employed	-0.4	-0.6	-0.6	-0.7	-3.1
Employer	-10.9	-8.5	-8.3	-8.8	-1.5

Source: IBGE

Considering growth of the working population by occupational category, the IBGE survey shows growth in the informal labor market in the six metropolitan regions studied, following a decline in 2001. Thus, when one considers January of this year and 2001, the number of unregistered workers increased by 4.6% while the number of registered workers rose by 2%. One should note that, in 2001, the latter heading was the employment category that registered the sharpest growth. On the other hand, a comparison with January 2001 shows that the total number of the self-employed dropped by 3.1%, while the total number of employers declined by 1.5%.

Among the various sectors analyzed, manufacturing and services absorbed labor, while construction and commerce reduced their payrolls. However, a comparison of data for January 2002 with the same month of 2001 shows that positive results under employment were achieved by commerce and services, while both manufacturing and construction reduced their labor force. At the same time, in January 2002, the construction industry registered its lowest number of employees since September 1993, while the reduction in the manufacturing sector reflected a loss of 96 thousand jobs.

Formal employment

1,000 employees

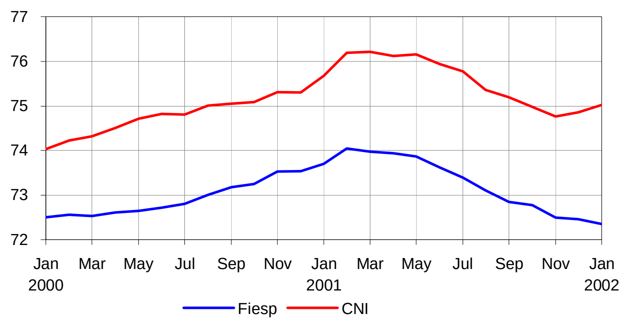
Itemization	2001				2002
	Oct	Nov	Dec	In the year	Jan
Total	77.2	-4.9	-253.9	591.1	44.2
Manufacturing industry	26.0	1.3	-61.8	103.8	15.0
Commerce	37.4	52.4	0.5	209.8	2.3
Services	28.8	20.1	-45.8	311.0	18.2
Building	-4.0	-12.7	-34.9	-33.4	2.0
Public utilities	1.7	-0.2	0.5	1.5	0.8
Others[1/]	-12.7	-65.7	-112.4	-1.6	6.0

Source: Ministry of Labor and Employment

1/ Includes mineral extraction, public administration, crop and livestock and others.

Despite the end-of-year seasonal reduction in the level of formal employment – elimination of 253.9 thousand positions in November and December – the number of employees registered growth of 591.1 thousand jobs in 2001. Based data purged of seasonal factors, there has been uninterrupted growth since September 1999. According to data contained in the General File of the Employed and Unemployed (Caged) of the Ministry of Labor and Employment (MTE), January 2002 witnessed creation of 44.2 thousand employment positions. It is interesting to note that, in the last thirteen years, the only month to surpass this mark was January 2001. Having purged the index of seasonal influences, formal employment in the country expanded by 0.24% compared to December. For the most part, the new positions were concentrated in the sector of services (18.2 thousand) and manufacturing (15 thousand). Compared to January 2001, the number of registered employees increased by 2.7%. Utilizing this basis of comparison, only the construction industry closed with a downturn in the employment level.

Industrial employment
Seasonally adjusted data
1992=100



According to the monthly survey carried out by the Federation of Industries of the State of São Paulo (Fiesp), industrial employment followed a downward curve as of the month of June, registering a monthly reduction of 0.1% in January, compared to contractions of 0.49% and 0.45% in November and December, respectively. All of these figures are based on the statistical series purged of seasonal factors. The weekly survey, which considers information provided by 47 employer associations, registered a reduction of 6.7 thousand positions compared to December. According to this survey, São Paulo industry dismissed approximately 40 thousand workers over a period of twelve months.

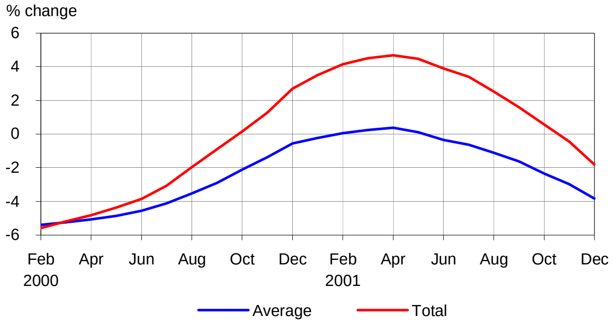
Based on CNI industrial indicators, the index corresponding to personnel occupied in the manufacturing industry increased by 1.1% in 2001, in the states encompassed by the survey. From June to November, based on data from which seasonal factors have been removed, employment registered negative monthly growth. However, this trajectory was interrupted in December, when the job level increased by 0.1%. In January 2002, the monthly employment rate turned in a positive 0.2% result, demonstrating that the comparison between the index for that month and the January 2001 index point to a drop of 0.9% in the job level in the period.

Earnings

The evolution of income and wages registered real losses in several employment categories in recent months, as demonstrated by the IBGE household survey. However, for the manufacturing sector, information made available by both CNI and Fiesp point to real gains for the sector's employees. It should be noted that part of this difference can be attributed to methodological questions and to the scope of the two surveys.

Based on data drawn from the IBGE household survey carried out in six metropolitan regions in 2001, overall real earnings dropped by 1.83% following a rise of 2.69% in the previous year. In its turn, overall nominal earnings closed with respective growth rates of 5.43% and 9.14%.

Real earnings - average and total
12 month moving average



Source: IBGE

When one considers real average earnings, one should note that there was a decline for the fourth consecutive year. The falloff of 3.8% followed reductions of 0.6% in 2000, 5.5% in 1999 and 0.4% in 1998. Monthly comparisons of the data for the last two years point to reductions in all months of the year, with greater intensity as of July. In the year. the category with the highest level of wage losses was that of registered employees (4.8%), followed by employers (2.6%), unregistered workers (2.1%) and, finally, the self-employed (1.4%). In the same sector-by-sector analysis, the sectors that closed with losses of more than 5% were construction, manufacturing and commerce. The declines came to 3.4% in the service sector and 1.8% in other activities.

Overall real wages and average real earnings

% accumulated growth in year

Itemization	2000	2001		
		Oct	Nov	Dec
Overall real wages	2.7	-0.5	-1.1	-1.8
Average real earnings	-0.6	-2.9	-3.4	-3.8
By activity				
Manufacturing industry	-1.9	-3.8	-4.3	-5.1
Building	1.9	-3.6	-4.1	-5.2
Commerce	2.6	-5.2	-5.5	-5.7
Services	-0.9	-2.4	-2.9	-3.4
By categories of employment				
Registered	-1.0	-3.4	-4.0	-4.8
Nonregistered	0.7	-1.3	-1.7	-2.1
Self-employed	-0.8	-0.7	-1.0	-1.4
Employer	0.2	-2.5	-2.7	-2.6

Source: IBGE

Real wages in the manufacturing industry

% accumulated growth in year

Itemization	2000	2001			2002
		Oct	Nov	Dec	Jan
CNI					
Overall real wages	2.8	3.9	3.6	3.1	-1.2
Fiesp					
Overall real wages	3.8	7.3	6.8	6.4	2.6
Average real wages	2.7	6.5	6.3	6.1	5.0

Source: CNI and Fiesp

Analysis based on data from which seasonal factors have been culled indicate that total earnings fell by 1.6% in November and 0.8% in December. A sector-by-sector breakdown shows that, with the exception of manufacturing, the losses were smaller in December.

The monthly Fiesp survey indicated recovery in real average wages in the São Paulo manufacturing sector in 2001, pointing to growth of 6.1% in the year, compared to 2.7% in 2000. Identical behavior was registered by overall wages, which increased by 6.4% and 3.7%, respectively. In January 2002, monthly growth came to 2.2% in the series free of seasonal influences. This level was 5% higher than in the same month of 2001. As far as overall wages are concerned, the respective percentages were 2.5% and 2.6%.

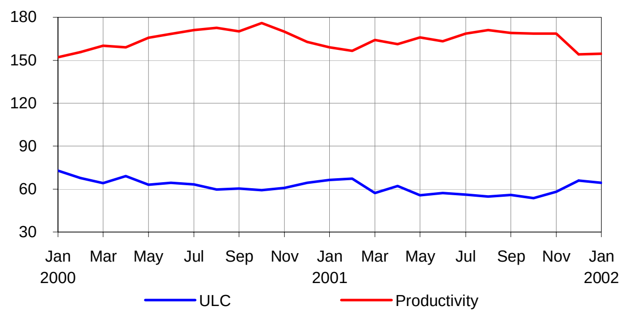
In much the same way, the CNI twelve state survey indicated upward movement in the earnings of employees. In this sense, overall wages increased by 3.2% in 2001 and 2.8% in 2000. In January 2002, real overall wages increased by 1%, following a decline of 0.3% in the month of December, based on data free of seasonal factors.

1.3.4 – Unit labor cost and productivity in the manufacturing industry

Calculated on the basis of the ratio between the index of physical output of the sector, as announced by IBGE, and the indicator of hours paid in production, calculated by the CNI, productivity of the manufacturing industry declined by 0.57% in 2001, compared to a rise of 1.93% in the previous year. Up to the end of the first six months of the year, growth had come to 1%, meaning that the indicator decelerated in the second half of the year. Analysis of the statistical series free of seasonal factors shows that productivity turned in positive results in just three months in 2001 – July, August and November. When one considers accumulated data for the year, the falloff was a consequence of output expansion that was below the growth of hours worked. The respective percentages were 1.2% and 1.8%.

ULC and productivity

1992=100



Source: IBGE, CNI and Banco Central do Brasil

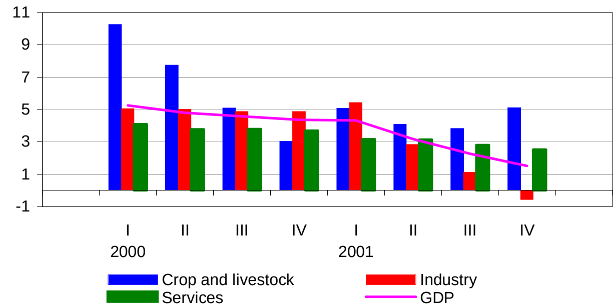
In regional terms, industrial enterprises located in Rio de Janeiro turned in the best performance in 2001, with productivity growth of 4.22%. Moving in the opposite direction, the State of Ceará registered a loss of 9.12%. Other states that registered positive performances in 2001, including Santa Catarina (3.52%), Minas Gerais (2.09%) and São Paulo (1.64%). In the State of Paraná, the reduction in manufacturing productivity came to 10.95%. Declines also occurred in Rio Grande do Sul (8.11%), Espírito Santo (6.51%), Bahia (5.51%) and Pernambuco (0.49%).

In real terms, the unit labor cost (ULC), which is calculated on the basis of the ratio between total wages paid by the industries surveyed by the CNI and the output of the manufacturing sector, as released by the IBGE, registered growth of 0.86% in 2001. In the two previous years, the trajectory had been more favorable, with declines of 3.3% in 2000 and 9.9% in the preceding year.

Calculation of the ULC in nominal values considered overall nominal wages calculated by the CNI in relation to the result of the multiplication of the industrial production index by the Wholesale Price Index – Overall Supply – Industrialized Products (IPA-OG-PI). Based on this ratio, the nominal ULC registered reductions of 2.3% in 2001 and 12.4% in 2000, demonstrating that labor has not been a source of pressures on industrial prices over the last two years.

1.3.5 – Gross Domestic Product

Gross Domestic Product
% growth accumulated in the year



Source: IBGE

Gross Domestic Product

Quarter/previous quarter seasonally adjusted

Itemization	2001			
	I	II	III	IV
GDP at maket prices	0.9	-0.8	-0.8	-1.7
Crop and livestock	6.7	-0.8	-0.6	3.2
Industry	1.1	-3.2	-1.8	-1.6
Services	0.8	0.2	-0.1	-0.2

Source: IBGE

Gross Domestic Product

Percentage change

Itemization	2000	2001			
	IV	I	II	III	IV
Accumulated in the year	4.4	4.3	3.2	2.3	1.5
Accumulated in four quarters	4.4	4.1	3.6	2.6	1.5
Quarter/same quarter of the previous year	3.7	4.3	2.1	0.5	-0.7
Quarter/previous quarter seasonally adjusted	1.8	0.9	-0.8	-0.8	-1.7

Source: IBGE

At market prices, GDP registered a decline of 1.7% in the final quarter of 2001, compared to the third quarter and based on seasonally adjusted data. This was the most accentuated reduction of the year in quarterly terms, as demonstrated by preliminary data released by the IBGE. A breakdown by sector of activity shows reductions in industry (1.6%) and services (0.2%). Only crop/livestock farming managed to close with a positive result (3.2%).

With this result, the rate accumulated in the year declined from 2.25% up to the third quarter to 1.5% at the end of 2001. In annual terms, industrial product fell by 0.6%, compared to 2000, registering declines in the activities of the construction industry (2.6%) and public utility industrial services (5.5), which were the areas most intensely affected by electricity rationing. With the exception of these two subsectors, the others turned in positive growth when compared to 2000. The crop/livestock sector expanded by 5.1%, with positive results in both crop and livestock output, while the sector of services expanded by 2.5%. In the latter case, this result mainly reflected growth in the subsectors of communications (11.9%) and other services (3.2%).

For 2002, a sector-by-sector analysis points to GDP growth of 2.5%. The product of the crop/livestock sector is expected to expand by approximately 3.9%, based on IBGE and Conab grain harvest estimates in the range of 100 million tons. At the same time, the favorable scenario for the farm sector is expected to continue, particularly in light of increased export opportunities.

For the most part, expectations for the secondary sector are concentrated on the performance of manufacturing. It is expected that the gradual process of recovery that has marked the segment will continue, particularly in light of the signs that the negative factors that impacted

Gross Domestic Product

Itemization	2000	2001	2002[1/]
			Percentage change in the year
Crop and livestock	3.0	5.1	3.9
Industry	4.9	-0.6	2.5
Mineral extraction	11.1	3.4	7.5
Manufacturing	5.4	0.6	1.8
Construction	3.0	-2.6	1.8
Public utilities	4.1	-5.5	5.2
Services	3.7	2.5	2.2
Commerce	4.7	0.7	0.7
Transportation	5.6	1.0	0.8
Communications	16.5	11.9	8.0
Financial institutions	3.5	1.1	2.3
Other services	4.4	3.2	2.4
Rents	2.5	2.1	2.3
Public administration	1.1	1.8	2.0
Financial dummy	4.4	1.5	2.2
Value added at basic prices	4.0	1.6	2.4
Taxes on products	7.1	0.8	1.6
GDP at market prices	4.4	1.5	2.5

Source: IBGE

1/ Banco Central do Brasil estimates.

the sector last year seem to have been resolved. According to projections, growth is expected to reach a level of 1.8% for the year, though part of this is a result of the low basis of comparison. Also with regard to the secondary sector of the economy, public utility industrial services are expected to expand by 5.2% now that the rationing of electricity has ended and should contribute sharply to the overall result for the year.

Growth for services in 2002 is projected at 2%. This percentage reflects forecast expansion in the subsectors of transportation and commerce, based on the performances of the manufacturing industry and crop/livestock sector. Among the other segments, mention should also be made of real estate rentals, public administration and other services which accounted for approximately 70% of the total product of the service sector. Quarterly performance of recent years was used for the first two items, both of which have been relatively stable. For other services, the outlook in terms of growth in formal employment according to data released by the Ministry of Labor and Employment was taken into consideration.

1.4 – Investment and output capacity

Investment indicators

Itemization	2001				2002	
	1st q	2nd q	3rd q	4th q	Jan	Feb
						% accumulated growth in year
Capital goods						
Production	20.8	19.0	16.5	12.7	-4.0	...
Imports	43.7	34.3	22.5	16.1	-11.2	...
Exports	-3.8	-8.2	-12.1	-13.7	24.9	...
Inputs for the building industry	4.1	2.2	-0.5	-2.5	-10.9	...
BNDES financing	54.7	57.3	38.7	9.4	34.8	66.1

Source: IBGE, Funcex and BNDES

In 2001, the results of investment indicators were not homogenous. This was evident in the sharp growth in investments in capital goods output, compared to a decline in those channeled to the construction industry.

It should also be noted that, as a consequence of the economic growth cycle that marked 2000, the first quarter of the year was marked by significantly higher investment indicators. However, investments moved into a downward curve, particularly as of the second quarter, and accompanied

Investment

Itemization		Gross fixed capital formation	Changes in inventories	Gross capital formation
				GDP share
1999	I	19.6	-0.3	19.2
	II	19.2	2.8	22.0
	III	19.3	0.7	20.0
	IV	19.1	1.2	20.3
2000	I	21.7	1.1	22.7
	II	20.3	2.3	22.6
	III	19.7	2.6	22.4
	IV	19.4	2.3	21.7
2001	I	20.6	1.8	22.4
	II	20.2	2.0	22.2
	III	20.0	2.1	22.1

Source: IBGE

Production of capital goods

Itemization	2001			2002
	Oct	Nov	Dec	Jan
				Percentage change
In the month1/				
Capital goods	-1.0	-3.1	-2.1	1.1
Industrial	-4.2	-1.8	-3.5	12.9
Serial	-6.2	-3.4	-3.5	14.7
Nonserial	9.5	-0.3	-4.0	7.0
Agricultural	7.0	5.3	-2.1	-7.0
Farm parts	-2.2	-2.0	-6.0	8.3
Building	11.9	2.6	-27.4	28.9
Electric energy	-8.6	-15.3	-12.1	5.8
Transportation	1.7	4.9	0.7	3.5
Mixed	-5.9	1.7	3.6	0.4
Quarterly moving average1/				
Capital goods	-0.7	-3.5	-2.2	-1.4
Industrial	-3.3	-6.3	-3.2	2.4
Serial	-4.0	-8.2	-4.4	2.4
Nonserial	2.3	2.0	1.5	0.8
Agricultural	3.8	11.4	3.2	-1.3
Farm parts	-1.1	-2.5	-3.4	-0.1
Building	3.8	2.0	-5.1	-1.5
Electric energy	0.5	-8.8	-11.9	-8.2
Transportation	-0.2	0.6	2.4	3.0
Mixed	-3.4	-4.9	-0.3	1.9
In the year				
Capital goods	15.7	14.1	12.7	-4.0
Industrial	5.9	5.2	4.1	7.0
Serial	5.9	5.0	3.5	4.6
Nonserial	6.0	6.6	6.8	15.5
Agricultural	19.3	18.5	19.4	12.1
Farm parts	3.7	3.8	3.4	13.9
Building	26.8	27.4	23.7	6.2
Electric energy	48.7	46.0	42.5	-3.5
Transportation	14.6	13.9	12.2	5.9
Mixed	7.1	4.2	2.7	-18.2

Source: IBGE

1/ Seasonally adjusted data.

the deceleration in the pace of economic activity. In this sense, production of capital goods, which had expanded by 20.8% in the first three months of the year, compared to the same period of 2000, increased by 12.7% for the year as a whole. In the case of the building industry, production of inputs for the sector reflected growth of 4.1% in the first quarter, when compared to the same period of 2000, and a decline of 2.5% up to December.

As a percentage of GDP, gross capital formation accompanied this trend, albeit at a less intense pace, considering that output of capital goods registered significantly more accentuated growth than GDP. To some extent, this fact offset the adverse results of the construction sector. Thus, according to the quarterly national accounts released by the IBGE, in the first quarter of 2001 the sum of outlays on investments and growth in inventories represented 22.4% of GDP. At the end of the third quarter, this figure dropped to 22.1%.

Analysis of the output of capital goods on a sector-by-sector basis shows that a considerable share of growth was a response to the difficulties generated by electricity rationing. This is evident in the fact that output of equipment precisely for the production of electricity rose by 42.5% in 2001. Production of equipment for the building industry and agriculture also surpassed the growth level for capital goods output as a whole, demonstrating that productive capacity in general has been broadened. Despite this, analysis of growth in quarterly movable averages points to a downturn in investments at the end of the year, caused mostly by exhaustion of demand for equipment to be used in electricity generation.

In January 2002, capital goods output moved upward once again, this time by 1.1%. A breakdown of this rate shows particularly good performances under output of equipment for the construction industry (28.9%) and for expanding industrial facilities (12.9%), as well as production of parts for farm equipment (8.3%).

Production of automotive vehicles

Percentage change

Itemization	2001			2002	
	Oct	Nov	Dec	Jan	Feb*
In the month[1/]					
Farm machines	3.7	3.6	1.1	-2.2	-3.3
Buses	22.0	13.3	-8.3	12.2	5.6
Trucks	6.3	-5.4	0.3	-0.7	6.9
In the year					
Farm machines	26.5	24.9	25.1	21.6	15.6
Buses	-1.3	1.5	1.1	37.2	37.1
Trucks	8.3	7.8	6.3	-13.9	-11.3

Source: Anfavea

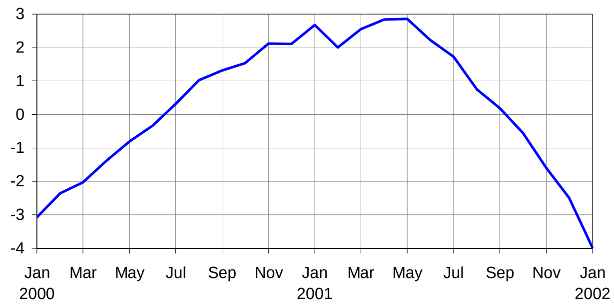
1/ Seasonally adjusted data.
* Preliminary.

Data released by the National Association of Automotive Vehicle Manufacturers (Anfavea) for the first two months of 2002 point to growth of 15.6% in the production of farm machines, when compared to the first two months of 2001. Output of harvesters expanded by 24.4%, with growth of 15% under tractors. Finally, the heading of others, which includes motorized planting equipment, caterpillar tractors and back-end ditch diggers, increased by 4.1%.

When one considers the statistical series purged of seasonal factors, total farm machines produced registered monthly reductions of 2.2% in January and 3.3% in February. Despite these adverse results, compared to the corresponding period of 2001, the 15.6% growth registered in the two month period demonstrated the ongoing process of technology absorption in the farm sector. In recent years, this has clearly been the major factor responsible for the sharp increase in farm income. However, it should also be noted that the share of farm machines channeled to the foreign market has also grown considerably, as shown by 34.6% growth in these sales in the two month period under consideration. At the same time, the dollar value of capital goods imports for the sector declined by 21.1% in the same period, suggesting a lower level of capital goods absorption.

Production of construction inputs

% change of the 12 month moving average



Source: IBGE

Utilizing figures released by Anfavea once again, growth in the production of buses totaled 37.1% in the first two months of the year, compared to the same period of 2002, while output of trucks diminished by 11.3%.

Production of inputs for the construction industry dropped over the course of 2001. When one considers data from which seasonal factors have been removed, monthly results were generally negative with the exception of January and August, as the result for the year closed with a 2.5% reduction. One should stress the relative importance of construction in outlays related to gross fixed capital formation, accounting for an average of 60% of the total. The decline registered by the sector in 2001, compared to 1.5% growth of GDP, jeopardizes the possibilities of investment growth in the sector.

In January 2002, production of inputs shifted upward once again, registering a rate of 0.3% when measured in terms of data free of seasonal factors. As a consequence of the downward trajectory in 2001, compared to January 2000, the overall result was a drop of 10.9%. Expectations are that the sector will turn in a positive growth performance over the course of the current year since, among other reasons, there has been sharp growth in the production of equipment for the sector for two consecutive years.

Total BNDES System disbursements – National Bank of Economic and Social Development (BNDES), Special Industrial Financing Agency (Finame) and BNDES Participações S.A. (BNDESpar) – came to R$4.4 million in the first two months of 2002, registering growth of 66.1% in relation to the same period of 2001. A breakdown by sectors of activity shows that financing received by commerce/services increased by 286.6%, while that received by the mining sector grew by 68.5%, followed by crop and livestock farming (56.4%) and manufacturing (0.8%).

The Long-Term Interest Rate (TJLP), which is the cost of financing contracted with the BNDES System, was set at 10% per year for the first quarter of 2000, a level in effect since the final quarter of 2001.

1.5 – Conclusion

At the end of 2001 and early 2002, activity indicators pointed to gradual recovery in consumer demand. Among the positive factors, mention should be made of improved consumer expectations, as well as good results in the labor market. On the other hand, consumption growth was limited by the level of default and signs of a downward slide in real average wages and earnings, though some sectors – particularly manufacturing – did turn in positive gains.

Furthermore, one should note that the cautious stance taken by consumers has clearly reduced their willingness to make future income commitments. In the most recent consumer intentions surveys, people have shown particular wariness with regard to unemployment and inflation. Therefore, one can conclude that there are no significant sources of pressure on consumer demand that could exert pressure on prices.

Industrial output data point to recovery as of November. This forecast is further backed by the results of surveys that indicate renewed confidence among businesspersons and a predominance of medium-term optimistic expectations. Among other factors, the shift in the economic scenario was brought about by the end of the restrictive impacts of electricity rationing on industrial production.

Early estimates for the 2002 grain harvest point to a decline of 1%. However, a number of products of importance to consumer price indices – particularly rice and beans – are expected to register strong output growth and thereby contribute to reductions in the prices of these goods, in contrast to the strong hikes that occurred in 2001. On the other hand, the forecast reduction in the first corn harvest could raise the prices of the product and, consequently, those of the livestock sector.

In general, therefore, the behavior of supply is compatible with the evolution of demand. Even in an environment conducive to growth in demand for industrial goods, the sector's capacity to respond will be greatly facilitated by a considerable degree of idle capacity.

Formal employment has followed a positive trajectory. Even the seasonal drop in employment that normally occurs in December was less intense than in previous years. In January. the indicator pointed to positive growth, accompanying the gradual upturn in the pace of economic activity in general. Despite expansion in unemployment in the month of January, the process of job generation has intensified in the formal sector of the economy, though the number of new job opportunities has not kept pace with growth in the economically active population.

On the other hand, growth in wages and earnings points to a loss of purchasing power, with the sole exception of the surveys carried out in the manufacturing sector. With this, growth in the number of jobholders has been accompanied only by nominal growth in overall wages and, therefore, has not provoked demand pressures.

However, one should note that the decline in productivity, combined with growth in the real unit cost of labor and less accentuated reductions in the nominal unit cost of labor points to lesser capacity on the part of the labor factor to absorb impacts on costs resulting from such factors as exchange depreciation and increases in government managed prices.

With regard to investments, sector-by-sector indicators registered deceleration in the final months of 2001. This movement was detected in the output of capital goods and inputs for the construction industry. Production of equipment, even with the reductions that marked recent months, was characterized by generalized expansion in the productive capacity of several sectors, for the second consecutive year.

2 – Prices

At the end of 2001, the behavior of the various price indices clearly reflected the pressures of production costs, generated mainly by exchange rate depreciation in the second and third quarters, and an upturn in the pace of economic activity in the period, providing companies with an opportunity to begin rebuilding their profit margins. Though still on a downward curve, inflation in the month of December pointed clearly to the process described above. Among other items, mention should be made of increases in the prices of furniture and home utensils, electric and electronic apparatuses and pharmaceutical products. Aside from this, growth in outlays on foodstuffs, principally due to increases in the prices of meats and upward movement in those of products subject to government administration, had a particularly strong impact in the final month of the year.

At the start of 2002, three factors were responsible for the evolution of inflation indices. The first two are seasonal by nature and involve outlays on education and increases in food prices. Though growth in these prices cooled somewhat, the increases were still relatively significant. The third factor is that of increases in the prices of government managed products, principally electricity rates and fuel prices.

2.1 – General indices

General indices

% monthly growth

Itemization	2001			2002	
	Oct	Nov	Dec	Jan	Feb
IGP - DI	1.5	0.8	0.2	0.2	0.2
IPA	1.9	0.7	-0.1	-0.1	0.1
IPC	0.7	0.8	0.7	0.8	0.1
INCC	0.9	0.7	0.3	0.4	0.6

Source: FGV

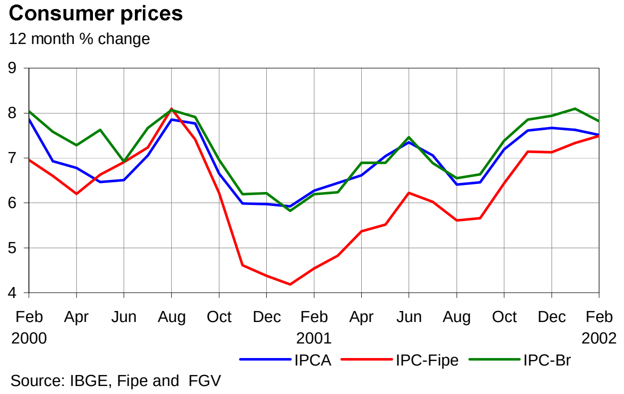
According to FGV, growth in general price indices in the month of December showed an accentuated decline and, since that time, monthly rates have been lower than those of the other price indicators. This behavior was due to the influence of wholesale prices, which decelerated sharply from November to

February, as a result of the behavior of farm and industrial prices. Monthly growth in wholesale farm prices, which had reached a level of 1.74% in October 2001, followed a downward trajectory from November of that year to February 2002. In the latter month, prices diminished by 0.44%. This movement reflected the end of the harvest season coupled with highly favorable meteorological conditions for the period.

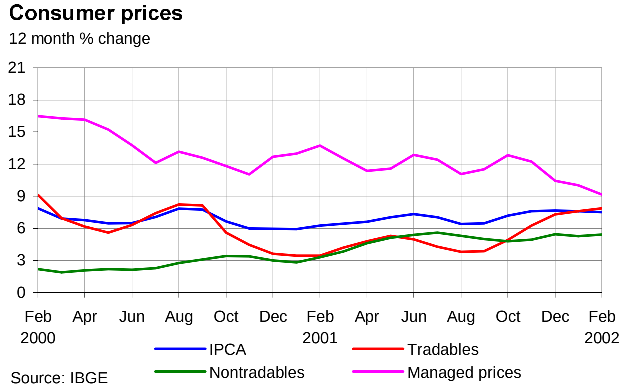
Industrial prices decelerated up to January, with rates of 0.65% in November, -0.32% in December and January and 0.36% in February. Aside from the impact of the rate of exchange, one should stress the favorable impact of the drop in fuel prices in the month of January, a factor seen to be even more important when one considers that it accounts for 11% of the composition of the Wholesale Price Index (IPA).

2.2 – Consumer price indices

Broad Consumer Price Index (IPCA)



Measured by the IPCA, inflation followed a downward curve toward the end of 2001 and in the early days of the current year. The downward movement that first became evident in November mainly reflected food prices, the heading responsible for the major share of the composition of the index. The November result came to 1.31%, dropping to 0.2% in February, as the off-season period for such goods as meats, beans and rice drew to a close. Aside from food products, government managed prices also produced a positive impact once the government decided to eliminate fuel price controls.



Despite deceleration, the December and January rates were still relatively high. In December, IPCA growth was fundamentally a consequence of increases in government managed prices – electricity rates and urban bus fares, both in Rio de Janeiro; the unfavorable seasonal nature of apparel prices; and highs under medicine prices.

Consumer prices

Percentage growth

Itemization	2001			2002	
	Oct	Nov	Dec	Jan	Feb
Monthly					
IPCA	0.8	0.7	0.6	0.5	0.4
IPC-Fipe	0.7	0.6	0.2	0.6	0.3
IPC-Br	0.7	0.8	0.7	0.8	0.1
Accumulated in the year (annualized)					
IPCA	7.5	7.6	7.7	6.4	5.4
IPC-Fipe	7.5	7.5	7.1	7.1	5.1
IPC-Br	7.6	7.9	7.9	9.9	5.7
12 months					
IPCA	7.2	7.6	7.7	7.6	7.5
IPC-Fipe	6.4	7.1	7.1	7.3	7.5
IPC-Br	7.4	7.9	7.9	8.1	7.8

Source: IBGE, Fipe and FGV

With the December result, the IPCA registered growth of 7.67% in the year, mostly as a result of the 10.45% increase in the prices of government managed goods and services. The following items turned in growth above the average for the various price indices: food (9.63%), particularly beef (12.17%), bread (22.09%) and rice (43.59%); housing (9.4%), which considers the items of electricity (17.93%), water and sewage rates (15.5%) and bottled gas (15.6%); and transportation (8%), particularly urban bus fares (15.54%) and gasoline (7.19%). Aside from the supply shocks generated by the farm sector, one should note that prices reflected the evolution of exchange rate, particularly in the second and third quarters of the year.

In January, the behavior of government managed prices was the major factor underlying IPCA results. The elimination of fuel price controls at the refinery level had differentiated impacts on the index, ranging from a 9.9% reduction in the price of gasoline at the consumer level, as compared to an increase of 16.7% in the price of bottled gas, as the subsidy formerly granted to this product was withdrawn. It should also be noted that electricity rates increased by 4.51%, reflecting expansion of 18.63% adopted in December by the electricity concession company of Rio de Janeiro, together with an extraordinary increase of 2.9% granted in December and applicable to most of the areas covered by the survey. The item of urban bus fares increased by 1.34% as a result of a 15% increase in fares in the city of Belo Horizonte toward the end of 2001.

The most accentuated decline was registered in the month of February and resulted from two major factors: the fuel price decline of 4.12% and deceleration in the prices of foodstuffs from 0.85% in January to 0.20%. The continuity of the decline in gasoline prices also reflected January elimination of price controls from the sector. The heading of foodstuffs was impacted principally by reductions in the prices of grains and legumes and beef and chicken. The contributions of these factors more than offset the effects of the 5.51% increase in school payments that was perceived by the IPCA exclusively in the month under consideration.

2.3 – Government managed prices

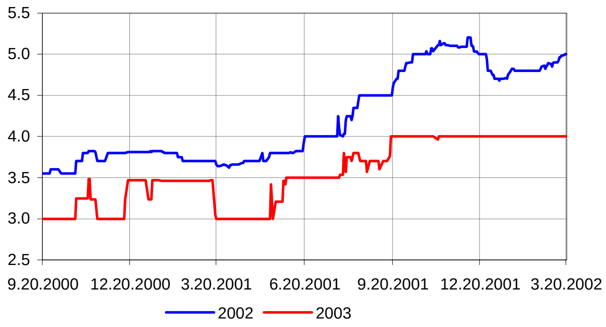
Increases in government managed prices contributed 0.14 p.p. to December IPCA growth of 0.65%. Among the impacts registered in the month, the most important were those related to increases in urban bus fares and electricity rates in Rio de Janeiro, both of which were authorized in the month of December, and vehicle licensing fees, which increased by an average of 13.25%. In 2001, government managed prices accounted for about 39% of the change in the IPCA, corresponding to 3.01 p.p. in the 7.67% growth registered by the index in the year. The items that brought the greatest pressures to bear on inflation in the period were urban bus fares (15.54%), fixed telephone service (7.56%), electricity (17.93%) and gasoline (7.2%).

On the first of January, the government deregulated the sector of fuels, putting an end to gasoline, diesel oil and bottled gas price controls at the refinery level and releasing freight charges and profit margins from government stipulated ceilings in all parts of the country. At the same time, this process resulted in substitution of the Specific Price Share (PPE) by the Contribution on Intervention in the Economic Domain (Cide), making it possible to achieve significant reductions in fuel prices. On the other hand, the end of the subsidy granted to bottled gas for cooking resulted in an increase in the price of this product. In the case of the IPCA, the impacts of these measures were principally perceived by changes of -9.92% and 17.87% in the prices of gasoline and bottled gas in January. Parallel to these figures, one should underscore the increases in residential electricity, as a result of the increase authorized in Rio de Janeiro at the end of December, and the upward movement in urban bus fares, mostly as a result of the increase adopted in Belo Horizonte. Consequently, government managed prices accounted for 0.11 p.p. in the 0.52% IPCA rate in the month of January.

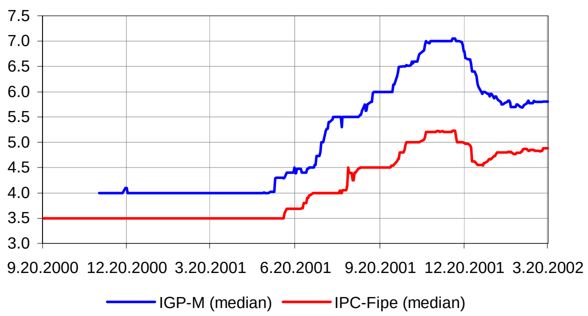
In February, government managed prices accounted for -0.11 p.p. in the monthly rate, mainly as a result of the steady drop in gasoline prices. Following deregulation of the sector, the price liberalization still exerted impact in February, due to the lag in the process of recalculation of the base for levying the Tax on the Circulation of Merchandise and Services and the Rendering of Interstate and Intermunicipal Transportation Services and Communications (ICMS), which is charged on fuels by state governments.

2.4 – Market expectations

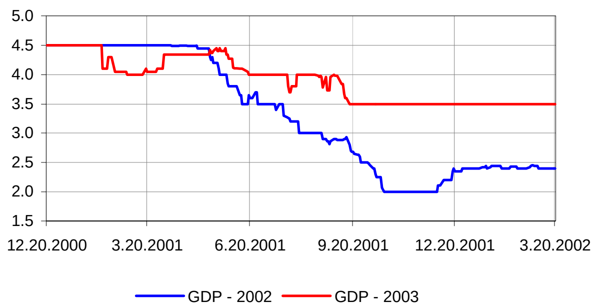
Daily evolution of market expectations for inflation (IPCA)



Daily evolution of market expectations for inflation for 2002



Daily evolution of market expectations for the real GDP growth for 2002 and 2003



The Banco Central Investors Relations Group (GCI) carries out a daily survey involving an average sampling of approximately 100 consulting companies and institutions, with the objective of detecting market expectations as to the performance of the major economic variables.

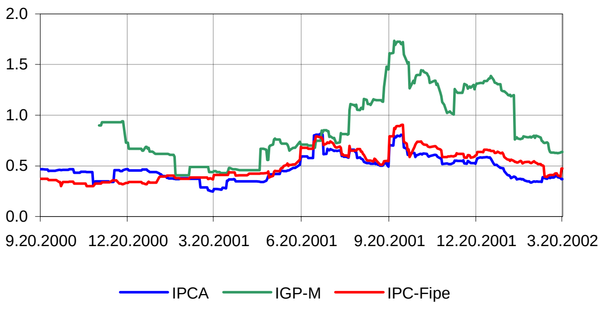
Median expectations of inflation for 2002 as measured by the IPCA came to 5% on March 20, 2002, which was the same level as on December 19, 2001. For 2003, expectations remained in the range of 4% per year in the same period. With respect to the short-term median of the Top five, the results reflected a drop from 5.31% to 4.87% for 2002 and from 4.65% to 3.78% for 2003.

With regard to the evolution of the General Price Index – Market (IGP-M), expectations for 2002 dropped as the median level varied from 6.8% on December 19, 2001, to 5.78% on March 20, 2002. For 2003, median expectations moved from 4.7% to 4.67%. Expectations regarding the Consumer Price Index calculated by the Institute of Economic Research Foundation (IPC-Fipe) for 2002 showed the same tendency as registered by the IGP-M, with a reduction from 4.99% on December 19, 2001, to 4.88% on March 20, 2002. For 2003, expectations remained at 4% in the same period.

With regard to the median short-term expectations of the Top five, the result mirrored a drop from 5.9% to 5.73% for 2002, and an increase from 4.04% to 5.18% for 2003, in the case of IGP-M.

Median expectations for growth in the pace of economic activity for 2002 remained at 2.4%, while the rate for 2003 came to 3.5%.

Standard deviation of market expectations for inflation for 2002



The standard deviations of the price indices expected for 2002 registered 0.52% for the IPCA, 1.29% for the IGP-M and 0.6% for the IPC-Fipe on December 19, 2001, moving to respective rates of 0.33%, 0.65% and 0.47% on March 20, 2002, following a trajectory that pointed toward diminishing dispersion of inflation expectations for 2002.

The standard deviation of real GDP growth expectations for 2002 moved from 0.53% on December 19, 2001, to 0.48% on March 20, 2002. For 2003, a decline from 0.51% to 0.36% was registered for the same period.

2.5 – Conclusion

The fuel price increase scheduled to go into effect as of March 16, coupled with the increase introduced on the second day of the month, is expected to temporarily interrupt the process of declining inflation. Thus, the adverse effects of this increase will neutralize exhaustion of the pressures generated at the start of the year by school material and *in natura* foodstuffs and the general reduction in farm product prices, which followed upon the favorable meteorological conditions that marked the period.

Despite this fact, one should note that the outlook for prices is quite positive, particularly in light of the following factors: in the first place, the absence of significant exchange rate pressures; secondly, despite upward movement in the level of activity, idle industrial capacity in the manufacturing sector is sharply lower than in the same period of 2001; and, finally, the perspective for productivity gains in all sectors of the economy as a result of increased investments in 2001 and 2002.

3 – Credit, monetary and fiscal policies

3.1 – Credit

Credit operations registered moderate growth in the December-February quarter, practically matching the performance of the previous quarter. This result was a function of specific seasonal factors, particularly the fact that business demand for credit tends to decline in the period of the year under consideration due to the increased inflow of revenues generated by installment sales at the end of the previous year. At the family level, just the opposite occurred, as demand for loans increased – particularly revolving credit operations – a clear sign of the concentration of financial commitments so characteristic of the early months of the year.

Growth in credit operations

R$ billion

Itemization	2001		2002		Growth	
	Nov	Dec	Jan	Feb	3 months	12 months
Total	336.7	332.4	333.5	334.4	-0.7	2.2
Nonearmarked	196.8	192.7	195.5	196.0	-0.4	21.0
Legal entities	126.6	122.8	123.3	123.4	-2.6	16.7
Referenced to foreign currency	42.4	39.8	41.5	41.5	-2.2	14.0
Individuals	70.2	69.9	72.2	72.6	3.4	29.0
Earmarked	118.2	118.2	117.4	117.8	-0.3	-15.7
Housing	21.2	21.3	21.4	21.4	1.0	-55.5
Rural	26.7	26.1	26.3	26.6	-0.3	-4.2
BNDES	65.4	65.7	66.1	66.7	1.9	13.8
Others	4.9	5.1	3.6	3.1	-36.5	-40.5
Leasing	12.0	11.6	11.0	11.0	-8.1	-17.8
Public sector	9.6	9.8	9.5	9.5	-0.6	-21.7
% participation:						
Total/ GDP	27.1	26.7	26.8	26.8		
Nonearm./GDP	15.8	15.5	15.7	15.7		
Earmarked/GDP	9.5	9.5	9.4	9.4		

One should stress that the conservative posture adopted by financial institutions in the granting of credits has been caused by greater perceived risk and higher levels of default, particularly in operations with individual persons. According to analysts, the underlying cause of this is a falloff in available family income. This situation has clearly led institutions to maintain interest on credit operations and banking spreads at high levels.

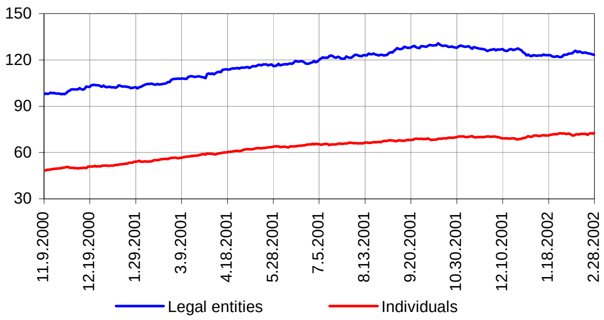
Consequently, the overall balance of financial system credit operations came to R$334.4 billion in February, corresponding to stability in the quarter and growth of 2.2% in 12 months. As a result, the participation of loans in relation to GDP came to 26.8%, compared to 28.3% in February 2001.

Operations based on targeted resources totaled R$117.8 billion, for a reduction of 0.3% when compared to the result for the previous quarter. In this context, particular mention should be made of BNDES System financing, which expanded by 1.9% in the period.

In the month of February, BNDES System disbursements added up to R$4.4 billion, compared to R$2.6 billion in the same period of the previous year. Financing absorbed by the manufacturing sector corresponded to 40.6% of the total granted. The sectors that received the largest shares of this financing were machines, other transportation equipment and food products and beverages. Financing channeled to the service sector – including commerce – represented 47.4% of the total and was concentrated mostly in activities related to energy and electricity, transportation and construction. An important indicator of medium and long-term investor confidence has always been the level of consultations with the Bank. Therefore, it is important to note that in February 2002, these consultations reached a level of R$9.8 billion, compared to R$4.1 billion in February 2001.

The stock of leasing operations totaled R$11 billion in February, reflecting a drop of 8.1% in the quarter. This performance was related to the ongoing process of liquidation of contracts and reductions in demand for this type of credit, indicating that borrowers began opting for modalities that did not incorporate exchange fluctuations, such as personal credits. The public sector banking debt came to R$9.5 billion for a reduction of 0.6% in the period extending from November to February.

Credits with nonearmarked resources - stock
R$ billion



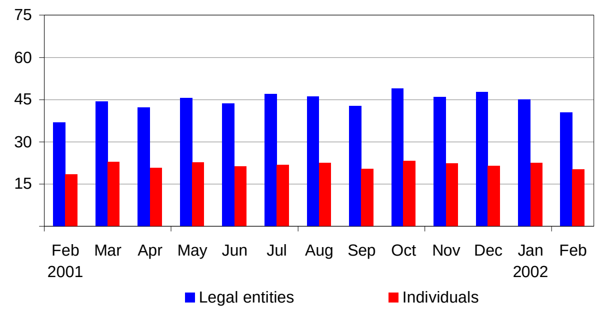
The volume of operations with nonearmarked resources remained at the same level as the previous quarter, registering a total of R$196 billion in February 2002, corresponding to 58.6% of the overall financial system balance.

The total credit stock contracted with legal entities added up to R$123.4 billion, for a reduction of 2.6% in the quarter. Operations tied to internal resources came to R$81.9 billion, for a reduction of 2.8% in relation to the total for November 2001. The decrease in the balance of these operations was principally a result of a lesser level of credits granted, signaling downward movement in business activity and a higher level of corporate liquidity. In this sense, one should note that the quarterly average of new operations contracted from December to February 2002 diminished by 5.6% in relation to the previous quarter.

Insofar as operations with legal entities are concerned, the balance of those referenced to foreign currency dropped by 2.2% in relation to November 2001, indicating a quarterly decline of 4.9% in the volume of operations involving onlendings based on funding from outside the country. This performance reflects the accounting impact of exchange rate alterations on portfolios and concentration of maturities in the period, particularly when one considers that the quarterly average of total disbursements of these operations expanded by 9.6% in comparison to the previous quarter.

Credits with nonearmarked resources - total grantings in the month

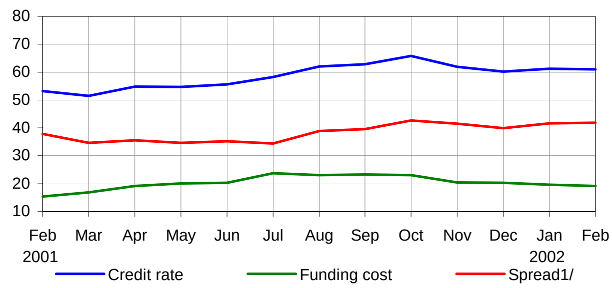
R$ billion



The total volume of operations with individual persons came to R$72.6 billion in February for a quarterly increase of 3.4%. It should be stressed that, over the course of the quarter, fluctuations in the value of the portfolios of special overdraft checks and credit cards reflect lesser December utilization of these credit lines. One of the major reasons for this was the greater availability of income with payment of the end-of-year Christmas bonus by companies. However, demand increased once again as families sought these resources as a way of alleviating the high level of expenditure concentration that marked the start of the year. With regard to disbursements to this segment, the quarterly average dropped by 2.7% in relation to the previous quarter.

Spread of credit operations based on preset rates - market average

% p.y.



1/ p.p.

Interest rates in the nonearmarked credit segment declined since the month of November, following upward movement in the third quarter of last year. In February, the median rate on credit operations declined by 0.9 p.p. in relation to November and closed at 61% per year. Not only was this a reflection of the enhanced stability of the economic scenario, it was also a result of downward movement in futures market interest rates. At the same time, the cutback of 0.25 p.p. in the Selic rate target announced by the Monetary Policy Committee (Copom) following its February 20 meeting had a highly favorable impact on market expectations since it signaled the possibility of a downward trajectory in these rates over the coming months.

In the segment of corporate credit, average interest came to a level of 43.8%, or slightly less than in the month of November. The relative stability of the period resulted from highly divergent types of behavior among the various instruments. Thus, the rise in interest on special overdraft accounts was caused by increased utilization of special corporate overdraft checks, a type of operation subject to the highest rates of interest. In contrast to this, interest on working capital credit operations, acquisitions of goods and vendor operations, all of which involve lesser levels of risk, declined in the period mostly as a result of the guaranties that are included in these operations.

In the case of operations with individual persons, the average rate of interest came to 72.4% per year in the month of February, for a reduction of 1.7 p.p. in comparison to November 2001. In this market segment, reductions were registered in the rates on personal credits while, in the opposite sense, the cost of vehicle financing in January and February clearly reflected the end of the clearance sales carried out by vehicle outlets with the objective of reducing factory inventories.

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

p.p.

Period		Market average	Legal entities	Individuals
2001	Jan	35.1	20.3	47.9
	Feb	37.8	22.2	50.6
	Mar	34.6	20.0	46.2
	Apr	35.6	21.0	46.8
	May	34.6	20.1	45.0
	Jun	35.2	20.4	45.9
	Jul	34.4	19.9	44.8
	Aug	38.9	23.0	50.2
	Sep	39.6	23.3	51.0
	Oct	42.7	26.2	54.3
	Nov	41.5	24.5	53.1
	Dec	39.9	24.4	51.0
2002	Jan	41.6	25.3	52.7
	Feb	41.8	25.2	52.9

In the month of February, the average spread practiced in preset operations came to 41.8 p.p., or 0.3 p.p. more than in the month of November. This performance reflects apparently sharper reductions in futures rates – the reference used to calculate funding costs – than observed under rates on credit operations.

The average funding costs for corporate operations dropped by 0.8 p.p. and the spread for the segment increased by 0.7 p.p., closing at 25.2 p.p. in February. The spread in operations with individuals remained relatively stable, reaching the mark of 52.9 p.p. at the end of the quarter. This result reflected a reduction of 1.5 p.p. in the funding rate for the segment and the drop in interest on credit operations. Particular mention should

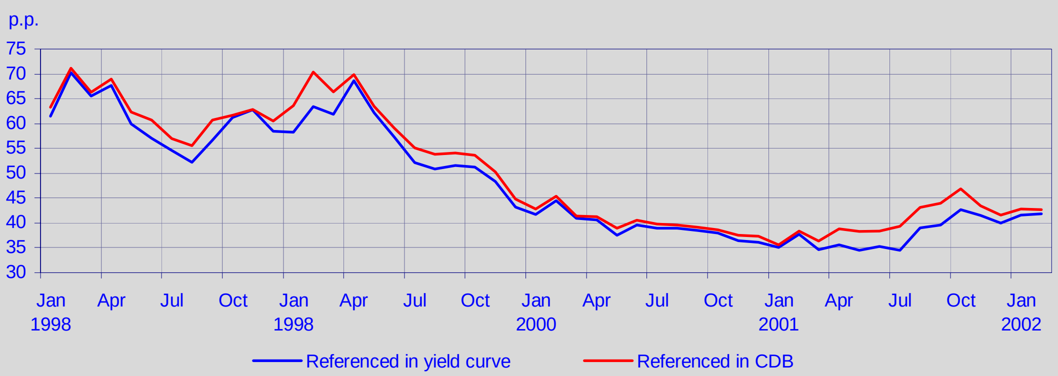
Alteration in the banking spread calculation

In 1999, Banco Central released its first study on the question of interest and the banking spread, demonstrating that the government had adopted the priority of reducing the interest charged by banks in their credit operations. The study in question defined the banking spread as the difference between interest rates charged on credit operations and the rate paid on Bank Deposit Certificates (CDB), which is the rate used as reference for funding costs. The same funding rate was applied as the cost reference in the calculation of the spreads charged in the different types of credit operations, without term-based differentiations.

Changes were later introduced for purposes of improving the initial methodology. These were mostly targeted at incorporating the influence of payment terms on funding rates and, consequently, on the costs borne by the institutions involved. The CDB rate was maintained as reference for operations with average terms in the range of thirty days. In longer term operations, the average rates of swap contracts involving deposits among financial institutions (DI) x pre were used as calculated by the Commodities and Futures Market (BM&F) with terms similar to those of the credit operations in question. The rates for legal entities and individual persons were aggregated by applying the costs found in each segment weighted by their respective balances.

The results obtained through the use of the new methodology are shown in the following graph and came to a level below that of the spread referenced in CDB, reflecting the higher cost of longer term operations such as vehicle acquisitions and personal credit, both of which have considerable weight in these portfolios. At times of greater interest market stability, the banking spread referenced to the yield curve showed a trajectory and values quite close to the former, considering that the lesser inclination of the curve reduces the difference between short and long-term rates.

Spread referenced in yield curve x referenced in CDB



However, in times of uncertainty such as occurred as of March 2001, the new methodology demonstrated that it was more efficient in perceiving market volatility. While the former system of calculation registered growth due to the increase in the rate on credit operations and maintenance of the CDB, the new banking spread held firm until July, demonstrating the increase in the costs of funding medium and long-term operations. As of the month of August, rates on credit operations moved sharply upward, generating growth in the spread as a result of the cost pressures caused by default rates. With this, financial institutions moved to introduce more profound alterations in their credit policies, restricting access to financing and increasing their rates in order to cover growth in credit risks.

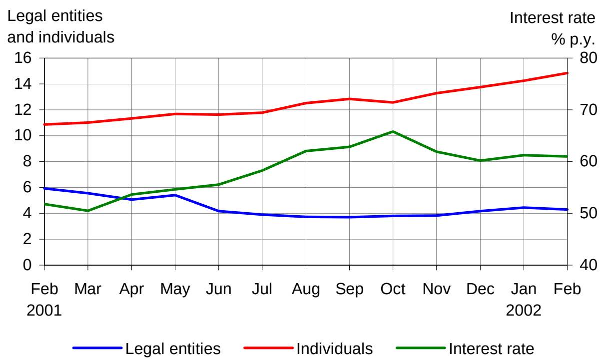
The increase in the dispersion between the two methodologies that occurred at times of crisis, such as the second half of 1998 (Russian crisis), the first half of 1999 (devaluation of the real) and as of March 2001 (Argentina) was caused by a sharper inclination in the interest curve, since the rates on longer term operations increased more than in the case of short-term rates. The reduction in volatility gradually reduced the gap between the two.

be made of rates on swap DI x pre long-term contracts which registered accentuated declines in short-term operations in the period.

The National Monetary Council (CMN) issued Resolution 2,933, dated 2.28.2002, with the purpose of stimulating a reduction in the risk factor in the composition of the banking spread. This instrument authorized the financial system to carry out derivative-based credit operations.

The average terms of credit operations expanded moderately, following the trajectory that had marked 2001. In this context, the terms for February 2002 came to 103 days in the corporate credit segment and 301 days under loans to individual borrowers. In both segments, these figures were 3 days greater than the figures for November 2001.

Default rate and average rate of credit



Defaults on credit operations contracted with nonearmarked resources moved upward over the course of 2002, reaching a level of 8.5% in February, compared to 7.6% in November. In operations with legal entities, the percentage of arrears increased by 0.5 p.p. in the quarter, closing at 4.3%. In the market involving credits with individual borrowers, the percentage of portfolio arrears hit the level of 14.9% in February, for a high of 1.1 p.p. in the quarter. This increase in the levels of arrears on operations with individual persons was caused principally by growth in transactions involving special overdraft checks. In this case, the percentage of arrears reached a level of 1.6 p.p. The deterioration in this type of portfolio was caused fundamentally by the effect of end-of-year buying, outlays on school costs and the volume of taxes levied at that time of year.

Credit derivatives

On 2.28.2002, Resolution 2,933 authorized financial institutions to perform derivative-based credit operations as part of the ongoing effort to reduce the risk factor in the composition of the banking spread. These instruments are contracts in which the parties negotiate the credit risk of the operation without transferring the asset cited in the operation at the time of contracting.

The asset negotiated, the value of which is the ceiling for the risk transfer, is defined as the credit generated by an operation involving a loan, financing, leasing, credit securities, stocks and bonds, guaranties, sureties and other financial or commercial instruments and contracts subject to credit risk, negotiated and practiced on the domestic market. The direct or indirect assign, sale or transfer of such is prohibited in any way and form whatsoever during the period in which the derivative-based credit operation to which it is referenced is in effect.

It should be noted that the major derivative-based credit instruments used internationally are credit default swaps and total rate of return swaps. In credit default swaps, the risk of the institution that performed the operation is transferred (the party transferring the risk) to the guarantor (the party receiving the risk), which then assumes the obligation of purchasing the referenced credits or, simply, payment of specific amounts should a default occur. In total rate of return swaps, both the earnings of the guarantor and that party's liabilities consequent upon default on the part of the borrower of the operation are calculated on the basis of the total flow of payments.

It is also important to stress that the credit risk of the underlying assets must necessarily be held by the party transferring the risk at the time of contracting, except when such has been regularly negotiated on organized markets, in such a way that the process of price formation is transparent and subject to market verification. However, both of the parties should compute these operations in the calculation of required net worth (PLE) in the proportion of the risk assumed.

Those authorized to act as the party receiving the credit risk are multiple banks, commercial banks, investment banks, the Federal Savings Bank (CEF), credit, finance and investment companies, real estate credit companies and leasing companies. Finally, one should note that the Circular that will regulate derivative-based credit operations was submitted to public hearings by Banco Central (Notification 14/2001).

Sector-by-sector distribution and credit quality

In the quarter ended in February, the volume of credit operations contracted by the private sector came to R$324.8 billion, reflecting a decline of 0.7%. This movement mirrored productive sector efforts to liquidate debts assumed up to the month of November to meet increased end-of-year demand, plus a lesser volume of new credit operations. This result was a consequence of a 2.5% reduction in the operations performed by private financial institutions. Note should be taken of the fact that only those operations contracted with private individuals and the rural sector turned in growth in the quarter. In contrast to this, loans granted by the public financial system expanded by 2.9%, registering growth in most of the different areas of activity and, particularly, in operations with individuals, the industrial sector and services.

A breakdown by sectors of activity indicates that the resources channeled into industry dropped by 0.7% in the quarter, as the credit stock closed at R$100.5 billion. With regard to the loans granted to the segment of other services, the balance reached a level of R$58.9 billion in February, a reduction of 3.2% in the quarter. In the same period of time, loans contracted by the sector of commerce reached R$35.6 billion, a reduction of 3.9%.

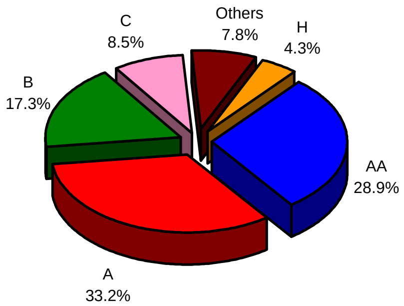
Housing financing expanded by 0.6% in the period from December to February, as the balance closed the latter month at R$24.1 billion. This result was impacted basically by incorporation of financial charges.

The balance of rural sector financing came to R$26.7 billion, a reduction of 0.3% in the quarter. This performance reflected a seasonal decline in demand for credit to cover current expenditures in the period. The relative participation of credits granted for current expenditures and marketing operations came to 43.2% and 7.5%, respectively. Here, note should be taken of the seasonal increase in the contracting of financing for marketing purposes in the second quarter of this year. In this context, the National Monetary Council authorized opening of credits in the amount of R$690 million from the Coffee Economy Defense Fund (Funcafé) to be channeled into the marketing of coffee with the objective of propping up the prices of the product in a period marked by excess supply on world markets.

Aside from this, the participation of credits for purposes of rural investment came to a level of 49.3%. These operations are supported by the Program of Modernization of the Farm Tractor Fleet and Like Implements and Harvesters (Moderfrota), which receives funding from BNDES and Finame. Considering the fact that the market has begun expanding, this program offered additional resources totaling R$670 million to be used in the period from January to June 2002, encompassing what is known as the pre-expenditure period in which farmers are deciding as to the amount of the investments they will need to plant the grain harvest scheduled for the second half of the year.

The credits channeled to states and municipalities totaled R$5.8 billion with growth of 2% in the quarter. Here, special mention should be made of the resources that the BNDES released for investment in the sector of gas distribution. The federal government banking debt came to R$3.7 billion, for a decline of 4.5% due basically to liquidation of the operations of a government company operating in the energy sector.

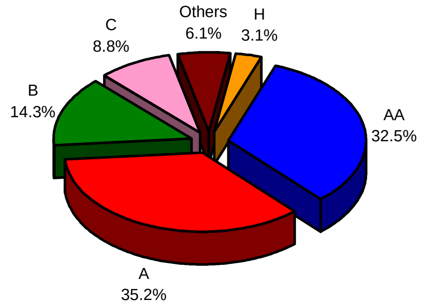
Credit operations in the financial system by levels of risk - February 2002



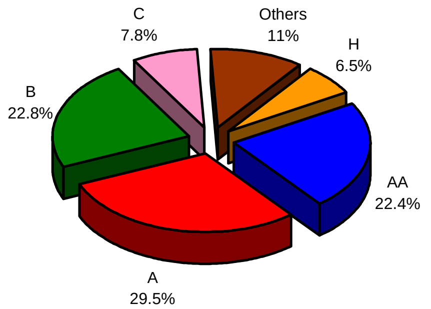
In February, operations granted by the private financial system totaled R$214.6 billion, for a quarterly decline of 2.4%. The classification by risk level indicated that 67.7% of the credit assets of this segment were included in groups AA and A and 3.1% in group H, compared to 68.8% and 2.9%, respectively, in November of last year.

The asset portfolio of the public financial system registered a balance of R$119.8 billion, for growth of 2.7% in the quarter. In the classification according to risk levels, 51.9% of the segment's credits were registered under levels AA and A and 6.5% under level H, compared to 51.8% and 5.5%

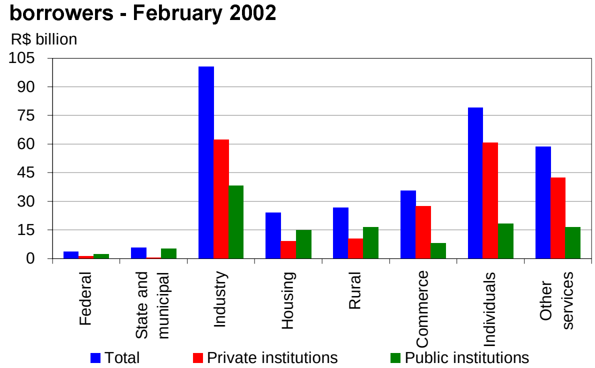
Credit operations in the private financial system by levels of risk - February 2002



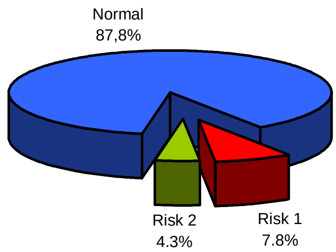
Credit operations in the public financial system by levels of risk - February 2002



Credit operations in the financial system by borrowers - February 2002



Credit operations in the financial system - February 2002



in the same order in November. The growth of operations classified under level H was caused by funding made available for the capitalization of a government institution in December, under the terms of the Program of Strengthening Federal Financial Institutions, making it possible to reclassify their credit assets and constitute the respective provisions.

With regard to the financial system credit portfolio profile, operations considered to bear a normal risk (from AA to C) totaled R$293.7 billion in February, representing 87.8% of the total. Loans registered under risk level 1 (from D to G) added up to R$26.2 billion, and those classified under risk level 2 (level H) came to R$14.5 billion, corresponding to 7.8% and 4.3% of the total, respectively. In November, these participation levels had reached 88.5%, 7.7% and 3.8%, in that order.

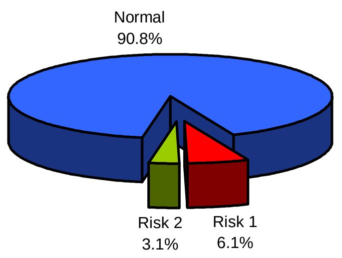
Total provisions set aside by the financial system came to R$25.3 billion in February, with growth of 10.4% from December to February. The relative participation of provisions in relation to total credits came to 7.6%. Total amounts set aside by public and private banks corresponded to percentage participation of 10.1% and 6.2%, respectively.

3.2 – Monetary policy

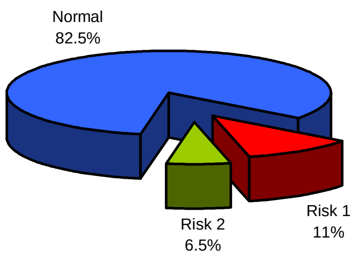
Monetary aggregates

Viewed under the prism of the restricted concept (M1), the average balance of the money supply came to R$74.4 billion at the end of February, for a reduction of 5.6% in relation to the month of December. Among the components, currency held by the public registered a downward slide in terms of its income velocity in the first two months of 2002,

Credit operations in the private financial system - February 2002



Credit operations in the public financial system - February 2002



following the period of stability that marked the second half of the previous year, indicating growth above nominal income.

With respect to the average balance of demand deposits, the year witnessed a drop of 3.6% to a balance of R$46.5 billion at the end of February. The income velocity of demand deposits has remained relatively stable, closing the month of February at the same level as in 2001. Basically, this performance was a consequence of the level of economic activity in the period and the behavior of credit operations.

Average daily monetary base balances came to R$50.1 billion at the end of February, for a reduction of 5.3% in the year. Among the components, the average balance of currency issued dropped by 7.3%, as a result of lesser seasonal demand for manual currency. The banking reserve balance dropped by 1%, reflecting no more than the decline that is characteristic of the month of February.

In its broadest concept, the broad money supply came to R$761.3 billion at the end of February, with growth of 0.5% in the quarter, a percentage that was lower than the capitalization of its components. For the most part, this behavior can be attributed to a drop of 0.9% in the financial system credit portfolio. Another factor that contributed to this result was the inflow of R$3.2 billion in taxes by pension funds in January and February.

Federal public securities

In keeping with the terms of the Annual Public Debt Financing Plan for 2002, the National Treasury maintained its strategy of restructuring the securities debt profile in the first quarter of 2002. The dual objective here was to lengthen the average term of the papers issued in public offer and to increase the participation of preset papers in the debt total.

Monetary programming in the inflation targeting system

Definition of monetary growth targets is a procedure traditionally adopted by central banks to ensure a level of liquidity in the economy that is compatible with the desired behavior of price levels. Initially, monetary targets were based on monetary aggregates, since control of such variables would impact the level of economic activity and, consequently, price levels.

Financial system development diversified the forms of payment and expanded the liquidity of financial assets, altering the way in which monetary aggregates influence the economic system. Currently, control of monetary aggregates has uncertain effects on the liquidity of the economy in the broad sense, generating uncertainties with respect to monetary policy efficacy.

In such circumstances, the central banks of countries with developed financial systems tend to control interest rates instead of setting monetary targets as the preferred way of influencing demand. In this way, once interest is controlled, the monetary aggregates become endogenous factors and the targets take on an indicative character when based on the aggregates.

In Brazil, monetary targets were initially introduced to remain in effect in the third and fourth quarters of 1994 and were backed by the terms of the provisional measures adopted for the purpose of defining the underlying rules of the Real Plan, later transformed into Law 9,069, dated June 29, 1995. According to this legal framework, as of the first quarter of 1995, Banco Central began elaborating the monetary program to be submitted for the approval of the National Congress, once it had been analyzed and accepted by the National Monetary Council.

In the past, monetary programming set growth limits for certain monetary authority and commercial bank accounts. Currently, monetary programming consists of projections of the major monetary aggregates through the use of a band system, referring to the final day of each calendar quarter. Programming considers the restricted concepts of the monetary base and money supply (M1) – for which observations are adopted in terms of the monthly average of balances on the business days of the month, in light of the seasonalities noted over the course of the week and the month – and the broad monetary base and money supply (M4) - whose observations are adopted in the end-of-month balances.

An important aspect in this context in which the current rules for monetary programming were instituted refers to the need for linking primary monetary issues to international reserves. This procedure was indispensable to the economic policy then in effect which, basically, had the objective of guarantying the credibility of the recently created monetary standard. At the same time, it indicated the monetary authority's commitment to external equilibrium without pressuring exchange rates, which is a fundamental condition for sustainable economic growth with price stability.

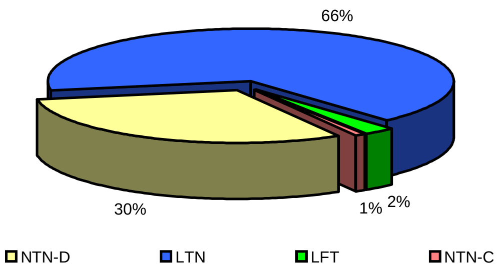
With adoption of the inflation targeting system in June 1999, the monetary authority's commitment before society shifted to the results obtained by its policy in terms of price stability, without necessarily strictly adhering to monetary issue targets. In this sense, once the floating system of exchange is considered, the instruments of monetary policy are no longer used to defend predefined exchange rates and the linkage of monetary issues to international reserves is seen to be not only unnecessary, but also an obstacle to adequate economic policy implementation.

Thus, though monetary targets can be defined in a manner consistent with the parameters considered in the determination of the targets for the rate of inflation, these targets should be understood as reference values to the extent that the monetary policy instrument is the rate of interest and, consequently, monetary growth is tied to changes in the interest rate target and changes in currency demand. One should note that price stability goal consequent upon creation of monetary programming is preserved in the inflation targeting system, making the monitoring of monetary targets dispensable.

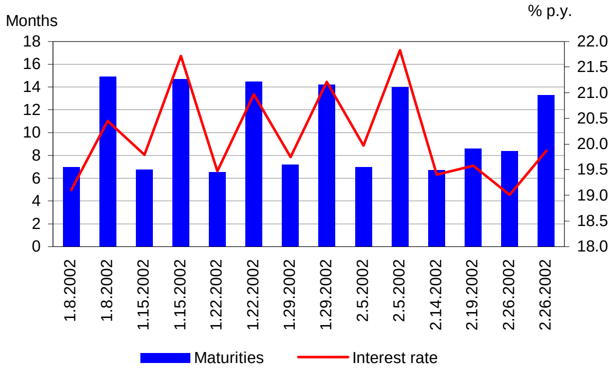
Nevertheless, it should be stressed that information on the present and future behavior of macroeconomic variables are incorporated in monetary aggregates. Thus, for instance, unexpected changes in monetary aggregates may signal unforeseen variations in aggregate demand, which, in turn, may affect prices. Thus, the monitoring of monetary aggregates is important for the projection of macroeconomic variables.

Preset papers represented 64% of the total financial result of papers issued in public offers in the months of January and February. This corresponds to strong growth when one considers the 43% level of participation in the fourth quarter of 2001. This result reflected the increase in demand for these papers and was consistent with the scenario of expectations of a reduction in the basic interest rate over the course of the year. Consequently, the participation of preset securities in the total securities debt issued competitively interrupted the downward trajectory registered since the start of 2001, when it came to 21%, before dropping to 11% at the end of the year and remaining at that level until February. Parallel to this, there was a strong reduction in the average rates registered in the auctions involving these papers: at the end of December 2001, the spread for six month National Treasury Bills (LTN) in relation to the basic interest rate came to approximately 1.5 p.p., dropping to -0.1 p.p. on March 5. In the same period, the spread for one year LTN dropped from 4 p.p. to 0.4 p.p.

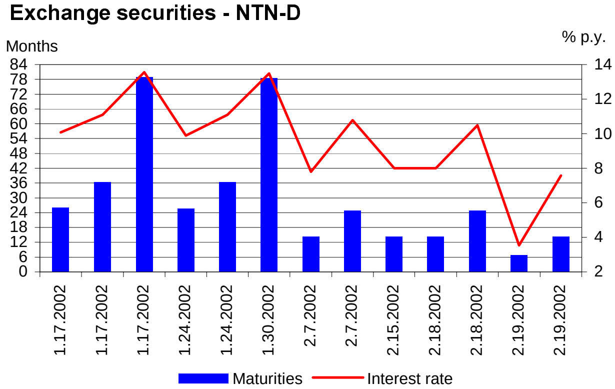
Competitive issues of federal public securities
1.1.2002 to 2.27.2002



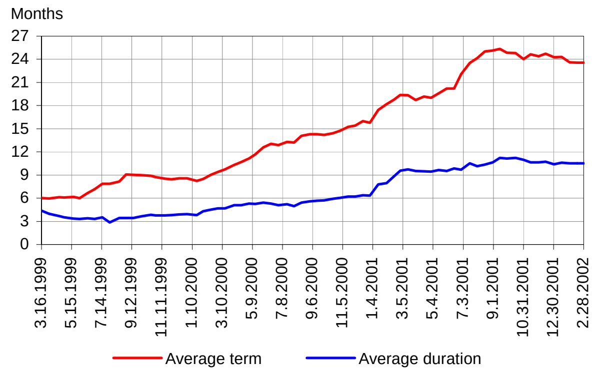
National Treasury Bills - LTN



Exchange securities - NTN-D



Public securities - duration and term



The participation of Treasury Financing Bills (LFT), which bear earnings at the Selic rate, in total securities issued competitively dropped from 45.3% in December to 43.4% in February. It was in this month that offers of these papers were recommenced, after they had been interrupted by the National Treasury in October 2002.

In January, emphasis should be given to two specific operations involving the exchange of Banco Central Notes – Special Series (NBCE) for National Treasury Notes – Series D (NTN-D), with the objective of lessening the concentration of NBCE maturities from the period between February and April of this year. This concentration is due to the exceptional volume of these papers placed last year to meet the demand of economic agents for exchange hedging. NBCE maturities between February and April came to R$21.1 billion, of which R$4.1 billion were exchanged in two operations for NTN-D, with maturities in 2004, 2005 and 2008.

With respect to the debt referenced to exchange rate variations, Banco Central and the National Treasury will carry out exchange swap operations conjugated with primary offers of LFT, thus improving the instruments available to the market for purposes of protection against exchange volatility. The procedure is expected to contribute to reducing the cost of the debt referenced to exchange, by reducing administrative costs for economic agents and to improving their perception of risk, since adjustments of margins will be made monthly.

The average term of competitively issued securities declined from 24.2 months at the end of December to 23.6 months at the end of February. This reduction was essentially due to the shortening of the term of papers with earnings based on the Selic rate from

LFT auction conjugated with Exchange Swap Operation

With the aim of improving the instruments used in financial market operations by banks, investment funds, companies and other economic agents, Banco Central and the National Treasury will carry out exchange swap operations conjugated with primary LFT offers.

With this, Banco Central and the Treasury will be duplicating the sale of exchange securities with the advantage that, instead of just one instrument (NTN-D/NBCE), it will offer two so as to allow the market to negotiate them separately. This will make it possible to define the price of the risk of exchange variation, of the exchange coupon and of the LFT individually, thus enhancing the efficiency of the operation.

The auctions will be carried out at different times on the same day, with the swap offer occurring first. For each institution, the swap acquisition will be limited to the financial volume of the proposals accepted in its offer of LFT. The institutions may acquire LFT independently of their participation in the swap auction. At the end of the LFT auction, Banco Central will be in a position of being able to reduce the number of swap contracts accepted preliminarily from each institution with the objective of adjusting the financial equivalent of the swap operation of each institution to the amount of its proposal(s) effectively accepted in the LFT offer. Just as now occurs, the new instruments may be offered earlier for purposes of rolling the maturities of the exchange papers.

The current system has been shown to be a more costly way of offering exchange protection to the productive sector. The requirements for margins and spreads involved result in increases in the total cost of the operation for the company that is seeking exchange hedging and in higher premiums demanded in auctions of exchange papers.

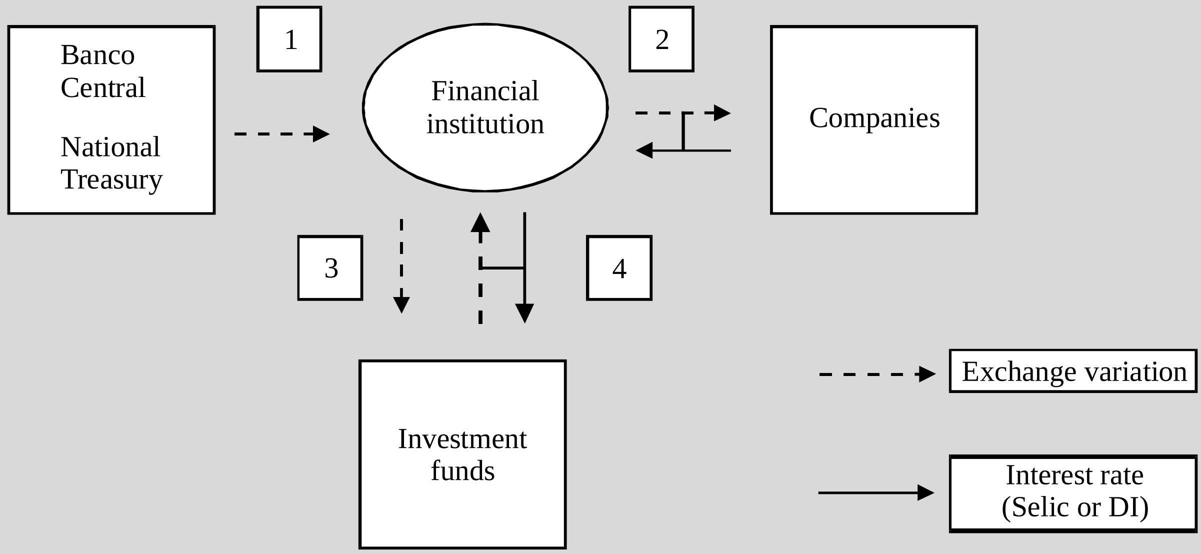
Utilization of the new instrument makes it possible to achieve the same objective through a more direct strategy, allowing investment funds to acquire LFT in the primary auction through financial institutions and that the latter purchase the exchange swap and pass it on to their clients.

In calculating public offers of both LFT and swaps, the single price criterion is used, with the minimum price quotations accepted in each event applied to all of the winning proposals.

The swap offer will occur in a highly transparent manner and will be carried out by the Department of Open Market Operations (Demab) through the System of Electronic Formal Public Offers (OFPUB). Registration will be made at the BM&F according to the specifics of the Exchange Swap Contract with Periodic Adjustment (SCC) on the date scheduled for financial liquidation of the LFT offer. The exchange exposure consequent upon these contracts will be indicated in press releases dealing with the internal securities debt and fiscal policy.

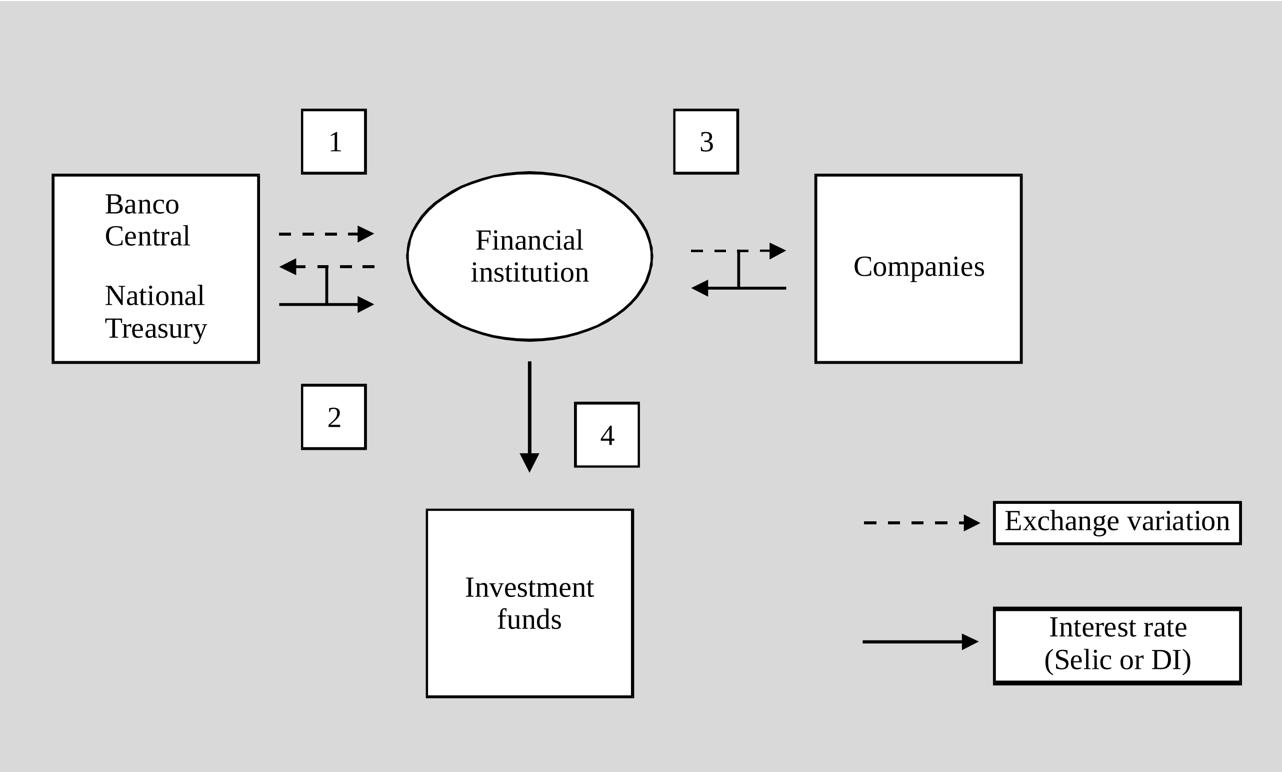
The diagrams below synthesize the current situation with exclusive utilization of exchange securities and a new operating structure with the use of exchange swaps combined with LFT sales.

The current system can be summarized as follows: 1) the National Treasury sells exchange securities in auction to financial institutions; 2) the financial institutions transfer the exchange risk through an exchange swap operation to companies seeking hedge; 3) and 4) later, the financial institution may opt to sell the NTN-D to investment funds and, simultaneously, carry out a swap operation opposite to that carried out with the companies.



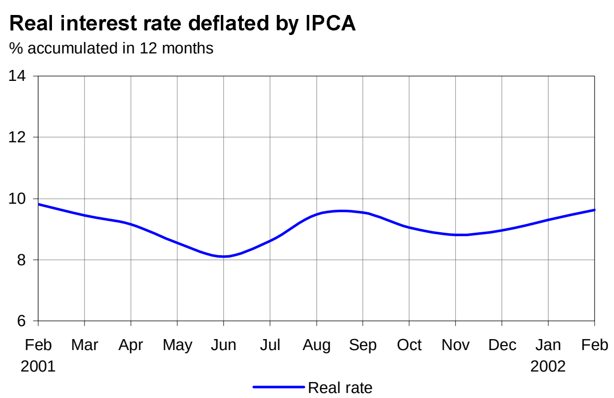
In summary, the combination of NTN-D and the exchange swap is equivalent to an application in Interbank Deposit Certificates (CDI) plus a premium (given by the difference between NTN-D exchange coupons and the swap). The DI investment funds, which are a significant part of the investment fund industry, are basically buyers of papers indexed to the internal rate of interest (for example, LFT), since they seek earnings closer to the benchmark defined by the CDI. For this reason, they acquire "packages" offered by the banks.

The new system can be summarized as follows: 1) the National Treasury sells LFT in auction to financial institutions and to investment funds; 2) conjugated with this operation, Banco Central offers exchange swap to the financial institutions; 3) these institutions negotiate the exchange swap on the BM&F, with companies interested in acquiring exchange protection; 4) the financial institution may opt to sell the LFT to the investment funds.



30.6 to 29.4 month, and to the reduction of the terms of Banco Central papers, which registered no issues in the period, from 15.7 to 14.7 months. The average duration of these papers moved in the opposite direction, expanding from 10.4 months in December to 10.5 months in February, reflecting the increase in the duration of preset papers in the period from 3.4 to 4.8 months.

Real rate of interest and market expectations

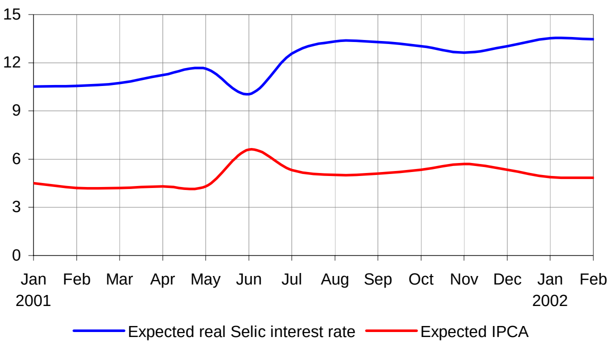


In 2001, the Selic rate – deflated by the IPCA – closed with its lowest level since 1990, just 9% per year, reflecting a reduction of 1.8 p.p. in relation to the previous year. In the month of February, the real rate accumulated in twelve months registered expansion for the third consecutive month, closing at 9.6% per year.

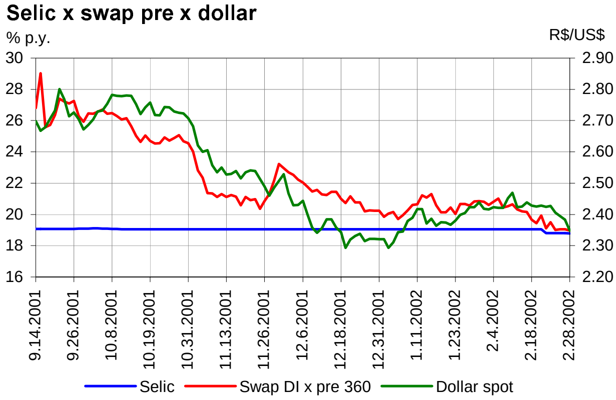
The real ex-ante rate of interest, defined as the ratio between the effective Selic rate in the month and market expectations for IPCA growth in the next

Ex-ante real interest rate

For 12 months



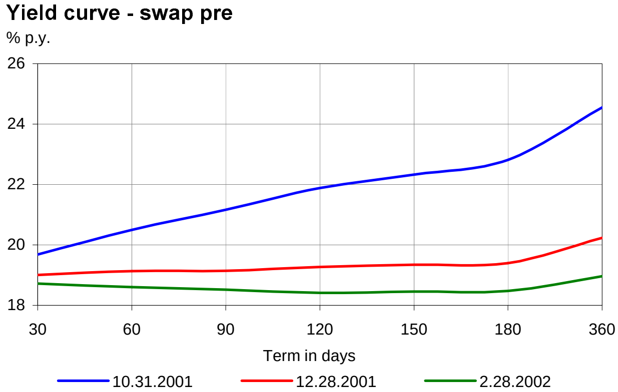
Selic x swap pre x dollar



12 months, based on data gathered in the Banco Central survey, closed at 13.5% per year. Here, one should note the reversal of the IPCA curve, a fact that is expected to generate additional pressure on the real rate in the coming months.

The favorable performance of the internal and external scenarios has contributed to the gradual reduction in futures market interest rates. Upward movement in the value of Brazilian papers on the international market demonstrate that foreign investors have drawn a clear distinction between the risks found in Argentina and those found in Brazil. At the same time, a flow of external resources in amounts sufficient to ensure the financing of the current accounts result created the conditions required for exchange market equilibrium, a situation that was later reinforced by the change in the posture of the risk classification agencies in relation to Brazilian papers. Going beyond this, evaluation of early inflation indices confirmed the downward trend and generated perspectives of a short-term reduction in the basic rate. Copom’s February decision to reduce the Selic rate target by 25 base points accelerated the process of definition of the prices of lower interest, thus inverting the interest curve over the coming months.

Yield curve - swap pre

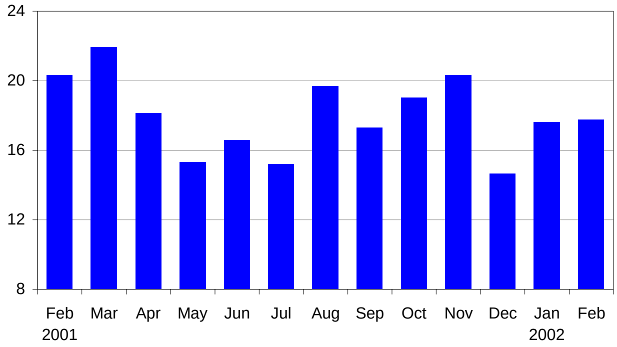


The yield curve which, at the end of October, registered a differential of 4.0 p.p. among the rates used in short-term contracts (30 days) and long-term contracts (1 year) registered a February differential of 0.2 p.p., with negative amounts in relation to the shorter terms, thus suggesting an outlook for a short-term drop in the basic rate.

In the first two months of the year, the volume negotiated in one day DI futures contracts remained stable at about R$17.6 billion, or quite close to the average for 2001. This performance is attributed to a market consensus with regard to Copom decisions on the Selic interest rate target.

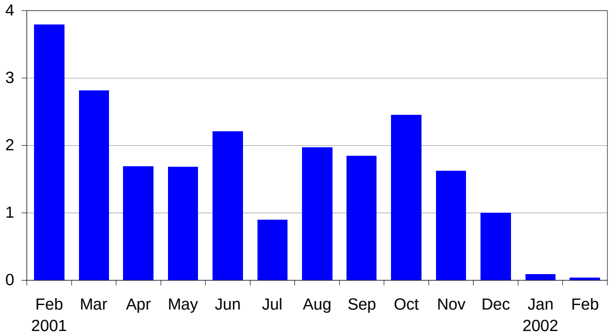
One day DI - average negotiated volume

R$ billion

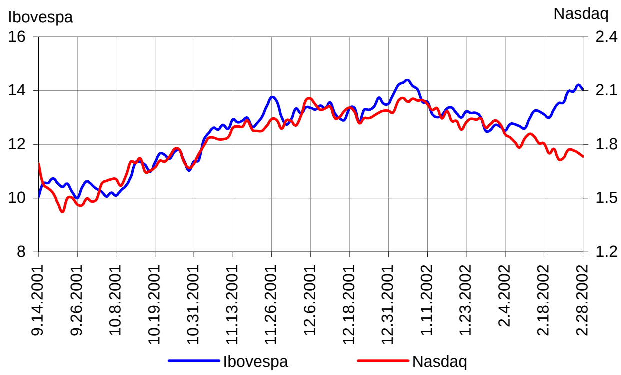


Forward DI - average negotiated volume

R$ billion

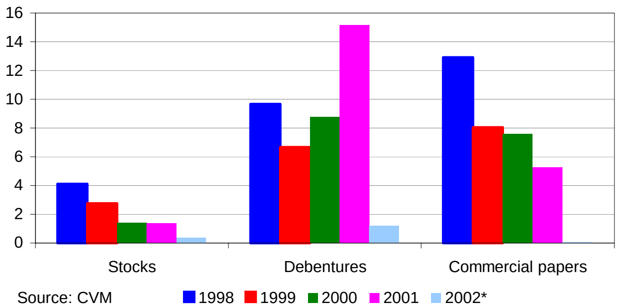


Stock exchanges - thousand points



Primary issues in capital market

R$ billion - accumulated in the year



Source: CVM

* Until February.

Following Copom's February decision, the average surpassed the mark of R$20 billion.

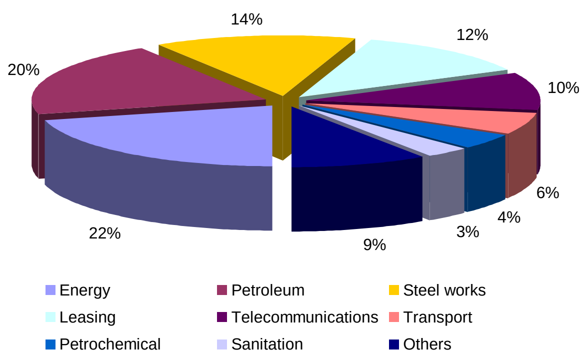
The forward DI contract with adjustment, which was created in June 2000 as an alternative to Swap contracts DI x pre, lost liquidity to one day DI contracts, since the latter have daily adjustments, lower operating costs and the possibility of opening negotiation of longer contract terms in the electronic system. In the month of February, the DI forward contract with adjustment registered a daily average of R$37 million, compared to an average of R$2.1 billion registered in 2001.

Capital market

The reduction in futures market interest rates, coupled with the outlook for exemption from the Provisional Contribution on Operations or Transmission of Values and Credits and Rights of a Financial Nature (CPMF) on stock market financial operations, impacted the value of the stocks traded on the São Paulo Stock Exchange (Bovespa). As of the beginning of February, the Bovespa Index (Ibovespa) moved into a trajectory that was different from that of the Nasdaq index. The Brazilian market's index, which leveled off in the range of 13,000 points since mid-November, closed the first two months of 2002 at 14,033 points.

With the increase in the costs and risks of external financing in 2001, Brazilian companies sought resources on the capital market, principally through issues of debentures in detriment to issues of promissory notes and, principally, stocks. Inflows through this type of operation closed with negative results as a consequence of low stock prices.

Debentures issues - 2001

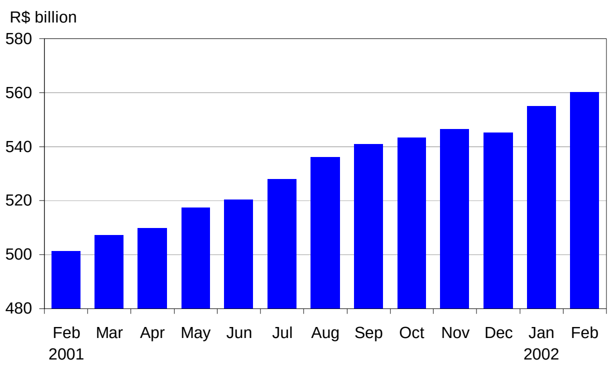


In 2001, debenture issues expanded by 73%, registering a level of R$15.2 billion, while inflows through stocks and promissory notes dropped by 4% and 31%, adding up to R$1.4 billion and R$5.3 billion, respectively. Companies from the energy sector obtained the largest volumes of resources through debenture issues and accounted for 22% of the total obtained in the year, followed by the petroleum sector, with 20%, and by steel, with 14%.

In order to provide an added incentive to the stock market, the new Corporate Law, which will go into effect in March 2002, instituted several systems of protection for minority stockholders, such as a limit of 50% of capital for issues of preferred stocks and stricter conditions for the closing of capital. Those holding preferred stocks are also able to count on safeguards, such as the right to elect a member of the Board (for those that possess at least 10% of the capital stock), a minimum dividend equivalent to 3% of net worth or 10% more than the amount paid to common shares, the right to reimbursement of 80% of the value paid to controllers (tag along) in cases of the sale of stock control.

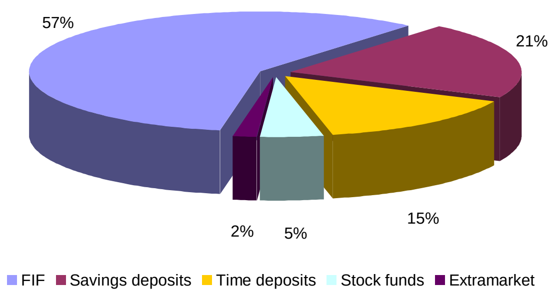
Financial investments

Total financial investments



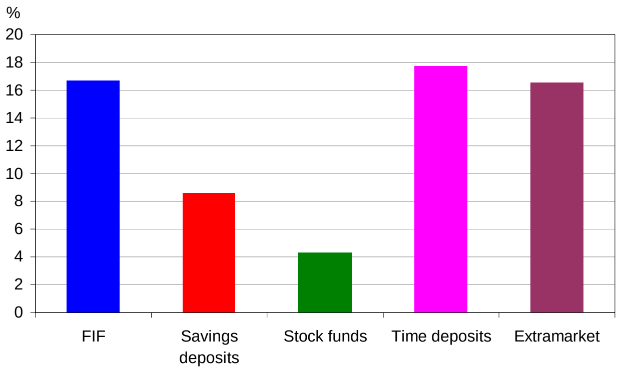
Total financial investments, encompassing the sum total of the balance of savings accounts, time deposits and investment funds, came to R$560.2 billion in February, with growth of 2.5% in relation to November 2001. Here, one should stress the evolution of the net worth of financial investment funds (FIF), which registered growth of 3.7%, coming to R$332 billion. This performance was the result of a high level of inflows in January 2002, which is one of the seasonal characteristics of the period. However, this occurred despite a strong outflow of resources on the 31st of January, coming to approximately R$4 billion, caused basically by the agreement on the payment of the income tax by pension funds, as a result of Provisional Measure 2,222, dated 9.4.2001. This measure defined incentives for the funds to adhere to the special system of taxation. In the period between January and February 2002, the FIF accumulated profitability of 2.8%.

Financial investment distribution
February 2002



The net worth of the stock funds, which encompass investment funds in securities and stocks (FITVM) and mutual privatization funds (FMP), came to R$25.8 billion in February, with growth of 5% in relation to November. The decision to place variable income funds and fixed income funds within the same income tax rate (20%) came as a factor that inhibits the contracting of resources on the variable income segment, in light of the magnitude of risk inherent to this market. Stock funds generated accumulated profitability of 3.8% up to February 2002.

Accumulated earnings in 2001



The extramarket funds produced net worth of R$9.5 billion in February, reflecting a reduction of 25.4% in the last three months. In December 2001, Resolution 2,917 was issued, permitting creation of exclusive extramarket investment funds that would be able to target their operations into the derivatives market, for the purposes of minimizing the risks consequent upon lags between the terms and indexing factors of the assets of the fund and the liabilities of quota-holders. This measure provided greater flexibility to specific investors, with a real need for exchange coverage. The extramarket funds accumulated profitability of 1.4% in 2002.

The CDB closed the first two months of 2001 with a balance of R$110.3 billion, for growth of 3.2% in the quarter. CDB have maintained their attractiveness as a result of increasing issues of postset papers that are better adapted to scenarios of interest rate fluctuations. Currently, about 90% of CDB on the market are related to interest rates. In February, savings accounts came to a balance of R$119.2 billion, for growth of 2.5% in the quarter. The accumulated rate of earnings in the year up to February closed at 2.5% for deposits with anniversary on the first day of the month.

3.3 – Fiscal policy

The Central Government primary surplus came to R$22.4 billion in 2001, equivalent to 1.89% of estimated GDP for the period. The National Treasury registered a surplus of R$35.9 billion, while the results of the General Social Security System (RGPS) and Banco Cenral closed with deficits of R$12.8 billion and R$646 million, respectively.

Though the rate of economic growth and inflows of atypical revenues in 2001 was below the amount estimated for the year, the National Treasury surplus was R$4.2 billion above that of the preceding year and, as a proportion of GDP, increased slightly from 2.9% to 3%. The loss of revenues consequent upon these two factors was offset by the effects of the rate of exchange on the income tax inflow, a stronger inflow of resources in the form of dividends and recovery of revenues under the terms of the Fiscal Recovery Program (Refis).

Treasury outlays also increased, moving from 10% of GDP to 10.8%. The heading that turned in the strongest rate of nominal growth in relation to 2000 was that of "other current and capital expenditures" (19.6%), followed by "personnel and charges" (15.4%). In the first case, growth is justified by the greater flow of transfers to the health sector under the terms of Constitutional Amendment 29/2000, coupled with release of expenditures to meet the needs of the sector of education and strategic Federal government programs. In its turn, outlays on personnel and charges generated pressures for wage realignments and the restructuring of certain strategic civil service careers, as well as judicially mandated payments.

The Social Security deficit totaled R$12.8 billion, reflecting a nominal increase of 27.4%, compared to the figure for 2000. As a proportion of GDP, the deficit represented 1.08%, for growth of 0.15 p.p. compared to the previous year's percentage.

The net inflow totaled R$62.5 billion for an increase of 12.2% in relation to 2000. Among the factors that contributed to this growth, the following deserve mention:

a) social security contribution, totaling R$63 billion in 2001, for an increase of 12.9% in relation to the previous year;

b) revenues of R$2.4 billion in inflows through the Integrated System of Tax and Contribution Payments by Micro and Small Business (Simples), compared to R$2 billion in the previous year;
c) collection of R$797.4 million in judicially mandated payments, compared to R$910.6 million in 2000;
d) growth of 67.3% in revenues consequent upon Refis to R$442.6 million in relation to those of the previous year;
e) collection through Treasury Financial Certificates (CFT-E) which moved from R$280.3 million in 2000 to R$426 million in 2001.

Although Social Security revenues have expanded at a pace higher than inflation, outlays increased even more sharply. Social security benefits totaled 6.31% of GDP or 0.26 p.p. more than in 2000. In nominal values, growth came to R$9.5 billion or 14.5% in relation to the previous year. This growth can be explained principally by the increase in the average value of social security benefits paid in the period, as a result of a 19.2% increase in the value of the minimum wage.

In January 2002, the primary Central Government result was a surplus of R$5.8 billion, compared to R$2.6 billion in January of 2001. The National Treasury registered a surplus of R$6.9 billion, while the Social Security System and Banco Central turned in deficits of R$1.1 billion and R$20 million, respectively.

Treasury revenues expanded by R$6.1 billion in relation to January 2001. A significant part of these revenues was generated by inflows of R$1.8 billion in taxes in arrears by pensions funds and extraordinary inflows of R$1.2 billion involving profit-taking by a state company as a result of transfer of public securities. Aside from this, growth occurred in the inflow of concession revenues, in the amount of R$657 million, due to inflows of resources on cell telephone services (D and E bands) and payment to the National Petroleum Agency (ANP) for occupation and retention of areas for purposes of petroleum production.

Public sector borrowing requirements (NFSP)

The nonfinancial public sector closed 2001 with the highest primary surplus in the series dating back to 1991. This result made an important contribution to overcoming the unfavorable impacts of the energy crisis and the Argentine situation.

In 2001, the primary surplus totaled R$43.7 billion, compared to R$38.2 billion in 2000. The surplus registered by regional governments increased by R$4.4 billion, while that of the Central Government expanded by R$1.5 billion. The surplus registered by state companies declined by R$495 million. The improved performance on the part of regional governments is basically explained by consolidation of the Fiscal Responsibility Law (LRF) and the conditioning factors imposed following renegotiation of debts to the federal government.

Nominal interest appropriated on an accrual basis came to R$86.4 billion in 2001 or 7.3% of GDP, compared to R$78 billion, or 7.2% of GDP in the previous year. The Central Government accounted for 54.7% of interest appropriated in 2001 compared to 58.3% in 2000; regional governments accounted for 40.2%, compared to 37%; and state companies from the three spheres of government, for 5.2%.

Considering public sector borrowing requirements in the nominal concept, the deficit accumulated in 2001 came to R$42.8 billion or 3.5% of GDP. In comparison to 2000, this result represents an increase in nominal values and a decrease as a proportion of GDP. In the latter system of calculation, only state companies registered an increase in requirements, due principally to a smaller primary surplus. Mention should be made of the decline in the borrowing requirements of regional governments. This was a reflection of the rise in the primary result that more than offset the increase that occurred in the appropriation of nominal interest.

For 2002, expectations point to maintenance of fiscal austerity. In this sense, the primary result for January was a surplus of R$5.5 billion, accounting for 48.2% of the floor value defined for the first quarter.

Net public sector debt and gross government debt

In January 2002, the net public sector debt (DLSP) came to R$685.3 billion, equivalent to 55.2% of GDP, compared to R$675 billion or 54.6% of GDP in October of 2001. The debt expanded once again in January following two months of relative stability and closed at R$660.4 billion, or 53.3% of GDP, and R$660.9 billion and 53.4% of GDP, respectively, in November and December 2001.

Debt growth performed in highly distinct manners in the period. From November to December, the value of the real rose by 14.3% and contributed to a reduction of R$46.2 billion in the net public sector debt. This reduction was partly offset by appropriation of nominal interest in the amount of R$15.5 billion and recognition of R$17 billion in debts, registering a reduction of R$14.1 billion in the total debt in the period. In January, recognition of debts and depreciation of 4.2% in the value of the real raised the debt by R$8.5 billion and R$13.5 billion, respectively, and became the primary factor responsible for a total rise of R$24.4 billion in the month.

The gross general government debt, which includes the federal government and state and municipal governments, but excludes Banco Central – meaning that the public federal government securities in the Banco Central portfolio are part of this indebtedness – came to R$905 billion or 73% of GDP in January, compared to R$885.3 billion in December. This increase was caused principally by exchange depreciation in January and by the exchange of R$4.2 billion in Banco Central papers (NBCE) on the market for National Treasury securities (NTN-D), which are neutral in relation to the DLSP, but have an impact on the gross general government debt.

Federal securities debt

In the period from October 2001 to January 2002, the federal securities debt, evaluated according to the portfolio position, declined from R$637.1 billion to R$635.1 billion. Net redemptions of R$16 billion and appreciation of the real against the dollar by 10.67% were the factors underlying this result.

Even with issue of R$2.5 billion in exchange securities, the upward movement in the value of the real against the dollar generated a reduction in the exchange securities debt from R$209.3 billion to R$186.5 billion, a drop that was reflected in their participation in the total federal securities debt which fell from 32.9% to 29.4%. In the same period, operations included redemptions of R$18.6 billion in papers not referenced to exchange, with participation of the preset debt moving from 8.3% to 7.6% and that of the debt referenced to the Selic rate rising from 48.8% to 52.6%.

3.4 – Conclusion

The volume of credit operations contracted with the financial system registered stability in relation to the previous quarter. Among the factors that contributed to this performance, one should cite lesser demand for credit on the part of companies, as a result of the added cash flow generated by installment sales at the end of the previous year and the lower pace of activity, both of which are characteristic of the period. On the other hand, there was greater demand for banking credit on the part of families, particularly short-term credits. For the most part, these credits were utilized to cover outlays in the early part of the year.

Despite these seasonal aspects, maintenance of the level of credit in the period reflected the falloff in new credit operations as of the second quarter of 2001. This performance was a reflection of the uncertainties that reigned on the world economy and to monetary policy restrictions, considering that the nation complied with its inflation target. Thus, parallel to the more selective approach taken by institutions in channeling credits and to the higher spreads in these operations, there was a gradual rise in the default level, particularly among individual debtors. In view of the positive indicators that point to increased stability for the current year, with consequent reductions in the levels of risk implicit in credit operations, expectations are that bank credits will leverage the process of renewed productive growth, albeit initially at a moderate pace.

This process is expected to favor attainment of quite comfortable fiscal results in 2002. In this sense, initial results suggest continuity of the austere trajectory that marked previous years, signaling compliance with the primary surplus target projected for March. Above all else, this performance will become feasible as a result of the increase in the federal revenue inflow generated by pension fund payments of taxes from previous years. Another factor that deserves mention is the projected cutback in spending, aimed at reestablishing budget equilibrium for 2002, in contrast to alteration of the income tax table and revision of estimated economic growth for the year.

With regard to public sector indebtedness, it should be emphasized that the trajectory of the debt/GDP ratio is sustainable as a result of the continued surplus primary results and lesser exchange rate pressures on the debt. One should further underscore the system of exchanging securities indexed to the dollar that will be implemented through Banco Central issues of LFT tied to swap operations. This system will guaranty that investor demand for protection against possible exchange rate fluctuations will be met at lesser cost, thus reducing the premium on papers issued by the public sector.

4 – International economy

The instability that hit world markets in the final quarter of 2001 declined in intensity in the early months of 2002, indicating that the impact of the events of September 11 in the United States were being gradually absorbed. At the same time, there are some indications that the global economic downturn that began in mid-2000 and was triggered by signs of lesser growth in the United States seems to be reversing course.

Early indicators of the year concerning the major world economies, particularly the United States, point to an end in the economic slowdown, despite uncertainties regarding the strength of the recovery.

With regard to the United States, the current recession is the weakest of the postwar period. However, notwithstanding the lesser intensity of the decline, the recovery process has not been nearly as strong as on other occasions.

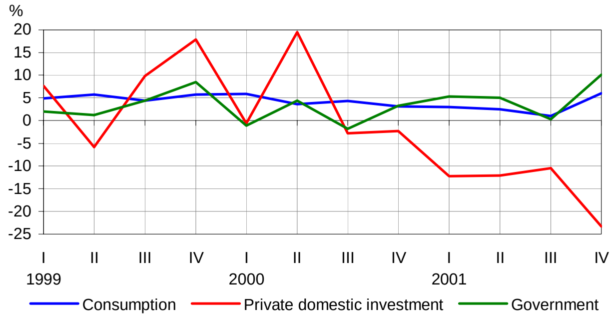
In Europe, the economic decline was less accentuated than in the United States but was certainly not negligible. Though data are still rather diffuse, they definitely point in the direction of recovery, albeit at a much lower pace.

In the case of Japan, the recession has continued and has had a ripple effect on other Asian nations. The fragility of the Japanese economy is reflected in the persistence of the process of deflation and has had a particularly strong impact on the banking sector, already immersed in severe problems of bad debts. Overcoming these problems will evidently require profound and wide-ranging structural reforms.

Most of the developing nations were also severely impacted by the downturn in the developed world. However, the early signs of recovery in the industrialized world have generated greater optimism among emerging nations. The upturn in expectations, in turn, has resulted in expanded foreign trade, lesser financial market volatility and increased inflows of foreign investment capital, indicating that the process of concentrating capital flows in the more developed economies is gradually reversing course toward the developing world.

4.1 – United States

Aggregate demand - components[1/]

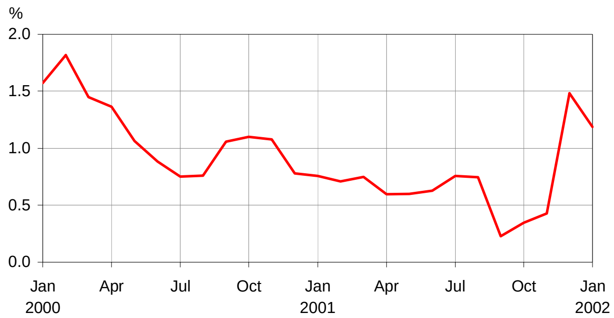


Source: Bureau of Economic Analysis
1/ Change, seasonally adjusted annual rate, deflated.

The first quarter of the year witnessed more consistent signs of renewed growth in the United States, though the data drawn from some economic indicators are still quite contradictory. However, these signs have resulted in some degree of measured optimism with regard to the imminence of recovery. Thus, while government consumption and spending expanded by 6% and 10.1% respectively in the fourth quarter of 2001, private investment fell by 23.3%, based on annualized, deflated data from which seasonal factors have been purged.

In the final quarter of 2001, orders placed with factories dropped by 0.4% utilizing data from which seasonal factors have been eliminated. In 2001, orders slipped by 8.6%. In the month of January, however, orders increased by 1.6%, with indications that the performance of consumer durables may have reached an even more significant growth level of 2.6%, when compared to the December results.

Personal consumption expenditures[1/]



Source: Bureau of the Census
1/ Change of the quarterly moving average seasonally adjusted, deflated.

Personal consumption outlays in the fourth quarter of the year increased by 1.5% according to the annualized statistical series purged of seasonal factors which, in turn, is based on the 1996 purchasing power of the dollar. In the year, spending on consumption expanded by 3.1%, though the rate of 12 month growth has been on a steadily downward slide. In the month of January, consumption increased by 0.3% in real terms.

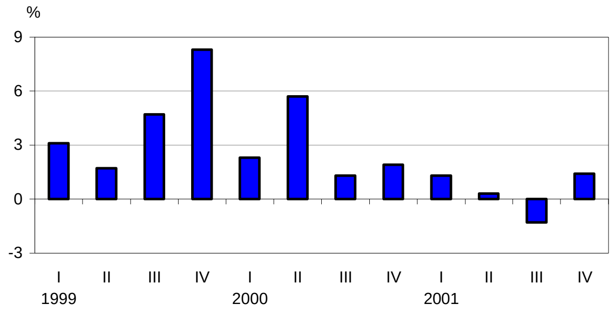
Sales in the retail trade sector increased by 3% in the final quarter of 2001, recovering from the decline of 0.4% in the third quarter. These are annualized figures from which seasonal factors have been excluded. In 2001, retail sector sales expanded by 1%. In the month of January, sales remained stable when compared to those of the previous month. It should be stressed that, once automotive vehicle sales are excluded – in other words, once the drop in automotive sales that followed termination of end-of-year installment-based clearance sales is ignored – sales of the retail trade sector increased by 1.2% in the period.

In real terms, the value of construction dropped by 0.5% in the final quarter of 2001, following a reduction of 1.6% in the previous quarter in the annualized series. In the year, construction expanded by 2.3% and was stimulated by downward movement in the interest charged on housing finance operations. In the month of January, the value of construction expanded for the fourth consecutive month and closed at 1.7%, corresponding to the largest monthly increase of the last twelve months.

The expansionary fiscal policy explicit in an ambitious program undertaken to cut taxes and increase spending resulted in a reversal of the process of accumulating fiscal surpluses. As a matter of fact, up to the month of January, the National Treasury registered a surplus of US$6.6 billion in the fiscal year. This process began in the month of October and is based on revenues of US$669.8 billion and spending of US$663.2 billion, while the surplus for the same period of the preceding fiscal year came to US$74 billion.

Insofar as the external sector is concerned, the weak performance of both exports and imports has generated a slowdown in the world economy and a recession at home. Thus, the trade deficit in goods dropped by 4.6% in the fourth quarter of 2001 according to data purged of seasonal factors. In 2001, the falloff came to 5.7% and reflected reductions of 6.7% in exports and 6.3% in imports. Should the process of economic recovery be confirmed, the United States external deficit is expected to increase in the near future, to the extent that growth in exports will be limited by the Japanese depression and the performance of the economies of the Euro Zone countries.

Gross Domestic Product[1/]



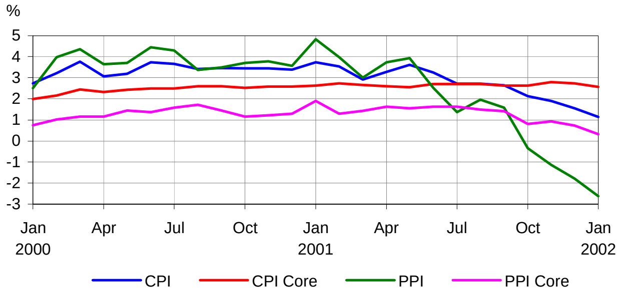
Source: Bureau of Economic Analysis
1/ Percent change from preceding period, seasonally adjusted at annual rates.

Insofar as aggregate supply is concerned, 1.4% GDP growth in the final quarter of the year surpassed the market consensus level of 0.8%, following four consecutive quarters of downward movement. Expansion in the fourth quarter was generated by consumer spending, particularly on consumer durables, and by government spending.

Once seasonal factors have been removed, data for industrial output fell by 1.8% in the fourth quarter of 2001, the year in which the decline totaled 3.8%. Output of capital goods fell by 3.8% in the fourth quarter and 14.1% in the year. In the month of January, industrial output remained stable while production of capital goods turned in its first positive result in the last seventeen months (0.4%).

Unemployment in the nonfarm sector fell from 5.8% in December to 5.6% in the month of January and 5.5% in February. Employment in the sector registered growth in the month of February for the first time in six months, while the manufacturing sector registered downward movement. Productivity in the nonfarm sector registered annualized quarterly growth of 5.2% in the fourth quarter and product per hour in the manufacturing sector turned in expansion of 1%. In both sectors, the ULC has been decelerating for the last five quarters.

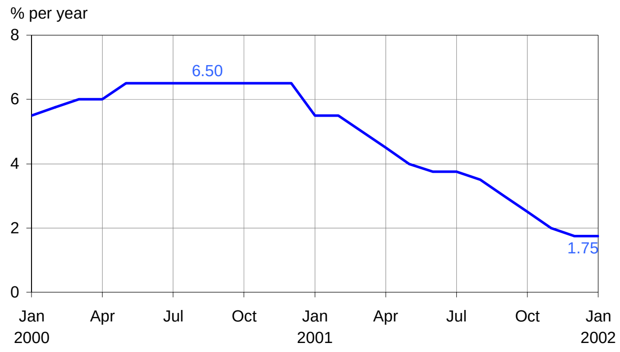
Prices
Annual change



Source: Bureau of Labour Statistics

Consumer inflation (CPI) over twelve months in the United States has been decelerating since May of last year, registering a price reduction of 0.51% in the fourth quarter of 2001. In the year, inflation fell to 1.6% compared to 3.4% in 2000 and closed the month of January at 0.17%. In recent months, the core CPI has also shown clear signs of downward movement, following a long period of relative stability. In the case of producer inflation (PPI), the downward trend was even more accentuated. In the fourth quarter of the year, prices fell by 2.48%, while the index registered negative growth of 1.79% in the year. In the month of January, the PPI expanded by 0.15%, following three consecutive months of downward movement in prices. The core PPI has been following a sharply negative trajectory.

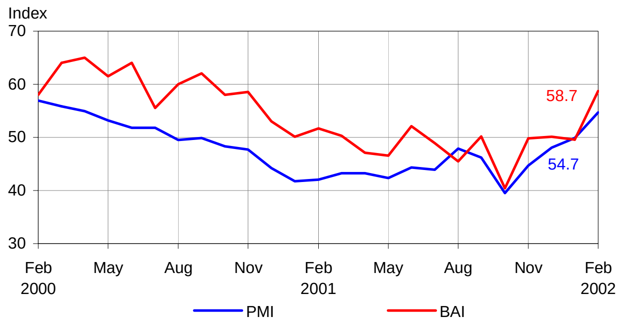
Federal funds rate target



Source: Federal Reserve System

After a series of consecutive reductions – the first five equivalent to 0.5 p.p. and the last to 0.25 p.p. – the Federal Open Market Committee (FOMC) decided to hold the federal funds rate to 1.75% per year, at its meeting on January 30. In a press release, the FOMC stated that its decision was based on more conclusive signs of recovery in the pace of economic activity. At the end of its statement, however, the Committee warned that the risk of recession will continue for the foreseeable future.

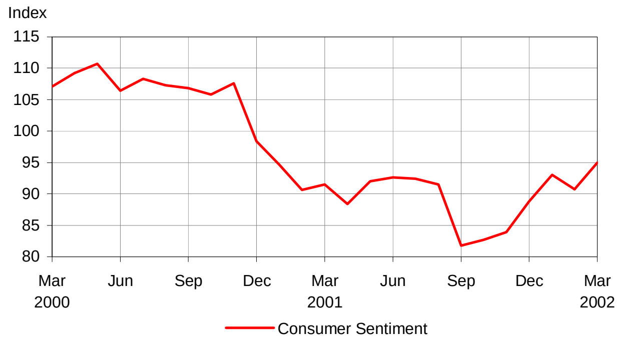
ISM indexes



Source: Institute for Supply Management

With regard to indicators of expectations, surveys that evaluate business and consumer attitudes turned sharply upward. Thus, the Institute for Supply Management (ISM) pointed to significant improvement in February, surpassing the leveling off mark of 50% for the first time. The Purchasing Managers Index (PMI) closed at 54.7%, for growth of 4.8 p.p. in the month, interrupting eighteen consecutive months of forecasts of downward movement in the pace of manufacturing activity. At the same time, the Business Activity Index (BAI) came to 58.7% for expansion of 9.1 p.p., registering the best result since November 2000. Aside from this, Consumer Sentiment, which is measured by the University of Michigan and evaluates consumer expectations, came to a level of 95 in March, the highest mark since December 2000.

University of Michigan indexes



Source: Bloomberg

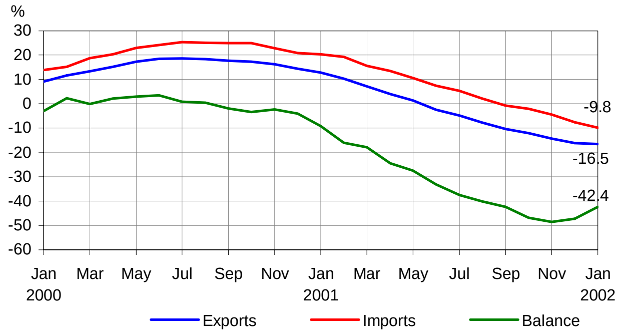
4.2 – Japan

The Japanese economy is mired in a situation of deflation as a result of declining private consumption aggravated by lessening exports and cutbacks in fixed investments. Investments in the construction industry have been slow, while public investments have also followed a gradually downward curve. In order to avoid the possibility of a deflationary spiral, the government has been attempting to mobilize its efforts to undertake needed structural reforms, though even these are not expected to generate immediate impacts.

Analysis of demand trends shows that orders placed with factories have been decreasing sharply, closing the fourth quarter with a drop of 43.9% when compared to the same period of the preceding year. New building starts decreased since January 2001, as demonstrated by the fourth quarter's highly negative performance of a drop of 5.9% in relation to the same period of the preceding year. Mirroring current employment and income conditions, private consumption has remained low. In the month of December, the available income of workers dropped by 1.5% compared to December 2000, while family and worker spending decreased by 6.6% and 4.4%, respectively.

Trade balance

Accumulated variation in 12 months

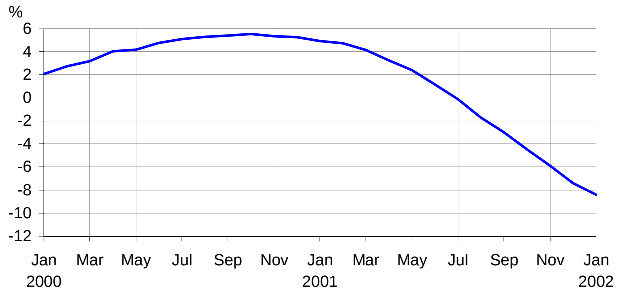


Source: Bank of Japan and Bloomberg

Foreign sales reflect the deceleration of the world economy, despite signs of depreciation of the rate of exchange. This is evident in the January monthly average of ¥117/US$ as compared to ¥128/US$ in December 2001. Growth in the balance of trade accumulated over twelve months followed a sharply downward trajectory as of July 2000. In 2001, foreign sales came to US$402.4 billion or 16.1% less than in 2000, and imports closed at US$347.7 billion, for a decline of 7.6%. However, with the ongoing recovery in North America and Eastern Asia, it is now expected that foreign sales could start to move gradually upward.

Industrial production

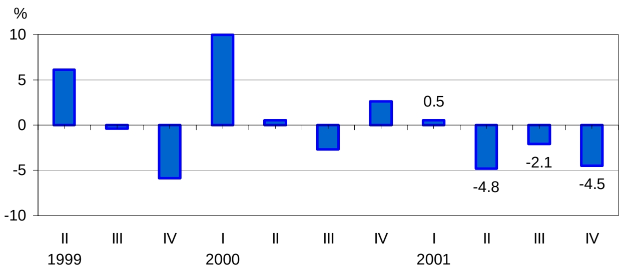
Accumulated variation in 12 months



Source: Ministry of Economy, Trade and Industry

In the fourth quarter of the year, industrial output declined by 2.5%, in comparison to the previous period, and 13.3% when compared to the same period of 2000. In 2001, the reduction came to 7.9%, the largest since 1975. This was due mostly to the drop of 17% registered in the chips industry and under other electronic equipment. However, as industries adjust their stock positions, there is a somewhat positive outlook for positive growth. The weak performance of the industrial sector has been reflected in unemployment which, as of 2001, has followed an upward curve, moving from 4.7% in February to 5.6% in December. This has led the government to allocate greater volumes of resources to the social protection network. Given government forecasts of a continued decline over the coming two years, this trend toward deterioration in the employment level is expected to worsen even further.

Gross Domestic Product[1/]



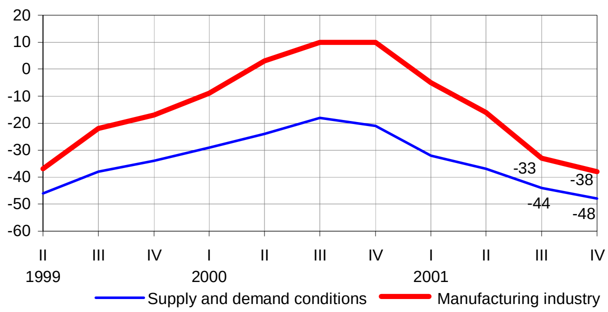
Source: Economic Planning Agency
1/ Growth over previous quarter seasonally adjusted, annualized.

For the fourth quarter of 2001, early GDP estimates point to a drop of 2.2% compared to the preceding quarter. Analysis of this result shows that private demand and public investments fell by 2.4% and 2.7%, respectively, while government consumption expanded by 1.2%. In a comparison with the same period of 2000, it is now estimated that the reduction in GDP came to 1.2%. The government forecasts a GDP falloff of 1% in fiscal year 2001, which is scheduled to close on March 31, 2002.

The economy followed a process of deflation in 2001, as the Consumer Price Index (CPI) registered a monthly decline of 0.1% in December and a reduction of 1.2% for the year, despite the expansionary policies adopted by the Bank of Japan and implemented on March 16, 2001. According to this policy, the basic interest rate was cut to zero and the supply of liquidity was expanded. In the month of December, wholesale prices registered monthly growth of 0.5% and annual expansion of -0.8%, mostly as a result of the impact of seasonal factors on energy prices.

With regard to matured and unpaid loans, the September 2001 balance came to ¥36.8 trillion (US$275 billion), 9.5% more than in the month of March. The President of the Central Bank defended the rendering of financial assistance through the Resolution and Collection Corporation (RCC), which would be provided with a fund equivalent to US$20 billion to purchase stock held by banks. However, it remains a question of defining just how the losses inherent to the RCC will be transferred.

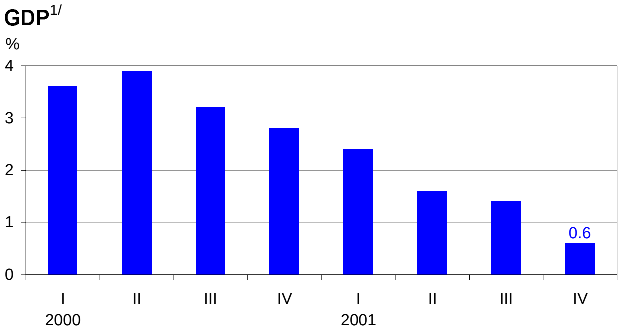
Business confidence index - Tankan



Source: Bank of Japan

The economic uncertainties consequent upon the difficulties involved in resolving such problems as deflation and bank lendings are reflected in the Tankan index, which is a measurement of the short-term expectations of the manufacturing sector. This index closed the third quarter of the year at -33, dropping to -38 in the subsequent period. The same index for supply and demand conditions dropped from -44 to -48 in the same periods.

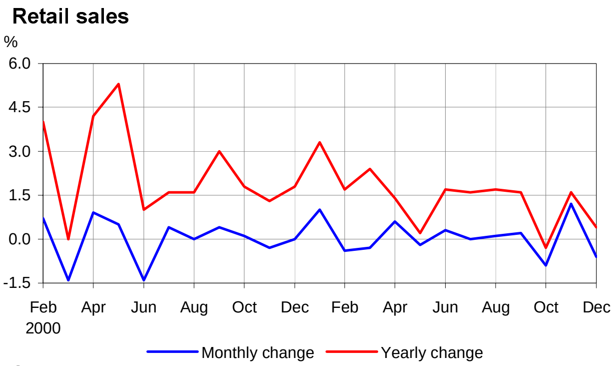
4.3 – Euro Zone



Source: Eurostat
1/ Change from corresponding quarter of preceding year.

GDP data on industrial output and retail sales confirm the downward trend in the level of economic activity in the Euro Zone countries in the final quarter of 2001. However, at the same time, signs of recovery have come to the surface principally reflected in more positive growth under several confidence indicators. However, it is expected that economic indicators will only corroborate these expectations during the course of 2002. The region's GDP increased by 0.6% in the fourth quarter of 2001, when compared to the same period of 2000, though it dropped by 0.2% in relation to the immediately previous quarter. The European Commission estimates that quarterly GDP growth came to 0.4% in the first quarter of 2002.

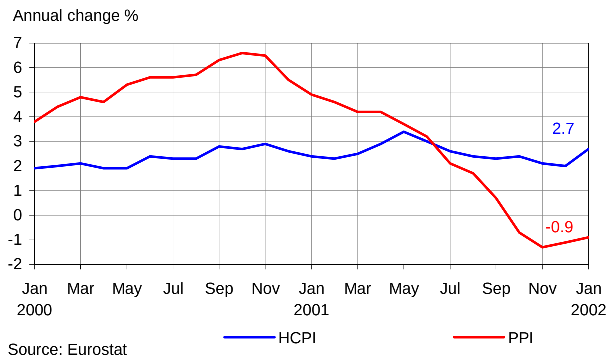
In December 2001, industrial output registered a reduction of 4.1%, once again in comparison to the same month of the previous year. Among the components of the consolidated index, production of manufactured goods dropped by 5.4% and that of intermediate goods fell by 8.4%, while production of consumer durables fell by 5.9%.



Source: Eurostat

Contrary to what has occurred in the United States, consumer spending in the Euro Zone countries has been insufficient to generate an upturn in economic growth. In historical terms, one should note that the propensity to save is more accentuated in Europe than in the United States. The result of this is that incentives to economic recovery tend to produce results in Europe with a greater time lag. In December 2001, retail sales declined by 0.6% when compared to November. In annual terms, sales expanded by 0.4%. This result reveals the defensive posture assumed by consumers as announcements of layoffs in many companies became increasingly common and fear of joblessness spread through the population. In the Euro Zone countries, unemployment fluctuated between 8.3% and 8.5% in 2001, closing January 2002 at 8.4%.

HCPI and PPI



Source: Eurostat

The rate of annual growth in the Harmonized Consumer Price Index (HCPI) declined over the course of the fourth quarter of 2001 from 2.4% in October to 2% in December, before rising sharply in January 2002, when it came to 2.7%. In the month of February, the rate closed at 2.5%. The reduction in this case was clearly not as intense as expected, particularly when one considers that the price hike in the early part of the year had been attributed to such episodic factors as the impact of the climate on food prices, increased indirect taxes in some countries and the process of rounding-off price that followed conversion to the Euro. Despite this, the slow pace of economic growth will contribute to a process in which the rate of inflation should converge in the coming months toward the European Central Bank (ECB) reference value of 2%. The producer price indicator registered annual deflation of 0.9% in January.

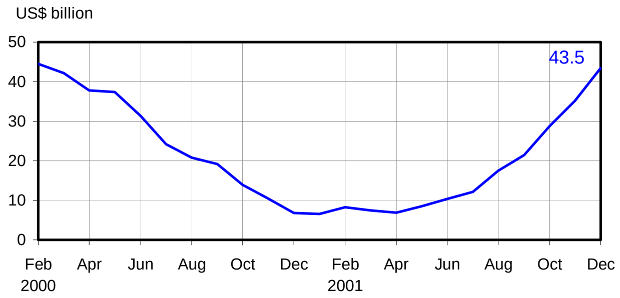
The annual rate of M3 growth, which is one of the pillars of ECB monetary policy, increased sharply in the second half of 2001, moving from 6% in August to 7.9% in January 2002, compared to the reference value defined at 4.5%. According to the ECB, M3 growth is founded upon situational factors and coincided with a period of increasing uncertainty that was reflected in increased investor preference for liquidity. At the same time, the behavior of this aggregate has been partly offset by limited growth in credit to the private sector, as the annual growth rate fell from 6.8% in December 2001 to 6.3% in January 2002.

In 2001, the ECB responded very cautiously to the economic recession, cutting its basic interest rate by 1.5 p.p. to 3.25% per year in December and maintaining this level into the first two months of 2002. New cutbacks are not expected in the early months of 2002, as a result of renewed expectations of recovery. In any case, the inflation high and M3 growth do not justify the interest rate hike.

The euro, which took on the role of value reserve and unit of account since it was first issued in January 1999 began circulating as legal tender in the twelve Euro zone countries as of January 1, 2002. The transition was uneventful, despite a small inflationary impact as a result of the process of rounding-off prices following conversion. The success of the operation and the impact of the adoption of a single currency in the entire region had a highly favorable impact on the expectations of economic agents.

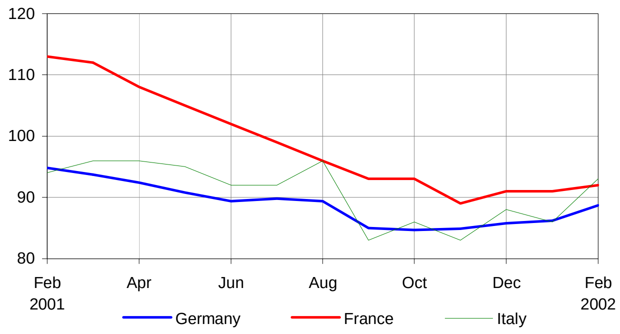
The European Commission proposed that Germany and Portugal be formally notified as a result of growth in their public deficits to the limit of 3% of GDP as determined in the 1997 Stability and Growth Pact. Ecofin, the council composed of the finance ministers of the member states, decided not to issue a formal notification after the two countries reaffirmed their readiness to make every effort required to avoid the possibility of the deficit reaching its previously determined limit.

Trade balance accumulated in 12 months



Source: ECB

Confidence indicators



Source: Bloomberg

In 2001, the region's balance of trade registered a surplus of US$43.5 billion, based on exports of US$940.7 billion and imports of US$897.3 billion. Of this total, US$23.1 billion were generated in the fourth quarter of the year, when foreign sales increased by 6.9% in relation to the previous quarter, and imports expanded by 3.8%.

Expectations that the recovery of the American economy will generate repercussions in the region provoked positive growth under several of the confidence indicators in the major countries of the region. In this sense, the General Index of Business Expectations, which is estimated by the Institute for Economic Research (IFO) of Germany registered growth in the month of February and closed at 88.7 points, the highest level since September. In France, the Industrial Trend Survey, which is carried out by the *Institut National de la Statistique et des Études Économiques* (Inséé), also points to improvement in expectation, rising from 89 points in November to 92 points in February. In Italy, the third largest economy in the Euro Zone, the business confidence indicator which is calculated by the *Istituto di Studi e Analisi Economica* (Isae) turned in even more accentuated growth, moving from 83 points in November 2001 to 93 points in February 2002.

4.4 – Emerging economies

4.4.1 – Asian economies

China

The Chinese economy has been expanding rapidly and persistently in recent years despite the downturn in the global economy as a whole and a rather moderate level of internal demand. The growth target for 2002 has been set at 7%. This objective is expected to generate strong pressures on the nation's finances and will demand considerably larger public spending.

The government has acted decisively for the purpose of generating product and has provided support to internal demand. In this sense, the wages of civil servants were increased twice in 2001 and efforts are under way to help the lower income populations of urban areas. Notwithstanding these programs, income stagnation in rural areas, which encompass 64% of the population and 15% of GDP, has been an obstacle to demand growth.

Following stabilization since May 2001, foreign sales increased more than expected in the fourth quarter, closing at US$71.3 billion, with particularly strong participation on the part of the American and Japanese markets. Imports added up to US$62.2 billion. On December 11, 2001, China was admitted to the World Trade Organization (WTO) and will certainly further strengthen the multilateral trade system, with positive repercussions for the world economy as a whole.

In the month of December, industrial production increased by 8.7% in relation to the same period of the preceding year. In September, growth came to 9.7%. This reduction in the pace of growth reflected moderate expansion in investments, together with a slight cutback in the volume of stocks.

Foreign direct investment flows targeted principally at the export sector turned in an excellent performance in 2001, despite the fact that a quarterly analysis points to sharp declines when the results for 2001 are compared to the corresponding quarters of the previous year. Part of these investments migrated to Japan, Korea and Taiwan.

Prices have followed a slightly downward curve after an equally discreet rise in the first half of the year. The CPI registered monthly growth of -0.2% in December and annual expansion of 0.7%.

Growth in bank deposits and lower business profits have provoked Prime Minister Zhu Rongji to declare that the climate in China favors a cutback in interest. At the moment, the interest rate for one year deposits stands in the range of 1.25% per year and could drop by an additional 25 p.p.

South Korea

In the fourth quarter of 2001, the Korean economy expanded by 3.7%, in relation to the corresponding period of the previous year. This result was higher than government expectations and was marked by particularly strong participation on the part of the service sector, which expanded by 7.2% in the period in question.

In the fourth quarter of the year, foreign sales climbed to US$36.1 billion, while imports closed at US$34.3 billion. Market forecasts indicate that, should the Japanese currency continue its ongoing process of depreciation and the rate of exchange reach a level of ¥138/US$, the competitiveness of Korean products will be seriously jeopardized.

In the month of December, industrial output grew by 3.3% in relation to December 2000. Unemployment in December closed at 3.3%, reflecting a situation of stability.

Inflation turned in annual growth of 3.2% in the month of December, compared to 3.6% in October. The process of depreciation of other currencies against the Korean currency has contributed to smooth growth in the prices of imports. The basic interest rate stands at 3.97% per year.

The favorable economic conditions are supported by the Consumer Confidence Index for a six month horizon. This index moved from 92.9 in October to 100.9 in December.

4.4.2 – Russia

A number of very important changes occurred in Russia during the course of 2001, including a more simplified system of licensing for the creation of new companies and the strengthening of land property rights. For 2002, it is expected that the legal system will be reformed and the foreign trade sector – including the nation's customs system – will become considerably more liberal.

In 2001, the Russian GDP registered growth rates that were higher than international averages, closing the first quarter at 4.9% and the following two quarters at 5.3% and 4.9%, respectively, utilizing the corresponding quarter of the previous year as the basis of comparison. According to forecasts, fourth quarter GDP declined, albeit at a less pace than occurred in the countries of Europe.

Industrial output in January 2002 registered growth of 2.2% in relation to the same month of the previous year. This was the lowest figure for the last 12 months. This deceleration was not reflected in the rate of unemployment which, in January 2002, came to 6.4%, the same level as in the previous month. In January 2001, the rate of unemployment had reached a level of 7.1%.

The interest rate reduction in the major G-7 countries, coupled with enhanced fiscal discipline and positive movement in needed structural reforms, have favored the inflow of foreign capital to Russia. One result has been real exchange valuation of approximately 8.6% in 2001. Despite the unfavorable external scenario, the trade balance registered a surplus of US$50 billion in 2001, compared to US$60 billion in the previous year, reflecting decreases in petroleum prices. In the same sense, the surplus in the Russian current account, which is quite significant when compared to the other emerging countries, dropped from US$46 billion in 2000 to US$34 billion in 2001, representing 11% of GDP.

In 2001 and early 2002, Russia increased several government managed prices with the intention of ensuring that a favorable fiscal result would be obtained. Public service tariffs were increased in January at rates ranging between 16% and 20%. As a result, inflation for the month came to 3.1%, the highest level since February 1999, interrupting the downward trajectory of annual inflation. Estimates for February 2002 point to monthly inflation of 2%.

Fiscal revenues in 2001 set a new record of 17.6% of GDP as compared to 15.5% of GDP in 2000. Government spending closed at 14.4% of GDP in the two years. In this context, the consolidated primary surplus expanded from 4.7% of GDP in 2000 to 5.7% of GDP in 2001 and the nominal result moved from 1.2% of GDP to 3.1% of GDP. International reserves closed at US$36.9 billion at the end of February 2002. Aside from this, the total external debt also evolved in a positive manner, closing 2001 at US$135.3 billion or 45% of GDP compared to US$142.6 billion in 2000, equivalent to 61% of GDP.

The interbank rate of interest came to 23.9% per year in December 2001 and 25% per year at the close of February 2002. Long-term rates (4-5 years) reached 17.12% per year at the end of 2001, compared to 27% per year at the end of 2000, reflecting a reduction in the rate of inflation in the second half of 2001.

4.4.3 – Turkey

Though the economic cycle does seem to have already bottomed out, the major economic activity indicators have not yet shown any significant positive results. In this sense, the decline in January industrial output was significantly lower than in December and the index of utilization of installed industrial capacity came to 74.2%, compared to 73.3% in December. On the other hand, the recovery in internal demand may become more difficult as a result of high unemployment, which came to 10.6% in the fourth quarter of 2001, compared to 8% in the previous period.

Industrial output moved along a steadily less inclined negative growth curve, registering 9.4% in December 2001 compared to 3.1% in January 2002. This behavior has been impacted by the volatility of the rate of exchange, which introduces an element of uncertainty into market operations, and by a persistently insufficient supply of credit consequent upon the difficulties of the banking sector.

Inflation remains high, threatening to jeopardize compliance with the targets of the economic adjustment program. Annual growth in the consumer price index has accelerated in recent months, closing December 2001 at 68.5%, January at 73.2% and February 2002 at 73.1%. The wholesale price index, in turn, rose by 91.8% in the twelve month period ended in February.

At the beginning of February, the IMF approved a three year stand-by agreement targeted at sustaining Turkey's macroeconomic adjustment program. A total credit of US$16 billion was approved, of which approximately US$9 billion were made available for immediate withdrawal. The new program substituted the December 1999 agreement, which totaled US$19 billion of which US$15 billion were utilized. Unused credits were included in the current agreement. The resources approved are to cover external borrowing requirements in 2002, estimated at US$10 billion. Once again, the IMF supported the adjustment program, recognizing the serious commitment that Turkish authorities had made to implementing much needed reforms, which included adoption of a flexible exchange system and advances in the restructuring of the banking sector and preparation of the privatization process. The major targets of the new program are consolidation of the fiscal adjustment and control of inflation. The planned measures include cutbacks in public employment, tax policy reform and implementation of an inflation targeting system. The major goals for 2002 as specified in the agreement are inflation of 35% and a primary fiscal surplus of 6.5% of GNP.

The fiscal performance – one of the major parameters of the macroeconomic adjustment program – was positive in 2001. The primary surplus came to 12.5 trillion Turkish liras, equivalent to 6.7% of GDP, well above the target defined in the IMF agreement (11.6 trillion Turkish liras). Above all else, the result was a consequence of expanded revenues, particularly nontax revenues, and benefited greatly from sale of the cell telephone concession. Other tax revenues also made important contributions, including the inflow of indirect taxes, particularly the Value Added Tax (VAT) and the Tax on Petroleum Consumption. It is worth noting that the VAT of some products was reduced in the last two months of 2001 with the objective of stimulating internal consumption.

The trade balance closed in a negative 2001 position of US$9.3 billion, compared to US$26.7 billion in the previous year. The sharp drop in the deficit reflected cutbacks in imports from US$54.5 billion in 2000 to US$40.5 billion in 2001, and growth in exports from US$27.8 billion to US$31.2 billion. The outlook for approving a new IMF agreement – which effectively occurred later on – generated accentuated improvement in financial market expectations and contributed to appreciation of the Turkish lira in relation to the American dollar by more than 20% between mid-October and the end of January.

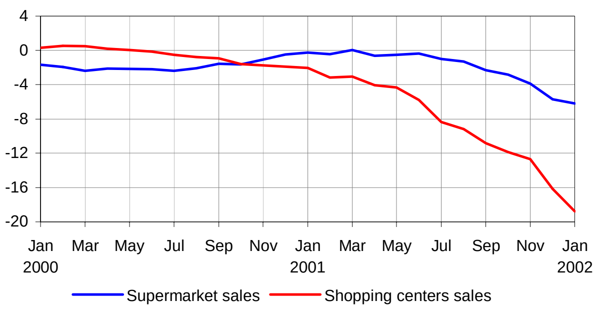
4.4.4 – Latin America

Argentina

After almost 11 years of convertibility, the transition to a floating exchange rate system severely impacted the Argentine economic scenario. The first quarter of 2002 was, once again, marked by the same uncertainties generated by a lack of monetary and fiscal policy definition under the terms of the new exchange system and the instability of the financial sector. In the process of "de-dolarizing" the economy, uncertainties arose even with regard to the degree of the system's solvency. These factors pointed to enormous difficulties on the path to recovery over the short and medium-term.

Consumer indicators

Percentual change accumulated in 12 months



Source: Ministry of Economy/INDEC

In the month of January, the scenario of uncertainty and the liquidity crisis that accompanied devaluation of the peso reflected the restrictions imposed on access to bank deposits and generated a severe worsening of the economic recession that had gripped that country. Supermarket sales dropped by 6.4% in comparison to the same month of the previous year and 6.2% in accumulated twelve month terms, while sales through shopping centers fell by 40.1% and 18.8%, respectively, using the same bases of comparison. The Synthetic Indicator of Industrial Activity (Isac), which reflects demand for inputs for the construction industry, plunged by 43.8% in January when compared to the corresponding month of the previous year, and 12.5% when viewed under the prism of accumulated twelve month terms.

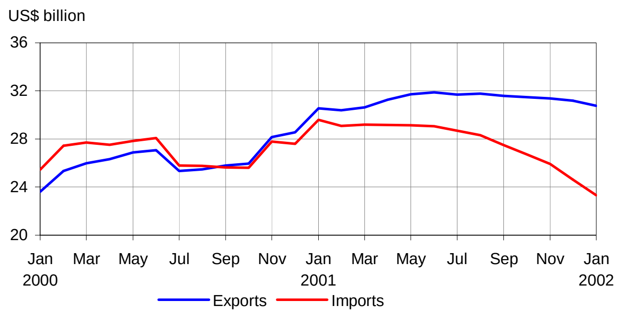
Since the fiscal impacts of the changes in the monetary and exchange systems are still not clearly defined, the fiscal sector has remained as a source of instability in 2002. In the month of February, the government sent the 2002 budget plan to the Congress, estimating the annual overall deficit at 3 billion pesos, compared to a global deficit of 9 billion pesos in 2001. Expectations of lesser primary spending are based on a reduction in outlays on the servicing of the debt as a result of suspension of payments to private external creditors and the nominal increase in the tax inflow as a result of growing inflation.

However, the slowdown of economic activity has led to a strong drop in the fiscal inflow, which closed with a reduction of 20% in February, following a similar decline in January. Evidently, this trajectory has seriously compromised revenue expectations for the year.

In the month of March, the federal government and the provinces reached an agreement on reductions in the constitutional transfers of the central government. In exchange, the national executive should assume part of the provincial debts, thus generating an increase of about 16 billion pesos in the central government public debt. This operation makes it possible to reduce short-term primary spending, at the same time in which the understanding between the two levels of government can eliminate a constant source of imbalance from the fiscal point of view. This is evident in the fact that the 2001 global deficit was potentialized as a result of the deficit registered by the provinces.

Insofar as reductions in outlays on the external debt service are concerned, it should be noted that the payments suspended were those due private creditors, meaning that the country intends to continue complying with its obligations to multilateral organizations and foreign governments. In this sense, in the month of January, the IMF approved an Argentine government request to extend amortizations of the loans granted in 2000 and 2001 for one year. In the same way, the government is making every effort to elaborate a consistent fiscal program that will observe the recommendations put forward by the IMF, thus making it possible for Argentina to seek the support of that organization, which will certainly be key to the recovery of the Argentine economy.

Trade balance
Accumulated in 12 months

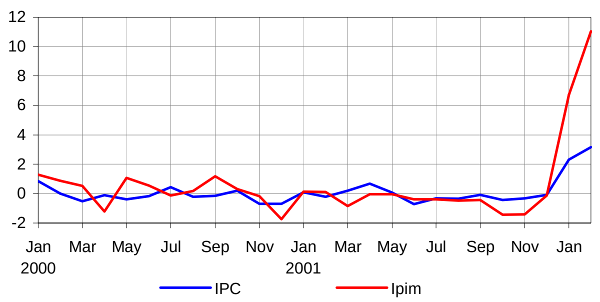


Source: Ministry of Economy/INDEC

Foreign trade results do not yet demonstrate the impact of devaluation of the peso. In January, still under the impact of the new economic environment, trade transactions with the international community declined as exports dropped by 12% and imports by 56%, using the same basis of comparison, even though the trade balance still registered a positive result of US$960 million, compared to a surplus of US$95 million in the same month of 2001. It should be noted that the reduction in exports was a consequence of price decreases.

Economic instability generated negative repercussions on industrial activity. According to the *Instituto Nacional de Estadísticas y Census* (Indec), the Monthly Industrial Estimator (EMI), the proxy for evaluating industrial output, declined by 18.2% in January 2002, in relation to the same month of the previous year. When one considers the accumulated twelve month period, the reduction in output came to 7.5%. From the sectoral point of view, the automotive, textile and metal-mechanics industries led the downturn in industrial activity, maintaining the trajectory begun in the preceding year.

Inflation
Monthly percentual change



Source: Ministry da Economy/INDEC

Though exchange devaluation has exerted pressures on prices, inflation remains under control since internal demand has plummeted. In February, the CPI came to 3.1%, accumulating inflation of 5.5% in 2002, a two month period in which the index was subjected to the pressures of rising prices for food and products for the home, compared to deflation of 0.14% in the same period of the previous year. The *Índice de Precios Internos al por Mayor* (Ipim), which measures wholesale price growth, registered an increase of 11% in the month of February. This result raised accumulated inflation in the year to 18.5%, principally as a result of rising prices for imported goods.

With regard to the newly adopted exchange system, the initial alteration pointed to adoption of a dual system that would be targeted to foreign trade operations and financial operations. This system was replaced by a single flexible exchange system. At the same time, measures were adopted with the aim of restricting sales of dollars by banks and remittances of dollars by companies. At the same time, it was announced that the Central Bank would intervene expeditiously in the exchange market.

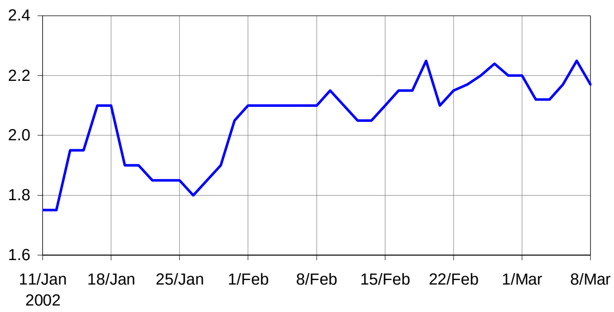
Alterations in the exchange system produced repercussions on the financial system, to the extent that part of banking assets and liabilities were composed of foreign currency. In this sense, the government opted for differentiated conversion rules for banking assets and liabilities in order to protect companies and that segment of the population holding debts in dollars, while also guarantying that bank deposits would not lose part of their value.

Banking system assets in dollars or, in other words, the liabilities of companies and the population denominated in dollars would be converted at the rate of 1 peso per dollar, while banking system liabilities, or banking deposits, would be converted at 1.4 pesos per dollar. To offset the losses caused be eliminating the link between assets and liabilities, the government signaled the possibility of issuing federal bonds which, in practical terms, would be tantamount to nationalizing private debt. However, the financial system scenario remains nebulous, since good estimates are not yet available regarding the magnitude of the imbalance in net worth nor are there good forecasts of the degree of risk of a systemic banking sector crisis.

Parallel to the measures involving debt conversion and banking deposits and changes in the exchange system, the government maintained restrictions on withdrawals. Initially, the government announced a schedule for releasing deposits, but some measures had to be adopted later on to make this system more flexible. These measures included release of operating accounts into which wages, retirement benefits and severance pay consequent upon payment of indemnities or work accidents are deposited.

The tight liquidity of the financial system and centralization of exchange market operations have made it possible to avoid even more accentuated currency volatility and maintained banking deposits and international

Exchange rate
Pesos per US$



Source: Reuters

reserves at stable levels. At the same time, the Baibor interest rate for 30 day interbank operations came to 105.4% per year on February 20, while the Argentine sovereign risk measured by J.P.Morgan's EMBI+ Index remained stable in the range of 4,000 base points, making Argentina the country with the highest investment risk index among all countries analyzed.

Mexico

The recession experienced by the Mexican economy during much of 2001 is evident in the drop in GDP equivalent to 1.5% in the third quarter and 1.6% in the subsequent period, in comparison to the corresponding periods of the previous year. These results were impacted by substantial reductions in the GDP of the manufacturing sector which came to 5.7% and 5%, respectively, utilizing the same bases of comparison.

The overall indicator of economic activity (Igae) registered successive reductions since May 2001. The December result was a drop of 2.4% in relation to the same month of the previous year. Analysis of the monthly index of industrial production makes the recession even more evident when one notes that, at the end of 2001, the index had fallen by 4.9% in relation to December of the previous year, following consecutive reductions since the month of February. The so-called "maquiladoras" operating in the export sector registered even more significant downward movement. As a result, the rate of open unemployment came to 3% in January 2002, the largest level of the past 12 months.

On the other hand, there are signs that would seem to indicate a turnaround in this situation. Examples would include growth of 2% in retail sales in December, in relation to sales in the corresponding month of 2000. Aside from this, the Moody's and Standard & Poor's rating agencies improved the country's risk classification at the start of this year, classifying it as investment grade and facilitating the possibility of obtaining new external resources. However, macroeconomic indicators have still not shown any solid signs of recovery in the activity level.

With regard to public accounts, revenues accumulated in 2001 came to 22.3% of GDP while spending came to 23% of GDP, indicating a consolidated nominal deficit of 0.7% of GDP. The budget for 2002 calls for an increase of 0.5% in the GDP in ordinary revenues and 0.76% of GDP in extraordinary revenues, including new privatizations and concessions.

Compared to US$8 billion in the previous year, the Mexican balance of trade deficit accumulated US$9.7 billion in 2001. This growth was tied to reductions in the value of exports of petroleum and to falloffs in other exports as a result of the world recession. In January 2002, the deficit totaled US$734 million, compared to US$944 million in January of the previous year.

The balance of payments registered a deficit of US$17.3 billion in current account in 2001, corresponding to 2.8% of GDP. Direct foreign investments came to US$23.4 billion in 2001 and international reserves closed the preceding year at US$40 billion.

The consolidated government debt came to 26.1% of GDP in 2001, compared to 21.8% in the previous year. An analysis of this result indicates that 13.7% corresponded to internal debt and 12.4% to the external debt. In 2001, the total external debt, including the private sector, totaled US$148.4 billion, corresponding to 24.4% of GDP.

The price trajectory has been in a process of decline. In this sense, in January 2002, the accumulated 12 month CPI came to 4.79%, as against 8.11% in the same month of the previous year. A more accentuated decline was registered in the producer price index, as the 12 month index dropped from a level of 5% at the end of 2000 to 1.29% in December 2001. Interest also followed a downward trajectory, as demonstrated by the decline in earnings on 28 day Treasury Certificates (Cetes) from 17.6% per year in the month of February 2001 to 6.3% per year in February of the current year.

For 2002, the Bank of Mexico (Banxico) projected GDP growth of 1.5%, inflation of 4.9% and a current account deficit equivalent to 3.2% of GDP.

Chile

The Chilean economy was significantly impacted by the Argentine crisis, particularly in terms of bilateral trade and capital flows (53% of total Chilean foreign investment in the 1990s was targeted to Argentina). Despite this fact, the policy of cutting interest rates adopted by other countries as of mid-September 2001 increased the flow of external resources to the Chilean economy and the average nominal rate of exchange dropped to $670,67/US$at the beginning of March 2002, after having reached a level of just over $700/US$in October of the previous year. The current rate of exchange still reflects nominal depreciation of 16.2% in relation to March 2001, maintaining a reasonable degree of competitiveness in the export sector.

Insofar as the level of activity is concerned, the Chilean economy has been strongly impacted by the world recession. Preliminary estimates indicate GDP growth of 3% in 2001, compared to 5.4% in 2000. The Monthly Economic Activity Indicator (Imacec), dated December 2001, diminished by 0.8% when compared to November and increased by 1.4% when viewed against the same month of the previous year. In the course of 2001, this was the lowest rate, using the same basis of comparison. The industrial output index of the *Instituto Nacional de Estadísticas* for December 2001 diminished by 6% with regard to November and was 1.9% less than when compared to the same month of the previous year. Despite all the unfavorable data, retail sales increased by 4.3% in December 2001, compared to the same month of the previous year, indicating average annual expansion of 1.7% in relation to the average for the previous year. The signs of expanding consumption are still inconclusive, as is evident in the fact that supermarket sales registered growth of just 0.4% in December 2001, compared to December 2000, while sales of apparel increased by 15.2% on the same basis of comparison. In any case, positive numbers have emerged as far as employment is concerned. The rate of unemployment in December 2001 was 7.9% below the level registered in the same period of the previous year, when it closed at 8.3%, following a September peak of 10.1%.

Foreign sales totaled US$17.4 billion in 2001, compared to US$18.1 billion in the previous year, mirroring the reduction that occurred in world trade in 2001. In the same time periods, imports accumulated a total of US$15.8 billion and US$16.7 billion. The accumulated balance of trade surplus closed 2001 at US$1.5 billion, compared to US$1.4 billion in 2000. In January 2002, exports came to US$1.5 billion and imports totaled US$1.4 billion. The current account deficit was US$988 million at the end of 2001, compared to US$903 million in 2000.

The total Chilean external debt (public and private) turned in a stable performance. In December 2001, it came to US$37.8 billion, compared to US$36.8 billion in December of the previous year, for an average GDP of US$63.2 billion in 2001. At the same time, the international reserve position remained stable at US$14.1 billion in February 2002, the same level as in the corresponding month of the previous year.

In February 2002, the Chilean CPI registered zero inflation when compared to January, hitting the lowest mark of the past twelve months. Accumulated annual inflation came to 2.5%. The *Índice de Precios al por Mayor* (IPM) for January 2002 came to 3.9% in the last twelve months. In the most recent meeting held on February 19, the Central Bank of Chile reduced the basic interest rate from 6% to 5.5% per year. The expansionary monetary policy has the purpose of ensuring recovery of the activity level for 2002, since the inflation level has already shown signs of downward movement.

4.5 – International financial market

The behavior of net private international capital market financial flows to the emerging countries in 2001 registered a reduction of 31.9% in relation to the previous year and closed at US$115.1 billion. World economic deceleration, financial crises in Argentina and Turkey and increased aversion to risk among investors impacted portfolio capital and international bank loans, though not direct investments which remained stable. For the current year, the Institute of International Finance (IIF) foresees growth of US$144.2 billion. This growth will be driven by recovery in the world economy as a consequence of improved performance in the United States and limited spillover of the Argentine crisis.

In the course of 2001, several different factors had adverse impacts on international market performance particularly with regard to the financing of the emerging economies. Led by the United States economy, which registered strong downward movement in annual GDP growth from 5% in 2000 to 1.2% in 2001, the world economy as a whole suffered a severe decline in its pace of growth. According to IMF forecasts published in the World Economic Outlook for December 2001, world product dropped by half, plunging from 4.7% in 2000 to 2.4% in 2001. Among the countries included in the G-7, the reduction was even more accentuated, dropping from 3.5% to 1% on the same basis of comparison.

In the same sense, the world's major stock markets registered sharp losses in the year and were marked by considerable volatility. The indices used on the New York market (Dow Jones, Standard and Poor's 500 and Nasdaq Industrial Average), London and Tokyo registered gains in the early months of 2001, before reversing course as of the month of May. The stock market was strongly impacted by the effects of the September 11 terrorist attacks and in the immediately subsequent period sank to its lowest point.

Parallel to all this, several emerging countries such as Turkey and Argentine were hit by sever financial crises. These events were responsible for a significant share of the reduction in net private flows of financing due to net capital outflows of US$20.6 billion in just these two cases.

Aside from this direct effect, international capital flows were indirectly impacted by the worsening world economic scenario and by rising uncertainties and increased investment risk. Notwithstanding this, contrary to previous financial crises, one should note that the spillover effect of the current crises, particularly in the case of Argentina, was severely limited due principally to widespread expectations that Argentina's economy had long been on the path to a crisis, coupled with international market perception of the improvements introduced into economic policy management in neighboring countries. As a result, international investors demonstrated that they were quite capable of drawing the necessary distinctions between the risks encountered in the different markets.

Finally, increased aversion to risk on the part of those participating in the international financial market also contributed to cutbacks in capital flows.

Despite the low rates of interest in the developed countries – in the case of the United States, interest dropped from 6.5% per year to 1.75% per year, compared to a falloff from 4.5% per year to 3.25% per year in the Euro Zone countries and a rate in the range of zero in Japan – and the weak performance of the stock market, with negative impacts on the profitability of the resources channeled into these economies by international investors, there was clear perception of the phenomenon of flight to quality, which contributed to reducing financing to emerging countries below the investment grade level.

According to preliminary IIF result, the net external financing of the emerging countries which had come to US$167.2 billion in 2000, dropped to US$135.1 billion in 2001. The reduction in net private credits was even more accentuated, shifting from US$169 billion to US$115.1 billion and was partially offset by the flow of government capital. In this case, the flow reversed course from net outflows of US$1.9 billion in 2000 to net inflows of US$20 billion in 2001, due to the financial difficulties faced by several countries.

Emerging markets' external financing

US$ billion

Itemization	Total			Latin America		
	2000	2001 1/	2002 2/	2000	2001 1/	2002 2/
External financing	167.2	135.1	161.9	49.6	71.7	65.4
Private flows	169.0	115.1	144.2	58.3	47.8	51.1
Direct investment	132.5	148.8	117.1	59.1	59.6	35.6
Portfolio	14.8	-1.7	13.5	-6.0	-1.5	-0.4
Loans	21.7	-32.0	13.6	5.1	-10.3	16.0
Official flows	-1.9	20.0	17.8	-8.7	23.9	14.3

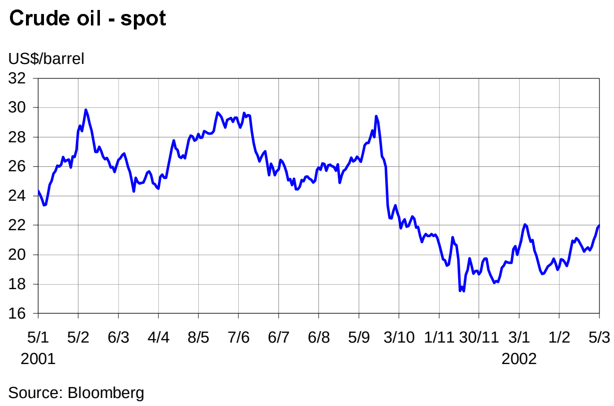
Source: Institute of International Finance. Capital Flows to Emerging Market Economies, January 30, 2002.

1/ Estimate.
2/ Forecast.

Among the major components of private financing, only direct investments registered positive growth, increasing by US$16.3 billion to a level of US$148.8 billion. This performance was impacted principally by two operations: the purchase of the Mexican bank *Grupo Financiero Banamex – Accival* (Banacci) by Citibank and the South African company De Beers which, taken together, totaled more than US$20 billion. Portfolio investments and international loans turned negative dropping from US$14.8 billion and US$21.7 billion, respectively, to net outflows of US$1.7 billion and US$32 billion in that order.

4.6 – Petroleum

The reduction in the petroleum production target set by the Organization of Petroleum Exporting Countries (Opec) in 2001 came to 3.5 million barrels per day and had the objective of stabilizing the market. However, the events of September 11 pushed prices sharply downward. For example, the price of the Opec reference basket moved from an average of US$25.00 per barrel in the first eight months of 2001 to US$20.00 at the end of September and, later on, to just under US$17.00 per barrel.

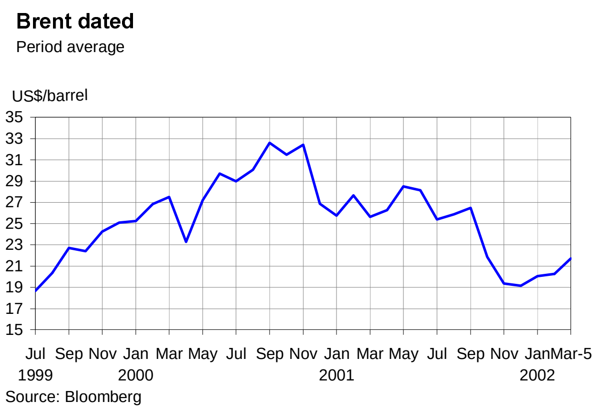


In mid-November, Opec decided to reduce the output target by an additional 1.5 million barrels per day for six months, starting as of January 1, 2002. Parallel to this decision, producers that do not belong to the Organization took on the obligation of reducing their output by 462 thousand barrels per day. Thus, in January 2002, the price of the Opec reference basket increased to US$18.50 per barrel, surpassing the November and December 2001 average.

On March 4, Opec and Russia began conversations on the adoption of measures aimed at stabilizing petroleum prices in the second quarter of the year, since Russia had committed itself to a production cutback only in the first quarter of 2002.

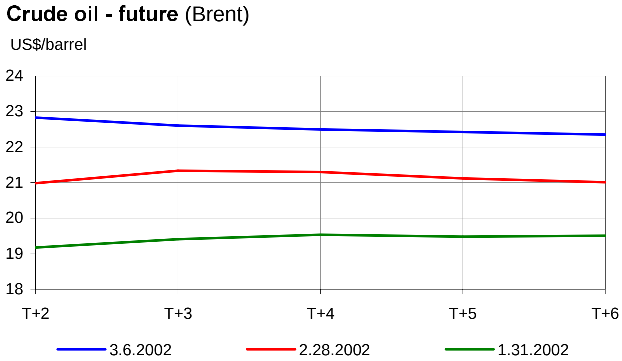
Petroleum demand increased by 100 thousand barrels per day in 2001, the lowest rate of yearly expansion since 1985, raising total demand to an average of 76 million barrels per day. In 2002, demand estimates for the first quarter point to 76.4 million barrels per day, compared to 76.9 million barrels per day in the same quarter of 2001.

Insofar as world production of petroleum is concerned, the cutback introduced by Opec and five other non-Opec countries reduced overall output by 510 thousand barrels per day. With this, average production for January 2002 came to 76.3 million barrels per day, compared to 76.8 million per day in the month of December.



Though the production target for the ten Opec countries in January was set at 21.7 million barrels per day, effective production in that month came to 23 million barrels per day. Iraq increased its production to 2.2 million, raising overall Opec output to a level of 25.19 million barrels.

The price of Brent type petroleum on the spot market increased from US$20.57/barrel at the end of



Source: Bloomberg

December to US$22.57/barrel on March 6, 2002, for an increase of 9.7% in the period.

In the case of the futures market, the price of Brent type petroleum remained practically constant for the different delivery periods negotiated on the same date. The price level increased in the quarter, moving from US$19.50 in January to US$21.20 in February and US$22.50 on March 6.

4.7 – Conclusion

Though world economic performance in 2001 was quite weak, it should be emphasized that the downturn was considerably less intense than had previously been imagined, particularly in the wake of the September 11 terrorist attacks in the United States. However, the world recession generated a drop in international trade, reductions in investment flows to the emerging nations as a whole and greater uncertainties that could have a much more lasting effect on aggregate global demand.

However, the coordinated reaction of the major world economies in terms of monetary and fiscal policy produced positive results in the early months of 2002 and may well have transformed the recession into a phenomenon of short duration. Given the high degree of existent economic and financial interdependence among the various nations of the world, it is expected that the positive results that have begun to appear in the world's major economies will generate a positive ripple effect on other nations. However, this impact will vary in both temporal terms and intensity due to a series of local factors.

World economic recovery, which had first been announced as a limited phenomenon that would only be felt toward the second or third quarters of the year, may well turn out to be much faster and stronger than originally forecast, particularly if the positive results achieved to this point continue into the near future. In this context, four quarter GDP in the Untied States in 2001 expanded by 1.4%, surpassing previous expectations of negative growth. When one adds in the outlook for continued application of a cautious monetary policy plus an expansionary fiscal policy with no inflationary incentives, the result will certainly be higher than expected growth in the current year, sharply improving the outlook for world liquidity. For 2002, it is probable that international capital markets will register considerable improvement, particularly in the absence of the highly restrictive factors registered in 2001. On the other hand, the financial crises seem to some extent to have been adequately resolved, particularly in the case of Turkey. As far as Argentina is concerned, the potential for spillover seems to have been held in check. Evidently, delay in achieving a sustained and definitive solution for the Argentine economic situation, the need for restructuring its financial system, maintenance of the moratorium on payments to investors and the lack of an agreement with international organizations remain as the major sources of uncertainty and risk for investors.

The return of world economic growth depends on verification of a crucial set of hypotheses and, above all else, confirmation of the recovery trajectory in several countries. Despite this rather optimistic view, there are several events that could act as a damper on expectations, including increases in the per barrel price of Brent type petroleum which has already surpassed the mark of US$22 per barrel, as a result of output cutbacks in several different producer countries. Should the current conflict in the Middle East continue, the upturn in prices could worsen as more intense economic activity generates greater demand.

5 – Foreign sector

At the start of the current year, the behavior of the major balance of payments components was quite similar to the final quarter of 2001. Imports of goods and services have adjusted to higher exchange rate levels. At the same time, the trend toward improvements in the current account position is not solely a result of the turnaround registered in the trade balance deficit, but rather a consequence of significantly lower outlays on such important service components as international travel.

External capital flows to Brazil declined in recent months as a consequence of the restrictions imposed by the turbulent international scenario. However, it should be underscored that inflows have been more than sufficient to finance steadily declining current account deficits.

5.1 – Trade in goods

Trade balance - FOB

US$ million

Period		Exports	Imports	Balance	Trade flow
Jan-Feb[1/]	2002	7 630	7 196	434	14 826
	2001	8 621	9 022	- 401	17 642
% change		-11,5	-20,2		-16,0

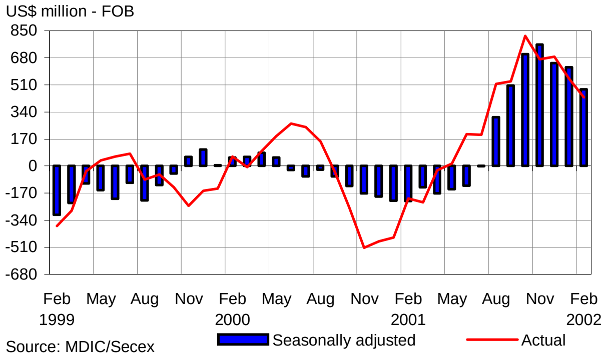
Source: MDIC/Secex

1/ In both years the two month period registered forty business days.

In the first two months of the year, Brazilian foreign trade registered a surplus of US$434 million, thus continuing the series of monthly positive results that began in April 2001. This performance was a result of reductions of 20.2% in imports, which totaled US$7.2 billion, and 11.5% in exports, which came to US$7.6 billion in relation to the same period of 2001. The reduction in the trade current totaled 16% and the trade current/GDP ratio dropped from 22.3% in 2001 to 17.9% in 2002.

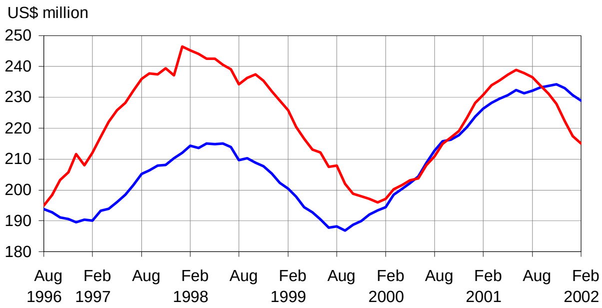
The reduction in exports occurred with greater intensity under the heading of industrialized goods (13.8%), compared to 9% in the case of basic goods. This evolution is a consequence of a downturn in the level of

Trade balance - 3 month moving average



Source: MDIC/Secex

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



Source: MDIC/Secex

Exports by category of goods - FOB
January-February[1/]

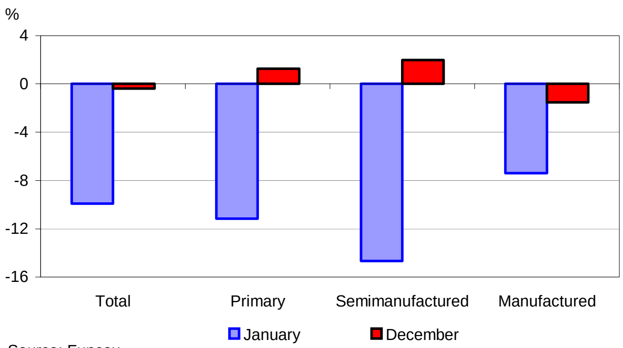
US$ million

Itemization	Accumulated		
	2001	2002	% change
Total	8 621	7 630	- 11.5
Primary products	1 851	1 685	- 9.0
Industrial products	6 345	5 470	- 13.8
Semimanuf. goods	1 451	1 210	- 16.6
Manufactured goods	4 894	4 260	- 12.9
Special operations	424	475	11.9

Source: MDIC/Secex

1/ In both years the two month period registered forty business days.

Exports - price index - January 2002
Change over the indicated period of 2001



Source: Funcex

world economic activity, which has generated impacts mainly on manufacturing and raw materials classified under both basic goods and semimanufactured products.

Data available for the month of January point to a drop of 3.5% in the quantity and 11.2% in the prices of basic products, when compared to January 2001. Despite this result, some products performed well in the two month period, including meats, particularly chicken and beef, and inputs for production of animal feed, especially corn, which registered a threefold price increase. These items generated an increase of US$134 million in foreign sales revenues in the two month period. On the other hand, external sales of iron, soy meal, coffee beans and petroleum registered a reduction of US$272 million in overall revenues.

Exports of semimanufactured products came to a January level of US$1.2 billion, reflecting the largest reduction in exported value (16.6%). The underlying cause of this result was a decline in prices and, in the case of several important products, cutbacks in volumes. The price index of semimanufactured goods registered a drop of 14.7% while the quantum index fell by 10.1%, compared to the same period of 2001.

Among the major products, only iron or steel semimanufactured products turned in revenue gains (US$18 million) as a result of growth in the volume of exports. Such other goods as cellulose, unrefined sugar cane, unprocessed aluminum and leathers and hides turned in a revenue decline of US$270 million.

In the two month period under consideration, foreign sales of manufactured goods added up to US$4.3 billion. The decline of 13% compared to the result

Exports by category - FOB
Main products - January-February[1/]

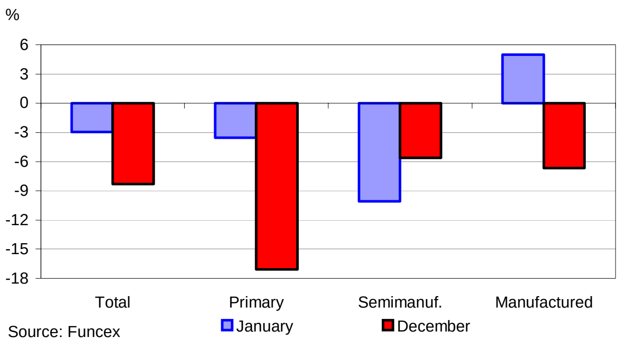
US$ million

Itemization	2001	2002	% change
Total	8 621	7 630	-11.5
Primary products	1 851	1 685	-9.0
Iron ore	506	418	-17.3
Soybeans, oil-cake and other residues	316	226	-28.5
Chicken meat	172	199	15.4
Coffee in beans	174	144	-17.3
Bovine meat	69	118	71.9
Crude petroleum oils	152	88	-42.1
Maiz	22	79	267.1
Other primary products	441	412	-6.5
Semimanufactured products	1 451	1 210	-16.6
Iron or nonalloy steel semifinished goods	197	215	9.0
Chemical wood pulp	313	177	-43.4
Hides and skins	141	132	-6.6
Cane sugar, raw	225	131	-42.0
Aluminum, unwrought	136	106	-22.3
Other semimanufactured products	440	450	2.4
Manufactured products	4 894	4 260	-13.0
Airplanes	412	348	-15.7
Footwear	275	247	-10.2
Transmission and reception apparatus	231	225	-2.5
Passenger motor vehicles	243	168	-31.0
Passenger motor vehicles engines	143	161	12.7
Cane sugar, refined	79	146	84.8
Parts and accessories for moto cars	148	145	-2.0
Orange juice	142	134	-5.5
Pumps, compressors, fans	95	90	-4.5
Iron or nonalloy steel flat-rolled products	116	77	-33.7
Paper and paperboard for writing, printing	83	71	-15.1
Pneumatic rubber tires	69	69	-0.9
Furniture and parts thereof	62	66	6.7
Iron and steel tubes, fittings for tubes	37	63	69.3
Gasoline	83	45	-45.8
Other manufactured products	2 675	2 205	-17.6
Special operations	424	475	11.9
Airplanes re-exports	105	329	213.6

Source: MDIC/Secex

1/ In both years the two month period registered forty business days.

Exports - quantum index - January 2002
Change over the indicated period of 2001



Source: Funcex

of the corresponding period of 2001 was a consequence of the slowdown in the pace of world economic activity.

Among the export products that registered the largest absolute reductions in the first two months of 2002, mention should be made of passenger cars (31%), aircraft (15.7%), flat rolled iron and steel (33.7%) and gasoline (45.8%). The falloff in exports of manufactured goods was somewhat attenuated by upward movement in exports of refined sugar (84.8%), iron or steel tubes (69.3%) and engines for automotive vehicles (12.7%).

Special operations added up to US$475 million for growth of 11.9%, principally as a result of re-export of aircraft, which expanded from US$105 million in the first two months of 2001 to US$329.3 million in the same period of 2002.

Imports in the two month period were impacted by reductions in internal economic activity and by depreciation of the rate of exchange, in relation to the levels registered in the first two months of 2001. In the month of January, both the price and quantum indices registered across-the-board reductions among the different final use categories, when compared to the results for January 2001. The most significant falloffs occurred under consumer durables, with a 15.1% drop in quantity, and fuels and lubricants, 41.5% under prices and 27.1% in terms of quantity.

Imports of consumer durables totaled US$354 million, representing the largest drop in relative terms (37%). This was a reflection of declines in acquisitions of passenger cars (53%), parts for durable consumer goods (45.8%) and machines and apparatuses for domestic use (37.8%).

Imports by end-use category - FOB
January-February[1/]

Itemization	Accumulated		
	2001	2002	% change
Total	9 021	7 196	- 20.2
Capital goods	2 430	1 916	- 21.1
Raw materials	4 517	3 671	- 18.7
Consumer goods	1 109	876	- 21.0
Durable	562	354	- 37.0
Nondurable	547	522	- 4.5
Fuels	965	733	- 24.1

Source: MDIC/Secex

1/ In both years the two month period registered forty business days.

Imports by end-use category - FOB
Main products - January-February[1/]

US$ million

Itemization	2001	2002	% change
Total	9 022	7 196	- 20.2
Capital goods	2 430	1 916	- 21.2
Industrial machinery	691	678	- 1.8
Machines/apparat.for offices, scientific serv.	430	354	- 17.6
Parts for industrial capital goods	292	210	- 28.1
Accessories for industrial machinery	157	160	2.0
Transportation movable equipment	189	125	- 33.6
Capital goods - sundry	672	388	- 42.2
Intermediate products and raw materials	4 518	3 671	- 18.7
Chemical and pharmaceutical products	1 253	1 175	- 6.2
Accessories for transportation equipment	667	618	- 7.5
Intermediate products - parts and spares	814	526	- 35.4
Mineral products	804	498	- 38.0
Naphthas	270	85	- 68.4
Foodstuffs	288	286	- 0.7
Inedible farm products	361	260	- 28.0
Intermed. prod. and raw material - sundry	330	308	- 6.8
Durable consumer goods	562	354	- 37.0
Passenger vehicles	223	105	- 53.0
Articles of adornment	111	99	- 10.9
Machines, apparatuses for domestic use	83	52	- 37.8
Durable consumer goods parts and spares	77	42	- 45.8
Furniture and other house equipments	29	28	- 4.2
Durables - sundry	38	29	- 25.1
Nondurable consumer goods	547	522	- 4.5
Foodstuffs	208	188	- 9.3
Pharmaceutical products	160	173	8.1
Beauty products	31	28	- 6.8
Apparel and other textil clothing	26	21	- 17.6
Beverage and tobacco	25	19	- 23.6
Nondurables - sundry	99	93	- 6.1
Fuels and lubricants	965	733	- 24.0
Crude oil	466	342	- 26.6
Fuels and lubricants-sundry	499	391	- 21.7

Source: MDIC/Secex

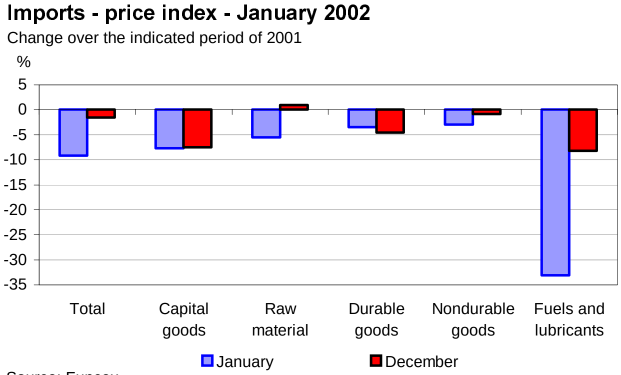
1/ In both years the two month period registered forty business days.

Imports of fuels and lubricants dropped by 24%, closing at a level of US$733 million, above all as a consequence of the reduction of 26.6% in imports of petroleum, due mainly to a sharp decrease of approximately 25% in international oil prices.

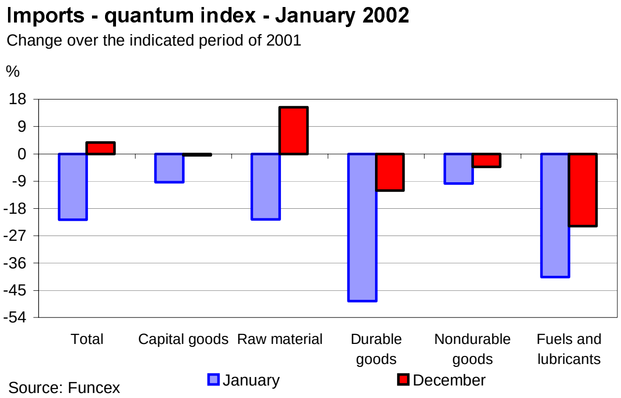
Imports of capital goods came to US$1.9 billion, a reduction of 21.2%. In absolute terms, the sharpest reductions occurred under purchases of parts for industrial capital goods, office machines and equipment and scientific services and movable transportation equipment which, taken together, totaled US$221 million. Purchases of industrial machines remained practically stable in the period.

Purchases of raw materials and intermediate products accounted for 51% of total imports, closing at a level of US$3.7 billion, reflecting a reduction of 18.7% in relation to the level of the first two months of 2001. Among the products with the greatest absolute reductions, one should mention mineral products, principally naphtha, as a result of upward movement in petroleum prices; parts and spares classified as intermediate products; and nonfood farm products. Imports of chemical and pharmaceutical products and transportation equipment accessories, which are the two most important items among raw materials and intermediate products, totaled 48.8% of the category, reflecting reductions of 6.2% and 7.5%, respectively. These rates, which are lower than those for the category as a whole, suggest a more favorable performance in the pace of activities in the chemical/pharmaceutical and automobile industries.

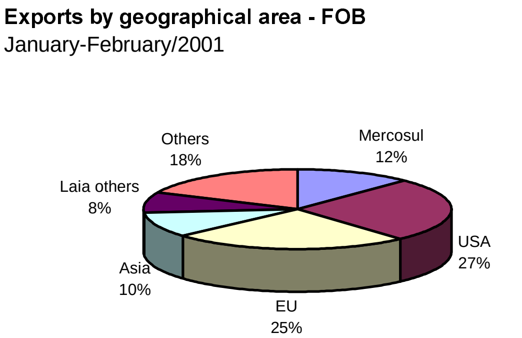
Imports of nondurable consumer goods came to US$522 million, registering the smallest reduction among the different categories of imports (4.5%).



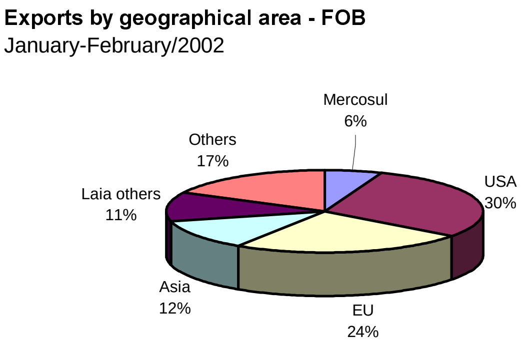
Source: Funcex



Source: Funcex



Source: MDIC



Source: MDIC

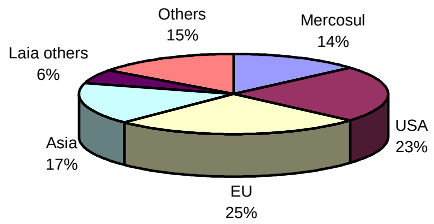
The most important items in the category accounted for 69.2% of the total and closed with highly differentiated performances: while imports of food products dropped by 9.3%, those related to pharmaceutical goods increased by 8.1%. The strongest reductions occurred under beverages and tobacco (23.6%) and apparel and other textile products (17.6%).

An analysis of trade by geographical area indicates improvement in operations with a significant share of countries and economic blocs though, in most cases, this was due more to reductions in imports than to growth in exports. Trade with Argentina was the major exception, as Brazilian exports plummeted by 67.1% and imports dropped by 27.5%, raising the deficit in bilateral trade from US$251 million in the first two months of 2001 to US$511 million in the same period of 2002. To some extent, this result was neutralized by trade operations with the other countries belonging to the Latin American Integration Association (Laia), particularly Mexico. In this case, Brazil's surplus expanded from US$97 million to US$167 million in the period.

Foreign sales to the United States turned in growth of 0.2%, reaching a level of US$2.3 billion, a figure that can be considered quite significant particularly when seen in the context of the general economic slowdown that occurred in that country. The 16.5% drop in imports to a level of US$1.7 billion made it possible to raise the Brazilian surplus from US$186 million in the first two months of 2001 to US$529 million in the corresponding period of the current year.

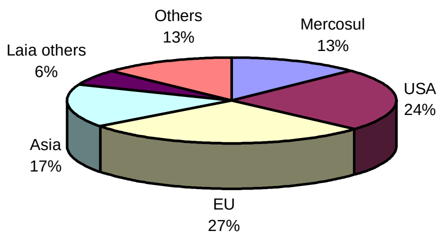
Trade relations with the European Union, on the other hand, produced an increase of US$10 million in the deficit as a consequence of a 16.2% reduction in

Imports by geographical area - FOB
January-February/2001



Source: MDIC

Imports by geographical area - FOB
January-February/2002



Source: MDIC

Current account

US$ billion

Itemization	2000	2001			2002	
	IV Q	Jan-Feb	IV Q	Year	Jan-Feb	Year 1/
Current account	-9.0	-4.1	-5.8	-23.2	-2.2	-20.8
Trade balance	-1.4	-0.4	1.4	2.6	0.4	5.0
Exports	13.7	8.6	13.8	58.2	7.6	60.0
Imports	15.1	9.0	12.5	55.6	7.2	55.0
Services	-2.5	-1.2	-1.7	-7.7	-0.6	-7.9
Transportation	-0.9	-0.4	-0.6	-3.0	-0.3	-3.2
Internat. travel	-0.6	-0.3	-0.2	-1.5	-0.1	-1.1
Comput. & inform.	-0.3	-0.2	-0.3	-1.1	-0.2	-1.2
Operat. leasing	-0.5	-0.3	-0.3	-1.9	-0.3	-2.7
Other	-0.2	0.0	-0.2	-0.4	0.3	0.3
Income	-5.5	-2.7	-5.9	-19.7	-2.3	-19.5
Interest	-4.7	-2.0	-4.4	-14.9	-2.1	-14.8
Profits and divid.	-0.8	-0.7	-1.5	-5.0	-0.2	-4.6
Comp. of emp.	0.0	0.0	0.0	0.1	0.0	0.0
Current transfers	0.4	0.2	0.5	1.6	0.2	1.6

1/ Forecast.

foreign sales, which closed at US$1.8 billion, and a drop of 14.5% in imports, which totaled US$2 billion.

5.2 – Services and income

In the first two months of 2002, services and income registered net outflows of US$2.9 billion, a reduction of 25.4% in relation to the results for the same period of the previous year. This trend had already become evident in the final quarter of 2001, when outflows dropped by 5.2% in relation to the same period of the previous year. Analysis of this result indicates a sharper drop in outlays on services than the increase in net remittances of income.

Net spending on services came to US$599 million in the first two months of 2002, compared to US$1.2 billion in the same period of 2001. Net outlays on transportation dropped by 24.5% to US$328 million due to lesser expenditures on freights and a falloff in spending on international travel tickets. Net spending on international travel fell by 54.5%, based on a decline of US$185 million in Brazilian spending on foreign travel. Under the heading other services, net outlays on royalties and licenses dropped by 20.4%, adding up to US$168 million, and specialized technical services increased by US$99 million, reaching a level of US$386 million.

In the fourth quarter of 2001, net spending on services came to US$1.7 billion, reflecting a reduction of 30.4% in comparison to the corresponding period of the previous year. These reductions were concentrated under net outlays on transportation (27.7%) and international travel (61%). Aside from these items, net spending on equipment rentals registered a reduction of US$204 million, mainly as a result of revenue growth of US$200 million.

Net remittances of income abroad totaled US$2.3 billion in the first two months of 2002, reflecting a reduction of US$409 million compared to the total for the same period of the previous year. Net remittances of income on direct investments diminished by 63.6% to US$249 million, with declines of 67.3% in net remittances of profits and dividends and 50.5% in net payments of interest on intercompany loans, which added up to US$174 million and US$75 million, respectively. Net remittances of income on other investments diminished by US$276 million, while income on portfolio investments expanded by US$286 million, of which US$222 million referred to the first earnings on Bonds of the Republic placed in 2001. On the other hand, debt nationalization operations in 2001 totaled US$3.3 billion and reflected a reduction of approximately US$120 million in payments of bond interest to be paid over the course of the current year.

5.3 – Financial account

Financial account

US$ billion

Itemization	2000	2001			2002	
	IV Q	Jan-Feb	IV Q	Year	Jan-Feb	Year[1/]
Financial acc.	8.5	5.9	2.8	26.9	2.3	18.3
Direct invest.	9.6	2.6	7.8	24.9	2.0	16.6
Abroad	-0.6	-0.1	0.4	2.3	-0.4	-1.4
In Brazil	10.1	2.6	7.4	22.6	2.3	18.0
Equity capital	9.1	2.0	6.4	18.9	2.1	17.0
Interc. loans	1.0	0.6	1.0	3.7	0.2	1.0
Portfolio inv.	0.5	2.3	-3.4	0.1	0.8	3.5
Assets	0.1	-0.3	0.0	-0.8	-0.1	-1.0
Liabilities	0.3	2.6	-3.4	0.9	0.8	4.5
Derivatives	-0.1	0.0	-0.1	-0.5	-0.2	-0.2
Other invest.	-1.5	1.0	-1.5	2.4	-0.3	-1.5
Assets	-2.5	-0.2	-0.5	-6.2	1.6	2.5
Liabilities	1.0	1.2	-1.0	8.6	-1.9	-4.1

1/ Forecast.

In the months of January and February, the financial account registered a net inflow of US$2.3 billion, with entries of US$2.3 billion in net foreign direct investments and net payments of US$1.9 billion in other foreign investments in the country. Emphasis here should be given to net inflows of US$830 million in portfolio investments, which had registered net outflows in the last three months of 2001 at an average level of US$1.1 billion.

Foreign direct investments in the country added up to US$2.3 billion, with net inflows of US$2.1 billion targeted to participation in the capital of Brazilian companies and intercompany loans totaling US$235 million.Consequently, as noted in the final quarter of the year, when investments came to US$7.4 billion, these inflows entirely financed the current account deficit of US$2.2 billion.

Here, particular mention should be made of the increase in the relative participation of foreign direct investments in the industrial sector, from 22.3% of the total in 2000 to 34.6% in 2001. The industrial segments

BP medium- and long-term financing sources

Selected items

US$ million

Itemization	2001 IV Q	2001 Year	2002 Jan-Feb	2002 Year[1/]
Medium- and long-term disbursements	2 933	19 916	2 073	15 185
Bonds	500	7 549	1 250	5 000
Notes and commercial papers	1 648	7 350	700	4 847
Direct loans	785	5 017	123	5 337
Short-term capital (net)	- 536	1 123	- 629	27
Rollover rates[2/]				
Bonds	27%	118%	n.a.	209%
Notes and commercial papers	63%	81%	55%	78%
Direct loans	70%	138%	16%	97%

1/ Forecast.
2/ Excludes conversions. Includes put/call options.

Uses and sources

US$ billion

Itemization	2000 IV Q	2001 Jan-Feb	2001 IV Q	2001 Year	2002 Jan-Feb	2002 Year[1/]
Uses	-15.8	-8.3	-15.8	-58.4	-6.2	-47.6
Current account	-9.0	-4.1	-5.8	-23.2	-2.2	-20.8
Am. ML-term[2/]	-6.8	-4.2	-10.0	-35.2	-3.9	-26.9
Securities	-2.4	-1.3	-5.8	-19.0	-1.3	-8.6
Paid	-2.4	-1.3	-5.8	-16.9	-9.0	-8.6
Nationaliz. debt	-	0.0	-	3.1	0.0	-
Refinanced	0.0	0.0	0.0	-2.2	0.0	0.0
Suppliers' credits	-1.4	-0.6	-0.7	-2.8	-0.4	-2.8
Direct loans[3/]	-3.0	-2.3	-3.5	-13.3	-2.3	-15.4
Sources	15.8	8.3	15.8	58.4	6.2	47.6
Capital account	0.1	0.1	-0.3	0.0	0.1	0.1
FDI	10.1	2.6	7.4	22.6	2.3	18.0
Dom. securities	0.3	0.8	0.0	2.2	0.4	3.4
ML-term disb.[4/]	7.9	5.9	6.0	32.4	3.4	26.4
Securities	2.4	2.9	2.1	14.9	1.9	9.8
Suppl.' credits	0.6	0.4	0.7	2.6	0.3	2.7
Direct loans	4.9	2.6	3.2	14.9	1.1	13.9
Braz. assets abr.	-2.7	-0.3	0.1	-4.2	1.4	0.3
Loans to Bacen	0.0	0.0	0.0	6.7	0.0	-2.4
Other[5/]	1.7	1.7	-1.0	-0.3	-1.2	-0.6
Reserve assets	-1.5	-2.5	3.6	-3.3	-0.1	2.4

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

that registered the most significant results were vehicles, chemical products and electronic and communications equipment. These segments are important not only in terms of exports but also due to the fact that they contribute to increased substitutions of imports of raw materials and intermediate products.

Foreign portfolio investments in the country registered net inflows of US$830 billion. This result points to improvement in net funding operations in the last three months of 2001, when average net amortizations of US$1.1 billion occurred. Net investments in fixed income papers added up to US$477 million, with inflows of US$1.3 billion referring to a January placement of Bonds of the Republic, scheduled to mature in 2012 (Global 12). Net amortizations operations based on notes and commercial papers (US$566 million) represented a drop in the ratio between disbursements and amortizations in relation to the three previous months, from 63% to 55%.

Other Brazilian investments abroad registered net returns of US$1.6 billion, with net disbursements of US$232 million in loans abroad and net returns of US$1.9 billion maintained abroad in the form of currency and deposits. In the fourth quarter of 2001, investments resulted in net outflows of US$511 million. The most important items were the November return of US$2.5 billion in amortizations on loans that had been granted to Poland together with outflows of US$3 billion in the form of deposits constituted abroad in the month of December.

Other foreign investments in the country registered net outflows of US$1.9 billion in the first two months period 2002. Suppliers' credits turned in net amortizations of US$778 million, with net payments of US$656 million in short-term resources and US$122 million in long-term resources. As noted during the course of 2001, the equilibrium registered in the flow of long-term trade credits indicates that the turnover of resources of this type has been maintained as a consequence of stagnation in the level of imports in the period and steady flow of suppliers' credit to the country. Loans registered net amortizations of US$1.1 billion, with net disbursements of US$126 million from organizations and net payments of US$245 million to branches, US$652 million in direct loans and US$372 million in buyers' credits. Between October and December 2001, net amortizations came to US$964 million, compared to net inflows of US$1 billion in the same period of the previous year.

The forecast for the 2002 balance of payments has been reviewed as a result of the release of new data for the foreign debt service, interest and amortization. These figures have been updated after the calculation of the debt balance for December 2001, resulting in small changes in projections. Foreign direct investments still remain as the major source of financing for the current account deficit, corresponding to 86.5% of the total. Medium and long-term disbursements are expected to be sufficient for financing almost the total amortizations in the year, 98%.

5.4 – Conclusion

Despite a lower level of exports in the first two months of the year, the trade balance has remained in a surplus position as a result of the more intense decrease registered under imports. The slowdown in the world economy has had an adverse impact on the nation's foreign sales and this situation has been further aggravated by the economic difficulties with which Argentina is grappling. However, there are significant signs that suggest an ongoing process of market diversification for Brazilian goods, which will certainly go a long way toward attenuating the impacts resulting from crises with individual trading partners and maintaining an adequate level of exports during the process of world economic recovery. This is particularly true with regard to the recovery in the United States, Brazil's largest trading partner. These are factors that will no doubt generate greater dynamism in the export sector during the year.

Aside from more dynamic expectations for exports in 2002, trade results will point to a decline in import operations that will be fully compatible with the higher rate of exchange. At the same time, depreciation of exchange is an element of essential importance to the substitution of imports since it will have the impact of curtailing external purchases of consumer goods and intermediate goods, even in periods of intense economic activity.

Since inflows of resources have been sufficient to finance foreign payments and the formation of assets abroad, the result has been very low level exchange rate volatility.

6 – Prospects for inflation

This chapter of the *Inflation Report* presents the Monetary Policy Committee (Copom) assessment of Brazilian economic performance since the last *Report*, in December 2001, 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 18.50% per year, rate set by Copom in its March 19th and 20th meeting, and the exchange rate will remain in the same value of the eve of Copom Meeting. In addition, an alternative forecast is presented, taking into account the market expectations for the interest rate and exchange rate paths on March 18th. 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 not only on the interest rate assumption, but also on assumptions concerning the behavior of relevant exogenous variables. The baseline scenario, based on which Copom makes its decisions regarding interest rates, depends 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 objective.

6.1 – The determinants of inflation

The 1.5% GDP growth in 2001 (preliminary data), despite being below the most recent expectations, indicates that the effects of the shocks occurred in 2001 on economic activity were smaller than what was expected last year. For 2002, the indicators of activity level show a recovery of the Brazilian economy. The likelihood that shocks of the same magnitude occurred last year hit the economy this year is small. Besides, the reduction of the Selic interest rate to 18.75% was followed by a reduction of the slope of the interest rate term structure, which started to be negative in March. The decrease of the six-month interest rate since the last meeting was nearly 180 basis points. This movement should contribute to a sustainable growth in 2002.

Sales recovery and the consequent fall in inventories confirm the recovery of activity level. In January, real sales increased by 2.1% compared to the previous month (CNI seasonally adjusted data). According to available indicators, a thoroughly reduction was observed in inventories after the high levels observed in the second and third quarters of 2002. The utilization rate of the installed capacity grew by 2.3% compared to December (CNI seasonally adjusted data), but it is still below the level observed in January 2001.

Since October 2001, industrial production has been growing. The level of industrial production in January was the highest observed since May 2001. Nevertheless, January output was 1.3% lower than the figure observed in the same period last year, when the economy was presenting a high pace of growth. The end of the energy rationing may enable an expansion of aggregate supply, and, as a consequence, should contribute to economic recovery. As a piece of evidence, electricity intensive sectors grew by 5.6% between December and January, compared to a 1.3% average growth of industry in the period.

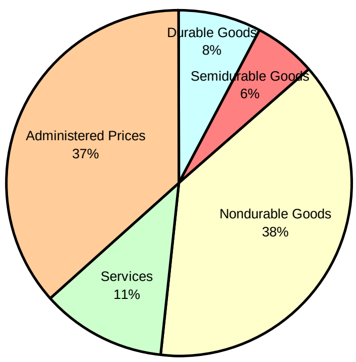
Economic recovery will depend on the recovery of aggregate demand. However, some factors may limit it: the slow growth of credit and the reduction of workers real total compensation occurred last year. Credit operations of the financial system to the private sector totaled R$ 324 million in January, about 27% of GDP, and fell 0.2% compared to December (seasonally adjusted data). Compared to January 2001, the total amount of loans to the private sector rose by 5.7% in nominal terms, below the inflation in the period. At the same time, there is no significant growth in non-earmarked loans. The balance of these operations amounted to R$ 195.8 billion in January, representing a 1.6% growth in the month. This increase, however, was only a partial compensation of the 3.3% reduction observed in the last two months of 2001. Worker's real total compensation was practically stable between November and December (seasonally adjusted data), but the annual average has been continuously falling since March 2001. In 2001, the average of worker's total real compensation was 3% below the average observed in 2000. If, by one side, this conjuncture may delay the growth process, it also implies that demand pressures should not occur during the year.

Regarding the external sector, an improvement in the Brazilian exports is expected as the recovery of global demand consolidates, in particular, the recovery of the U.S.A. economy. Clear signs of American recovery are already evident, like the GDP growth in the last quarter of 2001, the decrease in the unemployment rate in January and February and the rising of manufacturing orders.

On the other hand, a reduction in exports to Argentina is expected, which may reduce trade balance surplus. This reduction, however, can be minimized by the reorientation of exports to other markets. Recent statistics of trade indicate that this process is already in course. Brazilian exports for Mexico and China have been increasing.

The expectations of a good harvest in 2002 may exert a downward pressure on food prices. In the absence of adverse climate conditions, food prices should not exert pressure on the consumer price index, unlike the situation observed last year. In 2001, there were a harvest break of some products, such as bean and wheat, and an increase in tradable goods prices as consequence of the exchange rate depreciation.

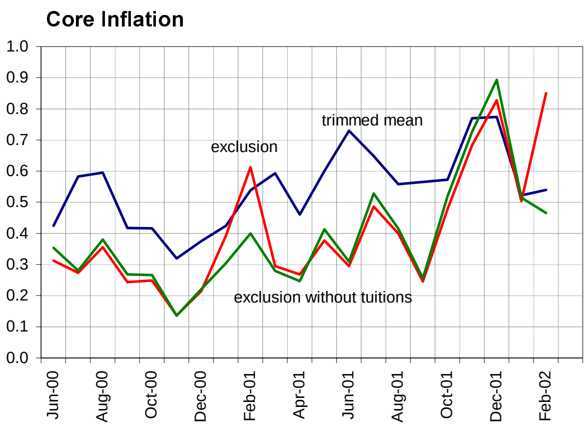
Contribution by category in the change of IPCA from Mar 2001 to Feb 2002



Regarding the group of administered by contracts and monitored prices – administered prices, for short – which represents about 30% of the IPCA, it is forecasted an inflation nearly 4 percentage points below the 10.4% figure observed in 2001. Such reduction is mostly explained by the downward trend expected for the general price indices (IGP's) – on which the adjustment of electricity and telephone fees are based –, by the fall of gasoline price and by the appreciation of the Real observed since the last quarter of 2001. Administered prices contributed 37% to the February 12-month IPCA inflation.

The increase of electricity fees in the first quarter of 2002 incorporates two exceptional adjustments. The first one, already occurred in December, but partially impacting on January inflation, referred to the compensation to the concessionaries for the losses caused by the energy rationing; the second one, occurred in March, is related to emergencial contracts of thermo electrical energy. These adjustments should make energy prices increase by 6.8% in the first quarter of 2002. However, it is expected an accumulated adjustment by the end of the year below the one observed in 2001, based on the assumption that the exchange rate appreciation at the end of 2001 and the smaller variation expected for the IGP-M should hamper future increases in electricity fees.

Along with the liberalization of fuel market, consumer prices started to be defined mainly by the international price of oil by-products and by the exchange rate. The observed 14.5% fall in gasoline prices in the first months of the year tends to be partially offset by the announced price adjustments by Petrobras in this quarter and by the increase of oil prices in the international market. In spite of that, futures markets project relative stability in oil by-products prices for the rest of the year.



Core inflation calculated by the trimmed-mean and by the exclusion methods showed significantly divergent results in February, differently from what had been occurring since October. While the trimmed-mean core showed some stability (0.54% in February, against 0.52% in January), the exclusion core, which excludes food at household and administered prices, increased from 0.50% to 0.85%. This result is explained by the inflation of the "education group" items, specially the "courses" item, which presents a seasonal behavior due to the renewal of contracts at the beginning of the school year. Excluding "courses" from the core, core inflation would have reduced to 0.47% in February.

6.2 – Baseline scenario: assumptions and associated risks

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 and the respective associated risk is part of the baseline scenario under which Copom makes monetary policy decisions.

The main sources of uncertainty concerning the forecasts for the inflation rate over the next two years refer to the behavior of the administered prices, the recovery of the world economy and the fading out of the effect of the shocks that hit the economy in 2001. Compared to the last *Report* the forecast inflation for administered prices increased by 1.3 p.p. and 1.4 p.p. for 2002 and 2003, respectively. The smaller reduction in gasoline and diesel prices and the higher increase in cooking gas were the main sources to explain this revision for 2002. For 2003, it is supposed that a higher proportion of administered price adjustments are based on specific hypothesis, instead of depending on market prices. The perspectives for the world economy have improved since December. The likelihood that the American economy leaves recession in the first semester of 2002 has increased. In the last months, since the Argentinean peso depreciation, the contagion effect of Argentina crisis on Brazil has been limited. Regarding the slope of the interest rate term structure, the decrease of about 180 b.p. in the six-month interest rate observed since the last *Report* is another important factor for the recovery of the Brazilian economy. As above mentioned in 6.1, this recovery has been slow with no additional pressures derived from aggregate demand.

For the set of administered prices, which weighs 30.5% in February IPCA, it is projected an inflation of 6.8% and 4.5% in 2002 and 2003, respectively. In the current baseline scenario, it is assumed that the readjustment of energy, telephone, transportation, health care and postal services are obtained from specific hypothesis. On average, inflation of these items should be 5.6% in 2003. Administered prices should contribute with 2.1 p.p. and 1.4 p.p. for the IPCA in these years.

Along with the liberalization of oil and oil by-products, the projections of their prices have started to be based on the following parameters: the exchange rate evolution; the spot price of gasoline in the U.S.A. (Energy

Information Administration) and the Brent barrel traded in the futures market of the International Petroleum Exchange (IPE) for the adjustment of gas and diesel; the spot price of propane in the U.S.A. (Energy Information Administration) and the future prices of propane gas traded in the New York Mercantile Exchange (NYMEX) for adjustment of cooking gas. Considering the average cost of the petroleum barrel around US$ 23.3 until the end of the year and the maintenance of the domestic currency at the current level, the prices of gasoline to consumers should increase by 8.2% until the end of the year. This amount already incorporates the most recent adjustments of 2.2% and 9.4% in the oil refinery, defined by Petrobras. For 2002, because of the decrease occurred in January and February, it is projected a 7.5% reduction in the gasoline price to consumers. Concerning cooking gas, the elimination of subsidies and the upward movement of the propane gas future curve should result in increases above 20% in 2002.

The current projections assume a 16.6% increase in electricity fees for consumers in 2002, with a direct impact of 0.67 p.p. in 2002 IPCA. This value incorporates the two emergency adjustments occurred in the first quarter of the year. Hence, between March and December, electricity fees should increase by 11.3%. Compared to the last *Report*, the projections for electricity fees fell by about 2.3 p.p. as a consequence of the lower path expected for the IGP-M, of the Selic rate reduction and of the exchange rate appreciation, parameters used for the fee adjustments. For 2003, the increase should be 13%, out of which 4% referred to the compensations given to the concessionaires for the losses occurred during the electricity rationing.

With the end of energy rationing, there is no further identified factor that may restrict the growth of aggregate supply. Regarding farming, the baseline scenario keeps the hypothesis of the last *Report* that agricultural prices should follow market inflation over the next two years. Grain crop for 2002 should be in line with the increase in demand.

The baseline scenario implies a stable path for the exchange rate in 2002. Particularly, the exchange rate remains stable around the level observed in the eve of Copom. Given the behavior of the Real at the beginning of this year, second quarter average should be more appreciated than the average observed in the first quarter, contributing to smaller inflation pressures.

Consistent with the exchange rate path, the baseline scenario assumes that the Brazil risk, measured by the spread over treasury of the Global 04, should fall from an average of 630 b.p., in the first quarter of 2002, to 550 b.p. in the second quarter, the value prevailing at the end of March. From then on, Brazil risk should remain constant. For the Fed Funds rate, based on the behavior of futures market, one forecasts a gradual increase from the current level of 1.75% p.a. to 3.2% p.a. until the end of 2002, remaining constant afterwards.

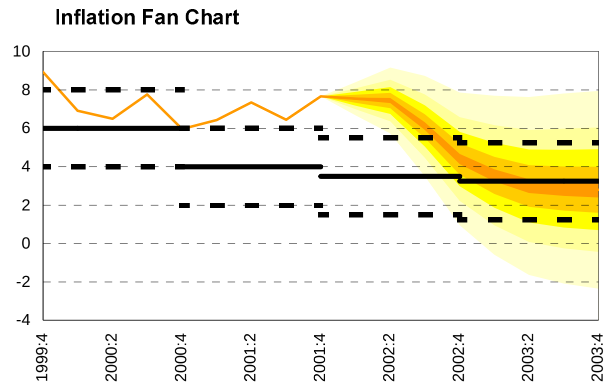
The projections for the exchange rate included in the baseline scenario imply a nominal value close to the average observed in 2001. Hence, there should be a small real appreciation of the currency that is consistent with the prediction of a trade balance surplus of US$ 5 billion in 2002 - prediction kept since the last *Report* - and with the improvement of the world economy. The higher likelihood that the American economy is out of recession already in the first semester of 2002 should improve the demand for Brazilian exports. The lower demand for exports by Argentina tends to be compensated by the improvement of other markets, such as Mexico and China. Finally, even assuming that the Fed Funds rate reaches 3.2% p.a. at the end of 2002, against the 2.25% p.a. used in the last *Report*, the faster normalization of the international financial markets should ease capital inflows.

Regarding the slope of the interest rate curve, measured by the difference between the six-month interest rate swap and the Selic rate, it is assumed the slope will start from the current level, around -0.18 p.p., will reduce until reaches a minimun of -0.7 p.p. at the third quarter of 2002, and then will gradually increase to zero by the end of 2003. These values were estimated from the term structure of interest rate, considering the risk premium and the implied forward rate.

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 economic program.

6.3 – Inflation forecast

Forecasted IPCA-inflation with interest rate fixed at 18.50% p.y.



(accumulated inflation in 12 months)

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 interest rate will remain constant at the level of 18.50% per year set out at the Committee's March 19th and 20th meeting, and the exchange rate will remain constant at the market level on the day before the meeting. This *Report* also presents an inflation forecast conditional on the basic interest rate path expected by the market.

IPCA with 18.50% p.y. fixed interest rate

Year	Q	Confidence Intervals						Central Projection
		50%						
			30%					
				10%				
2002	1	7.2	7.3	7.5	7.6	7.7	7.9	7.5
2002	2	6.7	7.1	7.3	7.6	7.9	8.2	7.5
2002	3	5.1	5.5	5.9	6.3	6.7	7.2	6.1
2002	4	3.0	3.6	4.1	4.7	5.2	5.8	4.4
2003	1	1.9	2.6	3.2	3.9	4.5	5.3	3.6
2003	2	1.1	1.9	2.6	3.4	4.1	4.9	3.0
2003	3	0.8	1.7	2.5	3.2	4.0	4.9	2.9
2003	4	0.7	1.6	2.4	3.2	4.0	4.9	2.8

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

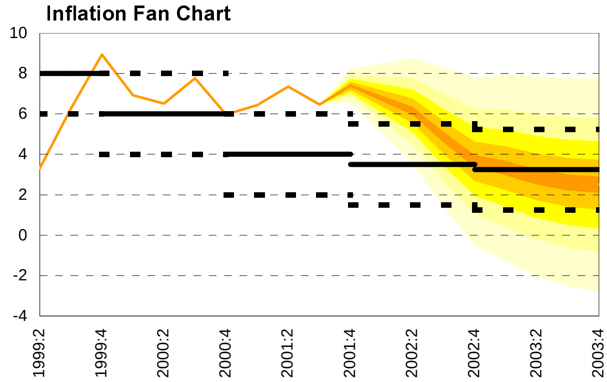
The inflation forecasts are constructed following different specifications for the structural model and the Copom members' judgment (see box *The Decision Making Process at the Copom*). Regarding model specification, there is a continuous effort to keep its use coherent along time while looking for refinements that may improve its predictive power. It was found that in the model specification used up to this *Report* the term structure of interest rates has presented a very strong influence on output gap. In a new specification, which is presently under scrutiny, both the Selic rate and the slope of the term structure are replaced by the 180-day interest rate – represented by the 180-day 'Pré-DI' swap rate – as the explanatory variable of the output gap. Preliminary results show that the effect of the curve slope on the economy is lower than the one that has been in use. Copom has decided to adopt this new model specification from the June *Report* on.

The central path for expected inflation declines monotonically to 4.4% at the end of 2002 and to 2.8% in 2003. Note that the probabilities of deviations are symmetrically distributed around the median, reflecting Copom's assessment of the risks associated with the forecast. The most important inflationary pressure comes from administered by contracts and monitored prices. It is expected that this group of prices will increase by 6.8% in 2002, contributing 2.1 percentage points to IPCA inflation. For the market prices, which form 70% of IPCA, the projected increase is 3.4%, with a contribution of 2.3 percentage points.

The estimated contribution of the primary effect of the administered by contracts and monitored prices' shock to the IPCA in 2002 – the value that exceeds the inflation target after discounting the impacts of exchange rate passthrough and inertia on administered by contracts and monitored prices – is up to 0.9 percentage point. Through inertial mechanisms, this year's inflation still carries over the effects of 2001 inflation. The inertia of last year's over-the-target inflation is thought to have an impact of 0.7 pp on the IPCA in 2002.

For 2003, administered by contracts and monitored prices are estimated to increase by 4.5%, thus contributing 1.4 pp to the IPCA inflation. For market prices, the expected rise is lower, 2.1%, but the contribution is the same, 1.4 pp. The expected IPCA variation for 2003, 2.8%, is well below the established target of 3.25%.

Forecasted IPCA-inflation with interest rate fixed at 19% p.y. (December Report)

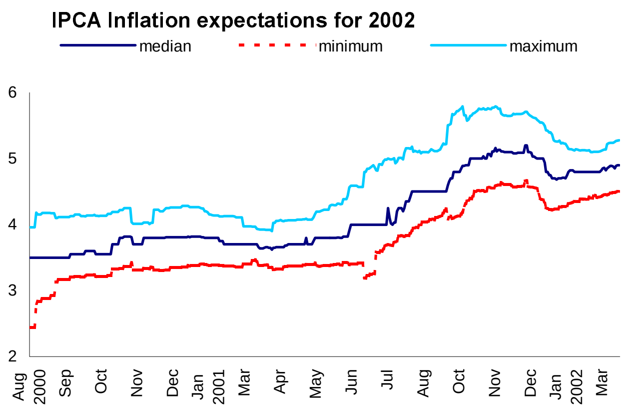


(accumulated inflation in 12 months)

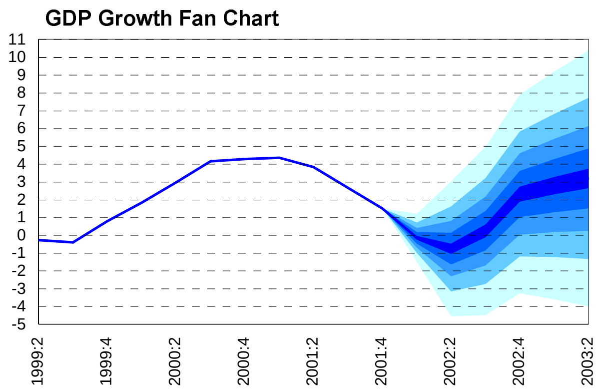
Comparing the current projection with the one in the December *Inflation Report*, here republished, there is an alteration in the expected trajectory of inflation. Although a direct comparison cannot be made since the projections are based on different assumptions regarding scenario and interest rates, as well as on different model specifications, a few points are worth mentioning.

The central projection for 2002 rose to 4.4% from 3.7%, and that for 2003 rose to 2.8% from 2.5%, in comparison to the last *Report*. For 2002, the main cause for the projection rise was the inflation derived from administered by contracts and monitored prices, whose expected increase was elevated to 6.8% from 5.3%, mostly due to upward reviews in gasoline and cooking gas prices. The projection for market prices increased to 3.4% from 3.0%.

For 2003, the main cause for the projection rise was also the inflation derived from the group of administered by contracts and monitored prices, whose expected increase was elevated to 4.5% from 3.1%. The projection for market prices remained essentially stable at 2.1% (it was 2.2% in the last *Report*).

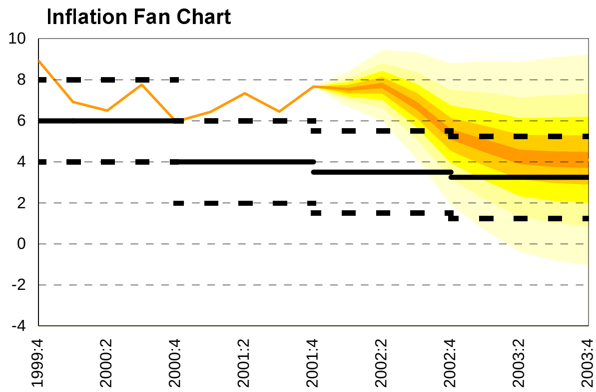


GDP growth with 18.50% p.y. fixed interest rate



(GDP variation, 12 months over previous 12 months)

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



(accumulated inflation in 12 months)

1/ From Investor Relations Group - 03/18/2002

The chart to the left shows the evolution of inflation expectations for 2002, surveyed by the Central Bank's Investor Relations Group (GCI). In comparison to the December *Report*, expectations are at the same threshold, around 5%. Along the quarter, there was a slight reduction, which was reverted in the last couple of weeks, mostly due to the announcement of the increase in gasoline prices. It is important to stress that a significant part of the difference between market and Copom's projections can be explained by the more depreciated exchange rate path taken into account by the market, which probably incorporates a tenser external outlook. The market-expected inflation for 2003 remains stable at 4%.

As in previous *Reports*, this issue also presents the fan chart for output growth. It is constructed on the basis of the same assumptions used in the baseline scenario. It should be stressed that the forecasting errors associated with GDP growth projections are considerably larger than in the case of inflation projections. This happens because GDP growth projections involve the trajectories of two non-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 2002 is approximately 2.5%, under the hypothesis that the basic interest rate remains constant at 18.50% per year.

This issue also presents the inflation fan chart taking into account the interest rate and exchange rate

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

Year	Q	Confidence Intervals						Central Projection
		50%						
			30%					
				10%				
2002	1	7.2	7.3	7.5	7.6	7.7	7.9	7.5
2002	2	7.0	7.3	7.6	7.9	8.1	8.4	7.7
2002	3	5.7	6.1	6.5	6.9	7.4	7.8	6.7
2002	4	3.9	4.5	5.1	5.6	6.2	6.8	5.3
2003	1	3.1	3.8	4.5	5.1	5.8	6.5	4.8
2003	2	2.3	3.2	3.9	4.6	5.3	6.1	4.2
2003	3	2.1	3.0	3.8	4.5	5.3	6.2	4.1
2003	4	2.0	2.9	3.7	4.5	5.3	6.2	4.1

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

1/ From Investor Relations Group - 03/18/2002

expectations of the private *sector* on March 15th. As in previous *Reports*, interest rates were taken directly from the median of market expectations collected by the GCI until that date. The market-expected interest rate curve was downward-sloped, starting from the current rate and falling to 16.5% and 14% at the end of 2002 and 2003, respectively. Besides the interest rate assumption, this fan chart is drawn considering a depreciation path for the domestic currency, which reaches 2.55 by the end of 2002 and 2.68 by the end of 2003. The inflation trajectory resulting from these assumptions hits 5.3% by end-2002 and 4.1 by end-2003. All other hypotheses in the baseline scenario were maintained.

The decision process of Copom

By the end of this quarter, the inflation targeting regime in Brazil completes three years of existence. It is worthwhile, this time, to describe once more the decision process of the Monetary Policy Committee (Copom).

In 1999, Brazil formally adopted a monetary policy regime based on targets for inflation. This decision followed the establishment of a floating exchange rate system. In that period, as a result of the exchange rate devaluation, inflation registered a temporary increase, although it soon returned to its declining path. Resolution nº 2615, of the National Monetary Council (CMN), dated June 30, 1999, defined the IPCA, calculated by IBGE, as the reference consumer price index for the target, and established the targets and their tolerance intervals for 1999, 2000 and 2001. Each year, the CMN discloses the target for the second year to come.

The inflation targeting regime, as it introduces a nominal anchor for monetary policy and for the expectations of inflation, allows for greater transparency and identification of responsibilities in the design and implementation of monetary policy. In this regime, monetary policy decisions are taken based on the widest set of available information. The Copom comprises the governor and deputy governors of the Central Bank – voting members – heads of departments and other participants – non-voting members. It meets in regular intervals of approximately one month to assess the behavior and the projections for inflation and to decide on monetary policy actions. The decisions are taken by majority of votes and are announced immediately after the closing of the meetings.

During the meetings, the heads of the departments of the respective areas make presentations covering the following topics regarding recent economic developments: economic activity, fiscal, monetary, credit and external situations; foreign exchange flows and the evolution of international reserves; open market operations; bank reserves and discount window operations; and prospective evaluation of inflation.

With regard to the prospective evaluation, participants analyze and revalue projection models, taking into account information external to the models, historical series, leading indicators, the path for relevant economic variables expected by the private sector, and other variables that can affect the path of inflation.

Various models were developed to make projections for inflation, within which, noteworthy the structural models, which with few equations, seek to capture interrelations of the main aggregates of the Brazilian economy. The aggregate demand is represented by the IS equation, which relates the output gap to interest rate. The aggregate supply is represented through a Phillips curve, which relates the inflation rate with the output gap, past and expected inflation rates and variation of the exchange rate. It is also projected the evolution of the exchange rate, the term structure of interest rate and the administered price inflation.

The projections of the structural models are complemented by a set of short-term projection models, within which, noteworthy non-structural Vector Autoregressive Models (VAR), Bayesians VARs (BVAR), and autoregressive moving average models (ARMA). These models have as main objectives: i) generate alternative short-run projections for inflation; ii) estimate, from their results, the real interest rate; and iii) simulate specific shocks over IPCA components.

Other models are also used, like the core inflation and leading indicators, which have as their main function, the identification of trends and inflection points of the inflation behavior. It is also estimated, the demand for money, to evaluate its consistency with regard to the projected path of the interest rate.

It is worth noting that the results obtained by the models are combined with the judgement of Copom members. This qualitative evaluation makes possible to increase the coverage of the universe of analysis, allowing elements of the economic scenario, not directly covered by models, to be incorporated. Within these elements, it is included subjective judgements related to the impact of the international market and of the liquidity of the economy over inflation. All these instruments have important role in monetary policy decisions. This process is complemented by organized and judicious communication of the decisions and their justifications through the minutes of the meetings – which relay the synthesis of the meetings within maximum eight days – quarterly inflation reports, press releases and sporadic communication of Copom members. Effective communication is essential for society to get to know the functioning of monetary policy and to understand Copom decisions.

Annex

Minutes of the 66th Meeting of the Banco Central do Brasil Monetary Policy Committee (Copom)

Date: December 18th and 19th, 2001
Place: Central Bank's Headquarters 8th floor meeting room (on **Dec 18**) and 20th floor (on **Dec 22**) -Brasília - DF

Called to Order: 4:26 PM on **Dec 18** and 5:00 PM on **Dec 19**
Adjourned: 8:23 PM on **Dec 18** and 9:08 PM on **Dec 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
Sérgio Darcy da Silva Alves

Department Heads (all present on Dec 18)
Altamir Lopes – Economic Department (DEPEC)
Felipe de Castro Ribeiro - 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 Dec 18)
José Pedro Ramos Fachada Martins da Silva – Advisor to the Board
Alexandre Pundek Rocha - 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 recent behavior of the economic indicators have shown that the country's economy is gradually overcoming the several shocks that affected it throughout the year. The level of economic activity is indicating the end of the deceleration process which has been present since April, and a trend of gradual recovery is emerging for the coming months. At the same time, the trade balance maintained its surplus, as observed throughout the year, reinforcing the adjustment of the external accounts. On the fiscal side, the results remained favorable, outperforming the targets agreed upon with the International Monetary Fund (IMF).

Regarding retail commerce, preliminary results for November confirmed the trend of consumption recovery observed since August. Retailers real turnover increased by 1.8% in the Metropolitan Region of São Paulo, according to the data from the Federation of Commerce of the State of São Paulo (FCESP), seasonally adjusted by Central Bank's Economic Department (Depec), reflecting bigger sales of durable and non-durable consumer goods. Year to November, the real turnover declined 4.8%. The recovery of the consumption continues to improve, according to recent results of surveys on consumer expectations. The Consumer Intentions Index (IIC), also surveyed by FCESP, increased for the third consecutive month in December, increasing by 3.5% in comparison to the previous month. This outcome resulted from the improvement of the two components of the index, current and future consumption intentions, reflecting the positive perception of consumers regarding the consequences of the domestic and external shocks. The National Consumer Expectations Index (INEC), issued quarterly by the National Confederation of Industries, presented similar behavior, recovering throughout the second semester by reaching 91.1 in June, 93.2 in September and 94 in November.

In spite of the favorable scenario of the retail trade, default rates increased considerably during last month. The net default rate, measured by the Commercial Association of São Paulo (ACSP), increased to 8.4% in November from 6.2% in October. According to ACSP, the main reasons for such behavior were the increase in unemployment and the fall in the real average income. Nonetheless, the ACSP expects the rate to decline in December, returning to the 6% level, as a seasonal occurrence and, as a result of the payment of 13th salaries plus seasonal consumer behavior, consequently recovering their credit status for end-of-year purchases. The share of checks with insufficient funds in relation to the total of cleared checks increased in November to 5.2% compared to 5.1% in the previous month. Regarding credit operations of the financial system, the ratio of loans in arrears for up to ninety days in relation to the overall credit balance reached

5.2% in November. Considering only private individuals operations, this ratio presented a small increase, reaching 6.9% compared to 6.8% in October.

The investment is another demand component that has performed favorably. The indicators still registered, in the last months, expansion of the production capacity of all sectors of the economy and the adaptation to the energy crisis. The composition of the growth rate of the production of capital goods showed the predominance of equipment related to the electric power generation, the civil construction sector and the agricultural activity. The demand for electric power generators will drop in the coming months, due to the reduction of the rationing targets. Nevertheless, the expectation of a hike in electricity tariffs will attenuate that reduction, by stimulating the search for energy self-sufficiency by industries. The production of agricultural equipment in the last few years has improved with the continuous expansion in grain crops, as well as other agricultural products, a trend expected to continue in 2002. In relation to the civil construction industry, the gap between the growth of production of equipment used by the sector and its modest performance in the last few years indicates favorable conditions for a future recovery.

Concerning the industrial sector, the analysis of production indicators in recent months shows that the negative effects from the constraints on electricity supply were absorbed. The 1.9% contraction in the October production, seasonally adjusted, resulted to a great extent from the strike of the petrol sector workers, affecting the mining industry and the production of the chemical industry. These effects apart, the variation of the industrial production in October is still negative, but close to zero, compatible with the scenario of leveling off of the industrial activity present since August. It is worth observing that, in spite of the unfavorable outcome in that month, twelve out of the 21 surveyed industrial sectors increased their production. Year to date, the results remained positive, with a 2.5% increase compared to the first ten months of 2000.

In November, the automobile industry produced 153.5 thousand vehicles, expanding by 8.5% year-to-date. Notwithstanding the seasonal influences, the monthly growth was 12.6%. Sales reached 148.1 thousand vehicles, an increase of 13.2% in the period (seasonally adjusted series). The production of agricultural machinery and equipment grew for the third consecutive month, registering a 1.6% elevation. The 25.1% increase ytd suggests the continuity of the increase of the agricultural productivity for the next crop, now being sowed.

The utilization rate of installed capacity, which had declined strongly in the months in which the restraints on energy supply were more intense, reflected the recent leveling off of the industrial production. Year to September the intensity of the reduction in the usage of industrial capacity fell, a process that presented signs of reversion in October, according to the statistics from the Federation of Industries of the State of São Paulo (FIESP) and the National Confederation of Industries (CNI), which registered utilization rates of industrial capacity of 79.4% and 79.6%, respectively, in the seasonally adjusted series.

The developments in the labor market reflected the lesser impact to the domestic and external shocks on industrial activity, the prospect of the end of economic deceleration, and the beginning of recovery. In industry, surveys revealed a lower number of dismissals than suggested by economic forecasts at the beginning of the electricity rationing, and October indicators point to the end of this trend. The open unemployment rate, calculated by the Brazilian Institute of Geography and Statistics (IBGE) for six Metropolitan Regions, reached 6.55% in October, compared to 6.15% in September, an increase originated from the 0.45% growth in the Economically Active Population (PEA), as the number of occupied workers remained stable. Data from the Ministry of Labor still indicated growth of the formal employment in October, as observed since the beginning of the year. The total number of formal labor positions in October corresponded to 23,830 thousand, increasing by 0.34% in comparison to the previous month and 2.94% ytd.

As for the financial system indicators, the outstanding balance of credit operations registered a 0.2% growth in November, reaching R$ 336.1 billion. This performance was basically due to the 1.1% fall in the operations with freely allocated resources, which represented 58.6% of the total operations, as compared with the 2.9% seasonal growth of resources directed to the rural sector, as well as the 7.3% expansion of on-lendings for investments from the National Bank of Economic and Social Development (BNDES).

The reduction of the stock of credit with freely allocated resources originated, to a great extent, from the appreciation of the Real in the period, affecting operations linked to the exchange rate and inducing the 1.6% reduction in the balance of operations with corporations. Regarding the 0.2% fall observed in the credit to private individuals, it is worth emphasizing the smaller use of overdraft accounts, in view of the increase of family incomes resulting from the receipt of part of the 13th salary in November.

With reference to the foreign trade, a US$ 129 million surplus was obtained in the trade balance in the month up to the second week of December, increasing the year-to-date surplus to US$ 1.9 billion. The positive result of the trade balance throughout the year is mainly reflecting the reduction of imports, as a consequence of the exchange rate depreciation and the deceleration of domestic economic activity, and the expansion of exports, particularly basic products, as the exports of manufactured products grow at a less accelerated rate due to the contraction of important markets for Brazil such as Argentina and the European Union. The continuity of the growth of sales to the USA should be highlighted, in spite of the deceleration of that economy, plus the gradual incorporation and expansion of sales to new markets in Asia, Africa, Eastern Europe and the Middle East. Thus, the current account deficit showed a declining trend, while foreign direct investments, an important source of funds to finance the balance of payments, reached US$ 2.2 billion in November, the highest result of the year, compared to a monthly average of US$ 1.4 billion in the period, August to October.

In summary, the evaluation of the recent performance of the indicators, both from the demand side and from the production sectors, permits the conclusion that that the economy has overcome, to a great extent, the negative effects related to the rationing of electricity supply and to the adversities of the international scenario, as demonstrated by the stability of the Gross Domestic Product (GDP) in the third quarter of the year, compared to the previous one, seasonal influences apart. The sustained dynamism of the domestic activity is also worth mentioning, furthermore thanks to the continuity of investments, the increases of agricultural income and the recovery in consumption, contributing to a gradual recovery in the growth trend.

External environment

Indicators recently released show that the world macroeconomic scenario is one of deceleration with reduction in inflationary pressure and low confidence of the agents, despite the efforts of the larger economies to adopt expansionist monetary and fiscal policies.

The U.S. economic indicators reinforce the decelerating trend of the expansion of economic activity, although at varying rates depending on the characteristics of each economic sector. In the third quarter, U.S. GDP contracted by 1.1%, reflecting reductions of 10.7% in private investment, and of 17.7% in exports. Consumption, which used to support outcome, expanded by 1.1%, and government expenditures grew by 0.8%, decelerating as compared with the previous quarter. From the supply side, factors of production are migrating from goods production to the services sector. In the job market, the increase in the unemployment rate observed in the last months is linked to the deterioration of corporate results, whose profits declined significantly in the third quarter. The job market is expected to remain in decline, as corporations adjust their costs by cutting investment and dismissing employees. Agents' expectations surveyed among entrepreneurs (NAPM) and consumers (Conference Board) were distinct from each other in November. Expectations of manufacturers recovered in November, after the drop in October, but were still below 50 points, for the 16th consecutive month, indicating retraction. The index that measures consumer confidence contracted 31.8 points from August to November, reflecting the uncertainties about the economic scenario in the short run. This suggests that the U.S. economy will not bounce back quickly.

The propagation of economic fragility helps to maintain inflation under control. Inflation is showing signs of deceleration. The CPI rose by 1.9% in the 12 months ending in November, as compared to 2.13% in October and 3.62% in May. The CPI core in November, however, grew by 0.37% compared to 0.16% in October. Price increases were considered as normal for the period and will not translate into inflationary pressure in the coming months.

The U.S. economic scenario does not show consistent signs of recovery of the level of activity. Market forecasts indicate sustained growth recovery only after the third quarter of 2002.

The economies in the Euro area continue to present deceleration in their growth rate of economic activity. The latter is made worse by the retraction in world demand, which may revert the upward trend of the regional trade balance, as a result of unfavorable forecasts for business. The deceleration in the Harmonized CPI, which is in a converging trend to the annual reference of 2%, may lead the European Central Bank to ease monetary policy, in an attempt to bring dynamism to regional economic activity. An expansionist fiscal policy could be limited by the public deficit ceilings imposed by the Maastricht criteria.

In Japan, main demand and supply indicators point to the deepening of recession. The maintenance of the zero interest rate monetary policy, associated to expansionist fiscal measures, are not producing positive results. Industrial production maintains a declining trend having reached in October a 12-month accumulated variation of -11.9%, one of the lowest levels since 1988.

The economic deceleration simultaneously observed in the more developed economies reflects on the performance of the emerging markets. In China and in Korea, domestic demand sustains economic growth, compensating the retraction in external demand. The approval of China's entry to the WTO, on November 10, means that export markets will be widened, as well as imposing new challenges due to the deep transformation that will occur in key sectors of the Chinese economy. In Turkey, the IMF emphasized the good results of the fiscal efforts taken by the government and the advances in the restructuring of the banking sector. The IMF announced that it intends to negotiate additional US$10 billion financing for Turkey, to permit the compliance with external financing needs in 2001 and in 2002, widened due to the effects of the September 11 events.

In Argentina, the deepening of the recession is a scenario of difficult solution. The deterioration of public accounts and the several economic packages in the last months failed to reestablish market confidence and barely contributed to the recovery of economic activity. The degree of popular dissatisfaction was shown through pillaging in the capital and in the main cities, leading to a decreed state of siege and the resignation of the Minister of Finance.

Prices

In November, the inflation rates measured by the main price indices declined. The Consumer Price Index - Extended (IPCA) varied 0.71%, compared to 0.83% in October, accumulating 6.98% in 2001 and 7.61% in the last twelve months. The smaller monthly variation of the IPCA was mainly due to the lower impacts of cigarette and fuel price increases, both occurred at the beginning of October. The reduction of the rate was not more intense due to increases of the expenditures with food, mainly cereals and meat, to the adjustments of electricity tariffs in the cities of Rio de Janeiro and Porto Alegre, as well as to the increase in urban bus tariffs, also in Rio.

The General Price Index – Domestic Supply (IGP-DI) showed a 0.76% variation in November, compared to 1.45% in October, accumulating 10.18% in the year and 11.02% in 12 months. Relative to the previous month, the variation of the Consumer Price Index (IPC-DI) accelerated 0.85% compared to 0.71%, mainly due to increases of administered prices in Rio de Janeiro, more intensively impacting on the IPC rather than the IPCA, in addition to the residual effect of cigarette prices in October. The slowdown in the variation of the Wholesale Price Index (IPA-DI), 0.73% in November compared to 1.88% in October, was the main reason for the behavior of the index in the month. The 0.93% hike in agricultural prices and the 0.65% increase in industry prices, 1.74% and 1.94%, respectively, in October, led to this deceleration in the Wholesale prices. The National Index of Civil Construction (INCC-DI) increased by 0.74%, from 0.93% in the previous month. For the coming months more favorable forecasts are being made. Many factors are contributing to this, such as the recent behavior of the exchange rate, the deceleration observed in the agricultural prices, namely cereals and meat, the absence of strong pressures from administered prices and the prospect of reduction in fuel prices. Thus, even if there are, in the next few months, seasonal pressures from the readjustments of school monthly payments and increase in domestic gas and electricity prices, the aforementioned factors should prevail, allowing for a decrease in the inflation rates.

Money market and open market operations

The yield curve showed higher volatility since the last Copom meeting. After the declarations of the Central Bank board confirming that it will firmly pursue the achievement of the 2002 inflation target and also after the announcement of the firm offer of 16-month LTN, the slope of the curve increased, with the spread between the one-year interest rate and the Over-Selic rate rising to 418 basis points on November 29th, the auction date, from 186 basis points on November 21st. The perception of an improvement in the domestic economy due to the appreciation of the Real against the U.S. dollar, the positive results of the trade balance, and the announcement of the external funding, favored the partial reversion of the trend of the interest rate slope, reducing this spread to 239 basis points on December 14th.

The Central Bank carried out buyback auctions of NBCE simultaneously with the selling auctions of NTN-D from the National Treasury, aiming at partially redistributing the redemption of NBCEs that will take place between February and April 2002. The net financial impact of this operation was neutral due to the purchase of R$1.1 billion of NBCE and the sale of R$1.1 billion of 3-year and 5-year NTN-D (64% and 36% of the total, respectively). The auctions indicated a stronger demand from the market for the reversion of the positions of shorter-term exchange rate indexed securities than opening positions in longer tenures.

Within the period, there was also the rollover of exchange rate indexed securities maturing on 2 different dates. The strategy adopted was based on the full rollover of the principal added to the final interest payments through the placement of 3-year and 5-year NTN-D. The total placement reached R$2.2 billion, with the 3-year securities representing around 70% of the total.

Since November 27th, there have been 7 auctions of LTN. The National Treasury promoted the lengthening of the issuance tenure, placing 16-month securities. These LTN were auctioned on three different dates, the first one being through a firm offer. The average interest rates ranged from 24.7% to 21.87%, while the demand/supply ratio ranged between 1.2 and 2.9. There were also 4 offers of 6-month securities. The upward trend in the average interest rates observed for the first 2 events (20.41% and 20.89%) were reverted in the last 2 auctions (20.18% and 20.35%). The demand/supply ratio ranged between 1.3 and 1.8. The resulting financial volume of the placements transacted reached R$8.1 billion, of which 91% referring to securities maturing in six months.

Considering the financial settlements occurred between November 21st and December 18th, there was monetary expansion of R$3.3 billion. This impact resulted, mainly, from the net redemptions of LTN (1.6 billion), LFT (R$0.8 billion) and exchange rate indexed securities (R$1.1 billion).

During a 20 working day period, the Central Bank intervened thirteen 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% p.a. The average volume of the interventions was of R$16 billion.

In November, the secondary market showed a growth in the trading of fixed rate securities compared to the previous month, with an average daily turnover of LTN growing to R$3.9 billion from R$2.5 billion, due to the increase in the volume of primary offers (to R$7.6 billion in November, from R$5 billion in October), to a more favorable economic scenario and to the expectations of a reduction in interest rates in the medium term.

The 6.6% appreciation of the Real in November was the main factor explaining the R$10.2 billion (-1.6%) reduction of in the domestic securitized debt and also the decline in the share of the debt indexed to the exchange rate to 31.1% from 32.9% in the previous month.

Assessment of inflation trends

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

1. November inflation rate, measured by the IPCA, reached 0.71%, a result higher than expected;

2. Regarding oil by-products, the hypothesis assumed was that, with the opening of the domestic market in January 2002, the prices of oil by-products will be determined by market forces, floating in accordance with supply and demand conditions. The forecast for gasoline, diesel oil and GLP prices for January 2002 were calculated by applying the price variation coefficient in Reais of December compared to November 2001 on the effective prices prevailing in December 2001. For the rest of 2002, the hypothesis assumed the variations of the prices in the futures market of Brent crude oil negotiated in the International Petroleum Exchange (IPE) for gasoline and diesel, and the future contracts of propane gas on the New York Mercantile Exchange (NYMEX) for GLP. For GLP, the hypothesis of elimination of subsidies was incorporated. Thus, in contrast with what should occur with the other oil by-products, domestic gas should increase by 16.4% in first quarter and 15.2% throughout the year. Even though this increase will be substantial, it is more than compensated by the average reduction expected for the prices of gasoline and diesel oil for consumers in 2002;

3. The projection for the readjustment of electricity tariffs in 2001 remained at approximately 20%. For 2002, the forecast of the readjustment was reduced to 19%;

4. For the wider set of administered prices, the 10.7% readjustment in 2001 remained practically unchanged in relation to the previous month. For 2002, the expected readjustment is of 5.2%;

5. The projected slope of the domestic yield curve, measured as the difference between 180-day term DI rate and 1-day Selic rate, was significantly reduced to an average of 290 b.p. for the fourth quarter of 2001, declining to100 b.p. in the second quarter of 2002;

6. The trend of the US Fed Funds rate, forecast based on the maturity of future contracts, was modified to reflect an average rate of 2.15% in the fourth quarter of 2001, declining to 1.75% in the first quarter of 2002, with a moderate rise 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 close to 700 b.p. from the first quarter of 2002 on, with stability thereafter.

The core inflation of the IPCA, calculated under the symmetric trimmed-mean method, rose in November to 0.77%, from 0.57% in October. Accumulated in 12 months, this core index increased by 7.05%. The core inflation of the IPC-BR, calculated under the symmetric trimmed-mean method, rose in November to 0,77%. Accumulated in 12 months, this core recorded a 6.87% variation. The core inflation calculated with the exclusion of the administered prices - considering the wide set of these items weighting 30.7% of the IPCA in November - and household food prices increased by 0.68% in November, with accumulated variation of 4.85% in 12 months.

The IPCA accumulated variation year-to-date reached 6.98% in October, reflecting a 2.9% contribution (10.0% variation) from administered prices and 4.1% contribution (5.7% variation) from free prices. A 0.2% contribution (0.7% variation) is expected from administered prices for the rest of the year. The evolution of these prices should directly contribute with 3.1% for the yearly inflation, compared to the 3.2% forecast in November. In 2002, the lower inflation of administered prices is due mainly to the readjustments of oil by-products prices, which will be determined by the market. It is expected a 5.2% increase of administered prices (direct contribution of 1.6%, which excludes the second-round effects on inflation), influenced by 19% hikes in electricity for the domestic consumer.

Regarding fiscal policy, it was assumed that the primary surplus targets for the consolidated public sector stated in the Economic Program of the Government will be achieved. The remaining assumptions established 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 19.0% p.a. and of the exchange rate at the same plateau as of the eve of the Copom meeting would result in an inflation over the upper limit of the target for 2001. For 2002, the projected inflation is closer to the medium range of a 3.5% target. For 2003, the projected inflation is significantly lower than the medium range target of 3.25%, using the scenario of constant interest rates at 19%.

Monetary Policy Guidelines

The economic scenario presented improvements since the last Copom meeting. The exchange rate appreciated quickly, in response to the positive evolution of the external accounts and the differentiation between the Brazil risk with Argentina's, which resulted in the reduction of the risk premium. Government forecasts for the readjustment of administered prices in 2002 were revised downward due to lower readjustments of the electricity tariffs, the liberalization of the market of oil derivatives and the changes in the taxation of this sector, which will revert into substantial price reductions. The reduction in the slope of the yield curve will have positive impacts on economic growth.

Consistently with the favorable prospects expressed in the Minutes of the last Copom meeting, the indicators of economic activity in the third quarter signal a smooth recovery of the level of economic activity next year. Even being lower than the forecast at the beginning of the year, the GDP growth in 2001 will be close to 2% but slightly higher in 2002. In the third quarter, the economy grew by 0.3% compared to the previous quarter (2.17% ytd). The agriculture and livestock activity contributed positively to the GDP growth, offsetting the negative evolution of the industrial sector. The industrial production, measured by IBGE's Monthly Survey of Industries (PIM) declined by 3.4% in the month, seasonally adjusted figures. In 2001, the investment rate will be higher than 23% of GDP. More pronounced increases in investment will be observed in the sectors of capital goods related to agricultural tractors, high tension transformers, railway wagons, and equipment for the civil construction industry.

The Balance of Payment accounts improved. The trade balance has accumulated a US$1.9 billion surplus ytd until the second week of December, explained by the depreciation of the Real in the second and third quarters. For the first time since 1994, the trade balance will finish the year with a positive result. The foreign direct investment registered higher than expected net inflows of US$2.2 billion in November, and will finish the year with net inflows higher than US$20 billion. In addition, the external funding, which was hindered by September 11 events, was reactivated by private firms. This set of favorable factors contributed to the reversal of the depreciating trend of the Real.

Market expectations for inflation, surveyed by the Central Bank, for the next quarters have been declining in the past weeks. This movement may be partly associated with the recently observed appreciating trajectory of the exchange rate. In the case of this trend persisting, the prospects for inflation may show additional decline, since the risk of the passthrough of the exchange rate depreciation accumulated this year to next year's inflation also declines. Noteworthy is that a significant part of the difference between Copom's projections and the market ones is explained by a more depreciated trajectory of the exchange rate used by the market.

The world scenario is uncertain. The deceleration of the world economy, intensified by the recession in the USA and the by the persistence of recession in Japan reinforce the perception that a recovery of the economy of industrialized countries will be postponed to the second half of 2002. This set of uncertainties, aggravated by the worsening of the Argentine economy, reflects in unfavorable expectations for the exchange rate and the inflation in 2002.

November inflation measured by the IPCA, as well as its core, remained at a high level. The exchange rate passthrough and the decompression of the profit margins seem to be the responsible for the high increases in the consumer price indices and yet the degree of influence of these factors in the next few months is uncertain, mainly in a context of economic recovery. Nonetheless, the four-week index, measured by the IPC-Fipe, already points to a reversal trend.

In summary, a sum of factors contributes to a scenario of interest rate reduction in the coming years. The simulation exercises with the various specifications of the structural model points to inflation near the medium range target in 2002. However, the uncertainties regarding the recovery of the international economy, the improvement in the inflation indices due to a lower passthrough of the exchange rate depreciation, and the evolution of the Argentine crisis recommend that we wait for a confirmation of the more favorable scenario that starts to materialize.

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 January 22nd, 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. 8911, of 10.3.2000.

Acronyms

ac 12m accumulated in 12 months
ACC Anticipated Exchange Rate Contracts
BM&F Mercantile and Futures Exchange
bp Basis Points
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
INCC Civil Construction National Index
IPA Wholesale Price Index
IPC Consumer Price Index
IPCA Consumer Price Index – Extended
IPC-BR Consumer Price Index - BR
IPCH Consumer Price Index – Harmonized

IPP Producer Price Index
IR Income Tax
IRF-M Market Fixed Income Index
IRRF Withholding Income Tax
LFT National Treasury Letters (floating)
LTN National Treasury Notes (fixed rate)
NAPM National Association of Purchasing Managers
NBC-E Central Bank Note **-** E Series (indexed to the exchange rate)
NTN-D National Treasury Note – D Series (indexed to the exchange rate)
p.a. per annum
p.m. per month
PEA Economically Active Population
pp percentage point
STN National Treasury Secretariat
ytd year-to-date

Minutes of the 67th Meeting of the Banco Central do Brasil Monetary Policy Committee (Copom)

Date: January 22nd and 23rd, 2002
Place: Central Bank's Headquarters 8th floor meeting room (on Jan 22) and 20th floor (on Jan 23) -Brasília - DF
Called to Order: 4:29 PM on Jan 22 and 5:32 PM on Jan 23
Adjourned: 8:15 PM on Jan 22 and 7:30 PM on Jan 23

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

Sérgio Darcy da Silva Alves
Tereza Cristina Grossi Togni

Department Heads (all present on Jan 22)
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 Jan 22)
José Pedro Ramos Fachada Martins da Silva – Advisor to the Board
Alexandre Pundek Rocha - 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 indicators of economic activity, at the end of 2001, showed continuity of the process of overcoming the factors that provoked the economic deceleration beginning in April 2001. The more favorable scenario for demand expansion is basically endorsed by the reduction in default rates and more favorable consumer inclination. However, these conditions, as well as labor market ones, favored a gradual recovery in consumption, as indicated by December sales, which should avoid pressures on prices in the future.
Preliminary data on the turnover of the retail commerce in the Metropolitan Region of São Paulo showed stability in December, after four consecutive months of growth. If confirmed, this indicator, as surveyed by the São Paulo State's Federation of Commerce (FCESP), will have decreased by 5.2% in 2001. This fall is partially explained by the high basis of comparison of the second half of 2000.

The Index of Consumer intentions (IIC), also surveyed by FCESP, increased in January for the third consecutive time, reflecting improvement in the two components of this indicator, actual and future consumption intentions. Although the index has not yet reached the optimism level (index above 100), these results indicate a gradual recovery of consumers' perception on the consequences of the domestic and external shocks.

The evolution of default rates contributed to favoring retailers' turnover. In December, the net rate of default, based on information of the São Paulo Trade Association (ACSP), decreased to 2.3%, compared to 8.4% in November, mainly due to the increase in debt cancellations. The ratio of checks returned due to insufficient funds in total discounted checks declined to 4.9% in December, compared to 5.2% in November.

Regarding company inventory levels, the indicators showed a reduction in the levels of the fourth quarter of 2001 compared to the previous one, for the majority of economy's segments, according to private surveys. Considering the general indicator, it should be noted that, compared to the same period in the previous year, the index remained at a level significantly higher in the second and third quarters of 2001, reflecting the shocks that occurred in that period. In the last quarter, the indicator reached the same level as in the fourth quarter of 2000, showing a return to normal levels for the period.

Seasonally adjusted industrial production increased by 1.5% in November, after falling by 1.9% in October, which was partially explained by the petroleum workers' strike in that month. Production of consumer goods increased by 3.6%, reflecting a 6.9% expansion in the production of durable goods and a 3.8% increase in the production of semi-durable and non-durable goods. Year-to-date up to November, overall industry grew by 2.1% compared to the same period of 2000.

Statistics of the automobile industry revealed growth of 3.8% in the production of vehicles and of 2% in agricultural machinery in December, seasonal effects excluded. The total yearly production reached 1,793 thousand vehicles and 44.5 thousand units of agricultural machinery, which surpassed the total in 2000 by 6.6% and 25.3%, respectively.

Following the performance of the activity level, the indicators of the labor market presented a favorable evolution. The open unemployment rate assessed by the Brazilian Institute of Geography and Statistics (IBGE), based on a survey by domiciles in six metropolitan regions, reached 6.4% in November, after reaching 6.55% in October. The fall was due to the 0.25% rise in job offers, which surpassed the 0.11% growth of the Economically Active Population (PEA). Similar evolution was indicated by the data from the Ministry of Labor and Employment, which continued to indicate growth in formal employment in November of 0.2%, considering the series excluding seasonal effects. The total number of formal jobs created up to November reached 845 thousand, with growth of 4% in commerce, 3.8% in services, and 3% in industry. The civil construction sector was the only one to present a decline in employment level (0.7%). CNI and Fiesp surveys, however, have shown reduction in industrial employment, which reached, in November, 0.3% and 0.45%, respectively.

Regarding the demand for investments, despite the falls observed in the last three months (seasonally adjusted data), the production of capital goods reached an accumulated growth of 14.1% in the year, up to November, due principally to the growth of agriculture, transport and electric power generating equipment. On the other hand, the production levels of civil construction showed an accumulated fall of 1.8%, also up to November. The recent fall in the production of capital goods, allied with the unfavorable performance of the construction sector, will reduce the share of gross capital formation in the GDP in the last months of the year.

The level of utilization of installed capacity declined once more in November after recovering in October. According to CNI statistics, which take into account information for twelve States, the average level of utilization reached 79.0% in November, compared to 79.5% in the previous month (seasonally adjusted data). The processing industry of the State of São Paulo also presented a lower level of utilization, falling by 0.4%, using the same basis of comparison.

In December, new loan concessions by the financial system with its free resources grew by 1.6%. The operations with corporations increased by 4.2%, with special attention to the operations linked to external resources, which increased by 18.3%. Loans to private individuals declined by 3.8%, due to a seasonal decrease in demand for credit of the financial system, as a result of the payment of the 13th-salary. This reduction affected mainly the rotating credit lines of overdraft accounts and credit cards.

The stock of credit granted by the financial system declined by 1.3% in December, as a result of the 2.2% fall in the stock of operations with free resources. This performance is associated with a lower demand for rotating credit lines for private individuals, which caused the 0.9% reduction in the volume negotiated with private individuals, as well as the exchange rate appreciation – affecting the operations referenced in foreign currency – leading to a 3% reduction in the volume of credit for corporations.

Regarding the external transactions of the Brazilian economy, the trade balance registered a surplus of US$ 857 million in December, the best monthly result since the implementation of the Real Plan. This result created an accumulated trade balance of US$ 2.7 billion in 2001. The surprising performance of the trade balance in December reflected, mainly, a 28.3% retraction in imports compared to the same month of 2000, since exports fell by 6.7% in comparison with the same month in the previous year. A retraction in expending was observed in all categories of usage, with especially with raw materials and intermediate goods, which declined by 32.8%.

The 5.8% increase in exports in 2001 reflected, to a great extent, the exceptional performance of sales of basic products, which contributed with 88.6% to the increase in revenues. Regarding imports, a 0.5% decline in spending was observed, especially as a result of the 4% retraction in expenditure with raw materials and intermediate goods.

In the first three weeks of January 2002, the trade balance accumulated a surplus of US$ 12 million. The higher growth of the world economy in 2002 should favor the expansion of Brazilian exports and the trade balance compared to 2001. In spite of the likely decrease in exports to Argentina, the expansion to new markets is estimated to offset the loss of revenue, a repetition of the behavior observed in 2001.

Foreign direct investment was among the main sources of financing of the balance of payments at the end of 2001 reaching US$ 3.9 billion, more than enough to cover the current account deficit of US$ 1.8 billion. In 2001, foreign direct investment defrayed almost all current account deficit (97.5%). Noteworthy was also the issuance of Republic Bonds, Global 2012, to the value of US$ 1.25 billion, at a 10-year tenure, as part of the Central Government funding expected to reach up to US$ 5 billion in the year.

In summary, the economic indicators show gradual and consistent overcoming of the adversities which hit the economy in 2001. This perception has been reflecting on consumer confidence level, which has been increasing since last October. The level of inventory in the last quarter of 2001 declined in relation to the preceding one, default rates in December reached the lowest level of the last five years and demand is signaling a gradual recovery. These facts reinforce the prospect of the renewal of economic activity, which in turn should not affect the positive outlook of the balance of trade in 2002 as the improvement of growth of the external markets becomes stronger.

External environment

Recent world macroeconomic statistics still do not clearly show consistent reversion of the recession in the short term. However, evidence of recovery can be noticed in the main developed economies, except for Japan. On the other hand, the deterioration of the Argentine economy adds uncertainties to the external scenario.

Despite the continued decline of the U.S. activity level, some indicators point to a phasing out of the recession process. Inventory reduced for the 10th consecutive month, registering 1% in December. This fact may contribute to the recovery of the industrial production, which will also depend on consumer behavior in the coming months. Industrial production in December presented the lowest rate of decline in the past six months (0.1%). Year-to-date, the retraction was 3.8%, the first since 1990 and the highest since 1982, when the industrial production declined by 5.4%. In November, factory orders – excluding the sector of military defense – increased for the 2nd consecutive month, which may be a sign of recovery in the manufacturing sector. Retail sales decreased by 0.3% in December, less than expected by the market. They were favored by the increase of the volume of transactions in the electronic, clothing and furniture sectors. Other factors, such as the persistent soundness of the housing sector and the increase of the consumer's confidence index lead to a more optimistic perspective for the U.S. economy in the next months.

The main economies of the Euro area, Germany and France, presented signs of recovery in the activity level. In Germany, industrial orders rose in November for the first time in three months, due to the increase in external demand. In addition, retail sales in November were above expectations, recording a 1.6% expansion compared to October. This result may be reflecting a greater enthusiasm of consumers, as tracked by a survey that displayed the first improvement for four months. In France, the industrial production remained stable in November after two months of retraction, while consumer expenditure grew for the 2nd consecutive month. Hence, in the light of the growing evidence of reactivation of the region's economy and of the perception that the current level of interest rates is consistent with the price stability target, there is the possibility that the expansionary monetary policy adopted in 2001 will be suspended, as long as the indications of a scenario of gradual recovery persists.

The Japanese economy has remained stagnant for a long time and has not responded to the stimuli from the economic policy. In the last BoJ meeting, on 1.16.2002, the monetary policy remained unchanged, but there is a possibility of a liquidity expansion at the end of their fiscal year, on 3.31.2002, with new assistance to banks with solvency problems.

Prices

The main inflation indices presented lower increases in December, compared to the previous month. The Consumer Price Index – Extended (IPCA) increased by 0.65%, compared to 0.71% in November. The IPCA reached 7.67% in the year, reflecting mainly the 10.45% rise in the prices of goods and services administered by contracts. The segments that presented variation above the index average were: food and beverage (9.63%), especially beef (12.17%), bread (22.09%), meals (11.93%), rice (43.59%) and black beans (162.36%); housing (9.4%), in which the items electricity (17.93%), water and sewage tariff (15.5%) and bottled gas (15.6%) are considered; and transport (8%), specially urban transport (15.54%) and gasoline (7.19%). In addition to the adjustments of the prices administered by contracts, these increases also reflected the exchange rate devaluation occurred in the year, as well as the unfavorable climatic conditions for the production of rice and black beans.

In December, the IPCA increase was mainly due to the rise in the prices administered by contracts (electricity and urban transport tariffs in Rio de Janeiro), clothing, medicines, poultry and new cars, partially offset by the decline in the prices of milk, beans, bottled gas and gasoline.

The General Price Index – Domestic Supply (IGP-DI) presented a more intense fall in the monthly variation, reaching 0.18% in December compared to 0.76% in November, and accumulated 10.4% in 2001. Compared to November, the variation of the Consumer Price Index (IPC-DI) declined to 0.7% from 0.85% due to the smaller increase of the "miscellaneous expenditure" group. It should also be pointed out the smaller increase in the prices of the housing and transport groups. The 0.09% fall in the Wholesale Price Index (IPA-DI), compared to the 0.73% rise in November, is the reason for most of the deceleration of the IGP-DI in the month. The IPA evolution reflected a fall of 0.32% in the industrial IPA, basically due to the exchange rate appreciation in the period, with the agricultural IPA increasing by 0.48%, against 0.93% in November. The National Index of Civil Construction (INCC-DI) also increased at a lower intensity, presenting a 0.34% variation, compared to 0.74% in November.

In January, the consumer price indices should reflect increases in the prices of in natura products, poultry and eggs, as well as rises of 18.63% in the electricity tariff in Rio de Janeiro and of 15% in urban transport tariffs in Belo Horizonte. The price increase of bottled gas should also be highlighted as well as the seasonal increase in the cost of education. These upward effects should be partially offset by the fall in gasoline prices.

For wholesale prices, the inflation indices should mainly reflect the rises of the prices of poultry, eggs, corn and beans, and the fall in industrial products caused, basically, by lower fuel prices and by the exchange rate appreciation.

Money market and open market operations

The yield curve showed smaller volatility since the last Copom Meeting. From the end of December on, the expectation of lower inflation in the first quarter of 2002, the trade balance results, and the placement of the global bonds led to a negative slope in the short part of the curve, with the spread between the 30-day interest rate and the Over-Selic rate falling to -12 basis points on January 3rd, from 19 basis points on December 20th. In the same way, within this period, the spread between the one-year interest rate and the Over-Selic rate narrowed to 39 basis points from 211 basis points. Subsequently, the release of higher than expected inflation rates and the environment of uncertainty due to the end of the bank holiday in Argentina caused the increase of the spread between the one-year interest rate and the Over-Selic rate to 180 basis points on January 15th. With the proximity of the Copom meeting, this spread fell to 102 basis points, due to the expectations of treasuries of some financial institutions that a reduction in the Over-Selic rate target might occur.

The swap operation of exchange rate indexed securities was carried out once more, aiming at partially redistributing the redemptions in 2002. On January 17th, the Central Bank carried out buyback auctions of NBCE with redemptions between February and April 2002, simultaneously with the selling auctions of National Treasury's NTN-D. The net financial impact of this operation was neutral on the market due to the purchase of R$ 1.9 billion of NBCE and the sale of same amount of NTN-D with redemption in 2-years (38% of the total), 3 years (36% of the total) and 6 years (26% of the total). Hence, as observed in the December operation, the auctions indicated a more significant market demand for the reversion of positions in shorter exchange rate indexed securities than for the opening of longer maturities positions.

The National Treasury has been promoting the lengthening of fixed-rate debt that began in November. Since January 8th, 6-month and 15-month securities were offered on three occasions. The upward trend in the yields observed at the beginning of the month was reverted in the most recent auction, declining from the previous one. The average yields were of 19.10%, 19.79% and 19.47%, respectively, for the shortest-tenure securities, and of 20.45%, 21.72% and 20.79% for the longest. The resulting financial volume of the placements reached R$ 6.8 billion, of which 80% referred to the shortest-tenure securities.

Considering the financial settlements occurred between December 19th and January 22nd, there was a monetary expansion of R$ 7.2 billion, resulting from the net redemptions of LTN (R$ 3.6 billion), of LFT (R$ 1.4 billion) and of the payment of intermediate interest on NTN-C (R$ 0.6 billion) and of exchange rate indexed securities (R$ 1.6 billion)

During the 22 working day period, the Central Bank intervened fourteen times in the open market, aiming at administering the very short-term interest rate. In thirteen interventions, the Central Bank provided liquidity to the market at a hurdle yield of 19.05% p.a., with an average volume of R$ 13.3 billion. In addition, there was an intervention to withdraw liquidity from the market at a hurdle yield of 18.9% p.a., which reached R$ 1.4 million.

In December, the secondary market registered growth in the traded volume of exchange rate indexed securities and of LFT, mainly as a result of the need for adjustment in the positions of some investment funds. The daily average turnover of exchange rate indexed securities increased to R$ 2.5 billion from R$ 1.6 billion, while the LFT turnover grew to R$ 2.9 billion from R$ 1.7 billion. On the other hand, the fixed-rate securities showed stability compared to the previous month, with a daily average turnover of R$ 3.8 billion, despite the decline in the volume of the primary offers (to R$ 6.0 billion in December, from R$ 7.3 billion in November).

As occurred in November, the significant appreciation of the Real allowed for a R$ 16.2 billion reduction, in December, of the share of the domestic securitized debt indexed to the exchange rate, reducing its relative share in the total to 28.6% from 31.1%.

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 assumes the following hypotheses:

1. December inflation rate, measured by the IPCA, registered a 0.65% increase. Despite the high result, it was lower than the observed in November;

2. The forecasts for gasoline and diesel oil prices for 2002 and 2003 were calculated based on the surveys of National Petroleum Agency (ANP), which indicate significant price reductions in the first weeks of January. From that moment on, the projections were based on the behavior of the futures market of Brent crude oil negotiated in the International Petroleum Exchange (IPE). Regarding bottled gas (GLP), the elimination of subsidies caused an increase in the price of bottled gas in January. After that, the price behavior was projected based on the future contracts of propane gas negotiated on the New York Mercantile Exchange (NYMEX);

3. For the wider set of prices administered by contracts, the expected readjustments are 5.4% in 2002 and 3.4% in 2003;

4. The projection for the readjustment of electricity tariffs in 2002 was slightly increased to 20.4%, due to the 2.9% increase occurred in the last days of 2001, which is reflected in the inflation of January 2002;

5. As regards the slope of the domestic yield curve, measured as the difference between the 180-day term DI rate and the 1-day Selic rate, the average assumed increases to above 100 b.p. at the end of 2002, from 50 b.p. in the first quarter of the year;

6. The trajectory of US Fed Funds rate, forecast based on the maturity of future contracts, was changed to reflect an average rate of 1.75% in the first quarter of 2002, increasing to 2.25% in the last quarter of the year;

7. For the sovereign risk premium, using Brazil's Global 04 Bonds, a stable trend is projected at a level of 600 b.p..

The core inflation of the IPCA, calculated under the symmetric trimmed-mean method, remained at a high level in December, the same as in November (0.77%). In 2001, this core index rose by 7.48%. The core inflation of the IPC-BR, calculated under the symmetric trimmed-method, presented a reduction to 0.71% in December from 0.77% in November. Accumulated in the 12 months of 2001, this core increased by 7.09%. The core inflation calculated by excluding the prices administered by contracts (considering the wide set of these items weighting 30.6% of the IPCA in December) and household food prices increased by 0.83% in December, with an accumulated variation of 5.49% in 12 months.

The IPCA variation in 2001 was of 7.67%, reflecting a 2.4% contribution from freely established prices and a 1.7% contribution from prices administered by contracts, excluded the effects of the exchange rate pass-through and inflationary inertia. The exchange rate pass-through contributed with 2.9% to the 2001 inflation, and inertia contributed with 0.7%. In 2002, prices administered by contracts are expected to increase by 5.4% (with a 1.6% direct contribution), influenced by the increases in electricity tariffs.

Regarding fiscal policy, the hypothesis of achieving the primary surplus targets for the consolidated public sector, as stated in the Economic Program of the Government, was maintained, as well as the remaining assumptions established in the previous meeting.

The simulation exercises with several specifications of the structural model permitted a conclusion that favored the maintenance of the basic interest rate at 19.0 % p.a., and the exchange rate at the same plateau as on the eve of the Copom meeting, resulting in an inflation below 4.0% in 2002. For 2003, the inflation projected by the structural model based upon the hypothesis of maintenance of the interest rate at current levels and constant exchange rate is below the central target of 3.25%.

Monetary Policy Guidelines

The scenario of recovery of the activity level of the Brazilian economy seems to be consolidating, although slowly. The level of consumer confidence has been increasing since last October, which stimulates sales. The retailers' turnover, which had increased for four consecutive months, stabilized in December. This increase reduced inventories in the last quarter of 2001, compared to the previous quarter, indicating the prospect of recovery in industrial production. The industrial production, measured by the IBGE, grew in November, after declining in October (seasonally adjusted data).

The existence of non-employed production capacity and the trajectory of the wage income indicate that the demand growth will not exert inflationary pressures. The increase in investment in capital goods observed in the first quarters of 2001 had the effect of increasing the installed capacity. The impact of the energy crisis has been smaller than expected, and the likely end of the energy rationing should enhance the potential growth of output.

The recovery of the economic activity in Brazil has been compatible with the improvement in the external accounts. In 2001, the upturn of the trade balance and the maintenance of capital inflows in the form of foreign direct investment contributed to reduce Brazil' risk premium and to stabilize the Real. The surplus of US$ 2.7 billions in the trade balance in 2001 reflects a 5.8% increase in exports and a 0.7% decrease in imports. The net flow of foreign direct investment was US$ 22.6 billion, financing 97.5% of the current account deficit in the year and largely surpassing the previous projections.

For this year, there are clearer signs that the recovery of the US economy, with positive impacts on the global economy, may start in the second quarter, what would stimulate exports and ease the financing of the Brazilian balance of payments. The Argentine crisis has had an additional but limited impact on the exchange rate and on the spread paid by the Brazilian bonds.

As a result of the improvement of the economic scenario, as well as of the phasing out of the primary effects of the shocks occurred in 2001 and of the lower pressure from prices administered by contracts, the prospects for the inflation rate in 2002 and 2003 indicate a decline towards the target trajectories. This perception is shared by the economic agents, as indicated in the expectations for inflation in 2002 and 2003, as surveyed by the Investor Relations Group (GCI) of the Central Bank of Brazil.

Nonetheless, some points of uncertainty remain in order to confirm this favorable outlook for inflation. Attention to the external scenario is essential, especially in regard to the aftermath of the Argentine crisis and the behavior of the flow of foreign capital, in the context of the domestic electoral process. In addition, attention is necessary to the likely additional pressures arising from the readjustments of prices administered by contracts this year and finally to the downward trajectory of inflation that has shown itself to be slower than expected.

In fact, the reversal of the inflation trajectory has occurred slowly. Inflation measured by the IPCA remains high, despite having declined to 0.65% in December. The core inflation, measured by the trimmed-mean method, remains high in December. In January, the first signs point to a lower index, yet a relatively high one. Contributing to this results were: i) adverse climatic conditions which distinctly affected several regions (rain and drought) with upward impact on food prices; ii) the pressures to recompose profit margins and the second-round effects of the shocks - reflex of the inertia of the higher inflation in 2001; and iii) the movement of the slower drop in prices of oil-by-products.

The contribution of the first-round effect of the shock from prices administered by contracts, in the share that exceeds the inflation target, once deducted from the impact of the exchange rate pass-through and of the inertia on the prices administered by contracts, is estimated at approximately

0.3 p.p. for the inflation in 2002. The inflationary inertia arising from a higher rate of inflation that exceeded the inflation target in 2001, contributed with a further 0.7 p.p.. The monetary policy should be oriented towards eliminating the second round effects of the shocks on inflation, preserving the initial relative price realignment. The monetary policy should, in addition, allow for an adequate period for inflation to return to its target trajectory, which depends on the magnitude of inherited inertia.

In the light of a slower fall of inflation and of the uncertainty that still prevails regarding the confirmation of a favorable outlook for inflation, the Copom unanimously decided to maintain the target for the Over-Selic interest rate at 19% p.a..

At the close of the meeting, it was announced that the Committee would meet again on February 19th , 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 the Calendar of Copom's Ordinary Meetings, published in the Central Bank Communiqué n. 8911, of Oct.3.2000.

Acronyms

ac 12m accumulated in 12 months
ACC Anticipated Exchange Rate Contracts
BM&F Mercantile and Futures Exchange
bp Basis Points
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 Federation of Commerce 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
INCC Civil Construction National Index
IPA Wholesale Price Index
IPC Consumer Price Index

IPCA Consumer Price Index – Extended
IPC-BR Consumer Price Index - BR
IPCH Consumer Price Index – Harmonized
IPP Producer Price Index
IR Income Tax
IRF-M Market Fixed Income Index
IRRF Withholding Income Tax
LFT National Treasury Letters (floating)
LTN National Treasury Notes (fixed rate)
NAPM National Association of Purchasing Managers
NBC-E Central Bank Note - E Series (indexed to the exchange rate)
NTN-C National Treasury Note - C Series (indexed to the wholesale price index)
NTN-D National Treasury Note – D Series (indexed to the exchange rate)
p.a. per annum
p.m. per month
PEA Economically Active Population
pp percentage point
Selic Central Bank's Custody and Settlement Center
STN National Treasury Secretariat
ytd year-to-date

Minutes of the 68th Meeting of the Banco Central do Brasil Monetary Policy Committee (Copom)

Date: February 19th and 20th, 2002
Place: Central Bank's Headquarters 8th floor meeting room (on Feb 19) and 20th floor (on Feb 20) -Brasília - DF
Called to Order: 4:36 PM on Feb 19 and 7:42 PM on Feb 20
Adjourned: 7:18 PM on Feb 19 and 6:44 PM on Feb 20

In attendance:
Members of the Board

Arminio Fraga Neto - **President**
Beny Parnes
Carlos Eduardo de Freitas
Edison Bernardes dos Santos
Ilan Goldfajn
Luiz Fernando Figueiredo
Sérgio Darcy da Silva Alves
Tereza Cristina Grossi Togni

Department Heads (all present on Feb 19)
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 Feb 19)
Antônio Carlos Monteiro - Executive Secretary
José Pedro Ramos Fachada Martins da Silva – Advisor to the Board
Alexandre Pundek Rocha - 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

Recent results of the performance of industry and commerce have confirmed the prospect of economic recovery signaled at the end of 2001. The improvements in consumer and business confidence revealed in the latest surveys on expectations indicate that this behavior show the likelihood of consolidating into a new trend of activity level. The intensity and the length of this movement will be conditioned to the growth of the real wage mass and to the evolution of the credit conditions, the main factors that support the demand.

Preliminary figures released by São Paulo State's Federation of Commerce (FCESP) about the retail commerce in the metropolitan region of São Paulo showed expansion of 2.1% in January (seasonally adjusted), compared to December. Excluding car dealers, whose sales dropped by

14.5% in the month, total turnover increased by 3.1%, driven by sales of durable consumer goods, which increased by 7.5% in the month, the sixth consecutive increase of this segment. Still in January, there was 2.4% rise in enquiries of check and credit sales, according to the São Paulo Trade Association (ACSP). It is the third consecutive month of expansion, which confirms the expansion of commerce.

The upturn in the consumer expectations and the increase in sales promotions are considered to be the main reasons for the recent improved performance of the retail segment. The Index of Consumer Intentions (IIC), surveyed by FCESP, grew for the fourth consecutive month in February, registering an increase of 2.2%. The result mirrors the improvement of the two components of the index, current and future consumption intentions, highlighting the performance of the first component, whose increase reflected, mainly, the surpassing of the negative effects of the external scenario. Business expectations in relation to the current economic scenario are similar to consumers. The Confidence Index of the Industry, surveyed by CNI, indicated that, in January, most of industry, regardless the size of the company, significantly improved its perception of the economic conditions – the current and for the next months – for the Brazilian economy and for the sector in which their companies operate, compared to October's survey.

Regarding company inventories, data released by CNI point to a significant drop in the levels of stock of final goods, raw materials and intermediate goods in the fourth quarter of 2001. This data strengthens the perception of recovery in the industrial activity.

The performance of the industrial production in December does in fact mirror in part this recovery identified in business expectations. According to the Brazilian Institute of Geography and Statistics (IBGE), the seasonally adjusted industrial production grew by 1% in December compared to November, accumulating an expansion of 1.5% in the year. The December result confirms the prospect of reversion of the declining trend that dominated the scenario in 2001, from March to October, by registering the second consecutive positive result after that period. The leadership of the consumption goods sector should be highlighted, in the recent recovery of the manufacturing sector, particularly durable goods, whose production grew by 6.1% in relation to November, accumulating an expansion of 11.3% in the last quarter of the year in relation to the previous quarter, considering seasonally adjusted data. The improvement in the economic scenario and the fulfillment of part of the demand restrained in the first months of electricity rationing explains this recovery, in addition to the relatively more attractive conditions of financing, particularly of new vehicles.

The recent labor market indicators reinforce the expectations of recovery in the economic activity. According to seasonally adjusted indicators calculated by CNI, the industrial sector expanded its hours worked in production by 1.9% in 2001, in relation to 2000, and the number of employed people grew by 1.1%. The open unemployment rate calculated by the IBGE reached 5.6% in December compared to 6.4% in November. According to data from the Ministry of the Labor and Employment, the total number of formal jobs in the country grew by 2.6% in 2001.

Still moving in the opposite direction to the expansion in the consumer goods sector, the production of capital goods declined for the fourth consecutive month in December, in comparison to the previous month. The performance of this category has a higher lag time compared to the changes in the activity level, as it depends on investment expenditures. Despite the weak results of the past months, a 12.8% expansion was registered in the year. It should be noted that imports of capital goods grew by 16.1% and the domestic absorption of capital goods increased by 18.7% in 2001, reflecting the investments in many sectors, mainly those associated with the overcoming the energy crisis and to the modernization of agriculture and the railway network.

The balance of credit operations contracted by the financial system reached R$333.5 billion in January, representing a 0.3% growth in relation to the previous month. Of this total, R$195.8 billion refer to the credit operations contracted with freely allocated resources from the financial system, which grew by 1.6% in the same period, as a result of the 0.4% expansion in the volume of credit contracted by corporations and of 3.7% by private individuals. The slight growth of the credit stock directed to corporations resulted, basically, from the exchange rate depreciation which applies to operations linked to foreign currency, since the credit concessions directed to the production activity registered a 5.4% fall in the month. At the same time, the 5.2% growth in the demand for new finance on the part of private individuals reflected a higher concession in the modalities of overdraft and personal credit, after the seasonal fall at the end of the year.

As to the external transactions of the Brazilian economy, the trade balance presented a US$175 million surplus in January, the first positive result for the month of January since 1997. Exports reached US$3,972 million, a 12.5% fall in relation to January 2001, while imports declined even more, 24.3%, totaling US$3,797 million. The 64.2% fall in the sales to Argentina was the main reason for the performance of the exports, but one should also consider the high comparative base of January 2001, when the international demand for soy meal and soybeans was high, creating shipments above the historical levels for the month. Regarding imports, all categories of products fell in relation to January 2001, at a moment of recovery of the domestic economy. Therefore, there are signs of imports substitution, mainly of raw materials and intermediate goods, by domestic production, due to the approximately 20% depreciation of the exchange rate. It should be emphasized that the purchases of industrial machinery and their accessories continued to expand, growing by 4.1% and 8.0%, respectively, indicating the maintenance of investments in production activity. The trade balance registered a US$100 million surplus up to the 17th February, with the daily average of exports and imports increasing by 6.0% and 4.4%, respectively, in relation to

January. In February, there was a recovery in trade in terms of daily averages between Brazil-Argentina compared to January, with increases of 13.8% in exports and 25.4% in imports.

In summary, the indicators of economic activity show a trend of recovery which initiated in the last months of 2001. Consumption, reflected in the indicators of retail commerce, continues to present positive results, influenced by the increase in consumer confidence and, due to the reduction in inventory levels observed at the end of 2001, this tends to stimulate industrial production in the coming months. The increase in production in the short term does not represent pressures originating from the increase in the level of utilization of installed capacity, considering the current level of idle capacity. Over a larger period of time, the growth of the activity level is sustainable in so much as it tends to be accompanied by productivity gains, coming from the larger flow of investments observed since 2000, and from the process of import substitutions, which reflects, amongst others, the evolution of the real exchange rate in the last months.

External environment

In the United States, indicators continue to point to the recovery of activity. The U.S. GDP expanded by 0.2% in the 4th quarter of 2001, contrary to the expectations of a 1% fall and in line with the last economic activity indicators released.

In the light of the improvement in the U.S. economy, but still highlighting the uncertainties, the Federal Reserve – FED decided to keep the interest rate unchanged at 1.75%, interrupting the trajectory of monetary policy loosening which had lasted for five consecutive meetings.. The FOMC report states that signs of the lowering of demand weakness are clearer and that the economic activity growth is starting to consolidate.

The retail sales, not including car sales, presented a 1.2% seasonally adjusted growth in January compared to the previous month, signaling the highest increase since March 2000. This result overcame the expectations of a 0.4% contraction. However, taking into consideration car sales, this indicator fell by 0.2% in the seasonally adjusted series compared to December.

The activity indicators surveyed by the Sales Management Institute show that industry and services maintain the trend of recovery. These indicators have been improving simultaneously with consumer confidence and with the labor market indicators, such as the unemployment rate, which declined in December. Recent information from the Labor Department indicates that the number of requests for unemployment insurance dropped for the fifth consecutive week. The deceleration of this indicator also suggests that the U.S. economy is starting to recover.

The Japanese economy has been on a deflationary spiral, the main reason being the high volume of loans to which the banking system was committed, which is decapitalized and generates insufficient profits to cover the deterioration of the loans granted.

In the Euro area, the European Central Bank kept the basic interest rate unchanged at 3.25% p. y.. According to the institution, the current level of interest rate is consistent with price stability, although the preliminary data of January has indicated a slight increase in inflation in the region, 2.5% in annualized terms, compared to 2.1% in December. According to the European Central Bank, this increase in inflation was mainly due to transitory and non-recurring factors, amongst which are the climatic conditions in some parts of Europe, causing an increase in food prices, anticipated influence of the indirect taxes, and the increase in the price of energy, in addition to the effects of the adaptation of the price system of a number of countries to the euro.

The first more positive signs in the direction of a possible recovery in the major world economies, especially in the United States, show that they have reached the end of a recessive trend observed since the end of the first quarter of 2001. The recovery of the U. S. economy will have a positive impact both to world trade and in the normalization of the international capital markets, with the decline in intensity of the “flight to quality” movement predominant in 2001. Nonetheless, a more vigorous growth of the world output and trade may be relatively restricted by the permanence of Japan in recession, with repercussion throughout Asia.

Prices

The Consumer Price Index – Extended (IPCA) increased by 0.52% in January, compared to 0.65% in December, accumulating a 7.62% variation in the last twelve months up to January. In spite of being in decline, the monthly result was influenced by the 0.85% rise in food prices, particularly *in natura* products, due to the unfavorable climate conditions, whereas the group of prices administered by contracts contributed with 0.11 of a percentage point, since the fall of prices of gasoline was more than offset by the increase in other important items, such as bottled gas, electricity and urban transport.

Prices of non-food products increased by 0.42% in January. Gasoline was 9.92% cheaper to consumers, but the removal of subsidies caused a 17.87% rise in bottled gas prices. The 4.51% variation in electricity was due to the 18.63% readjustment made by the concessionaire in Rio de Janeiro, in addition to the non-recurrent 2.9% readjustment granted on December 27th, in most of the surveyed areas. The item urban transport registered a 1.34% rise, reflecting the 15% readjustment in the tariffs in Belo Horizonte, at the end of December.

The General Price Index – Domestic Supply (IGP-DI) presented a 0.19% variation in January, practically repeating the December result, of 0.18%. The biggest decline of the Wholesale Price Index (IPA-DI), from 0.09% in December to –0.13% in January, was practically offset by the acceleration in the increase in the Consumer Price Index (IPC-Br), of 0.79% compared to 0.7% in December. At wholesale level the continuous fall in industrial prices (-0.32%) should be pointed out, while the prices of agricultural products increased by 0.37%, compared to 0.48% in the previous month. Regarding consumer prices, the IPC-Br reflected the seasonal effect of the expenditure with education, not yet reflected by the IPCA due to the differences in the survey methodology of both indices.

In February, the IPCA will also be pressured by the increase in the prices of medicines, in addition to the pressures from the readjustment in school payment installments and materials. However, a deceleration in the index is expected, considering the fall in the clothing prices and the continuity of the absorption of the decline in gasoline prices. This trend may be accelerated with the expected fall in food prices, already registered by the wholesale price indices, as shown in the partial results of the Market General Price Index (IGP-M).

Money market and open market operations

The yield curve showed only slight movement since the last Copom meeting. The decision to keep the Over-Selic rate target unchanged reverted the negative slope of part of the yield curve, with the spread between the 3-month interest rate and the Selic rate changing to 11 b.p. on January 24th, from –9 b.p. on January 18th. Later, the announcement of inflation indices, the smooth reopening of Argentina's market, and the expectation of a reduction in the Selic rate in the first quarter caused the reduction of that spread to –25 b.p. on February 18th. Within this period, the spread between the 1-year interest rate and Over-Selic rate also narrowed, moving to 47 b.p. from 102 b.p..

Continuing with the strategy of partially smoothening the redemptions of exchange rate indexed securities in 2002, Central Bank carried out, on January 24th, buy-back auctions of NBCE with redemptions between February and April 2002, simultaneously with selling auctions of National Treasury's NTN-D, amounting to R$ 2.3 billion. There was higher demand for shortest-tenure securities (2-3 years) than in the previous operation, when securities of up to 6-year maturities were offered. The NTN-D premiums presented an upward trend during the period.

Since January 29th, the National Treasury offered LTN on four occasions. At the first two events, securities of 7 and 14 months tenures were offered. Due to a reduction in the demand for longest-tenure securities, the offers of these securities were interrupted. The resulting financial volume of the placements reached R$ 8.3 billion, of which 92% referred to the shortest-tenure securities.

On February 19th, the Treasury returned to offer LFT, which had not occurred since October 2001. Due to reduced demand, only 538 thousand securities were auctioned out, of a total 1 million offered. The two year tenure securities were placed with a 0.35% average discount, resulting in a value of R$ 0.7 billion.

Considering the financial settlements occurred between January 23rd and February 19th, there was a monetary expansionist impact of R$ 3.0 billion, resulting from net redemptions of LTN (R$ 0.9 billion), of LFT (R$ 0.8 billion), and of intermediate interest payments on exchange rate indexed securities (R$ 1.3 billion).

During the 18 working day period, the Central Bank intervened thirteen times in the open market, aiming at administering the very short-term interest rate. During all the interventions, the Central Bank provided liquidity to the market at a hurdle yield of 19.05% p.a., with an average volume of R$ 8.9 billion.

The domestic federal securitized debt increased by R$ 11 billion in January. The 4.2% exchange variation generated an R$ 7.5 billion impact thus representing the main reason for the increase.

Assessment of inflation trends

Identified shocks and their impact were reassessed in light of newly available information. The scenario considered in the simulations considers the followings hypotheses:

1. The inflation rate in January 2002, measured by the IPCA, was 0.52%, lower than the 0.65% observed in December 2001;

2. The projections for consumer prices of gasoline, diesel oil and bottled gas for 2002 and 2003 were made based on the price surveys of the National Petroleum Agency (ANP), which indicate a significant price reduction in the period since the market liberalization on January 1st until February 9th. After March, the projections reflect the price behavior in the futures market of Brent type petroleum of the International Petroleum Exchange (IPE), and of propane gas, of the New York Mercantile Exchange (NYMEX);

3. Some items included in the group of prices administered by contracts had their prices liberalized recently, such as fuel and bottled gas. The behavior of those prices, although determined by demand and supply conditions, can be projected more accurately with the monitoring of their respective cost structures. Therefore, the wider set of prices administered by contracts also includes the monitored prices and will be referred to as such. The definition of items incorporated in that group, weighing 30.5% of the IPCA, was maintained. For this set of prices, the readjustments are

projected at 5.7% in 2002 and 3.8% in 2003. In the January meeting, the readjustments were projected at 5.4% in 2002 and 3.4% in 2003. Nonetheless, this 0.3 percentage point increase in the 2002 inflation projection of prices administered by contracts was basically concentrated in January, so that there was no significant alteration in the inflation forecast for the rest of the year.

4. The projections for the readjustment of electricity prices in 2002 and 2003 are 19.3% and 14.0%. These adjustments incorporate the non-recurrent energy price increases which have already occurred this year and the 4% forecast for next year;

5. The hypotheses of the previous meeting regarding the behavior of the slope of the domestic yield curve measured as the difference between the 180-day term DI rate and the 1-day Selic rate was maintained. The average slope of the domestic yield curve rises gradually to above 100 b.p. at the end of 2002;

6. The trend for the fed funds rate, projected based on the maturity of future contracts, was altered to reflect an average rate of 1.75% in the first quarter of 2002, which rises to 2.6% in the fourth quarter of 2002;

7. For the sovereign risk premium, a stable trend is forecast, using Global 04 Bond, at the level of 650 b.p.

The core inflation of the IPCA, calculated under the symmetric trimmed-mean method, declined significantly in January to 0.52% from 0.77% in December. Accumulated in 12 months, the core index increased by 7.58%. The core inflation of the IPC-BR, calculated under symmetric trimmed-mean method, rose slightly from 0.71% in December to 0.73% in January. Accumulated over 12 months, that core index increased by 7.40%. The core inflation calculated with the exclusion of administered prices - considering the wide set weighting 30.5% of the IPCA in January - and of household food prices increased by 0.50% in January, with accumulated variation of 5.61% in 12 months.

The IPCA increased by 7.62% in the last 12 months, reflecting a 4.6% contribution from free prices and 3.02% from monitored prices and prices administered by contracts. In 2002 and 2003, the monitored prices and prices administered by contracts are expected to increase by 5.7%, and 3.8%, with a direct contribution of 1.7 and 1.2 percentage points.

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

Simulations exercises with several specifications of the structural model have led to the conclusion that the maintenance of 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 Copom meeting would result in inflation around 4% for 2002. For 2003, the inflation projected by the structural model based on the hypotheses of maintenance of interest rate and of the exchange rate constant at the current level is below the center target of 3.25%.

Monetary Policy Guidelines

Inflation measured by the IPCA, after reaching 0.83% in October, has been continuously declining in the last 3 months, reaching 0.52% in January. The core inflation, measured by the trimmed average method, also declined in January, to 0.52%. The latter should be a sustainable trend as there is a reversion of the negative effects represented by the increases in monitored prices and prices administered by contracts, adverse weather factors and pressures for the recomposition of profit margins. These effects have been responsible for the slower than expected downward trajectory of the inflation.

Indeed, in spite of the significant reduction in gasoline prices at the beginning of the year - gasoline registered a decline of 9.9% in the monthly IPCA and 14.4% up to February 9th, as surveyed by the National Agency of Petroleum - the inflation of monitored prices and prices administered by contracts did not recede as much as expected, due to the readjustments in other monitored prices and prices administered by contracts. Influencing the projections were bottled gas, which increased by 17.9% with the end of subsidies, and other items, with a small weight in the index. For instance, the 15% increase in the urban transportation prices in Belo Horizonte, the 23.0% increase in the real estate tax in São Paulo and of 10.4% in Porto Alegre.

Pressure for recomposing profit margins (and the exchange rate pass-through) may decline due to some important factors. Firstly, due to the moderate expansion of credit, whose growth was low in the last few months. Secondly, the increase in investments observed in the past years, particularly in 2001, resulted in an increase of the productive capacity of the economy. This trend, associated with the existence of idle capacity in industry - the utilization of capacity in the industry reached 79.5% in January 2002 according to FGV's index and 78.6% in December 2001 according to CNI's index, both levels lower than the observed in 2001 - and to the absence of demand pressures coming from the real wage mass, indicate that the economy may expand without additional pressures on inflation. Besides, the end of the electricity rationing will increase the potential for output growth. Finally, inflation expectations surveyed by the Investor Relations Group (GCI) of Banco Central do Brasil are practically stable at 4.8% for 2002 and 4.0% for 2003.

The external scenario has improved but requires some attention. There is a chance that the U.S. economy recovery will already begin in the first half of 2002. However, the outcome of the Argentine crisis and the evolution of the domestic situation of other Latin-American countries merit monitoring. The moderate fluctuations in the exchange rate and the stability in Brazil’s risk indicate that the effect of the uncertainties in the international scenario are not worsening.

The management of the inflation target system requires an effort from Copom to understand and quantify the several inflationary shocks so as to adequately calibrate monetary policy. Central Bank forecasts point to an inflation rate of 4% in 2002, including the primary effect of the shock coming from monitored prices and prices administered by contracts and from the inertia inherited from 2001, as described in the Open Letter to the Minister of Finance, of January 16th. The primary effect of the shocks from monitored prices and prices administered by contracts on the IPCA in 2002 - which is the value that exceeds the inflation target, after deducting the impacts of the exchange rate pass-through and the inertia from the monitored prices and prices administered by contracts- is estimated at up to 0.5p.p. Therefore, the deviation between projected inflation and the target center for 2002 is approximately equivalent to the contribution of the primary shock of monitored prices and prices administered by contracts. This deviation should not be necessarily corrected by the monetary policy inasmuch as monetary policy should be oriented towards eliminating only the second-round effect of the supply shocks on inflation, preserving the initial alignment of relative prices.

Besides, due to the magnitude of the supply shocks occurred in 2001, the Copom understands that the appropriate time period for eliminating the inherited inertia may be extended beyond the calendar year. One estimates that the inflationary inertia resulting from the part of the inflation that exceeded the inflation target in 2001 should contribute with additional 0.7 p.p. to the IPCA in 2002. Part of this inertia will be eliminated in 2003.

From the last two paragraphs, and given the available information, one concludes that monetary policy should target an inflation rate between 4.0% and 4.5%, within the target range for 2002. As Copom’s projection is close to the lower limit of this range, monetary policy, at a first glance, could be eased.

Such treatment given to the supply shocks is based on the view that, after the direct effects of the shocks and suppressed their secondary effects, inflation would return to the desired trend. Examining the projection for inflation for beyond the current year may test the consistency of this understanding. In this respect, some countries manage supply shocks examining the projection of inflation 18 to 24 months ahead and adjusting the monetary policy so that the projected inflation converges to the target in that time horizon. In the Brazilian case, the below the central target projection for inflation in 2003 reinforces the recommendation that, as this scenario confirms itself, the monetary policy could be eased.

As the monetary policy operates with lags, its decisions should consider not only the past evolution of the relevant variables, but essentially their future behavior. Copom's projection of future inflation embodies a higher or lower degree of imprecision depending on the observed economic scenario. In this respect, part of the members of the Copom interpreted the domestic and external scenarios, including the recent fall in inflation, as sufficient evidence to confirm the projection of decrease in inflation towards its targets. Other members, however, considered that these signs are still preliminary and that further consolidation of the economic scenario is still necessary, which may occur in the near future.

After discussions, Copom decided, with a majority of 5 in favor and 3 against, to reduce the target for the Selic interest rate to 18.75%p.a.

At the close of the meeting, it was announced that the Committee would meet again on March 19th , 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 the Calendar of Copom's Ordinary Meetings, published in the Central Bank Communiqué n. 8911, of Oct.3.2000.

Acronyms

ac 12m accumulated in 12 months
ACC Anticipated Exchange Rate Contracts
BM&F Mercantile and Futures Exchange
bp Base Points
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 Federation of Commerce 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
INCC Civil Construction National Index
IPA Wholesale Price Index

IPC Consumer Price Index
IPCA Consumer Price Index – Extended
IPC-BR Consumer Price Index - BR
IPCH Consumer Price Index – Harmonized
IPP Producer Price Index
IR Income Tax
IRF-M Market Fixed Income Index
IRRF Withholding Income Tax
LFT National Treasury Letters (floating)
LTN National Treasury Notes (fixed rate)
NAPM National Association of Purchasing Managers
NBC-E Central Bank Note - E Series (indexed to the exchange rate)
NTN-C National Treasury Note - C Series (indexed to the wholesale price index)
NTN-D National Treasury Note – D Series (indexed to the exchange rate)
p.a. per annum
p.m. per month
PEA Economically Active Population
pp percentage point
Selic Central Bank's Custody and Settlement Center
STN National Treasury Secretariat
ytd year-to-date

Economic policy measures

Measures related to the financial system and credit market

Resolution 2,917, dated 12.19.2001 – Permits creation of exclusive extramarket investment funds, the resources of which may be channeled into derivatives market operations with the objective of minimizing risks consequent upon lags between maturity and application of the indexing factor viewed in the context of the fund's assets and the liabilities of those holding quotas. This measure is aimed at providing greater flexibility to specific investors who have a real need for risk coverage.

Resolution 2,920, dated 12.26.2001 - In the context of the program that imposed conditions on credit grants to the public sector, this measure specified an additional limit of R$1.000.000.000,00 (one billion reals), as the overall value of credit operations contracted as of 12.26.2001 under the terms of Resolution 2,827, dated 3.30.2001. Operations under the terms of the Program of Tax Administration Modernization and Management of Basic Social Sectors (PMAT), which is supported by National Bank of Economic and Social Development (BNDES) financial resources, were excluded from the overall limit.

Resolution 2,921, dated 1.17.2002 – Multiple banks, commercial banks, the Federal Savings Bank, investment banks, credit, finance and investment companies and leasing companies are permitted to perform earmarked credit operations based on resources made available by third parties, observing the following conditions:

a) linkage between funding operations and the corresponding credit operation, as well as subordination of the obligatory deposit of these resources to the payment flow of the earmarked operation;

b) earnings on the earmarked asset that are sufficient to cover the costs of the funding operation;
c) compatibility between the cash flows of the credit and funding operations and a time period for the funding operation that is equal to or greater than that of the credit operation to which it is related;
d) postponement of any payment to the creditor, including charges or amortizations, in cases of default in the corresponding credit operation.

Aside from the conditions cited above, the rendering of any type of guaranty by the contracting financial institution or by an individual/legal entity connected to that institution and that is included in the economic-financial consolidated result is prohibited. Earmarked asset operations are not included in the calculation of the client exposure limit, but are subject to the other operational limits and conditions defined in current legislation and regulations, including those related to risk classification and the constitution of provisions.

Resolution 2,922, dated 1.17.2002 – Deals with investment of the resources belonging to complementary pension fund entities, insurance companies and capitalization companies in acquisitions of investment fund quotas in credit rights and investment funds composed of quotas of investment funds in credit rights, duly complying with the limits defined in current regulations.

Circular 3,080, dated 1.17.2002 – In the context of the regulating of the activities of autonomous investment agents as foreseen in Resolution 2,838, dated 5.30.2001, this measure determined that employees of financial institutions who perform similar activities should comply with the formalities and conditions determined by the Securities and Exchange Commission (CVM), within a maximum term of one year as of the date of authorization of the entity in question.

Circular 3,082, dated 1.30.2002 - This instrument is targeted at harmonizing criteria for accounting recording and evaluation of derivative financial institutions with internationally adopted practices, thus making it possible to more effectively measure the assets of these financial institutions.

Resolution 2,931, dated 2.14.2002 – Considering the need for adjusting the accounting procedures used in evaluating financial investment funds and funds that invest in fund quotas to the new methodology adopted for classification and evaluation of securities, in compliance with the demands of the Council of Complementary Social Security Management (CGPC), this instrument maintained the obligatory nature of adoption of criteria for evaluating the assets included in the fund portfolio at their market value, with exception of the hypotheses expressly determined in Banco Central regulations.

Resolution 2,933, dated 2.28.2002 – With the aim of providing the financial system with modern risk management instruments and in this way reduce the risk factor in the composition of the banking spread, this instrument granted financial institutions and other institutions authorized to operate by Banco Central to carry out credit derivative operations in the modalities, forms and conditions herein set down. Multiple banks, commercial banks, investment banks, the Federal Savings Bank, credit, finance and investment companies, real estate credit companies and leasing companies were authorized to act as the counterpart receiving the credit risk.

Circular 3,088, dated 3.1.2002 – Determined that the demand for compulsory deposits and obligatory reserves on judicial deposits is to be complied with through the earmarking of federal public securities. Compliance based on the utilization of cash deposits or state public securities is no longer permitted.

Circular 3,093, dated 3.1.2002 – This instrument redefined the rule covering earnings on obligatory reserves on savings deposit resources. Earnings are to be paid to the respective deposit account on the business day following the daily closing of the account and are to be calculated on the basis of the Reference Rate (TR) of each business day. The earnings level is valid for the period ended on the corresponding day of the subsequent month. In the case of the inexistence of the corresponding day, the first day of the subsequent month will be considered as the end of the period. The previous system of calculation determined that earnings would be based on the TR set weekly on Monday for the date of adjustment and applied according to the number of business days, following the criterion “pro-rata-die” up to the subsequent adjustment.

Circular 3,097, dated 3.6.2002 – Determined new dates for remittances of financial statements as determined in the Accounting Plan of National Financial System Institutions (Cosif), to be observed by financial institutions, institutions authorized to operate by Banco Central and buyer group management entities, as of base date March 2002. It should be stressed that for quarterly analytical balance sheet positions (Cadoc 4010 and 4020), such positions should be delivered by the final day of the subsequent month, while the eighteenth of the month is reserved to the other base dates.

Fiscal policy measures

Constitutional Amendment 33, dated 12.11.2001 – Determined that the contribution on intervention in the economic domain may be levied on imports of goods or services received from abroad, including electricity, telecommunications services, petroleum derivatives, fuels, even when the party to whom such are channeled is an individual person who, in the case in question, can be considered as equivalent to a legal entity.

Law 10,331, dated 12.18.2001 – Determined that, for the 2002 fiscal year, the general review index of the earnings and wages of federal civil servants will be 3.5% (three point five percent). By way of exception, the percentages granted in the previous fiscal year as a consequence of the reorganization or restructuring of positions and careers, creation and increases of bonuses or additional payments of any nature and species, advances and other advantages inherent to public positions and employment will not be deducted from the review.

Law 10,336, dated 12.19.2001 – Instituted the Contribution on Intervention in the Economic Domain (Cide) on imports and marketing of petroleum and derivatives, natural gas and its derivatives and ethyl fuel alcohol to which articles 149 and 177 of the Federal Constitution refer, with the text provided by Constitutional Amendment 33, dated 12.11.2001.

According to the terms of budget law, the proceeds of the inflow will be channeled into:

a) payment of fuel alcohol, natural gas and derivatives and petroleum derivative price or transportation subsidies;
b) financing environmental projects related to the petroleum and gas industries;
c) financing of transportation infrastructure programs.

In 2002, the effective utilization of the resources obtained from the CIDE will be evaluated and, as of 2003, the criteria and guidelines will be defined in specific legislation.

Law 10,407, dated 1.10.2002 – Estimated federal government revenues and set expenditures for the 2002 fiscal year according to the terms of Law 10,266, dated 7.24.2001 (Law of Budget Guidelines for the 2002 fiscal year – LDO 2002), encompassing:

a) the Fiscal Budget;
b) the Social Security Budget;
c) the Investment Budget of companies in which the federal government directly or indirectly holds a majority of the voting capital stock.

Total revenues estimated in the Fiscal and Social Security Budget are R$650.4 billion, itemized as follows:

a) R$280.1 billion from the Fiscal Budget, excluding operations with public securities (refinancing of the federal public debt) and including that share of social contributions released for use as a result of Constitutional Amendment 27, dated 3.21.2000 (Release of Federal Government Funds), in the amount of R$20.3 billion.
b) R$149.8 billion from the Social Security Budget;
c) R$220.5 billion corresponding to refinancing of the internal and external federal public debt.

Total outlays defined in the Fiscal and Social Security Budget came to R$650.4 billion, itemized as follows:

a) R$262.9 billion from the Fiscal Budget;
b) R$167.1 billion from the Social Security Budget;
c) R$220.5 billion corresponding to refinancing of the federal public securities debt (R$220.2 billion from the Fiscal Budget and R$289 billion from the Social Security Budget).

Provisional Measure 22, dated 1.8.2002 – Updated the income tax table by 17.5% on the earnings of individual persons, effective as of 1.1.2002. In much the same way, increases were also introduced into the amounts that taxpayers can deduct under the heading of outlays on education (from R$1.700,00 to R$1.998,00, per dependent) and outlays on dependents (increased from R$1.080,00 to R$1.272,00).

With this updating, the progressive monthly income tax table now has the following levels:

a) earnings up to R$1.058,00, zero rate;
b) earning from R$1.058,01 to 2.115,00, rate of 15%;
c) above R$2.115,00, rate of 27.5%.

Provisional Measure 25, dated 1.23.2002 - Facilitated payment of pension fund debts with the Secretariat of Federal Revenue, reducing the tax load levied on this segment and making it possible for the funds to be included in government amnesties through application of Provisional Measure 2,222/2001.

In relation to MP 2,222/2001, the new measure reduced the calculation base of the taxes due by the funds. According to the new rules, only administrative revenues – excluding, therefore, revenues for payment of benefits – will be used as the calculation base for payment of PIS/Cofins, both in relation to taxes to mature and to past taxes.

In the case of the Social Contribution on the Profits of Legal Entities (CSLL), the calculation base continues as the surplus of the funds, however now with exclusion of the contingency reserves or, in other words, the provision of resources for cases of unforeseen outlays. With this, the surplus of the funds will be reduced and, consequently, payment of the CSLL will also decrease.

Federal Senate Resolution 40, dated 12.20.2001 - Determined that the consolidated net debt of the states, Federal District and municipalities at the end of the fifteenth fiscal year as of the closing of the year of publication (or, in other words, at the end of 2016) may not exceed, respectively:

a) in the case of the states and Federal District: 2 (two) times net current revenues;
b) in the case of the municipalities: to 1.2 (one point two) times net current revenues.

In relation to the established limits, possible excesses should be reduced to a minimum proportion of 1/15 (one fifteenth) in each fiscal year.

Federal Senate Resolution 43, dated 12.20.2001 - Treats of the internal and external credit operations of the states, Federal District and municipalities, including the granting of guaranties, their limits and authorization conditions.

Among the measures adopted, the two levels of government cited were prohibited from carrying out the following operations:

a) anticipated reception of amounts from companies in which the public authority directly or indirectly holds the majority share of the voting capital, with the sole exception of profits and dividends, as determined in legislation;
b) direct assumption of commitments, confessions of debt or similar operations with suppliers of goods, merchandise or services, based on the issue, acceptance or endorsement of credit securities, stressing that this prohibition is not applicable to dependent government companies;
c) assumption of obligations with suppliers without budget authorization for a posteriori payment of goods and services;
d) carrying out of a credit operations that represents a violation of refinancing agreements formalized with the federal government;
e) granting of any subsidies or exemptions, reduction of the calculation base, granting of presumed credits, incentives, amnesties, remissions, rate reductions and any other tax, fiscal or financial benefits that may be in disagreement with the terms of the Federal Constitution;
f) granting of rights related to the period subsequent to that of the term of the head of the Executive Branch in relation to credits consequent upon obligatory government participation in the modalities of royalties, special participation and financial compensation, in the result of the working of petroleum and natural gas deposits, water resources for electricity generation purposes and other mineral resources.

Decree 4,120, dated 2.7.2002 – Introduced a reduction of R$12.4 billion in expenditures on investments and other current expenditures foreseen in the federal government budget for 2002. Aside from several estimates having lagged prematurely, it was seen that outlays on personnel and charges will remain above the volume specified in Annual Budget Legislation.

The new revenue estimates are approximately R$9 billion below the volume initially expected. The most severe losses are expected to occur under the heading of the income tax (R$3.7 billion), due to the indexing of the withholding table; of revenues on public service concessions (R$3.4 billion); and in the framework of the Tax on Industrialized Products and the Income Tax (R$1.6 billion), due to lesser growth in the level of economic activity.

On the expenditure side, the heading of "personnel and social charges" is to absorb an additional R$3.6 billion due to wage readjustments in the sectors of education and social security, increases in unemployment insurance and supplementary outlays on judicial sentences.

Measures related to the foreign sector

Decree 4,041, dated 12.3 2001 – Added a provision to article 8 of Decree 3,937, dated 9.25.2001, which regulates Law 6,704, dated 10.26.1979, which deals with Export Credit Insurance.

Secex Circular 58, dated 11.21.2001 – Among the companies specified therein, distributes an import quota of 50,000 vehicles in the framework of the Brazil-Mexico Trade Preference Agreement.

Decree 4,056, dated 12.14.2001 – Altered the IPI rate on the products cited (industrialized products involving informatics and telecommunications).

Law 10,336, dated 12.19.2001 – Institutes the Contribution on Intervention in the Economic Domain (Cide) on the import and marketing of petroleum and its derivatives, natural gas and its derivatives and ethyl fuel alcohol, and takes other pertinent measures.

Decree 4,060, dated 12.21.2001 – Extended the time period for federal government assumption of civil liabilities before third parties in the case of terrorist attacks or acts of war against aircraft belonging to Brazilian aviation companies, as determined in the provision of Law 10,309, dated 11.22.2001, and takes other measures.

MAPA/MDIC Interministerial Directive 623, dated 12.21.2001 – Altered the criteria of the Coffee Retention Program. Cancels MAA/MDIC Interministerial Directive 197, dated 6.15.2001.

Camex Resolution 42, dated 12.26.2001, rectified in the Federal Government Register (DOU) published on 1.9.2002 - Released the Common External Tariff (TEC) with the temporary addition of 1.5% to the List of Exceptions to the TEC and the BIT List of Convergence; as well as the new NCM based on amendments to the Nomenclature of the Harmonized System of Designation and Codification of Merchandise. Revokes Camex Resolutions 7, dated 3.22.2001; 16, dated 6.1.2001; 24, dated 6.26.2001; 27, dated 8.16.2001; 28 and 29, dated 8.29.2001; and 35, dated 11.1.2001.

ANP Directive 312, dated 12.27.2001 – Regulated imports of solvents.

ANP Directive 313, dated 12.27.2001 - Regulated imports of diesel oil.

ANP Directive 314, dated 12.27.2001 – Regulated imports of automotive gasoline.

ANP Directive 315, dated 12.27.2001 – Regulated exports of petroleum derivatives.

Decree 4,059, dated 12.20.2001 - Regulated Law 10,295/2001, which treats of National Energy Conservation and Rational Use Policy.

Communique 9,229, dated 1.31.2002 - Treats of operations involving Brazilian exports to Argentina when such exports are not processed on the basis of the Reciprocal Payments and Credits Agreement (CCR).

Decree 4,089, dated 1.15.2002 - Promulgated the International Coffee Agreement – AICAFÉ/2001.

Decree 4,100, dated 1.24.2002 - Treats of execution of the Protocol of Cuban Adherence to the Trade Fostering Agreement based on the lowering of Technical Trade Barriers, dated 8.8.2001 among Brazil, Argentina, Bolivia, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Venezuela, Uruguay, on the one hand, and Cuba, on the other, as determined in the 1980 Montevideo Treaty.

Camex Resolution 1, dated 1.24.2002 (Ex-tariff) - Altered the ad valorem rates of the import tax to 4% up to 12.31.2003, levied on Capital Goods and Informatics and Telecommunications Goods and on the Integrated Systems specified therein.

Decree 4,117, dated 2.6.2002 – Treats of implementation of the Fourth Additional Protocol to ACE 39 between Brazil and the member countries of the Andean Community (Colombia, Ecuador, Peru and Venezuela).

Provisional Measure 29, dated 2.7.2002 – Treats of authorization for creation of the Electric Power Wholesale Market (MAE), a legal entity governed by private law, and takes other measures.

Provisional Measure 32, dated 2.18.2002 - Extended the authorization treated in Law 10,309, dated 11.22.2001, which treats of federal government assumption of civil liabilities before third parties in cases involving terrorist attacks or acts of war against aircraft belonging to Brazilian aviation companies.

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

Beny Parnes
Deputy Governor

Edison Bernardes dos Santos
Deputy Governor

Ilan Goldfajn
Deputy Governor

Luiz Fernando Figueiredo
Deputy Governor

Sérgio Darcy da Silva Alves
Deputy Governor

Tereza Cristina Grossi Togni
Deputy Governor

Members of the Monetary Policy Committee (Copom)

Voting members

Armínio Fraga Neto
Governor

Carlos Eduardo de Freitas
Deputy Governor

Beny Parnes
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 Sistem (Deban)

Sérgio Goldenstein
Head of the Department of Open Market Operations (Demab)

Acronyms

Abimaq	Brazilian Association of Machinery and Equipment Industry
ac.12m.	accumulated in 12 months
ac.a.	in accumulated terms for the year
ACC	Antecipated Exchange Rate Contracts
ACSP	São Paulo Trade Association
Anefac	National Association of Finance, Management and Accounting Executives
Anfavea	National Association of Automotive Vehicle Manufacturers
BAI	Business Activity Index
Banacci	Grupo Financiero Banamex - Accival
Banxico	Bank of Mexico
BM&F	Commodities & Futures Exchange
BNDES	National Bank of Economic and Social Development
BNDESpar	BNDES Participations S. A.
BoJ	Bank of Japan
Caged	General File of the Employed and Unemployed+B76
CBO	Congressional Budget Office
CCR	Reciprocal Payments and Credits Agreement
CDB	Bank Deposit Certificates
CDI	Interbank Futures Contract
CEF	Federal Savings Bank
Cetes	Treasury Certificates
Cetip	Center for Financial Custody and Settlement of Private Securities
CGPC	Council of Complementary Social Security Management
Cide	Contribution on Intervention in the Economic Domain
CMN	National Monetary Council
CNI	National Confederation of Industry
Cofins	Contribution to Social Security Financing
Copom	Monetary Policy Committee
Cosif	Accounting Plan of National Financial System Institutions
CPI	Consumer Price Index
CPMF	Provisional Contribution on Financial Transactions
CSLL	Social Contribution on Net Profit
CVM	Securities and Exchange Commission
Depec	Department of Economics
DI	Interbank Deposit
ECB	European Central Bank

EMI	Monthly Industrial Estimator
Fecomercio SP	Trade Federation of the State of São Paulo
Fenabrave	National Federation of Automotive Distribution
FGV	Getulio Vargas Foundation
Fiesp	Federation of Industries of the State of São Paulo
Finame	Special Industrial Financing Agency
FOMC	Federal Open Market Committee
Funcafé	Coffee Economy Defense Fund
GCI	Banco Central Investors Relations Group
GDP	Gross Domestic Product
HCPI	Harmonized Consumer Price Index
IBGE	Brazilian Institute of Geography and Statistics
ICMS	Tax on the Circulation of Merchandise and Services and the Rendering of Interstate and Intermunicipal Transportation Services and Communications
IFO	Institute for Economic Research
Igae	Overall indicator of economic activity
IGP-M	General Price Index – Market
IIA	Current Intentions Index
IIC	Consumer Intention Index
IIF	Institute of International Finance
IIF	Future Intentions Index
Imacec	Monthly Economic Activity Indicator
Indec	Instituto Nacional de Estadísticas y Census
Inséé	Institut National de la Statistique et des Études Économiques
IPA	Wholesale Price Index
IPA-OG-PI	Wholesale Price Index – Overall Supply – Industrialized Products
IPCA	Broad National Consumer Price Index
IPC-Fipe	Institute of Economic Research Foundation
IPIM	Índice de Precios Internos al por Mayor
IPM	Índice de Precios al por Mayor
Isac	Synthetic Indicator of Industrial Activity
Isae	Istituto di Studi e Analisi Economica
ISM	Institute for Supply Management
Laia	Latin American Integration Association
LDO	Budget Guidelines Law
LFT	Treasury Financing Bills
LSPA	Systematic Farm Production Survey
LTN	National Treasury Bills
MAE	Electric Power Wholesale Market
Moderfrota	Program of Modernization of the Farm Tractor Fleet and Like Implements and Harvesters
MTE	Ministry of Labor and Employment
NBCE	Banco Central Notes – Special Series
NTN-D	National Treasury Notes – Series D
Opec	Organization of Petroleum Exporting Countries
p.a.	per annum
p.m.	per month
PLE	Required Net Worth

PMAT	Program of Tax Administration Modernization and Management of Basic Social Sectors
PMC	Monthly Trade Survey
PMI	Purchasing Managers Index
PPE	Specific Price Share
PPI	Productor Price Index
RCC	Resolution and Collection Corporation
RMSP	Metropolitan Region of São Paulo
SPC	Credit Protection Service
TEC	Common External Tariff
TJLP	Long-Term Interest Rate
TR	Reference Rate
ULC	Unit Labor Cost
VAT	Value Added Tax
WTO	World Trade Organization