Inflation Report

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Inflation Report

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Statistical Conventions:

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

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

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Foreword

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

The report is divided into 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

Economic activity continues to expand gradually, but at a slower pace as compared to the first months of the year. The demand for consumption has been sustained by positive factors such as the path of the employment rate and the rise in agricultural income. On the other hand, the still high default rate and the drop registered in most indicators that measure the purchasing power of wages and earnings are factors that have been restricting the demand. There is no evidence in the short run of factors that could pressure the demand, as indicated by the behavior of inventory level indicators.

In addition, the discreet growth of credit operations in the second quarter, following the same trend observed since early this year, continues to reflect the cautious position assumed by agents in the prevailing scenario of economic uncertainties associated with the cost of credit. Special mention should be made, however, of the higher volume of disbursements of the BNDES for infrastructure items basically, revealing favorable prospects for investments in this area.

Investments have recovered somewhat as compared to the deceleration observed in the last months of 2001, a trend that can be felt in the production of capital goods and civil construction inputs. Similarly to what has been observed in consumption demand indicators, this recovery can be described as gradual and there is no evidence that the productive sector will be incapable of responding to this shift.

The recent and gradual recovery of the economic activity was confirmed by the GDP expansion in the first quarter of the year in relation to the previous period, after declines in the second and third quarters of 2001 and a relative stability in the last quarter. For 2002, GDP is expected to grow by 2% as a result of increases of 3.3% in agriculture, 1.8% in the industrial production, and 2.2% in services.

The 12-month trade balance continued to grow over the year regardless of the contraction in exports. Sales abroad are expected to regain impetus with the recovery of the world economy, making up for the loss of revenue caused by the drop in exports to Argentina. Imports have been replaced by domestic production and their recovery, which is linked to the recovery of industrial production, will take place at a more moderate pace. This behavior of both exports and imports is expected to sustain the surplus of the trade balance projected for the year. Net spending on services is also contributing to reduce the current account deficit, as well as the payment of interest rates, since the foreign debt is not growing.

The baseline scenario for the Copom forecasts for the next 18 months presupposes, on the one hand, that the economic policy in 2003 will remain committed to the targets set for the inflation rate and, on the other hand, that the transition to the future federal administration will not be subject to exaggerated and/or protracted turbulence.

The central path expected for the inflation accumulated in 12 months has declined steadily from 7.7% at the end of the second quarter of 2002 to 5.5% late this year. A marked drop in the inflation rate is anticipated between the third and fourth quarters of this year as a result of the substitution of an abnormally high inflation in the last quarter of 2001 with a figure that is more consistent with the targets set for the inflation in the last quarter of this year. The higher inflationary pressure has been caused by prices administered by contract and monitored prices. Projections indicate that the prices of this group will rise by about 8.1% in 2002, contributing 2.5 percentage points to the IPCA. For market prices, which account for about 70% of the IPCA, a 4.3% growth is expected, with a contribution of 3.0 percentage points. Because market prices have risen by 2.0% in 2002 already, the average monthly inflation of these prices by the end of the year will be lower than the figures registered until May. It is estimated that that the contribution to the IPCA in 2002 of the primary effect of the shock to prices administered by contract and monitored prices - the value exceeding the inflation target after the impact of the exchange rate pass-through and of inertia on prices administered by contract and monitored prices are eliminated - will amount to 0.5 percentage point. Calculations indicate that the inflation inertia above the target set for last year will have an impact of 0.9 percentage point in the IPCA in 2002.

For 2003, an inflation rate of 2.6% has been projected. Prices administered by contract and monitored prices are expected to vary by 6.1% and contribute 1.9 percentage points to the IPCA. For market prices, a lower figure is expected: 1.1%, which would contribute with 0.7 percentage point in the IPCA. For the IPCA as a whole, an inflation rate of 2.6% has been projected for 2003, which is below the target.

The main sources of uncertainty as to the evolution of inflation until the end of 2003 are the behavior of prices administered by contract and monitored prices, the evolution of the world economy, and the behavior of the exchange rate and of domestic assets. If the uncertainties in relation to the future and the recent adverse conjuncture of marked depreciation in the price of assets and in the exchange rate persist, the inflation forecasts for 2002 and 2003 could be higher.

1 – Activity level

The economic upturn that began in the final months of 2001 continued into the early months of the current year. However, more recently, economic activity indicators, particularly those that seek to measure consumer intentions and business expectations, have perceived a certain loss of momentum. It should be recognized that, to some extent, the April results reflected the fact that Holy Week occurred in March, resulting in a greater number of business days in April of this year compared to 2001. In May, the impact of this factor will be further diluted and is expected to produce a drop in most of the indicators.

1.1 – Retail sales

Since August 2001, the month in which the sector slumped to its lowest level, mostly due to the impact of the energy crisis, the retail trade sector has managed to achieve a rather steady growth trajectory. Initially, the recovery reflected gradual improvement in consumer expectations over the course of the second half of that year, followed by renewed sales growth as consumers who had postponed purchases returned to the market as the rationing process wound down. Other factors that deserve mention include increased employment and higher farm income. However, more recent data indicate that the sector has begun losing some steam, mostly as a result of the declining purchasing power of wages and earnings, continued relatively high levels of interest and exhaustion of the process of improvement in consumer expectations.

In the Metropolitan Region of São Paulo, the Trade Federation of the State of São Paulo (Fecomercio) registered 2.3% growth in retail

Real sales of the retail sector in São Paulo

Percentage change

Itemization	2001	2002				
	Dec	Jan	Feb	Mar	Apr	May*
In the month 1/						
General	-1.5	2.3	-1.2	2.9	-2.4	3.2
Consumer goods	-1.5	3.2	-0.1	4.6	-4.5	2.5
Durable	-1.7	3.0	-1.2	0.9	1.4	1.1
Semidurable	4.5	-0.6	-1.1	-2.5	-4.1	-1.0
Nondurable	-0.5	0.8	0.2	7.3	-10.5	3.3
Automotive trade	-0.6	-7.5	-3.2	-1.6	4.8	-5.6
Vehicle concessionaries	0.6	-10.5	-4.6	-0.8	6.7	-7.2
Autoparts and accessories	-8.8	7.2	1.5	-3.0	0.8	0.4
Building materials	-11.1	6.4	-0.8	0.9	2.3	-5.3
Quarter/previous quarter 1/						
General	3.7	2.9	1.3	1.8	1.0	2.3
Consumer goods	3.0	4.2	2.7	4.7	3.0	3.3
Durable	6.0	7.5	4.1	3.2	1.3	2.4
Semidurable	-10.0	-3.6	0.8	0.1	-3.0	-6.3
Nondurable	2.2	2.9	1.4	3.9	1.7	1.3
Automotive trade	7.1	1.6	-6.1	-11.1	-7.9	-5.1
Vehicle concessionaries	8.9	1.7	-7.4	-14.3	-9.8	-5.8
Autoparts and accessories	-2.1	-4.3	-4.3	0.2	1.3	0.9
Building materials	-7.5	-8.5	-8.2	-2.4	0.7	2.2
In the year						
General	-5.5	-5.5	-6.3	-4.6	-4.7	-2.9
Consumer goods	-4.4	-2.6	-3.3	-0.9	-1.7	0.1
Durable	-7.0	-5.3	-6.2	-5.6	-3.9	-1.5
Semidurable	-21.5	-20.9	-21.0	-21.9	-22.3	-24.7
Nondurable	0.9	-0.3	-0.8	3.5	0.5	1.9
Automotive trade	-16.3	-19.5	-23.0	-25.4	-21.8	-21.4
Vehicle concessionaries	-19.0	-23.3	-28.0	-30.2	-26.0	-25.5
Autoparts and accessories	-2.7	-1.5	3.2	0.0	-0.2	-0.2
Building materials	-1.3	-24.0	-23.9	-24.2	-21.6	-21.5

Source: Fecomercio

1/ Seasonally adjusted data.
* Preliminary.

sales in the March/May quarter, compared to the results of the immediately previous quarter. This figure was calculated on the basis of the statistical series purged of seasonal factors and confirms the existence of an ongoing process of recovery. Further analysis indicates that the major product groupings turned in improved results under consumer goods, including both durables and nondurables, as well as auto parts and accessories and building materials. The other groups showed a loss of dynamism, with particularly strong downward movement in the sales of factory authorized vehicle outlets.

Analysis of the series exempt from seasonal influences shows that April and May alternated positive and negative results in practically all sectors of the economy, indicating that retail revenues in the Metropolitan Region of São Paulo have begun leveling off into a more stable pattern. The only truly important exception were the rather strong highs registered in the two month period under real sales of auto parts and accessories and durable consumer goods. In the latter case, the two causal factors of greatest importance were the end of restrictions on the electricity supply and the impact of the World Cup tournament.

Compared to the same period in 2001, Fecomercio figures registered a decline of 2.9% in sales in the first five months of the year. Analysis of the major product groupings shows that growth was limited to revenues on sales of nondurable consumer goods, using the same basis of comparison. A breakdown of the major product groupings provides an insight into the headings that registered the most accentuated falloffs at the retail level in the first five months of the year. In this sense, reductions of more than 20% were noted under the subgroupings of film, photo, sound and optical equipment, 25.7%, CD outlets 34.7%, apparel, 28.1%, vehicle outlets, 25.5% and building materials, 21.5%. Basically, demand for the most part of these goods is highly sensitive to exchange rate variations and the conditions imposed on credit operations.

Sales volume index in the retail sector - Brazil

% accumulated in the year

Itemization	2001	2002			
		Jan	Feb	Mar	Apr
Retail sector	-1.2	-1.1	-1.3	-0.8	-1.1
Fuel and lubricants	-2.7	4.7	5.3	5.1	5.2
Supermarkets	1.0	-1.2	-1.9	0.6	-1.7
Textiles, clothing	1.6	0.3	-1.7	-2.7	-2.2
Furniture and white goods	-1.4	1.0	0.0	-1.4	1.0
Other domestic goods	-6.4	-5.7	-4.1	-4.6	-3.6
Vehicles, motorcycles	-3.5	-19.8	-20.7	-23.4	-20.6

Source: IBGE

At the national level, statistics indicate that the drop in trade sector activity was less accentuated than that registered by Fecomercio in the São Paulo Metropolitan Region. In this sense, the indicator of retail sales volume, calculated by the Brazilian Institute of Geography and Statistics (IBGE), turned in a reduction of 1.1% in the first four months of the year compared to the same period in 2001. Up to March, the falloff had come to 0.8%. As far as activity groupings are concerned, analysis points to recovery in sales of fuels and lubricants as a result of price reductions at the start of the year, and in the groupings of fabrics and apparel and furniture and home appliances.

Average interest rates effective in the retail sector

% p.m.

Itemization	2000	2001	2002			
	Dec	Dec	Jan	Feb	Mar	Apr
Average interest rates	6.85	6.72	6.70	6.66	6.64	6.62
By segment						
Large stores	5.83	5.70	5.67	5.64	5.61	5.58
Medium stores	7.16	6.94	6.91	6.88	6.86	6.82
Small stores	7.85	7.57	7.54	7.52	7.50	7.47

Source: Anefac

The interest rate levied by the retail sector and announced by the National Association of Finance, Administration and Accounting Executives (Anefac) has followed a gradually downward curve since July 2001 when it closed with a final figure of 6.88% per month. In December, the rate ended at 6.72% per month, dropping to 6.62% per month in April 2002. Based on the size of companies, one notes that the rates charged by the larger companies came to an April level of 1.9 p.p. less than those practiced by the smaller companies. Aside from this, the downward movement in the rate level was registered under all headings. Despite this performance, interest at the retail level remained high, partly as a consequence of a significant volume of defaults.

Default rates

Rate

Itemization	2000	2001	2002				
	Average	Average	Jan	Feb	Mar	Apr	May
SPC (SP)[1/]	5.7	7.4	5.4	8.2	6.0	9.4	8.8
Returned checks[2/]	3.6	4.9	5.5	5.2	5.2	5.0	...
Telecheque (RJ)[3/]	1.9	2.0	3.5	3.3	3.9	2.9	...
Telecheque (Nationa	2.3	2.5	3.3	3.1	3.0	2.8	...

Source: ACSP, Bacen and Telecheque

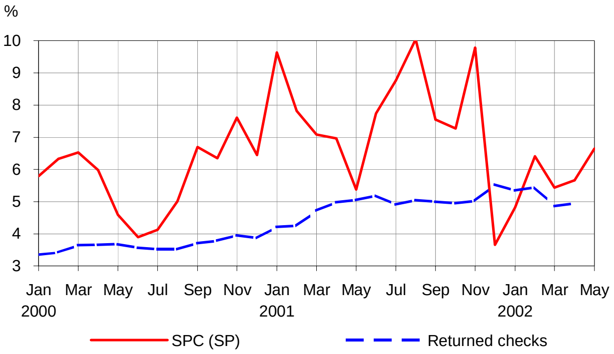
1/ New registrations - registrations cancelled out/effected consultations (t-3).
2/ Cheques returned due to insufficient funds/cleared cheques.
3/ Returned cheques/cleared cheques.
4/ Average in the following cities: Belém, Fortaleza, Recife, Salvador, Belo Horizonte, São Paulo, Curitiba, Porto Alegre, Ribeirão Preto and Rio de Janeiro.

In this sense, reflecting the unfavorable performance of wages and earnings, default indicators were quite high despite a recent downward trend. Even with this movement, these percentages were higher than in the corresponding months of 2001.

Based on data released by the São Paulo Trade Association (ACSP) and considering that there is a three month delay in the calculation of the number of consultations, the net rate of default registered by the Credit Protection Service (SPC) came to 8.8% in May, compared to 9.4% in April 2002. When one considers the average for the first five months of the year, the figures come to 7.5% in 2002 and 9.2% in 2001. The series exempt from seasonal impacts indicates a lower level of defaults in 2002 than in the previous year. Once seasonal factors are eliminated, when the average default level for the March-May quarter is compared to that of the immediately previous quarter, one perceives growth, with the respective averages reaching marks of 5.9% and 5%.

Default rates

Seasonally adjusted data

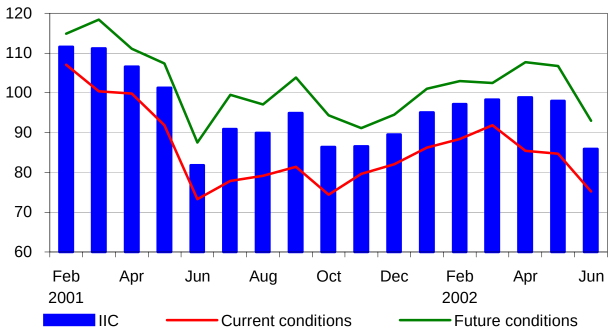


Telecheque figures for the country as a whole pointed to a decline in the default rate in the early months of 2002. The ratio between checks returned and received in the retail trade sector moved from a January level of 3.3% to 2.8% in April, a figure just slightly above the corresponding result for the same month of 2001, when it closed at 2.5%. The average in the first four months of the year, however, points to a default level of 3.1% in 2002, compared to 2.4% in the previous year, reflecting a performance that was just the opposite of the ACSP indicator.

The broader indicator of defaults, which takes account of the proportion between total checks returned due to insufficient backing and total checks cleared, generated positive growth in the first five months of the current year, with an average of 5.2% compared to 4.7% in the corresponding period of 2001. In the series purged of fluctuations provoked by seasonal factors, the trajectory of gradual growth that marked 2001 reversed course at the start of 2002. This is ratified by a comparison of the averages for the March-May and December-February quarters, which came to respective levels of 4.9% and 5.5%.

Aside from default rates, the recent behavior of consumer expectations has also been negative. Following November to April

Consumer Intention Index (IIC)



Source: Fecomercio

growth, the Consumer Intentions Index (IIC) which is released by Fecomercio, registered a May decline in both future intentions, which represents 60% of the indicator, and current intentions. Though the drop was not overly significant, it pointed to a sense of consumer wariness, particularly with respect to future intentions. Concerns are centered mostly on the questions of unemployment and the political scene.

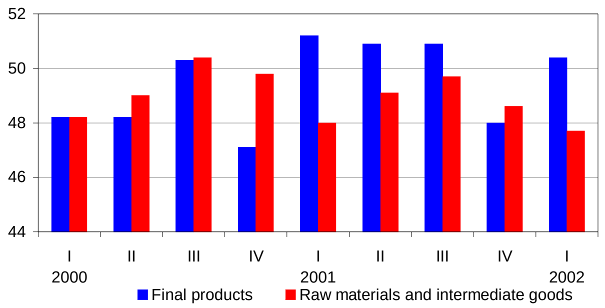
In the month of June, the IIC came to 85.9, a drop of 12.3% in relation to May. A result below 100 is considered emblematic of an increasingly cautious stance on the part of consumers. The month's result was based on falloffs of 11.1% in the Index of Current Intentions (IIA), which closed at 75.2 points, and 12.9% in the Index of Future Intentions (IIF), which came to a level of 93. Among the major causes underlying these results, mention should be made of rising unemployment, a relatively unstable political climate, pressures on exchange rates and a lower than expected activity level.

In the second quarter, the various factors that condition consumption patterns were relatively less favorable than at the end of 2001 and early 2002. In general, consumption tended toward a process of leveling off. Breaking out of such a situation depends on factors such as increased buying power of wages and earnings, higher employment rates and conditions that induce the consumer to opt for financing to expand demand for durable and semidurable goods.

1.2 – Inventories

At the start of the second quarter of 2002, the movement detected under stock levels was by no means homogeneous. In the case of the manufacturing sector, which is surveyed quarterly by the Getulio Vargas Foundation (FGV), there was a gradual reduction in inventory levels in relation to January findings. However, according to most of the businesspeople contacted, these inventories were still somewhat higher than would normally be desirable. As noted in January, the business community would like to lower these stocks

Manufacturing industry stocks[1/]



Source: CNI
1/ Values over 50 indicate stocks above the planned level.

to levels more in keeping with the absorption capacity of the consumer market. The fact that this has not yet been achieved indicates that these adjustments will still be felt in the months ahead.

The results of the Industrial Survey of the National Confederation of Industry (CNI) carried out in the first quarter of 2002 demonstrate that stock levels have performed in a manner quite diverse from product. Final goods registered increases in stock levels and raw materials and intermediate products turned in declines. In the first case, the growth indicator of inventory levels passed the fifty mark, reflecting a position above the planned level, while the second result closed below that limit.

Manufacturing industry stocks[1/]

Itemization	2001				2002
	I	II	III	IV	I
Manufacturing industry					
Final products	51.2	50.9	50.9	48.0	50.4
Raw materials and interm. goods	48.0	49.1	49.7	48.6	47.7
Large companies					
Final products	52.7	52.3	52.4	47.8	50.4
Raw materials and interm. goods	48.4	51.7	53.4	50.5	49.5
Small and medium companies					
Final products	50.4	50.1	50.0	48.2	50.3
Raw materials and interm. goods	47.9	47.6	47.7	47.5	46.7

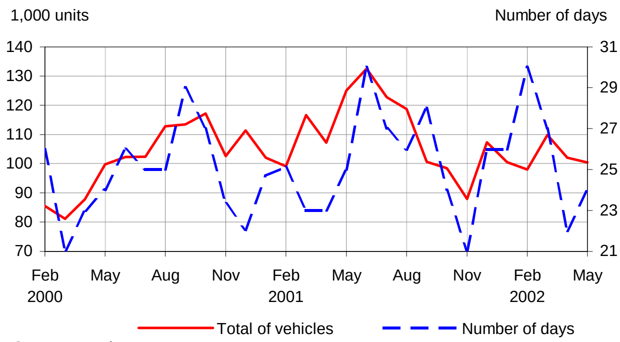
Source: CNI

1/ Values over 50 indicate stocks above the planned level.

In the case of final products, evaluations based on company size stress that the rise in stock levels was more accentuated in the larger companies as the indicator climbed from 47.8 in the fourth quarter of 2001 to 50.4 in the first quarter of 2002. For small and medium businesses, the stock level of final products increased from 48.2 to 50.3.

An analysis of the sixteen segments surveyed carried out by the CNI study identified stock levels of final products below 50 in five headings while eleven were found under raw materials and intermediate goods. In the first case, the lower levels were registered under transportation equipment, furniture, rubber, chemicals and beverages. In the case of raw materials and intermediate products, the headings were nonmetallic minerals, electric and communications equipment, wood, furniture, apparel, footwear and cloth goods, food products and beverages.

Stock of factory authorized vehicle sales outlets



Source: Fenabrave

According to statistics released by the National Federation of Automotive Vehicle Distribution (Fenabrave), the inventories of factory authorized sales outlets had an average number of units in the first four months of the year that was 3.4% below the same period of the preceding year. In a breakdown by vehicle type, only buses registered larger inventories. On the other hand, there was an increase in the number of days required for stock turnovers from 24, based on the average for the first four months of 2001, to 26.3 days in the same period of 2002. However, analyzing data for the last three months, the number of days required for turnover dropped from a level of 30 in February to 27 in March and 22 in April.

Consequently, though the data revealed by the various surveys of the recent behavior of stock levels were not uniform, it was possible to perceive a reduction in the level of some segments, such as raw materials and intermediate goods, indicating the possibility of stock replenishment over the short-term. In relation to final products, however, there are no truly significant signs that indications of a replenishment process could generate a corresponding response in terms of industrial output.

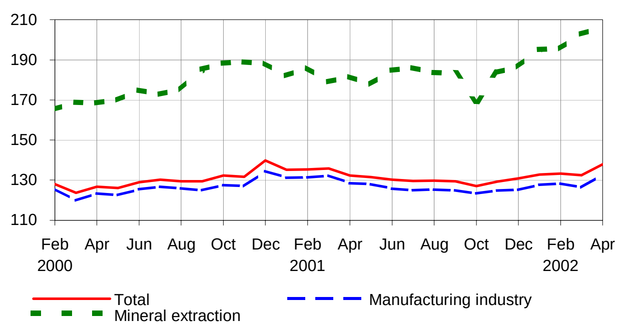
1.3 – Output and Gross Domestic Product (GDP)

1.3.1 – Industrial output

Following four consecutive months of positive results, industrial output turned downward in March according to calculations based on data purged of seasonal factors. Based on the same data, it should be noted that the month's result was impacted by the occurrence of Easter in March and not in April as normally occurs. This fact was offset in the month of April, when growth came to 4.1% under general industry, 5.2% under manufacturing and 1.8% under mining. Given the characteristics of the latter segment, it was not impacted by seasonal factors.

When the April results are adjusted by seasonal factors, the final figures are more modest though still positive, indicating that industrial

Industrial production
Seasonally adjusted data
1992=100



activity did effectively expand in April, principally in the sectors of capital and consumer goods.

Calendar effect on industrial production[1/]

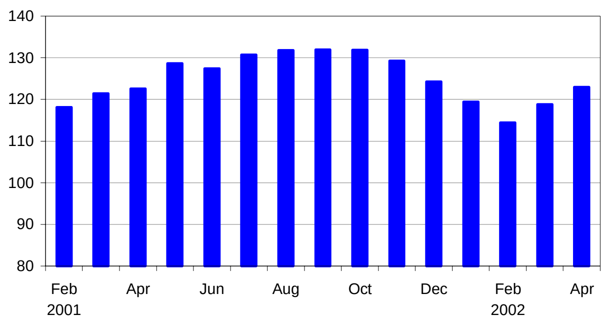
Percentage change

Itemization	2002					
	Jan	Feb	Mar	Mar[2/]	Apr	Apr[2/]
Industrial production	1.4	0.3	- 0.8	- 0.3	4.1	1.9
By segment						
Mineral extraction	5.7	- 0.5	3.5	2.5	1.8	0.8
Manufacturing industry	2.0	0.3	- 1.9	- 0.6	5.2	2.0
By category of use						
Capital goods	1.1	5.3	- 3.9	- 2.1	7.1	5.1
Intermediate goods	3.5	1.2	- 1.6	- 0.7	2.5	1.3
Consumer goods	0.9	- 1.4	- 1.1	- 0.2	7.0	3.1
Durable	- 2.1	1.2	1.0	2.2	7.0	2.5
Semi and nondurable	1.3	- 1.1	- 1.9	- 1.1	6.0	2.6

Source: IBGE and Banco Central do Brasil

1/ Seasonally adjusted data.
2/ Change enclosing calendar effect on seasonal factors.

Industrial production
Quarterly moving average



Source: IBGE

Notwithstanding the March decline, the average for the first quarter of 2002 came to 2.9% above the median level for the previous quarter, once seasonal factors have been eliminated. A breakdown by use categories shows that comparisons between the quarters cited above indicate a positive trajectory for all categories and subcategories, led by intermediate goods with 4.6%, followed by capital goods, with 3.4%, and consumer durables, 2.9%. Consumer goods registered growth of 0.9% and semidurable and nondurable consumer goods closed with 0.4% in the period.

Once the April result is incorporated, analysis of the movable quarterly average indicated a renewed process of gradual expansion as of February. To some extent, this performance was caused by the output of capital goods and intermediate goods. Note that recent stock evaluations carried out by the CNI had registered downward movement in the latter of the items cited above.

When one considers the April result, 17 or the 20 segments surveyed and all of the use categories turned in output growth. The highest rates were noted under food products, mechanics and electric and communications equipment. According to use categories, capital goods turned in an increase of 7.1% and both consumer goods and consumer durables with growth of 7% each. The output of semidurable and nondurable goods increased by 6%, while the intermediate goods industry achieved growth of 2.5%, the only result that was below the average for general industry.

Industrial production

Percentage change

Itemization	2001	2002			
	Dec	Jan	Feb	Mar	Apr
Industry (total)					
In the month 1/	1.0	1.4	0.3	- 0.8	4.1
Quarter/previous quarter 1/	- 0.4	1.7	2.9	2.9	2.7
Same month of the previous year	- 6.6	- 1.2	- 1.3	- 3.8	6.0
Accumulated in the year	1.5	- 1.2	- 1.3	- 2.1	- 0.1
Accumulated in 12 months	1.5	0.5	0.3	- 0.7	- 0.7
Manufacturing industry					
In the month 1/	0.4	1.9	0.2	- 1.9	5.2
Quarter/previous quarter 1/	- 0.5	1.1	2.1	2.0	2.7
Same month of the previous year	- 7.3	- 2.3	- 2.1	- 5.7	5.1
Accumulated in the year	1.2	- 2.3	- 2.2	- 3.5	- 1.3
Accumulated in 12 months	1.2	0.2	0.0	- 1.2	- 1.2
Mineral extraction					
In the month 1/	1.6	4.5	0.2	3.5	1.8
Quarter/previous quarter 1/	- 2.5	5.4	7.6	9.9	7.0
Same month of the previous year	- 1.1	7.1	5.1	13.1	13.5
Accumulated in the year	3.5	7.1	6.1	8.4	9.7
Accumulated in 12 months	3.5	3.1	2.6	3.2	3.7

Source: IBGE

1/ Seasonally adjusted data.

Industrial production by segment 1/

Percentage change

Itemization	2001	2002		
		1st q.	Apr	In the year
Industrial production	1.5	- 2.1	4.1	- 0.1
Mineral extraction	3.5	8.4	1.8	9.7
Manufacturing industry	1.2	- 3.5	5.2	- 1.3
Nonmetallic minerals	- 1.8	- 4.7	3.3	- 2.7
Metallurgy	0.7	- 4.0	- 0.2	- 2.9
Mechanics	5.2	- 0.9	8.4	1.8
Electric and comm. equip.	6.9	- 13.6	11.0	- 11.7
Transportation equipment	5.3	- 5.4	3.3	- 3.0
Wood	- 0.3	- 3.4	3.6	- 1.8
Furniture	- 1.1	2.8	13.4	7.3
Paper and cardboard	0.1	0.3	2.3	0.8
Rubber	- 4.5	- 6.2	2.0	- 3.3
Leather and hides	- 9.4	- 11.6	13.2	- 8.8
Chemicals	- 0.7	- 1.7	1.6	- 0.6
Pharmaceuticals	- 1.0	17.4	- 0.7	17.7
Perfumes, soaps, candles	- 1.2	- 5.2	- 3.7	- 4.2
Plastics	- 5.0	- 4.6	8.3	- 1.8
Textiles	- 5.7	- 6.3	7.0	- 3.7
Clothing, footwear, cloths	- 6.5	- 5.3	8.3	- 0.4
Food products	5.1	- 1.2	6.6	2.2
Beverages	0.2	- 6.9	3.2	- 5.7
Tobacco	- 4.7	34.3	8.2	37.8

Source: IBGE

1/ In April, seasonally adjusted change.

When one compares the production for the first four months of the year with the same period of 2001, output declined by 0.1%, as against a drop of 2.1% up to the end of the first quarter. This result was a consequence of growth of 9.7% in mining and a reduction of 1.3% under manufacturing. A closer analysis of the rate for general industry indicates that electric and communications equipment, metallurgy and transportation equipment were the sectors that generated the strongest negative impact, while mining had precisely the opposite effect.

Of the twenty segments covered by the IBGE survey, seven registered output growth when compared to the first four months of 2001, led by tobacco, 37.8%, pharmaceutical goods, 17.7%, mining, 9.7% and furniture, with 7.3%. Among the fourteen segments that turned in downward movement in 2002, the sharpest declines occurred under electrical and communications equipment, 11.7%, leather and hides, 8.8% and beverages, with 5.7%.

Going back to the analysis by use categories, the inclusion of the month of April transformed the results accumulated in the year under capital goods and consumer goods into a positive performance. Those consumer goods that are less dependent on credit conditions, namely semidurable and nondurable products (1.8%), achieved the best results. A further breakdown of this subcategory indicates growth of 11.6% under nondurable goods and a decline of 5.1% under semidurables, thus reinforcing the conclusion that it was the output of goods for which demand is not particularly sensitive to interest rates and credit conditions that undergirded industrial production in recent months. Production of

Industrial production by category of use

Percentage change

Itemization	2000 Dec	2001 Jan	Feb	Mar	Apr
In the month[1/]					
Industrial production	1.0	1.4	0.3	- 0.8	4.1
Capital goods	- 0.8	2.0	5.6	- 4.0	7.1
Intermediate goods	1.2	3.1	1.5	- 1.5	2.5
Consumer goods	0.9	0.5	- 1.9	- 1.1	7.0
Durable	5.9	- 3.4	1.1	1.0	7.0
Semi and nondurable	- 0.7	1.1	- 1.5	- 1.9	6.0
Quarter/previous quarter[1/]					
Industrial production	- 0.4	1.7	2.9	2.9	2.7
Capital goods	- 6.4	- 6.3	- 0.3	3.4	7.4
Intermediate goods	- 1.4	1.2	3.5	4.6	3.9
Consumer goods	3.0	4.7	3.2	0.9	0.5
Durable	11.4	13.6	10.5	2.9	3.9
Semi and nondurable	1.1	2.3	1.3	0.4	0.0
In the year					
Industrial production	1.5	- 1.2	- 1.3	- 2.1	- 0.1
Capital goods	12.7	- 3.9	0.3	- 1.8	0.3
Intermediate goods	- 0.2	- 1.9	- 1.6	- 2.2	- 0.4
Consumer goods	1.3	1.3	- 0.6	- 2.3	0.5
Durable	- 0.6	- 3.9	- 7.3	- 8.5	- 3.8
Semi and nondurable	1.8	2.7	1.3	- 0.4	1.8

Source: IBGE

1/ Seasonally adjusted data.

Vehicles - production and sales

Percentage change

Itemization	2001 Dec	2002 Jan	Feb	Mar	Apr	May*
In the month[1/]						
Production	1.7	1.9	- 5.5	1.0	1.0	- 7.4
Sales	- 3.5	- 6.2	0.1	- 2.1	1.2	- 7.9
Domestic sales	7.0	- 16.4	- 2.6	0.2	- 4.4	- 10.4
External sales	- 27.2	26.4	0.9	- 0.6	12.5	1.9
Quarter/previous quarter[1/]						
Production	2.0	11.2	7.3	3.4	- 2.8	- 3.9
Sales	12.4	14.5	3.8	- 4.9	- 6.3	- 6.0
Domestic sales	24.5	28.1	13.1	- 9.3	- 13.0	- 13.4
External sales	0.4	- 9.4	- 16.2	- 0.7	9.1	17.2
In the year						
Production	7.1	3.0	- 4.9	- 8.8	- 6.2	- 9.2
Sales	7.4	- 5.2	- 8.3	- 11.3	- 9.9	- 11.9
Domestic sales	8.6	- 4.6	- 9.1	- 12.1	- 11.2	- 14.2
External sales	3.3	- 8.5	- 4.3	- 7.6	- 4.2	- 2.5

Source: Anfavea

1/ Seasonally adjusted data.
* Preliminary.

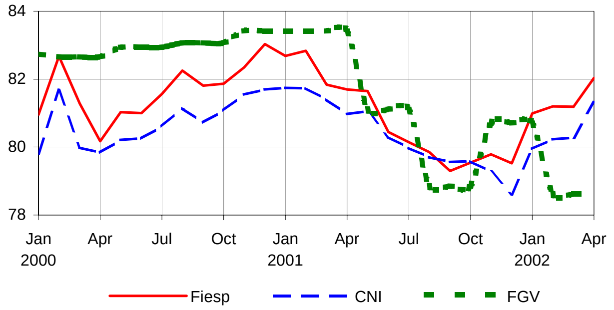
durable consumer goods slipped by an accumulated total of 3.8% in the year due partly to a rather high comparison base.

Utilizing data up to May, analysis of the output of the automotive industry indicates a decline of 9.2% compared to the same period of 2001, with total output of 739.2 thousand units. When one considers the series exempt from seasonal influences, the output reduction in the March-May quarter came to 3.9%, compared to the previous period. This behavior would suggest accentuated deceleration in the sector. As far as automotive sales are concerned, a comparison of quarterly averages indicates a drop of 13.4% in internal sales and a rise of 17.2% in foreign sales, reflecting a final drop of 6% in total units marketed.

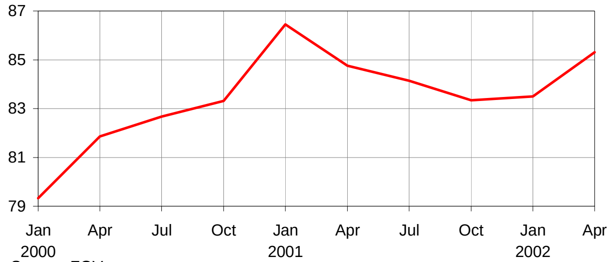
Calculated by the FGV, the average level of utilization of installed capacity in the manufacturing sector declined by 2.6% in the month of April in comparison to upward movement of 2.4% in January, based on data from which seasonal factors have been purged. Among the sectors that contributed to the increase in idle capacity, mention should be made of capital goods, -7.2%, intermediate goods, -2.2% and consumer goods, -0.9%. On the other hand, the falloff was somewhat attenuated by recovery in the building materials industry, which registered growth of 2.2% in the utilization of its production facilities.

Compared with April 2001 – therefore, before the onslaught of external crises and electricity rationing – there was a drop of 4.8 p.p. in the utilization level. To a great extent, this reflected decreased activity in the capital goods industry, -10.8 p.p. and intermediate consumer goods industry, -4.7 p.p. The only sector to register a

Utilization of installed capacity
Seasonally adjusted data
Average percentage

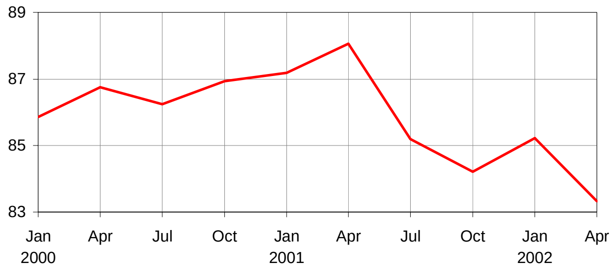


Utilization of installed capacity
Building materials
Seasonally adjusted data
Average percentage



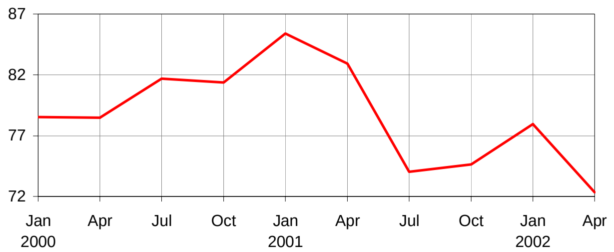
Source: FGV

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



Source: FGV

Utlization of installed capacity
Capital goods
Seasonally adjusted data
Average percentage



Source: FGV

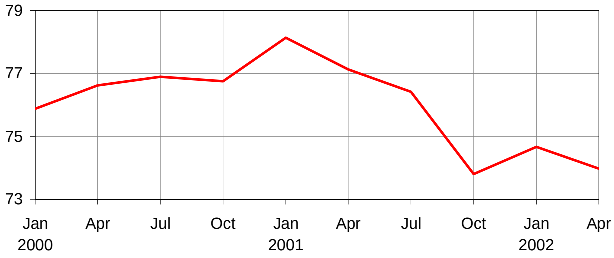
drop in idle capacity was that of building materials, 0.7%. An analysis of 21 industrial segments indicates that only seven were able to increase the level of utilization of industrial facilities and, in three of these – publishing and printing, textiles and paper and cardboard – there was a close causal relationship with the upcoming elections.

According to data gathered by the CNI in twelve states, the average level of utilization of installed manufacturing capacity increased by 1.3% in the first quarter of 2002, compared to the final quarter of the preceding year, while the April indicator rose by 1.3%, when one utilizes data purged of seasonal influences. However, even with this growth, an analysis of the results for the first four months of 2002 compared to the analogous period of the preceding year indicates a drop of 1.3%. In São Paulo industry, statistics released by the Federation of Industries of the State of São Paulo (Fiesp) revealed a decline of 1.1% in the utilization of installed capacity, using the same basis of comparison. In much the same way, using the statistical series free of seasonal impacts, the first quarter of 2002 registered a 1.9% higher level than in the final quarter of 2001. On a monthly basis, the month of April was the fourth to register positive results, with growth of 1%. Here, one should note that the period between March and February was marked by stability.

The indices that measure growth in the confidence levels of the business community in general revealed either a situation of stability or a slight decline in evaluations and expectations, when compared with recent results.

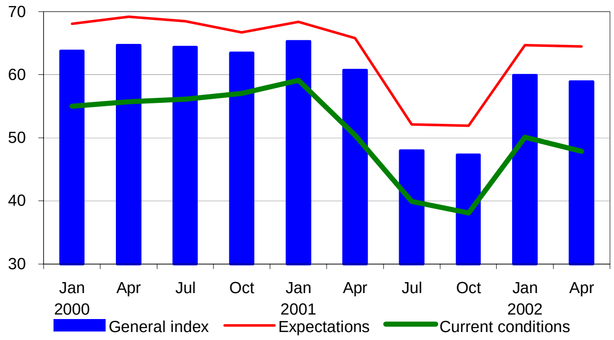
In this sense, the FGV's Manufacturing Industry Survey for April 2002 identified a still weak level

Utilization of installed capacity
Consumer goods
Seasonally adjusted data
Average percentage



Source: FGV

Industrial Business Confidence Index



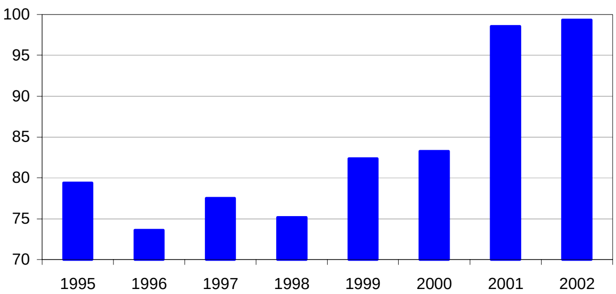
Source: CNI

of demand and higher than desired stocks. More evident signs of recovery were registered among intermediate and durable goods. Despite the decreased dynamism of manufacturing activity, forecasts for the April-June quarter remain positive, though companies are determined to reduce their stock levels. Among other factors, expectations are positive with respect to increased purchases of raw materials and components and in relation to employment.

The Industrial Confidence Index, which is calculated quarterly by the CNI on the basis of data provided by industrial federations from nineteen different states, signaled a leveling off of business expectations in April. One should note that expectations had risen sharply in January 2002, compared to October 2001. The drop of 1 p.p. to 58.9 in April was mostly a result of lesser confidence among small and medium businesses. It is also important to note that the index that evaluates current conditions slipped from 50.1 to 47.9, while that related to expectations fell by only 0.2 p.p. On the other hand, expectations with regard to the trajectory of the Brazilian economy declined. Despite these drops, the overall indicator maintained a level above the fifty market, a level that is interpreted to reveal continued businessperson confidence in the economy.

1.3.2 – Crop/livestock output

Grain production[1/]
In million of tons



Source: IBGE
1/ In 2002, estimate.

Crops

Total output of grains, legumes and oil-bearing crops could reach as high as 99.3 million tons or 0.8% more than the 2001 harvest, according to IBGE's April Systematic Farm Production Survey (LSPA).

Crops in 2002

Percentage change

Itemization	Production	Area	Average production
Grain production	0.8	7.9	-6.6
Cotton (seed)	-13.1	-10.8	-2.6
Rice (in husk)	2.5	1.4	1.1
Beans	29.8	20.5	7.8
Corn	-12.0	-2.1	-10.1
Soybean	11.3	17.2	-5.1
Wheat	18.8	8.3	9.7
Others	8.7	-1.8	10.7
Other products			
Potatoes	-2.3	-1.4	-2.3
Coffee fruit	10.2	0.4	9.8
Oranges	10.1	-0.4	10.6
Sugar cane	4.2	1.6	2.6
Manioc roots	1.8	-0.7	2.5

Source: IBGE

Grain production

In thousands of tons

Itemization	Production		Percentage
	2001	2002[1/]	change
Grain production	98 543	99 337	0.8
Cotton (seed)	1 718	1 493	-13.1
Rice (in husk)	10 195	10 453	2.5
Beans	2 436	3 163	29.8
Corn	41 439	36 462	-12.0
Soybean	37 683	41 923	11.3
Wheat	3 261	3 873	18.8
Others	1 812	1 970	8.7

Source: IBGE

1/ Estimate.

For the most part, the expected harvest increase was due to increases in expectations regarding rice, beans and soybeans. As far as beans are concerned, the positive result was achieved in the first and second harvests, as evident in the fact that the third harvest failed. However, the final harvest still managed to produce approximately 10% of the total. The good performance registered under this product, which is one of the stables in the basic food supply, was reflected in a price decline of 23.6% up to May, according to the Broad National Consumer Price Index (IPCA). In 2001, bean prices had expanded by 174%. In the case of soybeans, output is expected to expand by 11.3%.

Compared to the preceding year, rice production should expand by 2.5% while the area under cultivation is expected to increase by 1.4%. The basic reason for this performance is that prices had moved upward by 43.8% in 2001, measured by the IPCA. The LSPA for the month of October forecast a smaller harvest in 2002 when compared to the March survey, a result that is explained by heavy rains in Rio Grande do Sul and reductions in the area of non-irrigated rice cultivation in the State of Mato Gross do Sul, where prolonged drought sharply diminished the harvest result. Up to the month of May, the prices of this product had dropped by 10.8%.

The corn harvest will fall by 12% as a result of the 15.7% loss registered in the first harvest of the year, while the second harvest is expected to achieve growth of 8.6%.

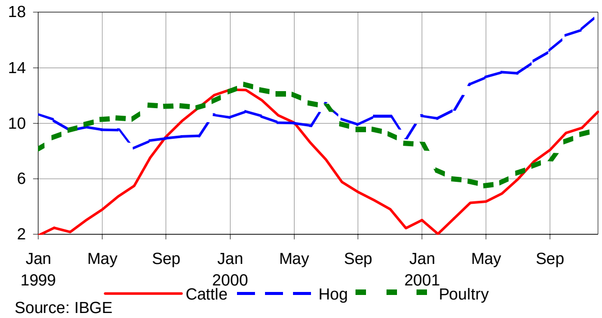
The herbaceous cotton crop is expected to suffer a sharp reduction in both area and output, mostly as a consequence of lesser production in Mato Grosso, the nation's major producer.

Among the other crops, accentuated increases were registered under coffee beans and oranges, followed by sugar cane, all of which have an impact on the nation's export performance, either directly or in the form of derivatives, such as orange juice.

Livestock

The performance of the livestock sector was evaluated on the basis of indirect indicators, since data for 2002 are not yet available. In this sense, one of the variables used was the evolution of the sector's foreign sales which registered expansion of 25.4% up to the month of April, thus maintaining the trend that has marked the past four years.

Livestock production
Total weight
Percentage change in 12 months



Source: IBGE

Itemization of foreign sales according to major product groupings indicates that the strongest growth occurred under exports of pork (64.6%), followed by beef (45.1%) and chicken (13.4%).

An analysis of industrial output, as calculated by IBGE, allows one to monitor the performance of sectors related to livestock activities. In this sense, the production of animal feed increased by 110.4% in the first four months of the year. Other positive results were achieved under industries operating in animal slaughter (excluding poultry) and preparation of meat products, with growth of 9.9% in the first four months of the year, slaughter and preparation of poultry, with 12.7%. On the other hand, activities related to the refrigeration and preparation of milk and dairy products turned in a reduction of 3.9%.

1.3.3 – Labor market

Employment

The labor market has been characterized by increased generation of formal employment opportunities, according to figures released by

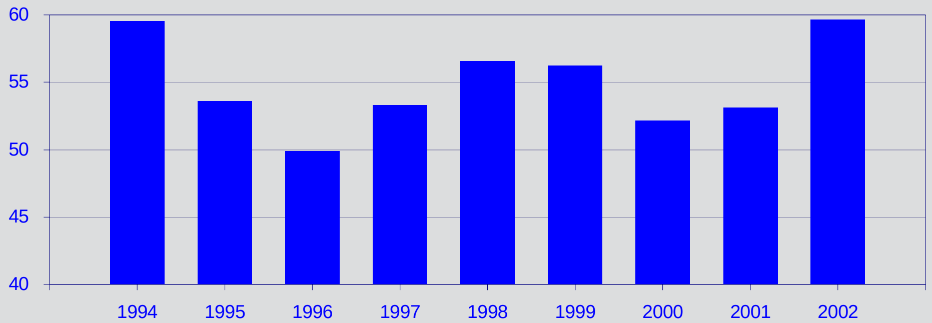
Farm income

Farm income, particularly that generated by the crop sector, is considered one of the major factors responsible for increased spending in the current year, especially on consumer goods, and for the steady flow of investment outlays in the sector. At the same time, it is a factor that aides in explaining the differences between the results produced by retail trade sector surveys in metropolitan regions (Fecomercio and the Trade Federation of the State of Minas Gerais - FECMG) and by the IBGE national survey, which indicates a lesser reduction in comparison to the same period of the previous year.

A study carried out by the Board of Sectoral Studies of the Institute of Applied Economic Research (Ipea/Diset) indicates that 2002 real farm income will register the sharpest growth of recent years, with a final figure in the range of 14%, as shown in the following graph. A similar result was achieved in 1994.

Agricultural sector - real farm income

In R$ billion



Source: Ipea

Ipea's calculation considers the harvest on a product-by-product basis, multiplied by the respective median annual prices[1] in each year. For 2002, the harvest estimate elaborated by the IBGE's Systematic Farm Production Survey (LSPA) was used. The amounts were updated by the General Price Index - Internal Supply (IGP-DI).

Some specific aspects deserve highlighting in the analysis by major farm items. In the first place, one should note that approximately 55% of the growth in farm income this year has been generated by the soybean and orange crops, both of which are traditional export products. Thus, aside from output growth, income increases also reflect higher prices generated to

1/ For 2002, the average annual price up to the month for which data are available (April) was used.

some extent by exchange depreciation in 2001. Part of the increase in the income of sugar cane farmers is also attributed to this effect.

Agricultural sector - real farm income

Percentage change in 2002

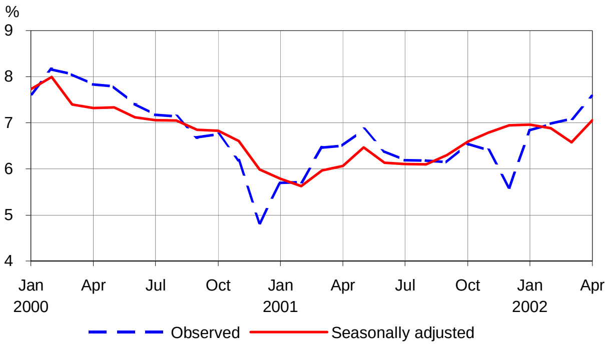
Itemization	Farm income - in R$ million		Income	Production	Price
	2001	2002			
Soybeans	13 504.15	15 901.15	17.8	11.3	5.8
Sugar cane	8 835.55	9 842.98	11.4	4.2	6.9
Corn	6 813.61	7 343.30	7.8	- 12.0	22.5
Oranges	4 367.15	6 005.30	37.5	10.1	24.9
Rice (in husk)	3 034.67	3 789.38	24.9	2.5	21.8
Beans	2 346.06	3 270.29	39.4	29.8	7.4
Banana	2 734.92	2 786.51	1.9	6.0	- 3.9
Coffee (beans)	1 756.56	1 674.52	- 4.7	10.2	- 13.5

Source: Ipea

Another point that deserves mention is that, among the various crops, only corn turned in a smaller harvest, to some extent as a result of low prices in the previous year. Thus, growth in farm income is not only a result of the change in relative prices, which would tend to increase the spending of one sector in detriment to another. It is, therefore, an increase that reflect real growth in farm output that, aside from the grain harvest, which is expected to expand by an estimated 1% in 2002, also encompasses other crops that turned in highly significant results in the year, such as sugar cane, with growth of 4.2%, coffee, with 10.2%, oranges, 10.1%, and bananas, with 6%.

the Ministry of Labor and Employment (MTE). With respect to unemployment, calculated on the basis of the IBGE household survey in six metropolitan regions, the rate increased in the quarter parallel to the process of job creation. In terms of employment in the manufacturing sector, CNI and Fiesp surveys turned in contradictory results, basically explained by the difference in the scope of the two studies.

Unemployment rate



Source: IBGE

In the first four months of 2002, the rate of open unemployment revealed by the IBGE's Monthly Employment Survey on the basis of information gathered in six metropolitan regions remained above the figures for the same months of 2001. The median for the first four months came to 7.1% or 1 p.p. above the figure for the same period of the preceding year. In April, the percentage came to 7.6%, compared to 7.1% in March and 6.5% in the corresponding month of 2001.

Occupied people by activity and by categories of employment

% accumulated growth in year

Itemization	2001	2002			
		Jan	Feb	Mar	Apr
Total of occupied people	0.7	1.2	1.8	2.1	2.3
By activity					
Manufacturing industry	0.6	-0.7	-0.6	-0.2	0.2
Building	-2.8	-8.5	-7.9	-6.3	-6.3
Commerce	-0.7	2.5	3.5	3.5	3.0
Services	1.5	2.5	2.8	3.0	3.3
By categories of employment					
Registered	3.8	2.0	2.0	2.2	2.3
Nonregistered	-1.2	4.6	4.8	5.0	5.1
Self-employed	-0.7	-3.1	-1.6	-0.9	-0.8
Employer	-7.1	-1.5	-0.3	1.2	1.5

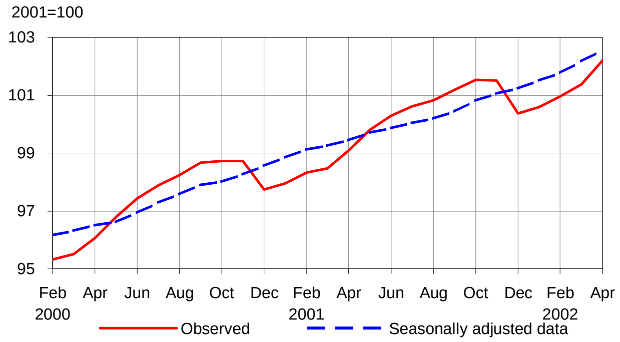
Source: IBGE

The increase in the overall labor force was proportionately greater than growth in the number of new vacancies and explains the rise in unemployment. While the labor force moved from 18.3 million persons in April 2001 to 19 million in the same month of 2002, for an increase of 4% in twelve months, the number of persons employed expanded by 2.7% in the period.

A breakdown by labor categories based on a comparison of the first four months of 2002 with the preceding year demonstrates that the sharpest rise in employment occurred in the number of unregistered workers (5.1%), compared to 2.3% for registered workers and 1.5% for employers. Total self-employed workers dropped by 0.8% in the period.

Viewed on a sector-by-sector basis, the construction industry registered successive declines in employment rolls in a month to month comparison with 2001, closing with an accumulated 6.3% drop in the four month period. In the other sectors of activity, the number of labor positions surpassed the figure for the same months of 2001, with growth of 3.3% in services, 3% in commerce and 0.2% in the manufacturing sector.

Formal employment



Source: Ministry of Labor and Employment

With regard to formal employment, MTE data based on the General Reference File of the Employed and Unemployed (Caged) point to a positive balance of 175.1 thousand job positions in April, the best monthly result since the series was first released in 1985. In accumulated terms for the year, the creation of formal employment opportunities in the country totaled 391.6

thousand positions, compared to 303.5 thousand in 2001. Of this total, 145 thousand occurred in the service sector, thus maintaining the trend that had marked the previous year, while 92.2 thousand were concentrated in the manufacturing industry and 42.6 thousand in the trade sector. The building industry was the only sector to decline in terms of the number of vacancies created in the period, dropping from 25 thousand to 18 thousand.

Formal employment

Number of job positions (1,000 employees)

Itemization	2001	2002				
		Jan	Feb	Mar	Apr	In the year
Total	591.1	44.2	82.0	90.3	175.1	391.6
Manufacturing industry	103.8	15.0	9.0	23.6	44.6	92.2
Commerce	209.8	2.3	11.0	10.9	18.4	42.6
Services	311.0	18.2	38.0	37.2	51.6	145.0
Building	-33.4	2.0	2.1	3.5	10.5	18.1
Public utilities	1.5	0.8	0.6	1.1	-0.3	2.3
Others[1/]	-1.6	6.0	21.3	13.9	150.2	191.4

Source: Ministry of Labor and Employment

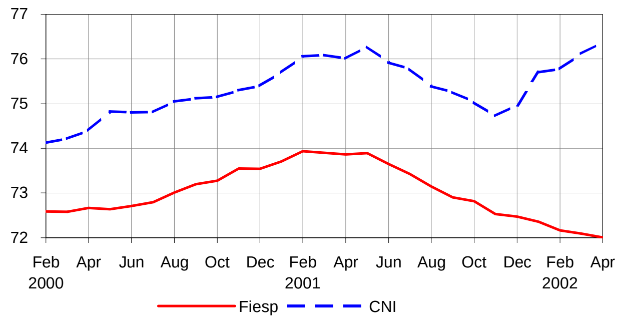
1/ Includes mineral extraction, public administration, crop and livestock and others.

Viewed under the prism of the statistical series purged of seasonal factors, formal employment has registered positive rates since October 1999. In this sense, the comparison of the averages for the first quarter of 2002 and the previous quarter reveals expansion of 0.8%. On a sector-by-sector basis, the most accentuated growth – using the same reference base – was concentrated under manufacturing (0.9%), thus ratifying the trajectory revealed by CNI indicators, while commerce and services closed with respective levels of 1.5% and 1%.

Industrial employment

Seasonally adjusted data

1992=100



In the first four months of the year, the level of employment in the manufacturing sector closed below the 2001 figure, closing with an accumulated decline of 1% according to a twelve state CNI survey, from which seasonal factors have been eliminated. The monthly Fiesp research data showed the sharpest decline in the period (2.3%). A comparison of the first quarter of 2002 with the final quarter of 2001, however, shows that Fiesp data pointed in the direction of deceleration, with a drop of 0.6%, while the CNI statistics registered recovery, with expansion of 1.3%. At the national level, this growth is ratified by the fact that monthly comparisons pointed to five consecutive months of favorable results. In the context of the São Paulo manufacturing industry, the employment level declined over a period of nine months. In April, industrial employment improved in the country as a whole but dropped in São Paulo, which could be an indication of a process of deconcentration of the output process and

Formal employment

The Ministry of Labor and Employment (MTE) issues monthly data on growth in formal employment, with sectoral and regional breakdowns. In principle, the monitoring of these figures makes it possible to identify economic activity trends, such as movements from one region to another.

In order to evaluate the significance of MTE data, it is estimated that the number of formal job positions in the economy came to 23,962,700 in April, the month in which the work force in the six metropolitan regions covered by the IBGE household survey came to 19,015,800 and those effectively working totaled 17,564,100. It should also be noted that, according to the 2000 IBGE census, the total number of occupied persons came to 76,158,500. In December of that year, there were 22,979,900 persons occupied on the basis of work contracts. Consequently, this type of employment bond represented about 30% of those occupied in the country.

Table 1 shows that, following the declines registered in the period from 1997 to 1999, the balances of formal employment positions turned positive. On a regional basis, the process of job creation in the first quarter of 2002 was a generalized phenomenon, with the sole exception of the northeast of the country. It should also be noted that 54.74% of the jobs generated in 2000 were concentrated in the southeast region. This figure dropped to 50% in 2001 before moving up again in the first four months of 2002, when the level came to a full 61%.

Table 1 - Growth of formal employment - by regions

In 1,000

Itemization	1997	1998	1999	2000	2001	2002 1/
Brazil	-35.7	-581.8	-196.0	657.6	591.1	391.6
Regions						
North	-6.1	-10.2	-3.6	35.5	22.2	9.5
Center-west	16.1	-13.9	-11.0	47.8	56.9	57.1
Northeast	-1.3	-35.2	-20.7	102.5	60.5	-13.3
South	-0.6	-83.7	-3.9	111.7	156.0	96.6
Southeast	-43.8	-438.8	-156.9	359.9	295.6	241.7

Source: Ministry of Labor and Employment

1/ Up to April.

The data in Table 2 indicate that the service sector was responsible for the major share of the jobs generated in the period under consideration. The only year that services registered negative growth was in 1998, a performance that was matched – albeit with lesser intensity – by the trade sector. It should be stressed that, in the first four months of the year, employment in the crop/livestock sector and building industry turned in strong growth. In the first third of 2002, 37% of new job positions were concentrated under services, followed by manufacturing, with 23.5%, and crop/livestock farming, with 17.5%.

Table 2 - Growth of formal employment - by segment

In 1,000

Itemization	1997	1998	1999	2000	2001	2002[1/]
Total	-35.7	-581.8	-196.0	657.6	591.1	391.6
Manufacturing industry	-133.1	-300.7	14.9	192.9	103.8	92.2
Commerce	65.6	-57.9	14.6	175.5	209.8	42.6
Services	61.1	-76.7	14.9	283.9	311.0	145.0
Crop and livestock	-3.8	-52.0	-119.6	9.8	-17.1	68.4
Construction	13.5	-63.5	-113.1	-1.6	-33.4	18.1

Source: Ministry of Labor and Employment

1/ Up to April.

A statistical breakdown of employment by sectors and regions indicates that, in 2002, the southeast region accounted for 37% of the jobs generated in the service sector, 47% of those created in the trade sector and 58% of those in manufacturing.

Comparison of the jobs generated in the January-April 2002 period with those created in the same period of the previous year indicates that growth in the central-west region was higher than for the rest of the country. A breakdown of the data for the major metropolitan regions shows that most new job opportunities have not been created in the major urban centers, since only Fortaleza and Salvador were able to register an increase in new registered jobholders in relation to the first quarter of 2001. This performance would seem to suggest that economic activity has apparently intensified less in the major urban areas.

Growth in formal employment in recent years indicates that the largest number of new jobs has been concentrated in the service sector. Taken together, the service and trade sectors were responsible for 69.9% and 88.1% of the jobs generated in 2000 and 2001, respectively. In the first four months of 2002, however, this participation dropped to 47.9%, which is explained by a significantly less intense pace of activity in the trade sector.

Table 3 - Formal employment - job positions

In 1,000

Itemization	Jan-Apr 2002	Jan-Apr 2001	% change
Total	391.6	303.5	29.0
Regions			
North	9.5	9.2	2.9
Center-west	57.1	41.7	36.8
Northeast	-13.3	-33.0	...
South	96.6	91.0	6.1
Southeast	241.7	194.6	24.2
Metropolitan regions	74.4	122.2	-39.1
Belém	0.4	2.8	-87.5
Fortaleza	2.2	0.9	149.7
Recife	-3.6	-2.9	...
Salvador	5.3	3.6	45.2
Belo Horizonte	9.9	10.4	-5.1
Rio de Janeiro	8.1	15.3	-47.3
São Paulo	42.3	70.3	-39.8
Curitiba	3.9	10.0	-61.4
Porto Alegre	6.0	11.7	-49.3

Source: Ministry of Labor and Employment

the outsourcing of many activities. Indeed, when considering growth in industrial employment in the January-April period this year, as compared to the same period of 2001, one notices that while São Paulo state registered a 2.2% drop, other important industrial areas turned in increases during the same period: Rio Grande do Sul 8.8%, Paraná 6.2%, Bahia 2.2%, Santa Catarina 0.73% and Minas Gerais 0.74%.

Overall real wages and average real earnings

% accumulated growth in year

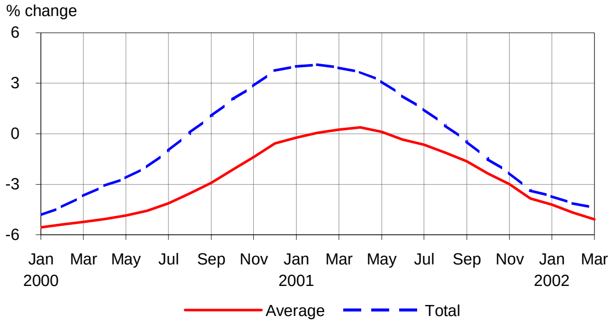
Itemization	2001	2002 Jan	Feb	Mar
Overall real wages	-3.4	-3.1	-3.3	-3.1
Average real earnings	-3.8	-5.3	-5.8	-5.6
By activity				
Manufacturing industry	-5.1	-4.5	-3.5	-4.1
Building	-5.2	-13.0	-12.5	-12.0
Commerce	-5.7	-8.5	-7.1	-8.5
Services	-3.4	-5.4	-6.9	-6.2
By categories of employment				
Registered	-4.8	-7.1	-6.8	-6.0
Nonregistered	-2.1	-2.2	-1.6	-1.2
Self-employed	-1.4	-6.7	-8.7	-8.7
Employer	-2.6	-2.0	-6.1	-8.6

Source: IBGE

Earnings

The growth in real average earnings in the first quarter of 2002 was better than in most of the months of the preceding year, though still insufficient to recoup accumulated losses. However, more positive results were perceived by surveys that monitor the performance of labor market indicators in the manufacturing industry.

Real earnings - average and total
12 month moving average



Source: IBGE

Real wages in the manufacturing industry

% accumulated growth in year

Itemization	2001	2002			
		Jan	Feb	Mar	Apr
CNI					
Overall real wages	3.2	-0.6	-0.6	-0.4	-0.4
Fiesp					
Overall real wages	6.4	2.4	2.2	2.6	2.7
Average real wages	6.1	4.7	4.9	5.4	5.6

Source: CNI and Fiesp

According to the IBGE survey, the trajectory of the real average earnings of persons employed has not been positive, as the monthly results have steadily declined. It is important to note that, in the first three months of 2002, positive results were registered in January and March, with 2% and 0.5%, respectively, with a decline of 0.3% in February, based on statistics from which seasonal influences have been removed. Despite these results, real earnings declined by 5.6% in the first quarter of the year, when compared to the same period of 2001. The sharpest losses occurred in the building industry (12%), followed by commerce (8.5%), services (6.2%) and manufacturing (4.1%). Among the employment categories, losses were generalized and were led by the self-employed and employers, with 8.7% and 8.6%, respectively, followed by registered workers, with 6%, and unregistered workers, with 1.2%.

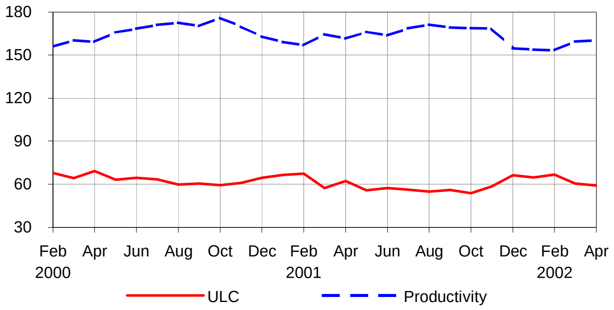
A comparison between the average earnings of the first quarter of 2002 and the previous period in relation to the averages registered in the immediately previous quarters, results in respective rates of 0.8% and -3.6%, thus suggesting a process of recovery.

Real wages in the São Paulo manufacturing sector increased by 0.9% in April, thus maintaining the process of steadily positive monthly results that began in October 2001. These figures are based on statistical data from which the influence of seasonal factors has been eliminated. This process produced a 5.6% rise in the real gains of persons employed in São Paulo industry, compared to the same period of 2001. One should note here that the deflation factor utilized is the Consumer Price Index issued by the Institute of Economic Research Foundation (IPC-Fipe), which has registered lesser levels of growth than the INPC, the index used by the CNI. Overall real wages, which also turned in gains in the same period, registered less significant increases in the four month period, with 2.7%.

The survey carried out by the CNI in twelve states indicated positive monthly growth in real overall wages over the course of the first four months, based on the seasonally adjusted series. Despite this, the four month period was marked by a drop of 0.4%, compared to the same period of 2001.

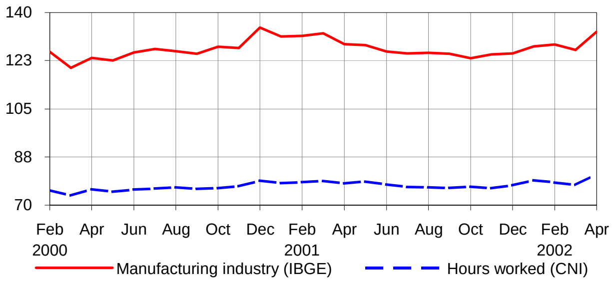
Productivity and Unit Cost of Labor (UCL) in the manufacturing industry

ULC and productivity
1992=100



Source: IBGE, CNI and Banco Central do Brasil

Manufacturing industry and number of hours worked in production
Seasonally adjusted data
1992=100



In the manufacturing sector, productivity is defined as the ratio between the sector's physical output index calculated by the IBGE's Monthly Industrial Survey – Physical Output and the index of hours worked in production announced by the CNI. In the first quarter of the year, the result closed with a reduction of 2.8% compared to the same period in 2001, reflecting a drop in hours worked that was less than the output decline.

In relation to the previous quarter, the result corresponded to improvement of 1% in the indicator which had declined by 0.8% in the final quarter of 2001, using the same basis of comparison with data free of seasonal influences.

With incorporation of the April result – productivity growth of 1% in the month for the third positive result in the year – the reduction in the annual indicator came to 2.3%, in comparison to the first four months of 2001.

On a region-by-region basis, the industrial sector of the State of Rio de Janeiro registered the sharpest productivity rise, with 10.3% in the first quarter of 2002, compared to the same period of 2001. Note should also be taken of the performances registered by Santa Catarina (3%) and Espírito Santo (2.8%). Moving in the opposite direction, the indicator dropped by 18.6% in Ceará, 14.2% in Paraná and 11.3% in Pernambuco.

The UCL for the manufacturing sector – defined as the ratio between overall wages paid by the industries encompassed by the CNI and the output of the sector as announced by IBGE – turned in results that were below those of recent months. Thus, in the first quarter of the year, the real UCL increase came to 2.9% with 3.5% growth in the nominal UCL, compared to the corresponding quarter of 2001. This result indicates greater participation of the labor cost factor in overall output. It is also important to note that the nominal UCL calculation considers the nominal output of industry, valued by the Wholesale Price Index - Overall Supply - Internal Supply (IPA-OG-DI) and overall nominal wages as announced by CNI.

When one considers data purged of seasonal factors, the UCL declined in January in both concepts, followed by growth in the two subsequent months. Aside from this, a comparison of the average position in the first quarter of 2002 with that of the final quarter of 2001, showed growth of 0.9% in the nominal UCL and a drop of 1.3% in the real indicator. One should further observe that, using the same basis of reference, the final quarter of 2001 registered respective decreases of 0.1% and 0.5%.

In April, the UCL turned positive once again. Both the nominal and real UCL registered declines of 3.5% in the series purged of seasonal factors. In comparison to the first four months of 2001, the results corresponded to respective increases of 1.3% and 0.9%.

In recent months, the productivity and UCL trajectories suggest positive growth, compared to the monthly figures registered during most of 2001. However, such indicators also show a downturn as compared to 2001.

1.3.4 – Gross Domestic Product

Gross Domestic Product

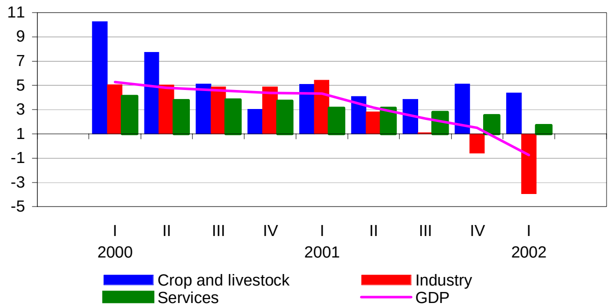
Quarter/previous quarter seasonally adjusted

Itemization	2001				2002
	I	II	III	IV	I
GDP at maket prices	1.2	-1.4	-0.4	0.1	1.3
Crop and livestock	7.1	-0.7	-0.6	2.8	1.9
Industry	-3.0	-2.1	1.4	-1.6	-1.5
Services	0.6	0.4	0.3	0.5	1.0

Source: IBGE

At market prices, GDP expanded by 1.34% in the first quarter of 2002, compared to the final quarter of 2001. The data used in these calculations have been purged of seasonal influences. Following declines in the second and

Gross Domestic Product
% growth accumulated in the year



Source: IBGE

Gross Domestic Product

Itemization	2001				2002
	I	II	III	IV	I
Accumulated in the year	4.3	3.2	2.3	1.5	-0.7
Accumulated in four quarters	4.1	3.6	2.6	1.5	0.3
Quarter/same quarter of the previous year	4.3	2.1	0.5	-0.7	-0.7
Quarter/previous quarter seasonally adjusted	1.2	-1.4	-0.4	0.1	1.3

Percentage change

Source: IBGE

Gross Domestic Product

Percentage change in the year

Itemization	2000	2001	2002 1/
Crop and livestock	3.0	5.1	3.3
Industry	4.9	-0.6	1.8
Mineral extraction	11.1	3.4	11.2
Manufacturing	5.4	0.6	1.3
Construction	3.0	-2.6	-0.8
Public utilities	4.1	-5.5	4.2
Services	3.7	2.5	2.2
Commerce	4.7	0.7	0.9
Transportation	5.6	1.0	1.8
Communications	16.5	11.9	6.9
Financial institutions	3.5	1.1	2.2
Other services	4.4	3.2	2.4
Rents	2.5	2.1	1.9
Public administration	1.1	1.8	1.7
Financial dummy	4.4	1.5	2.1
Value added at basic prices	4.0	1.6	2.2
Taxes on products	7.1	0.8	0.5
GDP at market prices	4.4	1.5	2.0

Source: IBGE

1/ Banco Central do Brasil estimates.

third quarters of 2001 and relative stability in the final quarter, this result confirms the recent and still gradual process of recovery.

In sectoral terms, this performance reflected the favorable results turned in by the sectors of crop/livestock farming (1.85%) and services (0.98%) and the reduction in the industrial sector (1.49%) in the period.

Viewed against the first quarter of 2001, GDP declined by 0.73%, a result that, to some extent, can be explained by the rather high basis of comparison. Using the same frame of reference, increases were identified under crop/livestock farming and services, with downward movement under industry. It should be stressed that the accentuated declines in the product of public utility industrial services basically reflects lesser energy consumption, while the drop in the product of the building industry was a consequence of the rather high reference based used in the comparison. Despite a less accentuated drop, growth in manufacturing had a determining impact on the GDP result, particularly in light of its relative participation in the sector and its influence in such subsectors as transportation and commerce.

With the result of the first quarter of 2002, growth accumulated in the four quarters moved from 1.5% in December to 0.3%, with deceleration under services and crop/livestock farming and a more intense drop under industry, with the sole exception of the subsector of mining.

For 2002, expectations are that GDP will expand by 2%. On a sector-by-sector basis, expected growth of 3.3% in the crop/livestock sector is based on continuity of the growth registered under livestock output, a process that has been facilitated by increased exports, coupled with estimated positive growth in crop output. Thus, aside from the increase in the grain harvest, growth is also forecast for the sugar cane, orange and coffee harvests, among others.

In the industrial sector, growth is forecast at 1.8% based on expected recovery in the subsectors of manufacturing, construction and public utility industrial services (SIUP). The end of the restrictions imposed on the electricity supply had a direct impact on public utility industrial services, at the same time in which it sharply improved the outlook for manufacturing. Given the importance of this subsector in the composition of GDP, the forecast positive rate will have impacts on such areas as commerce and transportation.

Aside from the influence of the impacts of the crop/livestock and industrial sectors on transportation and commerce, expected growth of 2.2% for services reflects the performance of the subsector of communications and financial institutions. As regards such sectors as government and real estate rentals, which accounted for about 23% of GDP, the quarterly performance figures registered in recent years were used since the rates under these headings have been quite stable. In the case of activities classified as “other services”, the positive perspectives related to growth in formal employment levels were included.

1.4 – Investment and output capacity

Despite the good performance registered by capital goods output in 2001, the participation of gross capital formation in GDP declined from 21.7% in 2000 to 21%, as a result of the unfavorable performance turned in by the construction industry. One should note that this sector accounts for approximately 60% of outlays on investments.

At the start of 2002, growth in the major investment indicators, measured by the comparison between the averages for the first quarter of 2002 and those of the final quarter of the preceding year, showed clear signs of improvement once the data had been purged of seasonal

Investment indicators

% accumulated growth in year

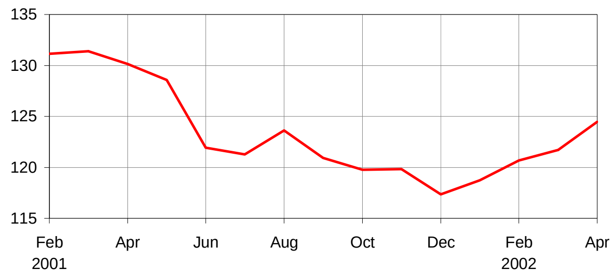
Itemization	2001				2002	
	I	II	III	IV	I	Apr
Capital goods						
Production	20.8	19.0	16.5	12.7	-1.9	0.3
Imports	43.7	34.3	22.5	16.1	-20.1	-18.0
Exports	-3.8	-8.2	-12.1	-13.7	-10.4	-12.5
Inputs for the building industry	4.1	2.2	-0.5	-2.4	-8.8	-7.3
BNDES financing	54.7	57.3	38.7	9.4	17.8	17.0

Source: IBGE, Funcex and BNDES

Production of construction inputs

Seasonally adjusted data

1992=100



Source: IBGE

influences. In this sense, in relation to the building industry, growth in the production of inputs for the sector came to 1.2% while expansion of capital goods output closed at 2.5%.

Upward movement in investments was confirmed by the results for April. Thus, output of inputs for the construction industry turned in the fourth consecutive positive result, with growth of 2.2% once seasonal factors had been removed from the data. Insofar as capital goods output is concerned, growth came to 7.1% for the third positive result in the year, following a 2.2% decline in the month of March.

Despite the trend toward recovery in recent months, the absorption of capital goods dropped in the first four months of the year, compared to the same period of 2001. The conjugation of internal production growth of 0.3% with a more accentuated drop in imports of capital goods (18%) than in exports (12.5%) resulted in a falloff of 4.9% in absorption.

Investment as proportion of GDP

GDP share

Itemization		Gross fixed capital formation	Changes in inventories	Gross capital formation
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
	IV	19.4	1.5	21.0

Source: IBGE

In the four month period, the drop in the production of building inputs came to 7.3%, compared to the same period of 2001 which registered positive growth. Such indicators as the reduction in idle industrial capacity in the sector, as identified by the FGV survey, and two consecutive months of rising real sales of building materials, perceived by Fecomercio, signal some degree of very moderate recent sectoral recovery.

As far as capital goods output is concerned, once the April result is incorporated the overall growth performance turned positive in relation to the first four months of 2001. A breakdown of selected capital goods shows that the month was marked by generalized growth. Based on data from which seasonal influences have been eliminated, the segments that registered results above the sector's average were industrial equipment not produced in series, 14.7%, and mixed equipment, with 10.6%.

Production of capital goods

Percentage change

Itemization	2001	2002			
	Oct	Jan	Feb	Mar	Apr
In the month 1/					
Capital goods	-0.8	2.0	5.6	-4.0	7.1
Industrial	-4.8	12.6	1.5	-1.3	3.6
Serial	-5.4	15.4	1.3	-0.2	2.2
Nonserial	-4.5	7.1	-0.5	-6.1	14.7
Agricultural	-2.3	-7.6	-1.7	-1.2	6.1
Farm parts	-5.3	8.2	-5.7	-5.1	7.1
Building	-12.0	30.9	-8.4	5.8	0.4
Electric energy	-13.6	10.9	35.6	-23.9	5.2
Transportation	1.2	4.1	-0.2	0.0	2.0
Mixed	3.8	2.2	6.4	-3.9	10.6
Quarter/previous quarter 1/					
Capital goods	-6.4	-6.3	-0.3	3.4	7.4
Industrial	-12.4	-7.8	1.3	9.0	8.3
Serial	-15.3	-9.8	1.1	11.2	9.8
Nonserial	2.3	0.8	1.1	0.8	3.1
Agricultural	18.3	12.0	-2.9	-9.1	-6.5
Farm parts	-7.1	-5.9	-4.4	-2.1	-3.6
Building	-7.7	-11.1	-5.6	8.7	8.6
Electric energy	-19.5	-24.9	-9.4	7.5	17.9
Transportation	2.9	6.5	7.7	6.4	3.6
Mixed	-8.4	-2.6	6.2	8.3	10.1
In the year					
Capital goods	12.7	-3.9	0.3	-1.9	0.3
Industrial	4.1	6.0	4.5	1.6	2.3
Serial	3.5	4.9	3.0	0.3	0.6
Nonserial	6.6	10.0	10.6	7.2	9.8
Agricultural	20.0	12.4	12.4	9.9	12.5
Farm parts	3.4	13.9	4.6	-1.0	-0.5
Building	18.3	7.0	2.3	2.3	2.5
Electric energy	42.5	-4.3	14.7	8.7	8.3
Transportation	12.2	7.3	6.0	1.8	4.4
Mixed	2.8	-18.0	-13.7	-15.2	-11.7

Source: IBGE

1/ Seasonally adjusted data.

In accumulated terms for the year, one can assert that growth in the productive capacity of the economy was also a practically generalized phenomenon, particularly in the farm and electricity sectors. In the first case, this process had a positive impact on accentuated growth under farm income and, in the second, expectations of growth in electricity rates stimulated the pursuit of self-sufficiency. One should also note that the performance under farm machines was, to some extent, due to growth in foreign sales, which expanded by 17.7% up to May.

According to figures released by the Brazilian Association of Machines and Equipment – National Union of the Machine Industry (Abimaq-Sindimaq), the performance indicators of the mechanical capital goods sector were generally positive in the first quarter, when viewed against the same 2001 period. This is evident in 0.2% growth in the utilization of installed capacity and expansion in the average number of weeks required to meet already placed orders from 18.8 to 24.5. Deflated by the Wholesale Price Index - Overall Supply - Industrial Products (IPA-OG-PI), the revenues of the industrial machines and equipment sector turned in growth of 5.4% in the four month period.

Data released by the National Association of Automotive Vehicle Manufacturers (Anfavea) for the January to May period revealed growth in the production of farm machines and buses, compared to the corresponding period of the previous year. In relation to output of farm machines, all segments turned in significant growth, with 26.8% under harvesters, 15.4% under wheel-based tractors and 8.6%

Production of automotive vehicles

Percentage change

Itemization	2001	2002				
	Dez	Jan	Feb	Mar	Apr	May*
In the month1/						
Farm machines	2.0	-6.0	-2.9	-6.1	17.1	-11.8
Buses	-9.6	10.9	4.4	-12.7	-6.8	-13.3
Trucks	-0.3	1.3	7.1	-1.6	4.3	-12.5
Quarter/previous quarter1/						
Farm machines	17.4	8.1	-0.2	-8.9	-5.1	-3.8
Buses	28.8	24.1	13.9	6.5	-3.3	-15.3
Trucks	-3.9	-4.3	1.9	3.8	8.3	1.8
In the year						
Farm machines	24.9	21.5	15.6	11.1	18.2	16.1
Buses	1.1	37.2	37.1	24.6	19.7	12.6
Trucks	7.0	-14.0	-11.3	-15.1	-10.2	-13.7

Source: Anfavea

1/ Seasonally adjusted data.
* Preliminary.

under other items, which include motorized planters, caterpillar tractors and ditch diggers.

However, based on data free of seasonal influences, a comparison of the average for the March-May quarter with that of the immediately previous period indicates a drop in the output of automotive vehicles, particularly under the heading of buses. On the other hand, using this basis of reference, growth was registered in the production of trucks. In the comparison of the May results with those of April, however, all segments registered decreases.

One should further stress that, despite the trend toward recovery in investment outlays, overall participation of this heading in GDP may well be declining. In this sense, the drop of 0.73% registered by product in the first quarter of the year, compared to the same 2001 period, was less than the decline in the absorption of capital goods (4.9%), and production of building inputs (7.3%).

BNDES disbursement1/

Accumulated in the year (In R$ million)

Itemization	2001	2002			
		Jan	Feb	Mar	Apr
Total	25 217	1 801	4 362	6 273	7 718
Manufacturing industry	12 760	1 041	1 772	2 588	3 230
Commerce and services	9 298	491	2 067	2 804	3 349
Crop and livestock	2 762	249	502	826	1 076
Extraction industry	396	20	22	55	63

Source: IBGE

1/ Includes BNDES, Finame and BNDESpar.

In the first four months of the year, total disbursements by the BNDES System – National Bank of Economic and Social Development (BNDES), the Special Industrial Financing Agency (Finame) and BNDES Participações S.A. (BNDESpar) – expanded by 17% in comparison with the same period of 2001 and closed at R$7.7 billion.

A breakdown of the major sectors indicates that the sharpest growth was registered under funding operations in the mining industry (213.3%), followed by commerce and services (142.9%) and crop/livestock farming (54.6%). The only major sector to register a decline was manufacturing, in which resources totaled 28.3% less than those received by the sector in the first four months of 2001.

As far as the cost of financing with the BNDES System is concerned, the Long-Term Interest Rate (TJLP) registered a reduction of 0.5 p.p. in the second quarter, closing at 9.5% per year, for a return level that was about equal to that of the third quarter of 2001.

1.5 – Conclusion

Economic activity has been gradually expanding, albeit at a lesser pace than in the early months of the year. This scenario is confirmed by stability in the indices that measure consumer intentions and business confidence. The favorable performance of employment, to the extent that new jobs have been created, and growth in farm income still indicate some degree of sustained consumer demand. However, retail trade sector indicators have turned in downward movement when compared to the first half of 2001. This drop was particularly strong in the Metropolitan Region of São Paulo.

On the other hand, among the factors that have restricted demand, mention should be made of high levels of default and a falloff in most of the indicators that verify the buying power of wages and earnings. With these factors, there are no short-term signs of anything that could generate demand pressures, a fact that is further corroborated by inventory level indicators.

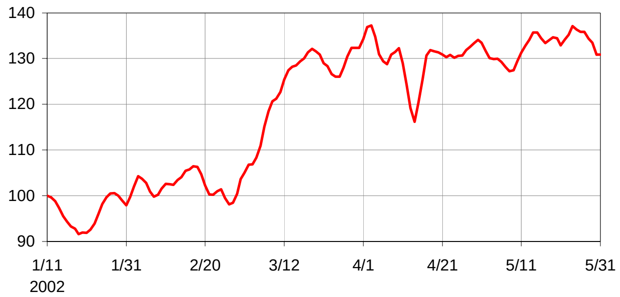
With regard to investments, there was some degree of recovery in comparison with the downturn in the final months of 2001. This was true under the input levels of both capital goods and building materials. In much the same way as consumer demand indicators, this recovery has moved at such a slow pace that there is no doubt with regard to the productive sector’s capacity to respond.

GDP results for the first quarter of the year were no surprise and are compatible with expectations of 2% growth up to the end of the year. Expansion in the manufacturing sector confirms this forecast, as the rates of recent months have signaled a trend toward leveling off at a point somewhat higher than in the final quarter of the year.

Also with regard to supply, grain production is expected to increase by 1% in 2002, following growth of 18% in the previous harvest. As regards the products that have the greatest impact on consumer price indices, such as rice and beans, larger harvests are predicted (2.5% and 29.8%, respectively) and this will certainly contribute to a price decline. However, the expected drop in the corn harvest has provoked a price increase that could impact prices in the livestock segment.

2 – Prices

Evolution of daily plotting of gasoline[1/]
Jan 2002=100



Source: Nymex/Reuters
1/ Unleaded, Spot.

The behavior of inflation indices in recent months has been impacted mostly by falling food prices and increases in government monitored prices. The first case is explained by the year's excellent farm harvest, favorable seasonal factors in the period and weather conditions that were highly propitious to production of important items classified under *in natura* foods. However, it should be stressed that the price reaction of several important products was only felt at the wholesale level at the end of May. With respect to government monitored prices, the performance of fuel prices basically mirrored growth in the international prices of petroleum and derivatives, both of which have registered sharp highs since February. Aside from this, electricity rates were readjusted in five state capitals over the last three months.

These conditioning factors are clearly classified as supply shocks – with opposite effects – that will tend to dissipate over the course of coming months. Once the impacts generated by these movements are eliminated, a breakdown of the different price indices makes it possible to identify isolated cases of recovery of margins, albeit at a rather unsteady pace. Recently, in several sectors of the economy, this movement has benefited from the proximity of the World Cup.

2.1 – General indices

Following relatively low rates in the first three months of the year, general price indices moved into an upward curve with 0.70% in April and

General indices

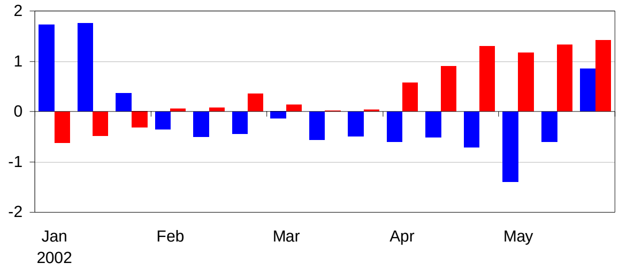
% monthly growth

Itemization	2002 Jan	Feb	Mar	Apr	May
IGP - DI	0.2	0.2	0.1	0.7	1.1
IPA	-0.1	0.1	-0.1	0.8	1.3
IPC	0.8	0.1	0.4	0.7	0.3
INCC	0.4	0.6	0.6	0.3	2.5

Source: FGV

Evolution of IPA (10, M and DI) - agriculture and industrial

Monthly % change



Source: FGV

1.11% in May. For the most part, the underlying reason for this shift is found under wholesale industrial prices which, in turn, were strongly pressured by a series of successive increases in fuel prices – gasoline, gas, fuel oil and diesel fuel. To some extent, these prices were offset in the case of wholesale price indices by the behavior of farm prices which, as already noted above, followed a downward trajectory in the period from February to May.

The recent change in the trajectory of farm prices was mostly due to higher prices for soybeans provoked by exchange rate movements. In the case of corn, prices had already been rising and continued in that direction as a result of supply restrictions. Finally, the prices of meats in general moved downward with considerable less intensity than previously. Furthermore, continued upward movement in the industrial Wholesale Price Index (IPA) is explained by growth in fuel prices, particularly diesel fuel. The impact of this price rise is expected to extend into the month of June. Aside from this factor, the effects of recent alterations in the rate of exchange are now being felt, particularly in the IPA, and this is expected to be even more evident in the June result.

2.2 – Consumer price indices

Broad National Consumer Price Index

The IPCA accumulated 1.62% growth in the March-May quarter. Basically, this performance was a result of growth in government monitored prices (3.49%) and food prices, which dropped by 0.59% in the quarter. Food prices moved down by 0.71% in April and 0.59% in May, mostly as a result of reductions in the prices of items of significant weight in what is termed the basic consumer basket of goods, such as rice, beans, meat and, more recently, *in natura* products. In the first five months of the year, the IPCA increased by 2.51%.

Consumer prices

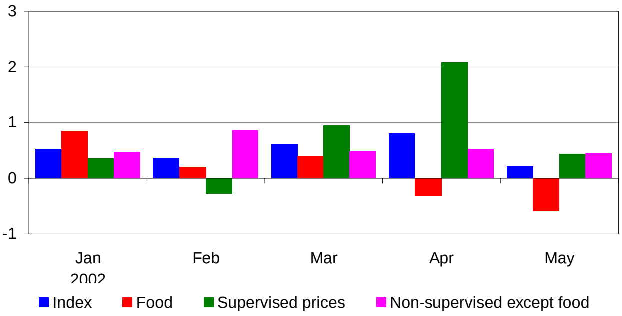
Percentage growth

Itemization	2002 Jan	Feb	Mar	Apr	May
Monthly					
IPCA	0.5	0.4	0.6	0.8	0.2
IPC-Fipe	0.6	0.3	0.1	0.1	0.1
IPC-Br	0.8	0.1	0.4	0.7	0.3
Accumulated in the year (annualized)					
IPCA	6.4	5.4	6.1	7.1	6.1
IPC-Fipe	7.1	5.1	3.7	2.9	2.5
IPC-Br	9.9	5.7	5.5	6.4	5.8
12 months					
IPCA	7.6	7.5	7.7	8.0	7.8
IPC-Fipe	7.3	7.5	7.0	6.4	6.3
IPC-Br	8.1	7.8	7.7	7.5	7.4

Source: IBGE, Fipe and FGV

Evolution of IPCA

Monthly % change



Source: IBGE

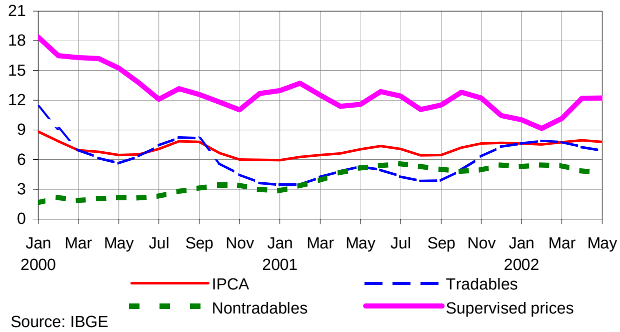
As far as government monitored prices are concerned, one should highlight increases under gasoline and bottled gas, with accumulated expansion at the consumer level of 13.8% and 4.45% since March, as well as electricity prices which rose by 5.13% in the period. The May result for this index points to lesser than expected increases in the prices of gasoline and a drop in the price of bottled gas. It is possible that the successive increases in fuel prices may well have had the impact of restricting the percentage of the increase at the refinery level that has been passed through to consumers, as consumption has declined and competition has sharpened.

Once food prices are eliminated, an analysis of free prices shows stable variation in recent months (0.48% in March, 0.52% in April and 0.46% in May). When the prices of only *in natura* food goods are excluded, these percentages moved downward (0.42% in March to 0.18% in May). The specific components responsible for this trend have changed in each of the months cited: education in February, medicines and perfumes in March, automotive vehicles and apparel in April. In May, the prices of electric-electronic goods led the way (particularly televisions, sound equipment and computer hardware, with growth of 1%) and repair and maintenance services (with growth of 0.94%).

In the month of June, the IPCA moved into an upward trajectory. Monitored prices will continue as the major source of inflationary pressures, mostly as a consequence of increases in the prices of bottled gas, urban bus fares and increases in fixed telephone rates. Aside from this, the contribution of food products will be smaller, particularly in view of the behavior of farm prices at the wholesale level. Parallel to this, apparel prices will continue upward, while the impacts of recent growth in the rate of exchange will be felt more strongly.

2.3 – Monitored prices

Consumer prices
12 month % change



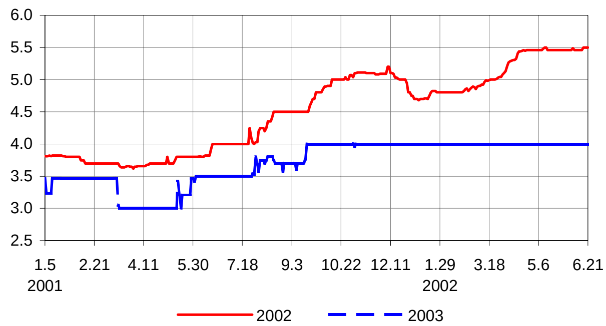
Source: IBGE

Monitored prices accounted for 1.05 p.p. of the 1.62% accumulated IPCA growth registered in the March-May quarter. The most important impacts originated in the average increases in gasoline prices at the refinery level: 2.28% on March 1, 9.39% on the 16th of the same month and 10.08% on April 6, for a total increase of 21.83% in the period (including the 1.08% reduction that occurred on May 15). Another item that produced a significant impact was the 15.07% increase in the price of kitchen gas at the refinery level on April 1. Aside from this, one should mention the increases permitted in electricity rates granted in March to distribution companies in Recife (15.17%) and in April to distribution companies in Belo Horizonte (10.51%), Porto Alegre (12.2%), Salvador (13.56%) and Fortaleza (14.27%).

Price indices in June and July are expected to reflect the impact of increases in fixed telephone rates, scheduled to go into effect on June 22; urban bus transportation in Rio de Janeiro (9.09%) and Salvador (10%) and the increase in the price of bottled gas (9.4% at the refinery level), effective as of June 1.

2.4 – Market expectations

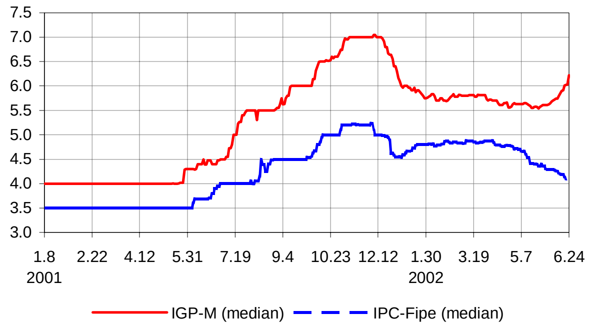
Daily evolution of market expectations for inflation (IPCA)



The Banco Central do Brasil Institutional Communications Group (GCI) carries out a daily survey of approximately one hundred consulting firms and institutions with the purpose of perceiving market expectations regarding the major economic variables.

Measured by the IPCA, median inflation expectations for 2002 increased from 5% on March 20 to 5.5% on June 21, 2002. For 2003, expectations on both of these dates point to 4%.

Daily evolution of market expectations for inflation for 2002

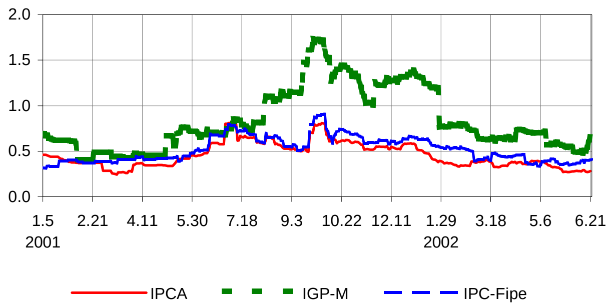


As regards the median short-term figures for the Top Five (five best forecasting institutions), the results increased from 5.12% to 5.53%, for 2002, and dropped from 4.25% to 4%, during the subsequent year.

Insofar as the evolution of the General Price Index - Market (IGP-M) is concerned, the median of expectations for 2002 moved from 5.78% on March 20, to 6.03% on June 21. For 2003, this median declined from 4.67% to 4.61%. Expectations regarding the IPC-Fipe for 2002 dropped from 4.88% on March 20 to 4.13% on June 21, 2002. For 2003, expectations remained at 4% for the corresponding period.

With regard to Top Five median short-term projections, expectations mirrored an increase from 5.73% to 6.02% for 2002, and dropped from 5% to 4.6% for 2003, in the case of the IGP-M.

Standard deviation of market expectations for inflation for 2002



The standard deviations of price indices for 2002 came to 0.33% for the IPCA, 0.65% for the IGP-M and 0.47% for the IPC-Fipe and moved to 0.28%, 0.62% and 0.41%, respectively, on June 21, 2002, following a trajectory toward reductions in the dispersion of inflation expectations for this year.

2.5 – Conclusion

In recent months, inflation has been impacted by several shocks, particularly those generated by fuel and farm prices. The weight of these factors will tend to disappear in the coming months. Aside from these factors, particularly in the first quarter of the year, prices mirrored recovery in margins in specific sectors of the economy and for still discontinuous time periods.

With regard to expectations, despite the fact that the decline in consumer price indices and the rise in the June and July rates were clearly evident months ago – demonstrated by the concentration of changes in government monitored prices – inflation estimates for 2002 were revised upward only recently. For the most part, this reflected changes in the rate of exchange in May and June and uncertainties regarding the behavior of the economy in the context of the upcoming presidential elections.

3 – Credit, monetary and fiscal policies

3.1 – Credit

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

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

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

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

Growth in credit operations

R$ billion

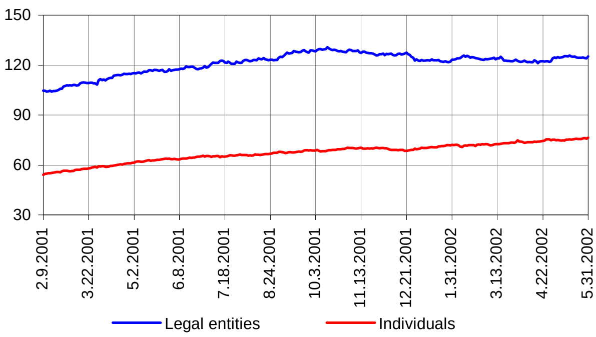
Itemization	2002				Growth	
	Feb	Mar	Apr	May	3 months	12 months
Total	334.4	335.5	338.8	343.4	2.7	-3.0
Nonearmarked	196.0	197.1	199.5	201.8	3.0	11.3
Legal entities	123.4	123.3	124.2	125.3	1.6	6.7
Ref. to exchange	41.5	41.0	41.5	43.3	4.4	2.9
Individuals	72.6	73.8	75.3	76.5	5.3	19.6
Earmarked	118.3	118.3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

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

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

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

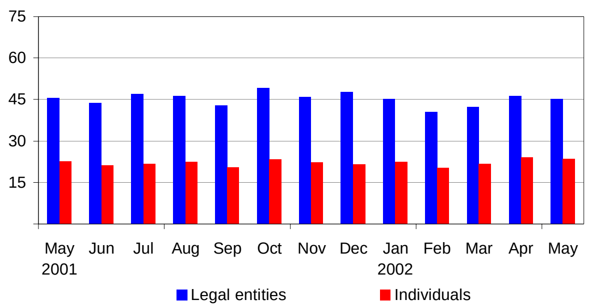
Credits with nonearmarked resources - stock
R$ billion



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

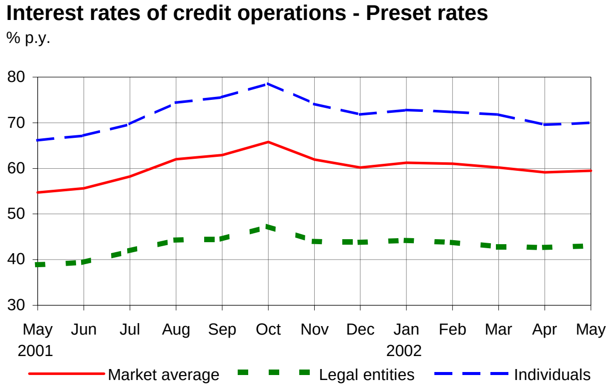
Operations contracted by legal entities came to R$125.3 billion, for growth of 1.6% in the quarter, compared to 11.1% in the same period of the previous year. Growth in 2002 was a result of expanded credits referenced to foreign currency, with a balance of R$43.3 billion and growth of 4.4% in the quarter.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

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



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

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



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

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

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

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

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

Floating interest rate

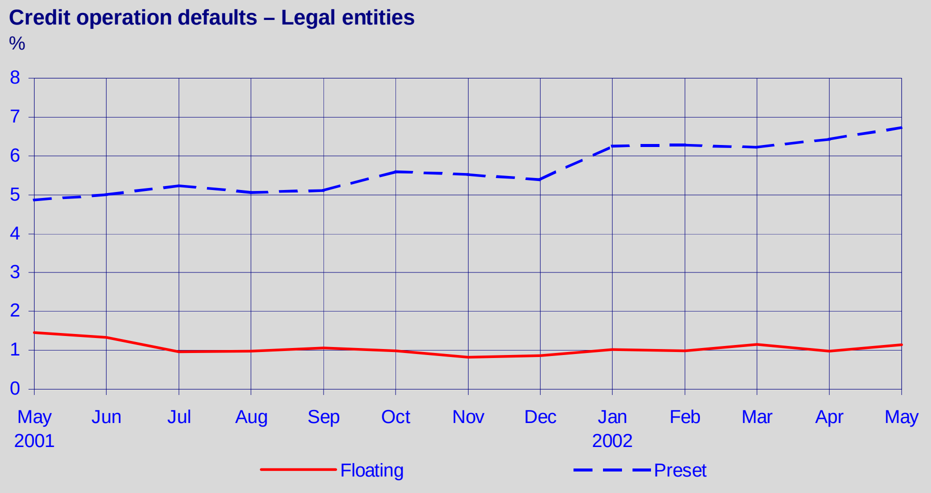
The systematic monitoring of interest rates and the banking spread – a policy adopted by Banco Central do Brasil in 1999 – is based on credit operations that utilize nonearmarked resources with earnings at preset interest rates. With introduction of Circular 2,905, dated June 1999, operations based on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

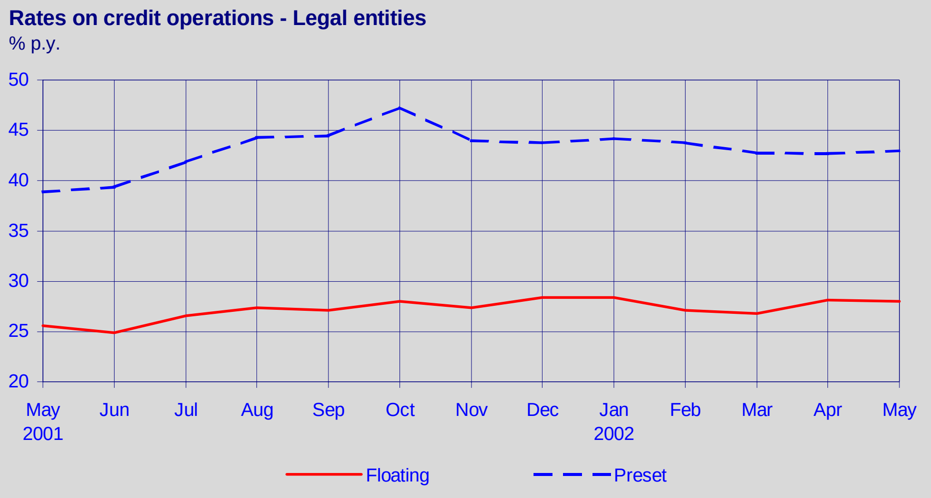
In December 1999, Banco Central issued Circular 2,957 and, aside from operations referenced to preset and postset operations, began a process of regular verification of data on floating rates particularly on business financing operations. The balance of operations at floating rates came to R$20 billion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

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

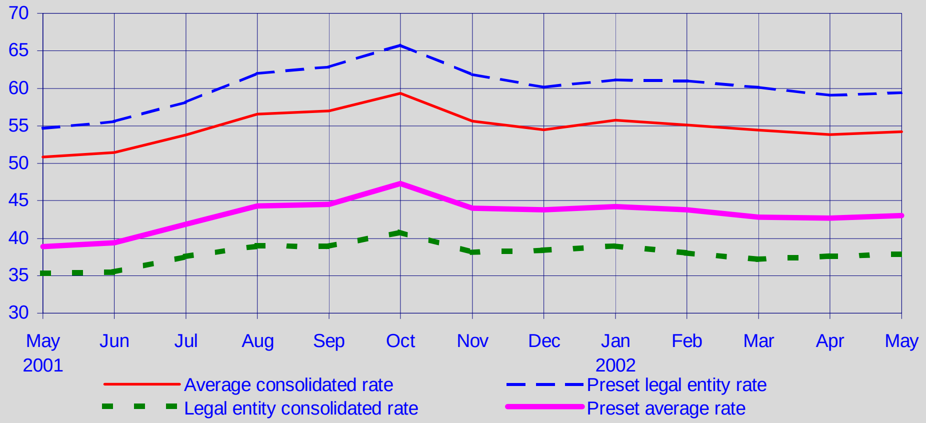
In light of the characteristics of these clients, floating rate operations have low default levels, when compared to the rates found in the case of preset operations. Not only are they lower, but default rates in operations referenced to floating rate operations tend to be more stable. While arrears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

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





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



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

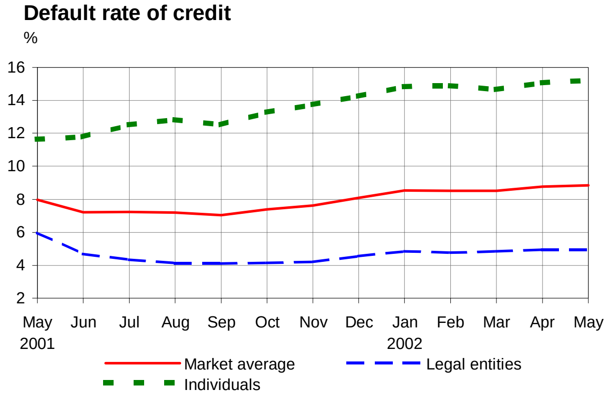
p.p.

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

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

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

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

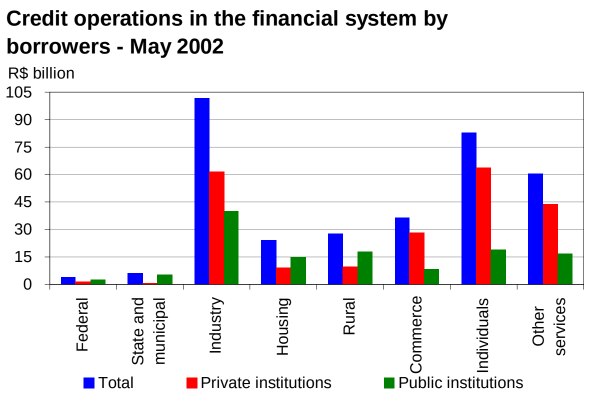


The percentage of arrears in the market reserved to legal entities totaled 4.9%, matching the February result. Insofar as operations with individual persons are concerned, the default rate, which had registered accentuated growth in the second half of 2001, remained stable in 2002, with 15.2% in May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

Sector-by-sector distribution and credit quality

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

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



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

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

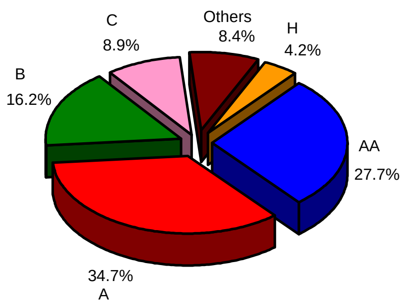
Credits to the rural sector came to R$27.7 billion in the month of May, for growth of 1.1% in the quarter. This performance reflected the targeting of public sector bank funding into current expenditures of the 2002 harvest and the marketing of the 2001/2002 summer harvest. On the other hand, private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

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

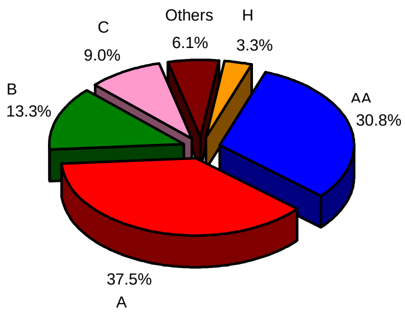
The state and municipal banking debt – including that of the indirect administration and government business sector – reached R$6 billion, with growth of 3.7% in the quarter. Here, emphasis should be given to the resources released for investments in the highway system and electric energy. In relation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

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

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



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

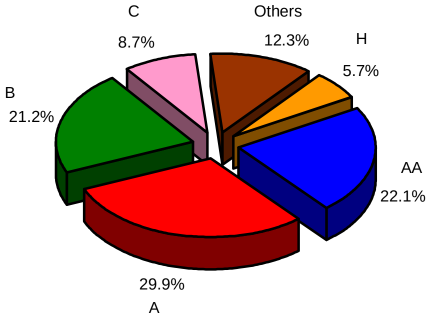


With regard to the profile of the overall financial system credit portfolio, operations classified as normal risk (levels AA and C) accounted for 87.4% of the total in the month of May, with an overall volume of R$300.3 billion.

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

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

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



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

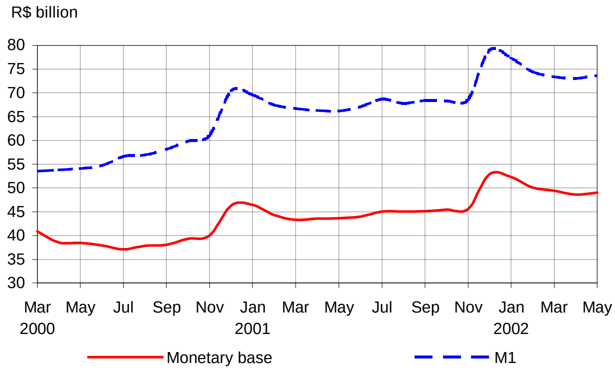
Total financial system provisioning came to R$26 billion in May, for growth of 1.8% in the quarter. This variation was impacted by expansion in the private financial system, due basically to incorporation of nonfinancial company assets by a credit, finance and investment company. Consequently, this should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

3.2 – Monetary policy

Monetary aggregates

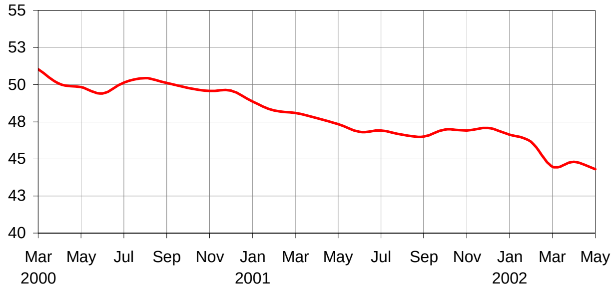
When one considers the concept of average daily balances, the money supply totaled R$73.7 billion at the end of May. Growth of 11.3% in the twelve month period corresponds to expansion of 13.5% in currency held by the public and 10.1% under demand deposits. The income speed of the two components has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

Monetary base and M1 - average daily balances



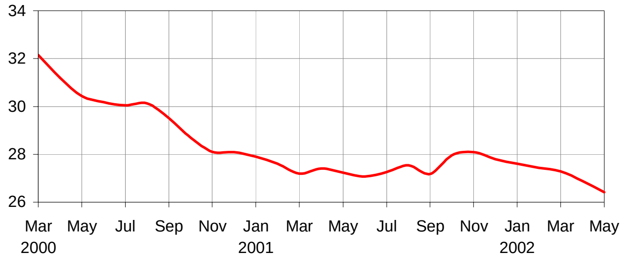
The daily average balance of demand deposits added up to R$46.4 billion at the end of May. The drop of 3.8% in the year reflected the seasonal factors that marked the period.

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



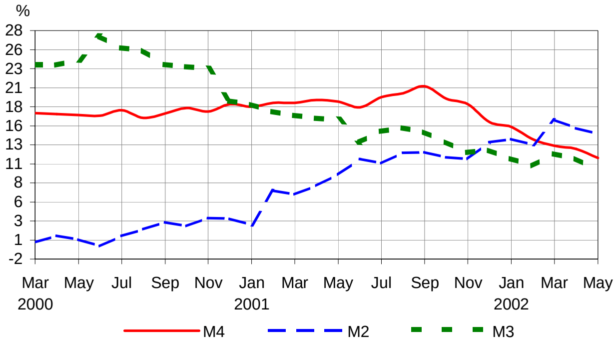
1/ Defined as the ratio between 12 month accumulated GDP (valuated by IGP-DI) and the monthly average balance of the seasonally adjusted monetary aggregate.

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



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

Broad money supply - 12 month percentage growth



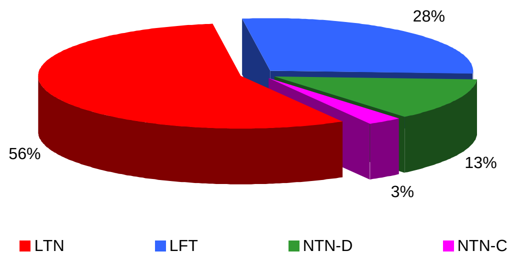
In a manner compatible with demand for demand deposits, average daily balances of the monetary base came to R$49.3 billion in the same period, a reduction of 6.8% in relation to December. Among their components, currency issued closed at R$32.5 billion and banking reserves totaled R$16.7 billion, corresponding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

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

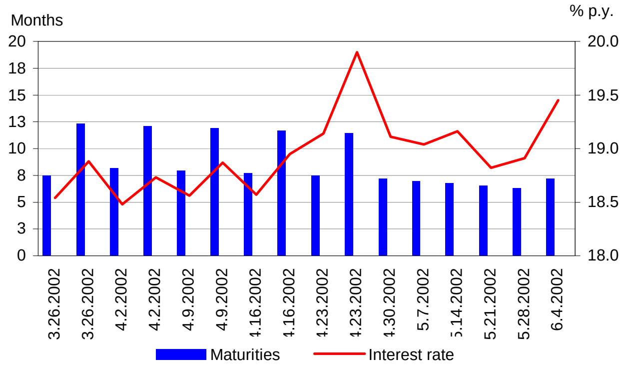
Public securities

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

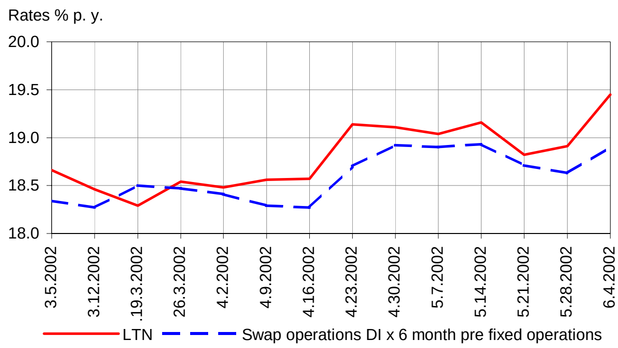
Competitive issues of federal public securities
4.1.2002 to 6.4.2002



National Treasury Bills - LTN



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

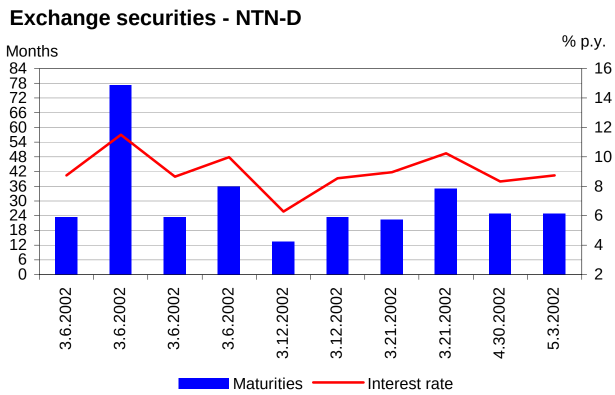


participation in the total stock of competitively issued papers, which moved from 13.1% in March to 13.8% at the end of May. The average annual rate on six month preset papers placed at the beginning of April held firm in the range of 18.5%, equivalent to the Selic rate target, while the rate for one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

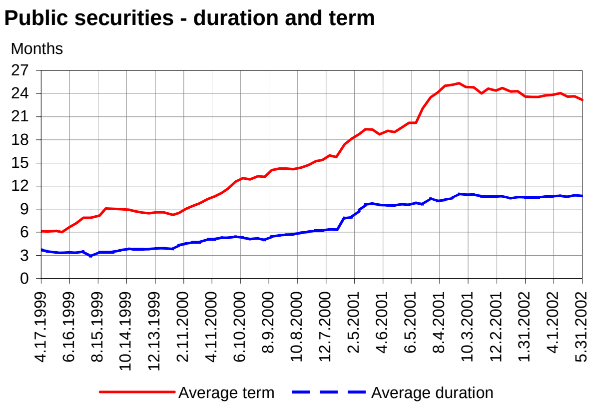
The second quarter of 2002 witnessed introduction of a new system of debt management referenced to exchange variation, as Banco Central held a series of exchange swap contract auctions. At the end of May, these operations had reached a financial value equivalent to R$14 billion. Initially, the swap auctions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

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

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



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

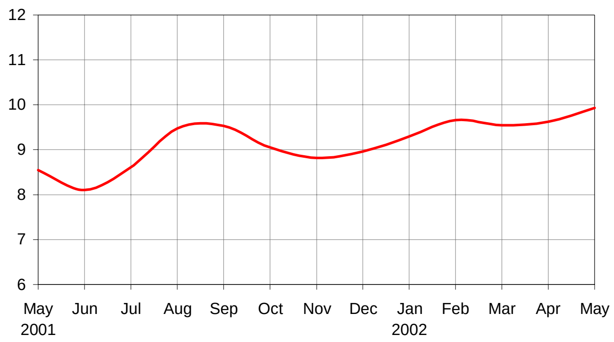


With regard to the management of the long-term securities debt, the National Treasury maintained its strategy of holding auctions of National Treasury Notes – Series C (NTN-C), which are indexed to the IGP-M, at the end of each month. The rates demanded on these operations rose slightly from the range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

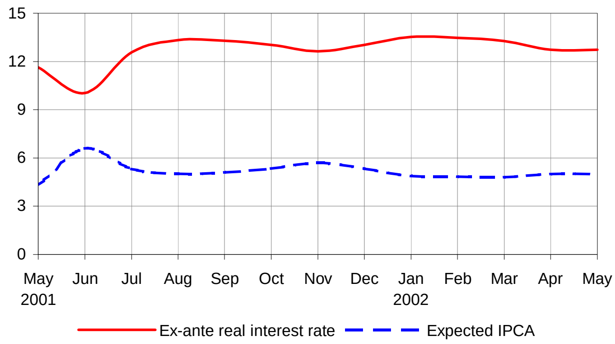
Placements of securities indexed to price indices have contributed to the medium-term stability of the competitively issued securities debt, despite the difficulties inherent to the current situation for issues of other longer term papers. At the end of May, the average term of the competitively issued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

Real interest rate and market expectations

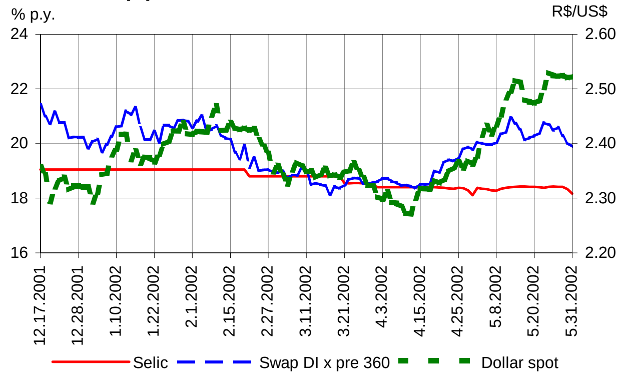
Real interest rate deflated by IPCA
% accumulated in 12 months



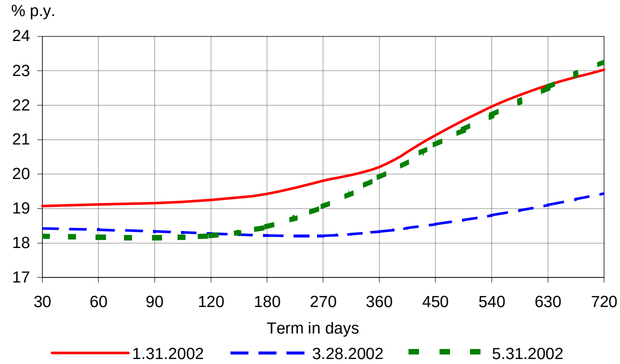
Ex-ante real interest rate
For 12 months



Selic x swap pre x dollar



Yield curve - swap pre

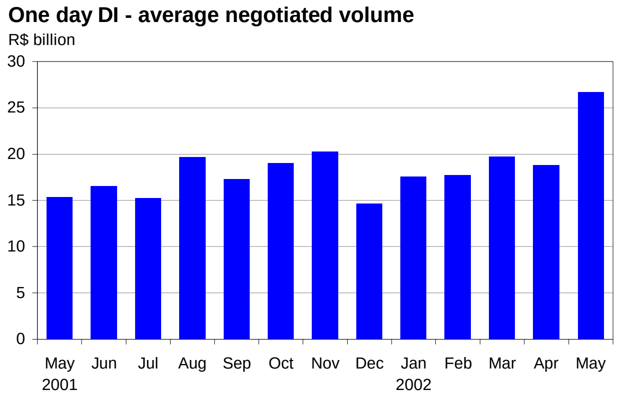


Deflated by the IPCA, the accumulated twelve month Selic rate came to 9.9% per year in May, or 0.2 p.p. above the February mark. This rate has held firm below the 10% per year level for the past sixteen months.

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

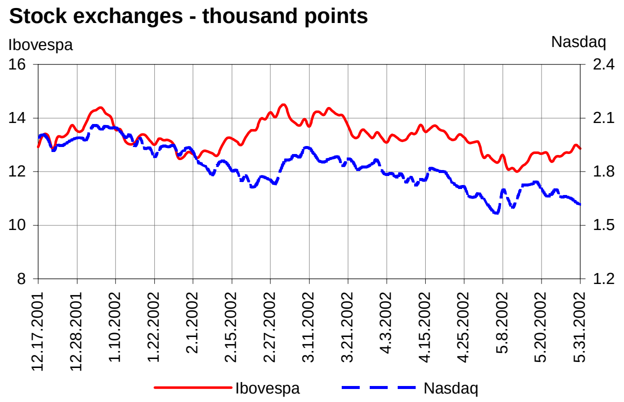
Expectations of an interest rate decline were favored by cutbacks in the Selic rate target and pushed rates on one year DI swap x pre to be negotiated in March below the Selic rate. However, difficulties at that time, including approval of the extension of the Provisional Contribution on Movements or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

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



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

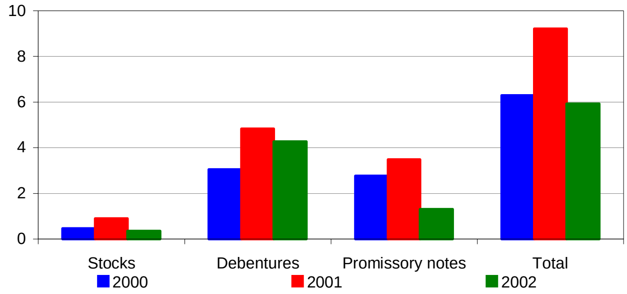
Capital market



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

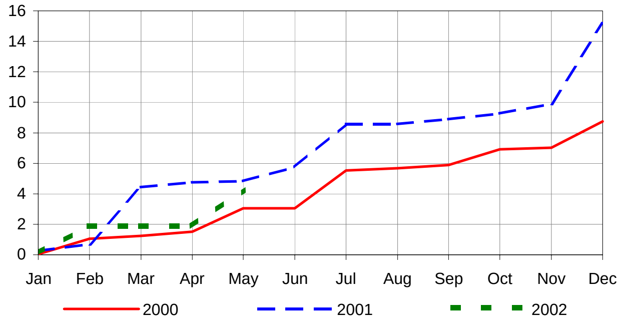
In this context, the São Paulo Stock Market Index (Ibovespa) dropped by 8.4% from February to May. At the start of the month of May, the period of greatest volatility, the Ibovespa hit 12,002 points before recovering in the following days and closing at 12,861 points. In that quarter, the Nasdaq index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

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



Source: CVM

Corporate bonds
R$ billion - accumulated in the year



Source: CVM

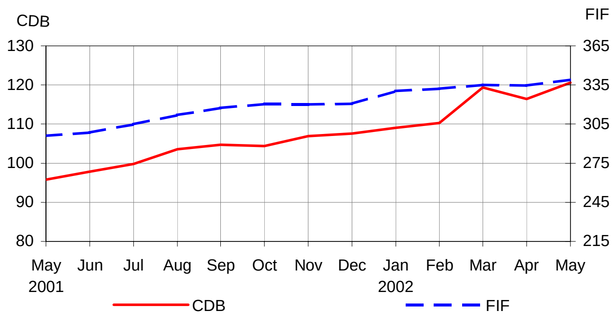
The funding obtained by companies on the capital market through issues of stocks, debentures and promissory notes registered a strong decline in the first five months of the year, in relation to the same period in 2001. However, the level achieved in the year was equivalent to that obtained in 2000.

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

Financial investments

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

Portfolio evolution of time deposits and FIF
R$ billion



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

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

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

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

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

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

The new Brazilian Payments System

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

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

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

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

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

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

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

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

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

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

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

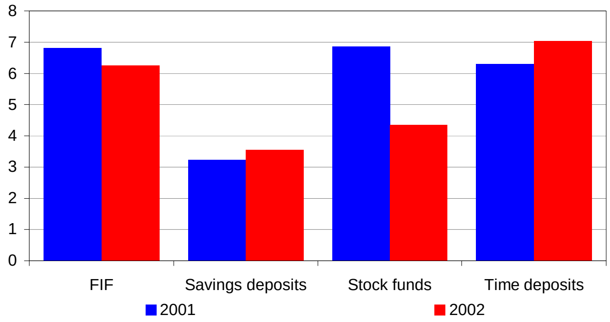
The following systems are now in the process of examination / approval by Banco Central:

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

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

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

Financial investments earnings
% accumulated until May



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

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

3.3 – Fiscal policy

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

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

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

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

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

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

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

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

Public sector borrowing requirements (NFSP)

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

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

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

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

Federal securities debt

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

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

Net public sector debt

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

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

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

3.4 – Conclusion

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

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

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

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

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

4 – International economy

Introduction

Based on a combination of expanding levels of activity and low inflation, world economic performance in the quarter was better than initially predicted by the market.

Just as occurred in the 2001 recession, the upturn in world economic growth in the current year has closely followed the evolution of the United States economy. After a period of declining GDP in the third quarter of last year, the American economy moved into an upward curve with growth rates of 1.7% and 5.6%, respectively, in the final quarter of 2001 and first quarter of 2002, when compared to the corresponding previous periods and expressed in annualized seasonally adjusted figures. The IMF forecast for the American economy points to growth of 2.3%, as against 1.2% in 2001. Though this figure does reflect recovery, it is still well below 4%, which was the lowest result registered in the period from 1997 to 2000.

The economic activity level in the United States has stimulated growth in the Euro zone countries and contributed to a process of growing recovery in the emerging Southeast Asian economies. Recovery in Europe is still slow and no better than moderate. In Japan, GDP figures seem to point toward the start of a positive growth cycle after years of recession.

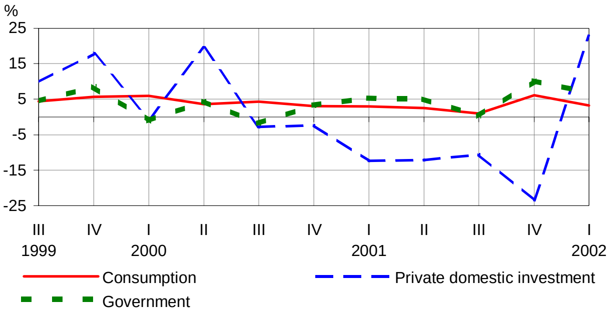
Data for Latin America have been contradictory. While Chile has been able to reverse the economic decline provoked by the world crisis, the Mexican economy has been decelerating. At the same time, the enormous difficulties faced by Argentina since mid-1998 have continued in 2002 and generated negative repercussions on Uruguay.

4.1 – United States

Signs of recovery in the United States indicate that the American economy may well be poised to lead the rest of the world out of the current recession. The outlook is one of moderate growth.

In the first quarter of 2002, government consumption and spending increased by respective rates of 3.2% and 6.7%, both of which were lower than in the previous quarter. Based on the annualized, deflated statistical series from which seasonal factors have been removed, gross private investment expanded by 22.8%, following a decline of 23.5% in the final quarter of 2001. Investments in inventories have added to this result.

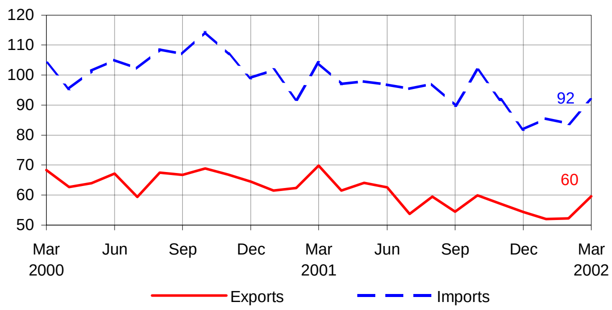
Aggregate demand - components[1/]



Source: Bureau of Economic Analysis
1/ Quarterly annualized growth, seasonally adjusted, deflated.

Other demand indicators confirm the upturn in United States economic growth. Utilizing data from which seasonal impacts have been purged, April orders placed with factories expanded by 1.2%, following 1% growth in March. Once the transportation sector has been excluded, orders increased by 2%. Twelve month figures up to April indicate an accumulated drop of 4.5% when set against the same period of the preceding year. Excluding food-related services, retail trade sector sales increased by 1.3% in April, expressed in figures free of seasonal factors. Over twelve months, retail sales expanded by 4.3% in April, as against 2.4% in March and 2.3% in February.

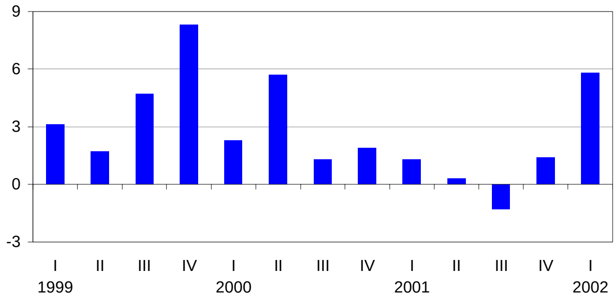
International trade



Source: Bureau of Economic Analysis

With the ongoing process of recovery, the trade and current account deficits tend to expand and, consequently, act as dampers on even more intense growth. It should be stressed that, despite the fact that depreciation of the dollar in recent months has aided in increasing exported volume, the trade deficit in goods remained at the level of US$30 billion per month in the first quarter of 2002, with a slight upward tendency. However, with the lesser volume of foreign capital flowing into security acquisitions in the United States – mostly involving stocks – pressures are expected to continue and contribute to a further weakening of the dollar.

Gross Domestic Product[1/]



Source: Bureau of Economic Analysis

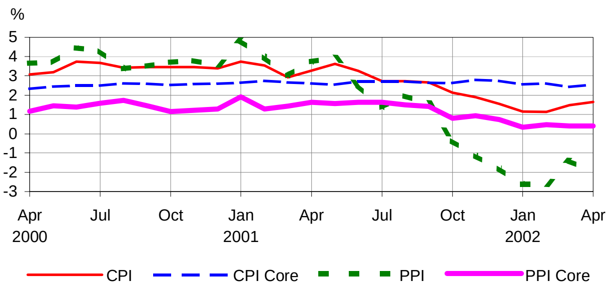
1/ Percentage change over preceding period, seasonally adjusted at annual rates.

In the first quarter of the year, GDP expanded by 5.6% in relation to the previous period, based on the statistical series free of seasonal influences. This result was impacted by 20% growth in defense spending, while final demand increased by 3.7%, a pace that was considerably slower than in the final quarter of 2001. Consequently, government spending and investments in inventory accounted for 77% of GDP growth in the first quarter of the year. For the fourth consecutive month, industrial output expanded in April, though the accumulated twelve month result closed at -4.4%.

Recent economic recovery in the United States has been accompanied by sharp improvement in productivity, thus reducing the impact of economic growth on the job market. As a matter of fact, labor demand has increased less than product and a significant share of this growth has been generated more by longer work weeks than new hirings. Thus, at the same time in which the economy has turned upward, unemployment expanded from 5.7% in March to 6% in April and 5.8% in May. Coupled with the rise in unemployment, requests for unemployment compensation increased in the month of April and surpassed the 400 thousand mark for the second consecutive month.

Prices

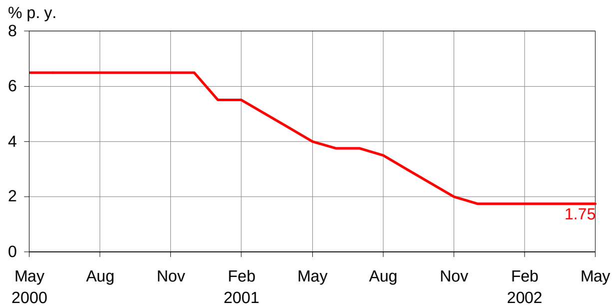
Annual growth



Source: Bureau of Labour Statistics

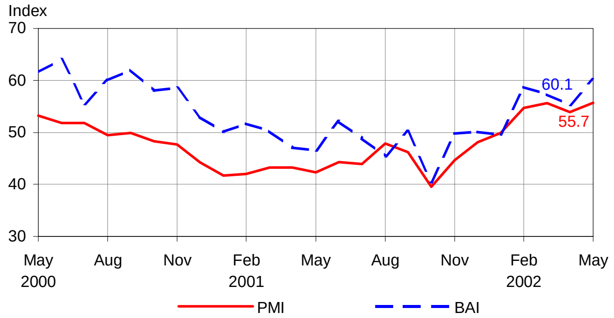
Measured by the Consumer Price Index (CPI), consumer inflation shifted gradually upward in March and April of this year following a gradual slowdown since May 2001. Energy was the major underlying cause of the recent increase. In twelve month terms, the CPI registered 1.6% growth in April, while the core index, which excludes food and energy prices, remained relatively stable. The producer price index (PPI) has registered negative growth since October of last year. Twelve month PPI growth came to -1.97% in April, while the core index expanded by 0.4% in the period.

Federal funds rate target



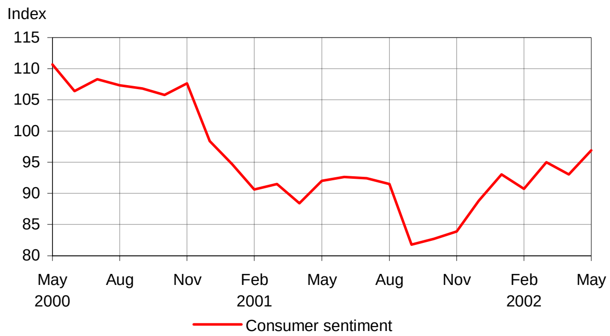
Source: Federal Reserve System

ISM Indexes



Source: Institute for Supply Management

University of Michigan Indexes



Source: Bloomberg

At its May 7 meeting, the Federal Open Market Committee (FOMC) decided to hold the federal fund target unchanged at 1.75% per year, thus strengthening expectations of moderate growth in the United States economy in the coming months. Under these circumstances, acknowledging that it has somewhat eased its current monetary policy posture, the FOMC has taken the position that the economy is ready to move into a sustained growth curve without the risk of added inflationary pressures.

As far as expectation indicators are concerned, following a period of sharp recovery beginning in October 2001, the Institute for Supply Management (ISM) indicators turned downward once again in March and April, though they remained above the leveling off point of 50. In May, both the Purchasing Managers Index (PMI) and the Business Activity Index (BAI) moved up to respective levels of 55.7 and 60.1. Following the same trend, according to a University of Michigan survey, the expectations of American consumers rose from 93 in April to 96.9 in May, the highest level since December 2000.

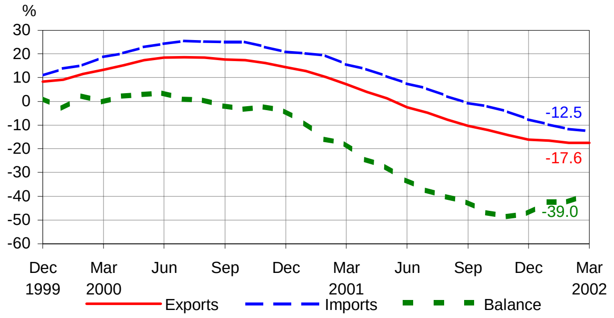
4.2 – Japan

The Japanese economy closed the 2001 fiscal year on March 31 in an ongoing process of deflation. GDP dropped for the third consecutive quarter and clearly reflected weak internal and external demand. Though it has not managed to implement expected structural reforms and has had to limit itself to no more than marginal progress in writing-off bad debts, the government was able to avoid the financial collapse that many observers had predicted as a result of bad loans and the cutback in deposit insurance guaranties from the former level of total protection to ¥10 million (US$75.7 thousand) as of April first. On the other hand, the performance of exports and industrial output indicators in recent months have improved short-term expectations and reinforced the thesis that sustained recovery based on external demand could well be more robust in the second half of the year than previously expected.

On the demand side, consumers adopted a conservative stance as evinced by the fact that, despite slight growth in available real worker income since July 2001, this has not resulted in additional family and worker spending. Orders placed with factories have reflected the weak performance of both external and internal orders, both of which have been dropping sharply since June 2000. In the first quarter of this year, the reduction came to 14.5% compared to the same period of the preceding year.

Trade balance

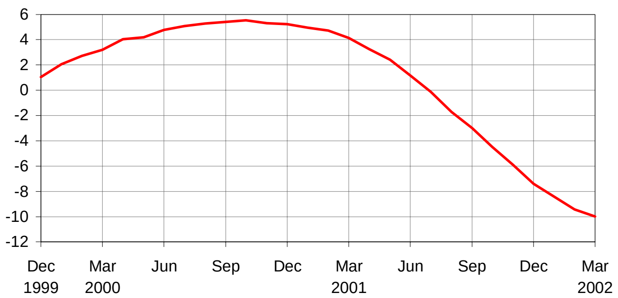
Accumulated variation in 12 months



Source: Bank of Japan and Bloomberg

Industrial production

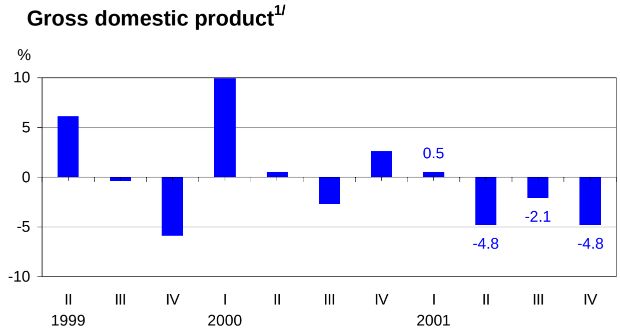
Accumulated variation in 12 months



Source: Ministry of Economy, Trade and Industry

Driven by the upturn in the American economy, foreign sales have been recovering and reached a level of US$95 billion in the first quarter of the year, or 0.7% more than in the previous quarter, though still 13.4% below the first quarter result in 2001. Imports added up to US$76.9 billion, for reductions of 8.1% and 16.5%, respectively, in the same periods. As of February 2002, growth in accumulated twelve month balances reversed the previously downward trajectory.

In the seasonally adjusted statistical series, the accumulated twelve month industrial output trajectory has been consistently downward, though at a less intense pace. In February and March, monthly growth was positive and expectations for April and May point to expansion of 1.3% and 3.1%, respectively. Unemployment remained high during the entire 2001 fiscal year, hitting a new peak of 5.4% in March as a consequence of the adjustments adopted by companies at the close of the fiscal year as they sought to cope with the task of restructuring both their businesses and their debts.

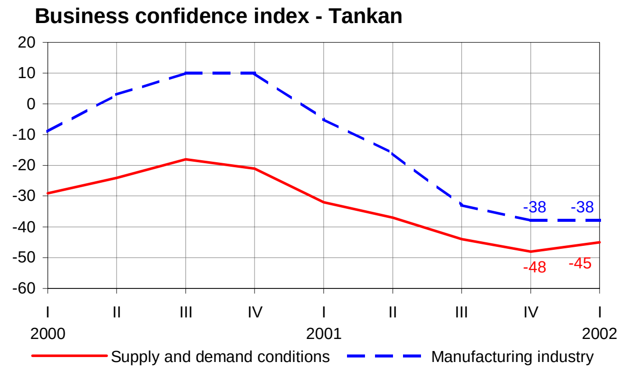


Source: Economic Planning Agency
1/ Growth over previous quarter seasonally adjusted, annualized.

According to the Bank of Japan, GDP declined by 1.2% in the fourth quarter of 2001 when compared to the previous quarter and by 2.3% when viewed against the fourth quarter of 2000. This was the third consecutive period of negative results. In calendar year 2001, the falloff came to 0.5%. The economic growth forecast for fiscal year 2002 was revised from a reduction of 0.5% to growth of 0.1%.

The economy was marked by steady deflation during the entire 2001 fiscal year, as the CPI registered annual expansion of -1.2% and the Wholesale Price Index closed with -1% in March. The basic interest rate of the economy remained close to zero.

In fiscal year 2001, the volume of write-offs of matured and unpaid loans came to ¥7.8 trillion (US$60 billion) or ¥1.4 trillion more than previously estimated. Despite these write-offs, bad loans still came to a total of ¥36.8 billion (US$277 billion) in September 2001.



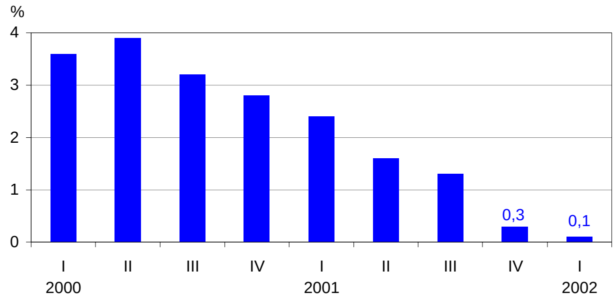
Source: Bank of Japan

A certain degree of improvement in expectations has been perceived in the Coincident Index of Economic Indicators which, for the first time in fifteen months, passed the mark of fifty in March and closed at a preliminarily estimated level of 56.3 compared to forty in the previous month. In its turn, the short-term index (Tankan) for large manufacturing companies registered -38 in the third quarter of the year and remained stable in relation to the fourth quarter of 2001.

4.3 – Euro zone

Following a decline of 0.2% in the first quarter of 2001, the Euro zone GDP expanded by 0.2% in the first quarter of 2002. This result was mostly a consequence of 0.9% growth under exports, which offset the 0.5% decline in domestic demand. Consumer spending

GDP[1/]

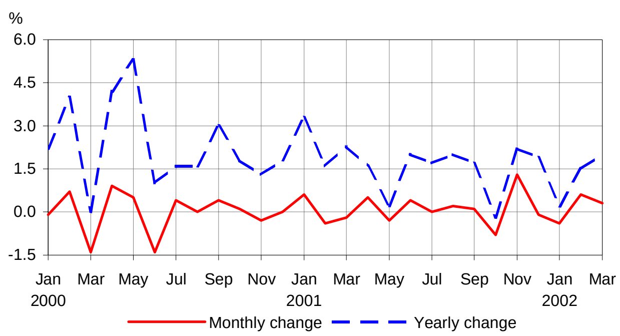


Source: Eurostat
1/ Growth over corresponding quarter of preceding year.

dropped by 0.2% and gross fixed capital formation by 0.7%. On the other hand, the reduction in stock levels, which came to 0.8% of GDP, is an item that points in the direction of expectations expressed by the European Commission regarding estimated GDP growth of 0.6% in the second quarter. Among the components that contributed to the added gross value, one should cite the sector of construction, with expansion of 0.8%, financial services with 0.7% and industry with 0.6%. With respect to the first quarter of 2001, GDP increased by 0.1% compared to expansion of 0.3% in the previous quarter. Using the same basis of comparison, external and internal demand registered respective declines of 1.7% and 0.8%. Unemployment increased to a level of 8.3% in April, after remaining stable at 8.2% in the first three months of the year.

Industrial output, which has followed a downward trajectory since September 2001, turned in negative annual growth figures in the first quarter of 2002. In March, the rate came to -2.9%, with a 2.3% drop under production of intermediate goods, 6.7% for capital goods and 8.1% under consumer durables. Monthly growth has been positive since December 2001 and closed March at 0.5%.

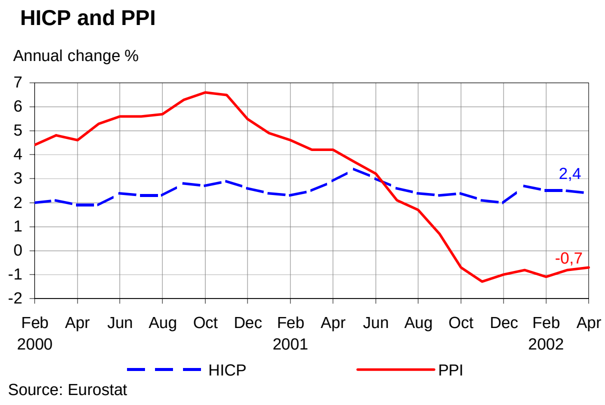
Retail sales



Source: Eurostat

Retail sales registered consecutive increases in the first quarter of the year. In March, the increase came to 0.3% when compared to February and 2% when viewed against the March 2001 result. Growth has been concentrated mostly under food and beverage products and apparel.

Measured by the Harmonized Consumer Price Index (HCPI), inflation inched upward in the early months of the year. The January rate was impacted by such passing phenomena as the upward rounding-off of prices following conversion to the euro, increased indirect tax rates and the influence of meteorological factors on food prices. While the impact of these items was also felt into the following months, early Eurostat figures point to a decline in the annual rate from 2.7% in



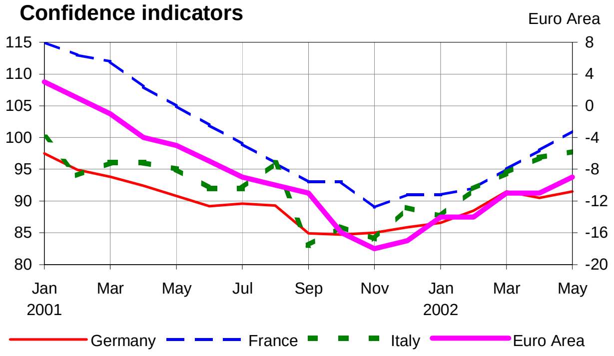
January to 2.4% in April and 2% in May. It should be noted that May 2001 witnessed the highest CPI increase of that year (3.4%), a fact that partly explains the reduction that occurred in May 2002. The PPI registered annual negative growth rates since October 2001 and closed April at -0.7%.

Annual M3 growth remained at a level above 4.5%, the reference mark defined by the European Central Bank (ECB) and closed April at 7.5%. According to the ECB, the behavior of this monetary aggregate reflects increased preference for liquidity generated by the growing economic uncertainties that marked the end of 2001. Annual growth in credits channeled to the private sector dropped from 6.8% in December 2001 to 5.1% in April 2002.

As noted in analyses of expectations, the persistence of annual inflation of more than 2% in 2002 has generated some degree of wariness regarding the possibility of generating a phenomenon of inflationary inertia. Nonetheless, the still insufficient pace of recovery, the May decline in the consumer price index and upward movement in the value of the euro tend to ensure that the ECB will maintain the interest rate level.

In March, the trade balance came to US$8 billion based on exports of US$79.9 billion and imports of US$71.9 billion. The accumulated 12 month surplus came to US$57.1 billion in March as against US$51.7 billion in February and US$7.4 billion in March 2001. It should be noted that the shift in levels was due basically to lesser imports. Accelerated growth in the trade surplus, however, could be stifled by upward movement in the value of the euro against the dollar which came to approximately 10% between the end of January and the month of May.

Business confidence indicators have evolved positively since October 2001. The industrial confidence index for the Euro zone, Confidence indicators



Source: IFO, Insee, Isae and European Comission

which is calculated by the European Commission, closed the month of May at -9, following levels of -11 in March and April and -14 in January and February. In Germany, following a decline to 90.5 in April, the index of business expectations moved to a level of 91.5, the same figure as registered in March. Similar indices in France and Italy showed increases from 98 to 101 and from 96.8 to 97.8 from April to May. Growth in consumer confidence indicators was less favorable. The European Commission indicator moved to -11, following -10 in April, while Italy turned in a decline from 122.2 in March to 119.3 in May. In Germany, the index remained stable, while the French index turned in a positive performance, shifting from -18 in April to -12 in May.

4.4 – Emerging economies

4.4.1 – China

Sustained by investment-driven internal demand growth, the outlook for rapid and steady expansion in the Chinese economy has been confirmed. In this sense, in the first four months of the year, gross fixed capital formation expanded by 27% compared to the same period of 2001. The reasons for this performance were earlier than expected public sector investments. Normally, these investments are concentrated in the second half of the year, but were moved up to the first half as a result of changes in the system of funding releases to state entities. Other factors that deserve consideration were rapid growth in the volume of private investments in the construction sector and 29% expansion in direct foreign investments in the first four months of the year, when compared to the same period of the previous year. Note that foreign investments already account for 10% of Chinese gross fixed capital formation. As a result, GDP in the first quarter of the year expanded by 7.6% compared to the same quarter of 2001. In this framework, the highlight was the performance of industrial output, with growth of 10.9%.

Investment growth, coupled with WTO measures to liberalize trade transformed China into an expanding market. In this context, Chinese foreign trade registered foreign sales of US$76.6 billion and imports of US$91.3 billion, in the first four months of the year.

Retail sales in the month of March increased by 8% when compared to March 2001. Using the same basis of comparison, this figure was lower than the February result of 9.1%. Also in March, annual inflation measured by consumer prices, closed at -0.8% compared to zero growth in the previous month.

4.4.2 – Russia

Industrial output registered monthly growth of 0.6% in April, which was the second positive result in the year. The accumulated result for the twelve month period ended in April was an output reduction of 5%, the same decline as occurred in March. The instability of industrial performance had no impact on the rate of unemployment, which came to 8.2% in the month, compared to 8.3% in March. In April 2001, unemployment had closed at 9.1%.

Insofar as foreign trade is concerned, the March result registered exports of US$8.6 billion and imports of US$4.7 billion. The positive results registered over the course of the year produced a surplus of US$9.8 billion in the first quarter, contributing to an accumulated twelve month surplus of US$44.9 billion in March, compared to US$45.7 billion in the previous month.

In the month of April, federal budget implementation showed that the volume of fiscal revenues continued expanding and closed at 22.2% of GDP, compared to 20.3% in the previous month. Government spending, including interest, also expanded and came to 20% of GDP, compared to 18.6% in March. Consequently, the nominal surplus totaled 2.2% of GDP, compared to 1.7% of GDP in the previous month. After deduction of interest outlays, which dropped from 3.5% to 0.6% of GDP, the primary surplus declined from 5.2% to 2.8% of GDP in April.

At the end of April, international reserves closed at US$39.1 billion, compared to US$37.3 billion in the previous month. This was the fourth consecutive month of growth in the reserve position. In the same month, the interbank interest rate closed at 9.7% per year, compared to 12.6% per year in March and 13.3% per year in February.

4.4.3 – Turkey

In the month of March, the trade balance registered a deficit of US$691 million, based on exports of US$2.8 billion and imports of US$3.5 billion. In the first quarter of the year, the deficit came to US$1.9 billion, compared to US$3.5 billion in the same period of the previous year. Utilizing the same basis of comparison, the trade flow increased by 10%.

Following a reduction of 4.5% in February, industrial output rose by 18.7% in the month of March, when compared to March 2001. For the most part, growth was driven by the performance of the manufacturing sector, which expanded by 20.5%. In terms of average, output in the quarter was 3.5% higher than in the first quarter of 2001.

The CPI registered monthly growth of 0.6% in May, the lowest rate since 1994. This result contributed to a drop in the twelve month index from 52.7% in April to 46.2%. Annual WPI growth came to 49.3% in May, compared to 58% in April. The drop in inflation could well create the conditions required for an interest rate cutback.

In the month of June, the IMF is expected to approve disbursement of a tranche of the agreement formalized in February with Turkey, since the country has fully complied with fiscal and monetary policy performance criteria. As part of the public sector reform program, the IMF is now awaiting the following steps: government adoption of a plan aimed at privatizing the Turk Telecom telecommunications company; notification of capital adequacy requirements to banks by the agency charged with banking regulation and supervision; consolidation of indirect taxes into a special tax on consumption;

and introduction of amendments to the public sector tender law. The IMF reiterated its confidence in the country's ability to comply with the inflation target of 35% at the end of the year and a projected GDP growth mark of 3% in 2002.

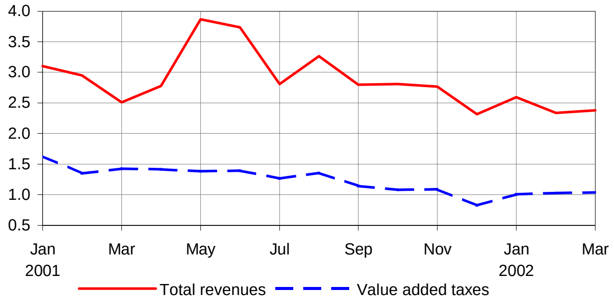
4.4.4 – Latin America

Argentina

The Argentine economic scenario worsened in the early months of 2002 as economic stagnation led to rapid deterioration in the expectations of economic agents.

In response to the drop in real income caused by upward movement in inflation rates, demand slid sharply downward. In this context, the *Instituto Nacional de Estadística y Censos* (Indec) released data showing that supermarket and shopping center sales dropped by respective rates of 2.6% and 27.3% in the first four months of 2002, compared to the same period of the previous year. Using the same basis of comparison, the Synthetic Index of Construction Activity (Isac), which reflects demand for inputs for the building sector, turned in a reduction of 40.1%.

Fiscal revenues
$ billion of pesos



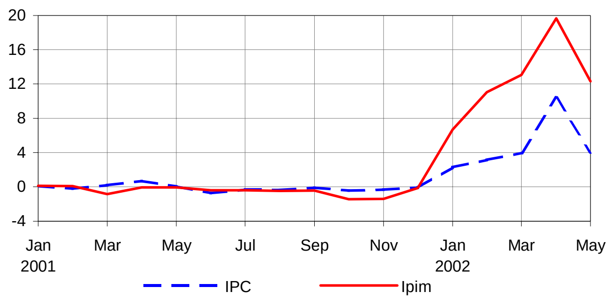
Source: Secretary of Finance

In a context of plunging revenues, the fiscal sector has registered consistently negative results. In the first quarter of the year, the overall result for the national public sector was a deficit of $2.5 billion, compared to the target of $3 billion proposed in the budget for the year. Compared to the first quarter of the previous year, the inflow registered a drop of 22% particularly as a result of the 30% reduction in the inflow of the Tax on Aggregate Value (IVA). The government has sought to negotiate a fiscal agreement with the provinces that would reduce provincial deficits by 60% and, in this way, meet one of the demands put forward by the IMF to recommence negotiations on financial assistance.

In the first four months of the year, the balance of trade turned in a surplus of US$5.2 billion, compared to US$625 million in the same period of the previous year. This result reflected a drop of 5% in exports and 65% in imports. While the cutback in foreign sales explains the drop in the prices of some products that have traditionally played an important role in the nation's exports, particularly primary goods, the falloff under imports points clearly to the downturn in all of the different segments.

The macroeconomic scenario has generated strong negative repercussions on the productive sector. In this sense, based on Indec's Monthly Industrial Estimator (EMI), the first four months of the year registered a reduction of 15.8%, compared to the same period of the preceding year and a 10.6% accumulated contraction over the last twelve months. The sectors that have been most harshly impacted by the decline in productive activity were the textile, automotive and metal-mechanics industries.

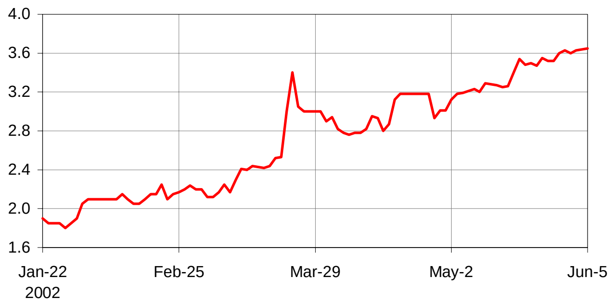
Inflation
Monthly percentual change



Source: Ministry of Economy/Indec

The price level trajectory has followed an upward curve, though the intensity of the rise in inflation diminished somewhat in the month of May. According to Indec, the CPI came to 4%, raising accumulated inflation to 23% over twelve months. The major sources of price pressures were food and apparel. Also in the month of May, the *Índice de Precios Internos al por Mayor* (Ipim), which measures changes in wholesale prices, registered a high of 12.3%, accumulating 72% growth over twelve months, due mostly to growth in the prices of imported products.

Exchange rate
Pesos per US$



Source: Reuters

The rate of exchange was marked by intense volatility. Despite Central Bank interventions and government imposed restrictions on the exchange market, which included limitations on the number of financial institutions authorized to operate on the foreign currency market and alterations in the procedures followed in liquidation of export operations, the nation's currency registered depreciation of more than 70% from February to the month of June, generating strong impacts on internal prices.

In the month of April, the decision taken by two foreign banks to suspend operations on the Argentine banking market further undermined the confidence of economic agents in the degree of financial system solvency. Aside from these factors, the restrictions imposed on bank withdrawals toward the end of 2001 have not been sufficient to avoid reductions in private deposits which, in the month of May, came to 1.7 billion pesos or 3% of the total.

Under intense internal and external pressures, the government presented a new program in the month of June aimed at releasing bank deposits. This program consisted of an exchange of deposits for government bonds denominated in dollars or pesos. According to official expectations, the volume of exchanges could total as much as 30% of deposits, corresponding to issues of $18 billion in federal bonds with varied maturity dates. These papers can be used for acquiring goods and should expand the liquidity of the economy.

Uruguay

The Uruguayan economy has been impacted by successive adverse external shocks which have resulted in recession and increased unemployment. Once Argentina had frozen bank deposits toward the end of 2001, the impact of these shocks became even more severe and led to a gradual falloff in Uruguayan national income levels as reflected in sharp growth in the public deficit as a percentage of GDP and in added pressures on the country's banking system.

The Physical Volume Index of the Uruguayan manufacturing sector fell by 9.8% in the fourth quarter of 2001, compared to the same quarter of the previous year. When one considers the same basis of comparison, the Index of Hours Worked per Worker and the Index of Persons Employed dropped by respective rates of 13.3% and 12.6%. In the year, the Physical Volume Index of the manufacturing industry registered a decline of 9.3%, when oil refining is excluded.

Calculated by the National Institute of Statistics, the Consumer Price Index rose by 1.2% in May, raising the accumulated figure for the last twelve months to 6.5%. In the same periods of 2001, growth came to respective levels of 0.6% and 5.3%. In the month of May of this year, the items that registered the strongest growth were transportation and communications, with 2.6%, and apparel and footwear with 1.5%.

The net external public sector foreign debt moved from a December 2001 position of US$2.6 billion to US$3.8 billion in February of this year.

In the first quarter of the year, the balance of trade turned in a deficit of US$63.6 billion, compared to US$164.9 million in the same period of the previous year. Foreign sales totaled US$443.9 million and imports closed at US$507.5 million.

At the end of May of this year, the IMF announced its intention of fostering an increase in the volume of financial resources channeled to Uruguay, and a mission from that organization is expected to arrive in that country in June with the aim of negotiating a strengthening of the current agreement. The objectives of the future program will be improvement in the fiscal situation, maintenance of banking system solidity and intensification of the process of structural reforms with the aim of building confidence and making it possible to recover the pace of economic activities and generate added job opportunities.

Mexico

The Mexican economy accompanied the 2001 downturn in the United States economy. However, when the American economy managed to regain a positive growth curve, the Mexican economy was unable to follow its lead. At market prices, Mexican GDP declined by 2% in the first quarter of 2002, compared to the same quarter of the previous year, a period in which it had expanded by 2% using the same basis of reference.

The Global Indicator of Economic Activity (Igae), which is issued by the National Institute of Statistics, Geography and Informatics (Inegi), dropped by 3.5% in the month of March of this year, compared to the same period of the previous year. This performance clearly corroborated the decline in economic activity evident since May of 2001. In the same sense, the Industrial Activity Indicator which has declined since February 2001, closed with negative growth of 7.6%. In the same period of time, the Mexican manufacturing sector registered a falloff of 9.1% under the pressure of the 21.4% reduction in the "maquiladora" export industry.

Inflation – expressed by the National Consumer Price Index – rose by 0.9% in January and reversed the downward trajectory that marked the final quarter of 2001. In February, the index registered negative growth, followed by upward movement of 0.5% in March and 0.6% in April. In the first four months of this year, the accumulated rate came to 4.7%, for an increase of 0.3 p.p. in relation to the previous period.

The current transactions account accumulated a deficit of US$3.9 billion in the first quarter of 2002, which was mostly financed by long-term resources. The trade balance registered a deficit of US$1.8 billion in the first quarter of 2002, compared to US$4.2 billion in the previous period. The result for the year was based on exports of US$36.6 billion and imports of US$38.4 billion. In the first quarter of the current year, exports and imports declined by respective rates of 7.6% and 8.3%, compared to the same quarter in the preceding year. In the first quarter of 2002, net international reserves held by the Bank of Mexico rose by US$1.3 billion to a total of US$42.2 billion.

Chile

In real terms, GDP expanded by 1.5% in the first quarter of 2002, when compared to the same quarter of the previous year, while gross fixed capital formation turned in growth of 3.1%, using the same basis of reference.

The Monthly Economic Activity Indicator (Imacec) registered growth of 0.4% in March, as compared to contraction of 0.2% in February, based on the series purged of seasonal factors. The Industrial Output Index declined by 2.1% in March compared to the same period of the previous year. In the statistical series purged of seasonal factors, the month closed with growth of 0.2%. Considering the same bases of comparison, the Index of Industrial Sales dropped by 2.7% and 1.5%, respectively.

Insofar as inflation is concerned, the Consumer Price Index, which is calculated by the INE, registered positive growth of 0.5% in March and 0.4% in April, after a sequence of negative or nil results from November 2001 to January of the current year.

Chile's trade balance turned in a surplus of US$692.2 million in the first quarter of this year, with exports of US$4.3 billion and imports of US$3.6 billion. The total external debt came to US$37.4 billion at the end of the first quarter, with US$31.1 billion referring to medium and long-term debt. International reserves totaled US$15.4 billion in April of this year.

4.5 – International financial market

Since issue of the previous Inflation Report, the international financial market has evolved in such a way as to somewhat facilitate meeting the borrowing requirements of the emerging countries. In the wake of the weak 2001 performance, expectations for the current year pointed to increased capital flows driven mostly by economic recovery in the industrialized nations. Nonetheless, according to statistics released by the Bank for International Settlements (BIS)[1] and forecasts by the Institute of International Finance (IIF)[2], the international financial market has surpassed initial expectations, in a scenario of higher than forecast growth in activity and maintenance of expanding basic interest rates, given the absence of significant inflationary pressures in the developed countries.

1/ BIS. Quarterly Review. International Banking and Financial Market Developments. June, 2002.

2/ IIF. Capital Flows to Emerging Market Economies. April 22, 2002.

With regard to the stock market, measured by the world's major stock exchange indices (Dow Jones Industrial Average, Standard and Poor's 500 and Nasdaq in the United States, plus the London and Tokyo markets) recovered smartly in relation to the strong downward movement registered after the September 11 attacks in the United States. Starting in the month of March, however, economic indicators in the United States began accumulating negative results once again and closed the June 7 trading day at levels of 4.8%, 11% and 22.4% below the year's opening indices, in the same order as listed above. Using the same basis of comparison, the London exchange dropped by 5.7% and the Tokyo exchange was the only major market that managed to register positive growth (4.6%).

With these results, the international environment was characterized by growth recovery, low interest and weak performances on the fixed and variable income markets, a setting that tended to encourage private net financial flows to the emerging nations. There are obvious risks in relation to the most probable scenario for the current year. Among these, one should cite earlier than predicted upward movement in interest rates in the industrialized countries, thus reducing or even neutralizing the expansionary nature of monetary policy; only moderate economic growth in those countries; the ongoing Argentine crisis and its possible ripple effect particularly with regard to Brazil, financial market volatility in relation to economic indicators and the political-electoral climate.

Emerging markets' external financing
2002 forecasts

US$ billion

Itemization	Total			Latin America		
	(A)1/	(B)2/	(B-A)	(A)1/	(B)2/	(B-A)
Total	161.9	176.3	14.4	65.4	66.7	1.3
Private flows	144.2	159.0	14.8	51.1	52.4	1.3
Direct investment	117.1	117.0	-0.1	35.6	37.4	1.8
Portfolio	13.5	21.3	7.8	-0.4	-0.3	0.1
Loans	13.6	20.8	7.2	16.0	15.4	-0.6
Commercial banks	-3.9	-5.6	-1.7	2.9	-0.9	-3.8
Nonbanks	17.5	26.4	8.9	13.0	16.3	3.3
Official flows	17.8	17.3	-0.5	14.3	14.3	0.0

Source: Institute of International Finance. Capital Flows to Emerging Market Economies, January 30 and April 22, 2002.

1/ Forecast as of January 30, 2002.
2/ Forecast as of April 22, 2002.

The IIF analyzed the current international economic scene and decided to revise its forecasts for 2002. Consequently, total net external financing to the emerging economies was revised upward to US$176.3 billion or 8.9% more than the previous forecast. The forecast increase is even more significant in the case of total net private flows, with addition of 10.3% to a level of US$159 billion.

Changes in private capital flows are basically due to portfolio and creditor flows, particularly nonbanking creditors, since commercial bank flows remain negative. Portfolio capital is expected to expand from US$9.5 billion in 2001 to US$21.3 billion in the current year. The forecast of inflows for this year was revised upward by US$7.8 billion, for growth of 57.8%. Net loans from the nonbanking sector – bond acquisitions, suppliers' credits and nonresident deposits in the domestic banking sector and purchases of domestic public securities – are expected to increase from US$6.2 billion in 2001 to US$26.4 billion in the current year. However, data for 2001 were negatively impacted by net withdrawals of US$11 billion as a result of the crises in Argentina and Turkey. These events are not expected to be repeated this year. The IIF forecast for April 2002 increased by 50.9% in relation to January. Commercial banks are to receive net remittances of US$5.6 billion from the emerging countries in 2002, according to IIF forecasts. The net contribution of these countries to financing has remained negative since 1998.

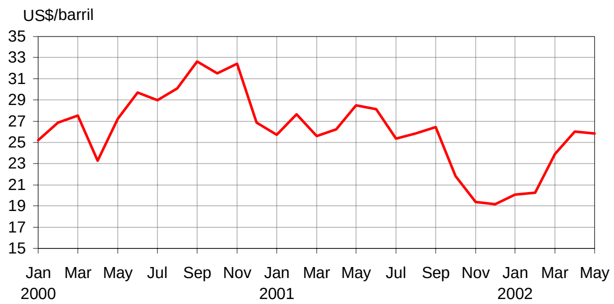
Foreign direct investment continues as the major component of net flows of private financing to the emerging countries. For the current year, it is estimated that foreign direct investments will account for inflows of US$117 billion, the same figure stated in the previous forecast. This is equivalent to 66.4% of total financing and 73.6% of private financing to the emerging countries.

Insofar as Latin America is concerned, the changes introduced by the revisions were less accentuated, as the total flow of financing in 2002 rose to US$66.7 billion, an increase of 2% in comparison to the previous forecast, while private financing increased to US$52.4 billion, for growth of 2.5%. It should be noted that, while private capital channeled to Latin America is expected to account for 33% of the total flow to emerging countries, this percentage is expected to increase to 82.7% in the case of official capitals due, partly, to the situation in Argentina.

4.6 – Petroleum

When compared to the previous quarter, demand for petroleum derivatives in the first quarter of 2002 registered an across-the-board decline, with the sole exception of gasoline. To some degree, this

Brent dated
Period average

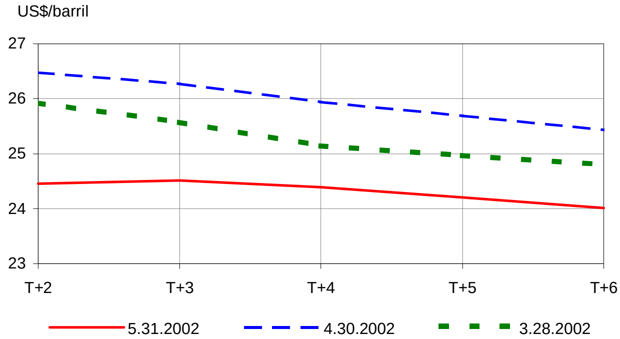


Source: Bloomberg

Crude oil - spot

Source: Bloomberg

Crude oil - future (brent)



Source: Bloomberg

performance was a consequence of higher winter temperatures in the northern hemisphere and increased 2001 orders placed by the United States, particularly for heating oil, as a result of the natural gas crisis.

International Energy Agency estimates of overall petroleum demand in the second quarter of 2001 indicate 75.3 million barrels per day (mbd), with the countries that do not belong to the Organization of Petroleum Exporting Countries (Opec) accounting for an estimated 50.6 mbd. Considering that Opec will produce 24.6 mbd in that period, the overall stock reduction was estimated at 0.1 mbd.

For the third quarter of the year, the IEA forecast total demand at 76.6 mbd, corresponding to an overall stock cutback of 0.6 mbd, since Opec output will come to about 25.2 mbd, despite renewed Iraqi production, and the nonmember countries will turn out about 50.8 mbd. Demand may be even more accentuated depending on the pace of the ongoing process of world economic recovery.

The end-of-month price of Brent-type petroleum increased from US$25.60 per barrel in March to US$26.34 in April, before dropping to US$24.44 in May. To some extent, this behavior can be explained by the suspension of Iraqi production on April 8 and renewed output on May 8, as well as by normalization of the political situation in Venezuela.

One should further stress that the current price level reflects the risk of a Middle East conflict and uncertainties surrounding the repercussions of the United Nations National Security Council Resolution, which imposed restrictions on the products, including civilian goods, that Iraq can purchase with the money it receives from external petroleum sales.

In the futures market, prices for Brent-type petroleum declined for subsequent delivery periods negotiated on the same date.

4.7 – Conclusion

Evolution of the United States economy is the fundamental variable in any attempt to define the trajectory of the world economy. Signs of renewed growth in the early months of 2002 confirm the end of a short recessionary phase. Thus, the extraordinary first quarter GDP growth of 5.6% plus higher rates of productivity in 2002 are positive signs of a new stage in the evolution of the American economy, despite the fact that first quarter GDP expansion was influenced by episodic factors, including a 20% increase in defense spending, while final demand increased by only 3.7%, a pace that did not match the result for the final quarter of the previous year. Thus, government spending and inventory investments accounted jointly for 77% of the growth registered in the first quarter of the year.

Even if the data are not repeated with the same intensity in the second quarter, it is expected that growth will intensify at the end of the current year and achieve a considerably more significant level.

Given today's high degree of economic and financial interdependence among countries, the gradual acceleration of United States economic growth is leading the economies of other countries into a slow but sustained recovery. What is clear is that the climate of plunging confidence and ballooning uncertainties that characterized the final quarter of 2001 is now a thing of the past.

International financial market behavior has evolved smoothly, particularly for the emerging economies. Current forecasts point to increases in net private financial flows to these nations. With the ongoing American recovery and normalization of international markets, the "flight to quality" attitude that dominated in 2001 will certainly decrease in intensity, though markets are still poised in a rather cautious stance.

5 – Foreign sector

5.1 – Trade in goods

Trade balance - FOB

US$ million

Period		Exports	Imports	Balance	Trade flow
Jan-May	2002	20 973	19 041	1 933	40 014
Jan-May	2001	23 885	24 238	- 353	48 124
% change		-12.2	-21.4		-16.9

Source: MDIC/Secex

Note: In 2001, 104 working days; in 2002, 103.

In the period extending from January to May 2002, Brazilian foreign trade operations generated a surplus of US$1.9 billion, a figure that contrasts sharply with the US$353 million deficit registered in the same 2001 period. The favorable result reflected decreases of 21.4% in import operations and 12.2% under exports, for an overall 16.9% reduction in the trade flow.

For the most part, the reduction under exports was concentrated in the heading of industrialized goods. In this case, in the first five months of the year, the daily average declined by 12.2% in comparison to the same period of the previous year. The result was a revenue falloff of US$2.2 billion in the period under consideration. With regard to basic products, these reductions came to 8.9% and US$570 million, respectively.

Exports by aggregate factor - FOB

Daily average - January-May

US$ million

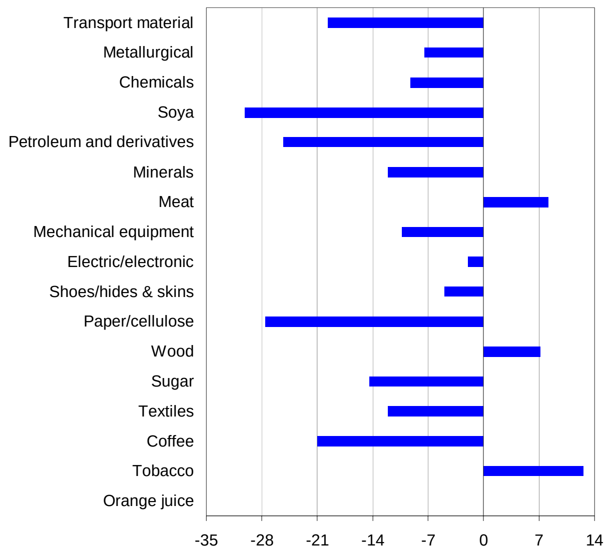
Itemization	Accumulated 2000	2001	% change
Total	229.7	203.6	- 11.3
Primary products	56.2	51.2	- 8.9
Industrial products	165.1	145.0	- 12.2
Semimanuf. goods	32.4	28.3	- 12.7
Manufactured goods	132.7	116.7	- 12.1
Special operations	8.3	7.4	- 11.1

Source: MDIC/Secex

Note: In 2001, 104 working days; in 2002, 103.

Among the major export sectors, only meats turned in a positive result (8.1%). Foreign sales of soybean products fell by 30.1%, reflecting lesser sales of beans and soy meal. To a great extent, the underlying cause of this drop was the fact that shipments had been anticipated to 2001 to be used by European livestock farmers to substitute animal-based inputs in their feed supply. Exports of petroleum and derivatives fell by 25.2%, with declines in foreign sales of fuel oils. These operations had been quite large in the

Exports by sectors - FOB - January-May/2002
Percentual change from the same period of the last year



Source: MDIC/Secex

previous year when the United States sharply increased its purchases of fuel oil for purposes of stock replenishment. Exports of gasoline and crude oil increased in the period. As far as transportation equipment is concerned, sales fell by 19.6%, principally as a result of cutbacks in exports of automobiles and parts, particularly to the Argentine market.

Analysis of price and volume data indicates that, in comparison to the same period of 2001, the drop in foreign sales in the first four months of the year was due to a steady decline in prices, coupled with cutbacks in exported volume.

A somewhat different performance occurred under basic products. This sector managed to achieve steady volume growth in its sales, albeit at a less intense pace than in 2001. In April 2002, prices in all of the product categories increased in relation to March, while volume also rose under industrialized goods at the same time in which the volume of basic goods remained stable. These movements may well signal a turnaround in the downward trajectory of the nation's export operations.

Exports to Argentina and other countries - FOB
Absolute change - Jan-Apr/2002 over Jan-Apr/2001

US$ million

Itemization	Argentina	Other	Total
Total	-1 268	- 718	-1 986
Manufactured products1/	-1 189	- 22	-1 211

Source: MDIC/Secex

1/ Includes manufactured product reexports.

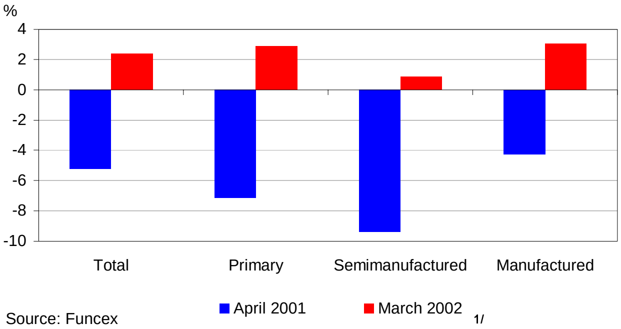
The falloff in Brazilian foreign sales in the four month period, principally in the case of industrialized goods, reflected lesser sales to Argentina and a lower level of world economic growth, particularly as of September 2001. Thus, a breakdown of the US$2 billion reduction in Brazilian exports in the period, when compared to the first four months of the preceding year, indicates that a full US$1.3 billion of this drop was due to lesser sales to Argentina. When one looks only at manufactured goods, this ratio becomes even more accentuated as evident in the fact that only US$22 million of the reduction of US$1.2 billion in sales of these goods was due to lesser sales to countries other than Argentina.

In the January-May 2002 period, import reductions occurred in all of the final user categories, except fuels and lubricants, when compared to the same 2001 period. The basic reason for this result was a rise in imports of crude oil. The falloff was most intense under imports of capital goods, raw materials and consumer durables and reflected cutbacks in industrial output and foreign sales. Aside from these items, there are signs that the tempo of the import substitution process has gained momentum.

Though the performance of imports in the period has reflected downward movement in both prices and volumes, the most significant was the quantity decrease, as revealed by data for the first four months of the year. In April, however, the pace of the decline lessened. The only exception in this case was the heading of consumer durables, which includes automobiles, a segment that registered a sharp downward slide as a result of suspension of Argentine-Brazilian negotiations on renewal of the automotive agreement between the two countries.

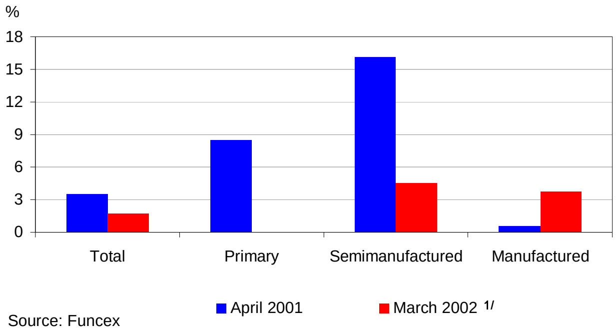
Imports of capital goods fell by 24.3%, when one compares the daily average from January to May 2002 with the results for the same period of 2001. This decrease reflected exceptional 2001 growth that was generated by acquisitions of electricity generating equipment, as well as the impact of the uncertainties that gripped the productive sector in the wake of adoption of electricity rationing measures and the falloff in world economic activity at the end of 2001, considering that there is a certain gap between a decision to acquire such goods and their effective import from abroad. In this context, the growing signs of industrial output growth in 2002 could certainly generate higher imports of capital goods.

Exports - price index - April 2002
Change from the indicated period



Source: Funcex
1/ For the change from March, 2002, the figures were seasonally adjusted.

Exports - quantum index - April 2002
Change over the indicated period



Source: Funcex
1/ For the change from March 2002, the figures were seasonally adjusted.

Imports by end-use category - FOB
Daily average - January-May

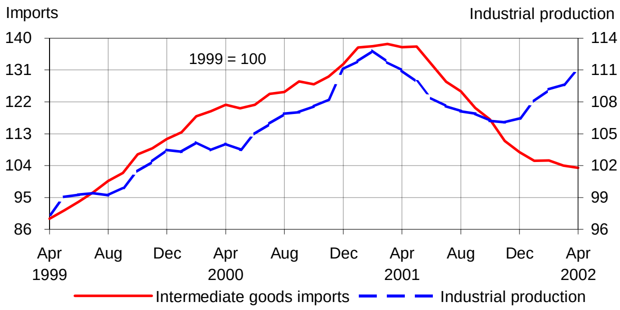
US$ million

Itemization	Accumulated		
	2001	2002	% change
Total	233.1	184.9	- 20.7
Capital goods	63.0	47.7	- 24.3
Raw materials	117.1	90.8	- 22.4
Naphthas	7.5	2.6	- 65.9
Consumer goods	30.3	23.4	- 22.7
Durable	15.3	9.8	- 36.5
Passenger vehicles	6.4	3.1	- 51.5
Nondurable	15.0	13.7	- 8.7
Fuels	22.6	22.9	1.0
Crude petroleum oil	9.9	12.1	22.6

Source: MDIC/Secex

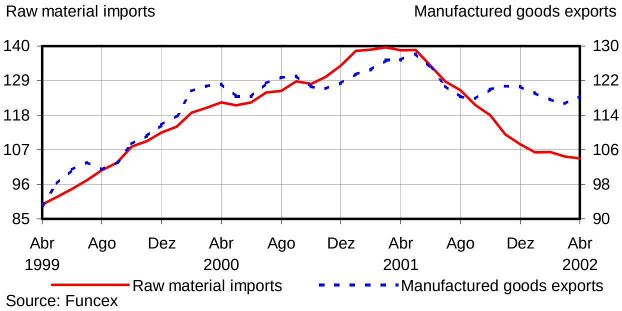
Note: In 2001, 104 working days; in 2002, 103.

Intermediate goods imports x industrial production
Seasonally adjusted indices - 3 month moving average



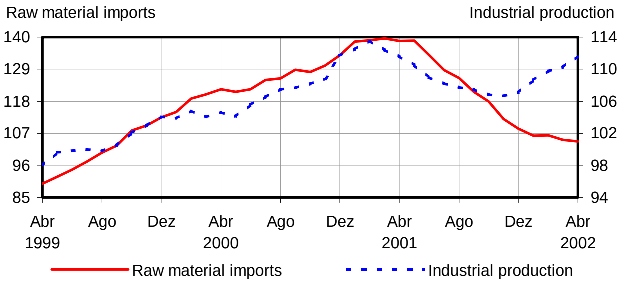
Source: IBGE and Funcex

Raw material imports and manufactured goods exports quantum indices
Three month moving average - 1999 = 100



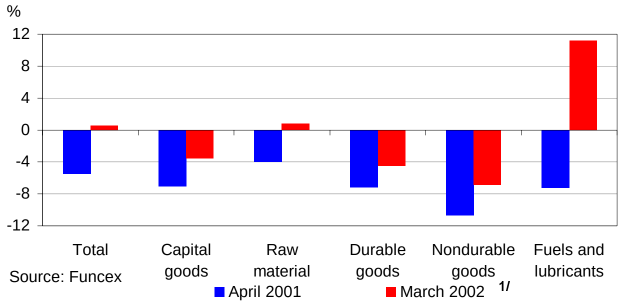
Source: Funcex

Raw material imports and industrial production quantum indices
Three month moving average - 1000 = 100



Source: Funcex and IBGE

Imports - price index - April 2002
Change from the indicated period



Source: Funcex

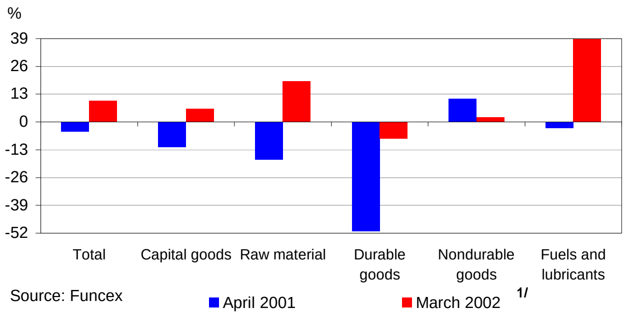
1/ For the change from March 2002, the figures were seasonally adjusted.

Average daily imports of raw materials and intermediate products fell by 22.4% in the period under consideration and were also impacted by the decreased pace of domestic industrial activity. Though there is normally a strong correlation between foreign purchases of these goods and the level of output in the manufacturing sector, indicating the importance of imported inputs to domestic industrial output, these two headings turned in highly distinct performances in the second half of 2001. As a matter of fact, industrial output declined at a less intense pace than imports of raw materials and intermediate goods. At the end of 2001, industrial production shifted into a positive growth curve, while imports of raw materials and intermediate goods continued on a downward slide, though at a less intense pace than previously. The fact that these two headings moved in opposite directions would seem to indicate a more intense process of import substitution.

Foreign purchases of consumer durables dropped by 36.5%, using the same basis of comparison. For the most part, this performance was generated by a reduction of 51.5% in passenger car imports, which correspond to about one third of this category's overall result. Purchases of nondurable consumer goods slipped by 8.7% in the period.

Daily average imports of fuels and lubricants closed with growth of 1%, with 22.6% expansion under the heading of petroleum. This growth reflected higher international market prices and increased quantities of imported petroleum. Here, one should evaluate this result in the context of national production of petroleum and derivatives. It is in light of this output, the nation's refining capacity and the types of derivatives that will be needed in a given period that decisions are taken

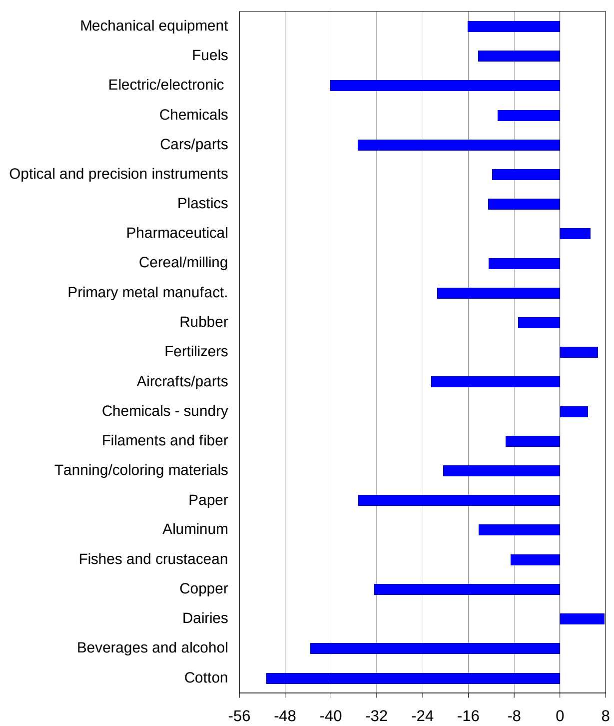
Imports - quantum index - April 2002
Change from the indicated period



Source: Funcex

1/ For the change from March, 2002, the figures were seasonally adjusted.

Imports by sectors - January-May/2002
Percentual change from the same period of the last year



Source: MDIC/Secex

to export excess national output and import foreign products, particularly in light of the different characteristics and quality types of the two products.

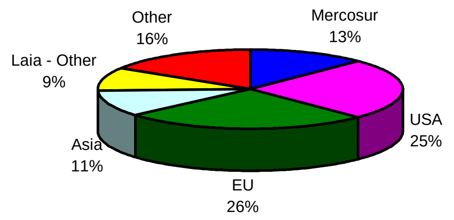
Imports by the different sectors of the economy point to a generalized downturn, with strong cutbacks under electric-electronic products (40.1%) and automobiles and auto parts (35.3%).

With respect to trade operations, one should note that the deficit with the Southern Common Market (Mercosul) countries increased by US$1.1 billion, moving from US$142 million from January to May 2001, to US$1.2 billion in the same period of 2002. With respect to trade with other countries, significant improvement (US$3.3 billion) was registered, including US$1.1 billion in operations with the United States, as the surplus moved from US$329 million to US$1.4 billion, and US$896 million in the overall surplus with the countries of Asia, as the trade deficit with these nations fell from US$1.5 billion to US$585 million.

5.2 – Services and income

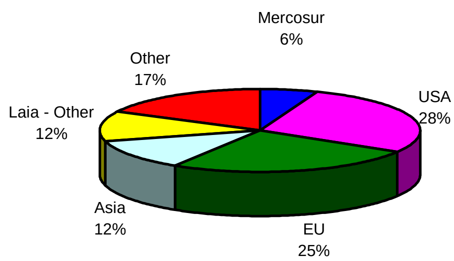
Services and income registered net balances of US$7.3 billion in the first four months of 2002, reflecting a reduction of 18.9% in relation to the result for the corresponding period of the previous year. Net expenditures on services totaled US$1.6 billion, for a decline of 30.4%. Net spending on transportation came to US$668 million, compared to US$1 billion in the previous year. This decrease was a consequence of the reduction in the overall trade flow, principally with regard to imports, and the resulting falloff in freight spending. Net spending on international travel also declined and closed at a level of US$305 million, compared to US$484 million in the first

Exports by geographic area - FOB
January-May/2001



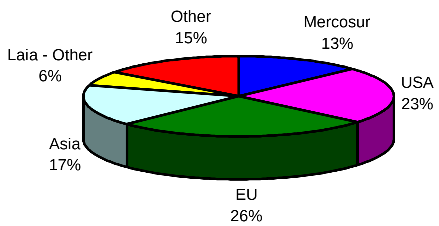
Source: MDIC

Exports by geographic area - FOB
January-May/2002



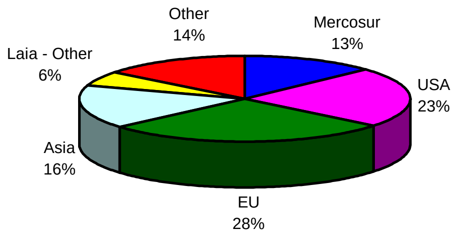
Source: MDIC

Imports by geographic area - FOB
January-May/2001



Source: MDIC

Imports by geographic area - FOB
January-May/2002



Source: MDIC

four months of 2001. The underlying cause of this drop was the fact that Brazilian tourists abroad had to adjust their spending to the new level of exchange. Net outflows on equipment rentals registered a reduction of 4.4%, while spending on computer and information services remained constant. Other services, which include administrative services and specialized technical services, turned in net inflows of US$301 million.

Net remittances of income abroad fell by US$1.1 billion and totaled US$5.7 billion in the four month period. Net interest payments fell by 7.8% to US$4.7 billion. Remittances of profits and dividends also declined during the period and totaled US$1.1 billion, compared to US$1.6 billion in the first four months of the previous year.

As a result of improvement in the balance of trade and service and income accounts, the current account deficit decreased by 42.4% and closed at a level of US$5.2 billion, an amount that was financed with inflows of foreign direct investments with plenty of room to spare.

For 2002, it is estimated that the current account deficit will total US$19.7 billion, corresponding to 3.7% of GDP, compared to 4.6% in 2001. The US$5 billion projection for the trade balance surplus is based on exports at the 2001 level and a 4.2% decline in imports. The lesser flow of trade (exports + imports) has steadily reduced net outlays on freight. This factor, coupled with lesser spending on airline tickets, is the element principally responsible for the projected downturn in transportation costs.

The total amount of US$19.6 billion projected for income, interest and profits and dividends was

Exports and imports by geographic area - FOB
January-May

US$ million

Itemization	Exports			Imports			Balance	
	2001	2002	% change	2001	2002	% change	2001	2002
Total	23 885	20 973	-12.2	24 238	19 041	-21.4	- 353	1 933
Laia	5 244	3 727	-28.9	4 519	3 568	-21.0	725	158
Mercosur	3 016	1 248	-58.6	3 158	2 461	-22.1	- 142	-1 214
Argentina	2 407	803	-66.6	2 795	2 099	-24.9	- 388	-1 296
Other	609	445	-27.0	364	363	-0.2	245	82
Mexico	690	834	20.9	314	234	-25.3	376	599
Other	1 538	1 646	7.0	1 047	873	-16.6	491	773
USA[1/]	5 956	5 800	-2.6	5 628	4 365	-22.4	329	1 435
EU	6 231	5 276	-15.3	6 429	5 278	-17.9	- 197	- 2
W.Europe[2/]	594	546	-8.1	359	275	-23.4	235	271
Asia	2 588	2 518	-2.7	4 069	3 103	-23.7	-1 481	- 585
Japan	818	766	-6.3	1 438	1 007	-30.0	- 620	- 241
South Korea	218	287	31.5	776	452	-41.8	- 558	- 164
China	667	538	-19.4	530	530	0.0	137	8
Other	885	926	4.7	1 325	1 115	-15.9	- 440	- 189
Sundry	3 272	3 107	-5.0	3 235	2 451	-24.2	37	656

Source: MDIC/Secex

Note: Forty working days in both periods.
1/ Includes Puerto Rico.
2/ Albania, Bulgaria, Hungary, Poland, Slovak Republic, Czech Republic, Romania and countries of the former Soviet Union.

Current account

US$ billion

Itemization	2001		2002	
	Jan-Apr	Year	Jan-Apr	Year[1/]
Current account	-9.0	-23.2	-5.2	-19.7
Trade balance	-0.6	2.6	1.5	5.0
Exports	18.5	58.2	16.5	58.2
Imports	19.1	55.6	15.0	53.2
Services	-2.3	-7.7	-1.6	-6.7
Transportation	-1.0	-3.0	-0.7	-2.0
International travel	-0.5	-1.5	-0.3	-1.1
Computer and information	-0.4	-1.1	-0.4	-1.2
Operational leasing	-0.6	-1.9	-0.5	-2.7
Other	0.0	-0.4	0.3	0.3
Income	-6.7	-19.7	-5.7	-19.6
Interest	-5.1	-14.9	-4.7	-15.0
Profits and dividends	-1.6	-5.0	-1.1	-4.6
Compesation of employees	0.0	0.1	0.0	0.0
Current transfers	0.5	1.6	0.6	1.6

1/ Forecast.

altered as a result of withdrawal of US$10 billion in IMF funding, which generated increased interest outlays.

5.3 – Financial account

The financial account registered a net inflow of US$3.1 billion in the first four months of the year. Here, emphasis should be given to the inflow of US$6.7 billion in foreign direct investments. At the same time, it is important to note that the major share of these inflows originated in autonomous investments, while only 4.2% were related to privatizations and about 26.4% involved debt-equity conversions.

Foreign portfolio investments came to US$3.8 billion, for growth of 8.6% compared to the corresponding four month period of 2001. The highlight in this context were fixed income investments, as bond placements moved to US$4.1 billion, including US$3.9 billion in sovereign bonds. Stock investments also increased, producing net inflows of US$2.2 billion due, in part, to issues of American Depositary Receipts (ADR), with US$1.8 billion, of which US$1.1 billion refer to sale of Vale do Rio Doce Company (CVRD) shares belonging to the National Treasury. Operations with notes and commercial papers turned in net outflows of US$768 million, compared to US$368 million in net inflows in the corresponding period of the previous year.

Other foreign investments registered net outflows of US$5.7 billion, due partially to anticipated April payment of US$4.2 billion of a Supplemental Reserve Facility (SRF) loan to the

Financial account

US$ billion

Itemization	2001 Jan-Apr	2001 Year	2002 Jan-Apr	2002 Year 1/
Financial account	9.7	28.0	3.2	25.2
Direct investments	6.6	24.7	5.9	16.6
Abroad	-0.1	2.3	-0.7	-1.4
In Brazil	6.8	22.5	6.7	18.0
Equity capital	5.6	18.8	5.5	17.3
Intercompany loans	1.2	3.7	1.2	0.7
Portfolio investments	3.2	0.1	3.6	1.8
Assets	-0.3	-0.8	-0.2	-1.0
Liabilities	3.5	0.9	3.8	2.8
Derivatives	-0.2	-0.5	-0.3	-0.2
Other investments	0.1	3.6	-6.1	7.0
Assets	-0.3	-6.6	-0.4	1.7
Liabilities	0.3	10.2	-5.7	5.3

1/ Forecast.

BP medium- and long term financing sources
Selected items

US$ million

Itemization	2001 Jan-Apr	2001 Year	2002 Jan-Apr	2002 Year 1/
Medium- and long-term disbursements	7 992	19 916	5 954	11 861
Bonds	3 697	7 549	4 060	5 150
Notes and commercial papers	2 024	7 350	1 134	4 319
Direct loans	2 272	5 017	760	2 392
Short-term capital (net)	187	2 746	- 3	3 347
Rollover rate				
Bonds	n.a.	118%	n.a.	220%
Notes and commercial papers	124%	81%	56%	65%
Direct loans	190%	138%	60%	65%

1/ Forecast.

IMF. Brazil had obtained these resources in September 2001, with amortizations scheduled in equal installments for September 2002 and March 2003.

As regards the sources of balance of payments financing, flows originating in placements of notes and commercial papers declined. The rate at which these operations were rolled (inflows over amortizations) moved from 124% to 56%, when one compares the first four months of the current year with the same period in 2001. At the same time, the rolling of direct loans dropped from 190% to 60% for the same period. Consequently, the stock of the external debt, particularly that of the private sector, diminished in the period.

For the current year it is expected that the percentage of rolling will close in the range of 70% for funding operations based on papers and direct loans, corresponding to an average of about 65% for the year. The lesser inflow of long-term resources is to be offset by short-term loans, without, therefore, losing the sources of balance of payments financing.

When one includes the US$10 billion withdrawal of IMF funds, the balance of payments is expected to close 2002 with a surplus of US$4.9 billion.

International reserves registered a reduction of US$2.9 billion in April and closed at US$32.9 billion in the concept of international liquidity. This reduction was the result of anticipated payment of the IMF loan cited above, while other amortizations came to a volume of US$714 million. Interest payments on the federal government foreign debt came to US$2.2 billion, while revenues earned on reserves added up to US$508 million. Inflows generated by bond operations came to US$3.9 billion.

Uses and sources

US$ billion

Itemization	2001 Jan-Apr	2001 Year	2002 Jan-Apr	2002 Year[1/]
Uses	-19.6	-58.4	-13.6	-47.9
Current account	-9.0	-23.2	-5.2	-19.7
Amortizations ML-term[2/]	-10.6	-35.2	-8.4	-28.2
Securities	-5.3	-19.0	-3.3	-10.9
Paid	-3.1	-16.9	-3.3	-10.9
Nationalization debt	0.0	3.1	0.0	-
Refinanced	-2.2	-2.2	0.0	0.0
Suppliers' credits	-1.1	-2.8	-0.8	-2.6
Direct loans[3/]	-4.2	-13.3	-4.3	-14.7
Sources	19.6	58.4	13.6	47.9
Capital account	0.1	0.0	0.1	0.1
FDI	6.8	22.5	6.7	18.0
Domestic securities	0.6	2.2	2.3	4.4
ML-term disbursements[4/]	13.4	32.5	9.0	23.4
Securities	7.9	14.9	5.2	9.5
Suppliers' credits	1.1	3.3	0.7	2.5
Direct loans	4.4	14.3	3.1	11.4
Brazilian assets abroad	-0.5	-4.6	-1.0	0.0
Loans to Bacen (FMI)	-0.1	6.6	-4.4	5.4
Short-term and other[5/]	1.3	0.3	-2.0	1.6
Reserve assets	-2.0	-3.3	2.9	-4.9

1/ Forecast.
2/ Registers amortization of medium and long term suppliers' 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 liabilities and errors and omissions.

Forecasts regarding the reserve position at the end of the year indicate a total of US$41.1 billion, for growth of US$8.3 billion in the June/December period. As far as uses are concerned, Central Government debt service operations are expected to consume US$5.2 billion and payments to IMF concerning stand-by credits will come to US$261 million. Sources of financing will originate in placements of bonds and disbursements from multilateral organizations in the amount of US$2.2 billion, funding from the IMF (US$10 billion) and sale of minority stock positions belonging to the National Treasury (US$1 billion), to be classified in the balance of payments as portfolio investments (stocks).

Net reserves are expected to reach a level of US$27 billion, for a decline of US$0.8 billion, when compared to December 2001 position.

5.4 – Conclusion

Statement of international reserves

US$ billion

Itemization	2001 Year	2002 Jan-May	2002 Jun-Dec[1/]	2002 Year[1/]
Reserve position in previous period	33.0	35.9	32.9	35.9
Sales to/purchases from resident banks	-7.2	0.0	-0.3	-0.3
Debt service (net)	-7.1	-2.8	-4.3	-7.1
Interests	-3.2	-1.7	-2.1	-3.8
Credit	1.9	0.6	0.9	1.5
Debit	-5.1	-2.2	-3.1	-5.3
Amortization	-3.9	-1.2	-2.1	-3.3
Disbursements	7.8	3.9	2.2	6.1
Multilateral organizations	1.2	0.0	1.1	1.1
Republic bonds	6.7	3.9	1.1	5.0
Exceptional financing (FMI)	6.8	-4.3	9.7	5.4
Disbursements	6.8	0.0	10.0	10.0
Amortization	0.0	-4.3	-0.3	-4.6
Others[2/]	2.6	0.2	1.0	1.2
Change in position	2.9	-3.0	8.3	5.3
Reserves position	35.9	32.9	41.1	41.1
Net reserves position	27.8	28.5	27.0	27.0

1/ Forecast.
2/ Includes Poland's prepayment in November 2001 (US$2,5 billion) and sales of minority shares.

Figures for the year and for twelve months indicate that the balance of trade followed an upward curve in accumulated terms, despite the reduction under exports. Foreign sales are expected to gain momentum as the world economic recovery picks up steam, thus offsetting losses in exports to Argentina. Imports have shifted to a lesser level, as nationally produced goods have gradually replaced items formerly purchased abroad. Thus, any recovery in import operations consequent upon industrial output growth is expected to be considerably more moderate. For both exports and imports, this behavior will sustain the trade balance surplus projected for the end of the year.

Net outlays on services also aided in reducing the current account deficit, just as occurred with interest payments, as the external debt remained stable.

These results have generated a lesser degree of pressure on external borrowing requirements. In this sense, the current account deficit accumulated over the past twelve months up to April totaled US$19.4 billion, or US$3 billion less than the accumulated flow of foreign direct investments.

For the year, it is estimated that foreign direct investments will finance 91% of the current transactions deficit. Medium and long-term amortizations will be partially covered by new funding and completed by stock investments and short-term loans.

6 – Prospects for inflation

This chapter of the Inflation Report presents the Monetary Policy Committee (Copom) assessment of the Brazilian economic performance since the last Report, issued in March 2002, as well as prospects for the inflation rate through 2003. The projections are based on the assumption that the basic interest rate will hold steady during the period under analysis at 18.50% a year, the rate set by Copom in its last meeting on June 18-19, and that the exchange rate will remain at the same level as on the eve of that meeting. An alternative forecast is also presented, taking into account market expectations for the interest rate and exchange rate paths on June 18. One should notice that these procedures are strictly technical. Hence, these assumptions should not be 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 that prevailed when the basic interest rate was set. Inflation forecasts are based not only on the interest rate assumption, but also on assumptions concerning the behavior of relevant exogenous variables. The baseline scenario, based on which the Copom makes its decisions on interest rates, depends on a set of assumptions considered as the most likely by the Copom. The forecasts of the Monetary Policy Committee presented in this Report are intended to enhance monetary policy transparency and its effectiveness in controlling inflation, which is its main objective.

6.1 - Determinants of inflation

The economic activity indicators observed in this quarter seem to confirm that the economy continues to recover from the levels registered last year, albeit at a slower pace. In the first quarter of 2002, seasonally adjusted GDP grew by 1.34% in relation to the previous quarter. The strong growth of industrial production in April (4.07%), as measured by the IBGE purged of seasonal factors, was partially influenced by movable holidays. In line with the industrial production growth, the total salary mass increased in April both in São Paulo, according to FIESP, and in Brazil at large, according to the CNI. Moreover, conjunctural factors such as the World Cup and the release of funds from the FGTS (Warranty Fund for Severance Pay) are likely to have a positive impact on consumption, just like electoral spending is expected to boost certain specific industries, such as the paper, cardboard, and electro-electronic industries.

In May, some indicators point to a decline in industrial production as compared to the previous month. As measured by IBGE, the open unemployment rate stopped dropping and began to rise again, hitting the mark of 7.6% in April, as compared to 7.1% in March. The Consumer Intention Index measured by Fecomercio of São Paulo declined by 12.31% in June, which is a significant drop. The consumer credit is expected to remain relatively constant in the next few months as a result of higher default rates, inhibiting consumption spending.

In 2002, investment spending is likely to be constrained by credit restrictions and by the entrepreneurs' state of confidence. The Industrial Entrepreneurs' Confidence Index rose significantly in the first quarter of the year in relation to the two previous quarters, but it dropped slightly in the current quarter. However, investment estimates based on spending on selected capital goods suggest a growth in the investment until April of 12.5% in agriculture and of 8.3% in electricity. This increase in investments indicates an expansion in the economy's productive capacity.

The Brazilian performance in the foreign trade sector is positive. The balance of trade posted a surplus of US$ 4.9 billion in the 12-month period ending in May. The current account deficit in the same period has been declining continuously since August 2001, reaching a level of US$ 19.4 billion in April. From January to May 2002, this deficit was fully financed by net inflows of direct foreign investments, which totaled US$ 22.4 billion in the 12-month period. For 2002, a deficit of about US$ 19 billion has been projected, which will be almost fully financed by net inflows of direct foreign investments amounting to US$ 18 billion.

The growth of Brazilian exports will be restricted by the prospects of modest growth in Mercosur economies, by restrictions imposed by the United States on Brazilian steel exports, and by the increased subsidies provided to agricultural activities in that country. On the other hand, the consolidation of new trade agreements, like the one signed with Mexico, and the growth of industrialized economies, particularly that of the United States, tend to offset the above-mentioned effects. The growth of imports, in turn, is expected to be smaller than that of exports, mainly as a result of incentives to replace foreign production by domestic production associated with the exchange rate depreciation. The exchange rate depreciation is also likely to stimulate exports, but imports are projected to have a stronger bearing on the increase in the trade balance surplus in 2002 than exports.

On the side of aggregate supply, there is room for production growth without inflationary pressure. The higher investment rate registered until April indicates an expansion in the productive capacity. Both the level of use of productive capacity and the situation of the labor market make it possible for the economic activity to grow without generating pressures on prices. The average use of the installed capacity (data provided by the Getúlio Vargas Foundation) was 79.1% in April, which is lower than the 81.7% average registered in 2001. Moreover, as opposed to last year, the production will not be limited by the electricity-rationing scheme, which was lifted in February.

The labor market is not a source of pressure on corporate costs either, meaning that it is not a factor of inflationary pressure. There are positive signs in this market, albeit not very significant so far. The level of employment in the transformation industry in April was the highest one since December 1998 (data provided by CNI). The real average income of employed personnel in the first quarter was above the one registered in the previous quarter, but below the figures for the remaining quarters of 2001 (data provided by IBGE with seasonal adjustments). The open unemployment rate as measured by the IBGE was falling but began to rise again in April, when it hit the mark of 7.6%, as compared to 7.1% in March.

A good agricultural harvest has contributed to bring the inflation of market prices down, with significant effects on the overall inflation rate in May. In the next few months, the beginning of the period between harvests may give rise to inflationary pressure. For 2002 as a whole, however, the inflation of food prices will surely be lower than the IPCA as a result of the positive performance of the agricultural sector.

According to CNI estimates, the inventories of raw materials and intermediate goods in the transformation industry decreased, while the inventories of final goods increased in the first quarter. For this reason, the economic activity is not likely to benefit from the stimulus of an inventory recovery movement, as was the case through the first quarter of the year.

The recent adverse conjuncture, characterized by higher uncertainty in relation to the future, has had a negative impact on the price of assets in both foreign and domestic currency. Comparing the figures registered between two meetings, the real depreciated by 7.5% since the last meeting of the Copom, and the risk as measured by the Embi+ index rose from 930 to 1300 basis points. The volatility of the markets affected other assets as well. Both the one-year exchange rate coupon and the discount of long term LFTs increased significantly compared to the observed at the beginning of the year.

The exchange rate depreciation impacts the inflation rate. The impact on market prices, however, can be small. First, given the slow growth of the economy, the capacity of corporations to pass the cost increase associated with the exchange rate variation on to their customers is limited. Second, prices were probably established in the first four months of the year on the basis of an exchange rate that was more depreciated than the actual rate. Likewise, economic agents may be defining prices on the basis of an exchange rate that is more appreciated than the actual rate. Under the methodology adopted by the Copom, according to which the exchange rate is assumed to hold steady during the projection interval, the exchange rate depreciation only exerts direct pressure on the inflation rate in 2002. In 2003, if the exchange rate remains stable, its impact will be null. The inertial effect of the exchange rate depreciation is expected to be stronger through the second semester of 2002. However, the turbulence in the financial market may have an impact on the pass-through of the exchange rate variation to market prices if the perception that the depreciation of the exchange rate is permanent increases.

The impact of the exchange rate variation on prices administered by contract and monitored prices is more direct than on market prices. In the case of the prices of oil by-products, domestic prices are set at approximately the same level of international prices converted into reais, although the price adjustment percentage for the consumer is lower, given the existence of other cost elements and the lack of proportionality between taxes and prices. In the case of electricity and fixed telephone services, contracts entered into with utility companies usually stipulate that price readjustments must be partly based on the exchange rate and/or on the IGP variation, which is influenced by the exchange rate.

Regarding the impact of inflation inertia, the effect of the high inflation rate registered in the last quarter of 2001 will be almost fully incorporated into the figures observed in the first semester of 2002. However, the inflation rate projected for the first semester of 2002 is likely to be 1.2 p.p. above the target, pushing the inflation up in the remaining quarters of the year. In 2003, the lower inflation of market prices and consequent reduction in the IPCA in the second semester of 2002 may reduce the inflationary pressure resulting from inertia.

The variation accumulated over 12 months in the IPCA was 7.77%, a value below the one registered in April (7.98%) and close to the one observed in March (7.75%). Market prices contributed 4.0 percentage points to the inflation rate and prices administered by contract and monitored prices contributed 3.7 percentage points.

Despite the current pressure on market prices brought about by the exchange rate depreciation, the inflation inertia, and the waning of the effects of a good agricultural harvest, the inflation of market prices is expected to resume its downward path in the medium run and remain at levels consistent with the established targets.

6.2 - Baseline scenario: assumptions and associated risks

Copom forecasts are based on a set of assumptions about the behavior of key economic variables. This set of assumptions and respective associated risks make up the baseline scenario on the basis of which Copom makes monetary policy decisions.

The baseline scenario for Copom forecasts for the next 18 months assumes, on the one hand, that the economic policy in 2003 will remain committed to fiscal balance and to the targets set for the inflation rate and, on the other hand, that the transition to the new federal administration will not be subject to exaggerated and/or protracted turbulence.

The main sources of uncertainty as to the evolution of inflation until the end of 2003 are the behavior of prices administered by contract and monitored prices, the evolution of the world economy, and the behavior of the exchange rate and of domestic assets. If the uncertainties in relation to the future of Brazilian economy and the recent adverse conjuncture of marked depreciation in the price of assets and in the exchange rate persist, the inflation forecasts for 2002 and 2003 may be higher. In particular, the temporary nature of the exchange rate variation and the magnitude of its pass-through to prices would be challenged, regardless of the factors that could inhibit the exchange rate pass-through described above.

In relation to the last *Report*, the inflation forecasted for prices administered by contract and monitored prices in 2002 rose 1.3 percentage points. This upward review for 2002 resulted from factors such as a lower drop in the gasoline price, a larger increase in the prices of cooking gas, diesel oil, and electricity and the exchange rate depreciation registered in the period**.** For 2003, an increase of 1.6 percentage points in relation to the *Report* of March can be observed. This increase is particularly due to the adjustment of a larger proportion of administered prices according to specific hypotheses and not to the actual inflation of market prices.

The prospects for the world economy have not changed significantly since the *Report* of March. The US economy is recovering. However, prospects have deteriorated for the Mercosur economies. Argentina has not managed to secure a definitive agreement with the IMF so far, delaying the access of that country to international financial markets. The Uruguayan economy is also being affected by the crisis experienced by its neighboring country.

As for the exchange rate, the depreciation observed in recent weeks, added to the effects of the higher volatility in the assets' market, affected the inflation forecast adversely by increasing both the projected figures and the uncertainty in relation to the pass-through to market prices.

The inflation projections were built on the basis of a new specification for the structural model using the 180-day interest rate swap as the explanatory variable, replacing both the Selic rate and the slope of the term structure. The projection of the six-month swap rate uses a VAR model with error correction *(see Box "New Specification for the Impact of Interest Rate on the Output and Methodology for Projecting Six-Month Interest Rate")*. Based on this model specification, the projection for the spread of the six-month rate over the Selic rate begins at 350 b.p. in the third quarter of 2002 and slopes downward thereafter until it reaches 50 b.p. during 2003.

For administered prices, which have a weight of 30.8% in the IPCA in May, inflation rates of 8.1% and 6.1% are forecasted for 2002 and 2003, respectively. In the current baseline scenario, the inflation for a larger group of items, particularly those related to transportation, began to be projected for next year based on the evolution of the IGP-M, instead of following the IPCA variation. On average, the inflation of these items in 2003 will amount to 5.2%. Prices administered by contract and monitored prices are expected to contribute 2.5 and 1.9 percentages points to the IPCA variation in these two years, respectively.

It should be highlighted that despite the higher projections since the *Report* of March, the inflation of administered prices is expected to follow a downward path during the projection horizon. Two particularly important factors will contribute to the lower forecasts between the two years: the smaller variation anticipated for the IGPs – approximately 6.0% in 2002 and 5.0 % in 2003 - and the assumption that the exchange rate will hold steady through next year.

The projection for prices of oil by-products are based on the following parameters: the evolution of the exchange rate; the spot and future price of gasoline in the United States for gasoline price adjustments; the spot price of propane gas in the United States and future prices negotiated in the New York Mercantile Exchange (NYMEX) for cooking gas price adjustments. The gasoline consumer price is expected to accumulate a fall of 4.5% in 2002 as a result of the drop registered in January and February. For cooking gas, the projections indicate price increases of approximately 28% in 2002, of which a hike of 21.5% was already registered between January and May as a result of the elimination of subsidies early this year.

Current projections suggest that there will be an increase of 19.4% in electricity rates for consumers in 2002, which will have a direct impact of 0.8 percentage point in the IPCA for 2002. Between January and May, they already increased 10.1%. In the last Report, electricity prices were projected to increase by 16.6% this year. The projection for the electricity price adjustment rose by 2.8 percentage points particularly because of the exchange rate depreciation observed since then. For 2003, a price adjustment of 12.3% has been projected.

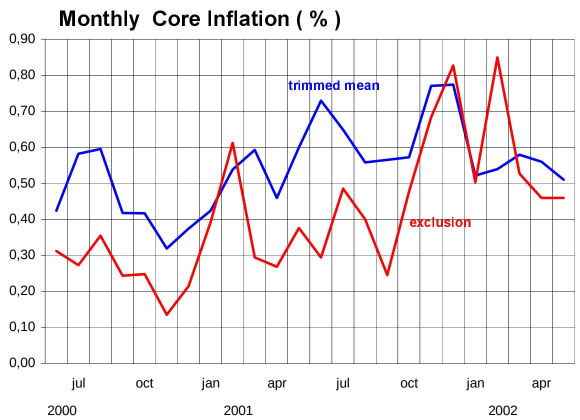
With the end of the electricity-rationing period in the previous quarter, no other factors that could restrict the growth of aggregate supply have been identified. For agricultural products, the assumption made in the last *Reports* that their prices would evolve according to the inflation of market prices until the end of 2002 and in 2003 was maintained.

The baseline scenario suggests a stable path for the exchange rate in 2002. In particular, the exchange rate holds steady in relation to the level observed on the eve of the Copom meeting. Because of this handling of the exchange rate and of its behavior in the second quarter, this hypothesis implies a more depreciated exchange rate in the third quarter of 2002.

The Copom recognizes that uncertainties in relation to the exchange rate variation pass-through and to the persistence of this variation have enhanced the degree of uncertainty of the inflationary projections.

As also explained in the Minutes of the Copom meeting in May, an assumption was made that the economic agents do not use the actual exchange rate as a parameter for defining prices, but rather the rate that they think is most likely to be permanent. In the projections presented here, it was assumed that the exchange rate that is relevant for the formation of market prices is based on the average level observed in the second quarter of 2002, which gradually converges toward the actual exchange rate in the first quarter of 2003.

The baseline scenario assumes that Brazil's sovereign risk premium, as measured by the spread over treasury of the Global 08, will drop from an average of 940 basis points in the second quarter of 2002 to about 850 b.p. in late 2002 and to 700 b.p. in 2003. The path for the fed funds interest rate, based on the futures contracts, was changed to reflect an average rate of 1.75% in the second quarter of 2002 that rises to 2.25% in the first quarter of 2003 and holds steady at 2.5% as of the second quarter of that year.

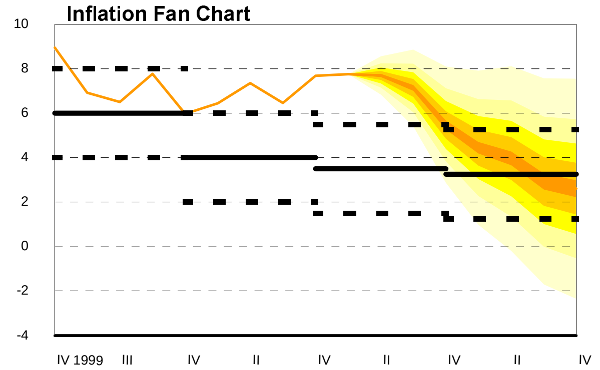


Finally, regarding the fiscal policy, it is assumed that the target of 3.75% set for the primary surplus of the consolidated public sector will be achieved.

The core inflation of the IPCA, as calculated by the symmetric trimmed-mean method, declined from 0.56% in April to 0.51% in May. In the last 12 months, a variation of 7.58% was registered in this core inflation. As for the core inflation of the IPC-BR, as calculated by the symmetric trimmed-mean method, it dropped from 0.46% in April to 0.36% in May. Accumulated in 12 months, the core index increased by 7.10%. The core inflation calculated with the exclusion of administered prices and of food prices at household rose by 0.46% in May and 6.39% in 12 months.

6.3 – Inflation forecast

Forecasted 12-month IPCA-inflation with Selic interest rate constant at 18.50% p.a.



12-month IPCA inflation with 18.50% p.a. fixed interest rate

Year	Q	Confidence Intervals						Central Projection
		50%						
			30%					
				10%				
2002	2	7,3	7,5	7,6	7,8	7,9	8,0	7,7
2002	3	6,4	6,7	7,0	7,3	7,5	7,8	7,1
2002	4	4,4	4,9	5,3	5,7	6,1	6,5	5,5
2003	1	3,0	3,6	4,2	4,7	5,3	5,9	4,5
2003	2	2,3	3,0	3,6	4,3	4,9	5,7	4,0
2003	3	1,0	1,8	2,6	3,3	4,0	4,8	2,9
2003	4	0,6	1,4	2,2	3,0	3,8	4,6	2,6

Note: The values correspond to the ones shown in inflation fan chart.

Based on the assumptions and associated risks considered by the Copom and on all the information available, the IPCA variation in twelve months was projected assuming that the basic interest rate will remain constant at the level of 18.50% a year, as defined at the meeting held on 18-19 June 2002, and the exchange rate will remain constant at the level observed on the eve of the Copom meeting. The inflation projection using the market-expected interest rate path will be presented as well.

The central path expected for the inflation accumulated in 12 months declines steadily from 7.7% at the end of the second quarter of 2002 to 5.5% in late 2002 and to 2.6% in 2003. A marked decline in the inflation rate between the third and fourth quarters of this year is anticipated as a result of the substitution of an abnormally high inflation in the last quarter of 2001 with a figure that is more consistent with the targets set for the inflation in the last quarter of this year.

Prices administered by contract and monitored prices are the ones causing the highest inflationary pressure. These prices are projected to rise by about 8.1% in 2002 and to account for 2.5 percentage points in the IPCA variation. Of the forecasted 8.1%, 3.6% has already been registered until May, and price adjustments will be mostly concentrated in the period between June and July, when the prices of electricity and fixed telephone services will be readjusted, adding to the 9.2% increase in the cooking gas price at the refineries that became effective on June 1st.

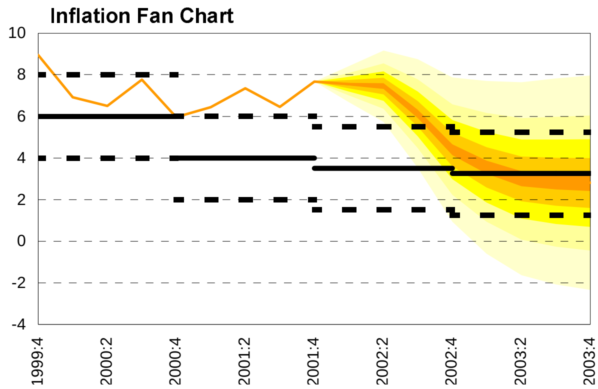
For market prices, which account for about 70% of the IPCA variation, a growth of 4.3% has been projected, contributing with 3.0 percentage points. Considering that market prices have already increased by 2.0% in 2002, the average monthly inflation of these prices by the end of the year is expected to be lower than the figures observed until May. In the short run, an increase in market prices after the seasonal drop of *in natura* food prices is expected. In the second semester of the year, however, the inflation of market prices is expected to resume a downward path as a result of the absence of inflationary pressures caused by an excessive aggregate demand, of credit stability, and of the recent increase in six-month interest rates.

It is estimated that the contribution to the IPCA variation in 2002 of the primary effect of the shock to prices administered by contract and monitored prices - the figure exceeding the inflation target after the impact of the exchange rate pass-through and of inertia on prices administered by contract and monitored prices is eliminated - is 0.5 percentage point *(see the Box "Methodology for Calculating The Inflation Inertia and the Effects of the Shock to Administered Prices").* Through inertial mechanisms, the inflation rate this year still carries the effects of the inflation in 2001. It is calculated that the inflation inertia above the target set for last year will have an impact of 0.9 percentage points in the IPCA in 2002. The increase of 0.2 percentage point in relation to the figure presented in the last *Report* is due to the higher inertia of prices administered by contract and monitored prices, which was reestimated to incorporate the chain effect of these prices on the inflation rate in 2002, as explained in the above-mentioned Box.

For 2003, an inflation rate of 6.1% for prices administered by contract and monitored prices has been projected, contributing 1.9 percentage points to the IPCA variation. For market prices, a lower figure is expected: 1.1%, contributing 0.7 percentage point to the IPCA. For the headline IPCA, an inflation of 2.6% has been projected for 2003, which is below the target.

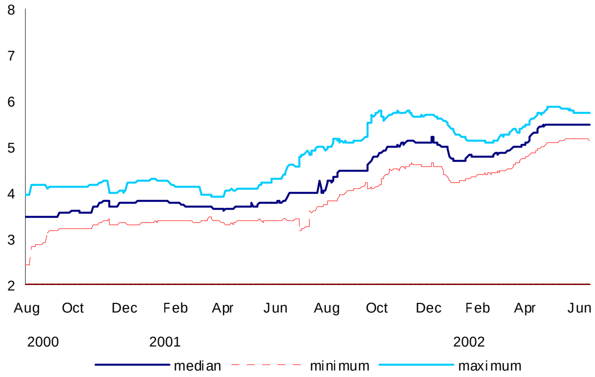
The lower inflation forecast for next year in relation to 2002 and the fall of almost 1 p.p. for market price inflation compared to the *Report* of March result from the combination of the following factors: i) inflation projections were based on the assumption of a constant Selic rate at 18.5% p.a., implying a high real interest rate. This fact, together with the current spreads observed in the market, implies that the trajectory for the 6-month swap rate used for projections was well above the one used in the *Report* of March (around 22% p.a., compared to 18% p.a. for 2002Q3). Because of the high real interest rates and the current swap rates, there is a strong downward pressure on market price inflation as of the last quarter of this year; ii) the assumption of a constant path for the exchange rate in the remainder of 2002 and in 2003 means that exchange rate variations will have no impact on the inflation forecast for market prices in 2003. Additionally, the recent levels of the real do not suggest that there will be any further exchange rate depreciation; and (iii) in this *Report,* the variation of administered prices is assumed to fall by almost 2 percentage points between 2002 and 2003.

Forecasted 12-month IPCA-inflation with interest rate constant at 18.50% p.a. (March Report)



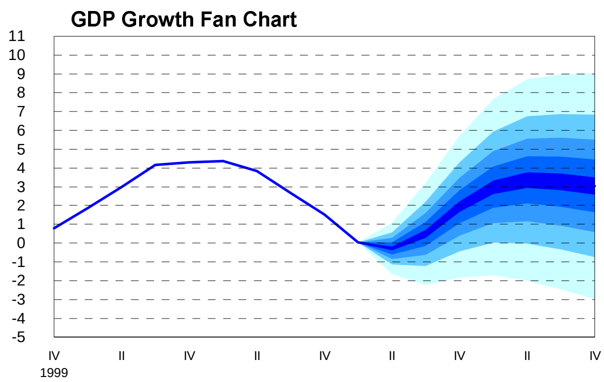
Comparing the current projection to the one presented in the *Report* of March, one notices a change in the expected path. Although no direct comparison can be made between the two projections, as they are based on different assumptions in terms of scenarios and interest rates, it is worthwhile to highlight certain points. The core projection for 2002 rose from 4.4% to 5.5%, while for 2003 it dropped from 2.8% to 2.6% as compared to the last *Report*. In 2002, the main reason for the higher projection was the inflation of prices administered by contract and monitored prices, the projected variation of which rose from 6.8% to 8.1%. This upward review caused mainly by the increase in the international prices of oil by-products since March and by the exchange rate depreciation observed in the period. The projection for the inflation market prices rose from 3.4% to 4.3% as a result of the exchange rate variation. For 2003, the main cause for the lower inflation projection was, as mentioned above, the lower variation anticipated for market prices as a result of the upward movement of the term structure of interest rates, which exerts a contractionist pressure on the economic activity and, consequently, on the inflation rate. As opposed to the projected fall for market prices inflation since the last *Report,* the inflation forecasted for prices administered by contract and monitored prices rose from 4.5% to 6.1%.

IPCA Inflation expectations for 2002 (%)



The graph on the left illustrates the expectations for the evolution of the inflation rate in 2002 according to information surveyed by the Investor Relations Group of the Central Bank of Brazil (GCI). In comparison to the *Report* of March, they rose slightly by about 0.5 percentage point, probably keeping pace with the evolution of the exchange rate, and are now stable at a level of about 5.5%. Market projections for inflation in 2003 remain stable at 4%.

GDP growth with 18.50% p.a. constant interest rate

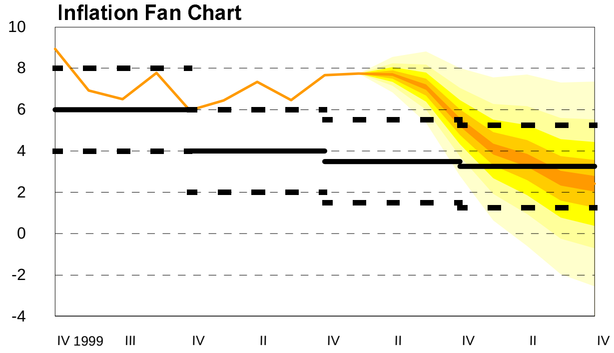


(GDP variation, 12 months over previous 12 months)

As in previous *Reports*, this issue also presents the fan chart for output growth, which was built according to the same assumptions used in the baseline scenario of Copom. It should be stressed that the forecasting errors associated with GDP growth projections are considerably larger than those in the case of inflation projections. This happens because GDP growth projections involve the trajectory of two non-observable components, namely, potential output and output gap and 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 2.0%, assuming a basic interest rate of 18.50% per year. Therefore, there was a drop of about 0.5 percentage points in the projection of GDP growth in 2002. This decline is particularly associated with the contractionist effect of a higher risk perception - translated into an increase in interest rates with longer maturity - on the level of economic activity,

The inflation fan chart taking into account the market-expected path for the basic interest rate and the exchange rate on June 18 is also

Forecasted IPCA-inflation with market interest rate expectation. [1/]



(accumulated inflation in 12 months)

[1/] From Investor Relations Group - 06/18/2002

IPCA-inflation with market expectations for interest rate and exchange rate expectation [1/]

Year	Q	Confidence Intervals						Central Projection
		50%						
			30%					
				10%				
2002	2	7,3	7,5	7,6	7,8	7,9	8,0	7,7
2002	3	6,4	6,7	7,0	7,2	7,5	7,8	7,1
2002	4	4,3	4,8	5,2	5,6	6,0	6,5	5,4
2003	1	2,7	3,3	3,8	4,4	4,9	5,5	4,1
2003	2	1,9	2,6	3,2	3,9	4,5	5,3	3,6
2003	3	0,8	1,6	2,3	3,0	3,8	4,6	2,7
2003	4	0,4	1,2	2,0	2,8	3,6	4,4	2,4

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

[1/] From Investor Relations Group - 06/18/2002

presented. As in the two previous *Reports*, the median of market expectations captured by GCI polls until that date was directly used. The market-expected interest rate path slopes downward from the current level to 17.25% p.a. in late 2002 and 15.00% in 2003. Based on this path and on the VAR model, the path for the six-month swap rate through the forecast horizon was estimated. Besides the interest rate assumption, this fan chart has assumed the real would reach 2.55 in late 2002 and 2.62 in late 2003. The inflation estimated on the basis of these assumptions amounts to 5.39% in late 2002 and to 2.48% in late 2003. The remaining assumptions are the same as those spelled out in the baseline scenario. One should notice that since the market-expected exchange rate is lower than the one used in the baseline scenario, which was the actual rate on the eve of the Copom meeting, the inflation projected for 2002 based on the figures expected by the market for the exchange rate and interest rates is lower than the one projected under the baseline scenario.

New specification for the impact of interest rate on the output and methodology for projecting six-month interest rate

The *Inflation Report* of March 2002 mentioned that changes were introduced in the specification of the output gap equation used in the structural model adopted by the Central Bank of Brazil (IS curve). The explanatory variables Selic interest rate and the slope of interest-rate term structure were replaced by the 180-day pre-fixed DI swap rate.

In the model used until March 2002, the equation of the output gap was the following:

$$h_t = \alpha_0 + \alpha_{1,1}h_{t-1} + \ldots + \alpha_{1,k}h_{t-k} + \alpha_{2,1}r_{t-1} + \ldots + \alpha_{2,k}r_{t-k} + \alpha_{3,1}IC_{t-1} + \ldots + \alpha_{3,k}IC_{t-k} + \alpha_4 z_t + \varepsilon_t$$

where h = output gap, defined as the difference between the actual and the potential output;
i = one-day Selic rate;
π = inflation rate as measured by the IPCA;
IC = slope of the term structure, as measured by the difference between the 6-month pre-DI swap rate and the one-day Selic rate;
z = other explanatory variables, such as the real exchange rate, the fiscalpolicy;
ε_t = random shock;
α = estimated parameters;
r = real interest rate, calculated by $(i - \pi)$.

The new specification restricts coefficients $\alpha_{2,k}$ to be equal to coefficients $\alpha_{3,k}$ for each lag k. This means that the explanatory variable is the 180-day pre-fixed DI swap rate (S180) and not the Selic rate and the slope of the term structure any longer. Thus, the new specification becomes:

$$h_t = \alpha_0 + \alpha_{1,1}h_{t-1} + \ldots\ldots + \alpha_{1,k}h_{t-k} + \alpha_{2,1}(S180_{t-1} - \pi_{t-1}) + \ldots\ldots. + \alpha_{2,k}(S180_{t-k} - \pi_{t-k}) + \alpha_4 z_t + \varepsilon_t$$

In addition to a better econometric adjustment, this new specification implies a lower impact of the curve slope on the output gap as compared to the one that was used until March 2002.

Because the swap rate has become the explanatory variable of the model, its path along the forecast horizon must be projected. For the meeting of the Monetary Policy Committee (Copom) in May, the projection of the swap rate was based on an error-correction model containing two variables: the Selic rate and the swap rate. Unit root and cointegration tests indicated that one cannot reject the null hypothesis that the two rates are integrated of order one and that they cointegrate. Thus, the model is a represented by a vector autoregression that includes an error-correction term:

$$\Delta Y_t = \beta_0 + \beta_1 \Delta Y_{t-1} + \ldots\ldots + \beta_k \Delta Y_{t-k} + \lambda Y_{t-1} + \mu_t$$

where Y = vector containing the two variables (Selic rate and swap rate);
Δ = difference operator: $\Delta Y_t = Y_t - Y_{t-1}$;
μ = random shock;
β, λ = vector of estimated parameters.

Based on this model, the *swap* rate is projected for the next eight quarters. In the case of the baseline scenario adopted by the Monetary Policy Committee to project the inflation rate, the verified figures for the swap rate and for the Selic rate until the current quarter are used and it is assumed that the Selic rate will remain constant over the projected period. In the case of the scenario built based on market expectations collected by the Investor Relations Group of the Central Bank of Brazil, the swap rate is projected assuming the expected path for the Selic rate.

It should be stressed that the models adopted by the Central Bank are constantly improved on and, therefore, subject to change. Moreover, the results obtained through the models are combined with assessments made by the members of the Monetary Policy Committee, as highlighted in the *Inflation Report* of March 2002. Therefore, both the results of the models and qualitative assessments are used in Copom's decision-making process.

Methodology for calculating the inflation inertia and the effects to the shock to administered prices

I. Introduction

This note describes the methodology being used today to quantify the effect, via inertia, of the inflation in the previous year on the inflation in the current year and the inflationary impact brought about by the shock to prices administered by contracts or monitored prices (administered prices for short). Measuring shocks is important because the Central Bank of Brazil needs to implement the monetary policy in a flexible manner and without losing sight of the larger objective of achieving the inflation targets set by the National Monetary Council. The inflationary pressure on the economy may be caused by changes in relative prices resulting from supply shocks. The monetary policy has been oriented towards eliminating only the secondary effect of supply shocks on the inflation rate while preserving the initial realignment of relative prices.

Since prices in the Brazilian economy behave differently, they can be divided into market prices and administered prices. Because administered items have a relatively high weight in the IPCA, 30.3% in March 2002, and since their prices have been rising above market prices, the efforts of the Central Bank to quantify the first-order inflationary impact on these prices have become particularly important.

First-order inflationary impact of the shock to administered items is defined as the variation in administered prices exceeding the target for the inflation rate, weighted by the bearing of administrated prices on the IPCA and excluding the effects of variations in the exchange rate and of the inflation inertia in the previous year. The effect of the inflation inertia is excluded because inflation propagation mechanisms should be neutralized by the monetary policy in a period deemed appropriate. In the case of the exchange rate variation, it is excluded because this variable is affected by the monetary policy and could reflect demand shocks. Therefore, in defining the shock to administered prices, only the component of relative price change that has no relation with the activities of the Central Bank of Brazil is maintained.

This note is made up of two sections. The first one describes the methodology for quantifying the effect of the inflation inertia in the previous year. The second one explains the methodology for calculating the primary effect of the shock to administered prices.

I - Calculating the effect of the inflation inertia on market and administered prices (except fixed telephone and electricity rates)

The model adopted by the Central Bank of Brazil assumes that the inflation in a given quarter depends on the inflation registered in the previous quarter, which in turn depends on the inflation in the quarter before and so on. The inertia inherited in a given year results from the inflation registered in the last quarter of the year before and its calculation is based on the inflation that exceeded the target. For market and administered prices, excluding fixed telephone and electricity rates, the inertia inherited from the last quarter impacts initially on the inflation in the first quarter of the year according to the following formula:

$$I^{g}_{j,y_t} = (IA_{j-1,y_t,} + IL_{j-1,y_t}) * C_{inertia} * \omega_{group},$$

where $I^{g}_{j=1,y_t}$ = effect of the inflation inertia in the previous year (y_{t-1}) on the inflation in the first quarter of the current year ($j=1,\ y_t$) estimated for group g (market or administered prices);

$\pi_{j=4,y_{t-1}}$ = inflation in the last quarter ($j=4$) of the previous year (y_{t-1});

$\pi^{*}_{j=4,y_{t-1}}$ = target for the inflation in the last quarter of the previous year, approximated by ¼ of the target set for that year;

$C_{inertia}$ = coefficient that measures the pass-through of the inflation in the previous quarter to the current quarter, according to Central Bank estimates;

ω_{group} = weight of the group (market or administered prices) in the IPCA. In the case of administered prices, electricity and fixed telephone rates are excluded, as they are calculated separately.

The inflation in the remaining quarters of the year suffers the impact of the inflation in the first quarter of the year and of its chain repercussions throughout the year. The repercussion in each quarter is calculated as follows:

$$I^{g}_{j,y_t} = (IA_{j-1,y_t,} + IL_{j-1,y_t}) * C_{inertia} * \omega_{group}, \qquad j=2,3,4,t$$

where one can see that the inertia of both administered prices as a whole (IA) and market prices (IL) in a given quarter affects the inertia in the next quarter.

The inertial effect in each quarter ($I_{j=1,y_t}$) is calculated by adding the effects estimated for market and administered prices, excluding fixed telephone and electricity rates. The total effect in the year is calculated by accumulating the effects estimated for each quarter:

$$I_{y_t} = \prod_{j=1}^{4}(1+I_{j,y_t})-1,$$

where Π represents the productory symbol.

II - Calculating the primary effect of the shock to administered prices

The first-order inflationary impact or primary effect of readjustments in administered prices is calculated by the difference between the inflation of administered prices and the inflation target for the year (weighted by the influence of administered prices on the IPCA), excluding the effects of inflationary inertia and of the exchange rate variation on administered prices:

$$ChA = \left(\pi_{adm} - \pi^*\right) * \omega_{adm} - (IA + CaA),$$

where ChA = first-order inflationary impact of administered prices;
π_{adm} = inflation of administered prices;
π^* = target for the inflation;
ω_{adm} = weight of administered prices in the IPCA;
IA = effect of the inertia in the previous year on the evolution of administered prices;
CaA = effect of the exchange rate variation on the evolution of administered prices.

The two following subsections explain how these two last components (IA and CaA) are calculated.

II.1 - Calculating the influence of the inflation inertia carried over from the previous year on the shock to administered prices

For calculating the influence of the inflation inertia carried over from the previous year, two items are treated differentiatedly: residential electricity and fixed telephone rates. Other administered prices are assumed to have been influenced by the inertia in the previous year like market prices in the model adopted by the Central Bank of Brazil. Therefore, the inertia effect can be rewritten as follows:

$$IA = ITel + IElet + IOut,$$

where *Tel*, *Elet* and *Out* refer to fixed telephone rates, electricity rates, and other administered prices.

The term *IOut* is calculated as described in section I. The inertia effect on fixed telephone and electricity rates is in turn calculated separately from other administered prices because these rates are readjusted annually according to predefined contracts. As a general rule, these contracts stipulate that these rates are to be readjusted according to the evolution of the inflation rate, as measured by the IGP-M, of the exchange rate and, in the case of electricity utilities, of the Selic rate as well. The inertial effect will therefore depend on the pass-through of the past inflation to these rates. The value of this pass-through is specific for each utility.

Therefore, the inertial effect is defined by the inflation accumulated in the previous year that is used to adjust the prices charged by each utility. For example, for a utility readjusting its prices in April, the inertial effect will be estimated based on the inflation registered between April and December of the previous year. In addition, the inertia estimated in the current year is added as described in section I for the missing months. In the example, the inflation inertia estimated for the period between January and March of the current year is added. Because each utility has its own pass-through coefficient, the estimated inertia is multiplied by the specific pass-through coefficient of the past inflation of this utility (α_1^c). For this reason, the effect of the inflation inertia carried over from the previous year on the readjustment of electricity and fixed telephone rates in the current year will be given by the following formula:

$$IC_t = \left[\left(\pi c_{t,y_{t-1}} - \pi c^*_{t,y_{t-1}} \right) + Ic_{j,y_t} \right] * \alpha_1^c * \omega^c$$

where IC_t = effect of the inertia in the previous year on the adjustment of prices charged by the utility in month t;

$\pi c_{t,y_{t-1}}$ = inflation accumulated over relevant months of the previous year, which are defined as those months whose inflation rates are used for calculating the adjustment of the price in question. In the previous example, for prices readjusted in April, the inflation accumulated over relevant months refers to the inflation accumulated between April and December of the previous year;

$\pi c^*_{t,y_{t-1}}$ = target for the inflation accumulated over relevant months of the previous year, calculated on a *pro-rata* basis according to the target established for the year;

$Ic_{j,y_t} = IA + IL$ = accumulated effect of the inflation inertia in the previous year on relevant quarters of year t. For prices that are not readjusted in the first month of each quarter, the calculation is proportional to the number of months in the quarter. In the example, the first quarter will be the relevant one for prices readjusted in April;

α_1^c = pass-through of the past inflation to the prices charged by utility "c". For each utility, the price adjustment depends on the evolution of the IGP-M, of the exchange rate, and of the Selic rate in the 12 months before the price adjustment, with weights defined on a case-by-case basis. For telephone companies, the price adjustment is based, to a large extent, on the variation of the IGP-M. Since the aim is to estimate the impact of the inertia of the IPCA, an assumption was made that the evolution of the IGP-M could be approximated by a weighted average of the IPCA evolution, with a weight of 70%, and of the exchange rate variation, with a weight of 30%. For this reason, for telephone companies, the value of α_1^c was established at 0.7. For electricity utilities, α_1^c was defined based on a coefficient of 0.7 – the pass-through of the IPCA to the IGP-M – and on the pass-through of the variation of the IGP-M to the price adjustment of the utility, which is defined on a case-by-case basis;

ω^c = weight in the IPCA of the utility that is used for price adjustment purposes in month t. For electricity, the proportion of utilities whose prices are adjusted each quarter is given by 28%, 52%, and 20% for the second, third, and fourth quarters, respectively. Over these values, the weight of electricity in the IPCA is multiplied. For fixed telephone rates, the proportion of utilities whose prices are adjusted each quarter is 20% and 80% for the second and third quarters. Similarly, the final weighting is obtained by multiplying these values by the weight of fixed telephone services in the IPCA.

The inertia effect on electricity and fixed telephone rates is defined by adding the effects calculated for each concessionaire throughout the year.

II.2 - Calculating the influence of the exchange rate variation on the primary impact of the shock to administered prices

For electricity and fixed telephone rates, the effect of the exchange rate variation is calculated taking into account the pass-through coefficient of the exchange rate (α_2^c) and the exchange rate variation accumulated over the twelve months ending in the month preceding the price adjustment:

$$CaC_t = (e_{t-1} - e_{t-13}) * \alpha_2^c * \omega^c \quad ,$$

where CaC_t = effect of the exchange rate variation on the price adjustment of utility C in month t;

$(e_{t-1} - e_{t-13})$ = exchange rate variation accumulated in the twelve months ending in the month preceding the price adjustment;

α_2^c = pass-through of the exchange rate variation to the prices charged by utility "c". For telephone companies, it is assumed that 30% of the exchange rate variation is passed through to the IGP-M, for which reason α_2^c =0.3. For electricity utilities, α_2^c is defined individually

Given the significant effects of the exchange rate on oil by-products, the effect of the exchange rate variation on their prices is also calculated. The pass-through of the exchange rate variation depends on two factors. The first one is the percentage of overhead costs in the final price, represented by the Contribution on the Intervention in the Economic Domain (Cide). The larger this percentage, the smaller the pass-through of the exchange rate variation to prices. The second factor is the percentage of the variation in the refinery price that is passed through to consumers, estimated at 76% for gasoline, at 80% for diesel oil, and at 70% for cooking gas. Taking into account the two above-mentioned factors, the estimated pass-through of the exchange rate variation to consumer prices was 35%, 56%, and 57% for gasoline, cooking gas, and diesel oil, respectively.

For these items, the effect of the exchange rate pass-through is calculated on a month-by-month basis according to the following methodology:

$$CaP_t = (e_{t-1} - e_{t-2}) * \alpha^P * \omega^P,$$

where CaP_t = effect of the exchange rate pass-through on the price adjustment of by-product "P" (gasoline, cooking gas, or diesel oil) in month t;

α^P = exchange rate pass-through coefficient of item P. α^P = 0.35 for gasoline, 0.56 for diesel oil, and 0.57 for cooking gas;

$(e_{t-1} - e_{t-2})$ = exchange rate variation between the two months preceding the price adjustment;

ω^P = weight of item P in the IPCA.

For the remaining administered items, the exchange rate pass-through is not considered. This way, the total impact of the exchange rate variation on the inflation is the sum of the impacts throughout the year calculated for electricity and fixed telephone rates and for the prices of oil by-products.

Annex

Minutes of the 69th Meeting of the Banco Central do Brasil Monetary Policy Committee (Copom)

Date: March 19th and 20th, 2002
Place: Central Bank's Headquarters 8th floor meeting room (on Mar 19th) and 20th floor (on Mar 20th) -Brasília - DF
Called to Order: 3:58 PM on Mar 19th and 4:51 PM on Mar 20th
Adjourned: 7:11 PM on Mar 19th and 7:43 PM on Mar 20th

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 Mar 19th)
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 Mar 19th)
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)
André Barbosa Coutinho Marques - 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 indicators of economic activity have confirmed the expectations of a gradual recovery, outlined at the end of 2001. Industrial production, which, last October, was very depressed reaching its lowest level since March 2000, has shown steady recovery since then. At the beginning of this year industrial production remains below the level registered in the same period of the last year. In the retail segment, the monthly results, in spite of showing a general trend of recovery, have fluctuated between periods of expansion and contraction. This recent difference in the pace of growth between industry and commerce suggests a movement of inventory re-composition, which should reflect favorably on the forecasts for the coming months, both from a consumer and business perspective, as recently surveyed.

For the recent behavior of retail commerce in the metropolitan regions, one should take into account that it is conditioned to the growth of the real wage mass, not perceptible in the last set of results, and to the still modest improvement of credit conditions. Nevertheless, consumption outside the metropolitan regions tends to be stimulated by the income expansion generated from the agricultural sector, especially at this time of the year.

Preliminary figures released by the São Paulo State's Federation of Commerce (Fecomércio) regarding retail commerce in the metropolitan region of São Paulo showed a 1.5% decrease in real turnover in February, compared to a 1.4% increase in the previous month (seasonally adjusted data). Still in February, according to the São Paulo Trade Association (ACSP), there was a 2.1% rise in enquiries to the Credit Protection Service (SPC), a 1.9% decrease of enquiries to the Telecheque, and an increase in default levels, 8.2%, compared to 5.4% in January.

The Index of Consumer Intentions (IIC), also surveyed by the Fecomércio, registered an increase in March, showing that consumers are recovering their confidence in the economy, but are still cautious, as the level of 98.3 registered by the indicator in March, compared to 97.2 in February, is still below the line of optimism on the scale, that varies between 0 and 200. In March, there was a significant improvement in the component that measures the current intentions, a 3.9% increase, mainly as a result of less concern with the international scenario, while the component related to the future intentions declined by 0.44%.

In relation to the industrial sector, there was a 1.3% increase in production, in January, as released by the Brazilian Institute of Geography and Statistics (IBGE). It was the third positive monthly result, what confirms the prospect of recovery evident in the last surveys regarding the expectations of business carried out by the National Confederation of Industry (CNI) and by the Getúlio Vargas Foundation (FGV).

Considering the analysis by categories of use and their performance after October, when the sector recovery began, one can identify a stronger increase in the production of durable goods, which has led the recovery of industrial activity. It should be highlighted, however, that in spite of the expansion of the production of durable goods in the last months, the result for January was negative, indicating that other factors related to the demand, such as the wage mass and the credit conditions, are also important to sustain the performance of this segment.

The indicators of activity in the primary sector were also favorable in the beginning of the year. According to a survey carried out by the IBGE, in February, national grain production should reach 97.5 million tons in 2002. According to the Institute, this volume tends to be higher in the next Systematic Survey of Agricultural Production, to be carried out in March, considering the initial results of the second corn harvest, that show a stronger than expected increase in production. It should be noted furthermore that the same survey forecasts an expansion in the production of items of great importance in the basic consumption basket, such as rice and beans, and in the exports, such as soybeans.

In the labor market, the formal employment index was 0.2% higher in January than in December, and 2.7% higher than in January 2001, according to the Ministry of Labor and Employment (seasonally adjusted data by Depec). The average open unemployment rate measured by the IBGE in the six main metropolitan regions reached 6.83% in January, compared to 5.6% in December and 5.7% in January 2001. This result was due to the 0.4% decline in the number of employed people in January and to an expansion by 23.2% in the number of people searching for jobs, which contributed to the 0.9% increase in the Economically Active Population (*PEA*). These results show that the perception of recovery of the economic activity is motivating the search for job places by unemployed people previously discouraged to do so.

In the financial system, the behavior of the balance of credit operations has been stable, revealing the existence of factors that restrict the recovery of its growth. Amongst the restricting factors, it is worth pointing out the relatively high level of lending rates and banking spreads, which to a large extent continue to be set by the default risk. In addition, the evolution of the income level and the real wage mass have contributed to the cooling off of the demand for new loans, observed since the second quarter of 2000 for both consumption and investment.

In February, the balance of credit operations contracted by the banking system remained stable in relation to the previous month, reaching R$334.4 billion. The operations with freely allocated resources, represented 59% of the total and registered a moderate increase of 0.2%, due to the 0.6% growth in the credit volume assigned to private individuals, whilst the balance of transactions with corporations remained unchanged. The stability observed in the stock of banking credit in February resulted, partly, from seasonal movements. On the one hand, the demand from corporations declined in the first two months of the year, as a result of the inflow of resources from transactions made at the end of the previous year, plus the lower level of activity. On the other hand, there was a moderate growth in the stock of credit contracted by households, resulting mainly from the higher demand for revolving credit, considering the usual concentration of commitments in the period, such as taxes and schooling expenses.

Regarding the external transactions of the Brazilian economy, the trade balance registered a US$259 million surplus in February, totaling a US$434 million positive balance in the first two months of the year, compared to a US$401 million deficit in the same period of 2001. Considering daily average values, exports declined by 11.5% and imports by 19.8%, in the same period of comparison. Regarding imports, all categories of products showed decline, even in relation to the first two months of 2001, in spite of the recovery of domestic activity, indicating import substitution by domestic production. The decline in the imports of fuels and lubricants also reflects their price reduction.

Besides the 67.1% drop in sales to Argentina, exports to other important markets such as Germany, Belgium, Italy and Japan also declined significantly, reflecting the deceleration of the European economies and the recession in Japan. Sales to the United States remained stable in comparison to the first two months of 2001, in spite of the difference in the momentum of growth in those periods, showing that Brazilian products have potential to increase their share in that competitive market. In the case of Mexico, with the deceleration of its economy, the growth in Brazilian exports is reflecting new trade agreements, particularly related to the automotive sector.

Up to March 17th, the trade balance registered a US$ 231 million surplus, as a consequence of the continued drop in imports and the beginning of the export recovery, mainly as a result of the expansion in the sale of basic products.

The recent trend of the economic indicators, as a whole, shows that the recovery of the activity level, which started at the end of 2001, has steadily and consistently continued in the first months of the year. The improvement in the expectations, the inventory re-composition and the additional demand resulting from the movement of import substitution are important factors in that process. It is worth highlighting once again, however, that the realization of this scenario is still conditioned, among other factors, to the recovery of earnings and the improvement of financing conditions, with the consequent expansion in the credit volume. In regard to the supply side, the idleness in the industrial plants allows the growth of the activity level currently observed without pressures on prices. The overcoming of the energy crisis and the end of the rationing, will also contribute to normalize the productive activity, mainly in the electricity-intensive sectors.

External environment

The U.S. economy has been presenting signs of recovery, although the uncertainty in relation to its intensity still persists. The first indicators of the year show that the retraction expected by the market did not materialize, as production has been stimulated mainly by domestic demand. Orders for manufactured goods increased by 1.6% in January, following the 0.7% increase in December. The retail sales increased by 0.2% in February, compared to January, and the wholesale sales rose by 1.2% in January, compared to December, considering seasonally adjusted series.

The U.S. GDP increased by 1.4% in the 4th quarter of 2001, compared to the previous quarter, while the industrial production rose by 0.4% in February, compared to the 0.2% revised growth in January. This growth trend has been followed by the decline in the unemployment rate, to 5.5% in February from 5.8% in December 2001, due mainly to the creation of 66 thousand new job positions, the first rise in occupation in the last seven months. The increase of 5.2% in the productivity of the non-agricultural sector in the 4th quarter should also be pointed out, followed by the reduction by 2.67% in the unit labor cost, that has been decreasing for four quarters.

The producer price index showed a –1.8% variation in 2001, while its core, which excludes variations in food and energy prices, increased by 0.7%. In February, the index rose by 0.2%, a seasonally adjusted monthly variation, while its core did not change. The consumer price index increased by 1.6% and its core increased by 2.7% in 2001.

The activity indicators surveyed by the Institute for Supply Management (ISM, ex NAPM) ratified that the country's economy is recovering. The national index of industrial activity, reached 54.7 in February, compared to 49.9 in the previous month, while the service index (BAI) rose to 58.7 from 49.6, both above 50, showing that the entrepreneurs believe in economic recovery. Showing a similar trend, the index of the Michigan University, which measures consumer confidence, rose to 95 in March, compared to 90.7 in February.

In Japan, the recession intensified in the last quarter of 2001. The GDP declined by 2.2% in the 4th quarter, compared to the previous quarter. The annualized fall reached 4.5% - the GDP declined for three consecutive quarters for the first time in almost a decade. Industrial production continued to show a declining trend, while the trade balance, which had been in decline since July 2001, registered a slight improvement, reflecting the performance of the U.S. and some Eastern Asian countries.

In the Euro area, the consolidated data remains patchy. On the contrary of the United States, consumer expenditure has not contributed to growth recovery. The recovery of the retail sales, verified in November, did not repeat itself in December, with a decline of 0.6% (seasonally adjusted monthly variation). The GDP declined by 0.3% in the 4th quarter, compared to the previous quarter, though growing by 1.5% in the year, following the 3.3% growth in 2000. However, the main economies in the region – Germany, France and Italy – whose indicators have a smaller lag than the ones in the Euro area as a whole, presented signs of recovery in activity level, although at a slower pace and lower intensity than in the United States.

The signs of a possible recovery in the developed countries improve perspectives for the emerging economies. The financial crises seem to be solved, as in the case of Turkey, or with an even more limited potential of contagion, in the case of Argentina.

Prices

The main price indices showed a decline in inflation in February. The Consumer Price Index – Extended (IPCA) decelerated for the fourth consecutive month, with a 0.36% variation in February, compared to 0.52% in the previous month. The deceleration of the index resulted from the smaller increase in food prices, 0.2%, compared to 0.85% in January, due to the beginning of the commercialization of the new harvest and favorable climatic conditions. The rise in prices of non-food products remained practically stable in February, with a 0.41% variation, compared to 0.42% in January.

Amongst the main factors that influenced the IPCA result, one may highlight the decline in prices of rice and beans, 12.1% and 2.1%, respectively, and the decline in gasoline price, 5.12%. Gasoline price variation was responsible for the highest negative contribution in the month, 0.2-percentage point. Prices of clothing declined by 0.67%, due to sales, compared to the 0.55% rise in January. Among the items that showed price increase, attention must be drawn to the school fees, which presented a 5.51% variation in the month, being responsible for the highest contribution to the IPCA in February, 0.22- percentage point. Pharmaceutical products rose by 2.09%, in consequence of the 5.83% average readjustment conceded at the end of January. The urban transport tariffs increased by 0.83%, mirroring rises in Porto Alegre and Curitiba. Electricity increased by 0.21%, reflecting the residue of the increase in January, when the contractual readjustment occurred in Rio de Janeiro.

The General Price Index – Domestic Supply (IGP-DI) varied 0.18% in February, compared to 0.19% in January. Despite the deceleration observed in the consumer prices component, 0.14% compared to 0.79% in January, basically for the same reasons already mentioned in the IPCA evolution, the general index remained practically stable, due to the rise registered by the Wholesale Price Index (IPA), 0.14%, compared to a decline of 0.13% in January. The National Index of Civil Construction (INCC) also held back the IPC deceleration, showing a 0.58% variation compared to 0.36% in January, due mainly to the effect of increase in cost of labor.

In the wholesale market, agricultural prices declined by 0.44% in the month, due mainly to the decline in cereals and grains (beans and rice) and Agriculture for export (soybean), in addition to the deceleration of the rise in prices of the group livestock and its products. Prices of industrial products increased by 0.36%, following consecutive drops of 0.32% in December and January, particularly pressured by the rise in prices of products of chemical, mechanical and mining industries, rubber, tobacco, pharmaceutical products and textiles, clothing and shoes.

It must be pointed out that the deceleration observed in the consumer price indices reflects favorable aspects prevailing in the current scenario – absence of pressures due to the exchange rate variations, increase of food supply, due both to the harvest season and to the adequate climatic conditions, and level of idleness of installed capacity in industry. In addition, it must be considered, over a larger time horizon, the prospect of productivity gains in all sectors of the economy, as a consequence of the increase in investment observed in 2000 and 2001.

Besides those aspects, it must be highlighted that, the fuel price readjustments occurred on March 2nd and 16th, will cause a temporary interruption of the inflation deceleration process. The impact of those increases, amongst other factors, will overlap the effects of the cooling off of agricultural prices and of the exhaustion of the typical pressures of the beginning of the year, as the ones coming from the school fee readjustments and from the increase in prices of fresh food.

Money market and open market operations

After the Copom decision in February, the yield curve, which already projected a reduction of the Over-Selic rate target, showed a downward shift for all maturities, maintaining the negative slope for the short run. In the following weeks the falling trend became stronger due to the improvement in the expectations related to the economic and political scenarios. On March 20th, the yield curve indicated a reduction for the Over-Selic rate target for this Copom meeting, with the spread between the 1-month interest rate and Over-Selic rate falling to –59 b.p., on March 20th, from –7 b.p., on February 21st. For 1-year term, the spread fell to –75 b.p. from 10 b.p.

For the rollover of NBCEs totaling R$3.9 billion, maturing on March 14th, nine auctions were carried out with terms of 1, 2, 3 and 6 years. In regard to the rollover of the securities maturing on February 21st, the average tenure of the issuances increased to 27 from 14 months. The auctions also showed a reduction in the demanded premiums in relation to the CDI curve.

The National Treasury has also promoted the lengthening of the tenure of fixed-rate securities. Between February 21st and March 19th, LTNs were offered on five occasions: in the usual auctions on Tuesdays, securities of 8- and 13-month tenures were offered; on March 15th, a firm offer auction was carried out with 22-month tenure securities. The average rates of 8-month securities fell to 18.29% from 19.01%, and of 13-month securities, to 18.65% from 19.87%. The 22-month tenure securities were totally placed at an average rate of 20.07%. The overall financial volume of the placements reached R$9.1 billion, of which 73% referred to the 8-month tenure securities.

Considering the financial settlements that occurred between February 20th and March 19th, there was a monetary expansionist impact of R$4.0 billion, resulting from net redemptions of LFT (R$11.7 billion) and intermediate interest payment on exchange rate indexed securities (R$1.0 billion), partially offset by the net placement of LTN (R$8.7 billion).

During a period of 19 working days, 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 18.80%, with an average volume of R$6.7 billion.

As in January, the overall daily average traded volume in the secondary market dropped, in February, to R$6.0 billion, from R$7.0 billion. This drop was due mainly to the 29% reduction in the daily average turnover of LTN, to R$2.4 billion from R$3.4 billion.

The appreciation of the Real in February was the main factor responsible for the R$3.5 billion decrease in the domestic federal securitized debt and for the reduction to 28.7%, from 29.4%, in the relative share of the exchange rate linked debt.

Assessment of inflation trends

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

1. February inflation variation, measured by the IPCA, fell to 0.36% compared to 0.52% in January;

2. Regarding the liberalization of the prices of petroleum and their by-products, the forecast for their prices adopted the following parameters: the behavior of the exchange rate; the spot price of the gasoline in the United States (Energy Information Administration) and the price behavior of Brent type petroleum in the futures market of the International Petroleum Exchange (IPE), for the readjustments of the gasoline and diesel oil; the spot price of propane gas in the United States (Energy Information Administration) and the price behavior of propane gas in the futures market of the New York Mercantile Exchange (NYMEX), for the readjustments of bottled gas. Considering the average price of the barrel of crude oil around US$23.3 until the end of this year and the maintenance of the Real on the current level, gasoline prices for the consumer should increase 8.2% until the end of this year. This increase already encompasses the pass-through of the last readjustments of 2.2% and 9.4% at refinery, defined by Petrobrás. For 2002, the forecast

for gasoline prices for consumer presents a 7.5% decline, due to the fall occurred in January and February. The elimination of the subsidies for the bottled gas and the increase in the future curve of propane gas will result in an increase in bottled gas prices of over 20% in 2002, of which 16.3% has already occurred in the first two months of 2002;

3. Regarding the set of prices administered by contracts and monitored prices, weighting 30.5% in the IPCA of February, the expected readjustments are 6.8% for 2002 and 4.5% for 2003, with direct contribution of 2.1 p.p. and 1.4 p.p. for the IPCA. In the February meeting, the expected readjustments were 5.7% and 3.8%, respectively. This 1.1 p.p. increase in the inflation forecast for 2002 reflects the increases already announced for gasoline prices. In March, the forecast for the readjustment of electricity tariffs for 2002 declined to 16.6% from 19.3% forecast in February. Regarding 2003, the forecast for the readjustment of electricity declined to 13.0% from 14.0% in February. These increases are concentrated between April and July;

4. The projection for the slope of the domestic yield curve for the next eight quarters, measured as the difference between the 180-day term DI rate and the 1-day Selic rate, is now based on a regression model that has as explicative variables: i) the Selic rate and ii) the projection of 180-days forward implied in the slope of the term interest rate, lagged by two quarters. This model indicates a trajectory beginning from the current plateau (around –0.18 p.p.), decreasing to a minimum of -0.7 p.p. until the third quarter, gradually increasing until becoming null at the end of 2003.

5. The trajectory of US Fed Funds rate, based on the maturity of futures contracts, was changed to reflect an average rate of 1.75% in the first quarter of 2002, increasing to 3.2% in the last quarter of 2002, stabilizing thereafter;

6. Regarding the sovereign risk premium, using Brazil's Global 04, a decline is forecasted for the second quarter of 2002 to the level observed in the end of March 2002 (550 b.p.), from the average 630 b.p. in the first quarter of 2002, stabilizing thereafter.

The core inflation of the IPCA, calculated under the symmetric trimmed-mean method, increased to 0.54% in February from 0.52% in January. In the last 12 months, this core recorded a 7.58% variation. The core inflation of the IPC-BR, calculated under the symmetric trimmed-mean method, recorded a high fall to 0.44% in February from 0.73% in January. This core accumulated a 7.49% variation in the last 12 months. The core inflation calculated by excluding the prices administered by contracts (considering the wide set of these items weighting 30.5% of the IPCA in January) and of household food prices registered a 0.85% variation in February, accumulating 5.86% in 12 months.

The IPCA variation accumulated in 12 months reached 7.51%, a figure lower than that observed in January (7.62%) and in December of 2001 (7.67%). The free prices and the prices administered by contracts and monitored prices contributed with 4.75 p.p. and 2.76 p.p. to inflation, respectively. The inflation expectations as surveyed by the Investor Relations Group (GCI) of the Central Bank recorded a slight increase to 4.99% in 2002 and remaining stable at 4.00% in 2003.

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 the maintenance of the basic interest rate at 18.75% p.a. and the exchange rate at the same plateau as on the eve of the Copom meeting, point to an inflation below 4.5% in 2002 and below 3.0% in 2003.

Monetary Policy Guidelines

The external scenario has improved since the February Copom meeting. There are clear signs of US economic recovery from the GDP growth in the fourth quarter of 2001, the drop in the unemployment rate in January and in February and the rise in the orders to the industry. Moreover, in the last months, since the Argentinean peso depreciation, Argentine crisis contagion on the Brazilian economy has been limited.

An improved international scenario has led to a reduction in the risk premium. Risk premium measured by EMBI-Brazil fell by 80 bp between February and March meetings. Compared to the average in the last quarter of 2001, this drop exceeded 300 bp. This shift favors balance of payment financing. The trade balance keeps presenting increasing surpluses, accumulating US$3.5 billion in the 12 months ended in February. Current account deficit, accumulated over 12 months, has been declining continuously since August 2001, reaching US$22.1 billion in January 2002. This improvement is mirrored by the 3.3% *real* appreciation since the last Copom meeting and by the capital flows stability.

The evolution of the economic activity level shows that economy has been growing, although at a moderate rate. Industrial production has been growing since October 2001, reaching in January 2002 its highest level for the last nine months. The use of installed capacity in industry grew by 2.3% as compared to December (CNI seasonally adjusted data). The end of the energy rationing may give room to an expansion in the aggregate supply, contributing to economic recovery. On the other hand, aggregate demand reacts to better consumer and entrepreneur confidence indices and to market interest rates reduction. Since October 2001 interest rate fall implicit in the 1-year DI-Pre swaps, dropped by 7 p.p.

However, evolution of credit operations and real wage mass may limit the speed of economic recovery and inhibit inflationary pressure that could arise from the demand increase or the profit margins re-composition. Economic uncertainties and a high level of payments in arrears have refrained credit expansion in the last months. The credit operations outstanding to the private sector have been relatively stable in the last months. As compared to January 2001, total loans to the private sector grew by 5.7% in nominal terms, lower than inflation in the period. Real wage mass declined for the first three quarters of 2001 and remained practically stable between November and December (seasonally adjusted data).

Inflation measured by IPCA declined continuously to 0.36% in February from 0.83% in October. Forecasts prepared through the various specifications of the structural model point to inflation slightly below 4.5% in 2002 and 3.0% in 2003. Since last Copom meeting, the forecast for IPCA in 2002 increased 0.4 p.p. due to the revision of gasoline prices, bottled gas (due to the rise in propane prices in the future markets), urban transport (by 15.8% in Porto Alegre and by 8% in Curitiba) and water and sewage tariff, in this order. Forecast for monitored prices and prices administered by contracts grew to 6.8% from 5.7%. These high readjustments in monitored prices and prices administered by contracts represent new primary shocks in the economy, and put pressure on free prices (secondary effect), causing inflation convergence to its target to be slower and costly.

The increase in the forecasts for the prices administered by contracts increased the estimate for the primary effect of the shock coming from these prices – which is the value that exceeds inflation target, after deducting the impacts of the exchange rate pass-through and the inertia from these prices – from up to 0.5 p.p. to up to 0.9 p.p. Since most of this rise is due to gasoline prices increase, naturally volatile, it is premature to consider the exact impact of this shock on the inflation range Copom will target.

The prospects for free prices are favorable and point to an inflation fall. The following factors acting favorably: i) exchange rate appreciated as compared to the average of the last quarter, and is stable; ii) energy rationing ended; iii) labor market and idle capacity do not put pressure on prices; iv) inflationary inertia inherited from 2001 tend to vanish; and v) an expected record harvest in 2002 has the effect of reducing food prices. Notwithstanding free inflation has reached 1.2% in the first two months of 2002, due to the mentioned factors, Copom maintains the projection of rises for free prices at 3.4% for 2002 and 2.1% for 2003.

Summarizing, positive external scenario, the trend of decline in the inflation and the projections for the IPCA in 2002 and 2003 justify a trajectory of declining interest rates. However, the secondary effect of the rises in monitored prices and prices administered by contracts on the inflation and the uncertainty prevailing on the speed of the fall of free prices recommend caution in the conduct of monetary policy.

After discussions, Copom decided, unanimously, to reduce the target for the Selic interest rate by 0.25 p.p. to 18.50% p.a.

At the close of the meeting, it was announced that the Committee would meet again on April 16th, 2002, at 3:00pm, for technical presentations and, on the following day, at 4:30pm, in order to discuss monetary policy guidelines, as set in the Calendar of Copom's Ordinary Meetings, published in the Central Bank Communiqué nº 8911, of Oct.3.2001.

Minutes of the 70th Meeting of the Banco Central do Brasil Monetary Policy Committee (Copom)

Date: April 16th and 17th, 2002
Place: Central Bank's Headquarters 8th floor meeting room (on Apr 16th) and 20th floor (on Apr 17th) -Brasília - DF
Called to Order: 4:47 PM on Apr 16th and 5:15 PM on Apr 17th
Adjourned: 7:41 PM on Apr 16th and 7:49 PM on Apr 17th

In attendance:
Members of the Board
Luiz Fernando Figueiredo **- Deputy Governor**
Beny Parnes
Carlos Eduardo de Freitas
Edison Bernardes dos Santos
Ilan Goldfajn
Sérgio Darcy da Silva Alves
Tereza Cristina Grossi Togni

Department Heads (all present on Apr 16th)
Altamir Lopes – Economic Department (DEPEC)
Carlos Yoshitaka Urata - 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 Apr 16th)
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 - 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 trend exhibited by the activity level indicators ratified the movement of gradual recovery, which began in the last quarter of 2001. Regarding production, industrial performance registered the fourth positive result in February, while the projections for grain production in the current harvest turned out to be more favorable since the last survey. As regards demand, investment presents itself as the main component of the expansion, showing recovery of the indicators of civil construction and capital goods production, in the three-month period ending in February. Consumption indicators have evolved with relative stability in the firsts months of the year, yet with positive prospects due to the income generated by the agriculture and livestock sector, the decline in default levels, and the improvement in consumer expectations. As for the external sector, trade transactions have presented favorable balances, mainly as a result of the contraction in imports, which reflects, among others, the import substitution process.

The real turnover of retail commerce in the metropolitan region of São Paulo showed a 0.2% decrease in March (seasonally adjusted data), according to preliminary figures released by the São Paulo State's Federation of Commerce (Fecomércio). The result in the month reflected drops in the segments of durable and semi-durable consumer goods, partly offset by positive results in the remaining sectors, especially the sales of building materials. With that outcome, the retail commerce accumulated a 1.2% increase in the first quarter of 2002 compared to the previous one, in the seasonally adjusted data. However, in relation to the same period of past year, the retail sector registered a 6.2% decrease in the first three months, the major drops occurring in the segments of vehicle sales and building materials. On the same basis of comparison, the country-wide survey carried out by the Brazilian Institute of Geography and Statistics (IBGE) also registered a decline, although much slighter, of 1% in the first two months of the year. The IBGE also confirmed that the major decline occurred in the sector of vehicle sales.

In accordance to São Paulo Trade Association (ACSP), the activity in the retail commerce should not show signs of recovery in March. The enquiries to the Credit Protection Service (SPC) presented a decrease of 6.1% in March in relation to February (seasonally adjusted data), while the enquiries to the Usecheque registered a less intense decline, of 0.9%. However, another indicator of this same institution was favorable. The number of consumers with credit rights legally revalidated registered new growth, which contributed to the drop of defaults in the retail commerce to 6% in March, from 8.2% in February, compared to 9.3% registered in March 2001. The default rate (ratio of number of checks returned due to insufficient funds and those cleared) reached 5.2% in March, showing stability in relation to February 2002 and March 2001.

The Index of Consumer Intentions (IIC) released by Fecomércio, in spite the 6.9% drop registered in the current intentions, increased by 0.6% in April, thus reflecting an improvement in future consumption intentions, a component that represents 60% of the index and that showed a 5% increase. The National Index of Consumers Expectations (INEC) has also evolved favorably, reaching 96.3 in March from 94.54 in November. For the most part, the index components presented a favorable evolution, mainly the general and personal income expectations. On the other hand, the index related to the prospects for the year declined to 108.17 from 112.08.

Industrial production rose by 0.3% in February (seasonally adjusted data), according to the IBGE. This result reflected mainly the steep growth of capital goods production, 5.3%, followed by the increase in the production of intermediate goods, 1.2%. In contrast, the production of consumer goods declined by 1.4%. Comparing February to the October index, when the industrial production resumed growth, a 4.8% growth was observed, with all categories of use in expansion.

The production of capital goods increased by 0.5% in the first two months of the year, basically reflecting the expressive expansion of 14.7% in the production of electric power generating equipment. Also worth mentioning is the growth rates observed in the production of agricultural machinery (12.4%) and industrial commissioned built goods (16.4%), which indicates the expansion of the production capacity in the respective sectors. Another favorable indicator of the investment behavior is the recent monthly increase in the production of inputs for civil construction, after the 2.5% drop in 2001, which has contributed to increase the participation of the Gross Capital Formation in the GDP.

The indicators of activity in the primary sector surveyed by the IBGE through its Systematic Survey of Agricultural Production were more favorable in February than the indicators released in the previous month. Total grain production will reach 99.1 million tons in 2002 (97.5 million tons in the previous survey), exceeding by 0.6% the total 2001 harvest. Production of beans will increase by 27.5%, a forecast that caused a 16.3% reduction in its prices in the first quarter of 2002, as measured by the IPCA. The Survey also registered an expansion of 10.5% in the production of soybeans and of 3.8% for rice. For the corn, a 10.4% drop is expected.

The index of formal employment, based on data from the Ministry of Labor and Employment, grew in February, presenting a 0.4% variation considering the series adjusted for seasonal effects. On the other hand, the open unemployment rate assessed by the IBGE, based on a survey carried out in the six main metropolitan regions, reached 6.98% in February, from 6.83% in January. This result was due to the 0.33% growth in the Economically Active Population (PEA), surpassing the 0.12% rise of job offers. In addition, based on IBGE data, real average wage increased by 2.02% and real wage mass grew by 3.02% (seasonally adjusted data). The real wage mass of industry also evolved favorably in February, increasing by 0.6% in the processing industry in São Paulo, as informed by Fiesp, and by 0.33% according to the CNI survey.

The credit operations continued to present a slight evolution in March. The stock of credit granted by the financial system reached R$335.5 billion, increasing by 0.4 % as compared to the previous month. Out of this total, R$197.2 billion referred to operations with free resources, which expanded by 0.6 % in the period, as a result of the 1.6% growth in the total balance of loans to households, while the stock of the operations with companies remained stable.

Regarding concessions, the monthly expansion in the flow of operations by 5.7% and 7.3%, respectively with households and companies, was basically due to the higher number of working days in the period. The average borrowing from the banking system in the first quarter of this year, when compared with the same period of 2001, increased by 4.4% and 4.7% for households and companies, respectively, thus below the accumulated variation of price indices in the period.

This performance is compatible with the modest growth observed in the economic activity level in the period, and indicates the cooling off in the demand for new resources by the industrial sector, while financial institutions have become more selective in their credit concessions, especially the ones granted to households. This restriction is expressed in the interest rates, whose composition is related to the increase in default levels in the credit operations, as a result of the fall in household's disposable income in the period.

Regarding the external transactions of the Brazilian economy, a significant improvement was observed in the first quarter of 2002, with a drop in the current account deficit, which registered US$3.2 billion, more than entirely financed by the net inflow of foreign direct investments, of US$4.7 billion.

The reduction in the current account deficit was due to an identical movement in the net expenses with services and revenues, to a deficit of U$4.6 billion in the first quarter of 2002, as compared to a U$6.4 billion deficit in the first quarter of 2001. Another reason was the reversion in the trade balance result, which showed a surplus of U$1.028 billion compared to a U$681 million deficit in the same period of the previous year. The trade balance result partially reflects the process of imports substitution, more evident since the last quarter of 2001, when the domestic economic activity resumed its recovery. The comparison of data from industry with imports illustrates this fact. Considering seasonally adjusted data, from October 2001 to February this year, the monthly industrial production grew by 3.1%, while imports of intermediate goods decreased by 2%.

In summary, the recovery of economic activity initiated at the end of 2001 continues. In general, both demand and supply indicators show an upward trend, albeit gradual. The improvement in the expectations favors the recovery of inventories and investment flows. These factors, allied to the imports substitution process, tend to boost domestic production. The idle capacity in the industrial plants and the end of electricity rationing have allowed production to respond to these stimuli without further pressure on prices. Finally, in the labor market, employment and income indicators more clearly reflect the movement of recovery, albeit incipient.

External environment

The world economy has performed better than expected by the market, combining increasing recovery in activity levels with low inflation rates. The United States seem to be leading this rebound, as occurred in the deceleration observed last year. Amongst the developed countries, the exception is Japan, whose economy remains in recession. In spite of the growth resumption, risks still remain in the external scenario, the main one being the volatility of oil prices, due to the political instabilities in the Middle East and Venezuela.

The final GDP growth estimate for the United States in the last quarter of 2001, according to seasonally adjusted and annualized data, was 1.7%, 1.5 p.p. above January's first estimate. Contributing to this result was the expansion in consumer and government expenditures, of 6.1% and 10.2%, respectively. Gross private investments accentuated their contraction to –23.5% from –10.5% in the preceding quarter, accumulating six quarters of negative variation.

Amongst demand indicators of the U.S. economy, retail sales increased by 1.8%, accumulated in the twelve months ending in March, from 1.3% in the previous month. Wholesale sales increased by 0.8% in February, after a 1.2% increase in January, with the quarterly moving average reached 0.2% and –1,1%, respectively. Factory orders continued with a negative accumulated variation over twelve months, 8.7% in February, although with positive results in the quarterly moving average, of 0.7%, indicating activity recovery. The beginning of new home construction varied by 8.6% in March, as measured by accumulated figures in the quarter, less volatile than the monthly indicator. Credit to consumers, on the seasonally adjusted series, registered a monthly increase of 5.2% in February, similar to the rate measured in the previous month.

In the United States, the industrial production in March presented the highest monthly expansion since May 2000, 0.7%, resulting in a 0.5pp increase in utilized capacity, to reach 75.4%. Inventory slowly declined by 0.1% in January and February. On the other hand, the unemployment rate resumed growth (5.7% in March from 5.5% in February), whilst the quarterly variation of the employment volume declined by 53 thousand positions in the non-farming sector.

In spite of these indicators of recovery in the U.S. growth, stimulated by the fiscal expansion and by monetary easing, mainly via interest rates, the inflation indices remain on a favorable trajectory. In March, consumer prices increased by 0.3%, with the core inflation rising by 0.1%, resulting in yearly variations of 1.5% and 2.4%, respectively. As for producer prices, the core index increased by 0.1%, accumulating a 0.4% inflation in 12 months, and, although the inflation in the head index was 1%, the annual variation in March was negative by 1.4%.

In relation to the expectations for the United States economy, the Institute for Supply Management (former-NAPM) indicators in March point to prospects for expansion (results above 50), both for the services sector and for the manufacturing sector (55.6 and 57.3, respectively). As regards consumers, the confidence survey of the Conference Board registered an increase of 15.2 points between February and March, to reach 110.2.

In the Euro Area, recovery still seems more uncertain, although the statistics are released with a longer time lag. Retail sales grew by 0.7% in January, compared to the same month of 2001, after a 0.5% expansion in the previous month. The trade balance continued to present growing surpluses, reaching an equivalent of US$46.6 billion in the past 12 months, US$40 billion above the 12 months ending in January 2001. The industrial production remained stable in January, after varying by 0.4% in December last year, but its annual result was still negative (3.2%). The unemployment rate remained stable at 8.4% between November 2001 and February 2002. In February, both the harmonized consumer price and the producer's price indices increased by 0.1%, accumulating annual variations of 2.4% and -1.1%, respectively.

The most positive issue in the economic scenario is the entrepreneurial expectations indicators of the main economies of the Euro Area. In Germany, the Overall Index of Business Expectations, measured by the Institute of Economic Research (IFO), increased by 3.3 points in March to reach 91.8, its highest level since April 2001. In France, the Industrial Trends Survey of the National Institute of Statistics and Economic Research (Insee) reached 94 points in March, compared to 93 in the previous month. In Italy, the index of the Institute of Economic Analysis and Research (Isae) accumulated a 5 points increase in 2002, reaching 94 points in March.

Prices

The Consumer Price Index – Extended (IPCA) increased by 0.6% in March, interrupting the trend of declining rates observed in the last months. The index accumulated a 1.49% rise in the year and a 7.75% rise in the last twelve months. Among the factors, which were responsible for the increase of the index variation in the month, the administered prices should be highlighted, due, mainly, to the readjustments in gasoline prices. Gasoline was the item that showed the highest individual contribution to the index in the period (0.15 percentage point). In addition to gasoline, the variations in the prices of electricity (0.09 percentage point), urban transport (0.03 percentage point), among others, led to a contribution of 0.29 of a percentage point from the prices administered by contracts in March.

Considering the free prices, the readjustments in the price of medicine should be pointed out and the faster increases in prices in the food segment, which mainly reflected the increases in the prices of milk and milk-by-products, ready made meals and fresh food – despite the continuity of the decline in the prices of meat, rice and beans.

The General Price Index – Domestic Supply (IGP-DI) varied by 0.11% in March, compared to 0.18% in February, accumulating a 0.48% increase in the year and a 9.14% increase in the last twelve months. The Wholesale Price Index (IPA-DI) has been relatively stable since the beginning of the year, mirroring the exchange rate evolution and the favorable agricultural harvest, amongst others. In March, the IPA declined by 0.11%, after the 0.14% increase in February. Despite the decline in wholesale prices, the Consumer Price Index (IPC-Br) increased by 0.42%, compared to 0.14% in the previous month due, basically, to the rise in costs with transport. The variation of the National Index of Civil Construction (INCC-DI) declined to 0.55% from 0.58%, with an increase in labor costs (to 0.75% from 0.69%) and a fall in materials and services (to 0.35% from 0.47%).

For April the main impacts on price indices should come once again from prices administered by contracts, due to the readjustments of gasoline on March 16th and April 6th (9.39% and 10.08%, respectively, at the refinery), bottled gas, after April 1st (15% at the refinery), and electricity, as a consequence tariff increases in Belo Horizonte, Recife, Salvador, Porto Alegre and Fortaleza.

It should be pointed out from the evolution of prices in February and March that the upward pressures resulted basically from supply shocks, related to the international market, as in the case of fuel, from seasonal factors, as in the case of the costs with education, or from climatic factors, as in the case of the several types of fresh food. Those shocks have not caused spill over to other prices in economy. Nevertheless, the major impact is still to be observed. The results of the price indices in April, as mentioned above, will incorporate, at a higher intensity, the effects of the fuel and electricity readjustments.

Money market and open market operations

After the last Copom decision to reduce the Over-Selic rate target by 25 b.p., the yield curve, which had indicated a reduction of approximately 50 b.p., shifted upwards for all maturities, maintaining a negative slope for the short run, however with a lower declivity. During the following weeks, the curve remained steady, showing a gradual reduction for the short run rates. On April 17th, the yield curve incorporated a reduction in the Over-Selic rate target by 25 b.p. The spread between the 1-month interest rate and Over-Selic rate fell to -24 b.p, on April 17th, from -3 b.p., on March 21st. For 1-year term, it increased to 2 b.p. from -28 b.p.

In the period between March 21st and April 17th, the National Treasury and Banco Central do Brasil carried out nine auctions to rollover two redemptions of NBCEs, totaling R$ 8.7 billion. For the first rollover, two NTN-D auctions were carried out - at two and three year tenures - together with four auctions of exchange rate swaps conjugated to LFT primary offers - at a two year term. For the second rollover, only exchange rate swaps conjugated to LFT auctions were carried out, also at a two-year term. As a result of applying the new mechanism (swaps), the demanded premiums over the CDI reduced. It should be stressed that Banco Central do Brasil decided not to rollover the final interest payments on the April 18th redemption, keeping with the integral rollover of the principal.

The National Treasury offered 8 and 12 month-tenure LTNs on four occasions, totaling a financial volume of R$ 9.2 billion. As a result, the average tenure of the placements increased. The issuance of over 12-month tenure securities represented 41% of the overall financial volume, compared to 18% in the previous period.

Considering the financial settlements which took place between March 20th and April 16th, there was a monetary expansionist impact of R$ 14.5 billion, resulting from high net redemptions of LFT.

During a 19 working day period, Banco Central do Brasil intervened 16 times in the open market, aiming at administering the very short-term interest rate. In 3 interventions, Banco Central provided liquidity to the market at a hurdle yield of 18.55% p.a., with an average volume of R$ 2.9 billion. In 13 interventions, Banco Central withdrew liquidity at a yield of 18.40% p.a., (except once, on 4/17/2002, when the rate was of 18.38%), with a R$ 3.8 billion average volume.

In March, the domestic federal securitized debt fell by R$5.3 billion, basically due to the net redemption of R$ 10.1 billion in securities. The securities indexed to the Over-Selic rate presented a R$ 16.8 billion net redemption, while the placements of fixed-rate securities reached R$ 8.7 billion, without any redemption in the period. The debt indexed to the exchange rate variation declined by R$ 1.7 billion, as a result of the 1.1% appreciation of the Real.

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. March inflation rate, measure by the IPCA, increased to 0.60% from 0.36% in February;

2. With the liberalization of the prices of petroleum and its by-products, the forecasts for their prices assumed the following parameters: the behavior of the exchange rate for all its by-products; the spot and futures prices of gasoline in the United States for the gasoline readjustments; and the spot price of the propane gas in the United States as well as the futures prices negotiated in the New York Mercantile Exchange (NYMEX) for the readjustment of bottled gas. There was a change in the methodology that had been applied up to the last Copom meeting, which considered the future price of the Brent crude oil barrel as a parameter for the forecast of the price readjustments of oil by-products. According to the new source of data, the consumer price of gasoline should increase by 4.9% by the end of the year, already taking into

account the 10.2% pass through in the refinery, implemented by Petrobrás on April 3rd. For 2002 as a whole, and due to the fall occurred in January and February, a 6.6% decline in consumer gasoline prices is forecasted. For the bottled gas, the elimination of the subsidies and the increase in the slope of future prices of propane gas should result in an increase close to 30% in 2002, of which 16% has already occurred in the first quarter.

3. Regarding the set of prices administered by contracts and monitored, weighting 30.3% in the IPCA of March, the expected readjustments are of 7.2% for 2002 and 4.3% for 2003, with a direct contribution of 2.2 p.p. and 1.3 p.p. in the IPCA. At the March meeting, the expected readjustments for these prices were of 6.8% and a 4.5%, respectively. This 0.4 p.p. increase in the forecast for the 2002 inflation of these prices reflects the already announced increase in gasoline. The average increase in electricity tariffs is projected to be 15% for 2002, compared to the 16.6% estimated in March. It should be highlighted that these increases are concentrated in the period between April and July. For 2003, the forecast for the readjustment of these tariffs has declined to 12.7% from 13.0% in March.

4. The inflation forecasts were based on the new specification of the structural model that has as its explanatory variable the 180-days swap DI-pre, which replaces both the Selic rate and the slope of the term structure of the interest rate. The projection for the nominal swap for the next quarters, keeping the Selic rate constant, starts in the current plateau of 18.6% to reach 19.5% at the end of 2002;

5. The trajectory of U.S Fed Funds rate, based on the futures contracts maturity, was changed to reflect a 1.8% average rate in the second quarter of 2002, increasing to 3.0% in the fourth quarter of 2002, remaining constant thereafter;

6. The sovereign risk premium measured by spread over treasury of Brazil’s Global 04 Bond is forecasted to remain at around 550 b.p.;

The core inflation of the IPCA, calculated under the symmetric trimmed-mean method, increased to 0.58% in March from 0.54% in February. In the last 12 months, this core registered a 7.58% increase. In turn, the IPC-BR core inflation, calculated under the symmetric trimmed-mean method, increased to 0.50% in March from 0.44% in February. In the accumulated over 12 months, this core registered a 7.46% variation. The core inflation calculated by excluding the prices administered by contracts (considering the wide set of these items weighting 30.3% of the IPCA in March) and household food prices increased by 0.53% in March, accumulating 6.10% in 12 months.

The accumulated variation of the IPCA in 12 months was 7.75%, a rate above the observed in February (7.51%) and January (7.62%). The free prices contributed to inflation with 4.68 p.p. and the prices administered by contracts and monitored, with 3.07 p.p.. The inflation expectations surveyed by the Banco Central do Brasil's Investor Relations Group (GCI) registered a 5.4% increase for 2002 and stability for 2003 at 4.0%.

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.

From the simulation exercises with several specifications of the structural model, the conclusion was that the maintenance of the interest rate at 18.5% p.a. and the exchange rate at the same plateau as on the eve of the Copom meeting indicate inflation above 4.5% in 2002 and below 3.25% in 2003.

Monetary Policy Guidelines

The Brazilian economy continues to recover, albeit at a slow pace. Industrial production increased for the fourth consecutive month, reaching its highest level in February since May 2001 (seasonally adjusted figures). However, these positive variations have been showing decline: 0.2% in February compared to 1.7% in November, in the monthly comparisons.

The consumption level has stabilized in the past months. The rebound in investment in this period has helped maintain the positive growth rate of the economy. In the monthly comparison, the 6.4% growth in the production of capital goods more than offset the almost 2% fall in the production of consumer goods. The retail turnover of the commerce in the metropolitan region of São Paulo remained practically unaltered between February and March.

In the medium term, there are prospects of consumption growth, as indicated in the 5% increase in the consumer future intentions index, according to Fecomércio. This improvement of future intentions is consistent with the perspective of real wage mass growth, which should encourage the production of non-durable and semi-durable consumer goods. A recovery of the credit to the private sector would foster the production of durable consumer goods.

The performance of the external sector remains positive. The outcome of February represented the seventh consecutive fall in the current account deficit, which reached US$21.4 billion in the past twelve months. In March, this deficit should be below US$20 billion. Brazil's risk, as measured by the spread over treasury of the Global Bond Br04, retreated by 30b.p. between March and April Copom meetings. The flow of foreign capital remains satisfactory in terms of the financing of the Balance of Payments. In this period, the Real appreciated by around 5 cents of a Dollar. Structural factors already mentioned in the previous Copom Minutes have contributed to this improvement. Within these factors, special notice should be given to the recovery of the U.S. economy, the limited contagion of the Argentine crisis in Brazil, and the macroeconomic fundamentals. Also reflecting this improvement, and evidencing confidence in the favorable performance of the external sector are the sovereign bond issuance, the well succeeded selling of Vale do Rio Doce's shares in the foreign market, and the decision to anticipate the payments of the Supplemental Reserve Facility (SRF) loan with the IMF, amounting to US$4.2 billion..

The macroeconomic picture points to a future reduction in the variation of the free prices in the basic scenario analyzed by Copom. The existence of high idle capacity, the still slow pace of the economic activity, and the absence of pressures from the labor market; as well as the appreciation of the exchange rate, the fall in wholesale price indices, and the recent behavior of food prices should contribute to a downward pressure in the inflation of free prices. It is expected that these prices will increase, on average, by around 0.20-0.30% p.m. throughout the remainder of the year.

Nonetheless, inflation has remained at a high level in these first months of the year. The IPCA increase to 0.60% in March from 0.36% in February was not only due to the increase in prices administered by contracts and monitored, but also in response to a slower deceleration in the inflation of free prices in February and March of respectively 0.64% and 0.45%.

The prices administered by contracts and monitored increased by 0.95% in March, due to the readjustments of prices of oil derivatives and electricity tariffs. The rises of 10.4% in the price of gasoline, and of 10.25% in bottled gas, will increase the inflation index in April. The pressure from prices administered by contracts and monitored should be concentrated between April and July this year, as a result of the recent readjustments of prices of oil derivatives and the concentration of price readjustments by the electricity distributing and telecommunications companies in the period. However, the curves of future prices of petroleum, gasoline and propane gas indicate a decrease of their prices in the remainder of the year.

The increase in the projection of the prices administered by contracts and monitored raised the estimate for the primary effect of the shock of these prices to a value around 1 p.p.. The shock of the prices administered by contracts and monitored is defined as the value that exceeds the inflation target, once deducted the impact of the exchange rate pass-through and of the inertia over theses prices. It is important to emphasize that the increase in prices administered by contracts and monitored have further effects on the freely set prices through its secondary effects.

The slower fall in the freely set prices and the higher inflation of the prices administered by contracts and monitored have led to an increase in the inflation expectations surveyed by the Investor Relations Group (GCI) of Banco Central do Brasil, to 5.4% in 2002. Similarly, the simulations carried out by the Banco Central also point to a rise in the projected inflation for 2002. The baseline scenario projects a variation between 4.5% and 5.0% for this year. The higher projection was due to the 0.60% inflation in March, reflecting the slower decrease of the freely set prices, and to the revision of the projections for the administered prices, which increased to 7.2% from 6.8% between March and April Copom meetings. For 2003, the projected inflation is below the 3.25% target.

In principle the monetary policy should be guided towards coping with the spillover of the shocks of prices administered by contracts and monitored, but not their primary effect. Besides, part of the inflationary inertia inherited from 2001 may be neutralized in 2003. As a result, and also considering the new estimate for the primary effect of the shock from administered prices, the Copom aims at an inflation rate between 4.5% and 5.0% for 2002. However, as the projection for the inflation this year rises, the risk of inflation reaching the upper limit of the tolerance interval also increases. This risk assumes a relevant role in the current context of the monetary policy, which seeks to guarantee the convergence of the inflation to the trend of its targets after the shocks that hit the economy in 2001, under a regime that is still maturing.

In summary, the slower convergence of inflation to its targets, together with the secondary effect of the shocks in prices administered by contracts and monitored and the proximity to the ceiling of the tolerance interval, recommends caution in conducting the monetary policy. In the face of these facts, Copom decided, unanimously, to maintain the target for the Selic interest rate at 18.5% a.a..

At the close of the meeting, it was announced that the Committee would meet again on May 21st, at 3:30pm, for technical presentations and, on the following day, at 4:30pm, in order to discuss monetary policy guidelines, as set in the Calendar of Copom's Ordinary Meetings, published in the Banco Central do Brasil Communiqué nº 8911, of Oct.3.2001.

Minutes of the 71st Meeting of the Banco Central do Brasil Monetary Policy Committee (Copom)

Date: May 21st and 22nd , 2002
Place: Central Bank's Headquarters 8th floor Meeting room (on May 21st) and 20th floor (on May 22nd) -Brasília - DF
Called to Order: 3:30 PM on May 21st and 11:35 AM on May 22nd
Adjourned: 8:05 PM on May 21st and 2:08 PM on May 22nd

In attendance:
Members of the Board
Armínio Fraga Neto **- Governor**
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 May 21st)
Altamir Lopes – Economic Department (DEPEC)
Daso Maranhão Coimbra - International Reserve Operations Department (DEPIN)
Paulo Springer de Freitas - Research Department (DEPEP)
José Antônio Marciano - Department of Banking Operations and Payment System (DEBAN)
José Henrique de Paula Freitas Simão - Open Market Operations Department (DEMAB)

Other participants (all present on May 21st)
Antônio Carlos Monteiro - Executive Secretary
Alexandre Pundek Rocha - Advisor to the Board
João Borges - Press Secretary (ASIMP)
Fabia Aparecida de Carvalho - 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 performance of the economic activity showed, at the end of the first quarter, signs of slowing of the recovery started in October 2001. This tendency is only partially explained by inventory level adjustments, mainly by industry, and to possible statistical seasonality effects that diminish March results. The loss of impetus is also attributed to the still modest growth of the payroll, the absence of a more expressive recovery in credit, plus the exhaustion of the process of recovery of consumer expectations that had been present since the end of last year.

Retail commerce was significantly influenced in the last two months by Easter holidays. The recovery of business activity observed since the end of last year came to a halt in the Metropolitan Region of São Paulo, as identified by April sales figures. The latter registered a 1.9% drop in real turnover for the month, compared to a 2.3% growth in March, according to the seasonally adjusted data from São Paulo State's Federation of Commerce (Fecomércio). From the analysis by segments it is evident that the decline in supermarket sales was the main reason. The supermarket sector declined 9.3%, compared to an 8% growth in the previous month when Easter holidays boosted business. Other segments less influenced by April seasonality factors showed expansion in the month, such as durable consumer goods, which grew by 2.4%, whilst sales of cars grew 7.5%.

According to the São Paulo Trade Association (ACSP), the enquiries to the Credit Protection Service (SPC) increased by 4.6% in April in comparison with March (seasonally adjusted figures), which coincided with the sales pattern of durable goods. Likewise, the enquiries to Usecheque increased by 7%. According to the same institution, the default rate rose to 9.4% in April from 6% in the observed series and increased to 5.8% from 4.9% in the seasonally adjusted series, reaching the same levels observed in April 2001. The default rate measured by the ratio of checks returned due to insufficient funds and those cleared declined slightly to 5% in April, compared to 5.2% in March.

Year-to-date retail commerce activity declined compared to the same period of 2001. According to IBGE's survey, the accumulated decline was 0.8% up to March and, specifically for the Metropolitan Region of São Paulo, according to data from Fecomercio, the accumulated decline is 3.8% up to April. It should be noted, however, that the growth in income generated by the agriculture and livestock sector has stimulated consumption outside the metropolitan regions. The better performance in the countryside partly explains the less accentuated negative results of the national statistics compared with those of the Metropolitan Region of São Paulo.

Consumer expectations are amongst the factors that explain the current cooling down of economic activity. The Index of Consumer Intentions (IIC), released by Fecomércio, registered growth throughout this year up to April, but at declining rates. In May, the growth sequence was interrupted and the index fell by 0.9%, showing a fall in the indicators that both reflect current conditions and that signal future conditions.

The survey of the National Confederation of Industry also showed a slight reduction in entrepreneurial confidence in April, reaching 58.9 compared to 59.9 in the January survey. The worse evaluation of the current conditions of the Brazilian economy was a reflection of the weaker levels of activity of the sector and enterprises taking part in the survey. However, the index remained above 50, indicating that entrepreneurs are still confident, mainly in regard to the expectations for the next six months, which remained practically stable at 64.5 from 64.7 in the previous survey.

Industrial production declined by 0.8% in March, according to seasonally adjusted data released by the IBGE, interrupting the sequence of four consecutive months of growth. Three out of the four categories of uses registered decline: 4% in the production of capital goods, 1.5% in intermediary goods and 1.9% in semi-durable and non-durable consumer goods. The production of durable consumer goods was the only one to grow by 1%, in comparison with the previous month. The analysis by sectors, however, shows that the deceleration in industry was not generalized, as 8 out of the 20 surveyed industrial sectors registered expansion. Of the sectors that registered negative results, the food industry showed the worst performance, possibly attributed to inventory adjustment, since the same sector had shown particularly high production in the first two months of this year. The increase in inventories may also be one of the reasons for the slower production levels of industry as a whole. The industrial survey carried out by the CNI reveals that inventory levels of final products increased in April compared to the beginning of the year. Excessive inventory levels were also detected by the Business Scenario Survey of the Processing Industry, carried out by FGV, but simultaneously revealed a reduction in the intentions of lowering inventory levels in coming months.

The weak performance of the production of electric power generating equipment in March was the main reason for the month-by-month decline in the production of capital goods. On an accumulated basis, however, capital goods production still show a growth of 8.7% in the first quarter, in comparison to the same period of 2001. Year to date, the expansion rates registered in the production of agricultural machinery and industrial commissioned built goods, 9.9% and 7.2% respectively, are noteworthy, indicating an increase in the production capacity in these sectors. Although on a yearly basis the production of material for the civil construction industry still registered a decline, it has grown for the last three consecutive months, to March, thus contributing to the share increase of the Gross Capital Formation in the Gross Domestic Product (GDP) to 18.8%, according to a forecast of current values released by BCB's Economic Department (Depec).

Regarding the performance of the primary sector, the Continuous Survey of Agricultural Production, carried out by the IBGE in March, estimated that total grain production should reach 98.6 million tons in 2002, remaining stable in relation to the total harvest of 2001. It should be highlighted that the increase in the production of staple foods is of great importance to the price of the basic consumer basket. A typical example is the production of beans and rice, which has already caused declines of 15.2% and 10.5%, respectively, in the prices of these products in the first quarter of 2002, according to the Consumer Price Index – Extended (IPCA).

The formal employment index increased again in March (0.4% in the seasonally adjusted series), reflecting the creation of 90 thousand job positions during the month in the labor market, according to data released by the Ministry of Labor and Employment. IBGE's monthly employment survey also registered an increase in the number of active workers in March; even so, since the 1.3% expansion was lower than the total increase in the number of unemployed workers, the unemployment rate rose to 7.1%, from 7% in February in the non seasonally adjusted series. The IBGE survey also showed a 0.26% drop in the average real wage, considering the seasonally adjusted series. It should be emphasized, however, that only service sector workers suffered a real average wage decline of 2.3%. The earnings of the workers employed in manufacturing, in commerce, in civil construction, and in other activities increased by 1.5%, 1.3%, 0.3% and 1.2%, respectively, in relation to the previous month. By occupations, there was a 0.3% increase in the real average wage of those formally and informally hired, and reductions of , respectively, 3.0% and 2.1% in the earnings of self-employed and employers.

The total stock of credit operations of the domestic financial system increased by 1%, in April, reaching R$ 338.8 billion. The operations with freely allocated resources reached R$ 199.5 billion, maintaining the trend of moderate growth, with variations of 1.2% in April and 3.5% in the year. The stock of credit contracted by private individuals grew by 2% in the month, with expansion in all modalities of operations, especially overdraft accounts (3.6%), and acquisition of vehicles (1.6%). The 1.2% growth in personal credit may be partially explained by the use of credit lines in anticipation of tax returns from the Internal Revenue.

The stock of credit to companies increased by 0.7% in April, reaching R$ 124.2 billion. Modalities contracted with domestic resources increased by 0.4%, especially those that are typically short run, such as guaranteed overdraft accounts and hot money. In relation to the operations linked to foreign currency, the stock returned to January levels, R$ 41.5 billion, showing a 1.3% increase in the month. The 3.8% increase in foreign transfers was partially neutralized by the 1% drop in Foreign Exchange Advances (ACC), causing the total balance of operations to grow by less than the 1.7% exchange rate depreciation in April.

The average interest rates charged on credit operations dropped by 1.1 p.p. in April. This was due to the 2.2 p.p. reduction in average rates charged to private individuals, reflecting the sales promoted by institutions linked to vehicles' assemblers. On the other hand, the stability of the average rates charged on operations to companies resulted from the offsetting of the increases in the modalities of turnover capital, rediscounts and guaranteed overdraft accounts against the reductions in hot money and, mainly, in vendor lines.

Financing requirements fell, for the international transactions of the Brazilian economy, in the first four months of 2002. The current account deficit decreased to US$5.2 billion, compared to US$9 billion in the same period of 2001. Foreign direct investments, reached US$6.7 billion in the period and were more than enough to finance the entire current account deficit.

The reduction in the deficit of the services and income accounts plus the positive trade balance enabled the better current account performance. The trade balance accumulated a US$1.5 billion surplus in the first four months of 2002, compared to a US$561 million deficit in the same period in 2001. This reversion in the trade balance result came from a sharp decline in imports, 21.3%, which counterbalanced the 10.7% drop in exports, consequence of the retraction observed in important markets for Brazilian products. Part of the fall in imports was a result of lower exports of manufactured products, a group comprised of representative items and with an intensive use of imported components. Imports substitution by domestic production was another factor that restrained imports, since the decrease in imports was higher than that of the domestic industrial production.

Summarizing, the economic recovery outlined in the last quarter of 2001 onwards was partially due to overcoming of the shocks that hit the economy last year. The recent cooling off in this expansion, observed in March and April, may be interpreted as a reflex of factors that tend to interfere with growth, such as: a) the small increase in credit and income, aggravated by conjuncture factors that contributed to negatively influence domestic expectations; b) readjustments of energy and fuel prices and their impacts on inflation indices; and c) the depreciation of the exchange rate. The slower growth of the economic activity created a slight increase in inventories to above desired levels in the sectors of production, as registered in the sector's recent performance. However, production should not keep on declining. Some sector indicators in April confirm this expectation i.e. vehicle production and corrugated paper, amongst others. In regardo to demand, a number of favorable factors can be cited such as the growth in income related to agricultural activities, the labor market improvement, continued government expenditure in social programs, plus the beginning of the payment of installments related to the Time in Service Guarantee Fund (FGTS) losses agreement.

External environment

In the United States, the prudent optimism of economic recovery prevailed. The most recent indicators however, still presented contradictory signs, a phenomenon peculiar to phases of economic cycle inversion. The 5.8% GDP growth in the first quarter was influenced by one off factors, such as the increase of 20% in defense expenditures and 22.6% in private investment, mainly in inventory, while final demand increased by only 3.7%, a slower pace than in the previous quarter. The 8.6% growth in productivity was accompanied by a 5.3% fall in unit labor cost and an increase in the unemployment rate to 6% in April from 5.7% in March. The increase in unemployment is associated with the return of the previously discouraged to the labor market, since the number of employed remained practically stable during the same period.

The retail commerce sales (excluding food services) increased by 1.3% in April, according to seasonally adjusted data, 3.7% above those in April 2001. Industrial production continued to rise for the fourth consecutive month, in April, by 4%, increasing the level of industrial capacity utilization to 75.5%. In the same month, the producer's prices index (PPI) declined 0.1%, maintaining a downward trend, although consumer inflation (CPI) increased, accumulating 1.6% in the 12 months up to April.

On the other hand, business and consumer expectation indicators showed signs that the recovery of the U.S. economy will not be as quick as the more optimistic forecasts make believe. In spite of remaining above the leveling off mark of 50 (activity expansion), the Purchasing Managers' Index (PMI) declined to 53.9% in April from 55.6% in March, while the services' index measured by the Business Activity Index (BAI) dropped to 55.3% in April from 57.3% in March, both surveyed by the Institute for Supply Management (ISM, former-NAPM). The Conference Board indicators show a similar trend, with a decline in the Consumer Confidence Index to 108.8 in April from 110.7 in March, and a drop of 0.4% in the Leading Indicator, the first decline in six months.

In the Euro Area, statistical information takes longer to be released, but they show a slower and still uncertain economic recovery. Retail sales grew by 0.5% in February, compared to the previous month, showing that domestic demand is providing only a small contribution to economic growth recovery. The progress of industrial production is also timid, with an increase of only 0.5% in March, but an annual decline of 2.9%, mainly due to Germany's performance, with a fall of 0.8% in the month, and 10.3% over 12 months. The behavior of the German economy affected the country's business sector expectations, interrupting the recent recovery trend. Nonetheless, the expectations of French and Italian businessmen continued to show optimism and a trend towards recovery. The 2.2% annual inflation rate stayed over ECB's reference level. The trade balance surplus continued to increase up to February, the last month of available data, as imports have been declining more than exports, a trend that may change due to the euro appreciation observed since February.

Prices

The main price indices showed an increase in the rate of inflation in April, due to the rise in monitored prices of gasoline, bottled gas and electricity tariffs in some capitals. On the other hand, the inflation of the free prices showed a higher deceleration than in the previous months, influenced by the negative variation in the food prices.

The IPCA increased by 0.8% in April, accumulating a rise of 2.3% in the year and 7.98% in the last twelve months. The 8.7% rise in gasoline prices, in consequence of the readjustments of 9.39% on March 16th and 10.08% on April 6th in the refineries selling prices, contributed with 0.34 of a percentage point to the monthly variation. The price of bottled gas increased by 8.74% in consumer retail outlets. Gasoline and bottled gas together were responsible for 0.47 of a percentage point in the 0.8% IPCA variation in April.

Still amongst monitored prices, the increase of 1.31% in the residential electricity tariff, in consequence of the readjustments in five capitals, and 0.28% in urban transport, due to the increase in the transport tariff in Fortaleza, should be noted. Considering the free prices, the deceleration in price rises was due mainly to the 0.32% negative variation in food prices, a result of the good harvest and the favorable meteorological conditions.

The General Price Index – Domestic Supply (IGP-DI) varied by 0.7% in April, compared to 0.48% in the first quarter, accumulating 1.18% in the year and 8.68% in the last twelve months. The rise in the monthly variation was due equally to the effects of the readjustment of fuel prices in the Wholesale Price Index (IPA), specially the ones of the chemical industry, and in the Consumer Price Index (IPC), in transport (gasoline) and housing (bottled gas) items. The decline of food prices maintained a negative variation in the agricultural IPA, softening the rise of the industrial IPA and of the IPC. The IPA monthly variation reached 0.75%, compared to 0.1% accumulated in the first quarter, following the 1.3% rise of the industrial prices in the month, against 0.08% in the quarter. The IPC rose by 0.71% in April, compared to 0.42% in March, accumulating 2.07% for the year.

The main pressures on the prices indices for May will come again from the increase in monitored prices, albeit at a lower level than registered in April. In addition to the residual effect of the recent readjustments in fuel and electricity, the readjustment in the transport tariff in Rio de Janeiro should affect the consumer indices. In the wholesale area, the decline of food prices should continue, although at a lower rate, since the preliminary results of the IGP-M showed some recovery in the prices of cereals and meat. In three out of the eleven surveyed capitals, the workers' wage renegotiations in the civil construction sector should significantly impact on the increase of the variation of the National Index of Civil Construction (INCC), with a consequent impact on the IGP-DI monthly variation.

Money market and open market operations

After the last Copom decision to keep the Over-Selic rate at 18.50%, the yield curve, which had indicated a reduction of approximately 25 b.p, shifted upwards for all maturities. For maturities of up to 1-month, the negative slope shifted to a positive one, and, for longer ones, the slope shifted upwards. Since then, the yield curve behavior was influenced, mainly, by the uncertainties stemming from the electoral process, by the unfavorable evaluations of the country risk and also by the increase in the Brazil EMBI, which rose to 968 points on May 22nd from 733 on April 17th . The spread between the 1-year interest rate and the Over-Selic target increased to 226 b.p from 49 b.p.

In the period between April 18th and May 22nd the National Treasury and Banco Central carried out ten auctions to rollover NBCE and NTN-D totaling R$ 9.6 billion. For the first rollover of R$ 5.0 billion in NBCE and NTN-D maturing on May 8th, the following auctions were carried out: two for exchange rate swaps conjugated to LFT at two and three year tenures, two NTN-D auctions at two year tenure, and one exchange rate swap auction at three year tenure. For the second rollover of R$ 4.6 billion in NBCE, redeeming on May 16th, five exchange rate swap auctions were carried out on May 10th and May 14th. After May 7th, the rollovers were exclusively carried out with exchange rate swaps, which led to a significant reduction in the premiums.

At the same time, the National Treasury offered 7 and 12 month-tenure LTNs. The short tenure securities were offered in the five weekly sales events in the period, while the 12-month tenure LTNs were only offered in the first week. The total financial volume of the placements reached R$ 7.2 billion, of which 94% referred to the placements of securities maturing in 2002.

Considering the financial settlements that occurred between April 17th and May 21st, there was an expansionary monetary impact of R$ 14.0 billion, resulting mainly from the R$ 5.0 billion redemptions of LFT, the R$ 6.2 billion placement of LFT conjugated to exchange rate swaps, and the R$ 14.9 net redemptions of dollar-indexed securities.

On April 19th, in order to guarantee liquidity at the beginning of the Brazilian Payment System (SPB) and also to deconcentrate the return of the operations, BCB carried out eight go-arounds, providing and withdrawing liquidity at 2 to 5 working day tenures. Due to the reduction in the number of transactions in the market of bank reserves after the beginning of SPB, Banco Central modified the way it intervenes in the money market, starting to carry out go-arounds at pre-defined spreads in the morning, and leveling off liquidity at the end of the day. In nineteen interventions through go-arounds, Banco Central provided liquidity at a minimum yield of 18.43% p.a, with a R$ 2.3 billion average volume and at an average term of 2.2 days. In twenty-five interventions, Banco Central withdrew liquidity at the maximum yield of 18.40% p.a, an average volume of R$ 6.7 billion and an average term of 1.2 day. Moreover, Banco Central carried out two auctions of LFT repurchase amounting to R$ 3.1 billion, and also R$ 270 million in swap of LFT maturing in February 2003 by LFT maturing in 2006. There were three selling operations of federal securities with repurchase agreements at open unit prices of return, at two and three month tenures, with only the first one being with free transactions of securities.

In April, the domestic federal securitized debt increased by R$ 7.0 billion or 1.1% compared to the previous month. This rise was inferior to the variation of the Over-Selic rate and to the exchange rate depreciation in the period, basically due to the net redemption of R$ 5.5 billion. Due to the R$ 4.2 billion net placements of LTN, the relative share of fixed-rate securities in the total debt increased to 9.8% at the end of April, from 9.1% at the end of March. Incorporating the LFT conjugated with exchange rate swaps, the dollar-indexed debt increased by R$ 3.0 billion, although maintaining its participation in the total debt practically steady at around 28.8%. Under this same concept, the LFT debt fell by R$ 3.4 billion, reducing its relative share in the total to 50.1% from 51.2%.

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. April inflation rate, measured by the IPCA, increased to 0.80% from 0.60% in March;

2. The forecasts for prices of petroleum by-products assumed the following parameters: the behavior of the exchange rate; the spot and future prices of gasoline in the United States for the gasoline readjustments, and the spot price of the propane gas in the United States as well as the futures prices negotiated in the New York Mercantile Exchange (NYMEX) for the readjustments of the bottled gas. For 2002 as a whole, a 6.6% decline is forecasted due to the fall in gasoline prices in January and February. This percentage figure is the same as was forecasted in the last Copom meeting. This forecast has been maintained despite the exchange rate depreciation, since the latter was offset by a lower-than-expected readjustment of gasoline consumer prices in April and a lower than expected increase of prices in the refinery in May, as defined by Petrobrás. For bottled gas, a 29% increase is forecasted for 2002, of which 26.1% has already occurred between January and April;

3. The average increase of electricity tariffs in 2002 is estimated at 18%, compared to the projection of 15% in April. This revision was due mainly to the exchange rate depreciation. For 2003, the forecast for the readjustment of electricity tariffs was increased to 13.6% from 12.7% forecast in April. These price rises are concentrated within the period of April to July;

4. Regarding the set of prices administered by contracts and monitored, with a weighting of 30.4% in the IPCA of April, the expected readjustments are 7.6% for 2002, and 4.5% for 2003, with a direct contribution of 2.3 p.p. and 1.4 p.p. for the IPCA. In the April meeting, the expected readjustments for these prices were 7.2% and 4.3%, respectively;

5. The inflation forecasts were based on the new specification of the structural model that has the 180-days pre-fixed DI swap as its explanatory variable, replacing both the Selic rate and the slope of the term structure of the interest rate. The projection for the 6-months spread over the Selic rate is based on a new specification. An error correction model is used. This model includes the Selic rate and the swap rate. The estimated value starts from the current plateau, near zero, to reach -100 b.p. at the end of 2003. This forecast was based on the hypotheses of a constant Selic rate at 18.5% up to the end of 2003;

6. The trend of the U.S. Fed Funds rate, based on the futures contracts maturities, was changed to reflect a 1.8% average rate in the second quarter of 2002, increasing to 2.7% in the first quarter of 2003, stabilizing thereafter;

7. The sovereign risk premium, based on the spread over treasury of Brazil's Global 08 Bond is forecasted to decline to around 700 b.p. for 2003 from the current plateau of 780 b.p..

The core inflation of the IPCA, calculated under the symmetric trimmed-mean method, declined to 0.56% in April from 0.58% in March. In the last 12 months, this core registered a 7.68% variation. The IPC-BR core inflation, calculated under the symmetric trimmed-mean method, declined to 0.46% in April from 0.50% in March. In the accumulated over 12 months, this core registered a 7.27% variation. Core inflation calculated by excluding the prices administered by contracts and monitored (considering the wide set of these items weighted 30.4% in the IPCA in March) and household food prices registered a 0.46% variation in April, accumulating 6.31% in 12 months.

The accumulated variation of the IPCA in 12 months was 7.98%, above the rate observed in March (7.75%) and February (7.51%). The free prices contributed with 4.48% p.p. to inflation and the prices administered by contracts and monitored contributed with 3.70 p.p.. The inflation expectations surveyed by the BCB's Investor Relations Group (GCI) registered a slight increase for 2002, reaching 5.46%, and stabilizing at 4.00% for 2003.

Regarding the 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.

From the simulation exercises with several specifications of the structural model, it has been concluded that the maintenance of the interest rate at 18.5% p.a. and the exchange rate at the same plateau as on the eve of the Copom meeting indicates an inflation rate a little over 5.0% in 2002 and below the 3.25% target in 2003.

Monetary Policy Guidelines

The recovery of the Brazilian economy over the last few months is showing signs of slowing down. Industrial production declined by 0.8% in March compared to the previous month (seasonally adjusted data). Regarding retail commerce, real sales in the metropolitan region of São Paulo fell by 1.96% in April (seasonally adjusted data), according to Fecomércio. The Consumer Intentions Index fell in May, after increasing for six consecutive months.

This result was partially offset by the fact that the Easter fell in March. The loss of impetus is also attributed to, the phasing out of the recovery process in consumer expectations, to the end of the cycle of inventory re-composition, to the still modest growth of the payroll, to the lack of credit recovery, and, more recently, to the steeper slope of the yield curve.

In spite of the above scenario there are no indications that the economy is heading for recession. The consumption of durable goods would increase as a result of the end of the electricity rationing and the approach of the World Cup. It is also expected that the elections stimulate some specific sectors, such as the electro-electronics, paper and pulp, and textiles. In addition, some indicators show that the real payroll has grown since January 2002 and that the level of industrial employment has increased since December 2001, according to CNI data (seasonally adjusted). The beginning of payment of the installments related to the FGTS agreement should trigger consumption.

The performance of the external sector remains positive. The current account deficit accumulated in 12 months up to April (US$19.4 billion) was entirely financed by the net inflows of foreign direct investment, which reached US$22.4 billion in the same period. From January to April 2002, the US$5.2 billion current account deficit was also entirely financed by the net inflows of foreign direct investment, which totaled US$ 6.7 billion

Nonetheless, the country risk and the exchange rate have not reflected this good performance of the external sector. Since the Copom meeting of April, the country risk as measured by the Embi+ increased to 940 b.p. from 733 b.p., and the Real depreciated by 7.6%.

Inflation measured by the IPCA was 0.80% in April, 0.20 p.p. above March inflation. Prices administered by contracts and monitored increased by 2.07%, influenced by the price readjustments of oil by-products, and those of free prices (0.24%). The variation of free prices has declined since February 2002. After reaching 0.64% in February, the monthly variation fell to 0.45% and

0.24% in the two following months. The downward inflationary trend of free prices is projected to continue during 2002 and 2003.

In relation to prices administered by contracts and monitored, Petrobras announced a 1.06% reduction in the price of gasoline at refineries and the maintenance of the bottled gas price. The projection for the inflation of the set of prices administered by contracts and monitored in 2002 is 7.6%, compared to 7.2% forecast in the Copom meeting of April. This projection embodies the increases of urban bus tariffs in the cities of Rio de Janeiro (9.09%) and Salvador (10.0%). The projection increase derives basically from the exchange rate depreciation that took place between the Copom meetings of April and May.

Shock of prices administered by contracts and monitored is defined as the value that exceeds the inflation target, once deducted the impact of the exchange rate pass-through and the inertia over these prices. As the exchange rate depreciated, the impact of its pass-through on the prices administered by contracts and monitored increased. However, the projection for the inflation of prices administered by contracts and monitored did not rise in the same proportion of this impact and, thus, the primary effect of the shock of prices administered by contracts and monitored declined to below 1 p.p.

According to the models used by BCB, the projection of the variation of IPCA for 2002 increased since the April meeting and is slightly over 5.0%. The revision was due almost exclusively to the exchange rate depreciation in the period.

The impact of the exchange rate variation on the inflation projection may be lower than usually predicted which was taken into account in the projection. There are two factors that may induce the recent depreciation of the real to have a relatively smaller than expected impact on inflation. Firstly, the cooling down of economic recovery should inhibit the exchange rate pass-through to the prices. Secondly, in a floating exchange rate regime, the impact of an exchange rate variation on prices should be reduced when the agents perceive this variation as temporary. Thus, in the first quarter of 2002, the appreciation of the real did not lead to a negative readjustment of prices possibly because the economic agents set prices taking into account a more depreciated exchange rate than actually observed. Thus, the exchange rate variation that is relevant for the economic agents between the first and second quarters of this year should be less significant than actually observed, causing weaker inflationary pressure. However, this does not mean that further exchange rate depreciations will have the same reduced effect on prices.

It is worth noting that, even if the economic agents made their decisions based on the effectively observed exchange rate, which would imply in a higher pass-through of the depreciation to inflation, the projected IPCA for 2002 would still be below the upper limit of the 5.5% target.

For 2003, the projected IPCA is below the target of 3.25%, with an estimated variation in prices administered by contracts and monitored of 4.5%. The low inflation in 2003 should result not only from the lower inflation of the free prices, but also from the convergence of the general price indices, which are used as the reference for the readjustment of prices administered by contracts and monitored in the IPCA.

The inflation expectations surveyed by the Investor Relations Group (GCI) of the BCB are still pointing to a declining trend in inflation in the near future. For 2002 and 2003, the expectations are converging to a figure below 5.5% and around 4.0%, respectively.

The members of Copom considered that the projected downward trend of inflation in 2002 and 2003 forecasted by BCB, reinforced by the market expectations, would recommend a resumption in the process of monetary policy easing, specially in a context of an observed decrease in the inflation of free prices and a trend in economic activity that should not pose inflationary pressures.

However, there was not a consensus on the adequate timing to resume the process of reduction of the basic interest rate. Despite the projection of inflation for 2003 being below the target, the majority of the members considered that the balance of risks for 2002 - the worsening of the country risk, the recent exchange rate depreciation, and the proximity of inflation projections to the ceiling of the target interval – recommends the confirmation of the downward trend of the inflation rate before the easing of monetary policy, which still has an impact on the outcome of this year's results.

In the light of these facts, Copom decided, with a majority of 5 to 3, to maintain the target for the Selic interest rate at 18.5% p.a..

At the close of the meeting, it was announced that the Committee would meet again on June 18th, at 3:30pm, for technical presentations and, on the following day, at 4:30pm, in order to discuss monetary policy guidelines, as scheduled in the Calendar of Copom's Ordinary Meetings, published in the BCB Communiqué nº 8911, of Oct.3, 2001.

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
Fecomércio 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
IPA Wholesale Price Index
IPC Consumer Price Index
IPCA Consumer Price Index – Extended
IPCH Consumer Price Index – Harmonized
IPP Producer Price Index
IR Income Tax
IRF-M Market Fixed Income Index
IRRF Withholding Income Tax
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 variation)
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

Circular 3,096, 3.6.2002 – determined that registration and evaluation of the securities held in the portfolios of the exclusive investment funds cited in Circular 3,086, dated 2.15.2002, should comply with the conditions, requirements and terms defined in Circulars 3,068, dated 11.8.2001, and 3,082, dated 1.30.2002, and in Resolution 4, dated 1.30.2002, issued by the Complementary Social Security Management Council, when the investor in such a fund is a financial institution, institution authorized to operate by the Banco Central do Brasil or a closed complementary social security entity. Such funds were given until 9.30.2002 to adapt to the provisions of Circular 3,086.

Circular 3,098, dated 3.20.2002 – deals with additional remittances of information by financial institutions, in the framework of the Credit Risk Center system, including – as of base date May 2002 - criteria and procedures related to reference data and client operations, in individualized and aggregate form. This measure is aimed at solidifying the Credit Risk Center by enhancing the transparency of financial institution information and increasing the capacity of the national financial system and bank supervision authorities to monitor credit risks.

Resolution 2,939, 3.26.2002 – authorized Banco Central to carry out swap operations referenced to interest rates and exchange rate variations, for monetary and exchange policy purposes.

Circular 3,099, 3.26.2002 – treats of Banco Central swap operations contracted through public offers, based on authorizations as defined in Resolution 2,939, dated 3.26.2002. Swap operations referenced to interest rates and exchange variations are carried out for monetary and exchange policy purposes and the net positions of outstanding contracts must be notified to the National Monetary Council (CMN) in each quarter. The availability of this instrument to the monetary authority is a component of the new rules involving management of the federal securities debt. According to Complementary Law 101, dated 5.4.2000 (Fiscal Responsibility Law), as of May 2002 Banco Central no longer issues its own securities.

Resolution 2,940, 3.27.2002 – set the Long-Term Interest Rate (TJLP) at 9.5% per year for the second quarter of 2002. The decision was based on the pro rata inflation target for the next twelve months, equivalent to 3.4375% per year, plus a risk premium of 6.0625%.

Resolution 2,945, 3.27.2002 – based on the terms of Resolution 2,827, dated 3.30.2001, excluded operations carried out by development entities based exclusively on utilization of a share of Reference Worth (PR) for purposes of making it feasible to finance urban development funds, from the sum total of credit operations with the public sector.

Circular 3,100, 3.28.2002 – instituted the Reserve Transfer System (STR) in the framework of the Brazilian Payments System (SPB). The STR is a system of real time gross liquidation of fund transfers among participating institutions. The System is managed by Banco Central and initiated operations on 4.22.2002. Aside from Banco Central, STR participants are financial institutions that hold bank reserve accounts, clearing house institutions and service providers charged with clearance and liquidation operations, holders of liquidation accounts and, optionally, the Secretariat of the National Treasury. Operations permitted through this system are transfers of funds in any amount for liquidation on the same day. Such operations are processed operation-by-operation through entries into the accounts maintained at Banco Central by the participating institutions.

Circular 3,101, 3.28.2002 – regulated operation of the bank reserve account and instituted the liquidation account at Banco Central. The bank reserve account represents available national currency amounts obligatorily maintained at Banco Central by commercial banks, multiple banks with trade portfolios and savings banks. With issue of the new regulations, investment banks and multiple banks that do not have trade portfolios are permitted to hold such accounts. In the framework of the new payments system, the bank reserve account is to be monitored in real time and will be permitted to maintain debt balances during the course of the day only until 6.21.2002. The clearance and liquidation entities and service providers hold title to the liquidation account which is to be used for purposes of liquidating the results registered in the respective systems. These systems must always register balances greater than or equal to zero, with the exception of the bank reserve account over the course of the day up to 6.21.2002.

Circular 3,102, 3.28.2002 – defined a new system for financial liquidation of interbank liabilities calculated at the Central Clearance System of Checks and Other Papers (Compe). Commercial banks, multiple banks with trade portfolios and savings banks must effect liquidations through Compe, exclusively through the use of funds deposited in an earmarked account at Banco Central.

Circular 3,103, 3.28.2002 – instituted the prior deposit required for commercial banks, multiple banks with trade portfolios and savings banks to participate in the daily Compe sessions as of 8.26.2002. The deposit is required for each business day and the value is determined on the basis of the checks withdrawn against the institution and the credit documents issued by that institution, with unit value equal to or greater than five thousand reals. The amount deposited receives no earnings and is used for purposes of financial liquidation of the interbank liabilities consequent upon clearance sessions on the date of constitution of the deposit in question.

Circular 3,105, 4.5.2002 – Altered and consolidated norms on Banco Central rediscount operations. With implementation of the new payments system as of 4.22.2002, the intra-day rediscount modality was instituted to meet the liquidity needs of financial institutions consequent upon the real time debiting of commitments against the bank reserve account. The operation involves Banco Central purchases of federal public securities registered in the Special System of Clearance and Custody (Selic), with a resale commitment. The purchase and resale are to occur on the same day and at the same prices. Following is a summary of the rediscount modalities available as of 4.22.2002:

a) purchase, with resale commitment, only with federal public securities registered at Selic: for intra-day and one day operations;
b) purchase, with resale commitment, of federal public securities registered at Selic or other assets of the financial institution, preferably with real guaranties: for operations of up to fifteen business days and with total terms of no more than 45 business days, in those cases in which the financial institution is not marked by a lack of structural equilibrium, and for operations of up to ninety calendar days in which the total period is no greater than 180 calendar days, in those cases in which adjustments are required in an institutions with a lack of structural equilibrium;
c) rediscount operations involving securities and credit rights of the financial institution: in the same periods defined in line “b”.

Furthermore, access to rediscount operations was permitted to investment banks and multiple banks without trade portfolios that have bank reserve accounts.

Circular 3,106, 4.10.2002 – regulated the carrying out of operations involving credit derivatives by financial institutions, based on the authorization given in Resolution 2,933, dated 2.28.2002. These operations refer to transfers of the credit risk on assets consequent upon loans, financing, leasing, credit securities and other instruments subject to this type of risk. Operations involving credit derivatives among individuals or controlling, associated or controlled legal entities were prohibited, as were operations in which flows were not in the same currency or indexing factor as the underlying asset.

Circular 3,107, 4.10.2002 – deals with the new modality of operation between Banco Central and institutions accredited to operate on the open market. These are freely usable committed operations and exclusively involve papers custodied in the Special System of

Clearance and Custody (Selic), in which the buyer of securities from Banco Central may effect their definitive sale, preserving the resale commitment with other securities, conjugated with a committed purchase operation by Banco Central. Thus, in this operation, the monetary authority makes a temporary loan of papers held in its portfolio against delivery of other securities. There is no impact on banking liquidity since the financial value of the sale operation corresponds to that of the purchase operation.

Circular 3,109, 4.10.2002 – instituted the Currency System (CIR) in the framework of the new payments system. The CIR is the means through which operations involving money carried out exclusively by commercial banks, multiple banks with trade portfolios and savings banks among themselves are to be registered and processed with Banco Central and with the custody institution. These financial institutions may provide excess currency to other institutions that hold bank reserve accounts.

Resolution 2,950, dated 4.17.2002 – altered and consolidated norms on operations involving fixed income papers, in light of implementation of the new payments system. In this sense, the major changes introduced by the regulations appended to this resolution refer to the carrying out of committed operations for liquidation on the same day, as well as to the possibility of registration of these transactions in other systems of registration and financial liquidation of assets, with Banco Central authorization. Thus, such operations are not restricted to the Special System of Clearance and Custody (Selic) and to systems managed by the Center of Financial Liquidation and Custody of Securities (Cetip).

Circular 3,115, 4.18.2002 – instituted the Available Electronic Transfer (TED) and the Scheduled Electronic Transfer (TEA) in the framework of the new payments system. The purpose of these instruments is the transfer of large amounts previously effected through checks and credit documents (DOC). The TED is an interbank transfer order against third parties or in the benefit of a client of the financial institution. The TEA has the purpose of registering, on the maturity date of the asset or redemption date of the investment, the resources that will be remitted through the TED system on the immediately following business day, in the case of transfers consequent upon redemption of investments made up to 9.30.2001, such may be offered only until 3.31.2004.

Circular 3,119, 4.18.2002 – altered article 1 of Circular 2,900, dated 6.24.1999, including – for purposes of calculating the Selic rate – daily financing operations with federal public securities custodied at the Special System of Clearance and Custody (Selic) that occur in the systems operated by clearance and liquidation entities or service providers. This measure has the purpose of preserving the universe of operations upon which the current calculation methodology is based, when the SPB is implemented.

Circular 3,120, 4.19.2002 – defined additions to the Selic rate for the following rediscount operations cited in Circular 3,105, dated 4.5.2002:

I – 1% per year for operations for one business day, increasing to 6% per year as of 7.1.2002;

II – 4% per year, for operations of up to fifteen business days;

III – 2% per year, for operations of up to ninety calendar days.

Resolution 2,951, 4.19.2002 – introduced more flexible rules covering operations through which stock and security brokerage and distribution companies obtain loans. As a consequence of the current credit and market risk management instruments, as well as the new payment system, these institutions were given the right to obtain loans or financing from financial institutions to be used in acquisitions of goods for their own utilization and for performing the activities defined in their bylaws. However, in keeping with the rules on controlling the leverage of the institutions that participate in the financial market, these operations may not surpass an overall total of two times their respective Reference Worth (PR), which is understood as the capital that the institution maintained for purposes of complying with the operational limits.

Resolution 2,954, 4.25.2002 – determines that operations contracted as of this date up to the amount of R$200 million under the terms of Fiscal Adjustment Programs, as integral parts of state refinancing contracts with the federal government, in the framework of Law

9,496, dated 9.11.1997, as well as those involving municipal debt refinancing contracts, as cited in Provisional Measure 2,185-35, dated 8.24.2001, are excluded from the overall ceiling on credit operations with the public sector.

Resolution 2,958, 4.25.2002 – reallocated additional resources of R$350 million by shifting resources from other investment programs into the Program of Modernization of the Fleet of Farm Tractors and Associated Implements and Harvesters (Moderfrota), with the objective of meeting farm sector demand in May and June of the current year.

Circular 3,123, 5.29.2002 – determined that adaptation to the provisions set down in Circulars 3,068, dated 11.8.2001, and 3,082, dated 1.30.2002, which deal with the criteria for evaluating securities and derivative financial instruments must be completed by 6.30.2002.

CVM Instruction 365, 5.29.2002 – moved the deadline up to 5.31.2002 for adaptation to the requirements of Circulars 3,086, dated 2.15.2002, and 3,096, dated 3.6.2002, which defined criteria for the registration and accounting evaluation of securities and derivative financial instruments by financial investment funds, funds that invest in investment fund quotas, individual programmed retirement funds and investment funds abroad. The new rules permitted funds reserved to investments belonging to the same conglomerate, economic-financial group or qualified investors to classify securities in the category of papers held to maturity, provided that they comply with the conditions set down in legislation.

Fiscal policy measures

Decree 4,206, 4.23.2002 – regulated the complementary private social security system, as dealt with in Complementary Law 109, dated 5.29.2001. The Decree determined:

a) exclusion from the minimum retirement age requirement of those who are associated to pension funds. According to the previous rule, those who paid into complementary systems could only receive the benefits after completing sixty years of age. Now, the

moment of retirement will be freely determined by the pension fund and the insured party;
b) permission for change from one type of plan to another (defined benefit or defined contribution);
c) increase in the government authority to intervene in these funds, when an understanding is not reached between the representatives of the sponsoring institution and the parties insured;
d) creation of the figure of a special administrator, who may be named by the government, in those cases in which problems with reserve funds occur;
e) adoption of administrative penalties for directors and funds that commit irregularities and increases in the value of fines applied to funds, in the case of irregularities.

Law 10,433, 4.24.2002 – authorized creation of the Electricity Wholesale Market (MAE), a nonprofit legal entity covered by private law subject to the authorization, regulation and inspection of the National Electric Energy Agency (Aneel). It is to be composed of those holding concessions, permissions or authorizations and other agents, as defined in the regulations, connected to electric energy services and installations, with the objective of making it possible to transact electricity purchase and sale operations among different interconnected systems.

Law 10,437, 4.25.2002 – deals with the lengthening of the term of debts originating in rural credits, as dealt with in Law 9,138, dated 11.29.1995. The law determined:
a) extension of the maturity of the installment due on 10.31.2001 to 6.29.2002, plus interest of 3% per year, pro rata die;
b) minimum payment of 32.5% of the amount due by 6.29.2002, maintaining the due payment bonus specified in indents I and V, line d, of paragraph 5 of article 5 of Law 9,138/1995.

To adhere to such conditions, borrowers must be fully up to date on their liabilities or normalize such liabilities by 6.29.2002. The acts practiced on the basis of Provisional Measure 9, dated 10.31.2001 are hereby validated.

Law 10,438, 4.26.2002 – treats of the expansion of the emergency electricity supply, extraordinary tariff recomposition, creates the

Program of Incentives to Alternative Electricity Sources (Proinfa) and the Energy Development Account (CDE), treats of the universalization of public electricity services and introduces a new text into Laws 9,427/1996, 9,648/1998, 3,890-A/1961, 5,655/1971, 5,899/1973 and 9,991/2000. Among other items, the Law took the following measures:

a) costs related to acquisitions of electric energy and the contracting of generation or power capacity by the Brazilian Emergency Energy Marketing Company (CBEE) will be distributed among all classes of final consumers served by the National Interconnected Electricity System, proportionately to individually measured consumption, on the basis of a specific tariff addition in compliance with Aneel regulations;
b) the distribution of costs related to acquisitions of electric energy does not apply to consumers who have monthly consumption of less than 350 kwh for the residential category and 700 kwh for the rural category;
c) the distribution of costs related to the contracting of generation or power capacity does not apply to low income residential consumers, considered as those that have monthly consumption levels of less than 80 kwh/month or that have consumption levels between 80 and 220 kwh/month, depending on the region of the country in question;
d) the extraordinary tariff recomposition will utilize the following indices: up to 2.9% for the categories of residential and rural consumers and public lighting, and up to 7.9% for other consumers. The measure is to remain in effect for a period to be defined by Aneel by 8.30.2002. Low income residential category consumers are excluded from the adjustment;
e) the federal government is authorized to issue federal public debt securities directly to the CBEE up to an amount of R$11 billion, which are to be held as guaranties of the operations that may come to be contracted by that company;
f) the BNDES will institute an emergency and exceptional program of support to concession companies that provide public services of electricity distribution and generation and to independent producers of electricity. For this purpose, the federal government is authorized to issue federal public debt securities of up to R$7.5 billion, in the form of direct placements, in the benefit of the

BNDES. The characteristics of papers to be issued are to be defined by the State Minister of Finance.

Provisional Measure 38, 5.14.2002 – treats of installment payment of tax debts of states, the Federal District, municipalities and public and private companies in the process of bankruptcy or liquidation; institutes the special system of installment payment of contributions to the Program of Formation of Civil Service Assets (Pasep); reestablishes time periods for payment of tax debts, including the income tax on inflationary profits; grants fiscal benefits to the installation, expansion or modernization of industrial units and equal tax treatment to nationally produced and imported newsprint; alters customs legislation and that referring to the charging of antidumping and countervailing duties; and takes additional measures.

Decree 4,230, 5.14.2002 – determined a reduction of R$5.3 billion in the current year's federal government budget for the purpose of overcoming budget account imbalances caused by inflow losses (delays in approval of the constitutional amendment that extends levying of the CPMF) and increased spending. Calculations made by technicians from the economic staff indicated an imbalance of R$6.4 billion, of which R$4.9 billion is a consequence of the loss of CPMF revenues and R$1.5 billion a result of additional outlays on personnel (R$1 billion) and charges within the National Social Security Institute (INSS) (R$500 million), not identified at the time of allocations made in the month of February. Aside from the cutback in spending, the government will raise the rates of the Financial Operations Tax (IOF) in order to produce an additional R$1.1 billion.

Law 10,464, 5.24.2002 – treats of the recontracting and lengthening of debts originating in rural credit operations contracted under the terms of the Special Program of Credits to Agrarian Reform (Procera), the National Program of Strengthening Family Farming (Pronaf) or other sources of funding by farm families, mini and small scale farmers, their associations and cooperatives and takes other measures.

Constitutional Amendment 36, 5.28.2002 – determined that at least 70% (seventy percent) of the total capital and voting capital of journalistic companies and sound and sound and image broadcasting companies must necessarily be held directly or indirectly by native born Brazilians or citizens who have been naturalized for more than ten years, and such persons will necessarily be charged with management of activities and definition of program content.

External sector measures

Camex Resolution 4, 3.18.2002 (Ex-tariff) – altered the nomenclature of several "Ex-tariff" items as treated in Ministry of Finance Directives 465 and 339, in order to adjust the merchandise to the new classification defined by Camex Resolution 42, dated 12.26.2001.

Secex Directive 3, 3.20.2002 – determined that Sale Registration (RV) for unprocessed coffee beans, with shipment scheduled for up to the end of the fifth month subsequent to negotiation may be accepted.

Bacen Communiqué 9,384, 4.9.2002 – released information from the Central Bank of the Argentine Republic referring to payment of Brazilian exports, as cited in Communiqué 9,229, dated 1.31.2002. As of 4.9.2002, the form cited in item 2 of Communique 9,229, dated 1.31.2002, was deactivated.

Camex Resolution 10, 4.16.2002 – altered Appendix II of Camex Resolution 42, dated 12.26.2001, excluding the products listed therein from the temporary 1.5% increase to the Common External Tariff (TEC).

MDIC Directive 58, 4.16.2002 – substituted the list of items presented in the Appendix to MDIC Directive 374/99, which lists the merchandise eligible for the equalization modality of the Export Financing Program (Proex). This alteration was made for purposes of adjusting the merchandise to the new classification determined by Camex Resolution 42, dated 12.26.2001.

Bacen Circular 3,114, 4.18.2002 – altered the Regulations on reciprocal Payment and Credit Agreements.

Camex Resolution 7, 4.25.2002 (Ex-tariff) – altered the ad valorem rates of the import tax on Capital Goods, Informatics and Telecommunications Goods listed therein to 4% for a period of two years.

Camex Resolution 8, 4.25.2002 – revoked Camex Resolutions 40, 45, 57, 66, 77, 79, 88, 93, 102, 111, 112, 114, 115, 116, 161, 169, 173, 174, 178, 182, representing an additional initiative to reduce obstacles to foreign market sales of agricultural goods.

Camex Resolution 9, 4.25.2002 – in the framework of the Camex Management Committee, instituted the Technical Monitoring Group of GMC Resolution 69/2000 (Getar-69), with the objective of examining proposals for temporary Common External Tariff (TEC) reductions of an exceptional character, in order to ensure the normal supply of goods in Mercosul.

Decree 4,214, 5.2.2002 – defined the authority of the Interministerial Commission of Control of Exports of Sensitive Goods, treated in Law 9,112, dated 10.10.1995, which deals with exports of sensitive goods and directly connected services and takes other measures.

Provisional Measure 38, 5.15.2002 – granted fiscal benefits to the installation, expansion or modernization of industrial units and equal tax treatment to nationally produced and imported newsprint, altered customs legislation and the charging of antidumping and countervailing duties and takes other measures.