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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.

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

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Contents

Foreword

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

The report is divided into six chapters: Activity level; Prices; Credit, monetary and fiscal policies; International economy; Foreign sector and Prospects for inflation. With regard to the activity level, growth in retail sales, inventories, output, labor market and investments are investigated. In the following chapter, price analysis focuses on the results obtained in the quarter as a consequence of monetary policy decisions and the real conditions of the economy outside the realm of government action. The chapter referring to the credit, monetary and fiscal policies, the analysis is centered on the behavior of credit, financial and budget operations. In the chapter dealing with the international economy, the report presents an analysis of the world's major economies and seeks to identify those conditions capable of impacting the Brazilian balance of payments. Insofar as the foreign sector chapter is concerned, analysis is targeted at economic-financial relations with the international community, with emphasis on trade results and foreign financing conditions. Finally, prospects on inflation growth are analyzed.

Executive summary

In 2003, a consistent macroeconomic policy has managed to curb the crisis drawn late in 2002, preventing an uncontrolled inflation process and allowing for the inflation rate to stabilize at relatively low levels. The availability of idle capacity in the economy, a favorable external environment, and expectations under control suggests a scenario of inflation within the targets and of resuming economic activity on a sustained basis.

Economic activity indicators confirm the prospects of economic recovery in the third quarter as a result of the elimination of inflationary risks and consequent monetary easing. The expansion trend followed the typical pattern of periods, which initially and more intensely are driven by the production of durable goods. According to the benchmark scenario, which assumes that the Over-Selic interest rate will remain at a level of 16.5% and the exchange rate will be close to the one observed on the eve of the December Copom meeting (R$2.94 = US$1) over the forecast horizon, a growth of 0.3% in 2003 and of 3.5% in 2004 for the Gross Domestic Product (GDP) is anticipated. The lower projection for GDP growth in 2003 as compared to the 0.6% rate projected in the September *Inflation Report* is largely due to the incorporation of the results published by the Brazilian Institute for Geography and Statistics (IBGE) for GDP growth up to the third quarter, which included methodological changes and data revisions for 2002 and for the first semester of 2003. Despite the weak performance registered in 2003, the economy has been recovering on the margin. The output fan chart containing the projections based on the market scenario, which takes into account the paths for the exchange rate and the Special System of Clearance and Custody (Selic) rate expected by market participants on December 12, according to a survey carried out by the Investor Relations Group of the Central Bank of Brazil (Gerin), points to a GDP growth of 3.8% in 2004. This higher projection in relation to the benchmark scenario reflects the impact of expected lower interest rates on the level of economic activity.

The behavior of credit operations in the third quarter shows that the borrowing of the private sector is recovering. The continued reduction in lending costs together with measures aimed at stimulating credit supply, such as those designed to expand microcredit mechanisms and loans which are automatically deducted from paychecks every month, reinforce expectations of economic growth.

As a result of the positive performance of exports in the third quarter, the foreign trade sector has been consolidated, for the fourth consecutive year in a row, as the main pillar of economic activity. Exports grew at the same time that markets and products are being diversified. Imports grew only slightly in the year as a result of low GDP growth and of imports substitution.

The current account surplus reduced the requirements to finance the balance of payments. Additionally, special mention should be made of the loans granted by the International Monetary Fund (IMF), which act as a buffer in case of a liquidity crisis. Projections for 2004 point to a current account deficit due to the resumption of the economic activity. Nevertheless, it is forecasted that there will be an increase in foreign direct investments, continuity of access to the external bond market, and that the external private debt will be fully rolled over. In this context, the balance of payments will be solidly financed, despite a reduction in gross international reserves caused by the amortization of IMF loans.

Regarding the fiscal accounts, a comfortable performance was registered in all public sector levels, confirming expectations that the target set for the year will be met. The declining path of the Over-Selic rate, the stability of the exchange rate, and the positive fiscal performance of the consolidated public sector are expected to stabilize debt/GDP ratio. Besides, the resumption of the economic activity reinforces expectations of a lower debt/GDP ratio in the medium term.

In this favorable environment, it is expected that inflation will continue to register relatively low rates in 2004, in spite of the recovery of economic activity. This expectation is supported by existing idle capacity, which will enable output to increase regardless of maturing investments. Moreover, core inflation measures, which reflect temporary factors less intensely, remained relatively stable through the second semester of 2003 and were consistent with the inflation targets set for 2004.

The benchmark scenario inflation projections (4.5% in 2004 and 4.0% in 2005) are below the respective inflation targets. As the market scenario considers a drop in interest rates and exchange rate depreciation over the forecast horizon, it projects higher inflation rates than those based on the benchmark scenario, namely, 5.8% in 2004 and 5.1% in 2005, both of which are higher than the targets.

1 Activity level

Once the risk of inflation had been overcome and the government began adopting a more flexible monetary policy, activity level indicators confirmed the outlook for the start of a process of economic recovery in the third quarter of 2003. Expansion followed the pattern characteristic of periods of renewed growth and was driven initially and with greatest intensity by production of consumer durables. It is important to stress that improvement in economic fundamentals in the period was not reflected in seasonally adjusted national accounts, due basically to the performance of crop farming[1], which reflects aspects that have little to do with the current macroeconomic scenario.

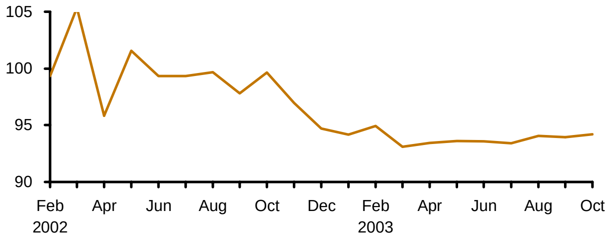
The contribution of the external sector continued in the third quarter and was sustained by steady growth in foreign sales in recent months. For the fourth consecutive year, this sector has proved to be the major factor underlying the nation's economic activity. However, the upturn in growth is also a consequence of recovery in internal demand generated initially by expanded credit and improved expectations. In the third quarter of the year, this scenario was evident in strong sales of vehicles and consumer durables. Parallel to this, other sectors turned in more moderate growth, including nondurable consumer goods which, to a great extent, depend on recovery in income levels to begin expanding, and capital goods, which tend to respond more intensively as the recovery scenario moves toward consolidation.

1.1 Retail sales

At the end of the third quarter and start of the final quarter of the year, the retail trade sector showed a tendency toward more consistent recovery, though the pace of activity is still

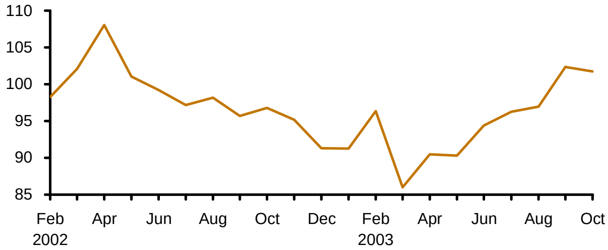
1/ More specifically, to the coffe output negative results which was previously appropriated in te third quarter, following the extraordinary growth of the soy bean crop, which impacted the second quater. aside from this, the available economic indicators for the steadily expanding livestock sector are out of date and therefore will be incorporated only in future results.

Sales volume index in the retail sector
Supermarkets
Seasonally adjusted data
2000=100



Source: IBGE

Sales volume index in the retail sector
Furniture and home appliances
Seasonally adjusted data
2000=100



Source: IBGE

Sales Volume Index in the Retail Sector – Brazil

Percentage change

Itemization	2003				
	Jun	Jul	Aug	Sep	Oct
Same month of the previous year					
Retail sector	-5.6	-4.4	-5.8	-2.8	-3.0
Fuel and lubricants	-1.3	-2.0	-8.5	-7.8	-4.3
Supermarkets	-8.6	-5.5	-5.7	-3.8	-4.3
Textiles, clothing and footwear	-4.6	-6.3	-6.7	-3.3	-1.8
Furniture and home appliances	-4.9	-1.0	-1.4	7.0	5.2
Other domestic goods	-2.1	-4.3	-6.1	-1.8	-4.1
Vehicles, motorcycles	-4.5	-11.0	-16.2	-4.0	-3.8
Accumulated in the year					
Retail sector	-5.6	-5.4	-5.5	-5.2	-4.9
Fuel and lubricants	-4.8	-4.4	-4.9	-5.3	-5.2
Supermarkets	-6.7	-6.5	-6.4	-6.1	-5.9
Textiles, clothing and footwear	-3.4	-3.9	-4.3	-4.2	-3.9
Furniture and home appliances	-10.4	-9.0	-8.0	-6.5	-5.2
Other domestic goods	-2.2	-2.5	-3.0	-2.9	-3.0
Vehicles, motorcycles	-11.7	-11.6	-12.2	-11.2	-10.5

Source: IBGE

well below the 2002 level. Sales in those sectors that are more sensitive to credit conditions turned in significant recovery, while sectors impacted more intensively by positive growth in worker income tended to expand at a lesser pace. The ongoing process of interest rate cuts and more flexible consumer credit conditions, coupled with the process of economic recovery, indicates a positive outlook for end-of-year sales.

According to the Monthly Trade Sector Survey (PMC), the Retail Sales Volume Index, which is released by IBGE and seasonally adjusted by Depec[2], turned in growth of 0.9% in the period extending from August to October when compared to the previous quarter. A breakdown based on the different types of activities indicates that the segments of furniture and home appliances and automobiles, motorcycles, parts and spares closed with the highest rates of growth, when the same basis of comparison is used, closing with 7.2% and 6.1%, respectively. Both of these results reflect improvement in the conditions applied to consumer credit operations. The only segment to turn in negative growth (1.6%) was that of other articles for personal and household use.

Based on a comparison with the corresponding periods of the previous year, the trade sector registered negative growth of 2.8% in September and 3% in October, raising the accumulated downturn for the year to 4.9%. Despite the negative growth, the results for these two months indicated a budding process of recovery compared to the previously registered rates.

At the level of activities, only the segment of furniture and home appliances registered positive growth, with 5.2%, when October is compared to the same month of the preceding year. Specific mention should be made of the growth registered under the grouping of automobiles, motorcycles, parts and spares, with September and October expansion of -4% and -3.8%, both of which were significantly better than the -11% and -16.2% registered in July and August 2003, respectively. Analysis of the results accumulated in the year demonstrates that the rates attained by all segments of the retail trade sector confirm the move toward recovery.

A breakdown on a state-by-state basis shows that Rondônia turned in positive growth of 5% in the year up to October 2003 and was clearly an exception, since all of the other

2/ The seasonal adjustment result of the series must be still considered cautiously since the number of observations in the series is not yet the ideal for the procedure.

states surveyed closed with declines when the same basis of comparison is used. The sharpest losses occurred in Roraima (-14.1%), Acre (-12.1%) and Alagoas (-11.3%).

Despite the 4.9% decline accumulated in the year up to October in the Retail Sales Volume Index, Nominal Sales Revenues increased by 14.2% in the same period of comparison. This result was generated by a median increase of 20.2% in prices, compared to 15.7% when the prices of the first ten months of 2003 are compared to those of 2002, as measured by IBGE's Broad National Consumer Price Index (IPCA). The supermarket sector, which is characterized by lesser price elasticity, was the only segment aside from fuels and lubricants to register nominal revenues above the average IPCA in the period.

Sales Volume Index in the Retail Sector – Brazil

2003, October

Itemization	Nominal revenue	Volume	Price change
			% growth in 2003
Retail sector	14.2	-5.0	20.2
Fuel and lubricants	21.1	-5.2	27.7
Supermarkets	15.9	-5.9	23.2
Textiles, clothing and footwear	6.5	-3.9	10.8
Furniture and home appliances	9.7	-5.3	15.8
Other domestic goods	11.5	-3.0	15.0
Vehicles, motorcycles	-4.8	-10.5	6.3

Source: IBGE

Contrary to what occurred in the national indicator, the results recorded by the Trade Federation of the State of São Paulo (Fecomercio SP) did not point to a clearly defined reversal in the downward movement registered during the year. Deseasonalized data indicated growth of -1.6% and 0.7% in physical sales at the retail level in September and October, respectively. In the latter month, a segment-by-segment breakdown shows that sales of consumer durables and nondurables increased by 2.4% and 0.4%, in that order, when compared to the results of the previous month, while sales of semidurable consumer goods dropped by 3.1%. A comparison of the growth in sales of consumer durables *vis-à-vis* those of the other segments clearly demonstrates the importance of the recovery in credit operations. Sales of the automotive sector are a good example, with sharp August growth of 10.5%, September expansion of 10.2% and a downturn of 3.1% in the following month. In overall accumulated terms for the year up to October, the general trade sector index diminished by 16.4%.

Effective physical sales of the retail sector in São Paulo

Percentage change

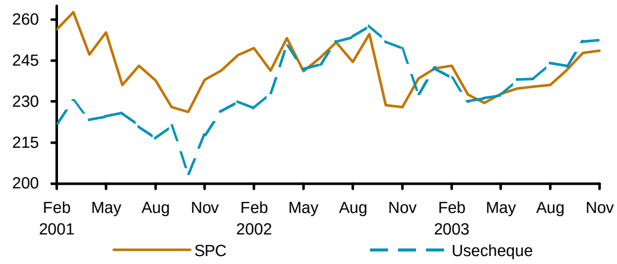
Itemization	2003				
	Jun	Jul	Aug	Sep	Oct
In the month1/					
General	-0.6	-3.1	0.4	-1.6	0.7
Consumer goods	1.0	-3.0	0.2	-1.6	1.0
Durable	6.9	-8.7	-6.8	0.1	2.4
Semidurable	-1.2	5.6	11.0	-3.8	-3.1
Nondurable	1.2	-1.3	4.3	-3.6	0.4
Automotive trade	-1.1	-5.2	10.5	10.2	-3.1
Company sales outlet	-1.6	-5.3	11.3	12.0	-1.7
Autoparts and accessories	3.6	-2.8	2.3	-1.9	-7.6
Building materials	-0.6	-9.2	-20.6	1.6	-1.2
In the year					
General	-13.0	-13.8	-15.1	-16.0	-16.4
Consumer goods	-14.7	-15.3	-16.5	-17.4	-17.7
Durable	-17.1	-15.9	-16.2	-16.2	-15.5
Semidurable	-24.6	-25.0	-23.9	-23.0	-22.8
Nondurable	-11.1	-13.0	-15.0	-16.7	-17.8
Automotive trade	-5.0	-6.1	-6.7	-4.6	-3.4
Company sales outlet	-5.8	-6.9	-7.5	-4.9	-3.1
Autoparts and accessories	-0.4	-1.4	-1.9	-1.5	-2.9
Building materials	-2.0	-3.4	-7.7	-11.2	-13.6

Source: Fecomercio SP

1/ Seasonally adjusted data.

Other indicators related to the trade sector confirmed the start of an upturn in consumption in the third quarter of 2003 and indicate that this trend will continue to the end of the year. According to the São Paulo Trade Association (ACSP), the number of consultations with the Credit Protection Service (SPC) and Usecheque turned in positive growth of 2.1% and 3.5%, respectively, in the third quarter of 2003, based on the deseasonalized statistical series and compared to the results of the previous quarter. October and November data – also deseasonalized – point to upward movement in the ACSP indicators, with growth of 2.2% and 0.4%, in the two months in question.

Retail sales indicators
Seasonally adjusted data
1992=100



Source: ACSP

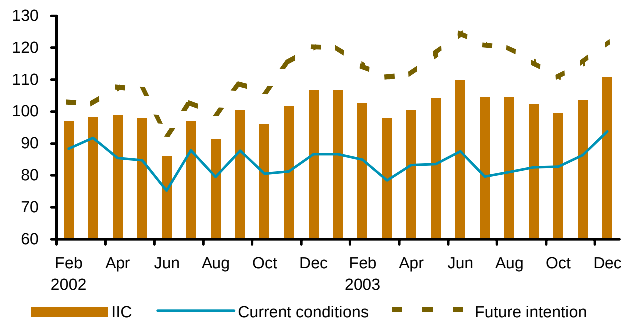
Default rates

Itemization	2003						Rate
	Jun	Jul	Aug	Sep	Oct	Nov	Year[1/]
SPC (SP)[2/]	4.9	5.2	4.0	4.0	5.4	4.2	5.5
Returned checks[3/]	5.1	5.5	5.2	5.1	5.4	5.2	5.4
Telecheque (RJ)[4/]	2.0	2.5	2.3	2.3	2.3	1.7	2.3
Telecheque (National)[4/ 5/]	2.1	2.6	2.4	2.4	2.5	2.3	2.4

Source: ACSP, Bacen and Teledata

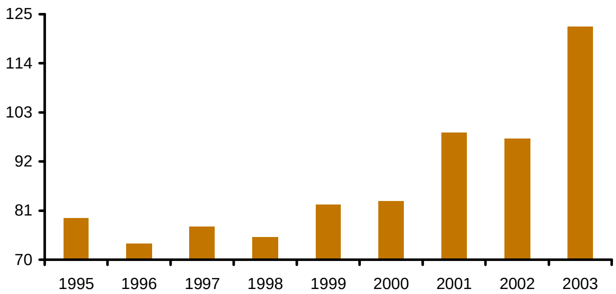
1/ Annual average.
2/ New registrations (-) registrations cancelled out/effected consultations (t-3).
3/ Cheques returned due to insufficient funds/cleared cheques.
4/ Returned cheques/cleared cheques.
5/ Average in the following cities: Belém, Fortaleza, Recife, Salvador, Belo Horizonte, São Paulo,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

Consumer Intention Index (IIC)



Source: Fecomercio SP

Grain production
In million of tons



Source: IBGE

Default indicators remained stable in the third quarter of 2003, with a slight rise at the start of the subsequent period. The register of checks returned due to insufficient backing to total checks cleared came to an average of 5.3% in the third quarter, compared to 5.4% in the second quarter, and a rate of 5.2% in the month of November. Another default indicator is the National Index released by Teledata, measuring the ratio between checks returned and received. This index pointed to relative stability in recent months as November closed with 2.3% compared to 2.5% in the previous month.

ACSP data for November based on SPC records indicated a small drop in the default level. The net rate came to 4.2% in the month, compared to 5.4% in October. When one analyzes defaults in the first eleven months of the year, the median rate came to 5.5%, as against 6.8% in the same period of the preceding year. To some extent, this reduction is explained by the effort made by those in arrears in the second half of the year to straighten out their situations, particularly in the period extending from July to September.

The results of the surveys aimed at evaluating consumer expectations indicated an interruption in the final months of the year of the process of deteriorating expectations. The Consumer Intention Index (IIC), released by Fecomercio SP, turned in a high of 6.8% in December, following reductions of 0.9% in November and 2.6% in the month of October. At the component level, highly divergent performances were registered. The Index of Future Intentions, which accounts for 60% of the general index, expanded by 5.9%, and the Current Intentions Index, by 8.8%, in the same period. This behavior reflects a transfer of the optimism and long-term expectations registered over the course of the first half of the year to perceptions of more favorable current conditions.

1.2 Output

Crop/livestock production

The 2003 grain harvest was 25.8% larger than in 2002. Other crops turned in highly varied results, such as sugar cane with a high of 6.2% and processed coffee and oranges with respective declines of 20.4% and 6.7%. Early indicators for the next harvest point to 3.6% positive growth, based on estimates of expansion of 3.1% in the area planted and 0.5% in average yield per hectare (see box Outlook for the 2003/2004 Harvest). In the livestock sector, while the outlook for a slowdown in production in the second quarter of 2003 was confirmed, overall production remained high when viewed in the framework of the historical statistical series.

Crops

Agricultural production

In 1,000 tons

Itemization	Production 2002	Production 2003 1/	Percentage change
Grain production	97 174	122 250	25.8
Cotton (seed)	1 407	1 429	1.6
Rice (in husk)	10 472	10 191	-2.7
Beans	3 051	3 292	7.9
Corn	35 500	47 489	33.8
Soybean	42 027	51 551	22.7
Wheat	2 926	5 409	84.9
Others	1 791	2 888	61.2
Other cultures			
Banana	6 504	6 468	-0.6
White potatoes	2 885	2 935	1.7
Cocoa (beans)	175	170	-2.4
Coffee (manufactured)	2 494	1 984	-20.4
Sugar cane	363 721	386 162	6.2
Tobacco (in leaves)	657	648	-1.4
Orange	18 447	17 216	-6.7
Manioc roots	23 131	22 454	-2.9
Tomatoes	3 608	3 567	-1.1

Source: IBGE

1/ Estimated.

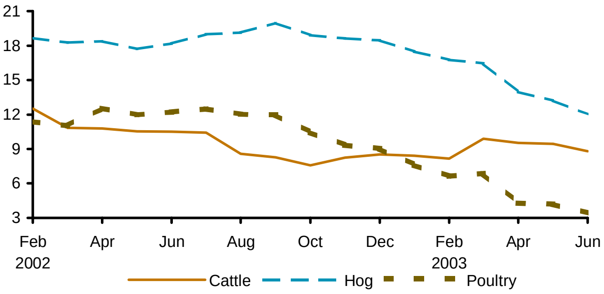
IBGE's Systematic Farm Production Survey (LSPA) for October confirmed the growth in 2003 grain production. Overall, the harvest of cereals, legumes and oil-bearing crops should close at 122.3 million tons, for growth of 25.8% over the previous harvest. In regional terms, output is distributed as follows: Southern Region, 58 million tons; Central-West region, 37.6 million tons; Southeast Region, 16 million tons; Northeast Region, 8.1 million tons; and Northern Region, with 2.6 million tons.

The 2003 grain harvest has for all practical purposes been concluded. The only production cycle that has yet to be closed is that of wheat, which is now in the final stage of the harvest. Expectations regarding the performance of this harvest are excellent, since climatic conditions have been favorable during the entire period of crop development.

The major determinants of production growth were strong expansion of 33.8% and 22.7% in the corn and soybean crops, respectively. Production of wheat is expected to expand by 84.9%, partly as a result of the serious climatic difficulties that occurred during the previous harvest, while the bean harvest should be 7.9% larger. Production of rice dropped by 2.7% in relation to the 2002 figure and reflected an increase of just 0.1% in the area planted and a yield loss of 2.8% caused by climatic adversities, particularly in the State of Rio Grande do Sul, where the largest share of production is concentrated.

With respect to the outlook for this sector of activity, indicators based on farm inputs point to a rather favorable scenario. Accumulated fertilizer production up to October came to 7.4 million tons or 8% more than in the same period of 2002, according to data released by the National Association of Fertilizer Distribution (Anda). Imports of this input closed at 11.9 million tons, for growth of 27% over the total in the corresponding period of 2002, while internal demand rose to 18.3 million tons, with growth of 12.7% in the period. Output of farm machinery, which is a solid indicator of investment growth in the sector, increased by 13% in the year up to October, according to data released by the National Association of Automotive Vehicle Manufacturers (Anfavea).

Livestock production
Total weight
Percentage change in 12 months (%)



Source: IBGE

Livestock

According to IBGE statistics, livestock production registered a positive performance in all of the varied segments up to the second quarter of 2003, when viewed against the same period of the previous year. Basically, this performance was a result of expanded foreign sales. It should be mentioned, however, that, despite the lag in the compilation of livestock data, more updated indicators based on deseasonalized data point to a reduction in slaughters of cattle and swine, with slight growth in poultry output in the third quarter, when compared to the previous quarter.

According to IBGE's Quarterly Survey of Animal Slaughters, total head of cattle slaughtered in the first half of the year came to 10.5 million, with growth of 11.5% in relation to the total in the same period of 2002. Total carcass weight came to 2.4 million tons, for growth of 8.5% in the period. One cannot fail to recognize the importance of external demand to this growth, as demonstrated by Ministry of Development, Industry and Foreign Trade (MDIC) statistics in the period extending from January to October. According to the data in question, beef exports came to 506.1 thousand tons, with growth of 51.8% over the total for the same period of 2002.

With regard to the slaughter of swine, the same IBGE survey indicates growth of 6.8% in the first six months of 2003, with total carcass weight of 944 thousand tons or 5.9% more than the total accumulated in the first six months of 2002. Analysis of accumulated totals up to October 2003 indicate that exports rose to 391.4 thousand tons, for an increase of 6.1% when compared to the corresponding period of 2002.

As far as the poultry sector is concerned, slaughters came to 1.6 billion chickens in the first six months of 2003, reflecting growth of 1.3% in relation to the same period of 2002. Total carcass weight in the half-year period closed at 3 million tons, for growth of 0.6% compared to the total for the first half of 2002. Here, one should also stress the role of foreign trade in the growth registered in the output of this segment. Exports came to 1.6 million tons, corresponding to accumulated growth of 19.9% in the year up to October, compared to foreign sales in the same period of the previous year.

Though there is a considerable lag in statistics on the production of beef and pork, IBGE's index of animals slaughtered, which is based on seasonally adjusted data and excludes poultry, is a component of the Monthly Industrial Survey (PIM) and is released well before the final results

Outlook for the 2003/2004 Harvest

Early field surveys aimed at estimating the coming year's farm production clearly confirm the outlook for positive growth as demonstrated by such leading indicators as sales of fertilizers, farm machines and equipment and the volume of credits granted. In the first Prognosis for the Survey of Planting Intentions for the 2003/2004 grain harvest, carried out by IBGE in October, as well as the forecasts made by the National Supply Company (Conab), growth estimates point to strong increases when compared to the previous harvest. The IBGE forecast, which includes only herbaceous cotton, peanuts (1st harvest), rice, beans (1st harvest), corn (1st harvest) and soybeans estimated volume at approximately 99.9 million tons of grain, reflecting expansion of 3.6% over the previous harvest. Conab figures point to a grain harvest of 129.7 million tons, for growth of 5.5% over the previous harvest. Evidently, confirmation of these estimates still depends on the regularity of climatic conditions.

It should be recalled that the outlook for the 2004 harvest was impacted by the upward movement registered in farm income in the previous harvest, made possible by favorable product prices. Obviously, the increase in income has had a positive impact on decisions regarding the planting of the current harvest. Another factor that deserves emphasis is the 2003/2004 Crop and Livestock Plan implemented by the Ministry of Agriculture, Livestock and Supply (Mapa), according to which the overall farm credit supply will total R$32.6 billion, of which R$16.4 billion will be channeled into current expenditures and marketing operations and R$5.8 billion into investments. Aside from these funds, mention should also be made of a forecast total of R$5 billion to be made available at market interest rates and R$5.4 billion through the

National Program for Strengthening Family Farming (Pronaf), which is managed by the Ministry of Agrarian Development (MDA). This volume of resources represents growth of 25.8% over the total granted in the previous harvest.

According to IBGE, a breakdown of the major crops indicates that the largest contribution to growth in the harvest will be made by soybeans. According to IBGE estimates, production of this crop is expected to total 54 million tons, for expansion of 6.1% over the previous harvest, with growth of 6.2% in the area planted. Growth in the output of this crop reflects the higher international prices generated by the lesser United States harvest, now estimated at 67 million tons of grain by the United States Department of Agriculture (USDA), and greater demand on the part of Asian countries, particularly China. Aside from this, continuous technological development and good climatic conditions have also contributed to the performance of this crop.

In much the same way, the increase in international prices has stimulated expansion of cotton production. The first IBGE estimates for the coming harvest indicate growth of 19%. Other factors that are expected to contribute to this increase are the positive results achieved in the previous harvest, growth in exports and government incentives to production of this fiber, as demonstrated in 25% growth in the limit on current expenditure financing for the next harvest.

With regard to coffee, which is another crop of importance to the trade balance result, production is estimated at between 34.1 million and 37.5 million bags, representing growth between 19.9% and 31.7% in comparison to the 2002/2003 harvest, according to Conab. Though climatic conditions have been normal in many production regions, the consequences of high temperatures coupled with the drought that occurred during the previous harvest will continue impacting the next harvest, as a result of their effects on the development of coffee trees. This factor, combined with low international market prices, has contributed to a situation in which producers have very little available capital, even though they are now at the start of the high point of the crop’s two year cycle. Consequently, their outlays on crop treatment and investments in inputs and fertilizes have necessarily been limited.

With regard to crops targeted to the internal market, special mention should be made of rice since this product was in short supply in 2003 and, consequently, underwent a price rise of approximately 35% over the course of the year. Rice production is now expected to climb by 11.9% over the previous harvest and reach a level of 10 million tons. According to expectations, productivity gains should be significant, particularly in those regions that were most seriously affected by the failure of the previous harvest.

Estimates for the first bean harvest indicate growth of 13.8% in output, with a reduction of 2.6% in the area planted and growth of 16.9% in average yield per hectare. The reduction in the area planted reflects the unsatisfactory prices registered toward the end of the 2003 harvest marketing period, coupled with the influence of soybeans, which have come to occupy areas previously dedicated to the production of such other crops as beans.

In the case of the first corn harvest, estimates point to a downturn of 3.8% as a result of the increased internal supply generated by the first 2003 harvest. This factor, coupled with exchange appreciation, resulted in downward price movement during the entire year. At the same time, the failure of the United States soybean harvest and consequent gains in international prices for the product encouraged many corn producers to shift over to soybeans.

As far as manioc is concerned, the area planted is expected to increase by 8.5% with production growth of 11.1% and a consequent increase of 2.4% in average yield. The reason underlying this performance is that of highly favorable current prices, when compared to the previous marketing period.

Another crop that deserve mentioning is sugar cane, due to its impact on fuel prices. It is estimated that the 2004 harvest will expand by 13.4% in the area under cultivation, with 30.7% growth in output and a consequent productivity gain of 15.3%.

In this context, the outlook for 2004 is one in which the farm sector will continue registering strong rates

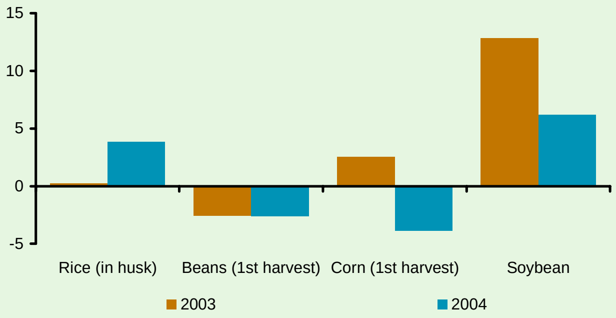
Prospects for the 2004 harvest

			Percentage change
Itemization	Production	Area	Average yield
Grain production	3.6	3.1	0.5
Cotton (seed)	19.0	20.7	-1.4
Rice (in husk)	11.9	3.8	7.8
Beans (1st harvest)	13.8	-2.6	16.9
Corn (1st harvest)	-3.8	-3.9	0.0
Soybean	6.1	6.2	-0.1
Other products			
White potatoes (1st harvest)	-1.1	-3.3	2.3
Onions	-5.0	-12.1	8.1
Sugarcane	30.7	13.4	15.3
Tobacco (in leaf)	-0.1	-0.2	0.0
Manioc roots	11.1	8.5	2.4

Source: IBGE

Planted area – 1st systematic survey

Percentage change



Source: IBGE

of growth, following the example of the last five years. This performance indicates the coming together of several important factors, including greater availability of resources to the sector as a result of both increased credit and higher levels of farmer capitalization generated by recent positive results; productivity gains; and the incentives provided by growth in international prices. With these factors, the farm sector will continue as an important source of support to the evolution of economic activity in general, making a highly positive contribution to the trade balance result and internal prices.

of the sector are tallied. It is important to note that this index pointed to growth of 3.5% in the quarter ended in October, compared to the previous quarter. In the first ten months of 2003, growth in this indicator came to 3.5%, compared to the same period of 2002. This performance demonstrates that, while the production of beef and pork remains quite high, there has been some degree of decline in overall output.

Going on to the poultry segment, when the same basis of comparison is utilized, overall growth came to 2.2%. In the first ten months of 2003, the indicator registered a decline of 3.1%, compared to the same period of the previous year.

Industrial output

In the period from July to September, industrial activity expanded steadily before registering a slight output slump in October. This performance was sustained by a more flexible monetary policy, recovery in business expectations and continued export growth and, based on the scope of the movement within the industrial sector as a whole and the intensity of expansion, demonstrated without a shadow of a doubt that the process of renewed growth is underway, particularly in light of the rather sluggish production performance of the first half of the year.

The August to October quarterly average turned in growth of 4.3% in industrial activity, when compared to the three previous months. This growth figure is based on deseasonalized data drawn from IBGE's Monthly Industrial Survey – Physical Output (PIM-PF). This result reflected growth of 2.6% in mineral extraction and, principally, a clear upturn in the trajectory of the manufacturing sector, which expanded by 4.9%, using the same basis of comparison. The positive result in the quarter raised accumulated output in the first ten months of the year to the same level registered in the corresponding period of 2002.

Within these percentages, one should note that the September result – a month in which the manufacturing sector registered strong 5.2% seasonally adjusted growth – was, to some extent, impacted by the fact that Independence Day fell on a Sunday. Thus, the occurrence of one more business day in September of this year when compared to the same month of previous years accentuated growth in the period. However, even when this aspect is considered, it is important to observe that the results of the final quarter were quite significant.

Industrial production

Percentage change

Itemization	2003				
	Jun	Jul	Aug	Sep	Oct
Industry (total)					
In the month 1/	- 2.4	1.0	1.9	4.1	- 0.5
Quarter/previous quarter 1/	- 2.6	- 2.5	- 1.2	1.9	4.3
Same month of the previous year	- 2.3	- 2.3	- 2.1	4.1	1.1
Accumulated in the year	- 0.1	- 0.5	- 0.7	- 0.1	0.0
Accumulated in 12 months	2.4	1.8	1.6	1.5	0.8
Manufacturing industry					
In the month 1/	- 1.6	0.3	1.7	5.2	- 0.1
Quarter/previous quarter 1/	- 2.7	- 2.4	- 1.0	2.0	4.9
Same month of the previous year	- 1.7	- 2.9	- 2.6	4.4	1.2
Accumulated in the year	- 0.4	- 0.8	- 1.0	- 0.4	- 0.2
Accumulated in 12 months	1.9	1.5	1.3	1.2	0.7
Mineral extraction					
In the month 1/	- 8.8	8.9	0.5	- 0.9	0.3
Quarter/previous quarter 1/	- 1.2	- 2.5	- 3.1	2.3	2.6
Same month of the previous year	- 7.0	2.3	1.7	2.1	0.2
Accumulated in the year	2.0	2.1	2.0	2.1	1.9
Accumulated in 12 months	5.6	5.0	3.9	3.2	1.6

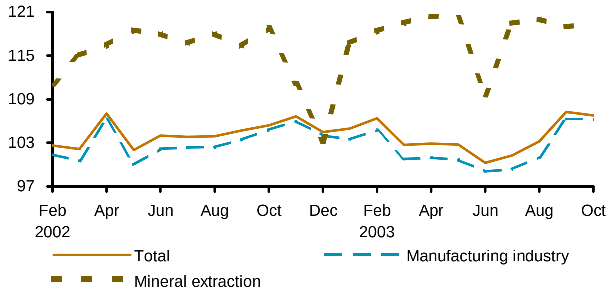
Source: IBGE

1/ Seasonally adjusted data.

Industrial production

Seasonally adjusted data

2000=100



Source: IBGE

Industrial production by category of use

Percentage change

Itemization	2003			
	Jul	Aug	Sep	Oct
In the month[1/]				
Industrial production	1.0	1.9	4.1	- 0.5
Capital goods	1.4	3.5	6.0	3.8
Intermediate goods	1.9	2.3	2.3	0.3
Consumer goods	- 0.8	- 0.3	5.9	0.5
Durable	1.7	5.5	7.2	1.8
Semi and nondurable	- 1.3	- 1.6	5.1	0.0
Quarter/previous quarter[1/]				
Industrial production	- 2.5	- 1.2	1.9	4.3
Capital goods	- 3.6	- 2.7	2.3	8.1
Intermediate goods	- 2.7	- 1.1	2.5	4.4
Consumer goods	- 2.6	- 0.5	0.7	3.2
Durable	- 2.0	6.3	8.3	13.1
Semi and nondurable	- 2.4	- 2.2	- 1.3	0.4
In the year				
Industrial production	- 0.5	- 0.7	- 0.1	0.0
Capital goods	- 2.6	- 2.6	- 1.4	- 0.5
Intermediate goods	1.1	1.0	1.4	1.4
Consumer goods	- 5.0	- 5.5	- 4.8	- 4.5
Durable	- 4.5	- 4.4	- 2.9	- 2.3
Semi and nondurable	- 5.2	- 5.8	- 5.3	- 5.1

Source: IBGE

1/ Seasonally adjusted data.

As of the start of the second half of the year, the upturn in the manufacturing sector has been a consequence of expanded internal demand and a favorable performance in the export sector (see box Aspects of the Upturn in the Pace of Industrial Activity). Though exports of semimanufactured products declined by a seasonally adjusted rate of 3.8% in the August-October quarter compared to the previous quarter, external sales of manufactured goods increased by 9.1% in the period in question.

Among the nineteen segments included in the manufacturing sector, eighteen registered average output growth in the period from August to October based on the deseasonalized statistical series, when seen against the results for the three previous months. In the period, strong growth was registered under production segments targeted to the internal market, including electric and communications material, 9.5%, perfumes, soaps and candles, 9.1%, and furniture, 8.9%. Anchored in the performance of the automotive sector, transportation equipment expanded by 11.4% in the period.

In accumulated terms for the year up to October, the best performances were concentrated in those segments focused on the export market, particularly mechanics, 9.1%, rubber, 6.1%, and metallurgy, 4.8%.

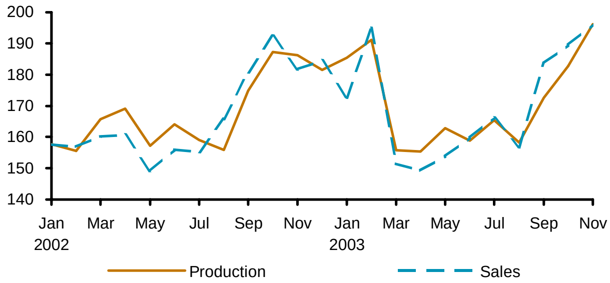
An analysis of use categories indicates that the reaction of the industrial sector began in the production of consumer durables, which expanded by 13.1% in the deseasonalized statistical series in the August-October quarter when compared to the previous quarter. Improvement in credit conditions produced a ripple effect in the economy and, for example, benefited such items as the production of TV sets, radios and sound equipment and furniture, with growth performances of 25.5% and 8.9%, respectively, using the same basis of comparison. Total output of home appliances expanded by 16.9% in the period, with positive growth under image and sound equipment (25%) and other household appliances (8.9%), while the segment of transportation equipment expanded by 11.4%.

Anfavea data ratify this performance, to the extent that, based on the deseasonalized series, they indicate 5.5% growth in the production of the automotive industry in the August-October quarter, compared to the previous quarter. In this case, the increased dynamism of this industrial segment was driven by 10.5% sales growth in the same period, with expansion of 13.8% in the internal market and a 1.5% reduction in external market operations. In the month

Vehicles - Production and sales

Seasonally adjusted data

1992=100



Source: Anfavea

of November, the segment continued its strong upward trajectory, turning in seasonally adjusted production growth of 7.3% in the month, coupled with a 3.5% increase in sales.

Growth was considerably more discreet under the heading of semi and nondurable consumer goods, with growth of just 0.4% in the August-October period, compared to the immediately previous quarter. The lag in the reaction of this category reflects the very gradual process of recovery in overall wages.

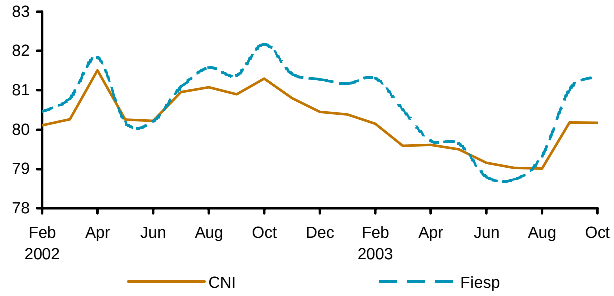
In the case of intermediate goods, growth closed the quarter at 4.4%. Once again, export-oriented segments made a positive contribution to this performance, particularly under metallurgical products, while other important segments of the industrial structure also turned in sharp growth in the period. Among these, emphasis should be attributed to basic and intermediate petrochemicals, with 13.4%, and glass and glass articles, with 11.7%.

Manufacturing of capital goods turned in growth of 8.1% in the quarter, registering a heterogeneous performance among the various segments. The growth process was led by capital goods for the farm sector, with 11.7%, and transportation equipment, with 7.7%, while output of capital goods for the construction industry dropped by 3.5% in the period. Note should be taken of the fact that 9.9% growth in the output of capital goods for the industrial sector in recent months indicates that companies have initiated reequipping processes. In this sense, industrial capital goods produced in series have been expanding steadily since August, turning in 12.2% in the August-October quarter compared to the previous quarter, while output of industrial capital goods produced on an order basis increased by 11.5% in September before settling back in October, when output fell by 1.5% compared to the immediately previous months.

Analysis shows that the recent evolution of foreign trade involving capital goods has acted as an additional underpinning for the process of renewed investment. In this context, imports of capital goods expanded by 24% in the August to October quarter, compared to the previous period, while exports of the products of this category increased by 9% using the same basis of comparison.

From the geographic point of view, nine of the ten states surveyed by IBGE registered upturns in the level of activity in the August-October quarter, when compared to the previous quarter, though it should be recalled that differences in growth rates are also a consequence of the distribution of industrial goods. A state-by-state breakdown indicates that output expanded in Pernambuco, 19.9%, Minas Gerais, 6.6%, Rio Grande do Sul, 5.9%, and Paraná, 5.2%.

Utilization of installed capacity
Seasonally adjusted data
Average percentage



Source: CNI and Fiesp

One should note that the recovery registered in recent months is in no way threatened by the possibility of bottlenecks in the nation's productive capacity, as is evident in the existence of a considerable margin of idle capacity in most industrial sectors. In the third quarter of the year, utilization of installed industrial capacity came to an average of 79.6% or 1.8 p.p. below the level registered in the same period of 2002, according to figures released by the National Confederation of Industry (CNI). Data released by the Getulio Vargas Foundation (FGV) and based on the same type of comparison, however, indicated a very different performance with positive growth of 1.8 p.p.

These surveys, however, converge in the sense that they confirm that, based on the seasonally adjusted statistical series, utilization of installed industrial capacity rose in the third quarter when compared to the second. Despite this rise, median utilization remained below historical peaks in all of the different use categories. One should underscore the fact that the utilization increase was concentrated in the sector of consumer and capital goods, both of which had been characterized by high levels of idle capacity. According to FGV data, the highest levels of utilization are concentrated under intermediate goods, particularly cellulose, paper and cardboard, 93.7%, metallurgy, 90.1%, rubber, 89.8%, and textiles, 88.8%. Repeating what occurred in the second quarter of the year, the level of utilization in the segment of food products is the only one that has moved to the highest point ever registered by the survey, with 88.8%.

Manufacturing industry stocks[1/]

Itemization	2002		2003		
	III	IV	I	II	III
Manufacturing industry					
Final products	51.7	49.7	53.4	56.3	54.6
Raw materials and interm. goods	49.0	48.1	49.1	48.5	49.6
Large companies					
Final products	54.2	51.1	53.9	58.9	57.1
Raw materials and interm. goods	51.7	49.3	51.9	52.6	52.9
Small and medium companies					
Final products	50.4	48.9	53.2	54.9	53.2
Raw materials and interm. goods	47.5	47.4	47.5	46.2	47.8

Source: CNI

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

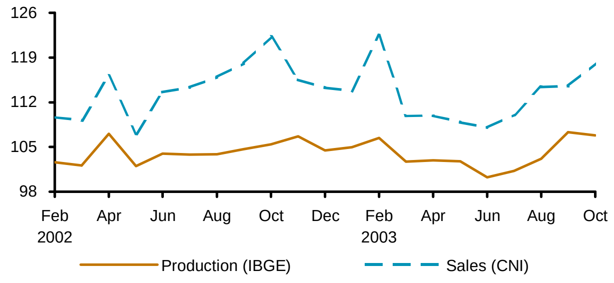
The October CNI Industrial Survey pointed to improvement in industrial conditions in the third quarter of the year. With regard to stock levels, those of raw materials were quite close to the desired volumes. In light of expectations of an upturn in demand, it is possible that a process of replenishment of stocks of inputs may begin as of the fourth quarter of the year. This, in itself, would be important in the sense that it would trigger an additional positive impact on the intermediate goods productive chain. As regards stocks of final products, the proportion of companies with excessive inventories is still quite high. However, CNI data indicated that there has been an already substantial adjustment in relation to the levels registered in the previous quarter.

The Overall Manufacturing Industry Survey, which is released by FGV, presented a positive business community evaluation in relation to growth in the level of demand, particularly on the internal market, and in business operations in general, in the third quarter of the year. In the period under consideration, the ratio of companies with excessive stocks surpassed that of companies with insufficient stocks, by a full 10 p.p., compared to as much as 19 p.p. in the second quarter. This comparison is, in itself, a confirmation of the partial adjustment in stocks that had already occurred in the July-September period.

Industrial production and sales

Seasonally adjusted data

2000=100



Source: IBGE and CNI

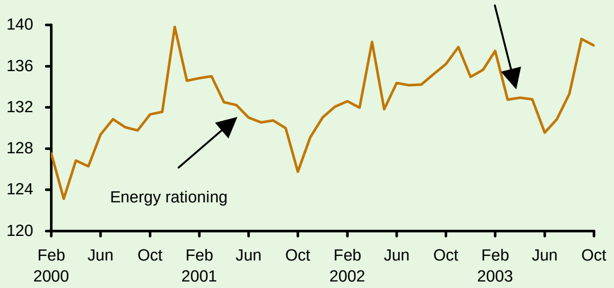
Industrial recovery was mirrored in real industrial sales indicators and hours worked in production. According to CNI, deseasonalized figures indicate that real sales expanded by 6.2% in the August-October quarter, compared to the previous quarter, while hours worked in production increased by 2.2%. For the State of São Paulo, figures released by the Federation of Industries of the State of São Paulo (Fiesp) indicate that, when the same basis of comparison is used, real sales increased by 6.6% and hours worked by 1.4%.

With respect to business expectations, surveys carried out at the end of the third quarter of the year indicated greater optimism regarding performance at the end of the year. According to CNI analyses, the business community is considerably more optimistic with respect to the situation of the Brazilian economy and that of their own business enterprises. Among those that turned in the sharpest improvement in expectations, the most important were sectors focused on the internal market, a fact that clearly reveals the enhanced optimism with regard to the outlook for growth in internal demand.

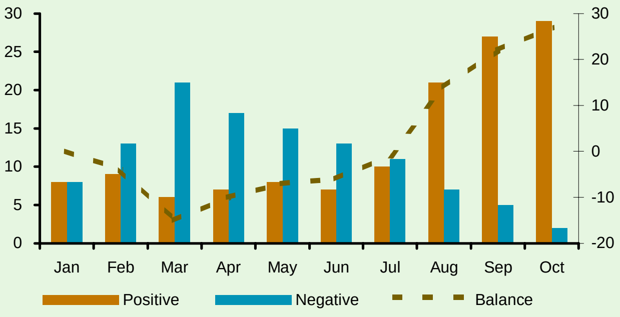
Statistics released by FGV corroborate the favorable outlook for the coming months. The responses of businesspersons with regard to expectation of demand in the fourth quarter of the year now stand at their most promising level since 1999 for this time of the year. Aside from this, forecasts regarding production are also positive, albeit not quite as optimistic. Aside from the seasonal component, these forecasts also indicate that the process of stock adjustment is moving forward.

Business community forecasts of industrial employment are surprising. Despite the presence of seasonal factors, according to which industry tends to reduce the number of employees in the fourth quarter of the year, the proportion

Aspects of the Upturn in the Pace of Industrial Activity



Source: IBGE



Source: IBGE

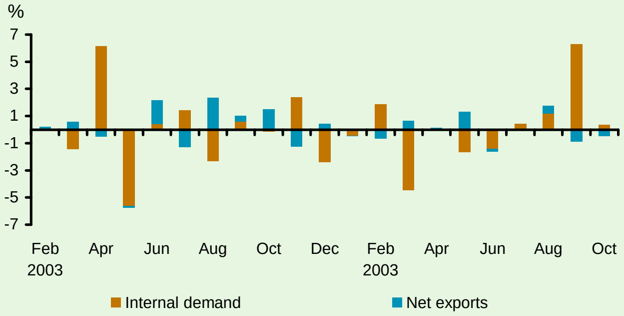
Industrial activity moved into an upward curve in July and attained a new output level in the final quarter of the year. In September, the seasonally adjusted output index hit its second highest mark of the series, second only to the December 2000 result. There are two aspects to the recent process of industrial recovery that indicate the effectiveness and consistency of expansion: the overall scope of the movement and the destination of output.

The first aspect is illustrated by the performance of the various industrial segments. Sign changes between movable half-yearly and quarterly output index medians point to alterations in the behavior of the individual segments and are an indicator of reversals in the sector's overall trajectory. Analysis of the 61 segments of the 100 level classification of IBGE's Monthly Industrial Survey demonstrates the breadth of the positive results and the growth trend achieved by industry.

Starting in April, the number of segments that registered negative growth in the half-yearly moveable average and positive growth in the quarterly moveable average – positive trend inversion – expanded steadily, while the number that registered the opposite behavior – negative trend inversion – diminished. This movement persisted until, which occurred as of the month of August, the segments that registered a positive trend surpassed the others. The generalization among the segments reflected the breadth of the expansion and the consistency of the upward trajectory of the industrial sector.

In its turn, analysis of product destination indicates that, despite the undeniable importance of exports, the gradual upturn in internal demand has played a preponderant role in recent industrial recovery. Estimates of the contribution of the internal market and net exports to monthly growth in manufacturing shows that internal demand was one of the major underpinnings of the results registered in the second half of the year. This performance contrasted sharply with the first half of the year, when the contribution of internal demand was sharply negative,

Contribution to manufacturing sector monthly growth
Seasonally adjusted data



Source: IBGE and Funcex

The fact of the matter is that, over the course of 2002 and in the first half of the current year, production of the manufacturing sector was mainly channeled into meeting the growing demand of the export sector and substituting previously imported goods. Thus, the performance of the external sector avoided an even more accentuated falloff in the industrial output index. However, in recent months, lesser growth under industrial exports and upward movement under imports have generated a scenario in which the contribution of the external sector to monthly growth in manufacturing has been sharply less or even negative. On the other hand, driven by positive expectations, the internal market has reacted positively to recently adopted more flexible credit conditions. Thus, as of July 2003, growth has been undergirded by increased dynamism in internal demand.

The coming together of these factors – the scope of recovery and expansion in internal demand – doubtlessly characterizes the start of an industrial growth cycle. This process will move toward consolidation to the extent in which recovery is registered in job market indicators and under investments – recent positive results in the production of capital goods and the construction industry indicate that this movement is already under way.

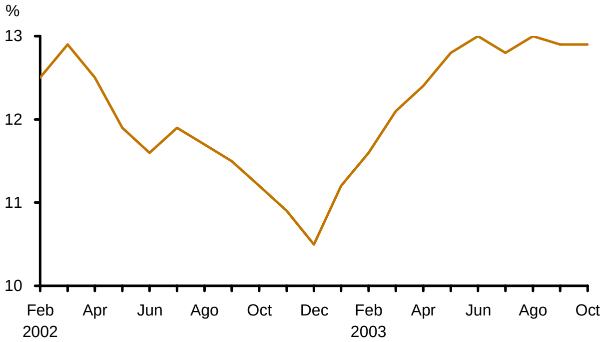
of companies that intend to hire additional labor has surpassed those that plan to lay workers off.

It should be underlined, however, that the process of industrial growth will be gradual. Among the conditions required to consolidate this growth, some of which are already clearly moving forward, one should cite the need for new investments and improvements in the labor market that would result in higher real income at the margin, driven by incorporation of the gains generated by control of inflation and by collective bargaining, as well as increases in the number of people holding jobs.

1.3 Labor market

Employment

Unemployment rate



Source: IBGE

Following steady growth in the first half of the year, the rate of open unemployment stabilized in the range of 13% as of the month of June and closed both September and October at 12.9%, according to the IBGE Monthly Employment Survey (PME), which encompasses six metropolitan regions. When one considers the March to October period, the Economically Active Population expanded by an average of 5.7% compared to the corresponding months of 2002. Analysis of this growth indicates several important factors, such as the participation of persons in the age bracket of 50 plus, with approximately 28%, followed by the group in the bracket from 25 to 49 years of age, with 57%. Parallel to this, the participation of women in the job market also increased in the period.

Occupied people by categories of employment

In 1,000,000

Itemization	2003				
	Jun	Jul	Aug	Sep	Oct
Total of occupied people	18.3	18.3	18.5	18.7	18.6
By categories of employment					
Registered	8.1	8.1	8.1	8.2	8.2
Nonregistered	4.0	3.9	4.1	4.2	4.1
Non-earning workers, military and civil servants	1.4	1.4	1.4	1.4	1.4
Self-employed	3.7	3.7	3.7	3.8	3.8
Employers	1.0	1.0	1.0	1.0	1.0

Source: IBGE

In comparison to 2002, the pace at which new job openings have been created has declined. In the wake of the 18.4% accumulated high registered up to March, this figure has been gradually moving downward, until reaching a level of 7.3% in October. This performance was found to exist in all of the different categories of employment, with reductions from 17.5% to 5.8% in registered employees, from 19.8% to 10.9% in the segment of unregistered workers and from 20.8% to 11.8% in that of the self-employed. On a category-by-category basis, the comparison of the number of jobs created in October of this year with that of the same month of 2002 points to an ongoing process of workers shifting from the formal to the informal employment market. In this sense, the number of new jobs increased by 7% and 6.2% in the segments of unregistered workers and the self-employed, while growth in the number of registered workers was no more than 0.3%.

Formal employment

Itemization	New job openings (1,000 employees)			
	2003			
	I H	III Q	Oct	In the year
Total	560.9	278.8	70.9	910.5
Manufacturing industry	128.0	82.5	16.2	226.7
Commerce	61.3	67.4	36.4	165.2
Services	160.7	105.2	32.4	298.4
Building	-20.6	13.5	4.0	-3.0
Crop and livestock	205.6	5.7	-20.2	191.1
Public utilities	2.1	0.1	0.3	2.5
Others[1/]	23.7	4.2	1.8	29.7

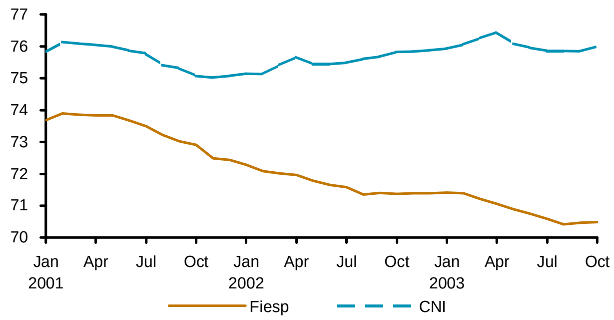
Source: Ministry of Labor and Employment

1/ Includes mineral extraction, public administration and others.

Industrial employment

Seasonally adjusted data

1992=100



According to a nationwide survey made by the Ministry of Labor and Employment (MTE), the number of job openings in the segment of registered workers increased by 162 thousand in September, the strongest increase of the year, and 71 thousand in October. In the first ten months of the year, 911 thousand job positions were created, corresponding to 11.1% less than in the same period of 2002, the year in which the series achieved its highest level. In the period, the service sector accounted for the sharpest generation of job opportunities, with approximately 300 thousand, followed by manufacturing, with 227 thousand, and crop/livestock farming, with 191 thousand. The trade sector also registered a positive performance with creation of 165 thousand new openings, while the construction industry, which registered the sharpest drop in production since 1996, turned in a larger number of layoffs than hirings, closing with a negative balance of 3 thousand positions. However, one should stress that this movement was concentrated in the first quarter of the year, as evinced by the fact that hirings surpassed layoffs by 23 thousand in the period from April to October.

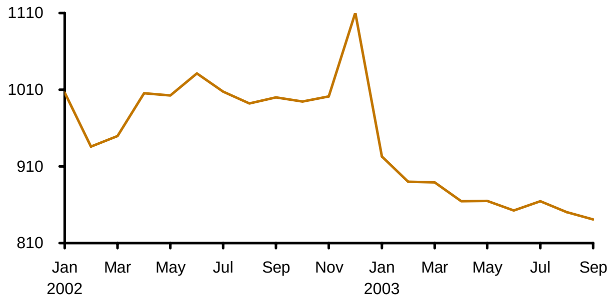
With respect to the labor market in the industrial sector, a CNI survey of the trade federations of twelve states, based on deseasonalized data, indicated a reversal of the downward trend that prevailed in the period between July, with a monthly result of -0.1%, and October, monthly growth of 0.2%. This behavior mirrors the recent performance of the industrial sector. The number of jobholders has evolved at an accumulated positive rate in the year, though the overall rate has been on a downward curve since the start of 2003. In the month of February, this percentage stood at 1.1%, compared to 0.7% in October.

In the case of the São Paulo industrial sector, deseasonalized Fiesp data pointed to an interruption in the downward trend in the number of jobholders registered in the period from January to August. In September, the employment level expanded by 0.1%, followed by stability in October. Analysis of the accumulated total for the year shows a reduction of 1.2% in the level of industrial employment. A survey of the State's employer unions indicated net positive creation of 12.1 thousand job openings in September and October, following five months of consecutive declines.

Earnings

According to the PME, the real 2003 earnings of the workers in six metropolitan regions declined, despite that fact that wage negotiations registered more favorable results in the

Real average earnings
In R$ at September prices, deflated by INPC



Source: IBGE

second half of the year. In September, the accumulated loss in the year came to 12.2% and, compared to September 2002, closed at 15.9%. At the start of the second half, the monthly analysis indicated a relative degree of recovery in the purchasing power of wages. Basically, this movement is a consequence of an accentuated downturn in inflation in the month of June. However, this behavior was not repeated in the following months, as each of these months closed with negative results. Consequently, the group of the self-employed turned in the most accentuated accumulated reduction of the year, with 20.2%, followed by registered workers, with 8.2%, and unregistered workers, with 6.6%.

The first half of the year was marked by a climate of uncertainty with respect to the performance of the nation's economy, a factor that resulted in wage increases below the level of the National Consumer Price Index (INPC) in 54.4% of the nationwide collective bargaining efforts studied by the Interunion Department of Socio-Economic Statistics and Studies (Dieese). In the second half of the year, the economic scenario showed signs of recovery in the level of activity, while collective bargaining negotiations were more favorable to workers. Analysis shows that, with the exception of bank workers, the major categories registered increases equal to or greater than the accumulated twelve month INPC.

In São Paulo, according to Fiesp statistics and using the Consumer Price Index released by the Institute of Economic Research Foundation (IPC-Fipe) as the reference base, real average wages paid by industry increased by 0.6% in October. When the accumulated result for the year is analyzed, real average wages declined in October by 1.6%. With regard to overall wages, the decline in the first ten month of the year came to 2.8%, corresponding to a more positive accumulated result in 2003.

Real wages in the manufacturing industry

% accumulated growth in the year

Itemization	2003							
	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct
CNI								
Overall real wages	-6.6	-6.9	-7.0	-6.7	-6.5	-6.1	-5.9	-5.6
Fiesp								
Overall real wages	-3.5	-3.9	-3.9	-3.6	-3.4	-3.2	-3.0	-2.8
Average real wages	-2.4	-2.8	-2.8	-2.5	-2.3	-2.0	-1.8	-1.6

Source: CNI and Fiesp

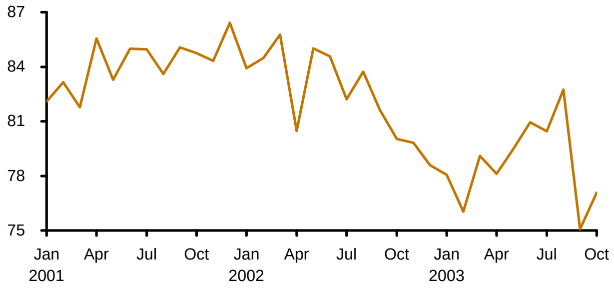
As far as industry is concerned, overall wages deflated by the IPCA and calculated by CNI increased by 2.3% in the third quarter, compared to the level of the previous period. This performance signaled significant gains in the wage negotiations of several important labor categories. In the same sense, the October result reflected recovery in overall wages, with growth of 0.6% in the month, based on data from which seasonal factors have been purged. In the year, the reduction in overall wages closed at 5.6%, with the sharpest falloffs in Rio de Janeiro, 7.6%, and Minas Gerais, 8.1%.

Unit labor cost and productivity

Unit Labor Cost

Seasonally adjusted data

1992=100

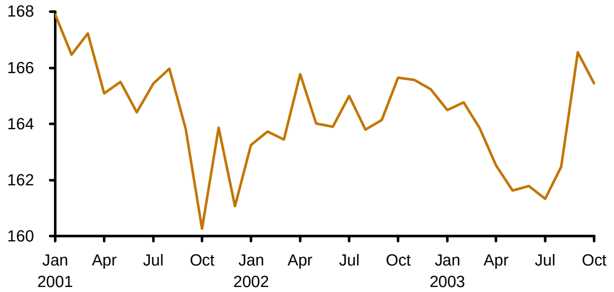


Source: IBGE, CNI and Banco Central do Brasil

Productivity

Seasonally adjusted data

1992=100



Source: IBGE, CNI and Banco Central do Brasil

Understood as the ratio between overall real wages, as released by CNI, and the physical output of the manufacturing industry, according to IBGE, the Unit Labor Cost (UCL) registered monthly growth of 2.7% in October in the seasonally adjusted statistical series. However, the indicator turned in a seasonally adjusted decline of 2.5% in the August-October quarter, when compared to the level of the previous quarter. As of the month of July, the upturn in the pace of production aided in reducing labor costs.

Productivity of the manufacturing sector, measured according to the ratio between the index of the sector's physical output, based on IBGE's PIM-PF data, and hours worked in production, as announced by CNI, expanded by 2% in the quarter ended in October, compared to the immediately previous quarter. Once again, this result is based on the deseasonalized statistical series. In the year, productivity slowed by 0.5% up to October. On a state-by-state basis, the sharpest growth was registered in Espírito Santo and Rio de Janeiro, with increases of 16.3% and 7%, respectively. The sharpest falloffs in productivity occurred in the Bahia and Santa Catarina industrial sectors, with 7.8% and 5.7%, in that order.

1.4 Gross Domestic Product

In the third quarter of the year, GDP expanded by 0.4%, compared to the previous period, based on seasonally adjusted IBGE data. To some extent, this result frustrated expectations for the period, since sector-by-sector indicators had previously pointed toward more expressive expansion. For the most part, the difference between these expectations and the result must be attributed to the final impact of the revisions of the series of National Accounts and to the result of the primary sector, which closed at a deseasonalized level of -6.7%.

Every year, when the GDP results for the third quarter are released, IBGE publishes its revisions of previously announced results, in order to incorporate statistics that were not available at the time the original data were announced and adopts possible methodological changes. As a consequence of this procedure, GDP growth in 2002 was revised from 1.5% to 1.9% while the accumulated result for the first half of 2003 was revised from 0.3% to 0.4%. In the half-year period, the adjustment reflected incorporation of the more positive crop/livestock results, with expansion of 8.8% compared to a previous estimate of 5.7%. In the case of the industrial sector, the decline was altered from 0.5% to 0.2%. Changes in the results of the service sector were negligible.

However, alterations of a methodological nature had an adverse impact on the deseasonalized result in the third quarter. These changes reflected sharp revisions in the series of the service sector's four major subsectors. These changes are summarized below:

- Communications – Aside from the postal service and fixed telephone services, this heading also includes mobile phone services. The procedure adopted in the calculation of the volume of mobile telephone services is based on deflation of the sector's net operational revenues, using the mobile telephone service heading of the IPCA. Adoption of this procedure means that not only the utilization of these telephones but also the services rendered over mobile telephone systems are incorporated into the indicator of mobile telephone volume;

- Other Services – The production volume index referring to commercial health services is one of the components of this heading. Here, this item began calculating the total number of days of hospitalization instead of the median time, thus making it possible to incorporate the sector's productivity gains. Aside from this, the volume index of services rendered to companies is now calculated according to respective demand, instead of using the subsector of formal employment (General File of the Employed and Unemployed – Caged) that had been use in a proxy function;

- Rentals – Encompasses effective and imputed rentals, with respective participation levels of 30% and 70%. In its turn, the participation of residential rent in effective rentals comes to approximately 60%. Imputed rentals are calculated on the basis of data drawn from IBGE's National Household Survey (PNAD) – a projection of the number of those living in their own homes, based on the data calculated in previous years. Effective rentals are calculated on the basis of the median growth of the economy for the "intermediate" component and the number of rented residential units, according to the PNAD, for the residential segment. The alteration introduced as of this quarter refers to the volume indicator of the change in effective residential rents which now considers the types of real estate rented, in contrast to the previous system of considering only the quantity of real estate rented. The calculation results from the weighted median of the changes in the number of real estate units per income bracket, using the total amount paid in the respective class as the weighting factor. The classes of rent considered were grouped according to the number of minimum monthly wages, as follows: up to 1, from 1 to 2, from 2 to 3, from 3 to 5, from 5 to 10, from 10 to 20 and more than 20 times the minimum monthly wage;

- Public administration – The public health component of this subsector now includes the total number of hours of hospitalization instead of the median time of hospitalization, just as is now done in the commercial health system.

When one considers third quarter sectoral results, the seasonally adjusted 6.7% reduction under agriculture can be mainly attributed to the failure of the coffee harvest, which, based on the appropriation system used by National Quarterly Accounts, generated repercussions in the third quarter of the year. Aside from this, another factor of considerable importance to the strong negative result was the exceptional growth achieved by the soybean sector, which raised the second quarter result sharply.

Confirming the behavior of the monthly activity level indicators, the industrial sector registered a high of 2.7% in the quarter. Analysis of the various industrial segments reveals a generalized process of expansion. Mining activity increased by 2.2% and manufacturing by 1.9%, emphasizing that the opening of the various segments indicates favorable performances in practically all of them, independently of whether they are focused on the internal or external markets; the construction industry expanded by 0.2%. Following three consecutive months of downward movement, the service sector expanded by 0.1% in the third quarter of 2003, compared to the result of the immediately previous quarter.

Analyzing the first nine months of 2003, compared to the same period of the previous year, GDP declined by 0.3%. This result was still influenced by the downturn in internal demand in the first half of the year, caused by less than favorable credit conditions and losses in real earnings. These

Gross Domestic Product

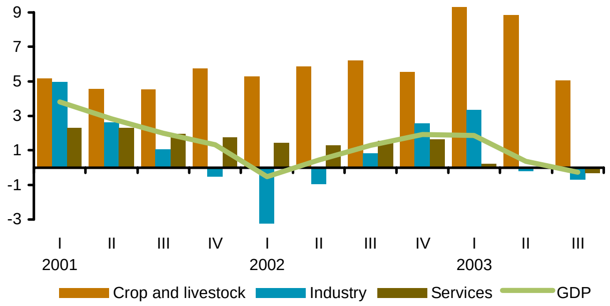
Quarter/previous quarter seasonally adjusted

Itemization	2002		2003		
	III	IV	I	II	III
GDP at maket prices	0.9	0.2	-0.8	-1.2	0.4
Crop and livestock	2.7	0.4	4.2	0.4	-6.7
Industry	1.1	1.3	-2.0	-3.7	2.7
Services	0.7	-0.1	-0.7	-0.2	0.1

Source: IBGE

Gross Domestic Product

% growth accumulated in the year



Source: IBGE

Gross Domestic Product

Percentage change

Itemization	2002		2003		
	III	IV	I	II	III
Accumulated in the year	1.3	1.9	1.9	0.4	-0.3
Accumulated in 4 quarters	0.8	1.9	2.5	1.9	0.7
Quarter/same quarter of the previous year	3.0	3.9	1.9	-1.1	-1.5
Quarter/previous quarter seasonally adjusted	0.9	0.2	-0.8	-1.2	0.4

Source: IBGE

two adverse factors were only partially offset by the performance of the foreign trade sector. In this sense, household consumption and gross fixed capital formation registered respective declines of 4.2% and 7.2%, using the same basis of comparison. Foreign sales expanded by 15.8% in the period, while imports dropped by 5.8%.

Gross Domestic Product

Percentage change in the year

Itemization	2002		2003		
	I H	Year	I Q	II Q	III Q
Crop and livestock	5.9	5.5	10.6	8.8	5.1
Industry	-1.0	2.6	3.3	-0.2	-0.7
Mineral extraction	9.3	6.7	4.3	1.8	2.1
Manufacturing	0.8	3.6	3.9	1.0	0.7
Construction	-6.8	-1.9	-0.9	-6.0	-7.7
Public utilities	-5.4	3.0	8.1	3.1	2.5
Services	1.3	1.6	0.2	0.0	-0.3
Commerce	-1.5	-0.2	-0.2	-2.0	-3.4
Transportation	4.1	3.4	-4.0	-2.3	-1.6
Communications	9.8	9.8	2.4	2.7	1.4
Financial institutions	0.3	2.1	2.2	1.1	0.1
Other services	0.8	1.1	-0.1	-1.0	-0.6
Rents	0.7	0.6	0.4	0.6	0.6
Public administration	1.8	1.7	0.2	0.6	0.5
Financial dummy	-0.7	2.3	4.4	1.7	0.6
Value added at basic prices	0.9	2.3	2.0	0.6	0.0
Taxes on products	-3.4	-0.8	0.5	-1.8	-2.4
GDP at market prices	0.4	1.9	1.9	3.6	-0.3

Source: IBGE

On a sector-by-sector basis, the results accumulated in the year also reflected the evolution of demand components. The crop/livestock sector, in which output has been driven by the external market, was the only sector to turn in positive growth, with 5.1%, generated by practically across-the-board expansion in the output of grain and other crops, as well as by increased livestock production. Using the same basis of comparison, industrial activity dropped by 0.7% and was mainly impacted by the negative performance of the building industry, with 7.7%, making it the only segment of the secondary sector to close with a negative result. The other subsectors turned in positive growth, with a particularly strong 2.5% gain under public utility industrial services, composed basically of electricity generation. Aside from this, the performance of this sector was also made possible by the very weak basis of comparison in the first nine months of 2002. Mineral production increased by 2.1% and was driven mostly by 2.7% expansion in the output of petroleum. Production of the manufacturing sector increased by 0.7%, as a consequence of a loss of dynamism in sectors focused on the internal market (automobiles, utility vehicles, trucks and buses and electric and communications equipment) and growth in the activities of sectors oriented more to the export market (steel, cellulose and mechanics).

In the first nine months of the year, the service sector declined by 0.3%, compared to the same period of 2002. To some extent, this was caused by negative rates of 3.4% and 1.6%, respectively, in the trade and transportation segments which, in turn, were strongly influenced by poor performances in several other sectors. The segment of other services closed with a drop of 0.6%, while communications, rentals, public administration and financial institutions turned in growth rates of 1.4%, 0.6%, 0.5% and 0.1%, in that order.

It is estimated that 2003 GDP growth will come to 0.3% (see box Estimates of GDP Evolution). This percentage is less than the forecast of 0.6% stated in the last Inflation Report, issued in September 2003. Basically, the reason for this change were revisions of the Quarterly National Accounts series.

Estimates of GDP Evolution

GDP in 2003

The release of National Accounts for the third quarter of 2003 included alterations resulting from revision of the statistical series and methodological changes. Consequently, the real rate of GDP growth in 2002, which had been initially assessed at 1.5%, moved to 1.9%, thus raising the basis of comparison for 2003. Another implication, caused by a methodological change, was a reduction in the growth rate of segments with high levels of participation in GDP composition. For example, growth of 2.6% in the subsector of Other Services in the first half of the year was reversed to a reduction of 1%, while expansion of 1.6% under Rentals was cut to 0.6%, using the same basis of comparison.

With these changes in methodology and in other indicators of the activity level, the estimate of GDP growth for 2003 was revised downward to 0.3%, based on expansion of 4.9% in the crop/livestock sector, 0.2% in the service sector and stability in the industrial sector.

Viewed under the prism of demand, GDP growth will be sustained by the foreign trade sector, with close to 16.5% growth in foreign sales and relative stability under imports. Despite recovery in the second half of the year, internal demand dropped sharply, with the largest falloff under investments as a result of the impact of the transition crisis, particularly in the first half of the year, and the reduction in household consumption that resulted from wage losses in the period.

It should be stated that the 2003 forecast is based on a seasonally adjusted estimate of 2.5% growth in the final three months of the year, when compared to the previous quarter.

GDP in 2004

Sector-by-sector forecasts point to GDP growth of 3.5% in the coming year. This outlook is based on expectations of recovery in internal demand, as a result of continued implementation of a more flexible monetary policy, recovery in expectations and gradual recouping of real wage losses. Another favorable factor is the statistical effect of a depressed reference base, since significant recovery in 2003 only occurred in the final quarter of the year.

A sector-by-sector analysis points to growth of 5.2% in crop/livestock production, based on initial IBGE and Conab forecasts of the next harvest. Here, it is important to note that Conab has forecast growth of 5.5% in the grain harvest, with strong 12.6% expansion in soybean output. Another factor that is expected to contribute to the primary sector result is the growth tendency of livestock production in recent years.

In the secondary sector, growth in manufacturing forecast for 2004 results from consolidation of the recovery process that began in the third quarter of 2003. Aside from the increased output expected in several important segments, such as the automotive, home appliance and capital goods industries, when the current situation is used as the forecasting base, the upward movement in economic growth is also expected to impact demand for nondurable consumer goods.

Growth in the service sector will be influenced by industrial and agricultural expansion, which tend to produce ripple effects in such segments as commerce, transportation, other services (particularly services rendered to companies) and financial institutions.

Finally, when viewed in terms of demand, one should emphasize that, contrary to what has occurred in recent years, the foreign trade sector is expected to make a negative contribution to this result. Expected growth in the Brazilian economy in 2004 will fire sharp

GDP – Accumulated growth in the year (%)

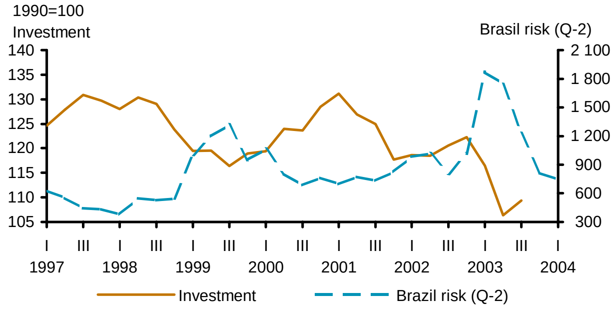
		2003				2004
		1stQ	2ndQ	3rdQ	4thQ	
Farm and livestock		**10.6**	**8.8**	**5.1**	**4.9**	**5.2**
Industrial sector	Mining	4.3	1.8	2.1	3.7	6.9
	Manufactoring	3.9	1.0	0.7	1.5	4.4
	Building	-0.9	-6.0	-7.7	-7.7	4.4
	Industrial utility	8.1	3.1	2.5	3.7	6.0
	Total	**3.3**	**-0.2**	**-0.7**	**0.0**	**4.8**
Service sector	Commerce	-0.2	-2.0	-3.4	-1.7	3.3
	Transportation	-4.0	-2.3	-1.6	-0.2	3.5
	Comunication	2.4	2.7	1.4	1.8	3.6
	Financial inst.	2.2	1.1	0.1	0.5	3.3
	Other services	-0.1	-1.0	-0.6	-0.2	2.4
	Rent	0.4	0.6	0.6	0.6	0.6
	Government	0.2	0.6	0.5	0.6	1.1
	Total	**0.2**	**0.0**	**-0.3**	**0.2**	**2.1**
Value added at basic prices		**2.0**	**0.6**	**0.0**	**0.5**	**3.3**
Taxes on products		0.5	-1.8	-2.4	-0.9	5.0
GDP at market prices		**1.9**	**0.4**	**-0.3**	**0.3**	**3.5**

upward movement in imports, particularly involving intermediate goods, at the same time in which this expansion will lessen the dynamic performance demonstrated by exports in 2003.

1.5 Investments

Investment (FBCF) and Brazil risk

Seasonally adjusted data



Source: IBGE and JP Morgan

Investment indicators

% accumulated growth in year

Itemization	2002	2003			
		I Q	II Q	III Q	Oct
Capital goods					
Absorption[1/]	-7.1	-8.4	-14.3	-15.5	-12.3
Production	-1.0	0.5	-2.0	-1.4	-0.5
Imports	-18.1	-28.1	-30.3	-31.7	-24.4
Exports	-5.9	-15.4	2.6	9.4	11.4
Inputs for the building industry	-2.7	-1.9	-6.7	-8.1	-8.5
BNDES financing	48.4	-9.4	-31.7	-23.0	-23.4

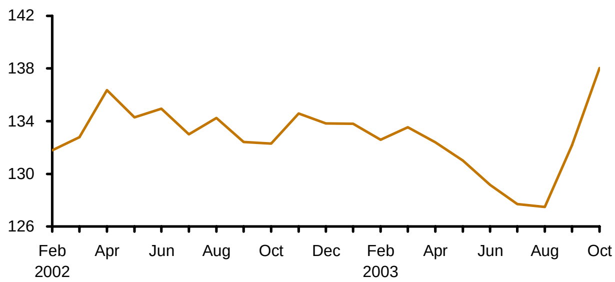
Source: IBGE, Funcex and BNDES

1/ Production + imports - exports.

Capital goods production

Seasonally adjusted data

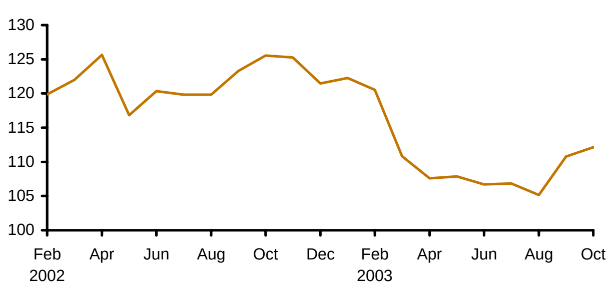
Quarterly moving average



Source: IBGE

Inputs production for the building industry

Seasonally adjusted data



Source: IBGE

Reversing the downward trajectory that marked the first half of the year, investments expanded in the third quarter. As mentioned in the previous Inflation Report, this performance had already been signaled by results of such leading indicators as the Brazil risk, measured by Embi+. This index had already pointed to reestablishment of a positive economic environment once the impact of the crisis of confidence caused by the presidential transition period had passed. However, investment growth in that period was very moderate, due to the still incipient nature of the recovery and the high levels of idle productive capacity in most industrial segments.

Based on the Quarterly National Accounts, released by IBGE, when growth in stock levels is excluded, investments expanded by 2.8% in the third quarter, based on the seasonally adjusted series and compared to the result for the previous period. Monthly indicators of gross fixed capital formation had already anticipated this performance. Using the same basis of comparison, output of capital goods rose by 1.9%, exports and imports of this category increased by 5.8% and 5.1%, respectively, and output of building industry inputs increased by 0.2%.

Despite third quarter growth, outlays on investments declined sharply in the year, closing the third quarter with 7.2%. This performance was a consequence of a 15.5% drop in the absorption of machines and equipment and a falloff of 8.1% in construction industry activity in the period.

Data for the month of October point to continued recovery under investments. Compared to September, an analysis of the seasonally adjusted monthly indicators reveals growth of 1.2% in the output of building industry inputs and 22% in absorption of capital goods. In the year, these indicators accumulated declines of 8.5% and 12.3% up to October, in the same order.

A breakdown of the figures for capital goods production indicates that the drop registered up to October was not a generalized phenomenon. Production of machines and tractors for the farm sector increased by 25.1% and that of parts for farm machinery by 10.9%; the segment of industrial goods produced in series registered growth of 15.5%, with particularly goods results under the production of diesel engines for the export market and farm sector.

Production of capital goods

Percentage change

Itemization	2003 Jul	Aug	Sep	Oct
Quarter/previous quarter[1/]				
Capital goods	-3.6	-2.7	2.3	8.1
Industrial	-8.3	-4.0	1.0	9.9
Serial	-8.6	-4.2	1.4	12.2
Nonserial	-7.8	-6.0	-4.3	-3.2
Agricultural	19.6	14.7	12.7	11.7
Farm parts	6.5	4.6	2.0	6.4
Building	-7.3	-17.0	-10.2	-3.5
Electric energy	-12.5	-7.3	-2.4	2.3
Transportation	-4.2	-0.1	4.7	7.7
Mixed	-6.6	-6.3	0.8	8.5
In the year				
Capital goods	-2.6	-2.6	-1.4	-0.5
Industrial	8.8	8.6	8.8	8.6
Serial	15.5	15.6	15.7	15.5
Nonserial	-15.5	-17.0	-17.1	-17.6
Agricultural	23.5	25.0	25.8	25.1
Farm parts	8.8	9.6	10.5	10.9
Building	-21.7	-22.8	-21.5	-21.1
Electric energy	-34.8	-34.0	-31.1	-28.2
Transportation	-0.2	-1.5	-0.5	-0.1
Mixed	-6.9	-7.7	-7.2	-6.0

Source: IBGE

1/ Seasonally adjusted data.

Production of automotive vehicles

Percentage change

Itemization	2003 Jul	Aug	Sep	Oct	Nov*
In the month[1/]					
Farm machines	-5.1	10.5	0.0	0.6	0.0
Busses	11.9	-9.1	28.1	16.8	12.0
Trucks	4.3	2.5	9.7	1.6	13.2
Quarter/previous quarter[1/]					
Farm machines	9.2	10.3	6.7	9.0	5.4
Busses	3.2	8.6	19.1	24.2	44.4
Trucks	-10.6	0.2	7.8	13.8	19.3
In the year					
Farm machines	11.9	13.6	13.7	13.0	13.6
Busses	4.1	5.2	8.2	13.3	17.7
Trucks	7.5	8.6	10.1	11.0	12.5

Source: Anfavea

1/ Seasonally adjusted data.
* Preliminary.

Capital goods indicators for the sector of mechanics, released by the Brazilian Association of the Machines and Equipment Industry (Abimaq) reflected a downward slide in investments in 2003. A comparison of the first ten months of the year with the same period of 2002 shows a reduction of 1.6% in the utilization of the sector's installed output capacity and a falloff in the average number of weeks needed to meet orders from 16.7 to 16.1 weeks. Real revenues of the companies belonging to the aforementioned Association – deflated by the Wholesale Price Index – Overall Supply – Industrial Products (IPA-OG-PI), industrial machines and equipment – registered a 17.2% decline up to October. It should be stressed that exports of machines and equipment, which are mostly targeted to the United States and Argentina, increased by 32.6% in the period.

Data released by Anfavea corroborate the performance of activities linked to the crop/livestock sector. In the year up to November, production of farm machines increased by 13.6%, compared to the same period of 2002. For the most part, this performance was driven by growth of 37.3% and 15.7% in the production of harvesters and wheeled tractors, respectively. Using the same basis of comparison, output of trucks increased by 12.5%.

According to the National Bank of Economic and Social Development (BNDES), disbursements of the BNDES System (BNDES, the Special Industrial Financing Agency – Finame and BNDES Participações S.A – BNDESpar) added up to R$22.2 billion in the first ten months of 2003, which was 23.4% below the amount granted in the same period of 2002. A breakdown by sectors of activity showed nominal declines in the financing granted to the mining industry, 55.3%, manufacturing, 35.5% and trade, 16.6%. Disbursements to crop/livestock activities expanded by 4.7%.

The Long-Term Interest Rate (TJLP), which is the basic cost of financing contracted with the BNDES system, remained at 12% per year, as of April 2003. At the end of September, the rate was reduced to 11% per year, to remain in effect in the final quarter of 2003.

1.6 Conclusion

The increase in the activity level toward the end of the third quarter and early part of the fourth was an unmistakable sign of an upturn in economic growth, particularly in light of the fact that the process was broadly disseminated among the various productive segments, as demonstrated by

BNDES disbursement[1/]

		Accumulated in the year (in R$ million)			
Itemization	2002	2003			
		I Q	II Q	III Q	Oct
Total	37 419	5 495	11 000	18 970	22 211
Manufacturing industry	17 178	2 500	4 578	7 587	9 009
Commerce and services	15 482	2 397	4 779	8 274	9 471
Crop and livestock	4 509	560	1 582	3 021	3 638
Extraction industry	250	38	62	88	93

Source: IBGE

1/ Includes BNDES, Finame and BNDESpar.

industrial activity data and the level of growth registered in recent months.

The increase in the volume of financing, together with a more flexible monetary policy and improved economic expectations, were the major determining factors underlying growth in demand in recent months. The impact of the convergence of these factors was particularly strong in sales of home appliances and vehicles. It is important to note that this is a process that is considered characteristic of periods of recovery.

Credit conditions and the evolution of expectations were also reflected in the Brazil risk, and were essential elements in the reversal of the downward trend under investments that began in the third quarter of the year. This behavior is a clear sign that industries have begun reequipping their productive structures in light of the favorable prospects for sustained growth. According to previous indicators, this type of behavior tends to become more accentuated in the final quarter of the year.

Externally, the favorable international outlook and forecasts of strong world economic growth in 2004 are seen as the harbingers of continued export growth, based on a strong trend toward diversification of both products and the number of trading partners.

With regard to demand, the process of growth will gain in sustainability to the extent that the effects of more flexible monetary policy measures move toward consolidation and begin producing impacts on job levels and overall wages.

On the side of production, early estimates for the crop/ livestock sector point to the continuity of the strong growth registered in recent years, based particularly on expectations involving soybean-related products and livestock output. In the industrial sector, recovery in the second half of the year and the existence of a rather large margin of idle productive capacity will create the conditions needed for robust growth in the coming year. In the same sense, declining interest rates, renewed investments and a greater availability of budget resources to be channeled into infrastructure indicate that the building industry can also be expected to shift into a positive growth curve. Among others, these factors are at the heart of estimates of strong economic expansion in the coming year.

Prices

2

Notwithstanding the recent upward movement in the pace of economic activity, price indices remained relatively low in the September-November period, though they were higher than in the previous quarter. The item that had the greatest impact on this trajectory was that of farm prices. The heading of foodstuffs, which had registered negative growth from June to August due mainly to climatic factors that favored production of *in natura* products, reversed course and turned in positive growth as the off-season harvest period began. The seasonal impact affected the prices of semi-elaborated goods, particularly those derived from beef and poultry. Industrialized and *in natura* products closed the quarter with accumulated negative price growth. Inflation in the period extending from September to November was also influenced by the favorable impact of exchange rates on prices, particularly in the cases of goods derived from wheat and sugar.

The rates of core inflation, which reflect factors of a temporary nature less intensively, remained stable over the second half of the year and closed the period at levels that were fully compatible with the targets defined for 2004.

2.1 General indices

The General Price Index – Internal Supply (IGP-DI) accumulated growth of 1.98% in the September-November quarter and was impacted by upward movement in the prices of the wholesale segment, particularly as regards farm products. The end of the process of marketing the harvest, higher international market soybean prices and growth in the prices of products of animal origin in recent months contributed to the 5.2% high in farm prices in the quarter. In the same time span, the prices of industrial products rose by 1.1%, with particularly strong highs under oils and fats (4.8%), meat and seafood (7.9%) and mining (2.7%), partly offsetting drops in the prices of sugar (22.8%) and alcohol (6.4%).

General price indices

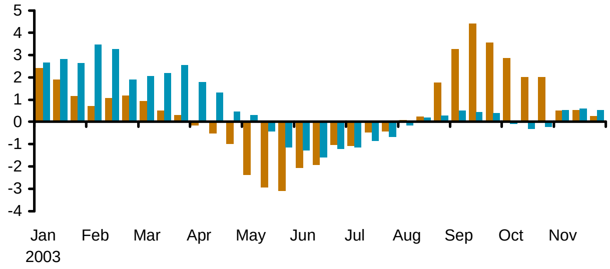
Monthly % change

Itemization	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
IGP-DI	0.4	-0.7	-0.7	-0.2	0.6	1.1	0.4	0.5
IPA	0.1	-1.7	-1.2	-0.6	0.7	1.3	0.5	0.5
IPC	1.1	0.7	-0.2	0.3	0.1	0.8	0.2	0.3
INCC	0.9	2.8	1.1	1.0	1.4	0.2	0.7	1.0

Source: FGV

Evolution of IPA (10, M and DI) – Agriculture and industry

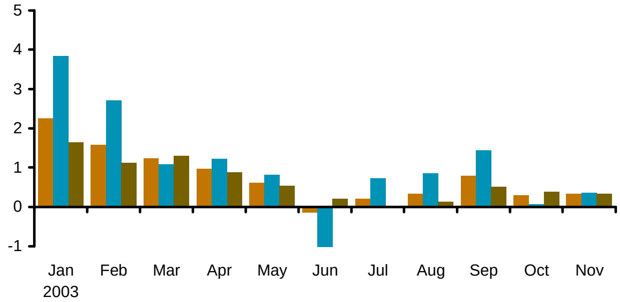
Monthly % change



Source: FGV

Evolution of IPCA

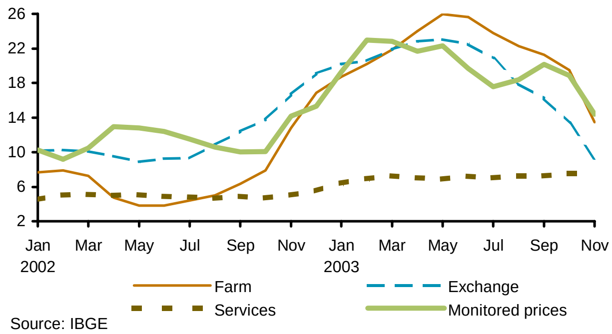
Monthly % change



Source: IBGE

IPCA – Main groups

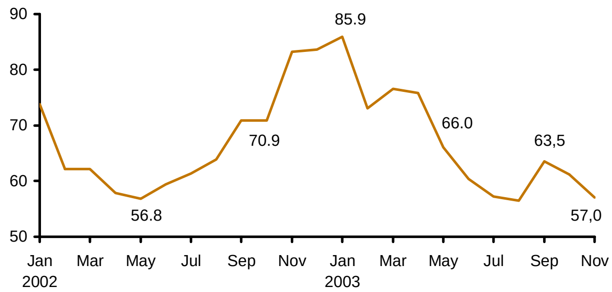
12 month % change



Source: IBGE

IPCA items1/

% of items with increase



Source: IBGE

1/ IPCA is made up of 512 items.

2.2 Consumer price index

The IPCA index turned in growth of 1.42% in the quarter ended in November, compared to 0.39% in the previous quarter. The rise in inflation in the period was a consequence of acceleration in the prices of food products and in government monitored prices, which varied in the quarter by respective rates of 1.5% and 1.9%, compared to -1.3% and 0.6% in the previous quarter.

Exchange appreciation over the course of the year impacted the prices of industrialized foodstuffs, particularly bakery goods, sugars and derivatives. In the September-November quarter, this factor contributed to stability in the prices of industrialized foodstuffs, offsetting price rises under beverages and animal origin products. The prices of *in natura* goods continued on a downward curve in the quarter, though the drop was less intense than in the previous quarter, registering respective negative rates of 1.9% and 16.5%. The prices of semi-elaborated goods, the grouping responsible for the high under food products, accumulated growth of 4.3% in the same period, compared to a decline of 0.5% in the June-August quarter. The headings of apparel, personal outlays and housing also brought pressures to bear on the index in the September-November quarter, accumulating respective highs of 2.7%, 2.5% and 1.9%, compared to 2.4%, 2.3% and 1.6% in the previous quarter.

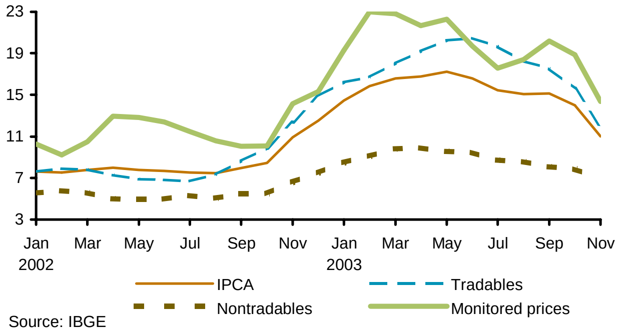
Though it had increased in September, the proportion of the number of items that registered positive growth declined once again in the two following months, returning to the level that had characterized the first half of 2002. This behavior clearly demonstrates the ephemeral nature of the September inflation hike.

With the November result, the IPCA turned in growth of 8.74% in the year, as a consequence of increases in the same period equivalent to 12.6% under the prices of government monitored goods and services and 7.2% under market prices. In the 12 month period, the growth rates came to 11.02%, 14.38% and 9.71%, respectively.

2.3 Government monitored prices

While growth in market prices in the period from September to November came to 1.2%, the increase in government monitored prices closed at 1.9%, corresponding to 0.54 p.p.

IPCA – Itemized groups
12 month % change



Source: IBGE

of the 1.4% IPCA rate in the quarter. Emphasis should be given to three specific items: urban bus fares, water and sewage rates and electricity rates. Taken together, these headings accounted for 0.32 p.p. in the period. Urban bus fares were increased in the Metropolitan Regions of Salvador (15.4%, on August 30) and Rio de Janeiro (7.14%, on November 1), corresponding to an increase of 2.3% under urban bus fares in the quarter. Here, one should stress that, in both state capitals, these were the second increases introduced in the course of the year. Water and sewage rates increased by 18.95% in São Paulo, as of August 29, reflecting 6.5% of the growth under this item. Electricity rates were increased in Goiânia, Brasília, Belém, Recife, Rio de Janeiro and Porto Alegre. In the quarter, the item residential electricity rose by 2.2%.

In so far as fuels are concerned, alcohol prices fell by 3.8% in the quarter ended in November, compared to a drop of 21.6% in the previous quarter. It should be stressed that this behavior reflected the increased supply of sugar cane in 2003 and lesser incentives to sugar exports, as a result of the evolution of the product's international prices. On the other hand, the prices of gasoline increased by 1.2%, compared to a reduction of 7.2% in the three previous months. In the year, gasoline and alcohol prices accumulated growth of 0.9% and -13.7%, respectively.

Furthermore, with regard to the recent behavior of inflation, one should underscore the 34.6% increase in the prices of lotteries, a heading that contributed 0.06 p.p. of the index in the quarter, despite its small participation in the IPCA.

In coming months, increases are expected in water and sewage rates in Belém and Curitiba, and in urban bus fares in Belém. As of January 2004, electricity rates will increase in Rio de Janeiro and São Paulo will raise its urban bus fares.

2.4 Core inflation

The IPCA core, which excludes food taken at home and government-monitored prices, has remained stable in recent months, registering the same 0.37% in July, August and September and 0.38% in November. Accumulated growth in the quarter came to 1.13%, as against 1.26% in the previous quarter. These percentages indicate that the rise in the IPCA in the same period was basically a consequence of acceleration under the headings of food taken at home and government monitored prices. Accumulated growth in

Consumer prices and core inflation

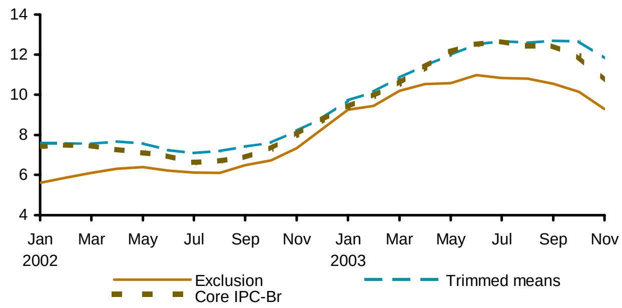
Monthly % change

Itemization	2003							
	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
IPCA	1.0	0.6	-0.2	0.2	0.3	0.8	0.3	0.3
Exclusion	0.8	0.6	0.5	0.4	0.4	0.4	0.4	0.4
Trimmed means								
Smoothed	1.1	1.0	0.9	0.7	0.6	0.9	0.8	0.6
Non smoothed	0.9	0.6	0.4	0.4	0.4	0.6	0.3	0.3
IPC-Br	1.1	0.7	-0.2	0.3	0.1	0.8	0.2	0.3
Core IPC-Br	1.2	1.1	0.7	0.5	0.5	0.7	0.5	0.4

Source: Bacen and FGV

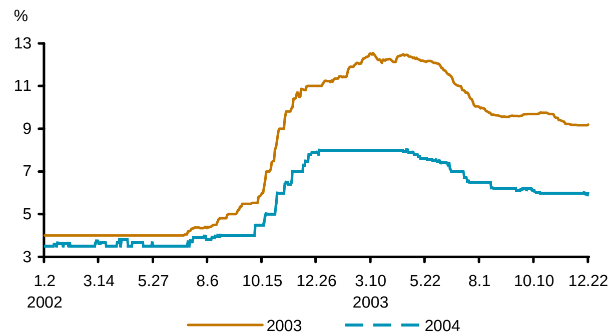
Core inflation

12 month % change



Source: Bacen and FGV

Daily evolution of market expectations for inflation (IPCA) (median)



the twelve-month period ended in November came to 9.3%, registering the sixth consecutive monthly decline when the year-over-year basis of comparison is used.

When the core is calculated on the basis of rounded medians, growth came to 0.86% in September; 0.77% in October and 0.56% in November, accumulating 2.2% in the quarter, as against 2.12% in the three previous months. The impact of the items that are smoothed in this measurement of the core has followed a steadily downward curve. This reflects the fact that the effects of the 2002 exchange shock have been mostly exhausted and it is now expected that this index will return to a level similar to that of the other cores. The criterion used by this measurement excludes items that have registered monthly growth above the 80 percentile mark or below the 20 percentile market in terms of distribution, at the same time in which it smoothes the growth rates of those items that are concentrated in just a few period of the year in such a way as to spread them out over twelve months. In the last twelve months, the core for rounded medians accumulated a high of 11.82%. Without the procedure of smoothing specific items, core inflation based on rounded medians turned in expansion of 0.6% in September, 0.29% in October and 0.31% in November, accumulating inflation of 9.36% in the last twelve months.

Core inflation for the Consumer Price Index – Brazil (IPC-Br), calculated according to the method of rounded medians, was also lower in relation to the last quarter. The index registered growth of 0.67% in September, 0.50% in October and 0.36% in November, accumulating a twelve month high of 10.7%.

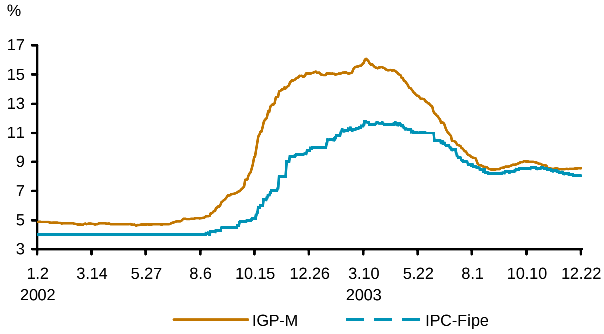
2.5 Market expectations

Gerin carries out a daily survey involving an average of approximately seventy consulting companies and financial institutions, with the objective of detecting market expectations regarding the evolution of the major economic variables.

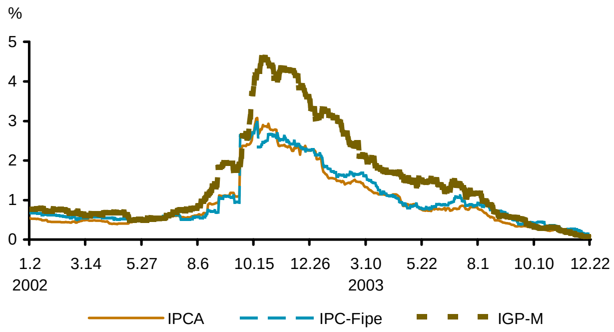
Median inflation expectations for 2003, measured by the IPCA, dropped from 9.59%, on September 22, 2003, to 9.19% on December 22, 2003. For 2004, expectations moved from 6.1% to 5.96% between the dates cited above.

With regard to the medians of the top five short-term forecasters, the figures diminished from 9.65% to 9.19% for 2003 and remained at 6% for 2004.

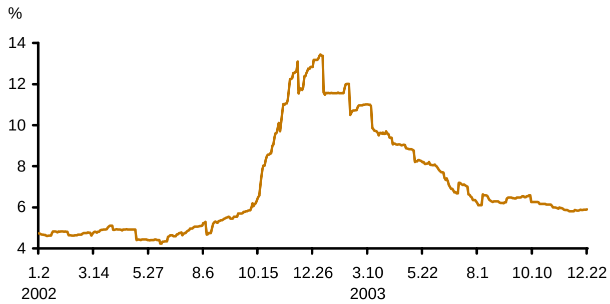
Daily evolution of market expectations for inflation in 2003 (median)



Standard deviation of market expectations for inflation in 2003



Daily evolution of the market expectations for the IPCA accumulated over the next 12 months (median)



Insofar as the evolution of the General Price Index – Market (IGP-M) is concerned, median expectations for 2003 moved from 8.84% on September 22, 2003, to 8.57% on December 22, 2003. For 2004, the median dropped from 6.45% to 6.4%. Expectations regarding the IPC-Fipe for 2003 dropped from 8.32% on September 22, 2003, to 8.04%, on December 22, 2003. For 2004, expectations shifted from 6.05% to 5.9%, for the same dates.

Median short-term expectations of the top five diminished from 8.84% to 8.45%, for 2003, and from 6% to 4.8%, for 2004, in the case of the IGP-M.

The standard price index deviations expected for 2003, which had registered 0.35% for the IPCA, 0.56% for the IGP-M and 0.40% for the IPC-Fipe on September 22, 2003, dropped to 0.09%, 0.08% and 0.1%, in the same order, on December 22, 2003. For 2004, the standard deviation of the IPCA dropped from 0.62% to 0.42% and that of the IGP-M fell from 0.89% to 0.84% and the standard deviation of the IPC-Fipe increased from 0.52% to 0.60%.

Analysis of median inflation expectations accumulated over the next twelve months, as measured by the IPCA, indicates a downward curve moving from 6.48% on September 22, 2003, to 5.90% on December 22, 2003.

2.6 Conclusion

Just as occurred toward the end of the first half of the year, the evolution of prices in the final months of the year was quite encouraging. For the most part, this was due to the fact that the threat of inflation risks that had existed at the start of the year was clearly overcome. However, above all else, the situation was generated by the efficacy of the economic policy measures adopted, including both in the fiscal and monetary frameworks.

Recent price index results point to an absence of inertial factors or of the need for across-the-board increases in the various segments of the economy. For the most part, upward movement was due to seasonal factors or increases in government monitored prices. In much the same way, attempts to recoup profit margins were shown to be sporadic and isolated events did not represent any significant risk. The various measurements of core inflation indicate that annualized rates reflect growth that is quite consistent with the specified inflation targets.

Despite the positive scenario, the coming months are expected to witness factors that will temporarily tend to pressure price indices upward. Aside from increases forecast for government-monitored prices, several seasonal factors are expected to generate increases in the prices of *in natura* foodstuffs, leisure activities and outlays on education.

Credit, monetary and fiscal policies

3

3.1 Credit

In the September-November quarter, growth in financial system credit operations was a consequence of the more dynamic pace of economic activity and, particularly, of the seasonal increase in demand for funding as a result of increased end-of-year sales and the planting of the farm crops. With respect to consumption, improved credit market conditions have stimulated growth in personal financing operations, especially for purposes of acquisitions of durable consumer goods. In this sense, recent measures adopted by the federal government, such as microcredit operations and loans paid through automatic payroll deductions, are expected to contribute even more significantly to reducing the costs of financing while, over the medium-term, stimulating demand, particularly for goods of lesser aggregate value (see box Outlook for Financial System Credit Operations).

Growth in credit operations

R$ billion

Itemization	2003				Growth	
	Aug	Sep	Oct	Nov	3 months	12 months
Total	385.3	389.9	395.0	404.9	5.1	7.7
Nonearmarked	213.9	215.9	218.1	222.1	3.8	3.8
Corporations	130.4	131.1	131.8	134.6	3.2	-1.6
Ref. to exchange	49.2	48.2	47.2	48.2	-2.1	-19.2
Individuals	83.5	84.8	86.3	87.5	4.8	13.4
Earmarked	147.9	150.4	153.0	159.3	7.7	14.4
Housing	22.8	22.9	23.0	23.1	1.2	7.2
Rural	39.3	41.2	42.9	43.8	11.6	33.7
BNDES	83.2	83.6	84.4	89.5	7.6	7.4
Others	2.6	2.6	2.7	2.9	11.6	76.7
Leasing	8.4	8.5	8.7	8.7	2.6	-11.7
Public sector	15.1	15.0	15.2	14.9	-1.6	15.5
% participation:						
Total/ GDP	25.5	25.5	25.4	25.6		
Nonearm./GDP	14.2	14.1	14.0	14.0		
Earmarked/GDP	9.8	9.8	9.8	10.1		

It should be noted that the evolution of credit operations in the period was affected by a more flexible monetary policy, as evident in the process of gradually declining interest rates and, consequently, of decreasing lending rates charged by banks. Expectations of convergence of inflation toward the established targets coupled with exchange market stability contributed to the reduction in bank spreads. At the same time, the enhanced competition among financial institutions targeted at increasing their credit portfolios as an alternative means of offsetting their losses in profitability on treasury investments should become an additional factor in reducing the cost of loans.

In this context, the overall volume of financial system credit operations came to R$404.9 billion in November, representing growth of 5.1% in the quarter and 7.7% in the last twelve months. Consequently, the percentage of loans in relation to GDP dropped from 25.5% to 25.6%, in the period.

Credits granted by the private financial system represented 59.3% of the total, with an overall volume of R$239.9 billion and growth of 4.6% in the quarter, particularly in the segment of operations with the industrial sector. Loans granted by public banks totaled R$165 billion, registering growth of 5.7% in the quarter, mostly involving disbursements for the sowing of the 2003/2004 harvest.

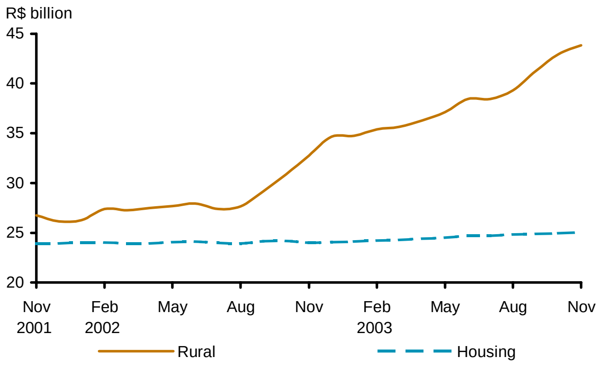
With respect to the distribution of credit by segments of economic activity, the volume of operations targeted to the private sector came to R$350 billion, with growth of 5.3% in the quarter. This performance reflected the increase in business operations that is traditionally characteristic of this time of the year, particularly in segments related to trade and industry.

In this sense, mention should be made of quarterly growth of 6.8% in operations granted to the trade sector, with a balance of R$42.5 billion. Loans to the industrial sector registered growth of 3.8%, with a total volume of R$116.9 billion. At the same time, loans contracted with the segment of other services added up to R$69.1 billion, for growth of 4.6% in the quarter.

Operations with the public sector totaled R$14.9 billion, for growth of 1.6% in the quarter. The banking debt of the states and municipalities declined by 2.2%, coming to a total of R$10 billion, partly reflecting disbursements to electric power distribution companies. Loans to the federal government totaled R$4.9 billion in November, corresponding to a decline of 0.3% in the quarter and reflecting amortization of debts on the part of electric power generation companies.

Leasing operations came to R$8.7 billion in November, registering growth of 2.6% in the quarter. The result in the period was generated by upward movement in vehicle leasing operations by individuals, as well as in the contracting of operations involving machines and equipment by industrial and service companies.

Growth in rural and housing credit



Credit operations with earmarked resources

Credit operations based on earmarked resources came to a total of R$159.3 billion in November, for growth of 7.7% in the quarter. To a great extent, this result was generated by expanded rural financing, clearly reflecting the positive performance turned in by the farm sector.

BNDES Disbursements

			R$ millions
Itemization	Jan-Nov		Growth
	2002	2003	(%)
Total	32 323	28 556	- 11.7
Industry	15 441	13 480	- 12.7
Other transport equipment[1/]	6 421	4 808	- 25.1
Food and drink products	1 951	1 613	- 17.3
Cellulose and paper	1 030	412	- 60.0
Motor vehicles	1 073	2 383	122.1
Basic metallurgy	940	832	- 11.5
Commerce/Services	13 102	10 789	- 17.7
Electricity, gas and hot Water	7 636	4 390	- 42.5
Commerce and reparition	1 103	1 422	28.9
Land transport	1 749	2 458	40.5
Mail andtelecommunications	338	50	- 85.2
Farming	3 561	4 145	16.4

Source: BNDES

1/ It includes aircraft industry.

The balance of BNDES financing increased by 7.6% in the quarter, coming to a total of R$89.5 billion in the month of November. Disbursements accumulated up to November 2003 totaled R$28.6 billion, for a reduction of 11.7% compared to the total registered in the corresponding period of the previous year. Analyzed on a sector-by-sector basis, the sharpest drop was registered in loans granted to industry, as a result of the cutbacks that have occurred in disbursements to the aviation industry since the start of the year. In the opposite sense, disbursements to crop/livestock activities – particularly in the segment of agribusiness investments – increased by 16.4% in the year and reached a level of R$4.1 billion. Financing to micro, small and medium companies expanded by 31%, reaching a total of R$9 billion. With this result, the participation of financing to these companies in total BNDES disbursements came to 32%, compared to 22% in the same period of 2002.

Consultations with BNDES – the first step in contracting future medium and long-term financing – accumulated a total of R$40.3 billion from January to November 2003, a result equivalent to that obtained in the same period of the previous year. This growth was a consequence of the falloff of 38.7% in requests from the segments of commerce and services, particularly in the sector of electricity and gas. The requests made by the industrial sector and the crop/livestock sector, on the other hand, increased 64.2% and 39.5%, respectively, in the period.

The volume of credits targeted to the rural sector registered growth of 11.6% in the quarter, reaching a level of R$43.8 billion in November. Current expenditure operations for the 2003/2004 harvest totaled R$16.7 billion in November, compared to R$14.7 billion in August, raising the participation of this heading in the rural portfolio from 38.5% to 40.6% in the period. In the same period, the share of investments fell from 52.9% to 51.7% while financing for the marketing of the harvest dropped from 8.6% to 7.7%.

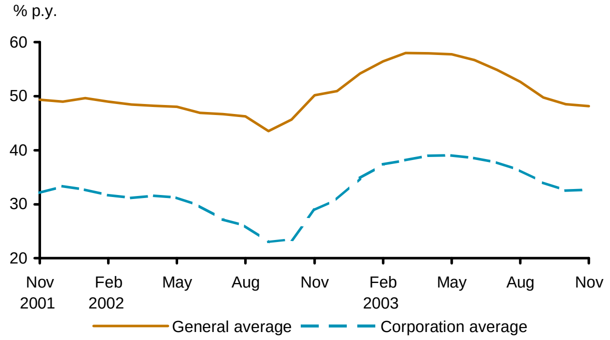
Housing financing operations, which include operations with individuals and housing cooperatives, totaled R$23.1 billion, for growth of 1.2% in the quarter. For the most part, this growth was a consequence of disbursements of Employment Compensation Fund (FGTS) resources, which accumulated a total of R$698 million in the period, while releases originating in savings accounts remained at the same level as in the previous quarter, with R$300 million. It should be further stressed that, in October, 82.8% of credits to the housing sector were granted according to the rules covering the Housing Finance System (SFH), as against 81.6% in

July. The share referring to operations carried out at market rates declined from a level of 16.4% in August to 17.2% in the period.

Credit operations with nonearmarked resources

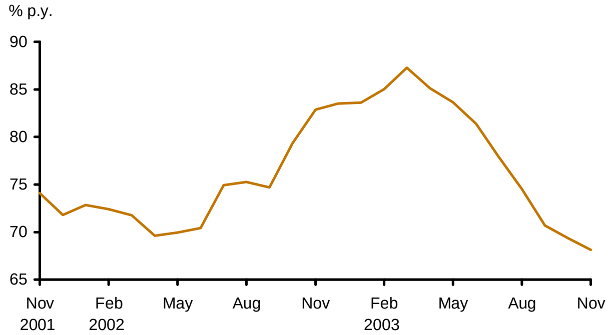
The median rate of interest on credit operations based on nonearmarked resources fell by 4.7 p.p. in the last three months, closing November at 48% per year. In the last twelve months, the drop came to 2.2 p.p., as the median rate returned to the level of the first half of the year. The evolution of the cost of loans in the quarter reflected measures taken to make the monetary policy adopted in the period more flexible, as evident in the successive reductions in the target of the Selic and in the cutback in the rate of the compulsory reserve on demand deposits that went into effect as of September. These measures had a positive impact on the futures market interest rate curve, as well as on the short-term scenarios used by financial institutions in decisions involving the cost of their lending operations.

Interest rates of credit operations with nonearmarked resources



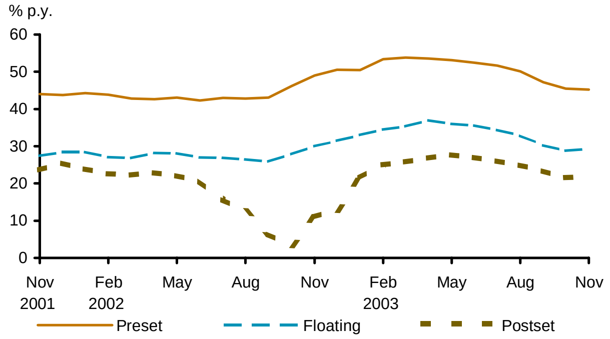
The median cost of loans targeted to individual persons, which are mainly contracted at preset interest rates, registered a reduction of 6.3 p.p. in the quarter and closed November at 68.2% per year. Compared to November 2002, the decline totaled 14.7 p.p., compared to a reduction of 4.5 p.p. in the basic rate in the period. In the last three months, it is important to stress that the rates on special overdraft credit portfolios and personal credit operations declined by 17.4 p.p. and 5.5 p.p., respectively, indicating that the overall economic situation has been evolving positively in recent months, particularly when one considers that these operational modalities have strong risk components. The median rate practiced in vehicle financing operations, which have the lowest costs among those targeted to individual borrowers, came to 36.6% per year, for a reduction of 4.8 p.p. in the quarter.

Interest rates of credit operations preset rates – Individuals



As regards loans to corporate entities, the median rate registered a drop of 4 p.p. in the quarter and closed at 32.3% per year. This result reflected the generalized reduction in the rates charged in these modalities and should be considered a consequence of the behavior of basic interest rates and exchange rate stability, which is the element that conditions the cost of operations referenced to foreign exchange.

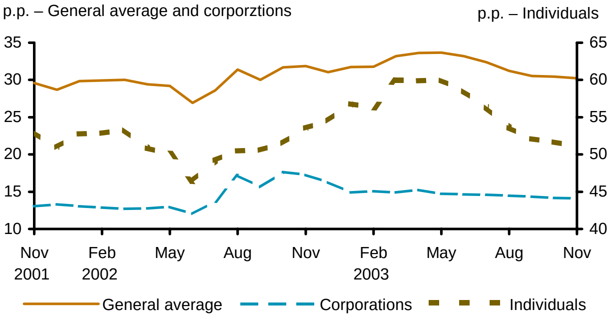
Interest rates of credit operations – Corporations



In contracts negotiated at preset interest, which account for 37% of loans to corporate entities, the median rate came to 44.6% or 5.5 p.p. less than in August, with reductions of 6.3 p.p. and 6.4 p.p., respectively, under the headings of guarantied overdraft accounts and the discounting of commercial invoices.

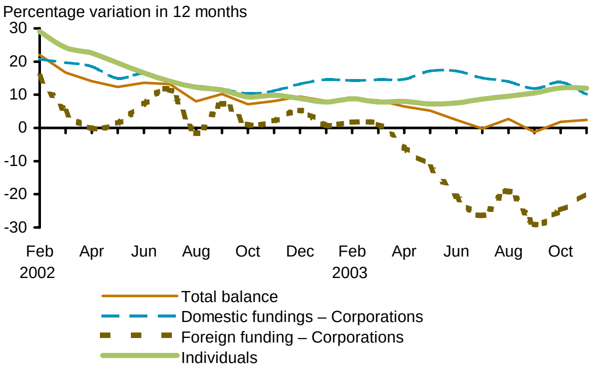
The median rate in operations contracted at floating rates of interest, which account for 24% of loans to companies, declined by 4.3 p.p. in the quarter and closed November at 28.5%. In contracts referenced to alterations in the rate of exchange, the projected rate came to 21.8% per year, for a reduction of 3.2 p.p. in the quarter. Over the last six months, maintenance of the rate of exchange at a level between R$/US$2.90 and R$/US$3.00 has contributed to attenuating expectations of future exchange depreciation and reducing expected costs for borrowers.

Median spread of credit operations with nonearmarked resources



In credit operations based on nonearmarked resources, the banking spread dropped to 30.4 p.p. in November, or 0.9 p.p. below the August level. This result was a consequence of improvement in market perceptions of risk, coupled with alterations in monetary policy and the stable behavior of default indices in credit portfolios. In the segment of corporate entities, the spread came to 14.4 p.p., for a reduction of 0.1 p.p. in the quarter, while in loans targeted to individual borrowers, the rate reached 51.2 p.p., or 2.4 p.p. below the level registered in August.

Growth of credit with nonearmarked resources



The balance of credit operations with nonearmarked resources registered an increase of 3.8% in the quarter and closed at R$222.1 billion. The participation of these loans in the financial system total, however, showed a slight reduction from 55.5% to 54.9% in November, reflecting the more accentuated increase in the portfolio targeted to the rural sector.

The stock of credits channeled to corporate entities came to R$134.6 billion in November, with quarterly growth of 3.2%. This performance was generated by growth of 6.3% in the modalities backed by domestic resources, with a volume of R$86.3 billion. The quarterly median corresponding to these credit operations came to R$45.2 billion, for growth of 8.1%. Basically these results reflect seasonal factors related to the increase in business during this period of the year and financing for the industrial segment involved in the production of farm inputs. Here, one should highlight the particularly strong growth under operations involving the discounting of commercial invoices and vendor operations.

In the opposite sense, the financing portfolio referenced to foreign currency declined by 2.1% in the quarter and came to a total of R$48.2 billion. The most significant reduction occurred in operations involving Advances on Exchange Contracts (ACC), with growth of 3.5%, as a result of the concentration of liquidations in the period in question. Disbursements of this type of operation increased by 3.7% in terms of the quarterly median, and closed with R$7.8 billion.

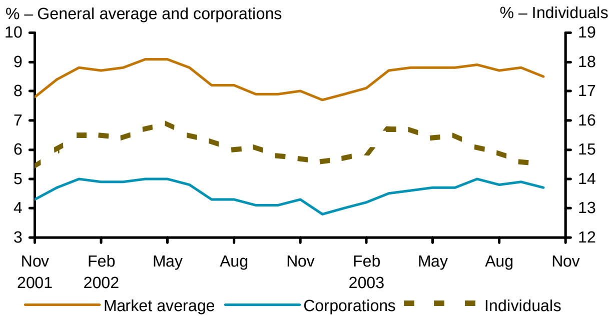
Credit operations with individual persons expanded by 4.8% in the quarter, adding up to R$87.5 billion. The quarterly median volume of disbursements to these borrowers increased from a level of R$26.3 billion in August to R$28 billion in November.

The increase in credit operations with individuals was strongest in the segment of consumer financing , particulaly involving durable goods. It is important to note that this segment is more sensitive to changes in interest rates and, therefore, has been an important factor in the upturn in the pace of economic activity. In this context, one should highlight the modality of vehicle acquisitions, with a high of 22.3% in quarterly median credit granted, a trajectory that is explained by a strong drop in the cost of this type of financing in the period and by a reduction in the rate of the Industrialized Products Tax (IPI) that has been in effect since August.

Also in this regard, one should highlight the growth of 14.6% in the quarterly median volume of personal credits, reflecting the impact of the interest rate decline and, possibly, the recent measures that were taken to stimulate credit operations.

Credit quality

Default rate of credit[1/]

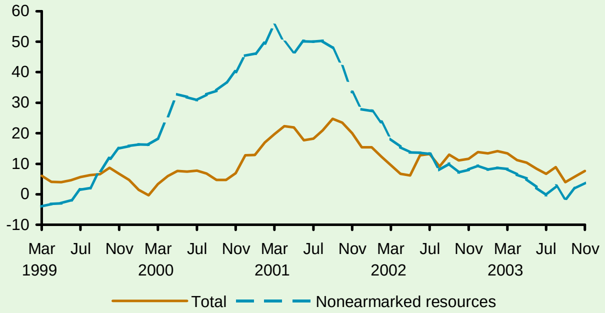


1/ Portfolio's percentage share of nonearmarked funds in arrears of more than 15 days.

Insofar as the quality of the credit portfolio backed by nonearmarked resources is concerned, the quarter was marked by relative stability, as the default rate remained in the range of 8.4%. The percentage of arrears in the segment of corporate entities remained in the range of 4.6%, while credits granted to individual persons registered their lowest value since November 2001, 14.2%, for a decline of 0.7 p.p. in comparison to the previous period. The downward trend in defaults on loans to individuals that has occurred since May is expected to continue in December, since households generally make use of their Christmas wage bonus to pay off their debts.

Outlook for Financial System Credit Operations

National financial system credit operations
12 month % variation



With introduction of the inflation targeting system and adoption of floating exchange in 1999, monetary policy became an instrument of fundamental importance to the expectations of economic agents and their decisions regarding price formation. In this framework, and considering the important role played by credit in transmitting the impact of monetary policy, Banco Central prioritized development of this market, adopting measures aimed at expanding the supply of resources to final borrowers and reducing financial system risks.

In the months following implementation of the targeting system, exchange stabilization and the reining in of inflation, the process of making monetary policy more flexible began, as the Selic rate was cut from 45% per year in March to 19% per year in December 1999 and the rates of compulsory reserves on demand and time deposits were reduced. Another measure of importance was the reduction of the Financial Operations Tax (IOF) on loans to individuals from 6% to 1.5%.

As a result, the rates applied by financial institutions to their lending and financing operations dropped sharply. These factors, coupled with improvement in the expectations of agents in the face of more positive evolution in the major macroeconomic fundamentals, leveraged demand for banking resources by households and businesses. Consequently, significant growth was registered in credit operations based on nonearmarked resources, with expansion of 45.4% in 2000, principally in operations with individual persons.

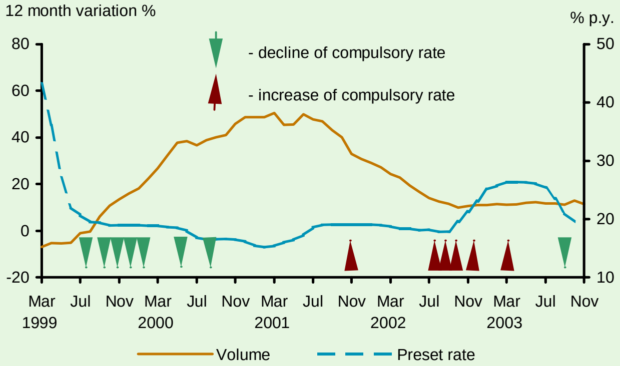
In 2001, however, the evolution of credit operations was impacted by the effects of energy rationing and the worsening international scenario, marked by a deepening of the Argentine crisis and the September 11 terrorist attacks. Thus, monetary policy took on the function of minimizing inflationary pressures caused by higher rates of exchange, through adoption of higher interest and compulsory reserve rates.

In the second half of 2002, uncertainties surrounding the economic policy of the new government and restrictions on the flow of external financing to the country pushed futures market interest higher and intensified exchange rate volatility. This adverse scenario resulted in adoption of a more rigid monetary policy, with moderate growth in the total volume of credit, particularly under operations based on nonearmarked resources, which expanded by 9.4% in the year.

The impact of lesser growth in credit operations based on nonearmarked resources was attenuated by expanded loans to the crop/livestock sector, which had benefited from recovery in commodity prices and exchange depreciation, and increased financing granted by BNDES. The highlights of the operations of the development bank were investments in infrastructure, particularly electric power, and credit lines targeted to exports, channeled mainly to the aircraft industry.

Domestic non-earmarked credit

12 month variation %

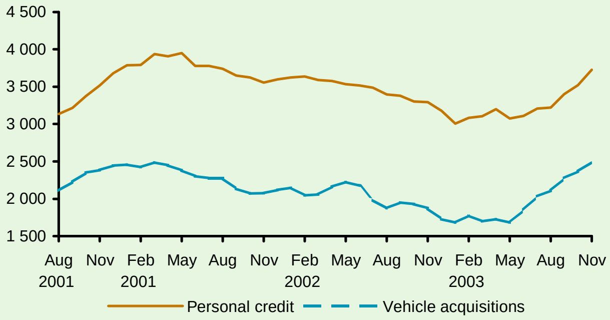


The restrictive monetary policy was maintained in the early months of 2003 and resulted in moderate growth in the credit stock in the period. Starting in June, price indicators began registering more favorable behavior and Banco Central started attenuating the rigidity of monetary policy, reducing the Selic rate by target 9 p.p. in the period from June to November. In August, the rate of the compulsory reserve on demand resources was cut by 15 points, returning to the previous level of 45%.

These measures, coupled with exchange market stability, convergence of inflation to the specified targets and increased confidence on the part of economic agents, impacted both the cost of operations and the banking spread in the segment of nonearmarked resources. From June to November, the average rate of interest on funding operations declined by 9.7 p.p., registering 6.8 p.p. in operations with corporate entities and 15.4 p.p. in those with

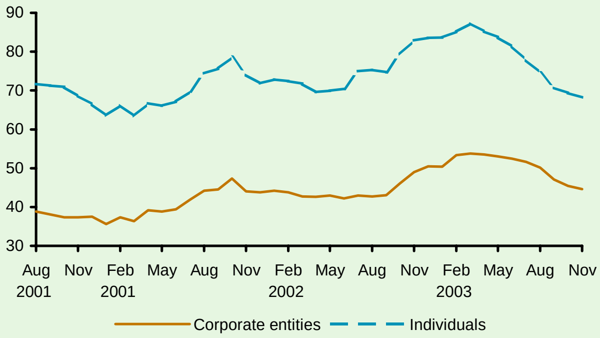
New grantings – Deseasonalized data at November 2003 prices – IPCA

R$ million

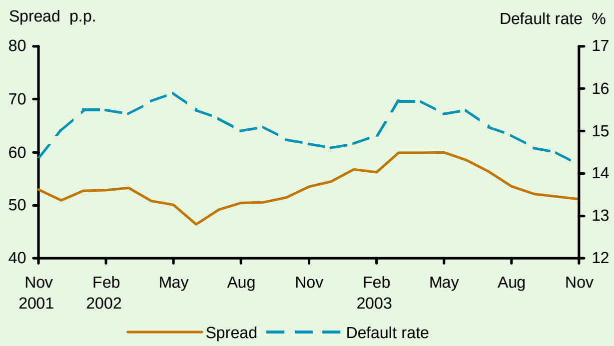


Preset interest rates of lending operations

% p.y.



Nonearmarked credit operations – Individuals



individual borrowers. In the period stated, the banking spread diminished by 3.2 p.p.

In this context, the first signs of growing credit demand appeared in September, becoming evident in the results of operations granted with nonearmarked resources. This movement was more significant in operations with individual borrowers, particularly those involving financing of consumer durables, such as automotive vehicles. Here, it is important to stress the significance of credit as a consumption incentive mechanism, since there is always a lag between an upturn in the pace of activity and increases in available income.

With respect to credits granted to corporate entities, the evolution of these operations in recent months points to consistent recovery in business demand. Though basically concentrated in such seasonal factors as stock replenishment for end-of-year sales and the marketing of inputs for the planting of the farm crops, this growth points to a reactivation of demand for investment financing in response to the process of recovery in economic activity, despite the idle capacity indicators in the productive sector.

Notwithstanding still very modest results in terms of recovery in the credit sector, maintenance of the current positive economic scenario and the more flexible monetary policy already adopted are the factors that should drive the process of credit growth in 2004, just as happened in 2000.

It is important to underscore the fact that growth in credit operations may also benefit from additional cutbacks in the banking spread. The underlying reason for this has been the falloff in default rates in recent months as a consequence of more effective management of credit portfolios and the efforts made by households to normalize their banking debts.

Another factor that is expected to contribute positively to a reduction in the cost of loans is enhanced credit market competition. Reductions in the revenues of financial institutions on treasury operations, caused by the interest rate reduction, demands that banks become more active in the credit market. In this sense, one can expect increased competition in operations involving financing of consumption, principally in the low income segment. Here, it is important to note that this market segment is characterized by strong presence on the part of finance companies and is hotly disputed by large banking institutions.

One should further stress that the systematic analysis of the credit market carried out by Banco Central in recent years with the purpose of identifying the factors responsible for the high levels of banking spreads in Brazil has produced a series of proposals and measures aimed at improving the system.

Among the changes required in the juridical framework, a good example is the bill now in its final stages of deliberation at the National Congress involving reform of bankruptcy law. The proposed alterations are expected to reduce the risk of credit operations and, consequently, lessen the banking spread, by correcting difficulties related to execution of loan guaranties and the lack of liquidity consequent upon these guaranties. Among the proposals presented, one should underscore the alteration of the order of creditor priority in cases of bankruptcy. This change would place the tax authority on an equal footing with those holding real guaranties on a one-to-one ratio. This alteration is expected to increase the efficiency of the mechanism of delivery of properties given as real guaranties of liabilities, thus reducing creditor lending risk.

It is also important to highlight the recently announced measures taken by the government in the segment of microcredit. The purpose of these operations is to facilitate access to credit for the low income population, while also making credit available to those micro and small businesses that are often not covered by traditional programs. In this sense, as of July 2003, financial institutions are obligated to make a minimum of 2% of their demand deposits available for microcredit operations, with effective interest rates of no more than 2% per month. These operations utilize simplified credit reference procedures and are well suited to low income clients who often operate in the informal economy.

Another important initiative involves the constitution and operation of credit cooperatives. In June 2003, regulatory provisions were put into practice making it possible to create cooperatives with freely admitted membership. This alteration is important to the current cooperative model, which was restricted in the past to specific economic segments. At present, the system provides access to cooperative credit to participants without ties to organized economic categories.

In operations with individual borrowers, emphasis should be given to Provisional Measure 130, which makes it possible to grant loans to private sector workers based on payroll deductions, thus increasing the level of guaranties available to banking institutions. In this context, various financial institutions formalized agreements with central labor unions in order to make these loans available to a large number of workers. It is important to stress that approximately 20% of total personal credits correspond to similar operations carried out by financial institutions with civil service employees. According to market estimates, this type of credit could reach as high as R$30 billion and a significant share of this amount is expected to be channeled into exchanges of debts originating in special overdraft accounts and credit cards, thus reducing the cost of household indebtedness.

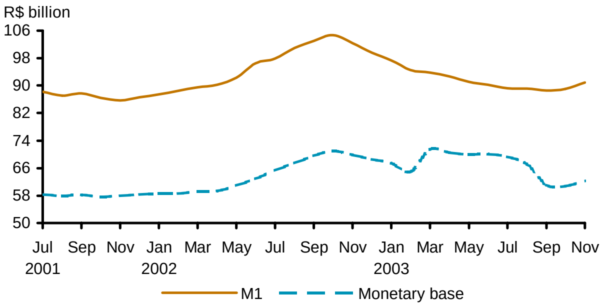
In summary, the institutional changes that have been implemented, expectations of enhanced credit market competition and the increasingly more flexible approach taken to monetary policy are the positive elements underlying the development of financial system credit operations and have clearly contributed to increasing the importance of these operations as an instrument for carrying out monetary policy. These aspects, coupled with favorable macroeconomic fundamentals in 2004, should contribute significantly to a sustained process of Brazilian economic recovery.

With respect to the profile of the financial system credit portfolio, operations classified as normal risk (AA to C) totaled R$354.2 billion in November, and accounted for 87.5% of the total. Loans registered at risk level 1 (D to G) came to R$32 billion and those classified at risk level 2 (level H) closed at R$18.7 billion, corresponding to participation levels of 7.9% and 4.6%, in that order. In the month of August, these percentages closed at 86.5%, 9.2% and 4.3%, respectively.

The value of the provisions set aside by the financial system came to R$31.9 billion in November, for growth of 1% in the quarter. These provisions were concentrated under risk level 2 which requires total provisioning. The participation of provisions in the total credit portfolio came to 7.9%, as against 8.2% in the quarter ended in August, mostly reflecting the increase registered in normal risk operations. The total set aside by the public financial system came to R$15.6 billion, corresponding to participation of 9.5% in total credits, while the private financial system registered a ratio of 6.8%. In the month of August, these participation levels came to 9.6% and 7.3%, respectively.

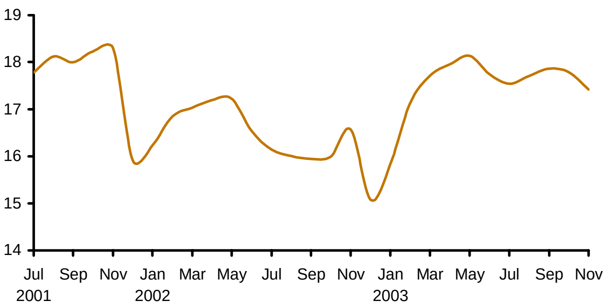
3.2 Monetary aggregates

M1 and monetary base at November 2003 prices seasonally adjusted[1/]



1/ Price index: IPCA.

M1 – Income-velocity[1/]

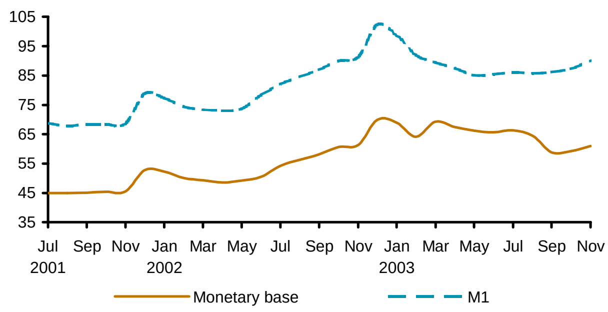


1/ Defined as the ratio between 12 month accumulated GDP (valued by IGP-DI) and the monthly average balance of the monetary aggregate.

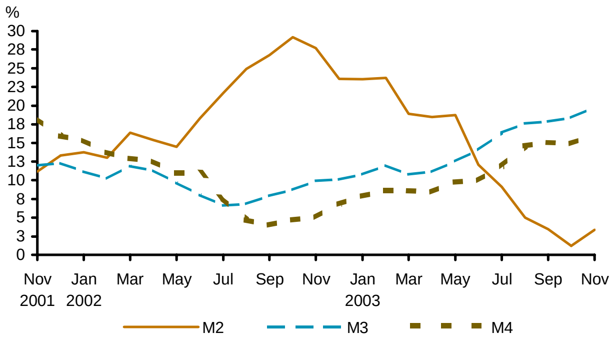
Viewed in terms of median daily balances in November, the restricted money supply (M1) came to R$90.1 billion, for a reduction of 1.3% in the last twelve months. With regard to money supply components, growth in the stock of currency held by the public came to 1% and the balance of demand deposits decreased by 2.8%. This negative growth reflected the high basis of comparison that resulted basically from the atypical migration of resources out of fixed income funds during the course of the previous year. Analysis of deseasonalized data deflated by the IPCA indicates that the impact of this process has been exhausted.

Reflecting the performance of M1, income velocity remained stable between August and November and repeated the performance of the previous quarter.

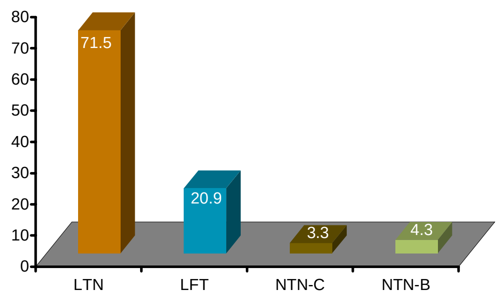
In terms of median daily balances, the monetary base registered a decline over the course of the year and closed November at R$61 billion, for a reduction of 0.6% over twelve months. Basically, this result was due to a reduction of 6.6% in the banking reserve position, since the median balance of currency issued expanded by 2.5%. During the quarter, mention should be made of the fact that the rate of compulsory reserves on demand resources diminished, Monetary base and M1 – Average daily balances



Broad money supply – 12 month percentage growth



Issues of federal public securities between September and November2003 – % share



dropping back to the level in effect in the same period of the previous year.

The expanded money supply turned in growth in the September-November quarter. Here, it is important to underscore the 9.1% rise in the quotas of fixed income funds, resulting basically from migration of resources out of other investments coupled with funding inflows targeted to investment funds. Such funds are basically originated from other investments and funding inflow. The M2 concept, which encompasses M1 plus savings deposits and securities issued by financial institutions, registered a high of 2.8% in the quarter and 3.4% in the last twelve months, which was less than the capitalization of its components. In this context, it is important to mention that the net inflow of time deposits and savings deposits was negative in the period, while the more restricted aggregate turned in an increase of 9.5% in the quarter, as a result of seasonal factors that occurred in the period.

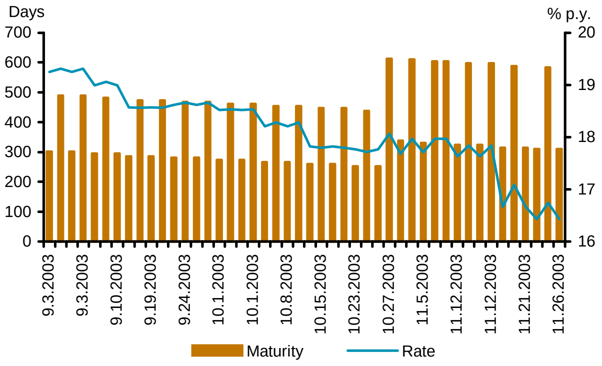
M3, which includes M2 plus the quotas of fixed income funds and federal public securities that are used as backing for the net position of financing in repo operations between the nonfinancial sector and the financial segment, registered a high of 6% in the quarter and 19.8% accumulated over twelve months. Mention should be made of the strong net inflow to investment funds, which came to R$14.4 billion in the quarter and R$54.8 billion in the year. The M4 concept, which includes M3 plus public securities held by nonfinancial entities, registered an increase of 5.4% in the quarter and 16.1% in the last twelve months, totaling R$924.6 billion in the month of November.

Federal public securities

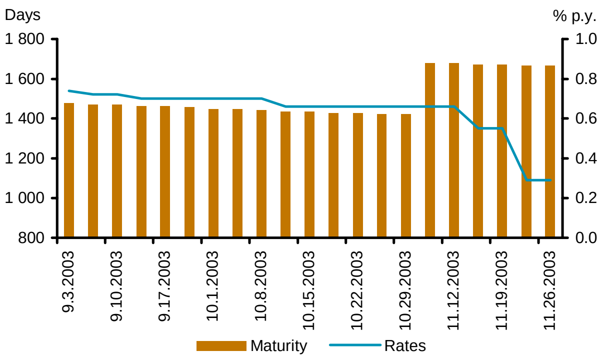
The conditions for placing public securities registered significant improvement in the period extending from September to November, with decreases in placement rates and longer issue terms. One should also note the utilization of anticipated purchase operations involving securities and the recommencement of issues of National Treasury Notes – Series B (NTN-B), which are tied to the IPCA. These issues were part of the debt management strategy adopted by the National Treasury.

In the quarter, operations with National Treasury papers produced a contractive impact of R$1.8 billion, based on placements of R$73.3 billion and redemptions of R$71.5 billion. When one ignores security purchase and exchange

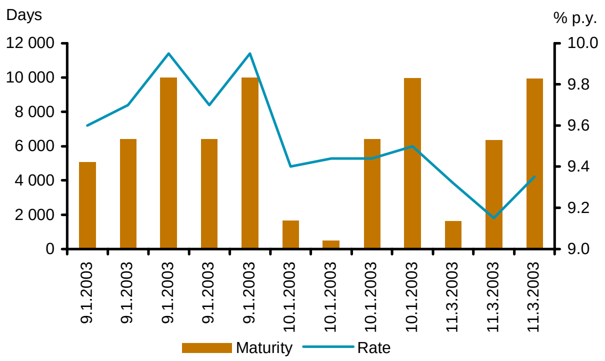
LTN placements – Maturity x rates



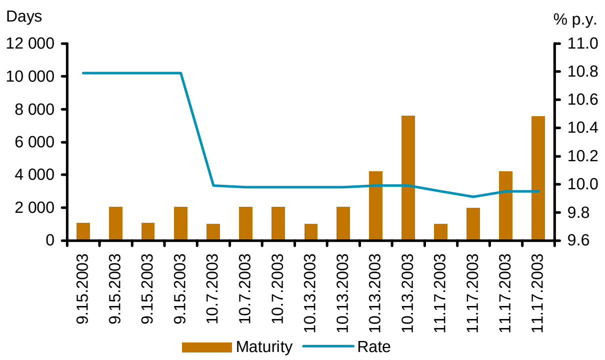
LFT placements – Maturity and rates



NTN-C placements – Maturity x rates



NTN-B placements – Maturity x rates



operations, issues totaled R$48 billion and maturities came to R$43 billion.

The progress achieved in improving the public debt profile is evident in the fact that preset papers (National Treasury Bills – LTN) represented 71.5% of issues, compared to 37% in the previous quarter. With respect to papers referenced to price indices, the participation of National Treasury Notes – Series C (NTN-C), which are papers indexed to the IGP-M, moved from 0.8% to 3.3%, while the participation of NTN-B represented 4.3% of issues in the quarter. In contrast to these results, the share involving Treasury Financing Bills (LFT), which are indexed to the Selic rate, dropped from a level of 62% to 20.9%.

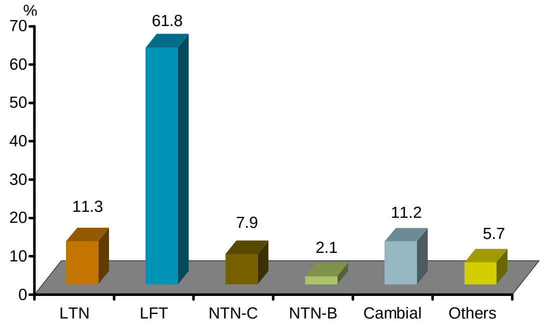
Renewed offers of NTN-B, which had not been issued since March 2002, had the objective of meeting the demand of institutional investors. Identification of pension funds as the sources of demand for longer term papers led to introduction of a program aimed at issuing these papers in a manner better suited to the structure of their balance sheets. In the same sense, NTN-B and NTN-C purchase auctions are aimed at reducing the transaction costs of long-term investors by increasing the liquidity of these papers on the secondary market. In their turn, the anticipated purchase auctions of LTN, which began in November, have the objective of reducing the concentration of short-term maturities of these instruments.

In general, the rates contracted in LTN auctions accompanied the futures interest curve and dropped from 19% to less than 17% per year, despite the longer issue terms. In November, LTN auctions with maturity in the month of July 2005 were carried out at rates that varied between 18.1% and 16.4% per year.

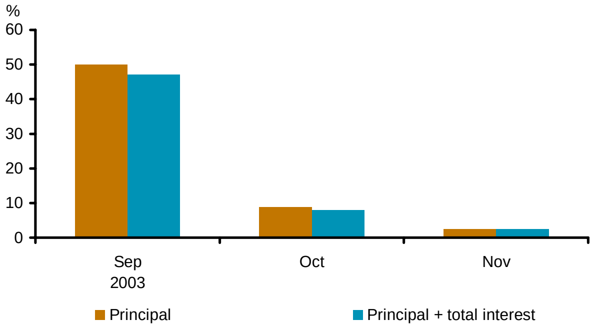
A similar movement was registered in operations involving LFT, for a reduction in the discount on these papers from approximately 0.7% per year to 0.3% per year, coupled with an increase in the issue term. In November, the Treasury abandoned the maturity of September 2007, and offered LFT with maturity in June 2008. NTN-C and NTN-B, which also registered declines in their respective rates during the quarter, were sold with maximum maturities in 2031 and 2024, respectively.

The change in the conditions for placing public securities continued producing significant alterations in the composition of the public debt. Following a trend that began in April of this year, the participation of preset papers in the total debt remained

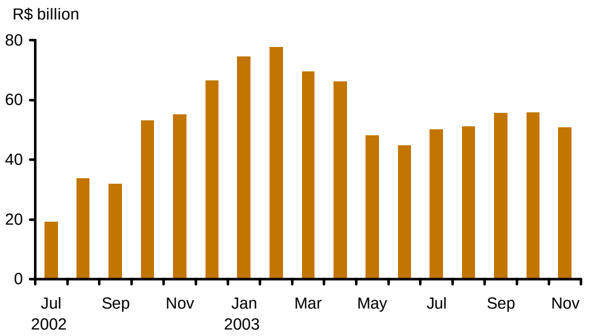
Federal securities debt structure – November 2003



Turnover of exchange-indexed securities and swaps



Net financing position of the federal public securities – Average daily



high, moving from 7.4% in August to 11.3% in November, while the proportion of papers indexed to price indices moved from 12.7% to 12.9%. On the other hand, the share of the public debt indexed to the Selic rate declined from 65.8% to 62.8%, and that referring to papers indexed to exchange variation dropped from 12.5% to 11.2% in the period.

Lesser demand for exchange hedge contributed to the gradual reduction of the exchange turnover in the quarter, moving from 49.9% in September to 8.8% in October and 2.5% in November. In the period, the turnover came to 20.1% when only the principal is considered. This figure was significantly lower than that registered in the June-August quarter, when 67.9% of exchange debts were renewed.

Banco Central altered the mechanism used in auctions of exchange instruments. The rolling of these papers was concentrated in a single auction at least four business days prior to maturity, always on a Wednesday or on the subsequent business day should the Wednesday in question be a holiday.

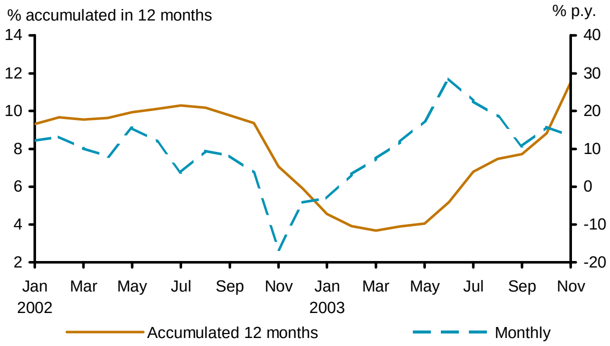
It should be noted that, in September and October, Banco Central maintained the strategy of controlling liquidity through repo operations with terms of 2 and 10 business days. One day operations were used exclusively on the eve of Copom meetings.

In November, an alternative form of controlling bank liquidity was adopted with the objective of reducing foreseeability and lengthening operation maturities. As of the 12th of the month, Banco Central no longer accepted the totality of offers, introducing a cutoff mechanism at specific prices, in repo operations with maturities of 10 business days. Parallel to this, LTN sale operations were carried out with resale commitments on the part of the buyer in 91 calendar days and defined profitability. This operation, which was instituted through Communiqué 7,669, dated 7.4.2000, permits free utilization of these securities and allows for anticipated resale, provided that the interested institution demonstrates its intention at least 24 hours beforehand and that the monetary authority be in agreement.

The median daily volume of the net financing position of federal public securities remained relatively stable in the quarter, fluctuating between R$50 billion and R$56 billion. At the end of November, repo operations scheduled to mature totaled approximately R$55.1 billion, of which R$7.2 billion were contracted with terms of 2 business days, R$43.3 billion with terms of 14 business days and R$4.7 billion with terms of 91 calendar days.

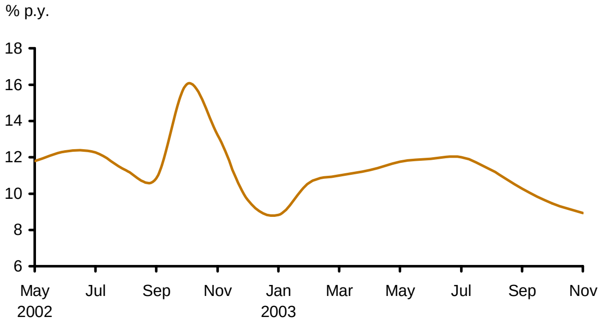
Real interest rates and market expectations

Ex-post real interest rate deflated by IPCA



Deflated by the IPCA accumulated over twelve months, the real Selic rate moved along an upward curve since May, reaching 11.5% per year in November. The upward tendency resulted from the statistical impact caused by the inclusion of monthly inflation rates lower then the corresponding rates of inflation registered in the same months of the previous year. In this sense, in the period extending from September to November 2002, the IPCA came to 5.1%, compared to 1.4% in the same period of this year. Consequently, the real rate of interest accumulated in 12 months increased by 4 p.p. in the quarter, a performance that was also a consequence of the lag between measures taken by Banco Central in specifying the Selic rate target and their impact on changes in price indices.

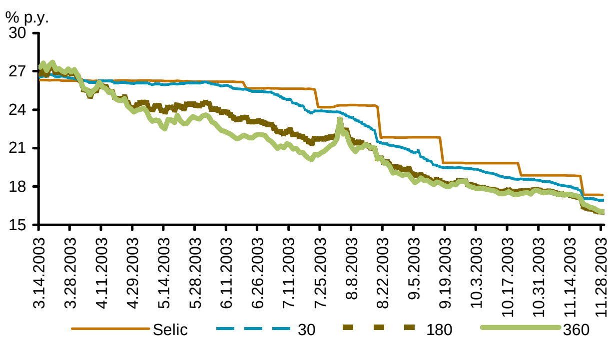
Ex-ante real interest rate deflated by 12 month IPCA forecast



When market expectations for IPCA growth over 12 months – as collected through surveys carried out by Banco Central among financial institutions – are analyzed, the downward curve that began in January slipped to 5.8% in November. Thus, using the basic scenario of market expectations for the Selic rate accumulated over the next 12 months and the already cited market expectations for the IPCA, it is possible to project a real rate of 9% per year, compared to 11.3% in August.

With this result, the maintenance of positive expectations in relation to internal economic indicators corroborates the greater confidence of economic agents with regard to the convergence of the future trajectory of inflation with the established targets.

Selic x swap DI x Pre



Source: BM&F and Bacen

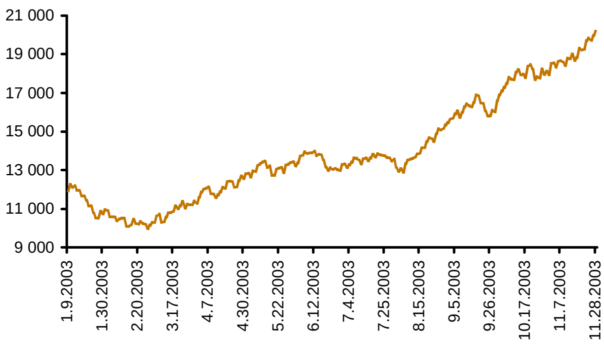
Expectations of a reduction in the basic rate are reflected in the future interest rate curve. DI swap x pre reference rates maintained the negative inclination begun in April. However, the difference between the rate on 30 day contracts and one year contracts dropped in the quarter. In principle, this reflects expectations of more moderate reductions in the basic interest rate in the coming months. Between August and November, there was a reduction of 3 p.p. in the reference rate for DI swap x pre contracts with terms of 360 days, moving to 16% per year. In the same period, Copom reduced the Selic rate target by 4.5 p.p.

Capital market

The São Paulo Stock Exchange (Bovespa) maintained the positive performance registered since February and

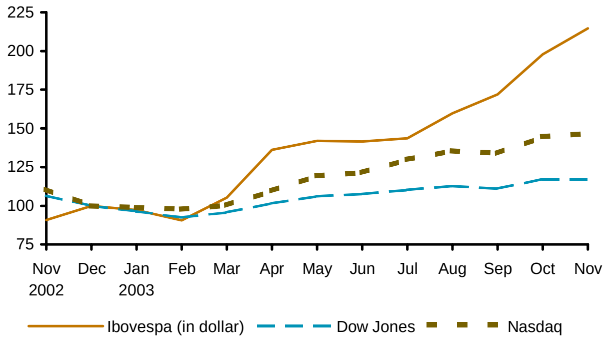
Ibovespa

Points



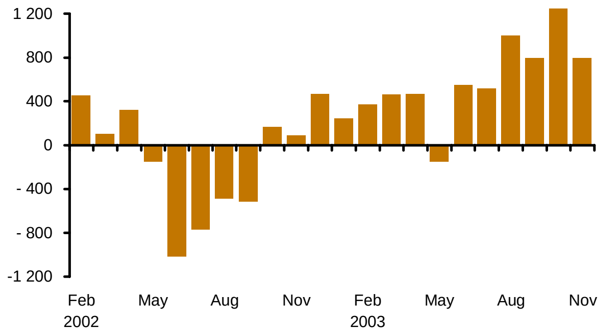
Stock exchanges

2002, December = 100



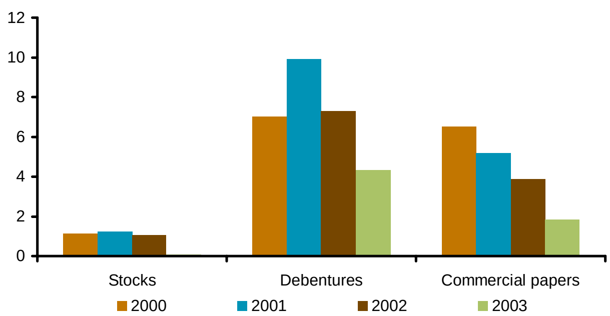
Net foreign investment in Bovespa

R$ million



Primary issues in capital market

R$ billion – In accumulated terms up to November



Source: CVM

accumulated profitability of 33% in the final quarter and 79% in the year. The São Paulo Stock Exchange Index (Ibovespa) came to 20,183 points at the end of November, the highest level since the historical series was first calculated in 1968.

For the most part, these results can be attributed to the inflow of approximately R$6 billion in foreign investments in the year, a process that was clearly stimulated by the signs of recovery in the Brazilian economy and by reductions in tensions on the international scenario which, in turn, favored decreases in risk aversion among foreign investors.

Parallel to this movement, the outlook for improvement in the national ranking by risk agencies, evolution of the constitutional reforms and a new agreement with the IMF made it possible to reduce the perception of the Brazil risk which declined to amounts in the range of 500 base points, as calculated by the Emerging Market Bond Index (Embi-Brazil).

Ibovespa profitability, plus exchange variation, came to 34.3% in the quarter, a figure that was higher than that registered by the National Association of Securities Dealers Automated Quotations (Nasdaq) and the Dow Jones Industrial Average (DJIA) which rose by respective rates of 8.2% and 3.8%. In accumulated terms for the year, the São Paulo exchange accumulated 114% in dollar terms, compared to 46% and 17% for the Nasdaq and Dow Jones, respectively.

In this scenario, the median daily volume of trading at Bovespa came to R$976 million in November, compared to R$471 million in February, the month in which the current process of upward movement in the Ibovespa began, corresponding to 97% of growth in the period. Here, it should be stressed that the daily median of R$1,139 million registered in October was the best result since August 2000, in real terms.

However, just as in the case of the bank credit market, improvements in expectations have yet to be reflected in a larger volume of funding operations on the corporate debt market. Issues of stocks, debentures and promissory notes on the Securities and Exchange Commission (CVM) totaled R$6.2 billion up to November, compared to R$12.9 billion in the same period of the previous year.

Among debenture issues, 58% of the R$4.3 billion refer to only two operations carried out by companies from the electric power sector and telecommunications sector, both of which are targeted to restructuring the profiles of their respective debts.

Financial investments

The balance of financial investments, which includes savings accounts, investment funds and time deposits, came to R$759.8 billion in the month of November 2003, for growth of 6.3% in comparison to August and 22.3% in relation to December 2002. It is important to highlight the evolution of the capital of financial investment funds (FIF), which registered R$50.2 billion in November, for growth of R$128.8 billion over the course of the year.

In the September-November quarter, FIF registered net inflows of R$14.4 billion, as a consequence of the continuity of the flow of resources back into these funds from the savings accounts and time deposits to which they had migrated in 2002, and of the funding operations involving external resources carried out by the business sector. In the year, the accumulated net inflows of these investment funds registered R$54.8 billion, against net redemptions of R$60.1 billion in the previous year.

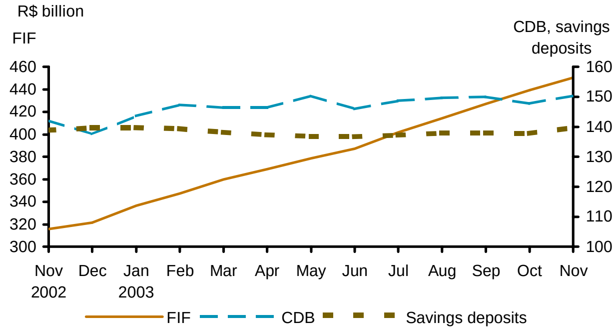
With respect to the migration of resources among the various segments of investment funds, fixed income funds were more attractive than funds referenced to interbank deposits (DI), as a result of the steady downward movement in basic interest rates. Consequently, preset papers maintained an upward trend in the composition of the FIF portfolios, moving from 9,4% in August to 15.2% in November.

In comparison to the FIF, savings account deposits and time deposits registered net negative inflows in the quarter corresponding to R$1.3 billion and R$5.6 billion, respectively. For the most part, this behavior is a consequence of the migration of resources into investment funds.

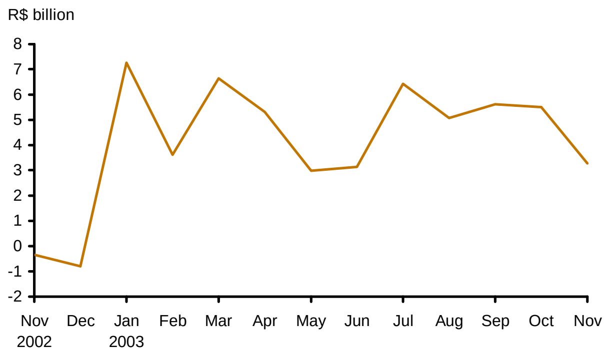
With regard to financial investment profitability, financial investment funds generated returns of 5.1% in the quarter, compared to 2.4% for savings accounts and 4.4% for time deposits.

When one takes due account of the taxes levied on financial investments with terms of more than 30 days (20% income tax – IR, and 0.38% for the Provisional Contribution on Financial Transactions – CPMF) and presuming a single redemption at the end of the period, net profitability for the

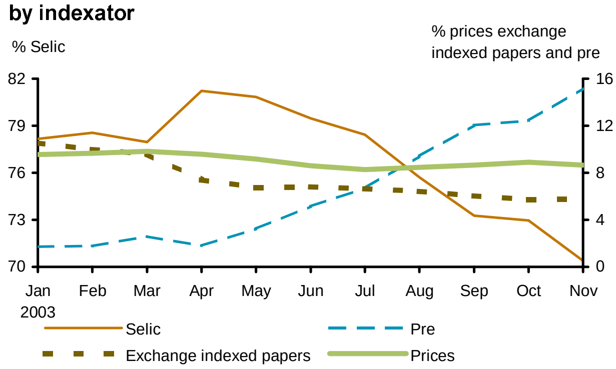
Portfolio evolution of time deposits, FIF and savings deposits



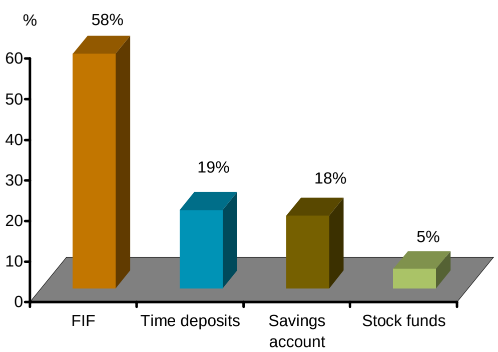
FIF – Net inflow



Growth in public securities in funds portfolio by indexator

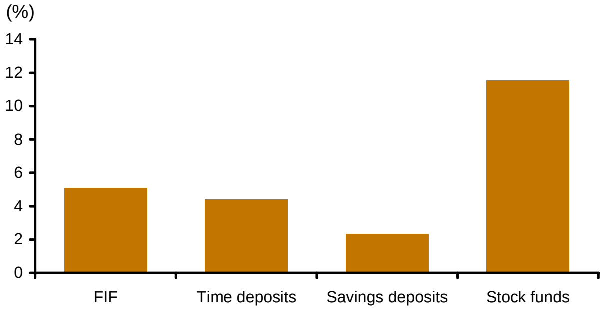


Financial savings structure – 2003, November



Financial investments earnings

In accumulated terms from September to November/2003



quarter came to 3.1% for time deposits and 3.7% for FIF. Since savings accounts are exempt from the income tax no matter what the duration of the investment and from the CPMF after 90 days, the profitability of savings accounts remained at 2.4%.

3.3 Fiscal policy

Public sector borrowing requirements

In November 2003, the primary surplus of the nonfinancial public sector came to R$6.3 billion. In the formation of this result, the central government (federal government, National Social Security Institute – INSS and Banco Central) contributed R$2.2 billion, regional governments contributed R$1.8 billion and state companies accounted for R$2.3 billion.

In the year, the primary surplus came to R$70.3 billion, or 4.94% of GDP, compared to R$57.1 billion, or 4.67% of GDP, in the same period of 2002. Of this total, the central government accounted for R$46.3 billion or 3.25% of GDP, for growth equivalent to 0.28 p.p. of GDP in relation to 2002. Regional governments turned in a surplus of R$14.4 billion or 1% of GDP, and maintained the same level registered in 2002, while state companies contributed a surplus of R$9.6 billion or 0.68% of GDP.

The results obtained up to November pointed to changes in the targeting of the fiscal effort which has now become more intense in the framework of the central government and less dependent on the segment of state companies.

The performance of the central government up to November was positively influenced by growth of 12.3% in net revenues, corresponding to R$29.1 billion, while overall spending registered growth of 9.5% in the period, equivalent to R$19.1 billion. As a proportion of GDP, revenues diminished by 0.97 p.p. and expenditures by 0.99 p.p.

The lesser participation of revenues as a proportion of GDP was a consequence of the reduction in atypical inflows, which fell from R$18.1 billion in 2002 to R$6 billion in 2003; to judicial decisions that were unfavorable to the fiscal authorities, in the framework of the Contribution on Intervention in the Economic Domain (Cide) and of the IPI; to the reduction in Import Tax (II) rates; and to the impact of deceleration in the pace of economic activity.

With respect to expenditures, disbursements on personnel and social charges and current and capital spending in the first ten months of the year registered growth of 6.9% and -0.9%, respectively, when compared to the corresponding period of 2002. It should be stressed that, as a proportion of GDP, these headings turned in reductions of 0.43 p.p. and 0.74 p.p., in that order. Spending by the ministries operating in social areas corresponded to 96.9% of the funding allocations, compared to 95.6% up to September 2003.

With regard to transfers to the states and municipalities, these operations increased by 7.6% in nominal values for the year.

Viewed in this context, the adjustment that has been implemented within the central government has not only made a major contribution to meeting the goals programmed for the current year, but has also taken on greater importance by the fact that its has more intensively targeted expenditures and has offset the occurrence of such adverse factors as the loss of the voluminous atypical inflows that were registered in the preceding year and the effects of the deceleration of the pace of economic activity.

Nominal interest appropriated in November totaled R$12.6 billion, compared to R$9.9 billion in October and R$11.5 billion in September. The major determining factors responsible for this trajectory were the positive results of exchange swap operations and the declining Selic rate trajectory. While during the months of September and October. These operations turned in respective gains of R$1.5 billion and R$3.1 billion, in November the results were negative by R$1.9 billion, partly reflecting the 3.3% exchange depreciation registered during the period.

Total nominal interest appropriated up to November came to R$136.3 billion or 9.59% of GDP, compared to R$96.6 billion, or 7.91% of GDP, in 2002. The central government appropriated R$95.2 billion, or 6.7% of GDP, while regional governments appropriated R$37.7 billion, or 2.65% of GDP, and the state companies closed with R$3.4 billion or 0.24% of GDP. Nominal interest appropriated in the last twelve months moved from R$150.7 billion, or 9.96% of GDP, in September, to R$153.7 billion, or 9.94% of GDP, in the month of November.

In the nominal concept, public sector borrowing requirements, which encompass the primary result and nominal interest appropriated, registered a deficit of R$66 billion, or 4.64% of GDP up to November 2003, compared to R$39.5 billion, or 3.24% of GDP, in the same period of 2002. When one analyzes accumulated flows in the last twelve months, the deficit came to R$88.1 billion, or 5.7% of GDP, the same level registered in the previous month, using the same basis of comparison.

With respect to the major sources of financing the nominal deficit accumulated in the year, the securities debt registered growth of R$115.3 billion, while the monetary base, banking debt and external financing registered reductions of R$10.9 billion, R$27 billion and R$14.8 billion, respectively.

Federal securities debt

Evaluated in terms of the portfolio position, the federal securities debt increased from R$696 billion, or 46.1% of GDP, in July, to R$728.3 billion, or 46% of GDP, in November. Among the factors that contributed to this growth, one should cite net issues of R$1.5 billion in the primary market, incorporation of interest and 0.6% appreciation of the real against the dollar.

The share of the federal securities debt indexed to the dollar fell from R$87.1 billion, in August, to R$81.7 billion, in November, as a result of net redemptions of R$6.9 billion in the primary market and appreciation of the real against the dollar. In the period, the participation of exchange securities in the total federal securities debt dropped from 12.5% to 11.2%, while the participation of the preset debt increased from 7.4% to 11.3% and that referenced to the Selic rate moved from 65.8% to 62.8%.

In November, the amortization schedule of the securities debt on the market, excluding financing operations, turned in the following configuration: R$15.2 billion, 2.1% of the total, with maturity in 2003; R$237.6 billion, 32.6% of the total, in 2004; and R$475.6 billion, 65.3% of the total, as of January 2005.

Exchange swap operation in November came to R$91.3 billion, compared to R$107.7 billion in August. The result of these operations, which is defined as the difference between DI profitability and exchange growth plus coupon, produced a favorable result of R$3.7 billion, when calculated on an accrual basis. In the cash concept, the positive result came to R$2.8 billion.

Net debt growth
Conditioning factors

Itemization	2002		2003			
	December		Up to November		November	
	R$ million	% GDP	R$ million	% GDP	R$ million	% GDP
Total net debt – Balance	881 108	55.5	905 293	57.2	15 257	- 0.1
Flows	**Accumulated in the year**				**November**	
Net debt – growth	220 241	2.9	24 185	1.7	15 257	- 0.1
Conditioning factors	220 241	13.9	24 185	1.5	15 257	1.0
PSBR	61 614	3.9	66 012	4.2	6 321	0.4
Primary	-52 390	- 3.3	-70 294	- 4.4	-6 259	- 0.3
Interest	114 004	7.2	136 306	8.6	12 579	0.8
Exchange adjustment	147 225	9.3	-58 797	- 3.7	8 555	0.5
Domestic securities debt[1/]	76 662	4.8	-21 081	- 1.3	2 572	0.2
External debt	70 564	4.4	-37 716	- 2.4	5 983	0.4
Others[2/]	753	0.1	15 083	1.0	196	0.0
Acknowledgement of debt	14 286	0.9	1 887	0.1	184	0.0
Privatizations	-3 637	- 0.2	0	0.0	0	0.0
GDP growth effect		- 11.0		0.1		- 1.0

1/ Dollar indexed internal securities debt.
2/ Parity of the currency basket taking part in the net external debt.

Net public sector debt

The net debt of the nonfinancial public sector totaled R$905.3 billion or 57.2% of GDP in November, compared to R$891.3 billion, or 59.1% of GDP in August, and R$881.1 billion, or 55.5% of GDP, in December 2002.

Net debt growth of 1.66 p.p. of GDP in the year reflected the impacts of 4.17 p.p. generated by borrowing requirements; 0.95 p.p. resulting from the variation of the parity of the basket of currencies that constitute the net external debt; 0.12 p.p. as a result of acknowledgement of debts; and 0.14 p.p., resulting from valued GDP growth. In the opposite sense, the impact of accumulated exchange appreciation in the year, resulted in a reduction in the value of the net debt equivalent to 3.71 p.p. in the year.

The gross general government debt, which encompasses the federal government, state governments and municipal governments, totaled R$1,247.2 billion, or 78.7% of GDP, in November, compared to R$1,210.8 billion, or 80.3% of GDP, in August, and R$1,132.9 billion, or 71.4% of GDP in December 2002.

3.4 Conclusion

The behavior of credit operations in the third quarter of the year indicates that, after a long period of stagnation, the financial system has once again begun opening a channel of financing to the private sector. In this framework, the growth that has occurred in the volume of credit, which not only reflects the recent upturn in these operations, but also the seasonal increase in the level of productive activity, was a consequence of greater household demand, expressed in the form of acquisitions of durable consumer goods based on the incentive of an expanding credit market.

In this sense, it is important to underscore the contribution made by both the decline in interest rates on funding operations as well as the lower spreads practiced by the banking system. Both of these factors were consequences of the more flexible monetary policy that has been adopted, accompanied by cutbacks in the basic interest rate and a decrease in compulsory reserves on demand deposits. Thus, the situation of macroeconomic stability has made it feasible to reduce the costs of loans while adopting measures aimed at stimulating credit, such as those designed to broaden the flow of microcredit and loans in which payment is deducted from payroll. Taken as a whole, expectations are that this financing channel will become an element that will consistently contribute to the process of recovery in productive activities.

However, it is also important to note that the expected growth, which began at the level of household consumption, and will be followed by increased business demand for investments, will be conditioned by the limits imposed by income and employment, both of which are now moving toward recovery.

At all segments of the public sector, fiscal performance has clearly ratified expectations of compliance with the targets set down for the year. The results obtained up to November indicate lesser participation of state companies in the public sector surplus. In the opposite sense, the fiscal adjustment implemented within the framework of the central government more than offset the performance of that sector and maintained the consolidated result at a level fully compatible with the programmed targets.

It is important to note that the magnitude of the adjustment implemented by the central government, with greater emphasis on spending, easily offset the loss of the extraordinary revenues registered in the previous year coupled with the tax reduction inherent to the deceleration of economic activity.

The positive evolution of the major factors that have conditioned the evolution of the net debt, as reflected in the declining tendency of the Selic rate, in exchange rate stability and the continued process of obtaining positive fiscal results in all public sector segments, should contribute to maintenance of the equilibrium of the debt/GDP ratio. Aside from this, the start of the process of renewed economic activity has clearly strengthened expectations of a decline in that ratio over the medium term.

International economy

4

The recent evolution of the three major economic regions, as demonstrated by quickened growth in the United States, continued expansion in Japan and an upturn in the pace of activity in the Euro zone countries suggests more consistent world economic recovery in this second half of the year. For the first time since 2000, these three regions are expanding simultaneously, indicating that the downward economic trajectory may well have come to an end. However, it is important to note that there is considerable doubt regarding the intensity of this recovery since the imbalances accumulated in previous economic cycles still persist.

Renewed world economic growth was driven not only by the evolution of the United States' economy, but also by the performance of the countries of Southeast Asia, particularly China. This movement generated direct impacts on Japan, as the evolution of that country's GDP indicated that, after years of recession, the process of economic recovery may finally be getting off the ground.

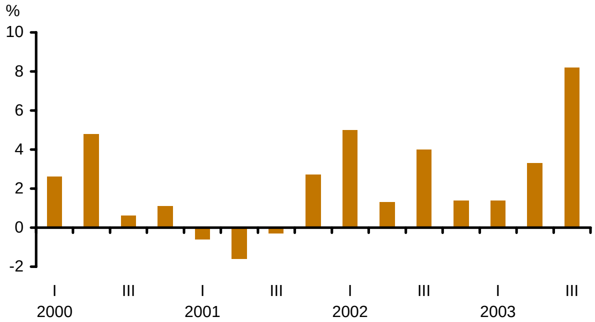
Improvement in the international scenario is closely related to the evolution of world trade. Once again, the strength of Chinese foreign trade stimulated development in various Asian nations, at the same time in which it powered the process of renewed economic activity in those countries most solidly integrated into the Chinese economy, such as Japan and South Korea, and several nations from other regions of the world.

In the emerging nations in general, improved economic fundamentals and better financial market evaluation of the risk represented by the assets of these nations produced a more attractive scenario for foreign financing, coupled with considerably more dynamic world trade.

4.1 Economic activity

Renewed growth in the American economy and positive – albeit moderate – results in Japan and the Euro zone countries in the third quarter confirmed optimistic expectations regarding world economic recovery in the second half of 2003. Among the factors that suggest the current growth trajectory will continue, mention should be made of the expanded geographic reach of the recovery process, signs of positive job market evolution in the United States, continued low inflation and expansionary monetary policies on a world scale. On the other hand, particularly over the medium-term, there are a number of imbalances that could act as obstacles to the sustainability of the recovery process. Among these, it is important to underscore the deficits in American public accounts and current accounts, the debility of the Japanese financial system and the fiscal problems that have affected the major Euro zone economies.

GDP – USA[1/]

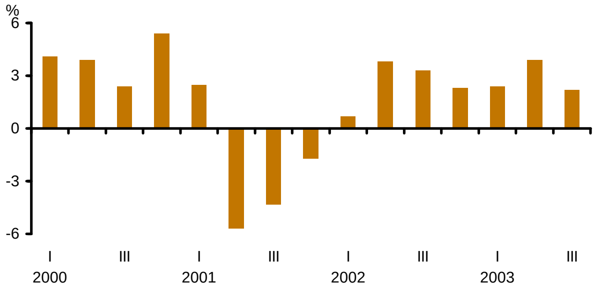


Source: Bureau of Labor Statistics
1/ Quarterly change seasonally adjusted annualized rate.

In the third quarter of the year, United States GDP expanded by 8.2% in annualized terms when compared to the previous period. From the viewpoint of demand, a breakdown of this result indicates strong growth in private investments and consumption of consumer durables. At the same time the export sector expanded, demonstrating that the recovery process in the third quarter impacted all of the major economic sectors of the American economy.

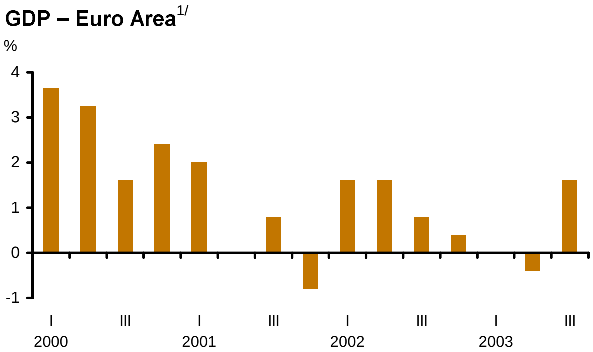
One of the most important factors in confirming the sustainability of the growth process is recovery in United States employment levels. Though unemployment rates point to a gradual decline and the number of nonfarm workers would seem to indicate some degree of still quite timid recovery, no definitive conclusions can as yet be drawn from employment data. If, on the one hand, the high level of idle industrial capacity indicates positive conditions for new hirings, on the other, strong gains in productivity tend to hamper job market recovery.

GDP – Japan[1/]



Source: Economic Planning Agency
1/ Quarterly change seasonally adjusted annualized data.

The economies of Japan and the Euro zone countries are now in positions quite similar to that of the United States at the start of the year. Indicators of business and consumer expectations have advanced positively, at the same time in which effective, though still very moderate, signs of recovery in the level of activity have begun appearing. Japanese GDP turned in annualized 2.2% growth in the third quarter, powered by private residential and nonresidential investments and by growing exports. At the same time, industrial output



Source: Eurostat
1/ Quarterly change seasonally adjusted annualized rate.

registered positive monthly growth of 3.8% in September and 0.8% in October.

In the Euro zone countries, GDP expanded by 1.6% in the third quarter in annualized terms, driven principally by growth in the export sector. Business expectations point to a steady rise under this heading, particularly in Germany and France.

In the emerging economies, the highlight has been the exceptional performance of the Southeast Asian economies and particularly China which, registered third quarter seasonally adjusted annualized expansion of 17.6%. The recent evolution of industrial activity has undergirded this trajectory, as October closed with monthly expansion of 1.7% and yearly growth of 17.2%, both of which were higher than the corresponding September and August results. To a great extent, this dynamism was due to the performance of companies controlled by foreign capital, since the major share of their output was targeted to the export market.

In Latin America, the Argentine economy moved from 5.4% GDP growth in the first quarter of 2003 to 7.6% expansion in the second quarter of the year, with strong upward movement in consumer confidence. In the third quarter, the consumer confidence indicator declined, demonstrating that conclusions regarding the sustainability of the economic recovery can only be drawn with a solid dose of caution.

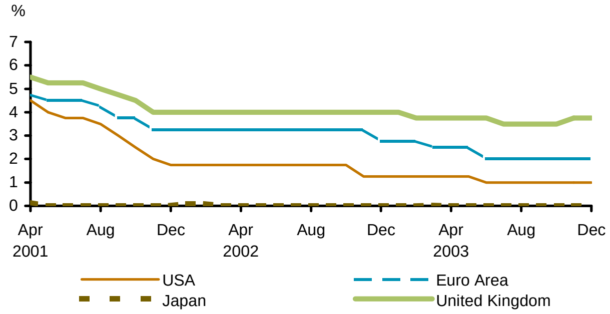
4.2 Monetary policy and inflation

As overall demand recovered, the outlook consolidated for upturns in the official rates of interest adopted in the major economic regions, with the sole exception of Japan. In this context, in early November, the central banks of Australia and England initiated a cycle of a somewhat more stringent monetary policies.

In the United States, the Federal Reserve (Fed) maintained the fed fund target at 1% per year, the lowest level of the last forty years. This decision was taken even after GDP figures for the third quarter pointing to strong expansion had become known. The monetary policy followed since the bursting of the so-called "bubble", as reflected in the strong interest rate cutbacks in 2001 and the more relaxed stance adopted since last year, seems to have been successful in realigning the financial position of the private sector, particularly the corporate sector, as is evident in the strong growth registered in investment outlays in the last two quarters. However, at the household level, the still high

Official interest rates

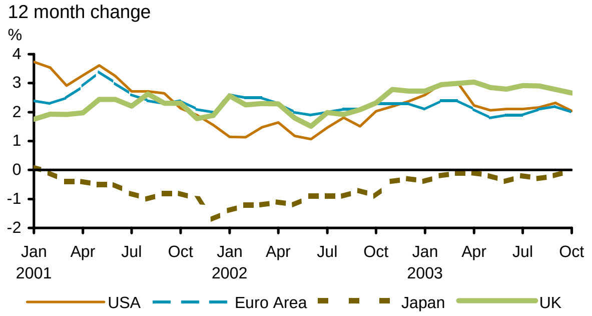
Annual rates



Source: Federal Reserve, ECB, Bank of Japan, Bank of England

Consumer prices

12 month change



Source: Bureau of Labor Statistics, Eurostat, Bloomberg, Office for National Statistics

level of indebtedness indicates that this adjustment has not yet been completed. The expected scenario of higher interest rates could make the servicing of these debts more difficult and, consequently, destabilize the mortgage market. At the moment, however, all indications are that the Fed will follow a policy of gradually raising interest only as of the middle of next year. The outlook for inflation points to a small rise starting from the current very low level.

In the Euro zone countries, the macroeconomic scenario has registered relative recovery in recent months. More consistent signs of demand growth, including external demand, have been registered despite appreciation of the euro. With this, it is expected that, much like the Fed, the European Central Bank (ECB) will begin moving interest rates into an upward curve. However, there would seem to be very little probability that this increase will occur in the near future. The reason for this hesitancy is that the still rather anemic recent growth in the region would seem to recommend that the ECB adopt a more cautious stance in order to avoid the possibility of prematurely suffocating the growth surge by imposing higher interest. On the other hand, differentials in productivity between the United States and the Euro zone countries and their impacts on potential GDP growth rates would seem to suggest a lesser degree of ECB flexibility in monetary policy execution when compared to the Fed. At the same time, with the lesser degree of price flexibility in the Euro zone countries, inflation in the region has remained quite close to the limit of the annual 2% target. To some extent, this explains the tenacity of the ECB's monetary policy, which has avoided sharp cutbacks in interest even when sluggish growth and steady appreciation of the currency seemed to suggest the need for a somewhat bolder attitude.

In summary, even when the region's growth achieves greater solidity, the highly valued currency will act as an obstacle to a more restrictive monetary policy. However, this factor could be gradually neutralized by the growth differential in favor of the United States economy, which is expected to be accompanied by strengthening of the dollar.

The Bank of England decided to raise its basic interest rate from 3.5% per year to 3.7% per year at the Monetary Policy Committee meeting held in November. This decision was maintained at the December meeting, which ratified forecasts that the process of raising interest rates would be gradual. The major justification for the monetary policy turnaround were more consistent signs of world economic recovery and wariness with respect to the possibility of the formation of a real estate sector growth "bubble". The fact of the matter is that, in both February and in June, the United Kingdom monetary authority had moved to cut interest rates, as a way of providing a type of "insurance" against the risk represented by the then still rather frail process of recovery in global demand, taking advantage of the maneuvering room provided by the appreciation of the pound sterling. Once the risk of product had been resolved, the central bank's major concern became that of reducing the bubble of assets in the real estate sector, by adopting a somewhat more stringent monetary policy.

At a meeting held on October 10, the Bank of Japan (BoJ) further strengthened its monetary incentives. These were maintained at later meetings, despite more secure evidence of recovery, as reflected in real GDP growth in the third quarter of the year, lengthening the positive growth cycle to seven consecutive quarters. In order to make monetary policy instruments more flexible, the BoJ raised the upper limit of the bank reserve balance at the central bank by ¥2 trillion. As a result the new target for the balance is between ¥27 trillion and ¥32 trillion. At the same time, the Bank of Japan extended the maximum maturity of Japanese government bond purchase operations in repo agreements from six months to one year. The monetary authority has reaffirmed its commitment to maintain a less restrictive monetary policy until such time as the consumer price core index registers either zero or positive inflation when viewed in annual terms. The underlying reason for adopting this position is that constant price deflation has hampered the possibility of real product growth being reflected in expanded nominal product.

Following a brief pause in September, the currencies of Japan, South Korea and Thailand were realigned to the dollar. To some extent, the fact that these rates moved in varied directions in that period was caused by speculative movements aimed at taking advantage of currency appreciation, as a result of the recommendation issued by the G-7 in favor of more flexible rates of exchange. This marked a return to an exchange market characterized by strong intervention, which had long been a hallmark of the central banks of the region. Very often, accumulation of international reserves originating in purchases of export exchange is not even sterilized, thus resulting in sharply expansionary monetary policies. In such countries as China and Malaysia, the fact that these funds are not sterilized is offset by capital controls.

However, pressures for currency appreciation exist. Chinese authorities have resisted these pressures, mostly in light of the adverse impacts they could produce on the country's still fragile banking system. Despite vigorous growth, inflation in China remains low, though there have been some recent signs of upward movement. If the tempo of inflation picks up, it is possible that Chinese authorities would resort to appreciation of the renminbi as a deflationary mechanism.

In Latin America, the reduction registered in consumer inflation has provided room for adopting a gradually less stringent monetary policy. In countries such as Argentina and Mexico, where the volume of currency is an intermediary target and, therefore, interest rates are determined by the market, the money supply is expanding. In Chile, inflation is below the specified target, possibly justifying adoption of a more expansionary monetary policy. Since many countries of the region follow policies that are aligned to the dollar, the improved outlook for growth in the United States economy should certainly contribute to adoption of less rigorous monetary policies. High international liquidity and lesser aversion to risk have facilitated financing of the balance of payments and made the use of monetary policy instruments considerably more flexible.

4.3 Fiscal policy

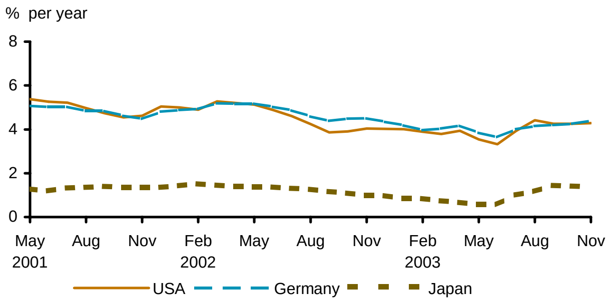
The more developed economies are expected to maintain a less stringent fiscal policy in 2004. In the United States, fiscal incentives implemented in 2003 aided in stimulating the activity level and no changes are expected in this policy over the short and medium-terms. If the sustainability of the economic recovery process is confirmed further into the future, some degree of fiscal adjustment would be required. However, the current trajectory toward an expanded public deficit, coupled with the growing current account deficit, has raised the risk of affecting the credibility of American public securities and the dollar itself.

In the Euro zone, the tolerance shown in relation to the public deficits of the major economies was to some degree made official at the end of November, when the European Union Finance Ministers decided not to apply sanctions to Germany and France as a result of the fact that both countries had registered deficits higher than the limits imposed by the Stability and Growth Pact. According to what was agreed upon at the time, the adjustment in public accounts in the next two years should be less intense than had been intended by the European Commission and the two nations will have until 2005 to reduce their deficits to less than 3% of GDP. The understanding that prevailed was that economic recovery is more important than the pursuit of short-term fiscal balance. Furthermore, the deterioration of public accounts is due to deceleration in the activity level and not to a more lax sense of fiscal discipline. It should also be stated that implementation of structural reforms that impact the social security system, labor market and tax system, with direct impacts on public accounts, have been moving significantly forward in Germany, France and Italy.

4.4 International financial markets

Capital flows have been favored by the high level of international liquidity and by the increased pace of economic activity in the major economic blocs, generated in turn by expansionary monetary and fiscal policies.

Yield on Treasury bonds[1/]

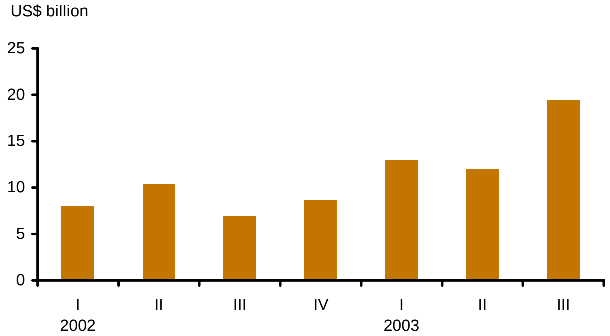


Source: Bloomberg
1/ Monthly average of nominal yields on 10 - year bonds.

Monetary policy implementation and the persistence of uncertainties surrounding the sustainability of United States economic growth have held long-term interest rates at historically low levels in the major international financial centers. This, in turn, has favored the continuity of the process of economic-financial adjustment of private agents in the developed economies and a strong inflow of resources to the emerging economies.

According to the Bank for International Settlements (BIS), there was a reduction of 14% in net issues of securities on the international market in the third quarter of 2003, due to the greater volatility of long-term interest rates in the month of August. Basically, this result was a consequence of a cutback in net Euro zone issues from US$208.3 billion to US$125.1 billion, in contrast to net American issues which increased by 202% to a level of US$88.1 billion.

Net issues of emerging economies



Source: BIS, Quarterly Review

The satisfactory risk-return ratios registered by the emerging markets coupled with stronger economic fundamentals in several Latin American economies have also contributed to the upturn in global flows. According to the BIS, the third quarter witnessed an increase of 62% in issues by developing countries, when compared to the previous quarter, closing with a total of US$19.5 billion.

The Institute of International Finance (IIF) forecasts that private net capital flows to the emerging countries will close 2003 at US$161.9 billion or approximately US$40 billion

Net capital flows to emerging economies

US$ billion

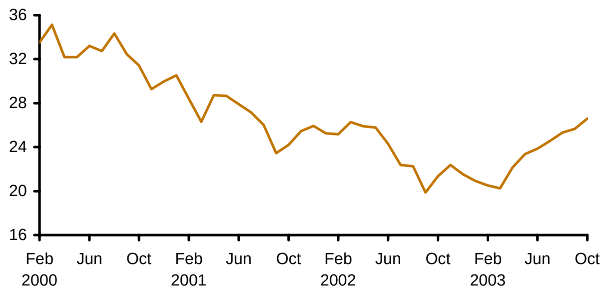
Itemization	2001	2002	2003 1/	2004 1/
Private flows	133.2	121.2	161.9	185.7
Latin America	51.9	15.0	26.4	39.4
Direct Investment, net	142.8	112.1	102.8	119.0
Latin America	60.7	35.2	24.8	32.4
Private portfolio investment, net	7.1	-0.9	13.3	16.9
Latin America	-1.3	-2.2	-0.6	-0.2
Commercial banks, net	-26.6	-5.7	13.4	10.4
Latin America	-9.6	-14.0	-6.0	-6.2
Others private flows	149.9	111.1	116.1	135.9
Latin America	59.4	33.0	24.2	32.2
Official flows	11.1	-3.2	-5.0	-9.1
Latin America	22.9	7.9	11.1	-1.3

Source: IIF – September 2003

1/ Forecast.

Market capitalization 1/

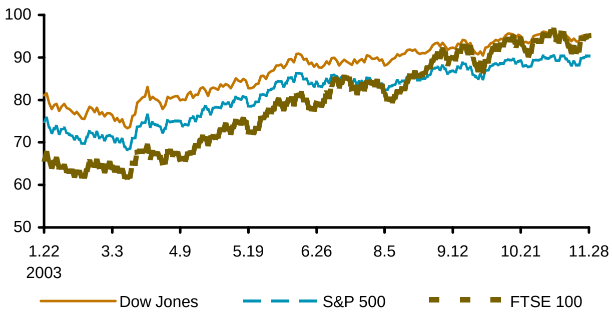
US$ trillion



Source: World Federation of Stock Exchanges
1/ 35 stock exchanges data.

Stock exchanges – USA

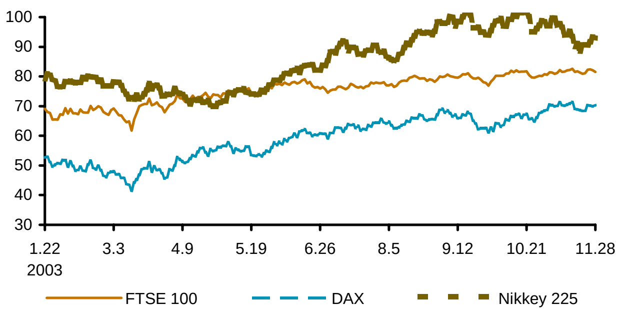
1.4.2002=100



Source: Bloomberg

Stock exchanges – Europe and Japan

1.4.2002=100



Source: Bloomberg

above the 2002 level. Of this total, Asia expects to receive about US$84.2 billion, equivalent to 52% of the total, and Latin America will receive US$26.4 billion or 16% of the total.

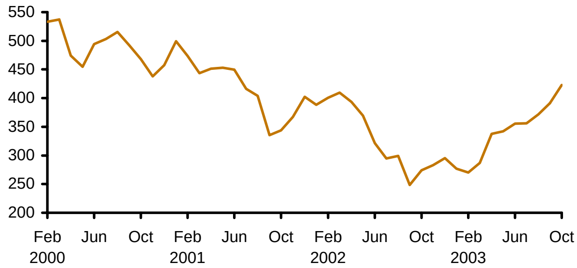
Stock markets in the industrialized nations registered considerable fluctuation from September to November and did not keep pace with macroeconomic indicators that pointed to improvement in the outlook for global economic recovery. Nonetheless, the limited upward movement in stock exchanges was not an obstacle to the fact that the market value of the companies listed on the world's 35 largest stock exchanges came to US$26.6 trillion in October. Though distant from the levels registered in 2000, this was the highest mark since July 2001.

In the United States, an announcement of higher than expected economic growth in the third quarter and positive corporate results in the same period was not enough to sustain the strong cycle of stock market growth. In this sense, market evolution in the September-November period was highly volatile. However, despite their volatility, markets moved upward in overall terms, as demonstrated by the DJIA and Standard & Poor's 500 (S&P 500) indices, in the case of the New York market, and the Nasdaq sectoral indicator. Simultaneously, maintenance of a still high ratio between prices and profits exposes the risk that unfavorable corporate gains could result in stock price reductions.

The European and Japanese markets turned in differentiated trajectories in the third quarter of the year. In Europe, markets turned in positive growth, albeit with considerable fluctuation, while, in the case of Japan, variable income assets declined in value, reflecting the uncertainties surrounding the sustainability of the more favorable economic performance. In both regions, however, investments in stocks registered accumulated positive returns in the year, as the Financial Times Securities Exchange Index (FTSE 100), referring to the London Exchange, the *Deutscher Aktienindex* (DAX), for the Frankfurt exchange, and the Nikkey 225, which reflects the Tokyo exchange, registered accumulated growth between 10% and 29%, expressed in local currency.

The reduction in the level of aversion and the situation of abundant liquidity led to growth in portfolio investments in the emerging countries and contributed to the sharp growth registered in the value of variable income assets, particularly in the emerging nations of Latin America and Asia. In the case of Latin America, the more favorable macroeconomic scenario also benefited local capital markets. A comparison

Market capitalization – Latin America[1/]
US$ billion



Source: World Federation of Stock Exchanges
1/ Data from São Paulo, Buenos Aires, Mexico City and Santiago Stock Exchanges.

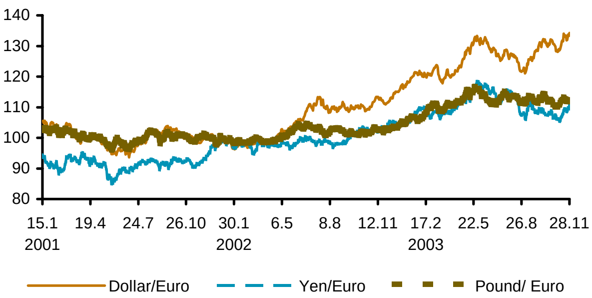
of growth in October with the same month of the previous year indicates expansion of 68% in the capitalization of stocks on the São Paulo exchange, 123% on the Buenos Aires exchange, 88% on that of Santiago and 14% on the Mexico City exchange, all measured in terms of United States dollars. Taken together, the market value of the companies traded on these four exchanges came to US$423 billion.

Since mid-June, the exchange market has been characterized by sharp oscillations in the value of the euro, principally against the United States dollar. The major factors underlying this behavior have been growth in expectations regarding the sustainability of American economic growth, its impact on the current account deficit of that country and the possibility of financing the deficit.

With the outlook for continued expansionary monetary and fiscal policies and improved economic indicators in the United States, the period from June to early September was marked by appreciation of the dollar against the euro. The more rapid pace of economic expansion in the United States compared to the economies of other large economic-financial centers produced a direct impact on expectations regarding the financing of the growing American current account deficit, since a sustained growth process is necessarily accompanied by upward movement in the value of assets, higher interest rates and the opening of new opportunities for direct foreign investments in the country.

As of the month of September, however, the dollar began depreciating once more against the euro, raising doubts regarding the sustainability of economic recovery in the United States. The rate of the euro at the end of November reached its highest historical level – though only slightly above the level registered in mid-June.

Euro exchange rates
1.8.2002=100



Source: Bloomberg

Impacted by the Japanese government's policy of maintaining the stability of the yen against the dollar, the Japanese currency also began to appreciate against the euro, with no sign of a reversal in this trend in September. The major factors that have conditioned the behavior of the Japanese currency since then have been increased confidence in the recovery of the country's economy and the declaration released on September 20 by the G-7 Finance Ministers. From that point forward, markets came to the conclusion that the Japanese government would give less attention to the level of parity of the yen against the United States dollar, and would accept appreciation of the country's currency as part of the gradual and wide-ranging adjustment of the international financial system.

4.5 World trade

In the World Economic Outlook report for September, the IMF revised its projections released in its April report on growth in the volume of world trade in goods and services in 2003 and 2004, from 4.7% and 6.2% to 2.9% and 5.5%, respectively. These forecasts are considerably more moderate than those released by the Organization for Economic Cooperation and Development (OECD) in its November issue of Economic Outlook, which predicts growth of 4% in 2003, 7.8% in 2004 and 9.1% in 2005. The promising scenario projected by the OECD reflects consistent signs that the global economy is in fact recovering, particularly when one takes account of the increased intensity of activity in the United States, Asia and the United Kingdom, as well as the positive outlook for continental Europe.

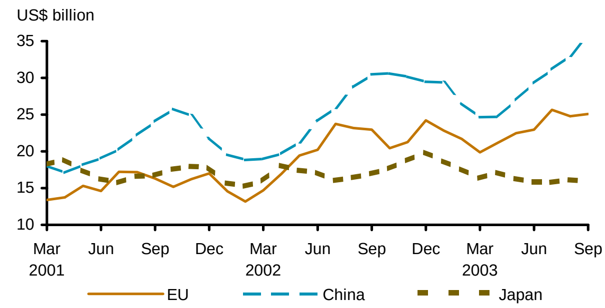
The factor of greatest importance is the simultaneity of the recovery in the various economies. This is expected to generate sustainability in global trade growth and recovery in commodity prices, the effects of which are already being felt by the developing countries that have obtained more favorable trade balances as a consequence of improvement in the terms of trade.

One should highlight two factors that have driven the upswing in world trade. On the one hand, the strong American growth that was consolidated in the third quarter of the year has driven the process of expanded exports from both the European and Asian economies, and particularly from China. On the other hand, the sound growth of Asian economies, leaded by China, has generated positive externalities for Japan and Latin America, with the exception of Mexico.

In the case of the United States, economic growth would seem to more than offset the impact of depreciation of the dollar on imports, which have registered an upward trajectory. After remaining relatively stable in the early months of the year, exports turned in growth in the four month period from June to September and tended to attenuate pressures on the trade balance deficit.

However, despite the relative stability evident since September 2003, strong growth in the American economy in the third quarter of the year and growing trade deficits with Asia and, particularly, with China, and the European Union (EU), have raised doubts with regard to the capacity of the United States to reverse these losses. The trade deficit

Trade deficit – USA[1/]



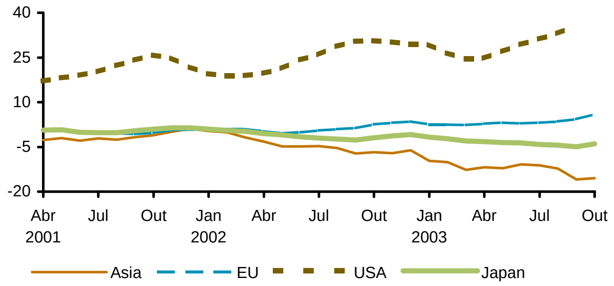
Source: Bloomberg
1/ Quarterly moving average.

with Japan seems to have stabilized, albeit at a considerably higher level.

The participation of the Asian economies in world trade has become increasingly more solid. Based on a vertical production structure in which China, which has registered very strong growth, is the center of gravity, these economies have made use of their comparative advantages in such a way that the stages of the productive process are distributed among the countries of the region. Trade within the region of Southeast Asia has become increasingly more intense and the region has registered a strong trade surplus with practically all of the other regions of the world, which is a factor that reflects the competitive division of labor in the region.

The strength of Chinese foreign trade growth, which has registered expansion of 40% in imports in the last twelve months, has contributed to converting that country into the second most important locomotive of global economic growth, following only the United States, and into the principal buyer of goods from the other nations of Asia, particularly countries such as Japan, South Korea and Taiwan whose economies are more closely integrated into the Chinese economy.

Trade balance – China[1/]
US$ billion



Source: Bloomberg
1/ Quarterly moving average.

Despite the fact that it has large trade deficits with most of the East Asian countries as a consequence of regionalized production, China has large surpluses in trade with the United States and European Union. These results guaranty that the country is able to turn in large net positive results in its trade operations. In the first nine months of the year, the accumulated surplus in Chinese trade with the United States came to US$89.7 billion, representing approximately one fourth of the American trade deficit. This balance, coupled with rapid accumulation of external reserves (totaling US$401 billion in October) recently generated a discussion on the need for the Chinese government to alter its exchange system, since this is said to be contributing to the growing American trade deficit.

In Japan, exports have moved along an upward curve as a result of sales of electronics and the country's strong partnership with China. In September, Japanese sales to China expanded by 42% in relation to the total registered in the same period of 2002. Analysis of the Japanese result shows a growing surplus in operations with Asia and a positive but stable balance in trade with the EU and the United States. If trade relations between Japan and the other Asian nations continue to deepen as they have in the past, the Japanese surplus with Asia will be greater than its surplus with the United States.

Just as in the case of Japan, economic recovery in the EU is being driven by growth in foreign trade flows, which recovered sharply in the third quarter of the year. The September result in the German trade balance could reflect a spike in both exports and the trade surplus, both of which had been declining in recent months. Germany turned in a trade surplus equivalent to €14.3 billion in September, compared to €11.8 billion in the corresponding period of 2002.

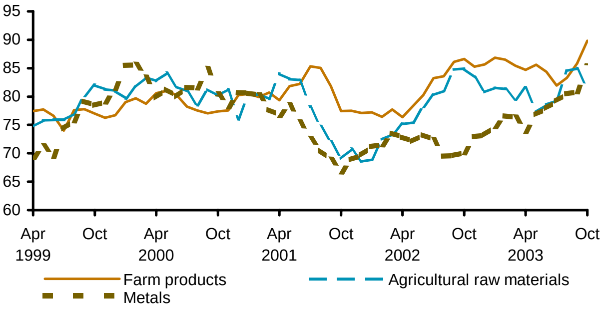
Latin American foreign trade was also impacted by Asian expansion. In general, countries like Brazil, Argentina and Chile, all of which are large scale exporters of primary goods, have benefited from growth in Asian demand for commodities such as soybeans, wheat, iron and steel, while the market for countries specialized in exports of manufactured goods, such as the case of Mexico, has become increasingly more competitive with Asian producers.

4.5.1 Commodities

While growth in Asia and the consequent increase in the supply of industrial goods has depressed the prices of these products, the price indices of the major commodities have shown some degree of recovery with upward – though rather volatile – movement in the prices of metals, inputs and farm products.

Commodity price index

1995 = 100



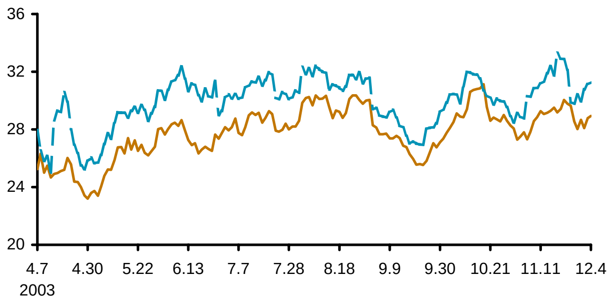
Source: IMF

Under the heading of metals, strong positive movement was registered in the value of gold which reached its highest level in seven years at the start of December. This movement was a consequence of strong depreciation of the dollar and uncertainties regarding the level of equilibrium. To some extent, just as occurred for many commodities, the appreciation registered under other metals reflects high levels of Chinese imports which, in 2002, accounted for 21% of all the aluminum marketed in the world, 24% of the zinc and 23% of the iron ore sold.

Among farm commodities, soybean prices continued high. In the November report issued by the United States Department of Agriculture, estimates of American production in 2003/2004 were revised downward as a result of a smaller than expected harvest. Aside from this, strong Chinese demand has pressured prices upward. The wheat market is particularly strong, since American stocks are at their lowest level in 25 years and world stocks are declining.

Oil – Spot market

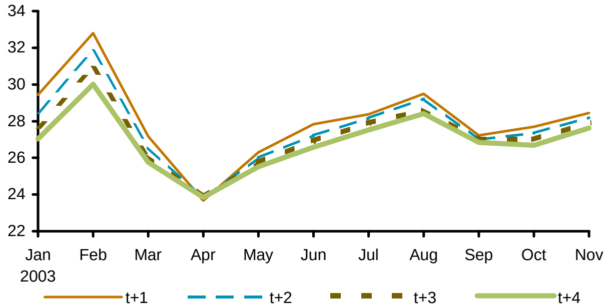
US$ per barrel



Source: Bloomberg

Oil – Futures market

US$ per barrel



Source: Bloomberg

4.5.1.1 Petroleum

Oil prices have remained above the US$22 - US$28/barrel interval defined by the Organization of Petroleum Exporting Countries (Opec). In November, the average per barrel price for Brent type petroleum closed in the range of US$28.8. However, the fact that world stocks have slowly begun to recover could generate additional leeway for prices, which would tend to fluctuate within the interval. Aside from this, despite forecasts that median daily Opec output in 2004 will be about 0.7 million barrels less than in 2003, expectations are that production in non-Opec countries will expand by about 1.3 million barrels per day in 2004, that Russia – the world's second largest producer – will not restrict its output and that Iraqi production should rapidly expand. The prices of futures contracts reflect this scenario of downward movement in per barrel prices, but suggest that this will be a gradual process, as prices are expected to remain below US$28 as of March 2004.

4.6 Conclusion

The element that will have the greatest impact on world economic performance in the coming year will still be the evolution of the United States economy, since sharp oscillations in the world's largest economy impact fluctuations in other economies and represent one of the most important mechanisms of transmission of economic cycles.

What is expected in 2004 is some degree of acceleration in the pace of world economic expansion, without ignoring the fact that course corrections may be needed over the course of the year since this acceleration will be a function of United States macroeconomic policy. However, there is little expectation of abrupt changes in implementation of this policy that could substantially alter the world economic trajectory during the coming year. What can be expected is the monitoring of United States monetary authorities with the aim of avoiding more intense acceleration than needed, without generating risks of inflation.

As a consequence of more intense growth in the world economy, international trade will tend to move upward in 2003, with positive impacts on commodity prices, which should benefit growth in the developing economies.

With regard to financial markets, it is expected that the start of 2004 will be marked by continued strong global liquidity and demand for higher risk assets. The major challenge for the coming year will be to precisely predict the right moment for the Fed to reverse its policy, a decision that will, without doubt, generate reductions in returns on higher risk assets, particularly returns on the debt bonds issued by emerging markets.

Foreign sector

5

Expectations regarding the external sector of the Brazilian economy improved substantially over the course of 2003. Internal and external economic recovery and maintenance of a consistent economic policy, coupled with the continuity of the process of adjusting the nation's external accounts, have contributed to perceptions of a more favorable scenario among international and national investors. With the record September and October export levels, these perceptions became even more evident and resulted in across-the-board external sector improvement, with positive repercussions on sovereign bond operations carried out with lesser spreads. This scenario has facilitated access of resident companies to external resources and guarantied a rate of rolling private debts in excess of 100% in the year or more than double the 2002 result. With this, the net flow of capital to the country has been positive, at the same time in which maturity profiles have improved considerably.

The behavior of external accounts in 2003 has been characterized by a far reaching adjustment process that eliminated the current account deficit from the results calculated both for the year in question and on a year-over-year basis. The accumulated year-over-year surplus came to US$3.7 billion up to November and was intensely impacted by the trade balance result. To a lesser extent, the positive performance of this account was also generated by a modest but steady reduction in the service and income account deficit. This environment made it possible to maintain expectations of positive results in the Brazilian balance of payments over the remainder of the current year and in the coming year.

5.1 Trade in goods

In 2003, Brazilian exports further improved upon the already excellent results produced since mid-2002, setting consecutive monthly records and registering accumulated

Trade balance – FOB

US$ million

Period		Exports	Imports	Balance	Trade flow
Jan-Nov	2003	66 336	44 264	22 072	110 600
Jan-Nov	2002	55 119	43 794	11 326	98 913
% change		20.3	1.1		11.8

Source: MDIC/Secex

Note: In 2002, 232 working days; in 2003, 231 working days.

Exports by aggregate factor – FOB
Daily average – January-November

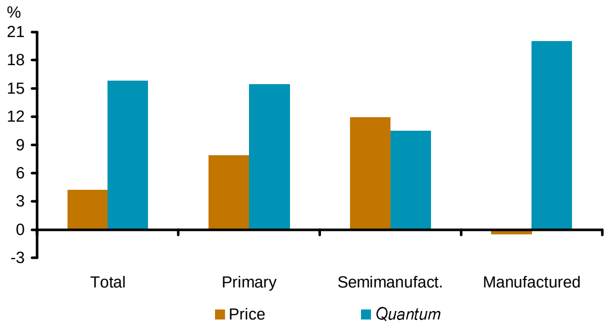
US$ million

Itemization	Accumulated		
	2002	2003	% change
Total	237.6	287.2	20.9
Primary products	67.6	84.5	25.1
Industrial products	164.1	197.5	20.3
Semimanufactured goods	35.3	42.7	21.2
Manufactured goods	128.9	154.8	20.1
Special operations	5.9	5.2	- 12.2

Source: MDIC/Secex

Note: In 2002, 232 working days; in 2003, 231 working days.

Exports – Price and volume index
January-October 2003/2002



Source: Funcex

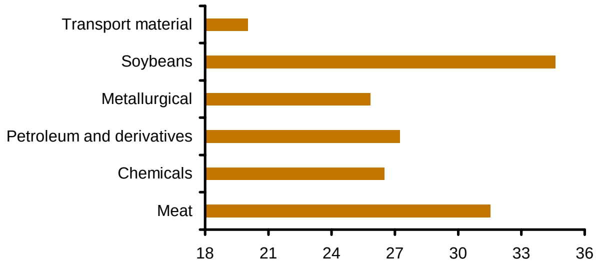
growth of 20.3% up to November 2003, compared to the result for the same period of the preceding year. In recent months, imports have also shown signs of recovery, with growth of 10.4% in November 2003 compared to the same month of 2002, and 1.1% when viewed in terms of the accumulated flow in the year. The January to November surplus came to US$22.1 billion, against US$11.3 billion in the same period of the preceding year, while the trade flow expanded by 11.8% using the same basis of comparison.

In qualitative terms, the surplus accumulated in 2003 is different from the 2002 surplus, since it is basically a result of growth in foreign sales. In contrast to this, the previous year's result was achieved mostly as a result of reductions in import flows. Several factors contributed to export growth, including exchange depreciation in the second half of 2002 and early 2003, which generated repercussions on the decisions then being taken by exporters; recovery of the Argentine economy; growth in Chinese foreign trade after than country's admission to the World Trade Organization (WTO); broadened trade relations with such less traditional partners as the countries of the Middle East, Africa and Eastern Europe; and recovery in commodity prices.

Growth in exports was greater under the heading of basic goods, with an increase of 25.1% in the daily average registered from January to November 2003, compared to the same period of 2002. Foreign sales of semimanufactured goods increased by 21.2% while sales of manufactured products expanded by 20.1%.

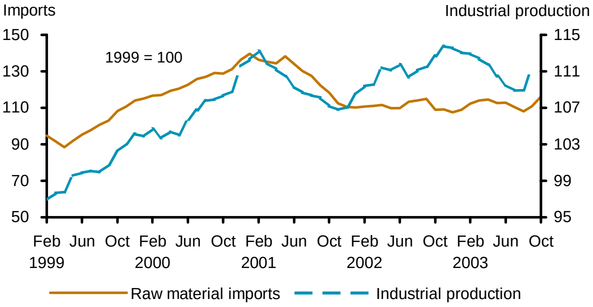
The three aggregate factor categories registered volume growth and, with the exception of manufactured products, small reductions in prices. Data on basic products released by the Foreign Trade Studies Center Foundation (Funcex) for the January to October period indicate growth of 15.4% in the volume of exports and 7.8% in prices, when viewed against the same period of 2002. Among the goods that registered price increases, the most important were those involving soybean products and coffee. Insofar as semimanufactured goods are concerned, growth in volume came to 10.5% while prices rose by 11.9%. Here, it is important to note that most of the major products registered significant price rises, particularly under semimanufactured iron or steel products, unrefined soybean oil, nickel cathodes, cocoa derivatives and laminated wood, all of which closed with price increases in excess of 20%. The volume of manufactured products sold abroad expanded by 20%, while prices diminished by 0.5%. However, there was a great deal of dispersion of these rates among the different products,

Exports by main sectors – FOB – January-November/2003
Percentage change from the same period of the last



Source: MDIC/Secex
1/ Daily average. In 2002, 232 working days; in 2003, 231 working days.

Raw material imports x industrial production
Seasonally adjusted indices – 3 month moving average



Source: IBGE and Funcex

as evident in the fact that petroleum derivatives and flat rolled steel turned in sharp price increases.

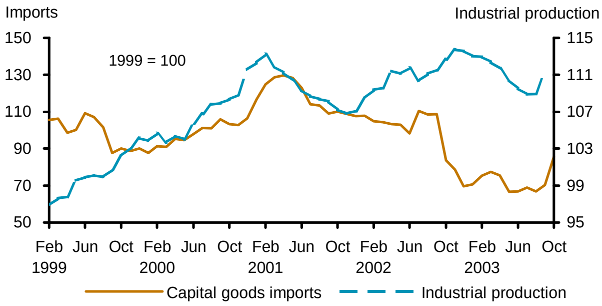
In the January to October 2003 period, daily average exports of the six major sectors, which accounted for approximately 55% of the country's overall foreign sales in the period, turned in growth of more than 20%, when viewed against the same period of 2002. Soybean-related products turned in the highest growth, with 34.6% and a total of US$7.7 billion, of which about 55% involved soybeans and 30% referred to soy meal. The major markets for the products generated by this sector were China and the EU. Exports of meats increased by 31.5% and added up to US$3.7 billion, of which 42% corresponded to chicken meat and 28% to beef. Brazilian meats are channeled to a number of different countries of destination, including nations in Europe, Asia and the Middle East. Foreign sales of petroleum and derivatives expanded by 27.2%, closing at a level of US$4.5 billion. These operations mainly involved exports of petroleum, fuel oils and gasoline. To some extent, this performance was due to an increase of approximately 16.6% in international petroleum prices, when one compares the averages in the January-November 2003 period with those of the previous year. Besides this, sharp increases occurred in exports of chemical products, with 26.5%, metallurgical products, with 25.8%, and transportation equipment, with 20%. External sales of the latter sector came to US$9.5 billion, equivalent to 14.4% of overall exports.

Imports turned in growth of 1.5% in terms of daily averages from January to November 2003, compared to the same period of 2002. This result reflected a reduction in internal absorption of imported goods, despite signs that this trend has begun gradually reversing course in recent months, together with an upturn in the pace of industrial activity. In November of this year, imports of capital goods increased by 10.9% while those involving raw materials and intermediate products rose by 19.1% when compared to the same month of 2002. Compared to the October average, however, capital goods purchases dropped by 5.5%.

Imports of raw materials and intermediate products expanded by 8.7% when January to November daily averages are calculated. It is important to note the growth that occurred in purchases of naphtha, with 20.4%, and fuels and lubricants, with 9.9%. At the same time, imports of petroleum expanded by 21%, mostly as a result of higher prices for this product.

Capital goods imports x industrial production

Seasonally adjusted indices – 3 month moving average



Source: IBGE and Funcex

Imports by end-use category – FOB

Daily average – January-November

US$ million

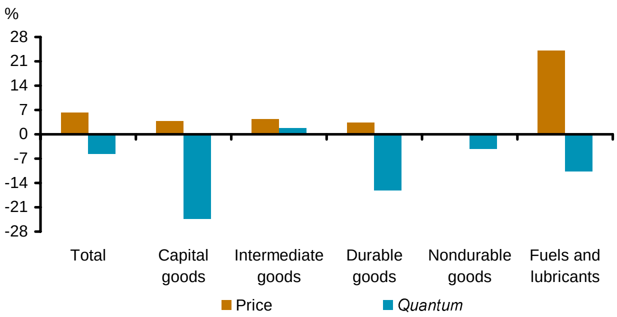
Itemization	2002	2003	% change
Total	188.8	191.6	1.5
Capital goods	47.0	40.9	- 12.9
Raw materials	93.7	101.9	8.7
Naphtha	2.5	3.0	20.4
Consumer goods	23.6	22.0	- 6.9
Durable	10.1	9.7	- 4.0
Passenger vehicles	3.0	2.4	- 20.6
Nondurable	13.5	12.3	- 9.1
Fuels	24.5	26.9	9.9
Crude oil	12.8	15.5	21.0

Source: MDIC/Secex

Note: In 2002, 232 working days; in 2003, 231 working days.

Imports – Price and volume index

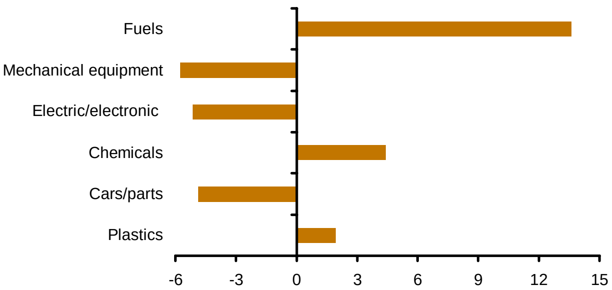
January-October 2003/2002



Source: Funcex

Imports by main sectors – January-November/2003

Percentage change over the same period of the last year[1/]



Source: MDIC/Secex

1/ Daily average. In 2002, 232 working days; in 2003, 231 working days.

Imports of consumer goods declined by 6.9%, as a result of reductions of 9.1% in the segment of nondurable goods and 4% under consumer durables, due mostly to 20.6% lesser purchases of passenger cars. Under the heading of capital goods, the segment hardest hit by the downturn in the level of industrial activity in the first half of the year, the reduction came to 12.9% in the period under consideration.

According to Funcex, all categories of imports registered lesser volume, with the exception of raw materials and intermediate goods, which closed with 1.8% growth in the January to October period, when viewed against the same period of the preceding year. The largest reduction occurred under capital goods, with 24.4%, as a result of the reduced pace of industrial activity and a falloff in investments in the first half of 2003. Insofar as prices are concerned, all categories turned in growth, with a particularly strong 24% rise under fuels and lubricants caused by increasingly higher international market petroleum prices over the course of the year.

On a sector-by-sector basis, the increases registered by the six major sectors, which accounted for about 61% of overall imports, were impacted by petroleum prices. Thus, imports of fuels and lubricants totaled US$7.1 billion, with expansion of 13.6% in the January to November 2003 daily average when compared to the 2002 result. Purchases of organic and inorganic chemical products added up to US$3.5 billion while purchases of plastics came to US$1.7 billion, for respective growth rates of 4.4% and 1.9%.

In the opposite sense, foreign purchases of mechanical equipment totaled US$7.1 billion, with a reduction of 5.8% when the daily average of the period under comparison is considered, while electric and electronic equipment came to US$6.3 billion and automotive vehicle and their parts turned in US$2.4 billion. These results were 5.1% and 4.9% below those registered in 2002, in the same order.

When compared to the same period of 2002, the US$10.7 billion increase in the trade balance in the January-November 2003 period reflected better results in trade with the major economic blocs. In this sense, the surplus in trade with the EU countries increased by US$3.1 billion, as a result of 19.4% expansion in exports and a 4.1% cutback in imports. The purchases made by these countries were concentrated principally in basic products, particularly soybeans, soy meal, iron ore, meat and coffee beans. Brazilian exports to the Netherlands and Germany, the fourth and fifth largest buyers of Brazilian goods, following the United States, China and

Exports and imports by geographic area – FOB
January-November

US$ billion

Itemization	Exports			Imports			Balance	
	2002	2003	% change	2002	2003	% change	2002	2003
Total	55.1	66.3	20.3	43.8	44.3	1.1	11.3	22.1
Laia	9.0	11.6	28.8	7.6	7.5	- 1.9	1.4	4.1
Mercosur	3.0	5.1	69.5	5.2	5.2	0.1	- 2.2	- 0.1
Argentina	2.1	4.1	94.0	4.4	4.2	- 3.1	- 2.3	- 0.2
Other	0.9	1.0	11.4	0.8	0.9	18.2	0.1	0.1
Mexico	2.1	2.5	18.5	0.5	0.5	- 8.4	1.6	2.0
Other	3.9	4.0	3.0	1.9	1.8	- 5.7	2.0	2.2
USA[1/]	14.2	15.4	8.6	9.8	8.8	- 10.0	4.4	6.6
EU	13.8	16.5	19.4	12.1	11.6	- 4.1	1.7	4.8
E. Europe[2/]	1.6	2.1	28.9	0.8	1.0	20.9	0.8	1.0
Asia	8.1	10.8	33.7	7.5	8.3	10.6	0.6	2.5
Japan	1.9	2.1	10.5	2.2	2.4	6.8	- 0.3	- 0.2
South Korea	0.8	1.1	40.0	1.0	1.0	- 3.1	- 0.2	0.1
China	2.3	4.3	81.1	1.4	2.0	37.1	0.9	2.3
Other	3.0	3.3	9.8	2.8	3.0	5.0	0.2	0.3
Sundry	8.5	10.1	18.3	5.9	7.1	19.0	2.6	3.0

Source: MDIC/Secex

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

Exports to Argentina and other countries – FOB
Monthly average January-November 2003

% change[1/]

Itemization	Argentina	Other	Total
Total	94.8	17.9	20.9
Manufactured products	102.6	14.8	20.1

Source: MDIC/Secex

1/ Over the same period of the last year.
Note: In 2002, 232 working days; in 2003, 231 working days.

Argentina, totaled US$3.9 billion and US$2.9 billion, respectively.

With regard to imports from the EU, the majority of these operations involved goods linked to the automotive industry, particularly parts, and purchases of medicines. Germany was the third largest source of Brazilian imports, surpassed only by the USA and Argentina.

Trade with the Latin American Integration Association (Laia) accounted for US$2.7 billion of the growth registered in the Brazilian trade surplus in the period, with expansion of 28.8% in Brazilian exports and a cutback of 1.9% under imports. Basically, this result was a consequence of the US$2.1 billion reduction in the trade deficit with Argentina, consequent upon a 94% increase in Brazilian sales to that country. The Argentine market absorbs mostly manufactured products from Brazil, especially those related to the automotive industry, as a result of the automotive agreement in effect between the two nations. The major products imported from Argentina in 2003 were wheat, naphtha and petroleum, aside from those involving the automotive industry.

Mention should also be made of US$438 million growth in the trade surplus with Mexico, based on a high of 18.5% in exports and a falloff of 8.4% under imports. To a great extent, this performance was due to foreign sales carried out according to the terms of the automotive agreement between the two countries. Mexico was the sixth most important destination for Brazilian exports in 2003, and was surpassed by Argentina as a result of the ongoing process of economic recovery moving forward in that country.

Trade with the USA resulted in an increase of US$2.2 billion in the Brazilian trade surplus from US$4.4 billion in the January to November 2002 period to US$6.6 billion in the same period of 2003, as a result of growth of 8.6% in exports and a reduction of 10% under imports. The total exported to the United States reached US$15.4 billion and was mostly concentrated under manufactured products, particularly aircraft, mobile phones and footwear, as well as automotive industry goods. Among the products purchased from the USA, one should highlight engines, generators and electricity transformers, aircraft engines and turbines, integrated circuits and microelectronics and medicines.

The surplus in trade with the countries of Asia came to US$2.5 billion, with growth of US$1.9 billion in the year. Of this total, China contributed US$1.4 billion, based on growth of 81.1% in exports and 37.1% under imports. With this result, the country became the second most important destination for Brazilian foreign sales, mostly involving raw materials and basic intermediate goods and semimanufactured products. Finally, 40% growth in exports to South Korea combined with a 3.1% reduction in imports deserves mention, as the Brazilian trade surplus with that country increased by US$347 million in the period.

5.2 Services and income

The nation's current accounts were highly positive in the period under analysis. In the fourth quarter up to November, the balance of trade turned in record setting surpluses, while net remittances from the services and income account declined slightly and current unrequited transfers closed with a more positive result.

Current account

US$ billion

Itemization	2002		2003		2004 1/
	Jan-Nov	Year	Jan-Nov	Year 1/	
Current account	-7.6	-7.7	3.8	3.8	-4.4
Trade balance	11.3	13.1	22.1	24.0	19.0
Exports	55.1	60.4	66.3	73.0	75.0
Imports	43.8	47.2	44.3	49.0	56.0
Services	-4.5	-5.0	-4.5	-4.9	-6.6
Transportation	-1.9	-2.0	-1.5	-1.7	-2.0
International travel	-0.4	-0.4	0.1	0.2	-0.6
Computer and information	-1.0	-1.1	-0.9	-1.0	-1.2
Operational leasing	-1.4	-1.7	-2.0	-2.2	-1.8
Other	0.3	0.2	-0.2	-0.2	-1.0
Income	-16.6	-18.2	-16.4	-18.1	-19.3
Interest	-11.9	-13.1	-11.8	-13.1	-14.0
Profits and dividends	-4.8	-5.2	-4.7	-5.0	-5.3
Compensation of employees	0.1	0.1	0.1	0.0	0.0
Current transfers	2.2	2.4	2.6	2.8	2.5

1/ Forecast.

The deficit balance in the service account in the period from January to November 2003 was slightly higher, 0.2%, than in the same period of 2002 and closed at US$4.5 billion. The most significant result in this account was registered under equipment rentals, with net expenditures of US$2 billion or 46% more than in the same period of the preceding year. This result was generated principally by 42.6% growth in remittances. Net outflows under transportation closed with a reduction of 18.7% and a total of US$1.5 billion. This performance was mostly a result of 18.9% expansion in revenues. International travel accumulated net revenues of US$145 million, compared to net outlays of US$448 million from January to November 2002.

Net income remittances in the period from January to November 2003 came to US$16.4 billion, corresponding to a reduction of 1.5% when viewed against the total registered in the same period of the previous year. Net interest outlays closed at US$11.8 billion, for a reduction of 0.8%, while remittances of profits and dividends added up to US$4.7 billion, reflecting a cutback of 3.3% in the period.

The overall trade surplus for 2003 is projected at US$24 billion, based on growth of 20.9% under foreign sales and 3.7% under imports. Net outlays on services and net income remittances are expected to close slightly below the 2002 level. With these results, it is now expected that the US$7.7 billion current account deficit will be transformed into a surplus of US$3.8 billion.

Financial account

US$ billion

Itemization	2002		2003		2004[1/]
	Jan-Nov	Year	Jan-Nov	Year[1/]	
Financial account	6.4	8.4	12.0	5.8	-0.6
Direct investments	12.7	14.1	8.5	9.3	11.5
Abroad	-2.4	-2.5	-0.2	-0.3	-1.5
In Brazil	15.1	16.6	8.7	9.6	13.0
Equity capital	15.5	17.1	7.7	8.5	12.0
Intercompany loans	-0.4	-0.5	1.1	1.1	1.0
Portfolio investments	-4.6	-5.1	4.9	5.7	-1.1
Assets	-0.3	-0.3	0.2	0.0	-0.1
Liabilities	-4.2	-4.8	4.7	5.7	-1.0
Derivatives	-0.3	-0.4	-0.2	-0.2	0.0
Other investments	-1.3	-0.2	-1.3	-8.9	-11.0
Assets	-3.0	-3.2	-5.4	-5.0	-4.2
Liabilities	1.7	3.0	4.1	-4.0	-6.8

1/ Forecast.

BP financing sources

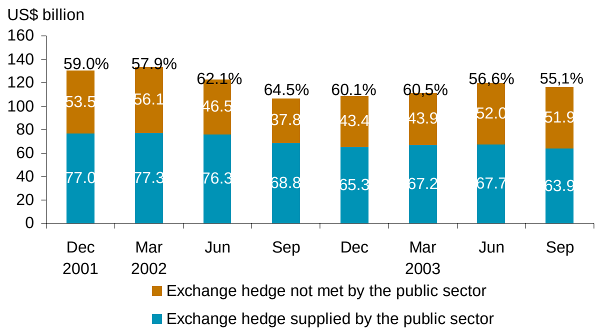
Selected items

US$ billion

Itemization	2002		2003		2004[1/]
	Jan-Nov	Year	Jan-Nov	Year[1/]	
Medium and long-term funds	8.2	8.5	11.5	12.7	22.3
Public bonds	3.9	3.9	4.5	4.5	4.0
Private debt securities[2/]	2.2	2.3	4.9	5.8	14.5
Direct loans	2.1	2.3	2.2	2.4	3.8
Short-term loans[3/]	-2.8	-3.0	-3.8	-4.0	0.4
Short-term securities	-0.7	-0.8	0.8	0.6	0.3
Roll-over rates[4/]					
Public bonds	198%	198%	93%	93%	94%
Private debt securities	35%	31%	148%	150%	100%
Direct loans	65%	64%	70%	70%	100%

1/ Forecast.
2/ Excludes bond swap in August 2003.
3/ Includes direct loans and trade credits transferred by banks.
4/ Roll-over rate equals the ratio of disbursements to amortizations, excluding amortizations of securities and loans converted into direct investment.

Public sector - supplied exchange hedge rate[1/]



1/ As of March, 2003 estimated data based on balance of payment flows.

5.3 Financial account

In accumulated terms for the year up to November, the balance of payments financial account registered net inflows of US$12 billion, including net IMF disbursements of US$11.1 billion. The constitution of assets in the form of deposits abroad resulted in net outflows of US$4.6 billion. Net foreign direct investments added up to US$8.7 billion, of which US$7.7 billion took the form of stock participation and US$1.1 billion corresponded to intercompany loans.

Foreign portfolio investments produced net inflows of US$4.9 billion, compared to net remittances of US$4.6 billion in the same period of the previous year. Stock investments increased by 78.8%, as the position of net investments in stocks traded in the country reversed course from a net outflow of US$1.4 billion from January to November 2002 to a net inflow of US$1.6 billion in the corresponding period of the subsequent year. Net inflows of medium and long-term private securities also reversed course, shifting from net amortizations of US$6.4 billion to net inflows of US$420 million in the period under analysis. This performance mirrored an increase from 35% to 148% in the rate of rolling private debt papers in the period.

The period up to November 2003 registered sharp improvement in spreads on issues of bonds of the Republic. New entries of these papers came to US$4.5 billion, excluding US$1.3 billion referring to security exchanges that occurred in August, compared to US$3.9 billion accumulated in 2002. The reduction in risk premiums generated impacts on the inflow of private medium and long-term papers, which accounted for net inflows of US$420 million, as against net remittances of US$6.4 billion in the same period of 2002. With respect to short-term papers, issues expanded sharply, as disbursements came to an accumulated total of US$3.1 billion up to November, compared to US$675 million in the corresponding period of 2002. Net inflows reached US$798 billion, compared to net outlays of US$704 million from January to November 2002.

The rate of rolling medium and long-term papers came to an accumulated level of 148% over eleven months, which was significantly higher than the 35% level registered in the corresponding period of 2002. In the case of direct loans, the rate increased slightly from 65% to 70%, using the same basis of comparison. For 2003 as a whole, it is projected that the renewal level registered up to the end of November will continue, when compared to the previous year, as the

Uses and sources

					US$ billion
Itemization	2002		2003		2004[1/]
	Jan-Nov	Year	Jan-Nov	Year[1/]	
Uses	-34.5	-38.8	-19.7	-23.5	-44.1
Current account	-7.6	-7.7	3.8	3.8	-4.4
Amortizations ML-term[2/]	-26.9	-31.1	-23.5	-27.4	-39.7
Securities	-10.5	-11.9	-9.2	-10.6	-22.2
Paid	-8.2	-9.2	-6.9	-8.2	-22.2
Nationalization debt	-0.3	-0.3	0.0	0.0	0.0
Refinanced	0.0	0.0	-1.2	-1.2	0.0
FDI conversions	-2.3	-2.8	-1.2	-1.2	0.0
Suppliers' credits	-2.3	-2.7	-1.7	-2.0	-2.7
Direct loans[3/]	-14.1	-16.6	-12.5	-14.8	-14.8
Sources	34.5	38.8	19.7	23.5	44.1
Capital account	0.4	0.4	0.4	0.5	0.5
FDI	15.1	16.6	8.7	9.6	13.0
Domestic securities[4/]	1.0	1.8	2.3	2.7	3.0
ML-term disbursements[5/]	17.0	18.6	20.3	23.3	32.5
Securities	6.1	6.2	10.7	12.8	18.8
Supliers' credits	1.2	1.3	1.0	1.2	1.4
Loans[6/]	9.6	11.1	8.6	9.2	12.4
Brazilian assets abroad	-4.9	-5.1	-4.8	-4.7	-5.2
Loans to Bacen	8.5	11.5	11.1	4.9	-4.2
Other[7/]	-3.6	-4.6	-3.8	-4.2	0.0
Reserve assets	1.1	-0.3	-14.6	-8.6	4.5

1/ Forecast.
2/ Registers amortization of medium and long term supliers' credit, loans and securities placed abroad minus refinancing and discounts. Excludes amortizations referring to loans to Banco Central and intercompany loans.
3/ Registers amortizations loans borrowed from foreign banks, buyers, agencies and multilateral organizations.
4/ Includes foreign investment in equity and debt securities traded in the domestic market.
5/ Excludes intercompany loans disbursements.
6/ Includes multilateral and bilateral financing and buyers' credits.
7/ Registers net values of bond swaps, short-term securities, short-term trade credit, financial derivatives, nonresident deposits, other liabilites and errors & omissions.

rate for private papers should come to 150% and that for direct loans to 70%.

Estimates on the need for exchange protection in the Brazilian economy dropped by US$3.9 billion in the third quarter of 2003, closing at US$115.8 billion in September 2003. Basically, this movement is explained by a reduction of approximately US$2.7 billion in the stock of short-term liabilities, including both trade credits and loans and financing.

The stock of exchange hedge supplied by the public sector accumulated a reduction of US$3.9 billion in the third quarter of 2003. With continued implementation of the policy of reducing the participation of the rate of exchange among the public debt indexing factors, the stock of these papers fell by US$7 billion, while outstanding DI x exchange swap contracts decreased by US$829 million. Exchange depreciation of 1.8% between the end of June and September also contributed to the reduction in the stock of exchange hedge supplied.

The rate of exchange protection offered maintained the downward trend that dates back to the start of 2003, reaching a level of 55.1% in the third quarter, compared to 56.6% and 60.5% in the previous quarters. Even with the lesser volume of exchange protection provided by the public sector, lesser demand for risk protection signals attenuation in the level of uncertainty surrounding changes in the rate of exchange and this is reflected in a downward trajectory in the rate of exchange hedge.

The period witnessed a strong reduction in external borrowing requirements, which moved from an accumulated total of US$34.5 billion up to November 2002 to US$19.7 billion in the corresponding period ended in November of this year. This recovery has been a consequence of the successive current account surpluses registered and of maintenance of net flows of foreign direct investments, albeit in lesser volumes than last year.

Gross international reserves increased by US$16.6 billion in the year up to November, totaling US$54.4 billion. Here, one should highlight net IMF disbursements, with net revenues of US$11.1 billion, based on inflows of US$17.6 billion and amortizations worth US$6.5 billion. Banco Central interventions in the domestic exchange market totaled net purchases of US$1.6 billion, which occurred in the period from January to May 2003 and corresponded to the repurchase of lines offered in 2002. External debt service with potential to impact the reserve position came to US$9.1

Statement of international reserves

US$ million

Itemization	2002	2003			2004
	Year	Jan-Nov	Dec	Year[1/]	Year[1/]
Reserves position in previous period	35.9	37.8	54.4	37.8	48.4
Net Banco Central interventions	-9.1	1.6	-	1.6	-
Spot and export lines	-7.3	-0.2	-	-0.2	-
Repurchase lines	-1.8	1.8	-	1.8	-
Debt servicing (net)	-7.7	-9.1	-0.7	-9.8	-11.8
Interest	-4.1	-4.8	-0.0	-4.8	-5.0
Credit	1.6	1.4	0.2	1.6	1.4
Debit	-5.7	-6.2	-0.2	-6.4	-6.3
Amortization	-3.6	-4.4	-0.6	-5.0	-6.8
Disbursements	5.3	5.4	-	5.4	6.5
Multilateral organizations	1.3	0.9	-	0.9	2.5
Sovereign bonds	3.9	4.5	-	4.5	4.0
International Monetary Fund	11.5	11.1	-6.2	4.9	-4.2
Disbursement	16.0	17.6	-	17.6	-
Amortization	-4.6	-6.5	-6.2	-12.7	-4.2
Others[2/]	1.5	2.8	-	2.8	-
Treasury's purchases	0.6	4.9	0.8	5.7	5.0
Change in assets	2.0	16.6	-6.1	10.6	-4.5
Gross reserves position	37.8	54.4	48.4	48.4	43.9
Net reserves position – Arrangement with IMF[3/]	14.2	17.2	17.3	17.3	18.6

1/ Forecast.
2/ Includes payments/receipts in the framework of the Reciprocal Credit Agreement (CCR), fluctuations in prices of securities, exchange parities and price of gold, discounts and premiums, duty fees and release of collaterals.
3/ In order to comply with the performance criterion, in the framework of the International Monetary Fund Arrangement, the calculation parameters for the net adjusted reserves - as defined in the Technical Memorandum of Understanding (TMU) of the third review of the Stand-By Arrangement - should be observed. In this case, the net adjusted reserves denominated in US$ take into account the parities set on dates established by the TMU to figure out the assets denominated in currencies unlike the US$, including the special drawing rights (SDR). The same methodology is applied in the case of the gold price. Also, pursuant the TMU, the outstanding debt with the IMF should be excluded from the reserve assets (international liquidity concept), as well as the deposits in banks domiciled abroad, though headquartered in the country, and the securities issued by residents that surpass altogether US$1,023 million.The exceeding value up to November 2003 was US$2,645 million.

billion, of which US$4.8 billion referred to interest and US$4.4 billion to amortizations. Issues of bonds of the Republic totaled US$4.5 billion, coupled with disbursements of US$902 million from international organizations, including US$900 million from the International Bank for Reconstruction and Development (IBRD). Other operations generated net revenues of US$2.8 billion. In the period, National Treasury market purchases added up to US$4.9 billion.

It is estimated that gross international reserves dropped to US$48.4 billion in December 2003, principally as a result of US$6.2 billion in amortization with the IMF in December. Using the IMF concept, net adjusted resources are expected to total US$17.3 billion, remaining US$12.3 billion above the minimum parameter agreed upon with that organization.

For 2004, a drop of US$4.5 billion in the international reserve position to US$43.9 billion is projected. This projection is based on outlays of US$11.8 billion on external debt service and amortizations of US$4.2 billion with the IMF, coupled with issues of US$4 billion in bonds of the Republic and disbursements of US$2.5 billion from international organizations, together with US$5 billion in National Treasury purchases on the exchange market. It is estimated that, based on the IMF concept, net adjusted reserves will come to US$18.6 billion in the period.

5.4 Conclusion

The positive performance of Brazilian current accounts, with an accumulated surplus of US$3.8 billion up to November, was driven mainly by large foreign trade surpluses. The strong balance of trade performance mirrored a process of foreign sales expansion, based on increasingly greater diversification of both markets and products. Imports turned in rather modest growth in the period, as a consequence of sluggish economic activity and efforts to substitute goods previously imported.

The current account surplus reduced balance of payments borrowing requirements. The falloff in net flows of foreign direct investments, which have been the major source of financing in recent years, was offset by improvement in the rates of rolling private sector funding operations, a process that has contributed to the strong adjustment in the nation's external accounts position in 2003. At the same time, it is important to recall that IMF loans have acted as a guaranty for possible liquidity crises.

Projections for 2004 indicate a moderate current account deficit, as a result of an upturn in the pace of economic activity (see box The Sustainability of Exports in 2004). In its turn, the net flow of direct investments is expected to surpass the 2003 result. Parallel to this, bond market operations will continue while the private debt will be totally rolled, notwithstanding forecasts of a higher level of amortizations. In this framework, there will be a solid base for financing the balance of payments, even though gross international reserves will undergo some degree of reduction as a consequence of amortizations of IMF loans.

The Sustainability of Exports in 2004

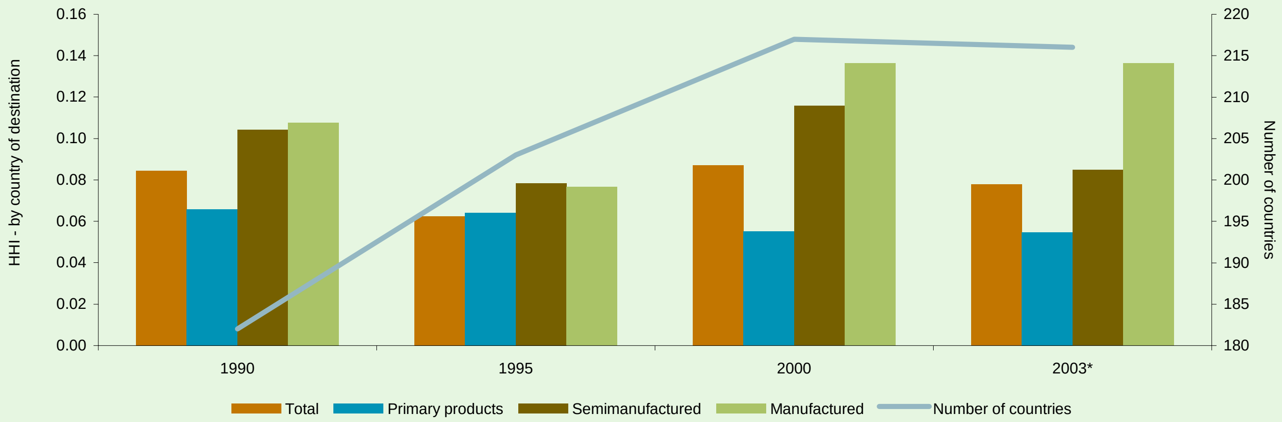
The performance of the Brazilian foreign trade sector in 2003 was marked by substantial growth in both the value and volume of exports. At this moment in which projections for the external sector in 2004 are being debated, it is important to assess whether this recent performance is not only consistent but can be projected into the future, or whether it has been no more than a reflection of specific conditions that triggered only temporary growth in foreign sales. In this context, this box summarizes the characteristics of the current Brazilian foreign sales structure, while presenting arguments that confirm that the result achieved in 2003 can be sustained into the new year.

Following is a list of the factors responsible for the structural changes that have occurred in Brazilian foreign sales and the situational aspects that should be present in 2004:

- government initiatives: government level initiatives with the potential of generating positive impacts in terms of the sustainability of Brazilian exports have concentrated on measures targeted at improving financing mechanisms, coupled with simplification of the procedures involved in foreign sales operations and reductions of taxation on these operations, as well as negotiation of trade agreements;

- diversification of both products and markets: as stated in the June 2003 Inflation Report (pg. 99 to 102), the list of Brazilian exports is less concentrated in value terms when compared to other countries. Graph 1 shows the distribution of Brazilian foreign sales by country and reveals the tendency toward distribution of the nation's sales to an increasingly larger array of nations, together with the country's concentration index. Particular mention should be made of the reduction in the level of concentration of the destinations of basic products, a process that reflects gains in the competitiveness of the crop/livestock sector and increased concentration of manufactured products after 1995. This points to the growing capacity of the nation to export goods of enhanced aggregate value to specific and generally more dynamic markets;

Graph 1 – Brazilian exports concentration index – by country of destination1/



1/ Herfindahl-Hirschmann index, varying between zero (null concentration) and one (full concentration, only one export destination country).
* In 2003, data are compiled up to the end of the third quarter.

- differentiated markets: foreign sales to such differentiated markets as the Middle East, Eastern Europe, Africa and Asia registered growth of more than 40%, compared to 2002. The expansion of these markets was reflected in growth in the percentage of countries that made purchases of more than US$1 billion from 4.6% in the period extending from 1989 to 1994, the apex of exports to Mercosul, to 5.5% in the 2000 – 2003 period;

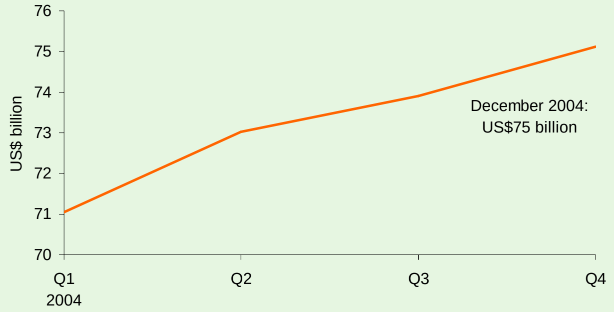
- traditional markets: exports to the United States, Argentina and China are expected to be fundamental to the performance of the Brazilian export sector, just as they were to 2003 performance. The recovery of economic activity in the United States is expected to sustain growth in sales to that market, mostly involving basic goods and semimanufactured products. Bilateral trade with China, marked by 81.1% growth in Brazilian exports up to November, when compared to 2002, will continue as an essential element to maintaining the current level of foreign trade operations. It is particularly important to stress the importance of that country to sustaining commodity prices. With regard to sales of manufactured goods, these operations have benefited from the process of recovery in the Argentine economy, which is expected to continue through 2004. The participation of Argentina in total Brazilian foreign sales increased over the course of 2003, coming to a November level of 7.8%, as compared to an average of 6.2% for the year. From 1995 to 2000, this participation stood at an average of 11.4%;

- sectoral aspects: positive prospects exist for exports of basic products in 2004, particularly those included among soybean based goods. The fact is that IBGE has forecast growth of 6% in the area planted in this crop and the Brazilian Association of Vegetable Oil Industries (Abiove) has forecast growth of US$2.4 billion (28.5%) in the external revenues earned on all soybean-related products. These forecasts indicate a revenue increase in the sector, despite the downward trajectory projected for future prices as of the second quarter of 2004. Foreign sales of such other important products as wood, furniture industry goods, paper and pulp, leather and footwear, metallurgy of nonferrous metals, transportation equipment, machinery and equipment and electronics, are expected to expand in a scenario of continued real exchange rates and already projected growth in the major world economies. Among the localized risks for export operations, mention should be made of the sectors of meat, which is subject to restrictions in Russia, and petroleum, as a result of price reductions and increased supplies from Iraq and Russia.

When this scenario for 2004 is taken into account, with a constant rate of exchange at R$2.95/US$1, growth of 3% in the Argentine and United States economies and export prices at the level of the third quarter of 2003, foreign sales would reach a level of US$75 billion, thus validating the balance of payments projection presented in this Inflation Report.

However, presuming that the prices of basic products follow the trajectory forecast by the futures commodity market at the end of November of the

Graph 2 – Estimated exports
Accumulated in 12 months
Scenario of constant primary good prices



current year, the expected value for the price index of these goods would register accumulated growth of 3.7% in 2004. In this case, and presuming that the other hypotheses are maintained, exports would come to US$76.6 billion, impacted by expected 8% growth in iron ore prices.

With respect to the sensitivity of exports to greater international economic growth, two additional scenarios were elaborated. The first is based on OECD forecasts of 4.2% growth for the United States, 4.3% for Argentina and 3% for the other OECD countries, while the second uses IMF forecasts of 3.9% expansion for the United States, 4% for Argentina and 4% for the international economy. In both cases, the level of basic product prices in effect in the third quarter of 2003 was maintained constant. In the first scenario, exports for 2004 are projected at US$78 billion and in the second, at US$77 billion, indicating a significant response on the part of exports to the demand incentives of the rest of the world.

Therefore, growth in Brazilian foreign sales is expected to maintain the significant diversification that has characterized not only the array of products but also the many destinations to which these goods are shipped, together with continuation of the pace of economic recovery in the major buyer markets. With this, possible losses as a result of changes in the prices of specific products should be offset by growth in volume. Simulations indicated that the amount presented as a projection for 2004 exports is most probably a conservative figure. Thus, it can be concluded that exports will not be an obstacle to the continued adjustment of current transactions in 2004.

6 Inflation outlook

This chapter of the *Inflation Report* presents the Copom assessment of Brazilian economic performance since the *Report* of September 2003, as well as projections for the inflation up to the end of 2005 and for GDP growth up to the end of 2004. The projections will be presented in two scenarios.

In the first one, which is referred to as the benchmark scenario, it is assumed that the Over-Selic interest rate will remain unchanged at 16.5% p.y., which is the rate set by the Copom at its last meeting, held on December 16-17, and that the exchange rate will remain close to the one registered on the eve of the meeting (R$2.94 = US$1). This benchmark scenario is therefore equivalent to the baseline scenario presented in previous *Reports*. The name of this scenario was changed for the purpose of more explicitly indicating that inflation forecasts associated with constant interest rate and exchange rate paths serve only as a reference for other scenarios assessed by the Copom.

The second scenario, which is referred to as the market scenario, includes the paths for the exchange rate and the Selic rate expected by market participants on December 12, according to the results of a survey carried out by the Gerin. It is important to note that these procedures are strictly technical. Therefore, the underlying assumptions mentioned above should not be taken as Copom forecasts of interest rates or exchange rates.

The inflation and GDP growth forecasts presented in this *Report* are not meant to be restricted to point estimates. They are projected within probability intervals, reflecting the degree of uncertainty when setting the basic interest rate. Inflation forecasts are based not only on interest rate assumptions, but also on assumptions concerning the behavior of relevant exogenous variables. By expounding these underlying assumptions in this *Report*, the Copom seeks to lend greater transparency to decisions related to the monetary policy, thereby contributing to enhance its effectiveness in controlling the inflation, which is its main objective.

6.1 Determinants of inflation

The economic indicators released since September confirm the trends observed since the second quarter of this year of a convergence between the inflation rate and the path of the targets and of a renewed confidence of economic agents in relation to the prospects of the economy. A set of factors reinforces the confidence that the inflation rate will remain at stable and relatively low levels over the next few years. The fact that various sectors of the economy are still operating with idle capacity suggests that the economic activity may be resumed without any significant inflationary pressures. The inflation expectations continue in a downward path, getting close to the targets set for 2004 and 2005. Finally, the exchange rate is relatively stable and is not expected to pressure the inflation significantly.

The behavior of the inflation was rather heterogeneous through 2003. Particularly because of the inertial effects of the 6.6% inflation rate registered in the last quarter of 2002, the inflation continued high early in 2003, and although the monthly results indicated a downward trend, the speed of convergence of inflation expectations was still slow (see box *Behavior of Central Bank and Market Inflation Forecasts*). Since May, as a result of a favorable external scenario and of a clearer perception by economic agents that the monetary policy would remain consistent with the inflation targeting regime and that the austerity of the fiscal policy would be maintained, inflation expectations began to fall and to converge toward the path of the targets. The improvement in the expectations, the low volatility of the exchange rate, and the positive results observed in the inflation rate allowed for the flexibilization of the monetary policy since the meeting of the Copom in June. The end of the period of turbulence and high uncertainties led to a rather positive economic scenario marked by expectations of higher economic growth and fulfillment of the inflation targets.

Economic activity began to recover as early as in the third quarter of 2003, as outlined in the last *Report*. A more flexible monetary policy, lower inflation rates, and the renewed confidence of private agents contributed toward the resumption of economic growth, which has been, marginally, a little faster than originally expected. However, this growth is still moderate due to the loss of real income caused by the higher inflation in the second semester of last year and by the lagged effects of higher interest rates in the first semester of the year.

After two successive drops, the quarterly GDP grew 0.4% in the third quarter of 2003 as compared to the preceding quarter (seasonally adjusted). The industrial sector played a major role in that growth, as it has been recovering since July and grew 2.7% in the third quarter. According to the monthly industrial survey carried out by the IBGE, the growth rates registered in July, August, September, and October were 1.0%, 1.9%, 4.1% and -0.5% respectively in relation to the preceding month, which was used as a comparison basis. The Copom believes that the small drop observed in October does not mean that the growth resumption process was interrupted. First, as mentioned in the Minutes of the Copom meeting in November, the industrial production in September partly benefited from the fact that the national holiday of September 7 was a Sunday. Moreover, the seasonally adjusted results show that the production in 17 of the 20 surveyed sectors grew in October. The quarterly moving average of the series continues to indicate that the economy is growing. The trend of recovery of the industrial activity is also corroborated by other economic activity indicators, such as the Economic Activity Level Indicator (INA) calculated by Fiesp and CNI indicators related to the use of the installed capacity and to real industrial sales. The retail sector has been recovering more slowly.

The recovery that has begun is not expected to bring about inflationary pressures posing significant threats to the targets. The conditions in terms of the aggregate supply are favorable. Monetary policy easing has been cautious, so as to ensure that the higher demand will be consistent with a higher productive capacity in the long run. Although the idle capacity in some recovery-leading sectors has already dropped, the average level of use of the installed capacity in the transformation industry is ranging between 80% and 82%, according to Fiesp, CNI, and FGV indicators. The labor market is still stalled, as one would expect in the initial stages of resumption of the economic activity. Despite an increase in the number of employed individuals, a larger economically active population has prevented the unemployment rate from falling and this fact has been keeping wage costs at moderate levels. As the economy continues to grow, real wages will be recovered. However, in the foreseen scenario of balanced growth, this increase in real wages should mainly reflect productivity gains without significant pressures on corporate costs, allowing for the real income to be gradually recovered and, consequently, for consumption to be stimulated.

Investments are also showing signs of recovery, allowing for the productive capacity to be expanded, a necessary condition for the production to grow in the medium term. After two consecutive drops, the gross formation of fixed capital grew in the third quarter of 2003. The domestic absorption of capital goods grew significantly in October, namely, 22%. The gross capital formation, which is still at historically low levels, is thus showing important signs of recovery, confirming the trends detected in the data for the third quarter.

Regarding the supply of agricultural products, a new record grain harvest is expected, obviously depending on weather conditions in 2004.

In terms of demand components, domestic demand is expected to play a relatively more important role in fostering economic growth than external demand. Besides having a higher weight in the composition of the total aggregate demand, the domestic demand has a higher potential to grow after being negatively affected by the crisis and stabilization efforts. In this period of economic recovery, demand and production movements tend to reinforce each other. Higher output leads to higher real payroll by increasing the number of worked hours initially, then the number of jobs, and later on the wages. The higher real payroll stimulates consumption and the perspective of higher output in the future stimulates investments.

The availability of bank credit is another important element for consumption to be resumed. The total credit outstanding in the economy is still low, but it has been recovering gradually. Total non- earmarked credit of the financial system grew about 4% between August and November. In 2004, a greater availability of credit is expected as a result of the economic recovery, of the lagged impacts of recent reductions in banking spreads and in the Over-Selic rate, and of the possibility of bank loans being automatically deducted from paychecks.

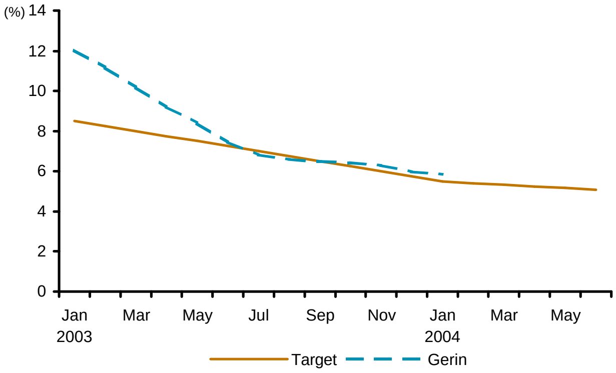
A component of the aggregate demand that, in relation to others, will play a less important direct role in fostering economic growth next year is the absorption of goods and services by the government, which will continue to be limited by the target of 4.25% set for the consolidated public sector primary surplus. Indirectly, however, a responsible fiscal behavior is a necessary condition for consolidating a stable macroeconomic scenario with sustained economic growth. Moreover, recovering the appropriate tax revenue levels will allow a higher level of spending compatible with the primary surplus target.

Concerning the external demand, the marginal contribution of net exports to economic growth shall reduce due to the significant rise of those exports in 2003. The trade account result in 2003 shall be a US$24 billion surplus, and a result of US$19 billion is projected for 2004.

As a result of the economic growth, imports are expected to rise. However, the final impact on the trade balance will be partly compensated by the boost experienced by Brazilian exports as a result of the synchronized recovery of the main economies in the world – the United States, the European Union and Japan. In addition, higher surpluses are expected in other accounts of the balance of payments in 2004, such as in direct foreign investments, as a result of more auspicious prospects for the Brazilian economy and of more favorable international liquidity conditions. The drop in the so-called country risk – the Emerging Market Bond Index Plus (Embi+) of the JP Morgan Chase dropped to 480 basis points in December, the lowest figure registered since the inflation targeting regime was adopted – indicates that private and sovereign bonds can now be more easily issued in the international market. Although it always adopts a cautious posture in relation to the international scenario, the Copom believes that the risk that these favorable conditions will not be materialized is low. In particular, the strong growth of the US economy in the third quarter of this year can be explained by its poor performance in previous quarters and by productivity gains, which means that it will not be accompanied by significant inflationary pressures in the short run. For this reason, the Copom assigned low probabilities to sharp movements in US interest rates over the next quarters that could seriously jeopardize the present favorable environment in terms of international liquidity. In sum, the domestic and international conditions indicate that the exchange rate will remain relatively stable and will not bring about significant pressures on the inflation rate.

The core inflation measures have followed the downward path of the inflation rate and have stabilized at about the same level as that of the headline inflation. The core inflation calculated with the exclusion of regulated prices and of food at household prices has been quite stable, with a monthly average of 0.37–0.38% between July and November, while the headline inflation had a monthly average of 0.39%. The core inflation calculated by the symmetric trimmed mean method with smoothing has been higher. According to this methodology, however, the price adjustment of some items, because they are concentrated in a few periods of the year, are smoothed over time in order not to be systematically excluded from the core inflation. When shocks concentrated in a period of the recent past occur, the core inflation tends to be contaminated by this past pressure and to show some resistance to drop. If the core inflation is estimated by the trimmed mean methodology without smoothing, a drop is also observed. Between July and November 2003, this core inflation had the same monthly average as that of the headline inflation (0.39%).

Twelve-month ahead inflation



The inflation expectations continue in a downward path, converging to the targets for 2004 and 2005. This convergence reflects the credibility of the economic policy and the fact that the economic crisis experienced recently has been overcome. Between the Copom meetings in September and December, the median of market expectations for 2004 collected by the Gerin dropped from 6.2% to 6.0%, a rate close to the target of 5.5%. Considering the twelve-month ahead inflation expectations, the figure dropped from 6.5% to 5.9%. The graph at left presents the evolution of the market inflation expectations and the path of the targets set for the twelve-month ahead inflation, showing that the convergence of expectations to the targets was consolidated in the last quarter.

The results achieved confirm that monetary policy has managed to curb the crisis drawn late in 2002, preventing an uncontrolled inflation process and allowing for the inflation rate to stabilize at relatively low levels. The fact that there is idle capacity in the economy, that the external environment is favorable and that expectations are under control suggests a scenario of inflation within the targets and of resuming economic activity on a sustained basis.

6.2 Main scenario: assumptions and associated risks

The Copom forecasts are based on a set of assumptions about the behavior of key economic variables, as well as their associated risks. This set of assumptions and the risks associated to it is part of the main scenario under which the Copom makes monetary policy decisions.

During the first semester of 2003, the Copom observed that a steady increase in the degree of inflationary persistence was one of the main factors that could prevent or delay the convergence of the inflation to the path of the targets. In the *Report* of September, the Copom indicated that this risk had been practically eliminated. This perception was confirmed by the positive results achieved with regard to the inflation rate, by the low volatility of the exchange rate, and by the continued convergence of the inflation expectations to the path of the targets since September.

As mentioned in the previous section, the scenario that can be predicted at the end of 2003 is quite favorable, as it is marked by positive prospects for the country to resume its economic growth and meet its inflation targets. The main risks perceived by the Copom for this scenario not to materialize stem from uncertainties related to the transmission mechanism, to the behavior of the foreign trade sector, to the availability of sufficient idle capacity to allow for production to be stepped up without generating inflationary pressures, and to the behavior of regulated prices. As discussed below, the Copom believes that it is not very likely that any of these risks will prevent the materialization of the favorable scenario with which it is working.

The uncertainties associated with the transmission mechanism of the monetary policy have become one of the main risk factors since the third quarter of this year. As mentioned in Copom's *Inflation Report* of September and in the Minutes of more recent meetings, uncertainties are inherent in any econometric model. Besides, the recent period of macroeconomic instability makes it even more difficult for projection exercises. Finally, since the Copom meeting of September, the target for the Over-Selic rate dropped by 350 percentage points, reducing the gap between the current basic interest rate and the rates that will prevail in a medium run equilibrium. As a result, the uncertainties associated with the gaps and magnitude of the monetary policy transmission mechanism become even more important than they were three months ago, when the *Report* of September was issued. Considering these uncertainties, to preserve the accomplishment in the inflation struggle and in the economic recovery requires a careful assessment in additional flexibilization of the monetary policy.

So far, the industrial activity, which in part has been already reflecting the impacts of the monetary policy flexibilization initiated in June, is being recovered at a moderate pace and spreading generally across different industrial sectors. Consumption, in turn, has been responding more slowly. Considering the usual gaps, only in the next few months will the Copom be able to evaluate more precisely the impacts of the recent reductions in the Over-Selic interest rate on the level of economic activity and of the level of economic activity on the inflation. It should be highlighted that as economic agents act in anticipation of certain events and because the recent reductions in interest rates were relatively well anticipated by the market, the moderate growth observed in the economic activity today shows that the monetary policy is being made more flexible at an appropriate pace.

The more negative the output gap in 2004 is, the lower the impact of the economic growth projected for that year will be on the inflation. The output gap is the difference between the actual output and the potential output of the economy, defined as the output level that does not generate inflationary pressures. When the output gap is negative, economic growth can be fostered by using the idle capacity, without pressuring prices. However, the output gap is a non-observed variable, which therefore must be estimated. According to the available evidence (see box *Methodologies for Estimating the Potential Output*), the output gap is negative right now, although uncertainties prevail in relation to its level. As discussed in greater detail below, the Copom believes that the best estimate for the output gap available today is the one obtained by calculating a production function. According to this output gap measurement, the current figures are sufficiently negative for the economic activity to be resumed in 2004 without jeopardizing the inflation targets. However, it is important to follow the evolution of investments to make sure that a higher aggregate demand will remain consistent with a higher aggregate supply. In this context, the recovery of investments registered in September and October, as suggested by a higher domestic absorption of capital goods and a higher production of construction inputs, reinforces the predictions of a favorable scenario of balanced growth between the aggregate supply and the aggregate demand in the medium term.

The foreign scenario is quite favorable for the Brazilian economy. The synchronous growth of the main economies in the world will lead to a higher demand for our exports, which will, at least partially, offset the expected rise in imports as our economy recovers. Other important accounts of the balance of payments, such as direct foreign investments and loans, will tend to present higher surpluses in 2004 as a result of the better prospects facing the Brazilian economy, of further drops in the so-called Brazil risk, and of positive international liquidity conditions. As discussed in the previous section, the Copom believes that the likelihood that this favorable scenario will not materialize is low. In particular, the recovery of the US economy has not been accompanied by inflationary pressures so far, so the Copom believes that the probability that US interest rates will rise over the next quarters to the point of significantly affecting the current favorable environment of international liquidity is low.

As an emerging economy, Brazil is not immune to crises affecting other emerging countries. The emerging economies are expected to have a positive performance in 2004, but if any country faces a crisis, the Copom believes that Brazil is duly prepared to deal with any temporary reversion in capital inflows as a result of the significant improvements registered in its macroeconomic framework and of its recent agreement with the IMF.

The Copom also believes that any changes in relative prices in the next few months will not bring about significant inflationary pressures. These changes could have two important sources. The first one would be the recovery of profit margins. The slowdown experienced in the economic activity in the first semester of this year affected different sectors in different ways. As the economy recovers, some of the more severely affected sectors may try to recover their profit margins through price hikes. Such movements, therefore, tend to be restricted to certain sectors and are not expected to pressure all prices up. The new regime adopted for the Cofins tax may lead to another important change in relative prices. Once again, because the total revenue from this tax will not increase but will rather be redistributed among its different paying sources, the Copom believes that any price adjustments derived from the new regime will not prevent the targets from being achieved.

The behavior of regulated prices is another source of inflationary pressure that the Copom should permanently follow. The projected inflation for regulated prices in 2004 associated with the benchmark scenario is 7.8%. In the market scenario, the inflation of regulated prices projected for 2004 rises to 9.1%. This higher projection takes into account the impact of the exchange rate depreciation anticipated by the market through 2004 on items that are more sensitive to the exchange rate variation, such as oil by-products and electricity and telephone rates.

As compared to the *Report* of September, the inflation of regulated prices projected for 2004 associated with the benchmark scenario dropped by 0.5 p.p. These figures, however, are not directly comparable, since there were changes in the methodology adopted to calculate them over the period. In September, a model for forecasting regulated prices was used, according to which the projected inflation of regulated prices was a function of the inflation of market prices, of the General Price Index (IGP), of the exchange rate variation, and of seasonal components (see box *Model for Forecasting Regulated Prices*). Since the Copom meeting in October, the inflation projected for regulated prices in 2004 has been based on specific projections for each item. This procedure is more appropriate for short run forecast, since more precise information can be obtained about price adjustments of specific items for that year, particularly for those whose price adjustments are decided upon at state and municipal level. For 2005, the model for forecasting the regulated prices continued to be used, based on which an inflation rate of 5.5% for regulated prices has been projected.

Amongst regulated items, the risks associated with projected adjustments in the prices of gasoline and fixed telephone lines should be highlighted. The benchmark scenario assumes that gasoline prices will be adjusted by 9.5%. As usual, this projection takes into account the path of prices in futures markets and corrections in the differential between the domestic prices charged at the refineries and the international prices converted into reais. In addition, an increase in the Cide was also assumed, so that the revenue of the federal administration derived from this contribution will not decrease after the tax reform is promulgated.

Regarding the rates for fixed telephone lines, it was assumed that the court decisions taken so far, which limit adjustments in these rates in 2003 to a percentage below the one authorized by Anatel, will not be overruled. Based on this underlying assumption, the price adjustment projected for the rates of fixed telephone lines in 2004 is 6.6%.

Beginning with this *Report*, the projections made by the Copom began to use the output gap calculated according to an estimate developed for the production function. The box *Methodologies for Estimating the Potential Output* explains how this output gap is estimated. Conceptually, the potential output estimated from the production function has the advantage of directly incorporating the impact of investments and of labor force growth on the economy's productive capacity. This is particularly relevant when one considers drops in investments as a proportion of GDP registered in recent years. Besides, the models estimated according to the output gap obtained from the production function showed a greater predictive power within the sample period than the models that used the output gap measured from a linear trend or from the Hodrick-Prescott filter.

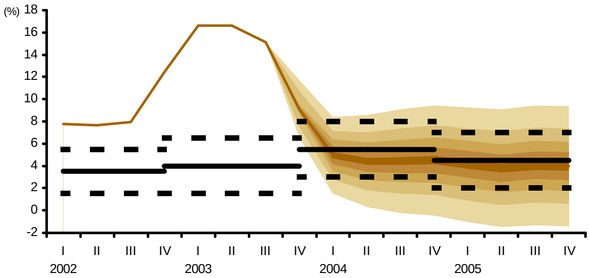
As in the baseline scenario of previous *Reports*, for the benchmark scenario the Copom maintained the underlying assumption of a constant exchange rate over the forecast horizon at a level close to the one observed on the eve of its December meeting (R$2.94 = US$1). In the market scenario, the exchange rate for the US dollar begins at R$2.93 on average in the fourth quarter of 2003 and rises to R$3.21 and R$3.43 in the last quarter of 2004 and 2005, respectively.

Regarding the interest rate, the benchmark scenario assumes that the target set for the Selic rate will remain constant at 16.5% over the forecast horizon. The market scenario, in turn, assumes that the Selic rate will hit the mark of 14.1% and 13.8% in the last quarter of 2004 and 2005, respectively. In tune with the paths of the Over-Selic interest rate mentioned here, the benchmark scenario assumes that the six-month pre-DI swap rate will be 17.7% and 18.0% in the last quarter of 2004 and 2005, respectively. The corresponding figures in the market scenario are 15.3% and 14.4%.

In the case of agricultural/livestock products, the underlying assumption made in the last *Reports* was maintained, namely, that their prices will evolve according to the inflation of market prices up to the end of 2004.

Regarding the fiscal policy, the underlying assumption is that the target of 4.25% of GDP set for the primary surplus of the consolidated public sector in 2003 and in the next two years will be achieved.

Forecasted IPCA-inflation with interest rate constant at 16.5% p.y. (Benchmark scenario)
Inflation fan chart



Note: Accumulated inflation in 12 months (% p.y.)

IPCA-inflation with interest rate constant at 16.5% p.y.
(Benchmark scenario)

Year	Q	Confidence interval 50%	30%	10%		30%	50%	Central projection
2003	4	8,7	8,9	9,0	9,2	9,3	9,5	9,1
2004	1	3,5	4,1	4,7	5,2	5,8	6,4	5,0
2004	2	2,7	3,5	4,1	4,7	5,4	6,1	4,4
2004	3	2,5	3,3	4,1	4,8	5,5	6,3	4,4
2004	4	2,5	3,4	4,1	4,9	5,7	6,5	4,5
2005	1	2,0	2,9	3,7	4,5	5,3	6,3	4,1
2005	2	1,6	2,6	3,4	4,2	5,0	6,0	3,8
2005	3	1,9	2,8	3,7	4,5	5,3	6,3	4,1
2005	4	1,8	2,7	3,6	4,4	5,2	6,2	4,0

Note: Accumulated inflation in 12 months (% p.y.)

6.3 Inflation forecast

Based on the assumptions and associated risks considered by the Copom and using the set of information available, the IPCA in twelve months was projected using the underlying assumptions of the benchmark scenario and of the market scenario. In the benchmark scenario, the underlying assumption is that interest rates will remain at 16.5% a year, as defined at the Copom meeting held on 16–17 December 2003, and that the exchange rate will remain constant at a level close to the one observed on the eve of the Copom meeting (R$2.94). In the market scenario, the Over-Selic interest rate of the economy drops to 14.1% p.y. in the last quarter of 2004 and to 13.8% p.y. in the last quarter of 2005, and the exchange rate rises to R$3.21 and R$3.43 in the last quarter of 2004 and 2005, respectively.

The central path associated with the benchmark scenario drops strongly in the first quarter of 2004, when the abnormally high inflation of 5.1% registered in the first quarter of 2003 is replaced by an inflation rate of 1.1%, lower than the path of the targets. Between the first and the second quarter, the inflation is expected to drop by more than 0.5 p.p. particularly because of seasonal factors associated with the beginning of the agricultural harvest. Based on the assumptions of constant exchange and basic interest rates and weak inertia after the second quarter of

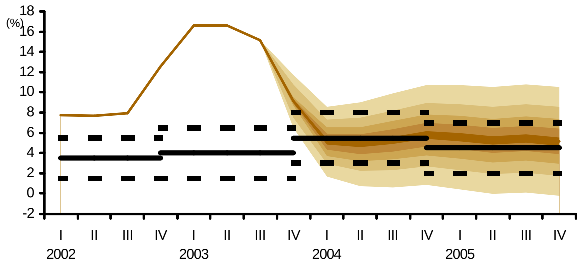
2004, significant inflationary pressures will have been eliminated and the inflation will stabilize at a level of about 4.5%, below the 5.5% target for the period. During 2005, the inflation will float according to seasonal factors, particularly the beginning of the agricultural harvest in the second quarter, pressuring the inflation down, and the concentration of price adjustments for regulated prices in the third quarter, pressuring the inflation up. However, the inflation will tend to drop due to the effects of interest rates being kept at high levels. The inflation associated with the benchmark scenario projected for 2005 is 4.0%, lower than the target of 4.5% set for the year.

Because the market scenario considers a drop in interest rates and an exchange rate depreciation over the forecast horizon, it projects higher inflation rates than the benchmark scenario, namely, 5.8% and 5.1% in 2004 and 2005, respectively. Similarly to what is projected in the benchmark scenario, the inflation in twelve months drops sharply, by about 4 p.p., in the first quarter of 2004. This drop will occur for the same reason mentioned above, namely, the substitution of the high inflation observed in the first quarter of 2003 by a lower inflation rate, 1.3%, in the first quarter of 2004. After the second quarter, the behavior of the inflation will be qualitatively different than the one projected in the benchmark scenario. In the second quarter, the inflation will drop again, particularly because of seasonal factors. After the second quarter, however, the inflation will tend to rise as a result of the exchange rate depreciation and of hikes in regulated prices particularly. As discussed in section 6.2, the market scenario assumes that the inflation of regulated prices in 2004 will hit the mark of 9.1%, against 7.8% in the benchmark scenario. In the second semester of the year, the projected adjustment in regulated prices in the market scenario is 4.8%, about 1 p.p. higher than the projections for the same period in the benchmark scenario. After the inflation peak projected for the end of 2004, apart from seasonal fluctuations, the inflation is expected to resume its downward path during 2005 as a result of a lower exchange rate depreciation and of a slower drop in interest rates as of the third quarter of 2004.

A comparison between the paths presented in this *Report* and those announced in the *Report* of September, which are reproduced in the table, shows that the most pronounced changes occurred in the benchmark scenario. However, the qualitative behavior is similar. In September, what was then described as the baseline scenario projected a strong drop in the inflation rate between the fourth quarter of 2003 and the first quarter of 2004 and a relative stability after the

Forecasted IPCA-inflation with market expected interest and exchange rates

Inflation fan chart



Note: Accumulated inflation in 12 months (% p.y.)

IPCA-inflation with market expected interest and exchange rates[1]

Year	Q	Confidence intervals 50%	30%	10%				Central projection
2003	4	8,7	8,9	9,0	9,2	9,3	9,5	9,1
2004	1	3,7	4,3	4,8	5,4	5,9	6,5	5,1
2004	2	3,2	3,9	4,6	5,2	5,8	6,6	4,9
2004	3	3,3	4,2	4,9	5,6	6,3	7,2	5,3
2004	4	3,8	4,6	5,4	6,2	7,0	7,8	5,8
2005	1	3,5	4,4	5,2	6,0	6,8	7,7	5,6
2005	2	3,1	4,0	4,8	5,6	6,5	7,4	5,2
2005	3	3,2	4,2	5,0	5,8	6,7	7,6	5,4
2005	4	2,9	3,9	4,7	5,6	6,4	7,4	5,1

Note: Accumulated inflation in 12 months (% p.y)
1. According to Gerin

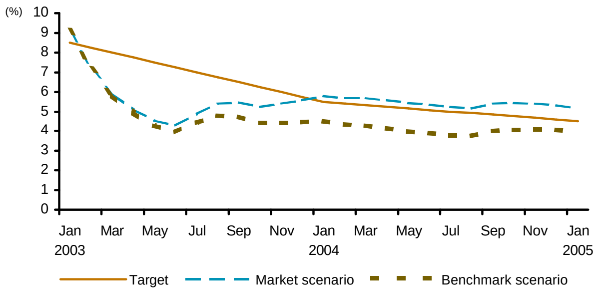
September 2003 *Inflation Report* forecasts

Period	Benchmark scenario	Market scenario
2003 IV	8,9	9,2
2004 I	4,5	5,1
2004 II	3,7	4,7
2004 III	3,8	5,4
2004 IV	3,9	5,8

second quarter. The inflation projected for 2004, however, was 0.6 p.p. below the one projected in this *Report*. The projected inflation rose because of the higher projection for the inflation of market prices in 2004: 3.2% against 2.2% projected in September. This increase was caused by a reduction in interest rates over the period and, particularly, by the fact that the projections began to use a different measurement of the output gap, which was calculated from the production function. The projections for regulated prices, in turn, dropped from 8.3% to 7.8% since September.

The 2004 inflation path projected in this *Report* according to the market scenario is practically the same as the one described in September. This means that the factors that would push the inflation up and down in the comparison between the two projections offset each other. Among other factors that would tend to lead to a higher inflation forecast, special mention should be made of the lower forecast interest rates and of the use of the output gap calculated from a production function. The recent figures show that the output gap is less negative using the production function than if the Copom continued to use the output gap calculated from the extraction of a linear trend. As factors contributing toward a lower inflation in 2004, the lower projection for the inflation of regulated prices, which dropped from 10.5% to 9.1%, and the improved market expectations, which fell from 6.2% to 6.0%, stand out.

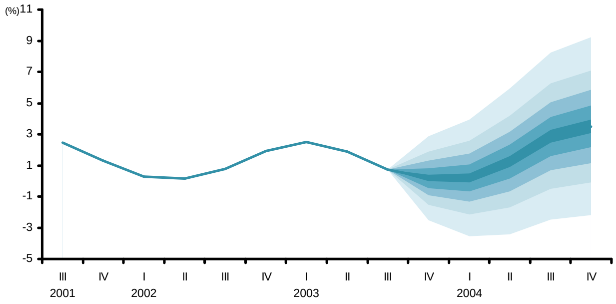
Twelve-month ahead inflation



The graph at left shows the evolution of the twelve-month ahead inflation according to the benchmark scenario and to the market scenario of this *Report*, as well as the interpolated path of the targets set for 2003 and 2004. These paths are defined by the inflation up to November 2003 accumulated with the inflation rates projected for after that month. As discussed in the *Report* of September, the twelve-month ahead inflation in January 2003, that is, the inflation projected between January and December of this year, is above the adjusted target of 8.5%. However, as of February, the projection based on the benchmark scenario is permanently below the path of the targets. The projections based on the market scenario, in turn, show that the twelve-month ahead inflation will be higher than the path of the targets after January 2004. As in the benchmark scenario, the projections based on the market scenario suggest that the inflation will tend to fall (except for seasonal factors), but this drop will occur at a lower speed than that of the reduction of the targets. However, because it considers a drop in interest rates and an exchange rate depreciation over the forecast horizon, the market scenario projects inflation rates higher than those of the benchmark scenario, namely, 5.8% in 2004 and 5.1% in 2005, both of which are still higher than the targets.

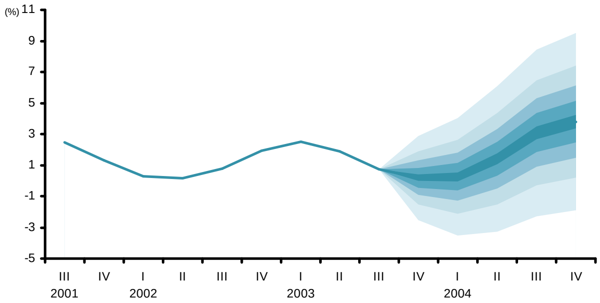
GDP growth with interest rate constant at 16.5% p.y. (Benchmark scenario)

Output fan chart



GDP growth with market expected interest and exchange rates

Output fan chart



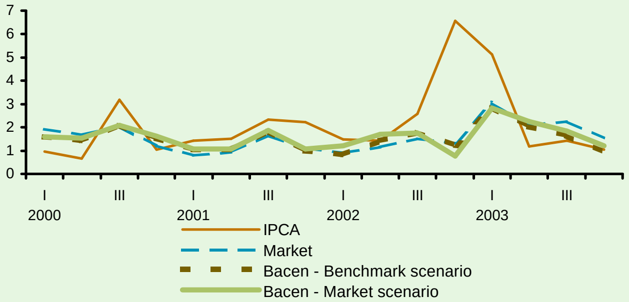
Fan charts are also presented for the output growth projected according to the underlying assumptions of the reference and market scenarios. It is worth emphasizing that the forecasting errors associated with GDP growth projections are considerably higher than in inflation forecasts because in the models used by the Copom they involve the paths of two non-observable components, namely, potential output and output gap, and the calculation of the output is more complex and less precise than that of the inflation. According to the benchmark scenario, which assumes that interest rates will remain at a level of 16.5% up to the end of 2005, the expected growth for 2003 and 2004 would be 0.3% and 3.5%, respectively. The lower projections for GDP growth in 2003 in relation to the 0.6% rate projected in September are largely based on the incorporation of the results published by the IBGE for GDP growth up to the third quarter, which included methodological changes and data revisions related to 2002 and to the first semester of 2003 (see the box *Estimates for GDP Evolution*). Despite the weak performance registered in 2003, it should be mentioned that the economy has been recovering marginally and that GDP is projected to grow by 2.0% in the fourth quarter in relation to the same period in the previous year. The output fan chart containing the projections based on the market scenario points to a GDP growth of 3.8% in 2004. This higher projection in relation to the benchmark scenario reflects the impact of lower interest rates on the level of economic activity.

Behavior of Central Bank and Market Inflation Forecasts

The objective of this box is to compare the behavior of market inflation expectations with the Central Bank's projections published every quarter in the *Inflation Reports*. In particular, it will be shown that both projections are not sufficiently precise to fully capture the rapid acceleration and deceleration movements observed in the inflation rate between the last quarter of 2002 and the second quarter of 2003. The median of market expectations surveyed by the Gerin provided a better prediction of the inflation upward movement in the last quarter of 2002 than the Central Bank's projections, but it was slower to capture the drop in the inflation rate registered after the second quarter of 2003. When projections made since the last quarter of 1999 are reviewed, one sees that the projections of the Central Bank were more accurate than the median of market expectations.

Actual and forecasted one-quarter ahead inflation

Quarterly % variation



Note: The value for the last quarter of 2003 was obtained assuming an inflation rate of 0.4% for December.

The graph at left shows the actual inflation registered in quarter t and the market and Central Bank projections made in the previous quarter (t-1) for quarter t. For market expectations, the median of the last working day before the beginning of each quarter was considered to make the sampling periods consistent with each other. They are compared to the Central Bank's projections made in the *Inflation Reports* with constant interest rate and exchange rate over the forecast horizon (the benchmark scenario) and with the Central Bank's projections with market interest rate and exchange rate paths (the market scenario).

Some important observations can be derived from this graph. First, none of the projections for 2000 shows any clear bias, while as of 2001 all the projections underestimated, on average, the actual inflation rates. This result was certainly influenced by the sample period, since 2000 was a year of relative macroeconomic stability, while the period beginning in 2001 was, for the most part, marked by strong cost-push shocks. Second, one cannot say that there is any projection whose figures are systematically higher or lower in all quarters. The median of market expectations was the one characterized by the most extreme figures as, in the sixteen quarters in the sample, market expectations provided the highest projections in seven quarters and the lowest ones in seven others.

Finally, the projections seem to follow, with certain gaps, the more pronounced oscillations observed in the inflation rate. As one can see, the strong rise in the inflation rate registered in the last quarter of 2002 was not anticipated by any of the projections. On the contrary, all of them predicted that the inflation in the fourth quarter would be lower than in the third quarter. For the first quarter of 2003, all projections were higher, but the market provided the one that was closest to the actual inflation. Again, all projections were slow to capture the strong change observed in the inflationary process since the second quarter of this year. All of them overestimated the inflation rates actually registered in the second and third quarters, but the projections of the Central Bank were the ones that more rapidly converged to the new lower levels of inflation.

The table summarizes the forecasting errors of the different projections for forecasting horizons of one to four periods ahead. The absolute mean error and the mean squared error were calculated for the full

Forecast errors for different projections

Quarters ahead	Whole sample					
	Absolute mean error			Mean squared error		
	Bacen - Benchmark scenario	Bacen - Market scenario	Market	Bacen - Benchmark scenario	Bacen - Market scenario	Market
1*	0,98	1,04	1,11	1,58	1,69	1,60
2**	1,58	1,58	1,67	2,33	2,36	2,27
3**	1,71	1,69	2,24	2,54	2,50	2,98
4**	1,77	1,76	2,30	2,62	2,53	3,15
	Sample excluding the period 2002:4 - 2003:2					
1*	0,56	0,58	0,73	0,65	0,65	0,79

* Sample from 2000:1 to 2003:3

** Sample from 2001:1 to 2003:3. This sample begins in 2001. Before, Gerin did not collect the market forecasts for more than one quarter ahead.

sample, from 2000:1 to 2003:4, and for a reduced sample that excludes the strong acceleration and deceleration of the inflation rate registered between 2002:4 and 2003:2.

One can see that forecasting errors are relatively high for the full sample, always close to or above 1 p.p. for an average quarterly inflation rate of 2.13% over the period. As one would expect to see in more normal periods and as suggested by the graph, the forecasting errors drop substantially when the period of strong changes in inflation is excluded from the sample. Considering that the average quarterly inflation in this sub-sample is 1.64%, the forecasting errors dropped not only in absolute terms, but also in relation to the average inflation registered in the period. When the criterion of mean absolute error is used, the Central Bank´s projections are more precise than those of the market for all the horizons and the two samples. The conclusion is about the same for the projections based on the benchmark scenario when the criterion of mean squared error is used. Also according to this criterion, the projections of the Central Bank using market exchange rate and interest rate paths are less precise than those of the market for up to two quarters ahead, but more precise for more distant horizons. Comparing the projections of the Central Bank, one sees that those based on the market scenario are more precise for longer projection horizons, suggesting that those paths that anticipate variations in the exchange rate and in interest rates are more realistic, in the medium run, than those that take into account the underlying assumption that interest rates and the exchange rate will remain constant during all the forecast horizon.

Methodologies for Estimating the Potential Output

This box resumes the discussion about methodologies for calculating the potential output presented in the *Inflation Report* of September 1999. The potential output corresponds to the output level that can be achieved by using the resources available in the economy in full without pushing the inflation rate up or down. Based on an estimate of the potential output, one can calculate the output gap, which is defined as the difference between the actual output and the potential output. Therefore, the output gap is a measure of the idle capacity in the economy. For monetary policy to be soundly conducted, the output gap should be measured in order to correctly evaluate the impact of interest rate changes on the inflation.

The Central Bank follows the evolution of the potential output as measured by three methods: linear trend extraction, Hodrick-Prescott (HP) filter, and production function. The linear trend extraction and HP filter methods are described in the box included in the *Inflation Report* of September 1999. It should be highlighted that the output gap estimated by the linear trend method does not incorporate structural changes in the economy, which is a shortcoming. This is a particularly important problem because of what happened in the Brazilian economy in recent years, when the energy crisis and the low rate of investments probably reduced the growth rate of the potential output. Using the potential output estimated by the HP filter method, in turn, can lead to mistakenly interpret cyclical changes in the actual GDP growth rate as changes in the potential output growth rate. The clearest example of this possibility is the failure of the output gap series estimated according to the HP filter method to detect the depression of the 1930s in the US economy appropriately. In general, both the linear trend extraction and the HP filter methods are criticized because they are mechanical methods which do not take into account information on the behavior of variables that explain changes in the potential output, such as the evolution of production factors and productivity considerations.

The potential output estimated from a production function avoids the limitations mentioned above, but it depends on the behavior of variables that are difficult to measure, such as the capital stock and the amount of labor. In order to calculate the potential output, one begins with a production function of the Cobb-Douglas type, using capital and labor as inputs[1], as specified below:

$$Y_t = A_t K_t^{a_t} L_t^{1-a_t}$$

where:

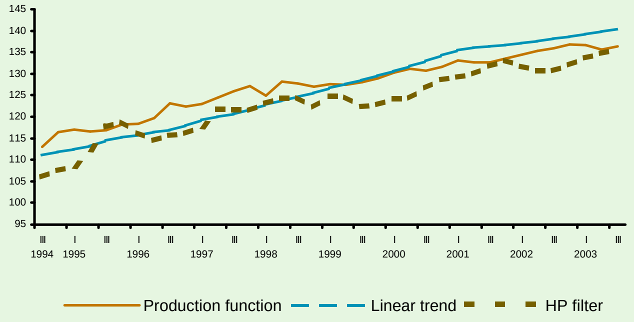
Y is the actual output of the economy;
K is the capital stock;
L is the number of workers;
a is the participation of capital remuneration in the national income;
A is the total productivity of factors, which corresponds to the estimated residue, that is, A_t is such that, given K_t, L_t and α_t, the equality above becomes true for all period t.

The potential output is calculated from the same production function using the known series of A_t and α_t and replacing the actual figures of K_t and L_t by figures corresponding to full employment.

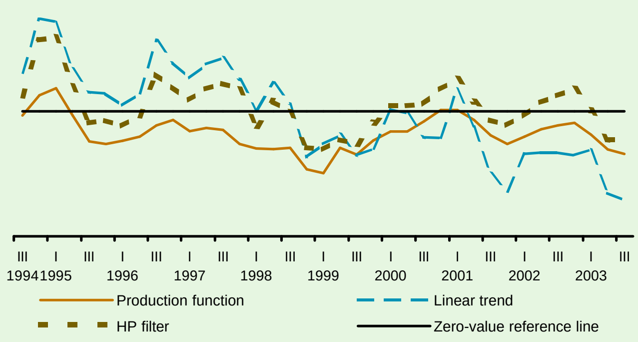
For the period corresponding to that of the Real Plan, the graphs show seasonally adjusted potential output series according to the three methods mentioned above and the corresponding series of the output gap.

As expected, one can see that the measured potential output varies according to the method selected. Since mid-2000, the linear trend method provides the highest figures for the potential GDP even with the inclusion of

Potential output using different estimation methods (Seasonally adjusted series)



Output gap series using different estimation methods



[1] This calculation is described in: Muinhos, Marcelo and Sergio A. L. Alves. (2003), *Medium-Size Macroeconomic Model for the Brazilian Economy*. Central Bank of Brazil. Working Paper Series no 64.

an inflection in the slope of the curve since 2001 for the purpose of reflecting the negative impact of the energy crisis and of lower investment rates on GDP growth.

Given the differences between the potential output series, the corresponding output gap series will also depend on the calculation methodology that is used. More specifically, because it generates the highest potential output estimates, the linear trend method also generates the most negative figures for the output gap in recent years. These most negative figures generate lower forecasts for inflation rates over the next few years. One can also see that, despite their different magnitudes, the current figures for the output gap are negative in the three series analyzed, meaning that there is room for the economy to grow in 2004 without pushing the inflation up, even without an immediate recovery of investments.

In principle, none of the three methods can be considered better than any of the others, since each of them has specific advantages and limitations. For this reason, the Copom monitors the evolution of the three output gap measurements, but, in order to build the projections contained in the *Inflation Report*, it must opt for the methodology that it deems most appropriate. The most recent reviews for the sample period under analysis showed that the most precise inflation forecasts are those that use the output gap derived from the production function as an explanatory variable.

Model for Forecasting Regulated Prices

In the *Notes of the Copom Meetings* held in June and July 2003, it was mentioned, in the section on the prospective evaluation of inflation trends, the model for forecasting regulated prices. The purpose of this box is to put into context the application of this model in the forecasts made by the Central Bank of the future behavior of th0se prices, with the aim of providing appropriate inputs to monetary policy decisions.

In Brazil, certain regulated prices, such as those of public utility services, are partially or fully adjusted according to the inflation accumulated in the previous 12 months as measured by the IGP-DI index. Others follow international commodity prices, such as those of oil by-products. Furthermore, 60% of the IGP-DI index is formed by wholesale prices, whose variation is strongly influenced by the behavior of the exchange rate.[1]

Recent results indicate that, in the short run, meaning a period of time of up to one year, it is more appropriate to use the data collected by the Economic Department (Depec) of the Central Bank to forecast the evolution of regulated prices. This shorter period reduces uncertainties in relation to the evolution of the exchange rate and of commodity prices, in addition to allow to identify possible impacts of administrative decisions more clearly.

Regarding medium and long-term forecasts, before the model for regulated prices was adopted, it was assumed that the change in those prices would be the same as the one expected by the market for the IGP-DI index. However, the data observed for the inflation of regulated prices indicated that the results obtained with this procedure were not always satisfactory.

[1] The IGP-DI index is also affected by consumer prices, albeit to a lesser degree.

For this reason, since July the model for forecasting regulated prices began to be used, based on the following equations:

$$p_t^{IGP-DI} = p_t^{IGP-DI}(p_{t-1}^{IGP-DI}, p_t^{market}, \Delta e_t, p_t^*, D_t, S_t)$$

$$p_t^{reg} = p_t^{reg}(p_{t-1}^{reg}, p_{t-1}^{IGP-DI}, \Delta e_t, p_t^*, D_t, S_t)$$

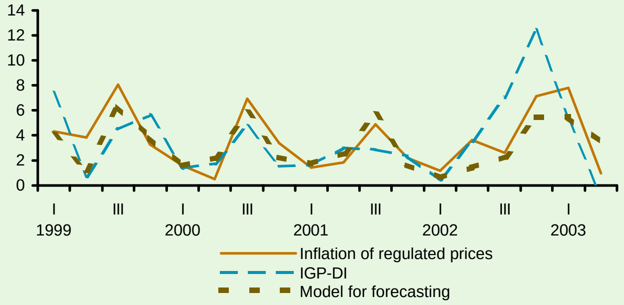
where:

p_t^{reg}	inflation of regulated prices;
p_t^{market}	inflation of market prices;
p_t^{IGP-DI}	IGP-DI inflation rate;
p_t^*	foreign inflation rate;
Δe_t	exchange rate variation;
S_t	seasonal dummy for quarter i;
D_t	level dummy: 0 before 1999 and 1 thereafter.

First, an equation for the IGP-DI index was estimated, where this index is a function of its value in the previous period, of the inflation of market prices, of the foreign inflation in *reais* (that is, of the combined effect of the exchange rate variation plus the foreign inflation) over the same period, and of seasonal components. Next, an equation was estimated for the behavior of regulated prices where these depend on: (i) their value in the previous period, (ii) the IGP-DI index, (iii) the foreign inflation in *reais* (including a level dummy for the change in the exchange rate regime in 1999) over the same period, and (iv) seasonal components. In addition, certain conditions are imposed to ensure convergence to the inflation of market prices in the long run.

The figure at left shows the inflation rates observed for regulated prices and for the IGP-DI index, as well as the in sample forecast of the model, made for the period after the change in the exchange rate regime in 1999.

Inflation of regulated prices, IGP-DI and endogenous model (% p.y.)



Source: FGV and IBGE

The analysis of the figure indicates that, as expected for in-sample forecasts, the model for forecasting regulated prices produces better results than the method used before, which considered only market forecasts for the IGP-DI index. This fact can be confirmed by comparing the correlation coefficient among the series presented: 0.62 for the inflation of regulated prices and the IGP-DI, and 0.82 for the inflation of regulated prices and the forecasting model. Regarding the medium-term out-of-sample forecasting capacity, more information is still required to ensure a meticulous evaluation. Therefore, to forecast the behavior of regulated prices in the medium term, the Copom will continue to consider other indicators as well, which include market expectations.

Annex

Minutes of the 88th Meeting of the Monetary Policy Committee (Copom)

Date: September 16th, from 4:10PM to 6:30PM, and September 17th, from 3:00PM to 6:00PM
Place: BCB's Headquarters meeting room of the 8th floor (on September 16th) and 20th floor (on September 17th) – Brasília – DF

In attendance:
Members of the Committee
Henrique de Campos Meirelles – Governor
Afonso Sant'Anna Bevilaqua
Antonio Gustavo Matos do Vale
Beny Parnes
Eduardo Henrique de Mello Motta Loyo
João Antônio Fleury Teixeira
Luiz Augusto de Oliveira Candiota
Paulo Sérgio Cavalheiro

Department Heads
(present on September 16th)
Altamir Lopes – Economic Department
Daso Maranhão Coimbra – International Reserves Operations Department
José Antonio Marciano – Department of Banking Operations and Payments System
José Pedro Ramos Fachada Martins da Silva – Investor Relations Group
Marcelo Kfoury Muinhos – Research Department (also present on September 17th)
Sérgio Goldenstein – Open Market Operations Department

Other participants
(present on September 16th)
Alexandre Pundek Rocha – Advisor to the Board
Antônio Carlos Monteiro – Executive Secretary
Flávio Pinheiro de Melo – Advisor to the Board
João Batista do Nascimento Magalhães – Special Advisor to the Governor
Jocimar Nastari – Press Secretary
Katherine Hennings – Advisor to the Board

The members of the Monetary Policy Committee analyzed the recent performance of and prospects for the Brazilian and international economies under the monetary policy framework, which is designed to comply with the inflation targets established by the government.

Recent Evolution of Inflation

1. The IPCA increased 0.34% in August, after an increase of 0.20% in the previous month, accumulating increases of 7.22% and 15.07% in 2003 and in 12 months, respectively. The IGP-DI increased 0.62% in August, compared to a decrease of 0.20% in July, reflecting an increase in the IPA-DI (+0.70% in August compared to -0.59% in July) and a deceleration of the IPC-BR (to 0.13% from 0.34%). The 12-month changes of the IGP-DI and IPA-DI decreased for the fifth consecutive month in August, reaching 22.03% and 25.85% respectively.

2. Regulated prices rose 0.85% in August, contributing 0.24 p.p. to the overall result of the IPCA, while free prices rose 0.14%, contributing 0.1 p.p. Among regulated prices, notable increases included fixed telephone and electricity tariffs, water and sewage tariffs, and the price of gasoline, which had

been falling for five consecutive months. With respect to free prices, the most significant impacts came from increases in the prices of domestic services and meat. Food prices decreased 0.27% in August, less sharply than the 0.67% decline in the previous month.

3. Both agricultural and industrial wholesale prices rose in August. Agricultural prices increased 1.77%, reversing the declines observed in the previous four months, as a result of the beginning of an inter-harvest period and increases in the international prices of some commodities. The most significant pressures came from the prices of meat (cattle, pork and poultry) and meat-related products, coffee, manioc and rice. Industrial prices increased 0.29%, after falling in the previous three months, with notable increases in common steel plates, fuel oil, sulfur, sugar, roasted and ground coffee, and copper wires.

4. Core IPCA inflation calculated by excluding household food items and regulated prices increased 0.37% in August, repeating the change registered in July. The accumulated change in the last twelve months stood at 10.8%, decreasing for the second consecutive time.

5. Core IPCA inflation calculated under the trimmed-mean method (smoothed) reached 0.58% in August, compared to 0.65% in July. In the last twelve months, the accumulated change stood at 12.59%, decelerating for the first time this year. Inflation calculated without the smoothing procedure for pre-selected items resulted in rates of 0.35% and 11.47% in the month and in twelve months, respectively.

6. Core IPC-BR inflation calculated under the symmetric trimmed-mean method was 0.45% in August, accumulating an increase of 12.43% in the twelve months ending in August.

7. In September, consumer price indices will post larger increases than in August, mainly reflecting pressures on regulated and food prices. Among regulated prices, water and sewage tariffs in São Paulo, electricity in Brasília and Goiânia and the second readjustment of urban transportation in Salvador should be highlighted, along with other items with countrywide impacts such as alcohol, gasoline and fixed telephone tariffs. Free prices will increase as a result of increases in food prices, which were seen in the wholesale indices in August.

8. It should be noted that the one-time price increases to be observed in the next few months, mainly due to regulated prices and seasonal pressures, do not represent any change in the process of disinflation that has been observed in recent months. This is highlighted by the continuing downward trend of core inflation.

Assessment of Inflation Trends

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

a. The projections for the readjustment of gasoline prices in the remainder of 2003 were revised. The new projection for this year's readjustment stands at 2.2%, 2.7 p.p. lower than in August. This decrease results mainly from the exchange rate appreciation in the last month and the fall of international oil prices. The projections for bottled cooking gas for the full year decreased to 5.4% from 5.8%, as the actual increase in this price in August was slightly lower than expected. However, the projections for the remainder of the year were not changed;

b. The projection for the readjustment of electricity tariffs decreased to 20.8% from 22.3%. The projection for the readjustment of telephone tariffs in 2003 increased 0.2p.p. to 25.7%. It should be noted that the dates for the readjustments were revised as a result of a judicial injunction against the readjustment of these tariffs according to the annual change of the IGP-DI. The Copom utilized the hypothesis that differences between the increases authorized by Anatel and the actual readjustment to date will be compensated in the remainder of the year;

c. The projected increase of 14.0% for regulated prices, which had a 28.6% weight in the August IPCA, was maintained;

d. For 2004, it is assumed that the readjustment of regulated prices will follow the endogenous determination model of regulated prices. Under this methodology, which considers the change in the exchange rate, free price inflation and the change in the IGP-DI, as well as seasonal factors, the projection for the readjustment of regulated prices in 2004 was reduced by 0.6 p.p., to 8.3%;

e. The projection for the 6-month spread over the Selic rate, following the specification of the VAR model using the Selic and the swap rate on the eve of the Copom meeting, was –275 b.p. for the fourth quarter of 2003, gradually rising to 50 b.p. at the end of 2004.

10. Regarding fiscal policy, it is assumed that the primary surplus target of 4.25% of GDP for this year and the following two years will be accomplished. The other related assumptions established in the August meeting were maintained.

11. Considering the baseline scenario hypotheses, including the maintenance of the Selic interest rate at 22.0% p.a. and the exchange rate at the level prevailing on the eve of the Copom meeting (R$2.90), inflation is projected above the adjusted target of 8.5% for 2003 and below the target of 5.5% for 2004.

Monetary Policy Decision

12. The behavior of inflation in August confirmed the positive results of June and July. The maintenance of exchange rate stability and inflation expectations in line with the trajectory of the inflation targets indicate that the cycle of readjustment of relative prices that the Brazilian economy had experienced since 2002 has reached its end.

13. August IPCA inflation reached 0.34%, in line with projections presented at the August Copom meeting. The increase of 0.14 p.p. compared to July was due to increases in regulated prices and seasonally sensitive items. Among these prices, notable increases included the prices of meat, due to the inter-harvest period, and the price of domestic services, which was captured in the August IPCA for methodological reasons even though changes typically occur mainly in April and May. It is important to highlight that the proportion of items with positive readjustments in the monthly IPCA has been falling since March, and stood at 56.4% in August, the lowest figure since January 2001.

14. The behavior of core inflation signals a downward trend in inflation. Core IPCA inflation calculated under the trimmed-mean method with smoothing and excluding regulated prices fell for the fifth consecutive month, and core inflation calculated under the trimmed-mean method without smoothing fell in August, after relative stability in June and July. Core inflation excluding regulated prices and household food items increased 0.37%, the same increase observed in July. Other core inflation measures, such as the IPC-BR, also point out to a downward trend for inflation.

15. After three consecutive months of deflation, wholesale prices increased in August, reflecting the beginning of an inter-harvest period and the end of the passthrough of the exchange rate appreciation that had been occurring since March. In August, the wholesale price index for agricultural products increased 1.8% while the wholesale index for industrial products rose 0.3%. Agricultural wholesale prices will continue to put upward pressure on retail prices in the next few months. As is typical at the end of the year, these increases are expected to reverse as the inter-harvest period ends. However, the reversal may be partial, since there may be a change of price level for some items. This seems to be the case for soybean products, as soy prices increased recently in the international market.

16. As a consequence of the inter-harvest period and expected readjustments for regulated prices, inflation is expected to increase slightly in the upcoming months. In the medium-run, however, the Copom judges that inflation will return to the moderate levels observed recently.

17. The economy has started to show signs of a recovery from the deceleration observed in the first half of the year. As is usual in the early stages of a recovery, indicators of economic activity are giving contradictory signals. Hours worked, industrial production and sales, and electricity consumption in São Paulo all increased in August compared to July (s.a. data). Retail sales and employment were stable in June and July, while installed capacity utilization, and purchase of capital goods and civil construction inputs decreased.

18. The Copom estimates that activity will be recovering from the second half of this year onward.

The easing of monetary policy, inititiated in June and intensified in subsequent months, the increase in the supply of credit, and the increase in real incomes due to the decrease in inflation will allow consumption to increase progressively. Net exports, continue to provide support to aggregate demand, although at a lower relative magnitude. As a result of the level of idle capacity in the economy, a recovery of investment may take some months to occur. Generally speaking, even if investment recovers after consumption, the Copom maintains its judgement from the August meeting that the the recovery of the economy will be balanced, and will occur at a speed that keeps demand growth in line with the growth of aggregate supply.

19. To maintain price stability in a longer horizon, the growth of aggregate demand must continue to be compatible with increases in aggregate supply. The decrease of investment in recent years – sharpened in the second quarter of 2003 - has had a negative effect on the growth of productive capacity. On the other hand, the maintenance of monetary and fiscal policies consistent with macroeconomic equilibrium and the approval of reforms now in the Congress will have positive impacts on the growth of potential GDP. The Copom will monitor the evolution of aggregate demand, in order to ensure that the growth of installed capacity utilization does not outstrip the completion of new investments.

20. The external scenario improved significantly since the August Copom meeting. The Real was less volatile and appreciated moderately against the US dollar, with the exchange rate falling from a plateau of R$3.00 to a level around R$2.90. Country risk measured by the Embi+ fell from 730 b.p. to 650 b.p. The Brazilian external accounts continued to post positive results, with increasing surpluses in the trade balance due to export growth, enough to produce small surpluses in the current account. FDI recovered in July and August, and sovereign and private securities were placed in the international market between August and September. As a consequence of the stability of the real and the favorable behavior of the external accounts, there is no expectation of new inflationary pressures coming from the exchange rate.

21. The BCB's inflation forecasts, assuming the maintenance of the Selic interest rate at 22.0% p.a. and the exchange rate at R$2.90/US$, point to inflation above the adjusted target of 8.5% for 2003. A small reduction of the projection for this year was due to the fall of market expectations for inflation, exchange rate appreciation and the 2Q2003 GDP released by IBGE, which was lower than expected and incorporated into the projections for the year. The trajectory of inflation remains compatible with the path presented in the Open Letter sent by the BCB Governor to the Ministry of Finance on January 21st, 2003.

22. The BCB's inflation forecasts for the next 12 months and for 2004 were reduced slightly, due to the lower than expected GDP results and the 0.4 p.p. reduction in the projection for regulated price inflation in 2004. The new projections, assuming the maintenance of the Selic interest rate at 22.0% p.a. and the exchange rate at R$2.90/US$, remain below the trend of the inflation targets.

23. During the last few months, the convergence of inflation expectations to the trajectory of the inflation targets played a key role in generating positive inflation results. Monetary policy should guide the basic interest rate in order to ensure that expectations are consistent with the convergence of inflation to the targets. The median of market inflation expectations has been roughly stable since the August Copom meeting. For inflation in 2003, market expectations decreased to 9.6% from 9.7%. Regarding expectations for inflation in the next twelve months, there was a slight increase to 6.5% from 6.4%. For 2004, market expectations were stable at 6.2%.

24. The Copom evaluates the risks in the projections for the inflation trajectory on an ongoing basis. Some of these risks have become less significant, such as the doubts regarding the degree of inertia after the inflationary peak in the last quarter of 2002. During the last quarter of the year, the Copom will be observing wage readjustments that will occur under collective bargaining agreements. It will be important to differentiate two types of readjustments: i) those in sectors with relative price gains since last year, notably the sector of tradables, which has benefited from the exchange rate depreciation; and ii) those based on past inflation, rather than its projected or current performance for the sector.

25. As the disinflation process continues, other risks become more important. With consecutive reductions in the over-Selic rate since June, the real interest rate has come closer to the medium-run level consistent with sustainable growth and price stability. As the basic interest rate approaches this level, the greater the relative importance of risks associated with the uncertainties of the monetary policy transmission mechanism, including the lags and magnitudes of the impact of changes in the over-Selic rate on the inflation. With this progressive change in the relative importance of risks, gradualism in the conduct of monetary policy becomes increasingly important.

26. With the projection of inflation for the next twelve months and for 2004 below the target, market expectations stable and consistent with the targeted path, and the exchange rate and external accounts not presenting a source of inflationary pressure in the short-run, the Copom believes it is appropriate to continue the process of monetary policy easing, and decided unanimously to fix the Over-Selic rate target at 20% p.a.

27. At the close of the meeting, it was announced that the Copom would meet again on October 21 for technical presentations and on the following day, in order to discuss the monetary policy decision, as established in the Communiqué 10,187, of October 2nd, 2002.

Summary of Data Analized by the Copom

Economic Activity

28. According to the IBGE, national retail sales fell 5.4% year-on-year in the January-July period. The negative performance has been generalized, reaching all activities and 22 out of the 27 States. By sector, the category including hypermarkets, supermarkets, food products, beverages and tobacco once again exerted the main negative influence in the overall retail results, accumulating a decline of 6.5% in the year.

29. Statistics from Fecomercio SP confirmed the bad performance of the retail sector with a 3.2% month-on-month (s.a.) decline in retail sales in the metropolitan region of São Paulo in July. This result was due to declines in sales of consumer goods, vehicles and construction inputs of 2.8%, 5.2% and 5.3%, respectively. In the year up to July, retail sales dropped 13.8% compared to the same period in 2002.

30. Despite the negative performance of retail commerce in July, data from the ACSP signal better prospects. Seasonally adjusted data on consultations to the SPC system and Usecheque show growth of 2.3% in August in relation to July.

31. The monthly Fecomercio SP survey on consumer confidence (IIC) showed a decrease of 2.2 p.p. in September, mainly due to a decline of 3.9 p.p. in future purchasing intentions, while current intentions registered an increase of 1.9 p.p. It is worth noting that even with this decline, the IIC stood at 102.2 (out of a 0-200 range), still in the “optimistic” range.

32. Regarding investment indicators, there has been a slight increase (0.4%) in the s.a. monthly series of capital goods production. However, in the year up to July, capital goods production fell 2.6% in relation to the same period in 2002. It is important to highlight that the export oriented part of capital goods production increased by 3.7% in the year, which, added to the decrease of 33.6% in the quantity of capital goods imports, resulted in an estimate of a 14.2% fall in the domestic purchase of capital goods in 2003, compared to 2002. The production of civil construction inputs decreased 0.3% in July and accumulated a contraction of 7.3% in the year up to July. Another indicator unfavorable to investments in the period from January to July 2003 is the 12% decline in the volume of medium and long-term financing provided by the BNDES.

33. According to the IBGE, July industrial production registered an increase of 0.4% over June, in the s.a. series. This was a result of the positive performance of mineral extraction, which increased 8.8%, returning production of oil and natural gas to normal levels after a technical stop in the production of some platforms in June. The transformation industry, which represents approximately 90% of manufacturing production, registered a drop of 0.1% in the month. Up to July, compared to the same period in 2002, industrial production decreased 0.3%, which reflects the negative performance of the transformation industry (-0.6%), notwithstanding an increase in mineral extraction of 2.1% in the same period.

34. By categories of use, the favorable performance of the month reached intermediate goods, durable and capital goods, with increases of 1%, 0.7% and 0.4%, respectively. Only the semi-durable and non-durable goods production registered decrease in July (2.1%).

35. Data on industrial activity released by the CNI showed a slight recovery in July. In the month, s.a. data, real industrial sales increased by 1.7% and hours worked in production increased 0.9%. In the year, both indicators registered positive increases of 0.06% and 0.42%, respectively. Still considering the s.a. series, installed capacity utilization reached 78.9% in July, compared to the recent peak of 81.6% registered in October 2002.

36. In the automotive sector, in August auto output, domestic and external sales fell 6.3%, 9.1% and 14.2% month-on-month, respectively, according to the s.a. series. Production increased 1.8% in the eight first months of the year, driven mainly by a 36.8% increase in external sales, while domestic sales fell 7.7%.

Labor Market

37. The index of employment increased 0.1% month-on-month in July (s.a.), and 3.1% year-on-year up to July, according to Ministry of Labor and Employment data. According to the new methodology for the IBGE's employment survey, the unemployment rate in the six main metropolitan areas reached 12.8% in July, compared to 13% in June, mainly as the result of a contraction in the economically active population, while the number of occupied people decreased 0.1% in the month.

38. Also according to the IBGE´s survey, average real wages of employed workers in June 2003 fell 17.3% compared to the same month in 2002. In the industrial sector, according to the CNI, real wages increased for the third consecutively month in July, but still remained 4.9% lower than the same month in 2002. In 2003 up to July, real wages in manufacturing declined 6.4% in comparison to the same period in 2002.

Credit and Delinquency Rates

39. Total non-earmarked or freely allocated credit rose 0.6% in August, after declining repeatedly between March and July. The monthly expansion was driven mainly by increases of 1.2% and 0.2% in individuals and company credits, respectively. Among credit operations to companies, internally funded credits rose 0.3% while externally funded credits rose 0.1%.

40. The average interest rate on non-earmarked credits fell again in August (2.2 p.p.), to 52.7% p.a., as a consequence of the reduction of the Over-Selic target rate since June. The decline was more significant for the interest rate on lending to individuals, which fell to 74.5% from 77.9%, especially for overdraft accounts and consumer credit. In corporate loans, the average rate was 36.3% p.a., falling 1.4 p.p., compared to July. The delinquency rate on non-earmarked bank credits fell to 8.6% in August from 8.7% in July, essentially as the result of the decrease of 0.3 p.p. in individuals' delinquency rate.

41. Regarding default rates on retail credit, there was a new improvement in August, driven by a 3.5% increase in cancelled default registrations, signaling debtors and creditors intention to renegotiate. In 2003 up to August, the number of cancelled default registrations rose 7.5%. ACSP data showed that the delinquency rate reached 4% in August and 5.8% on annual average until August, compared to the 6.4% average rate registered last year.

External Environment

42. There are signs that a global economic recovery is in progress, stimulated by US economic performance. However, there is still a high level of uncertainty about its pace and degree. The US GDP growth rate in the second quarter of 2003 was revised up to 3.1% against 2.4% in previous estimates. Retail sales rose by 0.5% in August compared to the previous month. Inventories fell 0.1% in July and the inventory/sales ratio stood at 1.37, after 1.39 in June. Installed capacity utilization remained unchanged in August (74.6%). The unemployment rate decreased to 6.1% in August, which is still considered high, and claims for unemployment compensation are still around 400,000 per week.

43. The Federal Reserve decided to keep its basic rate at 1%, and was accompanied by the world's main central banks, which also kept official rates constant at their last meetings.

44. In Japan, there is also an optimistic environment regarding the recovery of the economy. Annualized GDP registered growth of 3.9% in the second quarter. The conditions are more favorable to exports and there is a moderate recovery in corporate investment occurring, but private consumption remains weak. The timing mismatch between the signs of growth in US and Japan is caused by European stagnation. The retraction of 0.4% of GDP (annualized rate) in the Euro Zone in the second quarter followed zero growth in the previous quarter. This situation has impacted the European labor markets. The unemployment rate stood at 8.9% in July, the same as in the previous month and the highest level in 3 ½ years, the same rate registered last month. One estimates that 12.5 million people were jobless in the Euro Zone last July.

45. The recovery of activity in the US and Japan and the weak performance in Europe is taking place with low inflation rates. The US consumer price index (CPI) rose 0.3% in August. The core index, which excludes energy and food prices, increased 0.1% in August. In the last twelve months, the CPI remained practically stable, with a 2.2% increase. The US PPI also registered an increase in August (0.4%), while its core increased 0.1%. In Japan, household prices are still falling, but at a lower pace in annual terms, registering deflation. In Euro Zone, the annual wholesale index remained unchanged in July; 1.3% in comparison with the same month in 2002, while the Harmonized Index of Consumer Prices (HICP) registered an annual increase of 2.1% in August, above the target of 2% fixed by EBC.

46. The business confidence index showed a prospective of business heating in the main economic areas. US manufacturing activity indicators rose in August for the second consecutive month, to 54.7 points, the highest level since December 2002. The Business Activity Index (BAI) remained at the same level, 65.1 points, in July and August. In Japan, Tankan index has been showing an upward trend in all their segments, but it still remains negative. In Europe, the confidence of German investors measured by Zew Institute rose in September to its highest level in 14 months, suggesting that the economic activity is recovering. The index that measures the economic growth expectations increased to 60.9 in September, compared to 52.5 in August. Amongst consumers, there is no uniform behavior. In US, a preliminary measurement of the Consumer Sentiment Index of University of Michigan showed a decrease to 88.2 p.p. in September. In Europe and Japan there is a slight improvement in the consumer's spirit.

Foreign Sector

47. The trade balance posted a US$ 2.7 billion surplus in August, the highest monthly trade balance ever recorded, which led to new records of US$ 15.1 billion and US$ 22.9 billion surpluses in the year-to-date and 12-month accumulated results. Up to August, exports increased 22.9% and imports declined 4.1%, in comparison to the same period of 2002. In August, daily average exports increased 14.9% in comparison to the previous month, and 16.6% as compared to August 2002 values. Imports rose 0.9% and declined 6.4% considering the same bases. Up to the second week of September (10 working days), the trade surplus reached US$ 1.4 billion, with exports and imports expanding 13.7% and 10.6%, in comparison to the average data of September 2002.

48. Exports increased in all categories of products, setting historical records for the months of August and the January-August period. It should be noted that this remarkable expansion resulted from many factors: higher shipped volumes, the recovery of international prices of important commodities, the diversification of items and markets, the inclusion of new enterprises in the export drive, the increase of competitiveness and the deceleration of economic activity.

49. Considering daily average data, semi-manufactured goods sales rose 20.6% in comparison to August 2002, with highlight to gross sugar and gross soy oil. Exports of basic products increased 17.4% in the same basis of comparison, driven by meat, soybeans and soy flour. Manufactured items increased 14.7%, most notably ethylene polymers, fuel oils, transport vehicles, automobiles, tires, car parts and furniture. As far as international demand is concerned, exports expanded to all regions in August, most notably shipments to China and Argentina, which remained as the second and third largest buyers of Brazilian products, with increases of 69.1% and 82.9% in the month, and of 136.7% and 84.5%, respectively, in January-August 2003, compared to the same period of 2002.

50. With reference to imports, the 2.9% decline in the daily average of the first eight months of 2003, in comparison to the same period of 2002, was mainly caused by drops of 21% and 10% in imports of capital goods and consumer goods, respectively. Imports of fuel and lubricants, due to the increase of prices and volumes, rose 11.4%, while imports of intermediate goods increased 5% in the same period.

51. The current account posted a US$1.2 billion surplus in August, compared to a US$305 million deficit in the same month of 2002. The deficit in the services and income accounts reached US$1.7 billion and unilateral transfers posted a US$236 million surplus. The year-to-date current account result reached US$2.5 billion. The financial account registered a net inflow of FDI of US$980 million, accumulating US$5.7 billion in 2003. At the end of August, international reserves stood at US$47.8 billion, while adjusted net reserves stood at US$15.4 billion.

Money Market and Open Market Operations

52. Since the Copom's decision in August, the yield curve dropped significantly at all maturities. In addition to the larger-than-expected reduction of the Over-Selic target rate, several factors contributed favorably to this movement, including the advance of the social security and tax reforms, the appreciation of the exchange rate, the fall of country-risk and the release of indicators showing a low level of economic activity. Between August 20th and September 16th, 1-month and 1-year future interest rates fell by 187 b.p. and 183 b.p., respectively.

53. The maturities of FX-linked bonds and FX swaps in the period were rolled over by means of swap operations with terms ranging from 4 to 58 months (21 months on average). The rollover rate reached 50% of the principal. The lower rates offered in these operations, compared to the previous period, were due to the downward shifting of the FX coupon curve, caused by the improvement of the country-risk and the announcement of new foreign settlements by Brazilian enterprises.

54. The National Treasury conducted four LTN auctions, totaling R$10.7 billion. Together with the movement of the interest rate curve, placement rates fell significantly. There were also four LFT auctions, which totaled R$6.9 billion.

55. NTN-Bs (IPCA indexed securities) were also offered, in the second placement of these securities, the first having occurred in March of 2002. Both August 2006 and May 2009 maturities were offered at 10.79%. The operation totaled R$2.4 billion, R$991 million of which was paid in currency and the rest with swaps for other securities.

56. Financial redemptions between August 21st and September 17th caused a monetary contraction of R$2.4 billion, explained mainly by the net placements of R$10.7 billion of LTN and of R$3.2 billion of NTN-B and NTN-C, partially offset by net redemptions of R$7.8 billion of LFT and of R$2.9 billion of dollar-indexed securities.

57. The Central Bank intervened in the open market on a weekly basis with 2-week repo operations and conducted daily liquidity management operations. These operations withdrew from the banking reserves market excess liquidity of R$55.6 billion on average.

58. In August, the net securitized public debt increased by 0.9%. The prefixed share increased to 7.4% from 6.3% in July, and the share linked to the dollar declined to 28.1% from 28.5%.

Minutes of the 89th Meeting of the Monetary Policy Committee (Copom)

Date: October 21st, from 3:30PM to 6:40PM, and October 22nd, from 4:00PM to 7:00PM
Place: BCB's Headquarters meeting room of the 8th floor (on October 21st) and 20th floor (on October 22nd) – Brasília – DF

In attendance:
Members of the Committee
Henrique de Campos Meirelles – Governor
Afonso Sant'Anna Bevilaqua
Antonio Gustavo Matos do Vale
Beny Parnes
Eduardo Henrique de Mello Motta Loyo
João Antônio Fleury Teixeira
Luiz Augusto de Oliveira Candiota
Paulo Sérgio Cavalheiro
Sérgio Darcy da Silva Alves

Department Heads (present on October 21st)
Altamir Lopes – Economic Department
José Antonio Marciano – Department of Banking Operations and Payments System
José Pedro Ramos Fachada Martins da Silva – Investor Relations Group
Paulo Springer de Freitas – Research Department (also present on October 22nd)
Renato Jansson Rosek - International Reserves Operations Department
Sérgio Goldenstein – Open Market Operations Department

Other participants (present on October 21st)
Alexandre Pundek Rocha – Advisor to the Board
Antônio Carlos Monteiro – Executive Secretary
João Batista do Nascimento Magalhães – Special Advisor to the Governor
Jocimar Nastari – Press Secretary
Katherine Hennings – Advisor to the Board

The members of the Monetary Policy Committee analyzed the recent performance of and prospects for the Brazilian and international economies under the monetary policy framework, which is designed to comply with the inflation targets established by the government.

Recent Evolution of Inflation

1. The main price indices showed higher rates of inflation in September, reflecting pressures on food prices, mainly caused by the effects of the inter-harvest period, and readjustments in regulated prices.

2. The IPCA rose by 0.78% in September, after an increase of 0.34% in the previous month, accumulating increases of 8.05% and 15.14% in 2003 and in 12 months, respectively. The IGP-DI rose by 1.05% in September, after an increase of 0.62% in August, driven by an increase of 1.29% in the IPA-DI and 0.76% in the IPC-Br.

3. Regarding the IPCA, the increase of 1.44% in regulated prices contributed 0.41 p.p. to the overall result of the index, while the 0.51% increase in free prices contributed the remaining 0.37 p.p. Among regulated prices, notable increases included water and sewage tariffs, fixed telephone and electricity tariffs, and the price of auto fuel. With respect to free prices, the most significant impact came from the reversal in the behavior of food prices, with a 0.78% increase in September, after a decline of 0.27% in August. This reversal was due to the effects of the inter-harvest period, which caused increases in cattle and poultry prices. The notable performance of exports of these products in 2003 has contributed to sustain price increases. Still considering food products, the evolution of perishable food prices is also worth mentioning, as they remained stable in September (-0.07%), after accumulating a decrease of 16.5% in the June-August quarter.

4. Both agricultural and industrial wholesale prices registered higher rates of inflation in September. The agricultural IPA rose 3.55%, compared to a 1.77% increase in August, as a result of the price increases of meat (cattle, pork and poultry) and corn, due to the inter-harvest period, and soy, because of the evolution of international market prices. Industrial prices increased 0.40%, after a 0.29% increase in August, pressed by food

products (mainly meat, fish and vegetable oil), agricultural machines and mining products.

5. Core IPCA inflation calculated by excluding household food items and regulated prices increased 0.37% in September, repeating the increase registered in the previous month. The accumulated change in the last twelve months stood at 10.54%.

6. Core IPCA inflation calculated under the trimmed-mean method (smoothed) increased 0.86% in September, compared to 0.58% in August. In the last twelve months, the accumulated change stood at 12.68%, still reflecting the effects of price increases at the end of 2002. Inflation calculated without the smoothing procedure for pre-selected items reached 0.60% and 11.51% in the month and in twelve months, respectively.

7. Core IPC-Br inflation calculated under the symmetric trimmed-mean method by Fundação Getúlio Vargas (FGV) rose to 0.67% in September, accumulating an increase of 12.43% in the twelve months ending in September.

8. In October, both consumer and wholesale price indices should register lower increases. In the wholesale index, a decrease in agricultural prices is expected, which has already been detected in the partial IGP-M results released by FGV. In the consumer index, the price deceleration will result mainly from lower readjustments of regulated items. Concerning free prices, pressures on food prices and clothing prices will likely persist, the former as a consequence of the inter-harvest period, and the latter due to seasonal factors.

Assessment of Inflation Trends

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

a. The projection for the readjustment of gasoline prices in the remainder of 2003 was revised. The new projection for this year's readjustment stands at 1.3%, 0.9 p.p. lower than the projection in the September Copom meeting. The projections for bottled cooking gas for the full year decreased to 5.3% from 5.4%;

b. The projection for the readjustment of electricity tariffs increased slightly to 21.2%, from 20.8% in the September meeting. On the other hand, the projection for the readjustment of telephone tariffs in 2003 was reduced by 0.2 p.p., going back to the 25.5% that had been projected in the July and August meetings;

c. The projection for regulated price inflation in 2003 (which had a 28.75% weight in the September IPCA), decreased by 0.1 p.p., to 13.9%, as a consequence of a fall in the projected readjustment for gasoline and fuel alcohol;

d. For regulated prices in 2004, the Copom started to work with specific projections for each item, substituting for the endogenous determination model used in the previous meetings. The new procedure is justified because, as 2004 approaches, it becomes possible to obtain more precise information about the readjustment of specific items for next year, notably for those items whose price readjustments are decided at the sub-national levels. Under this new methodology, the projection for regulated price inflation in 2004 rose by 0.6 p.p., reaching 8.9% in October;

e. The projection for the 6-month spread over the Selic rate, following the specification of the VAR model using the Selic and the swap rates on the eve of the Copom meeting, was -190 b.p. for the fourth quarter of 2003, gradually rising to 85 b.p. at the end of 2004.

10. Regarding fiscal policy, it is assumed that the primary surplus target of 4.25% of the GDP for this year and the following two years will be accomplished. The other related assumptions established in the September meeting were maintained.

11. Considering the baseline scenario hypotheses, including the maintenance of the Selic interest rate at 20.0% p.a. and the exchange rate at the level prevailing on the eve of the Copom meeting (R$2.85), inflation is projected above the adjusted target of 8.5% for 2003 and below the target of 5.5% for 2004.

Monetary Policy Decision

12. September inflation measured by the IPCA was 0.78%, 0.44 p.p. above August inflation. The higher inflation in September was observed in all components of the IPCA: non-tradable goods, tradable goods and regulated prices, especially in the latter two categories. Inflation measured by other consumer price indices like the IPC-Fipe, the IPC-Br and the INPC also registered increases from August to September, as did inflation measured by the IGPs and IPAs. Regarding the IPAs, it is important to highlight the increase in inflation in the agricultural IPA to 3.6% in September, from 1.8% in August, mainly due to a stronger impact of the inter-harvest period and increases in the prices of some internationally traded commodities.

13. All core inflation measures also increased, except for the one calculated excluding regulated prices and household food items, which remained stable at 0.37% for the third consecutive month. After decreasing for 5 consecutive months, from August to September core inflation calculated under the trimmed-mean method with smoothing increased to 0.86%, from 0.58%, compared to an increase to 0.60% from 0.35% in core inflation calculated under the method without smoothing. Combining the smoothed trimmed-mean core of the IPCA with the corresponding core of the IPCA-15, a gradual elevation since August is evident and, with the October change in the IPCA-15, the series registered the fourth consecutive fortnightly increase. The performance of core IPC-Br inflation was similar, increasing in September after four consecutive months of decline. Finally, the ratio of IPCA items that had positive changes also rose, to 63.5%% in September from 56.4% in August, surpassing the proportion observed in the three previous months.

14. The Copom maintains the diagnosis presented in previous Minutes that the increase of inflation in September was temporary, explained by the inter-harvest period, by the increase of international prices of some commodities, such as soy, and by the readjustment of regulated prices. Considering that the inter-harvest effects have not yet ended, some pressures on inflation may continue in the short run. However, the Copom will continue to act in order to consolidate the current gains against inflation. For that purpose, in the coming months it will follow the evolution of inflation and of the different measures of core inflation, distinguishing between specific readjustments and persistent or generalized price increases.

15. The economic activity indicators released since the September meeting confirm the recovery scenario that the Copom was assuming in recent months. According to the IBGE, industrial production rose 1.5% between July and August (seasonally adjusted). This increase was broad-based, with a higher number of industrial sectors reversing the trend of declining production, which prevailed in the first half of the year. Other indicators also point to a recovery of production, including industrial sales, which according to the CNI increased 5% between July and August, and the consumption of energy, which rose 0.8% in the same period and 1.6% in September. The industrial business confidence index, released quarterly by the FGV, also increased in October, compared to July, and reached a level of 56, above the reference value of 50, indicating better future prospects.

16. The recovery of industrial production should be confirmed in the coming months, due to favorable prospects for real sales in the retail sector. Among the factors supporting this forecast are low banking delinquency rates, the increase in real wages and a likely increase in lending to businesses and consumers – in the latter case, with an additional impulse from recently created mechanisms for discounts of loan repayment installments from payrolls, which should allow not only an increase in credit, but also a decline in interest rates. In spite of the fact that real wages are still below the levels prevailing at the end of 2002, they have been gradually recovering in recent months. With the prospect of inflation stabilizing in line with the trajectory of the inflation targets, real earnings will tend to increase. Furthermore, despite the fact that the unemployment rate remains at around 13%, due to the continuous increase in the economically active population, total employment has increased in recent months. The slower recovery of consumption, in comparison to production, reinforces the perception that the recovery of economic activity will continue to be well-balanced, and it is important to note that installed capacity utilization remains low.

17. The external accounts maintained the positive performance observed so far this year. In September,

the trade surplus reached US$ 2.7 billion, very close to the peak value registered in August. The trade balance accumulated up to September is US$ 17.8 billion, more than twice the result registered in the same period of 2002, and is due more to the increase of exports (21.3% in comparison to the same period of the previous year), than to the decline of imports (1.8%). It is important to highlight that the increase of exports in this period was mainly due to growth of export volumes, although it was also favored by higher export prices. Finally, the growth of exports was also explained by market diversification, including to China, and the recovery of traditional trade partners, as in the case of Argentina. As a consequence of the higher trade surpluses, the current account balance now shows a surplus in the year.

18. Since the September Copom meeting, there was a decrease in the volatility of the foreign exchange rate, which has appreciated moderately against the US dollar from a plateau of R$2.90 to a level around R$ 2.85. In this period country risk measured by the Embi+ fell from 650 b.p. to 607 b.p.. In addition, the Republic issued US$1.5 billion in bonds at a lower rate than in previous issues. Considering the current scenario the Copom believes that the external scenario in the coming months will remain significantly more favorable for the Brazilian economy than in recent years. This is true even if there is a deceleration in the speed of recovery of the advanced economies or a deterioration in international liquidity or risk appetite.

19. The reduction of country risk, the stability of the exchange rate and the good performance of the external accounts are a result of the consistent macroeconomic policy and the favorable international scenario, which is characterized by improved prospects for growth in the US and Asia and by the increase of global liquidity. The progress of domestic structural reforms, which will improve the flexibility of the economy and the composition of public expenditure and revenues, will bring medium-term benefits for monetary policy, help decreasing risk premiums and strengthen the capacity of the Brazilian economy to withstand shocks.

20. After the relative stability between August and September, the median of market inflation expectations for next year has decreased in October. For the next 12 months, market expectations decreased to 6.25% from 6.50%, which is in accordance with the trajectory of the inflation targets up to September. For 2004, market expectations decreased to 6.0% from 6.2%. These results show that monetary policy has been able to coordinate market expectations so that they converge to the trajectory of the inflation targets and suggest that economic agents consider the increase of inflation in September as a one-off event. Nonetheless, market inflation expectations increased for 2003 to 9.8% from 9.6%, which reflects the fact that September inflation was higher than projected.

21. The BCB´s inflation forecasts, assuming the maintenance of the Selic rate at 20% p.a. and the exchange rate at R$ 2.85, still point to inflation above the adjusted target of 8.5% for 2003. Using the same assumptions for the exchange and interest rates, the BCB´s forecasts for the next 12 months and 2004 are below the targets. The forecasts for 2004 are slightly higher than the September meeting projections mainly due to the impact of the higher projections for the readjustments of regulated prices next year. Even with the increase of the inflation forecasts, the inflation trajectory for the coming months remains below the path presented in the Open Letter sent by the BCB Governor to the Ministry of Finance on January 21st, 2003.

22. In the Minutes of its September meeting, the Copom analyzed the risks of wage readjustments under collective bargaining agreements to the trajectory of inflation. The readjustments so far have been below the level of 12-month accumulated inflation but higher than projected inflation for the next 12 months. As a consequence, it appears that a moderate increase of real wages, compatible with the recovery of the economic activity without a generalized process of re-indexation, is set to materialize.

23. The Copom forecasts inflation based on models which, by their nature and limitations, have some uncertainties about the magnitude and lag of the monetary policy transmission mechanism. The main impacts of the reductions in the Selic rate in the third quarter of this year on economic activity are still beginning to materialize. The recovery of economic activity that has been observed since the third quarter is mainly due to improvements in the risk profile of

the Brazilian economy and the effects of monetary policy on the yield curve in previous quarters. For this reason, the Copom will be carefully following the recovery of economic activity so as to keep it balanced and to avoid inflation pressures. This monitoring is important as a consequence of the changes in the real interest rate in recent months. However, with the progressive consolidation of the favorable prospects recently observed for medium-term inflation, the Copom considers that there is room for additional cuts in the Selic rate in the future.

24. Since forecasts for 12 month ahead and 2004 inflation remain below the target, market expectations continue to converge to the trajectory of the targets, and the favorable external scenario contributes to price stability, the Copom decided to fix the Selic rate target at 19.0% p.a., continuing the process of monetary policy easing.

25. At the close of the meeting, it was announced that the Copom would meet again on November 18 for technical presentations, and on the following day in order to discuss the monetary policy decision.

Summary of Data Analyzed by the Copom

Economic Activity

26. Retail sales have been posting better performance in recent months, even though they are still down compared to the previous year. Fecomercio SP data, s.a., show a 1.3% increase in sales in July to September, compared to the previous quarter. In September, considering preliminary data, real sales were relatively stable, after the sharp 4.8% increase observed in August.

27. According to the broader IBGE survey, national retail sales showed a moderate recovery in the most recent months. Sales increased an average of 2.2% (s.a.) the 3-month period ended in August, compared to the previous 3 months. It is important to highlight this performance in light of the downward trend in sales that occurred in the second half of 2002 and beginning of 2003. The result of this behavior is high negative year-on-year growth rates (-5.9% in August and –5.5% in the January-August period).

28. ACSP data also confirm the recovery in the retail sector in recent months. Consultations to the Credit Protection System (SPC) and Usecheque show 9.1% and 1.9% increases, respectively, in the first fortnight of October, year-on-year.

29. The monthly Fecomercio SP survey on consumer confidence showed a decrease of 2.6 p.p. in September, reaching 99.5 out of a 0-200 range. This result was mainly due to a 3.9 p.p. decrease in future purchasing intentions, while current intentions registered a 0.2 p.p. increase.

30. Regarding investment indicators in August, s.a. output of capital goods increased 1.5%. However, in the year up to August, capital goods outcome decreased 2.6%, year-on-year. Output of export-oriented capital goods increased 5.4% and the volume of imported capital goods decreased 34.7%. The domestic absorption of capital goods in 2003 up to August is estimated to have decreased 15%. The production of civil construction inputs decreased 1.3% in August, compared to July, s.a., with an accumulated decrease of 8% in the year up to August. Another indicator of the unfavorable scenario for investment in the period is the 18.9% decrease in the volume of medium and long term financing for investment by the BNDES accumulated in the year.

31. The industrial sector shows clear signals of recovery. According to the IBGE's Monthly Industrial Survey, Brazilian industrial output grew 1.5% in August, following the 0.9% s.a. increase registered in July. By categories of use, the production of durable goods, capital goods and intermediate goods, all posted favorable performance, with increases of 5.2%, 1.5% and 1.2%, respectively. The production of semi- and non-durable goods declined by 0.8%. Most of the industrial sub-sectors show signals of reversing the downward trend of production in the first half of the year. Up to August, year-on-year, industrial production decreased 0.5%, reflecting the performance of the manufacturing industry (-0.8%), while mineral extraction grew 2%.

32. Data on manufacturing activity released by the CNI showed a recovery in August, with real industrial sales increasing by 5% and hours worked in production decreasing 0.14% (both s.a.). In the year,

these indicators registered declines of 0.38% and 0.07%, respectively.

33. The quarterly CNI survey on business confidence showed an improvement in current conditions and expectations for the next 6 months. Business confidence increased to 55.7 in October, compared to 51.9 in July, out of a 0-100 range.

34. Also according to the CNI, the indicator of final stocks decreased to 51.4 in the third quarter, compared to 54.2 in the second quarter. For raw materials, stocks increased to 48.2 from 47.4 between the second and third quarters. Values above 50 points indicate that stocks are higher than planned. In the retail sector, the Fecomercio SP survey carried out at the end of September showed that only 10% of the surveyed companies had higher than planned levels of inventory.

35. In September output, domestic and external auto sales increased 8.9%, 11.3% and 21.1% month-on-month (s.a.), respectively. In the year up to September, production increased 2.3%, compared to the same period of 2002, driven mainly by a 37.2% increase in external sales, while domestic sales fell 7.3%.

Labor Market

36. The employment index increased 0.5% month-on-month in September (s.a.), and 3% year-on-year up to September, compared to the same period of 2002, according to Ministry of Labor and Employment data. According to the IBGE’s employment survey, the unemployment rate in the six main metropolitan areas reached 12.9% in September, compared to 13% in August, mainly as the result of a 1.2% increase in the number of employed people. In September, the economically active population increased 0.5%. Although the unemployment rate increased compared to September 2002 when it stood at 11.5%, there has been an increase of 4.3% in the number of employed people in the period. Comparisons with periods before 2002 are not possible due to methodological changes.

37. Also according to the IBGE´s survey, average real wages of employed workers in August 2003 fell 1.6% compared to the previous month and fell 14.2% compared to the same month in 2002. In the industrial sector, according to the CNI, real wages increased for the fourth consecutively month in August, but were still 3.9% lower than the same month in 2002. In 2003 up to August, real wages in manufacturing declined 6.1% in comparison to the same period of 2002.

Credit and Delinquency Rates

38. Total credit increased 1.2% in September, reflecting a 1% increase in freely allocated credit, and 1.9% in earmarked credit. In the total freely allocated credit, there was a 1.7% increase in the total amount of credit to individuals, driven mainly by increases in auto financing credit, which resulted from the decline in interest rates. Lending to companies increased 0.6%, with an increase of 2.2% in local currency loans and a decrease of 2.1% in the amount of FX denominated loans. With respect to earmarked credits, there was in increase of 4.8% in rural lending.

39. The average interest rate on non-earmarked credit fell again in September (2.92 p.p.), to 49.8% p.a., as a result of the reduction of the Selic target rate and of reserve requirements. The decline was more significant on lending to individuals, which fell by 3.8 p.p. to 70.7%, especially for overdraft accounts and personal credit. For corporate loans, the average rate was 34% p.a., falling 2.3 p.p. compared to the previous month. The delinquency rate on non-earmarked bank credit remained at 8.5%, with a decrease of 0.4 p.p. in the delinquency rate for individuals.

40. Regarding default rates on retail credit, there was a new improvement in September, driven by a 0.7% decrease in new default registrations. The number of cancelled default registrations increased 0.1% in the month accumulating a rise of 8.1% in the year up to September, signaling debtors’ and creditors’ intentions to renegotiate. ACSP data showed that the delinquency rate remained at 4% in September and registered an average rate of 5.6% in the year to September, compared to the 6.4% average rate registered last year.

Foreign Sector

41. The trade balance showed a surplus of US$2.7 billion in September, totaling US$17.8 billion in 2003 up to September and US$23.1 billion in twelve months,

establishing new records. Considering the daily average figures, exports increased 7% in September and 22% in the year to September, compared to the same period of 2002. Imports increased 10% in September, and posted a decrease of 1.4% in year to September, also in the comparison to the daily averages registered in the same periods of last year. In the first three weeks of October (13 working days), the trade surplus totaled US$ 1.6 billion, with a 20.9% increase in exports and a 15.9% increase in imports, compared to the daily averages registered in October of 2002.

42. Exports totaled US$7.3 billion in September, setting a historical record, driven by an expansion of manufactured exports, which at US$ 3.8 billion also constituted a monthly record. Exports of basic goods and semi-manufactured goods both recorded their second highest historical monthly values. In addition to the strong performance of these three categories, goods with a small share in total exports also performed strongly, signaling the continuing diversification process of Brazilian exports. Exports broadened for all regions, except for Asia. Exports to Mercosur continued to increase in September, particularly the recovery of sales to Argentina, which increased by 112.7% to hit US$479 billion. The United States remained a major buyer of Brazilian goods in 2003, representing 24% of Brazil's total exported in the year up to September.

43. With respect to imports, the 10% increase in the daily average registered in September in comparison to the same month of 2002 resulted from increases in imports in all categories, highlighting the increase of 16.8% of raw materials and intermediary goods. Up to September, daily average imports declined by 1.4%, driven mainly by an 18.9% decline in the average imports of capital goods.

44. The current account posted a US$1.3 billion surplus in September, compared to US$1.2 billion in September 2002. The deficit in the services and income accounts reached US$1.6 billion and unilateral transfers presented a US$225 million surplus. The year-to-date current account result reached US$3.9 billion. The financial account registered a net inflow of FDI of US$739 million in September, accumulating US$6.5 billion in 2003. At the end of September, international reserves stood at US$ 52.7 billion and adjusted net reserves stood at US$16.2 billion.

Money Market and Open Market Operations

45. In the period between the September and October Copom meetings, the yield curve continued to shift downward. The main factors underlying this behavior were the release of some lower-than-expected inflation indices, the forecasts presented in the September Inflation Report, and the decrease of country-risk. Between September 17 and October 21, the one month and one year interest rates decreased 0.98 p.p. and 0.92 p.p., respectively.

46. Due to the significant decrease in the demand for FX instruments, the average rollover rate on FX-linked securities and FX swaps was 13% of the maturity on October 1st; none of the maturity on October 15 and 3.2% of the maturity on November 3. Thus, the net redemption of FX instruments accumulated in the year reached US$14.8 billion.

47. The National Treasury carried out five LTN auctions, totaling R$13.5 billion. Together with the higher demand for these securities and the downward shift of the yield curve, interest rates on these instruments fell again. There were also five auctions of LFT maturing in 2007, totaling R$3.6 billion, which had the lowest discount of the year. Continuing the placement of NTN-Bs (IPCA indexed securities), the National Treasury carried out in October two auctions, offering securities maturing on 2006, 2009, 2015 and 2024. The interest rates on the two first maturities decreased to 9.98% in October from 10.79% in September. Total issue reached R$1.8 billion, R$946 million of which was paid in currency and the rest exchanged for other securities.

48. Financial redemptions between September 18 and October 22 caused a monetary contraction of R$2.9 billion, explained mainly by the net placements of R$7.5 billion of LTN and of R$2.1 billion of NTN-B and NTN-C, partially offset by net redemptions of R$3.3 billion of LFT and of R$2.2 billion of dollar-indexed securities.

49. The BCB intervened in the open market on a weekly basis with 2-week repo operations and conducted daily liquidity management operations. These operations drained from the banking reserves market excess liquidity of R$56.7 billion on average.

50. In September, the net securitized public debt increased 1.7%. The fixed rate share increased to 9.0% from 7.4% in August, maintaining the upward trend that has occurred in 2003. The share linked to the dollar decreased from 28.1% to 26.5%, the lowest of the year.

Minutes of the 90th Meeting of the Monetary Policy Committee (Copom)

Date: November 18th, from 3:30PM to 6:00pm, and November 19th, from 3:30pm to 7:00pm

Place: BCB's Headquarters meeting room of the 8th floor (on November 18th) and 20th floor (on November 19th) – Brasília – DF

In attendance:
Members of the Committee
Henrique de Campos Meirelles – Governor
Afonso Sant'Anna Bevilaqua
Alexandre Schwartsman
Antônio Gustavo Matos do Vale
Eduardo Henrique de Mello Motta Loyo
João Antônio Fleury Teixeira
Luiz Augusto de Oliveira Candiota
Paulo Sérgio Cavalheiro
Sérgio Darcy da Silva Alves

Department Heads
(present on November 18th)
Altamir Lopes – Economic Department
Daso Maranhão Coimbra – International Reserves Operations Department
José Antonio Marciano – Department of Banking Operations and Payments System
José Pedro Ramos Fachada Martins da Silva – Investor Relations Group
Marcelo Kfoury Muinhos – Research Department (also present on November 19th)
Sérgio Goldenstein – Open Market Operations Department

Other participants
(present on November 18th)
Antônio Carlos Monteiro – Executive Secretary
Alexandre Pundek Rocha – Advisor to the Board
Flávio Pinheiro de Melo – Advisor to the Board
João Batista do Nascimento Magalhães – Special Advisor to the Governor
Jocimar Nastari – Press Secretary
Katherine Hennings – Advisor to the Board

The members of the Monetary Policy Committee analyzed the recent performance of and prospects for the Brazilian and international economies under the monetary policy framework, which is designed to comply with the inflation targets established by the government.

Recent Evolution of Inflation

1. The main price indices showed lower changes in October, confirming the evaluation that the increase registered in September was temporary. Besides, the results for October revealed that the main contributions to the monthly inflation were localized, ratifying the downward trend for various core measures of consumer price inflation.

2. The IPCA rose 0.29% in October, compared to 0.78% in the previous month, accumulating an increase of 8.37% in the year, and of 13.98% in twelve months. The IGP-DI rose 0.44%, after an increase of 1.05% in September, influenced by a 0.50% increase in the IPA-DI, and a 0.21% increase in the IPC-Br. The IGP-DI and the IPA-DI indices accumulated in twelve months were reduced for the 7th consecutive month in October, reaching 15.78% and 16.36%, respectively.

3. Regarding the IPCA, the 0.38% increase in free prices contributed with 0.27 p.p. to the overall result of the index, while the 0.07% increase in regulated prices contributed with the remaining 0.02 p.p.. In the first group, the increases were concentrated in specific items, of which chicken price alone, with a

11.4% increase in the month, contributed with 0.1 p.p. in the overall result for October. Most part of the food prices, however, showed deceleration in October, jointly registering a 0.45% variation, compared to 0.78% in September.

4. Concerning regulated prices, a 1% increase in electricity tariffs was observed, due to the increase of the so-called "emergency capacity fee" and the tariffs readjustment in the city of Goiânia. On the other hand, the fall in fuel prices, as well as in airplane ticket prices, explain the stability of overall regulated prices in the month, after expressive increases observed from July to September.

5. In the wholesale sector, both agricultural and industrial prices registered smaller variations in October, compared to the previous month. The Agricultural-IPA rose 1.30%, after an increase of 3.55% in September, still reflecting the increase of soy prices in the international market, and pressures in meat prices, albeit in lower magnitude than in the previous month. Industrial prices increased 0.18% in the month, after a 0.40% increase in September. The deceleration of industrial prices was determined mainly by the decrease in prices of motor fuel, fertilizers, pharmaceutical products, iron, steel and by-products.

6. Core IPCA inflation calculated excluding household food items and regulated prices increased 0.37% for the fourth consecutive month, accumulating a 10.14% increase in the last twelve months.

7. Core IPCA inflation calculated under the smoothed trimmed-mean method increased 0.77% in October, compared to 0.86% in September. In the last twelve months, the accumulated change stood at 12.67%, still reflecting the effects of price increases in the end of 2002. Inflation calculated without the smoothing procedure for pre-selected items reached 0.29% and 10.87% in the month and in twelve months, respectively.

8. Core IPC-Br inflation calculated under the symmetric trimmed-mean method by FGV rose 0.5% in October, accumulating an increase of 11.91% in the twelve months ending in October.

9. In November, both consumer and wholesale price indices should register variations close to those observed in October. In the wholesale index, increases in the prices of vegetables, fruit, fertilizers and mechanic industry goods are expected, whereas decreases are expected in the prices of eggs, beans, corn and sugar. The relative stability expected for the IPCA variation will result from the continuity of deceleration of free prices, particularly food prices, and increases in regulated prices. The price increase expected for this group comes from the price readjustments for lotteries, urban bus services in Rio de Janeiro, and electricity tariffs in the concession areas of Light and Companhia Estadual de Energia Elétrica (CEEE), whose impacts should more than compensate price decreases that have been observed in motor fuel.

Assessment of Inflation Trends

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

a. There has been a 0.5% reduction in the projections for the readjustment of gasoline in 2003. The new projection for this year's readjustment stands at 0.8% for the whole year. Regarding bottled gas, projections have also been reduced, and, for 2003, a 4.6% readjustment is expected;

b. In relation to household electricity tariffs, the readjustment projection slightly increased from the last Copom meeting, to 21.7% in November, from 21.2% in October. Projections for fixed telephone fees readjustments in 2003 were reduced significantly in November, falling from 25% to 19.1%, value that has already been accumulated in the year up to October. Therefore, projections for 2003 assume that no new judicial decision will be made until the end of the year allowing fixed telephone companies to readjust tariffs;

c. For all regulated prices, with a total weight of 28.9% in the IPCA of October, inflation projected for 2003 fell 0.6% p.p., posting 13.3%, mainly due to the fall in the projections for price readjustments of gasoline and bottled gas, despite the slight exchange rate depreciation that took place in the last month;

d. The regulated prices projections in 2004, based on specific projections for each item, decreased 0.4

p.p., to 8.5% in November, mainly as a consequence of a fall in the projected readjustment for public transportation for 2004;

e. The projection for the 6-month spread over the Selic rate, following the specification of the VAR model using the Selic and the swap rates on the eve of the Copom meeting, was –130 b.p. for the fourth quarter of 2003, gradually rising to 70 b.p. at the end of 2004.

11. Regarding fiscal policy, it is assumed that the primary surplus target of 4.25% of the GDP for this year and the following two years will be accomplished. The other related assumptions established in the October meeting were maintained.

12. Considering the baseline scenario hypotheses, including the maintenance of the Selic interest rate at 19.0% p.a. and the exchange rate at the level prevailing on the eve of the Copom meeting (R$2.95), inflation is projected above the adjusted target of 8.5% for 2003 and below the target of 5.5% for 2004.

Monetary Policy Decision

13. The inflation decrease in October confirms the Copom's evaluation expressed in the minutes of the previous month's meeting that the acceleration of inflation in September was temporary. Regarding the IPCA, the 0.29% inflation in October was almost 0.5 p.p. lower than the result of September. This reduction was generalized, having been verified in regulated prices and in both components of free prices: tradable and non-tradable items. Other consumer price indices, as the IPC-Fipe and the IPC-Br, also showed lower inflation in October. Preliminary data for November, as the IPCA-15, IPC-Fipe and the weekly IPC of FGV, suggest that inflation for November tends to fall or stabilize at levels around the one observed in October. The behavior of the general and wholesale price indices was similar. It is worth mentioning that the agricultural IPA, with a variation of 1.30%, a 2.3 p.p. decrease in comparison to September, shows the reduction of the "inter-harvest" effects over inflation. It is increasingly likely that a one-digit inflation for the IPCA will be accomplished in 2003, which has already been anticipated by market participants since August according to the surveys carried weekly by the Investor Relations Group (Gerin).

14. All core inflation measures had the same behavior of the inflation indices. Core inflation measures calculated under the trimmed-mean method, either smoothed or not, fell. Core IPCA inflation calculated by excluding household food items and regulated prices remained stable at 0.37% for the fourth consecutive month. The ratio of IPCA items that had positive variations fell to 61.1% in October from 63.4% in September, below the 63.5% mean observed since the beginning of the floating exchange rate regime.

15. Economic activity indicators released since the October meeting confirm the recovery scenario that the Copom was outlining in recent months. According to IBGE, industrial production rose 7.0% since June (s.a.). In September industrial production rose 4.3%, reaching a level higher than in the same month in 2002, what had not occurred since May 2003. Following the trend outlined since August, industrial production growth was more spread, with expansion reaching 17 of 20 sectors and all the category of uses. The recovery of industrial activity evidenced in the IBGE indicators is confirmed by the CNI seasonally adjusted data, which shows an increase in working hours and in the installed capacity between August and September. The Copom evaluates that the recovery in the economy should strengthen in the next months, even though a decrease in the growth rates occur compared to the high rates observed in September

16. The scenario of recovery in consumption is now more clearly outlined, although at a slower pace than output. According to IBGE, the volume of retail sales in 2003 is lower than the level for the same months of 2002. However, the decreases are gradually falling, reaching 2.7% in September from 5.9% in August. Compared to June, seasonally adjusted data show an accumulated growth of 0.9% that should be interpreted with caution due to the reduced size of the series. Preliminary sales figures in the greater São Paulo, according to Fecomércio, show a 0.5% s.a. increase in October, compared to September. Another evidence of the recovery in consumption is the increase of consultations to the Credit Protection System (SPC) and Usecheque in October.

17. The Copom foresees a consolidation of the consumption upward trend over the next months due to better credit conditions and progressive recovery

in real income due to wage agreements and other developments in the labor market. The new scheme of repaying loans directly from payrolls should continue to allow the expansion of credit concessions at significantly lower costs. Besides, according to CNI and Fiesp, real wages in the manufacturing sector are expanding since the beginning of the year. According to the CNI, wage payroll in September is very close to the observed at the end of the third quarter of 2002. In September there was an increase of both total number of employed workers (1.2%, according to the IBGE) and formally employed workers (0.5%, according to the Ministry of Labor). However, the unemployment rate calculated by IBGE in September is practically unaltered at 12.9% due to continued increase in the labor force. The lag between improvement in activity and fall in jobless rate is usual in cyclical recoveries, as the number of workers entering the labor force increases more than job positions. In the short run, consumption shall be supported by the end-of-year bonus (13th wage) in an environment of more favorable expectations regarding the economy.

18. Another important result for the consolidation of a improving economic activity scenario is the evidence that investment also begins to recover. In September there was an increase of 11.4% in absorption of capital goods compared to August (s.a.), which corresponds to the sum of production and net exports of capital goods, a good indicator of the investment in the economy. So, the increase in investment reinforces the Copom evaluation presented in previous minutes in the sense that economic growth will be balanced without inflationary pressure, using excess of idle capacity in the beginning followed by an increase in installed capacity.

19. External accounts sustained the positive performance observed so far this year. The excellent results from October and the first weeks of November rose the Central Bank's trade balance forecast to US$23.5 billion from US$20.5 billion. The current account projection to 2003 increased in this period to US$3 billion surplus from a US$1.2 billion deficit. The country risk measured by the Embi+ fell 25 b.p. since last Copom meeting reaching 583 b.p. The foreign exchange rate has depreciated against the US dollar from R$2.85 to R$2.95.

20. In the last months the probability of a scenario of jointly growth of the world economy has increased, with good perspectives in the US, Europe and Japan. The perspectives of growth in the developing economies are the most favorable in recent years. The growth of world economy will boost international liquidity and increase demand for Brazilian exports. As a consequence, Brazilian economy may recover without more significant pressures over the Balance of Payments financing or the exchange rate.

21. The medians of the market inflation expectations sustained the downward trend. For 2003, probably as a result of the lower-than-expected October inflation, expectations decreased to 9.4% from 9.8%. For the next 12 months, market expectations decreased to 5.9% from 6.25%, which is lower than the 6.0% stipulated by the trajectory of the inflation targets for October 2004. For 2004, expectations remained at 6.0%. This evolution in inflation expectations occurred together with an increase in GDP expectations to 3.4% from 3.2%. Economic agents seem to anticipate a balanced recovery, without threatening the inflation target set up for 2004.

22. The Central Bank's inflation forecasts, assuming the maintenance of the Selic rate at 19% p.a. and the exchange rate at R$2.95, still point to an inflation above the adjusted target of 8.5% for 2003. Under the same assumptions for the exchange and interest rate, the Central Bank's forecasts for the next 12 months and 2004 are below the targets. The forecasts have not changed significantly since October because the inflationary impact of the exchange rate depreciation was compensated by the lower-than-projected inflation in October and the decrease to 8.5% from 8.9% of expected regulated prices growth for 2004. Thus, inflation trajectory for the coming months remains below the path presented in the Open Letter sent by the Central Bank's Governor to the Ministry of Finance on January 21st, 2003.

23. The Copom understood consensually that it was necessary to carry on with monetary easing, considering that the inflation projections associated to the baseline scenario for the next twelve months and for 2004 remained below the inflation target; that inflation expectations were compatible with the path of the target and with the balanced recovery of the economy;

and that the external scenario is favorable to price stability. It was also consensual in the Copom that the direct and indirect effects of successive reductions of the Over-Selic rate target since June did not yet materialize totally in the behavior of activity and inflation. These reductions, which accumulated 750 b.p. between June and October, were accompanied by the sustained reduction of market real interest rates for different maturities. As highlighted in previous meetings, there are important uncertainties regarding the magnitude and the lag of monetary transmission.

24. Two members of the Copom considered more adequate, at this moment, to reduce the Over-Selic rate target by 100 b.p., continuing the monetary easing at a slower pace, and adjourning more expansionist moves when economic growth consolidates whilst inflation is consistent with the targets. However, most of the Copom members understood that the risk balance for activity level and inflation already justified a complementary expansionist impulse, through the reduction of 150 b.p. in the Over-Selic rate target, not ignoring the uncertainties regarding the monetary transmission.

25. Thus, for seven votes to two, the Copom decided to reduce the target for the Over-Selic rate to 17.5% p.a., without bias.

26. At the end of the meeting, it was announced that the Copom would meet again on December 16th, 2003, for technical presentations, and on the following day in order to discuss the monetary policy decision, as set by the Communiqué 10,187, of October 2nd, 2002.

Summary of Data Analyzed by the Copom

Economic Activity

27. Retail sales fell 2.7% in September and 5.2% in the period between January and September 2003, compared to the same periods of the last year, according to the IBGE. Although still negative, the September result reflected the marginal improvement in comparison to the previous months. Four out of five activities remained registering decreases in sales volume compared to the same month of 2002, however with lower growth rates than those observed in August, while the furniture and appliances sector expanded 7%. Considering seasonally adjusted data, monthly increases were observed in four of the five activities, also highlighting the furniture and appliances sectors.

28. According to preliminary data from the Fecomercio SP, retail sales in the greater São Paulo increased 0.5% in October, compared to September, considering seasonally adjusted series. This result was due to the increase of 0.7% in consumer goods sales, mainly durable goods, proving the recovery of domestic consumption triggered by better credit conditions.

29. Consultations to the ACSP regarding credit and checks purchases increased 8.5% and 4.8%, respectively, in the first half of November, compared to those observed in the same period of 2002.

30. The monthly Fecomercio SP survey on consumer confidence showed a decrease of 0.9% in November, reaching 98.6 in a scale from 0 to 200. This result was mainly due to the new decrease of the future consume intentions (-5.2%), while current intentions sustained the upward trend, increasing 7.8%.

31. Investment indicators recovered in September, compared to the previous months. Machines and equipments output increased 8%. Capital goods imports and exports increased 19.3% and 15%, respectively. Capital goods domestic absorption grew 11.4% in September. Construction activity, the component with the highest share in investment, also showed significant recovery.

32. Brazilian industrial output grew 4.3% in September, s.a., according to the IBGE. The result was due to the increase of 5.5% in manufacturing industry and the decrease of 1% in mineral extraction production. Although there is no doubt regarding the improvement of industrial activity – it is the third consecutive month with positive performance, it should be highlighted that this expressive result was partially influenced by the higher number of working days in September, compared to the previous years, since the Independence holiday was on a Sunday.

33. The production expansion reached 17 of the 20 surveyed sectors and all categories of use, highlighting the increase of 8% in capital goods, 5.1% in durable consumer goods and 4.6% in semi-durable and non-durable consumer goods output. Intermediate goods

production, although growing in a rhythm slower than the industry average, maintained the dynamism that has been presented during the year, with a monthly s.a. increase of 3.1%.

34. Data on manufacturing activity released by the CNI confirmed the cyclical recovery. Hours worked in production increased 1.9% (s.a.) and the level of industrial capacity reached 80% in September, compared to the peak of 81.6% registered in October 2002. However, real industrial sales decreased by 0.4%, after an increase of 3.8% registered in the last month. Real industrial sales published by Fiesp showed a 0.65% increase in September (s.a.), following the same trend observed in August (rise of 3.5%). These opposite trends can be suggesting a larger dynamism of the São Paulo industry since the deceleration of industrial activity in the first half-year was more intense in São Paulo.

35. In the automotive sector, in October, auto output and domestic sales increased 3.5% and 12.4%, respectively, according to the s.a. series. These figures reflected the incentive to the sector as a result of the temporary reduction of the tax charged over vehicles, as well as the improvement of credit conditions and expectations. Vehicles external sales decreased 1.3% (s.a.) in October. However, in the year to October, the increase of 35.7% in vehicles exports confirm the key contribution of the external sector for the expansion of 1.6% in automotive output, since domestic sales declined 7.4%.

Labor Market

36. The index of employment increased 0.5% month-on-month in September (s.a.), and 3.8% year-on-year up to September, according to the Ministry of Labor. Regarding the expansion of employment in 2003, manufacturing presented the largest growth (4%), followed by commerce (2.7%) and services (2%), while civil construction fell 3.7% in the same period.

37. The unemployment rate in the six main metropolitan areas reached 12.9% in September, compared to 13% in August, mainly as the result of a 1.2% expansion in the number of employed workers in September and despite the 1.1% expansion in the labor force. According to the IBGE's survey, average real wages fell by 14.2% compared to the same month of 2002, showing a slight improvement compared to the 17.3% fall registered in June.

38. In the industrial sector, according to the CNI, there was an increase of 0.1% (s.a.) in employment in September, compared to the previous month. The real wages increased (s.a.) for the fourth consecutive month in September, but still 4.1% lower than in the same month of 2002. In the year to September, real wages in manufacturing declined 5.9% in comparison to the same period of 2002.

Credit and Delinquency Rates

39. Total credit increased 1% in October, reflecting a 1.1% increase in non-earmarked credit, and 0.8% in earmarked credit. In the total non-earmarked credit, there was a 1.9% increase in credit to households, driven mainly by increases in auto financing and personnel credit, responding to declining interest rates. Lending to companies increased 0.6%, in spite of the decline of 2.1% in external funded credit. With respect to earmarked credits, there was in increase of 4.8% in rural lending.

40. The average interest rate on non-earmarked credit fell again in October (1.2 p.p.), to 48.6% p.a., as a result of the reduction of the Selic target rate. The decline was more significant on lending to companies, which fell 1.5 p.p. to 32.5%, mainly due to the fall of the expected cost for FX-linked loans. For household loans, the average rate was 69.4% p.a., falling 1.3 p.p. compared to the previous month. The delinquency rate on non-earmarked bank credit fell 0.3 p.p. in October, reaching 8.5%.

41. Regarding retail trade default rates, there was a fall of 12.8% in the number of cancelled default registrations, whilst the number of new default registrations declined 1.7%. However, one should consider that in the last months the renegotiations of debts were intense, reducing the average default rate to 5.6% in October of 2003 as against 6.9% in the same period of last year.

External Environment

42. Worldwide economy continued posting positive figures. In the US, recently released data confirmed that recovery is in course, although uncertainties prevail regarding its speed and the Fed future monetary stance. In Asia, there is a favorable environment to growth, mainly driven by China and Japan. Even in Europe, there are signals of economic activity recovery, highlighting the 1.6% GDP growth expansion (annual, s.a.) in the third quarter.

43. The US GDP increased 7.2% in the 3rd quarter of 2003, boosted by an increase of 9.3% in gross private investment and an increase of 6.6% in consumption. Retail sales registered a decline of 0.3% in October, after a fall of 0.4% in September. Industrial production increased 0.2% in October and installed capacity was 75%, registering a slight increase compared to the previous month. The unemployment rate declined to 6% in October.

44. Japan GDP increased 2.2% in the 3rd quarter of 2003, the seventh consecutive quarter with a GDP increase. Growth was due to residential and non-residential private investment, which increased 11.4% and 11.7%, respectively, and exports, which increased 11.5% in the period.

45. Business expectations in the US, Japan and Europe point to favorable economic environment. Regarding consumers, an optimistic outlook prevails, although less intense than entrepreneurs'.

46. Interest rates remained stable in the US, Japan and Euro Area, but they increased in the UK and in Australia, signaling a possible global trend due to recovery of economic activity. Virtually all stock markets remain in an upward trajectory since the end of the Iraq war. At the same time, there has been a slight decline of risk aversion towards emerging markets in October. Expectations of economic and world trade growth have increased agricultural commodities prices, favoring emerging market economies. Oil prices oscillated above OPEC band, reflecting market disturbances in relation to inventory levels in the North Hemisphere and uncertainty about the recovery of Iraq's production.

Foreign Trade and Balance of Payments

47. Following the favorable behavior in the year, trade balance showed a surplus of US$2.5 billion in October, totaling US$20.3 billion in 2003 up to October. The trade balance and the total exports for October were US$23.4 billion and US$70 billion, establishing new records for twelve-month periods. Considering the daily average figures, exports increased 16.9% in October and 22.3% in the year to October, compared to the same period of 2002. Imports increased 17.3% in October, and posted an increase of 0.6% in year to October, also in the comparison to the daily averages registered in the same periods of last year. In the first two weeks of November (10 working days), the trade surplus totaled US$986 million, with a 20.5% increase in exports and a 9.4% increase in imports, compared to the daily averages registered in November 2002.

48. Exports totaled US$7.6 billion in October, setting a new historical record, driven by an expansion of exports of manufactured goods, which increased 19%, accounting for more than 53% of the total exports and whose total amount - US$4 billion – was also a monthly record. Exports of basic goods reached US$2.4 billion, a new monthly record, increasing 24.8% compared to October 2002. Exports of semi-manufactured goods declined 1.8% in the annual comparison, mainly due to the high comparison basis in October 2002.

49. There was a significant increase in all categories both in the sales of traditional goods and in less significant items due to the diversification in the exports basket in some categories. It is possible to observe similar diversification regarding destination markets. In October, the main markets to Brazilian products were US, China and Argentina.

50. Imports totaled US$5 billion. The 17.3% increase in the daily average registered in October in comparison to the same month of 2002 resulted from increases in imports in all categories, with highlights for the 30.9% increase for capital goods and 18.1% for raw materials and intermediate goods.

51. The current account posted a US$3.9 billion surplus in the year up to October, reverting the US$7.5 billion

in the period January-October 2002. The deficit in the services and income accounts reached US$18.7 billion compared to US$19.5 billion in the same period of 2002. The financial account registered a net FDI inflow of US$314 million in October, accumulating US$6.8 billion in 2003. At the end of September, international reserves stood at US$54.1 billion and adjusted net reserves stood (IMF Agreement) at US$17.5 billion.

Money Market and Open Market Operations

52. In the period between the October and the November Copom meetings, the yield curve shifted due to a decrease in short-term interest rates and an increase in longer-term interest rates. This movement was basically a consequence of price indices slowdown, especially the October IPCA, the new agreement with the IMF, the improvement in the country risk and the higher-than-expected activity level. Between October 22 and November 18, the six-month and one-year interest rates decreased 0.40 p.p. and 0.13 p.p., respectively, whilst the two-year interest rate increased 0.10 p.p.

53. The average rollover rate on FX-linked securities and FX swaps was 12.8% of the total maturity, as a result of rollovers of none of the maturity on November 13 and 15.1% of the maturity on December 1st. Thus, the net redemption of FX instruments accumulated in the year will reach US$17.6 billion on December 1st.

54. The National Treasury carried out five LTN auctions, totaling R$8.9 billion. Interest rates on these instruments fell again, as well as the premium on future interest rate yields. There were also three auctions of LFTs maturing in 2007 and 2008, totaling R$1.7 billion. The reduction in the amount of offered LFTs was due to the strategy of the National Treasury aiming at improving the profile of the securitized debt, increasing its fixed rate share and decreasing its post-set share.

55. Financial settlements between October 23 and November 19 caused a monetary expansion of R$3.0 billion, mainly explained by the net redemptions of R$8.8 billion of LFTs and R$1.3 billion of dollar-indexed securities, partially offset by net placements of R$8.0 billion of LTNs.

56. The BCB intervened in the open market conducting daily liquidity management operations. The BCB also intervened on a weekly basis with 2-week repo operations and started 3-month prefixed repo operations on November 12. This new strategy is consistent with the gradual return to the use of traditional instruments to sterilize banking liquidity, and reflects the aims of lengthening tenures and boosting the efficiency of the market of banking reserves. These operations, jointly, drained from the banking reserves excess liquidity of R$51.0 billion on average.

57. In October, the net securitized public debt increased 1.4%. The fixed rate share increased to 9.9% from 9.0% in September, while the share linked to the dollar decreased to 24.4% from 26.5%, reaching the lowest participation since March 2001.

Economic policy measures

Measures related to the financial system and credit market

Circular 3,200, 8.15.2003 – Altered and introduced provisions into the regulations covering the Special System of Clearance and Custody (Selic), dealing with inclusion of clearing houses as system participants. Depending on the type of custody or the nature of the operation, financial settlement of the operations of the clearing houses occurs in one of the following accounts:

I – Banco Central do Brasil settlement account: for operations involving payments of interest, amortizations, redemptions of securities held in custody and safeguards adopted in the system;

II – account managed by the Banco Central do Brasil Department of Banking Operations and the Payment System (Deban): for payments of interest, amortizations and redemptions of securities belonging to the special capital assets of the clearing houses;

III – banking reserve account of the standard settlement agent: for other clearing house operations.

Provisional Measure 130, 9.17.2003 – Authorized employees covered by Consolidated Labor Legislation (CLT) to deduct from payroll installments on loans, financing and leasing operations contracted with financial institutions and leasing companies up to a limit of 30% of available earnings. This prerogative also applies to retirees and pensioners of the National Social Security Institute (INSS). Parallel to this, agreements between financial institutions and companies and/or labor unions were permitted for the purpose of implementing such operations. The agreements in question would have the objective of defining the financial parameters and general conditions applicable to the employees.

Resolution 3,120, 9.25.2003 – Set the Long-Term Interest Rate (TJLP) at 11%, to remain in effect in the fourth quarter of 2003, corresponding to a reduction of 1 percentage point in relation to the rate for the previous quarter.

Resolution 3,121, 9.25.2003 – Altered and consolidated the rules that determine the guidelines for application of the resources of the benefit plans of closed complementary pension fund entities. Among these alterations, one should stress the new system for controlling and evaluating the risks of the resources invested, determining that such entities must maintain a system within the framework of each benefit plan for purposes of controlling unplanned differences between the value of a portfolio and the value projected for the same portfolio, in which the minimum actuarial rate should be considered. The period for adaptation is up to sixty days as of the date on which the resolution goes into effect. The obligation of calculating the value-at-risk (VaR) for the segments of fixed and variable income is maintained until such time as they are fully compatible with the new system.

Circular 3,206, 9.25.2003 – Altered Circular 2,905/1999, which prohibits inclusion of provisions in contracts calling for more than one earnings base or price index in funding and lending operations carried out on the financial market. In this context, more than one earnings base or price index was permitted in contracts covering time deposits, provided that the base or index that provides the highest earnings to the depositor prevails. The enhanced flexibility will allow for increased competition among financial institutions, while also reducing costs for savers, to the extent that it will diminish the need for contracting derivative operations to protect investments against scenarios different from those in which the contracting was carried out.

Circular 3,207, 10.22.2003 – Altered Circular 3,188/2003, which deals with the System of Centralization of the Clearing of Checks and Other Papers (Compe). The major alteration was elimination of the demand for a prior deposit for Credit Documents (DOC), effective as of February 18, 2004, since the processes of clearing and settling these instruments will no longer be effected by Compe.

Resolution 3,128, 10.30.2003 – Increased the value of the limit on credit operations granted to low income individuals from R$500.00 to R$600.00. Such loans are taken into account in the calculation of the channeling of the minimum of 2% of demand deposit balances into the microcredit operations of commercial banks, multiple banks with commercial portfolios, the Federal Savings Bank and credit cooperatives.

Resolution 3,140, 11.27.2003 – Altered the provisions related to procedures for the constitution and operation of credit cooperatives. The most important of these refers to the possibility of constituting cooperatives based on the admission of participating businesspersons from companies connected to the same employer union or association, with at least three years of operations. Resolution 3,106, dated June 2003, determines that credit cooperative may be created on the basis of groups of small businesspersons for any area of activity or groups of small scale professionals, provided that the cooperatives be distributed by sector of economic activity. In this sense, this Resolution added the criterion of association centered on the linkage between the businesspersons in question and a professional entity, without segmentation by area of activity and size limitations. Parallel to this, it excluded investments in federal public securities and quotas of investment funds from the limit on exposure per client. The only exceptions are those funds in which the cooperative is the sole participant. This rule is applicable to all modalities of cooperatives.

Fiscal policy measures

Provisional Measure 132, 10.20.2003 – Instituted the Family Assistance Program with the objective of implementing systems of income transfers subject to specific conditions, while unifying the management and execution procedures of the National Program of Minimum Income Linked to Education – School Financial Assistance Program; the National Program of Access to Food (PNAA); the National Program of Minimum Income Linked to Health – Food Assistance Program; and the Kitchen Gas Assistance Program. The Program consists of a single basic benefit that is to be channeled to households in situations of extreme poverty, and of a variable benefit component, targeted to households in situations of poverty or extreme poverty and that have, among the members of the family, pregnant women, infants still being breastfed, children between zero and twelve years of age and adolescents of up to fifteen years of age. In the 2003 fiscal year, expenditures related to execution of the programs cited above will continue to be implemented, in both budget and financial terms, by the respective ministries and appropriate entities concerned. In 2004, the funding of these programs will be decentralized to the entity responsible for implementation of the Family Assistance Program.

Law 10,748, 10.22.2003 – Instituted the National Program of Incentives to First Jobs for Youth (PNPE), which involves actions targeted at fostering the placement of youth in the job market and their education, strengthening the participation of society in the process of formulating policies and adopting measures aimed at generating jobs and income. The basic objective is to create jobs for youth and train young people for the job market. The Program is designed for youth between 16 and 24 years of age in situations of involuntary unemployment who meet the following requirements:

a) they do not have ties with a previous employment position;

b) they are members of households with per capital income of up to one half of the value of the minimum monthly wage;

c) they are enrolled and are regularly attending the primary or secondary education levels, or education courses for youth and adults;

d) they are registered at the Program's executive units.

Provisional Measure 133, 10.23.2003 – Created the Special Low Cost Housing Program, with the objective of offering access to housing appropriate for the population segments with monthly family income of up to three times the minimum wage. The resources allocated to the Program will be targeted, in the form of aid or financial assistance, to the production or acquisition of housing units and urban lots, acquisitions of building materials, urbanization of precarious settlements and urban retraining.

Provisional Measure 135, 10.31.2003 – Altered tax legislation, with emphasis on the following measures:

a) Contribution to Social Security Financing (Cofins): as of 2.1.2004, levying of this Contribution will no longer be cumulative and will be applied to aggregate value. With the new system, companies qualify to receive, in the form of a tax credit, the difference between what is owed at the time of application of the rate to the tax calculation base which, in this case, is the value of monthly revenues, and what has been paid at previous stages of the productive chain. Since the contribution will be levied on the basis of the lowest calculation, the rate was increased from 3% to 7.6%, with the objective of maintaining the revenue flow close to the current level. As of 2004, the tax will also be levied on inputs acquired abroad. Cofins will not be levied on revenues generated by exports of merchandise; on services rendered to individuals or corporate entities domiciled abroad, with payment in a convertible currency; and on sales to export companies for the specific purpose of selling such goods abroad. The following remain subject to the rules set down in Cofins legislation in effect prior to issue of this Provisional Measure: financial institutions; corporate entities subject to the income tax on the basis of presumed or arbitrated profits (companies with monthly revenues of up to R$4 million); companies that have opted for the Integrated System of Payment of the Taxes and Contributions of Microbusinesses and Small Scale Companies (Simples); legal entities exempt from the tax; cooperatives; companies that render telecommunications services and journalistic and radio and television broadcasting companies; and revenues subject to the special taxation system (Law 10,637, dated 12.30.2002);

b) Industrialized Products Tax (IPI): as of February 2004, the tax is to be calculated every fifteen days (currently, every ten days) and, in 2005, will become monthly;

c) Provisional Contribution on Financial Transactions (CPMF): until December 1, 2003, foreign investments entering stock exchanges will be subject to levying of the tax at only one stage or, in other words, they will be exempt from payment at the time of remittance of the resources abroad at liquidation of such operations;

d) Income Tax on capital gains: in cases of transfers of goods by foreign individuals or corporate entities to persons resident in the country, the national buyer will be equally responsible for payment of the tax;

e) combating smuggling: bus companies that transport passengers to countries that share common borders with Brazil will be obligated to identify baggage and their respective owners when returning to the country. Noncompliance with these rules will subject the company to payment of fines and loss of their operating license for two years.

Federal Senate Resolution 19, 11.5.2003 – Altered the text of article 7 of Resolution 43/2001, so as to exclude those credit operations carried out in the framework of the National Program of Efficient Public Lighting (Reluz), specified in Law 9,991/2000, from the limits on internal and external credit operations to which states, municipalities and the Federal District are subject.

Federal Senate Resolution 20, 11.7.2003 – Expanded the period for compliance with the debt limits defined in Resolution 40/2001, which deals with the global limits for the volume of the consolidated public debt and for the public securities debt of the states, municipalities and Federal District.

Law 10,762, 11.11.2003 – Instituted the Emergency and Exceptional Program of Support to Electric Power Distribution Public Utility Concession Companies, which has the objective of offsetting funding insufficiencies caused by postponement of the application of the compensation mechanism treated in article 1 of Provisional Measure 2,227, dated 9.4.2001, for the rate increases and revisions carried out between 4.8.2003 and 4.7.2004, based on financing granted by the National Bank of Economic and Social Development (BNDES). The concession companies that comply with the legal requirements for obtaining credits based on public resources and that are up-to-date on their obligations with companies belonging to the BNDES System may be beneficiaries of the Program. The value to be financed will be calculated and notified by the National Electric Power Agency (Aneel), in compliance with current legislation.

Decree 4,873, 11.11.2003 – Instituted the Program of Universalization of Access and Use of Electric Power – "Light for All", which has the objective of providing electric power to the segment of the Brazilian rural population that does not yet have access to this service.

Decree 4,902, 11.28.2003 – Extended the three percentage point reduction in the rates of the Industrialized Products Tax (IPI) charged on vehicles of up to two thousand cubic centimeters from 11.30.2003 to 2.29.2004.

Measures related to the external sector

Camex Resolution 24, 8.12.2003; 29, 10.9.2003; and 35, 11.27.2003 – Altered the *ad valorem* rates of the Import Tax on Capital Goods and Informatics and Telecommunications Goods and the products specified therein, under the heading of ex-tariff, to 4% (four percent) up to 6.30.2005, in the case of the first rule, and up to 12.31.2005, for the others.

Decree 4,820, 8.27.2003 – Deals with implementation of the Rectification Minutes of the Thirty First Additional Protocol to Economic Complementation Agreement 14, between Brazil and Argentina, dated 5.5.2003 (Agreement on Common Automotive Policy).

STN Directive 445, 8.29.2003, and 498, 10.6.2003 – Authorized issue of National Treasury Notes – Series I (NTN-I) to be used in payment of interest rate equalization in the financing of exports of Brazilian goods and services supported by the Export Financing Program (Proex).

Secex Directive 12, 9.3.2003 – Revoked SCE Directive 2/1992 and several others; consolidated the regulatory provisions of export operations as related to exporter registration, accreditation and qualification, export registration, administrative treatment applied to products, documentation, sales records, examination of prices and payment periods, agent commissions, financing, international agreements and returns of merchandise. All information that is already included in previous legislation was subjected to a detailed study in order to adapt the legislation to the real needs of export operations, particularly with the aim of streamlining procedures. This Directive should be viewed in the context of MDIC Directive 405, dated 9.3.2003.

Legislative Decree 606/2003 – Approved the text of the XXI Additional Protocol to Economic Complementation Agreement 35, formalized between Mercosul and Chile and signed on 10.19.1999.

Provisional Measure 131, 9.25.2003 – Defined norms for the planting and marketing of production of the 2004 soybean harvest and takes other measures.

Decree 4,846, 9.25.2003 – Regulated article 3 of Provisional Measure 131, dated 9.25.2003, which establishes rules for the planting and marketing of the production of the 2004 soybean harvest and takes other measures.

Decree 4,857, 10.13.2003 – Introduced new composition into the second paragraph of article 5 of Decree 4,732, dated 6.10.2003, which deals with the Foreign Trade Chamber (Camex), of the Council of Government and alters the name of the Executive Management Committee, as stated in the same Decree.

Legislative Decree 712, 10.15.2003 – Approved the Olivos Protocol for the Solution of Mercosul Controversies, signed in Olivos, Buenos Aires Province, on 2.18.2002, by Brazil, Argentina, Paraguay and Uruguay.

Mapa Directive 795, 10.27.2003 – Defined criteria for the allocation of preferential sugar export quotas reserved by the Untied States to Brazil, to beneficiary sugar production units, for calendar year 2003/2004.

Provisional Measure 135, 10.30.2003 – Altered the system of charging the Contribution to the Financing of the Social Security System (Cofins) to a noncumulative system, introducing new provisions with respect to the generating fact, calculation base and levying of the Contribution among other questions. Cofins will not be levied on the revenues of the export operation; however credits referring to acquisitions of imported inputs will not be accepted. Aside from this, it alters other aspects of tax and customs legislation, in which it includes provisions related to customs systems, fines and penalties, while also altering the texts of important legislation.

Circular 3,209, 11.3.2003 – Altered the periods for settlement of exchange operations of a financial nature from 90 to 180 days, when the client is the Secretariat of the National Treasury. The original period was introduced by Bacen Circular 3,205, dated 9.18.2003.

Law 10,755, 11.4.2003 – Specified fines in import operations and takes other measures.

Camex Resolution 34, 11.27.2003 – Altered the *ad valorem* rate of the Import Tax on the product of NCM Code 8473.30.49 (Informatics and telecommunications goods – BIT) to zero percent, in the special ex-tariff condition (Ex 001, granted by Camex Resolution 13, dated May 12, 2003).

Appendix

Banco Central do Brasil Management

Members of the Monetary Policy Committee (Copom)

Banco Central do Brasil Management

Board

Henrique de Campos Meirelles
Governor

Afonso Sant'Anna Bevilaqua
Deputy Governor

Antonio Gustavo Matos do Vale
Deputy Governor

Alexandre Schwartsman
Deputy Governor

Eduardo Henrique de Mello Motta Loyo
Deputy Governor

João Antônio Fleury Teixeira
Deputy Governor

Luiz Augusto de Oliveira Candiota
Deputy Governor

Paulo Sérgio Cavalheiro
Deputy Governor

Sérgio Darcy da Silva Alves
Deputy Governor

Members of the Monetary Policy Committee (Copom)

Voting members

Henrique de Campos Meirelles
Governor

Afonso Sant'Anna Bevilaqua
Deputy Governor

Antonio Gustavo Matos do Vale
Deputy Governor

Alexandre Schwartsman
Deputy Governor

Eduardo Henrique de Mello Motta Loyo
Deputy Governor

João Antônio Fleury Teixeira
Deputy Governor

Luiz Augusto de Oliveira Candiota
Deputy Governor

Paulo Sérgio Cavalheiro
Deputy Governor

Sérgio Darcy da Silva Alves
Deputy Governor

Non-voting members

Altamir Lopes
Head of the Department of Economics (Depec)

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

José Antonio Marciano
Head of the Department of Banking Operations and Payments Sistem (Deban)

José Pedro Ramos Fachada Martins da Silva
Head of the Investor Relations Group (Gerin)

Marcelo Kfoury Muinhos
Head of the Research Department (Depep)

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

Acronyms

Abimaq	Brazilian Association of the Machines and Equipment Industry
Abiove	Brazilian Association of Vegetable Oil Industries
ACC	Advances on Exchange Contracts
ACSP	São Paulo Trade Association
Anda	National Association of Fertilizer Distribution
Aneel	National Electric Power Agency
Anfavea	National Association of Automotive Vehicle Manufacturers
BIS	Bank for International Settlements
BIT	Informatics and telecommunications goods
BNDES	National Bank of Economic and Social Development
BNDESpar	BNDES Participações S.A.
BoJ	Bank of Japan
Bovespa	São Paulo Stock Exchange
Caged	General File of the Employed and Unemployed
Camex	Foreign Trade Chamber
Cide	Contribution on Intervention in the Economic Domain
CLT	Consolidated Labor Legislation
CNI	National Confederation of Industry
Cofins	Contribution to Social Security Financing
Conab	National Supply Company
Compe	System of Centralization of the Clearing of Checks and Other Papers
Copom	Monetary Policy Committee
CPMF	Provisional Contribution on Financial Transactions
CVM	Securities and Exchange Commission
DAX	*Deutscher Aktienindex*
Deban	Banco Central do Brasil Department of Banking Operations and the Payment System
DI	Interbank Deposits
Dieese	Interunion Department of Socio-Economic Statistics and Studies
DJIA	Dow Jones Industrial Average
DOC	Credit Documents
ECB	European Central Bank
Embi+	Emerging Market Bond Index Plus
Embi-Brazil	Emerging Market Bond Index
EU	European Union
Fecomercio SP	Trade Federation of the State of São Paulo
Fed	Federal Reserve
FGTS	Employment Compensation Fund
FGV	Getulio Vargas Foundation

Fiesp	Federation of Industries of the State of São Paulo
FIF	Financial investment funds
Finame	Special Industrial Financing Agency
FTSE 100	Financial Times Securities Exchange Index
Funcex	Foreign Trade Studies Center Foundation
GDP	Gross Domestic Product
Gerin	Investor Relations Group of the Central Bank of Brazil
IBGE	Brazilian Institute of Geography and Statistics
Ibovespa	São Paulo Stock Exchange Index
IBRD	International Bank for Reconstruction and Development
IGP	General Price Index
IGP-DI	General Price Index – Internal Supply
IGP-M	General Price Index – Market
II	Import Tax
IIC	Consumer Intentions Index
IIF	Institute of International Finance
IMF	International Monetary Fund
INA	Economic Activity Level Indicator
INPC	National Consumer Price Index
INSS	National Social Security Institute
IOF	Financial Operations Tax
IPA-OG-PI	Wholesale Price Index – Overall Supply – Industrial Products
IPCA	Broad National Consumer Price Index
IPC-Br	Consumer Price Index – Brazil
IPC-Fipe	Consumer Price Index released by the Institute of Economic Research Foundation
IPI	Industrialized Products Tax
Laia	Latin American Integration Association
LFT	Treasury Financing Bills
LSPA	Systematic Farm Production Survey
LTN	National Treasury Bills
Mapa	Ministry of Agriculture, Livestock and Supply
MDA	Ministry of Agrarian Development
MDIC	Ministry of Development, Industry and Foreign Trade
MTE	Ministry of Labor and Employment
Nasdaq	National Association of Securities Dealers Automated Quotations
NTN-B	National Treasury Notes – Series B
NTN-C	National Treasury Notes – Series C
NTN-I	National Treasury Notes – Series I
OECD	Organization for Economic Cooperation and Development
Opec	Organization of Petroleum Exporting Countries
PIM	Monthly Industrial Survey
PIM-PF	Monthly Industrial Survey – Physical Output
PMC	Monthly Trade Sector Survey
PME	Monthly Employment Survey
PNAA	National Program of Access to Food
PNAD	National Household Survey
PNPE	National Program of Incentives to First Jobs for Youth
Pronaf	National Program of Strengthening Family Farming
Reluz	National Program of Efficient Public Lighting
S&P 500	Standard and Poor's 500

Selic	Special System of Clearance and Custody
SFH	Housing Financial System
Simples	Integrated System of Payment of the Taxes and Contributions of Microbusinesses and Small Scale Companies
SPC	Credit Protection Service
TJLP	Long-Term Interest Rate
UCL	Unit Cost of Labor
USDA	United States Department of Agriculture
VaR	Value-at-risk
WTO	World Trade Organization