II

MONEY AND CREDIT

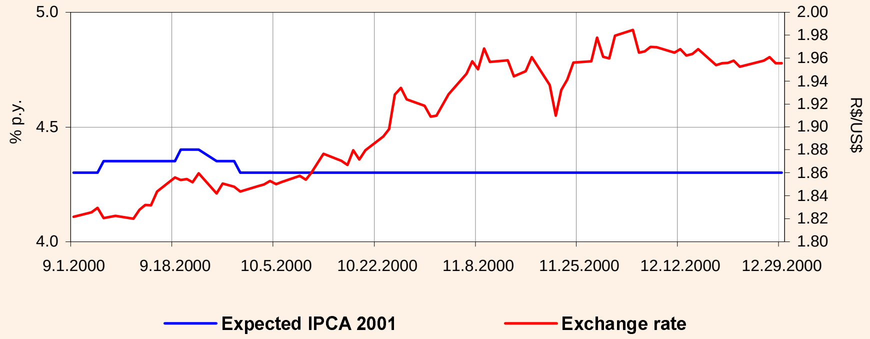
The monetary policy model based on inflation targeting and floating exchange adopted in mid-1999 has gradually consolidated its position as an adequate instrument for ensuring continued price stability. This is clear in the fact that the nation was successful in complying with the inflation targets set for 2000. The positive results achieved by monetary policy are evinced in the minimization of both supply shock passthrough and the use of indexing mechanisms, at the same time in which the country has achieved consistent recovery in its macroeconomic fundamentals. Unmistakable signs of this improvement are found in the persistent favorable fiscal results, in the lengthening of federal securities debt maturities and in the current account financing profile, in which direct investments now play an increasingly important role.

However, over the course of 2000, monetary policy management was conditioned by uncertainties on the international scenario. In this context, one should cite increases in international petroleum prices since the start of the year, together with uncertainties regarding the overall thrust of United States monetary policy and difficulties that have hit the Argentine economy and produced clearly negative impacts on the sovereign risk evaluations elaborated by external agents with respect to Argentina, coupled with a less favorable outlook for Brazil.

In this framework, the Selic rate target was gradually reduced over the course of the year, though there were moments of greater uncertainty when authorities had to adopt a more rigid approach. In 2000, one can identify two distinct levels for the Selic rate target. In the first half of the year, the target leveled off at 19% per year up to April when it was cut to 18.5% per year, remaining at that level for two months. In the middle of the year, lessening international uncertainties made it possible to reduce interest rates to 17.5% per year in June and 16.5% per year in the month of July. In the second half, in the midst of rising doubts regarding the international scenario, the Selic rate slide was halted and no more reductions were adopted until December 21, when the rate was cut to 15.75% per year.

Among the major indicators of economic policy credibility, one should stress the improvement that occurred in the results of competitive issues of federal securities

Graph 2.1
Exchange rate x expected inflation



in 2000. In comparison to the end of the previous year, participation of the debt indexed to foreign currency dropped from 30.2% to 28%, reflecting less exposure of the internal debt to exchange rate fluctuations. The participation of the preset debt, in turn, increased from 12.9% to 21%, thus reducing the volatility of the federal securities debt by diminishing its sensitivity to interest and exchange rates. Aside from this, the profile of the competitively issued debt was lengthened, registering average duration of 6.3 months and an average term of 15.8 months at the end of the year, compared to 3.9 months and 8.6 months, respectively, at the end of the previous year.

Aside from the goal of achieving compatibility between aggregate supply and demand, monetary policy was conducted with the objective of contributing to the economic development process by stimulating increased private sector participation. In this context, monetary policy measures were targeted at creating a more dynamic credit market through reductions in both the risks and indirect costs of financial intermediation. Among these measures, one should stress cutbacks in the rates of compulsory reserves on demand resources from 65%, in effect since October 1999, to 55% in March and 45% in June 2000.

Parallel to the measures cited above, Banco Central adopted a new system of classifying credit operations with the aim of reducing the credit risks to which financial institutions are subject. Implementation of the new system began with the financial statements for the month of March. Among these innovations, the following aspects deserve mention:

a) classification of credit operations at differentiated risk levels, based on consistent and verifiable criteria that make it possible to identify the risk levels of each operation with a higher degree of accuracy;
b) introduction of a new system of setting aside provisions for hard-to-recover credits based on a technically more suitable foundation;
c) adoption of a stricter system of dealing with credits in arrears, with restrictions on recognition of charges and reclassification of renegotiated credits, coupled with more homogeneous rules for longer term operations.

Table 2.1 - Collection rate on mandatory reserves

Percentage

Period		Demand deposits	Time deposits	Savings deposits	Credit operations	FIF Short-term	FIF 30 days	FIF 60 days
Prior to Real Plan		40	-	15	-	-	-	-
1994	Jun	100	20	20	-	-	-	-
	Aug	"	30	30	-	-	-	-
	Oct	"	"	"	15	-	-	-
	Dec	90	27	"	"	-	-	-
1995	Apr	"	30	"	"	-	-	-
	May	"	"	"	12	-	-	-
	Jun	"	"	"	10	-	-	-
	Jul	83	"	"	"	35	10	5
	Aug	"	20	15	8	40	5	0
	Sep	"	"	"	5	"	"	"
	Nov	"	"	"	0	"	"	"
1996	Aug	82	"	"	"	42	"	"
	Sep	81	"	"	"	44	"	"
	Oct	80	"	"	"	46	"	"
	Nov	79	"	"	"	48	"	"
	Dec	78	"	"	"	50	"	"
1997	Jan	75	"	"	"	"	"	"
1999	Mar	"	30	"	"	"	"	"
	May	"	25	"	"	"	"	"
	Jul	"	20	"	"	"	"	"
	Aug	"	"	"	"	0	0	"
	Sep	"	10	"	"	"	"	"
	Oct	65	0	"	"	"	"	"
2000	Mar	55	"	"	"	"	"	"
	Jun	45	"	"	"	"	"	"

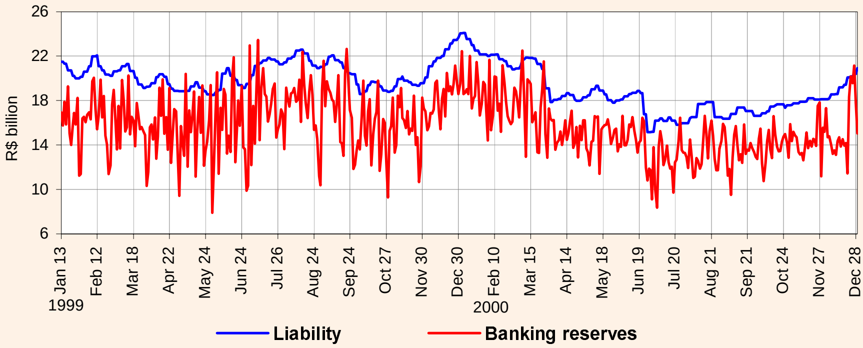
Viewed in a context that was more propitious to economic growth recovery, the improvements introduced into risk management instruments strengthened the role of banking credits in monetary policy transmission. Thus, the new system of classifying credit operations tends to favor private spending as a consequence of more efficient financial system credit allocations.

One should also stress the alterations introduced into operational rules applicable to the charging base, calculation periods and utilization of compulsory reserves on demand resources. These changes were regulated by Resolution 2,725, dated May 31, and Circular 2,986, dated June 23. The charging base has incorporated demand deposits and deposits subject to notification effected at service outposts as of October 1, 2000 and in pioneering branches as of June 1, 2003. As of July 2000, the resources originating in the expenditure invoices of public service concession companies are no longer exempt. In contrast to this, an exemption from compulsory reserves on demand deposits was granted to deposits reserved to acquisitions of federal public securities.

The lengthening from one to two weeks of the periods of calculation and compliance with these requirements which are to be maintained as banking reserves has operational implications for monetary policy. In the previous system, the calculation and utilization of these requirements occurred over a period of five business days, which was sometimes reduced to four or even three days as a result of holidays. In this way, institutions were able to position themselves at a minimum in the range of 60% of the average requirement during a few days of the operating period. The alterations introduced into these parameters aided in reducing the volatility of banking reserves, while making management of these reserves by banking institutions more flexible. Consequently, the need for monetary authority intervention to achieve balance in the market has tended to lessen.

Graph 2.2

Banking reserves - valuated balances



Federal public securities

Operations with federal public securities over the course of the year were impacted by favorable growth in internal macroeconomic fundamentals and by uncertainties on the international scenario. One factor that should be highlighted is that the process begun last year of expanding the secondary security market moved forward, with implementation of measures aimed at achieving greater transparency and liquidity in operations with these papers.

In this sense, measures were introduced in the month of August with the aim of expanding the volume of operations on the secondary federal public securities market. These measures were designed in such a way as to utilize the Rio de Janeiro stock exchange to stimulate utilization of electronic systems in operations with federal securities. In much the same way, security sales operations were introduced with resale commitments assumed by the buyer, at the same time in which institutions have been permitted to operate freely with these papers. The added flexibility includes the possibility of anticipating the resale date and in this way encouraging the involvement of new economic agents in this market.

In order to facilitate secondary market operations, July 1, 2000 was specified as the single base date to be used as reference for updating the nominal value of preset papers. In practical terms, papers issued on different dates will have the same nominal value.

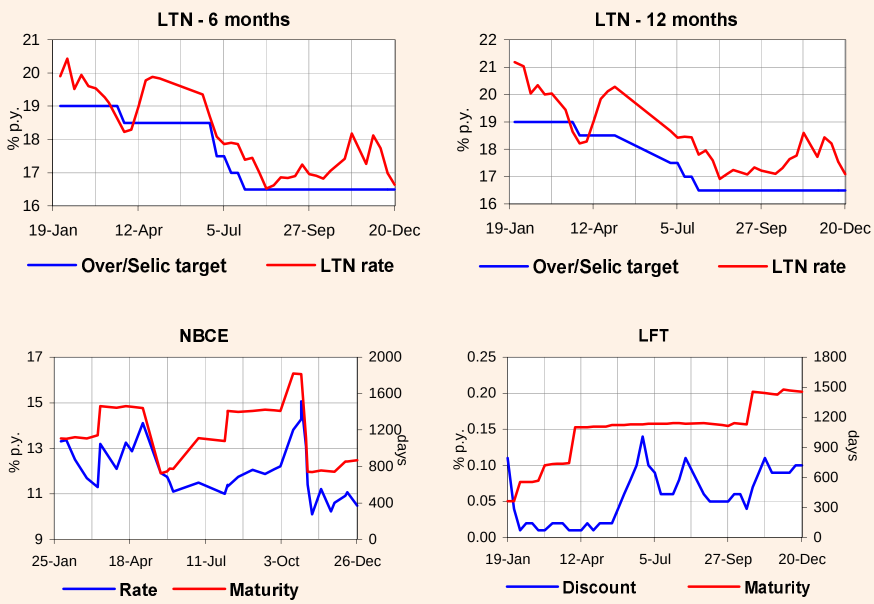
In the month of September, the criteria for expressing the profitability rate of the federal papers registered in the Special System of Liquidation and Custody (Selic) were standardized. The profitability of papers for which nominal value is updated according to the value of the dollar is to be calculated according to the internal rate of return based on a period of 360 calendar days and the system of simple capitalization. The profitability of other papers is to be calculated as an annual effective rate, based on 252 business days and the system of compound capitalization. With this measure, it should be possible to enhance the comparability of domestic interest rates and those practiced on the international market.

Competitive Banco Central offers of federal securities in definitive operations were restricted to rolling the federal securities debt indexed to exchange. In early 2000, Banco Central Notes - Special Series (NBCE) were placed with terms of two years at an average rate of 11.3% per year. In March, maturity was raised to four years at an average rate of 12% per year. In mid-April, international uncertainties forced the rates on NBCE placements upward to a level of 12.6% per year, despite a cutback in the terms of these papers to two years. In the August-September period, the federal government adopted the strategy of partially rolling maturities in order to reduce its participation in the total public debt and, in this way, diminish exposure to external financial shocks. However, the strategy of partially rolling the debt was suspended as unfavorable expectations loomed ever larger on the international scenario. With this, the volatility of the internal exchange market increased sharply. In its quest for market stability, Banco Central began making net placements of these papers.

Another factor of great importance to monetary and exchange policy implementation was passage of Complementary Law 101 (Fiscal Responsibility Law). Article 34 of that law prohibited Banco Central from issuing public securities, effective as of May 2003.

Competitive operations with National Treasury securities continued and had the dual objective of lengthening maturities and reducing the financial costs of the securities debt. As of the end of January, preset papers – National Treasury Bills

Graph 2.3
Auctions - placement rates - 2000

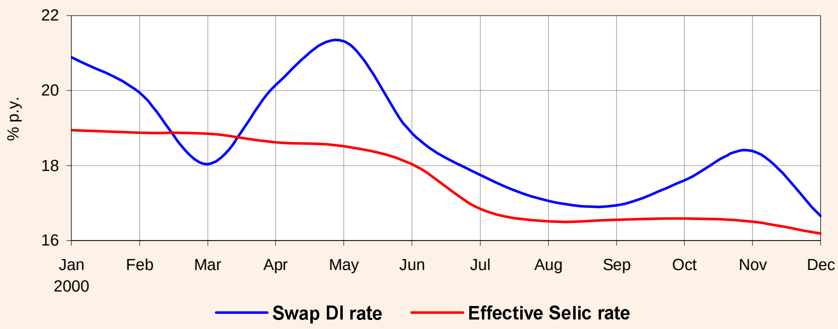


(LTN) – were offered with terms of one year. Up to that time, they had been placed with maturities of three and six months. At the same time in which maturities were being lengthened, there was a sharp cutback in placement rates from 21.2% per year on January 21 to 18.2% per year on March 28. In the month of May, international financial market instability led to interruption of security placements following the May 2 auction when the rate moved to 20.3% per year. With the calming of the international situation, Banco Central began offering LTN once again as of June 13. During the half year period, placements were made with maturities of six months and one year at steadily declining rates of interest, which dropped to a level of 16.6% per year for six month LTN and 17.1% per year for one year papers on December, 20. In that period, one should take particular note of LTN placements with maturity of 670 days, with a firm purchase proposal, at 17.6% per year. One should note here that placement of these papers with similar terms had not occurred since the outbreak of the Asian crisis in October 1997. In December, the average term of LTN placements came to 291 days, for growth of 144.5% in relation to December 1999.

The placement terms of National Treasury papers indexed to the Selic rate and issued in public offers increased consistently since the start of the year, moving from almost 12 months to three years in the month of April. As of October, placement terms increased to four years. In keeping with the National Treasury's strategy of reducing the participation of postset securities in the composition of the internal

Graph 2.4

Swap DI rate x effective Selic rate



federal securities debt, Treasury Financing Bills (LFT) represented 52.1% of the total debt at the end of the year, reflecting a reduction of 9 percentage points in relation to the end of the previous year.

Auctions involving National Treasury Notes - Series C (NTN-C),which are indexed to the IGP-M, were also held during the year and followed the system used for NBCE, with a single price for each maturity. At the start of the year, the terms for NTN-C increased to three and seven years. Annualized placement rates for business days varied between 12.6% in March, with a term of seven years, and 11% in September, with terms of five years. One should also cite December placements of NTN-C with thirty year maturities and a rate of 11.97% p.y.

The procedures for exchanging securitized credits were altered as of the month of February, when utilization of these credits was permitted for payment of auctions, with predetermined discounts. The purpose of these changes was to make NTN-C operations more dynamic. In the context of the new system, the first stage defines the price of NTN-C and only offers in cash are accepted. In the second, an auction is held to determine the prices of the securitized credits and the participants make proposals involving sale of the credits they hold. The major objective of NTN-C is to contribute to strengthening the long-term parameters of the Brazilian economy, since their role in the financial market is to act as backing for long-term liabilities.

The duration of federal securities issued in public offers registered an upward trajectory over the course of the year, as the indicator moved from 3.95 months in December 1999 to 6.32 months in December 2000. To a great extent, this result was impacted by the lengthening of the terms of preset and exchange securities placed on the market. The average duration of LTN increased from 1.96 month at the end of 1999 to 5.07 months at the end of 2000. For NBCE, the indicator moved from 10.76 months to 17.64 months in the same period.

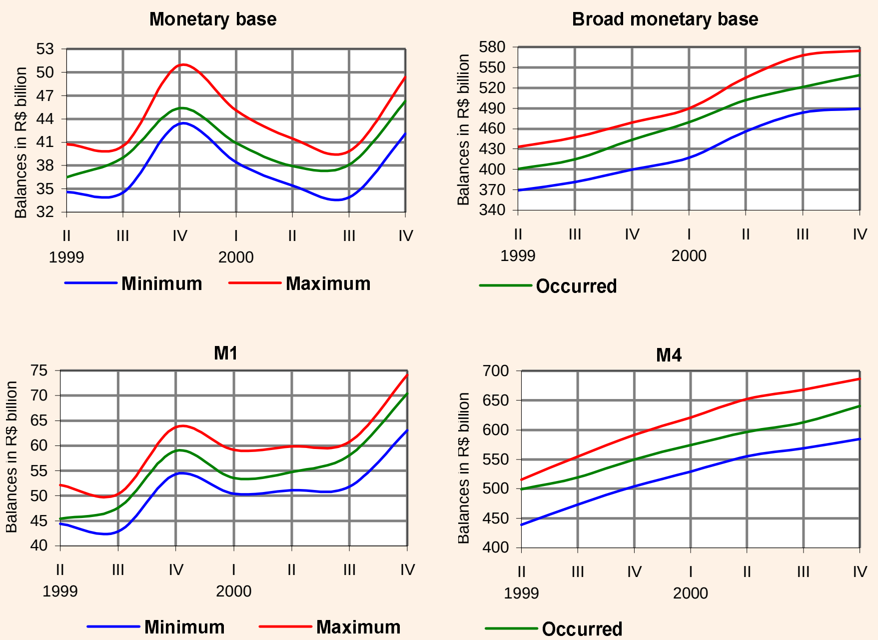
Monetary aggregates

The behavior of the monetary aggregates reflected a process of gradual recovery in the pace of economic activity, expanded credit operations and reductions in the volume of resources that had to be maintained in non-interest bearing accounts. In this framework, viewed under the prism of monthly average daily balances, the money supply expanded by 19.2% in the year and, just as occurred in the case of the other aggregates, closed the period well within the parameters defined in monetary program for the period. Demand deposits declined in terms of income-velocity, basically as a result of the volume of resources transiting through credit operations and greater banking system interest in this type of funding operation, which is marked by the greater volume of nonearmarked resources generated by reductions in the compulsory reserve rate. Thus, the average balance of demand deposits increased by 23.2% in the year. Currency held by the public, which is less sensitive to shocks in the allocation of the portfolios of economic agents, such as changes in reserve requirements, registered stationary income-velocity, as the monthly average of the daily balances of the aggregate increased by 13.2% in the same period.

Graph 2.5

Monetary base and money supply

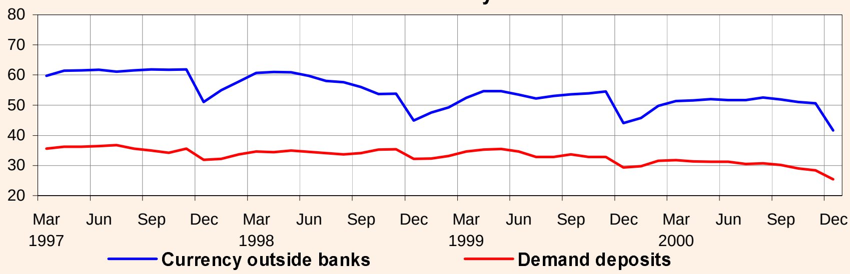
Monetary program and values occurred



Graph 2.6

Currency held by the public and demand deposits

Income-velocity[1/]



1/ Defined as the ratio between 12 month accumulated GDP, valuated by IGP-DI, and the monetary aggregate average balance in the reference period.

Based on the criterion of monthly average daily balances, the monetary base came to R$46.3 billion in December, with growth of 2% in the year, or considerably less than in the case of the money supply. This performance reflects a drop of 14.4% in demand for banking reserves, while the average balance of currency issued increased by 12.8%.

Insofar as the sources of monetary issues are concerned, the major monetary base conditioning factors in the period, on the supply side, were transactions through the National Treasury operating account, with a net contractive impact of R$26.5 billion, and external operations, with expansion of R$4.4 billion. These results were achieved through direct and timely interventions in the interbank exchange market that were fully consistent with the floating rate exchange system. Over the course of 2000, the only moments in which this occurred were on November 23, when a higher than usual volume of resources had to be internalized for payment of the privatization of *Banco do Estado de São Paulo S.A.* (Banespa), and on December 29, as a prudential measure taken in light of the transition to the new year. Parallel to growth of R$897 million in monetary base demand, these results generated net redemptions of the federal security debt in a total amount of R$20.6 billion.

With respect to the broad monetary aggregates, the more inclusive concept of the monetary base, as a measurement of the monetary debt and high liquidity federal securities debt, closed the year with a balance of R$538.7 billion, for growth of 20.5% in the period. For the most part, this result is attributed to upward movement caused by the rise in the value of the federal securities debt and to issues of securities related to state and municipal debt restructuring program, particularly that involving the municipality of São Paulo. The expansionary factors cited were equivalent to R$113 billion and were partially attenuated by net deposits to the National Treasury operating account.

Table 2.2 - Monetary program

R$ billion

Itemization		Restricted monetary base			Broad monetary base		
		Minimum	Maximum	Occurred	Minimum	Maximum	Occurred
1999	1st quarter	35.4	41.6	37.6	353.0	414.4	388.0
	2nd quarter	34.6	40.7	36.5	368.9	433.0	400.7
	3rd quarter	34.5	40.5	39.0	381.3	447.6	414.8
	4th quarter	43.4	50.9	45.4	399.6	469.1	447.1
2000	1st quarter	38.4	45.1	40.9	417.2	489.8	469.3
	2nd quarter	35.4	41.5	37.9	455.8	535.1	501.9
	3rd quarter	33.9	39.8	38.1	483.9	568.0	521.3
	4th quarter	42.1	49.4	46.3	489.2	574.3	538.7

(continues)

Table 2.3 - Factors conditioning the monetary base

Accumulated flows in the month (R$ million)

Period		National Treasury	Operations with federal securities	Foreign sector operations	Discount window operations
1999	Jan	- 100	7 113	-4 756	-1 502
	Feb	- 815	-2 008	285	- 27
	Mar	-1 768	5 076	-3 812	- 316
	Apr	-2 650	3 631	-1 950	- 6
	May	25	3 254	659	- 30
	Jun	- 843	-6 657	8	- 7
	Jul	-1 627	9 333	- 13	- 7
	Aug	-6 434	-4 139	- 296	- 7
	Sep	-2 901	4 518	- 11	- 7
	Oct	723	- 69	-1 411	- 7
	Nov	607	1 201	- 823	- 7
	Dec	221	13 672	-2 759	- 15
2000	Jan	2 243	-11 253	2 387	0
	Feb	-1 383	1 378	69	- 8
	Mar	-3 288	483	38	- 16
	Apr	-3 704	2 159	- 13	0
	May	-2 014	- 50	- 1	- 8
	Jun	-2 146	-1 239	12	- 39
	Jul	1 229	3 092	- 3	0
	Aug	-5 710	8 586	19	- 8
	Sep	-2 744	1 145	- 6	- 9
	Oct	714	- 99	5	- 38
	Nov	-9 647	8 101	3 836	- 520
	Dec	- 90	9 095	-1 942	0

(continues)

Table 2.2 - Monetary program (concluded)

R$ billion

Itemization		Money supply (M1)			Money supply broader concept (M4)		
		Minimum	Maximum	Occurred	Minimum	Maximum	Occurred
1999	1st quarter	46.0	54.0	46.6	436.7	512.6	477.4
	2nd quarter	44.4	52.1	45.4	439.0	515.4	498.9
	3rd quarter	42.9	50.3	47.6	472.9	555.1	519.1
	4th quarter	54.3	63.7	59.0	504.2	591.9	550.2
2000	1st quarter	50.4	59.2	53.5	528.8	620.8	574.6
	2nd quarter	51.1	59.9	54.7	555.5	652.1	596.4
	3rd quarter	51.8	60.8	58.1	569.1	668.1	612.7
	4th quarter	63.1	74.1	70.4	584.8	686.5	640.2

Table 2.3 - Factors conditioning the monetary base (concluded)

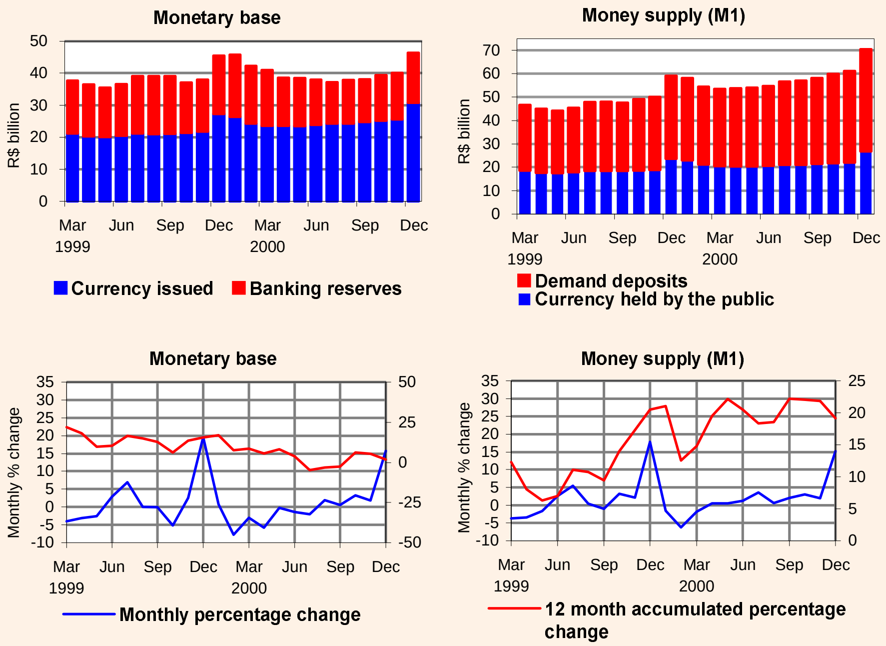
Accumulated flows in the month (R$ million)

Period		Deposits				Other accounts	Monetary base change
		Financial institutions	Investment funds	DVR	Total		
1999	Jan	- 111	- 171	7	- 275	- 29	451
	Feb	89	496	0	585	201	-1 779
	Mar	227	2	1	230	- 34	- 624
	Apr	199	154	0	353	- 259	- 881
	May	107	42	0	149	27	4 083
	Jun	47	183	0	231	12	-7 257
	Jul	55	210	0	265	33	7 985
	Aug	- 64	3 629	0	3 565	18	-7 292
	Sep	528	0	0	528	- 26	2 100
	Oct	544	0	0	544	100	- 121
	Nov	485	0	0	485	25	1 488
	Dec	8	0	0	8	- 35	11 093
2000	Jan	71	0	0	71	14	-6 538
	Feb	42	0	0	42	- 72	28
	Mar	84	0	0	84	- 129	-2 827
	Apr	297	0	0	297	- 111	-1 373
	May	263	0	0	263	- 35	-1 845
	Jun	- 22	0	0	- 22	- 125	-3 560
	Jul	- 186	0	0	- 186	3	4 136
	Aug	- 110	0	0	- 110	- 107	2 670
	Sep	182	0	0	182	- 170	-1 601
	Oct	590	0	0	590	- 58	1 115
	Nov	394	0	0	394	- 70	2 095
	Dec	- 127	0	0	- 127	20	6 955

Graph 2.7

Monetary base and money supply (M1)

Average daily balances



In its broader concept, which corresponds to M4, the money supply closed 2000 at R$640.2 billion, with annual growth of 16.2%, while accumulated Selic rate growth came to 17.4%, pointing to moderate expansion in internal financial savings. Following some degree of recovery in the month of December, savings deposits expanded by 0.9% in the year, while private securities dropped by 4.4%. This performance was a factor of importance to the 67.2% growth in fixed income funds and federal public securities, taken as a whole. This migration can be explained in terms of the daily liquidity and profitability levels registered by fixed income funds, as well as by the reduction in financial institution investments in federal securities as they shifted these resources into credit operations.

Financial system credit operations

Continuing the policy adopted in the previous year, credit policy in 2000 was implemented with the aim of expanding the availability of resources for final borrowers. Among the most important measures taken to achieve this objective, one should cite the reduction in the rate of compulsory reserves on demand deposits from 65% to 45%. Parallel to this step, a program was initiated that provides information over the Internet on the interest rates practiced by financial institutions in their major credit operations. The purpose here was to achieve greater transparency in banking operations and further competition among institutions.

Table 2.4 - Financial assets

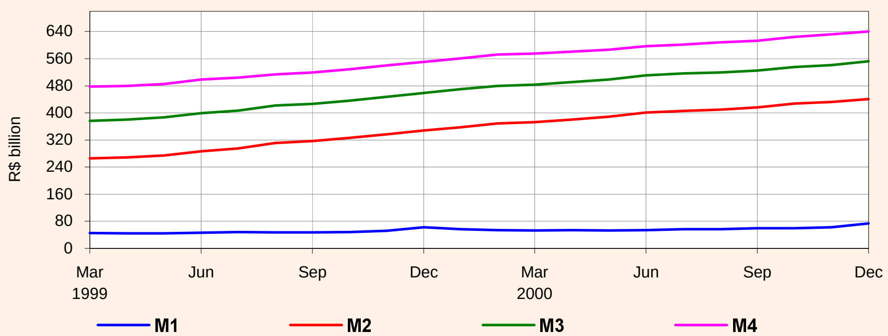
Percentage share of GDP[1/] (%)

Period		M1	M2	M3	M4
1999	Jan	5.64	29.52	41.74	52.30
	Feb	5.40	29.72	42.17	53.30
	Mar	5.11	29.83	42.31	53.64
	Apr	4.86	29.63	41.92	52.82
	May	4.75	29.61	41.74	52.38
	Jun	4.84	30.24	42.04	52.56
	Jul	4.98	30.63	42.21	52.31
	Aug	4.85	31.78	43.12	52.47
	Sep	4.71	31.75	42.80	52.02
	Oct	4.75	31.89	42.63	51.73
	Nov	4.92	32.18	42.69	51.60
	Dec	6.00	33.31	43.90	52.66
2000	Jan	5.57	35.21	46.24	55.25
	Feb	5.48	37.36	48.64	58.00
	Mar	5.40	37.79	49.02	58.31
	Apr	5.26	37.30	48.13	56.96
	May	5.00	36.66	47.03	55.29
	Jun	5.02	37.03	47.23	55.11
	Jul	5.23	37.54	47.76	55.70
	Aug	5.27	38.24	48.52	56.80
	Sep	5.55	39.06	49.29	57.53
	Oct	5.58	39.82	49.90	58.17
	Nov	5.78	39.90	49.94	58.35
	Dec	6.76	40.31	50.53	58.55

1/ Last 12 month GDP at prices of indicated month (deflator IGP-DI), based on the series released by IBGE.

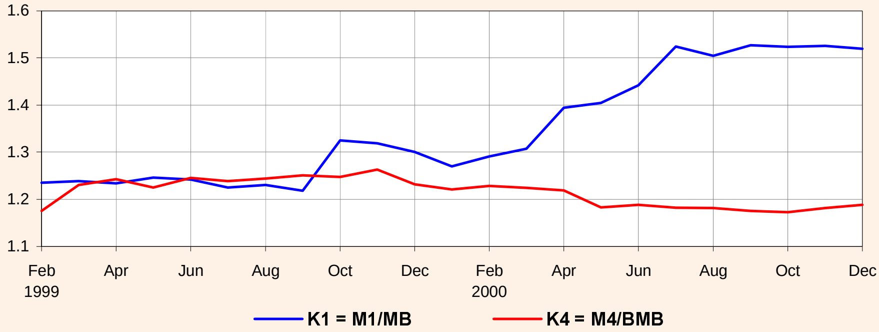
Graph 2.8

Financial assets - end-of-period



Graph 2.9

Monetary multiplier - k1 and k4



The rates charged on preset credit operations carried out with nonearmarked resources confirmed the downward interest rate trajectory that marked the entire year of 1999. The interest rate slide in 2000 can be attributed to the convergence of a series of positive factors that occurred in the period, including cutbacks in the Selic rate target, government measures to expand the credit supply and reduce interest, enhanced competition among banks and a higher level of financial institution confidence in the stability of the internal economic scenario.

Average interest rates on preset operations with individuals and legal entities declined from 62.3% per year at the end of 1999 to 51% per year in 2000, while the rates on funding operations (Bank Deposit Certificates - CDB) dropped from 18.1% per year to 15.8% per year in the period.

With the results of funding and lending rates, the average spread in credit operations dropped to 35.2% per year in December 2000, indicating a change of 9 percentage points (p.p.) in relation to the level registered in the same period of the previous year. In operations with individual persons, the falloff in the average spread was even more significant, closing at 20.6 p.p. compared to 12.2 p.p. in operations with legal entities.

Among the different types of operations with individual consumers, the spread in personal credit operations turned in the most accentuated reduction, dropping from 68.4% per year in December 1999 to 51.9% per year at the end of 2000. On the other hand, the spread in operations with special overdraft checks increased from 120.7% per year to 136.9% per year in the same period.

Analysis of the operations classified under the heading of legal entities points to reductions in average spreads in all credit modalities, and particularly those involving guarantied overdraft accounts and working capital operations, with respective falloffs of 15.2 p.p. and 12.8 p.p. in the period.

Table 2.5 - Rates for preset credit operations - 2000[1/]

% p.y.

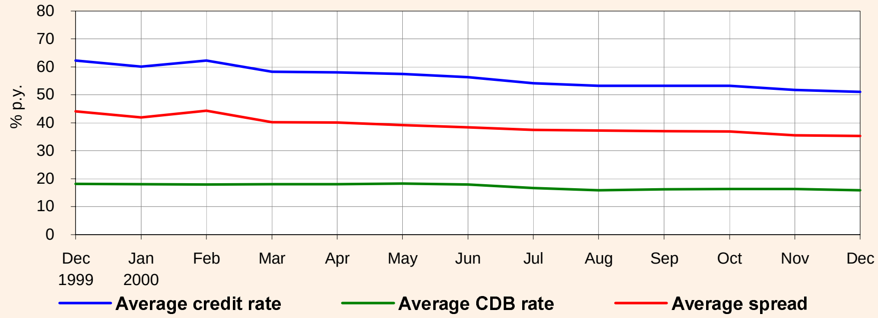
Itemization	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Interest rates - general	60.0	62.3	58.3	58.1	57.4	56.4	54.1	53.3	53.3	53.2	51.9	51.0
Legal entities	47.8	49.2	46.1	45.7	44.1	38.0	35.8	34.8	34.6	34.4	33.8	34.6
Discount of trade bills	54.6	55.6	53.9	54.3	50.5	46.6	44.3	44.5	43.7	44.7	44.1	44.7
Working capital	46.9	48.5	46.4	45.7	43.7	34.3	33.1	32.6	32.2	32.3	32.7	32.5
Guarantied overdraft accounts	55.6	56.7	51.1	50.5	49.7	47.0	42.3	40.6	41.4	40.4	38.0	41.2
Acquisition of goods	40.4	42.1	36.9	35.7	34.1	31.2	30.9	30.4	28.1	26.7	27.9	30.7
Individuals	83.3	85.3	78.3	77.8	75.1	76.7	73.4	71.7	71.3	71.0	68.7	66.5
Special overdraft checks	144.9	152.7	144.8	152.3	142.2	163.3	156.8	151.3	151.8	151.3	153.8	152.7
Personal credit	75.6	76.5	68.9	68.1	67.1	70.1	70.6	69.9	71.6	72.5	72.0	67.7
Acquisition of goods Vehicles	-	-	-	-	-	35.5	35.9	34.8	35.2	34.2	34.3	35.0
Acquisition of goods Others	-	-	-	-	-	84.3	77.5	78.0	73.9	63.8	65.1	66.5
CDB rate	18.0	17.9	18.0	18.0	18.2	17.9	16.6	15.9	16.2	16.3	16.3	15.8
Spread - general	42.0	44.3	40.3	40.1	39.2	38.4	37.5	37.4	37.1	36.9	35.5	35.2
Legal entities	29.7	31.3	28.1	27.7	25.9	20.0	19.3	18.9	18.4	18.1	17.5	18.8
Discount of trade bills	36.5	37.7	35.8	36.3	32.3	28.7	27.7	28.6	27.5	28.4	27.7	28.8
Working capital	28.9	30.6	28.4	27.7	25.5	16.4	16.5	16.7	16.0	16.0	16.3	16.7
Guarantied overdraft accounts	37.6	38.8	33.1	32.5	31.5	29.1	25.8	24.8	25.2	24.1	21.6	25.4
Acquisition of goods	22.4	24.2	18.9	17.8	15.9	13.3	14.4	14.6	11.9	10.4	11.6	14.9
Individuals	65.3	67.4	60.3	59.8	56.9	58.8	56.8	55.8	55.1	54.7	52.3	50.7
Special overdraft checks	126.9	134.8	126.8	134.3	124.0	145.4	140.2	135.4	135.6	135.0	137.5	136.9
Personal credit	57.5	58.6	50.9	50.1	48.8	52.1	54.0	54.0	55.4	56.2	55.7	51.9
Acquisition of goods Vehicles	-	-	-	-	-	17.6	19.4	18.9	19.0	18.0	18.0	19.2
Acquisition of goods Others	-	-	-	-	-	66.4	61.0	62.1	57.7	47.6	48.8	50.7

Source: Sisbacen, userkey PEFI300

1/ Yearly rates are obtained by raising to 252 the geometric mean of daily rates in the month.

Insofar as the credit operation rates announced by Banco Central are concerned, one should note that important alterations were introduced into their calculation as of June 2000. The average rates of each type of credit are now obtained on the basis of the volume of credits granted by the financial institution instead of the simple arithmetic average. The purpose here is to avoid the distortions inherent to situations in which the rates of large financial institutions differed from those practiced by smaller scale institutions. The more significant impacts of these changes on average rates were perceived in the May-June period, precisely the period of transition in which institutions had to adapt to the recently introduced alteration, particularly under the heading of operations with individual consumers.

Graph 2.10
Spread between interest rates of credit operations - market average

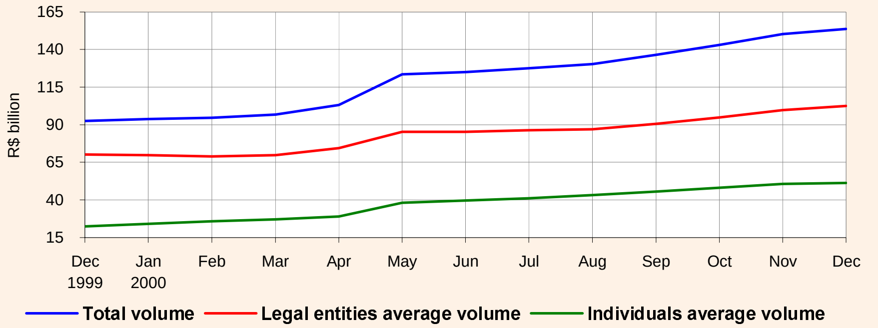


The stock of credits granted by the financial system turned in positive growth over the course of the year, especially with regard to credits targeted at individual persons, particularly in personal credit operations and credits for acquisitions of goods. Financing granted to the productive sector moved upward in the final quarter of the year and contributed to a more dynamic pace of economic activity.

The balance of credit operations based on nonearmarked resources, which exclude real estate, rural and leasing operations, as well as those based on onlendings of public sector funds, came to a level of R$153.9 billion in December 2000, for growth of 66.4% in relation to the previous year. This growth can be attributed to a decline in the lending rates practiced by financial institutions in the period, a factor that has contributed significantly to growth in the pace of economic activity.

Loans contracted by individual consumers totaled R$51.3 billion at the end of 2000, for growth of 129% in 12 months. Personal credit operations, which accounted for 32% of the overall value for this segment, registered the highest growth in the period (71.6%), closing December 2000 at R$16.3 billion. Aside from this, financing for vehicle acquisitions increased by 99% in the period from June to December of last year. One should note that growth in these two credit categories can be attributed to the decreased use of rotating credits.

Graph 2.11
Average volume of credit operations



With respect to legal entities, growth in the total volume of credit operations not only reflected the cost reduction, but also the need for replenishing stocks at a time of increasingly more intense economic activity. The volume of credit granted to the segment came to R$102.6 billion, for growth of 46.4% in relation to December 1999. The balances of operations involving the discounting of commercial invoices and guarantied overdraft accounts are responsible for a considerable share of the overall volume. These operations closed the period with respective growth rates of 54.3% and 46.2%. Operations involving guarantied overdraft accounts gained momentum as a result of the expanded supply of credits at floating rates, tied for the most part to deposits among financial institutions.

In order to expand the daily volume of available information on credit operations backed by nonearmarked resources submitted by financial institutions, Circular 2,957/1999 was issued setting down rules covering data on the balance of portfolios that are indexed by income appropriated, the values of new credit operations and the average term of the portfolios of each credit modality. Aside from this, institutions are to inform as to the classification of credit portfolios according to levels of default and the segregation of interest rates into basic interest, operational charges and fiscal charges. Another alteration refers to information on credits granted to individuals for acquisition of goods. These operations are now distributed according to the purpose of the financing into the categories of vehicles and other goods.

In order to intensify application of prudential rules and apply improved bank supervision mechanisms more in keeping with international standards, CMN (National Monetary Council) issued Resolution 2,682, dated 12.21.1999, defining more rigorous criteria that would ensure improvements and transparency in credit operations. The overall objective here was to reorganize and streamline the allocation of resources and, consequently, reduce the costs of financial intermediation.

Thus, the CMN carried out a review of the procedures set down in Resolution 1,748, dated 8.30.1990, making them more objective and inclusive for the classification of credit operation portfolios. At the same time, the Council called for provisions for losses to be set aside on technically more appropriate bases.

According to Resolution 1,748, the rules for classifying credit portfolios were based exclusively on the period of default, while the potential risk of the borrower and of the operation itself was ignored. Credits were classified as follows:

a) normal, when matured for up to 60 days;
b) in arrears, when matured for more than 60 days and covered by a guaranty;
c) in liquidation, when matured for more than 60 days with no guaranties or for more than 180 days with sufficient guaranties.

As of adoption of Resolution 2,682, issued in March 2000, credit operations are classified into nine different levels in the increasing order of risk (AA, A, B, C, D, E, F, G and H), with provisions to be set aside on a gradually increased basis as of the second level.

Classification methodologies are the responsibility of the financial institution and are to take the following factors into consideration among others:

a) in relation to the debtor and guarantors:
   i. economic-financial situation;
   ii. degree of indebtedness;
   iii. capacity to generate results;
   iv. cash flow;
   v. administration and quality of controls;
   vi. punctuality and payment arrears;
   vii. contingencies;
   viii. sector of economic activity;
   ix. credit limit;
b) in relation to the operation:
   i. nature and purpose of the transaction;
   ii. characteristics of the guaranties, particularly as regards sufficiency and liquidity;
   iii. value.

Aside from these points, it was determined that risk classification levels were to be revised at least:

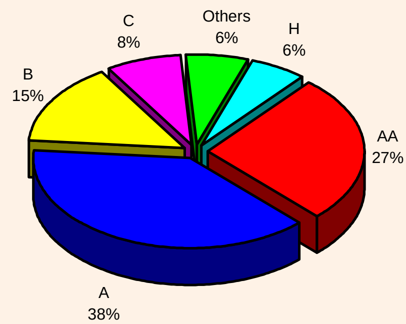
a) monthly, at the time of the issue of balance sheets and financial statements, with such reviews to be based on defaults in the payment of principal and financial charges. In those cases in which the term of the operation extends for more than an additional 36 months, the time periods foreseen may be calculated at double their value and the operations are to be defined as follows:
   i. arrears between 15 and 30 days: at least B level risk;
   ii. arrears between 31 and 60 days: at least C level risk;
   iii. arrears between 61 and 90 days: at least D level risk;
   iv. arrears between 91 and 120 days: at least E level risk;
   v. arrears between 121 and 150 days: at least F level risk;
   vi. arrears between 151 and 180 days; at least G level risk;
   vii. arrears of more than 180 days: H level risk;
b) every six months for operations of a single client or economic group when the volume is greater than 5% of adjusted net worth;
c) once every 12 months in all situations, except for credit operations contracted by clients whose total liability is less than R$50 thousand. The classification of these operations may be carried out a single time automatically as a consequence of arrears in payments of the principal and financial charges.

It is important to note that noncompliance with the period defined for review of the classification of operations at their respective level will result in compulsory reclassification to risk level “H” by the financial institution involved, together with application of other administrative measures by Banco Central.

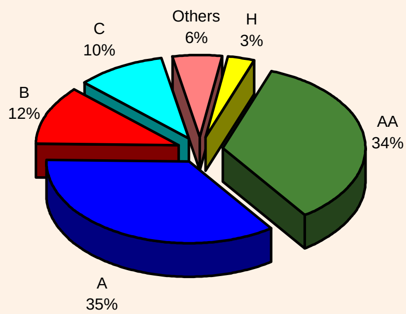
Reclassification of portfolios into risk levels will result in constitution of provisions that are no less than the sum total of the following percentages:

a) 0.5% of the value of operations classified under risk level A;
b) 1% of the value of operations classified under risk level B;
c) 3% of the value of operations classified under risk level C;
d) 10% of the value of operations classified under risk level D;
e) 30% of the value of operations classified under risk level E;
f) 50% of the value of operations classified under risk level F;
g) 70% of the value of operations classified under risk level G;
h) 100% of the value of operations classified under risk level H.

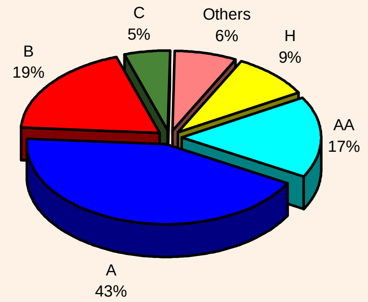
Graph 2.12
Credit operations in the financial system by risk levels - December



Graph 2.13
Credit operations in the private financial system by risk levels - December



Graph 2.14
Credit operations in the public financial system by risk levels - December



In the month of December, the overall volume of financial system credit operations, which include both nonearmarked and targeted resources, came to a total of R$317 billion, when one includes all nine risk levels. Growth over the nine month period came to 10.8%. Among the factors that contributed to this result, one should cite growth in loans to the private sector, particularly operations with the trade sector, the sector of other services and individual consumers. Thus, participation of total credits granted by the financial system in relation to GDP ended at 26.8%, compared to 27.2% in 1999.

When one analyzes the distribution of financial institution credit portfolios according to risk levels, one notes that R$211 billion of total credits granted were concentrated under levels AA and A, while level H, which requires provision of 100%, registered a total of R$18.6 billion.

In the case of the private financial system, the stock of credits granted came to R$176.7 billion for growth of 26.3% in nine months, while the balance for the public financial system came to R$140.4 billion, for a reduction of 4% in the same period.

On a sector-by-sector basis, the volume of loans contracted by individuals came to R$59.7 billion in December, with growth of 38.6%. Among the factors that contributed to this performance, one should note greater demand for personal credits and for financing of acquisitions, particularly involving automotive vehicles. These classes of credits were positively impacted by interest reductions and longer payment terms, at the same time in which employment and income indicators moved sharply upward. An analysis by risk levels shows that the greatest share of these operations was classified under level A (64%) while just 4.9% were covered by level H.

Loans to the industrial sector came to R$84.6 billion in December, for growth of 2.7%. Particular note should be taken of 6.9% growth registered in the final quarter of the year. In terms of risk levels, 63.1% of credits were concentrated under levels AA and A.

Insofar as credit operations with the trade sector are concerned, total credits contracted added up to R$31.5 billion, for growth of 15.4% in relation to the month of March. It is important to note that growth in the October-December quarter came to 11.5% and was basically due to financing of stock for end-of-year sales.

Total loans allocated to the segment of other services registered a balance of R$45.2 billion, for growth of 20.4%, mostly as a consequence of greater demand on the part of the telecommunications and transportation sectors. One should stress, however, that the major share of these resources was classified under level AA, with 42.9%, while operations under risk level H accounted for 3.2%.

In the last nine months of the year, the rural credit portfolios held by financial institutions expanded by 2.2%, closing December with a balance of R$26.4 billion. Credits recorded under levels AA and A came to 61.2%, while those under level H came to 4.9%. In relation to the composition of the sources of financial system resources for the rural sector, data available up to November indicate that investments with obligatory resources accounted for 49.8%. The second most important item was that of funding channeled through onlending operations with participation of 44.8%, while nonearmarked and agroindustrial investments accounted for a joint total of 5.4%.

Aside from setting down rules aimed at making rural current expenditure financing feasible, the rural policy implemented in 2000 also focused on various other programs aimed at increasing investments in strategic activities. These programs generate such benefits as additional jobs and income, while also diversifying the sector's output.

Insofar as current expenditures are concerned, the CMN issued Resolution 2,764 on 7.27.2000, setting down the rules for these operations, as regards the target client, time periods, including grace periods, financial charges (specifying interest of 8.75% per year for small scale producers), financing ceilings, insurance premiums and the required guaranties. It is important to emphasize that, in the September-October period, funding releases for financing the planting of the 2000/2001 summer harvest increased considerably. As a matter of fact, the balance of credit operations channeled to the sector in the period in question increased by a total of R$800 million.

With regard to the rules on rural investment credits, one should underscore the fact that the economic cycle and financial return of rural activities are characterized by time spans and market conditions highly peculiar to the sector. Thus, programs involving rural investments not only provide minimum terms of 5 years, but also have built-in systems of renegotiating interest rates, within the limits specified for government credit operations. Consequently, diverse programs with regulations dating to 6.29.2000, were either renewed or implemented by the government. Among existent programs, the BNDES budget set aside a total of R$300 million for the Program of Incentives to the Use of Soil Correction Agents (Prosolo). According to Resolution 2,749, these funds are to be utilized by 6.30.2001. The Program of Incentives to the Mechanization, Cooling and Bulk Transportation of Milk Production (Proleite) is aimed at improving the competitiveness of national producers in the context of the competition of other Southern Common Market (Mercosul) members. A total of R$200 million was set aside under conditions quite similar to those defined in Resolution 2,748. The Program of Modernization of the Farm Tractor Fleet and Like Implements and Harvesters (Moderfrota), which is maintained by BNDES/Finame and has the objective of financing acquisitions of farm machinery, received an allocation of R$800 million based on the terms of Resolution 2,699, dated 2.24.2000.

Among other efforts that deserve mention, one should highlight the June 29, 2000 creation of programs aimed at providing financing to floodplains production, recovery of degraded pastures, fish farming, fruit farming, wine-making, sheep and goat raising and bee farming. The rules specify individual credit limits that vary from R$20 thousand to R$40 thousand, preset interest of 8.75% per year, terms from 5 to 8 years, including a 2 to 3 year grace period, half-yearly and yearly amortizations, depending on the revenue flow of the property and an overall budgeted total of R$760 million.

With respect to the norms covering this segment of operations, Resolution 2,766, dated 8.10.2000, imposed a reduction in the interest rates charged on financing operations through Pronaf. At the same time, the price-product equivalency system was eliminated from contracts with smaller scale producers and farmers who depend primarily on rural activity. The purpose of this step was to preserve their income in the face of the sharp rise in the floor prices of several farm commodities.

With regard to the housing portfolio, which includes both individuals and housing cooperatives, growth in relation to March came to 4.3% with a balance of R$56 billion in December. One should underline the fact the final quarter registered a drop of 7.7% due to anticipated liquidation of contracts formalized under the terms of the Wage Variation Compensation Fund (FCVS), in the context of Provisional Measure 1,981-52, dated 9.27.2000. This measure determined that debts related to contracts formalized with final borrowers of the housing finance system under the responsibility of that fund and signed up to 12.31.1987 could be renewed in an amount corresponding to 100% of the debt balance on the date of contract readjustment. With this, FCVS responsibility over these contracts was abolished. With regard to the distribution of credits by risk brackets, those registered under AA and A accounted for 66.9% of the total and those classified under level H for 12.2%.

In order to channel a larger volume of resources into the building industry, Resolution 2,706 was issued on 3.30.2000, raising the share of the savings account resources within SBPE that must necessarily be channeled into housing financing from 60% to 65%.

In order to generate improved conditions for the refinancing of real estate foreclosed by financial institutions that accept demand deposits and operate with real estate credits, Resolution 2,789, dated 11.30.2000, allowed multiple banks with commercial and real estate credit portfolios and the Federal Savings Bank to utilize a new system of financial leasing. This is a special type of real estate leasing in which the lessee assumes the commitment of paying the lessor monthly installments over a specific period of time during which that person occupies the property. According to the terms of Provisional Measure 1,981-53, dated 10.26.2000, the lessee has the right to exercise a purchase option at the end of the contract period. This type of operation is to be utilized for real estate that the financial institution has acquired through auction, a court judgement or as payment-in-kind of a previous housing finance contract.

Also with regard to the private sector, disbursements by the BNDES System – including Finame and BNDESpar – channeled to industry came to a level of R$10.4 billion in accumulated terms for the year, compared to R$8.4 billion in the same period of the previous year. Services, including commerce, received a total of R$10.7 billion for financing its investments, compared to R$8.3 billion in the same period of 1999. In the case of the crop/livestock sector, the accumulated flow in the year came to R$1.9 billion, for growth of 48.4% when viewed against the result for 1999. This behavior reflects the continuity of the process of expanding economic activity vis-à-vis the drop in the rate of interest, particularly the TJLP, which declined from 12.5% per year at the end of 1999 to 9.75% per year in December 2000.

Going on to the public sector, at the institutional level, Complementary Law 101 went into effect on 5.4.2000. This law is termed the LRF and deals with the questions of transparency and control of indebtedness and assumption of public sector expenditures. The measures preserve the roles of the CMN, which is charged with regulating financial system activities in relation to credits granted to the public sector, and of the Federal Senate, which has the task of defining parameters for borrowers and analyzing improvements in the credit market in its relations to the public sector. This is especially important in defining an adequate allocation of funding in the form of investments.

Credits granted to the consolidated public sector came to a balance of R$13.6 billion in December, for a decline of 16.9% in nine months, indicating a situation of increased control over public finances. The adjusted volume of credits contracted by state and municipal governments came to R$9.9 billion, reflecting a contraction of 15% in relation to March. Of this total, 44.6% were classified under levels AA and A. The volume of the federal government banking debt was cut by 21.6% in the period and closed at R$3.7 billion, mostly as a consequence of the securitization of operations involving renegotiation of state debt and liquidation of the debts of state companies referenced to exchange in the final quarter of the year. In the case of credits channeled to the federal public sector, 68.4% of the total were concentrated under risk level AA.

According to the terms of Resolution 2,784, issued on 10.18.2000, as of the month of October credits for which the National Treasury is liable or to which it has given a formal, total and specific guaranty were excluded from the limit of 45% of adjusted net worth (PLA) for purposes of calculating the balance of credit operations with public sector organs and entities in the financial system framework. Aside from this, the overall value of new credit operations was raised from R$600 million to R$1 billion, in consolidated terms for financial institutions in general.

In order to reduce default levels and adapt the Credit Risk Center to the new structure of information on credit operations, Circular 2,977, dated 4.6.2000, determined that the information provided monthly by financial institutions with the values of client liabilities are to be classified according to their risk level, as specified in Resolution 2,682/1999. Furthermore, the amount to be informed to the system was reduced from R$20 thousand to R$5 thousand according to the terms of Circular 2,999, dated 8.24.2000. This change was to go into effect in January 2001.

In recent years, credit assigns have been stimulated with the objective of lengthening the terms of operations for the borrower and improving the management of assets and leveraging of the assigning institutions. It is in this context that one should understand the entities that have been created with the exclusive objective of acquiring such credits (Resolution 2,493/1998). These entities are not components of the national financial system and contract funding basically through long-term instruments, such as stock and debenture issues in the country and securities abroad. Initially, some restrictions were imposed on transfers of receivables to these companies, avoiding the possibility of the risk returning to the assigning institution, even indirectly.

With issue of Resolution 2,686, dated 1.26.2000, assigning of all types of securities was permitted with joint liability on the part of the assigning institution. Repurchase in a single payment and acquisitions by the assignor institutions involving securities issued by the assignees backed by these receivables was also permitted. However, following prudential rules the new norms demand additions to the net required worth of the institution that transfers receivables with joint liability or another type of risk retention, except when the assignor acquires debentures from the assignee. In this case, provisions have to be made for the respective securities according to the risks of the credits to which they are tied.

This more flexible approach was adopted in a context in which the national financial system has consolidated its own mechanisms of evaluation and controlof credit risks, particularly in light of the adoption of new rules governing classification of the credit portfolio and constitution of the respective provisions according to the potencial risk level of the borrower.

Table 2.6 - Credits granted by the financial system
Percentage share

Itemization	1998	1999	2000
Total	100.0	100.0	100.0
Deposit money banks	91.4	87.6	70.9
Commercial and multiple banks	80.0	66.6	52.4
Banco do Brasil	7.7	11.7	9.1
Other public banks	56.7	27.6	3.8
Private banks	15.5	27.3	39.5
Domestic	10.1	16.0	23.7
Foreign	5.4	11.3	15.8
Savings banks	11.4	21.0	18.5
Development and investment banks	5.9	8.4	21.1
BNDES	5.0	7.3	19.8
Others	0.9	1.1	1.3
Nonbanking financial institutions	2.7	4.0	8.0

National Financial System

In recent years, the National Financial System (SFN) has gone through a series of structural transformations, following a trend already found on the international market. In this sense, Banco Central has adopted important policies in the area of banking supervision with the aim of ensuring continued financial market stability by limiting risks - particularly systemic risks, since this is considered a fundamental condition for preserving macroeconomic stability.

The measures implemented since the start of the Real Plan have the objective of restructuring and strengthening the system as a whole, with the aim of gradually reducing public sector presence in the banking sector, while adopting guidelines on changes in private sector stockholding structures with the purpose of capitalizing and strengthening operational structures. In this context, one should cite the importance of the presence of external capital, particularly at the retail level, coupled with pursuit of greater efficiency in intermediation activities.

Aside from these points, adoption of prudential rules already followed on the international market has aided in improving instruments of preventive control of financial system activities, independently of whether this is done through the action of supervisory authorities or through controls imposed by the institutions themselves, while significantly improving the regulatory structure.

As of 1994 and the issue of Resolution 2,099, prudential regulations have demonstrated greater concern with the principles defined by the Basle Committee, based on the minimum capital required of financial institutions to serve as a permanent base for its activities, plus constitution of reserves to cover risks and future losses defined in terms of the quality of the institution's investments. This concept is defined as required net worth (PLE).

The methodology used in calculating PLE has evolved in the sense of including the diverse types of risks inherent to intermediation activities. In this sense, systems of measuring credit risk and market risk were incorporated. Resolution 2,692, dated 2.24.2000, deals with the most recent alteration introduced into the calculation methodology of the Basle index, which draws a relation between PLE and PLA, defining what the institution effectively possesses to cover risk, according to the terms of current legislation.

In light of the new regulations set down in Circular 2,972, dated 3.23.2000, the calculation of PLE includes those resources for coverage of market risk consequent upon the exposure of operations denominated in real, with earnings at preset rates tied to the rates practiced on the market. This amount to be added in the capitalization is to be calculated daily on the basis of the sum of the amounts that represent the risk value (VaR) of operations referenced in interest rates. This methodology is dynamic in the sense that it seeks to make capital requirements compatible with fluctuations in macroeconomic variables.

Aside from credit and market risks, the activity of intermediation is subject to other types of risks, including both operational and liquidity risks. The operational risks are directly related to the degree of efficiency of the internal controls systems maintained by the institutions themselves. Resolution 2,554/1998 defined criteria for creation and implementation of these systems so that financial institutions would be able to adapt their technical and operational structures in order to be able to more effectively evaluate each type of risk to which they are subject, including both internal and external risks.

With respect to liquidity risk, Resolution 2,804 was issued in December 2000 defining the procedures to be adopted by institutions in the context of internal controls, so that this type of risk could be correctly identified and managed. The period allotted to institutions to adjust to this measure was a maximum of six months. Liquidity risk is a consequence of the degree of incompatibility between negotiable assets and callable liabilities, in light of the currency, term and rates involved in the operations in question, a reality that can result in financial imbalances for institutions.

Among the procedures adopted, one should highlight the prospective evaluation of different scenarios capable of impacting the cash flows of institutions, periodic re-evaluation of the control systems implemented, as well as immediate dissemination of information and analyses on liquidity risk to the managerial and operational sectors of the institution. Furthermore, the established controls should at least make it possible to perform a daily evaluation of operations with liquidation terms of less than ninety days.

Another measure to be viewed in the context of prudential regulation is Resolution 2,802, dated 12.21.2000, which defined a new basis of calculation for verifying the operational limits to be observed by financial institutions, termed the Reference Worth (PR). Previously, the basis of calculation for all limits, except the Basle limit, was equivalent to the value of net worth adjusted by the creditor and debtor profit and loss accounts. In the case of the Basle limit, the basis of calculation had already been defined according to internationally accepted principles, such as the sum total of principal and supplementary capital.

The new rules defined the PR for all limits with the exception of the limit on investments of resources in permanent assets. This was due to the schedule that calls for gradual reductions in the limit on setting aside permanent assets up to the end of 2002. The definition of PR follows the PLA concept of the Basle limit and is composed of two capital levels: level I (principal capital) and level II (supplementary capital).

It is the separation between these two levels that determined the different leverage potentials according to the quality of the capitalization instrument. With this, net worth and profit and loss accounts, with reduction of some reserves such as the reevaluation reserve and of some amounts referring to cumulative preferred shares and redeemable preferred shares, are the components of level I of PR. On the other hand, level II includes the items deducted from level I, hybrid capital and debt instruments and subordinated debt. The latter two are sources of resources with low degrees of liability in which payment of charges cannot compromise the classification of the institution within operational limits. The volume of level II is limited to the value of level I.

The consolidation of monetary stability and the floating exchange rate system have resulted in a broad process of increasing financial market flexibility, targeted mostly at developing more efficient channels in the allocation of funding available for consumption and investment, aside from reducing the costs of these operations. In this context, one should highlight the new rules covering the operation of investment funds in effect since August 1999, as well as the new system of obtaining and investing external loans.

According to the terms of Resolution 2,683/1999, financial institutions and leasing companies have, as of the month of January 2000, been permitted to contract external funding to be used freely on the internal market, eliminating the minimum periods for amortization of these resources and for the permanence of this capital in the country. The various rules that restricted short-term capital flows were substituted by restrictions of a fiscal nature, while speculative flows were discouraged through levying of the Financial Operations Tax (IOF).

In this framework, Resolution 2,770 was issued on 8.30.2000 consolidating the rules on external loan operations and the operations of financial and nonfinancial borrowers. The major alterations introduced were as follows: end of the demand for prior Banco Central authorization for the contracting of loans, except when the borrowers are public sector entities; undefined interest rate maturities are no longer permitted; inclusion of onlendings to individual persons by financial institutions in the context of the free targeting of resources on the internal market. The basic norms defined rules of a general character, with specific items regarding operations with public sector borrowers. The reasons for these restrictions are the need for preserving the objective of reducing and lengthening the public debt profile.

With regard to the reduction of public sector presence in banking activities, one should observe that, in 2000, the São Paulo State Bank(Banespa) was privatized and was transferred to the Spanish group Santander in an auction held on November 20. The sale price came to R$7.05 billion, with a premium of 281%. An analysis of the conglomerate as a whole indicates assets of R$28.3 billion and net worth – excluding the profit and loss statement – of R$4.44 billion in the November 2000 position.

In the context of the Program of Incentives to the Reduction of the State Public Sector in Banking Activities (Proes), the Banco do Estado do Paraná S.A. (Banestado) was privatized and acquired by the Itaú Group for R$1.62 billion on October 17, with a premium of 303% over the minimum price. Up to the end of the year, of the 13 institutions designated for privatization through Proes, seven were sold and the other six were federalized so that the process of privatization could be carried out by the federal government. Another two institutions opted for transformation into development agencies, bringing the overall total to 16 institutions. Of the 44 institutions participating in Proes, the majority opted for transformation into development agencies (36%), while another 30% resolved to follow through on privatization.

In 2000, the monetary authority decreed the extrajudicial liquidation of four institutions including two private national multiple banks. On the other hand, extrajudicial liquidation processes were concluded for 16 institutions, including the commercial and development banks of the State of Rio Grande do Norte, the operations of which had been suspended. By December, 95 institutions were still subject to special systems of administration including 29 banks, 18 stock and bond distribution companies and 14 buyer group administration companies.

The changes in stockholding structures that occurred in the financial system reflect the trend common on the international market toward cost reductions and increased competitiveness through economies of scale. Banco Central has improved its direct and indirect inspection activities with the objective of achieving greater transparency in these processes and guarantying adequate monitoring of operations among institutions belonging to the same conglomerate.

In this context, it was determined that institutions would be obligated to elaborate the Consolidated Economic-Financial Reports (Conef) and remit them monthly as of July 2000. This document is to be submitted by the controlling financial institution and has the purpose of providing the instruments required for consolidated banking supervision of the entire conglomerate, including its nonfinancial companies. Insofar as is suitable, the operations of these companies are to be classified according to the same criteria adopted for financial institutions which are aimed at defining the required net worth of the economic group in the basis of the degree of risk of its operations.

Parallel to this, alterations were introduced into the norms related to the processes of incorporation, merger and division involving financial institutions. As of December 6 and issue of Circular 3,017, several new accounting rules went into effect with the aim of adapting the recording of premiums and discounts to prudential considerations, while also fostering greater transparency in alterations of stockholding structures.

Consequently, the explanatory notes to the financial statements should present the reasons or purposes of the merger, incorporation or division, with emphasis on the benefits to be gained in terms of strategy, assets, financial and tax concerns. With these alterations, institutions are also required to submit a detailed breakdown of these liabilities and liability conditioning factors that are not registered and are to be assumed by the company resulting from the operation.

With respect to the functions of investment banks, Circular 2,998, dated 8.24.2000, granted these institutions the right to provide services related to the management of companies whose corporate objective is directly linked to operations carried out in the context of the financial market. As a matter of fact, these banks already have the necessary structures required to support development of the private companies, particularly through measures aimed at stimulating investments in the sector.

Another important aspect at the institutional level is that involved in the project designed to restructure the Brazilian payments system. This project is being carried forward by the monetary authority with the participation of financial institutions and was approved in June 1999, with the major objectives of improving management of systemic risk involved in operations based on fund transfers, changes in the operational system used in the Banking Reserves account and implementation of systems of transferring large amounts of resources in real time.

With respect to changes in the operations of Banking Reserves, a system is being developed that makes it possible to monitor this account in real time and will take the place of the current system which allows for monitoring only at the end of the day. In this sense, it was determined that, as of October 1, 2001, the Banking Reserves Account maintained at Banco Central by the financial institution would not be permitted to register a negative balance at any point during the course of the day.

The schedule of activities aimed at making the new system operational was defined by Circular 3,018, dated 12.20.2000, determining that, as of August 1, 2001, the monetary authority will perform real time monitoring of balances and financial liquidations registered in this account. The participation of clearance and liquidation houses will be of essential performance to ensuring financial liquidation even before the operation is recorded in the banking reserve account. Thus, Banco Central will share with the market the task of managing systemic risk generated by transfers of funding in the economy.

With regard to the analysis of economic-financial indicators for large segments of the National Financial System under the prism of the origin of the capital, independently of transitory events that may have a temporary impact on their accounting positions it is evident that these institutions have adapted well to the structural changes introduced after adoption of the Real Plan.

With respect to the administrative expenditures of national private institutions broken down by asset unit, reductions have become common in recent years. The drop in this indicator when compared to December 1999 reflects the increase in total assets and the cutback in these expenditures, pointing to a more effective relationship between the administrative structure and the management of investment resources.

Looking at the segment of public institutions, the drop in this indicator in November 2000 was, above all, a consequence of the cutback of approximately 34% in administrative outlays due partly to the sale of Banespa to the Spanish Santander group. Even if one included Banespa in the public segment in November 2000, the month in which the institution was privatized, there would still have been a reduction in administrative outlays per asset unit in the public system from 3.08% in December 1999 to 2.25% in November 2000.

Table 2.7 - Financial system indicators

Itemization	1997	1998	1999	2000*
Credit operations leverage[1/]				
Public system	4.38	5.68	4.38	4.40
Private system				
Domestic	3.03	1.94	1.92	2.25
Foreign	3.11	2.10	2.09	2.46
Administrative expenditures by unit of asset				
Public system	2.82	2.61	3.08	1.96
Private system				
Domestic	3.29	3.03	2.93	2.24
Foreign	2.69	2.83	2.69	2.52
Profitability of net worth				
Public system	1.30	-2,60	2.05	4.03
Private system				
Domestic	-5.95	6.30	3.89	4.54
Foreign	-0.19	1.77	3.66	-4.31
Gross operating profit margin[2/]				
Public system	1.15	1.18	1.37	1.29
Private system				
Domestic	1.18	1.28	1.32	1.33
Foreign	1.31	1.27	1.38	1.43

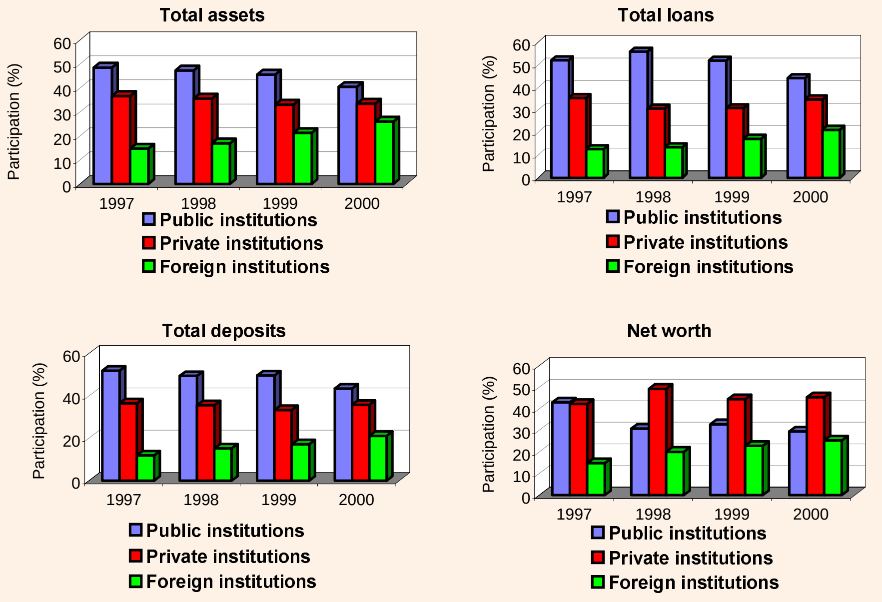
1/ It indicates how many times credit operations exceed net worth.
2/ Operating profit revenues in relation to operating profit expenditures. The main operating profit revenues refer to credit, exchange and securities operations. The main operating profit expenditures refer to inflow, exchange, loans, on-lendings and provision for hard-to-recover credits.
* Refers to Nov/2000.

Growth in the participation of the public and private segments in total assets in November 2000 points to an accentuated decline in the participation of the public segment, mostly as a result of the Banespa privatization, since that conglomerate accounted for 2.7% of SFN assets in the same month. Independently of this fact, one can perceive that recent years have been marked by frequent reductions in public sector participation, moving downward from 48.5% in December 1997 to 40.5% in November 2000, as well as greater participation of foreign capital in SFN investments from 14.7% in December 1997 to 25.9% in November 2000.

With regard to the profitability of the capital belonging to the institutions themselves, this indicator registered considerable recovery under the heading of national private institutions as of 1998. In the segment of foreign institutions, the November 2000 index of -4.3% reflects inclusion of Banespa since the auction of that institution was held just days prior to the closing of the month's balance sheet. As a matter of fact, the negative result registered by Banespa was a consequence of adjustments and provisions made in preparation for transfer of the various institutions belonging to the group. Were Banespa to be excluded, the profitability of foreign institutions would close November 2000 at a positive level of 4.7%.

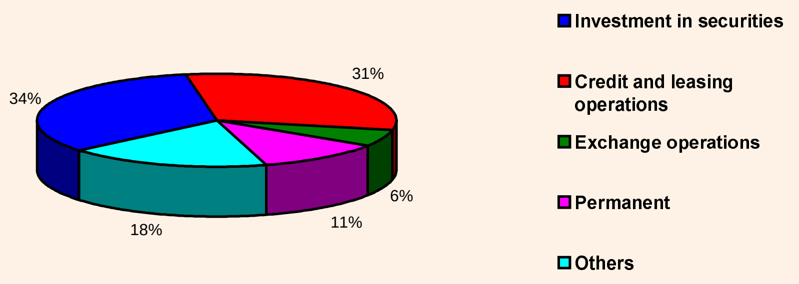
Graph 2.15

National Financial System - participation by segment



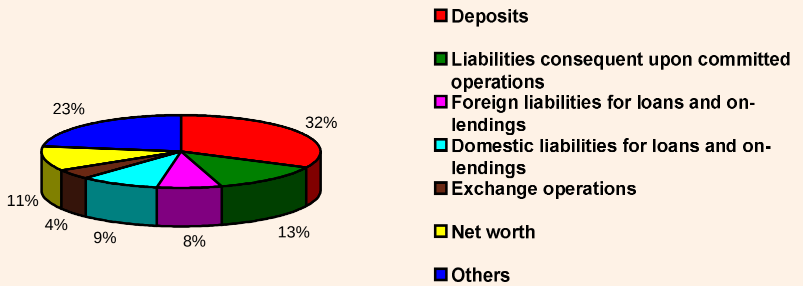
Graph 2.16

Assets' breakdown in the National Financial System - 2000



Graph 2.17

Liabilities' breakdown in the National Financial System - 2000



Between 1999 and 2000, the indicator of credit operation leverage for the national and foreign private segments points to still rather small but steadily increasing growth in credit operations as a consequence of the greater capitalization of these segments of the SFN. As a matter of fact, the measures adopted as of the second half of 1999 with the purpose of stimulating credit operations - many of which involved institutional aspects - are expected to generate their major impact in terms of the creation of a credit culture, fostering the conditions required for growth in the credit supply in relation to GDP, while ensuring the financial security of the system as a whole.