III

CAPITAL AND FINANCIAL MARKETS

In 2000, interest rates followed a steadily downward trajectory that began in March 1999. The Selic rate for the period closed at 17.4%, while the rate on Certificates of Deposit among Financial Institutions (CDI) closed with 17.3%, reflecting a reduction of approximately eight percentage points when compared to the 1999 figure. In real terms, using the IPCA as deflator, the Selic rate closed at 10.8% per year, compared to 15.3% per year in 1999.

Table 3.1 - Interest rate

Percentage p.y.

Rate	Dec 1999	Dec 2000	1999 (a)	2000 (b)	Diference (b-a)
Selic	18.99	16.19	25.59	17.43	-8.16
DI	18.77	16.13	25.63	17.12	-8.51
TR	3.66	1.20	5.73	2.10	-3.63
TBF	20.32	14.85	24.71	16.76	-7.95
TJLP	12.50	9.75	13.22	10.75	-2.47

Calculated on the basis of the preset 30 to 35 day CDB funding rate, the Basic Financing Rate (TBF) closed at 16.8% in the year, while the Interest Reference Rate (TR), which is used to calculate earnings on savings accounts as well as the rates charged on housing finance contracts, closed at 2.1%. The difference between the TBF and TR, which is a consequence of the TR reduction factor, was clearly compatible with the objective of these rates, which is to eliminate the need for estimates of real interest rates and the effects of taxation on financial assets during the course of the year.

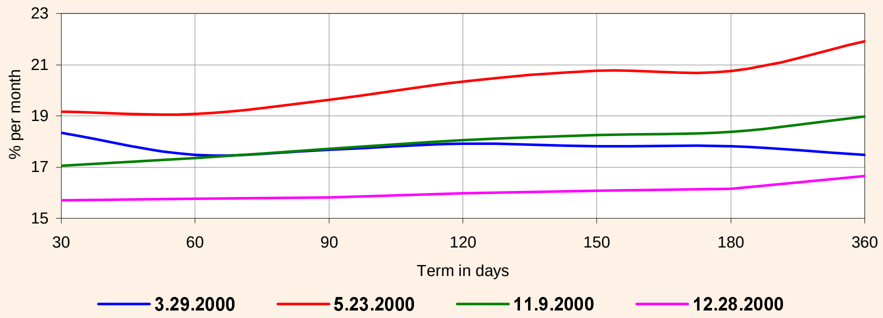
The TJLP, which is calculated on the basis of the pro rata inflation target and the risk premium, was reduced from 12.5% per year in December 1999 to 9.75% per year in December 2000. The downward trajectory of inflation targets, coupled with improvement in the country's risk rating, were the elements responsible for this trend, which is expected to continue in 2001.

Futures market

The rates negotiated on the Commodities and Futures Exchange (BM&F) followed a downward curve in the first quarter of 2000, as the outlook for higher than targeted fiscal surpluses and steady economic growth created expectations of a new cutback in basic interest rates. This was reflected in the forward structure of interest rates, which shifted into a negative inclination toward the end of March.

Graph 3.1

Forward interest rate structure

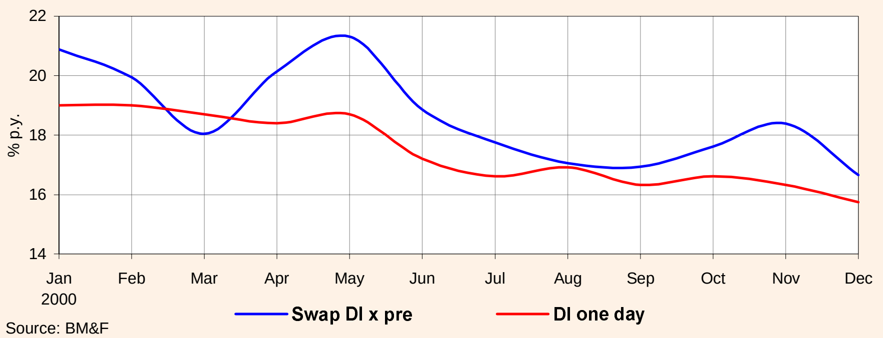


Source: BM&F

In April, the impact of the crisis on American stock exchanges, particularly in the case of the National Association of Securities Dealers Automated Quotations (Nasdaq), spread into capital markets and had an especially strong impact on the emerging market countries. The result was a climate of insecurity among investors and, consequently, a reversal in interest rate expectations. Rates on one year swap contracts increased by 5 percentage points in the period from March to May.

Graph 3.2

Swap DI x pre 1 year versus DI future in t



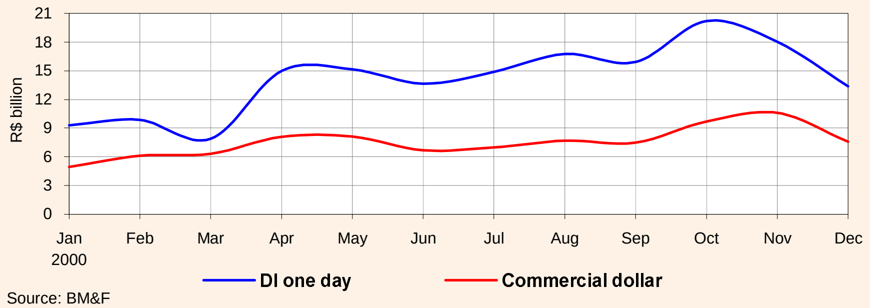
Source: BM&F

Gradual improvement in the external scenario and, principally, the June-July falloff in the Selic rate defined a new interest level and generated expectations of a further drop in the third quarter of the year. As of the end of the third quarter, the international scenario was marked by new uncertainties provoked by the petroleum crisis and the worsening performance of macroeconomic fundamentals in both the United States and Argentine economies. These were reflected in the curve of the forward interest rate structure, which registered an inclination similar to that of the month of May. Observers interpret this as a sign of increased wariness among investors with regard to the possibilities of a recession in the United States. Later, downward movement in petroleum prices, coupled with progress in foreign assistance negotiations with Argentina and attenuation of fears of a recession in the United States, generated more positive expectations and exerted downward pressure on interest rates, which closed the year at 16.7% per year. The difference between the rate on one year contracts and that on 30 day contracts came to 95 points, compared to a closing figure of 21.7% per year in 1999 and a difference of 260 points.

The average daily volume negotiated through one day DI (Interbank Deposit) contracts increased by 90.3% in the month of April and closed at R$15 billion. To some extent, this very significant growth is due to expectations regarding the medium-term interest rate trajectory, which increased demand for hedging. In the month of October, growth came to 26.8% with an average of R$20.2 billion, the largest volume since May 1998. The volume of futures contracts based on the commercial exchange rate expanded by 28% in April and 29.7% in October, clearly mirroring uncertainties generated on the external market and the deficit in Brazilian trade operations.

Graph 3.3

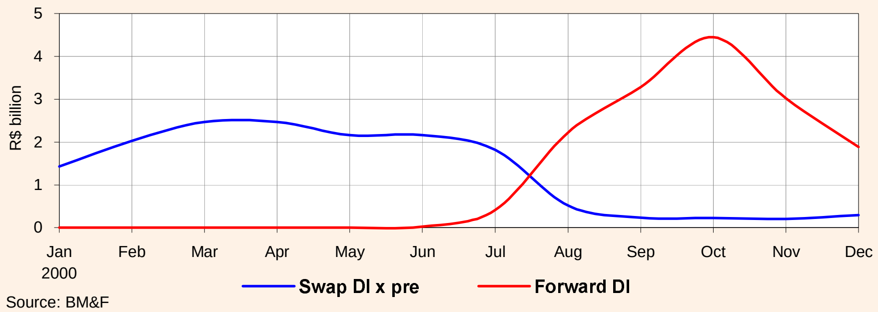
Traded volume of DI one day and commercial dollar futures contracts - daily average



Source: BM&F

In the month of June, the BM&F offered DI forward contracts with adjustment as an alternative to contracts involving swaps between preset and postset rates . The essence of these contracts is similar to that of DI x pre swap contracts. At the same time, these contracts have predefined terms and allow for consolidation of asset and liability positions, with the possibility of closing prior to maturity. Adjustment of positions is effected periodically, with monthly liquidation of the financial result obtained in the contract. In view of these advantages in relation to traditional swap contracts, the market migrated into forward contracts. These operations expanded sharply up to October when an average of R$4.4 billion was negotiated. The DI x pre swap contracts, which registered an average in the range of R$2.2 billion prior to creation of the forward contract, closed December with an average of just R$300 million.

Graph 3.4
Traded volume of swap DI x pre and forward DI - daily average

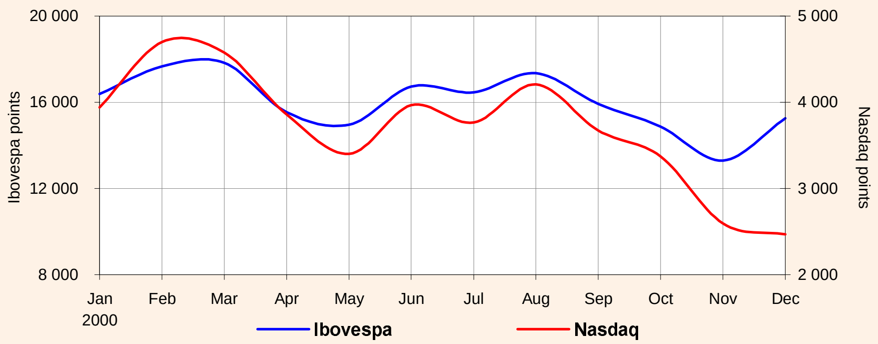


Source: BM&F

Capital market

In 2000, stock exchanges registered losses in the world's principal markets and were unable to repeat the 1999 performance. At the start of the year, stock operations had led the way among financial investments mostly as a result of the 151.9% value growth registered in the previous year. Thus, the Quotation Index of the São Paulo Stock Exchange (Ibovespa) maintained its growth trajectory in the first quarter, hitting the historic high of 18,951 points on 3.27.2000. In March, the Nasdaq exchange registered accumulated 12 month upward movement of 85.8%, a result attributed to expectations of future profits to be earned by Internet and genetic engineering companies. This very vigorous expansion attracted the attention of investors, in detriment to the stocks of the more traditional companies traded on the New York Stock Exchange (NYSE).

Graph 3.5
Ibovespa x Nasdaq



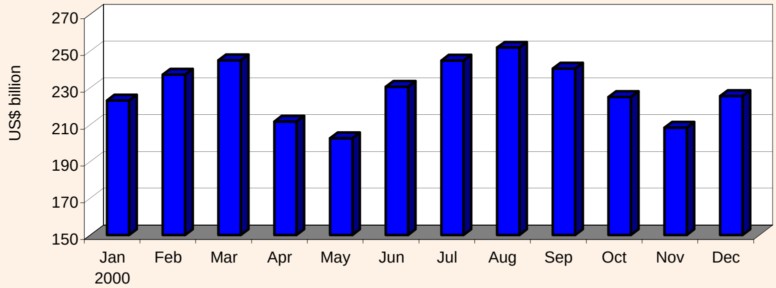
However, the decision taken by the American judiciary regarding the breakup of Microsoft altered the positioning of investors, who began ascribing greater value to current results when compared to the future prospects of asset prices. Evidently, this movement generated successive declines in stock market indices. In April alone, Nasdaq dropped by 15.6%, leading large scale investors to close their positions in emerging markets with the aim of covering their losses. It was in this context that Ibovespa dropped by 12.8% in the month of April.

The reduction in volatility and the drop in interest rates in the month of June, coupled with the low value of stocks in relation to the month of March, created the conditions required to attract investors back to the stock market. With the outbreak of the petroleum crisis, Ibovespa shifted into a new negative cycle that was further aggravated by the Argentine crisis and uncertainties regarding the future of the United States economy, and registered a loss of 23.4% between September and November. The Nasdaq index was marked by strong volatility and sharp downward movement, resulting in losses of 41.3% between September and December.

The December drop in petroleum prices coupled with progress in negotiation of international assistance for Argentina reduced market uncertainties and created the conditions required for stock purchases, particularly in view of the fact that the Ibovespa had lost 22.3% in the year up to the end of November. The Brazilian stock market index rose by 14.8%, while the Nasdaq lost 4.9% and maintained the downward trajectory begun in September. This result reflects the greater importance accorded by the market to internal economic fundamentals.

The market value of companies increased by 7.9% and closed the year at R$441 billion. In dollar terms, the value of these companies dropped by just 1.3% despite the falloff in the Ibovespa, devaluation of exchange and a cutback in the number of companies listed on the São Paulo Stock Exchange (Bovespa) from 478 to 459. This result is explained by the capitalization or rising value of such first line companies as *Petróleo Brasileiro S.A.* (Petrobras), *Empresa Brasileira de Aeronáutica*

Graph 3.6
Market value
Open capital companies - Bovespa

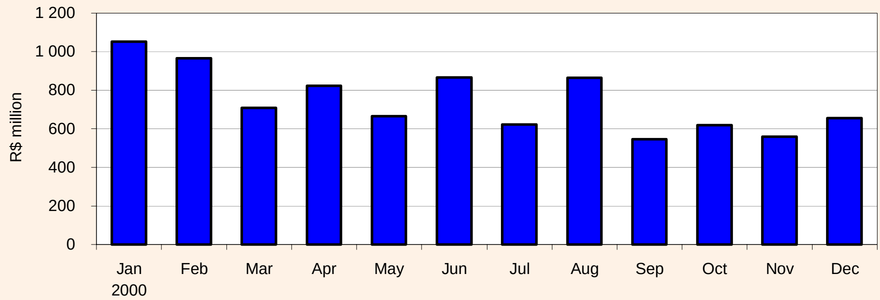


Source: Bovespa

(Embraer), *Banco Bradesco S.A.* (Bradesco) and *União de Bancos Brasileiros S.A.* (Unibanco), among others.

In this scenario, the average volume of trading at Bovespa diminished over the course of the year after having reached the highest monthly average since April 1998 in the month of January. In 2000, average daily trading came to R$746 million, representing an increase of 18.8% in relation to the previous year. One should stress that the average volume registered in 1999 was impacted by uncertainties consequent upon changes in exchange policy and expectations of an upturn in price indices.

Graph 3.7
Traded average volume in Bovespa



Source: Bovespa

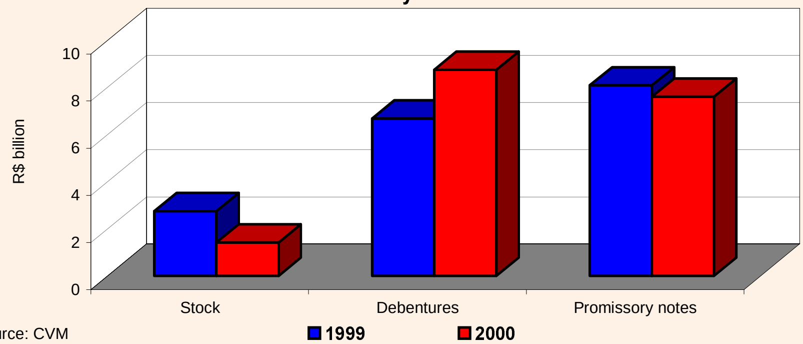
Resolution 2,786, dated 10.18.2000, authorized international investors to contract exchange in direct operations with the Brazilian Clearance and Custody Company (CBLC) for purposes of stock investments on the Brazilian market. The purpose of this measure was to reduce investor costs by eliminating levying of the Provisional Contribution on Financial Transactions (CPMF) and, in this way, enhance the attractiveness of the domestic capital market.

Parallel to this, in the month of December, Bovespa introduced rules for the so-called New Market, somewhat along the lines of the German *Neuer Market*. These rules specify more rigid conditions for improving relations between investors and controllers. In order to issue stocks on this market, companies commit themselves, among other things, to issue only common shares, grant equal treatment to minority stockholders should stock control be sold to another party, maintain a minimum share of stocks representing 25% of capital in circulation, release information aimed at providing the market with the transparency required for price formation, including publication of balance sheets based on international models. These measures will ensure new companies of access to the capital market under conditions that are more advantageous than has traditionally occurred.

The Rio de Janeiro Stock Exchange (BVRJ) terminated stock trading activities on April 28. According to a protocol signed with Bovespa, the São Paulo Exchange assumed responsibility for stock trading and the BVRJ concentrated public security operations. This dual system went into operation as of the second semester.

Inflows through primary issues of stocks, debentures and promissory notes remained stable in relation to 1999 and ended the year at a level of R$17.7 billion compared to R$17.5 billion in the previous year. Debenture issues turned in expansion of 31% in the period, demonstrating evident business preference for this type of funding operation. The underlying reason for this preference is the fact that costs of these operations are tied to the evolution of interest rates and, therefore, have followed a steadily downward curve since 1999.

Graph 3.8
Primary issues



Source: CVM

Table 3.2 - Primary issues of companies

Issues - CVM (R$ million)

Period	Stocks		Debentures		Promissory notes	
	1999	2000	1999	2000	1999	2000
Jan	94	0	80	35	405	529
Feb	246	468	902	1 007	96	165
Mar	0	0	1 480	200	365	586
Apr	19	0	244	280	465	100
May	0	0	0	1 525	338	1 393
Jun	300	33	1 001	10	1 760	599
Jul	0	440	590	2 465	440	1 921
Aug	0	0	280	162	200	590
Sep	1 466	0	362	202	569	60
Oct	390	191	215	1 033	365	5
Nov	84	0	833	100	1 642	560
Dec	150	278	690	1 729	1 400	1 083
Total	2 749	1 410	6 676	8 748	8 044	7 591

Source: CVM

Financial investments

Financial investments registered growth in 2000 that was consistent with expanding economic activity, improved liquidity conditions and an increased credit supply. The overall balance invested in Financial Investment Funds (FIF), savings accounts, Banking Deposit Certificates (CDB) – excluding the CDB in investment fund portfolios – and stock funds expanded by 16.7%, increasing from R$412.4 billion in 1999 to R$481.4 billion in 2000.

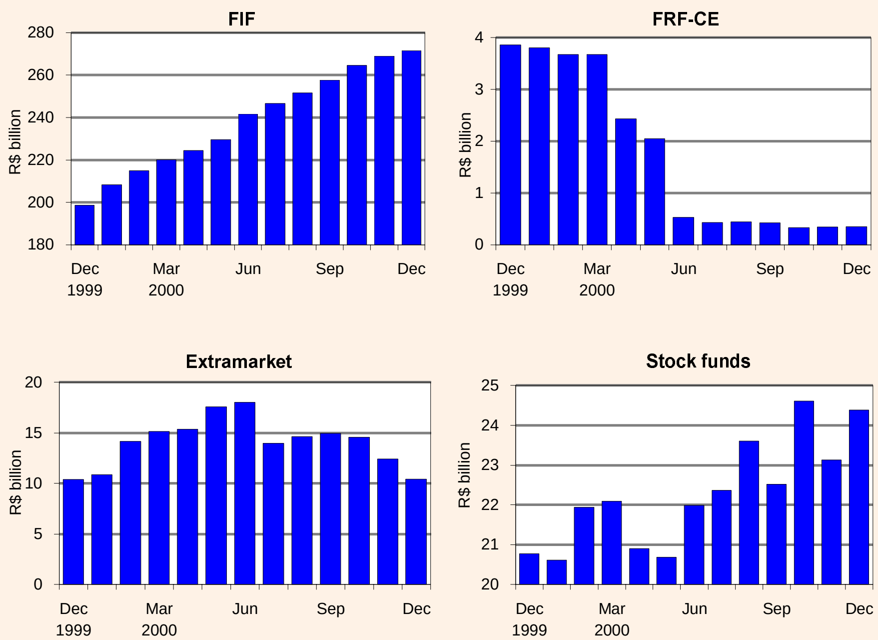
Table 3.3 - Nominal income of financial investments - 2000

% p.m.													% p.y.	
Itemization	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	1999	2000
FIF	1.55	1.43	1.37	1.26	1.46	1.42	1.28	1.32	1.20	1.26	1.23	1.26	26.20	17.26
FRF-CE	2.00	-0.06	1.14	3.78	2.79	-0.76	-0.24	2.90	1.95	3.40	4.15	2.98	168.64	26.71
Extramarket	1.40	1.39	1.39	1.24	1.43	1.34	1.26	1.35	1.17	1.24	1.17	1.15	24.40	14.17
Stock funds	-0.79	4.23	1.18	-5.55	-1.03	8.72	-0.08	3.74	-4.42	-1.38	-6.10	5.96	61.15	3.36
Savings	0.72	0.73	0.73	0.63	0.75	0.72	0.66	0.70	0.60	0.63	0.62	0.60	12.25	8.39
CDB	1.42	1.42	1.42	1.26	1.48	1.36	1.28	1.35	1.20	1.26	1.21	1.17	25.28	17.05

Among financial investments, FIF led the way in terms of resources inflows, closing the year with net worth of R$271.5 billion, with growth of 36.7% in the period. The

Graph 3.9

Investment funds

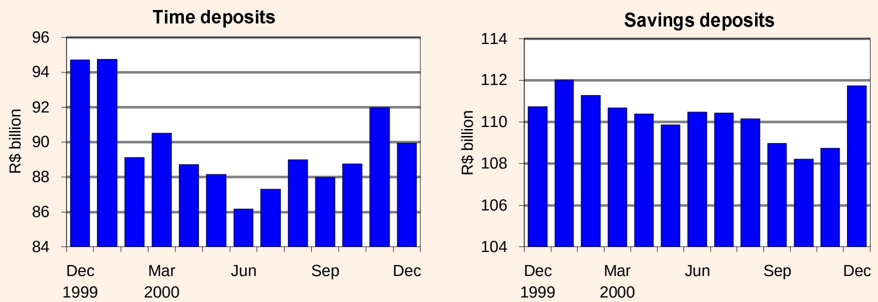


total for the year came to R$35 billion, with the sharpest growth being registered in June (R$8.9 billion). The performance of FIF resulted basically from the provisions in Circular 2,958, dated 1.6.2000, which authorized these funds to invest up to 49% of their portfolios in stock and investment fund quotas, in modalities regulated by the Securities and Exchange Commission (CVM), making it possible to combine fixed income assets, variable income assets and derivative operations and, in this way, achieve cost reductions in stock operations when compared to direct operations on the market. Among financial investments, FIF registered the second best performance in terms of profitability, with an accumulated result of 17.3% in the year.

Savings accounts closed the year with a balance of R$111.7 billion, compared to R$110.7 billion in the previous year. This type of investment registered less attractive returns (8.4% per year) vis-a-vis those generated by investment funds and this factor resulted in a loss of resources in the period. The resources outflow was attenuated in the fourth quarter when net inflows came to R$2.8 billion as a result of payment of the Christmas wage bonus, which traditionally occurs at the end of the year, and of the programs implemented in the period by several important financial institutions aimed at stimulating investments.

Graph 3.10

Time and savings deposits



Aside from this, Resolution 2,809, dated 12.22.2000 was issued for the purpose of creating the mechanism of automatic alteration of the “b” factor - a component of the TR reduction factor – to keep pace with changes as they occur in the level of the Selic rate target. Through this mechanism, the ratio between the profitability of savings and the profitability of CDB net of income tax came to be inversely proportional to the Selic rate target. This factor, therefore, has led to a gradual convergence of the profitability levels of financial investments, one of the hallmarks of economies in which interest rates are low.

Resolution 2,689 was issued on 1.26.2000, with the objective of providing nonresidents of the country with direct and simplified access to Brazilian financial and capital markets. This instrument specified that Foreign Capital Fixed Income Funds (FRF-CE) must be incorporated or transformed into FIF by 3.31.2001, or be abolished. It further determined that no new quota issues would be permitted as of 3.31.2000. With this, the net worth of the FRF-CE was reduced from R$3.9 billion in 1999 to R$348.2 million in December 2000.

The Extramarket Fund, which has the objective of investing the available funding of entities of the indirect federal administration and foundations supervised by the federal government, closed the year with assets of R$10.4 billion or practically the same result registered in 1999. As of June, CMN authorized Petrobras to invest its available cash resources freely on the financial market in federal public debt securities.

Accompanying the performance of the stock exchange, stock funds registered low profitability levels in 2000. Despite this, their net worth came to R$24.4 billion at the end of the year, as compared to R$20.8 billion in 1999. One should note that, as of the month of July, this item has included Privatization Mutual Funds (FMP), with approximately R$2.4 billion in Employment Guaranty Fund resources (FGTS) (FMP-FGTS). The FMP-FGTS were created with the aim of making it possible to acquire shares of the companies included in the National Privatization Program (PND) through utilization of FGTS resources. The overall purpose of this measure was to broaden the shareholder base of these companies to the maximum extent possible. Once these resources are subtracted, the change in net worth declines from 17.4% to 5.7% in the year.