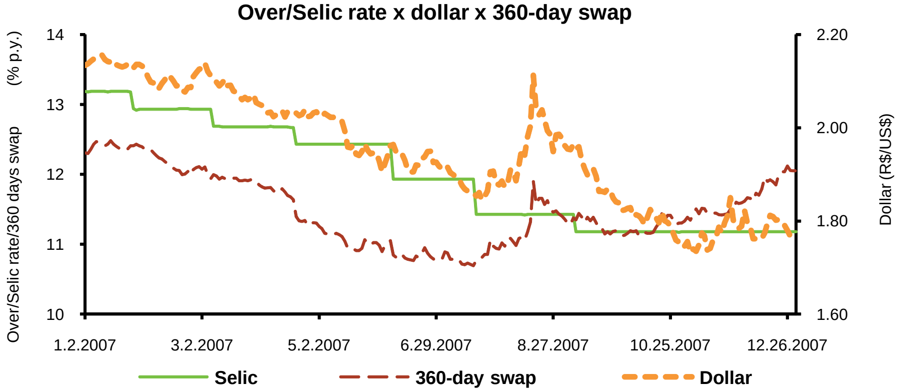
Capital and Financial Markets

Real interest rates and market expectations

The more flexible approach to monetary policy begun in September 2005 was preserved in 2007. The highlights of this process were a success of reductions in the basic interest rate target through October, when Copom decided to hold the rate at 11.25% per year, 2 p.p. below the final 2006 level. When one analyzes market expectations for interest rate and inflation as shown in the Central Bank Market Report survey, real ex-ante interest rates reached 6.5% per year at the end of 2007, corresponding to a decline of 1.4 p.p. against December 2006. For the most part, this performance reflected adjustments in expectations regarding the evolution of the basic rate of interest in a

Graph 3.1
Over/Selic rate

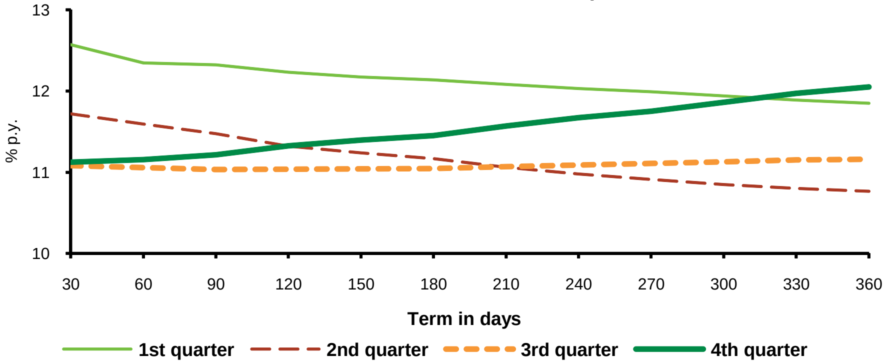
Graph 3.2
Over/Selic rate x dollar x 360-day swap



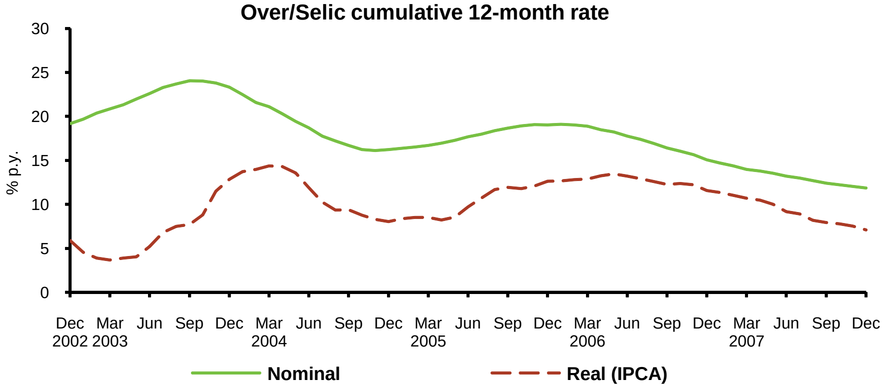
scenario of stable inflation, thus stimulating reductions in risk premiums through the end of August. Following that period, expectations indicated a relatively stable R$ rate, mainly as a consequence of increased uncertainties on international financial markets and deterioration in the prospective scenario of inflation.

In the derivatives market, 360-day DI swap contracts x pre accompanied the declining trajectory of the basic rate of interest through mid-2007. This movement reversed course as of July, as inflation expectations and the level of investor uncertainty regarding the impact of the United States economic performance on other economies increased. With this, these contracts closed the year at 12.05% per year, corresponding to a 33 basic point reduction compared to December 2006.

Graph 3.3
Yield curve – ID x fixed rate swap



Graph 3.4
Over/Selic cumulative 12-month rate

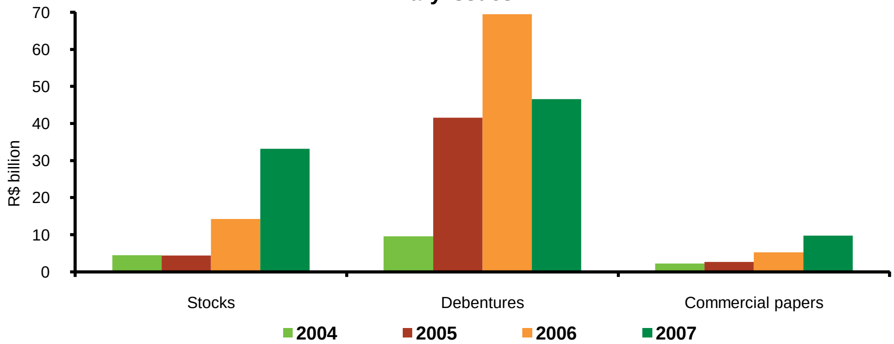


Capital market

The 2007 performance of the Capital Market continued the positive trajectory of previous years. Issuances of stocks and securities registered at the Securities and Exchange Commission (CVM), including stocks, debentures and promissory notes, reached a level of R$89.5 billion in 2007, for growth of 0.6% compared to the previous year. Particular mention should be made of growth of 133.5% in issuance of new shares, totaling R$33.2 billion, together with 146.2% expansion in 64 initial public offers registered in 2007, in a total amount of R$28.9 billion.

The participation of foreign investors in public offers came to 75.4%, with a total of R$65.5 billion in 2007. The participation of this group of investors in the secondary stock market shifted from 35.5% of total operations on the São Paulo Stock Exchange (Bovespa) in 2006 to a level of 34.5% in 2007.

Graph 3.5
Primary issues

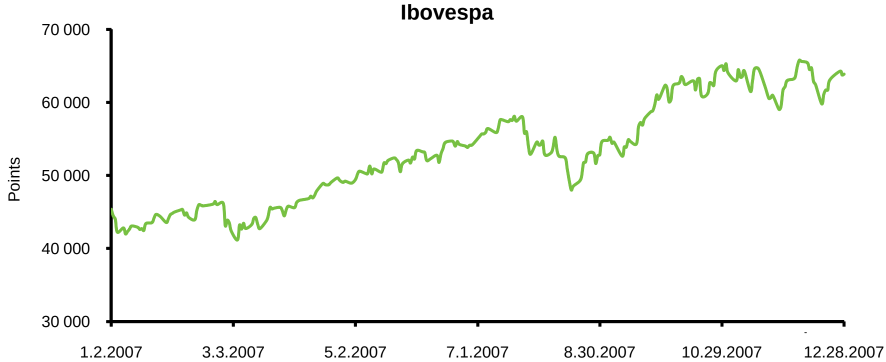


Source: CVM

Issuances of Stock Investment Fund (FIP) reached R$22.3 billion at the end of 2007, reflecting 366.2% growth compared to the previous year. The performance of these offers demonstrates continuity of the strong growth that characterized the private equity market in Brazil, sustained mostly by foreign institutional investors.

The ongoing economic stabilization process and a more flexible monetary policy stance have contributed to the enhanced dynamics of the secondary stock market. Nominal profitability of the São Paulo Stock Exchange Index (Ibovespa) reached 43.7% in 2007, accumulating 467% since 2003. This result is seen to be even more significant when

Graph 3.6
Ibovespa

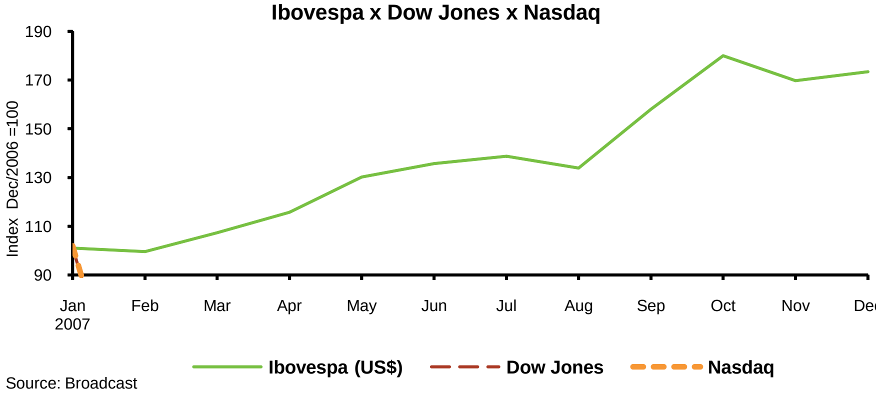


Source: Broadcast

one considers the turmoil that marked financial markets in the second half of the year, in response to deterioration of the United States subprime real estate credit market. In this scenario, following a period of relative stability in the first half of 2007 and a worsening of volatility in the early months of the second half of the year, Ibovespa closed the year at 63,886 points after having achieved a record 65,790 points on December 6, clearly reflecting investor perceptions regarding the positive conditions of the domestic economy.

In dollar terms, the Bovespa profitability reached 73.4% in 2007, eight gross level consistent with the process of exchange appreciation registered during the year. This result was sharply higher than the final figures for the Dow Jones and Nasdaq indices, 6.4% and 9.8%, respectively, both of which were heavily impacted by the repercussions of the subprime market crisis.

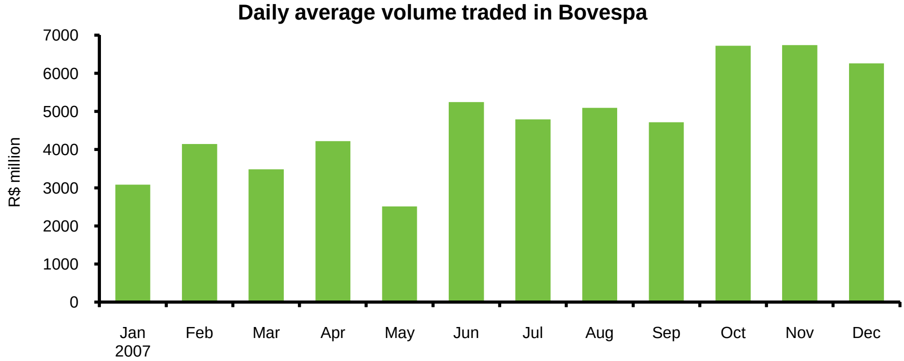
Graph 3.7
Ibovespa x Dow Jones x Nasdaq



Source: Broadcast

The average volume of trading at Bovespa posted annual growth of 100%, setting a record of R$4.9 billion in 2007, while capitalization of the companies listed at Bovespa rose 60.4% in the 12-month period ended in December, closing with a record total of R$2.5 trillion. Viewed over the longer term, the volume of trading and the value of capitalization increased 749% and 465%, respectively, in the last five years.

Graph 3.8
Daily average volume traded in Bovespa

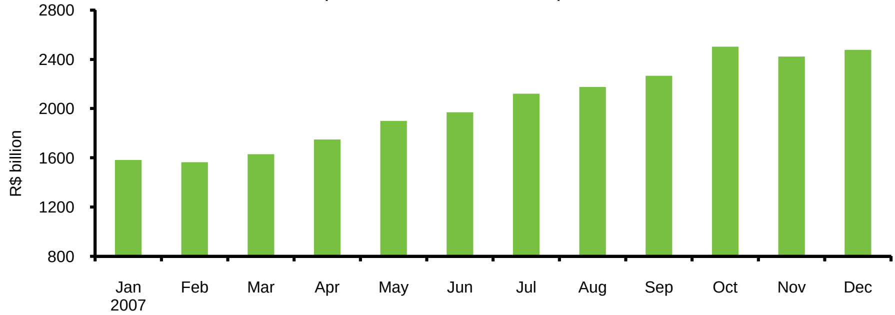


Source: Bovespa

Graph 3.9

Market capitalization

Corporations listed in Bovespa



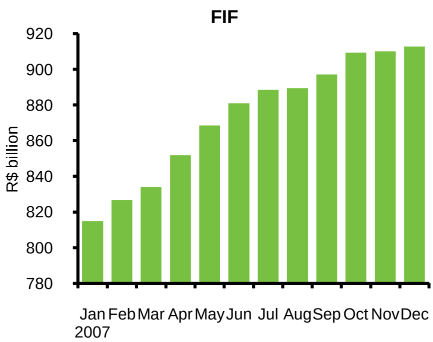
Source: Bovespa

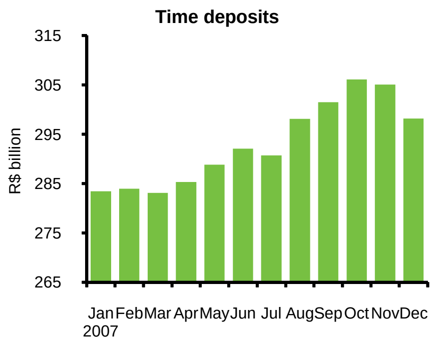
Financial investments

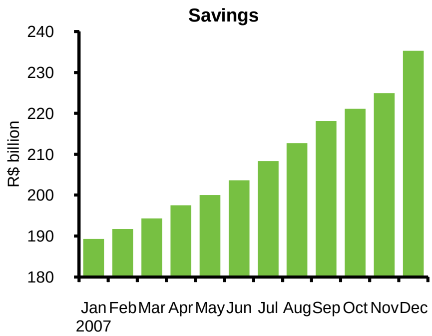
The aggregate balance of investment funds, time deposits and savings accounts reached R$1.5 trillion in December 2007, reflecting growth of 19.6% over the corresponding period of the previous year.

Graph 3.10

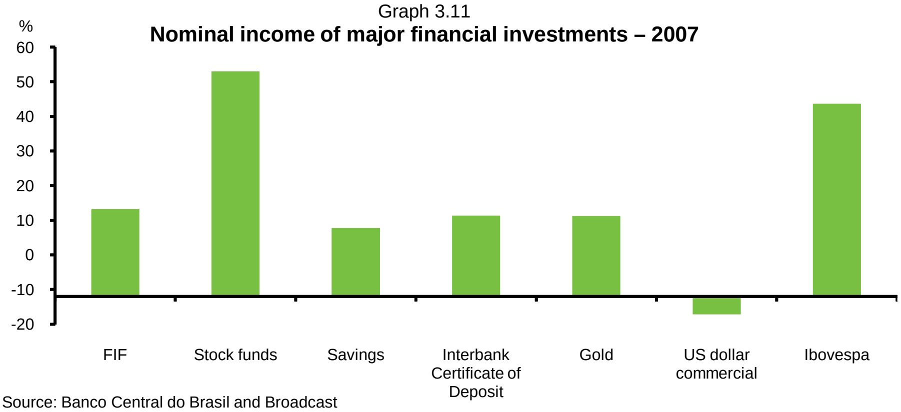
Financial investments – Balances







Graph 3.11
Nominal income of major financial investments – 2007



Source: Banco Central do Brasil and Broadcast

The consolidated net worth of investment funds reached R$1.1 trillion at the end of December, posting growth of 22% in the year. The balance for fixed income investment funds, multimarket funds, reference funds, short-term and exchange funds totaled R$912.9 billion, while those involving extra market funds and variable income investment funds reached levels of approximately R$25.9 billion and R$164.1 billion, for respective increases of 14.8%, 11.8% and 86.6%.

At the end of December, the consolidated portfolio of fixed income investment funds, multimarket funds, reference funds, short-term and exchange funds was composed primarily of public securities, with 56.1% of total, followed by repo operations, 20.8%, and private instruments, with 23.1%, compared to 2006 levels of 60.9%, 17.3% and 21.8%, in the same order. International financial market uncertainties generated a powerful impact on the distribution of fixed-rate-and inflation-indexed securities issued by the National Treasury in the fund portfolio. In this sense, growth was registered in the participation of NTN-B and NTN-C, both of which are tied to price indices, while securities with preset interest rates declined in terms of their participation.

After obtaining a net total of R$36.4 billion in the first half-year, the resources channeled to fixed income fund tended to decline in the months following the final reduction in the Selic rate target, closing the year with a net negative inflow of R$6.6 billion. With regard to referenced investment funds, net redemptions in the year totaled R$10.5 billion, including R$9.7 billion in the first half of the year. This performance reflected increased demand for this investment modality in periods of growing uncertainty on international markets. Parallel to this, growth in the net worth of multimarket funds, registering net inflows of R$40.6 billion, maintained the positive performances of recent years.

The net worth of extra market investment funds, charged with management of the funding belonging to the indirect federal administration, totaled R$25.9 billion at the end of 2007, posting net redemptions of R$115.1 million in the year.

Reflecting the dynamics of the capital markets, the assets of variable income, investment funds expanded 86.6% in 2007, posting net deposits in every month and closing the year at R$25.7 billion. The net worth of the Mutual Privatization Funds (FMP-FGTS) and Free Portfolio of Mutual Privatization Funds (FMP-FGTS-CL) increased 64%, reaching a level of R$17.7 billion, considered consistent with the increase in the value of Petrobras and Vale shares, while the net worth of other stock funds totaled R$146.4 billion, an increase of 89.9% in the year.

The balances of savings accounts and time deposits totaled R$235.3 billion and R$298.1 billion, respectively, at the end of 2007, f registering respective annual growth rates of 25.2% and 5.7%. It should be stressed that savings accounts registered net deposits in every month of the year, totaling R$36 billion, while time deposits posted net redemptions of R$873.5 million.

Table 3.1 – Nominal income of financial investment – 2007

%

Itemization	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	2007	Memo: 2006
FIF	1.13	0.87	1.19	1.21	1.41	0.89	1.13	0.23	1.47	0.99	0.99	0.93	13.17	15.53
Stock funds	0.47	-0.34	2.42	5.07	4.45	2.81	2.66	-1.17	8.59	6.98	-1.55	13.98	53.01	36.14
Savings	0.72	0.57	0.69	0.63	0.67	0.60	0.65	0.65	0.54	0.61	0.56	0.56	7.70	8.33
CDB	1.03	0.85	1.01	0.90	0.99	0.84	0.90	0.95	0.76	0.90	0.82	0.82	11.31	14.64
Gold	3.22	1.34	-1.54	3.91	-5.48	-3.41	-2.59	2.42	3.77	7.95	5.89	-3.78	11.26	12.69
US dollar commercial	-0.62	-0.70	-2.82	-0.80	-5.16	-0.14	-2.52	4.50	-6.27	-5.16	2.28	-0.70	-17.15	-8.66
Ibovespa	0.38	-1.68	4.36	6.88	6.77	4.06	-0.39	0.84	10.67	8.02	-3.54	1.40	43.65	32.93

Source: Banco Central do Brasil, CVM, Bovespa and BM&F

In order to adjust savings account profitability to that provided by other fixed income financial investment modalities, the CMN issued Resolution no. 3,446, dated March 6, 2007, altering article 5, paragraph 1 of Resolution no. 3, 354, which defined the methodology for calculating the Reference Rate (TR). Parallel to this, article 5, paragraph 2 of Resolution no. 3,354 authorizes the Central Bank to determine in the value of parameter "b" should the Basic Financing Rate (TBF) be lower than 11% per year, Circular no. 3,356, dated July 19, 2007, determined the following standards for parameter "b", according to the value of the TBF: 0.32 for TBF of less than 11 and greater than or equal to 10.5; 0.31 for TBF below 10.5 and greater than or equal to 10; 0.26 for TBF of less than 10 and greater than or equal to 9.5; and 0.23 for TBF be load 9.5 and greater than or equal to 9.