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BANCO CENTRAL DO BRASIL

Inflation Report

March 2004

Volume 6 – Number 1

Portugal, XVII century
100 réis, stamp of 200 réis, silver

Museum of Money of
Banco Central do Brasil Collection

Portuguese stamps

After the Union of the Portuguese and Spanish crowns ended, continuing battles against Spain and Holland lead to an increase in the price of metals and so to instability in the Portuguese economy.

In order to both support the military expense and avoid money being sent abroad, the Portuguese kings D. João IV (1640-1656), D. Afonso VI (1656-1667) and D. Pedro II (1667-1706) ordered the gold and silver Portuguese coins and the silver Spanish coins in circulation in Portugal to be stamped with a new increased value.

During the reign of D. Pedro II (1667-1706), the gold and silver coins were given a milled edge called "cordão", to prevent people from scratching off some of the metal. These coins also received a stamp of an armillary sphere, topped by the royal crown, called "marca".

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Inflation Report

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Inflation Report

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Statistical Conventions:

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

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

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

There are no references to sources in tables and graphs originated in the Banco Central do Brasil.

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Foreword

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

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

Executive summary

The positive performance of the Brazilian economy in the second half of 2003, with a relatively high level of activity at the end of the year, is expected to be maintained in the first semester of this year. The maintenance of the growth of credit lines, the pace of sales in the retail market, and the performance of exports in the first months of the year are indicators that allow one to predict that the expansion begun in the second semester of 2003 will continue over the next months. In addition, the evolution of the real earnings clearly shows an inversion in the downward path that took place during most of 2003, which is a relevant aspect if one considers the influence of this variable on the sales of non-durable consumption goods – the main category of final goods of the industry.

It should be mentioned, however, that the growth rates of demand-conditioning factors decreased at the beginning of this year, indicating a possible cyclic slowdown of the recent economic expansion. It is worthwhile to mention that this slowdown is usually expected after a certain recovery of the economic activity level, and it was also observed in previous resumption periods.

According to the benchmark scenario used in this *Report*, which assumes that the Selic rate will remain constant at 16.25% p.y. and the domestic price of the US dollar will remain at R$2.91 over the forecast horizon, one expects a GDP growth rate of 3.5% in 2004, therefore, unchanged since the last *Report*. Using the exchange rate and interest rate paths expected by the market, surveyed by the Investor Relations Group of the Central Bank of Brazil (Gerin), the projected growth in 2004 rises to 3.7%. This projection is higher than the one made under the benchmark scenario mainly because of the impact of lower interest rates on the economic activity level.

As for the credit operations of the financial system, there was a reduction in their volume in the first two months of the year due to typical seasonal factors. However, the maintenance of the growth of these operations in the medium run, started in the last quarter of 2003, should be highlighted. This expansion has been mainly driven by the demand for durable consumption goods, indicating the favorable impact of a more flexible monetary policy – expressed in lower interest rates of credit operations and banking spreads – on the sales of that sector. Moreover, one should mention the contribution of loans automatically deducted from paychecks, whose consolidated statistics are not yet available, and of the continuous drop of default rates to the development of a suitable environment for the consistent expansion of bank loans.

As in previous years, the contribution of the external sector remains relevant to the country's economic recovery process. The current account surpluses through 2003 and early this year were determined by the country's positive behavior in the foreign trade area. In 2004, the expected increase in imports, which is consistent with a scenario of resumption of economic activities, will not prevent last year's results from being obtained again. The trade balance forecast is on the order of US$24 billion. Therefore, the current account surplus is expected to be maintained.

Regarding the financial account, the data observed in the first two months corroborate the expectation of net inflows of foreign direct investment higher than the ones registered in 2003. Similarly, it is expected the maintenance of bond market operations and the rollover of private debt in rates higher than 100%, even taking into account the magnitude of the forecasted amortizations. Therefore, the balance of payments should be financed with no difficulty.

The resumption of domestic demand is a major factor in sustaining the recovery of the economic activity. In this context, one should emphasize the recent increase in the real earnings as a result of labor agreements involving important professional categories and, mainly, of the drop in inflation rates.

In fact, the latest figures for consumer price indices have been at lower levels than those of the end of 2003 and last January. Such behavior indicates that the pressures observed in specific segments did not disseminate and will not prevent inflation rates from converging to a level consistent with this year's target. In this sense, although the inflation of the first quarter of 2004 was higher than the one originally anticipated, the median of market expectations, surveyed by the Gerin, remained stable at about 6% in 2004 and 5% in 2005, thus close to the targets.

The benchmark and market scenarios built in this *Report* are different from those usually presented because they incorporate the underlying assumption that part of the inflation observed in the first quarter of 2004 will not follow the regular propagation mechanisms captured by projection models. This procedure was adopted based on indications that monetary policy has successfully anchored both the inflation expectations and the behavior of price-setters, limiting the extent of the inflation surprise of the first quarter and preventing it from contaminating the results in the following quarters. In building both scenarios, it was assumed for March a 0.40% inflation, which corresponds to the median of expectations of the Top 5 institutions, according to the Gerin classification. Using these two underlying assumptions, the benchmark scenario shows a downward trend for the 12-month accumulated inflation, from 5.8% in the first quarter of 2004 to 5.2% at the end of the year and 4.2% at the end of 2005, thus below the targets set for each of those years. The market scenario projects higher inflation rates than the benchmark scenario, namely, 6.2% and 5.4% for 2004 and 2005, respectively, as this scenario considers a fall in the Selic rate and an exchange rate depreciation over the forecast horizon.

The government reaffirmed its commitment to ensure the objectives of the fiscal policy, particularly this year's primary surplus, when it adjusted its budget program and even implemented preventive expenditure cuts. In the medium and long run, the fiscal balance is expected to continue at all governmental levels with greater emphasis on the management of expenses. That includes legal provisions that inhibit practices that could jeopardize the efficiency of public spending, as part of the Fiscal Accountability Law's guidelines. The debt/GDP ratio is expected to have a decreasing trend, considering the reduction in the level of interest rates applied to the debt over the last months and the favorable prospects of economic growth.

1 Activity level

Recovery in the pace of economic activity began in the third quarter of 2003, consolidated toward the end of the year and has continued into the early months of 2004. This process has been quite similar to what occurred in other periods of recovery in recent years, starting with initial accentuated expansion that tends to settle back into steady and more consistent growth in the second phase of recovery. This is evident in industrial and commercial growth indicators which, in general, expanded at positive – albeit more moderate – rates from November 2003 to January of this year, when compared to the immediately previous months.

In terms of internal demand, the highlight of the period has been increased consumption of consumer durables, driven mostly by continued expansion in credit operations. In the wake of a long period of downward movement, there are even signs of growth under nondurable consumer goods as real earnings have begun to expand. In their turn, outlays on investments have registered positive though still sporadic growth in the months following the exceptional upturn that marked the third quarter of 2003. For the third consecutive year, the performance of the external sector in 2003 was the major factor underlying the upturn in demand. This has continued into the current year and is expected to remain as the single element most responsible for increased activity over the course of the year.

Parallel to recovery in the industrial and commercial sectors, primary sector output has also played an important role. Here, farm surveys have confirmed expectations of a new record grain harvest this year, generated by continued expansion of soybean production and the outlook for strong growth in a number of other crops of importance to internal supply. At the same time, livestock production has been fired by the possibility of increased exports due, among other factors, to incorporation of new external markets.

1.1 Retail sales

Sales Volume Index in the Retail Sector – Brazil

Percentage change

Itemization	2003				2004
	Sep	Oct	Nov	Dec	Jan
In the month[1/]					
Retail sector	1.3	0.0	2.0	0.0	2.1
Fuel and lubricants	1.6	1.3	1.9	-0.9	-6.0
Supermarkets	0.2	0.5	1.1	0.1	0.3
Textiles, clothing and footwear	-0.1	1.6	0.6	-0.3	2.7
Furniture and home appliances	5.4	-0.1	2.0	5.4	-0.8
Vehicles, motorcycles	7.7	3.6	5.7	-0.1	-1.2
Quarter/previous quarter[1/]					
Retail sector	1.0	1.1	1.8	2.1	3.1
Fuel and lubricants	2.4	1.3	2.8	2.8	0.6
Supermarkets	0.2	0.6	1.1	1.5	1.7
Textiles, clothing and footwear	3.4	5.6	2.4	2.7	2.4
Furniture and home appliances	6.9	6.7	6.9	6.8	7.1
Vehicles, motorcycles	2.2	5.8	12.0	13.0	10.3

Source: IBGE

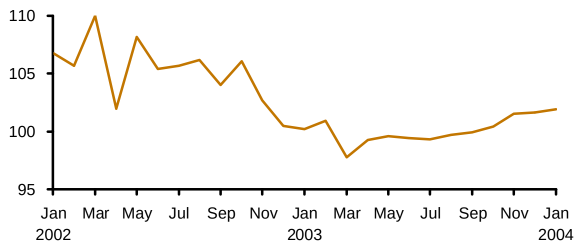
1/ Seasonally adjusted data.

Sales volume index in the retail sector

Supermarkets

Seasonally adjusted data

2003=100



Source: IBGE

Sales Volume Index in the Retail Sector – Brazil

2004, January

% growth in 2004

Itemization	Nominal revenue	Volume	Price change
Retail sector	10.2	6.1	3.9
Fuel and lubricants	-3.2	-0.6	-2.6
Supermarkets	8.5	2.9	5.4
Textiles, clothing and footwear	11.7	5.3	6.0
Furniture and home appliances	23.4	19.6	3.1
Vehicles, motorcycles	11.6	8.1	3.3

Source: IBGE

Retail activity indicators showed the first signs of growth at the start of the second half of 2003. This tendency continued through to the end of the year and the first month of 2004. This performance was generated by an increased credit supply, particularly financing for acquisitions of consumer durables, made possible by interest rate reductions and improved consumer expectations. In this context, one should also include the positive impacts that collective bargaining agreements have had on real earnings in several important labor categories, at the same time in which inflation has followed a downward curve. Consequently, demand for nondurable consumer goods has also increased in recent months, though this process is still rather incipient.

According to the Monthly Trade Sector Survey (PMC), which is published by the Brazilian Institute of Geography and Statistics (IBGE), the Retail Sales Volume Index registered a high of 3.1% in the quarter ended in January 2004, compared to the result of the quarter ended in October 2003, when data from the seasonally adjusted statistical series are used. Using this basis of comparison, all of the activity categories registered positive results, with particularly strong performances under furniture and home appliances (7.1%), fabrics, apparel and footwear (2.4%) and fuels and lubricants (0.6%). Once again, using the same reference base, the heading of automobiles, motorcycles, parts and spares, which is not part of the general index, registered the highest rate of growth, with 10.3%. In 2003, despite recovery in the sector of commerce in the second half of the year, physical sales dropped by 3.7% in the year. For the most part, this result was caused by a reduction under segments that depend heavily on income growth, such as supermarkets, with 4.9%, fuels and lubricants, with 4.3%, and fabrics, apparel and footwear, with 3.1%.

A breakdown according to states shows that, of the twenty seven states included in the survey, only six registered positive results in 2003. The most significant increases occurred in Rondônia, with growth of 6.8%, Mato Grosso, with 1.8%, and Paraná, with 0.9%. On the other hand, the largest reductions occurred in Roraima, 13.2%, Paraíba, 9.4%, and Alagoas, 9.3%.

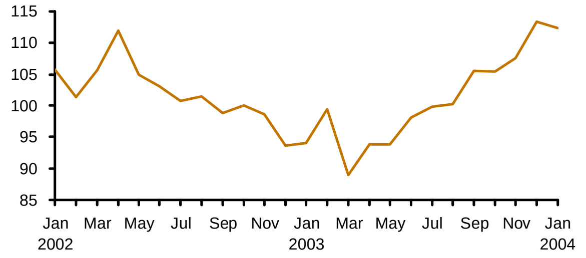
Though the Retail Sales Volume Index closed 2003 with negative growth, Nominal Sales Revenue expanded by 13.4% in the year, as a result of 17.7% growth in retail prices when median 2003 prices are compared to those of the previous year. In 2003, the sectors of fuels and lubricants

Sales volume index in the retail sector

Furniture and home appliances

Seasonally adjusted data

2003=100



Source: IBGE

Effective physical sales of the retail sector in São Paulo

Percentage change

Itemization	2003				2004
	Sep	Oct	Nov	Dec	Jan
In the month[1/]					
General	-1.1	1.1	3.2	-0.2	8.7
Consumer goods	-1.2	1.3	2.4	0.1	8.9
Durable	-0.2	4.4	4.3	-1.8	-0.3
Semidurable	-2.1	0.0	7.4	0.9	8.7
Nondurable	-4.0	1.4	2.4	3.0	12.2
Automotive trade	10.4	-1.8	10.6	-3.8	4.0
Company sales outlet	12.3	-0.8	11.2	-4.7	1.8
Autoparts and accessories	-0.7	-6.9	9.6	1.9	11.6
Building materials	0.3	0.6	-1.8	3.9	-2.1
Quarter/previous quarter[1/]					
General	-3.4	-1.6	0.3	2.8	6.5
Consumer goods	-3.0	-1.3	-0.1	2.3	6.0
Durable	-7.7	-9.5	-4.0	4.0	5.9
Semidurable	10.5	14.5	9.8	7.4	10.4
Nondurable	-1.2	2.5	0.7	2.8	8.3
Automotive trade	5.4	15.1	20.0	15.1	11.4
Company sales outlet	6.5	17.4	23.7	17.9	11.8
Autoparts and accessories	1.2	-0.2	-1.3	0.3	9.6
Building materials	-20.8	-25.8	-17.8	-7.4	0.5

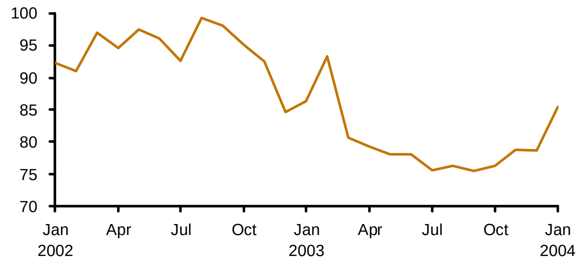
Source: Fecomercio SP

1/ Seasonally adjusted data.

Effective physical sales of the retail sector in São Paulo

Seasonally adjusted data

2000=100



Source: Fecomercio SP

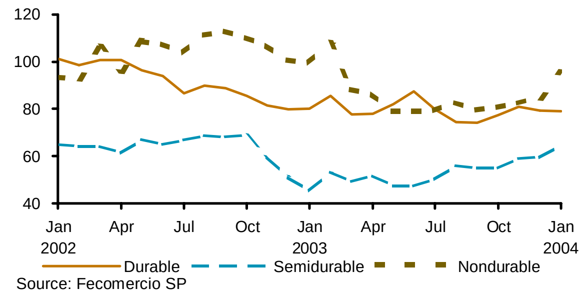
and supermarkets registered nominal revenue growth equal to or greater than median growth of the Broad National Consumer Price Index (IPCA) in the year. In January 2004, the Retail Sales Volume Index registered growth of 6.1%, coupled with 10.2% in nominal revenues, compared to the figures for January 2003.

Just as in the case of the national indicator, the results released by the Trade Federation of the State of São Paulo (Fecomercio SP) confirmed the process of growth recovery in the fourth quarter of 2003 and early 2004. Deseasonalized data pointed to growth of 6.5% in sales in the November-January quarter, compared to the quarter ended in October 2003. It should be emphasized that recovery in the São Paulo trade sector was not caused exclusively by the performance of segments that are more sensitive to credit conditions, but was marked by growth of 5.9% and 11.4%, respectively, in sales of consumer durables and automotive vehicles, together with 8.3% under sales of nondurable consumer goods. Here, it should be stressed that growth under the latter heading, though present in previous months, hit its highest level in January of this year.

In the early months of 2004, other commerce-related indicators pointed to continuation of the growth process, though at a less intense pace than at the end of 2003. Based on deseasonalized data, the number of consultations with the Credit Protection Service (SPC), which is an installment purchase indicator published by the São Paulo Trade Association (ACSP), expanded by 1.6% in the first two months of the year, when compared to the previous two months. At the same time, Usecheque, which is an indicator of low value purchases made through the use of checks, registered a reduction of 3.9% using the same basis of comparison. These percentages suggest that, at the margin, improved credit conditions remain as a relevant factor in consumer decisions.

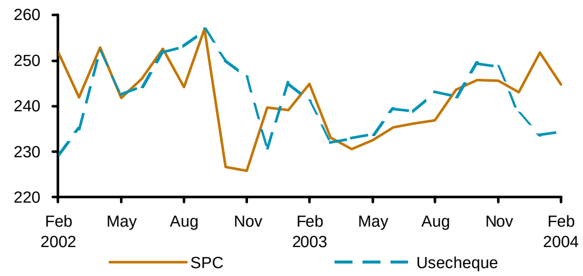
At the end of 2003 and early 2004, default indicators have been lower than those registered in the first half of 2003. The ratio between checks returned due to insufficient backing and total checks cleared registered a median rate of 5.1% in the final quarter of 2003, compared to 5.3% in the previous period. In the first two months of 2004, the rate remained stable when compared to the same period of 2003, closing at 5.4%. Another default indicator is the National Index released by Teledata, which measures the ratio between checks returned and checks received. This index was also stable in the final months of 2003 and early

Consumer goods – Effective physical sales at the RMSP
Seasonally adjusted data
2000=100



Source: Fecomercio SP

Retail sales indicators
Seasonally adjusted data
1992=100



Source: ACSP

Default rates

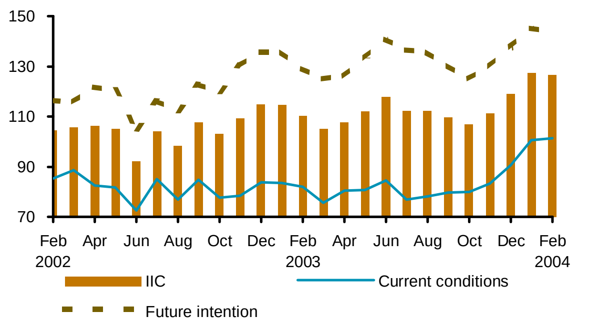
Rate

Itemization	2003			2004		
	Oct	Nov	Dec	Jan	Feb	Year[1/]
SPC (SP)[2/]	5.4	4.2	1.9	4.7	7.2	5.9
Returned checks[3/]	5.4	5.2	4.5	5.5	5.4	5.4
Telecheque (RJ)[4/]	2.3	1.7	1.5	1.9	...	1.9
Telecheque (National)[4/ 5/]	2.5	2.3	1.9	2.7	...	2.7

Source: ACSP, Bacen and Teledata

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

Consumer Intention Index (IIC)



Source: Fecomercio SP

2004. In January, the indictor registered 2.7%, as against 2.5% in the same month of the previous year.

ACSP statistics for the first two months of the year pointed to an even more accentuated reduction, as the net rate came to 5.9%, compared to 6.5% in the same period of 2003. The reduction in the median rate is explained to some extent by the increased volume of cancellations of defaults in the first two months of the current year, compared to the same period of 2003.

The results of surveys that have the objective of evaluating consumer expectations indicated that the optimism that marked the final months of 2003 has continued. The Consumer Intention Index (IIC), released by Fecomercio SP, declined by 0.5% in February, following strong increases of 6.8% in December and 7% in January. At the component level, the Index of Future Intentions (IIF), which accounts for 60% of the general index, expanded by 10.9% in January and 0.7% in February, while the Current Intentions Index (IIA), which represents the remainder of the general index, turned in a decline of 1% in February, following growth of 5.9% and 5.4% in December and January. The behavior of the IIF indicates a process of recovery of long-term optimism, following the accentuated decline registered under this component in the third quarter of 2003.

The quarterly National Consumer Expectations Index (Inec), based on the survey carried out from the 4th to the 8th of December 2003 by the National Confederation of Industry (CNI), expanded by 2.7% in the fourth quarter when compared to the previous period.

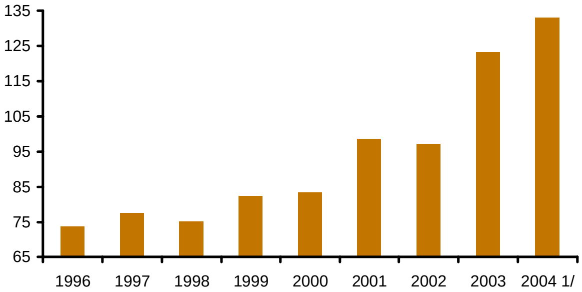
1.2 Production

Crop/livestock output

The Brazilian primary sector registered growth of 5% in 2003, according to the national accounts released by the IBGE. This positive performance was quite similar to what occurred in 2002 and 2001 and reflects productivity gains under both crop and livestock activities, giving added momentum to the recent performance of the Brazilian export sector. Crop/livestock production indicators for the final months of 2003 and early 2004 point to continued and relatively strong growth in the sector.

Grain production

In million of tons



Source: IBGE

1/ Forecast.

Agricultural production

In 1,000 tons

Itemization	Production		Percentage
	2003	2004 1/	change
Grain production	123 181	132 969	7.9
Cotton (seed)	1 436	1 924	34.0
Rice (in husk)	10 199	12 210	19.7
Beans	3 310	3 648	10.2
Beans 1st harvest	1 645	1 975	20.0
Beans 2nd harvest	1 204	1 213	0.8
Beans 3rd harvest	461	461	0.0
Corn	47 809	47 304	-1.1
Corn 1st harvest	34 759	34 256	-1.4
Corn 2nd harvest	13 051	13 048	0.0
Soybean	51 532	58 952	14.4
Wheat	5 900	5 900	0.0
Others	2 995	3 030	1.2
Other cultures			
Banana	6 518	6 537	0.3
White potatoes	3 070	3 119	1.6
Cocoa (beans)	171	171	0.4
Coffee (manufactured)	1 970	2 183	10.8
Sugar cane	389 929	392 111	0.6
Onions	1 187	1 162	-2.1
Tobacco (in leaves)	649	858	32.3
Orange	16 936	16 937	0.0
Manioc roots	22 236	23 726	6.7
Tomatoes	3 641	3 591	-1.4

Source: IBGE

1/ Estimated.

Crops

According to IBGE's Systematic Farm Production Survey (LSPA) for the month of January, total output of cereals, legumes and oil-bearing crops is expected to reach 133 million tons in 2004, reflecting an increase of 7.9% compared to the previous harvest. In the northeast region, harvest growth is forecast at 30.2% based, among other factors, on the adequate rainfall that occurred during the year. It is important to mention here that, as a result of the farm calendar, products from the winter harvest, such as wheat, and the second and third corn and bean harvests, still include results from the 2003 harvest. With this, the major farm crops for which estimates are already available are herbaceous cotton, processed coffee, the first bean harvest, manioc, rice in husk, corn from the first harvest and soybeans.

Analyzing the principal crops, the estimate for the soybean harvest was set at 58.9 million tons or 14.4% more than in the previous harvest. International prices have acted as a major incentive for producers, together with the reduction in the United States harvest last year and increased demand on the part of Asian countries, particularly China. Growth in the country's soybean production has occurred as a result of both expansion of the area under cultivation and incorporation of areas that were previously occupied by such crops as corn, rice and even pastures.

National output of corn in this year's first harvest is expected to reach 34.3 million tons, for a volume that was 1.4% below the total for 2003. The area planted and productivity are expected to decline by 0.7% and 0.8%, in that order, as a result of the loss of areas to soybean production and the increased supply of corn in the second 2003 harvest, which provoked a reduction in internal prices. Aside from this, climatic conditions this year have not been as favorable as they were in 2003.

According to the same survey, the rice harvest is expected to close at 12.2 million tons, for growth of 19.7% compared to the previous harvest. The area under cultivation and productivity should expand by 12.5% and 6.5%, respectively. The factors underlying this growth were high internal prices in 2003, caused by supply shortages, together with excellent climatic conditions in Rio Grande do Sul, the nation's largest producer state. With the strong growth expected in this segment, internal production will still not be sufficient to meet internal demand, even though it should be possible to reduce imports to a level in the range of 500 thousand tons this year.

Output of the first bean harvest was estimated at 1.98 million tons or 20% more than in 2003. The factors responsible for this performance were increases of 1.5% in the area harvested and productivity growth of 18.1%, mostly reflecting the 2003 harvest failure. These are very positive results, particularly when one considers the adverse climatic conditions that forced producers to delay planting, coupled with the price drop that occurred in 2003, principally in the second half of the year.

Output of processed coffee is expected to total 2.2 million tons, equivalent to 36.4 million bags, for growth of 10.8% over the previous harvest. These results should be seen in the context of the 2003 crisis that resulted from low international prices and adverse climatic conditions.

The excellent performance of the crop sector has been ratified by field surveys in 2003/2004 carried out by the National Supply Company (Conab), according to which the grain harvest will close in the range of 130.8 million tons, or 6.2% more than in 2003. The difference in relation to IBGE estimates for several of the major products, such as soybeans, corn, beans and processed coffee, is due to methodological factors and to the fact that the surveys were carried out at different points in time.

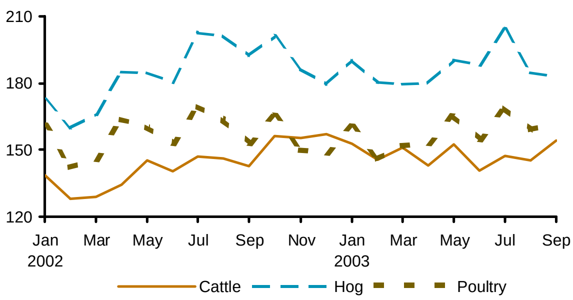
Livestock

In the final six months of 2003 and early 2004, livestock farming continued on the upward curve that has marked recent years. According to the quarterly IBGE survey of animal slaughters, total carcass weight in the third quarter of 2003, calculated on the basis of seasonally adjusted data, came to 1.2 million tons, for growth of 0.9% compared to the immediately previous quarter. In the first nine months of the year, the increase came to 8.1% when compared to the same period of 2002. Figures released by the Ministry of Development, Industry and Foreign Trade (MDIC) indicate that beef exports, which have clearly had a dynamic impact on the foreign sales sector, closed at 145 thousand tons in the third quarter of 2003 and 179.2 thousand tons in the following quarter. In the first two months of 2004, daily average exports expanded by 49.8% over the first two months of the preceding year. The performance of national cattle production has reflected such factors as more attractive prices, increased sales to traditional importers and market diversification.

Livestock production

Total weight

1997=100



Source: IBGE

In the poultry sector, the deseasonalized statistical series indicates that total carcass weight came to 1.6 million tons in the third quarter of 2003, or 1.4% more than in the previous quarter. The accumulated result up to September shows production of 4.5 million tons, with growth of 1%. According to MDIC, poultry exports came to 518.8 thousand tons in the third quarter of 2003, for a deseasonalized increase of 7.5% when compared to the previous quarter, and dropped to 490.5 thousand tons in the fourth quarter, corresponding to a reduction of 2.6%, when calculated according to the deseasonalized series. Exports totaled 1.9 million tons in 2003, for growth of 20.1% over 2002. Median daily exports in the January-February 2004 period indicates an ongoing process of expansion, with growth of 50.3% when viewed against January-February 2003. The good performance of the poultry sector was basically a result of export market diversification.

Swine production in the third quarter of 2003, measured according to deseasonalized figures, came to 487.6 thousand tons carcass weight, for a reduction of 6.3% when compared to the result for the second quarter. In the first nine months of the year, however, growth came to 5% when viewed against the same period of the previous year. Despite restrictions imposed by Russia, foreign sales in 2003 totaled 458 thousand tons, for growth of 2% in the year, principally as a result of exports to new markets.

The scenario for livestock production in 2004 is one of continued growth, principally under beef and poultry. Health questions – mad cow disease and bird flu – that have had such an enormous impact on the Asian nations, the United States and Canada, together with the climatic problems that occurred in Australia, which is an important international supplier of beef, have acted as an incentive to Brazil's exports, particularly to the Asian and European markets and clearly aided in consolidating Brazil's position of leadership in world meat exports.

Industrial output

At the end of 2003 and early part of 2004, industrial activity stabilized at a high level, after registering relatively strong growth at the start of the second half of the year. Just as occurred last December, this process of settling back – even including occasional negative figures – is similar to what occurred in previous periods of recovery that preceded consolidation of the upward trajectories.

Industrial production

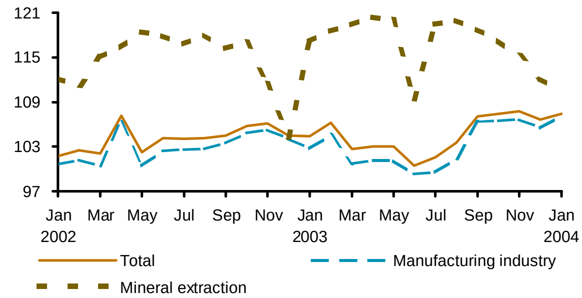
Itemization	2003				2004
	Sep	Oct	Nov	Dec	Jan
Industry (total)					
In the month1/	3.5	0.3	0.3	- 1.0	0.8
Quarter/previous quarter1/	1.9	4.3	5.5	3.1	1.2
Same month of the previous year	4.1	1.3	0.4	3.0	1.7
Accumulated in the year	- 0.1	0.0	0.1	0.3	1.7
Accumulated in 12 months	1.5	0.8	0.5	0.3	0.2
Manufacturing industry					
In the month1/	5.0	0.1	0.2	- 1.1	1.7
Quarter/previous quarter1/	1.9	4.7	6.4	3.7	1.7
Same month of the previous year	4.4	1.4	0.1	2.4	2.8
Accumulated in the year	- 0.4	- 0.2	- 0.2	0.0	2.8
Accumulated in 12 months	1.2	0.7	0.3	0.0	0.1
Mineral extraction					
In the month1/	- 1.0	- 1.2	- 1.8	- 2.6	- 1.5
Quarter/previous quarter1/	2.4	2.0	0.7	- 3.7	- 5.1
Same month of the previous year	2.1	0.2	3.0	7.3	- 5.7
Accumulated in the year	2.1	1.9	2.0	2.4	- 5.7
Accumulated in 12 months	3.2	1.6	1.5	2.4	1.5

Percentage change

Source: IBGE

1/ Seasonally adjusted data.

Industrial production
Seasonally adjusted data
2000=100



Source: IBGE

Using the deseasonalized series of IBGE's Monthly Industrial Survey – Physical Output (PIM-PF), industrial production expanded by 1.2% in the quarter between November and January of this year, compared to the quarter ended in October 2003. This growth was mostly due to a 1.7% upswing in the manufacturing segment. Mining closed with a decline of 5.1% in the quarter, due basically to a reduction in petroleum production caused by platform maintenance. In annual terms, the output of Brazilian industry in 2003 was quite close to the 2002 result – growth of 0.3%. This result, however, was a consequence of opposite tendencies in the two halves of the year, with a slowdown in the first half and recovery in the final six months.

The positive performance of the manufacturing sector in recent months was a consequence of positive growth under exports and improvement in domestic market credit conditions. Compared to the quarter ended in October 2003, the average volume of exports of manufactured goods in the November-January quarter, based on deseasonalized figures, expanded by 4.1%, according to the Center of Foreign Trade Studies Foundation (Funcex), while new credit operations with nonearmarked resources increased by 0.9% in real terms, when the IPCA is used as deflator.

The importance of exports and credit is evident when one identifies the product types and use categories that managed to achieve the sharpest output growth in recent months. In this sense, when one considers the results of the quarters closed in January 2004 and October 2003, transportation equipment increased by 8.6%, electric and communications material by 5.3%, metallurgy by 4.2%, furniture by 4.2% and mechanics by 2,9%, based on data from which seasonal factors have been purged.

The performance of the automotive industry in the period deserves special attention. According to the National Association of Automotive Vehicle Manufacturers (Anfavea), production of the sector registered growth of 15%, when the final figures for the quarters ended in January 2004 and in October 2003 are compared. This increase in production was accompanied by growth of 13.6% in internal sales and 11.4% in foreign market sales.

Among the different use categories, output of capital goods registered expansion of 5.5% while production of consumer durables increased by 4.8%. In both cases, the final figures resulted from comparisons between the average for the November-January period and the quarter that closed in October 2003. Manufacturing of intermediate goods

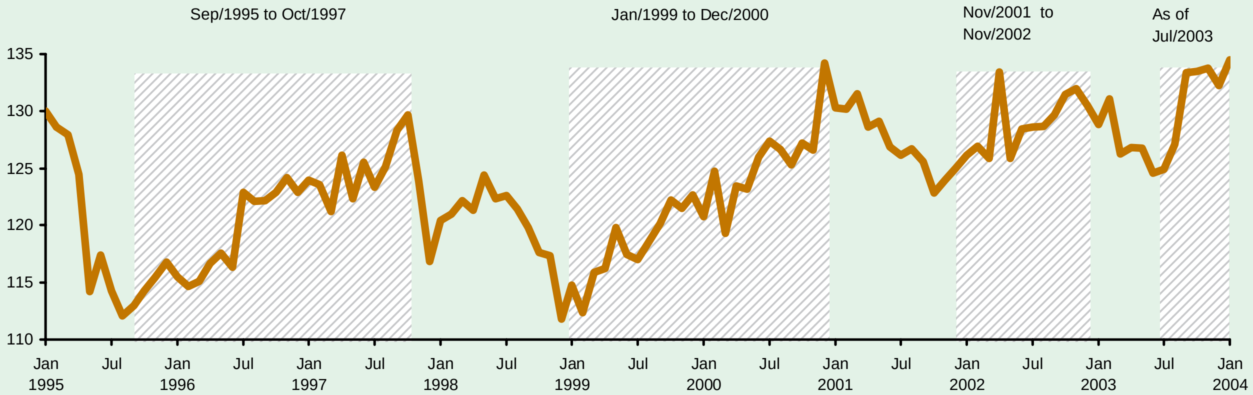
Characteristics and Conditioning Factors in Recent Periods of Expanded Industrial Activity Levels

In 2003, the real sector of the economy – industry, in more specific terms – turned in two distinct performances: downward movement in the first half of the year and a second half of accelerated recovery in the activity level. The first period followed the monetary policy measures adopted to curtail the impact of the crisis of confidence caused by the period of political transition while, to a great extent, the period of recovery was generated by the more flexible approach taken to these measures and by improved expectations.

The recovery process continued into early 2004, albeit with more moderate growth rates. The behavior of the manufacturing sector was characterized by initially strong expansion, followed by a period of less accentuated growth, quite similar to the pattern noted in more recent periods of recovery.

Since 1995, four main periods of recovery in industrial activity were identified. These periods were marked by activity downturns and followed upon exogenous

Recent contraction and expansion cycles in the manufacturing industry
Seasonally adjusted data
1992=100



shocks: from September/1995 to October/1997 – following the Mexican crisis; from January/1999 to December/2000 – in the wake of the Asian and Russian crises and the shift in the nation's exchange system to a floating rate mechanism; from November/2001 to November/2002 – after the electricity rationing crisis; and as of July/2003.

Just as in the periods of declining growth that preceded them, the processes of growth varied in duration and intensity. Despite this, analysis of several central variables makes it possible to identify important similarities and differences between the current period of recovery and those that occurred in the past. The following table shows the growth rates of selected indicators in the four recovery processes cited[1].

Recent contraction and expansion cycles

Accumulated change to the previous month before the recovery cycle

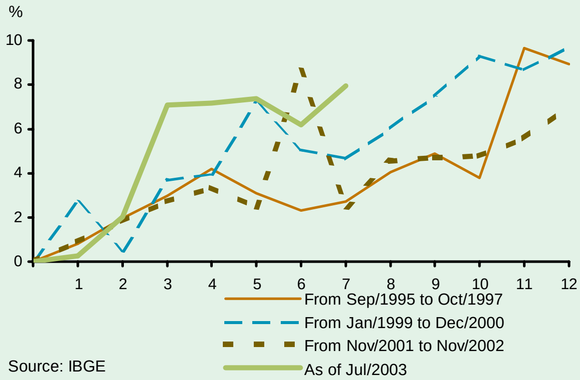
	From Sep/1995 to Oct/1997			From Jan/1999 to Dec/2000			From Nov/2001 to Nov/2002			As of Jul/2003	
	3 months	6 months	12 months	3 months	6 months	12 months	3 months	6 months	12 months	3 months	6 months
Manufacturing industry	3.0	2.3	8.9	3.7	5.1	9.7	2.7	8.6	7.0	7.1	6.2
Capital goods	-5.0	-4.9	-4.0	8.9	8.1	17.9	-2.9	6.1	1.3	11.3	12.7
Intermediate goods	4.5	3.7	9.2	3.0	4.2	11.6	4.5	9.0	9.5	6.7	8.3
Durable goods	-0.2	3.9	14.0	-1.7	-1.4	5.9	5.2	19.4	15.7	15.0	16.6
Semi and nondurable goods	3.7	3.2	8.7	3.2	2.4	0.6	5.2	9.8	2.8	2.0	-3.9
GFCF	0.2	-0.8	9.4	-1.0	1.9	0.0	-2.1	5.7	3.4	9.1	6.1
Exports of manufactured goods	4.6	7.4	0.2	1.9	13.0	25.3	-0.2	5.9	25.0	12.4	12.6
Overall real wages	3.5	3.8	10.9	-6.7	-6.0	-5.5	0.3	2.1	-0.7	-0.7	-1.5
Credit operations - individuals	...	...	...	-5.6	-7.4	18.2	4.2	5.6	2.1	4.2	11.8

Source: IBGE, Funcex and Bacen

The first point to be highlighted in the table is the more accelerated pace of the first three months of the current recovery – in September/2003, growth in manufacturing (accumulated since June/2003) reached 7.1%, a level that was only achieved after

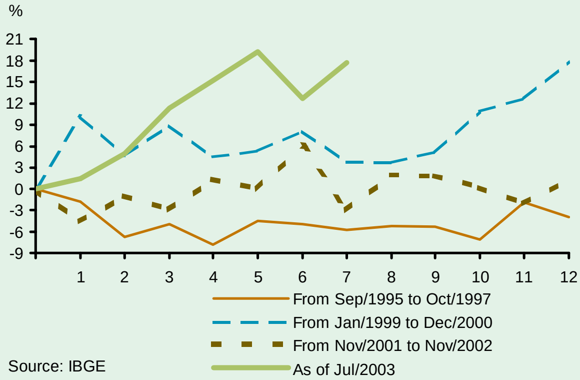
1/ With the exception of the series of real overall wages, which represents a combination of two other series published by IBGE, the calculations were based on deseasonalized data. The series of real overall wages corresponds to an index composed of growth in earnings (up to November/2002, deseasonalized median real earnings of persons employed and, as of December/2002, habitual real median earnings of persons employed) and of growth in the number of persons employed (up to November/2002, according to the former PME methodology and, after December/2002, according to the current PME methodology) The series of real credits to individual borrowers (PF) refers to the sum of the consolidated balances of credit operations based on nonearmarked resources in the "personal credit" category and "acquisition of total goods by individual borrowers", deflated by the IPCA and purged of seasonal factors – there are no data prior to October/1996. The series Real FBCF (Real Fixed Capital Formation) is a monthly proxy of this variable constructed on the basis of indicators of building industry inputs and physical production, exports and imports of capital goods, with adjustment of the monthly data to the quarterly FBCF results released by the IBGE.

Manufacturing industry



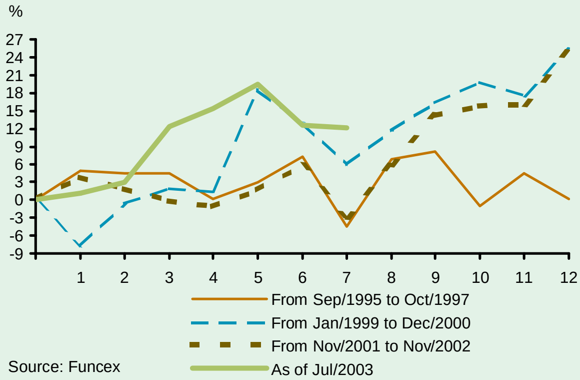
Source: IBGE

Capital goods production



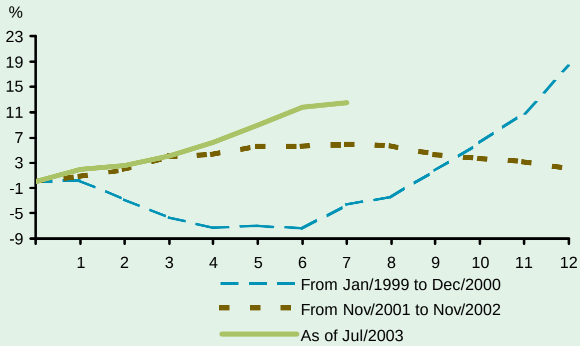
Source: IBGE

Exports of manufactured goods



Source: Funcex

Credit operations – individuals



Source: Bacen

six or more months of recovery in the previous periods. Analysis of the first half-year growth period points to a process in which the stage of rapid growth gives way to a more moderate rate of expansion. The same process has been repeated in other periods of recovery and, as can be noted in the graph, normally precedes a new period of expansion. However, when one considers the rate accumulated in the first seven months, the current recovery is more intense, with growth of 8%. The next most intense process was the 1999 recovery that followed upon alteration of the nation's exchange system, with accumulated growth of 4.7% in an equivalent period[2].

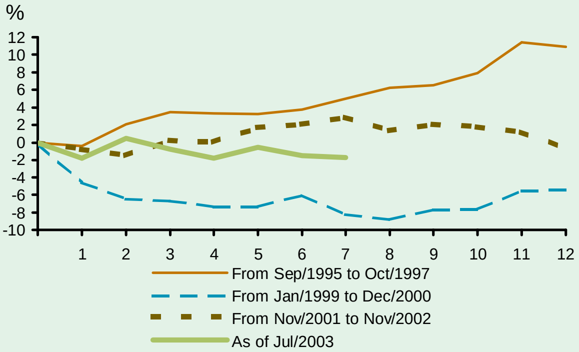
Other important characteristics of the current recovery are a considerably stronger performance in the output of consumer durables and capital goods and a rather sluggish reaction on the part of semidurable and nondurable consumer goods, when compared to other periods under analysis.

Recent evolution in output by use categories reflects the demand components that have driven the process of industrial recovery. Just as in 1999/2000, exports have taken on a position of crucial importance. In the current stage, however, their contribution has been even more decisive, since there was sufficient time to reorganize marketing channels within the framework of the more flexible exchange system. In the same manner, investments have turned in a positive performance, though there are lingering concerns regarding the possibility of discontinuity and the optimal combination between investment rates and demand growth rates in each segment.

The dynamism of the credit market is also a factor of vital importance and is destined to play an even more significant role than in previous periods since, in the current case, it has been the driving force underlying the reaction of consumer durables. Deflated by the IPCA, the real balances of personal credit operations and vehicle financing targeted to individual borrowers accumulated growth of 11.8% in the first six months of the current recovery, compared to 5.6% in the recovery that followed upon

2/ When the third period of recovery under analysis completed six months of growth, April/2002 is the outlier of the series of the industrial manufacturing indicator. In the thirteen months of that stage of growth, the accumulated rate never returned to growth of 8.6% registered in April/2002. In May/2002, in the seventh month of the recovery, the accumulated rate came to 2.5%.

Overall real wages



Source: IBGE and Bacen

the period of electricity rationing. When monthly credits granted to individual borrowers are calculated in real terms, growth came to 13.1% in the first six months of the current recovery, as against 4.5% in the previous period.

In the opposite sense, up to the moment, losses of real income stood as a powerful obstacle to demand recovery, particularly in the cases of semidurable and nondurable goods. As a matter of fact, with the sole exception of the period from September/1995 to October/1997, overall real wages did not keep pace with growth in the industrial activity level in the more recent processes of expansion.

In the case of the more recent period, real overall wages accumulated a decline of 1.5% between June/2003 and December/2003. This reduction is seen to be even more severe when one recalls that real income had already been on a downward curve since the end of 2002 – the average real habitual earnings of working people dropped by 12.5% between November/2002 and January/2004. The falloff in real overall wages in recent months was even more intense than in other periods – with the exception of 1999/2000, when exchange depreciation generated negative impacts on real income, and clearly hampered both production and sales of semidurable and nondurable goods.

Aside from identifying similar dynamics in other recovery processes, some facts of the current process indicate that industrial output has moved into a period of more moderate growth in the early months of 2004, though the overall trajectory is still clearly positive. On the one hand, Brazilian exporters have been quite successful in opening new markets, while consolidating their positions on traditional markets. However, there are serious concerns with regard to infrastructural questions and, particularly, the productive capacity of given industrial segments. Parallel to these considerations, according to CNI figures, real industrial sales have reacted sharply in recent months, with growth of 17.8% between June/2003 and January/2004. This result was much higher than growth in production and suggests that the process of adjusting stock levels is nearing its end. As a result, production will now be considerably more sensitive to new peaks in demand. Finally, when one takes into account relatively low default levels and the current financial system liquidity situation, credit growth is expected to provide increasingly greater leverage to economic expansion, depending primarily on the evolution of the expectations of economic agents regarding employment and income trends.

Automotive vehicles – Production and sales

Itemization	2003				2004
	Sep	Oct	Nov	Dec	Jan
In the month[1/]					
Production		6.3	8.3	-1.6	0.5
Total sales		3.1	5.8	-7.3	12.5
Domestic sales		10.9	6.5	-7.7	5.9
External sales		1.7	-4.4	-6.7	51.8
Quarter/previous quarter[1/]					
Production		6.8	16.5	18.9	15.0
Total sales		11.5	16.9	14.1	10.9
Domestic sales		13.7	21.5	19.6	13.6
External sales		2.2	4.7	9.0	11.4
In the year					
Production		1.0	1.1	2.0	9.2
Total sales		1.6	2.1	2.3	20.0
Domestic sales		-7.9	-6.0	-4.9	16.8
External sales		33.9	29.1	26.0	30.6

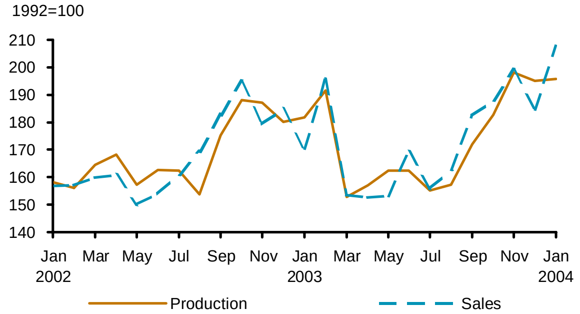
Percentage change

Source: Anfavea

1/ Seasonally adjusted data.

Vehicles – Production and sales

Seasonally adjusted data



Source: Anfavea

expanded by 1.5% and was adversely impacted by the already cited interruption in petroleum extraction. Despite the result in the period, production of intermediate goods, together with capital goods, turned in the best performance in a year-over-year comparison, with expansion of 1.4% in each one of these two categories.

Internal absorption of industrial inputs and capital goods in the final quarter also deserves mention. With respect to intermediate goods, internal production increased by 1.5%, while imports expanded by 11.8% compared to 0.4% growth in exports. These figures indicate a higher level of internal absorption in the November-January 2004 quarter, compared to the quarter ended in October 2003. This movement clearly signaled an ongoing process in which companies have been replenishing their stocks of raw materials, at the same time in which it points to a more favorable level of industrial output in the coming months. On the other hand, though production of capital goods increased by 5.5%, foreign sales expanded by 10.1% and imports dropped by 13.1%, using the same basis of comparison. This may suggest that companies have temporarily curtailed the process of introducing new equipment.

With regard to semi and nondurable consumer goods, indicators have reacted rather sluggishly despite the positive January result. In comparison to previous periods, this segment, which is highly dependent on labor market results, has had the greatest difficulty in shifting into a growth trajectory. Despite this, however, growth is expected to disseminate throughout the economy and eventually impact this category, as the other segments begin gradually strengthening overall wages. It is worth noting that, in the indicators of the retail trade sector, sales of nondurable goods have already begun registering signs of recovery.

In the fourth quarter of 2003, most industrial sectors were operating with considerable idle capacity, registering an average level of utilization in the range of 80.3%, according to the Getúlio Vargas Foundation (FGV). This figure is considered relatively low when viewed against the historical peak of 86% in the first quarter of 1995. Analysis of the recent performance of the deseasonalized aggregate series points to steady growth in the utilization of output capacity. Some sectors – it should be added – are already nearing their production limits, including paper and cardboard, with 91.6%, rubber, with 90.5% and metallurgy, with 90.4%, while still others deserve considerable attention, particularly in the mechanics and petrochemical industries. These sectors have received significant investments and not only turn out

Industrial production by category of use

Percentage change

Itemization	2003				2004
	Sep	Oct	Nov	Dec	Jan
In the month[1/]					
Industrial production	3.5	0.3	0.3	- 1.0	0.8
Capital goods	6.0	3.5	3.5	- 5.5	4.5
Intermediate goods	2.2	0.4	0.2	0.8	- 0.8
Consumer goods	5.7	0.3	- 1.3	- 3.3	2.5
Durable	7.2	2.0	1.6	- 2.2	3.0
Semi and nondurable	4.4	- 0.4	- 2.1	- 3.4	2.2
Quarter/previous quarter[1/]					
Industrial production	1.9	4.3	5.5	3.1	1.2
Capital goods	2.5	8.2	12.8	9.2	5.5
Intermediate goods	2.6	4.4	4.8	3.0	1.5
Consumer goods	0.8	3.0	4.9	1.9	- 0.7
Durable	8.3	13.3	13.8	9.0	4.8
Semi and nondurable	- 1.3	0.2	2.2	- 0.4	- 2.5
In the year					
Industrial production	- 0.1	0.0	0.1	0.3	1.7
Capital goods	- 1.2	- 0.4	0.4	1.0	7.8
Intermediate goods	1.4	1.4	1.4	1.6	1.7
Consumer goods	- 4.8	- 4.4	- 4.4	- 4.4	- 1.6
Durable	- 2.8	- 2.0	- 1.3	- 0.5	8.6
Semi and nondurable	- 5.3	- 5.1	- 5.3	- 5.5	- 4.6

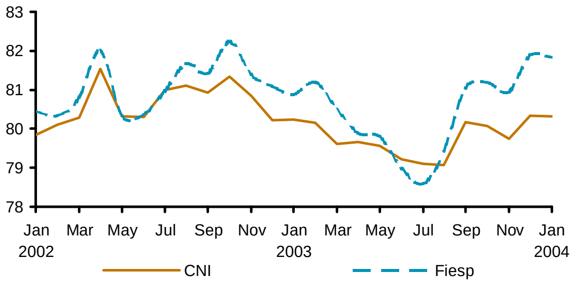
Source: IBGE

1/ Seasonally adjusted data.

Utilization of installed capacity

Seasonally adjusted data

Average percentage

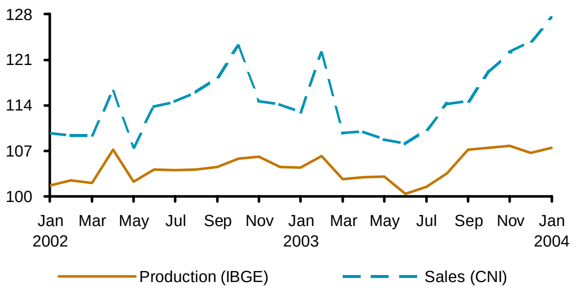


Source: CNI and Fiesp

Industrial production and sales

Seasonally adjusted data

2000=100



Source: IBGE and CNI

important inputs for the productive chain but also make a highly important contribution to the flow of the nation's exports. Data on utilization of installed capacity, released by CNI and the Federation of Industries of the State of São Paulo (Fiesp) turned in growth that was compatible with the figures announced by the FGV.

According to CNI's survey of Industrial Indicators, real sales of the manufacturing sector increased by 7.3% in the November-January quarter, compared to the result for the quarter ended in October 2003, based on deseasonalized data. Real industrial sales have expanded steadily since June. The result calculated by Fiesp for the state of São Paulo repeated the national average, indicating growth of 7.3%. Expansion under real industrial sales surpassed the increase in production in the quarter, suggesting acceleration of the process of stock adjustment in the period. As a matter of fact, the reduction in stocks was perceived by the CNI Survey. According to this study, stocks of both final products and raw materials declined in the fourth quarter of 2003. Despite the fact that they are still considered excessive, stocks of final products came close to the desired level, while those of raw materials were below the planned level. These data represent a sign that the process of adjustment may be nearing its end and that, in the coming months, one can expect a gradual process of stock replenishment in several segments, including the vehicle sector.

At the end of 2003, the outlook of the business community was quite optimistic among large, small and medium businesses. In the fourth quarter of 2003, the Industrial Confidence Index (Icei), released by CNI, reached the highest level since the final quarter of 2000, when the industrial sector turned in an extraordinary performance, with average growth of 6.6%. Positive expectations have disseminated among the various industrial segments, as the Icei increased under all of the eighteen sectors surveyed by CNI in the period from the third to the fourth quarter of last year. The lack of demand, which had occupied second position among the major problems pointed out by businesspeople in the survey carried out at the end of the third quarter of the year, dropped to fourth position in the new survey, following the tax load, intense competition and high rates of interest.

FGV's Manufacturing Industry Survey in January ratified perceptions of improvement in economic conditions in the fourth quarter of 2003. The business situation was considered good by 21% of the companies and weak by 14%, while 40% of the companies surveyed foresaw growth

Manufacturing industry stocks[1/]

Itemization	2002	2003			
	IV	I	II	III	IV
Manufacturing industry					
Final products	49.7	53.4	56.3	54.6	52.1
Raw materials/intermediate goods	48.1	49.1	48.5	49.6	48.2
Large companies					
Final products	51.1	53.9	58.9	57.1	53.5
Raw materials/intermediate goods	49.3	51.9	52.6	52.9	50.6
Small and medium companies					
Final products	48.9	53.2	54.9	53.2	51.3
Raw materials and interm. goods	47.4	47.5	46.2	47.8	46.8

Source: CNI

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

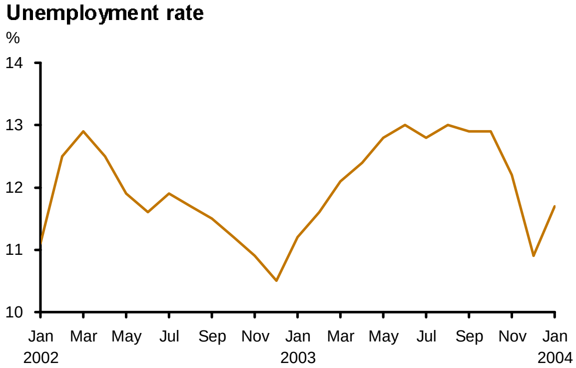
in production in the first quarter of 2004 and 32% projected a decline. This was the best result for this period of the year since 1997.

Forecasts for industrial employment were also positive, as the proportion of companies that intend to contract personnel was 7 p.p. higher than the number that intended to lay workers off. According to the FGV, there was an unmistakable intention to contract workers in the segments of chemicals, textiles, electric and communications equipment and transportation equipment.

Analysis of the current stage indicates that production has settled into a new level, following several months of accelerated expansion. Consequently, the indicators point to divergent movements. Companies have been delaying investment decisions. This is evident in the drop in absorption of capital goods in the last three months and in the reduction in the number of consultations in January with the National Bank of Economic and Social Development (BNDES), for purposes of obtaining financing from that institution. However, the outlook for investments in the current year is still positive. A survey carried out by the Brazilian Association of the Machines and Equipment Industry (Abimaq) concluded that 42% of manufacturers of machines and equipment foresee production growth in 2004, as a result of more intense economic activity and the cutback in the industrialized products tax (IPI) from 5% to 3.5%, for a long list of goods in this category.

Finally, one should stress that, though there may be fluctuations in the monthly results, there has been a persistent trend toward growth in this first quarter of 2004. Consolidation of growth over the medium-term will depend on continuation of the foreign trade situation, conditions that are propitious to credit growth and labor market recovery.

Unemployment rate



Source: IBGE

1.3 Labor market

According to the IBGE Monthly Employment Survey (PME) carried out in six metropolitan regions, the rate of open unemployment reached 11.7% in January 2004. This result interrupted the typically seasonal downward slide evident in the final two months of 2003. In the year, the median rate came to 12.3%, or 0.6 p.p. more than in 2002, indicating that the number of job opportunities was clearly insufficient to absorb workers entering the Economically Active Population (PEA) in the period. The 2003 increase in the PEA occurred at a pace that was unprecedented since the

Methodological Alterations in the Monthly Industrial Survey of Physical Output (PIM-PF)

IBGE's PIM-PF is the primary source of information on Brazilian industry, providing data on the short-term evolution of industrial product. Starting in April – data for February/2004 – and retroactive to January 2002, IBGE will publish the PIM-PF based on a new methodology designed to adjust it to aspects recently incorporated into the reality of national industry[3]. The new sampling of activities, products and informants was selected intentionally, based on information gathered within the industrial productive structure by the Annual Industrial Survey of Companies and by the Annual Industrial Survey of Products. The weighting system is also referenced to these data and is based on median values for the 1998/2000 period.

In this sense, the new survey has adopted classification of activities and products that make them compatible with other studies of industrial data, while preserving the commitment to release the results with a maximum lag of six weeks (42 days).

Here, it is important to underscore that introduction of these changes will not result in loss of the historical series. The simultaneous gathering of the primary data of the current and reformulated survey in the last two years provided IBGE with the conditions required to link these indices for most of the industrial segments/divisions. Only a few divisions in the new methodology do not have corresponding divisions in the previous methodology, making it impossible to link them.

3/ Aside from this, collection of primary data will be carried out on the basis of an electronic questionnaire available on the IBGE Internet site, to be answered by the local informant units.

The topics below briefly describe the major differences between the old methodology (in effect up to January/2004) and the new methodology (starting with the results released as of April/2004):

- the reference base, which was previously the 1985 Industrial Census, will become the Annual Industrial Survey of Companies (PIA-Company) and the Annual Industrial Survey of Products (PIA-Product), for 1998, 1999 and 2000. In the survey used up to that point, the panel of products and informants is the intentional sampling representative of approximately 62% of the value of production in the 1985 Industrial Census; the reference base for weighting the indicators is the 1985 value structure of industrial manufacturing. In the reformulation, local units that accounted for an overall total (based on the median PIA for 1998 to 2000) of 70% of their production, reaching more than 90% for the one hundred principal industrial products, were selected to form the panels of informants for each product; the system of weighting considers the participation of activities and products in the value structure of industrial manufacturing, based on the 1998-2000 median of the PIA-Company for industrial activities and the PIA-Product, for products;

- the selection of activities and products will use the National Classification of Economic Activities (CNAE) and the List of Industrial Products (Prodlist), derived from the Common Mercosul Nomenclature (NCM) and structured according to CNAE class;

- at the level of Brazil, indices will be issued for use categories – capital goods, intermediate goods, consumer durables and semidurable and nondurable consumer goods – and for the classes of the mineral extraction and manufacturing industries, as well as the result for twenty six divisions/segments of the manufacturing industry;

- with respect to geographic coverage, aside from the states of Ceará, Pernambuco, Bahia, Espírito Santo, Minas Gerais, Rio de Janeiro, São Paulo, Paraná, Santa Catarina and Rio Grande do Sul, Amazonas, Pará and Goiás will also be incorporated. The regional indices will be announced for each one of these states of the federation, while the aggregate index for the Southern Region will no longer be calculated, since figures will be released for each one of the three component states. In this way, the survey will provide information for all states in the Federation that, according to the PIA-Company, accounted for a minimum of 1% of the value of industrial manufacturing. The Brazil and regional samplings are independent, ensuring that, in both case, the activities will account for an overall total of 80% of the total production of each one of the localities selected;

- the seasonal adjustment of the series, now carried out through the X-11 method, will be based on the X-12 method for the linked series as far as possible. This latter method has additional options that will make it possible to achieve greater sophistication and more appropriate filters.

The new PIM-PF incorporates products and activities that have taken on increased importance in the Brazilian industrial structure in recent years. Changes were introduced into the relative positions of products, while new products were incorporated, including newspapers, magazines, mobile phones, cell phone transmitters and receivers, books and CDs. By adopting a new activity classification (CNAE), the reformulation aggregated or separated segments and included new segments, depending on their respective participation in the PIA and based on the CNAE classification. The following table shows the new structure of PIM-PF divisions and their weights in the composition of the index for Brazil, as well as their correspondence, taking due account of the compatibility restrictions of the two breakdowns.

According to IBGE information, when the two methodologies are compared and the two classifications made compatible, three groups of sectors are identified in general terms:

- leaders: maintained their relative importance though, when viewed in overall terms, their participation in the general index dropped from 68% to 63%. This grouping includes mining;

Monthly Industrial Survey – Physical production – Brazil

	Previous survey – Segments	% VTI[1/]		Reviewed survey – Segments	% VTI[1/]
1	Mineral extraction	7.27	1	Extraction industries	4.96
2	Food products	10.87	2	Food products[2/]	12.97
3	Beverages	1.16	3	Beverages[2/]	3.20
4	Tobacco leaves	0.73	4	Tobacco leaves	0.92
5	Textiles	5.70	5	Textiles	3.02
6	Clothing, footwear and cloth goods[3/]	4.77	6	Clothing and cloth goods[3/]	1.93
7	Leather and hides[3/]	0.54	7	Leather and footwear goods[3/]	1.88
8	Wood	1.44	8	Wood	1.25
9	Paper and cardboard	2.76	9	Pulp, paper and paper products	3.97
10	Issue, priting and copy of recording[3/ 4/]	1.68	10	Issue, priting and copy of recording[3/]	4.51
11	Chemicals[3/]	16.70	11	Petroleum and alcohol refining[3/]	7.94
12	Pharmaceuticals[3/]	1.57	12	Pharmaceuticals[2/ 3/]	3.48
13	Perfumes, soaps and candles[3/]	0.71	13	Perfumes, soaps, detergents and cleaning products[2/ 3/]	1.68
			14	Other chemical products[2/ 3/]	7.44
14	Rubber	1.74	15	Rubber and plastics	3.92
15	Plastics	2.03			
16	Nonmetallic minerals	3.82	16	Nonmetallic minerals	3.88
17	Metallurgy	11.04	17	Metallurgy	5.92
			18	Metal products - excludes machinery and equipments	3.56
18	Mechanics	8.63	19	Machinery and equipments	5.79
19	Electrical and communications equipment	6.96	20	Office and computer equipments	0.80
			21	Electrical appliances and equipments	2.62
			22	Electronical and communications equipments	2.88
			23	Medical and hospital equipments[5/]	0.88
20	Transportation equipment	6.26	24	Automotive vehicles	7.00
			25	Other transportation vehicles	1.39
21	Furniture	1.31	26	Furniture[2/]	1.26
22	Other[4/]	2.31	27	Other[2/]	0.88
			28	Recycling[4/ 5/]	0.05

Source: IBGE

1/ Participation in the manufacturing industry.
2/ To be displayed both in an agregate or separate form.
3/ There are differences as to the breakdown of previous and reviewed segments.
4/ Not chosen to build the index, its weight will be shared by others.
5/ Segment without an equivalent in the previous survey.

metallurgy; mechanics; electric and communications equipment; transportation equipment; chemicals and food products;

- sectors that registered increased participation: nonmetallic minerals; paper and cardboard; rubber; pharmaceuticals; perfumes, soaps and candles; plastics; beverages; tobacco and publishing and printing;

- sectors with lesser participation: wood; furniture; leather and hides; textiles; apparel and footwear and others.

survey was first carried out, registering 5.5% in the period from March to December, when compared to the same period of 2002[4]. This behavior reflects the inflow of persons to the labor market, particularly women and people in higher age brackets, suggesting that job seeking has become an option for complementing family income, as a result of the process of declining real earnings that has marked recent years.

Toward the end of 2003 and in the early days of 2004, the behavior of the labor market followed the pattern evident throughout the year, with sharp growth in informal employment. Despite expansion of the registered labor force in practically the entire second half of the year, at the end of the year, the overall level of this segment was still below the 2002 mark. In January 2004, according to the PME, this category incorporated 53 thousand workers less than in the same month of the previous year.

As far as unregistered and self-employed workers are concerned, employment levels have been increasing steadily since February 2002. When the months of January 2003 and 2004 are included, the period witnessed an increase of 129 thousand workers in the first group and 326 thousand in the second.

Occupied people by categories of employment

In 1,000,000

Itemization	2003				2004
	Sep	Oct	Nov	Dec	Jan
Total of occupied people	18.7	18.6	18.8	18.9	18.5
By categories of employment					
Registered	8.2	8.2	8.3	8.2	8.2
Nonregistered	4.2	4.1	4.2	4.3	4.1
Non-earning workers,					
Military and civil servants	1.4	1.4	1.4	1.4	1.3
Self-employed	3.8	3.8	3.8	3.9	3.8
Employers	1.0	1.0	1.0	1.0	0.9

Source: IBGE

However, when one looks at the country as a whole, growth in the number of formal job openings continued in 2003, as the General Register of Employed and Unemployed Persons (Caged), which is maintained by the Ministry of Labor and Employment (MTE), registered an increase of 645 thousand positions. One should note that there are methodological differences in the data collection systems used for Caged and the PME. While the first of these is national in scope and even includes the farm sector, the second is restricted to just six metropolitan regions. Aside from this, the Caged results are drawn from administrative records that are supplied to the regional offices of the MTE by employers, while the PME is a household survey.

In January 2004, the Caged study noted a historic peak in job generation for that month, with creation of 100 thousand new positions, indicating that recovery in formal employment was moving forward, with February growth of 139 thousand job positions. In the year, total jobs created came to double the 120 thousand registered in the same period of 2003. Though the level of employment has been expanding, a

4/ Annual comparison, when the months are taken as a whole is hindered by the fact that during the first two months of 2002, data are inaccurate as a result of data gathering problems.

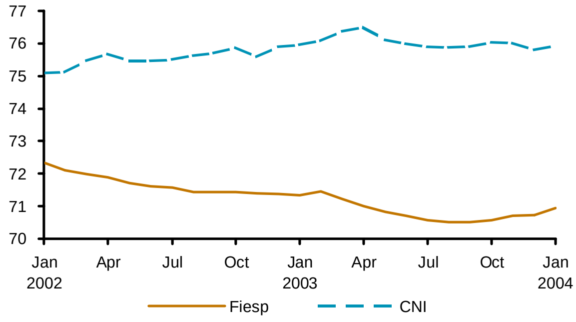
Formal employment

Itemization	2003			2004	
New job openings (1,000 employees)	I H	II H	n the year	Jan	Feb
Total	560.9	84.5	645.4	100.1	139.1
Manufacturing industry	128.0	0.8	128.8	36.1	38.1
Commerce	61.3	164.6	225.9	2.9	20.4
Services	160.7	99.6	260.3	34.1	52.4
Building	-20.6	-27.6	-48.2	14.0	1.6
Crop and livestock	205.6	-147.4	58.2	11.1	15.1
Public utilities	2.1	1.0	3.1	2.1	0.6
Others[1/]	23.7	-6.4	17.3	-0.2	10.9

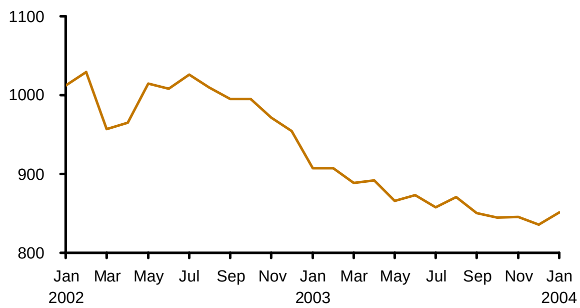
Source: Ministry of Labor and Employment

1/ Includes mineral extraction, public administration and others.

Industrial employment
Seasonally adjusted data
1992=100



Real average earnings
In R$ at January 2004 prices, deflated by INPC



Source: IBGE

sectoral analysis reveals that the pace of hirings in 2003 declined in all segments of activity, when compared to 2002, the year in which 756 thousand positions were created. Once again, the sector of services has generated the largest number of new openings, with 260 thousand new positions or 26 thousand less than in the previous year, followed by commerce, with 226 thousand, manufacturing with 129 thousand, and crop/livestock farming, with 58 thousand new jobs. The building industry closed with a negative annual balance. In this case, the downturn was more severe than in 2002, as 48 thousand positions were eliminated compared to 29 thousand in the previous period.

Industrial employment expanded by 0.7 in 2003, according to twelve state data released by the CNI. Based on deseasonalized data, the year can be divided into two distinct periods, the first extending from the start of the year to the midpoint of the second half, marked by a declining labor market, and the second extending from that point forward, in which the labor market stabilized. The annual rate reflected the level of industrial employment in the first half of the year which, even though it followed a downward trajectory, was still higher than in the first half of 2002. The highest levels of annual growth occurred in Goiás, 9.3%, Amazonas, 6.8%, Ceará, 5.9%, and Bahia, 5.4%.

According to a Fiesp survey of 47 employer associations in the state, industrial employment in São Paulo increased in the second half of 2003. However, for the year as a whole, there was an overall loss of 1.4 thousand vacancies. This result was better than in 2002 and 2001, when the job loss came to respective levels of 69 thousand and 32 thousand. Utilizing deseasonalized data, an examination of the trajectory of industrial employment based on the Fiesp Employment Survey ratifies the trend toward growth in the number of hirings as of September. In the quarter ended in January 2004, employment expanded by 0.4% when viewed against the level registered in the quarter ended in October 2003.

Earnings

Continuing the trend evident since mid-2002, average real earnings habitually received by workers registered an average falloff of 12.5% in 2003, according to IBGE's PME. This trajectory reflected a process of recovery in nominal wages that was unable to keep pace with median growth in IBGE's National Consumer Price Index (INPC). In January 2004, real habitual earnings rose by 1.9%. Two factors contributed to this growth. In the first place, the base dates for the collective bargaining agreements of a number of important professional categories were concentrated in the final months of the year. In median terms, these negotiations managed to obtain real wage gains as a way of at least partially offsetting the losses generated by inflation in the last twelve months. Another important aspect that justifies the increase in earnings at the start of this year is less favorable from the economic point of view and refers to the impact of the reduction of 222 thousand workers in the month, including unregistered workers and the self-employed who, traditionally, tend to have average earnings that are less than registered workers. The latter category closed with a loss of 58 thousand positions. The cutback in 2003 earnings affected all labor categories, but was particularly intense in the case of the self-employed, with 21.2%, followed by registered workers, with 9.3%, and unregistered workers, with 8.3%.

Real wages in the manufacturing industry

% accumulated growth in the year

Itemization	2003				2004
	Sep	Oct	Nov	Dec	Jan
CNI					
Overall real wages	-5.9	-5.6	-4.9	-4.2	4.6
Fiesp					
Overall real wages	-3.0	-2.8	-2.3	-1.8	4.8
Average real wages	-1.8	-1.6	-1.1	-0.6	5.3

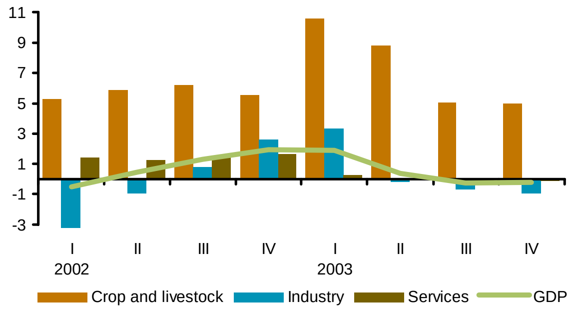
Source: CNI and Fiesp

With regard to the payroll of the manufacturing sector, the CNI survey indicated that, as a consequence of price rises in the period, real earnings were particularly low at the start of 2003, when compared to previous years. However, recomposition of nominal earnings and downward movement in inflation made it possible to register real gains during the course of the year. This process became even more intense in the final month of the year, resulting in average wages at the end of the year that were considerably higher than at the end of 2002. In the final quarter of 2003, real earnings expanded by 0.9%, when viewed against the same period of 2002. In comparison to the third quarter of 2003, the increase came to 3.3%, when deseasonalized data are used.

In the state of São Paulo, real average wages in the manufacturing sector registered growth from March to November 2003, according to figures released by Fiesp. In November, the highlights were increases of 2.7% in industrial wages when compared to October, calculated on the basis of deseasonalized data, and of 4.2% compared to November of the previous year. The underlying cause of these results was the fact that the base dates of important categories covered by the survey occurred during the month in question.

Gross Domestic Product

% growth accumulated in the year



Source: IBGE

1.4 Gross Domestic Product

GDP declined by 0.2% in 2003, according to IBGE figures. This result was a consequence of reductions in internal demand, characterized by decreases of 6.6% in gross fixed capital formation and 3.3% in family consumption. On the

Gross Domestic Product

Percentage change

Itemization	2002	2003			
	IV	I	II	III	IV
Accumulated in the year	1.9	1.9	0.4	-0.3	-0.2
Accumulated in 4 quarters	1.9	2.5	1.9	0.7	-0.2
Quarter/same quarter of the previous year	3.9	1.9	-1.1	-1.5	-0.1
Quarter/previous quarter seasonally adjusted	0.2	-0.8	-0.9	0.1	1.5

Source: IBGE

Gross Domestic Product

Percentage change in the year

Itemization	2002	2003			
		I Q	II Q	III Q	IV Q
Crop and livestock	5.5	10.6	8.8	5.1	5.0
Industry	2.6	3.3	-0.2	-0.7	-1.0
Mineral extraction	6.7	4.2	1.8	2.1	2.8
Manufacturing	3.6	3.9	1.0	0.7	0.7
Construction	-1.8	-0.9	-6.0	-7.7	-8.6
Public utilities	3.0	8.1	3.1	2.5	1.9
Services	1.6	0.2	0.0	-0.3	-0.1
Commerce	-0.2	-0.2	-2.0	-3.4	-2.6
Transportation	3.4	-4.0	-2.3	-1.6	-0.8
Communications	9.8	2.4	2.7	1.4	0.1
Financial institutions	2.1	2.2	1.0	0.1	0.1
Other services	1.1	-0.1	-1.0	-0.6	-0.5
Rents	0.6	0.4	0.6	0.6	0.9
Public administration	1.7	0.2	0.6	0.5	0.5
Financial dummy	2.3	4.4	1.7	0.6	0.3
Value added at basic prices	2.3	2.0	0.6	0.0	0.0
Taxes on products	-0.8	0.5	-1.8	-2.4	-1.7
GDP at market prices	1.9	1.9	0.4	-0.3	-0.2

Source: IBGE

Gross Domestic Product

Quarter/previous quarter seasonally adjusted

Itemization	2002	2003			
	IV	I	II	III	IV
GDP at maket prices	0.2	-0.8	-0.9	0.1	1.5
Crop and livestock	0.5	3.9	0.2	-6.4	7.3
Industry	1.4	-2.1	-3.5	2.6	1.2
Services	-0.2	-0.7	-0.1	0.2	0.8

Source: IBGE

other hand, the performance of the external sector, which registered export growth of 14.2% and a falloff of 1.9% under imports, was, once again, the principal factor underlying the increase in the nation's economic activity. The direct impact of foreign trade on GDP represented 2.5 p.p. in the year's result. In 2003, this dichotomous pattern between domestic demand and external demand was a consequence of a significant adjustment in the Brazilian balance of payments and the costs inherent to the process of downward movement in inflation.

On a sector-by-sector basis, crop/livestock farming turned in the highest rate of growth, with 5% in the year. This is explained by the positive performance of the export sector and, from the viewpoint of supply, by increased crop and livestock productivity. Industry dropped by 1%, as a result of the results of the building industry, which was the only industrial subsector to register negative growth, closing with a drop of 8.6%. It should be stressed that, since 1999, the construction industry has registered results below those of industry in general, reflecting such factors as declining income, reduced investments and unfavorable home financing. Production of the mining sector expanded by 2.8%. This growth was basically generated by 3.6% expansion in oil production, according to data released by the National Petroleum Agency (ANP). The manufacturing sector expanded by 0.7% while public utility industrial services (electricity generation and distribution, for the most part) closed with growth of 1.9%. The service sector turned in a decline of 0.1% in 2003, with the sharpest negative result under the subsectors of commerce and transportation, with respective falloffs of 2.6% and 0.8%. Among other factors, these results mirror the evolution of industrial activity.

Despite the 2003 decline in GDP, the final quarter registered growth of 1.5%, compared to the previous quarter, when measured on the basis of the deseasonalized series. This result confirms the increased dynamism of the economy in that period, as is also clear in sectoral indicators. All of the different sector turned in positive expansion, as industry closed with 1.2%.

GDP growth in 2004 is estimated at 3.5%. This growth is sustained by the available sectoral production indicators, particularly the crop/livestock sector, and by the outlook for continued recovery in internal demand. Aside from this, one should stress the positive statistical effect generated by the basis of comparison, since recovery became evident in the final two quarters of 2003.

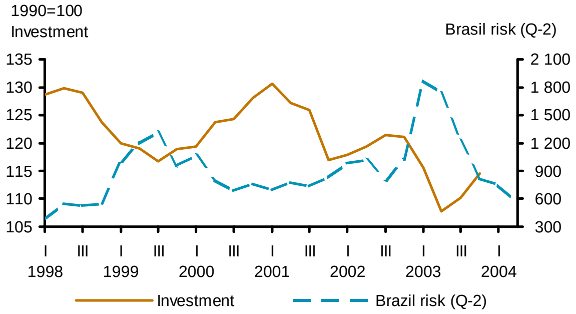
Gross Domestic Product

Itemization	2003	2004 Estimated
	Percentage change in the year	
Crop and livestock	5.0	5.2
Industry	-1.0	4.5
Mineral extraction	2.8	3.8
Manufacturing	0.7	5.1
Construction	-8.6	3.2
Public utilities	1.9	3.6
Services	-0.1	2.3
Commerce	-2.6	4.2
Transportation	-0.8	3.9
Communications	0.1	2.9
Financial institutions	0.1	3.3
Other services	-0.5	2.9
Rents	0.9	0.9
Public administration	0.5	1.1
Value added at basic prices	0.0	3.3
Taxes on products	-1.7	4.4
GDP at market prices	-0.2	3.5

Source: IBGE and Banco Central do Brasil

Investment (FBCF) and Brazil risk

Seasonally adjusted data



Source: IBGE and JP Morgan

On a sector-by-sector basis, growth in the crop/livestock segment is estimated at 5.2%. This result is calculated according to IBGE growth estimates of 7.9% for the grain harvest, compared to the previous harvest, with increases of 19.7% in rice production, 14.4% in soybean output and 10.8% in the production of processed coffee. Other factors that have contributed to this forecast include the growth trend evident in the livestock segment, as occurred in previous years, and the outlook for increased external demand.

In the secondary sector, industrial growth forecast for 2004 reflects the prospects of continued expansion under foreign sales, just as occurred in the first months of the year, and recovery in internal demand, as a consequence of gradual growth in income.

The service sector is expected to register positive growth as a result of the expansion of activities in both the industrial and crop/livestock sectors, since both of these areas tend to produce strong impacts on such activities as commerce, transportation, other services (particularly services rendered to companies) and financial institutions.

1.5 Investments

In the final months of 2003 and start of the current year, investments continued on the positive trajectory that had begun in the second half of 2003, and have clearly consolidated the recovery process. This behavior had been anticipated by the evolution of expectations as evinced, among other factors, by Brazil's country risk position. At the same time, the performance of investments in the past year can be divided into two distinct periods.

In the first six months of 2003, which was a period marked by the uncertainties of the transition from one government administration to another and by a sudden rise in inflation, the investment trajectory was strongly negative, hitting its lowest point of the last nine years in the second quarter. In the second half of the year, however, these factors were gradually overcome and the administration was able to adopt a more flexible monetary policy. As a result, the previously negative trend turned positive. With the possibility of an upturn in economic growth, the productive sector began making decisions to prepare itself for a positive cycle. Analysis of investment growth in the period, based on the composition of capital goods according to the destination of the different products, indicates that this movement was

Investment indicators

Percentage change

Itemization	2003				2004
	I Q	II Q	III Q	IV Q	Jan
Quarter/previous quarter[1/]					
Capital goods					
Absorption[2/]	1.3	-5.5	1.5	8.7	2.3
Production	-0.7	-2.6	2.5	9.2	5.5
Imports	12.2	-13.4	5.4	31.4	-13.1
Exports	-9.2	12.9	6.2	15.0	10.1
Inputs for the building industry	-5.2	-8.2	0.1	2.9	1.1
In the year					
Capital goods					
Absorption[2/]	-7.9	-13.8	-15.1	-9.1	-3.8
Production	0.5	-1.9	-1.2	1.0	7.8
Imports	-26.1	-28.3	-29.8	-17.5	-8.2
Exports	-13.3	5.3	12.1	16.1	36.8
Inputs for the building industry	-1.9	-6.6	-8.1	-8.7	-8.9
BNDES financing	-9.4	-31.7	-23.0	-10.4	20.2

Source: IBGE, Funcex and BNDES

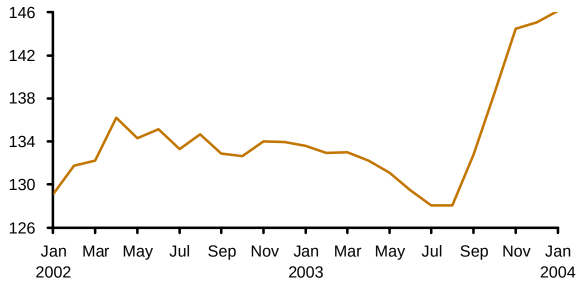
1/ Seasonally adjusted data. In the month of January, monthly growth compared to December 2003.

2/ Production + imports - exports.

Capital goods production

Seasonally adjusted data

Quarterly moving average

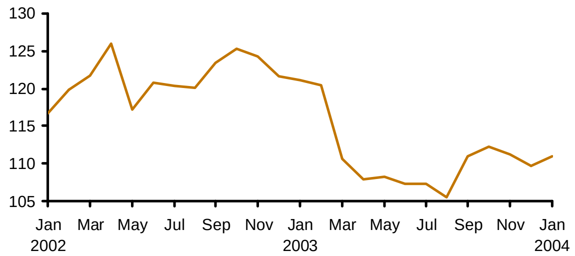


Source: IBGE

Inputs production for the building industry

Seasonally adjusted data

1992=100



Source: IBGE

disseminated among the different sectors of the economy and was particularly strong in those targeted to the external market.

Though the reaction of investments in the second half of the year was significant, it was not sufficient to recover the level registered at the end of the preceding year, nor to avoid a significant degree of reduction in the overall investment flow. Nonetheless, it is important to observe that the growth that began in that period continued into the first half of this year, albeit at a less accentuated pace, making it possible to recompose investments at historically observed levels.

According to Quarterly National Accounts released by IBGE, investments in 2003, excluding stock variations, dropped by 6.6%. This performance had been expected as a result of the evolution of monthly indicators of gross fixed capital formation, which had indicated falloffs of 8.7% under building industry activity and 17.5% under imports of machines and equipment. Production of capital goods increased by 1%, while exports of machines and equipment expanded by 16.1%.

As already mentioned, the accumulated 2003 result was a consequence of two distinct periods in the year. While the first two quarters turned in negative growth of 4.6% and 6.5% in gross fixed capital formation, the latter two closed with respective upturns of 2.3% and 3.9% (in relation to the immediately previous quarters, based on deseasonalized data). In the final quarter of 2003, output of capital goods expanded by 9.2%, while construction closed with growth of 2.9%. In relation to the foreign trade sector, imports dropped by 31.4% and exports expanded by 15%. As a result of this behavior, absorption of capital goods increased by 8.7% in the period, using the same basis of comparison.

Data available for early 2004 reveal growth in investment outlays. Production of construction inputs expanded by 1.1% in January, compared to the December 2003 level, according to data from which seasonal factors have been eliminated. Using the same basis of comparison, production of capital goods expanded by 5.5% and exports by 10.1%. At the same time, imports of capital goods decreased by 13.1%, with an increase of 2.3% in the absorption of machines and equipment in January 2004.

A breakdown of capital goods production data in 2003 indicates expansion in the production of farm machines and equipment, with 24.7% in the year, parts for farm machines, with 8.9%, and machines and equipment for industry, with

Production of capital goods

Itemization	2003				2004
	Sep	Oct	Nov	Dec	Jan
Quarter/previous quarter 1/					
Capital goods	2.5	8.2	12.8	9.2	5.5
Industrial	0.7	10.0	13.8	11.7	7.2
Serial	1.0	12.2	16.7	15.3	10.6
Nonserial	-4.6	-3.7	1.6	-1.1	-3.1
Agricultural	12.5	9.7	4.1	-5.7	-9.7
Farm parts	1.5	6.6	2.5	-2.8	-9.0
Building	-10.8	-2.3	13.0	16.6	27.2
Electric energy	-3.0	1.5	11.3	7.2	8.3
Transportation	4.7	7.4	15.7	13.6	8.8
Mixed	1.7	8.4	15.6	15.2	10.6
In the year					
Capital goods	-1.2	-0.4	0.4	1.0	7.8
Industrial	8.8	8.5	8.7	8.1	4.2
Serial	15.7	15.5	15.7	15.0	10.3
Nonserial	-17.1	-17.6	-17.9	-18.2	-21.8
Agricultural	25.8	25.1	25.0	24.7	30.9
Farm parts	10.5	10.9	9.6	8.9	11.2
Building	-21.5	-21.1	-20.7	-18.7	31.3
Electric energy	-31.1	-28.2	-27.2	-26.5	1.4
Transportation	-0.5	-0.1	0.6	0.9	-10.6
Mixed	-6.7	-5.6	-4.4	-2.8	16.2

Percentage change

Source: IBGE

1/ Seasonally adjusted data.

Production of automotive vehicles

Itemization	2003				2004
	Sep	Oct	Nov	Dec	Jan
In the month 1/					
Farm machines	-0.1	0.0	0.0	-12.5	29.2
Busses	33.1	14.5	18.0	-8.6	-38.0
Trucks	9.3	1.5	12.6	6.6	-7.4
Quarter/previous quarter 1/					
Farm machines	6.8	8.7	4.8	-1.2	0.0
Busses	18.8	21.1	46.3	41.9	15.7
Trucks	7.9	13.7	18.4	20.3	19.1
In the year					
Farm machines	13.7	13.0	13.6	13.0	37.3
Busses	7.2	12.1	16.6	18.2	-24.2
Trucks	11.4	12.3	13.8	15.1	2.2

Percentage change

Source: Anfavea

1/ Seasonally adjusted data.

8.1%. Output of transportation equipment expanded by 0.9%. The increase in the production of farm machines and equipment and spare parts accompanied the performance of crop/livestock production. Once again, output of electricity supply equipment turned in the sharpest drop in the capital goods sector, with a decline of 26.5% in 2003 or just about the same as in the previous year. This behavior reflects cutbacks in investments in the sector, which had registered growth of 42.6% in 2001, when the electricity crisis encouraged companies to invest heavily in production of their own energy. Output of goods for the building sector declined by 18.7% in 2003, mirroring the weak performance of the building industry itself.

According to Abimaq, indicators for the mechanical capital goods industry were negative in 2003, as is evident in the downturn of 0.9% in the utilization of installed output capacity and the drop from 16.5 to 16.1 in the average number of weeks required to meet orders already in portfolio. Aside from this, using the item of industrial products, industrial machines and equipment of the Wholesale Price Index – Overall Supply (IPA-OG) as deflator, real billings of the sector dropped by 16% in the year. Exports of machines and equipment expanded by 33.5% using the same basis of comparison, while imports fell by 6.4%.

Data on the output of farm machines, released by Anfavea, reflected the behavior of activities related to the crop/ livestock sector. Production of the segment expanded by 13% in 2003, as a result of the 34.2% increase in the production of harvesters and 15.1% under wheeled tractors. Using the same basis of comparison, production of trucks grew by 15.1%. Data available for January also registered strong growth in the output of farm machines and trucks, with respective growth levels of 37.3% and 2.2%, compared to the results for the same month of 2003.

Disbursements by the BNDES System – BNDES, Special Industrial Financing Agency (Finame) and BNDES Participações S.A. (BNDESpar) – totaled R$33.5 billion in 2003, for a nominal reduction of 10.4% and a real decline of 27% when compared to 2002, deflated by the median General Price Index – Internal Supply (IGP-DI).

A breakdown by sectors of activity shows that, in real terms, all sectors registered negative growth. Thus, financing granted to the manufacturing sector registered a reduction of 24.5%, while that targeted to commerce and the service sector and crop/livestock farming declined by 32.4% and

BNDES disbursement[1/]

Itemization	2003				2004
	Accumulated in the year (in R$ million)				
	I Q	II Q	III Q	IV Q	Jan
Total	5 495	11 000	18 970	33 533	2 168
Manufacturing industry	2 500	4 578	7 587	15 937	1 040
Commerce and services	2 397	4 779	8 274	12 844	518
Crop and livestock	560	1 582	3 021	4 595	600
Extraction industry	38	62	88	157	10

Source: IBGE

1/ Includes BNDES, Finame and BNDESpar.

17%, respectively. The falloff in financing extended to mining closed with 48.9%, in real terms.

The Long-Term Interest Rate (TJLP), which is the basic cost of financing contracted with the BNDES System, has been declining since September 2003, when it was reduced to 11% per year, to be levied in the final quarter of 2003. In January 2004, the rate was cut further, to 10% per year, to remain in effect until the end of March 2004.

1.6 Conclusion

After reaching a relatively high level toward the end of 2003, the pace of economic activity is expected to continue expanding in the first six months of this year and should be sustained by continued growth in credit, the pace of retail sales and the performance of the export sector. Aside from this, there are signs that growth in real earnings will reverse the downward trend that marked all of 2003. This fact takes on significant importance when one considers its impact on sales of nondurable consumer goods, the major category of final industrial products.

However, it is important to consider that the growth of the various factors that determine demand has been quite moderate in the early part of the year, indicating some degree of cooling in the recently verified pace of growth. At the same time, it should be stressed that, after an initial period of rather strong recovery in the activity level, this process of settling back to a more moderate pace of growth has been one of the hallmarks of previous periods of recovery.

Prices

2

Price behavior toward the end of 2003 and in early 2004 was influenced by seasonal pressures – particularly under the groupings of food and education – and by cost factors, driven for the most part by growth in commodity prices. These factors contributed to higher rates of interest and impacted price indicators with varying degrees of intensity and over distinct periods of time, depending on the methodological peculiarities of each index.

At the same time, the recovery in the pace of activity in the second half of 2003 culminated at the turn of the year, in a more favorable environment, particularly in those segments that managed to draw the greatest benefit from improved credit conditions, making it possible not only to transfer costs to final prices but also to rebuild profit margins. With the January and February interruption in the process of adopting a more flexible monetary policy, those segments responsible for price formation were led to reconsider just how tolerant prospective demand conditions would be to the dissemination of price increases. This very important impact of monetary policy on expectations, coupled with exhaustion or reversal of seasonal and extraordinary sources of inflationary pressures, generated a rather benign scenario in which growth in consumer price indices tended to settle back to levels more in keeping with the trajectory of the target system.

2.1 General indices

Growth in the general price indices calculated by the FGV gained momentum in the December-February quarter, reflecting the behavior of both consumer and wholesale prices. The wholesale price index registered the sharpest upward movement as a result of industrial price hikes, which more than offset the downward slide in farm prices.

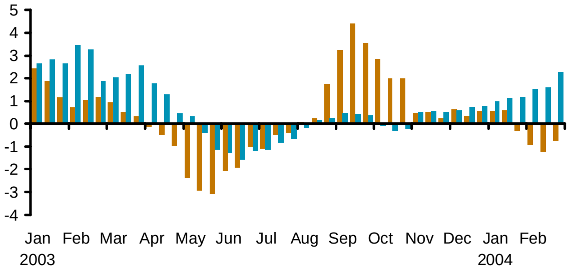
General price indices

Monthly % change

Itemization	2003					2004	
	Aug	Sep	Oct	Nov	Dec	Jan	Feb
IGP-DI	0.6	1.1	0.4	0.5	0.6	0.8	1.1
IPA	0.7	1.3	0.5	0.5	0.7	0.8	1.4
IPC	0.1	0.8	0.2	0.3	0.4	1.1	0.3
INCC	1.4	0.2	0.7	1.0	0.2	0.3	1.0

Source: FGV

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



Source: FGV

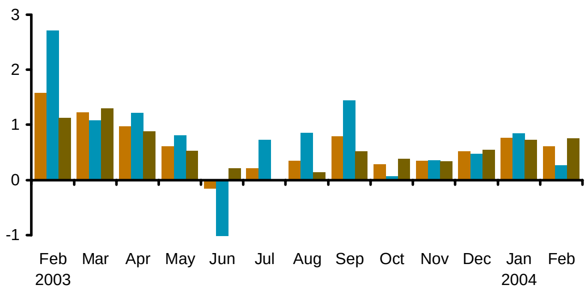
Growth in industrial prices moved from 0.5% in November 2003 to 0.8% in December, 1.2% in January 2004 and 2.3% in February, closing the three month period with an accumulated total of 4.3%, compared to 1.1% in the immediately previous quarter. This more rapid growth reflected rises in commodity prices of importance to the productive chain, with particularly strong increases under plastics (12.5%), fabrics and natural threads (10.9%), fertilizers (11.2%), iron, steel and derivatives (8.9%) and electric equipment (6.6%).

It is important to stress that, in the period extending from July 2003 to February of the current year, the index of farm commodities – corn, wheat and soybeans – increased by 38.2% while the index of metallic commodities rose by 31.1%, according to data released by the International Monetary Fund (IMF) and Reuters CRB. The major factor underlying this high was synchronized recovery in the world's major economies, particularly China.

Monthly growth in the wholesale prices of crop/livestock products, which had reached 3.6% in September 2003, turned downward and closed February 2004 at -0.8%. In the quarter ended in that month, accumulated growth came to -0.5%, as against 5.2% in the previous quarter. This reduction reflected the start of the farm harvest and the favorable perspectives for output of the major products. Taken together, these factors offset the high registered under in natura products, caused by the heavy rains of recent months.

The consumer price index also exerted upward pressure on general price indices, which increased by 2% in the quarter, compared to 1.3% in the preceding quarter. The factors responsible for this rise were increasing prices under the groupings of food, education, reading and leisure and other outlays.

Evolution of IPCA
Monthly % change



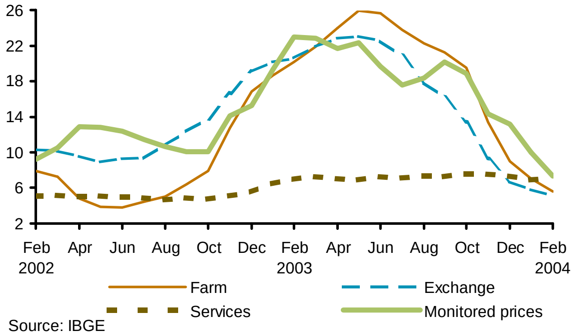
Source: IBGE

2.2 Consumer price indices

Broad Consumer Price Index (IPCA)

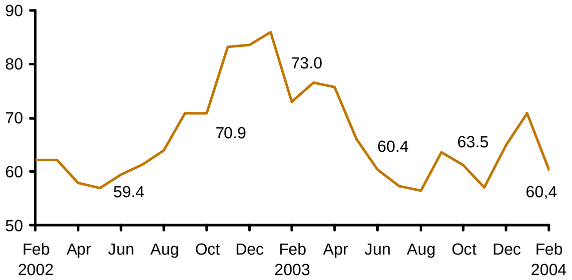
Measured by the Brazilian Institute of Geography and Statistics (IBGE), monthly increases in the IPCA were relatively high after November 2003, registering rates of 0.5%, 0.8% and 0.6%, in the three subsequent months. Consequently, accumulated growth for the index in the quarter ended in February closed at 1.9%, as against 1.4% in the quarter ended in November. For the most part,

IPCA – Major groups
12 month % change



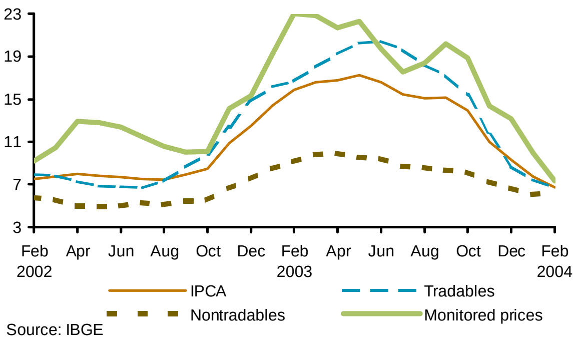
Source: IBGE

IPCA items[1/]
% of items with increase



Source: IBGE
1/ IPCA is made up of 512 items.

IPCA – Itemized groups
12 month % change



Source: IBGE

acceleration of this index during the quarter was caused by an increase of 2% under market prices, as against 1.2% in the previous quarter. It is important to note that these prices account for more than 70% of the composition of the index. Increases in education outlays, higher prices for cigarettes, new automobiles and beans and in natura foodstuffs, as a result of the excess rainfall registered in several important production regions, impacted market prices in the last three months.

IPCA growth in 2003 closed at 9.3% and, above all else, reflects the 13.2% rise in government monitored or administered contracted prices. Among the groupings that closed with higher than average price index group, mention should be made of health and personal care (10%), particularly medicine (11.5%) and personal hygiene articles (12.2%); housing (12.3%), which incorporates electricity (21.4%) and water and sewage rates (21%); personal outlays (9.6%), due mostly to 12.5% growth in leisure prices; communications (18.7%), mostly involving fixed telephone rates (19.1%); education (10.2%); and apparel (10.2%). It should also be noted that several items classified under the grouping of food products exerted strong pressure on the index, particularly beef (9.4%), rice (25.2%), meals (9.6%), poultry and eggs (11.7%) and soft drinks (9.6%).

Following an increase in December 2003 and January 2004, the number of items that registered positive growth in February declined, dropping to the same level as the second half of 2003.

In the month of January, government monitored prices generated a strong impact on the IPCA rate. The prices of bottled gas and alcohol rose sharply, together with electricity rates, which were adjusted at the end of December in Rio de Janeiro. Aside from government monitored prices, January increases of 3% and 1.6% in the prices of in natura foodstuffs and new automobiles, respectively, also exerted pressures on the IPCA in January.

The decrease in the February rate was a consequence of reductions in the growth of government monitored prices from 0.84% in January to 0.26%, and of food prices, which dropped from 0.88% in January to 0.15% in February, particularly as a consequence of lesser highs in the prices of cereals and legumes, in natura foodstuffs and beef and chicken meat. The slowdown in the growth registered under these items offset acceleration under the heading of education, which moved from 0.68% in January to 6.7% in February. For the most part, this increase was caused by growth of 8.1% in school payments, which was perceived by the IPCA in the latter month.

2.3 Government managed prices

In 2003, government managed prices increased by 13.2% and accounted for approximately 40%, or 3.76 p.p., of the 9.3% growth registered under the IPCA in the year. Those that exerted the greatest pressure on inflation in the period were the prices of lottery tickets (43.1%), fixed telephone rates (19.1%), urban bus fares (21%), electricity (21.4%) and water and sewage (21%). One should also mention a slight increase in 2003 gasoline prices, with 1.2%, compared to 12.1% in 2002. At the same time, alcohol prices dropped by 12.6%, following a rise of 31.5% in the previous year.

In the December-February quarter, market prices and government monitored prices included in the IPCA increased by 2% and 1.6%, respectively, compared to 1.2% and 1.9% in the quarter ended in November 2003. The increase in government monitored prices accounted for 0.45 p.p. of the 1.9% change in the IPCA in the quarter, with increases in the prices of several items of relatively important weight in the composition of the index.

In this sense, electricity rates rose by 2.4% in the quarter, principally as a result of the 10.6% rise in the rates charged by the Rio de Janeiro Electricity Company (Cerj). Other factors responsible for the rise in electricity rates were increases in the Tax on the Circulation of Merchandise and Services (ICMS) in Recife and Fortaleza, and a reduction in the percentage of the discount applied to billings in Curitiba. Urban bus fares increased in Belém (15%) and Fortaleza (7.1%). Water and sewage rates increased in Curitiba (14%) and Brasília (20%). Increases in tolls and intercity bus fares also rose by respective rates of 5.5% and 2.5%.

2.4 Cores

Excluding food at home and government monitored prices, core inflation increased by 2.3% in the quarter ended in February, as against 1.13% in the quarter ended in November 2003. Items such as cigarettes, new and used automobiles and monthly school payments exerted pressure on the core, while the prices of food at home and government monitored prices expanded at rates lower than the average.

Consumer prices and core inflation

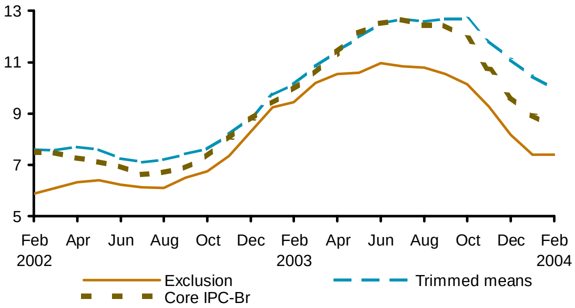
Monthly % change

Itemization	2003					2004	
	Aug	Sep	Oct	Nov	Dec	Jan	Feb
IPCA	0.3	0.8	0.3	0.3	0.5	0.8	0.6
Exclusion	0.4	0.4	0.4	0.4	0.6	0.6	1.0
Trimmed means							
Smoothed	0.6	0.9	0.8	0.6	0.7	0.7	0.5
Non smoothed	0.4	0.6	0.3	0.3	0.5	0.6	0.3
IPC-Br	0.1	0.8	0.2	0.3	0.4	1.1	0.3
Core IPC-Br	0.5	0.7	0.5	0.4	0.5	0.7	0.5

Source: Bacen and FGV

Core inflation

12 month % change



Source: Bacen and FGV

Growth in the core, measured on the basis of smoothed rounded medians, remained stable in the December-January period, when it reached 0.72% and 0.73%, respectively, following consecutive decreases in the three previous months. The rate dropped to 0.48% in February, accumulating a high of 1.9% in the quarter ended in that month, as against 2.2% in the quarter ended in November 2003. Part of this reduction is explained by exhaustion of the impact of several of the specific highs that had been responsible for high rates of inflation between the end of 2002 and early 2003. In the last twelve months, this core turned in growth of 9.97%.

According to rounded medians, without smoothing, core inflation registered a high of 1.5% in the quarter ended in February, as compared to 1.2% in the quarter ended in November 2003. In much the same way as the already cited cores, growth in this indicator also shifted to a December level of 0.54%, compared to 0.31% in November and 0.29% in October. January and February closed with respective rates of 0.63% and 0.28%, as the level for the first two months of the year remained below that of the full index. Though this core indicates rising inflation in the quarter, when viewed against the previous quarter, analysis demonstrates that expansion was less intense than that registered under the IPCA. In 12 months, the core accumulated a high of 6.45%.

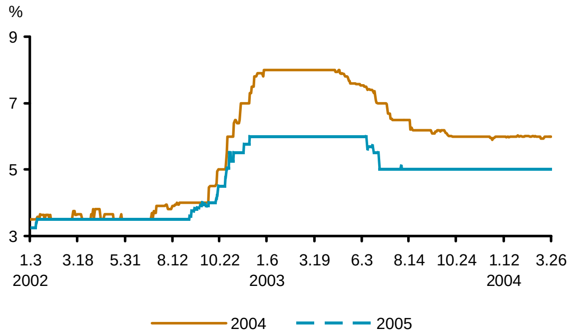
Measured according to the method of rounded medians, core inflation for the Consumer Price Index – Brazil (IPC-Brasil), which is calculated by the FGV, also closed at a higher level than in the previous quarter, with growth of 0.46% in December, 0.65% in January and 0.46% in February. In the last twelve months, the accumulated indicator rose by 8.45%.

2.5 Market expectations

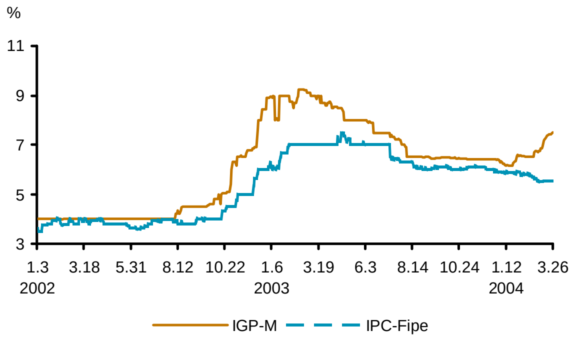
Gerin is a sector of Banco Central does Brasil that carries out a daily survey of a sampling of approximately seventy consulting firms and financial institutions, with the objective of detecting market expectations regarding the evolution of the major economic variables.

In the case of the IPCA, median expectations of inflation in 2004 remained relatively stable in the period at a level of 5.96% on December 22, 2003 and 6% on March 26, 2004. For 2005, median expectations remained at 5% between the two dates considered.

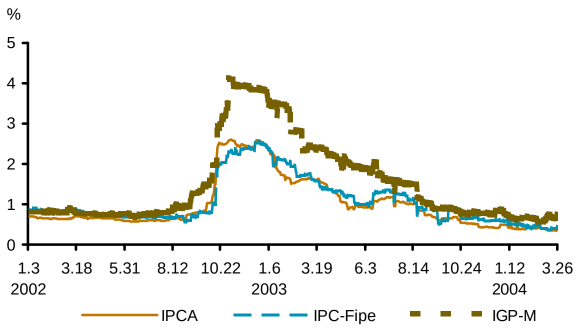
Daily evolution of market expectations for inflation (IPCA) (median)



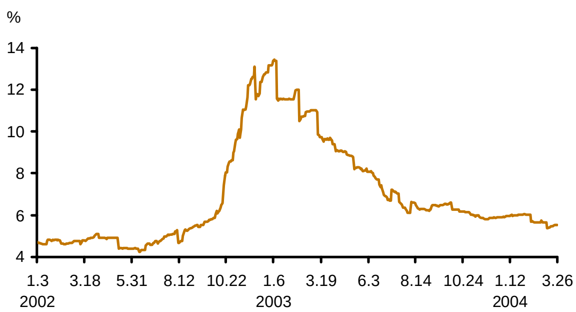
Daily evolution of market expectations for inflation in 2004 (median)



Standard deviation of market expectations for inflation in 2004



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



With regard to the median expectations of the Top five sources over the median term, the result increased from 5.49% to 5.98% for 2004 and remained at 5% for 2005.

With regard to growth in the General Price Index – Market (IGP-M), median expectations for 2004 moved from 6.4% on December 22, 2003 to 7.15% on March 26, 2004. For 2005, the result increased from 5% to 5.48%. Expectations regarding the Consumer Price Index calculated by the Institute of Economic Research Foundation (IPC-Fipe) for 2004 dropped from 5.9% on December 22, 2003 to 5.52% on March 26, 2004. For 2005, expectations remained at 5% for the dates considered.

Insofar as median expectations for the IGP-M over the medium term as informed by the Top five are concerned, the result increased from 6% to 7.31% for 2004 and from 5% to 5.9% for 2005.

The standard deviations of the price indices expected for 2004, which stood at 0.42% for the IPCA, 0.84% for the IGP-M and 0.6% for the IPC-Fipe on December 22, 2003, dropped to respective levels of 0.37%, 0.75% and 0.43% on March 26, 2004. For 2005, standard deviations declined from 0.65% to 0.43% in the case of the IPCA, from 1.06% to 0.91% for the IGP-M and from 0.7% to 0.54% for the IPC-Fipe.

Based on IPCA growth, median expectations for accumulated inflation over the next twelve months dropped from 5.9% on December 22, 2003 to 5.52% on March 26, 2004.

2.6 Conclusion

The most recent consumer price index results indicated upward movement at a pace below that registered in December 2003 and January of the current year. This performance points to greater probability of confirming a more benign scenario for future inflation. According to these results, the rather strong upward pressures registered recently in specific segments have not spread into other segments, at the same time in which the high level of inflation in the first quarter does not seem to have the persistence that would be required to continue into the following quarters.

However, the impact generated by upward movement in the prices of commodities of importance to the production chain has been perceived in the growth of the Wholesale

Price Index – Industrial Products (IPA-PI) and its repercussions on consumer prices are still uncertain. Even if this impact turns out to be attenuated, this would only tend to diminish the reduction in price indicators over the coming months, which will be a period in which the seasonal nature of farm product prices should attenuate any upward movement in the indices.

Credit, monetary and fiscal policies

3

3.1 Credit

Financial system credit operations registered moderate growth in the December-February quarter, principally as a consequence of seasonal factors. With this result, the lesser volume of operations that is characteristic of the early months of the year basically conditioned business demand for resources. At the same time, household demand for credit was conditioned by a concentration of financial commitments in the period, with a considerable amount being channeled into the financing of consumer durables.

With regard to the supply of resources, the tendency registered in the second half of 2003 continued, with lower interest rates and spreads, particularly in the segment of individual borrowers. This process, coupled with the system of payroll loans, for which consolidated data are not yet available, has contributed significantly to the increase in operations with these borrowers.

Consequently, the overall financial system credit portfolio added up to R$412.1 billion in February, mirroring an increase of 1.8% in the quarter and 8% in the last twelve months. Over the course of the quarter, however, this performance resulted in a drop in the ratio of loans to GDP from 26.1% in November to 25.6% in February.

Credits granted by the public financial system evolved by 0.6% in the quarter, with particularly strong growth in operations with earmarked resources. Operations carried out by private financial institutions registered growth of 2.6%, with emphasis on loans to individual borrowers.

Loans to the private sector came to R$396.6 billion, with growth of 1.7% in the quarter. The highest rates of growth occurred under operations contracted with individual borrowers, with 4.9% and volume of R$97.1 billion, and financing contracted by the service sector, with 2.9% and a

Growth in credit operations

R$ billion

Itemization	2003	2004			Growth	
	Nov	Dec	Jan	Feb	3 months	12 months
Total	404.9	409.9	409.0	412.1	1.8	8.0
Nonearmarked	222.0	224.2	224.7	229.4	3.3	6.7
Corporations	134.5	136.1	135.0	137.8	2.4	1.4
Ref. to exchange	48.2	48.0	48.4	49.7	3.1	-12.6
Individuals	87.5	88.1	89.7	91.6	4.7	16.0
Earmarked	159.3	161.7	159.4	157.6	-1.0	9.5
Housing	23.1	23.1	23.1	23.0	-0.2	5.7
Rural	43.8	44.9	44.7	45.3	3.4	28.0
BNDES	89.7	91.1	89.5	87.3	-2.6	1.9
Others	2.7	2.6	2.1	1.9	-29.0	92.0
Leasing	8.7	9.0	9.7	9.7	10.5	7.9
Public sector	14.9	15.0	15.3	15.5	4.0	11.2
% participation:						
Total/ GDP	26.1	26.1	25.7	25.6		
Nonearmarked/GDP	14.3	14.3	14.1	14.3		
Earmarked/GDP	10.2	10.3	10.0	9.8		

volume of R$71.1 billion. In the latter case, the highlights were operations with the segments of civil aviation and telecommunications. Aside from these results, the volume of credits contracted by the trade sector, R$43.8 billion, turned in an increase of 3.2%, due to greater demand on the part of the retail segment, sell supermarkets and stores that market home appliances and electric-electronic goods.

In the opposite sense, loans granted to industry registered a stock of R$114.2 billion, with a decline of 2.3% in the quarter. However, this result was a consequence of acquisitions of BNDES credits against AES/ELPA, the company that controls Eletropaulo, by the nonfinancial company BNDESPar.

Credits to the public sector came to R$15.5 billion, with growth of 4% in the quarter. Basically, this performance reflected the 4.3% increase in the debts of state and municipal governments, which came to R$10.4 billion in February. For the most part, this result reflected operations granted to the segment of urban transportation infrastructure, coupled with incorporation of financial charges in contracts with the energy sector. The debts contracted by the federal level increased by 3.4% in the period, with a total of R$5 billion.

The stock of leasing operations came to R$9.7 billion in February, with growth of 10.5% in the quarter, mostly involving operations with automobiles, machines and equipment. Disbursements in the period accumulated R$2.3 billion, compared to R$890 million in the same period of 2003. Aside from the reduction in financial charges, another factor that contributed to this result was a judicial decision that confirmed the legality of contracts with anticipated charging of the guarantied residual value.

Credit operations with earmarked resources

Credit operations with earmarked resources came to R$157.6 billion in February, with a decline of 1% in the quarter. In this case, the highlights were a reduction in financing granted by the BNDES system, particularly in direct operations, and an increase in credits to the rural sector. The overall volume of BNDES credits declined by 2.6% in the quarter, closing at a level of R$87.3 billion in February.

In the first two months of the year, credits granted by the development bank totaled R$5.2 billion, with growth of

BNDES Disbursements

R$ millions

Itemization	Jan-Feb 2003	Jan-Feb 2004	Growth (%)
Total	3 844	5 214	35.6
Industry	1 863	2 593	39.2
Other transport equipment[1/]	457	346	- 24.3
Food and drink products	252	528	109.5
Machines and Equipment	36	222	516.7
Motor vehicles	234	672	187.2
Basic metallurgy	262	196	- 25.2
Commerce/Services	1 670	1 530	- 8.4
Electricity, gas and hot water	829	334	- 59.7
Commerce and reparation	252	237	- 6.0
Land transportation	290	419	44.5
Construction	66	328	397.0
Crop and livestock	310	1 092	252.3

Source: BNDES

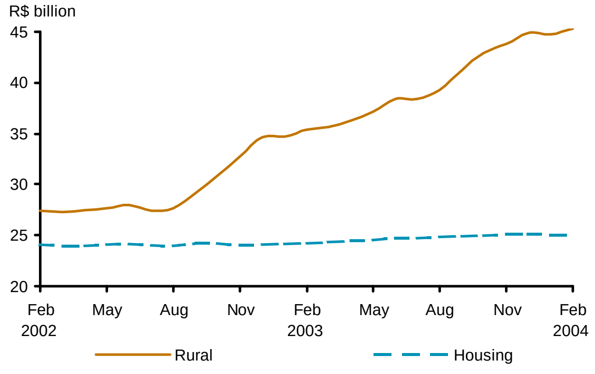
1/ It includes aircraft industry.

35.6% compared to the total registered in the corresponding period of 2003. Here, emphasis should be given to a sharp increase in releases of funding to the rural sector, which moved from R$310 million in 2003 to R$1.1 billion, particularly involving resources from the Program of Modernization of the Farm Tractor and Associated Implements and Harvester Fleet (Moderfrota). In a complementary sense, it is important to stress growth of 39.2% in contracting by the industrial sector, with a total of R$2.6 billion in the first two months of 2004, due mostly to exports in the sectors of food and beverages and vehicles. In the opposite sense, releases to the services and trade segment diminished by 8.4%, closing at R$1.5 billion, as a consequence of a falloff in disbursements to the energy sector.

Contracting by micro, small and medium businesses increased by 83.4%, reaching a total of R$1.9 billion. As a consequence, the participation of this financing in total disbursements moved from 26% in the first two months of 2003 to 37% in 2004.

With regard to consultations with BNDES, considered an indicator of future financing operations, there was a decline of 7.4% when compared to 2003, with an accumulated total of R$3.9 billion in the two month period. This result reflected a downturn of 57% in consultations by the sector of services and trade, particularly the segments of electricity and gas. The accentuated reduction can be explained by the strong volume of resources contracted in 2003, under the terms of Law 10,438, dated 4.26.2002, which deals with growth in the supply of emergency energy. On the other hand, requests submitted by the industrial sector added up to an accumulated total of R$1.9 billion in the two month period, with growth of 52.8% compared to those submitted in the same period of 2003, with a particularly strong performance under requests submitted by the segment of oil refining, coke and alcohol.

Growth in rural and housing credit

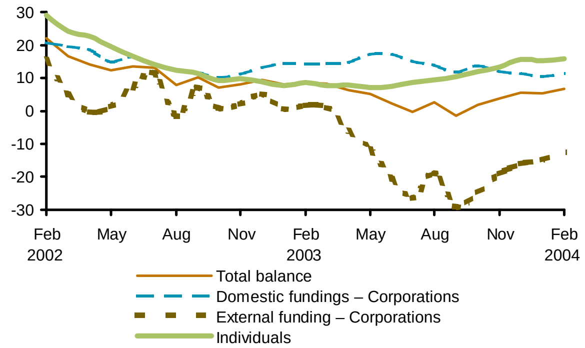


The volume of credits granted by the financial system to the rural sector reached the mark of R$45.3 billion, with growth of 3.4%, principally as a result of releases of resources for current expenditure and investment operations. In this way, the participation of investments in total rural credits increased from 50.6% in November to 53.1% in February. In the opposite sense, the share related to the financing of marketing operations declined from 8.5% to 6.2%, due to a low volume of releases in the month of January. The participation of current expenditure operations closed at 40.7%.

The portfolio of housing financing operations granted to individuals and cooperatives, with both earmarked and nonearmarked resources, closed at R$25 billion, remaining at the November 2003 level. Disbursements utilizing savings account resources from November to January, however, closed at R$689 million, for growth of 21.7% compared to the quarter ended in October 2003.

Credit operations with nonearmarked resources

Growth of credit with nonearmarked resources
Percentage growth in 12 months



The stock of credit operations based on nonearmarked resources came to R$229.4 billion in February, with growth of 3.3% in the quarter. With this result, the participation of these loans in the financial system total increased from 54.8% in November to 55.7% in February.

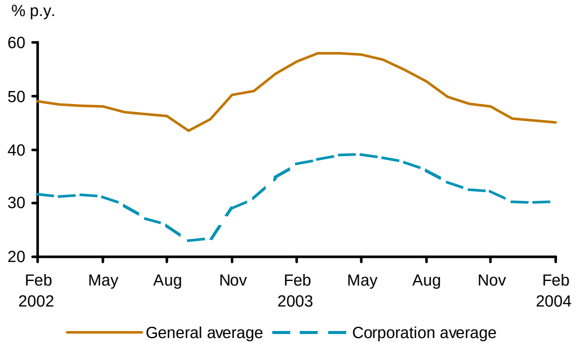
The volume of credits targeted to legal entities registered an increase of 2.4% in the quarter, totaling R$137.8 billion in February. The balance of the modalities based on internal resources closed at R$88.1 billion, a high of 2%, due mostly to demand for resources for purposes of stock replenishment following the period of end-of-year sales. In much the same way, portfolios referenced to foreign currency registered a stock of R$49.7 billion, with growth of 3.1%, consequent upon increased operations involving advances on exchange contracts (ACC), which kept pace with the performance of the export sector in the period.

With respect to new credit operations granted to legal entities, the quarterly average reached R$54.1 billion, with growth of 1.9%, compared to the previous period. This result is a consequence of high levels of disbursement in the month of December, as well as of the increase in financing for the export sector.

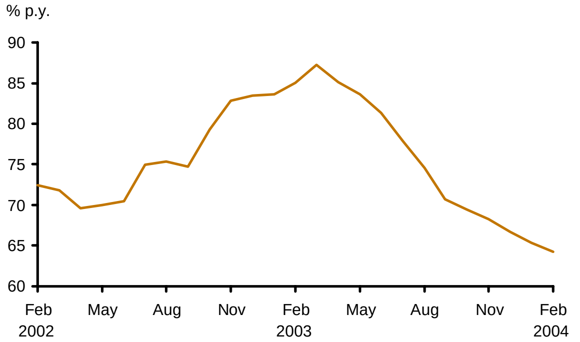
Credit operations with individual persons came to R$91.6 billion in February, for growth of 4.7% in the period. These loans were influenced by growth in consumer financing, particularly in the vehicle segment as a result of the extension to February 2004 of the IPI reduction agreement. In this case, emphasis should be given to demand for loans, particularly involving personal credits, for purposes of meeting financial commitments that are normally concentrated in the early part of the year and that mostly involve outlays on education and taxes.

With regard to personal credit operations, this modality registered significant growth over the last twelve months,

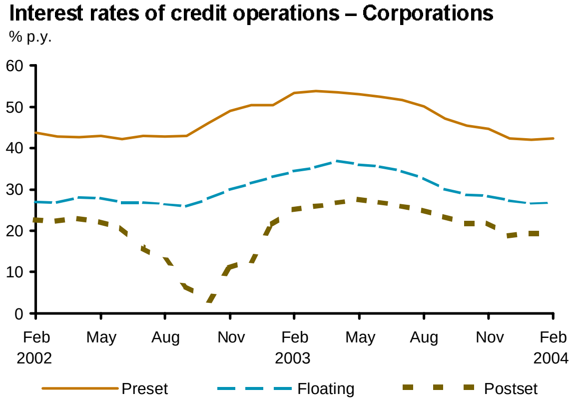
Interest rates of credit operation with nonearmarked resources



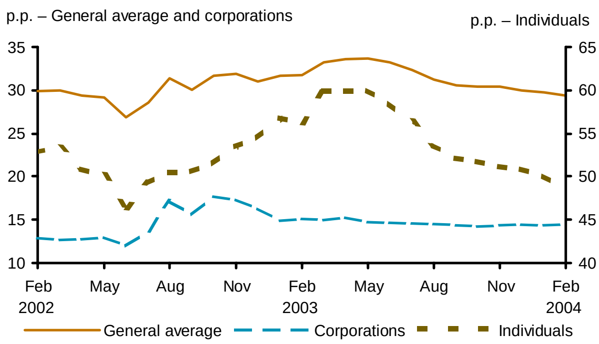
Interest rates of credit operation preset rates – Individuals



Interest rates of credit operations – Corporations



Median spread of credit operations with nonearmarked resources



mainly reflecting the migration of debts away from special overdraft checks in pursuit of lesser financing costs and, more recently, growth in loans deducted from payroll.

Operations contracted by households declined by 0.5% in the quarter, closing with a quarterly median of R$27.8 billion. This result was caused by a decline in operations involving special overdraft checks, particularly since personal credit operations and vehicle acquisition financing registered positive growth.

The average rate of interest in credit operations based on market resources closed at 45.1% per year in February, for a reduction of 2.9 p.p. in the last three months. This figure represented the lowest rate since September 2002, when the rate closed at 43.7% per year. For the most part, this trajectory reflected a more flexible monetary policy as evinced by the gradual downturn in the Selic rate that began in June 2003.

The median cost of contracts formalized mostly at preset interest with individual borrowers declined by 4 p.p. in the quarter, closing at 64.2% per year in February. In the period under consideration, the highlights were a falloff of 5.4 p.p. in the rate on personal credit operations, together with an increase in the average maturity of this portfolio. It is important to note that these movements were at least partly impacted by the performance of loans deducted from payroll. In the case of loans based on special overdraft checks, there was a decline of 3.6 p.p., as rates moved to 142.9% per year, the lowest level since May 2000, when the rate came to 141.9% per year.

In loans to legal entities, the median rate diminished by 2.1 p.p. in the quarter, closing at 30.2% per year. This result reflected a generalized reduction in the cost of these contracts, particularly under operations at preset interest, with an average decline of 2.2 p.p. The rate on financing referenced to exchange variation turned in a reduction of 2.6 p.p. in the period, while operations contracted at floating rates of interest dropped by 1.6 p.p.

The banking spread on credit operations utilizing nonearmarked resources dropped to 29.4 p.p. in February, 1 p.p. below the November level. The spread fell by 2.5 p.p. in the segment of individual persons, reaching the mark of 48.6 p.p., and remained at 14.4 p.p. in the segment of legal entities. It should be stressed that, as of June 2003, with adoption of a more flexible monetary policy, the spread has followed a downward curve, accumulating a reduction

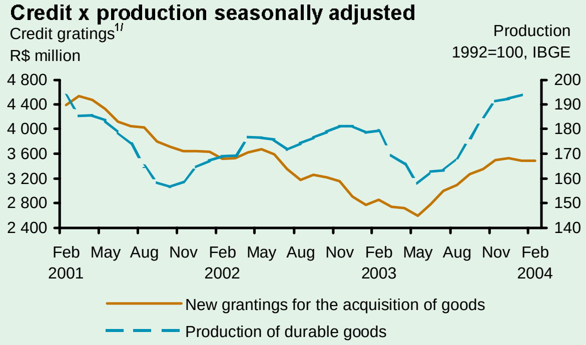
Recent Evolution of Credit Operations with Individual Borrowers

In February 2004, credit operations with nonearmarked resources came to R$229.4 billion. In the second half of last year, the first signs of more intense credit demand were noted, particularly in operations with individual borrowers, mostly in response to the more flexible monetary policy adopted in the period. These credit portfolio registered growth of 11.3% in the last eight months, with an overall volume of R$91.6 billion. Here, it should be stressed that these operations were mostly stimulated by a reduction of 17.2 percentage points in lending rates since June 2003.

Among the most significant individual credit modalities, the most important was that involving financing for the acquisition of goods, which accounted for 40% of the segment's overall portfolio. The volume of these operations came to R$36.6 billion, with growth of 15.5% since June. It is important to note that 85% of these financing operations refer to vehicle acquisitions. Growth in this type of financing resulted mostly from improved credit conditions and has aided in driving the positive results achieved in the output of consumer durables and, therefore, in hastening the pace of economic activity.

One should also stress the importance of personal credit, which accounted for 35% of all loans granted to individual borrowers. The balance of these operations came to R$32 billion, in February 2004, with growth of 17.9% in the last eight months. Among other aspects, this growth reflected the migration of debts away from special overdraft accounts, since the conditions imposed on personal credits are much more favorable to the borrower. With this, operations involving special overdraft checks, which have significantly higher costs, declined by 1% in the same period.

Credit x production seasonally adjusted



1/ Volume at February 2004 prices, deflated by the IPCA.

Credit targeted to individuals

Segment	2003		2004	Growth %	
	Feb	Jun	Feb	8 months	12 months
Public institutions					
Individuals - total	17.1	18.4	21.1	14.5	23.1
Personal credit	10.8	11.5	14.3	24.5	32.8
Private institutions					
Individuals - total	61.9	65.1	70.5	8.4	14.0
Personal credit	14.7	16.5	17.7	7.6	20.4

R$ billion

Personal credit

Segment		2003		2004	Growth %[1/]	
		Feb	Jun	Feb	8 months	12 months
Major banks						
Amount	R$ billion	16.0	16.9	19.8	16.8	23.5
Interest	% a.a.	99.9	96.3	81.8	-14.5	-18.1
Default[2/]	%	14.1	14.7	13.1	-1.6	-1.1
Specialized FIs						
Amount	R$ billion	6.2	6.6	7.9	18.9	27.7
Interest	% a.a.	115.7	116.7	94.8	-21.9	-20.9
Default[2/]	%	11.0	11.9	14.5	2.6	3.5
Financial Institutions (FIs)						
Amount	R$ billion	0.8	0.9	1.2	38.2	59.8
Interest	% a.a.	194.1	165.0	153.4	-11.6	-40.7
Default[2/]	%	15.5	15.5	17.0	1.5	1.6

1/ Growth in interest and default in p.p.
2/ Percentage portfolio in arrears for more than fifteen days.

Another factor that has contributed to growth in personal credit, particularly in the last four months, is that of payroll loans, which were regulated by Provisional Measure nº 130, dated 9.17.2003, later transformed into Law 10,820, dated 12.17.2003. Basically, this measure encouraged public banks to participate in this type of operation, since they already had the operational structures in place that would be needed for these operations, especially in the case of civil servants. Among private banks, these operations have become increasingly common in the first two months of the current year.

Analysis of personal credit portfolios by financial institution segment indicates that these operations are concentrated in those large banks that operate on the retail market and have extensive networks of branches throughout the country. These are the institutions that account for the major share of the principal credit products targeted to individual borrowers. With this, the operations of the seven institutions classified in this grouping account for approximately 62% of the total volume of this credit modality and expanded by 16.8% in the last eight months.

It is also important to stress the participation of the segment specialized in personal credit – defined here as those institutions with more than 30% of their operations in this credit modality. This category involves 41 institutions, of which 14 are financial institutions, normally involving those that are specialized in meeting the demand of the low income population at higher rates of interest. Loans from specialized institutions that account for 24.5% of the volume of personal credits expanded by 18.9% since June. The growth of the finance companies involved in this segment was even higher, closing at a level of 38.2% in their portfolios.

With respect to the interest rates charged in personal credit operations, the average rates of the large banks reached 81.8% per year in February 2004, compared to 94.8% per year in operations with specialized institutions and 153.4% per year for finance companies. The lower interest rates charged by the large banks can, to some extent, be explained by the possibility of diluting their fixed costs in highly diversified product portfolios, as well as by the economies of scale that they are able to achieve through their large bank networks and often enormous client bases. Specialized institutions – particularly, finance companies – not only have to cope with these restrictions, but are often faced with significantly higher default rates, which may be due to the fact that they tend to operate mainly with the low income population.

In the case of financing for purposes of vehicle acquisitions, these operations increased by 14.8% in the last eight months, as the volume of operations moved to R$31.2 billion. This growth reflected a decline in interest rates, promotional campaigns carried out by the large assembly plants and the added incentive of a reduction in the industrialized products tax (IPI) rate on these goods, which remained in effect from August 2003 to the end of February 2004.

Vehicle acquisition

Segment		2003		2004	Growth %[1/]	
		Feb	Jun	Feb	8 months	12 months
Major banks						
Amount	R$ billion	8.7	9.0	10.3	14.8	18.8
Interest	% p.y.	55.8	48.6	37.9	-10.7	-17.9
Default[2/]	%	12.0	14.7	12.6	-2.1	0.7
Specialized FIs						
Amount	R$ billion	14.7	14.5	17.2	18.8	16.8
Interest	% p.y.	49.8	43.8	34.2	-9.6	-15.6
Default[2/]	%	11.0	10.7	9.4	-1.3	-1.6
Banks associated with assembly plants						
Amount	R$ billion	3.9	3.7	4.2	13.6	6.5
Interest	% p.y.	42.1	37.7	23.6	-14.1	-18.5
Default[2/]	%	9.6	9.9	7.4	-2.5	-2.2

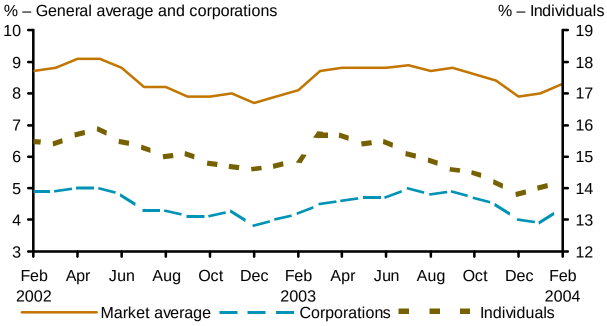
1/ Growth in interest and default in p.p.
2/ Percentage portfolio in arrears for more than fifteen days.

This type of operation is also segmented between large banks and specialized institutions, defined by the same criterion as in the case of personal credit. The specialized institutions operate directly with factory authorized sales outlets and independent vehicle merchants. In this way, they are able to increase the number of outlets for their products and the size of their client base.

The group specialized in vehicle financing is composed of 32 institutions, accounting for 55% of the market, including nine banks that are directly tied to the largest assembly plants. Financing provided by the specialized institutions expanded by 18.8% in the last eight months. In the case of the large banks, which account for 32% of this financing and concentrate their operations preferably on their own clients, growth came to 14.8%.

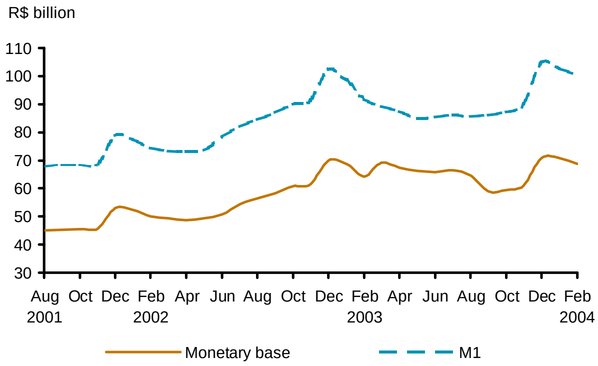
Financial institutions specialized in vehicle financing charge lower interest in this type of operation. Analysis indicates that, in the period extending from June to February 2004, these rates dropped by 9.6 p.p.. In this context, the sharpest reductions were registered by banks connected to the vehicle manufacturing companies and came to 14.1 p.p. in the same period. The rates charged by the large banks dropped by 10.7 p.p.. In terms of portfolio quality, the specialized institutions turned in improved results, probably reflecting more efficient charging systems, since the activities of these institutions are concentrated in this type of operation.

Default rate of credit[1/]

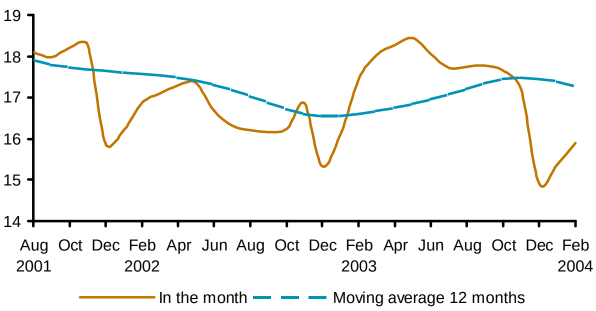


1/ Portfolio's percentage share of nonearmarked funds in arrears of more than 15 days.

Monetary base and M1 – Average daily balances

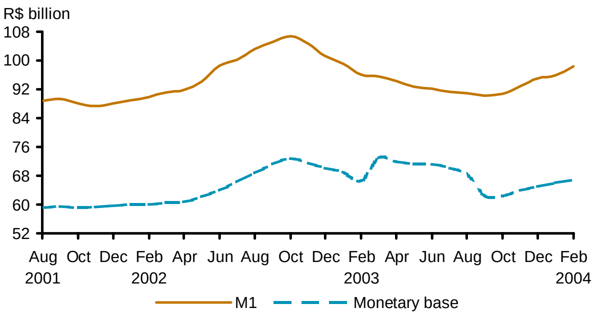


M1 – Income-velocity[1/]



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

M1 and the monetary base at February 2004 prices seasonally adjusted[1/]



1/ Price index: IPCA.

of 4.3 p.p. up to February, including 11.4 p.p. in the segment of individual persons and 0.4 p.p. in operations with legal entities.

The default rate of the credit portfolio based on nonearmarked resources remained relatively stable, with a February level of 8.3%. The percentage of business arrears declined by 0.1 p.p., closing at 4.4%, while defaults on the part of individual borrowers remained stable in the quarter at 14.2%.

3.2 Monetary policy

Monetary aggregates

The money supply (M1), defined as median daily balances, came to R$100.3 billion in February, with growth of 9.1% in 12 months. With respect to the different components, currency held by the public expanded by 6.8% and demand deposits increased by 10.6%.

Currency velocity of the M1 components increased over the short-term, mostly as a consequence of lesser seasonal demand for currency in the first half of the year. Analysis of the movable 12 month average indicates that the ratio between the valued GDP and the monetary aggregate remained relatively stable in the December to February quarter at approximately 17.5.

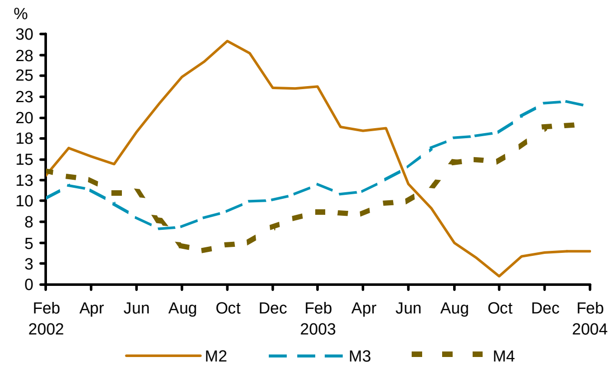
Based on seasonal data deflated by the IPCA, the steady rise in the monetary aggregates as of the final quarter of 2003 mainly reflected a downturn in inflation and, to a certain extent, recovery in financial system credit operations.

Average daily monetary base balances expanded by 7.3% in 12 months, reaching a level of R$68.8 billion in February, with increases of 9.2% in the median balance of currency issued and 3.4% in banking reserves.

In the case of the expanded money supply, the December-February increase was basically a result of the inflow of exchange and seasonal movement of the more restricted monetary aggregate (M1).

The M2 concept, which includes M1, savings deposits and securities issued by financial institutions, registered growth of 2% in the quarter. Analysis of the percentage change on a year-over-year basis indicates that the downward tendency of this aggregate was reversed. This reduction indicates the return to financial investment funds of resources that had migrated to savings deposits and time deposits.

Broad money supply – 12 month percentage growth



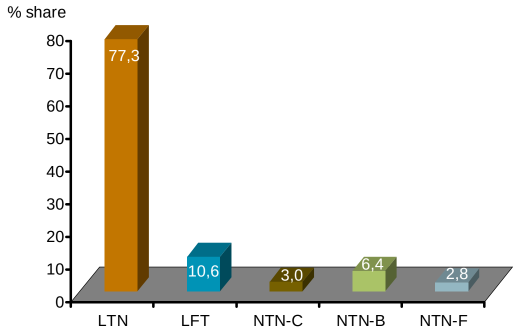
M3, which encompasses M2, fixed income fund quotas and federal public securities used as backing for the net financing position in repo operations between the nonfinancial sector and the financial system, increased by 5.3% in the quarter. Over the course of the period, net inflows into investment funds came to R$23.8 billion, as the percentage change of M3 reached 21.4%, when measured in 12 month terms.

The M4 concept, which aggregates public securities held by nonfinancial entities into M3, registered a balance of R$981.5 billion at the end of February, with an increase of 5.8% in the quarter and 19.2% in 12 months.

Federal public securities

From December 2003 to February 2004, issues of National Treasury securities came to R$40.6 billion and redemptions closed at R$49.1 billion, without including operations involving exchanges which came to a total of R$10.3 billion. Considered together with net redemptions of Banco Central papers, which came to approximately R$2.1 billion, operations with federal public securities expanded by R$10.6 billion in the quarter.

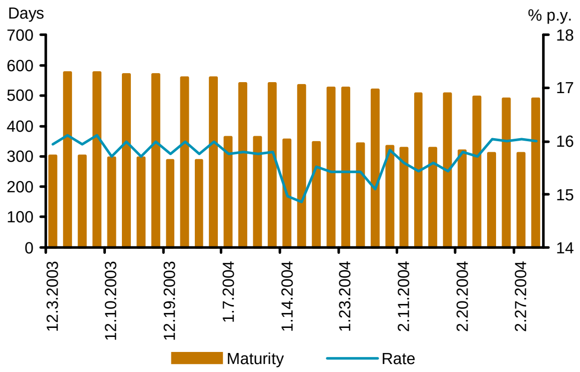
Issues of federal public securities – December 2003 to February 2004



As of the month of December, National Treasury Notes – Series F (NTN-F) have been auctioned in order to increase the placement term of preset papers. The principal characteristic of these papers, which differentiates them from National Treasury Bills (LTN), consists in half-yearly payment of coupons, which can be negotiated separately. These coupons reduce the duration of NTN-F compared to that of LTN with the same maturity terms.

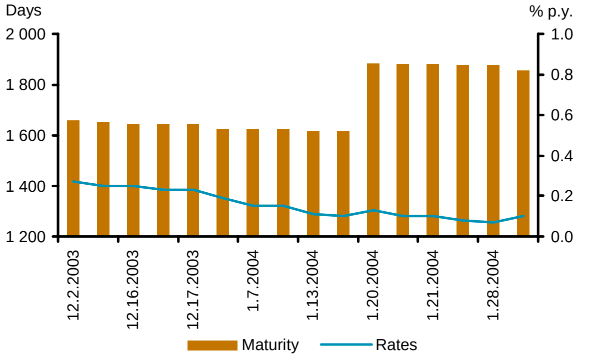
With regard to the composition of issues made in the quarter, LTN corresponded to 77.3% of security placements. Issues of Treasury Financing Bills (LFT), which are indexed to the Selic rate, accounted for 10.6%. NTN-C and NTN-B, which are tied to price indices accounted for 9.4% of placements and NTN-F for 2.8%.

LTN placements – Maturity x rates

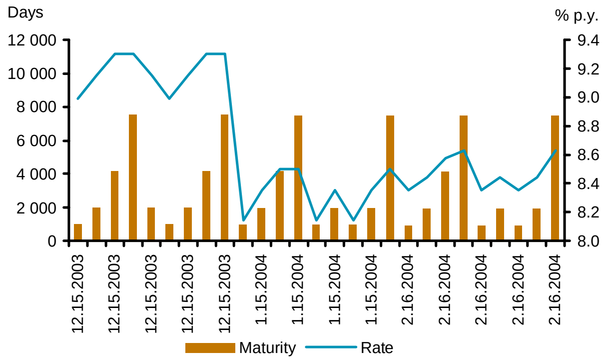


In the month of January, Banco Central decided to maintain the Selic rate target at 16.5% per year, at the same time in which the United States Federal Reserve signaled the possibility of raising the basic interest rate, resulting in a course reversal in expectations regarding external financing flows to the emerging economies. Consequently, as a result

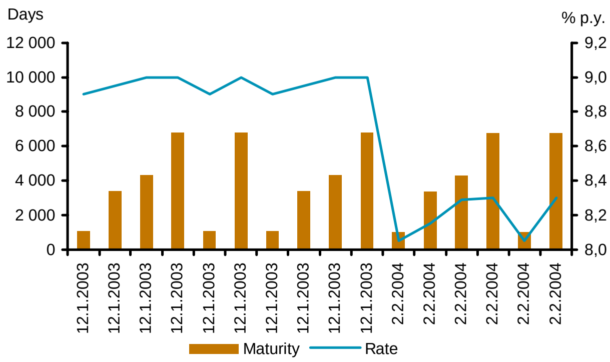
LFT placements – Maturity and rates



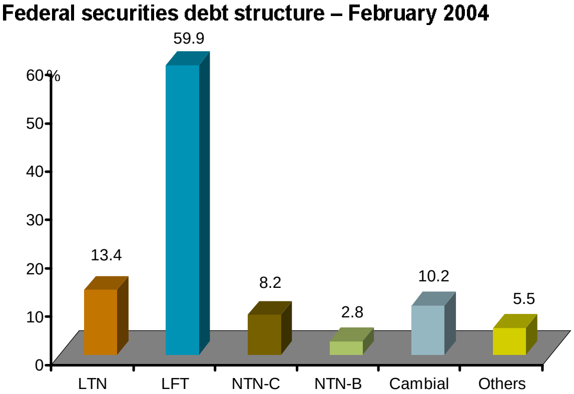
NTN-B placements – Maturity x rates



NTN-C placements – Maturity x rates



Federal securities debt structure – February 2004



of these monetary policy decisions, the interest curve peaked, following a period of decline in December and in the first fifteen days of January.

With this, rates agreed to in Treasury auctions moved upward. For example, LTN, which were negotiated at 14.96% per year on January 13 for shorter maturity terms, were auctioned on February 26 at 16.04%.

LFT auctions were also affected, particularly as of February, when the National Treasury repeatedly refused the discounts demanded by the market. Consequently, there were no LFT placements in February.

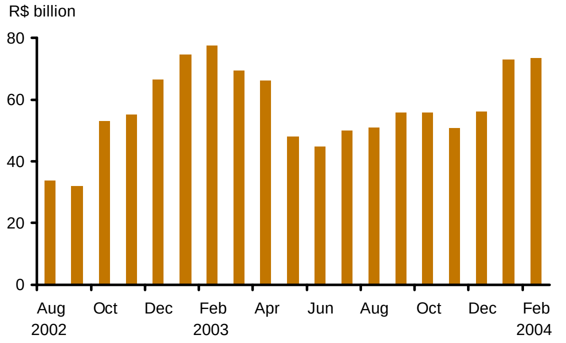
The Treasury adopted the strategy of holding only one monthly auction for purposes of NTN-F placements. In December, when this paper was offered for the first time, the market absorbed the entire offer of 500 thousand papers at 17.19% per year. In January, this security was negotiated at 15.67% per year in the same volume. In February, despite a reduction in volume to 300 thousand papers, the rate rose to 16.49% per year.

The longest terms of the papers negotiated in the quarter were not significantly altered. Only LFT which, as of January, were auctioned by the Treasury with terms of 1884 calendar days and redemption on 3.18.2009, managed to obtain longer terms.

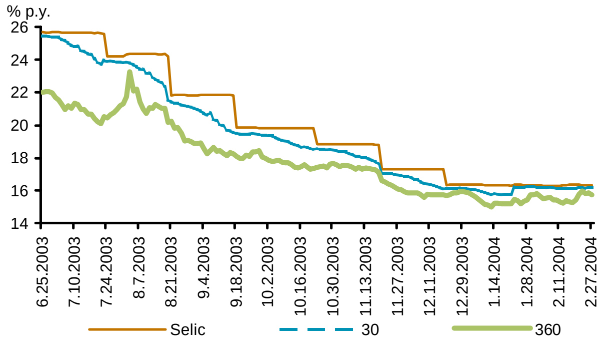
In keeping with the results obtained in primary auctions, the participation of preset papers in the total public debt remained high, coming to 13.6% in February, compared to 11.3% in November of the previous year, while the proportion of papers tied to the Selic rate dropped from 62.8% to 60.7% in the period. The percentage of papers tied to the price indices rose from 13% to 13.8%, while the percentage of exchange papers, excluding swaps, dropped from 11.2% to 10.2%.

Considering the reduction in financial institution demand for exchange hedge, exchange turnover in the quarter came to 3.4%, when only the principal is considered. When final and intermediate interest is taken into account, turnover drops to 3% of maturities. It should be emphasized that exchange turnover in the first two months of this year was nil, with net redemptions of US$7.6 billion, including US$1.8 billion in exchange papers (NTN-D and NBCE) and US$5.8 billion in exchange swaps. When net redemptions in December 2003 are factored in, the total came to US$11.2 billion in the quarter.

Net financing position of the federal public securities – Daily average

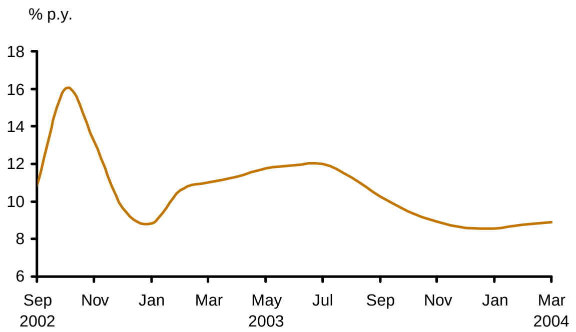


Selic x swap DI x Pre

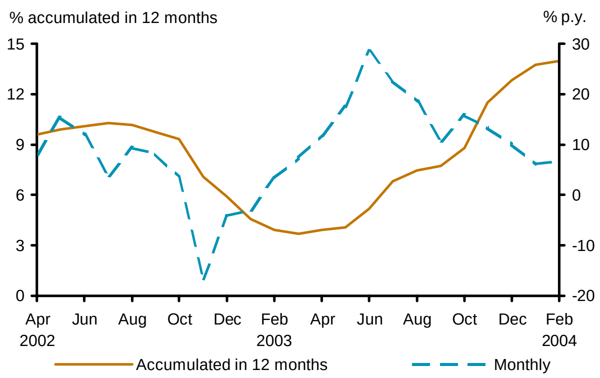


Source: BM&F

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



Ex-post real interest rate deflated by IPCA



In January, growth in the net financing position with federal public securities was basically impacted by Banco Central operations on the exchange market and by net redemptions of public securities. Aside from these items, National Treasury operations and adjustments based on exchange swap operations are also included. Parallel to this, Banco Central maintained its strategy of controlling liquidity through repo operations with terms of up to 10 business days and forward operations with median terms of 61 business days.

Real interest rates and market expectations

The swap DI x pre reference rate for 360 day contracts came to 15.7% per year at the end of February, compared to 16% per year in November. Though this rate had registered only slight growth at the end of February as a result of uncertainties surrounding the speed of the future decline in the Selic rate, the interest curve generated by the reference rates of these contracts remained on a negative incline. The difference between the rates on contracts with terms of 360 days and 30 days changed from -0.9 p.p. in November to -0.5 p.p. in February.

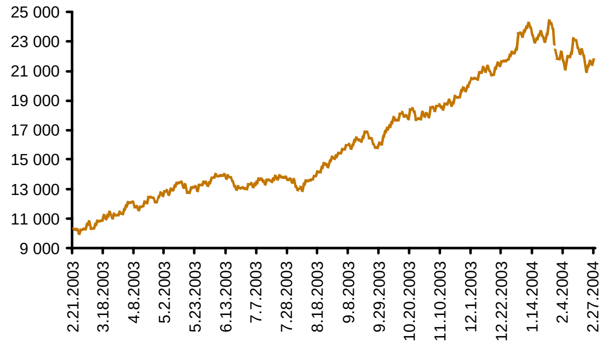
Surveys carried out by Banco Central among financial institutions indicate a downward trend for 12 month IPCA growth, with 5.5% per year on March 19. Using this result and market expectations regarding the Selic rate over the next twelve months as the basic scenario, the real rate of interest in March was projected at 8.9% per year.

The Selic rate accumulated over twelve months and deflated by the IPCA remained on the upward trajectory that began in the second half of 2003 and reached 14% per year in February compared to 11.5% per year in November. It should be noted that, with the more flexible rate of exchange, the real rate of interest accumulated in 12 months remained at levels close to 10% per year, with the exception of the period in which inflation peaked between the fourth quarter of 2002 and the third quarter of 2003. In response to the monetary policy adopted over the course of that period, real ex-post interest accumulated over twelve months moved upward once again and, as of November 2003, closed at a mark above 10% per year.

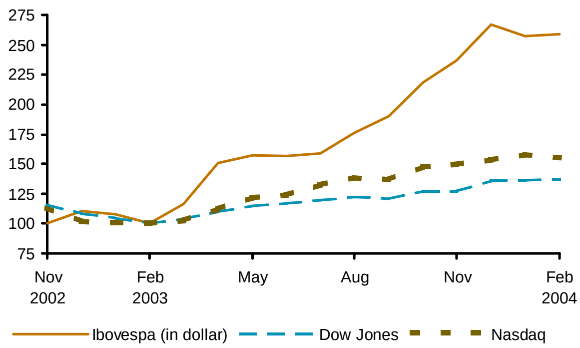
Capital market

The São Paulo Stock Market Index (Ibovespa) registered a nominal high of 7.8% in the final quarter and closed at 21,755

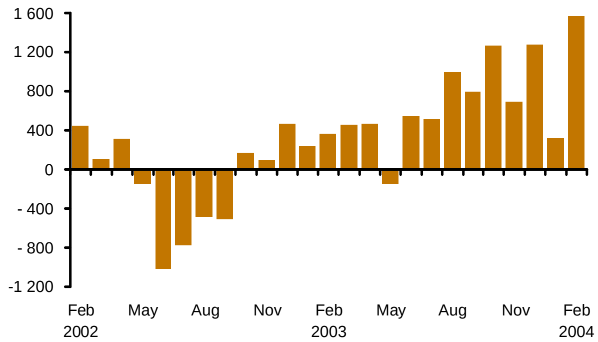
Ibovespa
Points



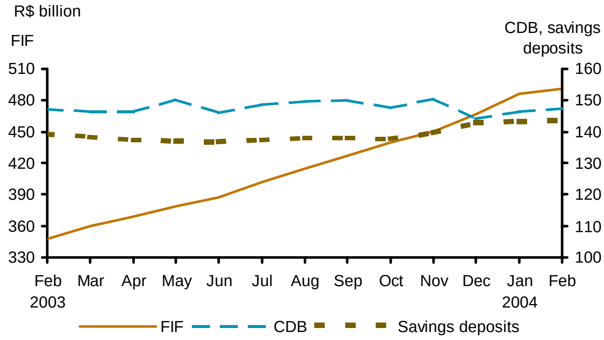
Stock exchanges
2003, February = 100



Net foreign investment in Bovespa
R$ million



Portfolio evolution of time deposits, FIF and savings deposits
R$ billion



points at the end of February. Strong upward movement in stock values over the second half of the year continued to the end of January, when the Ibovespa set a record of 24,349 points.

However, increased expectations of a future decision on the part of the Federal Reserve (Fed) to raise American rates, coupled with maintenance of the basic rate in Brazil, were factors that played a role in interrupting the upward movement registered on the stock market, as investors began a process of profit-taking and the Ibovespa settled back to 22,000 points.

However, Ibovespa profitability in dollars was still quite attractive to international investors, who accounted for net inflows of R$3.2 billion in the quarter. From December to February, the Dow Jones Industrial Average (DJIA) accumulated upward value movement of 8.2% and the National Association of Securities Dealers Automated Quotations (Nasdaq), registered 3.5%. In dollar terms, the Ibovespa rose by 9.1% in the same period.

Analysis of the median monthly volume of trading indicates growth of 7.8% in the quarter (R$1,137 million), when compared to the previous period. This result is a consequence of growing international market liquidity, as well as the highly positive internal macroeconomic environment.

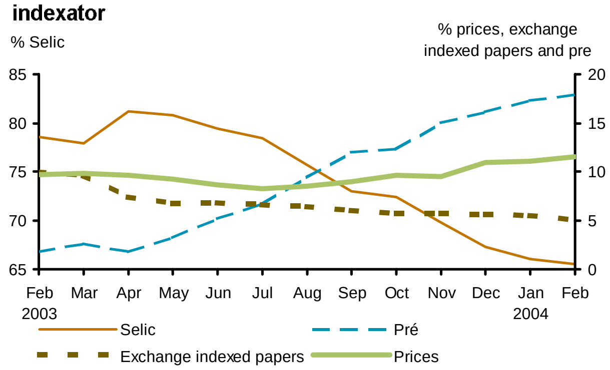
Up to February, business financing involving primary issues of stock, debentures and promissory notes in 2004 came to a total of R$1.6 billion, mostly involving debentures, compared to R$1 billion in the same period of the previous year, when funding was sought predominantly through issues of promissory notes. In 2003, there was a falloff of 62% in primary issues, with a final figure of R$7.5 billion.

Financial investments

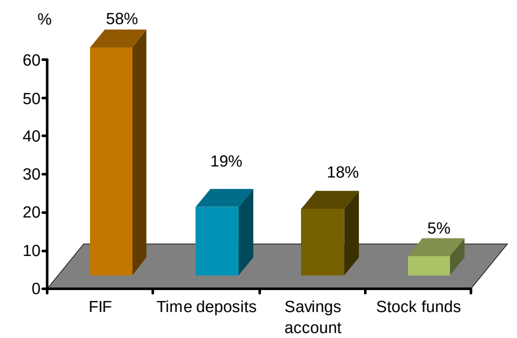
The balance of financial investments, encompassing savings accounts, time deposits and investment funds, totaled R$800.8 billion in February, with growth of 5.7% in relation to November 2003. For the most part, this result was impacted by inflows of resources into financial investment funds (FIF).

At the end of February, investment fund capital reached R$491.4 billion, with net inflows of R$23.8 billion in the quarter, concentrated mostly in the December-January period. This movement was a consequence of inflows of exchange and the flow of operations at the end of the year.

Growth in public securities in funds portfolio by indexator

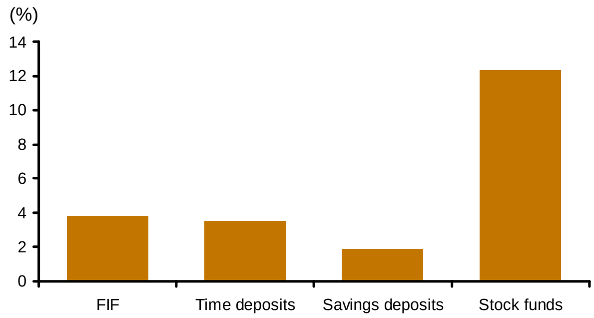


Financial savings structure – 2004, February



Financial investments earnings

In accumulated terms from December to February/2004



Analysis of inflows to the different types of funds indicates that those referenced to interbank deposits (DI) which, following a declining trajectory in the second half of 2003 accompanying the reduction registered in the basic interest rate, stabilized as of the month of December. In their turn, fixed income funds, which hold a large volume of preset papers in their portfolios, registered a drop in inflows in the first two months of 2004, mostly as a result of maintenance of the basic interest rate in the period.

The profitability of the different types of financial investments kept pace with the interest rate trajectory, closing the quarter with a reduction in comparison to the level for the previous quarter. FIF and time deposits turned in similar performances, with earnings of 3.8% and 3.5%, respectively. Savings accounts generated earnings of 1.9% in the period. In year-over-year terms, FIF registered profitability of 20.3% in February, followed by time deposits (20.5%) and savings accounts (10.3%).

The balances of savings accounts and time deposits reached R$143.6 billion and R$147.5 billion, respectively, at the end of February 2004. Savings accounts closed with net inflows of R$1.2 billion in the quarter, with a particularly strong performance of R$2.4 billion in December mostly as a consequence of seasonal factors that are typical of the period. Time deposits lost R$8 billion in the period, principally as a result of the R$8.1 billion loss registered in December.

Stock funds, which encompass stock and security investment funds (FITVM) and mutual privatization funds (FMP), which are responsible for investing FGTS resources, closed February 2004 with capital of R$41.3 billion, with growth of 10.5% in the quarter and profitability of 12.3% in the period.

3.3 Fiscal policy

Public sector borrowing requirements

Primary result of the consolidated public sector

Segment	2002		2003		2004/Jan
	R$ billion	% GDP	R$ billion	% GDP	R$ billion
Central government	-31.9	-2.4	-38.7	-2.5	-7.2
Regional government	-10.6	-0.8	-13.8	-0.9	-1.8
State companies	-9.8	-0.7	-13.6	-0.9	2.0
Total	-52.4	-3.9	-66.2	-4.3	-7.0

In 2003, the nonfinancial public sector registered a primary surplus of R$66.2 billion, corresponding to 4.32% of GDP, thus complying with the target of 4.25% of GDP defined for the period.

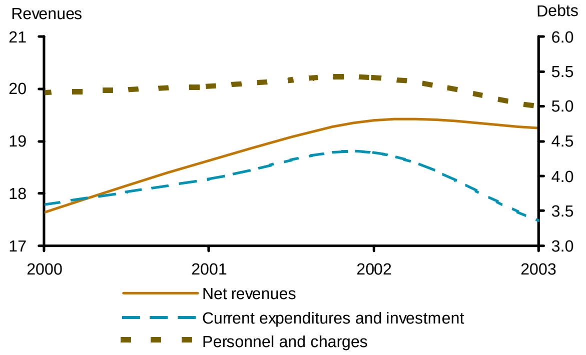
Analyzing the contribution of the various segments of the public sector to this result, all of the different spheres registered improvement in the surplus as a ratio of GDP, when compared to the previous year.

At the level of the Central Government, the adjustment was concentrated principally under expenditures, making it possible to offset the reduction in tax inflows that resulted from the economic slowdown and the loss of the strong inflow of atypical revenues that occurred in the previous year.

The primary surplus of the Central Government in 2003 came to R$38.7 billion, corresponding to 2.53% of GDP, compared to R$31.9 billion in 2002, or 2.37% of GDP. In the 2003 result, R$65.3 billion corresponded to the surplus registered in National Treasury accounts and R$26.4 billion and R$195 million to the Social Security System and Banco Central deficit.

Revenues added up to R$357.9 billion, for nominal growth of 11.2% compared to the preceding year. However, as a proportion of GDP, there was a drop from 23.94% to 23.45%. The factor that contributed most significantly to this reduction was deceleration in the level of economic activity in the first six months of the year, particularly in the industrial sector. At the same time, restructuring of import tax and industrialized products tax rates produced negative impacts on the inflow of these taxes, while judicial decisions that went against the positions taken by the Federal Revenue Secretariat provoked losses in revenues generated by the Cide-fuels and the IPI. Finally, one should note that deposits of atypical and extraordinary inflows, particularly those involving payment of debts in arrears and conversion of judicial and administrative deposits into Treasury revenues, declined from R$18.5 billion in 2002 to R$7.9 billion in 2003.

Revenues x Debts – Federal Government
% GDP

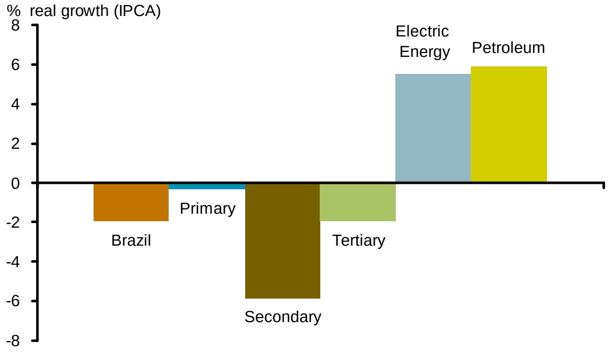


Total outlays, net of transfers to the states and municipalities, added up to R$257.8 billion, for growth of 10.5% in the year, representing 16.92% of GDP, compared to 17.42% in 2002. Outlays on the Social Security System came to R$107.1 billion, for growth of 21.7% in the year, while outlays under the responsibility of the National Treasury dropped by 1.1% to R$143.7 billion. Treasury outlays are composed of two major components, "personnel and social charges" and "current and capital expenditures". Though these two headings closed with nominal growth of 6.5% and 0.3%, respectively, when viewed against 2002, they declined by 0.35 p.p. and 0.63 p.p. as proportions of GDP, in the same order.

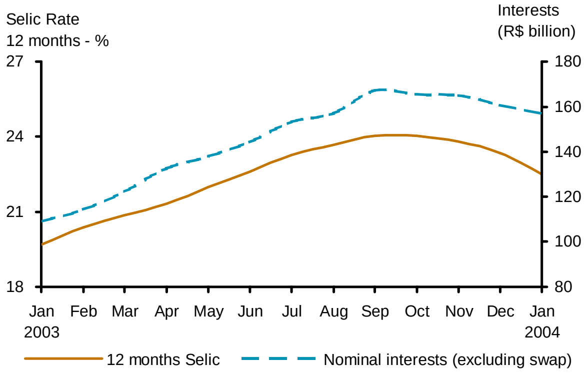
Insofar as the result for regional governments is concerned, there has been a steady process of implementation of measures targeted to compliance with the parameters defined by the Fiscal Responsibility Act, particularly as

ICMS Inflow 2003

Total and by sectors



Selic rate x Appropriated interests



regards fiscal equilibrium, management of outlays aimed at maintaining the operations of the public sector and compliance with indebtedness limits. These measures were crucial in offsetting losses of ICMS revenues and those consequent upon constitutionally dictated transfers. These items, which are the major revenue headings of subnational governments, registered a real decline of 1.9% and 7.1%, respectively, using the IPCA as deflator.

Consequently, just as occurred at the level of the Central Government, the results registered by regional governments were a consequence of adequate management of outlays. This is taken as evidence that there has been qualitative improvement in the implementation of fiscal adjustment policies which have not only taken on a lasting character, but have also been contributing to enhanced efficiency in economic performance by hampering adjustments based on revenue expansion.

In January, the consolidated primary public sector surplus came to R$7 billion. In the composition of this result, the Central Government and regional governments contributed with respective surpluses of R$7.2 billion and R$1.8 billion, while state companies registered a deficit of R$2 billion. This result suggests compliance with the target of R$14.5 billion defined for the first quarter.

The initiative taken by the central government to adjust the budget to the annual surplus target of 4.25% of GDP, by making a preventive cutback of R$6 billion in the limit authorized for discretionary spending, deserves to be underscored. These expenditures will now depend on compliance with the macroeconomic parameters defined in budget law and their impacts on inflow in the period.

Total nominal interest appropriated in 2003 came to R$145.2 billion, or 9.49% of GDP, compared to R$114 billion, or 8.47% of GDP in 2002. In January the total appropriated came to R$11 billion.

Among the factors responsible for the increase in nominal interest appropriated in 2003, when compared to the previous year, the most important is the rise in the Selic rate from 18% per year in October 2002 to 26.5% per year in March 2003. The latter rate remained in effect up to July, when interest rates shifted into a downward curve. It should be noted that, when viewed in 12 month terms, the downward curve registered by the Selic rate began in November 2003. This movement was reflected in the behavior of the flow of interest appropriated on the debt in annual terms, with

Charging of the Contribution to the Financing of the Social Security System (Cofins) on Aggregate Value

Law 10,833, dated 12.29.2003, introduced various alterations into tax legislation, with particular emphasis on implementation of a new system of Cofins charging, on noncumulative bases.

The new charging model reflects demands for the modernization of the Social Security System's current expenditure system without, however, jeopardizing the volume of revenues produced by the contribution, in strict compliance with the Fiscal Responsibility Act. As a matter of fact, a basic premise of the model is maintenance of the same collection level registered up to January 2004, at the same time in which it redistributes the tax load among the various sectors of the economy. Aside from this, elimination of cumulative levying of the contribution over the entire productive cycle has the objective of generating economic efficiency gains and enhanced competitiveness of national products.

The measures adopted reflected continued restructuring of the system of charging contributions on billings, a process that began with changes in PIS/Pasep legislation, as of 1.1.2003. The fact is that Provisional Measure 66, dated 8.29.2002 (converted into Law 10,637, dated 12.30.2002), which instituted the new base for levying this contribution, determined that the executive branch should send a bill to the National Congress by 12.31.2003, with the objective of making charging of Cofins noncumulative and, if necessary, introduce alterations into the PIS/Pasep rate (raised from 0.65% to 1.65%), in order to guaranty the same inflow level.

The generating fact of the noncumulative Cofins is overall monthly billings, defined as total revenues earned by the legal entity independently of its denomination or accounting classification. Considering that the new system presupposes compensation of tax credits granted in the previous stages of the productive chain, the tax rate was altered from 3% to 7.6% so as not to jeopardize the previous collection level. Utilization of credits on the calculation base refers to expenditures resulting from outlays on goods and services used as inputs (including electricity), goods for resale, diverse financial outlays, spending on rentals of buildings and machinery, among other expenditures inherent to the productive process.

Notwithstanding the basic premise of maintaining the overall inflow level, the measure has the effect of altering costs over the course of the productive chain, imposing a greater burden on the segments that form the initial stages of production or that aggregate greater value into the product/service, since these segments have the lesser volume of tax credits to offset at the time of payment. The opposite occurs for the segments situated at the end of the productive chain. Consequently, they can expect alterations in relative prices.

However, in order to minimize the impact and correct/avoid imbalances, some segments were excluded from the new charging model and will continue complying with the previous system: cooperatives; companies opting for the Simples tax system; financial institutions; private companies that operate in the area of guard services and transportation of values; legal entities subject to the income tax based on presumed or arbitrated profits (companies with monthly billings of up to R$4 million); public sector entities, semi-autonomous agencies and public foundations; legal entities immune to taxes; revenues taxed in a single stage or by tax substitution; companies dedicated to the purchase and sale of automotive vehicles; revenues consequent upon the rendering of telecommunications services and services rendered in journalistic and sound and image broadcasting companies; revenues related to contracts formalized prior to 10.31.2003; revenues resulting from the rendering of public transportation services (excluding air carrier); revenues consequent upon services rendered by hospitals, emergency hospitals, and the like; and revenues resulting from daycare, primary and secondary and university level education services.

One should further stress institution of the Cofins-Imports and PIS/Pasep – Imports (Provisional Measure 164, dated 1.29.2004, which had the purpose of giving equal tax treatment to goods and services produced internally and therefore subject to the levying of PIS/Pasep and Cofins and to imported goods and services. Charging of this contribution will go into effect as of 5.1.2004, with rates similar to those applied to goods and services produced internally: 1.65% and 7.6%, respectively.

Payment of contributions on imports may be offset in the contributions due by companies subject to noncumulative levying of the tax, in the cases of goods acquired for resale; goods and services used as inputs in the rendering of services and in production or manufacturing of goods and products for sale, including fuels and lubricants; electricity consumed in the facilities of the legal entity; rentals and payments in the leasing of buildings, machines and equipment used in the company's activity; and machines, equipment and other goods incorporated into fixed assets, acquired for utilization in the production of goods for sale or the rendering of services.

exception of the result of exchange swap operations, which have registered downward movement that is expected to continue in the coming months.

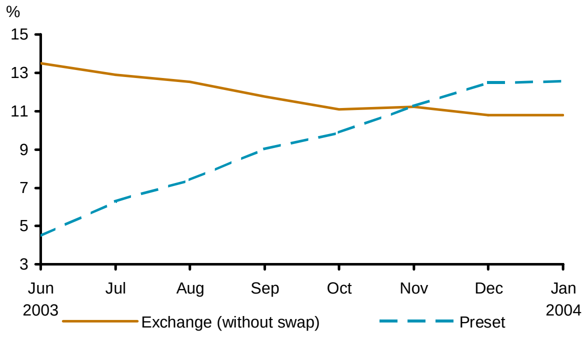
In the nominal concept, public sector borrowing requirements, which encompass the primary result and nominal interest accumulated, registered a deficit of R$79 billion, or 5.16% of GDP in 2003, as against R$61.6 billion, or 4.58% of GDP in 2002. In the month of January, the deficit totaled R$4 billion, corresponding to 3% of GDP in that month, dropping to 4.79% of GDP in 12 months.

With respect to the major sources of financing of the nominal deficit accumulated in the year, the bank debt and external financing registered contraction of R$31.4 billion and R$15.5 billion, respectively, and the securities debt increased by R$122.4 billion.

Federal securities debt

Evaluated in terms of the portfolio position, the federal securities debt increased from R$717.9 billion, or 46.5% of GDP in October 2003, to R$737.3 billion or 46.7% of GDP in January 2004. Among the factors that contributed to this growth were net redemptions of R$11.2 billion on the primary market, incorporation of interest and 3% depreciation of the real against the dollar.

Federal securities debt
Participation by indexing factor



The share of the federal securities debt indexed to the dollar remained stable, with R$79.6 billion in January, considering that net exchange redemptions of R$4.8 billion offset the incorporation of interest and the impact of depreciation of the real against the dollar. In the period, the participation of exchange securities in the total federal securities debt dropped from 11.1% to 10.8%, while the participation of preset debt increased from 9.9% to 12.6% and that referenced to the Selic rate moved from 64.3% to 61.3%.

In January, swap operations came to R$75 billion, compared to R$94.3 billion in October. Defined as the difference between DI profitability and exchange variation plus coupon, the result of these operations in the quarter was favorable to Banco Central in a total amount of R$97.7 million, based on the accrual criterion. Using the cash criterion, this result had a negative impact of R$222 million.

Net debt growth
Conditioning factors

Itemization	2002		2003		2004	
	December		December		January	
	R$ million	% GDP	R$ million	% GDP	R$ million	% GDP
Total net debt – Balance	881 108	55.5	913 145	58.1	921 854	58.2
Flows	**Accumulated in the year**				**January**	
Net debt – growth	220 241	2.9	32 037	2.7	8 709	0.0
Conditioning factors	220 241	13.9	32 037	2.0	8 709	0.5
PSBR	61 614	3.9	79 037	5.0	4 009	0.3
Primary	-52 390	- 3.3	-66 173	- 4.2	-6 950	- 0.4
Interest	114 004	7.2	145 210	9.2	10 960	0.7
Exchange adjustment	147 225	9.3	-64 316	- 4.1	4 473	0.3
Domestic securities debt[1/]	76 662	4.8	-22 722	- 1.4	1 394	0.1
External debt	70 564	4.4	-41 594	- 2.6	3 079	0.2
Others[2/]	753	0.0	16 712	1.1	227	0.0
Acknowledgement of debt	14 286	0.9	604	0.0	0	0.0
Privatizations	-3 637	- 0.2	0	0.0	0	0.0
GDP growth effect		- 11.0		0.6		- 0.5

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

Net public sector debt

The net debt of the nonfinancial sector totaled R$921.9 billion or 58.18% of GDP, in January 2004, compared to R$913.1 billion, or 58.15% of GDP in December 2003, and R$881.1 billion, 55.5% of GDP, in December 2002.

A breakdown of the major factors responsible for growth of 2.7 p.p. in the net debt for 2003 shows that borrowing requirements accounted for the addition of 5.03 p.p.; growth in the parity of the basket of currencies included in the net external debt was responsible for an increase of 1.06 p.p.; acknowledgement of debts for 0.04 p.p.; and the effect of valued GDP growth, for 0.62 p.p.. In the opposite sense, the impact of exchange appreciation accumulated in the year contributed to a reduction equivalent to 4.10 p.p. in the period.

In the month of January, the debt/GDP ratio remained stable, considering that increases corresponding to borrowing requirements, 0.25 p.p. of GDP, and to the impact of exchange depreciation in the month, 0.28 p.p. of GDP, were neutralized by the effects of valued GDP growth, -0.51 p.p. of GDP.

3.4 Conclusion

The slight growth in financial system credit operations in the quarter ended in February of this year was a consequence of seasonal factors that are characteristic of the period. This is a time of the year in which business demand for resources is normally less intense and the pace of productive activity is slowly beginning to expand. Consequently, household financial commitments were the factor that drove the more significant demand for credit, though it should be stressed that growth in this type of operation, which began in the final quarter of 2003, has been powered basically by demand for consumer durables which, in its turn, evinces the positive impact of the more flexible monetary policy adopted, expressed as lower interest rates and bank spreads on the sales of this sector.

Aside from these points, emphasis should be given to the impact of the system of payroll loans as well as of the steady drop in the default rate on the formation of an environment that is more propitious to consistent growth in bank credits. The growing participation of the modality of personal credit in the volume of overall credits targeted to individual persons, coupled with longer terms for these operations, suggests a process of migration of short-term credits away from special overdraft checks.

The government's initiative to adjust budget programming, including a preventive cutback in current expenditures, clearly ratifies its commitment to fiscal policy objectives, particularly regarding the primary surplus target defined for the year. It is important to perceive that the January result signaled compliance with the surplus target for the first quarter, particularly when one takes the seasonal behavior of the major revenue and expenditure headings into account.

For the medium and long-term, the tendency is continuity of fiscal equilibrium at all levels of government, with greater emphasis on management of outlays, including the application of legal provisions that inhibit practices that compromise the efficiency of public sector outlays, viewed specifically in the context of the guidelines set down in the Fiscal Responsibility Act. Furthermore, emphasis should also be given to the impact of the measures adopted as a result of implementation of the Social Security reform approved by the National Congress. The measures included in the reform have already begun generating positive impacts on the fiscal performance of the different levels of government.

On the revenue side, the current tendency is toward continued implementation of policies compatible with the objectives of economic growth and stability. Based on the framework defined by the recently approved tax reform, the objectives are now defined as the pursuit of increased tax system efficiency and reductions in taxes on the productive system.

As far as the debt/GDP ratio is concerned, the downward movement of interest rates on the debt, coupled with a positive outlook for economic growth, leads to the conclusion that this ratio will now follow a declining trajectory.

International economy

4

The final quarter of 2003 and early months of 2004 witnessed a gradual process of world economic recovery, evident in more rapid international rates of GDP expansion and increased manufacturing output. The uncertainties rooted in the war in Iraq and the spread of the Severe Acute Respiratory Syndrome – SARS that marked the first half of last year had dissipated and practically disappeared by the end of 2003. The dynamic center of the process – a position occupied by the United States and the emerging Asian nations – managed to consolidate growth in the fourth quarter and, from that point forward, began a consistent process of drawing other economies into the process through increased trade operations.

Stimulated by expansionary monetary and fiscal policies, world economic growth has been accompanied by low inflation and gradual labor market recovery in the wealthy nations and developing world. According to the International Labor Organization (ILO), the number of jobless people reached 185.9 million in 2003, corresponding to 6.2% of the economically active world population.

In general, emerging markets continued to benefit from high levels of financial market liquidity and a steady decline in risk premiums. Maintenance of responsible economic policies, coupled with efforts to strengthen economic fundamentals, have resulted in more positive international financial market evaluations of these economies. This factor, taken together with progressive improvement in the world macroeconomic scenario, has significantly improved the access of these countries to external financing. It is now expected that the flow of foreign direct investments to these economies will expand in 2004. Aside from this, solid recovery has occurred in the prices of farm commodities and basic metal goods, making it possible for these countries to draw enhanced benefits from international trade.

4.1 Economic activity

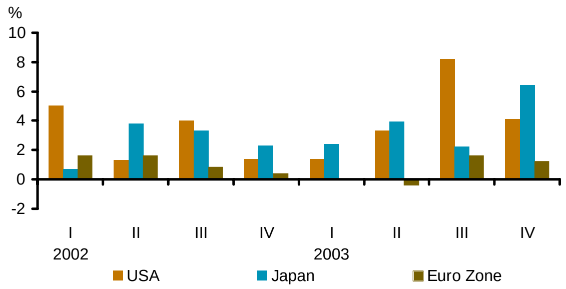
Signs of recovery in the pace of world economic activity became clear in the final months of 2003 and early part of 2004. GDP growth rates in the fourth quarter remained positive in the developed economies. In the United States, GDP expanded by 4.1%, while Japan achieved a level of 6.4%, more than double the average registered in the six previous quarters. Growth in the same period was somewhat slower in the Euro zone, where GDP expanded by 1.2% in annualized terms.

Despite relative deceleration in the previous quarter, GDP growth in the United States remained high and further reinforced the perception that continued implementation of expansionary fiscal and monetary policies will further stimulate economic activity. However, at the same time, there are lingering doubts with regard to the pace of reaction in the job market, which registered only very gradual recovery in the early months of 2004. Though there was some degree of reduction in the jobless rate, this was more a consequence of a decline in the economically active population than an increased supply of employment positions. As a matter of fact, the number of workers listed on payrolls expanded only slightly in the final months of 2003, while average salaries declined over the course of the entire year.

The most recent indicators released in the United States confirm the continuity of the process of economic recovery. Activities in the real estate sector have been intense, particularly as a result of low mortgage rates, while consumer spending has remained strong, as the manufacturing sector has shown more consistent signs of recovery. In their turn, indicators of expectations moved consistently upward during all of 2003 before dropping somewhat in the early days of 2004. The latter reaction seems to have been more a reflection of concern on the part of consumers at job market results.

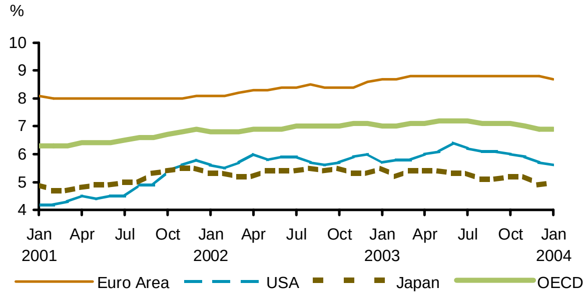
Over the medium-term, the sustainability of United States economic growth will depend on the fiscal and current accounts deficit. So far, these imbalances have not had significant impacts, since large scale acquisitions of American securities by the major Asian economies have made it possible to finance these deficits with relative ease. Another source of uncertainty has been the possibility of an increase in the basic interest rate, as a result of subsequent increases in the level of activity. However, any change in monetary policy will depend directly on a more positive job market performance.

GDP[1/]



Sources: Bureau of Economic Analysis, Economic Planning Agency, Eurostat
1/ Quarterly growth. Seasonally adjusted annualized rate.

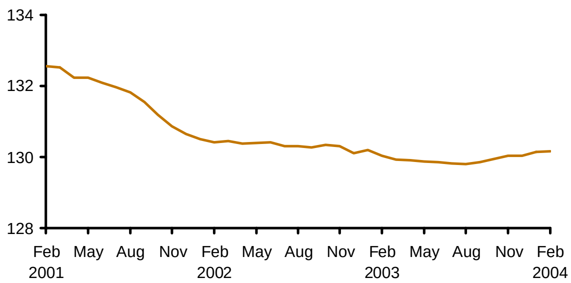
Unemployment rate



Sources: Eurostat, Bureau of Labor Statistics, Ministry of Public Management of Japan, OECD

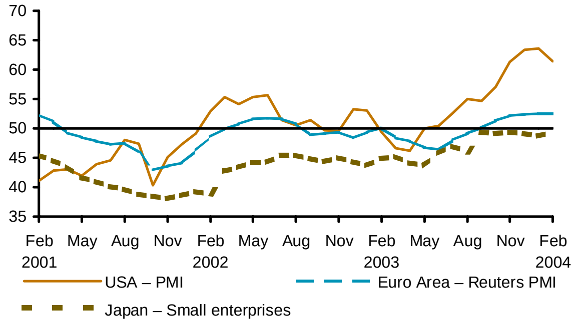
USA – Non-farm payrolls

Millions of workers



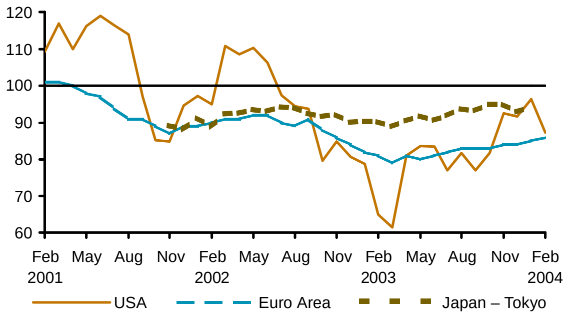
Source: Bureau of Labor Statistics

Business confidence



Source: Institute for Supply Management (ISM), Reuters, Shoko Chukin Bank

Consumer confidence



Source: Conference Board, European Comission, Economic and Social Research Institute

Moderate growth in the euro zone economy has continued and, despite accentuated appreciation of the euro against the dollar, has been driven mostly by external demand. Reductions in volatility consequent upon a downturn in the rate of exchange would contribute to stimulating the still fragile recover in internal demand. Positive evolution in business sector expectations continued up to the end of 2003 but was interrupted in the early months of 2004. At the same time, consumer confidence remained negative, primarily as a result of persistently high jobless rates.

In Japan, economic growth was driven by substantial expansion under exports and fixed investments. However, the overall scenario of deflation continues, despite the steadily increasing liquidity offered by the Bank of Japan (BoJ). On the other hand, business profitability recovered sharply, to some extent reflecting the ongoing process of corporate restructuring under way at a number of major companies. Industrial production has expanded steadily, accompanying a slight rise in internal demand. The trajectories of the various expectation indicators remained positive both among large corporations, which have benefited from greater exports, and even among small businesses, which concentrate their activities primarily on the internal market. It is estimated that the pace of GDP growth will slow in the first quarter before picking up speed in the following period. Over the long-term, the sustainability of the recovery process is linked to confirmation of projections of rapid growth in major external partners and to exchange rate behavior, since exchange appreciation has been attenuated by government market interventions. The high public debt, an increasingly more elderly population and the fragilities that remain in the financial system are still important risks that will only be overcome if the process of economic growth is maintained for a considerably longer period of time.

Chinese GDP expanded sharply in 2003, closing with 9.1%. This performance coincides with recent concerns regarding the possibility of strong growth in the monetary base and consumer and business loans resulting in an overheated economy. At the same time, the economy was marked by important imbalances caused by high levels of idle capacity in various sectors, intense activity in the real estate market and a high volume of bad banking system loans. In this context, China could become a major source of instability, with repercussions on the level of world economic activity and commodity prices. The sustainability of the current pace of growth depends on the exchange rate trajectory as demand for appreciation, considered an instrument capable of restoring global balance in trade flows, has intensified.

In Latin America, the Argentine economy has registered rapid recovery, with annualized GDP growth of 8.7% in the third quarter of 2003. This was the best quarterly result since 1996. The monthly estimator of economic activity registered accumulated growth of 8.4% in 2003. Activity indicators point to the fact that the process of economic recovery continued into the early months of 2004. Above all else, growth in the activity level occurred in the industrial sector, particularly as a result of its strong export performance. Unemployment has followed a downward curve, though the third quarter result in 2003 was still a rather high 14.5%.

4.2 Monetary policy and inflation

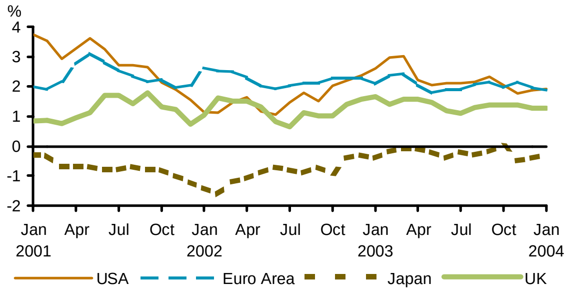
Though it came as no surprise when the Federal Open Market Committee (FOMC) decided to hold the target for fed funds unchanged at 1% per year, the communiqué released by that body at the close of its meeting provoked some degree of nervousness in financial markets, giving the impression that the cycle of a more relaxed monetary policy was nearing its end. Core consumer inflation remains low at just over 1% per year, though the risk of deflation now seems to be increasingly distant, primarily as a result of consolidation of the economic recovery and the passthrough of depreciation of the dollar.

The European Central Bank (ECB) once again resisted political pressure and held the Euro zone's basic interest rate at 2% per year in the month of March. Pressure to reduce interest was further intensified by estimates of February inflation, which indicated a drop in accumulated 12 month consumer inflation to 1.6%, the lowest level of the last four years. The decline under several indicators of business expectations at the start of the year is expected to further strengthen pressures for some form of additional monetary incentives. Given the already depressed level of interest rates, such a measure would represent one of the last resorts to conventional monetary policy instruments still available to the ECB.

Though the signs of Japanese economic recovery were confirmed over the course of the quarter, the BoJ raised the current account target for banks from ¥27-32 trillion to ¥30-35 trillion. This more active monetary policy reflects intense BoJ exchange market sales of yen, as a way of attenuating pressures to appreciate local currency against the United States dollar. The Ministry of Finance revealed that ¥7.2 trillion (US$67 billion) were injected into money

Consumer inflation

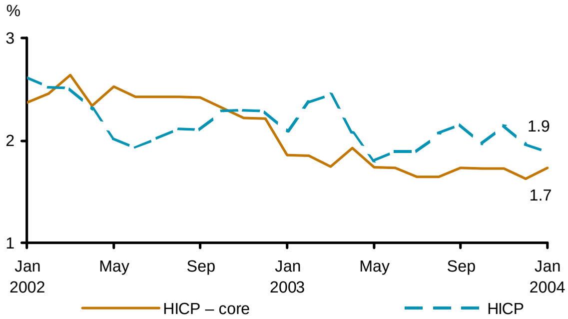
Annual growth



Source: Bureau of Labor Statistics, Eurostat and Bloomberg

Consumer inflation – Euro Area

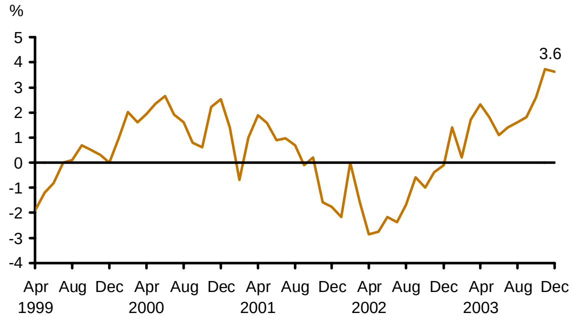
Annual growth



Source: Eurostat

markets in January alone. This was the largest monthly intervention in history and was equivalent to 2/3 of total interventions in 2003. However, the dual reality of debt-deflation continues obstructing monetary policy transmission channels. Thus, despite annualized real GDP growth of 3.4% in the fourth quarter, the GDP deflator in the period diminished by 2.7% in annual terms. In the case of consumer prices also, deflation has yet to show signs that it is running out of steam, despite the fact that the core is gradually nearing zero. Thus, it is difficult to avoid a prognosis that the BoJ should continue its zero interest policy for a reasonable period into the future.

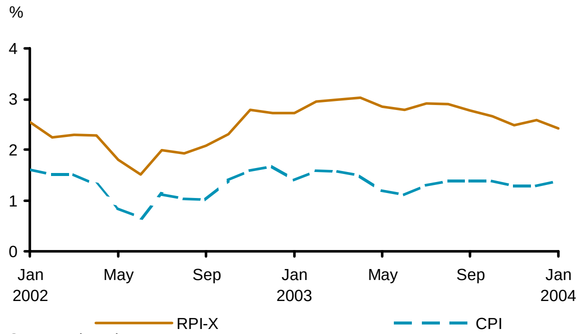
Consumer inflation – China
Annual growth



Source: Bloomberg

In China, inflation has moved into an upward curve, reaching a level of 3.6% at the end of 2002, despite the fact that it had been held in check up to 2003 and, at given moments, had even given way to deflation. With a system of fixed exchange in relation to the United States dollar, the monetary policy followed by the Central Bank of China has been characterized by strong expansion evident in the intense process of accumulation of international reserves. This scenario of accumulating of reserves – it should be added – is a characteristic common to the entire Asian region and particularly to Japan. Should the signs of an overheating of the Chinese economy multiply – as some analysts have warned in light of strong growth in credit and real estate speculation – pressures for appreciation of the yuan will become more intense. In any case, alteration in the exchange parity used in China will certainly result in a general realignment of exchange rates throughout Asia, even though the alteration will not include modification of the basic exchange system. However, provided that the process be coordinated by central banks, this broad realignment will not necessarily take on critical proportions.

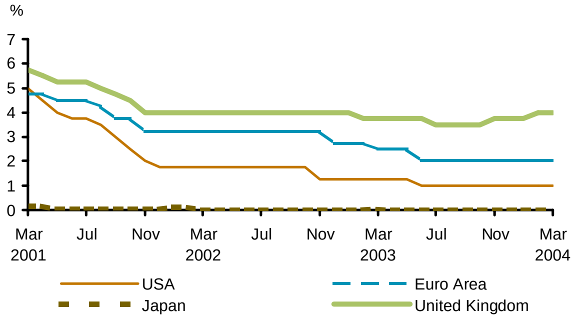
Consumer inflation – United Kingdom
Annual growth



Source: Bloomberg

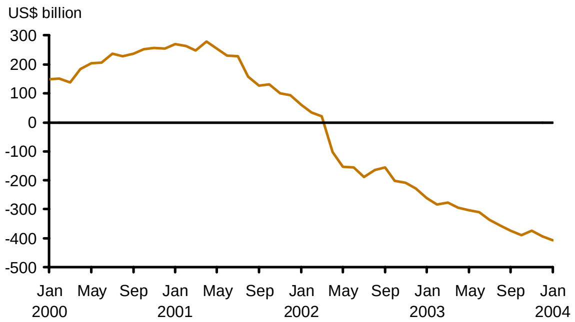
Analysis of the world's major economies indicates that only the United Kingdom has begun raising interest rates. In February, despite a favorable inflation scenario, the Bank of England (BoE) did just what the market had anticipated and raised basic rates to 4% per year. At the same time, the Harmonized Consumer Price Index – the new price index used in the inflation targeting system – was well below the 2% per year target and quite close to the lower parameter of 1% per year. This apparent contradiction is justified by the Bank of England on the basis of the allegation that the monetary policy transmission mechanism in that country is particularly slow, demanding periods as long as 18 months. Consequently, the economy of the United Kingdom is still under the impact of the monetary incentives that marked the recent period in which interest rates had fallen to their

Official interest rates
Annual rates



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

USA – Fiscal balance
In accumulated terms for 12 months



Source: Department of the Treasury

lowest level in the last forty five years. Thus, the preventive measure taken by the central bank is explained by the need to make the expected inflation trajectory converge with the official target over a period of 1.5 to 2 years. However, the true objective of the monetary authority seems to be that of gradually deflating the real estate market bubble that was formed in the environment of abundant and cheap credit in recent years. With this, among the central banks of the major economic areas, the Bank of England is expected to generate the most accentuated – albeit smooth – reversal in its monetary policy posture in the current year.

4.3 Fiscal policy

The public deficit in the United States remained high even considering the initial impact of the fiscal package implemented in mid-2003. In the first four months of fiscal year 2004 which began in October 2003, the budget deficit came to US$130 billion or US$32 billion more than in the same period of the previous fiscal year. Over the course of coming months, the expansionary fiscal policy is expected to continue. Government forecasts for the 2004 fiscal year, formulated by the Congress and by the White House Office of Management and Budget, point to deficits of US$477 billion and US$527 billion, respectively. These deficits have been consistently financed through acquisitions of United States Bonds by the major East Asian economies, particularly Japan and China. It is estimated that Japanese purchases of American securities came to US$100 billion in the first two months of 2004.

In the euro zone, the fiscal deficits of the major economies also remained high, when compared to the ceiling of 3% of GDP determined by the Stability and Growth Pact. In Germany and France, preliminary estimates point to public deficits of 3.9% and 4%, respectively, in 2003. For the current year, estimates point to 3.25% of GDP for Germany and 3.6% of GDP for France. In Italy, the deficit increased from 2.3% in 2002 to 2.4% of GDP in 2003. In November, the European Council decided to accept the commitments assumed by Germany and France to reduce their deficits to less than 3% of GDP by 2005, at the latest. However, in February 2004, the European Commission considered the programs presented by the two countries, detailing their strategies for complying with their commitments, to be insufficient, given the risk that the forecasts of reductions in expenditures and positive GDP growth may not be achieved. At the same time, according to the Commission, the programs that extend through the period from 2003 to

2007 do not ensure that the target of budget equilibrium will be attained by the end of the aforementioned period.

4.4 International financial markets

Financial markets remained on a stable trajectory over the course of the first quarter and accompanied the signs of renewed economic activity in the industrialized economies. The Institute of International Finance (IIF) raised its estimate for net flows of private capital to the emerging countries. For 2003, the estimate closed at US$187.4 billion, for growth of approximately US$63 billion when compared to 2002. Of this total, Latin America is expected to receive US$26.4 billion or 14% of the total. For 2004, the forecast is that capital flows to the emerging economies will rise to US$196.2 billion, of which US$38.7 billion will be channeled to Latin America and US$96.7 billion to Asia.

International liquidity and the low level of risk aversion on the part of investors continued benefiting emerging markets, particularly at the start of the current year when the Emerging Markets Bond Index (EMBI+), which is a proxy used by the JP Morgan bank to measure emerging market risk, came to its lowest levels since 1998. Taking advantage of this extremely favorable environment, the emerging nations made sovereign issues totaling US$12.2 billion in January, with longer terms and exceptionally low spreads.

In the month of January, the communiqué issued following the FOMC meeting was initially interpreted as a sign that the American central bank would soon reverse the trajectory of its monetary policy. This resulted in a brief period of instability reflected in a slight rise in the premiums associated with higher risk asset investments. In this context, the steady downward movement of the EMBI+ was interrupted and its volatility increased. However, at the end of February, the indicator still stood at a historically very low level of around 450 points.

In the case of the fixed income market, the release of the FOMC communiqué did not alter the long-term interest curve in major international financial centers. Once the initial nervousness had been dissipated, American Treasury bonds continued paying the lowest levels of interest of recent years, partially reflecting strong demand on the part of Asian central banks. Obviously, a downturn in Asian demand coupled with a more resolute move toward a more contractive posture on the part of the Fed could generate pressures on Treasury

Net capital flows to emerging economies

US$ billion

Itemization	2001	2002	2003[1/]	2004[1/]
Private flows	126.6	124.2	187.4	196.2
Latin America	49.4	18.6	26.4	38.7
Direct Investment, net	139.8	112.1	93.6	110.7
Latin America	57.7	34.7	26	29.1
Private portfolio investment, net	7.7	1.1	30.3	28.6
Latin America	-0.7	-0.2	-2.5	-0.7
Others private flows	-20.9	11.0	63.5	56.9
Latin America	-7.6	-15.9	2.9	10.3
Official flows	11.2	-4.6	-12.9	-9.8
Latin America	22.6	7.4	3.0	-1.8

Source: IIF – January 2004

1/ Forecast.

Emerging markets sovereign net issues [1/]

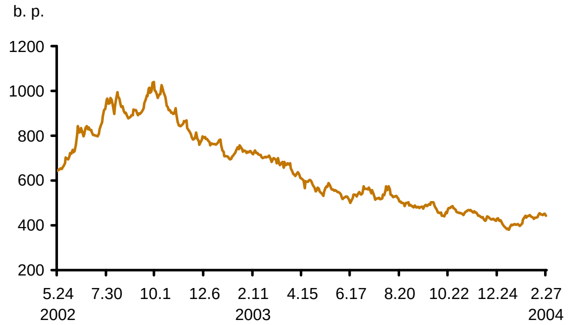
US$ million

	Total amount issued
Turkey	2 750
Mexico	1 920
Poland	1 920
Brazil	1 500
Hungary	1 250
Venezuela	1 000
Chile	600
Panama	576
Colombia	500
Costa Rica	250

Source: Bloomberg

1/ Data from January 2004.

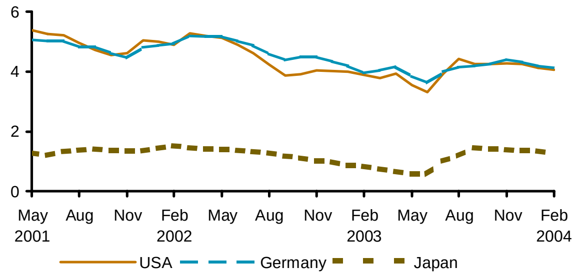
Emerging Markets Bond Index (Embi+)



Source: Bloomberg

Yield on Treasury bonds[1/]

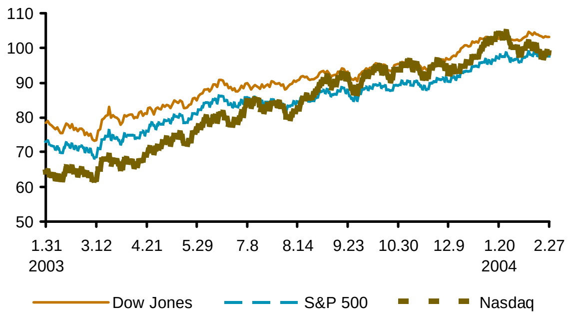
% per year



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

Stock exchanges – USA

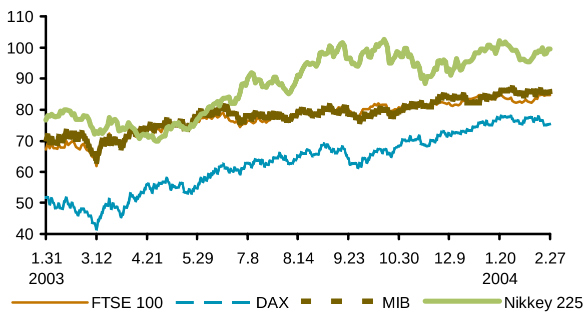
1.4.2002=100



Source: Bloomberg

Stock exchanges – Europe and Japan

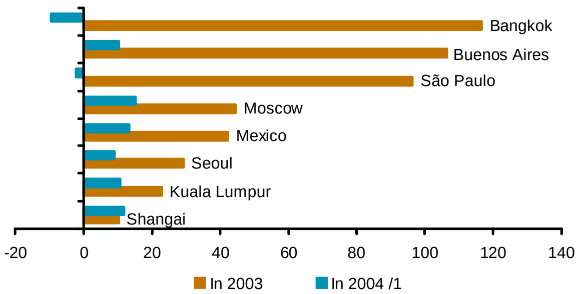
1.4.2002=100



Source: Bloomberg

Stock exchanges – Emerging markets

% change in local currency



Source: Bloomberg
1/ Data until February 2004.

bond earnings, particularly in the case of shorter term papers. In Europe and Japan, the need for monetary incentives to sustain the economic growth cycle has maintained short-term interest at a low level, with no greater alterations in the long-term trajectory.

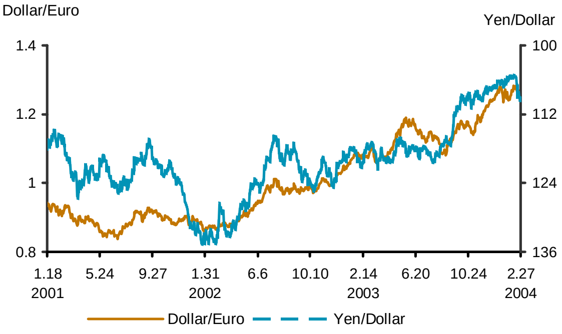
In the United States, the positive performance of corporate profits in the final quarter of 2003 was not sufficient to sustain vigorous stock market growth in the first quarter of the year. Uncertainties surrounding the Fed's activities, particularly following release of the January 28 communiqué, generated additional uncertainties, since increases in interest rates on American securities could generate shifts in investor portfolios toward fixed income assets. In this context, the Dow Jones Industrial Average (Dow Jones) and Standard & Poor's 500 (S&P 500) registered stability in the January-February period. The indicator of the National Association of Securities Dealers Automated Quotations (Nasdaq), however, was more significantly impacted by the Fed communiqué and has been considerably more volatile since the end of January.

Just as in the United States, European stock markets turned in a stable performance in the first quarter. In Italy, the outbreak of the Parmalat scandal and the subsequent suspension of trading in that company's stock in December, did not lead to a loss of investor confidence in relation to variable income securities, as is demonstrated by growth in the Milan Stock Market Index (MIB). In Japan, strong upward movement in the stock market in the second half of 2003 did not continue into the early days of 2004, to some extent as a result of the poor performance of banking sector stocks.

In the emerging markets, stock market growth in the first quarter demonstrated that the positive environment persisted, though some markets, such as those of São Paulo and Bangkok, that had registered strong positive growth during the entire previous year, registered devaluation between mid-January and the end of February. Though internal factors have influenced the performance of these stock markets, the reversal in market performance, when compared to the previous year, suggests a process of profit-taking on the part of investors.

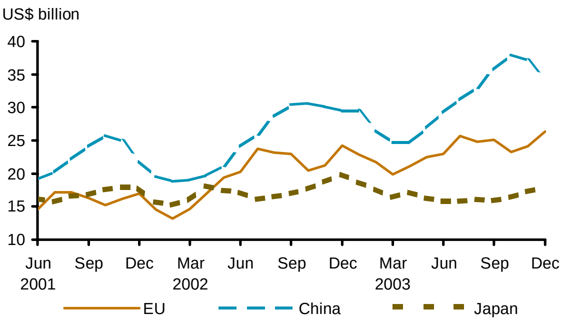
Exchange markets were characterized by strong volatility, as the dollar remained on a downward trajectory against the world's major currencies. From the start of September 2003 to the end of February of this year, the euro and the yen appreciated in nominal terms by respective rates of 13% and 6% against the United States dollar. Compared to the

Dollar exchange rates



Source: Bloomberg

Trade deficit – USA[1/]



Source: Bloomberg
1/ Quarterly moving average.

Japanese currency, greater appreciation of the euro against the dollar reflects the different postures adopted by their respective central banks. In this sense, the ECB allowed exchange to fluctuate freely without directly interfering in rates, while the BoJ maintained a policy of active exchange market intervention with the objective of preserving the value of the Japanese currency, coupled with intense accumulation of foreign currency reserves.

The declaration issued by the G-7 finance ministers following their February 2004 meeting reiterated the fact that exchange rates must reflect market fundamentals, in an obvious reference to the Asian countries, particularly China. Despite the fact that abrupt changes in the Chinese exchange system are not expected over the short-term, China has signaled in recent months that it would be willing to move toward some degree of flexibility.

The decision to alter exchange parity, however, will more than likely be part of a broad set of government policies that would include, among other factors, partial liberalization of the balance of payments capital account and wide-ranging restructuring of the very fragile banking system. The caution shown by Chinese authorities is rooted in a sense of wariness regarding the impact of currency appreciation on the dynamics of the economy.

4.5 World trade

The growth registered in global trade flows was a consequence of recovery in the world economy. Strong demand for imports was basically sustained by recovery in the United States economy and by the increased dynamism of the Asian economies where demand, principally in China, has generated upward pressures on the prices of the major commodities.

In the United States, growth in imports of goods was greater than under exports, generating an increase of US$3 billion in the trade deficit to a level of US$139 billion in the final quarter of 2003, when compared to the immediately previous period. It is important to note that expansion in trade flows occurred under both value and volume. It is important to underscore that, in terms of the volumes of capital goods exports and imports, expansion in annualized terms came to approximately 30%, thus confirming the ongoing process of recovery in the world economy coupled with larger outlays in the capital goods sector.

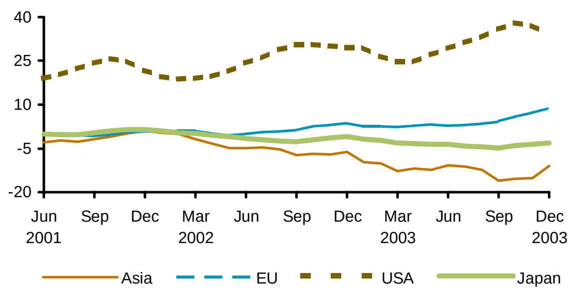
The trade flows of the Euro zone countries registered evident recovery, as the process of economic recovery in the region was driven by exports. Despite this, imports increased at a higher pace than exports and contributed to a reduction in the trade surplus for the fourth quarter of 2003 to a level of €17.5 billion, when compared to the previous quarter. Stronger external demand reflected renewed economic growth in the United States and in the emerging countries of Asia, thus limiting the negative impacts of appreciation of the euro on foreign trade. Strong trade exchanges among the countries of the region, including approximately 60% of their exports, and inelastic demand for such products as automotive vehicles, machinery and chemical products, acted in the same sense.

Japan's trade flow demonstrated the nation's positive export performance in the final quarter of 2003. The trade balance surplus increased by 27.9% compared to the third quarter, reaching a level of ¥3179.5 billion (approximately US$29 billion). In annualized terms, exports expanded by 9.7% in the quarter, despite appreciation of the yen, and clearly reflected the ongoing process of world economic recovery. On the other hand, even in this scenario of upward movement in the value of the yen, imports – expressed in annualized terms – dropped by 7.4% in the quarter. Asia continued as the principal supplier of goods to Japan.

The trade surplus registered by the emerging Asian countries expanded in the final months of 2003 and was powered by strong growth in exports, particularly on the part of China. The Chinese surplus reached RMB$135.2 billion (US$16.3 billion) in the final quarter of 2003, representing a gain of 57.3% over the same period of 2002.

Trade balance – China[1/]

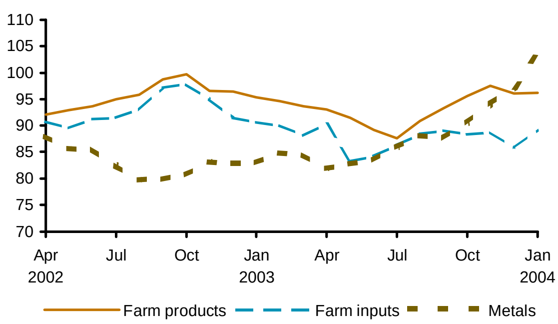
US$ billion



Source: Bloomberg
1/ Quarterly moving average.

Commodity price index in SDR

1995 = 100



Source: International Monetary Fund

4.5.1 Commodities

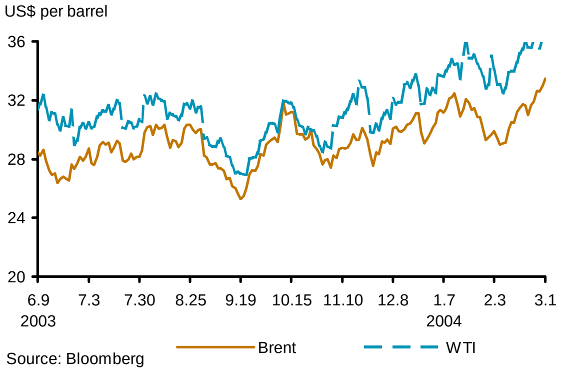
The commodities market has continued benefiting from rising world demand, particularly Chinese imports of raw materials and farm goods. The Reuters CRB[5] commodities index, which is a basket of prices composed of 17 commodities from the sectors of energy, grain, metals and other raw materials, increased by about 10% since the start of the year and was mostly impacted by increases in the prices of metals and energy. Since they are quoted in dollars, the prices of the major commodities reflect that currency's depreciation. However, even when the impact of exchange devaluation is purged, it is evident that commodity prices turned sharply upward as of the third quarter of 2003.

5/Commodity Research Bureau.

Growing world demand has, in fact, created space for price increases. With strong Chinese demand, iron ore exporters were able to raise their prices by about 18% in the early months of the year. This was the sharpest increase in ten years. Copper prices have also moved rapidly upward, registering a rise of 30% since the end of last year.

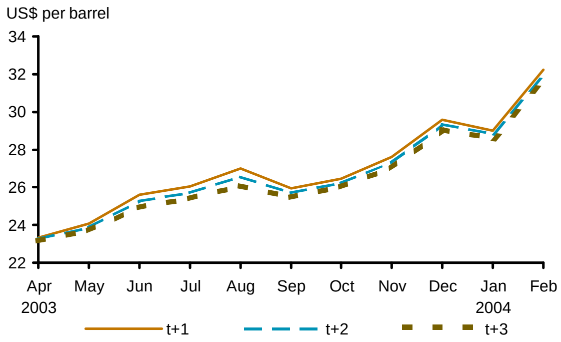
Forecasts released by the United States Department of Agriculture (USDA) indicate that 2004 will witness the lowest level of US meat exports in the last 25 years. In the wake of the occurrence of mad cow disease in the American herd, the USDA reduced its estimate of shipments from 1.2 million tons to 100 thousand tons of meat. Discovery of the disease could generate additional pressures on the already strong soybean market, since this grain is expected to be used to substitute the animal origin components found in the feed given to cattle herds. Soybean prices negotiated in the first quarter of 2004 are approximately 50% higher than those registered in the third quarter of 2003. Asian demand, coupled with world economic expansion, has consistently pressured the upward price movement evident in futures contracts and, despite the outbreak of Asian flu, China is expected to increase its imports of this grain. Given the adjusted demand and supply scenario, prices are expected to remain high until the next United States harvest.

Oil – Spot market



Source: Bloomberg

Brent Oil – Futures market



Source: Bloomberg

4.5.1.1 Petroleum

Oil prices remained high in the first quarter of 2004 as a result of higher consumption and low stock levels in the United States. These stocks had been recovering but have since become a source of concern as a result of the greater than expected severity of the American winter. Aside from this, on February 10 of this year, the Organization of Petroleum Exporting Countries (Opec), which accounts for about one third of world petroleum production, decided to reduce output by 1.5 million barrels per day (mbd), in order to comply with the previously specified and still unfulfilled production quota, while also defining a new output limit of 23.5 mbd – representing a cutback of 1 mbd in relation to the previous limit – to be achieved as of April.

Basically, this was a preventive measure taken to deal with the effects of seasonally lower than normal consumption in the second quarter of the year – when the winter season in the northern hemisphere comes to an end and prices tend to be lower – and of depreciation of the dollar. With the start of spring, it is expected that prices will move downward into the range of US$22 – US$28 per barrel, defined by

Opec as its target price range. Futures market prices reacted to the scenario of reduced supply, as monthly median prices in futures contracts due to mature in the coming three months moved upward in February.

4.6 Conclusion

The global economic outlook has improved considerably and now points to positive growth in 2004 world output, with a strong upward trajectory in the international merchandise trade, as evident in the sharp recovery of commodity prices.

At the same time, the outlook for inflation remains highly positive, despite small localized inflationary spurts of no greater importance. The absence of inflationary pressures has led the central banks of the major world economies to hold their short-term interest rates at their current levels.

In general, the overall scenario of continued low United States short-term interest rates and growth in the world's major economies can be highly beneficial to the emerging nations, to the extent that international liquidity is maintained and export operations can be expected to expand even further. Renewed growth on a world scale is a factor of decisive importance to stimulating capital flows, principally to those sectors that tend to draw benefits from economic recovery. At the same time, expectations are that recovery will begin generating positive impacts on the jobless rate.

However, it is important to note that the current scenario is not without risks. Excessive exchange rate volatility clearly does not favor economic growth. Up to the moment, initial impacts on markets, particularly currency markets, have been tenuous as the dollar has steadily depreciated, principally against the euro. Though the weak dollar creates a more favorable situation for the United States, it has negative consequences for recovery in the European and Japanese economies, both of which are highly dependent on exports. The reason for this is that, with a weakened dollar, the potential of fiscal and monetary incentives in these economies becomes practically nil. Even in the United States, depreciation of the dollar could cause additional price and cost pressure over the medium term, with added risks of inflation.

Insofar as capital flows to the emerging economies are concerned, the major risks are found in the short and medium-term stress that would result from a premature rise in United

States interest rates, though such an event is considered quite improbable over the short-term, and from political difficulties in the countries receiving capital. Taken together, such factors could generate considerable market fluctuation.

In general, continuity of the process of world economic recovery will depend on a harmonious conjugation of economic activity, government policies, exchange rates and external accounts and, principally, correction of the macroeconomic imbalances identified in economies that have taken the lead in powering world economic growth. More recently, the tensions generated by the terrorist attack in Spain clearly justify adoption of a more cautious stance, since one cannot ignore the possibility of further attacks against key centers of the world economy, capable of jeopardizing the scenario of world economic growth and demonstrating the vulnerability of the world economy to non economic events.

Foreign sector 5

The adjustments introduced into the Brazilian economy over the course of 2003 resulted in increasingly more positive expectations regarding the external sector. These more positive perceptions led to improved external credit conditions, making it possible to obtain returns on sovereign issues with increasingly smaller spreads, while also facilitating private sector access to external resources, with improved maturity and financial cost profiles.

The improved external results continued into the early months of 2004. With this, current accounts registered a surplus of US$1.2 billion in the quarter ended in February, compared to a deficit of US$145 million in the quarter ended in February 2003. When one considers the accumulated year-over-year balance, this account registered a surplus of US$5 billion in February, against a US$5.5 billion deficit in the corresponding month of the preceding year. The positive current account performance was, to a great extent, powered by the trade balance and, to a lesser degree, by a larger positive balance in unrequited transfers. Projections that the trade surplus will continue at a level similar to that of 2003, the surplus registered on the exchange market in the first two months of the year and the fact that the private sector managed to roll an increasingly greater share of its debts are all factors that make it possible to conclude that the outlook for the 2004 Brazilian balance of payments would seem to be quite positive.

5.1 Trade in goods

In the first two months of 2004, the balance of trade continued along the positive trajectory of recent months and, despite the fact that the first two months of the year had three less business days than in 2003, managed to set a new record for the period.

Trade balance – FOB

US$ million

Period	Exports	Imports	Balance	Trade flow
Jan-Feb 2004	11 521	7 951	3 570	19 473
Jan-Feb 2003	9 806	7 536	2 270	17 343
% change	17.5	5.5		12.3

Source: MDIC/Secex

Note: In Jan-Feb/2003, 42 working days; in Jan-Feb/2004, 39 working days.

Exports by aggregate factor – FOB

Daily average – January-February

US$ million

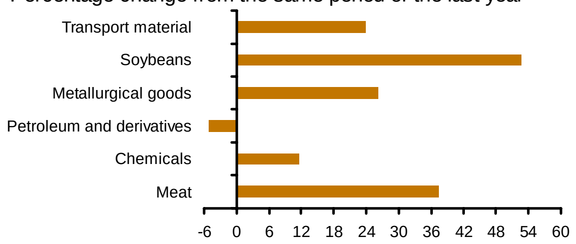
Itemization	Accumulated		
	2003	2004	% growth
Total	233.5	295.4	26.5
Primary products	59.1	86.1	45.7
Industrial products	169.7	204.5	20.5
Semimanufactured goods	41.7	47.9	14.8
Manufactured goods	128.0	156.6	22.4
Special operations	4.7	4.9	3.6

Source: MDIC/Secex

Note: In Jan-Feb/2003, 42 working days; in Jan-Feb/2004, 39 working days.

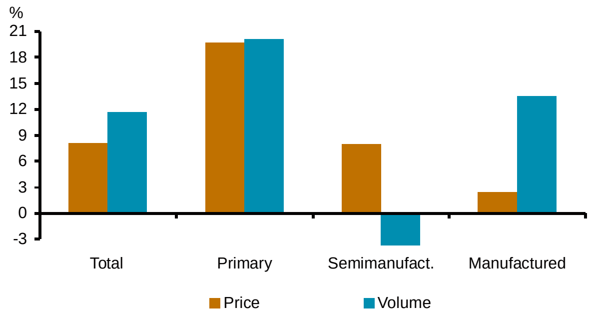
Exports by main sectors – FOB – January/February-2004/2003

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



Source: MDIC/Secex
1/ Daily average. In Jan-Feb/2003, 42 working days; in Jan-Feb/2004, 39 working days.

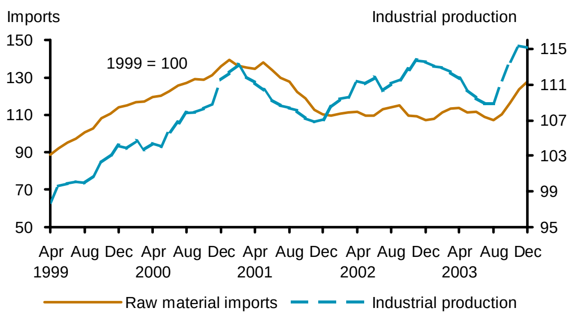
Exports – Price and volume index January-2004/2003



Source: Funcex

Raw material imports x industrial production

Seasonally adjusted indices – 3 month moving average



Source: IBGE and Funcex

Exports were driven by strong external demand for important Brazilian commodities, as well as by higher international prices. Among the factors that stimulated export growth in 2003, it is important to underscore increased trade with China and sharp recovery in exports to Argentina, together with across-the-board growth in world trade and maintenance of an effective exchange rate that was quite favorable to the export sector. This scenario suggests that 2004 will also register a strong trade surplus.

Exports expanded by 17.5% in the first two months of 2004, compared to the same period of the preceding year. Using the same basis of comparison, imports moved from US$7.5 billion to US$8 billion, for growth of 5.5%. Consequently, the surplus accumulated in the period reached US$3.6 billion, compared to US$2.3 billion in the first two months of 2003, while the trade flow increased by US$2.1 billion to US$19.5 billion.

In the two month period, median daily exports reached a level of US$295 million, for growth of 26.5% compared to the same period of 2003. Increases were registered in all categories, with 45.7% under basic products, 22.4% under manufactured goods and 14.8% under semimanufactured products.

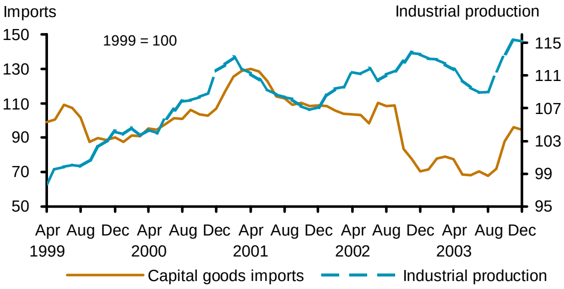
In the same sense, significant growth was registered in the median daily exports of the major sectors in the period, with particularly strong performances under soybeans, 52.6%, and meat, 37.3%. On the other hand, foreign sales of petroleum and derivatives declined by 5.2%.

With respect to the volume of exports in the month of January, data released by Funcex indicate 20.1% growth in sales of basic products and 13.5% in those involving manufactured goods, compared to the same month of the preceding year. Growth under manufactured goods was a consequence of expansion in the sales of products with only small levels of participation in overall sales. This performance is considered as a sign that the nation's exports are clearly diversifying. The volume of exports of semimanufactured goods declined by 3.7%, with reductions under foreign sales of iron alloys, 28%, cocoa butter, fats and oil, 23.3%, and raw cane sugar, 8.1%.

The prices of exports of basic products closed with an increase of 19.7% in January, compared to the corresponding month of 2003. This performance reflected intense world demand consequent upon the ongoing recovery process in the world's major economies. In the case of Median daily

Capital goods imports x industrial production

Seasonally adjusted indices – 3 month moving average



Source: IBGE and Funcex

Imports by end-use category – FOB

Daily average – January-February

US$ million

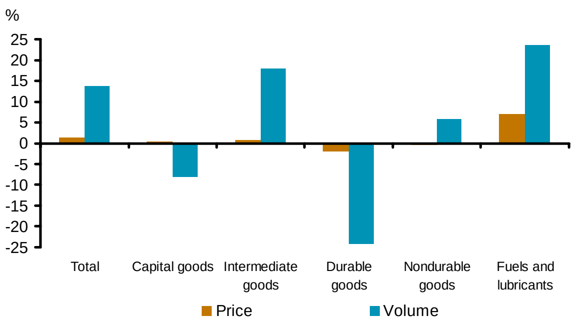
Itemization	2003	2004	% growth
Total	179.4	203.9	13.6
Capital goods	41.3	40.6	- 1.6
Raw materials	92.5	111.4	20.5
Naphtha	3.5	3.1	- 12.0
Consumer goods	20.5	22.8	11.6
Durable	9.9	11.3	14.5
Passenger vehicles	3.2	2.4	- 24.6
Nondurable	10.6	11.5	8.8
Fuels	25.3	29.0	14.9
Crude oil	15.0	19.2	27.7

Source: MDIC/Secex

Note: In Jan-Feb/2003, 42 working days; in Jan-Feb/2004, 39 working days.

Imports – Price and volume index

January-2004/2003



Source: Funcex

Exports to Argentina and other countries – FOB

Monthly average January-February 2004

% change[1/]

Itemization	Argentina	Other	Total
Total	92.4	19.9	23.5
Manufactured products	100.4	12.6	19.4

Source: MDIC/Secex

1/ Over the same period of the last year.

Note: In Jan-Feb/2003, 42 working days; in Jan-Feb/2004, 39 working days.

imports increased by 13.6% in the first two months of the year, compared to the same period of the previous year. Purchases of raw materials and intermediate products expanded by 20.5%, despite a 12% reduction in naphtha purchases. The result under this product category could mean increased growth in the industrial sector, with expanded utilization of installed industrial capacity. Purchases of fuels and lubricants increased by 14.9%, with particularly strong expansion of 27.7% under petroleum imports, mostly as a result of higher oil prices.

Imports of consumer goods increased by 11.6%, with growth of 8.8% under nondurable consumer goods and 14.5% under consumer durables, despite a reduction of 24.6% under purchases of passenger cars.

With respect to the volume of imports, Funcex data for January 2004 point to growth of 17.9% in the heading of raw materials and intermediate goods, when compared to the same month of the previous year. with respect to nondurable consumer goods, the increase came to 5.9%, while growth under fuels and lubricants closed at 23.6%. The sharpest reduction was registered under consumer durables, with 24.2%, followed by capital goods, with 8.2%.

As far as prices are concerned, the largest increase occurred under fuels and lubricants, with 7%, while the prices of capital goods increased by 0.5% and those of intermediate products by 0.8%. In the opposite sense, the prices of durable and nondurable consumer goods declined by respective rates of 2.1% and 0.3%, in the period.

With regard to trade exchanges, strong growth was registered in the surplus with the Laia countries, moving from US$214 million in the first quarter of 2003 to US$952 million in 2004, for growth of 44.9% in exports and a reduction of 2.4% in imports. This result was a consequence of expansion of US$468 million in the bilateral trade balance with Argentina which, in turn, is based on growth of 83% in exports and a reduction of 7.4% under imports. Here, the most important items were sales of manufactured goods related to the automotive industry, iron ore and reception and transmission apparatuses. A breakdown of Brazilian imports from Argentina indicates significant performances under wheat grain and naphthas. Aside from this, the surplus with Mexico increased by US$42 million, mirroring growth of 11.7% under exports and a 2.3% reduction under imports.

Exports to the European Union increased by 25.5% in the two month period, while imports dropped by 2%, generating

Exports and imports by geographic area – FOB
January-February

US$ million

Itemization	Exports			Imports			Balance	
	2003	2004	% change	2003	2004	% change	2003	2004
Total	9 806	11 521	17.5	7 536	7 951	5.5	2 270	3 570
Laia	1 572	2 278	44.9	1 358	1 326	- 2.4	214	952
Mercosur	616	1 086	76.4	994	908	- 8.7	- 379	178
Argentina	488	894	83.0	847	784	- 7.4	- 358	110
Other	127	192	50.9	147	124	- 15.9	- 20	68
Mexico	343	383	11.7	76	74	- 2.3	267	309
Other	614	809	31.8	288	344	19.3	325	465
USA[1/]	2 668	2 397	- 10.2	1 548	1 577	1.9	1 121	820
EU	2 389	2 999	25.5	2 039	1 998	- 2.0	351	1 001
E. Europe[2/]	343	346	0.8	135	237	75.5	208	109
Asia	1 326	1 677	26.5	1 277	1 433	12.2	49	244
Japan	313	366	16.8	372	344	- 7.4	- 58	22
South Korea	134	189	40.9	163	199	22.2	- 29	- 10
China	397	635	60.0	263	419	59.6	134	216
Other	481	486	1.1	480	470	- 1.9	2	16
Sundry	1 507	1 824	21.0	1 179	1 380	17.0	328	444

Source: MDIC/Secex

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

Current account

US$ billion

Itemization	2003			2004		
	Feb	Jan-Feb	Year	Feb	Jan-Feb	Year[1/]
Current account	-0.2	-0.1	4.1	0.2	0.9	0.2
Trade balance	1.1	2.3	24.8	2.0	3.6	24.0
Exports	5.0	9.8	73.1	5.7	11.5	80.0
Imports	3.9	7.5	48.3	3.7	8.0	56.0
Services	-0.3	-0.5	-5.1	-0.2	-0.3	-6.2
Transportation	-0.1	-0.3	-1.7	-0.1	-0.3	-2.1
International travel	0.0	0.1	0.2	0.1	0.2	0.0
Computer and information	-0.1	-0.2	-1.0	-0.1	-0.2	-1.2
Operational leasing	-0.1	-0.2	-2.3	-0.1	-0.3	-2.3
Other	0.0	0.1	-0.2	0.1	0.3	-0.7
Income	-1.2	-2.3	-18.6	-1.8	-2.9	-20.1
Interest	-1.0	-1.9	-13.0	-1.2	-2.3	-14.4
Profits and dividends	-0.3	-0.4	-5.6	-0.6	-0.7	-5.8
Compensation of employees	0.0	0.0	0.1	0.0	0.0	0.1
Current transfers	0.2	0.4	2.9	0.2	0.5	2.5

1/ Forecast.

a surplus of US$1 billion. With respect to trade with the Eastern European countries, exports came to US$346 million and imports to US$237 million, for growth of 0.8% and 75.5%, respectively, when compared to the result for the first two months of 2003.

The surplus with the countries of Asia came to US$244 million, of which US$216 million were registered in trade with China, the major target country in the region for Brazilian exports. As a matter of fact, exports to China expanded by 60% in the first two months of 2004, compared to the corresponding period of 2003, with particularly strong performances under sales of raw materials and basic intermediate goods, mostly including iron ore and soybeans, and of semimanufactured goods, involving iron and steel products and unrefined soybean oil. Foreign sales to South Korea expanded by 40.9% and imports increased by 22.2%, resulting in a reduction in the bilateral deficit from US$19 million to US$10 million. Trade with Japan turned in growth of 16.8% under Brazilian foreign sales and a reduction of 7.4% under imports, resulting in growth of US$80 million in the bilateral trade result, which is favorable to Brazil.

Brazilian exports to the United States declined by 10.2% in the first two months of 2004, representing the only reduction in trade with the major blocs and countries, and closed at US$2.4 billion. Imports from the United States increased by 1.9% and totaled US$1.6 billion. With this result, the surplus in trade with the United States dropped by US$301 million to US$820 million.

5.2 Services and income

In the first two months of 2004, the trade balance registered a strong surplus of US$3.6 billion, setting a new record for the period. The services and income account deteriorated when compared to the first two months of 2003, while net inflows of current transactions came to US$865 million, compared to the US$55 million deficit in the same period of 2003. Considering the accumulated year-over-year result, the surplus in current transactions totaled US$5 billion, equivalent to 0.98% of GDP.

Net remittances of income abroad totaled US$2.9 billion in the first two months of 2004, corresponding to 27.1% more than the result in the same period of 2003. Interest remittances added up to US$2.3 billion or 17.7% more than in the previous year. To some extent, this result was worsened by a 77.8% increase in remittances of profits

Remittances for Support of Residents

Inflows of foreign resources generated by remittances from Brazilians residing abroad for purposes of supporting residents in the country have grown systematically in recent years. In annual nominal terms, the gross revenues of this account increased by 81.5% from 2000 to 2003, reaching a level of US$2 billion. In comparison with other sources of balance of payments financing, these inflows moved from 2.8% of foreign direct investment revenues in 2000 to 10.5% in 2003.

The amounts referring to the support of residents are included under current unrequited transfers in the current accounts of the balance of payments, since the basic characteristic of these operations is a relationship between the nonresident and resident, without any type of compensation of a financial nature or any other nature on the part of the beneficiary. Remittances typically classified as support of residents involve persons who have migrated to other countries with the intention of remaining there for more than one year. As a result, these persons, who are normally blood relations or have other types of relationships with the beneficiaries in the country of origin, are considered to be residents of that country[6].

The primary source of Brazilian statistics are the records of exchange contracts formalized by the banking sector and other financial agents, authorized by Banco Central do Brasil. Classification of transfers as support for residents is based on a declaration of the beneficiary and documentation or evidence of the remittance.

6/ The methodological benchmark for classifying these operations may be found at the 5th edition of the IMF's manual of the Balance of Payments, chapter XV, paragraph 302.

Workers' remittances – Credit

US$ million

Country	2000	2001	2002	2003	2000-2003
United States	664	556	898	1 108	3 226
Japan	294	443	532	545	1 814
Germany	28	29	55	100	211
Switzerland	15	17	20	24	76
United Kingdom	9	12	18	22	62
Italy	11	13	16	21	61
Portugal	9	9	11	16	45
France	7	8	6	7	28
Spain	5	6	6	10	27
Angola	6	7	8	1	21
Others	64	78	140	164	447

In 2003, gross remittances to the country involving support for residents added up to US$2 billion, for growth of 17.9% compared to the result for the previous year. In that year, this heading represented approximately two thirds of the total inflow of current unrequited transfers.

In 2003, these inflows originated in 123 countries. When all inflows since 2000 are taken into consideration, the number of countries of origin increases to a full 153 nations. However, it should be noted that there is a strong concentration of remittances to Brazil with the 10 most important sources accounting for 92.2% of gross revenues. In the entire period under analysis, the major countries of origin of resources for purposes of support for residents were the United States, with 54.9% in 2003, and Japan, with 27% in the same year. As expected, the sources of these remittances mirror both the economic importance of the remitting country and the destinations of the major shares of Brazilian emigrants. Thus, all of the G-7 countries were among the 11 largest sources of these funds in 2003. Aside from these countries, particular mention should also be made of Portugal and, up to 2000, of Angola.

With respect to the conditions and sources of balance of payments financing, inflows for purposes of resident support have reduced – albeit growing - relative importance. Analysis of data since 2000 indicates that, aside from strong growth in revenues, the flows of resident support were not subject to the volatility of the financial account and, consequently, were a stable source of exchange inflows.

Selected sources of balance of payments financing

%

	2000	2001	2002	2003
Workers' remittances/ exports	2.0	2.0	2.8	2.8
Workers' remittances/ debt securities[1/]	5.9	6.9	27.6	17.1
Workers' remittances/ FDI	2.8	3.9	6.5	10.5

1/ Include bonus, notes and commercial papers.

With these results, inflows under the heading in question registered larger growth than exports in the 2000-2003 period, as reflected in expansion of the ratio of resident support inflows/exports from 2% in 2000 to 2.8% in 2003. Similar, though more accentuated, movements occurred when resident support revenues are compared with security inflows (bonds, notes and commercial papers) and inflows of foreign direct investments which increased from 5.9% to 17.1%, and from 2.8% to 10.5%, respectively, when the same basis of comparison is used.

and dividends, coming to a total of US$679 million in the two month period.

For 2004, the trade surplus is projected at US$24 billion or practically the same level registered in 2003. This result is based on growth of 9.5% under exports and 16% under imports. Net outlays on services and net remittances of income are expected to increase by 11.3%. With this, current accounts are expected to close in a position close to equilibrium, with only a small surplus of US$0.2 billion in the year.

Financial account

US$ billion

Itemization	2003			2004		
	Feb	Jan-Feb	Year	Feb	Jan-Feb	Year[1/]
Financial account	0.0	0.6	5.0	-1.1	2.7	-3.3
Direct investments	0.5	1.2	9.9	1.0	1.9	11.5
Abroad	-0.3	-0.5	-0.2	0.0	-0.1	-1.5
In Brazil	0.8	1.7	10.1	1.0	2.0	13.0
Equity capital	0.4	1.1	9.3	1.2	2.4	12.0
Intercompany loans	0.4	0.6	0.8	-0.2	-0.4	1.0
Portfolio investments	0.4	1.0	5.3	1.0	3.6	-0.5
Assets	-0.1	-0.1	0.2	0.0	0.1	-0.1
Liabilities	0.5	1.1	5.1	0.9	3.6	-0.4
Derivatives	0.0	0.0	-0.2	0.0	0.1	0.0
Other investments	-0.9	-1.6	-10.0	-3.1	-2.9	-14.3
Assets	-0.7	-0.8	-7.8	-2.3	-1.9	-8.4
Liabilities	-0.2	-0.8	-2.2	-0.8	-1.0	-5.9

1/ Forecast.

BP financing sources

Selected items

Itemization	2003			2004		
	Feb	Jan-Feb	Year	Feb	Jan-Feb	Year[1/]
Medium and long-term funds	0.3	0.4	13.4	1.1	3.7	22.5
Public bonds[2/]	0.0	0.0	4.5	0.0	1.5	4.0
Private debt securities	0.2	0.2	6.0	0.9	1.9	14.5
Direct loans	0.1	0.2	2.9	0.1	0.3	4.0
Short-term loans[3/]	0.3	0.1	-3.7	-0.1	-0.4	0.4
Short-term securities	0.3	1.2	0.3	0.0	0.0	0.3
Roll-over rates[4/]						
Public bonds	n.a.	n.a.	130%	n.a.	n.a.	94%
Private debt securities	188%	44%	138%	255%	286%	113%
Direct loans	39%	33%	85%	163%	113%	100%

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

5.3 Financial account

The financial account of the balance of payments registered net inflows of US$2.7 billion in the two months under analysis. The rate of rolling long-term bonds, notes and commercial papers came to 286%, compared to 44% in the same period of 2003, while the assets of residents abroad in the form of deposits increased by US$1.6 billion.

Net foreign direct investments added up to US$2 billion, with inflows of US$2.4 billion in the form of stock participation. Net amortizations of intercompany loans closed at US$358 million.

In the first two months of the year, foreign portfolio investments generated net inflows of US$3.6 billion, compared to US$1.1 billion in the same period of the preceding year. Aside from the return of medium and long-term sources of financing, an important factor in this result was issue of US$1.5 billion in bonds of the Republic. Here, it is important to highlight the sharp improvement in maturities and spreads obtained in the issue of these papers.

Reductions in risk premiums reflected inflows of medium and long-term notes and commercial papers, accounting for net inflows of US$841 million in the first two months of 2004, compared to net amortizations of US$248 million in the same period of 2003.

For 2004, the level of rolling for private papers is projected at 105%, with 100% for direct loans.

In the first two months of 2004, gross foreign reserves increased by US$3.7 billion, reaching a total of US$53 billion. In the same sense, based on the IMF concept, net adjusted foreign reserves expanded by US$3.8 billion to a level of US$21.2 billion. In the period under analysis, given the excess

Uses and sources

US$ billion

Itemization	2003			2004		
	Feb	Jan-Feb	Year	Feb	Jan-Feb	Year[1/]
Uses	-1.4	-2.8	-23.1	-1.4	-2.4	-38.5
Current account	-0.2	-0.1	4.1	0.2	0.9	0.2
Amortizations ML-term[2/]	-1.2	-2.7	-27.2	-1.6	-3.2	-38.7
Securities	-0.1	-0.5	-10.3	-0.6	-0.9	-21.5
Paid	-0.1	-0.4	-7.9	-0.4	-0.7	-21.2
Refinanced	0.0	0.0	-1.2	0.0	0.0	0.0
FDI conversions	0.0	0.0	-1.1	-0.3	-0.3	-0.3
Suppliers' credits	-0.1	-0.2	-2.0	-0.2	-0.3	-2.5
Direct loans[3/]	-1.0	-2.0	-15.0	-0.8	-2.0	-14.7
Sources	1.4	2.8	23.1	1.4	2.4	38.5
Capital account	0.0	0.1	0.5	0.1	0.1	0.5
FDI	0.8	1.7	10.1	1.0	2.0	13.0
Domestic securities[4/]	0.1	0.2	3.1	0.6	1.1	3.0
ML-term disbursements[5/]	0.9	1.8	23.0	1.4	4.4	33.1
Securities	0.2	0.2	11.8	0.9	3.4	18.6
Supliers' credits	0.1	0.2	1.1	0.0	0.1	1.9
Loans[6/]	0.6	1.4	10.1	0.4	0.9	12.6
Brazilian assets abroad	-1.0	-1.3	-7.2	-2.2	-1.8	-9.4
Loans to Bacen	0.0	0.0	4.8	0.0	0.0	-4.4
Other[7/]	0.2	0.6	-2.7	0.3	0.4	0.2
Reserve assets	0.5	-0.3	-8.5	0.3	-3.9	2.4

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

liquidity on the market, Banco Central do Brasil acquired US$2.6 billion in the exchange spot market, particularly in the month of January. With respect to external operations, the most important were disbursement of US$1.5 billion in bonds of the Republic and payment of US$1.3 billion in external debt service, including US$1.1 billion in net interest, of which US$329 million were paid to the IMF, US$1 billion involved interest on bonds of the Republic and US$211 million in revenues earned on reserves and US$151 million in amortizations with the Paris Club. Payments of interest and principal related to bonds and the Paris Club (US$1.2 billion) were effected through National Treasury market acquisitions. Other operations generated outlays of US$345 million.

At the end of 2004, it is estimated that gross reserves will decline by US$2.7 billion, when compared to December 2003, closing at a level of US$46.6 billion. The factor that explains this reduction is amortization of US$4.4 billion with the IMF, without any new disbursements in the period. Parallel to this, when the amounts for the first two months are included, payments of external debt service are forecast at US$12.1 billion. According to the projection included in this Inflation Report, the factors responsible for the accumulation of reserves are disbursements from international organizations (Interamerican Development Bank – IDB/International Bank for Reconstruction and Development – IBRD), with US$2.5 billion; issues of sovereign bonds, US$4 billion; and accumulation of US$2.6 billion resulting from exchange market interventions. Settlements of National Treasury exchange market acquisitions are expected to total US$5 billion. With this result, net reserves in the IMF concept, which are not affected by amortizations with that institution, are expected to expand from US$3.4 billion to US$20.8 billion.

5.4 Conclusion

Over the course of 2003 and early months of this year, the surplus registered under current accounts of the balance of payments was a result of the positive performance of the foreign trade sector. In 2004, growth forecast for the import sector is consistent with the scenario of renewed economic activity and is not expected to hinder repetition of the highly positive result attained in the preceding year. The final result is now forecast at US$24 billion. Thus, expectations are that the surplus in current accounts will be maintained.

Statement of international reserves

US$ million

Itemization	2003 Feb	2003 Jan-Feb	2003 Year	2004 Feb	2004 Jan-Feb	2004 Year[1/]
Reserves position in previous period	38.8	37.8	37.8	53.3	49.3	49.3
Net Central Bank interventions	-0.2	0.7	1.6	0.0	2.6	2.6
Spot and export lines	-0.0	-0.2	-0.2	0.0	2.6	2.6
Repurchase lines	-0.2	0.9	1.8	-	-	-
Debt servicing (net)	-0.5	-0.9	-9.7	-0.7	-1.3	-12.1
Interest	-0.5	-0.8	-4.8	-0.7	-1.1	-5.1
Credit	-0.7	-1.1	-6.3	-0.8	-1.4	-6.6
Debit	0.2	0.4	1.5	0.1	0.2	1.5
Amortization	-	-0.1	-4.9	-	-0.2	-7.1
Disbursements	-	-	5.4	-	1.5	6.5
Multilateral organizations	-	-	0.9	-	-	2.5
Sovereign bonds	-	-	4.5	-	1.5	4.0
International Monetary Fund	-	-	4.8	-	-	-4.4
Disbursement	-	-	17.6	-	-	-
Amortization	-	-	-12.8	-	-	-4.4
Others[2/]	0.3	0.5	3.9	-0.1	-0.3	-0.3
Treasury's purchases	0.2	0.4	5.5	0.5	1.2	5.0
Change in assets	-0.2	0.7	11.5	-0.3	3.7	-2.7
Gross reserves position	38.5	38.5	49.3	53.0	53.0	46.6
Net reserves position –	-	-	-	-	-	-
Arrangement with IMF[3/]	14.3	14.3	17.4	21.2	-	20.8

1/ Forecast.
2/ Includes payments/receipts in the framework of the Reciprocal Credit Agreement (CCR), fluctuations in prices of securities, exchange parities and price of gold, discounts and premiums, duty fees and release of collaterals.
3/ In order to comply with the performance criterion, in the framework of the International Monetary Fund Arrangement, the calculation parameters for the net adjusted reserves - as defined in the Technical Memorandum of Understanding (TMU) of the third review of the Stand-By Arrangement - should be observed. In this case, the net adjusted reserves denominated in US$ take into account the parities set on dates established by the TMU to figure out the assets denominated in currencies unlike the US$, including the special drawing rights (SDR). The same methodology is applied in the case of the gold price. Also, pursuant the TMU, the outstanding debt with the IMF should be excluded from the reserve assets (international liquidity concept), as well as the deposits in banks domiciled abroad, though headquartered in the country, and the securities issued by residents that surpass altogether US$1,023 million.The exceeding value up to February was US$2,493 million.

With respect to the financial account, data registered in the first two months confirm expectations that net foreign direct investment flows in the year will surpass the 2003 mark. In much the same sense, it is expected that operations involving the sovereign bond market and the rolling of the private debt will continue on a similar trajectory, with rates of rolling in excess of 100%, even when the magnitude of forecast amortizations is taken into account. In this scenario, financing of the balance of payments will be achieved with no difficulties.

Inflation outlook

6

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

In the first one, which is referred to as the benchmark scenario, it is assumed that the Over-Selic interest rate will remain unchanged at 16.25% p.y., which is the rate set by the Copom in its last meeting, held on March 16-17, and that the exchange rate will remain close to the one registered on the eve of the meeting (R$2.91 = US$1).

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

As explained in section 6.2, the benchmark and market scenarios built in this *Report* are different from those usually presented because they incorporate the underlying assumption that part of the inflation registered in the first quarter of 2004 will not follow the regular propagation mechanisms captured by projection models. This procedure was adopted based on indications that monetary policy has successfully anchored both inflation expectations and the behavior of price-setters, limiting the extent of the inflation surprise of the first quarter and preventing it from contaminating results in the following quarters.

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

6.1 Determinants of inflation

The IPCA inflation in January and February was higher than that projected in the *Inflation Report* of December 2003. The main consumer and wholesale price indices reflected the inflation acceleration of the first two months of 2004. The results related to the level of economic activity have, in turn, confirmed the scenario of a gradual and sustained recovery of the economy outlined in the last *Report*. There were no substantial changes in the external scenario since December either. The trade balance continues to present significant surpluses. Notwithstanding certain moments of higher volatility, the exchange rate has been relatively stable, while the country risk has had a small rise over the period, as in other emerging countries. Considering the indicators released through the first quarter, the Copom decided in its meetings held in January and February to keep interest rates at 16.50% p.y., interrupting the sequence of cuts occurred between June and December 2003. The measures taken by the Copom contributed to keep inflation expectations for 2004 stable at about 6% over the period, close to the year's target of 5.5%. Therefore, the high inflation of the first quarter has not contaminated the expectations for the year.

Although January and February are months in which inflation tends to be higher due to seasonal factors, the figures of the different indices should not be solely attributed to such factors. Increases in the international prices of commodities – namely, oil, agricultural products (particularly soybeans) and metals (particularly copper) – pressured up the wholesale prices, which had a 6% rise since August (IPA-OG). The higher inflation in the wholesale market is not necessarily fully transferred to consumers, as commodities account only for part of the cost of products sold in the retail market and price increases for consumers are limited by market conditions. In this context, the economic activity recovery occurred since the second semester of 2003 has contributed to create, at the turn of the year, a particularly favorable environment for price adjustments in sectors that are more credit sensitive, the leading sectors of the resumption process.

The higher inflation measured by the IPCA in January and February was not limited to a small number of items, as shown by the behavior of the core inflation measures and of the proportion of items that had positive price adjustments. The core inflation had already increased considerably in December, in tune with the increase of the headline inflation rate, and remained at high levels over the two following months. The core inflation calculated by excluding regulated prices and household food prices rose by 0.63% in December, 0.64% in January, and 1.0% in February, after a 0.38% rise in November. When the core inflation is measured by the symmetric trimmed-mean methodology with smoothing of the series, the resulting figures were 0.56%, 0.72%, and 0.73% for November, December, and January, respectively. In February, it dropped to 0.48%. When the same core inflation is calculated without smoothing, the resulting figures were 0.31%, 0.54%, 0.63%, and 0.28%, respectively. The proportion of items with positive price adjustments rose from 64.8% in December to 70.9% in January and declined to 60.4% in February.

This scenario, combined with the uncertainties related to the impacts on the economic activity and inflation of a 10-percentage-point reduction in interest rates between June and December, led the Copom to be more cautious when setting the Selic rate. In the first two months of 2004, interest rates were kept constant after successive falls since June 2003. Given the indications of lower risks of surpassing the inflation targets, the Copom decided to reduce the Over-Selic interest rate to 16.25% p.y. in March without bias. The inflation is expected to decrease in March after the seasonal factors of January and February wear out and as a result of the effect on price setting of the monetary policy commitment to the inflation-targeting regime. However, some items may continue to pressure inflation up over the year, particularly durable consumption goods, whose sales have been recovering rapidly and whose stock levels are low. Furthermore, the effects of a potential pass-through of the increases in industrial prices, which has been going on since the end of the last year, to consumer prices are bound to happen.

Regarding the level of economic activity, there was a significant recovery in the second semester of 2003, after a weak performance in the first semester. According to IBGE data, the Brazilian GDP, when compared to the previous quarter, after presenting a decrease of 0.9% in the second quarter of 2003, rose by 0.1% in the third quarter and by 1.5% in the last quarter of that year, the latter representing an annualized increase of over 6%. The economic recovery was led by an increase in the production of consumption goods, with credit playing a relevant role. After a weak first semester, non-earmarked credit operations grew remarkably in the second semester, particularly credit to individual persons, sustaining the recovery process.

The resumption of domestic demand was also observed in the second semester of 2003 as the aggregate consumption of families and investment grew at higher rates than that of output. Therefore, one can expect economic growth to be more broadly sustained by the domestic demand, rather than being fostered only by specific sectors. The external sector will continue to contribute positively to expand the aggregate demand, considering the expected exports expansion resulting from better conditions in the international scenario.

The economic activity recovery is expected to continue in the first quarter of 2004. This behavior is consistent with the performance of the industrial activity in January and with the seasonal reduction of credit in the first quarter of the year, and it is corroborated by leading and coincident private consumption indicators. In recent months the industrial activity has been marked by a higher rise in sales than in production and by low stocks in some industries, which provide an additional stimulus for a rise in production. Besides, growth rates in the medium run will still reflect the impacts on the level of economic activity of the 10-percentage-point reduction in the interest rates between June and December of last year. This does not mean, however, that the growth pace will be as fast as the one observed during the cyclic recovery process of the second semester of 2003. Considering the cyclic dynamics of output, it is natural that growth rates may be lower in certain months.

Regarding the performance of the industrial sector, IBGE data measured by quarterly moving averages of the seasonally adjusted series indicate a fall of over 3% in the first semester of 2003, particularly for durable consumption and capital goods, with decreases of 10% and 4%, respectively. However, a recovery trend was detected in the second semester in most industrial sectors. The general industrial output grew by 5%, with a rate of 13.7% for capital goods and of 18% for durable consumption goods. In the second semester, eighteen out of the nineteen categories of the manufacturing industry presented a positive growth in their quarterly moving averages. Wage-goods and civil construction industries also had a positive growth over the period after experiencing negative rates in the first semester, even though the resumption of their growth was not enough to take them back to the levels registered before 2003. The reaction is still relatively more intense in sectors that are credit-sensitive, namely, capital goods and durable consumption goods. According to CNI and Fiesp data, the average utilization of installed capacity was, respectively, 80% and 80.7% in the fourth quarter of 2003.

A strong resumption of investment was registered in the second semester of 2003. The seasonally adjusted data provided by the IBGE indicated a growth of 4.0% for the gross formation of fixed capital in the fourth quarter of 2003 compared to the previous quarter. Despite possible minor flotations in the short run, the recovery of the real income will stimulate the production of semi-durable and non-durable consumption goods, while the maintenance of the growth in the production of capital and durable consumption goods will continue to stimulate investment and foster the growth of the aggregate supply in the medium run.

In the labor market, the PEA has been growing at higher rates than the employment, leading to a temporary rise in the unemployment rate. Most of the jobs created are informal and marked by a lower average income. Nevertheless, the growth in the real payroll since the second quarter of 2003 is expected to stimulate the recovery of the demand. This effect will be reinforced in the medium run as the average income rises as a result of improvements in the overall conditions of the labor market and, in particular, of a larger creation of new jobs in the formal sector. According to CNI data, real wages in the last two months of 2003 were the highest since May 2002, exceeding the average of 2002. IBGE data on the real average income of employed individuals point to a recovery in the last quarter of 2003. Although this recovery has not been sufficient so far to bring the rates back to their average level of 2002, the average monthly growth rate in the last two quarters of 2003 was higher than that of the same period in 2002. This is an important factor, since a higher real income can nurture economic recovery at a latter moment as the stimulus generated by the expansion of credit wears out. This stimulus will continue to play an important role in the medium run since total credit should keep growing throughout the year, at lower rates and with a relatively lower pressure on the borrowers' repaying capacity, despite the projected drop in the first quarter due to seasonal factors. The wage increases of certain professional categories will also contribute to a higher real income, since they will be above the expected inflation so as to make up for part of past inflation.

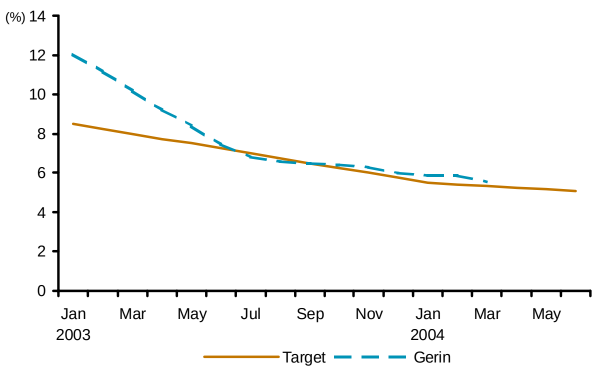
The gross federal tax revenue decreased by 8.5% in 2003 as compared to 2002. Nevertheless, the federal administration has ensured a tax surplus close to the target of 4.25% of GDP by focusing mainly on suppressing expenses after an unusual drop in the tax revenue.

The international scenario continues to provide favorable prospects as a result of the growth of the main economies in the world – United States, Japan, and the Euro area – and of non-traditional markets, such as China. These factors may have positive effects on capital inflows to emerging economies and foster higher trade balances, thereby contributing to the resumption of economic growth in Brazil.

The external environment continues to present even more optimistic perspectives. The trade balance surplus in 2003 was US$24,825 million, in contrast to US$13,121 million in 2002. Trade balance projections rose from US$19 billion in the *Inflation Report* of December 2003 to US$24 billion in this *Report*. This growth will be basically ensured by increases in exports, which are expected to amount to US$80 billion. The lower exchange rate volatility in the second semester of 2003, the world economy's growth, and commodity prices are among the factors that explain the exports performance. In addition to contributing to the expected trade balance, the higher exports should make it possible for Brazil's net international reserves to increase from US$17.4 million to US$20.6 million.

The scenario remains favorable for external financing, as high levels of international liquidity are likely to be preserved. The current account improvements in December and January when compared to the previous month suggest that Brazil is in the process of reducing its vulnerability. The exchange rate stability and the inflow of external resources have made it possible for the country to reduce the portion of its domestic debt that is linked to the exchange rate, further reducing its vulnerability to external shocks. The Central Bank took advantage of the higher market liquidity to acquire foreign exchange to strengthen international reserves.

Twelve-month ahead inflation



The median of market expectations before the Copom meeting in December 2003 was of a 6% inflation in 2004. In March, these expectations remained the same for 2004, but they began to point to a 5.64% rate for the twelve-month ahead inflation. This result shows that monetary policy has successfully anchored the expectations to the path of the targets, despite the inflation peak observed in the first two months of this year.

In summary, the scenario outlined in the December *Report* has not changed substantially during the first quarter, i.e., the economy continues to experience a process of sustained recovery in tune with the inflation targets. Copom's decisions to keep the Over-Selic interest rate constant at 16.5% in the meetings of January and February, necessary because of the behavior of the economy in the first quarter, will play a decisive role to consolidate this favorable scenario in the medium run.

6.2 Main scenario: assumptions and associated risks

The Copom's forecasts are based on a set of assumptions about the behavior of key economic variables, as well as their associated risks, both of them being part of the main scenarios under which the Copom makes monetary policy decisions.

The economic environment since the last *Inflation Report* has confirmed the consistency of the process of convergence of the inflation rate to the path of the targets, despite the high rates in January and February. This conclusion is supported by the maintenance of the market inflation expectations close to the targets set for 2004 and 2005 – about 6% and 5%, according to the survey carried out by the Gerin, as compared to the targets of 5.5% and 4.5%, respectively – and by the relative stability of the exchange rate in the last months. Therefore, the scenario projected for the remainder of 2004 is favorable, with economic growth and compliance with the inflation targets. This evaluation of the economic activity is confirmed by the sustained recovery of the economy, which can be verified by the performance of the industrial sector and other data released recently (see item 6.1 of this *Report*). On the demand side, the external sector is expected to keep contributing to economic growth through the exports increase induced by the recovery of the international economy, together with the expansion of private consumption and investment already detected in the IBGE data for the second semester of 2003.

The considerations about uncertainties surrounding monetary policy transmission mechanisms made by the Copom on various occasions since the December *Report* remain valid. As highlighted in that *Report*, three factors have particularly contributed to the concerns of Copom about this source of risk: i) uncertainties are inherent in any econometric model; ii) the macroeconomic instability of recent years makes forecasts even more difficult; and iii) as monetary policy becomes more flexible, the target set for the Selic rate becomes closer to that compatible with the term structure of interest rates that is expected to prevail in the medium run. For this reason, uncertainties have become more pronounced concerning the lags and magnitude of the monetary policy impact on inflation rates.

As a result of these uncertainties, the Copom decided to interrupt the flexibilization of the monetary policy in the meetings held in January and February. The decisions were made, first, to make price-setters reconsider to what extent prospective demand conditions would tolerate price adjustments. This effect of monetary policy through the expectation channel played a key role in reverting an environment that tended to favor a pass-through of costs to final prices and a quick resumption of profit margins created at the turn of the year – as a result of the significant recovery of the economic activity in the last quarter of 2003 – particularly in sectors which are more credit-sensitive. Second, it meant to allow a clearer perception of the propagation dynamics of the total lagged effects of the interest rates cuts of the last semester of 2003. Third, it was intended to avoid the abnormally high results of early 2004 – which were higher than would be expected considering only the period's typical seasonality – to contaminate the annual inflation through inertial mechanisms or their incorporation by the market when forming expectations, which could jeopardize the target as early as the beginning of the year.

To minimize underlying uncertainties of econometric models, comprehensive research efforts have been made, with the inclusion of new estimation methodologies and techniques in the Central Bank's models, such as using the output gap estimated from a production function (see box *Methodologies for Estimating the Potential Output* in the *Inflation Report* of December 2003), in addition to the ones that were already being used. Analyzing projections of different models and based on different scenarios is a way to reduce uncertainties concerning the future evolution of the economy and minimize the risks associated with the monetary policy transmission mechanism.

Therefore, besides evaluating the scenario built in the traditional way, in the March meeting the Copom paid special attention to another set of scenarios that assumes a lower persistence of the inflation of the first quarter. These scenarios were motivated by the marginal data for the IPCA and by the stability of inflation expectations for 2004 and 2005 registered since January. They include the underlying assumption that part of the high inflation observed in the first quarter of this year will not propagate throughout the following quarters and that there will even be reversions in some price increases caused by temporarily unfavorable weather conditions. This assumption is more likely to occur as monetary policy becomes more effective as a coordinating mechanism in preventing sporadic inflation rises caused by supply shocks and seasonal factors from contaminating future inflation expectations. To make this assumption operational, the Copom, attributing part of the inflation of the first quarter to a seasonal shock, assumes that shocks of a similar nature will also affect the inflation in each of the remaining quarters of the year and likewise in 2005. The magnitude of the shock typical of each quarter was estimated so as to reproduce the seasonal pattern of the recent series of market-price inflation rates in the Copom's projection models. It should be stressed that the reliability of this procedure as a projection mechanism will be conditioned: i) to the continuity of favorable results for the evolution of the marginal IPCA inflation, and ii) to the maintenance of the stability of the inflation expectations of the recent months.

In this set of scenarios marked by a low persistence of the inflation of the first quarter, the benchmark scenario maintains the assumption of a constant path for the exchange rate through the forecast horizon at a level close to the one prevailing on the eve of the meeting (R$2.91 = US$1). The scenario also assumes that the Selic rate will remain at 16.25% p.y., which is the target set at the March meeting. For this interest rate path, the benchmark scenario projects that the six-month pre-DI swap rate over the Selic rate will reach 40 basis points in the last quarter of 2004 and 56 basis points at the end of 2005.

The market scenario is built based on the interest rate and exchange rate paths expected by market participants collected by the Gerin. In this scenario, the figures for the fourth quarter of 2004 and 2005 are R$3.07 and R$3.24 for the domestic price of the dollar, respectively, and 14.0% and 12.6% for the Selic rate. Consistently with the path of the Over-Selic interest rate, the model forecasts that the six-month pre-DI swap rate will be 15.5% and 13.9% in the last quarter of 2004 and of 2005, respectively.

The behavior of regulated prices is a source of inflationary pressure that requires a permanent monitoring from the Copom. For the set of these items, with a total weight of 28.9% in the IPCA in February, an increase of 7.3% is projected for 2004 using the benchmark scenario. For the market scenario – which includes the impact of the exchange rate variation on items such as oil by-products, electricity, and telephone rates – the projection of the inflation of regulated prices is 8.3% for 2004.

At disaggregated levels, the benchmark scenario assumes a price increase of 9.5% for gasoline, 10% for cooking gas, 6.9% for residential electricity, and 6.8% for fixed telephone rates over the year. For 2005, the model with endogenous determination of regulated prices – whose specification considers seasonal components, exchange rate variations, the inflation of market prices, and the inflation as measured by the General Price Index (IGP) – projects a variation of 6.0%.

One of the main risks for the inflation of consumer prices over the next few months lies in the possibility of a contagion of retail prices by wholesale industrial prices. It should be noted that this possibility has not been included in the projection scenarios analyzed below, except to the very limited extent that it might already be contaminating IPCA results for the first quarter, as there is no clear sign of its transmission through another channel, namely, that of market expectations, to the IPCA over the next quarters. The recent years' experience suggests that any actual pass-through of the industrial IPA to the portion of the IPCA represented by industrialized products tends to be relatively fast (see box *Evolution of the Prices of Industrial Products*). In this regard, the recent deceleration of consumer price rises, despite the increases in wholesale prices, is rather encouraging. In any case, the usual speed of the pass-through allows us to anticipate the dissipation, soon, of lingering uncertainties about the pressure of price increases already observed in wholesale prices on consumer prices.

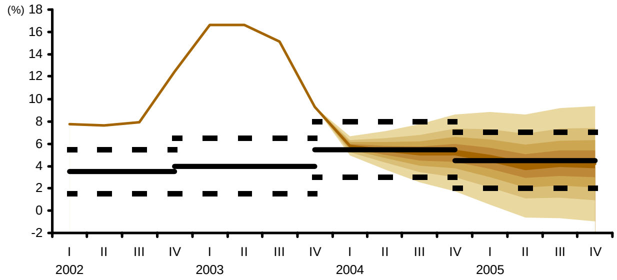
As for the fiscal policy, it is assumed that the target for the consolidated public sector primary surplus, which was set at 4.25% of GDP this year and over the next two years, will be fulfilled.

6.3 Inflation forecast

Based on the assumptions and associated risks considered by the Copom and using the set of information available, the 12-month accumulated IPCA inflation was projected using the assumptions of the benchmark and of the market scenarios, in both cases assuming the previously mentioned low persistence of the inflation in the first quarter. Besides assuming that interest rates will be kept at the level set in the last Copom meeting (16.25% p.y.) and that the exchange rate will remain constant at a level close to that observed

Forecasted IPCA-inflation with interest rate constant at 16.25% p.y. (Benchmark scenario)

Inflation fan chart



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

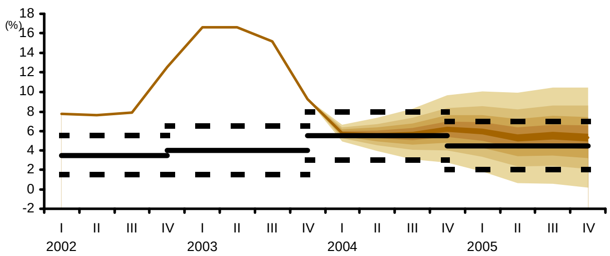
IPCA-inflation with interest rate constant at 16.25% p.y. (Benchmark scenario)

Year	Q	Confidence interval 50%	30%	10%				Central projection
2004	1	5.5	5.6	5.7	5.9	6.0	6.2	5.8
2004	2	4.7	5.0	5.3	5.6	5.8	6.1	5.4
2004	3	4.1	4.5	4.9	5.3	5.7	6.2	5.1
2004	4	3.8	4.4	4.9	5.5	6.0	6.6	5.2
2005	1	3.0	3.7	4.4	5.0	5.7	6.4	4.7
2005	2	2.1	2.9	3.7	4.4	5.1	5.9	4.0
2005	3	2.2	3.1	3.9	4.6	5.4	6.3	4.3
2005	4	2.1	3.0	3.8	4.6	5.4	6.3	4.2

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

Forecasted IPCA-inflation with market expected interest and exchange rates

Inflation fan chart



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

IPCA-inflation with market expected interest and exchange rates1/

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

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

on the eve of the Copom meeting (R$2.91 = US$1), the benchmark scenario included the underlying assumption of a 0.40% inflation rate in March, which is the median of expectations of the Top 5 institutions, according to the Gerin classification. In the market scenario, the Over-Selic interest rate of the economy decreases to 14.0% p.y. in the last quarter of 2004 and to 12.6% p.y. in the last quarter of 2005, while the domestic price of the US dollar reaches, on average, R$3.07 in the last quarter of 2004 and R$3.24 in the last quarter of 2005. The same assumptions of the benchmark scenario were made for the inflation in March.

The central path associated with the benchmark scenario shows a downward trend for the 12-month accumulated inflation from 5.8% in the first quarter to 5.2% at the end of the year, below the 5.5% year's target. Between the last quarter of 2004 and the first quarter of 2005, the inflation in twelve months will fall 0.5 p.p. as a result of the replacement of a higher inflation rate in the first quarter of 2004 (1.8%) by a more moderate one (1.3%). A further reduction was projected for the first and second quarters of 2005, with a partial reversion in the third quarter. This results from the dynamics of the inflation of regulated prices, which attribute a higher number of price adjustments in the third quarter of 2005 when compared to the same period in 2004. The projection of the benchmark scenario for 2005 is 4.2%, which is also below the year's target.

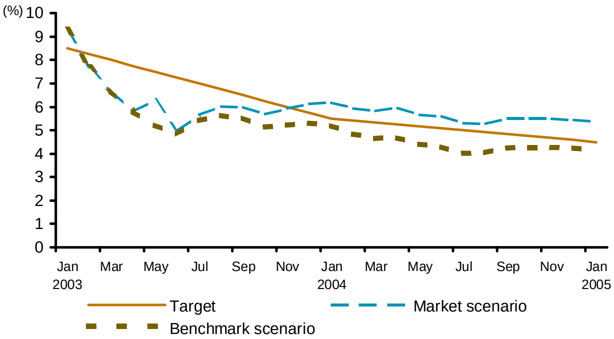
Because the market scenario considers a drop in the interest rates and an exchange rate depreciation over the forecast horizon, it projects higher inflation rates than the benchmark scenario does, namely, 6.2% and 5.4% in 2004 and 2005, respectively. As opposed to the benchmark scenario, the 12-month accumulated inflation rises in the last quarter of 2004, being the highest figure of the forecast horizon. This higher inflation is explained by the exchange rate depreciation embedded in the market scenario, which contrasts with the path of appreciation of the real that took place in the twelve-month period ending in March 2004, and by a higher adjustment of regulated prices, namely, 8.3% against 7.3% in the benchmark scenario. The inflation will tend to drop through 2005, with a slight increase between the second and third quarters, which can be explained, as in the benchmark scenario, by the dynamics of the inflation of regulated prices.

By comparing the paths presented in this *Report* with those described in the December *Report*, whose core projections are shown in the table ahead, one notices that the projections are higher in both scenarios. They are higher in 2004 almost

December 2003 *Inflation Report* forecasts

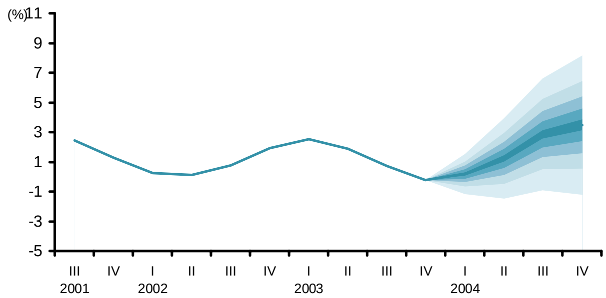
Period	Benchmark scenario	Market scenario
2004 I	5,0	5,1
2004 II	4,4	4,9
2004 III	4,4	5,3
2004 IV	4,5	5,8
2005 I	4,1	5,6
2005 II	3,8	5,2
2005 III	4,1	5,4
2005 IV	4,0	5,1

Twelve-month ahead inflation



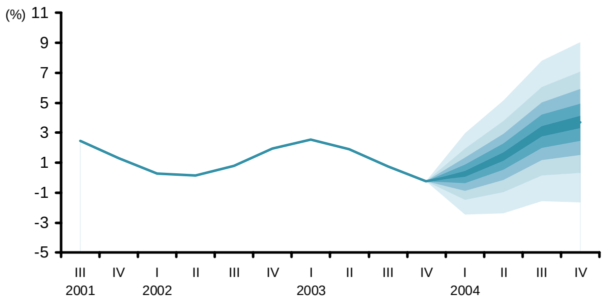
GDP growth with interest rate constant at 16.25% p.y. (Benchmark scenario)

Output fan chart



GDP growth with market expected interest and exchange rates

Output fan chart

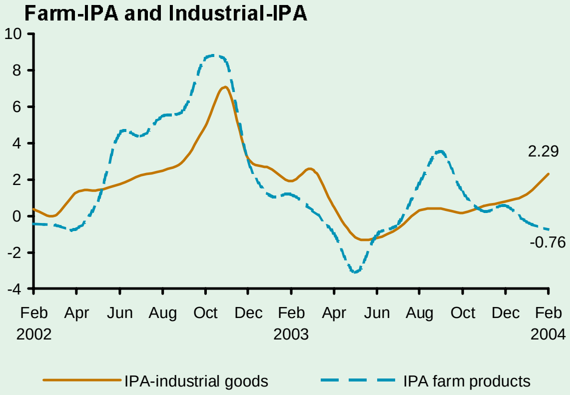


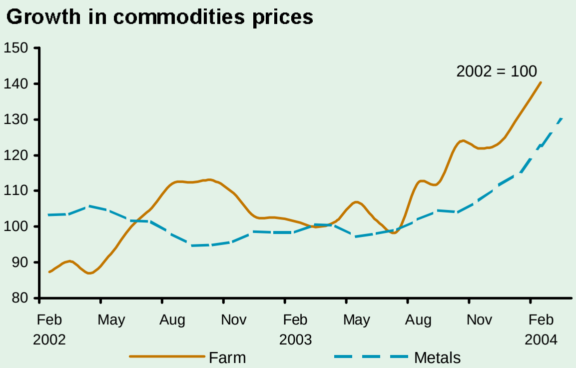
exclusively because of the increase from 1.1% to 1.8% in the inflation estimated for the first quarter of 2004. The inflation projected for the last three quarters of this year has remained at 3.4%, while in the market scenario it has reduced from 4.5% to 4.3%. This stability is due to the offsetting of upward by downward pressure sources. Projections for regulated prices in the three quarters, rising from 5.3% in the December *Report* to 6.2% in this *Report*, are among the upward pressure sources. Major downward pressure sources are the drop in the inflation expectations between the second and fourth quarters of 2004 – from 4.3% in the previous *Report* to 4.0% in this *Report* – and the GDP in the fourth quarter of 2003, which was smaller than that anticipated in the December *Report*. Concerning the evolution of projections for 2005 since the December *Report*, there was an increase of 0.2 p.p. in the benchmark scenario and of 0.3 p.p. in the market scenario. This increase was mainly due to the higher projection for regulated prices, which rose from 5.5% to 6.0% over the period.

The graph at left shows the evolution of the twelve-month ahead inflation according to the benchmark and market scenarios of this *Report*, as well as the interpolated path of the targets set for 2003 and 2004. As in the December *Report*, the twelve-month ahead inflation is below the path of the targets since February 2003, according to the benchmark scenario. On the other hand, the inflation estimated according to the market scenario is above the path of the targets since December 2003. As can be seen, except for seasonal factors, in both scenarios the deviations between the projection and the target have been relatively constant since January 2004.

Fan charts are also presented for the output growth projected according to the underlying assumptions of the benchmark and market scenarios. It is worth emphasizing that the forecast errors of GDP growth projections are considerably higher than those of inflation forecasts because, in the models used by the Copom, they involve the paths of two non-observable components – namely, potential output and output gap – and because calculating output is more complex and less precise than calculating inflation. According to the benchmark scenario, which assumes that interest rates will remain at a level of 16.25% up to the end of 2005, the expected growth for 2004 would be 3.5%, the same presented in the last *Report*. The output fan chart containing the projections of the market scenario points to a GDP growth of 3.7% in 2004. This higher projection when compared to the benchmark scenario reflects the impact of lower interest rates on the level of economic activity.

Evolution of the Prices of Industrial Products





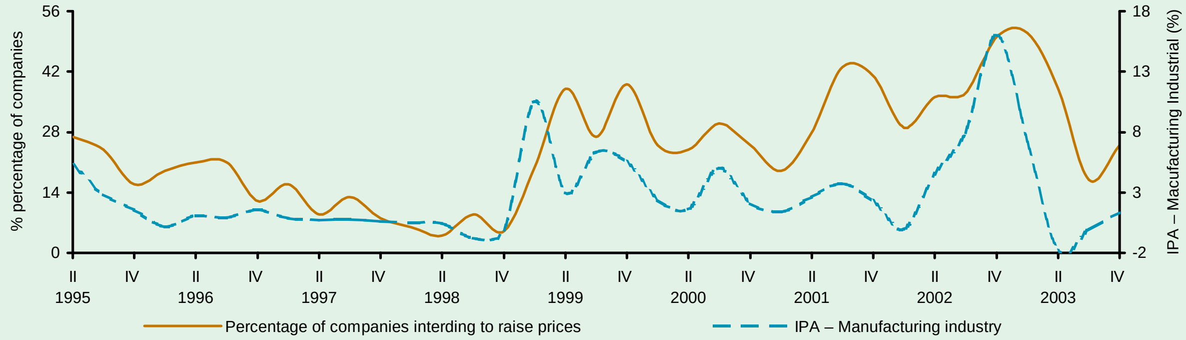
Source: CRB and FMI

Industrial wholesale prices, with a weight of 71.5% in the Wholesale Price Index – Internal Availability (IPA-DI) issued by the Getulio Vargas Foundation (FGV), have experienced pronounced increases in recent months. These movements began in October 2003 and continued in the first months of this year. The main source of pressure in this period was the increase in the prices of commodities that play an important role in the composition of industrial prices. In addition, seasonal pressures have marked the behavior of that index at the end of 2003, mainly caused by the period between harvests (an already overcome factor) and, since February, by the influence of changes in the Cofins.

The international prices of important inputs in the industrial chain have risen up since the beginning of the second semester of 2003. From July to February, the index for agricultural commodities – corn, wheat, and soybeans – rose by 38.2% according to the Commodities Research Bureau, while the one for metallic commodities – copper, aluminium, iron, tin, nickel, zinc, lead – went up by 31.1% according to the International Monetary Fund (IMF). The synchronized boom in the main economies in the world, especially in China, has been the main cause of those price rises. In the soybean market, prices have also been pushed up by other factors. Lower predictions for the harvest in Latin America and the simultaneous occurrence of avian flu and mad cow diseases, which tend to increase the consumption of vegetal protein by humans, is expected to offset partially the effect of an anticipated reduction in the demand for soybeans for animal feed. Soybean prices are expected to remain high at least until the harvest period in the northern hemisphere, which will begin in July and August.

The increases in the prices of commodities have affected the evolution of domestic prices. The Industrial Survey carried out by the FGV last January pointed out a strong increase in the intention of price adjustments by part of corporations, in a movement associated with a rise in costs also presented by the survey. It should be stressed that the FGV indicator of price adjustment intention, which is clearly correlated with the industrial IPA, points to the maintenance of the pressure on price indices.

Percentage of companies intending to raise prices and IPA – Manufacturing Industrial



Industrial IPA – selected itens

					% Change
	2003			2004	
	Oct	Nov	Dec	Jan	Feb
IPA – General	0,50	0,46	0,74	0,75	1,42
Consumer goods	0,00	0,12	1,39	0,48	1,55
Production goods	0,76	0,63	0,40	0,90	1,35
Intakes					
Metallurgy	0,06	0,60	0,74	5,21	4,01
Wood	1,05	0,93	1,57	0,36	2,33
Plastics	-0,02	0,08	0,10	4,70	7,39
Other – chemical ind.	-0,78	-1,20	1,32	1,16	3,83
Fabrics, appared and footwear	0,18	5,43	3,26	5,45	
Produto					
Mechanical	0,55	0,15	0,50	1,12	2,77
Electric appliances	0,04	0,16	1,15	1,17	4,14
Furniture	-0,03	0,28	0,71	0,46	2,15
Fertilizers	1,58	1,58	5,51	1,38	3,97
Fabrics, apparel and footwear	0,03	2,35	2,08	2,09	2,45

Source:FGV

By analyzing the industrial IPA disaggregated by items, one can infer the impact of the rise in the commodity prices on production costs in certain industries and, consequently, on the prices of final or intermediate products belonging to the same production chain. Considering selected items, one can observe, for instance, considerable increases in the price of metallurgical items, plastic materials, chemical products, and timber, which have a direct bearing on the prices of mechanical items, electric materials, fertilizers, and furniture items.

Although they were meant to protect tax revenues, amendments made to the Cofins[7] law enforced in February imply changes in costs along the production chain. That is so because they impose a higher tax burden on segments located at the beginning of the

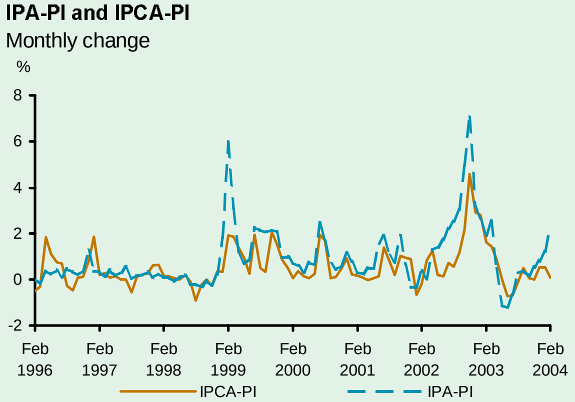
7/ See box “Charging of the Contribution to the Financing of the Social Security System (Cofins) on Aggregate Value”, on page 66 in this *Report*.

chain – which would have less credit to offset the higher tax rate or, from a different perspective, a higher value-added/turnover ratio – and benefit productive segments at the end of the chain. Therefore, changes in relative prices can be expected as a result of these new measures. Depending on its composition, this change in relative prices may reflect on specific price indices as well.

The direct impact of the Cofins, however, will be relatively lower on retail than on wholesale prices due to different factors. First, most services to consumers are provided by corporations or legal entities opting for the so-called Simple tax rate or with a turnover of less than R$4 million/month, or even by public companies or concessionaires, which are segments that were not affected by the changes introduced in the tax regime. In addition to the service sector, the non-industrialized food segment also tends to be affected in a limited extent, considering the significant participation of small and medium-sized farmers or cooperatives in the production of these items, which were also excluded from the new system. Therefore, the effect on prices in these segments tends to be relatively low as they are restricted to those caused by increases in the price of inputs used in the provision of these services or in the production of these food items. As a consequence, considering the IPCA as a basis, about 65% of the items (services and non-industrialized food products) would not be subject to direct effects of the amendments made to the Cofins law.

A relevant aspect of the recent behavior of wholesale industrial prices is its impact on retail prices because of increases in the price of inputs in recent months and of the amendments to the Cofins law in February. The magnitude of this effect depends on different factors that determine the intensity of the pass-through to the final consumer. Among them, special mention should be made of the demand level, the competition framework, and the level of expectations, which determine the degree of acceptance of the pass-through of industrial wholesale prices to retail prices.

Despite the inherent restrictions in any effort to measure these impacts, the following exercise was carried out to obtain a reference percentage: by



Dependent variable: IPCA-PI

Adjusted period: 1996:06 2004:02

	Varible			
	Coefficient	Standard deviat	t-Statistic	Probability
C	-0,01	0,06	-0,09	0,93
IPA-PI	0,28	0,06	4,80	0,00
IPA-PI (-1)	0,15	0,08	1,93	0,06
IPCA-PI (-1)	0,23	0,09	2,51	0,01
DUM 1102	1,39	0,51	2,73	0,01
DUM 0700	1,11	0,45	2,44	0,02
R^2 Adjusted	0,74			

disaggregating the IPCA, a subgroup made up of industrialized products (IPCA-PI) was obtained, with an approximately 36% weight. The evolution of this group – which is obtained by weighing monthly variations of its items against their respective weight in the IPCA – reveals a strong contemporary adherence to the industrial IPA, as can be seen in the graph at left. The correlation coefficients for the sample from January 1999 and for the whole sample are 0.81 and 0.76, respectively.

By adjusting an equation between the IPCA-PI and the IPA-PI, the estimates presented at left can be obtained.

Based on the parameters found, one can infer that the impact of the sharp variations of the industrial IPA in January and February (1.20% and 2.29%, respectively) on the IPCA would be of 0.30 p.p. altogether (the rise in the industrial IPA each month was weighed by the coefficient found and by the weight of industrial products in the IPCA). However, this effect was not actually observed in February, as shown in the graph by the gap between the IPCA-PI and the IPA-PI. This gap may indicate pressures from industrial prices on consumer prices over the next months, which should be closely monitored when implementing monetary policy. It is worthwhile to mention that the market estimates of a 0.40% variation in the IPCA in March are consistent with these pressures, which tend to be attenuated by the drop in food prices and the relative stability of regulated prices.

Annex

Minutes of the 91st Meeting of the Monetary Policy Committee (Copom)

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

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

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

Other participants (present on December 16th)
Alexandre Pundek Rocha – Advisor to the Board
Flávio Pinheiro de Melo – Advisor to the Board
Hélio José Ferreira – Executive Secretary
Hélio Mori – Advisor to the Board
João Batista do Nascimento Magalhães – Special Advisor to the Governor
Jocimar Nastari – Press Secretary

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

Recent Evolution of Inflation

1. The main inflation indicators remained stable in November, compared to October, presenting low rates and low dispersion. This behavior confirms the favorable recent inflationary outlook, in which the main disturbing factors are seasonal and temporary.

2. The IPCA increased 0.34% in November compared to 0.29% in the previous month, totaling 8.74% in the year and 11.02% in the last twelve months. The IGP-DI changed 0.48%, after an increase of 0.44% in October, influenced by the IPA-DI and the IPC-Br increases (0.46% and 0.33%, respectively). The IGP-DI and IPA-DI changes accumulated in twelve months to November decreased for the eighth consecutive month, to 9.92% and 8.79%, respectively.

3. Regarding the IPCA, lotteries and urban bus fares in Rio de Janeiro were the main individual contributors to the November result (contributing 0.06 p.p. and 0.05 p.p., respectively). Clothing, under seasonal factors influence, presented an average increase of 0.99% in November, compared to 0.92% in October, contributing 0.05 p.p. to the IPCA result. Food prices increased 0.25%, compared to 0.46% in the previous month, mainly due to the deceleration of meat and chicken prices increase.

4. Still regarding the IPCA in November, market prices changed 0.33% and regulated prices increased 0.36%, contributing 0.24 p.p. and 0.10 p.p. to the overall result, respectively. In the first group, the increases were concentrated in clothing, meat and chicken prices. Regarding regulated prices, besides lottery and urban bus fares in Rio de Janeiro, electricity tariffs were increased in Rio de Janeiro, Porto Alegre and Goiânia. On the other hand, gasoline, fuel-alcohol and bottled gas prices decreased during the month.

5. The IPA-DI reached 0.46% compared to 0.50% in October, with divergent behaviors for agricultural and industrial prices. The Agricultural-IPA decelerated 0.26%, after an increase of 1.30% in the previous month, due to lower increase in soybean prices and drop in prices of milk, eggs and pork. On the contrary, rice prices increased.

6. On the other hand, wholesale industrial prices presented a slight acceleration, increasing 0.54% in November compared to 0.18% in October. This acceleration was caused by chemical prices, especially oil and lubricating products, paint products, and fertilizers and pesticides. Also important were the increases in prices of cotton fabrics, reflecting the increase in the raw material, and of steel.

7. The IPCA core inflation, excluding food and regulated prices, remained stable in November for the fifth consecutive month, at 0.38%. In the last 12 months, the core accumulates a 9.28% change.

8. Core IPCA inflation calculated under the smoothed trimmed-mean method reached 0.56% in November compared to 0.77% in October. The accumulated variation in 12 months reached 11.82%, still affected by the inflation upsurge at the end of 2002. The non-smoothed trimmed-mean core stood at 0.31% in November and 9.36% in 12 months.

9. Core IPC-Br inflation calculated under the symmetric trimmed-mean method by FGV reached 0.36% in November, accumulating an increase of 10.69% in the last twelve months.

10. In December, both consumer and wholesale inflation are likely to register changes close to November. At the wholesale level, some pressure is expected in prices of vegetables, fruit, rice and corn, while prices of milk, eggs, soybeans and sugar cane are expected to fall. For the IPCA, the December result will be affected by rises in regulated prices (lotteries and urban bus fares in Belém and Fortaleza), as well as a slight acceleration in food prices.

Assessment of Inflation Trends

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

a. Gasoline and bottled cooking gas prices are projected to accumulate increases of 0.9% and 3.7%, in 2003, respectively. For 2004, the changes in gasoline and bottled cooking gas prices are projected to reach 9.5% and 3.5%, respectively. The readjustment of gasoline prices encompasses an increase in the CIDE rate to partially compensate the federal government for sharing this tax with states and municipalities, as part of the recently enacted tax reform;

b. The projection for the readjustment of household electricity tariffs in 2003 decreased 0.1 p.p., reaching 21.6%. For 2004, the readjustment is expected to be 7.2%. Concerning telephone tariffs, there was no change in the projection for 2003 since the last Copom meeting. For 2004, Copom estimates an increase of 6.6%, assuming that the judicial injunction which limited the readjustment of the tariffs authorized for 2003 will not be reverted;

c. For the inflation of regulated prices in 2004, which weighted 28.9% in the November IPCA, the BCB projection decreased 0.7 p.p., reaching 7.8%;

d. The projection for the readjustment of regulated prices for 2005 was based on the model of endogenous determination that was used until the September Copom meeting to estimate 2004 readjustments. This model, which considers seasonal components, the exchange rate behavior, market prices inflation rate and the IGP-DI variation, forecasts a 5.5% change for regulated prices in 2005;

e. The projection for the 6-month spread over the Selic rate, following the specification of the Vector Autoregressive model using the Selic and swap rates on the eve of the Copom meeting was –70 b.p. for the fourth quarter of 2003, gradually rising to 20 b.p. in the last quarter of 2004 and 50 b.p. at the end of 2005.

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

13. Considering the baseline scenario hypotheses, including the maintenance of the Selic interest rate at 17.5% p.a. and the exchange rate at the level prevailing on the eve of the Copom meeting (R$2.94), inflation is projected above the adjusted target of 8.5% for 2003 and below the target of 5.5% for 2004.

Monetary Policy Decision

14. November inflation results confirmed the convergence of inflation to the target path. Regarding the IPCA, the 0.34% inflation in November was just 0.05 p.p. higher than October. When the IPCA change is decomposed into three groups – regulated, tradable and non-tradable prices – low price dispersion is noticed in November, with changes for the three groups between 0.25% and 0.44%. Perishable food prices grew 0.5% due to weather factors, after two consecutive months of falling prices. This behavior is likely to repeat in the first quarter of 2004, without causing a generalized disturbance on market prices. Other consumer inflation indicators, such as the IPC-Fipe and the IPC-Br, also showed inflation around 0.3% in November.

15. Core inflation measures also posted positive results, falling or remaining stable in moderate levels (from 0.3% to 0.4%) for the different methodologies – exclusion, smoothed trimmed mean and non-smoothed trimmed mean. The IPC-Br core also fell in November, reaching 0.36%.

16. Considering accumulated inflation for the year until November and market inflation expectations for December, the IPCA change in 2003 may be slightly above 9%. This rate is close to the 8.5% adjusted inflation target and almost 3.5 p.p. lower than the 2002 inflation rate. This result confirms the monetary policy effectiveness in curbing the extremely negative outlook in the beginning of the year.

17. Recent indicators provide additional evidence of the rebound in economic activity already outlined in previous Copom's meetings. Industrial output maintains the upward trend. Seasonally adjusted results for October showed growth or stability for all categories of use, although total industrial output fell 0.5%. This apparently contradictory result is explained by the seasonal adjustment methodology. The 3-month moving average for October is 1.8% higher than the September average. Leading indicators suggest the continuation of the upward trend for November. The recovery has spread among different industrial sectors, and the diffusion index reached 79% (64% in September) in a scale where 100% indicates that all the 61 sub-sectors surveyed by the IBGE posted positive growth.

18. Consumption recovery is becoming clearer, despite its slower growth compared to production growth. The IBGE retail survey shows an unambiguous marginal improvement, although the accumulated performance for the year is still being affected by the results in the first half of this year. Year-on-year accumulated sales are still negative, but its fall diminished to 5.0% in October from 5.2% in September. Furniture and appliances remain leading the retail segment, with positive performance for the second consecutive month (a 5.2% growth in comparison to October 2002). The assessment of the 3-month moving average of seasonally adjusted primary data of IBGE proves the gradual recovery of retail sales. Another evidence of consumption recovery is the increase in consultations to the Credit Protection System and Usecheque in October. Due to the improvement in credit conditions of the economy,

durable goods are leading the recovery, which is expected to strengthen in view of the improvement in consumers' confidence, the gradual recovery in real earnings and low delinquency indicators.

19. Investment data surprised positively. Capital goods domestic absorption increased 22% in October compared to September. Considering this result, investment rate, although still at a historically low level, confirmed the rebound trend already outlined in the third quarter GDP data. Investment increase reinforces the Copom's expectation of a well-balanced growth recovery, based on expansion in credit to consumers, increase in real earnings and expansion of productive capacity in the tradable goods sector, which idle capacity presents low levels due to exports growth.

20. As in previous months, the external accounts performance remained positive. In the fourth quarter, daily exports grew 20% on average, compared to the same period of 2002, while imports increased 17% in the same period. The trade surplus may be close to US$24 billion in 2003, far above previous estimates. The positive performance should repeat in 2004, when a US$19 billion surplus is expected, despite the significant imports growth caused by the recovery of economic activity. The current account is expected to post a US$4 billion surplus this year, the first positive result since 1992. The country-risk has continued to fall since the last Copom meeting to close to 480 basis points, together with the drop in several international risk aversion indicators. The exchange rate remained roughly stable between the last Copom meetings.

21. There was no alteration in the recovery external scenario assessed in the November meeting. The Copom shares the concerns of several international observers that a monetary tightening cycle may initiate in mid-2004 in the United States. However, considering the recent behavior of US inflation and productivity growth, it is not likely that an increase in US interest rates aborts the global recovery process and drastically reduces international liquidity. The Copom also fears that the widespread improvement of emerging markets risk perception may be reverted in case some countries suffer more intensively the effects of the worsening of the international scenario in 2004. Even so, Brazil is in better conditions than in previous years to face these situations, due to the significant improvement of its fundamentals and the government decision to extend the IMF agreement.

22. The median of market inflation expectations for 2004 stabilized at 6%. As the mode and the median of market inflation expectations are equal, marginal variations only affect the mean, which fell below 6% for the first time in the year between the November and December Copom's meetings. On the eve of the December meeting, the mean stood at 5.88%. The median of market expectations for GDP growth in 2004 increased to 3.5% from 3.4%.

23. Inflation projections by the BCB for 2003 are above the adjusted target of 8.5%, assuming the maintenance of the Over-Selic rate at 17.5% p.a. and of the exchange rate at R$2.94. Considering the same hypotheses for the exchange rate and for the Over-Selic rate, inflation projections are below the target for 2004 and 2005. In comparison to November estimates, there was a slight reduction in inflation projected for 2004, due to the reduction to 7.8% from 8.5% in regulated prices.

24. The positive trend of inflation, the well-balanced recovery of economic activity and the favorable external scenario led the Copom's members to endorse the monetary easing. The Copom unanimously decided to reduce the target for the Over-Selic rate to 16.5% p.a., without bias.

25. However, it is important to emphasize once again that there are important lags between monetary decisions and its effects on economic activity and inflation. Since the beginning of the ease cycle, the Over-Selic rate has been reduced by 10 p.p. Part of the effects of this cut has not materialized on the activity level yet. Nor has the recent recovery of activity shown its effects on inflation.

26. The Copom evaluates that the reduction in the real yield curve, which accompanied the reduction of the Over-Selic rate, will sustain the recovery in economic activity in the coming months. The continuous convergence of inflation to the targets and the resulting consolidation of a long-lasting scenario of macroeconomic stability will contribute to a progressive

reduction of risk perception. This environment will naturally create the conditions required for a lower real interest rate in the coming years.

27. Considering the uncertainties in the transmission mechanism of monetary policy, the Copom understands that the sustainability of the disinflation gains in recent months and of the economic recovery process requires a careful assessment in future monetary decisions. In particular, monetary policy should not endorse the inflationary impact of the readjustment of prices in those sectors that now lead the recovery process. This is the only way to ensure the continuous convergence of inflation to the target path, in an environment of sustained economic growth.

28. At the end of the meeting, it was announced that the Copom would meet again on January 20th, 2004, for technical presentations, and on the following day in order to discuss the monetary policy decision, as set by the Communiqué 11,516, of October 15th, 2003.

Summary of Data Analysed by the Copom

Economic Activity

29. According to IBGE data, retail sales decreased 3.0% in October and 5.0% from January to October, compared to the same period of 2002.October sales performance, although still negative, presented significant improvements when compared to the previous months, as already observed in September. Growth remained negative for four out of the five activities surveyed by the IBGE, while the furniture and appliances sector grew 5.2%.

30. According to Fecomercio SP, retail sales in the greater São Paulo grew 0.7% in October, compared to September, considering seasonally adjusted series. This result was favored by the increase of 1% in consumer goods sales, mainly durable goods, demonstrating the recovery of domestic consumption triggered by better credit conditions.

31. Consultations to the ACSP regarding credit purchases and check purchases increased 10.6% and 10%, respectively, in the first half of December, compared to the same period of 2002.

32. The monthly Fecomercio SP survey on consumer confidence registered a 6.8% increase on its indicator in December, reaching 110.7 in a scale from 0 to 200. Consumers' optimism reflects both current and future consumption intentions due to more positive economic environment.

33. Regarding investment data, a generalized and expressive improvement was observed in October, considering seasonally adjusted data. Compared to September, machines and equipments output increased 3.8%. Capital goods imports increased 47.6% and exports grew 0.6%. As a consequence, capital goods domestic absorption increased 22% in October. Construction output also rebounded in October, growing 1.2% as against September (seasonally adjusted data). Finally, it should be highlighted the increase of BNDES disbursements to medium and long terms investments, which reached R$9.5 billion in the October/November period (R$28.5 billion accumulated in the year until November).

34. According to IBGE, Brazilian industrial output remained stable in October, after the expressive recovery from June to September. Industrial output decreased 0.5% (s.a.). Manufacturing industry output fell 0.1%, while mineral extraction production increased 0.3%. Seventeen out of the twenty sectors surveyed grew, with highlights to the metallurgical and transport industries, which have increased output for six consecutive months. Among the categories of use, the highest monthly increases were registered for capital goods (3.8%) and durable consumer goods (1.8%). Intermediate goods production increased 0.3% and semi and non-durable goods production remained stable.

35. Data released by the CNI regarding the manufacturing industry performance in October confirmed the sector recovery. Real sales increased 3.1% and hours worked in production increased 0.7%, both seasonally adjusted. The level of industrial capacity reached 80.2% in October, compared to the peak of 81.3% in October 2002.

36. In the automotive sector, vehicles production and domestic sales increased 7.3% and 6.2% respectively, in November (s.a.), benefiting from the temporary tax reduction on cars and improved credit conditions. External sales decreased 7.9% in November.

However, up to November, the increase of 31.7% in vehicles exports contributed to the expansion of 1.8% in output, counterbalancing the internal sales fall of 6.5%.

Labor Market

37. The index of employment increased 0.3% month-on-month in October (s.a.), and 3% year-on-year, according to the Ministry of Labor. In accordance with the new methodology of the IBGE's employment survey, the unemployment rate in the six main metropolitan areas remained stable at 12.9%, in October, due to the 0.4% fall of both the number of employed people and the labor force. Still according to the same source, average real earnings (deflated by the IPCA) reached R$686 in September, representing a decrease of 15.9% compared to the same month of 2002, a better result than the 17.3% fall registered between June 2002 and June 2003.

38. In the industrial sector, according to the CNI, there was a 0.2% increase (s.a.) in employment in October, compared to the previous month. Total real wages increased for the sixth consecutive month, but remained 2.8% below the result of the same month of 2002.

Credit and Delinquency Rates

39. Non-earmarked credit rose 1.8% in November, with highlight to the recovery of external funded operations. Lending to companies increased 2.1%, again under the influence of seasonal factors as the harvest and the orders of the end of the year, being worth mentioning the operations with overdraft accounts, vendor and discount of trade bills. Credit to households expanded 1.4%, more noticeably in auto financing and personnel credit, favored by the decline of interest rates.

40. The average interest rate on non-earmarked credit decreased again in November, by 0.6 p.p. to 48% p.a., in response to the consistent downward trend of the Selic rate. The effect was more intense on lending to households, which fell 1.2 p.p. to 68.2%, the lowest level since June 2001. The average rate on corporate lending was 32.3% p.a., falling 0.2 p.p. in comparison to the previous month, the lower result since December 2002. The delinquency rate on non-earmarked banking credit fell 0.2 p.p. in November, reaching 8.4%, due to the reduction of non-performing credit of companies and individuals, whose respective rates stood at 4.6% and 14.2%.

41. Regarding default rates on retail trade, the net delinquency rate of ACSP reduced to 4.2% in November, from 5.4% in October. The new default registrations fell 4.1% and the number of cancelled default registrations increased 4.1%, in comparison to October data.

External Environment

42. For the first time since 2000, the three main economic areas in the world - the United States, Europe and Japan - show signs of a simultaneous pickup in activity. The signs of world growth recovery have been favored by the economic performance in Asia, particularly China, which is now the main destination of exports of Japan, South Korea and Australia.

43. In the United States, the most recent economic indicators confirm that growth sustained momentum, following the 8.2% growth rate in the third quarter. Retail sales increased 0.9% in November, reversing the negative trend experienced in the two previous months. The unemployment rate fell to 5.9% in November from 6% in October, at the same time that unemployment benefit claims fell. The fiscal deficit diminished to US$43 billion in November from US$69.5 billion in October, and the trade deficit rose 1% in October.

44. Industrial production in the Euro area grew 1.3% in October compared to the previous month, particularly benefited from the 1.3% growth in France. Notwithstanding, the euro appreciation is affecting exports growth, bringing doubts about the sustainability of the recovery. In Germany, exports fell 6.6% in October, the largest drop in more than a decade.

45. In Japan, activity has been favored by exports growth, especially vehicles sales to Asian countries. Growth in Asia has been led by China, which posted growth rates of 8.2% in the first half of the year and 9.1% in the third quarter.

46. With inflationary pressures subdued, interest rates remained low across the globe. The equity markets sustained the upward trend, albeit at a slower pace. Ample liquidity in the international market and continued positive risk appetite favored the demand for emerging markets assets. Expectations concerning global growth and world trade have increased food and metal prices, benefiting emerging markets. Oil prices remained volatile and above the upper limit of the Opec band mechanism.

Foreign Trade and Balance of Payments

47. Trade balance registered a US$1.7 billion surplus in November, totaling US$22.1 billion in the year and US$23.9 billion in 12 months. Exports grew 16.6% in November and 20.4% accumulated in the year, compared to the same periods in 2002. Imports grew 10.4% in November and 1.1% in the year, also compared to the same periods in 2002. Up to the second week of December (10 working days), trade surplus totaled US$1.3 billion. Accounting for this period, accumulated surplus in the year to December 14 reached US$23.4 billion.

48. In November, exports reached US$6.0 billion, the highest level ever for the month. Manufactured exports (US$3.5 billion) and basic goods exports (US$1.6 billion) also posted the highest figures ever for November. Imports grew in November, compared to the same month in 2002, with highlights to the increases in raw materials and intermediate goods (19.1%), and capital goods (10.9%), confirming the scenario of investment and activity rebound.

49. As in previous months, in November there was a consistent evolution of exports of goods with a small share in the total, particularly manufactured goods. This strategy of exports and markets diversification and the increase of non-traditional products in total exports reflect the gain in competitiveness of the economy and support projections of a continuous growth in exports.

50. Current account registered a US$3.8 billion surplus in the year up to November, reversing the US$7.6 billion deficit registered in the same period of 2002. The deficit in the services and income account reached US$20.9 billion in the year up to November, compared to US$21.1 billion last year. Financial account balance reached US$12 billion in the January/November period, compared to US$6.4 billion in the same period in 2002. In November, net FDI reached US$2 billion, accumulating US$8.7 billion in 2003. At the end of November, international reserves stood at US$54.4 billion and net adjusted reserves (IMF agreement) stood at US$17.2 billion.

Money Market and Open Market Operations

51. In the period between the November and the December Copom meetings, the yield curve shifted downward in its whole extension. The main factors underlying this behavior, besides the reduction in the Over-Selic rate above market consensus, were the release of lower-than-expected GDP data for the third quarter, improved inflation expectations and the fall of the sovereign country-risk. Between November 19th and December 16th, the 6-month, 1-year and 2-year interest rates decreased 1.44 p.p., 1.39 p.p. and 1.42 p.p., respectively. The 1-year interest rate, deflated by the median of inflation expectations 12 months ahead, fell to 9.3% from 10.6%.

52. The BCB did not carry out the rollover auction of Fx linked securities and swaps maturing on December 18, the last of the year. Consequently, the net redemption of Fx securities and swaps totaled US$19.1 billion for the year.

53. The National Treasury carried out four LTN auctions, totaling R$11.8 billion. Following the downward shift of the yield curve and the higher demand for fixed rate securities, auction rates fell sharply. In tandem with the National Treasury's strategy of improving the profile of the debt, increasing its fixed rate share and decreasing its Over-Selic indexed share, only two auctions of LFT totaling R$1.1 billion were carried out. The placement of inflation-indexed securities (NTN-C and NTN-B) reached R$5.2 billion in the period, R$1.4 billion of which paid in currency. The NTN-B rate maturing in August 2006 fell to 8.99% in the December auction, compared to 9.95% in the previous month.

54. The BCB, in its open market interventions, maintained the 2-week indexed and the 3-month fixed repurchase operations, as well as the daily bank

liquidity management operations. The BCB also carried out in this period five fixed-rate repurchase agreements, maturing between 1 and 4 working days. The average excess of banking liquidity drained from the market reached R$48.4 billion.

55. In November, the net securitized domestic public debt increased 1.5%. The fixed rate share increased to 11.3% from 9.9% in October, while the share linked to the dollar decreased for the sixth consecutive month to 23.8%.

Minutes of the 92nd Meeting of the Monetary Policy Committee (Copom)

Date: January 20th, from 3:30 pm to 6:15 pm, and January 21st, from 4:00 pm to 6:45 pm.
Place: BCB's Headquarters meeting room of the 8th floor (on January 20th) and 20th floor (on January 21st) – Brasília – DF.

In attendance:
Members of the Committee
Henrique de Campos Meirelles – Governor
Afonso Sant'Anna Bevilaqua
Alexandre Schwartsman
Antônio Gustavo Matos do Vale (only on January 21st)
Eduardo Henrique de Mello Motta Loyo
João Antônio Fleury Teixeira
Luiz Augusto de Oliveira Candiota
Paulo Sérgio Cavalheiro
Sérgio Darcy da Silva Alves

Department Heads (present on January 20th)
Altamir Lopes – Economic Department
Carlos Yoshitaka Urata – International Reserves Operations Department
Ivan Luis Gonçalves de Oliveira Lima – Open Market Operations Department
José Antonio Marciano – Department of Banking Operations and Payments System
José Pedro Ramos Fachada Martins da Silva – Investor Relations Group
Paulo Springer de Freitas – Research Department (also present on January 21st)

Other participants (present on January 20th)
Flávio Pinheiro de Melo - Advisor to the Board
Hélio José Ferreira – Executive Secretary
João Batista do Nascimento Magalhães – Special Advisor to the Governor
Jocimar Nastari – Press Secretary
Katherine Hennings – Advisor to the Board

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

Recent Evolution of Inflation

1. The Broad Consumer Price Index (IPCA) rose 0.52% in December against a 0.34% rise in November and a 0.29% increase in October. As a consequence, inflation accumulated 9.30% in the year, substantially lower than the projections made at the beginning of 2003, which pointed to consumer prices growth of around 12% for the year. The IGP-DI rose 0.60% in December, after a 0.48% increase in November, influenced by the 0.74% and the 0.43% variations of the IPA-DI and IPC-Br, respectively. Accumulated changes of the IGP-DI and the IPA-DI in 2003 totaled 7.67% and 6.26%, respectively, remarkably lower than the 2002 results of 26.41% and 35.41%, in the same order.

2. The more important individual contributions for the IPCA rise in December came from tobacco, clothing, rice and meat, and the readjustment of regulated prices such as urban bus tariffs, which altogether accounted for 0.23 p.p. of the total change of the index. Conversely, price falls of chicken, milk, beans and bottled gas contributed with -0.07 p.p. for the IPCA monthly variation. For the 9.30% variation in 2003, regulated and market prices contributed with 3.76 p.p. and 5.54 p.p., respectively. Among the latter, price pressures were substantial in some oligopolized sectors, as in the cases of personal hygiene products

(12.2%), cleansing products (13.9%), furniture (11.8%) and medicine (11.5%). Rice prices, under unfavorable supply conditions since the beginning of the year, rose by 25.2% in 2003.

3. Still regarding the IPCA behavior in December, market prices increased 0.54%, being responsible for 0.38 p.p. in the total change, while the 0.47% rise in regulated prices accounted for the remaining 0.14 p.p.. In the first group, the main pressures came from clothing, tobacco, meat and rice. Regarding regulated prices, the main pressures came from health insurance and urban bus tariffs, which rose by 7.1% in Fortaleza and in Rio de Janeiro (in both cities, the second readjustment in 2003) and by 15% in Belém.

4. Concerning wholesale prices, the 0.74% change of the IPA-DI in December (against 0.46% in November) reflected the elevation of both agricultural and industrial prices. The Agricultural-IPA rose 0.58% in the month, after a 0.26% increase in November. This upsurge was due to an increase in prices of fresh food products (a result of the rainy period) and to the inter-harvest period. Industrial prices rose 0.80%, above the 0.54% change in November, reflecting price readjustments in metals (mainly copper) and in the manufacturing sector (metallurgy, mechanics, electric equipment, wood and furniture, rubber, tobacco and food products). The monthly average price rise of textiles, clothing and shoes remained at a high level (2.08%), albeit lower than in November.

5. Core IPCA inflation, calculated excluding household food items and regulated prices, posted a 0.63% variation in December, after five consecutive months of variations in the range between 0.35% and 0.40%.

6. Core IPCA inflation calculated under the smoothed trimmed-mean method rose by 0.72% in December, from 0.56% in November. Accumulated variation in 12 months hit 11.11%, still reflecting the effects of price increases at the end of 2002. Inflation calculated without the smoothing procedure for pre-selected items reached 0.54% and 8.35%, respectively in the monthly and in the annual basis.

7. Core IPC-Br inflation calculated under the symmetric trimmed-mean method increased to 0.46% in December, from 0.36% in November, accumulating 9.68% in the year.

8. The surge in the core inflation measures reveals that the price increases in the last two months were not only due to seasonal factors, but affected most of the items included in the consumption basket. The ratio of goods with price rises in the IPCA increased to 64.8% in December, from 57.0% in November.

9. In January, both wholesale and consumer inflation are expected to accelerate further. At the wholesale level, more intense seasonal pressures are expected from food prices. A recent survey unveiled that industries plan to accelerate price readjustments in the first quarter of 2004. Consumer inflation should also reflect the effects of seasonal price increases in food and the seasonal pressure in education prices. Amongst regulated prices, the impact of the readjustment of electricity tariffs in Rio de Janeiro should stand out.

Assessment of Inflation Trends

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

a. the projection for gasoline price readjustment for 2004 was kept at 9.5%. For bottled gas, there has been a revision in the projected price change for 2004 to 10% instead of the 3.5% expected in the December Copom meeting. This revision was a consequence of higher international oil prices and the current gap between the price charged at the refinery and the international price denominated in reais;

b. for household electricity tariffs, the price readjustments projected for 2004 stand at 6.8%. Concerning fix telephone tariffs, the 6.6% readjustment projection was maintained. This projection assumes that the judicial decisions limiting tariffs readjustment in 2003 will not be reverted;

c. Regarding all regulated prices, with a total weight of 28.9% in the December IPCA, the Copom maintained the 7.8% price change projection for 2004;

d. the projection for the readjustment of regulated prices for 2005, of 5.4%, is based on the model of endogenous determination, which considers seasonal components, the exchange rate behavior, market prices inflation rate and the IGP-DI change;

e. the projection for the 6-month spread over the Selic rate, following the specification of the Vector Autoregressive model using the Selic and swap rates on the eve of the Copom meeting, rose from –120 b.p. in the first quarter of 2004 to 50 b.p. in the end of 2005.

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

12. Considering the benchmark scenario hypotheses, including the maintenance of the Selic interest rate at 16.5% p.a. and the exchange rate at the level prevailing on the eve of the January Copom meeting (R$2.84), inflation is projected below the target of 5.5% for 2004 and below the target of 4.5% for 2005. According to the market scenario, which takes into account the consensus exchange rate and the Selic rate paths as surveyed by the BCB's Investor Relations Group on the eve of the Copom meeting, inflation is projected slightly above the target for 2004 and above the target for 2005.

Monetary Policy Decision

13. Inflation accelerated between November and December. Consumer inflation measured by the IPCA rose to 0.52% in December, from 0.34% in November. This acceleration was verified in the three sub-groups of the IPCA: tradable, non-tradable and regulated prices. The increase in inflation in December was also captured by other consumer price indices, as the IPC-Fipe and the IPC-Br, as well as the wholesale price indices (IPA-M and IPA-DI) and the general price indices (IGP-M and IGP-DI). Preliminary results for January do not anticipate any change in this pattern in the very short run.

14. Core inflation measures also increased in December, showing that December's figures cannot be attributed to the behavior of specific items. The higher increase was observed on core IPCA inflation calculated by excluding household food prices and regulated prices, which rose to 0.63% in December, after remaining stable in the range between 0.35% and 0.40% from July to November. Albeit in lower intensity, core IPCA and core IPC-Br calculated under the trimmed-mean method also increased in December. Another evidence that price increases are spreading out is the higher ratio of goods in the IPCA basket with positive variation, which increased to 64.8% in December, from 57.0% in November, the highest rate since May 2003.

15. Assessing all available information, the inflation increase in December might be an isolate occurrence owing to seasonal or one-off factors, or it might signal a persistent trend. It is certain that seasonal and extraordinary factors contributed to the December results. If this hypothesis is true, inflation will return to the target path in the medium term, similar to what happened last September.

16. The Copom maintains the recovery scenario outlined in the last meetings. According to the IBGE, industrial output increased 0.8% in November, s.a., reaching the highest level ever. Between July and November, the quarterly moving average of industrial output increased 7.7%. Capital goods posted the highest increase (20.8%), while durable consumer goods grew 19.7%, as a result of increased credit supply. Only the segments of semi and non-durable consumer goods have not showed significant growth rates, as they depend more strongly on real earnings. Industrial output is likely to continue to expand as signaled by leading indicators such as electricity consumption, steel output and the flow of heavy vehicles in the highways. The low level of inventories in some sectors (e.g., automobiles) and the gradual recovery in real income and credit will contribute to higher industrial output. Capital goods absorption increased 27% between July and November, while production of inputs for civil construction increased 5% in the same period. This increase in investment is essential for a sustainable growth path, with no imbalances between supply and demand.

17. Retail sales growth in November surpassed industrial production growth for the first time since the beginning of the upturn. According to IBGE data seasonally adjusted by the BCB, the volume of sales in Brazil rose by 2.1% between October and November. If the quarterly moving average is taken, the result in November was the sixth increase in a row. The growth was sharper in the sectors more dependent on credit, such as automobiles, furniture and appliances. Several indicators anticipate a continuous recovery of consumption, including stronger consumer sentiment; lower default rates; real payroll growth; and lower unemployment rate, which fell to 12.2% in November from 12.9% in October.

18. The Copom restates that a stronger contribution of monetary policy to the recovery of less credit sensitive sectors in industry and retail should stem from its indirect impact, through higher employment and real earnings, both initially concentrated in the more sensitive sectors and gradually spreading over the whole economy. It should not be a result of additional monetary stimulus that could produce, in the short term, larger gaps between the recovery pace in the different activities and generate inflationary pressure in the leading ones.

19. As in previous months, the performance of the external sector has been extremely favorable. There were good results both in trade balance and in the current account balance, the latter closing 2003 with a surplus of approximately US$4 billion – the first positive result since 1992. Besides, private external borrowing surpassed US$2 billion in the beginning of this year, and country-risk measured by J.P. Morgan Chase's Embi+ remains in a downward trend, falling to 430b.p. from 480b.p. between the December and the January Copom meetings. Significant trade surpluses, an open international market for Brazilian companies and a more favorable scenario for the external accounts allowed the real to appreciate between the last Copom meetings. As a consequence, the dollar fell from R$2.94 to R$2.84, even after the BCB announced in the first week of January the start of an international reserves accumulation policy.

20. Even though consistent with seasonal patterns, the recent inflation acceleration made market participants revise upwards their first quarter inflation expectations, a revision led by the most accurate market analysts in the short-term inflation forecasts. Between the eves of the last two Copom meetings, the median of market inflation expectations for the first quarter increased to 1.61% from 1.51%. However, when only the five most accurate forecasters are considered (the Top 5 forecasters), expected inflation rose to 1.68% from 1.48%. For 2004 as a whole and for 2005, the median of market inflation expectations remained stable, at 6.0% and 5.0%, respectively.

21. The BCB inflation projections, according to the benchmark scenario (assuming unchanged Over-Selic rate at 16.5% p.a. and exchange rate at R$2.84/US$), are below the 5.5% target for 2004 and below the 4.5% target for 2005. Under the market scenario, which considers the exchange rate depreciation and the over-Selic rate decrease expected by market participants on the eve of the Copom meeting, BCB inflation estimates are slightly above the 5.5% target for 2004 and above the 4.5% target for 2005.

22. One of the members of the Committee considered that a 0.25 p.p. cut in the target for the Over-Selic rate would be adequate in the current environment, taking into account the pace of recovery in activity, the stability of market inflation expectations for 2004 and 2005, the favorable exchange rate behavior, and the BCB inflation projections under the benchmark and the market scenarios.

23. The other Committee members decided to keep the Over-Selic rate unchanged and to continue monetary easing only when there are more consistent signals that the risk of inflation deviating from its targets is low enough. Several considerations supported this decision.

24. Differently from what was seen last September, in the current inflation acceleration episode, even one-off factors may trigger inflationary pressures for a longer period, as the impacts associated to increases in fresh food prices, education prices and electricity tariffs are higher than initially expected. If one-off inflation pressures are higher and longer than originally expected, the maneuver room for bringing inflation back to the target will be reduced in the first months of the year.

25. Also differently from September, despite the fact that inflation pressures in December and in the first months of 2004 are partially seasonal and non-recurrent, they will hit the economy in a period of stronger demand. Therefore, there is more room for realignments in relative prices to develop into pressures on inflation.

26. Even though there is no sufficient information to a precise diagnosis about the factors that caused the surge in inflation in December and the increase in inflation expectations in the January-February period, some signals suggest that this trend may persist. Firstly, as already outlined, core inflation and partial inflation figures for January do not anticipate an inflation slowdown. Secondly, the increase in the industrial IPA to 0.80% in December may put a pressure on consumer inflation over the next months, especially in a higher demand environment. The increase in wholesale prices was triggered by several factors, including increases in world commodity prices; higher demand for intermediate goods; and the change in relative prices that has benefited sectors more directly favored by the growth in demand, thus enabling increases in profit margins.

27. The higher change of the industrial IPA differs from what happened last September, when the higher IPCA variation was accompanied by an increase in the agricultural IPA, while the industrial IPA remained well-behaved (0.40%). Stronger inflation pressures are also suggested by the FGV survey in January, which showed that 43% of the companies interviewed intended to increase prices in the first quarter of the year. Historical data show an important statistical correlation between those intentions and industrial wholesale prices.

28. The recent appreciation of the real against the dollar is, undoubtedly, an important factor to be considered. However, the Copom believes that in the current environment the effects of this exchange rate appreciation over inflation will not be so intense as it was when the exchange rate floating was the main determinant of changes in tradable goods prices in reais. The US dollar depreciation in relation to other relevant currency, such as the euro and the Japanese yen, has to be accounted. Also, the world economy growth and the US dollar depreciation pushed commodity prices up, which may pressure wholesale prices in Brazil, as has been occurring.

29. Stable inflation expectations for 2004 suggests that the market not only considers the first quarter inflation increase as temporary, but also believes that this increase will be compensated by reductions in the following quarters. If no exogenous factors trigger those reductions, it is assumed that monetary policy will be responsible for producing the compensatory effect.

30. According to the forecasting exercises carried out by the BCB and described in the paragraph 21 above, when the inflation forecasts for the first quarter are substituted by the Top 5 inflation expectations (supposing unchanged Over-Selic rate and exchange rate), projected inflation come to the inflation target in 2004. This upward reevaluation is due to the new estimate of the first quarter inflation and its inertial impacts over the remaining quarters. When the exchange rate and the interest rate path expected by the market are taken, inflation is projected above the target of 5.5% in 2004 and above the target of 4.5% in 2005.

31. The Copom understood that the recent inflation acceleration and the increase in inflation projections might not only be a one-off event, as occurred last September, but a possible accommodation of inflation at higher levels. Even taking for granted that this acceleration is really temporary, the increase in inflation projections is enough to suggest caution in monetary management. As already mentioned before, it is not possible to establish accurately the impacts of the 10 p.p. reduction of the Over-Selic rate between June and December 2003 over the output gap and inflation. Considering that there is a strong possibility that inflation deviates from the targets, monetary policy should act preemptively. A more prudent monetary management will not risk the upturn trend in course since the third quarter of 2003.

32. Thus, the Copom weighted the risk of following with monetary easing and, in case inflation deviates from the targets, the need to change its policy in the medium term, with larger changes in interest rates and significant impacts over economic activity, against the risk, considered very low, of disrupting the recovery process due to the interruption of the

monetary easing. Balancing the risks, the Copom understood to be more adequate to interrupt temporarily the monetary easing. This is the only way to retain the disinflation gains obtained during 2003, not endorsing price increases in the sectors that benefited from the rebound in demand to contaminate overall inflation.

33. Thus, the Copom decided, for eight votes to one, to maintain the target for the Over-Selic rate in 16.5% p.a., without bias.

34. At the end of the meeting, it was announced that the Copom would meet again on February 17th, 2004, for technical presentations, and on the following day in order to discuss the monetary policy decision, as set by the Communiqué 11,516, of October 15th, 2003.

Summary of Data Analysed by the Copom

Economic Activity

35. According to IBGE, retail sales increased 2.1% in November compared to the previous month, considering seasonally adjusted data. Compared to the same periods of the previous year, retail sales decreased 0.3% in November and 4.5% between January and November. Despite representing the 12th consecutive fall compared to the same month of the previous year, the 0.3% change in November was the lowest, confirming the sales recovery. Only two activities out of the five in retail decreased in November, compared to the same period of 2002. Furniture and appliances posted the higher growth rate (9.1%). Vehicles and motorcycles sales, which are not included in the retail general index, increased 6%.

36. According to preliminary data from Fecomercio SP, retail sales in the greater São Paulo increased 2.7% s.a. in November, compared to October. Except for construction materials, there was generalized expansion in sales. Car sales increased 10.2% and semi-durable and durable goods sales increased 7.5% and 4.4%, respectively.

37. The monthly Fecomercio SP survey on consumer confidence showed an increase of 7.1% in January, reaching 118.5 in a scale ranging from 0 to 200, the highest level since the beginning of the survey, in 1999.

38. Regarding investment data, capital goods output increased 3.9% in November compared to October. However, construction industry inputs fell 0.6% seasonally adjusted. BNDES' medium and long term financing amounted to R$12.6 billion in the last quarter of 2003, nearly 38% of the total accumulated in 2003.

39. After remaining flat in October, Brazilian industrial output resumed in November the growth trend initiated in the beginning of the second half of the year. According to the IBGE, industrial output increased 0.8% in November, accumulating a 7.6% expansion since July. The November output increase was driven by durable consumer goods and capital goods, which rose by 2.2% and 3.9%, respectively. Intermediate goods output grew 0.4% while semi and non-durable goods production fell 1.6%. Eight out of the twenty sectors surveyed presented growth, led by mechanical, metallurgical, transportation, electrical and communications materials industries. Up to November, industrial output grew 0.1% compared to the same period of 2002, and 0.4% in the last twelve months.

40. Data on manufacturing activity released by the CNI in November confirmed the cyclical recovery. Industrial sales increased 3.2% (s.a.) compared to October, accumulating five consecutive rises and totaling a growth of 13.6% in the period July-November. In comparison with the same period of 2002, real sales registered the first positive change since March 2003, of 4.3%. Worked hours increased 0.4% in November, growing by the fifth consecutive month. The level of capacity utilization fell to 79.6% in November from 80.0% in October.

41. In the automotive sector, vehicles production and external sales fell 2.3% and 5.0% in December (s.a.), respectively, while domestic sales increased 7.7%. In 2003, output and exports increased 2.0% and 29.1% respectively, while domestic sales fell 2.4%.

42. According to a FGV survey, industrial growth should strengthen in the next few months. Business confidence remained positive, favoring the increase in output. However, there are evidences of profit

margins increases in industry, with a growing share of companies intending to increase prices in the next three months.

Labor Market

43. The index of employment increased 0.4% month-on-month in November compared to October (s.a.), and 3% year-on-year, according to the Ministry of Labor. According to the IBGE's survey, the unemployment rate in the six main metropolitan areas reached 12.2% in November, compared to 12.9% in October. This fall was mainly a result of a 1.1% expansion in the number of employed workers, above the 0.3% increase of the economic population. The same survey also registered that the average wage reached R$850.3. In real terms (deflated by the INPC), the average wage increased 0.6% compared to the previous month and posted a 14.9% fall compared to the same month of 2002.

44. In the industrial sector, according to the CNI, there was a 0.1% increase (s.a.) in employment in November, compared to the previous month. In the accumulated up to November, there was a 0.8% increase. Industry real payroll increased 2.9% in November, sustaining the trend outlines since June. Compared to the same month of 2002, real payroll recorded a 1.6% growth in November, the first positive rate in 2003 considering the same basis.

Credit and Delinquency Rates

45. Total credit increased 1.6% in December, reflecting a 1.4% increase in non-earmarked credit, and 2.1% in earmarked credit. Regarding non-earmarked credit, there was a 0.8% increase in credit to households and a 1.9% increase in credit to companies, due to the increase in domestically funded operations, mainly working capital credit and overdraft accounts. The lower increase in household loans was caused by a fall in overdraft accounts as a consequence of the end-of-year bonus (13th wage). With respect to earmarked credits, there was an increase of 2.6% in rural lending and of 2.4% in BNDES lending.

46. New loans roared in December. Daily new loans to companies increased 9.4%, as a consequence of payment to employees of the 13th wage, the rebuild of inventories and debt rollovers. Concerning household borrowing, new loans increased 7% in December, driven mainly by increases in auto financing and personnel credit.

47. The average interest rate on non-earmarked credit fell 2.2 p.p. in December to 45.8% p.a., as a result of the continuous reduction of the Over-Selic rate and the larger volume of credit to companies. The decline in rates was more significant for companies, which fell to 30.2% in December from 32.3% in November. For household loans, the average rate diminished to 66.6% from 68.2%. The delinquency rate on non-earmarked credit fell in December to 7.9% compared to 8.4% in November.

48. Regarding the retail sector, net default rates declined to 1.9% in December from 4.2% in November. The average default rate stood at 5.2% in 2003 as against 6.4% in 2002.

External Environment

49. Global economic activity strengthened in the fourth quarter of 2003, mainly due to demand recovery in the US and Japan. The outlook for 2004 suggest an acceleration of the world economic growth without significant inflationary pressures, but with growing risks that the fiscal and external imbalances in the US and fiscal deficits in some European countries could lead to larger protectionist barriers and to an interruption in capital flows to emerging markets.

50. In the US, industrial production in December increased (0.1%) for the sixth consecutive month. Sales increased for the sixth consecutive month in November, although industrial orders have declined 1.4%. The unemployment rate decreased in December to 5.7% and the same occurred with the unemployed benefit. The budget deficit totaled US$16.2 billion in December, the first deficit for December in five years.

51. Business sentiment in the US, Japan and Europe continued improving, despite the possible negative effects of the Parmalat's affair in Europe. Consumer confidence remained weak because of the labor market conditions.

52. The fixed-income market in the US has not reacted to the upturn of the economy, in part due to the Federal Reserve signaling of a steady interest rate in the near future. In the foreign exchange markets, the US dollar depreciation is expected to persist, even after accumulating a nominal fall of 24% in relation to the euro and 12.7% in relation to the Japanese yen during 2003.

53. Huge liquidity in the financial markets is facilitating emerging markets external financing. As a consequence, many sovereign issues took place in the beginning of the year. FDI to emerging markets should also increase in 2004, unless there are changes in the Federal Reserve monetary stance or in expectations regarding advanced economies growth. Stronger demand worldwide has benefited commodity prices, and oil prices continued to oscillate the OPEC price band.

Foreign Trade and Balance of Payments

54. The Brazilian trade balance posted a US$2.8 billion surplus in December, a new record for this month. Exports and imports increased 22.9% and 10.6%, respectively, compared to the December 2002 daily averages. In the first 11 working days of January, the trade surplus totaled US$657 million.

55. In December, Brazilian exports totaled US$6.7 billion. Imports stood at US$4 billion, expanding for the fourth consecutive month. Raw material and intermediate goods (26.8%) and capital goods (15.5%) led the increase in imports.

56. The external trade registered a US$24.8 billion surplus in 2003, with exports reaching US$73.1 billion and imports summing up US$48.3 billion. Both the trade surplus and exports reached the highest levels ever. Exports grew 21.1%, equivalent to US$12.7 billion. Manufactured goods accounted for 54.3% of total exports.

57. The current account registered a US$349 million surplus in December and a US$4.1 billion surplus in 2003, reversing the US$7.7 billion deficit obtained in 2002. Net FDI totaled US$1.4 billion in December, thus accumulating US$10.1 billion for the year. International reserves closed the year at US$49.3 billion, and net adjusted international reserves (IMF agreement concept) stood at US$17.4 billion.

Money Market and Open Market Operations

58. After December's Copom meeting, the yield curve moved downwards until January 13th. This movement was caused by capital inflows and the subsequent exchange rate appreciation, and the fall of the sovereign risk. As a result, the 3-month, 1-year and 2-year interest rates recorded in the period a decrease of 0.42 p.p., 0.74 p.p. and 1.01 p.p., respectively. After the disclosure of the IPCA readings for December, the yield curve shifted upwards. The ex-ante real interest rate fell to 8.7% on the eve of the January Copom meeting from 9.3% in December.

59. The BCB decided not to rollover the FX debt and swaps maturing in January and in the beginning of February. Consequently, the net redemption of FX securities and swaps in the year to February 2nd reached US$6.3 billion.

60. The National Treasury carried out three LTN auctions, totaling R$10.8 billion. The yield curve reduction and strong demand for fixed rate securities contributed to diminish the auction rates. In regard to LFT, three auctions were carried out, with securities maturing in 2008 and 2009. Total sales reached R$2.8 billion. Auctions of inflation-indexed securities were restricted to NTN-B (indexed to the IPCA), reaching R$1.3 billion.

61. The National Treasury also carried out for the first time a public offering of NTN-F, a fixed rate 4-year security with a 6-month coupon.

62. The BCB maintained in its open market operations the 3-month fixed and the 2-week indexed repurchase operations, as well as the daily liquidity management operations. The BCB also carried out in this period 9 fixed rate repos falling due between 1 and 4 working days. The excess liquidity drained from the market averaged R$51.9 billion.

63. In December, the net securitized domestic public debt increased R$3.1 billion. The fixed rate share increased to 12.5%, while the dollar-linked share decreased for the seventh consecutive month, to 22.1%.

Minutes of the 93rd Meeting of the Monetary Policy Committee (Copom)

Date: February 17th, from 4:10 pm to 6:15 pm, and February 18th, from 3:30 pm to 6:45 pm.
Place: BCB's Headquarters meeting room of the 8th floor (on February 17th) and 20th floor (on February 18th) – Brasília – DF.

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

Department Heads (present on February 17th)
Altamir Lopes – Economic Department
Carlos Yoshitaka Urata – International Reserves Operations Department
José Antonio Marciano – Department of Banking Operations and Payments System
José Pedro Ramos Fachada Martins da Silva – Investor Relations Group
Marcelo Kfoury Muinhos – Research Department (also present on February 18th)
Sérgio Goldenstein – Open Market Operations Department

Other participants (present on February 17th)
Alexandre Pundek Rocha – Advisor to the Board
Flávio Pinheiro de Melo – Advisor to the Board
Hélio José Ferreira – Executive Secretary
João Batista do Nascimento Magalhães – Special Advisor to the Governor
Jocimar Nastari – Press Secretary
Katherine Hennings – Advisor to the Board

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

Recent Evolution of Inflation

1. The main price indicators showed an inflation increase in January. The Broad Consumer Price Index (IPCA) rose 0.76% in January, compared to 0.52% in December, registering three consecutive monthly increases. The General Price Index – Domestic Supply (IGP-DI) rose 0.80% in January, after a 0.60% increase in December and a 0.48% increase in November. The IGP-DI change was influenced by the 0.75% increase in the Wholesale Price Index (IPA-DI) and by the 1.08% increase in the Consumer Price Index – Brazil (IPC-Br). The accumulated changes of the IPCA, IGP-DI and IPA-DI in twelve months sustained a downward trend in January, registering 7.71%, 6.22% and 4.75%, respectively.

2. Concerning the São Paulo Consumer Price Index (IPC-Fipe), inflation diminished to 0.46% in the first week of February, from 0.65% in January. However, this decrease in the IPC-Fipe is not necessarily representative of the IPCA trend, as the indices encompass different geographical areas, different basket of goods and different methodologies. Both indices have also presented different behaviors in the recent past. In the last twelve months, the IPC-Fipe posted a 6.53% change, 1.18 p.p. lower than the IPCA change over the same period. The gap in the changes of prices in São Paulo and in the other areas in Brazil is also detected in the IPCA regional breakdown: in the last twelve months, the accumulated change of the São Paulo IPCA rose by 6.26%, while the average change in the other 10 cities surveyed rose by 8.51%.

3. The more important individual contributions for the IPCA result in January were electricity tariffs, car prices, fresh food products, rice, beans and bottled gas, which altogether accounted for 0.28 p.p. of the total change of the index. Market prices changed 0.73% in the month, contributing 0.52 p.p. to the overall result of IPCA, while the 0.84% increase in regulated prices contributed 0.24 p.p. Among the latter, the higher contributions came from

electricity, bottled gas, gasoline, alcohol-based auto fuel and health insurance plans.

4. Concerning wholesale prices, the IPA-DI remained roughly stable at 0.75% in January. This behavior resulted from the reduction of agricultural prices and from the increase of industrial prices. The Agricultural IPA registered a -0.34% variation in January, after rising 0.58% in December, mainly reflecting the falls in the prices of meat, chicken, milk and egg products, which more than compensated the price increases of fresh food items, coffee and beans. The Industrial IPA posted a 1.20% change, compared to 0.80% in December, the third consecutive acceleration. The higher contributions to the Industrial IPA acceleration came from the metallurgy industry (iron, non-iron metals, steel and by-products), chemical industry (plastics, fertilizers and others) and transportation industry. For fabrics, clothing and shoes, the monthly change remained stable, albeit in a high level for the third consecutive month, still reflecting the effects of cotton price increase.

5. Core IPCA inflation, calculated excluding household food items and regulated prices, posted a 0.64% increase in January, remaining relatively stable in comparison to the 0.63% variation in December. Transportation and personal expenses have contributed more intensely to this result. Considering the accumulated change in twelve months, the core registered a 7.39% variation in January, compared to an 8.17% variation in December.

6. The variation of the IPCA core inflation, calculated under the smoothed trimmed-mean method, reached 0.73% in January compared to 0.72% in December. The 12-month accumulated change posted 10.47%. The same measure, without the smoothing procedure, showed acceleration for the third consecutive month, reaching 0.63% in comparison to 0.54% in the previous month.

7. Core IPC-Br inflation calculated under the symmetric trimmed-mean method by Fundação Getúlio Vargas (FGV) reached 0.65% in January, compared to 0.46% in December, accumulating an increase of 8.95% in the last 12 months.

8. The effects of the food prices recent slowdown – reflecting the beginning of the harvest period and the fall of fresh food prices – is likely to moderate the remaining pressures on inflation in February. Such trend is already noticeable in the partial results already disclosed for February wholesale inflation. As to industrial prices, it should continue to reflect the costs increases. Regarding the IPCA, the favorable evolution of food prices should be offset by the price increases in education, health insurance plans and telephone tariffs.

Assessment of Inflation Trends

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

a. Gasoline and bottled cooking gas price projections for 2004 were maintained at 9.5% and 10%, respectively;

b. Household electricity tariffs are expected to increase 6.3% in 2004, a reduction of 0.5 p.p. compared to the expectation in the last Copom meeting. The projections for telephone tariffs were slightly risen, by 0.2 p.p., reaching 6.8%;

c. Regarding all regulated prices, with a total weight of 28.9% in the January IPCA, the Copom maintained the projection for 2004 nearly unchanged at 7.7%;

d. The projection for the readjustments of regulated prices in 2005, based on the endogenous determination model, increased to 6.0% from 5.4%. This model takes into account seasonal factors, the exchange rate behavior, market prices change and the IGP inflation rate;

e. The projection for the trajectory of the 6-month spread over the Selic rate, following the specification of a Vector Autoregressive model using the Selic and swap rates on the eve of the Copom meeting, reached 17.1% in the fourth quarter of 2005.

10. Regarding fiscal policy, it is assumed that the primary surplus target of 4.25% of the GDP for 2004 and the following two years will be achieved. The

related assumptions considered in the previous meeting were maintained.

11. Considering the benchmark scenario hypotheses, including the maintenance of the Selic interest rate at 16.5% p.a. and of the exchange rate close to the level prevailing on the eve of the Copom meeting (R$2,91), IPCA inflation was projected below the 5.5% target for 2004. Inflation projections based on the trajectories of the exchange rate and Selic rate expected by market participants on the eve of the meeting, gathered by the BCB´s Investor Relations Group (Gerin), were above the central targets of 5.5% and 4.5% for 2004 and 2005, respectively.

Monetary Policy Decision

12. The inflation rate accelerated from December to January. The 0.76% IPCA variation in January was significantly higher than market consensus on the eve of the December Copom meeting (0.60%). Inflation for the three groups in the IPCA – tradable, non-tradable and regulated items – stood high and/ or increased in January. For tradable goods, the January result remained similar to the one observed in December, around 0.5%. Non-tradable and regulated prices changes departed from an already high level in December and increased about 0.4 p.p. in January, posting 0.97% and 0.84%, respectively, the third consecutive rise for both series.

13. The IPC-Br accelerated to 1.08% in January, from 0.43% in December. Inflation measured by the general price indices (IGP-M and IGP-DI) and by the IPA-M also rose in January. Inflation measured by the IPA-DI remained practically stable from December to January, but at a high rate (0.75%), in spite of being strongly favored by the Agricultural IPA 0.34% fall. The Industrial IPA rose for the third month in a row and reached 1.20% in January, the highest figure since March 2003.

14. Core inflation measures remained practically stable in January, in a level inconsistent with the inflation targets. The core IPCA calculated by excluding household food items and regulated prices posted 0.64% in January, close to the variation observed in December, but higher than that of November (0.38%). The core IPCA calculated under the smoothed trimmed-mean method presented a similar behavior: 0.56% in November, 0.72% in December and 0.73% in January. The core IPC-Br calculated under the symmetric trimmed-mean method rose to 0.65% in January, from 0.46% in December. The ratio of items with positive variations in the IPCA increased to 70.9% in January, from 64.8% in December, the highest level since April 2003.

15. Economic activity indicators remain consistent with the economic recovery scenario that the Copom has been working with in the last months. After a significant fall in the first half of 2003, industrial production presented strong growth in the second half of the year. The industrial production quarterly moving average accumulated a 5.1% growth from June to December, seasonally adjusted. For the same period, durable goods and capital goods output production presented an 18.4% and 12.3% growth, respectively.

16. In the same period, the semi and non-durable goods output, strongly influenced by real earnings, registered a 1.8% drop (quarterly moving average). The Copom stresses the remarks made in the January meeting minutes that these sectors recovery will come naturally, as a consequence of the gradual dissemination of growth throughout the economy. An excessive monetary easing with the objective of pushing these specific sectors forward would intensify, in the short run, the recovery gaps amongst sectors, and would allow for inflationary pressures to arise from leading sectors.

17. In December, industrial output presented a 1% fall, seasonally adjusted, in relation to the previous month. When the quarterly moving average is taken, the output decrease in December diminishes to 0.1%, month-on-month, and is close to the December 2000 historical peak. Volatility around the underlying output trend is normal in periods of economic recovery. This volatility does not indicate that the economic rebound process is losing steam, especially because the monetary easing that took place in the second half of 2003 has not yet fully materialized.

18. Industrial sales growth surpassed industrial production growth for the third consecutive month. In the second half of 2003, industrial sales increased

2.5 p.p. more than industrial output. This gap augmented in the fourth quarter, when industrial sales increased 4.3 p.p. more than output. The different growth rates suggest a higher expansionary stimulus for industrial output in the short-term, coming from the inventories build-up dynamics, as well as from improved consumer confidence, real earnings growth and credit expansion.

19. According to IBGE data seasonally adjusted by the BCB, retail sales quarterly moving average grew 0.5% in December, compared to November, and 2.9% from June to December. As for industrial sales, retail sales growth was led by sectors directly favored with credit expansion, as furniture and appliances (14.4% from June to December), and automobiles and motorcycles (16.2% for the same period). The most likely scenario is a continuous recovery in consumption as a consequence of improved consumer sentiment, higher real payrolls and lower consumer default rates.

20. As in previous months, the external sector continued to post a positive performance. In January, exports and imports increased 26.5% and 20.9%, respectively, compared to January 2003. The trade balance and the current account registered an US$1.6 billion and a US$0.7 billion surplus, respectively. There was an increase in the sovereign risk perception due to market concern about an earlier-than-expected rise in US interest rates and its impact in emerging markets liquidity. As a consequence, the Brazil Embi+ increased nearly 100 b.p., to 520 b.p. between the January and the February Copom meetings. In the same period, private external funding diminished and the dollar appreciated from R$2.84 to R$2.91. Nonetheless, the external scenario remains positive, with favorable perspectives for global growth, increase in demand for Brazilian exports and adequate liquidity conditions.

21. First quarter market inflation expectations have been increasing since December. The inflation in January was higher than market consensus and preliminary data suggest that February inflation will also be higher than the previous forecast. Considering the eves of the Copom meetings, the median of the first quarter inflation expectations for the five most accurate short-term forecasters (the Top 5 short-term forecasters) increased to 1.98% in February from 1.68% in January and 1.48% in December. The median of the market inflation expectations rose to 1.90% in February from 1.51% in December. Despite higher expectations for the first quarter inflation, the medians for 2004 and 2005 inflation remained stable at 6.0% and 5.0%, respectively.

22. The BCB inflation forecasts, according to the benchmark scenario (assuming unchanged Over-Selic rate at 16.5% p.a. and exchange rate at R$2,91/US$), are below the 5.5% target for 2004 and below the 4.5% target for 2005. Compared to January, there was an increase in the inflation projection for 2004, due to higher-than-anticipated inflation in January and due to the impact of the exchange rate depreciation. The forecast for 2005 remained unaltered. Under the market scenario, which takes into account the path for the exchange rate and the Over-Selic rate expected by market participants on the eve of the Copom meeting, the BCB inflation estimates are above the targets for 2004 and 2005.

23. The Copom also examined the inflation projections produced according to the same methodology and according to the same benchmark and market scenarios, taking into account the Top 5 short-term inflation expectations for February and March, and hence projecting inflation for the following months. In this exercise, the projected inflation for 2004 is slightly above the target even in the benchmark scenario, although the projection for 2005 remains below the target. The same procedure considering the market scenario shows an increased difference between the projected inflation rate and the targets for 2004 and 2005.

24. Considering the post-Real Plan period, the January inflation was the highest in the first quarter in 7 out of 9 years. It is justified to expect that this seasonal behavior persists and that the February inflation shows some reversion in relation to January. However, since the January meeting, the Copom has not yet identified factors that could reduce the risks of an inflation higher than the 5.5% target for 2004. First, the IPCA and the different core measures in January, as well as the expectations for February, do not point out any reduction trend. Preliminary evidence of an

inflation deceleration can be found in the partial results of the IPC-Fipe and the weekly IPC-S. For the IPC-S, however, inflation persists at a high level; for the IPC-Fipe, the reduction was more intense, and yet, due to the reasons described in paragraph 2 above, this pattern may not be the same for the IPCA. Second, inflation measured by the Industrial IPA remained high and accelerated, influenced by an increase in some commodities prices, by a higher demand for inputs and by the relative price realignment, favoring the sectors that benefited from stronger demand. Although a higher wholesale inflation will not necessarily be transmitted to consumers with the same intensity, a higher passthrough would happen as a consequence of the perception of a lenient monetary policy and of an over-optimistic scenario produced by the recovery of certain sectors.

25. Even considering that the recent inflation increase was caused by seasonal and one-off factors, and considering the return of inflation to a path consistent with the inflation target in the near future, the achievement of the 5.5% target for 2004 will require a more cautious monetary policy, as a result of higher inflation in January and of higher short-term inflation expectations.

26. Consequently, and considering the uncertainties about the magnitude and the lags on the output gap and on inflation of the 10 p.p. reduction in the Over-Selic rate that took place from June to December, the Copom maintains the January minutes diagnosis, that there is a real likelihood that inflation deviates from the target, requiring an extra concern in monetary policymaking.

27. The balance between the risks of inflation deviating from the target and the interruption in the economy recovery process has not changed significantly since January. Resuming monetary easing prematurely can significantly increase the risk that actual inflation deviates from the target, which could force a change in monetary stance in the medium run, with strong interest rates movements and a significant effect on economic activity. On the other hand, an unchanged Over-Selic rate causes a substantial lower risk of damaging the process of economy recovery.

28. As a result, the Committee decided, unanimously, to maintain the target for the Over-Selic rate at 16.5% p.a., without bias, looking forward to consistent signals of low risk of inflation deviating from the target path.

29. At the closing of the meeting, it was announced that the Copom would meet again on March 16, for technical presentations and on the following day, in order to discuss the monetary policy decision, as established in Communiqué 11,516, of October 15, 2003.

Summary of Data Analyzed by the Copom

Economic Activity

30. Retail sales decreased 0.3% in December, month-on-month, considering seasonally adjusted data. After twelve consecutive decreases, sales grew 3.2% in December compared to the same month of 2003.

31. Consultations to the São Paulo Trade Association and the Usecheque increased 4.6% and 0.2%, respectively, in the first half of February, compared to the same period of 2003, indicating the continued expansion of the retail activity.

32. The Federação de Comércio de São Paulo survey on consumer confidence showed in February a 0.5% decrease of consumption intentions, after a substantial increase in the three previous months. However, the result of 126.7, in a scale ranging from 0 to 200, reflects an overall positive sentiment, mainly regarding future consumption intentions.

33. Regarding investment data, for the second consecutive month, capital goods output decreased in December, compared to the previous month. Machines and equipments production and capital goods imports decreased 5.3% and 15.2%, respectively (seasonally adjusted). The construction industry input also decreased by 1.2% in December.

34. The Brazilian industrial production decreased 1% month-on-month in December, seasonally adjusted, interrupting a sequence of five positive results. Out of the twenty surveyed segments, fifteen decreased, as well as in three out of four use categories. Capital goods production fell 5.3%, while semi and non-

durable goods production decreased 3.6%, and durable goods production declined 2.1%. Intermediary goods production, the only category showing a positive change, increased 0.9%, maintaining the upward trend for the sixth consecutive month. Compared to the same month of the previous year, industrial production increased 2.9% in December, completing four months of positive changes in this comparison. In 2003, compared to 2002, industrial production grew 0.3%.

35. The National Confederation of Industry (CNI) statistics regarding the performance of the manufacturing activity in December showed recovery continuity. Real sales changed 1.3% in the month (seasonally adjusted), increasing for the sixth consecutive month and accumulating an expansion of 14.8% in the period. Comparing to the same month of 2002, real sales increased 10.9%, registering the second consecutive positive rate. After five months increasing, the worked hours decreased 2.1% in December. The level of capacity utilization, however, increased slightly to 80.3% in December from 79.7% in November.

36. According to CNI, business confidence increased 12.4% in January, compared to the previous survey in October. The 62.4 result, in a scale ranging from 0 to 100, reflected greater optimism of businessmen in relation to both current conditions and next six months expectations.

37. In the automotive sector, vehicles production and external sales increased 0.3% and 50.2%, respectively, month-on-month, while domestic sales fell 2% (seasonally adjusted data).

Labor Market

38. The index of employment increased 0.1% month-on-month in December compared to November (seasonally adjusted), and 3% year-on-year, according to the Ministry of Labor. According to the IBGE's survey, the unemployment rate in the six main metropolitan areas decreased to 10.9% in December from 12.2% in November, indicating the second fall in a row. This fall was mainly a result of a greater reduction in the number of unemployed workers relatively to the fall of economic population. The same survey also registered that the average wage, earned by employed workers in November, increased 2.8% compared to the previous month and posted a 13.1% fall compared to the same month of 2002.

39. In the industrial sector, according to the CNI, there was a 0.24% decrease in employment in December, compared to the previous month. Industry real payroll sustained the recovery trend, increasing 0.5% in December compared to November, completing seven months of growth. Compared to the same month of 2002, real payroll recorded a 4.0% growth in December, the second consecutive positive rate in 2003, considering the same basis.

Credit and Delinquency Rates

40. Non-earmarked credit increased 0.2% in January. This modest increase reflected low corporate financing needs, due to seasonal factors. As a consequence of lower demand, there was a 1.6% fall in domestically funded operations, whereas external funded operations recorded a 0.8% fall. Regarding credit to households, there was a 1.7% increase, reflecting higher demand due to expenditure on vacation, schooling and tax payment.

41. The average interest rate on non-earmarked credit fell 0.4 p.p. in January, reaching 45.4% p.a. The decline in rates was more significant for households, which fell 1.2 p.p., reaching 65.4% p.a. The average interest rate on credit provided to companies reached 30.1% p.a., stable in relation to last month (30.2%). The delinquency rate on non-earmarked credit increased 0.1 p.p. in January, reaching 8%, as a consequence of the 0.3 p.p. seasonal increase in non-performing credit of individuals. Regarding credit to companies, there was a 0.1 p.p. decrease.

42. Regarding the retail sector, there was an improvement in the default figures of January, compared to same month in 2003. Net default rates declined to 4.7% in January from 6.2% in January 2003. The average default rate stood at 5.2% in 2003.

External Environment

43. Recent GDP growth figures for the central economies reinforce the global economy recovery scenario. U.S. growth rate stood at 4% in the last

quarter of 2003, accumulating a 3.1% annual growth rate. In the second half of 2003, private investment replaced government expenditures as the component with the highest growth. The Euro Area grew 0.4% in 2003, after registering a growth rate of 1.2% in the last quarter of the year.

44. In the U.S., recent figures confirm the growth trend, despite the 0.3% decrease in retail sales in January. Wholesale sales increased in December for the seventh consecutive month (1%), accumulating 8% in the year, mainly due to the performance of durable goods. The unemployment rate declined to 5.6% in January, but the number of unemployed benefit claims remained stable. In the Euro Area, the unemployment rate stood stable in 8.8%, while in Japan and in the other OECD countries this rate fell.

45. Business sentiment in the US, Japan and Europe continued to improve. Consumer confidence declined in the U.S. but increased in Japan and remained flat in the Euro Area (except in Italy due to the Parmalat affair). However, in general, consumer confidence remained weak due to the labor market conditions in the respective countries.

46. In the absence of inflationary pressures, the basic interest rates remained steady in the central economies, except for the United Kingdom, where there was an increase of 25 b.p of the Bank of England's repo rate. The U.S. fixed income market has not reacted to the signs of economic recovery in the country. However, the change in the Federal Reserve's statement caused negative reactions in the sovereign bonds market, in the FX market and in the stock market.

47. In the FX markets, there is a near consensus about the continuity of the dollar depreciation due to the increasing U.S. current account deficit. The dollar depreciation together with strong Chinese demand is affecting commodities prices, which reached record levels in January. The oil price increased again in February, reflecting the producers' decision to reduce output by 1 million barrels/day, starting April 1st.

Foreign Trade and Balance of Payments

48. The Brazilian trade balance posted a US$1.6 billion surplus in January, a new record for this month. Exports and imports increased 26.5% and 20.9%, respectively, compared to the December 2003 daily averages. In the first 10 working days of February, the trade surplus totaled US$873 million.

49. In January, Brazilian exports totaled US$5.8 billion. The three categories – basic, semi-manufactured and manufactured – registered record exports. Imports amounted to US$4.2 billion, expanding in all categories.

50. The results in 12 months to January for the trade balance and for exports were historical records: US$25.3 billion and US$74.1 billion, respectively.

51. The current account registered a US$0.7 billion surplus in January. Income and services registered a US$1.2 billion deficit, the same level of January 2003. Financial account balance increased substantially, to a US$3.8 billion surplus from US$550 million in January 2003, expressing better rollover rates not only for direct loans (to 92% from 29%) but also for private securities placed abroad. Net FDI totaled US$993 million in January, slightly above the result for the same month of 2003 (US$905 million). At the end of January, international reserves stood at US$53.3 billion, and the net adjusted international reserves (IMF agreement concept) stood at US$21.5 billion.

Money Market and Open Market Operations

52. After the January's Copom meeting, volatility in the money market increased significantly. Between January 21st and February 17th, the 3-month, 6-month and 1-year interest rates increased 0.27 p.p., 0.20 p.p. and 0.08 p.p., respectively, while the 2-year rate decreased 0.13 p.p. The ex-ante real interest rate increased to 9.1% on the eve of the February Copom meeting, from 8.7% in January.

53. As in the previous month, the BCB decided not to rollover the FX debt and swaps maturing on February 11th. Consequently, the net redemption of FX securities and swaps in the first two months of the year totaled US$7.6 billion.

54. The National Treasury carried out four fixed rate LTN auctions, totaling R$10.5 billion, with

maturities in January and July 2005. Placement rates oscillated, following the volatility of the yield curve. A NTN-F auction was also carried out totaling R$427.6 million and maturing on January 1st, 2008. The placement rate decreased to 15.67% from 17.19% in a similar event in December. In regard to Selic-indexed LFTs, only one auction was carried out, offering securities maturing in 2009. Total sales reached R$936.9 million. Auctions of inflation-indexed securities (NTN-C and NTN-B) reached R$2 billion.

55. The BCB maintained in its open market operations the 3-month fixed and the 2-week indexed repurchase operations, as well as the daily liquidity management operations. The BCB also carried out in the period 11 fixed rate repos with 1-working day tenure. The excess liquidity drained from the market averaged R$57 billion.

56. In January, the net securitized domestic public debt increased R$5.9 billion, or 0.8%. The dollar-linked share decreased to 21%, the lowest level since July 2000.

Economic policy measures

Measures related to the financial system and credit market

Resolution 3,145, 12.11.2003 – Raised the resources of the Banco do Brasil rural savings account system to be applied to agricultural current expenditures from R$3.9 billion to R$4.5 billion, when such are formalized according to the conditions applied to earmarked resources, among which is a rate of interest of 8.75% per year.

Resolution 3,153, 12.11.2003 – Authorized the states and municipalities to contract operations in the total amount of R$2.9 billion, for purposes of investment in environmental restructuring operations, based on the following limits:

a) up to R$1.1 billion will be linked to new international tenders, with contracting to take place by 4.30.2004;

b) up to R$1 billion, with contracting up to 4.30.2004, in operations foreseen in the Fiscal Adjustment Programs of the states, according to the terms of Law 9,496, dated 9.11.1997, as well as in municipal debt refinancing contracts, signed under the terms of Provisional Measure 2,185-35, dated 8.24.2001; and

c) up to R$800 million channeled to operations in the framework of the System of Registration of Operations with the Public Sector (Cadip).

Resolution 3,156, 12.17.2003 – Extended the possibility of contracting correspondents to all financial institutions and other institutions authorized to operate by Banco Central. Previously, this right was limited in general to banking institutions. Consequently, this measure has the objective of stimulating the supply of financial products and services in regions located far from urban centers, providing the low income population of these regions with access to the market.

Resolution 3,160, 12.17.2003 – Set the Long-Term Interest Rate (TJLP) at 10% per year, to remain in effect in the first quarter of 2004. This rate represents a reduction of 1 percentage point when compared to the previous quarter's rate.

Resolution 3,161, 12.18.2003 – Altered the rules on the Credit Guaranty Fund (FGC), which is a mechanism supported by contributions from financial institutions designed to protect bank deposits. The major alteration refers to a more flexible system of determining ordinary monthly contributions. The FGC board of directors will be charged with setting this percentage, provided that it be submitted to prior Banco Central authorization. Previously, this contribution was set at 0.025% of the balance of the liabilities covered by the guaranty. However, with the new rule, this will be the maximum percentage, meaning that it may be lower and would thus contribute to reducing both funding costs and the banking spread.

Circular 3,217, 12.19.2003 – Altered procedures for calculating exposure in gold, foreign currency and assets and liabilities subject to exchange variation, as dealt with in Resolution 2,606, dated May 1999. In this sense, in calculating their exposure, financial institutions were given the option of considering their exposures in United States dollars, euros, pounds sterling, yens and Swiss francs as a single currency in such a way as to incorporate the effects of currency diversification into the calculation of the capital required to cover market risk. In those cases in which the institution opts for this methodology, an additional capital requirement will be demanded, considering that the contrary positions in the currencies do not represent perfect hedges. This additional requirement will be obtained by multiplying the coefficient of 0.70 to the amount representative of the contrary positions.

Resolution 3,164, 1.20.2004 – Authorized the National Bank of Economic and Social Development (BNDES) to invest a total of up to R$2 billion over the coming twelve months, an effective rate of 17% per year with maturity terms of up to 60 months, in financing for purposes of acquisitions of trucks, tractor trailers, trailers, semi-trailers, chasses and truck bodies, including both new units and used units with up to seven years of age. Of this amount, up to R$600 million drawn from the Worker Support Fund (FAT) will be channeled into the financing of used vehicles.

Resolution 3,165, 1.29.2004 – Permitted constitution of a commercial bank under the direct stock control of the commodities and futures market. This bank will restrict its activities to the contracting and investment of resources and will exclusively perform the functions of liquidator and central custodian, providing services to the exchange and to economic agents involved in the operations of markets for financial, physical and futures assets. Among its responsibilities, mention should be made of the function of centralizing market participant client accounts, reception of guaranties and liquidation of operations. The possibility of constituting this bank will make it possible to centralize the aforementioned operations, with minimization of the risks that previously originated in the participation of a larger number of intermediating entities.

Resolution 3,170, 1.30.2004 – Altered the rules related to the auditing of financial institutions. Among these modifications, mention should be made of the fact that the obligation of constituting an auditing committee has been extended to financial institutions that have reference assets equal to or grater than R$1 billion, altering the previous limit which was equal to or greater than R$200 million. Among the responsibilities of this committee, the most important are the assessment of the effectiveness of the independent and internal auditing operations, as well as verification of management compliance with the recommendations made by the auditors.

Circular 3,223, 2.6.2004 – Abolished compulsory reserves on judicial deposits and on guaranties backed by bank endorsements, as of May 15, 2004. This revocation is being implemented gradually as of the January 2004 position. Compliance with reserves on judicial deposits is based on the earmarking of federal public securities while, in the case of bank guaranties, the deposit is made in cash.

Resolution 3,171, 2.19.2004 – Permitted freely operated repo operations with respect to any fixed income security. These operations are those in which the buyer of the securities in a repo operation may sell the papers definitively, maintaining the resale commitment with other securities. Previously, freely operated repo operations were only permitted when restricted to papers issued by the National Treasury or Banco Central. However, for utilization of other papers to become possible, these operations must be registered and settled financially in the framework of the same chamber or of the same party providing clearance and settlement services, acting as the contracting party for purposes of settlement of the operations carried out through its intermediation.

Resolution 3,175, 2.20.2004 – Altered the rules that deal with exchange variation in leasing operations. In leasing contracts, in which the goods have been acquired with external loan resources, agreement on the use of exchange variation clauses is permitted, thus eliminating the obligation of including such clauses in effect up to that time. This more flexible approach is a result of the updating of the rules applied to leasing operations, in keeping with the rules set down in Resolution 2,770/2000, which determined that resources contracted abroad could be freely invested, with or without exchange variation clauses.

Resolution 3,177, 3.8.2004 – Deals with compliance with the callable resources level applied to savings deposits. In this sense, the monthly deduction referring to credits of renewed debts of the Wage Variation Compensation Fund (FCVS) and of the amounts corresponding to the balances of financing negotiated in the framework of the Program of Incentives to the Restructuring and Strengthening of the Financial System (Proer), to be computed for purposes of compliance with the requirements applied to funds obtained in saving deposits, was altered from 1/100 to 1/50. The resources that are not invested and are deposited at Banco Central will be entitled to monthly earnings equivalent to 80% of the basic earnings of saving deposits. Aside from this, acquisition of Real Estate Credit Bills (LCI) and Mortgage Bills (LH) by the institutions belonging to the Brazilian System of Savings and Loans (SBPE) are limited for each institution to the amount existent on March 9, 2004.

Fiscal policy measures

Law 10,819, 12.16.2003 – Determined that judicial deposits in cash referring to taxes and their accessories under municipal jurisdiction, including those subject to judicial execution, should be made in a federal government financial institution or a public financial institution in the state to which the municipality belongs. Such deposits should be made through utilization of an instrument that identifies the nature of the tax.

Constitutional Amendment 41, 12.19.2003 – Approved the social security system reform, the highpoints of which are as follows:

a) **retirements**: ensures civil servants already entitled to request this benefit that they will receive full or proportional retirement based on the rules defined in Constitutional Amendment 20, dated 12.15.1998, which are as follows: minimum age of 53 years (men) and 48 years (women), five years of public service, and a period of contribution to the system totaling 35/30 years (men/women), with the addition of 20% (in the case of full retirement) and 40% (proportional) of the period of employment still lacking on 12.15.1998 to be entitled to the benefit;

b) **full wages**: only those civil servants who cumulatively meet the following conditions will be entitled to retire at their final salary: 60 years (men) and 55 years of age (women); 35 years (men) and 30 years (women) of contribution, 20 years of public service, 10 years in the same career and 5 years of effective exercise of the position in which the person retired. Those who do not meet these requirements will be subject to retirement calculated on the basis of median social security contributions since July 1994;

c) **social security contribution**: extended charging of the tax at the rate of 11% to retirees and pensioners and defined two distinct situations: i) the deduction will be applied to the value of the benefit in excess of R$1,200.00, in the case of state and municipal civil servants, and R$1,440.00 in the case of federal civil servants; ii) for those still on active duty, the discount at the time of retirement will be applied to the amount over and above R$2,400.00. Charging of the contribution will only begin 90 days after issue of the law or provisional measure regulating the question;

d) **reduction in the value of pensions**: pensions granted subsequent to promulgation of the Constitutional Amendment will be subject to a discount of 30% of the amount that exceeds R$2,400.00. Ordinary legislation will define the manner in which the new pensions will be indexed;

e) **permanence bonus**: all employees who attain the conditions required to request retirement will be entitled to a permanence bonus equivalent to 11% of the social security contribution. According to current legislation, only those civil servants who have attained the conditions required for full employment will be entitled to the bonus;

f) **ceiling on INSS benefits**: increases from R$1,869.34 to R$2,400.00;

g) **unification of rates**: the Amendment unifies the social security contribution rates at a minimum of 11%. States and municipalities are permitted to exceed this percentage;

h) **ceiling on retirements of current civil servants**: in the case of federal civil servants, the ceiling will be equivalent to the earnings of a Minister of the Federal Supreme Court, which is currently in the range of R$17,000.00. What are termed sub-ceilings were defined for the state and municipal governments: at the state executive level, the ceiling is the salary of the governor; for municipal civil servants, the limit is the salary of the mayor. In state legislatures, the limit is the salary of the elected member of the state assembly, while in the state judiciary; the limit is equivalent to 90.25% of the salaries of ministers of the Federal Supreme Court (STF).

Constitutional Amendment 42, 12.19.2003 – Instituted alterations in tax legislation and extended the validity of provisions of a fiscal nature designed to achieve short-term equilibrium in the nation's fiscal accounts:

a) **Provisional Contribution on Financial Operations (CPMF)**: extended charging of this contribution at the same rate of 0.38% from 12.31.2004 to 12.31.2007;

b) **Release of Federal Government Revenues (DRU) from Entitlements**: extended the validity of this measure from 12.31.2004 to 12.31.2007;

c) **Contribution on Intervention in the Economic Domain (Cide)**: determined that, as of 2004, 18.75% of the amount collected will be channeled to the states and Federal District and 6.25% to the municipalities, to be applied to transportation infrastructure projects;

d) **fiscal incentives**: extended the fiscal incentives granted to companies located in the Manaus Free Zone (from 2013 to 2023) and the fiscal benefits for training in the information technology sector (from 2009 to 2019);

e) **Rural Land Tax (ITR)**: permitted this tax, which is subject to the jurisdiction of the Federal Government, to be supervised and charged by the municipalities that opt to do so, according to current legislation. In this case, the total amount collected will remain with the collecting municipality;

f) **Compensation Fund for Elimination of Export Taxes**: added article 91 to the Law of Transitory Constitutional Provisions. This article deals with creation of the fund through approval of a complementary law.

Until such time as this law is approved, the system of compensation defined in Complementary Laws 87, dated 9.13.1996, and 115, dated 12.26.2002, remain in force.

Law 10,828, 12.23.2003 – Extended the Individual Income Tax (IRPF) rate of 27.5% levied on taxpayers with monthly incomes of more than R$2,115.00 for an additional two years (up to December 31, 2005).

Decree 4,928, 12.23.2003 – Regulated fiscal incentives related to outlays on technological research and development of product technological innovation, as dealt with in articles 39, 40, 42 and 43 of Law 10,637, dated 12.30.2002, and took other measures.

Decree 4,929, 12.23.2003 – Attributed responsibility as the managing entity of the Export Guaranty Fund (FGE) to the National Bank of Economic and Social Development (BNDES).

Law 10,835, 1.8.2004 – Created the basic citizen income, scheduled to go into effect as of 2005. In summary, this is a basic monetary benefit to which all Brazilians resident in the country and all foreign residents in the country for at least five years will be entitled independently of their social and economic conditions.

Decree 4,950, 1.9.2004 – Determined that all inflows of all revenues through government bodies, funds, semi-autonomous agencies, foundations and other entities classified within the fiscal and social security budgets will be effected through National Treasury operating account mechanisms, according to the terms specified in this decree.

Decree 4,955, 1.15.2004 – Reduced the rate of the Industrialized Products Tax (IPI) on capital goods from 5% to 3.5%.

Law 10,837, 1.16.2004 (annual budget law) – Estimated federal revenues and expenditures for the 2004 fiscal year. Revenues were defined at R$1,469,087,406,336.00 distributed as follows:

I - Fiscal Budget: R$396,724,445,938.00;

II - Social Security Budget: R$212,321,546,108.00;

III - refinancing of the federal public debt: R$860,041,414,290.00.

Expenditures are distributed as follows:

I - Fiscal Budget: R$376,121,429,113.00;

II - Social Security Budget: R$232,924,499,933.00;

III - refinancing of the federal public debt: R$860,041,414,290.00.

Of the amount set aside in indent II above, the share of R$20,602,953,825.00 will be covered by Fiscal Budget resources.

Decree 4,959, 1.16.2004 – Defined limits on the commitment of budget allocations of executive branch organs, funds and entities, until such time as financial programming and a monthly disbursement schedule are defined.

Decree 4,961, 1.20.2004 – Regulated article 45 of Law 8,112, dated 12.11.1990 which deals with payroll loans to public civil servants, retirees and pensioners belonging to the direct administration, semi-autonomous agencies and foundations of the executive branch of the federal government.

Provisional Measure 161, 1.21.2004 – Added an article to Law 10,336, dated 12.19.2001, which instituted the Contribution on Intervention in the Economic Domain (Cide), with the objective of permitting transfer of 18.75% of inflow to be transferred to the states and Federal District and 6.25% to municipalities. The resources will be distributed quarterly by the federal government to the states and Federal District, by the fifth business day of the month subsequent to the end of each quarter. Such transfers will be credited to specific accounts opened at Banco do Brasil or another financial institution indicated by the federal executive branch, in compliance with the following criteria:

I - 40% in proportion to the dimensions of the federal and state paved highway network existent in each state and in the Federal District, according to data elaborated by the National Department of Transportation Infrastructure (DNIT);

II - 30% in proportion to each state's and to the Federal District's consumption of the fuels on which the Cide is levied, according to data elaborated by the National Petroleum Agency (ANP);

III - 20% in proportion to the population, as calculated by IBGE;

IV - 10% distributed in equal shares to the states and Federal District.

Provisional Measure 164, 1.29.2004 – Instituted the Contribution to the Programs of Social Integration (PIS) and Formation of Civil Service Assets on Imports of Foreign Products or Services (Pasep-Imports) and the Social Contribution to the Financing of the Social Security System due by Importers of Foreign Goods or Services from Abroad (Cofins-Imports), based on the terms of Constitutional Amendment 42, dated 12.19.2003, which altered the National Taxation System. The major topics of the Provisional Measure are as follows:

a) **generating fact**: will be the entry of foreign goods into national territory or the payment, credit, delivery, utilization or remittance of amounts to those resident or domiciled abroad, as counterpart to the service rendered;

b) **taxpayers**: the importer, considered as the individual or legal entity responsible for entry of foreign goods into national territory; the individual or legal entity that contracts the services of those resident or domiciled abroad and the beneficiary of the service in those cases in which the contracting party is also resident or domiciled abroad.

c) **calculation base**: the customs value used or that would be used as the basis for calculating the import tax, plus the amount of this tax, of the ICMS due and of the value of the contributions themselves;

d) **rates**: 1.65% for the PIS/Pasep-Imports and 7.6% for the Cofins-Imports. In the case of imports of Liquid Petroleum Gas (LPG), the respective rates are 2.56% and 11.84%; imports of aviation kerosene: 1.25% and 5.8%. The measure set other rate levels for products included in the Common Nomenclature of Mercosul (NCM);

e) **exemptions**: imports made by entities of the public administration, diplomatic missions and representatives of international organizations of a permanent nature to which Brazil belong, and by their respective members; goods acquired in free shops, in the country; goods imported under the special drawback customs system, in the exemption modality; postal remittances and international airmail orders placed by individuals; baggage of travelers from abroad and imported goods to which the special or simplified import systems apply; machines, equipment, apparatuses and instruments and their parts and spares, accessories, raw materials and intermediate products, imported by scientific and technological institutions, with due compliance with the requirements of Law 8,010/1990, etc.;

f) **period allotted for effecting deposit**: on the date of registration of the import declaration, in the case of the entry of foreign goods into national territory; on the date of payment, credit, delivery, utilization or remittance of amounts to those resident or domiciled abroad as the counterpart for the service rendered; on the date of maturity of the period of permanence of the product in the area covered by customs.

Decree 4,992, 2.18.2004 – Defined budget and financial programming, together with the monthly disbursement schedule of the executive branch for the 2004 fiscal year. With regard to the discretionary outlays of the executive branch, which were defined at R$66.8 billion, R$6.0 billion were subjected to preventive conditioning factors (R$3.0 billion in current expenditures and R$3.0 billion in investment outlays). Should the budget revenues needed to cover these outlays be confirmed, the blocked amounts will be gradually released.

Provisional Measure 167, 2.19.2004 – Regulated various provisions of Constitutional Amendment 41, dated 12.19.2003, which instituted the Social Security reform, as follows:

a) **contribution of inactive employees**: the current retirees and pensioners of any federal government branch will begin contributing, as of 5.21.2004, with 11% of the total amount of their retirement and pension benefits that exceed the level of R$1,440.00. In the case of future retirees and pensioners, the contribution will be equivalent to 11% of the amount that exceeds R$2,400.00;

b) **contribution of active duty civil servants**: contributions of active duty civil servants from any federal government branch to be used in the maintenance of the civil service' special retirement system will be 11% on the totality of the contribution base, understood as the wage of the civil servant's effective position, plus any permanent monetary advantages defined in law, while additional amounts of an individual character or any other advantages are excluded from the calculation: per diems; allowances to cover moving costs consequent upon job relocation; transportation indemnities; the family support wage; food assistance programs; childcare assistance programs and bonuses for time served. The civil servant effectively occupying a position may opt for inclusion within the contribution base of the amount received as a consequence of exercising commissioned positions or functions of trust for purposes of calculating the retirement benefit, duly respecting the established limit of R$2,400.00;

c) **calculation of retirements**: civil service retirements will be calculated on the basis of the simple arithmetic average of the largest pay levels, corresponding to 80% of the entire period of contribution since July 1994 or since the start of the period of contribution, should that occur after that date. In order to make this calculation, the contributions will be corrected on a month by month basis, according to the total change of the index determined for updating benefits in the general social security system (National Consumer Price Index – INPC, calculated by the Brazilian Institute of Geography and Statistics – IBGE). The earnings considered in the calculation of civil service retirements may not be less than the minimum wage nor greater than the value of the maximum civil service wage levels of the respective entity or of the contribution wage, with respect to those months in which the civil servant was covered by the general social security system;

d) **pensions**: pension benefits by reason of death will be subject to a deduction of 30% of the amount that exceeds R$2,400.00, which is the maximum limit determined for the benefits of the General Social Security System (RGPS);

e) **employer contribution**: the contribution of the federal government, states, Federal District and municipalities to the respective specific social security systems may not be less than the contribution paid by the party insured nor greater than twice the value of that contribution. In the case of the federal government, the contribution will be 22% levied on the same calculation base as the contributions of the respective active duty civil servants, retirees and pensioners, and the product of this inflow is to be registered in a specific account. The federal government, states, Federal District and municipalities are responsible for covering possible financial insufficiencies in the respective system that may result from payment of social security benefits;

f) **permanence bonus**: the civil servant who occupies an effective position and has fulfilled the requirements for voluntary retirement and opts to remain on active duty will be entitled to a permanence bonus equivalent to the value of that person's social security contribution until that person has completed the requirements for compulsory retirement; and

g) **social security inclusion**: in order to increase the number of contributors to the social security system, an article was included in the Provisional Measure that deals with income tax deductions of contributions to private pension funds. From this point forward, only those workers will be entitled to this income tax deduction who, aside from contributing to that pension fund, also contribute to the National Social Security Institute (INSS) or to a civil service social security system. The previous legislation permitted deduction even for those who may not have been affiliated to a social security system.

Measures related to external sector

Camex Resolutions 35, 46 and 3, respectively dated 11.27.2003, 12.24.2003 and 2.13.2004 – Altered the ad valorem rates of the Import tax on capital goods and informatics and telecommunications goods to 4% (four percent) until 12.31.2005, as specified in the ex-tariff position.

Secex Directive 17, 12.2.2003 – Consolidated the regulatory provisions of import operations, dealing with: importer registration; accreditation and qualification; licensing of imports; commercial aspects; examination of similarities; imports of used goods; tariff quotas; special procedures; leasing; donations; imports without exchange coverage; discounts on imports and Southern Common Market (Mercosul). This ruling revoked several instruments that had been published by Secretary of External Trade/Department of External Trade Operations (Secex/Decex).

Provisional Measure 142, 12.3.2003 – Determined that Banco Central do Brasil credits against financial systems accredited to operate in the Reciprocal Credit and Payment Agreement (CCR) framework and related to operations involving imports from the Laia countries and the Dominican Republic would not be covered by a decree of intervention in the accredited financial institutions, declarations of extrajudicial liquidation or bankruptcy. The effects of the Provisional Measure would also be applied to other payment agreements that may be established between Banco Central do Brasil and the central banks of other countries.

Bacen Circular 3,211, 12.5.2003 – Eliminated the requirement of anticipated deposit in Banco Central do Brasil of the amount stated in payment instruments referring to import operations carried out in the Reciprocal Credit and Payment Agreement (CCR) framework on the date of registration of the aforementioned instrument in Sisbacen.

Provisional Measure 143, 12.11.2003 – Abolished the Board of Directors of the Export Guaranty Fund and altered Law 9,818/99, which created the Export Guaranty Fund.

Law 10,814, DOU 12.16.2003 (Transgenic soybeans) – Defined norms for the planting and marketing of the production of genetically modified soybeans in the 2004 harvest. Conversion of Provisional Measure 131, dated 9.25.2003, into law.

CESPORTOS Resolution 12, 12.18.2003 – Approved the Terms of Reference and Outline for the elaboration and analysis of Public Security Plans for Brazilian Ports and Maritime Terminals and Guidance for elaboration of the "Persons and Vehicles Access and Circulation Control Rules". As of 7.1.2004, the International Code of Ship and Port Facilities Security will go into effect, obligating the 162 member countries of the International Maritime Organization (IMO) to implement their port security plans.

Constitutional Amendment 42, 12.31.2003 (Tax Reform) – Altered the National Taxation System and took other measures.

Bacen Circular 3,217 – Altered procedures for calculating and elaborating information on the monitoring and control of exposure in gold, foreign currency and assets and liabilities subject to exchange variation on a consolidated basis, as dealt with in Resolution 2,606/1999, and the Regulations in Appendix IV of Resolution 2,099/1994.

Camex Resolution 41, 12.19.2003 – Altered Import Tax rates included in the Common External Tariff (TEC), as dealt with in Appendix I of Camex Resolution 42, dated 12.26.2001. Among the alterations, the most important was withdrawal of the temporary increase of one and one half percentage points from the rates of the TEC codes, except those codes shown in Appendix II of Camex Resolution 42, dated 12.26.2001, and the Capital Goods codes, indicated in the TEC under the acronym "BK", the rates of which had already been excluded from this increase.

Decree 4,929, 12.24.2003 – Attributed responsibility for management of the Export Guaranty Fund to the National Bank of Economic and Social Development (BNDES).

Camex Resolution 44, 12.24.2003 – Defined guidelines for utilization of Export Credit Insurance, in operations processed through the Reciprocal Credit and Payment Agreement (CCR) of the Latin American Integration Association (Aladi).

Camex Resolution 45, 12.24.2003 – Altered Resolution 33/2002, which dealt with the measures to be taken to allow for utilization of Export Financing Program (Proex).

Law 10,833, 12.30.2003 – Altered the system of charging the Social Security Financing Contribution (Cofins) to a non-cumulative system, setting out new provisions regarding the generating fact, calculation base, rate, and other like questions. Cofins will not be levied on revenues consequent upon exports; however, credits related to acquisitions of imported inputs will not be accepted. Aside from this, the Law altered other aspects of tax and customs legislation, in which provisions related to customs systems, fines and sanctions were included, while also altering the composition of important laws. Conversion of Provisional Measure 135, dated 10.30.2003.

STN Directive 654, 1.9.2004 – Authorized issue of National Treasury Notes, Series I, NTN-I, in the amount of R$313,856,440.80 (three hundred and thirteen million, eight hundred and fifty six thousand, four hundred and forty reals and eighty cents), referenced to 12.15.2003, to be used in the payment of equalization of the interest rates on the financing of exports of Brazilian goods and services supported by Export Financing Program (Proex).

Decree 4,965, 1.29.2004 – Set the coefficient for reduction of the specific rates of Program of Social Integration/Program of Civil Service Asset Formation (PIS/Pasep) and Social Security Financing Contribution

(Cofins), as dealt with in articles 51 and 52 of Law 10,833, dated 12.30.2003.

Provisional Measure 164, 1.29.2004 – Treats of the Contribution to the Programs of Social Integration and Formation of Civil Service Assets and the Contribution to the Financing of the Social Security System levied on imports of goods and services and took other measures. Related to Law 10,833, dated 12.30.2003.

Decree 4,982, 2.10.2004 – Promulgated the Olivos Protocol for Resolution of Controversies in the Southern Common Market (Mercosul) Framework.

Decree 4,993, 2.19.2004 – Created the Financing and Export Guaranty Committee (Cofig) provided new composition for the heading of article 5 of Decree 4,732, dated 6.10.2003, which deals with the Foreign Trade Chamber (Camex), subordinated to the Council of Government.

Camex Resolution 5, 3.2.2004 (ex-tariff) – Altered the ad valorem rates of the Import Tax on Capital goods and Informatics and Telecommunications goods, either by themselves or as parts of Integrated Systems, benefited by the ex-tariff position.

Bacen Circular 3,225, 2.13.2004 – Determined the form, limits and conditions of the declaration of goods and values held abroad by individuals or legal entities resident, domiciled or headquartered in the country.

Bacen Circular 3,227, 2.18.2004 – Altered the Regulations on Exchange Operations of a Financial Nature on the Free Rate Exchange Market, in order to make it possible to process new operations of a financial nature of interest to legal entities covered by internal public law, as well as those of interest to diplomatic representations, as well as to determine that transfers to meet support expenditures of individuals abroad involved in programs of an educational, scientific or cultural nature, directly in the banking network authorized to perform exchange operations, when the buyer of the foreign currency is different from the legal entity covered by internal public law.

Appendix

Banco Central do Brasil Management

Members of the Monetary Policy Committee (Copom)

Banco Central do Brasil Management

Board

Henrique de Campos Meirelles
Governor

Afonso Sant'Anna Bevilaqua
Deputy Governor

Alexandre Schwartsman
Deputy Governor

Antonio Gustavo Matos do Vale
Deputy Governor

Eduardo Henrique de Mello Motta Loyo
Deputy Governor

João Antônio Fleury Teixeira
Deputy Governor

Luiz Augusto de Oliveira Candiota
Deputy Governor

Paulo Sérgio Cavalheiro
Deputy Governor

Sérgio Darcy da Silva Alves
Deputy Governor

Members of the Monetary Policy Committee (Copom)

Voting members

Henrique de Campos Meirelles
Governor

Afonso Sant'Anna Bevilaqua
Deputy Governor

Antonio Gustavo Matos do Vale
Deputy Governor

Alexandre Schwartsman
Deputy Governor

Eduardo Henrique de Mello Motta Loyo
Deputy Governor

João Antônio Fleury Teixeira
Deputy Governor

Luiz Augusto de Oliveira Candiota
Deputy Governor

Paulo Sérgio Cavalheiro
Deputy Governor

Sérgio Darcy da Silva Alves
Deputy Governor

Non-voting members

Altamir Lopes
Head of the Department of Economics (Depec)

Daso Maranhão Coimbra
Head of the Department of International Reserve Operations (Depin)

José Antonio Marciano
Head of the Department of Banking Operations and Payments System (Deban)

José Pedro Ramos Fachada Martins da Silva
Head of the Investor Relations Group (Gerin)

Marcelo Kfoury Muinhos
Head of the Research Department (Depep)

Sérgio Goldenstein
Head of the Department of Open Market Operations (Demab)

Acronyms

Abimaq	Brazilian Association of the Machines and Equipment Industry
ACC	Advances on Exchange Contracts
ACSP	São Paulo Trade Association
ALADI	Latin-American Integration Association
Anfavea	National Association of Automotive Vehicle Manufacturers
ANP	National Petroleum Agency
BCE	European Central Bank
BID	Inter-American Development Bank
Bird	International Bank for Reconstruction and Development
BNDES	National Bank of Economic and Social Development
BNDESpar	BNDES Participações S.A.
BoE	Bank of England
BoJ	Bank of Japan
Cadip	System of Registration of Credit Operations with the Public Sector
Caged	General File of the Employed and Unemployed
Camex	Foreign Trade Chamber
CCR	Reciprocal Credit and Payment Agreement
Cerj	Rio de Janeiro State Electricity Company
Cide	Contribution on Intervention in the Economic Domain
CNAE	National File of Economic Activities
CLT	Consolidated Labor Legislation
CNI	National Confederation of Industry
Cofig	Export Financing and Guarantee Committee
Cofins	Contribution to Social Security Financing
Cofins Import	Contribution to Social Security Financing due by the Importer of Goods and Services
Conab	National Supply Company
Compe	System of Centralization of the Clearing of Checks and Other Papers
Copom	Monetary Policy Committee
CPI	Consumer Price Index
CPMF	Provisional Contribution on Financial Transactions
CRB	Commodity Research Bureau
Decex	Department of Foreign Trade Operations
DI	Interbank Deposits
DJIA	Dow Jones Industrial Average
DNIT	Department of National Transportation Infrastructure
DRU	Release of Federal Government Entitlements
Embi+	Emerging Market Bond Index Plus
EUA	United States of America

FAT	Worker Suport Fund
FBCF	Gross Fixed Capital Formation
FCVS	Wage Variation Compensation Fund
Fecomercio SP	Trade Federation of the State of São Paulo
Fed	Federal Reserve
FGC	Credit Guaranty Fund
FGV	Getulio Vargas Foundation
Fiesp	Federation of Industries of the State of São Paulo
FIF	Financial Investment Funds
Finame	Special Industrial Financing Agency
FITVM	Funds Based on Investments in Securities and Stocks
FMI	International Monetary Fund
FMP	Mutual Privatization Funds
FOMC	Federal Open-Market Committee
Funcex	Foreign Trade Studies Center Foundation
Gerin	Investor Relations Group of the Central Bank of Brazil
GLP	Liquefied Petroleum Gas
IBGE	Brazilian Institute of Geography and Statistics
Ibovespa	São Paulo Stock Exchange Index
Icei	Industry Businessman Confidence Index
ICMS	Tax on the Circulation of Goods and Services
IED	Direct Foreign Investment
IGP	General Price Index
IGP-DI	General Price Index – Internal Supply
IGP-M	General Price Index – Market
IIA	Index of Current Intentions
IIC	Consumer Intentions Index
IIF	Index of Future Intentions
IIF	Institute of International Finance
IMO	International Maritime Organization
Inec	Consumer Expectation National Index
INPC	National Consumer Price Index
INSS	National Social Security Institute
IPA	Wholesale Price Index
IPA-DI	Wholesale Price Index – Internal Supply
IPA-Industrial	Wholesale Price Index – Industry
IPA-M	Wholesale Price Index – Markets
IPA-OG-PI	Wholesale Price Index – Overall Supply – Industrial Products
IPC	Consumer Price Index
IPC-Br	Consumer Price Index – Brazil
IPCA	Broad National Consumer Price Index
IPCA-PI	Broad National Consumer Price Index – Industrial Products
IPI	Industrialized Products Tax
IRPF	Income Tax on Individual Persons
ITR	Rural Land Tax
LCI	Real Estate Exchange Bill
LFT	Treasury Financing Bills
LH	Mortgage Bills
LRF	Fiscal Responsibility Law
LSPA	Systematic Farm Production Survey

LTN	National Treasury Bills
mbd	million barrels /day
MDIC	Ministry of Development, Industry and Foreign Trade
Mercosul	Southern Common Market
MIB	Milan Stock Exchange
Moderfrota	Program of Modernization of the Farm Tractor Fleet and Like Implements and Harvesters
MTE	Ministry of Labor and Employment
Nasdaq	National Association of Securities Dealers Automated Quotations
NBCE	Banco Central Note Special – Series E
NCM	Common Mercosul Nomenclature
NTN	National Treasury Note
NTN-B	National Treasury Notes – Series B
NTN-C	National Treasury Notes – Series C
NTN-D	National Treasury Notes – Series D
NTN-F	National Treasury Notes – Series F
NTN-I	National Treasury Notes – Series I
OECD	Organization for Economic Cooperation and Development
OIT	International Labour Organization
Opec	Organization of Petroleum Exporting Countries
Pasep	Program of Civil Service Asset Formation
Pasep-Importação	Program of Civil Service Asset Formation levied on imports of goods and services
PEA	Working Population
PF	Individual Person
PIA-Empresa	Annual Industrial Survey – Company
PIA-Produto	Annual Industrial Survey – Product
PIB	Gross Domestic Product
PIM	Monthly Industrial Survey
PIM-PF	Monthly Industrial Survey – Physical Output
PIS	Social Integration Program
PMC	Monthly Trade Sector Survey
PME	Monthly Employment Survey
Prodilist	Industrial Products List
Proer	Program of Incentives to the Restructuring and Strengthening of the National Financial System
Proex	Export Financing Program
RGPS	Social Security General System
RMSP	Metropolitan Region of São Paulo
S&P 500	Standard and Poor's 500
Sars	Severe Acute Respiratory Syndrome
SBPE	Brazilian System of Savings and Loans
Secex	Foreign Trade Secretariat
Selic	Special System of Clearance and Custody
TJLP	Long-Term Interest Rate
USDA	United States Department of Agriculture