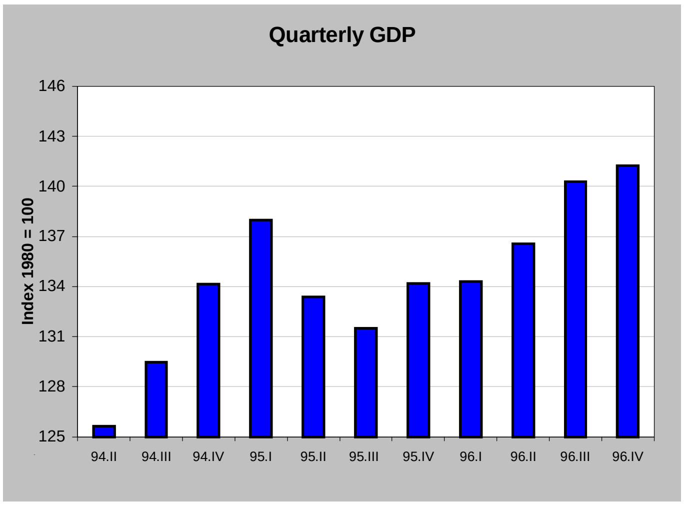
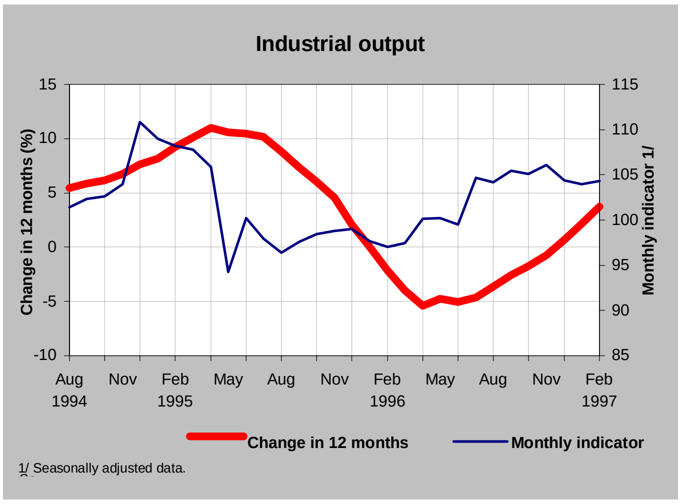
Monetary Programming for the Second Quarter of 1997

A. The economy in the first quarter of 1997

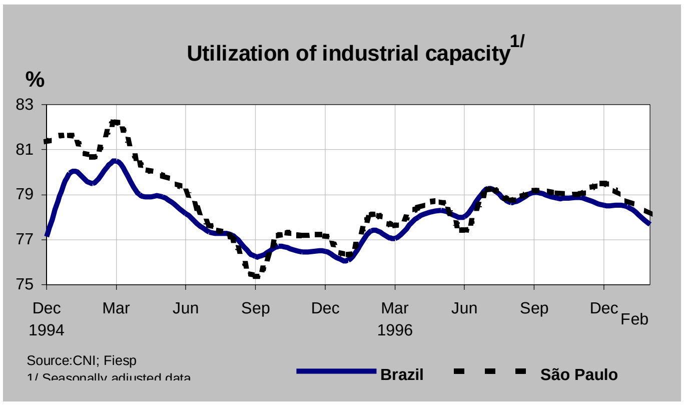
1. In 1996, Gross Domestic Product (GDP) growth came to 2.91%, reflecting the upturn in economic activity that took on added momentum as of the second quarter of 1996. In sectoral terms, the strongest performance occurred under services (3.34%), followed by crop and livestock farming (3.12%) and industry (2.34%). For the most part, the industrial sector's final figure was generated by the poor performance of manufacturing, particularly the 14.3% reduction under capital goods output.



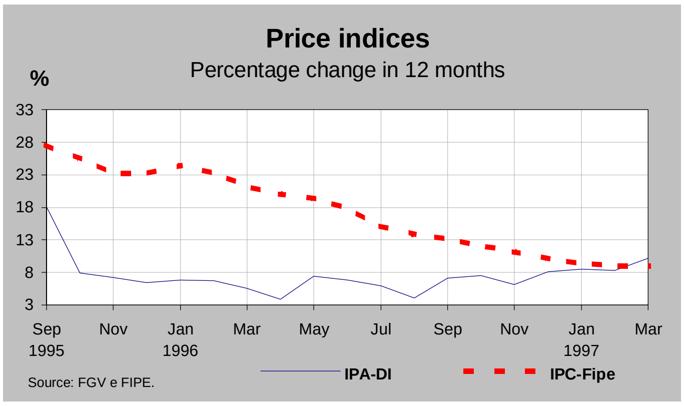
2. In recent months, the level of activity has remained practically stable. A closer look shows that, in the seasonally adjusted series, industrial production dropped by 0.5% in January, before moving up by 0.3% in February. Since July 1996, when industrial production growth closed at 4.3%, output levels have remained relatively stable, with only slight fluctuations over the past six months.



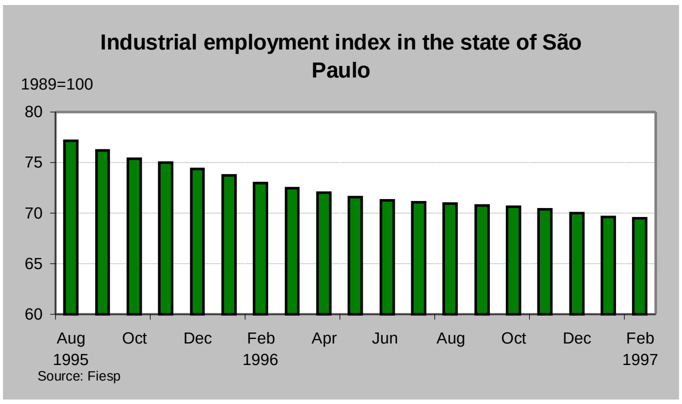
3. At the start of 1997, the trajectory in terms of installed capacity utilization pointed to a weakening industrial activity pace. In the first two months of the year, average utilization came to 78.1%, for a reduction of one percentage point in comparison to the average for the second half of 1996, a period in which utilization of installed capacity was approximately two percentage points higher than the average for the previous half-year period and, therefore, coherent with the pace of industrial production.



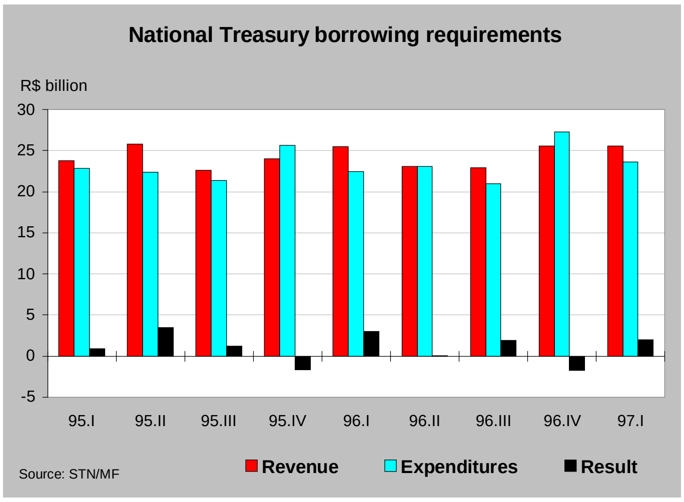
4. Growth in the major price indices has been compatible with the nation's rising participation in international economic transactions. Here, it is important to stress that this involvement has had a stabilizing impact on prices, particularly in the sector of tradables. In the first quarter of the year, growth in the IPA-DI and IPC-Fipe — respectively, associated to operations in tradables and nontradables — moved upward by 1.6% and 1.5%. It is important to note that, when viewed in 12 month accumulated terms, these indices converged significantly and closed at levels of 10.1% and 9%.



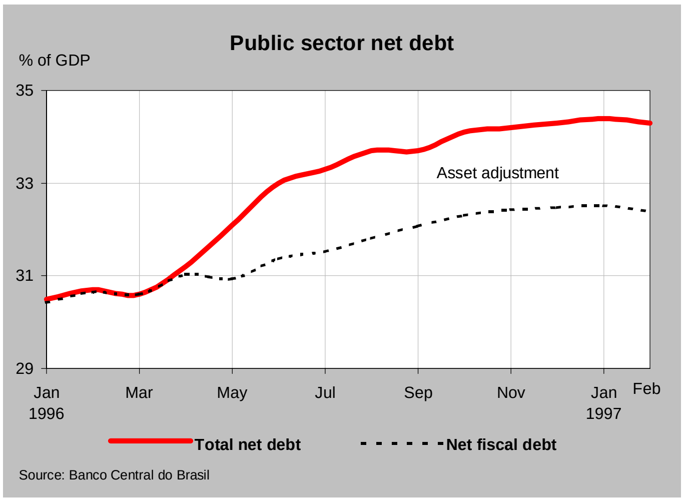
5. The Ministry of Labor's employment level index points to a 1.22% reduction in 1996. This index closed with negative growth in all sectors of activity, with the sharpest drops under manufacturing and construction. In the State of São Paulo, the level of industrial employment continued in decline and accumulated a drop of 0.74% in the period. However, since May 1996, the accumulated 12 month layoff rate has been declining systematically and expectations are that this tendency will continue.



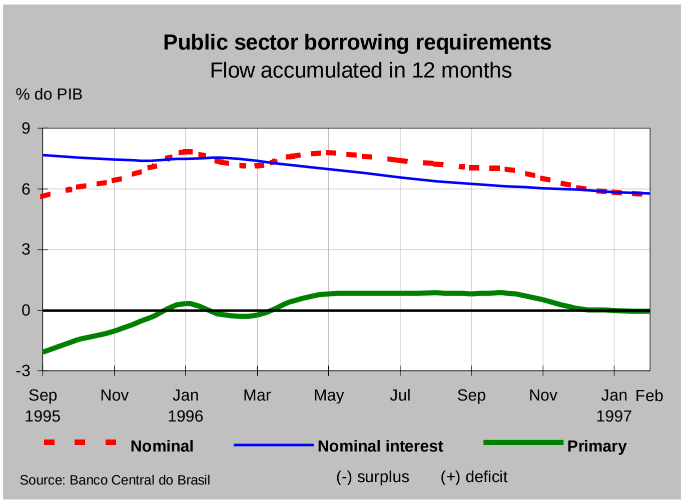
6. In the first quarter of 1997, the National Treasury surplus (concept of borrowing requirements) came to R$ 2 billion (1% of GDP), as compared to a surplus of R$ 2.8 billion (1.5% of GDP) in the same period of 1996. Net real interest liabilities totalled R$ 2.8 billion, for an operational deficit of R$ 0.8 billion (0.4% of GDP). Based on the accrual concept, total Treasury revenues came to R$ 25.7 billion, for growth of 0.3%, when compared to the first quarter of 1996, while expenditures totalled R$ 23.7 billion, for growth of 3.8%. The Treasury's cash result closed with a deficit of R$ 2.4 billion in the first three months of the year, 63.3% less than in the same period of last year (R$ 6.5 billion). Here, special mention should be made of 16.9% growth in revenues and a decline of 1.5% under outlays.



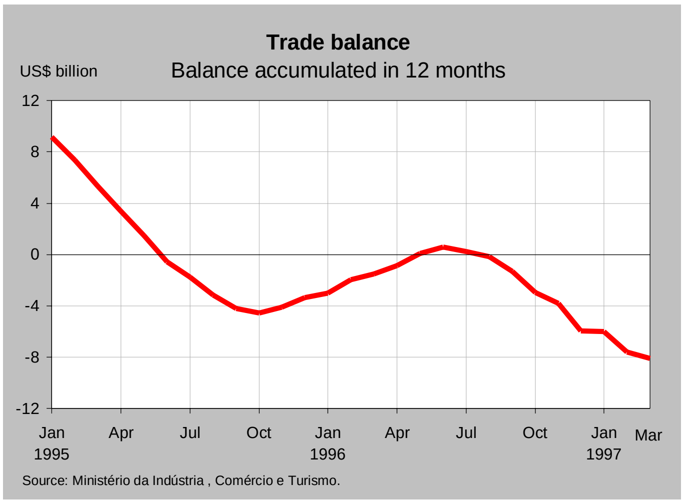
7. In February 1997, the balance of the net public sector debt totalled R$ 276.2 billion, corresponding to 34.4% of GDP, as against 32% in the same period of 1996. Of that total, R$ 243.1 billion involve internal debt and R$ 33.1 correspond to foreign debt. With exclusion of asset adjustments consequent, for the most part, upon Banco do Brasil capitalization and acknowledgement of debts from previous years, the net fiscal debt came to R$ 260.9 billion (32.4% of GDP).



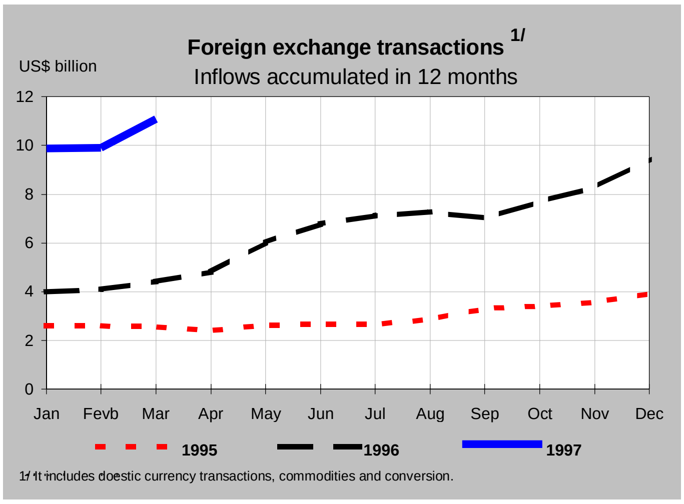
8. In the twelve month period ended in February 1997, public sector borrowing requirements registered a nominal deficit of 5.75% of GDP, as against 7.33% in the same period of the previous year. Despite debt growth provoked by acknowledgement of debts contracted in the past, nominal interest outlays declined at all levels of government, moving from 7.54% of GDP, in terms of the accumulated twelve month flow up to February 1996, to 5.77% in the same 1997 period. The primary surplus dropped from 0.22% of GDP to 0.02% in that period.



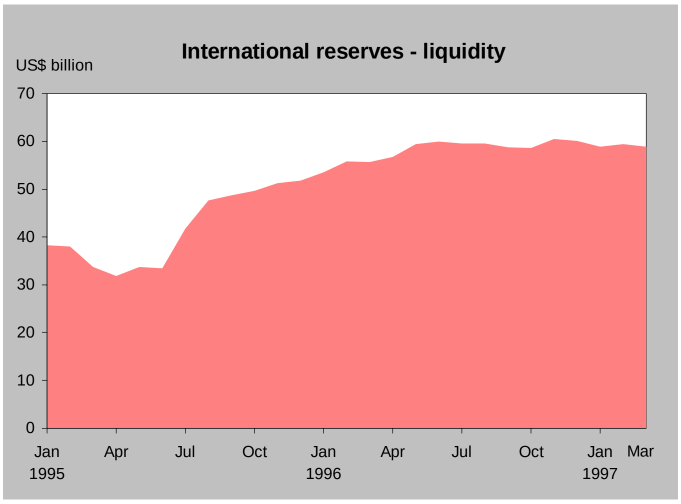
9. In the first quarter of 1997, physical exports came to US$ 10.7 billion or 3.6% more than in the same period of the previous year. However, imports expanded by 27.6%, moving from US$ 10.7 billion to US$ 13.7 billion. The difference between export and import growth rates generated a trade deficit of approximately US$ 3.1 billion in the quarter. Import growth can be attributed to foreign acquisitions of capital goods, durable consumer goods and fuels and lubricants. These items expanded at respective rates of 41.3%, 38.4% and 34% in relation to the same quarter of the previous year. Here, it is important to stress that imports of capital goods and raw materials and intermediate products accounted for 70.7% of total foreign purchases. This proportion was slightly lower than in the first quarter of the previous year.



10. In the first three months of the year, the current account balance closed in a deficit position of US$ 6.8 billion, with US$ 4.4 billion of this amount corresponding to the service deficit. A further breakdown shows that US$ 2 billion of the latter figure refer to interest payments. Financing of the current account deficit has been marked by increased participation of longer term resources. Net inflows of foreign resources totalled US$ 7.4 billion in the quarter, of which US$ 2.9 billion reflected portfolio investments, US$ 2.9 billion corresponded to direct investments and US$ 1.6 billion to credit inflows. The higher proportion of direct investments in the early part of the year confirms a trend in evidence since the previous year.



11. Foreign resources inflows have made it possible to maintain a comfortable international reserve position. In March, the reserve level came to US$ 59 billion in the international liquidity concept. This is equivalent to 12.6 months of imports when one considers average foreign purchases over the past 12 months.



12. At the end of the first quarter of 1997, the exchange rate float band was US$ 1.05 and US$ 1.14. In the free rate segment of the market, the exchange rate devalued by 1.92% in the quarter and closed at R$ 1.0585 for purchase and R$ 1.0593 for sale. Exchange contracting operations on the free rate segment closed with a net inflow of US$ 3.2 billion, based on a US$ 3.4 billion surplus in financial transactions and a deficit of US$ 0.2 billion in trade-related transactions.

B. Monetary policy in the first quarter of 1997

13. The first quarter of 1997 was marked by significant reallocations of financial resources provoked by the start of effective CPMF charging. This had an expansionary impact on restricted monetary aggregates and generated changes in the composition of the broader aggregates.

14. Viewed under the prism of average daily balances, the restricted monetary base came to R$ 24.7 billion in March, or well within the parameters estimated in monetary programming for the first quarter of the year (R$ 23.3 billion - R$ 27.3 billion). This corresponds to growth of 37% in relation to the same month of the previous year and 22.8% in the year. The monetary base components turned in a similar level of expansion when viewed over the 12 month period ended in March: 34.4% in banking reserves and 38.5% in currency issued.

Table 1. Observed and forecast monetary program for the first quarter of 1997

Itemization	Forecast		Observed	
	R$ billion	Percentage change in 12 months 1/	R$ bilhões	Percentage change in 12 months 1/
M1 2/	33,2 - 39,0	54,0	36,9	57,4
Restricted base 2/	23,3 - 27,3	40,2	24,7	37,0
Expanded base 3/	191,5 - 224,8	51,7	194,2	41,1
M4 3/	323,9 - 380,2	33,6	336,4	26,8

Source: Banco Central do Brasil

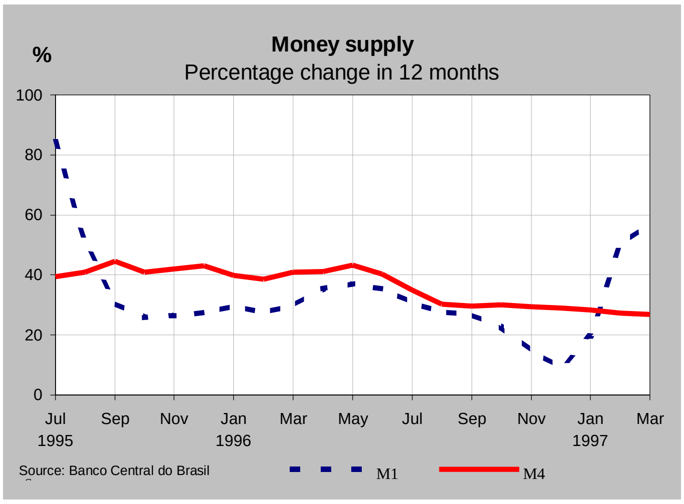
1/ Percentage changes are based on the medium point of forecast.

2/ Working-day balance average of last day in period.

3/ End-of-period balances.

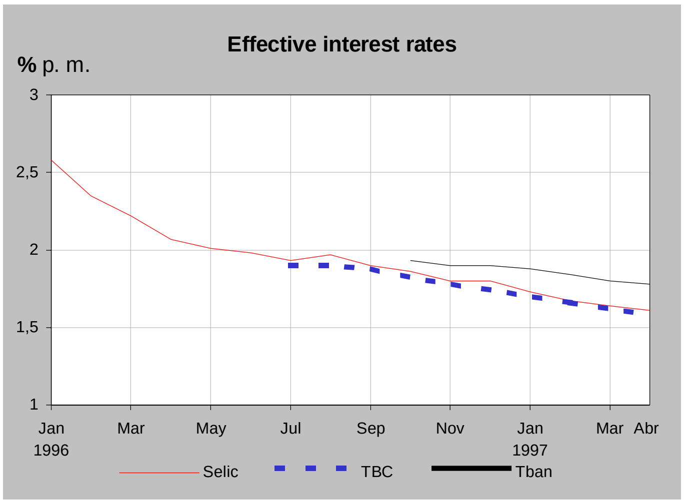
15. The expanded monetary base — composed of the restricted monetary base plus federal public securities and other compulsory cash resources — came to R$ 194.2 billion in March, well within estimated monetary programming parameters (R$ 191.5 billion - R$ 224.8 billion) and turned in growth of 5.2% in the first quarter and 41.1% in relation to March 1996.

16. Average daily M1 balances came to R$ 36.9 billion in the month of March. This figure was within the monetary programming limits set for the first quarter (R$ 33.2 billion - R$ 39 billion). Accumulated growth in the quarter came to 27.1%, reflecting transfers of resources from short-term financial investment funds (FIF-CP) to demand deposits which expanded by 60.5% in the period, as compared to a reduction of 11.4% in the same quarter of 1996. Currency held by the public dropped by 5.8% in the quarter.



17. M4 — the broadest liquidity concept in the economy — came to R$ 336.4 billion at the end of March, for respective growth rates of 4.1% and 26.8% in the year and in 12 months. This figure was also in keeping with monetary programming estimates for the first quarter of 1997 (R$ 323.9 billion - R$ 380.2 billion).

18. The process of gradually reducing interest rates continued in the first quarter of 1997. In this framework, the Monetary Policy Committee (Copom) set the March TBC and TBAN at 1.62% and 1.80%, respectively, as compared to 1.74% and 1.90% last December. The trajectory of the effective over/Selic interest rate was quite similar and moved from 1.80% per month in December to 1.64% per month in March, as reflected in a drop in the compound annual rate from 23.9% to 21.6% in that period.



C. Outlook for the second quarter and for 1997

19. During the course of 1997, monetary policy will be conditioned to maintenance of economic activity at a level compatible with the restrictions imposed on the foreign sector of the economy.

20. The current situation suggests that the rate of real GDP growth in 1997 was greater than in 1996 (2.91%), particularly in light of the upturn in economic activity as of the second quarter of last year. This expectation is further strengthened when one analyzes 1996 GDP growth in sectoral terms. The weak performance of the industrial sector in that year is expected to be reversed, as the productivity gains generated by the process of industrial modernization are incorporated. This modernization has been achieved through profound changes in the profile of Brazilian imports.

21. Inflation should close 1997 in the single digit range, a level compatible with the growing role of the nation's economy on the international scenario. At the same time, the economy's international stance has aided in consolidating the process of eliminating price indexing. Expectations for the second quarter are that general price indices will return to the levels registered in the final months of 1996 and close in the range of 0.5% per month, despite recent adjustments in public utility tariffs.

22. Public accounts are expected to perform in a favorable manner in 1997. Recently, in the first of two rounds of voting, the Chamber of Deputies approved the administrative reform and generated expectations that the constitutional reform process will make a significant contribution to balancing public sector accounts. Aside from this highly positive aspect, infraconstitutional measures were adopted at the end of 1996 and should also have a positive impact on public accounts.

23. With such measures as alterations in tax legislation, changes in the calculation base of the Social Contribution on Net Profits, creation of the CPMF and extension of the Fiscal Stabilization Fund to December 31, 1999 — a measure already approved by the Constitution and Justice Committee of the Chamber of Deputies, the tax inflow should increase sharply in 1997. Another factor expected to generate added revenues is the change in the level of economic activity. On the expenditure side, emphasis should be given to a series of measures taken to reduce outlays on personnel and effect budget cuts of R$ 3.2 billion. Aside from this, a ceiling of 85% was imposed on releases of funding allocated in the budget. The remainder would then be released only when pre-established inflow goals have been met.

24. Recovery of state finances has been strengthened by negotiations of agreements on the restructuring of state debts with the federal government. These agreements were signed under more favorable term and interest conditions and

included effective commitments to adjustments in public sector outlays and privatization of state companies.

25. The balance of payments is expected to achieve relative equilibrium in 1997. As a result of incentive measures and the process of restructuring and modernization that has occurred in the industrial sector, the economy has become more competitive and better prepared to operate in an open environment and this is expected to have a highly positive impact on the nation's exports. Aside from this, recent measures taken to discipline import financing conditions should also aid in attenuating the current trade imbalance.

26. In 1997, foreign capital inflows are expected to expand considerably as the process of economic stabilization consolidates and sectors long coveted by foreign capital interests are included in the privatization process. This will be a factor of decisive importance to maintaining the financing required by the current account deficit in a scenario of foreign capital inflows marked by more favorable term and cost profiles.

D. Indicative growth goals for the monetary aggregates

27. Programming of monetary aggregates for the second quarter of 1997 and their estimates for the end of the year take due account of the probable economic scenario and government inflation targets, GDP, interest rates, the monetary impacts of foreign sector operations, National Treasury operations and discount window transactions. Introduction of the CPMF, a contribution charged on financial transactions, had a powerful impact on the trajectory of restricted monetary aggregates in the first quarter of 1997 and provoked a strong migration of funding into demand deposits and, particularly, away from Short-Term FIF. It is estimated that the process is virtually

Table 2. Monetary program for 1997 1/

R$ billion

Itemization	Second quarter	Year
M1 2/	35,1 - 41,2	36,7 - 44,9
Restricted base 2/	24,0 - 28,1	26,0 - 31,8
Expanded base 3/	220,3 - 258,7	225,9 - 276,1
M4 3/	337,5 - 396,2	352,9 - 431,3

Source: Banco Central do Brasil

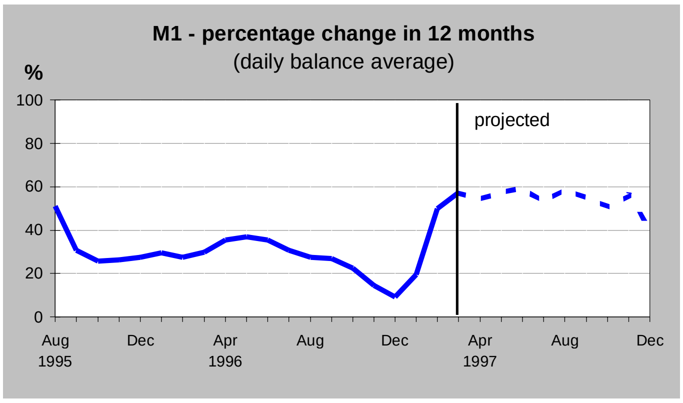
1/ Refers to the final month in the period.

2/ Working-day balance average in month.

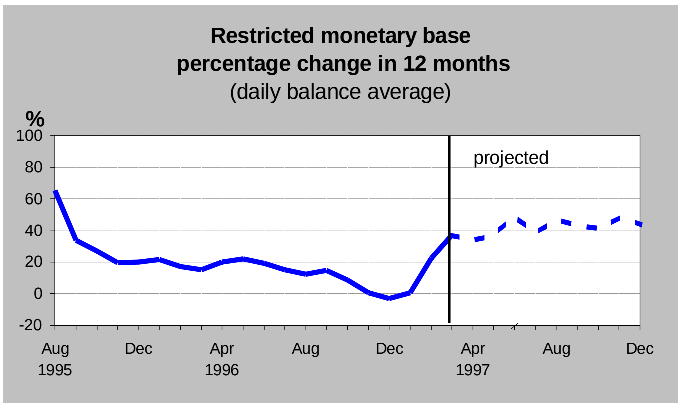
3/ End-of-period balances.

finalized and, during the coming months, may result in a less significant impact on M1 and on the monetary base. Table 2 shows the projected bands for monetary aggregates at the end of the second quarter and for the year 1997 as a whole.

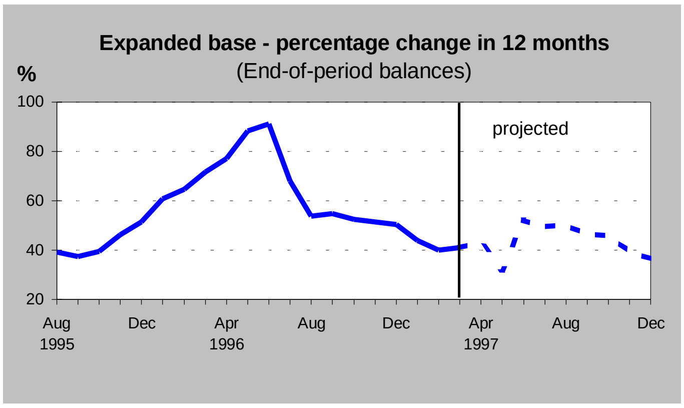
28. With the impact of CPMF on demand deposits, the M1 aggregate moved to a higher level. As a result, the growth projection of the monthly average of this aggregate over 12 months increased by 59.3% in June and 40.6% in December 1997.



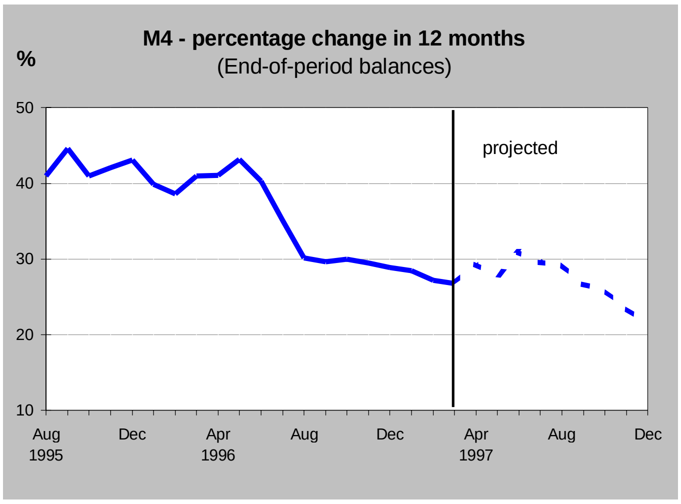
29. Based on the expected performance of current demand (M1) and the forecast trajectory of the monetary multiplier, projected 12 month monetary base growth (currency issued plus banking reserves) came to 49.3% in June and 43.6% in December 1997.



30. In terms of the expanded base, expectations are that the sources of expansionary/contractive pressures on the restricted base will be neutral in 1997. The major expansionary factor will be state debt restructuring operations. As a result, the 12 month projection for this aggregate is growth of 52.1% in June and 36.4% in December 1997.



31. In the same manner, it was estimated that 12 month growth for the M4 aggregate would come to 30.9% in June and 21.4% in December 1997. Not only is this consistent with the behavior standard of the other aggregates but also points to a downward trend in the growth of this item.



32. Growth of the monetary aggregates is summarized in the following tables, which present the values registered in 1996 and for the first quarter of 1997, as well as the amounts defined for the second quarter and for 1997. Data for the second quarter and for 1997 as a whole utilize the average of the various forecasts as their point of reference.

Table 3. Evolution of monetary aggregates [1/]

Itemization	1996		1997					
	Year		First quarter		Second quarter [2/]		Year [2/]	
	R$ billion	% change in 12 months	R$ billion	% change in 12 months	R$ billion [3/]	% change in 12 months	R$ billion [3/]	% change in 12 months
M1 [4/]	29,0	9,2	36,9	57,4	38,1	59,3	40,8	40,6
Restricted base [4/]	20,1	-3,1	24,7	37,0	26,1	49,3	28,9	43,6
Expanded base [5/]	184,0	50,5	194,2	41,1	239,5	52,1	251,0	36,4
M4 [5/]	323,0	28,9	336,4	26,8	366,9	30,9	392,1	21,4

Source: Banco Central do Brasil

1/ Refers to the final month in the period.

2/ Projected.

3/ Medium point of forecasts.

4/ Working-day balance average in month.

5/ End-of-period balances.

33. Growth of the different multipliers implicit in monetary programming is summarized in the following table:

Table 4. Monetary multiplier [1/]

Itemization	1996		1997					
	Year		First quarter		Second quarter [2/]		Year [2/]	
	Multiplier	% change in 12 months	Multiplier	% change in 12 months	Multiplier	% change in 12 months	Multiplier	% change in 12 months
M1 / Restricted base [3/]	1,444	12,7	1,494	14,9	1,462	6,6	1,414	-2,1
Banking reserves / Demand deposits [3/]	0,231	-53,6	0,383	-21,5	0,383	-3,8	0,337	45,9
Currency / M1 [3/]	0,504	18,3	0,374	-11,6	0,374	-14,4	0,463	-8,1
M4 / Expanded base [4/]	1,755	-14,3	1,732	-10,2	1,532	-13,9	1,562	-11,0

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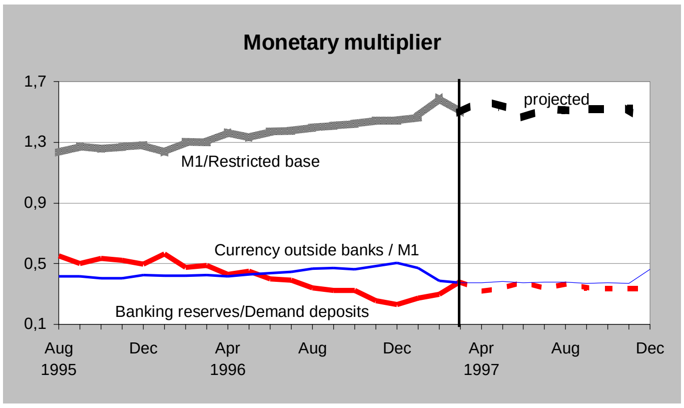
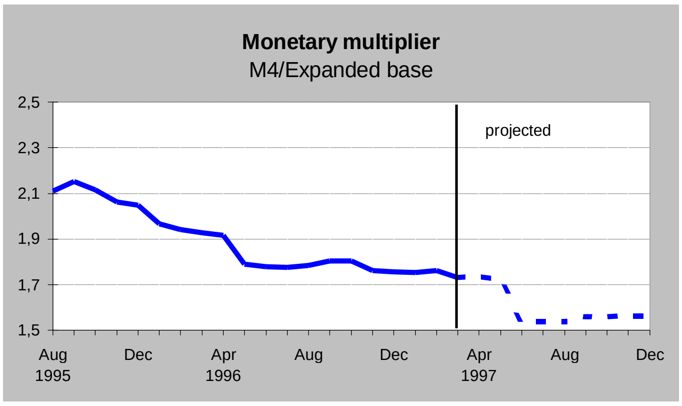
34. Despite expectations of monetization of a part of the remaining balance of short-term investment funds, the ratio of currency held by the public/M1 is not expected to change significantly, while reserve requirement rates on demand deposits should be maintained. This is expected to sustain the restricted monetary base multiplier at the same level during all of 1997.



35. The multiplier of the expanded base is expected to move downward as of the second quarter of 1997, as a result of operations carried out in the framework of state debt restructuring, since part of these operations is not expected to impact M4, though there will be an impact on the expanded base.



Summary of projections

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R$ billion

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