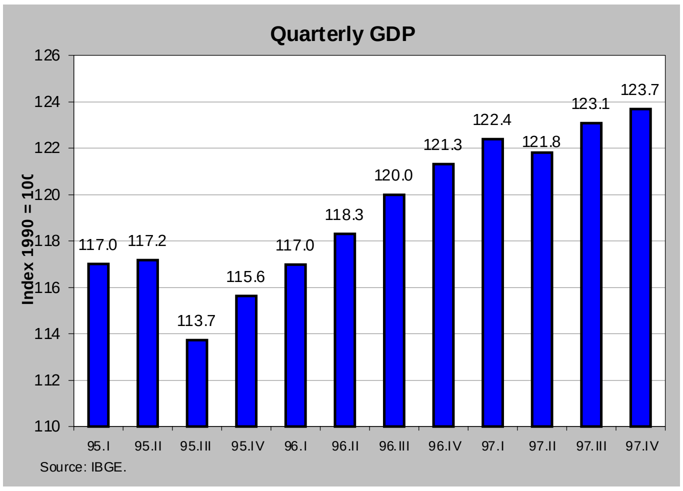
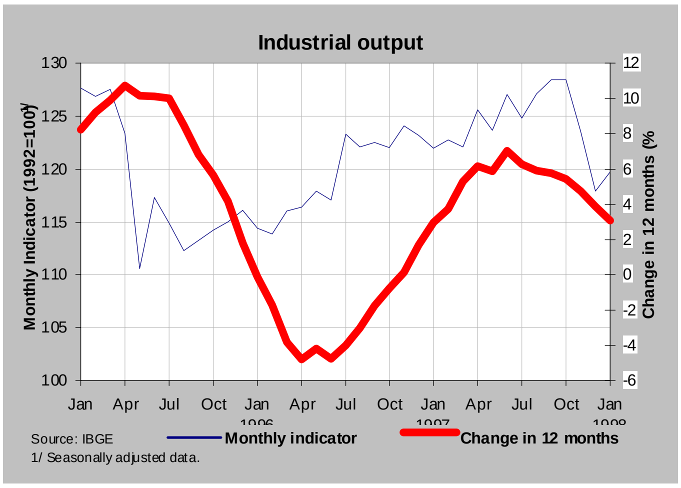
Monetary program for the second quarter of 1998

A. The economy in the first quarter of 1998

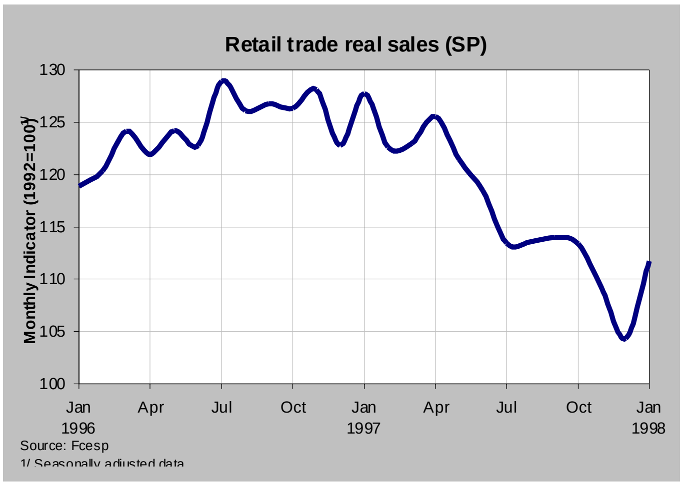
1. Gross domestic product (GDP) expanded by 3% in 1997, marking the fifth consecutive year in which internal output of goods and services has increased. On a sector by sector basis, the highest growth occurred under industry (5.5%), followed by services (1.3%) and crop and livestock farming (1.2%). The performance of the industrial sector was powered by growth in the subsectors of construction (8.5%) and mineral extraction (7.3%).



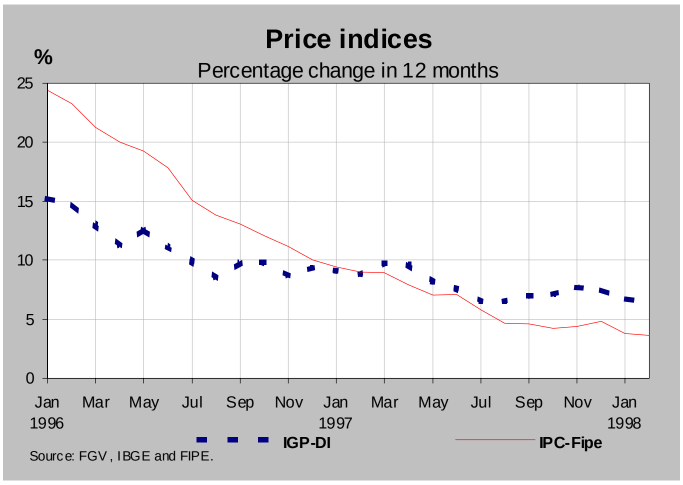
2. IBGE's Monthly Industrial Survey (PIM) indicated 1997 expansion of 3.9%. Accumulated growth up to October had reached a level of 5%. This movement was interrupted by the effects of the Asian financial crisis, as production in November and December closed at a level that was 2.3% below that registered in the same period of 1996. In January 1998, the manufacturing industry turned in growth of 1.6% in the seasonally adjusted series, when compared to the previous month.



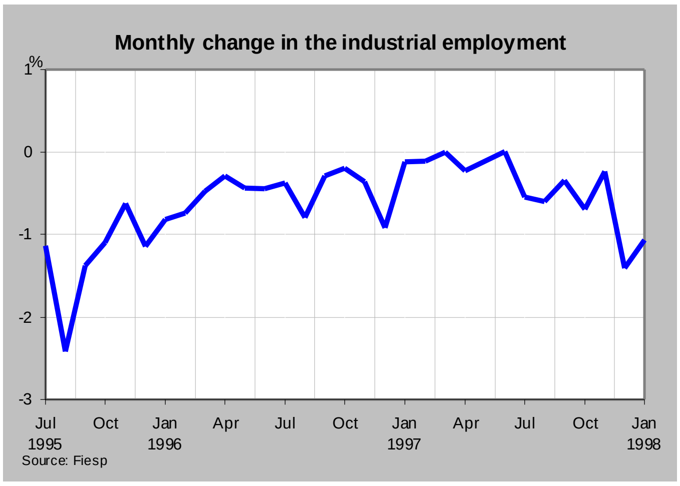
3. The performance of the real billings of the retail trade sector in the metropolitan region of São Paulo was unable to accompany 1997 industrial production growth and, according to Fcesp, closed with a decline of 6.3%. In January 1998, billings expanded by 7% in the seasonally adjusted series in comparison to the previous month. Here, the highlight was the performance of the automotive segment with growth of 13.8%.



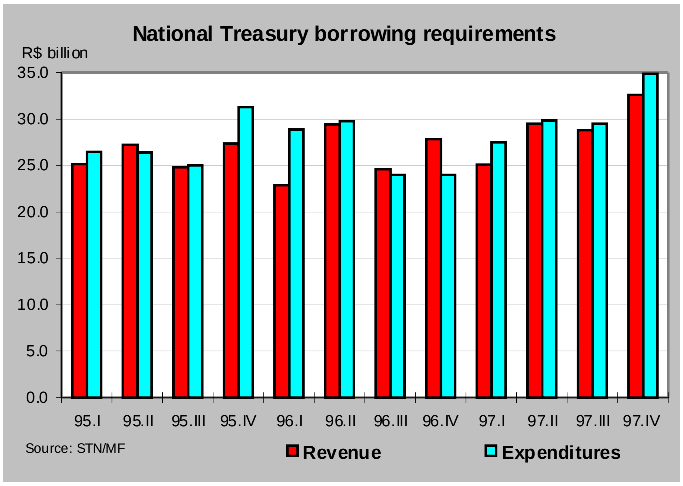
4. At the beginning of 1998, the trajectory of the major price indices confirmed the downward movement evident in recent years. In the first two months of the year, accumulated growth of the IGP-DI and IPC-Fipe closed at 0.9% and 0.08% and expectations are that the first quarter IPC-Fipe will close with negative growth. In terms of growth over the past 12 months, the IGP-DI and IPC-Fipe accumulated rates of 6.3% and 3.6% with a decline of 1.2 percentage points in both cases in comparison to the end of 1997.



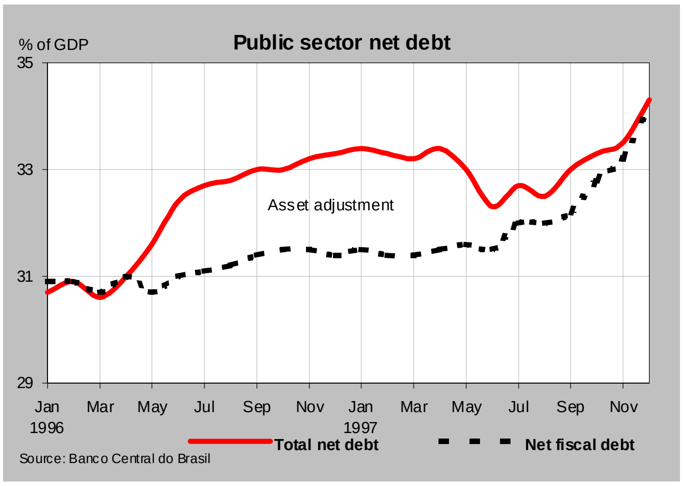
5. According to Ministry of Labor information, the level of formal employment in the country dropped by 0.4% in 1997. The 2% decline in the manufacturing industry was the factor most responsible for the falloff in total employment and was partly offset by growth in job vacancies in the segments of commerce (1.2%) and construction (0.6%). In January 1998, industrial employment in São Paulo turned in a reduction of 5.2% when compared to the same month of the previous year. This decline is due to an ongoing process of restructuring in the industrial sector coupled with a lesser pace of economic activity, arising out of the impact caused by Government measures adopted as from the end of October.



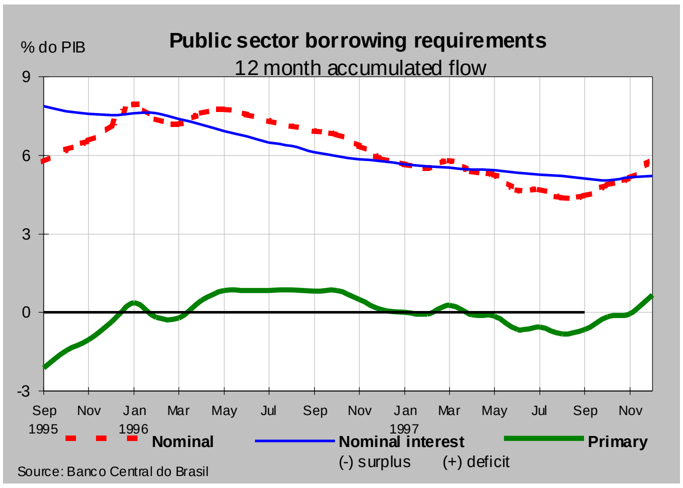
6. In December, National Treasury budget operations registered revenues of R$ 13.1 billion and expenditures of R$ 14 billion. In 1997, revenues totaled R$ 119.6 billion (13.5% of GDP) and outlays came to R$ 125.4 billion (14.1% of GDP), closing with a cash deficit of R$ 5.8 billion. In comparison to 1996, revenues and expenditures turned in real growth of 10.2% and 5.6%, respectively.



7. The net public sector debt (DLSP) in December turned in a balance of R$ 306.5 billion, corresponding to 34.3% of GDP. In relation to December 1996, nominal growth came to 13.9%. With incorporation of privatization resources and contingent liabilities ("skeletons"), the net fiscal debt reached a level of R$ 287.7 billion, as compared to R$ 253 billion in December 1996.

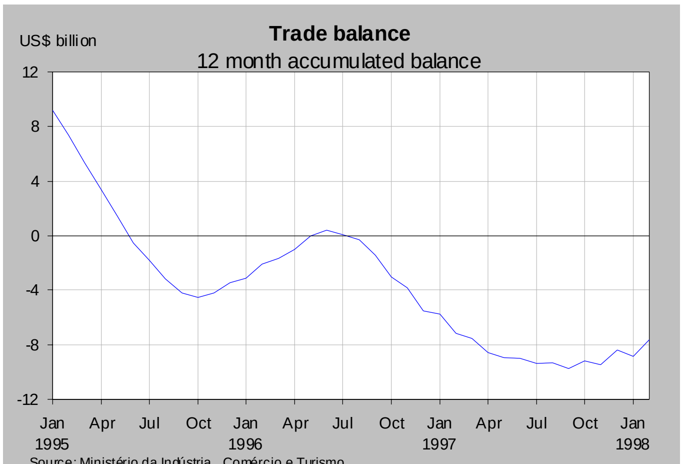


8. With respect to public sector borrowing requirements (NFSP), the primary deficit came to 0.7% of GDP in 1997. In terms of nominal interest, public sector outlays came to 5.2% of GDP, thus generating a nominal deficit of 5.9% of GDP. In the operational concept, the deficit came to 4.1% of GDP. When one considers privatization resources as fiscal revenues, NFSP turned in a surplus of 1.2% of GDP in the nominal concept, as compared to a surplus of 0.06% in 1996. Following the same line, the operational concept registered a deficit of 2.2% of GDP (3.6% in 1996), while the nominal concept closed with a deficit of 4% of GDP (5.7% in 1996).



9. In the first two months of 1998, the federal tax inflow came to R$ 21.4 billion, for growth of 23.2% in real terms in relation to the same 1997 period. The deflator used in this calculation was the IGP-DI. The factor most responsible for this growth was the income tax inflow, which moved from R$ 5.4 billion to R$ 8.6 billion, reflecting the impact of the fiscal measures announced last November. At the same time, the Provisional Contribution on Financial Transactions (CPMF) instituted on January 23, 1997, aided in increasing the inflow in that two month period, registering a total of R$ 1.4 billion in comparison to R$ 517 million in the first two months of 1997.

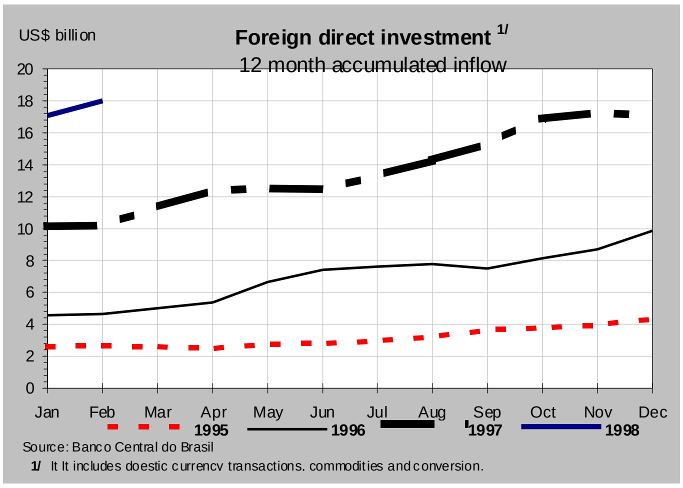
10. With respect to external sector transactions, exports totaled US$ 53 billion in 1997 and imports came to US$ 61.4 billion, generating a negative balance of US$ 8.4 billion. In the first two months of 1998, foreign sales came to US$ 7.6 billion and imports added up to US$ 8.5 billion, closing at levels that were 11.7% and 0.9% higher than in the same period of 1997, respectively. Consequently, the trade balance turned in a deficit of US$ 878 million or 45.1% less than the accumulated result for January and February of the previous year.



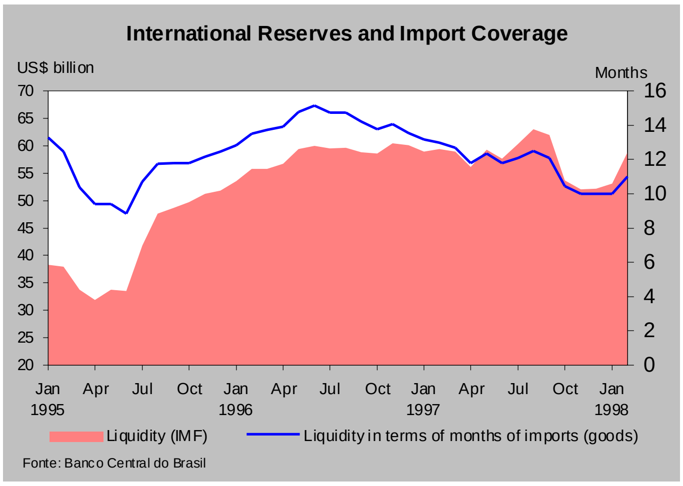
Source: Ministério da Indústria , Comércio e Turismo.

11. In 1997, the service account turned in a deficit of US$ 27.3 billion. The most important items were net interest outlays (US$ 10.4 billion), profit and dividend remittances (US$ 5.6 billion), transportation (US$ 4.5 billion) and international travel (US$ 4.4 billion). In the January-February period, the service account turned in a negative balance of US$ 3.2 billion, with a reduction of 8.6% under net expenditures, excluding interest. The current account deficit in the first two months of the year came to US$ 3.8 billion, representing 3% of GDP. This result was 0.2 percentage point below that of the same 1997 period.

12. In 1997, net inflows of foreign direct investments totaled US$ 17.1 billion, or 72.8% more than in 1996. This volume corresponded to 51.1% of the current account deficit. Net inflows of foreign investments to the capital market came to US$ 5.3 billion. This result incorporates the negative impact of the crisis that occurred in the final quarter of the year. Gross inflows of medium and long-term loans came to US$ 26.6 billion.



13. Net receptions of foreign direct investments in the first two months of 1998 reached US$ 2.2 billion, for growth of 71.9% in comparison to the same period of 1997. Here, one should stress that there were no inflows through privatization auctions. In the same period, net inflows of portfolio investments totaled US$ 2.9 billion, indicating a reversal in the pessimistic outlook commonly perceived among foreign investors soon after the Asian crisis. Gross inflows of medium and long-term financial loans came to US$ 6.9 billion. The positive balance under capital movements was higher than the current account deficit in the period and, consequently, resulted in US$ 6.6 billion end-of-February growth in the reserve position, viewed under the prism of the concept of international liquidity. Reserves closed at US$ 58.8 billion, corresponding to 11 months of imports of goods.



14. The upper and lower limits of exchange rate fluctuations were altered in February 1998, closing at R$ 1.12/US$ for purchase and R$ 1.22/US$ for sale. Up to February, the minifloat band had shifted by 1.249%, closing at R$ 1.13/US$ for purchase and R$ 1.135/ for sale. The exchange rate devalued by 1.253% in the period.

B. Monetary policy in the fourth quarter of 1998

15. In the concept of average daily balances, the monetary base came to R$ 32.3 billion at the end of December 1997, well within monetary programming parameters for the fourth quarter (R$ 31.7 billion – R$ 37.2 billion). The December increase in the base came to 24.1% and was impacted by seasonal factors. The result was a rise in yearly growth to 60.6%. Currency issued and banking reserves totaled R$ 20 billion and R$ 12.3 billion, for respective growth rates of 19% and 270.1% in 1997. Growth in banking reserves was due mostly to the effect of levying of the CPMF during the year.

16. The expanded monetary base – a concept that includes the restricted monetary base, compulsory cash deposits and federal public securities outside Banco Central – reached R$ 280.1 billion in December, precisely at the midpoint between the upper and lower parameters defined in monetary programming for the fourth quarter (R$ 257.7 billion – R$ 302.5 billion). One should also note that the period under consideration was marked by LFT issues reserved to renegotiation of State of São Paulo security and contractual debts. With this, the rate of monthly growth of the expanded base came to 27.4% in December, with an annual rate of 52.2%.

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

Itemization	Forecast		Observed	
	R$ billion	Percentage change in 12 months 1/	R$ billion	Percentage change in 12 months
M1 2/	48.6 - 57.1	82.2	45.6	57.4
Restricted base 2/	31.7 - 37.2	71.2	32.3	60.6
Expanded base 3/	257.7 - 302.5	52.2	280.1	52.17
M4 3/	371.4 - 436.0	25.3	392.8	21.92

Source: Banco Central do Brasil

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

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

3/ End-of-period balances.

17. In terms of average daily balances, the money supply (M1) totaled R$ 45.6 billion at the end of 1997, for growth of 16.3% in December and 57.4% in the year. This was below the lower limit defined in monetary programming (R$ 48.6 billion – R$ 57.1 billion), caused by the reduction in currency demand that was generated by the October interest rate hike. Currency held by the public and demand deposits registered growth rates of 19.8% and 95.7% in 1997, with respective totals of R$ 17.5 billion and R$ 28.1 billion.

18. The broader aggregate (M4) totaled R$ 392.8 billion in December (monetary programming parameters of R$ 371.4 billion and R$ 436 billion). The growth rate came to 2.54% in monthly terms and 21.9% in annual terms.

19. The final quarter of the year was marked by a sharp rise in basic interest rates on the final day of October, when the TBC and TBAN moved to 3.05% and 3.23% per month, respectively. These rates held steady at that level during the entire month of November. In December, the TBC was set at 2.9% per month and the TBAN at 3.15% per month. These movements generated an over-Selic rate that moved from 1.67% per month in October to 3.04% per month in November and 2.97% per month in December.

C.Monetary policy in January-February 1998

20. Average daily balances of the restricted monetary base came to R$ 31.9 billion in February, with a reduction of 4.9% in the month and growth of 41.2% in 12 months. Currency issued and banking reserves came to R$ 18 billion and R$ 14 billion in that order, for growth rates of 12.3% and 111.5% in 12 months.

21. The expanded monetary base balance reached R$ 294.2 billion in February, reflecting growth of 3.3% in the month and 56.5% in 12 months.

Table 2. Observed February and forecast monetary program for the first quarter of 1998

Itemization	Forecast		Observed	
	R$ billion	Percentage change in 12 months 1/	R$ billion	Percentage change in 12 months
M1 2/	36.1 - 42.4	6.4	42.6	17.9
Restricted base 2/	25.1 - 29.4	10.4	31.9	41.2
Expanded base 3/	313.9 - 368.5	75.7	294.2	56.5
M4 3/	406.6 - 477.3	28.5	406.1	22.5

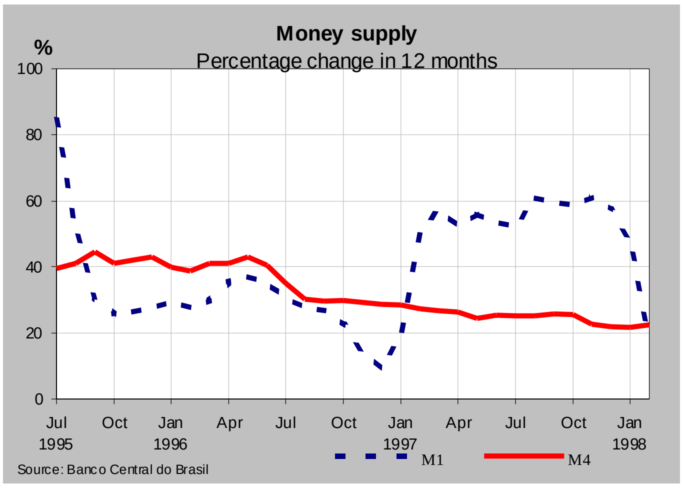
Source: Banco Central do Brasil

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

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

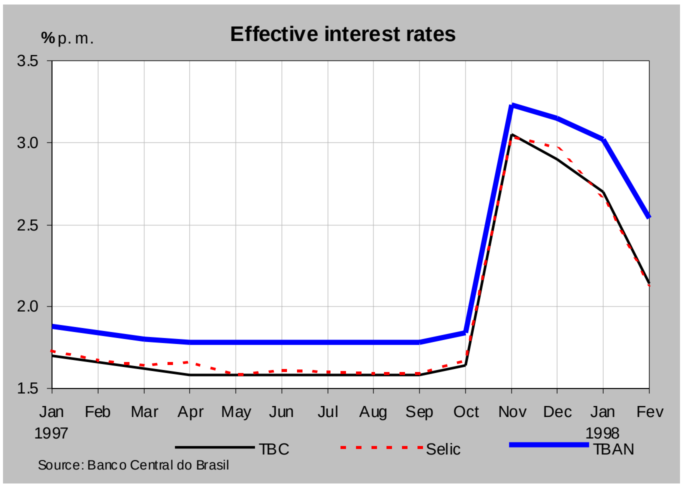
3/ End-of-period balances.

22. The money supply (M1) added up to R 42.6 billion, with a monthly decline of 4.4% and growth of 17.9% in the 12 month period ended in February. Currency held by the public and demand deposits registered monthly averages of R$ 15.7 billion and R$ 26.9 billion in February, with growth of 12.5% and 21.2% in 12 months.



23. In its turn, the broader money supply concept (M4) registered growth of 2.2% in February, with a balance of R$ 406.1 billion, raising the 12 month rate to 22.5%.

24. When one looks at interest rates on an annual basis as stipulated in Circular no. 2,761, dated 6.18.97, the average TBC for January came to 37.66% per year and the TBAN to 42.9% per year. The February rate closed at 34.5% per year for the TBC and 42% per year for the TBAN. In the case of the over-Selic rate, the January rate of 37.19% per year dropped to 34.32% per year in February, thus accompanying the downward movement under basic interest rates.



D. Outlook for the second quarter and for 1998

25. At the end of October, changes in the foreign scenario coupled with the consequent internal policy alterations generated a downturn in industrial production in the final two months of the year. This phenomenon was most strongly felt under capital goods and durable goods, since these are high value items and, therefore, depend on credit to leverage sales. Statistics available for early 1998 indicate a higher level of industrial production in comparison to December. Though this movement should be seen in the light of November and December declines (3.2% and 5%, respectively), it does suggest that the impact of the measures taken in the wake of the Asian crisis in October 1997 will be less intense than initially forecast.

26. The cutback in the level of economic activity in the final two months of 1997 is associated to the re-evaluation of expectations regarding the pace of Brazilian economic growth under the impact of higher interest rates and in the framework of adverse foreign sector conditions.

27. In terms of internal absorption, no pressures have been noted on the level of supply, as is evident in the performance of the major indices for prices, defaults, employment and credit granted. During the course of the year, price growth is expected to move downward, while the continued drop in interest rates is expected to have a positive impact on investment levels and, consequently, on the pace of economic activity.

28. Public sector borrowing requirements should incorporate the effects of the fiscal measures taken at the end of 1997. As a matter of fact, the first results in terms of inflow for the current year have created expectations of an improved performance under 1998 public sector accounts. This trend may be positively influenced by the upswing under economic activity and by the appropriate conclusion of the administrative and social security reforms.

29. The flow of foreign capital to the country indicates a reversal in the expectations of international investors. The early months of the year were marked by a strong inflow of resources, at the same time in which outflows related to operations among financial institutions in the country and abroad moved downward. This movement has made it possible to recompose the international reserve level and even required measures designed to improve the profile of the funds entering the country. In terms of 1998, the current situation of foreign liquidity suggests that the restrictions imposed by the balance of payments will be somewhat attenuated as far as economic growth is concerned.

E. Growth targets for monetary aggregates in the second quarter and for 1998

30. Programming for the monetary aggregates in the second quarter of 1998 and estimates for the year as a whole are based on expected inflation, nominal interest rates, production and the monetary impacts generated by National Treasury operations through the so-called Single Account, PROES operations and Banco Central activities on the exchange market and in the financial market in general. Table 3 shows the upper and lower limits projected for monetary aggregates at the end of the second quarter and for all of 1998.

Table 3. Monetary program for 1998 [1/]

R$ billion

Itemization	Second quarter	Year
M1 [2/]	37.9 - 44.5	47.0 - 57.4
Restricted base [2/]	30.2 - 35.5	36.6 - 44.8
Expanded base [3/]	320.4 - 376.1	362.3 - 425.3
M4 [3/]	405.8 - 476.3	429.9 - 525.4

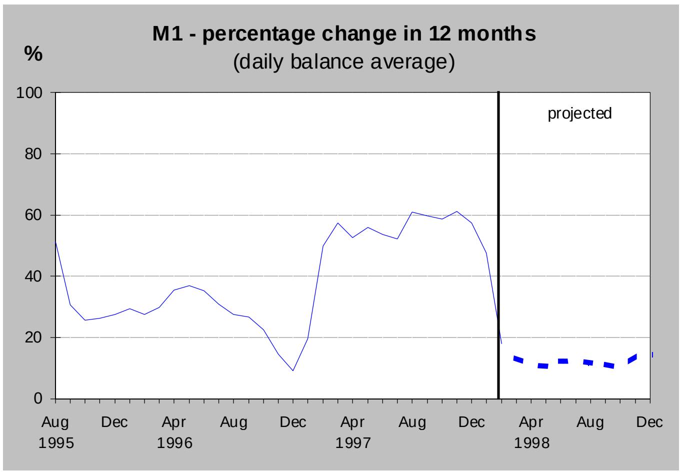
Source: Banco Central do Brasil

1/ Refers to the final month in the period.

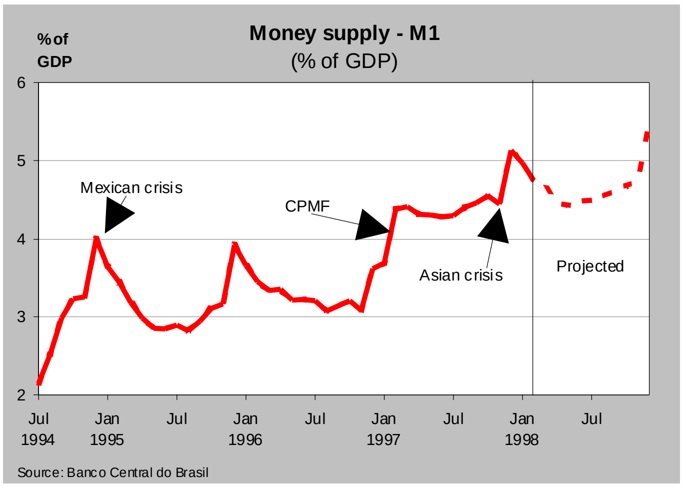
2/ Working-day balance average in month.

3/ End-of-period balances.

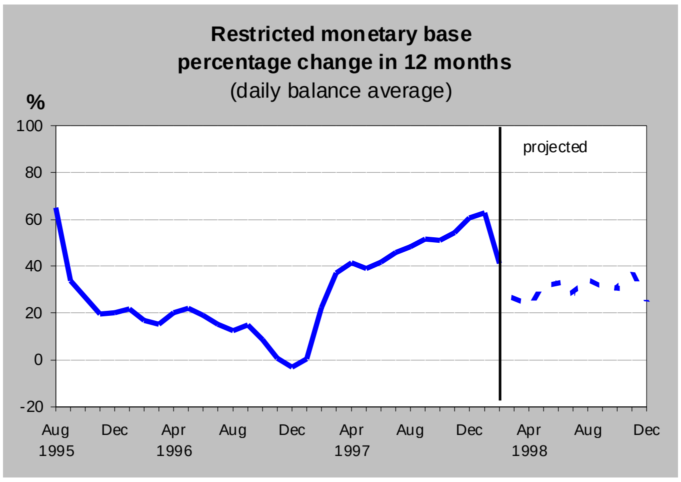
31. Despite the recent decline in interest rates, they are still quite high and this fact, coupled with the drop in economic activity, should have the effect of dampening money supply demand in the second quarter. Thus, the midpoint of the M1 projection for June 1998 is R$ 41.2 billion, with 12.2% accumulated growth in the 12 previous months. For the end of the year, when currency demand is expected to have recovered, the average estimated value is R$ 52.2 billion, with growth of 14.4% in the year.



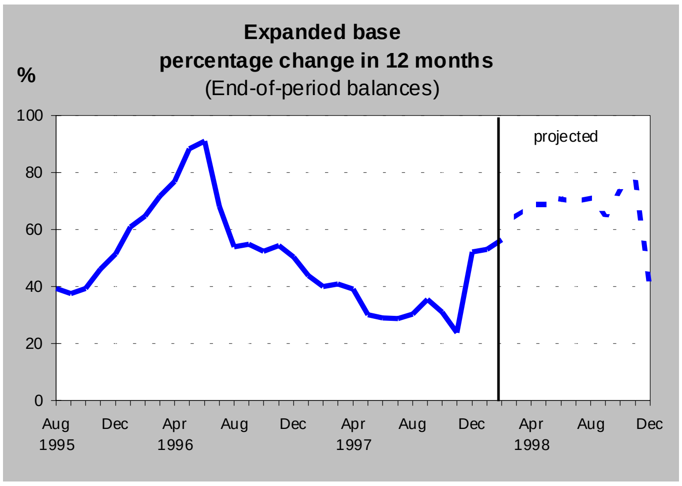
32. In relation to GDP, the proportion of M1 shows an upward tendency as of the start of the Real Plan. In that period, the gradual approach taken to monetary policy was only interrupted in the first half of 1995 and end of 1997, in response to pressures on the domestic exchange market generated by the financial crisis in Mexico and Asia, respectively. Fluctuations in the overall trend were also caused by the process of remonetization that followed adoption of the stabilization plan in 1994 and 1997 introduction of the CPMF. For the second half of 1998, it is expected that the downward trajectory in M1 participation in GDP that began with the interest rate hike in October 1997 will be maintained, as a consequence of the gradualist approach that has marked monetary policy implementation. In the second half of the year, currency demand is expected to recover as the factors that have inhibited growth run out of steam.



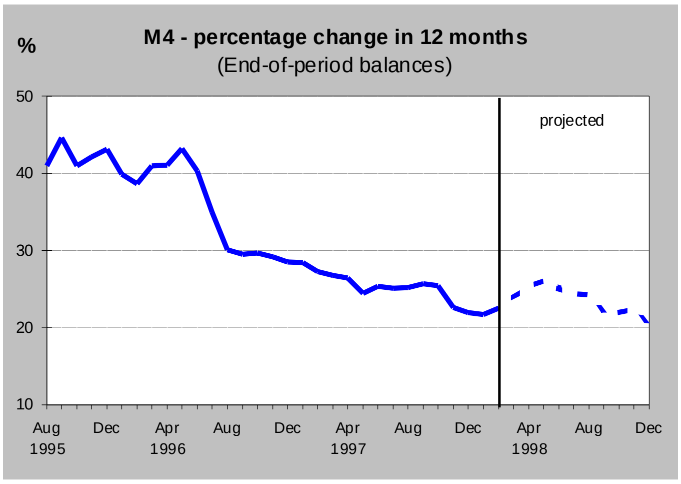
33. Based on M1 projections together with estimates of the behavior of the monetary multiplier, monetary base projections have been elaborated. In the restricted concept, the midpoint of the base in June 1998 is projected at R$ 32.8 billion, with growth of 33% in 12 months. At the end of the year, the monetary base is expected to reach a level of R$ 40.7 billion, with annual growth of 26% or less than the 1997 result. The reasons for this were that the initial impact of the CPMF has run its course at the same time in which the effects of the interest rate hike on economic growth and on the cost of retaining monetary assets were gradually dissipated.



34. For the second quarter of the year, the projection of the expanded base reflects the expansionary impact of the foreign sector caused by recomposition of the international reserve position and operations involving restructuring of state debts. Thus, the midpoint of the expanded base projection for June 1998 is R$ 348.3 billion, with growth of 71.4% in 12 months. In December, the expanded base is expected to reach R$ 393.8 billion, for growth of 40.6%.



35. The M4 concept projected for June totals R$ 441 billion, with growth of 25.5% in 12 months. The estimated value for December is R$ 477.6 billion, with growth of 21.6% in the year.



36. Table 4 presents a summary of the effective and expected behavior of monetary aggregates, with their values for 1997 and for the January-February period of 1998, together with the average midpoints of projections for the second quarter and for all of 1998.

Table 4. Evolution of monetary aggregates [1/]

Itemization	1997		1998		1998			
	Year		*January´February*		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/]	45.6	57.4	42.6	17.9	41.2	12.2	52.2	14.4
Restricted base [4/]	32.3	60.6	31.9	41.2	32.8	33.0	40.7	26.0
Expanded base [5/]	280.1	52.2	294.2	56.5	348.3	71.4	393.8	40.6
M4 [5/]	392.8	21.9	406.1	22.5	441.0	25.5	477.6	21.6

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.

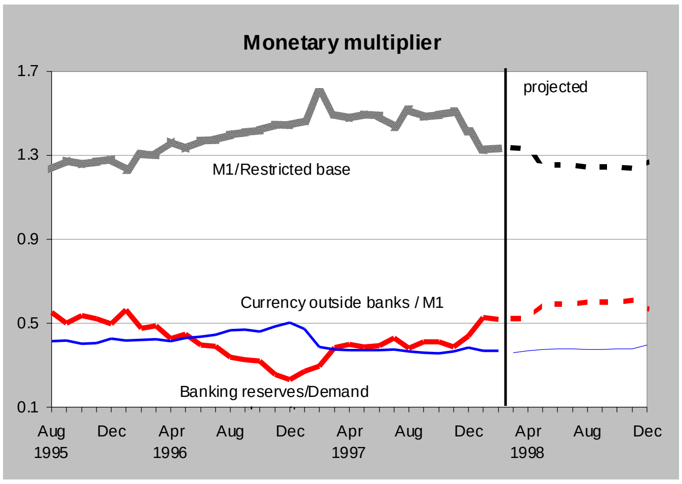
37. The behavior of the M4/Expanded Base and M1/Restricted Base multipliers are detailed in table 5.

Table 5. Monetary multiplier [1/]

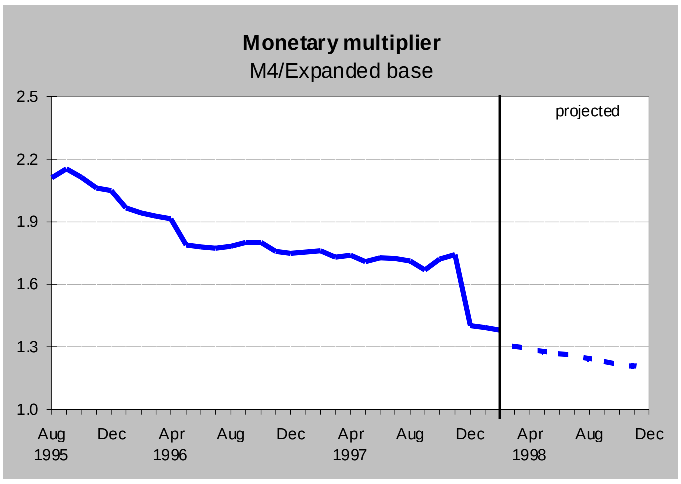
Itemization	1997		1998		1998			
	Year		January-February		Second quarter [2/]		Year [2/]	
	Multiplier	% change in 12 months	Multiplier	% change in 12 months	Multiplier	% change in 12 months	Multiplier	% change in 12 months
M1 / Restricted base [3/]	1.413	-2.0	1.334	-16.6	1.256	-15.6	1.283	-9.2
Banking reserves / Demand deposits [3/]	0.232	-53.4	0.518	74.4	0.589	49.5	0.544	24.2
Currency / M1 [3/]	0.505	18.5	0.368	-4.7	0.378	1.9	0.407	6.0
M4 / Expanded base [4/]	1.750	-14.6	1.380	-21.7	1.266	-26.8	1.213	-13.5

Source: Banco Central do Brasil
1/ Refers to the final month in the period.
2/ Projected.
3/ Working-day balance average in month.
4/ End-of-period balances.

38. Consolidation and preservation of economic stability have generated a relatively steady multiplier in the case of the restricted base. However, this is still impacted by the process of remonetization, which has still not been exhausted, and also by Banco Central operations with the financial market. As a result, the value of the multiplier is expected to register a slight reduction by the end of the second quarter.



39. In the same way, the expanded base multiplier is expected to decline in the second quarter since operations involving restructuring of state debts are forecast to have a greater impact on the expanded base than on M4.



Summary of projections

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

Itemization	Forecast		Observed	
	R$ billion	Percentage change in 12 months 1/	R$ billion	Percentage change in 12 months
M1 [2/]	48.6 - 57.1	82.2	45.6	57.4
Restricted base [2/]	31.7 - 37.2	71.2	32.3	60.6
Expanded base [3/]	257.7 - 302.5	52.2	280.1	52.17
M4 [3/]	371.4 - 436.0	25.3	392.8	21.92

Source: Banco Central do Brasil

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

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

3/ End-of-period balances.

Table 2. Observed February and forecast monetary program for the first quarter of 1998

Itemization	Forecast		Observed	
	R$ billion	Percentage change in 12 months 1/	R$ billion	Percentage change in 12 months
M1 [2/]	36.1 - 42.4	6.4	42.6	17.9
Restricted base [2/]	25.1 - 29.4	10.4	31.9	41.2
Expanded base [3/]	313.9 - 368.5	75.7	294.2	56.5
M4 [3/]	406.6 - 477.3	28.5	406.1	22.5

Source: Banco Central do Brasil

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3/ End-of-period balances.

Table 4. Evolution of monetary aggregates [1/]

Itemization	1997		1998		1998			
	Year		*January´February*		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/]	45.6	57.4	42.6	17.9	41.2	12.2	52.2	14.4
Restricted base [4/]	32.3	60.6	31.9	41.2	32.8	33.0	40.7	26.0
Expanded base [5/]	280.1	52.2	294.2	56.5	348.3	71.4	393.8	40.6
M4 [5/]	392.8	21.9	406.1	22.5	441.0	25.5	477.6	21.6

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.

Table 5. Monetary multiplier [1/]

Itemization	1997		1998		1998			
	Year		January-February		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/]	1.413	-2.0	1.334	-16.6	1.256	-15.6	1.283	-9.2
Banking reserves / Demand deposits [3/]	0.232	-53.4	0.518	74.4	0.589	49.5	0.544	24.2
Currency / M1 [3/]	0.505	18.5	0.368	-4.7	0.378	1.9	0.407	6.0
M4 / Expanded base [4/]	1.750	-14.6	1.380	-21.7	1.266	-26.8	1.213	-13.5

Source: Banco Central do Brasil

1/ Refers to the final month in the period.

2/ Projected.

3/ Working-day balance average in month.

4/ End-of-period balances.