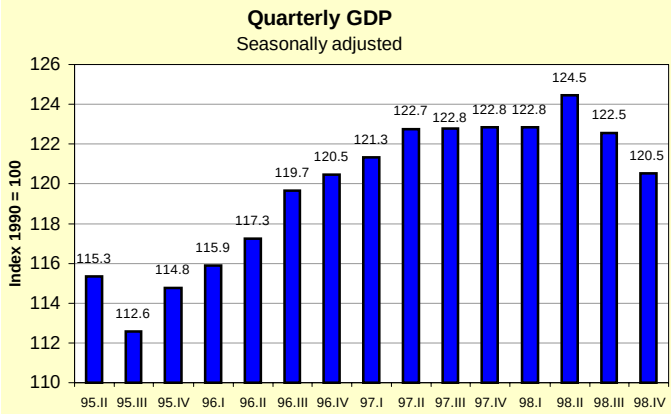
Monetary program for the second quarter and the year of 1999

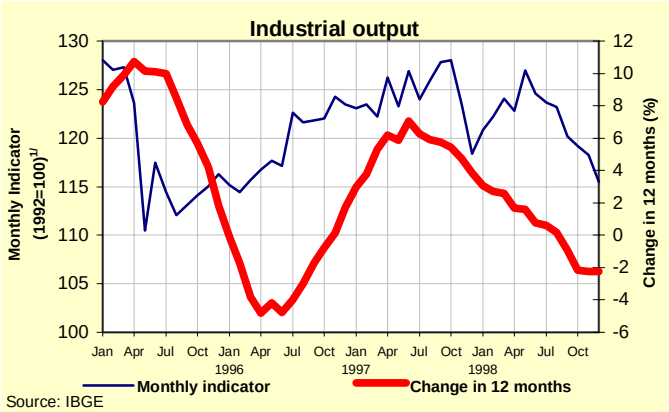
A. The economy in the first quarter of 1999

1. Brazilian economic performance in 1998 was strongly impacted by a worsening international crisis and by fiscal and monetary measures adopted by the Brazilian government in order to cope with the profound alterations that occurred in the international scenario during the course of the year. In this sense, analysis of the seasonally adjusted series released by IBGE indicates that gross domestic product (GDP) dropped by 1.64% in the fourth quarter of the year when compared to the previous quarter. This reduction was generated by declines in the sectors of crop and livestock farming (6.45%), industry (2.45%) and services (0.65%). In 1998 as a whole, GDP expansion came to 0.15% as against 3.47% in 1997. A breakdown of the 1998 result shows growth of 0.36% and 0.75% under crop and livestock farming and services, coupled with a falloff of 0.98% in the industrial sector.



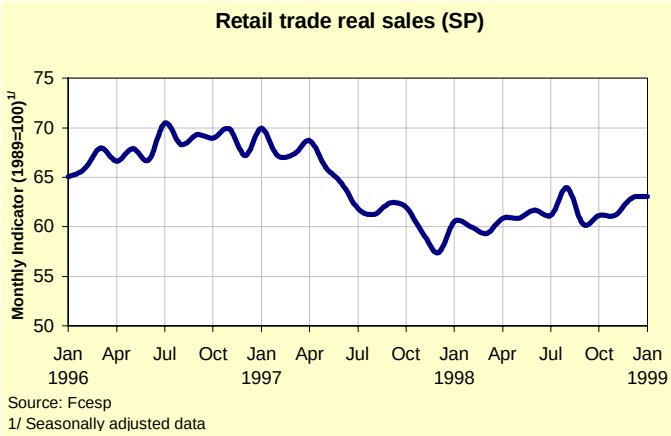
Source:IBGE

2. According to IBGE data, industrial production fell by 2.2% in 1998 when compared to the previous year's results. This performance reflects negative results registered in the sectors of capital goods (-1.9%), intermediate goods (-0.9%) and consumer goods (-5.5%). Based on IBGE data from which Banco Central has purged seasonal factors, January 1999 registered 1.83% growth in industrial production when compared to the preceding month. However, this growth should not be construed as a sign that the downward slide under this heading that began toward the end of the first half of 1998 has been reversed.

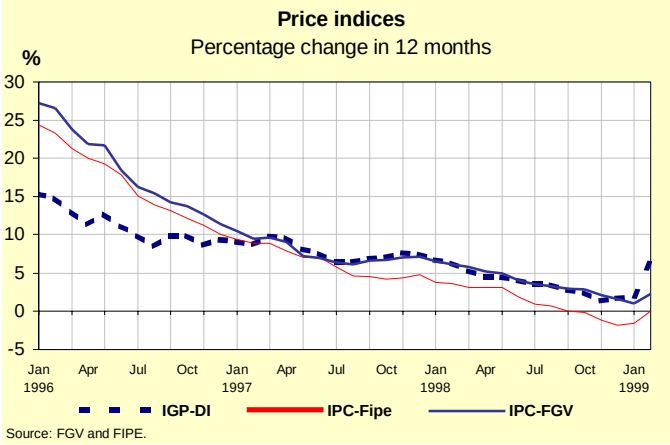


Source: IBGE
1/ Seasonally adjusted data.

3. Figures for the real billings of the retail trade sector in the metropolitan region of São Paulo were 3.8% below the results of the previous year. When one considers the series from which Banco Central has eliminated seasonal impacts, sales expanded by 0.32% in January 1999 when viewed against the previous month's performance and by 4.21% when compared to the same month of the previous year. In the 12 month period up to January, sales declined by 2.96%. A breakdown of this figure shows that sales of consumer goods (durable, semidurable and nondurable) increased by 4.52%, while the automotive sector registered a reduction of 23.72% and sales of construction material dropped by 15.05%. According to the Brazilian Association of Wholesalers and Industrialized Product Distributors – ABAD, real billings of the wholesale sector expanded by 5.98% in 1998, while the data released by the Brazilian Association of Supermarkets – ABRAS points to growth of 7.63% in the same period. This trend was maintained in January 1999, as evinced by expansion of 1.02% in the wholesale trade sector and 11.12% in supermarket sales, in comparison to the same month of the previous year.

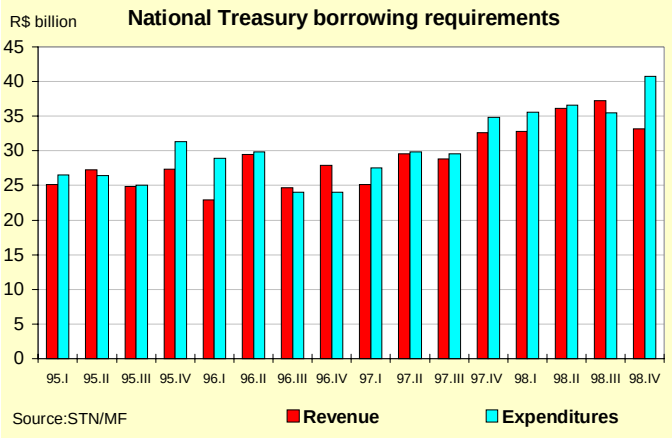


4. Inflation continued downward in 1998 as the indices for both tradable and nontradable goods followed converging curves. In the year, the general price index – internal supply (IGP-DI) expanded by 1.7%, while the consumer price index – Getúlio Vargas Foundation (IPC-FGV) and the consumer price index – Fipe (IPC-Fipe) registered 1.66% and –1.79%, respectively. In the first two months of 1999, growth in price indices accelerated mostly in response to the exchange devaluation that occurred in the period. The IGP-DI accumulated expansion of 5.64% in the two month period, while the expanded price index – internal supply (IPA-DI) rose by 8.68%. The fundamental cause of this rise was upward movement in the prices of farm products, principally coffee, wheat, soybeans and cocoa. In the first two months of 1999, the IPC-Fipe registered growth of 1.92% as a result of price rises under food (3.88%), transportation (5.27%) and housing (0.92%), while the IPC-FGV closed with an increase of 3.38%.

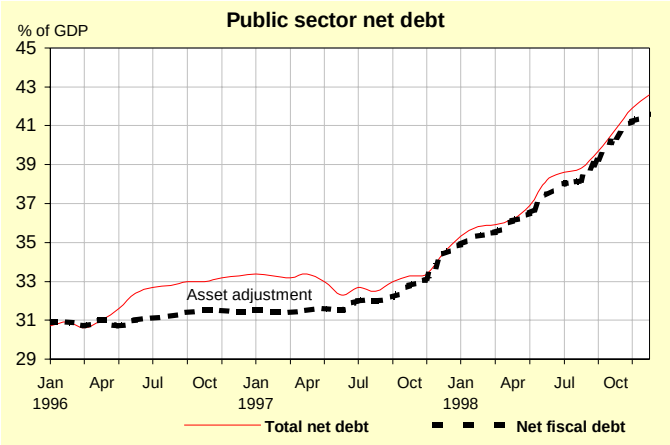


5. The effects of the international liquidity crisis coupled with the ongoing process of restructuring Brazilian productive activities impacted the job market in 1998. During the year, the average rate of unemployment came to 7.6%, as compared to an average of 5.7% in 1997. In January 1999, basic unemployment measured by the IBGE came to 7.73%, as compared to 6.32% in the previous month. This increase in the jobless rate during the month (22.31%) reflects a falloff of 0.18% in the economically active population and a rise of 22.45% in the number of persons unemployed.

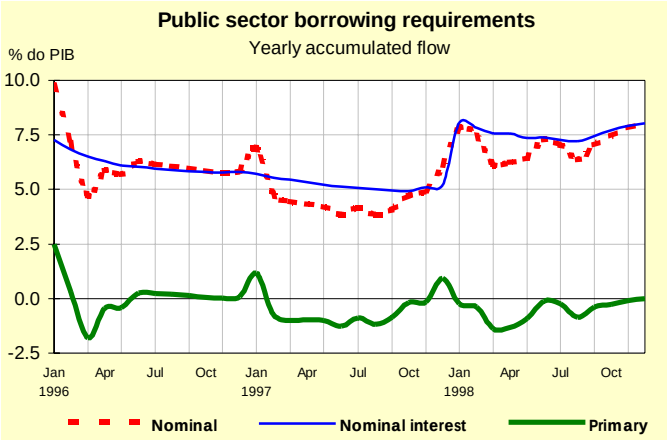
6. In 1998, National Treasury budget operations registered revenues of R$ 140 billion and expenditures of R$ 149 billion. A comparison with 1997 data indicates that revenues expanded by 15.1% in real terms as a consequence of alterations introduced into the legislation governing the income tax and import operations, as well as an atypical inflow of funds generated by telecommunications service concessions. In January 1999, National Treasury budget operations turned in a negative result of R$ 1.7 billion, as revenues totaled R$ 10.1 billion and expenditures came to R$ 11.9 billion.



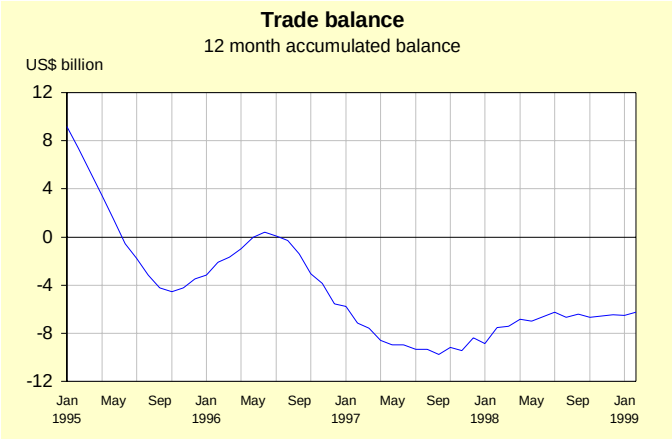
7. In December, the net public sector debt (DLSP) added up to R$ 379.8 billion (41.6% of GDP), as external indebtedness reached a level of 6.6% of GDP. In the month in question, the net internal debt came to 36% of GDP. Of the aforementioned total, 21.1% referred to the central government, 11.8% to state governments, 1.9% to municipal governments and 1.3% to state government companies.



8. Public sector borrowing requirements (NFSP) registered an accumulated nominal deficit of 8.02% of GDP up to December. When nominal interest (8.03% of GDP) is deducted from this amount, the result is a primary surplus of 0.01% of GDP. In 1998, the central government – encompassing the federal government, Banco Central, social security system and federal state companies – closed with a primary surplus of 0.32% of GDP, while regional governments, including state and municipal government administrations and state and municipal government companies, turned in a deficit of 0.31% of GDP.

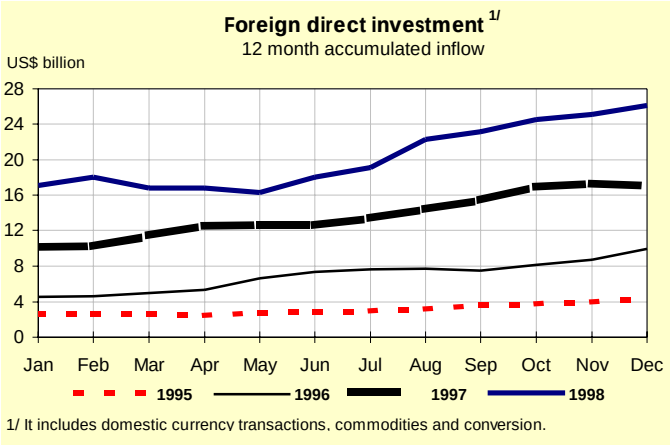


9. The balance of payments result in current account closed in a negative position of US$ 35.2 billion in 1998, as against US$ 33.4 billion in 1997. The trade deficit dropped from US$ 8.4 billion to US$ 6.4 billion as a consequence of a US$ 3.8 billion falloff under imports, which declined from US$ 61.4 billion to US$ 57.6 billion, and of a drop of US$ 1.9 billion in the export column, with a reduction from US$ 53 billion in the previous year to US$ 51.1 billion. In the first two months of 1999, the current account deficit came to US$ 3.5 billion as a result of deficits of US$ 535 million in the trade balance and US$ 3.4 billion in the service account. The US$ 754 million January trade balance deficit was transformed into a February surplus of US$ 219 million, reflecting growth in exports from US$ 2.9 billion to US$ 3.3 billion and a reduction in imports from US$ 3.7 billion to US$ 3 billion.

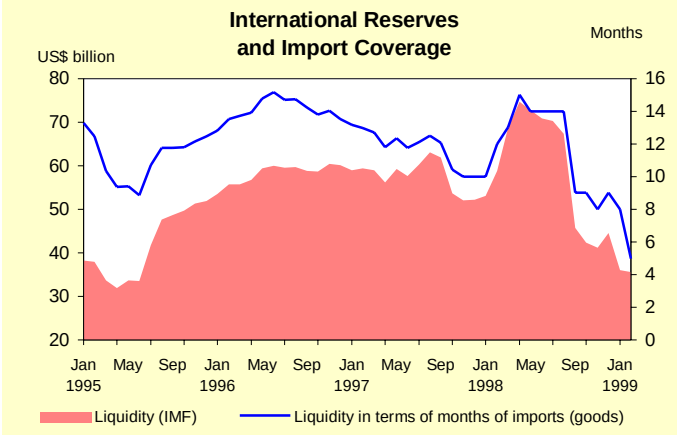


10. The service account turned in a negative result of US$ 30.7 billion in 1998, an increase of US$ 3.4 billion in relation to the previous year. The headings that made the strongest contributions to this growth were net profit and dividend remittances, which increased from US$ 5.6 billion to US$ 7.2 billion, and net interest payments, which rose from US$ 10.4 billion to US$ 12.1 billion. In the first two months of 1999, the most important headings were net interest payments (US$ 1.5 billion) and net profit and dividend remittances (US$ 871 million).

11. Net inflows of direct foreign investments in 1998 totaled US$ 26.1 billion, for growth of 53% in relation to the previous year. With this result, this heading accounted for 74.3% of the current account deficit. Of the inflow volume, 23.4% (US$ 6.1 billion) were generated by foreign participation in the privatization program. In the first two months of 1999, foreign direct investments came to US$ 5.7 billion and totaled US$ 29.7 billion in the 12 month period up to February.



12. In 1998, international reserves came to US$ 44.6 billion in the international liquidity concept and US$ 43.6 billion in the cash concept. In both cases, these totals correspond to nine months of imports. In the concept of international liquidity, foreign reserves came to US$ 35,5 billion at the end of February, registering a falloff of US$ 20.4 billion in relation to December 1998. In the cash concept, reserves reached a level of US$ 34.6 billion.



B. Monetary policy in the fourth quarter of 1998

13. In December, the restricted monetary base totaled R$ 39.3 billion when calculated according to the concept of average daily balances. This result was well within the parameters forecast by monetary programming for the fourth quarter of the year. In the month, the monetary base expanded by 17.5%, while 1998 closed with growth of 21.7%. Currency issued and banking reserves registered respective rates of growth of 21.1% and 12.4% in December and closed the 1998 period with expansion of 17.9% and 27.8%.

14. The expanded monetary base, which corresponds to the restricted base plus compulsory cash deposits and federal public securities outside Banco Central, came to R$ 352.3 billion in December and closed within the parameters specified in monetary

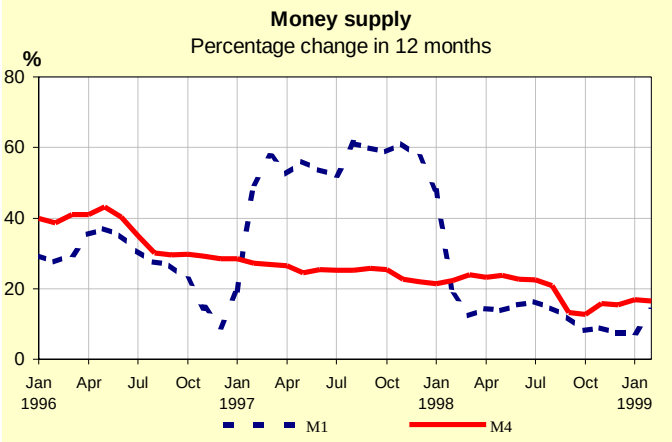
Table 1. Observed results and forecast monetary program for the fourth quarter of 1998[1/]

Itemization	Forecast		Observed	
	R$ billion	Percentage change in 12 months [2/]	R$ billion	Percentage change in 12 months
M1 [3/]	45.0 – 52.8	7.2	49.0	7.4
Restricted base [3/]	34.6 – 40.7	16.6	39.3	21.7
Expanded base [4/]	347.7 – 408.2	35.0	352.3	25.8
M4 [4/]	435.1 – 510.7	20.4	453.2	15.5

1/ It refers to the last day in the period.
2/ Percentage changes are based on the medium point of forecast.
3/ Working-day balance average of last month in the period.
4/ End-of-period balances.

programming for the fourth quarter of 1998. In the month, growth under this aggregate came to 0.4%, while the year closed with expansion of 25.8%.

15. The money supply (M1) totaled R$ 49 billion in December when viewed under the concept of average daily balances. This figure represented growth of 14.8% in the month and 7.4% in the year and was well within the parameters defined in monetary programming. In the same period, currency held by the public and demand deposits added up to R$ 20.5 billion and R$ 28.5 billion, respectively, with growth of 20.7% and 10.8% in the month, and 16.7% and 1.6% in 1998 as a whole, in the same order.



16. The broader monetary aggregate (M4) came to R$ 453.4 billion in December and closed within the maximum and minimum limits defined in monetary programming for the quarter. In the month, growth under this aggregate came to 2.3%, as against 15.6% in the year.

17. At a meeting held on December 16, the Monetary Policy Committee (Copom) approved reactivation of discount window operations based on the Banco Central Base Rate (TBC). These operations had been suspended since September. The TBC was set at 29% per year and the Banco Central Assistance Rate (TBAN) was stipulated at 36% per year. Consequently, the TBAN, which had been hiked to 49.75% in September, turned downward as of November, when it closed at a level of 42.25%. The over-Selic rate stabilized in the same range as the TBC and closed the month at 28.96% per year, as compared to 34.4% per year in the month of November.

C. Monetary policy in January-February 1999

18. In February, the restricted monetary base came to R$ 39.2 billion according to the concept of average daily balances. This result represented positive growth of 0.2% in the month and 22.7% in the last 12 months. Currency issued and banking reserves came to respective levels of R$ 22.4 billion and R$ 16.8 billion, for monthly growth of 0.6% in the first case and –0.4% in the second. Over the last 12 months, these rates came to 24.3% and 20.6%, respectively.

19. The expanded monetary base came to R$ 401.6 billion in February. In the month, growth in this aggregate reached 3.4%, with expansion of 36.5% in the last 12 months. To some extent, this result was generated by the expansionary impact of the appropriation of interest on federal public securities.

Table 2. Forecast monetary program for the first quarter of 1999 and observed results in the January/February period[1/]

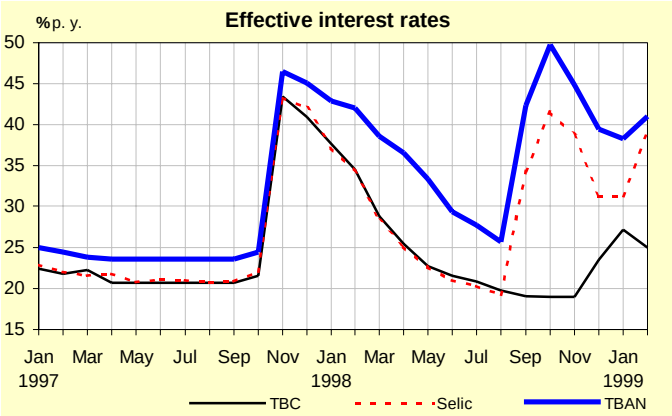
Itemization	Forecast		Observed	
	R$ billion	Percentage change in 12 months [2/]	R$ billion	Percentage change in 12 months
M1 [3/]	46.0– 54.0	20.5	48.4	13.6
Restricted base [3/]	35.4 – 41.6	24.8	39.2	22.7
Expanded base [4/]	353 – 414.4	23.5	401.6	36.5
M4 [4/]	436.7 – 512.6	13.8	472	16.5

1/ It refers to the last day in the period.
2/ Percentage changes are based on the medium point of forecast.
3/ Working-day balance average of last month in the period.
4/ End-of-period balances.

20. In February, the money supply (M1) totaled R$ 48.4 billion in the concept of average daily balances. Growth in the month closed at 0.9% with 13.6% in the last 12 months. Currency held by the public and demand deposits reached respective levels of R$ 19.5 billion and R$ 28.9 billion. The balance of currency held by the public increased by 0.3% in the month, while demand deposits expanded by 1.2%. In the last 12 months, growth under these aggregates came to respective levels of 24.1% and 7.4%.

21. The balance of the broader monetary aggregate (M4) totaled R$ 472 billion at the end of February, for positive growth of 2% in the month and 16.5% in the last 12 months.

22. At a meeting held on January 18, Copom opted to suspend loans referenced to the TBC and set the value of the TBAN at 41%. The purpose of this measure was to preserve economic stability at a time when the country was still adapting to the new system of exchange. The over-Selic rate was subjected to daily Banco Central monitoring through open market operations and reached a level of 39% per year in the month of February.



23. At its March 4 meeting, the Monetary Policy Committee (Copom) deactivated the TBC and TBAN and determined that the Selic reference rate would be the operational instrument applied to monetary policy. Copom defined the level of this rate at 45% per year with a descending bias. In other words, it was determined that the Banco Central President was authorized to reduce the Selic rate further without the need for calling an extraordinary Copom meeting.

D. Outlook for the second quarter and for 1999

24. In mid-January, the Brazilian government opted for adoption of a flexible exchange rate system. This measure was taken when it became clear that foreign investor wariness of assuming new risks, coupled with the literal shutdown of international resources flows to the emerging economies, had begun imposing a much too heavy burden on the nation's reserve position. With this decision, economic policy considerations and expectations regarding the future trajectory of the economy made it necessary to renegotiate the targets defined in the financial cooperation agreement signed between Brazil and the International Monetary Fund at the end of 1998.

25. Initially, the change in the exchange system led to sharp devaluation of the real, though it is expected that this process will be partially reversed in coming months. The increase in the prices of imported goods that resulted from the exchange devaluation exerted pressure on the prices of tradable products and on wholesale price indices. However, these pressures are expected to be no more than temporary and will reach their peak in the first half of the year before sliding downward once again in the second half.

26. The performance of the Brazilian economy during the course of 1999 will be marked by compliance with the commitments assumed in the framework of the macroeconomic adjustment program. Consequently, gross domestic product will be impacted by monetary and fiscal policy which, in turn, will be targeted to preserving currency stability and pursuing fiscal balance.

27. Interest rates and the classic instruments available to the monetary authority will be utilized to implement a monetary policy capable of ensuring price stability. However, alteration of the exchange system and intensification of the fiscal adjustment have also contributed to downward movement in real interest rates and, consequently, to an upswing in economic activity and improvement in public sector results.

28. The government will seek to attain a fiscal surplus while gradually reducing the ratio between public debt and gross domestic product. With this, the strengthening of the fiscal adjustment process in early 1998 is expected to generate a primary surplus of approximately 3.1% of GDP in 1999. It was precisely with this in mind

that various measures have been adopted to curtail current expenditure outlays, raise tariff prices, limit budget outlays, intensify the privatization process and improve the social security system, among others.

29. Real devaluation of the rate of exchange is expected to result in enhanced competitiveness for Brazilian exports on the international market and in a cutback in import operations. These trends will certainly produce a positive impact on the balance of trade and reduce the current account deficit. Financing of this result is to be done basically through inflows of direct investments and by the nation's reintegration into the international financial community. This is a process that will intensify as the country manages to obtain positive results as a consequence of the austere economic policy now being implemented.

E. Targets for monetary aggregates in the second quarter and for 1999 as a whole

30. Programming for monetary aggregates in the second quarter of 1999 was based on probable performance scenarios for inflation, GDP, interest rates and the monetary impact consequent upon National Treasury operations and Banco Central interventions in the financial system.

Table 3. Monetary program for 1999 [1/]

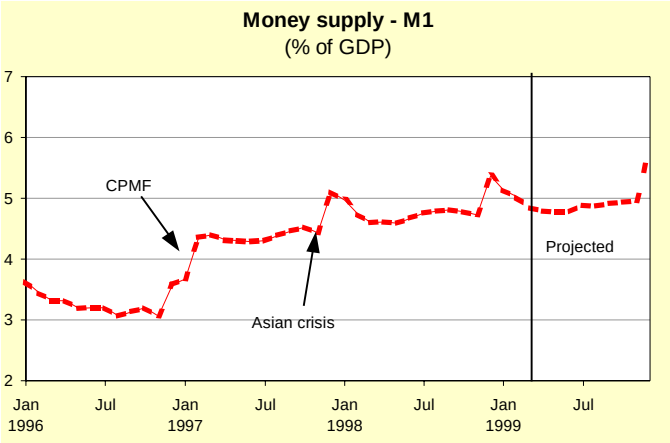
R$ billion

Itemization	Second Quarter		Year	
	R$ billion	% change 12 months[2/]	R$ billion	% change 12 months[2/]
M1 [3/]	44.4 - 52.1	13.7	50.0 - 58.8	11.1
Restricted base [3/]	34.6 - 40.7	13.7	39.9 - 46.8	10.3
Expanded base [4/]	368.9 - 433.0	17.9	401.6 - 471.4	23.9
M4 [4/]	439.0 - 515.4	10.7	469.2 - 550.8	12.5

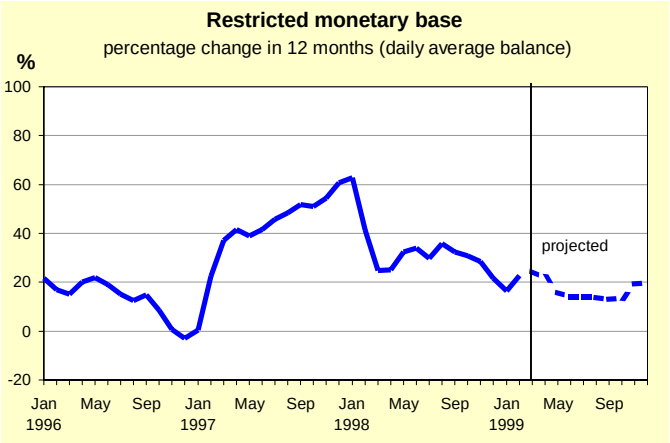
1/ It refers to the final month in the period.
2/ Percentage changes are based on the medium point of forecast.
3/ Working-day balance average of last month in the period.
4/ End-of-period balances.

31. Money supply projections (currency held by the public plus demand deposits) were based on forecasts of internal interest rates and growth in nominal income in coming months. Twelve month growth in the average daily balances of the money supply in June 1999 was estimated at 13.7%.

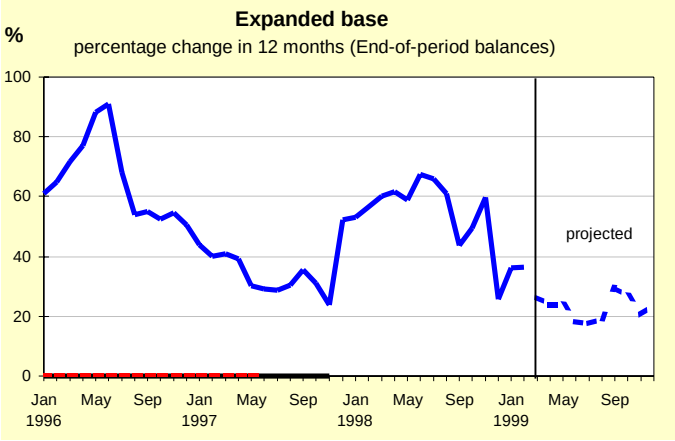
32. The upward trend in the ratio between M1 and GDP that has existed since the start of the Real Plan can be ascribed to the process of monetization of financial assets that occurred in the wake of the stabilization program and, starting in 1997, to the introduction of taxation on financial operations (CPMF). Up to the month of June, no significant changes are expected in the M1/GDP ratio.



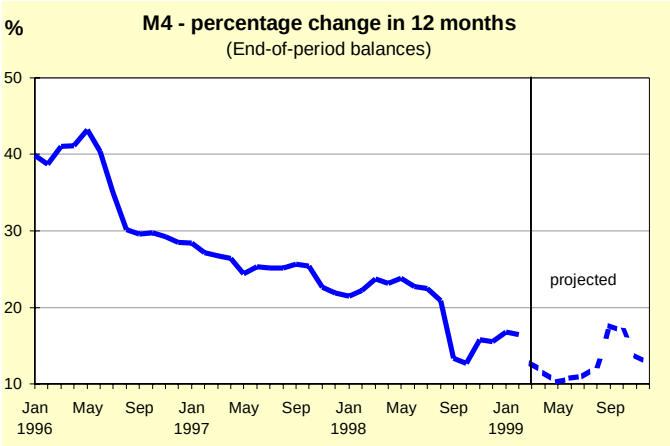
33. Based on expected currency demand, as well as on the expected scenario for obligatory reserves on demand resources, 12 month growth in the average monetary base balance (currency issues plus banking reserves) is projected at 13.7% in June 1999.



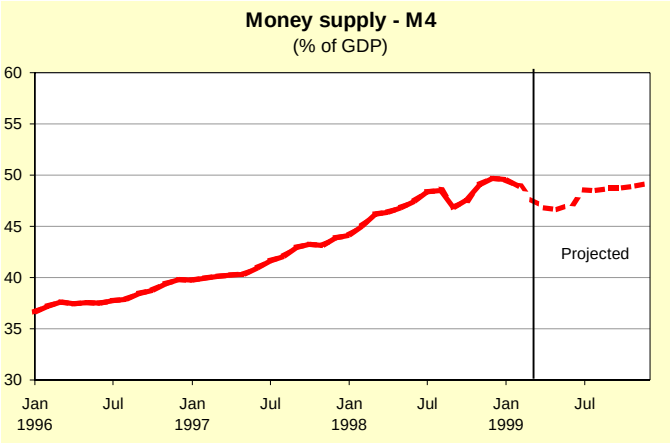
34. Projections for the expanded base (a measurement of the federal monetary and securities debt), which presuppose neutralization of undesired impacts of conditioning factors on the restricted monetary base, took due account of the fact that interest on the federal securities debt – considered the major expansionary factor in coming months – will to a great extent be offset by the primary results achieved by the National Treasury and by Banco Central operations on the exchange market. With this, growth in this monetary aggregate is projected at a 12 month level of 17.9% in June 1999.



35. In much the same way and in a manner consistent with the performance standard of the other aggregates, 12 month M4 growth is estimated at 10.7% in June 1999.



36. In the first half of the year, the ratio between M4 and GDP is not expected to increase since the projected performance of the expanded base in the period will reflect the fiscal adjustment measures and the more restrictive monetary policy adopted and will be quite similar to GDP growth.



37. Growth of the monetary aggregates is summarized in the following table, which shows the results achieved in 1998 and in the January/February 1999 period, as well as the figures expected for the second three month period of 1999.

Table 4. Evolution of monetary aggregates [1/]

Itemization	1998		1999					
	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/]	49.0	7.4	48.4	13.6	48.2	13.7	54.4	11.1
Restricted base [4/]	39.3	21.7	39.2	22.7	37.7	13.7	43.3	10.3
Expanded base [5/]	352.3	25.8	401.6	36.5	401.0	17.9	436.5	23.9
M4 [5/]	453.2	15.5	472.0	16.5	477.2	10.7	510.0	12.5

1/ It 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.

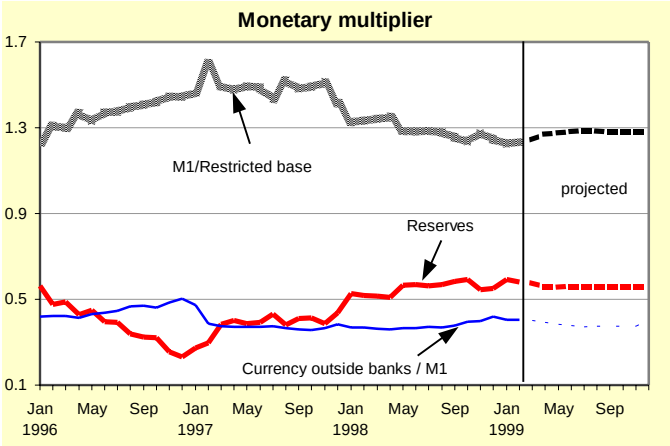
38. Growth in the various multiplier factors implicit in monetary programming is summarized in the table below:

Table 5. Monetary multiplier [1/]

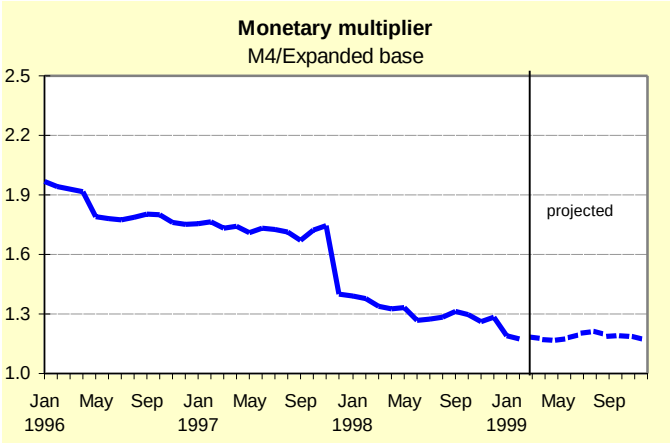
Itemization	1998		1999					
	Year		January - February		Second quarter [2/]		Year [2/]	
	Multiplier	% change in 12 months	Multiplier	% change in 12 months	Multiplier	% change in 12 months	Multiplier	% change in 12 months
M1 / Restricted base [3/]	1.247	-11.7	1.235	-7.4	1.281	0.0	1.255	0.6
Banking reserves / Demand deposits [3/]	0.552	25.7	0.582	12.4	0.559	-1.6	0.562	1.8
Currency / M1 [3/]	0.418	8.6	0.403	9.5	0.378	3.0	0.403	-3.6
M4 / Expanded base [4/]	1.286	-8.2	1.175	-14.7	1.190	-6.2	1.168	-9.2

1/ It refers to the final month in the period.
2/ Projected.
3/ Working-day balance average in month.
4/ End-of-period balances.

39. Despite expectations of price growth in the first few months of 1999 at a level higher than last year, no truly volatile increases are expected in the future values of the multiplying factor of the restricted monetary base.



40. The expanded monetary base multiplier is expected to show relative stability in coming months, particularly in light of the fact that operations consequent upon the restructuring of state government debts, which have generated a greater impact on the expanded base than on M4, are now nearing conclusion.



Summary of projections

Table 1. Observed results and forecast monetary program for the fourth quarter of 1998[1/]

Itemization	Forecast		Observed	
	R$ billion	Percentage change in 12 months [2/]	R$ billion	Percentage change in 12 months
M1 [3/]	45.0 – 52.8	7.2	49.0	7.4
Restricted base [3/]	34.6 – 40.7	16.6	39.3	21.7
Expanded base [4/]	347.7 – 408.2	35.0	352.3	25.8
M4 [4/]	435.1 – 510.7	20.4	453.2	15.5

1/ It refers to the last day in the period.
2/ Percentage changes are based on the medium point of forecast.
3/ Working-day balance average of last month in the period.
4/ End-of-period balances.

Table 2. Forecast monetary program for the first quarter of 1999 and observed results in the January/February period[1/]

Itemization	Forecast		Observed	
	R$ billion	Percentage change in 12 months [2/]	R$ billion	Percentage change in 12 months
M1 [3/]	46.0– 54.0	20.5	48.4	13.6
Restricted base [3/]	35.4 – 41.6	24.8	39.2	22.7
Expanded base [4/]	353 – 414.4	23.5	401.6	36.5
M4 [4/]	436.7 – 512.6	13.8	472	16.5

1/ It refers to the last day in the period.
2/ Percentage changes are based on the medium point of forecast.
3/ Working-day balance average of last month in the period.
4/ End-of-period balances.

Table 3. Monetary program for 1999 [1/]

R$ billion

Itemization	Second Quarter		Year	
	R$ billion	% change 12 months[2/]	R$ billion	% change 12 months[2/]
M1 [3/]	44.4 - 52.1	13.7	50.0 - 58.8	11.1
Restricted base [3/]	34.6 - 40.7	13.7	39.9 - 46.8	10.3
Expanded base [4/]	368.9 - 433.0	17.9	401.6 - 471.4	23.9
M4 [4/]	439.0 - 515.4	10.7	469.2 - 550.8	12.5

1/ It refers to the final month in the period.
2/ Percentage changes are based on the medium point of forecast.
3/ Working-day balance average of last month in the period.
4/ End-of-period balances.

Table 4. Evolution of monetary aggregates [1/]

Itemization	1998		1999					
	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/]	49.0	7.4	48.4	13.6	48.2	13.7	54.4	11.1
Restricted base [4/]	39.3	21.7	39.2	22.7	37.7	13.7	43.3	10.3
Expanded base [5/]	352.3	25.8	401.6	36.5	401.0	17.9	436.5	23.9
M4 [5/]	453.2	15.5	472.0	16.5	477.2	10.7	510.0	12.5

1/ It 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	1998		1999					
	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/]	1.247	-11.7	1.235	-7.4	1.281	0.0	1.255	0.6
Banking reserves / Demand deposits [3/]	0.552	25.7	0.582	12.4	0.559	-1.6	0.562	1.8
Currency / M1 [3/]	0.418	8.6	0.403	9.5	0.378	3.0	0.403	-3.6
M4 / Expanded base [4/]	1.286	-8.2	1.175	-14.7	1.190	-6.2	1.168	-9.2

1/ It refers to the final month in the period.
2/ Projected.
3/ Working-day balance average in month.
4/ End-of-period balances.