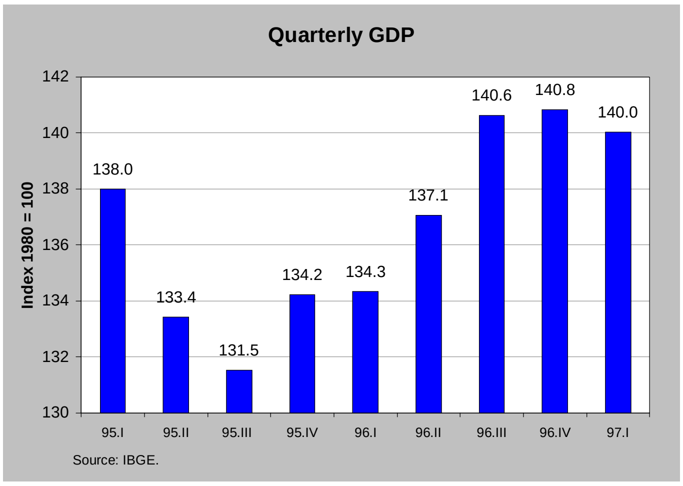
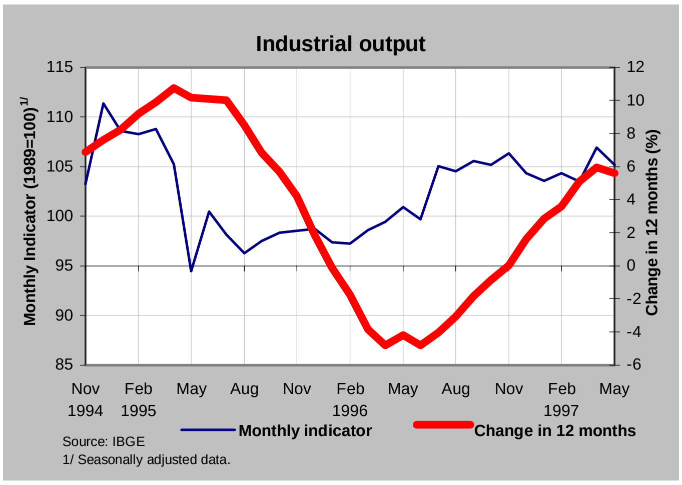
Monetary program for the third quarter of 1997

A. The economy in the second quarter of 1997

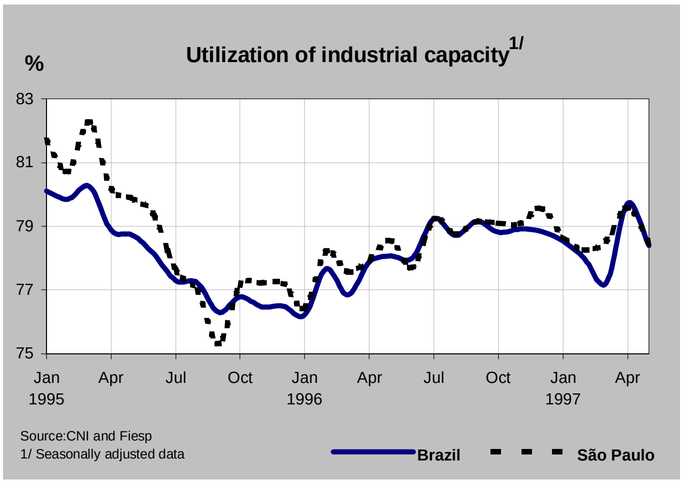
1. In the first quarter of the year, gross domestic product (GDP) in the seasonally adjusted series declined by 0.6% in comparison to the immediately previous quarter. This result reflected the performance of manufacturing (-2%), commerce (-2.4%) and crops (-4.8%). At the same time, livestock (3.8%), transports (1.9%) and public services (2.2%) registered positive growth.



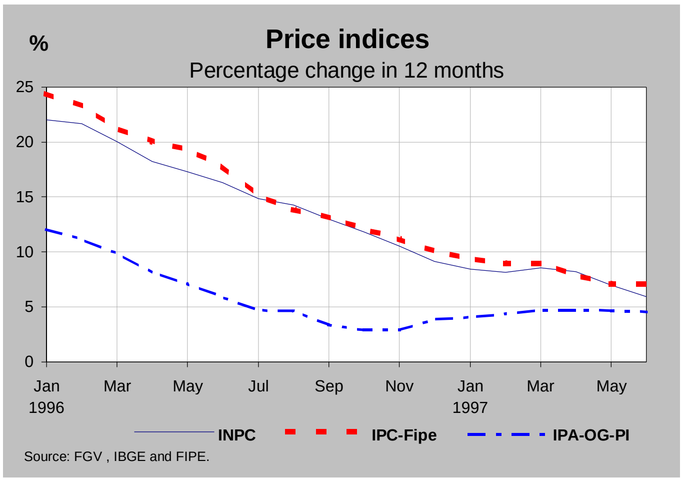
2. Industrial data for April and May point to higher production than in the first quarter of the year. In the seasonally adjusted series, average industrial output in these two months was 0.8% higher than in the second half of 1996 and 2.2% above that of the first quarter of 1997.



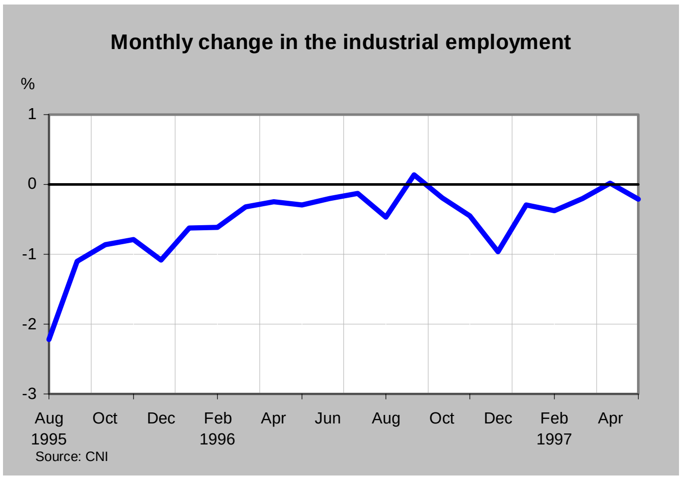
3. The increase in industrial production in the second quarter is compatible with the level of utilization of installed capacity. In April and May, average utilization of domestic industrial capacity came to 79.1% or 1.2 percentage points above the average for the first quarter of the year and close to that of the second half of 1996.



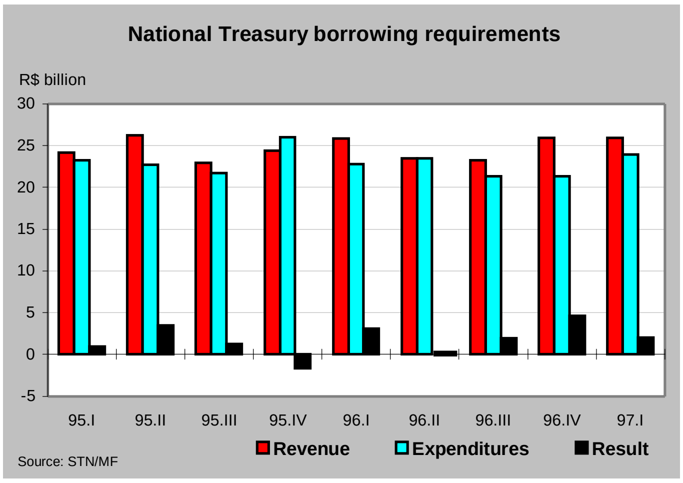
4. In the second quarter of the year, annual inflation continued downward due mostly to deceleration in price growth under nontradables. The INPC and IPC-Fipe dropped from a March level of 8.56% and 8.95% to 5.92% and 7.08%, respectively, in June. Parallel to this movement, the IPA-OG (industrial products), which reflects operations with tradables, slipped from 4.69% in March to 4.56% in June.



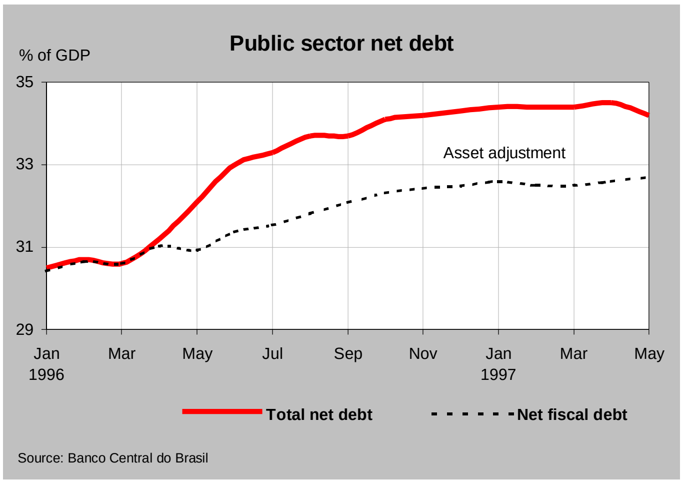
5. Though the process of industrial production recovery that began in 1996 was not sufficient to reverse the downward movement in industrial employment levels generated by the sector's ongoing adjustment, it did help to attenuate the intensity of the slide. At the end of May, the number of persons employed by industry was 1.1% lower than in December 1996. At the same time, however, overall formal employment figures released by the Ministry of Labor and covering the other sectors of the economy as well turned in growth of 0.3%, with the strongest gains being concentrated under construction and services.



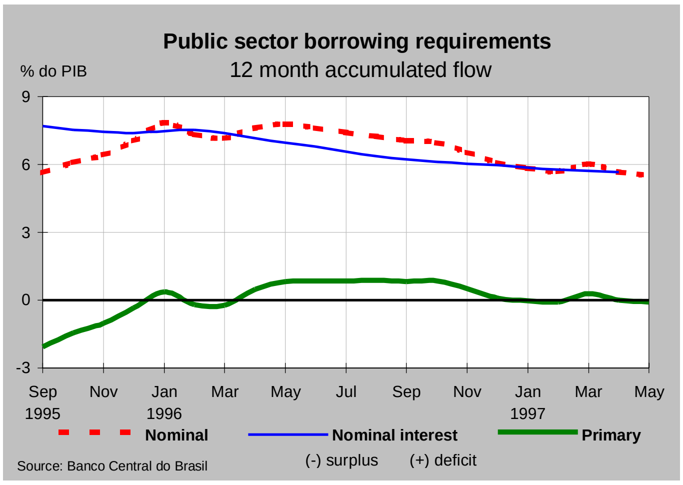
6. The National Treasury's primary surplus (concept of borrowing requirements) came to R$ 4.1 billion in the first six months of the year, as against R$ 2.9 billion in the same 1996 period. Impacted by the inflow of the Provisional Contribution on Financial Transactions (CPMF), revenues increased by 5.5% over the accumulated January-June 1996 result and closed at R$ 52.4 billion. Expenditures registered growth of 3.1%, coming to R$ 48.3 billion. The operational result, which includes outlays on real interest (R$ 6.4 billion), turned in a deficit of R$ 2.2 billion in the first half of the year, as compared to a R$ 1.7 billion deficit in the same 1996 period.



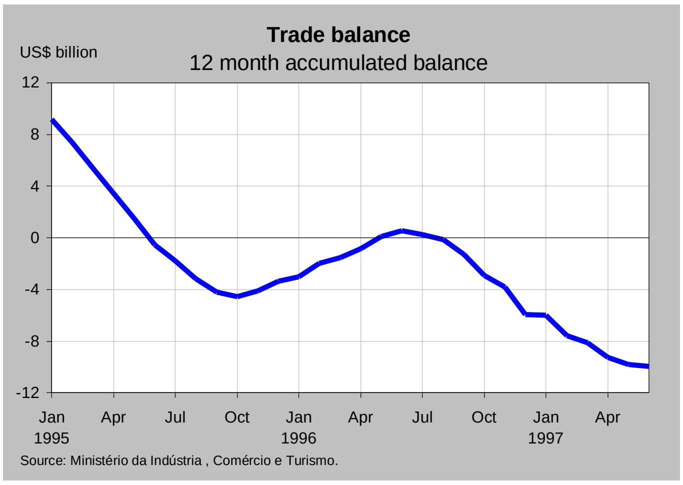
7. The net consolidated public sector debt — including the indebtedness of the federal government and Banco Central, states and municipalities and public sector companies — totaled R$ 282.1 billion in May, representing 34.2% of GDP, the same level registered at the end of 1996. One should note that maintenance of the net debt/GDP ratio was made possible by primary surpluses registered during the year and to the debt reduction that resulted from privatization of Cia. Vale do Rio Doce (CVRD). The net fiscal debt reached a level of R$ 269.5 billion (32.7% of GDP). Here, one should recall that public sector borrowing requirements are a direct consequence of growth under this item. This concept of indebtedness sterilizes the revenues generated by the privatization process.



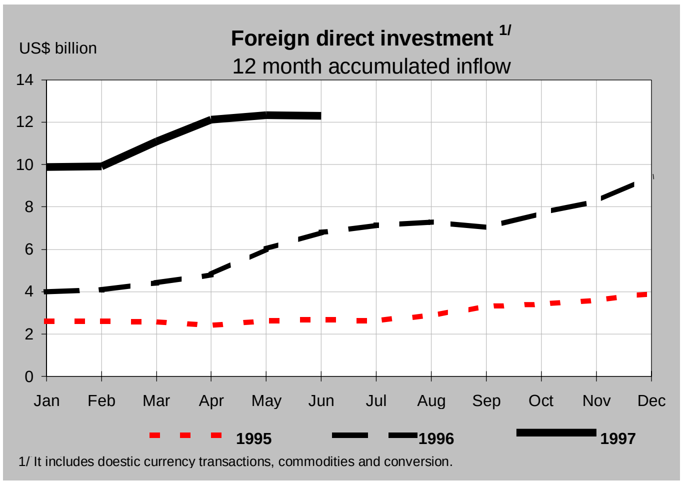
8. Public sector borrowing requirements (PSBR) turned in a nominal deficit of 5.53% of GDP in the accumulated 12 month flow for the period ended in May, as compared to 7.8% in the same period of the previous year. This result was a consequence of decreased nominal interest outlays and an accumulated primary surplus of 0.08% of GDP, as against a deficit of 0.82% in the same 1996 period.



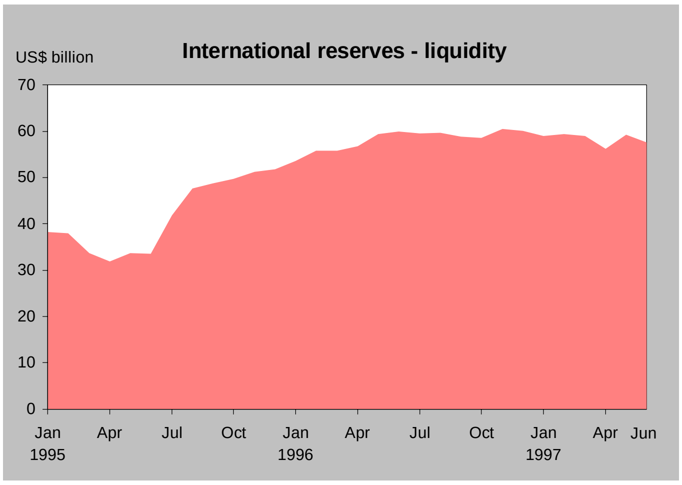
9. In the first seven months of the year, physical exports reached US$ 30 billion or 9.7% more than in the same period of the previous year. Imports totaled US$ 35.4 billion for growth of 26.3% in comparison to foreign purchases in the January-July 1996 period. Up to July 1997, the trade deficit totaled US$ 5.4 billion.



10. The current account balance closed the first half of the year with a deficit of US$ 15.6 billion, equivalent to 4.2% of GDP. This result was generated by a US$ 4.7 billion trade deficit and a US$ 12.1 billion deficit under services. Here, the most important items were net outlays on interest totaling US$ 4.6 billion and profit and dividend payments, with US$ 2.4 billion. The major share of this deficit was financed by net direct foreign investment inflows (47.3%). The net inflow of direct investments reached US$ 7.4 billion in the half-year period, raising the accumulated 12 month total to US$ 12.4 billion up to June. Net inflows of investments to the capital market totaled US$ 6.2 billion while financial loans added US$ 13.2 billion in the first half of 1997.



11. Interest payments on the foreign debt renegotiated with creditor banks and the Paris Club and remittances of amortizations of contracted credits have been offset by foreign resources inflows. These operations have had localized effects on the foreign reserve position which closed the month of June at US$ 56.8 billion in the cash concept, and US$ 57.6 billion in the concept of international liquidity. This reserve level corresponds to 12 months of imports.



12. The exchange rate float parameters were not altered in the second quarter of 1997 and remained at the levels defined in February: R$ 1.05/US$ for purchase and R$ 1.14/US$ for sale. In the free rate market, the rate of exchange devalued by 1.66% in the quarter, bringing accumulated devaluation in the first half of 1997 to 3.6%. Accumulated exchange contracting in the free rate segment in the January-June period registered a net inflow of US$ 7.2 billion, as financial transactions closed with a surplus of US$ 8 billion and trade-related exchange contracting operations ended the period with a deficit of US$ 0.9 billion.

B. Monetary policy in the second quarter of 1997

13. No difficulties were encountered in attaining the monetary targets set for the second quarter of 1997, including both those reserved to the restricted aggregates and those defined for the broader aggregates. With respect to interest rates, the period was marked by interruption of downward movement under basic interest rates and by increased volatility in the over/Selic rate.

14. In terms of the business day average for the month, the restricted monetary base came to R$ 24.7 billion in June, well within the parameters set by monetary program for the second quarter of 1997 (R$ 24 billion - R$ 28.1 billion). This result reflected growth of 22.9% in the year and 41.6% in relation to the corresponding month of the previous year. Among the monetary base components, banking reserves registered 12 month growth of 69.6%, as against 29.2% under currency issued. Growth in banking reserves resulted from increases in demand deposits that occurred once levying of the CPMF began.

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

Itemization	Forecast		Observed	
	R$ billion	Percentage change in 12 months 1/	R$ billion	Percentage change in 12 months
M1 2/	35.1 - 41.2	59.3	36.8	53.6
Restricted base 2/	24.0 - 28.1	49.3	24.7	41.6
Expanded base 3/	220.3 - 258.7	52.1	203.6	29.3
M4 3/	337.5 - 396.2	30.9	351.3	25.4

Source: Banco Central do Brasil

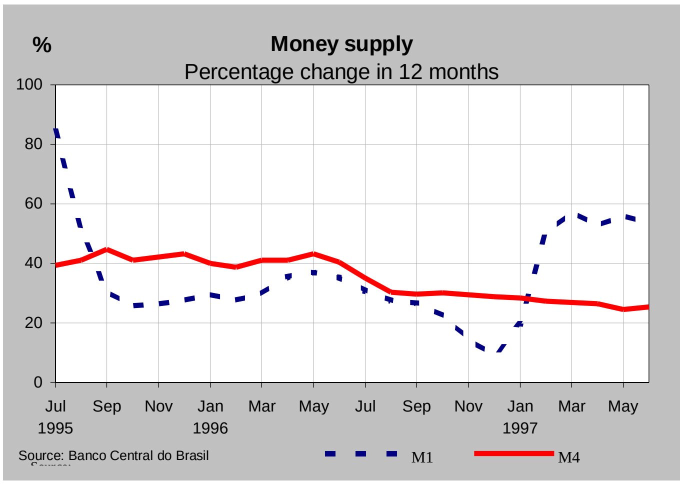
1/ Percentage changes are based on the medium point of forecast.

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

3/ End-of-period balances.

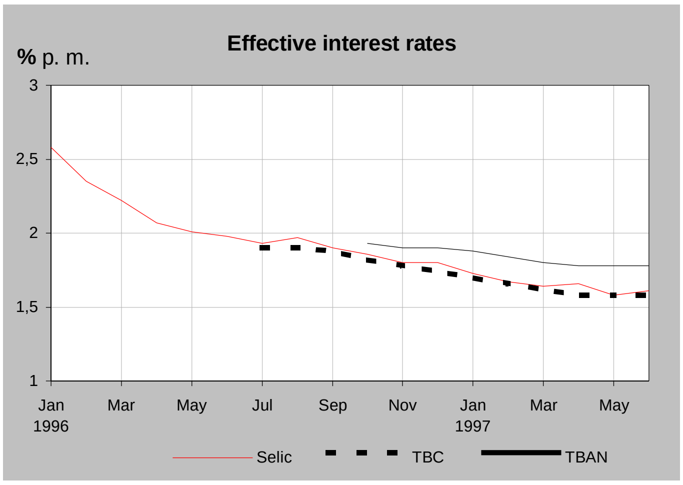
15. The expanded monetary base, which includes the restricted base, compulsory cash deposits and federal public securities held by the public, reached a level of R$ 203.6 billion in June. This figure was below the level defined as the lower limit of the monetary program band for the second quarter (R$ 220.3 billion - R$ 258.7 billion). This was due to the fact that restructuring of state debts was not implemented in the quarter. Such debt restructuring bill, which has been under consideration by the National Congress, would have a strong expansionary impact on the expanded monetary base. Consequently, the rate of expanded base growth came to 10.6%, in the half-year period, and 29,3% in comparison to the same month of the previous year.

16. In the concept of average daily balances, the money supply (M1) came to R$ 36.8 billion in June or well within the parameters set by monetary program (R$ 35.1 billion - R$ 41.2 billion), reflecting annual growth of 26.8% and 53.6% in 12 months. Expansion under currency held by the public and demand deposits came to respective levels of 30.7% and 71.5% in 12 months.



17. The broader liquidity concept of the economy (M4) totaled R$ 351.3 billion at the end of June. This figure was also within the parameters defined by monetary program (R$ 337.5 billion - R$ 396.2 billion), for growth of 9.05% in the half-year period and 25.38% in 12 months.

18. The gradual and steady decline in the economy's basic interest rates was interrupted in the second quarter of the year, as the TBC and TBAN held at 1.58% per month and 1.78% per month, respectively, in the period. This period was also marked by greater volatility in the effective average over/Selic rate, particularly in April when the rate hit 1.66% and drifted away from the TBC level. In May, the Selic rate closed at the same level as the TBC (1.58%), and increased to 1.61% in June.



C. Outlook for the third quarter and for 1997 as a whole

19. In a framework of low inflation, monetary policy is conditioned by the level of performance of economic activity and conformed to restrictions imposed by the foreign sector. The process of gradually reducing interest rates in the first quarter of the year was curtailed in the second quarter in light of uncertainties with respect to the major variables indicative of the level of economic activity and the convenience of maintaining a comfortable reserve level in a period marked by expectations of possible alterations in international interest rates.

20. In 1997, GDP growth is expected to surpass the 1996 level (3%), with improvement under crop and livestock farming, industry and services. Particularly strong recovery is expected under crop production, construction — partly as a result of the privatization process — and communications and transportation.

21. Expectations of an investment rate higher than in the previous year are founded mostly upon the results of the ongoing privatization program, maintenance of economic stability and growth under capital goods imports. At the same time, particular mention should be made of the downward trajectory under the long-term interest rate (TJLP) applied by the National Bank of Economic and Social Development-BNDES. In June 1997, this rate came to 10.15% per year, as against 15.44% per year in the same month of 1996.

22. Starting in January 1998, as part of its efforts to perfect monetary policy instruments, Banco Central will begin announcing the basic rates it manages in compound annual form, based on business day rates. The new system will avoid both the sharp oscillations noted in the formation of rates at the end of the month and the consequent arbitrage operations. At the same time, it is also a sign of a process of lengthening the terms of financial market investments and enhanced stability in the nation's monetary indicators.

23. All indications are that inflation will not only remain in the one digit range, but continue to drop even further. The reason for this is the ongoing process in which relative prices are gradually settling down as a consequence of the lesser impact of the prices of nontradables.

24. In terms of public finance, CPMF resources, extension of the Fiscal Stabilization Fund, the process of restructuring the financial system and state debts have contributed to the continuity of the adjustment process. However, one should recall that the gains achieved through infraconstitutional measures adopted in 1996 (personnel and social security outlays) tend to exhaust their impacts over the short-term. At the same time, 1998 revenue performance is expected to be affected by the postponement until 1998 of the gains resulting from changes in income tax regulations.

25. In this context, it is essential that long-needed structural changes be adopted so that it will be possible to attain effective fiscal balance and the consequent consolidation of economic stabilization. In clearer terms, the process of administrative and social security reform must go forward, accompanied by continuation of the privatization program.

26. The magnitude of the privatization program and the highly beneficial contribution it is capable of making to reductions in the public debt and a lesser financial burden on the State take on even greater importance when viewed as a channel for foreign capital flows. These resources will generate incorporation of new technologies, enhanced foreign competitiveness and new jobs, at the same time in which they will facilitate financing of the nation's foreign accounts.

27. Insofar as the foreign sector is concerned, following the trade deficits registered in the early months of 1997, the performance of exports and imports in the second quarter of the year points to relative trade balance stabilization. Exports have begun reacting to already adopted incentive measures. Starting in the second half of the year, sales of industrialized products are expected to climb, while imports will move into a process of relative stabilization.

28. In this context, it has been possible to finance the current account deficit with relative ease, particularly as a result of highly favorable international market liquidity conditions. At the same time, one should note the strong qualitative improvement that has occurred in foreign resources flows with increased participation of direct investments.

D. Monetary aggregate growth targets

29. Program for monetary aggregates in the third quarter of 1997 and estimates for the end of the year took account of the probable performance scenario and government inflation targets, GDP, interest rates, monetary impacts consequent upon National Treasury operations, Banco Central exchange market interventions and rediscount operations with the financial system. Introduction of the CPMF had a strong impact on the trajectory of the restricted monetary aggregates in the first quarter of 1997. The result was a strong migration of resources into demand deposits and mostly away from Short-Term Financial Investment Funds (FIF-CP). The results of recent months indicate that the process was restricted to that quarter. Table 2 shows the projected monetary aggregate figures for the end of the third quarter of 1997 and for the year as a whole.

Table 2. Monetary program for 1997 [1/]

R$ billion

Itemization	Third quarter	Year
M1 [2/]	33.8 - 39.7	41.0 - 50.1
Restricted base [2/]	22.7 - 26.7	26.8 - 32.7
Expanded base [3/]	225.8 - 265.1	230.3 - 281.5
M4 [3/]	340.4 - 399.6	346.8 - 423.8

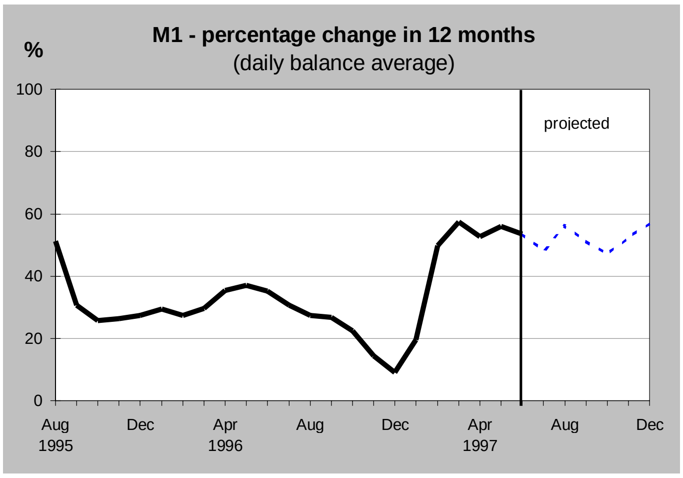
Source: Banco Central do Brasil

1/ Refers to the final month in the period.

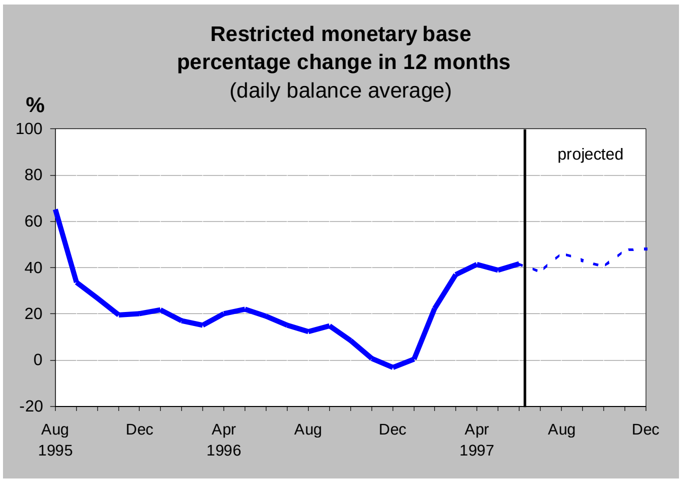
2/ Working-day balance average in month.

3/ End-of-period balances.

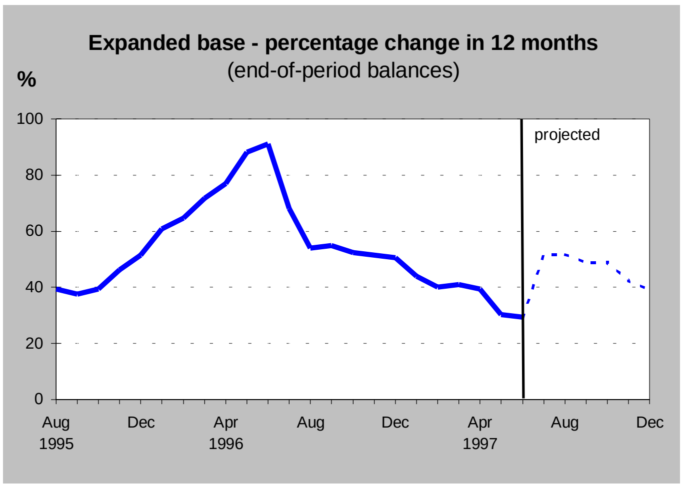
30. Under the impact of the CPMF, the M1 aggregate (currency held by the public plus demand deposits) moved to a new plateau. As a result, the projection of average growth over 12 months increased from 51.3% in September to 57.1% in December 1997.



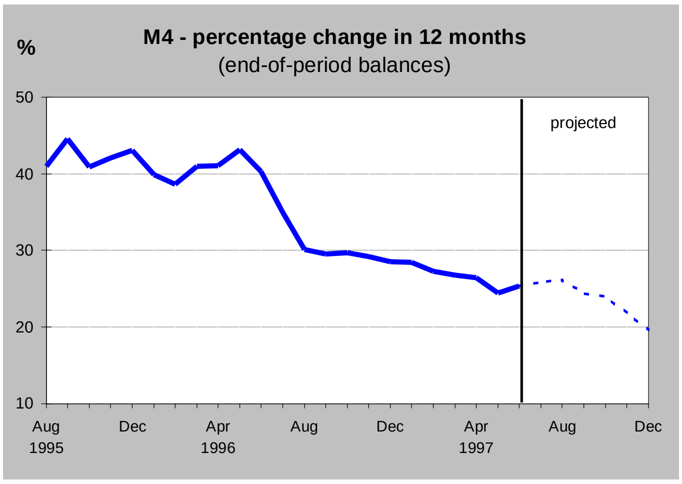
31. Based on forecast performance of currency demand (M1) and the monetary multiplier, coupled with expected stability in reserve requirement rates on demand resources, 12 month monetary base growth (currency issued plus banking reserves) was estimated at 43.2% in September and 47.9% in December 1997.



32. Based on a presumption of neutrality in the performance of the factors that condition the restricted monetary base, projection of the expanded base (measurement of the federal gross internal debt in currency and securities) for the period shows that the major expansionary factor in coming months will be that of state debt restructuring operations scheduled for implementation in the period. Thus, in the case of this aggregate, 12 month growth is projected at 48.7% in September and 39.1% in December 1997.



33. Consistent with the performance standard of the other aggregates, 12 month growth under the M4 aggregate is estimated at 24.4% in September and 19.6% in December 1997.



34. Growth in monetary aggregates is summarized in the following table, which includes the figures for 1996 and the second quarter of 1997, together with forecast results for the third quarter and for all of 1997. The projected data are based on the average point of the forecasts.

Table 3. Evolution of monetary aggregates [1/]

Itemization	1996		1997					
	Year		Second quarter		Third 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	9.1	36.8	53.7	36.7	51.3	45.6	57.1
Restricted base [4/]	20.1	-3.1	24.7	41.6	24.7	43.2	29.7	47.9
Expanded base [5/]	184.1	50.5	203.6	29.3	245.4	48.7	255.9	39.1
M4 [5/]	322.1	28.5	351.3	25.4	370.0	24.4	385.3	19.6

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.

35. Growth of the different multipliers implicit in monetary program is summarized in the table below:

Table 4. Monetary multiplier [1/]

Itemization	1996		1997					
	Year		Second quarter		Third 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/]	1.442	12.6	1.488	8.5	1.488	5.7	1.532	6.2
Banking reserves / Demand deposits [3/]	0.232	-53.4	0.394	-1.0	0.393	20.9	0.354	52.6
Currency / M1 [3/]	0.505	18.5	0.371	-15.1	0.371	-21.1	0.381	-24.6
M4 / Expanded base [4/]	1.750	-14.6	1.726	-3.0	1.507	-16.3	1.506	-13.9

Source: Banco Central do Brasil

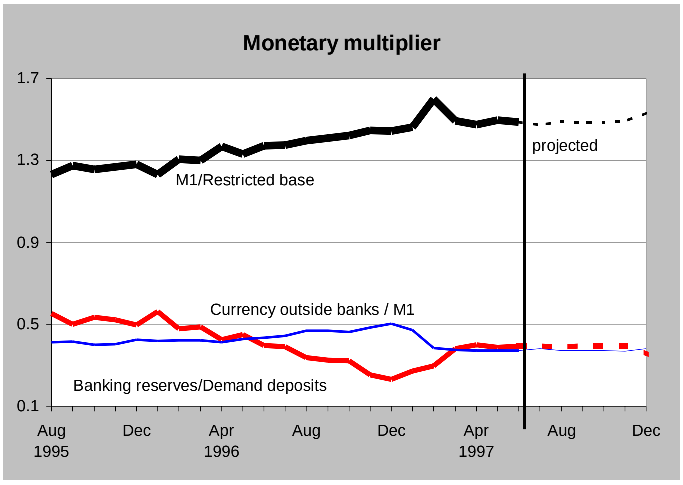
1/ Refers to the final month in the period.

2/ Projected.

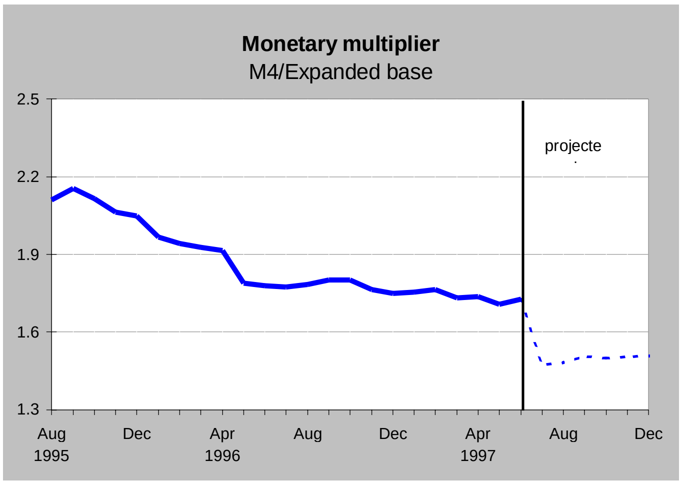
3/ Working-day balance average in month.

4/ End-of-period balances.

36. With the long period of price stability already achieved, there are no expectations of strong volatility in future values of the restricted monetary base multiplier, though the process of monetization has not fully run its course.



37. The expanded base multiplier is expected to decline in the second half of 1997, thus reflecting operations consequent upon restructuring of state debts since, despite their impact on the expanded base, part of these debts will not impact M4.



Summary of projections

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

Itemization	Forecast		Observed	
	R$ billion	Percentage change in 12 months 1/	R$ billion	Percentage change in 12 months
M1 2/	35.1 - 41.2	59.3	36.8	53.6
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Expanded base 3/	220.3 - 258.7	52.1	203.6	29.3
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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. Monetary program for 1997 [1/]

R$ billion

Itemization	Third quarter	Year
M1 2/	33.8 - 39.7	41.0 - 50.1
Restricted base 2/	22.7 - 26.7	26.8 - 32.7
Expanded base 3/	225.8 - 265.1	230.3 - 281.5
M4 3/	340.4 - 399.6	346.8 - 423.8

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2/ Working-day balance average in month.

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Table 3. Evolution of monetary aggregates [1/]

Itemization	1996		1997					
	Year		Second quarter		Third 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	9.1	36.8	53.7	36.7	51.3	45.6	57.1
Restricted base [4/]	20.1	-3.1	24.7	41.6	24.7	43.2	29.7	47.9
Expanded base [5/]	184.1	50.5	203.6	29.3	245.4	48.7	255.9	39.1
M4 [5/]	322.1	28.5	351.3	25.4	370.0	24.4	385.3	19.6

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Itemization	1996		1997					
	Year		Second quarter		Third 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/]	1.442	12.6	1.488	8.5	1.488	5.7	1.532	6.2
Banking reserves / Demand deposits [3/]	0.232	-53.4	0.394	-1.0	0.393	20.9	0.354	52.6
Currency / M1 [3/]	0.505	18.5	0.371	-15.1	0.371	-21.1	0.381	-24.6
M4 / Expanded base [4/]	1.750	-14.6	1.726	-3.0	1.507	-16.3	1.506	-13.9

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